



02/10/2006 10:38

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To: taxreform@fstb.gov.hk

cc:

Subject:

Dear Sir/Madam,

The following is my comments to GTS:

As we know, public policy is not just an issue of expert opinions. It should be a combination of expert opinions, political considerations and economic principles. The HK SAR Government--s recent push of the Goods and Services Tax (GST) suggested that the related policy decision process had too much focus on expert opinions and lacked a thorough consideration of political factors and economic principles. Although the GST made a lot of sense among the tax experts, the Financial Secretary, the Chief Executive and, to a certain extent, the Executive Council, should incorporate political factors and economic principles into the decision process.

Pushing GST lacks political common sense

As I have repeatedly pointed out in the Public Affairs Forum and previous letters to the Government, the HK SAR Government must govern with common sense when it does not have a popularly elected mandate. The GST push is again an illustration of a deviation from this principle.

If you ask ordinary people on the street about taxation principles, the common sense response is that the more you earn, the more you should pay tax. Tax should generally be based on income, and rich people should pay more while poor people should pay less. This is the political common sense to taxation. Common sense also tells us that if we want to deviate from this political common sense of taxation, one must have a popularly elected mandate. General international exposure to countries that have launched GST would have acquired this observation. GST is a very controversial initiative and the relevant government must resolve it through a popularly elected political process. If you do not have a popularly elected mandate, you better follow the above political common sense of taxation. This is my advice to the HK SAR Government.

GTS is not consistent with the pegged exchange rate system

Unlike a floating exchange rate system, which can use the moving exchange rate to adjust external disturbance, a pegged exchange rate system needs to use the whole domestic economy to adjust for external changes. The process generally is that when the external environment is good, our exports would increase. We

would earn more foreign currency. Under the 7.8 conversion rate, it would be converted into more Hong Kong dollar. As a result, our Hong Kong dollar money supply would increase. With more money chasing after the goods, there would be inflation. Our cost structure would increase which would affect our external competitiveness reducing our exports. On the other hand, when the external environment is bad, our exports would decrease. We would earn less foreign currency. Under the 7.8 conversion rate, it would mean less Hong Kong dollar. As a result, our Hong Kong dollar money supply would decrease (or grow slower).

With less money chasing after the goods, there would be deflation. Our cost structure would be lowered, which would improve our external competitiveness increasing our exports. This is a generally accepted economic common sense.

One of the key features of GST is to reduce the volatility of the revenue of the Government through increasing the expenditure-based component of tax revenue. In other words, during the above self-adjustment process mandated by the pegged exchange rate system, the pressure on the public sector to follow the adjustment during bad time would be reduced. The Government does not need to follow the private sector to streamline its operations and improve its efficiency in order to contribute to the process of increasing the competitiveness of the Hong Kong domestic economy. Since the public sector accounts for a significant portion of the GDP, this is not beneficial to the above adjustment process. The Government is telling the public that I would not take the medicine. You would have to take the medicine alone.

In conclusion, the Government's recent push of GST put too much focus on expert opinion and lacked an appropriate consideration of political and economic common sense. The Financial secretary, the Chief executive, and to a certain extent, the Executive Council, are not playing an appropriate role in the decision process. This again shows that Hong Kong needs a popularly elected Government in order to incorporate common sense into the political decision process.

Prepared by

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Oct 1, 2006