



Spontaneous Catallaxis in Urban & Rural Development Under Planning by Contract in a Small Open Economy: The Ideas of Hayek and Mises at Work in Town & Country Planning in Hong Kong*

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Abstract. This paper discusses the espoused and actual achievements of government urban planning in Hong Kong in terms of the ideas of Hayek and Mises. With reference to observed facts, it is argued that it is indeed the spontaneous forces of the land market predicated on a leasehold system, a system of “planning by contract” or “planning by consent,” that have attained what the government planner in Hong Kong has not been able to deliver.

Key Words: Mises, Hayek, planning by contract, Hong Kong, urban and regional planning

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Preamble: The Concept of Spontaneity and the Contribution of Austrian Economics

“To understand our civilization, one must appreciate that the extended order resulted not from human design or intention but spontaneously: it arose from unintentionally conforming to certain traditional and largely *moral* practices, many of which men tend to dislike, whose significance they usually fail to understand, whose validity they cannot prove, and which have nonetheless fairly rapidly spread by means of an evolutionary selection—the comparative increase of population and wealth—of those groups that happened to follow them” (Hayek 1988:6).

“Our civilization” in Hayek’s statement should refer to the civilization of the human species in general and not just narrowly to Western society. The recognition of the driving force of rational spontaneity in human society has been universal and was recognized early by classic Chinese philosophers. The *Book of Guan Zi*, written in or around the fourth century B.C., offers a Chinese version of the Hayekian idea of spontaneity, the Lockean concept of property, and Adam Smith’s idea of the invisible hand:

*To the best of the knowledge of the author, the only published work on Hong Kong’s economy that argues that it is predicated on Austrian entrepreneurship is that by Yu (1997), which is developed on the basis of his doctoral thesis (Yu 1995). See Shulman and Shulman (2001). For a critical evaluation of Hayek’s ideas on town planning specifically, see Lai (1999b, 2002c). The idea of this paper comes from Samuel R. Staley.

“It is human nature to feel pleased on getting what one desires and to feel worried on meeting what one is averse to. This is something common to both the high and the low” (Chapter “Jin Zang” in *Guan Zi*, as quoted in Hu 1988:108).

“It is human nature not to refrain from going after profit and to keep away from danger when either of them is in sight. Where profit is anticipated, traders will quicken their pace day and night and make light of travelling over a thousand li (miles) to get it. When gain is expected from the water, fishermen will go out to the sea thousands of fathoms deep, sail against the tide and venture on a dangerous voyage of hundred of li for nights on end. . . . They will go forward with no body’s push and come along with nobody’s pull, and the ruler has no worries and troubles while the people get rich spontaneously. It will be like a bird hatching eggs, sitting there easily and silently, expecting fledglings to come out” (Chapter “Jin Zang” in *Guan Zi*, as quoted in Hu 1988:108).

“Profit” in *Guan Zi* refers generally to interest or benefit and is not limited to the accounting difference between revenue and cost. But, would the spontaneous manifestation of rational individuals lead to collective suffering? The answer of the totalitarian thinker is always positive. The solution of the believer in authoritarian government, whether he is in the vein of the Chinese classic legalist or the Hobbesian, is invariably the imposition of harsh laws and dictatorship. There is no better characterization of Adam Smith’s ingenious alternative answer to this potentially destructive question, namely the “invisible hand” or the market, than that of Mises and Hayek.

“Freedom, as people enjoyed it in the democratic countries of Western civilization in the years of the old liberalism’s triumph, was not a product of constitutions, bills of rights, laws, statutes No government and no civil law can guarantee and bring about freedom otherwise than by supporting and defending the fundamental institutions of the market economy. Government is a guarantor of liberty and is compatible with liberty only if its range is adequately restricted to the preservation of what is called economic freedom. Where there is no market economy, the best-intentioned provisions of constitutions and laws remain a dead letter. The freedom of man under capitalism is the effect of *competition*” (von Mises 1996:285).

In other words, where spontaneous endeavors of rational individuals are constrained by “competition” or, more precisely, competition predicated on a system of private property and rule of law, competition would work to the maximum collective benefit and minimum collective misery of society.

“Economic liberalism . . . regards competition as superior not only because it is in most circumstances the most efficient method known but even more because it is only method by which our activities can be adjusted to each other without coercive or arbitrary intervention of authority” (Hayek 1944:36).

Notwithstanding the sensibility and persuasiveness of the spontaneous approach expounded by Hayek (1944, 1960, 1988) and Mises (1935, 1956, 1996), many nations have only recently admitted the inherent limitations of the state in ordering society, rendering it “mathematically manageable” or maneuverable, a theme that underlies historian Ray Huang’s analysis of pre-modern China (Huang 1998). Such admission is rarely based on logical arguments *per se* but is driven by famine, poverty, terror and even the collapse of the entire political order.

Spontaneity, or freedom, and competition are the major ideas of Hayek and Mises, leaders of Austrian school economics. The necessary condition for the best operation of these ideas is a system of private property operating under the rule of law. This system is viable in any society where there is freedom of exit. This is so even where there is no freedom of voice—or representative democracy, as revealed by the economy of colonial Hong Kong.

The case of Hong Kong is interesting as it offers persuasive empirical evidence that helps correct the cultural bias among some great libertarians against “Asiatics” or Orientals, whom they have often depicted as being inherently despotic or lacking in creativity.¹ The fact is that behavior and potential for achievements of individuals and nations depend on their institutional constraints rather than ethnicity or culture. Indeed, the ghost of cultural explanation, which may express itself in terms of such concepts as “Confucian ethics” and “guanxi”, has confused the mind of many people. The economic achievement of colonial Hong Kong, as a predominantly Chinese society that has worked out means to survive without state assistance in terms of “social welfare,” Keynesian economics or central banking, not to mention central economic planning, is instructive in this “cross-cultural” context in several ways.

First, the better economic performance of colonial Hong Kong (Ho and Chau 1993), as a small place devoid of natural resources save labor and a fine deep water and sheltered harbor, relative to China during the Cultural Revolution is a convincing test of the economic merits of two types of institutional arrangements, capitalism *vis-à-vis* communism. This test is “controlled”, that is, holding constant the factor of “ethnicity” or “culture”. Second, colonial Hong Kong’s better economic performance relative to Macau, another western colony founded several hundred years earlier and also dominated by Chinese in terms of population, offers much insight into the effectiveness of two types of western colonialism, again controlling the factor of “ethnicity” or “culture”. It appears that the use of the common law and English has enabled Hong Kong to surpass Macau in the last two centuries.

That some countries, such as North Korea, Burma and Cuba, appear to have resisted changes in favor of an open economy, not to mention an open society, should not affect our analysis. It takes time or even shocks for the melting down or breaking up of interest groups that see changes as threats to their survival (Olson 1982). In the long run, a system that incurs excessive transaction costs must crumble (North and Thomas 1973, Cheung 1982). In any event, even “irrational” economic agents must act within objective constraints rather than mere psychological factors (Becker 1962). Based on the above observations and given the universal applicability of libertarian economics, one may reasonably establish two empirical postulations. First, the economic performance of post-colonial Hong Kong relative

to colonial Hong Kong is a measure of Hong Kong's ability to maintain her capitalist and legal systems in the absence of "foreign supervision". Second, the pace with which China is catching up with (or falling behind) post-colonial Hong Kong in terms of economic performance is also a measure of the maturity (or hindrance) of the free market economy and the rule of law of China as a whole.

The Constitutional Capitalism of Hong Kong

Hong Kong is an exciting place in "the battle for the world economy", to borrow the phraseology of Yergin and Stanislaw (2002). In Hong Kong, this battle is not fought with slogans but by the individual small shopkeepers, households, individuals and private enterprises that act spontaneously according to the rules of the market under the law. In this battle, there is no discrimination on the basis of status or nationality that has influenced local politics and administration.

From a "sweat-shop" colony that was capable of "dumping" in the 1960s, Hong Kong evolved into an international financial centre in the 1980s (Jao 1993). No businessperson or immigrant would dispute that the economic success and evolution of Hong Kong has been a result of her radically free market. While there has been no real parliamentary democracy in Hong Kong,² businesspersons and immigrants have cast their vote of confidence in this tiny place with money and feet, respectively. For those who disagree or become dissatisfied, the option of exit has always been available. This exit option is applicable to both financial and human capital. In other words, while Hong Kong has not much representative or political democracy, her "market democracy" is well entrenched. Indeed, socialist China has sought to conserve the market democracy of Hong Kong by constitutionally requiring post-colonial Hong Kong to maintain her "previous capitalist system and way of life"³ and the post-colonial government to "protect the right of private ownership of property..."⁴ These and other requirements, which in effect stand for China's tacit acknowledgment of the economic contribution of British colonialism, are now part of the *Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China* (or simply the Basic Law) (Information Services Department 2001).

