

# The 2014-2015 Budget

March 2014

The Government has to spend within its means as stipulated under Article 107 of the Basic Law. Yet years of revenue under-estimation may have restricted total government expenditure growth, resulting in larger than expected budget surpluses. The Government has distributed part of the surpluses in the form of one-off relief measures.

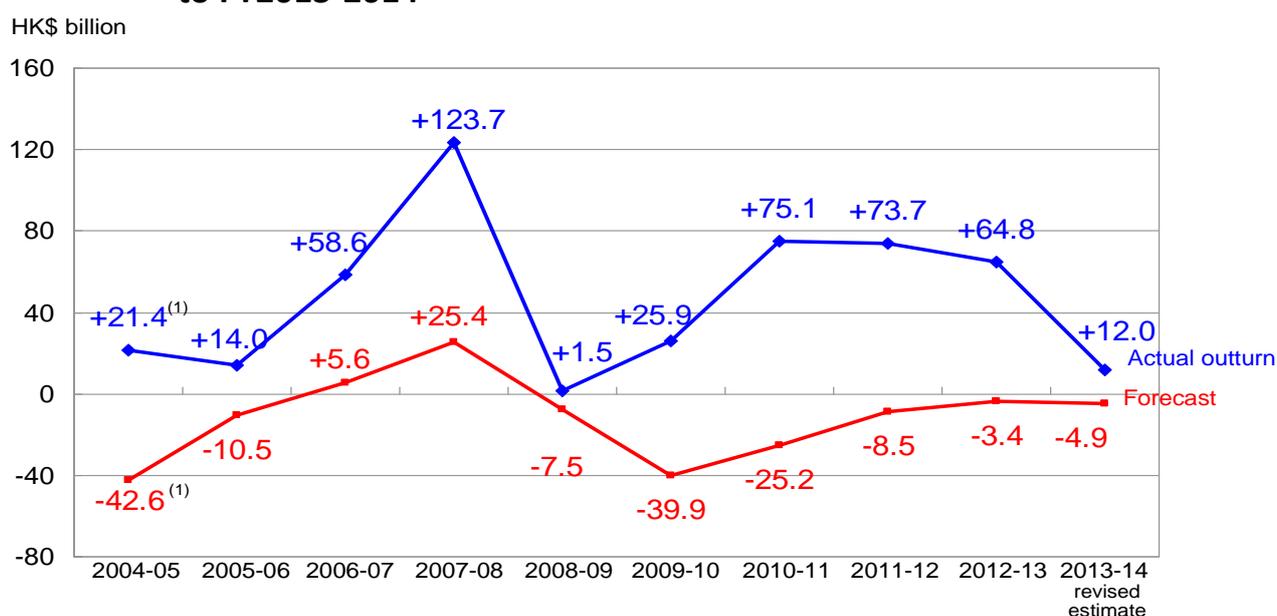
The Government spent a total of HK\$220 billion on one-off relief measures between FY2007-2008 and FY2013-2014. The beneficiaries of these one-off relief measures were the general public, low-income group, taxpayers, private flat owners, companies, public housing tenants and disadvantaged group, of which the general public benefited the most.

In his 2014-2015 Budget, the Financial Secretary has proposed to reduce the scale and variety of the one-off relief measures. Such a retrenchment is likely to continue in subsequent budgets in view of the need to contain the expenditure growth as recommended by the Working Group on Long-Term Fiscal Planning.

## 1. Background

1.1 The Financial Secretary delivered his seventh budget speech on 26 February 2014. He announced an estimated surplus of HK\$12 billion for the Financial Year ("FY") 2013-2014, against the deficit of HK\$4.9 billion originally forecast. The forecast turnaround for FY2013-2014 was one of the many seen in the budget speeches delivered between FY2004-2005 and FY2013-2014 (**Figure 1**), as the Government has consistently under-estimated revenue (**Figure 2**) and over-estimated expenditure (**Figure 3**) which totalled HK\$442 billion and HK\$140 billion respectively during the period.

