

An aerial tour of Hong Kong's monopolies and anti-competitive practices

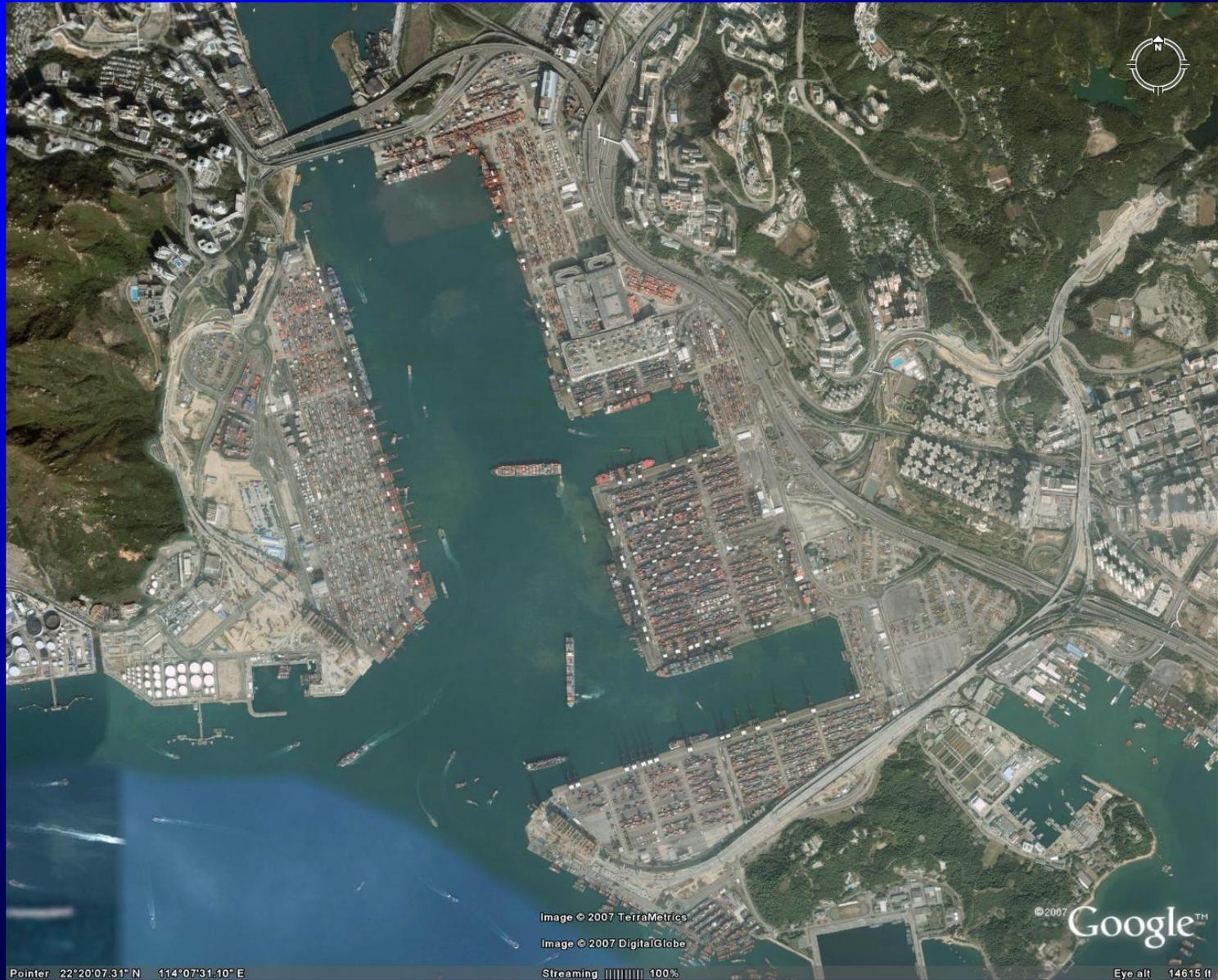
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at