To be faithful to the Basic Law command for maintaining a capitalist system, the constitutional duty of the post-colonial government is threefold. First, it must uphold the rule of law and the freedom of contract, a necessary condition for maximizing individual and responsible creativity. Second, it must consciously restrain its scope of activities, which is the only way to minimize tax and maximize private enterprise. Third, subject to the other conditions, it must adhere to a balanced budget.⁵

As Hayek puts, "A group of men normally become a society not by giving themselves law but by obeying the same rules of conduct." (Hayek 1960:106–107). The sustainability of the capitalist economy of Hong Kong relies not as much as written laws, including her Basic Law, but the endorsement of Hong Kong society as a whole of a free market economy.

Although many world-class economists, notably Friedman (Friedman and Friedman 1990) and Olson (1982) and such jurists as Siegan (1989, 1994, 1997) have found *laissez faire* economics the source of success of Hong Kong's economy (Lai 2002a, 2002b), there are many commentators who argue that the economic achievement of Hong Kong

is a result of government intervention rather than the invisible hand of the market. The standard argument of these free market cynics rests with the massive government financial injection into the economy. Such injection has allowed the existence of a massive public housing programme that has accommodated more than 50% of Hong Kong's 6.7 million population; a comprehensive "9-year free education" policy; and other social spending items that have their roots in the later part of Hong Kong's colonial history. In making their case, which is often self-serving, these cynics choose to ignore the perennial criticism not only of free market economists about the long term harmful effects of these policies but also of the complaints of dissatisfied users of public housing and government controlled education. The voices of the interventionist have become louder as the recent "democratization" of Hong Kong has developed hand in hand with growing government interventionism. Indeed, one wonders whether the post-colonial regime is paying any attention to the need to sustain "capitalism" Hong Kong as a matter of constitutional law.

After Hong Kong's reversion to China, the government of Hong Kong sought to dampen property speculation by undertaking a massive housing supply policy for the production of 85,000 home units per annum for a decade, rescuing stock prices, fighting "foreign speculators" by aggressively buying shares, and promoting homeownership (and controlling speculation in the property market) by the said massive government building programme. The government has also "modernized" Hong Kong's economy by importing the idea of a mandatory provident fund for labor, low interest loans to "high-tech" industries; and a compulsory scheme of bank deposit insurance. All of these internationally and locally much criticized initiatives,⁶ have cumulated in an inevitable result: added burdens on investors; falling tax revenue; the gradual dissipation of fiscal reserves built up by the colonial regime; and the emergence of the signs of a structural budget deficit. Since the "Asian Economic Crisis" of October 1997, local property prices have dropped by more than 50% and unemployment has reached 7% with more employed labor forced to accept shorter-term contracts and lower wages. After a few years vacillation, the government eventually, vaguely and embarrassingly, conceded that the ambitious home units supply programme, publicly criticized for being "socialist planning", was no longer applicable. Announced on 1 July 1997, the housing programme was a supply side approach to tackle rising property prices. In all fairness, the policy became unnecessary because demand for housing collapsed as a result of the Asian Financial Crisis. The problem with housing now is that property prices are falling. Many home purchasers blame the government for having "enticed" them to buy properties through its policy of promoting homeownership. This saga testifies to the fundamental libertarian norm that no government should seek to intervene in the market with a view to regulate prices or quantities.

Yet, the GDP of the Hong Kong economy has resumed real growth since 1998 after a brief recession and the lessening in hour restriction and quotas on cross-border passenger traffic has promoted tourism. Furthermore, the Basic Law requirement for the Hong Kong Special Administrative Region Government to maintain a balanced budget has forced the government to cut the salaries of its civil servants and contract off many activities such as street washing and cleaning to the private sector. The recent challenges to the economy of Hong Kong therefore are not of lending support to the visible hand of the state. Rather, they testify to the resilience of Hong Kong's free market economy and, above

all, the danger of fettering with the invisible hand and competition. The argument of free market cynics for more intervention must be viewed in the historical context of their argument for “industrial diversification” by means of subsidies in the late 1970s. This policy proposal, were it not ignored by the colonial government, would have become a bad investment as the opening up of China back then has altered the comparative advantage of Hong Kong in manufacturing. Though many have claimed that Shanghai will soon surpass Hong Kong in economic performance, the fact that many commercial shops in that city are state enterprises shows that she is far from being a more laissez faire economy like Hong Kong.

Having provided the institutional setting for the economy of Hong Kong, we shall take a journey through a number of real world examples. These examples show how the Mises-Hayekian spontaneous catallaxis (Webster and Lai 2003) has occurred in the land and marine resource markets interacting with government planning⁷ in colonial and post-colonial Hong Kong. We shall see how catallaxis in these has been shaped by and subdued various modes of government intervention. Before embarking on our journey, let us first explain the potential positive role of government town planning and describe a few myths propagated by town planners about the nature of planning problems and their contribution to tackling these problems.

The Potential Positive Roles of Government Planning and its Limits

Government town planning as an institutional arrangement that emerged during the Industrial Revolution has a reason to exist (Lai 1996, 1997, Webster and Lai 2003). The problem with this arrangement is that government town planners, as members of an interest group (Tullock 1993), have sought to expand their powers through zoning legislation and other means that fetter with the working of the land market. In *The Constitution of Liberty* (Hayek 1960), Hayek strongly criticized government town planning that attempts to “go national” beyond the design for a neighborhood (Lai 1999). Government town planning today is often characterized by edict and measures, compromising private property rights and the freedom of the market, thus retarding wealth creation and dissipating resources.

A challenging public choice question is how the powers of government planners can be constrained in such a way that they play a potential positive role in serving only to enhance wealth creation rather than dissipating resources in the land market. Following the ideas of Hayek and Mises, the most important constraint for economic behavior is market competition. Thus, a planning system that exposes any government planning proposal to market competition is most conducive to wealth creation. As illustrated in this paper, this happens to the leasehold land system as a kind of planning in Hong Kong where land purchasers can vote with money their preferences for a certain planning design embodied in the land lease (at least before the statutory zoning plan emerges).

Given the presence of the right kind of constraints described above and illustrated in this paper, one important potential positive role for government planning is what Abercrombie referred to as “development planning” (Abercrombie 1933), which is described as

“administrative planning” in Hong Kong. As explained further below, development planning happens when government plans are implemented by voluntary agreement and where an “exit option” is open to those who do not accept the plan. This is a land system that is referred to as “planning by contract (or consent)” in this paper and elsewhere (Alexander 2001, Booth 2002, Lai 1994, 1996, 1997a, 1997b, 1998). The gist of the idea of “planning by contract” is consent, which means mutual agreement rather than the securing of permission from an authority (Booth 2003), and thus should be capable of describing “non-zoning” in Houston where development control is in fact governed by mutual agreements among landowners (Siegan 1974). Development planning based on contract or consent is radically different from “planning by edict” (Lai 1994, 1996, 1997, 1998), a regime through which government planners force, by law or policy, land users to submit to their ideas for a change in use or redevelopment. Instead of market forces, “planning by edict” allows some claiming to have better expertise in deciding the investment outcome over land resources they do not own. “Planning” in this sense means “forcible superseding of other people’s plans by government officials” (Sowell 1982).

Another potential positive role of government planning is the granting of resource entitlements to open access resources or resources in the public domain where competition is causing rent dissipation. Government planning in this sense involves the *initial allocation of private property rights to overcome the so-called “tragedy of the commons”*. This view is consistent with Coase Theorem with its focus on private property (Coase 1959, 1960, Barzel 2003). The assignment of some form of entitlement to resources is conducive to the attainment of sustainable development (Yu et al. 2000, Lai and Lorne 2003). Subsequent reallocation of rights should be left to the market.

Hong Kong Urban Planning Problems and Solutions as Perceived by Government Planners

Urban development in the city core of Hong Kong, especially the areas that surround Victoria Harbor, is extremely high-rise and high density (Lai 1993a). The fundamental legal basis of private development in these areas and elsewhere in Hong Kong has always been the leasehold land tenure under which rights to develop and use land are sold as commodities by the government to lessees (referred to as “landowners” in Hong Kong) at open market values.

Developing Major Infrastructure

The government town planner is proud of his role in expanding the urban infrastructure. Well-publicized examples are the relocation of the new airport, the expansion of the container port and the delineation of the alignments of new transport routes.

“Guiding Development” and Developing New Towns

The government town planner believes that he has made a major contribution to the form of urban living in Hong Kong by “guiding development” in proper locations by statutory

zoning, which may override the rights or obligations on a piece of private land as specified in the land lease. From the planner's point of view, there is a "development control" need to cover all leasehold land by statutory zoning plans to impose an order based on planning concepts. This planned order involves the obtaining of planning permissions (which often entail the impositions of planning conditions) for changes in use even where such changes were originally permitted by the terms of the land lease. Planning permissions amount to non-price allocation of development or redevelopment rights, fettering with any existing rights under the land leases. The allocation of leases is the function of the Lands Department, a natural enemy of the Planning Department in so far as the latter does not take into account land revenue as a valid planning consideration.

