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Far east tax policy lessons: good and bad stories from Hong Kong

Richard Cullen¹

Abstract

Some claim that Hong Kong is a remarkable tax policy museum while others say it is a centre of tax policy innovation – who is right? In fact, both views are credible. In both cases, these outcomes are the product of a near continuous economic dialectic - and happenstance - set within a particularly relevant culture. Textbook policy planning has provided after-the-fact rationales far more than it has generated future policy blueprints.

This article explains why the Hong Kong Revenue Regime (RR) has such a museum feel. And also how this ‘arrested development’ has produced an ‘innovative system’. The innovation is unorthodox but real enough. Compared to most other developed jurisdictions, it has involved, above all, applying an instinctive version of ‘Occam’s Razor’ to system review and development: reform has been kept to the bare minimum. Hong Kong thus retains an RR which is (formally) low tax, clearly simple (with low compliance costs) and it has generated revenues sufficient to build excellent infrastructure, to provide often first rate government services, to enable Hong Kong to stay virtually debt free and to amass huge Fiscal Reserves. All of these achievements pivot, fundamentally, on Hong Kong’s remarkable, long-term (and continuing) reliance on significant, land-based funding of public revenue. It also offers potentially important revenue policy lessons for application beyond Hong Kong – at least, where this may still be politically possible.

But how about the bad stories? First, the cost of doing anything in Hong Kong is notably inflated by the very high cost of land – ultimately provided by a de facto monopoly supplier: the Hong Kong Government. Further examples: the poverty gap is far wider than it should be; and planning to cope with the onset of major demographic changes is poor. This paper will clarify how the success of the RR, together with other important factors, continues to underpin unacceptable policy inflexibility.

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1. INTRODUCTION

One can reasonably claim that Hong Kong is a remarkable tax policy museum and also argue that has been a centre of revenue policy innovation.² In both cases, these outcomes are the product of a near continuous economic dialectic - and happenstance - set within a particularly relevant culture.³

The innovative aspects of revenue policy making in Hong Kong are essentially the result of decades of try-it, test-it and (mostly) retain-it experience set against a remarkable history of dynamic trading and much political turbulence, including outright war. Text book policy planning has provided after-the-fact rationales rather more than it has generated future policy blueprints.

The innovation, above all, has pivoted on successfully accessing non-usual sources of public revenue. This has allowed for the application, from the creation of British Hong Kong (in 1842) to the present day, of an instinctive version of ‘Occam’s Razor’ to system review and development: reform has been kept to the bare minimum.⁴ Hong Kong thus retains a Revenue Regime (RR) which is (formally) low tax, clearly simple (with low compliance costs) and it has generated revenues (within the special and relevant features of Hong Kong society) sufficient to build excellent infrastructure, to

² Hong Kong has consistently used British terminology to describe its public revenue system, thus the primary taxation statute is the Inland Revenue Ordinance (1947). One usually talks of the revenue regime and revenue policy (although the terms tax system and tax policy are also used). As we will see, the varied sources of public revenues which are not, in fact, taxes make this British terminology more apt, overall.

³ Hong Kong’s population is over 90% Chinese, which is predominantly post-war, migrant-based. Hong Kong consists of Hong Kong Island, the Kowloon Peninsula situated on the Mainland opposite Hong Kong Island, the New Territories comprising the area north of Kowloon up to the Shenzhen River and 235 islands. Hong Kong Island was ceded in perpetuity to Britain by China in 1842 at the end of the First Opium War (1839-1842) pursuant to the Treaty of Nanking (Nanjing). The Kowloon Peninsula was ceded in perpetuity in 1860 at the end of the Second Opium War (1856-1860) under the Convention of Peking (Beijing). The New Territories and the islands were leased for 99 years from 1 July 1898 under the Convention Respecting the Extension of Hong Kong Territory. The Hong Kong Special Administrative Region (HKSAR) was established in accordance with the Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People’s Republic of China (PRC) on the Question of Hong Kong (Joint Declaration) signed on 19 December 1984. The PRC said in the Joint Declaration that it had decided to resume the exercise of sovereignty over Hong Kong (the leased territories, together with Hong Kong Island and Kowloon) with effect from 1 July 1997. The UK declared that it would restore Hong Kong to the PRC with effect from 1 July 1997. The Joint Declaration entered into force on 27 May 1985 when the two governments exchanged instruments of ratification. It was registered as a treaty at the United Nations by the Chinese and British governments on 12 June 1985, which creates international rights and obligations for both parties. The Basic Law of the HKSAR of the PRC (Basic Law) was adopted by the National People’s Congress of the PRC on 4 April 1990 and came into force on 1 July 1997. The HKSAR Court of Final Appeal, the pinnacle of the judicial process (which is entirely separate, under the Basic Law) found, in 1999, that the Basic Law enjoyed constitutional status within the HKSAR (Ng Kar Ling & Others v. Director of Immigration [1991] 1 Hong Kong Law Reports & Digest, 315). For a detailed discussion on these historical, political developments within the context the evolution of the British Hong Kong RR, see, Cullen, Richard and Wong, Antonietta, ‘How History has Shaped the Hong Kong Revenue Regime’ in (Sharkey, Nolan (ed.)) *Taxation in ASEAN and China* (Routledge, Abingdon, 2012). See, also, Ghai, Yash, *Hong Kong’s New Constitutional Order* (2nd ed.) (Hong Kong University Press, Hong Kong, 1999).

⁴ The test associated with William of Occam (1285 – 1349 AD) is commonly rendered as: *Pluralitas non est ponenda sine neccesitate* or ‘plurality should not be posited without necessity’. See, further, Occam’s Razor, at: <http://www.skepdic.com/occam.html>.

provide often first rate government services, to enable Hong Kong to stay virtually debt free and to amass huge Fiscal Reserves.

The bad stories are striking, also. The very success of the RR, together with other important factors, have helped entrench what today, more than ever, is an unacceptable level of revenue policy inflexibility. The poverty gap is far wider than it should be; and (revenue policy) planning to cope with the onset of major demographic changes is poor. Moreover, the cost of doing anything in Hong Kong is notably inflated by the very high cost of land – ultimately provided by a de facto monopoly supplier: the Hong Kong Government.

The next Part of the paper reviews the origins of revenue policy making in British Hong Kong. Part 3 provides a brief operating profile of the current RR. Part 4 moves on to consider the key policy lessons which can be drawn from the Hong Kong experience. I argue that these lessons are both important for Hong Kong and also more widely. Part 5 is the Conclusion, where the potential wider relevance of certain positive lessons to be drawn from the Hong Kong Revenue Policy experience is explored, not least for the People's Republic of China (PRC).

2. 'BLACK CAT-WHITE CAT'. THE ORIGINS OF REVENUE POLICY IN HONG KONG

It is claimed that in 1962, the later Paramount Leader (1978 – 1992) of China, Deng Xiaoping first used the expression *Buguan bai mao, hei mao, lizhu laoshu jiu shi hao mao*, often translated as, *It doesn't matter if the cat is black or white, so long as it catches mice*. The expression was apparently borrowed by Deng from a farmer in Anhui Province. It was deployed to try and steer public policy in the People's Republic of China (PRC) back towards comprehensive, economic pragmatism.⁵ As we review the development of the RR in Hong Kong from 1842, it is fair to say that the British look to have relied on an early, occidental variant of this dictum.

A heavy dependence on land-related revenues (wherever possible) within the British Colonies was well established as a key public finance measure by the early 19th century. In essence, this approach sought to fund the running of many British Colonies by relying, primarily or significantly, on the disposal of (appropriated or discount-purchased) Crown land by Colonial Governments.⁶ It appears the policy was developed in London through the Colonial Office in response to the unhappy outcome arising from

⁵ Li, Kwok-sing (trans. Mary Li), *A Glossary of Political Terms in the People's Republic of China* (Chinese University Press, Hong Kong, 1995) 13. Available at Google Books: http://books.google.com.hk/books?id=J5QbQpQTegwC&pg=PA13&lpg=PA13&dq=black+cat+white+cat+china&source=bl&ots=qoDM11-vm4&sig=Iqsg5cq2fDTf_zUCkGipyr8waLo&hl=en&sa=X&ei=Rg9yUafICbG8iAeTooCYCw&ved=0CGMQ6AEwBw#v=onepage&q=black%20cat%20white%20cat%20china&f=false. (As with many such sayings, whether they were actually uttered by the claimed person (and when) gives rise to plentiful disputation).

⁶ See: Hooper, Keith C., *Substance but not Form: Capital Taxation and Public Finance in New Zealand* (1840 – 1859) at: www.findarticles.com/p/articles/mi_qa3933/is_200311/ai_/; and, Harris, R. Cole, *Making Native Space: Colonialism, Resistance and Reserves in British Columbia* (University of British Columbia Press, Vancouver, 2002) Chapter 1. See, also, Pierce, Steven, *Farmers and the State in Colonial Kano: Land Tenure and the Legal Imagination*. (Indiana University Press, Bloomington, 2005).

attempting to impose long-distance, London-devised costs and taxes in the British–American Colonies in the second half of the 18th century.⁷

From a London point of view, these long-distance imposts were originally seen to be necessary to help cover local colonial expenditure in America on, for example, maintaining local military garrisons and the provision of public infrastructure in the American Colonies. This approach, *inter alia*, culminated in the loss of those colonies and the establishment of the USA.⁸

Another feature of colonial financing within the British Empire was a general avoidance of direct taxes (on, for example, salary, wages, profits or rents). This was especially the case in the smaller British Crown Colonies (such as Hong Kong).⁹ It was felt that such taxes required an element of understanding as to why they were needed on the part of the individuals subject to said taxes and this understanding was usually widely lacking.¹⁰ This meant that there was a strong preference for collecting revenue from indirect taxes (for example, Customs Duties, Excise Duties) business licence fees, certain specific taxes (for example, Stamp Duties) – and from land sales and land usage charges.¹¹

Ideally, these post American Revolutionary War, British colonial revenue systems were meant to be: colony-confined (no extra-territorial taxation); self supporting (but not ‘Mother-Country’ supporting); and crafted to suit the local political-economy.¹² Where the ‘chief economic consideration’ of a colony was trade with foreign countries then, it was argued, all trade-related taxes (especially, Import Duties) should be kept very low or be non-existent. In some colonies (in Africa and the Pacific) poll taxes were used, also.¹³ As various British Colonies developed more sophisticated economies – including more taxpayers blessed with a capacity to ‘understand’ – a greater use of income-type (direct) taxes began to be imposed.¹⁴

By 1890, 55% of China's imports and 37% of Chinese exports passed through Hong Kong.¹⁵ Over the first 50 years, economic growth in British Hong Kong was, in sum,

⁷ The position of Secretary of State for the Colonies was first established in 1768 in response to restiveness in the American Colonies. By 1801, after the loss of those colonies a new position of Secretary of State for War and the Colonies was established. In 1854 a fully separate Colonial Office was established under the now Secretary of State for the Colonies. See, Secretary of State for the Colonies, at: http://en.wikipedia.org/wiki/Secretary_of_State_for_the_Colonies.

⁸ See, American History Series: Britain Says No to 'No Taxation Without Representation', at: <http://www.voanews.com/specialenglish/archive/2007-12/2007-12-05-voa2.cfm>.

⁹ Reinsch, Paul S. *Colonial Administration* (MacMillan, London, 1912), 92ff (Available at: <http://books.google.com/books?id=uZJKdzOZ0pAC&pg=PA98&lpg=PA81&dq=colonial+taxation&output=html&sig=80hpdTPdUtPuIQH1bClQdH57BQY>).

¹⁰ Ibid.

¹¹ Ibid.

¹² Ibid.

¹³ Eichelgrun, G., ‘Income-Tax in British Colonies’ (1948) 58 *The Economic Journal*, 128.

¹⁴ By 1922, an Inter-Departmental-Committee in London had devised a ‘Model Ordinance’ for imposing Income Tax. This Model Ordinance drew on older precedents developed within the Australian and New Zealand colonies together with more recent laws from Canada and Australia. Ibid.

¹⁵ Rating and Valuation Department of the Hong Kong Special Administrative Region, *A Chronology of Events*, at: http://www.rvd.gov.hk/en/publications/chron_events.htm.

notably impressive. As in the case of another key East Asian, British Empire City-State, Singapore, a foundation stone of this economic success was the trade in opium.¹⁶

Despite this huge growth in trade, especially in the opium trade, and Hong Kong's pivotal role, the Hong Kong government battled with only limited success for several decades to use opium-based transactions as a primary if not the primary source of public revenue for the new colony. This lack of success seemed odd given the comparative ease with which Singapore (and other colonial outposts in East Asia) had been able to deploy an officially-sanctioned opium monopoly regime to raise very significant public revenues.¹⁷

It is true that, as Hong Kong was declared a Free Port from the outset of its founding, there was no way to derive revenue from the import-export trading activities in opium (or other goods). But this restriction also applied to Singapore. Arguably the most credible explanation advanced for this interesting discrepancy is that the British administration in Singapore, at its founding as a British Colony, was able to work with certain established Chinese trading elites who could see the benefits of running the new 'opium farm' over the longer term.¹⁸ In Hong Kong, at the same point in its history, there were, it appears, no similarly (long-term) motivated elite groups with which to work.¹⁹

From its inception, British Hong Kong did not allow (virtually) any sale of freehold land.²⁰ All land was made available as leasehold land (with strict conditions attached to each particular leasehold-usage). And landholders wishing to vary the usage allowed on a particular lease had, on each such occasion, to pay a premium to the Hong Kong government to secure the variation.

