Research Brief
Issue No. 1
2022

Research Office
Legislative Council Secretariat

The 2022-2023 Budget

April 2022

As the fifth wave of COVID-19 epidemic led to major disruption to the economy, combating the epidemic and providing relief remain the main focuses of the 2022-2023 Budget, with HK$170 billion committed to countercyclical measures and HK$54 billion allocated to bolstering anti-epidemic work.

To stimulate consumption and alleviate people's hardship, the latest Budget proposed a new round of electronic consumption voucher scheme with the amount per eligible resident doubling to HK$10,000. An unprecedented rental enforcement moratorium was also unveiled, with an aim to ease short-term cashflow burden of enterprises in specific sectors. Such alleviation measure is seen in a number of overseas jurisdictions as well, some of which like Australia and Singapore also provide support to help tenants and landlords come up with a repayment plan and resolve disputes.

Ballooning expenditure in recent years, in part due to epidemic-related spending, have led to concerns over soundness of public finance. Reforms on the revenue front introduced in the Budget, namely, "affordable users pay" principle to the rating system and domestic minimum top-up tax on large multinational enterprises in line with international tax standards, are expected to increase government revenue starting from 2024-2025 fiscal year.

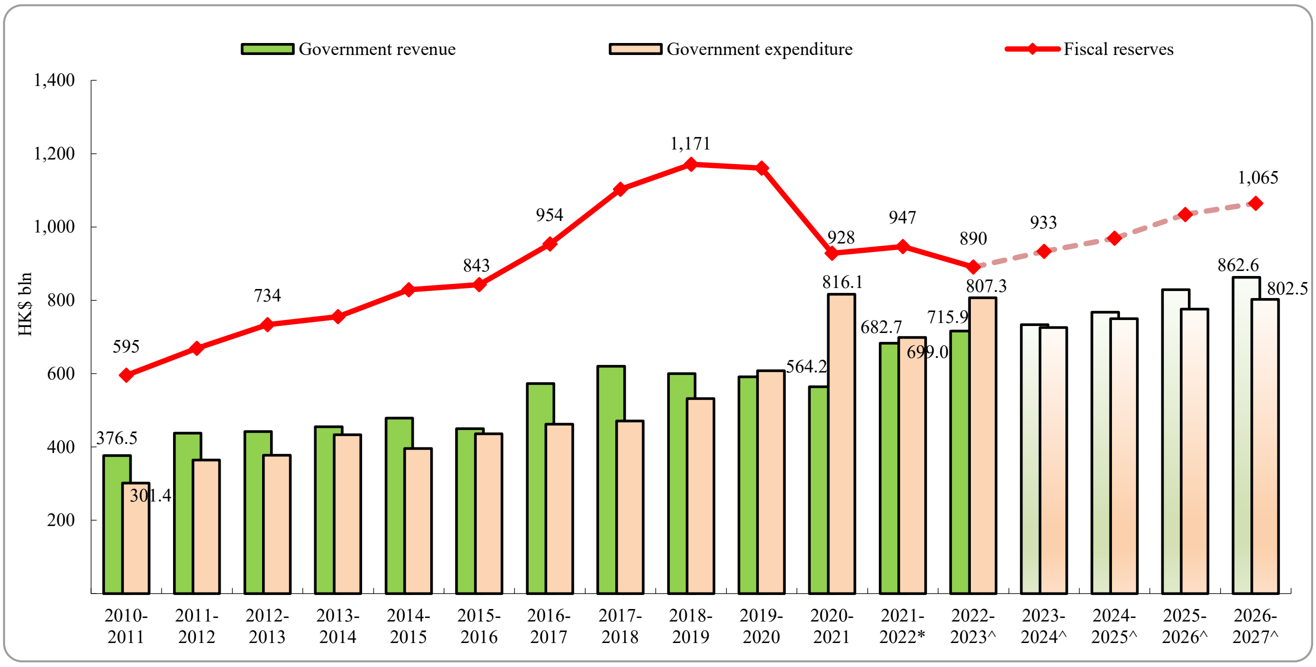
Meanwhile, given investment income is emerging as another key revenue source for the public coffers, related policies and information disclosure practice may receive increasing attention from observers.

The Legislative Council will resume the Second Reading debate on the Appropriation Bill 2022 at its meeting of 27 April 2022.

1. Introduction

1.1 The Financial Secretary delivered the fifth Budget of the current-term Government on 23 February 2022. According to the revised estimates, government revenue in 2021-2022 will exceed government expenditure by a small margin, achieving a mild surplus of HK$18.9 billion. Fiscal reserves are expected to rise slightly to HK$946.7 billion (**Figure 1**), which is about 18% higher than the original estimate. Nevertheless, the Financial Secretary has highlighted that due mainly to the anti-epidemic expenditure and one-off relief measures, the consolidated account would record a deficit this fiscal year, estimated at HK$56.3 billion which would be the second largest deficit since 2003-2004 fiscal year, and only behind the substantial shortfall of HK$232.5 billion in 2020-2021.

Figure 1 – Trend of government revenue, expenditure and fiscal reserves(1)



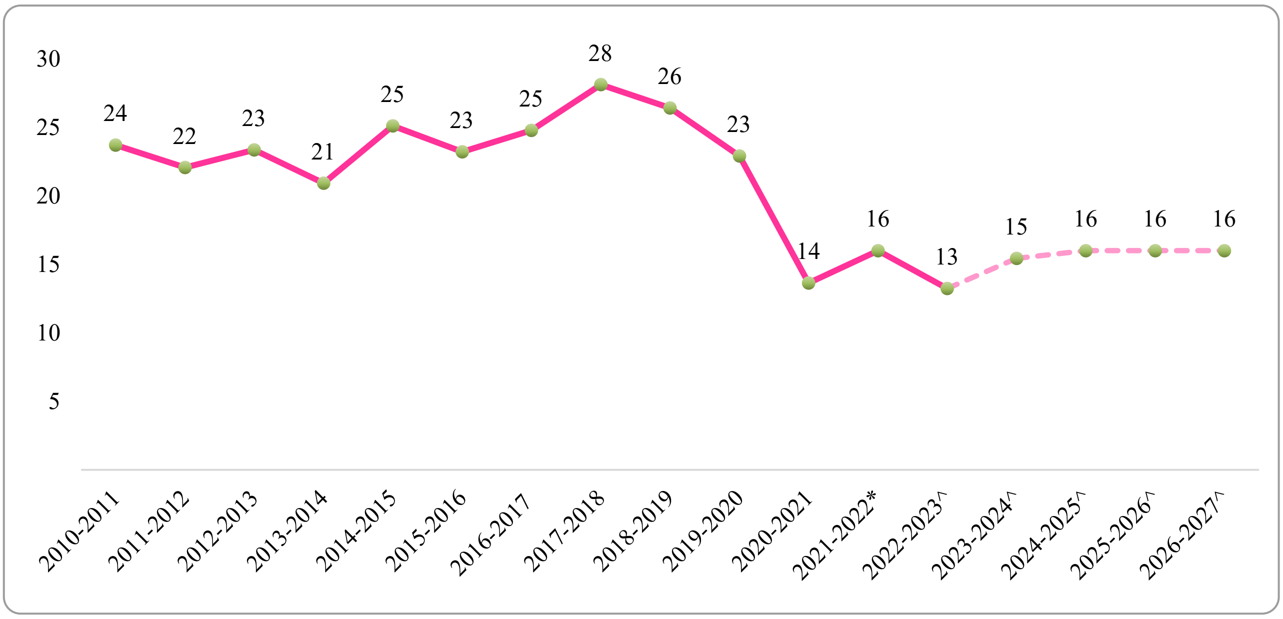
Notes: (*) Revised estimate.
(^) Estimate/forecast.
(1) Government revenue and expenditure do not include issuance and principal repayment of green bonds issued under the Government Green Bond ("GGB") Programme. Following the offering of the inaugural tranche of green bond in 2019, issuance under the GGB Programme amounted to HK$7.8 billion, HK$19.3 billion and HK$35.1 billion over 2019-2020 to 2021-2022 fiscal years respectively, and planned annual issuance during 2023-2024 to 2025-2026 is also set at HK$35.1 billion. Meanwhile, annual principal repayment of green bonds over 2024-2025 to 2026-2027 would range from HK$7.1 billion to HK$29.7 billion.

Data sources: 2022-2023 Budget speech and The Treasury (various years).

1.2 In its four-year medium range forecast up to 2026-2027, the Financial Secretary anticipates that there will be an annual surplus of between HK$30 billion and HK$65 billion, under the assumption of a 3% real economic growth per annum and similar rate of growth for tax revenue. The forecast however has included the expected proceeds from annual issuance of green bonds at HK$35.1 billion between 2023-2024 and 2025-2026, without which the budget would only be just balanced in 2023-2024 and 2024-2025. Moreover, the forecast figures have not taken into account any potential tax rebate or relief measures that may be implemented in the coming years.[1] Although the value of fiscal reserves is forecast to rise steadily in the medium term, when expressed as a ratio to government expenditure, fiscal reserves will hover in the range of 13 to 16 months of expenditure which remained noticeably lower than over 20 months in the 2010s (**Figure 2**), indicating a less ample strength of the public coffers.

1 For the 2022-2023 fiscal year, for example, salaries tax reduction and rates concession for domestic properties are expected to result in a HK$24.8 billion reduction in government revenue.

