

# The future for Letters B

**W**HEN HONG KONG Island was ceded to Britain in 1841, it was largely uninhabited and all land was declared Crown Land.

Subsequently when the New Territories (some 350 square miles of mainland and outlying islands) were leased to Britain by China for 99 years in 1897, the area included a number of established villages and associated agricultural land.

This land was declared Crown Land, but leases were granted by the Hong Kong Government to occupiers for the period of the lease from China, less 3 days.

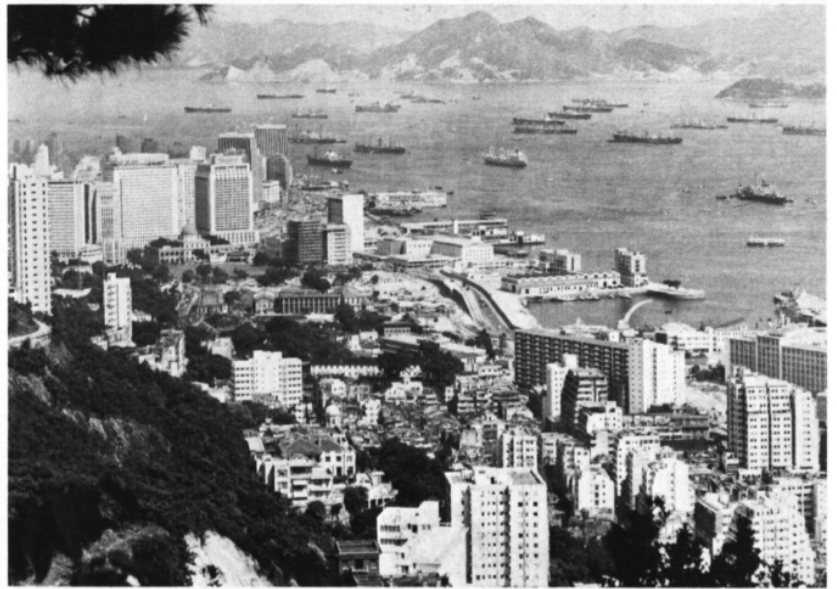
These leases classified land as building or agricultural land dependent on its then use.

During the first 50 years of this century, little change took place in the New Territories to disturb the rural nature of the countryside.

From 1950 onwards, however – and particularly in the last 20 years – the demands of an increasing and immigrant population have required urbanisation of much of the area.

The construction of new towns, provision of associated infrastructure and the influx of new people and ideas have forged great changes in the way of life of the villagers and in the pattern of land ownership and use.

To provide for these changes and,



## ANALYSIS by PETER POOLE

at the same time, to enable existing villagers (who were largely descendants of the original occupiers) to retain a status in their ancestral holdings, a novel system of land exchange was evolved.

Initially, Government offered land in new urban areas in exchange for land in rural areas to make way for new development. This land was exchanged on a value-for-value basis.

Since agricultural land had a value for that purpose of only, say, 25 cents a square foot, whilst building land with services was often worth (even in the 1950s) \$10-20 per square foot, some 40 or more square feet of agricultural land would have had to be surrendered to acquire one square foot of building land.

This system worked well in the first few years and helped in the release of

## Land market slump boosts budget deficit

**H**ONG KONG, traditionally one of the few places in the world whose government spending is less than its revenues, looks set for two years of budget deficits – because of a slump in the local land market, reports Norman Gerrard.

In his budget statement, Financial Secretary John Brembridge forecast a fiscal 1982/83 deficit on current revenue account of H.K.\$3.8 billion (around U.S.\$600 million).

He raised indirect taxes, with spirits for instance going up 20 to 30 H.K. dollars a bottle, and plans to get more money from the services the government provides, such as airport facilities and mooring buoys in the harbour.

These moves, he estimates, will bring in \$3 billion, leaving a 1983/84 deficit of \$3.2 billion.

*That the deficit is almost solely due to the depressed state of the land market can be clearly seen from the figures.*

In 1981/82, Hong Kong received \$9.7 billion dollars, nearly a quarter of its entire government revenue, from land sales and other transactions.

Brembridge had forecast in his 1982

budget statement that the 1982/83 figure would rise to 12.5 billion. Instead, it has slumped to an estimated 4.6 billion.

In the coming year, Brembridge estimates income from land transactions at just 3 billion dollars.

**H**ONG KONG's government, contradicting Mark Twain's well known dictum about land – "they don't make it any more" – actually does produce land, by bulldozing hills into the sea. This, and expiring leases, give it around 100 hectares a year to dispose of.

In the 1970s, when prime sites in the Central and Tsim Tsa Tsui districts were as valuable as land almost anywhere in the world, this gave the government an ideal opportunity to keep taxes on the wealth producing sectors low, and build up reserves.

In fact, Hong Kong half way through 1982/83 had uncommitted reserves of 16 billion dollars, some of which Brembridge now feels justified in using.

However, now the lower prices which land is fetching are leading the government to cut the amount of land it offers on the market for fear of depressing it still further.

One stockbroking analyst noted that Brembridge had excluded the sale of five prime sites from its estimates of land transaction revenues in the coming year. But the Financial Secretary said in his speech he would put these sites on the market as soon as it seemed commercially sensible to do so.

