Budget Speech by the Financial Secretary (11)

Public Finance

Deficit Budget

164. As an open economy with a relatively narrow tax base, Hong Kong’s government revenue is susceptible to changes in the economic environment. The ageing population also poses pressure on public expenditure. Though I have great confidence in Hong Kong’s fundamental strengths and long-term prospects, we must, in the face of an economic downturn and the aforesaid challenges, exercise extra prudence in managing public finance.

165. Our fiscal reserves are the fruits of the economic development of Hong Kong and the hard work of our people over the years. They enable us to adopt a deficit budget amid the prevailing economic downturn and launch counter-cyclical measures to support the economy and relieve people’s burden. In the past year, we have increased government expenditure substantially to combat the epidemic and roll out relief measures, which resulted in our fiscal reserves dropping sharply in two years from the equivalent of 23 months of government expenditure to 13 months.

166. Although I forecast an improvement in revenue for the next financial year, I expect that the fiscal deficit will be $101.6 billion, accounting for 3.6 per cent of GDP, due to the counter-cyclical fiscal measures and the continued increase in recurrent expenditure. In other words, Hong Kong will record a deficit for a number of years after achieving a surplus for 15 years. As shown in the Medium Range Forecast (MRF), the Operating Account is projected to be in deficit for five consecutive years. The operating deficit for 2021-22 will be more than $140 billion mainly due to the counter-cyclical measures while the operating deficit for the remaining four years will range from $22.4 billion to $40.7 billion. The Consolidated Account is also expected to record a deficit for four consecutive years. The above forecast has not yet taken into account any tax rebate or relief measure that the Government may implement in the future.

167. The deficits are mainly caused by the fact that the rise in government expenditure is outpacing the increase in government revenue, especially in terms of recurrent expenditure. Recurrent expenditure of the Government increased from about $150 billion in 1997-98 to about $470 billion in 2020-21, representing a more than three-fold increase. The significant rise in government expenditure in recent years is for enhancing services or investing for the future. However, as emphasised in my last Budget, government expenditure should enter a consolidation period, and the long-term financial commitments should also be commensurate with the increase in revenue.

168. As a number of measures announced in this year’s Budget will have a

bearing on the new financial year and the MRF, I would like to offer some explanations here.

169. To optimise the use of fiscal reserves for seeking a better return to meet future needs, the Government set up the Future Fund in 2016 to make longer-term investments for a period of ten years. The investment return of the Fund forms an integral part of public financial resources, and has accumulated a return amounting to nearly $100 billion. While the Government has all along been disclosing the rate of return of the Future Fund, the investment return yet to be brought back has not been reflected under the cash-based government accounts. Starting from 2021-22, I will reflect the cumulative investment return of the Fund in the Operating Account on a progressive basis, with $25 billion brought back in the first year.

170. The 2021-22 Budget has also included $23 billion brought back from the Housing Reserve and the annual proceeds of about $35 billion from the expansion of the Government Green Bond Programme as mentioned earlier. The sums raised under the Government Green Bond Programme will provide funding for green projects under the Capital Works Reserve Fund but will not be used to finance operating expenditure, and hence will not undermine public finance discipline. The issuance of bonds cannot bolster our real financial strength as it ultimately requires the repayment of principal and interest. Nonetheless, the issuance of additional green bonds for financing eligible projects can definitely relieve the Government’s fiscal pressure arising from the need to use existing resources to meet capital expenditure. This is a reasonable and appropriate approach in the light of the current low interest rate environment, and is also conducive to the development of Hong Kong’s bond market.

171. The above measures of bringing back the Future Fund’s investment return and the Housing Reserve and issuing additional green bonds will ensure that our fiscal reserves can be maintained at a relatively robust level despite deficit budgets in the next few years. They would enhance confidence in Hong Kong’s fiscal strength and are conducive to maintaining our financial stability. However, in the long run, the key to maintaining healthy public finances is to follow the principle of keeping expenditure within the limits of revenue and ensure that the growth of expenditure is commensurate with economic growth. In the face of the challenges of fiscal deficits, we should not only reduce expenditure but also increase revenue.

Reduce Expenditure

172. This year’s Budget will continue to roll out a series of measures for supporting individuals and businesses. Last year, Hong Kong’s economy was battered by the epidemic, and all sectors of the community were generally affected in varying degrees, particularly the grassroots. Despite the fiscal deficit, I have decided not to reduce our spending in areas related to people’s livelihood, especially resources allocated to the three policy areas of education, social welfare and healthcare, in order to safeguard people’s livelihood and maintain public confidence. In 2021-22, the recurrent funding for these three policy areas amounts to $302.3 billion in total, accounting for 58 per cent of the Government’s total estimated recurrent expenditure and

representing an increase of 45 per cent over the provision of $208.2 billion in 2017-18.

