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8 April 2003

Clerk to Panel on Financial Affairs
 (Attn: Ms Connie Szeto)
 Legislative Council Secretariat
 3th Floor, Citibank Tower
 Central, Hong Kong

Dear Ms Szeto,

Proposed Amendment to the Resolution of the Land Fund

I refer to the meeting of the Panel on Financial Affairs on 7 April 2003 and would like to provide below the supplementary information in response to the questions raised by Members at the meeting.

Estimated sum to be transferred from the Land Fund

As shown in the latest Medium Range Forecast, we will have continued budget deficits in 2003-04 to 2005-06, as analysed below, before returning to balanced budgets in 2006-07 and 2007-08. A copy of the forecast is at **Annex A** for Members' easy reference.

<u>Year</u>	<u>Consolidated deficit</u> \$ million
2003-04	67,870
2004-05	38,220
2005-06	<u>15,780</u>
Total :	<u>121,870</u>

The estimated sum of \$120 billion to be transferred from the Land Fund is mainly to cope with the budget deficits totalling about \$122 billion in 2003-04 to 2005-06. It should also be noted that as many major types of revenue including taxes are mostly received towards the end of a financial year, we need to use the fiscal reserves to finance shortfalls in the initial months of a financial year. The amount so transferred will also serve to provide a buffer to meet the cashflow requirements in the course of these years.

Projected balance of the fiscal reserves

A table showing the projection of the balances of the Land Fund, the General Revenue Account (GRA) and the various Funds within the fiscal reserves is at **Annex B**. The estimated balance of the Land Fund as at the end of 2007-08 will be about \$147 billion, representing 73% of the fiscal reserves. Meanwhile, the fiscal reserves exclusive of the Land Fund will be about \$54 billion as at the end of 2007-08.

Statutory provisions on the use of accumulated surplus of Exchange Fund

Regarding the use of the accumulated surplus of the Exchange Fund, which forms an integral part of the Exchange Fund, to meet operating and contingency requirements of Government, the relevant sections in the Exchange Fund Ordinance (Cap. 66) are reproduced at **Annex C** for Members' easy reference. This issue has in fact been covered in the Information Paper [CB(1)410/02-03] submitted by the Hong Kong Monetary Authority to the Panel on Financial Affairs in November 2002. The major points are set out in the ensuing paragraphs.

In the first place, it is not possible to use any assets of the Exchange Fund "to meet operating and contingency requirements of Government", because this purpose does not fall within those specified in sections 3(1) and 3(1A) of the Exchange Fund Ordinance. However, section 8 of the Ordinance allows "the transfer from the Fund to the general revenue or to such other fund or funds of the Government as may be authorised by the Chief Executive in Council any sum or part of any sum ..." under certain conditions. The mechanism for making such a transfer as specified in section 8 involves -

- (a) the Financial Secretary's satisfying himself "that such a transfer is not likely to affect adversely his ability to fulfill any purpose for which the Exchange Fund is required to be or may be used under section 3(1) or (1A);
- (b) the Financial Secretary's consulting the Exchange Fund Advisory Committee;
- (c) the approval of the Chief Executive in Council;
- (d) the authorisation of the Chief Executive in Council of the Government Fund for receiving the transfer; and
- (e) satisfying the requirement that the transfer would not reduce the assets of the Exchange Fund to a level less than "105% of the total obligations of the Fund for the time being outstanding".

There are two factors to be considered when contemplating a transfer under section 8 of the Exchange Fund Ordinance. The first is the statutory minimum 105% cover for the total obligations of the Fund at the time of the transfer. The second is, crucially, the likelihood of such a transfer affecting adversely the ability of the Financial Secretary “to fulfill any purpose for which the Exchange Fund is required to be or may be used under section 3(1) or (1A) of the Ordinance.

Specifically, the Financial Secretary has to satisfy himself that his ability to affect “either directly or indirectly the exchange value of the currency of Hong Kong and for other purposes incidental thereto” will not be adversely affected. He also has to satisfy himself that his ability “to maintain the stability and the integrity of the monetary and financial systems of Hong Kong” will not be adversely affected.

It is very difficult to give an authoritative assessment on the possible implications of making a section 8 transfer. These depend very much on a number of factors, e.g. the vulnerability of Hong Kong to sizeable speculative attacks, public confidence in and market perception on the Government’s ability to maintain monetary and financial stability after the transfer.

In view of the above, we consider it neither feasible nor advisable to transfer funds from the Exchange Fund to top up the anticipated shortfalls.

Urgent need to amend the Resolution of the Land Fund

I wish to take this opportunity to point out that there is an urgent need for us to transfer funds from the Land Fund to the GRA as early as May 2003. The estimated balance of fund in the GRA is only \$15 billion by the end of March 2003, and will not be sufficient to meet the cashflow requirements in May 2003 if there is no topping up by fund transfer.

We hope that the supplementary information as set out above would help clarify Members’ questions on our proposed amendment to the Resolution of the Land Fund. We look forward to Members’ support of the amending Resolution.

Yours sincerely,

(Allen Leung)
for Secretary for Financial Services and
the Treasury

Encls.

Internal

AA/SFST

D of J (Attn : Miss Shandy Liu, Law Drafting Division) - fax 2523 5104

SECTION II - THE MRF FOR 2002-03 TO 2007-08

11 The current MRF (*Note a*) is summarised in the following three tables which indicate the forecast operating position, capital financing position and consolidated reserves position.