A classic way the government planner demonstrated the need for zoning and planning permission was to compare and contrast the chaotic "Kowloon Walled City" with the orderly appearance of a major residential estate that is governed by a master layout plan approved by the Town Planning Board. Another customary way of publicity was to show the appearance of lower-density and "well-planned" new towns in newer development areas away from Victoria Harbor. These new towns all satisfy planning standards not met in older urban areas. The new towns are controlled by statutory town plans that regulate change of land uses. The living densities in these new towns are lower, public open space and community facilities more abundant. Apparently, it is the government planner who has identified a planned solution for people in Hong Kong to cope with high-density living through high-rise development controlled by statutory zoning and efficient public transport by development planning.

Conserving the Countryside

As regards the planning for the countryside specifically, the government planner once complained that he had no "teeth" to prevent private agricultural land from lying fallow and used as container yards. He did indeed succeed in persuading the legislator to grant them the statutory power from 1990 to impose statutory plans which zone rural areas for various land use and conservation categories⁸ and to enforce against "unauthorized development", notably open storage of containers and building materials, which were otherwise lawful according to case law.

Now, the government planner has imposed statutory plans on almost all private lands held under agricultural leases, requiring planning permissions for such uses as building, excavation, pond filling, open storage of containers and building materials. Any change in use or development of land without permission is liable to prosecution and fine.

Re-Shaping the Urban Structure

The government town planner is also enthusiastic in publicizing his role in reshaping run down urban fabric by government-led urban renewal, backed by "land resumption" (the equivalent of "takings" or eminent domain in the USA). This resumption power is exercisable by a government urban renewal corporation, previously called the Land Development Corporation (LDC)—now known as the Urban Renewal Authority (URA).

The Great Disappointment

Before rebuking the alleged success stories of government planning, one must realize that government planning for Hong Kong is disappointing in many respects. First, big plans are always overtaken by events. The 85,000 home unit programme mentioned above is but one recent example. Statistical analysis of planning application statistics has shown that the Town Planning Board has been unresponsive to government housing policy or the state of the economy (Lai and Ho 2001a, 2001b, 2001d, 2002a, 2002b, 2002c, 2002d, 2003). This mismatch between the market, plans and other regulatory initiatives reflects one problem inherent in any “socialist economic calculation”: the plans simply do not work. Another example is that the building up of the population in Hong Kong has always frustrated any attempt to put a ceiling on, if not to “thin out”, population in the old urban cores, as what has happened to the Metroplan of the late 1980s and early 1990s. This means that the high-rise high density living in Hong Kong is not a matter of the wise choice of the government planner as a means to save environmental resources but a must to tackle the problem of numbers as a matter of resource economics.

Second, the government has not been successful in eradicating unauthorised development on private rural land. Land users prefer to break the law that criminalizes their trade rather than following government advice to relocate or start their open storage business in designated zones, the “Open Storage Zones”, which government has publicized to be the best places for the storage of containers and building materials. The reason is a matter of economics. Open storage of either category of storage is not an “always permitted use” but a “Column 2 use” that requires planning permission, a distinction explained further below. Furthermore, econometric evidence shows that the chance of obtaining planning permissions for either use is not higher, if not lower, than that in places outside this class of zones (Lai and Ho 2002c). Rational land users would not be so foolish to repeatedly apply for some uses that would unlikely be permitted. We shall revisit this point in the discussion of zone separation below.

The Governance of Statutory Zoning

It is submitted in this paper that the above widely publicized positive contributions of government planning are not so much a result of statutory “development control” via zoning. They are rather the outcomes of market initiatives under the governance of planning in Hong Kong: it is politically, legally and economically highly constrained. In other words, it is because the visible hands of the government planner are so bounded that the land market is allowed to exploit the opportunities of gain from trade, thereby not only fulfilling the object of planning but also correcting the mistakes of planning.

It is also argued that the creation of various “lumpy” infrastructure development is not a case showing the power of the visible hand but the resilience of the market and that government-led urban renewal is unimaginative besides being disastrous in terms of property rights violation. Quite to the contrary, the spontaneous forces of the market have worked out better means of landuse-transport interface and new ways of rejuvenating old urban

structures. A degree of government regulation may arise as a result but such regulation is better informed by market signals.

Government planners as an interest group of course do wish to seek rent by creating monopoly rights and powers through legislation. They have succeeded in introducing a *Town Planning Ordinance* in 1939 but the real working of this ordinance commenced only in the 1960s when Hong Kong managed to establish itself as an export-oriented manufacturing centre. Before 1939, the British colonial government had introduced statutory zoning that excluded the Chinese from residing in the Peak area of the Island of Hong Kong (Lai and Yu 2001) but racial segregation by law has seldom been discussed in the literature on the planning history of Hong Kong. The extent of non-price allocation of development or redevelopment rights under the planning permission mechanism has been restrained in three ways.

Legally, statutory zoning control has remained highly permissive save the areas held under agricultural lease. Though they may override the terms of the land lease where there is a conflict, the plans for the old urban areas and new towns are generally, at least initially, not that destructive of leasehold interests. Rather than truly “guiding” new development, statutory zoning when first imposed often simply reflects the existing land use patterns.⁹ They tolerate the continual existence of existing building development and its use; permit “as of right” some basic uses for all zones and a lot more items of uses in specific zones (Column 1 uses). A noteworthy feature of the “as of right” uses for various classes of zones is that they have a high degree of overlapping, implying that any uncertainty due to zoning differentiation is reduced. In many instances, “zone separation” is hard to tell (Lai and Ho 2001c). Furthermore, the toleration of existing use and almost universal permission commercial uses on the lowest three floors of any building in most urban zones (such as Residential (Group A) zones (RA zones)) mean that a criterion of Pareto optimality was observed by the founder of the modern zoning system. In a context that most prewar buildings were just three-storey in height, the imposition of the zoning plan would only have affected post-war redevelopment, when building heights had to be relaxed to accommodate the growing population: refugees and migrants from China. Ever since 1945, the population in Hong Kong has been growing at a rate of 1 million per decade. The zoning system also specifies a finite number of uses that may be permitted for specific zones (Column 2 uses) instead of indiscriminatorily requiring planning applications for any development or redevelopment. The only significant exception is Comprehensive Development Area (CDA) zoning which entails the need for the submission of a master layout plan for planning permission if the affected land is to be redeveloped. This universal requirement for development permission in CDA zoning, duplicated in “Unspecified” zones imposed on private farmland, is like the situation in the UK, where any development requires planning permission. However, unlike the Green Belt in the UK, where housing development is prohibited, “houses” may be developed even in the Green Belt zones in Hong Kong. This is especially true of a special category of buildings exempted from statutory building codes, the “small houses” for “indigenous villages” (Lai 2000d, 2002b, Lai and Ho 2001a).

Politically and administratively, major development planning initiatives have remained market driven and kept out of reach of the government planner. The executive government has been able to resist the legislative proposals for expansion of statutory zoning powers viz. the provision of third party participation in the planning application system and the

effective abolition of Column 1 uses by the concept of “planning certificates” for all uses in all zones. The limits placed on public participation have helped avoiding such problems as those created by “ballot box zoning” (Staley 2001). Above all, the government planner has never been granted any power or budget to intervene in the land market in terms of allocation of leasehold interests or levying of charges on the use of land other than in the rural areas through imposition of fines for unauthorised uses.

Economically, business interests backed by market forces have not been just able to resist expansion of statutory zoning powers, as mentioned above, but also to implement, correct and even frustrate zoning plans. It is indeed that the government planner has not been given too much power that their good plans may have a chance of becoming successful.

Contractually, the prime mover of development planning and control has always been the land lease, a contractual document, which statutory development control by zoning often compromises. This is indeed the driving force for the factual implementation of the Abercrombie Report (Abercrombie 1948, Lai 1999a). In fact, the statutory zoning plan has worked best where it simply reflects or follows the pattern of existing development and observes the Paretian principle—as in the case of the old urban areas and new towns. In this scenario, the zoning boundary follows existing private property boundaries and allows lessees the maximum freedom of contract. The land use categories permitted are actually those that have already been in existence as a matter of market evolution. Where it is imposed on rural areas according to the planning criteria of the government planner, which often pay no respect to pre-existing property boundaries, it only works to stimulate illegal use of land. The powerful and creative manifestation of urban development predicated on this simple institutional order based on the land lease is discussed below.

