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Legislative Council

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

Background Brief

Purpose

This paper sets out the background to the proposed resolution to authorize the Government to borrow, for the purposes of the Capital Works Reserve Fund, a sum or sums not exceeding in total \$20 billion, and summarizes the concerns raised on this issue.

Background

2. At the Council meeting on 22 October 2003, the Financial Secretary (FS) gave a statement on "Hong Kong's Economy and Management of Public Finances". In his statement, the FS pointed out that the issuance of bonds was another possible source of funding for capital projects. It will also help promote the development of Hong Kong's capital markets and offer an additional investment avenue for members of the community. In his Budget speech for 2004-05 on 10 March 2004, FS announced his proposal to issue government bonds to fund infrastructure or other investment projects which will bring long-term economic benefits to Hong Kong. He highlighted the benefits of the issuance of government bonds in providing greater flexibility in the management of liquidity and in Government's asset sale and securitization programme, obviating the need to sell government assets at low prices under unfavourable market conditions. FS proposes to issue bonds not exceeding \$20 billion in 2004-05.

3. 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 established by resolutions passed under Section 29 of the Public Finance Ordinance (Cap. 2) (Proposed Resolution) (**Appendix I**).

4. 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.

5. 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.

Concerns raised on the issuance of government bonds

6. There was wide public discussion on Government's plan to issue bonds for funding infrastructure and other investments projects soon after the plan was announced. To facilitate members' discussion, the Research and Library Services Division of the LegCo Secretariat has prepared an information note on public views expressed on the issuance of Government bonds during the period from 23 October 2003 to 6 May 2004. The information note is attached at **Appendix II**. The majority of those who have given views on the subject are in support of the issuance of government bonds and consider it a help to the development of the bond market. Those who object to the proposal are more concerned about the risks involved and the lack of financial returns from the infrastructure projects to be funded by the borrowed sums.

7. There were also discussions on the subject at the special briefing for the Finance Committee (FC) on 11 March 2004 and at the special FC meeting to examine the Estimates on 29 March 2004. Members expressed support for the Administration's initiative to promote Hong Kong's debt market. The following issues were also raised for discussion:

- (a) The issuance of government bonds would receive more favourable responses with the assistance of the financial services sector. Nevertheless, new Government bonds and securitized bonds should not only be limited to institutional investors;
- (b) There should be more bonds distribution channels for retail and small investors; and
- (c) There should be full details on the amount of repayments made by the Government in respect of the bonds it issued in the Estimates of the corresponding repayment years.

Issues raised by the Legal Service Division

8. The Legal Service Division, in its report on the Proposed Resolution in LC Paper No. LS73/03-04, has raised a number of issues including some issues which were raised during the discussion of the recent offering of the "Five Tunnels and One Bridge". These issues include the discretion to be given to FS to exclude the agreement relating to the issuance of bonds from the application of section 3(3) of the Loans Ordinance, which requires a copy of the agreement to be laid on the table of the Legislative Council.

9. The Legal Service Division also points out that the means to raise the loan, i.e. by way of issuance of bonds, is not specified in the Proposed Resolution. The Administration's explanation is that section 3(1) of the Loans Ordinance requires the sum and the purposes of the loan to be approved by resolution of the Legislative Council while the manner and terms and conditions of borrowing are to be agreed between the Government and the lender. In the recent offering of "Five Tunnels and One Bridge", the means of raising fund is specified to remind investors and other parties that General Revenue is not involved, whereas in the present case, this reminder is not necessary as repayment for plain/vanilla bonds (bonds issued in the name of Government) would be made from future appropriations out of the General Revenue.

Public Consultation

10. To facilitate the study of the Proposed Resolution, the Secretariat has invited those organizations and persons (except LegCo Members) who have given views on the issuance of government bonds to give their views on the Proposed Resolution to the Subcommittee. A list of these organizations and persons is given in **Appendix III**. As at 11 May 2004, the following submissions have been received:

- (a) Fitch Ratings Hong Kong
- (b) ACCA Hong Kong

Other reference materials

11. Members may also wish to refer to the following documents:
- (a) LegCo Brief on the Proposed Resolution issued on 31 March 2004; and
 - (b) Report of the Subcommittee on proposed resolution under Section 3(1) of the Loans Ordinance (by way of securitizing Government revenue receivable from tolls on specified bridges and tunnels) (LC Paper No. CB(1)866/03-04)

Council Business Division 1
Legislative Council Secretariat
12 May 2004

LOANS ORDINANCE

RESOLUTION

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

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.

