



31 May 2005

Mr. Stephen Ip Shu-kwan
Secretary for Economic Development and Labour
Economic Development and Labour Bureau
2/F Central Government Offices, Main & East Wings
Lower Albert Road, Central
Hong Kong

Dear Mr. Ip:

Response to Consultation Paper on Partial Privatization of the Airport Authority

SynergyNet, as an independent think-tank, is devoted to the formulation of medium to long term strategies and policy proposals for the Hong Kong Special Administrative Region, so as to enhance the quality of governance and promote economic and social progress. We have studied the government's recent consultation paper on the Partial Privatization of the Airport Authority. Attached please find a policy paper, which contains our analysis of privatization in general, and our specific recommendations regarding on-going privatization plans in Hong Kong, including that of the Airport Authority. We hope our views would be useful to the government in the current consultation exercise.

Yours sincerely,

Professor Anthony B. L. Cheung, JP, BBS
Chairman
SynergyNet

A SynergyNet Policy Paper

**Privatization and Divestment of
Government-Owned Public Utilities
in Hong Kong:
Issues and Prospect**

Professor Anthony Cheung
and
Dr. Rikkie Yeung

Published by SynergyNet, Hong Kong
Website: www.synergynet.org.hk

**June 2005
Hong Kong**

About SynergyNet

SynergyNet, established in February 2002, is a policy think-tank organized as a network, devoted to the formulation of medium to long term strategies and policy proposals for the Hong Kong Special Administrative Region, so as to enhance the quality of governance and promote economic and social progress.

SynergyNet Policy Papers

SynergyNet publishes policy papers and organizes seminars and forums from time to time, to examine major governance and policy issues. It produces annually two flagship research reports, respectively on Hong Kong's Governance and the Performance of the Legislative Council. In addition, studies are conducted on constitutional reform, the public utilities, health finance and education reform.

About the Authors

This Paper is jointly written by Professor Anthony B. L. Cheung and Dr. Rikkie Yeung. Professor Cheung is Professor of the Department of Public and Social Administration at the City University of Hong Kong, and Chairman of SynergyNet. He specializes in research on privatization, public sector reforms, Hong Kong politics and Asian administrative reforms. Dr. Yeung is a management consultant as well as a project researcher at the Centre for Civil Society and Governance of the University of Hong Kong. She specializes in research on privatization, public management reforms, public enterprise governance, and civil society development in Hong Kong.

Their work has received research support from Leo Sham Ka-Fai, project officer of SynergyNet.

Acknowledgement

The research leading to this Policy Paper is funded by SynergyNet Research Fund, a special fund set up by SynergyNet to support research projects undertaken both by members and outside individuals and groups.

Comments Welcome

We welcome comments on this Policy Paper. Please email them to: office@synergynet.org.hk, or send them by post to:

SynergyNet
3/F Regal Dragon Centre
149-151 Woosung Street
Jordan, Kowloon
Hong Kong

Abstract

This policy paper is mainly concerned with the policy, processes and implications of the Hong Kong Special Administrative Region (SAR) government's privatization or divestment of government assets, in particular government-owned public utilities or enterprises. From the perspective of promoting good public governance, policies on public utilities need to transcend dogmatic ideological 'government vs. market' debates. Regardless of the form of ownership, various (and sometimes conflicting) public interests involved in key public service provisions need to be properly managed, balanced and, in many cases, regulated; and so must the process of privatization or divestment.

The constant themes in privatization exercises worldwide have been the need to balance public interests and stakeholder interests, to maintain effective mechanisms for public accountability, and to ensure the operational autonomy and financial sustainability of the privatized enterprises. Some useful lessons can be drawn from the challenges experienced in the process of and after privatization in other countries.

The process of privatization could be potentially a political bomb. There was often strong opposition from trade unions, political parties, anti-globalization groups and various stakeholders. Strong public criticisms and labour protests were not uncommon and could even turn violent. People were worried about a range of problems – unemployment; deterioration in service quality, safety and availability; increase in prices; underselling of public assets; and sale of national industries to foreign powers; etc. Where national enterprises were sold to foreign companies, strong negative public sentiments arose in many cases for the fear of selling out the family silver. On the whole, when opposing stakeholders are more organised, the process of divestment is more likely to be controversial.

Many governments have also experienced problems after privatization or divestment, especially for the privatized public utilities such as railways, electricity, telecommunications or gas. Common problems related to public control, deterioration of service quality and accessibility, diminishing service safety and stability, privatized monopolies under inadequate regulation, deterioration of corporate governance, or bankruptcy of privatized enterprises. Some of the problems relating to inadequate market competition and public regulation stemmed mainly from the fact that governments focused mostly on maximising the asset price at the time of privatization and ignored the issues arising from privatized monopolies. Inevitably, new forms of public check and balance were sometimes re-introduced following the problems created by privatization, as found in many Anglo-Saxon pioneers of privatization since the 1990s through enhanced market competition and re-regulation. Sometimes, planned privatizations were postponed or cancelled.

Taking into account the potential conflicts among different (and sometimes competing) public/stakeholder interests, a *stakeholder approach* is generally preferred when a government implements a privatization plan. The conflicts and challenges of privatization as encountered by other countries in the main illustrate the critical importance of maintaining the right balance when handling the privatization process.

Different kinds of business involve different issues of public interest specific to the nature of the service. Not all businesses are equally suitable for privatization. Generally speaking, if the business is more commercial than social in nature, it is more suitable for privatization. Also, different modes of privatization (such as listing, securitization, tender, and divestment) involve different specific issues of concern. Hence, each privatization exercise is different. Privatization by way of listing cannot be dealt with in the same way as the normal IPO of private sector firms because of the *publicness* of such exercises.

With the above understanding of privatization, this Policy Paper comments in detail on the Link-REIT listing, the proposed partial privatization of Airport Authority and the further railway divestment following the proposed merger of the two railway corporations. Specific recommendations are made to ensure policy transparency, public consultation, political support, stakeholder consensus, consumer interest and post-privatization governance.

Table of Contents

Chapter 1	Introduction	1
Chapter 2	Privatization: Forms, Methods and International Experience	2-5
Chapter 3	Issues of Public Interest in Privatization	6-7
Chapter 4	Privatization in Hong Kong	8-9
Chapter 5	Lessons from Recent Privatizations in Hong Kong	10-20
Chapter 6	How to Pick Up the Pieces in The Link-REIT Listing	21-26
Chapter 7	Should the Airport Authority be Privatized?	27-35
Chapter 8	Further Railway Divestment after Merger of MTRC and KCRC	36-38
Chapter 9	Recommendations	39-41
Appendices	A. Chronology of the Privatization of MTR Corporation	42-43
	B. Chronology of the Securitization of Hong Kong Link 2004 Limited (“Five Tunnels and One Bridge”)	44
	C. Chronology of the Privatization of Link-REIT	45-47
	D. Chronology of the Proposed Privatization of Airport Authority	48-49

Chapter 1 - Introduction

1.1 Broadly understood, 'privatization' can be construed as that range of policies designed to reduce the scope, limit the functions, and generally weaken the influence of the public sector. Some academics have identified four main components or forms of privatization – namely user-charging, contracting out, denationalization (i.e. transferring state-owned enterprises to private ownership), load-shedding (e.g. reducing public subsidy), and liberalization (i.e. reducing government regulation).¹

1.2 Strictly interpreted, the 'privatization of state-owned assets' refers to the transfer of state-ownership in full to private hands, or partial transfer of ownership (usually in the form of shareholding) known as 'divestment'.

1.3 Since the 1980s, when the 'New Right ideology' prevailed in the political leadership of the UK and US, privatization has become a popular policy of an increasing number of developed and developing countries. The growing emphasis on the importance of private sector production and provision has been driven by an increasing acceptance of market-based doctrines of competition and incentives, and a corresponding denigration of the public bureaucracy, represented prominently by the public choice critique of government. Such ideological shift has also given rise to a new culture within the public sector – a new set of administrative doctrines collectively referred to as 'new public management'.

1.4 By the 1990s privatization and divestment had become a global trend, greatly promoted by international organizations in developing countries. According to the World Bank², more than 7,000 public enterprises were privatised in 70 countries of different stages in economic development between 1980 and 1993.³

1.5 This policy paper is mainly concerned with the policy, processes and implications of the Hong Kong Special Administrative Region (SAR) government's privatization or divestment of government assets, in particular government-owned public utilities or enterprises. From the perspective of promoting good public governance, policies on public utilities need to transcend dogmatic ideological 'government vs. market' debates. Regardless of the form of ownership, various (and sometimes conflicting) public interests involved in key public service provisions need to be properly managed, balanced and, in many cases, regulated; and so must the process of privatization or divestment.

¹ D. Heald (1984) "Privatization: Analyzing its Appeal and Limitations", *Fiscal Studies* (UK), No. 5, pp. 36-46.

² World Bank (1995) *Bureaucrats in Business: The Economics and Politics of Government Ownership*, Washington, DC: World Bank.

³ For a latest review of the turn-of-the-century trends and future prospects of public enterprises and privatizations, see the special symposium issue of *Public Finance and Management*, Vol. 2, No. 1, 2002.

Chapter 2 - Privatization: Forms, Methods and International Experience

2.1 The 'small government' ideology was not the only driver of privatization. More often, privatization was for practical reasons: such as the need to reduce budget deficits, national debts or subsidies to public enterprises in loss; the political motives to dissipate the power of opposing parties and trade unions, or to expand political support for conservative parties; the need to restructure public enterprise management so as to enhance operational efficiency; and/or the requirement for developing economies to comply with the loan conditions imposed by international organizations.

2.2 In an overview of the politics of industrial privatizations in Western European countries during the 1980s, Vickers and Wright identified a mixture of overlapping objectives on the part of the 'privatizers'⁴:

- *Ideological objectives*: anti-state sentiments; the belief that public industries and services limit consumer choice because of their monopoly positions; the desire to build a 'property-owning democracy'⁵.
- *Economic objectives*: a means of further liberalization; the assumed intrinsic inefficiency of public sector production and services; the ability to adopt tough labour policies by distancing governments from unpalatable political choices; the need to spread the 'enterprise culture'; to hive off inefficient or loss-making operations so as to rationalize the rest of the enterprise.
- *Political objectives*: to gain political popularity; to create conservative voters and to undermine the trade unions, hence depriving the Left of one of its traditional bastions of support.
- *Financial objectives*: to diminish Public Sector Borrowing Requirement by sale of public assets; to facilitate quicker and more direct access for denationalized firms to the international capital market; to foster the growth of the stock market; to reduce commercial risk for the government in the uncertain business climate; to raise money and reduce large budget deficits.
- *Managerial objectives*: rationalization of managerial structures to ensure autonomy, incentives and efficiency.

2.3 Privatization policies are therefore not simply an end-product of economic prescriptions (resulting from economic recession or fiscal stress), but should rather be seen as the result of an interaction of exogenous and endogenous factors, some of them structural and others more actors-induced. These factors include: economic and fiscal crises, crisis of the dominant policy consensus, the emergence of a new ideological hegemony, intentions of political leaders, bureaucratic self-interest, and to some extent, client politics and international influence.⁶ To facilitate a consistent privatization policy, some governments (such as Singapore's) conducted a full review

⁴ J. Vickers and V. Wright (1988) "The Politics of Industrial Privatization in Western Europe: An Overview", *Western European Politics*, No. 11, pp. 1-30.

⁵ For example, former British Prime Minister Margaret Thatcher strongly advocated expanding the number of small property owners and shareholders so as to weaken the opposing Labour Party in the long-term. See her autobiography, Margaret Thatcher (1993), *Margaret Thatcher: The Downing Street Years*, London: HarperCollins Publishers, pp. 676-680.

⁶ Anthony B. L. Cheung (1997) "The Rise of Privatization Policies: Similar Faces, Diverse Motives", *International Journal of Public Administration*, Vol. 20, No. 12, pp. 2213-2245.

of all government-linked companies and statutory bodies and presented a fairly comprehensive policy on divestment.⁷

2.4 During the 1980s and 1990s, Hong Kong did not join this global trend. The ideas about privatization were first visited in the government report *Public Sector Reform* in 1989 but there was no follow up. First, there was no strong external, political or budgetary pressure to reform its public sector as admitted by senior officials⁸. Much envied by other governments, Hong Kong recorded public budget surpluses year after year in the post-war period. Major government-owned bodies including the Mass Transit Railway Corporation (MTRC) and the Housing Authority had been financially healthy or even highly profitable in the 1990s, thanks to the booming economy and property market. The second main reason for not privatizing government assets was political, as China opposed any such move by the British colonial government during the political transition.

2.5 Given such background, Hong Kong should ideally have learnt from the international experience in privatization and the challenges encountered during the 1980s-1990s. We shall introduce the different forms and methods of privatization of state assets before drawing some general lessons from international experience.

Forms and methods of privatization

2.6 In terms of privatization of ownership in government assets, there are different forms and means of transferring government ownership, including management buyout, negotiated sale to select private firms, and the public offering in the form of stocks or investment funds (through 'initial public offering' or IPO). IPO can be regarded as an approach of privatization or divestment that allows wider public participation as retail investors and stimulates the development of the financial market. This general approach was adopted by the SAR government in the recent privatization exercises.

2.7 In any method of privatization/divestment, the government assets concerned must be first vested in a company of divisible shareholding. Unless the assets prior to privatization are already held in the form of a government-owned company, organizational restructuring is a must. The restructuring required may be the change from a government department or statutory body or other body under public law to a company governed by the Companies Ordinance. In case of divestment by way of public offering of stocks or investment funds, the public assets must first be vested in a limited company suitable for listing purposes. Such organizational restructuring bears important implications on the process of privatization and post-privatization governance. This is because the privatized body may need:

- to completely change the management of the services concerned and become profit-seeking;
- to comply with a different set of market laws and regulations, possibly including regulations applying to international financial markets; and
- to automatically become autonomous or independent from the government's direct control, unless new laws are enacted.

⁷ Public Sector Divestment Committee, Singapore Government (1987) *Report of the Public Sector Divestment Committee*, February, Singapore National Printers.

⁸ For example, the Secretary for the Treasury, Donald Tsang, in his article "Public sector reform: Key issues and future directions," in Jane C Y Lee and Anthony B L Cheung (eds.) (1995), *Public Sector Reform in Hong Kong: Key Concepts, Progress-to-date and Future Directions*, Hong Kong: Chinese University Press.

2.8 In short, a privatized body, especially in the form of a listed company, is required to operate as a profit-seeking firm according to market norms, regardless of the nature of services. This may potentially be in conflict with social objectives or non-commercial purposes that the former government-owned enterprise or public body was originally established to serve. The potential tensions are higher in the case of divestment resulting in mixed government-private ownership. As a result, in many international cases, privatized enterprises (in particular public utilities) are often put under additional public laws and regulatory controls.

2.9 In this connection, 'securitization' as another tool of privatization in a broad sense, does not so much affect the management of public services concerned. Securitization is a form of government lending and does not transfer the government ownership of assets. It merely refers to the financing arrangements designed to translate the expected future stream of revenues into government loans in the form of securities, notes or bonds, which can be issued through public offering or other means. While securitization is not privatization of government assets in the strict sense, it can serve the purpose of re-financing and cashing-in for the government. Securitization also requires some organizational structuring such as setting up a company as a new vehicle to hold the assets and for other necessary financial arrangements. However, the management mode of the public services before securitization does not necessarily need to be overhauled. Theoretically, these services can still be managed along either commercial or non-commercial lines, as the case may be, although the latter would mean a higher cost of government lending and is thus less preferred. In any case, securitization does not remove the ownership and responsibility of management from the government.

