1. Should HKSAR Government follow public opinion in spending money? Why does the Government adopt the principle of balanced budget?
2. Why should I be interested in public finance?
3. Why doesn’t HKSAR Government, with its huge annual surplus, give more money to the poor and reduce the gap between the rich and the poor?
4. Why are the other wealthy countries able to provide more welfare benefits to their citizens?
Do you know the relationship between the following matters and the public finance of Hong Kong?

Hard luck! I had my truck parked on the roadside for only 5 minutes while delivering goods and got a $360 penalty ticket!

Mr. Lee

I am a chronic patient suffering from diabetes and need to take medication. I only need to pay $45 for receiving general out-patient service and medication from public hospitals each time, which is exceptionally cheap and impossible at private clinics!

Mr. Lee

Fight against the hegemony of property developers! Support government’s policies of resuming Home Ownership Scheme and increasing supply of public housing! Increase social welfare services and support the under-privileged! Reduce the gap between the rich and the poor!

A group of Hong Kong people
1. Which of the above events will affect government revenue, and which of them will affect government spending?

2. The financial policy of the government is that money obtained from the public would be spent through different ways on the public. What are the reason(s) for that?

3. How can individuals benefit from government spending? What do you expect our government do for us? Why?

4. What is the overall impact of the government’s policy of public finance on Hong Kong?

Think About It:

- I would consider expanding my business by establishing branches in Hong Kong if Hong Kong Government lowers the profits tax rate from 16.5% to 15%!

- A businessman from Singapore

Hello everyone, I am Mr. Lai. I am working as a financial planner for a financial institution in Hong Kong. I am the breadwinner in my family. I earn a high annual salary but I have to reserve $200,000 for tax purposes every year. I hope the Financial Secretary would introduce more tax relief measures this year so that we can benefit from it.

- A businessman from Singapore
Worksheet (1): What are the sources of government revenue?

Figure 1: Items of major revenue of the government and their respective percentages in total revenue (2008-2009)

† Other revenue includes:
1. Loan, reimbursements and other receipts
2. Estate duty
3. Capital Works Reserve Fund
4. Motor Vehicle First Registration Tax
5. Air passenger departure tax
6. Capital Investment Fund
7. Royalties and concessions
8. Hotel accommodation tax
9. Fines, forfeitures and penalties
10. Loan Fund (excluding land premium)
11. Civil Service Pension Reserve Fund
12. Disaster Relief Fund
13. Innovation and Technology Fund
14. Lotteries Fund

Source: The “Hong Kong Fact Sheets” (2009)
1. List the three most important sources of government revenue.

No.1:
Item of revenue: .................................................................
Percentage in total revenue: ............................................

No.2:
Item of revenue: .................................................................
Percentage in total revenue: ............................................

No.3:
Item of revenue: .................................................................
Percentage in total revenue: ............................................

2. Please classify different types of government revenue into the following two types. (excluding other revenue).

<table>
<thead>
<tr>
<th>Tax Revenue</th>
<th>Non-tax Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Percentage in total revenue of the Hong Kong Government: ............

Percentage in total revenue of the Hong Kong Government: ............
3. Which social strata are the most important revenue sources of the Hong Kong government? Explain your answer with the information contained in Figure 1.

Figure 2: Total government revenue of Hong Kong (1989-2010)

Note: The above mentioned years are financial years. Each financial year is from 1 April to 31 March of the following year.

4. What is the impact of this practice on the general public?
5. Why does the government revenue of Hong Kong fluctuate? Suggest possible reasons behind it. (Hints: What are the important financial events occurred in the years that have caused impact on the economic development of Hong Kong and government revenue?)

6. “People who earn more have to pay more tax.” Do you agree with this saying? Why do we have to pay taxes? (Hint: Students may consider this issue from the perspective of fairness and realize that paying taxes is the responsibility of every citizen.)
Government revenue

Sources of government revenue:

There are two types of government revenue, which include tax revenue and non-tax revenue. The following are some examples of tax revenue and non-tax revenue in Hong Kong.