Fact Sheet

Public views on the Proposed bond issuance by the Hong Kong Government 23 October 2003 to 6 May 2004

Views in favour of bond issuance by the Hong Kong Government		
<i>Central Government Officials</i>		
Mr JIN Rengqing (Minister of Finance of the PRC)	Bond issuance by the Hong Kong Government is one of the measures to solve the deficit problem, and bonds are also issued in the Mainland. Keeping the expenditure within the limits of revenues is a financial principle to be adhered to.	Wen Wei Po (11/3/04)
Mr ZHOU Xiaochuan (President of the Bank of China)	The issuance of bonds, which is a normal practice, can solve the problem relating to the fiscal imbalance in Hong Kong. Proper bond issuance should not pose any problem. According to international standards, it is acceptable for the fiscal deficit to account for 3% of the GDP.	Wen Wei Po (11/3/04)
Mr WEN Jiabao (Premier of the State Council)	The Central Government has adopted a positive attitude towards Hong Kong's issuance of bonds totalling HK\$20 billion.	Wen Wei Po (8/4/04)
A research specialist in a central government department	The Central Government may, by utilizing its foreign exchange reserves or other means, purchase the government bonds to be issued by the Hong Kong Government, and this will be one of the important policies being formulated by the Central Government for the support of Hong Kong. This would undoubtedly help promote the development of Hong Kong's capital market, enhance Hong Kong's position as a financial centre, and in particular consolidate investors' confidence in the HKSAR Government.	Wen Wei Po (8/4/04)

Views in favour of bond issuance by the Hong Kong Government		
<i>Hong Kong Government Officials</i>		
Mr Henry TANG Ying-Yen (Financial Secretary)	The issuance of bonds by the government is conducive to the development of the capital market in Hong Kong, and it provides the public with an additional investment channel.	Sing Tao Daily News (5/12/03)
	Bond issue increases the flexibility in the use of funds by the Government, and finances capital projects that will bring long-term economic benefits to Hong Kong. Also, bond issuance facilitates the development and increases the depth of the bond market in Hong Kong, further reinforcing Hong Kong's position as an international financial centre.	Hong Kong Economic Journal (5/2/04)
	The issuance of bonds by the government has three major objectives. First, to finance the government's infrastructure projects for the next five years, amounting to about \$29 billion; second, to increase the depth of the debt market in Hong Kong; and lastly, to provide small investors with an additional investment channel.	Wen Wei Po (11/3/04)

Views in favour of bond issuance by the Hong Kong Government (cont'd)		
<i>Hong Kong Government Officials (cont'd)</i>		
Mr Frederick Ma Si-Hang (Secretary for Financial Services and the Treasury)	The debt market is vital to Hong Kong's long-term economic development and its position as an international financial centre. It can provide companies with an additional financing channel, and is especially beneficial to the financing of longer-term projects; and for investors, the bond market can provide them with an additional investment alternative.	Hong Kong Daily News (27/1/04)
	The government's objective is to issue government bonds to be distributed to the general public, to promote the development of the local bond market.	Hong Kong Economic Journal (5/5/04)
Mr Joseph YAM (Chief Executive, Hong Kong Monetary Authority)	Not worried that the government's on-going bond issuance would cause the public to think that the amount obtained would be used to offset the fiscal deficit, which would in turn affect the credit ratings, because the Administration has already stressed that bond issuance is only to offset the capital account deficit.	Apply Daily (10/12/03)
<i>Legislative Council, Legislative Council Members and Political Parties</i>		
Mr SIN Chung-kai	Hong Kong has the right conditions for bond issuance, however, it should be disciplined and should not do so for the sake of fiscal deficit.	Hong Kong Economic Times (8/12/03)
The Democratic Party	Supported the issuance of government bonds and the disposal of assets to solve the deficit problem.	Metro Daily (12/2/04)
	The results of an opinion survey shows that 60 % of the interviewees support the issuance of government bonds as proposed in the Budget, and 21% have expressed opposition.	Apply Daily (28/2/04)

