



The Lion Rock Institute

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Legislative Council
Hong Kong Special Administrative Region
c/o Legislative Council Secretariat

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Submission to the Housing Panel Meeting For Friday April 13th, 2007.

Respect for property rights and freedom to enter into lawful contracts underpin our civilization and Hong Kong's prosperity. Recent discussions taking place in the legislature suggest that some legislators do not fully considered the ramifications of their legislative activism in repeatedly calling to task The Link to account for normal business decisions.

By doing so, legislators:

- **Degrade Private Property Rights.** Premises under The Link are no longer government property. By impinging on the independence of managers, the legislature is setting precedence for the government to exercise arbitrary power and single out individual firms for political cause.

Indeed, the use of so-called special legislation should not be used as a Damocles sword held over the corporate head of Hong Kong owners and managers to coerce them to toe a populist line. The abuse of political pressure in this manner creates a climate of fear among property owners, big or small.

(Reference: *At Your Doorstep*. Originally published in the South China Morning Post, 30th March, 2007.)

- **Obstruct Lawful Contract Negotiation.** Contracts should be negotiated between parties voluntarily and enforced by courts, but not imposed and interpreted by politicians. By introducing political factors into the normal business negotiation, legislators are encouraging rent-seeking behaviors that are inefficient, if not counter-productive. Excessive rent-seeking behaviors will also undermine the robustness of our political and social institutions.



The Lion Rock Institute has two excellent reasons to take a position on this issue.

1. By singling out The Link, the political this may deter future investors from taking a stake in newly privatized ventures (such as the Airport Authority), reducing returns to the government and indirectly penalizing Hong Kong's hard working taxpayers. The Lion Rock Institute is an advocate of returning assets to the hands of the public and this hectoring sets a discouraging example.
2. This may deter investment in Hong Kong in general. If it is the Link today, why not Citigroup, Starbucks, MacDonald's or even Mr. Wong's fruit-stall tomorrow? Increases the political risk appending to all Hong Kong investments will reduce returns and the wealth of all Hong Kong's people.

We recognize that some legislators, deeply distrustful of the benefits of the market economy, all evidence to the contrary, may prefer these outcomes. However, we hope more reasonable people wish to see Hong Kong free and prosperous, with local and international investors alike happy to invest in Hong Kong to the manifest benefit of our people.

Instead, perhaps the Housing Panel could spend time investigating novel ideas like the one enclosed in the attached essay, *How to Unleash Hong Kong's Dead Capital*, from May 2005.

Thank you for your consideration and continued work serving Hong Kong.

By and On Behalf of:

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How to Unleash Hong Kong's Dead Capital

A Lion Rock Institute Publication

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Author: Andrew Work, Executive Director, The Lion Rock Institute

I usually don't pay too much attention to economic issues facing developing country economies. I made an exception to read Henando de Soto's *The Mystery of Capitalism: Why Capitalism Triumphs in the West and Fails Everywhere Else*. I'm glad I did - it turns out we have a third world - but solvable - problem right here in Hong Kong.

de Soto describes what he calls dead capital. Dead capital describes assets that, while serving their primary function such as providing shelter, do not exist in the world of capital. For example, if you have a house, you can live in it and store your property there. However, you cannot use it as capital, for example take a mortgage on it, unless you have clear title to it and it is described on paper as part of a larger system that recognises your property rights.

He postulates that homes lived in by people in the third world lack such title, meaning they cannot be used to generate capital. This represents trillions of dollars in capital that is "dead" - that is, it cannot be deployed in any useful manner. In countries that do have a clear system of land title, de Soto notes that the number one source of funds for entrepreneurs is normally a mortgage on their home. This means that in the third world where no clear land title system exists, entrepreneurship, the generator of wealth in society, is stunted.

Even though Hong Kong is frequently treated as a developing country by many international publications and agencies, we know this not to be the case. We have a GDP per head greater than that of many OECD countries. Our legal system is inherited from the British and adequately establishes property rights. Clearly there is no relevance to Hong Kong from this endemic third world problem. Or is there?

Another startling fact about our supposedly free market economy is that the Global Entrepreneurship Monitor consistently ranks Hong Kong at the bottom of their ranking of Total Entrepreneurial Activity. This is strange in a city that consistently ranks as one of the easiest places in the world to set up a business.

Could it be that for 31% of Hong Kong's population living in Public Rental Housing, the lack of title to their homes keeps them shut out of the first time entrepreneurs' most common form of start-up capital? By keeping people in public housing, are we killing Hong Kong's entrepreneurship?



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The question bears investigating. The value of Housing Authority residential assets is unknown, but could run over \$500 billion dollars. This is distinct from other Housing Authority assets it tried to free to the market through the Link REIT. This is dead capital to the residents of these flats - and the banks that could lend them money against these assets.

By accepting a life in government housing, these people will never own their own homes. They will not have assets to pass to their children. They cannot take a mortgage on property they do not own to start a new business. Their ability to raise funds, capital, using their homes in non-existent.

How do we unleash the entrepreneurial drive of those living in Housing Authority flats? How do we give them access to the capital dormant in their residences? The government needs to identify the current housing situation as a major drag on entrepreneurship and begin the process of creating a space for Hong Kongers to become homeowners. Two schemes suggested for this include expanding the current program of selling flats to their current inhabitants or even just giving them away.

