

Research Brief

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The 2019-2020 Budget

April 2019

In his second Budget, the Financial Secretary continued to adhere to the new fiscal philosophy of the current-term Government. Reflecting increased spending, government expenditure in 2019-2020 will reach HK\$607.8 billion, equivalent to 97% of government revenue, up from 90% in 2018-2019. Public expenditure as a proportion of GDP will stay above 20%.

Over the years, land premium has grown into a significant source of government revenue. Stamp duty has seen rising contribution, with a notable portion deriving from the so-called "spicy" measures. Salaries tax has seen broadening base with more people being brought into the tax net. On the other hand, profits tax has seen shrinking base with increasing reliance on the sector of banking, finance, investment and property.

While diversifying the economy is crucial to strengthening government coffers, the Government's past efforts to promote diversified development of industries have seemingly not yielded desirable results. Certain sectors, e.g. cultural and creative industries, considered to be of growth potential, seem to have lost the momentum in recent years despite resources commitment.

Outside the cash-based government accounts, there are some 20 designated-purpose funds in operation which roughly amount to over HK\$91 billion. A number of them have used government injection as seed money to generate investment income to fund projects. This suggests that a huge sum of public money is being locked up and the funding activities are to a certain extent constrained by the level of investment return.

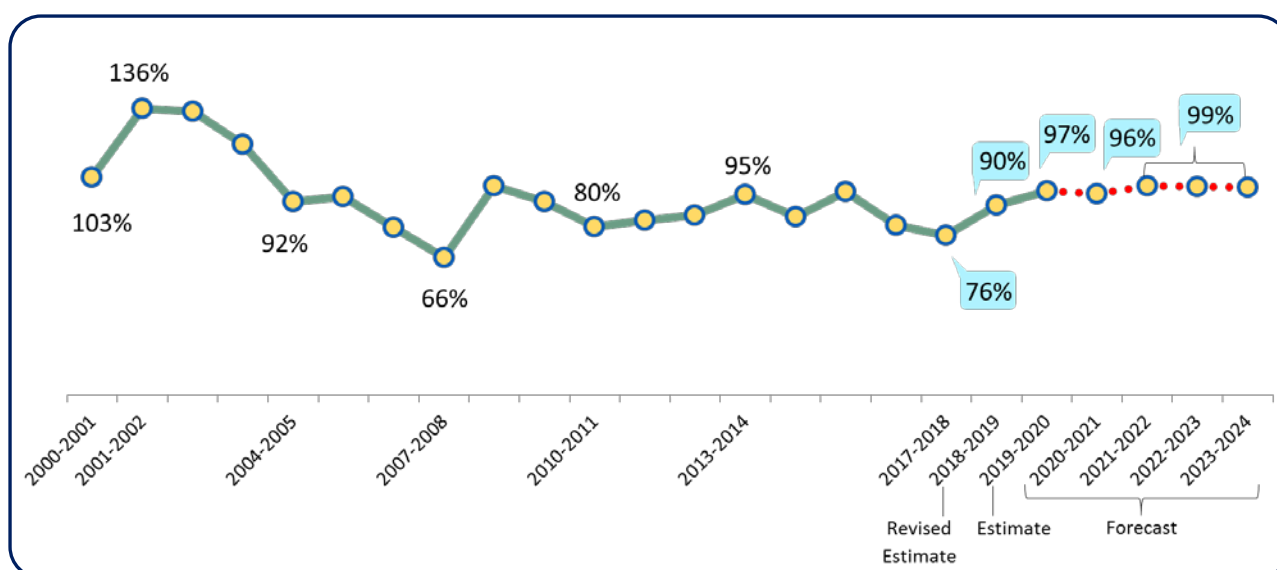
The Council will resume the Second Reading debate on the Appropriation Bill 2019 at its meeting of 17 April 2019.

1. Introduction

1.1 The Financial Secretary delivered his second Budget on 27 February 2019. According to the budget estimates, government expenditure continues to grow, up 13% from 2018-2019. This year's Budget continues to reflect the new fiscal philosophy of "adopting forward-looking and strategic financial management principles to invest for Hong Kong and relieve people's burden on the premise of ensuring healthy public finance" put forward by the current-term Government.

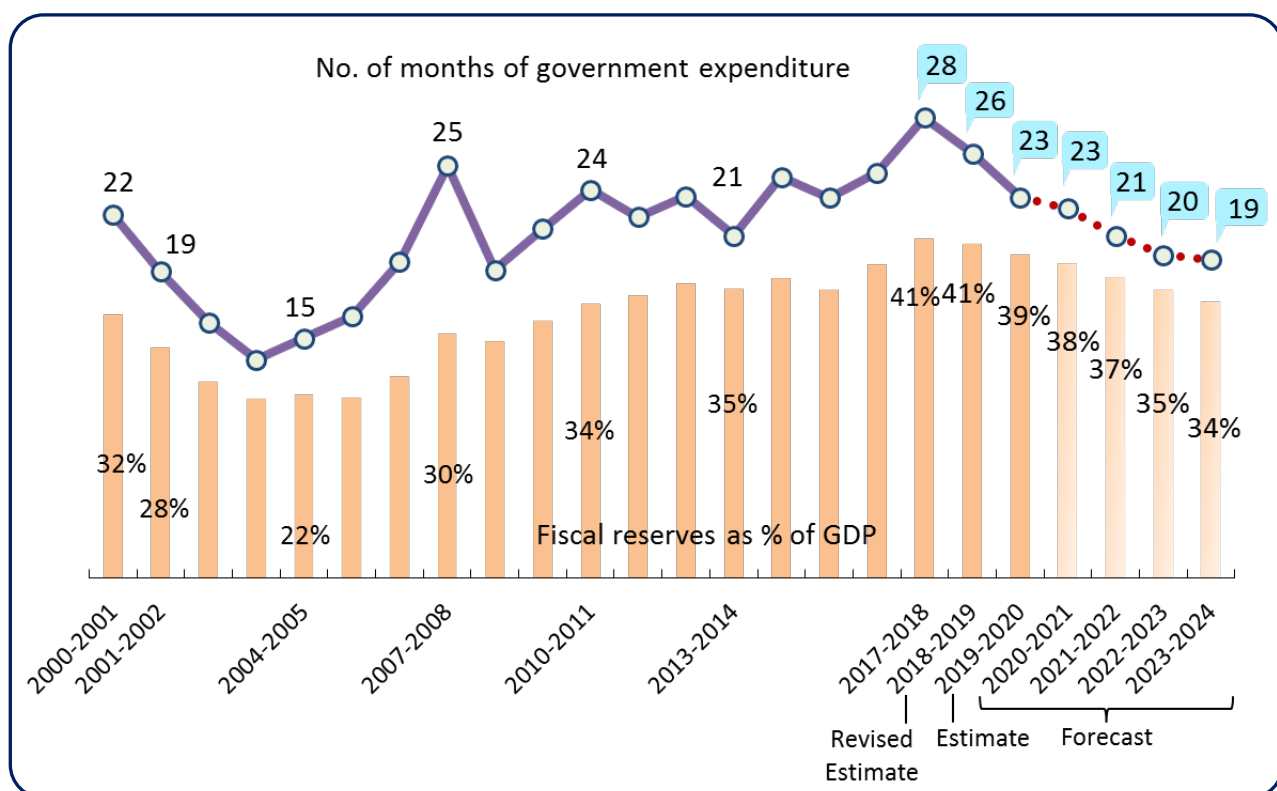
1.2 Government expenditure in 2019-2020 is expected to reach HK\$607.8 billion, equivalent to 97% of government revenue, with fiscal surplus slipping to HK\$16.8 billion from HK\$58.7 billion in 2018-2019. Based on the Government's medium range forecast, the ratio of government expenditure to government revenue will even peak at **99%** in the coming few years (**Figure 1**). As a result, Hong Kong's fiscal reserves growth is forecast to slow down and there will be a **downtrend** in terms of the number of months of government expenditure and percentage of Gross Domestic Product ("GDP") (**Figure 2**).

Figure 1 – Ratio of government expenditure to government revenue



Data sources: 2019-2020 Budget Speech, Census and Statistics Department (2018b and 2018c).

Figure 2 – Fiscal reserves of the Government



Data sources: Census and Statistics Department (2018a) and The Treasury (various years).

