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# PEOPLE'S REPUBLIC OF CHINA—HONG KONG SPECIAL ADMINISTRATIVE REGION

## SELECTED ISSUES

May 2026

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INTERNATIONAL MONETARY FUND

# PEOPLE'S REPUBLIC OF CHINA—HONG KONG SPECIAL ADMINISTRATIVE REGION

## SELECTED ISSUES

April 30, 2026

Approved By
**Asia and Pacific Department**

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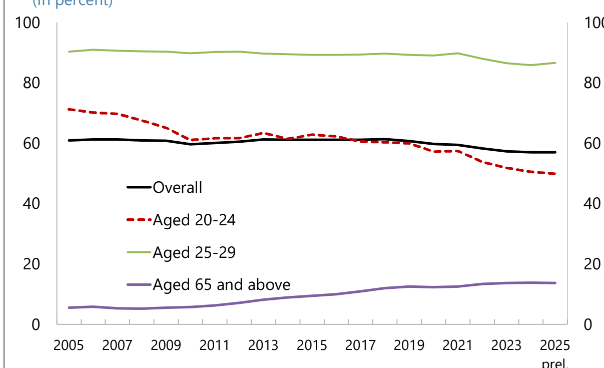
# DIAGNOSIS OF DECREASING LABOR FORCE PARTICIPATION IN HONG KONG SAR[1]

*Hong Kong SAR is facing a sustained decline in labor force participation rate (LFPR), which accelerated in recent years, driven mainly by population aging and further exacerbated by a drop in participation among youth. While the decline in youth LFPR was partly attributable to the mechanical effect of rising share of non-local students in Hong Kong SAR, it also points to postponed labor market entry among the youth which largely reflects continued education. The underlying motivations may suggest shifting job market landscape and labor skill requirements amid structural sectoral shifts, the emergence of artificial intelligence, and more intense labor market competition with increasing labor force educational attainment.*

## A. Introduction

**1. Hong Kong SAR is facing a sustained decline in its labor force participation rate (LFPR), a trend that has accelerated in recent years.** The territory's LFPR[2] fell from 61.1 percent in 2015 to approximately 56.9 percent in 2025, representing a contraction in labor market supply relative to the working-age population. The decline has been most pronounced among youth aged 20-24, particularly since 2021 (text chart), in sharp contrast to the rising LFPR observed across several other older age groups.

**Hong Kong SAR: Labor Force Participation Rate**
(In percent)




Sources: HKCSD; and IMF staff calculations.

**2. The secular decline in Hong Kong SAR's LFPR reflects two key factors: population aging and falling youth labor force participation.** As highlighted in the [2024 Hong Kong SAR Article IV Consultation](), population aging continues to exert downward pressure on labor force participation, mainly through the extensive margin. For instance, the population share of older cohort (aged 65 and above), who typically exhibit the lowest LFPR, has risen steadily from 15.6 percent in 2015 to 24.2 percent in end-2025. Meanwhile, the LFPR of the 65 and above age group rose from 9.4 percent in 2015 to 13.5 percent in 2025 (text chart), in part due to healthy aging and longer working lives. However, it remains well below the levels of the younger cohorts, resulting in negative contribution to the overall LFPR. In addition, an increasing share of the youth cohort has

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[1] Prepared by Narayanan Raman, Hamid Reza Tabarraei, Yizhi Xu, and Ruihua Yang (all from the IMF) and Ceara Hui, Zhang Wu, and Stella Tam (all from the HKMA).

[2] Refers to the LFPR for all workers in Hong Kong SAR, including foreign domestic workers. The more expansive definition was used to facilitate cross-economy comparisons later in this chapter. That said, using the LFPR for the workforce excluding foreign domestic workers leaves the subsequent analysis largely unchanged.

opted to remain outside the labor force in recent years, weighing on the aggregate LFPR through the intensive margin. The trend of declining youth participation raises important questions about the underlying drivers as well as implications for future labor market policies-- the focus of this note.

**3. This Selected Issues Paper addresses the following three sets of key questions with a focus on youth labor force participation, while recognizing population aging as the main driver of the decline in LFPR:**

- **What are the stylized facts about Hong Kong SAR's labor market?** What are structural trends and cyclical patterns in labor force, employment and LFPR (Section B)?
- **What are the main compositional drivers of Hong Kong SAR's declining LFPR?** Specifically, how much of the decline can be attributed to population aging versus falling youth labor force participation (Section C)? How does Hong Kong SAR's decomposition of LFPR changes compare to peer economies?
- **What factors explain the recent decline in youth participation (Section D)?** What are the structural drivers—such as economic structure transformation, higher labor market educational attainment, and technological change—that contribute to the decline of youth LFPR? Does rising re-education among youth reflect adaptation to evolving skill demands amid the emergence of artificial intelligence and other technological disruptions?

**4. The paper highlights the role of demographic trends, youth education choices, and structural labor market shifts in shaping labor force participation outcomes in Hong Kong SAR.**[3] The shift-share analysis of the compositional changes in LFPR shows that population aging remains the primary driver of the decline in aggregate LFPR, while the recent fall in youth LFPR also made a contribution to the decline in aggregate LFPR, distinguishing Hong Kong SAR from some peer economies. In addition, household surveys and labor market data show that continued education is the main driver of the decline in youth LFPR, shedding light on the underlying motivations for extended training including sectoral structural shifts and evolving labor skill requirements, emergence of AI, and possibly rising labor market competitiveness arising from higher educational attainment. The paper concludes with policy implications.

---

[3] The decline in labor force participation is widely viewed in literature as structural, driven primarily by population aging and shifts in cohort-specific behavior. Evidence for advanced economies suggests that aging and longer-term forces, such as technological change, health and disability, and changing attachment patterns, explain most of the post-2000 decline in total LFPR, with cyclical factors playing a more limited role (Grigoli et al., 2021; Pérez Arce and Prados, 2021). However, recent studies highlight prolonged cyclical responses among younger workers in the U.S. following major shocks (Cajner et al., 2021).

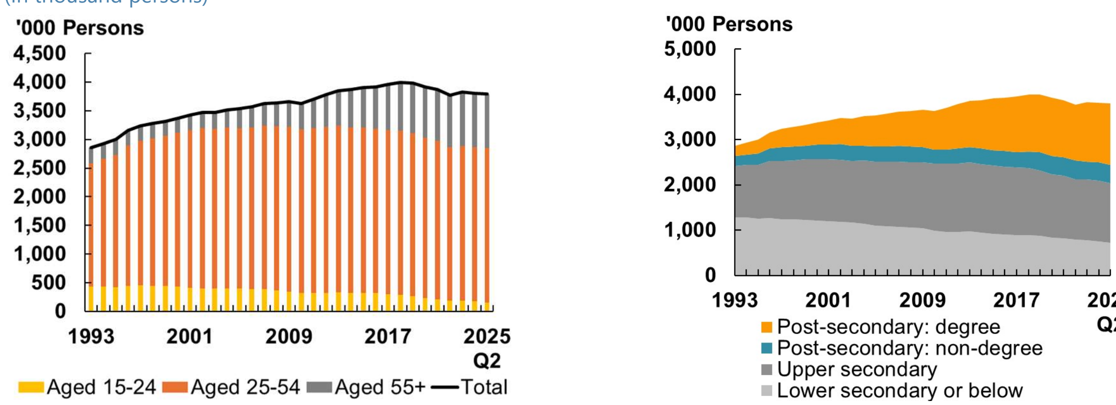
## B. Stylized Facts of Hong Kong SAR's Labor Market

### Structural and Cyclical Trends in the Labor Market

**5. Over the past three decades, Hong Kong SAR's labor force has undergone significant structural transformation.** The share of older workers (aged 55 and above) has almost doubled, rising from 13 percent in 2010 to 25 percent in 2025Q2, while the proportions of youth (aged 15–24) and prime-aged workers (aged 25–54) have declined (Text Figure 1, panel 1). Meanwhile, the workforce has become increasingly well-educated. The share of individuals with post-secondary education attainment (degree or above) increased markedly from 24 percent in 2010 to 36 percent in 2025Q2 (Text Figure 1, panel 2). This upward trend is particularly pronounced among youth (aged 15–24), for whom the proportion with post-secondary education doubled, from 25 percent in 2010 to 52 percent in 2025Q2, reflecting a strong shift toward higher educational attainment.

**Text Figure 1. Hong Kong SAR: Structural Trends of Labor Force**

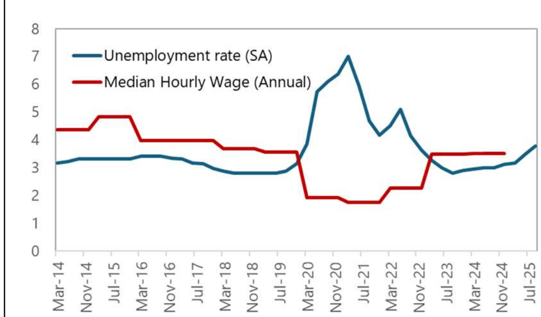
**Labor Force by Age** (In thousand persons) | **Labor Force by Education Attainment** (In thousand persons)




Sources: C&SD; and IMF and HKMA staff calculations.
Note: Labor force includes foreign domestic helpers.

**6. Cyclical indicators point to a recovery in labor market conditions from the pandemic trough, although the rebound has been uneven across population groups.** The unemployment rate declined to below 4 percent following the COVID reopening, down from a peak of 7 percent in 2021Q1. Hourly wage growth has also strengthened, rising to above 3 percent year-on-year compared from a trough of 0.9 percent during the pandemic peak. Despite these improvements, pressures persist for specific segments of the labor force. Notably, the unemployment rate among individuals with high

**Hong Kong SAR: Cyclical Labor Market Indicators**
(Percent)

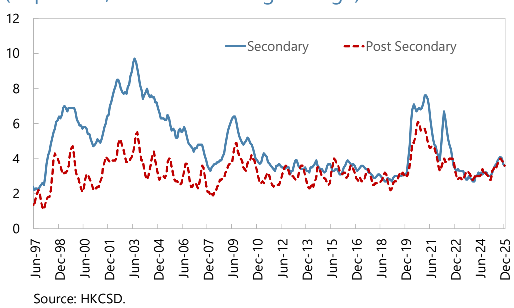



Sources; C&SD; and IMF staff calculations.

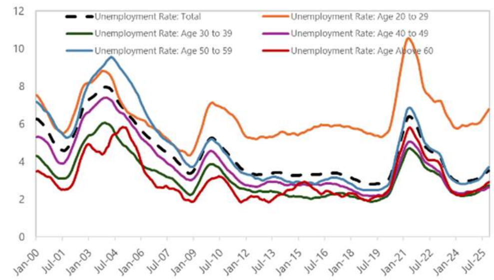
educational attainment (i.e., those with post-secondary qualifications) has trended upward over time, recently converging with that of workers with lower educational attainment (Text Figure 2, panel 1). This may indicate increased competition and some potential mismatch between worker skills and job demands in the labor market. Moreover, the youth unemployment rate has diverged markedly from other age groups over the past decade, with the gap widening further in recent years (Text Figure 2, panel 2).

**Text Figure 2. Hong Kong SAR: Breakdowns of Unemployment**

**Unemployment Rate by Educational Attainment**
(In percent, 3-month moving average)




**Unemployment Rate by Age Groups**
(Percent; 12-month moving average)



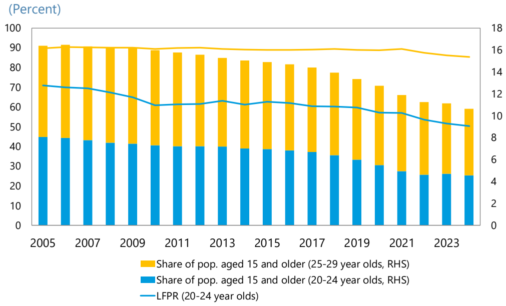

Sources: CEIC; C&SD; and IMF staff calculations.

### Compositional Shifts in the Labor Force Participation Rate

7. **The shifting demographic structure has played a significant role in shaping Hong Kong SAR's LFPR.** The youth cohort has seen its population share and participation rate decline steadily over the past two decades (Text Figure 3, panel 1). In particular, the LFPR for those aged 20–24 fell from above 70 percent in 2005 to slightly below 50 percent in recent years, while their share in the total population also contracted, amplifying the downward pressure on aggregate LFPR. In contrast, the share of older individuals (aged 65 and above) has more than doubled since 2005, rising from around 14 percent of the population aged 15 and above to over 26 percent of this population (Text Figure 3, panel 2). Although the participation rate among seniors has increased gradually, it remains low relative to other age groups, suggesting that demographic aging will continue to weigh on overall LFPR.

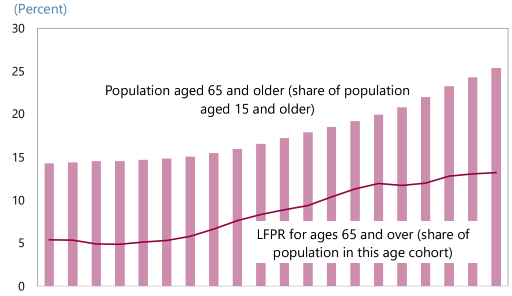
**Text Figure 3. Hong Kong SAR: Labor Force Participation Rate by Age**

**Youth LFPR and Population Share**
(Percent)




Sources: Hong Kong SAR Census and Statistics Department, staff's calculations.

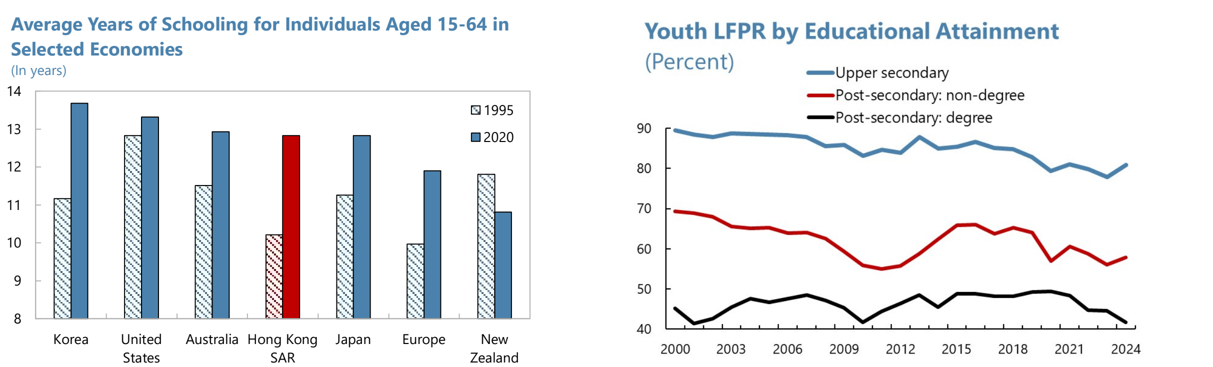
**Senior LFPR and Population Share**
(Percent)




Sources: Hong Kong SAR Census and Statistics Department, staff's calculations.

