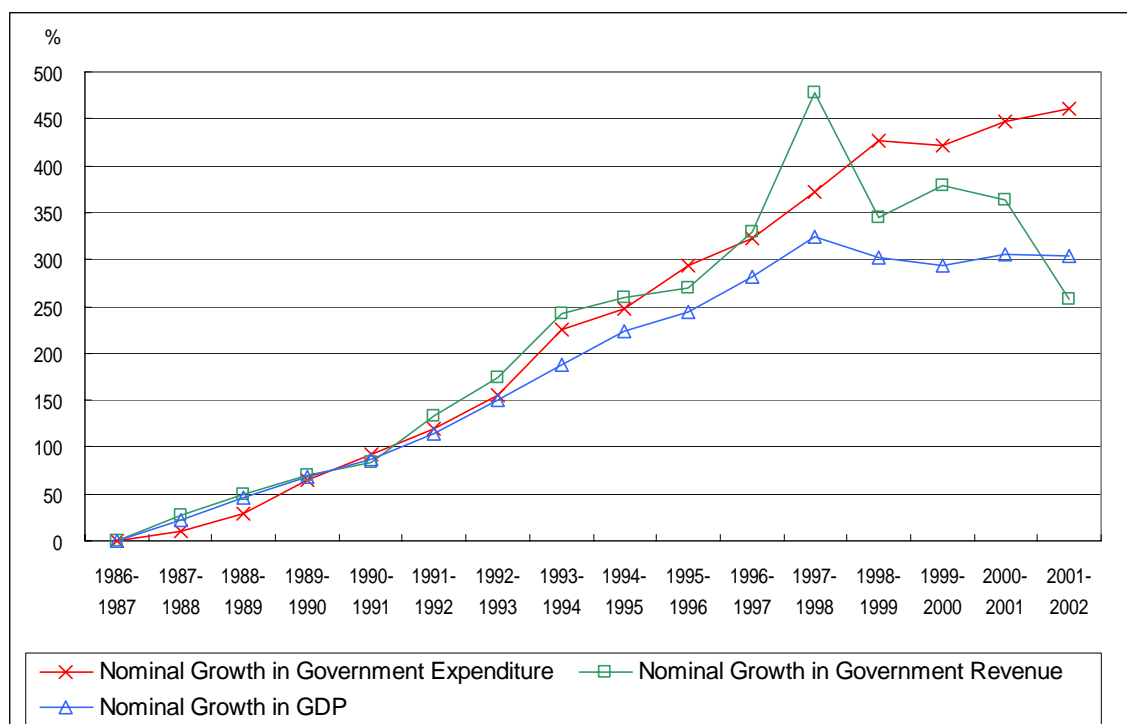


PAST BUDGETARY TRENDS

Overall Cumulative Position

12. Against the above economic backdrop, the Task Force has analysed the overall cumulative growth of GDP against the cumulative growth of government revenue and expenditure¹ over the last 15 years in nominal terms. As can be seen from Chart 7 below, cumulative growth in government expenditure started to outstrip that of the economy from 1993-94 onwards and the gap between the two widened from 1997-98. On the other hand, cumulative growth in government revenue exceeded somewhat the cumulative growth of GDP until the current year.

Chart 7 – Cumulative Growth Rate in Government Expenditure, Government Revenue and GDP in Nominal Terms

