

# APPENDICES

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*Note:* Expenditure figures for 2014-15 and before have been adjusted to align with the definitions and policy area group classifications adopted in the 2015-16 estimate.



# **APPENDIX A**

## **MEDIUM RANGE FORECAST**



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## SECTION I FORECASTING ASSUMPTIONS AND BUDGETARY CRITERIA

1 The Medium Range Forecast (MRF) is a fiscal planning tool. It sets out the high-level forecast of government expenditure and revenue covering the five-year period including the budget year, i.e. from 2015-16 to 2019-20.

2 A wide range of assumptions underlying the factors affecting Government's revenue and expenditure are used to derive the MRF. Some assumptions are economic in nature (the general economic assumptions) while others deal with specific areas of Government's activities (other assumptions).

### General Economic Assumptions

#### *Real Gross Domestic Product (real GDP)*

3 GDP is forecast to increase by 1% to 3% in real terms in 2015. We have used the mid-point of this range forecast in deriving the MRF. For planning purposes, in the four-year period 2016 to 2019, the trend growth rate of the economy in real terms is assumed to be 3.5% per annum.

#### *Price change*

4 The GDP deflator, measuring overall price change in the economy, is forecast to increase by 1.5% in 2015. For the four-year period 2016 to 2019, the GDP deflator is assumed to increase at a trend rate of 1.5% per annum.

5 The Composite Consumer Price Index (CCPI), measuring inflation in the consumer domain, is forecast to increase by 3.5% in 2015. Netting out the effects of various one-off relief measures, the underlying CCPI is forecast to increase by 3% in 2015. For the ensuing period 2016 to 2019, the trend rate of increase for the underlying CCPI is assumed to be 3% per annum.

#### *Nominal Gross Domestic Product (nominal GDP)*

6 Given the assumptions on the rates of change in the real GDP and the GDP deflator, the GDP in nominal terms is forecast to increase by 2.5% to 4.5% in 2015, and the trend growth rate in nominal terms for the period 2016 to 2019 is assumed to be 5% per annum.

### Other Assumptions

- 7 Other assumptions on expenditure and revenue patterns over the forecast period are as follows –
- The operating expenditure for 2016-17 and beyond represents the expenditure guideline only, assuming operating expenditure would grow in line with nominal GDP.
  - The capital expenditure for 2015-16 and beyond reflects the estimated cash flow requirements for capital projects including approved capital works projects and those at an advanced stage of planning.
  - The revenue projections for 2016-17 and beyond basically reflect the relevant trend yields.

### Budgetary Criteria

8 Article 107 of the Basic Law stipulates that “*The Hong Kong Special Administrative Region shall follow the principle of keeping expenditure within the limits of revenues in drawing up its budget, and strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of its gross domestic product.*”

9 Article 108 of the Basic Law stipulates that “*... The Hong Kong Special Administrative Region shall, taking the low tax policy previously pursued in Hong Kong as reference, enact laws on its own concerning types of taxes, tax rates, tax reductions, allowances and exemptions, and other matters of taxation.*”

10 For the purpose of preparing the MRF, the following criteria are also relevant –

#### *Budget surplus/deficit*

The Government aims to achieve a balance in the consolidated and operating accounts. The Government aims, over time, to achieve an operating surplus to partially finance capital expenditure.

#### *Expenditure policy*

The general principle is that, over time, the growth rate of expenditure should not exceed the growth rate of the economy. The Government aims to keep public expenditure at or below 20% of GDP.

#### *Revenue policy*

The Government aims to maintain, over time, the real yield from revenue.

#### *Fiscal reserves*

The Government aims to maintain adequate reserves in the long run.

