

Hong Kong Land for Hong Kong People

Fixing the Failures of Our Housing Policy

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Preface

This is my second collection of essays on social and economic affairs in Hong Kong. In this volume I focus on land, property, and housing issues, which I began to study 30 years ago. As my understanding has grown over the years, I have concluded that land, property, and housing are the central factors impacting economic growth and economic equality in Hong Kong. Moreover, they are relatively easy to put right. I believe that doing so will bring considerable immediate political benefits for our society as well as longer-term economic and social benefits, and it will help to address one of Hong Kong's deep economic and social contradictions: the need to accommodate the conflicting requirements of dual integration with the global economy and the economic opening of the Chinese Mainland.

I will explain how a simple set of policies that requires hardly any new resources, creates no losers, contributes to economic growth, promotes economic equality, and fosters social harmony and political stability can address Hong Kong's deep contradictions. All the government has to do is to sell public rental housing units to the sitting tenant, provide a more generous subsidy through land premiums, and reform the public sector housing program along the lines of the Singapore Housing Development Board's approach. Adopting these policies would release valuable public resources now committed to housing development that can be used to address other pressing issues, such as health care, that an ageing population needs badly.

Over the years I have spent considerable time explaining my ideas and analyses to politicians, officials, legislators, opinion makers, other academics, entrepreneurs, property developers, and ordinary people. I have received two types of reactions.

There are those who do not like my ideas because they think half of society (the haves, I presume) would not agree to give the other half (the have-nots?) such a big free lunch. But they fall silent when I tell them the capital gains reaped by the haves in the past decades have also been free lunches.

Some tell me my ideas have been tried before and many tenants are not interested in buying their units. But they fall silent when I tell them previous attempts have not allowed tenants to sell the unit they owned on the open market without first settling

an exorbitant unpaid land premium, which effectively taxes away most of the capital gains they achieved.

Others tell me managing an estate with owners and tenants is complicated, that, in short, my ideas are troublesome to put into practice. But I have not found out what exactly are these difficulties they mention. In the private housing estate where I live, there is also a mixture of owners and tenants. I suppose the housing managers must consider the residents a rather nasty bunch to deal with, especially when it is time to negotiate management fees.

Then there are those who say they like my ideas and agree with my analysis. I hope they will get to implement them and overcome the opposition and vested interests before it is too late.

The first of the essays is an article I wrote in 1997, when I was asked to reflect on the challenges and opportunities that Hong Kong would face after the handover. At that time, I thought there were four challenges, and I chose to write about two of them: housing and population. Sadly, the concerns I raised then have not been addressed, and the challenges they bring to Hong Kong have deepened. This book focuses on the challenge of housing. The population challenge, and specifically the issue of immigrants from the Mainland, has to be taken up in a future publication.

In preparing this collection of essays I am fortunate to have the unfailing support of Ms. Kathy Griffin to help me edit my drafts and turn them into the clear, crisp manuscript you see today. Dr. Tsui Sio-Ming, my former University of Chicago schoolmate and apartment mate, translated my first drafts into Chinese and provided numerous editorial improvements. Ms. Ginnie Tsoi Sio-Wai provided superb research support in finding information and analyzing data at very short notice. Mrs. Diane Law managed the production process in getting these essays edited and completed. Mr. Chan King-Cheung of the *Hong Kong Economic Journal* and his editors worked on the drafts that I first published in their newspaper. Two anonymous referees provided valuable comments and suggestions for improvement. *The South China Morning Post* gave kind permission to reproduce an earlier article of mine in this volume. The Hong Kong Centre for Economic Research provided invaluable support and sponsorship for this project. This work would not have been possible without the enormous sacrifices made by my family. My wife, Jane, and two children, Michael and Christina, had to endure long periods of my absence and silence in order for me to finish each draft. To you all, I thank you from the bottom of my heart.

Yue Chim Richard Wong

May 2014

1

Time to Count the Social Cost of Uniting a People Divided

May 1997

The world's interest in Hong Kong in the months ahead will be focused on the political transition that will take place. As Hong Kong comes under the political microscope, every event and act will be scrutinized for clues about whether the promise of "one country, two systems" will be honored and, indeed, survive the 50 years guaranteed by the Joint Declaration and enshrined in the Basic Law. By any yardstick, 1997 will be a significant year for the future of both Hong Kong and China. However, the economic and social forces unleashed in 1979 in China's open door policy and Hong Kong's response to them may ultimately determine our fate.

China's opening has had a momentous and highly visible impact on Hong Kong. Within a span of 18 months between 1978 and 1980, some 300,000 individuals crossed the border into Hong Kong. The impact on labor market conditions was swift. Real wages failed to grow for several years, but Hong Kong's labor-intensive manufacturing industries received a new lease on life as competitiveness was restored with the injection of a new army of workers.

Nevertheless, the sudden influx quickly led to an agreement between Chinese and Hong Kong authorities to regulate and limit the flow to 75 individuals per day as a result of public concern over the consequences to labor markets, social-educational provisions, housing, health care, and infrastructure services. Although the number of one-way entry permit border crossers has been increased to 150 over time, illegal flow continues to be a permanent problem.

The fear of population inflows from the Mainland is a cause of anxiety to many local residents. However, there is a clear difference in the attitudes of capital and labor towards such inflows. The fact that everyone in Hong Kong must carry an official identity card at all times and police are empowered to check it in public is a constant reminder to all that political factors are not the only threats to civil liberties.

The opening of China began to have a more perceptible impact on the economy as our manufacturing base migrated northwards across the border. At its peak, our manufacturing enterprises employed some 900,000 workers in Hong Kong. Today,

they reportedly employ as many as 6 million workers on the Mainland and fewer than 250,000 in Hong Kong.

These changes have important social dimensions that have had an enormous impact on the lives of individuals and families in Hong Kong. As many as 500,000 workers have had to seek new jobs in service industries due to the loss of manufacturing jobs, and many of those workers are middle-aged. Organized labor in Hong Kong has since found an enduring agenda in hostility to free-market labor inflows—an alien concept throughout the history of Hong Kong—where most inhabitants before the war were sojourners and those after the war first- or second-generation immigrants.

Today, hundreds of thousands of individuals in our workforce commute regularly across the border to work on the Mainland, and millions from Hong Kong enter China every year for short visits. As social and economic contacts continue to grow, a rising number of marriages are taking place between Hong Kong and Mainland residents.