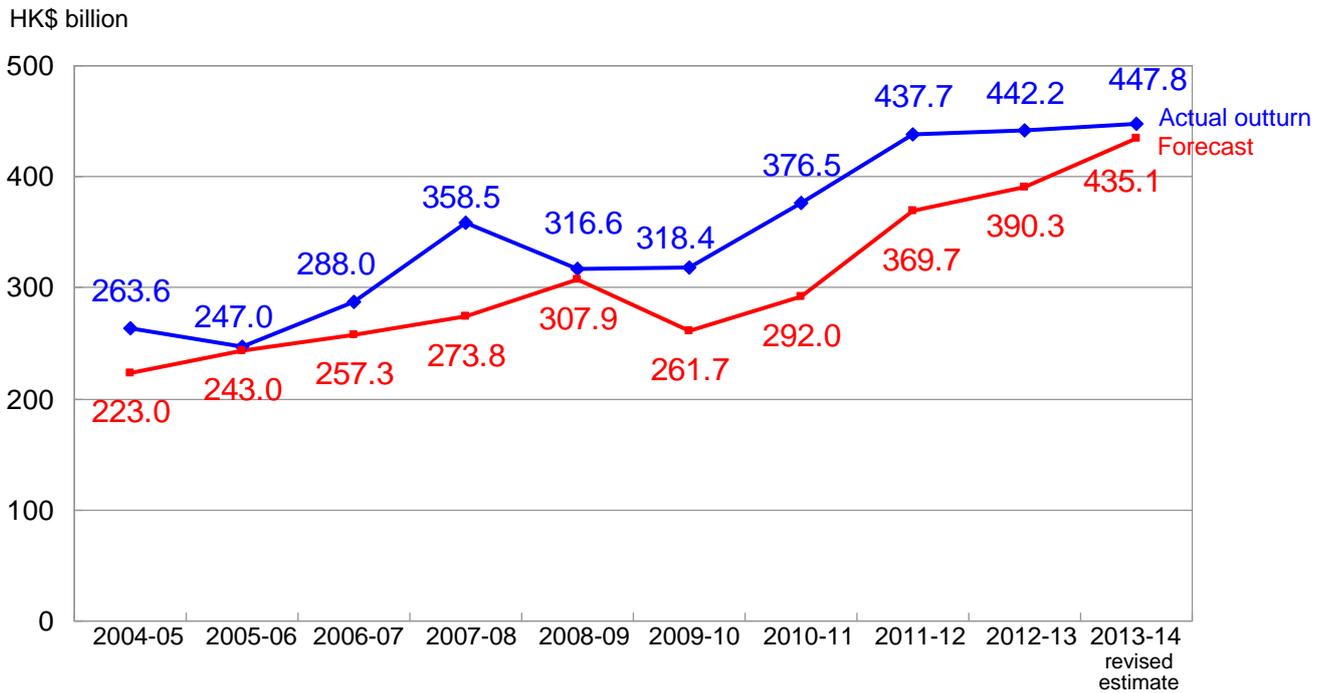
**Figure 1 – Budget surplus/deficit forecast against the actual outcome, FY2004-2005 to FY2013-2014**



Note: (1) A positive sign means surplus while a negative sign means deficit.

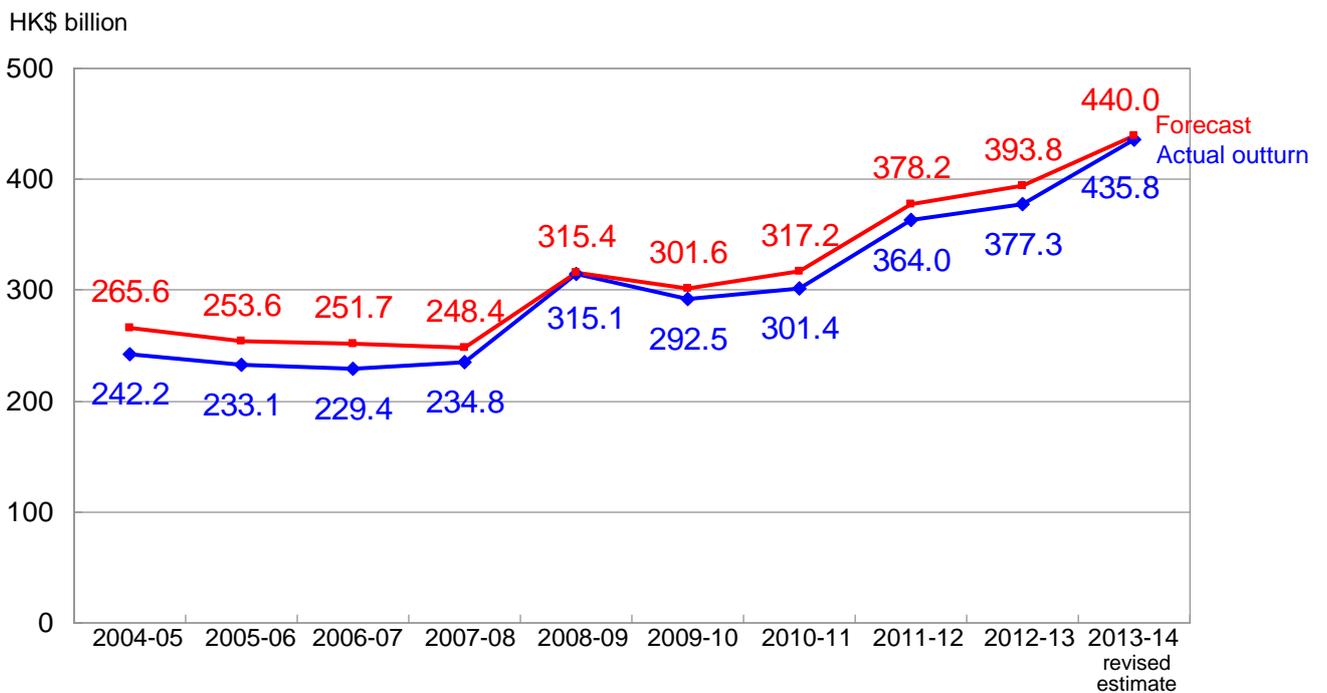
Source: Budget speech, various years.

