

APPENDIX A

MEDIUM RANGE FORECAST

1996-1997 TO 2000-2001

MEDIUM RANGE FORECAST 1996-1997 TO 2000-2001

INTRODUCTION

The *Medium Range Forecast* (MRF) is a projection of expenditure and revenue for the forecast period based on the forecasting assumptions and budgetary criteria outlined in Section I of this Appendix.

- 2 The MRF is presented in three sections:
 - (I) Forecasting assumptions and budgetary criteria.
 - (II) The MRF for 1996-1997 to 2000-2001.
 - (III) Commentary on the MRF in relation to budgetary criteria.

SECTION I--FORECASTING ASSUMPTIONS AND BUDGETARY CRITERIA

3 A number of computer based models are used to derive the MRF. These models reflect a wide range of assumptions about the factors determining each of the components of Government's revenue and expenditure. Some are economic in nature (the general economic assumptions) while others deal with specific areas of Government's activity (the detailed assumptions). These are supported by studies of historical and anticipated trends.

General Economic Assumptions

Growth in Gross Domestic Product (GDP)

4 There is a clear link between many of Government's major revenue sources and economic growth. For planning purposes the medium range assumption as to annual GDP growth for the current MRF has been set at 5% in real terms.

Inflation

5 Over the forecast period the average year on year inflation is assumed to be 8%. It is emphasised that this is a *trend* assumption related to the GDP deflator.

Detailed Assumptions

6 A wide range of detailed assumptions relating to developing expenditure and revenue patterns over the forecast period are taken into account. These include:

- estimated cash flow of capital projects.
- forecast completion dates of these capital projects and their related recurrent consequences in terms of staffing and running costs.
- estimated cash flow arising from new commitments resulting from policy initiatives.
- the expected pattern of demand for individual services.
- the trend in yield from individual revenue sources.
- new revenue measures in 1997-1998.

Budgetary Criteria

7 In addition to the above forecasting assumptions there are a number of criteria against which the results of forecasts are tested for overall acceptability in terms of budgetary policy. Any significant breach of these parameters results in a review of the underlying programmes and adjustments where necessary and appropriate.

8 The following are the more important budgetary criteria:

--Total cash flow surplus/deficit

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

--Total expenditure growth

It is intended that, over time, expenditure growth should not exceed the assumption as to the *trend* growth in GDP.

--Capital expenditure growth

By its nature some fluctuations in the level of capital expenditure are to be expected. However, over a period the aim is to contain capital expenditure growth within overall expenditure guidelines, i.e. within the assumption as to the *trend* GDP growth but allowance is made for unavoidable expenditure on exceptional projects. Allowance is also made for a number of major projects due to start in the forecast period. In planning the size of the capital programme regard is had to the recurrent consequences of capital works (staffing, maintenance, etc.).

--Revenue Policy

The projections reflect the revenue measures introduced in this year's budget. Account is taken of the need to maintain the real yield from fees and charges, fixed duties etc. and to review periodically the various tax thresholds in the light of inflation.

SECTION II--THE MRF FOR 1996-1997 TO 2000-2001

9 The current MRF is summarised in the following three tables which indicate the forecast operating position, capital cash flow and consolidated reserves (*Note a*).

10 It is emphasised that the forecasts are based on *trends* and, therefore, the actual results of any individual year may vary from the *trend* assumption.

Operating Statement (General Revenue Account)

Table 1

	Revised Estimate	Forecast			
	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001
	\$m	\$m	\$m	\$m	\$m
Revenue (<i>Note b</i>)	167,950	177,840	200,550	224,830	257,710
Less : Expenditure (<i>Note c</i>)	(141,480)	(159,400)	(181,550)	(206,540)	(235,530)
Operating surplus for the year	26,470	18,440	19,000	18,290	22,180

Capital Financing Statement (The Funds)