Major lessons from international experience

2.10 The constant themes in privatization exercises worldwide have been the need to balance public interests and stakeholder interests, to maintain effective mechanisms for public accountability, and to ensure the operational autonomy and financial sustainability of the privatized enterprises. Some useful lessons can be drawn from the challenges experienced in the process of and after privatization in other countries.

2.11 The process of privatization could be potentially a political bomb. There was often strong opposition from trade unions, political parties, anti-globalization groups and various stakeholders. Strong public criticisms and labour protests were not uncommon and could even turn violent.⁹ People were worried about a range of problems – unemployment; deterioration in service quality, safety and availability; increase in prices; underselling of public assets; and sale of national industries to foreign powers; etc. Where national enterprises were sold to foreign companies, strong negative public sentiments arose in many cases for the fear of selling out the family silver.¹⁰ On the whole, when opposing stakeholders are more organised, the process of divestment is more likely to be controversial.

⁹ Early-day examples included the coal-miner strikes in UK. More recent examples include the national strike and mass protests against privatization in France, Bolivia, and some parts of the European Union. (See <http://www.wsws.org/articles/2002/oct2002/demo-o09.shtml>; <http://www.cislac.org.au/index>; <http://www.socialistworld.net/eng/2005/04/07europe.html>).

¹⁰ Early-day examples can be found in the public controversies in New Zealand over the sale of a number of state-owned enterprises (energy, airlines) to British and Australian companies, etc. See R. C. Mascarenhas (1995) "New Zealand," in Ian Thynne (ed.) *Corporatization, Divestment and Public-Private Mix: Selected Country Studies*, Hong Kong: Asian Journal of Public Administration in collaboration with International Association of Schools and Institute of Administration. After the Asian Financial Crisis, the privatization of public enterprises in some

2.12 Many governments have also experienced problems after privatization or divestment, especially for the privatized public utilities such as railways, electricity, telecommunications or gas. Common problems related to public control, deterioration of service quality and accessibility, diminishing service safety and stability¹¹, privatized monopolies under inadequate regulation, deterioration of corporate governance, or bankruptcy of privatized enterprises¹². Some of the problems relating to inadequate market competition and public regulation stemmed mainly from the fact that governments focused mostly on maximising the asset price at the time of privatization and ignored the issues arising from privatized monopolies.

2.13 Inevitably, new forms of public check and balance were sometimes re-introduced following the problems created by privatization. Since the 1990s, many Anglo-Saxon pioneers of privatization have begun to redress the balance by: (a) introducing market competition in parallel to privatizing state-owned monopolies by de-regulation (for example, the privatized British railway sector was broken up into almost a hundred private railway operators); (b) re-introducing regulation to the privatized markets by appointing regulators or setting up statutory monitoring bodies (for example, in the UK, there are the Monopolies and Merger Commission and regulators for public utilities such as the Office of Water Service, Office of Electricity Regulation and Railways Regulator¹³); (c) intervening in the ownership or management of privatized companies (such as the introduction of government shares in such enterprises known as Kiwi shares in New Zealand and golden shares in UK; and (d) even postponing or cancelling certain privatization programmes (for example the Conservative Government in UK dropped its plan to privatize the Post Office in 1994, and New Zealand's Labour Government stopped its asset sale programme in 2000)¹⁴.

ASEAN countries as required by the International Monetary Fund or World Bank also met with local opposition or controversies.

¹¹ For instance, after the privatization of British Rail into about a hundred mostly private railway bodies, there were several serious and fatal railway accidents.

¹² For example, after the privatization and breaking up of British Rail, the network infrastructure owning company Railtrack, a listed company, went into bankruptcy. Later, the UK government had to establish jointly with the railway industry a new non-profit making company, Network Rail, to replace the collapsed Railtrack.

¹³ Francis R. Terry (1996) "Private management of public enterprises: how services in the United Kingdom have been transformed," in Ali Farazmand (ed), *Public Enterprise Management: International Case Studies*, Westport: Greenwood Press; Francis R. Terry (2001) "Privatization and public enterprise reform: The New Labour agenda for public management in the United Kingdom," in Ali Farazmand (ed), *Privatization or Public Enterprise Management: International Case Studies*, Westport: Greenwood Press.

¹⁴ Peter McKinlay (2002) "Turn-of-the-century changes in New Zealand's public enterprises," *Public Finance and Management*, Vol. 2, No. 1; Francis Terry (2001), *op. cit.*

Chapter 3 - Issues of Public Interest in Privatization

3.1 Privatization involves major changes in the ownership of government assets and management of public services. Inevitably, such changes would raise concerns about the public interests and affect the interests of different stakeholders. This section highlights some general issues of public interest associated with privatization exercises.

Positive impact

3.2 There are key concerns in privatization of any form. The *first* and positive outcome in favour of the public interest is the likelihood of enhancing economic efficiency by increasing operational flexibility (often along commercial lines) in service provision. *Second*, it is possible to increase economic efficiency further by introducing market competition together with privatization. But it should be emphasized that privatization *per se* does not necessarily bring about market competition. It all depends on whether the government opens up the market at the same time as the state-owned enterprises, which are very often monopoly in nature, are privatized.

Problematic outcome

3.3 *Third*, the concerns about the market structure after privatization lead to the general issue of public control and public accountability of the privatized enterprises. If government ownership is removed from a monopoly, usually in public utilities, the community is justified to be concerned about the potential loss or deterioration of public interests, in particular the impact on fares, regulation of public or service safety, service standards and availability, and related regulatory issues. Worthy of particular attention is the likely change from non-profit and social objectives to a mix of profit and non-profit objectives on the part of the privatized enterprises.

3.4 *Fourth*, privatization often results not in a change from state-owned to privately-owned enterprises, but the emergence of hybrid companies. These are companies of mixed public-private ownership under the control of mixed public body law and market laws. This may create new complications in the corporate governance of the enterprise concerned. The government and public would also find it a big challenge to properly regulate such hybrid companies. Hence, privatization is not only about selling government assets but also imposes a fundamental change to the management of public services concerned or even the entire relevant industry.

3.5 *Last* but not the least important, if the privatization or sale of public assets is implemented purely to cash in for the public purse, the government needs to take into account the long-term financial impact of selling the family silver.

3.6 It needs to be highlighted that different kinds of business involve different issues of public interest specific to the nature of the service. Not all businesses are equally suitable for privatization. Generally speaking, if the business is more commercial than social in nature, it is more suitable for privatization. Also, different modes of privatization (such as listing, securitization, tender, and divestment) involve different specific issues of concern. Hence, each privatization exercise is different. Privatization by way of listing cannot be dealt with in the same way as the normal IPO of private sector firms because of the *publicness* of such exercises.

3.7 Taking into account the potential conflicts among different (and sometimes competing) public/stakeholder interests, a *stakeholder approach* is generally

preferred when a government implements a privatization plan. The conflicts and challenges of privatization as encountered by other countries in the main illustrate the critical importance of maintaining the right balance when handling the privatization process.

Recommendations

Different kinds of business involve different issues of public interest specific to the nature of the service. Not all businesses are equally suitable for privatization. Generally speaking, if the business is more commercial than social in nature, it is more suitable for privatization. Also, different modes of privatization (such as listing, securitization, tender, and divestment) involve different specific issues of concern. Hence, each privatization exercise is different. Privatization by way of listing cannot be dealt with in the same way as the normal IPO of private sector firms because of the *publicness* of such exercises.

Taking into account the potential conflicts among different (and sometimes competing) public/stakeholder interests, a *stakeholder approach* is generally preferred when a government implements a privatization plan. The conflicts and challenges of privatization as encountered by other countries in the main illustrate the critical importance of maintaining the right balance when handling the privatization process.

Chapter 4 - Privatization in Hong Kong

4.1 Hong Kong was a relatively new comer to the global club of privatizers. After 1997, the economic and political factors against privatization during the transition years were reversed. Facing the budget deficits, the government has identified divestment and securitization of government assets as an important financing strategy.

4.2 Privatization was first put on the government's agenda in 1989 with the launch of the *Public Sector Reform* report. Part III of that document on 'Private Sector Participation' made the following observations:

"The end of the second world war brought with it a dramatic growth in the size and scope of the public sector around the world. This trend did not always carry with it the expected improvements in economic development, and efforts are now being made in many countries to reverse the trend. This is not such an important issue for Hong Kong because the private sector has traditionally played a major role in the provision of public services. ...

However, Hong Kong should not be complacent as there are many advantages to extending private sector participation....

Such participation usually takes one of two forms:

- Divestiture, where the public sector withdraws from providing a service or the ownership of an enterprise is transferred to the private sector.
- Contracting out, where the private sector acts as an agent of the government."¹⁵

4.3 Divestiture did not feature much before the establishment of the SAR in July 1997. Contracting out has been adopted as a flexible way of incorporating private sector involvement, through:

- *service contracts* (e.g. cleaning or security management contracts) and other types of outsourcing;
- *management contracts* (e.g. granting concession to a private company to management car parks); and
- *build-own-operate* (BOO) or *build-own-operate-transfer* (BOOT) schemes (e.g. granting concession to a private company to build, finance and operate, or subsequent transfer to government, a new infrastructure project such as a bridge or tunnel).

4.4 After the handover, because of economic slowdown and increasing fiscal deficits, the SAR government has instructed departments to actively pursue contracting out and private sector participation measures in order to 'do more with less' and to improve productivity (through the EPP – 'enhanced productivity programme'). The 1999-2000 Budget identified the 'privatization of public corporations' and 'rethinking the mode of delivering public services, with more private sector involvement and contracting-out' as some of the major reform initiatives¹⁶. In 2000, the Housing Authority adopted a phased service transfer of estate management and maintenance services to private firms or staff-initiated 'management buy-out' companies.

¹⁵ Finance Branch (1989) *Public Sector Reform*, February, Hong Kong, p. 21.

¹⁶ Donald Tsang (1999) *The 1999-2000 Budget: Onward with New Strengths*, speech by the Financial Secretary moving the second reading of the Appropriations Bill 1999 at the Legislative Council, 3 March, Hong Kong, paras. 72-94.

4.5 The first divestment of public assets started with the MTRC in late 2000, involving the sale of up to 49% of its shares by stages through public offering to local and overseas investors.¹⁷ In the 2003-04 Budget, in order to make up the shortage of revenue, the government decided to sell and securitize a total of \$112 billion worth of public assets in the next 5 years¹⁸. Initially a total of \$15.5 billion worth of housing loans to the Hong Kong Mortgage Corporation was sold in 2003-04, and another \$6 billion was raised in August 2004 through the securitization of revenues from the following government toll tunnels and bridges (so-called '5 tunnels and 1 bridge') which were placed under the 'Hong Kong Link 2004 Limited' owned wholly by government:

- Aberdeen Tunnel;
- Cross-Harbour Tunnel;
- Lantau Link (comprising Tsing Ma Bridge, Ma Wan Viaduct, and Kap Shui Mun Bridge);
- Lion Rock Tunnel;
- Shing Mun Tunnels; and
- Tseng Kwan O Tunnel.

The now shelved listing of the Link-REIT, originally scheduled for December 2004 was supposed to be another major divestment of government assets (see Chapter 6).

4.6 Current Financial Secretary Henry Tang also announced in his 2004-05 budget speech the intention to implement the privatization of the Airport Authority as well the merger of the two railway corporations (MTRC and Kowloon-Canton Railway Corporation, KCRC) within 2005-06.¹⁹

¹⁷ So far, 24% has been sold. The second phase of public offer has since been delayed because of the unfavourable economic and investment climate which might not achieve a good selling price for government.

¹⁸ Antony Leung (2003) *The Budget 2003-04*, speech by the Financial Secretary moving the second reading of the Appropriations Bill 2003 at the Legislative Council, 5 March, Hong Kong, para. 106.

¹⁹ Henry Tang (2004) *The Budget 2004-05*, speech by the Financial Secretary moving the second reading of the Appropriations Bill 2004 at the Legislative Council, 10 March, Hong Kong, para. 93.

Chapter 5 - Lessons from Recent Privatizations in Hong Kong

5.1 Hong Kong has not had too much experience in privatization. However, even based on the few major privatization exercises conducted since 2000 – namely the MTRC, tunnels and Link-REIT, which were all in the form of IPO of stocks, bonds or funds, some good lessons can be drawn.

The three cases

5.2 *The MTRC case:* The privatization was first announced by former Financial Secretary and now Acting Chief Executive Donald Tsang in his 1999-2000 Budget²⁰. Before the required organizational restructuring, the government introduced legislation to franchise to a new limited company (Mass Transit Railway Company Limited, MTRCL) the right to operate the subway systems. The Legislative Council (LegCo) passed the new law in February 2000 after intense debates and careful political lobbying by the government. Formerly a statutory corporation, MTRC was restructured in April 2000 into a wholly government-owned MTRCL owning all railway infrastructure, properties and assets. In October 2000, about 24% of MTRCL's shareholding (worth some HK\$10 billion) was divested by way of listing in Hong Kong (and also London and New York) stock markets. The initial public offering (IPO) was 18 times oversubscribed and broke the local record. The government originally intended to divest the second trench of shares but the plan is being held up until the proposal of merger with KCRC is completed (to be discussed in Chapter 8 below). The responsible policy bureaux in the divestment of MTRC were the former Transport Bureau and Finance Bureau²¹.

5.3 *The tunnels case:* This was part of the five-year programme of sale and securitization of government assets announced in former Financial Secretary Antony Leung's 2003-04 budget²². LegCo approved in February 2004 the resolution under the Loans Ordinance to empower the government to issue the relevant bonds. In August 2004, the government securitized the future revenues from five tunnels and one bridge in the form of listing government notes of about HK\$6 billion (with an average maturity of 8 to 9 years). The IPO for retail investors was two times oversubscribed while the portion earmarked for institutional investors was heavily oversubscribed. All the assets continue to be government-owned through setting up a new issuer company Hong Kong Link 2004 Limited. A new fund management structure including trustee, clearing and underwriting arrangements was introduced. The day-to-day operation of the tunnels and bridge continues to be managed by the respective franchised private firms. The responsible policy bureaux in the exercise were the Environment, Transport and Works Bureau and the Financial Services and Treasury Bureau.

5.4 *The Link-REIT saga:* The Executive Council approved in 15 July 2000 the Housing Authority's (HA) plan to divest most of its retail and car-parking facilities in public housing estates. The plan was that the government would first set up a new

²⁰ Donald Tsang (1999), *op cit*.

²¹ After the introduction of the new ministerial system of political appointments from July 2002, the Transport Bureau was merged with the Environment and Works portfolios to become the Environment, Transport and Works Bureau. The Finance Bureau was merged with the Financial Services Bureau to become the Financial Services and Treasury Bureau.

²² Antony Leung (2003), *op cit*.

company, the Link Limited, and then divest 100% of the government ownership by way of listing as a real estate investment fund ('Link-REIT') to both institutional and retail investors; and finally HA would have injected the retail and car-parking assets into the Link, which would own and manage the facilities. The REIT mode was chosen for two main reasons: (a) it would restrict the scope of the Link's business to real estate management; and (b) the government intended to promote REIT as a new financial product just approved by the Securities and Futures Commission. HA considered that it had sufficient legal power to divest the assets and did not legislate or seek LegCo's approval before the listing. After contentious public debates, two public housing tenants filed a judicial review in December 2004 to challenge the legal power of HA to divest the assets, just before the deadline of the IPO. Although the High Court ruled in favour of HA, one of the tenants reserved the rights to appeal to the Court of Final Appeal. Amidst the uncertainties, the government and HA decided to shelve the IPO. This decision was not due to the judicial review *per se*, but because the IPO prospectus did not mention the legal risks and thus the government was exposed to heavy risk of compensation should the court appeal be lost. The government maintains that it would proceed with the listing once the legal issues are cleared. Meanwhile, the Link Limited has taken over the day-to-day management of HA's retail and car-parking facilities. The responsible policy bureau was the Housing, Planning and Lands Bureau (which had merged with the Housing Department in late 2002).

