

# **The Visible Hand in the 'Freest' Economy: Public Housing in Hong Kong (Summarized Version)**

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## **Abstract:**

A Continuous Flow of Refugees from Communist China after World War II had led to a population explosion in Hong Kong. With a population of just over a million not too long after the War, this tiny territory of 1097 square kilometers is now the home to 6.6 million people. Nevertheless, as Milton Friedman puts it, Hong Kong is the freest economy of the world. Yet, the government controls 88% of the land, and runs more than 50% of the housing stock. How did this massive visible hand come to pass, and what are the problems associated with it? This paper reviews these dramatic experiences, and tries to summarise any lesson we might have ever learnt.

**Keywords:** land auctions, rent control, refugees, housing authority, land supply

## **(1) Land Sales and Government Finance**

The clear benefit, of financing government expenditure by selling land leases, is that taxes are kept low. Hong Kong imposes no tariffs, quotas, embargoes on imports and exports, or taxes on interests, sales, or capital gains. The major taxes in Hong Kong are on income, profit, and property, which are currently between 15 to 16%.

## **(2) Refugees and Rent**

The main drawback of the long-term reliance on land sales is the tendency of high rentals. To ensure a steady income, the government tends not to sell a lot of land within any one period as this will flood the market. This leads to under-supply and higher rentals<sup>1</sup>.

High rents are not too serious a problem for those who could afford it, but not for refugees. The political environment in main land China had not been stable for the last two centuries. There were the Tai Ping Rebellion (1850), the Chinese Revolution (1911), the Japanese Declaration of War on China (1937), World War II (1939-1945), the Civil War and the rise of Communist China (1949), the Peoples' Communes (1953), the Great Leap Forward (1958), and the Cultural Revolution (1966). Refugees flooded Hong Kong from time to time. Without a penny in their pockets, many of them had to squat along the hillsides or simply sleep under stairways. For those who could find a job, they had to pay the majority of their income for a tiny bed space.

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<sup>1</sup> Steven Cheung argued that considering the high rents we pay, taxes in Hong Kong are never as low as 15%. People have to spend 30% to 50% of their income on rents or mortgages.

### **(3) The Postwar Population Explosion**

Tenement buildings, which either survived World War II or were reconstructed shortly after, were typically 4 stories high<sup>2</sup>. The frontages were 4-meter wide, and buildings were joined together by party walls in order to save construction materials and space. Windows were only available at the front and the rear, but not on both sides. Each level of the building was about 50 square meters, which would be sub-divided into 4 or 5 rooms by stud partitions, on which the top portions were left open for ventilation. After deducting floor areas for a stair, a corridor, a tiny common kitchen and a minimum shower space from the 50 square meters, each room would just allow the space of a single bed and this would accommodate the entire family. In many cases a bunk bed was used instead. The average family size in 1954 was estimated as 4.3.<sup>3</sup> In cases of large families, a single bed would have to be shared by a family of 6 or 7. In some extreme cases, a single bed space could be rented to three different tenants each of whom would be entitled to one shift based on a 3-shift daily rotation.

Even this kind of space was expensive. Rent for a tiny room might cost more than half the family's income. The free market rent, at one time, cost ten times the controlled rent. Those who were enjoying the small controlled rent would be more than reluctant to move out. Moreover, they often sublet it to a number of other subtenants, or sub-subtenants. The larger the number of tenants and subtenants in one single block, the more difficult it was for landlords to negotiate compensations to sitting tenants for the reason of reconstruction. Together with the postwar fragmentation of ownership in one single block, it led to the never-ending problem of urban decays.

### **(4) Squatters on Fire**

The alternative to squeezing the entire family into one single bed space was squatters along the hillsides. There were 260,000 squatters in Hong Kong in 1954.<sup>4</sup> Besides the problem of hygiene and crime, the biggest problem was the risk of fire. Temporary structures of tin and timber were highly combustible. Thousands of people might become homeless overnight.

The first public organization to deal the housing problem after the war was in fact not initiated by the government, but by the church. In 1948, a prominent leader of the Hong Kong Social Welfare Council, Anglican Bishop Ronald Hall, asked the Council to use the £14,000 donation from Lord Mayor of London to launch a society to build homes for workers and refugees.

Eventually, this led to the formation of the Hong Kong Housing Society. The government offered a 40-year \$2.5 million loan at low interests rates of 3 to 5% for the Society's first

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<sup>2</sup> This frontage was dictated by the common length of the fir timber available in southern China, which spanned across the party walls.

<sup>3</sup> See Cheung, Steven N.S., *Rent Control and Housing Reconstruction: The Postwar Experiences of Prewar Premises in Hong Kong*, Journal of Law and Economics, April 1979.p.31.