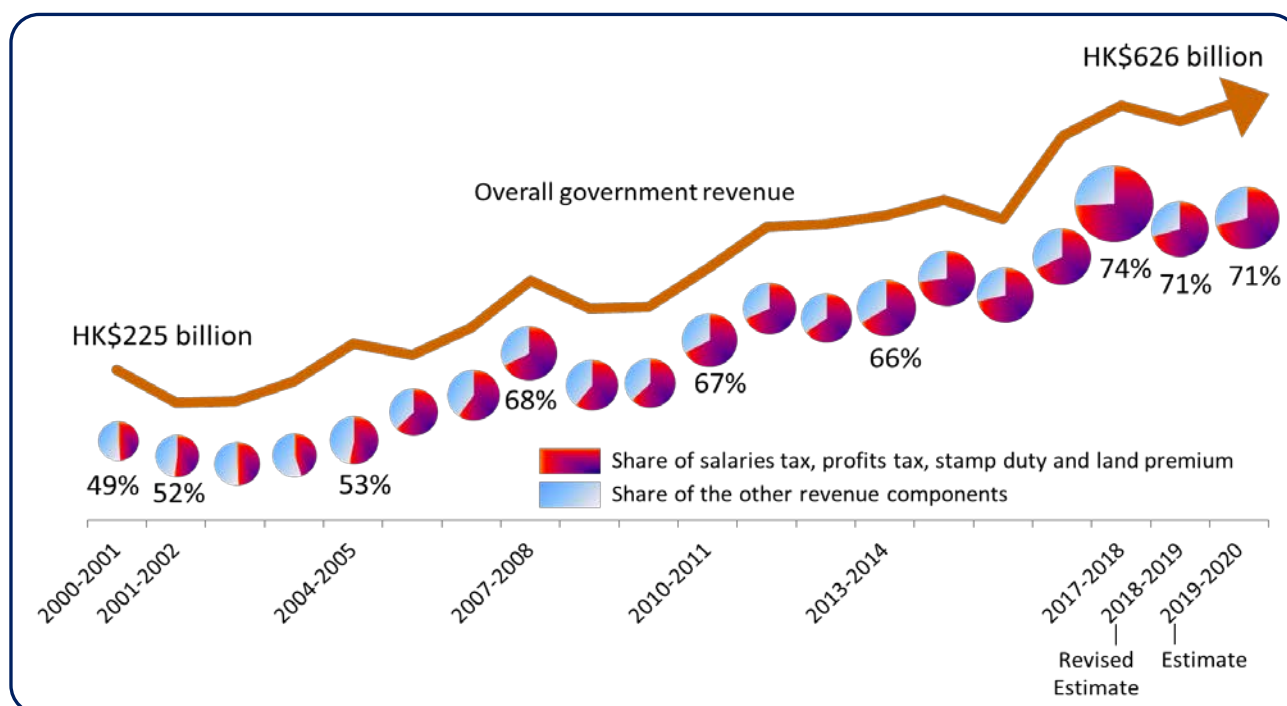
1.3 According to the Government, the estimated fiscal surplus of HK\$16.8 billion in 2019-2020 has already taken into account the HK\$21.2 billion brought back from the Housing Reserve. **Budget deficit** would have taken place if

the Housing Reserve were not taken back to the government accounts. All these signs point to the challenges of Hong Kong's fiscal strength in the medium to long term, with renewed concerns over the stability of government revenue to sustain government expenditure.

2. Challenges of the current revenue regime

2.1 Hong Kong's government revenue is all along known to be narrow-based and highly sensitive to economic performance. Salaries tax and profits tax are the largest sources of direct tax, whereas stamp duty and land premium are the greatest components of indirect tax and non-tax revenue respectively. In 2017-2018, they together accounted for **74%** of total government revenue.¹ Amid reduction in the amount of stamp duty and land premium collected in the past one year, the four revenue sources still made up **71%** of total government revenue in 2018-2019 (Figure 3).

Figure 3 – Total government revenue and the four largest revenue components



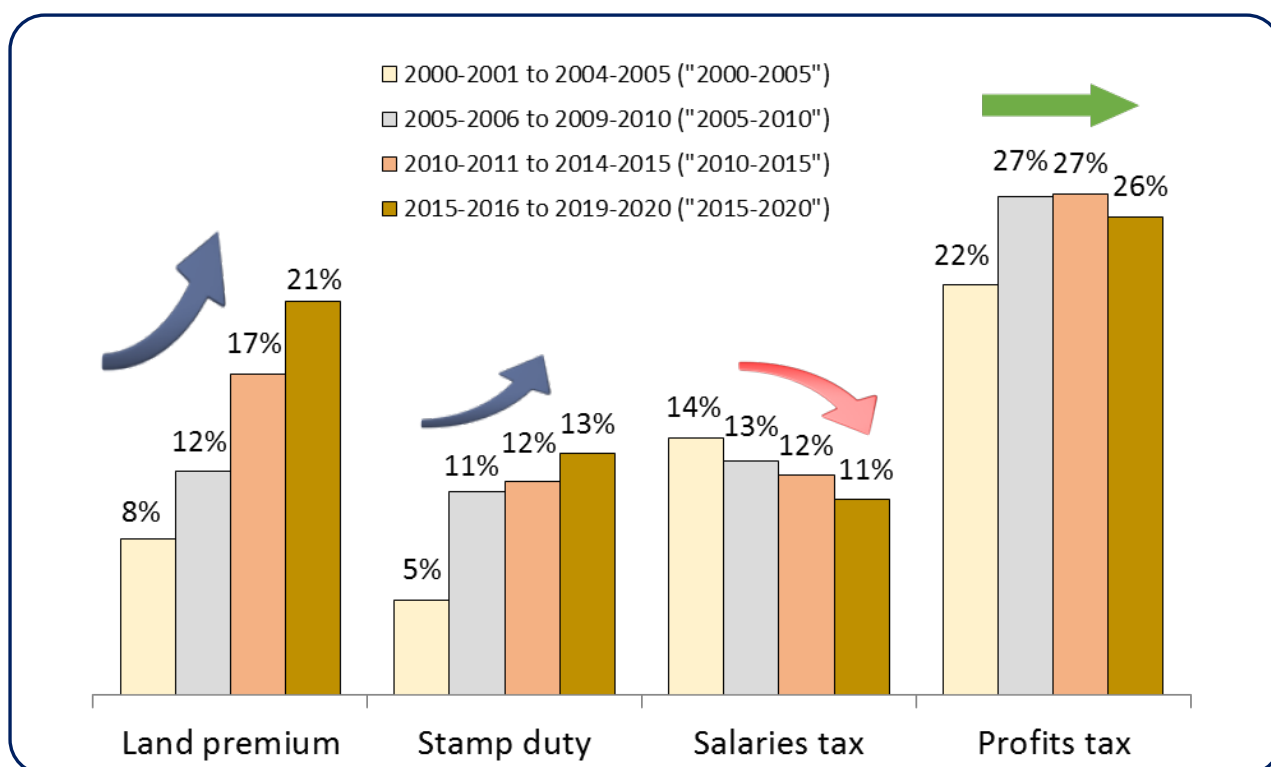
Data sources: 2019-2020 Budget Speech and Census and Statistics Department (2018c).

¹ Investment income used to be the fourth/fifth largest revenue component. With the establishment of the Future Fund in January 2016, its investment income has been retained by the Exchange Fund for reinvestment. In 2017-2018, investment income generated from other sources accounted for about 3.5% of total government revenue, down from 10.4% in 2000-2001 when all investment income was added up.

Land premium

2.2 While **land premium** is a non-tax capital revenue, it has grown into a significant source in financing government expenditure. As shown in **Figure 4**, the average revenue contribution has surged from **8%** in the period of 2000-2005 to **21%** in 2015-2020, largely the result of increases in both land sale and land prices. The Government has all along emphasized that land premium is highly susceptible to market fluctuations and highly market driven, thus it is hard to predict land revenue. In preparing the medium range forecast, estimation of land revenue is simply based on the average of the past statistics.² Recently, the Government has announced its plan to take forward the "Lantau Tomorrow" initiative. The projected land sale revenue is referenced from the ballpark estimate of The Hong Kong Institute of Surveyors.³ Lack of a robust forecast or projection may render a concern over its long-term reliability and stability, especially when it is becoming a giant revenue source.

Figure 4 – Average contribution of major revenue components



Data sources: 2019-2020 Budget Speech and Census and Statistics Department (2018c).

