

Summary on the Concerns Raised on the Subject of Proper Use of Fiscal Reserves

Concerns	Administration's Responses
<p><i>Budgetary principles enshrined under Article 107 of the Basic Law (BL 107)</i></p> <ul style="list-style-type: none"> • There should be discretion for the Financial Secretary (FS) under BL 107 in managing public finances, in particular the management of fiscal reserves. • The Government should earmark more public funds in the annual budget for new initiatives to improve the livelihood of the general public and to stimulate the economy . 	<ul style="list-style-type: none"> • The Government has to uphold fiscal prudence in the management of public finances. It has to adhere to the two budgetary principles enshrined in BL 107: <ul style="list-style-type: none"> (a) to keep its expenditure within limits of revenues; and (b) to keep the budget commensurate with the growth of the Gross Domestic Products. • The Government has the flexibility to fulfil the requirements over an appropriate time horizon. At present, a five-year forecast period is adopted to achieve fiscal balance.
<p><i>The formula for determining the appropriate level of fiscal reserves (A total of 12 months' government expenditure and Hong Kong dollar money supply under the M1 definition, with a margin of plus or minus 25%)</i></p> <ul style="list-style-type: none"> • The Government should use the huge fiscal reserves of over HK\$440 billion to fund public programmes. • There has been no public consultation on the 1998 guidelines. Some reputable academics/experts have commented that the guidelines are inappropriate. 	<ul style="list-style-type: none"> • The guidelines for determining the appropriate level of fiscal reserves was announced in the 1998-99 Budget Speech. The FS has defined the three purposes of the fiscal reserves, namely to meet the operating, contingency and monetary requirements of the Government.

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<ul style="list-style-type: none"> • The rationale for the 1998 guidelines is questionable. It has been suggested that the guidelines are used to justify the retention of the vast amount of investments held by the former Trustees of the Hong Kong Special Administrative Region Government Land Fund which was transferred to the fiscal reserves in 1997-98 through the establishment of the Land Fund. • The guidelines have no practical use. It is not clear what actions the Government will take when the upper or lower limit of the fiscal reserves level is reached. 	<ul style="list-style-type: none"> • The Government cautions that an unhealthy fiscal position will undermine international confidence and lower the credit rating for Hong Kong which will raise borrowing costs for business and adversely affect economic growth. • So far, the feedback on the 1998 guidelines from reputable economists and international organizations such as the International Monetary Fund has been positive and no better alternative has been proposed. Moreover, there has been no strong objection to the guidelines within the community. • The guidelines are subject to ongoing reviews. The Government will keep an open-mind and welcome views from LegCo Members and the public. • The Government forecasts that by the end of 2004-05 financial year, the fiscal reserves will stand at HK\$427.5 billion, which is close to the lower limit of fiscal reserves level under the said guideline. It is still unclear whether the operating deficits in recent years are cyclical or structural in nature. The Government's Task Force on Review of Public Finances will continue to examine the matter and the Advisory Committee on New Broad-based Taxes will study taxes suitable for Hong Kong to broaden its tax base. • In theory, when the upper limit of the fiscal reserves level has been reached, the Government will consider tax concessions and reduction in fees and charges to enable the public to reap the benefits of economic prosperity.

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<p data-bbox="125 185 1122 256"><i>The circumstances under which the fiscal reserves could be used and the relationship between the Exchange Fund and fiscal reserves</i></p> <ul data-bbox="125 304 1122 735" style="list-style-type: none"> <li data-bbox="125 304 1122 496">• The current level of Exchange Fund (EF) which reaches HK\$1 trillion is well above the level required to provide full backing for the current monetary base of HK\$220 billion, i.e. the theoretical minimum level. The need of the fiscal reserves for meeting the monetary purpose is therefore minimal. <li data-bbox="125 544 1122 735">• Given the huge size of EF, the Government should review the current level of foreign reserves. Both EF and fiscal reserves are public money which should be used for the interests of the people of Hong Kong. The investment return of EF should be treated as recurrent income for the Government. 	<ul data-bbox="1178 304 2152 1214" style="list-style-type: none"> <li data-bbox="1178 304 2152 496">• The fiscal reserves have been used to finance fiscal deficits, e.g. the deficit of HK\$23.2 billion in 1998-99 was financed by drawing down the reserves. The reserves are used as a source of income. The investment income from fiscal reserves gained each year is used to fund government expenditure. <li data-bbox="1178 544 2152 695">• As Hong Kong is a small economy with an entirely open market, it will be prudent to maintain a level of foreign reserves well above the theoretical minimum in order to strengthen the financial position of EF for meeting possible vulnerabilities and risks. <li data-bbox="1178 743 2152 935">• The decision to place the fiscal reserves with EF rests entirely with the Government. The EF and the fiscal reserves are invested together by the HKMA but they belong to two separate and distinct entities. The fiscal reserves enjoy the same rate of investment return achieved by the entire EF in a year. <li data-bbox="1178 983 2152 1214">• The use of EF is governed by the Exchange Fund Ordinance (EFO) (Cap. 66). There are provisions under EFO for FS, as the controller of the EF, to transfer the accumulated surplus of EF to the general revenue after satisfying certain conditions, for example, such transfer will not adversely affect the purposes of EF as stipulated under EFO.

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<p data-bbox="120 185 607 220"><i>Practices of overseas jurisdictions</i></p> <ul data-bbox="120 264 1133 576" style="list-style-type: none"> <li data-bbox="120 264 1133 576">• The practice of some jurisdictions of setting up stabilization funds to build up the reserves through accumulating budget surpluses to pay for government spending when there is shortfall in government revenue is more flexible than maintaining an appropriate level of fiscal reserves according to an unscientific guideline. The stabilization fund will help adjust government spending in response to changes in the economic situation and fluctuations in the level of revenue. 	<ul data-bbox="1173 264 2152 416" style="list-style-type: none"> <li data-bbox="1173 264 2152 416">• Although stabilization funds have contributed to enhancing the effectiveness of fiscal policy by making budget expenditure less driven by revenue availability, it is clear that a stabilization fund cannot be a substitute for sound fiscal management.

Legislative Council Secretariat

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