



THE ROLE OF GOVERNMENT IN THE HOUSING MARKET

The Experiences from Asia



UNITED NATIONS HUMAN SETTLEMENTS PROGRAMME

The Human Settlements Finance and Policies Series

The Role of Government in the Housing Market: The Experiences from Asia

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FOREWORD



As we move into the new millennium, one trend overwhelms our concerns: the rapid urbanization with deepening poverty, environmental degradation and increasing slums, which poses tremendous challenges for achieving adequate shelter for all. The challenges we face in human settlements cannot be met by governments, private sector or civil society alone. It requires the actions of all aspects of the society.

Human settlements are places of organised human activities. The way in which human settlements are organised is influenced by the pace and breadth of socio-economic development. Such development cannot take place without linkages and continuous interactions between physical, institutional, economic and social structures. Human settlements are the product of deliberate planning or of spontaneous and uncontrolled economic and social activities. The problems and issues of human settlements cut across the conventional socio-economic sectors and are of multi-sectoral and multi-disciplinary nature.

The national resource allocation and finance strategies are evolving towards the identification of national development priorities and challenges. Therefore, a full understanding of human settlements needs to be looked upon in the national policy context, and links finance to policy debate. This approach is increasingly appreciated by policy-makers and planners when addressing human settlements problems and policy options. *The Human Settlements Finance and Policies* series aims to explore the intricacy of finance and policy interrelations and to promote better human settlements finance policy and strategies.

This series addresses the most important issues in improving human settlements. It draws the intellectual leaders and practitioners from the governments, local authorities, private sectors and civil society to confront human settlements and finance problems and to exchange views and experiences in tackling human settlements problems and issues, and to explore and promote innovations in policies and strategies and methods to address challenges in human settlements. Publications in this series provide opportunities to move towards a deeper understanding of the broad range of human settlements and finance issues.

Our habitat is shaped by human actions and policies. Policies have profoundly shaped our cities, towns and villages in the past and they will continue to define the 21st century. Decision-makers face

challenges of designing policies that allow their countries and cities to meet the increasing human settlements challenges. I hope that this series will contribute to the policy debate and will enhance the capacity of member states to design new policies and strategies to address human settlements challenges. In human settlements policy debate, choices made today will impact our common future of habitat tomorrow.

A handwritten signature in black ink, appearing to read 'Anna Tibaijuka', written in a cursive style.

Dr. Anna Tibaijuka
Under-Secretary-General and
Executive Director
UN-HABITAT, Nairobi, 2008

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INTRODUCTION

THE ROLE OF GOVERNMENT IN THE HOUSING MARKET EXPERIENCES FROM ASIA

Housing touches everyone's heart. It has been the long-term focus in urban development, social and economic policy. In the past several decades, some countries have made tremendous progress in meeting the housing needs of their nations, while others still face great challenges of severe housing shortage, substandard housing and slums. Today about one third of the total urban population live in slums. In some developing countries, the majority of urban population live in poor conditions. For a long period, the housing issues in developing countries have only received marginal interest in the academic community and political arena. The political and public concern with the housing conditions of the developing world is a relatively recent phenomenon.

The world leaders now recognise that the social and economic problems of the developing world are among the great challenges facing human beings. These problems are high on the international and national agenda. Fighting poverty and slums is now incorporated in one of the Millennium Development Goals declared by the World Leaders. What accounts for this change in attitude and upsurge of interest in the social and economic issues of the developing countries?

A number of factors can be pinpointed. First, after World War II, there was a wave of national independence movement. The newly independent developing countries had strong desire to change their own fates and to improve their economic and living conditions. Second, there has been increasing recognition by both developing and developed nations about the interdependence and globalisation of the world economy. Third, agencies of United Nations and NGOs actively advocate for social and economic justice and equity among nations and between the rich and the poor. Fourth, the progress and material well-being of people and nations have been at the centre of government policy and academic interests, which have long been searching for the effective mechanism for growth and development. There is an increasing interest in integrating housing into social and economic policies, which advocate inclusiveness and progressiveness. Fifth, the developing countries have trained a large pool of experts and developed a good awareness of the housing issues and their marginalised status in world development.

Globalisation has changed the course of development and exemplifies the mutual interdependence of nations in the world economy. There is also growing awareness

of interdependence between mankind and nature, and between the rich and the poor. This recognition has shifted the development philosophy and paradigm, and emphasises sustainable development and inclusiveness in opportunities and benefits. Poor people and disadvantaged ones are increasingly regarded as resources rather than burdens. Provision of housing for the poor not only has social benefits but also improves human capital and lifts the economic capacity. Inclusive development promotes cohesive society and binding nations, which increases the mobilisation power and motivates people towards achieving national development goals. Adequate housing for all is now more accepted than ever before. However, different countries adopt different housing systems based on their ideological, political, economic, social and cultural theories or beliefs.

The past few decades have seen the tremendous progress in the housing sector in developed countries, while many developing countries have encountered a bottleneck of development, stagnation and even worsening of housing conditions. These outcomes often lead to straightforward conclusions about the effective models for providing adequate housing, which directly or indirectly advocate market mechanisms. However, the economy and society are increasingly complex. Attempts to identify an ideal model of the market mechanism often run into a particular kind of difficulty. A system is often required to redefine itself and reinvent itself to meet new challenges and accommodate new needs. The interaction and inter-penetration of market mechanisms with other models lead to

different types of institutions and new models.

The professional interest in housing no longer focuses on the documentation of static conditions but rather on the process of the system to respond and adjust itself to meet the changing economic and societal conditions. Governance has been the catchword to describe the mediating forces to coordinate the economic and social systems. The tension between market and state has swung toward the market end of the pendulum. Market becomes a dominant mediating force for organising economic and social activities since late 1970s. The triumph of market mechanism has diluted the power of state. Globalisation has further limited the sphere of state over economic activities, and increased competition among nations. Market mechanisms and participatory/decentralised governance are strongly advocated by the two powerful world financial institutions – the World Bank and the International Monetary Fund (IMF), which often become a precondition for countries to receive loans from international institutions and norms for attracting more foreign investment. However, the penetration of market mechanisms in the housing sector in many poor developing countries does not solve the housing problem, but rather sees the rapid increase of slums. More and more poor people who dream to have better living conditions in urban areas become the victims of the market forces because of their inability to generate effective demand in the housing markets. Policies in favour of market mechanisms failed to solve housing problems for the poor mass. The False-Paradigm theory attributes such

failures in developing countries to the faulty and wrong advices provided by external experts. The “magic of the marketplace” and the “invisible hand” of market prices to guide the interplay of demand and supply of housing “disqualifies” the majority of the population as a player in the market place in many poor developing countries, while the state already gives up much of its role to the market. This leads to a situation in which the housing issues of the majority in many poor countries are not catered for either by the market or by the state. They become the “orphans” of the housing policies.

The controversy and contradictory outcomes of applying or imposing one country’s paradigm or values to another country alert us to the importance of comparative housing studies, which help to distinguish between broad patterns of social and economic changes, cultural and traditional influence, government policy and institutional restructuring and to understand the situated-ness of theories or models in their usefulness. Although there is no universally accepted doctrine or paradigm in the housing sector, comparative housing studies help to provide insights into the true forces driving the changes and differences in housing markets and policies as well as their performance. It provides the basis of examining the possibilities of tackling the housing problems of diverse developing nations in Africa, Asia and Latin America.

Although a good deal of housing theories or paradigms originated in the developed countries must be modified to fit the situated social, economic, cultural, institutional and structural circumstances of developing countries, there is no doubt

that state and market are now the twin forces to devise successful housing policies. This report is designed in a way which demonstrates how the twin forces of state and market interact (and sometimes with other forces) in the housing development process. More specifically, it examines how the government intervenes in housing markets and the impact of government intervention on housing markets; the performance of housing markets; and the characteristics and dynamics of the housing systems in various Asian countries. The selected country cases cover a wide spectrum of social, economic and institutional conditions to enrich the housing experiences and situated solutions. They include a highly developed nation – Japan, a newly developed industrial country – South Korea, a centrally planned country – Vietnam and two countries with strong religious influence – Malaysia and Indonesia.

The case of Japan focuses on the issue of home ownership. The promotion of home ownership is the cornerstone of Japanese housing policies. The mass construction of owner-occupied housing is regarded as an engine of economic growth and boosting the middle-class home ownership is considered as a key factor to achieving social stability. The Government actively intervenes in the owner-occupied housing sector. The Government-supported housing production increased about 5 times over the last five decades. The Government uses housing as a means to materialise its social value system. However, the economic recession witnessed since 1990s increased the economic burden for the state to provide mass owner-occupied housing as well as for individuals to buy housing. Under this context, the Government begins to re-

duce its role in direct provision but still be able to create a policy in favour of home ownership by reforming the Renters and Leaseholders Act to make the tenants less secured in their tenure, in order to loosely maintain a socially hierarchical society. However, the loss of economic benefits of being part of the home owning class drives many young people to take a more realistic life approach rather than pursuing the social class symbols, eventually leads to the dysfunctioning of the home ownership system.

The success of South Korea in the economic and housing sector is often quoted as a good example of the “free market” model. However, in reality, we can see that South Korea is far from the laissez-faire neoconservative prototype. In many aspects, the Government intervention in South Korea is no less than those classified as socialist countries in transition. The case of South Korea points to the fact that the housing sector in that country is characterised by pervasive and direct government intervention. The Government controls the housing market as well as its production process through land and finance. Extremely complex regulations make housing supply irresponsive to changing demands. The significant improvement of housing conditions largely attributes to the active role of state in the housing sector. The Government controls all the major elements of the housing sector which include housing prices, land supply, size distribution of housing units, housing loans with subsidised interest rates; and even the customers of private developers are controlled by the Government. The private sector can only sell housing units to those selected according to the Government’s

rules. The degree of intervention in South Korea may be higher than in China. The South Korea case demonstrates that attribution of South Korea’s success in the housing sector to the free market model is misleading, rather the state can play a more constructive role in meeting the housing demands at the earlier stages of economic development and in conventionally state-dominated countries.

The case of Vietnam goes beyond the conventional analysis of housing markets. It states that the conventional analysis of housing markets ignores the intangible factors which are actually strong underlying forces to drive the market. This chapter argues that the intangible forces sometimes can surface to the front to play a dominant role in the housing market behaviour and in the people’s decision-making process regarding market transactions. These intangible factors are often culturally and traditionally conditioned. The people’s cultural and traditional attachment transforms cultural and traditional attributes into value of housing. The cultural and traditional factors are often linked to particular geographical locations. Some locations have a heavy concentration of such intangible assets which raise their value stock. This chapter shifts away from traditional models in which housing prices are mainly determined by accessibility to amenities and workplace in relation to time (opportunity cost) and transport cost spent to reach them. It tries to configure a theoretical model to illustrate the trade-off between social and economic factors in the decision-making process of housing transactions. Based on the well-established theory that people always want to move up the social ladder, it is very natural for

people to move from socially undesirable areas to socially desirable areas. People are prepared to pay for such enhanced social status attached to the location. A similar concept of creating a social ladder through the housing sector is also discussed by the Japanese case.

The case of Malaysia examines the government intervention in housing markets. The focus of Malaysian housing policy is on the provision of adequate and decent housing especially for the lower income groups. It is a policy to provide "adequate shelter for all" rather than to create "a home owning class". Like other cases such as Japan and Vietnam, the Malaysian case also illustrates the social role of the housing sector. However, the difference is that housing in Malaysia is treated as an agent for social engineering to achieve societal and racial harmony rather than to form a hierarchy of social status. Malaysia has a long history of government intervention which started during the British colonial period for construction of low cost housing. After independence in 1957, the Government continued to play a leading role through its public low cost housing program, while the private sector is mainly involved in the provision of medium and high cost housing. It forms a dual housing model – the co-existence of state and the private sector in housing provision. Since 1980s, the private sector is also given an increasingly important role in low cost housing provision. The private sector is required to provide mixed development for both rich and poor people, in which at least 30 percent of housing units should be low cost and to be sold to low income households. The Government sets house prices, design standards and households' eligibility for

such low cost housing. The housing sector is heavily regulated by more than 30 sets of regulations. Apart from the direct provision, the Government uses a variety of intervention instruments such as taxation including stamp duty, capital gains tax, foreign investment tax and levy on foreigner ownership. The chapter further examines the performance of government intervention and finds that government intervention results in the massive construction of low cost housing which is mostly self-contained in facilities and amenities. It provides low income households with a decent living condition. The mixed development of low, medium and high cost housing promotes inclusiveness and racial and social harmony.

The Indonesia case demonstrates the close relationship between economic growth and housing development. The economic boom during the 1980s and the early 1990s led to massive housing development. A quarter million housing units were sold in the year 1997 alone. However, the economic crisis in 1998 resulted in the stagnation and almost cessation of housing activities. The chapter examines the government intervention in the housing sector before and after the economic crisis. The social and economic structure of the population demands the government intervention. In Indonesia, about 71 percent of the urban population belong to middle-low and low income groups. Only 15 percent of the urban population can afford to buy decent housing units on the market, the majority can only buy simple or very simple housing units with subsidies. Therefore the Government actively intervenes in the housing sector to meet the housing needs of the vast majority. The Government cre-

ated three separate institutions to address the housing problems, particularly the low income housing problems, at the policy level (through National Housing Authority), and at the operational levels (through National Urban Development Corporation for housing provision, and through State Saving Bank for mortgage finance). The private sector provides housing for middle and high income households. It is virtually another dual model. The Government also heavily intervenes in the private housing sector and requires the private developers to provide mixed housing development at a 1:3:6 ratio for high, middle and low income housing respectively. The Government puts great emphasis on the formal housing finance system. A series of deregulation policies during the years 1983-1988 created a favourable environment for domestic savings and for the private developers to access funds. It facilitates the booming of the housing sector. However the excessively rapid expansion of the housing loan market and lack of appropriate financial management damaged the healthy growth of the financial market. As a result, three quarters of the real estate loans were non-performance loans, which turned out to be an important contributing factor to the financial crisis. The financial crisis points to the importance of the process approach rather than a market transactions approach in relation to housing development. There are two parallel processes in the housing sector – the formal process and the informal process. The setback of the formal process leads to the growth of the informal sector for the poor people's housing. However, the informal sector rising from institutional and political constraints on the formal sector often takes place outside the legal system and

gives space to bribery, corruption, evasion of legal restrictions and the arbitrary use of power and ignoring/undermining of the government authority. The informal activities have influenced the government intervention in housing markets and also contribute to ineffectiveness of government intervention. The post-crisis government intervention puts more weight on financial management and monetary policies. The reduction in housing loan subsidy required by IMF has immediate negative impacts on the production of low income housing. The actual production of low income housing drops to less than 18 percent of the government target. The informal activities make the government intervention fail to achieve its intended objectives and benefit developers more than the large majority of low income households in Indonesia.

This report illustrates the diverse approaches to the housing problem in selected Asian countries. However, all cases point to the strong role of the state despite their different economic systems. Therefore, the common existence of government intervention is not much determined by economic systems/theories but rather by similar cultures and political traditions. The beneficiaries of government intervention vary in different countries according to the economic development stages. The developed country – Japan focuses on promoting middle or high income owner-occupied housing. Less developed countries concentrate on low income housing issues. Among the case countries, Indonesia faces the most severe housing challenges and government intervention is also less effective. It depends more on the informal sector. However, many informal sector players

often bypass the government rules and regulations and to make themselves or their activities invisible to government control. The operations of the informal sector undermine the formal institutions, rule of laws and society as well as the effectiveness of governance by the Government. But, if the Government does not allow the functioning of the informal sector in housing, the Government cannot afford other alternatives. This is a dilemma.

In fact, developing countries face many dilemmas and/or uncertainties in dealing with housing issues. Should the housing sector be treated as an economic sector or social sector or consumption sector? What is the role of housing in economic development? What priorities should be given to the housing sector in national development? What stakeholders/resources should be mobilised to promote housing development, particularly low income housing and slum upgrading? These are the central questions to determine the direction and effectiveness of housing policy.

The well-promoted free market model does not exist in reality. Every country has some degree of government intervention in the housing sector. This report well reflects major housing approaches in practice. From the models presented in case countries, we can see some relationship between the types of models and economic development stages. We can induce the following hypotheses:

i. A higher level of economic development provides a better condition for the healthier operation of a market model.

- ii. In a market housing model, the benefits of the system are lean toward the middle and high income groups.
- iii. In a mature economy's market housing model, government intervention often leans toward benefiting middle and high income groups more than low income groups.
- iv. Government intervention is more needed in countries at earlier development stages than those at later development stages.
- v. Government intervention is preferred to market mechanism in the provision of low come housing.
- vi. A dual model of state and market is often more effective in solving the housing problem in low and middle income developing countries.
- vii. The housing sector is a dual sector. The high and middle income housing segments can have major positive impact on economic development, and low income housing and slums have little or very low economic contribution. Therefore, for developed countries/economies, the housing sector can be a growth pole, and for developing countries/economies, large investment in low income housing and slums may not yield significant economic growth or even hinder national economic development. Therefore, many poorest developing countries may not have the strong political will for massive investment in slum upgrading and construction of low income housing.
- viii. Extremely poor people may not treat housing as a top priority of their needs when they still have difficulties in meeting their daily subsistence needs.
- ix. In the Asian culture, housing is also viewed as symbol of social status, therefore, housing may be given higher priorities and people may be

willing to devote more resources in housing than in other cultures.