Moreover, the practice grew of restricting the availability of land for development. This tended to drive up the price of land (towards the upper limits of what the market would accept) and also revenue receipts.²¹ When one factored in the consistent strong, opium-

¹⁶ See, for example: La Motte, Ellen N., *The Opium Monopoly* (MacMillan, New York, 1920) at: <http://www.druglibrary.org/schaffer/history/om/om15.htm>; and Feige, C. and Miron, J. A. 'The Opium Wars, Opium Legalization, and Opium Consumption in China' at: http://www.economics.harvard.edu/faculty/miron/files/opiumwars_ael.pdf.

¹⁷ A detailed review of the (eventual) development of direct, opium-related revenues as a prime source of public funding in British Hong Kong can be found in Cullen and Tso, *op. cit.* note 1.

¹⁸ Today the term used would be an 'opium franchise'. The term farm did not, of course, refer to some sort of horticultural farm. Rather the term indicated a 'farming out' of the right to retail opium.

¹⁹ Munn, Christopher, 'The Hong Kong Opium Revenue 1845-1885' in (Brook & Wakabayashi, (eds.)) *Opium Regimes: China, Britain and Japan, 1839-1952* (University of California Press, Berkeley, 2000).

²⁰ The Hong Kong Anglican Cathedral occupies freehold land. Landholders in the New Territories have also historically been allowed, by the government, to enjoy certain special rights to land based on ancestral rights which derive from membership of long established communities in the New Territories. See, Nissim, Roger, *Land Administration and Practice in Hong Kong* (2nd. Ed.) (Hong Kong University Press, Hong Kong, 2008).

²¹ In 1995/96, during the last years of British rule, the Hong Kong government still derived some 32% of total revenues from land-related transactions (including sales, lease modification premiums and Stamp Duties – but not including Profits Tax and Salaries Tax arising directly from the real estate sector) see, Loh, Christine, *The Government's High-Land-Price Policy: Can Hong Kong People Afford it?* at: <http://www.citizensparty.org/housing/landpric.html>. See, too, Bell, D.A., *Hong Kong's Transition to Capitalism* at: http://www.findarticles.com/p/articles/mi_qa3745/is_199801/ai_n8787332. When one adds in the Profits Tax paid by developers and all the others involved in construction, transaction based Stamp Duties and Salaries Tax paid by those working in the sector, the HKSAR government has continued to rely on land transaction related revenues for around 50% of its income, see, Halkyard,

based, growth in the economy over the first 50 years, the Hong Kong government found that its land-based revenue regime more than compensated for the shortfall in expected funding from the opium-based revenue stream. Indeed, the colony's fiscal foundations proved to be so sturdy that, within around 40 years of its founding, the Hong Kong government had already amassed more than one year of total, normal, public expenditure in Fiscal Reserves.²²

This land-related revenue regime was further strengthened as the total area comprising the Crown Colony increased significantly, initially in 1860 and then in 1898. The expansion of Hong Kong increased the Hong Kong government's 'land-bank' greatly.²³

In 1945, following the political, personal and economic devastation of Japanese occupation during the war, Hong Kong's per capita Gross Domestic Product (GDP) was, by some estimates, lower than that of India and Kenya.²⁴ By 1992, Hong Kong's per capita GDP had overtaken that of the UK. By 2004, Hong Kong was ranked at 23 in a global, 'highest GDP per head' table, ahead of Canada and Australia.²⁵ The HKSAR now ranks 5th according to recent World Bank and IMF GDP per capita tables.²⁶

Wealth distribution in Hong Kong remains very uneven; significant poverty persists. But there is no denying that the British City-State materially transformed itself over the

Andrew, 'The Hong Kong Tax Paradox' (1998) *Revenue Law Journal*, 1. This heavy reliance on land transaction revenues in Hong Kong bears some resemblance to the theories propagated by Henry George, the 19th century American economist and social reformer who long advocated the introduction of a single tax on the unimproved value of all land to replace all other taxes. See: Smith, J. P., *Taxing Popularity: The Story of Taxation in Australia* (Federalism Research Centre, Canberra, 1993), 18-24; and *Dictionary of American Biography*, 1st. ed., 'George, Henry,' (Johnson and Malone (eds.)), Vol. VII (Charles Scribner's Sons, New York, 1931), 211-212. A Henry George follower (also a Quaker) Lizzie Magie, created the precursor to the board game Monopoly in 1904 to demonstrate his theories (see: <http://www.answers.com/topic/henry-george>).

²² In 1884, Hong Kong was one of the few colonies within the British Empire carrying zero debt. In fact Hong Kong ran a current account surplus for most of the years from 1873 to 1882 with that surplus in some years reaching close to 20% of total expenditure thus allowing the accumulation of very significant reserves. See, *The Colonial Office List for 1884*, (Harrison, London, 1862-1925), 18, 92. This savings habit has persisted; around mid-2013 Hong Kong's public foreign reserves exceeded US\$300 billion (see: <http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2013/20130328e2a1.pdf>.) of which approximately US\$85 billion are Government Fiscal Reserves (close to 2 years of total current Hong Kong government expenditure.) see: http://www.gov.hk/en/about/abouthk/factsheets/docs/public_finance.pdf. The Hong Kong government has also historically been able to control expenditure quite effectively. Services were limited in keeping with 19th century practice but even more so given the remarkable self-reliance (repeated examples of dire poverty notwithstanding) of the majority Chinese population. This was the case from when the British established their Hong Kong colony and it remains the case to a very large extent, today (see, Goodstadt, Leo F., *Uneasy Partners: The Conflict Between Public Interest and Private Profit in Hong Kong* (Hong Kong University Press, Hong Kong, 2005).

²³ See note 3.

²⁴ Bartholomew, J., *The Welfare State Made Britain Poor*— extract from book at: <http://www.moneyweek.com/article/593/the-welfare-state-made-britain-poor.html>.

²⁵ *Pocket World in Figures 2005* (Profile Books / The Economist, London, 2004) 28.

²⁶ See: <http://databank.worldbank.org/ddp/home.do?Step=12&id=4&CNO=2>; and <http://www.imf.org/external/pubs/ft/weo/2013/01/weodata/index.aspx>. (GDP estimates are derived from Purchasing Power Parity (PPP) calculations.)

decades following 1945, from a war ravaged colony of less than 800 000²⁷ to a leading international service centre with a population of over 7.5 million.

Post-war governments in Hong Kong were, in fact, quietly but actively hostile to the idea of seeking low-cost development finance from the World Bank when Hong Kong was being re-built right through into the 1960s. Almost certainly, Hong Kong would have qualified to borrow from this then new international financial institution (which had been established in 1947). Successive Hong Kong governments implied they would accept such loans if they were offered on 'reasonable terms' – whilst, in reality, avoiding entering into any such borrowing for fear of the way the World Bank might begin to demand changes in the Hong Kong government's preferred economic model. In particular, the government worried that the World Bank would strongly advocate the adoption of a more modern tax system and insist on the collection of proper economic statistics.²⁸

The opium-reliant revenue policies set down during the first 50 years of the colony proved to be remarkably strong. The indirectly strengthened land-based revenue system has proved to be so successful that it remains a mainstay of the Hong Kong fiscal regime to this day. On these foundations has been built an extraordinarily successful, low tax, trading economy which long ago gave up being opium-reliant.²⁹ These foundations were also fundamental in allowing the colony to thrive without need to resort to any sort of direct income taxation for around 100 years – and when such taxes came they were kept low and simple – see below. The very high levels of economic activity have been an important factor in maintaining sufficient revenues using a minimalist taxing approach. That minimalist taxing approach has, in turn, amplified the attractiveness of Hong Kong as a trading centre. A more business (or taxpayer) friendly tax regime operating within a normal (non-palm-tree) integrated trading economy would be difficult to find.

Those early experiences also demonstrated to Hong Kong that, even when financial public policies do not proceed according to plan, other alternatives which can help put things right may well emerge – *provided* your economy maintains strong growth. Above all, this growth - and Hong Kong's success - are attributable to the cross-generational, consistent energy, hard work, intelligence and remarkable self-reliance of the local population.³⁰

²⁷ See: <http://www.demographia.com/db-hkhist.htm>.

²⁸ Goodstadt, Leo F., *Profits Politics and Panics: Hong Kong's Banks and the Making of a Miracle Economy, 1935 – 1985* (Hong University Press, Hong Kong, 2007) 98-100.

²⁹ Against remarkable odds and as a product of an agreement between the UK and Qing Dynasty China, the officially sanctioned trade in opium between Hong Kong and Mainland China was increasingly and greatly reduced between 1907 and 1917. See, La Motte, Ellen N., *The Opium Monopoly* (MacMillan, New York, 1920) Chapter 15 (History of the Opium Trade in China) at: <http://www.druglibrary.org/schaffer/history/om/om15.htm>. The retailing and consumption of opium were finally made illegal in Hong Kong shortly after World War 2 (at US insistence) once the British resumed control of Hong Kong from the Japanese.

³⁰ Goodstadt puts it this way: 'There was never any need for the rulers to keep the people of Hong Kong at a distance or to exclude them from participation from government....It would have been hard to find anywhere a society more socially responsible and tolerant, more politically mature and self-reliant, or a people easier to serve and rule. They were ideal constituents, the secure foundations on which Hong Kong's success had been built despite the economic turbulence and political uncertainty...' see, Goodstadt, Leo F., *Uneasy Partners; The Conflict Between Public Interest and Private Profit in Hong*

3. PROFILE OF THE CURRENT REVENUE REGIME³¹

3.1 A Turning Point

The first moves to introduce an income tax in Hong Kong came in December 1938 when Governor Northcote established the Taxation Committee to look at the possible adoption of income taxation in the jurisdiction. The committee recommended that an Income Tax be introduced.³² The Chinese business community was 'vehemently opposed in principal to any form of tax on income. In particular, they were opposed to any tax at all on business profits.' Their stance quickly attracted the support of the expatriate business community.³³

The committee proposed only a 'partial income tax' and while the colonial authorities 'regarded the committee's proposal as barely adequate, even as a temporary wartime measure,' they nonetheless adopted the proposal.³⁴ The War Revenue Ordinance passed by the Hong Kong Legislative Council (LegCo) in 1940 created a system of schedules, establishing three separate taxes on different categories of income - a Property Tax with a flat rate, a Salaries Tax with progressive rates and a Profits Tax with a flat rate for corporations and progressive rates for unincorporated firms. The Ordinance exempted all offshore income from taxation.³⁵

In drafting the Ordinance, the War Revenue Committee copied, it is said, the schedular British Income Tax system introduced by Prime Minister Addington in 1803, despite the fact that the British system itself had been reformed in 1910 to base tax liability on a taxpayer's total income. In Littlewood's view, the committee chose to copy a system which Britain, 'had effectively discarded thirty years earlier' because the representatives of business believed the separated schedular structure would reduce the possibility of future increases in tax rates.³⁶

Kong (Hong Kong University Press, Hong Kong, 2005), 228. There is claim, possibly apocryphal, that Friedrich Hayek once observed that 'socialism is an excellent system – for up to 12 people'. The socio-economic operation of the typical Chinese family in Hong Kong lends a certain credence to this claim.

³¹ The matters covered in this part are dealt with in more detail in Cullen and Wong, op. cit. note 3.

³² Littlewood, Michael, 'Taxation Without Representation: The History of Hong Kong's Troublingly Successful Tax System' (2002) British Tax Review 212. See, also: Littlewood, Michael, 'Tax Reform in Hong Kong in the 1970s: Sincere Failure or Successful Charade?' in Tiley, John (ed.), *Studies in the History of Tax Law* (Hart, Oxford, 2004); and Littlewood, Michael, *Taxation Without Representation: The History of Hong Kong's Troublingly Successful Tax System* (Hong Kong University Press, Hong Kong, 2010).

³³ Littlewood, 2002, *ibid*.

³⁴ *Ibid*.

³⁵ *Ibid*. This approach was consistent with the 19th century tax policy – favouring sourced-based taxation in the colonies – adopted by the British as their Empire developed. See, Barker, William B., 'Expanding the Study of Comparative Tax Law to Promote Democratic Policy: The Example of the Move to Capital Gains Taxation in Post-Apartheid South Africa' (2005) 109 *Pennsylvania State Law Review*, 101.

