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University of Hong Kong

Free Markets & Property Rights
Infrastructure
Lessons from Hong Kong

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Meaning of Free Markets

Nobel Laureate Joe Stiglitz put it succinctly:

“While markets are at the center of the success of our economy, markets do not always work well by themselves, why they do not solve all problems, and why government will always be an important partner to them”

Theory vs Reality

Three pieces of advice:

- Keynes said “The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist.”
- Myrdal said “Economic theorists, more than other social scientists, have long been disposed to arrive at general propositions and then postulate them as valid for every time, place and culture.”
- Common sense is not common. One must therefore check perception or theory against objective facts. In China, this is called “seek truth from facts” [實事求是]

•John Maynard Keynes, “The General Theory of Employment, Interest and Money”, Macmillan, 1942, pp383

•Gunnar Myrdal, “Asian Drama: An Inquiry into the Poverty of Nations”, Vol. 1, “The Beam in Our Eyes”, Penguin, 1968, pg17

Capitalism and Free Markets

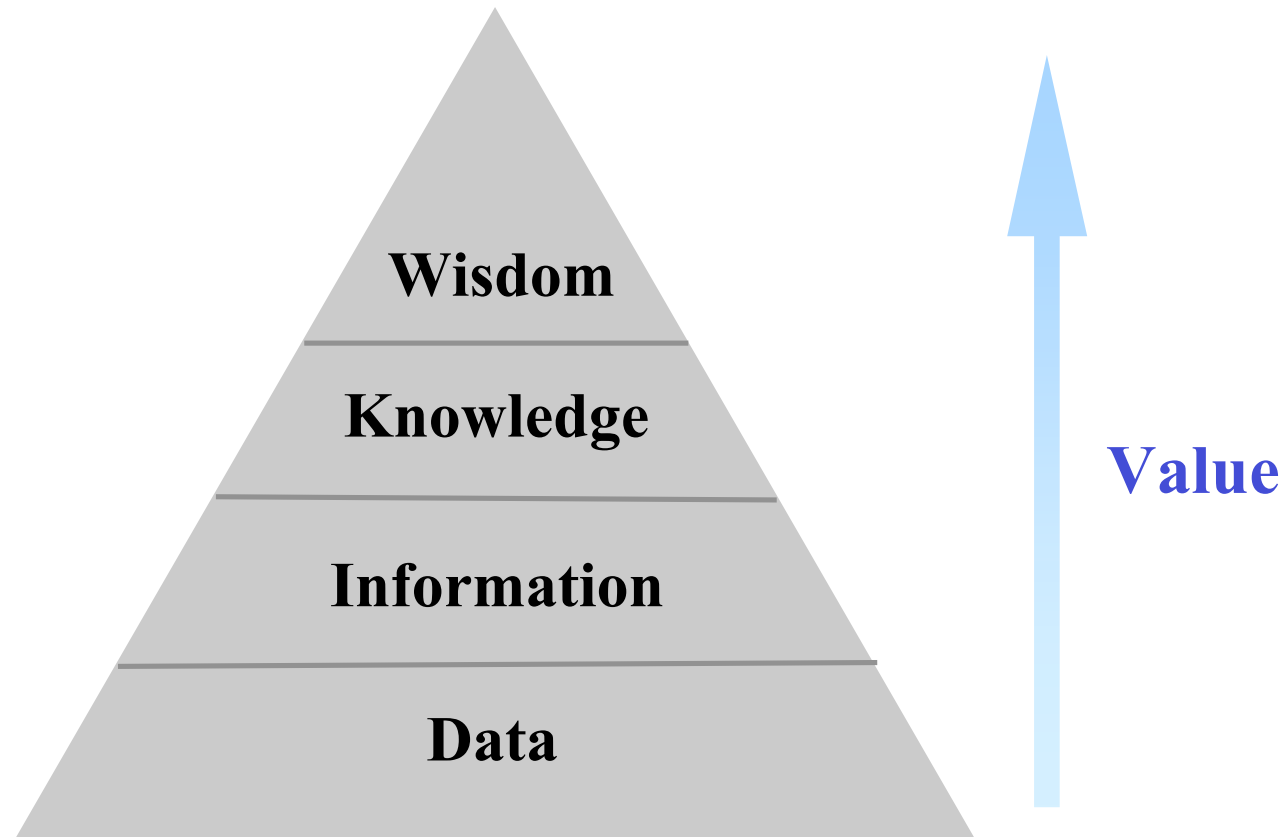
- **Adam Smith** - the entrepreneur “in such manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases led by an **invisible hand** to promote an end which was no part of his intention”
- This naïve version of capitalism and free markets was adopted for former Soviet economies.
- **Milton Friedman** admitted: “What do these ex-communist states have to do in order to become market economies? And I used to say: “You can describe that in three words: **privatise, privatise, privatise.**” **But, I was wrong.** That wasn’t enough. The example of Russia shows that....It turns out that the **rule of law is probably more basic than privatisation.**”

