Executive Summary

According to the analysis by the British Chamber of Commerce the 2011-2012 Budget priorities comprise the following key areas:

- Further encouragement and stimulation of the development of RMB banking services.
- Diversification of financial services through developing of Hong Kong as an offshore financial centre, Intellectual Property holding centre, and insurance centre.
- Advancement of Hong Kong International Airport expansion.
- Urgent increase in the HKSARG investment in development of International Schools to help to attract and retain senior executives.
- Objectively reconsider the cost and benefits of the addition of a rail element to the, Judicial Review-stalled Hong Kong-Zhuhai-Macau Bridge, without delay to a target HKZMB opening by mid 2017.
- Introduction of eco/green taxes and launch a major HKSARG-funded Environmental Improvement Programme fund, as a combined contribution towards a Green Pearl River Delta and to address forthwith the deteriorating air quality.
- Support sustained investment in the next ten ‘mega’ infrastructure projects to enhance Hong Kong’s long-term ‘superconnectivity’ regionally and internationally.
- Funding of a third party consultancy examination on the competiveness of Hong Kong as an international business and financial centre and Regional Headquarters’ (RHQ) location, versus its competitors.
- Introduce longer-term funding and strategies to tackle youth unemployment and support low-income groups in New Towns.
- Reduce Profits Taxation to 15% to encourage Hong Kong’s competiveness with global and regional competitors.
- Continue concessions for SMEs to ensure a sustained economic recovery and future prosperity.

Introduction / Current fiscal outlook

As a small, open economy with extensive external trade and financial links, Hong Kong has always been an avid consumer of what the rest of the world has to offer. An example is Hong Kong’s ability to benefit from policy stimuli elsewhere since the onset of the global financial crisis. Indeed, with the US Federal Reserve now undergoing a fresh round of quantitative easing (‘QE2’), the flood of liquidity into Hong Kong is likely to be further prolonged.

Ample liquidity and well-supported asset prices, underpinned by reductions in unemployment and sustained tourist arrivals, should support strong retail consumption in 2011 - much like 2010. Net exports may spur growth, despite the fragile recovery in the West. All this, with closer economic and financial ties to the Mainland, should translate into GDP growth rate of 5.0% in 2011, (above the 4.5% trend), according to Standard Chartered Bank projections.

That said, such a backdrop will bring new challenges. For one, CPI inflation will be higher in 2011, probably 4.0% from 2.5% in 2010. The lagged effect of higher residential rents since early 2009 should start to bite. The side effects of (very rightly) maintaining a currency peg, with higher wages and global food prices, mean inflation worries will remain under the spotlight.

Asset-price inflation has the potential to be a bigger worry than CPI inflation – both from the economic (rising risk of a bubble forming) and social (decreasing supply of affordable housing) standpoints. The 'silver-lining' is that during the current fiscal year (FY11), Hong Kong's fiscal performance should be on full display, as a liquidity-driven recovery has contributed to higher direct tax receipts, combined with significant windfalls from land sales and stamp duty income.

Overall, we believe the Budget (FY12) can remain generous without undermining fiscal prudence. The key will be to spend wisely, striking a balance between tackling the economic problems *du jour* and shoring-up the economy's long-term competitiveness.

Opportunities arising from the Budget Surplus

Given the expected buoyant growth rate in 2011, addressing social concerns should top the FY12 Budget agenda. An inevitable rise in CPI inflation in 2011 means the Government should, in its upcoming FY12 Budget, consider extending economic relief measures to help households cope with higher living costs near-term, and tackling so-called 'deep social conflicts' from a more structural standpoint. This could come in the form of salaries tax rebate and a property rates waiver for low-income and middle-class taxpayers, or other concessions, such as extra allowance to welfare (CSSA, Old Age Allowance and Disability Allowance) recipients and additional public housing rent waivers for existing government social welfare beneficiaries. Greater spending on education, healthcare, environmental protection (described below), caring for the elderly, supporting job seekers, and the promotion of income equality would be welcomed, underpinned by an objective review or reappraisal of the MPF system. Structurally, ongoing commitment to public investment in major infrastructure projects should create more jobs and raise incomes, but as described below should consider the next tranche of public works' investment.

