

HONG KONG: SCRUTABLE LESSON

BRITISH left-of-centre policy-makers who are searching for alternative economic models ought to pay close attention to Hong Kong. The British colony offers perhaps the most incisive example of all that is good - and bad - in the modern industrial economy.

That Hong Kong is something special is illustrated by the boast of its governor, Chris Patten, who said in his address to the colony last year: "how many other finance ministers in the world could have used their budgets this year simultaneously to cut taxes, raise spending and increase the reserves?"¹ How was such a neat trick performed?

First, all the land in the colony is held on lease. No one is a freeholder.

Lesson: you can have a thriving capitalist economy without the property right that is conventionally held to be imperative for the efficient operation of markets. The myth that investors must have the right to "own" land, if they are to take risks and make profits, is spurious: witness Hong Kong. Unfortunately, the myth is being actively retailed in the former Soviet economies by Western advisers who are on the payroll of the World Bank and the US AID.

Second, Hong Kong derives such a large part of its public revenue from land that it is able to settle for low rates of taxation on labour and capital. The revenue is biased in favour of capital sums (from sale of leases) rather than from annual rental income (see the graph).

Lesson: a distinctive fiscal strategy for raising incentives for investors and rescuing ailing market economies (by expanding their supply-side capacity) exists. It is based on the restructuring of the tax system, rather than tinkering at the edges of the present "anti-progress" taxes.

AN EQUALLY important lesson from Hong Kong, however, is the flaw that periodically destabilises the economy. This flaw exists in all market economies - the propensity to speculate in land.

Land speculation differs from all other forms of speculation in that it disrupts the supply and price of one of the essential factors of production. So long as we have land speculation, there can be no sustainable inflation-free/full-employment growth. But how can land speculation operate in an economy where there is no private ownership of land? Hong Kong is important because it directs our attention to the thing that matters: rental income, and the ability to capitalise that income into a selling price.

When people speculate in land, it is not the right to

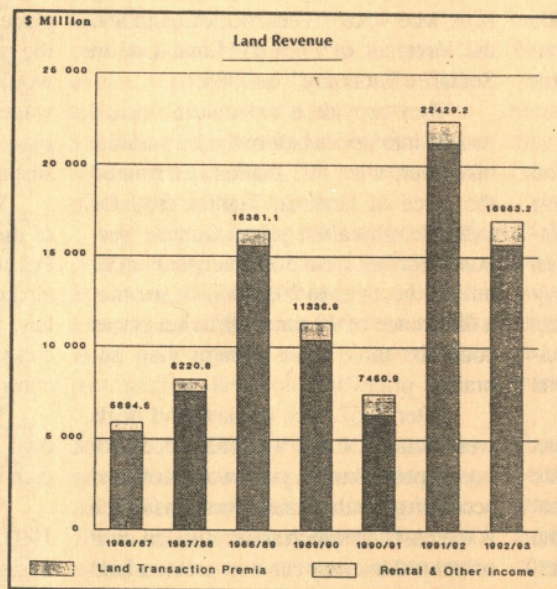
"own" land that matters. Speculators are after the rent which, when capitalised, provides a capital gain. And that capital gain can be made out of the sale of leases, if the government fails to capture the full annual rental income.

Thus, in Hong Kong, despite the law on property, the fiscal system fails to socialise all the rent of land. If it did, the colony could be tax-free: no income tax, no corporation tax, no taxes at all! Unfortunately, despite its distinguished performance, the Crown colony's government has allowed its subjects to be victimised by speculation.

The current phase began in 1991 in the residential market. Apartment prices rose above the means of many families. The government was accused by property developers, who claimed that the problem was the insufficient supply of land in the auction rooms. This is the argument in Britain, where planners are blamed for failing to zone sufficient land for development. Neither explanation is

correct. People do not consider the possibility that speculation, *per se*, is the problem).

To combat the problem, the Hong Kong government introduced "anti-speculation" measures in 1992, and supplied additional land to the market. But the damage was done. This was reflected in the investment intentions of entrepreneurs, as disclosed by the interest shown in the acquisition of new sites. The government noted that "response to the auctions of residential sites during 1992 remained generally favourable. However developers were cautious about acquiring industrial sites".²



WHAT WILL HAPPEN after 1997? At present, land grants and leases are made for terms that expire not later than 2047. They are made at premium and nominal rental until 1997, after which an annual rent equivalent to 3% of the property's rateable value will be payable.

This formula will still not capture the whole of the rent of land. To achieve that, a new philosophy - with matching institutional arrangements - are needed. To achieve optimum results, the need is to synthesise the market with efficient assessment procedures; and the market (i.e., people) - not the bureaucrat, or taxman - must be the arbiter of what land is worth to people as users.

The lesson for Britain's new Labour Party leaders - if they are interested - is clear. Sustainable growth begins, and ends, with the tax system.

¹ Hong Kong: *Today's Success, Tomorrow's Challenges*, Address by the Governor at the opening of the 1993/4 Session of the Legislative Council, 6 Oct., 1993, p.2.

² Hong Kong 1993, Government Information Services, Hong Kong, p.48.