

Consolidate our advantages Spread the economic benefits among community

Proposal of the 2007-8 Budget Civic Party

16.11.2006

Background

- 1 The function of the Budget is to facilitate and implement master plans of the government, with adjustments in accordance with the changes in political and economical circumstances. However, Donald Tsang, the Chief Executive, has confined himself as a leader of the “transitional government”, thus evading many long-term development problems in his recent Policy Address. This poses a challenge for the Financial Secretary to make amends and set up a solid base for the long-term development of Hong Kong in the forthcoming Budget.
- 2 The Consolidated Account of the government had recorded deficits for many years consecutively since 1998. In 2002, the Task Force on Review of Public Finances concluded that the public finances of Hong Kong are confronted with structural problems, i.e. over-reliance on property market related incomes and lack of flexibility on government expenses. As a result, the foremost task of the next few Budgets would be to eliminate fiscal deficit.
- 3 In the same year, Anthony Leung, the former Financial Secretary, set three targets for the public finances in 2006/7: to attain a balanced Operating Account, to restore balance in the Consolidated Account, and to reduce public expenditure to 20% of GDP or below. He also suggested that it should be sufficient to have fiscal reserves equivalent to around 12 months of government expenditure to meet operating and contingency requirements.
- 4 Over the years, the government has achieved these targets. The public

expenditure in year 2004/5 has been reduced to below 20% of GDP.; and from 2005/6 onwards, balances have been achieved in both Consolidated and Operating Accounts, and the government expenditure has shrunk to less than \$200 billion as well.

Estimation and mis-estimation

- 5 In addition to the rapid recovery of the economy, the government has adopted a series of measures to restrict the expenditure and expand the income, and as a result, balances were restored in both accounts just within few years. It should be noted that, however, the Budgets from 1997 to now had, without exception, over-estimated the deficit and underestimated the surplus. As a result, the accumulated actual income of the government in that period is \$87.4 billion more than the estimated in the Budgets.

Year	Consolidated Surplus/Deficit in the Budget (\$ billion)	Actual Consolidated Surplus/Deficit (\$ billion)	Difference (\$ billion)
1997/98	59.2	86.8	27.6
1998/99	-32.2	-23.2	9.0
1999/2000	-1.6	10.0	8.4
2000/01	-11.4	-7.8	3.6
2001/02	-65.6	-63.3	2.3
2002/03	-70.0	-61.7	8.3
2003/04	-49.0	-40.1	8.9
2004/05	12.0	21.4	9.4
2005/06	4.1	14.0	9.9
2006/07	5.6		

- 6 As stated in Article 107 of the Basic Law, the SAR government should strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of its GDP. Nevertheless, managing finance with care does not mean to be over-conservative. The Budget deviates from the projection in the long run and underestimates the government income. The story of “Cry wolf” runs over year in, year out. This systematic mis-estimation creates confusion

to the community and damages the creditability of the Budget. It is the responsibility of the government to reflect honestly the situation of the public finance, ensuring that accurate information are released and public views on public expenditure are expressed in a more efficient way..

Stalling makes a knot tight

- 7 The present situation is somehow paradoxical. On one hand, the government keeps huge fiscal reserves in hand, and has achieved the targets to balance the public accounts while the economy has been recovering. Knowing that the government's income becomes stable, the public are reluctant to discuss introducing new taxes and some even asked for a tax reduction. On the other hand, the government provided a host of rationales on the claim that the existing tax base is narrow and government income is volatile and fluctuates with economic cycles. It is generally agreed that there are many serious problems in Hong Kong yet to be tackled.
- 8 The Report of the Task force on Population Policy pointed out some worrying trends of the society, which included the extremely low level of fertility rate (927 children per 1,000 women); aging population (a quarter of its population is expected to be aged 65 or above by 2031); and low education attainment (only some 52% of the population aged 15 and over had at least upper secondary school education, and some 13% had tertiary education in 2001). All these will lead to serious and complicated education, medical and social welfare problems, which call for our immediate attention.
- 9 We have to pay particular attention to the problem of health care financing. Hong Kong citizens have got used to the cheap public medical service over the years. However, these services are almost fully subsidized by the government, a practice not sustainable in long run. The government studied the option of mandatory medical insurance to substitute direct funding in early 90's; and also made public the "Harvard Report" in 1999, which proposed five financing options for public discussion. Nonetheless, these are all remained at the study stage, and the date for announcing a concrete proposal was delayed time and again. According to the latest information, the announcement date is scheduled at

the second season next year.