Another key theme is that the post-crisis world presents Hong Kong with opportunities to shore up its long-term economic and financial competitiveness. Hong Kong has enviable fiscal resources, with most other international financial centres struggling to recoup money spent on stimulus and bailout packages. In addition to the pull of a fast-growing China and an ascending Chinese Yuan (CNY), draconian bank levies and the crackdown on financial institutions in the West may well drive financial professionals, institutions and investors to the East. To capitalise on the situation, Hong Kong's already low and simple tax regime could be made more attractive by lowering tax rates; however, holding onto greater public resources to create an even more business-friendly environment would appear an equally viable strategy.

Some further spending priorities to consider:

- Advancement of Hong Kong International Airport expansion.
- Funding of a third party consultancy examination on the competiveness of Hong Kong as an international business and financial centre and Regional Headquarters' (RHQ) location, versus its competitors; concluding with a list of prioritised recommendations to address identified shortfalls.
- Urgent reconsideration of the addition of rail element to the, Judicial Review-stalled, Hong Kong-Zhuhai-Macau Bridge.
- Acceleration of development of Kai Tak as a green district.
- Reconsideration of a meaningful Hong Kong international business centre/ regional headquarters location brand that enunciates Hong Kong's strengths.
- Further development of Hong Kong as an Offshore Centre.
- Promotion of Hong Kong as a Centre of Innovation for industry, learning and benefitting from the experience of London.
- Support individual citizens (medical insurance / healthcare and implementation of minimum wage, review of MPF).
- Support SMEs (mitigating the impact of implementing minimum wage).

Education

The most critical concern, as regards to Hong Kong's competiveness and the Education sector, is the lack of spaces in International Schools for expatriate children, especially in pre-schools (reception) and primary schools. Particularly worryingly, the Chamber is increasingly aware of senior management from well-known corporations relocating to Singapore as a result of this problem. This will have an impact upon the decision of overseas multinational corporations to base their RHQ in Hong Kong (exacerbated by air quality issues). The Government should address this school places' problem on an urgent basis, possibly through the provision of further green field sites and, more immediately, by identifying redundant government schools or former military sites suitable for immediate conversion into International Schools.

Tax reform measures

In order to enhance Hong Kong's competitiveness as a RHQ, the Chamber suggests reduction in the current Profits Tax rate, to 15 %. Timely introduction of such measures will also enhance Hong Kong as a Global Financial Centre, and attract global talent through tax benefits.

The Inland Revenue Ordinance should be reviewed and amended to enable 'group relief', thereby offering tax benefits to groups.

The Chamber considers that it would be timely to introduce eco / 'green' environmental taxes. Monies raised should not be provided to general revenue, but fund environmental improvement initiatives to contribute towards a 'Green' Pearl River Delta.

Enhancing Hong Kong's regional competitiveness and role as a global financial centre

The past year has seen Hong Kong's main regional rivals – namely, Singapore and Shanghai – achieve impressive growth and development as financial services centres. In diversifying our economy, we must not rest on our laurels or neglect our traditional area of strength. To maintain our status as Asia's leading financial centre, the government must pursue a proactive policymaking approach.

For example:

- The urgent need to modernise the Companies Ordinance. Although there is a Companies Ordinance review underway, the Chamber wishes to see this urgently expedited and expanded to include consideration of the Companies Rescue Bill provisions.
- Despite previous statements of the aspiration to develop Hong Kong as a centre for Islamic finance, the necessary changes to Hong Kong's tax regime required to facilitate this have still not been made.
- If Hong Kong is to remain Asia's leading financial centre, the needs of the financial sector must be continually monitored and catered for, within reason. Hong Kong needs to ensure that sufficient office space is available to house these organisations, especially with increased competition and availability of such space from Singapore, and in future from Shanghai. The lack of suitable planned sites over the next 5-10 years could impact negatively upon Hong Kong.
- The Government and the banking sector should continue to work with the Chinese authorities to promote Hong Kong as a centre for RMB banking and as an offshore RMB Settlement Centre and international financial centre, serving as a bridge for money flow between China and the rest of the world.
- Encourage issue of Hong Kong RMB denominated bonds (for example a 50% or full reduction in Profits Tax on income from such bonds). Additionally, encourage the use of Hong Kong for internationalisation of the RMB as a trading currency, by permitting RMB Letters of Credit, and extending RMB banking beyond the 400 companies having RMB banking facilities in Hong Kong.
- When economies improve and the financial services businesses in different locations recover, competition for skills will increase. Hong Kong must ensure it is attractive as both a place to work and in which to establish businesses. We should seek to increase skills rather than allow a drain of expertise.
- Consideration should be given to other sectors in which Hong Kong could establish itself, which complement our role as a financial and professional services centre, such as a captive insurance centre. Bermuda dominates this sector, but Singapore is increasingly competitive. Introducing an insurance regulatory approach friendly to captives could be a first step. The Government would attract not only the captive insurance sector, but also prospectively reinsurance and mainstream insurance sectors, collectively generating significant employment and investment opportunities.
- In the field of Intellectual Property (IP), some groups are registering or re-registering their IP here, rather than in the EU, the traditional favourite. Expanding Hong Kong's Double Taxation Treaty network will encourage flows

