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To: taxinfo@ird.gov.hk

cc:

Subject: GST - Why Bite the Bullet? - Newsletter 9 by Anthony Cheung

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Dear Friends,

This summer, Hong Kong's public agenda has been captured by debates on two consultation papers rippling since mid-July – one on tax reform and the other on the further development of political appointment. In my Newsletter No. 7 of 8 June 2006, I have shared with you some of my thoughts on the need to extend the political appointment system and on the question of political talent. So I will not be repeating them here.

As to tax reform, the issue at stake is the proposal to introduce GST (Goods and Services Tax) in Hong Kong so as to broaden the tax base and stabilize public revenues. Due to the initial hostile responses from different quarters to the idea, media reports speculate that GST has in practice become a non-starter.

Commentators are quick to point out that GST had proved to be political poison in other countries. The Australian experience is most classical. In 1993, the opposition Liberal-National coalition under John Hewson, an economics professor, took up GST as a key platform and lost what was widely believed to be an "unloseable election". His successor John Howard promised never to introduce GST and won a landslide victory in 1996. Yet in the 1998 election he campaigned for GST but only won narrowly. He managed to get the support of the Democrats in passing the GST legislation in 1999, after making some concessions on exemptions. The issue subsequently split the Democrats.

GST – Why bite the bullet ?

But why had many governments still "bitten the bullets" despite GST being unpopular? The answer must be that there is no better way out of the fiscal quagmire. The advantage and disadvantage of GST are ironically two sides of the same coin. Its strength lies in the capacity to tax almost everyone – whether rich or poor – as consumer of goods and services. To that extent its tax base is the broadest. Critics, however, fault it for making the taxation system more regressive. Retail businesses worry that it would make their goods and services more pricey. While public sentiments on GST seem clear, as Lingnan University president Professor Edward Chen points out, the present public discussion is too emotional. I agree with him that we need more rational debate.

To promote GST as part of tax reform, government has to win both the economic and political arguments. *Economically*, it should explain why more tax needs to be raised when it has returned to fiscal surplus. A more comprehensive critique of the present fiscal system is warranted to prove its long-term non-sustainability. *Politically*, government has to impress the public that the new tax money is not for regressive redistribution, e.g. to facilitate reduction of corporate tax and income tax of the better-off.

It must convince people that the extra tax income is for the long-term social good. GST should be linked to proactive social investment in furtherance of people-based governance. If the additional tax burden is to help enable more comprehensive public healthcare, education, elderly care and retirement protection to be provided, then the public will see they have something to gain. Any reform perceived to make most people a loser is unlikely to gain political support.

(See more in *The Economics and Politics of GST* (in Chinese), Ming Pao, 2006-07-12. To read the full article, please go to www.anthonychung.org/policy/)

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Executive Councillor

22 August 2006