The Asian Competition Forum
Hong Kong, 9-Dec-2014

Container Port



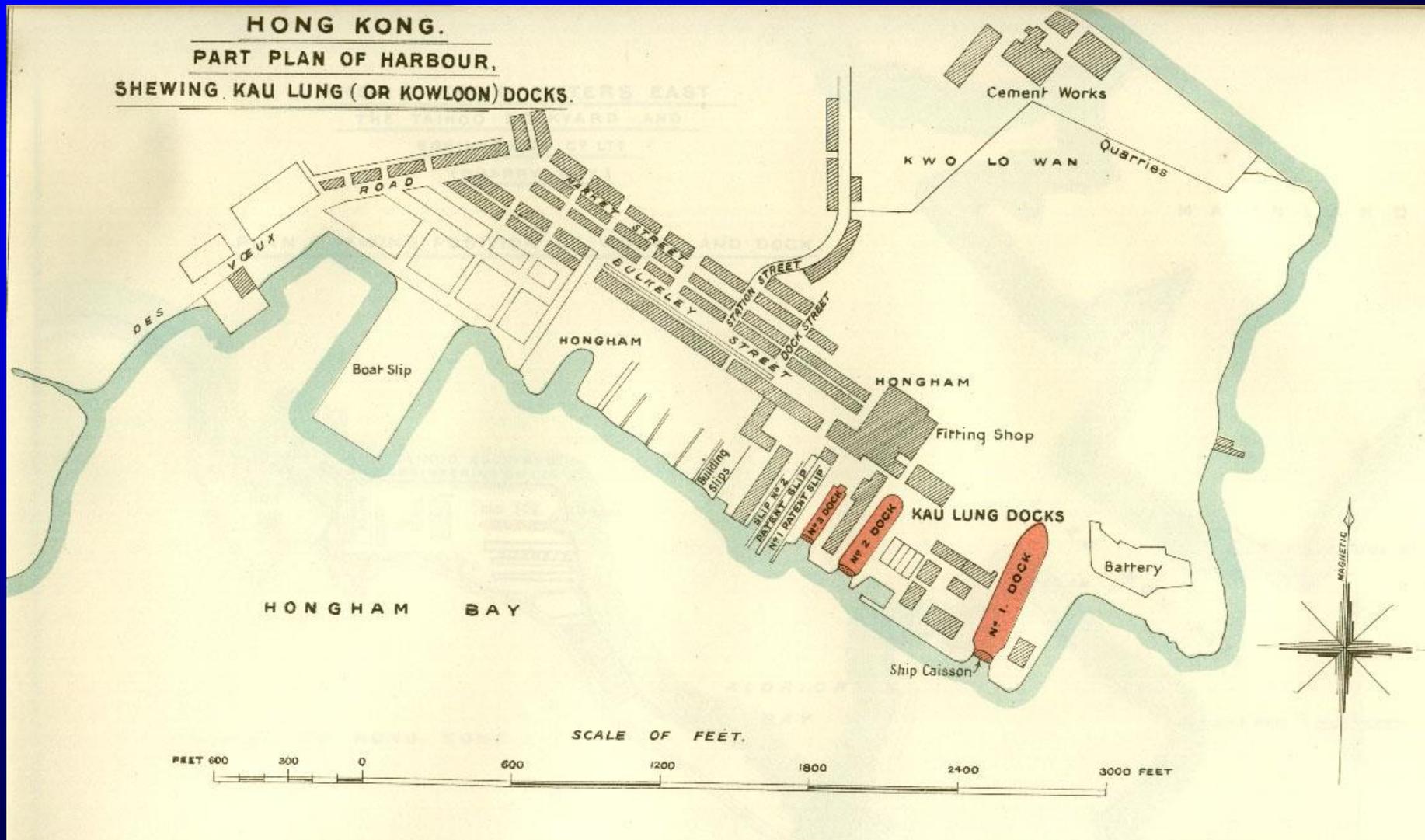
Container Port

- Our only land border is with mainland China.
- Most heavy goods imported to HK (other than from mainland China) arrive by ship.
- There is only one ocean container port in HK.
- The port has 24 berths.
- Hutchison International Terminals Ltd operates 14 berths (including 2 in joint venture with COSCO Pacific Ltd) and is ultimately controlled by Li Ka-shing.
- Modern Terminals Ltd operates 7 berths and is ultimately controlled by the Woo/Pao family.
- So between them, they have 87.5% share of berthing space.
- HK Terminal Handling Charges, charged by shipping lines to shippers to recover costs charged by container terminals, are the highest in the world.

Pre-container docks, now Whampoa Gardens, and CLP power plant, now Laguna Verde



Kowloon Docks in 1900s



HKE power plant (1968-89), now South Horizons



Real Estate

- HK's property market is dominated by a few large developers who account for the majority of private-sector production.
- HK Government leases land for development on a 50-year basis.
- With land scarcity, the majority of a property's value is in the land rather than the building.
- Barrier to entry is the land premium system, which requires almost all the ground rent to be paid as an up-front premium, with rent on new leases set at just 3% of rateable value (the rent which can be achieved on the premises).
- Premiums often run to US\$ billions. As a result, developers require large balance sheets in order to finance the projects.
- The result is a feudal system in which a few lords collect payments from the peasants and pay the crown after taking a large cut.
- A substantial portion of Government revenues comes from land premiums.
- Solution: increase in ground rents on new leases, thereby lowering land premiums, say 3% per year for 9 years until we reach 30% of rateable value.
- Developers love to own utilities (buses, electricity, gas, ferry terminals) for their land value.

