How Tax Reform will Help Hong Kong's Long-Term Sustainable Development?

Mr Frederick Ma, Secretary for Financial Services and the Treasury

Since the SAR Government launched its public consultation on proposals to broaden the tax base, there has been much heated discussion. I hope to provide information that ensures this discussion is based on facts.

Our tax income is derived mainly from Salaries Tax and Profits Tax, which make up two-thirds of the total tax collected. Our tax base is very narrow. Salaries Tax is paid by only some 1.2 million of our working population of 3.4 million (35%). Of these, the top 100,000 contribute 60%. Where Profits Tax is concerned, out of around 750 000 registered businesses, the top 800 pay 60%.

The chief problem with a narrow tax base is that government income is unstable. Over the past eight years, our major income has been highly volatile, as can be seen from the table below.

Revenue Items	Lowest Amount received *	Highest Amount received *	Volatility
Land Premium	$5 billion	$35 billion	600%
Profits Tax	$38 billion	$71 billion	87%
Stamp Duty	$7 billion	$18 billion	157%
Salaries Tax	$25 billion	$37 billion	48%

* figures rounded to the nearest billion

Such volatility makes it difficult for us to plan median to long-term public services as well as infrastructural facilities. Moreover, Hong Kong faces a serious ageing problem. It is anticipated that the percentage of persons aged 65 or above will increase from the present 12% of the total population to 27% by 2033.

The ageing of the population will lead to two major problems:

1. the proportion of salaries taxpayers relative to total population will decrease; and
2. expenditure on health, elderly and related social services will increase.

The ageing population will further restrict our already narrow tax base. So although government finances have temporarily achieved a balance, in the long run, the narrow tax base and ageing population will remain unresolved hurdles that cannot be neglected.

Although personal consumption fluctuates according to economic circumstances, its volatility is lower than that of property prices, business profits and salaries.

We have used economic data of the past eight years to generate a model that calculates the volatility of the Goods and

Services Tax (GST) revenue, assuming GST were implemented. Figures show that estimated revenue ranges from $24 to $30 billion, a volatility of only 25%.

Proposals in the consultation document include the following important parts:

1) to adopt a low, single GST rate;

2) to provide relief measures for low-income and other groups, as well as businesses; and

3) to seek public views on how to use GST revenue to reduce the rates of Salaries Tax and Profits Tax, as well as to enhance public services.

Therefore, in assessing the impact of the proposals, one should consider the overall package instead of just focusing on GST.

We have proposed a series of measures to relieve the impact of GST on low-income households, through cash allowance, credit for water and sewage charges and credit for Rates. Our target is to ensure that the quality of life of low-income households will not be affected by GST.

Some people may worry that GST will affect the retail industry by reducing people’s will to consume. In fact, GST has been implemented in more than 135 jurisdictions around the world. Judging from overseas experience, there is no need to be too worried. Australia implemented GST in July 2000. There were initial inflation and reduction in retail and household consumption. But these disappeared within the first two years and Australia’s economy has actually improved. Other countries such as New Zealand, Canada and Singapore had similar experience, with implementation of GST having only a minor and temporary effect on the economy. Some contend that Japan’s economy was seriously affected because of GST. In fact, Japan introduced GST at the peak of its economic bubble, so that when the bubble burst, the economy declined. This result should not be blamed on introduction of GST. We expect that our experience would be similar to that overseas, producing no marked effect in the short term, while in the long run the effect will be positive.

To maintain Hong Kong’s competitiveness, we would ensure a low GST rate if it is to be implemented. Moreover, after levying GST, we would have room to lower income tax rates to attract capital and talent, as well as to improve our business environment. Therefore, GST will help enhance Hong Kong’s competitiveness.

We have heard diverse views in the past two weeks. Our tax reform proposals are suggested as preparation for a rainy day, ensuring Hong Kong’s long-term sustainable development. I urge the community to consider them carefully and come up with constructive views. Let’s join hands in formulating a well-provided tax reform package.