<table>
<thead>
<tr>
<th>Tax Revenue</th>
<th>Non-tax Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Salaries tax</td>
<td>• Penalties</td>
</tr>
<tr>
<td>• Profits tax</td>
<td>• Proceeds and interests from land sales</td>
</tr>
<tr>
<td>• Property Tax</td>
<td>• Charges for public services (e.g. car park fees, postal service fees and water charges)</td>
</tr>
<tr>
<td>• Rates</td>
<td>• Capital Investment Fund</td>
</tr>
<tr>
<td>• Betting Duty</td>
<td>• Deposit interest</td>
</tr>
<tr>
<td>• Stamp Duty</td>
<td>• Others</td>
</tr>
<tr>
<td>• Hotel Accommodation Tax</td>
<td></td>
</tr>
<tr>
<td>• Air passenger departure tax</td>
<td></td>
</tr>
<tr>
<td>• Motor Vehicle First Registration Tax</td>
<td></td>
</tr>
<tr>
<td>• Others</td>
<td></td>
</tr>
</tbody>
</table>

As we can see from the distribution of the government revenue (Figure 1), tax revenue is the major source of government revenue, which accounts for more than 60% of the total revenue, and among which profits tax and salaries tax make up the largest proportion (46%) of the government revenue.

Why does government collect taxes?

Tax revenue is the major source of government revenue. The functions of tax revenue are as follows:

1. To provide the government with the funds required for the rendering of goods and services to the people:
   The government provides the people with many public services and goods that are not sufficient in the market to meet their needs. Examples of the publicly provided goods and services include security, fire safety, health care, education, social welfare and they are heavily subsidised by the government.

2. To reallocate income:
   Through public expenditure, the government supports those who are in need by the taxes collected from the affluent, so as to achieve the objective of reallocation of wealth and fulfilling the basic needs of the people.
3. To improve the overall economic performance of Hong Kong:
With tax revenue, the government can have sufficient funds for infrastructure, economic developments, and the design of strategic directions for the development of Hong Kong. These are important for economic development of Hong Kong.

**Why do we have to pay taxes?**
To perform civic responsibilities:
We enjoy goods and services provided by the government, so we have the duty to pay for them in terms of taxes. Moreover, a good citizen should contribute to the development of society.

---

### : Is goods and services tax a viable option?

Hong Kong’s tax base is exceptionally narrow. That means the government relies heavily on a few taxpayers to pay a few types of taxes as the source of revenue. Moreover, the main sources of government revenue are sensitive to economic fluctuations. To secure the long-term sustainability of our revenue base and our capacity to meet public expenditure needs, the government has proposed Goods and Services Tax (GST) at a rate of 5%, to generate HK$30 billion for the government. We are going to discuss the proposal of imposing such a tax in respect to its merits and drawbacks.

---

### What is GST?
Goods and services tax (GST) is a tax levied by a government on various goods and services. Unlike a general sales tax, consumers are not the only one that pays the GST. Manufacturers and distributors are also required to pay the tax. Currently, GST has been implemented in Canada, Australia, New Zealand, Singapore and some other countries.
Effect of taxation:
Taxation would have different effects on individuals and society as a whole. Some examples are as follows:

To individuals:
1. Incentive to work would be reduced: People have to give a part of their income to the government as taxes. Their incentive to work would therefore be reduced. On the other hand, some jobless people can live on social resources under the social security system. This may also dampen people’s incentive to work.
2. Consumer spending would reduce: taxes would lead to a lower percentage of income for consumption as people need to retain money for paying taxes. This would lower consumer spending.
3. Consumption would reduce: if taxes are imposed on certain consumer goods (e.g. tobacco and alcohol), the prices of these goods would rise and higher prices would reduce people’s consumption for these goods.

To society:
1. Income reallocation can help to reduce the gap between the rich and the poor: Through public finance policy, a government can provide the underprivileged with public services using the taxes paid by the more affluent. This can help to reduce the gap between the rich and the poor.
2. Investment incentive would be dampened: Some taxes associated with business investment (e.g. profits tax and stamp duty) have to be paid for doing businesses and investments. Investment incentive would be dampened, as corporate and trading expenses will increase and in turn decreasing the actual revenues and profits.
3. Prices would be raised: Most of the taxes levied on goods and services (e.g. tobacco tax and hotel accommodation tax) would be reflected on prices. Increase in taxes imposed on certain goods would cause a rise in the prices of those goods and causes a rise in general prices.
The average annual public expenditure of the HKSAR Government is around $250-300 billion. As government expenditure has significant effects on people’s livelihood and the entire economy, what are the expectations of people with respect to government expenditure?

In view of the huge gap between the rich and the poor in Hong Kong, the government should make good use of the resources to improve people’s livelihood, ease the poverty of employed persons and create diversified work opportunities in order to provide relief to the disadvantaged.

In what area(s) do you think the government may increase its expenditure in order to solve the above problems?