**Figure 2 – Government revenue forecast against the actual outturn, FY2004-2005 to FY2013-2014**



Source: Budget speech, various years.

**Figure 3 – Government expenditure forecast against the actual outturn, FY2004-2005 to FY2013-2014**



Source: Budget speech, various years.

1.2 The conservative budget strategy reflects the prudent financial management as set out in Article 107 of the *Basic Law*, under which the Hong Kong Special Administrative Region shall:

- (a) follow the principle of keeping the expenditure within the limits of revenues in drawing up its budget;
- (b) strive to achieve a fiscal balance and avoid deficits; and
- (c) keep the budget commensurate with the growth rate of its gross domestic product ("GDP").

1.3 The Government has also set out a number of budgetary criteria to ensure adherence to prudent financial management. For example, as a general principle, expenditure growth over time should not exceed the growth of the economy and the Government aims to keep public expenditure at or below 20% of GDP. In addition, the Government aims to achieve a balance in the consolidated and operating accounts. It aims, over time, to achieve an operating surplus to partially finance capital expenditure.

1.4 The Financial Secretary has all along prepared his Budget in line with Article 107 of the *Basic Law* and the budgetary criteria mentioned above. This year's Budget has also taken note of the various findings and recommendations from the Working Group on Long-Term Fiscal Planning.<sup>1</sup> It discussed the three projections from the Working Group for the future state of Hong Kong's financial health based on prevailing economic growth trend and demographic changes.<sup>2</sup> The Budget also touched on the Working Group's recommendation to implement a combination of measures, including containing the expenditure growth, preserving the revenue base and saving for the future, to cope with the fiscal challenges.

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<sup>1</sup> The Working Group was set up by the Government in June 2013 to explore ways to make more comprehensive planning for Hong Kong's public finances in order to cope with the ageing population and the Government's other long-term commitments.

<sup>2</sup> Taking into account economic growth trend and demographic changes, the Working Group projects that a structural deficit would surface between seven and 15 years' time based on different expenditure growth scenarios.

## 2. Government revenue and expenditure

2.1 The Government has consistently under-estimated its revenue, and the amount of discrepancy totalled HK\$442 billion in the past decade. Systematic under-estimation of revenue income has invited repeated calls from the public for the Financial Secretary to come up with a better forecast of the revenue yields.

2.2 Years of revenue under-estimation may have also restricted total government expenditure growth as Hong Kong has to spend within its means as stipulated under Article 107 of the *Basic Law*. While capital expenditure<sup>3</sup> continued to rise in recent years, gradually catching up with capital revenue in FY2013-2014 (**Figure 4**), growth of recurrent expenditure<sup>4</sup> still fell short of that of operating revenue (**Figure 5**).<sup>5</sup> Recurrent expenditure grew by 48.3% between FY2004-2005 and FY2013-2014, which was lower than would otherwise be possible in view of the 85.1% increase in operating revenue.<sup>6</sup> In order to help the public cope with short-term financial pressure and preserve economic stability and short-term employment, the Government has distributed part of the budget surpluses in the form of one-off relief measures. Hence, operating expenditure grew by 72.1% between FY2004-2005 and FY2013-2014, mainly due to the spending on one-off relief measures.