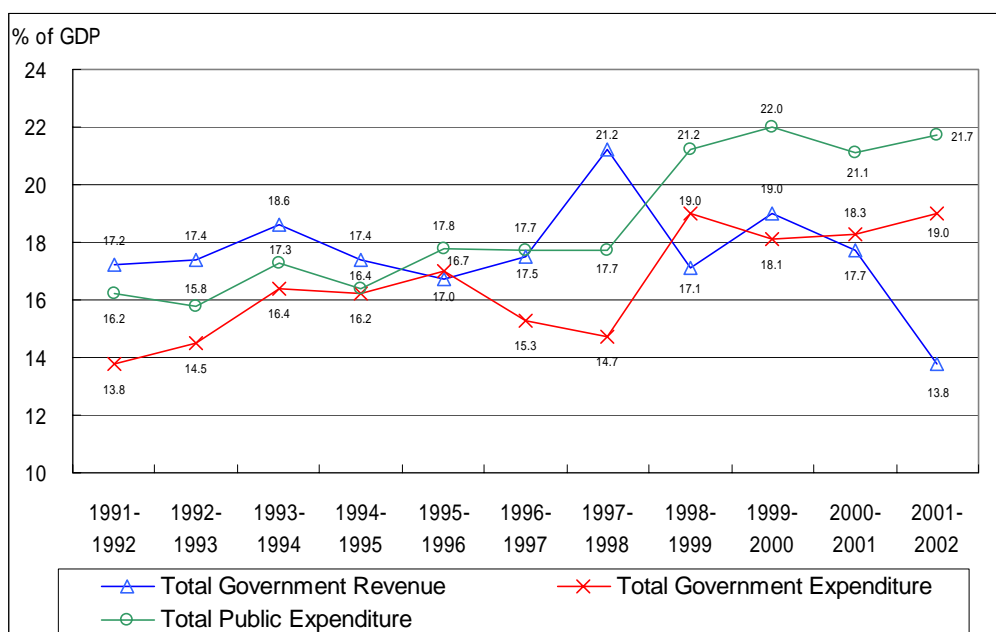


¹ For the purpose of this analysis, government revenue and expenditure do not include revenue and expenditure by the Trading Funds and the Housing Authority and payments from the Lotteries Fund.

Year-on-Year Position

13. The Task Force has also analysed the Government's revenue and expenditure as a share of GDP, on a year-on-year basis since 1991-92. The outcome is set out in Chart 8 below. For illustration purpose, the public sector expenditure² is also shown in the Chart for reference.

Chart 8– Government Revenue, Government Expenditure and Public Sector Expenditure as a Percentage of GDP



14. As can be seen from the above chart, total government expenditure exceeded total government revenue (expressed as a share of GDP) in the years 1995-96, 1998-99, 2000-01 and 2001-02. Full details of government revenue and expenditure in money terms since 1991-92 are at Annex III.

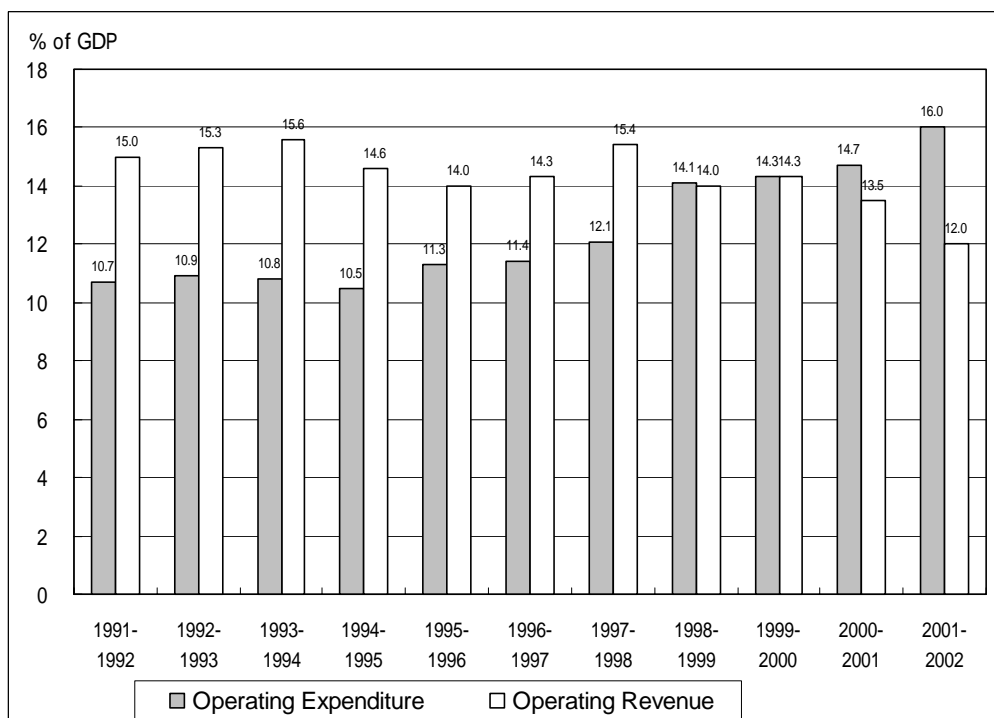
Annex III

² Public expenditure includes government expenditure (less advances and equity investments from the Capital Investment Fund), plus expenditure by the Trading Funds, Housing Authority and the previous (Provisional) Urban and Regional Councils up to 31 December 1999; and payments from the Lotteries Fund.

Operating Expenditure and Revenue

15. The profile of government operating expenditure and revenue, as a share of GDP, from 1991-92 to 2001-02³ is set out in Chart 9.

**Chart 9 – Government Operating Expenditure and Revenue
as a Percentage of GDP**



16. Overall, government operating expenditure has increased during this period, from 10.7% of GDP in 1991-92 to 16.0% of GDP in 2001-02. More specifically, before 1995-96, the share of government operating expenditure was below 11% of GDP. It rose to above 11% of GDP in 1995-96, to over 14% between 1998-99 and 2000-01, and to 16% of GDP in 2001-02. Since 1998-99, the high percentage levels have largely coincided with years of negative GDP growth except in 2000-01.