Spontaneous Catalaxis Under Planning by Contract or Consent

The power of the land market is immense. Before discussing the manifestation of such power, one must realize the business environment for the land market in Hong Kong. On the one hand, the land market has to operate in an increasingly hostile environment in which the public housing sector has been expanding rapidly since the early 1970s.

On the other hand, the private development sector of this market has never received any government subsidy. Rather, it has to pay monopoly rent to government as the landlord in various forms, such as land prices, lease modification premiums, rates, land rents, and stamp duties, which have been a significant source of government revenue with which government can spend lavishly on public sector housing and other services.

Note that the sale of leasehold interests as a way of “planning by contract” in Hong Kong is a way of allocating private property rights and is different from land taxation in many significant ways. Leasehold interests differ from freehold ones only in terms of the terms of years: those for the former are pre-specified whereas the latter not pre-specified. Both types of estates are otherwise full private property and are both subject to the possibilities of statutory zoning and resumption (“takings”) by government. The sale of leasehold interest is not just a matter of taxation. Land rights in Hong Kong are not granted as free goods based

on bureaucratic or legislative fiat but are sold as commodities through a process which, as shown below, subjects government planning to market forces. As some academics have argued (Jao 1976), land premiums obtained by government can be regarded as a kind of tax income. However, land transaction as a form of planning by contract is different from such ordinary taxes as income or profits tax in that there is no compulsion to submit payment. Any payment for buying a piece of land from government, unlike the case of excise tax, is not based on government-determined rates but the payer's financial assessment of prospective returns. By contrast, statutory zoning in Hong Kong, which compromises the above way of planning, is more akin to taxation in terms of the freedom of compliance. The reason is that lessees affected by statutory zoning can hardly say no to the government zoning plan and must comply with government development ceilings. Furthermore, unlike an ordinary tax on land transactions (viz. stamp duties), the premiums paid for obtaining government land are tied to a land contract that stipulates conditions that both the state and the lessee must fulfil or avoid. As the lease covenants "run with the land", they bind government as well as all subsequent purchasers of the land. Thus, land premiums is not just a kind of fiscal levy on land transactions.

The degree of freedom in the use of and building manifestation on land under the terms of the land lease, as modified by the provisions in statutory zoning plans, affects the spatial flexibility in business operation in Hong Kong, there being otherwise little regulations to the entry or exit of trades. Violation of the user and building restrictions of the lease or zoning plan will create title problems in conveyancing. Thus, such restrictions are real constraints for business activities. Generally, the older is the vintage is the land leases and statutory zoning plans, the greater is the degree of freedom. The "999-year lease, for instance, only rules out several specified "obnoxious trades" and permits all types of land uses, commercial, industrial, residential, or institutional and any mix of them. The old Commercial/Residential (C/R) zones are also highly permissive. Whereas the R (A) zones permit any commercial uses on the lower three floors of a building, the C/R zoning allows any mix of commercial and residential uses in an entire building.

Market-Driven Destruction of Racial Discriminatory Zoning Laws

The spontaneous forces of the market, not great politicians, liberal public opinion or the government planner *per se*, succeeded in overthrowing racially discriminatory zoning laws in 1946. These laws were the *European District Reservation Ordinance* of 1888; the *Hill District Reservation Ordinance* of 1904; the *Peak District (Residence) Ordinance* of 1918 and the *Cheung Chau (Residence) Ordinance* of 1919. These laws were enacted in the 19th century as a protectionist measure (Lai and Yu 2001). With the lifting of the protectionist law, more European and Chinese people have been able to live in previously exclusively European reserves and land prices of these "liberated" areas have been rising rather than falling. The effect has been beneficial to all ethnic groups.

While the incentive of the government in abolishing racial segregation has never been explained clearly, her choice has been proven to be fruitful in terms of land revenue generation. This factor of land revenue consideration can explain why government has

often constrained the behavior of her landuse planner. But the government's motivation was less powerful than the forces of the land market as an explanation for the destruction of racial segregation in colonial Hong Kong. The destruction of the Second World War was a kind of "Olson shock" that overcame the interest of the group that wished to retained protectionism in the land market when the ability of pay by the Chinese citizens for better living environment of Hong Kong was overwhelming. The following facts are revealed by a study of the first three telephone directories¹⁰ of the immediate post-war years:

- (a) In the year 1946, there were 47 persons with their phones installed in the Peak area. One person/family (**2.1%**) was Chinese. Others were all European.
- (b) In the year 1947, there were 181 persons with their phones installed in the Peak area. A total of 3 persons/families (**1.7%**) were Chinese. Others were mostly European persons.
- (c) In the year 1949, there were 265 persons/families with their phones installed in the Peak area. A total of 14 persons/families/companies/government bodies (**5.3%**) were Chinese. Others were mostly European persons.
- (d) In all three years (1946, 1947 and 1949), all the Chinese person(s) found in the directory for one year is (are) also found in those for the subsequent years.
- (e) In all three years (1946, 1947 and 1949), most European people lived in apartment units and then moved into houses on the Peak. However, some later migrated to the Southern District, notably Shouson Hill, Shek O.
- (f) In all three years (1946, 1947 and 1949), the names of the Chinese persons who purchased property on the Peak as found by Lai and Yu (2001) are not associated with phone numbers assigned to the Peak areas.
- (g) In time (from 1946 to 1949), more and more British companies had residences for their directors and senior managers on the Peak (and also the Southern District).

The repeal of the racially discriminatory zoning did only permit the "intrusion" or "invasion" of the better off Chinese people into the Peak area but also attracted more European dwellers to the same areas. As a result, the absolute number of both European and Chinese population on the Peak increased. A process of "catalaxis" obviously occurred once the artificial legal constraint placed upon the market was removed.

Co-Evolution of Big and Small Firms in International and Local Transportation

The spontaneous forces of the market, rather than premeditation or "socialist calculation" of the government planner, created the international container port at Kwai Chung with minimum government investment. The major government-led planned-expansion of this port in the last 10 years was indeed a response to a growing demand for more handling space and berths by its multi-national operators. The government development planning strategy was pragmatic by focussing on the existing port.

This "grand scheme", however, does not mean that the logistics market of Hong Kong has been monopolized by big firms and that small operators have no chance to have a share in the market, as some anti-market theorists may wish to suggest. The fact is that though

the big firms have a much advantageous position by controlling deep berths for ocean going container liners, small-scale firms called “mid-stream operators” have been able to have a share in the container handling industry by barging. Unlike container liners, the barges operated by the mid-stream operators cannot navigate and must be pulled by tugs. With a crane to lift containers, each of these barges can take up to 45×8 TEUs.

The mid-stream operators may not use the berths in the container port but they manage to lease waterfront land from government on “short-term tenancy” or pay for public cargo working areas controlled by the Marine Department.

The activities at the international container port are computerized and high-tech. Those at the yards of the mid-stream operators have to make up with speed. A folk truck that operates on such sites can place a loaded container from the barge onto a container truck in as short as 30 seconds. Like a duel between Goliath and David converted into an amicable game, the large international container port operators have co-evolved with these “mid-stream” operators. Government has been playing the role of a landlord who maximizes the joint rent from the private international port, the private waterfront “short-term tenancies” and the public cargo working areas. The basis of such rent-capturing role is the land lease, executed contractually in response to market demand for lands in specific locations. Statutory zoning has the subsidiary clerical role in reflecting the status of the land already granted to the container port or the Marine Department on a statutory plan. It has no role to play in respect of the mid stream operators who lease land with marine access from Lands Department on short term tenancies as such a use of land is a “temporary use” that is always permitted on statutory plans.

A similar pattern of competition has happened with franchised buses, government water supply, government postal services and many other trades in which the government has a financial interest or regulations: the market has never been barred from competing with government firms or franchised companies. The entrants indeed often help explore new profitable modes of operations that the government subsequently assigns, at a charge, to franchised firms. The evolution of the “green maxi-cab” is another good example to dismiss the myth of the wisdom of the government planner in “guiding” infrastructure development.

The conventional wisdom of the government transport planner was that residents of large housing areas should walk to a major franchised bus terminus or station for job commuting according to fixed and approved bus routes. This was a correct government thought in the 1960s when income and time cost was low. Yet, the world will always change and so will the market as a means of cooperation. Congestion in the taxi market and appearance of an illegal 9-seater minibus market that was too hard to suppress led government to de-criminalize the minibus market and permit the private running of red 14-seater (now, 16-seater) minibuses. The government has levied a license fee of course. Unlike the regulated big double-deck franchised bus, the minibus allows greater freedom in terms of location of picking up passengers and routing. Above all, the level of charges for each mini-bus is completely free. The service of the red minibus is more flexible and consumer-oriented. This kind of bus was also first to become air-conditioned. Though speeding and aggressive behavior of drivers appears to be the norm, the red minibus sorts out new routes that are more profitable than the franchised buses. Government captures the chance of making a profit out of this kind

of bus by assigning specific routes to “green maxi-cab” companies for a term of years by tender. The green buses have pre-determined routes and fares and a change in either needs permission.