5.5 **Appendices A to C** provide the more detailed chronologies of the three cases. Given the multifarious concerns about public interests in privatization and the international experience discussed above, it must be emphasized that the success of privatization by way of IPO should not necessarily be regarded as successful privatization. Nonetheless, the 'success' of the IPO of MTRC and tunnels and the 'failure' of the listing of Link-REIT provide good lessons to be drawn for privatization in future. These are discussed below.

Transparency of overall privatization policy

5.6 The government announced in the annual budget the general intention to sell or securitize public assets and some of the major privatization plans such as MTRC and Airport Authority (AA). However, it has not informed the public what is in the full list of all those assets to be privatized or securitized. As a matter of fact, the Link-REIT listing was not mentioned at all in the Financial Secretary's budget. Unlike in Singapore, for example, the public is not presented with the full picture of government's overall policy towards privatization – what is to be privatized and why, what approach will be taken and why, how the management of public services will be changed, and what public control measures or regulation will be taken to safeguard public interests, etc. Nor had any public consultation been conducted prior to the three major privatization exercises (MTRC, tunnels and Link-REIT) even though the first two were formally approved by LegCo. In this regard, the government's latest initiative to consult the public and various stakeholders on the proposed partial privatization of AA should be commended as an improvement. Indeed, it would be more conducive to a fuller public debate of privatization issues if government could publish a proper Privatization Policy Consultation Paper.

Different public interests, different stakeholders

5.7 The nature of goods is a key factor in determining the extent to which privatization is suitable. It has been accepted by economists that government has to provide services of 'public goods' nature because there is theoretically no interest among private producers in the market to supply such goods which are non-exclusive

and non-divisible. If the relevant goods serve more commercial than social objectives, privatization should conceptually be less contentious. Among the three Hong Kong cases, the railways and toll tunnels/bridges are 'toll goods', whereas the retail facilities in public housing estates are more like private goods. The public interests of the railways and tunnels (such as fare level, safety and accessibility to the service) are high as they are integral parts of the public transport infrastructure necessary for economic and urban development. In contrast, HA's retail facilities constitute about 11% of the largely private-sector market in Hong Kong²³. Arguably, these retail facilities are more commercial in nature than the railways and tunnels and thus more appropriate for privatization.

5.8 Nonetheless, the HA shopping malls have been serving major social functions as the community-based facilities for the low-income class and are different from private malls. The rentals and grocery prices there are generally cheaper. The trade mix is different too, with more small or family-owned shops. Some space, though of limited amount, is rented out for community or social service purposes at welfare rent level. If the management of the HA facilities is changed to become wholly market-driven and profit-seeking, such social objectives will be mitigated. There are justifiably concerns about the possible negative implications of privatization on the low-income tenants and small shop owners when the community is being confronted with a widening income gap²⁴. It is therefore incumbent on the government to clearly identify the public interests and stakeholders' interests that may be affected by privatization.

5.9 The stakeholders environment for the railway, tunnels and the HA retail facilities are not entirely the same (see **Table 5.1** at the end of this chapter). It is quite clear that HA faces the most complex situation with a large pool of tenants in the public housing estates who would fear having much to lose and are potentially better organized to protect their interests. Dealing with the stakeholder environment has proved to be a critical challenge to the process of privatization, as the Link-REIT listing vividly illustrates.

Mode of management matters

5.10 The impact of privatization on the interests of the general public and other stakeholders stems not only from a change of ownership structure, but more from a change of management mode. As discussed, the public is most concerned if the privatized management or company goes after only commercial objectives and ignores vital social purposes in providing public services. This is one major reason why the privatization of the Link-REIT was more contentious in public than the MTRC or tunnels. In the tunnels case, there is no change at all to the management and operation except the financing arrangements. In the MTRC case, the former statutory corporation had already operated in a fully commercial and profit-making mode for more than two decades. Although there were worries that MTRC Limited would cut staff or charge higher fares, people generally expected minimal change to the subway management. In both the MTRC and tunnels cases, the public understood that there would not be major change to the mode of public service provision, except for a change in ownership structure.

²³ Legislative Council Secretariat (2004) *Panel of Housing: Divestment of Housing Authority's Retail and Car-parking Facilities – Background Brief*, 19 November, para. 2.

²⁴ The gap between the rich and the poor is deteriorating in Hong Kong, with the Gini co-efficient in 2003 standing at 0.53, worse than some Third World economies. See United Nations (2003) *Human Development Report 2003*, New York: United Nations.

5.11 The Link case was quite different. It was more than just divestment of ownership but potentially an overhaul of management. The HA shopping malls had always been under direct management (or via contracting out) of the Housing Department, the executive arm of HA. The Link-REIT was established to fully commercialize the management of these retail facilities. Uncertainties over the new management policies by the Link led to the quite justifiable worries of the public housing residential and commercial tenants about a big change in service delivery and potential loss of their interests. 'Change management' for the public at large and major stakeholders should have been a key challenge and strategy in the Link project, which combined privatization and commercialization of management all in one go. Looking back, it might have been easier for the HA to reassure the public if a government-owned Link company was initially franchised to manage the facilities for a period of time before any public listing was attempted. The Link would then have had more time to settle down with new management policies to secure their acceptance by the stakeholders.

LegCo: Rightful partner in legal-political process

5.12 One much debated question is whether LegCo is a stumbling block to privatization. In the past exercises, the legislature (including most pro-democracy legislators) was consistently in favour of privatization in principle. LegCo was co-operative towards the government in accepting tight legislative schedules to clear privatization proposals, and government had also been successful in lobbying for sufficient political support in the legislative process. Both the MTRC and tunnels cases show that inclusion of LegCo as a rightful partner in the legal-political process of approval did not hinder the progress of privatization. On the contrary, inadequate participation of LegCo in the decision-making process, as in the Link case, could trigger undesirable societal dynamics. A brief review of the legal-political process in the three cases is as follows.

5.13 The *MTRC divestment* in 2000 went through the most vigorous legal-political process. LegCo was formally involved in the decision-making through voting on a new Mass Transit Railway Ordinance to replace the old MTRC Ordinance governing the former statutory corporation. The government had to do so because the legal framework for the new MTRC Limited needs to be totally different from that for a public corporation. Most political parties in LegCo supported the divestment in principle. There were contentious debates on some issues. The main concern was why a listed and profit-seeking company should be given the same public powers and privileges as before.²⁵ Other more contentious issues included the continuation after privatization of the corporation's legal autonomy over fares and its property rights along railways without open tender. In particular, the government's insistence on not exercising control over railway fares could have risked the legislature's disapproval of the bill. Although the political debates were intense, the legislators proved to be co-operative in rushing through the legislation within the tight legislative schedule the government imposed. The relevant bills committee, composed of more than one-third of the legislators, held 15 committee meetings and public hearings of different stakeholders within only 10 weeks.

5.14 The debates on the MTR Bill were along the usual partisan lines, with major parties having split positions on the issue of fare autonomy. Benefiting from Hong Kong's constitutional design biased towards executive power, government had also proved to have the political skills in lobbying the legislators and taking advantage of

²⁵ MTRC even as a statutory corporation already had very high legal autonomy and was subject only to the control of the government. However, government had very rarely exercised its interventive power under the old policy of 'arms-length relationship'.

their political divisions. After making only one major concession – that it pledged to keep majority government ownership in the new MTRC Limited for 20 years – the legislation was passed in a safe margin of 34:22 votes. Afterwards, the company restructuring and IPO were conducted with little hassles except for the administrative hiccups over the distribution of wrong share certificates (see Appendix A).

5.15 Even at a time when public confidence in the SAR government was in low ebbs, following the 1 July 2003 anti-government protests by 500,000 people, government was still able to garner sufficient legislative support to *the securitization of five tunnels and one bridge* in 2004. The government sought Legco's approval in the form of a resolution under the Loans Ordinance to issue bonds. Like in the MTRC case, government imposed a tight legislative schedule of only one month with an intervening Christmas break. In the legislature, all major parties supported securitization in principle. At the request by the Democratic Alliance for the Betterment of Hong Kong (DAB), Legco set up a sub-committee to spend only a month in studying the details of the draft resolution. The resolution was passed in February 2004, following which the IPO was conducted quite smoothly.

5.16 In the *Link-REIT* case, government decided that it had sufficient legal power to divest HA assets and would not seek approval from the legislature in any form. HA's political strategies were: (a) to brief the Housing Panel of LegCo, which has no proper legal power over any public policy, save making comments on government's policy proposals; and (b) to appoint a few legislators from major political parties, who concurrently sit on HA as members, to the HA Supervisory Group on Divestment. In addition, HA launched some public participation initiatives such as briefings for the tenants, meetings with commercial tenants and issuing publicity pamphlets. The response of tenants to these initiatives was, however, less than enthusiastic.

5.17 As in the other two cases, most legislators and major political parties supported the divestment in principle. During the Housing Panel meetings in late 2003, major concerns already surfaced in relation to the impact on key stakeholders including the staff (mainly civil servants) and commercial tenants. The key issues included the rental policy, social responsibility, competition from conglomerates against small shops and so on. After the LegCo elections in September 2004, some public housing tenants and shopowners began to raise their worries to a few newly elected legislators who decided to take up the issue. Later, over 100 tenants sought support from pro-democracy legislators to help safeguard their interests. LegCo, however, had no authority to disapprove or postpone the divestment exercise. Inside the legislative chamber, what the opposing legislators could do was to first pass a non-binding motion in the Housing Panel to urge HA to postpone the Link-REIT listing until consensus with commercial tenants had been reached; and then to move another non-binding motion of similar wording at the full Council in December 2004. The latter motion was negated. So in the end, the opponents resorted to judicial review in order to abort the listing.

5.18 The contrasting experiences from the three cases highlight the importance of appropriate legal-political processes and the role of LegCo, the most representative institution at the moment, in order to forge the necessary policy consensus. In both the MTRC and tunnels cases, LegCo was allowed to take a critical part in the decision-making. The risk for government of being voted down in the process was not high due to the SAR's conservative constitutional design and the LegCo's general positive attitude towards privatization as a means to raise public revenue during the period of prolonged fiscal deficits. By involving LegCo in the decision-making, the most controversial issues at the time could be more thoroughly debated and digested by the public. Government could make use of the media attention to legislative

debates to fully put forward its case to the public and to clear any misunderstanding about its policy intentions. Proper legal-political process with the formal participation of LegCo would enhance government's public communication on privatization.

More than about profitable IPO

5.19 Invariably in all the past privatization exercises, the government, and also the public, had accorded an overriding priority to the financial success of the IPO process. The use of IPO for privatization has the advantages of (a) allowing public participation in the investment, (b) promoting the expansion of the financial market, and (c) disclosing the details of business to the public. Generally speaking, the IPO approach of privatization is suitable for Hong Kong, an international financial centre, and readily accepted by many citizens, who justifiably see IPOs as profit opportunities.

5.20 Nonetheless, the listing of a government-owned enterprise is very different from IPO of private companies. This is not only because there are political concerns. More importantly, proper public accountability and regulation mechanisms need to be built into privatization schemes for public enterprises in order to safeguard public interests in service delivery. However, public control is in conflict with maximizing the asset value of the business to be privatized (which underlines the attractiveness of IPO). In the past exercises, government gave higher priority to making the IPO attractive than ensuring public or policy controls to safeguard public interests. Such an approach, however, is not without long-term social costs.

5.21 The MTRC case is a good case in point. Government adopted a 'status quo' approach in the privatization by preserving the same business model and thus policies as applicable to the former wholly government-owned corporation - e.g. it strongly resisted any control over MTRCL's fare autonomy. Such 'status quo' policy no doubt had stood the best chance of promoting the IPO subscription. However, it has in effect only delayed the need to confront the dilemma over railway fare controls after privatization. In the Link-REIT case, HA attempted to reassure tenants of the intention to maintain some existing management policies (such as on rentals), however not all of these assurances were (or could be) put into writing or revealed to the public, in order not to put the success of the IPO in jeopardy.

5.22 In the case of securitization (such as the tunnels case), it was not so much of a dilemma to focus attention only on the financial success of the IPO. This is because the government's ownership and management responsibility towards the public services concerned have not formally changed.

Role of IPO professionals versus policy makers

5.23 During the three privatization/securitization exercises by IPO, the market professionals (investment bankers, analysts, consultants and corporate lawyers, etc.) have played critical roles in both the technical and political aspects. In the MTRC case, financial professionals actively lobbied for the legislature's support to fare autonomy. Similarly, HA's commissioned lawyers tried to explain and defend in public that the best professional standards had been upheld in the Link-REIT saga. IPO market professionals certainly have to be employed in such kind of privatization exercises because the public-sector managers do not possess the necessary professional experience and qualifications in the financial market operations, which aim solely at investment-friendliness and profit-maximization. On the other hand, however, the market professionals do not necessarily have relevant and sufficient experience in public policy-making, which requires the art of balancing conflicting interests and

objectives. As the painful lesson in the Link-REIT saga has shown, the ultimate responsibility must rest on the public officials to make the best judgement on matters of public interest and politics, which are sometimes in conflict with normal market practices and thinking, and not to defer everything to the market professionals.

Handling staff reaction

5.24 Unlike in many overseas cases, staff opposition was not strong in the Hong Kong divestments, partly reflecting the relatively weak bargaining power and organization of the trade unions. The general acceptance by the employees of ownership and management restructuring was also because the management had carefully devised schemes that would financially compensate or even benefit the staff, such as allocating preference shares in the IPO of MTRCL to MTRC employees and offering voluntary exit schemes in both the MTRC and Link-REIT cases. Such experience indicates that staff reaction to privatization in Hong Kong can be well managed so long as good dialogues are held between the management and employees and properly compensation or incentives schemes are available.

Post- privatization governance

5.25 Given the short history of privatization in Hong Kong, only MTRCL has had some post-divestment experience. There have been some policy dilemmas given that MTRCL is a listed company of hybrid ownership, with legal-formal form and businesses, while the mode of public control stays almost the same as its former status as a statutory corporation²⁶. The mixed public-private ownership of MTRCL has made its corporate governance more complicated, with the addition of tens of thousands of retail and institutional shareholders. MTRCL has the duty to protect the interests of these shareholders whose primary aim is to maximize return on investment. This may sometimes be in conflict with other government policy objectives in relation to the operation of the mass transit system. Although government as the majority shareholder has more legal and political powers over the minority shareholders, in formulating railway policies, it cannot totally ignore the response of minority shareholders and the stock market reactions.

5.26 As explained, MTRC was divested in 'status quo' leaving a number of public policy and control issues raised during the legislative debate in 2000, mostly by pro-democracy legislators, largely unresolved. Some of them have resulted in dilemmas for both MTRCL and government. One of the most contentious issues still being debated is the fare determination mechanism. During the 2000 legislative debate, many alternative mechanisms were proposed by different political parties, including the price index-linked mechanism currently being studied by government.²⁷ At the time of privatization, government reiterated the long-held position that fare autonomy was of utmost importance for the financial survival of MTRC. Fare autonomy was promised in the IPO. After MTRC has become a listed company, however, government officials have directly and openly intervened into MTRCL's fare decisions.²⁸ Not only was such intervention unprecedented as government officials

²⁶ In fact, since the 1990s it has been much debated as to how to strengthen the public accountability arrangements of the former MTRC as a statutory corporation.

²⁷ Most of the alternatives were first raised in the 1990s.