Operating Account

Table 1

	Original Estimate	Revised Estimate	Forecast				
	2002-03	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Operating revenue (<i>Note b</i>)	149,400	135,060	149,180	165,950	181,900	190,910	194,540
Less : Operating expenditure(<i>Note c</i>)	208,110	201,310	210,300	206,890	203,400	199,760	202,990
Operating surplus/(deficit) before extraordinary expenditure/ investment income	(58,710)	(66,250)	(61,120)	(40,940)	(21,500)	(8,850)	(8,450)
Extraordinary expenditure:							
Voluntary Retirement Schemes(<i>Note c</i>)	(3,250)	(1,300)	(3,300)	(5,300)	—	—	—
Operating surplus/(deficit) before investment income	(61,960)	(67,550)	(64,420)	(46,240)	(21,500)	(8,850)	(8,450)
Investment income (<i>Note b</i>)	12,640	14,590	11,000	8,820	8,410	8,390	8,750
Operating surplus/(deficit) after investment income	(49,320)	(52,960)	(53,420)	(37,420)	(13,090)	(460)	300

Capital Financing Statement

Table 2

	Original Estimate	Revised Estimate	Forecast				
	2002-03	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Capital revenue (<i>Note d</i>)	36,440	22,340	11,240	20,540	26,750	27,780	29,100
Sale of government assets (<i>Note d</i>)	15,000	—	21,000	30,000	24,000	21,000	16,000
Less : General Revenue Account capital expenditure (<i>Note e</i>)	4,160	2,050	2,000	1,430	3,860	3,970	4,030
: Expenditure on capital projects (<i>Note f</i>)	34,360	32,270	36,200	39,110	37,010	29,470	29,520
Loans and investments (<i>Notes g</i>)	9,370	6,120	8,000	10,790	11,610	6,840	3,620
Aid for disaster relief (<i>Note h</i>)	—	10	—	—	—	—	—
Expenditure for innovation and technology (<i>Note i</i>)	560	330	520	610	640	120	120
Grants and loans for social welfare services (<i>Note k</i>)	—	—	1,080	1,390	1,360	640	640
Capital financing surplus/(deficit) before investment income	2,990	(18,440)	(15,560)	(2,790)	(3,730)	7,740	7,170
Investment income (<i>Note d</i>)	1,120	1,350	1,110	1,990	1,040	870	930
Capital financing surplus/(deficit) after investment	4,110	(17,090)	(14,450)	(800)	(2,690)	8,610	8,100

Consolidated Reserves

Table 3

	Original Estimate	Revised Estimate	Forecast				
	2002-03	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Fiscal Reserves at 1 April (<i>Note j</i>)	369,760	372,500	303,040	239,140	200,920	185,140	193,290
Lotteries Fund balance at 1 April	—	—	3,970	—	—	—	—
Operating surplus/(deficit) (per Table 1)	(49,320)	(52,960)	(53,420)	(37,420)	(13,090)	(460)	300
Capital financing surplus/(deficit) (per Table 2)	4,110	(17,090)	(14,450)	(800)	(2,690)	8,610	8,100
Consolidated surplus/(deficit)	(45,210)	(70,050)	(67,870)	(38,220)	(15,780)	8,150	8,400
Write-back of provision for loss in investments with the Exchange Fund	1,030	590	—	—	—	—	—
Fiscal Reserves at 31 March (<i>Note j</i>)	325,580	303,040	239,140	200,920	185,140	193,290	201,690
As number of months of Government Expenditure	15	15	11	9	9	10	10

**Projection of the Balances of the
Land Fund, General Revenue Account and Other Funds**

Account and Funds	Revised Estimate	Forecast				
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
	\$m	\$m	\$m	\$m	\$m	\$m
Land Fund	259,245	145,510	146,130	146,440	146,490	147,310
General Revenue Account and other Government Funds	43,800*	93,630	54,790	38,700	46,800	54,380
Total	303,045	239,140	200,920	185,140	193,290	201,690

* Note : The breakdown of the estimated balance of the fiscal reserves exclusive of the Land Fund by the end of March 2003 is as follows -

Account and Funds	Estimated balance as at 31 March 2003 \$m
General Revenue Account	15,134
Capital Works Reserve Fund	4,508
Capital Investment Fund	3,705
Civil Service Pension Reserve Fund	12,310
Disaster Relief Fund	36
Innovation and Technology Fund	4,638
Loan Fund	3,469
Total	43,800

Extract of Relevant Sections in the Exchange Fund Ordinance (Cap. 66)

Section	Provisions
3(1)	There shall be established a fund to be called “the Exchange Fund” which shall be under the control of the Financial Secretary and shall be used primarily for such purposes as the Financial Secretary thinks fit affecting, either directly or indirectly the exchange value of the currency of Hong Kong and for other purposes incidental thereto. The control of the Financial Secretary shall be exercised in consultation with an Exchange Fund Advisory Committee of which the Financial Secretary shall be ex officio chairman and of which the other members shall be appointed by the Chief Executive.
3(1A)	In addition to using the Fund for its primary purpose, the Financial Secretary may, with a view to maintaining Hong Kong as an international financial centre, use the Fund as he thinks fit to maintain the stability and the integrity of the monetary and financial systems of Hong Kong.
8	Where the Financial Secretary is satisfied that such transfer is not likely to affect adversely his ability to fulfill any purpose for which the Exchange Fund is required to be or may be used under section 3(1) or (1A), he may, after consulting the Exchange Fund Advisory Committee, and with the prior approval of the Chief Executive in Council, transfer from the Fund to the general revenue or to such other fund or funds of the Government as may be authorized by the Chief Executive in Council any sum or part of any sum in excess of the amount required to maintain the assets of the Fund at 105% of the total obligations of the Fund for the time being outstanding and may for the purpose of any such transfer realize any of the assets of the Fund.