2.3 This year's Budget will continue the one-off relief measures, but the Financial Secretary has proposed to reduce the amount of which to HK\$20 billion in FY2014-2015 from HK\$33 billion in FY2013-2014. The reduction is mainly a result of the waiver of rates being cut by half to two quarters and no electricity subsidy being given for FY2014-2015. The phasing out of one-off relief measures is likely to continue in subsequent budgets to save for the future spending on other areas, particularly in view of the need to contain the expenditure growth as proposed by the Working Group on Long-Term Fiscal Planning.

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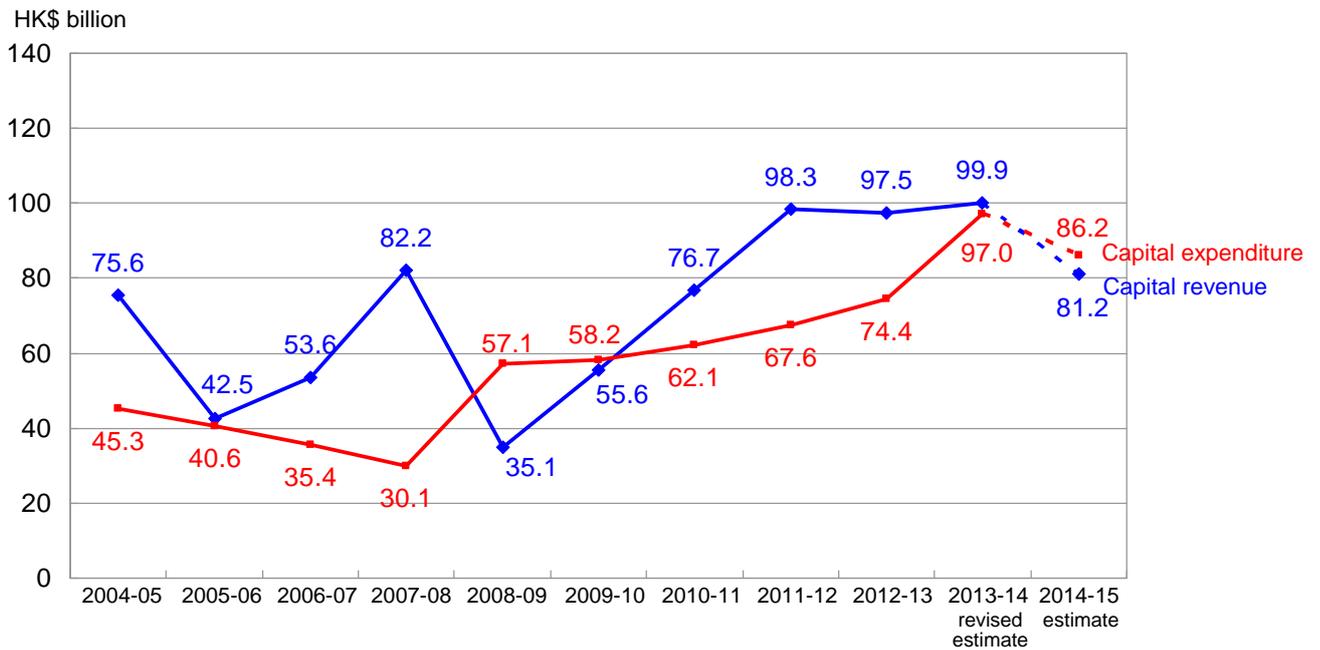
<sup>3</sup> Capital expenditure comprises all expenditure charged to the Capital Account of the General Revenue Account, Capital Investment Fund, Capital Works Reserve Fund (including interest on government bonds and notes but excluding repayment of the bonds and notes), Disaster Relief Fund, Innovation and Technology Fund, Loan Fund and Lotteries Fund. Expenditure charged to the Capital Works Reserve Fund accounts for the largest part of capital expenditure, from which the Financial Secretary may expend money for development, purchase and installation of major systems and equipment, the public works programme, land acquisitions, capital subventions, computerization, the payment of redemption money in respect of land exchange entitlements etc. These capital projects serve the purpose of enhancing Hong Kong's competitiveness, thereby creating employment and generating higher economic growth.

<sup>4</sup> Recurrent expenditure is used for financing the Government's permanent measures to provide daily services in policy areas such as education, health services and social welfare for the benefit of improving people's livelihoods.

