

**Box 1.1**

**Counter-cyclical fiscal measures**

A counter-cyclical fiscal strategy refers to the efforts of a government to suppress or alleviate economic overheating or recession through fiscal measures or other means. Specifically, in times of an economic contraction, an increase in expenditure and a reduction in revenue is a counter-cyclical fiscal measure by a government.

Apart from taking all-out efforts to address the problems of the financial system and credit market, major economies are also pursuing an expansionary fiscal policy to revive their economies. This is because the transmission of monetary policies has been greatly weakened amid the global financial crisis where credit flow has yet to return to normal. As a result, compared with accommodative monetary policies, the adoption of expansionary fiscal policies is more effective and practicable as an economic stimulant. Given the severity of the current economic downturn, it is essential to take fiscal measures to stimulate the economy in the short term. However, governments must consider whether their public finances are sustainable in the longer term.

In light of such exceptional times of our economy, the Government has stated clearly in the 2009-10 Budget that it will continue to adopt counter-cyclical measures to ease the pressure of economic contraction, boost domestic demand and increase employment opportunities. The expansionary strength of the Budget can be analysed on three fronts.

**Stimulating effect of the Budget on the economy**

First, public expenditure is estimated to be \$319.4 billion for this year, equivalent to 19.4% of the GDP. In comparing this figure with that of 2008-09, it should be noted that some items of public expenditure for that year involved fund transfers and had no immediate effect on the Hong Kong economy or GDP. These include the \$21.6 billion endowment to the West Kowloon Cultural District Authority, the establishment of an \$18 billion Research Endowment Fund, injections of \$8.6 billion into the Mandatory Provident Fund and \$6 billion into the fund for Sichuan Reconstruction. As such, these items should not be taken into account in considering the effects of government expenditure on the economy. Excluding these special items, the provisional figures of the Government Account shows that last year's public expenditure was about 16.5% of the GDP. The public expenditure's share in GDP has risen significantly from 16.5% last year to 19.4% this year as indicated in the Budget. This illustrates that the 2009-10 Budget has an expansionary effect on the economy.

**Box 1.1 (Cont'd)**

Second, with respect to government revenue, the total estimated revenue for 2009-10 is \$261.7 billion, which is \$54.8 billion less than the provisional amount for 2008-09 and \$96.7 billion less than the actual revenue for 2007-08. This partly reflects the concessions to be provided by the Government this year, such as the waiving of rates for the first two quarters of 2009-10 which involves \$4.2 billion. As a result of a decrease in government revenue and an increase in expenditure, the fiscal deficit for 2009-10 is estimated to be \$39.9 billion, equivalent to 2.4% of the GDP, while the fiscal position was broadly balanced for 2008-09. That the fiscal balance will turn into a deficit also shows that the effect of the 2009-10 Budget is basically expansionary in nature and will help stimulate the economy and counter the recession.

Third, the fiscal stimulus measures that the Hong Kong Government has proposed since last year compare favourably in intensity with those of other economies. The Government announced a series of relief measures in the 2008-09 Budget and in last July. The 2009-10 Budget also proposed additional expenditures on various concessions, expedition of minor works and creation of employment. The total expenditure on all these economic stimulus measures exceeds \$70 billion, representing about 4% of the GDP. According to the report published by the International Monetary Fund (IMF) in March, the average cumulative expenditure of the G-20 nations on economic stimulus measures for countering the financial crisis in 2008 and 2009 accounts for just 2.3% of their GDP. It is evident that the fiscal measures in Hong Kong are stronger in intensity than those of many other economies. It is roughly estimated that the discretionary fiscal measures implemented by the Government since last financial year, taking into account the import content of the various expenditure items and the multiplier effect, can increase the GDP by about 1.5% in 2009 alone. In other words, in the absence of these measures, the Hong Kong economy will contract by a larger margin this year.

**Maintaining financial health in the medium and long term**

According to the report published by the IMF in March, while adopting stimulus measures to boost demand in addressing the current crisis, governments around the world must also ensure a healthy financial position in the long term. The IMF therefore suggested that stimulus measures should not have long-term implications on fiscal deficit. Governments should also formulate medium-term strategies expressing the intention of revising their financial commitments when economic conditions improve. Given that this economic recession will be longer and deeper, the IMF also recommended that governments should employ public works and infrastructure projects as the major means to stimulate the economy because they would bring more lasting impact on economic activities and greater economic benefits compared with tax concessions and other short-term measures.

**Box 1.1 (Cont'd)**

The main themes of the economic stimulus measures proposed in this year's Budget are to create ample job opportunities specifically for the construction industry where unemployment is most serious by enhancing medium-sized and minor works projects and expediting infrastructure projects; to provide internship opportunities for young people; while ensuring that the Government is capable of dealing with the risks of future economic uncertainties.

Regarding the medium range forecast, the Government will adhere to the principle of prudent financial management. Although this year's Budget forecasts a deficit in the Operating Account for the next three years, it will be followed by a return to surplus in 2012-13. Besides, with the infrastructure projects entering their construction stage, annual capital works expenditure will be at a very high level over the next few years, and may reach \$50 billion. These infrastructure projects will be able to provide great impetus to an economic recovery even when the external environment has not totally returned to normal. In summary, the Government will also take care of the long-term public finances and social needs when countering the financial tsunami.