Figure 2 – Fiscal reserves as number of months of government expenditure



Notes: (*) Revised estimate.
(^) Estimate/forecast.
Data sources: 2022-2023 Budget Speech and The Treasury (various years).

2. Trend of key revenue components and new revenue initiatives

2.1 Based on revised estimates, government revenue reached HK$682.7 billion in 2021-2022, about 21% higher than that in 2020-2021. The increase is mainly attributable to the sharp rebound in revenue from **land premium** and decent growth in **stamp duties**. In particular, the latter remained one of the significant income sources and is expected to account for 15% of total revenue or higher. Benefited from the thriving stock market trading in recent years, 62% of stamp duty revenue in 2020-2021 came from securities trading and just 33% from property transactions.[2]

2.2 Meanwhile, **investment income** has risen rapidly to become the fourth largest revenue source, with its share in total revenue amounting to **12%** in 2021-2022 and projected to rise further to **15%** in 2022-2023 (**Figure 3**). The enlarged share is largely due to the Government's arrangement to bring back as investment income the sum in the Housing Reserve[3] and the unrecognized returns on

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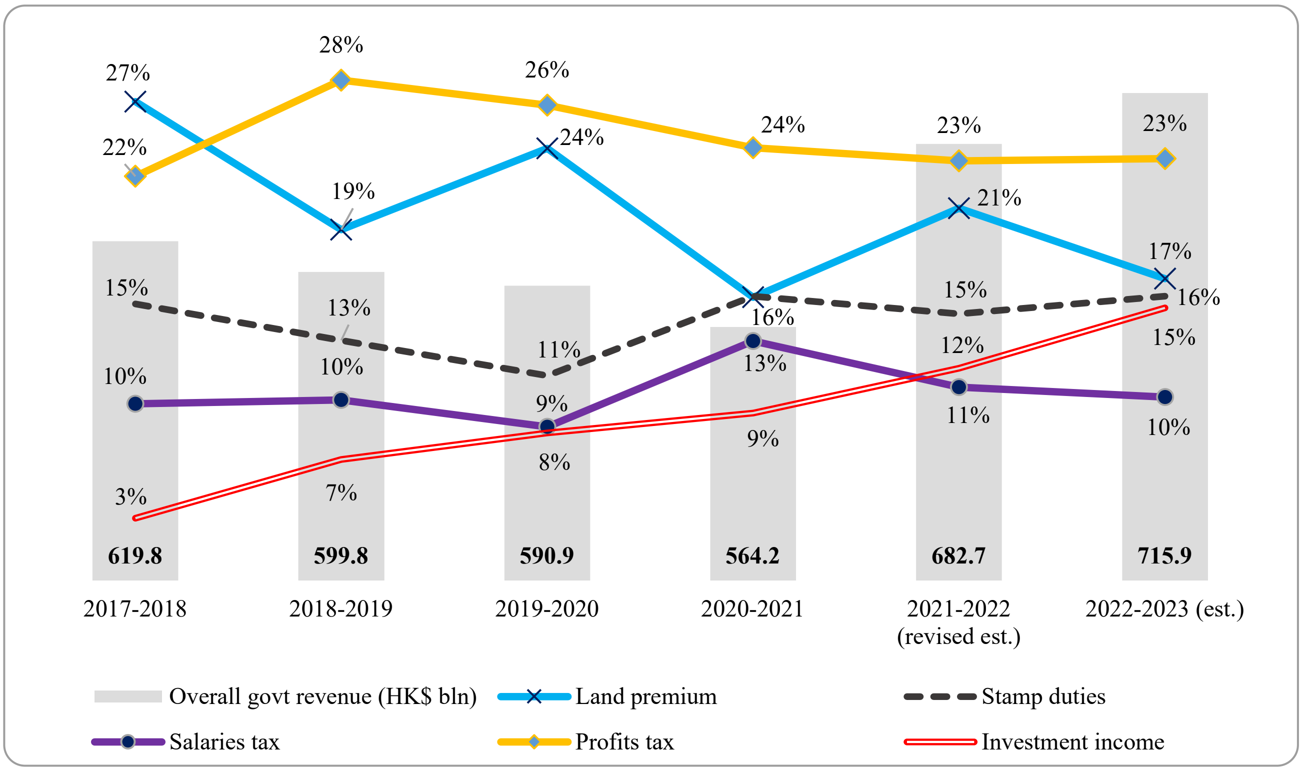
2 This represents a significant reversal from the respective shares of 36% from security trading and 60% from property transactions as recently as 2017-2018. See Inland Revenue Department (2018).

3 The Housing Reserve, valued at HK$82.4 billion as at end-2018, was set up in 2014 through setting aside the investment return on fiscal reserves to fund public housing and related infrastructure projects. Since 2019-2020, the Government has been bringing back the accumulated balance in the Housing Reserve to the fiscal reserves over four financial years. After the HK$21.2 billion and HK$22.0 billion brought back as investment income in 2019-2020 and 2020-2021, the balance of Housing Reserve at end-March 2021 was HK$44.6 billion, of which HK$23.1 billion was further brought back in 2021-2022.

the Future Fund. The combined amount brought back as investment income via the Land Fund's account is estimated at HK$37.7 billion in 2021-2022 and HK$62.4 billion in 2022-2023, accounting for **over 5%** and **8%** of total government revenue in the respective years.

2.3 The growing significance of land premium, stamp duties and investment income suggests a possible trend towards a **loosening of the positive correlation** between government revenue and performance in the real economy (measured in GDP growth). When compared to profits and salaries taxes, these revenue sources depend on a wider range of factors such as asset market sentiment, investment performance and, to certain extent, policy decisions (e.g. land sale programme), all of which may or may not be entirely synchronized with the underlying economic and business cycles.

Figure 3 – Percentage share of major tax revenue components



Data sources: 2022-2023 Budget Speech and The Treasury (various years).

2.4 **Profits tax**, on the other hand, has been consistently shrinking in relative importance since 2018-2019 despite a robust recovery in absolute amount received in 2021-2022 after the economic setback in 2020-2021. The two-tier tax regime introduced in March 2018 might have given rise to its declining share, among other factors.[4] In 2022-2023, profits tax is expected to further bounce up, with its share in total government revenue remaining stable at 23%.

2.5 Meanwhile, revenue received from **salaries tax** was surprisingly resilient notwithstanding the weakened economy, thereby consistently accounting for about 10% of total government revenue. According to the Financial Secretary, the pandemic has affected the **grassroots level** the most, and low to middle income earners generally paid less tax. Yet, high-income taxpayers earned more and thus paid more tax, thus smoothening the revenue collection.[5]

2.6 Hong Kong's **narrow-based tax structure** remains a long-standing concern in many sectors of society. The Government has repeatedly reiterated its commitment to tackle the issue and has attempted to explore new types of tax over the years. There is no mention of any plan to re-visit the matter in the latest Budget, possibly considering economic uncertainty arising from the pandemic. However, with due consideration to fiscal sustainability, two **initiatives** were highlighted in the latest Budget with the effect of increasing revenue (albeit generated from existing taxpayers rather than a widening of tax base).

2.7 First, the Financial Secretary unveiled his concrete plan to introduce a progressive element to the **rating system** for domestic properties beginning in 2024-2025, to reflect the "affordable users pay" principle. For domestic properties with rateable value over HK$550,000 (broadly translating into a monthly rent of about HK$46,000), the rates to be charged will be raised progressively to 8%-12% (versus 5% for the first HK$550,000 of rateable value).[6] The impact appears to be mild, affecting just around **42 000** or **2%** of domestic properties, which are likely to be larger-sized luxury flats, and generating an additional revenue of **HK$760 million annually**, equivalent to an increase of 3%-4% in revenue arising from general rates.[7]

2.8 Further on rates collection and "affordable users pay" principle, changes will also be made to the mechanism to administrate **one-off rates concession** to domestic properties, which has been in place as a financial relief measure for residents for many

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[4] According to the Inland Revenue Department, the amount of profits tax assessed in respect of corporations has dropped from HK$167.2 billion in 2018-2019 to HK$153.2 billion in 2019-2020 and HK$132.5 billion in 2020-2021. The number of demand notes issued to corporations chargeable to profits tax in the respective three years was 133 912, 134 444 and 122 577. See Inland Revenue Department (2021).