- x. In countries which put community and society on top of their values, they often vigorously promote social integration through mixed housing development in terms of income and ethnic groups.

The danger in searching for housing solutions is to isolate the housing issues from other wide issues in a country. The housing sector is part of the big chain in the social, economic, political, institutional and cultural system. The housing problem may not necessarily be created within the housing sector. It may be the result of the interaction of many sectors and forces in the society. For better understanding, we construct an economic development and urbanisation residual model to explain the potential for housing solutions. When urbanisation is far beyond the economic growth pace to accommodate increased urban population, the imbalance between economic growth and urbanisation can lead to the growth of slums. Slums can be seen as the negative residual of economic growth and urbanisation equation. As long as the dynamic imbalance between economic growth and urbanisation continue to generate negative residual (i.e. the urbanisation outpaces the economic capacity), purely demolishing slums and replacing with new housing will not be a sustainable solution to slums. In many de-

veloped countries, urbanisation is almost completed and therefore urbanisation rate is very low, while the economic development has reached a very high level, the imbalance between economic development and urbanisation yields a positive residual. This means that the developed countries have sufficient economic capacity to accommodate the housing needs of urban population. In some developing countries, the economic development level is low, while the urbanisation rate is high. The imbalance between economic development and urbanisation yields negative residual, which indicates that the national economic capacity has difficulties to accommodate the housing needs of urban population. Therefore, promoting economic growth and managing urbanisation to reduce the negative residual caused by the imbalance between economic growth and urbanisation may be more effectively in reducing slums and solve housing problems for low income groups. Therefore, an effective housing solution not only needs actions in the housing sector but also in other sectors. It requires a holistic approach. It can not leave the housing issue to the market alone. It requires appropriate government interventions.

CHAPTER 1

THE ROLE OF GOVERNMENT IN THE HOUSING MARKET: Restructuring of the home ownership system in Japan

Introduction

The home ownership system in Japan has been playing a key role in stabilizing society and the economy. After the end of the Second World War, the macro economy grew at a great rate, generated an increase in the middle class and promoted their acquisition of housing. Mass construction of owner-occupied housing was considered an engine to stimulate economic growth. To own housing was accompanied by a capital gain and was an effective means of acquiring an asset since land and housing prices were continuously and rapidly rising. That middle-class people, obtaining their own housing and accumulating an asset, were regarded as contributing towards social stability.

The central government took the initiative in establishing the system to expand home ownership. The Housing Loan Corporation (HLC), an agency of the government, has been providing people who hope to purchase a house with low-interest loans.

Among the various means of implementing housing policy, the HLC loan has always played a central role. The government built a structure in which the expansion of housing acquisition, economic growth and an increase in the middle-class were closely linked together.

However, Japan today has entered a period of drastic change, with shifts from a growing to a destabilized economy, from state intervention to a deregulated market, and from a cohesive to a fragmented society. Changes in the circumstances concerning housing have deprived the traditional home ownership system of its effectiveness (Hirayama, 2001a, 2001b). The 'bubble economy' appeared in the late 1980s and collapsed at the beginning of the 1990s. Since the bubble burst, a serious recession has been persistent, employment has become more mobile and increase in income has stopped.

Housing and land prices have dropped sharply for the first time since the end of World War II.

The security of owner-occupied housing as an asset has been undermined. Stability of the middle-class which has formed the core of society has weakened.

This chapter focuses on the restructuring of the home ownership system in Japan today. The housing system not only provides housing but also is deeply involved in the wider economy and social structure. It is made clear in the following discussion how vividly the change in home ownership reflects the reorganization of social and economic conditions.

1. Home Ownership System in the Post-War Period

Japan achieved amazing economic development after the Second World War. During the period from 1955 to 1973, when the oil crisis occurred, the average GDP growth was as high as 10 per cent. Immediately after the oil crisis, the economy began to grow again. The growth of the Japanese economy continued at a high level until the burst of the 'bubble economy'.

One of the elements which supported this economic growth was the mass-construction of housing. There was a great shortage of housing after the war until the first half of the 1970s. A large part of the housing stock was lost in war-devastated cities. Approximately 4.2 million housing units - over one fifth of the total number of existing units - were needed immediately

after the war. Rapid urbanization in the post-war period put increasing stress on the demand for housing. The proportion of the population in urban areas jumped from 37.7 per cent in 1950 to 63.9 per cent in 1960, and to 72.1 per cent in 1970. There was a tremendous demand for housing underlying its mass construction.

Housing construction came to have an important position in the macro economy. The housing industry began to expand in the 1960s and to increase housing construction. Over 90 per cent of housing investment came from the private sector.

The rate of housing investment in the GDP remained at a high level between 7.2 per cent and 8.9 percent throughout the 1970s (Ministry of Construction, 1996, 19). Large-scale housing construction has been a prominent feature in Japan up to the present time.

The post-war housing policy was systematized in the 1950s. Its core consisted of the so-called 'three pillars'; the Housing Loan Corporation (HLC) Act in 1950, the Public Housing Act in 1951 and the Housing Corporation (HC) Act in 1955. The HLC mainly provides individuals with a long-term, fixed-low-interest loan for the building and acquisition of their own home. Public housing, which is constructed, owned and managed by local governments and subsidized by the central government, is available for low income households at a low rent. The HC was founded in order to construct rental housing and condominiums for middle-income workers in large cities.

Table 1. Housing tenure

Year	Owned Houses %	Public rented houses (owned by local government) %	Public rented houses (owned by public corporation) %	Private rented houses %	Company houses %	Total (Including tenure not reported) N
1963	64.3	4.6		24.1	7.0	20,374,000
1968	60.3	5.8		27.0	6.9	24,198,000
1973	59.2	4.9	2.1	27.5	6.4	28,731,000
1978	60.4	5.3	2.2	26.1	5.7	32,189,000
1983	62.4	5.4	2.2	24.5	5.2	34,705,000
1988	61.3	5.3	2.2	25.8	4.1	37,413,000
1993	59.8	5.0	2.1	26.4	5.0	40,773,000
1998	60.3	4.8	2.0	27.3	3.9	43,892,000

Sources: Statistics Bureau. 1963 Housing Survey of Japan - 1993 Housing Survey of Japan. and 1998 Housing Survey of Japan

Among these ‘three pillars’ of housing policy, the government has constantly emphasized the HLC’s low interest loan (Hirayama, 2001a, 2001b; Hirayama and Hayakawa, 1995; Oizumi, 2002; van Vliet and Hirayama, 1994). As shown in Table 1, the level of owner-occupied housing remained at around 60 per cent between 1963 and 1998. Despite the rapid urbanization, the level of home ownership was maintained because of the measures used to accelerate housing acquisition. The percentage of private rental housing has been the second highest at around 25 percent. However, private rental housing has not been supported by housing policy. The ratios of public housing and HC housing have been very low at around 5 per cent and 2 per cent, respectively.

In post-war Japan, the middle class who owned houses were considered to form the main stream of society (Hirayama, 2001a). Households which had secure employment and income in a time of economic growth aimed at obtaining a

house. The prices of land and housing, except during the oil crisis periods, kept going up at a rapid pace until the burst of the bubble economy. This rate was far in excess of general price and income growth. Households who could once acquire housing were promised a capital gain. The combination of an increase in the middle class, the expansion of home ownership and building of an asset through capital gain was expected to stabilize society.

However, it should be noted that the policy which concentrated public resources on expansion of home ownership produced disparities in housing conditions between renters and owners, and between low income and higher income households. According to the Housing and Land Survey in 1998, there was a difference in floor space - 121 square meters for an owner occupied housing unit and 44 square meters for a rental housing unit. The income of residents differs largely according to the type of tenure. 36 per cent of households living in owner occupied housing earned

7 million yen or more a year, while 47 per cent of those in private rental housing of wooden structure earned 3 million yen or less.

Home ownership policy was implemented as a means of accelerating economic growth. Private banks, which had concentrated on the provision of capital for business enterprises in the period right after the war, began lending for the acquisition of owner-occupied housing in the 1960s. Households who acquired a house utilized a combination of the HLC and bank loans. The HLC's low-interest loan withdrew capital from family finances, expanded the bank's financial market, and stimulated private housing investment. Housing construction caused a significant economic ripple effect

on the steel, cement and lumber industries. Households which purchase a new house also usually buy new furniture and electrical appliances. The government structured a policy to increase investment on housing with significant multiplier effects using the HLC as a lever.

With the oil crisis in the early 1970s as a turning-point, housing policy became more of a measure to stimulate the economy, putting more stress on encouraging people to purchase their own houses with an HLC loan. The proportion of houses using HLC loans to housing construction funded publicly increased from 63 per cent in the 1971-75 fiscal year to 79.5 per cent in the 1976-80 fiscal year, and to nearly 90 per cent in the 1990s (see Table 2).

Table 2. Housing tenure

Fiscal Year	Housing by housing loan corporation A	Publicly founded housing of other types B	Publicly founded housing C=A+B	Private housing	Total N	A/C*100 %	A/N*100 %
1961 - 65	392	290	682	2,794	3,476	57.5	11.3
1966 - 70	697	575	1,272	4,764	6,035	54.8	11.5
1971 - 75	1,154	689	1,844	5,997	7,840	62.6	14.7
1976 - 80	1,967	508	2,475	4,786	7,261	79.5	27.1
1981 - 85	1,994	374	2,368	3,525	5,893	84.2	33.8
1986 - 90	2,085	296	2,382	5,748	8,129	87.5	25.6
1991 - 95	2,653	303	2,956	4,361	7,318	89.7	36.3
1996 - 00	2,171	256	2,427	4,164	6,591	89.5	32.9

Sources: Ministry of construction

2. The Bubble Economy and Home Ownership Policy

The economic conditions for the home ownership system changed drastically because of economic globalization, financial deregulation and the formation of a more competitive business environment. The rise and collapse of the 'bubble economy' played an important role in restructuring the environment surrounding the housing system.

The bubble economy appeared in the latter half of the 1980s. The abnormal upsurge in the prices of land and housing started in Tokyo and spread to Osaka, Nagoya, and then all over the country (Hayakawa and Hirayama, 1991). Measured against that of the previous year, the price of residential land was recorded at 68.6 per cent in Tokyo in 1988 and 56.1 per cent in Osaka in 1990 (Figure 1). The average cost of housing in the Tokyo metropolitan area increased between 1980 and 1990 from 24.8 million yen to 61.2 million yen for a condominium, and from 30.5 million yen to 65.3 million yen for a ready-built single-family house. Price-income ratios rose from 5.0 to 8.0 times for a condominium and from 6.2 to 8.5 times for a ready-built single-family house (Ministry of Construction, 1996, 24).

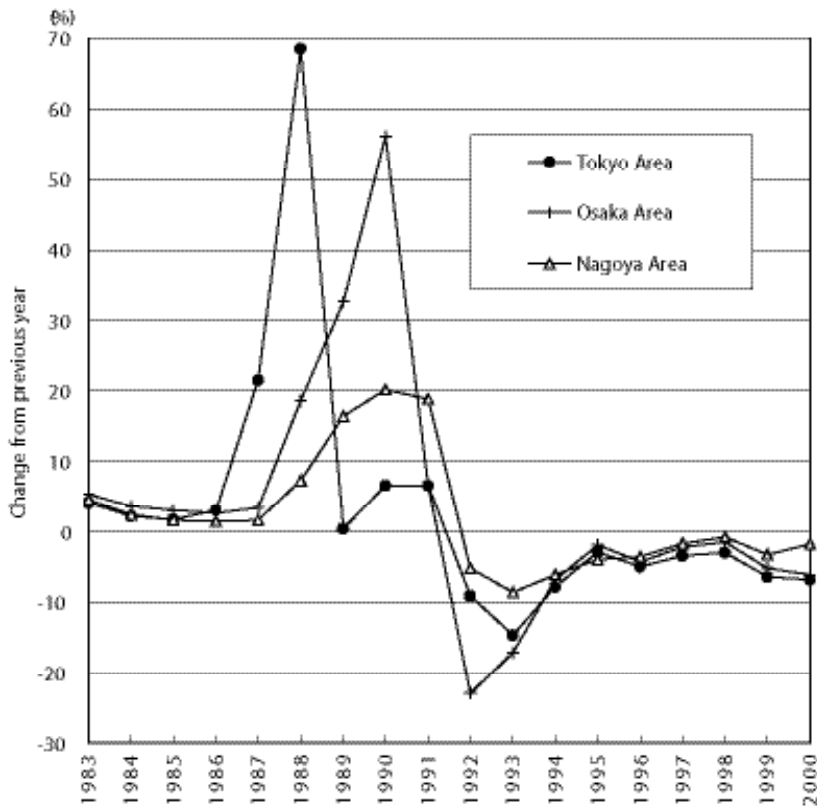
Finance was eased and surplus capital flew into real estate. With a trade conflict between Japan and the United States, the Japanese yen rose suddenly after the Plaza Agreement in September, 1995, and interest rates were lowered. The Japanese government, requested by the United States to expand its domestic demand was forced to increase expenditure on public works on top of the relaxed finance. Once the price

of land began to rise, not only real estate-related businesses but also all kinds of enterprises rushed to invest in land. Banks, non-banks, life insurance companies and stock companies poured a huge amount of funds into land purchases.

The collapse of the bubble economy began in Tokyo in 1989, and spread to other cities. Land prices have continuously been declining since the beginning of the 1990s until now (Figure 1). The sustained fall in land prices, experienced for the first time since the end of the war, has thrown Japanese society into confusion.

Since the bubble burst, a serious recession has continued with minimal or negative real growth in GDP. The banking sector was plunged into crisis as a huge amount of bad debts were generated. The government has been putting a large amount of public money into the banking sector to deal with these bad debts. The total amount of bad debts, however, is still on the increase. While the injection of public capital has reduced existing bad debts, new debts are being generated by the economic stagnation. As of 1999, according to the Financial Investigation Agency, bad debts in total increased from 21.8 trillion yen in 1996 to as much as 30.4 trillion yen in 1999 (Watanabe, 2001, 21). Stability of employment and income has disappeared. Many companies have started to address restructuring by down-sizing. Employment is now becoming more mobile and there are more part time workers, workers on detachment and employees on fixed term contracts. A chain reaction of the collapse of many banks and businesses began in 1997. The unemployment rate increased from 2.1 per cent in 1990 to 5.6 per cent

Figure 1 Population living in water-scarce and water-stressed countries, 1995–2050



Source: Housing Loan Corporation

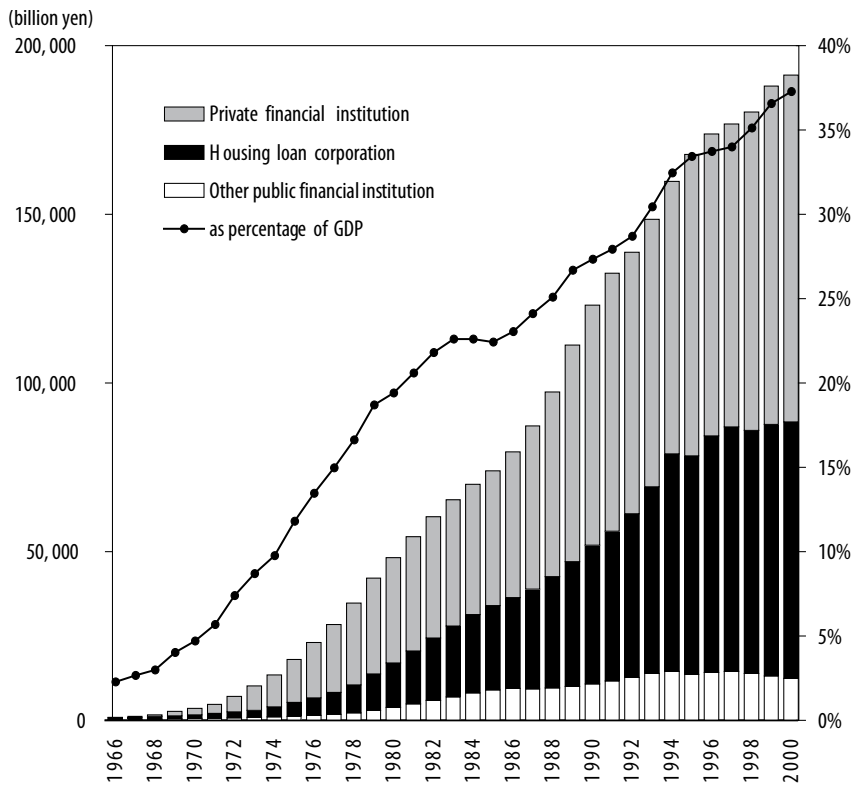
in 2001. The average annual income in the 1990s stopped increasing steadily; there were only repeated small increases and decreases ranging from 7.3 million yen to 8 million yen.

Housing finance has played an important role to boost the housing sector. The government has increased the HLC loan and encouraged housing construction throughout the time before, during and after the bubble period. The HLC created a series of new programs in order to enable people to acquire their own homes.

The Step Repayment System in which the amount of repayments was set at a low level for the first five years was introduced in 1979. A housing loan system for two generations was established in 1980 to enable a child's household to take over its parent's loan. The Supplementary Loan Program which adds a supplementary loan to basic loan was launched in 1985.