**8. Longer schooling to achieve higher educational attainment and adapt to evolving skill demands appears to be a key factor behind the decline in youth labor force participation in Hong Kong SAR.** As a result of extended years of free education provision (from 9 years to 12 years) and increased opportunity for post-secondary education, average years of schooling increased significantly since the 1990s, with the magnitude of the rise exceeding that in most peer advanced economies (Text Figure 4, panel 1). Participation rates have fallen across all education groups among the youth over the past decades, with the decline particularly pronounced among those with secondary or non-degree post-secondary educational attainment during 2000-20, whose LFPR fell by almost 10 percentage points (Text Figure 4, panel 2). More recently, youth LFPR for those with post-secondary educational attainment started to decline. These shifting patterns reflect an increasing share of youth enrolled in post-secondary education and may have the incentives toward further postgraduate degree education in order to adapt to evolving labor market skill demand. This could lead to delays in their labor market entry.

**Text Figure 4. Hong Kong SAR: Education and LFPR**



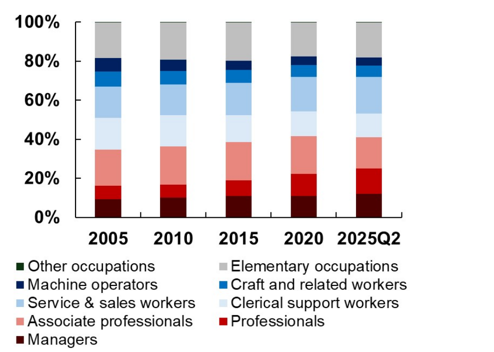

Sources: Barro and Lee (2015); Lee and Lee (2016); and Our World in Data.

Sources: C&SD; IMF and HKMA staff calculations.

**9. Consistent with this interpretation, the share of high-skill professional occupations has increased over the past decade, suggesting a rising demand for labor with higher educational attainment and more comprehensive skill requirement.** The share of employed workers in manager, professional and associate professional roles has risen since 2005, while employment in elementary occupations and clerical support roles has declined (text chart). This structural shift implies that job seekers, particularly the youth, may increasingly perceive additional education as necessary to remain competitive in a labor market that is moving toward higher-skill, higher-qualification jobs.

**Hong Kong SAR: Total Employment by Occupation**

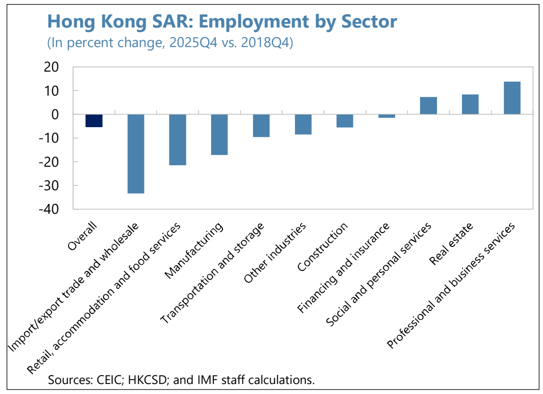
(Percent)




Sources: C&SD; HKMA and IMF staff calculations.

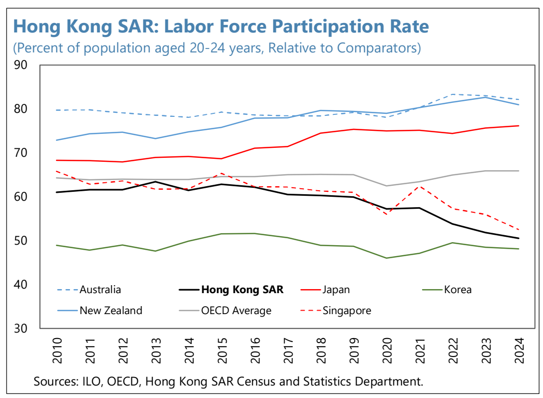
Note: Data on employment by occupation across years were compiled based on slightly different classification schemes. Specifically, data for 1993–2010 follow ISCO-88, data for 2011–2015 follow the old ISCO-08 framework, and data from 2016 onwards follow the new ISCO-08.

**10. Recent sectoral shifts in employment highlight Hong Kong SAR's continued transition toward a services-oriented economy centered on financial and business services.** Employment has expanded in professional services and real estate (text chart). In contrast, traditional sectors, including manufacturing, trade and wholesale, retails, and accommodation and food services, have recorded substantial declines in employment since 2018. These sectoral shifts are also reflected in youth employment patterns, as discussed in Section D, with finance and other professional service sectors accounting for a growing share of youth employment. This structural reallocation underscores Hong Kong SAR's role as a regional hub for financial and business services and reflects the ongoing economic transition in the context of the Greater Bay Area integration.




### Cross-Economy Comparison

**11. Hong Kong SAR is not unique in facing low and decreasing youth labor force participation.** While Hong Kong SAR differs from OECD average in both the level and trend of LFPR, similar pressures are found in two regional peers—Korea and Singapore. In Korea, while relatively stable, youth LFPR has remained significantly below that of other advanced economies, as a large share of youth postpones their careers in order to land jobs in large firms or professional jobs (see 2024 Korea Article IV Consultation). A downward trend has been observed in Singapore, where education-related delays in labor market entry have contributed to falling youth LFPR (MAS, 2024). Against this backdrop, a cross-economy comparison provides useful context and helps identify potential policy lessons for Hong Kong SAR.




## C. Shift-Share Analysis

**12. To assess the relative importance of declining youth labor force participation versus population aging, changes in the LFPR are decomposed into contributions from demographic shifts and within-group changes in participation rates.** As shown above, factors such as age cohort composition and within-cohort LFPR trends can exert offsetting effects on the aggregate LFPR. For instance, although elder age LFPR has increased from a low base, it remains below the overall LFPR. Consequently, a rising elderly share tends to weigh on the aggregate LFPR. Similarly, with high albeit falling youth LFPR, the declining youth share could result in lower aggregate LFPR. A shift-share analysis (SSA) helps disentangle these potentially offsetting forces and clarify their respective contributions to observed change in the LFPR. This approach has been widely applied not only in labor market analyses (e.g., Cheung, 2024; Grigoli, Koczan, and Topalova, 2018) but also in studies of shifts in trade patterns and productivity growth (IMF, 2024; Novta, Xu, and Zymek, 2024).

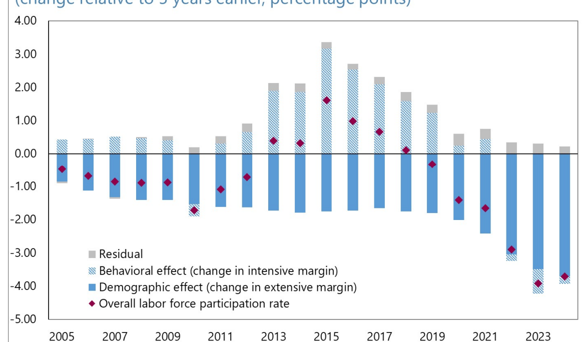
**13. Specifically, the SSA quantifies the impact of demographics by holding cohort level LFPRs constant (the extensive margin) and impact of behavioral changes by holding demographic factors constant (the intensive margin)**. Formally, the change in the LFPR is expressed as the following:

$$\Delta \mathrm{LFPR}_{\mathrm{overall,t}} = \sum_{\mathrm{i}} \mathrm{S}_{\mathrm{i,t-b}} \times \Delta \mathrm{LFPR}_{\mathrm{i,t}} + \sum_{\mathrm{i}} \Delta \mathrm{S}_{\mathrm{i,t}} \times \mathrm{LFPR}_{\mathrm{i,t-b}} + Residual_t$$

where $S_{i,t}$ is the population share of the i[th] age group in the population at time *t* such that $\sum_i S_i = 1$ and *b* is the base period relative to which the changes are being examined. The groups are mutually exclusive and exhaustive, which allows us to further break down the extensive and intensive margin contributions by each age cohort. The analysis examined the population aged 15 and above, breaking them down into 10 five-year cohorts from ages 15-19 through 60-64, with a final cohort for those aged 65 and above. Further, as year-on-year changes in LFPR data may be impacted by short-term cyclical fluctuations, the analysis focuses on changes over the medium term, proxied by the change in each year relative to 5 years earlier (i.e., *b* = 5). Data are taken from the mid-year population statistics and LFPR data published by the Hong Kong SAR Census and Statistics Department (C&SD).

**14. The SSA confirms that both demographic and behavioral shifts have contributed to the decline in the LFPR, with demographic shifts accounting for the bulk of the adjustment.** The largest contribution comes from demographic changes, both a decline in the number of younger workers (aged 15 to 59 years) and an increase in the population aged 60 and above, reflecting the aging population. The behavioral component of the decline has played a more limited but negative role: of the 3.7 percentage point decline in the LFPR in 2024 relative to 2020, about 0.22 pp was due to behavioral changes.

**Hong Kong SAR: Decomposition of Change in LFPR**
(change relative to 5 years earlier, percentage points)



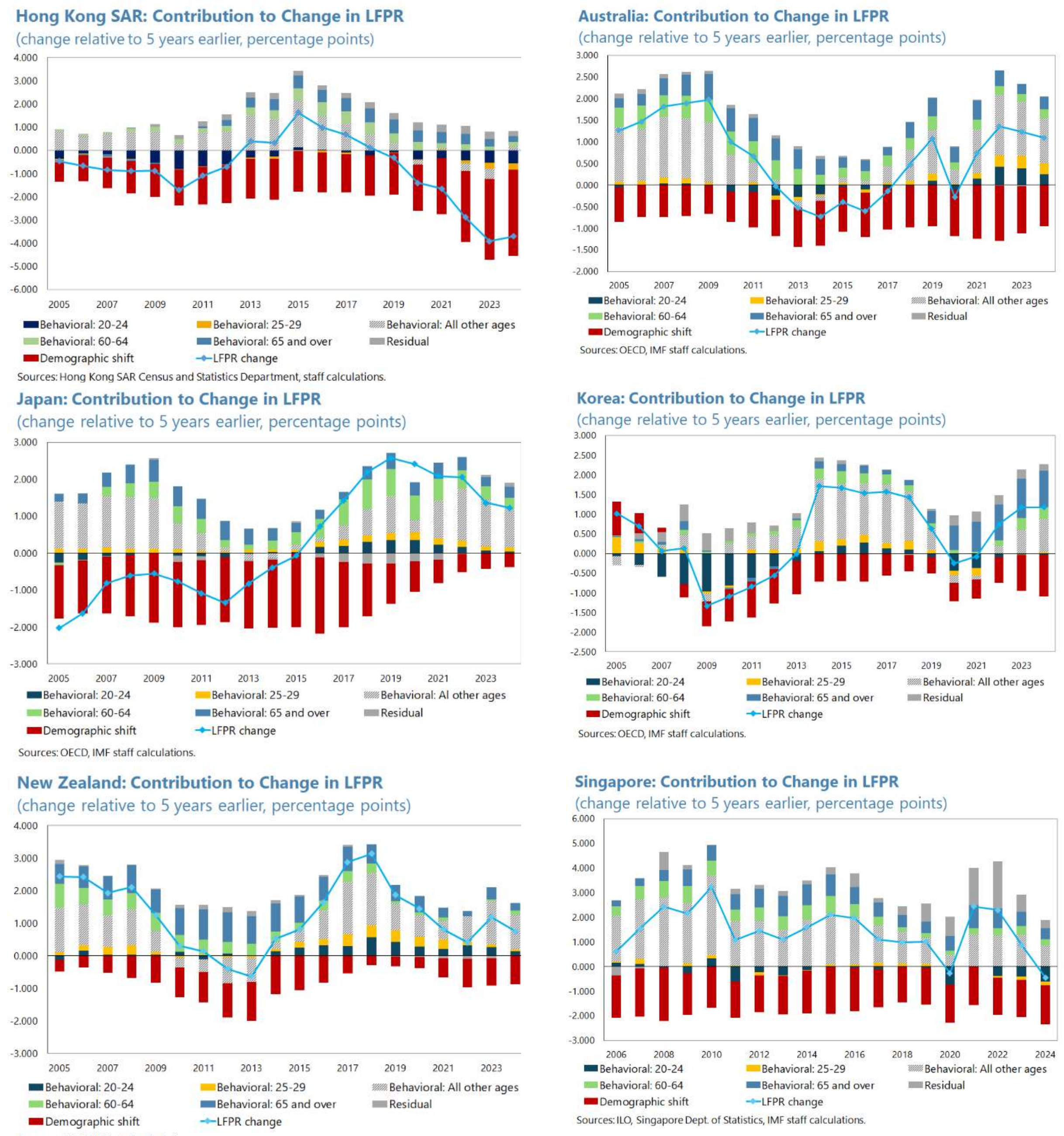

Sources: Hong Kong SAR Census and Statistics Department, staff's calculations.

**15. The modest behavioral contribution reflects offsetting LFPR trends across age groups, with the recent decline in youth participation slightly outweighing gains among older cohorts.** Behavioral changes impacting the aggregate LFPR primarily reflect changing willingness of both younger and older adults to remain engaged in the labor force. To simplify the presentation, age cohorts are aggregated into 5 groups: 20-24 year olds; 25-29 year olds; 60-64 year olds; 65 and above; and all other age groups covering the 15-19 and 30-59 age cohorts. This more granular decomposition analysis suggests two key findings:

- The single most significant factor impacting the decline in the aggregate LFPR is the demographic impact of falling share of younger cohorts, particularly adults in their 20s. As younger cohorts tend to have higher levels of LFPR, the shrinking population share of these age groups exerts downward pressure on overall LFPR.

- Cohort-level participation behavior has diverged markedly across age groups: older workers have become more willing to remain in the labor force. However, participation among younger cohorts has declined. In particular, there has been a significant decline in the LFPR in the 20-24 age cohort, which was the most significant behavioral contributor to the lower overall LFPR, accounting for 0.56 pp of the overall 3.71 pp decline over 2020-2024. In contrast, the significant increase in the LFPR of older workers exerted an opposite impact on the overall LFPR, mitigating the impact of lower LFPR among younger workers and the demographic shift. Indeed, the higher LFPR for workers in the 65 and over offset nearly half the contribution from the behavioral shift among workers aged 20-24.