## SECTION II MEDIUM RANGE FORECAST

11 The financial position of the Government for the current MRF period (*Note (a)*) is summarised below –

Table 1

(\$ million)	2014-15 Revised Estimate	2015-16 Estimate	2016-17 Forecast	2017-18 Forecast	2018-19 Forecast	2019-20 Forecast
<b>Operating Account</b>						
Operating revenue ( <i>Note (b)</i> )	390,189	392,586	426,019	433,509	466,747	490,107
Less: Operating expenditure ( <i>Note (c)</i> )	317,678	354,300	379,600	397,300	410,900	410,400
<b>Operating surplus</b>	<b>72,511</b>	<b>38,286</b>	<b>46,419</b>	<b>36,209</b>	<b>55,847</b>	<b>79,707</b>
<b>Capital Account</b>						
Capital revenue ( <i>Note (d)</i> )	80,489	84,995	75,721	77,758	82,086	85,483
Less: Capital expenditure ( <i>Note (e)</i> )	79,462	86,527	105,048	110,321	115,911	114,000
<b>Capital surplus/(deficit)</b>	<b>1,027</b>	<b>(1,532)</b>	<b>(29,327)</b>	<b>(32,563)</b>	<b>(33,825)</b>	<b>(28,517)</b>
<b>Consolidated Account</b>						
Government revenue	470,678	477,581	501,740	511,267	548,833	575,590
Less: Government expenditure	397,140	440,827	484,648	507,621	526,811	524,400
<b>Consolidated surplus before repayment of bonds and notes</b>	<b>73,538</b>	<b>36,754</b>	<b>17,092</b>	<b>3,646</b>	<b>22,022</b>	<b>51,190</b>
Less: Repayment of bonds and notes ( <i>Note (f)</i> )	9,688	-	-	-	-	1,500
<b>Consolidated surplus after repayment of bonds and notes</b>	<b>63,850</b>	<b>36,754</b>	<b>17,092</b>	<b>3,646</b>	<b>22,022</b>	<b>49,690</b>
<b>Fiscal reserves at 31 March</b>	<b>819,567</b>	<b>856,321</b>	<b>873,413</b>	<b>877,059</b>	<b>899,081</b>	<b>948,771</b>
In terms of number of months of government expenditure	25	23	22	21	20	22
In terms of percentage of GDP	36.5%	36.8%	35.8%	34.2%	33.4%	33.6%
<b>Being balance held in –</b>						
General Revenue Account	473,774	496,831				
Funds with designated use	126,063	127,675				
Capital Works Reserve Fund	72,203	71,126				
Capital Investment Fund	1,499	1,636				
Civil Service Pension Reserve Fund	27,029	28,617				
Disaster Relief Fund	18	50				
Innovation and Technology Fund	971	2				
Loan Fund	2,626	2,860				
Lotteries Fund	21,717	23,384				
Land Fund	219,730	231,815				
	819,567	856,321				

Notes –

(a) *Accounting policies*

- (i) The MRF is prepared on a cash basis and reflects forecast receipts and payments, whether they relate to operating or capital transactions.
- (ii) The MRF includes the General Revenue Account and eight Funds (Capital Investment Fund, Capital Works Reserve Fund, Civil Service Pension Reserve Fund, Disaster Relief Fund, Innovation and Technology Fund, Land Fund, Loan Fund and Lotteries Fund). It does not include the Bond Fund which is managed separately and the balance of which does not form part of the fiscal reserves.

(b) *Operating revenue*

- (i) The operating revenue takes into account the revenue measures proposed in the 2015-16 Budget, and is made up of –

(\$ million)	2014-15	2015-16 Estimate	2016-17 Forecast	2017-18 Forecast	2018-19 Forecast	2019-20 Forecast
	Revised Estimate					
Operating revenue before investment income	389,978	355,085	393,442	400,854	427,180	452,527
Investment income	211	37,501	32,577	32,655	39,567	37,580
Total	390,189	392,586	426,019	433,509	466,747	490,107

- (ii) Investment income under the Operating Account includes investment income of the General Revenue Account which is credited to revenue head Properties and Investments, and investment income of the Land Fund. The rate of investment return is 5.5% for 2015 (vs 3.6% for 2014) and is assumed to be in the range of 4.3% to 5% a year for 2016 to 2019.
- (iii) The investment income for 2014-15 includes investment income from cash balances but excludes investment income placed with the Exchange Fund for 2014. The latter, which stood at \$22,748,856,000, along with the investment income under the Capital Account, has been set aside and retained within the Exchange Fund for the Housing Reserve (Note d(iv) is also relevant).

(c) *Operating expenditure*

- (i) This represents expenditure charged to the Operating Account of the General Revenue Account. The operating expenditure for 2016-17 to 2019-20 assumes a 5% growth per annum, in line with the latest GDP forecast in nominal terms. This would be the expenditure guideline for the purpose of containing Government's expenditure growth. The figures for 2016-17 and beyond do not represent the spending needs of departments; unless otherwise flagged up, they do not reflect the impact of population ageing, policy changes or service enhancements.
- (ii) The provisions for 2015-16 and 2018-19 include \$10 billion and \$20 billion respectively for supporting healthcare reform. A total of \$50 billion has been earmarked for better retirement protection for the elderly in need, with \$25 billion provided in each of 2016-17 and 2017-18.