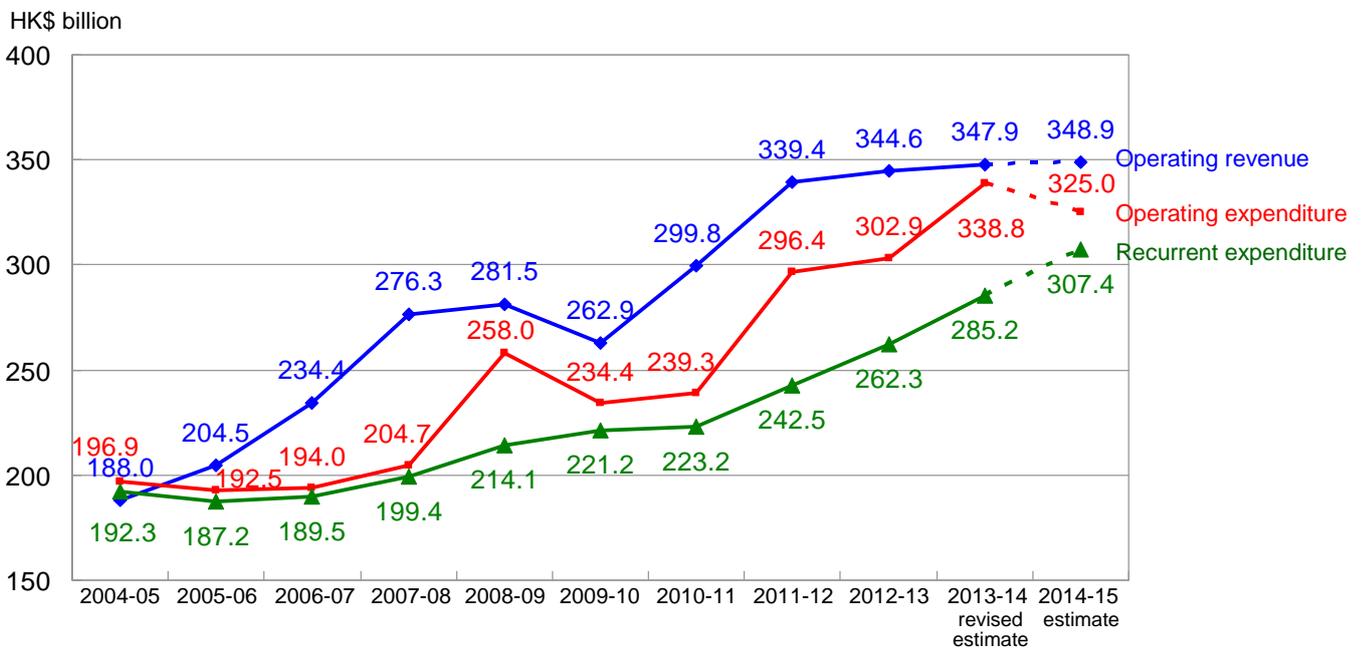
<sup>5</sup> Operating expenditure comprises all expenditure charged to the Operating Account of the General Revenue Account. It consists of recurrent and non-recurrent expenditure. Non-recurrent expenditure covers expenditure on items of one-off nature.

<sup>6</sup> The shortfall may affect people's livelihood, as education, social welfare and health are the three major recurrent expenditure items: they accounted for about 60% of the total in FY2013-2014. Some members of the public are of the view that higher recurrent expenditure would improve people's livelihood such as through (a) providing better child care services to support families in need, (b) hiring more medical staff to share the heavy workload in public hospitals, and (c) implementing small-class teaching in secondary schools.

**Figure 4 – Capital revenue and capital expenditure, FY2004-2005 to FY2014-2015**



**Figure 5 – Operating revenue, operating expenditure and recurrent expenditure, FY2004-2005 to FY2014-2015**



### 3. One-off relief measures

3.1 Between FY2004-2005 and FY2013-2014, the expenditure and revenue forecasts were of such variance from the actual outturn to cause an under-estimation of the actual financial result by HK\$582 billion. Since FY2007-2008<sup>7</sup>, the Government has persistently distributed part of the budget surpluses in the form of one-off relief measures such as public rental and rates waiver, tax concessions, electricity subsidy, extra social welfare payment and even cash handout (**Table 1**). These one-off relief measures cost the Government a total of HK\$220 billion between FY2007-2008 and FY2013-2014.