The government in the bubble period expanded the HLC loans based on the premise that housing supply shortage pushes the price of housing up. Loan interest was

Figure 2 Residential loan debt outstanding



Source: Housing Loan Corporation

slashed and the size of supplementary loans was increased in 1986. The loan limit was raised and the supplementary amount was again increased in 1987. A policy which added to the initially projected number of houses with HLC loans was implemented every fiscal year. The total number of new housing started in the 1986-90 fiscal year was as many as 8,129,000 units, the highest on record (see Table 2). The increase in housing supply, however, did not result in a drop in housing prices during the bubble period since speculative investment into real estate pushed up the prices of land and housing. The increase in the supply

of finance by the HLC, if anything, fuelled real estate speculation thus swelling the bubble.

After the bubble collapsed, the government increased public finance even more in order to revive the economy through housing construction. The amount of a supplementary loan was raised in 1992 and 1997. The amount of repayment for the first five years in the Step Repayment System was lowered in 1993 and 1994. A great amount of housing units financed by the HLC was added to the initially planned number in 1993. The tax-reduction period

for those who bought their own housing was extended from 6 to 15 years in 1999. This was devised as a measure valid for only two years but was not abolished after the projected period. The new starts of housing financed by the HLC reached as many as 2,653,000 units in the fiscal years 1991-95, the highest record in history, accounting for 36.3 per cent of the total number of new starts (see Table 2).

As a countermeasure for both the occurrence and collapse of the bubble economy, the government continuously placed importance on the expansion of housing construction. A significant result is that Japanese home owners have become deeply in debt. As illustrated in Figure 2, the total amount of outstanding housing loans swelled from 48,229 billion yen in the 1980 fiscal year to 191,203 billion yen in the 2000 fiscal year.

The ratio of outstanding housing loans against GDP rocketed from 19.4 per cent to 37.3 per cent during the same period. The HLC encouraged the increase of whole housing loans. The amount of outstanding HLC loans was 75,922 billion yen, as high as 40 per cent of the total amount of outstanding loans in the 2000 fiscal year.

3. Deteriorating Economic Conditions for Home Ownership

Housing prices have been continuously falling for the last decade. Owner-occupied housing, which, without exception, used to generate a capital gain, has begun to create a capital loss. A household who became a house-owner during the bubble

period is now suffering from serious asset deflation just because the time of housing acquisition was not good.

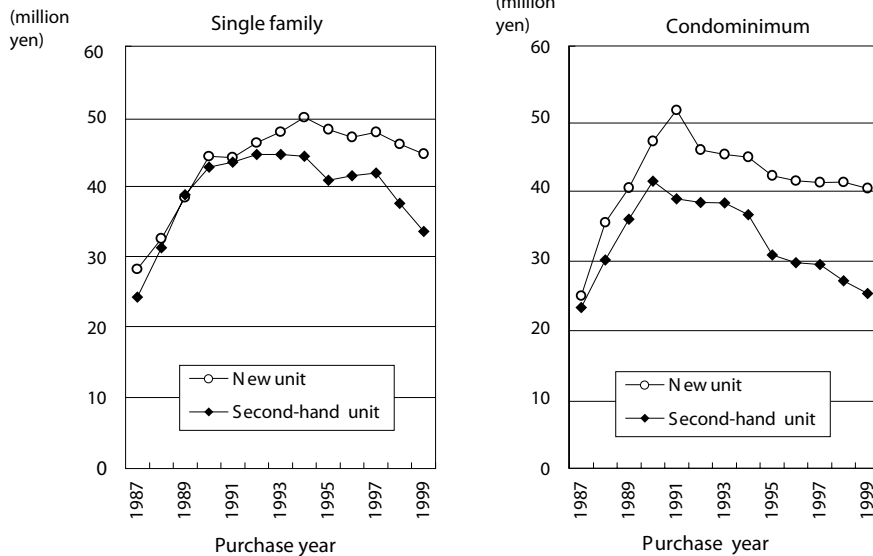
It was in second-hand condominiums in big cities that prices dropped most significantly. Figure 3 shows the shift in the price of housing purchased with an HLC loan. According to this, the price drop has been more apparent in the case of condominiums than that of single-family houses, and among the condominiums, it has been more noticeable in second-hand ones than in newly built ones. The price of a second-hand condominium between 1990 and 1999 went down from 40.8 million yen to 24.9 million yen in Tokyo and from 33.5 million yen to 20.7 million yen in Osaka. The ratio of second-hand condominium prices to newly-built condominium prices between 1993 and 1999 decreased from 84.7 per cent to 62.6 per cent in Tokyo and from 86.3 per cent to 60.0 per cent in the Kinki area (see Figure 4).

Capital losses on condominiums in the major cities have been substantial (see Figure 5). A condominium purchased during the bubble period has lost half of its value. In 1991, the average price of a newly-built condominium using an HLC loan in Tokyo was 51 million yen. This dropped to 24 million yen by 1999 indicating a capital loss of some 27 million yen as of 1999. Similarly, a newly-built condominium in Osaka in 1992 cost 45 million yen on average and its value dropped to 21 million yen in 1999 which generated a capital loss of some 24 million yen.

There are two main reasons for the drop in the marketability of second-hand condominiums. First, a large quantity of new

Figure 3a Prices of housing with the HLC's loan

Tokyo



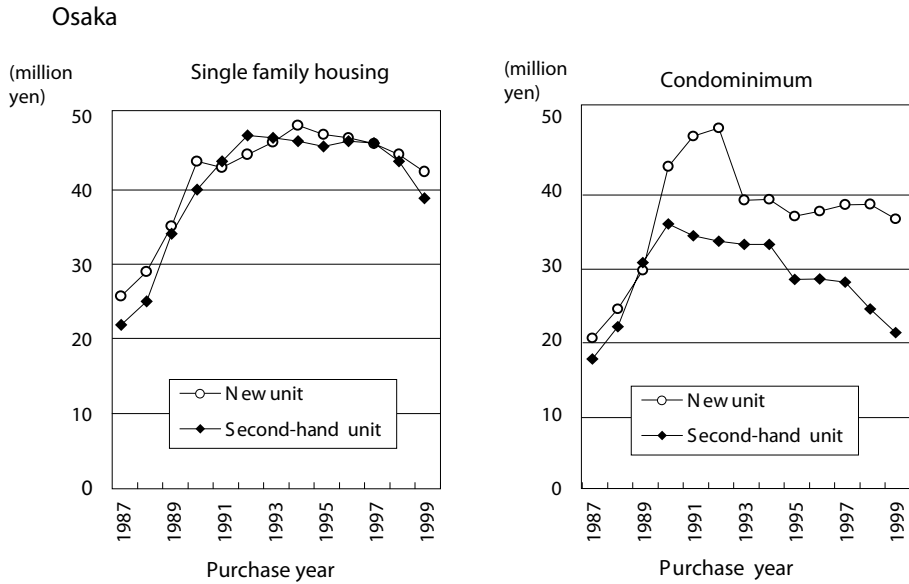
Source: Housing Loan Corporation

condominiums was built in big cities in the 1990s. A combination of factors such as the decrease in housing prices, a continual low interest rate and the improvement of the HLC's loan conditions encouraged people to buy a newly-built condominium unit. As the market of new condominiums expanded, the price of second-hand ones went down. Second, the home ownership policy is designed to be advantageous as for the acquisition of new housing. The longest repayment period for an HLC loan is generally 35 years for new housing, while it is 25 years for second-hand housing. The HLC does not finance those who purchase second-hand housing which is over 25 years old. The taxation system also gives an advantage to purchasers of new housing.

The greatest capital loss occurred in the inconveniently located 'suburban bubble condominiums'. A household which moves to the suburbs generally desires a single-family house. During the bubble period, however, many households purchased condominiums in the suburbs since the increase in housing prices was extreme. In the post-bubble period, the prices of condominiums in inferior locations have fallen further than other kinds of properties.

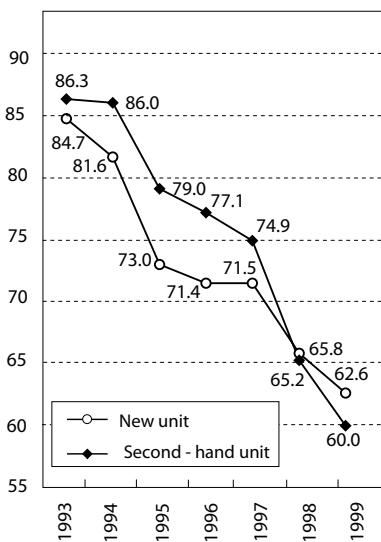
The family budget of households who have a loan for housing deteriorated in the 1990s. Households who purchased housing during the bubble period had a large amount owing. Though housing prices decreased in the post-bubble period, many

Figure 3b Prices of housing with the HLC's loan



Source: Housing Loan Corporation

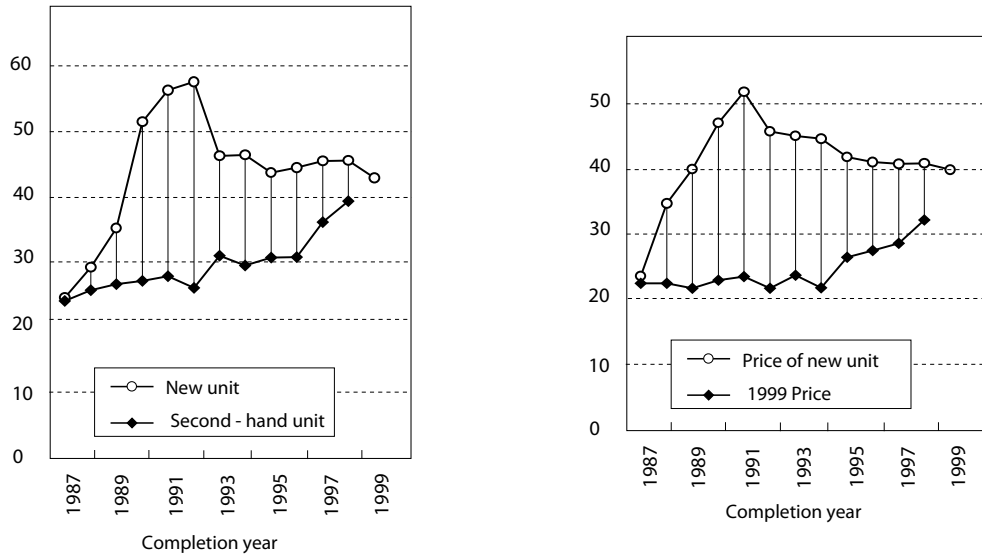
Figure 4 Ratio of second-hand condominium prices to newly built condominium prices



Source: Housing Loan Corporation

households paid only a small deposit and ended up taking out considerable loans to acquire a house because of the improved lending conditions by the HLC. Employment has become insecure due to the persistent recession and income has not increased since the beginning of the 1990s. The Step Repayment System was one of the main factors causing the deterioration of family budgets. Households who adopted this system had to repay a suddenly increased amount after the first 5 years of the low repayment period though their incomes did not increase. The system was criticized for encouraging households with a not-so-high income being coerced into acquiring a house and was abolished in 2000.

Figure 5 Capital losses on condominiums with the HLC's loan



Source: Housing Loan Corporation

The average annual income and the repayment amount of a household with a housing and/or land loan are shown in Table 3. The average annual income steadily increased from 5,549,000 yen to 8,695,000 yen between 1981 and 1991, but almost stopped increasing in the 1990s. The average repayment amount, on the other hand, kept increasing from 605,000 yen in 1981 to 923,000 yen in 1991, and to 1,430,000 yen in 2000. The repayment-income ratio which remained around 11 per cent in the 1980s rose in the 1990s to reach 16.1 per cent in 2000.

The financial situation of households has been generally deteriorating since the early 1990s. As shown in Table 4, the average balance of savings minus the amount of debt for a household decreased from 8,165,000 yen in 1991 to 7,760,000 yen in 2000. The figures for households which have loans for housing and/or land fell markedly from 2,244,000 yen in 1991 to minus 1,121,000 yen in 1995, and to minus 4,158,000 yen in 2000.

Table 2. Housing tenure

Year	Income (thousand yen)	Repayment (thousand yen)	Repayment income ratio B/A* 100(%)
1981	5,549	605	10.9
1982	5,887	625	10.7
1983	5,997	680	11.3
1984	6,329	750	11.9
1985	6,488	746	11.5
1986	6,711	796	11.9
1987	6,960	806	11.6
1988	7,189	840	11.7
1989	7,487	942	12.6
1990	8,115	956	11.8
1991	8,695	923	10.6
1992	8,832	889	10.1
1993	8,859	1,010	11.4
1994	8,737	1,169	13.4
1995	8,979	1,351	15.0
1996	9,047	1,286	14.2
1997	8,977	1,286	14.3
1998	9,232	1,410	15.3
1999	8,889	1,587	17.9
2000	8,884	1,430	16.1

In the prolonged recession, an increasing number of households are finding themselves unable to repay their housing loans. The number of loans over 6 months in default for HLC loans increased from 14,205 to 33,306 and the total amount of these which were outstanding increased rapidly from 193.7 billion yen to 500.2 billion yen between 1995 and 2000 (see Table 5). When an HLC loan is unable to be repaid, the Financial Security Association takes over the loan. The number of such cases increased from 4,820 in 1990 to 17,757 in 2000.

Table 5. Housing tenure

Year	Number of cases	The amount of loan outstanding (billion yen)
1995	14,205	193.7
1996	15,800	215.5
1997	18,525	271.1
1998	22,905	337.2
1999	28,118	416.3
2000	33,306	500.2

The housing system kept providing owner-occupied housing throughout the period during which land and housing prices skyrocketed and nose-dived, putting the system itself into a critical condition. Japan at the beginning of the 21st century has been left with a mass of owner-occupied housing bearing huge capital losses, unmarketable 'suburban bubble condominiums', and a large number of house-owners with heavy loans and insecure incomes. Home ownership before the bubble period placed home owners at an advantage and renters at a disadvantage in relation to asset formation. The system, however, has become one which is unable to protect even the advantage for home owners in the post-bubble period.

4. Decline in the Housing Ladder System

A 'housing ladder system' has been encouraging households to move from a rental house to an owner-occupied house and from a condominium to a single-family home (Hirayama, 2001a, 2001b). This envisaged the following: when a family is young, they may rent a house of poor quality as their income is low; as the family matures, their income increases and they can move to a better house; and in the end, the family should be able to purchase a house, and once they own a house, it means they can make a capital gain which enables them to move from a small house to a larger house. Single-family housing was located at the top of the ladder and regarded as the 'Japanese dream'.

This mechanism was based on the assumption that most people follow a 'standard life course' and produce 'standard families' of a couple and child(ren). The structure of society, however, has been fragmented by rapidly diversifying family types and life styles, thus causing the function of the ladder system to be less effective. The definition of 'standard family' and 'standard life course' today has become vague.

The population structure is undergoing a dramatic change signified by an increase in the elderly and a decline in the birth rate. The proportion of those 65 years old or older in the population increased from 7.1 per cent in 1970 to 14.5 per cent in 1995, and it is estimated to rise above 25 per cent in the 2020s. The birth rate has been falling significantly. The number of births per 1,000 of population fell from 18.8 in 1970 to 13.6 in 1980 and to 9.5 in

2000. Japan is one of the nations where an increase in the elderly and a decrease in births are most prominent.

Family structure has also drastically changed. The proportion of households with a couple and child(ren) to the total number of households decreased from 46.1 per cent in 1970 to 35.4 per cent in 1995. A family with a couple and child(ren) can today no longer be regarded as the norm. Single people, elderly-only households and couples without children have been increasing. The proportion of single households rose from 10.8 per cent in 1970 to 23.1 per cent in 1995. The average family size has fallen. The proportion of households with four or more members decreased from 54 per cent in 1970 to 34 per cent in 1995.

Changes in the form of marriage have accelerated the diversification of life course (Japan Statistical Association, 2001, 24-25). The number of marriages in a population of 1,000 went down from 10.5 in 1975 to 6.1 in 1999. The average age of getting married for the first time rose to 30.5 for men and 27.2 for women in 1995. It is the second highest in the world next only to Sweden. The unmarried rate of 30 to 34 year olds increased from 11.7 per cent to 37.3 per cent for men and 7.2 per cent to 19.7 per cent for women between 1970 and 1995. The number of those who choose not to marry has been constantly increasing as has that of those who marry but choose not to have children.

An increase of so-called 'parasite singles' is one of the elements confusing the ladder system (Yamada, 1999). Twenty to thirty four-year-old persons living with their

parents are defined as 'parasite singles'. Two-fifths of men and one-third of women between 25 and 29, and one-fifth of men and one-eighth of women between 30 and 34 were 'parasite singles' in 1995. They enjoy free housing and food and probably have their housework done for them. Believing that their quality of life will decline if they become independent and/or get married, they live for longer periods in their parents' home.

The ladder system has been effective under conditions where most of society is occupied by a stable middle-class and home ownership is accompanied by capital gain. Even if it was a burden to buy a house, repayments of the loan were expected to ease as income increased and the value of the house rose. However, the value of privately owned houses today is at risk, incomes are not increasing and stability of employment is fragile. The size of the middle class is estimated to be shrinking (Sato, 2000; Tachibanaki, 1998). According to research by the Ministry of Health and Welfare, the Gini-index of income before tax increased from 0.349 in 1980 to 0.441 in 1994, and the Gini-index of income after tax from 0.314 to 0.361 in the same period.

