

Rebuilding free markets in Hong Kong

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At

Project Chambers

16 June 2017

Stamp Duty



Launched in 1694 under King William III of Orange and Queen Mary II, to finance a war in France

Special Stamp Duty

- SD taxes assets, not profits or earnings, thereby distorting the economy
- In 1997, highest SD rate was 2.75%, raised to 3.75% in 1999 and 4.25% in 2010. Now, the highest rate is 50% (SSD+BSD+AVD), and its declared purpose is not to raise revenue but to penalize a Basic Law (BL) right.
- BL Article 105: “The HKSAR shall...protect the right of individuals and legal persons to the acquisition, use disposal and inheritance of property...” (including real estate).
- Introduced 20-Nov-2010, increased 27-Oct-2012: Special Stamp Duty (SSD), up to 20% for sale within 6 months (10% for sale in 1-3 years), is a penalty for exercising the BL right of disposal. It is not intended to raise revenue, so it is not sheltered by the Government’s right to impose taxes under BL Article 108.
- Imagine the outcry if new taxes were imposed on Mosques, Synagogues or Cathedrals and their congregations, for exercising Basic Law freedom of religion (BL Article 32). Freedom of transaction, to a free market, is just as important.
- SSD locks people into their homes for 3 years, even if they want to move to take a job on the other side of HK, or are posted overseas, or need to upsize for children or downsize (loss of breadwinner).
- SD was already a deterrent to ownership. I rented 7 homes in 15 years as my requirements changed from single to married-with-children, before buying in 2006. Today, stamp duty at 4.25% on a home is about 2 years’ rent for the same home.