Table 2

	Revised Estimate	Forecast			
	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001
	\$m	\$m	\$m	\$m	\$m
Opening balances of the Funds	43,240	45,300	62,820	72,090	78,200
Add : Revenue (<i>Note d</i>)	34,320	56,900	51,680	55,310	59,650
: Transfers from General Revenue Account (<i>Note e</i>)	13,420	4,280	5,000	6,000	7,000
Less : Expenditure on capital projects (<i>Note f</i>)	(30,360)	(35,680)	(40,810)	(47,990)	(54,910)
: Loans and investments (<i>Notes g & h</i>)	(15,300)	(7,980)	(6,600)	(7,210)	(9,740)
: Aid for disaster relief (<i>Note i</i>)	(20)	—	—	—	—
Closing balances of the Funds	45,300	62,820	72,090	78,200	80,200

Consolidated Reserves

Table 3

	Revised Estimate	Forecast			
	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001
	\$m	\$m	\$m	\$m	\$m
General Revenue Account					
Opening balance	104,690	117,740	296,500	310,500	322,790
Operating surplus (per Table 1)	26,470	18,440	19,000	18,290	22,180
Transfers to the Funds (per Table 2) (<i>Note e</i>)	(13,420)	(4,280)	(5,000)	(6,000)	(7,000)
Closing balance	117,740	131,900	310,500	322,790	337,970
The Funds - closing balances (per Table 2)	45,300	62,820	72,090	78,200	80,200
Injection into Mandatory Provident Fund Authority (<i>Note j</i>)	—	(5,000)	—	—	—
Fiscal Reserves at 31 March (<i>Note k</i>)	163,040	189,720	382,590	400,990	418,170
SARG Land Fund - balance at 1.7.97 (<i>Note l</i>)		163,500			
- interest from 1.7.97		6,100			
Total		359,320			

Notes on the Medium Range Forecast*(a) Accounting policies*

- (i) The Medium Range Forecast, like Government's Accounts, is prepared on a cash basis and reflects forecast receipts and payments, whether or not they relate to recurrent or capital transactions.
- (ii) The Medium Range Forecast includes the General Revenue Account and the Funds (the Capital Works Reserve Fund, the Loan Fund, the Capital Investment Fund, the Disaster Relief Fund and the Civil Service Pension Reserve Fund).
- (iii) The Suspense Account of the Capital Works Reserve Fund is excluded from the Medium Range Forecast since the funds in this Account are not available to the Government until they have been distributed between the Hong Kong Government and the future Hong Kong Special Administrative Region Government (SARG) in accordance with the Joint Declaration.
- (iv) For the purpose of the Medium Range Forecast it has been assumed that the total income received from land transactions from 1 July 1997 will continue to be credited to the Capital Works Reserve Fund.

(b) General Revenue Account - Revenue

This comprises all receipts to be credited to any of the eleven revenue heads, namely -

Duties
 General Rates
 Internal Revenue
 Motor Vehicle Taxes
 Fines, Forfeitures and Penalties
 Royalties and Concessions
 Properties and Investments
 Land Transactions
 Loans, Reimbursements, Contributions and Other Receipts
 Utilities
 Fees and Charges

(c) General Revenue Account - Expenditure

This comprises all expenditure to be charged to the General Revenue Account in accordance with the Appropriation Ordinance, with the exception of the transfers to funds. It includes the day to day operational expenses of government departments together with minor capital purchases of a routine nature.

(d) Funds - Revenue

This comprises all revenue receivable by the Funds except the transfers from General Revenue Account. It includes -

Hong Kong Government's share of land premia received up to 30 June 1997 distributed in accordance with Annex III of the Joint Declaration and the full proceeds of land premia from 1 July 1997
 Loan repayments received
 Recovery from Mass Transit Railway Corporation
 Interest and Dividends
 Donations towards capital projects

The breakdown of revenue to the various funds is —

	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001
	\$m	\$m	\$m	\$m	\$m
Capital Works Reserve Fund <i>(Note 1)</i>	29,030	49,370	40,040	46,940	49,380
Capital Investment Fund	3,090	3,140	3,570	4,180	4,750
Civil Service Pension Reserve Fund	510	650	450	470	500
Loan Fund	<u>1,690</u>	<u>3,740</u>	<u>7,620</u>	<u>3,720</u>	<u>5,020</u>
Total	<u>34,320</u>	<u>56,900</u>	<u>51,680</u>	<u>55,310</u>	<u>59,650</u>