The mass-construction of owner-occupied housing was buttressed by strong demand. The government focused public money on home-ownership assuming that it would generate a chain reaction of household moves through the housing ladder and would expand housing demand and construction. It is estimated, however, that housing demand will be on a definite downward path. Urbanization settled down in the latter half of the 1970s. Japan's population will start decreasing in

the foreseeable future. The rate of household formation will also decline. The total number of housing units exceeded the total number of households in the early 1970s. Since then, the vacancy rate has been constantly rising from 7.6 per cent in 1978 to 9.8 per cent in 1993, and to 12.6 per cent in 1998.

Table 6 shows the change in the number of households who shifted house in the last five years. According to this, the absolute number of shifts remained between around 11.0 million and 12.2 million with no big change. The ratio of moves to the total households, however, dropped from 35.8 per cent in 1978 to 27.7 per cent in 1998. The decrease in the proportion of shifts reflects the trend toward a decrease in housing demand. According to the Housing Demand Survey, between 1978 and 1998, households who planned to improve their housing decreased from 35.1 per cent to 18.7 per cent among home owners, and from 44.1 per cent to 28.2 per cent among those living in rental housing.

Table 6. Household

Year	Movers A	All households B	A/B* 100 (%)
1968	8,740,100	24,686,800	35.4
1973	11,258,800	29,103,400	38.7
1978	11,603,000	32,434,300	35.8
1983	11,361,600	34,956,000	32.5
1988	11,033,700	37,562,500	29.4
1993	11,858,800	40,934,000	29.0
1998	12,209,100	44,133,900	27.7

Table 7. Household moves and tenure change

	1974 -1978	1979 -1983	1984 -1988	1989 -1993	1994 -1998
Total	11,603,000 (100%)	11,361,00 (100%)	11,033,700 (100%)	11,858,800 (100%)	12,209,100 (100%)
Own - Own	987,800 (8.5%)	1,065,100 (9.4%)	940,600 (8.2%)	965,700 (8.2%)	887,800 (7.4%)
Own - Rent	435,900 (3.8%)	667,100 (5.9%)	1,151,900 (9.8%)	1,115,900 (9.8%)	1,085,900 (9.1%)
Rent - Own	2,185,500 (18.9%)	2,050,300 (16.3%)	1,659,100 (14.1%)	1,659,100 (9.8%)	2,123,900 (17.7%)
Rent - Rent	4,460,200 (38.5%)	4,046,300 (35.8%)	4,149,300 (38.9%)	4,744,00 (40.3%)	4,457,900 (37.2%)
Parents'- Own house	669,300 (5.8%)	710,800 (6.3%)	463,800 (4.3%)	368,200 (3.1%)	480,200 (4.0%)
Parents'- Rent house	2,744,900 (23.7%)	2,692,700 (23.8%)	2,440,800 (22.9%)	2,836,200 (24.1%)	2,887,400 (24.1%)
Other types of tenure change	94,700 (0.8%)	77,300 (0.7%)	45,700 (0.4%)	51,300 (0.4%)	65,800 (0.5)

The change in the pattern of tenure related to household moves is shown in Table 7. The actual situation of such shifts concerning home ownership indicates the fact that the housing ladder system has become less effective.

First, the number of moves from rental housing to owner-occupied housing dropped by a large amount from 2,186,000 in the period 1974-1978 to 1,659,000 in the period 1989-1993. The jump in housing prices during the bubble period is presumed to have reduced the number of first-time home buyers. Other factors related to the diversification of family structure such as the increase in single-households and couples without child(ren) and the delaying of marriage have also lessened the demands of first-timers. This pattern increased to 2,124,000 in the period 1994-1998 because housing prices have gone down in the post-bubble era.

Second, the number of moves within the owner-occupied housing sector decreased from 1,065,000 in the period 1979-1983 to 888,000 between 1994 and 1998. One of the factors responsible for this is that households who bought condominiums during the bubble period have become tied down by a capital loss. Many had anticipated a move to a better condominium or into a single-family house using the condominium as a stepping stone, but this became impossible with the bursting of the bubble economy. If a capital gain was a key factor of the ladder system, a capital loss has become an obstacle to the system.

Third, the number of moves from an owner-occupied house to a rented house increased greatly from 436,000 in the period 1974-1978 to 1,152,000 in the period 1989-1993, though it slightly decreased to 1,086,000 in the period 1994-1998. What has caused this is not clear though there are some factors which are possible. Home ownership may have pressured family finances so much that an increasing number of households have sold their homes. More and more elderly households may have sold their homes to obtain living expenses. If the ladder system is to propel moves from rental accommodation to an owner occupied house, the increase in moves in the opposite direction implies that the function of the system has collapsed.

5. Marketisation of Home Ownership

The state played a leading role in the construction of a housing system in the post-war period in Japan. Housing Policy by the national government formed a framework to build a relationship between the central role of home ownership, economic growth through housing construction and an increase in the middle-class. The present government, however, began to retreat from housing policy and to promote the marketisation of housing.

A series of measures to put housing into the market and to deregulate the market have been undertaken since the 1990s (Hirayama, 2001b; Oizumi, 2002). The Amendment to the Public Housing Law in 1996 reduced the upper limit on income for households eligible to move into public housing. Public housing has been defined as 'welfare housing' for the lowest-income

group who cannot access the market. The HC was re-organized into the Housing and Urban Development Corporation (HUDC) in 1981 and again into the Urban Development Corporation (UDC) in 1999. The new UDC greatly reduced its housing-related projects so as not to compete with the housing businesses in the private sector. The Renters and Leaseholders Act was amended in 2000 in order to deregulate the rental housing market (Morimoto, 1998). Before this amendment, tenants' security of tenure was protected and landlords could not easily request them to move out. With this amendment, however, it is now possible for owners to rent their houses for a limited period.

Housing policy until the first half of the 1980s had a clear purpose of improving housing conditions. The goals in relation to the Five-Year Housing Construction Plan were transparent: the goal set in 1966 was that housing for all households was to be ensured; the one set in 1971 was that a room for everyone was to be guaranteed; the one set in 1975 was that substandard housing would be eliminated by 1985. Now, however there are no clear goals in relation to what kind of housing should be provided or what kind of problems should be solved. Housing marketisation appears to have become the sole purpose of housing policy.

The beginning of the 21st century has seen the near abolition of the traditional 'three pillars' of housing policy by the central government. The Koizumi administration, established in April 2001, set out to deregulate the market economy and to downsize the government sector employing radical methods. As regards public housing, it laid

out a policy that new starts be suspended in principle, though existing housing could be re-built. The UDC is scheduled to be out of existence by the end of 2005 and its successor, a new corporate body of the government, is to deal only with management work and in principle with no plans for new construction. In addition, a plan has been proposed to allow private enterprises to take part in the management of the UDC housing, and to purchase the UDC's rental housing property.

The home ownership policy of the Koizumi Administration is most controversial. The administration planned to abolish this organization within 5 years. The new corporate body replacing the HLC is scheduled to retreat from the primary market of housing loans and be concerned only with the secondary market in which housing loans changed into bonds are circulated. Private banks have been calling for the expansion of the private housing loan market because there is a tendency of enterprises to procure funds not only by borrowing from banks' loans but also by equity financing and because the risk associated with housing loans for individuals is comparatively small. In order to reduce government spending, the Koizumi Administration judged it to be effective to do away with the HLC which is a huge financial burden. There have been, however, a lot of doubts being raised whether private banks' housing loans can take the place of the HLC's long-term, fixed and low-interest loans. A stable secondary market is required for private banks to supply loans under the same conditions as the HLC. There exists, however, almost no secondary market in Japan at present and whether the new corporate body, the successor to the HLC, can estab-

lish it within a 5 year period remains to be tested. While the HLC has been supplying moderate-income households with loans, private banks are predicted to respond to demands from higher income households only. As the HLC occupies an extremely large section of the current housing loan market, the question is whether the abolition of the HLC is feasible or not.

The new administration has planned to remove most governmental interference in housing provision and has put forward a policy to encourage an even more rapid marketisation of housing. Home ownership in Japan, which has until now been expanding under the control of the government, will be dealt with on a deregulated market. The history of the strong role of the central government in the housing sector will be largely weakened.

Conclusions

Home ownership in the post-war period has been going in a definite direction for both individuals and society. Mass construction of owner-occupied housing was considered to stimulate economic growth and to stabilize society. Many people were ensured of employment, had a family, participated in the housing ladder system and aimed at obtaining a house. Possessing a house generated a capital gain and promoted asset accumulation for the owner. Home ownership was not only defined in a material sense, but also as a place for the family, a keystone of a life plan and a middle class symbol.

As economic and social conditions are becoming transient and more complicated, the home ownership system is losing its direction. People who became a home owner between the second half of the 1980s and the first half of the 1990s have been bound by a capital loss only because they bought housing at a wrong time. House-owners' family budgets have deteriorated and more and more households are becoming unable to repay their loans. The one-time 'standard family' and 'standard life course' are no longer 'standard' and the effectiveness of the ladder system has deteriorated. It has become difficult to plan a life course in relation to housing.

The nature of home ownership has started to change together with the new conditions created by a volatile economy and fragmented society. We may call such conditions post-modern, post-Fordist, or pure-modern. Whatever the new conditions are called, it is the characteristics of a reorganised home ownership system which has no certain direction. The state has begun to withdraw from housing provision and to promote the deregulation of the housing market. Housing as a pure commodity does not generate a social sense of direction but just circulates in the market.

The change in the home ownership system today will allow people to feel released from the housing ladder. In post-war Japan, many families have felt that they cannot be accepted as a member of the social core group unless they buy a house. Many people have worked hard to be an owner of a single-family house - the 'Japanese dream'. Under current circumstances, however, it is no longer of importance to

people as it used to be whether they can buy a house or not. Even if you bought a house, it would not produce a capital gain any more. Today's young generation do not necessarily think they should have a family and bring up children and do not consider a single-family house as the 'Japanese dream'.

On the other hand, the new nature of home ownership reflects an uneasy society which is now emerging. With a slow economy and an uncertain future, society has no longer any ladder.

It is vague, at this point in time, what role the new nature of home ownership is going to play. What is the meaning of home ownership without any capital gain, the housing market with minimal state intervention, and a life plan without a housing ladder? The only thing that is apparent is that the housing system in post-war Japan has already lost its traditional role.

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CHAPTER 2

THE ROLE OF GOVERNMENT IN THE HOUSING MARKET IN SOUTH KOREA

Introduction

The South Korean experience of economic growth is considered one of the most successful stories of development in modern times. South Korea has risen from a small agrarian economy to the world's twelfth largest over the past four decades and the living standards of the nation have improved enormously. The economy was hit hard by the Asian crisis in 1997 but managed to recover from it much faster than expected. Compared with such remarkable overall economic achievements, the housing sector was an under-performer. Although housing conditions of the nation have improved substantially since mid-1980s, supply of housing failed to meet the aspirations of urban households for better housing as their income grows. Housing prices shoot up occasionally and decent housing remains unaffordable for many urban households.

In this environment, it is not surprising that housing has become a charged and emotional subject in South Korea. The media, the general public and the nongovernmental organizations (NGOs) are very much involved in policy debate on housing issues. This places housing

policy in the political arena in which policy makers are forced to come up with short-term solutions rather than a fundamental reform. Consequently, government keeps adding new regulations and ad hoc measures each time a new round of housing price hike arrives.

Housing markets and housing policy can be analyzed from various perspectives, the choice of an appropriate framework of government housing policy itself is a subject of debate. South Korean housing markets appear tempered by pervasive government intervention and the performance of the housing sector was neither efficient nor equitable. To those who approach housing policy from a social welfare perspective, government may have relied too much on market mechanisms and made grossly inadequate efforts in addressing the needs of the low-income segment of the population. However, even a market advocate would agree that some government intervention may lead to desirable outcome for the society, whereas an interventionist would not believe that government can take the place of the market. The real issue is therefore about

determining where and how government should intervene to improve the housing outcome, on the basis of a careful analysis of how it affects the environment in which markets function.

This chapter looks at the impact of government intervention on South Korean housing markets. It starts with an overview of the evolution of housing policy and policy instruments employed. This will be followed by an evaluation of policy in terms of achievements of policy goals, the incidence of benefits, and side effects on the housing outcome. Time trends of key housing indicators will be presented and international comparison will be attempted as appropriate. The chapter concludes with a discussion of implications and some thoughts on future policy directions.

1. Evolution of Housing Policy in South Korea

Absolute shortages and high prices have been perceived as the two major housing problems in South Korea. Therefore, government policies were designed to increase the supply of new houses at affordable prices. The Government also promoted the goal of “one dwelling unit per household” and tried to make sure that the benefits from housing programs accrue to the “right” groups of households. This has been done through an elaborate process of selecting qualified first-time homebuyers and through counter-speculation measures.

Stabilising housing prices has been an overarching concern of the South Korean government. In a market economy, housing prices fluctuate in real terms due to demand and supply factors emanating from both within and outside the housing sector. During the period of rapid economic growth and accompanying urbanization in South Korea, housing prices had risen faster than other prices with sporadic price hikes. Macroeconomic variables played an important role in some cases although the inability of supply to keep pace with demand was the main problem. Government responded to such cases mainly with short-term measures to clamp down speculation deemed responsible for them. Although the government also worked on the supply-side, it often ended up restraining the operation of the private sector through complicated systems of regulations impacting both the output market and key input markets. A combination of tight control on land use conversion¹, the price of new apartments and the mechanism for their allocation to potential buyers has made supply extremely unresponsive to market conditions². By late 1980s, it had become quite obvious to some Korean experts that cumulative government intervention over the long period of time has distorted the South Korean housing sector.

South Korean housing markets and housing policies have drawn the attention of some international experts as well. To outside observers, South Korea appeared to be a fascinating case of how bad policies can lead to poor housing outcome. For

1 Hannah et al (1993) and Son and Kim (1998) discuss how rigid urban land use control has constrained the supply of housing.

2 The housing policy paper of the World Bank (1993) presents Korea as an example of inelastic housing supply system.

example, Renaud (1993) said "due to the cumulative long-term effects of piecemeal public regulations, . . . , South Korean housing market distortions have become a serious burden on the economy and they hold the dubious distinction of being among the most severe market economies in the world." (p.291) He also argued "...housing policies have been incremental, relative to short-term issues, physically-oriented and lacking a coherent economic framework during the most critical phase of South Korea's urbanization." (p.293). Then, based on international comparative studies, he points out that high house price to income ratios in South Korea have an institutional and regulatory origin rather than being caused by a physical or permanent shortage of land (p.306). He concluded, "Improvements are needed in at least four areas: urban planning reforms and a streamlining of the process of producing residential land decentralized at the local level; financial sector liberalization which is neutral to housing; efficient and equitable taxation of land, housing and other forms of real estate; and genuine programs of direct assistance to low-income households, not middle-class programs" (p.326). He then added, "given the necessary scope of such an alternative policy program, its political feasibility may be an important obstacle (p. 325)". Hence, the title "Can Korean Policies Break with the Past?"

Another paper by Green et al (1994) written at about the same time agreed that South Korea has performed relatively poorly in the provision of high quality housing at reasonable prices (p.330) and shared Renaud's pessimist prospects about the future. They said, "...little has been done to change the fundamentals, particularly the

regulatory environment and the housing finance system; rather a political decision has been taken to increase production in response to rising prices" (p. 351).

The drive to build two million new dwelling units during the 1988-1992 period could arguably be labeled as the first serious attempt to increase the supply of new housing on a large scale. The drive included the development of five new towns in the suburbs of Seoul to accommodate nearly 300,000 households. The unprecedented increases in the supply of developable land and housing finance initiated by government policy resulted in a quantum leap in the average annual production of houses from 200,000 to 250,000 units to 500,000-600,000 each year until 1997. In fact, the cumulated supply of new housing over the 1988-97 period amounted to 55 % of the total stock at the end of 1997.

Although it was an impressive outcome, the ambitious government campaign was also a vindication that housing supply was a political parameter under government control, rather than a response of housing producers and the factor markets to changes in demand conditions. As such, the drive in no way represented a fundamental departure from the approaches of the past. This formed the basis for the pessimistic view about future housing policy. Renaud (1993, p.326) said, "Unfortunately, these results are achieved by overriding the institutional problems of the sector, and not by addressing them directly through a program of institutional, regulatory, financial and fiscal reforms. In more technical terms, the government policy shifted the steep supply curve to the right, instead of making supply more responsive

to price changes through deregulation.” Green et al (1994, p. 351) pointed out that “...what South Korea does in response to rising prices is to shift a fundamentally inelastic supply curve from time to time, encouraging a boom and bust cycle.”

Housing prices fell in absolute terms as a result of the massive increases in new supply throughout the mid-1990s, and housing issues almost disappeared from a public policy arena for a while. It is fair to say that some policy reform took place relating to the housing sector in the wave of an across-the-board deregulation of the economy. As the problem of housing shortages was under control to a large extent, government began to lift the price control on new apartments in phases starting in 1995. The housing finance sector was also deregulated so that new players entered the market for housing loans in 1996 while the Korea Housing Bank, the government-owned predominant supplier of housing loans, was privatized in 1997. Land-use conversion regulation on agricultural land near the outer edge of built up urban areas was partially relaxed in 1994. Nevertheless, the reform was implemented in a sluggish and piecemeal way³.

Then the Asian crisis broke out in late 1997, and housing prices collapsed in 1998. the Government now wanted to boost the housing sector in an attempt to stimulate economic recovery⁴. Many regulations that had been taken for granted for many years were suddenly removed or amended. Partial relaxation of green belts and the

abolition of the price control on new apartments were examples. In addition, a generous set of tax breaks and financial assistance was introduced. As the economy started bouncing back since 1999, housing price trends were also turned around.

