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Legislative Council
Panel on Financial Affairs

Minutes of special meeting held on
Wednesday, 26 September 2001 at 10:00 am
in Conference Room A of the Legislative Council Building

Members present : Hon Ambrose LAU Hon-chuen, GBS, JP (Chairman)
Hon Henry WU King-cheong, BBS (Deputy Chairman)
Hon James TIEN Pei-chun, GBS, JP
Hon Albert HO Chun-yan
Hon LEE Cheuk-yan
Hon Eric LI Ka-cheung, JP
Dr Hon David LI Kwok-po, GBS, JP
Hon NG Leung-sing, JP
Hon James TO Kun-sun
Hon Bernard CHAN
Hon CHAN Kam-lam
Hon SIN Chung-kai
Dr Hon Philip WONG Yu-hong
Hon Jasper TSANG Yok-sing, JP
Hon Emily LAU Wai-hing, JP

Non-Panel Members : Hon Cyd HO Sau-lan
attending Hon Margaret NG
Hon CHAN Yuen-han, JP
Hon LAW Chi-kwong, JP
Hon LI Fung-ying, JP
Hon Tommy CHEUNG Yu-yan, JP
Hon Michael MAK Kwok-fung
Dr Hon LO Wing-lok
Hon IP Kwok-him, JP
Hon Audrey EU Yuet-mee, SC, JP

**Public officers
attending**

: For Item I

Hon Antony LEUNG
Financial Secretary

Mr Stanley YING
Acting Secretary for the Treasury

Mr K Y TANG
Government Economist

Mr Howard LEE
Administrative Assistant to the Financial Secretary

For Item II

Mr Albert LAM
Acting Deputy Secretary for the Treasury

Mr Moses CHENG
Chairman of the Advisory Committee on New Broad-
based Taxes

Mr Marshall BYRES
Member of the Advisory Committee on New Broad-
based Taxes

Mr Tim LUI
Member of the Advisory Committee on New Broad-
based Taxes

Mr Michael OLESNICKY
Member of the Advisory Committee on New Broad-
based Taxes

Clerk in attendance : Mrs Florence LAM
Chief Assistant Secretary (1)4

Staff in attendance : Ms Pauline NG
Assistant Secretary General 1

Ms Anita SIT
Senior Assistant Secretary (1)8

I Reviving the economy

LC Papers No. CB(1)2100/00-01(01) to (03)

The economic outlook

The Financial Secretary (FS) said that whilst Hong Kong was continuing its economic restructuring and facing the cyclical economic downturn of major overseas markets, the terrorist attacks on the United States (US) on 11 September 2001 (the "911" incident) would likely put additional pressure on the local economy. The Administration was at present soliciting views from different sectors of the community on measures to provide relief and revive the economy. In briefing Members on Hong Kong's prevailing economic conditions, he wished to make use of the opportunity to invite Members to give views and suggestions in this regard.

2. The Government Economist (GE) said that being a small and open economy, Hong Kong was bound to be much affected by global economic conditions especially those in the US. The full impact of the "911" incident on various aspects of the US economy had yet to be reflected by relevant economic data to be released some time later. At this stage, it was observed that the major stock markets, exchange rates and oil prices in US had remained relatively stable after some brief initial gyrations. The concerted efforts of the key monetary and financial authorities had helped. Yet, a further downturn of the US economy would have significant impact on the global economy, and henceforth on the Hong Kong economy. The US Consumer Confidence Indicator was at its lowest for five years in September 2001, and the extent of decline was the largest since 1991. The US Leading Indicator for near-term economic activity dropped in August after it had edged higher for a few months, indicating that overall economic conditions was already weak before the "911" incident. Many enterprises had issued warnings about their earnings and near-term business outlook. Compared to the economic recession in the US a decade ago, the prospective recession in the US this time would likely have a greater impact on the global economy. Indeed, many European economies, the Japanese economy and most of the other East Asian economies were already experiencing along with the US economy.

3. On the forecast for the Hong Kong economy, GE anticipated that virtually all sectors of the local economy would have to face a difficult period in the aftermath of the "911" incident. Apart from the civil aviation and insurance sectors, the export and retail sectors would also be significantly affected by the incident and its ensuing effects. On visible trade, exports in August already showed a double-digit year-on-year drop. Exports to the US in the fourth quarter and early next year were not optimistic. The outlook for invisible trade, in particular inbound tourism, was also not optimistic. On local consumption expenditure, there had already been signs of slowdown in the third quarter before the "911" incident. With a rising unemployment rate and with the impact of the incident filtering through, local consumption was set to ease further in the fourth quarter. As business enterprises were getting more cautious, investment

expenditure was also expected to decline. It was therefore envisaged that on the whole, the Hong Kong economy would slacken further in the third and fourth quarters of 2001 and would likely continue to be so in early 2002.