²⁸ For example, in June 2001 the former Chief Executive and Financial Secretary appealed to MTRCL in public to re-consider fare rises and to maintain lower fares in light of the poor economy ("Rail firms agree to postpone fare rises", *South China Morning Post*, 5 July 2001). In August 2002, the first policy comment that the then newly-appointed Secretary for Environment, Transport and Works made was that the transport fares should be lowered ("減

had never openly interfered with MTRC's fare decisions in the past, it had also posed a dilemma to MTRCL which was torn between government interests (both as government and majority shareholder) and shareholders' interests.

5.27 Another major dilemma is about MTRCL's property development rights without open tender, which had also been debated in 2000 but not resolved. Property-financing of railway development has long been Hong Kong's successful formula in railway financing during economic boom. When the property market went into recession, however, the private sector lobbied the government hard to reduce the supply of railway properties or even take back such development rights. The government eventually asked MTRCL (and the KCRC) to postpone several major property development projects.

5.28 There are still other examples of policy dilemma. The government had to partially finance the Penny Bay's Rail Link (PBRL) by waiving dividend payments, because the project could not meet MTRCL's expected financial return and would thus be not too commercially viable. Government was committed to building PBRL as part of the Disneyland project to boost tourism.

5.29 The above policy dilemmas reinforce the lesson that the success of privatization should not be based only on the successful listing of the government business by IPO. There are many issues concerning public policy and public accountability that need to be openly debated and carefully resolved before the privatization, even if that might be at the expense of lower asset valuation for the IPO.

Recommendations

Taking in the lessons from Hong Kong's previous privatization exercises and international experiences, the following general recommendations are made for the overall policy and approach in the privatization of government assets:

(a) Transparency. The government should enhance the transparency of its privatization policy. It should provide the public with the details about the overall rationales, priorities and action plans of its privatization programme as indicated in the 2003-4 Budget, as well as the planned privatization of other major assets held by government-owned statutory bodies (including the Housing Authority).

(b) Public consultation and participation. The government should enhance public participation in the formulation of privatization policy so as to better understand the stakeholder concerns and promote public understanding of the post-privatization arrangements. The convention of public consultation for all major privatization exercises should be established (as in the Airport Authority case).

(c) Commercialization before privatization. If privatization of the government-owned enterprise or service would lead to drastic commercialization and management changes, the government needs to be particularly careful of the implications on public and stakeholders interests. A more cautious option for consideration is to commercialize the management first. When commercialization is proven effective, it would be easier to convince the public of the case for privatizing the ownership as well.

價 廖秀冬上任頭把火 促各公交機構降票價 讓市民鬆口氣", *Wen Wei Pao*, 2 August 2002; "廖秀冬擬削交通票價收費監管機制須修改", *Hong Kong Economic Journal*, 2 August 2002).

(d) Securitization or privatization? If the government's primary objective of privatization is only to generate cash for public finance purposes, the option of securitization instead of privatizing the ownership should be considered a priority approach.

(e) LegCo as rightful partner. In all privatization exercises (whether conducted by government departments or government-owned statutory bodies), LegCo should be treated as a rightful partner in the legal-political process. For major privatization exercises concerning vast public interests, it would be better to let LegCo play a part in the formal decision-making (through special legislation or at least a motion debate).

(f) Privatization is not just an IPO. Privatization is more complicated than an IPO due to the immense public interests involved and the potential social tensions created. While expertise from IPO professionals is important, the public responsibility lies on the government officials and policy makers.

(g) Post-privatization regulation. If the objective of implementing a successful IPO overrides other considerations, the risk for problems in post-privatization governance or industry regulation will increase, particularly in the case of mixed public-private ownership. It is important to give due recognition to the need for post-privatization regulation or public control, sometimes even at the expense of lowering the attractiveness of the IPO.

Table 5.1:

Stakeholder Environment of the Divestment Cases in Hong Kong

	MTR Corporation Limited	Hong Kong Link 2004 Limited ("Five Tunnels and One Bridge")	Link-REIT	Airport Authority
Initiator	Former Financial Secretary Donald Tsang in 1999	Former Financial Secretary Antony Leung in 2003	Housing Authority in 2000	Former Financial Secretary Antony Leung in 2003
Government Sectors	Transport Bureau Secretary for Transport Nicholas Ng	Environment, Transport and Works Bureau Secretary for Financial Services and the Treasury Frederick Ma	Housing, Planning and Lands Bureau Secretary for Housing, Planning and Lands Michael Suen Housing Authority's Commercial Properties Committee and Supervisory Group on Divestment	Economic Development and Labour Bureau Financial Services and the Treasury Bureau
	Consumer Council (government-funded statutory body)		The Link Management Limited	
Ordinance/Legal foundations	The MTR Ordinance replaced original MTRC Ordinance	The Loans Ordinance (Cap. 61) section 3(1)	The Housing Ordinance	The Hong Kong Airport Authority Ordinance (Cap. 483) & the Airport Authority (Amendment) Bill 2004
	Companies Ordinance (Chapter 32)			

	The Memorandum and Articles of Association of Operating Agreement			
Staff & its unions	A voluntary early retirement scheme received 750 applications accounted for 9% of the workforce	N/A	A voluntary exit scheme for Housing Department staff received 156 applications	N/A
	The MTRC Staff Union and other staff associations		The Housing Authority staff unions and staff of the Commercial Properties Sub-division	
LegCo	LegCo Panel on Transport	LegCo Panel on Financial Services	LegCo Panel on Housing	LegCo Panel on Economic Services
	LegCo Committee on the MTR Bill 2000	Subcommittee formed by the House Committee of the LegCo	Establishment Subcommittee of Finance Committee of LegCo	LegCo Committee on the Airport Authority (Amendment) Bill 2004
Political groups	Democratic Party, Democratic Alliance for the Betterment of Hong Kong (DAB), and the Hong Kong Progressive Alliance, etc.		LegCo members Albert Cheng and 23 other pro-democracy legislators expressed concerns about potential rental rises and refurbishment costs after the listing. LegCo member Albert Cheng raised a non-binding motion in LegCo aimed at postponing the IPO of the Link REIT.	
Professional sectors and communities	Mercer Management Consulting	Hong Kong and Shanghai Banking Corporation Limited (HSBC) as financial adviser and arranger & Citigroup as arranger	Swiss investment bank UBS Warburg studied the feasibility of the project Capital and provided consultancy and advisory services	International credit rating agencies, such as Standard & Poor
	Goldman Sachs, HSBC Investment Bank and Warburg Dillon Read as global coordinators and sponsors of the IPO and public listing		UBS Investment Bank, Goldman Sachs (Asia) and Hong Kong and Shanghai Banking Corp as joint global co-ordinators for the divestment	
	N.M. Rothchild as the sole financial adviser Financial and investment community		JP Morgan Securities (Asia-Pacific) as financial adviser PricewaterhouseCoopers as auditor and reporting accountant.	
			LinkLater as Legal advisor	Hangzhou Xiaoshan International Airport
Civil groups/communities	Millions of non-organized passengers	Professional drivers associations and non-organized private vehicle owners	About 3.5 million of public housing tenants organized into around 10 major retailer concern groups, such as H.K. Public Housing Estate	Professional airlines, airport services operators associations, such as The International Air Transport Association (IATA)
	A few small public transport fare concern groups			

			Shop-Operators Union. Estate Restaurant (HK) Merchant Association. Hong Kong Retail Management Association. Grassroots Housing Rights Defence Alliance. Wong Chuk Hang Estate Re-development Group. Neighbourhood and Worker's Service Centre. Markets and Shopping Centres (Single Operator) Association Ltd and other medical and social welfare groups	Academics
	Academics	Academics	Two public housing estate residents, Lo Siu-lan and Ma Ki-chiu. Some 500,000 small investors applying for the Link-REIT IPO	
			Academics	
Competitors	Competing transport operators (such as buses, mini-buses)	The operators of the Eastern Harbour and Western Harbour tunnels	Private or commercial property developers and shopping centres' owners	Competing international airports in the Pearl River Delta and around the Asian region

Chapter 6 - How to Pick Up the Pieces in The Link-REIT Listing

Introduction

6.1 The present debate on the listing seems to rest on whether Ms Lo Siu-lan, the public housing tenant who earlier lodged an unsuccessful legal challenge to the legality of the sale of Housing Authority (HA) assets (in this case retail and car-parking facilities) for the real estate investment trust, could successfully appeal against HA's action at the Court of Final Appeal. Her appeal is expected to conclude within 2005. Legality issues aside, we should also consider whether the divestment of HA's retail and car-parking (RC) facilities would be in the best public interest. Some of the problems in the divestment process have already been touched upon in the previous chapter and are not repeated here.

Reasons for divestment

6.2 Divestment of HA's RC facilities was first mooted in 2000. These facilities comprise about 1 million square meters of retail facilities and some 100,000 car-parking spaces, representing some 11% and 16% of the market territorywide.²⁹ The reasons put forward for the divestment are:

- First, it would enable HA to focus its resources on its core functions as a provider of subsidized public housing;
- Second, with the cessation of production and sale of Home Ownership Scheme (HOS) flats indefinitely, HA lacks a recurrent source of income. Proceeds from the divestment, expected to be in the region of \$30 billion will definitely help to meet HA's funding requirements in the short term.

6.3 The first argument is weak. There is no reason why HA could not competently engage in housing-related business as private property developers do (in the case of management of major shopping centres, e.g. in Taikoo Shing). MTRC also manages shopping centres. HA has always maintained that its commercial portfolios, which are not publicly funded and expected to conform to prudent commercial principles, are separated from its non-commercial, i.e. residential, portfolios. There is no reason why using revenue generated from commercial properties to help finance subsidized public housing is not a viable means of funding a public service provider.

6.4 The second reason seems a more genuine motive, as part of the government's fiscal strategy to divest public assets to raise funds to ease the deficit situation, as in the case of the sale and securitization of toll roads and bridges, the partial privatization of MTRC and the proposal to partially privatize the Airport Authority and the future merged railway corporation.

6.5 The question before the public is whether the long-term loss of steady future revenue from assets with good returns will outweigh the short-term gain from privatizing HA's RC facilities. If so, HA should not list Link-REIT, unless there is a deliberate policy decision to let the general public, as owners of government assets, to share the fruits of good investment by way of IPO. In other words, the listing should

²⁹ Legislative Council Secretariat (2004) *Panel of Housing: Divestment of Housing Authority's Retail and Car-parking Facilities – Background Brief*, 19 November, para. 2.

not be a short-sighted relief measure to a cash-stricken HA, but a bolder attempt to return benefits to ordinary citizens of our society.

6.6 Another consideration would be that by listing Link-REIT, the government is taking the lead to develop an active REIT sector in the financial market, as an important step to expand the capital base of Hong Kong. One should note that Singapore is also moving in the same direction.³⁰ As the debate stands, the government has not been forthcoming with strong arguments for the divestment.

Impact of divestment on public housing residential and commercial tenants

6.7 Having said that, one should not jump to conclusions at the other extreme by assuming that divestment of HA's RC facilities and IPO of Link-REIT must necessarily harm the interests of public housing residential and commercial tenants. Some legislators and public housing tenants and shop-owners groups worry that after divestment, the RC facilities would be operated fully on a commercial basis. The new company would be more ready to increase rents and the burden of which would eventually be passed onto consumers in terms of higher prices for goods and services. Some of the doubts raised may need to be further examined:

- *That a private owner is bound to increase rent.*

The usual economic argument for privatizing a public sector operation is that this helps to rationalize the cost structure and reduce costs. In the case of contracting out public housing estate management and maintenance in 2000, HA contended that it cost 40% more to use civil servants for these services than to use a private contractor. Link-REIT should actually be able to lower rental levels should less costly private sector employees instead of civil servants as under HA be used, with a more streamlined and cost-effective staffing structure after reengineering. There is thus no reason for Link-REIT to talk about large-scale rental reviews which had triggered much worry on the part of existing commercial tenants.³¹

- *That private sector management of public housing shopping and retail facilities may adversely affect the welfare of tenants.*

Although HA is obliged under the Housing Ordinance to provide relevant services and facilities to the residents of public housing estates, there is no reason why such services and facilities cannot be owned and operated by private companies. This is also the legal view taken by High Court judge Michael Hartman who ruled in the Court of First Instance on 14 December 2004 that HA was not overstepping its powers in selling off its commercial assets under Link-REIT. Since 2000, public housing estate management and maintenance has already been transferred by phases to private operators. There is no indication that the management and maintenance service quality has deteriorated as a result.

³⁰ According to its 2005 budget, the Singapore government will strengthen Singapore as the preferred location in Asia for listing REITs, in order to broaden its capital market. Stamp duty on the instruments of transfer of Singapore properties into REITs to be listed, or already listed on the Singapore Stock Exchange, will be waived for a five-year period. Withholding tax on REIT distributions will be lowered from 20% to 10% for a five-year period. See Ministry of Finance (2005) *Budget Statement 2005 – Creating Opportunity, Building Community*, 17 February, Singapore, para. 2.19.

³¹ The Link's executives have said rents might go up and that the aim was to boost the operating margin on the properties from 50% to 70%, according to the report "Coalition gears up to fight rent rises", *South China Morning Post*, 26 November 2004.

Critics may still argue that the contracting out of estate management and maintenance services is ultimately subject to HA's rental policy which is based on the principle of affordability and thus ensures that tenants will not face rental increase arising from any undue level of fees charged by private operators. However, the rental level of commercial properties in public housing estates has always been determined by HA according to prudent commercial principles, with reference to market trends. Whether or not such properties are managed by HA or a privately-owned REIT, in principle, should make no difference unless it is assumed that HA is subject to political pressure and may be more sensitive to demands from retail operators to reduce rent in times of economic downturn. Such argument may stand to some extent, though even in the private sector, it is not uncommon for major commercial property owners to reduce rent or offering other forms of rebates to help their tenants cope with serious economic recession. The issue of welfare rent to certain commercial tenants on grounds of community and social services purposes is a separate one which should, of course, be dealt with by a corresponding management policy of Link-REIT in consultation with HA.

- *That a private owner of all public housing retailing facilities may have the commercial motive to upgrade shopping malls and bring in brand goods outlets and supermarket chains, thereby marginalizing or even driving out small shops and businesses (so-called neighbourhood shops); and that as a result, consumer goods sold at the upgraded malls may cost more, to the disadvantage of lower-income public housing residents.*

Such concern sounds plausible, but should not be taken too far, for two reasons. First, public housing shopping malls mainly serve the local clientele whose ability to pay determines what kinds of retail business and what range of consumer goods could best survive the market forces. If the neighbourhood is predominantly of the low-income sector, one cannot image the private owner of commercial properties blindly seeking to turn the shopping mall into a Pacific Place or Festival Walk. Second, if the shopping mall is able to attract a lot of 'outside' shoppers, then a reasonable degree of upgrading and revitalization should not be a bad thing as this would increase the business volume that would ultimately benefit the retail businesses there.

There is no denying that many public housing retailers and other local neighbourhood businesses are facing the challenge of changing shopping habits and growing competition from shopping malls and supermarket chains, which threaten their economic survival. The government needs to adopt a pro-active policy to help them revitalize and upgrade. Such consideration, however, is separate from the question of listing Link-REIT because even if with HA ownership, under its prudent commercial principles, a public owner could still favour bringing in chain brand shops, department stores and supermarkets. This was indeed happening in some public housing shopping malls even when under HA management.

Impact on HA staff

6.8 The divestment would affect some 650 civil servants, ranging from professionals to front-line officers, currently managing or maintaining the RC facilities. HA had offered voluntary redundancy ('voluntary exit scheme') to 650 staff, while some of the existing staff may be required to support the new company during the initial stage

through secondment or service contracts³². A spokesman for the Housing Department said, "There won't be any forced redundancy. Staff who chose to stay would be redeployed"³³. Legislators, however, have urged government to sort out measures to mitigate impact of the divestment on the contract staff.³⁴

Concern about Link's monopolistic capacity and other matters of public interest

6.9 Members of LegCo's Housing Panel have also expressed other concerns about the operation and structure of the new company:

- There is a possibility of monopoly or oligarchy of the RC facilities by a limited number of big corporations which have sufficient financial strength to buy up all the shares of the new company;
- If HA does not retain any share in the new company, it would not have any role to play in its management to ensure continuity of tenancy policy; and
- The new company should have a proper corporate structure to ensure that it would not be controlled by a few persons and the terms of its board of directors would not be extended indefinitely³⁵.