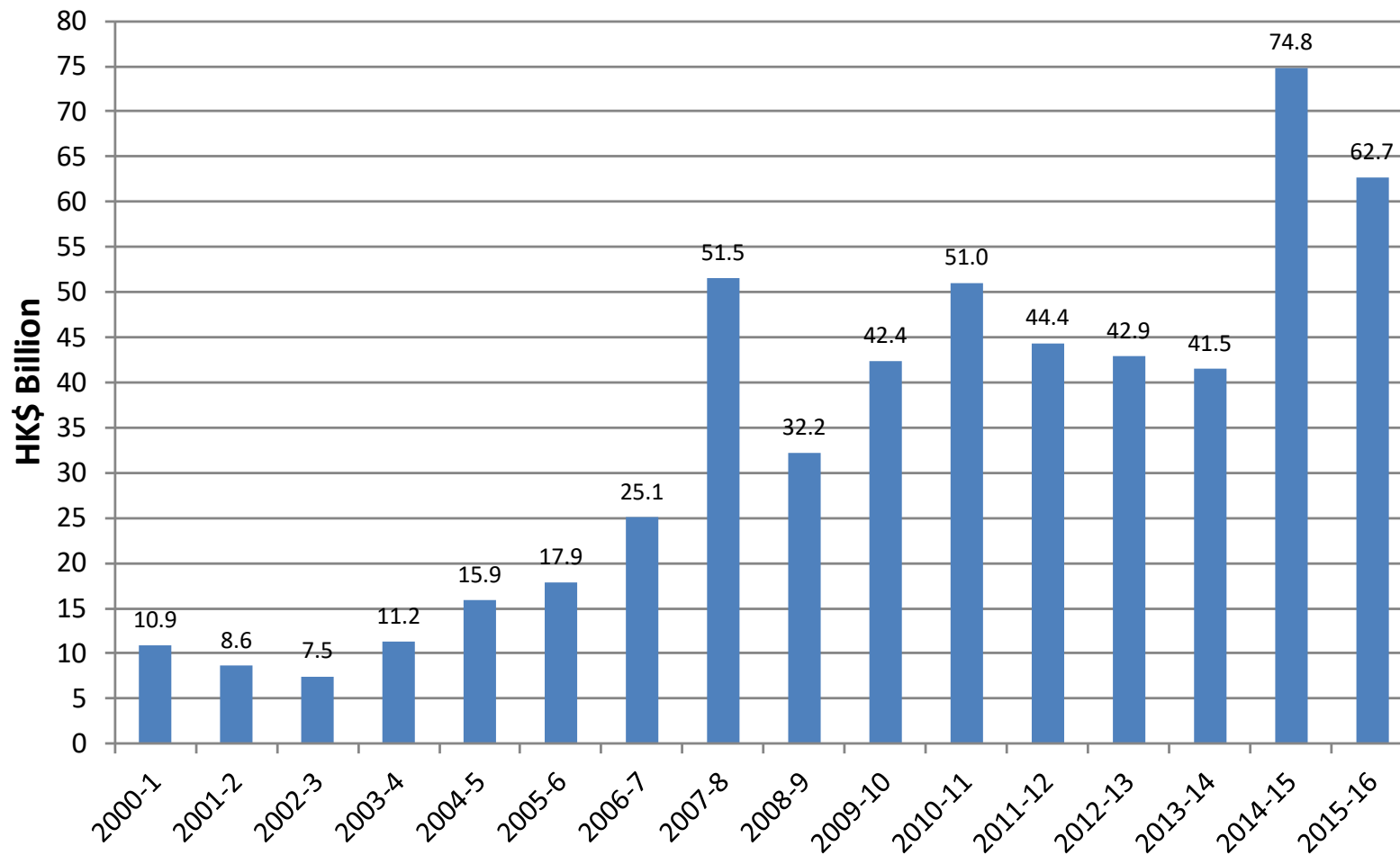
Buyer's Stamp Duty

- Hong Kong, Asia's World City
- BL Article 25: "All Hong Kong residents shall be equal before the law."
- C Y Leung manifesto: "We will study the introduction of a "*Hong Kong property for Hong Kong residents*" policy...Hong Kong residents include non-permanent residents, i.e. those who have not yet lived in HK for 7 years"
- 19-Jun-2012, CE-Elect office: "although non-Hong Kong residents are still coming to the city to purchase properties, they are not doing so in numbers that affect resident Hong Kong buyers" (true)
- 20-Oct-2012: contradicts that by imposing 15% foreigner's stamp duty (aka Buyer's Stamp Duty), also on companies
- Latest change (pending): even Permanent Residents shall be charged 15% stamp duty to buy a second or subsequent residential property – because Government knows best
- ...thereby reducing the stock of properties available to rent. Non-permanent residents must now pay 30%, including 15% BSD
- How can HK attract skilled professionals?

Double stamp duty

- 22-Feb-2013: playing whack-a-mole, SD on non-residential property was doubled to up to 8.25%
- That is around 3 years' rent
- This impacts business flexibility – should you buy an office, shop or warehouse, or should you rent?
- The market is migrating to more corporate transfers – transfer the company which owns the property (0.2%, or 0% if offshore)
- Corporate owners can transfer the property to an offshore subsidiary and after 2 years (with group relief), transfer that instead, no SD.
- For individuals, enveloping is no longer an option for residential, due to BSD, but at the higher end, many existing properties, including mine, are already held by companies, so the corporate transfer market has expanded.

Government's stamp duty addiction (incl. shares)



Mortgage interest deduction

- Introduced in 1998 budget at max \$100k per year for 5 years of salaries tax, extended in 2003 (7), 2005 (10), 2012 (15) and 2017 to 20 years. Cap was raised to \$150k for 2 years 2001-2003.
- At the standard rate, worth up to $20 \times \$100k \times 15\% = \$300k$.
- An \$8m flat incurs 3.75% stamp duty or \$300k.
- So what Govt takes up front, it may return, but only if you keep a mortgage open for 20 years
- No tax deduction for rental payments, so interest deduction distorts the rent v buy decision, and distorts the decision between cash purchase and borrowing.
- Government's role should be limited to ensuring that we *have* a home, not that we *own* one.
- So the deduction should be scrapped, at the same time as scrapping stamp duty of all kinds.

Central planning in land use

- Govt decides whether a piece of land should be an office, hotel, residential, data centre, movie studio, private hospital etc
- In residential land sales, govt has even prescribed the minimum number of units (and implicitly, the maximum unit size) – because Govt knows best?
- Restrictions on land usage make future conversion hostage to negotiations (viz, old industrial areas). Govt should just set a standard plot ratio that the site can bear, and let the winning bidder (and future leaseholder) determine the best use at any time.
- Auctions, with visibility, have been abandoned in favour of sealed tenders
- Govt-owned MTRC and URA still don't disclose the terms of winning tenders

Stock market intervention

- The Government invaded the Stock Market in August 1998, manipulating prices upwards (the stated goal) and buying 15% of the free float of the HSI
- Some of this was returned by forming and selling the Tracker Fund of HK, but at 31-Dec-2016, HKMA still holds HK\$148bn of HK stocks, and \$307bn of overseas stocks. The peg-backing fund is now a Sovereign Wealth Fund
- Total reserves (including Exchange Fund Surplus) at end 1997: \$623bn, 2016: \$1535bn. Hoarding of \$912bn in 19 years – a drag on the economy, investing in overseas companies with taxpayers' money.
- Banking supervision taken to a whole new level: 88/F of IFC2, purchased by Joseph Yam with the Exchange Fund

Economic intervention

- Propping up unviable businesses with loan guarantees, up to 80%, not just for fixed assets but even working capital, and cash grants
- Watering the weeds prevents the flowers from blooming and ties up resources, avoiding creative destruction.
- The Innovation and Technology Fund – investing your money because you (the private sector) won't?
- Even if they outsource VC to an asset manager, it will be an AM which isn't good enough to raise private funds, or will invest in projects that the private sector won't take.
- The Movie Fund – financing movies because the private sector won't? And why is that? Or could it be for Election Committee votes?
- The Government doesn't know best – it will make lower returns on money siphoned from the economy into reserves and deployed into pet projects and themes.