The presence of draconian laws to limit the flow of individuals from China into Hong Kong has created a heartrenching phenomenon. An increasing number of families now have members who are forced to live apart for years, separated by a border. The sight of children and mothers torn from their loved ones and forcibly repatriated to the Mainland is a familiar one on television. They, too, remind us that civil liberties are not limited to politics.

The human cost is immense today. Tomorrow it will be even more staggering as numbers and the prolonged agony of those waiting to be united keep growing. It is inconceivable how people living in two economies and societies so close to each other with such intense contact will fail to develop closer ties and relations.

Divided families lead eventually to a society of alienated individuals, fostering social divisiveness. The day of reckoning for Hong Kong will arrive when the social pressures of a distorted family life, a lonely and isolated childhood, maladjusted youth, and lasting memories of despair, humiliation, anxiety, and unfulfilled promises finally erupt in full force. Hong Kong will pay dearly for its current policies to regulate and limit population inflows.

I cannot imagine how any amount of social welfare spending can heal the scars from these self-inflicted wounds. And if society erupts, the civil liberties and economic freedoms that are so dear to Hong Kong will fall by the wayside to be eclipsed by a culture of authoritarianism, paternalism, and social welfarism.

If these views appear to be alarmist, it is useful to remind ourselves that not too long ago we witnessed a sort of pre-staging that took the form of the “great society” undertakings of former governor, now Lord, Murray MacLehose, who took charge of Hong Kong in 1971 in the wake of the civil disturbances of 1967–68. Even if society does not erupt dramatically with deft management, the drift towards the great society will be difficult to resist.

In contrast to the worrying social forces that have been released by the opening of China, the economic impact on Hong Kong is far more positive. The enormous complementarities between the Mainland and Hong Kong have created numerous opportunities for economic cooperation to the benefit of both Hong Kong and the Mainland. These developments are so well known to the people of Hong Kong that any further elaboration here would add little value.

Nevertheless, the huge economic strides made by Hong Kong have a price. Inflation is now a permanent feature of an economy that is always operating at full capacity, even during cyclical downturns. The capacity constraint is to a large measure a result of the policy to regulate and limit the inflow of population and labor from the Mainland.

The damaging effects of inflation are most serious in its impact on savings. Families in Hong Kong have little choice but to buy property as a means to protect their savings, thereby further fueling property prices in a market already suffering from severe shortages. Property ownership today divides society into the “haves” and “have-nots”; and the gulf that separates them appears to be ever widening. This, too, is socially divisive.

Fortunately for Hong Kong, there is a choice that could take us a long way towards alleviating these social pressures. I have long supported a plan to sell the existing stock of public housing to sitting tenants as a solution to many problems. The sales must take place at prices well below market levels, and tenants must be allowed to have the right to transfer the unit on the free market and to keep any capital gains that arise from the sale.

Today this proposal is even more relevant and urgent. More than a third of our households live in public housing, so privatization would provide them with a genuine asset that could be an effective hedge against inflation. The asset could be used as collateral for financing business activities, as an annuity to provide for old age retirement, or as a bequest to loved ones. At one stroke and at almost no cost to society, the inseparable gulf between the haves and the have-nots would be largely eliminated.

As Hong Kong becomes a predominantly propertied society, the hostility of local residents toward immigrants will be greatly reduced. The arrival of immigrants will be perceived to enhance property and capital values and not to depress wages and take away jobs.

I believe our government should announce a clear, credible policy to allow spouses and children to arrive in Hong Kong after July 1 any time they wish. It need not trigger an immediate rush into the city. Most parents are, after all, responsible individuals who will not send for their dependents until arrangements for settling them in Hong Kong have been made.

In the longer run, such a policy would also enhance the attractiveness of local residents as marriage partners for Mainlanders, while Hong Kong would be able to

attract better-quality immigrants through marriage. Indeed, Hong Kong has much to gain from a long-term policy to reunite separated families.

If these proposals sound incredible, then it is only that too many of us are overwhelmed by the idea our public housing, public education, public health care, and public welfare services will be stretched to their limits in the short run. It is useful to refresh our memories to the time when 300,000 individuals crossed the border into Hong Kong over an 18-month period in 1978–80. The economy and society adapted very well to that sudden shock. Similar episodes have existed throughout the postwar period in Hong Kong's history, and we have always handled it well, even when the resources that were at our disposal appeared meagre by current standards.

Perhaps the real problem lies with the way in which we view our housing, education, health care, and welfare services. It is a mistake to believe that individual problems are always and everywhere a public responsibility. This is a false premise that Hong Kong must shake off if we are to avoid being overwhelmed by the challenges of managing population and labor inflow. Otherwise, we will be permanently condemned to holding the floodgates to a raging torrent.

Our puny efforts to devise interim solutions to control the inflow will eventually corrode the foundations of our free economy and open society. In the final analysis, they will also be futile, inhumane, and self-defeating. We should, on the contrary, make provision for Hong Kong to develop as a metropolis with a population that is much larger than is currently contemplated in official forecasts. And we should privatize our public housing units to help our residents become a propertied class. In doing so, we will soon be gladly welcoming all those who have a legitimate and humanitarian claim to be here.

(Reprinted from the *South China Morning Post*, May 19, 1997, p. 12.)

2

Setting the Scene

An Overview of Long-Term Housing Strategies in Hong Kong

The aim of this book is to propose a better approach to housing provision in Hong Kong and the social and economic benefits that this could bring. But before considering the options and aims for a new long-term housing strategy, we have to consider how Hong Kong got to where it is today. The history of Hong Kong's housing strategy in the postwar era—and the one we still pursue—is best described as a massive attempt by government to provide rental shelter and homeownership (or more accurately pseudo homeownership) for the population.

Most people in Hong Kong are so accustomed to this provision that they hardly stop to think about what the government's role in housing should be. Should it continue to build more rental shelters and pseudo-homeownership units? What is the proper balance between publicly and privately provided housing? And more importantly, how does a housing strategy fit into the economic, social, and political development of Hong Kong for the long term?

I believe Hong Kong's long-term housing goal should be to provide a mixture of public and private units so that at least 80% of permanent residents can become *bona fide* homeowners. This 80% represents an advancement over the missed targets for homeownership previously proposed by the government, of 60% by 1997, in *A Review of Public Housing Allocation Policies (1984)* and of 70% by 2006, in the *Ten-Year Housing Plan (1998)*. The rest of the population, including visitors, can rent housing on the open market. I will explain why this approach is justified for Hong Kong. I will also propose a strategy to achieve this goal quickly and to the advantage of all.