6.10 A more critical issue has to do with the scale of divestment. Given the huge portfolio of assets now bundled under Link-REIT, valued to be \$21.9 billion net, any over- or under-valuation for the purpose of IPO may affect public interest³⁶. If the government is keen on divestment, then the opportunity for the public to buy into and benefit from such divested assets must be made widely open. Secretary for Financial Services and the Treasury, Frederick Ma, has since promised that the public would get a generous share of Link-REIT. Retail subscribers would now receive 56.5% of the total offering. The allocation is larger than the 52.2% of the final offering size allocated to the retail investors for the IPO of MTRC. Originally, only 10% of the IPO of Link-REIT had been earmarked for ordinary investors³⁷.

How to move forward

6.11 Since the government has already decided on 18 December 2004 to postpone the listing of Link-REIT until after all legal challenges to the divestment of HA commercial assets are disposed of, through a Court of Final Appeal hearing of Ms LO Siu-lan's appeal against the Court of First Instance's ruling in favour of HA, whether or not the IPO can proceed further depends on the judicial outcome.³⁸

³² Legislative Council Secretariat (2004) *Panel of Housing: Divestment of Housing Authority's Retail and Car-parking Facilities – Background Brief*, 19 November, paras. 8-9.

³³ "Property executive to head sell-off", *South China Morning Post*, 22 April 2004.

³⁴ Legislative Council Secretariat (2004) *Panel of Housing: Divestment of Housing Authority's Retail and Car-parking Facilities – Background Brief*, 19 November, para. 9.

³⁵ *Ibid*, para. 11.

³⁶ The net asset value of Link-REIT is estimated at \$21.9 billion, based on a \$30.9 billion valuation of the underlying assets offered by independent property valuer CB Richard Ellis, adjusted for about \$9 billion in debt and other liabilities. The retail properties are valued at \$24.51 billion and the carparking spaces at \$6.34 billion. At Goldman's projected yield of 7.3%, Link-REIT would pay a premium of 380 basis points above the 10-year Hong Kong bond yield, making it an attractive investment in a low interest-rate environment. ("First property trust listing to reap dividend yield of 7.3pc", *South China Morning Post*, 10 November 2004).

³⁷ "Public to get bigger share of Link offer", *South China Morning Post*, 13 December 2004.

³⁸ Secretary for Housing, Planning and Lands Michael Suen said: "As we do not know whether an appeal will be lodged with the Court of Final Appeal, and what the final decision of the court would be, uncertainties remain" and that "If we proceed to list, this may not be in the best interest of the market and the investors. In order to protect the interests of the hundreds of

6.12 Even if the listing of Link-REIT is to proceed, the following should be addressed in order to meet the major concerns discussed above:

- To prevent the monopoly or oligarchy of RC facilities by a limited number of big corporations which buy up all or most of the shares of Link-REIT, the government should firmly stick to the principle that retail investors should take up a majority shareholding of the company vis-a-vis large institutional and government investors, say on 60:20:20 basis.
- Link-REIT should commit itself to a transitional agreement to ensure continuity of existing HA tenancy policy, say for a three-year period, to ease the minds of present commercial tenants.
- Link-REIT should set aside a number of retail spaces for allocation by HA, based on compassionate or community/social considerations and non-commercial rental levels (so-called 'welfare rent'). If necessary, HA or government should compensate Link-REIT for such special commitments.
- Link-REIT may also consider allotting a certain proportion of shares for subscription by sitting public housing commercial tenants so that they too can stand to gain from a commercially prudent management of RC facilities under the company.
- To ensure that neighbourhood consumer interests are adequately taken care of, Link-REIT should establish for each public housing estate a consumer advisory group comprising tenant representatives, along similar lines as the current estate management advisory committees of HA, to serve as an important sounding board on matters relating to RC management and letting policy.
- HA must communicate well with the public and consult LegCo and major stakeholders on the revised proposals and their implications relating to the post-listing management. The political consent of LegCo should be properly secured. HA should also consider whether the relevant provisions of the Housing Ordinance need to be amended in order to remove any legal doubts regarding the Authority's powers.
- The ultimate answer to ensuring fair competition must rest with a proper competition law, as monopolistic behaviour by business conglomerates is also observed in private housing shopping retail business.
- Government should also have a proper policy on small enterprises and shops to help facilitate market innovation and nurture entrepreneurship and self-employment.

thousands of investors, the listing of the Link Reit will not proceed as originally scheduled.”
(*South China Morning Post*, 18 December 2004).

Recommendations

The question before the public is whether the long-term loss of steady future revenue from assets with good returns will outweigh the short-term gain from privatizing HA's retail and car-parking (RC) facilities. The privatization must be shown to achieve efficiency gain which can benefit public housing tenants and the community as a whole.

We support the IPO of Link-REIT in principle, but the following steps need to be considered:

(a) To prevent the monopoly or oligarchy of RC facilities by a limited number of big corporations. The government should firmly stick to the principle that retail investors should take up a majority shareholding of the company *vis-a-vis* large institutional and government investors. To prevent monopolistic behaviour by business conglomerates in RC facilities managed by Link-REIT, a proper competition law must be the long-term policy and legislative answer.

(b) Continuity of existing HA tenancy policy as transitional arrangement. Link-REIT should commit itself to a transitional agreement to ensure continuity of existing HA tenancy policy, say for a three-year period, to ease the minds of some present commercial tenants.

(c) Community and non-commercial tenancies. Link-REIT should set aside a number of retail spaces for allocation by HA, based on compassionate or community/social considerations and non-commercial rental levels (so-called 'welfare rent'). If necessary, HA or government should compensate Link-REIT for such special commitments.

(d) Sharing benefit with sitting commercial tenants. Link-REIT may also consider allotting a certain proportion of shares for subscription by sitting public housing commercial tenants) so that they too can stand to gain from a commercially prudent management of RC facilities under the company.

(e) Consumer interests. Link-REIT should establish for each public housing estate a consumer advisory group comprising tenant representatives, along similar lines as the current estate management advisory committees of HA, to serve as an important sounding board on matters relating to RC management and letting policy.

(f) Political communication and consensus. The political consent of LegCo and the consensus with major stakeholders should be properly secured. HA should also consider amending the relevant provisions of the Housing Ordinance in order to remove any legal doubts regarding the Authority's powers.

(g) Policy on small enterprises and shops. Government should also have a proper policy on small enterprises and shops to help facilitate market innovation and nurture entrepreneurship and self-employment.

Chapter 7 - Should the Airport Authority be Privatized?

Airport privatization – some pertinent issues

7.1 Traditionally airports have been considered classic examples of 'public enterprises' operating a natural monopoly with indispensable service to the society and of important strategic value to a city or nation. Given the critical role of airports to the regions and cities in which they are located, and the high costs of constructing and operating these facilities, public control of airports has not been questioned throughout most of aviation history³⁹.

7.2 The UK was the first to launch the privatization of its airport, with the setting up of British Airport Authority (BAA) plc in 1987 with the passage of the 1986 Airports Act. Seven airports – Heathrow, Gatwick, Stansted, Prestwick, Aberdeen, Edinburgh and Glasgow – were set up as limited companies subsidiary to BAA plc. Sixteen local authority-owned airports were commercialized. In the USA, the government's traditional role in the aviation industry was challenged first with the enactment of the Airline Deregulation Act of 1978 which ended 40 years of federal economic regulation of commercial airlines. Airline deregulation has subsequently fuelled further the drive for airport privatization⁴⁰. Since the 1980s, the Reagan, Bush and Clinton administrations had all encouraged greater private-sector participation in airport management and operations⁴¹. In Australia, the operation of 23 airports was first placed under the management of the Federal Airport Corporation (FAC), a government-owned corporation charged with the responsibility to run airports on a commercial basis, in 1988 and then gradually privatized since the 1990s, with the largest, Sydney's Kingsford Smith Airport, sold in 2002. By 2000, more than 50 countries already had introduced some kind of private-sector involvement into the ownership, financing, and/or management of their airports⁴².

7.3 Airport privatization can cover a broad range of initiatives to bring in and extend private-sector involvement:

- the contracting out of selected airport services;
- a management contract whereby a private company is awarded a contract to manage the entire airport for a relatively short period of time, say 3-5 years;
- a long-term lease whereby the lessee has complete responsibility for the operation and management of the airport over a longer-term lease period (usually 30 years or more) within guidelines set by the lease on a profit-sharing basis; and
- full-fledged divestiture whereby ownership of the airport is transferred into private sector hands even though, as in the case of BAA plc in UK, the government still maintains a 'golden share' for strategic control – over aeronautical charges and regulated accounts.

³⁹ L. J. Truitt and M. Ester (1996) "Airport Privatization: Full Divestiture and Its Alternatives", in *Policy Studies Journal*, Vol. 24, No. 1, pp. 100-110. p. 100.

⁴⁰ Truitt and Ester, *op. cit.*, p. 101.

⁴¹ L. E. Gesell (1994) *Airport privatization (Part I): The rush to deregulate*, paper presented at the 34th airport management short course, American Association of Airport Executives, Monterey, California, USA.

⁴² I. Humphreys, G. Francis, and J. Fry (2001) "Lessons from Airport Privatization, Commercialization, and Regulation in the United Kingdom", *Transportation Research Record*, No. 1744, Transportation Research Board – National Research Council, Washington, DC: National Academy Press, pp. 9-16. p. 9.

Arguments in favour of airport privatization are two-fold: (a) enhanced efficiency and (b) new source of financing. It is considered that privatization helps to enhance efficiency in the operation of airports as private companies are subject to less government rules and bureaucratic red-tape and can build facilities cheaper and faster than government. In the current fiscal climate when many governments are stripped of cash and have reduced public investment in airports as a result of deficit politics, privatization can bring in new capital from the private sector for upgrading and expanding airport infrastructure to cope with growing passenger and cargo load.

7.4 However, airport privatization is not without its opponents and sceptics. Airlines and other aviation user groups are worried about high landing fees once airports are run by profit-seeking private monopolies. Airport employees fear that privatization would result in job losses and wage cuts. Some argue that successful examples of privatization like BAA derives new income from innovative commercial operations rather than traditional airport sources of revenue such as gate leases and landing fees⁴³. While privatization may indeed attract risk-taking private investors, it was pointed out that large public enterprises like airports also enjoy access to lucrative financial terms and have seldom experienced difficulty in accessing investment capital in the market⁴⁴.

Establishment of AA and operational performance

7.5 In July 1995, the Hong Kong Airport Authority Ordinance was enacted by Legco. It came into effect on 1 December that year, with government advances of HK\$36.6 billion to the Provisional Airport Authority being converted into equity upon the establishment of the new Airport Authority (AA). The Financial Support Agreement and the Land Grant were also signed between government and AA. On 2 July 1998, the new international airport at Chek Lap Kok was opened by President Jiang Zemin. In 2000-01, AA reported for the first time a consolidated net profit, at HK\$71 million (this quickly grew to HK\$236 million in 2001-02)⁴⁵.

7.6 Meanwhile AA started planning for the expansion of facilities and diversification of business, including a marine cargo terminal and logistics centres. In October 2001, AA unveiled *The HKIA Master Plan 2020*, outlining plans to further develop the international airport to meet its ultimate design capacity of 87 million passengers and 9 million tones of cargo annually around 2020⁴⁶. In August 2003, AA and the government entered into a joint venture with the consortium led by Dragages et Travaux Publics (HK) Limited to design, construct and operate a new International Exhibition Centre at the airport⁴⁷. In its 2001-02 annual report AA expressed its confidence to meet the target should the government decide to arrange for its privatization⁴⁸. A summary of the key financial and operational performance indicators of AA since 1998-99 is as follows (**Table 7.1**):

⁴³ J. A. Gomez-Ibanez and J. R. Meyer (1993) *Going private: The international experience with transport privatization*, Washington, DC: The Brookings Institution.

⁴⁴ Truitt and Ester, *op. cit.*, p. 104.

⁴⁵ Hong Kong Airport Authority (2004) "Hong Kong International Airport – About Us – Key Dates and Events", <http://www.hongkongairport.com>.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ Hong Kong Airport Authority (2002), *2001-02 Annual Report*, Hong Kong: Airport Authority.

Table 7.1: Performance indicators of AA

Indicators (in thousands)	1998-99*	1999-2000	2000-01	2001-02	2002-03	2003-04
Return on net assets	(1%)	(0.5%)	0.2%	0.6%	1.4%	1.0%
Debt/equity ratio	1:4.7	1:4.7	1:4.8	1:4.3	1:4.7	1:4.8
Total passengers	21,607	30,915	33,844	33,101	34,198	27,673
Cargo tonnages	1,199	2,061	2,230	2,121	2,546	2,738
Aircraft movements	122	169	186	198	212	190

Period from 6 July 1998 to 31 March 1999

Source: Hong Kong Airport Authority⁴⁹

Proposal on partial privatization of AA

7.7 On 22 November 2004, the government's Economic Development and Labour Bureau released a *Consultation Document on Partial Privatization of the Airport Authority* for public consultation⁵⁰. The rationale of privatization was essentially two-fold: (a) to help strengthen AA's market discipline in the running of the airport for greater efficiency and more commercial opportunities; and (b) to introduce an additional quality stock to Hong Kong's financial market.

7.8 To prepare for that the government has already taken steps to enhance AA's capital structure by reducing its equity capital and hence optimizing its debt-to-equity ratio⁵¹. A new company will first be formed under the Companies Ordinance with all the assets, properties, rights and obligations of AA to be vested in it by statute. Then government will dispose part of its shares in the new company through an initial public offering (IPO) and list the new company on the Hong Kong stock exchange. But government will continue to be the majority shareholder in the foreseeable future, and retain adequate powers over the new company in order to safeguard public interests in addition to its role as regulator.⁵²

⁴⁹ Hong Kong Airport Authority (2003), *2002-03 Annual Report*, Hong Kong: Airport Authority, p. 80; Hong Kong Airport Authority (2004), *2003-04 Annual Report*, Hong Kong: Airport Authority, p. 90.

⁵⁰ Economic Development and Labour Bureau (2004) *Consultation Document on Partial Privatization of the Airport Authority*, November, Hong Kong.

⁵¹ Done in June 2004 to enable AA to have a debt-to-equity ratio about 1:2 instead of current ratio of about 1:4.

⁵² IPO is preferred partly because of its success in MTRC's partial privatization and partly because it was commonly adopted in airport privatizations elsewhere (more recent ones including Beijing, Vienna and Guangzhou). In addition, the government's financial advisers UBS Investment Bank concluded that other options – including sale to strategic investors, securitization, issue of exchangeable bond, and sale to the Exchange Fund – were less effective in conferring ownership of the airport to members of the public. See Economic Development and Labour Bureau and Financial Services and the Treasury Bureau, (2004), *Privatization of Airport Authority*, paper for discussion at Legislative Council Panel on Economic Services on 23 February 2004, CB(1)1017/03-04(05). February, Hong Kong, paras. 2-3.