<sup>4</sup> *Hong Kong Annual Report*, 1954, p.3

project, together with a site at one third market value. A few years later, 360 flats in 5 blocks were built in 1952<sup>5</sup> on the basis of 3.25m<sup>2</sup> of usable floor space per adult and half for children under the age of 10.<sup>6</sup> This project “was wildly hailed as a paradise compared with existing tenement housing”<sup>7</sup> or squatters. Facilities like balconies, gardens surrounding the blocks, and children play areas had left the first tenants in awe. Unfortunately, the speed of construction was far too slow to meet the pressing demands.

On the Christmas Night of 1953, a serious fire broke out in the squatters of Shek Kip Mei, a popular squatting location as it was adjacent to factories in Sham Shui Po. Some 53,000 people became homeless overnight.<sup>8</sup> The colonial government had no choice but to step in. The Housing Authority was set up in 1954 to construct fast track, H-shape, 7 stories buildings called resettlement blocks. They could be built at the average rate of one block every 10 days.

In the late fifties, the Hong Kong Government took a good hard look at the housing problem. Mao’s series of political revolutions were not likely to end in the near future. The population problem was here to stay. The government also decided that there was no point in lending more money to voluntary organisations. Confidence in building resettlement blocks since 1953 enabled the government to propose a White Paper in 1964. It set out the ambitious plans to resettle 1.9 million people in 10 years at the cost of \$1,700 million, and at the same time to house another 290,000 in low cost housing units at the cost of \$353 million.

### **(5) The Housing Authority**

This was how the biggest visible hand in the freest economy emerged. Yet in this very beginning, the long term burden of these public rental housing was never foreseen.

Since 1954, the Housing Authority had always been expanding, following closely to what the Parkinson’s Law<sup>9</sup> has to say. Housing designs became more sophisticated, and more costly. By 1999, the Authority hires 14,400 employees and spends the vast majority of the annual government housing budget of HK\$47 billion a year. They have all types of employees all under one roof, from directors, architects, engineers, surveyors, public relations officers, marketing managers, housing managers, watchmen, down to janitors. There are 8,736 staff on management, 2,009 on marketing, 1,546 on construction, 1,091 on commercial development, 807 on corporate services and 204 on accounting. It provides housing for 3.2 million people<sup>10</sup>, or 52% of the total population.<sup>11</sup> Dr. Rosanna Wong (who subsequently resigned in June 2000), Chairman of the Housing Authority,

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<sup>5</sup> Hutcheon, Robin, *High-Rise Society: The First 50 Years of the Hong Kong Housing Society*, Chinese University Press, 1998, p.4-6.

<sup>6</sup> Pryor, E.G., *Housing in Hong Kong*, Oxford, 1973, p.24.

<sup>7</sup> See Hutcheon, *Ibid.*, p.6.

<sup>8</sup> The Hong Kong Annual Report, 1954, p.131.

<sup>9</sup> See Parkinson, C.N., *Parkinson’s Law, or the Pursuit of Progress*. John Murray 1958.

<sup>10</sup> The *Hong Kong Housing Authority Annual Report* 1999. Hong Kong: Government Printer, 1999.

<sup>11</sup> The majority of these housing are rented to low income families.

openly admitted that the Authority has become a “big elephant”. Yet the Authority’s current plan is still further long-term expansions<sup>12</sup>.

To evaluate the financial efficiency of public rental housing, a rough analysis is sufficient for an overall picture. In 1999, there were 645,329 family units of subsidised rental housing, which were run at a deficit. Assuming that the medium term rental housing target is rounded as 800,000 units, the government annual housing budget of HK\$ 43 billion<sup>13</sup> would give an average subsidy of \$53,750 per family per annum, including both capital and recurrent costs. Land is provided free by the government, but the *opportunity* cost of selling these development sites to private developers ranges, depending on locations, from \$15,000 to \$35,000 per square meter of allowable gross floor area. Taking the minimum land value of \$15,000 would still imply a minimum land subsidy \$675,000 per unit. Using a long-term interest rate of, say, 5% per annum, the annual land subsidy is in the order of \$33,750.

Hence, the total government subsidies including land is \$87,500 per family per annum, or \$7,300 per month. Even with these subsidies, the average family has to pay, out of their own pockets, a monthly rent of \$1,300 to the Authority. This implies that the total subsidy to each family amounts to \$8,600 per month (or USD 1100 for a 35 square meters flat per month). With this money, the family could rent a newer flat, 50% bigger, professionally managed, with much more amenities and modern facilities, and much better maintenance in the private housing market, where much wider choices are available.