Views in favour of bond issuance by the Hong Kong Government (cont'd)		
<i>Legislative Council, Legislative Council Members and Political Parties (cont'd)</i>		
Mr James Tien Pei-chun	Hong Kong should actively develop its debt market to enable Hong Kong to become a bond centre in the region; bond issuance can provide an additional investment channel for the public, however, as bond issuance is “taking money from the left pocket and putting it in the right”, it might not actually help alleviate the fiscal deficit.	Hong Kong Economic Journal (9/3/04)
The Breakfast Group	The SAR government may consider issuing bonds to maintain its fiscal reserves at a certain level.	Wen Wei Po (9/3/04)
MA Lik (Secretary General of the Democratic Alliance for Betterment of Hong Kong)	Bond issuance for large scale infrastructure projects which support future economic development is worth supporting; however, if it is intended to reduce the fiscal deficit, the government’s financial management approach will virtually be the same as that of those using credit cards to make ends meet, which is unacceptable to the DAB.	Wen Wei Po (9/3/04)
Mr CHAN Kam-lam	As long as the purpose of the government’s bond issuance is to support the development of infrastructure projects but not to “offset the shortfalls”, issuance of bonds in Hong Kong dollars or US dollars is worth supporting.	Wen Wei Po (9/3/04)

Views in favour of bond issuance by the Hong Kong Government (cont'd)		
<i>Legislative Council, Legislative Council Members and Political Parties (cont'd)</i>		
Dr David LI Kwok-po	Supported the government's initiative to increase revenue by way of bond issuance.	Ta Kung Pao (11/3/04)
Mr Jasper TSANG Yok-sing	Recognized that the government's proposal to issue bonds is a right move. It can raise funds for investment in infrastructure projects, increase the flexibility of the government's asset disposal and securitisation exercises, and avoid disposing assets at low prices when market conditions are unfavorable; furthermore, the issuance of government bonds also facilitates the development of the bond market in Hong Kong.	Ming Pao (22/4/04)
Dr David CHU Yu-lin	Supported the issuance of bonds by the government, on the one hand, bond issuance can decrease the huge cut back in various social and economic infrastructure investments in an attempt to reduce the fiscal deficit, on the other hand, the revenues from bond issuance can be used specifically to offer tax concessions to the middle class, and help the negative-equity property owners tide over their difficulties. However, the bond issuance proposal in the Budget was not ambitious enough, the amount of \$20 billion is too small indeed.	Oriental Daily (28/4/04)
<i>International Financial Organizations</i>		
P.Gruenwald (Hong Kong Representative, International Monetary Fund(IMF))	Supported the issuance of bonds by the government.	Apple Daily (12/3/04)

Views in favour of bond issuance by the Hong Kong Government (cont'd)		
<i>Chambers of Commerce and Institutes</i>		
Mr Raymond Or (Chairman, the Hong Kong Association of Banks)	Welcomes the government's bond issue initiative, and believes that it will promote the development of the debt market in Hong Kong; however, bond issuance is not a long-term solution for the deficit problem.	ATV On-line News (5/12/03)
Mr Edward CHOW (Vice Chairman, the Business and Professionals)	Supports the issuance of bonds by the government to meet the expenses on infrastructure.	The Sun (6/1/04)
Mr Leo C M LI (President, ACCA Hong Kong)	The issuance of bonds by the government will not create any impact on the existing market, on the contrary, there will be an additional bond product available in the market, which is a good thing for the development of the bond market in Hong Kong.	Ta Kung Pao (11/3/04)
Mr LI Man Fai (Chairman, the Taxation Institute of Hong Kong)	Supports the government's initiative to issue bonds, which facilitates the more effective use of funds by the Government, and provides the public with more investment opportunities.	Metro Daily (15/3/04)
Ms Helen WONG (The Hong Kong Capital Markets Association)	Believes that the government's bond issuance will attract more retail investors to the market.	Ta Kung Pao (17/3/04)
Junior Chamber International Hong Kong	Recognizes the government's bond issue initiative.	Ming Pao (3/4/04)