4. A number of members expressed disappointment at not hearing anything concrete from the FS in addressing the present critical economic situation. They were hoping that FS would announce at this meeting some immediate measures to revive the economy rather than inviting members to continue to give views. They had in the past weeks forwarded their views separately to the Chief Executive and to the FS. They therefore could not see the reason why they had to repeat their views again. Nevertheless, for the benefit of the public and in response to FS's request, they would list out what they believed would benefit Hong Kong people immediately and in the long run, and enquire how far their suggestions could be pursued.

5. Miss Cyd HO highlighted the importance of establishing an "alert system" so that there were indicators for the need to take contingency measures to tackle potential crises. She commented that the economic information provided by the Administration at this meeting was not particularly useful as similar information had already revealed by the media. What appeared necessary was some objective yardsticks to trigger the implementation of specific contingency measures.

6. ES responded that the "911" incident had both short-term and long-term effects on Hong Kong's economy. The information provided at this meeting sought to inform members and the public of the prevailing economic circumstances. At this stage, the Administration was listening to the views of the community but would announce concrete measures very shortly. Where the situation warranted, prompt actions would be taken to avert potential crisis. The recent funding proposal to the Finance Committee in relation to securing guarantee for third-party insurance coverage for the aviation industry was an example.

7. Miss Emily LAU further enquired whether the Administration would accord greater importance to Members' proposals if such proposals were put up jointly by Members of different political affiliations. In response, ES said that the Administration would treasure every and each proposal from Members and would examine such proposals very carefully irrespective of whether they were separately proposed or jointly proposed by Members.

Measures to revive the economy

8. Mr CHAN Kam-lam said that at this time of perilous economic conditions, a primary task of the Government was to restore the confidence of the general public in Hong Kong's future. He referred to the proposals of Members of the Democratic Alliance for Betterment of Hong Kong forwarded to FS earlier on and highlighted their suggestion of providing immediate relief for those

citizens under immense economic hardship, such as the property owners with negative equity and the unemployed. He opined that the current situation warranted contingency measures, which though might require utilizing the fiscal reserves. Mr CHAN also expressed concern about the heavy reliance of the local economy on the US market and urged the Administration to put more efforts on capitalizing the business opportunities arising from the Mainland's imminent accession to the World Trade Organization.

9. ES stressed that the Administration ought to be very prudent on the use of the fiscal reserves. The reserves should only be spent in ways that would benefit the community in the long term. ES further said that the Administration was not insensitive to the difficulties and worries of the public. Therefore, the Chief Executive (CE), himself and his colleagues were arduously collecting views and suggestions from different sectors of the community. In formulating relevant measures, the Administration would take into account the need to provide immediate economic relief as well as the need to strengthen the fundamentals of the economy. Apart from considering external factors, there was also a need to address the internal economic restructuring in Hong Kong. Nevertheless, he agreed that the local business sector should seize the opportunities arising from the fast growing Mainland market.

Relief measures

10. Mr James TIEN highlighted that the impact of "911" incident on Hong Kong's export orders to the US would surface in a few months' time as export orders for seasonal goods from Hong Kong had drastically dropped. Against the prevailing economic conditions, Members of the Liberal Party (LP) proposed a package of relief measures, including the waiving of property rates payments for one year, creation of new jobs, suspension of contributions to the Mandatory Provident Fund Schemes (MPFS) for one year by both employers and employees. He highlighted that the suspension of MPFS contributions might affect the MPFS service providers, but it would not involve additional public expenditure. This measure would relieve the financial burden of employers and employees and release some \$20 billion to \$30 billion to the consumption market.

11. Mr CHEUNG Yu-yan added that there was a strong support in the catering sector for the suspension of MPFS contributions by employers and employees for one year. He highlighted that there had been double-digit plunge in the business turnover of the catering sector. There was also a need to withhold all legislative proposals under consideration which might adversely affect the business sector. A business impact assessment should be conducted for each of these proposals before they were introduced to the Legislative Council.

