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Note: Expenditure figures for 2013-14 and before have been adjusted to align with the definitions and policy area group classifications adopted in the 2014-15 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 2014-15 to 2018-19.

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 3% to 4% in real terms in 2014. We have used the mid-point of this range forecast in deriving the MRF. For planning purposes, in the four-year period 2015 to 2018, 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% in 2014. For the four-year period 2015 to 2018, the GDP deflator is assumed to increase at a trend rate of 2% per annum.

5 The Composite Consumer Price Index (CCPI), measuring inflation in the consumer domain, is forecast to increase by 4.6% in 2014. Netting out the effects of various one-off relief measures, the underlying CCPI is forecast to increase by 3.7% in 2014. For the ensuing period 2015 to 2018, the trend rate of increase for the underlying CCPI is assumed to be 3.5% 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 4% to 5% in 2014, and the trend growth rate in nominal terms for the period 2015 to 2018 is assumed to be 5.5% per annum.

Other Assumptions

7 Other assumptions on expenditure and revenue patterns over the forecast period are as follows –

- The operating expenditure for 2015-16 and beyond represents the expenditure guideline only, assuming operating expenditure would grow in line with nominal GDP.
- The capital expenditure for 2014-15 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 2015-16 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 current MRF (*Note (a)*) is summarised in the following table which indicates the forecast financial position of the Government –

Table 1

(\$ million)	2013–14 Revised Estimate	2014–15 Estimate	2015–16 Forecast	2016–17 Forecast	2017–18 Forecast	2018-19 Forecast
Operating Account						
Operating revenue (<i>Note (b)</i>)	347,868	348,882	392,241	405,615	431,440	467,486
Less: Operating expenditure (<i>Note (c)</i>)	338,781	325,000	388,800	357,400	377,100	397,800
Operating surplus	9,087	23,882	3,441	48,215	54,340	69,686
Capital Account						
Capital revenue (<i>Note (d)</i>)	99,937	81,165	70,058	70,299	74,098	78,739
Less: Capital expenditure (<i>Note (e)</i>)	97,010	86,163	101,779	108,735	107,230	107,038
Capital surplus/(deficit)	2,927	(4,998)	(31,721)	(38,436)	(33,132)	(28,299)
Consolidated Account						
Government revenue	447,805	430,047	462,299	475,914	505,538	546,225
Less: Government expenditure	435,791	411,163	490,579	466,135	484,330	504,838
Consolidated surplus/(deficit) before repayment of bonds and notes	12,014	18,884	(28,280)	9,779	21,208	41,387
Less: Repayment of bonds and notes (<i>Note (f)</i>)	-	9,750	-	-	-	-
Consolidated surplus/(deficit) after repayment of bonds and notes	12,014	9,134	(28,280)	9,779	21,208	41,387
Fiscal reserves at 31 March	745,928	755,062	726,782	736,561	757,769	799,156
In terms of number of months of government expenditure	21	22	18	19	19	19
In terms of percentage of GDP	35.1%	34.0%	31.1%	29.8%	29.1%	29.1%
Being balance held in –						
General Revenue Account	394,241	402,613				
Funds with designated use	131,957	124,809				
Capital Works Reserve Fund	78,679	70,307				
Capital Investment Fund	1,992	1,341				
Civil Service Pension Reserve Fund	27,029	28,002				
Disaster Relief Fund	29	50				
Innovation and Technology Fund	1,801	990				
Loan Fund	1,357	2,098				
Lotteries Fund	21,070	22,021				
Land Fund	219,730	227,640				
	745,928	755,062				

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 2014-15 Budget, and is made up of –

(\$ million)	2013-14 Revised Estimate	2014-15 Estimate	2015-16 Forecast	2016-17 Forecast	2017-18 Forecast	2018-19 Forecast
Operating revenue before investment income	317,760	326,862	355,779	374,022	399,468	429,296
Investment income	30,108	22,020	36,462	31,593	31,972	38,190
Total	<u>347,868</u>	<u>348,882</u>	<u>392,241</u>	<u>405,615</u>	<u>431,440</u>	<u>467,486</u>

- (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 for 2014 is 3.6% and for 2015 to 2018 is assumed to be in the range of 4.8% to 6% a year.