³⁶ Littlewood, 2002, *ibid*. The perception amongst the business elites that the reliance on separate schedules would help forestall future tax increases may not have been well founded, however. Significant discrepancies in tax rates applicable to personal exertion, corporate and income from property have characterized Australia's uniform tax system for over 70 years now, for example. This level of discrepancy has produced strains and continues to attract criticism: 'A large gap between the top personal income tax rate and the company tax rate creates an incentive to redefine personal income as company income' (Shorten, Bill, *An Alternative Vision for Australia – Building our Nation*, at: http://www.fabian.org.au/library/event_papers_2005/1118116108_23303.html). Despite this long history of significant tax rate divergence, the Australian tax system has remained politically workable

The War Revenue Ordinance (1941) replaced its predecessor and introduced small changes, including the introduction of an additional Interest Tax and an increase in the maximum rate of taxation.³⁷ The new Ordinance, however, was short-lived. In December 1941, six months after its adoption, Hong Kong was occupied by the Japanese.

The new, post-war, 1947 tax legislation passed by LegCo, the Inland Revenue Ordinance (IRO), retained the basic schedular structure and the restricted territorial ambit of the War Revenue Ordinance of 1941. There were separate schedules for salaries, profits and interest originating in Hong Kong (with low tax rates). Since 1947, the IRO has been formally re-examined on three occasions, in 1954, 1968, and 1976, by Review Committees. No major alterations have been made to the IRO, however.

The 1976 review committee made the most significant recommendation for reform when it suggested that Income Tax should be assessed on total income, eliminating the separated schedular system of assessment. In 1978, the Government was still considering this recommendation but, by the following year, the authorities had decided not to pursue such a reform. The Government's decision was again, it would seem, influenced by the business community's 'firm and vociferous opposition to tax reform.'³⁸

3.2 The Current System

As noted above, the British established Hong Kong as a Free Port which meant that goods could enter and leave free of any customs or similar duties. This continues to be the case today. Indeed, Hong Kong has long prided itself on its low rate and simple RR.³⁹ Direct taxes applied to business profits and earned income still remain amongst the lowest in the developed world.⁴⁰

The RR in the HKSAR today encompasses the following key features:⁴¹

- A narrow taxation base;
- Low taxation rates;
- Separate schedules applying separately identified taxes to different classes of income – no general income tax;
- No taxation of income derived from outside of Hong Kong regardless of the residence status of the taxpayer (source-based taxation);
- Simple and relatively stable taxation laws;
- Retention of Stamp Duties in the system;

over many decades, however. See also, Sorensen, Peter, Birch, The Nordic Dual Income Tax – In or Out? at: <http://www.econ.ku.dk/pbs/diversefiler/oecdual.pdf>.

³⁷ Littlewood, 2002, *ibid*.

³⁸ Littlewood-2004, *op. cit.* note 32.

³⁹ Reynolds, Alan, Hong Kong's Excellent Taxes, at: http://www.cato.org/pub_display.php?pub_id=3793.

⁴⁰ See table at: <http://www.forbes.com/global/2005/0523/024chart.html>. See also, table at: <http://invest.vic.gov.au/About+Melbourne/Doing+Business+in+Melbourne/Taxation.htm>.

⁴¹ This outline of the current Hong Kong revenue system summarises and updates a more comprehensive review of the taxes applying in the HKSAR, which can be found in Cullen, Richard, 'Revenue Law in Hong Kong: The Future' in (Wacks (ed.)) *The New Legal Order in Hong Kong* (Hong Kong University Press, Hong Kong, 1999) Chapter 12.

- Until recently almost no use of Double Taxation Treaties (DTTs);⁴²
- Comparatively constrained government spending;
- Very little government borrowing;
- Infrequent deficit budgeting; and
- Massive accumulated Fiscal Reserves.

The main taxes imposed (using separate schedules) by the IRO are:

- Profits Tax;
- Salaries Tax; and
- Property Tax.

Profits Tax, the most important tax in terms of revenue raised, is imposed by Part IV of the IRO. The crucial practical and legal issue is source: only profits which can be shown to have (or which, in a few limited cases, are deemed to have) a source in Hong Kong are subject to profits tax. The adherence to this source rule has been driven, to a large extent, by the desire of businesses, at all levels, to use Hong Kong as a base from which to operate without incurring tax on any offshore operations.⁴³ The operation of the source principle in Hong Kong has been the subject of much litigation. Overall, its application has, historically, worked fairly well, however.⁴⁴ Hong Kong remains, in practice, the last remaining first-world jurisdiction to rely so heavily on a rule which excludes from the tax-net all profits which can be shown to have arisen outside of the jurisdiction.⁴⁵

Salaries Tax, which is imposed by Part III of the IRO, is also an important funding source. Salaries Tax applies at progressive rates but it is subject to fixed percentage 'maximum' or 'standard' rate on total taxable income.⁴⁶ The Salaries Tax system is also source-based but the specified source rules in Part III (backed by case law and

⁴² Hong Kong's approach to DTTs has been changing since 1997, however. As a result of external pressures and international campaigns against Tax Havens, the HKSAR has now signed up to over 20 DTTs. See further, Liu, Irene Jay, 'HK Seeking Tax Treaties to Silence Tax Haven Claims', South China Morning Post, March 31, 2012.

⁴³ The motivation for retaining a source-based taxation system dates back to Hong Kong's original status as a Free Port. This status meant that Hong Kong was a place where trading business could be done, in the 19th century, without need to be concerned about taxation, either through Customs Duties or Income Tax. As the need for some sort of Income Tax was grudgingly conceded just prior to and after World War 2 (see discussion above) the impact of the new Tax Regime was restricted from the outset by the incorporation of a source rule restricting the application of Profits Tax to profits arising within Hong Kong. This sourced-based taxation regime has remained highly attractive to business as Hong Kong has, since the 19th century, made the transition from trading port, to manufacturing centre to, nowadays, a sophisticated, mostly service-based economy. See, further, Cullen and Wong, *op. cit.* note 3.

⁴⁴ Halkyard, Andrew, 'The Hong Kong Tax Paradox' (1998) 8 *Revenue Law Journal* 1, 20. This article contains a useful summary of the key cases on source.

⁴⁵ Cullen and Wong, *op. cit.* note 3. See, also, Major Sources of [HKSAR] Government Revenue (June 2011) at http://www.legco.gov.hk/yr10-11/english/sec/library/1011fs05_20110621-e.pdf (Profits Tax generated 29.6% of Government Revenue in 2009-2010).

⁴⁶ The term 'flat tax' is often used as a (rather inaccurate) short-hand term in place of the more correct 'maximum' or 'standard' tax rate. See also, Major Sources of [HKSAR] Government Revenue (June 2011) at http://www.legco.gov.hk/yr10-11/english/sec/library/1011fs05_20110621-e.pdf (Salaries Tax generated 16.3% of Government Revenue in 2009-2010).

Departmental Interpretation and Practice Notes) have meant that source is less of an issue than with Profits Tax.⁴⁷

The final schedular tax imposed by the IRO is Property Tax, which applies at a flat rate on rent received, less a statutory allowance of 20% for repairs and maintenance. Corporations owning property are exempt from property tax – they pay Profits Tax on rents received instead.

Betting Duty (on horserace, lottery and football betting) imposed by the Betting Duty Ordinance (1950), normally raise less than 10% of total revenue. Estate and Gift Duties used to be imposed by the Estate Duties Ordinance (1950) but these duties ceased to operate in 2006.⁴⁸ The yield from these duties had been quite low for some time.⁴⁹ Other comparatively minor sources of revenue include: property rates, various fees and duties (such as Excise Duties on tobacco, alcohol and petroleum products) utility charges and vehicle-related imposts. More significant, non-taxation sources of revenue include: investment and interest income (on Fiscal Reserves and direct land-transaction revenues (already noted in Part 2 and discussed, further, below).

Despite this low tax regime, Hong Kong has still managed to provide public housing on a massive scale, to finance excellent transport and communications systems and comparatively sound education and health systems.⁵⁰ At the same time, it has managed to amass public foreign currency reserves of over \$US300 billion.⁵¹

⁴⁷ Cullen and Wong, *op. cit.* note 3. See too, DIPN 10 The Charge to Salaries Tax at: http://www.ird.gov.hk/eng/pdf/e_dipn10.pdf.

⁴⁸ See, Revenue (Abolition of Estate Duty) Ordinance 2005, at: <http://www.ird.gov.hk/eng/tax/edu.htm> See, also, Hong Kong – Abolition of Estate Duty, at: <http://www.bakernet.com/NR/rdonlyres/3834909F-DAF6-403E-B6E9-ED3DC84F088A/38385/HKAbolitionofEstateDuty.pdf>. The argument is that, by becoming one of the first jurisdictions in East Asia to remove Death/Estate/Gift Duties, Hong Kong will: help small Hong Kong businesses with cash flow problems; encourage increased location of assets in Hong Kong; and strengthen the HKSAR's position as a location for regional fund managers (see, Abolition of estate duty helps promote HK's asset management business, at: <http://www.fstb.gov.hk/eng/sfst/fstb19.html>.)

⁴⁹ The Hong Kong Institute of Certified Public Accountants estimated that the EDO typically generated less than 1% of total government revenues (see, Estate Duty Review Consultation Document, at: http://www.hkicpa.org.hk/professionaltechnical/taxation/submissions/submission_201004.pdf.)

⁵⁰ Cullen and Wong, *op. cit.* note 3.

⁵¹ See note 22. These Fiscal Reserves are known, officially, as the Exchange Fund. The Exchange Fund, today, essentially comprises: (A) the Fiscal Reserves (money saved from revenues raised but not spent over previous decades) of the Government's General Revenue Account (roughly 40% of the Exchange Fund); and (B) the balance of government foreign currency reserves which back the Hong Kong Dollar (HKD) (roughly 60% of the Exchange Fund). (Until 1998, a separate Land Fund was also retained by the Hong Kong Government. In that year, the assets of the Land Fund were merged with the Exchange Fund – although the uses to which the Land Fund could be put remained restricted (primarily to capital expenditure). See, Merger of Land Fund Assets into Exchange Fund, at: <http://www.info.gov.hk/hkma/eng/press/1998/981117e.htm>.) The Exchange Fund is managed by the Hong Kong Monetary Authority (HKMA). The HKMA also manage the quasi-currency board pegging of the HKD to the US Dollar (USD). That part of the Exchange Fund backing the HKD covers about 240% of all HKD notes and coins in circulation plus certain other securities. It only covers about 30% of all HKD deposits, however. A Currency Board fixes the exchange rate of Currency A (the HKD in this case) to an 'anchor', much stronger Currency B (the USD in this case) at a fixed rate and promises to convert cash and equivalent holdings of Currency A to Currency B at any time at the fixed rate (see, <http://users.erols.com/kurrency/intro.htm>). It is argued that Hong Kong does not have a real Currency Board system because, amongst other things: (a) the HKMA manages the HKD other than in accord with strict Currency Board principles; and (b) the HKMA (unlike a true Currency Board) also operates like a

3.3 The Fiscal Firewall

The crucial role of the Basic Law (see note 3) is to provide for a high degree of separation of the HKSAR from the Mainland (Two Systems) within the PRC (One Country). Particular effort has been put into drafting provisions in the Basic Law which are designed to install a constitutional, ‘fiscal firewall’ between the two Tax Systems.

Article 106 of the Basic Law provides that Hong Kong is to have its own independent finances and prohibits the PRC from raising taxes in Hong Kong or sharing the HKSAR’s tax revenue. Article 108 further provides that:

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.

The Preamble of the Basic Law also stresses the need to preserve the prosperity and stability of Hong Kong.

Some 16 years after the handover, the policy of separating the two Tax Systems has been followed practically to the letter. Both economies (and the participants in those economies) operate within the context of two entirely separate Tax Systems. This is recognized, too, in the Double Tax Arrangement in place which applies to the two Tax Systems. This separation is well recognized outside of the PRC and the HKSAR, for example, by the Australian Taxation Office.⁵²

4. TAX POLICY LESSONS GOOD AND BAD

4.1 Introduction

I believe there are two primary (interlocked) positive lessons to be drawn from the Hong Kong Revenue Policy experience. The paramount, evolved-innovative, policy idea is the continuing use of land, to this day, as a fundamental public revenue source.

Central Bank, in certain respects – by regulating the banking and financial systems. See, further: *An Introduction to the Hong Kong Monetary Authority*, at: http://www.info.gov.hk/hkma/ar2004/english/summary/summary_eng.htm; Lo, Chi, *The Demise of the Hong Kong Dollar*, at: <http://www.chinabusinessreview.com/public/0303/commentary.html>; and Greenwood, John, *Hong Kong’s Link to the US Dollar* (Hong Kong University Press, Hong Kong, 2008). The unprecedented heavy reliance by the HKSAR Government over several consecutive years following the Asian Financial Crisis, which commenced in mid-1997, was paid for out of the Government’s Fiscal Reserves in the Exchange Fund. No borrowing was needed to fund deficits which exceeded 20% of Government expenditure in some years. This deficit financing ran for 5-6 years. Within a further 5 years, the Fiscal Reserves were fully replenished and stronger than ever (see, too, note 22). Unlike in the case of accessing additional revenues through extra taxation, where the approval of LegCo is mandatory, the HKSAR Government can access the Fiscal Reserves without being compelled to seek approval from the Legislative Council (LegCo).

⁵² See, Australian Tax Office, Taxation Ruling TR97/19, Income Tax: Tax Implications of Resumption of Chinese Sovereignty over Hong Kong.