- 10 As these social problems keep accumulating, they will develop into lingering illness of the society and eliminate the competitiveness of Hong Kong, which will bring a heavy burden to our next generation. In our opinion, the coming Budget is a prime occasion to deliver solutions for these long-term social problems.

The obligations of paying taxes and the rights of citizens

- 11 The government announced the consultation paper in July this year and suggested broadening the tax base by introducing Goods and Services Tax (GST). It is supported by the following reasons: introducing GST brings steady revenues and broadens the tax base; it is a fair system (the more a person spends the more tax he pays); tax evasion will be more difficult; the tax base expands along with consumption; the competitiveness of Hong Kong can be maintained etc. The government's suggestion has aroused heated public debates. The Legislative Council, meanwhile, passed a motion to oppose the introduction of GST. To defend their position, government officials made strong accusations that the LegCo members only focused on the immediate interest so as to appease voters
- 12 However, the narrow base of Hong Kong tax system is not an isolated phenomenon. Instead, it is developed and coexisted with various issues such as the high land premium policy, highly centralized wealth, extreme disparity between the rich and the poor. To take a step further, under an inadequate openness in politics, to maintain a narrow and direct base tax system is advantageous for authoritative governance.
- 13 Paying tax is an obligation of a citizen, but it should be accorded with rights. While the political rights in Hong Kong is extremely lacking behind at present—the representation of the HKSAR government is much narrower than its tax base. Expanding tax sphere should accord with the increasing representation of the government; otherwise it will arouse challenges to the legitimacy of the governance.
- 14 As the Chief Executive and the main officials of the HKSAR government are not

elected by universal suffrage, it is hard for them to introduce controversial policies. On the contrary, since the citizens have no rights to affect the decision-making process on public finance by election, they can never feel engaged or only gathered negative feelings on some occasions, such as when the official questioned in strong tone “Where does the money come from?”. Feel the strong public opinion, even political parties with members in the Executive Council make it clear that they oppose the introduction of GST.

- 15 The Civic Party understands, in long run, that the government has to broaden the tax base in order to maintain steady revenue; but under the situation of extreme disparity between the rich and the poor, and the climate of inadequate openness in politics, any tax reform should share the tax burden in a fair way so that the more capable a person is, the more he pays. Also, the new tax system should bring the function of reallocating wealth into full play so that the public can share the fruits of economic prosperity and the tax base expands in accordance with the political development.

Analysis on Current Situation

- 16 The Government revenue has emerged from the deficit nightmare. As the government forecasted, Operating Account and Consolidated Account recorded surplus since 2006/07. Fiscal Reserves will rise from \$306.4 billion in 2006/7 to \$391.6 billion in 2010/11, equivalent to 17 months of government expenditure.
- 17 Apart from the Fiscal Reserves, there is also a huge Accumulated Surplus. As at October 2006, Hong Kong’s Foreign Currency Reserves is approximately \$1,016.3 billion. The Monetary Base and Fiscal Reserves of Hong Kong are around \$300 billion each. Here we can derive that the Accumulated Surplus of Foreign Currency Reserves should be approximately \$400 billion, which means the total reserve under the command of the government is approximately \$700 billion.

- 18 Hong Kong's economy has been growing steadily. In the first quarter of 2006, gross economic growth is recorded at 8%, and 5.2% for the second quarter. Hang Seng index has climbed from 15,700 in the beginning of 2006, to over 18,000 recently.
- 19 Structural unemployment is deeply entrenched under the veil of supposed prosperity. Low-skilled labour is getting more difficult to get employed. Though unemployment rate has dropped from 5.3% at the beginning of the year to 4.7% this September, the unemployment rate of low-skilled labour stands high still. For instance, unemployment rate of sales is 6.4%, of craftsmen is 8.9%, of construction workers is 10.2%, and that of teenagers aged 15-19 is as high as 26.8%.
- 20 Income disparity and working poverty is also getting more serious. Gini coefficient has risen from 0.472 in 1991, to 0.525 in 2001, which ranks fifth among the world. There are 74,100 people getting a monthly salary less than \$5,000. The number has been doubled as compared to the 37,900 in 1998, in the period of financial meltdown. Among them, there are 39,100 people with monthly salary under \$3,000, which is more than double than in 1998.

