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# The 2020-2021 Budget

**April 2020**

*Fiscal deficit is forecast to more than triple to HK$139.1 billion in 2020-2021, along with a new package of relief measures of HK$122 billion (4.3% of GDP) to combat COVID-19. While some are concerned about local fiscal discipline, others view it as a good use of past savings for rainy days.*

*Pandemic-induced fiscal relief packages as a ratio of GDP hit double digits in many advanced places, including the UK (22%), the US (11%) and Singapore (11%). Majority of them are loan guarantees assisting enterprises to survive amidst business shutdown.*

*Past practice of taking about 19 months to complete cash payout is longer than 4-10 months in Macao and Singapore. There are concerns over high administrative cost of HK$140 per successful application under the cash payout scheme.*

*Risks of structural deficits in the longer term cannot be dismissed, due to profound impacts of ageing on demand for social services, shrinking workforce and intertwined relationship between tax base and the structure of income distribution. Most recently, there is more overseas skepticism over Hong Kong as a global financial centre and as the best place to do business after social unrest last year.*

*Public housing plays a key role in local social mobility, with greater poverty alleviation effect than CSSA. Yet its share in public expenditure halved to 5% in 22 years, with continued impact on income disparity.*

*The Legislative Council will resume the Second Reading debate on the Appropriation Bill 2020 at its meeting of 22 April 2020.*

## 1. Introduction

1.1 Public finance serves three important functions in modern society, namely (a) macroeconomic stabilization; (b) efficient resource allocation; and (c) equitable income distribution.[1] In face of economic hardship caused by the triple shocks (i.e. US-China trade tension, local social incidents and global spread of the Coronavirus Disease 2019 ("COVID-19")), there is high hope on the 2020-2021 Budget in Hong Kong. To meet these functions and public expectation, the Financial Secretary ("FS") presents the Budget with a huge deficit of HK$139.1 billion on 26 February, equivalent to 4.8% of Gross Domestic Product ("GDP"). It also contains a massive package of counter-cyclical and relief measures aggregated at over HK$122 billion, including a universal cash payout scheme ("CPS") of HK$10,000 to all adult permanent residents.

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[1] Buchanan (1989).

1.2 While the Budget is responding to concerns over livelihood and severe business disruption caused by the pandemic, there are doubts over (a) practical arrangements of CPS and (b) sustainability of the local fiscal system in the longer term, as the fiscal balance of Hong Kong is forecast to stay in red for five consecutive years. This Research Brief looks into these issues, after a quick update on the local fiscal landscape.

## 2. Government revenue and expenditure in 2019-2020

2.1 **Total government revenue** fell by 5.4% to HK$567.3 billion in 2019-2020, primarily because of double-digit plunge in profits tax, salaries tax and stamp duties (**Figure 1**). This in turn could be partly attributable to a slackening in overall economic activity amidst local social unrest in the second half of 2019.[2] Yet land premium held up well and surged by 21%, despite withdrawal of a plot of commercial site at Kai Tak from sale in September 2019.[3] Looking ahead, FS expects total revenue to rebound to a modest growth of 0.9% in 2020-2021.

2.2 A few highlights on key changes in revenue composition in 2019-2020 can be made. ***First***, the proportion of land premium in total revenue surged from 19% to 25%, but the share of profits tax eased from 28% to 23%, so did salaries tax from 10% to 9.6%. As a result, land premium overtook profits tax to become the largest revenue source. ***Secondly***, together with stamp duties, land-related revenue took up more than one-third (36%) of total revenue.[4] This reinforces the public concerns about the over-reliance of local public coffers on property market, which in turn have implications on fiscal stability. To a certain extent, sizable capital revenue is a "happy problem" for Hong Kong, as it can alleviate the tax burden of the general public. Yet its wide volatility also makes it difficult to match with recurrent expenditure, posing a challenge for the Government to allocate

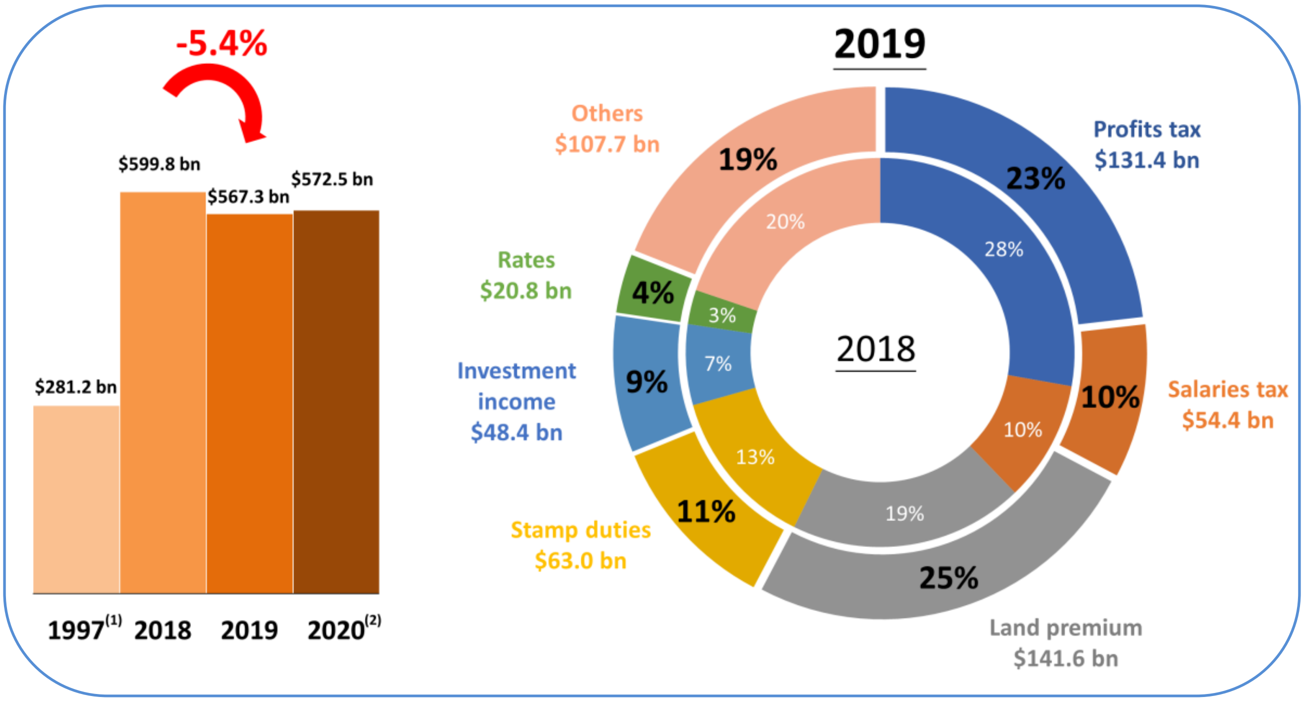
[2] The Government has recently assessed the economic impact of the social incidents in the third quarter of 2019. In terms of the disruptions in retail, restaurant and accommodation activities, it could have led to possible economic losses of HK$15 billion or 2% of quarterly GDP. In view of the 2.8% year-on-year contraction of GDP in the third quarter, this suggests that over two-thirds of the reduced output was attributable to local social incidents. The adverse impact on GDP was likely to be "even more" in the fourth quarter of 2019. See Office of the Government Economist (2020a and 2020b).

[3] The site in Kai Tak was sold at a high bid of HK$11.1 billion in May 2019, but the bidder abandoned it citing concerns over local unrest situation. The site was re-opened for bidding again and attracted five bidders. Yet the government rejected all these bids in September because the tendered premiums "did not meet the government's reserve price" for the site.