By conventional modern measures, Hong Kong is frequently said to have a narrow tax base.⁵³ We can see from the outline in Section 3.2 why this claim is made and why it is cogent. If, however, we consider the full *revenue base* of the HKSAR, the picture changes markedly. When land-related revenues are factored in to the public revenue calculation, it turns out that Hong Kong has, in one important way, a far more broad revenue base than probably any other (non-oil-based) developed jurisdiction. Thus, in the Forward Estimates for 2013-2014, land revenue is estimated to be 16% of total Government revenues⁵⁴ Such revenues have exceeded 20% of total revenues in the relatively recent past.⁵⁵ This is essentially just the sum for land sales and lease modification premiums. It does not include Stamp Duties and the IRO taxes arising from income directly related to the real estate sector.

A positive concomitant of the (conventionally) narrow tax base is the clear, relative low rate, operational simplicity of the Hong Kong RR. This is the second key positive lesson which Hong Kong offers: it is possible to maintain, in the modern era, a low rate, highly effective revenue regime which is minimalist, clear and easy to comply with – where you have been able to retain a significant, land-based, revenue source. The ‘system simplifying role’ of these land-related public revenues commenced in 1842. They continue to underpin Hong Kong’s low rate, simple, low compliance cost RR over 170 years later.

The success of this evolved-innovation also underpins the primary, bad aspects of the HKSAR RR, however. Again, two stand out. Broadly stated, these are notable revenue policy inflexibility and the high on-cost effects of the land-based, revenue system.

4.2 Land-Related Revenues

We need, at this point, to revisit the land-based revenue system to understand its scope and operation in greater depth. As we saw above, from its inception, British Hong Kong did not allow (virtually) any sale of freehold land. All land was made available as leasehold land. Moreover, the practice grew of restricting the availability of land for development. This tended to drive up the price of land (towards the upper limits of what the market would accept) and revenue receipts.

The entire land management system has become self-reinforcing and, arguably, financially addictive (for the Government).⁵⁶ Government land policy has fostered one of the highest population densities of any major city in the world. Hong Kong has more skyscrapers, at over 7 400, than any other city on the planet, including New York.⁵⁷ The majority of these are residential. This density has allowed the provision of first rate transport and communications systems with greater speed and lower cost than would otherwise have been the case. It has also, originally incidentally and now as a matter of

⁵³ See, for example, IMF, Hong Kong SAR: Preliminary Conclusions of the 2004 Article IV Consultation Mission, at: <http://www.imf.org/external/np/ms/2004/110204.htm>.

⁵⁴ For 2013-2014, total Government revenue is estimated to be US\$56 billion with land revenue making up almost US\$9 billion of that sum.

⁵⁵ See, Loh, op. cit. note 21.

⁵⁶ Brown, Stephen, Fung, Edward K. W., Loh, Christine, Uebergang, Kylie and Xu, Stephen, The Budget and Public Finance in Hong Kong,, 34-35, at: <http://www.civic-exchange.org/publications/2003/BudgetReport.pdf>.

⁵⁷ ‘Tall Buildings’, The Economist, April 9, 2005, 90.

policy, left the greater part of Hong Kong's total area either subject to low density use or zoned as public (mostly park) areas.⁵⁸

Government policy has, predictably, had a significant upward impact on the price of land. The Government, historically, could always, it seemed, rely on accessing additional revenue by leasing land long-term (as the sole supplier) into a market with ever rising prices. The Government also takes a large fiscal bite from many secondary market transactions. Strict usage conditions are stipulated in each government lease. If a developer purchases an old building wishing to rebuild at say five times the height of the building to be replaced, the developer needs to obtain a variation to the purchased lease. To get this, the developer has to pay a substantial 'lease modification premium' to the Government.

A good way to get a feel for just how financially significant this system is, in operation, is to look at an example. In 1995, the Hong Kong Government put a parcel of land (Lot 129) of around 180 000 square feet up for sale on Ap Lei Chau, which is an island located to the south of Hong Kong island. Ap Lei Chau is connected by a causeway bridge to neighbouring Aberdeen on Hong Kong island. The whole area is densely populated. As is the case across much of Hong Kong, this high density urban areas is surrounded by wooded mountains and hills and the sea.

Lot 129 is located along the Ap Lei Chau waterfront, across a road from numerous smaller scale shipyards which service the local fishing fleet and the many pleasure junks and luxury yachts moored in the large Aberdeen Typhoon Shelter. The Government sold the Lot 129 lease – for industrial use – for just under US\$30 million in 1995 to a secondary commercial-industrial developer. By 2005, two primary residential property developers had acquired a significant interest in Lot 129 (by now valued at about US\$74 million). The two property developers needed to have the lease modified to allow a major, high-end residential development in several modern high-rise tower blocks. The lease modification premium – paid to the Government - to convert the lease from the original-sale industrial use to the high-end residential use was approximately US\$504 million. The Hong Kong Government thus derived around US\$534 million within around 10 years, from the two Lot 129 transactions.⁵⁹

There are, of course, market limitations on just how high land prices may be pushed by a government – even within a comparatively closed system such as that which has operated in Hong Kong. That is, the Government cannot simply set any price for land it chooses. If a price is too high, then buyers in the market simply will not respond. Thus the Hong Kong Government has had experience with trying to sell commercial land where there were simply no takers.⁶⁰ More recently, following the onset of the

⁵⁸ This does not mean that the Government has especially good 'green' credentials. On the contrary, successive Hong Kong Governments have displayed almost a mania for land reclamation from Victoria Harbour and beyond and for massive road and bridge building projects, for example. See, further, Loh, Christine, *Alternative Policy Address 2005-2006*, at, <http://www.civic-exchange.org/publications/2004/apa05e.pdf>. The fact that Hong Kong has taken a very high density approach to building (thus maximising government land-related revenues) has, by accident more than design, left much of its land area comparatively under-developed or undeveloped.

⁵⁹ For a detailed, well documented record of this transaction, see Webb, David, Larvotto – Do You Know the Boatyard? March 3, 2010, at: <http://webb-site.com/articles/larvotto.asp>.

⁶⁰ The Hong Kong Government experienced serious difficulties in selling (leasing) land for commercial / industrial use in East Kowloon in the past, for example (discussion with Leo Goodstadt, September 30, 2005).

Asian Financial Crisis in mid-1997 the Government found it difficult to sell plots for residential development. Moreover, between mid-1997 and 2003, residential property values dropped by around 70%. Today those values are back at, or higher than the 1997 levels. Subject to these fundamental constraints, successive Hong Kong Governments have played a significant role in creating conditions which have typically put upward pressure on land values.⁶¹

In theory, one might aim to replicate this Hong Kong model of accessing land-related revenues by: (a) introducing a very high rate, annual land tax system, combined with; (b) greatly increased charges for zoning changes and planning/building permits. In some jurisdictions with Bills of Rights, for example the USA, constitutional protection of (real and other) property rights presents immediate and complex challenges for any such plan.⁶² Even where such constraints do not apply, such a scheme would be far less effective in terms of scope - or political feasibility- than a scheme such as that applying in the HKSAR which pivots around the *core proprietary interest* retained by the Government in virtually all land. A measure of the accuracy of this view is the lack of evidence any operational example of such an alternative model capable of producing revenues at the levels enjoyed in Hong Kong, now, for around 170 years.⁶³

4.3 Simple, Low Rate Tax System

The 'system simplifying role' of land-related public revenues commenced in 1842. These rather special revenue foundations depended for their success, prior to World War 1, on the then substantial legal international trade in opium and the way in which that trade consolidated the role of British Hong Kong as a major trading port and entrepot to Imperial China.

Apart from the opium-related revenues (which took decades to become significant) these land-related revenues were fundamental in allowing the colony to thrive without need to resort to any sort of direct income taxation for around 100 years. When such taxes came they were kept low and simple.

⁶¹ 'Bubble-economy' real property values became established during the final years of British rule. Property prices began to collapse by 1998, shortly after the Asian Financial Crisis (AFC) hit. By 2003, at the height of the Severe Acute Respiratory Syndrome (SARS) health crisis, residential property prices had fallen by about 70% from their bubble-market peak. This, in turn, had a devastating impact on the revenue flow to the HKSAR Government. The Government came to rely, over a period of years (and for the first time in living memory) on substantial deficit financing to meet recurrent expenditure (see note 51). The dramatic collapse in prices was amplified greatly by the HK Dollar currency peg to the US Dollar (see note 51). After the AFC hit, the US Dollar rose greatly in value, taking the HK Dollar with it. With no currency adjustment possible in the HKSAR to cushion the impact of the AFC, asset values sank savagely and fairly swiftly. As it happens, default rates on mortgages remained very modest - especially considering the very high level of negative equity mortgages (around 100,00 in June, 2003 - or 29% of all residential mortgage loans - see: Residential Mortgage Loans in Negative Equity, at: <http://www.hkeconomy.gov.hk/en/pdf/box-03q3-3-1.pdf>.) Mass market residential property values have since recovered from the low point in 2003 and they now are back to or exceed 1997 levels.

⁶² See, for example: Rose, Carol M., 'Property as the Keystone Right' (1996) 71 Notre Dame Law Review, 329; and 'Property Rights and the Constitution' in Cato Handbook For Policy Makers (7th Edition) at: <http://www.cato.org/sites/cato.org/files/serials/files/cato-handbook-policy-makers/2009/9/hb111-34.pdf>.

⁶³ I am grateful for the discussion generated during the Tax Workshop for drawing my attention to this possible alternative approach.

As we saw in Section 3.2, they remain so using any modern comparative measure. Income tax in the HKSAR applies at low rates and is firmly territorial or source based.⁶⁴ Income taxes are applied by the IRO using separated schedules and there is typically no tax on dividends or interest and no Capital Gains Tax.⁶⁵ Goods and services are left largely free of formal taxation.⁶⁶ Fringe benefits are barely taxed.⁶⁷

The IRO has remained not that much longer today (set out in two official languages) than it was when enacted in 1947. Apart from being short, it is fairly straight-forward to read. Compliance costs are comparatively minimal. In fact for around 60% of wage and salary earners, they are essentially zero. Due to the rather generous fixed allowances applying to Salaries Tax, the majority of potential taxpayers in this category fall below the taxable threshold.

Even collection is kept simple – at least for the Inland Revenue Department – as the HKSAR still uses a Provisional Tax system rather than a Pay-As-You-Go system.

And still this system has played a key part of building up those massive Government Fiscal Reserves – enough to cover almost two years total recurrent public spending.⁶⁸

Hong Kong has been able to adhere to the advice of William of Occam (to keep it as simple as possible) even it has done so instinctively. For this reason, amongst others⁶⁹,

⁶⁴ Holmes, Kevin, *The Concept of Income – A Multi-Disciplinary Analysis* (IBFD, Amsterdam, 2001) 28–29. Holmes noted, as examples of schedule-based systems, Hong Kong, Belarus, Sudan and the UK. In the case of the UK – and unlike Hong Kong – although the schedules remain in the form, as a matter of practice, a single income tax is applied to collective income, see: *Tax in England*, at: http://www.adviceguide.org.uk/index/life/tax/income_tax/index/life/tax/income_tax.htm; and *Income Tax*, at: <http://www.economicexpert.com/a/Income:tax.html>.

⁶⁵ Section 14 of the IRO, which imposes Profits Tax, specifically excludes capital profits from assessment of Profits Tax. Section 14 does tax ‘trade’, however, and the case law – and the IRO definitions section – stipulate that this term includes ‘an adventure in the nature of trade’. Thus, one-off transactions can still be regarded as ‘trading’ in certain circumstances (normally fairly rapid re-selling of real estate) and taxed accordingly.

⁶⁶ It is arguable that the Hong Kong Government’s long established, high land price policy has imposed a ‘de facto’ Consumption Tax on all consumers in Hong Kong. Inflated land prices (which have benefited the Government most of all) have driven up the costs of doing almost every sort of business in Hong Kong because of high rents or high initial land-purchase costs. These input costs have then been passed on to all consumers as prices for goods and services have been set.

⁶⁷ Reduced taxes apply to the provision of employee housing and certain education and share benefits. Otherwise, the ‘cash-convertibility’ rule applies. This rule, which is based on old English case law, provides that provided an employee fringe benefit is not paid in cash and cannot be converted to cash by the employee, then it will not be considered a perquisite which can be taxed as part of a salary or wages.

⁶⁸ See, note 22.

⁶⁹ Other economic-success, influencing factors include the relatively small ‘City-State’ nature of the economy and the extraordinary range of (changing) trading opportunities related to China from 1842 onwards. The British also brought with them a style of experienced, pragmatic colonialism which included an understanding of how to build sound governance based on sound institutions (including the Rule of Law) (see, Tso, Kevin, ‘Fundamental Political and Constitutional Norms: Hong Kong and Macau Compared’ (2012) 13 Australian journal of Asian Law, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2159544). Above all, Hong Kong’s economy flourished because of the remarkable collective hard work and astuteness of the local Chinese population (see note 30).

it has escaped falling prey to the ‘million monkeys’ syndrome.⁷⁰ No mean achievement for Tax System operating within a developed, First World economy.

