

LEGISLATIVE COUNCIL BRIEF

Public Finance Ordinance
(Chapter 2)

AMENDMENT TO RESOLUTION OF LAND FUND

INTRODUCTION

At the meeting of the Executive Council on 25 March 2003, the Council ADVISED and the Chief Executive ORDERED that the amending Resolution under section 29 of the Public Finance Ordinance, at the **Annex**, should be introduced into the Legislative Council to enable Government to transfer money from the Land Fund to the General Revenue Account or other Government funds.

JUSTIFICATIONS

Overall Financial Position

2. Government's fiscal reserves comprise the accumulated balances of the General Revenue Account (GRA), the Land Fund, the Capital Works Reserve Fund (CWRF), the Capital Investment Fund (CIF), the Loan Fund, the Civil Service Pension Reserve Fund, the Disaster Relief Fund, the Innovation and Technology Fund and the Lotteries Fund⁽¹⁾. The purpose of holding these reserves is to meet operating and contingency requirements of public finance. In case there are budget deficits which arise either in those months of the financial year when expenditure exceeds revenue, or as a result of the downswing in the economic cycle, we use the fiscal reserves to finance shortfalls.

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

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

Locking up of Resources in Land Fund

4. The Land Fund has accounted for and will continue to account for the vast majority of Government's fiscal reserves. The estimated balance of the Land Fund will amount to \$259 billion by the end of March 2003, representing about 85% of Government's fiscal reserves. Similar to other Funds set up under section 29 of the Public Finance Ordinance (PFO)⁽²⁾, the usage of the Land Fund is governed by the provisions laid down in the Resolution passed by the legislature in 1997. On the provision for expending moneys from the Land Fund, the Resolution only provides that all expenses relating to the administration and management of the Land Fund (but nothing more) are to be met at the expense of the Land Fund. As such, the Land Fund cannot be used to fund the provision of any Government services. The Resolution also has no provision to allow Government to transfer money from the Land Fund to the GRA or other Government funds. As a result, the vast majority of the fiscal reserves are effectively locked up in the Land Fund.

Note⁽²⁾ Under section 29 of the PFO, the Legislative Council may by resolution provide for the establishment of funds to which moneys appropriated for the purpose, and such other moneys received for the purposes of the Government as may be specified in the resolution, may be credited and from which moneys may, under the authority of a funds warrant issued by the Financial Secretary, be expended for the purposes for which the funds were established subject to such conditions, exceptions and limitations as may be specified in the resolution.

Financial Position of Other Funds

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

The Proposal

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

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

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

OTHER OPTIONS

Abolition of the Land Fund

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

External Borrowing

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

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

THE AMENDING RESOLUTION

12. The amending Resolution adds a provision to give the Financial Secretary power to transfer, from time to time, from the Land Fund to the general revenue any balance held in the Fund which is not in his opinion reasonably required for the purpose of the Fund.

LEGISLATIVE TIMETABLE

13. The legislative timetable will be -

Moving a motion to amend the Resolution in the Legislative Council	30 April 2003
Publication in the Gazette and Commencement	2 May 2003

IMPLICATIONS OF THE PROPOSAL

14. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. The amending Resolution will not affect the current binding effect of the PFO. It has no productivity, economic, environmental, sustainability or staffing implications.

PUBLIC CONSULTATION

15. There will be no public consultation specifically on the proposal. The Financial Affairs Panel of the Legislative Council was consulted on the proposal on 7 April 2003.

PUBLICITY

16. Background briefings will be arranged as necessary. A spokesman will be available to answer media and public enquiries.

BACKGROUND

Setting up of the Land Fund

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

18. With the establishment of the HKSARG on 1 July 1997, the assets of the HKSARG Land Fund with a net value of \$197 billion were handed over to the HKSARG. It will thereafter be for the HKSARG to decide how the Fund shall be expended. The Chief Executive appointed the Financial Secretary as the public officer to receive these assets as part of the HKSARG fiscal reserves. These assets became part of the general revenue⁽³⁾ in accordance with section 3 of the PFO. The estimated balance of the Land Fund will amount to \$259 billion by the end of March 2003, representing about 85% of Government's fiscal reserves. After the establishment of the HKSARG, all income from land premium is credited directly to the CWRP for the purposes of financing the capital works programme and the acquisition of land.

19. As the HKSARG had not yet decided on the long-term use of the assets held in the trust fund, a separate fund, namely the Land Fund, was established by Resolution made and passed by the Provisional Legislative Council under section 29 of the PFO to receive, hold and invest the assets of the HKSARG Land Fund on 1 July 1997.

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

Investment of the Land Fund

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

21. Following the merger, the Land Fund remains a separate Government fund managed in exactly the same way as other Funds in the fiscal reserves which have also been placed with the Exchange Fund. The merger does not pre-empt consideration of the long-term use of the Land Fund.

ENQUIRIES

22. Enquiries on the brief should be made to Mr Allen Leung, Principal Assistant Secretary for Financial Services and the Treasury (Treasury)(MA), on telephone number 2810 3729.

PUBLIC FINANCE ORDINANCE

RESOLUTION OF THE LEGISLATIVE COUNCIL

LAND FUND

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

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

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

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

Clerk to the Legislative Council

2003