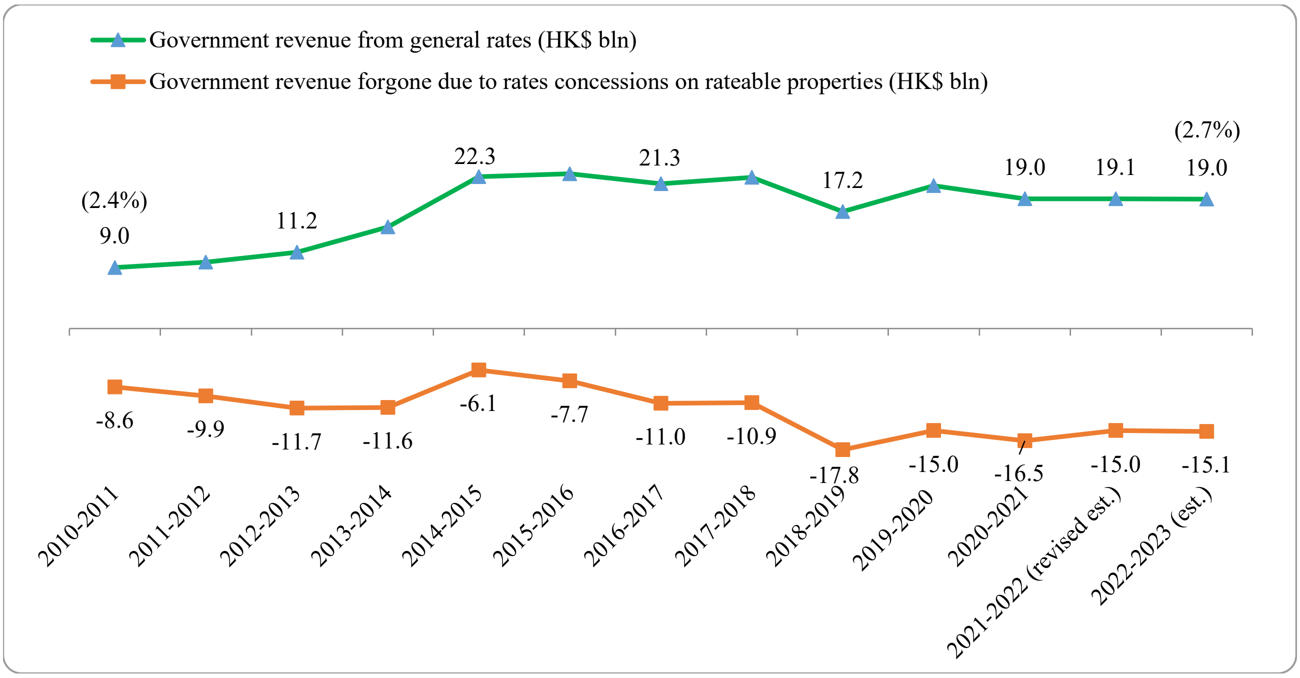
[5] See GovHK (2022d). The increase in salaries tax collection in 2020-2021 specifically was also partly due to the pandemic relief arrangement that deferred the payment deadlines and recovery actions from the preceding fiscal year. See Inland Revenue Department (2021).

[6] It is proposed that rates be charged at 5% of the rateable value on the first HK$550,000 and at 8% of the rateable value on the next HK$250,000, and then at 12% on rateable value exceeding HK$800,000. In other words, for properties with rateable value of HK$550,000 or below, rates payable will be unaffected and still be charged at the current flat rate of 5%.

[7] See 2022-2023 Budget Speech and GovHK (2022d).

years that resulted in government revenue forgone of between **HK$6 billion and HK$18 billion** per year during 2010-2011 to 2021-2022 (**Figure 4**).[8] Under the refined arrangement, starting from 2023-2024, owners with multiple domestic properties will only be allowed to enjoy the rates concession for one domestic property under their names. While the arrangement will be relevant only when rates concession is provided, the positive impact on the Government's fiscal position is apparently more significant than the progressive rating system: taking the rates concession in 2022-2023 as a reference, it would translate into savings of around **HK$3.1 billion**.

Figure 4 – Revenue from general rates and rates concession[(1)]



Note: (1) Figures in bracket represent general rates revenue as a percentage of total government revenue. However, there is no breakdown between the portion from domestic properties and non-domestic properties.
Data sources: Budget Speech (various years).

2.9 In addition, to fulfil Hong Kong's pledge to comply with new international tax standards on base erosion and profit shifting (commonly known as "BEPS 2.0") spearheaded by the Organisation for Economic Co-operation and Development and G20, the Financial Secretary announced in his latest Budget certain tax reforms concerning large multinational enterprises ("MNEs"). Most notably, starting from the year of assessment 2024-2025, the Government plans to introduce a **domestic minimum top-up tax** on MNEs with global turnover of at least EUR750 million (HK$6.46 billion) in order to ensure their effective tax rates reach the global minimum level of 15% as required by BEPS 2.0. According to the Financial

[8] Generally, the concession has a ceiling of HK$1,000 to HK$2,500 per quarter per tenement.

Secretary, the new tax may bring in an extra HK$15 billion of profits tax per year, although the actual boost to public finances will depend on how the affected MNEs will adjust their tax planning strategy as the BEPS 2.0 rules come into effect internationally in 2023.

2.10 On the other hand, the latest Budget also include a new deduction for **domestic rental expenses** under salaries tax and tax under personal assessment, starting from the year of assessment 2022-2023 with an annual ceiling of HK$100,000. The Government expects that renters, as a group, will receive HK$3.3 billion tax alleviation. Given deductions of **home loan interest** (also capped at HK$100,000 a year) have been put in place for over two decades, some commentators welcome the new deduction as a measure to put households with different housing tenures on a more equal footing in terms of tax burden alleviation.

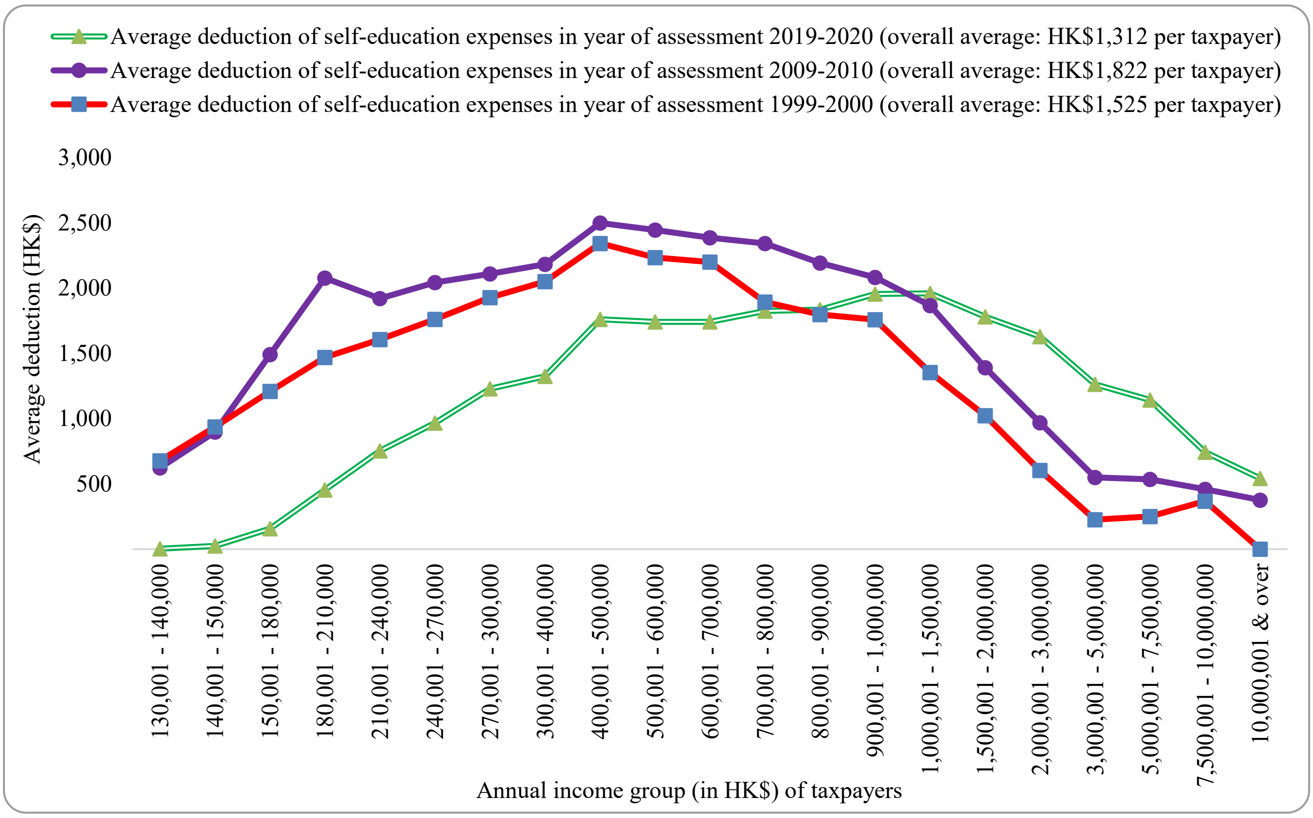
2.11 In the decade up to the year of assessment 2019-2020, **deductions** claimed by taxpayers of salaries tax increased substantially across most categories. Total deductions on **home loan interest** and **contributions to recognized retirement schemes** more than doubled over the period, increasing by 131% and 103% to HK$10.3 billion and HK$17.3 billion respectively in the year of assessment 2019-2020. At the same time, **donation to charities** and **elderly residential care expenses** claimed also saw considerable growth of 51% and 93% to HK$7.5 billion and HK$507 million respectively. From April 2019 onwards, taxpayers are allowed to claim deductions on their **premiums paid for Qualifying Deferred Annuity Policy** ("QDAP") and **tax deductible MPF voluntary contributions** ("TVC") up to a combined maximum of HK$60,000, as well as up to HK$8,000 deductions per insured person on **Voluntary Health Insurance Scheme** ("VHIS") **premiums**. In the year of assessment 2019-2020, deductions in relation to QDAP, TVC and VHIS totalled HK$5.7 billion, HK$2.7 billion and HK$882 million respectively.