4.4 The Bad Examples

As noted previously, the success of this evolved-innovation also underpins the primary, bad aspects of the HKSAR RR. The two foremost bad lessons are: revenue policy inflexibility and the high on-cost effects of the land-based, revenue system, which are intertwined.

4.4.1 The Revenue Policy Deficit

Given the advanced nature of the economy in the HKSAR, the lack of institutionalized revenue/tax policy planning is notable. The HKSAR Government itself lacks any sort of high level, standing Tax Policy research infrastructure as does the Inland Revenue Department. When official Revenue Policy research is undertaken, a committee is typically formed, where professional, academic and public input is sought.⁷¹ The most recent example was in 2000, when the HKSAR Government set up an Advisory Committee on New Broad-Based Taxes.⁷² This was done at the height of the deficit-financing era following the onset of the AFC.⁷³

Within the tax academic and professional community in the HKSAR, there is a view that this long-time, largely ad hoc approach to Tax Policy research and review puts those seriously urging reform, including the HKSAR Government, in a weakened position.

It is almost always the case with tax reform, that one can rely a wide array of ‘Status Quo Warriors’ (SQWs) to man the roadblocks. This is particularly the case in Hong Kong. Take the debate over the possibility of introducing a Goods and Services Tax (GST) in Hong Kong which unfolded from 2004 to 2006: the SQWs included the widest cross-section of civil society from plutocrats through to ‘grass roots’ groups. They were ranged against an intimidated Government⁷⁴, moderately backed up by some professional and academic commentators – and the IMF.

⁷⁰ Gerber, Paul (Senior Member Administrative Appeals Tribunal (Australia)), ‘I suspect that if a million monkeys were put in front of a million typewriters, by Wednesday one of them would have come up with an improved version of the [Australian] Income Tax Act.’ Quoted in: Burns, Lee and Krever, Richard, ‘Individual Income Tax’ (in Thuronyi (ed.)) *Tax Law Design and Drafting* (Volume 2) (International Monetary Fund, Washington, 1998) Chapter 14.

⁷¹ For a thorough review of historical attempts to introduce reform, see Littlewood, (2002) and Littlewood, (2004), op. cit. note 32. See, too, Halkyard, Andrew, *The Hong Kong Tax Paradox, or Why Jurassic Park Exists in the Pearl River Delta* (1998) 8 *Revenue Law Journal*, 1; and Tang, Shu-Hung, *The Political Economy of Tax Reform in Hong Kong* (2005) *Asia-Pacific Journal of Taxation*, 52. Tang provides a useful review of the history of previous discussions (and failed attempts) to introduce a general tax on consumption in Hong Kong.

⁷² See: See, *A Broader Tax System for Hong Kong*, at: <http://www.fstb.gov.hk/tb/acnbt/english/finalrpt/finalrpt.html>.

⁷³ See, note 51.

⁷⁴ The fact that no one within the Government, not even the Chief Executive (Head of Government) is democratically elected helps explain a significant part of this timidity. The HKSAR has a plurality of newspapers and magazines expressing the widest range of views – far more so than in Australia or Canada. Social media is even more animated and the broadcast media can also very ‘lively’. In fact, no other place in the developed world combines so much civic freedom with so much political restriction. One result is that HKSAR Governments have tended towards caution far more than one would expect

At the same time as it released the relevant discussion document (based on the Advisory Committee's work) the Government instigated a public consultation period (from July 2006 to March 2007) on the possible directions for reform. After the announcement of the public consultation period, Hong Kong quickly witnessed a series of significant demonstrations against the GST proposal (which was clearly favoured in the official discussion document). Given the intensity of opposition to the GST in the streets (echoed in much of the media) and the fact that political parties from across the political spectrum (pro-government/Beijing and pan-democrat) expressed hostility to the tax, the Government withdrew it as an option 'on the table' in December 2005, well before the consultation period was over.⁷⁵

One elementary component of the explanation for this lack of forward revenue policy planning is the very success of the current system and, in particular, its long proved capacity to build up huge Government Fiscal Reserves. As noted earlier, these now stand at around US\$85 billion. They are readily available for Government use – formal LegCo approval is not required for an appropriation from the Fiscal Reserves.⁷⁶ Thus it is easy to argue 'Why should we plan – the system has worked so well and we enjoy a super-solvency. Long-term Tax Policy planning is driven by the need to maintain high-complexity social welfare systems and to service very significant debt – neither of which reality burdens Hong Kong.'

Allied to this point of view is the 'Scrooge Mc Duck' factor. Walt Disney's Uncle Scrooge famously fashioned a single future planning strategy: build a huge Money Bin and keep it filled to the brim. Do these two things, and you will be ready for any challenge which the future may present. Alex Lo, a thoughtful (and acerbic) writer at the South China Morning Post recently put it this way:

[O]ur city is full of people from desperate families who don't even have a home where they can be properly cared for. Hong Kong is sitting on HK\$1.38 to HK\$1.6 trillion in reserves, depending on how you calculate it, equivalent to 70 per cent of the city's gross domestic product. In 2012/13, our fiscal surplus is HK \$64.9 billion - against an original forecast of a HK\$3.4 billion deficit. But thanks to officials like our Ebenezer Scrooge of a financial secretary John Tsang Chun-wah, we won't be using a cent of that if the money doesn't come from our annual fiscal budget.⁷⁷

given the level of power conferred on them by the Basic Law and the lack of any need to face the general electorate. This arrangement is, in fact, part of the British legacy. Beijing prefers this arrangement but it did not create it. See, also, discussion at Section 4.5, below.

⁷⁵ Cheng, Jonathan, Sales tax fiasco clouds Tang's fourth budget, *The Standard*, February 26, 2007 at: http://www.thestandard.hk/news_detail.asp?we_cat=4&art_id=38915&sid=12372543&con_type=3&d_str=20070226. Hong Kong's political parties remain divided primarily according to whether they support faster-paced or slower/very slow-paced further democratization, with pro-Beijing and pro-government parties all being in the latter camp. The Pan-Democratic camp are, however, now also split into a wide range of different groups and parties where tense relations and regular squabbling are common. See Lo, Alex: 'Alliance a Recipe for Democratic Impasse', *South China Morning Post*, March 25, 2013, 2. See, also, Lo, Alex: 'Pan-Dem Elders Offer a Slither of Hope', *South China Morning Post*, January 8, 2013, 2; and 'Hysteria will not hasten Democracy' *South China Morning Post*, March 13, 2013, 2.

⁷⁶ See note 51.

⁷⁷ Lo, Alex, 'Just Whose Rainy Day is it, Mr Tsang?', *South China Morning Post*, April 25, 2013, 2. See, too, Latter, Tony, 'Shaping a Budget Strategy for Hong Kong' in, *Hong Kong's Budget: Challenges and Solutions for the Long Term* (Civic Exchange, Hong Kong, 2009) at: <http://civic->

Instinctively if not always explicitly, the majority within Hong Kong's business and professional elite groups likely feel that this almost studied avoidance of detailed Revenue Policy planning is a 'good thing': with such planning comes greater understanding – and with that, enhanced (and informed) demands for provision of particular (usually publicly-financed) services.⁷⁸

4.4.2 The On-Cost Impact

The broad outlines of the way in which the land-related revenue system has evolved and now operates have already been set out. We need, now, to consider some more of the relevant detail, though, due to limitations of space, in a rather simplified form.⁷⁹

It has become attractive for both the Government and major developers for (new leasehold) land for sale to be released in large very expensive lots. For developers, it means only the major members of their group (there are around 20 large-scale developers) can readily come to the market in many cases. For the Government these, usually very highly cashed-up, developers are able to pay the huge up-front lease premiums swiftly. Government rental payments on the purchased leases are minimal compared to the premiums. In a way, the Government has a limited 'cache' of highly solvent 'taxpayers' who pay vast 'land taxes' almost completely in advance.

For a range of reasons, it would make good sense to move away from the current format to one where Land Premiums were significantly reduced and, in tandem, Government Rents on those leases were lifted. This would lower the initial cost of land (and Government income) whilst providing a much fattened long-term flow of enhanced primary rental payments.⁸⁰

For different range of reasons this is a most difficult political-economic task. One can rely almost certainly, once more, on many of the usual the SQWs to take a stand against any such move. Moreover, both Government and big developers are accustomed to and comfortable with the current system in many embedded ways.

The consequences of the current regime, in the way in which it has developed in modern Hong Kong, however, can be highly disruptive for doing business. Sub-leases for all forms of businesses, large and small, are made more expensive by the high up-front costs associated with the underlying lease. This encourages short-term leasing (to lower immediate risk), which, especially in a market of rising rents, is a key source of instability, particularly for smaller businesses.⁸¹

exchange.org/en/live/upload/files/200902_budget.pdf, where the author suggests that some may derive a certain 'fiscal virility' satisfaction from this striking savings success.

⁷⁸ Goodstadt has noted the way in which British administration in Hong Kong maintained an active hostility to collecting economic statistics after the last War for just such reasons, see note 28 and accompanying text. Once more one can see how the roots of these Tax Policy lessons, good and bad, are essentially British.

⁷⁹ For a first class review of the historical development of Hong Kong's direct land-related revenue system, complete with systematic reform proposals, see: Webb, David, Hong Kong Land Lease Reform Part 1 (October 7, 2010) at: <http://webb-site.com/articles/leases1.asp>; and Hong Kong Land Lease Reform Part 2 (November 1, 2010) at: <http://webb-site.com/articles/leases2.asp>.

⁸⁰ Webb (Part 2), Ibid.

⁸¹ Ibid.

This means all goods and services provided in Hong Kong have a higher than usual rent-recovery component. Hong Kong has thus had, it is fair to say, a *de facto* general consumption tax particularly since World War 2, when ground rents began to fall in significance and the up-front land premiums grew and grew as the economy (generally) boomed.⁸²

The current system also typically ensures higher than usual pricing for residential properties (which also normally are quite small⁸³). For those ‘in the system’ this has an upside, of course. For those trying to buy-in for the first time, it can be particularly difficult.⁸⁴

The single factor which has made the serious on-cost drawbacks of the land revenue system sustainable over the post-War decades has been Hong Kong’s vast stock of Public Rental Housing (PRH) and provision of subsidized home ownership. All such flats are small with average living space per person at around 11 square metres (or less). Older PRH estates are often conveniently located and even new estates normally have good public transport access. Rents typically average 10-15% of disposable income (with such income normally being below the taxable threshold⁸⁵). Thus, the large majority of low income Hong Kong residents are comparatively sheltered from the on-cost impact of the land revenue system. A system exists, too, for passing on a PRH flat from one generation to the next, subject to a means test regime.⁸⁶ About 30% of Hong Kong residents live in PRH with about another 20% living in subsidized, privately owned housing.⁸⁷

4.5 The Residual Welfare State

Hong Kong Governments have historically been able to control expenditure quite effectively. Cultural-economic reasons provide an important part of the explanation for this. Briefly, Hong Kong people have long relied heavily on family and related networks to cope with a multitude of life’s exigencies. Moreover, from the 1960s until the 1990s, Hong Kong maintained high economic growth rates sustaining full employment. Also important was the long established reluctance of the Government to introduce more comprehensive programmes to tackle endemic social justice deficiencies within Hong Kong.⁸⁸

This combination of factors meant that the Government was put under (and placed itself under) significantly less pressure to develop a ‘welfare state’ of the complexity typically

⁸² Ibid. See also note 66.

⁸³ In 2010, it was said that over 70% of Hong Kong residents lived in flats smaller (some times very much smaller) than 700 square feet. Over 50% lived in flats of less than 500 square feet. See Leung, Chun-ying, ‘Does Hong Kong have the Policy Vision for the Coming Years’ (2010) (January) Hong Kong Journal available at: http://www.hkjjournal.org/archive/2010_spring/1.htm. (Mr Leung has been the Chief Executive of the HKSAR since July 1, 2012).

⁸⁴ Leung identifies this decent home access problem as a massively alienating challenge facing Hong Kong, *ibid*.

⁸⁵ About 60% of wage and salary earners fall outside the Salaries Tax net, see Section 4.3, above.

⁸⁶ See, Fung, Ping Yan, Statistics on Public Rental Housing of the Hong Kong Housing Authority, at: <http://www.legco.gov.hk/yr04-05/english/sec/library/0405in15e.pdf>.

⁸⁷ Hong Kong: The Facts, at: <http://www.gov.hk/en/about/abouthk/factsheets/docs/housing.pdf>. See, also, Public Housing in Hong Kong: Past Present and Future, at: [http://www.cih.org.hk/event_speaker_download/events2006100801/Public%20Housing%20in%20Hong%20Kong-%20Presentation%2024-9-06\(insert%20photo\).pdf](http://www.cih.org.hk/event_speaker_download/events2006100801/Public%20Housing%20in%20Hong%20Kong-%20Presentation%2024-9-06(insert%20photo).pdf).