The analyst estimated that Brembridge would cover his 1983/84 deficit if he put these sites on the market in the coming year.

*But will the land market pick up sufficiently to enable him to do so?*

The market is not depressed simply by the economic recession in the colony and in the rest of the world. There is also "the 1997 factor."

Britain's lease on most of the territory of Hong Kong runs out in 14 years' time. Even the part which is not due to revert to the Chinese would scarcely be viable alone.

People are paying less for land they may be able to use for only 14 years.

land from agricultural use and its conversion to urban purposes. But there were problems.

- Some owners objected to giving up large areas of agricultural land for much smaller areas of building land.

- It also became difficult to find suitable serviced land immediately available to grant in exchange.

- And some villagers were not always in a position to undertake development of the new land – an essential prerequisite laid down by Government on any grant of land.

**T**O MEET this situation, the Hong Kong Government created land exchange arrangements which have become known as the Letter B system – as distinct from Letter A, an earlier and less important scheme.

The Letter B is an undertaking by Government to grant land at some later unspecified date in return for the surrender of existing land titles giving Government immediate access to that land.

In view of the land requirements for social infrastructure and public utilities when agricultural land is urbanised – i.e. changed from a low to a high population density – it would clearly have been impractical to offer an *equal area* of building land for agricultural land surrendered, which is what the villager would have liked, whilst the villager was reluctant to accept an exchange basis on *equal value* which the Government had been happy to grant.

*So a compromise was sought.*

It was found that in a typical high-density urban development in Hong Kong, some 60 per cent of the land was required for public use (roads, schools, community uses, etc) leaving 40 per cent for development by private enterprise.

The Letter B therefore provided for the grant of 2 sq. ft. of building land fully serviced for every 5 sq. ft. of agricultural land surrendered and equal area for building land given up, i.e. land in the original villages disturbed by development. (More recently this arrangement has been modified to 1 sq. ft. of new land for every 5 sq. ft. of agricultural land in order to provide more land for public housing.)

In addition, to provide an equitable contract, the Letter B provided for the payment of a premium based on the difference in value of the land surrendered and the land granted, both valuations being deemed to take place on the date of surrender.

# New market order needs land value tax says World Bank adviser

- CHINA is experimenting with a new market-orientated order.

One early feature is the abolition of communes and their replacement with new forms of economic organisation.

Pilot schemes were first launched in Sichuan, the home province of Deng Xiaoping which was under the control of his protegee, Zhao Ziyang, until he was made Prime Minister in 1980.

China's leaders still have much to learn from Western economics, however.

PAUL KNIGHT reports.

**P**REMIER Zhao Ziyang has launched a programme to quadruple China's economic output by the year 2000.

But such a programme ought to include land value taxation, according to World Bank consultant Bela Balassa, who is Professor of Political Economy at the Johns Hopkins University.

His conclusion is part of a report he produced after visiting Red China last May.

In the past two years, Chinese leaders have come to terms with the need to reintroduce individual incentives and free market pressures into the economy.

In agriculture, for example, household plots have increased from seven per cent to 15 per cent of the total. Under the Cultural Revolution, household plots were banned.

Food grown on household plots can be sold at market prices and without the payment of any taxes to the commune.

The professor reports: "The family-responsibility system has assumed increased importance, covering 60 per cent of the land area of the communes in Sichuan province, with family groups accounting for another seven per cent.

"In the same province, production on private plots, occupying 13.5 per cent of the land area, and sideline activities carried out by the family, reportedly accounted for 47 per cent of agricultural income in 1981."\*

**O**UTPUT on private plots has far outstripped the yields from communally-owned land, for which procurement targets are set by the communes.

But this new market reality poses critical problems, says Prof. Balassa, and one of them is the threat of widening income inequalities.

"While income disparities owing to differences in effort are considered desirable, such disparities also result from differences in the quality of land.

To eliminate this source of inequality, it would be desirable to place increased reliance on land taxes while raising agricultural prices.

Land taxes should be fixed in amount but varied according to the quality of land, so as to absorb a considerable part of the rent element in agricultural incomes."

The present land tax (called an agricultural tax) accounts for only three per cent of the value of agricultural output in Sichuan province.

The professor identified an important advantage of a tax on land values compared to a progressive tax on agricultural incomes: the latter would reduce income differences but discourage effort.

The tax on land values, then, would meet the demands of the peasants, as articulated by the Minister of Agriculture, Liu Hujia.

In November 1981, he stressed the need to "further improve the various forms of responsibility systems in farm production with remuneration based on output, since they are welcomed by the peasants."

\*Bela Balassa, 'Economic Reform in China', *Banca Nazionale Del Lavoro Quarterly Rev.*, Rome, Sept. 1982.

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**OUTPUT ON PRIVATE PLOTS SOARS**

# HONG KONG

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**T**HIS SYSTEM has proved to be of immense value over the years in smoothing the way for large reclamation and development schemes which destroyed old established villages and their associated agriculture, whilst enabling the villagers to retain a stake in the new environment.

