Paper No. CB(2)1570/00-01(01)

SUBMISSION TO THE BILLS COMMITTEE (REVENUE BILL) FROM THE HONG KONG BEER INDUSTRY COALITION

Proposed Increase of the Duty Rate on Liquors with an Alcoholic Content of 30 per cent and below

Introduction

This submission is made by the Hong Kong Beer Industry Coalition (HKBIC), a coalition comprising seven substantial Hong Kong companies which manufacture or import beer products in Hong Kong.

On 7th March 2001, the Financial Secretary presented his 2001-02 Budget to the Legislative Council and proposed to increase from 30% to 40% the duty rate on liquors with an alcoholic content of 30% and below, excluding wine. The proposal became effective immediately under a Public Revenue Protection Order, which will expire on 7th July. As a result, the government introduced a Revenue Bill into the Legislative Council on 25 April 2001, to amend Schedule 1 to the Dutiable Commodities Ordinance to implement the proposed increase in the duty rate. The product most affected by the proposal is beer. On 27 April, a Bills Committee was formed to scrutinize the proposals laid out in the Revenue Bill.

Purpose

The purpose of this submission is to express HKBIC members' strong opposition to the proposed duty increase and to urge the Bills Committee to oppose the proposed increase in the duty rate. All the major companies involved in the manufacture and/or sale of beer in Hong Kong believe that such an increase would damage the businesses and adversely affect the livelihood of several hundred thousand people working in the beer, catering, retail and entertainment industries. It could also fail in its objective of raising revenue for the government, if it leads to a decline in the volume and value of beer sold in Hong Kong. HKBIC's reasons for such strong opposition are explained in detail below.

1. <u>Raising the duty from 30% to 40% will not generate the additional revenue the government expects</u>

   In proposing this increase, the Financial Secretary stated that he expected to generate additional revenue of HK$90 million in 2001-02 and HK$360 million over the period to 2004-05. He also said (paragraph 111) that he had decided not to increase the duty rates on strong spirits or wine because he thought that "might significantly push up retail prices and risk a switch to the consumption of cheaper products, defeating [his] objective of significantly increasing revenue". Members of the HKBIC believe that the same argument applies equally to beer.

The following charts provide scenarios showing HKBIC's estimates of how the government's excise revenue from beer would be affected under different market conditions.

- **Scenario 1: Beer duty rate is increased to 40% and the market remains unchanged**

	1999	2000	2001
Production and Import Volume (hl)	1,619,322	1,512,564	**1,512,564**
Production and Import Value (HK$)	991,766,130	840,024,827	**840,024,827**
Duty per hl	184	167	**213**
Duty paid	297,529,839	252,007,448	**322,009517**
		Extra revenue (HK$)	**70,002,069**

- **Scenario 2: Beer duty rate is increased to 40% but market volume drops by 10% and value drops proportionately**

	1999	2000	2001
Production and Import Volume (hl)	1,619,322	1,512,564	**1,361,308**
Production and Import Value (HK$)	991,766,130	840,024,827	**756,022,344**
Duty per hl	184	167	**213**
Duty paid	297,529,839	252,007,448	**289,808,565**
		Extra revenue (HK$)	**37,801,117**

- **Scenario 3: Beer duty rate is increased to 40% but market volume drops by 10% and value drops by an additional 10% (trading-down effect)**

	1999	2000	2001
Production and Import Volume (hl)	1,619,322	1,512,564	**1,361,308**
Production and Import Value (HK$)	991,766,130	840,024,827	**672,019,861**
Duty per hl	184	167	**189**
Duty paid	297,529,839	252,007,448	**257,607,614**
		Extra revenue (HK$)	**5,600,166**

1999 and 2000 data provided by the Customs and Excise Department

In the year 2000-01, the government collected approximately HK$252 million in revenue from the duty on beer. As the market for beer in Hong Kong has shown an overall decline since the mid-1990s, the government's expectation of an increase in revenue of HK$90 million (about 35%) in 2001-02 is highly optimistic. Such an increase in revenue would require market growth of approximately 5%. Yet the latest Customs and Excise figures show that from 1 February 2000 to 28 February 2001, the total volume of beer sold in Hong Kong decreased by 6% over the previous twelve months.