Brief History of Misguided Government Policies

In most countries, governments are not involved in providing housing, and certainly not on the scale of Hong Kong, where some 50% of the population live in public housing units. This is a postwar phenomenon: until 1954, the Hong Kong government was not involved in building homes. The decision to adopt such an approach was the product of a set of unique circumstances and misguided government policy in the immediate postwar years.

First, housing supply could not be easily increased at that time. Private developers faced formidable constraints in redeveloping the urban housing stock. Rent control imposed on prewar housing in 1947 made it difficult to evict tenants for redevelopment.

Second, the massive influx of immigrants increased the population from 600,000 in 1945 to 2.3 million in 1951 and led to an explosive growth in demand for housing. No society in peacetime had experienced such a phenomenon. It was a unique situation. Land available for development was invaded by about 300,000 squatters seeking alternative housing from the old private tenement apartments.

Third, the government was initially reluctant to facilitate housing development despite intensive lobbying from private business interests. There was general hostility towards private developers, many of whom took part in building squatter housing.

The government therefore became a provider of public housing by default. This path may have been motivated in part by public relations reasons, to put a humanitarian face on its actions to clear squatter housing, but this secondary reason subsequently became the main justification for the continued growth of the public housing program. After the social disturbances of 1967, the public housing program became the centerpiece of a policy to restore public confidence and calm the community.

There could have been other strategies, but these were not explored. Singapore, for example, saw public housing as an instrument of land reform, the foundation for a socialist vision of society, and a nation-building tool of the People's Action Party to capture the hearts and minds of the people. In 1959, fully six years before Singapore became an independent nation, Lee Kuan Yew created the Housing Development Board very shortly after being elected prime minister.

In another example, the city of Lima, Peru, decided against building homes for rural migrants and simply chose to tolerate their presence in shantytowns after it became politically infeasible to get rid of the newcomers and their settlements. Ultimately, the Peruvian government learned to appreciate the broader social, economic, and political benefits of allowing the squatters to gain legal titles to the shantytown property that they had illegally occupied and developed. Economist Hernando de Soto saw legalization of land and property titles in the shantytowns as part of an economic answer to the terrorism in Peru.

Hong Kong's housing strategy has lacked any such forward-looking goals. Moreover, it is characterized by a high level of government involvement in the housing market.

Supply-Led Development in the Early Years

Usually the number and type of housing units a society builds are determined by demand and supply conditions. Increases in population, income and the number of

households, and changes in business cycle conditions, can all affect the demand for housing. Changes in building costs (including construction costs for labor and materials), planning and building regulations, the politics of development, compliance with environmental restrictions, and so on can affect the supply of housing because of their potential to cause long and uncertain delays that affect the time needed to build new units.

Most societies leave these decisions to the market, where developers and contractors can make huge profits or losses (and even become bankrupt), depending on whether they make good or bad forecasts of demand and supply conditions. This is a hazardous business, especially over the long term. The list of failed private developers, in Hong Kong and elsewhere, is very long. Fifty years ago Hong Kong had a thousand developers; overwhelming numbers of them have since gone out of business.

But in addition to these market factors, the Hong Kong government has become unavoidably involved in the business of forecasting the demand for housing because it is the monopoly supplier of land and the predominant provider of housing. As land supplier, the government need not have become a supplier of housing, but it ended up in this role for reasons that I have mentioned and shall elaborate on in this book.

Since 1954, the government has been the undisputed hegemon in property development. Unlike private developers, the government does not face financial losses or profit rewards for the accuracy of its forecasts. Good and timely forecasts are sometimes rewarded with political praise; bad and mistaken ones draw political condemnation. Praise and condemnation are, however, blunt instruments for motivating government officials to deliver performance.

In the three decades from the mid-1950s to the mid-1980s, the government had a pretty much effortless task in making demand-side forecasts. Because of a severe chronic shortage of housing units, planning could be conveniently approximated by the excess number of households over the number of housing units.

The figures in Figure 2.1 show that, in 1971, the ratio of domestic households to permanent housing units was 1.27. The ratio fell to 1.02 in 1986 and then to 0.92 in 1991. The ratio has since remained within the range of 0.98 to 0.93 despite considerable variations in supply and demand conditions.

Demand Starts to Matter

The planner's problem until the mid-1980s did not require forecasting the many complex factors that drive market demand. Rather, the job was to fix a supply shortfall based on a simple arithmetic rule: count the number of housing units in supply, and drive the ratio of domestic households to permanent housing units to slightly above one. The aim of the long-term housing strategy was to determine how long it would

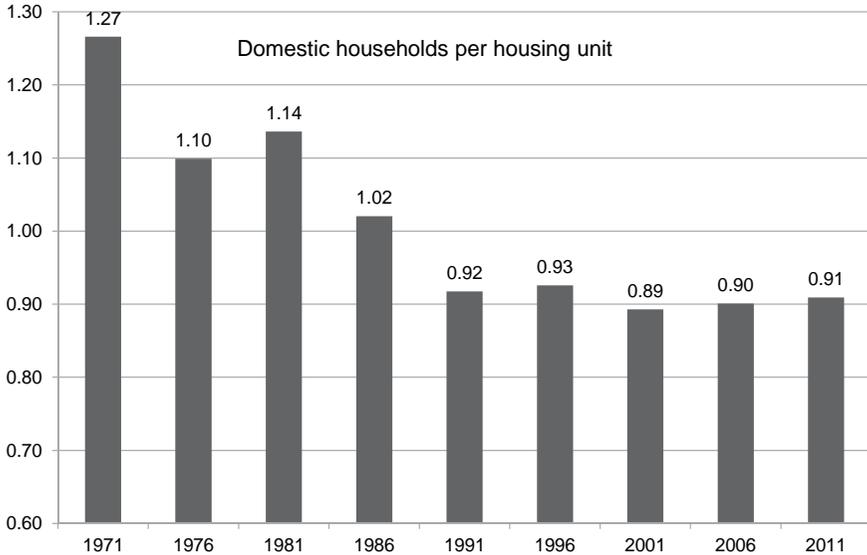


Figure 2.1

Number of domestic households and housing units

Source: Robert J. Shiller, *Irrational Exuberance*, 2nd edition (Princeton: Princeton University Press, 2005; Broadway Books 2006), as updated by author.

take for government to achieve this goal, so the only constraints on the accuracy of the forecasts were on the supply side. The demand side could be totally ignored. This was a planner's ideal environment.