Another run-up of housing prices started in late 2001, this time caused by record-low interest rate, rapid expansion of consumer credit and the cumulated effect of the drop in housing production in 1998 and 1999. As usual, the government went back to its arsenal of traditional weapons to suppress speculators. In early 2000s, the government engaged in its fight to restore housing price stability. Four major policy packages were announced during the first nine months of 2002. The array of measures is almost as comprehensive as possible, and its implementation will engage the Ministry of Finance and Economy, National Tax Administration, the Ministry of Government and Home Affairs, Financial Supervisory Board, as well as the Ministry of Construction and Transportation, the main ministry in charge of housing policy.

3 Kim and Kim (2000) try to explain the reasons for that.

4 Kim (2000) discusses the impact of the economic crisis on the real estate sector and government responses.

2. Housing Policy Instruments Employed

The South Korean government has been controlling the whole process governing housing supply, i.e. what types and sizes of houses to build, where and for whom. Each year, the Ministry of Construction and Transport (MOCT) drafts a detailed plan for housing supply, and implements it using various instruments at their disposal. The major instruments have been the price control on new apartments and regulations on their size distribution, rules for selecting purchases of new dwelling units, control on the conversion of agricultural and forest land into residential use, and the provision of housing loans at subsidised interest rates. In this policy environment, a typical private developer purchased plots of serviced land from a public developer and built apartments for the customers selected according to government rules. Compared with that of the Ministry, the role of local government has been marginal, limited to issuing building permits and extending trunk infrastructure where appropriate.

Supply of Developable Land

Once the national housing supply plan has determined the total number of new houses to be produced by both the public sector and the private sector by size categories and locations, the Ministry of Construction and Transport estimates the amount of land needed for residential, commercial, industrial development as well as infrastructure projects and ensures that the exact amount of land that is required be rezoned and developed. The Ministry also controls land use conversion such that large-scale land development

projects are virtually monopolized by the public sector comprising the Korea Land Corporation (KLC), the Korea National Housing Corporation (KNHC) and local governments (Hannah, Kim and Mills 1993). They purchase plots of raw land from landlords at appraised prices, exercising the power of eminent domain when necessary. The plots are serviced and rezoned as residential and commercial sites before they are sold to homebuilders. Prices of serviced plots are set by the Ministry based on the cost of land purchase and infrastructure according to government regulations.

The Price Control and Size Regulation

The price control on new apartments had been enforced from 1977 until 2000. The regulated price was determined as a mark-up to the cost of production and was much lower than the market price. Since the size of the windfall gain from the price control gets bigger with the size of the dwelling unit, the purchasers of new apartments prefer larger units as long as they are eligible to buy the units and have the ability to mobilize funds. The developers also had an incentive to maximize the share of large units in a project because the controlled price on the large units (exceeding 85 square meters of net floor space) was set higher than that on the small units while the cost of production of an apartment decreases with its size and also because larger units sold better. For these reasons, too many large units could be produced in the free market. Therefore, the government regulated the size distribution of apartments to ensure that smaller units were to be supplied in large quantities so that a large segment of population could benefit from the

price control. Land development projects were required to set aside at least 60 % of developed residential sites for houses smaller than 85 square meters in net floor space, and 20 % to those smaller than 60 square meters. This add-on regulation to the price control on new apartments was lifted in January 1998. However, it was reintroduced in a weaker form effective in November 2001 to require that a minimum of 20 % of new apartments built in the Seoul metropolitan region be of a size less than 60 square meters in net floor space.

Allocation of New Apartments

Since the price control created a long queue of households wishing to purchase new apartments at subsidised prices, qualifying buyers were selected based on a set of criteria set by the government. In order to qualify for bidding to purchase a new dwelling unit, a household had to fulfill requirements by subscribing to a contractual savings scheme for a certain amount of time. The eligibility for purchasing apartments was granted in three different size categories i.e., 85 square meters and smaller, between 85 and 102 square meters, between 102 and 135 square meters, 135 meters and above, and the required deposit increased with dwelling size. Eligible homebuyers were selected on the basis of the bid within the specified limit and then by a random draw. However, all dwellings with a net floor space under 60 square meters and 50 % of those with a net floor space ranging from 60 to 85 square meters were reserved for households who did not own any other dwelling units.

Counter-speculation Measures

Although there is no official definition of speculation, it has been perceived as a major cause of housing price hikes. Therefore, counter-speculation campaigns form a backbone of government intervention in housing markets in South Korea. The complex and elaborate criteria for allocating new houses produced by both the public and the private sector developers or granting the public sector developers a monopoly status in land development could be understood in this context. Other direct measures employed to fight speculation include special audits by the National Tax Administration on individuals and real-estate brokers engaged in frequent trading. Transfer of the title ownership of pre-sold apartments is prohibited and real estate taxes are designed so as to discourage holding and transactions rather than a revenue source for local government.

Public Sector Housing Finance

Development of market-based housing finance system has never materialized until very recently. On the other hand, the National Housing Fund, a public sector specialised lending vehicle established in 1981, has played a dominant role in providing subsidised loans to qualifying homebuyers and developers. The Fund has been operated by the Korea Housing Bank according to the rules and procedures set by the Ministry of Construction and Transport⁵.

5 See Kim (1997) and Lee (2002) for a discussion of housing finance.

Rental Housing

South Korea has a big rental market. Just over one half of all housing units are occupied by their owners and the rest are rented mostly based on chonse contracts. Under this contract, the tenant pays the landlord an up-front deposit that exceeds 50% of the value of the property. The deposit is fully returned to the tenant at the end of the lease, which is typically two years⁶. The Tenancy Protection Law has a provision that rent should not increase more than 5 % per annum, but it is not binding. The Government does set the rent and deposit level on rental apartments built by the public sector or those built by the private sector with financing from the National Housing Fund. The “standard rent” is set based on the cost of operating the rental housing and is much lower than the market rent. But the overall impact of rent control is limited because it covers a very small fraction of the total rental housing stock

3. Evaluation of government intervention

Achievements of Housing Policy Goals

The ultimate goal of government intervention in housing markets should be improving the quantity and quality of housing as well as its affordability. South Korea’s overall housing conditions improved substantially since the mid-1980s as can be seen from the key indicators summarized in table 1. Total housing stock doubled over the past two decades. Housing supply ratio, defined as the ratio between the

number of dwelling units and the number of households, jumped from 71.7 % to 94.1 % between 1985 and 2000. The figure has already surpassed 100% in several provinces and is expected to reach 100 % very soon for the country as a whole⁷. In addition, per capita floor space increased from 46.4 square meters to 62.9 square meters during the same period. Other indicators of overcrowding as well as quality of dwelling and facilities improved remarkably.

Housing has also become more affordable during 1990s, excepting in Seoul. Although the data are sketchy, the housing price to income ratio (PIR) is declining for the whole country. However, PIR for Seoul was 7.9 in 2000 and it might be even higher due to the recent price increases. There are no data on the homeownership rate, and the figure in the table represents the share of houses inhabited by their owners. Since new houses were supplied in large numbers and most of them allocated to first-time homebuyers, home ownership rate must have increased substantially. However, the reported figure showed no sign of inching up during the past five years⁸.

Government intervention should be responsible for reducing the overall housing shortages and stabilizing the prices of housing to a large extent. Although macroeconomic conditions were favorable to house price stability in the 1990s, massive

⁶ See Kim (1990) for a detailed description.

⁷ The housing supply ratio is not an ideal measure of housing shortages because it is based on inadequate definitions of housing and household. But it has been used as the single most important indicator in Korea.

⁸ It is likely that many more people now own homes but a substantial fraction of them live in rented property because their own houses do not meet their preferences for size, location and school district.

increases in the supply of new housing were the dominant factor. But the very high PIR in Seoul shows that housing in preferred locations still remains scarce.

The Incidence of Benefits of Housing Policy

Government housing policy focused on promoting home ownership by middle-income groups although greater attention has been directed to address housing problems of the lower income households in recent years. The heavy subsidies generated through the price control on new housing accrued predominantly to the middle class. Those who were lucky enough to be selected to purchase new apartments received a windfall capital gain that was equivalent to a few years' of average salary. There are several reasons to believe that the system favors the relatively well-to-do. First, the size of the capital gain rises with the size of the dwelling unit.

Table 1. Housing tenure

	1980	1985	1990	1995	2000
Housing supply ratio(%)	71.2	71.7	72.4	86	94.1
Housing stock ('000)	5,463	6,271	7,357	9,205	10,950
Owner occupancy (%)	58.6	53.6	50.8	53.3	54.2
Per capita floor space (m2)	10.1	11.3	13.8	17.2	20.2
Average number of persons per dwelling	45.8	46.4	51	57.3	62.9
Average number of persons per dwelling	4.7	4.2	3.8	3.3	3.1
Rooms per household	2.2	2.2	2.5	3.1	3.4
Share of households living in a single room (%)	N/A	32.5	28.3	12.3	7.9
Share of houses with hot bath (%)	4.3	20	34.1	74.8	87.3
Share of houses with hot bath (%)	9.7	34.6	52.4	84.1	93.9
House price-to-income ratio, Korea (Seoul)	N/A	N/A	N/A (9.2)	5.7 (N/A)	5.0 (7.9)

Source: Kim and Suh (2002) and Kookmin Bank

Secondly, one needs to mobilize a larger amount of funds in order to profit from purchasing an apartment at the controlled price. Thirdly, the pre-sale scheme favors those who are capable of mobilizing funds for advance payments (Kim 1993).

In addition, policy emphasis on promoting home-ownership and punishing speculation has made the life of renters very difficult. New houses get built only when there is demand for them. Since not every household can afford to become a homeowner, some new houses must be sold to those who already own a house, and then rented out to those who cannot afford to buy their own houses. But those who own more than one house are often labeled as speculators rather than suppliers of rental housing. Such social environment tends to discourage the rental housing business, and to limit the housing options for the low- income renters. A disproportionately large number of small

single-family houses were demolished to give way to higher-density redevelopment aggravated shortages of affordable housing for the poor. Although government provides financial support to the production of rental housing, public rental housing stock is only 6.9 % of the total housing stock (MOCT 2001, p.39). Moreover, 42 % of the subsidised public rental housing was allocated to those who did not meet the selection criteria (MOCT 2001, p.385)

A similar point can be made regarding the incidence of benefits from interest subsidies. The two most important sources of housing loans in South Korea have been the Korea Housing Bank (currently Kookmin Bank) and the National Housing Fund. Although the latter is supposed to serve a clientele with lower average income, the distinction has not been that obvious in practice. One reason is that families with income level below say 40 % from the bottom have little chance to be homeowners.

Side-effects of Government Intervention: Price Control and Regulation on Size Distribution

An analysis of the impact of government regulation should ideally be based on costs and benefits of specific regulations. The case of the price control on new apartments and the regulation on size distribution is described in the previous section. Although a typical price control normally leads to a decrease in supply, this was not true in the case of the price control on new apartments. The reason was that government was able to control the supply of housing by controlling the amount of land rezoned for development. A major efficiency consequence of the price control

and the regulation of size distribution has been the distortion of the size distribution of new apartments supplied.

Data on the size distribution of all apartments supplied during the 1993-96 period reported in Kim and Kim (2002) shows that 41 % of new supplies were clustered between 59 and 61 square meters in net floor space, 33 % between 83 and 85 square meters, and 5 % between 133 and 135 square meters. One could recall that the line was drawn at 60 square meters, 85 square meters and 135 square meters to divide up the would-be home purchasers into three size categories. On the other hand, two other categories accounted for 2 % each and eight other size categories had 1 % each, while no units were found in other categories in more than 1 % of the total supply. Most interestingly, no units within the range of 62 to 82 square meters or 85 to 133 square meters are supplied. In short, the price control and the supplementary regulations led to skewed and concentrated size distribution of new apartments. In the absence of such regulations, the size distribution of new apartments would more or less resemble that of household income, and hence be very different from the observed pattern of distribution.

The regulation also created an artificial scarcity of large apartments and consequently the price per square meter of floor space rises more than proportionately with size. Empirical evidence clearly points to a positive relationship between the price of unit floor space of an apartment and its size. A hedonic price study by Chung and Lee (2002) using a sample of about 4,700 apartments located in Seoul confirms this.

The study reports that the unit price of a small apartment (up to 60 square meters in floor space) was 3 % lower than the medium-sized apartment (60 to 85 square meters in floor space) while the unit price of a large apartment (85 square meters and up) is 8.5 % higher than that of the medium-sized apartment. Kim and Kim (2002) further suggest that the regulation must have resulted in a net welfare loss and that some households among the intended target group might have made worse off.

There are other distortions created by the current system of housing supply. Houses are built where developable land is supplied, and this does not coincide with where the demand is. As a result, houses remain unsold in some markets and shortages persist in other areas.

4. Lessons and policy implications

South Korea's housing sector is a showcase of pervasive direct government intervention throughout the entire process from land development to the production and allocation of new housing. Such pervasive intervention might have contributed to tackling the problem of overall housing shortages, and stabilizing housing prices since late 1980s. But the very fact that the housing prices fell following the massive production of new housing units demonstrates that high housing prices have been attributable to government restrictions on the supply of developable land. The first lesson therefore is that government should allow more land to be converted for urban development where there is demand.

But a more important question is whether an alternative, enabling approach would have worked better. My indirect answer is that the interventionist approach of government to ameliorate housing shortages was neither efficient nor equitable. Its achievements were not worth the costs in the form of wasteful utilization of resources to produce housing in quantities and qualities unwarranted by preferences and willingness to pay by potential customers. International comparative studies using housing indicators data endorse the conclusion on the efficiency side. Angel (2000) found that cities with more enabling policy environment produce better housing outcome in prices and affordability as well as living space. And Seoul was one of the cities with the least enabling environment among the high-income countries.

A natural question arising from the conclusions above is why inefficient and inequitable policies have been maintained for so long. The answer is their political palatability. The general public wanted deep subsidies for housing and government catered to such demand with an elaborate system of regulations that had no direct cost to them. Such coincidence of wants has sustained housing policy and also contributed to expanding the society's middle class. Consequently, it was very difficult for government to repeal regulations even after they were judged unjustifiable. The piecemeal and lukewarm approach to deregulation in the recent years can be understood in this context (Kim and Kim 2000).

An important lesson then is that government must be very careful in introducing a policy program that generates large benefits to a wide cross-section of the society. One such regulation may necessitate a host of other regulations to allocate the benefits to confound the system, which becomes difficult to change later.

A related point is that deregulation should be carefully designed and implemented considering its short-term dynamics and the role of expectations in determining the impact of deregulation. A major reason for the delay in lifting the price control on new apartments has been the pervasive belief that deregulation will raise the overall prices of housing at least in the short-run⁹.

Deregulation in one area should be coordinated with that on other related sectors so as to avoid side effects. For example, expanding housing finance in a city with inelastic supply may lead to housing price increases without much gain in housing production.

The next point concerns the interaction between housing shortages and speculation. Contrary to the majority view in South Korea, speculation may be a consequence, and not a cause, of housing price hike. Speculation cannot be sustained unless housing prices are expected to rise in the future and such expectations make much more sense when government regulation limits the supply of developable land and urban housing. Speculation interacts with housing shortages and destabilizes the housing markets¹⁰. The fundamental cure

of speculation then is to secure a system in which supply can adequately respond to demand in terms of both quantity and quality.

South Korea needs a different approach to address the housing challenges of the future. Housing is a local issue, although not entirely, that requires a local approach. Since the nature and severity of housing problems vary across markets and points in time, a uniform and national solution may not work. It is intriguing to see government resort to the same set of measures all the time regardless of the cause of housing price increases¹¹.

Also in light of the projected changes in the demographics of the population and their diversifying preferences for housing, a greater role should be granted to the private sector. Government needs to facilitate such transition by allowing the private developers to participate in the process of land development and by removing the remaining regulatory bottleneck. It should also monitor the performance of the housing sector using relevant indicators and make policy adjustments as necessary.

On the issue of enhancing equity in housing outcome, government is responsible for providing assistance to those who deserve it. Assistance should be targeted at people as opposed to houses, and efforts should be made to minimize the cost of such programs¹². As long as government assistance takes the form of interest rate

9 See Kim and Kim (1999) for details.

10 See Malpezzi and Wachter (2002).

11 The current price run-up is mainly attributable to low interest rates and the imbalance between demand and supply by location, size, quality, and neighborhood rather than overall shortages.

12 Government plans to identify those households whose housing conditions fall short of a minimum standard recommended by KRIHS (1999) and reduce their number with various means.

subsidies on housing loans, it cannot reach the very poor because they may not afford to buy their own houses¹³. What matters in the end is how to secure decent housing option whether it is an owner-occupied unit or a rental unit.

Looking ahead, government policy choices are likely to be bound by political constraints. For example, engaging the National Tax Administration for housing policy purposes looks strange. It is their job to ensure that all forms of income are taxed properly all the time, not just when housing prices rise. However, such intervention has become a widely accepted practice over the years and the public seems to like even harsher action. Another example concerns the call for raising the local taxes on holding of housing and land. A prominent NGO recently claimed that too light a tax burden on property holding was the fundamental cause of speculation and hence housing price increases. But one should look at the user cost of housing of which property taxes are only one component. Implications on the incidence of the proposal and its impact on the rental market should also be considered. Besides, property taxes are local taxes tied to the provision of local public services. Nevertheless, this proposal seems to sell quite well. The same group opposes to new town development projects in the Seoul metropolitan area saying that it will exacerbate the problem of over-concentration of people in the region and will be detrimental to the environment. Unfortunately, it appears to be the most viable option for increasing the supply of housing units people demand

most, and thereby alleviating the problem of mismatch between supply and demand. Again, many people sympathize with the anti-growth sentiments .