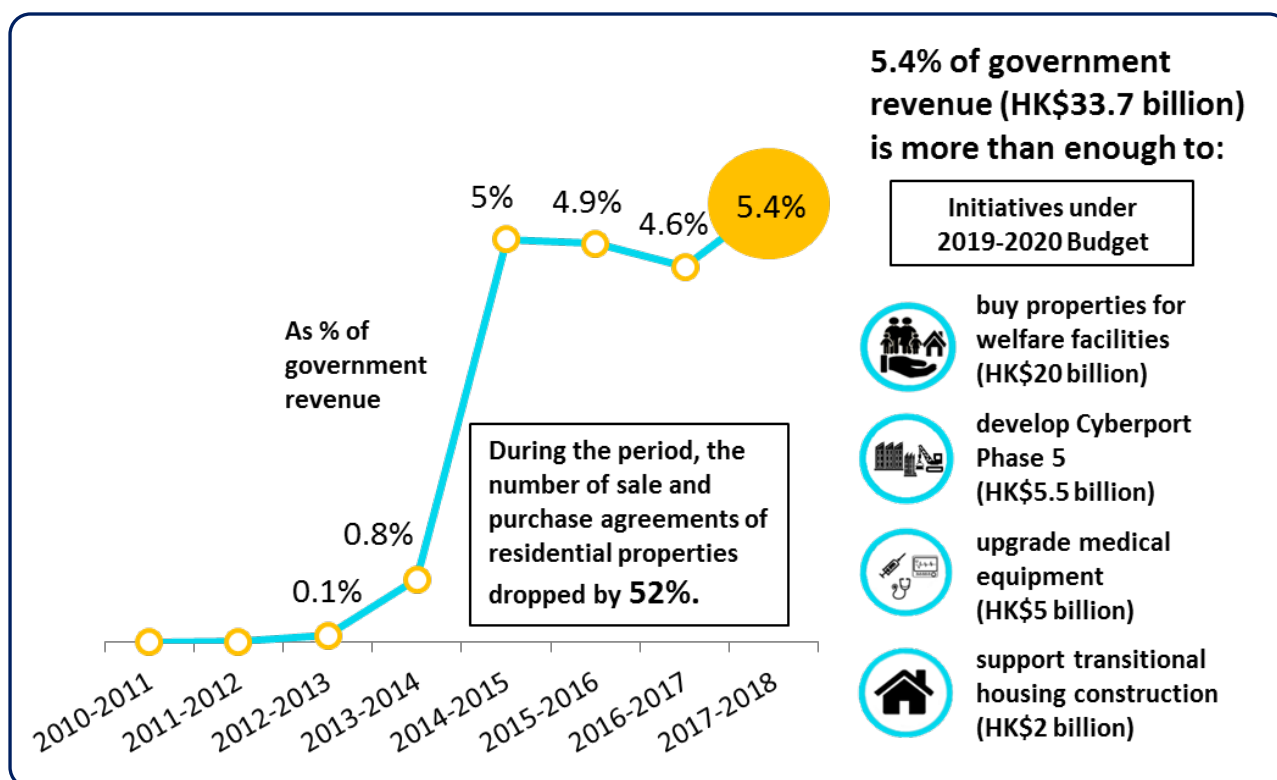
² In 2019-2020, estimation is based on the average proportion of land revenue to GDP over the past decade. Between the years of 2010-2011 and 2018-2019, medium range forecast of land revenue was in the range of 2%-3.3% of GDP. However, actual figures were often higher than forecasts and the differences were mostly between HK\$26 billion and HK\$62 billion.

³ The ballpark estimate on the land sale revenue on Kau Yi Chau Artificial Island is approximately HK\$974 billion to HK\$1,143 billion.

Stamp duty

2.3 A growing trend is similarly seen in **stamp duty**. In 2015-2020, its average revenue contribution has risen to 13%, exceeding the contribution of salaries tax of 11%. This appears to be largely linked to the series of so-called "spicy" disincentive measures⁴ imposed to curb the overheating property market. As indicated in **Figure 5**, these stamp duties consistently made notable contribution of about **5% to government revenue** during 2014-2015 to 2017-2018, though they were deemed to be short-term when first introduced. Recently, the Government has reiterated that it had no plan to lift them.⁵ In other words, these non-regular measures will likely continue to make favourable contribution to government revenue. Though it is unclear when and whether the Government will end these disincentives, doing so one day will certainly have implications on government coffers.

Figure 5 – Revenue contribution from "spicy" property-related measures*



Note: (*) Residential property transactions accounted for a majority of the S&P transactions.

Data sources: DATA.GOV.HK (2019) and The Land Registry (various years).

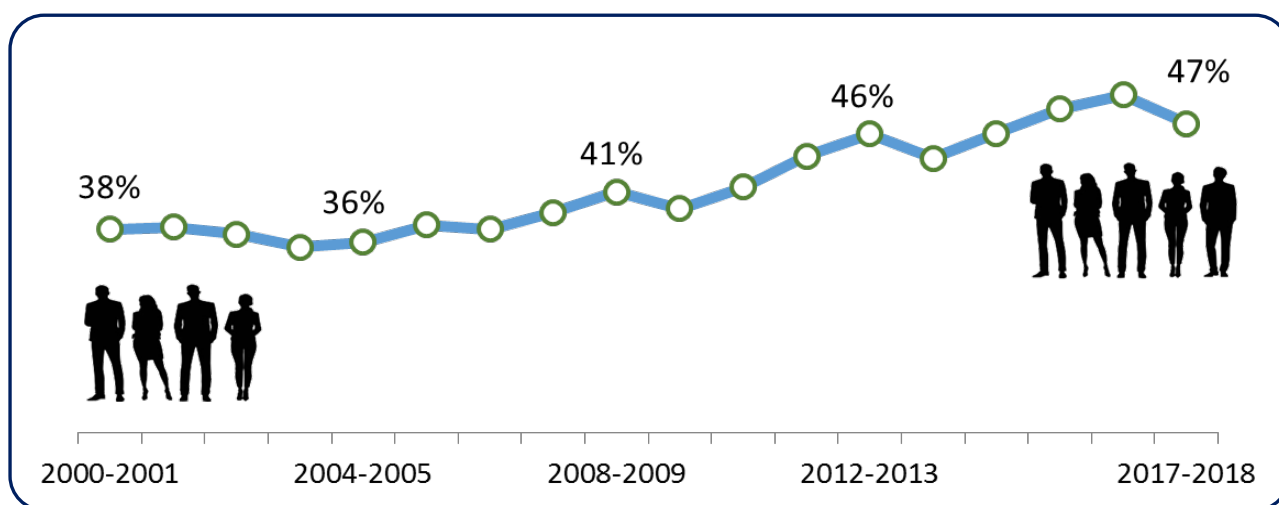
⁴ These are Buyer's Stamp Duty, Special Stamp Duty, and Part 1 and Part 2 of Ad Valorem Stamp Duty (Scale 1).

⁵ See 香港電台 (2019) and South China Morning Post (2019).

Salaries tax

2.4 **Salaries tax**, though relatively more stable, have declined in revenue contribution from the average of **14%** in 2000-2005 to **11%** in 2015-2020. However, the base of working population paying salaries tax has **widened** markedly from 38% to 47%, meaning that almost one in two employed people are now paying salaries tax (**Figure 6**).

Figure 6 – Proportion of employed population paying salaries tax*



Note: (*) The years shown above refer to financial years. The figures are based on the respective assessment years and are calculated by dividing the total number of salaries taxpayers by the total number of employed persons in Hong Kong. Number of employed persons is based on calendar year.

Data sources: Inland Revenue Department (various years) and Census and Statistics Department (2019b).

2.5 A higher proportion of the working population being caught under the salaries tax regime largely reflects growth in earnings over the years. During 2001-2017, the median monthly employment earnings had grown by 55% from HK\$11,000 to HK\$17,000. However, if adjusted for inflation, real earnings growth was just **14%**. During the assessment years from 2001-2002 to 2017-2018, basic allowance claimable was adjusted from HK\$108,000 to HK\$132,000, which, when adjusted for inflation, represented a **negative real growth of 10%**,^{6, 7} meaning more people had become liable to tax and been brought into the tax net. Indeed, the

⁶ Inflation is measured by Composite Consumer Price Index.

⁷ Apart from personal allowance and married person's allowance, the Government has also raised other allowances, including child allowance and dependent parent allowance. During the assessment years of 2001-2002 to 2017-2018, child allowance was increased from HK\$30,000 to HK\$100,000, representing a real growth of 146%; and allowance for dependent parent (aged 60 or above) was increased from HK\$30,000 to HK\$46,000, representing a real growth of 13%. In the assessment year of 2018-2019, child allowance and dependant parent allowance were further raised to HK\$120,000 and HK\$50,000 respectively.

Government has in the past years persistently put in place **one-off tax reduction measures** to reduce taxpayers' burden. The most obvious effect is seen among the lower income groups with 75% tax saved (**Table 1**). For the highest income group, the relief effect in terms of percentage tax reduction is far less obvious.

Table 1 – Effect of tax reduction measures of salaries tax and tax under personal assessment

Budget year	2019-2020		2016-2017		2013-2014		2010-2011	
Assessment year	2018-2019		2015-2016		2012-2013		2009-2010	
Tax reduction	75%, capped at HK\$20,000		75%, capped at HK\$20,000		75%, capped at HK\$10,000		75%, capped at HK\$6,000	
Assessable Income (HK\$)	Average tax reduction (HK\$)/%	Share of no. of tax-payers	Average tax reduction (HK\$)/%	Share of no. of tax-payers	Average tax reduction (HK\$)/%	Share of no. of tax-payers	Average tax reduction (HK\$)/%	Share of no. of tax-payers
<= \$200,000	\$550/ 75%	15%	\$730/ 75%	24%	\$670/ 75%	23%	\$740/ 75%	32%
\$200,001 to \$300,000	\$2,540/ 75%	21%	\$3,900/ 75%	23%	\$3,470/ 73%	24%	\$3,000/ 62%	26%
\$300,001 to \$400,000	\$6,460/ 75%	16%	\$8,790/ 73%	16%	\$6,040/ 53%	17%	\$4,320/ 35%	16%
\$400,001 to \$600,000	\$11,720/ 61%	21%	\$13,750/ 54%	18%	\$8,270/ 31%	18%	\$5,470/ 19%	15%
\$600,001 to \$900,000	\$16,690/ 37%	14%	\$18,400/ 32%	10%	\$9,840/ 16%	9%	\$6,000/ 9%	6%
Above \$900,000	\$19,780/ 8%	12%	\$20,000/ 7%	9%	\$10,000/ 3%	9%	\$6,000/ 2%	6%

Data sources: Budget (various years).