Views in favour of the bond issuance by the Hong Kong Government (cont'd)		
<i>Credit Rating Agencies</i>		
Mr David Marshall (Managing Director, Fitch Ratings Hong Kong Limited)	The issuance of bonds by the Hong Kong government will strengthen Hong Kong's position as a financial centre. If the objective of bond issuance is to raise funds for infrastructure projects, under the current circumstances of a serious deficit, it can indeed reduce the extent of the decrease in fiscal reserves and help stabilize public confidence in the linked exchange rate.	Apple Daily (28/2/04)
<i>Banking Sector/Financial Sector</i>		
Mr David PM CHAN (Senior Economist, DBS Bank (Hong Kong) Ltd.)	The issuance of bonds by the government helps increase the depth of the local bond market, because these are longer-term bonds, and can thereby establish a benchmark for the market, to make up for the deficiency of the present market. This will have positive effects on strengthening Hong Kong's position as a financial centre.	The Sun (23/10/03)
Mr George LEUNG (Chief Economist (Greater China) of the HSBC)	It is a good opportunity for the government to issue bonds to alleviate its financial burden, however, the government should not increase its recurrent expenditure as a result.	Wen Wei Po (29/2/04)
Mr FUNG Hao- chung (Managing Director of Treasury and Markets, DBS Bank)	Bond issuance by the government can increase the depth of development of the local debt market and change the problem of polarization of the public's investment patterns (i.e. investing only in shares and fixed deposits).	Wen Wei Po (11/3/04)

Views in favour of bond issuance by the Hong Kong Government (cont'd)		
<i>Banking Sector/Financial Sector (cont'd)</i>		
Mrs Sandra Tse (Investment Management Director & Head of Retail & Marketing & Product Development of HSBC)	For retail investors, government bonds, as compared with other low-risk investment tools such as guaranteed funds in terms of returns, will be a good option.	Wen Wei Po (11/3/04)
Mr Alasdair G. MORRISON (Chairman and CEO of Morgan Stanley Asia)	Hong Kong government's issuance of bonds demonstrates its commitment to strengthening Hong Kong's position as an international financial centre. Although the issue size is only \$20 billion, it is sufficient to show that the Hong Kong government intends to play a leading role in promoting the local bond market.	Oriental Daily (11/3/04)
Mr DAI Daohua (Economic Researcher with Bank of China)	The government's on-going issuance of bonds for infrastructure investment will be of significant help to the development of the local bond market; however, when the total amount of bonds issued has reached a certain level two to three years later, factors such as whether the ratings of the Government will be undermined should be considered.	Hong Kong Economic Journal (16/3/04)
Mr David ELDON (Chairman, HSBC Asia Pacific)	It is a good idea for the government to issue bonds, which will facilitate the development of the bond market in Hong Kong.	Ming Pao (16/3/04)
<i>The Accounting Sector</i>		
Mrs Yvonne LAW (Senior Tax Partner of Deloitte Touche Tohmatsu)	In favour of implementing specific infrastructure projects or investment projects by way of bond issuance.	Apply Daily (5/12/03)

Views in favour of bond issuance by the Hong Kong Government (cont'd)		
<i>The Accounting Sector (cont'd)</i>		
Ms Jennifer WONG (Tax Partner, KPMG)	In favour of the government's issuance of government bonds.	Ta Kung Pao (4/3/04)
Ms Brenda CHEUNG (Tax Controller, Grant Thornton LLP)	The issuance of bonds by the government can, on the one hand, reduce its fiscal deficit, and on the other hand, promote the development of the local bond market and infrastructure projects.	Ta Kung Pao (11/3/04)
<i>Academics</i>		
Professor Simon HO (Director, MBA Programme in Finance Master of Science Programme, the Chinese University of Hong Kong)	The issuance of bonds by the Hong Kong government can provide local banks with a stable and healthy investment alternative for their excess funds, it will also improve the bond market and the relevant regime in Hong Kong, which is conducive to the development of Hong Kong into Asia's bond centre.	Hong Kong Economic Journal (20/2/04)
Professor Leo SIN (Professor, Department of Marketing, the Chinese University of Hong Kong)	The issuance of bonds by the government will improve Hong Kong's financial system and thus lift its international ratings	Apply Daily (28/2/04)
Dr Samuel CHAN (Associate Professor, School of Accounting and Finance, the Hong Kong Polytechnic University)	Government bond is a relatively stable and healthy low-risk investment tool, it can stimulate the investment sentiment of institutional and retail investors.	Metro Daily (11/3/04)

