

Press Release
LCQ13: Fiscal reserves and Government expenditure
Wednesday, December 4, 2013

Following is a question by the Dr Hon Chiang Lai-wan and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (December 4):

Question:

The official foreign currency reserve assets stand at about US\$300 billion at present, including an accumulated surplus of over HK\$600 billion, while the fiscal reserves of the Government stand at HK\$670 billion. There is hence a view that the Government has a very robust financial position. In this connection, will the Government inform this Council:

- (a) as the Financial Secretary has stated in the 2012-2013 Budget that Hong Kong needs to maintain adequate fiscal reserves to take on the challenges posed by an ageing society as well as to cope with economic contingencies, whether the Government currently has put in place clear criteria for determining an appropriate level of fiscal reserves; if it has, of the details; if not, the reasons for that;
- (b) as the Government has indicated that it would set up a working group to be led by the Treasury Branch, and scholars and experts would be invited to join the working group to study ways to make more comprehensive planning for public finances in order to cope with the ageing population and the Government's other long-term commitments, of the latest work progress of the working group, the scope of the study, and the expected time for publishing the findings of the study;
- (c) as there is a view that the existing financial management philosophy of the Government is too conservative, whether the Government will consider taking appropriate measures, such as setting up or injecting monies into funds for designated purposes in order to release part of the reserves, with a view to allocating more resources for the enhancement of the education, healthcare, social security net, retirement protection system and economic development of Hong Kong, thereby promoting social mobility and alleviating the problem of

disparity between the rich and the poor in Hong Kong; and

(d) since it is learnt that while each year the authorities draw up the recurrent expenditure estimates for the next year on the basis of economic growth forecast, the growth of government revenue has been consistently higher than the local economic growth in real terms in recent years, whether the authorities will consider making appropriate adjustments to that estimation approach; if so, of the details; if not, the reasons for that?

Reply:

President,

(a) Fiscal reserves is not a back-up asset, but represents the total amount of resources that the Government can use on a day-to-day basis. The level of reserves reflects the Government's entire cash balance.

Fiscal reserves serves to meet our day-to-day operational expenses and public works expenditures. It also comprises funds for designated uses that cannot be freely transferred, such as the Land Fund, the Lotteries Fund and the Disaster Relief Fund. We must ensure that the fiscal reserves is sufficient to perform its major functions, which include strengthening the stability of Hong Kong dollars, serving as a buffer during economic downturns, coping with unfunded liabilities and committed expenditures, generating investment income, and meeting future needs, such as the challenges of an ageing population. In view of the multiple functions of fiscal reserves and uncertainties in the external economy, it serves little purpose to determine an "appropriate level" for fiscal reserves.

Fiscal reserves is not inexhaustible. The Government has the responsibility to strictly control expenditure and ensure fiscal sustainability.

In fact, the Government has been adhering to the fiscal discipline of keeping expenditure within the limits of revenues and committing resources only where justified. Fiscal reserves is not the most important factor in determining the level of expenditure.

(b) The Financial Secretary announced in the 2013-14 Budget Speech that a

working group to be led by the Treasury Branch of the Financial Services and the Treasury Bureau would be set up to explore ways to make more comprehensive planning for Hong Kong's public finances to, amongst others, cope with the ageing population and the Government's other long-term commitments.

The Working Group on Long-Term Fiscal Planning was set up in June 2013. It aims to assess, under existing policies, the long-term public expenditure needs and changes in government revenue, and to propose feasible fiscal measures with reference to overseas experience to enable the Government to make more comprehensive fiscal planning in the face of the challenges on public finances posed by the ageing population. The Working Group is carrying out its work and aims to report to the Financial Secretary by early 2014.

(c) Government expenditure on public services is mainly met from the General Revenue Account on an annual basis. However, where justified and necessary, we may seek funding approval from the Finance Committee of the Legislative Council to set up a dedicated fund for a specific service area. This is to provide a steady funding source for the particular service despite the fluctuations in the economy or government revenue. Examples include the Environment and Conservation Fund, the Community Care Fund and the Language Fund.

While adhering to the principles of fiscal prudence and committing resources only where justified, the Government's spending has been far from conservative. Recurrent expenditure has increased from \$150 billion in 1997-98 to more than \$290 billion in 2013-14, an increase of nearly one-fold. The increase in recurrent expenditure reflects the Government's long-term commitment to improving people's livelihood. Recurrent expenditure in areas such as education, health services and social welfare accounts for about 60%. When compared to 1997-98, the expenditure on education increased by about 70%, and the expenditure on health services increased by about 90%, while the expenditure on social welfare increased by about two-fold.

(d) The Basic Law stipulates that the Government shall follow the principle of keeping the expenditure within the limits of revenues in drawing up its budget, and strive to achieve a fiscal balance, avoid deficits and keep the budget

commensurate with the growth rate of its gross domestic product (GDP).

Since 1997-98, we have had budget deficits in five years and surpluses in 11 years. In 2012-13, the cumulative nominal GDP growth was about 50%, with comparable cumulative increase in income. The cumulative increase in expenditure, however, nearly doubled. In the 2013-14 Budget, the government expenditure was estimated to reach \$440 billion, an increase of about \$250 billion as compared with 1997-98, which is more than a one-fold increase. Yet, the nominal GDP growth during the same period is only slightly more than 50%.

Hong Kong is a small and open economy. Our tax base is narrow and some major revenues, in particular land premium and profits tax, are highly vulnerable to economic fluctuations. They are so volatile that they are somehow beyond the Government's control or accurate estimation. All along, government revenue and expenditure have been hovering around 20% of GDP. Over the past 15 years, there has been a significant increase in our recurrent expenditure. We also have to make more comprehensive planning to cope with the ageing population and other long-term financial commitments. Therefore, in preparing the annual budget and Medium Range Forecast, the Government should not consistently deviate from the rate of economic growth and related factors.

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