Budget Speech by the Financial Secretary (11)

Public Finance

Deficit Budget

168. The HKSAR Government runs a fiscal deficit in 2019-20, the first time for Hong Kong over the past 15 years. I forecast a deficit for the next five years as well.

169. The US-China trade conflict and the violent incidents in Hong Kong significantly dampened our economic momentum. In the past six months, I have announced four rounds of relief measures costing over $30 billion. These measures, together with the $30 billion Anti-epidemic Fund established in response to the recent novel coronavirus outbreak, resulted in a deficit of about $37.8 billion for 2019-20, which is about 1.3 per cent of GDP.

170. Regarding 2020-21, taking into account the impact of the external economic environment and the epidemic, Hong Kong's economy is expected to be under contractionary pressure, with enterprises facing difficulties and the unemployment rate on the rise. As such, this year's Budget focuses on "supporting enterprises, safeguarding jobs, stimulating the economy and relieving people's burden". Measures for supporting the general public and enterprises, including the cash payout scheme, will be rolled out.

171. Though confident in Hong Kong's fundamental strengths and long-term prospects, I must prudently assess the impact of the current situation on government revenue in the coming year. I thus forecast a decrease in tax and land revenues. Taking also into account the launch of countercyclical fiscal measures on a much larger scale and the continued increase in recurrent expenditure as I have just mentioned, I expect that the fiscal deficit for next year will be $139.1 billion, accounting for 4.8 per cent of GDP.

172. Although the deficit will hit an all-time high, a close look at its components shows that almost $120 billion of the deficit is related to the cash payout scheme and other one-off relief measures, which will not incur long-term financial commitments.

173. Besides, the revenue for the same financial year will include $19.5 billion from the issuance of green bonds and $22 billion brought back from the Housing Reserve. Netting out the aforesaid revenue and one-off expenditure, the deficit is about $59 billion, accounting for 2 per cent of GDP.

174. Our current fiscal reserves of about $1,100 billion enable us to roll out special measures amid the prevailing economic downturn, such as paying out cash. Such special measures and the ever-growing expenditure, however, will deplete our fiscal reserves. Take the 2020-21 financial year as an

example. Our reserves which are equivalent to 22 months of government expenditure at the beginning of the year will drop to a level equivalent to 16 months of government expenditure at year-end. If we keep running a fiscal deficit, our reserves will eventually be used up. This is something which we do not want to see. Moreover, the Government will have to draw on the fiscal reserves to meet the funding already earmarked for a number of large-scale projects, for example the two 10-year Hospital Development Plans amounting to about $500 billion in total.

175. It is worth noting that the Operating Account is projected to record a deficit for five consecutive years, as shown in the Medium Range Forecast. In the four financial years starting from 2021-22, there will be an annual deficit of about $50 billion in the Operating Account, and the overall deficit in the Consolidated Account will range between $7.4 billion and $17 billion. That said, the above forecast has not taken into account tax rebate and relief measures that the Government may implement.

176. The deficits are mainly caused by the fact that government revenue cannot keep up with drastic increases in government expenditure, especially recurrent expenditure. Since reunification, recurrent expenditure increased from $150 billion to $440 billion recorded last year. It started to rise from $150 billion to $200 billion in the first decade after reunification, further increased to $300 billion over the following seven years (i.e. in 2014-15) and to $400 billion after four years (i.e. in 2018-19). For this year (i.e. in 2019-20) alone, recurrent expenditure shows a further increase of about $40 billion, and in the coming year (i.e. in 2020-21), it will be almost $500 billion. Such rapid growth is not sustainable.

Face the Challenge

177. The significant rise in government expenditure over the years was for enhancing services or increasing investment in various areas of the community, which were essential to catching up with the needs of the public. In the coming years, government expenditure will enter a consolidation period. We will focus on the optimal use of resources to implement the committed initiatives in an orderly and effective manner so that the public will see progressive improvements in public services and social infrastructure. As for future increase in spending, we should be more mindful of the Government’s long-term affordability. It should also be commensurate with the increase in revenue.

178. We need to maintain the growth and vibrancy of our economy and identify new areas of economic growth, with a view to increasing our revenue, promoting social development, coping with the challenges arising from an ageing population, and providing more quality employment opportunities. Besides, we may need to consider seeking new revenue sources or revising tax rates. The one-off relief measures may also have to be progressively reduced.

179. Hong Kong is renowned for its simple and low tax regime which is based on the principle of territorial source. In recent years, we rolled out a number of tax concession measures to promote investment in and the

development of specific sectors. However, new developments in the international tax arena will affect the competitiveness of Hong Kong’s tax regime.

180. In response to the use of tax policy in the international community as a means of competition, the Organisation for Economic Co-operation and Development (OECD) is actively exploring the proposal of setting rules for imposing a global minimum tax rate. Under this proposal, if the tax paid by a multinational corporation in Hong Kong is lower than the new global minimum tax rate, its parent company will be subject to additional taxes or defensive measures imposed by the jurisdictions where they are located. As an international financial and business centre, Hong Kong will inevitably be affected.

181. The imposition of a global minimum tax rate may undermine the attractiveness of Hong Kong’s low tax policy to multinational corporations, thus posing challenges to our territorial-source-based tax regime. The proposal will also bring additional tax burden and compliance costs to multinational corporations, and affect their incentives for investing and operating in Hong Kong.

182. The Government will continue to keep a close watch on the developments of the OECD’s work, make assessments and devise corresponding measures. I will invite scholars, experts and members of the business community who are experienced in the fields of international taxation and economic development to tender advice on the matter. This is to ensure that Hong Kong’s tax regime is not only in line with new developments in the international tax scene, but also helps us maintain our premier business environment and competitiveness.

Future Fund

183. The Government set up the Future Fund in 2016. In its first three years of operation, the Fund achieved a composite rate of return of 4.5 per cent, 9.6 per cent and 6.1 per cent respectively. To further optimise the Future Fund, I indicated in my last Budget that I would invite several experienced persons in the financial services sector to advise on the Fund’s investment strategy and portfolios, with a view to enhancing returns while reinforcing Hong Kong’s status as a financial, commercial and innovation centre. This is also crucial for raising Hong Kong’s productivity and competitiveness in the long run.

184. A team led by Dr Victor FUNG Kwok-king has made recommendations to me, which include using part of the Future Fund to set up the Hong Kong Growth Portfolio for direct investments in projects with a “Hong Kong nexus”. I have accepted the recommendations and will start preparing for their implementation.

Concluding Remarks

185. Hong Kong has been intensely affected by the profound changes in the international political and economic landscape. Meanwhile, we had an

extraordinary year with the occurrence of local social incidents. Social unrest and turbulence have revealed deep-seated conflicts in our community, which cannot be resolved overnight. We need to address these conflicts patiently and carefully as they have a far-reaching impact on the stability and development of Hong Kong in the future.

186. I have picked an earth tone colour for the cover of this year’s Budget Speech. I believe that Hong Kong is still a fertile piece of land. The quality of its crops, however, depends on the seeds we sow and the way we cultivate and irrigate it. I believe that, no matter what our backgrounds, beliefs and aspirations are, we all cherish and love Hong Kong.

187. Living on the same land, we are closely connected, sharing joys and sorrows. Hong Kong may have all sorts of shortcomings, but it is our home which allows diversity and freedom of development. Even if we have been disappointed, we can choose to feel hopeful for our future. Even if we are striving for different goals, we can work together to put aside our differences, make room for resolving conflicts, and drive Hong Kong forward.

188. Thank you, Mr President.