Consumers are extremely price sensitive in the current economic environment: an increase in the retail price of beer will almost certainly lead to a further decline in overall consumption. Moreover, such an increase in the retail price will encourage consumers to trade down to lower-priced beers, leading to a decrease in the dutiable value of beer purchased. Both these developments will cause a significant shortfall in revenue expected by the government, as demonstrated in Scenarios 2 and 3.

2. A duty increase would impose an unfair price burden on ordinary consumers

An increase in the duty rate on beer, which constitutes 90% of all alcoholic beverages sold in Hong Kong, would have a much broader, adverse impact on the general population than an increase in the duty rate on many other less widely consumed products. Beer is consumed by every sector of the population, much of which is still suffering from the effects of the economic downturn. The HKBIC does not believe it is fair to impose a duty rate increase, which affects a broad spectrum of ordinary consumers, while the duty rates on luxury products remain unchanged.

3. A duty increase would also harm the catering, hospitality and entertainment industries

The proposed duty increase would not only affect the companies in the HKBIC and the wholesale and retail industries. It would also seriously affect the catering, hospitality and entertainment industries. Revenue from sales of beer is particularly important to the catering industry, which alone buys 40% of all beer sold in Hong Kong. This industry employs over 200,000 people and generates HK$50 billion in turnover per year. Under current market conditions, the owners of Hong Kong's restaurants, hotels, bars and entertainment outlets are unlikely to pass on to consumers any price increases resulting from the duty rate increase. If the profit margins of businesses in these industries are further eroded, the livelihoods of all those who work in them will also be affected.

4. A duty increase would result in a further consumption shift across the border to Shenzhen and could increase smuggling of beer into Hong Kong.

The proposed duty increase would further widen the price disparity between products in Hong Kong and Shenzhen, so making it even more attractive for consumers to go across the border for shopping, dining and drinking. This would not only harm the beer industry in Hong Kong, but also the restaurants, bars and entertainment outlets which are already coping with a downturn in their business.

A greater price gap between beer products in Hong Kong and mainland China could also lead to an increase in beer smuggling from the mainland into Hong Kong, putting additional pressure on the Customs and Excise Department.

Hong Kong Beer Industry Coalition

16 May 2001

<u>Member companies:</u>

Carlsberg Hong Kong Ltd.

Foster’s International Hong Kong

Heineken Hong Kong Ltd.

Jebsen &Co Ltd.

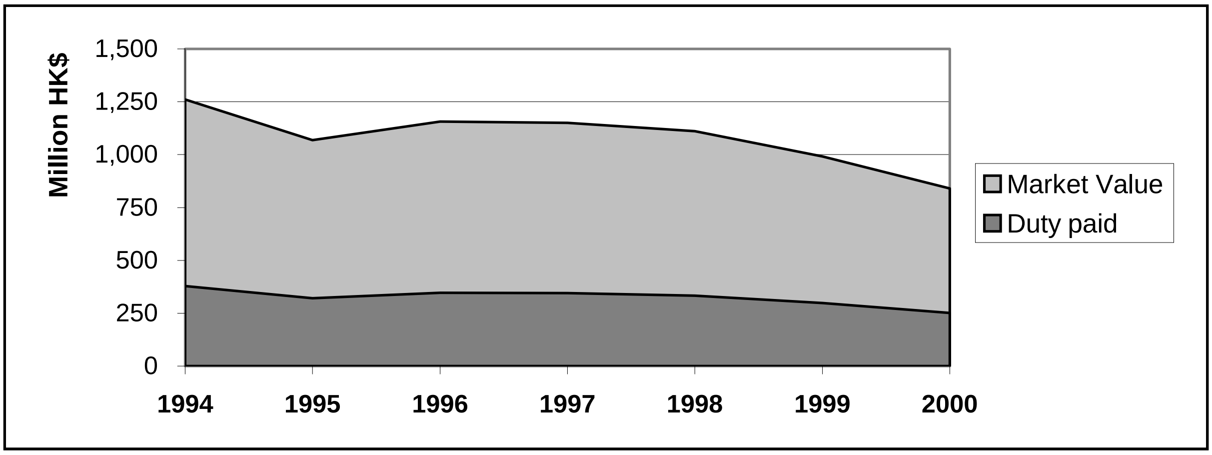
San Miguel Brewery Hong Kong Ltd.