Views in favour of bond issuance by the Hong Kong Government (cont'd)		
Academics (cont'd)		
Mr Robert CHUNG (Director, the Public Opinion Programme, the University Hong Kong)	A survey of the HKU Pop Site indicates that there is general support for the government's proposed bond issue initiative.	Wen Wei Po (12/3/04)
Professor TANG Shu Hung (Head & Professor, Department of Economics, Hong Kong Baptist University)	Mr Henry TANG Ying-Yen has made the right decision in proposing the issuance of government bonds to stop the continual shrinkage in the size of the fiscal reserves; government bonds, which is a means of financing employed by a lot of countries, can also finance non-recurrent infrastructural expenditures.	Hong Kong Daily News (13/3/04)
Professor Stephen Y L CHEUNG (Department of Economic and Finance, City University of Hong Kong)	With the prevailing low interest rates, it is a good opportunity for the government to issue bonds; however, the government should introduce legislation on the upper threshold of the issue size, and establish stringent controls in order that the funds so raised would only be used in infrastructure projects.	Apply Daily (29/3/04)

Views not fully subscribing to bond issuance by the Hong Kong Government		
<i>Legislative Council, Legislative Council Members and political parties</i>		
Dr Eric LI Ka-cheung	Issuing bonds for toll-free infrastructure creates the impression of “advance spending”.	Ming Pao (5/12/03)
<i>Banking Sector/Financial Sector</i>		
<i>Financial Commentary</i> , No.21, Bank of China (Hong Kong)	<p>No matter how the Hong Kong bond market develops, as the linked exchange rate has to be maintained, the government should not take the lead to launch large-scale bond issues, otherwise, new risks would emerge.</p> <p>Besides, with the huge excess funds in the banking sector of Hong Kong, it is foreseeable that the \$20 billion worth of Hong Kong dollar bonds will not be able to meet the demand. There has to be on-going supplementary bond issues from now on, otherwise, there will be undue expectations that the secondary market will be heated up or private institutions will follow suit. Thus, although the government’s bond issuance is a breakthrough, excessively high expectations would be unrealistic.</p> <p>It would be prudent to recognize that the \$20 billion loan has to be repaid eventually. As details of the bond issuance have yet to be released, the accounts in the Budget have not reflected the fact that the loan has to be repaid. Hence, it is essential for the government to clarify as soon as possible whether its bond issuance is a one-off or recurrent exercise, as it relates to whether new bonds will be issued for the repayment of the old ones.</p>	Hong Kong Economic Times (1/4/04)

Views not fully subscribing to bond issuance by the Hong Kong Government (cont'd)		
Academics		
Professor Francis LUI (Centre for Economic Development, Department of Economics, Hong Kong University of Science and Technology)	Does not subscribe to the government's objective of issuing bonds because the revenue generated will only be used on infrastructure projects without projected investment returns, which is "advance spending" in disguised form.	Apply Daily (28/2/04)

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Reference

1. Wisers Information Limited (23 October 2003 to 6 May 2004)
Electronic press clipping services for the Legislative Council.

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

**List of Organizations and Individuals
Invitations for Submission**

Organizations

The Hong Kong Association of Banks

The Taxation Institute of Hong Kong

Junior Chamber International Hong Kong

Association of Chartered Certified Accountants Hong
Kong

The Hong Kong Capital Markets Association

The Business and Professionals Federation of Hong Kong

CPA Australia - Hong Kong Branch

Fitch Ratings Hong Kong Limited

Individuals

Mrs Yvonne LAW
Senior Tax Partner
Deloitte Touche Tohmatsu

Miss Brenda CHEUNG
Tax Controller
Grant Thornton

Miss Jennifer WONG
Partner, Tax
KPMG

Professor Leo SIN
Department of Marketing
CUHK

Professor TANG Shu-hung
Head & Professor
Department of Economics
Hong Kong Baptist University

Dr Samuel CHAN
Associate Professor
School of Accounting and Finance
The Hong Kong Polytechnic University

Professor Simon HO
Dean, School of Business
Hong Kong Baptist University

Mr Robert CHUNG
Director
The Public Opinion Programme
The University of Hong Kong

Professor Francis LUI
Director
Center for Economic Development
Department of Economics
Hong Kong University of Science and Technology