John Kay: Truth about Markets

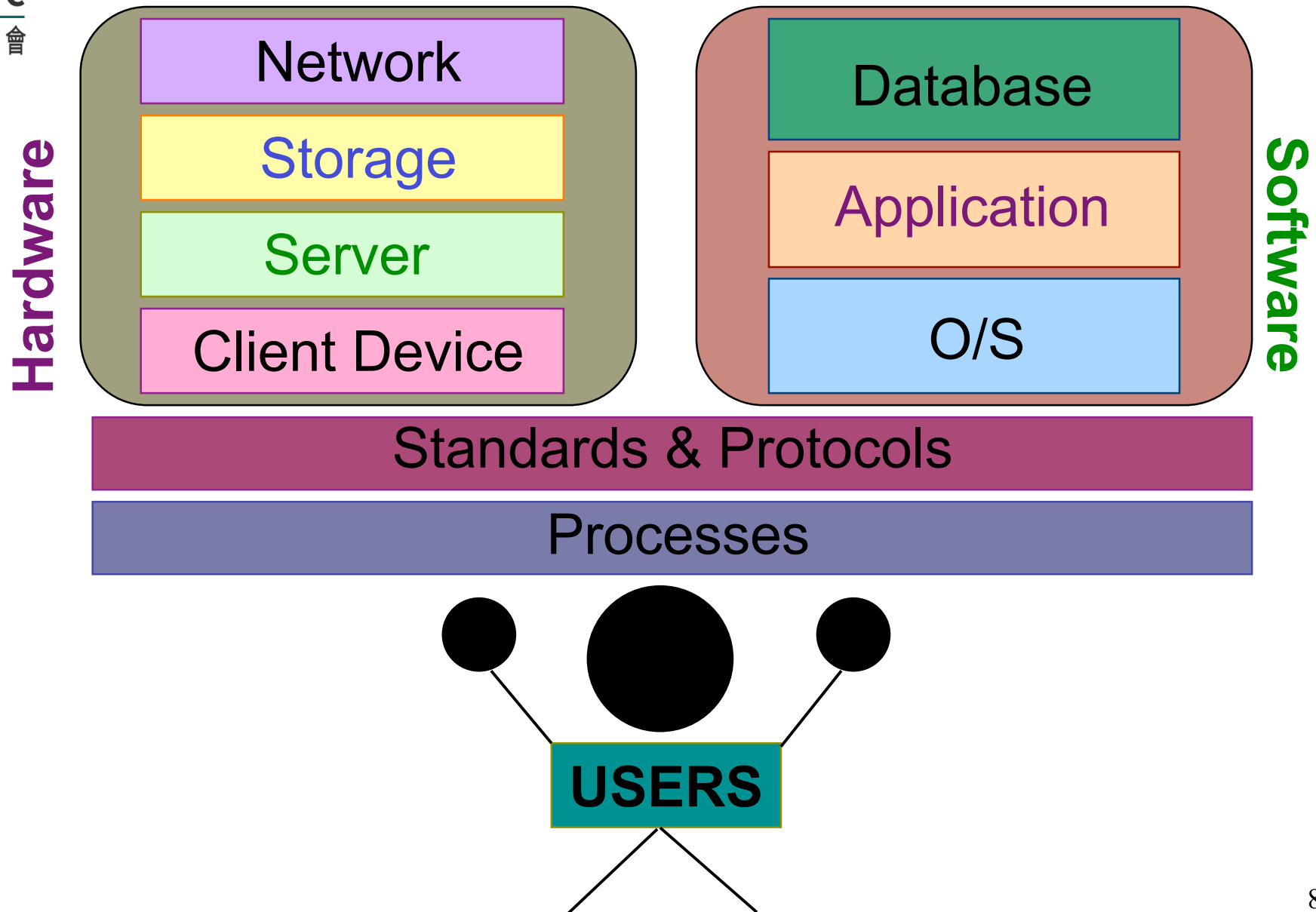
Penguin 2003

- **Effective market economies are embedded in an elaborate social, political and cultural context, and could not function outside that context.**
- **Markets work because they match market participants incentive compatibility**
- **Markets are adaptive and have feedback – behaviour is influenced by incentives and enforcement of rules and laws**
- **Market economies succeed because disciplined pluralism is more innovative and more responsive to customers than centralized decision-making**
- **Spontaneous Order – no one designs the market: it evolves**
- **Why some nations are rich, but most remain poor is the difference in the quality of governance.**

Hierarchy of Information



IT Analogy of a Financial System



How Financial Systems Define, Exchange, and Enforce Property Rights

A financial system comprises a set of **hardware** across which **participants** transact and exchange financial products, according to a set of agreed standards and rules of the game.

- These financial products are transacted and then settled and cleared through various **processes**.
- Global markets are a **network of local market networks**. Financial systems are subject to local shocks and contagion, which could spread risks across the global networks.
- Increasingly, the **standards and rules relating to operations in financial systems** are being globalized and formalized given the competitive pressures on each local market.
- Property rights are described by information. Hence, **disclosure and transparency is crucial** in making good decisions and ensuring accountability in market systems.

Elements of a Modern PRI

Institutions for delineation of property rights:

- **Central Registry** to officially record property rights. This is crucial in transparency of the property right and reducing the costs of enforcement.
- **Accounting and legal process** to define and verify the property rights.

Institutions for exchange of property rights:

- Trading process
- Clearing, settlement and payment infrastructure
- Regulated intermediaries

Institutions for enforcement and fine-tuning of property rights:

- Rules of Games – norms, standards, codes, regulations and law
- Enforcement infrastructure – regulators to enforce the rules
- Robust media and disclosure regime to ensure that property right can be independently verified and players are accountable
- Independent and transparent judiciary to adjudicate disputes over property rights

