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The Housing Problem -- A New Perspective

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The most important non-market sector in capitalist Hong Kong is housing. Half the population live in government provided housing at heavily subsidized prices. Long queues of people wait eagerly to get into public housing. The program has often been hailed as a major achievement and as evidence of the positive aspects of intervention.

Many books give a colorful and compassionate account of the origins of the program. It was initiated in the wake of a disastrous fire in a squatter settlement at Shek Kip Mei in December 1953 which, overnight, made 53,000 people homeless. An alternative explanation advanced here is that the program was a response to the devastating consequences of rent control.

At the end of World War II, the government imposed rent control on all pre-war housing. Discrimination against new immigrants was implicit. Between 1945 and 1950, massive immigration from China increased the local population from 600,000 to 2,100,000. Land around the fringes of the urban areas was invaded by the new immigrants. Squatter settlements literally mushroomed overnight.

The process of urban redevelopment was also severely complicated by the imposition of rent control on pre-war housing. The Landlord and Tenancy Ordinance provided that rent on these units could not be raised unless a tenant vacated his premises. In actual practice, the cost of evicting tenants was made prohibitive by the legal process. It became almost impossible to repossess existing premises for reconstruction purposes. This severely limited the incentive for private developers to undertake housing reconstruction during the immediate post-war years. It is a mistake to conclude that this was a case of market failure. A market solution was rendered impossible from the very beginning because of rent control. An interventionist solution in the form of a public housing program soon appeared as a practical solution.

The situation became critical as the economy grew rapidly and housing demand increased. There was growing pressure on government to either (1) resettle squatters in order to clear the illegally occupied squatter settlements, or (2) relax the conditions for evicting tenants for urban redevelopment purposes. The government did both. In fact, the decision to

resettle large numbers of squatters into multi-storied public housing blocks after the fire in December 1953 was taken before the Landlord and Tenancy Ordinance and amended in August 1955.

Rent Control

The situation after 1955 was radically altered. The Buildings Ordinance was amended on December 21, 1955 to permit considerably higher structures. The gains from evicting tenants thus rose dramatically. The pressure to reduce the cost of repossessing buildings for reconstruction purposes mounted. The Landlord and Tenant Ordinance was amended on August 17, 1955. Henceforth, the Tenancy Tribunal was effectively granted the power of eminent domain in reconstruction proposals and the power to determine the rate structure of compensation. The cost of evicting tenants was greatly reduced.

These two amendments together led to a belated surge in housing reconstruction. The tearing down of numerous old premises, which had been delayed for 10 years, within a narrow span of time led to a short-run worsening of the squatter situation as large numbers of tenants were evicted.

Even more disastrous was the decision by the courts to allow the rate structure of compensation to be essentially frozen throughout the period from the late 1950s to the early 1970s. Market rents had meanwhile skyrocketed. Landlords were soon finding it increasingly inexpensive to evict tenants. This set the stage for the rush towards excessive reconstruction. The disastrous building rush between 1962 and 1965 was partly due to the low compensation rate structure, but the principal cause was an oversight in an amendment to the Building Ordinance that occurred in September 1962.

The high intensity of reconstruction between 1955 and 1962 had increased urban congestion, and imposed severe strains on the transportation system and the reprovisioning of utility services. The government then decided to scale down the permitted intensity of development. In September 1962, a plot-ratio amendment was enacted to take effect in October 1962, restricting the ratio of gross floor space to the area of the site. An odd thing happened. The amendment included an escape clause, which allowed any landlord who could apply for reconstruction with a plan before the end of 1965 to be exempt from these new restrictions. Since the amended plot-ratio implied a decrease in the supply of floor space in the future, it was in the interest of the landlord to beat the deadline.

During the period of grace between 1962 and 1966, there was an unprecedented wave of private residential development. The housing market became vastly oversupplied. A series of

bank runs began to occur in 1964. The housing boom had collapsed into a deep depression which lasted from mid-1965 to 1969. The human and economic costs were immeasurable. Subsequently, rent control on post-war housing was also introduced in the 1970s, but its disastrous effects on property values and private housing development prompted government to eventually remove them through a series of policy measures. Today rent control is fortunately no longer important.

Public Housing

The public housing program was introduced to resettle squatters so that land can be reclaimed for urban development. Since income redistribution was not on the agenda, there was little attempt to institute a means test to identify the most needy. At that time most of the squatters were among the most impoverished sectors in society. Consequently, the resettlement program was able to achieve significant redistribution of income at a modest cost to society. Unfortunately, the policy encouraged private housing tenants to become squatters. They were betting on the chance of being offered resettlement.