So, what do I foresee? Can South Korean policies finally break with the past by tackling the multiple layers of regulations? For one thing, South Korea is a highly dynamic society capable of changing the course of policies once a consensus is somehow reached. But it also has a short memory. The momentum for serious deregulation built in the aftermath of the economic crisis dissipated once the crisis was over. In order to implement a long-term reform in real estate policy, it will be necessary, at a minimum, to break many myths about land and housing. After all, the desire to live in a larger and better house as income increases is as natural as wanting to wear better clothes and drive more comfortable cars. The average South Korean consumes less housing space than his income would justify. Wouldn't it make sense then to rezone more land for residential development?

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13 Not knowing what the current ownership rate is, it is difficult to decide how further government can promote home ownership.

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CHAPTER 3

THE IMPACT OF THE INTANGIBLE FACTORS ON THE HOUSING MARKET IN VIETNAM

Introduction

Of all the public policies carried out in urban areas, perhaps housing policy is the one that has the most close and visible link to the market. To some extent, it can be said that this link - or the absence of it - is the main force shaping modern cities, especially in developing countries. There is a consensus in the view that "...urban policies do best when they work with market forces, not against them" (Hall, 2001). The aim of working together implies a full account of the factors having strong influence on the market behaviour of residents, the understanding of which can inform the policy. All too often in practice, however, only the obviously and literally "countable" factors are being paid attention to, leaving out many directly un-measurable, or intangible factors. The omission of these factors can be attributed, on one hand, to the disagreement between the analysts and decision makers, and on the other, to the difficulties faced in dealing with proper definitions of intangible factors themselves.

1. Housing as a special good in the market

Rothenberg et al (1991) commented that many housing economists tend to make housing into some sort of generic good so that it could be treated in a normal way. In their theoretical treatment of the housing market which they called a "maze", Rothenberg et al instead emphatically pointed to the idiosyncrasies of housing: spatial immobility, durability, heterogeneity, modifiability, as serious issues to be analysed. It can be argued that what Rothenberg et al called "idiosyncrasies", are in fact the most intrinsic attributes of housing. A glance at these attributes can prove the point

As one of the most important attributes, the spatial immobility of housing embodies the locational advantages or disadvantages, which are totally absent in most other goods. This fixity in space makes housing value extremely sensitive to the changes in geographical patterns of consumption that are linked with changes in cultural tastes and environmental perceptions.

The extremely long service life, or the durability of housing, in combination with its modifiability, creates the somewhat paradoxical appreciation for older residential properties, resulted from the sophisticated demand for historical artefacts.

The heterogeneity of housing not only allows the residents to have a great variability of choice (if sometimes only theoretically), it also suggests many possible ways of adaptation for new uses. To a certain extent, this adaptability can temper the disadvantages resulting from spatial fixity.

To the above mentioned attributes, something quite important can be added: the normally very high degree of compatibility of housing with the residents' social status. This compatibility is gradually increased throughout the residents' life cycle and the advance toward it, is perhaps the strongest motivation behind the housing behaviour of any social group. This compatibility makes housing the most important item of conspicuous consumption, and as such, the normal concept of "utility" applied to other goods can hardly be valid without heavy qualifications. It is clear that for a "conspicuous consumption" good such as housing, the cultural and traditional context is of extreme importance.

These attributes, or idiosyncrasies, suggest that the "normal" treatment of housing by economists has to be changed to take into account the factors that cannot be normally measured or observed, especially the ones related to location.

The first type of difficulties faced in carrying out this change is concerned with the problem of definition. For example, in housing economic literature, locational factors are normally called "externalities", of which some are positive and some are negative, or both at the same time (Pinch, 1985). Distinction is also made between "contextual" (location) and "compositional" (housing stock) effects of externalities, with the second being paid far more attention than the first one. The problem is that no clear guidance is offered for the exact determination of the attributes to be included in the analysis (regression or hedonic models).

The second type of difficulties is related to the intangible character of the attributes, which make them much harder to quantify.

2. The Increasingly Dominant Role Of The Intangible Factors

There is a visible trend among the economists to recognise that economics as a whole is moving into the area of non-market interactions (Glaeser, 2000). Some even went as far as to predict that "...maybe the future of basic theory in urban economics will be of a non-spatial form" (Oates, 2000).

The build-up of this trend was slow and gradual. It was the concepts of human capital and social capital which recognised that non-market interactions are extremely important in bringing growth to economies and success to societies. As most of the human capital and social capital elements are difficult to quantify or observe in a direct fashion, they can be classified as intangible factors.

In the way they influence the market behaviour of people operating within a housing market, the intangible factors are far more complex than what the economists call "externalities".

The cultural roots of intangible factors in housing market

If many attributes of housing are deemed idiosyncratic, it would seem that the cultural context in which they are perceived can even make them more complex. A house is not only a shelter, but is truly an "institution" (Rapoport, 1969). Without the understanding of cultural concepts and habits, some of which were institutionalised, it is impossible to explain peculiar tastes and behaviours associated with one's home. This led to very specific material manifestations. For instance, the tax levied on the steps of the riverside houses in Amsterdam prompted many residents, who wanted to show off their wealth, to build more steps than they needed, forming unique street fronts. Likewise, a ban imposed on the Vietnamese commoners' shophouses in the 19th century Hanoi so that they could not be taller than the Chinese residences, has created a special charm of the 36 Old Streets. In both examples, the traces of past lifestyles added substantial cultural (and property) values to modest physical

structures. In a wider context of the urban centres, intangible cultural elements such as "charm" and "the feel of a place" are the bases on which the "inertia" of place (Hall, 1995) is formed, facilitating competitiveness of a city, especially in terms of artistic and scientific creativity, which finally leads to a lively housing market.

In the households' decision-making process relating to residential location, in many cultures, a significant role is attached to social status (Maclennan, 1982), especially in societies with a strong hierarchical structure. It can be argued that social hierarchy may stem from any form of differentiation (power, wealth, knowledge, culture, etc.) and can take different forms of expressions, some of the most important of which being the home and its location (Lawrence, 1987; Cooper, 1972).

The cultural context is known to have a strong influence on the market demand for different goods, especially those linked to specific lifestyles. The demand for living space is known to be adjustable within very wide margins (Rapoport, 1977), and in many instances, especially in the more traditional societies of developing countries, it is often sacrificed for other needs, such as the desire for an extended family to live together, or the different forms of consumption (often conspicuous), including those of culture and traditions.

The historically and culturally conditioned perception of the significance of the place (Bachelard, 1958; Tuan, 1979) is playing a leading role in decision-making processes. The belief that a place has more than the observed physical properties is widely recognised and dates back to very early (even

prehistoric) practices of finding appropriate locations for settlements, in which cosmological, religious prescriptions and health concerns are merged into some sort of 'divine set of rules'.

In many cultures with strong links with tradition, as are those of many developing countries, these factors and sentiments cannot be simply ignored in explaining residential location behaviour. On the other hand, in developed countries, new trends in urban life styles have emerged with strong environmental and spiritual contents (Lawrence, 1998), which have started to challenge the very economic rationality, on which the mainstream residential location theory is based.

The spatial expression of the tangible/intangible factors relationship

In modern cities, physical distance, or more precisely, the costs related to it, has become less and less important with the dispersal of employment centres and increased personal mobility. The information revolution of the last decades, with its computer networking and the internet, is fast shrinking the dominance of physical distance (Harvey, 1991; Dear & Flusty, 1998).

In its place, other kinds of distances started to exercise their influence, such as the traditional social distance and the gap between the information society and the information-less enclaves. This abstract distance is often related to the physical distance, as a cause rather than an effect of it, in other words, the physical distance is the calibrated result of the abstract one.

The information economy did not eliminate the need for large cities, as access is no longer directed at raw materials sources or the market place, but to information, which is obtained in the most important and productive way by face-to-face communication (Hall, 1995). As a result of this communication, the continuing urban agglomeration process is capable of creating ever more hierarchical urban space, and with it, the maze of the urban housing market.

To a substantial extent, the spatiality of housing market is an expression of a complex interaction of tangible and intangible factors, that varies greatly from place to place.

3. A new theoretical model of urban residential location and city structure

Conventional residential location theory basically states that, given an opportunity, a perfect mobile household would move to a plot where it can satisfy its spatial requirements while paying acceptable transport costs; that is, to make the access/space trade-off in the way proposed by Hurd (1903), Isard (1956), Alonso (1964), Muth (1969), Evans (1973), Romanos (1976) and Thrall (1987). Based on von Thunen's pioneering proposition on agricultural land pricing (von Thunen, 1826/1968) and elegantly developed by Alonso and others in the 1960s, the theoretical model has been dominating the field of urban economics ever since.

There is, however, a growing realisation that further than an intellectually satisfying proposition, practical applications of the access/space trade-off model would encounter serious discrepancies. The reason is that modern cities are far more complex, multi-polar and fast evolving than the monocentric urban centres of the 1920s, when the early access/space trade-off theory took its roots in the sociological observations of the Chicago School (Maclennan, 1982).

The recent understanding of the importance of intangible factors in residential location is leading inevitably to the search for other avenues of thinking. To capture the complex influence of intangible elements in the working of the housing market, a new model is suggested based on the interaction between the tangible and intangible factors. Following the line of reasoning emphasising a dichotomy of elements, this interaction is expressed in housing status/dwelling quality relationship.

In this model, *housing status* is a measure of the social desirability attached to housing in a particular locality. It can represent wealth, culture, religion, environmental quality, etc., depending on the current value system of a given society, and as such, it is closely related to concrete historical conditions, i.e. the temporal dimension. The measurement of status can be carried out, either through the estimation of a proxy, by a ranking process (with the use of focus groups, for instance) or by estimating the 'implicit' prices of attributes related to status using different regression techniques, such as hedonic analysis (Griliches, 1969; Rosen, 1974;

Megbolugbe, 1986). In any case, with the computing means and methods that are now available, the quantification of status is no more complex than the definition of such an abstract quantity as "a unit of housing service" in the access/space trade off model.

Dwelling quality includes physical, measurable characteristics such as floor area, number of bathrooms, number of stories, etc. To these can be added indicators of product quality, such as durability, compatibility with a given construction technology, etc. Very often these characteristics, separated from their status content, make up the bulk of housing condition statistics. It can be argued that the very neutrality of dwelling quality measurements has created part of the seeming paradox of the simultaneous presence of both housing shortage and floor space redundancy in many market economies. This suggests that many housing units are rendered unfit for even being classified as housing because they lack acceptable attributes of social status.

Since the physical standards of housing differ substantially from locality to locality and, likewise, the subjective criteria of housing status also differ considerably from society to society, in any particular urban context, an identifiable characteristic relationship of the two components may be found. As these two components - dwelling quality and housing status - can be either compatible or antagonistic to each other, a simple graphic representation of their interaction using satisfactory methods of measurement can be shown as capable of describing nearly all possible types of housing in almost any society.

In a very simple form, the idea behind a new theoretical model of housing dynamics can be illustrated by a series of graphs (Fig. 1a). In these graphs, the O-DQ axis represents dwelling quality, while the O-HS axis represents housing status. At points on the O-HS axis, there is a threshold, or an acceptable dwelling quality level, below which housing can be classified as substandard or undesirable. The dotted line, connecting these points and forming an angle with O-HS, is the threshold line between desirable and undesirable housing. For any particular socio-economic setting, this line will have a unique position, but for simplicity of comparison, the line is drawn in its general position. The examples shown in Fig. 1.a only reflect some of the most familiar situations, and it is clear that the model is capable of depicting many more possibilities. It is postulated that in real life the threshold line would be a more complex curve (Fig. 1.c), than a straight line.

In Fig. 1.d, a hypothetical city is shown with three status poles. The HS-DQ relationship as shown in Fig. 1.b is expressed three-dimensionally, where the threshold lines for each of the three poles together form a "threshold surface", above which housing units can be perceived as "desirable", and below as "undesirable". Effectively, this surface divides any city into two parts: a "dual city" expressed in spatial, three-dimensional terms.

In a more α formal way, the components of a new residential location theory can be presented as follows:

The residential location patterns of most cities conform to a polar structure, in which one or several poles represent the highest points of certain kinds of social status, recognised by a given proportion of the population. The parameters of social status embrace such qualitatively distinctive notions such as wealth, political power, business, culture, ethnicity, education, etc. The distribution of social groups is based on the following principles:

- i. Residential areas in cities make up largely continuous and overlapping rings around the status pole or poles. The ring pattern is the outcome of a trade-off between that desirable status and an acceptable level of dwelling quality.
- ii. House value for any social group consists of two components: housing status (HS) and dwelling quality (DQ). Housing status is a combination of attributes, often non-physical, that distinguishes different levels of housing desirability, or status, which are accepted by certain social groups, sometimes irrespective of the actual physical state of the dwelling. Dwelling quality embodies the physical, measurable elements that constitute the basis for the normal use of a dwelling.
- iii. At any level of housing status, there exists an acceptable level of dwelling quality, or point, below which houses are considered as substandard. The locus of these points forms a line called Dwelling Quality Threshold (Fig. 2). This threshold divides the whole housing stock in question into two zones: the zone above threshold is called "desirable"; the zone below it is called "undesirable". Each housing situation (of a country or city) has a uniquely

characteristic Quality Threshold that can be compared with others.

- iv. At the lower price levels, dwelling quality is the dominating component, while at the higher price levels, housing status predominates. With a certain degree of simplification, it can be said that housing units at the lower price levels are mainly characterised by their utility as shelter, i. e. by their use value, while houses at the higher price levels are characterised more by the attributes that make them commodities and favourable investments, i. e. by their exchange value.

There are substantial differences between this model and the conventional access/space trade-off model.

First, while the access/space trade-off model puts the physical centre at the focus of importance, the new model looks at the factors of status which make that centre important. Second, in the access/space trade-off model, the distance to the centre is an unambiguous, physical quantity (provided the urban boundaries are clear cut, which they often are not). In the Quality-status model, the housing status axis begins from where the status in question is lowest. Third, instead of the static character of the conventional access/space trade-off model (Knox, 1994), the status-quality model, through its polar mechanism, can transmit societal changes, which are making cities very different places compared with themselves a few decades ago, into everyday urban scene.

In Fig. 3, the dynamic character of the city residential structure can be seen through the representation of typical housing situations using status-quality model as an

analytical tool. As the poles shift, following (or signalling) transitions in society at large, they change the spatial boundaries between desirable and undesirable zones. Thus, some traditionally desirable housing areas may become less desirable, even slums, prompting the flight of the middle class, and later of other groups, ultimately leading to abandonment. In the same way, it is also easy to see how some ordinary dwellings, or areas, become fashionable, stimulating changes that are then magnified by the commercial interests of developers. Indeed it is not uncommon for developers (private or institutional) to initiate such change in the interests of uplifting the market.

4. The social trade-off

To depart further from the basic status-quality model in Fig. 2, the main scenarios are presented in which the residents are making decisions about location. Theoretically, at any dwelling quality level there is an unlimited range of possibilities of housing status. In reality, however, they are accompanied by serious conditionalities. Basically, in making decisions about their housing, any household can have two types of trade-off:

a) The trade-off with a fixed dwelling quality level:

In this type of trade-off, that is, when the quality level of a housing unit is kept fixed (Fig. 4a), a household may choose between different locations, but all choice patterns fall into two main scenarios:

Scenario 1: A housing unit is on the left of threshold line (point A in Fig.4.a). In this case, although the status of the unit is low, it nevertheless belongs to the “desirable” zone.

Scenario 2: A housing unit is on the right of the threshold line (point B in Fig. 4.a). In this case, despite the fact that its potential status may be higher (located nearer to the status pole) this housing unit belongs to the “undesirable” zone.

It can be seen that, rather than between transport costs and housing expenditure as the access/space theory says, in this case the trade-off is between the desired housing status and a socially acceptable level of dwelling quality. The latter, a household’s position vis-à-vis the threshold line, can be provisionally called “standing”. A household thus can make a trade-off between i) staying in A, which offers a desirable standing (being above the threshold line) but low general status (located far from the status pole), and ii) staying in B, which is below the threshold line (undesirable standing) but within high-status area (nearer the status pole). The trade-off, thus, is essentially social, rather than economic, although the house price plays an important role: it represents the socially perceived degree of desirability.

With the same level of dwelling quality being kept, the movement into a higher status area generally leads to a higher house price and a lower level of desirability, and vice versa. Translated into the real world, Scenario 1 (point A, Fig. 4.a) is common for many housing units that are located in the lower status parts of the city. Comparatively, their not-too-high level of

physical quality is acceptable, even desirable locally. Scenario 2 (point B, Fig. 4.a) is common for housing units in slums located in high status parts of the city. Although in absolute terms their physical quality level may not be very low, they are nevertheless seen (by those above the threshold) as unacceptable, undesirable.

Theoretical implications

These scenarios of social trade-off with fixed dwelling quality levels can be used to explain familiar concepts with a good degree of clarity.