12. ES responded that although Hong Kong was facing a critical economic downturn, the community should not be too pessimistic. Being the closest economic partner of the Mainland, Hong Kong had an edge over other economies

in capitalizing the business opportunities in the Mainland. Hong Kong citizens should seize every opportunity to upgrade their capabilities to maintain competitiveness and meet new challenges. He agreed that the Administration should have regard to the potential effect on the business sector in the process of formulating new policies.

13. Mr LO Wing-lok observed that the general public's confidence in the economy had plunged to record low. There was an urgent need to undertake concrete measures to restore public confidence. He however alerted the Administration of the importance to stand firm on policies which would benefit the community at large, such as the Government's recent proposal on banning smoking in eateries, which according to objective surveys would not adversely affect their business. Mr LO also urged the Administration to review the plan to increase charges for public health and hospital services in April 2002 in view of the present-day circumstances.

14. Mr SIN Chung-kai highlighted the proposed relief measures of Members of the Democratic Party as follows -

- (a) The payment of property rates should be waived for all households for one year.
- (b) A special tax deductible allowance of \$50,000 for salaries tax should be provided for one year.
- (c) Rents of all public housing tenants and commercial tenants of public housing estates should be reduced by 30% for one year or a longer period.
- (d) The Government should set up a fund, preliminarily estimated to be about \$3 billion, to facilitate property owners with negative assets to re-mortgage their self-occupied property at a lower mortgage interest rate.
- (e) To ease unemployment, the Government should create temporary job opportunities and provide tax incentives to employers for employing those workers who had undergone job retraining.

15. On the suggestion of setting up a re-mortgage loan fund, ES remarked that the required size of the fund might be over 10 times the amount of \$3 billion. Apart from the initial financial commitment and the subsequent credit risk involved, the Administration also needed to carefully consider whether the measure would set an undesirable precedent of using public money to provide financial assistance to citizens who had incurred losses in their investment.

16. Mr James TIEN further said that Members of LP agreed that property owners with negative assets warranted assistance. However, they had reservation on the proposal to set up a re-mortgage loan fund in view of the

substantial public funds required and the current sentiments of the property market.

17. Mr SIN Chung-kai stressed that the proposed re-mortgage loan fund only sought to enable property owners with negative assets to obtain a lower prevailing market interest rate for their mortgaged property. To avoid possible abuse, the fund should apply only to self-occupied properties mortgaged at an interest rate substantially higher than the prevailing market rate due to negative assets.

18. Dr Philip WONG opined that the banking sector should have a role to play at this critical period. He suggested that to provide a respite for property owners under financial hardship, banks should provide options for property mortgagors to extend the mortgage period and to suspend the repayment of the loan principal for a few years. ES noted Dr WONG's suggestion and remarked that it was a matter for the banking sector to consider.

19. Miss Emily LAU considered that the Government should not provide direct financial assistance to property owners with negative equity but should explore alternative means to assist these citizens. For example, the Administration might request property developers to set up a fund to provide assistance for these citizens.

20. Miss LAU stressed that there was an urgent need to help those with negative assets and small businesses. She queried whether the Administration was aware of the devastating changes in economic conditions, resulting in more businesses being on the verge of closure. Yet the Government had just recently adjusted the pay of civil service upward in July 2001 and incurred some \$4 billion to purchase office accommodation for the Hong Kong Monetary Authority. She enquired whether the Government had made any projection of the rate of closure of businesses due to economic downturn.

21. GE explained that the surveys conducted among various industries/sectors in early 2001 had not indicated a severe slackening in economic growth. On the contrary, positive sentiments were revealed in the survey results. Nevertheless, the Government had cautioned the public about the prospect of rising unemployment each time when the unemployment figures were announced. The Administration had all along been closely monitoring the economic conditions. Major economic data were compiled and analyzed on a monthly or quarterly basis.

22. As regards the projection of closures of businesses, GE advised that as revealed by past experience, there was usually a time gap between the onset of a financial crisis and company closures. It was expected that large corporations as well as small and medium enterprises (SMEs) would face increasing difficulties in the coming months, while the pressure on SMEs might even be greater.

23. In response to Miss Emily LAU's remarks on the 2001 civil service pay adjustment, ES reiterated that under the current mechanism, the annual civil service pay adjustment mainly reflected the pay adjustments in the private sector in the previous year rather than those in the current year. As regards the purchase of office accommodation for HKMA, ES advised that the Government had already signed the legal documents for the purchase.