*(d) Capital revenue*

(i) The breakdown of capital revenue is –

(\$ million)	2014-15 Revised Estimate	2015-16 Estimate	2016-17 Forecast	2017-18 Forecast	2018-19 Forecast	2019-20 Forecast
General Revenue Account	1,873	2,903	642	627	1,697	1,693
Capital Investment Fund	1,517	1,044	1,079	1,046	1,068	1,072
Capital Works Reserve Fund	73,380	70,025	64,578	67,808	71,549	75,498
Disaster Relief Fund	2	-	-	-	-	-
Innovation and Technology Fund	40	8	-	-	-	-
Loan Fund	2,137	2,216	2,391	2,589	2,628	2,704
Lotteries Fund	1,384	1,384	1,445	1,509	1,576	1,647
Capital revenue before asset sales and investment income	80,333	77,580	70,135	73,579	78,518	82,614
Asset sales	153	216	223	223	223	223
Investment income	3	7,199	5,363	3,956	3,345	2,646
Total	80,489	84,995	75,721	77,758	82,086	85,483

(ii) Land premium included under the Capital Works Reserve Fund for 2015-16 is assumed to be \$70 billion. For 2016-17 onwards, it is assumed to be 2.7% of GDP.

(iii) Investment income under the Capital Account includes investment income of the Capital Investment Fund, Capital Works Reserve Fund, Civil Service Pension Reserve Fund, Disaster Relief Fund, Innovation and Technology Fund, Loan Fund and Lotteries Fund.

(iv) The investment income for 2014-15 includes investment income from cash balances but excludes investment income placed with the Exchange Fund. The latter, which stood at \$4,738,564,000, along with the investment income under the Operating Account, has been set aside and retained within the Exchange Fund for the Housing Reserve (Note b(iii) above is also relevant).

*(e) Capital expenditure*

The breakdown of capital expenditure is –

(\$ million)	2014-15 Revised Estimate	2015-16 Estimate	2016-17 Forecast	2017-18 Forecast	2018-19 Forecast	2019-20 Forecast
General Revenue Account	2,912	3,917	4,423	4,565	4,708	4,851
Capital Investment Fund	12	18	2,154	410	268	268
Capital Works Reserve Fund	71,264	75,373	89,288	97,010	103,980	103,818
Disaster Relief Fund	44	-	-	-	-	-
Innovation and Technology Fund	882	1,014	1,065	1,101	1,135	1,178
Loan Fund	3,508	5,286	4,946	4,150	3,387	2,706
Lotteries Fund	840	919	3,172	3,085	2,433	1,179
Total	79,462	86,527	105,048	110,321	115,911	114,000

*(f) Repayment of bonds and notes*

Repayment of bonds and notes is only in respect of the global bond issue in 2004. The outstanding principal of \$1,500 million would be fully repaid in 2019-20.

### SECTION III RELATIONSHIP BETWEEN GOVERNMENT EXPENDITURE/PUBLIC EXPENDITURE AND GDP IN THE MEDIUM RANGE FORECAST

12 For monitoring purposes, expenditure of the Trading Funds and the Housing Authority (collectively referred to as “other public bodies” in this Appendix) is added to government expenditure in order to compare public expenditure with GDP.

#### Government Expenditure and Public Expenditure in the Context of the Economy

Table 2

(\$ million)	2014-15	2015-16 Estimate	2016-17 Forecast	2017-18 Forecast	2018-19 Forecast	2019-20 Forecast
	Revised Estimate					
Operating expenditure	317,678	354,300	379,600	397,300	410,900	410,400
Capital expenditure	79,462	86,527	105,048	110,321	115,911	114,000
<b>Government expenditure</b>	<b>397,140</b>	<b>440,827</b>	<b>484,648</b>	<b>507,621</b>	<b>526,811</b>	<b>524,400</b>
Other public bodies expenditure	28,864	33,336	37,328	40,693	45,073	47,193
<b>Public expenditure (Note (a))</b>	<b>426,004</b>	<b>474,163</b>	<b>521,976</b>	<b>548,314</b>	<b>571,884</b>	<b>571,593</b>
<b>Gross Domestic Product (calendar year)</b>	<b>2,245,747</b>	<b>2,324,300</b>	<b>2,440,600</b>	<b>2,562,600</b>	<b>2,690,700</b>	<b>2,825,300</b>
Nominal growth in GDP (Note (b))	5.3%	3.5%	5.0%	5.0%	5.0%	5.0%
Growth in government expenditure (Note (c))	-8.4%	11.0%	9.9%	4.7%	3.8%	-0.5%
Growth in public expenditure (Note (c))	-6.9%	11.3%	10.1%	5.0%	4.3%	-0.1%
<b>Public expenditure in terms of percentage of GDP</b>	<b>19.0%</b>	<b>20.4%</b>	<b>21.4%</b>	<b>21.4%</b>	<b>21.3%</b>	<b>20.2%</b>

