

Budget Speech by the Financial Secretary (10)

Public Finance

Financial Position of the Current-term Government: Retrospect and Prospect

176. The current-term Government has all along been adhering to the principles of exercising fiscal prudence, keeping expenditure within the limits of revenue and committing resources as and when justified and needed in public finance management. We have also strived to enhance the transparency of public finance. Thanks to years of economic development and the hard work of our people, the fiscal reserves stood at about \$950 billion when this term of the Government took office, and subsequently reached a record high of \$1.17 trillion in 2018-19. The ample fiscal reserves have enabled the Government to allocate additional resources in a prompt and decisive manner to defuse crises over the past two years, including setting up the AEF with an injection of about \$200 billion in total and implementing counter-cyclical measures on a massive scale to relieve people's hardship and stabilise the economy. Though consolidated deficits were recorded from 2019-20 to 2020-21 as a result, the positive impact of the above initiatives, along with our solid foundation built on the principle of "One Country, Two Systems", have turned the consolidated deficit projected in the Original Estimates into a consolidated surplus projected in the Revised Estimates for this financial year. Our fiscal reserves are estimated to stand at about \$940 billion at the end of the current-term of the Government, and will gradually rebound to over \$1 trillion (equivalent to 16 months of government expenditure) during the five-year period in the Medium Range Forecast (MRF).

177. On enhancing the transparency of public finance, I have brought back the Housing Reserve to the fiscal reserves since 2019-20 and also announced last year that the investment return of the Future Fund would be progressively reflected in the Operating Account. These measures will allow one to have a full grasp of the Government's fiscal strength and help maintain our financial stability.

Striving to Maintain Healthy Public Finances

178. To address social aspirations and strive for service enhancement, the current-term Government has significantly increased the recurrent expenditure on social welfare, healthcare and education. Based on the Revised Estimates for the current financial year, the overall cumulative increase in the recurrent expenditure in these three areas will exceed 40 per cent, or close to \$85 billion in dollar terms. In view of the very substantial increase in the recurrent expenditure from \$361.8 billion in 2017-18 to over \$510 billion in the Original Estimates for this year, I emphasised last year that government expenditure should enter a consolidation period. I also announced an expenditure reduction programme, under which government departments were

required to cut recurrent expenditure by one per cent without affecting livelihood-related spending. Given the lasting effect of the recurrent expenditure reduction, we will not roll out any further expenditure reduction programme this year, otherwise the cumulative impact may disrupt departmental operations and in turn affect the delivery of public services. We will, however, continue to examine carefully any new initiatives that will incur recurrent expenditure and strictly control the growth of the civil service, so as to ensure that our long-term financial commitments are commensurate with the increase in our revenue.

179. The current-term Government actively promotes the Government Green Bond Programme. Given that green bonds are issued to finance certified green projects and our commitment not to use the proceeds for meeting operating expenditure, they are widely accepted by investors. The issuance of green bonds will not undermine our fiscal discipline, but can relieve the Government's fiscal pressure arising from the need to meet capital expenditure with existing resources, and hence further reinforce the confidence in our public finances.

Increasing Revenue

180. Hong Kong is an open economy with a relatively narrow tax base. Our revenue is susceptible to changes in the economic environment. To maintain healthy public finances, we follow the principle of keeping expenditure within the limits of revenue to ensure that the growth of expenditure is commensurate with economic growth. We also need to maintain the development and vibrancy of Hong Kong's economy and identify new areas of growth, with a view to increasing revenue.

181. Our simple and low tax regime, one of the cornerstones of our success in maintaining Hong Kong's competitiveness, is of utmost importance in bolstering our competitive edge. It is also closely related to our economy and people's livelihood. On the other hand, owing to the implementation of various policy objectives, enhancement of services and increase in investment in various areas of the community pursued by the current-term of Government, public expenditure will remain at a relatively higher level. Our anti-epidemic efforts and the relief measures implemented in the past two years have also incurred additional expenditure. Given that government revenue should be commensurate with its expenditure, we need to implement measures to increase revenue without affecting people's livelihood, so that we can broaden our revenue sources while maintaining our policy of low tax rate in Hong Kong.