The great majority of Letters B have been given up in exchange for land in new towns now fully developed in accordance with lease conditions.

Many Letters B however remain in private hands and have become in effect "land futures".

They give their owners (Letters B being freely negotiable) the right to acquire land of a net area at a value assessed at the date of the letter.

*This presents some difficult valuation problems, particularly in respect of land which was part of the sea and not even reclaimed, let alone provided with services or surrounded by other development at the date in question!*

The value of any particular Letter B fluctuates according to the land market and serves to illustrate in rather graphic form what is happening in respect of the 'real' land which provides the backing for the letter.

This is also another factor extending the area of speculation.

Letters B originally restricted the land to be granted to the same district as that of the land surrendered. Later, this restriction was removed and land in any part of the New Territories (not in the ceded area of Hong Kong Island and Kowloon) could be granted in exchange.

Thus, since fluctuations in land value are not uniform over the whole of the New Territories, holders of Letters B need to look for land when the change in value from the date of the letter is greater than elsewhere. Any one new grant may well involve surrender of a considerable number of Letter B of various dates to make up the area of land required.

Thus the system requires much 'professional' input to obtain the best bargain and is subject to very lengthy negotiations in the tea houses of the New Territories before any transaction is finalised.

**T**HE LETTER B system has been criticised as establishing a series of open ended IOUs in land which may never be redeemed – leading to speculation in land futures.

*Such criticism is rather superficial.*

It is surely better to allow speculation in land IOUs than in land itself.

● The Letters B provide a market in land futures without delaying the development of land itself. Once the land is taken in exchange, it has to be developed to a specified level within a limited period of months as a condition of the grant. If not, it is forfeit to the Crown.

● Secondly the system has cleared the way, politically, for the redevelopment of much of the New Territories in the interests of the Colony as a whole and with the co-operation of the existing occupiers which might otherwise have been difficult to obtain.

It has also given many of the original villagers a real stake in the new world.

Some concern has been expressed about the increasing value of outstanding Letters B and the ability of the Government to provide sufficient land in exchange to meet demand.

*This again is somewhat superficial.*

As regards the price commanded by Letters B, this clearly goes up and down according to the market and it is entirely a matter for the holders to decide when to cash in for land. The Government is to provide the area of land to meet the demand established by the figures in Letters B; there is no financial problem as far as the Government is concerned since every exchange involves the applicant in the payment of a premium.

Nevertheless the time may be approaching when the system may cease to have the appeal that it once had.

With fluctuations in land values – and these recur at irregular intervals in the volatile Hong Kong market – the values of Letters B also oscillate and can be a source of loss to the unwary.

Government – ever wary of its financial reputation – is sensitive to such losses since they can be presented as something arising from Government's Letter B system – a system of IOU's which sometimes deprive an owner of his anticipated compensation.

Thus Government may revert to direct monetary compensation, but this will present problems in valuation since the Letter B system has led to distorted agricultural land values.

Purchase of outstanding Letters B is a possibility, but it may well be difficult to agree terms and some Letters B are likely to be around the market for some years yet.

*One may ask what effect land value taxation would have had on such a system.*

In practice, provided LVT could have been maintained at up-to-the-minute valuations in the rapidly developing situation, it would have simplified the acquisition of land for new towns and Letters B may not have been necessary.

Had they been issued, however – and since the Letter B is an entitlement to land at a fixed price (i.e. a "land future") – it would itself be subject to the land value tax.

*A convenient way for a government to increase its tax base!*

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road-blocks that obstruct this process and uncover the root cause of Britain's stagnation.

In one near-analytical paragraph he refers to the fall in the share of national income that will go to wages and the consequent increase in the share going to the "institutions which own the machinery that replaces labour." But he does not pursue the analysis and ask himself how the inevitable competition among the machinery makers would affect the situation and whether there was not some other group – perhaps those who own the land the machinery stands on – who might, in fact, be taking the lion's share of the benefit brought by the new technology.

He might then have pursued the possibility that a country's system of land tenure (especially where the price of land is kept high by being held idle for safe investment) might have something to do with the failure of industry to expand to absorb those workers displaced by the new machinery.

Until Mr. Jordan has made an effort on these lines to track down the reason for Britain's stagnation, he is in no position to propose a remedy, especially one which would be not so much a solution as an act of humiliating surrender.

## REFERENCES

1. The money supply (M3) increased by 60 per cent in the two years 1972-73.
2. Labour Party conference, September 1976.
3. Bill Jordan, *Automatic Poverty*, Routledge & Kegan Paul, 1981.
4. "I am convinced that the substitution of machinery for human labour is often very injurious to the interests of the class of labourers." David Ricardo, *Principles of Political Economy and Taxation* (1817), Chapter 31, Everyman Edition, Dent, 1912, p.264.

## TRIBAL CONFLICT

**L**AND hunger was the cause of the mass slaughter in Assam earlier this year.

Every square mile of Assam's cultivated land supports 1,600 people. Next door, in Bangladesh, a square mile has to support nearly twice this number.

And it was fears arising from this pressure on natural resources that led to the inter-tribal conflict that left over 1,000 Bengali Moslems dead – because they were regarded as land-grabbing intruders.