⁸⁸ Goodstadt, *op. cit.* note 22.

encountered in most other developed economies. What evolved is a system which has been aptly described as the ‘residual welfare state’.⁸⁹ Hong Kong is characterized by a somewhat paradoxical combination of heavy public involvement in financing and provision of direct public goods, especially housing (see Section 4.4, above) plus educational and health and general infrastructures - while at the same time maintaining comparatively low overall government spending (compared to revenues).⁹⁰

The rate of public welfare spending has been increasing, however. Hong Kong’s ageing population and rising social welfare expectations help explain a significant part of this growth.⁹¹ It is in the area of transfer payments (direct payments by government to individual citizens) that welfare budgets in other developed countries have seen the greatest growth and where they typically exceed direct public welfare spending (on the likes of housing, schools and hospitals) significantly. Until the 1990s, Hong Kong was notable for its comparatively low level of transfer payments.⁹² From the mid-1990s, welfare spending of all kinds (including transfer payments) began to rise in Hong Kong.⁹³ Since 1997, welfare spending has been cut back in Hong Kong.⁹⁴ Goodstadt argues that Hong Kong’s social spending policies have long been and remain deeply flawed – a position made all the more indefensible given the HKSAR’s massive Fiscal Reserves and familiarity with world-wide best practice.⁹⁵

Another factor of importance in the provision of public welfare infrastructure is the Hong Kong Jockey Club (HKJC). The HKJC is a not-for-profit organisation which has long held a monopoly granted by the Government to run all legal gambling activities in Hong Kong. In 2011-2012 the HKJC had a turnover of around US\$18 billion.⁹⁶ The HKJC typically contributes over 10% of HKSAR Government revenues in the form of betting duties and other taxes.⁹⁷ Also significant is the major public spending programme of the HKJC based on its operating surpluses.⁹⁸ Hong Kong is dotted with hospitals, educational establishments and a substantial number of other public facilities all funded in full or in part by the HKJC.⁹⁹

Hong Kong continues to experience major problems with poverty and income disparity. A 2007 report by the Hong Kong Council of Social Services showed that 20% of Hong

⁸⁹ Lee, Eliza, Wing-ye, ‘The Politics of Welfare Developmentalism in Hong Kong’, at: <http://www.unrisd.org/unrisd/website/document.nsf/0/B764A113DEE628D4C125706D0032DA66?OpenDocument>.

⁹⁰ Ibid.

⁹¹ Ibid.

⁹² In 1997, less than 5% of public expenditure was devoted to transfer payments in Hong Kong, whilst 50% of public spending went on direct health, welfare, education and housing infrastructure. In the US, at the same time, the comparable figures were around 33% and 22%, respectively. See, ‘It is already 1997 in Hong Kong’ *The Economist*, 18 December 1997, 27.

⁹³ One commentator has estimated that broad social welfare spending increased by a total, nominal, 236% between 1994 and 2004 (see, Dom, James A., *Economic Freedom Must Lead the Way in Hong Kong*, at: <http://www.cato.org/dailys/11-27-04.html>).

⁹⁴ Lee, op cit. note 89.

⁹⁵ Goodstadt, op. cit. note 22.

⁹⁶ See, 2011-2012 Season End Results-Hong Kong Jockey Club, at: <http://corporate.hkjc.com/corporate/operation/english/11-12-results.aspx>.

⁹⁷ See, Lovelock, Peter and Grant, Ken, *Hong Kong Chronicles*, at: <http://english1.e21times.com/asp/fd.asp?r=974>.

⁹⁸ See, *Strengthening Philanthropy in the Asia Pacific: An Agenda for Action – Background Paper: Hong Kong*, at: <http://www.asiafoundation.org/pdf/APPC.HK.pdf>.

⁹⁹ All of this expenditure has helped keep the Government’s own spending under control.

Kong people (well over 1 million residents) lived below the poverty line. By some measures, this figure has eased by a small margin since¹⁰⁰ – but it remains very high for a jurisdiction enjoying such a high per capita GDP (ranked 5th in the world).¹⁰¹ The Gini-coefficient, which measures income inequality in a society (the higher the number, the greater the raw gap between rich and poor) was 0.525 in 2001, 0.533 in 2007 and 0.537 in 2011. This figure (for the HKSAR) is one of the highest in the developed world and is comparable to the wealth disparities in nations like Paraguay and Papua New Guinea. Comparable (World Bank) figures for the UK and the USA are 0.34 (2005) and 0.45 (2007), respectively.¹⁰²

The most recent HKSAR Government, led by Chief Executive (CE), C. Y. Leung, took office on 1 July 2012. For the first time since the handover of British Hong Kong to China, in July, 1997, Hong Kong has a Government with a clearly prioritised social-justice platform. The policy agenda of the new Government is focussed, inter alia, on issues like basic housing, poverty reduction, environmental improvement and care for the aged. This is the most comprehensive and explicit social-justice platform presented in Hong Kong since the 1970s. Due to the controversial circumstances surrounding the 2012 CE ('small circle') election process and the above agenda, the new Government has encountered unrelenting criticism from much of the mass media. The new CE is seen to be far 'too close' to Beijing by Pan-Democrats. It appears he owes few if any debts to Hong Kong's dominant 'Big Money' and professional elites. The Plutocrats and the Pan-Democrats (and many in the mass media) seem often to find themselves sharing an embedded level of hostility towards the new CE (and his government – which includes some leading Pan-Democrats, as it happens). Notwithstanding the fact that the HKSAR currently finds itself more trapped than ever before in an uninviting period of severe negative politics, the Government has pressed ahead with its agenda. It is fair to expect that levels of government, public welfare spending are more likely to increase rather than decrease over the coming 5-10 years.¹⁰³

¹⁰⁰ Professor Wong, Hung said that the figure for the overall poverty rate in 2010 was 18.1%, see Wong, Hong, Poverty in Hong Kong: An Overview, at: http://web.swk.cuhk.edu.hk/~hwong/pubfile/presentation/201203_NA_Poverty_in_HK.pdf.

¹⁰¹ See note 26 and accompanying text.

¹⁰² See, List of Countries by Income Equality, at: http://en.wikipedia.org/wiki/List_of_countries_by_income_equality. See also, Poverty in Hong Kong, Hong Kong Council of Social Services, at: http://www.hkcss.org.hk/praecep/pov_rate_91-05.pdf. (This study also showed that the Gini-coefficient figure in the HKSAR in 2001 (0.524) was even higher than that applying in the Mainland PRC (0.447) in the same year.) See, too, Oxfam Advocates Legislation of Minimum Wage, at: <http://www.oxfam.org.hk/english/>. The HKSAR Government contends that raw Gini-coefficient figures can be misleading and that the real situation in Hong Kong is not as bad as that indicated by such figures. Moreover, it argues that, as an economy in transition to a largely knowledge and skills-based economy such figures are likely to be amplified (during the transition period). See: Chan, K. C., Gini-coefficient, Response to LegCo Question, by Prof. K. C. Chan, Secretary for Financial Services and the Treasury, 4 July 2007, at: <http://www.info.gov.hk/gia/general/200707/04/P200707040186.htm>. See, too, The Gini Coefficient of Hong Kong: Trends and Interpretations (2011), at <http://www.hkeconomy.gov.hk/en/pdf/box-12q2-5-2.pdf>.

¹⁰³ There is no space here to cover all the detail of the controversies surrounding the new HKSAR Government and what the implications and real risks could be for Hong Kong's political and economic destiny. A fairly wide range of comments following the CE's first policy address (on January 10, 2013) may be found at: <http://www.scmp.com/topics/cy-leung-policy-address-2013> (South China Morning Post). See, also: Lee, Peter, 'Maiden Policy Address a Step in the Right Direction' at http://www.chinadaily.com.cn/hkedition/2013-01/17/content_16128757.htm. (Despite the fact that the

4.6 Synopsis

The paramount (overall-positive) policy idea is the continuing use of land, to this day, as a fundamental public revenue source.

Hong Kong's land-related revenue system has by most (but not all) measures proved to be a remarkable success. It has generated very substantial public revenues virtually from the creation of British Hong Kong in 1841.¹⁰⁴ It continues to do this today. As previously noted, in the Forward Estimates for 2013-2014, land revenue is estimated to be 16% of total Government revenues. Such revenues have exceeded 20% of total revenues in the relatively recent past. Several decades ago such income exceeded 30% of all Government revenues.

The land-related revenue system played a key role in building up very significant public reserves within 50 years of the founding of British Hong Kong. Today those reserves total well in excess of US\$300 billion. Around US\$85 billion are official Fiscal Reserves available, *prima facie*, for high-priority immediate spending by the Government. These Fiscal Reserves have been used, for example, to defend the HK Dollar most successfully (in 1997-98) and to fund significant deficit budgets over several years with zero recourse to borrowing.

The success of this land-based revenue system has always been driven by Hong Kong's remarkable economic success especially in trade and, until World War 1, by the trade in opium above all. Successive Hong Kong Governments have managed the system so as to maximize its revenue generating capacity. They have deliberately restricted the supply of land. They have also, historically, tightened the system so as to enhance and make still more secure, the Government core-interest in all land in Hong Kong.¹⁰⁵

This, in turn, has notably encouraged the regular *re-development* of land originally released for residential, commercial and other uses. Because of the (highly conditional) leasehold system, any such redevelopment almost always requires the redeveloper to pay a lease modification premium to the Government. These continuing premium payments are rarely modest and can be very high indeed. This aspect of the system ensures that the Government continues to collect public revenues at regular (redevelopment) intervals based on enhanced land values, indefinitely.

From 1986, after the UK and the PRC signed the *Joint Declaration*,¹⁰⁶ land-based revenues were placed in a separately managed Land Fund Trust (presumably to ensure that the British did not spend these funds in ways not acceptable to Beijing, prior to the 1 July 1997 Handover).¹⁰⁷ In 1998, shortly after the Handover, the assets of the Land Fund were placed within the Exchange Fund to be managed in the same way as all other

China Daily is an official, PRC English language newspaper, it enjoys a reputation for being more than a simple Chinese Communist Party mouthpiece. Mr Lee is Divisional President of CPA Australia, Greater China); and Lo, Alex, 'Just Who's Rainy Day is it Mr Tsang?' South China Morning Post, 2, 25 April 2013.

¹⁰⁴ The first land auctions were held in Hong Kong in 1841, the year the British first took possession of Hong Kong Island. That possession was formalized in 1842 when the Treaty of Nanking (see note 3).

See Webb, Part 1, *op. cit.* note 79.

¹⁰⁵ Webb, *ibid.*

¹⁰⁶ See note 3.

¹⁰⁷ See, Land Fund, at: http://www.hkma.gov.hk/gdbook/eng/l/land_fund.shtml.

Fiscal Reserves, by the Hong Kong Monetary Authority (HKMA).¹⁰⁸ Notwithstanding this relocation, Land Fund Reserves are ear-marked for capital works. They are transferred, for spending, in accordance with long-standing policy, into the Government's Capital Works Reserve Fund¹⁰⁹ (the HKMA manages this fund (along with all Government reserve funds (eight in total)) within the Exchange Fund).¹¹⁰

Another notable feature of the land-based revenue system is the way in which it has operated in an open way, largely free of serious corruption. Given the immense sums involved, this is an important achievement. The predominantly 'clean' market-driven operation of the system has been another key to its success. A combination of factors explains this outcome. There is no space here to detail them. In summary, the role of Hong Kong's Independent Commission Against Corruption (ICAC) has been significant. It is also the case that the system has been built so that most all stakeholders have developed a vested (financial) interest in maintaining its basic integrity.

The ICAC was established in 1974 as a very well resourced, fully independent anti-corruption authority. As the ICAC explains:

Hong Kong was in a state of rapid change in the sixties and seventies. The massive growth in population and the fast expansion of the manufacturing industry accelerated the pace of social and economic development. The Government, while maintaining social order and delivering the bare essentials in housing and other services, was unable to satisfy the insatiable needs of the exploding population. This provided a fertile environment for the unscrupulous. In order to earn a living and secure the services which they needed, the public was forced to adopt the 'backdoor route'. 'Tea money', 'black money', 'hell money' - whatever the phrase - became not only well-known to many Hong Kong people, but accepted with resignation as a necessary evil.¹¹¹

In 2012, the HKSAR maintained its strong reputation for a low corruption jurisdiction ranking 14th in the Transparency International Corruption Perception Index, ahead of both the USA and the UK.¹¹²

¹⁰⁸ See, History: Establishment of the Exchange Fund, at <http://www.hkma.gov.hk/eng/key-functions/exchange-fund/history.shtml>. See, also, note 51.

¹⁰⁹ See, Loh, Christine, Recurring Problem, at: http://www.civic-exchange.org/wp/wp-content/uploads/2011/01/110114_SCMP.pdf.

¹¹⁰ Cheung, Tony, 'Calls for Government to limit size of Fiscal Reserve', South China Morning Post, February 19, 2013, at: <http://www.scmp.com/news/hong-kong/article/1153362/calls-government-limit-size-fiscal-reserve>.

¹¹¹ See <http://www.icac.org.hk/eng/about/index.html>. Hong Kong was strongly influenced, in its move to establish the ICAC, by the earlier, successful, experience of Singapore in drastically reducing corruption (see Goodstadt, Leo G. *Uneasy Partners: the Conflict Between Public Interest and Private Profit in Hong Kong* (Hong Kong University Press, Hong Kong, 2005) 141. For a detailed review of the history, achievements and challenges facing the ICAC, see, Cullen, Richard, Yang, Xiaonan and Loh, Christine, 'Executive Government' in (Chan and Lim (eds.)) *Law of the Hong Kong Constitution* (Sweet & Maxwell, Hong Kong, 2011) Chapter 9.