2.12 On the contrary, deductions on **self-education expenses** have declined 4% over the ten-year period to HK$2.5 billion in the year of assessment 2019-2020. The average deductions per taxpayer dropped noticeably from HK$1,822 in the year of assessment 2009-2010 to HK$1,312 in 2019-2020, even when the Government has raised the deduction ceiling several times to the current level of HK$100,000 per year with the goal of encouraging life-long learning.[9] Looking closer at the deductions by income groups, the fall in average self-education expenses is particularly significant among the lower-income taxpayers (**Figure 5**). The trend may be hinting that taxpayers with lower incomes perceive less importance on or have difficulty in participating in continuing education, or they have a low awareness

[9] The deduction ceiling was HK$30,000 in early 2000s.

on such deduction arrangement.[10] If it is the former case, it might have implications on Hong Kong's human capital competitiveness in the long run, and measures may be required to address the relevant issue.

Figure 5 – Average deduction of self-education expenses under salaries tax by income groups



Data source: Inland Revenue Department (various years).

3. Expenditure trend in major policy areas and expenditure initiatives amidst the pandemic

3.1 On government expenditure, it is estimated that the total amount in 2021-2022 fiscal year will reach HK$699.0 billion, and increase by 15.5% to HK$807.3 billion in 2022-2023. It is noticeable that expenditure on **education**, often the top policy area in terms of government expenditure allocated in the past, is estimated to shrink for the second consecutive year in 2021-2022. Although

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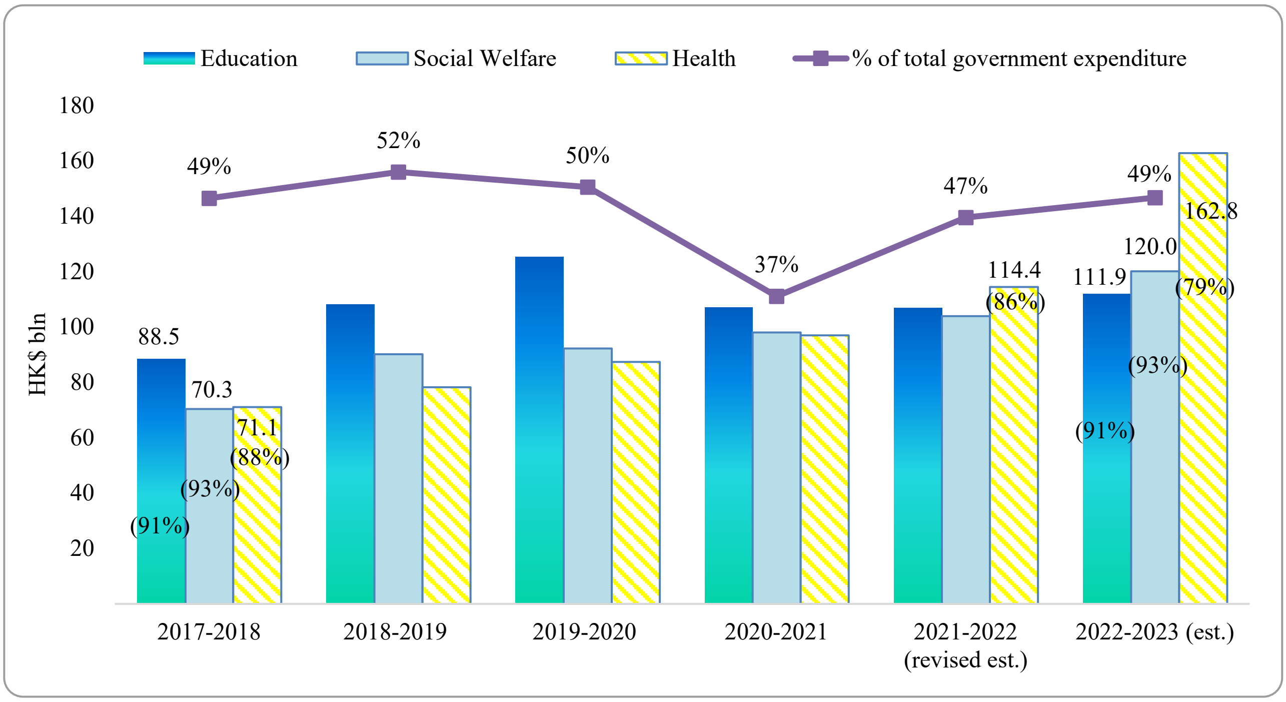
[10] It is not clear whether some taxpayers have chosen to support their education financially with the Continuing Education Fund, which provides Hong Kong residents aged 18-70 a lifelong subsidy of HK$20,000 on eligible programmes. Applicants are required to co-pay course fees, at 20% for the first HK$10,000 and 40% for the second HK$10,000. However, in 2019-2020, there were just 20 711 applications received. See Education Bureau (2021).

education spending is estimated to rebound in 2022-2023, much larger budget expansion in other major policy areas mean that education is expected to descend to the third place in terms of share in government expenditure in 2022-2023, after **health** and **social welfare**. The three policy areas combined are expected to account for 49% of total government expenditure (**Figure 6**). Reflecting efforts to combat the fifth wave of the COVID-19 epidemic, funding allocated to the policy area of health will rise most markedly to HK$162.8 billion in 2022-2023, 42% more than the revised estimate in 2021-2022.

Figure 6 – Expenditure by selected policy areas in 2017-2018 to 2022-2023



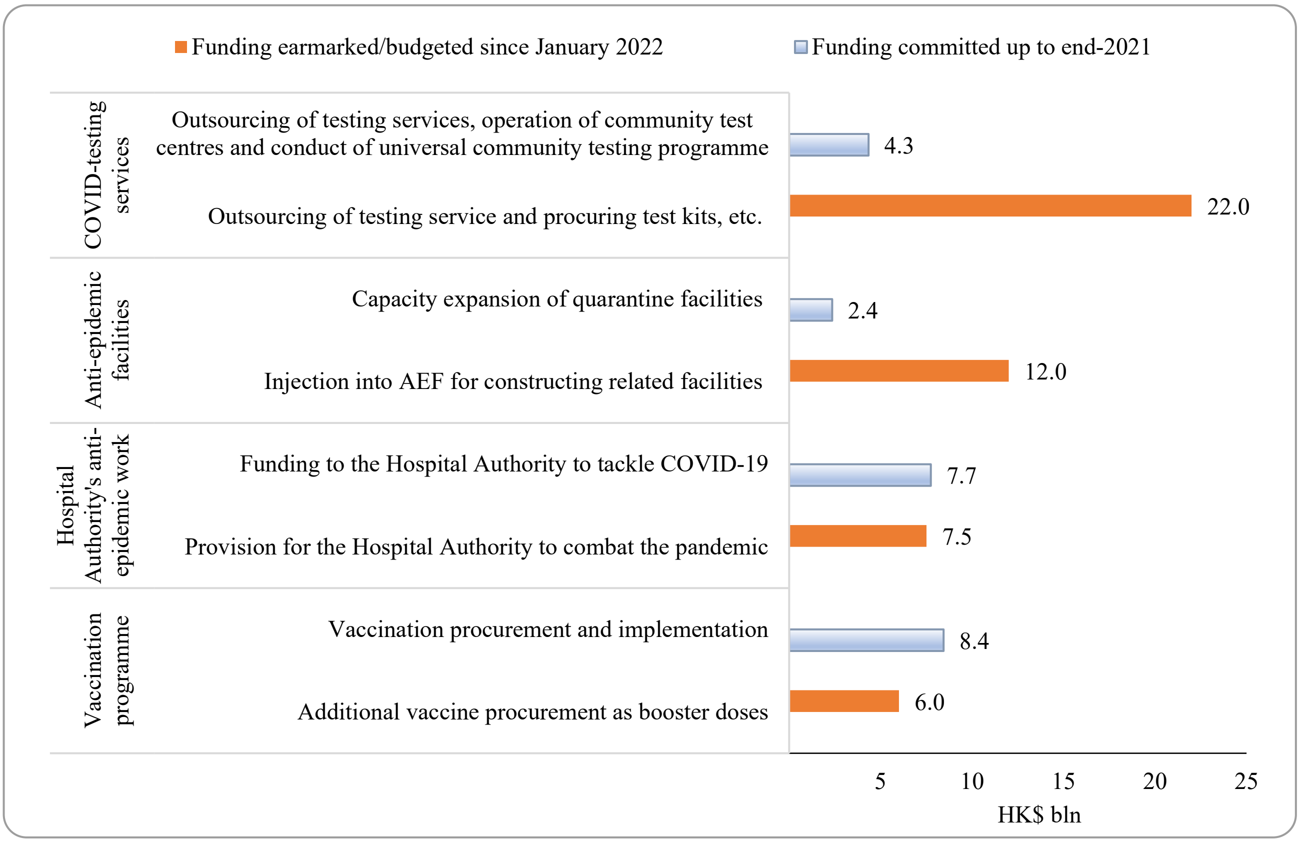
Note: Figures in brackets represent the percentage of recurrent expenditure in total expenditure of each policy area.
Data source: Budget Speech (various years).

3.2 According to the Financial Secretary, the budget directly associated with **anti-epidemic work** for 2022-2023 would involve **HK$54 billion**, including a total of HK$22 billion to procure test kits and strengthen testing service in the community, and HK$12 billion to construct quarantine facilities.[11] Such estimates have significantly increased, both being five-fold of the relevant expenditure/commitments up to end-2021, before the fifth wave of epidemic hit (**Figure 7**). However, as new developments related to the epidemic continue to unfold, resource required for anti-epidemic work may subject to constant review. On one hand, despite the resourceful financial allocation, actual implementation of anti-epidemic work may

[11] However, the Financial Secretary reportedly said that the budget of HK$12 billion is a rough estimate, which may vary subject to actual implementation. See 香港電台 (2022b).

face bottleneck on the infrastructure and manpower fronts. On the other hand, latest epidemic situation may reveal additional needs of financial injections, such as potential need of further support to the Hospital Authority (on top of the HK$7.5 billion extra allocation in the 2022-2023 Budget) to increase hospital service capacity and procure additional supplies as required.