[4] In 2019-2020, revenue of stamp duties dropped by 21% amidst a plunge in property trading, dragging down its revenue share from 13% to 11%. The respective decline for "spicy taxes" (i.e. Buyer's Stamp Duty, Special Stamp Duty and Ad Valorem Stamp Duty) was much more significant, estimated at some 40%.

additional resources for public services.[5] ***Thirdly***, the share of investment income derived from the stock of fiscal reserves enlarged from 7% to 9%, providing noticeable contribution to public coffers. As a whole, the aforementioned top five items took up 77% of the total revenue in 2019-2020, similar to the preceding year.

**Figure 1 – Total government revenue and its major sources, 1997-2019**




Notes: (1) For presentation convenience, 1997 stands for the financial year 1997-1998, and so on.
(2) Figure for 2020-2021 is an estimate (i.e. forecast).
Data sources: Census and Statistics Department and Budget Speech.

2.3 **Total government expenditure** went up steeply by 15.0% to HK$611.4 billion in 2019-2020, mainly due to (a) four packages of helping measures[6] summed at HK$30 billion launched during August-December 2019; and (b) establishment of the HK$30 billion Anti-epidemic Fund ("AEF")[7] in February 2020. Looking ahead, government expenditure is forecast to accelerate

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5 Indicative of its volatility, the combined revenue of stamp duties and land premium fell to a low of HK$17-19 billion each year between 2001-2002 and 2003-2004, with a share in total government revenue of 8%-11%. For the peak in 2017-2018, the respective figures could hit HK$260 billion or 42%.

6 In an attempt "to support enterprises, safeguard jobs and relieve people's financial burden" amidst local social unrest, FS announced four packages of helping measures on 15 August, 4 September, 22 October and 4 December during 2019. See GovHK (2019b).

7 On 21 February 2020, the Finance Committee approved the funding request of the Government to set up AEF to enhance local capability to combat the spread of COVID-19 and to relieve the financial burden of enterprises and general public. It contains 24 measures with a sum of HK$30 billion. See Office of the Chief Secretary of Administration (2020).

to a 19.6% growth to HK$731.1 billion in 2020-2021. Most of the additional spending is related to the HK$122 billion package of relief measures.

2.4 Taking into account spending of Housing Authority and the Trading Funds as well, **total public expenditure** rose by 14.1% to HK$647.6 billion in 2019-2020, and is forecast to rise further by 19.4% in 2020-2021 (**Figure 2**).[8] Here are the top four expenditure items by policy area:[9]

(a) **Education:** The share of education in public expenditure went up by 0.4 of a percentage point to 19.4% in 2019-2020, mainly boosted by the one-off injection of HK$20 billion into the Research Endowment Fund ("REF"). Although it maintained the top position amongst all policy areas last year, the adjusted share of education expenditure is forecast to ease back to just 16% (after netting out the one-off effect of CPS from public expenditure) in 2020-2021, in the absence of new major initiative similar to REF last year;[10]

(b) **Social welfare:** The share of social welfare in public expenditure declined by 1.5 percentage point to 14.4% in 2019-2020. Over two-thirds of the recurrent welfare expenditure goes to social security payments, whereas the rest on welfare services in kind. Looking ahead, the adjusted share of social welfare in public expenditure is forecast to rebound to 16.4% in 2020-2021, with more visible increases in social security, elderly and rehabilitation services. Social Welfare is thus expected to overtake education to become the largest spending item;

(c) **Health:** In spite of new initiatives such as earmarking HK$10 billion under stabilisation fund for public healthcare provision of Hospital Authority, the share of health expenditure edged down by 0.2 of a percentage point to 13.6% in 2019-2020. Yet the adjusted share is expected to bounce up slightly to 13.9% in 2020-2021. Health stays at the third largest spending item in these two years; and

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8 Examples of public bodies run under the Trading Funds include Office of the Communications Authority, Post Office, Land Registry, and Companies Registry.

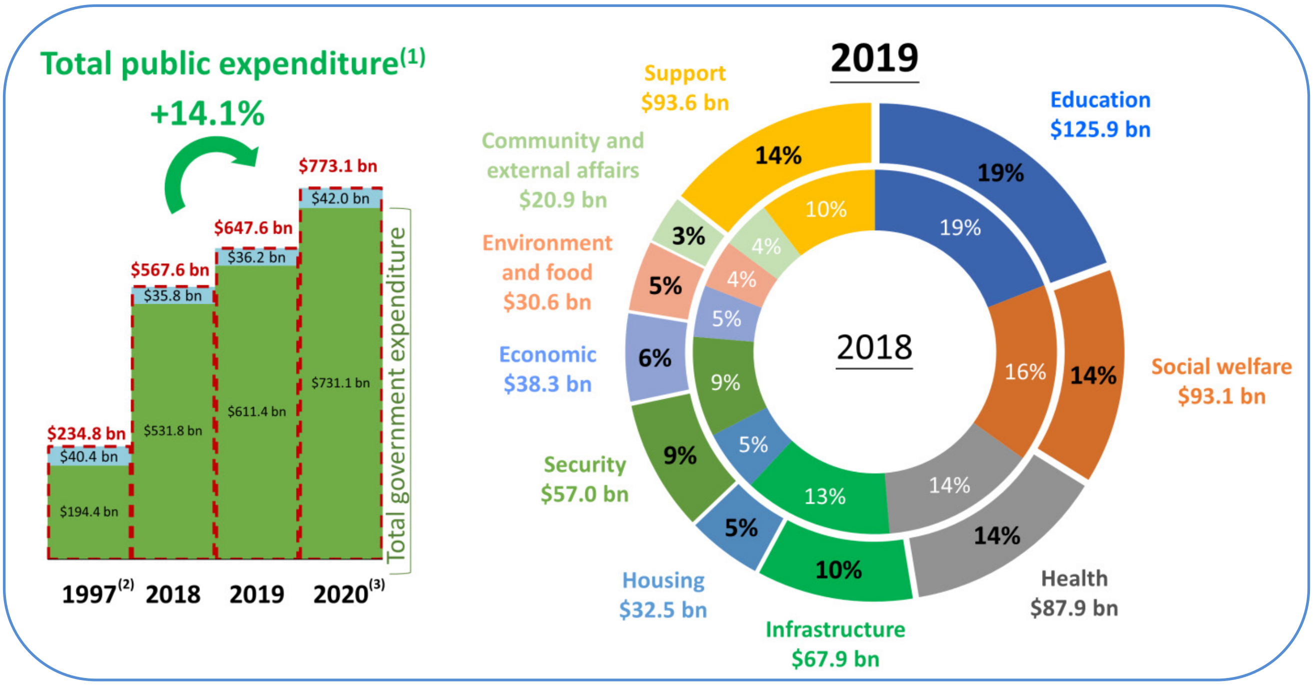
9 Public expenditure on "support" surged by 58% in 2019-2020, mostly related to the use of contingency fund to set up the HK$30 billion AEF. As this is one-off and AEF usage spills over to other policy areas, this brief does not put "support" into the ranking exercise.

10 As one-off CPS of HK$71 billion (apparently categorized as expenditure in the "economic" policy area) takes up some 10% of public expenditure in 2020-2021, its inclusion will distort trend movement of composition analysis. CPS is thus netted out throughout this paragraph for like-with-like comparison.