HK Electric, Lamma Island



CLP, Castle Peak

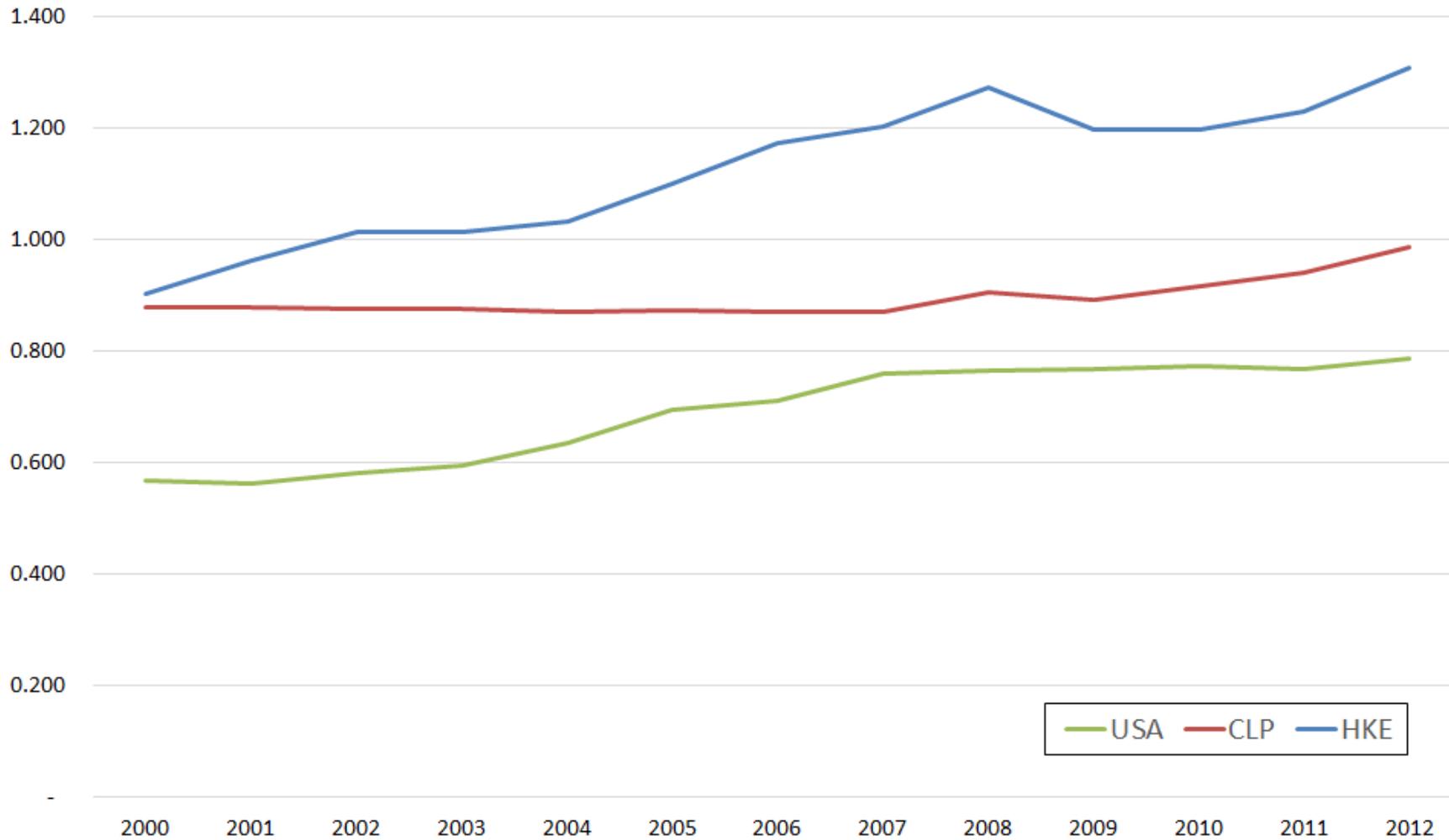


Electricity monopolies

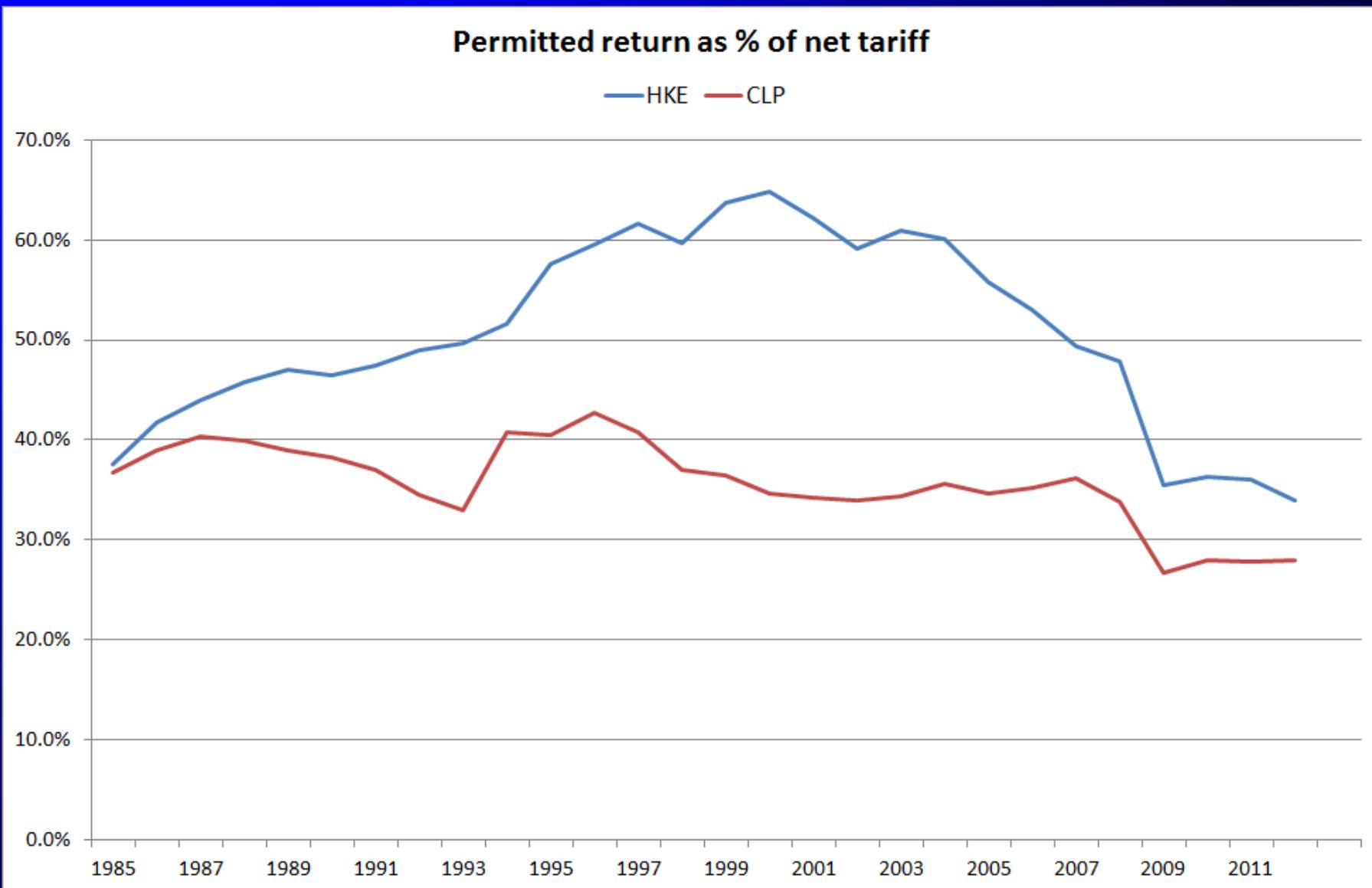
- Two vertically integrated power companies owning generation, distribution (grid) and retail in geographic monopolies.
- Hongkong Electric covers HK Island and Lamma and is ultimately controlled by Li Ka-shing.
- CLP covers Kowloon, the New Territories and the other islands and is controlled by the Kadoorie family.
- A scheme of control guarantees them a 9.99% post-tax “permitted return” on fixed assets (cosmetically more acceptable than 10%, but not based on market cost of capital)
- Consequently there is an incentive to over-invest.
- Despite our compact geography with low transmission distances and high density of users, we have among the highest tariffs in the world.
- In 2012, the average net tariff per kWh of HKE was HK\$1.309, and for CLP was HK\$0.987, respectively 67% and 26% higher than the average across the USA of US\$0.1008 (HK\$0.786).
- The CLP/HKE schemes of control expire 30-Sep/31-Dec-2018. Government has an option to renew for 5 years, exercisable by 31-Dec-2015, so next year will be interesting.