(e) Transfers from General Revenue Account to the Funds

The transfers from General Revenue Account to the Funds are assessed with regard to the commitments of the Funds and their forecast cash flow requirements. The breakdown of the transfers for 1996-1997 and 1997-1998 is

Note 1 : The significant increase in Capital Works Reserve Fund revenue from 1997-1998 onwards reflects the accounting changes to the treatment of income received from land transactions from 1 July 1997. From the coming into force of the Sino-British Joint Declaration to 30 June 1997 income from land transactions is shared between the HKG and the SARG Land Fund. From 1 July 1997 all income from land transactions will be retained by the HKSARG. Revenue from land transactions for the period 1 July 1997 to 31 March 1998 is estimated to amount to \$22,630 million.

Notes on the Medium Range Forecast —Contd.

	1996-97	1997-98
	\$m	\$m
General Revenue Account	(13,420)	(4,277)
Capital Works Reserve Fund	6,390	0
Loan Fund	3,500	3,750
Capital Investment Fund	3,500	0
Disaster Relief Fund	30	27
Civil Service Pension Reserve Fund	0	500

(f) Expenditure on capital projects

This comprises expenditure chargeable to the Capital Works Reserve Fund in respect of the Public Works Programme (including land acquisition), capital subventions, major systems and equipment and computerisation.

(g) Loans

These comprise loans made from the Loan Fund, including loans to the Housing Society, the Hong Kong Industrial Estates Corporation, schools, teachers, students as well as housing loans to civil servants.

The forecast of payments from the Loan Fund is —

1996-1997	1997-1998	1998-1999	1999-2000	2000-2001
\$m	\$m	\$m	\$m	\$m
5,860	7,150	5,700	6,210	8,640

(h) Investments

These comprise, in the main, advances and equity investments made from the Capital Investment Fund to trading funds and statutory bodies including the Mass Transit Railway Corporation and the Airport Authority.

The forecast of payments from the Capital Investment Fund is—

1996-1997	1997-1998	1998-1999	1999-2000	2000-2001
\$m	\$m	\$m	\$m	\$m
9,440	830	900	1,000	1,100

(i) Aid for disaster relief

This is actual expenditure made from the Disaster Relief Fund for providing relief to disasters that occur outside Hong Kong. Because of the unpredictable nature of disasters, no estimate of future expenditure is made for the forecast period.

(j) Mandatory Provident Fund Authority

In 1997-1998, provision has been made for a proposed injection of \$5 billion into the Mandatory Provident Fund Authority, the timing of which is uncertain as it depends on the progress in establishing the Authority and the enactment of the necessary legislation. It is assumed that this payment will be made from the General Revenue Account and hence the opening balance of the General Revenue Account at 1 April 1998 has been adjusted accordingly.

(k) Fiscal reserves

The fiscal reserves represent the accumulated balances of the General Revenue Account and the Funds. The movement in the fiscal reserves from one year to the next year represents the estimated surplus/deficit for the year. A significant factor contributing to the forecast surpluses from 1997-1998 onwards and thus the accumulated fiscal reserves is the accounting changes to the treatment of income from land transactions from 1 July 1997 as described in Note 1 of item(e). The forecast surpluses and fiscal reserves take no account of the likely substantial equity contributions to either the Kowloon-Canton Railway Corporation and/or the Mass Transit Railway Corporation towards the costs of the high priority projects under the Railway Development Strategy. The precise manner, amount and timing of any contributions for this purpose are uncertain and will be the subject of decisions to be taken by the future SARG.

(l) SARG Land Fund

(i) From the entry into force of the Joint Declaration until 30 June 1997 premium income from land transactions is shared between the Hong Kong Government and the future SARG. The future SARG's share of revenue is credited to the SARG Land Fund.

(ii) The balance of this fund at 1 July 1997 has been estimated after taking into account the known balance at 31 March 1996 together with the future SARG's share of land revenue to 30 June 1997. It is assumed that the balance of the Fund will be consolidated with the General Revenue Account from 1 April 1998.

SECTION III— COMMENTARY ON THE MRF

Expenditure Growth

11 To demonstrate that expenditure growth, over time, does not exceed the trend growth rate in the economy, Government's spending plans should be compared with the budgetary guidelines (Diagrams 1 and 2).