24. Mr Henry WU considered that the local economy was in a critical situation. He was particularly worried that with a declining labour market, social instability might result. He remarked that the survival of SMEs was fundamental to the local economy. At times of economic downturn, SMEs would usually endeavour to keep their businesses afloat even under very great pressure. Hence, the stability of the society would be in question if many SMEs had no alternatives but to wind up their businesses. As such, he urged the Administration to critically review all planned measures which might impact adversely on SMEs, such as the planned abolishment of the minimum brokerage commission rate in April 2002. Mr WU echoed some other members' view that the Government should work proactively to facilitate the business sector to capitalize business opportunities in the Mainland.

25. ES said that the Administration all along recognized the importance of SMEs for the local economy and understood their difficulties under the current economic conditions. He assured members that the Administration would devise measures to assist SMEs to overcome short-term difficulties and to foster their strengths in face of economic restructuring. He also agreed to review the implementation timetable of certain policies in the light of the current economic situation.

26. The Chairman referred to the four recommendations put forward recently by the Small and Medium Enterprises Committee (SMEC) and enquired whether and when these recommendations would be implemented. He said that Members of the Hong Kong Progressive Alliance (HKPA) had proposed to create 23 000 temporary jobs for low-skilled workers and estimated that the measure would require some \$2 billion. Members of HKPA also suggested that provided that both the employer and employees concerned agreed, enterprises should be allowed to suspend their MPFS contributions.

27. In response, ES confirmed that the Administration would implement the recommendations of the SMEC as soon as possible. He thanked members for their views and suggestions and assured them that the Administration would examine measures to ease unemployment and revive the economy. Such measures would be geared towards improving the business environment, upgrading our human capital, exploiting new technologies etc. to meet both the short-term and long-term challenges.

28. Mr Eric LI took this opportunity to clarify that except for his comments on the suggestion of suspending MPFS contributions, he had not commented in public or before the press on the economic relief measures suggested by LegCo

Members. He called on the Administration to work in collaboration with LegCo Members in formulating economic relief measures.

Measures to address unemployment

29. Mr NG Leung-sing remarked that LegCo Members were keen to work out feasible relief measures in collaboration with the Administration. He highlighted the urgent need to tackle rising unemployment lest social instability would result. Referring to his written submission (LC Paper No. CB(1)2100/00-01(02), he opined that the Administration should work out promptly feasible measures that could provide immediate assistance to the unemployed.

30. Referring to the written views submitted by herself, Mr CHAN Kwok-keung and Mr LEUNG Fu-wah, (LC Paper No. CB(1)2100/00-01(03), Miss CHAN Yuen-han said that in face of the perilous economic situation, the Administration should have the courage to take vigorous measures to tackle unemployment and to provide immediate relief for those citizens under immense financial hardship. Referring to recent media reports that the measures being considered by the Administration would still focus on job retraining and education, she expressed disappointment with the Administration adopting such a restrained approach at this critical period. She also expressed grave concern that individual Government departments would discard the unemployment problem and implement layoff plans in their departments in the coming months.

31. Mr James TIEN commented that civil service salaries were too high when compared with the present private market. The Liberal Party had all along advocated downsizing the Civil Service, but in view of the present economic condition, they had no objection to deferring the Enhanced Productivity Programme by one year.

32. Mr LEE Cheuk-yan highlighted his concern about the worsening trend of layoffs in the public and private sectors. He urged FS to halt any layoff plans in the civil service, including those affecting the temporary staff in the civil service. He also proposed that the Government should set aside some \$2 billion from the fiscal reserves to create 20 000 new job opportunities in one year.

33. FS reiterated the need to be very prudent over the use of the fiscal reserves. He said that the Administration would continue to seek productivity improvement which however did not necessarily imply layoffs in the civil service.

34. Miss Emily LAU commented that the fiscal reserves belonged to the Hong Kong public and hence utilizing the reserves for the benefits of the public should not be conceived as handouts to the public.

35. Pointing out that further layoffs in the civil service would aggravate the unemployment situation, Ms LI Fung-ying asked whether the Administration had plans to implement the second phase of the Voluntary Retirement Scheme. She also opined that the Administration should set up an emergency loan fund to enable the unemployed to overcome a transient period of financial hardship.

36. ES said that the Administration appreciated the worries of the general public about job security and affirmed that the Administration was committed to providing a safety net to ensure that every citizen would be provided with the essential means of living. He undertook to convey Ms LI's concern about the implementation of the Voluntary Retirement Scheme to the responsible Policy Secretary.

