

GST for HK—Yes or No?

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A Document Submitted to SKDC and
HKSAR Government

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HKSAR Government's Strong Reasons for GST

- Producing stable and predictable revenue.
- Very broad based.
- Fair
- Avoidance is difficult.
- Growing with consumption.
- Maintaining HK's competitiveness (s61).

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Other Supporting Arguments

- The Advisory Committee (Feb 2002): "GST is the only new tax with the long-term capacity to broaden the tax base which is not incompatible with HK's external competitiveness." (s63)
- IMF (2003): "The introduction of a GST is the best option to broaden the tax base and stabilize the revenue in the medium term."

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But Arguments are Dubious-- Stable Revenue?

- "does not fluctuate to the same extent as income or asset values".
 - Relating to asset values, yes.
 - Relating to income, not necessarily true.
- | | 2000 | 01 | 02 | 03 | 04 | 05 |
|-----------|------|-----|------|------|-----|-----|
| • GDP(%) | 10 | 0.6 | 1.8 | 3.2 | 8.6 | 7.3 |
| • PCE (%) | 6.0 | 2.1 | -1.0 | -0.9 | 7.3 | 3.4 |

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"Fair"--Not True

- Fair: more consumption paying more GST.
- Based on widely accepted fiscal principle:
- "ability to pay" means higher income should pay larger proportion of tax
- That's why all major countries are having progressive income and profit tax.
- GST is regressive, particularly if broadly based.

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Avoidance Difficult--Easy?

- High-end consumption shifting to Macau.
- Low-end consumption shifting to Shenzhen (more people retiring in the Mainland).
- Consumption shifting to non-registered firms.
- Delay consumption for durables.
- Any other ingenious ideas?

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Ageing-- Major Reason for GST?

- Elderly increases to 27% by 2033.(s40)
- Ageing leads to fall in salary tax revenue in relative terms (s42), in need of GST.
- This conclusion depends on assumption on GDP growth.
- If GDP would grow in the long term, salary will increase (resulting later retirement and more import workers as well). Thus salary tax revenue may not decrease.

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Ageing & GST

- If GDP would contract in the long term, salary may fall with higher unemployment. Then the new consumption tax will make everyone suffered more.
- I pay salary tax for more than 30 years and will retire soon. Consumption tax will tax me again. Is this fair?
- If HK works on a more liberal immigration policy now, ageing may not be a problem.

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Why Borrowing not an Option?

- SAR Govt did not discuss borrowing.
- All major economies (central, state and local governments) borrow regularly, particularly for infrastructure & education.
- SAR Govt concerns very much about credit ratings (p.iv). But Govt could borrow more during bad times (interest rates usually low), repay in good times.

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Borrowing as an Option

- Long-term borrowing is a "fair" fiscal tool as well, as it provides inter-generations' sharing of responsibility.
- HK's huge reserves provide good collateral for borrowing.
- There is a great demand for high-grade HK gov. papers, a necessary strategy to develop HK's debt market.

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Why a Moderate Progressive Tax not an Option?

- Every major economy is having a progressive tax system (s37, over 40%).
- Why not HK?
- HK's salary tax is cap at 16%, marginal rate tops at 19%; profit tax for incorporated businesses is 17.5%. (Taxes increased by 1 to 1.5% during last recession.)
- But Singapore is getting closer rapidly: ST:21%, PT:20% (40% in 1986).

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Tax Revenue Neutral Now— What Does That Mean for Future?

- Govt promises that for 1st 5 years, all\$30b additional revenue would be returned to community as tax relief or comp. (s195).
- Then what's next? HK people deserve a comprehensive answer for this.
- The sole purpose of introducing GST is to increase tax revenue (during bad times?), not revenue neutral!

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GST Must Go Up— Government is not Honest

- As HK Govt claims, HK is facing ageing, structural unemp, recession threat, higher welfare spending, thus implying that Govt expects GST going up in the future.
- UK's GST is 17.5% now, up from 3% in 19??.
- HK community deserves to know. E.g. if HK economy declines for 5% for 3 years, how much GST would be increased?

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Reasons for Other Economies Introducing GST—No Other Option

- Serious fiscal difficulties for major economies since 1970s:
- Borrowing too much, some local govt could not even service their debts. Interest rates were very high in 1980s.
- Top rates for income and profit taxes are too high, which could not be increased further. Tax havens are competing for business relocation.
- Import taxes are declining rapidly due to liberalization of foreign trade.

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OECD's Low Corp Tax Revenues—Why?

- Many Corporations in OECD have been losing money (e.g. entire global aviation industry losing money for many years). Thus corp tax revenue was small, despite high tax rates (Ch1). HK companies have been very profitable for a long time.

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GST & 3-Tier Govt

- Major economies have a 3-tier Govt. Most of income and profit taxes go to Central govt. Inter-govt transfers are important.
- GST becomes a major source of revenue for state govt.
- Cal State Govt had total debts of US\$104b, with 166b for local govt.
- There is a trend for national govt to adopt GST (NZ, 86; Can, 91; Aust, 2000).

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California's State & Local Finances (2003-04)

	State	Local	HK
• Total Rev	US\$229b	205b	27b
• Int Govt Transfer	22%	39%	0%
• Prop-R Tax	1%	16%	14%
• Gen Sales Tax	12%	4%	0%
• Select Sales Tax	3%	2%	11%
• Income Tax	16%	0%	16%
• Corp Tax	3%	0%	28%
• Charges	10%	30%	13%
• Insur Trust Rev	31%	8%	0%
• Invest Income	0%	0%	11%

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What Do We Learn From This —I Am Not Sure?

- Does US or OECD have a more optimum revenue structure than HK? How? Why?
- At local govt level, prop-related taxes are equally important as in HK (Ch1). Prop are taxed and land is sold at local level.
- Revenues from selective consumption taxes (duties, betting, vehicle tax, hotel, air passengers, etc.) in HK are relative high, despite absence of GST.
- Charges are important sources of income.

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High Social Security Tax

- Other than high income tax, there are high social security and payroll taxes at various govt. levels as well (Ch1) to support social welfare. Should HK follow this as well?
- Just comparing HK's tax structure with that of OECD Central Govts is very misleading. We should examine state and local govts' finances, and learn from them as well.

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Concluding Remarks

- The Consultation Document is misleading.
- Many important arguments are without theoretical and empirical substantiation.
- We do not have a 3-tier Govt in HK, pay no tax to Central, nor military expenditure.
- The Govt may have a case for GST for the long term, but political manoeuvre has been very weak and ineffective so far.
- I do not see any upside coming. Politically, it is dead.

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