**Table 1 – One-off relief measures and beneficiary groups, FY2007-2008 to FY2013-2014**

Beneficiary group	One-off relief measure	2007-2008	2008-2009	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014
Taxpayers	Salaries tax rebate	✓	✓	✓	✓	✓	✓	✓
Private flat owners	Rates waiver	✓	✓	✓	✓	✓	✓	✓
	Property tax reductions		✓					
Public housing tenants	Public rental waiver	✓	✓	✓	✓	✓	✓	✓
Disadvantaged group	Extra social welfare payments <sup>(1)</sup>	✓	✓	✓	✓	✓	✓	✓
Low-income group	Injection of HK\$6,000 into Mandatory Provident Fund ("MPF") accounts <sup>(2)</sup>		✓					
General public	Electricity subsidy		✓			✓	✓	✓
	"Scheme \$6,000" <sup>(3)</sup>					✓		
Companies	Business registration fees waiver		✓	✓	✓		✓	✓
	Profits tax rebate		✓				✓	✓
	Rental reduction for government properties			✓				

Notes: (1) Extra social welfare payments include extra allowances of Comprehensive Social Security Assistance ("CSSA"), Old Age Allowance, Old Age Living Allowance and Disability Allowance (payable between FY2007-2008 and FY2013-2014); as well as short-term food assistance (payable in FY2008-2009, and between FY2011-2012 and FY2013-2014) and allowance to students receiving CSSA or student financial assistance (payable between FY2008-2009 and FY2010-2011).

(2) In FY2008-2009, the Government injected HK\$6,000 into the MPF accounts of those people earning not more than HK\$10,000 a month.

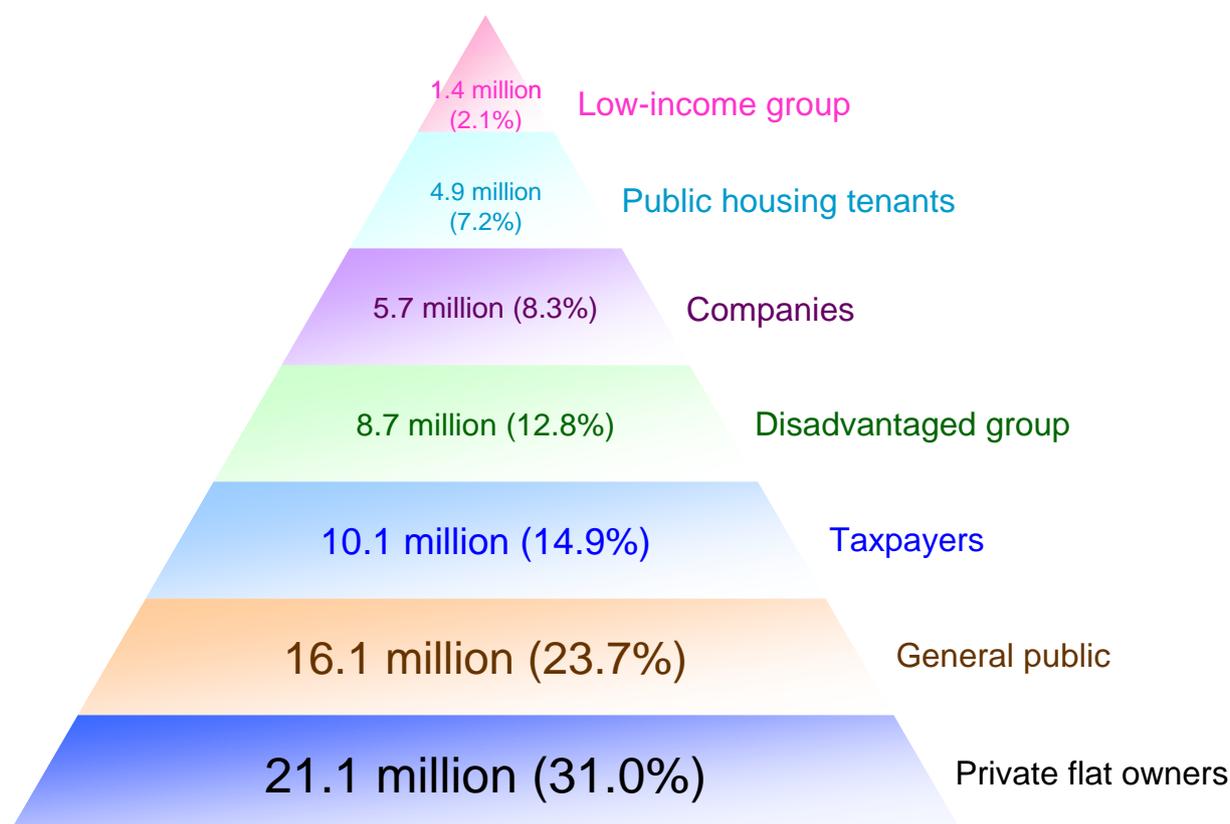
(3) In 2011, the Financial Secretary implemented "Scheme \$6,000" that gave a sum of HK\$6,000 to each Hong Kong Permanent Identity Card holder aged 18 or above. A bonus of HK\$200 was given to those eligible persons who chose to register for the Scheme after 31 March 2012. The Scheme cost the Government HK\$37.4 billion for paying to eligible persons.