## Figure 1. Shift-Share Analysis in Selected Economies



**16. Hong Kong SAR's experience differs from that of most regional peers, particularly with respect to labor force participation among younger adults.** Replicating the SSA for other advanced economies in the Asia-Pacific region (Australia, Japan, Korea, New Zealand and Singapore) shows that Hong Kong SAR's experience stands out relative to most of this group, with the exception of Singapore,[4] and to a lesser extent Korea. For all economies, the demographic impact of aging reduces overall LFPR. However, in many economies, this is offset by increases in the LFPR for both younger and older workers. For instance, in Australia, Japan and New Zealand, the increase in the LFPR for workers aged 20-24 accounted for between one-twentieth to nearly a quarter of the increase in the overall LFPR in 2024. In Korea, while youth participation declined, its contribution on the overall LFPR was marginal, and the overall LFPR nonetheless rose by 1.2 pp in 2024. In contrast, Singapore stood out as the only jurisdiction, along with Hong Kong SAR, where the overall LFPR declined in 2024. In 2024, the overall LFPR for Singapore declined by 0.46 pp relative to 2020, while the negative contribution from declining participation among young adults exceeded this decline, at 0.61 percentage points. This pattern likely reflects a decline in the LFPR of younger workers following the unwinding of a temporary pandemic-era boost to youth labor force participation, in particular women, who had delayed returning to education during the pandemic lockdown. However, with the normalization of conditions, younger workers fell below their pre-pandemic LFPR (MAS, 2024).

## D. Drivers of Declining Youth Labor Force Participation

**17. The declining youth participation in labor force appears to be largely driven by delayed entry into the labor force associated with continued education.** According to the General Household Survey conducted by the C&SD, 90 percent of economically inactive labor force aged 20–24 cited "attending an educational institution" as the main reason for not participating in the labor market in 2024 (Figure 2, panel 1).[5] This share is notably higher than in 2020 (85.7 percent) and exceeds the pre-pandemic average of 86.9 percent over 2000-2019 (Figure 2, panel 2). This upward trend has been mostly driven by economically inactive females (Figure 2, panel 3) and is consistent with the growing share of youth enrolled in full-time education (Figure 2, panel 4), suggesting that education-related decisions are playing an increasingly important role in aggregate youth labor supply, particularly among the female group.

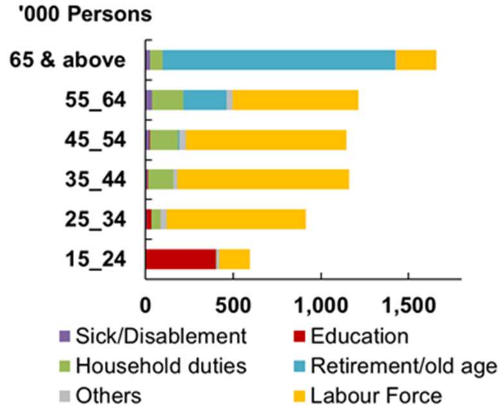
[4] Note that the data for Singapore is drawn from the national authorities and International Labor Organization, whereas for the other economies, data was sourced from the Organization for Economic Development. This may potentially drive the relatively large residuals observed in the SSA for Singapore relative to the other economies.

[5] According to the C&SD, economically inactive population are the ones who are part of the working-age population but are not participating in the labor force.

## Figure 2. Hong Kong SAR: Distribution of Working-Age Population

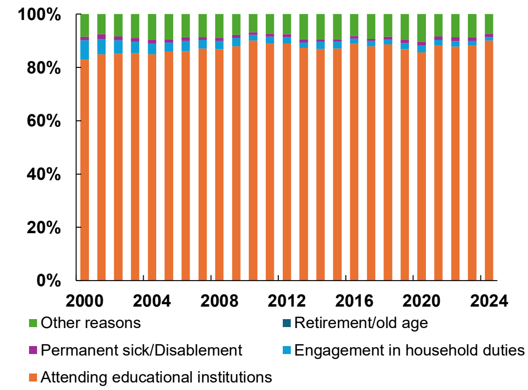
**Distribution of Working-Age Population by Age**

(Thousand; 2024)



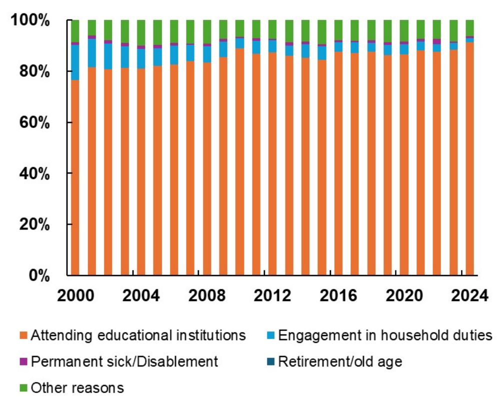

**Economically Inactive Persons by Reason**

(Percent of total inactive persons; aged 20-24)



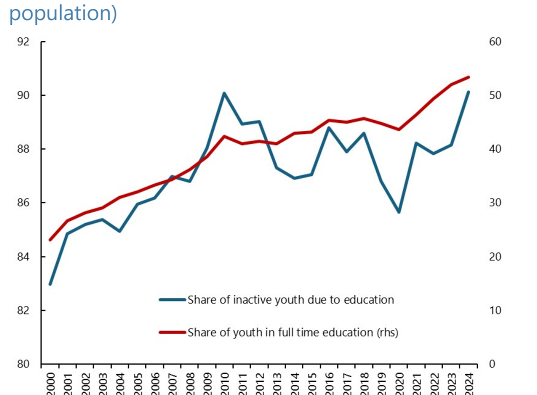

**Economically Inactive Female by Reason**

(Percent of total inactive persons; aged 20-24; female)




**Share of Youth Aged 20-24 Receiving Education**

(LHS: percent of inactive youth; RHS: percent of youth population)

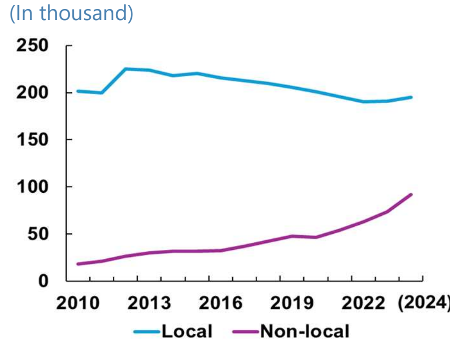



Sources: Census and Statistics Department (C&SD) General Household Survey, IMF and HKMA staff calculations.

18. **Besides the incentive for further education, the rising share of non-local students in Hong Kong SAR has also mechanically lowered the LFPR among youth.** The rapid increase in the share of non-local student enrollments in Hong Kong SAR's post-secondary programs (text chart), driven by the authorities' efforts to position Hong Kong SAR as an international education hub and attract global talents since early 2010s, has expanded the working-age population with individuals who typically do not participate in the labor market, thereby mechanically lowering the LFPR.

**Hong Kong SAR: Total Post-Secondary Program Enrollments**

(In thousand)




Sources: Hong Kong Education Bureau; and IMF and HKMA staff calculations.

**19. The rest of the section unpacks and discusses several potential factors that may influence youths' decisions to pursue further education and postpone entry into the labor force.** These factors include sectoral structural shifts, rising educational attainment in the labor market, changing labor skill requirement, and the emergence of AI.

**Sectoral Structural Shifts and Evolving Labor Skill Requirement**

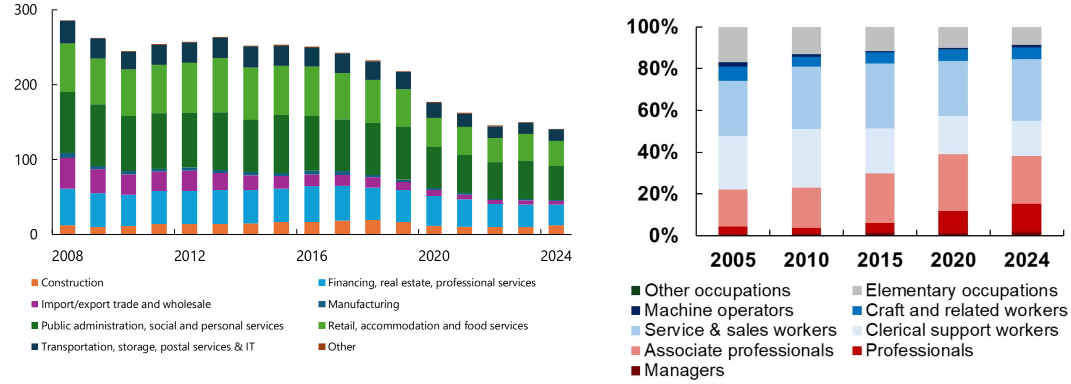
**20. The ongoing structural shifts in Hong Kong SAR's economy have altered labor demand and the skill composition of employment, further encouraging youth to pursue additional education and training.** As part of the efforts to deepen the integration with the Greater Bay Area (GBA), some traditional sectors, particularly retail and consumer services, have increasingly expanded and relocated activity to neighboring cities such as Shenzhen, contributing to changes in the territory's sectoral composition. At the same time, employment share has been rising in high-value sectors, including financial and professional services. These developments are reshaping the skill requirements of the labor market and reinforcing incentives for youth to upgrade qualifications in order to remain competitive.

**21. Consistent with these structural trends youth employment in Hong Kong SAR has contracted markedly over the past decade, with the decline concentrated mostly on traditional sectors and low skill occupations.** As shown in Text Figure 5 panel 1, total youth employment has fallen steadily since the late 2000s and accelerated since the pandemic, possibly reflecting both weaker youth labor supply and softer demand. The contraction is most pronounced in retail, accommodation, and food services sectors, which have historically been the largest employer of youth, amid the pandemic outbreak during 2020 to 2023, ongoing structural transformation, rising regional competition, and changing consumption patterns. Meanwhile, youth employment in finance and professional-related sectors has remained relatively stable although the employment is small in scale. In addition, the occupational distribution of youth employment has shifted away from lower-skill jobs (Text Figure 5, panel 2). The share of craft and related workers, services and sales workers, and clerical support workers, have shrunk over the past decade. The broad-based deterioration in labor market prospects for low-skill youth in traditional sectors underscores the increasing importance of skills upgrading and continued education as pathways to labor market entry in an economy transitioning toward higher-value activities.

**Text Figure 5. Hong Kong SAR: Compositions of Youth Employment**

**Employment of Youth Aged 20-24 by Sectors**
(In thousand)

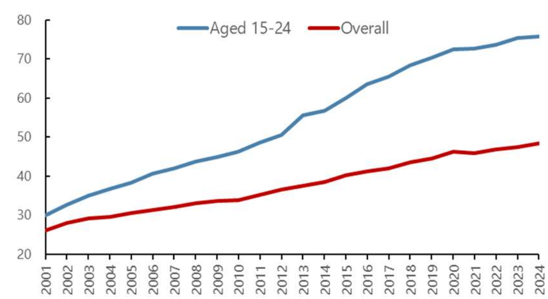
**Youth Employment by Occupation**
(Percent of total youth employment)




Sources: CEIC; C&SD; and IMF and HKMA staff calculations.

## Increasing Labor Market Competition and Educational Attainment

**Hong Kong SAR: Share of Employed Workers with Post-Secondary Educational Attainment**
(Percent)




Sources: C&SD; IMF and HKMA staff calculations.

**22. Higher educational attainment especially among the youth, could be an important factor behind delayed entry into the labor force.** The General Household Survey shows that continued education is the main reason for the delayed labor force entry. Meanwhile, educational attainment of employed workers has been rising, particularly within the youth cohort (text chart), indicating increasing job market competition and shifting job market landscape that youth may face amid the transformation of economic structure. Against this backdrop, the central hypothesis examined is that a more educated workforce encourages youth to invest further in education to meet the evolving skill requirement while the economic structure shifts and thereby delay entry into the labor force.

**23. A cohort-based regression is estimated to gauge the extent to which competition in the labor market has contributed to the recent decline in youth LFPR.** The exercise distinguishes age fixed effects (i.e., labor market attachment over the life cycle), cohort fixed effects (i.e., systematic differences across birth cohorts), as well as cyclical and structural indicators. Following the approach of Balleer et al. (2009), the model is expressed as follows:

$$log\frac{LFPR_{g,t}}{1-LFPR_{g,t}} = \alpha_g + \sum_{b=1976}^{2004} C_{g,b,t}\beta_b + \lambda_g X_t + \varepsilon_{g,t}$$

where $g$ indexes five-year age groups ranging from 15–19 to 45-49,[1] $t$ denotes year, and $b$ is birth year. The dummy indicator $c_{g,b,t}$ is equal to 1 when cohort $b$ is observed as age group $g$ in year $t$. The vector $X_t$ includes controls capturing the business cycle (output gap, contemporaneous and two lags), fertility (total fertility rate)[2]. Importantly, educational attainment—measured as the share of employed persons aged 25 and above who have ever attained a post-secondary degree—is included in the model[3] to assess if a more educated labor force tends to create an incentive for younger individuals to invest in further education, enhancing their competitiveness in the labor market.[4] For each gender, a system of seemingly unrelated regressions for seven age groups with the constraint of identical cohort effects across equations is estimated simultaneously. Data on output gap is estimated by the Hong Kong Monetary Authority (HKMA)[5], while other data are sourced from the General Household Survey and the Demographics Statistics Section of the C&SD.[6]

**24. Regression results indicate that higher educational attainment among the youth labor force is negatively associated with the likelihood of youth entering the labor force.** A one-percentage-point increase in the share of workers aged 25 and above that have ever attained a post-secondary degree is associated with the decline in the relative likelihood of entering the labor force for the 20-25 age group by about 5 basis points for both males and females. This is consistent with the narrative that suggests that the education level of the labor market may have affected youth population's education and participation decisions (Text Figure 6, panel 1). The impact of the labor force's education level differs between gender in the 25-30 age group, possibly reflecting differences in household duties and fertility-related considerations among women. Counterfactual exercises further underscore the role of education. Holding educational attainment at its 2010–2021 average from 2022 onward implies that LFPR among the 20-24 age group during 2022–2024 would have been, on average, 5.7 percentage points higher for both males and females (Text Figure 6, panel 2). These results confirm that rising educational attainment has been an important driver for the recent decline in youth labor force participation.