Economic intervention

- Donald Tsang, FS, 17-Mar-1999: “It is wrong, very wrong, to say the Cyberport is a property development”
- The project was awarded to Richard Li without tender
- Today, the Cyberport houses leading technology businesses such as wedding shops and the West Kowloon Cultural District Authority
- In the same budget, he announced talks for HK Disneyland (which we are still paying for), again without tender, and a cruise terminal at North Point (proposed by Cheung Kong, without tender, later abandoned).
- When Govt invited tenders to BOT a cruise terminal at Kai Tak for 50 years, nobody wanted it, so Govt, certain in the knowledge that the market was wrong, built it anyway, for HK\$8.2bn.

No, not that kind of cruiser



Government in business

- Government shouldn't be competing with the private sector, but it does, increasingly.
- HK Post competes for local courier service
- TDC runs trade exhibitions
- HK Mortgage Corporation offers mortgage insurance, reverse mortgages, loan insurance, microfinance and soon, annuities, competing with private sector
- HK Export Credit Insurance Corp offers trade insurance
- Urban Renewal Authority develops property using compulsory purchase powers, paying above market rates and making losses. We now have the Land (Compulsory Sale for Redevelopment) Ordinance, which allows the private sector to do this. The URA has outlived its utility.
- Govt-owned hotel, offices and shopping complex at Cyberport.
- Govt-owned offices at Science Park

Labour flexibility

- In 1997, the price of labour and skills was determined by supply and demand
- Now, we have a minimum wage. If struck low enough, it has minimal effect, but put high enough, it increases unemployment, out-sourcing and self-employment (independent contractors). It becomes a political hot potato.
- Govt's role should be to ensure adequate incomes through welfare, not to fix wages. The LIWFA is a better approach.
- In 1997, employees were free to save or spend
- Since 2000, Govt forces them to save via MPF, and to pay banks to manage their money – the same banks they pay to borrow money to buy a home. A removal of free choice. MPF= Mandatory Payment to Fund-managers.

The MPF Offset (topic du jour)

- Govt, 8-Mar-1995: “At present, the employer's contributions to a retirement scheme may be set off against any amount he has paid out for severance payments or long service payments. Employers do not pay twice. Severance payments and long service payments are not designed as supplementary retirement schemes. They are intended to be alternatives to these retirement schemes. That is why the offsetting provisions exist under the present voluntary system of occupational retirement schemes. We do not intend to change it under the MPF”
- Employers should not have to pay twice. The MPF has made SP/LSP obsolete. If we are keeping the MPF, then the accrual of SP/LSP should be terminated, with existing rights protected, and the offset amount frozen. In return, employees should have full portability of all contributions.
- For those who are out of work for whatever reason and have run out of assets, we have CSSA. Government should not try to privatise social obligations into the labour contract.
- Similarly, maternity leave should be paid for by Govt, not employers – to reduce discrimination in employment. Otherwise employers faced with 2 equally qualified candidates will be more likely to choose the one who is least likely to get pregnant.

