

**For meeting on
3 May 2004**

Legislative Council Panel on Financial Affairs

Resolution to Authorise Fund Transfer of \$40 Billion from the Land Fund to the General Revenue Account

PURPOSE

This paper briefs Members on the proposed resolution under the Public Finance Ordinance (PFO) (Cap. 2) to authorise the Government to transfer \$40 billion from the Land Fund to the General Revenue Account (GRA) to meet the anticipated cashflow shortfall in 2004-05, and invites Members' views on our preliminary proposal on the way forward for the Land Fund.

BACKGROUND AND ARGUMENT

Setting up and Use of the Land Fund

2. The Land Fund was established on 1 July 1997 by Resolution of the Provisional Legislative Council to receive and hold all of the assets, net of expenses, transferred from the Hong Kong Special Administrative Region Government Land Fund. A copy of the Resolution is at **Annex A**. From the tenor of the Resolution, the Land Fund can be used only for investment and not for the provision of any Government services. The Resolution also had no provision to allow the Government to transfer money from the Land Fund to the GRA or other Government funds.

3. The arrangement to set up the Land Fund as a separate fund within the Government's fiscal reserves was mainly to facilitate the management of the assets, enabling them to be clearly identified and accounted for vis-à-vis the rest of the fiscal reserves. It would also provide flexibility for the Administration to decide on the long-term use of the assets. Some further background information on the Land Fund is set out at **Annex B**.

4. To cope with the continued budget deficits, we moved the Resolution at **Annex C** under the PFO in the Legislative Council on 7 May 2003 to authorise the transfer of \$120 billion from the Land Fund to the GRA in order to meet the Government's expenditure requirements. The \$120 billion fund transfer, which was effected in May 2003, was broadly assessed based on the budget deficits previously envisaged for 2003-04 to 2007-08¹. When moving the motion, we undertook to examine and consult the Financial Affairs Panel of the Legislative Council in future on the review of the long-term use of the Land Fund, including whether or not the Land Fund should be abolished and the fund balance be transferred to the general revenue.

Financial Position of Government

5. The continued budget deficits in recent years have resulted in a significant reduction in the fiscal reserves held outside the Land Fund. The projected balance of the fiscal reserves as at 31 March 2004 is about \$266 billion, comprising -

Account and Funds	Fund balance as at 31 March 2004 \$ million	%
General Revenue Account	69,243	26.0
Land Fund	157,765	59.2
Capital Works Reserve Fund (CWRF)	7,687	2.9
Capital Investment Fund	3,927	1.5
Loan Fund	4,442	1.7
Civil Service Pension Reserve Fund	14,523	5.4
Disaster Relief Fund	38	0.0
Innovation and Technology Fund	4,634	1.7
Lotteries Fund	4,189	1.6
Total	<u>266,448</u>	<u>100.0</u>

¹ According to the Medium Range Forecast for 2003-04 to 2007-08 published in the 2003 Budget Speech, the consolidated deficits for the years 2003-04, 2004-05 and 2005-06 would be \$67.9 billion, \$38.2 billion and \$15.8 billion respectively, which add up to \$121.9 billion.

6. The GRA is the main Government account for day-to-day departmental expenditure and revenue collection. It also serves as a central funding device with resources transferred as necessary to the other funds established to finance specific activities. As shown in the above table, notwithstanding the transfer of \$120 billion from the Land Fund in May 2003 as mentioned in paragraph 4 above, the projected 2003-04 year-end balance of the GRA would only be about \$69 billion, which is less than four months' recurrent expenditure.

7. We formerly envisaged that the transfer of \$120 billion from the Land Fund to the GRA in 2003-04 should be sufficient to meet the cashflow requirements in the medium term. However, last year's projected requirements are no longer valid mainly due to the following -

- (a) our updated asset sale/securitisation programme published in this year's Budget shows that total proceeds from the sale/securitisation of assets will only amount to \$17 billion in 2004-05, which is \$13 billion less than the forecast of \$30 billion in last year's Budget. This will necessitate the transfer of funds from the GRA to the CWRF to ensure that there is a sufficient cash balance in the latter to meet capital expenditure requirements prior to the completion of the planned asset sale/securitisation as well as the budgeted issuance of \$20 billion Government bonds during 2004-05; and
- (b) we need to maintain a sufficient cash balance in the GRA to cope with any possible slippage in the cashflow of the land revenue forecast of \$12 billion in 2004-05 and the deficits in the initial months of 2004-05 and 2005-06.

