

March 11, 2004

## **2004/2005 BUDGET COMMENTARIES**

The Financial Secretary, Mr. Henry Tang, delivered his maiden budget proposal for 2004/2005 yesterday. The budget contains no surprises or drastic measures.

### **Budget Deficit**

For the year 2004/2005, the forecasted operating deficit is \$46.6 billion and the consolidated deficit (after Government bond issuance) is \$42.6 billion. The corresponding numbers for the year 2008/2009 are \$5.2 billion (deficit) and \$6.0 billion (surplus) respectively.

The budget contains no dramatic measures for the generation of revenue. Mr. Tang is relying on the economic growth to generate additional revenues in the coming years. There are also no details on the measures for the cutting of expenditures. Instead the Total Public Expenditure and the Total Government Expenditure will grow in real term in the 2004/2005 fiscal year by 2.1% and 3.1% respectively from the original estimate for 2003/04. Expenditure reduction will come in the years more towards 2008/2009. We believe the Government should elaborate on the measures they will implement to achieve this back-end loaded expenditure cut.

We believe the lack of more active measures is designed to give our community a respite which is in line with the policy address delivered by the Chief Executive. We are cautiously optimistic on the achievement of the forecasted numbers. We have been seeing signs of Hong Kong's economy recovering on the backing and continual support from the Central People's Government. However the budget balance may not be achieved if the economy fluctuates and do not bring in the additional revenues as budgeted. Therefore, it is extremely important for the Government to monitor the situation closely in the coming years and to introduce proper corrective measures once there are signs that the forecasted economic growth are not achievable.

### **Broadening the Tax Base**

In our budget submission to Mr. Tang, we have asked the Government to draft a preliminary plan for the introduction and implementation of a broad based tax. We welcome the Government's decision to conduct a comprehensive study of the implementation of a GST in Hong Kong. We believe that this is the right direction for the Government to broadening Hong Kong's tax base and adopting a more stable source of public revenue. We suggest the Government to view the GST as a revenue neutral measure in the medium term. Once the deficit situation has been under control, the extra tax revenue generated should be returned to taxpayers by way of reduction of existing direct taxes.

## **Issuance of Government Debt**

We endorse the decision taken by the Government to issue debt to fund infrastructure or other investment projects that will bring long term economic benefits to Hong Kong. In our previous budget submissions, we have suggested the Government to issue debts and we are delighted for the Government to have taken the action. We also agree that this action will have the added benefit of promoting the development of the bond market of Hong Kong. We would warn the Government not to rely on issuing debts to maintain or bolster its consolidated surplus amount.

## **“Green” Tax**

The “Polluter Pays” principle was introduced for the charging of fees relating to environmental issues. We agree with the measure in using the user pays principle. We further suggest the Government to perform a comprehensive study on how tax policies can be used to help manage environmental issues.

## **Other tax measures**

The study on ways of adjusting estate duty could have the effect of increasing capital flow into Hong Kong which will benefit our financial service industry as well as to improve Hong Kong’s position to become an asset management centre.

The extension of the salaries tax deduction for home loan interest for another two years is also a welcome measure. This provides a moderate relief to benefit several hundred thousand families. It is also a very flexible measure which the Government could decide in the next two years on whether to further extend based on the then economic conditions.

## **Design – related activities and other tax deductions**

We welcome the proposal of extending the tax deduction for research and development expenditure to include design related activities.

In our earlier budget submission, we proposed to allow a tax deduction for specific expenditures at 150% of the expenditures incurred. These expenditures could be training costs, research, development and design costs, film production costs, etc. We believe our proposal is more effective and simple to administer as compared to the direct granting of subsidies to specific industries. For every \$100 million of tax concession granted, the taxpayers will have to incur \$380 million in order to obtain the concession to the full extent. The tax leverage will therefore give rise to an expenditure outlay of 3.8 times the tax concession granted. It will also encourage business to re-invest so long as the deduction is still there.