2.6 While one-off tax reduction has reduced the tax burden especially for the lower income groups, revenue contribution from salaries tax has been on a persistent downtrend since 2000-2001.⁸ (Figure 4) Going forward, population ageing will pose further challenge on this revenue source, as raised by the Working Group on Long-Term Fiscal Planning⁹. According to the latest projection,

⁸ Even if the one-off tax reduction had not been in place, the revenue contribution would just have been higher by 1-2 percentage points, and it would not halt the downward trend.

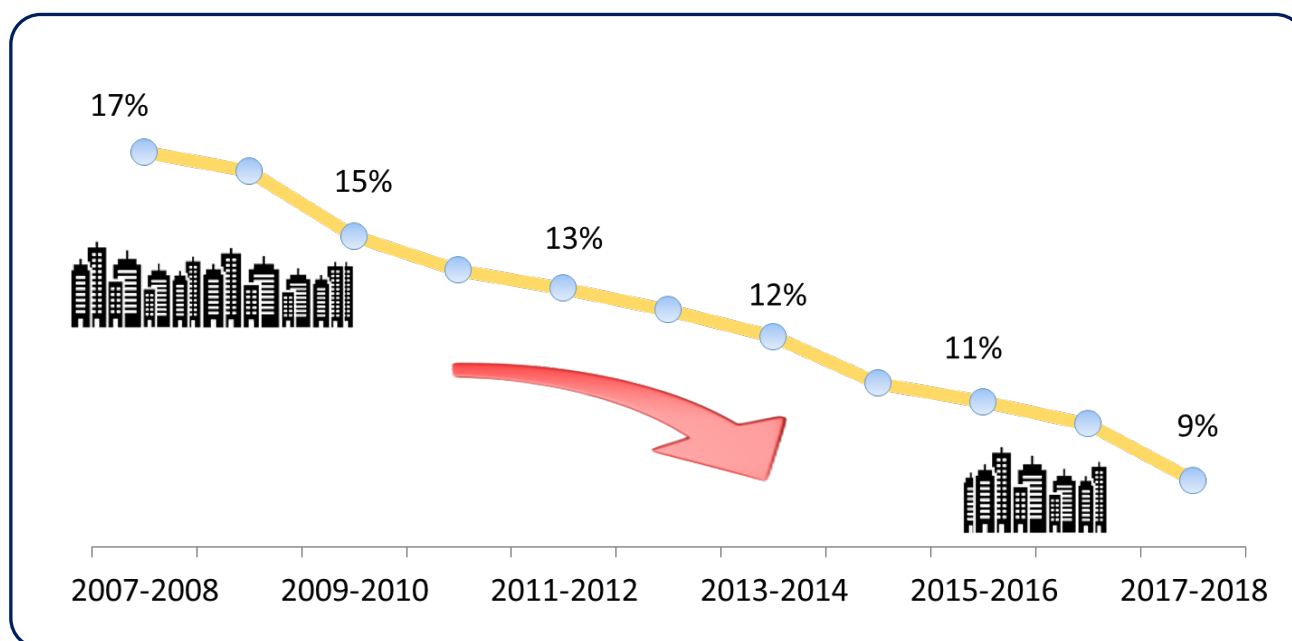
⁹ The Working Group on Long-Term Fiscal Planning, was set up by the Government in June 2013 to explore ways to make more planning for Hong Kong's public finances to cope with the ageing population and the Government's other long-term commitments.

the labour force will shrink from 59.3% in 2017 to less than 55% in 2027 and further to 51.6% in 2037. While it is too early to say whether this will eventually lead to cut in allowances or rise in tax rates, it makes it likely that profits tax will be relied upon more heavily.

Profits tax

2.7 **Profits tax** is the most stable and the largest revenue item, making an average contribution of 22%-27% to government revenue during the various periods across 2000-2020 (Figure 4). However, contrary to salaries tax, profits tax has seen a **shrinking base** with only about 9% of corporations paying tax in 2017-2018, as opposed to 17% in 2007-2008 (**Figure 7**). The phenomenon is largely explained by the significant growth in the number of corporations over the past decade. Between March 2008 and March 2018, the number of registered corporations has more than doubled to 1.27 million. Probably because of smaller in size, these newly registered companies mostly did not need to pay profits tax.¹⁰

Figure 7 – Proportion of corporations paying profits tax*



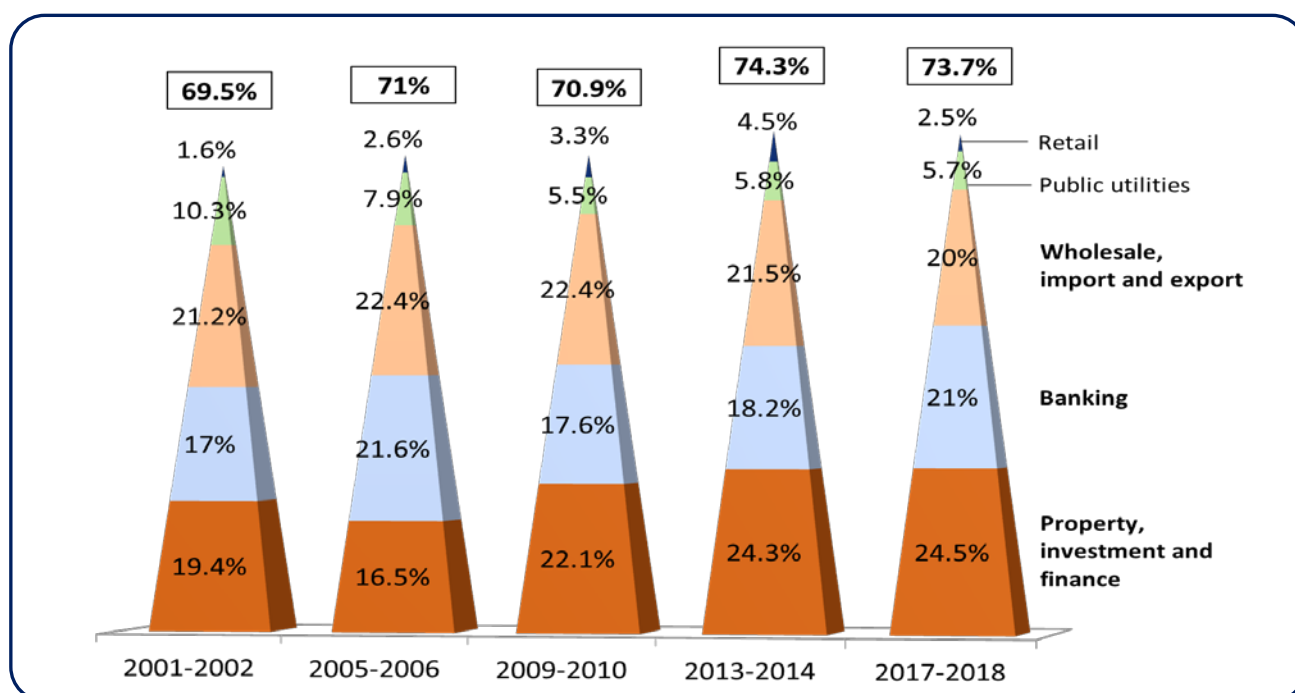
Note: (*) The years shown above refer to financial years. The figures are based on the respective assessment years, and are calculated by dividing the total number of corporations chargeable to profits tax by the total number of registered corporations as at year end of the respective assessment year.

Data sources: 2019-2020 Budget Consultation (2018) and Financial Services and the Treasury Bureau (various years).

¹⁰ Many corporations are dormant, newly-formed with the first tax returns not yet issued, loss cases or without assessable profits. See Treasury Branch, Financial Services and the Treasury Bureau (2014).

2.8 On the other end of the spectrum, however, the reliance on high-profit companies remained high. For the assessment year of 2016-2017, corporations with assessable profits of above HK\$10 million, representing **6.8%** of 106 700 tax-paying corporations, had contributed a total of **88%** to profits tax.^{11, 12} Tax-paying corporations tend to be concentrated in **(a) property, investment and finance, (b) banking, and (c) wholesale as well as import and export**, with each accounting for 20%-25% of profits tax assessed and the former two sectors registering growing share (**Figure 8**). Profits tax contribution of **public utilities** to public coffers, on the other hand, has been on the **decline** since 2001-2002. In this year's Budget, the Financial Secretary has revealed that he would transfer the Tax Policy Unit¹³ formed in 2017 under the Financial Services and the Treasury Bureau to the Financial Secretary's Office. Whether it will put forward any plan to head start a comprehensive review of tax regime remains to be seen.