8. As many major types of revenue including taxes are mostly received towards the end of a financial year, a deficit in the initial months of the financial year is not unusual. Accordingly, the GRA will likely have shortfalls in the second and third quarters of 2004-05 if there is no topping up by transfer of funds within the fiscal reserves, as shown below -

**Cashflow projection of the GRA in 2004-05
(assuming no transfer from the Land Fund)**

	First quarter \$ million	Second quarter \$ million	Third quarter \$ million	Fourth quarter \$ million
Opening balance	69,243	32,343	(13,157)	(34,357)
Cash surplus/(deficit) including inter-fund transfers ²	(36,900)	(45,500)	(21,200)	34,900
<u>Closing balance</u>	<u>32,343</u>	<u>(13,157)</u>	<u>(34,357)</u>	<u>543</u>

9. On the other hand, the estimated balance of the Land Fund is \$158 billion by the end of March 2004, representing about 59% of the Government's fiscal reserves. Similar to other Funds set up under section 29 of the PFO³, the usage of the Land Fund is governed by the provisions laid down in the Resolution passed by the legislature in 1997. On the provision for expending moneys from the Land Fund, the Resolution only provides that all expenses relating to the administration and management of the Land Fund (but nothing more) are to be met by the Land Fund. As such, the Land Fund cannot be used to fund the provision of any Government services. As a result, the vast majority of the fiscal reserves are effectively locked up in the Land Fund.

10. The other Funds within the fiscal reserves will not be able to make up the shortfalls, partly due to the restriction placed on the usage of these Funds, and partly due to their insufficient balances as shown in paragraph 5 above.

² The GRA surplus/(deficit) position is different from that shown in the 2004-05 Estimates as we have made necessary adjustments to the investment income and transfers to other Funds should there be no topping up from the Land Fund.

³ Under section 29 of the PFO, the Legislative Council may by resolution provide for the establishment of funds to which moneys appropriated for the purpose, and such other moneys received for the purposes of the Government as may be specified in the resolution, may be credited and from which moneys may, under the authority of a funds warrant issued by the Financial Secretary, be expended for the purposes for which the funds were established subject to such conditions, exceptions and limitations as may be specified in the resolution.

THE PROPOSAL

11. To obviate the anticipated cashflow shortfall of the GRA during the course of 2004-05, we **propose** to transfer \$40 billion from the Land Fund to the GRA.

12. We will review the need for any further fund transfers over the next few years having regard to the prevailing fiscal situation. Nevertheless, if Members support our initial view to dissolve the Land Fund and transfer its balance to the GRA as elaborated in paragraphs 14 to 17 below, we would proceed to introduce another resolution into the Legislative Council at a later stage to implement the recommendation.

13. The proposal is not meant to provide additional funds to finance Government spending. The Government will remain committed to enforcing strict financial discipline in controlling its expenditure.

REVIEW OF LONG-TERM USE OF THE LAND FUND

14. We have carried out a preliminary evaluation of the possible uses of the Land Fund. In the light of the evaluation and with regard to the current fiscal situation, we have come to a view that there may be a case to dissolve the Land Fund and transfer its balance to the GRA. The main considerations in arriving at this conclusion are set out in paragraphs 15 to 16 below.

15. Given that we are still faced with a large fiscal deficit and have set out to restore fiscal balance by 2008-09, we need to be cautious in making a decision on the long-term use of the Land Fund. We have considered the suggestion of reserving sufficient funds in the Land Fund to finance the capital works programme and acquisition of land to facilitate infrastructural development and urban renewal. Such purposes may however equally be fulfilled by funding from the CWRP or, if necessary, from alternative sources of funding through the sale or securitisation of assets or the issuance of bonds. As regards other designated purposes for the Fund which may be identified in the future, they can also be equally met by other means without resorting to the Land Fund. For

example, we may seek funding from a variety of funds established under the PFO, other enactment or trusts, if the intended purpose falls within the ambit of the relevant funds. A list showing the purposes and ambits of some of these funds is at **Annex D**. We may also seek appropriation from the GRA, which will be subject to the approval of the Legislative Council via the Appropriation Bill at the beginning of the financial year or the Finance Committee during the course of the year.