Major stakeholders' concern about AA privatization

7.9 The government had earlier consulted Legco's Panel on Economic Services in March 2004 about the partial-privatization proposal⁵³. The key concerns expressed by legislators were:

- Impact on AA employees and staff of airport franchisees and contractors;
- Possibility of AA abusing its monopolistic power (given its holding on 1,255 hectares of land on the airport island) and becoming 'an independent kingdom' after privatization;
- Whether AA would just focus on maximizing returns to shareholders after privatization, at the expense of airport users and resulting in high airport charges that hurt the Hong Kong airport's competitiveness;
- Risk of AA engaging in anti-competitive practices after privatization;
- How service standards and efficiency at the airport could be ensured after privatization; and
- Whether government's arm's length control would make the privatized AA less effective in negotiations and cooperation with regional airports, thus weakening the hub status of Hong Kong.

7.10 The government has admitted in its public consultation document that some members of the airport community and labour organizations are concerned about the potential negative impact of privatization on their companies or the welfare of workers at the airport, and that the new airport company would become more profit-oriented and exploit them whenever possible.

7.11 Airlines are concerned that the new airport company may set high airport charges and have thus suggested that the airport should adopt a 'single till' approach, with both airport services and non-airport services included in one single 'regulated' account. This is a valid concern because AA's existing return on equity is less than 2%, which is far lower than what would be considered reasonable from a commercial perspective⁵⁴, creating pressure for airport charges to be increased prior to IPO so as to demonstrate to potential investors its ability to achieve a commercial return within a reasonable timeframe. Airport charges presently account for about 45% of AA's total revenue⁵⁵. At this stage the government is still undecided on the level of aeronautical charges, putting the pros and cons of fee increase as follows (Table 7.2):

Table 7.2: Arguments for and against increase in airport charges

For	Against
<ul style="list-style-type: none">• User pays principle• Airport charges account for less than 4% of airlines' operating costs	<ul style="list-style-type: none">• Airport is a public infrastructure and a long-term investment• High charges hurt the airport's

⁵³ Economic Development and Labour Bureau and Financial Services and the Treasury Bureau, (2004), *Response to Questions raised on 23 February 2004 Relating to Privatization of the Airport Authority*, paper for discussion at Legislative Council Panel on Economic Services on 2 March 2004, CB(1)1154/03-04(01), February, Hong Kong.

⁵⁴ Economic Development and Labour Bureau and Financial Services and the Treasury Bureau, (2004), *Privatization of Airport Authority*, paper for discussion at Legislative Council Panel on Economic Services on 23 February 2004, CB(1)1017/03-04(05), February, Hong Kong, para. 6.

⁵⁵ *Ibid.*

- | | |
|---|-----------------|
| <ul style="list-style-type: none"> • Airlines respond to demand, not levels of airport charges | competitiveness |
|---|-----------------|

Source: Economic Development and Labour Bureau (2004) *Consultation Document on Partial Privatization of the Airport Authority: Summary*. November, Hong Kong.

7.12 The International Air Transport Association (IATA), which represents airline operators' interest, has expressed its reservation on AA's privatization. IATA Director General and CEO Giovanni Bisignani claimed that US\$40 billion is paid annually to airlines' monopoly suppliers – namely airports and air navigation service providers – representing 10% of their operating costs⁵⁶. Airlines are therefore much concerned about airport privatization which might lead to higher airport charges and thus greater costs to them. According to Bisignani:

“Already Hong Kong has the highest charges to airlines in this region [i.e. Asia] next to Japan and the mainland of China. Any increase in charges will disadvantage Hong Kong compared to its neighbouring airports. A successful privatization should generate efficiencies to allow for reduced costs.”⁵⁷

7.13 There is also concern in the business sector that AA would be privileged over other developers or other private enterprises given the huge amount of land it holds and its status as the operator of the airport, which may give rise to unfair competition or anti-competitive practices.

Proposed regulatory controls and safeguards

7.14 According to the government's consultation document, the new AA company will be subject to the following regulatory controls and safeguards (**Table 7.3**):

Table 7.3: Proposed government controls and safeguards for privatized AA

	Proposed government controls and safeguards	Compared to status quo
<i>Government powers</i>	<ul style="list-style-type: none"> • Future legislation will contain sufficient powers for government to exercise various regulatory functions • Government intends to remain as majority shareholder in foreseeable future • Government be empowered to appoint a minority number of additional numbers to the company board, to represent government or the public interests, on top of any rights it may have as a shareholder • Government be empowered to obtain information from company for purpose of enforcing relevant laws and regulations • Company be required to submit capital investment plans to government as airport regulator for information • Government be empowered to give directions to the new company in the public interest, with compensation to it under specified circumstances 	<ul style="list-style-type: none"> • Similar as in AA • New arrangement • New arrangement • Same as in AA • New arrangement • Same as in AA

⁵⁶ Giovanni Bisignani (2005) Speech at Aerospace Forum Asia, 15 April, Hong Kong.

⁵⁷ *Ibid.*

	<ul style="list-style-type: none"> • Government be empowered to take over company's assets in case of its default or under emergency situation, with compensation to it under specified circumstances; such takeover provision being the ultimate safeguard of public interests • Government be empowered to impose financial penalties on company for breaches of relevant laws and licensing conditions, and to suspend or revoke aerodrome licence in justifiable cases 	<ul style="list-style-type: none"> • New arrangement • New arrangement
<i>Company board</i>	<ul style="list-style-type: none"> • More than half of board members, excluding the additional government-appointed directors, should be ordinarily resident in Hong Kong • Company chairman must be Hong Kong permanent resident, as current AA chairman 	<ul style="list-style-type: none"> • New arrangement • Same as in AA
<i>Shareholding</i>	<ul style="list-style-type: none"> • Any single shareholder (including associates) to own not more than 10% of total voting rights of all shareholders • Voting rights in the aggregate by non-Hong Kong shareholders be limited to not more than 49% of total voting rights – similar to provision for broadcasting companies 	<ul style="list-style-type: none"> • New arrangement • New arrangement
<i>Economic regulation</i>	<ul style="list-style-type: none"> • To set out a transparent regulatory framework for the determination of airport charges • Regulatory framework should subscribe to user pays principle, to allow company a reasonable return on its investment, and to provide incentives for enhancing efficiency and increasing capacity to cater for demand • Only airport charges (i.e. landing, parking and terminal building charges) paid by airlines be regulated • Single till approach not accepted – it is considered that making the aeronautical operations a commercially viable business on its own would also better encourage the company to maintain its aeronautical services at high standards • The level of company's target return for aeronautical activities should commensurate with risk of aeronautical business, which may not necessarily be the same as the average cost of capital of company as a whole • Company be allowed to negotiate with airlines' representatives on level of airport charges every 3 years or as need arises, against a set of pre-agreed parameters • In the event of disagreement, either government or a government-appointed 	<ul style="list-style-type: none"> • Existing AA Ordinance has not specified the framework for air charges, except general requirement for such charging scheme to be approved in draft by Chief Executive in Council

	<p>independent panel be empowered to adjudicate on the reasonable level of airport charges</p> <ul style="list-style-type: none"> • Company be required to draw up a set of service standards, on the basis of which a financial reward and penalty system be devised to link actual service standards to level of airport charges 	
<i>Land use, competition and scope of business</i>	<ul style="list-style-type: none"> • Company to continue, as AA, to hold and make use of land on the airport island in order to retain flexibility in planning and developing necessary facilities in support of airport operations • Existing controls over land uses, including limitation on AA to use land only for airport-related purposes, and requirement for AA to obtain prior government approval for its building plans to continue • Existing restrictions on range of airport-related activities that AA may conduct be retained; but in view of the company's new corporate status as a listed company, government may consider if existing prior approval by Financial Secretary for AA's commercial activity be replaced by new legislative provision empowering government to direct company to divest an investment or desist from undertaking an activity if found outside the range of permitted activities • Company be prohibited from engaging in anti-competitive activities and abuse of its dominant position in relation to its land use and scope of business 	<ul style="list-style-type: none"> • Same as in AA • Same as in AA • Same as in AA but replaced by provision serving similar purpose • Same as in AA

Critical questions to be answered before privatization

7.15 Government argues that privatization can strengthen AA's market discipline for operating the airport for greater efficiency and looking for more commercial opportunities. *But is AA not already claiming that it operates efficiently according to market principles? Government has to explain how and what extra efficiency can be gained out of partial privatization, and how such gain will benefit the consumers, airline industry and community as a whole.*

7.16 As analyzed above, the new airport company is unlikely to gain more new powers and unchecked freedoms not currently enjoyed under the Airport Authority Ordinance. Government will continue to be majority shareholder in the foreseeable future and no other single shareholder can own more than 10% of total voting rights. It will also appoint a minority number of directors to represent public interests in addition to any rights it may have as shareholder. As majority shareholder, the government can appoint the chairman. *The question, though, is how public interests can be safeguarded should the company be one day fully privatized.* Arguably, like in the case of BAA plc, the government can still retain a golden share.

7.17 At present restrictions are imposed by government on AA over pricing, use of land, financing and borrowings. Such controls and safeguards geared towards preventing AA from abusing its monopolistic power or not acting according to government-defined public interests are supposed to remain intact after partial privatization. *However, the devil is always in the details. One has to look further into the detailed legislative and administrative arrangements yet to be presented by government before getting reassured. Will government favour the setting up of a proper airport regulatory authority as a one-stop regulator?*

7.18 Whether or not AA is privatized, airport pricing and regulation policy remains a contentious subject and should be given greater transparency. Though the government will cap the return from regulated activities after privatization, it will let the airport company adopt any target return for non-regulated activities. Such 'dual till' approach will prevent the use of profits from the non-aeronautical side to help keep aeronautical charges low as in the case of UK where a 'single till' system is adopted. Pressure on increasing airport charges would be high. The problem with single till is, of course, that aeronautical-side efficiency cannot be guaranteed should cross-subsidy be allowed, if not encouraged. *The pros and cons of the two approaches should be investigated further and given wider debate.*

7.19 Summing up, for strategic, economic and political reasons, the case of partial privatization of AA should not be reduced to a simple 'yes' or 'no' to privatization. Government has to convince the public why the existing AA status and structure are too much of a straitjacket on operational efficiency and expansion, otherwise the only point of privatization will seem to be selling the family silver in order to generate some quick cash, at the expense of diluting government ownership of a potentially good-return asset, and this is too short-sighted an objective for privatization.

Recommendations

For strategic, economic and political reasons, the case of partial privatization of AA should not be reduced to a simple 'yes' or 'no' to privatization. Government has to convince the public why AA's existing status and structure are too much of a straitjacket on its operational efficiency and expansion, otherwise the only point of privatization will seem to be selling the family silver in order to generate some quick cash, at the expense of diluting government ownership of a potentially good-return asset, and this is too short-sighted an objective for privatization.

Specific issues to be addressed are:

(a) Efficiency gain. Government has to explain what and how extra efficiency gain can be achieved out of partial privatization of AA, and how such gain will benefit the consumers, airline industry and community as a whole.

(b) Public interest. Government should institutionalize the safeguarding of public interest within the new corporate structure of a privatized AA, such as through the retention of 'golden shares'.

(c) Airport regulator. Government should set up a proper airport regulatory authority, to monitor AA particularly in pricing. Detailed legislative and administrative arrangements to ensure proper regulation should also be presented for wider public consultation.

(d) Pricing regulation. Airport pricing and regulation policy should be given greater transparency. The pros and cons of the 'single till' and 'dual till' approaches, in terms of revenue from activities to be regulated, should be investigated further and given wider debate. A 'dual till approach' may be preferred for AA such that non-aeronautical income can be used to help keep airport charges at a relatively low level, so as to maintain the Hong Kong airport's competitiveness.

Chapter 8 - Further Railway Divestment after Merger of MTRC and KCRC

Not much is known

8.1 So far, the public knows very little about the government's planned merger of the two railways (MTRCL and KCRC) and the subsequent programme of further divestment. Government originally planned to divest the shareholding of MTRCL in two tranches. The first tranche of about 24% was completed in 2000. The second tranche was being held up initially due to the poor market sentiments and later because of the government's new policy to merge MTRCL and KCRC. The intention on the merger was first announced in June 2002 at the same time as government awarded the Shatin-Central Link project to KCRC. Policy inconsistency was quite obvious in this regard. Both MTRCL and KCRC were asked to compete for the project, yet as soon as the vigorous tendering process was completed, the government deliberated a merger.

8.2 In February 2004, the government released proposals on the possible merger of MTRCL and KCRC⁵⁸. The benefits of such merger were presented as improving the overall efficiency of an integrated railway system and maximizing synergies, as well as providing an opportunity for the adoption of a more objective and transparent fare adjustment system (including the possibility of a price-index linked formula and abolition of the existing second boarding or interchange charge) to the benefit of passengers⁵⁹.

8.3 At the same time, government formally asked the MTRCL (partially privatized, with government remaining majority shareholder) and KCRC (a wholly government-owned corporation) to negotiate the merger. It laid down 'five key parameters' of public interest for the purpose of the negotiation, as follows⁶⁰:

- adoption of a more objective and transparent fare adjustment mechanism;
- reduction of fares and interchange fares;
- early resolution of interchange arrangement in the Shatin-Central Link;
- improved interchange arrangements in the long run; and
- job security for front-line staff.

8.4 According to the 2003 report of Rothschild & Sons⁶¹, who conducted a feasibility of the merger for the government, the merger should take the form of MTRCL acquiring KCRC on the basis of a "merger of equals" (p. 21), with the subsequent

⁵⁸ Environment, Transport and Works Bureau (2004), *Press release on the possible merger of MTRC Limited and KCRC*, 24 February, Hong Kong, accessed on web <http://www.etwb.gov.hk>; Environment, Transport and Works Bureau (2004) *Legislative Council Brief – Possible Merger of MTR Corporation Limited and Kowloon-Canton Railway Corporation*, 24 February, Hong Kong.

⁵⁹ The Environment, Transport and Works Bureau has proposed a fare adjustment mechanism with a formula that creates an index used to track the cost base of the merged company. This index would be used to indicate the direction and extent of fare changes that would be required if fares were to track the cost base (see Rothschild & Sons (Hong Kong) Limited (2004) *KCRC/MTRCL Merger Feasibility Study*, abridged version of report dated 12 August 2003, March, Hong Kong, pp. 22-3).

⁶⁰ Hong Kong SAR government, "Two railway corporations invited to start talks on possible merger". *Press release*, 24 February 2004.

⁶¹ Rothschild & Sons (Hong Kong) Limited (2004) *op. cit.*

sell-down of equity in the merged company in effect bringing forward the privatization of KCRC (p. 16), which might take a longer time through IPO (p. 15). In September 2004, the two railway corporations submitted a proposal on the merger to government. No detail at all about the proposal has so far been released to the public. However, implicit in the Financial Secretary's 2005-06 Budget is the government's intention to divest shareholding of the future merged railway company within the context of the sale and securitization of government assets⁶².

