

**For meeting on
7 April 2003**

Legislative Council Panel on Financial Affairs

Amendment to Resolution of Land Fund

PURPOSE

This paper seeks Members' views on the proposed amendment to the resolution of the Land Fund under section 29 of the Public Finance Ordinance (PFO) (Cap. 2) to permit the transfer of funds from the Land Fund to the General Revenue Account (GRA) in order to meet Government expenditure requirements.

BACKGROUND AND ARGUMENT

Setting up of the Land Fund

2. The Sino-British Joint Declaration stipulated that premium income received by the Hong Kong Government from land transactions during the period from 27 May 1985 to 30 June 1997 shall, after deduction of the average cost of land production, be shared equally with the future Hong Kong Special Administrative Region Government (HKSARG). A HKSARG Land Fund was thus established in 1986 by the Chinese side in the Joint Liaison Group by way of a Deed of Declaration of Trust for the purpose of holding in trust for the future HKSARG its share of the land premium income.

3. With the establishment of the HKSARG on 1 July 1997, the assets of the HKSARG Land Fund with a net value of \$197 billion were handed over to the HKSARG and the Deed of Declaration of Trust ceased to have effect. It was thereafter for the HKSARG to decide how the Fund should be expended. The Chief Executive appointed the Financial Secretary as the public officer to receive these assets as part of the HKSARG fiscal reserves. These assets became part of the general revenue¹ in accordance with section 3 of the PFO. Following the establishment of the HKSARG, all income from land premium is credited directly to the Capital Works Reserve Fund (CWRF) for the purposes of financing the

¹ Section 3 of the PFO stipulates that except where otherwise provided by or under the PFO or any other enactment, any moneys raised or received for the purposes of the Government shall form part of the general revenue.

4. In July 1997, a resolution was made and passed by the Provisional Legislative Council under section 29 of the PFO to establish the Land Fund to receive, hold and invest the assets transferred from the HKSARG Land Fund. A copy of the Resolution is at **Annex A**. The arrangement to set up the Land Fund as a separate fund within the fiscal reserves was mainly to facilitate the management of the assets, enabling them to be clearly identified and accounted for vis-à-vis the rest of the fiscal reserves, and to allow the investment performance of the assets to be properly reflected and evaluated. It would also provide flexibility for the Administration to decide on the long-term use of the assets.

Investment of the Land Fund

5. Between 1 July 1997 and 31 October 1998, under the direction of the Financial Secretary, the Land Fund was managed by the Hong Kong Monetary Authority (HKMA) as a portfolio separate from the Exchange Fund. Effective on 1 November 1998, the assets of the Land Fund were merged with the Exchange Fund and managed as part of the investment portfolio of the Exchange Fund to achieve administrative efficiency and economies of scale by allowing effective deployment of resources within the HKMA as a whole.

6. Following the merger, the Land Fund remains a separate Government fund managed in exactly the same way as other Funds in the fiscal reserves which have also been placed with the Exchange Fund.

Financial Position of Government

7. Government's fiscal reserves comprise the accumulated balances of the GRA, the Land Fund, the CWRP, the Capital Investment Fund (CIF), the Loan Fund, the Civil Service Pension Reserve Fund, the Disaster Relief Fund, the Innovation and Technology Fund and the Lotteries Fund². The purpose of holding these reserves is to meet operating and contingency requirements of public finance. In case there are budget deficits which arise either in those

² In accordance with the recommendations in the June 2002 Report by the Task Force on Review of Government's Financial Reporting Policy and to be consistent with the accounting treatment of other Funds established by resolution of the Legislative Council, the Lotteries Fund, which was established on 30 June 1965, will be included in the Consolidated Account of the Government and be treated as part of the fiscal reserves with effect from 1 April 2003.

months of the financial year when expenditure exceeds revenue, or as a result of the downswing in the economic cycle, we use the fiscal reserves to finance shortfalls.

8. As a result of the continued budget deficits, the balance of the fiscal reserves is projected to decline from \$303 billion in 2002-03 to \$202 billion in 2007-08 according to the latest Medium Range Forecast. The balance of the GRA, which is the main Government account for day-to-day departmental expenditure and revenue collection, will consequently drop from an opening balance of \$87 billion by \$72 billion to a closing balance of \$15 billion during 2002-03, and will then have shortfalls in subsequent years of the projection period if there is no topping up by transfer of funds within the fiscal reserves. The CWRP (for financing public works programmes, acquisitions of land, capital subventions, etc.) and the CIF (for financing loans, advances and investments) will similarly have shortfalls, albeit to a much lesser extent, if there is no topping up.

