

**立法會**  
**Legislative Council**

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**Paper for circulation to the House Committee**

**Report of the Subcommittee on proposed resolution  
under Section 3(1) of the Loans Ordinance  
(by way of issuance of Government Bonds)**

**Purpose**

This paper reports on the deliberations of the Subcommittee on proposed resolution under Section 3(1) of the Loans Ordinance (by way of issuance of government bonds) (the Subcommittee).

**Background**

2. In his Budget Speech for 2004-05, the Financial Secretary (FS) announced that the Government plans to issue up to \$20 billion worth of government bonds within 2004-05 to fund infrastructural or investment projects which will bring long-term economic benefits to Hong Kong. On 23 April 2004, the FS gave notice that he would, at the Council meeting on 12 May 2004, move a resolution under Section 3(1) of the Loans Ordinance (Cap. 61) to allow the Government to borrow an amount not exceeding \$20 billion or equivalent for the purposes of the Capital Works Reserve Fund (CWRP) established by resolutions passed under Section 29 of the Public Finance Ordinance (Cap. 2) (Proposed Resolution) (**Appendix I**).

3. At the House Committee meeting on 30 April 2004, members agreed to form a subcommittee to study the Proposed Resolution. The

Administration then withdrew the notice given for moving the Proposed Resolution at the Council meeting on 12 May 2004. On 7 May 2004, FS wrote to the House Committee and explained the need for sufficient lead-time for executing the proposed issuance of government bonds before the beginning of the Summer vacations. In response to his request, the House Committee agreed in principle that subject to the deliberation of the Subcommittee, it would recommend to the President of the Legislative Council in support of the proposed waiver of notice for moving the Proposed Resolution at the Council meeting on 19 May 2004.

### **The Subcommittee**

4. The Subcommittee comprises five members including Hon SIN Chung-kai who was elected Chairman at the Subcommittee meeting on 13 May 2004. The membership list of the Subcommittee is in **Appendix II**.

5. Prior to the meeting on 13 May 2004, with the concurrence of the Members who had signified membership, the Secretariat invited those organizations and individuals who had given views on the subject to submit views to the Subcommittee. A total of three submissions were received from the following organizations: the Association of Chartered Certified Accountants, Fitch Ratings Hong Kong and the Hong Kong Association of Banks. The Subcommittee met with the Administration on 13 May 2004.

### **The Proposed Resolution**

6. The Proposed Resolution authorizes the Government to borrow a sum or sums not exceeding in total \$20 billion or equivalent for the purposes of the CWRP established by resolutions passed under Section 29 of the Public Finance Ordinance (Cap.2). In the Legislative Council Brief on the Proposed Resolution, the Government states that it plans to issue up to \$20 billion worth of government bonds within 2004-05, and that the funds received from the proposed bond issue will be used to assist in financing Public Works Programme.

## **Deliberations of the Subcommittee**

7. Members of the Subcommittee are in support of the Proposed Resolution. They however are aware that some concerns have been raised by individual Members as well as organizations and individuals in the financial and academic sectors on the implications of the issuance of government bonds for the purpose of financing capital projects. In studying the Proposed Resolution, the Subcommittee has made reference to these views and concerns, and examined in particular the following aspects of the Proposed Resolution:

- (a) how the borrowing would have impact on Government's commitment to reduce fiscal deficit; and whether it is the right time to borrow;
- (b) whether the issuance of government bonds is the most appropriate way to raise fund for financing capital projects; and how the effectiveness of the bond issue can be assessed;
- (c) how far the financial services sector would be involved in the bond issue exercise, the other details such as costing of the exercise, management of cash flow, and Government's obligations and liability; and
- (d) the wording of the Proposed Resolution and the implications of not specifying the means of borrowing, i.e. issuance of government bonds, in the Proposed Resolution.

### Impact on Government's commitment to reduce fiscal deficit

8. The Subcommittee notes that while there is general support in the financial sector for the issuance of government bonds, there are however questions on why market borrowing is necessary when Hong Kong is still in a strong fiscal position, and whether the bond issue would contribute to any easing in pressure on the Government to reduce fiscal deficit. In this respect, the Administration reiterates that the target of balancing the Government's Operating and Consolidated Account by 2008-09 and to reduce Government annual operating expenditure to \$200 billion by 2008-09 will not be changed. The issuance of government bonds provides an alternative source of funds for

capital projects and greater flexibility in the implementation of Government's asset sale and securitization programme, obviating the need to sell Government assets at low prices under potentially unfavourable market conditions. The borrowing is for the purposes of the CWRF. Only those projects which have been or will be approved by the Finance Committee will be funded by the CWRF. The Government would continue to adhere to its prudent financial management principles and would continue to invest in infrastructural and investment projects which will bring significant economic benefits to Hong Kong in the long term.