of royalties and licence fees into Hong Kong. This function complements RHQ operations and Regional Holding company activities in Hong Kong.

Environment

Air quality remains an issue of great concern to the entire community and Chamber members and a significant challenge to Hong Kong's competiveness, its role as a global financial centre and RHQ location. The Government must urgently provide significant financial support to accelerate the air pollution mitigation proposals in the Air Quality Objective Review through allocation of government incentives, especially the urgent necessity to upgrade the bus and HGV fleets.

Hong Kong must also consider the present clement financial conditions and fiscal reserves to advance a major, prioritised, spending initiative on environmental and natural resource improvement and protection projects, to support the Green PRD initiative advanced at state level in China. This could be through the creation of a dedicated Environmental Improvement Programme fund. It is considered that to be meaningful and show real HKSARG commitment that the scale should be no less than the public works programme annual spending, (presently ~HK$50 billion per annum). This should be committed for the next five years to realise genuine improvements and create a momentum for change.

Specifically, it is considered that through this fund, HKSARG could urgently consider as a priority, dealing with a key component of the current air quality problem from locally derived air pollution via a one-off payment to all HGV owners, including bus fleets owners, to phase out old pre-Euro 5 vehicles and replace with Euro 5 vehicles. Such as initiative would yield immediate benefit to the community health of all Hong Kong citizens.

Enhancing local, regional and global superconnectivity

The Chamber has for the past two years been a strong advocate of 'superconnectivity' as a crucial element of Hong Kong's continued relevance, both to China and the wider world. Hong Kong must not falter in establishing an extensive, preeminent and truly world-class infrastructure network. In terms of our links with the Mainland, this would encompass a system of rail and road connections that guarantees seamless access to the hinterland, facilitating the free flow of goods and people. For global connectivity, we must ensure that the Hong Kong International Airport remains world-class, as the undisputed regional aviation hub through offering a level of capacity, service, range of global connections and a reputation for efficiency and courtesy surpassing all of its competitors.

Whilst fully in support of the ongoing 'Ten Mega Projects' and associated infrastructure as a cornerstone of Hong Kong's superconnectivity, the Chamber is concerned that spending on this tranche of projects gives the appearance of a 'one-off' stimulus. This investment should be viewed as a necessary 'catch up' in infrastructure investment to reverse ten years of under-investment, leading to a sustained period of spending at near-current levels, thereby securing our future competitiveness and superconnectivity in a rapidly changing world. The Government must urgently identify and earmark spending for the following decade's 'mega projects', to ensure Hong Kong has a world-class infrastructure and superconnectivity locally within Hong Kong, regionally through enhanced, rail-based, connections into the Greater Pearl River Delta and internationally through prioritised port and airport expansion.

The recent legal proceedings connected with the Hong Kong-Macau-Zhuhai Bridge Project are a welcome reminder of the advantages we enjoy in Hong Kong in a transparent legal process underpinned by respect for the complex and challenging environmental issues associated with development, particularly in the North Lantau region. The Chamber would hope that the Government bears in mind the significance of its obligations to the community, sustainability and the environment, in always ensuring that development plans are carefully vetted and subject to full transparency, consultation and scrutiny from the outset, to ensure efficient project delivery thereafter.