Suggestion for income: Review on tax system

- 21 Several proposals have been made out in the consultation document on broadening tax base: raising tax rate of the existing taxes, introducing new taxes like properties-related tax, tax on worldwide income, also some new direct taxes (including impose tax on capital gain, share dividends and personal interest income). All these proposals are said to be either unable to broaden the tax base, nor weaken the competitive power of Hong Kong. Some are even said to go against the international trend. The consultation paper also pointed out that the tax base of salaries tax will be narrowed upon the aging of population. Such claims will lead to a one-way-out conclusion: introducing GST.
- 22 Such conclusion leads our mindset to one direction only, i.e., to impose tax on more citizens, whilst other possibilities are being ignored. For example, adopting two or more proposals as a mixed approach.

- 23 We suggest freezing the tax rates of salaries tax and profits tax, and conduct a comprehensive review on the existing tax system, including tax base, tax band and tax rate. Options include imposing tax on asset profits and impose mild and progressive element in the profits tax regime, while keeping the tax system simple and preserving the competitiveness of the economy. The effect of different proposals on government income, fiscal reserves, the level of the accumulated surplus, as well as expenditure trend of education, medical and social welfare should be spelt out for the public to take into consideration.
- 24 The Monetary Authority current divides their annual investment surplus with the government at certain proportion. Yet, the amount depends on the total return, thus makes hard to estimate the governmental income. The Civic Party suggests setting up a fix-amount profit division system to stabilize the income of the public purse.
- 25 We suggest that a fixed amount of \$30 billion should be channeled to the government from the Monetary Authority as an annual dividend. In case the investment return exceeds this amount, the Monetary Authority can choose to give all or part of the surplus to the government. When the return is less than the agreed level, a flat sum of \$30 billion will go to the public purse. Referring to the current Fiscal Reserves and accumulated surplus, which with a total \$700 billion, such minimum return rate is just 4.3%, which should be achieved easily. Such practice can reduce the instability due to the fluctuation of the capital market to the Government Revenue, and can facilitate the government for long term planning and investments.
- 26 On the other hand, the government should clarify if they are still adopting the standard of 12-month government expenditure as the bottom line of Fiscal Reserves, as the ex-Financial Secretary proposed. The government should also consider whether it is a desirable practice to keep accumulating enormous reserve but not making proper social investments, and whether this will hinder the long term development of Hong Kong. The reserves should be directed to facilitate solutions of the long-term problems of the community, in any case.

Income Proposal

- 27 Direct Tax:** We suggest freezing the present rate of salaries tax and profits tax. We suggest considering an introduction of a mild and progressive profits tax only if the present review on our tax base shows that there is a real need to increase the government income for our long-term development. A mild and progressive profits tax rate is one of the ways to enable those lucrative corporations to contribute back to the society.
- 28 Dutiable Commodities:** We propose to increase the tax rate for cigarettes and cigars in order to couple with the latest amendments of the anti-smoking ordinance and to counter the effects brought by a general price decrease in cigarettes products. We suggest a higher tax rate should be imposed so that the price level of cigarettes products will be brought to the level before the plunge.
- 29 Green Tax:** The government should table the Product responsibility Bill to the Legislative Council for scrutiny as to set out a legal framework for initiating green taxes expeditiously. According to the policy framework of the Environment Protection Department, the producer responsibility schemes will be introduced next year and it will be extended to plastic bags, tyres, electric appliances, electronic products in the next few years. An implementation timetable and details should be included in the budget for open discussion. The income generated from the green taxes should be used to promote recycling industries and environmental conservancy.
- 30 Estate Duty:** The estate duty has been abolished for one year. The government should report to the Legislative Council and explain how or in what ways the abolition of estate duty attracts foreign investments, and what necessary steps will be taken to compensate the loss in government income after the abolition.