³ Data for 2001-02 for all revenue and expenditure are based on the latest forecast of the revised estimates, which have not been finalised at the time of this report.

17. Overall, government operating revenue moved within a relatively narrow range of 15.6% of GDP (in 1993-94) to 14% of GDP (in 1995-96) up to 1999-2000. However, government operating revenue fell to 13.5% and 12.0% of GDP in 2000-01 and 2001-02 respectively.

Operating expenditure

18. The changes in the main constituent components of government operating expenditure over the period since 1991-92 are set out in Table 1 below.

Fiscal Year	1991-1992	1992-1993	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002 ³
	%	%	%	%	%	%	%	%	%	%	%
Personal emoluments	3.8	3.3	3.2	3.2	3.2	3.1	3.0	3.5	3.8	4.0	4.1
Personnel-related expenses	1.0	1.0	1.0	1.0	1.0	1.1	1.0	1.0	1.1	1.1	1.4
Departmental expenses	0.7	0.6	0.6	0.5	0.6	0.6	0.6	0.7	0.8	1.0	1.2
Other charges	1.6	1.5	1.5	1.5	1.7	1.8	1.8	2.3	2.4	2.4	2.6
Recurrent subventions	3.5	4.1	4.1	4.2	4.6	4.7	4.8	5.6	6.0	6.0	6.4
Other non-recurrent	0.1	0.4	0.4	0.1	0.2	0.1	0.9	1.0	0.2	0.2	0.3
Total	10.7	10.9	10.8	10.5	11.3	11.4	12.1	14.1	14.3	14.7	16.0

⁴ Government operating expenditure does not include expenditure of those departments operated on a trading fund basis and expenditure funded by the Housing Authority and the two provisional municipal councils before their dissolution. The relevant items are listed below (items below 0.1% of GDP have not been included except where stated):

Expenditure Item	Year of change	Effect on GDP%
Post Office Trading Fund	Excluded from government expenditure since 1995-96	-0.2%
Electrical and Mechanical Services Trading Fund	Excluded from government expenditure since 1996-97	-0.1%
Sewage Services Trading Fund	Excluded from government expenditure from 1995-96 to 1997-98 Included in government expenditure in 1998-99	Insignificant +0.1%
Food and Environmental Hygiene Department	Included in government expenditure since 2000-01	+0.35%
Leisure and Cultural Services Department	Included in government expenditure since 2000-01	+0.4%

19. The component that has registered the largest increase is “recurrent subventions”. Recurrent subventions are payments to government-funded external bodies to support their on-going operations. Included within subvention payments is the majority of the spending on education and health. Recurrent subvention expenditure has risen from 3.5% of GDP in 1991-92, by almost 3 percentage points, to 6.4% of GDP in 2001-02.

20. The other major contributor to the increase in operating expenditure is “other charges”, which consist mainly of social security payments made under the Comprehensive Social Security Assistance (CSSA) and Social Security Assistance (SSA) schemes. The expansion of the social security system, coupled with rising unemployment particularly from 1998-99 onward, has put pressure on expenditure on social security payments. From 1991-92 to 2001-02, expenditure on “other charges” has risen from 1.6% to 2.6% of GDP.

21. Two other component items, namely “personal emoluments” and “personnel-related expenses”, have registered a steady increase, from around 4.2% of GDP in the period up to 1997-98 to 5.5% of GDP in 2001-02.

Operating revenue

22. Government operating revenue arises principally from direct and indirect taxes, general rates, other non-tax revenue such as government fees and charges, and investment income from the fiscal reserves. Each of these items is, to a greater or lesser extent, driven by economic performance. Table 2 below sets out the position of government operating revenue as a share of GDP since 1991-92. Overall, it shows operating revenue between 1991-92 and 1999-2000 was at or above 14% of GDP; for 2000-01 and 2001-02, however, government operating revenue fell to 13.5% and 12.0% of GDP respectively.