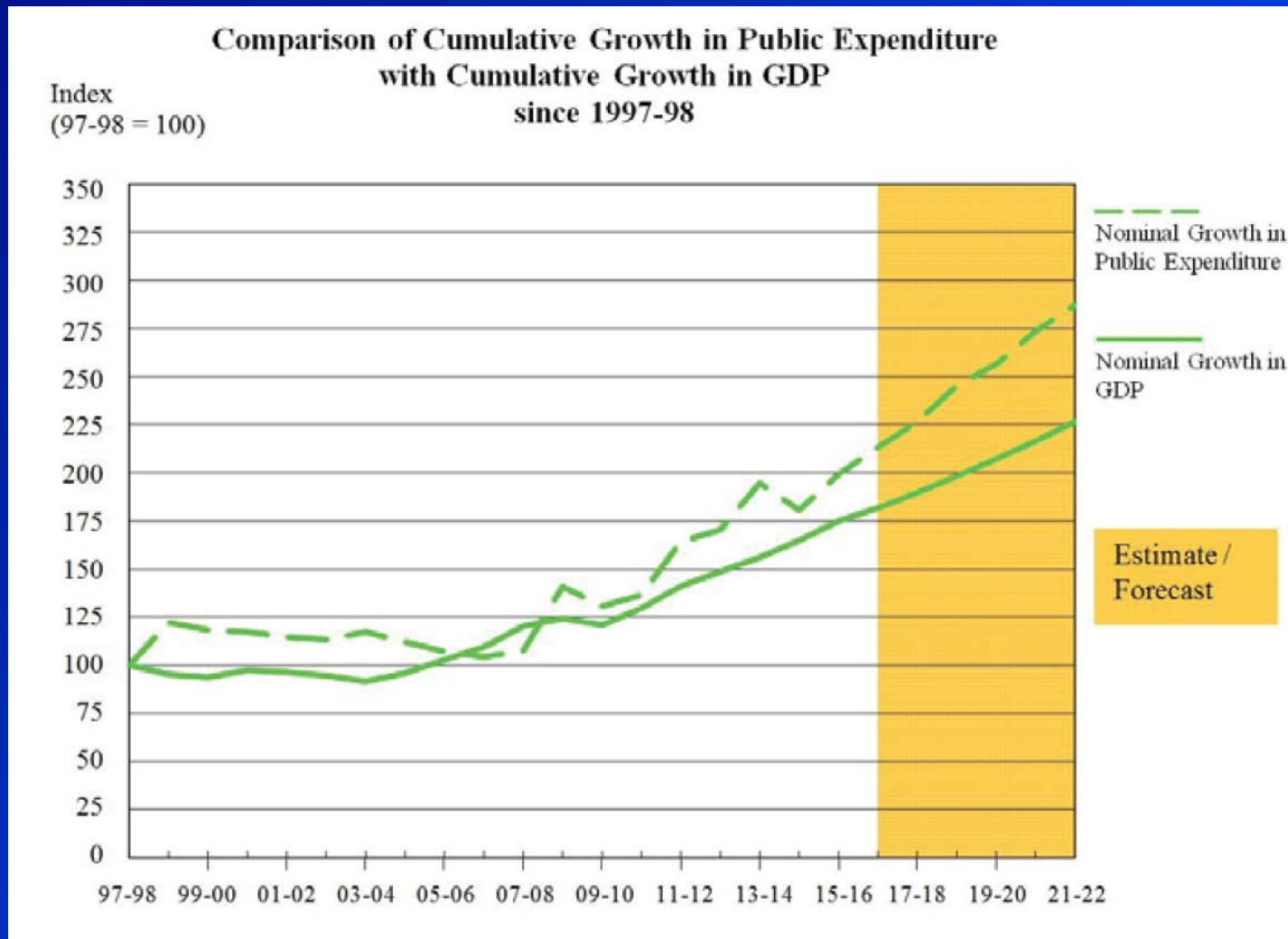
Scattergun welfare

- Taxpayers now subsidize fares down to \$2 for anyone who reaches 65, rich or poor, cost \$1.2bn p.a. and rising.
- 24-Oct-2008: after fruit was thrown at him, Donald Tsang boosted non-means-tested fruit money by 42% to \$1000/m (now \$1325/m) for those over 70
- 2011: after abandoning plan to inject \$6k into each MPF account, Govt hands out \$6k to each permanent resident.
- Dumping cash into electricity accounts is just as bad
- If you are collecting too much cash, cut the tax rates
- From 1-Apr-2013: Old Age Living Allowance \$2565/m: home is disregarded, assets cap \$329k. Reverse mortgages are available which allow equity release, or you can sell or rent, so why do we give cash to people who don't actually need it?