Factors taken into account in formulating relief measures

37. Mr Eric LI enquired about the factors which the Administration would take into account in assessing the merits of individual proposals from Members and other members of the public and the relative priority among these factors.

38. In reply, ES advised that the following were the major factors that the Administration would take into account in assessing the merits of individual proposals -

- (a) whether the proposal would benefit the community in the long term;
- (b) the extent and type (non-recurrent or recurrent) of effects of the proposal on the Government's financial position, and how such effects would in turn affect the credit rating of Hong Kong;
- (c) the non-financial effects of the proposal, such as whether certain proposed measures would adversely affect the entrepreneurial spirit of Hong Kong people; and
- (d) whether the proposal would cause the Government to take on undue risks in the short term and long term, such as the risks associated with the provision of Government guarantee for loans.

Fiscal position

39. In response to Mr James TIEN's enquiry about the Administration's current projection of fiscal surplus/deficit for the 2001-02 financial year, ES advised that the Administration had not made a precise projection in this regard, but a few important figures were worth noting. In the 2001-02 Budget, the Administration had estimated an income of \$28 billion from land premiums, an investment return of \$36 billion from the fiscal reserves held in the Exchange

Fund and \$15 billion from the issue of the second batch of Mass Transit Railway Corporation (MTRC) shares. By the end of July 2001, there was only a return of \$1.6 billion from land premiums. In view of the drop in Hang Seng Index, it was doubtful if the estimated investment returns of \$36 billion from the fiscal reserves would be forthcoming. There was also grave uncertainty over whether further issue of MTRC shares could be absorbed by the market.

Admin 40. At Miss Emily LAU's request, FS agreed to inform Members when the Administration had firmed up its plans on reviving the economy. As regards Miss LAU's another request that the Administration provide a summary of the views received from the public on the subject for members' reference, FS said that virtually all the views expressed in the community so far had been disseminated through the media. He however agreed to further consider Miss LAU's suggestion.

Admin

II A Broader-based Tax System for Hong Kong? - Consultation document issued by the Advisory Committee on New Broad-based Taxes in August 2001

(LC Papers Nos. CB(1) 1862 and 1878/00-01)

41. At the Chairman's invitation, Mr Moses CHENG, Chairman of the Advisory Committee on New Broad-based Taxes (the Advisory Committee), briefed members on the objectives and purposes of the Consultation Document. Mr CHENG said the function of the Advisory Committee was to consider what types of broad-based taxes might be suitable for introduction in Hong Kong, under the principle of maintaining a low and simple taxation regime and preserving Hong Kong's competitiveness. Pursuant to this designated function, the Advisory Committee had examined whether Hong Kong's tax base was narrow, and if so, whether maintaining such a narrow tax base would pose problems to government finances in the long term.

42. Mr Moses CHENG further said that according to its terms of reference, the Advisory Committee should solicit views from the Legislative Council, the community at large and interested parties on the subject. He and other members of the Advisory Committee therefore took this opportunity to listen to Members' views and to provide further information/clarification where necessary. The public consultation exercise was scheduled to end on 6 October 2001, and the Advisory Committee would submit its final report to the Financial Secretary (FS) by the end of 2001. He stressed that the Advisory Committee was open to views from the public and had no pre-determined position on any tax options in the Consultation Document.

Timing and scope of the consultation exercise

43. Mr CHAN Kam-lam said that he fully appreciated the professional efforts put into this study, but he had doubt on whether it was appropriate to consult the public on new taxes when the nature and extent of the problems with

the existing tax regime had not yet been ascertained. Mr CHAN pointed out that in analysing the existing tax regime, one should also take into account the characteristics of Hong Kong's expenditure patterns and how Hong Kong was different from other tax regions.

44. Miss Emily LAU also queried the timing of the consultation exercise in view of the prevailing economic circumstances. She considered that it might be more appropriate to review the local tax system from a broader perspective which would serve to respond to the current needs of the community. In this respect, Mr Eric LI also pointed out that the economic circumstances had changed considerably since the appointment of the Advisory Committee. He enquired whether and how the prevailing economic circumstances would be taken into account in deciding on the timing for the introduction of any new broad-based tax.