Figure 8 – Profits tax contribution by top five business sectors*



Note: (*) The years shown above refer to financial years. Figures are expressed as a percentage of final tax assessed for the respective assessment years.

Data source: Inland Revenue Department (various years).

¹¹ This compared to 5.7% of tax-paying corporations contributing to 83% of profits tax in the assessment year of 2006-2007. See Financial Services and the Treasury Bureau (various years).

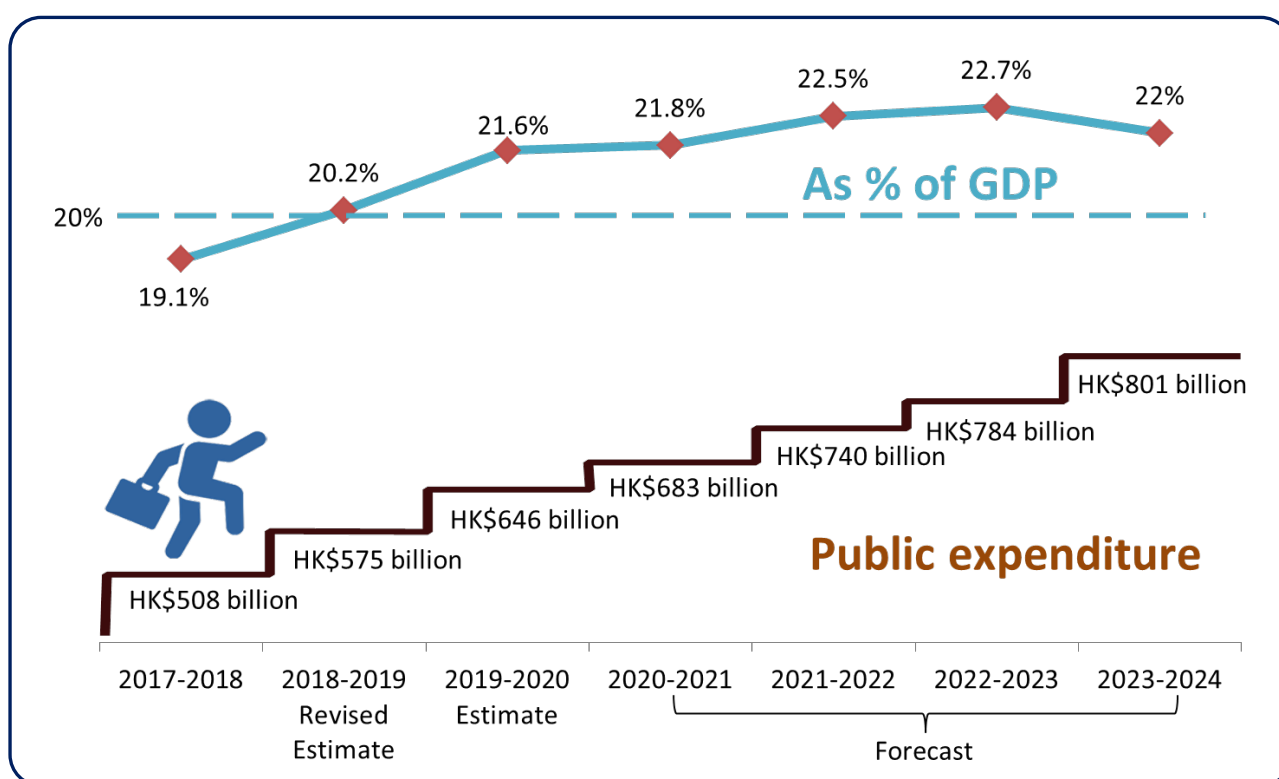
¹² In the past seven years, the Government has provided 75% reduction for profits tax, up to a cap being the same as that for salaries tax.

¹³ The Tax Policy Unit has three objectives, namely (a) to ensure that the tax regime aligns with international standards; (b) to leverage the tax policy to promote the development of Hong Kong's economy and industries; and (c) to explore ways to broaden the tax base and increase revenue, with the first priority being to capitalise the tax policy to facilitate the development of Hong Kong's industries and economy. See GovHK (2017).

3. Investing to improve public services and grow the economy

3.1 In the current-term Government, the Chief Executive introduced a new fiscal philosophy with the allocation of more resources to alleviate people's burdens and nurture talent. Since 2018-2019, the Government has dropped the previous budgetary criterion that public expenditure should be kept at or below 20% of GDP. In 2018-2019, public expenditure in terms of GDP is estimated at 20.2%, and is projected to rise to 21.6%-22.7% in the coming few years (**Figure 9**).

Figure 9 – Total public expenditure and its share of GDP



Data sources: 2019-2020 Budget Speech and Census and Statistics Department (2018a).

3.2 The continued growth of government expenditure warrants the Government to sustain a stable stream of revenue in order to maintain the fiscal health of the economy. The Working Group on Long-Term Fiscal Planning projected in 2014 that structural deficit would surface in 2029-2030 under the scenario of no service enhancement. With service enhancements, structural deficit would take place earlier and the soonest expected is 2023-2024.¹⁴ While it is not clear whether or when this will happen¹⁵, the recent initiative of "Lantau Tomorrow" will certainly incur a significant amount of infrastructural expenditure.¹⁶ Hence, growing the enterprises and developing a diversified economy is crucial to strengthening the economy and ensuring soundness of the government coffers.






3.3 In this year's Budget, initiatives relating to diversifying economy continue to focus on innovation and technology (**Table 2**), with funding commitments of about HK\$44 billion. There is also a series of facilitative measures for the pillar industry, the financial services industry. The measures include a plan to establish a limited partnership regime and introduce tax arrangement to attract private equity funds to run business in Hong Kong.

¹⁴ Under the service enhancement scenario at 1% per annum. See Treasury Branch, Financial Services and the Treasury Bureau (2014).

¹⁵ The Chief Executive had reportedly disapproved of the projections made by the Working Group. She considered them to be pessimistic with the underlying assumptions being too conservative, and that the assumptions could be adjusted through changes in policy to make the financial position more sustainable. See 明報 (2017).

¹⁶ The ballpark estimated construction cost is HK\$624 billion, based on prices in September 2018.