A raft of objections springs up immediately: What would it do to current market values? How would people bear maintenance costs? How would fairness, previously guaranteed by random ballot, be maintained? How would fairness be maintained between selling or giving away a flat in Yuen Long and one in Stanley? How would taxpayers be reimbursed for their expenses?

Jettisoning decades of housing policy would be a radical shift that could invigorate Hong Kong's economy and release literally millions from government dependence. It would require a massive privatization effort following guidelines set out by The Lion Rock Institute: Complete privatization of housing units and deregulation of their use, a robust legal framework for effecting the transfer and strong political backing to enroll the people of Hong Kong in this vision.

The massive benefits to be realized bear investigation and the effort required to address the hurdles involved. Radical ideas start as just that: ideas. They need support and nurturing. They require a final goal that is not only desirable, but also noble. Reducing the state dependence of millions is such a goal and one within the reach and spirit of the people of Hong Kong.

Increasing independence, unleashing billions in capital for use in the economy and empowering millions of Hong Kongers is a noble goal that demands our attention. There will be naysayers and a flat sale or giveaway scheme may only be partially feasible with tremendous efforts. However, rather than heed pessimists and those defending a status quo where millions depend on government munificence, we should support those with idealistic aims and realistic means of working towards them. This is the way forward for a free and prosperous Hong Kong.

For more, please see www.lionrockinstitute.org, email at info@lionrockinstitute.org or call us at +852 2854 4544.



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At Your Doorstep

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Author: Andrew Work, Executive Director, The Lion Rock Institute
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Property rights matter. Immensely. Starting with dominion over your own body, all freedoms in society flow from your ability to retain and control the use of your property. That is why it is so alarming that in Hong Kong, property rights seem to be under assault from the corporation to the lowly hawker stall and right up to your doorstep.

The Property Rights Alliance recently launched their first International Property Rights Index. Hong Kong did middling well, ranking 17, just behind the US and Canada. However, there is little doubt that it will drop in the future given the changes sweeping our society.

The PRA Index outlines 3 areas: Political and Legal Environment, Physical Property Rights (including financial property) and Intellectual Property Rights. Many components are based on attitudinal surveys conducted by groups like Transparency International and the World Bank. They reflect what people believe based on their experience of property rights. How can any observer in Hong Kong today believe but that we are losing ground on two of three components? While Hong Kong has mounted some of the most aggressive defenses of intellectual property rights in the online sector, we are losing ground on the two other components.

Many legislators are quick to oppose to government mandated evictions to make way for new development in SOHO, Mong Kok's Garden Street, or Wanchai's Wedding Card Street. Long-standing hawker stalls and roadside restaurants are shunted aside by bureaucrats in the name of societal development. Where people have clear right to their property, legislators are right to stand in defense of these individuals. They understand that the use of *eminent domain*, government mandated seizure of property for assumed benefits to society, is wrong in this case. However, their recent attacks on Link have undermined their ability to defend these constituencies by setting the precedent for violations of all property rights in Hong Kong.

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It was a step forward when the Link REIT returned assets to the people of the market. Hong Kong people, along with international investors, relieved taxpayers of the burden of an inefficiently run car park and shopping centre conglomerate. The results have ended a system of a minority of shop-owners and privileged workers receiving unfair subsidization from Hong Kong's middle class taxpayers. A previously unrealized asset is now contributing to many retirement funds. These shares are property as sure as the ownership of a flat and their protection is vital to people's independence in old age. The ability of the designated managers to operate these assets free of arbitrary whims of coercive government power is the basis of the shareholders' expectations of returns. However, many legislators would violate the property rights associated with these assets to indulge in political grandstanding.

The Link is repeatedly called upon by legislators, goaded by unions (on wages) and industry special interests (complaining over tenancy agreements for restaurants and doctors), to explain its actions under threat of special legislation. This populist legislative activism deters investment in Hong Kong by external investors and Hong Kong people alike. If Link today, then who tomorrow? Ironically, the legislators who meddle in Link's affairs are setting the precedent for violating the rights of other constituencies, weakening property rights for all.

Legislators attacking Link would no doubt argue they were working for the common good. This is the exact argument used to violate all property rights. At one extreme it justifies absolute communism, the elimination of property rights for the common weal. At a more nuanced level, it justifies government's exercise of eminent domain. Eminent domain is often justified by providing a government or third party determined level of compensation. But for some, no money can replace what is taken from them: A shop in the family for generations. A flat they grew up in and inherited from their parents. A New Territories property belonging to native ancestors.

Lawmakers aggressively use legislative power to pursue their vision of Hong Kong by violating one group's property while defending another's right to freedom. You cannot morally deny and promote the same rights in one breath.

This attack comes closer to our homes at every turn. Bars, restaurants, (formerly) private clubs, and your apartment building (run normally by incorporated owners) were overnight transformed from private establishments, *property*, into public spaces under the new Smoking Ordinance. Whereas these were previously private areas, the new legislation deemed them public by virtue of the fact that people visited them and employees were present. If the doorstep of your flat is now public domain, how long before the government walks into your living room?

Nobel laureate Friedrich Hayek said, "Private property is the most important guarantee of freedom." He was right. Who will stand for your right to your property when everyone else's has been taken away?

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