16. The Land Fund forms part of the Government's fiscal reserves. The purpose of holding these reserves is to meet the operating and contingency requirements of public finance. In case there are budget deficits which arise either in those months of the financial year when expenditure exceeds revenue, or as a result of the downswing in the economic cycle, we use the fiscal reserves to finance shortfalls. With the dissolution of the Land Fund, its balance can be transferred to other parts of the fiscal reserves to meet the Government's cashflow requirements.

17. We would like to consult Members on our initial view before proceeding further with the suggestion to dissolve the Land Fund.

OTHER OPTIONS

Short-term Borrowing to Fund Recurrent Spending

18. We may resort to external short-term borrowing to meet the recurrent cashflow requirements. This would, however, invariably cause an alarm bell to ring for international credit rating agencies, the International Monetary Fund, and other observers of our public finances, who may doubt the Government's determination and ability to restore fiscal balance by 2008-09. We may also need to pay interest at a rate higher than the corresponding investment return.

Transfer of Funds from the Exchange Fund

19. It has been suggested that we use the accumulated surplus of the Exchange Fund to meet our operating and contingency requirements. It should however be noted that the Exchange Fund Ordinance (Cap. 66) defines clearly the purposes for which the Exchange Fund may be used in safeguarding the exchange value of the Hong Kong dollar and maintaining the stability and the integrity of the monetary and financial systems of Hong Kong. Any arbitrary reduction in the Exchange Fund could lead to unwarranted speculation on the sustainability of the Hong Kong/US Dollar link. We therefore consider it inadvisable to transfer funds from the Exchange Fund to top up the anticipated shortfalls.

LEGISLATIVE TIMETABLE

20. We intend to move the proposed resolution under section 29 of the PFO, at **Annex E**, at the sitting of the Legislative Council on 16 June 2004.

ADVICE SOUGHT

21. Members are invited to comment on the proposed resolution to authorise the Government to transfer \$40 billion from the Land Fund to the GRA in 2004-05, and on our preliminary proposal on the way forward for the Land Fund.

Treasury Branch
Financial Services and the Treasury Bureau
April 2004

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Section of Enactment



Chapter:	20	Title:	LAND FUND	Gazette Number:	L.N. 398 of 1997
Section:		Heading:		Version Date:	01/07/1997

Resolution made and passed by the Provisional Legislative Council under section 29 of the Public Finance Ordinance (Cap 2) on 23 July 1997.

RESOLVED that with effect from the establishment of the Government of the Hong Kong Special Administrative Region on 1 July 1997-

1. there shall be established a fund called the Land Fund;
2. the Land Fund shall receive and hold all of the assets, including all accounts receivable, net of expenses, transferred, upon the establishment of the Government of the Hong Kong Special Administrative Region, from the Hong Kong Special Administrative Region Government Land Fund established by a Declaration of Trust of the Hong Kong Special Administrative Region Government Land Fund Trust made on 13 August 1986 to the Government of the Hong Kong Special Administrative Region and which have become part of the general revenue in accordance with section 3 of the Ordinance and the provisions of the Declaration of Trust of the Hong Kong Special Administrative Region Government Land Fund Trust;
3. the Land Fund shall be administered and managed by the Financial Secretary who may delegate his power of administration and management to other public officers;
4. there shall be credited to the Land Fund-
 - (a) all sums earned by way of interest, dividends or other investment revenue relating to the investment of the Hong Kong Special Administrative Region Government Land Fund and all sums earned from the sale or other disposal of all or part of any assets of the Hong Kong Special Administrative Region Government Land Fund, after the deduction of all of the expenses relating to the administration and management of the Hong Kong Special Administrative Region Government Land Fund; and
 - (b) all accounts receivable and all sums earned by way of interest, dividends or other investment revenue relating to the investment of the Land Fund and all sums earned from the sale or other disposal of all or part of any assets of the Land Fund, after the deduction of all of the expenses relating to the administration and management of the Land Fund;
5. all expenses relating to the administration and management of the Land Fund, including expenses for meeting the management staff costs, and the costs incurred

by the Trustees of the Hong Kong Special Administrative Region Government Land Fund Trust in the dissolution of the Trust in accordance with clause 29 of the Declaration of Trust of the Hong Kong Special Administrative Region Government Land Fund Trust, and any accounts payable in respect of the Hong Kong Special Administrative Region Government Land Fund after 30 June 1997, shall be met at the expense of the Land Fund;