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[1] Given the constraint on degrees of freedom and the focus on younger generations, the model covers only cohorts born between 1976 and 2004, corresponding to seven 5-year age groups covering individuals aged 15 to 49.

[2] The total fertility rate is included only as a control variable in the model for females aged 20 to 39, the ages during which fertility is most likely to occur.

[3] Educational attainment is included only in the equations for three most junior age groups (i.e. 15-19, 20-24 and 25-29), as these age groups are more likely to face a choice between full-time education and labor force participation.

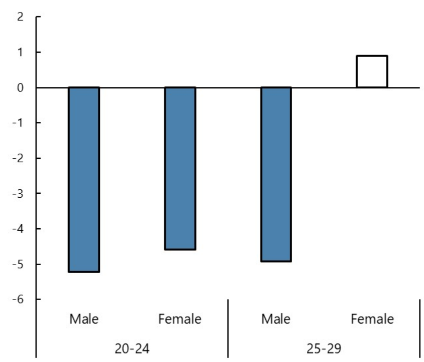
[4] That said, it is also acknowledged that the higher educational attainment ratio may be driven not only by an individual's incentive to increase his/her competitiveness in the market, but also by factors such as structural changes in industry sectors, rising educational requirements for desirable positions, and easier access to post-secondary degree program.

[5] The output gap is estimated by the HKMA based on four methods, namely (1) the production function approach; (2) the Hodrick-Prescott filter; (3) the Kalman filter; and (4) the IMF multivariate filter. For details, refer to Cheng, M., L. Chung and I. Yu (2011), "On the Estimation of the Output Gap of Hong Kong", HKMA Occasional Paper 03/2011.

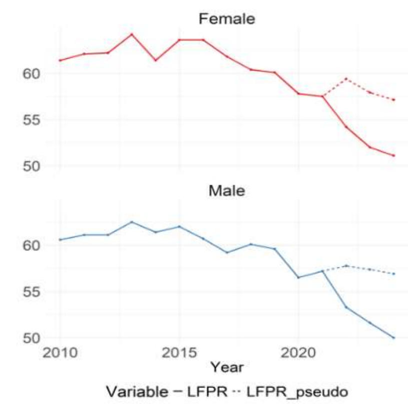
[6] While the LFPRs including foreign domestic helpers are used in the cohort-based analysis, the results are little changed if foreign domestic helpers are excluded from the LFPR calculation.

### Text Figure 6. Hong Kong SAR: Role of Labor Market Competition on Youth LFPR

**Estimated Educational Attainment Effect on Likelihood of Youth Joining the Labor Force**
(with a 1 percentage point increase in labor force post-secondary degree share)




**Estimated Counterfactual Analysis on Youth LFPR**
(Percent; aged 20-24)




Sources: C&SD; HKMA and IMF staff calculations.
Note: Blue bars denote coefficients significant at the 5% level; white bars denote coefficients that are insignificant at that level.

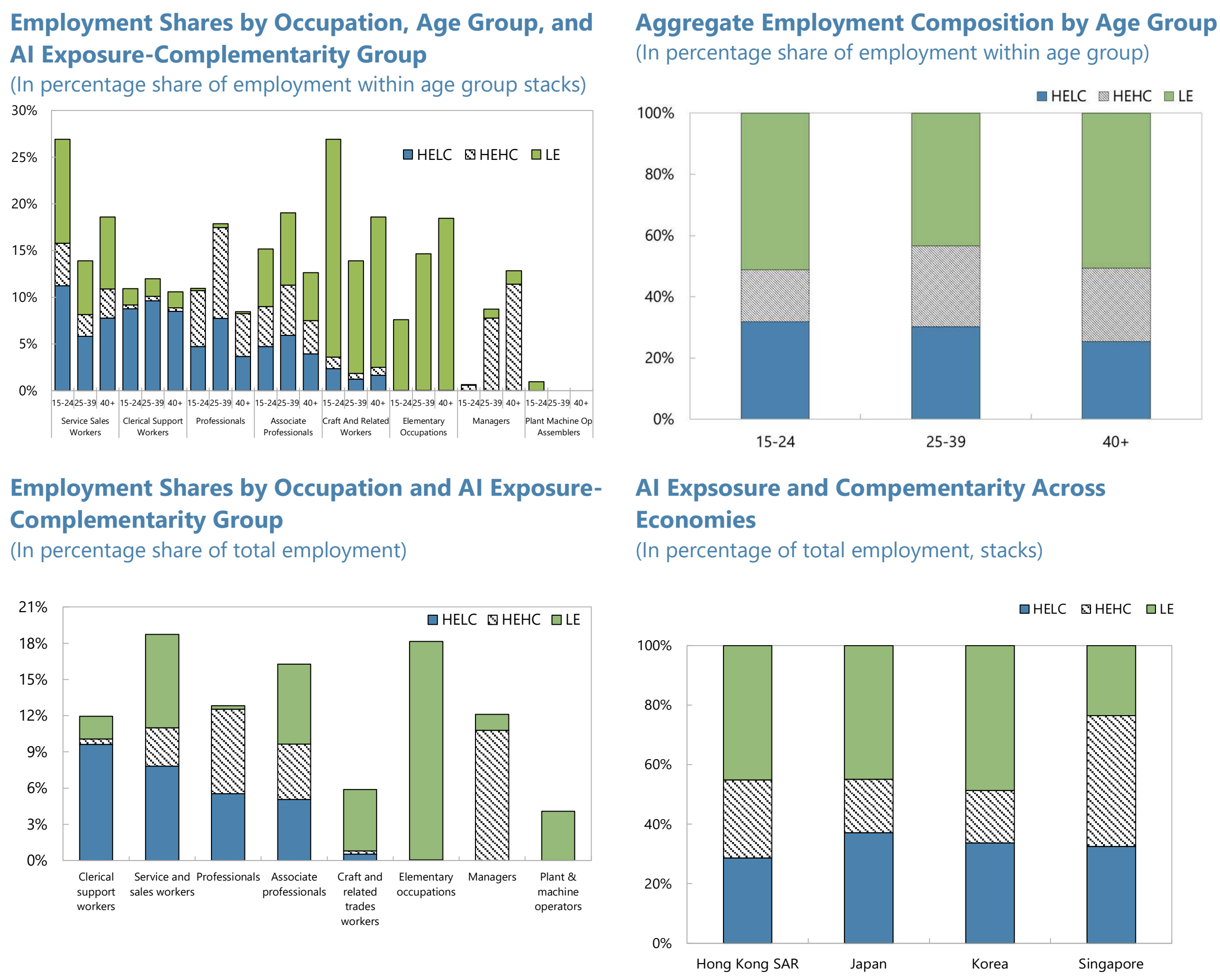
## Emergence of AI

25. **The emergence of AI may increase the displacement risks for the more vulnerable groups in the labor market, particularly youth and women.** Exposure to AI varies markedly across occupations and demographic groups in Hong Kong SAR, with important implications for labor market adjustment. Employment decomposition indicates that younger workers are slightly more concentrated in high-exposure, low-complementarity (HELC)[7] occupations, particularly in routine service roles (Text Figure 7, panel 1 and 2). These jobs rely heavily on routine tasks that are more easily automated, implying elevated displacement risks as AI adoption progresses. In contrast, older workers are more likely to be employed in occupations with higher task complementarity, reflecting experience-driven task complexity and greater reliance on non-routine cognitive and interpersonal skills. While aggregate patterns are broadly similar across genders, women show a slightly higher concentration in HELC occupations, suggesting that AI-related adjustment costs may be somewhat unevenly distributed across gender groups (Text Figure 7, panel 3). From a cross-

[7] Occupations are classified by AI exposure and task complementarity following a two-step mapping approach. Measures of AI exposure are taken from Felten, Raj, and Seamans (2021) and capture the extent to which occupational tasks overlap with AI capabilities. Task complementarity indices are based on Pizzinelli et al. (2023) and reflect the degree to which AI is likely to augment rather than substitute human labor within an occupation. Employment by occupation is mapped to ISCO one-digit categories and decomposed into three groups: high exposure–high complementarity (HEHC), high exposure–low complementarity (HELC), and low exposure (LE), using exposure-complementarity ratios applied to sectoral employment shares. Due to lack of granular occupation-level data, these exposure and complementarity scores are derived from U.S.-based occupational task data and mapped to Hong Kong labor market outcomes using broad one-digit ISCO categories, implying an assumption of cross-economy similarity in task content within occupational groups and limited granularity in capturing within-group variation. While this assumption may introduce some measurement bias, reflecting differences in occupational structures within one-digit categories between the United States and Hong Kong SAR, it represents the most feasible approximation to the best of our knowledge. Aggregate results are constructed by age and gender using labor force survey microdata.

economy perspective, the territory's employment share in high-exposure, high complementarity (HEHC) occupations, those most likely to benefit from the AI developments, is broadly comparable to some regional peers, though it remains behind that of AI frontier economies such as Singapore (Text Figure 7, panel 4).

**Text Figure 7. Hong Kong SAR: AI Exposure and Complementarity Across Economies**




Sources: CEIC, Felten et al (2021), Pizzinelli et al (2023); IMF staff calculations.

**26. These patterns imply that AI adoption may intensify downside risks to youth employment prospects in the absence of policy intervention, potentially contributing to delayed labor market entry as young workers seek to better prepare for changing skill demands.** These risks could materialize through several channels, including lower vacancy creation for routine entry-level occupations, heightened job competition for remaining positions, downward pressure on starting salaries, and increased reliance on short-hour or temporary contracts in HELC occupations (Jaumotte et al., 2026). In addition, the observed segmentation across AI exposure and complementarity categories also suggests there are frictions to occupational mobility, as transitions from HELC to high-complementarity roles require substantial changes in task content and skill requirements (see Korea's case in Chang et al., 2025, where data suggests limited mobility between low- and high-complementarity jobs throughout the life cycle).

## E. Conclusion and Policy Recommendations

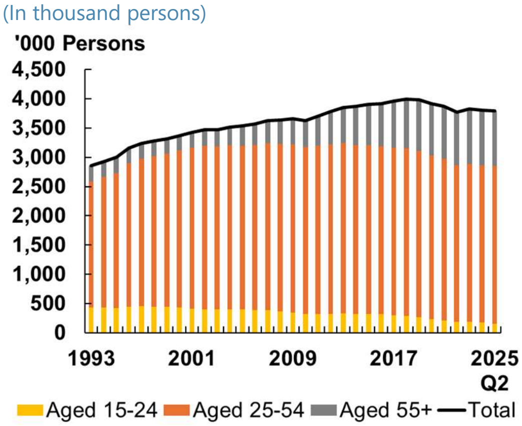
**27. This paper documents a sustained decline in Hong Kong SAR's LFPR and identifies its main underlying drivers.** Cohort-based shift-share decompositions indicate that both the decline in youth LFPR and population aging— the rising weight of older cohorts with structurally low LFPR—have materially contributed to the decline in aggregate labor force participation. Household survey indicates that education is the predominant reason for delayed labor-force entry among youth. This finding is consistent with shifts in sectoral composition toward higher-skill activities, the emergence of AI, and intensifying labor-market competition, which together raise the perceived returns to additional qualifications and skills upgrading. Although the continued pursuit of further education has lowered youth labor supply, it can enhance human capital formation, strengthening long-term productivity and potential growth.

**28. Addressing these overlapping demographic and structural pressures requires a coordinated policy response:**

- **Population aging and female labor force participation:** Policies should promote longer and healthier working lives through incentives to raise effective retirement ages, flexible and phased retirement options, targeted mid-career reskilling, and expansion of the capacity of overall elderly care services and childcare infrastructure as appropriate to help relieve the stress of their family carers, thus easing participation constraints. The development of the Northern Metropolis provides an opportunity to attract younger skilled workers, both locally and across the border, by integrating housing, employment, and innovation ecosystems. Although female labor force participation has improved at older ages, it diverges from that of men during prime working years, reflecting childcare and family care responsibilities. Expanding access to affordable childcare and more flexible work arrangements would support sustained labor market attachment.

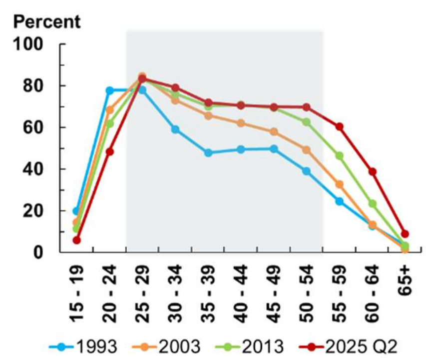
**Hong Kong SAR: Labor Force by Age**

(In thousand persons)




**Hong Kong SAR: Female Labor Force Participation Rate**

(Percent)




Sources: C&SD; and HKMA and IMF staff calculations.

- **Skill mismatch:** As demand shifts toward digital, green, professional, and advanced services skills, education and training systems should place greater emphasis on market-relevant competencies. Targeted support for vulnerable youth, particularly low-income and low-skilled groups, would help mitigate scarring effects and ease school-to-work transitions.

- **AI risk:** Policy priorities should focus on accelerating acquisitions of AI-complementary skills, strengthening occupational mobility, and reinforcing social protection systems to support workers during transition periods. Enhanced unemployment insurance and active labor market policies would improve resilience while enabling more efficient labor reallocation.