Figure 7 – Expenditure or commitment to perform major anti-epidemic work



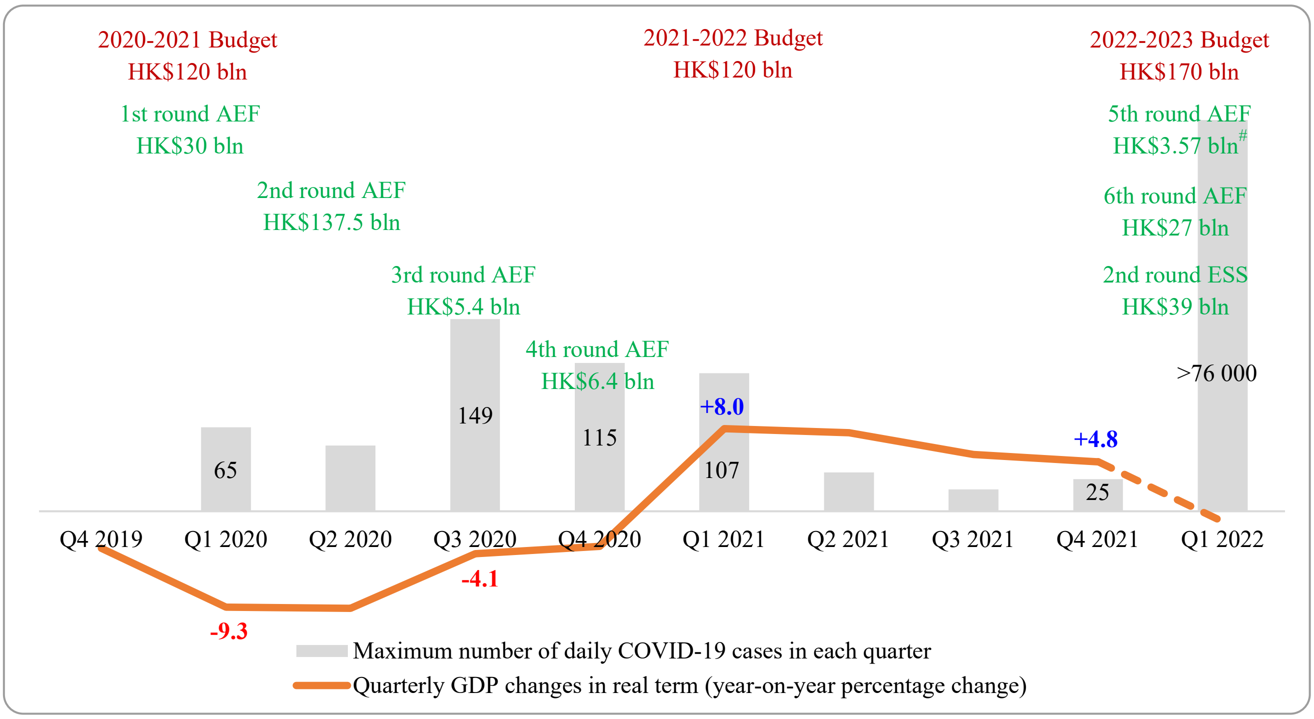
Notes: Funding committed up to end-2021 includes expenditure incurred in 2020-2021 and funding committed during calendar year 2021 for 2021-2022.
Data sources: Budget Speech (various years), Food and Health Bureau (2020a, 2020b, 2021), GovHK (2022a, 2022d), The Treasury (2021b) and 香港電台 (2022a, 2022b).

3.3 Health-related expenditure aside, during 2019-2020 and 2020-2021, a considerable sum was injected into the **Anti-epidemic Fund** ("AEF") in four rounds to support various sectors and individuals affected by the social distancing measures and for job retention/creation, among others. Expenditure under AEF included over HK$90 billion under the Employment Support Scheme ("ESS")[12] and about

[12] See Chief Secretary for Administration's Office (2022).

HK$9.2 billion [13] targeted at the catering sector which faced dire operating environment during the pandemic. In response to the fifth wave of epidemic and the consequential tightened social distancing measures, the Government rolled out in January 2022 the fifth and sixth rounds of relief measures under AEF, mainly targeted at those establishments and businesses subject to mandatory closure, estimated to cost over HK$30 billion. A fresh round of ESS, involving a further injection of HK$39 billion into AEF, was announced recently to cover wages over May to July 2022 (**Figure 8**).

Figure 8 – Injections into the AEF and financial commitment on counter-cyclical measures announced since 2020



Note: (#) Funded with existing uncommitted balance under the AEF.
Data sources: Budget Speech (various years), Census and Statistics Department (2022a) and GovHK (2022a).

3.4 In the latest Budget, the Financial Secretary has further committed over **HK$170 billion** for the counter-cyclical measures, involving various one-off relief measures and financial commitment.[14] The committed amount is about 40% higher than that in the previous two Budgets (**Figure 8**), though the measures appear largely recurrences of previous measures or extension of ongoing ones. In particular, to

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13 This included the sum under Catering Business (Social Distancing) Subsidy Scheme (HK$4.59 billion in the 2nd round of AEF) and the Catering Business Subsidy Scheme (3rd and 4th rounds at HK$1.44 billion and HK$3.17 billion respectively). See Chief Secretary for Administration's Office (2021, 2022).

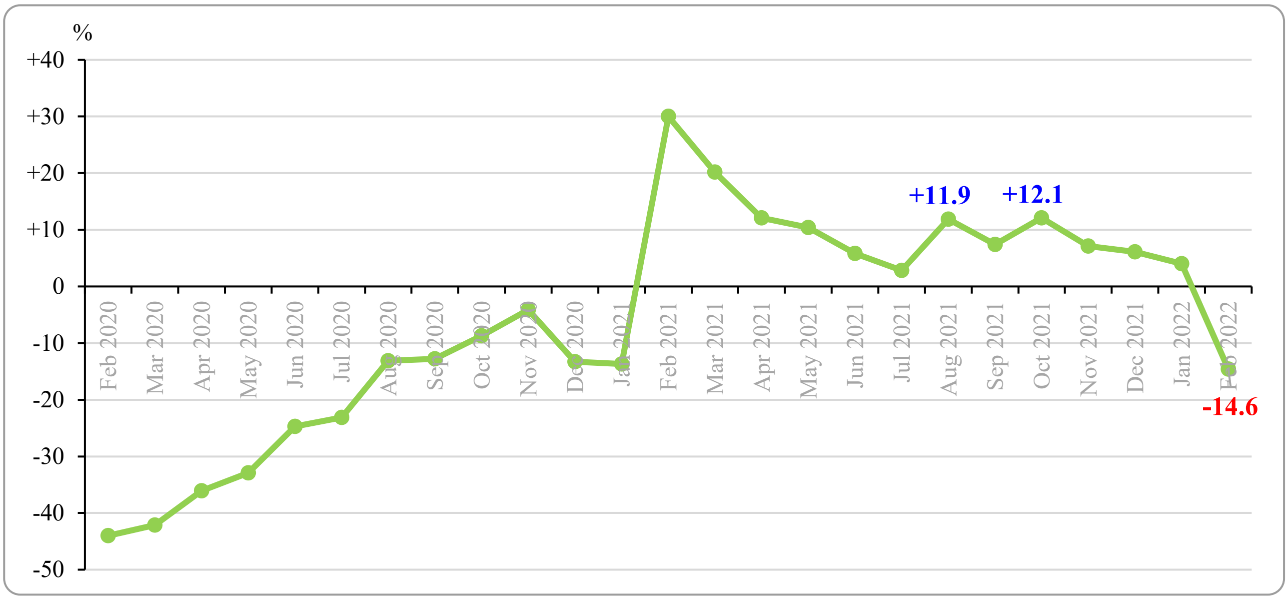
14 See Financial Secretary's Office (2022a).

stimulate local consumption, the Government will re-introduce the **electronic consumption voucher scheme** with the amount doubled to HK$10,000 per eligible resident, involving a total cost of **HK$66.4 billion**, up notably from HK$36 billion set aside in the 2021-2022 Budget. This initiative, together with the first-ever **rental enforcement moratorium** proposal to help small and medium-sized enterprises ("SMEs"), have drawn much public attention and interest. Observations on these two initiatives will be presented in the ensuing paragraphs.

<u>Consumption trend subsequent to the 2021 consumption voucher roll-out</u>

3.5 In the vouchers' inaugural roll-out last year, about 6.3 million people[15] have received the electronic consumption vouchers thus putting about HK$32 billion into buttressing local consumption. **Retail sales** have seen a boost, especially in August and October, when the year-on-year increase in value terms was at double-digit percentages, as they were the months in which distribution of vouchers began for the first and second installments respectively (**Figure 9**). However, apart from fresh demand as spurred by the additional spending power, the boost might also in part be attributable to consumers holding up major purchases as they anticipated the distribution of consumption vouchers, as suggested by the slowing growth in months leading up to the actual disbursement of consumption vouchers.