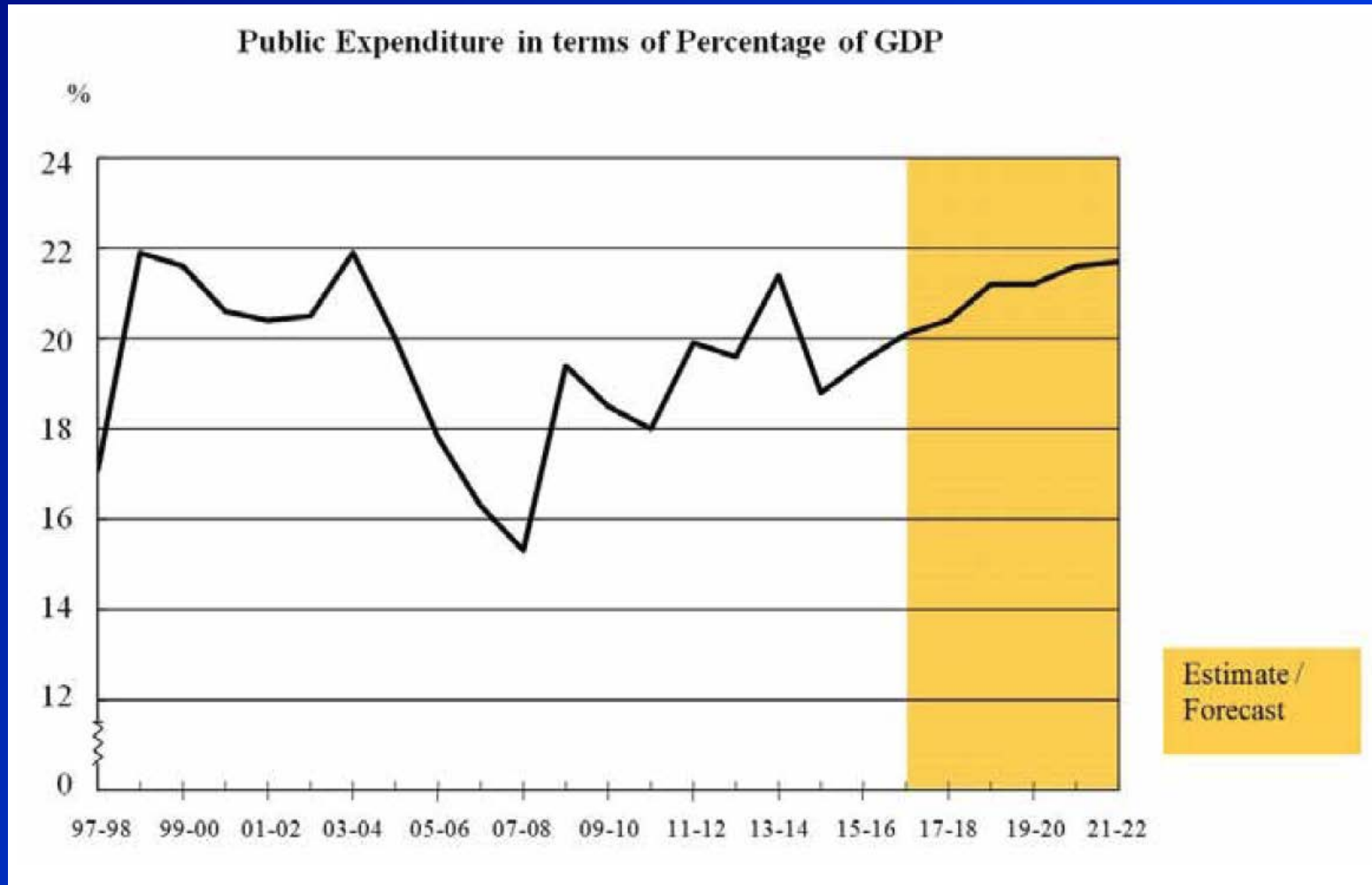
The growing government

- Basic Law Article 107: “The [HKSAR] shall...keep the budget commensurate with the growth rate of its gross domestic product”.
- But watch out...

Mind the gap!



Not commensurate.



Transport

- Govt floated MTRC in 2000, promising fare autonomy, then took it away by imposing a “Fare Adjustment Scheme”
- Last red/green taxi licences issued in 1994, 50 blue on Lantau in 1997, and 25 blue in 2016. There are now 15,250 red, 2,838 green and 75 blue, total 18,163.
- Green/Red Public Light Buses: statutory cap at 4,350 since May-1976. Only 69,600 people, or about 1% of population, can take a PLB simultaneously.
- Non-franchised public buses: de facto cap since 2007 at 7000.
- Huge premiums in taxis (Lantau: \$5.5m, Urban: \$6.5m) PLBs and NFBs. Govt protects owners of transport licences ahead of public interest.
- More minibuses would reduce peak road congestion, not increase it, as they carry 16+ people each, while a car often carries 1. More people would use MTR if they could reach a station at peak times.
- Anti-competitive: to operate a vehicle for a living, you have to pay someone else not to, by buying or renting their taxi, PLB or NFB.
- A free market approach would abolish all licence caps, grant a licence to any roadworthy, insured vehicle, and introduce congestion pricing to ration roads at peak times.
- Bus franchises should also be abolished – let anyone announce their fares and operate a bus service if it is economically viable.

Fuel duty

- 22-Jun-1998: CE Tung cuts diesel duty from \$2.89/l to \$2/l
- 28-Jul-00: ULSD launched at \$1.11/l, thereafter, old diesel phased out
- 1-Dec-2007: Euro V diesel launched at \$0.56/l, thereafter ULSD phased out
- Jun-2008: container trucks parked in Queen's Road Central in protest
- 14-Jul-2008: Euro V diesel duty waived
- Until now, this waiver is an ongoing subsidy to the transport constituency, costing us billions in annual lost revenue and air pollution consequences
- LPG also duty-exempt since launch, despite contributing to air pollution
- Petrol still at \$6.06/l.

Vehicle registration & licensing

- First Registration Tax: a blunt tool and an envy tax
- Why even charge FRT? Owning a car is not a problem. Driving it on the roads (at peak times) is. Congestion pricing is the answer.
- To control congestion on a beach, do you: (a) put a tax on the sale of bathing suits or (b) charge for entry to the beach?
- A \$2m car takes the same road space as a \$0.2m car, but the FRT is \$2.02m v \$97.5k.
- We don't tax other goods this way – fine art, jewellery etc.
- Light goods vehicles over 1.9t pay 17%. HGVs 15%, taxis & buses 3.7%.
- Vehicle licence fees are based on engine size – but why? If they burn more fuel, they will pay more fuel duty. If they are seldom used, they will pay less. Fees should be no more than the cost of licensing. Road maintenance costs can be recovered via the fuel duty and congestion pricing.

Parking

- 1999: FS Donald Tsang proposes raising parking meters from \$8/h to \$16/h, unchanged since 1994, and raising illegal parking fines by 26.5% from 1994 levels
- Both were vetoed by LegCo. 23 years later, a commercial car park now costs 3-4x as much as a parking meter
- Who are they protecting? Meter gangs?
- Parking fines at \$320 are now good value if you only get caught once every 10-12 hours (and you won't be).