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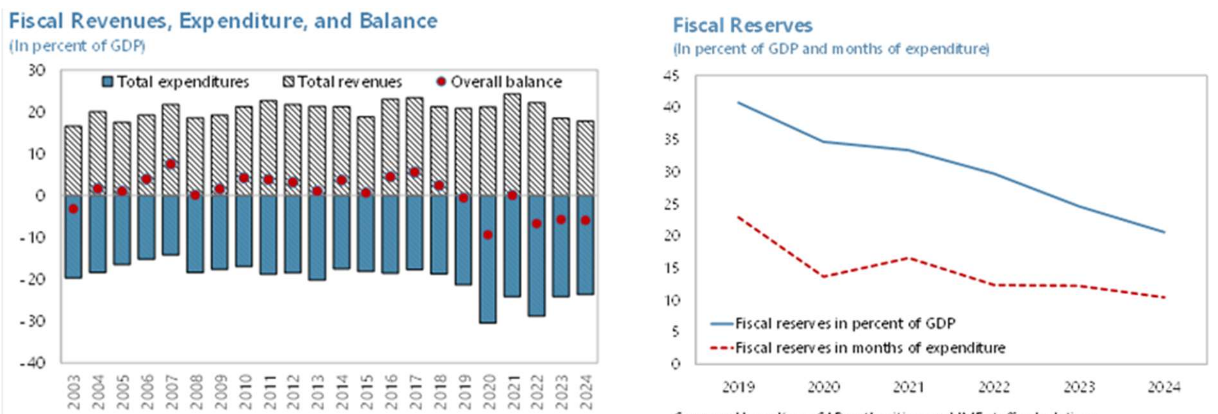
# HONG KONG SAR: DIVERSIFYING AND BROADENING REVENUE[1]

## A. Introduction

**1. Hong Kong SAR has faced persistent fiscal pressures in recent years.** Hong Kong SAR has maintained a reputation for strong fiscal prudence, underpinned by consistent adherence to the Hong Kong Basic Law's balanced-budget principle and sound public financial management. In recent years, however, substantial falls in revenue associated with changes in land use (land premiums), reduced stock market initial public offerings, headwinds to corporate profits, and weakness in the labor market have contributed to persistent fiscal deficits and a decline in fiscal reserves (Text Figure 1).

**Text Figure 1. Hong Kong SAR: Fiscal Developments**




Sources: CEIC; and IMF staff calculations.

Sources: Hong Kong SAR authorities; and IMF staff calculations.

**2. In response, the authorities have implemented several revenue-raising measures.** These include a global minimum tax (GMT)/Hong Kong Minimum Top-up Tax (HKMTT) framework for in-scope multinational enterprise (MNE) groups[2], adjustments to stamp duties, a hotel accommodation tax, and revisions to the airport passenger departure tax. However, these have not been sufficient to restore fiscal balance.

**3. Looking ahead, medium- to long-term fiscal pressures could build because of an ageing population, government pensions, large capital expenditure projects and the need to expand social safety nets.** While the Basic Law sets a general principle of fiscal balance, demographic trends, combined with a relatively limited social safety net, are expected to generate increasing fiscal pressures over the long term. Higher health care spending, financial assistance payments to older residents, and spending on providing subsidized long-term care services to the

[1] Prepared by Dan Devlin and Yizhi Xu.

[2] See discussion in Section C.

elderly are all expected. By 2040, the extra spending is projected at around 1.8 percentage points of GDP annually (Hoyle, 2025). In addition, outlays associated with the now-closed pension scheme for civil servants are projected to increase, and improvements to the social security system could also increase spending by around 0.9 percent of GDP by 2040.[3] At the same time, Hong Kong SAR is embarking on a multi-year, multi-phased mega project known as the Northern Metropolis, which will add to spending pressures, albeit with significant uncertainty on both their timing and magnitude.

4. **Sustained fiscal discipline helps support monetary and financial stability.** The Hong Kong dollar's link to the U.S. dollar is anchored by ample foreign exchange reserves and a robust monetary framework and is complemented by sound fiscal fundamentals. A gradual erosion of fiscal buffers or a sustained rise in public debt could reduce policy space to respond to external shocks, potentially leading to greater pressure on capital flows. Maintaining prudent fiscal policies and adequate reserves therefore remains important for supporting Hong Kong SAR's overall monetary and financial resilience.

5. **There are multiple paths available to address rising fiscal pressures, including increased revenue mobilization, expenditure control, and preparatory government saving.** As reflected in recent budgets, fiscal consolidation has focused on tighter expenditure control, including measures such as a public-sector pay freeze, reductions in the civil service establishment, and adjustments to transport subsidy schemes. As the timing and magnitude of additional medium-term spending requirements are established, governments can consider preparatory policy responses. If future spending needs exceed what can be accommodated through regular budget process, it may be appropriate to proactively set aside resources through, for example, a dedicated savings vehicle or sovereign wealth fund.

6. **This paper examines options to expand the revenue base to help meet these growing spending needs, building on the existing tax policy debate in the territory**.[4] Section B provides an overview of the current structure of revenues and main revenue instruments. Section C assesses key taxes and potential policy options to raise additional revenue. Section D focuses on larger reform and the possible introduction of a broad-based consumption tax. Section E examines the fiscal implications of these options. Section F concludes.

## B. Hong Kong SAR's Main Revenue Sources

7. **Hong Kong SAR's tax system has long been guided by the principles of simplicity and investor-friendliness.** Over the past century, the territory has prioritized a simple and relatively low-tax environment to help position the territory as a pro-business jurisdiction supportive of economic growth and job creation. However, Hong Kong SAR's high cost of living - particularly its status as

[3] As suggested in Hoyle (2025), raising the OALA's benefit levels to improve the net replacement rate by 10 percentage points—closing the gap with the OECD average net replacement rate by about half—could lead to increased spending of around 0.9 percent of GDP by 2040.

[4] Several revenue mobilization reform measures have been discussed with the public over the past decades (see Section D).

having one of the world's least affordable residential property markets - has prompted policy responses that come at an expense to fiscal resources, such as reductions in property-related revenues or increased rental subsidies for lower-income households.

**8. Hong Kong SAR operates under the Hong Kong Basic Law, with a separate tax system from the Chinese mainland.** As a Special Administrative Region, the Basic Law is akin to a constitutional framework granting the territory a high degree of fiscal, taxation and judicial autonomy.[5] The absence of fiscal transfers from the Central Government of China implies a general expectation that the territory manages its public finances prudently. Hong Kong SAR's tax autonomy includes the authority to negotiate and conclude international agreements, including tax treaties. A tax protocol with the Chinese mainland also facilitates cooperation in tax administration. The Basic Law also limits the use of tariffs and mandates a free trade policy that safeguards the free movement of goods, intangible assets, and capital.

**9. The territory's public finances are organized around a central account complemented by several dedicated funds.** Most revenue, including all tax revenue, is collected through the General Revenue Account, which in turn finances the bulk of government expenditure. This is complemented by eight special purpose funds with the capacity to raise and retain revenue to finance dedicated spending (e.g., infrastructure), though transfers to the General Revenue Account can be made when needed.

**10. The tax system is underpinned by two primary revenue "pillars": corporate profits and property.** Effective tax rates are significantly lower than those of international peers across almost all tax categories (Text Figure 2, panel 1). The corporate income tax (CIT, locally referred to as the profits tax) and property-related revenues take on a heavy share of revenue generation. Personal income tax (PIT) rates are at the lower bound of peer economies, and there is no value-added tax (VAT, locally referred to as a goods and services tax, GST). The budget is also heavily reliant on non-tax revenues (Text Figure 2, panel 3), but these have exhibited high historical volatility (Text Figure 2, panel 4, and discussed further in this section).

**11. The profits tax is the largest source of tax revenue.** It typically accounts for about 5-6 percent of GDP and has generated roughly 25 percent of total general government revenue between 2010 and 2023 (Text Figure 2, panel 2). This is considerably higher than international averages, including among Organization for Economic Cooperation and Development (OECD) countries and the Group of Seven (G7), where the corresponding share is typically below 10 percent.

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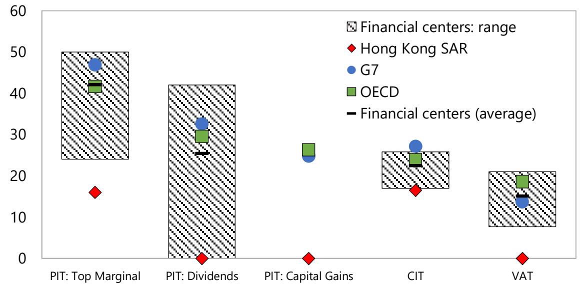
[5] For further information, see Government of Hong Kong SAR: Basic Law - Some Facts about the Basic Law (EN).

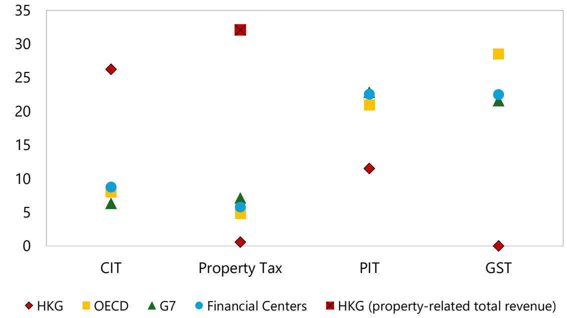
## Text Figure 2. Hong Kong SAR: Tax Framework

### Tax Rates by Type vs. Comparators
(In percent)



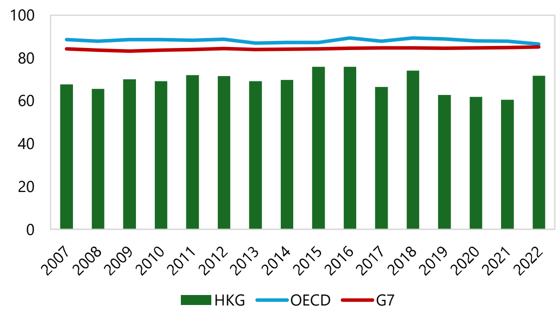

Sources: OECD, Price WaterHouse Coopers, and IMF staff analysis.
Note: PIT=personal income tax. CIT=corporate income tax. VAT=value-added tax. Financial centers include Belgium, Luxembourg, Netherlands, Singapore, and Switzerland. Data shown are based on 2024 data or latest available, and are averages unless otherwise indicated.

### Fiscal Revenue by Type vs. Comparators
(In percent of general government fiscal revenue, 2010-2023 average)



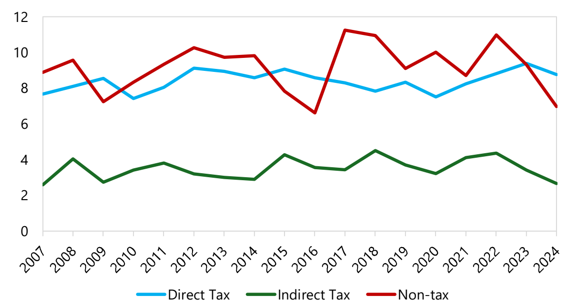

Sources: CEIC; OECD; and IMF staff calculations.

### Tax Revenue vs. Comparators
(In percent of General Government Revenue)




Sources: CEIC; OECD; and IMF staff calculations.

### Fiscal Revenues in Hong Kong SAR
(In percent of GDP)




Sources: CEIC; and IMF staff calculations.

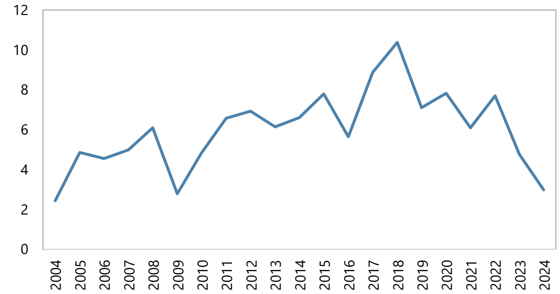
12. **The second revenue pillar relates to land development and usage, which are subject to a range of tax and non-tax instruments.** All land is publicly owned and leased for private use, while leaseholders own buildings on the leased land.[6] Key instruments include:

- an upfront, one-off "land premium" paid by property developers based on the projected increase in land value arising from changes in land use,
- an annual Government rent levied on the rateable value (RV) of the property on certain land,
- general rates, levied on the annual rateable value of a property,
- "property tax" of 15 percent on net assessable value of properties occupied by tenants (part of the PIT), and
- stamp duty (referred locally to as "ad valorem duty", AVD) applied on property transfers.

[6] For further information, see Government of Hong Kong SAR: https://www.landsd.gov.hk/en/resources/land-info-stat/land-tenure-system-land-policy.html

Taken together, these property-related revenue instruments have historically accounted for around 6 percent of GDP, but with considerable variability from year to year, for example exceeding 8-10 percent in some years but dropping to 3 percent in FY24/25 (text chart).

**Hong Kong SAR: Property Related Revenue**
(In percent of GDP)




Sources: CEIC; and IMF staff calculations.
Note: Property related revenue includes property tax, property related stamp duties, general rates, and other property related revenues.

**13. Other taxes such as PIT and indirect taxes have a more limited role in total revenue.** PIT on salaries and other income contributes between 2-3 percent of GDP annually (around 10 percent of total revenue), and indirect taxation is limited, comprising mainly of excises (referred to domestically as "duties"). Stamp duty on equity transactions (contract notes) contribute about 6 percent of total revenue, although their share has fluctuated over time. Gambling taxation also makes a material contribution to total revenue (around 4-5 percent of total revenue).

**14. While corporate profits and property have historically been robust in generating revenue, their high shares of total revenue make the fiscal position susceptible to volatility and shocks.** In combination, total revenue from corporate profits and property has fluctuated from around 15 percent of GDP in 2018 to under 9 percent in 2024. Land premium revenue fluctuations have been notable: revenues averaged around 4 percent of GDP between 2010 and 2022 but dropped to around 0.7 percent in FY 2023/24 and further to 0.4 percent of GDP FY 2024/25. Similar changes – which are well understood by the authorities - were observed following the 2008 Global Financial Crisis, the 2015-2016 stock market correction in China, and the recent property market downturn.[7] The narrow concentration of revenue sources and the associated volatility further underscore the need for revenue reforms.

## C. Potential Reforms Consistent with the Current Revenue Framework

### The Profits Tax

**15. The profits tax has a relatively low rate of 16.5 percent for larger corporations, applied on a territorial basis.** A tiered tax regime applies, with the first HKD 2 million (around USD 250,000) of annual profit taxed at 8.25 percent before the 16.5 percent rate applies (IBFD, 2025). These rates are below that of most economies in the Asia-Pacific region and the OECD, where headline CIT rates are generally 20 percent or higher, with Singapore the exception at 17 percent. Only profits sourced in Hong Kong SAR are taxed, and there are several tax concessions provided, including for research

[7] See for example, Government of Hong Kong SAR: https://www.budget.gov.hk/2025/pdf/2025-26_Budget_Consultation_Information_Pack.pdf

and development, and reduced rates for insurance and intellectual property (patent box) income.[8] These incentives have been implemented in line with international standards (e.g., the OECD's Harmful Tax Practices initiative).