6. the Land Fund shall assume-

(a) all the liabilities of the Trustees of the Hong Kong Special Administrative Region Government Land Fund Trust incurred before and outstanding upon the dissolution of the Trust, in accordance with clause 29 of the Declaration of Trust of the Hong Kong Special Administrative Region Government Land Fund Trust; and

(b) all the obligations of the Financial Secretary to indemnify the Trustees and each of them and each of their personal representatives and estates from and against all actions, proceedings, claims and demands and all costs and expenses in respect of or arising out of the administration of the Hong Kong Special Administrative Region Government Land Fund Trust, in accordance with the covenant clause 9 of a Vesting Deed executed on 1 July 1997;

7. the Financial Secretary may, in his discretion, authorize and direct the investment of any assets of the Land Fund which are not immediately required to meet expenses in respect of the Land Fund at any time in such manner as he may determine.

Note:

Please also see the Resolution of the Legislative Council in L.N. 117 of 2003, which is reproduced below-

"Resolution made and passed by the Legislative Council under section 29 of the Public Finance Ordinance (Cap 2) on 7 May 2003.

RESOLVED with respect to the Land Fund established by resolution made and passed by the Provisional Legislative Council on 23 July 1997 and published in the Gazette as Legal Notice No. 398 of 1997, that a sum of \$12000000000 be transferred from the Land Fund to the general revenue."

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Further Background Information on the Land Fund

Setting up of the Land Fund

The Sino-British Joint Declaration stipulated that premium income received by the Hong Kong Government from land transactions during the period from 27 May 1985 and up to 30 June 1997 shall, after deduction of the average cost of land production, be shared equally with the future Hong Kong Special Administrative Region Government (HKSARG). A HKSARG Land Fund was thus established in 1986 by the Chinese side in the Joint Liaison Group by way of a Deed of Declaration of Trust for the purpose of holding in trust for the future HKSARG its share of the land premium income.

2. With the establishment of the HKSARG on 1 July 1997, the assets of the HKSARG Land Fund with a net value of \$197 billion were handed over to the HKSARG and the Deed of Declaration of Trust ceased to have effect. It was thereafter for the HKSARG to decide how the Fund should be expended. The Chief Executive appointed the Financial Secretary as the public officer to receive these assets as part of the HKSARG fiscal reserves. These assets became part of the general revenue¹ in accordance with section 3 of the Public Finance Ordinance (PFO). Following the establishment of the HKSARG, all income from land premium is credited directly to the Capital Works Reserve Fund for the purposes of financing the capital works programme and the acquisition of land.

3. As the HKSARG had not yet decided on the long-term use of the assets held in the trust fund, a separate fund, namely the Land Fund, was established by Resolution made and passed by the Provisional Legislative Council under section 29 of the PFO to receive, hold and invest the assets of the HKSARG Land Fund on 1 July 1997.

¹ Section 3 of the PFO stipulates that except where otherwise provided by or under the PFO or any other enactment, any moneys raised or received for the purposes of the Government shall form part of the general revenue.

Investment of the Land Fund

4. Between 1 July 1997 and 31 October 1998, under the direction of the Financial Secretary, the Land Fund was managed by the Hong Kong Monetary Authority (HKMA) as a portfolio separate from the Exchange Fund. Effective on 1 November 1998, the assets of the Land Fund were merged with the Exchange Fund and managed as part of the investment portfolio of the Exchange Fund to achieve administrative efficiency and economies of scale by allowing effective deployment of resources within the HKMA as a whole.

5. Following the merger, the Land Fund remains a separate Government fund managed in exactly the same way as other Funds in the fiscal reserves which have also been placed with the Exchange Fund.

L.N. 117 of 2003

PUBLIC FINANCE ORDINANCE

RESOLUTION OF THE LEGISLATIVE COUNCIL

LAND FUND

Resolution made and passed by the Legislative Council under section 29 of the Public Finance Ordinance (Cap. 2) on 7 May 2003.

RESOLVED with respect to the Land Fund established by resolution made and passed by the Provisional Legislative Council on 23 July 1997 and published in the Gazette as Legal Notice No. 398 of 1997, that a sum of \$120,000,000,000 be transferred from the Land Fund to the general revenue.