Pricing power

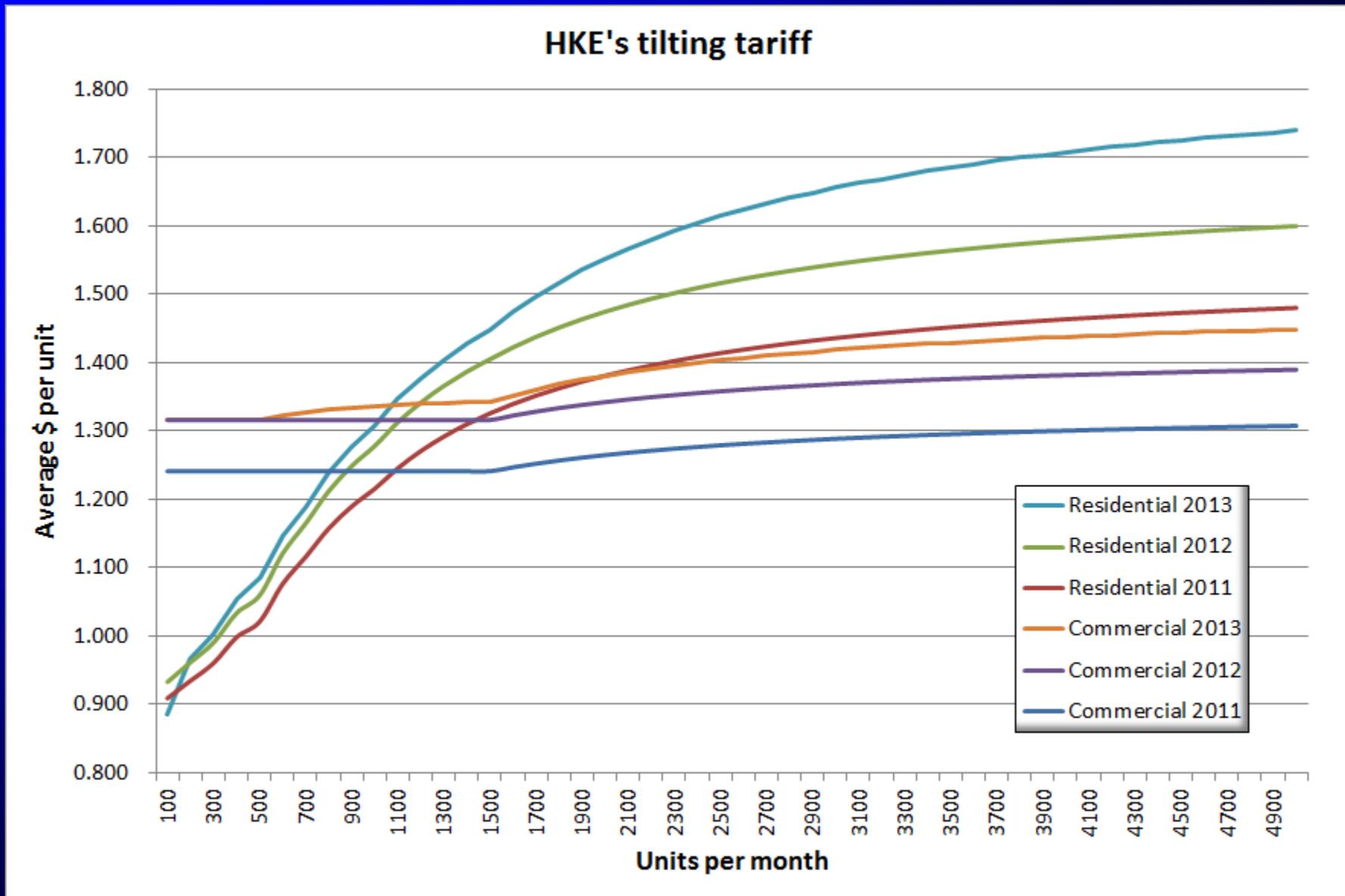
Net tariff, USA v HK (HK\$/kWh)



Still wonderful post-tax profit margins!