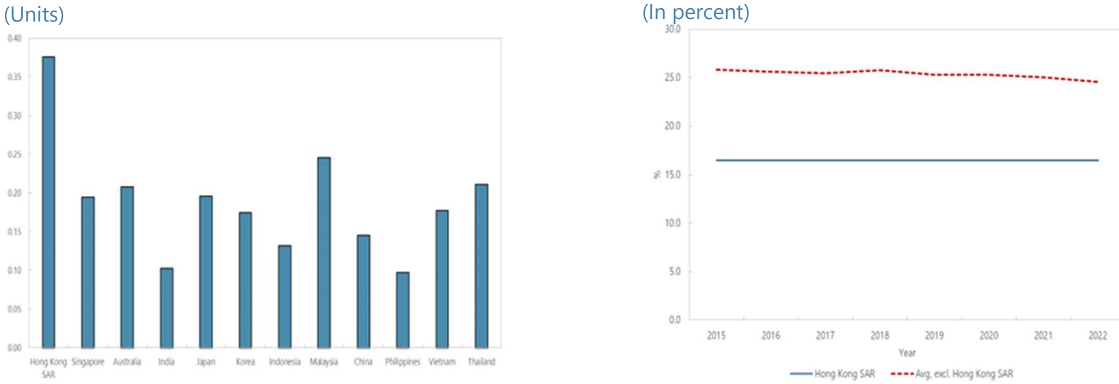
**16. The profits tax has been reinforced by the introduction of the GMT and HKMTT.** The GMT and HKMTT have been implemented with effect from January 1, 2025, to align with the Global Anti-Base Erosion (GloBE) framework promulgated by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS). MNE groups with annual consolidated revenue of EUR 750 million or above in at least two of the four fiscal years immediately preceding the current fiscal year (referred to as "in-scope MNE groups") are subject to the GMT/HKMTT rules. These measures provide a mechanism to impose additional taxation on income that might otherwise face top-up taxation abroad and are expected to bring in an additional tax revenue of about HKD 15 billion annually from 2027-28.[9]

**17. The profits tax has higher revenue productivity than in most other economies.** Hong Kong SAR has maintained a rate of CIT productivity – the amount of revenue received as a percentage of GDP from each percentage point of the CIT rate – consistently above 0.35 (Text Figure 3, panel 1), compared with an average of around 0.2 in other Asia-Pacific economies such as Singapore, Thailand, and Australia. This indicates that the profits tax is currently a highly effective revenue instrument. At the same time, CIT payments are highly concentrated: for example, only 5,300 businesses – 3.3 percent of all businesses operating under the profits tax – accounted for 86 percent of total profits tax revenue in 2021-22.[10]

**Text Figure 3. Hong Kong SAR: CIT Productivity and Headline CIT Rates vs. Comparators**

**CIT Productivity, Latest Available Year**
(Units)

**Combined CIT Rate, 2013-2023**
(In percent)




Source: IMF Staff calculations.
Note: Average CIT rate represents the average headline CIT rate across major Asian economies (Australia, China, India, Indonesia, Japan, Republic of Korea, Malaysia, Philippines, Singapore, Thailand, and Vietnam).

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[8] For a prospective hypothetical investment, the OECD estimate the effective average tax rate to be 14.3 percent, explained primarily by faster tax depreciation. A marginal prospective investment would face an effective marginal tax rate of only 2.0 percent, due to the combination of interest deductibility, tax depreciation, and research and development incentives. See OECD (2025).

[9] See Government of Hong Kong SAR 2025-26 Budget Speech: https://www.budget.gov.hk/2025/eng/budget51.html

[10] Latest available. Source: Government of Hong Kong SAR 2024-25 Budget Consultation.

**18. High revenue productivity reflects several factors, including the allocation of global MNEs profits to Hong Kong SAR and potentially, firms earning economic rents**. International tax rate differentials can incentivize MNEs to book global profits to jurisdictions with lower profit tax rates (Text Figure 4, panel 2), reducing their overall tax bills. The substantial allocation of profits to Hong Kong SAR means the profits tax can generate substantial revenues.[11] Hong Kong SAR's high revenue productivity may be reflective of its unique strategic position in global and regional finance as a key gateway for global investors accessing the Chinese mainland and for mainland investors raising offshore capital. It may also indicate, however, companies earning economic rents (e.g., associated with limited competition).

**19. At the same time, CIT revenue is vulnerable to tax rate competition.** Competitive tax pressures have been relatively subdued in recent years, and the economies of the Asia-Pacific region have largely resisted CIT rate cuts, except for India in 2018 and Indonesia in 2021. The territory's profits tax revenues also remained resilient after the substantial United States CIT rate cut in 2018. However, an aggressive CIT rate cut by any economy in the region — for instance, as a response to slowing growth — could trigger rate reductions across the region in response. This could impose spillovers on the rest of the region including Hong Kong SAR through some reduction in profits allocated to the territory and would increase the pressure for Hong Kong SAR to cut its tax rate in response.[12]

**20. Given the already large contribution of the profits tax to total revenue, scope for further revenue mobilization through this channel is conceptually possible but would elevate concentration risks.** A statutory rate below most regional peers does suggest some room for a moderate rate increase that would raise material revenue without materially undermining competitiveness (e.g., a two percentage-point increase in the CIT rate could generate revenue of around 0.6 percent of GDP, after factoring in the potential for some offsetting reduction in MNE profits booked in the territory).[13] However, such an increase would further concentrate the revenue base and heighten vulnerability to fluctuations in corporate profitability and the international allocation of profits.

### Personal Income Taxation

**21. Hong Kong SAR has adopted a schedular approach to income taxation with two alternative tax rate structures.** PIT is levied on a territorial basis, excluding foreign income from the tax base. Income from employment is taxed under the "salaries tax", which is either applied at

[11] In other words, many financial centers (including Hong Kong SAR) could collect less CIT revenue if global corporate profits were allocated between jurisdictions based on production factors such as assets, employment or payroll (IMF 2014).

[12] The larger revenue risk would stem from responding with a domestic CIT cut (see discussion in Beer et. Al., 2018).

[13] As an approximate estimate based on de Mooij and Liu (2018), a 2-percentage-point reduction in the statutory tax rate differential of MNE groups – driven by an increase in the domestic CIT rate - might reduce CIT revenue by 0.17 percent of GDP.

progressive rates between two and 17 percent, or under a "standard rate" system with a rate of 15 percent for most taxpayers, rising to 16 percent for income exceeding HKD 5 million.[14]

**22. Tax is paid under whichever method results in a lower tax payment.** A basic allowance (deduction) is provided for the first HKD 145,000 of income to reduce taxable income.[15] Business income including royalties is subject to profits tax. Interest from banks, dividends, and most capital gains[16] are exempt. Rental income is taxed at a flat 15 percent (the "property tax"), after an allowance for repairs and expenses.

**23. PIT revenue is broadly in line with that of several Asian economies but remains well below the OECD average.** At around 3 percent of GDP, PIT revenue is below other advanced economies such as Japan, Republic of Korea, and Australia, but higher that in Singapore (2.2 percent), the Chinese mainland (1.2 percent) and emerging economies in the region such as Indonesia (1.8 percent), Vietnam (1.7 percent) and Thailand (1.9 percent). The relatively low rate structure of the PIT means revenue is considerably below the OECD average of 8.4 percent.

**24. Almost all wage earners are taxed under the progressive schedule, but the two-tiered standard tax rate alternative shields the highest income earners from the full impact of the 17 percent marginal rate.** The dual structure of a progressive scale and the standard rate structure – particularly with the large standard deduction – means most taxpayers will face lower taxes under the progressive PIT scale. However, the average tax rate under the two systems switches at approximately HKD 2.1 million (Text Figure 4), at which point the standard rate system would apply.[17] In practice, this means around 30,000 (high income) taxpayers enjoy a reduced tax burden relative to the total tax that would have been paid under the progressive scale.

[14] This increase to 16 percent for income exceeding HKD 5 million took effect from the 2024-25 year of assessment.

[15] This allowance increased in the 2026-27 Budget, it was previously HKD 132,000. The Budget also provided a one-off tax rebate up to HKD 3,000 for taxpayers under the salaries tax, profits tax, and those taxed under personal assessment. See Gov of Hong Kong SAR: https://www.budget.gov.hk/2026/eng/sm.html As at April 2026, these measures remained subject to Legislative Council approval.

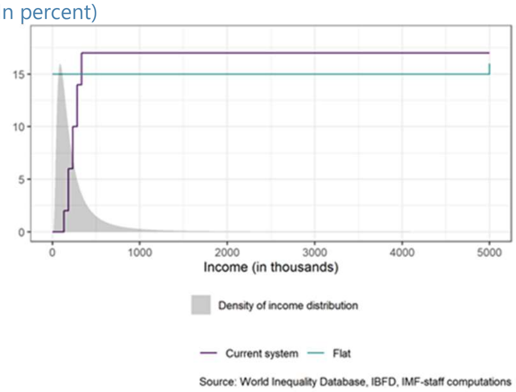
[16] Gains associated with speculative transactions such as property trading can attract profits tax (IBFD, 2025).

[17] This is based on a simplified single income filer with no deductions who receives the basic allowance only for the 2026-27 year of assessment. This is consistent with the Government of Hong Kong SAR Inland Revenue Department Salaries Tax Calculator, available at: GovHK: Tax Computation of Salaries Tax and Personal Assessment.

**Text Figure 4. Hong Kong SAR: PIT Rate Structure and Average Tax Rates Across Incomes**

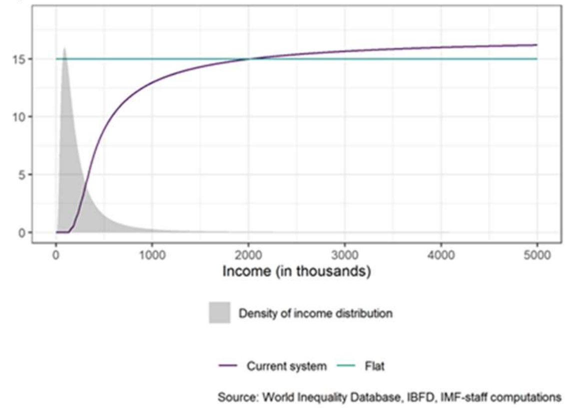
**Marginal Tax Rate**

(In percent)




**Average Tax Rate**

(In percent)

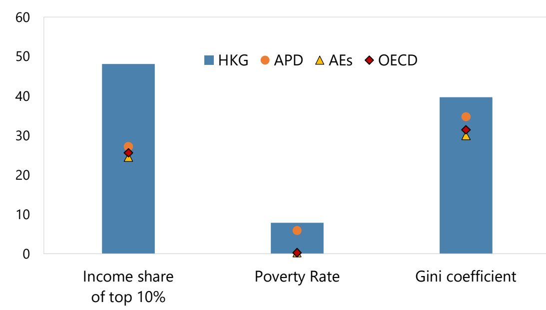



Source: IMF Staff calculations.

**25. PIT reform could generate additional revenue, while also helping to reduce income inequality.** The relatively low tax rates encourage labor participation but limit the redistributive capacity of the tax system in addressing the territory's high degree of income inequality (text chart). If left unchecked for long enough, high levels of income inequality could erode social cohesion, fostering instability.[18]

**Hong Kong SAR: Inequality Indicators**

(In percent; Higher values = higher inequality)




Sources: World Bank; OECD; and IMF staff calculations.

**26. A substantial increase in PIT rates and some base broadening could generate significant additional revenue but would have adverse effects on work incentives and growth.** Higher and more progressive PIT rates would address income inequality directly but would require a fundamental change in taxation philosophy in the territory and substantial reforms in tax rate structure. Simulation analysis suggests that in order to raise additional revenue of 2.5-3.0 percentage points of GDP, would require a PIT scale with a top marginal tax rate of around 40 percent (Text Figure 5). This would bring Hong Kong SAR broadly in line with advanced economy practices. However, this could be more growth-distorting than alternative options such as increasing consumption taxation.[19] Moreover, in the context of population ageing, such a drastic PIT rate change would risk disincentivizing older workers, whom the economy will increasingly need to retain.

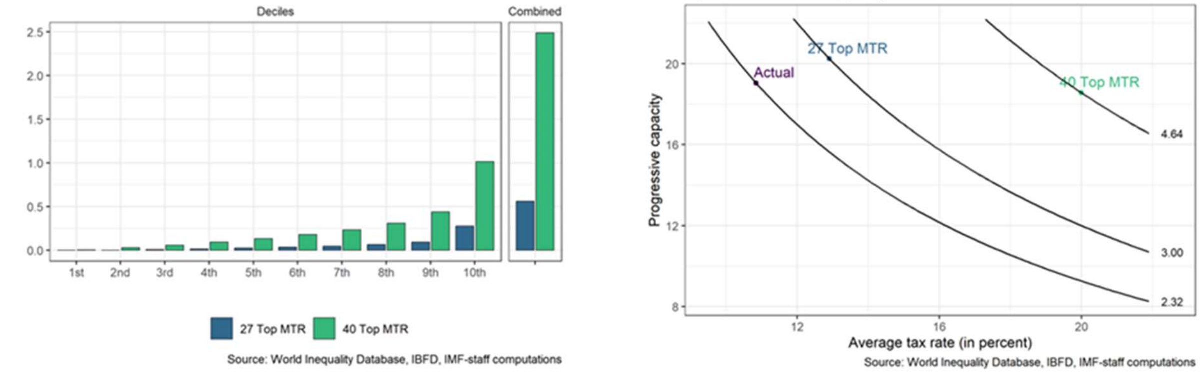
[18] See discussion in IMF (2015).

[19] Previous research such as Acosta-Ormaechea and Yoo (2012) have indicated increasing income taxation whilst reducing consumption and property taxes is associated with slower long-run growth. By extension, a substantial PIT increase *without* offsetting tax cuts could thus be expected to result in stronger adverse growth effects.

**Text Figure 5. Hong Kong SAR: Revenue Impact of Simulated PIT Rate Increases**

**Revenue Change**
(In percent of GDP – by income group)

**Decomposition of Redistributive Capacity**
(Higher values toward upper right corner)




Source: IMF Staff calculations.

**27. To enhance progressivity, the progressive PIT scale could be applied to all salaries income and rental income, removing the flat rate alternative enjoyed by high-income earners.** This would improve the progressivity of the tax system without affecting lower-income households and would remove the current shielding of very high-income earners from the top marginal rate. On similar grounds, rental income could be taxed at marginal rates, as properties tend to be held by higher income earners.

**28. Modest increases in the rates at the upper end of the PIT scale could also be considered.** As an illustration, raising the 10, 14 and 17 percent rates by 2 percentage points each, in concert with the removal of the flat rate alternative, could generate around 0.4 percent of GDP in additional revenue from higher income earners while shielding lower income taxpayers from the higher tax burdens.