Hong Kong has always been an externally oriented economy. As businessmen, we hope that more business partners from different parts of the world would be drawn to Hong Kong for investments and cooperation with local manufacturers. Although Hong Kong got the first place, together with the United States, in the Global Competitiveness Report 2011 for the first time, it only ranked 21st in terms of infrastructure developments, which obviously lags behind. Therefore, we believe that the government has not taken sufficient measures to enhance the competitiveness of Hong Kong!

In what area(s) do you think that the government may increase its expenditure in order to solve the problem?
Due to the high inflation rate in Hong Kong, even the so-called middle class like us experience a drastic decline in living quality. In particular, the property prices in Hong Kong are so high that even professionals cannot afford to buy one. However, the government is not providing us with sufficient welfare and social security. Therefore, we are living under tremendous pressure!

In what area(s) do you think the government may increase its expenditure in order to solve the problem?

Miss Wong, accountant

Worksheet (2): Government expenditure in Hong Kong

Source 1: Public expenditure of the government for 2008-09 (by Policy Area Group)
<table>
<thead>
<tr>
<th>Policy Area</th>
<th>Housing</th>
<th>Security</th>
<th>Support services</th>
<th>Health</th>
<th>Social welfare</th>
<th>Infrastructure</th>
<th>Education</th>
<th>Other spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual Expenditure (HK$ Million)</td>
<td>17403</td>
<td>27999</td>
<td>29432</td>
<td>36706</td>
<td>39248</td>
<td>29238</td>
<td>74995</td>
<td>75947</td>
</tr>
<tr>
<td>Percentage</td>
<td>5%</td>
<td>8%</td>
<td>9%</td>
<td>11%</td>
<td>12%</td>
<td>9%</td>
<td>23%</td>
<td>23%</td>
</tr>
</tbody>
</table>

Source: Hong Kong: The Facts (2009), Government Secretariat: Financial Services and the Treasury Bureau

Source: Total government expenditure between 1989-2010

Source: the Census and Statistics Department of Hong Kong
“First, the Budget should demonstrate the Government’s commitment to our society; second, financial policies should be sustainable; and third, we should be pragmatic in decision-making,” Mr. Tsang explained while delivering his first budget at the Legislative Council.

On commitment to the society, Mr. Tsang said: “It is the duty of the government to provide the final safety net for those who cannot help themselves. Concern over the livelihood of low-income families has now become a consensus in our community.” In addition, he proposed a range of measures to help the elderly and the disadvantaged. These include an additional $1 billion to subsidise more new medicines for patients with financial difficulties; an additional one-month payment for CSSA and Disability Allowance recipients; and a $1 billion subsidy to help elderly people maintain their properties.

Mr. Tsang singled out healthcare as the greatest challenge to the stability of long-term public finances because of an ageing population. To assist the implementation of health care reform, he pledged to inject $50 billion from fiscal reserves to help meet this major challenge to future public finances.

On sustainability, Mr. Tsang said he would strive to achieve fiscal balance over the next five years. “I may introduce one-off measures which will increase government expenditure in the short term if there are needs in the community and our finances permit,” he said.

The Financial Secretary said a pragmatic approach would ensure that the resources were allocated where they were required most, and that every dollar would be well spent. He added that he would continue to uphold the well-established principles of prudent management of public finances by keeping expenditure within the limits of revenues, maintaining a low and simple tax regime, and by following the direction of “Market Leads, Government Facilitates”.

Mr. Tsang said the benefits of many of his proposals would not be immediately felt, but that they would have a positive impact on Hong Kong in the medium and long run.

Source: Extracted from “FS outlines his budgeting philosophy”, Government Press Releases, February 27, 2008
1. What are the major items of government spending?

<table>
<thead>
<tr>
<th>Rank</th>
<th>Policy Area</th>
<th>Percentage in total spending</th>
<th>Explain the actual use of these expenditures with two specific examples.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2nd</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3rd</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. Why are these three policy areas the major items of government spending? What are their significance to Hong Kong people and social development?
3. Government spending is mainly addressing the needs of certain social strata. What are these social strata? Explain.

4. With reference to source 2, source 3 and your knowledge, what are the factors that would affect government expenditure? Please explain.