Setting an example on illegal parking



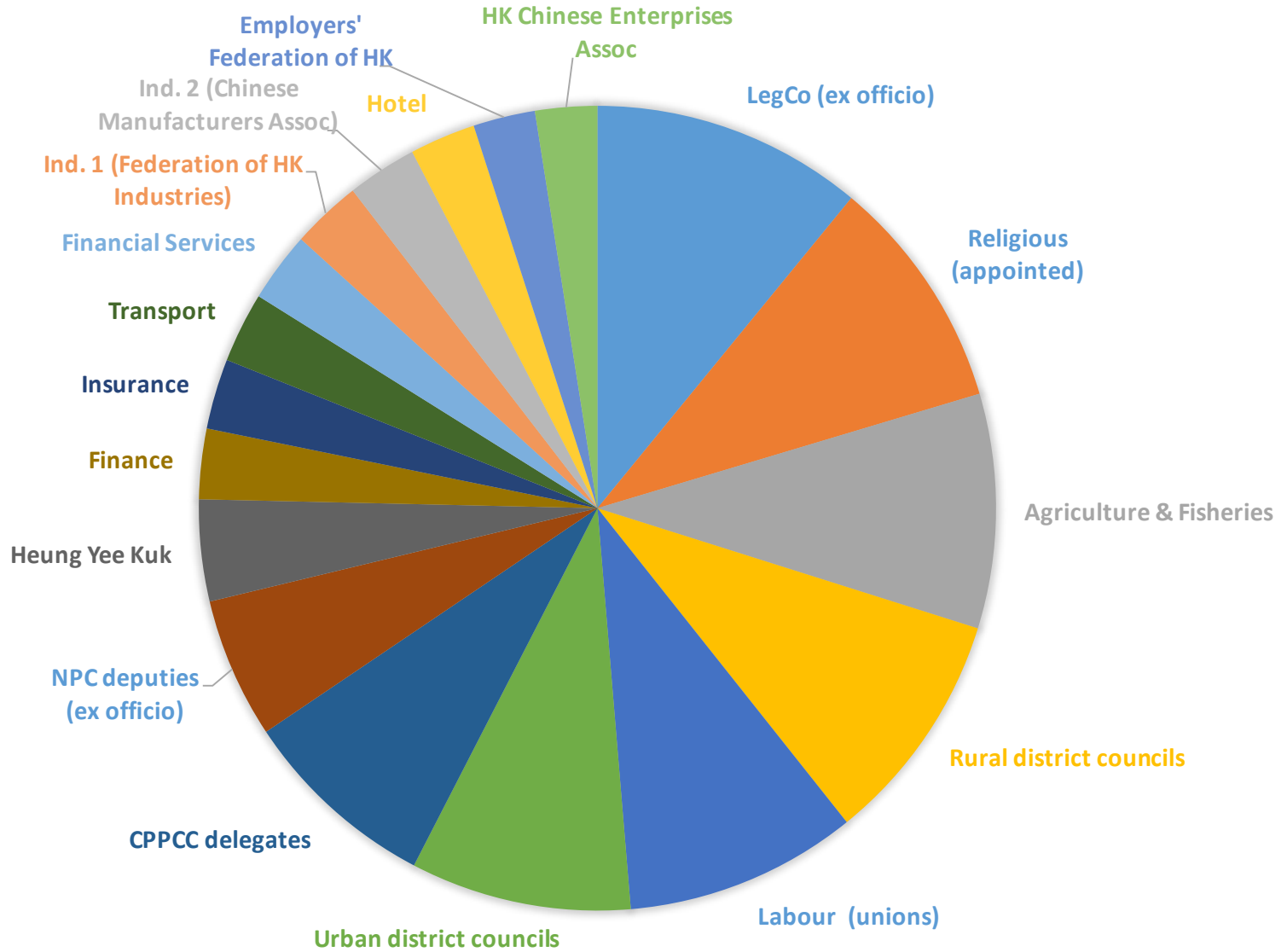
Anti-competitive laws

- Gambling ordinance – a monopoly for HKJC. No betting exchanges, licensed bookmakers or casinos. Placing bets with an overseas-licensed bookmaker is also illegal, even for tourists – WTO?
- Well, one casino – HKEX. A statutory monopoly on stocks and *de facto* monopoly on Futures. High transaction costs, enormous profit margins, and rigid practices. Exempt from Competition Ordinance
- POPE Ordinance – prohibition on resale of event tickets at a premium, except for LCSD venues (which are not covered by POPEO). So no ticket bureaus.
- Policy: monopoly electricity companies. Singapore has managed to introduce competition, but HK has repeatedly deferred the issue and has just signed away the future for 15 years to 2032.
- Closed data: the world is moving to open data, but our registries (Land, Companies, others) maintain paywalls and prevent innovation in the application of these data