Specifically, the Chamber's business members fully understand the huge importance and enormous multiplier affect of the Hong Kong International Airport to the entire Hong Kong economy. For this reason, the Chamber considers that the HKSARG should immediately consider acceleration of the priority of HKIA expansion, in advance of the, Judicial Review-stalled, Hong Kong-Zhuhai-Macau Bridge.

Addressing the poverty/wealth gap

The Chamber supports the Government's measures to support low income groups and the unemployed, and commends the Chief Executive for giving community care issues prominence in his last Policy Address. Unfortunately, this is guarded praise as many of the measures proposed provide short-term relief, without tackling the root of issues so serious that they could jeopardise Hong Kong's future stability and prosperity. The United Nations Development Programme's Gini Coefficient Index highlights the gravity of the situation, which show that Hong Kong ranks very poorly amongst developed societies in terms of income equality.

In our last Chamber's Budget Submission, we focused on the problematic New Towns in the fight against poverty, with low employment and Mainland immigrant integration difficulties. The Chamber feels much more could be done to institute lasting solutions to such issues. Whilst measures such as the transport subsidy scheme provide some short-term relief to the unemployed living in remote areas, the Government's own admission is such measures do not encourage sustainable reductions in unemployment and poverty. The Chamber believes that further emphasis should be placed in the following areas:

- Introduce a concerted campaign to generate employment prospects in New Towns, by providing incentives such as rent reductions or subsidies to private businesses to relocate their operations to low income areas, backed up with funding for image enhancement campaigns.
- Complement investment in sustainable enterprises by introducing further incentives and conditions, which encourage entrepreneurs to consider establishing their operations in New Towns.

- Further relocation of public sector employment to the New Towns.
- Design and implement subsidy and benefit schemes at the district and sub-district level, rather than simply 'territory-wide', to maximise efficiency and ensure benefits reach the most needy, with particular focus on remote and problematic areas.
- Continued financial support of the one-stop employment and training centre in Tin Shui Wai to ensure its viability and effectiveness, alongside funding support for other centres in New Towns. Encourage private sector cooperation with government agencies to deliver high quality assessment and training services relevant to the needs of the labour market.

The Chamber understands that an important source of funding going forward will be the Community Care Fund, established in conjunction with Hong Kong's leading businessmen. The Government should be commended for attempting to tap the private sector's considerable resources in its fight against poverty in a swift and targeted fashion. However, the Chamber is concerned about the long-term viability of such initiatives, with their reliance on discretionary private sector funding, susceptible to oscillations in the fortunes of the local and global economy. In light of the hardships felt during the recent recession, especially by low-income workers in developed countries, this type of *ad hoc* funding structure must only complement, rather than substitute, proper social welfare paid for by long-term, regular expenditure from the Government.

Support to small and medium-sized enterprises (SMEs)

These remain challenging times for SMEs, for which cash flow is the single biggest concern. With the economic environment still uncertain for many SME, it remains difficult for SMEs to predict revenue. We suggest the following initiatives for the Government's consideration:

- Tax breaks for SMEs, suspending provisional tax and basing tax demands on actual profits for a tax year.
- Reduction in the percentage of tax imposed for companies with profits under a reasonable ceiling, in order to help SMEs to retain staff and reinvest in growing the business.
- A reintroduction of the Training Subsidy.
- Extension of the loan guarantee scheme, recalibrated along micro-finance principles and administered by a dedicated SME bank.
- Open up government bidding processes to allow SME consortiums to bid on projects in competition with (single) large companies.

Healthcare reform

The Chamber supports the Government's '*My Health My Choice*' Healthcare Reform Second Stage Consultation proposals and agrees that it should improve healthcare for the people of Hong Kong, give people a stake in their healthcare spending (with the hope of controlling costs) and bring more services and more competition into the Hong Kong Healthcare market, whilst curtailing the abuses of our system by our neighbours. However, the Chamber notes that the document concentrates on hospital care, and the Chamber is concerned that an important opportunity to reform primary care, which has a vital role in promotion of health, prevention of illness and control of costs, is being missed.

The Chamber notes also that *medical tourism* was promoted as an important element of healthcare within the 'Six Pillars' in the 2009 Policy Address, but medical tourism is hardly mentioned in the current consultation document.