(d) **Infrastructure:** Infrastructural spending fell for the third consecutive year, dragging down its expenditure share from the peak of 18.1% in 2016-2017 to 10.5% in 2019-2020. Its ranking amongst all policy areas thus slipped from the top to the fourth position. Yet its adjusted share is expected to rebound moderately to 11.2% in 2020-2021.

Taking the above top four items together, their combined share in government expenditure was 57.9% in 2019-2020, down from 62.0% in the preceding year.

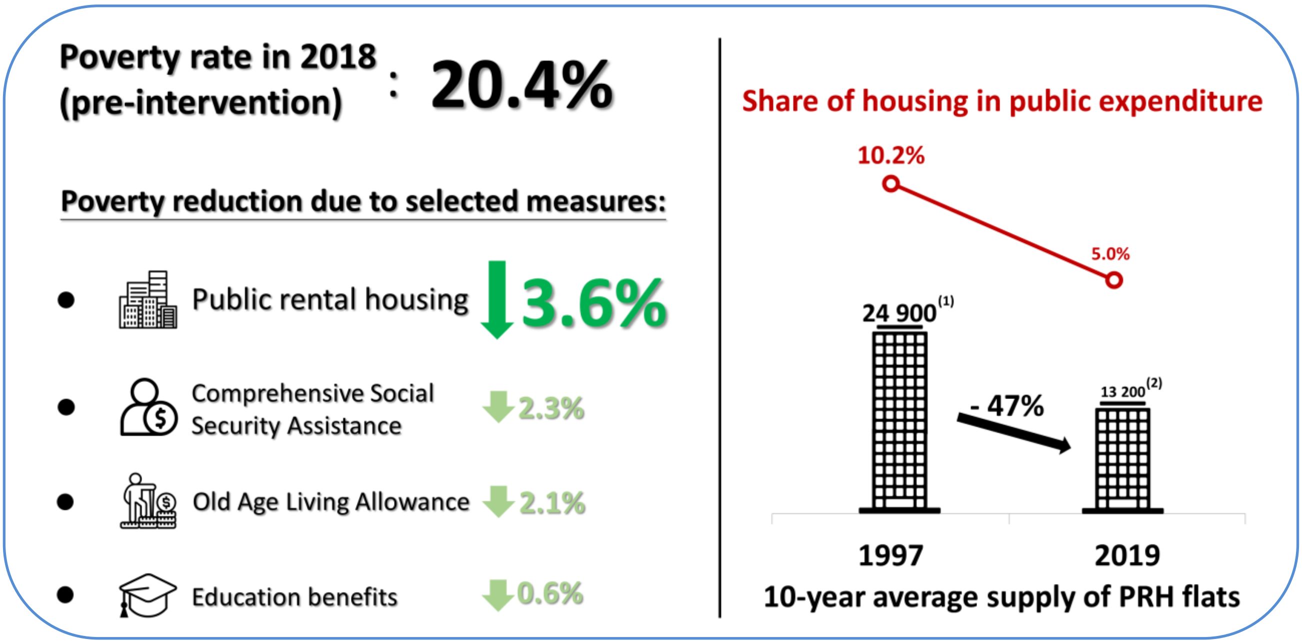
**Figure 2 – Total public expenditure and its major components, 1997-2019**




Notes: (1) Public expenditure is the sum of government expenditure as well as spending of Housing Authority and Trading Funds.
(2) For presentation convenience, 1997 stands for the financial year 1997-1998, and so on.
(3) Figure for 2020-2021 is an estimate (i.e. forecast).
Data sources: Census and Statistics Department and Budget Speech.

2.5 More specifically on **housing expenditure**, its share halving over the past 22 years to just 5% in 2019-2020 warrants special attention, given the key role of public housing in poverty reduction and social mobility**.** In 2018, there were 1.4 million poor people before any policy intervention in Hong Kong, with an overall poverty rate of 20.4%. Based on a recent assessment of the Government, provision of public rental housing ("PRH") is equivalent to granting average monthly benefits of HK$3,940 to each beneficiary family, helping to reduce local poverty rate by some 3.6 percentage points (**Figure 3**).[11] This was even larger than the poverty reduction effect of recurrent cash benefits under the Comprehensive Social Security Assistance ("CSSA"), estimated at 2.3 percentage points only.[12]

**Figure 3 – Public rental housing: poverty reduction and its share in public expenditure**




Notes: (1) Figure of 24 900 refers to the annual average completions of PRH flats during 1988-1997.
(2) Figure of 13 200 refers to the annual average completions of PRH flats during 2010-2019.
Data sources: Office of the Government Economist and Census and Statistics Department.

2.6 Notwithstanding this income redistributive effect, the share of housing in public expenditure halved from 10.2% in 1997-1998 to only 5.0% in 2019-2020, along with a 47% plunge in the 10-year average completions of PRH flats to 13 200 units per annum during 2010-2019. As such, the International Monetary Fund ("IMF") alerts that "delays in addressing structural challenges of insufficient housing supply and high income inequality" could undermine competitiveness of local economy.[13] An academic even suggests that local housing crisis is "the most serious example of government mismanagement".[14] Looking ahead, as supply of

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[11] The Government estimated that PRH provision is tantamount to a transfer payment of HK$38.4 billion in 2018. With a stock of 813 000 PRH flats, it is equivalent to providing annual benefit of HK$47,200 to each occupant of PRH flats. PRH provision is considered to be more "targeted" to assist low-income families, due to tight income eligibility criteria. See Office of the Government Economist (2019).

[12] Pre-intervention poverty rate in Hong Kong was 20.4% in 2018. Netting out recurrent cash assistance, post-intervention poverty rate dropped to 14.9%. After adjustment for in-kind benefits (e.g. PRH), the poverty rate would have dropped further to 10.6%. See Office of the Government Economist (2019).

[13] International Monetary Fund (2019b).

[14] This could be in part attributable to a re-positioning of the housing policy in the early 2000s and the lack of a land bank in Hong Kong. See Godstadt (2018).

PRH flats is forecast to hover at a low average annual level of 14 900 units till 2023-2024, its adverse impacts will still be felt in the medium term.[15]

## 3. New package of one-off relief measures in the 2020-2021 Budget

3.1 In face of the severe setback induced by the spread of pandemic, the 2020-2021 Budget offers a new package of relief initiatives to support business and livelihood.[16] The package costs HK$122 billion (4.3% of GDP in 2019), the largest in the fiscal history of Hong Kong.[17] This notwithstanding, small and medium-sized enterprises in many sectors voice out that it is still far from adequate to address their loss amidst business shutdowns, while employees are under intensified threats of unemployment.

3.2 Analysed by nature, 28% of the one-off relief spending in 2020-2021 are tax refunds (i.e. returning part of tax revenue to tax and rates payers), while 9% are targeted for enterprises (**Figure 4**). For the rest of 63%, they are universal cash distribution and dedicated support to lower-income families, both are considered to have stronger income redistributive effect. By contrast, less than one-fifth of the one-off relief measures in the preceding five Budgets had such income redistributive function, as the majority (i.e. four-fifths) of them were tax refunds.[18]

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15 Reflecting the severe shortage of PRH flats, there are 151 900 general applicants for PRH flats. The average waiting time has tripled from 1.8 years in 2009 to 5.4 years by end-2019.

16 This new package includes also extension of four rounds of helping measures launched in late 2019. For HK$30 billion on earlier helping measures and establishment of HK$30 billion AEF, the spending was already incurred in the past fiscal year, and hence, is beyond the scope of this Brief.

17 For relief measures in the preceding five years, they ranged from a low of HK$34 billion (1.4% of GDP) in 2015-2016 to a high of HK$64 billion (2.2% of GDP) in 2018-2019.

