

Press Release

LCQ21: Report of the Working Group on Long-Term Fiscal Planning

Wednesday, March 26, 2014

Following is a question by the Hon Kenneth Leung and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (March 26):

Question:

The Government set up the Working Group on Long-Term Fiscal Planning (the Working Group) in June last year to explore ways to make more comprehensive planning for Hong Kong's public finances to cope with the ageing population and the Government's other long-term financial commitments. The Working Group has completed a fiscal sustainability appraisal on the public finances of Hong Kong and released its report on March 3 this year, explaining in detail the future challenges that Hong Kong will face in public finances and the relevant recommendations. In this connection, will the Government inform this Council:

(1) given that the Chief Executive (CE) indicated during the press conference on the 2014 Policy Address that he had confidence that the Government could afford the increased expenditure this year, and was determined to make good use of public money, but the Financial Secretary (FS) pointed out in his speech on the Motion of Thanks on the Policy Address at the Council meeting of February 12 this year that the Government was obliged to uphold the principle of "keeping expenditure within the limits of revenue" to avoid the structural fiscal deficit caused when the rate of spending continued to expand beyond the growth in revenue, and there are views that the aforesaid remarks show that the respective principles adopted by CE and FS in managing public finances are inconsistent, of the concepts and principles adopted by the Government in drawing up its budget;

(2) as the Working Group suggested in its report that public expenditure should be strictly contained at 20 per cent of the gross domestic product in future, of the Government's stance on the suggestion, and whether it will take on board the suggestion;

(3) as the Working Group pointed out in its report that the Government was

increasingly reliant on direct tax revenue, and the contribution from indirect tax to the total government revenue had dropped, of the Government's counter-measures in this regard; whether the Government has plans to increase the contribution from indirect tax to the total government revenue; if so, of the details; if not, the reasons for that;

(4) as the Working Group suggested in its report that the cost recovery rates for various government services should be raised in order to strictly follow the principles of "cost recovery", "user pays" and "polluter pays", of the target cost recovery rates for various government services at present; the total number of paid services provided by the Government, and set out in the Annex a breakdown by different cost recovery rates; and

(5) of the following information (to be set out in table form) in relation to each of the government services with their cost recovery rates lower than 30 per cent: (i) fee type, (ii) government department providing the service, (iii) date of last fee adjustment, (iv) current fee level, (v) cost recovery rate (against the price level in 2014-2015), and (vi) whether there are plans to adjust the fee level (if so, of the new fee levels proposed, the amount and extent of the increase, as well as the cost recovery rate after the implementation of the new fee level)?

Reply:

President,

(1) Fiscal prudence has been the guiding principle of the Government on the management of public finances. Article 107 of the Basic Law stipulates that the Hong Kong Special Administrative Region shall follow three principles in drawing up its budget: first, keeping the expenditure within the limits of revenues; second, striving to achieve a fiscal balance and avoid deficits; and third, keeping the budget commensurate with the growth rate of its gross domestic product (GDP). In other words, the budget should not grow faster than the economy as a whole. We also adhere to the principles of pragmatism, commitment to society and sustainability in managing public finances. Following the principle of fiscal prudence, we adhere to keeping expenditure within the limits of revenues, and committing resources only where justified; when implementing new policies and measures, especially those involving long-term financial commitments, the Government will go through thorough

deliberation and appropriate planning to ensure prudent use of public resources.

(2) In respect of the recommendation from the Working Group on Long-Term Fiscal Planning (Working Group) that public expenditure should be controlled at or around 20 per cent of the nominal GDP, the Government's position is as follows:

(a) The Government considers this a suitable level since it can help maintain Hong Kong's competitiveness and ensure that Government will not consume excessive social resources which may impede the development of the private sector.

(b) More importantly, this is in line with the principle of keeping the expenditure within the limits of revenues in managing public finances. Although government revenue swings along with and in the same direction as fluctuations in the local and global economy, government revenue as a percentage of nominal GDP has seldom exceeded 20 per cent (only seven times in the past 40 years). While government revenue exceeded 20 per cent of GDP in recent years, but the excess was largely attributable to the increase in land revenue, which amounted to some 3 to 4 per cent of GDP, as compared with the average of about 2 per cent for the first ten years after 1997-98. Nevertheless, land revenue is not recurrent in nature. Government revenue was on average 18.6 per cent of nominal GDP between 1997-98 and 2012-13, with the trough at 13.3 per cent and the peak at 22.6 per cent. This essentially reflects the inherent low tax regime in Hong Kong. Given this stipulated requirement in Article 108 of the Basic Law, it would be hard to expect major hikes in government revenue beyond 20 per cent. If public expenditure were to consistently exceed 20 per cent, we need to explore how to increase revenue to sustain such an expenditure level.

(c) The 20 per cent of GDP guideline on public expenditure is a target for managing public finances. It can be exceeded if necessary. For example, in the 2013-14 Budget, public expenditure went beyond the 20 per cent of GDP. The underlying principle is that, over time, expenditure growth should not exceed the growth of economy.

(3) The Government concurs with the findings in the report of the Working Group. On broadening the revenue base, there is little room for major tax

hikes (irrespective of direct tax or indirect tax), having regard to the competitiveness of Hong Kong and the impact on the community. In principle, the Government will not rule out any means to increase tax revenue. However, we also understand that any tax increase proposals will be controversial and may entail other policy considerations. It takes time for the community to engage in rational discussions with a view to forging a consensus on the matter.

(4) and (5) Government services are generally charged in accordance with the "user pays" principle. The principle seeks to link the service fee levels with the service costs, so that service users will pay for the full costs of the services without requiring taxpayers to bear the burden of the service costs. This is a long-established fee charging principle and an important measure of fiscal discipline. If service fee levels are lower than service costs, individual service users will be subsidised by the general revenue, which is unfair to the general taxpayers.

From the practical perspective, the Government will set the level of subsidies to some services having regard to the policy requirements. For the subsidised services, the "user pays" principle seeks to link the service fee levels with the pre-set levels of cost subsidy, so that service users will pay for part of the service costs without requiring taxpayers to bear the burden of all the service costs.

At present, there are more than 4 000 fees and charges with their fee levels set according to the "user pays" principle. All policy bureaux and departments are reviewing their respective fees and charges. In reviewing the fees and charges, policy bureaux and departments will take into account factors including the specific circumstances of the services provided, public affordability and acceptability, and the views of Legislative Council Members before making proposals for fee revisions. All government departments will consult relevant stakeholders on their proposals for fee revisions to ensure compliance with the "user pays" principle.

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