Press release

Working Group on Long-Term Fiscal Planning releases report (with photo/video)

Monday, March 3, 2014

The following is issued on behalf of the Working Group on Long-Term Fiscal Planning:

The Working Group on Long-Term Fiscal Planning has completed a fiscal sustainability appraisal on the public finances in Hong Kong and released its report today (March 3).

The fiscal sustainability appraisal covers long-term trend projections on economic growth, government revenue and government expenditure for the coming two to three decades. The projections were made on the basis of the population projections up to 2041 and prevailing government policies and funding commitments.

Appointed by the Financial Secretary in June 2013, the Working Group is convened by the Permanent Secretary for Financial Services and the Treasury (Treasury), Ms Elizabeth Tse, with Professor Liu Pak-wai, Professor Francis Lui, Mr Mark Saunders, Mrs Jennifer Wong, Mr Marcellus Wong, the Director of Accounting Services, the Government Economist and the Deputy Secretary for Financial Services and the Treasury as Members.

Unveiling the full report at a press conference today, Ms Tse expressed her gratitude to Members of the Working Group for their independent professional advice and unfailing support during the course of the deliberations.

Introducing the report, she said, "The Working Group's report is the first comprehensive fiscal sustainability appraisal on the Government's budget since 1997-98. It provides a basis for the Government and the community to look beyond the short to medium term, and to consider policy choices that would best prepare Hong Kong to cope with the challenges and opportunities of an ageing population and a maturing economy.

"The Working Group projects that under population ageing, the Hong Kong economy would see real trend growth of 2.8 per cent per annum, or nominal growth of 4.4 per cent per annum, to 2041. This long-term economic outlook would still put

Hong Kong amongst the league of mature economies, which typically have real trend growth of around 2 to 3 per cent per annum.

"Through econometric modelling, government revenue is projected to grow at a trend rate of 4.5 per cent per annum, broadly comparable to the projected growth in nominal Gross Domestic Product (GDP). It is projected at 19.8 per cent of GDP in 2041-42.

"On the other hand, government expenditure is projected to grow at a trend rate of 5.3 per cent per annum (i.e. higher than the nominal GDP trend growth of 4.4 per cent per annum) under the assumption that education, social welfare and health services would only be kept at current standards and that other spending items would grow in line with GDP. The trend growth rates would be 6 per cent, 6.7 per cent or 7.5 per cent per annum under three other spending scenarios, which assume that service standards for education, social welfare and health services would grow by 1 per cent, 2 per cent and around 3 per cent per annum respectively.

"Population ageing cannot be avoided. Due to the capacity constraint posed by a stagnant workforce after 2018, our trend economic growth is bound to go lower in the coming decades. With government expenditure growing faster than government revenue and GDP, a structural deficit would seem unavoidable. The key to addressing the problem is aligning the pace of growth of government expenditure with that of the economy and government revenue."

Drawing on the experience of seven selected economies (namely Australia, Canada, Germany, Japan, Singapore, Switzerland and the UK) in fiscal consolidation, and the circumstances of Hong Kong, the Working Group has recommended to the Financial Secretary the adoption of a comprehensive package of fiscal measures to cope with the fiscal challenges ahead. These include:

(a) containing expenditure growth;
(b) preserving, stabilising and broadening the revenue base;
(c) saving for the future;
(d) segregating and balancing the Operating and Capital Accounts;
(e) making clear what the fiscal reserves cover;
(f) stepping up the management of the Government's assets; and
(g) sustaining the financial health of the Housing Authority.

The Working Group sees a need to contain the growth of government expenditure. Given that government revenue is projected at around 20 per cent of GDP in the long run and the Government would need to live within its means, the Working Group recommends that government expenditure should continue to be contained within this benchmark level. This would necessitate prioritisation and offsetting within or amongst policy areas. Fiscal sustainability should be assessed for major recurrent spending initiatives exceeding $100 million. Fundamental expenditure reviews should be undertaken for key spending bureaux, departments and subvented organisations.

The Working Group recommends that the Government should preserve, stabilise and broaden the revenue base. This can be done by avoiding excessive reliance on direct taxation (salaries tax, profits tax and property tax, which make up around 65.3 per cent of total tax revenue), stepping up tax enforcement, and reinforcing the "cost recovery", "user pays" and "polluter pays" principles.

Given the fiscal pressures that the long-term projections have unveiled, the Working Group believes that the call for prudence and the need to save for the next generation is far more urgent and critical than in the past. As a complementary measure to promoting economic and revenue growth and containing expenditure growth, the Working Group recommends that a savings scheme be established. The Working Group notes that the Land Fund has served as a de facto standby facility for the Government and recommends that the Government explore the feasibility of turning the Land Fund into a "Future Fund" or savings scheme for the future generation, and that it should not form part of the fiscal reserves. The Working Group believes that the Government would need to consult stakeholders on the exact mode of operation of the "Future Fund".

The Working Group recommends that the Operating Account and the Capital Account should be more clearly segregated. As a guideline, operating expenditure should not exceed 90 per cent of the operating revenue. The Capital Account (primarily for funding capital works expenditure) should strive to stay within the limits of the capital revenue (primarily revenue from land disposals). Loan financing may be considered for meeting project-based or short-term shortfalls in the Capital Account, subject to a cap on the debt level for this type of borrowing set at 5 per cent of GDP.

The Working Group also recommends that the Government make clear what the fiscal reserves cover. Of the $745.9 billion estimated as the figure for end-March 2014, only around $394 billion held in the General Revenue Account could be flexibly deployed for meeting the day-to-day cash flow requirements. Another $132 billion would be held in seven funds with designated uses, and another $220 billion would be held in the Land Fund with no authorised use.

To step up the management of the Government's assets, the Working Group recommends that the Government consider taking measures such as asset disposals or securitisation for generating financial return to help reduce pressures in the coming decades. It also recommends that the Government should ensure efficient and cost-effective management of government business enterprises.

To sustain the financial health of the Housing Authority, the Working Group recommends that the Government should negotiate and review with the Housing Authority its business model with a view to reducing the budgetary pressure on government finances in the long run.

The Working Group concludes that the current state of Hong Kong's public finances is healthy. That said, the Working Group considers that Hong Kong can ill afford to continue increasing spending beyond the pace of economic growth and revenue. The Government and the community would need to acknowledge the problem ahead and make adjustments accordingly. The Working Group is reasonably optimistic that, if the Government takes serious and early action to realign the growth of expenditure with that of revenue and of the economy, the structural gap in public finances can be narrowed and the onset of a structural deficit deferred.

The full report of the Working Group can be downloaded from the homepage of the Treasury Branch of the Financial Services and the Treasury Bureau (www.fstb.gov.hk/tb/en/).

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長遠財政計劃工作小組
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