The government, however, failed to deliver its targeted number of housing units. Under Governors Robert Black and David Trench, it was supposed to supply 220,000 units in the period 1964–73, and under Governor Murray MacLehose to supply 350,000 units in the period 1973–83. Both plans famously fell short of their targets by about half (see Table 2.1). This did not bode well for government long-term housing strategies after the mid-1980s, which depended on accurate forecasts of both supply and changing demand conditions.

But until then, the severe chronic shortage of housing units in effect meant that accurate demand-side forecasts were unimportant. It was not possible to get it wrong because demand was unsatisfied and the correct thing to do was simply to increase supply. And since the market was not producing housing units fast enough, the government decided to build them.

The public provision of housing units year after year was driven *only* by supply. When the supply fell short of the target, another plan would be put in place. This practice continued even after the mid-1980s, when such a strategy had outlived its use and the number of housing units exceeded the number of households. At that point, demand ceased to be simply a matter of counting households. Business cycle effects

Table 2.1
Summary history of public housing

Period / Governor or CE	Policy Statement	Housing Targets	Housing Outcomes
1954-64 Grantham	Major goal to resettle squatters, minor goal to provide low-cost housing for financially disadvantaged people	500,000 persons resettled	600,000 persons resettled 240,000 persons allocated Low-Cost Housing
1964-73 Black and Trench	Review of Policies for Squatter Control, Resettlement, and Government Low-Cost Housing (1964)	1,980,000 persons rehoused	1,000,000 persons rehoused
1973-83 MacLehose	Ten-Year Housing Program (1972)	1,535,000 persons housed 350,000 public units built	177,000 public rental and 23,000 HOS units built Net increase in persons housed was 669,000
1985-2001 Youde, Akers-Jones, and Wilson	A Review of Public Housing Allocation Policies (1984) Long-Term Housing Strategy (1987) Mid-Term Review of the Long-Term Housing Strategy (1993)	1985-2001 1,085,000 public and private units built 1985-93 605,600 public and private units built 1993-2001 343,200 public units built 1997 60% ownership	1985-93 350,000 public and 262,000 private units built 1997 46.6% ownership

(continued on p. 12)

Period / Governor or CE	Policy Statement	Housing Targets	Housing Outcomes
1995–2006 Patten	Long-Term Housing Strategy Review (1997)	1995–2006 47,000 public and 23,000 private units built per year 1995–2001 54,000 public and 31,000 private units built per year 2001–06 39,000 public and 34,000 private units built per year	(See note.)
1997–2007 Tung	Ten-Year Housing Plan (1998) Review of the Institutional Framework for Public Housing (2002)	1997–2007 85,000 units built per year 50,000 public and 35,000 private units built per year 2007 70% ownership No targets announced	1997–2007 50,000 units built per year 32,000 public and 23,000 private units built per year 2007 53.1% ownership

Note: This table summarizes the historical development of Hong Kong public housing programs conveniently divided into sometimes overlapping periods, from Governor Alexander Grantham to Chief Executive Tung Chee Hwa. It provides an outline of every housing plan announced by government and the main goals and outcomes. The period 1995–2006 under Chris Patten was short-lived and quickly superseded by Tung Chee Hwa's era.

and the formation of new households became incredibly important in determining the demand for housing units. The number of adult children who wanted to leave the old household and the number of couples who wanted to divorce now mattered.

The challenge was no longer simply one of meeting housing production targets, as in the 1950s to 1980s. An even more important task was to set the criteria for allocating units to households. And what a mess that turned out to be!

Competing Objectives

From the 1980s, there have been three incompatible objectives in the government's housing strategy: the resettlement objective, the income support objective, and the homeownership objective. These have continued to create problems to this day.

The *resettlement objective* was a response to squatter clearance and did not require means testing. Although urban squatters have largely been cleared, the problem of rural squatters continues to be troublesome for the government's development plans in the New Territories.

The *income support objective* aims to help poor households obtain decent shelter. Yet many households in the public housing program are quite well-off, and many living in the private housing market are quite poor. Progress in recovering public housing units from well-off tenants in order to make more of them available to private housing tenants in need has not only been slow, but it has also become hugely expensive. More than half of the Homeownership Scheme (HOS) units are allocated to public housing tenants as an incentive for recovering the units they occupy, which they are not keen on surrendering.

Without a market for public housing units, it is difficult to rectify the widespread misallocation of public housing resources created by the two incompatible objectives of resettlement and income support.

This situation started becoming apparent in 1987, when the Long-Term Housing Strategy was being prepared by Governor Edward Youde, Chief Secretary David Akers-Jones, and Governor David Wilson. The severe chronic shortage in housing was gradually being alleviated as more public and private units were built. But the supply shortage problem was replaced by a more complex and diverse set of supply and demand factors.

The effects of rent-control legislation were also fading as the share of prewar housing units in the total housing stock declined over time. Private developers were returning to the market. The annual production of public and private housing units was about the same, but economic growth and the rise of the middle-income class created a growing demand for better-quality and larger private housing units.

At the same time, it was becoming more difficult to determine the proper balance between public and private housing units because clients in both sectors

aspired to be homeowners. Their incomes overlapped to a considerable extent: many well-off households in the public sector, and many poor households in the private sector.

The *homeownership objective* aimed to address the situation by increasing the rate of homeownership in the community. The Long-Term Housing Strategy (1987) wanted to achieve a 60% homeownership rate by 1997. This was revised to 70% by 2007 in the Ten-Year Housing Plan (1998). Both targets have been missed. The actual homeownership rate was 35.1% in 1986, 44.5% in 1996, 52.8% in 2006, and 52.1% in 2011.

Over the past 25 years, the homeownership targets have slipped both when the private housing market was bullish and when it was bearish. When markets are bullish, buying homes becomes unaffordable, and when the market is bearish, nobody is interested in buying homes.

The Long-Term Housing Strategy (1987) reflected a realization that important changes were happening in the population's demand for housing. Most importantly, the housing strategy envisaged both public and private housing units playing significant roles in meeting housing goals. By incorporating private units into the housing strategy, the role of market demand became relevant and important for meeting housing goals because, at the end of the day, the number of private housing units supplied would depend on whether developers could make a profit from them.

The government's original planning horizon was from 1985 to 2001, even though its strategy was released in 1987. But it could not have anticipated the dramatic events that were soon to unfold. The rising demand for homeownership and private property as an investment asset in the period after the mid-1980s coincided with the globalization of the world economy. Subsequently, the rapid growth of the Chinese economy beyond all imagination and the onset of the Asian financial crisis and the global financial tsunami together made government forecasts of housing demand largely irrelevant. Private property prices surged by 332% from 1989 Q3 to 1997 Q3, then plummeted by 65% from 1997 Q3 to 2003 Q3, then rose again by 314% from 2003 Q4 to 2013 Q4.