18 Between 2014-2015 and 2018-2019, the Government had accumulated about HK$415 billion of fiscal surplus. FS usually returned some of the surplus to the public through one-off relief measures in the ensuing years, aggregating at some HK$207 billion (or 50% of the accumulated fiscal surplus). Most of them were returned to tax payers, with limited income redistributive effect.

**Figure 4 – Recipients of one-off relief in the 2020-2021 Budget**

| | 2020 | 2015-19 |
|---|---|---|
| **Annual average amount** | **$122 billion** | **$41 billion** |
| • Return of tax payments | **28%** | **78%** |
| • Supporting enterprises | **9%** | **3%** |
| • Cash payout | **58%** | **5%** |
| • Lower-income families(1) | **5%** | **14%** |
| **Income redistribution:** | **63%** | **19%** |

Note: (1) Including dedicated support to grassroots households and disadvantaged groups.
Data sources: Budget Speech, various years.

3.3 Globally, many governments have likewise introduced pandemic-induced emergency packages in February-March 2020 to rescue their economies, given that some 2.5 billion people has been reportedly under city lockdown by late March. Including only fiscal measures, the emergency package in the United Kingdom ("UK") is valued at £487 billion (HK$4.9 trillion), equivalent to 22% of its GDP in 2019 and amongst the largest in the world (**Figure 5**).[19] About two-thirds of this package is loan guarantees aiming to solve cash-flow problems faced by enterprises.[20] For the United States ("US"), its fiscal relief package valued at US$2.3 trillion (HK$17.9 trillion) is also substantial, amounting to 11% of its GDP. For Asia, the respective package as a ratio of GDP is the largest in Malaysia (18%), followed by Singapore (11%), Macao (8.5%) and South Korea (8%). Hong Kong (5.3%) took the fifth position in the region, including also AEF.[21]

3.4 Six places (i.e. US, UK, Spain, South Korea, Singapore and Japan) are selected for closer analysis of their fund usage. While 11% of the relief sum in these six places is for enhancement of medical facilities and anti-epidemic capability, 26% is for livelihood and 63% for business support (**Appendix**). Two measures are particularly noteworthy:

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19 As this Brief focuses on fiscal policy, monetary policy of central banks is not counted.

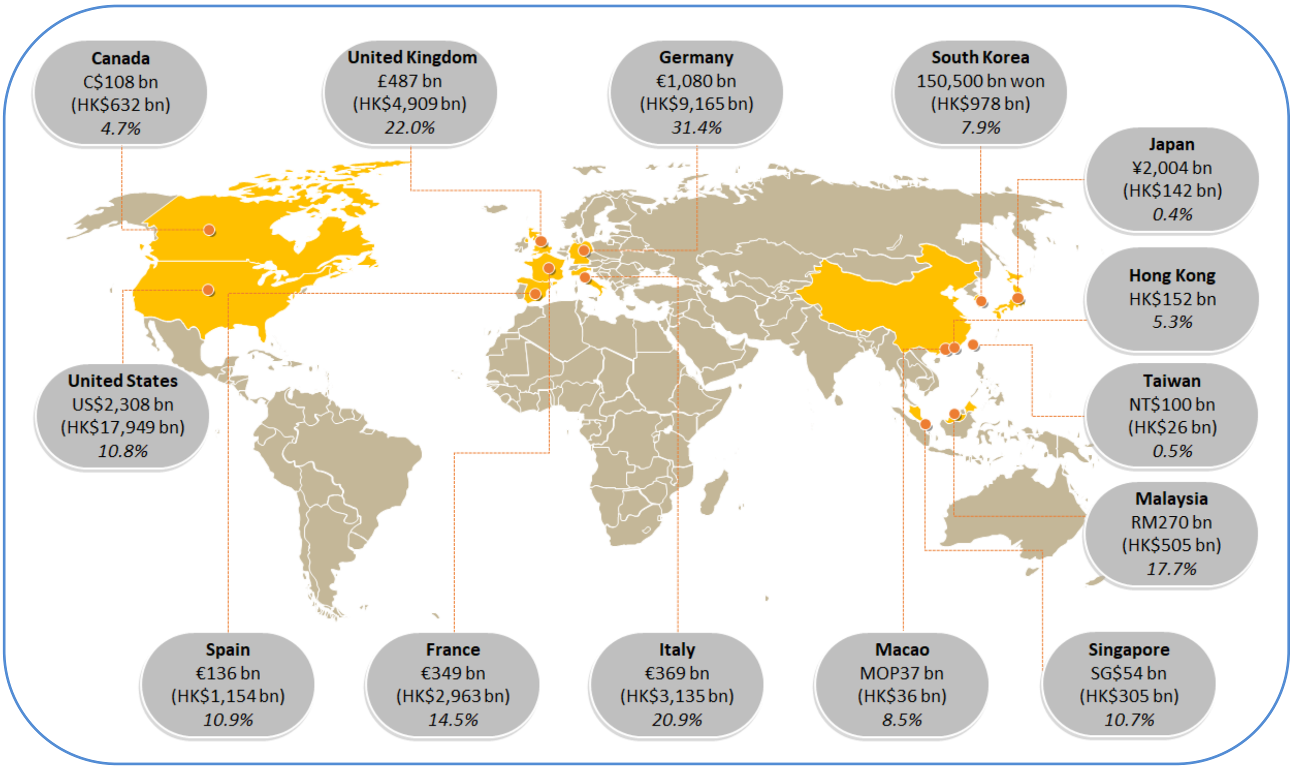
20 Most of the relief measures are traditional tax rebates and deferrals, cash payout and consumption vouchers, waiver of utility charges and rentals and business bailout.

21 For like-with-like comparison, the relief package in Hong Kong also includes HK$30 billion AEF.

(a) **Wage subsidy:** In face of looming risks of massive unemployment amidst city lockdown, the UK government offers subsidy up to 80% of the wages for three months to employers in all sectors, provided that they promise to retain their staff. Wage subsidy is subject to a monthly ceiling of £2,500 (HK$25,200), with total cost estimated at some £78 billion (HK$786 billion) or 16% of the emergency package. Similar wage support schemes are also introduced in Sweden and Denmark;[22] and

(b) **Government-guaranteed business loans:** As business enterprises face huge liquidity problem in the absence of cash inflow, many governments offer loan guarantees at zero or low-interest rate from the public coffers to help them weather the storm. In the UK, the scale of such government-sponsored loans is about 15% of GDP, and larger magnitude is seen in Italy and Germany.

**Figure 5 – Fiscal packages to combat COVID-19 in selected places (end-March 2020)**




Notes: (1) It includes only fiscal measures funded by public coffers, excluding monetary policy of central banks.
(2) Figures in parenthesis denote ratio to GDP in 2019.
(3) Figure for Hong Kong includes also the HK$30 billion AEF.

Data sources: Official websites of the respective governments.

[22] While the Swedish government subsidizes workers up to 90% of wage income for their reduced working hours, the Danish government covers 75% of salaries for firms promising not to lay-off staff.