Source: Budget speech, various years.

<sup>7</sup> The Government has implemented one-off relief measures in every Budget since FY2007-2008. Prior to that, the measures were less frequent and smaller in scale.

3.2 The total amount spent on each one-off relief measure during the study period depends on the size of the benefits, recurrence of the relief measures and the accumulated total number of beneficiary cases for each beneficiary group.<sup>8</sup> As shown in **Table 1** above, taxpayers, private flat owners, public housing tenants and disadvantaged group all received one-off relief benefits in each year of the period between FY2007-2008 and FY2013-2014. Analyzed by the accumulated total number of beneficiary cases, the four largest beneficiary groups were private flat owners (21.1 million), general public (16.1 million), taxpayers (10.1 million) and disadvantaged group (8.7 million) between FY2007-2008 and FY2013-2014 (**Figure 6**).

**Figure 6 – Accumulated total number of beneficiary cases by beneficiary group between FY2007-2008 and FY2013-2014**

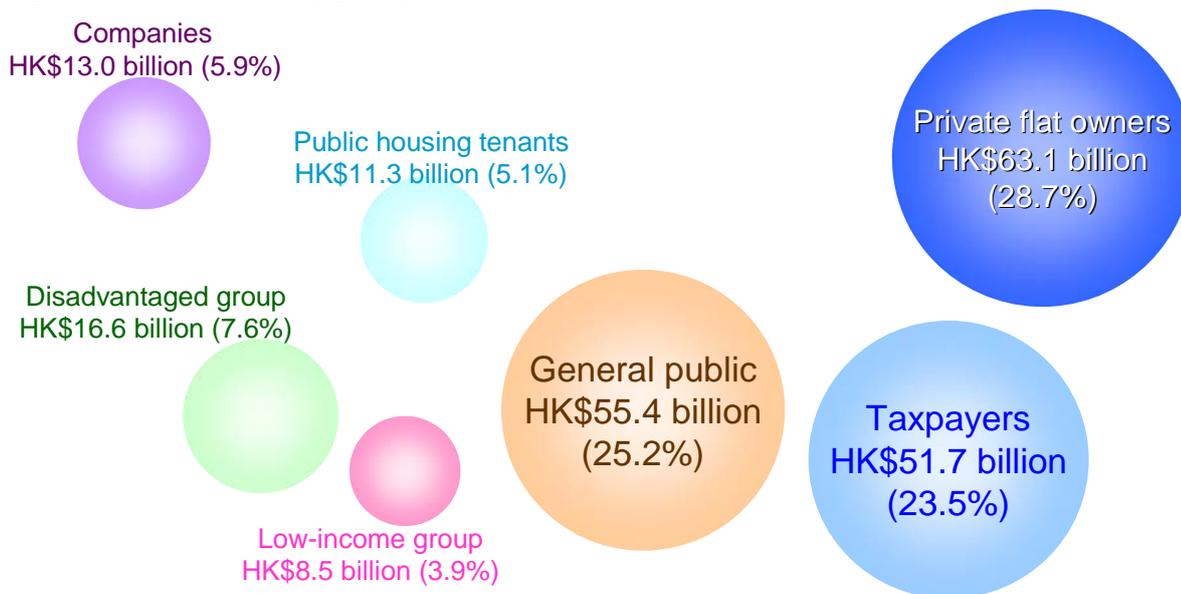


Sources: Budget speech (various years), Hong Kong Annual Digest of Statistics (various issues), and Annual Report of the Inland Revenue Department (various issues).

<sup>8</sup> Different units of beneficiaries are all equated to a common unit in terms of beneficiary cases. The size of each beneficiary group is calculated by summing up the number of beneficiary cases in the group during the study period.

3.3 Taken into account the size of the benefits dispersed under each one-off relief measure, private flat owners benefited the most as rates waiver and property tax reductions amounted to HK\$63.1 billion or 28.7% of the total amount of one-off relief measures between FY2007-2008 and FY2013-2014 (Figure 7). Over the same period, low-income group benefited the least as the one-off injection of HK\$6,000 to their MPF accounts in FY2008-2009 amounted to HK\$8.5 billion or 3.9% of the total.

**Figure 7 – Beneficiary groups of one-off relief measures, FY2007-2008 to FY2013-2014**



Source: Budget speech, various years.

