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for information

FUTURE OF THE SEWAGE SERVICES TRADING FUND

INTRODUCTION

This paper is to inform Members of the Administration's proposal to close the Sewage Services Trading Fund on 31 March 1998.

BACKGROUND

The Sewage Services Trading Fund

2 The Sewage Services Trading Fund (SSTF) was established on 11 March 1994 by resolution of the previous Legislative Council (LegCo) under the Trading Funds Ordinance and became responsible for the provision of all the services specified in the said resolution following the introduction of the sewage charging scheme on 1 April 1995. Under the Ordinance, the General Manager of the SSTF is required to meet expenses incurred in the provision of government sewage services out of the income of the trading fund, taking one year with another.

3 The broad aim of the Trading Fund is to provide cost-effective, comprehensive, efficient and environmentally acceptable public sewage services geared to the needs of the users. Sewage services provided under the Trading Fund comprise, inter alia, the design and construction of the capital projects forming the High Priority Programme of the Sewage Strategy; maintenance and operation of public sewerage systems and sewage treatment and disposal facilities; and billing and collection of charges for sewage services levied in accordance with the Sewage Services Ordinance.

The High Priority Programme

4 In 1994, the Government injected \$6.8 billion into the SSTF as trading fund capital to finance the design and construction of the High Priority Programme (HPP). This guarantees funding of the programme and underlines government commitment to improve the environment.

5 The HPP comprises Stage I of the Strategic Sewage Disposal Scheme (SSDS) and the six Sewerage Master Plans (SMPs) around the Victoria Harbour connected with it. Under the SSDS Stage I, six deep underground tunnels totalling about 24 km long will be constructed to convey waste water from the existing sewage screening plants in the six sewage catchment areas of Tseung Kwan O, Chai Wan/Shau Kei Wan, West Kowloon, North and South Kowloon, Northwest Kowloon and Tsuen Wan/Kwai Chung/Tsing Yi to Stonecutters Island. At the Stonecutters Island Sewage Treatment Works the waste water will undergo a chemically enhanced primary treatment process prior to discharge to the sea through an interim submarine outfall. This is intended to give substantial relief to the heavily polluted Victoria Harbour, pending implementation of further stages of the SSDS which would involve the collection and treatment of the remaining flows from Hong Kong Island and eventual discharge of the treated sewage through a deep oceanic outfall.

6 All the contracts under the HPP have been awarded and a number of projects, including the Stonecutters Island Sewage Treatment Works, have been completed. However, due to unsatisfactory progress and contractual dispute, the Administration re-entered in December 1996 the contracts for the six underground tunnels. The new completion contract for the two northern tunnels has since been awarded. We are inviting tenders for the completion contracts for the remaining four tunnels.

The Sewage Charging Scheme

7 A scheme of charging for sewage services was introduced on 1 April 1995. A Sewage Charge designed to reflect the cost of collecting and treating domestic strength sewage is levied on all water accounts based on the volume of water consumed. A Trade Effluent Surcharge also applies to 30 specified trade categories to reflect the additional cost of treating their more polluting effluents. The charging scheme was based on

the "Polluter Pays" principle, and the proposals were presented for public consultation during 1994-95 before implementation.

8 The Administration has accepted that, as sewage services are an essential public service, the SSTF would operate under an exceptional financial arrangement whereby it would not be required to make a return on the assets employed in the provision of services, as required of all other trading funds. In addition, in 1996-97, the Administration waived the requirement for the SSTF to recover the cost of asset replacement in setting charges. As a result, we only aim to recover the operating and maintenance costs through sewage charges and the Trading Fund has in effect been provided with all its assets free of charge.

9 When the sewage charging scheme was introduced in 1995, we briefed Members of the then LegCo on the statutory obligations of a trading fund to be financially independent and the need to build up a buffer before the commissioning of the HPP facilities to smooth out future increases. LegCo Members supported the introduction of a charging scheme, but preferred to set the initial charges at a level much lower than originally proposed, and acknowledged that major increases in charges would be needed in future years as a result (of the order of 10%, 10%, 50% and 10% increases from 1996 to 2000).

Present Position of the SSTF

10 The setting of the level of sewage charges under the Sewage Services Ordinance is subject to disallowance by the legislature. As the Administration was unsuccessful in 1996 in securing LegCo's agreement to increase sewage charges in line with inflation, these charges have not been adjusted since 1995. Up to now, the SSTF has been able to balance its books mainly because of the delay in the commissioning of the full SSDS Stage I works. The Operating Account for the year 1996-97 and the Balance Sheet as at 31 March 1997 are at Annexes A & B.