**29. Over the medium-term, Hong Kong SAR could consider harmonizing the PIT system, taxing all income at progressive rates.** This would reduce the economic distortions associated with the differentials between taxes on different types of income, remove any incentive for taxpayers to recharacterize income to take advantage of lower rates and simplify the system. Broadening the PIT base to include domestic capital income (capital gains and dividends) could further improve progressivity as such income is more concentrated among higher income earners, although it would raise risks of capital income shifting offshore in response to higher taxation.[20]

## Indirect Taxes

**30. With no broad-based sales tax, Hong Kong SAR relies on excises to tax goods and services.** As a result, the territory's overall indirect tax revenue is low relative to other economies in the region (Text Figure 6, panel 1). Most Asian economies – especially those that have a VAT – have indirect tax revenue at 20 percent of total revenue or more. In the region, most of the larger

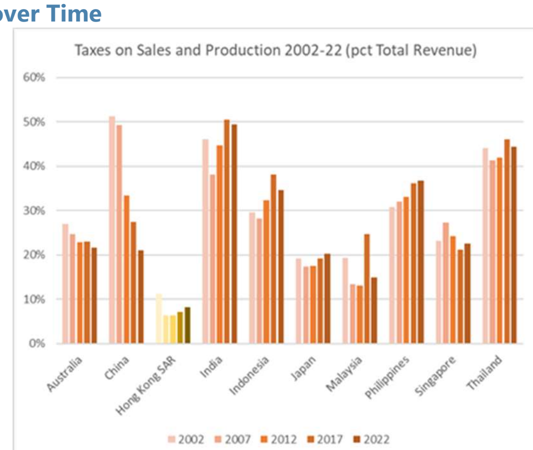
[20] The taxation of capital income may also enable the efficiency-enhancing removal of stamp duty on HKEX share transactions.

economies have a VAT with a standard rate between 10-13 percent, with the exceptions of Singapore (7 percent), Malaysia (no VAT), India (18 percent), and the Chinese mainland (16 percent). Hong Kong SAR's excise revenues (locally referred to as duties) are broadly in line with regional practice, applying to tobacco, fuels such as gasoline and diesel, and some alcoholic products.

**31. Hong Kong SAR applies excise at fixed rates on tobacco but does not routinely adjust rates.** Tobacco taxes are in the mid-range among Asian economies, but recent increases in the 2023-24 and 2024-25 budgets (HKD 0.6 and HKD 0.8 per stick of cigarette, respectively) have moved the excise duty burden closer to the levels prevalent in Asia's advanced economies (Text Figure 6, panel 2). As a result, excises now account for approximately 70 percent of the retail price of cigarettes,[21] approaching the World Health Organization's recommended 75 percent share.[22] At the same time, the widening price gap with the Chinese mainland has increased the incentive for arbitrage and smuggling.[23] Tobacco excises are not routinely adjusted for inflation.

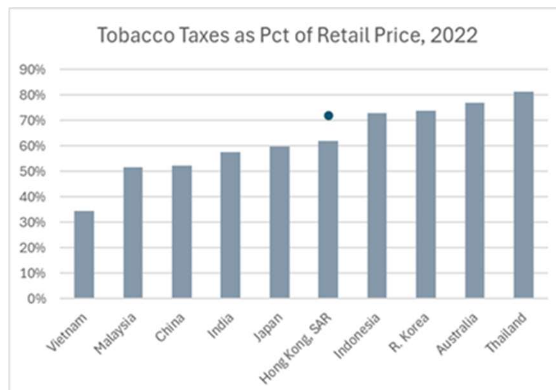
**Text Figure 6. Hong Kong SAR: Taxes on Sales and Production**

**Indirect Taxes as Percentage of Total Revenue over Time**




Source: IMF World Revenue Longitudinal Database (WoRLD). Comprises sales taxes, excise, and includes taxes on betting.

**Tobacco Taxes as Percentage of Retail Price, 2022**




Sources: WHO, Government of Hong Kong SAR, Staff Estimates.
Note: Hong Kong SAR dot shows indicative effect of subsequent excise increases in 2023 and 2024.

**32. The territory taxes alcoholic products lightly, and fuel excises generate only limited revenue.** Excise duty on liquor is applied only to beverages with alcohol content exceeding 30 percent by volume, with beer and wine fully exempt. In 2024, the government sharply reduced the excise on liquor, in line with prior policy actions such as the 2008 duty exemption for wine, aimed at encouraging the importation and consumption of these products.[24] Only modest revenue is

[21] 2024-25 Budget speech: https://www.budget.gov.hk/2024/eng/pdf/e_budget_speech_2024-25.pdf

[22] See WHO (2025): https://www.who.int/news-room/fact-sheets/detail/tobacco

[23] The price of a 20-pack of cigarettes in Hong Kong SAR is approximately 100 HKD, vs Shenzhen 30 yuan (32 HKD).

[24] From October 2024, the duty on the value of imported liquor exceeding HKD 200 was reduced from 100 percent to 10 percent for the portion above HKD 200, while the duty rate for the portion of HKD 200 and below as well as liquor with import price of HKD 200 or below will remain at 100 percent.

generated from fuel excises: the high urban density of the territory, extensive public transport network, and high retail gasoline prices have all made car ownership less essential.[25]

**33. There is therefore scope to expand excises and index them to inflation.** Alcoholic excises could be expanded to cover beer and wine and applied based on alcoholic content. This would simplify the excise and ensure it addresses the negative externalities associated with excessive alcohol consumption, with any additional revenue as a secondary benefit. Per-unit excise rates, such as on tobacco, could also be automatically indexed annually to inflation to maintain their real value over time. Tobacco taxes on the existing base (electronic tobacco devices are illegal) may have passed their revenue-generating maximum, however.[26] Duty could also be extended to sugar sweetened beverages to curb their consumption.

**34. Existing charges on motorists could also be expanded, including for electric vehicle owners.** The growing adoption of electric vehicles (EVs) - accounting for 14 percent of vehicles in Hong Kong SAR[27] - poses a risk to fuel excise revenues, a trend likely to intensify in line with the Climate Action Plan 2050. To offset this erosion, additional charges could be introduced for EVs as part of the first registration tax (FRT) and/or on an annual basis, to ensure motorists continue to contribute to road maintenance and to address the externalities of car use (e.g., congestion). The authorities have already begun to move in this direction, by allowing the FRT EV concession to expire on March 31, 2026[28] and the adoption of a license fee structure based on EV rated power in November 2025. To extend these charges further, a mileage-based tax could be developed, to impose higher costs on more frequent drivers.[29]

### Property Taxes and Land Sales

**35. Hong Kong SAR applies a recurrent property tax (the 'general rates' tax) on property values.** General rates are charged based on the rateable value (RV) of properties, which includes both land and structures.[30] These rates are charged at 5 percent of the RV for non-domestic tenements. For domestic tenements, the 2024-25 Budget introduced a progressive scale whereby domestic tenements with an RV of HKD 550,000 or below continue to be charged at 5 percent, but

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[25] As at the end of 2025, there are around 800,000 cars registered in the territory – see CEIC, 2026. Fuel excise makes up around 20 percent of the retail price of unleaded gasoline (albeit with fluctuations associated with fuel prices and discounting by retailers).

[26] Despite duty hikes of over 30 percent in both 2023 and 2024, tobacco revenue fell from HK$7.25 billion in 2023-24 to HK$4.32 billion in 2024-25.

[27] See Government of Hong Kong SAR Environmental Protection Department: Promotion of Electric Vehicles

[28] See: Government of Hong Kong SAR Transport Department announcement: FRT Concessions for Electric Vehicles

[29] Given that total road usage in Hong Kong amounts to nearly 40 million vehicle-kilometers per day (The Annual Traffic Census, 2024), a mileage-based vehicle taxation scheme could generate substantial revenue. Even a modest per-kilometer charge—for example, HK$0.05 per km—would yield roughly HK$2 million per day (around HK$730 million annually), with higher contributions from more frequent drivers.

[30] Rateable value is the estimated annual rental value of a property in the open market at a designated valuation reference date, assuming that the property was then vacant and to let. Source: Government of Hong Kong SAR.

tenements above this limit will be taxed at 5 percent on the portion up to HKD 550,000, 8 percent for the next HKD 250,000, and 12 percent for the RV amount that exceeds HKD 800,000.[31]

**36. Hong Kong SAR also applies stamp duty on property transfers.** The AVD applies to the transfer of property based on the higher of consideration or the assessed value of the property.[32] A scale of rates is applied, with the 2026-27 Budget increasing the maximum rate to 6.5 percent for residential property transfers valued above HKD 100 million (previously the maximum was 4.25 percent).[33] These duty rates have fluctuated in recent years which appears to reflect a balancing between revenue generation and as a tool to influence housing affordability.[34]

**37. As noted earlier, substantial non-tax revenue is generated from land premiums and to a lesser extent from payments associated with land held by way of a Government lease ('Government rent').** One-off payments are made by developers associated with a land transactions, calculated based on the expected increase in land value. This calculation takes into account the existing development value, the costs of the development, potential changes in land use, and the profit margins of the developers. With a scarcity of land and the central role of the authorities in land ownership and usage, this instrument has historically generated considerable, albeit volatile, revenue (Text Figure 7, panel 2). While the structure and calculation of these premiums are outside the scope of this paper (as a non-tax revenue instrument), it is worth noting that such payments may be passed on to the ultimate users of the land through higher prices. In addition, properties held under Government lease are subject to a 3 percent Government Rent charge, based on the RV of the property.

**38. Hong Kong SAR's property-related revenues are heavily concentrated in stamp duty (Text Figure 7, panel 1).[35]** AVD revenue has routinely made up over 10 percent of total revenue, reaching as high as 16 percent in 2018 and 2022. By contrast, direct property tax is less than one percent of total revenue, while general rates account for around 3-5 percent. Moreover, AVD revenues are more volatile, often fluctuating by one percentage point of GDP year on year, relative to recurrent taxes that tend to be more stable with fluctuations of around 0.2 percent of GDP or less.

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[31] The 2026-27 Budget provided a concession on general rates on domestic and non-domestic properties for the first two quarters of 2026-27 capped at HK$ 500 per quarter. Source: Gov. of Hong Kong SAR: https://www.budget.gov.hk/2026/eng/sm.html.

[32] Source: Gov. of Hong Kong SAR: GovHK: Stamp Duty Rates

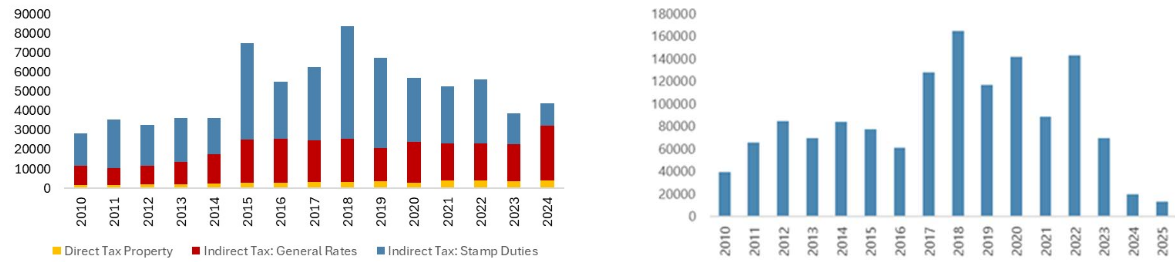
[33] As at April 2026, this measure was still subject to Legislative Council approval.

[34] Stamp duty appears to have been used periodically as a tool to influence conditions in the residential property sector. Between 2010 and 2024, there had been additional stamp duties applied: the special stamp duty (SSD), buyer's stamp duty (BSD), and new residential stamp duty (NRSD) - see: Government of Hong Kong SAR: IRD : FAQ – and is some evidence the AVD (and previous SSD and BSD) slowed house price growth in the territory (Rabanal, 2018).

[35] The stamp duty revenue item includes stamp duties from home purchases and from transactions in shares listed on the Hong Kong Stock Exchange (see: HKEX.)

**Text Figure 7. Hong Kong SAR: Property-Related Revenue**

**Property Related Fiscal Revenue** (Million HKD) | **Land Premium** (Million HKD)




Source: CEIC; and IMF staff calculations.

**39. Transaction taxes on property transfers are common internationally but have distortionary effects on real estate sales, especially when levied at high rates.** The AVD benefits from administrative simplicity, particularly since the purchase price usually constitutes an accurate measure of market value. But if set at high rates, stamp duty can disincentivize property transactions and impede the efficient use of the existing capital stock - the so-called 'lock-in' effect.[35] Residents may delay or avoid moving in response to changing family circumstances, while the progressive rate structure further incentivizes owners of higher-value properties—who tend to be higher-income households—to retain properties they might otherwise sell.

**40. Recurrent property taxes offer a more efficient and stable means of mobilizing revenues, particularly given the scarcity of land in the territory.** Broadly-based recurrent property taxes are known to be less distortionary, particularly relative to taxes on labor, as it is considerably harder for taxpayers to change behaviors to avoid the tax. In addition, these taxes can combat income inequality, given the strong association between property ownership and wealth (Grote and Wen, 2024). While scope to further expand property taxation is constrained, a revenue-neutral reduction in stamp duty in favor of recurrent taxes would improve the efficiency of the tax system, promote a more efficient use of the housing stock and reinforce efforts to combat inequality by increasing the taxation of higher value properties. This transition could be phased in gradually over time to limit large tax increases.[36]

## D. Expanding Consumption Taxation

**41. Domestic consumption represents a clear opportunity to broaden the territory's tax base and diversify the tax system.** Broad-based consumption taxes, such as GST, are used widely given their efficiency, revenue stability and relative resilience to economic fluctuation. They also offer the capability to expand the domestic taxation of consumption that is otherwise hard to tax

[35] See discussion in, for example, Grote and Wen, 2024.

[36] Changes in property taxation could be complemented by a more detailed examination of the effects on residents wishing to transition from subsidized public domestic premises into private home ownership, to minimize any disincentive for this mobility.

(e.g., the local consumption of digital services and ecommerce/delivery of goods from the mainland).