Expenditure Proposal

Education

31 Pre-school Education : Improve the present scheme on education vouchers so that the subsidies go directly to the hands of parents and students and the parents can have a greater choice on kindergartens. The education vouchers should be given to kindergartens with quality that satisfies the Education Manpower Bureau's standard no matter it is a private kindergarten or a non-profit making one.

32 Primary and Secondary Education: In order to carry out the education reform smoothly, realize the quality education and nurture talents for our future, we suggest small class teaching should be implemented gradually and extended to all forms in primary and secondary schools.

32.1 In May 2005, the government claims that an annual expenditure of 2.4 billion is needed to carry out small class teaching in all government and aided primary schools in the school year of 2010-2011. We find the aforementioned estimate has not taken into account two factors: (1) it is a comparison of expenses between running normal class-size teaching and running small class teaching in 2010-2011. It is not a comparison between the present education expenses and the one in 2010-2011. Hence, a huge education savings brought by the declining student population has not been considered and the government in fact, has over-estimated the expenses on small class. In the past few years, the government saved 10.1 billion¹ due to the decline in student population. If the government had made use of the savings and implemented small class teaching a few years ago, no extra cost would have been involved. That explains why the government keep on revising it estimates from 3.6 billion in 2002, to 3.1 billion in 2004 and further to recent 2.4 billion; (2) The government estimates 800,000 as the cost for operating each additional class of small class teaching. However, due to the decline in student population, there are plenty of empty classrooms for implementing small class teaching. Instead of building extra classrooms, the government should consider making use of the present available resources when calculating the budget

¹ The accumulated difference between the Original Estimate and the Revised Estimate on education from 2003/04 to 2005/06.

on small class teaching. Extra costs on building classrooms are not necessary and hence the government budget is over-estimated.

32.2 Based on the aforementioned reasons, the Civic Party finds government's estimate is still too high even though it has been revised recently. According to our projections, if small class teaching is carried out next school year, the government will still achieve a surplus in education expenditure in the first two years of implementation. Only an extra of 40 million is needed at the third year of implementation and 600 million is needed for a full implementation in the sixth year, which is a huge difference to the government annual estimates: 2.4 billion.

Cost projection for small class teaching for the academic years 2007/08 to 2012/13 –
Gradual Implementation in primary school

Year	Implementation Status	No. of enrollments in government, aid and DSS schools ²	No. of class ³	Difference in the no. of classes (comparing with that of 2005/06)	Difference in expenses (million dollars) ⁴
2002/03		432,458	13,303		
2003/04		423,235	12,903		
2004/05		402,652	12,413		
2005/06		381,428	11,781		
2006/07		364,800	11,225		
2007/08	P.1	349,600	11,697	-84	-\$40
2008/09	P.1-P.2	338,700	11,693	-88	-\$42
2009/10	P.1-P.3	331,300	11,873	92	\$44
2010/11	P.1-P.4	328,700	12,152	371	\$179
2011/12	P.1-P.5	328,800	12,533	752	\$364
2012/13	P.1-P.6	325,500	13,020	1,239	\$600

² The student enrollments between 2002/03-05/06 come from the table 3.2 of the 'Statistics on Kindergarten, Primary and Secondary School Teachers 2005/06' by EMB. The enrollments between 2005/06 – 2011/12 is from the written reply of question 0209 (Reply Serial No. EMB013) of the Estimates of Expenditure 2006-2007.

³ The number of classes between 2002/03-05/06 comes from table 3.2 of the 'Statistics on Kindergarten, Primary and Secondary School Teachers 2005/06' by EMB. The estimate of the number of students in each grades is based on the EMB's projected total enrolments for the period 2006/07 - 2011/12. It is done by Dr. Paul S. F. Yip, the Senior Lecturer of the Department of Statistics & Actuarial Science, the University of Hong Kong and Stephen Law, the Postdoctoral Fellow at the HKJC Centre for Suicide Research and Prevention, the University of Hong Kong.