(c) Operating expenditure

This represents expenditure charged to the Operating Account of the General Revenue Account. The levels of operating expenditure in 2015-16 to 2018-19 represent the expenditure guideline for these years based on the latest GDP forecast in nominal terms (i.e. 5.5% growth per annum). The sum for 2015-16 has been adjusted to include \$50 billion for supporting healthcare reform.

(d) Capital revenue

- (i) The breakdown of capital revenue is –

(\$ million)	2013-14 Revised Estimate	2014-15 Estimate	2015-16 Forecast	2016-17 Forecast	2017-18 Forecast	2018-19 Forecast
General Revenue Account	3,376	1,248	626	586	1,719	1,715
Capital Investment Fund	1,532	1,273	1,026	989	947	934
Capital Works Reserve Fund	84,252	70,131	57,990	60,894	64,565	68,793
Disaster Relief Fund	1	-	-	-	-	-
Innovation and Technology Fund	31	15	-	-	-	-
Loan Fund	2,503	2,114	2,337	2,436	2,593	2,645
Lotteries Fund	1,212	1,227	1,250	1,273	1,296	1,321
Capital revenue before asset sales and investment income	<u>92,907</u>	<u>76,008</u>	<u>63,229</u>	<u>66,178</u>	<u>71,120</u>	<u>75,408</u>
Asset sales	151	177	177	177	177	177
Investment income	6,879	4,980	6,652	3,944	2,801	3,154
Total	<u>99,937</u>	<u>81,165</u>	<u>70,058</u>	<u>70,299</u>	<u>74,098</u>	<u>78,739</u>

- (ii) Land premium included under the Capital Works Reserve Fund for 2014-15 is assumed to be \$70 billion. For 2015-16 onwards, it is assumed to be 2.5% 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.

(e) *Capital expenditure*

The breakdown of capital expenditure is –

(\$ million)	2013-14 Revised Estimate	2014-15 Estimate	2015-16 Forecast	2016-17 Forecast	2017-18 Forecast	2018-19 Forecast
General Revenue Account	2,585	3,329	3,970	3,970	3,970	3,970
Capital Investment Fund	12	12	888	868	268	268
Capital Works Reserve Fund	88,325	76,854	88,874	97,775	97,804	97,837
Disaster Relief Fund	172	-	-	-	-	-
Innovation and Technology Fund	723	882	939	969	868	877
Loan Fund	4,305	4,079	4,752	2,872	2,568	2,613
Lotteries Fund	888	1,007	2,356	2,281	1,752	1,473
Total	<u>97,010</u>	<u>86,163</u>	<u>101,779</u>	<u>108,735</u>	<u>107,230</u>	<u>107,038</u>

(f) *Repayment of bonds and notes*

Repayment of bonds and notes is only in respect of the global bond issue in 2004. Outstanding principal as at 31 March 2019 is estimated at \$1,500 million.

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)	2013-14	2014-15 Estimate	2015-16 Forecast	2016-17 Forecast	2017-18 Forecast	2018-19 Forecast
	Revised Estimate					
Operating expenditure	338,781	325,000	388,800	357,400	377,100	397,800
Capital expenditure	97,010	86,163	101,779	108,735	107,230	107,038
Government expenditure	435,791	411,163	490,579	466,135	484,330	504,838
Other public bodies expenditure	25,662	28,875	32,463	37,455	40,659	42,560
Public expenditure (Note (a))	461,453	440,038	523,042	503,590	524,989	547,398
Gross Domestic Product (calendar year)	2,122,492	2,218,000	2,340,000	2,468,700	2,604,500	2,747,700
Nominal growth in GDP (Note (b))	4.2%	4.5%	5.5%	5.5%	5.5%	5.5%
Growth in government expenditure (Note (c))	15.5%	-5.7%	19.3%	-5.0%	3.9%	4.2%
Growth in public expenditure (Note (c))	15.3%	-4.6%	18.9%	-3.7%	4.2%	4.3%
Public expenditure in terms of percentage of GDP	21.7%	19.8%	22.4%	20.4%	20.2%	19.9%