3.4 However, if the average concept is applied, the general public received the most from one-off relief measures and received HK\$7,909 on average between FY2007-2008 and FY2013-2014 (Figure 8).<sup>9</sup> This was followed by low-income group (HK\$6,000), taxpayers (HK\$5,104), private flat owners (HK\$2,990), companies (HK\$2,299), public housing tenants (HK\$2,297) and disadvantaged group (HK\$1,910). The above figures were arrived at assuming no overlap between the beneficiary groups. Indeed, there were cases where people could benefit from one or more of the one-off relief measures.<sup>10</sup>

<sup>9</sup> The general public benefited from the one-off relief measures through the "Scheme \$6,000" and electricity subsidy during the study period. The total expenditure for the "Scheme \$6,000" programme payable to the eligible persons was HK\$37.4 billion and the number of beneficiary cases was 6.12 million, meaning **HK\$6,109** for each beneficiary case on average. The total expenditure for electricity subsidy amounted to HK\$18 billion and the number of beneficiary cases was 10 million, meaning **HK\$1,800** for each beneficiary case. As such, the total amount of one-off benefit received by the general public was **HK\$7,909 (HK\$6,109 plus HK\$1,800)**.

<sup>10</sup> For example, in FY2011-2012, a needy elderly was entitled to receive Old Age Allowance and Disability Allowance (the one-off relief measures for the disadvantaged group), as well as getting the cash handout of HK\$6,000 and electricity subsidy (the one-off relief measures for the general public). Another example was the rates waiver in FY2012-2013 whereby all tenements were exempted from the payment of rates subject to a ceiling of HK\$2,500 per quarter for each rateable property. An individual owner of a number of tenements liable to pay rates might have the benefit of rates concessions up to the number of tenements owned by him or her. For example, one organization received an estimated HK\$90.6 million from rates concession in FY2012-2013, the highest among all ratepayers.

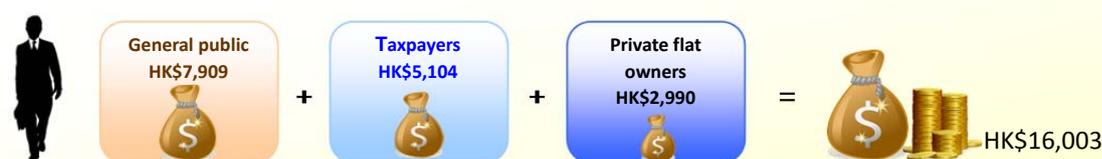
**Figure 8 – Average amount received by each beneficiary group, FY2007-2008 to FY2013-2014**



Examples of people who might benefit from multiple one-off relief measures:



A Hong Kong Permanent Identity Card holder aged 18 or above, who is also a public housing tenant and receives social welfare payment, gets HK\$12,116 on average.



A Hong Kong Permanent Identity Card holder aged 18 or above, who is also a taxpayer and a private flat owner, receives HK\$16,003 on average.

Source: Budget speech, various years.

## 4. Observations

4.1 Based on the findings above, the following observations are highlighted from the Government's budget strategy:

- (a) the Government has consistently under-estimated its revenue and the amount of discrepancy totalled HK\$442 billion between FY2004-2005 and FY2013-2014. Years of revenue under-estimation may have restricted total government expenditure growth as Hong Kong has to spend within its means as stipulated under Article 107 of the *Basic Law*;

- (b) while capital expenditure has gradually caught up with capital revenue between FY2004-2005 and FY2013-2014, growth of recurrent expenditure still fell short of that of operating revenue over the same period. The shortfall might affect people's livelihood, as education, social welfare and health are the three major recurrent expenditure items accounting for about 60% of the total in FY2013-2014;
- (c) the Government has persistently distributed part of the budget surpluses in the form of one-off relief measures. It spent a total of HK\$220 billion on one-off relief measures between FY2007-2008 and FY2013-2014, of which the general public benefited the most and received HK\$7,909 on average. This was followed by low-income group (HK\$6,000), taxpayers (HK\$5,104), private flat owners (HK\$2,990), companies (HK\$2,299), public housing tenants (HK\$2,297) and disadvantaged group (HK\$1,910). The above figures were arrived at assuming no overlap between the beneficiary groups. Indeed, there were cases where people could benefit from one or more of the one-off relief measures; and
- (d) the Financial Secretary has proposed to reduce the scale and variety of one-off relief measures in his 2014-2015 Budget. Such a retrenchment is likely to continue in subsequent budgets in view of the need to contain expenditure growth as recommended by the Working Group on Long-Term Fiscal Planning. The Working Group has projected that a structural deficit would surface between seven and 15 years' time based on different expenditure growth scenarios, after taking into account the economic growth trend and demographic changes.

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