

***A GST/VAT Can Be Made To Work  
Well In A Small Jurisdiction With  
Time: The New Zealand Experience***

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# Media Reporting & Public Debate

- **Time ripe for GST debate, says Tang Chester Yung**  
*11 July 2006*
- **FHKI has reservation on introducing GST in Hong Kong**  
*18 July 2006*
- **Institute advises keeping GST on the table**  
*China Daily, RTHK, and other media*  
March 2007



## City University hosts forum to promote discussion on GST



**Panel speakers for round table discussion: (from left) Professor Martin Painter, Professor Julia Tao, Professor Stephen Cheung, Mr Frederick Ma, and Professor Anthony Cheung, the moderator.**

# Overview of Presentation

- Introduction to seminar
- An overview of the GST proposal and debate
- An overview of the GST literature in NZ
- The NZ experience with introducing GST
- Lessons for HKSAR
- Concluding observations





# Introduction

- Proposal for a GST in HKSAR set out in a consultative document for debate during second half of 2006.
- Following the 2007 elections the new Government would, if the proposal was supported, then develop the details over the coming 2-3 years.
- HKSAR is perhaps an outlier in terms of its narrow tax base, has been encouraged by the IMF to undertake tax reform, and is facing increased competition from Singapore, which has a GST at 7% and company tax rate of 17%.
- The reaction was mainly one of opposition to the proposal, with very few organisations seeking to encourage genuine debate.
- Proposal was withdrawn prior to the expiry of the consultation period, with other possible reforms in the mix.

# The HKSAR GST Proposal

- What is a GST as compared to a VAT?
- What is meant by Valued Added?
- How does a GST/VAT differ to a sales tax?
- HKSAR proposal: broad base (almost no exemptions), low rate (possibly 5%), high registration threshold (\$HK5m), more like NZ than Australia/UK GST/VATs.
- No special treatment for food, education or healthcare but residential property exempt.
- Exports to be zero-rated along with financial services, with a Tourist Refund Scheme.
- Compensatory provision for low income earners to accompany GST.

# HKSAR GST - Survey Results

- Yeung (2010) claims:

“The result of the survey was *widely publicised and reported* by the media [in 2006]. It provided some references for the Government whether the GST was really needed and whether accountants supported the GST. *To a large extent, it caused the Government to set aside the GST consultation in September 2006 and suspend the implementation of the GST.*”

“The GST supporters felt that the GST was fair, broad-based, and consistent with the user-pays principle. The GST opponents expressed their concerns on the high administrative costs, unfairness to the poor, widening of the income distribution gap, impact on the business environment, tourism and consumption, weakening of Hong Kong’s competitiveness, and deterioration of the simple tax system.”

# HKSAR GST - Survey Results - 2

- Yeung' survey results were released prior to the HKICPA's (2006) survey of its members. Key findings:
- Most agreed a need to broaden the HKSAR tax base, but 59% opposed GST and 35% supported it. A wide range of alternatives were preferred by small minorities.
- 67% said GST had not been well explained, with 60% believing it would complicate HKSAR's tax system.
- In HKICPA's submission on the GST proposal (2007):  
“[T]here is no option that, by itself, would be better able than a GST to meet the objectives of broadening the tax base, reducing volatility in revenues, causing minimal economic distortions, achieving a substantial yield at relatively low rates of tax, ...”

# HKSAR GST - Survey Results - 3

“[I]f it is decided to put forward the GST option again in the future, then a good deal more information and explanation will need to be provided and various issues will need to be addressed, which have not been covered in the current proposals or not in sufficient depth to remove the considerable uncertainties that exist.”

- Cullen and Simmons (2008) suggest that the GST proposal was “buried” so as not to be an election issue. In the survey negative publicity was a major factor for the low level of support.
- Littlewood (2010) reviews the debate and earlier failed proposals for a consumption tax. In all cases the proposals were opposed by the business community.
- To be successful one needs a technically sound and politically acceptable approach.



# HKSAR GST commentary

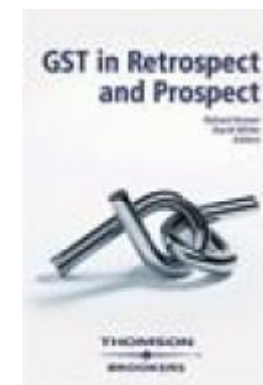
- Halkyard and Phua (2007) comment that the Government was not assured of legislative support when it initiated the proposal. In addition to the lack of public support the conditions were not right for introducing a GST.
- Wong (2011) comments in relation to the GST:  
“... looks to be the “least bad” option to enable Hong Kong to build a robust long-term taxation system for the long term. The GST has stood the test of time. ... One argument for a GST is that it makes good sense to introduce such a tax when there is little room for further increases in direct taxes on income. ... The option of a GST looks to provide the best way of buttressing the longer-term foundations for maintaining Hong Kong’s territorial source-based direct tax system.”

# New Zealand's GST

- Key event was the 1984 General Election with new Labour Government willing to make significant changes given NZ's precarious financial situation.
- Teixeira, Scott and Devlin (1996) review background, issue of White Paper, Advisory Committee and make comparison to UK.
- Quiggin (1998):  
“... the lack of popular support for a GST was not an obstacle to its implementation. The Labour government, with an outright majority in a unicameral Parliament, saw no need to seek national consensus before adopting a tax policy that had not been mentioned in its election campaign or to worry about compensating low-income earners.”
- Bollard (1992): reviews background, various minor consultation concessions, broad base, the wider tax reform package & distributional effects. One rate of 10% (some 0% & exemptions).