Table 2 – Initiatives on diversifying economy announced in 2019-2020 Budget

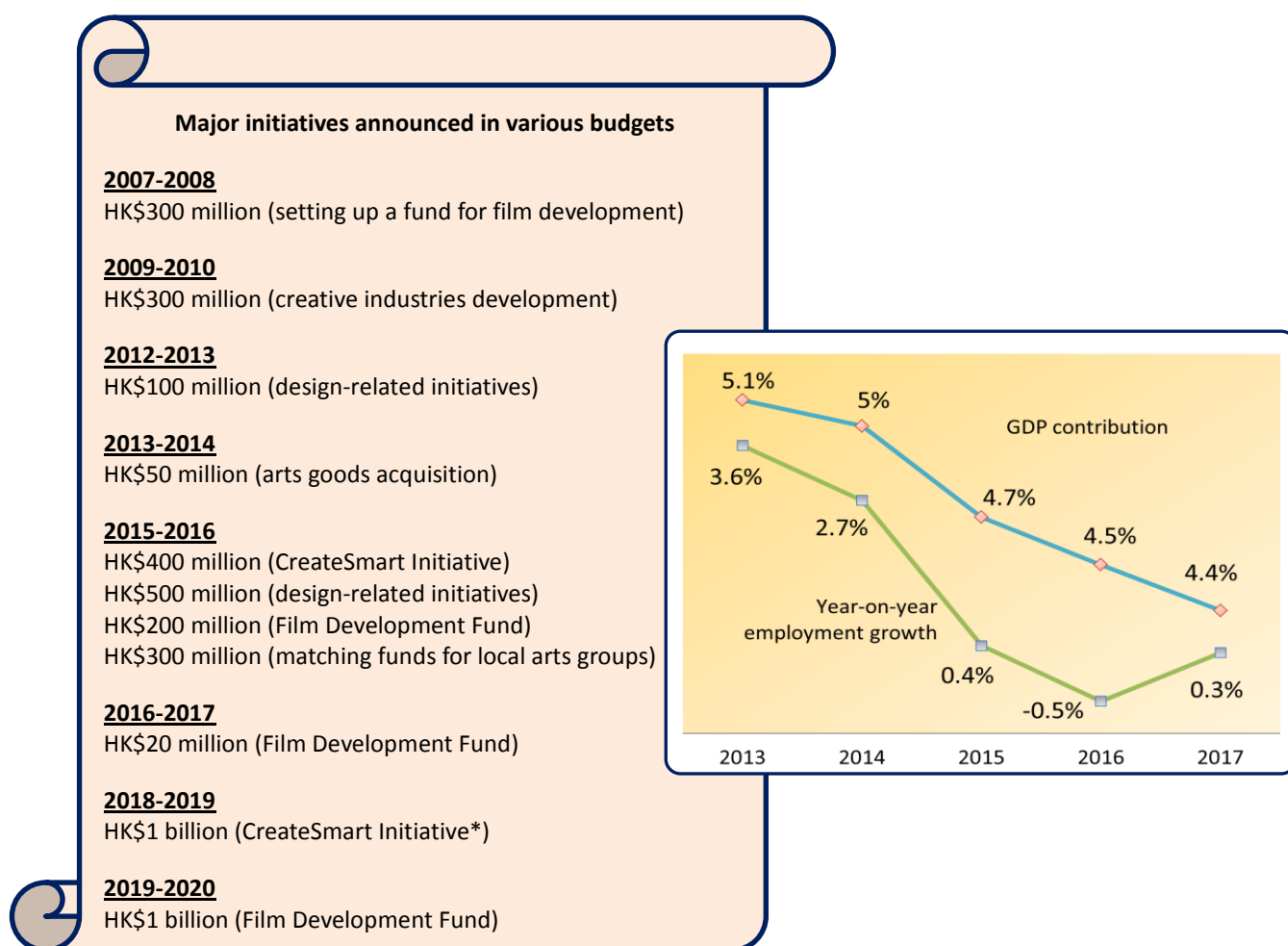
Sector	Initiatives and measures	GDP contribution	
		2013	2017
Financial services industry	<ul style="list-style-type: none"> • Issue government green bonds • Introduce facilitative measures to attract private equity funds • Broaden distribution network of local fund products • Provide tax concession etc to promote marine insurance • Promote Faster Payment System for payment of government bills • Issue virtual bank licences • Establish the Academy of Finance • Provide HK\$400 million seed capital for Financial Reporting Council 	16.5%	19.0%
		 2.5 percentage points	
Construction industry	<ul style="list-style-type: none"> • Earmark HK\$40 million to enhance project delivery capability of public officers • Promote digitization, strengthen cost management and improve productivity, quality, safety, etc. 	4.0%	5.1%
		 1.1 percentage points	
International Transportation Centre	<ul style="list-style-type: none"> • Consider introducing tax and related measures to attract ship finance companies to develop businesses in Hong Kong • Provide 50% profits tax concession to marine insurance businesses 	5.7%*	5.7%*
		(No change)	
Professional services	<ul style="list-style-type: none"> • Allocate HK\$150 million to support development of an online international dispute resolution platforms by non-governmental organizations 	4.8%	4.8%
		(No change)	
Innovation and technology	<ul style="list-style-type: none"> • Allocate HK\$5.5 billion for Cyberport development • Allocate HK\$16 billion for enhancing universities campus facilities • Inject HK\$20 billion into the Research Endowment Fund • Launch HK\$2 billion Re-industrialisation Funding Scheme • Allocate HK\$800 million for research and development at universities and research centres • Expand the Corporate Venture Fund of the Science Park • Increase funding ceiling under the Technology Start-up Support Scheme for Universities • Establish two innovative clusters in Science Park, etc. 	0.7%	0.7%
		(No change)	
Tourism	<ul style="list-style-type: none"> • Provide HK\$353 million for continued implementation of the Development Blueprint for Hong Kong's Tourism Industry 	5.0%	4.5%
		 0.5 percentage point	
Cultural and creative industries	<ul style="list-style-type: none"> • Inject HK\$1 billion into the Film Development Fund • Commence the works for the Sham Shui Po Design and Fashion Project 	5.1%	4.4%
		 0.7 percentage point	
Trading and logistics	<ul style="list-style-type: none"> • Not specifically highlighted 	23.9%	21.5%
		 2.4 percentage points	

Note: (*) The GDP contribution refers to the services sector of "transportation and storage" based on the economic activity classification of the Census and Statistics Department.

Data sources: 2019-2020 Budget Speech, Census and Statistics Department (2018b and 2018e).

3.4 In fact, the financial services industry has registered a new high of 19% of GDP in 2017, on the other hand, the biggest pillar trading and logistics industry has continued to see contraction to 21.5% (Table 2). Judging from the economic contribution, the Government's previous efforts to diversify the economy has not yielded desirable results seemingly. In particular, the emerging cultural and creative industries, being considered a potential growth driver, seem to have lost the momentum in recent years. Its economic contribution as a percentage of GDP has registered persistent decline from the peak of 5.1% in 2013 to 4.4% in 2017 (**Figure 10**). In the past various budgets, the Government has committed over HK\$3 billion to nurturing the industry alongside the setting up of the Create HK Office. In view of the downward signs, it may warrant a revisit of the constraints being faced by the sector as well as the effectiveness of the support measures.

Figure 10 – Cultural and creative industries



Note: (*) Over the years, a total of HK\$2 billion has been injected into the CreateSmart Initiative. See CreateHK (2019).

Data sources: Budget (various years), Census and Statistics Department (2018e and 2018f).

3.5 Based on the prevailing landscape of the economic structure, it is likely that going forward, the **financial services industry will continue to increase in economic significance, and so is the reliance on this sector for profits tax.** The recently released Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area places paramount importance on Hong Kong's financial services industry, besides trade and transportation. Earlier on, the Chief Executive has indicated that Hong Kong's role in the development of the Greater Bay Area needs to change from being a "connector" to being a more proactive "participant".¹⁷ Meanwhile, the Financial Secretary has stated that they would seize the opportunity and make dedicated efforts to promote development in the Greater Bay Area. In this year's Budget, a sum of HK\$38 million is earmarked for setting up a Guangdong-Hong Kong-Macao Greater Bay Area Development Office to implement the relevant work.

4. Designated-purpose funds

4.1 To finance the expenditure needs, it is common for the Government to set aside funding for specific purpose. Within the General Revenue Account, there are various funds established for dedicated uses. Outside the General Revenue Account, there are also a number of **designated-purpose funds** other than those established under section 29 of the Public Finance Ordinance.¹⁸ According to the Government, some 20 of these designated-purpose funds are mainly funded by the Government which is also responsible for their use.¹⁹ However, they are not reflected in the cash-based government accounts.²⁰ These funds amounted to over **HK\$91 billion**²¹ (Table 3) and represented approximately 15% of the cash-based balance of the General Revenue Account.²²

4.2 According to the Government, these funds were established with specific modes of operation. To cater for their respective needs, the investment strategies of these funds are also different.²³ It is noted that many of these funds have investment portfolios managed by the Treasury and/or are placed with the Exchange

¹⁷ See GovHK (2019).

¹⁸ Examples of those established under the Public Finance Ordinance are Capital Works Reserve Fund and Innovation and Technology Fund.

¹⁹ The funds are listed in the accrual-based consolidated financial statements of the Government. Many of them exist as trust funds.

²⁰ The accounts submitted under the Audit Ordinance are prepared mainly on a cash basis. See Financial Services and the Treasury Bureau (2002).

²¹ Based on the fund balance of the latest available financial statements or annual reports.

²² Based on the balance of the General Revenue Account at HK\$628.25 billion as at end 2017-2018.

²³ See GovHK (2014).

Fund managed by the Hong Kong Monetary Authority (Table 3).²⁴ Some have specified that the **investment income is primarily used to meet the operational needs, and/or government injection is used as seed money**. For example, for the Quality Education Fund, both its cumulative expenditure and fund balance have far exceeded the total government injection, indicating investment returns are more than sufficient to support fund operations and fund growth. However, it also prompts the question of whether it is suitable to continue to lock up such a large sum of unused money in the fund.

4.3 On the other hand, certain younger funds have seen relatively lower expenditure, such as the Self-Financing Post-secondary Education Fund and the HKSAR Government Scholarship Fund.²⁵ It is not clear if the low expenditure reflects that expenditure is not required or is constrained by the level of investment return. Take the Qualifications Framework Fund as an example, as the Government perceived that there was a funding shortfall between the forecast investment income and estimated funding requirement for the coming years, additional injection of HK\$1.2 billion was made in 2018 to generate more investment income.²⁶ Similar situation is also seen in the Elite Athletes Development Fund. Since investment income is not enough to cover funding needs, the Government has sought additional injection of HK\$6 billion to generate more investment income.²⁷

4.4 For all these designated-purpose funds, the Government has made an aggregate injection of over **HK\$96 billion** over the years, with an aggregate fund balance of over HK\$91 billion approximately. Since this represents a huge sum of public money, there have been concerns about the effectiveness in meeting the fund purposes and whether unused investment income/capital can be deployed for other areas with more pressing needs.^{28, 29}

²⁴ According to GovHK (2015), controlling Officers are advised to invest funds not immediately required, and to make reference to the Fund Management Guide issued by the Treasury. See GovHK (2015).

²⁵ For these two funds, the cumulative expenditure was both HK\$0.68 billion between inception and 2018. On average, its annual expenditure represented about 2.8% and 3.0% of government injection respectively. The rates are lower than the corresponding rate of 6.3% for the Quality Education Fund.