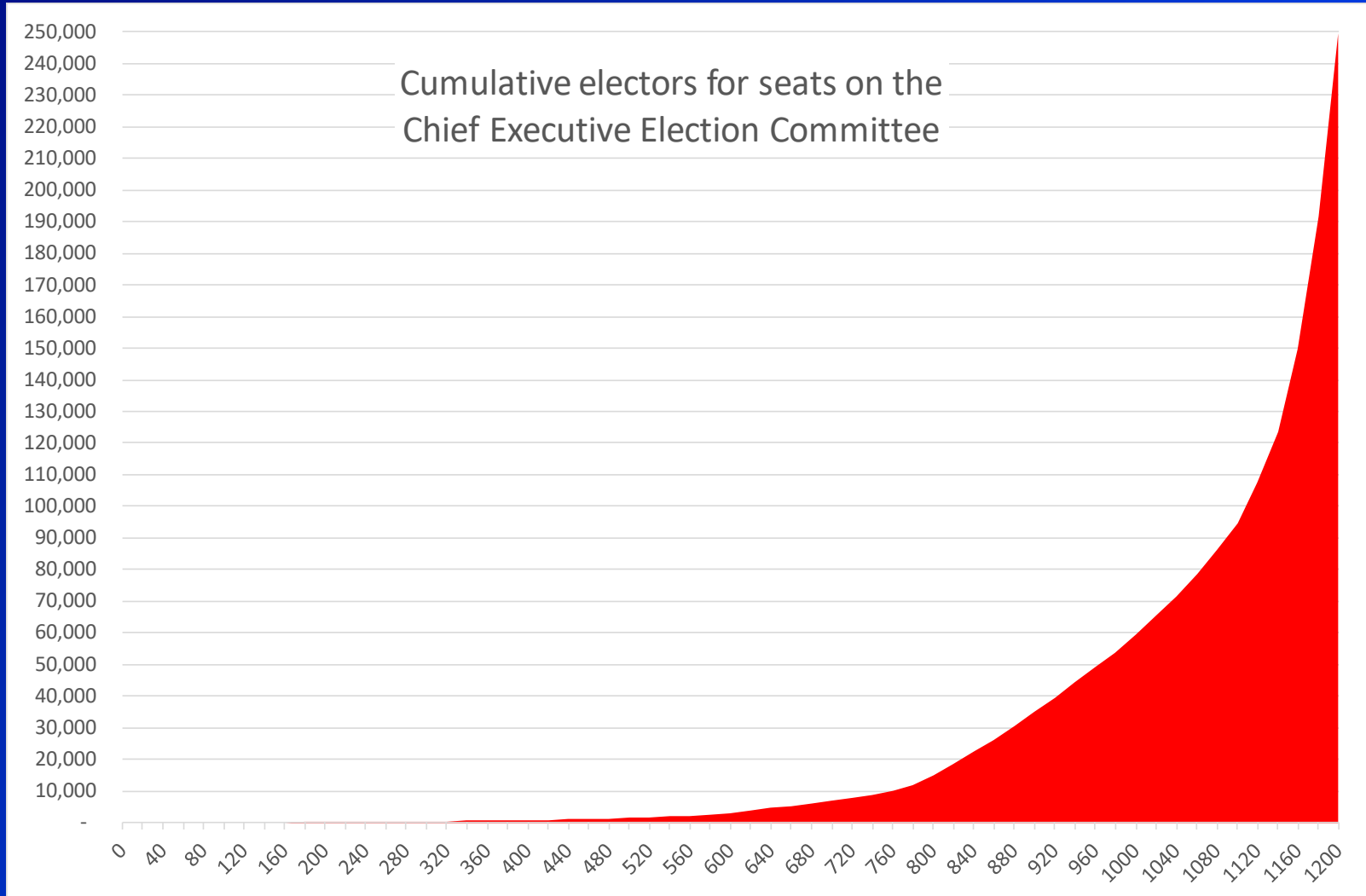
The 4 sectors of the Election Committee

Sector	Seats	Registered voters 2011		
		Bodies	Humans	Total
1 Industrial, commercial and financial sectors	300	12,369	14,459	26,828
2 The professions	300	347	204,052	204,399
3 Labour, social services, religious and other	300	3,211	14,361	17,572
4 LegCo, DCs, NPC, CPPCC	300	-	700	700
Total	1,200	15,927	233,572	249,499