Diagram 1

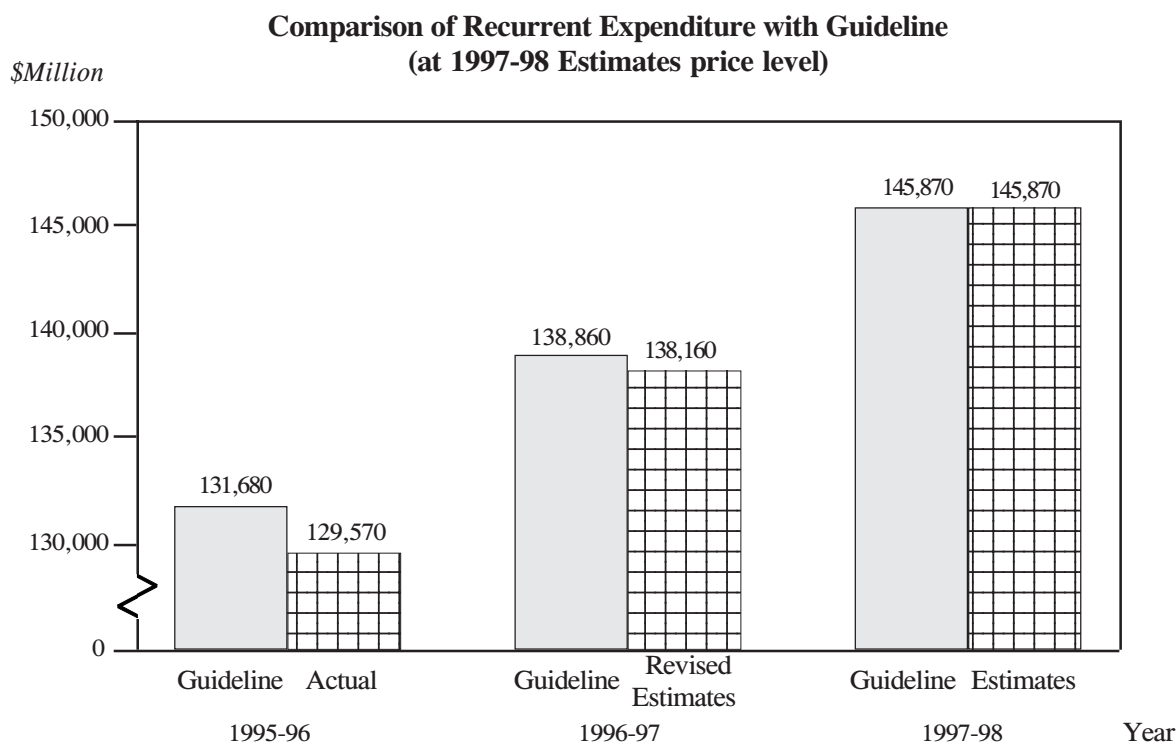
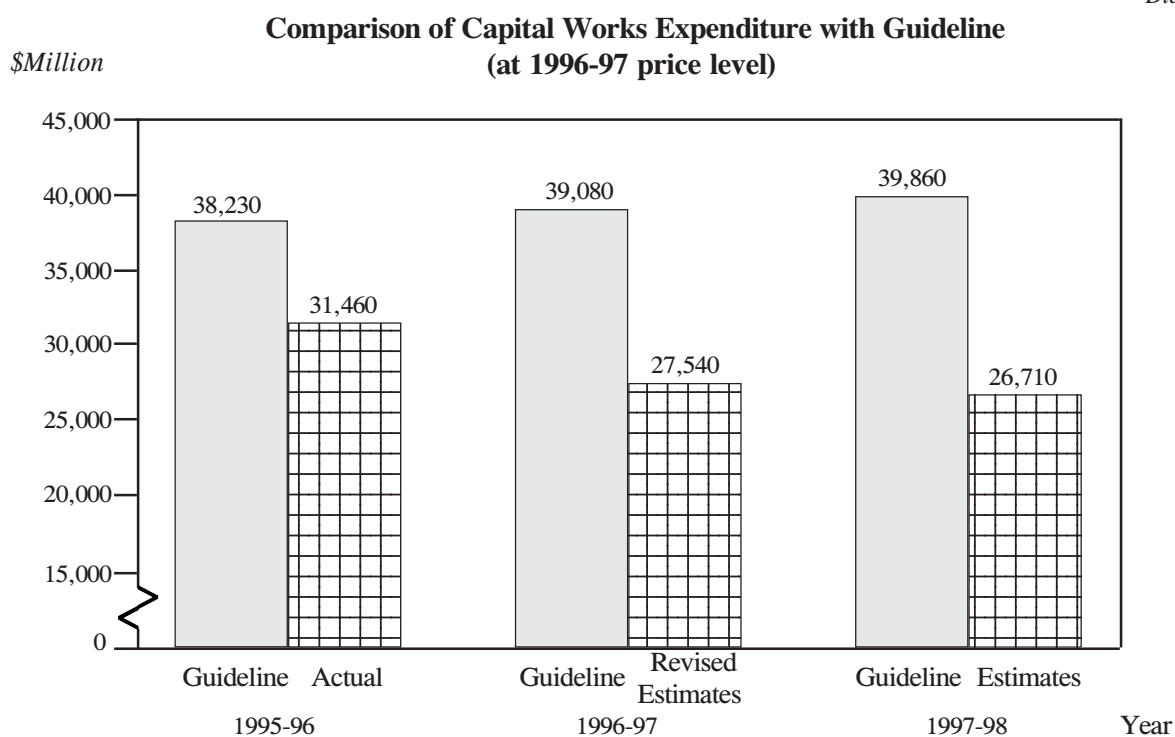