Hong Kong's PRI

Information and transparency:

- High quality market information is readily accessible because HK has 24,000 qualified accountants, preparing and auditing according to international standards.
- If information is false or misleading, there are listing rules and securities laws to punish offenders.
- The integrity of information is checked both by the banking system as lenders, the tax authorities who depend on audited accounts and a media that questions the information.

Examples of Hong Kong's PRI

Property and entity registries:

- Any prospective buyer can check the legality of the title to an asset, such as real estate, through ready access to the public land registry.
- World Bank investment climate indicators suggest that it takes 11 days in HK to register a business, compared with 198 days in Laos (average for East Asia & Pacific being 72.9 days).
- It takes 56 days to register property in HK versus 956 days in Croatia (average for East Asia & Pacific being 59.4 days).

Rule of Law

Functioning judiciary and rule of law:

- Having a tested and tried **common law** system that is broadly understood and trusted in major markets is a huge advantage. The effective functioning of courts to protect property is important for market efficiency.
- World Bank data shows that it takes 211 days in HK to enforce a contract, compared with 1459 days in Guatemala (average of 373.8 days for East Asia & Pacific)
- It takes 1.1 years in Hong Kong to resolve insolvency, compared with 10 years in India and average 4.2 years in East Asia & Pacific.

Government's Role in Establishing PRI

- **Setting standards, rules, and legislations;**
- **Defending property rights of citizens against non-citizens;**
- **Enforce and protect private property rights by resolving disputes between citizens and citizens; and**
- **Creating mechanisms to constrain abuses of state power and resolve property rights disputes between citizens and the state.**

Concluding Thoughts

It is too easy to take a well-functioning PRI for granted.

- The common law evolved through over 1,000 years of case law is the best empirical evidence that the laws, principles and structures are well tested by time.
- China has reached the stage of economic development where the macroeconomic conditions provide a favourable opportunity for the construction of a robust PRI.
- Hong Kong can bring in a wealth of market experience in building the PRI to facilitate the Mainland's transition to a fully competitive market economy.

Thank you very much