Figure 9 – Year-on-year percentage change in retail sales value



Note: Electronic consumption vouchers disbursed through AlipayHK, Tap & Go and WeChat Pay HK expired no later than end-January 2022, while those disbursed through Octopus did not have expiry dates. However, residents who opted to receive the consumption vouchers through Octopus were required to accumulate HK$4,000 eligible spending in order to receive the third batch of consumption vouchers worth HK$1,000.

Data source: Census and Statistics Department (2022c).

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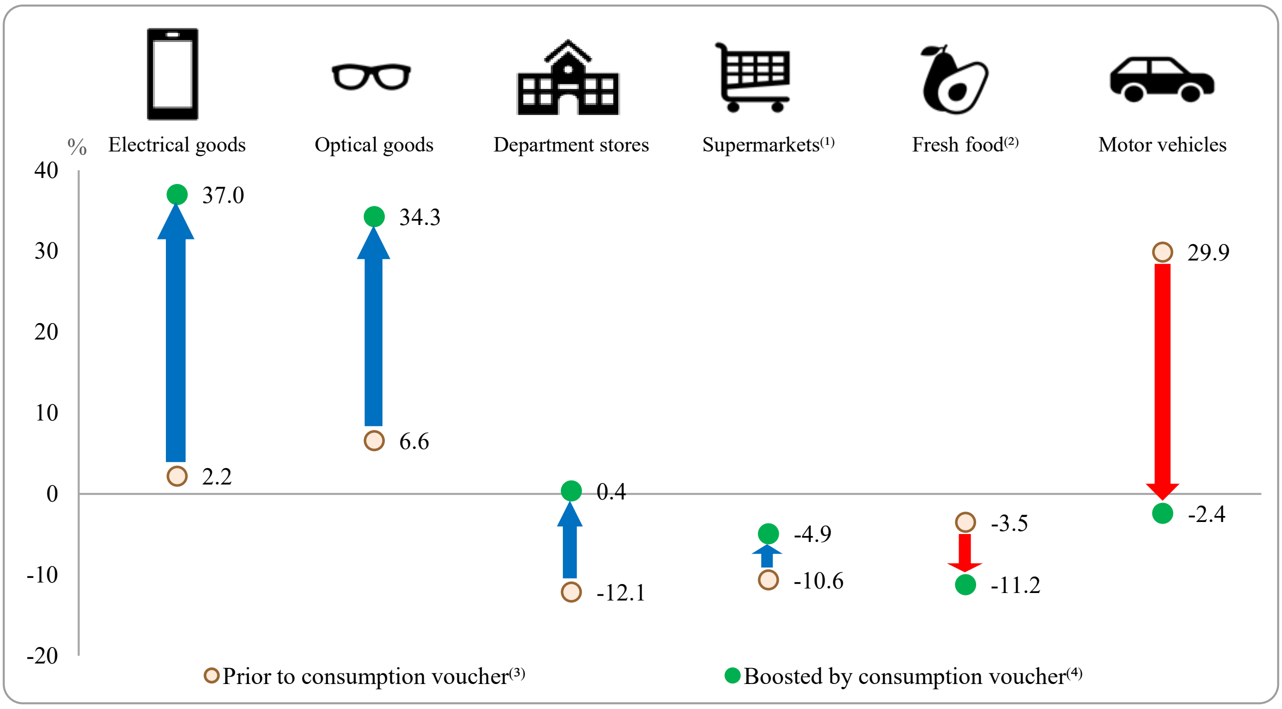
15 According to actual disbursement figures. See GovHK (2022b).

3.6 All in all, discretionary spending especially on low to medium price range consumer durables appear to have benefited the most from the scheme, as indicated by sales at electrical appliance stores and department stores, as well as optical shops (**Figure 10**). On the other hand, sales of fresh food and high-end products, such as motor vehicles, failed to receive visible stimulation.

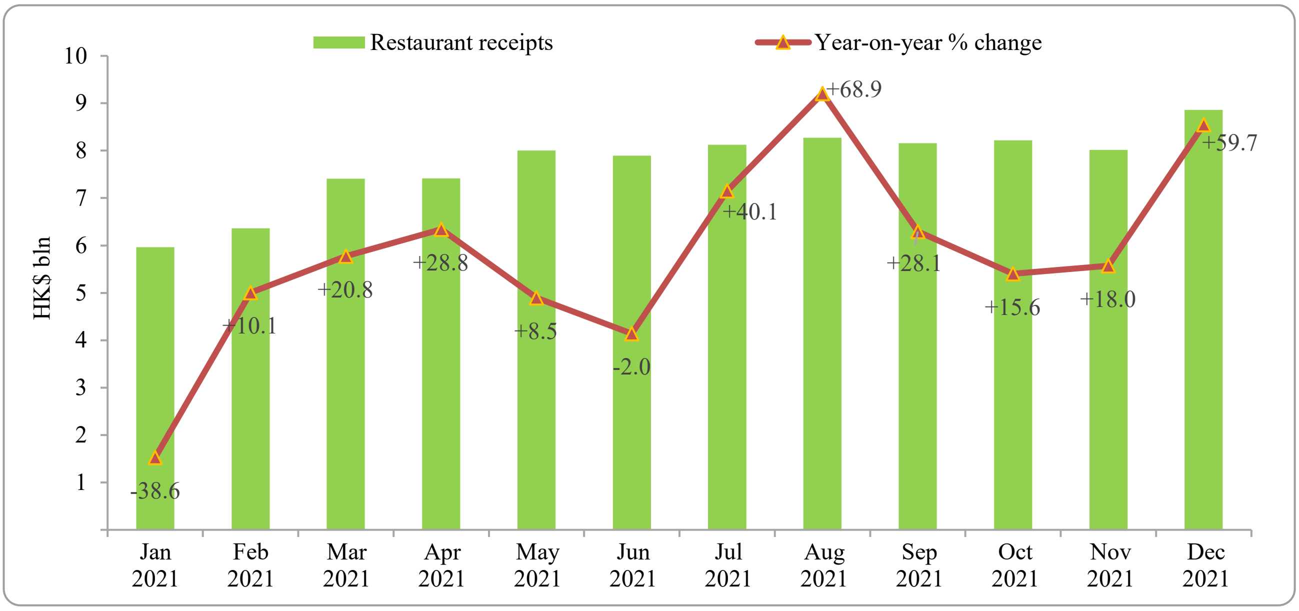
Figure 10 – Year-on-year changes in retail sales by type of retail outlets



Notes: (1) Includes supermarket sections of department stores.
(2) Includes fish, livestock and poultry, and fruits and vegetables.
(3) Refers to the three-month period from May to July 2021 (compared to May to July 2020).
(4) Refers to the three-month period from August to October 2021 (compared to August to October 2020).
Data source: Census and Statistics Department (2022c).

3.7 Meanwhile, the overall effect of the consumption voucher scheme appeared to be minimal on restaurant receipts compared with retail sales. **Restaurant receipts** during May to November 2021 hovered within a narrow range of HK$7.9 billion to HK$8.3 billion, though the year-on-year change saw a spike in August 2021 (**Figure 11**), which might largely be attributed to the low base a year earlier when a ban on dine-in after 6:00 pm and mandatory closure of bars were in force during the third wave of outbreak. Restaurant business performance picked up more notably in December 2021, apparently due mostly to seasonal demand rather than benefiting from the bolstering effect of consumption vouchers.

Figure 11 – Restaurant receipts and year-on-year percentage change



Data source: Census and Statistics Department (2022b).

3.8 With the increase in voucher value, the upcoming consumption voucher scheme is likely to see a **stronger** stimulating effect, which could be timely to buttress against the adverse economic effect arising from the fifth wave of epidemic. The Financial Secretary expects that the new round of coupon scheme to boost the economy by 1.2% (versus the estimate of 0.7% from the scheme last year, broadly commensurate with the 84% increase in expected outlay from $36 billion to $66.4 billion this year). Recently, it has been announced that the first installment will be distributed on 7 April (with validity until end-October) while timing of the remaining installments has yet to be determined. Some have expressed **concerns** that widespread of infected cases, if persistent, may constrain the effectiveness of the scheme since people may use the sum for daily necessities and anti-epidemic goods rather than increase discretionary spending on lifestyle goods and services.[16] The fortune of certain sectors, such as restaurants, are expected to be more heavily reliant on the loosening of social distancing measures while the boosting effect from consumption vouchers may be limited judging from the experience in 2021. With the above considerations, some observers commented that it is necessary to carefully plan the remaining installment schedule and the validity duration of the vouchers.

<u>Overseas experience in implementing rental enforcement moratorium</u>

3.9 Apart from the various financial support measures to provide alleviation to citizens and businesses amidst the economic challenges, the Government had

[16] See GovHK (2022c) and 香港電台 (2022c).

ventured into using specific initiatives to ease cash flow challenges for businesses without involving direct financial commitments. For instance, the Hong Kong Monetary Authority launched a Pre-approved Principal Payment Holiday Scheme ("Payment Holiday Scheme") for eligible enterprises in May 2020. The latest Budget not only further extended the Payment Holiday Scheme, it also proposed a **three-month rental enforcement moratorium**, which bans landlords of commercial properties from terminating the tenancy of or taking legal actions against tenants for non-payment of rent. Just like the Payment Holiday Scheme, the latest policy aims at providing breathing space for businesses as well as strives to respect and encourage the effort of landlords and tenants to negotiate mutually acceptable solutions. The Temporary Protection Measures for Business Tenants (COVID-19 Pandemic) Bill has been introduced into the Legislative Council on 23 March 2022, and the Bill is now being scrutinized.