From the above examples, we can see that it is the ability of the small firms in market and profit seeking on the one hand and the incentive of the government in seeking revenue by free riding on the information provided by the small firms on the other hand that has shaped the transport market of Hong Kong. The role of the government planner is at best to accommodate and regulate the changes in spatial terms in the light of market signals: deleting or relocating a declining franchised bus terminus; devising parking standards for red and green minibuses; and other fine tuning matters. The power of the planner becomes greater where there is a chance to impose as a planning condition the requirement to provide in a private development a major public transport interchange.

Transport Infrastructure Development as a Result of Public Failure in New Town Planning

The alleged contribution of the government planner in respect of new towns must be viewed in a proper perspective. While the actual development of the land uses inside the new towns itself is in fact private sector-driven rather than the labor of the planner, as elaborated in a separate section below, the originally planned external links of the new towns failed squarely. It was this initial tragic planning disaster that created the need for the *expost* expansion of resource using transport links.

The originally planned links between the new towns and the old urban core were all under-capacity as the government planner had erroneously believed that their ideas of “balanced development” and “self-containment” for new towns would work in a free labor market. With a view to “minimize commuting”, the government planner reserved “adequate industrial sites” in each new town. He thought that these sites would generate sufficient blue-collar jobs for the labor force in the new towns. In his opinion, the new town was a manufacturing work camp with open space and community facilities. The planner erred in two ways. Firstly, he had underestimated the growth of the office sector as a major employment generator. A lot more new town workers turned out to be white-collar. Secondly, even though the industrial sites in each new town were actually generating lots of jobs, these jobs did not always attract labor residing in that particular new town. Blue-collar workers of one new town frequently adhered to their old jobs in the old urban core or traveled to another new town for jobs. The planner simply did not understand the implications of the complexities of the manufacturing sector or freedom of employment.

The apology of the government planner about traffic congestion for all new towns was that he did not control the programming of transport development so that population built up ran faster than the expansion in transport capacities of road and rail links. The reality was that it was well after the transport market clearly revealed acute shortages in capacity, expressed in long traffic queues, and much lobbying by the affected new town dwellers that government subsequently put in place more transport links as remedial measures.

Contractual not Statutory Development of the New Towns

Ignoring the initially difficulties of commuting, it remains true that the structure and amenities of new towns are physically better than those in the old urban core. However, one must appreciate that the private development of the new towns has nothing to do with the “proper land use structure” of the towns as expressed in their statutory town plans. Such development emerged purely as a matter of contract based on the land lease. It is planning by contract or consent (Lai 1994, 1996, Lai 1997a, 1997b, Lai 1998, Alexander 2001), based on the lease drafted by the Lands Department, rather than by the statutory zoning scheme that has been the real *de facto* and *de jure* prime mover of private development in all new towns.

It is true that the government planner has made a contribution in planning. However, such planning was conducted on an “administrative basis” through large-scale department plans known as “layout plans” and “outline development plans” rather than by the statutory “outline zoning plans”. The development plan, which involves no lengthy legislative procedures, can be readily amended in response to market preferences. To claim that the statutory plan guides development in new town is misrepresentation. The statutory plan only regulates post-development change in use.

Table 1 shows the progress of actual development of new towns in terms of population build-up and the dates when the first statutory plan for each was imposed. The truth revealed is that the statutory town plan was introduced as an *ex post* measure to regulate any further change in use of land after the new town has matured. In other words, the actual development of private housing in new towns was the outcome of the land market.

Spontaneous Use of Land in Kowloon Tong Under Statutory Zoning

Where statutory plans are imposed on existing leasehold interests, the land market is still able to exploit the maximum opportunities for trade and the result is often beyond the expectation of the planner. The evolution of the land use pattern in Kowloon Tong, originally a low rise housing area designed in the prewar years under the influence of the Garden City concept, is a case in point. After the war, the building height of this area has not been released due to airport height restrictions. In seeking more profitable alternative use of their properties, some lessees sold their properties to new owners who have used the properties as “love” motels. The scarcity of land, the development of major public transport interchanges and the vicinity of the area to the old airport and nightclub areas were factors that had contributed to the concentration of these motels in Kowloon Tong.

The government planner was annoyed by this kind of social change of the once exclusive residential area. He regarded such kind as the manifestation of a kind of market failure, ignoring the constraint of the airport height restrictions and market demand for sex transactions—implicit in tourism and many entertainment activities elsewhere in Hong Kong. After a survey of various “intrusive uses,” the government finally imposed a statutory plan that does not permit commercial uses as of right. Note that the planner did not seek to eliminate sex motels, as they can operate as a matter of course in commercial zones

Table 1. Hong Kong new towns and town plans.

New towns	(a) Year designated as new town	(b) Date of first ODP covering whole new town	(c) Date of first OZP covering whole new town after first ODP	(d) and (e) Population								
				1931	1961	1966	1971	1976	1981	1986	1991	1996
Tsuen Wan (including Kwai Tsing)*	1961	1954 (LTW/7C)	13/11/73 (LTW/138)	— [5335]	— [84823]	— [205700]	— [271892]	100650 [448710]	116564 [606864]	131362 [645603]	167229 [682320]	181550 [716820]
Shatin (and Ma On Shan)*	1961 (1965)	1954 (LST2)	13/06/67 (LST/47)	—	28112	—	29478	35330	116807	355810	427322	445383 [583880]
Tuen Mun	1965	1964 (LCP/11A)	19/07/83 (LTM/2)	—	—	—	20977	33070	89901	262458	367914	445771
Tai Po	1979	1980 (TPF/80/120)	12/12/80 (LTP/47)	—	—	—	20938	29370	39891	119679	192600	271661
Fanling-Sheung Shui	1979	1984 (TPF/84/200)	23/10/87 (S/FSS/1)	—	—	—	32394	39480	49593	87206	121472	192321
Yuen Long	1978	1984 (OD/NWNT/3A)	12/4/91 (SYL/1)	—	—	—	20998	39010	51392	75740	112441	126369
Tin Shui Wai	1982	1982 (MDP/TSW/1)	21/10/94 (S/TSW/1)	—	—	—	—	0	0	0	0	96129
Tseung Kwan O (previously Junk Bay)	1982	1956 (LJB/1)	11/12/92 (S/TKO/1)	—	—	—	—	6080	15871	17486	89952	143032

*Figures in square brackets relate to the combined towns.

Sources:

(a) Bristow, R. (1989) App. II: 320–48.

(b) Bristow, R. (1989) App. I: 316–19. Plan numbers are shown in brackets.

(c) Explanatory Statements of various OZPs quoted. Plan numbers are shown in brackets.

(d) *Hong Kong Statistics 1947–67* Census and Statistics Department Hong Kong.

(e) Hong Kong By-census and Hong Kong Census 1971, 1976, 1981, 1986, 1991 and 1997) Census and Statistics Department, Hong Kong.

elsewhere, he simply wished to prevent further intrusion of them in Kowloon Tong as a prestigious residential area.

Beyond the expectation of the government planner, it has turned out that the next most beneficial uses of land under the statutory plan are international schools, kindergartens, old age homes and seminaries. They mushroom and the spontaneous outcome of statutory zoning has produced a mosaic of sex motels, high schools, kindergarten and religious retreat places. Whether one approves of such mixed land uses in Kowloon Tong as a sign of liberty or decadence is immaterial to our analysis. The point is that Kowloon Tong is a garden city no more and the statutory plan fails to serve the purpose of conserving the housing stock of the area.

Spontaneous Time Zoning at Boundary Street

If the spread of sex motels in a prestigious area as a bad social phenomenon is difficult to control due to the power of the market, the same market is able to sustain a decent trade even where it cannot afford to pay high land rent or assisted by government. Every morning at Boundary Street, a spontaneous time zoning arrangement without government regulation occurs to allow bulk and non-bulk transactions of ornamental fish and pets. Local people call this the “morning goldfish market”. In “normal time” during the day, Boundary Street is a major urban road with heavy traffic and on-street parking is prohibited. At 5:00 AM everyday, vans arrive at a section of this road and offload foam boxes onto the pedestrian pavement, which is government property. These boxes contain transparent plastic bags that hold ornamental fish, aquatic animals and plants in water with compressed oxygen. The boxes are distributed quickly to buyers who start doing their business at the spot. A temporary market emerges, measuring about 100 meters in length. All transactions are complete by 7:00 AM when the sellers clean up the pavement and leave with the vans. The “normal function” of Boundary Street returns as a major traffic corridor as if nothing has happened. In the next morning, the same story will repeat itself.