Tung's Unfortunate Timing

Combining market and planning forecasts to achieve multiple long-term housing objectives, such as efficiency, equity, and homeownership, became a nightmare compared with the previous strategy of setting quantitative targets to provide relief for severe chronic housing shortages. Planners everywhere have difficulty delivering strategies with multiple objectives. In Hong Kong's housing arena, it is even more difficult because of the long and variable development lags and wildly fluctuating market demands.

And let us not forget that, even in the simpler days of the 1950s to 1980s, when planners had to worry only about supply and not demand, the proposed targets were still missed. They fell short by about half!

By the time Chris Patten and Tung Chee Hwa got into the business of addressing Hong Kong's housing situation, the problem had changed enormously. In the decade before the restoration of sovereignty, housing demand outstripped supply for many reasons, but not because there were more households than housing units.

China's opening and the migration of manufacturing across the border had created enormous wealth in Hong Kong. Inflation here reached double-digit levels brought on in part by a weak US dollar. Real interest rates were negative, and property prices famously shot through the roof as households across the city invested in property and became homeowners. The labor market was so tight that some businesses were buying homes for their staff, to prevent them from leaving. Households wanted better housing, to own their own homes, to own more than one home, and to invest in property. Therefore, although the housing production targets of the 1987 housing plan attributable to Youde, Akers-Jones, and Wilson were successfully achieved, they fell short of the rising housing demand.

In the wake of this, Tung Chee Hwa developed his Ten-Year Housing Plan (1998), which unfortunately was unveiled just after the onset of the Asian financial crisis. Tung's housing plan was in fact quite similar to Governor Patten's earlier proposal. Ironically, unlike the plans under Black, Trench, and MacLehose, *the public housing targets* under Tung's plan were executed with more success than that of his predecessors under the leadership of two highly determined and skilled individuals: Rosanna Wong, Chairman of the Housing Authority, and Tony Miller, Director of Housing.

The lesson from all this is that the task of developing a long-term housing strategy must incorporate both demand and supply factors once the number of housing units is greater than the number of households. It is not enough to look alone at the supply side, as early housing plans had done. But what are the dangers of devising a long-term housing strategy today? What should be the goals? These are vital questions that will determine not only the housing situation but the economic and political future of this city.

3

Supply and Demand Factors in Housing

The goals and tasks of a long-term housing strategy in which the number of housing units is greater than the number of households is different from the goals and tasks when the opposite is true. In the immediate postwar period, most immigrants arriving in Hong Kong had relatively undifferentiated housing needs. Their immediate goal was to find shelter, any shelter. The government's task, under this scenario, was simply to tackle a severe housing shortage, so a plan and command approach was a convenient solution even though decades later it would come to haunt society.

But by the mid-1980s, the housing situation had completely changed. Hong Kong's increasingly prosperous community had developed diverse housing and property investment needs. When shortages occur today, they are no longer general shortages but shortages in a particular segment, for example, a defined type of housing unit, a particular type of housing tenure, the availability of choice between investment and shelter purposes, or the demand from a specific group of households.

Matching demand and supply today is no longer simply about matching the number of units to the number of households. It is also about meeting the preferences of different households for different types of units, recognizing why these preferences will change over people's life cycle, and understanding why they are influenced by market conditions such as business cycles. The demand of households is far more dynamic than that of previous generations and requires a multidimensional dynamic market approach, not simply a plan and command approach.

One Step Forward, Two Steps Back: The Homeownership Scheme

An early but flawed attempt at merging the two approaches happened in the MacLehose era, when the Housing Authority devised the Homeownership Scheme (HOS). It encountered a problem in that initial batches of the new HOS units in the early 1970s were sold to eligible buyers at a subsidized price set at 70% of the prevailing market level. The pricing policy embodied three features: (1) the price was set to be affordable to eligible households, (2) the subsidy rate was fixed, and (3) the unit was sold to the household with complete ownership (including the right to dispose of

it on the open market 10 years after purchase without having to settle any unpaid land premium, because in those days there was none).

This pricing model had to be subsequently abandoned when property prices in the market increased rapidly a few years later. The HOS units became unaffordable to eligible households, but the HOS pricing policy had failed to appreciate the full implications of this possibility. An important lesson was learned. When market demand changes, property prices often change even faster, leaving many households behind in the dust. More importantly, demand changes cannot be foreseen by the planner. Even if the planner turns out to be a clairvoyant, it is unlikely he or she will be able to persuade other stakeholders to change an approved plan.

It was apparent that the level of subsidy had to be varied to make the units affordable, but the authorities chose not to do this and instead avoided the issue. They decided to deny the purchaser title to the full value of the land under the pretext that only the user's right to the property was sold, not the right of free disposal. The latter right became conditional on repaying the remaining portion of the unpaid land premium. The purchaser therefore had only a half title under his or her name. Unfortunately, the value of the unpaid land premium appreciated over time at a rapidly rising rate as land values surged ahead of income growth. The government could easily have extended the purchaser a mortgage loan at the time of purchase to cap the value of the unpaid land premium, but for reasons I am unable to fathom it chose not to do so.

This has become the central issue of the subsidized public homeownership scheme: that instead of acting as a banker and extending a mortgage loan to the subsidized buyer, the government has chosen to retain part ownership and sell only a half title to the property. Purchasers become pseudo owners of housing units that they cannot sell on the open market, without paying a hefty premium. Due to extremely limited turnover, land has been assigned to an inferior use that is value-destroying.

As a consequence, the HOS has become locked into the public housing sector rather than gradually integrated into the market, which would have enabled land values to appreciate to the benefit of the homeowner. In future, when HOS buildings are rundown with age, the issue of redevelopment will become impossible to resolve without addressing the question of titles. The owners will have no right to redevelop the buildings without the government's approval nor could they afford to do so on their own. Developers and other intermediaries will be reluctant to enter this messy situation.

Complicating the housing scenario is the fact that, because of allocation decisions made in the past, many households in the public housing sector are well-off, but many households in the private sector are not. As a result, the mix of large and small units between the public and private sectors is wrong and certainly misallocated. Forecasting changes in demand and supply in such a market is theoretically

and practically difficult, as it is in any highly regulated market, but errors in prediction have potentially profound economic and political consequences.