## 4. Cash payout scheme

4.1 Turning to CPS, it pays HK$10,000 to each of the seven million Hong Kong permanent residents aged 18 or above ("PR18") for "boosting local consumption" and "relieving people's financial burden", with a total cost of HK$71 billion. While the community generally welcomes CPS, there are a number of concerns. ***First***, it is not clear whether the cash can reach the needy soon enough to soothe their plight. For the "Scheme $6,000" introduced in March 2011, it took the Government about 21 months to pay HK$6,000 to each of the six million PR18.[23] For the Caring and Sharing Scheme ("CSS") launched in March 2018, it took about 19 months to pay HK$4,000 to each of the three million eligible adults.[24] ***Secondly***, the administrative cost at HK$1 billion (1.4% of total cost) is apparently on the high side, with average unit cost exceeding HK$140 per successful application. ***Thirdly***, as cash payment is not "targeted" at low-income people, indiscriminate distribution may lead to squandering of public coffers. By contrast, the Singaporean government takes a differentiated approach when handing out cash to their citizens, with higher income-earners receiving less. This will be further discussed below. ***Fourthly***, some recipients especially those better-off tend to save part of the cash payout, mitigating the boosting effect of CPS on local consumption.[25]

4.2 Globally, cash payout also forms an integral part of the pandemic-induced emergency packages in some places. In the US scheme announced in late March, adults with annual income less than US$75,000 (HK$583,200) is entitled to full payment of US$1,200 (HK$9,330), but cash will be deducted by 5% for every dollar

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23 On 23 February 2011, the then FS proposed to inject HK$6,000 into the Mandatory Provident Fund ("MPF") account of low-income workers in the 2011-2012 Budget, after registering a large fiscal surplus of HK$75.1 billion in the preceding year. Yet the public asked for more imminent relief. In response, FS replaced the MPF injection by "Scheme $6,000" on 2 March. All PR18 needed to register by phases within 16 months from August 2011 to December 2012 for cash handout of HK$6,000, and those late registrants during April-December 2012 could earn extra bonus of HK$200. Registrants through banks normally could receive cash in 10 weeks after registration, and by post to collect cheque in 12 weeks. Around 6.12 million people had successfully registered, with total payment of HK$36.7 billion.

24 On 28 February 2018, FS delivered the 2018-2019 Budget and registered a record high fiscal surplus of HK$149 billion in the preceding year. In response to strong public pressure to return a larger amount of this surplus to the community, the Government launched CCS on 23 March, paying cash of HK$4,000 to each eligible adult. CCS was means-tested and recipients could not be property-owning and did not pay salaries tax. Total administrative cost was HK$311 million (or HK$104 per successful application). CCS was open for application during February-April 2019, receiving 3.47 million applications. In September 2019, 98% of the applications were processed, with an approval rate of 88%. Around HK$11 billion was distributed to 3 million eligible adults.

25 According to a study on the subject, the government of Taiwan granted consumption vouchers to their people in January 2009. Yet these vouchers crowded out about three quarters of original private consumption. See Kan (2010).

earned above this threshold.[26] As to US children aged 16 and below, their parents are also paid US$500 (HK$3,890). More specifically in Asia, Macao and Singapore are able to pay cash to their people more frequently, as elaborated below:

(a) **Recurrent scheme in Macao:** The Macao government has been paying cash to its residents for 13 consecutive years since 2008 under the Wealth Partaking Scheme ("WPS"), with a view to sharing "the fruits of economic development with general public". Irrespective of age, annual payment to permanent residents ("PR") has increased steadily from MOP5,000 (HK$4,850) in 2008 to MOP10,000 (HK$9,700) in 2020, while entitlement of non-PR is fixed at 60% of PR. After years of implementation, WPS recipients need not register in advance, with reportedly negligible administrative cost. About half of cash is distributed through bank transfer, and the other half through postal cheques. It took only four months after the first announcement to complete the whole cash distribution exercise in 2019, with a sum of MOP7.0 billion (HK$6.8 billion) distributed to 716 110 recipients.

    For the latest 2020-round of WPS, cash distribution will be advanced to April-June this year (from the past practice of July-September), in order to assist its residents to tide over hardship caused by COVID-19. The total cost is around MOP7.1 billion (HK$6.9 billion), while other implementation details stay the same; and

(b) **Ad hoc scheme in Singapore:** The Singaporean government pays cash to its people on an irregular basis under different scheme names, mostly after recording budget surplus (e.g. 2008, 2011 and 2018). For instance, the scheme in 2018 was called "SG Bonus", aiming to share "the fruits of Singapore's development" with its people. Only citizens aged 21 and above were entitled to the SG Bonus, excluding permanent residents and non-residents. SG Bonus was designed with progressivity, with maximum bonus of SG$300 (HK$1,680) paid to those with lower income.[27] For highest income earners or those owning more than one property, they were entitled to minimum bonus of SG$100 (HK$560) only. Citizens need to register in Paynow (i.e. a nationwide cashless funds transfer services) beforehand, taking

26 In other words, for those US adults earning more than US$99,000 (HK$767,300) per annum, they will not receive any cash.

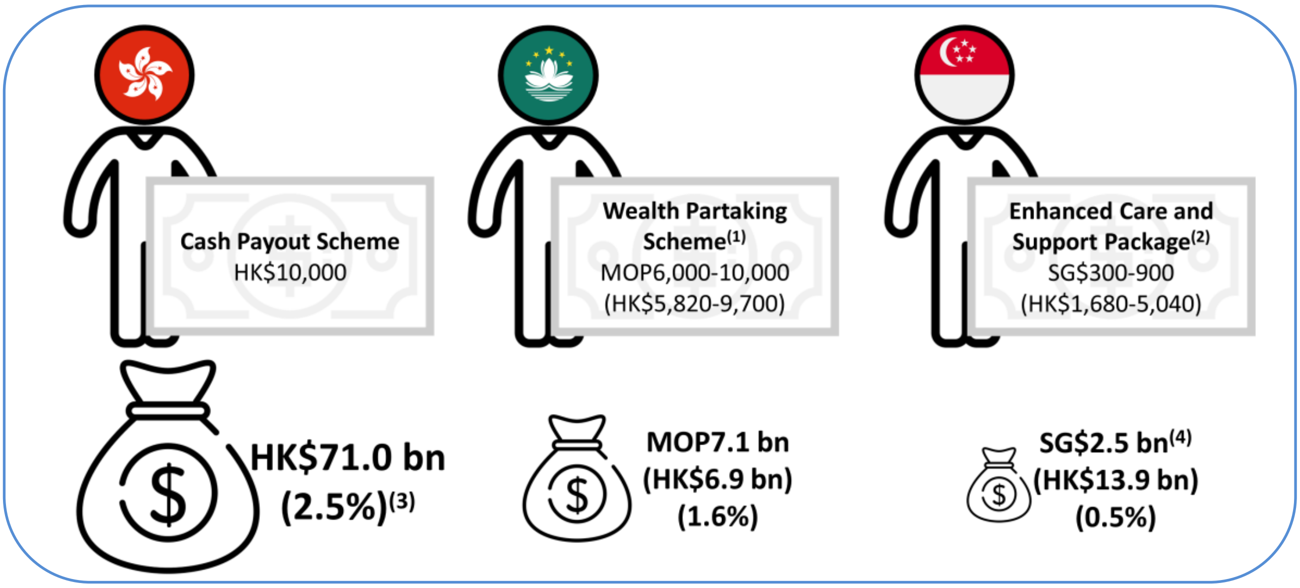
27 Maximum bonus was paid to those recipients with annual income less than SG$28,000 (HK$156,800), whereas the minimum bonus was paid to those earning more than SG$100,000 (HK$560,000) or those owning more than one property. For those with income lying between these two ends (representing 40th and 90th of income distribution in Singapore), they could receive bonus of SG$200 (HK$1,120). See Singaporean Government (2019).

just 10 months to distribute cash to all 2.8 million recipients in 2019, with a sum of SG$0.7 billion (HK$3.9 billion).