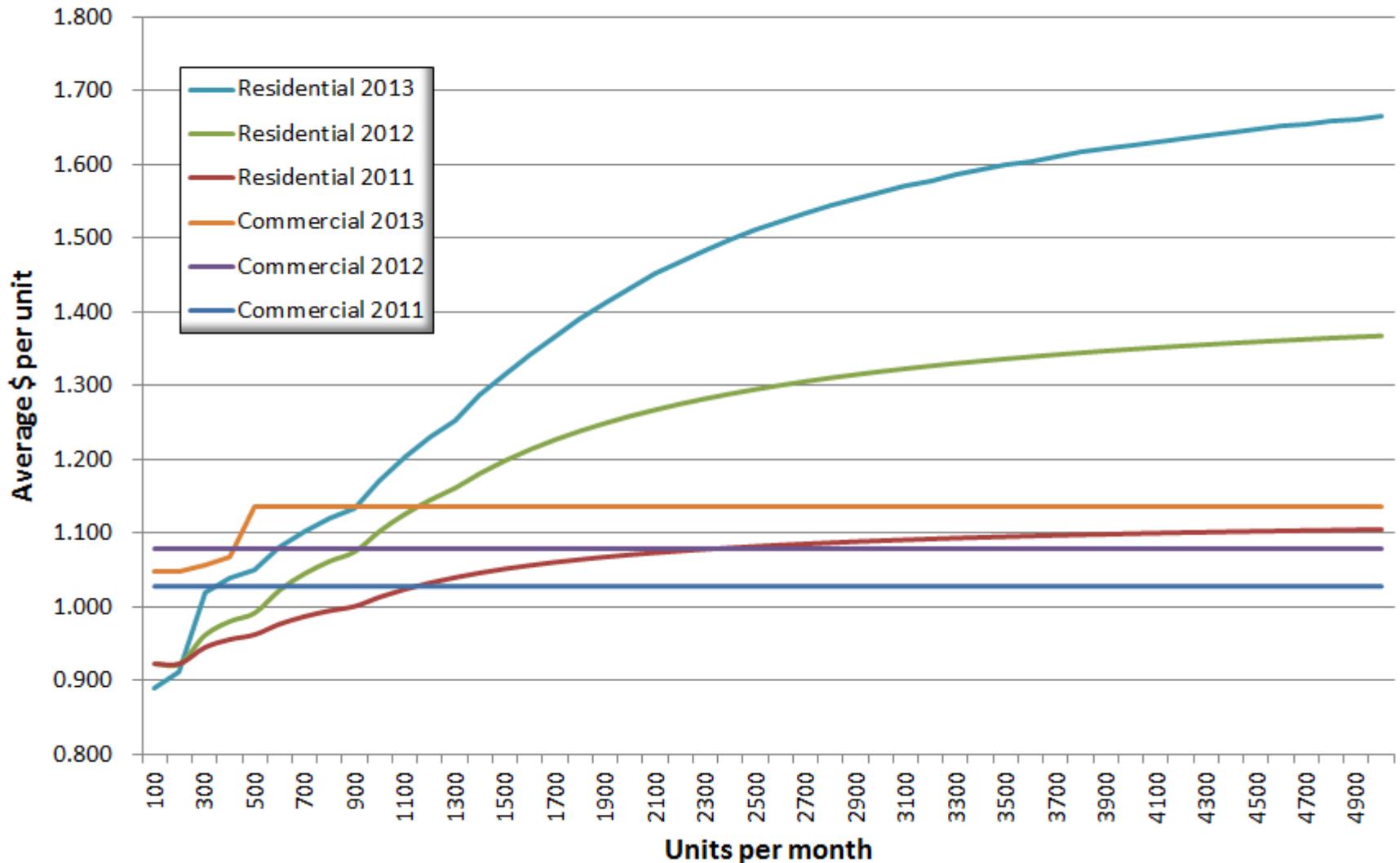


Government tilts tariff as it rises...