On top of the problem of financial viability, tenants are facing the endless problems of poor quality, maintenance, and inefficiencies in design and management. Mr. Miller, the Director of the Housing Authority, openly admitted that the Authority received around 7,200 formal complaints in 1998, and has topped the Ombudsman’s Complaint Chart.<sup>14</sup> Water leakage, the falling off of tiles and plastering, defective wiring, cracks, or pavements being opened up with no work in progress are the everyday lives of the tenants. An internal assessment of the strength of concrete in the Authority’s existing housing blocks reviewed that 85% of the 843 blocks under assessment were below standard, and they were mostly constructed in the seventies. Some of the concrete could only resist 2.4MPA, while the designed strength was 20MPA. The Authority had no choice but to demolish 26 blocks, in which the concrete is 50% below the designed strength. These were all done in the excuse of a housing renewal program. Yet the youngest one of these blocks was only 15, while the average 18 years.

Perhaps the most scandalous of all was the discovery of defective plies. In March 1999, the Independent Commission Against Corruption arrested ten people in connection

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<sup>12</sup> In a seminar at the University of Hong Kong in 1999, Dr. Rosanna Wong, Chairman of the Housing Authority, openly admitted that the Authority was a “big elephant”, yet they still needed more money from the government as there were “needs to be satisfied”.

<sup>13</sup> HK\$3.8 billion out of the total housing budget of 47 billion has been used to finance Hong Kong Housing Society’s projects.

<sup>14</sup> The Hong Kong Housing Authority Press Release on 6 December 1999. See <http://www.info.gov.hk/hd/eng/achive/p061299.htm>

of a suspected bribery case on substandard piling works: some of them built shorter than designed and others stuffed with unwanted materials. Construction managers were fired and the public was alarmed. By March 2000, non-compliance of piles had been reported in six major construction sites in Tung Chung<sup>15</sup>, Yau Tong and Shatin. This forced the Authority to hire an independent group of consultants to completely re-assess the foundations of 364 housing blocks in 105 projects under construction. Yet structural consultants could not firmly conclude that all of these buildings are safe. Instead, they said that six particular blocks of flats require continuously building monitoring. On March 16, 2000, the Authority had to decided to tear down two blocks on one of these sites in Shatin, which had been built to the 34<sup>th</sup> of a planned 41 floors. Beneath these two blocks, only 4 out of 36 plies were found up to standard. In the mean time, the sale of flats built by the Authority was seriously under-subscribed despite big discounts offered on their prices.

The low mobility of tenants is another serious problem. Families which have become better off, and some even own their own private flats, refuse to move out or pay higher rents, as requested by the Authority. People emigrating overseas who should have “handed back” their units deliberately ignore to inform the Authority thus causing serious under-occupation. Families getting smaller in size, e.g. because of children having grown up or getting married, refuse to move to smaller flats. Consequentially, old people residing at city centers are reluctant to be re-located to sub-urban areas, while young families are forced to live far away from city centers, and thus have to commute to work or to schools. All these exert enormous pressures on the transportation network. Parents spending long hours in commuting either have to leave their kids alone or to let them wander in the streets. In these massive housing estates, gangsters find it much easier to gather young people from the streets, organise them for drug deals and other crimes.

Political parties, on the other hand, consider rental housing estates their permanent source of votes. They keep organising tenants to fight against any proposal of increasing fees or rentals. Housing, originally an economic problem of settling the homeless by means of limited resources, now becomes a permanent political issue.

The alternatives to public housing were never seriously discussed until the Authority had become too large, the qualities of construction too poor, and political forces too deep rooted for changes. The visible hand might have grown too big before the government suddenly realised that privatisation schemes were necessary.

A pilot scheme was launched in 1991 to sell rental flats to sitting tenants, and was poorly responded. Tenants protested that sale prices were too high and worried about the burden of high maintenance costs on the poor quality buildings. Moreover, stringent restrictions on reselling the flat in the market were imposed. If a buyer has to sell his flat within five years, he could sell it only back to the Authority at the original purchase price; and from five years to ten, at the current price dictated by the then current scheme of the Authority. If he were to sell it to the open market after ten years, he has to pay a

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<sup>15</sup> On May 27, 2000, 2 to 3% of the steel reinforcement bars in the superstructure of these blocks in Tung Chung were found to be below standard strengths. See Ming Pao Daily, p.A1, 28 May 2000.

substantial portion of the selling price to the Authority, according to the respective percentage market discount on the original sale price charged by the Authority. These restrictions were justified as means to “prevent speculative activities”, yet to the tenants, the Authority had been successful in making the scheme prohibitive. Another scheme with less resale restriction was launched in 1997, and responses were a little better. Nevertheless, the long-term maintenance problem was still the biggest threat to sitting tenants. Compared to the overwhelming number of public rental flats, the potential purchasers were a small minority.