The government soon found itself in the unending task of resettling squatters. The more people that the government resettled, the more people chose to be squatters. Indeed, surveys of squatters in the late 1950s indicated that about half of them had lived in private housing before becoming squatters. One of the reasons they had opted to live there was because of the crowded conditions in the private sector. These people were not necessarily poor; many were opportunists who were betting on the chance of being resettled. The positive income redistributive features of the public housing program had disappeared.

As the population in public and private housing became increasingly similar in terms of income distribution, pressures mounted for the government to provide housing support for poor tenants in the private housing sector. In 1961, government housing policy began to incorporate such goals. Means tests were introduced for those seeking public housing for poverty reasons. The qualifying income criterion was current family income at the time of admission into the program. Households were not required to subject themselves to subsequent means tests in order to stay in the program. Although this omission avoided certain disincentive effects on work effort, it also made it easier for families to misrepresent their true income and failed to take into account the future income prospects of the family. The program therefore failed to transfer income towards the genuinely poor.

Thus despite massive efforts by the government to provide public housing for the poor and the squatters in the 1970s, the income distribution of renters in public housing was not significantly different from that in private housing even by 1986 (see Table). Indeed, at very

low levels of income, there were proportionately more poor families who were private renters than public renters. This meant that the public housing program would continue to grow because of pressure from poor private renters.

By the mid-1970s, some 45 percent of the population were living in public housing. The program had become very large and expensive, and threatened to become even more so.

Since public housing is an in-kind transfer and tenants are given little choice with respect to location, size, and other characteristics, the actual perceived benefits fall short of the amount of subsidies the government provides. According to two separate estimates obtained for 1981 and 1986, we know that for each dollar the taxpayer spent on the public housing program, only 60 cents worth of benefits were obtained by the tenant. An enormous amount of resources were wasted. In 1981 and 1986, the total efficiency losses were 1.04 and 0.64 percent of gross domestic product for the respective years. The reduction in the inefficiency of the program during the period between 1981 and 1986 is a result of the decline in the subsidy provided by the government.

In 1976, the publicly subsidized Home Ownership Scheme (HOS) and Private Sector Participation Scheme (PSPS) were introduced, whereby flats built by government and private developers were offered for sale to tenants in both public and private housing. One of the aims of the schemes was to shorten the queue for public housing units and to entice well-off public housing tenants to become homeowners. Since the homes were offered at concessionary rates, the government sought to limit profit taking by putting limitations on the resale options available to the homeowners, which naturally reduced their attraction.

The attempt to get the well-off tenants to give up their public housing units was not entirely successful. Many public housing units remained "frozen." To make things worse, many public housing tenants were lobbying for legitimizing the transfer of public housing tenancy rights to their descendants. From the point of view of the public housing tenant, the ownership of a home that entails financial outlays at the outset and cannot be transferred for many years may be inferior to having a permanent claim to public housing tenancy rights. The latter claims were almost risk free, and their value would appreciate over time if the government were perceived to be committed to a policy of replacing current buildings with better structures over time.

In a bid to encourage more well-off tenants to become homeowners, the Housing Authority proposed in 1985 to double public housing rents for tenants who had been in the program for more than 10 years, if their family income exceeded 1.5 times the qualifying income level of new applicants. Initial opposition to the proposals were severe, but the policy

prevailed and achieved its aims.

Nevertheless, the large stock of aspiring homeowners in both the public and private sectors could not be accommodated quickly enough. The competing demands of private renters who could not afford to buy homes and were waiting to join the public housing program also limited the rate of expansion of homeownership because scarce resources had to be spent on the provision of public housing.

The most interesting new development now under consideration by the Housing Authority is to sell some of the public housing units to existing tenants. This policy will naturally be greeted with some apprehension by those whose interests will be adversely affected by the demise of public housing. The tenants, however, will benefit enormously if privatization succeeds. This would require the setting of an attractive selling price with no restrictions on the rights to transfer the property. If the policy materializes, we shall be rediscovering the market after a detour of almost half a century.

Summing Up

By choosing to impose rent control in 1945, the government set in motion a sequence of events whose consequences have continued to plague us. To its credit, the government had the wisdom to remove rent controls, but the public housing program will be much more difficult to get rid of. The Housing Authority is now looking at privatization as a solution. It is seeking to recreate the market which it had gradually destroyed over four long decades.

This account of the history of housing policy attempts to dispel some of the commonly held myths about housing policy, its causes and effects. The story illustrates vividly how one form of market intervention creates the conditions that lead to further intervention. It is only when the scale of intervention becomes so massive, and its ill effects become so apparent, that we come to recognize them as such. But by then so many vested interests have been created that the system becomes almost impossible to reform. The effort to privatize public housing is a courageous one and should be applauded.

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