Notes –

- (a) Public expenditure comprises government expenditure and expenditure by other public bodies. It does not include expenditure by those organisations, including statutory organisations in which the Government has only an equity position, such as the Airport Authority and the MTR Corporation Limited.
- (b) For 2015-16, the nominal GDP growth of 3.5% represents the mid-point of the range forecast of 2.5% to 4.5% for the calendar year 2015.
- (c) The growth rates refer to year-on-year change. For example, the rates for 2014-15 refer to the change between revised estimate for 2014-15 and actual expenditure in 2013-14. The rates for 2015-16 refer to the change between the 2015-16 estimate and the 2014-15 revised estimate, and so forth.

13 Table 3 shows the relationship amongst the sum to be appropriated in the 2015-16 Budget, government expenditure and public expenditure.

**Relationship between Government Expenditure  
and Public Expenditure in 2015-16**

Table 3

(\$ million)	Appropriation	Government expenditure and revenue			Public expenditure
		Operating	Capital	Total	
<b>Expenditure</b>					
General Revenue Account					
Operating					
Recurrent	324,584	324,584	-	324,584	324,584
Non-recurrent	29,716	29,716	-	29,716	29,716
Capital					
Plant, equipment and works	2,288	-	2,288	2,288	2,288
Subventions	1,629	-	1,629	1,629	1,629
	358,217	354,300	3,917	358,217	358,217
Transfer to Funds	3,130	-	-	-	-
Capital Investment Fund	-	-	18	18	18
Capital Works Reserve Fund	-	-	75,373	75,373	75,373
Innovation and Technology Fund	-	-	1,014	1,014	1,014
Loan Fund	-	-	5,286	5,286	5,286
Lotteries Fund	-	-	919	919	919
Trading Funds	-	-	-	-	5,189
Housing Authority	-	-	-	-	28,147
	361,347	354,300	86,527	440,827	474,163
<b>Revenue</b>					
General Revenue Account					
Taxation		319,747	70	319,817	
Other revenue		60,754	2,833	63,587	
Land Fund		380,501	2,903	383,404	
		12,085	-	12,085	
		392,586	2,903	395,489	
Capital Investment Fund		-	1,155	1,155	
Capital Works Reserve Fund		-	74,296	74,296	
Civil Service Pension Reserve Fund		-	1,488	1,488	
Disaster Relief Fund		-	2	2	
Innovation and Technology Fund		-	45	45	
Loan Fund		-	2,520	2,520	
Lotteries Fund		-	2,586	2,586	
		392,586	84,995	477,581	
<b>Surplus/(Deficit)</b>		38,286	(1,532)	36,754	

**SECTION IV CONTINGENT AND MAJOR UNFUNDED LIABILITIES**

**14** The Government's contingent liabilities as at 31 March 2014, 31 March 2015 and 31 March 2016, are provided below as supplementary information to the MRF –

(\$ million)	2014	At 31 March 2015	2016
Guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance	31,397	31,902	34,332
Guarantees provided under the SME Financing Guarantee Scheme – Special Concessionary Measures	26,531	27,504	25,967
Legal claims, disputes and proceedings	6,364	7,713	7,804
Possible capital subscriptions to the Asian Development Bank	6,577	6,172	6,172
Guarantees provided under the SME Loan Guarantee Scheme	7,610	6,819	6,048
Guarantees provided under the Special Loan Guarantee Scheme	41,689	22,871	5,733
Guarantees provided under a commercial loan of the Hong Kong Science and Technology Parks Corporation	-	2,048	2,002
Guarantees provided under a commercial loan of the Ocean Park Corporation	1,388	1,388	1,388
Total	<u>121,556</u>	<u>106,417</u>	<u>89,446</u>

**15** The Government's major unfunded liabilities as at 31 March 2014 were as follows –

(\$ million)	
Present value of statutory pension obligations	747,157
Untaken leave ( <i>Note (a)</i> )	25,838
Government bonds and notes issued in 2004 ( <i>Note (b)</i> )	11,250

*Notes –*

(a) The estimate for “untaken leave” gives an indication of the overall value of leave earned but not yet taken by serving public officers.

(b) Based on US\$1 = HK\$7.8

**16** The estimated outstanding commitments of capital works projects as at 31 March 2014 and 31 March 2015 are \$338,174 million and \$296,074 million respectively. Part of these are contractual commitments.