Comparing to the Authority’s public housing and sales flats, in which 49.5% of the population of Hong Kong now live, other alternatives to the government-subsidised housing were also the minority. Low interest loans to the Housing Society for the construction of rental flats only accommodate 1.8% of the total population. Sale flats, loan schemes to sandwich class, and other schemes of the Society house only 0.6% in 1997.

From a cost-effectiveness point of view, public rental housing, which is now the home for 40% of the population, is the largest long-term financial burden. In addition, tenants suffers poorer qualities of accommodation, lower social status, and more importantly, there are more serious social, political and mobility problems. The underlying reasons for such a dominance of public rental housing are lessons deserving special attention.

#### **(6) Government ownership of land**

As we have discussed earlier, a long-term financial dependence on land sales implies a tendency of high rents due to a small land supply. The majority of land being held as the government land stock would mostly be under-utilized. Figures in 1953 shows that build-up areas constituted only 15.7% of the entire territory of 1,060 square kilometers. With continuously reclamation, the total area of the territory grew to 1,097 square kilometers in 1998, yet the percentage built-up land only increased to 16.3%, and only 4% are for private residential land use. Although woodlands, grass and scrub, badlands, swamp and mangrove constitute the majority (71.3%), it is accurate to say that the government still controls 88% of the land stock.<sup>16</sup> A recent success of an application to develop a large swamp area rejects the earlier saying that this 71.3% land is not financially feasible for development.<sup>17</sup> Nevertheless, vacant development sites constitute 3.7% of the territory in 1997 and are clearly ready for development. If these vacant sites were developed for homes, residential land use would be doubled. Yet the government has been keeping this valuable asset, plus all other potential sites, in its land bank for future sales.

It is difficult, in not impossible, to assess the level of land prices if the government were to sell its entire stock. Nevertheless, if the majority of land stock were owned by private sector, the housing problem would have been much less serious. A simple calculation will help to illustrate the point.

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<sup>16</sup> *Hong Kong Annual Report*, 1953, p.26; and 1998, p.470.

<sup>17</sup> See *Ming Pao Daily*, 30 May 2000, p. A8.

In 1961, the Housing Society needed on average \$2500 to house one person, and the government \$1200 by means of low cost housing. Presumably, the difference between the two figures, \$1,300, was roughly attributed to the sum of (a) one-third market value for land, and (b) the loan interests of 3 to 5% paid to government. An average family of five had to pay a monthly rent of \$30 in order that the Society could balance the books. This means that if the market land value were to drop by two-thirds due to an increase in land supply, then a development project would be feasible to the working class if they could afford an extra rent to cover the difference between the market and subsidised interest. This interest differential was around 3% per annum in the fifties. A \$2,500 loan would therefore imply additional interest of \$75 per annum, or \$6.25 per month per person. A family of 5 would be required to pay an addition of \$31.25 per month, or in total roughly doubling the Society's monthly rental of \$30. The monthly wage for a skilled workman in the late fifties was around \$200. A monthly rent of \$60 would be 30% of his family income, which would apparently be affordable to him. However, with full land value under a land stock control policy, private development would cost at least a rent 2 or 3 times higher: a sum apparently not affordable to him. This also explains why they had to squeeze the family into a single bed space.

Unfortunately, earlier data in the fifties were not sufficient to allow a numerical analysis of the land stock and land prices during this initial stage of the Housing Authority. Yet in a statistical analysis of land prices from 1986 to 1997,<sup>18</sup> it is estimated that it takes the government to sell 66 of hectares residential land per annum in order to lower the land prices by two-thirds from its peak. During the same period, the government was on average selling only 17 hectares per annum. With a readily available stock of 4,100 hectares, the government could have been able to sell much more.

After all, to satisfy the housing demand, the control of land stock would not have been necessary, if the majority of land were privately owned in the first place.

### **(7) The Real Estate and Building Booms**

With this long-term shortage of land supply in the market, a series of building booms was experienced after the war. The first started in the early sixties. It was basically due to the influx of refugees on one hand, and a release of building heights on the other. With the introduction of elevators after the war, buildings got higher and higher. In 1956, a new building ordinance was enacted, allowing buildings to rise a height with a main wall facing the street not exceeding 76 degrees from the horizontal. The average height of newly constructed buildings sharply rose from 3 to 4 stories to an average of 8.85 stories from 1957 to 1962. In 1962, a 'plot-ratio'<sup>19</sup> amendment was enacted to reduce the allowable floor areas considerably. Applications for re-construction flooded the Building Authority before the 1962 amendment was actually enforced at two stages in 1963 and 1966.<sup>20</sup> A construction boom was triggered.