The time zoned fish market at Boundary Street in no way obstructs traffic and can be permitted as of right under statutory zoning plans because it takes place as temporary uses in a road zone. Interestingly, it co-exists with a permanent ornamental fish retail market nearby. The latter operates from about 11:00 AM to 12:00 midnight. This permanent market, the so-called “Goldfish Street”, is located at Tung Choi Street. The permanent market is in the form of a high concentration of street level shops that specialize in ornamental fish trade (Han et al. 2002). The fish shops have displaced car repair garages and local shops that were originally found in the street but were not able to pay as much rent as the fish shops. This change in business types is permitted by the terms of the land leases and the permissive R(A) zoning for the area. It appears that the morning market at Boundary Street and the Goldfish Street at Tung Choi Street have co-evolved. Both the business hours and locations of these two markets are complementary. And they have emerged, respectively, as a matter of free riding of government land and out of an unregulated land market. Neither is the product of any scheme of government to promote ornamental fish trade as a foreign exchange earning business. The two examples show the power of the market given a flexible

leasehold land regime left relatively undisturbed by a permissive residential zoning. This system allows the emergence of the formal market at Tong Choi Street that co-evolves with the spontaneous morning market at Boundary Street.

Spontaneous Urban Renewal Compared with Government-Led Urban Renewal

The spontaneous forces of the market, not government urban renewal agencies, have created many interesting shopping and entertainment areas outside the Goldfish Street. As a matter of the Basic Law, the constitutional legitimacy of the ordinances that enable the government urban renewal corporation to resume private leasehold interests is suspect (Lai 2002a, 2002b). The major economic problem of this kind of urban renewal is that it provides no exit option for the unwilling lessees. The affected lessees may not pull out of the government scheme or even put forward their competing scheme. In other words, government-led renewal schemes displace and crowd out private initiatives by law. The correctness of the law and property rights apart, government-led urban renewal endeavors have been most disappointing in terms of delivery. They simply produce more floor space in a protectionist environment.¹¹ They have failed squarely to instill any viable new ideas of modern urban living or shopping.

On the contrary, the spontaneous forces of the market have renewed urban backwaters in ways government-led urban renewal agencies have failed to do. The cases of the Stanley bargain market at Stanley Bay and the Lan Kwai Fong precinct off D'Aguiar Street in Hong Kong are cases in point. The voluntary behavior of individual shops in these two cases also testifies to the possibilities of privatizing positive externalities and internalizing negative externalities by voluntary clubs driven by market forces in the absence of government interference.

The Stanley market was originally a run-down residential area with a few shops along a narrow lane (Stanley New Street) that sold clothes and daily necessities to the British garrison stationed at Stanley Fort. A more entrepreneurial shopkeeper stocked some export garments with tourists in mind. In due course, the entire lane became a shopping area for tourists. An interesting feature of this bargain market is, unlike those in conventional tourist shops elsewhere in Hong Kong that may exploit on the ignorance of tourists about local prices, all goods sold here have price tags though price bargaining is welcome. This significantly reduces the cost of bargaining and expands the volume of trade. This collective practice of exhibiting the prices of the goods is not a matter of any centrally imposed or enforced policy but a good practice adopted by imitation to enhance individual survivability.

What is more interesting in planning terms is the way in which the shops manage to tackle a major "public good" or "externality" problem. There being no centralized property management, each individual shop in the Stanley market has air-conditioning units. The cool air of each shop escaped into the lane as a kind of positive externality—cool air mass in front of each shop is an asset for shops in sub-tropical Hong Kong. Given the narrowness of the lane as well as the frontage of each shop, it pays for each shopkeeper to construct a transparent canopy over the stretch of lane in front of his or her shop to retain as much

cool air as possible. It was not long before a contiguous canopy appeared along the entire shopping area, serving as a facility not only for air-conditioning but also rain shelter. The case of Stanley market again shows the power of the market given a flexible leasehold land regime left relatively undisturbed by a permissive R(A) zoning that allows commercial activities as of right on the street level.

The government urban renewal agency pays great respect to the success of the Stanley market. It has sought to duplicate the success of Stanley market by “creating” similar theme markets in connection with its massive urban renewal schemes. These schemes typically involve the forced purchase of private properties, bulldozing the sites and develop new office and residential towers at a mammoth scale. In this process, existing markets (such as the birds market) that had been tourist attractions were uprooted. In an attempt to rescue these assets and repeat the story of the Stanley market by design, these markets have been rehoused inside their scheme areas. Not all of these efforts are fruitful, however. The new shopping facilities in the urban renewal areas, which replace the old high-street type of retailing, are typically cool and unattractive to local or foreign visitors. This stands in sharp contrast with the hectic shopping areas near Lan Kwai Fong, to which we now turn.

Lan Kwai Fong was initially a backyard area in the foothill area of Central District (in which the traditional CBD of Victoria City lies) with a supermarket and a few Chinese restaurants. The opening up of an English pub soon became an anchor for the proliferation of places for drinking, dancing and other western entertainment. Eventually, a trade association was organized which holds festivals and lobbied government for improvement to the locality (planting, street paving and pedestrianization). The business success of private enterprises in Lan Kwei Fong has also led to gentrification and redevelopment of its hilly hinterland areas, fostering the emergence of another entertainment-arts/antiques shop concentration in the vicinity, known to “expatriates” as “Soho”. This has happened in the absence of the involvement of any state enterprises or high handed state intervention by the Land Development Corporation (Lai 1993b) or Urban Renewal Authority, which as a government corporation is inevitably constrained by the Hayekian problem of knowledge: the difficulties of public bodies in realizing consumer preferences of individuals. Indeed, the incremental and piecemeal but stylish redevelopment triggered off by the English pubs at Lan Kwei Fong or “Soho” would not have been possible if the government renewal agencies had got involved. They tend to destroy every existing building and replace each by larger blocks. The choice of shop tenants in the redevelopment would be the top down decision of a property manager rather than the spontaneous choice of individual entrepreneurs.

Contractual Introduction of the Master Layout Plans

The government-led urban renewal schemes, being subject to statutory “Comprehensive Development Area” zoning, are invariably controlled by “master layout plans” (MLPs) approved by the Town Planning Board. In fact, the total number of housing projects governed by MLPs supplied by the government urban renewal agency is far less than those produced by developers.

Table 2. Major residential development in Hong Kong controlled by master layout plans stipulated by lease conditions in the absence of statutory zoning requirements or planning conditions.

Development (location)	Crown lease			First OZP covering the development (Zoning/date)	Number of flats
	Number (location)	Date of grant/ exchange	Provisions for layout plan		
Pearl Island (Tuen Mun)	New grant no. 658 (Lot 746 in DD379)	September 1965	General conditions clause 6	L TML (R(B)/29/7/83)	130
Discovery Bay (Lantau Island)	New grant no. 6122 (Lot 385 in DD352)	September 1979	Special conditions clause 6	S/I-DB/1(14/9/2001)	6064
Mei Foo Sun Chuen (Lai Chi Kok)	New Kowloon Inland lot no. 5085	March 1966	Special conditions clause 4	S/K16/1 (R(A)/8/11/85)	13110
Nam Fung Chuen (Quarry Bay)	Inland lot no. 8397	July 1975	General conditions clause 4(a)	LH 21/9 (R(B)/29/10/76)	2424
Taikoo Shing (Quarry Bay)	Inland lot no. 8397	July 1975	General conditions clause 4(a)	LH 21/9 (C/R/29/10/76)	12690

Note: Brackets used in headings relate to material in brackets within that column of the table.

Source: Land Registry, Hong Kong Government.

Note that Pearl Island was almost completely redeveloped in the mid 1990s and no statutory plan was imposed on Discovery Bay until 14 September 2001 when *draft Discovery Bay Outline Zoning Plan* No. S/I-DB/1 was published in the gazette.

Many believe that such MLPs were introduced by the government planner as statutory zoning requirements. The truth is that the government planner borrowed the idea of a MLP from the land officer who first invented the idea in the land lease. Table 2 shows the evidence for this opinion. The table lists a number of major residential housing estates that have been governed by MLPs as part of their leases, not as part of planning permissions.

*The Kowloon Walled City is not a Case of Market Failure*¹²

The spontaneous forces of the market apply equally to the land market and oceanic resources. Before going to sea next, let us evaluate the classic planning case of the Kowloon Walled City. The truth about the Kowloon Walled City is not a case of market failure but a case where the institution of the land market is refrained from operating perfectly due to political uncertainties.