²⁶ See Education Bureau (2017b).

²⁷ See Home Affairs Bureau (2018). Further examples are seen in Education Bureau (2018b) and Social Welfare Department (2014).

²⁸ See GovHK (2011), GovHK (2015) and GovHK (2016).

²⁹ There were cases of returning funds back to government accounts. For instance, according to Innovation and Technology Bureau and Innovation and Technology Commission (2018), the New Technology Training Scheme funded by the New Technology Training Fund under the administration of the Vocational Training Council has been replaced by the Reindustrialisation and Technology Training Programme under the Innovation and Technology Fund in 2018. Remaining funds will be returned to the Government after the replacement. More recently, the Housing Reserve, setting aside for investment within the Exchange Fund, has been brought back by phase to fiscal reserves in view of the funding adequacy of the Housing Authority.

Table 3 – Funds established for specific purposes

Fund (Launch year)	Purpose	Injection from the Government	Cumulative expenditure (as at)	Fund balance (as at)	Investment management		Remarks
					The Treasury	Exchange Fund	
Funds using government injection as seed money to generate investment income to meet fund expenditure							
Research Endowment Fund (2009)	Support research at the UGC-funded institutions	Initial: HK\$18 bln 2012: HK\$5 bln Total: HK\$23 bln ^(a)	HK\$5.76 bln (Aug 2017)	HK\$26.57 bln (Aug 2017)		✓	Operation is funded through its investment return
Community Care Fund (2011) ^(b)	Provide assistance to people facing economic difficulties	Initial: HK\$5 bln 2013: HK\$15 bln Total: HK\$20 bln	HK\$7.44 bln (Mar 2018)	HK\$19.67 bln (Mar 2018)		✓	Operation is mainly funded by investment returns on the seed capital
Quality Education Fund (1998)	Provide funding support to worthwhile projects from the school education sector	Total: HK\$5 bln	HK\$6.32 bln (Aug 2018)	HK\$9.49 bln (Aug 2018)	✓	✓	Investment objective of the Fund is to generate growth in fund value and produce recurrent income to meet funding need
Language Fund (1994)	Improve Hong Kong people's proficiency in Chinese (including Putonghua) and English languages	Initial: HK\$0.3 bln 2001: HK\$0.2 bln 2003: HK\$0.4 bln 2005: HK\$0.5 bln 2006: HK\$1.1 bln 2010: HK\$0.5 bln 2014: HK\$5 bln Total: HK\$8 bln	HK\$2.79 bln ^(c) (Aug 2017)	HK\$6.37 bln (Aug 2017)		✓	HK\$5 bln injected in 2014 serves as seed capital to provide investment income

^(a) A further injection of HK\$3 billion into the Research Endowment Fund was made in 2018. More recently, the Government proposed to inject additional HK\$20 billion but the proposal was withdrawn from the Finance Committee in January 2019 in response to that some Members of the Legislative Council would like to obtain more details on the funding proposal.

^(b) The injection did not include public donations. The balance referred to the amount administered by the Secretary for Home Affairs Incorporated. It did not include the balance of HK\$1.79 million administered by the Director of Social Welfare Incorporated.

^(c) Information before 1997 is not available. The amount refers to the cumulative expenditure since 1997-1998.

Table 3 – Funds established for specific purposes (cont'd)

Fund (Launch year)	Purpose	Injection from the Government	Cumulative expenditure (as at)	Fund balance (as at)	Investment management		Remarks
					The Treasury	Exchange Fund	
Funds using government injection as seed money to generate investment income to meet fund expenditure (cont'd)							
Elite Athletes Development Fund (2012)	Provide funding to the Hong Kong Sports Institute Limited to support the development of elite sport and elite athletes	Initial: HK\$7 bln ^(d)	HK\$2.43 bln (Mar 2018)	HK\$6.19 bln (Mar 2018)		✓	Funding is mainly from investment return
Environment and Conservation Fund (1994)	Provide funding for educational and research projects relating to environment and conversation	Initial: HK\$0.05 bln 1998: HK\$0.05 bln 2002: HK\$0.1 bln 2006: HK\$0.035 bln 2008: HK\$1 bln 2011: HK\$0.5 bln 2013: HK\$5 bln Total: HK\$6.735 bln	HK\$1.94 bln ^(e) (Mar 2018)	HK\$5.89 bln (Mar 2018)		✓	HK\$5 bln injected in 2013 serves as seed money to generate investment income
Beat Drugs Fund (1996)	Promote and support anti-drug programmes	Initial: HK\$0.35 bln 2010: HK\$3 bln Total: HK\$3.35 bln	HK\$0.81 bln ^(f) (Mar 2018)	HK\$4.66 bln (Mar 2018)	✓	✓	Anti-drugs projects are financed through investment income
Self-financing Post-secondary Education Fund (2011)	Enhance the quality of self-financing post-secondary education	Initial: HK\$2.5 bln 2012: HK\$1 bln 2013: HK\$0.02 bln Total: HK\$3.52 bln	HK\$0.68 bln (Aug 2018)	HK\$3.97 bln (Aug 2018)	✓	✓	Operation is funded through its investment return
Sir David Trench Fund for Recreation – Arts and Sport Development Fund (1997) ^(g)	Provide funding for the key initiatives of the Hong Kong Arts Development Council and other arts and sport related projects	Initial: HK\$0.3 bln 2007: HK\$0.08 bln 2009: HK\$0.15 bln 2010: HK\$3 bln Total: HK\$3.53 bln ^(h)	HK\$1.73 bln (Mar 2018)	HK\$3.28 bln (Mar 2018)	✓	✓	HK\$3 bln injected in 2010 serves as seed money for generating investment return

^(d) A further injection of HK\$6 billion into the Elite Athletes Development Fund was approved by the Finance Committee in January 2019.

^(e) Information before 1997 is not available. The amount refers to the cumulative expenditure since 1997-1998.

^(f) Ibid.

^(g) Sir David Trench Fund for Recreation comprises a total of six sub-funds. The Arts and Sport Development Fund is the largest fund accounting for 93% of the total fund balance. The other five funds are Main Fund; Sports Aid for the Disabled Fund; Sports Aid Foundation Fund; Arts Development Fund; and Hong Kong Athletes Fund, which are not shown above.

^(h) A further injection of HK\$1 billion into the Arts and Sport Development Fund was approved by the Finance Committee in January 2019.

Table 3 – Funds established for specific purposes (cont'd)

Fund (Launch year)	Purpose	Injection from the Government	Cumulative expenditure (as at)	Fund balance (as at)	Investment management		Remarks
					The Treasury	Exchange Fund	
Funds using government injection as seed money to generate investment income to meet fund expenditure (cont'd)							
HKSAR Government Scholarship Fund (2008)	Recognize outstanding local and non-local students	Initial: HK\$1 bln 2011: HK\$0.25 bln 2012: HK\$1 bln 2013: HK\$0.02 bln Total: HK\$2.27 bln ⁽ⁱ⁾	HK\$0.68 bln (Aug 2018)	HK\$2.50 bln (Aug 2018)	✓	✓	Operation is funded through investment return
Qualifications Framework ("QF") Fund (2014)	Support schemes/initiatives for the sustainable development and implementation of QF	Initial: HK\$1 bln ^(j)	n.a. ^(k) (Aug 2017)	HK\$1.05 bln (Aug 2017)		✓	Expenditure is met by the investment returns
Gifted Education Fund (2016)	Support the operation of the Hong Kong Academy for Gifted Education	Initial: HK\$800 mln ^(l)	HK\$14 mln (Aug 2017)	HK\$796 mln (Aug 2017)		✓	Operation is funded through its investment return
Hong Kong Paralympians Fund (2001)	Foster the development of sports for persons with disabilities	Initial: HK\$50 mln 2009-2012: HK\$5.44 mln 2014: HK\$200 mln Total: HK\$255.44 mln	HK\$71 mln (Mar 2018)	HK\$237 mln (Mar 2018)		✓	HK\$200 mln injected in 2014 serves as seed capital to provide investment income
Queen Elizabeth Foundation for the Mentally Handicapped ("QEF") (1988)	Improve the welfare, education and training of persons with intellectual disability	Initial: HK\$91 mln (included HK\$61 mln from donations and other source)	HK\$268 mln ^(m) (Mar 2018)	HK\$224 mln (Mar 2018)	Investment placed with fund managers		HK\$81 mln of initial injection reserved for investment required under the QEF Ordinance

⁽ⁱ⁾ A further injection of HK\$800 million into the HKSAR Government Scholarship Fund is planned in 2019.

^(j) A further injection of HK\$1.2 billion into Qualifications Framework Fund was made in 2018.

^(k) There was no expenditure shown in the financial statements. According to the Government, as it takes time for the QF Fund to generate and accumulate investment income to meet the funding requirements, the Education Bureau had been deploying funds out of the remaining balance of the approved commitment for the Qualifications Framework Support Schemes for meeting the cash flow requirements under the QF Fund. It is expected that the investment income from the QF Fund will be utilized to meet the expenditure in late 2017. See Education Bureau (2017a).