173. The Government will set an example by cutting expenditure so as to strengthen fiscal discipline. In 2021-22, we will have zero growth in the civil service establishment. Besides, the Government will implement an expenditure reduction programme by requiring all policy bureaux and departments to reduce expenditure without affecting livelihood-related spending. The objective is to trim recurrent expenditure by one per cent in 2022-23. The estimated savings will be about $3.9 billion. While it seems not too difficult to achieve the one per cent cut in recurrent expenditure, there is limited room for curbing expenses related to personal emoluments which account for about 60 per cent of recurrent expenditure of government departments. We can only achieve the target mainly through savings from the remaining 40 per cent of recurrent expenditure, including major items such as general expenses and subventions. All departments have to undertake critical review, adjust priorities and enhance efficiency in order to achieve the savings target without affecting day-to-day operation and the public services they provide. Many a little makes a mickle.

Increase Revenue

174. As I have pointed out in my last Budget, Hong Kong needs to maintain the development and vibrancy of our economy and identify new areas of growth, with a view to increasing our revenue. I have just elaborated on the long-term positioning of Hong Kong's economy and the strategies for the development of our major sectors, which will help increase government revenue in the long run.

175. Besides, I mentioned last year that we need to consider seeking new revenue sources or revising tax rates, and reducing one-off relief measures progressively. Though raising tax rates can increase revenue in the short run, the choice must be made carefully.

176. Having duly considered the impact on the securities market and our international competitiveness, we have decided to introduce a bill to raise the rate of Stamp Duty on Stock Transfers, from the current 0.1 per cent to 0.13 per cent of the consideration or value of each transaction payable by buyers and sellers respectively. The Government will continue to spare no efforts in introducing measures to facilitate the development of the securities market, so as to take our financial services sector to the next level.

177. As businesses and individuals are generally under considerable financial pressure amid the prevailing economic environment and the epidemic, I consider that it is not the appropriate time to revise the rates of profits tax and salaries tax, which are our major sources of revenue. Nevertheless, we will keep in view the situation and make adjustments at the appropriate time.

178. During Budget consultations, I received many proposals to introduce new taxes. If we do so, we have to carefully examine the proposals, take all

factors into consideration, and earnestly listen to views of various sectors of the community. Fighting the epidemic and reviving the economy are our current priorities. This is not the time to introduce new taxes. Nevertheless, we will carry out related research and make preparation to facilitate in-depth discussions at a suitable time, and forge consensus before we introduce new taxes to increase revenue.

International Tax Co-operation

179. The Organisation for Economic Co-operation and Development (OECD) is drawing up new proposals to address base erosion and profit shifting (BEPS 2.0), which include the introduction of a global minimum tax rate and a digital tax. In mid-2020, the Advisory Panel on BEPS 2.0 commenced work on assessing the impact of the proposals on Hong Kong. At the same time, the Government has been collecting views from stakeholders in the business sector. Taking into account the preliminary views of the Advisory Panel, I would like to outline the direction of the Government's response measures so that the business sector can have a better grasp of the issue and make early preparation. First, as an international financial and business centre, Hong Kong will actively implement the BEPS 2.0 proposals according to international consensus. Second, as most of the rules under BEPS 2.0 are only applicable to large multinational corporations, we will minimise the impact on local SMEs where possible when drawing up the response measures and strive to maintain the simplicity, certainty and fairness of our tax regime, which are our key advantages. Third, while safeguarding Hong Kong's taxing rights, we will at the same time minimise the compliance burden on affected corporations. Fourth, we will keep up our efforts in improving Hong Kong's business environment and enhancing our competitiveness, with a view to attracting multinational corporations to invest and operate in Hong Kong. Once the OECD has finalised the proposal, the Advisory Panel will put forth its recommendations on the specific response measures in its report to me.

Rating System

180. The rating system in Hong Kong has not undergone any major change since 1995. To ensure that our rating system could keep pace with the times, I have requested the FSTB and the Rating and Valuation Department to review whether there is any room for improvement in respect of the rating system. We will review the case for introducing a progressive element to the rating system and that for providing rates concession to owner-occupied properties on a regular basis. Furthermore, we will consider shifting the primary liability for rates payment from the occupier to the owner of a property to reflect that the ultimate responsibility with regard to a property should rest with its owner. The Government will consult the relevant LegCo panel on whether and how to revise the rating system.

(To be continued.)