⁴ According to the replies of one of the LegCo written questions put in May 2006, the government subvene 800 thousand on each additional class in primary school which includes fixed and non-fixed costs. However, according to the written reply of question 0597 (Reply Serial No. EMB066) of the Estimates of Expenditure 2006-07, the government saves only 340 thousand from each class by deducting 60% of the fixed cost during the schools slashes. As running additional classes will not increase the fixed costs, Raymond Yeung & Co., projects that the additional cost of running each class in primary school ranges from 350 thousand to 485 thousand. And we take 485 thousand in our projection.

- 33 Higher education: In order to satisfy the human resources need of a knowledge-based society and to get HK prepared for acting as a regional education hub, we suggest increasing the university participation rate, enhance the quality of higher education and hence attract more overseas students.⁵

Economy

- 34 To operate with coordination with the conclusion of Fair Trade Ordinance, an independent Fair Trade Commission with statutory investigation and penalizing powers should be set up, to protect the rights and benefits of consumers and business operators.
- 35 To create more employment opportunities and encourage corporate citizenship, the Civic Party suggests that the government to encourage the development of social enterprises. To provide an environment for the social enterprises to develop in a more diversified way, it is necessary to evaluate and amend on the “Co-operative Societies Ordinance”. Also establish “Seed Fund for Social Enterprises”, through fund loan or allocation, assisting social enterprises in need to start their plans.
- 36 To vitalize the economy of low-income communities and margin communities, the government should foster public investments, accelerate sustainable infrastructure items and community facilities, to improve the living environment and create employment opportunities for the residents of these communities. Regional tax-reduction policy can also be considered, to encourage commercial investment to participate as a part of poverty elimination.

⁵ According to the Estimates of Expenditure 2005-06, the actual cost of each funded place by the University Grant Committee is HKD207,100. Hence, the government has to allocate an extra of 3.37 billion to bring the present university participation back to 18%.

Urban planning and land management

- 37 Provide appropriation to the District Boards, allowing them to seek for professional opinion in architecture, surveying and urban planning, when studying topics related to urban planning and land uses in the district. This can facilitate discussions on land management among the residents within the community.

Medical

- 38 At present, the medical service is mainly provided by the Hospital Authority (HA). In year 2004/5, the government had appropriated \$28.2 billion to HA, which is about 15% of the total public expenditure. The Budget of such appropriation in year 2005/6 and 2006/7 is \$27.5 and \$27.7 billion respectively. The Civic Party urges the government to announce a concrete proposal on public health financing promptly, let the citizens buy the medical insurance as early as possible in order to avoid enormous medical expenses in case of accidental injuries. On the other hand, a safety net should be set up, and evaluation on the existing Drug Formulary System is necessary as well, to guarantee that the lower-income groups can also receive appropriate treatment.
- 39 Appropriate 10% more, i.e., at least \$300 million, to the psychiatric departments of public hospitals to improve the situation of lengthy waiting time for clinical diagnoses, and fleeting average diagnosis time.⁶

Environment

- 40 Establish an Energy Management Bureau in order to formulate long term policies and prepare for opening up the electricity market to raise energy efficiency in various aspects.

⁶ According to the information provided by the Hospital Authority, the person-time using the psychiatric clinics of public hospitals rises from 504,118 in 2001 to 572,877 in 2004. However, the appropriation of the government on psychiatric services drops from \$3.25 billion in 2003/4 to \$3.13 billion in 2005/6. At present, there are on 258 psychiatric doctors in public hospitals. New patients have to wait up to 162 weeks for a clinical diagnosis, and the average diagnose time for old patient is only 5 minutes each time.

- 41 In collaboration of Guangdong Province, establish a Blue Sky Action Fund in order to encourage academies and the business sector to explore and develop environmental friendly skills and to promote energy saving.
- 42 Comprehensively review the government purchasing policies, including construction materials, government vehicles and office facilities etc; and maximize the possibilities of using recycled products to facilitate green procurement.