^(l) A further injection of HK\$800 million into the Gifted Education Fund was made in 2018.

^(m) Information before 1997 is not available. The amount refers to the cumulative expenditure since 1997-1998.

Table 3 – Funds established for specific purposes (cont'd)

Fund (Launch year)	Purpose	Injection from the Government	Cumulative expenditure (as at)	Fund balance (as at)	Investment management		Remarks
					The Treasury	Exchange Fund	
Other funds							
AIDS Trust Fund (1993)	Provide assistance to HIV-infected haemophiliacs, strengthen medical and support services on AIDS	Initial: HK\$350 mln 2013: HK\$350 mln Total: HK\$700 mln	HK\$731 mln (Mar 2018)	HK\$235 mln (Mar 2018)	✓	✓	
Supplementary Legal Aid Fund (1984)	Finance the Supplementary Legal Aid Scheme	Initial: HK\$1 mln 1995: HK\$27 mln 2012: HK\$100 mln Total: HK\$128 mln	HK\$231 mln ⁽ⁿ⁾ (Sep 2017)	HK\$192 mln (Sep 2017)		✓	Part of the income is contributed by those aided persons successful in the proceedings
Education Development Fund (2004)	Provide differentiated school-based professional support to build up schools' capacity	Initial: HK\$0.55 bln 2012: HK\$0.55 bln Total: HK\$1.1 bln	HK\$1.06 bln (Aug 2018)	HK\$0.14 bln (Aug 2018)	Fund assets are held in fixed deposits		
Social Innovation and Entrepreneurship Development Fund (2014)	Support social entrepreneurship in developing innovations	Total: HK\$190 mln ^(o)	HK\$67 mln (Mar 2018)	HK\$127 mln (Mar 2018)	Fund assets are held mainly in time deposits		
Emergency Relief Fund (1962)	Provide prompt assistance to persons in need of urgent relief, e.g. natural disasters	The Government has made contribution every year since 1973	HK\$156 mln ^(p) (Mar 2018)	HK\$86 mln (Mar 2018)		✓	
Trust Fund in Support of Reconstruction in the Sichuan Earthquake Stricken Areas (2008)	Support the reconstruction in the Sichuan earthquake affected areas	2008-2010: HK\$9 bln	HK\$9.37 bln (Mar 2018)	HK\$0.07 bln (Mar 2018)	Fund assets are held in cash and time deposits		

⁽ⁿ⁾ Information before 1997 is not available. The amount refers to the cumulative expenditure since 1997-1998.

^(o) Total commitment is HK\$500 million, allocated from the Lotteries Fund. According to the Government's reply in response to the request of the Research Office, the remaining HK\$310 million would be drawn by phases based on the actual spending position and cash flow projection.

^(p) Information before 1997 is not available. The amount refers to the cumulative expenditure since 1997-1998.

Table 3 – Funds established for specific purposes (cont'd)

Fund (Launch year)	Purpose	Injection from the Government	Cumulative expenditure (as at)	Fund balance (as at)	Investment management	Remarks
Other funds (cont'd)						
Elder Academy Development Foundation (2009)	Provide funding for setting up elder academies	Initial: HK\$10 mln 2014: HK\$50 mln Total: HK\$60 mln	HK\$36 mln (Mar 2018)	HK\$43 mln (Mar 2018)	About 60% of fund assets are held in bank deposits	
Pneumoconiosis Ex Gratia Fund (1993)	Provide compensation for persons who were diagnosed before 1981 to have contracted pneumoconiosis	Initial: HK\$175 mln 1997: HK\$27 mln 2006: HK\$9.8 mln 2007: HK\$89 mln Total: HK\$300.8 mln	Incomplete information	HK\$19 mln (Mar 2017)	Fund assets are held mainly in fixed deposits	
Health Care and Promotion Scheme ^(q) (1995)	Fund health promotion projects to help people adopt healthier lifestyle	Initial: HK\$80 mln	Incomplete information	HK\$19 mln (Mar 2018)	Fund assets are mainly held in time deposits	
Trust Fund for Severe Acute Respiratory Syndrome ("SARS") (2003)	Provide special ex-gratia assistance to the dependent family members of the deceased SARS patients and other victims	Initial: HK\$150 mln 2007 & 2011: HK\$100 mln Total: HK\$250 mln^(r)	HK\$250 mln (Mar 2018)	HK\$13 mln (Mar 2018)	Fund assets are mainly held in bank deposits	
Consumer Legal Action Fund (1994)	Provide financial support and legal assistance to consumers	Initial: HK\$10 mln 2010: HK\$10 mln Total: HK\$20 mln^(s)	HK\$29 mln ^(t) (Mar 2018)	HK\$7 mln (Mar 2018)	Fund assets are mainly held in bank deposits	Part of the income is contributed by those aided persons successful in the proceedings
Approximate total injection from the Government				HK\$96.4 bln^(u)		
Approximate total funding balance				HK\$91.8 bln^(u)		

Data sources: Various years of the financial statements and annual reports of the above funds, GovHK (2011) and The Treasury (2019).

^(q) Formerly known as Health Care and Promotion Fund, the Health Care and Promotion Scheme has been incorporated into the Health and Medical Research Fund since 28 April 2017.

^(r) A further injection of HK\$50 million into the Trust Fund for SARS was made in 2018-2019.

^(s) A further injection of HK\$10 million into the Consumer Legal Action Fund was made in 2018-2019.

^(t) Information before 1997 is not available. The amount refers to the cumulative expenditure since 1997-1998.

^(u) Aggregate injection and balance do not include the Emergency Relief Fund. Aggregate balance covers different financial-year end dates in 2017 or 2018.

5. Observations

5.1 Based on the above analysis, the following observations are made:

- (a) in this year's Budget, the Financial Secretary continued to adhere to the new fiscal philosophy of "adopting forward-looking and strategic financial management principles to invest for Hong Kong and relieve people's burden on the premise of ensuring healthy public finance". Reflecting increased spending, public expenditure as a share of GDP in 2018-2019 has slightly gone beyond the previous budget criterion of 20% at 20.2%, and is forecast to stay in the range of 21.6%-22.7% in the coming five years;
- (b) government expenditure in 2019-2020 is expected to hit HK\$607.8 billion, equivalent to 97% of government revenue, up from 90% in 2018-2019. Accordingly, fiscal surplus is expected to contract to HK\$16.8 billion in 2019-2020, the lowest since 2015-2016. Based on the Government's medium range forecast, the ratio of government expenditure to government revenue will even peak at 99% from 2021-2022 and onwards, raising concern about the sustainability of the revenue sources;
- (c) the narrow-based revenue sources of the Government have all along been the concern of society. In recent years, with the increases in land sale supply and prices, land premium has made weighty contribution to government revenue, at an average of 21% during 2015-2020. At the same time, stamp duty has also grown in importance since the introduction of a series of "spicy" measures, which unexpectedly represented a notable government revenue of 5.4% in 2017-2018. The observations further reinforced the reliance on property-related revenue in recent years;
- (d) the base of salaries tax has broadened over the years, with the proportion of working population paying tax increasing from 38% to 47% between 2000-2001 and 2017-2018, indicative of more people being brought into the tax net. The Government has been offering one-off tax reduction relief since 2007-2008, which helped reduce the burden of taxpayers, in particular the taxpayers of the lower income groups. However, tax relief is not a regular measure and subject to the revenue strength of the past fiscal year. Moreover, ageing population also poses challenges on salaries tax with concerns

whether salaries tax could remain a large revenue source to meet government expenditure;

- (e) on the other hand, the proportion of registered companies paying profits tax had halved from 17% to 9% between 2007-2008 and 2017-2018, due probably to the tremendous growth in the number of registered corporations with many being not liable to profits tax. For the large companies with assessable profits of over HK\$10 million in the assessment year of 2016-2017, their profits tax contribution was 88% but they just represented 6.8% of tax-paying corporations. Moreover, tax-paying corporations appear increasingly concentrated in the sector of banking, investment and finance, as well as property;
- (f) in view of growing expenditure needs, there remains concern whether government revenue is abundant and stable enough to sustain expenditure given the limitations of the revenue structure. While the Government has not indicated any future plan to comprehensively review the tax regime, strengthening the industries' competitiveness is crucial to Hong Kong's economic development and thereby government coffers. The Government has sought to diversify the economy by committing resources to promoting both innovation and technology and cultural and creative industries, which are considered to be the potential growth engine. However, the latter seemed to have lost the momentum in recent years, with its GDP contribution falling persistently from 5.1% in 2013 to 4.4% in 2017; and
- (g) there are some 20 designated-purpose funds which the Government is responsible for their use but are not reflected in the cash-based government accounts. These funds roughly amount to over HK\$91 billion and have existed from several years to over 50 years. Some of them maintained high balance with investment income primarily used to fund operations, prompting concerns about the effectiveness of public resources allocation in view of a huge sum being locked up.

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