Challenge

In the face of economic downturn, why do some countries still choose to increase government spending with budget deficits?
Public spending of the Hong Kong Government

- Classification of expenditure according to policy area (Distribution of public spending for 2008-09)

<table>
<thead>
<tr>
<th>Policy area</th>
<th>Major items</th>
<th>Percentage in total spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing</td>
<td>Public Housing</td>
<td>5%</td>
</tr>
<tr>
<td>Security</td>
<td>Border defense, rule of law &amp; public order, entry and exit procedures</td>
<td>8%</td>
</tr>
<tr>
<td>Support</td>
<td>Government administration</td>
<td>9%</td>
</tr>
<tr>
<td>Health</td>
<td>Medical management</td>
<td>11%</td>
</tr>
<tr>
<td>Social welfare</td>
<td>Social welfare services</td>
<td>12%</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>Transport, housing, land planning, waterworks</td>
<td>9%</td>
</tr>
<tr>
<td>Education</td>
<td>Education services</td>
<td>23%</td>
</tr>
<tr>
<td>Other spending</td>
<td></td>
<td>23%</td>
</tr>
</tbody>
</table>

- Factors affecting government spending

1) Requirements of the Basic Law: Articles 107 and 108 of the Basic Law states the Hong Kong Special Administrative Region shall follow the principle of keeping expenditure within the limits of revenues in drawing up its budget, strive to achieve a fiscal balance, avoid deficits, implement a low tax policy and practise an independent taxation system. These requirements provide established guidelines to government revenue and spending that the government has to follow.

2) Government revenue: The economic environment will affect government revenue. Government revenue increases in a better economic environment, and the government may put more resources into government spending. Therefore, the government may increase its spending when its revenue increases.

3) Policy Agenda: Policy agenda and directions of development for the following year will be formulated in the annual policy address prepared by the Chief Executive. Government spending will be allocated in accordance with the policy agenda proposed by the government in order to ensure that such allocation is in line with the general direction of development of the community. For example, according to the Policy Address 2011-2012, to ease the burden on the grassroots, the government will pay two months' rent for around 700 000 public housing tenants, with an expenditure of about $1.9 billion. The government has also pledged to increase public health
expenditure to enhance healthcare services and fund the cost of procuring electric buses for improving air quality. Accordingly, policy agenda is another important factor in affecting government spending.

Worksheet (3) The trend of public revenue and spending of the Hong Kong government

Figure: Total government revenue and spending between 1989-2010

Source: the Census and Statistics Department of Hong Kong

1. Compare the total revenue and spending of the Hong Kong Government over the past 20 years.

...
The use of financial revenue by the Hong Kong Government

The financial revenue of the government is used to foster the overall development of the society. First, the government develops infrastructure and enhances the quality of human resources through spending on infrastructure, education, transport and other areas. It facilitates the economic development of Hong Kong through spending on industries that Hong Kong enjoys advantages (e.g. the four traditional pillar industries which include financial services, tourism, trading and logistics, and professional services and the other priority industries which include education services, medical
services, testing and certification services, environmental industries, innovation and technology, and cultural and creative industries.

Second, the government invests resources in housing, healthcare, social welfare and other areas to address the basic needs of people and provide them with social security. The government enhances social cohesion by re-distributing income and supporting the disadvantaged through tax revenue and spending.

The relation between the government and citizens in respect of public finance

As a member of the society, citizens have certain rights and obligations in respect of public finance. Citizens have the rights to enjoy various social services, social welfare provided by the government and enjoying social rights of citizens. On the other hand, citizens who are financially capable have the obligation to pay taxes, contribute to the overall development of the society and assist those in need.

Worksheets (4) Comparison of tax rates

Source 1: Salaries tax rates in Hong Kong and other countries / regions in the world

Comparison of the Highest Salaries Tax Rate across different countries / regions

- Hong Kong, China: 17%
- Mainland China: 45%
- Japan: 50%
- Australia: 45%
- France: 40%
- Germany: 45%
- Britain: 50%
- U.S.A.: 46%
Hong Kong has a simple, low-rate tax system and its financial management system is also relatively simple and clear compared with other countries. For example, the profits tax rate for corporations in Hong Kong is 17.5%, while the rates in some developed countries (e.g. the US) can be as high as 30%-40%.

The characteristics of the taxation in Hong Kong are “low tax rate, limited types of taxes, clear and precise tax regulations, and it is fair for all individuals and corporations.” According to the Global Competition Report 2008-2009 published by World Economic Forum, Hong Kong ranked third in the world in terms of tax competitiveness. Hong Kong also ranked third in the world in terms of tax friendliness, according to Forbes Asia. Low tax rate and simple tax regime in Hong Kong are one of the key factors in attracting foreign companies to have their regional headquarters or offices established in Hong Kong.