182. In last year's Budget, I proposed to raise the rate of Stamp Duty on Stock Transfers as a measure to help increase government revenue in the short run. However, with the outbreak of the fifth wave of the epidemic, businesses and individuals are generally under considerable financial pressure. Having regard to the current economic situation, I believe that this is still not the appropriate time to revise the rates of profits tax and salaries tax, which are our major sources of revenue. We anticipate that a deficit will still be recorded in 2022-23. In the medium term, with the implementation in 2023 of the international tax reform proposals drawn up by

the Organisation for Economic Co-operation and Development (OECD), the introduction of a global minimum tax rate may help increase revenue from profits tax. I also propose to introduce a progressive rating system for domestic properties to reflect the “affordable users pay” principle. I will elaborate on these two measures in the latter part of the Budget.

183. Taking into account these new revenue streams, we expect that the Government will start to achieve fiscal balance beginning from 2023-24.

184. In the long run, there will still be challenges in alleviating the pressure on public expenditure in the face of an ageing population. The Government will continue to explore different ways to broaden revenue sources, and will initiate in-depth discussions in due course to forge a consensus on how to sustain healthy public finances to meet the development needs of our economy and society.

Rating System

185. Revenue from rates accounts for about three to four per cent of total government revenue. Last year, I announced in my Budget a review of the rating system. Upon review, I propose to revise the rating system as follows:

(a) granting rates concession in a more targeted manner: The Government will continue to consider on an annual basis whether to provide rates concession in the light of the prevailing circumstances, to allow flexibility for the measure. In addition, in view of public concern over the multiple rates concession received by owners with multiple domestic properties under the current rates concession mechanism, we propose that for future rates concession for domestic properties, only those eligible owners who are natural persons can apply for rates concession for one domestic property under their name. Taking the rates concession ceiling of 2022-23 as a reference, the new arrangement can save around \$3.1 billion for the Government when a one-off rates concession is implemented in the future; and

(b) introducing a progressive rating system for domestic properties: For domestic properties with rateable value of \$550,000 or below, it is proposed that rates be charged at the present level of five per cent of the rateable value. For domestic properties with rateable value over \$550,000, it is proposed that rates be charged at five per cent of the rateable value on the first \$550,000 and at eight per cent of the rateable value on the next \$250,000, and then at 12 per cent on rateable value exceeding \$800,000. This can better reflect the “affordable users pay” principle. It is expected that about 42 000 domestic properties will be affected, accounting for around two per cent of the total number of private domestic properties, with an increase of about \$760 million in government revenue each year.

186. The above revisions to the rating system will involve significant modifications of the IT system of the Rating and Valuation Department. The Government will implement the above revision proposals in phases. The proposal regarding rates concession for domestic properties will be rolled out in the first phase in 2023-24, whereas the proposed progressive rating

system for domestic properties will be introduced in the second phase in 2024-25. The Government will in due course consult the LegCo Panel on Financial Affairs on the outcome of the rating system review, the details and the implementation timetable of the proposals.

New International Tax Standards

187. Last year, Hong Kong, together with more than 130 jurisdictions across the globe, pledged to implement the international tax reform proposals drawn up by the OECD to address base erosion and profit shifting (abbreviated as BEPS 2.0). As the global minimum effective tax rate under BEPS 2.0 only targets large multinational enterprise (MNE) groups with global turnover of at least 750 million euros, it will not affect local SMEs. The Government has been exchanging views with the affected MNEs on matters relating to the implementation of BEPS 2.0, and reaffirmed that we would preserve the advantages of Hong Kong's tax regime in terms of its simplicity, certainty and transparency, maintain our territorial source principle of taxation as well as minimise the compliance burden on MNEs when implementing BEPS 2.0. The Government will maintain communication with relevant MNEs to enable them to familiarise with the new tax rules as soon as possible.

188. We plan to submit a legislative proposal to the LegCo in the second half of this year to implement the global minimum tax rate and other relevant requirements in accordance with the international consensus. At the same time, we will consider introducing a domestic minimum top-up tax with regard to the aforesaid MNEs starting from the year of assessment 2024-25 to ensure that their effective tax rates reach the global minimum effective tax rate of 15 per cent so as to safeguard Hong Kong's taxing rights. Based on our rough estimates, the domestic minimum top-up tax will involve an amount of about HK\$15 billion per year.

(To be continued.)