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Privatise Public Housing

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Editor's Note: The new governor, Mr. Chris Patten, announced that two-thirds of the people in Hong Kong would own their own homes by the year 2001. The statement was dismissed by some as being unrealistic since at present only 41 percent of the population are homeowners. The following analysis shows why the governor's goal may be far too conservative. Indeed, 36.5 percent of the households can become homeowners almost instantly by privatizing existing public housing units, and at little cost to the government.

After health and education, the most important nonmarket sector in free market Hong Kong is housing. In 1991, 576,313 households or 36.5 percent of the domestic households lived in public and aided rental housing blocks at heavily subsidized rents. The public housing program has often been hailed as a major social achievement and as evidence of the positive and necessary aspects of government intervention. Nothing can be further from the truth.

In principle, a public housing program should help the poor and permit them to consume more housing than they would have in its absence. Available evidence shows that this is not the case. In 1981, about 52 percent of the households who lived in public housing were consuming less housing than their counterparts in the private sector with similar income and demographic characteristics. The public housing program was not helping the households to obtain better shelter than what would have been available in their absence. Half the households were worse off in housing terms, but chose to stay in the program because of the cheap rent.

The poor were also not the main beneficiaries of the public housing program. In 1986, the income distribution of renters in public housing was not significantly different from that in private housing (see Table 1). Indeed, at very low levels of income, there were proportionately more poor families who were private renters than public renters. This meant that there would be continuing pressure to expand the public housing program because of pressure from poor private renters. The long queues of people waiting eagerly to get into public housing is clear evidence to this effect.

Attempts were made to encourage the well-off tenants to give up their public housing

units through operating Homeownership Schemes and Private Sector Participation Schemes. In a further 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. These schemes were subsidized by the government, but there were severe restrictions that prevented the units from being freely transferred on the market. 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 on public housing tenancy rights. The latter claims are almost risk free, and their value may appreciate over time if the government is perceived to be committed to a policy of replacing current buildings with better structures over time.

TABLE 1
Distribution of Households by Income in 1986

Household Income (\$)	Private renters		Public renters	
	Percent	Cumulative Percent	Percent	Cumulative Percent
0-999	3.23		1.68	
1,000-1,999	9.64	12.87	4.56	6.24
2,000-2,999	14.81	27.68	10.17	16.41
3,000-3,999	17.08	44.76	18.10	34.51
4,000-4,999	12.39	57.15	16.20	50.71
5,000-5,999	9.09	66.24	12.49	63.20
6,000-6,999	6.85	73.09	9.58	72.78
7,000-7,999	5.02	78.11	6.50	79.28
8,000-8,999	4.36	82.47	5.61	84.89
9,000-9,999	2.57	85.04	4.21	89.10
10,000-11,999	4.44	89.48	4.94	94.04
12,000-14,999	3.15	92.63	3.62	97.66
15,000-19,999	3.23	95.86	1.78	99.44
20,000-	4.14	100.00	0.57	100.00

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 of the limited resources that were available to the Housing Authority, which had to maintain a balance between the provision of public housing and homeownership units.

The Housing Authority has recently proposed a limited program to sell some of its public housing units to current tenants. This is by far the most interesting initiative of the Housing Authority to date. Various grass root organizations concerned with public housing have reacted negatively to the proposal. They accuse the government of relinquishing its

commitment to house the poor. Public housing tenants were more concerned about the price at which government would sell the units. In the end, the tenants refused to accept the offer even when the units were being offered at 43 percent of the estimated market price. The Housing Authority is now apparently reconsidering its offer with the possibility of giving an even more generous offer.

The real reason the tenants refused to take up the offer made by the Housing Authority was simple: There were severe limitations imposed on the resale options. These limitations were similar to those imposed on the sale of Home Ownership Scheme flats. They reduced enormously the value of the flat as a transferrable asset. Everyone knows that an asset which cannot be transferred on the open market can only be sold at a deep discount to its true market value. It would be logical for most tenants to be unwilling to pay more than the present value of their expected rental expenditures if they are unable to reap any capital gain when they sell the asset.

Indeed, it may be more in their interest to remain as a public housing tenant and retain the benefits that accrue from a permanent entitlement. They can at least look forward to lobbying the government to improve housing over time as the economy prospers. The reason the initial sale of public housing units failed is therefore not that the price was not cheap enough, or that the tenants could not afford it, or that the quality of the units was not good enough, but simply that the tenants were unwilling to trade a valuable permanent entitlement for an asset whose market value would be limited by transfer restrictions.