9. Members however note that under CWRF, the FS may expend moneys from the Fund for purposes other than Government's public works programme, e.g. for acquisition of land. The Administration reiterates that the \$20 billion to be credited into CWRF only aims to finance those projects approved or to be approved by the Finance Committee. In response to members, the Administration agrees to state this point in FS's speech when moving the Proposed Resolution in the Council.

#### Sources of funding for capital projects

10. The Subcommittee notes that according to the 2004-05 Budget, over the next five years, capital expenditure will amount to \$43 billion a year on average, of which around \$29 billion will be allocated to works projects. The present issuance exercise aims to generate funding to meet the shortfall in capital financing in 2004-05. The source of funding for financing capital works projects in future years would have to come from proceeds from land sales and the sale of other government assets. Members are concerned that where funding from capital revenue is not sustainable, borrowings through the issuance of government bonds may not be one-off. Given that interest rates are likely to rise in the near future, the issuance of government bonds may not be the best or most cost-effective solution to raise fund for capital projects. The Administration advises that it will consider whether to issue additional bonds in the future in the light of funds required for infrastructural and investment projects, progress of implementation of the asset sale and securitisation programme, and market conditions. At present, the Government has no plan to issue more government bonds than the proposed \$20 billion or equivalent limit. The Administration also confirms that \$20 billion is an absolute ceiling. If any portion of the \$20 billion or equivalent worth of bonds issued has matured and

has been redeemed, any further borrowing would have to be approved by resolution of the Legislative Council.

11. To work towards the objective of closing budgetary gap, the Administration advises that apart from encouraging economic growth, the internal committee set up by the Government to study the implementation of the Goods and Services Tax (GST) in Hong Kong will be submitting its recommendations by the end of 2004. GST will be one of the means to provide a more stable source of revenue and to open up a new revenue stream for financing the capital spending in future years. Some members have however cautioned the Administration that there may not be general support for GST. The Government should explore other measures to control public expenditure.

#### Timing of issuance

12. According to FS's letter to the House Committee, the Government's assessment is that there is likely to be significant advantages to the taxpayers if the proposed issuance of government bonds can be executed before the beginning of the Summer vacations. With the impending rise in interest rates, there is concern among members that it might not be the right time for bond issue. The Administration stresses that it has confidence that there will be support for the \$20 billion bonds as there is a strong demand for good quality bonds like bonds issued by the Hong Kong Government which enjoys a high credit rating. Although there are signs that interest rate will go up, interest rates are still at historically low levels. The Government will appoint the arranger shortly after the Resolution and arrange for the issuance as soon as possible.

#### Assessment of the effectiveness of the bond issue

13. The Subcommittee notes the concern of Association of Chartered Certified Accounts over the difficulty in assessing the effectiveness of the bond issue. The Association recommends that the Government should have a comprehensive plan on the bond issue, in particular the projects or assets to be financed, the financial arrangements for interest payment and principal redemption, and the impact on public finance. In this respect, the Administration reiterates that the \$20 billion to be raised in this bond issue will all be credited into the CWRF, which is an ongoing account, to finance those projects approved by the Finance Committee. Interest expenditure on

Government bonds will be paid out of CWRP. This allows the capital spending to be spread over the period of economic benefit of the projects.

14. On the assessment of the effectiveness of the bond issue, the Administration explains that consideration should also be given to how far the objectives of the issuance of government bonds are achieved. These objectives include the development of the local bond market, fiscal flexibility and whether it is a successful benchmark issue of the Hong Kong government bonds. Another potential measure of success is the pricing of the proposed bonds achieved when compared with other similar bonds in the international market.

#### Details of the subscription arrangements for the bonds

##### *Involvement of the financial services sector*

15. The Subcommittee notes that the financial services sector welcomes the inclusion of brokers of the Hong Kong Stock exchange and Hong Kong Securities Clearing Company Limited in the recent offering of "Hong Kong Link 2004 Limited" (for the securitisation of Government toll tunnels and bridge). The brokers wish that they could also be included in this upcoming issue of government bonds. To make their involvement more effective, an internal survey has been conducted and some suggestions to improve the subscription arrangements are being made to the Government. These suggestions include the provision of a standard electronic subscription form for giving electronic instruction, and provision of more information about the role of brokers on the cover of prospectus. The Administration considers that the securitisation exercise, which was the first offering involving a large number of brokers, was already quite successful. The Administration, nevertheless, would convey the suggestions of brokers to the arranger once it is appointed.