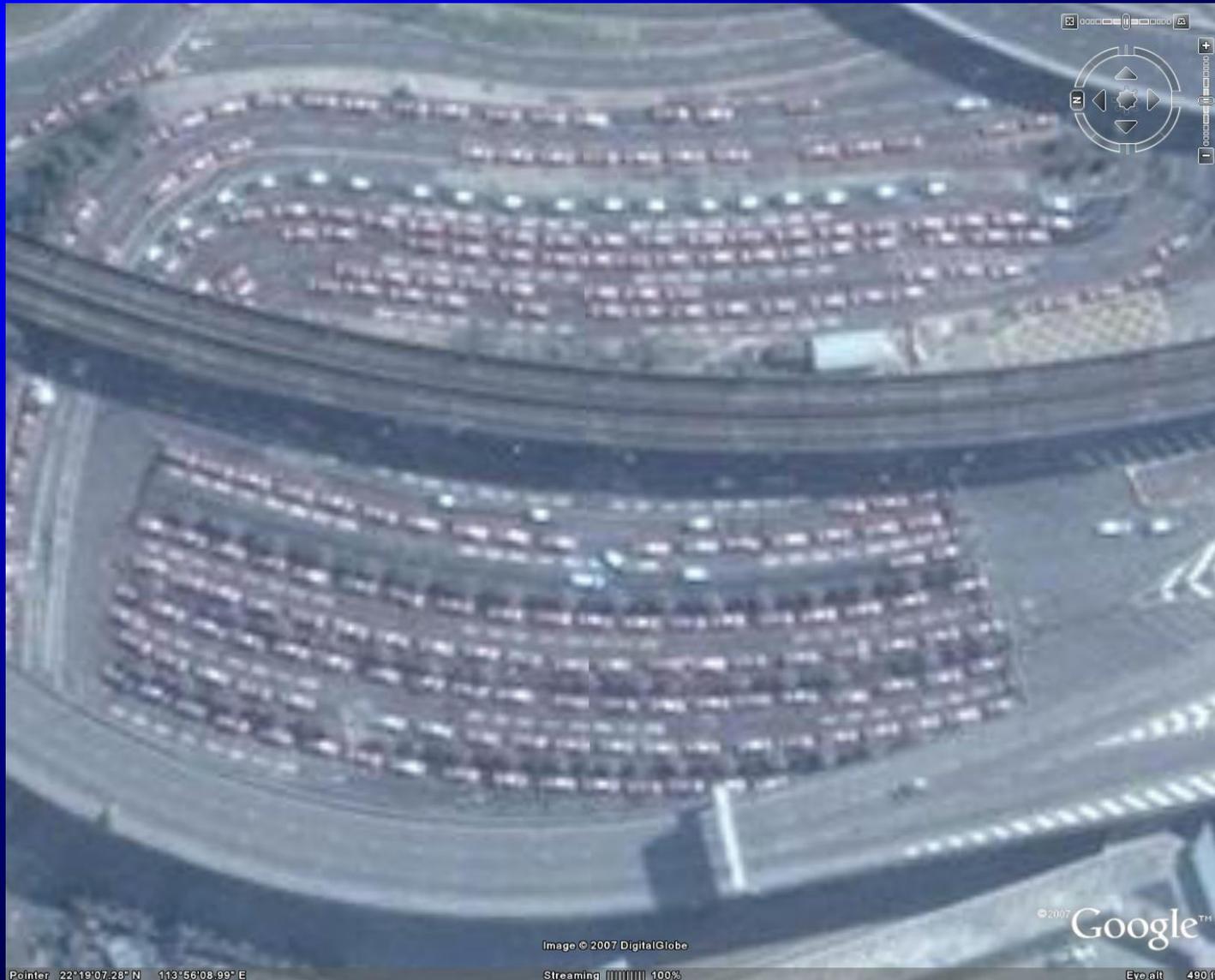


...to cross-subsidise smaller users

CLP's tilting tariff



Now let's talk about transport



Taxis

- The HKSAR has never issued a taxi license!
- There are 15,250 red (urban) taxis, 2,838 green (New Territories) taxis (both unchanged since 1994), and 50 blue (Lantau) taxis (+10 in 1997).
- So in order to drive a taxi in Hong Kong, you have to pay someone else not to. This is anti-competitive.
- The cost of a licence has varied, but stands at around HK\$6 million (weighted average – red is highest).
- Accordingly there is capital locked up of around HK\$109bn (US\$14bn).
- It is illegal for taxi drivers to offer a discount on the fixed fares (again, anti-competitive).
- They run on LPG, after converting from diesel with the help of a Government hand-out of HK\$40,000 each, costing the public around HK\$725m.
- LPG is cleaner, but still contributes to pollution. It is exempt from fuel duty.
- Solution: allow anyone to purchase and drive a taxi for a living, but tax the fuel to reduce emissions and price the roads to reduce congestion.

On the buses



Franchised buses

- There is a de facto duopoly in buses.
- Kowloon Motor Bus cover Kowloon and the New Territories. KMB is controlled by Sun Hung Kai Properties (Kwok family).
- On HK Island, there are two bus companies, New World First Bus, and Citybus, but they are both owned by the New World group (Cheng Yu-tung).
- Most of the cross-harbour routes are operated jointly between KMB and NWFB/Citybus.
- Diesel duty is zero, and buses pay virtually no road tax.
- Bus fares are approved by the Chief Executive of HK.
- Buses compete with the railways run by MTRC, which is majority-owned by Government and has fare increases capped on an Inflation-X formula.
- On non-franchised buses, Government has a de facto cap, resulting in similar problems to taxis

Retail price maintenance/ price-fixing

- Perfectly legal in HK, until Competition Ordinance takes effect
- Go into an electronics chain and try to buy a digital camera. Often the price will be the same as all the competing chains.
- After you have bought the camera, the store will then shower you with “free gifts” that you didn’t want, like a rucksack, or a wallet. If you ask for a discount instead, the answer is “no”.
- Online electronics retailers either display RPM prices or none at all
- Many petrol stations do not display prices at the roadside, only on the pumps. Pump prices are the same nearly everywhere. Belatedly, the Govt has put price displays into new lease conditions.
- A litre of Petrol costs HK\$15.64, or \$9.58 before duty. If you sign up for a loyalty card, you get \$0.9/l off – or 9.4% off, and they still make a profit. The margin on drive-in customers must be huge.

Air fares – not competitive

- Let's try flying Business Class, Hong Kong-London, mid-January, lowest possible fare that week on Cathay Pacific

Itinerary Details

Date	Flight	Operated By	Departure	Arrival	Stop	Duration	Aircraft	Booking Cabin	Rules
15 Jan 2015	CX253	Cathay Pacific	HKG 15:05	LHR 20:10	0	13:05	77W	Business (I)	
22 Jan 2015	CX250	Cathay Pacific	LHR 18:05	HKG 13:50 +1	0	11:45	77W	Business (I)	

Inflight entertainment (available on CX/KA serviced flights only): [Hong Kong To London](#) , [London To Hong Kong](#)

Fare Details

Passenger	Fare	Carrier Surcharges	Taxes/Fees/Charges	Total fare
Adult x 1	HKD 44,740.00	HKD 1,256.00 	HKD 2,701.00 	HKD 48,697.00

Currency Converter [\[+\] Show](#)

Total fare
HKD 48,697.00

Air fares – not competitive

- Too much? What if we add two sectors and start in Taipei, same airline:

Date	Flight	Operated By	Departure	Arrival	Stop	Duration	Aircraft	Booking Cabin	Rules
15 Jan 2015	CX421	Cathay Pacific	TPE 12:05	HKG 14:00	0	16:05	773	Business (I)	
15 Jan 2015	CX253	Cathay Pacific	HKG 15:05	LHR 20:10	0		77W	Business (I)	
22 Jan 2015	CX250	Cathay Pacific	LHR 18:05	HKG 13:50 +1	0	14:45	77W	Business (I)	
23 Jan 2015	CX510	Cathay Pacific	HKG 15:15	TPE 16:50	0		772	Business (I)	

Inflight entertainment (available on CX/KA serviced flights only): Taipei To Hong Kong , Hong Kong To London , London To Hong Kong , Hong Kong To Taipei

