

Introduction

1. There is general recognition that the fiscal health of Hong Kong is in good shape, that the Government should spend more to keep pace with community aspirations, and that population ageing would be a drag on productivity and economic growth. But there is less appreciation on why the Government should be concerned at all about the public finances in the long term, how serious the problem – if exists, could be and what should be done to relieve the burden of the taxpayers and the community at large in the coming decade or two. With fiscal reserves reaching some \$750 billion, with the Mainland offering invaluable opportunities for Hong Kong as hinterland, do we really have a fiscal problem in the long run?
2. As announced in the 2013-14 Budget Speech, the Financial Secretary appointed the Working Group on Long-Term Fiscal Planning in June 2013 to explore ways for our public finances to cope with the ageing population and the Government's other long-term commitments. Specifically, the Working Group is tasked to –
 - (a) review projections of the Government's long-term fiscal position up to around 2041, having regard to forecasts of demographic trends, economic growth and other major funding liabilities under prevailing policies;
 - (b) review measures adopted by other economies in coping with longer term challenges on public finances; and
 - (c) identify and analyse options consistent with Articles 107 and 108 of the Basic Law to address the longer term funding needs of Hong Kong.

The membership is at **Annex A**.

3. The Working Group first performed a health check on the current state of Hong Kong's public finances and the challenges ahead in Chapter 1. The Working Group then examined projections under different spending scenarios (with demographic change and different degrees of service enhancement being the key variables) and different economic growth and price assumptions (with Base Case, supplemented by sensitivity analyses on High, Low and Shock Cases as set out in Chapter 2). The projections will facilitate a proper recognition of the indicative nature and scale of the fiscal problems that may surface in the coming decade or two.
4. The projections confirm that it would **not** be financially sustainable for the Government to keep increasing expenditure at a rate faster than the increase in government revenue or the growth of the economy. The impact of demographic and price changes alone is projected to give rise to a structural budgetary problem in about 15 years' time, even assuming no change to existing policies throughout the projection period to 2041-42. Under three other scenarios where services on education, social welfare and health are assumed to be enhanced at different rates between 1% to about 3% per annum (the latter following historical trends), a structural deficit would surface within a decade or two - whether under the Base Case or any of the sensitivity analysis. The fiscal reserves could be depleted another decade or so thereafter.
5. The Working Group has made a conscious effort to avoid overstating the expenditure requirements or understating the revenue projections. The Working Group would not wish the inherent limitations of long-term projections being posed as excuse for obscuring a proper recognition of the issues involved. Chapters 3 and 4 set out the expenditure and revenue projections. Chapter 5 consolidates them to offer an overview of the fiscal outlook.

6. Population ageing is a common phenomenon and there is a lot to learn from the visionary and early actions adopted by some governments to cope with their known fiscal challenges. Remedial measures to reinstate budget balances, impose tough expenditure constraints, introduce debt brakes, etc. are rather prevalent too. The Working Group has studied the measures adopted by the governments of Australia, Canada, Germany, Japan, Singapore, Switzerland and the United Kingdom to tackle the issues of ageing and fiscal pressures. The findings are in Chapter 6.

7. The most challenging yet meaningful task of the Working Group is to identify and analyse options and tender advice to the Financial Secretary in the light of the fiscal pressures projected and experience learnt from other economies. The Working Group holds strongly that resolute action is needed to contain the growth of overall government expenditure; preserve, stabilise and broaden revenue streams; and resist short term or cyclical windfalls being diverted to fund new recurrent initiatives. The balance between short-term and longer-term needs of the Government and the community will need to be recalibrated. The Government should start saving for the future. The recommendations are in Chapter 7.