Ricky FUNG Choi-cheung
Clerk to the Legislative Council

7 May 2003

**Examples of Funds Established
under the Public Finance Ordinance, Other Enactment or Trusts**

**(I) Funds established under section 29 of the Public Finance Ordinance
(excluding the Land Fund)**

Name of Fund	Purposes
(a) Capital Works Reserve Fund	To finance public works programmes, acquisitions of land, capital subventions and major systems and equipment items.
(b) Capital Investment Fund	To finance investments in and loans to public sector bodies which are not part of Government structure and such other bodies as the Finance Committee of the Legislative Council (LegCo) may specify.
(c) Civil Service Pension Reserve Fund	To meet payment of civil service pensions in the most unlikely event that Government cannot meet such liabilities from the general revenue.
(d) Disaster Relief Fund	To provide a ready mechanism for Hong Kong to respond swiftly to international appeals for humanitarian aid in relief of disasters that occur outside Hong Kong.
(e) Innovation and Technology Fund	To finance projects to help promote innovation and technology upgrading in manufacturing and service industries.
(f) Loan Fund	To finance loans and advances for schemes of developments in Hong Kong and loans to such persons (such as loans to students, schools and teachers in training and housing loans for civil servants) as approved by the Finance Committee of the LegCo.
(g) Lotteries Fund	To finance social welfare services by grants, loans and advances.

(II) Funds established under other enactment or trusts

Name of Fund	Purposes
(a) Quality Education Fund (Trust Fund)	<ul style="list-style-type: none"> - Set up for promoting quality school education in Hong Kong - Financing grants to institutions
(b) Sir David Trench Fund for Recreation (Trust Fund)	<ul style="list-style-type: none"> - Set up for providing facilities for recreational, sporting, cultural and social and related activities - Financing grants to institutions
(c) Beat Drugs Fund Association	<ul style="list-style-type: none"> - Set up for promoting anti-drug activities - Financing grants as approved by the Governing Committee
(d) AIDS Trust Fund (Trust Fund)	<ul style="list-style-type: none"> - Set up for promoting AIDS education and publicity activities - Financing grants to institutions
(e) Language Fund (Trust Fund)	<ul style="list-style-type: none"> - Set up for promoting proficiency in the use of Chinese (including Putonghua) and English language
(f) Environment and Conservation Fund (Trust Fund)	<ul style="list-style-type: none"> - Set up for the purposes of funding educational, research and other projects and activities in relation to environmental and conservation matters
(g) Supplementary Legal Aid Fund	<ul style="list-style-type: none"> - Set up for granting legal aid to qualified persons in need of civil proceedings under the Supplementary Legal Aid Scheme
(h) Emergency Relief Fund (Trust Fund)	<ul style="list-style-type: none"> - Set up for making grants and loans to persons in need as a result of fire, flood, tempest, typhoon or other occurrence which has caused suffering or loss
(i) New Technology Training Fund (Trust Fund)	<ul style="list-style-type: none"> - Set up for providing assistance in the form of training grants to companies in Hong Kong that wish to have their staff trained in a new technology that would be useful to their business

Name of Fund	Purposes
(j) Consumer Legal Action Fund (Trust Fund)	- Set up for giving greater consumer access to legal remedies by providing financial support and legal assistance for the benefit of, particularly, groups of consumers with similar grievances in cases involving significant public interests and injustice.
(k) Health Care and Promotion Fund	- Set up for providing financial support to: (a) health promotion activities; (b) research on health care and promotion; and (c) patients of rare diseases, treatment of which is not available in Hong Kong.
(l) Health Services Research Fund	- Set up for providing financial support to health services research projects
(m) Queen Elizabeth Foundation for the Mentally Handicapped	- Set up for furthering the welfare, education and training of the mentally handicapped in Hong Kong and promoting their employment prospects

PUBLIC FINANCE ORDINANCE

RESOLUTION OF THE LEGISLATIVE COUNCIL

LAND FUND

Resolution made and passed by the Legislative Council under section 29 of the Public Finance Ordinance (Cap. 2) on 2004.

RESOLVED, with respect to the Land Fund established by resolution made and passed by the Provisional Legislative Council on 23 July 1997 and published in the Gazette as Legal Notice No. 398 of 1997, that a sum of \$40,000,000,000 be transferred from the Land Fund to the general revenue.

Clerk to the Legislative Council

2004