# New Zealand's GST - 2

- Stephens (1993) focuses on the distributional impact & change in tax burden.
- White (2006) comments:  
“ ... the design and implementation of this tax is still regarded as international best practice. Its basic design features remain unchanged.”
- In 2006 a Symposium was held to celebrate 20 years of the GST. Speakers included: Sir Roger Douglas (Finance Minister at time), Richard Green (Member of Advisory Panel), Jeff Todd (Director of GST Coordinating Office), and Ian Dickson (member of Treasury at time).



# New Zealand's GST - 3

- Douglas (2006) claims after the GST was implemented that:
  - it was supported by two out of every three New Zealanders within days of its introduction;
  - it ceased to be a political issue within six months of introduction;
  - it was an accepted part of the economic frameworks of New Zealand within months;
  - its introduction ran smoothly; and
  - twenty years later it remains fundamentally unchanged.
- Todd (2006) observed that you need a:

“... bold government with a strong mandate, committed to sound tax reform principles; a fair, simple, “clean” tax with minimal exemptions; a genuine commitment to public consultation; widespread dissatisfaction with the current tax system and a public reasonably willing to contemplate radical change; ...”

# New Zealand's GST - 4

- James and Alley (2008) observe that the choice of name (GST) was in part to distinguish from UK VAT. Period of consultation was also vital to successful implementation.
- Vial (2009) comments that the NZ GST is: “... an international benchmark for indirect tax design” and that it has the highest C-efficiency ratio in the OECD (at 93.5 percent) – the next closest come in at the mid 70 percent level. Tax Review 2001 refused to introduce exemptions or narrow the base. The rate increased to 12.5% in 1989 & for a second time, in 2010, to 15%.
- White (2009) comments on the supportive environment Roger Douglas was in when proposing & implementing the GST, & the consultative manner used with the commitment to a GST.
- Current Head of Treasury advocates for the NZ GST Model.



# Analysing NZ's Experience

- Key factors to the success: the financial situation at the time, the major driver was the Minister of Finance, & the need for major tax reform. Government was not concerned about political impact – willing to take ‘hit’ now for benefits downstream.
- Now have a MMP Government, not FPP – may make process more difficult with minority governments, but note major tax reform of 2010 was the largest in 25 years.
- Possibility of changes after 2014 if change in Government – several parties want exemptions, e.g. food.
- Contrast with Australia – Opposition lost election with original GST proposal; the 2000 GST was a political compromise.
- EU needs to look at NZ's approach – PWC (2012):

# Analysing NZ's Experience - 2

“... a carbon copy of the best-in-class consumption taxes model ... the broad-base/standard rate model we have here in New Zealand. ...

New Zealand's bold policy approach in the 1980s – of a broad base/(low) standard rate model – will be a golden lesson to others; and the New Zealand GST model will be at the forefront of study for European policymakers, which is a fascinating dimension. ...

Although the New Zealand model has proven to be successful here, the European law makers (and also businesses) will need to be convinced it can work for them.”

- While not perfect, the experience suggests that New Zealand's GST should be the blueprint for all other GST models. Is HKSAR different?



# Lessons for HKSAR

- Table 1: Comparative Analysis of GST Proposals: the HKSAR and NZ

Evaluation characteristic	HKSAR	New Zealand
Economic environment	Facing increased competition from Singapore, global financial crisis, narrow tax base	Economy in difficulty, heavy reliance on income tax creating a narrow tax base, a heavily regulated economy
Constitutional environment	Growing influence from PRC, historical resistance to tax reform	Parliamentary system with one House of Representatives
Political structure	Less influence of political parties; proposal to be decided by next government	Domination by two parties, under First Past the Post (FPP) system; proposal developed and implemented within parliamentary term. Now a Mixed Member Proportional (MMP) model
Role of consultation	Release of detailed papers and 9 months public consultation; 2-3 year period then to implement GST	White paper released, independent consultative committee, publicity committee and period to refine legislation – over 2 years
Publicity campaign	High profile through protests and debate by politicians; lack of coordinated effort	Independent committee to coordinate all aspects of development and implementation; little in way of opposition
‘Purity’ of GST	Relatively pure, drawing upon NZ model, but with more exemptions	Purist model of GST ever proposed, minimal exemptions
Reform package	Reduction in income tax, compensation packages for households, and areas of further public expenditure – revenue neutral approach	Extensive reduction in income tax rates, compensation packages for households – revenue neutral approach

# Lessons for HKSAR - 2

- Three key differences:
  1. Political commitment to the GST from the NZ politician with the greatest ability to influence the process, the Minister of Finance.
  2. Extent (and length of time) of consultation and publicity was facilitated by bodies' independent of the government, but made with strong backing of government and associated bureaucracy.
  3. Economic environment of the time; NZ was facing a much worse situation than the HKSAR, necessitating radical change for its survival. HKSAR facing pressure from rivals, e.g. Singapore. Moves towards a GST/VAT in PRC.
- Evidence of NZ success also its sustainability over 25 years, even with changes in rate & concepts. It has a C-efficiency rating of 93% from OECD – no other GST comes close; but less equity.

# Concluding Observations

- Implementing any form of tax reform is a balancing exercise that in part reflects: the political will of the government; the competing pressures facing the economy; and the level of planning and willingness to allow genuine public consultation in refining the policy and subsequent legislation.
- Both NZ & HKSAR are small open economies, so literature should similarly apply. However, political environment differs.
- Consultation approach is critical – HKSAR somewhat ‘timid’ and needed to do more with education and provision of information to public. The proposal based on the literature was essentially sound as a starting point.
- Should HKSAR look at a GST again it could do no better than examine NZ’s GST model and experience as a starting point.