45. On the scope of the Advisory Committee's study, The Deputy Secretary for the Treasury (DS/Tsy) explained that in his 2000-01 Budget, FS had highlighted the phenomenon of successive operating deficits since 1998-99 and some potential problems that might erode the revenue base of the Government. These potential problems included the narrow and shrinking profits and salaries tax nets; the possible loss of profits tax due to globalization; the freeze in government fees and charges; the effects of illegal gambling and gambling on the Internet on betting duty yields; and the pressure of global competition on the yields from stamp duty on stock transactions. As a result, the Administration had adopted a two-pronged approach to examine the nature of the problems as well as to find solutions for them. The Task Force on Review of Public Finances (the Task Force) and the Advisory Committee were appointed for these purposes. The Task Force was to determine whether the successive operating deficits were structural or cyclical in nature and to consider whether and if so, what changes should be introduced to the tax system. The Advisory Committee on the other hand was to advise what types of new broad-based taxes would be suitable for introduction in Hong Kong should there be a need for such new taxes. To expedite the deliberation process, the Task Force and the Advisory Committee were required to carry out their respective studies concurrently, so that once the need for the introduction of new broad-based taxes was established, the Administration could proceed to consider various options based on the advice of the Advisory Committee.

46. In this connection, DS/Tsy advised that the Task Force had augmented studies on the correlation between economic performance and government revenue, and was developing a comprehensive model to project the state of government finances in the longer term. These studies were scheduled for completion in late 2001. The Administration would present the key findings to the Panel. He added that the Secretary for the Treasury, who was also a member of the Advisory Committee, provided a link between the Task Force and the Advisory Committee in the conduct of their work.

47. Regarding the timing for the consultation exercise, Mr Moses CHENG said that the subject of introducing new taxes was usually unwelcomed by a community at large both at times of buoyant and sluggish economic conditions. Hong Kong had been able to maintain a simple and low tax regime with a narrow tax base in the past. This had provided a competitive edge for Hong Kong in retaining and attracting local and overseas investment. However, with changes in the economic structure and conditions, it came into question whether the simple and low tax system featured by a narrow tax base would be sustainable. Indeed, the economic restructuring in Hong Kong had brought about and would likely continue to bring about decline in non-tax revenue. To make up for the decline in non-tax revenue and to ensure the viability of long-term government finances, it would be necessary to raise the revenue productivity of existing taxes by increasing tax rates and/or reducing taxation allowances etc., if the tax base was to be maintained at the present level. Against this background, he considered it desirable for the community to examine the suitability of introducing new broad-based taxes at an earlier time. He however shared members' view that as the economic circumstances had changed significantly, it might be necessary for the Government to also consider the need for an overall review of the current tax system.

48. Regarding the sustainability of a narrow tax base for Hong Kong, Mr Marshall BYRES said that although it had long been recognized that Hong Kong's tax base was narrow, many had not considered it a problem in the 1980s and 1990s when the local economy was characterized by a buoyant property sector. Apart from the changes in the local economic structure and circumstances, the narrowness of the tax base had all along posed problems to the Administration in budgeting, as a narrow tax base made the Government vulnerable to fluctuations in revenue yields. It had therefore been difficult for incumbents of the Financial Secretary post to predict the fiscal situation partly because of the narrowness of the tax base. Indeed, many countries had brought in a much broader tax base simply for the sake of enhancing the Administration's ability to predict its revenue.

49. Mr Tim LUI, member of the Advisory Committee, said that being a representative of the Hong Kong Society of Accountants, he understood that the local accounting profession had been urging the Administration to consider the need to undertake a more comprehensive review of the tax system to ensure that Hong Kong maintained and enhanced its competitiveness in an increasingly competitive global economy. One major issue raised by the accounting profession was that under the current territorial-based tax system, the Government had only taxed on locally-derived income. It was questionable whether the "territorial" taxation principle would still be sound given the growth of electronic commerce.

50. Mr Tim LUI further said that the Advisory Committee was not unaware of other important aspects of government finances and the tax system. Given its terms of reference, the Advisory Committee had focused on the task of

identifying feasible and possible solutions if it was confirmed that Hong Kong was in need of a broader-based tax system.

51. At Miss Emily LAU's request, DS/Tsy agreed to provide further information setting out Hong Kong's sources of revenue in the past ten years.

(Post-meeting note: The relevant information provided by the Administration was circulated to members vide LC Paper No. CB(1)16/01-02(01).)