Moreover, the principle of “those who are financially capable pay more” has revealed the principle of fairness in the tax regime of Hong Kong. For profits tax, a single tax rate has been implemented to prevent companies’ tax evasion by split-up. This practice is in line with the principle of fairness of “those who earn more pay more”. Currently, only some 70,000 of the 700,000 listed companies in Hong Kong have to pay taxes, and the tax paid by the 1,000 highest tax paying companies account for approximately 70% of the total profits tax.

I consider that the existing tax system is essential for maintaining the overall competitiveness of Hong Kong.
I have never left the UK in my life. Although I have to hand in almost half of my salary to the government when I was a working adult, I still think it is worthwhile. It is because the government fulfils our needs from cradle to grave, by providing us with services in housing, healthcare, education, social security, social services and other areas. I will explain that to you with some examples.

For welfare for children and women, if you work for at least 16 hours per week but still earn very little, and you are raising at least a child, then you are eligible for family allowance. A single parent who needs to raise one or more children is entitled to a single parent allowance for their living expenses.

In addition, the government will provide welfare for the disabled and the sick. For example, the government provides benefits to disabled workers who are out of work due to occupational injury or occupational diseases. Furthermore, an allowance is provided for those taking care of the disabled. The relatives taking care of the severely disabled will be entitled to an allowance if they are taking care of the disabled for at least 35 hours per week.

Answer the following questions with reference to the above information.

1. Compare the highest salaries tax rates in Hong Kong and other developed countries.

<table>
<thead>
<tr>
<th>Regions</th>
<th>Highest rate for salaries tax (%)</th>
<th>The gap between the tax rates in Hong Kong and different countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>46%</td>
<td></td>
</tr>
<tr>
<td>UK</td>
<td>50%</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>45%</td>
<td></td>
</tr>
<tr>
<td>France</td>
<td>40%</td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>45%</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>50%</td>
<td></td>
</tr>
<tr>
<td>Mainland China</td>
<td>45%</td>
<td></td>
</tr>
</tbody>
</table>
2. What are the characteristics of the taxation in Hong Kong, according to source 2?

3. How can Hong Kong benefit from low tax rates?

4. Some people think that although Hong Kong is a highly developed city, its welfare services and policies are still insufficient compared with those affluent countries. Therefore, some people suggest that the government should learn from the developed countries and raise the tax rate and impose new taxes to increase government revenue and provide more welfare benefits to the citizens. Do you agree? Please explain.
1. Why should the government be responsible for the re-distribution of income?
2. What are the principles guiding the government to re-distribute income?
3. Some people think that reallocation of income would have effects on the operation of market and cause lower economic efficiency. Do you agree? Why?

### Difference between Hong Kong and other developed countries in respect of tax rates and types of taxes

Hong Kong practises a simple, low-rate tax system. Its types of taxes are also relatively simple and clear compared with overseas countries. The major sources of financial revenue in Hong Kong are direct taxes such as profits tax, land fund, real estates and investments, and salaries tax. Other indirect taxes (e.g. tobacco tax and fuel tax) account for a smaller portion of the government revenue. The tax rate for salaries tax in Hong Kong ranged from 0% to 17%. Citizens have to pay tax according to their salaries. Meanwhile, the salaries tax rates in developed countries like Europe and America can be as high as 30% to 50%. In addition, there are many other taxes such as sales tax and capital gain tax. Such taxes expand the sources of these governments’ revenue so that the government can provide more social benefits for their citizens. These developed countries are also known as “welfare states” as the governments of these countries can provide more benefits to their citizens by a larger scale reallocation of income through larger financial revenue and spending.

### Article 108 of the Basic Law:

The Hong Kong Special Administrative Region shall practise an independent taxation system. The Hong Kong Special Administrative Region shall, taking the low tax policy previously pursued in Hong Kong as reference, enact laws on its own concerning types of taxes, tax rates, tax reductions, allowances and exemptions, and other matters of taxation.
A concept map of the public finance in Hong Kong

Differences between Hong Kong and other developed countries (e.g. low tax rates and simple tax system)

Paying taxes

Obligation

Factors affecting government spending (principles of financial management, internal and external environments)

Government revenue

Major items of government revenue and spending

Government spending

Reallocation of wealth

Driving economic development

Increase in job opportunities and income

Civic rights

Hong Kong citizens