Table 2 - Government Operating Revenue as a Percentage of GDP

Fiscal Year	1991-1992	1992-1993	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002 ³
	%	%	%	%	%	%	%	%	%	%	%
Direct tax revenue	6.7	7.1	7.3	7.3	7.2	7.0	6.9	6.0	5.5	5.8	6.2
Indirect tax revenue	2.8	3.0	3.3	2.3	2.2	2.9	3.3	1.9	2.0	1.9	1.7
General rates ⁵	0.5	0.6	0.5	0.5	0.5	0.5	0.5	0.3	0.6	1.1	1.0
Other non-tax ⁶ revenue	4.6	4.4	4.1	4.0	3.6	3.4	3.6	3.3	3.2	3.1	3.1
Investment income	0.4	0.2	0.4	0.5	0.5	0.5	1.1	2.5	3.0	1.6	0.0
Total	15.0	15.3	15.6	14.6	14.0	14.3	15.4	14.0	14.3	13.5	12.0

23. Direct taxes are earnings-related and include profits tax, salaries tax, property tax and personal assessment. In revenue productivity terms, profits tax and salaries tax provide the bulk of direct tax revenue. Indirect taxes are taxes that are not earnings-related and include stamp duties, betting duties and the like.

24. Revenue from direct and indirect taxes showed a stable trend in the period prior to the Asian financial crisis. From 1991-92 to 1997-98, tax revenue amounted to between 9.4% and 10.6% of GDP. Thereafter, tax revenue fell to below 8% of GDP. The turning point was in 1998-99, in which year the Government substantially increased the personal allowances and deductions under salaries tax, and lowered the tax rates under salaries tax and profits tax. These were implemented on the back of exceptionally high revenue out-turns in the preceding fiscal year.

25. Revenue from “other non-tax revenue” includes revenue from government fees and charges. The steady decline in recent years reflects the freezing of many government fees and charges.

⁵ Before 1 January 2000, more than half of the general rates were collected to finance the then Urban and Regional Councils which became the Provisional Urban and Regional Councils on 1 July 1997. This is not included as revenue in Table 2.

⁶ Besides government fees and charges, “other non-tax revenue” includes fines, royalties, properties and investments, etc.

26. Investment income is largely derived from the investment of fiscal reserves. As can be seen in Table 2 above, there was a marked turning point in 1997-98 when revenue from this source jumped to 1.1% of GDP, more than doubled the 0.5% of GDP yield in 1996-97. This was due to a sudden swelling of the Government's fiscal reserves on 1 July 1997 when the accumulated balance in the HKSAR Land Fund was transferred to the Government. (The HKSAR Land Fund was set up in 1985 to receive half of the net premium obtained from land transactions. It was a separate entity from the then Government and its balance did not constitute part of the then Government's fiscal reserves.) The high yield achieved in 1998-99 and 1999-2000 was largely due to the high rates of investment return achieved by the Exchange Fund (namely 9.2% for 1998 and 10% for 1999). The drop in 2001-02 was due to an unfavourable investment environment leading to a low rate of return, coupled with the reduced amount of fiscal reserves available for investment following several years of consolidated deficits.

Operating Balance

27. Before 1998-99, the operating account was in surplus. Since then, Hong Kong has experienced four consecutive years of operating deficits. The size of the deficit reached 3.9% of GDP in 2001-02, as shown in Table 3 below.

28. The Task Force has noted that investment income has since 1997-98 become a major contributor to government operating revenue. Without the investment income, the operating deficits since 1998-99 would have been more serious as shown in Table 3 below. Given the inherent volatility of investment income, the Task Force has some doubt on its dependability as a steady source of revenue.

Table 3 – Operating Surplus/Deficit Before and After Investment Income as a Percentage of GDP											
Fiscal Year	1991-1992	1992-1993	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002 ³
	%	%	%	%	%	%	%	%	%	%	%
Operating Surplus/(Deficit) after investment income ⁷	4.2	4.4	4.8	4.0	2.7	2.9	3.3	-0.05	-0.1	-1.2	-3.9
Investment Income	0.4	0.2	0.4	0.5	0.6	0.4	1.1	2.5	3.0	1.6	0.0
Operating Surplus/(Deficit) before investment income	3.8	4.2	4.4	3.5	2.1	2.5	2.2	-2.6	-3.1	-2.8	-4.0

⁷

In this context, investment income includes returns on General Revenue Account and Land Fund only, and does not include returns earned on the various Funds account.

Capital Expenditure and Revenue

29. The profile of government capital expenditure and revenue, as a share of GDP, from 1991-92 to 2001-02 is set out in Table 4 below.