Welfare

- 43 Since the implementation of the Lump Sum Grant in 2001, there has been continuous cut by the Social Welfare Department to all subvented agencies such as the 5% efficiency saving from 2000 to 2003, the 1.8% cost saving in 2003 to 2004, and the 2.5% cut in 2004 to 2005. All these added up to a total cut of 600 million in subvention in the last five years. Moreover, SWD planned to reduce the baseline subvention to 90.7% of the original, meaning that there will be a permanent cut of 9.3% in the total subvention budget. The drastic cut has tremendously affected the budget of social service agencies which directly affected the quality of services. The Civic Party urges the government to stop the cut in social welfare subvention.
- 44 The calculation of “basic needs” amount in CSSA was set up in 1996. The calculation is outdated as many necessities, such as computer, telephone, or newspapers are not included as basic needs. The Civic Party recommends the government to review the “Basic Needs” calculation immediately. At the same time, the CSSA amount (including the standard rate and the special allowance) and the Disability Allowance (including the normal disability allowance and the higher disability allowance) granted to the elderly, the disabled, single parent families and children, should be reverted back to the 2003 level, i.e. the level before the cut. The government should also re-instate special allowance such as allowance for eye-glasses and all allowances connected with learning. On the other hand, the Civic Party urges the government to research on the universal retirement protection scheme, to implement measures to eliminate poverty and to legislate for minimum wages. (see appendix for details.)

- 45 The Civic Party urges for an increase in resources to prevent domestic violence, enhance services for families having elderly or disabled members, and enhance assistance to single families and new arrivals families, e.g. re-open the five single family centers and the four new arrivals centers. The government should also remove the requirement of 7 years' residence for eligibility of CSSA. Apart from the above, the Civic Party recommends the continuation of the one-stop service for victims of sexual violence. (see appendix for details.)

Home Affairs

- 46 More resources should be set aside to assist the owners of private buildings to set up Owners' Corporations.

— End —

Appendix : recommendations for welfare budget (total: \$2,636.9 million)

1. measures to prevent domestic violence (\$92.3 million)

- 1.1. provision of \$18.3 million for increase of 1 social worker in each of the 61 integrated family service centers.
- 1.2. provision of \$12 million for employment of 40 social workers in IFSC to station in 200 full-day kindergarten schools.
- 1.3. set up a team comprising of 13 professional social workers to provide 24 hours services for all cases of domestic violence and related services. This special team would require \$12 million per year.
- 1.4. set up a fund of \$50 million for prevention of domestic violence programs and long term programs for collaboration between the legal profession and the community.

2. Measure to eliminate poverty (\$1,338 million)

- 2.1 provision of \$900 million for CSSA for elderly to be reverted back to the 2003 level and recommendation to the government to research on universal retirement protection scheme.
- 2.2 provision of \$128 million for disability allowance (normal and higher rate) to be reverted back to the 2003 level.
- 2.3. provision of \$210 million (this figure does not include budget for the reversion of all special allowance) for CSSA for children to be reverted back to the 2003 level and re-instate allowance for eye-glasses and allowance related to learning.
- 2.4. provision of \$100 million to expand the “transport subsidy” from remote areas to all 18 areas as assistance to people searching for a job and raise the existing \$1500 maximum subsidy.

3. enhance services for families having elderly or disabled members (\$827.1 million)

- 3.1. provision of \$110 million to increase 1,200 beds in care and attention homes.
- 3.2. Provision of \$43 million to increase 400 beds for nursing homes.
- 3.3. Provision of \$38 million to increase 100 infirm beds.
- 3.4. Provision of \$26 million to increase at least 400 day care units.
- 3.5. Provision of \$190 million and \$53 million to increase 50% of the existing integrated home care services and enhanced home care service.
- 3.6. Provision of \$14.1 million to run three more elderly health centers in three of the

ageing population areas.

- 3.7. Provision of \$138 million to increase 1200 beds in hostels for the disabled.
- 3.8. Provision of \$200 million to increase the service hours of the community support service for the disabled from 1 hour to 8 hours.
- 3.9. Provision of \$15 million to increase 20 rehabilitation buses in order to reduce the booking time for such buses.

4. Support services to single families and new arrival families(\$376.5 million)

- 4.1. provision of \$8.5 million to re-open 5 single family centers
- 4.2. provision of \$8 million to re-open 4 new arrivals centers.
- 4.3. Provision of \$360 million for CSSA for single families to be reverted back to the pre-cut level.

5. one stop service for victims of sexual violence (\$3 million)

- 5.1. provision of \$3 million to subvent two one-stop service centers for victims of sexual violence.