52. In response to Mr James TIEN's enquiries, DS/Tsy confirmed that it was the Advisory Committee's responsibility to solicit views from the Legislative Council, the community at large and interested parties, before finalizing its recommendations to FS. Submissions to the Advisory Committee should focus on the development of a broader tax system for Hong Kong. However, as there were representatives of the Administration sitting on the Advisory Committee, views on other issues forwarded to the Advisory Committee would be channelled to the Administration as appropriate.

Views on introducing new broader-based taxes

53. Mr James TIEN said that the Hong Kong General Chamber of Commerce (HKGCC) had forwarded a submission to the Advisory Committee as well as the Administration setting out its views on the introduction of new broad-based taxes and other related issues. He highlighted the concerns of HKGCC as follows -

- (a) While HKGCC did not object to exploring new revenue sources, it considered that the Administration should put more efforts on reducing public expenditure. There had been substantial increase in public expenditure as a percentage of the Gross Domestic Product (GDP) in recent years. Although the percentage (21.9% in 2000-01) was not particularly high among developed economies worldwide, one should bear in mind that unlike other developed economies, the Hong Kong SAR Government did not need to spend on defence and its expenditure on external affairs was minimal.
- (b) HKGCC in principle agreed to the need to broaden the tax base but was concerned that introducing a general consumption tax would bring about too drastic changes to the existing system, and the tax might put additional pressure on the business sector which was already operating under immense difficulties.

54. Mr SIN Chung-kai said that he did not agree with the Advisory Committee that Hong Kong's tax base was narrow. He considered that as virtually every citizen was subject to one or more items of indirect taxes, Hong Kong's tax base was in fact very broad. He stated that Members of the

Democratic Party would object to the introduction of any new tax in the coming few years.

General consumption tax

55. Mr CHAN Kam-lam remarked that the Advisory Committee had appeared to be more in favour of introducing a general consumption tax than other new tax options, but there had not been sufficient attention given to the potential difficulties and problems involved in implementing a general consumption tax. He reiterated that a simple and low tax system was fundamental to maintaining Hong Kong's international competitiveness in the global economy and the Administration should adopt a very cautious approach for any changes to the system which might result in Hong Kong losing its competitive edge. Mr Henry WU echoed his concern on the effect of any new tax on Hong Kong's international competitiveness and on inbound tourism in Hong Kong.

56. Mr Albert HO opined that consumption tax was a regressive tax and its implementation would aggravate the parity between the rich and the poor. He considered that taking into account also the psychological impact, introduction of a consumption tax would inevitably undermine Hong Kong's international competitiveness.

57. Mr LEE Cheuk-yan agreed with Mr CHAN Kam-lam that the Advisory Committee had a strong inclination towards the introduction of a general consumption tax. He echoed Mr Albert HO's view that consumption tax was a regressive tax under which the poor had to pay a higher rate in relation to their financial capacity. He sought elaboration on the compensations that might be instituted to lessen or eliminate the impact of consumption tax on the lower income groups.

58. Mr Moses CHENG said that general consumption tax was one of the broad-based tax options which the Advisory Committee considered feasible for implementation in Hong Kong, as assessed against the internationally tenets of a good tax system design. To enable a better understanding of this tax option and to provide a common basis for further discussion by the community, the Advisory Committee had included additional information in the consultation paper on this tax option.

59. Mr Moses CHENG further said that the impact of any new tax on Hong Kong's competitiveness was a major factor in assessing the merits of each tax option, and the Advisory Committee's views in this regard had already been set out in the Consultation Document. As regards the possible impact on inbound tourism, he advised that for nearly all countries where some form of consumption tax was levied, there was also a tax rebate system for overseas visitors to mitigate the adverse impact of the tax on tourism. He shared the concern about the possible adverse impact of consumption tax on the lower-income groups and

advised that in most places, the authority would institute certain arrangements to eliminate or lessen the impact on the lowest income groups. While he considered it too early to discuss such arrangements at this stage, he suggested that concerned organizations should make known their views on this issue to the Administration. He added that the Advisory Committee would highlight this issue in the report to FS.

60. Mr Albert HO commented that while a tax rebate system might help alleviate the impact on inbound tourism, there was hardly any effective mechanism to tackle the effect on domestic consumption, particularly the shift to consumption across the border.

61. On the basis for the estimated annual revenue yield of \$18 billion from a broadly-based consumption tax of 3% as stated in the Consultation Document, Mr Marshall BYRES explained that the actual revenue yield would hinge on the tax system design. The estimated annual revenue yield of \$18 billion was derived from assuming that some 50% of the GDP of Hong Kong (which was \$1.2 trillion in 2000-01) was subject to a 3% consumption tax. Traditionally, consumption tax did not apply to certain sectors of the economy such as the financial services sector.