¹¹² Corruption Perceptions Index 2012, at: <http://www.transparency.org/cpi2012/results#myAnchor1>. See, also ICAC Post, March, 2012, at: http://www.icac.org.hk/filemanager/en/Content_1025/post1202.pdf.

This comparatively low corruption environment has been very good both for doing business and living life, for ordinary residents. Business and ordinary residents are both firm supporters of the HKSAR's low rate, minimalist Income Tax system.¹¹³ The second significant positive lesson which Hong Kong offers is, thus, that it is possible to maintain, in the modern era, a highly effective revenue regime which is minimalist, clear and easy to comply with. This second positive example depends greatly on the first policy innovation (although other factors also are important).

The success of this evolved-innovation also underpins the primary, bad aspects of the HKSAR RR, however. Two examples stand out: notable revenue policy inflexibility; and the high on-cost effects of the land-based, revenue system.

Briefly, habits of wariness about long-term Revenue Policy planning shared over many decades by both Government and, especially, big business and its advisors are well entrenched in the HKSAR.¹¹⁴ On the positive side, many argue with some cogency, that the long-term, 'keep it simple' approach has worked so remarkably well, there is no need for complex forward planning in this area. This perspective is reinforced by the view that the time-proved, preeminent mode of planning for the future is to save with gold medal vigour, which is just what Hong Kong has always done. Less positively, such planning is seen as a trigger for enhanced public expenditure designed to shift Hong Kong away from its residual welfare state model.

The land-based revenue system means that the effective monopoly supplier of land, the Government, has a powerful vested interest in maintaining high land prices. Two of the most clear adverse, on-cost consequences of this are: high (often very high) entry prices to achieve any sort of home ownership; and an inflation impact on the provision of most goods and services due to the high costs of renting or buying business premises.

A major housing crisis has been avoided, though, above all by the Government building Public Rental Housing (PRH) and subsidized owner occupied housing¹¹⁵ on a massive scale. This programme began in earnest in the mid-1950s after a major fire in a squatter settlement in Shek Kip Mei left some 50 000 people homeless in December, 1953. It gained real momentum in the early 1970s when the Government announced plans to house or re-house around 2 million people within 10 years.¹¹⁶ All these flats are small (or very small) typically providing less than 50 square feet to house a growing family. But the Housing Estates are typically well run, well maintained and generally safe for tenants of all ages. The most poorly located are in remoter districts but they still usually have good public transport access. The many well located Estates are close to all facilities including the excellent and extensive Mass Transit Railway (MTR) system.

¹¹³ Cullen, Richard and Simmons, Richard, 'Tax Reform and Democratic Reform in Hong Kong: What do the People Think?' [2008] *British Tax Review*, 667.

¹¹⁴ The fundamental policy-setting alliance between Hong Kong's business and professional elites and the Government during the entire period of British rule in Hong Kong is extensively documented in Goodstadt, Leo F., *Uneasy Partners; The Conflict Between Public Interest and Private Profit in Hong Kong* (Hong Kong University Press, Hong Kong, 2005).

¹¹⁵ Since 1978, over 465,000 subsidized flats have been sold to low and middle income households in Hong Kong, see, Hong Kong: The Facts, September 2012, at: <http://www.gov.hk/en/about/abouthk/factsheets/docs/housing.pdf>.

¹¹⁶ Fung, Ping Yan, Statistics on Public Rental Housing of the Hong Kong Housing Authority, at: <http://www.legco.gov.hk/yr04-05/english/sec/library/0405in15e.pdf>.

Once the Government had settled on this policy, it was able to provide all the necessary land for building without any direct acquisition costs. Moreover, the land-based revenue system was a major factor in helping to fund this massive new building programme.

The Hong Kong Housing Authority, created in 1972, remains the primary body responsible for running this system and for building new public housing. The Housing Authority estimated total capital expenditure for the 2013-2014 financial year at US\$1.5 billion approximately. Total cash and investment reserves for the Housing Authority at the close of the same year are estimated at US\$8 billion.¹¹⁷ Annual production of new Housing Authority rental flats ranges from 13 000 to 20 000 over the four year period from 2012.¹¹⁸ The total stock of existing PRH flats is over 760 000.¹¹⁹

The very high densities of residential accommodation in Hong Kong (public and private) have been fostered significantly by the land-based revenue system. By restricting land supply, the Government has husbanded its 'land bank' and helped ensure the best price for all released land (and high redevelopment premiums). This system has also ensured that residents enjoy one of the very best, low cost public transit systems in the world. Moreover, communications systems are first rate and access to health, hospital, educational, recreational and shopping etc facilities are also highly regarded. A further advantage is that almost all Hong Kong residents live within a relatively short, regular-service bus ride to hillside country parks. Beaches are readily accessible, too.

The higher costs of service provision noted earlier, arising from the land-based revenue system are also offset in a number of ways. The MTR system subsidizes its transport service through development rights it enjoys which are typically linked to newly built MTR lines and stations. The very high densities (and low car usage due to high garaging costs, inter alia) help build in viability for the extensive bus, mini bus and taxi networks. The Government also subsidizes all bus and taxi services through fuel excise relief mechanisms.

The lack of any need to pay direct taxation for thousands of small businesses (and their employees) also helps to keep costs down for consumers – the majority of whom also pay no direct taxes.

So far, so good, one might say. The serious problem is that, right now and especially looking forward many major public policy challenges face the HKSAR.

Hong Kong's new Chief Executive, C. Y. Leung (from 1 July 2012), identified a range a major challenges in a policy review article he published in early 2010.¹²⁰ His Government is the first since the handover of British Hong Kong to China, in July, 1997

¹¹⁷ Housing Authority Budgets 2013-2014, at: <http://www.housingauthority.gov.hk/mini-site/budgets1314/en/view.html?f=5>.

¹¹⁸ Forecast Public Housing Production 2012/13 to 2016/17, at: <http://www.housingauthority.gov.hk/en/about-us/publications-and-statistics/forecast-public-housing-production/index.html>.

¹¹⁹ Hong Kong: The Facts, September 2012, at: <http://www.gov.hk/en/about/abouthk/factsheets/docs/housing.pdf>.

¹²⁰ Leung, Chun-ying, Does Hong Kong Have the Policy Vision needed for the Coming Years, at: http://www.hkjjournal.org/archive/2010_spring/1.htm.

to offer a clearly prioritised social-justice platform. This policy agenda is focussed, above all, on issues like basic housing, poverty reduction, environmental improvement and care for the aged. Not since the 1970s, when the British set about building public housing on a massive scale (and created the ICAC) has Hong Kong seen such an explicitly activist Government.

The reasons for Hong Kong to undertake an in-depth and comprehensive review of Revenue Policy have been evident for some years. The pressures to do so, not least coming from within the new Government itself, are now intensifying. The extraordinary fiscal fitness of the HKSAR Government offers a remarkable opportunity to address existing and coming policy challenges innovatively and effectively - without immediately having to worry about where the money is coming from. This same rude financial health underpins serious policy inertia, too, unfortunately.

5. CONCLUSION

The discussion so far has set out key aspects of the development of Hong Kong's rather usual public revenue profile. It has also argued what the primary positive and negative aspects of that revenue system are and how they have come to be as they are.

In this Part, I first consider what principles can be argued to underpin the crucial defining factor in the HKSAR's RR; the continued conspicuously heavy reliance, since 1842, on a land-based revenue system. Next, I argue why this aspect of the RR may have lessons beyond Hong Kong – and how such lessons might be acted upon, especially in urban areas.

5.1 Land as the common heritage of humanity

It would seem that in most all major developed jurisdictions, economically valuable, surface real estate (not least central urban real estate) has been alienated, over the course of time, by the State through some form of absolute or near-absolute sale or disposal.¹²¹ Even in the UK, on which Hong Kong has based its leasehold mode of land 'sales', the underlying title – the 'Landlord's Title' – is now, in urban areas, either 'freehold' (owned by the occupier) or the lessor interest is in private hands or owned by the Crown Estate.¹²² Leasehold interests give leaseholders significantly more rights than those enjoyed in Hong Kong. State, ultimate ownership of land in the UK, especially in urban

¹²¹ Cahill, Kevin, 'Who Owns the World', *New Statesman*, 17 March, 2011, available at: <http://www.newstatesman.com/print/global-issues/2011/03/land-queen-world-australia>.

¹²² The Crown Estate is an extensive property portfolio in the UK owned by the Monarch in the name of Crown. It is no longer the private property of the reigning Monarch and cannot be sold by him/her, nor do the revenues from it belong to the Monarch personally (as each Monarch, upon accession, surrenders the surplus revenues to the Treasury in return for an annual grant known as the Civil List. The entire portfolio is managed (commercially and for the public (beaches etc)) by an organization known as The Crown Estate, headed by the Crown Estate Commissioners. By 1760, when George III came to the throne, taxes had become the major source of revenue (rather than land held by the Monarch). From that time, the Monarch gave up rights to all revenues from Crown Lands in return for the agreed a fixed annual payment (today called the Civil List). See, *The Crown Estate: Our History*, at: <http://www.thecrownestate.co.uk/about-us/our-history/history/>.

areas, is now minimal having shrunk significantly during the period of Conservative Government (1979-1997).¹²³

At the heart of the land-based revenue system in Hong Kong is the fact that all Hong Kong Governments since 1842 to the present day have retained a core proprietary interest in virtually all real estate in Hong Kong. As we have seen above, this policy has emerged initially from practical concerns about basic public financing of the new colonial outpost (influenced by lessons learned from the British, North American colonial experience). As it proved its worth, it has been developed further – and entrenched. There has never been any real outcry about this retention of core Government proprietary interests, even from very large and powerful private owner-stakeholders. Key explanations for this private-stakeholder support would appear to be that, over time, the system has proved, if anything, even more beneficial to private landholders in terms of gains in value (and scope to trade in land profitably), plus it has ensured the retention of a low rate, simple Tax System which finds favour across almost all interest groups in Hong Kong.

At a pragmatic policy level, the land-based revenue system has clearly proved itself - drawbacks (outlined above) notwithstanding. But such a system can also be strongly justified in principle.

The work of Henry George, the American economist who favoured a single tax on land has already been mentioned.¹²⁴ His economic arguments have had some limited influence and have also been subject to significant criticism.¹²⁵ His argument that land is part of the ‘common heritage’ of humanity¹²⁶ has a coherence which is easily overlooked, however, in jurisdictions where almost all land of economic value has been alienated by the State. (This alienation has not happened in all jurisdictions, of course – and it has not happened in Hong Kong.)

More recently, some Property Law theorists have argued that individual ownership of land, especially, is qualified by a powerful ‘social-obligation norm’. This concept stresses obligations owed (by property owners) to other members of various communities. This concept can also be employed to stress that such obligations can be met by conceding rights to the State to hold core proprietary interests in land for the purpose of protecting and enhancing community interests. (At a practical-political

¹²³ Home, Robert, ‘Land Ownership in the United Kingdom: Trends, Preferences and Future Challenges’ (2009) Land Use Policy, 103, available at: http://www.bis.gov.uk/assets/foresight/docs/land-use/jlup/12_land_ownership_in_the_united_kingdom_-_trends_preferences_and_future.pdf.

¹²⁴ See note 21. See, also: George, Henry, *Progress and Poverty*, (Kegan Paul, Tench & Co., London, 1886 (reprinted)); and Backhaus, Jurgen G., ‘Henry George’s Ingenious Tax: A Contemporary Restatement’ (1997) 56 *American Journal of Economics and Sociology*, 453.

¹²⁵ For a recent summary of this criticism, see Hudson, Michael, ‘Henry George’s Political Critics’ (2008) 67 *American Journal of Economics and Sociology*, 1. (Also available at: <http://michael-hudson.com/wp-content/uploads/2010/03/0801GeorgesCritics.pdf>.)

¹²⁶ ‘The equal right of all men to the use of land is as clear as their equal right to breathe the air—it is a right proclaimed by the fact of their existence. For we cannot suppose that some men have a right to be in this world, and others no right.’ George, *Progress and Poverty*, op. cit. note 124.

level, this is particularly so when the State has retained significant rights over most or all land in a given jurisdiction).¹²⁷

As the discussion above has shown, modifications to Hong Kong's land-based revenue system are warranted generally and also because it has produced certain troubling side-effects. Notwithstanding these concerns, there remains a strong, in principle argument, that the retention of a core proprietary in all land by Government is (and has proved to be) fundamentally in the public interest; this core-interest is retained, ultimately, for the benefit of all Hong Kong residents.

As it happens, Governments in numbers of developed jurisdictions, which have allowed the full or near complete alienation of surface rights of economically valuable land – particularly in urban and near-urban areas - have moved to retain ownership or economic control of sub-surface rights (mineral rights, service-tunnelling rights etc).¹²⁸ Here too, the justification is often put in terms of Government acting to preserve a common heritage.¹²⁹

5.2 State retention of a core proprietary interest in land – policy realities

First, we should reconsider some key elements – outside of the revenue collection system itself – which have helped ensure the remarkable success and durability of the land-based revenue regime in Hong Kong.