**42. A GST would broaden and diversify Hong Kong SAR's tax structure and is compatible with the territory's long-standing emphasis on encouraging saving and investment.** It could provide a durable source of revenue to help meet growing spending pressures. In recognition of this, Hong Kong SAR has explored introducing a broad-based consumption tax over the past two decades, including as part of the 2002 Advisory Committee on New Broad-Based Taxes. The proposal was progressed further in 2006 with public consultation on how to broaden the tax base. While these exercises recognized the potential contribution of a GST to fiscal sustainability, the reform was ultimately not pursued due to the absence of public consensus.[37]

**43. The 2002-2006 reform experience can inform any renewed consideration of a GST.** Although a broad-based consumption tax is well aligned with the territory's need to diversify revenue sources, earlier reform attempts struggled to secure public buy-in—particularly regarding assurances that such a reform would not impose a substantially higher burden on households. While the Advisory Committee process in 2002 established that GST could strengthen fiscal sustainability, public consultation revealed disagreement among citizens and stakeholders over how the rest of the tax system might adjust to ensure progressivity of the reform. Consultations also underscored the importance of communicating distributional impacts, the role of compensatory measures for lower-income households, and how progressivity, fairness, and simplicity would be preserved within the broader tax system.

**44. A single-rate GST, set at 10 percent (or lower), could improve the prospects of successful implementation.** Given Hong Kong SAR's already high cost of living and the proximity of Shenzhen as a shopping destination - despite the Mainland's VAT of 16 percent - a GST set too high could encourage further cross-border consumption. A low rate of 5 percent would increase the prospect of achieving broad support while remaining sufficient to cover the administrative costs of implementation. A higher rate of 8-10 percent would, however, offer the possibility of reducing other taxes that can be more damaging to growth (e.g., transaction taxes on equity purchases). In either case, a single rate with a broad base would fit with the territory's goal of maintaining a simple tax system. As an interim path towards a broad-based GST, domestic consumption taxation could be expanded (e.g., to tourism-related spending).[38]

**45. GST usually applies to the supply of new residential property[39] and the first sale of existing properties, to tax the future stream of housing services those properties will provide.** However, to reduce compliance costs for owner-occupiers, any later resale of those properties could be exempted, along with residential rental contracts in order to foster neutrality between renting

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[37] See the Final Report of the Advisory Committee (2007): https://www.taxreform.gov.hk/eng/finalreport.htm.

[38] The design of this approach, however, would warrant further public consultation, as such taxes would inevitably also capture consumption by Hong Kong SAR residents.

[39] There will also be a policy choice on whether the supply of new government residential properties should be included. As most government housing is provided to relatively lower income earners, there may be merit in exempting these supplies.

and buying. Existing property tax instruments could be adjusted on those taxable sales to reduce the overall tax impact on owner-occupiers (e.g., a once-off stamp duty discount could be afforded to each first home buyer).

**46. The supply of commercial real estate is usually subject to GST, but there can be some complexity around companies operating across property sectors.** Standard international practice for commercial real estate is to apply GST to the sale and use of new and existing properties. This would mean that most businesses (i.e., those registered for GST) could recover GST paid on construction inputs, limiting any flow-through of the tax to construction costs. However, complexity can arise with businesses such as real estate investment trusts (REITs) where, for example, the business spans GST-exempt (residential leasing) and GST-taxable activities (commercial leasing) through, for example, mixed use properties (Swistak et.al, forthcoming).

**47. Taxation of financial services would pose additional design challenges.** A standard credit-invoice GST cannot readily be applied to intermediation services where remuneration arises from spreads rather than explicit fees. Many countries therefore exempt the supply of margin-based financial services, but this means business inputs used in the provision of those services (which have attracted GST) cannot be recovered and so the tax becomes embedded in business costs. Singapore, for example, has elected to effectively zero-rate financial services by allowing partial recovery of input GST to reflect the share of services provided to taxed businesses (Swistak et.al, forthcoming).

**48. A GST would also necessitate a reorganization and scale-up of tax administration and customs enforcement**. These issues – outside the scope of this paper but substantial in importance – include an expanded role for the Customs and Excise Department (e.g., to assess import values for import GST) and for the Inland Revenue Department (e.g., to implement e-invoicing and reporting systems, process refunds, and combat fraud).

**49. Introducing a GST would increase consumer prices, but households could be compensated.** The increased tax on consumption would flow through to the CPI, but typically this is a one-off spike. The recovery of input tax by firms means the tax should not be embedded into production costs. Nevertheless, consumers may need protection from undue price rises and profiteering around the time of introduction. Lower-income households could be expected to incur a relatively larger impact on their consumption, particularly if the supply of residential property (rentals) is exempted from the tax base, as this tends to be of greater benefit to higher income households. A targeted compensation package would be essential to protect vulnerable groups and gain public acceptance for the reform.

**50. Compensation is best focused on protecting low-income and vulnerable households**. Measures could include a one-off increase in social security payments, calibrated to the expected increase in the CPI.[40] Low-income households could also be shielded by rebates for GST paid on

[40] For a GST in the range of 8-10 percent, international experience indicates a one-off increase to headline CPI of around 3-6 percentage points in the quarter following commencement, although this is highly variable based on the tax reform undertaken, whether existing taxes are removed/modified, and the structure of markets (e.g., scope for raising prices).

essential goods and services. An income tax rebate could also be provided to low-to-middle income tax filers (see Table 1). Duty on goods already subject to taxation could also be adjusted — at some cost to revenue — to limit price increases and mitigate incentives for consumption to move to the Chinese mainland.

## E. Reform Directions and Fiscal Impacts

**51. The proposed package of revenue reforms should be calibrated to close the medium-term fiscal gap arising from population aging and capital expenditure for the Northern Metropolis project.** As noted earlier, additional fiscal costs from population aging and the relatively limited social safety net are projected to reach 3.6 percent of GDP annually by 2040. Moreover, the Northern Metropolis project will require sustained expenditure, albeit these spending requirements remain uncertain as detailed analysis and design continues. The structural nature of the changes to Hong Kong SAR's demographics – especially when coupled with Northern Metropolis capital spending – warrant a structural policy response.

**52. Incremental revenue measures within the existing tax bases, while more consistent with past practice, are unlikely to be sufficient to meet these pressures.** Incremental changes to tax policies would still leave the budget exposed to the shortcomings of the existing revenue system. A combination of modest revenue raising measures and government savings could help offset the additional medium-term spending pressures, but such efforts are likely to yield only about 1 percent of GDP in additional revenue by 2040. This is also, however, conditional on a near-term recovery in government finances.[41]

**53. A GST of 8-10 percent could finance most - if not all - of the expected increase in fiscal spending related to population ageing and the Northern Metropolis project.** A GST set at 8 percent could yield between 3-4 percentage points of GDP (Table 1), which should afford fiscal space to finance the additional spending. Setting the rate at 8-10 percent would also minimize the prospect of subsequent rate adjustments (and repeated rounds of compensation). In addition, ensuring only limited exemptions from the GST base would naturally raise expected revenue.

**54. At the same time, the near-term process of fiscal consolidation would be supported by the adoption of some (or all) of the more modest such measures identified.** Many of the smaller actions identified in Section C would contribute to fiscal recovery and would improve the overall revenue system. For example, PIT reforms would help improve income distribution in the territory, higher alcohol duty and increased EV taxation would better externalize the costs of their consumption, and indexing per-unit duties to inflation would help sustain revenue over time. With a stronger economy and a recovering property sector, such actions would help narrow fiscal deficits in the near term.

[41] The scale and phasing of the Northern Metropolis introduces additional uncertainty: a larger population in the territory would expand the revenue from existing tax instruments, but there are also fiscal risks associated with project cost overruns.

**Table 1. Hong Kong SAR: Policy Directions: Potential Revenue Impact of Reforms**

| Fiscal Item | Change in annual fiscal impact in 2040, relative to 2025 (pct GDP) | Summary of Estimate |
|---|---|---|
| **Medium-Term Spending Pressures** | | |
| Projected Fiscal Cost of Ageing Population | 3.6 | Estimates drawn from Hoyle (2025): age-related spending increases (1.8 ppt annual increase by 2040), increased social security payments (0.9 pct), increased old-age payments (0.9 pct). Excludes cost of defined benefits scheme for public servants (unquantified in that paper). |
| Northern Metropolis Infrastructure Spending | .. | Not zero but remains uncertain in both timing and scale. |
| **Potential Tax Policy Actions – Existing Framework** | | |
| PIT – tax all salaries income at progressive rates | 0.1 | Based on simulation analysis of Hong Kong SAR's personal income tax scale. Existing PIT collections and distributional data used to calibrate the tax paid by existing taxpayers. Simulation estimates revenue gap between progressive PIT schedule and the standard rate. |
| PIT -- extend scale to all salary income, adjust upper end of PIT scale to 27 percent. | 0.5 | Based on simulation analysis of Hong Kong SAR's personal income tax scale, as above. Existing PIT collections and distributional data used to calibrate the tax paid by existing taxpayers, with a simulation of that distribution then created based on a higher PIT rate scale. |
| PIT – increase marginal rates to include a top marginal tax rate of 40 percent. | 2.5 | Based on simulation analysis of Hong Kong SAR's personal income tax scale as above. Simulated rates and thresholds: up to HK$ 132,000: 0 percent, 132-182k: 4 percent, 182-232k: 15 percent, 232-282k: 20 percent, 282-332k: 25 percent, 332 – 2,000k: 30 percent, 2,000-5,000k: 35 percent, above 5,000k: 40 percent. |
| PIT – introduce CGT for individuals for HK gains | .. | Not zero but unquantifiable due to challenges in reliably establishing the cost base for assets for the new tax. |

**Table 1. Hong Kong SAR: Policy Directions: Potential Revenue Impact of Reforms (continued)**

| **Fiscal Item** | **Change in annual fiscal impact in 2040, relative to 2025 (pct GDP)** | **Summary of Estimate** |
|---|---|---|
| Increase CIT rate by 2 percentage points | 0.5-0.6 | Increase based on current revenue generated per percentage point of the tax (approximately 0.37) but reduced by a modest behavioral response (e.g., movement of profits abroad) of 0.17 pct GDP from de Mooij and Liu (2018). |
| Expand alcohol excise | .. | Restoring alcohol taxation to 2006-07 levels as a starting point (returning duties to their levels prior to wine duty reductions in 2008) could raise approximately HKD 2 billion in additional revenue. |
| Index per unit excises to inflation | .. | Based on gradual loss in revenue due to inflation over 15 years if no adjustments implemented. By 2040, tobacco and gasoline fixed excises would reduce in value by 25 percent assuming 2 percent annual inflation, reducing annual revenue in 2040 by approximately 1.5 billion HKD. |
| Vehicle taxes – additional charge | .. | Based on estimated total road usage of nearly 40 million vehicle kilometers per day. If taxed at HKD 0.05 per km, estimated revenue is approximately HK$2 million per day (around HK$730 million annually). |
| **Major Consumption Tax Reform** | | |
| GST with 5% standard rate | 1.9-2.5 | Estimated as a range, based as a percentage of Hong Kong SAR's total private consumption. 5 percent rate applied to total consumption and then discounted using range of C-efficiency estimates for other countries in the Asian region (0.45-0.85) to approximate for administrative capacity and to reflect that not all consumption is covered by the tax (e.g., exemptions, zero rating). |
| (Alternative) GST with 8% standard rate | 3.0-4.0 | As above, using 8 percent of total private consumption as starting base. |
| GST Compensation package for low-income residents | | Compensation presented below is assumed to be upper end – calibrated to the implementation of a GST at 8-10 percent. |

**Table 1. Hong Kong SAR: Policy Directions: Potential Revenue Impact of Reforms (concluded)**

| Fiscal Item | Change in annual fiscal impact in 2040, relative to 2025 (pct GDP) | Summary of Estimate |
| --- | --- | --- |
| -- Increase in government payments to low-income households | 0.4 | CSSA, SSA, OAA, and OALA payments assumed increased by 5 percent (the approximate increase in CPI in the year a GST was introduced), which would be sustained. Also includes an associated increase in fixed annual expenditure provided to social welfare services, elderly services provided by the Social Welfare Department (HKD 500m each). |
| -- Tax rebate for income earners below median | 0.8-1.2 | Estimated as a rebate of approximately HKD 20,000-30,000 for taxpayers with annual income up to HKD 400,000 from the year of a GST's introduction. |

Source: IMF Staff calculations.

Note: .. indicates non-zero, but rounded to zero.

## F. Conclusion

55. **Hong Kong SAR's long-standing record of prudent fiscal management could be increasingly challenged by structural shifts in the economy, warranting a reassessment of the current approach to revenue generation.** The territory is uniquely placed to prosper as key interface between the Chinese mainland and global investors and has clear ambitions to further diversify its growth engines. At the same time, projected changes in economic structure and population demographics pose new fiscal challenges, which are expected to be compounded by potentially large-scale capital expenditure commitments — most notably the Northern Metropolis development — adding funding needs to the government's budget. Preparing early for these fiscal challenges is essential.

56. **A range of policy options could be considered: while the government's main priority is expenditure control, it should be complemented with significant revenue mobilization.** Incremental measures within the existing revenue framework — such as extending the progressive PIT schedule to all salary income, broadening excise duties, and modestly increasing the CIT rate — could generate additional revenue while remaining consistent with the territory's long-standing low-tax, simplicity, and competitiveness objectives. But their revenue potential is relatively limited, estimated at around 1 percent of GDP. Major tax reform would more comprehensively and sustainably finance higher future spending. A GST on domestic consumption could generate 3-4 percent of GDP in additional revenue and would broaden and diversify the tax base in line with the territory's emphasis on savings and investment.

**57. Although the tax reform would entail some near-term economic costs, it would help secure the territory's medium-term fiscal capacity.** Conservative estimates based on the proposed tax revenue reforms suggest that the near-term impact on GDP growth could be up to -0.5 percentage points, with larger effects during economic downturns and more muted effects during upswings.[42] However such a reform would swiftly turn the fiscal balance positive (within 2 years), strengthen the government's ability to meet rising age-related spending pressures and ensure adequate investment in strategic priorities to boost medium-term growth potential. This includes addressing the needs of an aging population, providing for the expansion of social safety nets, and sustaining the substantial capital expenditure required for large-scale development initiatives such as the Northern Metropolis. In this way, short-term adjustments would lay the groundwork for a more resilient and forward-looking fiscal framework.

[42] The calculation draws on multipliers from various sources including the World Bank's CPAT, Romer and Romer (2010), Riera-Crichton, Vegh, Vuletin (2016), and IMF (2020). In particular, the multipliers for PIT, CIT, and GST are respectively -0.5, -0.2, and -0.2, and the increase in government payments to low-income households as well as the one-off tax rebate are associated with a significantly higher multiplier of 1.0. All the revenue reform and compensation measures are taken as proposed in Table 1.

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