Locking up of Resources in Land Fund

9. The Land Fund has accounted for and will continue to account for the vast majority of Government's fiscal reserves. The estimated balance of the Land Fund is \$259 billion by the end of March 2003, representing about 85% of Government's fiscal reserves. Similar to other Funds set up under section 29 of the PFO³, the usage of the Land Fund is governed by the provisions laid down in the Resolution passed by the legislature in 1997. On the provision for expending moneys from the Land Fund, the Resolution only provides that all expenses relating to the administration and management of the Land Fund (but nothing more) are to be met at the expense of the Land Fund. As such, the Land Fund cannot be used to fund the provision of any Government services. The Resolution also has no provision to allow Government to transfer money from the Land Fund to the GRA or other Government funds. As a result, the vast majority of the fiscal reserves are effectively locked up in the Land Fund.

³ Under section 29 of the PFO, the Legislative Council may by resolution provide for the establishment of funds to which moneys appropriated for the purpose, and such other moneys received for the purposes of the Government as may be specified in the resolution, may be credited and from which moneys may, under the authority of a funds warrant issued by the Financial Secretary, be expended for the purposes for which the funds were established subject to such conditions, exceptions and limitations as may be specified in the resolution.

Financial Position of Other Funds

10. As regards other Funds within the fiscal reserves which are projected to have balances up to the end of the forecast period (e.g. the Loan Fund), they will not be able to solve the problem partly due to the restriction placed on the usage of these Funds and partly due to the meagre balances they have vis-à-vis the huge projected shortfalls in the GRA, CWRP and CIF.

PROPOSED AMENDMENT TO LAND FUND RESOLUTION

11. To obviate the anticipated shortfalls in the GRA, CWRP and CIF, we **propose** to add a provision to the Resolution of the Land Fund to enable the Fund balance to be transferred to the general revenue as and when needed to meet the cashflow requirements of the GRA and other Government Funds. In view of the prevailing fiscal constraints, this is a measure necessary to provide funds from one part of the fiscal reserves to meet the expected shortfalls in other parts. For reasons set out in the following section, other options are considered by the Administration to be undesirable.

12. Similar to the existing practice for inter-fund transfers under GRA Head 184 Transfers to Funds, the amount of funds required to be transferred from the Land Fund will be assessed each year with regard to the commitments and forecast cashflow requirements of the GRA and other Funds. Subject to the passage of the amending Resolution, the estimated amount of fund transfer is included as part of the Estimates submitted to the Legislative Council each year.

13. As shown in the 2003-04 Estimates, we anticipate that an estimated sum of \$120 billion is required to be transferred from the Land Fund to the general revenue in 2003-04 to meet the cashflow requirements in the medium term. Thereafter, we do not envisage any major requirement for further transfers in subsequent years of the projection period.

14. It is worth emphasising that the proposal is to help solve the cashflow requirements and is not meant to generate additional fund to finance certain Government spending, which will be subject to the approval of the Legislative Council via the Appropriation Bill at the beginning of the financial year or the Finance Committee during the year.

15. We propose to bring this amendment to the Land Fund resolution into operation on a date to be appointed by the Financial Secretary by notice in the Gazette after it has been passed by the Legislative Council. Given the urgent need for us to transfer funds from the Land Fund to the GRA as early as May 2003, we intend to bring the amendment into effect on 2 May 2003.

OTHER OPTIONS

Abolition of the Land Fund

16. Given that the long-term use of the Land Fund is yet to be decided, an option is to dissolve the Land Fund and to transfer its entire balance to the GRA or other Government Funds. We do not favour the outright abolition of the Land Fund as our intention is to utilise only part of the Fund balance to meet the budget deficits in the medium term, and to retain the flexibility to formulate a policy on the long-term use of the Fund in future. We remain open to suggestions from Members and the general public on the usage of the Fund. Abolition of the Land Fund will deprive us of considering further uses for the Fund on a longer term basis.

External Borrowing

17. Another option is to resort to external borrowing to meet the shortfalls in the GRA, CWRP and CIF. We may, however, need to pay interest at a rate higher than the corresponding investment return. We would also lose our current debt-free status, take on a considerable debt repayment obligation for the future, and invariably cause an alarm bell to ring for international credit rating agencies, the International Monetary Fund, and other observers of our public finances, who may doubt Government's resolve to achieve a balanced budget by 2006-07.

Transfer of Funds from the Exchange Fund

18. It has been suggested that we use the accumulated surplus of the Exchange Fund to meet operating and contingency requirements of Government. It should however be noted that the Exchange Fund Ordinance (Cap. 66) defines clearly the purposes for which the Exchange Fund may be used in safeguarding the exchange value of Hong Kong dollar and maintaining the stability and the integrity of the monetary and financial systems of Hong Kong. The use of any

assets of the Exchange Fund to meet operating and contingency requirements of Government does not fall within the purposes defined in the Ordinance. Moreover, this option could lead to unwarranted speculation on the sustainability of the Hong Kong/US Dollar link. We therefore consider it neither feasible nor advisable to transfer funds from the Exchange Fund to top up the anticipated shortfalls. On the other hand, one of the purposes of the fiscal reserves, as set out by the Financial Secretary in the 2002 Budget Speech, is to meet such operating and contingency requirements as we now face.