Diagram 2



Public Expenditure in the Context of the Economy

12 For monitoring purposes, the Government's own expenditure is consolidated with the expenditure of some other public bodies such as the Municipal Councils in order to compare total public expenditure with the size of the economy.

13 The results of this comparison are set out in Table 4 and the historical and forecast relationship between GDP and public expenditure is illustrated in Diagram 3. A comparison of cumulative growth in public expenditure with cumulative growth in GDP since the introduction of the MRF in 1986-1987 is shown in Diagram 4.

Public Expenditure in the Context of the Economy (Note 1)

Table 4

	Revised Estimate	Forecast			
	1996-1997	1997-1998	1998-1999	1999-2000	2000-2001
	\$m	\$m	\$m	\$m	\$m
Operating expenditure	139,390	156,970	178,790	203,580	232,170
Capital expenditure	38,330	45,260	49,270	57,160	66,910
Total government expenditure	177,720	202,230	228,060	260,740	299,080
Add: Other public sector bodies	39,470	46,150	53,000	57,000	58,190
Total public expenditure	217,190	248,380	281,060	317,740	357,270
Gross Domestic Product (calendar year) (Note 2)	1,195,315	1,355,490	1,537,120	1,743,100	1,976,670
Growth in GDP					
Money terms	10.2	13.4	13.4	13.4	13.4
Real terms	4.7	5.0	5.0	5.0	5.0
Growth in public expenditure					
Money terms	13.5	14.4	13.2	13.1	12.4
Real terms	6.0	6.9	4.5	4.4	3.7
Public expenditure as a percentage of GDP (at current prices) (Note 3)	18.2	18.3	18.3	18.2	18.1

Note 1 Public expenditure comprises expenditure by the trading funds, the Hong Kong Housing Authority, the Urban Council and the Regional Council, expenditure financed by the Government's statutory funds and all expenditure charged to the General Revenue Account. Expenditure by institutions in the private or quasi-private sector is included to the extent of their subventions. The payments of government departments which are wholly or partly financed by charges raised on a commercial basis are also included (e.g. airport, waterworks). But *not* included is expenditure by those organisations, including statutory organisations, in which the Government has only an equity position, such as the Mass Transit Railway Corporation and the Kowloon-Canton Railway Corporation. Similarly, advances and equity investments from the Capital Investment Fund are excluded as they do not reflect the actual consumption of resources by the Government.

Note 2 For years beyond the current year, the GDP figures are based on *trend* assumptions.

Note 3 Caution should be exercised in interpreting these percentages as the public expenditure is estimated on a fiscal year basis while the GDP is estimated on a calendar year basis.