Supply Factors

Supply is affected by the straightforward production costs of supplying land, labor, and materials for building and construction. The lack of productivity gain in the local construction industry and the shortage of skilled construction workers will drive up costs.

But more significant are the numerous regulatory-related transaction costs involved in property development, including navigating planning rules, complying with building codes, negotiating costs associated with land acquisition due to holdouts, and holding public consultations that often result in long delays. The uncertainty over how long these things will take makes development ever more costly. Large teams of advisors and professionals are now retained by developers and government to facilitate development. The expertise required to successfully manage these transaction costs forms a formidable barrier to entry for less experienced prospective developers. Many have left the market.

I have estimated that, since 1989, such regulatory uncertainties and delays have increased the gap between property prices and construction costs by about 67% on average. In Essay 21, I examine these “regulatory costs” of development.

The case of the old Kai Tak Airport site is a vivid illustration of these costs. It has taken an inordinate amount of time to develop the site. For years it remained a huge vacant lot. Imagine how long it takes to develop sites that are not vacant. Always, delays add to the final cost of development. Reducing these transaction costs will make a huge difference to the success of any long-term housing strategy—and, indeed, have an impact on the high prices of non-residential properties, which are also affected by transaction costs. It may not be customary for a housing strategy to address the cost of property development, but in Hong Kong today this factor is a major determinant in the success of any housing proposals.

Many people have argued that the scarcity of land in Hong Kong is the reason property prices are high. This is blatantly false. Consider Singapore, where over 90% of the land has been developed; by contrast, less than 25% of the land in Hong Kong is developed. The real problem is that our planning rules and regulations have made most land unavailable for development or subject to long and uncertain delays that deter development.

There are many ways to lower the regulatory cost of development. The most radical approach is to remove zoning rules that differentiate land into agricultural, residential, industrial, and office and commercial categories. Town planning approval could then focus only on the intensity of development and narrowly specified incompatible

uses of land. The volume of development each year or every 3 to 5 years could be controlled. This approach may sound iconoclastic but should be studied seriously. Quite a lot of property in Hong Kong is indeed zoned for mixed use, and it does not appear to be a problem in the service economy of today.

Another approach is to set and preannounce each year the rates of compensation for land use conversion on every plot of land. These preannounced rates would be totally transparent to all and be valid for a period of, say, 12 months. This would significantly lower the negotiation costs in settling land conversion premiums. It would also remove suspicion and concern over the opportunity for corruption in these negotiations.

Would government revenues suffer as a consequence? This is not obvious, because the transaction process would be speeded up, and this could lead to more successful negotiated outcomes. Moreover, even if government revenues suffered, society would benefit from less costly transactions, speedier development, and less risk of corruption. It is useful to appreciate that, when government revenues suffer, society benefits from the transfer. In recent years, government transfers of benefits have come under much criticism, but this is targeted at selective transfers that benefit the few and not the many. My approach benefits all equally and is therefore a non-discriminating transfer to the public.

Demand Factors

Demand is affected in the long-term by economic and population growth. The critical policy variables relevant for economic growth are investments in human capital (education and health care) and the lowering of the transaction costs of development. The relevant variables for population growth are immigration policy and the drivers of household formation. Most of these variables can be estimated, and some depend on what other policies will also be implemented and when they will take place.

A difficult issue in forecasting the demand for new housing units is that it depends on the pace of formation of new households. For example, children will leave the household as they grow up and form new households, but the pace of this will depend on the available supply of new housing on the market and in the public housing sector. When supply is tight, the process will be delayed. This means that estimating the growth in the number of new households is itself dependent on the demand and supply of housing units. Moreover, one cannot use past trends (even recent past trends) to make accurate forecasts of the future pace of new household formation. Untangling these interactions is not going to be trivial.

As adult children leave the home, there is also the particularly intriguing question of what happens to the original housing unit. The answer depends very much on whether it is a private or a public housing unit.

If it is a public housing unit, then the adult children move out and the parents stay behind in order to retain the unit. When the original unit is private, then one can think of three other possible outcomes: the parents leave and the children stay, the children and the parents stay, or both leave to find a new arrangement that may include them living together or living apart. Many young new purchasers of private housing units rely on their parents to make the initial downpayment, and parents may refinance their existing home to do so. This phenomenon is common in other societies as well, where homeownership is an important channel to enhance the value of one's savings and achieve upward mobility.

So, while household formation is part of all households' life cycles, it leads to demand for different housing types and tenures in the private market, but only one solution in the public housing sector. The lack of choice for those living in public housing means that a large portion of the population—the public housing tenants and pseudo homeowners—see limited prospects for homeownership for future generations.

Faced with fewer choices, young adults who live in public housing have chosen to become early applicants for their own public housing units. Table 3.1 shows that the number of non-elderly single-person households on the public rental housing applicants' waiting list has grown from 35% in 2007 to 49% in 2013. Those under 30 have risen from 13% to 26% of applicants. As the table shows, most of them live with their parents, and the majority have postsecondary or tertiary education.

Table 3.1

Characteristics of non-elderly one-person household applicants on the public rental housing waiting list

	2007	2009	2011	2013
Non-elderly households on waiting list	35%	38%	42%	49%
Under 30	13%	14%	19%	26%
30 or over	22%	24%	23%	23%
Not living alone	67%	71%	86%	88%
Living with parents	–	–	79%	85%
Under 30	–	–	93%	94%
30 or over	–	–	58%	70%
Postsecondary and tertiary education	–	21%	33%	40%
Under 30	–	37%	53%	67%
30 or over	–	7%	11%	10%
Private permanent housing	53%	53%	48%	45%
Public rental housing	28%	31%	28%	29%
Subsidized sale flats	14%	12%	21%	23%

Source: Housing Authority, *Memorandum for the Subsidized Housing Committee of the Hong Kong Housing Authority, Survey on Waiting List Applicants for Public Rental Housing 2013*, December 31, 2013.

Meanwhile, the percentage of non-elderly one person households on the waiting list who live in private permanent housing has decreased from 53% in 2007 to 45% in 2013. A growing number of applicants are now residents in subsidized sale flats, increasing from 14% in 2007 to 23% in 2013. Another important and growing source of demand for household formation since the 1990s has been the rising divorce rate, but this has largely gone unnoticed. I discuss this issue in greater detail in Essays 13 and 14.

A society with a large public housing sector reduces the upward mobility of the next generation, because the occupants are denied the opportunity to benefit from appreciating housing values available to those who are homeowners in the private sector. The long-term consequence is to create a more polarized society. The next generation, whose parents could have helped them if the sale of HOS units had not ended up in the awkward compromise of selling only half a title, looks to the government for assistance. The issue of a lack of intergenerational mobility is likely to be magnified by the advent of rising divorce rates among low-income households.