The Hong Kong Government has dealt effectively with the immediate housing-crisis threat posed by such a system, particularly when it is premised on a high-density, high-price model. The massive intervention of the Government into the market through the

¹²⁷ Professor Alexander puts it this way: 'Private property ordinarily triggers notions of individual rights, not social obligations. The core image of property rights, in the minds of most people, is that the owner has a right to exclude others and owes no further obligation to them. That image is highly misleading. Property owners owe far more responsibilities to others, both owners and non-owners, than the conventional imagery of property rights suggests. Property rights are inherently relational, and because of this characteristic, owners necessarily owe obligations to others. But the responsibility, or obligation, dimension of private ownership has been sorely under-theorized. Inherent in the concept of ownership is an implicit norm that might be called the social-obligation norm. This norm captures the various obligations that owners owe to others, specifically, to certain members of the various communities to which they belong. The moral foundation of this norm is human flourishing. As a moral and legal value human flourishing differs importantly from welfare as that term is commonly used today by economists and legal analysts.' (Abstract of Lecture delivered to the Faculty of Law, Hong Kong University, 15 April 2013. See, also, Alexander, Gregory S. and Penalver, Eduardo M., *An Introduction to Property Theory* (Cambridge University Press, Cambridge, 2012).

¹²⁸ In Australia for example, Crown rights to all gold were proclaimed in NSW and Victoria in 1851 shortly after gold was discovered. Statutory Crown claims to rights over all (onshore) minerals in all Colonies (later States) followed. Once the Commonwealth (Federal Government) was established it too made similar claims, especially in the offshore, in the 1970s. (Cullen, Richard, *Federalism in Action* (Federation Press, Sydney, 1990). Crown rights over minerals (onshore and offshore) in Canada are also extensive, see Cullen, *ibid* and Thompson, Andrew R., 'Resource Rights', *The Canadian Encyclopedia*, at: <http://www.thecanadianencyclopedia.com/articles/resource-rights>.

¹²⁹ 'Julia Gillard told a dinner hosted by the council last night that Australians deserved to benefit from the mining boom - and that the nation's resources belonged to its people and not the government or mining companies. Mr Hooke [Head of the Minerals Council of Australia] said Ms Gillard's remarks were well received - and that the industry had never contested the fact the sovereign state owned the minerals.' Baker, Mark, 'The Boom is not Yours, PM tells Miners' *Sydney Morning Herald*, 31 May 2012, at: <http://www.smh.com.au/opinion/political-news/boom-is-not-yours-pm-tells-miners-20120530-1zjfb.html>.

supply of low-cost public housing has been vital to the success of the system. It has done this by building (and continuing to build) Public Rental Housing on a vast scale and by subsidizing the means-tested purchase of owner-occupied housing by the less-wealthy, accounting (in combination) for around 50% or all housing in Hong Kong, still.

The high density (public and private) housing model has resulted in smaller living spaces – but it has also enabled provision of world-class, low-cost public transport and communication services coupled with, usually, good-excellent access to all services, including schools/education, health care/hospitals, recreational amenities and excellent shopping facilities. This development model also facilitates easy access to extensive country parks and other green areas for residents, which is hard to find in any other city of comparable size.

Next, the model has been developed so that most all the stakeholders have come to see that they have a vested interest in maintaining the governance-integrity of the system. The very effective work of the ICAC, constantly ‘riding shotgun’ around the system (for around four decades, now) has helped significantly in convincing players – and maintaining their perception – of this vested interest.¹³⁰ This ‘must-have-stick’ has been deeply supported by the ‘carrot’ of the low rate, simple Tax System, which has significant roots in the land-based revenue regime. Within this framework, an often pulsating free market normally operates at both wholesale (developer) and retail levels – ensuring market mechanisms largely remain vital in allocating scarce land resources.¹³¹

That part of the very significant Fiscal Reserves referred to as the Land Fund of the Hong Kong Government, currently suffers from being too restricted in terms of how they may be spent. What is clear, however, is that they have never been allowed to become a general ‘Slush Fund’, still less, a ‘Rolex Reserve Fund’ – that is a fund the use of which systemically lacks transparency the better to allow industrial-scale, organized political pocket-lining.

Finally, the British had established a pattern of sound training, pay and career path opportunities for its Colonial Civil Service by the early 19th century. This policy

¹³⁰ ‘In an astonishing scene in a Hong Kong courtroom on Friday, Sun Hung Kai Property (SHKP) co-chairmen and managing directors Thomas Kwok Ping-kwong, 60, and Raymond Kwok Ping-luen, 58, were charged under the bribery ordinance, as was the top official they are accused of bribing, former chief secretary Rafael Hui Si-yan, 64. According to ICAC investigators, from 2000 to 2009, the Kwok brothers provided a rent-free luxury apartment and nearly HK\$35 million (US\$4.5 million) in kickbacks to Hui; meanwhile, SHKP-Hong Kong’s (and perhaps Asia’s) biggest developer, which employs more than 27,000 people, was allegedly the beneficiary of one sweet government favor after another.’ Ewing, Kent, ‘Landmark Corruption Trial Looms in Hong Kong’ Asian Times Online, 17 July 2012, at: <http://atimes.com/atimes/China/NG17Ad01.html>.

¹³¹ The HKSAR has also had the most direct experience of collapsing (70% drop in values on average) real property market spread over several years, see note 61. Government sales on ‘favoured terms’ are also not unknown. The Government land (and related) deals to encourage the establishment of ‘Hong Kong Disneyland’ and ‘Cyberport’ (plus land-development opportunities / subsidies provided to privately run utilities) are examples. See, Loh, Christine, ‘How the Hong Kong Government Makes Decisions,’ CLSA Emerging Markets Report (September, 2000), at: http://www.civic-exchange.org/wp/wp-content/uploads/2010/12/200009_HKGovMakesDecision.pdf. See, also, Ng, Kang Chung, ‘Hong Kong Disneyland’s Fairy Tale had a Wicked First Chapter’, South China Morning Post (19 February 2013) at: <http://www.scmp.com/news/hong-kong/article/1153359/hong-kong-disneylands-fairy-tale-had-wicked-first-chapter>.

approach served Hong Kong comparatively well from the outset.¹³² This strategy for limiting systemic, high level (and later, all-level (with the help of the ICAC)) public corruption was maintained and continues to be maintained in Hong Kong – it is an important component in the achievement of continuing low-corruption scores on international comparative studies.¹³³

5.3 State retention of a core proprietary interest in land – policy possibilities

First, we should note some basic parameters and some clear human development trends. Total World population reach 7 billion in 2011. Although population growth has slowed somewhat, it is still expected to reach 8 billion by 2025 and over 9 billion by 2050.¹³⁴ In the early 20th century, 20% of the World's population lived in urban areas. By 1990, the figure was less than 40%. By 2010, it exceeded 50%. By 2050, it is estimated that 70% of the World's population will be urbanized.¹³⁵

This massive shift to urban living, across the World, can clearly only be achieved with some measure of success for those involved if intelligent Government planning and management apply. It equally follows, in the view of many, that these massive changes in the way most people live, will have to rely heavily on high to very high density living, not least to limit the 'carbon footprint' impact of these changes.¹³⁶

I believe that these future urbanisation assumptions are basically sound. The potential relevance (of the full operational aspects) of the Hong Kong model of very high density urban development (built, as it is, on the land-based revenue-pivot of the Hong Kong Revenue System) are also clear.

In the developed jurisdictions of the World, the opportunities to apply lessons drawn from Hong Kong are greatly limited because of the long-term transfer of land – and particularly urban land – almost entirely, *prima facie*, into private hands.

In the developing jurisdictions of the World this drawback may or may not apply. In particular, this (dominant) private-ownership shortcoming does not apply in Mainland China. Since the establishment of the PRC in 1949, all ultimate ownership of land

¹³² Tso, Kevin, 'Fundamental Political and Constitutional Norms: Hong Kong and Macau Compared' (2012) 13 Australian Journal of Asian Law, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2159544. There are always exceptions to (which help prove, one hopes) the rule. Former HKSAR Chief Secretary, Raphael Hui has now been charged with corruption in relation to certain property development deals (see note 130). His base salary when in Government employment (before significant benefits) was around US\$300,000 per annum. It is said that Hui had developed a serious (non-successful) gambling habit. Details of the (often very generous) salaries paid across the HKSAR public sector (including to the police) can be found at: Note For [Legislative Council] Finance Committee: 2012-2013 Civil Service Pay Adjustment, <http://www.legco.gov.hk/yr11-12/english/fc/fc/papers/f12-49e.pdf>.

¹³³ See note 112.

¹³⁴ See, Current World Population, at: <http://www.worldometers.info/world-population/>.

¹³⁵ See, 'Urban Population Growth', World Health Organization, at:

http://www.who.int/gho/urban_health/situation_trends/urban_population_growth_text/en/.

¹³⁶ See, for example: Mensel Mensel, 'Cities are Making us More Human (Interview with Prof. Edward Glaeser (Harvard))', The European, December 20, 2011, at: <http://www.theeuropean-magazine.com/420-glaeser-edward/421-humans-cities-and-the-environment>; and Owen, David, 'Greenest Place in the US? It's Not Where You Think' Yale Environment 360, 26 October 2009, at: http://e360.yale.edu/feature/greenest_place_in_the_us_its_not_where_you_think/2203/.

(urban and non-urban) has passed into the hands of the State – or its formal offspring (Rural Collectives, State Owned Enterprises, Municipalities, etc).¹³⁷

The complex tensions – and abuses of (land grabbing) power – in the PRC since the first moves to ‘privatize’ (to a degree) land-usage rights following the commencement of Deng, Xiaoping’s major economic reforms in 1978 have created immense ongoing political, social and economic problems.¹³⁸ At the same time, new urbanization on an unprecedented scale has also been achieved and is ongoing.¹³⁹ China had less than 11% of its population living in urban areas when the PRC was established in 1949. By the time Deng’s ‘opening up’ reforms commenced, in 1979, that figure was still under 19%. Today over 50% of all citizens live in urban areas in China and by 2030, it is expected that China may have 1 billion urban residents.¹⁴⁰

The post-Deng land reforms which have underpinned this vast shift from non-urban to (typically) high density urban living are significant in this discussion. What private land-holders enjoy, largely, in the PRC today, are ‘land use rights’ nominated for periods of between 40-70 years.¹⁴¹ One pays a purchase price for these now normally transferable rights – and mortgage purchase-loans are fundamentally secured against these rights. The State ultimately holds the core interest in the relevant land. Rights (and modes) of ‘lease’ renewal remain less than clear.¹⁴²

In short, this means that in China, given the retention of the core-title by the State, there is real potential to apply much of what Hong Kong has tested and has shown to work in terms of retaining land as a fundamental and significant, long-term source of public revenue.

Already, however, we have seen in China what massive potential there is for corruption and social disruption in the process of development-land acquisition and disposal of wholesale (especially) land-usage rights.

What the Hong Kong experience shows, is that for land-based revenue system to function with the greatest effectiveness (over the long-term) you need for Government to retain a core proprietary interest in all land. Also Government needs to stipulate very specifically what building/usage rights are permitted in each lease – so that redevelopment, often decades later, can be approved, subject to Government drawing on new revenues resulting from agreed lease changes. But this is far from enough. Government also needs: to address directly (and very effectively) the inevitable, amplified need for low-cost public rental and subsidized owner-occupied housing; and to put in place a raft of full-bodied measures to address the many civil and criminal

¹³⁷ Ding, Chengri and Gerrit Knaap, ‘Urban Land Policy Reform in China’ (2003) 15 Land Lines, at: http://www.lincolnst.edu/pubs/793_Urban-Land-Policy-Reform-in-China. Land Lines is published by the Lincoln Institute with its headquarters at the University of Hartford in Connecticut in the US. The institute was the creation of John C. Lincoln, a Cleveland industrialist, in 1946, who was, in starting the Institute, inspired by the written work of Henry George (see, About the Lincoln Institute of Land Policy, at: <http://www.lincolnst.edu/aboutlincoln/>).

¹³⁸ Ding and Knaap, Ibid.

¹³⁹ Ibid. See, also, Page, Jeremy, Davis, Bob and Areddy, James T., ‘China Turns Predominantly Urban’ Wall Street Journal, 18 January 2012, at: <http://online.wsj.com/article/SB10001424052970203735304577166652002366514.html>.

¹⁴⁰ Page et al, *ibid*.

¹⁴¹ Ding and Knaap, *op. cit.* note 137.

¹⁴² Ibid.

fraud and related hazards such a system generates. But if you can put in place a robust and comprehensive governance and market framework, this sort of system works. It can deliver decent, basic housing, potentially for all, and back that up with significant, long-term public fiscal benefits. It is hard to see an alternative, better, tried and tested model, which could help cope with the consequences of the coming vast, world-wide urbanization in a more practical and humane way. That is, where adopting a Hong Kong style model is still legally and politically possible.