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 2014-15, the nominal GDP growth of 4.5% represents the mid-point of the range forecast of 4% to 5% for the calendar year 2014.
- (c) The growth rates refer to year-on-year change. For example, the rates for 2013-14 refer to the change between revised estimate for 2013-14 and actual expenditure in 2012-13. The rates for 2014-15 refer to the change between the 2014-15 estimate and the 2013-14 revised estimate, and so forth.

13 Table 3 shows the relationship amongst the sum to be appropriated in the 2014-15 Budget, government expenditure and public expenditure.

**Relationship between Government Expenditure
and Public Expenditure in 2014-15**

Table 3

(\$ million)	Appropriation	Government expenditure and revenue			Public expenditure
		Operating	Capital	Total	
Expenditure					
General Revenue Account					
Operating					
Recurrent	307,433	307,433	-	307,433	307,433
Non-recurrent	17,567	17,567	-	17,567	17,567
Capital					
Plant, equipment and works	1,789	-	1,789	1,789	1,789
Subventions	1,540	-	1,540	1,540	1,540
	328,329	325,000	3,329	328,329	328,329
Transfer to Funds	7,519	-	-	-	-
Capital Investment Fund	-	-	12	12	12
Capital Works Reserve Fund	-	-	76,854	76,854	76,854
Innovation and Technology Fund	-	-	882	882	882
Loan Fund	-	-	4,079	4,079	4,079
Lotteries Fund	-	-	1,007	1,007	1,007
Trading Funds	-	-	-	-	5,041
Housing Authority	-	-	-	-	23,834
	335,848	325,000	86,163	411,163	440,038
Revenue					
General Revenue Account					
Taxation		290,784	70	290,854	
Other revenue		50,188	1,178	51,366	
		340,972	1,248	342,220	
Land Fund		7,910	-	7,910	
		348,882	1,248	350,130	
Capital Investment Fund		-	1,361	1,361	
Capital Works Reserve Fund		-	73,232	73,232	
Civil Service Pension Reserve Fund		-	973	973	
Disaster Relief Fund		-	2	2	
Innovation and Technology Fund		-	71	71	
Loan Fund		-	2,320	2,320	
Lotteries Fund		-	1,958	1,958	
		348,882	81,165	430,047	
Surplus/(Deficit)		23,882	(4,998)	18,884	

SECTION IV CONTINGENT AND MAJOR UNFUNDED LIABILITIES

14 The Government's contingent liabilities as at 31 March 2013, 31 March 2014 and 31 March 2015, are provided below as supplementary information to the MRF –

(\$ million)	2013	At 31 March 2014	2015
Guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance	29,475	30,282	34,425
Guarantees provided under the Special Loan Guarantee Scheme	50,955	42,534	29,061
Guarantees provided under the SME Financing Guarantee Scheme – Special Concessionary Measures	20,924	29,685	27,561
Guarantees provided under the SME Loan Guarantee Scheme	7,452	7,958	7,571
Possible capital subscriptions to the Asian Development Bank	6,391	6,558	6,558
Legal claims, disputes and proceedings	7,821	7,529	4,653
Guarantees provided under a commercial loan of the Ocean Park Corporation	1,388	1,388	1,388
Total	<u>124,406</u>	<u>125,934</u>	<u>111,217</u>

15 The Government's major unfunded liabilities as at 31 March 2013 were as follows –

(\$ million)	
Present value of statutory pension obligations	714,745
Untaken leave (<i>Note (a)</i>)	25,106
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