Demand and Market Equilibrium

Two factors that affect housing demand are very difficult to forecast: the demand from non-domestic sources, and the business cycle. For an open city like Hong Kong, these external factors inevitably play an important role in influencing housing demand.

For example, when property prices are high in Hong Kong, some of the domestic demand may spill over across the border to Shenzhen. Moving in the other direction, cross-border family reunion has created an additional housing demand in Hong Kong. For some people, regular commutes across the border have become a way of life and will be facilitated if regulatory barriers are lowered (for example, by lifting local residency requirements for receiving welfare payments or privatizing public housing).

This of course raises the question of whether a long-term housing strategy can be developed if Hong Kong is viewed as an isolated entity. There is a need for a broader vision of the future of the Special Administrative Region so that all related policies can be coordinated to form a coherent whole.

Similarly, the availability of cheap credit in recent years has fueled property prices in Hong Kong, including demand coming from buyers on the Mainland. By its very nature, foreign demand is likely to be primarily for investment rather than consumption. Forecasting this demand is difficult because it is driven primarily by business cycle factors and cannot be differentiated from business cycle effects, such as the Asian financial crisis and the global financial tsunami.

Whatever the source, the most difficult thing with forecasting long-term changes in housing demand is that it is subject to considerable short-term fluctuations, some

of which may last a few years. Given that the supply of new housing units takes several years to come on stream, the housing planner faces a dilemma: If the planner heeds political calls to speed up supply, then reverses course a few years later, society will be faced with a huge property market glut. What was supposed to be a countercyclical intention will have become a procyclical mistake! And society belatedly will scream that the property market bubble has burst and go after the politicians and bankers.

But the fluctuations in demand and long lags in supply mean property prices in the market inevitably make large upward and downward swings. These periodic swings are necessary for demand and supply to equilibrate in the market; no long-term housing strategy can avoid them, because this is the nature of the property market.

Many recent commentators have proposed that a large land bank should be established so that the supply of housing can be readily increased when demand rises and vice versa. This view fails to appreciate that it is difficult to know when demand will increase until after it has happened. Such calls are always made only after prices have started to increase. Even then, most policymakers are still not certain whether the increase is temporary or the start of something permanent. They may consult economists and entrepreneurs, but most likely these experts will advise the government to wait for more signs before making a move.

By the time everyone from Tuen Mun to Ap Lei Chau knows what has happened, so does the policymaker, but it is already too late to commit. The politician, however, has no choice and commits to a given path in order to curry favor with constituents. If the market collapses in a few years, then he or she just re-enters the scene as a new white knight to save the fair maiden from another dark night.

Just how difficult it can be to forecast demand is evident in the failed housing plans proposed by various administrations. Youde, Akers-Jones, and Wilson met their targets but failed to build enough units to meet the surging demand. Tung's housing plans also met the targets, but demand collapsed and too many units were built. Tsang had no housing plans and no targets to meet, so he is now blamed for doing nothing in the face of surging demand. This short history is not to apportion blame or praise. It merely observes that getting it right is a difficult job.

Political Reality

The government's central role in providing land and housing means any long-term housing strategy requires not only good forecasts but also continuity in policies across administrations. This was more possible under British colonial rule because we did not have political elections. Today, the new political dynamics of electioneering are changing public perceptions of the continuity of any policy.

A long-term housing strategy today has to straddle administrations, making it less secure than in the past. Policy uncertainty reflects the underlying uncertainty of a

political system that is still in transition and has become an additional dimension to the market—one that magnifies the existing market uncertainties.

The question for Hong Kong is: What kind of long-term housing strategy would be prudent, given market fluctuations and the need for political approval to meet private housing demands?

As I will show in these pages, a great expansion in homeownership could address not only housing but economic and social issues in Hong Kong. Past attempts at this have been well intentioned but flawed. I will examine the development of public sector housing and propose a readily available and easily achieved means of increasing homeownership: let sitting tenants in public housing purchase their units outright and curtail the land premium to make this option affordable. Through these purchases, and the subsequent creation of a market for the housing units, Hong Kong and its people stand to gain in terms of wealth and a stake in the future: to realize the goal of “Hong Kong land for Hong Kong people.”

Epilogue

Homeownership and the Youth Protest Movement

The youth protest movement that started on September 26, 2014 is demanding greater political freedom, but there are also obvious economic and social causes behind their action.

On one level, the youths are protesting that the present political arrangements are not sufficiently inclusive. They fear that these unfair and unequal arrangements will threaten Hong Kong's core values, including compromising our present economic freedoms and civic liberties.

Numerous reports from journalists, social workers, teachers, church ministers, and others who have spoken to the young men and women occupying the streets have found that the divergence in fortunes between Hong Kong's wealthy and the general public is an underlying reason for the social tensions in the city (see Gu, 2014 and Chu, 2014).

Although Hong Kong today is more prosperous than a generation ago, many middle-class residents feel squeezed. Landlords and homeowners have benefited. Property prices are at a record high, up by a third from a previous peak in 1997. Hong Kong's retail rents are now the most expensive in the world.

But the percentage of households with private homes has increased by a mere 0.6% since 1991, from 35.3% to 35.9% today. Back then, an apartment of 400 square feet in the city would on average cost \$1.04 million and could be acquired with a 5% down payment. Median household income was \$10,325 per month. Today, a similar apartment costs \$4.63 million and there is a 40% down payment requirement. Median household income is now \$22,900 per month.

The down payment in 1991 was equal to 5.0 months of earnings; today, it equals 80.9 months—15 times higher and almost out of reach for the average family. Society inevitably becomes divided and the middle class no longer feels secure about its economic future. A society inevitably becomes restless when the majority of its people feel deprived.

People also see that most of the things they spend their earnings on (housing, public utilities, groceries, transportation, telecommunications, entertainment, and the like) all appear to be supplied by a dozen or so corporations, many related to

property development. The youths have easily embraced the radical view that tycoons dominate the economy and property developers are hegemonic. For them, society is unjust and the injustices stem ultimately from Hong Kong's political arrangements, with Beijing as the master behind the curtains.

This radical narrative of Hong Kong capitalism, in which non-inclusive political arrangements lead to non-competitive economic markets and unjust societies, is very persuasive in Hong Kong and especially among our youths. This was not the case in the past when the general public believed in the "establishment narrative" that promised a level playing field for all and where effort will be properly rewarded.