3.10 Furthermore, it is noted that similar measures have been implemented since early 2020 in various overseas jurisdictions, including in **Australia**, **Singapore**, and the **United Kingdom** ("UK") (**Figure 12**), which might provide useful experience for Hong Kong regarding implementation and effectiveness of the policy. While the scope of restricted actions and tenant eligibility criteria vary across different places (e.g. decline in turnover above specified thresholds in Australia), the abovementioned jurisdictions have implemented supportive guidelines or rules to help tenants and landlords deal with **rent arrears** so as to come up with a **repayment plan**. For example, in Australia, commercial property owners and tenants were required to negotiate based on a set of **mandatory code**, which specifies that, among others, payment of rental deferrals by the tenant must be amortized over the balance of the lease term and for a period of no less than 24 months, whichever is the greater.[17] In Singapore, the repayment scheme for rental arrears, which is available to SMEs, allows a tenant to pay for a specified portion of their arrears over an extended period of time (up to nine months) in equal installments, with interest rate capped at 3% per annum.[18]

3.11 It is noteworthy that **support on the negotiation process** has been or will be provided in all three overseas places. In Australia, **free mediation service** was provided to resolve disputes between tenants and landlords. In Singapore, the two sides can make an application for an official **Assessor's Determination**, which will be final, in case they fail to arrive at a mutually agreeable solution. In the UK, a new law was passed in March 2022 to introduce a **binding arbitration process** to help landlords and tenants resolve the COVID-19 related rent debt.[19]

[17] See Prime Minister of Australia (2020).
[18] See Ministry of Law Singapore (2020).
[19] See UK Parliament (2022).

3.12 While rental enforcement moratorium is always intended to be short-term, the experience in overseas jurisdictions show that **extension of the schemes' validity** is often considered when local social distancing restrictions are kept in place in response to the pandemic situation. For example, the protection measures for tenants in the UK, which was initially set to run for three months from April to June 2020, was extended five times and eventually expired only recently in March 2022. Similarly, Australia made multiple extension to the relevant scheme as well.[20]

Figure 12 – Rental enforcement moratorium for commercial properties in selected jurisdictions

	Hong Kong	Australia	Singapore	The UK
Effective period or protection period	3 months starting from enactment of legislation	April 2020-March 2021, July 2021-June 2022[(1)]	April-November 2020	April 2020-March 2022
Eligibility criteria	Business tenants of specified premises hard-hit by social distancing measures	Passing the "decline in turnover test"; and cap in turnover size	Filing a Notification for Relief, which includes explanation of how COVID-19 had materially caused the inability to pay rent	Sectors prohibited from operating due to COVID-19 related measures
Examples of landlord actions temporarily restricted	× re-entry to the premises × forfeiture × lease termination × deducting from security deposit × bankruptcy/ winding-up petition against tenant × recovering interest or surcharge on unpaid rent × suspension of utility services	× re-entry to the premises × eviction × forfeiture × lease termination × recovery of the premises × deducting from security deposit × requiring payment related to unpaid rent × seizure of goods	× re-entry to the premises × eviction × lease termination × commencing court proceedings or insolvency proceedings × unilaterally impose new charges, increase charges or interest rates	× eviction × winding-up petitions against tenant × seizure of goods
Availability of guidelines or rules to deal with rent arrears	• Not mentioned in publicly announced information to date	• Yes	• Yes (for SME tenants and non-profit organization tenants only)	• No
Support on negotiation process		• Free mediation service	• Official Assessor's Determination service	• Binding arbitration service
Breach of rule	• A fine not less than HK$50,000 generally	• No penalty specified	• A fine not exceeding S$1,000 (HK$5,730)	• No penalty specified

Note: (1) Effective dates of the policy in New South Wales is taken for illustration purpose as implementation details vary by state/territory.

Data sources: Financial Secretary's Office (2022b) and official websites of the respective governments.

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20 In New South Wales of Australia, rental moratorium for commercial tenants was initially effective from 1 April to 24 October 2020, was extended twice to 28 March 2021. A modified version, reintroduced in July 2021 in face of a new round of lockdowns, ceased on 13 March 2022 for tenants with annual turnovers greater than A$5 million (HK$28 million) and will cease on 30 June 2022 for other commercial tenants.

4. Implications of a more active investment strategy of the Future Fund

4.1 Ballooning recurrent expenditure coupled with rounds of ad-hoc anti-epidemic expenditure in recent years have caused the fiscal reserves to dwindle by almost 20% from the peak in 2018-2019, leading to heightened concerns over the soundness of public finance. Back in 2016, the Government set up the **Future Fund** as part of the fiscal management measures to cope with the long-term fiscal challenges arising from **ageing population and slower economic growth**. The Future Fund is a notional savings account within the fiscal reserves, turned from the Land Fund with an initial endowment of HK$219.7 billion, and HK$4.8 billion top-up from account surplus, thus constituting **24%** of fiscal reserves as at end-March 2021.[21] The Future Fund is placed with the Exchange Fund for investment, with about half of its capital placed with the Exchange Fund's Long-Term Growth Portfolio (consisting of private equity and overseas real estate) and the rest with the Exchange Fund's Investment Portfolio (which invests in bond and equity markets) or other investment assets. Investment return on the Future Fund placement, calculated at a composite rate determined annually on a weighted average basis based on the performance of different portfolios under the Exchange Fund, is retained for reinvestment and not reflected in the cash-based government accounts, until a date as directed by the Financial Secretary (or at the end of the 10-year initial placement period, i.e. 31 December 2025).[22]

<u>Planned arrangement for the accumulated returns</u>

4.2 After some five years of investment, the accumulated returns of the Future Fund stood at **HK$110.7 billion** as at end-December 2020. Possibly in view of the huge budget deficit arising from anti-epidemic expenditure in 2020-2021, the Government began to bring back part of the returns to the government accounts as investment income, at HK$25 billion in 2021-2022 (**Figure 13**).[23] In this year's Budget, the Financial Secretary further indicated that HK$100 billion from the accumulated returns of the Future Fund would be set aside for a dedicated fund under the Capital Works Reserve Fund ("CWRF"), in order to expedite the implementation of infrastructure works in the **Northern Metropolis** (Figure 13). Nevertheless, detailed plan about when the transfer will take place, its transfer mechanism, and how the dedicated fund under CWRF will be operated are yet to be unveiled.

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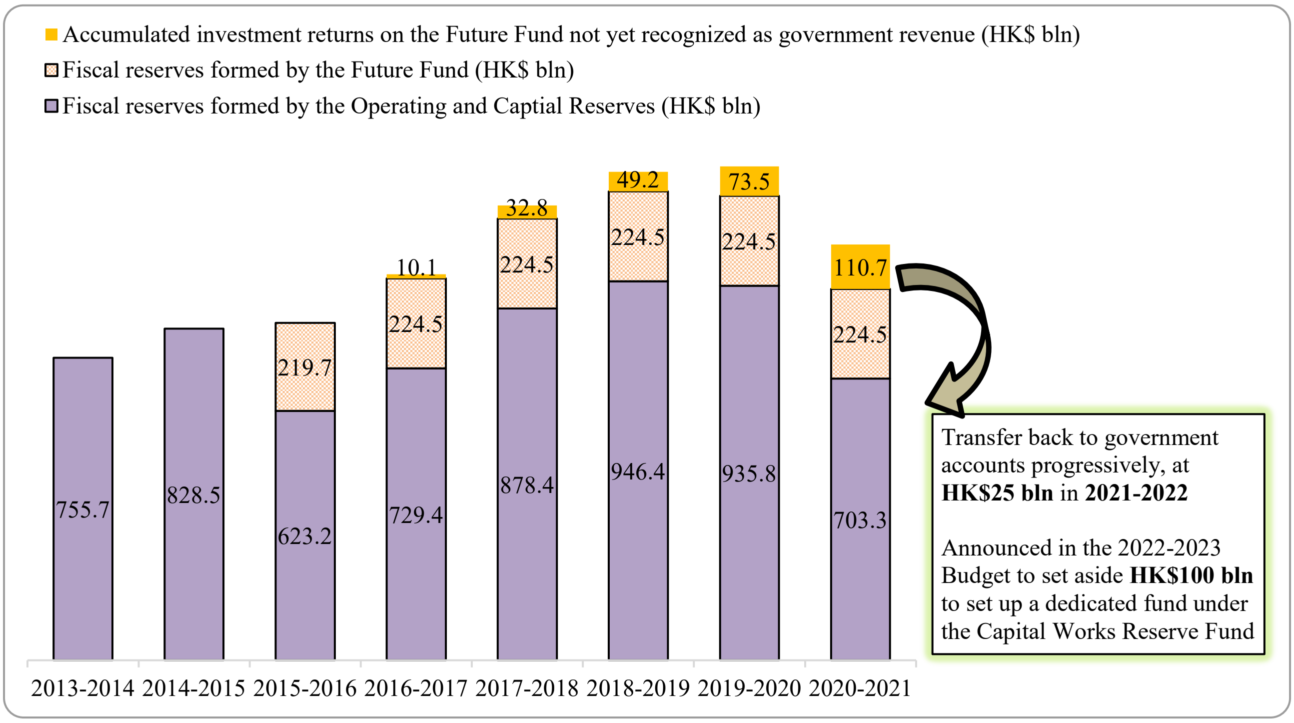
[21] The remaining 76% of the fiscal reserves is referred to as Operating and Capital Reserves.
[22] See Hong Kong Monetary Authority (2021) and The Treasury (2021a).
[23] See 2021-2022 Budget Speech and GovHK (2022d).