19. To strike a balance in allowing Government to utilise part of the Land Fund to meet the budget deficits in the medium term, while retaining the flexibility to formulate a policy on the long-term use of the Fund in future, and to avoid burdening ourselves with debt, we recommend to retain the Fund and to add a provision to the Resolution of the Land Fund to enable the Fund balance to be transferred to the general revenue as and when needed.

LEGISLATIVE TIMETABLE

20. We intend to move the amending Resolution under section 29 of the PFO, at **Annex B**, at the sitting of the Legislative Council on 30 April 2003.

ADVICE SOUGHT

21. Members' views on the proposed amendment to the resolution of the Land Fund are sought.

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Section of Enactment



Chapter:	20	Title:	LAND FUND	Gazette Number: L.N. 398 of 1997
Section:		Heading:		Version Date: 01/07/1997

Resolution made and passed by the Provisional Legislative Council under section 29 of the Public Finance Ordinance (Cap 2) on 23 July 1997.

RESOLVED that with effect from the establishment of the Government of the Hong Kong Special Administrative Region on 1 July 1997-

1. there shall be established a fund called the Land Fund;
2. the Land Fund shall receive and hold all of the assets, including all accounts receivable, net of expenses, transferred, upon the establishment of the Government of the Hong Kong Special Administrative Region, from the Hong Kong Special Administrative Region Government Land Fund established by a Declaration of Trust of the Hong Kong Special Administrative Region Government Land Fund Trust made on 13 August 1986 to the Government of the Hong Kong Special Administrative Region and which have become part of the general revenue in accordance with section 3 of the Ordinance and the provisions of the Declaration of Trust of the Hong Kong Special Administrative Region Government Land Fund Trust;
3. the Land Fund shall be administered and managed by the Financial Secretary who may delegate his power of administration and management to other public officers;
4. there shall be credited to the Land Fund-
 - (a) all sums earned by way of interest, dividends or other investment revenue relating to the investment of the Hong Kong Special Administrative Region Government Land Fund and all sums earned from the sale or other disposal of all or part of any assets of the Hong Kong Special Administrative Region Government Land Fund, after the deduction of all of the expenses relating to the administration and management of the Hong Kong Special Administrative Region Government Land Fund; and
 - (b) all accounts receivable and all sums earned by way of interest, dividends or other investment revenue relating to the investment of the Land Fund and all sums earned from the sale or other disposal of all or part of any assets of the Land Fund, after the deduction of all of the expenses relating to the administration and management of the Land Fund;
5. all expenses relating to the administration and management of the Land Fund,

including expenses for meeting the management staff costs, and the costs incurred by the Trustees of the Hong Kong Special Administrative Region Government Land Fund Trust in the dissolution of the Trust in accordance with clause 29 of the Declaration of Trust of the Hong Kong Special Administrative Region Government Land Fund Trust, and any accounts payable in respect of the Hong Kong Special Administrative Region Government Land Fund after 30 June 1997, shall be met at the expense of the Land Fund;

6. the Land Fund shall assume-

(a) all the liabilities of the Trustees of the Hong Kong Special Administrative Region Government Land Fund Trust incurred before and outstanding upon the dissolution of the Trust, in accordance with clause 29 of the Declaration of Trust of the Hong Kong Special Administrative Region Government Land Fund Trust; and

(b) all the obligations of the Financial Secretary to indemnify the Trustees and each of them and each of their personal representatives and estates from and against all actions, proceedings, claims and demands and all costs and expenses in respect of or arising out of the administration of the Hong Kong Special Administrative Region Government Land Fund Trust, in accordance with the covenant clause 9 of a Vesting Deed executed on 1 July 1997;

7. the Financial Secretary may, in his discretion, authorize and direct the investment of any assets of the Land Fund which are not immediately required to meet expenses in respect of the Land Fund at any time in such manner as he may determine.

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PUBLIC FINANCE ORDINANCE

RESOLUTION OF THE LEGISLATIVE COUNCIL

LAND FUND

Resolution made and passed by the Legislative Council under section 29 of the Public Finance Ordinance (Cap. 2) on 2003.

RESOLVED that the resolution made and passed by the Provisional Legislative Council on 23 July 1997 and published in the Gazette as Legal Notice No. 398 of 1997 be amended -

- (a) in paragraph 7, by repealing the full stop at the end and substituting a semicolon;
- (b) by adding after paragraph 7 -

"8. the Financial Secretary may, from time to time, transfer from the Land Fund to the general revenue any balance held in the Land Fund which is not in his opinion reasonably required for the purposes of the Land Fund."