It is important to recognize that public housing is a transfer-in-kind rather than a cash subsidy. Tenants had little choice with respect to location, size, and other housing characteristics when they took up the units. They either accepted the offer or went back into the queue and waited for an uncertain period until they would be called again. Therefore acceptance of an unit does not imply that you value it at its full market value, but only that the rent is so cheap that you are willing to tolerate all the unpleasant and inconvenient aspects of accepting the offer. For example, if someone who works in Aberdeen gets a public housing unit in Tuen Mun, he will not value the unit as much as someone who works in Tuen Mun.

According to two separate estimates obtained for 1981 and 1986, we know that on average the public housing tenant values that unit in which he lives in at only 58.7 percent and 64.7 percent of the market value of it. In other words, 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. The total losses to society as a whole can be derived from the efficiency estimates of the housing program. For 1981 and 1986, they amounted to 1.18 and 0.48 percent of gross domestic product for the respective years. This is

a huge amount of wasted resource, and that waste stems from the fact that public housing units are not provided by the market.

The key question for privatization to succeed is therefore transferability. If the units could be freely transferred after the tenant acquires it, then an initial selling price set at 43 percent of the market price as originally proposed by the Housing Authority would be attractive. The tenants would have implicitly received a capital gain equal to 57 percent of the value of the unit. One would be foolish not to accept it. Banks would be willing to offer mortgages of up to 100 percent of the initial sale price since they would have as security an asset whose value is substantially higher. There would be little need for making an initial downpayment.

With privatization, the ex-tenant could also sell his unit at the market price, but what can he purchase in return? For the typical public housing ex-tenant, most existing private housing units are beyond his budget. The ex-tenant who wishes to relocate is compelled to choose from other privatized public housing units. If only a small proportion is privatized, then ex-tenants who wish to relocate will have a very limited choice. The full benefits of privatization are realized only when the vast majority of the public housing units are sold off. Administratively this would of course take time.

There may be some concern that allowing public housing tenants, who have already benefited from living in subsidized housing for so many years, to further benefit from capital gains through privatization today is unfair to those who have been deprived of both benefits. While the concern appears reasonable, this is not an excuse for not going ahead with privatization. A greater injustice is perpetuated by wasting vast amounts of resources tied down in public housing estates that have no alternative use. Those who live in private housing have little to gain and much to lose from refusing to privatize public housing units. Privatization will make available to the Housing Authority vast resources through the sale of public housing units, so that private tenants and those in temporary housing can look forward to faster provision of both public housing and homeownership units.

Privatization will immediately make available to society an enormous amount of resources locked in nontransferable housing units. The benefits will not be limited to those who live in public housing, but will spill over to all households. This is a more effective and efficient initiative to help households in the sandwich class. Any attempt to operate a subsidized homeownership program for the sandwich class is not only expensive, but will inevitably lead to massive fraud and social injustice. In 1991, households in the income bracket between HK\$18,000 and 40,000 numbered 257,540. Of these, there were 156,345 homeowners, 58,002 public housing tenants, and 31,021 private housing tenants. The

incentive for some existing homeowners to sell their units in order to qualify for any new program targeted at the sandwich class is substantial. The cost of distinguishing between the genuine and nongenuine sandwich class will be enormous. If the Housing Authority has failed to screen people effectively for the public housing program, what assurance can we have that it will do a better job with the more difficult task involving the sandwich class?

Alternatively, with the privatization of close to 600,000 public housing units, one can look forward to creating a society of genuine homeowners within a realistic time span. What policy can be more genuinely equitable at so little cost? A society of homeowners contributes enormously to social stability. Unlike public housing tenants who lobby incessantly for transfers in their favor by robbing others in the name of social justice, homeowners have a stake in defending and striving to strengthen the integrity of private property rights. The government has nothing to lose by privatizing public housing. Land on which these massive estates sit has already been given away; it is merely a matter of allowing the estates to realize their full market worth. Society, on the other hand, has much to gain from acquiring such vast amounts of wealth. Indeed, at a time of high inflation induced by structural transformation of the economy, privatization would at one stroke create an asset that can hedge against the ill effects of inflation for more than one-third of the population.

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