The Kowloon Walled City had its origins as a fort, built by the Chinese in the area now called Kowloon City as a defence against the British who were busily developing the Island of Hong Kong. The British took over Kowloon and regarding the fort as a threat, later leased the part of China they called the New Territories. In the lease, the Walled City remained expressly a Chinese enclave under Imperial Chinese jurisdiction and in the years that followed its status remained ambiguous, with successive governments of China

maintaining that it belonged to them. As a result, the property laws and regulations of Hong Kong were haphazardly applied or not applied at all. The land lots in the city had no title that was recognized at common law and thus the degree of private property in this enclave was far from being complete than that in the rest of Hong Kong. A chaotic pattern of building construction emerged after World War II, leading to the removal of the remnants of the original wall, over-development, under-provision of infrastructure and services and unhealthy living conditions not dissimilar to medieval walled cities—apart from modern levels of density. Builders did not submit building plans and properties had no title, as there were no Crown leases for the area. With a lack of state policing, the Walled City famously became a concentration of vice dens. It was also home to many decent and hard-working people, whose industry benefited from the lack of state regulations over labor markets, health and safety and so on. Market-based exchange within the Walled City clearly had much inefficiency in the Pigovian market-failure sense. The source of the problems, however, lay principally with the uncertainty in institutional jurisdiction and resultant ill-defined property rights.

A certain kind of order prevailed within the Walls, however. Builders, for example, respected the airport height restrictions for the nearby Kai Tak Airport, voluntarily agreeing not to build taller than was regarded safe for aviation. Internal methods of maintaining law and order developed and informal customs evolved to cope with the problems of crowding. Though many physical standards, such as means of escape and open space for buildings, were inferior in this *city within a city*, it was not socially stigmatized as a ghetto. The rates of reported crime and suicide for the city were not higher than the territory average and were lower than some of Hong Kong's infamous public and private housing developments. Politically, it may have been among the most tolerant of areas as people with hostile political stands lived together peacefully without major violent confrontation between factions or with the government that from time to time was called upon to "clean up" the vice dens.

The British and Chinese governments had an interest in resolving the problem since the Walled City was an eyesore and a reminder of old wounds. It took until 1984, however, with the signing of the Sino-British Agreement concerning "the Future of Hong Kong", to seal the City's fate. Before the return of Hong Kong to China, all post war high-rise buildings in the Walled City were demolished and only a few "indigenous" structures, including a chapel, were retained as part of a Chinese landscape garden open to the public. Displaced residents were all well compensated and/or re-housed in public housing estates.

It was the State's inability to confer effective property rights that led to such a disorganized settlement. By the time China and Britain had negotiated a solution to their territorial dispute, property rights within the Walled City had fragmented to an irretrievable state of complexity. Owners and users of land and buildings had, over time, asserted their own economic rights, largely in disregard of third party interests; and a certain kind of informal property rights equilibrium spontaneously developed. The only solution open to the State at this stage was to forcibly reorganize rights—re-combining and expropriating the fragmented rights in return for new rights to alternative housing and monetary compensation.

The lesson we may draw from Hong Kong's Walled City is not that the market fails, or that the state's role is to clear up the mess of market-led urban development. It is that

the leasehold-based “planning by contract” system that prevails in the rest of Hong Kong could not work due to ambiguity of governance. The lesson is that the market requires the state, in particular the institutional frameworks it creates, in order to operate efficiently. However, the state is needed most not for interventionist government land use planning but the creation of a leasehold land system.

Mai Po Wetlands are Habitats Created by Human Endeavors

The statutory “Conservation Area” zoning imposed on private lands near Mai Po Marshes to freeze them against development serves the “planning intention” of conserving existing fish ponds as feeding grounds for migratory birds that visit the Mai Po Marshes, a RAMSAR site owned by government. This planning intention is achieved by preventing the infilling of private fishponds. The bird lovers have therefore achieved their objective at the expense of the uncompensated economic loss suffered by the landowners and the fish farmers. The latter have to sacrifice their fish as feeds for visiting birds, which have been growing in numbers.

How has the present habitat of the Mai Po Marshes arisen? It is a habitat in which the indigenous mangrove forest has co-evolved with human activities since the migration of villagers from China several hundred years ago. The principal human activities in the last century that contributed most to the creation of the existing bird heaven were the construction of tidal shrimp ponds inside the government site; the development of fishponds upon removal of mangroves and earth excavation; and the planting of “fung shui” trees in village settlements.

Obviously, the co-evolutionary interaction between human and other species has made a beneficial contribution to biodiversity (Yu et al. 2000, Lai and Lorne 2003). Now, the government planner has decided to freeze the co-evolutionary process by law, considering that suburban development in the fishpond areas would inevitably compromise the survival and welfare of the migratory birds.

To the owners of fishponds, the imposition of statutory Conservation Area zoning has rendered the property rights of their land ambiguous. The common law rights to use their land for the purpose of open storage have been nullified. The freedom of use of their property is now subject to the uncertainty built in the planning application and rezoning mechanisms.

Unauthorised Development and Frustrating Statutory Rural Zoning Classes

From the landowner’s point of view, the older type of statutory planning for the urban areas was bearable as it was (a) still very permissive and (b) merely reflecting the existing land use patterns. But the more recent statutory measures for the rural areas are highly regressive and have a disastrous economic impact on landowners. Other than Conservation Area zones, the typical rural zoning classes introduced since the 1991 amendment to the *Town Planning Ordinance* are the Agriculture, Open Storage, Industrial (Group D) zones. Officially, these zones are to provide more certainty to areas once subject to “Unspecified”

use zoning where any development or change in use requires planning permission. They should provide more certainty as, unlike the very restrictive Conservation Area zoning, they include under Column 2 non-agricultural uses that may be permitted. Statistical evidence as shown in Table 3, however, is that the chance of success in obtaining planning permissions in all these three classes of zones is not higher, is not lower, than that in "Unspecified" use zones. In other words, the degree of "zone separation" (Lai and Ho 2001b) of the subsequent new rural zoning classes from the initial or residual "Unspecified" use zoning is ambiguous, thus rendering uncertain the land use and investment market for rural land resources. Thus, rural zoning fails to serve the purposes it is represented to be meant for.

The market is not irrational and that result is that unauthorised development has continued to proliferate, as making applications is likely a waste of resources. Where the sum of the product of the chance of being prosecuted and the average amount of fine and costs of litigation is lower than the total costs of obtaining a planning permission, it pays for the land users to use land in ways that are sound from an economic, though not necessarily planning, standpoint. Worse still, some land owners have sought to sterilize their lands by poisoning trees, frogs and fishes thereon in anticipation of the green group's lobbying for the enclosure of their lands as nature reserves. They have also started to fence off their property, disallowing hikers and picnickers from coming onto or through their lands, in retaliation to government refusal to allow their lands to be used for non-agricultural purposes. Statutory zoning has therefore created a zero sum game situation with opportunities to trade artificially restrained. The situation is reminiscent of segregational zoning in the Pre-War years.

*Fish Farming Under Licenses Erodes Government Monopoly of Trade in Captured Ocean Fish*¹³

The key problem confronting the owners of lands in the Kowloon walled City, Mai Po Marshes and rural zones is a matter of ambiguous or unclearly defined property rights in land. The main problem with marine resources, such as fish, is a matter of common or open access property rights. Whereas government regulation of rural leasehold land has led to uncertainty and illegal use of land, illegal use of marine resources by fish farmers as squatters led to regulation that has fostered spontaneous investment and innovation in the conservation of fish species. More significantly, such spontaneous activities erode the monopoly of government in the wholesale trading of marine fish captured from the ocean.

After the return of the British colonial administration to Hong Kong in 1945, the state monopoly in the wholesale trading of captured marine fish created by the Japanese occupation authority was retained. This state of affairs was soon regulated on a statutory basis. All marine fish, other than fish alive and in water, must be landed at piers owned and managed by a government body the Fish Marketing Organization (FMO). The landed fish are sorted by FMO staff and then auctioned basket by basket by grade and species to a limited numbers of "licensed buyers". The FMO charges a commission on the sum

Table 3. Probit estimates of the decision function (Agriculture, Open Storage and Unspecified Use Zones).

Zones	β_0	OS	CTN	VTH	TIME	ln(GFA)	NCS	ln(GSA)	IND	RES	W	REC	CVP	Log- Likelihood	% Correct prediction
A	-0.0614 (0.3406)	-0.3760** (-2.4043)	-0.4488 (-1.6565)	0.4246** (3.0612)	0.0422 (0.5719)	-8.7697* (1.9813)								-814.387	
OS	1.0448 (1.2726)		0.2972 (0.6555)				1.5058** (4.0967)	-0.0687 (0.5933)						-44.286	88.535
U	1.4176** (6.3247)	-0.4926** (2.8693)		0.0348 (0.2507)		-0.1892** (6.1919)			-0.0899 (0.4223)	-0.3687 (1.8654)	-0.2829 (1.3505)	0.4710* (2.0713)	-0.4940 (1.7934)	-628.797	8.9417

Notes: Number of observations: 1392 in A zones; 157 in OS zones; 1008 in U zones; figures in parentheses are the absolute value of *t*-statistics; ** indicates statistically significant at 1% confidence level; * indicates statistically significant at 5% confidence level.