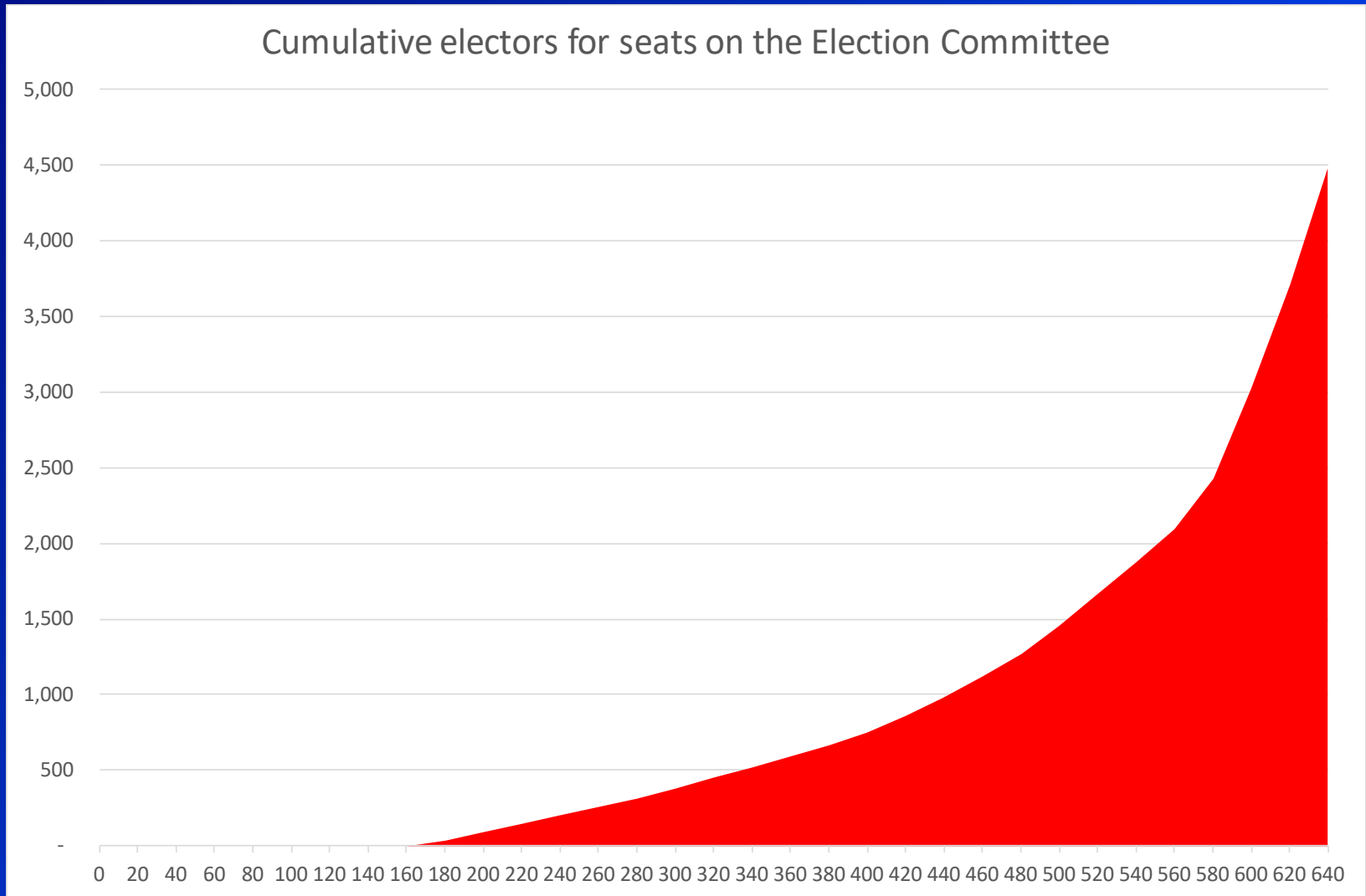
637 Seats with fewest electors per seat



How many votes does it take to elect the majority of the Election Committee?



Need to zoom in...



Political reality

- If you are an accountant, teacher, doctor, nurse, lawyer, architect or surveyor, you may feel like you have a say in the CE election as a “professional”. You don’t. The small-circle constituencies are enough to determine the majority of the committee. You are just window-dressing.
- 637 seats had a combined electorate of 4,363 in 2011: 3,648 bodies and 715 humans. Many of the corporate voters have common controlling shareholders, so in reality there are even fewer independent decision-makers.
- Any candidate just needs the support of the smallest circles to be sure of election. No wonder then that the CE panders to them. He or she has to.

About Webb-site

- Founded in 1998. Not-for-profit, partly funded by speaker fees, but mostly funded by me. The site and related activity takes about half my time.
- The other half, I research and invest in HK small-caps, currently holding >5% of 18 listed companies
- Corporate horror stories end up in *Webb-site Reports* (time permitting), while under-valued well-governed companies go into my portfolio, and hopefully not *vice versa*
- Over 22,000 subscribers to a free newsletter, opt-in/out
- Opinion polling
- Hall of Shame for jailed directors, CCB watch, SFC watch, ICAC watch
- Site also covers economic governance, advocating transparency, accountability, civil liberties, tax reform, land lease reform, minimal intervention and economically-rational policy-making
- *Webb-site Who's Who* covers all HK-listed directors, auditors, advisers since 1990; legislators, district councils, statutory/advisory bodies, CE election committee, relationships between them
- Frequent news flow from courts, tribunals, ICAC, HKICPA, SEHK, SFC and others, often with commentaries
- *Webb-site Total Returns* series – since 1994, all HK stocks including delisted
- Tracking all SFC-licensees, and all HK-registered companies (over 1 million live)
- CCASS Analysis System for stock movements
- Directors' share dealings since 2003

Thank you!