##### *Target investors and types of bonds*

16. The Subcommittee notes that the bond issue will offer a major domestic and global offering to retail and institutional investors. It is expected that there will be a mix of three tranches for local retail, local institutions and international institutions. The Government has not been able to provide the Subcommittee details of its offering, nor the cost of the bond issue, because in compliance with regulatory requirements, such information cannot

be disclosed prior to the formal launch of the bond. Nevertheless, the Government agrees to provide as much information as possible to the Panel on Financial Affairs in mid June 2004.

17. On the allocation of bonds for major investors, the Administration assures members that opportunities would be offered to all types of investors, in particular local investors. The Government will determine the size of each tranche having regard to the different tiers of bonds to be suggested by the arranger. Depending on the advice of the arranger, there may be a higher percentage of bonds with a longer term.

18. As regards the currency to be adopted for the bonds, the Administration advises that since the bonds are intended to be offered in the international market, it is likely that part of the bonds would be in foreign currency. The exact type(s) of currency and the percentage of bonds in foreign currency will have to be considered on the advice of the arranger. Nevertheless, it is expected that it would be in substantial amount in order that a successful benchmark can be established in the international market.

#### Wording of the Proposed Resolution

19. The Subcommittee notes that the means of borrowing, i.e. issuance of government bonds, is not specified in the Proposed Resolution as in the case of the recent securitization exercise. The Administration explains that Section 3(1) of the Loans Ordinance only requires the sum and purposes of the loan to be approved by resolution of the Legislative Council. The manner and terms and conditions of borrowing are to be agreed between the Government and the lender. The manner of borrowing in the recent securitization exercise was specified as the borrowing is to be repaid from future revenue from concerned facilities. The situation is different in the present case as repayment in respect of plain/vanilla government bonds will be made through future appropriations out of General Revenue. The wording of the Proposed Resolution is based on that used in similar resolutions passed by the Legislative Council in 1975 and 1991.

20. The Subcommittee notes that the Administration would recommend to the FS to exercise his discretion under Section 3(4) of the Loans Ordinance to exclude the loans agreements from the application of Section 3(3). Under

Section 3(3) of the Loans Ordinance, FS shall cause a copy of the agreement between the Government and a lender in respect of sums borrowed to be laid on the table of the Legislative Council. As most of the information contained in the agreement will be included in the prospectus, the only information that is not laid before the Council is the identity of the investors and the sum invested.

21. The Subcommittee notes that the raising of loans in Hong Kong by the issue of bonds is also provided for in the Loans (Government Bonds) Ordinance (Cap. 64). According to the Government, it considers the Loans Ordinance (Cap. 61) more appropriate in the present proposal as Cap. 61 allows the issue of bonds in paperless form. In Cap. 64, Section 3 specifies that the bonds should be "bearer bonds". Bearer bonds are no longer applicable in today's bond issuance as paperless form is the norm of the day. Besides, by moving the resolution under Cap. 61, the resolution could clearly provide for the credit of proceeds to the CWRP and payment of interests and principal therefrom. The Subcommittee suggests that the Administration should take steps to review whether any parts of Cap. 61 and Cap. 64 have become obsolete or outdated having regard to the current market situation. The Administration agrees to this suggestion.

### **Recommendation**

22. The Subcommittee has completed its deliberation on the Proposed Resolution. The Subcommittee supports the Proposed Resolution and recommends that the FS may move the Proposed Resolution at the Council meeting on 19 May 2004.

### **Advice sought by circulation**

23. As no House Committee meeting will be held before 19 May 2004, this paper is circulated to all members of the House Committee for endorsement of the recommendation in paragraph 22 above.

Council Business Division 1  
Legislative Council Secretariat  
14 May 2004

LOANS ORDINANCE

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**RESOLUTION**

(Under section 3(1) of the Loans Ordinance (Cap. 61))

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RESOLVED, in the exercise of the powers conferred by section 3(1) of the Loans Ordinance, that the Government be authorized to borrow, for the purposes of the Capital Works Reserve Fund established by resolutions passed under section 29 of the Public Finance Ordinance (Cap. 2), a sum or sums not exceeding in total \$20 billion or equivalent.

**Subcommittee on  
proposed resolution under section 3(1) of the Loans Ordinance  
(by way of issuance of Government Bonds)**

**Membership list**

**Chairman**                      Hon SIN Chung-kai

**Member**                      Dr Hon David CHU Yu-lin, JP  
                                      Hon Emily LAU Wai-hing, JP  
                                      Hon Henry WU King-cheong, BBS, JP  
                                      Hon Audrey EU Yuet-mee, SC, JP

(Total : 5 members)

**Clerk**                              Ms Pauline NG

**Legal Adviser**                Mr Stephen LAM

**Date**                                13 May 2004