The primary reason why our society has been divided economically and socially into "haves" and "have-nots," however, is not the result of the political arrangements. True, these arrangements have failed miserably to tackle the growing economic and social divisions. But there are other reasons for the high property prices that are at the root of society's divide.

First, economic globalization during 1980–2008 created an era of rapid economic growth and accumulation of wealth worldwide. The demand for all kinds of assets rose rapidly, including financial assets, property in prime locations, jewelry, art, antiques, wines, and other rare items. The emergence of shadow banking as a financial innovation was driven by the rising demand for financial assets. Property in Hong Kong was valued worldwide because the city is a prime international economic and financial center where assets and contracts are protected by the common law and a robust legal system.

Rising property prices have not been unique to Hong Kong. Thomas Piketty's acclaimed *Capital in the 21st Century* finds that the ratio of housing capital to national income in industrialized economies rose dramatically from 1980 to 2010. In France it rose from 122% to 371%, in the United Kingdom from 134% to 300%, in Germany from 134% to 236%, in Canada from 121% to 208%, and the United States from 151% to 182% (see Wong, 2014). In Hong Kong it rose from 122% to 209% over the period 1980–2013. (All percentages are 10-year averages.) The high regulatory cost of development contributed to rising prices in all of these places, which brings me to my next point.

Second, unlike financial assets, the supply of property is much less responsive to demand due in part to the scarcity of land in prime locations. Supplying new properties often requires redeveloping existing ones. Rigid planning rules and building codes often hamper the process of redevelopment, a pattern seen in most societies. Politics and the transactions cost of redevelopment result in long delays, pushing up property prices.

In Hong Kong, I have estimated that since 1989 such regulatory uncertainties and delays have increased the gap between property prices and construction costs by

about 67% on average (see Essay 21). The gap has persisted through both boom and bust cycles.

Third, China's opening and economic reforms, while part of the process of economic globalization, have been an independent factor because of their enormity, rapidity, and proximity to Hong Kong. China's opening triggered a migration and expansion of our manufacturing industries across the border. Structural economic transformation and rising prosperity created a growing demand for domestically supplied services at a time when labor markets were very tight for demographic reasons.

Prices in Hong Kong escalated rapidly and reached double digits in 1992. The process was so rapid that within two decades Hong Kong became a service economy. Property prices naturally shot through the roof. Those who failed to acquire property during this period soon discovered that prices had moved beyond their reach.

Fourth, the linked exchange rate regime tied Hong Kong's currency to the US dollar. During most of the past three decades US interest rates have been kept low. This has fueled property price increases in Hong Kong because international capital flowed into the city. As the share of bank loans exposed to home mortgages rose, the Hong Kong Monetary Authority began to raise the down payment ratio on fresh mortgage loans to protect the banking sector from exposure to systemic risk. This measure made the acquisition of homes even more difficult for the average household.

All these factors took place well before 1997. So the post-1997 political arrangements cannot be the cause of high property prices. The radical narrative is fundamentally wrong. Even back in 1997, I wrote in the *South China Morning Post* that “[p]roperty ownership today divides society into the ‘haves’ and ‘have-nots’; and the gulf that separates them appears to be ever-widening” (see Essay 1).

Large landlords and property developers in Hong Kong have been major beneficiaries of the four factors I describe. They have become extremely capital rich and able to make major acquisitions within Hong Kong and also abroad. Thus, it is those factors that have resulted in the growing concentration of wealth, not the post-1997 political arrangements.

The creation of a tycoon-dominated economy was largely an accident of the circumstances Hong Kong found itself to be in during the 1980s and 1990s. Those who started with property or were able to acquire them reaped a huge windfall gain. The non-inclusive political arrangements are being defended by the establishment in Hong Kong because of their fear of populism. Beijing, on the other hand, is defending it because the political opposition is stubbornly critical of China.

Rising property prices create multiple fissures in the economic and social fabric of any society. The deep divide between homeowners and renters is only one aspect of this. A young person starting life today faces a huge uphill battle to save enough for

the down payment on a home without the support of a well-off parent. The generation born since the 1980s is the most affected.

The advantage of homeownership is that it provides a cheaper means for arranging finances. By borrowing against home equity, a parent can provide a better education for his children, arrange financing for starting and operating a small business, and support themselves in old age, as children become an increasingly unreliable source of funding with declining fertility rates.

Homeownership also provides a positive incentive for families to stay together when marriages come under pressure. Broken families inevitably take a toll on children.

Upward social mobility in Hong Kong today is closely connected to homeownership. Without it, Hong Kong will be increasingly saddled with problems of rising intergenerational inequality.

Unfortunately, the very high property prices we see in Hong Kong today will not go away. This creates two problems. The half of society that cannot afford to own a home complains about high prices. The other half does not want property prices to go down. Bridging the two is impossible. Even when the conflicts manifest in many different ways, high property prices are the fundamental source of division in society.

Bringing down property prices would be the wrong solution because Hong Kong's economy would drop, too. The correct approach is to turn the "have-nots" into "haves."

Fortunately for Hong Kong, there is an option: sell the existing stock of public housing to sitting tenants. The sales must take place at prices well below market levels and tenants must be allowed to have the right to transfer the unit on the free market and to keep any capital gains that arise from the sale.

More than a third of our households live in public housing. Privatization would provide them with a genuine asset to help them face the many challenges in life. At one strike and at almost no cost to society, the inseparable gulf between the "haves" and "have-nots" would be significantly reduced.

Privatization can be achieved in several ways. A modified Tenant Purchase Scheme should be revived. The amount of unpaid land premiums on our Homeownership Scheme units should be lowered. And the existing public rental housing and Homeownership Scheme should be combined into a single program allowing eligible applicants to have the option to rent, purchase, or rent now-purchase later with greater flexibility.

The problem of high property prices is only a problem because half the population in the society does not have property. If Hong Kong becomes a predominantly propertied society, then the present divisions will be removed. Even the hostility of local residents toward Mainlanders will abate. Immigrants and visitors will be welcomed because they enhance property and capital values, not take away jobs and create congestion.

Hong Kong is a capitalist society, but when capital is so unequally distributed it becomes a political problem. The voices of those on the streets come from a generation that has grown up amidst the rising gap in the ownership of capital. Only a bold housing policy initiative can help us break out of the political rut we are in. I believe this requires the courage and mandate of a popularly elected Chief Executive. If the housing problem is not resolved, every generation in future will continue to believe that our political arrangements are at fault.

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