62. Mr James TIEN queried whether the suggested rate of 3% for a general consumption tax (if introduced at all) was too low to be economically efficient bearing in mind that some revenue yield from the tax would be offset by the cost incurred to the Government for administering the tax. He also asked whether the Advisory Committee had taken into account the administrative cost to be borne by the business sector in assessing the merits of this tax option.

63. Mr Moses CHENG said that if a general consumption tax was to be introduced in Hong Kong, the rate of the tax would be determined through community-wide discussion and the necessary legislative process. The basic consideration was to maintain a simple and low rate tax regime to maintain Hong Kong's competitiveness. Thus, a tax rate which was lower than regional or international norms would probably have no material impact on Hong Kong's competitiveness. Mr Marshall BYRES added that while a higher consumption tax rate, say 7% to 8%, would probably cause greater impact on the economy during the initial period of operation, the higher revenue yield generated would provide more room for the Government to consider changes to other aspects of the tax system, such as reduction or removal of certain existing tax items.

64. On the administrative costs required for implementing a general consumption tax, DS/Tsy advised that according to the views given to the Advisory Committee from experts in this aspect, the level of administration costs would depend very much on the tax system design. If a system similar to that recently introduced in Australia was adopted in Hong Kong, the recurrent administrative costs to the Government would amount to some 2.5% of the revenue yield from the tax. As regards the administrative costs to be borne by the business sector, the experience in Australia and Singapore revealed that the

business sector would need to incur a one-off cost for necessary changes to their business systems, but the recurrent administrative costs would not be significant.

65. Mr James TIEN remarked that apart from profits tax, the business sector was also required to pay various government fees and charges, some of which included a tax element. He enquired about the possibility of reducing government fees and charges after the introduction of a consumption tax. Mr Moses CHENG said that in introducing any tax reform measure, the Government should take into account other aspects of the tax system and government finances. Overseas experience revealed that a new consumption tax was usually introduced in the context of a broader tax reform programme.

66. As regards the expected time frame for introducing a general consumption tax in Hong Kong, Mr Moses CHENG said that the Administration had yet to form a view on the introduction of any new tax having regard to the Advisory Committee's report. After that, it would probably carry out further public consultation, including consultation with the Legislative Council, and thereafter would proceed to drawing up relevant legislative proposals and working out the administrative arrangements. He expected that the whole process would at least take a few years. He added that the Advisory Committee considered that adequate public education was essential for the successful implementation of any new tax or tax reform measure and such a public education programme would also require some time to implement.

67. DS/Tsy added that the International Monetary Fund, one of the international expert organizations enlisted by the Advisory Committee for advice, had advised that apart from the public consultation and legislative processes involved, a lot of preparatory work would be required on the part of the relevant enforcement authorities, i.e. the Customs and Excise Department and the Inland Revenue Department, and such preparatory work would take at least two to three years.

Other concerns

68. Mr LEE Cheuk-yan considered that the Government or the Advisory Committee should further examine introducing progressive rates, say within the range of 15% to 19%, for profits tax which, he considered, would not necessarily breach the principle of simple and low tax system. He also opined that a social security tax under which both employers and employees contribute 1% of the employees' wages to provide a "safety net" system specifically for the unemployed was worth further examination.

69. In response, Mr Moses CHENG remarked that given the advance of information technology and communications, it was not difficult for business enterprises to arrange business transactions to take place at a no-tax regime though the preceding negotiations might have taken place in Hong Kong. He therefore considered that this was the most imminent issue that needed to be

addressed in respect of profits tax. As regards taxing worldwide income of businesses and individuals, Mr CHENG said that it would necessitate substantial changes to the existing legislation on taxation and would definitely complicate the tax system. This taxing approach would also involve high cost for recovery of evaded taxes from overseas.

70. Regarding the effect of E-commerce on government's tax revenue, DS/Tsy advised that the Organization for Economic Co-operation and Development had set up a committee to study the issue. He was given the understanding that the current international consensus, with the United States taking the lead, was that to avoid stifling the development of E-commerce, taxes targeting at E-commerce should not be introduced for the time being.

71. The Chairman thanked Mr Moses CHENG and other members of the Advisory Committee for attending this meeting.

72. There being no other business, the meeting ended at 1:05 pm.