Public interest considerations

8.5 In the absence of information, it is difficult here to evaluate the government's railway merger and divestment proposals. The terms and conditions of the merger will greatly affect the subsequent divestment exercise, presumably by IPO. It is important to note that the major considerations of public interest in this exercise do not arise from the further divestment of the government shareholding in MTRCL *per se*, but whether and how the merger will be conducted. The merits and problems of merger are not the theme of this Policy Paper, but some major policy questions are presented here in relation to the discussion on railway privatization:

- *How much cost or economic efficiency will be gained from a merger?* The two railways operate technically different railways systems; and the geographical overlap in the networks is small. The cost savings are not expected to be high except in the areas of top management and some overheads. Moreover, there will be administrative costs in the merger and hidden costs of internal management change after the merger.
- *Is a single railway monopoly good for Hong Kong?* There are pros and cons. On the positive side, potential inefficiency of over-competition in a small and densely populated Hong Kong can be avoided (such as in the case of the expected competition between KCRC's future Shatin-Central Link and MTRCL's cross-harbour lines). A single railway organization can better integrate the entire railway network and avoid bad co-ordination arising from two rivalling operators. On the negative side, however, a railway monopoly that also enjoys a lot of overhead property development rights may be regarded as too powerful in the market. In particular, opening up railway market competition has been a recent global trend (e.g. the privatization of British Rail and Japan Rail in the 1990s). There must be very strong reasons (economic, operational and logistical) for Hong Kong to go against such trend by merging the existing two railway operators.
- *How will the fare determination mechanism be changed?* On the one hand, a more objective and transparent fare adjustment as promoted will certainly be much welcomed in the public interest. On the other hand, this will mitigate the financial autonomy of the privatized railways and will not be an appealing proposal to investors. Price cap over public utilities has always been a controversial issue.
- *How will the railways be financed in future?* This is a taxing problem when (a) government intends to withdraw from the property market; and (b) some of the new railway links such as the West Rail is making quite a heavy loss. Unless government is willing to finance more directly the building of new railways, the

⁶² Henry Tang (2005) *The Budget 2005-05*, speech by the Financial Secretary moving the second reading of the Appropriations Bill 2005 at the Legislative Council, 16 March, Hong Kong, para. 100.

business proposition of a merger will unlikely be very attractive to investors. On the other hand, the community would be highly cautious about subsidizing a 'private-sector' railway organization.

8.6 The above questions are all policy dilemmas that cannot be resolved among the government and the two railways behind closed door. They have critical implications for transport policy and livelihood issues, which are not only of major public interest but also politically controversial. Government should invite participation from the public and LegCo in the policy discussion on the impact of the merger proposal sooner rather than later.

Implications of merger on further divestment

8.7 Regardless of the terms and conditions of merger to be proposed and finally agreed, certain organizational restructuring seems unavoidable for a merged corporation and its subsequent divestment. If we assume that government will try to minimize the organizational change, then the following route may be considered:

- KCRC should first be restructured as a company of divisible shareholding. Then MTRCL will buy up the shares of KCRC. Alternatively, government can dissolve KCRC and inject/sell its railways assets directly to MTRC.
- Afterwards, the government shares of MTRCL, with the new asset holding in KCRC, will be divested via public offering.

8.8 There are many options of restructuring under the above broadly outlined framework. One critical issue is that government's merger proposal will need to be attractive enough to the minority shareholders of MTRCL. That would mean government is confronted with the dilemma of making the proposal financially attractive enough for the market, rendering the new policies on fares and railway financing publicly acceptable, and minimizing the public subsidy in the whole process, all at the same time. Advancing such a big policy change will require strong public support that must be garnered through full co-operation with LegCo, transparency in policy formulation, public consultation, and excellent public communication.

Recommendations

Transparency and consultation. The government should release more information about the terms of the proposed merger and consult the public on the policy arrangements before proceeding with the merger. The major issues of the merger for public consultation would include: the overall regulatory mechanism of a single merged railway operator, the fare determination mechanism, strategies for funding future railways, transport competition implications, organizational structure of the merged railway, economic costs and benefits of the merger in the short and long term, and the government's future plan for privatizing the merger railway.

Chapter 9 - Recommendations

A stakeholder approach

9.1 Different kinds of business involve different issues of public interest specific to the nature of the service. Not all businesses are equally suitable for privatization. Generally speaking, if the business is more commercial than social in nature, it is more suitable for privatization. Also, different modes of privatization (such as listing, securitization, tender, and divestment) involve different specific issues of concern. Hence, each privatization exercise is different. Privatization by way of listing cannot be dealt with in the same way as the normal IPO of private sector firms because of the *publicness* of such exercises.

9.2 Taking into account the potential conflicts among different (and sometimes competing) public/stakeholder interests, a *stakeholder approach* is generally preferred when a government implements a privatization plan. The conflicts and challenges of privatization as encountered by other countries in the main illustrate the critical importance of maintaining the right balance when handling the privatization process.

On overall privatization policy and process

9.3 Drawing upon the lessons from Hong Kong's previous privatization exercises and international experiences, the following general recommendations are made for the overall policy and approach in the privatization of government assets:

(a) Transparency. The government should enhance the transparency of its privatization policy. It should provide the public with the details about the overall rationales, priorities and action plans of its privatization programme as indicated in the 2003-4 Budget, as well as the planned privatization of other major assets held by government-owned statutory bodies (including HA).

(b) Public consultation and participation. The government should enhance public participation in the formulation of privatization policy so as to better understand the stakeholder concerns and promote public understanding of the post-privatization arrangements. The convention of public consultation for all major privatization exercises should be established (as in the AA case).

(c) Commercialization before privatization. If privatization of the government-owned enterprise or service would lead to drastic commercialization and management changes, the government needs to be particularly careful of the implications on public and stakeholders interests. A more cautious option for consideration is to commercialize the management first. When commercialization is proven effective, it would be easier to convince the public of the case for privatizing the ownership as well.

(d) Securitization or privatization? If the government's primary objective of privatization is only to generate cash for public finance purposes, the option of securitization instead of privatizing the ownership should be considered a priority approach.

(e) LegCo as rightful partner. In all privatization exercises (whether conducted by government departments or government-owned statutory bodies), LegCo should be

treated as a rightful partner in the legal-political process. For major privatization exercises concerning vast public interests, it would be better to let LegCo play a part in the formal decision-making (through special legislation or at least a motion debate).

(f) Privatization is not just an IPO. Privatization is more complicated than an IPO due to the immense public interests involved and the potential social tensions created. While expertise from IPO professionals is important, the public responsibility lies on the government officials and policy makers.

(g) Post-privatization regulation. If the objective of implementing a successful IPO overrides other considerations, the risk for problems in post-privatization governance or industry regulation will increase, particularly in the case of mixed public-private ownership. It is important to give due recognition to the need for post-privatization regulation or public control, sometimes even at the expense of lowering the attractiveness of the IPO.

On privatization of HA's retail and car-parking facilities

9.4 The question before the public is whether the long-term loss of steady future revenue from assets with good returns will outweigh the short-term gain from privatizing HA's retail and car-parking (RC) facilities. The privatization must be shown to achieve efficiency gain which can benefit public housing tenants and the community as a whole.

9.5 We support the IPO of Link-REIT in principle, but the following steps need to be considered:

(a) To prevent the monopoly or oligarchy of RC facilities by a limited number of big corporations. The government should firmly stick to the principle that retail investors should take up a majority shareholding of the company *vis-a-vis* large institutional and government investors. To prevent monopolistic behaviour by business conglomerates in RC facilities managed by Link-REIT, a proper competition law must be the long-term policy and legislative answer.

(b) Continuity of existing HA tenancy policy as transitional arrangement. Link-REIT should commit itself to a transitional agreement to ensure continuity of existing HA tenancy policy, say for a three-year period, to ease the minds of some present commercial tenants.

(c) Community and non-commercial tenancies. Link-REIT should set aside a number of retail spaces for allocation by HA, based on compassionate or community/social considerations and non-commercial rental levels (so-called 'welfare rent'). If necessary, HA or government should compensate Link-REIT for such special commitments.

(d) Sharing benefit with sitting commercial tenants. Link-REIT may also consider allotting a certain proportion of shares for subscription by sitting public housing commercial tenants) so that they too can stand to gain from a commercially prudent management of RC facilities under the company.

(e) Consumer interests. Link-REIT should establish for each public housing estate a consumer advisory group comprising tenant representatives, along similar lines as the current estate management advisory committees of HA, to serve as an important sounding board on matters relating to RC management and letting policy.

(f) Political communication and consensus. The political consent of LegCo and the consensus with major stakeholders should be properly secured. HA should also consider amending the relevant provisions of the Housing Ordinance in order to remove any legal doubts regarding the Authority's powers.

(g) Policy on small enterprises and shops. Government should also have a proper policy on small enterprises and shops to help facilitate market innovation and nurture entrepreneurship and self-employment.

On privatization of the Airport Authority

9.6 For strategic, economic and political reasons, the case of partial privatization of AA should not be reduced to a simple 'yes' or 'no' to privatization. Government has to convince the public why AA's existing status and structure are too much of a straitjacket on its operational efficiency and expansion, otherwise the only point of privatization will seem to be selling the family silver in order to generate some quick cash, at the expense of diluting government ownership of a potentially good-return asset, and this is too short-sighted an objective for privatization.

9.7 Specific issues to be addressed are:

(a) Efficiency gain. Government has to explain what and how extra efficiency gain can be achieved out of partial privatization of AA, and how such gain will benefit the consumers, airline industry and community as a whole.

(b) Public interest. Government should institutionalize the safeguarding of public interest within the new corporate structure of a privatized AA, such as through the retention of 'golden shares'.

(c) Airport regulator. Government should set up a proper airport regulatory authority, to monitor AA particularly in pricing. Detailed legislative and administrative arrangements to ensure proper regulation should also be presented for wider public consultation.

(d) Pricing regulation. Airport pricing and regulation policy should be given greater transparency. The pros and cons of the 'single till' and 'dual till' approaches, in terms of revenue from activities to be regulated, should be investigated further and given wider debate. A 'dual till approach' may be preferred for AA such that non-aeronautical income can be used to help keep airport charges at a relatively low level, so as to maintain the Hong Kong airport's competitiveness.

On privatization of the proposed merged railway corporation

9.8 **Transparency and consultation.** The government should release more information about the terms of the proposed merger and consult the public on the policy arrangements before proceeding with the merger. The major issues of the merger for public consultation would include: the overall regulatory mechanism of a single merged railway operator, the fare determination mechanism, strategies for funding future railways, transport competition implications, organizational structure of the merged railway, economic costs and benefits of the merger in the short and long term, and the government's future plan for privatizing the merged railway.

Appendices

A. Chronology of the privatization of MTR Corporation

Date	Events
03-03-1999	Financial Secretary Donald Tsang Yam-kuen announced in Budget Speech a series of government initiatives, including that government would privatize a substantial minority share of MTRC through a public offering. He expected "partial privatization" would bring in HKD 15 billion in cash for government.
24-03-1999	Legislative Council (LegCo) doubted whether government had made the right decision to privatize MTRC when coffers were still overflowing. Their concerns were that privatization of MTRC might violate public interest as profits were the prime concern of private companies.
25-06-1999	LegCo's Panel on Transport discussed proposal of privatization of MTRC
28-07-1999	LegCo's Panel on Transport discussed overseas experience in privatization of railways prepared by Transport Bureau and Mercer Management Consulting.
30-07-1999	MTRC proposed a voluntary early retirement scheme for its 8,400 employees to cut costs and boost efficiency. MTRC proposed to compensate any employee who joined early retirement scheme with an ex-gratia pay ranging from half a month to one month for every year of service. MTRC Staff Union was worried that company would lay off staff if scheme failed.
14-09-1999	Executive Council (ExCo) endorsed a proposal for partial sale of MTRC. Government wanted to raise at least \$30 billion from MTRC privatization in the next two years. Democratic Party, Democratic Alliance for Betterment of Hong Kong (DAB), and Hong Kong Progressive Alliance all expressed the need for an independent mechanism to monitor fare increases after privatization.
15-09-1999	MTRC received 750 applicants for voluntary early retirement scheme. These accounted for 9% of their workforce. MTRC estimated that \$250 million would be saved in the long run.
24-09-1999	Government gazetted MTR Bill in LegCo.
04-10-1999	LegCo Panel on Transport discussed MTR Bill and how public views collected in relation to fares had been taken into account by MTRC.
13-10-1999	MTR Bill was introduced. It vested the assets and liabilities of MTRC in new MTRC Limited, set out the relationship between government and the new company, granted MTRC Limited a 50-year franchise to operate MTR, provided for an Operating Agreement on new company's performance, and replaced original MTRC Ordinance.
10-1999 to 02-2000	A LegCo bills committee on Mass Transit Railway Bill was formed. It held 15 meetings during the period to conduct detailed and in-depth studies of privatization of MTRC, in particular over the fare mechanism. Financial experts, credit rating agencies, international railway experts, academics, Consumer Council as well as three staff unions of MTRC had been invited to bills committee to express their views on privatization of MTRC. Government had prepared a total of 15 committee stage amendments in consultation with bills committee to further refine the Bill, while committee members had proposed a total of 18 amendments mainly focusing on regulation of MTR fares after privatization.
03-01-2000	MTRC pledged that structure and staffing would remain unchanged after privatization.
22-02-2000	Secretary for Transport Nicholas Ng said government would retain more than 50% of privatized MTRC shares, and more than 50% of voting power in company at its general meeting for at least 20 years from the date of its listing on stock exchange. Government believed that privatized MTRC would not raise fares drastically because it would only drive away passengers and hurt company's interest.
23-02-2000	LegCo passed MTR Bill with 34 legislators in favour of and 22 members against, which paved way for partial privatization of MTRC. During LegCo debate, legislators expressed concern over some controversial issues, such as staff interest and operational standards, fare autonomy and corporate governance. MTRC was reconstituted into a limited company incorporated under Companies Ordinance and adopted Articles of Association. An Operating Agreement was later signed between government and MTRC Limited concerning powers and duties of the franchise.

14-04-2000	MTRC appointed Goldman Sachs, HSBC Investment Bank and Warburg Dillon Read as global coordinators and sponsors of IPO and public listing of MTRC. N.M. Rothchild would become sole financial adviser of corporation in relation to initial share sale, replacing Goldman Sachs. Three joint global coordinators would develop strategies for promotion and marketing of IPO, and supervise the design, management and execution of IPO and listing. They would participate in all aspects of preparation of IPO and listing, including valuation analysis and documentation, and would be responsible for distribution of shares both in Hong Kong and internationally.
25-08-2000	Government said MTRC would be listed on Hong Kong Exchanges and Clearing in early October with an initial market capitalization of HK\$50 billion to HK\$60 billion.
03-09-2000	Hong Kong Clearing, a unit of Hong Kong Exchanges and Clearing, would launch an IPO platform on internet. This electronic IPO model would be introduced upon flotation of MTRC in October.
11-09-2000	Financial Secretary Donald Tsang announced government intended to sell an approximately 20% stake in MTRC through share offering. Initial price range for the institutional offering was set at HK\$8.00 to HK\$9.38 per share. Final issue price will be determined through an institutional book building process.
24-09-2000	Partial sell-off of MTRC began.
28-09-2000	Over 610,000 applicants submitted applications by deadline of MTRC IPO. An over-subscription of 18 times at a total of \$163 billion from both local retail and institutional investors worldwide. Government finally divested 23.9% of government shares to all applicants, each of whom was offered a smaller number of shares at an IPO price of HKD 9.38.
02-10-2000	More than 57% of MTRC share offering was allocated to retail investors who applied for up to 50,000 shares.
02-10-2000	Confusion arose from invalid and poor-quality share certificates mistakenly sent out to investors as proof of share ownership. Error meant nearly 3,000 duplicate certificates that had been mailed to investors. Confusion kept some shareholders from trading on opening day.
05-10-2000	MTRC was publicly listed on Hong Kong Exchange.
06-10-2000	Investors of MTRC who received duplicate share certificates will be paid \$500 each to return them to the Central Registration Hong Kong who apologized for the mix-up.
09-10-2000	About 876 investors who received invalid certificates for shares in MTRC had exchanged them for new valid certificates of MTRC.
13-10-2000	Central Registration Hong Kong will extend for two weeks deadline for investors to replace duplicated MTRC share certificates.
18-10-2000	Government would schedule a discussion on chaos surrounding distribution of duplicate share certificates for MTRC in Panel of Financial Affairs of LegCo in early November after some legislators had raised questions.