Diagram 3

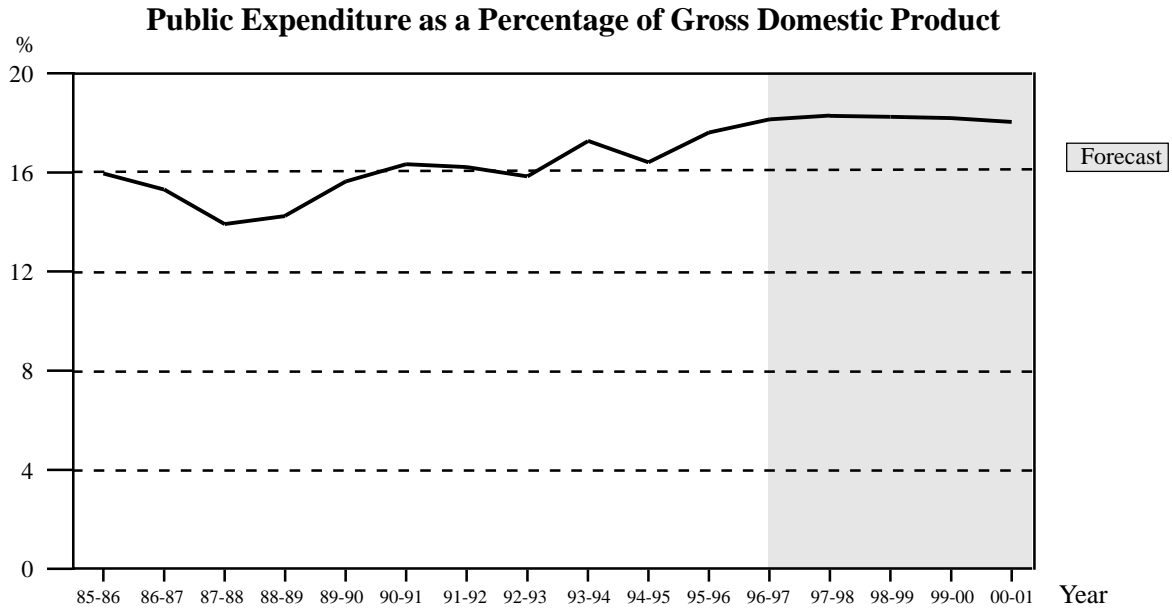
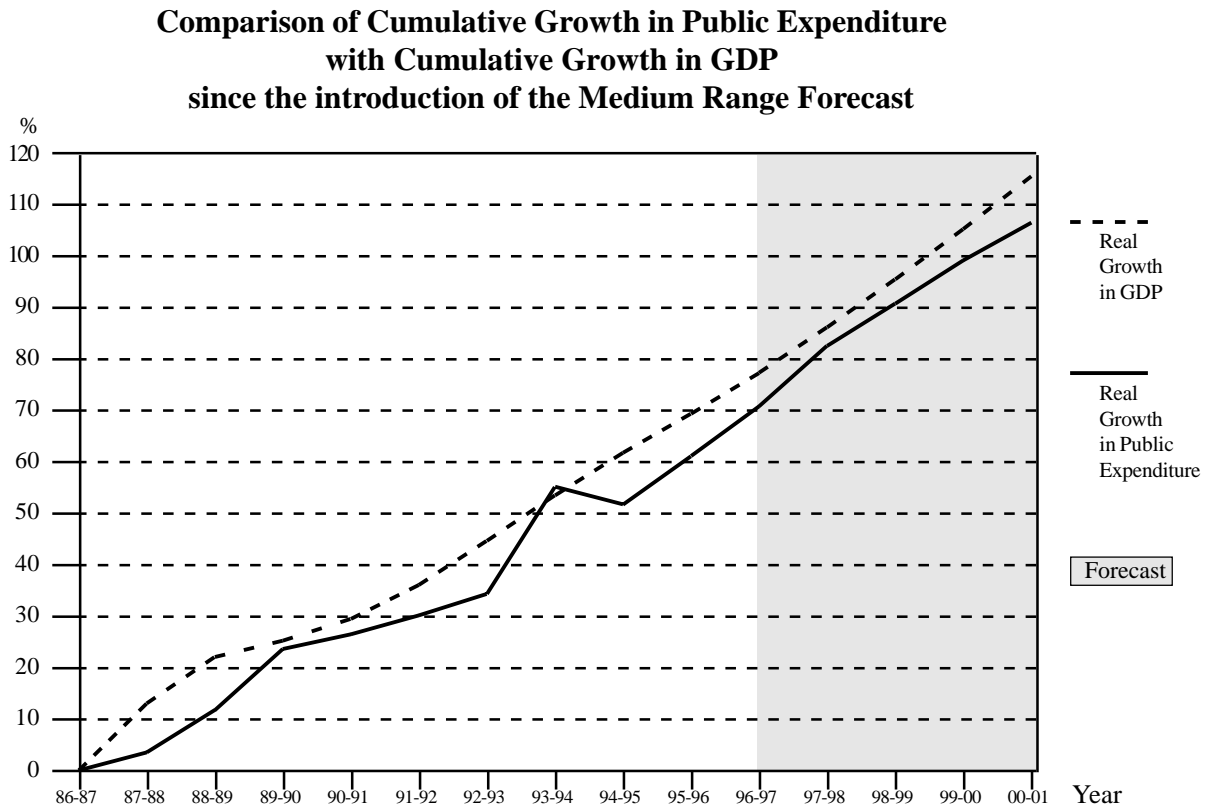