Gentrification

The household in A (Fig. 4.a) can have many options while keeping itself above threshold. It can stay-put, or move a little along both dimensions, DQ and HS, and still be within the desirable zone. It can also move along A-B, and then B-R. In the real world, this implies moving location and then improving the dwelling. Alternatively it can move directly to R. In the real world, this is a direct high status move, for which the household has to pay for a more expensive house to be able to stay in the desirable zone. If high-income residents from other affluent areas move to B for the purpose of eventually proceeding to R, the process is called gentrification.

Abandonment

By contrast, for the household in B, the options are more limited. It can move left, keeping the same quality level while hoping to enter the desirable zone (i.e. by moving along B towards A, a rare occurrence often partly related to abandonment). It can move right, into areas nearer to the status pole, where there may be higher

chances for the gains outlined above, but locationally well into the undesirable zone. When this balancing can no longer be justified, that is, for instance, when the increase in social and environmental degradation outweighs the gains, abandonment happens.

Upgrading

Alternatively, the household can stay put and hope that it will be able to eventually improve the physical quality of its dwelling (moving along B-R). Improving the physical quality of poor housing is normally called upgrading and although the dwelling quality (DQ) may increase considerably, in practice it is rarely enough to get it above the threshold line, in this way differing from the process of gentrification, not only in terms of motivation but also in terms of physical quality.

Upmarket housing

As the status level increases, the range of possibilities to stay in the acceptable zone gradually decreases, until it reaches point N (the lower limit for highest value housing), where acceptable dwelling quality falls within very narrow margins (MN). This means that at the top of the market, houses differ little from each other in terms of dwelling quality.

b) The trade-off with predetermined level of status

Some households make decisions about their residential location with a predetermined level of status in mind. In developed countries, for instance, many families looking for a good local school for their children belong to this category. In developing countries, better off rural-urban migrants often do so, for the purpose of being seen respectable in the eyes of their peers. For these people, there are two seemingly straightforward and unambiguous choices:

Scenario 1: A household has to spend more money for the housing unit, to be in the desirable zone (point A in Fig. 4.b).

Scenario 2: A household can spend less money and stay in the undesirable zone (point B in 4.b).

Thus, the trade-off is between housing expenditure and social acceptability. If the status level is predetermined, no matter how much one wishes, one cannot spend less money to pay for a higher level of acceptability (except, perhaps, in cases of corruption or favouritism in selling or letting public accommodation).

In the long term, the household in Scenario 2 (point B, Fig. 4.b) can wait for its finance to improve, then start to improve the quality of its house. This is the so-called “slums of hope” where the low income residents are optimistic that their low quality housing in a high status area will eventually be upgraded.

5. Possible applications of the new theoretical model

At the micro-level, the new theory opens a new direction in the application of the hedonic price index technique in determining property prices. Conventionally, the hedonic regression on house price tends to take four groups of variables: external and internal variables of the housing stock, neighbourhood variables and the residents' socio-economic variables. Some authors even take more than four groups of variables. The results of regression in some cases may be better that way, but the uncertainty remains: there is no firm guidance not only on how to select variables, but also on the question of what number of groups of variables is the meaningful one.

By reducing the numbers of variables' groups into two, two important goals are achieved. First, every variable can be grouped easily into one of the two broadly defined categories of tangible and intangible. Second, as it has been seen in Fig 1.d, the two groups of variables can be organised into axes of the familiar Cartesian system of coordinates, bringing back the inherent three-dimensional, or spatial nature of the variables.

At the intermediate level, the theory can contribute to the on-going debate on the best way to invest in new housing programmes as well as in rehabilitation schemes. Perhaps the most obvious point of the model is that the perceived status attached to housing, as opposed to its physical quality, is what makes an area desirable (or not) for its (potential) residents. And since the perceived status is essentially a subjective construct, it can be changed with pro-active strategies.

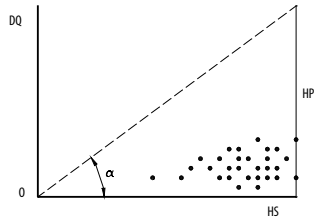
The tangible/intangible, or quality/status factors relationship can serve as a powerful tool to analyse the residential location patterns. Based on their interdependency, the knowledge of one factor may lead to reliable predictions of how the other factor would behave.

The analysis of the threshold of dwelling quality can have an important role to play in realistic, not bureaucratic, evaluation of housing conditions. The ability of the model to pinpoint the critical region where housing status components overtake the dwelling quality components in housing value can be instrumental in understanding changes in the overall standard of the housing stock, and in considering appropriate forms of intervention, either to enhance the efficiency of the housing market, or protect the low income groups from exploitative developers. In developing countries, application of the theory can inform decisions concerning a wide range of housing issues, from inner city slum upgrading to the incidence or likelihood of gentrification and the most effective location of public housing schemes.

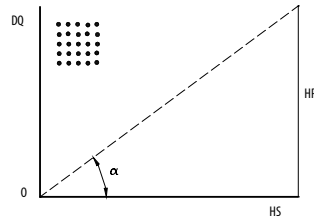
At the macrolevel, the status/quality theoretical model can serve as a tool for the evaluation of urban regions' potentials. The main idea of the model - the dichotomy of the tangibles and intangibles - can be applied for the determination of a city's position within a country's urban system, or even within the global urban network. If positions of major cities are plotted on a system of coordinates, with the x-axis representing some measurements of a combined intangible factor such as

intentionality (degree of conformation to planning principles, for instance), and the y-axis representing a tangible, countable factor, such as population, one can easily identify the pattern of distribution: the most economically competitive cities are in the middle, and the so-called world cities (London, New York, Tokyo) are concentrated in a rectangular (Fig 5).

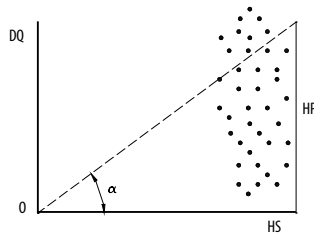
Figure 1a Housing status (HS) and dwelling quality (DQ) in different social contexts



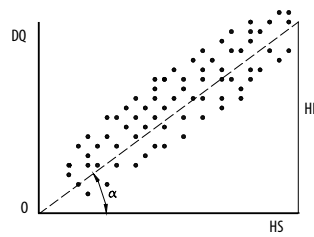
A. Housing in a society that values social status more than the physical qualities, e.g. primitive settlements, where houses are located according to cosmological prescriptions and tribal hierarchy, thus the most sought after dwellings may not be the ones with the highest physical quality.



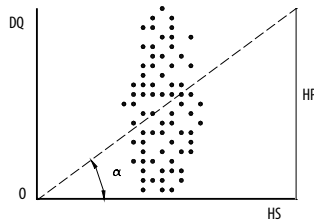
B. Housing in a culture which does not officially recognise differences in social status. Dwellings may have medium to high quality but almost no distinction in status, e.g. public housing estates in (former) socialist countries, built in locations which are "rational" in physical terms but devoid of social meaning. The cluster is not necessarily of low-value on O-HS.



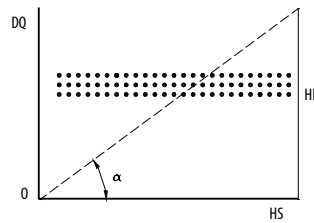
C. Two types of housing sharing the same high-status location, e.g. those located under the threshold line are the slums and squatters, those located above the threshold line are the dwelling of the gentrifiers.



D. Housing in a "normal" capitalist society, with dwelling quality and housing status largely compatible with each other, i.e. lower status housing has correspondingly lower dwelling quality, and high status, higher quality. This type of housing alignment implies a strong socio-spatial segregation in the city structure.



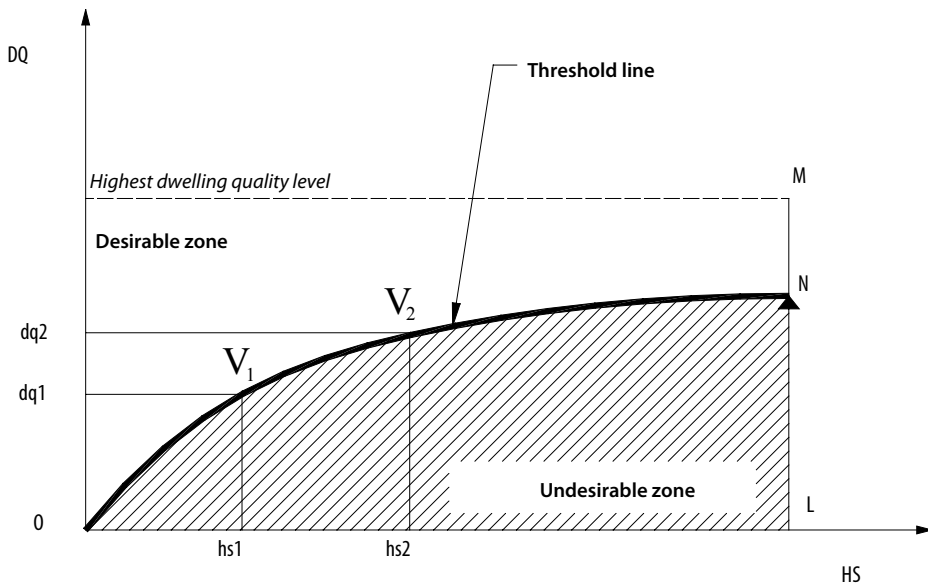
E. Housing stock in a supposedly "classless" society, which has been inherited from a status-conscious society. Dwelling quality is varied but all the houses share the same level of status, e.g. old quarters of the former socialist cities or housing vacated by a deposed regime which is inhabited by residents with different values.



F. Housing units of roughly the same standard but differing considerably in social status, e.g. public housing projects in capitalist societies which were built to the same physical standard but located in areas with different status levels, the fact that makes essentially similar housing units very different in their desirability.

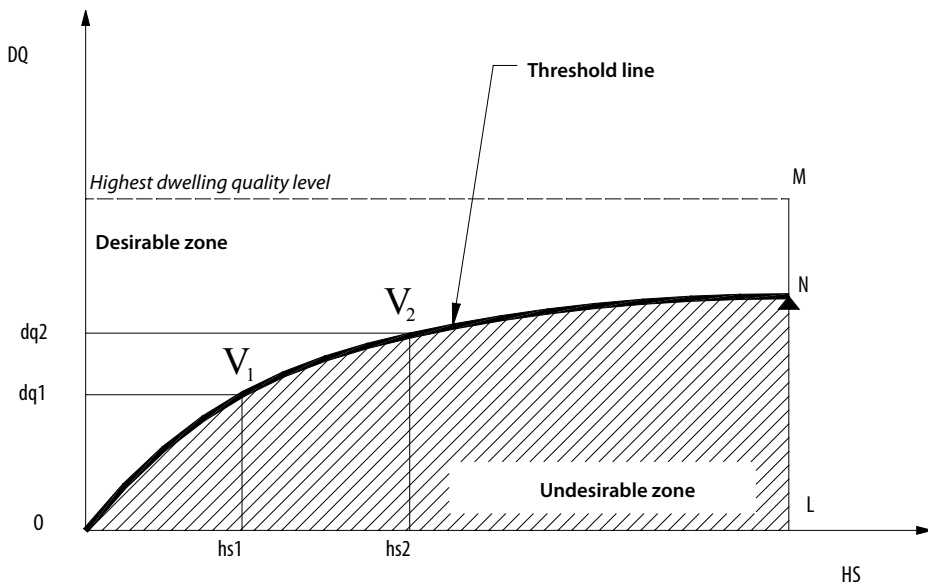
Source: Housing Loan Corporation

Figure 2 Housing status (HS) and dwelling quality (DQ)



Source: Housing Loan Corporation

Figure 3 The shift of a status pole and changed



Source: Housing Loan Corporation

Figure 4a Trade-off with fixed dwelling quality (DQ) level

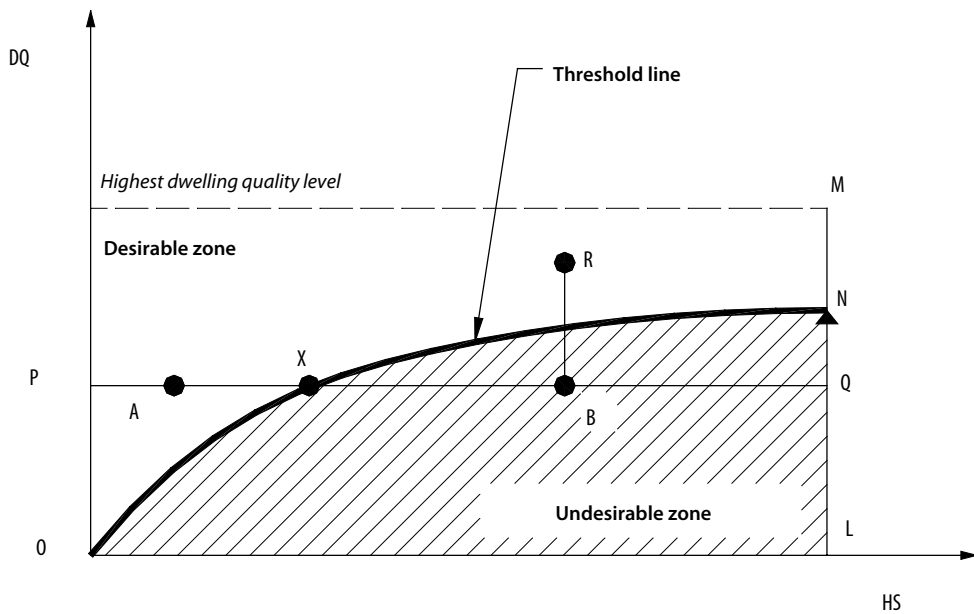


Figure 4b Trade-off with predetermined level of housing status (HS)

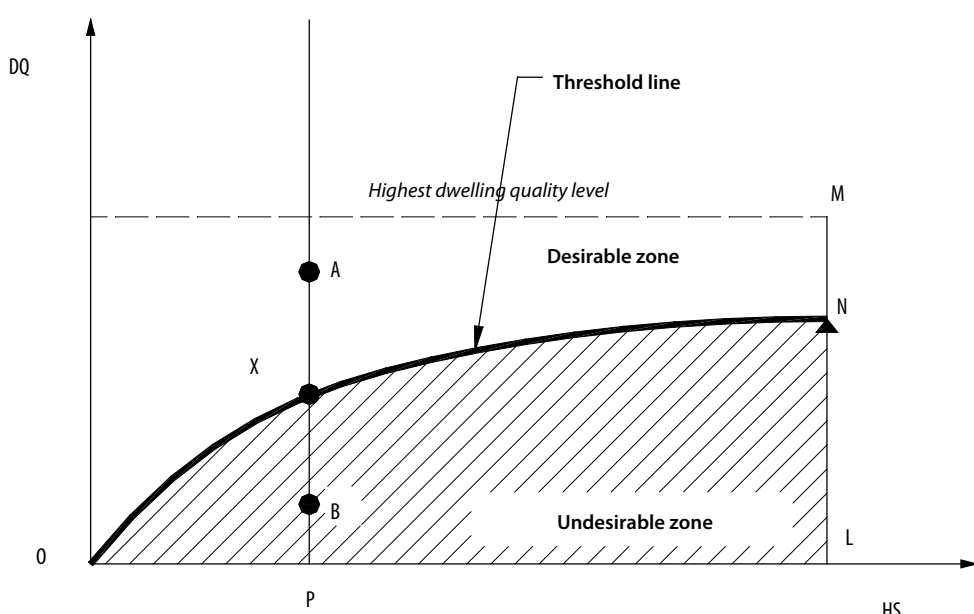


Figure 5 Application of the quality/status theory for evaluation of a city's position in the global urban network

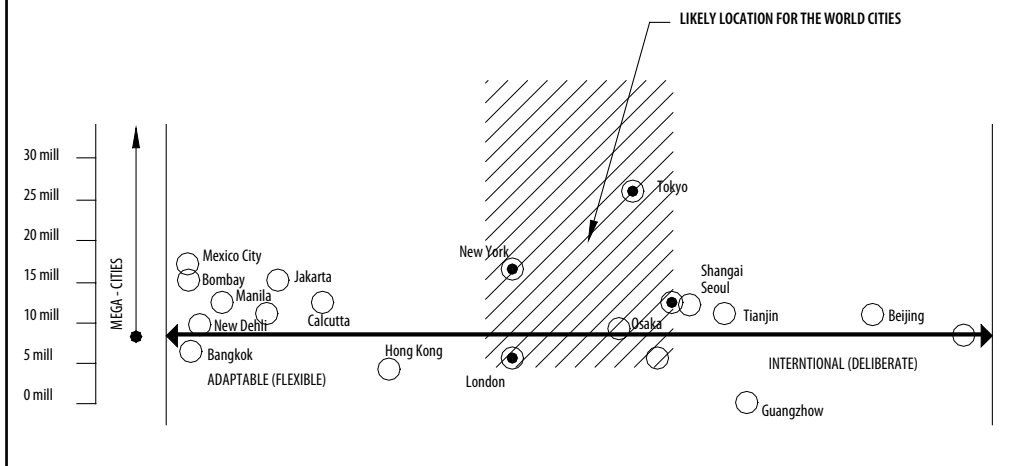
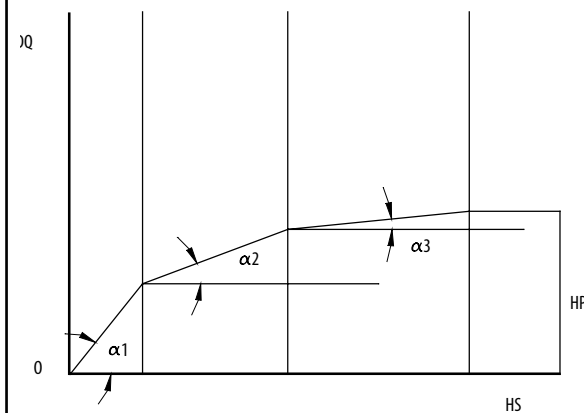
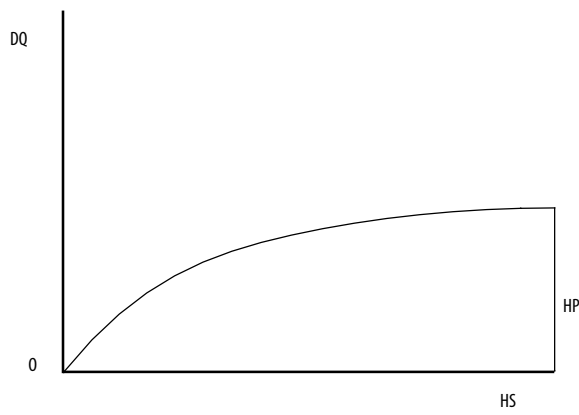


Figure 1b Housing status and dwelling quality - a hypothetical model



A hypothetical model of housing dynamics including different levels of status. At the lower quality level, a small change in status corresponds to a much larger change in dwelling quality. At a higher level, the changes in dwelling quality and status is reversed. At the highest quality levels, the changes in dwelling quality become negligible or impossible: status can be changed presumably only by moving or, in extreme cases, by creating new types of status. Houses in these groups have the theoretically highest possible physical quality, i. e. it is impossible to further improve the quality in a rational way. The status, however, can be added or created, for example, by being associated with special events or personalities.