In the Budget 2020 released on 18 February 2020, cash payout of the same amount in three tiers is offered to all Singaporeans under the name of "Care and Support Package" to combat COVID-19. However, in view of deepening of the pandemic impact, the Singaporean government "enhanced" the package on 26 March, tripling the three-tier cash payment to SG$300-900 (HK$1,680-5,040). Moreover, parents are newly entitled to payout of SG$300 (HK$1,680) for each child aged 20 and below. It is estimated that the enhanced package will cost SG$2.5 billion (HK$13.9 billion) and the whole exercise is scheduled for completion by September 2020.

4.3 Some broad comparison on the latest cash payout scheme in Asia can be made here. In terms of the ***per capita cash payment***, it amounts to 53% of median monthly employment earnings in Hong Kong, compared with 35%-59% in Macao and 7%-22% in Singapore. In terms of the ratio of ***total cost to GDP***, it is about 2.5% in Hong Kong, higher than 1.6% in Macao and 0.5% in Singapore. As regards ***time required in cash distribution after announcement***, it takes just four months in Macao and 10 months in Singapore, far shorter than the past practice of about 19 months in Hong Kong. In terms of ***progressivity***, Singaporean scheme allows grassroots families to receive more cash than high income-earners (**Figure 6**).

**Figure 6 – Latest cash payout schemes in Hong Kong, Macao and Singapore in 2020**




Notes: (1) In Macao, non-permanent residents receives 60% of cash paid to the permanent residents.
(2) In Singapore, the three tiers of cash payments is inversely related to their annual income.
(3) Figures in parenthesis denote the ratio of the total cost of the scheme to GDP.
(4) Estimation based on the budgeted amount of SG$825 million before enhancement on 26 March.

Data sources: Official websites of various governments.

## 5. Fiscal sustainability in the longer term

5.1 After recording fiscal surplus for 15 years in a row, Hong Kong reverts to a fiscal deficit of HK$37.8 billion (i.e. 1.3% of GDP) in 2019-2020 (**Figure 7**). Concerns are raised in regards to the following developments:

(a) **More deficit years ahead:** While the size of fiscal deficit is expected to more than triple to HK$139.1 billion (4.8% of GDP) in 2020-2021, FS forecasts four more deficit years ahead;[28]

(b) **Public expenditure to exceed 24% of GDP:** The ratio between public expenditure and GDP averaged at only 19.5% over the past 10 years till 2018-2019. Yet it rose noticeably to 22.6% in 2019-2020 and is forecast to go up to a range of 24%-27% in the next three years;

(c) **Rapid growth in recurrent expenditure:** Recurrent expenditure has increased by 50% in five years, twice the pace of the 21% growth in GDP. FS reiterates that "such rapid growth is not sustainable";

(d) **Constitutional requirement:** There are concerns whether recent fiscal developments are in line with Article 107 of the Basic Law, under which the Government is obliged to (i) keep "the expenditure within the limits of revenues"; (ii) strive to "achieve a fiscal balance"; and (iii) keep "the budget commensurate with the growth rate of GDP"; and

(e) **Heavy burden of one-off relief measures:** In view of the heavy burden of the one-off relief package this year, FS forewarns that they may "have to be progressively reduced".

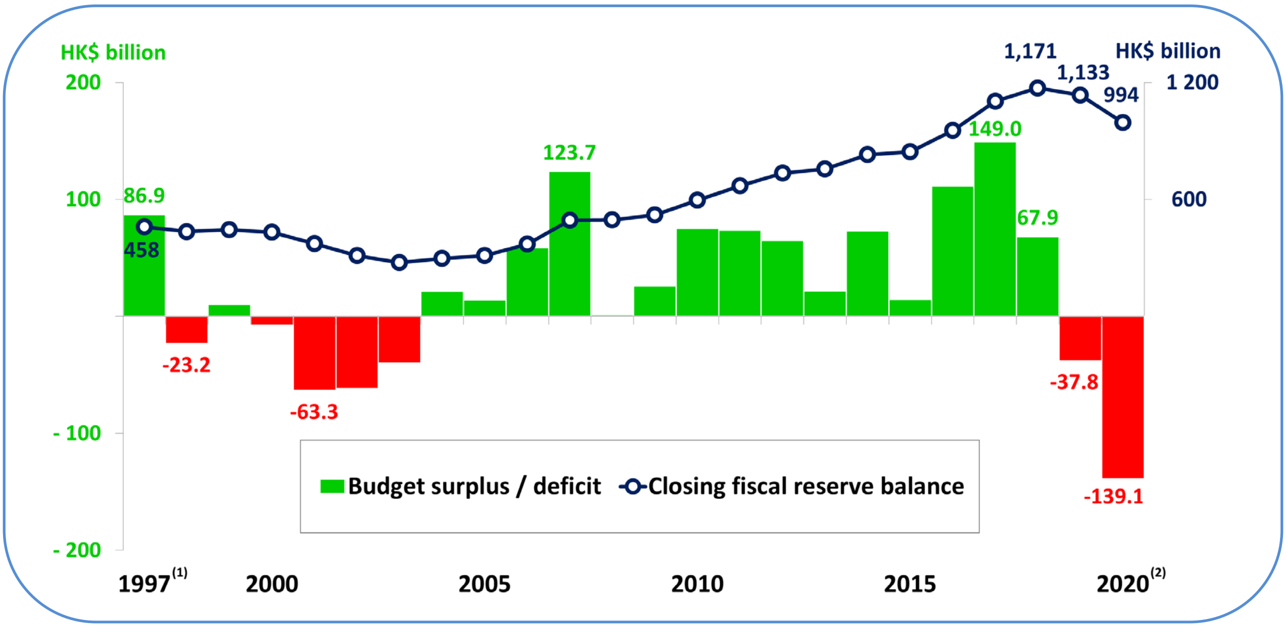
5.2 Nonetheless, there are views that the current deficit is largely cyclical and there is no need to be excessively anxious. ***First***, Hong Kong is globally renowned for its fiscal discipline, as it is one of the four places managed to record fiscal surplus throughout the past nine years during 2010-2018, amongst the 35 advanced places included in comparison.[29] ***Secondly***, benefited from sizeable fiscal surplus averaging at 3% of GDP per annum over the past decade, the stock of fiscal reserve

[28] The forecast budget deficit will be smaller in scale in the next four years, declining to HK$16.8 billion in 2021-2022 and HK$7.4 billion in 2024-2025, equivalent to 0.2%-0.5% of GDP.

[29] The other three advanced places with fiscal surplus throughout 2010-2018 are South Korea, Singapore and Norway. See International Monetary Fund (2019a).

ballooned to a record high of HK$1.13 trillion in March 2020 (40% of GDP). Even after five deficit years under the worst scenario as discussed above, the stock of fiscal reserves is still expected to stay at a very high level of HK$937 billion (26.5% of GDP) in March 2025. ***Thirdly***, Hong Kong has been saving hard for rainy days. Now the rain has come (as manifested in contraction in GDP for two consecutive quarters and unemployment rate surging to nine-year high of 3.7%) and more stormy weather is ahead. Arguably, it is the right time to make good use of past savings. ***Fourthly***, apart from the Basic Law, the current-term Government has reiterated that it has been taking a more "forward-looking" principle in public finance management since July 2017, such as "optimising the use of surplus to invest for Hong Kong and relieve our people's burdens".[30] ***Fifthly***, more rapid growth in public expenditure in recent years can be seen as a catch-up from a "low base" of service provision, especially after prolonged fiscal deficit in the early 2000s.[31] ***Sixthly***, the forecast of more deficits years in the medium term needs to be interpreted with more cautions, due to high degree of uncertainty in many macroeconomic and fiscal variables.[32]

**Figure 7 – Fiscal balance and fiscal reserves in Hong Kong, 1997-2020**




Notes: (1) For presentation convenience, 1997 stands for the financial year 1997-1998, and so on.
(2) Figure for 2020-2021 is an estimate (i.e. forecast).