A & B

11 The SSTF is forecast to have an operating deficit before depreciation of \$261 million in 1997-98. Even assuming that sewage charges will be increased by 50% and 33% in 1998 and 1999 respectively, and by 12% each year thereafter, as is forecast in the Business Plan, accumulated deficit will rise to \$615 million by 31 March 2001 and the SSTF will not break even before 2007. This is because we anticipate a

rapid and sustained growth in operating expenditure as new facilities are brought on stream. Without substantial regular increases in the sewage charges, break even will not be in sight at all. The projected revenue and expenditure of the SSTF for the next 10 years, with and without increases in sewage charges, are at Annexes C & D.

C & D

CLOSING OF THE SSTF

Reasons for Closing

12 The SSTF projects large operating deficits in the coming years unless substantial increases are made in sewage charges to keep pace with the rapid growth in expenditure as new facilities are brought on stream. The Administration has grave reservations as to whether the forecast increases in charges of 50% in 1998, 33% in 1999 and 12% in 2000 and thereafter are attainable, let alone considerably larger increases which will be required to cover additional operating costs in future as the subsequent stages of the SSDS are commissioned.

13 The only other way of making up the deficits of the SSTF is through injection of funds from the General Revenue. This would however be against the letter and spirit of the Trading Funds Ordinance. We are therefore left with no choice but to close the SSTF, write off the accumulated operating deficit and re-establish sewage services on a vote-funded basis.

Vote-funded Arrangement for Sewage Services

14 We intend, with the Legislature's agreement, to close the SSTF on 31 March 1998. From 1 April 1998, sewage services will continue to be managed by the Drainage Services Department but on a vote-funded basis. That is, expenditure on the operation of sewage services will be voted by the legislature in the context of the annual Estimates. Taking into account the characteristics and capital intensive nature of sewage services, we will deem it as a government utility. Separate operating accounts will be kept and published annually, as for other government utilities, to ensure accountability and transparency. The operating accounts will provide an overall picture of the financial position of the sewage services undertaking, enable comparisons to be made with

past performance and provide a basis for the setting of charges. We will continue to maintain our performance standards and improve productivity.

15 The remaining capital works projects under the SSDS Stage I and those under the SMPs will continue to be implemented. We will fund these and other contracts that may be awarded in the future (including those for the remaining four tunnels under SSDS Stage I) through the Public Works Programme.

Implications for the Sewage Charging Scheme

16 As the Sewage Services Ordinance has provided for the sewage charges to be paid to Government, the closing of the Trading Fund will not affect the legitimacy of the collection of these charges. The polluters will continue to pay for a large share of the direct operating and maintenance costs of running the sewage services. Thus the "Polluter Pays" principle, as applied under the SSTF, would be preserved. The Administration intends to maintain the polluters' share of the sewage costs in real terms and will seek the Legislature's approval of increases in charges to continue to recover part of the full operating and maintenance costs consistent with that objective. Whether and how these charges could be increased to cover the expenses fully is a separate issue.

17 The "Polluter Pays" principle was promulgated as government policy in the 1989 White Paper on Pollution, partly as a means of ensuring that the costs of cleaning up or preventing pollution are borne by those directly responsible, and partly to ensure appropriate financial incentives are in place to encourage pollution-reducing behaviour. The principle has also been applied to other environmental charges and, being a central plank of government environmental policy, it is crucial that it be maintained.

IMPLEMENTATION

18 We propose to move a Resolution in the Provisional Legislative Council (PLC) under the Trading Funds Ordinance to close the SSTF on 31 March 1998, and to nullify previous resolutions for the appropriation of assets to the SSTF. We will also seek approval from the Finance Committee via the Public Works Sub-Committee of the PLC for

additional funds required to complete the four remaining deep underground tunnels.

19 As we consider it appropriate to close the SSTF at the end of the current financial year, it is essential that the Administration moves the Resolution within this session. We propose to do so in mid November 1997.

FINANCIAL AND STAFFING IMPLICATIONS

20 The closing of the SSTF will necessitate certain changes to accounting arrangements but will not have any major impact on Government's finances in overall terms.

21 Staff of a trading fund department remain civil servants. Thus the proposed reversion of the SSTF back to a vote-funded department will have no staffing implications.

PUBLICITY

22 The Administration will issue a press release in the afternoon of 10 September 1997.

Works Bureau
Government Secretariat
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