Sources: Ngai (2002), Lai and Ho (2002c), Kwan (2002).

transacted. Trading outside this regulated and close door auctioning system is illegal and offenders are punishable by fine. With the effect like price control (Cheung 1974), the FMO system has prevented lawful vertical integration of fishing efforts and marine food processing and has shaped Hong Kong's postwar development in ocean fishing in which spontaneous response of the fisherman is instructive of the power of the market.

Ocean fishing as an open access activity has a natural tendency for the fall in rent. The compulsory trading of captured fish through the government regulated auctioning system in this context hastened the process rational adjustment. In the early 1970s, some fishermen discovered that they could rear marine fish in floating cages in coastal areas of Hong Kong. As the demand of local Chinese people for live marine fish, to be consumed as whole fish presented on dish, is income-elastic and as income grew, the pioneers in marine fish culture made huge profits. Many therefore quitted ocean fishing and switched to marine fish culture. The growth of the culture industry in the absence of clearly delineated private property rights led to incidents "might make rights" (Umbeck 1981) involving physical violence. The culture activities also trespasses on to territories of rightful users of marine resources. As a result of such development, the government started to regulate the culture industry by restricting culture activities to designated Marine Fish Culture Zones. The delineation of these zones actually followed the existing culture areas. Culture licenses were granted at zero premiums to the culturists found at the time of the legislation and to subsequent entrants by waiting.

By respecting existing rights, the imposition of the marine fish culture zones, like urban zoning, is therefore observing the principle of Paretian efficiency. In addition, the granting of licenses establishes a degree of private property over marine resources. The consequences of this are economically and environmentally enormous. Not only has the quantity of marine fish generated in these zones surpassed that captured in the same water bodies, the variety of good quality marine fish made available to the consumer has grown tremendously. This shows that the establishment of exclusive property does not only tackle the problem of the tragedy of the commons by limiting competition but also promotes innovations. This in turn has fostered the development of specialist seafood restaurants in Hong Kong. While all this occurs, the quantity and quality of captured fish that are transacted through the FMO have been falling. Though it is a legal monopoly, the FMO has seen a structural fall in rent and incurred deficits. Even a legally protected monopoly is collapsing under competition (Lai and Yu 2002a).

Ecologists have complained that the marine fish culture industry is environmentally unfriendly as, unlike animal farming on land, the seeds and feeds of cultured marine fish rely on open access (Sadovy and Lau 2002). Furthermore, the high concentration of culture fish generates problems of diseases and pollution of local water. This complaint must however be viewed in the light that a specialist marine fish fry and breeding industry is emerging (Lai and Yu 2002b) and that ecologically more friendly feeds have been identified. Fish culture can also be combined with the culture of muscles that can absorb waste produced by fish. In any case, culturing marine fish is definitely more environmentally friendly than open access harvesting that can quickly wipe out a species.

Lessons Learnt

What lessons might be learnt from the experience of above discussion of government town and country planning in Hong Kong?

The first lesson is that the statutory zoning regime as a parasite fixed by legislation onto the contractual planning system leasehold land tenure of Hong Kong can be no more and no less than a rent-seeking measure (Gifford 1987, Tullock 1993). And there is empirical evidence that the planning permission system does systematically favors certain types of uses (Lai and Ho 2001a, 2001b, 2002c) or size of development (Lai and Ho 2002b, 2003). The government planner has to answer the fundamental questions as to the constitutionality of his invasion of leasehold interest and as to the real need for an extra statutory screening of redevelopment in addition to the lease modification procedure. Government estate surveyors and town planners, now appearing as two separate professional grades employed by two separate government departments, should be fused into one rank "development planner" to save taxpayers money and to ensure that those who plan understand the impact of government planning on land values. This is not a blanket criticism of government planning but a rejection of planning by legislation that erodes private property rights without compensation. This is also a reminder that major achievements in town planning, as epitomized by the development of new towns and major residential estates according to master layout plans, are outcomes of market forces voluntarily regulated by contract, i.e. planning by contract.

The second lesson is that the resource market must operate under private property rights and the government planner could have a role to play in allocating initial property rights as in the case of development planning which is contract-driven. For this type of planning, any initial mistakes can be self-corrected/rectified by market forces. In the absence of clear private property rights, the Kowloon Walled City type of development will emerge and "might make rights". Provided there is certainty in the entitlements to use rights, the market is capable of conserving resources and generating innovations even in the absence of an enabling government plan or blue print or protectionist laws. Clear rights conferred contractually by the land lease or a marine license are sufficient to set the scene for imaginative private ventures and "Schumpeterian efforts" (Yu et al. 2000). This has happened in the emergence of the marine fish culture industry and the seafood restaurants, the morning ornamental fish market and "Goldfish Street", the tourist niches of Stanley market and Lan Kwai Fong-"Soho" circuit. The spontaneous products of the market are able to compete with large firms in industries where the entry costs are supposedly prohibitively high, as revealed by the success of mid-stream operators and red mini-buses. These products are also often superior to outcomes produced by government plans backed by draconian state measures, such as takings (resumption), as reflected by the inability of government-led urban renewal schemes in producing any urban excitements.

The third lesson is that even where a government plan, statutory or otherwise, or law is patently hostile to the free operation of the market, the spontaneous forces of the price mechanism are powerful enough to eventually defeat the market restrictions imposed. This happened in the destruction of racial segregation zoning as a means to establish a protectionist

land market that excluded the wealthy Chinese; the demise of the FMO as a government monopoly in the trading of oceanic resources; and the co-inhabitation of sex business, religious institutions and schools in Kowloon Tong where the government plan seeks to turn the clock back to the 1950s. It is just a matter of time that the rural zoning classes within and without Mai Po Marshes and planning enforcement legislation will be replaced by measures that are more market-friendly and conducive to investment. The argument is the same behind the line of reasoning of libertarian economists about the eventual downfall of all centrally planned regimes.

The fourth lesson is that government plans, as statutory products of a professional interest group not constrained by the profit mechanism, tend to fail due to the Hayekian knowledge problem. This failure is less disastrously or even self-correcting where these plans are humble enough to follow the pattern of development that emerged under planning by contract in accordance to the land lease and where rezoning is readily approved. The only means to avoid such failure is that the government planner is so constrained that he has to work with the market through development planning subject to the price mechanism.

The above lessons are surely not confined by the idiosyncrasies of Hong Kong because they are intelligible in terms of the ideas of Hayek and Mises. These lessons serve to illustrate the reasons for the belief that a free land market, given some clearly defined property rights, is full of vitality and the general concept that emerges is that the government planner should work with the market rather than against it, as that is doomed to fail, and it is better to plan small than big, if at all. If the market has to produce high-rise development, there is no point of forcing it to develop low-rise. The reverse is also true.

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Notes

1. See for instance the Chapter "Liberty and Western Civilization" in Mises's *The Anti-Capitalistic Mentality* (Mises 1956). Compare this with Cheung's *Will China Go Capitalist* (Cheung 1982). Mises believe that "Asiatics," or those who live in the Orient the have no natural propensity for liberty and creativity (Mises 1956:102–104). This racist belief immensely compromises the greatness of this liberal thinker.
2. The colonial regime did have political censorship for movies and screening for civil service and public appointments. She also favored British trade interest. However, she did not interfere with the freedom of contract in business or private affairs of those who were not "most favored". That was sufficient for economic prosperity.
3. Article 5, *The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China*.
4. Article 6, *The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China*.
5. Article 107 of the Basic Law dictates that government of Hong Kong should "strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of its gross domestic product."
6. See for instance the view of the European Parliament (<http://www.europarl.eu.int>) and that of Snee (2000) and Bowring (2002) in the *South China Morning Post*, the leading English newspaper in Hong Kong.
7. There has been little dedicated inquiry into the working of planning in Hong Kong from an institutional economics perspective. Some notable earlier exceptions are Staley (1994), Booth (1996), and Lai (1996,

- 1997c, 1998, 1999c). For the practice of town planning in Hong Kong, see Lai (1999c, 1999d), Lai (2000a, 2000b, 2000c), and Lai and Fong (2000) and for a theoretical inquiry of the nature of Hong Kong's zoning, see Lai (1997a, 1997b).
8. The idea of extending zoning control to the New Territories was first mooted in the Talbots' Report (Talbot and Talbot 1965).
 9. Statutory zoning for the old urban areas and the new towns became more aggressive in the mid 1980s.
 10. The use of telephone directories as a source of location and trade specific data can be found in Lai (1997) and Han et al. (2002).
 11. Those developers, especially smaller ones, that have not been selected as joint venture partners are competing on unequal grounds with the agency, which has the statutory power to resume land.
 12. This section is an extract from Webster and Lai (2003).
 13. See Lai and Yu (2002a) and Chapter 12 in Lai and Yu (2003).

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