Data sources: Census and Statistics Department and Budget Speech.

30 GovHK (2018).

31 Financial Services and the Treasury Bureau (2014).

32 Taking the 2009-2010 Budget as an example, the then FS forecast that fiscal balance would stay in red for five straight years till 2013-2014 due to the adverse impact of global financial crisis. Yet it turned out that surplus was recorded in all five fiscal years. See Budget Speech in 2009-2010.

5.3 That said, the risks of running into structural deficits in the longer term cannot be dismissed, in view of the profound and irreversible impact of ageing on public spending. As the population of elderly persons aged 65 and above is projected to increase progressively from 1.3 million in 2019 to 2.1 million in 2030 and further to 2.5 million in 2040 (with their respective proportion in local population rising from 17.5% to 26.5% and further 30.5%), public coffers are bound to be heavily stretched upon the continued upsurge in demand for welfare services and healthcare services. A dedicated study conducted by the Government a few year ago cautioned that "structural deficit could strike in 2029-30" and all fiscal reserves would deplete by 2041-2042.[33] While the timing and magnitude of this gloomy scenario is still subject to debate, few doubt growing pinch in balancing the budget in the longer term. There are calls on the Government to make early planning to resolve this dilemma.

5.4 On government revenue, it likewise faces the following challenges in the longer term:

(a) **Shrinking workforce:** Local tax base is expected to face emerging downward pressure after decades of ultra-low fertility rate and upon retirement of older workers. During 2019-2030, local labour force is projected to drop by 3.3%, resulting in a smaller pool of taxpayers;

(b) **Tax base embedded into the structure of income distribution:** Narrow tax base in Hong Kong is partly related to its income disparity. Taking the salaries tax as an example, the top 4.5% of the 3.83 million workforce paid as much as 79% of the total tax amount in 2017-2018, whereas half (51%) of the workforce did not earn enough to meet the tax threshold.[34] As the bottom half of the local workforce earned only 21% of overall salaries in 2019, it explains why most of them need not pay any salaries tax (**Figure 8**). The same phenomenon is also seen in profits tax.[35]

Some may view this as an illustration of narrow tax base, but others may interpret it as a result of growing income disparity in Hong Kong, as its Gini Coefficient at 0.539 is one of the highest in the world. This is echoed by IMF, highlighting the need to "ensure fiscal sustainability and greater equity";[36]

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[33] Financial Services and the Treasury Bureau (2014) and Legislative Council Secretariat (2019).

[34] GovHK (2019a).

[35] In 2017-2018, the top 0.6% corporations paid 90% of the overall profits tax, whereas 91% of registered corporations did not pay any profits tax at all. See GovHK (2019a).

[36] International Monetary Fund (2019b).

(c) **New tax sources:** FS highlights the need to "consider seeking new revenue sources". Actually, the Government has floated the idea of introducing new taxes from time to time, such as launching a public consultation on Goods and Services Tax ("GST") in 2006. Yet the proposal had been shelved due to strong opposition;[37]

(d) **Raising tax rates:** FS also suggests "raising tax rates", but the effect of which would depend on the type of tax subject to such increase. As discussed above, given that the bottom 50% of the workforce earns only one-fifth of overall salary income, putting them into the tax net does not help much in raising revenue; and

(e) **Competitiveness of the local economy:** There are emerging concerns over economic competitiveness of Hong Kong after prolonged social unrest last year. In a global ranking on economic freedom released by the Heritage Foundation ("HF") in February 2020, Hong Kong slipped to the second position, having been at the top for 25 years in a row. HF cites "the ongoing political and social turmoil" as the contributory factor, eroding Hong Kong's "reputation as one of the best locations…to do business" and "dampening investment inflows".[38] Most recently in late March 2020, the ranking of Hong Kong as a global financial centre slipped from the third to the sixth position, overtaken by Tokyo, Shanghai and Singapore.[39] Another global research institute also cautions that local protests could "cause an exodus" of financial institutions from Hong Kong, making it one of the top five risks faced by the global economy in 2020.[40]

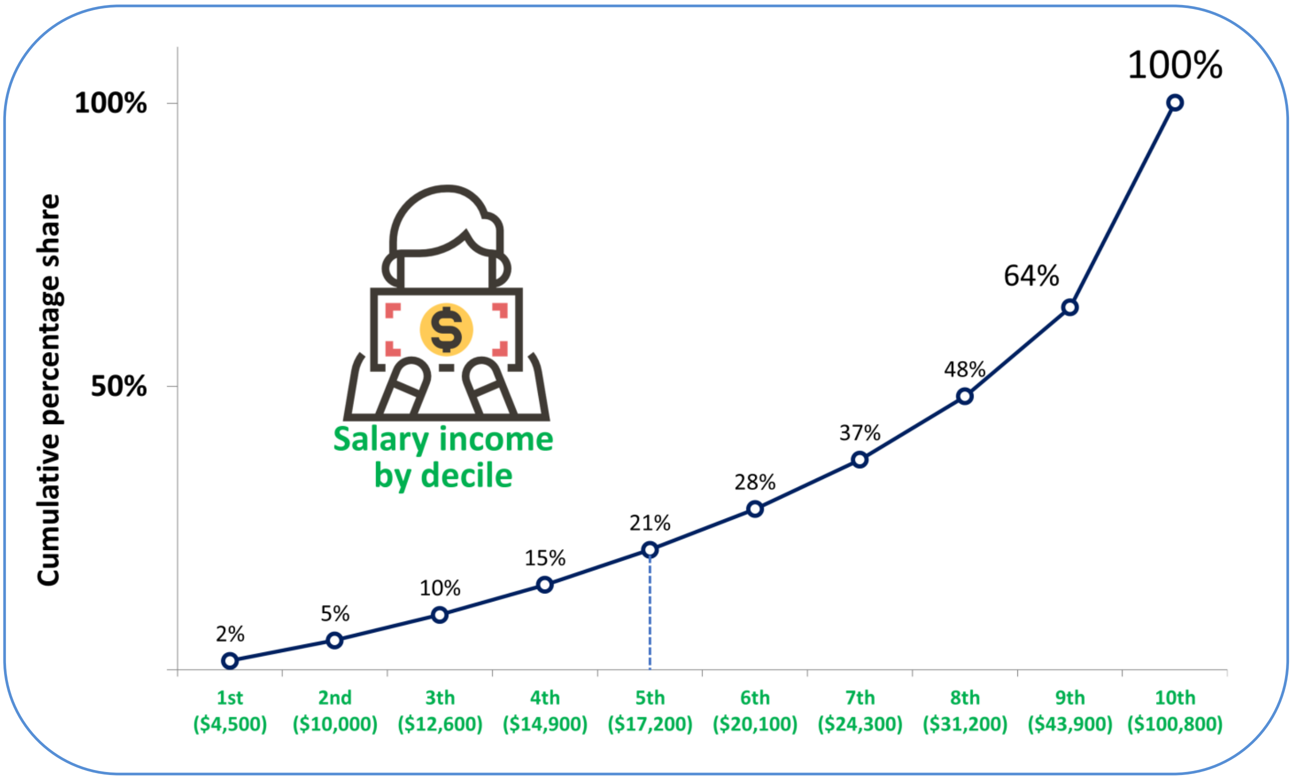
[37] The proposed GST could not go ahead because of the regressive nature of GST, adverse effect on consumption and tourist spending and negative implications on the competitiveness of the local economy. See Financial Services and the Treasury Bureau (2007).