Fiscal Year	1991-1992	1992-1993	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002 ³
	%	%	%	%	%	%	%	%	%	%	%
Capital Revenue	2.2	2.1	3.0	2.8	2.7	3.2	5.8	3.1	4.7	4.2	1.8
Capital Expenditure	3.1	3.6	5.6	5.7	5.7	3.9	2.6	4.9	3.8	3.6	3.0

Capital expenditure

30. The bulk of government capital expenditure is public works and land resumption payments. From time to time, the Government had also invested equity in railway corporations and other bodies. By nature, capital expenditure is lumpy. This may be illustrated by the figures in Table 5 below, which show that, as a share of GDP, capital expenditure ranged from 2.6% to 5.7% of GDP in the past decade or so. The highest figures were recorded between 1993-94 and 1995-96, which was the peak period for the construction of the Airport Core Programme. As a share of GDP, capital expenditure registered another jump in 1998-99 due to the injection of equity by the Government into the Kowloon-Canton Railway Corporation for the West Rail Project.

Fiscal Year	1991-1992	1992-1993	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002 ³
	%	%	%	%	%	%	%	%	%	%	%
Capital Works Reserve Fund	2.5	2.5	3.9	3.0	3.1	2.4	2.2	2.5	2.4	2.4	2.4
Capital Investment Fund	0.3	0.8	1.4	1.8	2.0	0.8	0.0	1.6	0.7	0.6	0.0
Others ⁸	0.3	0.3	0.3	0.9	0.6	0.7	0.4	0.8	0.7	0.6	0.6
Total Capital Expenditure	3.1	3.6	5.6	5.7	5.7	3.9	2.6	4.9	3.8	3.6	3.0

⁸ "Others" include capital expenditure of other funds such as Loan Fund, Disaster Relief Fund and capital items under the General Revenue Account.

Capital revenue

31. Government capital revenue has fluctuated between 1.8% and 5.8% of GDP in the past decade or so as shown in Table 6 below.

Fiscal Year	1991-1 992	1992-1 993	1993-1 994	1994-1 995	1995-1 996	1996-1 997	1997-1 998	1998-1 999	1999-2 000	2000-2 001	2001- 2002 ³
	%	%	%	%	%	%	%	%	%	%	%
Land premium	1.3	1.1	2.1	1.9	1.8	2.3	4.8	1.5	2.8	2.3	0.7
Other capital revenue	0.9	1.0	0.9	0.9	0.9	0.9	1.0	1.6	1.9	1.9	1.1
Total	2.2	2.1	3.0	2.8	2.7	3.2	5.8	3.1	4.7	4.2	1.8

32. The principal capital revenue item is land premium. This accounted for 0.7% of GDP in 2001-02, being the lowest in the period as against 1.3% of GDP in 1991-92, and the historical peak of 4.8% in 1997-98. As explained in paragraph 26 above, half of the net land premium received for the period up to 30 June 1997 went to the HKSAR Land Fund and was not credited into government revenue. In the absence of this arrangement, the land premium item would have exceeded the percentages of GDP listed in 1991-92 to 1996-97 in Table 6 and become, for example, 3.2% of GDP in 1991-92 and 4.9% of GDP in 1996-97. Seen in this light, revenue from land premium registered a sharp reduction from 1998-99 to 2001-02. This reflected the consolidation of the property market following the Asian financial crisis.

33. Another major item of capital revenue arises from the proceeds of the sale of government assets (excluding land). For instance, the partial privatisation of MTR Corporation Limited yielded \$10.1 billion in 2000-01.

Capital Balance

34. As shown in Table 7 below, annual government capital expenditure normally exceeded government capital revenue. The exceptions are in 1997-98, 1999-2000 and 2000-01. For the year 1997-98, this was due to lower than normal capital expenditure following the completion of the Airport Core Programme. For 1999-2000, this was because of higher than normal capital revenue due to a repayment of a loan for Sandwich Class Housing by the Hong Kong Housing Society. For 2000-01, it was because of the proceeds from the partial privatisation of MTR Corporation Limited.

Fiscal Year	1991-1992	1992-1993	1993-1994	1994-1995	1995-1996	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001	2001-2002 ³
	%	%	%	%	%	%	%	%	%	%	%
Capital Revenue	2.2	2.1	3.0	2.8	2.7	3.2	5.8	3.1	4.7	4.2	1.8
Capital Expenditure	3.1	3.6	5.6	5.7	5.7	3.9	2.6	4.9	3.8	3.6	3.0
Capital Account Surplus/(Deficit)	-0.9	-1.5	-2.6	-2.9	-3.0	-0.7	3.2	-1.8	0.9	0.6	-1.2

Consolidated Position

35. Taking both the operating and capital components of government expenditure and revenue together, Hong Kong recorded four years of consolidated fiscal deficits since 1991-92, as set out in Chart 10 below. Expressed as a share of GDP, the deficit recorded was 0.3% for 1995-96, 1.8% for 1998-99, 0.6% for 2000-01 and an estimated 5.2% for 2001-02.

Chart 10 – Consolidated Surplus/Deficit as a Percentage of GDP