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<sup>18</sup> See Wong, Chau and Ma (1999), *The Disposal of the Hong Kong Land Stock under the Sino-British Joint Declaration*, *Journal of Property Research*, v.16, no.4, Dec 1999, p.325-331.

<sup>19</sup> The ratio of total gross floor area to site area.

<sup>20</sup> See Cheung (1979), p.42 ff, for a full discussion on the effects of these building regulations.

The percentage income from land sales to the total government revenue rose from 1.48% in 1951 to a record high level of 16.61% in 1962. The respective income of land sales, ground rents together with other land related income rose to 23.57%. The cost of new buildings reached its peak in 1966, with a record high value of \$1,058 million.<sup>21</sup> Incidentally, with a shortage of water supply from the mainland, there were continuous rumors that contractors had been using salted seawater in concrete construction in the sixties.

The construction craze was severely interrupted by the outbreak of the Cultural Revolution in China in 1966. By 1967, the relations between the Colonial Government and left-wing labor unions in Hong Kong were very tense. Riots broke out. Rumors of Communist take-over were plenty. Land and stock prices dropped like a rock. In 1968, land sales income contributed only 1.92% of government revenues.

The economy soon recovered from the 1967 political instability. With the development of banking and financial sectors of the economy in the early seventies, a second property boom was on its way. The percentage of government revenue derived from land sales rose back to 8.85% in 1970. This percentage kept rising to a new record of 35.2% in 1980, and 27.3% in 1981. But when China and Britain negotiated over future of Hong Kong, a confidence crisis was aroused in 1983. Revenue from land sales dropped to 12% in that particular year. Worst still, the Sino-British Joint Declaration in 1984 on the future of Hong Kong restricted government disposal of land from 1986 to 1997 to only 50 hectares per annum, including land for public use. This was far below the fast growing need of the economy, especially when China had been opening her door to the modern world since 1980. Revenue derived from land sales therefore rose sharply after 1985, and eventually to 26% in 1995.<sup>22</sup>

The government was challenged for adopting a “high land price” policy. The percentage of land stock controlled by the government had always been an overwhelming majority of 88%, where residential land in the private sector is only 4%. Land supply has always been in full control of the government ever since the beginning of the colonial days.

With all these problems of financial dependence, limited land supply, refugees, high rents, and squatters, the biggest visible hand in the freest economy have one last strong reason to stay. Continuous capital incomes derived from land sales provide a substantial and continuous budget available for common exploitation. When the government launched the massive plan in 1964 to expand the Housing Authority in order to build homes for 1.9 million people, Hong Kong was in the middle of a building boom. And this was no coincidence. Land sales income had just hit a record high of \$208 million in 1962, and \$195 million in 1963, contributing 14 to 16% to the government revenue. In other

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<sup>21</sup> *Hong Kong Annual Report*, 1972, p.94; and percentages figures in the financial appendices of 1950-1995.

<sup>22</sup> Half of these land sales incomes went to a Land Fund, as required by the Sino-British Joint Declaration in 1984. See discussions in Wong K.C., Chau, K.W., and Ma, S.M., (1999), p.329.



words, there was money to spend. Even without a democratic political environment at that time, pressures from all walks of life could filter through the government machinery, forcing them to use the incomes for public housing.

Property booms came one after another. The economy was developing continuously. Constant revenues from land sales have enabled the Authority to grow bigger and bigger. Political and special interest groups now simply claim public housing a welfare the government must pay for. The development of democracy after the colonial rule, together with politics over the housing issue, have let the Authority to grow much beyond its economies of scale. Public funds were simply dissipated away.

### **(8) Conclusion**

In a nutshell, the biggest visible hand in the freest economy has come to pass simply because the government owns the overwhelming majority of land. With private ownership of land, there would not have been a serious under supply of sites for profitable development, or the need for the government to give a big helping hand. Public housing has become so large an operation that all citizens in Hong Kong have to bear its burdens: a 43 billion annual budget, poor quality, defective construction, inefficient maintenance and management services, a low tenant mobility, as well as an under utilization of the scarce land resource. The low rent enjoyed by the sitting tenants, together with a concentrated supply of votes for political parties, makes it rather impossible to rectify. The Housing Authority, originally a temporary solution intended for the refugees in the fifties, has now become a permanent burden to the government. Unfortunately, incomes derived from land sales still form a significant portion of government revenues.

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