[38] Heritage Foundation (2020).

[39] Z/Yen Group (2020).

[40] The Economic Intelligence Unit (2020).

**Figure 8 – Distribution of monthly employment earnings by decile in 2019**




Note: (1) On the horizontal axis, the money value represents the average earnings level of the respective decile.
Data source: Census and Statistics Department.

## 6. Observations

6.1 The following observations can be made from the above analysis:

(a) **Enlarging fiscal deficit due to relief measures:** Hong Kong reverts to a fiscal deficit of HK$37.8 billion in 2019-2020, mostly attributable to four packages of helping measures aggregated at HK$30 billion launched in late 2019 and establishment of the HK$30 billion AEF in February 2020. The budget deficit is expected to more than triple to HK$139.1 billion in 2020-2021, mostly due to a new package of counter-cyclical and relief measures of HK$122 billion to combat COVID-19;

(b) **Halving of the share of housing in public expenditure to only 5% in 22 years:** PRH plays a key role in social mobility, helping reduce local poverty rate by 3.6 percentage points, more than 2.3 percentage points under CSSA. In spite of this significant income redistributive effect, the share of housing in public expenditure plummeted from

10.2% in 1997-1998 to only 5.0% in 2019-2020, along with a plunge in the supply of PRH flats. As this is expected to continue in the next few years, this could have continued impact on income distribution in the medium term;

(c) **New package of one-off relief measures having stronger income redistribution effect than before:** The new package is valued at HK$122 billion, the largest in the fiscal history of Hong Kong. Within this total, 28% are tax refunds and 9% business support. For the rest of 63%, they are universal cash distribution and support to lower-income families, both have stronger income redistributive effect than the previous five budgets;

(d) **Massive pandemic-induced fiscal relief measures across the globe:** Pandemic-induced fiscal relief packages as a ratio of GDP hit double digits in many advanced places, including the UK (22%), the US (11%), and Singapore (11%). Majority of these packages are loan guarantees assisting enterprises to survive amidst business shutdown;

(e) **Cash payout of HK$10,000 triggering logistics concerns:** The public is concerned whether the cash can reach them soon enough to soothe their plight, as the past practice of taking about 19 months to distribute the cash to recipients under "Scheme $6,000" in 2011 and under CSS in 2018 is longer than that of 4-10 months in Macao and Singapore. Also, the administrative cost of over HK$140 per successful application under CPS appears to be on the high side;

(f) **Continued deficits in the next couple of years:** As fiscal balance is expected to stay in red for the next five years, coupled with continued uptrend in public expenditure, there are concerns whether these fiscal developments are in line with Article 107 of the Basic Law. However, there is an alternative view that Hong Kong had been saving hard for years for rainy days, accumulating fiscal surplus over HK$1.13 trillion by March 2020. Arguably, rainy days have come and it is the right time to make good use of past savings;

(g) **Fiscal sustainability in the longer-term:** Risks of running into structural deficits in the longer term cannot be dismissed, given the profound and irreversible impact of ageing. As the elderly population aged 65 and above is projected to double from 1.3 million to 2.5 million during 2019-2040, public coffers are bound to be pinched by the continued upsurge in demand for welfare and healthcare services. Moreover, shrinkage in local labour force will result in a smaller pool of taxpayers;

(h) **Local tax base intertwined with the structure of income distribution:** Narrow tax base in Hong Kong is partly related to its income disparity. For instance, the top 4.5% income-earners paid as much as 79% of the total amount of salaries tax, whereas 51% of the workforce did not pay any. Some may view this as a vivid example of narrow tax base, but others may see it as a result of uneven income distribution; and

(i) **Concerns over economic competitiveness in the longer term:** More overseas institutions cast doubt on competitiveness of local economy in recent months. While Hong Kong lost its 25-year long crown in the ranking as "freest economy in the world" after prolonged unrest last year, its ranking as a global financial centre has also slipped from the third to the sixth. These doubts, if not properly addressed, may have implications for local tax base in the longer term.

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**Appendix**

## Emergency fiscal relief packages due to COVID-19 in selected places
## (As at end-March 2020)

| | | Hong Kong | UK | US | Spain | Singapore | South Korea | Japan |
|---|---|---|---|---|---|---|---|---|
| 1. | **Date of announcement** | **Feb 2020** | Mar 2020 | Mar 2020 | Mar 2020 | Feb-Mar 2020 | Feb-Mar 2020 | Mar 2020 |
| 2. | **Number of rounds** | **2** | 4 | 3 | 3 | 2 | 4 | 2 |
| 3. | **Package sum in local currency** | **HK$152 bn**[(1)] | £487 bn | US$2,308 bn | €136 bn | SG$54 bn | 151 tn won | ¥2,004 bn |
| 4. | **Package sum in HK$ (billion)** | **152** | 4,909 | 17,949 | 1,154 | 305 | 978 | 142 |
| 5. | **As a ratio to GDP** | **5.3%** | 22.0% | 10.8% | 10.9% | 10.7% | 7.9% | 0.4% |
| **Breakdowns of the emergency packages** | | | | | | | | |
| 6. | **(a) Anti-epidemic capacity** | **9%** | 1% | 15% | 3% | 2% | 4% | 4% |
| 7. | **(b) Business support** | **18%** | 82%[(4)] | 54% | 96% | 85% | 79% | 53% |
| 8. | **(c) Livelihood support** | **73%** | 17% | 31% | 1% | 14% | 17% | 43% |
| **Cash payout scheme** | | | | | | | | |
| 9. | **Per capita cash payment to adults** | **HK$10,000** | - | US$0-1,200 (HK$0-9,330)[(5)] | - | SG$300-900 (HK$1,680-5,040) | - | - |
| 10. | **Ratio to median employment income** | **53%** | - | - | - | 7-22% | - | - |
| 11. | **Basic eligibility** | **PR18**[(2)] | - | Citizens | - | Citizens[(6)] | - | - |
| 12. | **Number of beneficiary (million)** | **7** | - | 250 | - | 2.8 | - | - |
| 13. | **Processing time after announcement** | **-**[(3)] | - | - | - | 6-7 months | - | - |
| 14. | **Total cost** | **HK$71.0 bn** | - | US$300 bn (HK$2.3 trillion) | - | SG$2.5 bn (HK$14 bn) | - | - |
| 15. | **As a ratio to GDP** | **2.5%** | - | 1.4% | - | 0.5% | - | - |

Notes: (1) In Hong Kong, the package also includes HK$30 billion AEF.
(2) Permanent residents aged 18 or above.
(3) Time required to distribute cash under CPS is not announced yet, but it takes about 19 months in the past.
(4) In the UK, wage subsidy scheme valued at £78 billion (HK$786 billion) is included in the business support.
(5) In the US, the maximum amount of cash of US$1,200 is paid to adults with annual income less than US$75,000 (HK$583,200), but cash will be deducted by 5% for every dollar of income earned above this threshold. In other words, adults with annual income above US$99,000 (HK$767,300) will not receive any cash.
(6) In Singapore, three tiers of cash paid to citizens aged 21 or above is inversely related to income.

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