Tsingtao Beer (H.K.) Trading Co. Ltd.

Wing Hing Provision, Wine & Spirits Trading Co. Ltd.

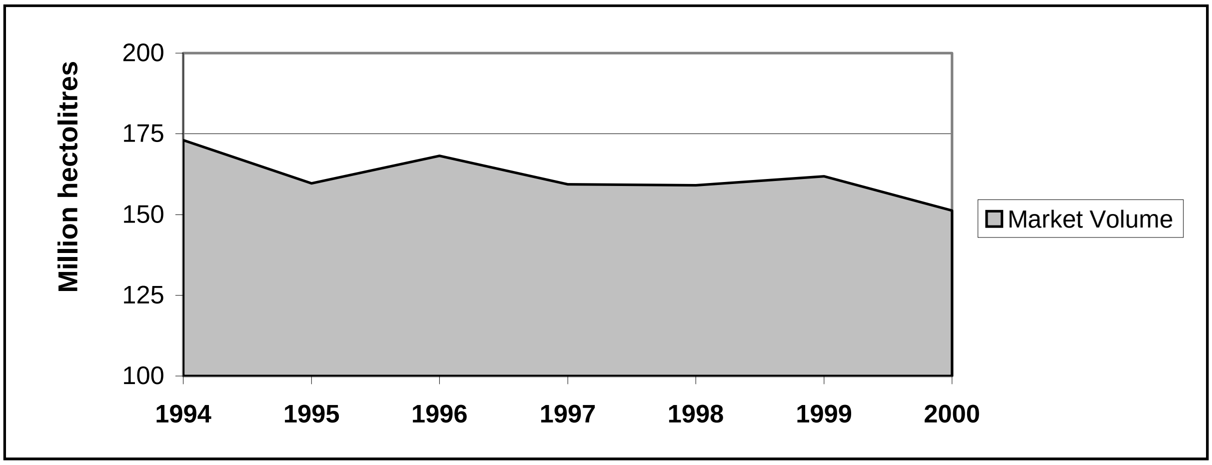
APPENDIX

Beer Production and Import Value (1994-2000)



Source: C&E Department; Duty rate=30%

Beer Production and Import Volume (1994-2000)



Source: C&E Department

Key-points:

- Between 1994 and 2000, the value of the beer market in Hong Kong fell by approximately 34%, with an average annual decline of 10% for the past three years.
- The amount of beer duty paid to the government decreased by about the same percentage over this period.
- Between, 1994 and 2000, the total volume of the beer market decreased by 14%.

Table D

Parking Meter Utilization Surveys in March 1999

Region	District	No. of Metered Parking Space	Average Utilization Rate	Utilization Rate during Peak hours*
Hong Kong	Central & Western	459	65%	75%
	Wan Chai	1,021	90%	90%
	Eastern	631	75%	74%
	Southern	521	53%	75%
	Total	***2,632***	***71%***	***79%***
Kowloon	Yau Tsim Mong	2,336	89%	91%
	Sham Shui Po	1,528	65%	73%
	Kowloon City	2,880	66%	77%
	Wong Tai Sin	499	85%	93%
	Kwun Tong	522	81%	92%
	Total	***7,765***	***77%***	***85%***
Overall Total		**10,397**	**74%**	**82%**

(* Peak hours from 1900 to 2100 hours on weekdays)

Table E

Parking Meter Utilization Survey, March 2001

Region	District	No. of Metered Parking Space	Average Utilization Rate	Utilization Rate during Peak hours*
Hong Kong	Central & Western	487	68%	80%
	Wan Chai	985	81%	87%
	Eastern	666	66%	77%
	Southern	527	80%	91%
	Total	***2,665***	***74%***	***84%***
Kowloon	Yau Tsim Mong	2,148	93%	95%
	Sham Shui Po	1,545	69%	77%
	Kowloon City	2,823	70%	81%
	Wong Tai Sin	499	68%	89%
	Kwun Tong	491	84%	90%
	Total	***7,506***	***77%***	***86%***
NT NT(E)	Sai Kung	929	69%	88%
	Sha Tin	1,233	75%	85%
	Tai Po	977	84%	85%
	North	864	64%	67%
	Sub-total	***4,003***	***73%***	***81%***
NT(W)	Tsuen Wan	579	96%	98%
	Kwai Tsing	480	85%	89%
	Tuen Mun	956	89%	92%
	Yuen Long	658	92%	94%
	Lantau Island	39	-	-
	Sub-total	***2,712***	***91%***	***93%***
	Total	***6,715***	***82%***	***87%***
Overall Total		**16,886**	**78%**	**86%**