Diagram 4



14 Table 5 shows the sum to be appropriated in the 1997-1998 Budget analysed between operating and capital expenditure and, after including expenditure from the various funds and other public sector bodies, shows the derivation of public expenditure for 1997-1998 given in Table 4.

15 The table also illustrates the effect of the budget revenue measures on the overall surplus/deficit position for 1997-1998.

16 The table can be read with Tables 1-4.

**Relationship Between Government Expenditure
and Public Expenditure in 1997-1998**

Table 5

Components of expenditure and revenue	Appropriation	Government expenditure and revenue			Public Expenditure
		Operating	Capital	Total	
	\$m	\$m	\$m	\$m	\$m
Expenditure					
General Revenue Account:					
Recurrent account	154,410	154,410	---	154,410	154,410
Capital account					
Plant, equipment and works	1,280	---	1,280	1,280	1,280
Other non-recurrent	2,555	2,555	---	2,555	2,555
Subventions	1,155	---	1,155	1,155	1,155
	159,400	156,965	2,435	159,400	159,400
Transfers to funds	4,275	---	---	---	---
Capital Works Reserve Fund:					
Works account and Reserve account	---	---	35,685	35,685	35,685
Loan Fund	---	---	7,145	7,145	7,145
Lotteries Fund (1)	---	---	---	---	915
Housing Authority (1)	---	---	---	---	28,640
Urban Council (1)	---	---	---	---	6,530
Regional Council (1)	---	---	---	---	4,595
Trading funds (1)	---	---	---	---	5,470
	163,675	156,965	45,265	202,230	248,380
Revenue					
General Revenue Account:					
Taxation		138,390	1,445	139,835	
Other revenue		38,450	4,295	42,745	
		176,840	5,740	182,580	
Capital Works Reserve Fund		---	49,365	49,365	
Capital Investment Fund		---	3,145	3,145	
Civil Service Pension Reserve Fund		---	655	655	
Disaster Relief Fund		---	---	---	
Loan Fund		---	3,735	3,735	
		176,840	62,640	239,480	
Cash surplus/(deficit) before budget revenue measures		19,875	17,375	37,250	
<i>Less:</i> Effect of budget revenue measures		(4,730)	(10)	(4,740)	
Cash surplus/(deficit) after budget revenue measures		15,145	17,365	32,510	
<i>Less:</i> Advances and equity investments from the Capital Investment Fund (2)		---	(830)	(830)	
Consolidated cash surplus/(deficit) (3)		15,145	16,535	31,680	

(1) These other public sector bodies which contribute to public expenditure are all self-financing and receive no recurrent subsidies from the Government.

(2) Advances and equity investments from the Capital Investment Fund are excluded from government expenditure (see also Note 1 to Table 4).

(3) See Note (k) on page 9.