Fare Details

Passenger	Fare	Carrier Surcharges	Taxes/Fees/Charges	Total fare
Adult x 1	TWD 94,328.00	TWD 6,148.00	TWD 11,865.00	TWD 112,341.00

Currency Converter [\[+\] Show](#)

=HKD 27,874

Total fare
TWD 112,341.00

Air fares – not competitive

- The same airline, on the same dates, picking the best fares for that week, and flying on the very same flights between HK and London
- But even though they have to carry us on two extra flights, Taipei-HK and back, the price is 43% lower
- And you get extra air miles!
- Possible causes: HK Government protectionism, unwillingness to open skies
- Airlines squatting on take-off and landing slots
- Meanwhile, if you can be bothered, take a 1-way positioning flight to Taipei, and get off in HK on the way back.

The POPE Ordinance



Entertainment ticketing

- Under the Places Of Public Entertainment Ordinance, it is illegal to resell tickets to events or entertainment venues for a profit.
“No person shall sell...any ticket or voucher authorizing...admission to any place of public entertainment...at a price exceeding the amount fixed by such proprietor, manager or organizer.”
- Consequently, Hong Kong has no legal secondary market in ticketing. Agencies can only sell tickets from the event organiser.
- Rather like a stock exchange which allows IPOs but no secondary trading.
- A secondary market would help event organisers to better gauge the price at which they could sell primary tickets.
- If you are visiting HK and want to buy a ticket for an event which has sold out, such as the Rugby Sevens, you risk breaking the law.
- Despite that, many of the sold-out events, such as shows at the Arts Festival, are subsidised by Government.

Thou shalt not gamble – except with HKJC



Gambling

- The Hong Kong Jockey Club is the monopoly licensed bookmaker in HK.
HKJC sets racetrack prices through a pari-mutuel system, offers fixed-price odds on offshore football matches (local ones are not trusted due to match-fixing risks), and runs the only lottery, the “Mark Six”. The HKJC allows off-course betting, including telephone and internet.
- Protectionism
Under the Gambling Ordinance, it is illegal to place bets (by phone or online) with an offshore bookmaker, even if they are licensed in an overseas jurisdiction. If you visit Hong Kong as a tourist, and call your UK bookmaker to place a bet, you are breaking HK law.
- Hong Kong is a WTO member.
Antigua has successfully challenged the USA’s ban on offshore gambling through the WTO. Is Hong Kong’s prohibition on offshore bookmakers sustainable?
- Why not liberalise bookmaking and betting exchanges in HK, in a proper regulatory regime with taxation of profits?

Thou shalt not trade stocks & futures – except at HKEx

- Securities and Futures Ordinance, s19(1):
“No person shall operate a stock market unless the person is the [Stock Exchange of Hong Kong Limited]”
- HKEx owns SEHK and Hong Kong Futures Exchange Ltd, and their respective monopoly clearing houses
- Government has proposed exempting them all from the Competition Ordinance – which would allow them to defend their monopolies with anti-competitive practices
- SFC has to approve HKEx rule changes but cannot order them, so cannot regulate the margins
- In 2013, HKEx had a pre-tax profit margin of 80% on its cash (equities) business, 71% on its derivatives business and 91% on its clearing business
- HK Government owns 5.7% of HKEx and appoints majority of its board

The policy-making cartel

- Hong Kong lacks a democratic system for electing government.
- A democracy is a competitive market for policies, elected by the “consumers” of those policies. We have no competitive market in policies.
- Instead, we have a China-Tycoon coalition in a 1200-member Election Committee that elects the Chief Executive of HK.
- The Election Committee is elected by sub-sectors each with a quota of seats.
- Some sub-sectors have very small constituencies of corporate voters.
- Tycoons through their conglomerates have multiple votes through subsidiaries in various sub-sectors.
- It’s difficult to make progress in dismantling cartels if you are elected by them.

A Cheesy Competition Law

- In 2001, Financial Secretary Antony Leung and I wrote two sides of the debate on a competition law for a Financial Times supplement. His position then:

“It is not felt that Hong Kong’s economy suffers from horizontal and vertical constraints, or abuse of market dominance, to an extent that merits general outlawing...Will a competition law adversely affect the business sector as a whole? I believe the answer is ‘yes’”

“I am not convinced that having a general competition law is the best way forward for Hong Kong”

- Until 2005, we were led by a former shipping cartel tycoon whose friends were tycoons. Then we were led by a career civil servant who disliked having to answer to tycoons (or anyone), so he commenced a review.
- Finally in 2012 a “Swiss Cheese” competition law was passed – full of holes, but at least it’s cheese.
- If we get real democracy, then competition starts at the top, and there will be political pressure to reform the law.

And finally, a few words from our leader



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 13 listed companies
- Corporate horror stories end up in *Webb-site Reports* (time permitting)
- Under-valued well-governed companies go into my portfolio
- Over 20,000 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

Thank you!