Figure 13 – Use of accumulated investment returns on the Future Fund



Note: Balance of accumulated investment return was as at end-December of every year.
Data source: The Treasury (various years).

<u>More active and diverse investments in the pipeline for the Future Fund</u>

4.3 In the 2019-2020 Budget, the Government already pledged to invite financial services sector experts to advise on the Future Fund's investment strategies and portfolios to achieve more diversified investments, with a view not only to enhancing return but also (a) consolidating Hong Kong's status as a financial, commercial and innovation centre, and (b) raising Hong Kong's productivity and competitiveness in the long run.

4.4 As a first move in the direction, the Government deployed HK$19.5 billion under the Future Fund to invest in the Cathay Pacific Airways Limited in 2020 due to the devastating impact of COVID-19 on the aviation industry. The HK$19.5 billion represents the cost of investment and does not reflect the market value.[24]

4.5 In 2021, the Government also established a portfolio, namely **Hong Kong Growth Portfolio** to invest part of the Future Fund in strategic projects with a "Hong Kong nexus", with an initial allocation of 10% of the Future Fund.[25] More

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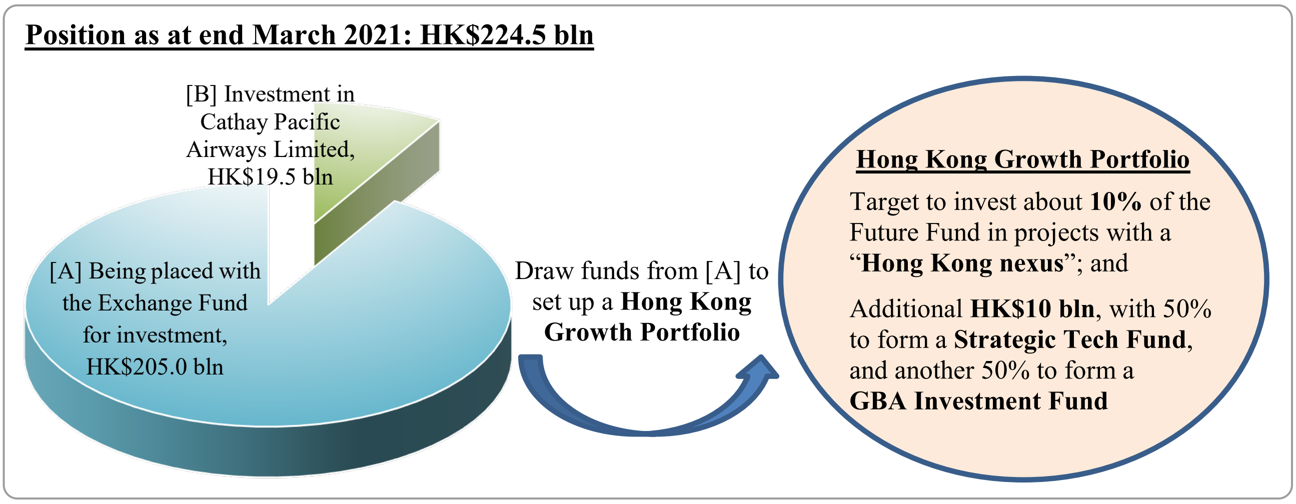
[24] The amount represented the cost of investment for subscription of preference shares with detachable warrants. For details, please see Financial Secretary's Office (2020).

[25] The Government appointed in 2021 eight fund managers as general partners to make strategic investment, but it has not been disclosed whether the investment has taken place.

recently, the Financial Secretary announced in his latest Budget to set up two more funds under the Hong Kong Growth Portfolio – Strategic Tech Fund and Guangdong-Hong Kong-Macao Greater Bay Area ("GBA") Investment Fund (**Figure 14**). Seemingly, the Future Fund is increasingly exposed to **more active and diverse investments**.

Figure 14 – New investment arrangement under the Future Fund



Data sources: 2022-2023 Budget Speech and The Treasury (2021a).

4.6 Though it is still in an early stage, how the funds of the Hong Kong Growth Portfolio are invested and help grow the fiscal reserves, as well as potentially generate investment return that can contribute towards government accounts in annual Budgets, will be of interest to the public. While some commentators wish to see a similar level of transparency as the part placed with the Exchange Fund (the rate of return of which is reported in the Government's annual accounts and the types of investment are disclosed in the annual financial statements of the Exchange Fund), some others wish the Government to consider making reference to overseas places with reserve funds/sovereign wealth funds, where a wider range of **regular disclosure** about their portfolio and performance is reported annually or on a regular basis.[26] Disclosure practices of **Australia**'s Future Fund, **Norway**'s Government Pension Fund Global, and **Singapore**'s GIC and Temasek are listed alongside those of the Exchange Fund in **Figure 15** for comparison.

4.7 In addition to financial disclosures, insofar as generating long-term benefits to the Hong Kong economy is the objective of Hong Kong Growth Portfolio, there could be calls for a mechanism to monitor and evaluate its attainment of such an objective. It is noted some overseas funds provide certain disclosure in this regard.

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[26] For example, see iMoney (2017) and 明報 (2021).

For instance, Norway's Government Pension Fund Global, on its environment-related mandates, made regular disclosure on amount invested in environment-related equity and carbon footprint of its portfolio; for Australia's Medical Research Future Fund ("MRFF"), one of the six funds managed by the Future Fund Board, the Australian Government announced recently the second 10-year investment plan for the MRFF worth A$6.3 billion (HK$35 billion), setting out the planned annual grant amount from the Fund to be directed into four thematic areas, namely, Patients, Researchers, Research Missions and Research Translation.[27]

Figure 15 – Information disclosure provided by Exchange Fund and selected overseas reserve funds/sovereign wealth funds

	Exchange Fund (Hong Kong)	Future Fund (Australia)	Government Pension Fund Global (Norway)	GIC (Singapore)	Temasek (Singapore)
Statutory purposes/ objectives	• Affecting, either directly or indirectly, the exchange value of the currency of Hong Kong; and maintaining the stability and integrity of Hong Kong's monetary and financial systems	• Strengthening Australia's balance sheet and long-term financial position	• Serving as a financial reserve and as a long-term savings plan by investing the revenue from oil and gas production	• Achieving good long-term returns above global inflation, and preserving and enhancing the international purchasing power of the reserves	• Separating the government's policymaking and regulatory function from its role as a shareholder, and investing to create value for generations to come
Rate of return	✓	✓	✓	✓	✓
Balance	✓	✓	✓		✓
Allocation by asset class (e.g. equities, bonds, real estate)	✓	✓	✓	✓	✓
Breakdown by region/sector		✓	✓		✓
Cash flow information	✓	✓	✓		✓
Volatility		✓	✓	✓	
Sharpe ratio		✓			
Key credit parameters					✓

Data sources: Official websites and/or annual reports of the respective funds.

[27] The MRFF was established in 2015 by the Medical Research Future Fund Act 2015. It provides an ongoing funding stream for medical research and medical innovation into the future with the credits to the MRFF preserved in perpetuity. The capital of the MRFF is invested, with the earnings used to make financial grants for medical research and medical innovation activities.

5. Observations

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

(a) Thanks to higher-than-expected revenue and proceeds from green bond issuance, there was a mild surplus in the 2021-2022 fiscal year. However, it should not be surprising that the latest Budget is returning to red: with the considerably larger number of persons infected in the fifth wave of epidemic and the consequent severe disruption to economic activities, funding committed to anti-epidemic work and countercyclical measures in the 2022-2023 fiscal year represented a step up from the previous two fiscal years.

(b) While the fresh round of the electronic consumption voucher scheme, with voucher amount doubled from last year's, was largely popular, evidence on the potency of its stimulating effect in 2021 was mixed across sectors. The latest Budget also proposed a rental enforcement moratorium on commercial properties as another measure to provide breathing space for enterprises in specific sectors, without invoking additional financial commitment from the Government.

(c) Even though the Government forecast sustained fiscal surplus in the medium term, fiscal reserves would stay at no more than 16 months of expenditure, compared with well above 20 months in the 2010s, thereby indicating a possible weakening of the public coffers.

(d) In the latest Budget, health and social welfare have emerged as the two largest policy areas in terms of shares in government expenditure, overtaking education which had traditionally been the largest spending policy area of the Government. Heavier spending on health and social welfare may well persist in the medium to long term due to the trends in local demographics and some deep-rooted issues exposed by the pandemic.

(e) The latest Budget introduced two reforms on the revenue front that are expected to increase government revenue visibly starting from the 2024-2025 fiscal year, namely, a domestic minimum top-up tax on large MNCs and the "affordable users pay" principle to the rating system that is manifested in a progressive rates percentage charge.

(f) Notwithstanding such efforts, land premium and stamp duties together with investment income would likely be the increasingly significant sources of government revenue, making fiscal position susceptible to a wider range of factors on top of the performance in the local economy, and thus more volatility.

(g) In addition to being a source of investment income to the Government's account, the Future Fund (which holds about a quarter of our fiscal reserves) is increasingly venturing into more diversified investments, with a view to benefiting Hong Kong's economy in the longer term. Disclosure of the Future Fund's financials as well as its effectiveness in enhancing Hong Kong's productivity and competitiveness would likely become a matter of public interest.

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