(* Peak hours from 1900 to 2100 hours on weekdays)

LETTERHEAD OF SECRETARY FOR THE TREASURY

Annex

7 May 2001

Mr Jan-Kees Nieman
General Manager
Heineken Hong Kong Ltd
22/F, Lincoln House
979 King's Road, Quarry Bay
Hong Kong
[fax: 2259 7001]

Dear Mr Nieman,

Thank you for your letter of 17 April 2001, and for attending a meeting with Martin Glass, my deputy and other colleagues on 27 April 2001. I now write to formally set out our response to your letter. I understand that you have sent a similar letter to the Financial Secretary. This letter serves as the co-ordinated reply from the Government.

As explained by the Financial Secretary in the 2001-02 budget, we have to consider raising additional revenue when enhancing productivity and controlling expenditure alone cannot achieve fiscal balance. This is especially important in the face of successive operating deficits from 1998-99 to 2004-05. However, the Financial Secretary is also aware that we should not impose too great a burden on the community at this time. This is why he has proposed to make only modest adjustments to a small number of revenue items that do not impact on economic growth and have a negligible effect on people's living standards.

It was against this background that the Financial Secretary proposed, among other things, to increase from 30% to 40% the duty rate on liquors with an alcoholic content of 30% and below. As far as beer is concerned, the proposed increase is very mild. For the more popular brands of beer, the proposal will only increase the duty amount per can of beer in a range from less than 10 cents to around 26 cents. You may also wish to note that the duty rate on liquors with an alcoholic content of 30% and below has not been adjusted ever since the existing *ad valorem* system was put in place in 1994. Indeed, based on the consumption pattern in 2000-01, the duty rate on beer per can (0.33 litre), even after the proposed adjustment, is still lower than that under the previous system by around 30%.

Given the very modest nature of the proposed increase, we do not believe that this would cause any significant adverse impact on the consumption of beer. On this basis, we estimate that the proposal would generate a revenue increase of around $90 million for the Government in 2001-02. Whether we will eventually be able to achieve that amount of additional revenue depends on a host of other factors apart from the direct impact of the duty increase, including concurrent changes in consumer preferences and the pace of our economic recovery. We will examine the actual effect of the proposed increase on our duty revenue from liquor when we prepare the Budget for the next year.

We have not proposed a similar increase in duty rates on strong spirits or wine because their duty rates are already very high at 100% and 60% respectively. Given that the ex-factory price of such products is far higher than for beer, the impact of a duty increase in absolute terms would be much more significant for such products. The risk of a switch to the consumption of cheaper products should be relatively higher, hence defeating the objective of increasing revenue.

You have expressed concern at the meeting on 17 April that the proposed increase would lead to smuggling of beers. I would like to assure you that the Customs and Excise Department is committed to combating all kinds of smuggling activities. The Department will continue to take vigorous enforcement measures against the supply and use of duty-not-paid goods.

You pointed out in your position paper that there had been no consultation with the beer industry on the proposed increase. I hope you will understand that for reasons of budgetary sensitivity, it is not possible for us to consult the industry on the details of any revenue proposal before the announcement of the Budget. However, in preparing the Budget, we did take into account views from different sectors of the community expressed during the budget consultation exercise. Specifically, my colleagues met with the Liquor and Provision Industries Association in January this year to discuss issues relating to the duty on alcoholic liquors. The beer industry was also represented at the meeting. We welcome any updated market information specifically on beer consumption from the industry in future budget consultation exercises, which will be useful to our consideration of budget revenue proposals.

I hope this letter will help to clarify the policy considerations behind the proposed increase of liquor duty in the 2001-02 Budget.

Yours sincerely,

(Miss Denise Yue)
Secretary for the Treasury