**B. Chronology of the Securitization of Hong Kong Link 2004 Limited
("Five Tunnels and One Bridge")**

Date	Events
03-2003	Financial Secretary Antony Leung announced in 2003-04 Budget to sell or securitize HK\$112 billion in assets over next five years and LegCo authorized government to borrow up to HK\$6 billion by securitizing government's revenue from certain tolled tunnels and bridges.
25-04-2003	Environment, Transport and Works Bureau briefed LegCo on proposal to put all three cross-harbour tunnels under ownership of one company. Government said it had approached operators of Eastern Harbour and Western Harbour tunnels to see if either one was interested in becoming a common owner of all three cross-harbour links, but neither indicated any interest in proposal.
27-06-2003	Secretary for Financial Services and the Treasury Frederick Ma said up to \$16 billion could be raised by further asset sales and securitizing toll incomes of five tunnels and one bridge.
05-11-2003	Government announced appointment of Hong Kong and Shanghai Banking Corporation Limited (HSBC) as its financial adviser on legal and financial structure and other related matters of proposed securitization of toll revenue of Government-owned tunnels and bridge.
16-12-2003	Executive Council advised and Chief Executive ordered that Resolution under section 3(1) of Loans Ordinance should be introduced into LegCo to enable Government to securitize its revenue from toll roads by offering notes backed by such revenue to investors.
05-01-2004	During meeting of LegCo's Panel on Financial Services, legislators expressed concerns that bond issue might lead to an increase in toll prices, restrict implementation of transport policies or affect staff involved. Government also submitted prospectus of securitization of government bridges and tunnels to LegCo Panel.
09-01-2004	A subcommittee on proposed resolution under section 3(1) of Loans Ordinance (Subcommittee) was formed by House Committee of LegCo to study proposal of securitization of toll tunnels and bridge projects and government's draft resolution.
16-01-2004	Subcommittee completed scrutiny of proposed resolution. Members supported objectives of proposed securitization exercise, and agreed that a report be submitted to House Committee for its consideration at meeting on 30 January 2004.
30-01-2004	LegCo's House Committee discussed proposed resolution. Members did not raise objection and agreed to move modified version of proposed resolution to LegCo on 18 February 2004.
18-02-2004	LegCo approved resolution under section 3(1) of Loans Ordinance by 34:4 in favour of resolution. It allowed securitization of toll tunnels and bridge projects by selling bonds backed by future toll revenues.
26-02-2004	Government appointed HSBC and Citigroup to arrange planned securitization of toll revenues from a bridge and five tunnels. Frederick Ma reiterated government plans to use \$600 million to \$700 million of \$1 billion annual net revenue from tunnel and bridge assets to repay principal and interest, and stressed that securitization would not affect government's ownership or management of assets involved.
19-04-2004	Government launched the first securitized bond issue, worth \$6 billion, offering interest of up to 4.28% and promising to guarantee revenue shortfalls. Government hoped issue will strengthen local debt market, long considered weakest part of Hong Kong's finance industry.
27-04-2004	Securitization bonds backed by toll income from five tunnels and bridge were two times oversubscribed by investors. One-year and 12-year tranches, earmarked for institutional investors, were quite heavily oversubscribed.
04-05-2004	Government announced that all 35,403 applicants of three retail tranches would receive at least one HK\$50,000 note.
11-05-2004	Government's HK\$6 billion securitization of tunnel and bridge revenues yielded only 22 transactions with value of about HK\$2.12 million on first day of trading.

C. Chronology of the Privatization of Link-REIT

Date	Events
2000	Divestment of Housing Authority (HA)'s non-core retail and car-parking businesses was first mooted with objective of enabling HA to focus its valuable resources on its core functions.
27-06-2002	According to Report on Review of the Institutional Framework for Public Housing, published by government, it proposed selling off HA's car parks and shopping centres to keep the cash-strapped HA afloat.
22-07-2002	HA hired Swiss investment bank UBS Warburg to study ways of divestment and improvement on profits from non-core businesses.
28-10-2002	HA's Commercial Properties Committee suggested HA to set up an independent body to divest its shopping complexes and car parks.
11-11-2003	Secretary for Housing, Planning and Lands Michael Suen announced after Chief Executive's Policy Address that HA will conduct a detailed assessment on divestment options for its retail and car parking facilities.
27-02-2003	HA's Revised Budget for 2002/03 and Proposed Budget for 2003/04 were endorsed. Housing Department (HD) was actively pursuing a number of initiatives to ensure availability of funds to meet HA's programmes and operations in longer term, including potential divestment of HA's non-core businesses.
07-03-2003	Securities and Futures Commission (SFC) launched a REITs (real estate investment trusts) code to broaden choice of investment products available to investing public.
15-07-2003	Divestment plan of HA approved by Chief Executive in Executive Council.
24-07-2003	HA approved divestment plan.
18-10-2003	HA set up supervisory group on divestment to advise, guide and monitor implementation of plan to divest HA's non-core businesses.
03-11-2003	A senior official of HD briefed legislators on proposed divestment of HA's non-core businesses.
28-11-2003	During the first meeting of Supervisory Group on Divestment, the group decided to step up its communication with stakeholders impacted by plan, including commercial tenants and staff of HD.
01-12-2003	HD officials reported on progress of divestment of HA's RC facilities at meeting of Legco's Panel on Housing.
09-12-2003	HA's Supervisory Group on Divestment met with commercial tenants
12-2003	HA met with staff unions and staff of commercial properties sub-division to exchange views
21-04-2004	HA appointed Victor So as Chief Executive Officer (CEO) of new management company to take over management of the retail and carparking facilities.
03-05-2004	A senior HD official briefed legislators on progress made in divestment of the non-core businesses; and voluntary exit scheme (VES) for civil servants affected by divestment.
05-07-2004	More than 10 tenants and retailers-concerned group participated at a meeting of Legco's Housing Panel, together with government officials.
13-07-2004	HA approved VES for about 650 surplus staff arising from divestment plan.
11-08-2004	Link Management Limited (Link) was set up to run HA's non-core businesses.
27-08-2004	HA selected CapitaLand as strategic partner of Link Management. In addition to providing consultancy and advisory services, CapitaLand has committed to invest US\$180 million as a cornerstone investment in Link.
13-10-2004	HA appointed UBS Investment Bank, Goldman Sachs (Asia) and HSBC as joint global co-ordinators for divestment. JP Morgan Securities (Asia-Pacific) was engaged as financial adviser and PricewaterhouseCoopers as auditor and reporting accountant.
16-11-2004	Tenants from 107 retail properties in HA's shopping centres sought assistance from legislator Albert Cheng (elected in September 2004) and 23 other pro-democracy legislators to express their concerns about potential rental rises and refurbishment costs after divestment.
22-11-2004	Government officials updated Legco's Housing Panel on latest progress of divestment of Link.

24-11-2004	HA promised a \$32 billion income for government by divesting 180 of its non-core businesses. Legislators Albert Cheng, Albert Chan and Leung Kwok-hung criticized \$32 billion HA would receive for divestment of Link as underestimating the full market value of the assets and that there was lack of concern for commercial tenants
25-11-2004	24 pro-democracy legislators joined coalition of public housing shop tenants to fight against rent rises after divestment.
27-11-2004	Hong Kong Public Housing Estates Shop-operators Union and other representatives of tenants met Victor So. So promised that in the future Link would consult tenants before increasing rents.
30-11-2004	Link managers have been introducing proposals to add zest to former HA's properties. So said rent increases were not on the top priority list of business plans. Link aimed to cut costs and enhance efficiency and potential of centers.
01-12-2004	Legislator Albert Cheng raised a non-binding motion in LegCo aimed at postponing IPO of Link. Motion was voted down after debate.
06-12-2004	Link received more than 1.4 million application forms in the first day of application. Albert Cheng was seeking a judicial review on the ground that listing of Link is not permitted under Housing Ordinance.
07-12-2004	HA stressed legal opinion obtained was that proposed divestment is clearly a proper use of HA's statutory powers.
08-12-2004	Two public housing estate residents, Lo Siu-lang and Ma Ki-chiu, applied to High Court for a judicial review to halt divestment of Link.
13-12-2004	Court of First Instance indicated that it would deliver his verdict on legality of divestment of HA assets before listing of Link.
14-12-2004	HA decided to delay listing of Link until 20 December after Court of First Instance ruled in favour of offering.
15-12-2004	Court of Appeal ordered that period for filing appeal by two public housing estate residents would expire at 1 pm on 16 December.
16-12-2004	HA would apply to Court of Final Appeal (CFA) to shorten time allowed for lodging an appeal, usually 28 days. Chief Executive Tung Chee-hwa denounced mastermind behind the legal challenge to listing of Link.
17-12-2004	Government intended to go ahead with Link listing on 20 December after CFA confirmed Lo's right to take 28 days to launch her appeal against Court of First Instance ruling over HA's right to divest its assets.
18-12-2004	Financial Secretary Henry Tang said incident was "more or less a stain [on Hong Kong] and had become an after-dinner joke" to outsiders. He was very disappointed matter had become so politicized.
19-12-2004	Government shelved Link listing after failing to resolve uncertainties caused by legal challenge to divestment of HA's non-core business.
20-12-2004	Michael Suen deflected calls for accountability. He said heads do not need to roll over Link listing fiasco.
21-12-2004	A group of financial services staff criticized legislator Albert Cheng for ignoring interests of 510,000 retail investors who had subscribed to Link.
24-12-2004	Two small investors, Kan Hau-ming, and William Tang Yun-lim, filed a claim with Small Claims Tribunal against legislators Albert Cheng and Albert Chan for derailing listing of Link.
28-12-2004	Michael Suen said HA expected Lo to ask court for more time to consider her next move in an attempt to extend appeal process at last minute.
29-12-2004	At a special open meeting of HA, Dominic Tsun of law firm Linklaters revealed that HA had considered three contingency plans if listing had gone ahead as planned on December 20 and court action was taken.
01-01-2005	Thousands of stockbrokers, investors and securities-industry workers took to street to protest against politicians over Link fiasco.
05-01-2005	Michael Suen told LegCo it would cost taxpayers about \$900 million if government planned to re-list Link.
07-01-2005	Lo rejected government offer to bear fees of her legal team, given that the condition was that Lo would have to agree not to seek further legal action if offer was taken.
14-01-2005	An application for legal aid by Lo had been rejected. Lo had 14 days to appeal against decision of Director of Legal Aid.
15-01-2005	Michael Suen said paying for Lo's appeal was one way of resolving issue swiftly.

17-01-2005	HA members noted that lawyers representing Lo had proposed that government shouldered her legal costs in exchange for speeding appeal process by Lo. Meanwhile, CFA has rejected a move to shorten 28-day for Lo to lodge appeal.
26-01-2005	Lo rejected a conditional offer from HA to fund her legal costs on Link judicial review.
01-02-2005	Court of Appeal rejected HA's attempt to shorten appeal process.
21-02-2005	Court of Appeal agreed to an open-ended extension of deadline for an appeal against Link divestment. Lo could defer her appeal plans until an independent review of her rejected legal aid application was completed.
10-03-2005	Board of Directors (BoD) of Link has accepted resignation of Chief Financial Officer and Executive Director, Alfred Li Hung-kwan.
24-03-2005	Lo was granted legal aid to take her case to CFA. She has seven days to file notice of an appeal against decisions by two lower courts to throw out her charge.
26-03-2005	Paul Cheng was appointed as a non-executive Director and chairman of BoD of Link with effect from 1 April 2005.
02-04-2005	Michael Suen said Link could be re-launched before end of 2005. He stressed that a renewed listing would depend on progress of judicial review.
06-04-2005	Lo filed an application for leave to appeal to CFA almost two weeks after she was granted legal aid. Court of Appeal would set a date for hearing to determine whether to grant Lo's approval to take her case to CFA.
18-04-2005	Court of Appeal agreed to grant Lo leave to have her judicial review heard by CFA.
29-04-2005	A British barrister, James Goudie, was hired by Link for forthcoming judicial review.
26-05-2005	CFA turned down application of Lo for leave to appeal to CFA concerning court orders to abridge time for her to appeal to Court of Appeal and to expedite Court of Appeal hearing.

D. Chronology of the Proposed Privatization of Airport Authority

Date	Events
04-1990	Provisional Airport Authority (PAA) was established under Provisional Airport Authority Ordinance to plan, design and construct new airport at Chek Lap Kok.
07-1995	Hong Kong Airport Authority Ordinance was enacted by LegCo which endorsed establishment of permanent Airport Authority.
12-1995	Government advanced HK\$36.6 billion to PAA being converted into equity upon establishment of the new Airport Authority (AA).
01-1998	Government gazetted AA Scheme of Airport Charges for new Hong Kong International Airport.
02-07-1998	Hong Kong International Airport (HKIA) was opened.
26-06-2000	1999-02 AA Annual Report submitted to LegCo showed improvement with a consolidated operating profit of HK\$291 million. Its consolidated loss was reduced to HK\$168 million after deduction for finance costs and minority interests.
20-09-2000	Standard & Poor's accorded an "A+" corporate credit (local currency) rating and an "A" foreign currency rating to AA.
09-02-2001	AA issued HK\$2.5 billion floating rate notes (FRN) and was given "double A minus" for local currency corporate credit rating and "single A plus" for foreign currency rating by Standard & Poor's.
11-07-2001	AA reported consolidated net profit of HK\$71 million in 2000-2001 Annual Report submitted to LegCo.
29-10-2001	AA unveiled "The HKIA Master Plan 2020", outlining the plans to further develop HKIA to meet its ultimate design capacity of 87 million passengers and 9 million tonnes of cargo annually around 2020.
07-2002	AA posted a profit of HK\$236 million for 2001-02. Total turnover grew by 2.2% to HK\$5,274 million. Total operating expenses for the year were HK\$4,615 million, including HK\$1,843 million depreciation. Operating expenses before depreciation amounted to HK\$2,772 million. The declining interest rate during year had also helped cut AA's interest and finance charges by 17% or HK\$84 million.
06-08-2003	Government announced that it would commence work in preparation for proposed privatization of AA. It was proposed that as a first step, AA should return about \$6 billion of equity capital to government through capital restructuring prior to privatization
23-08-2003	Government, AA and the consortium led by Dragages et Travaux Publics (HK) Limited entered into a joint venture agreement for the design, construction and operation of a new International Exhibition Centre (IEC) at Hong Kong International Airport.
23-02-2004	LegCo's Panel on Economic Services discussed proposed partial privatization of AA.
01-03-2004	Government provided LegCo's Panel on Economic Services with background information on privatization of AA.
30-06-2004	AA reported a net profit after tax of HK\$386 million for financial year 2003-04. For the first time, the Board has declared and paid dividends of HK\$380 million to government.
27-08-2004	Government announced that airport services sector has been included in Phase II of the Closer Economic Partnership Arrangement (CEPA II) between Mainland and Hong Kong.
27-10-2004	AA signed a HK\$6 billion dual-tranche syndicated loan facility with 22 leading local and international banks.
22-11-2004	Economic Development and Labour Bureau released a consultation document on partial privatization of AA for public consultation.
17-01-2005	AA signed a letter of intent with Hangzhou Xiaoshan International Airport in Zhejiang province, paving way for its first major investment in airports outside Hong Kong.
31-01-2005	LegCo's Panel on Economic Services discussed proposed partial privatization of AA. Government officials responded to members' concern over labour and airport regulation issues relating to partial privatization.
01-02-2005	Government announced that public consultation period on AA's privatization plans will be extended to late-May from the originally scheduled end-February date.

04-03-2005	AA discussed partial privatization proposal with airlines.
14-03-2005	During the second round of public consultation on proposed partial privatization of AA, airlines expressed deep reservations over key issues such as airport's accounting policies and a regulatory and charging structure that could reflect importance of airport to development of local economy.
15-04-2005	Hangzhou Xiaoshan International Airport Co Ltd and AA signed Agreement in Hangzhou for a capital increase subscription to Hangzhou Xiaoshan International Airport Co Ltd by AA.