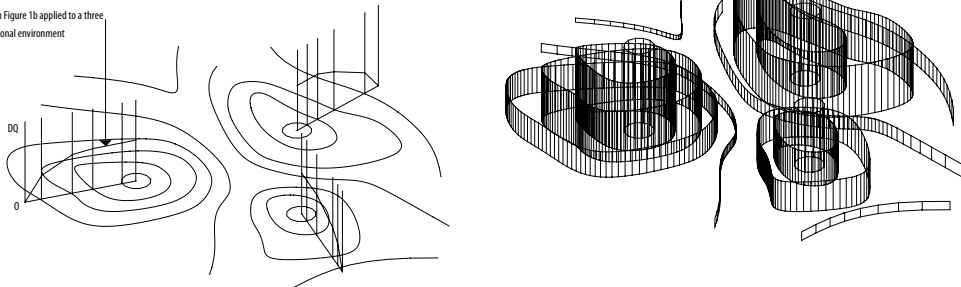
Figure 1c The smoothed threshold



The smoothed line representing integrated thresholds of dwelling quality and status which is steep at the lower dwelling quality and housing status levels and more gradual, almost flat, at the higher end of the dwelling quality and housing status. Dwellings located below this line would be perceived as ranging from undesirable down to slums and shanties. HP is the minimum quality level for a given level of status.

Figure 1d Possible application of the model for mapping a multi-polar city

Graph in Figure 1b applied to a three-dimensional environment



Conclusions

The emphasis on the intangible factors and their relationship with the tangible ones has opened a new way to look at the housing market with all its seemingly idiosyncratic attributes. These attributes are very often culture-specific and contribute greatly in bringing about the diversity of housing solutions. Through the analysis of real-life housing scenarios, it seems that a proposed theory of residential location, based on the intangible/tangible dichotomy, is able to satisfactorily describe the complex relationships between status (as a combination of intangible factors), and quality (as a combination of tangible factors), and their influence on property value in the housing market. It seems logical to conclude that if the residential location decision is a trade-off, then this trade-off is essentially social rather than economic, and complex rather than mechanistic. The new theoretical model obviously requires much more testing in different housing situations, and it is hoped that the preliminary points touched in this paper will be elaborated and verified in other research efforts that try to go deeper into the ways the housing market functions in order to find viable policy options.

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CHAPTER 4

THE ROLE OF GOVERNMENT IN THE HOUSING MARKET IN MALAYSIA

Introduction

Malaysia housing policy is geared towards the provision of adequate and decent housing especially for the lower income group. This will enable all Malaysians, particularly those in the lower income categories, to access adequate, decent and affordable housing. The policy emphasises that there must be constant adequate supply of houses affordable to Malaysians especially to the poorer households. It is a policy of "Shelter for All" rather than a policy of "Home Ownership Democracy" because some may prefer to have a shelter by renting rather than involving high investment and long financial commitment of owning a house. Affordability implies that the prices of such houses must be within the range where the population can readily obtain necessary financing to purchase and own them.

The Malaysian Government recognised the need to have a formal housing program to achieve the objective of adequate and affordable housing. The formal housing program outlines the total housing supply defined by the housing category in terms of high cost, medium cost and low cost houses to be provided by the private and

public sectors in a five-year period within a development plan. Since Malaysia gained independence in 1957, there are a total of 10 five-year plans inclusive of the recent Eight Malaysia Plan (2000-2005)

The beginning of direct intervention by the government started as early as 1952 during the British colonial period whereby a Housing Trust was established to carry out the construction of low cost housing in the country (Ahmad Zakki Yahaya, 1997). Since Malaysia gained independence in 1957, the Government has assumed a leading role through Public Low Cost Housing Program. Private developers are mainly involved in the provision of the medium and high cost housing. It was only until the early 1980s that the Government sought direct private participation through the involvement of private developers to build low cost housing. The role of private developers in low cost housing development was spelt out as total target units to be built by the private sector in the Fourth Malaysia Plan (1981-85). Since then, the private sector has played the role as the main provider accounting for about 65% of the target of low cost housing production in the country.

In 1997, Malaysia was highlighted as a best practice model and most successful program of housing for the poor at the United Nations Habitat II conference in Istanbul. On one hand, the present low cost housing policy has successfully improved the living quality of the low-income population. On the other hand, Malaysia faced problems of abandoned housing projects in the late 1980s and properties overhang in the present situation. What are the issues related to government intervention on the housing market? What are the forms of Government intervention and public private partnership in the housing market?

Like most countries, Government interventions in housing market are in the form of taxation such as stamp duty, real property gain tax, foreign investment tax, levy on foreigner ownership. Apart from taxation on landed residential property to prevent property speculation in the housing sector, Malaysian Government also imposes quota on ownership and house category to socially engineer a balanced multi-ethnic community. This approach is possible because of the large-scale housing development or commonly known as housing estates or new township in the 1980s and 1990s. Many of the oil palm and rubber plantations of more than 100 hectares in the suburbs were converted for mixed housing development.

This chapter examines some of the issues related to government intervention and housing price performance from 1971 to 2000. It also attempts to define housing market and low cost housing in the Malaysian context. The Five Year Development Plan is commonly known as Malaysia Plan. These development plans' housing target and

percentage of housing completion will be used as a yardstick for the performance. The 30-year period consists of six five-year development plans from the Second Malaysia Plan (1971-1975) to Seventh Malaysia Plan (1996-2000).

The Ministry that is responsible for the housing policy is the Ministry of Housing and Local Government. Under this ministry, there are several departments that are directly involved in the implementation, approval of public housing development and also providing the guidelines and planning standards for the State and Local Government. Among the key departments are Housing Department and Town and Country Planning department. The other Ministry that has a direct impact on the housing property is the Finance Ministry which has control over the stamp duties, property valuation and foreign investment approval.

Under the Constitution, land is a State matter; hence the implementation of housing policy, such as approval of land conversion, subdivision of a housing project, allocation, racial quota and pricing of low cost houses, levy on foreign ownership, lies in the power of the State Government.

1. Housing market in Malaysia

Malaysia follows a free economy model where housing is left to individuals and private developers. It must be noted that in Malaysia like many other countries, the social responsibility of meeting adequate supply of housing especially social housing is not left entirely to the free operation of

the market forces. Table 1 shows the formal and informal sectors of housing market in the urban and rural areas.

Table 1: Housing Markets by Sectors in Malaysia

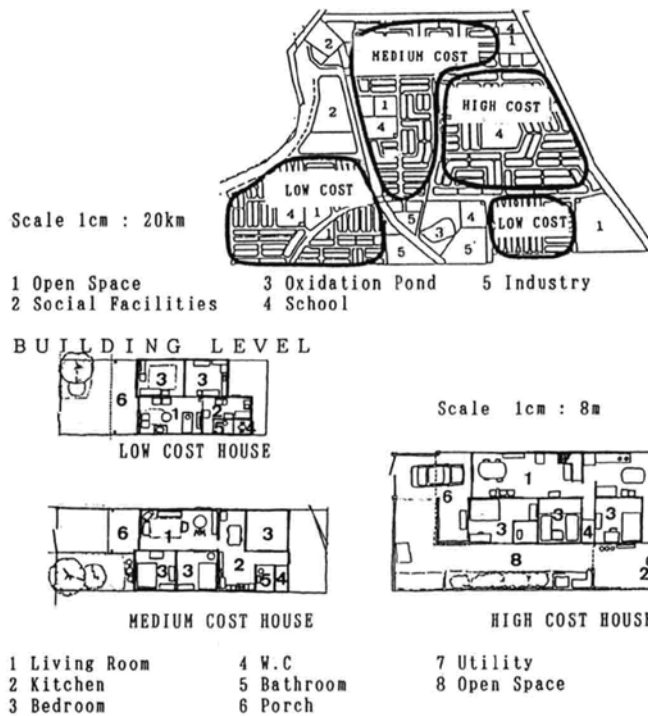
	Formal Sector		Informal Sector	
	Public	Private	Private	
Urban	Federal Agencies such as National Housing Department, State Agencies such as State Economic Development Corporations, Local Authorities, Urban Development Authority Institutional quarters	Private developers, Individuals or groups, cooperative societies.	Squatters in inner city (e.g. river reserve, railway reserve etc) * The numbers are diminishing as many State governments have taken steps toward Zero Squatter Policy by 2005	
Rural	Regional Development Authorities, Federal Land Development Authority (FELDA) Federal Land Consolidation & Rehabilitation Authority (FELCRA)	Private estates or Plantation owners, Individuals	Squatters in the fringe (e.g. State land, road reserve and other infrastructure reserve.	

The private urban housing market before 1980s closely followed a laissez-faire approach where private developers built houses after obtaining relevant approvals from authorities and then sold them on the “open” market. An “open” market did not mean an absolute free market of willing buyers and willing sellers. All projects approved by the local authorities were subjected to conditions based on the racial quota of a minimum of not less than 30% of the property shall be sold to bumiputra (indigenous) population. This is in line with the two-prong objectives of National Economic Policy (NEP)(1970-1990) (i.e. to eradicate poverty and to restructure the society) so that the occupational structure is not based on racial lines. In many States, for houses to be sold to bumiputra buyers, there is a discount of 10%-15% mark down price of the non bumiputra price. The NEP policy is presently replaced with New Development Policy (2000) whereby the policy implementation on the above quota and discount still prevail.

A typical housing project of medium scale development (20-hectare project of about 500 units) will consist of high cost houses (detached, semi detached houses and large double row houses) and medium cost houses (single and double story terrace houses). Shops or shop-houses may be provided in the housing project to cater to the demand of the local population. Figure 1 shows a typical example of a housing project with a mixed housing equipped with amenities and infrastructure.

After 1980s, low cost houses emerged as a new housing type to the commonly medium cost housing (usually single or double-storey terrace house with building area of 100-200 sq m) and high cost housing (usually semi-detached or detached houses or more than 200 sq m) categories in a private housing project. This new category of low cost housing is that of social housing that is well defined in

Figure 1 Typical example of an urban housing project



terms of house price, qualified prospective buyers, and design standards. Under this policy, developers need to provide specific minimum percentage of total houses to be allocated for low cost houses and quota of the total units to be sold to the bumiputra buyers.

Private developers usually rely on external financing for their property development activities. This is done in the form of bridging finance to be retired from the end finance marked out for house buyers and released progressively in accordance with a schedule of payment of purchase price signed in Sale and Purchase agreement between buyers and developers. As pre-sale

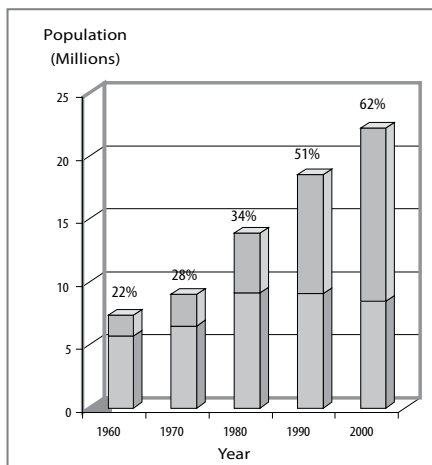
is permitted and buyers are required to meet the pre-specified progress payment, bridging finance requirement for the housing developer can be lower. (Thillainathan, 1997)

Like many other developing countries, Malaysia experienced rapid urbanization in the 1970s and 1980s whereby it involved massive rural-urban migration (Table 2). The high growth of more than 5% annual rate in major cities has contributed to squatter's problems and housing shortages, especially of low cost housing. As such, public housing provision by the Federal and State Government are impor-

tant to ensure the urban poor have decent housing.

Table 2: Urbanisation in Malaysia

Year	Urban Population	% urban population to total population	Note
1960	1.67 million	22.0	The urbanization rate 1986-1990= 3.8%, 1991-95 =4.5%, 1991-2000 = 4.82% and average population growth rate of 2.6%
1970	2.53 million	28.0	
1980	4.75 million	34.2	
1990	9.47 million	51.1	
2000	13.73 million	61.8	



Source: *Seventh Malaysia Plan (1996-2000) pp 163, Preliminary Count Report for Urban and Rural Areas, (2001)*

As for public housing in urban areas, the Federal and State governments have played key roles since Independence (1957) in providing low cost housing for the low-income population especially in major cities like Kuala Lumpur, Johor Bahru, Penang and other State capitals.

The urban public sector through National Housing Department and various State

government agencies took up challenges of low cost housing provision as a priority in the 1970s and 1980s. Local Authorities, especially the bigger ones and State Economic Development Corporation (SEDC) had been building low cost housing and subsidized low rent houses for decades until the 1980s.

It is common for both Federal and State Governments to co-operate in implementing numerous low cost housing projects. The State government identifies and allocates suitable lands and National Housing Department assists the State Government in tender procedures and the supervision of the physical progress of projects. In many cases, the State governments also identify eligible buyers and make necessary arrangements to extend end-financing facilities. Most of the State Governments carry out balloting to identify eligible buyers. For public low cost housing programmes, the financial assistance is provided by the Treasury to State governments and managed through Ministry of Housing and Local Government. Housing loans are normally issued on a 25-year term with additional grace period of two years. The Treasury charges an interest of not more than 4% p.a on the State government.

Rural areas in Malaysia are diverse. They encompass villages made of living quarters of individuals or plantations, new villages created during the 1948-1960 Emergency period, traditional villages, and aborigine's settlement and land settlement villages. The housing market for the private sectors in the rural areas is similar to that of the urban sector except for that these projects are located in rural area. These

include housing in the plantation estates or individual owners or worker housing. Individual houses built by private developers or landowners in the rural area are sold in the open market. However, plantation owners do build villages in the plantation areas consisting of living quarters for the workers. The quality of these quarters for the workers is subjected to meeting the requirement of the Workers Minimum Standard Housing and Amenities Act 1990.

As for rural housing of the public sector, the Federal Government through Ministry of Rural Development and Ministry of Agriculture is involved in the provision of houses in land settlement villages of Federal Land Development Authority (FELDA), Federal Land Consolidation and Rehabilitation Authority (FELCRA) and also Regional Development Authorities. Most of these settlements are planned with organised infrastructure such as roads, drains, water supply and electricity supply. Most of these houses are of simple wood structure with relatively large land area of about a size of 0.1 hectare for each house.

Under the land development scheme, the construction costs of settler houses are relatively low as compared with the total development cost of agricultural land and infrastructure. Hence, the financial assistance for the housing units is usually included into loans for the overall land development and agricultural planting and management of the land.

2. Definition of Low cost housing

The definition of low cost housing varies from State to State. Under the Federal Constitution, land is a State matter. State Government has the jurisdiction to impose conditions related to landed property development. The state and local authorities may impose additional guidelines from time to time.

Generally, the guidelines given by the Federal Government is that low cost housing is defined to be housing units which are priced as RM 25,000 or less, with total building area of not more than 52 sq m – 60 sq m and to be sold to low income population with a monthly salary of less than RM 750. This type of housing units may be in the form of apartments, row houses or cluster-linked houses with a minimum 2 bed rooms, living room, kitchen and bathroom.

Private developers are required to have a minimum of 30% of the total housing units to be allocated for low cost housing. Exemptions are allowed by the State Authorities for small projects of less than 1 hectare or a project with total units of less than 10. In addition, there is a requirement of minimum 30% of the total units of low cost houses to be allocated for bumiputra buyers.

The price has recently been reviewed by the Government and now ranges from RM 25,000 to RM 42,000 depending on the locality of the project. There has been a long debate and developers have requested for the review due to increasing land cost and building material. Some of the States have reviewed the pricing of the low cost houses, for example in the State of Johor, the low cost housing provision is re-categorized into three types - i.e. 50% of the total quota to be less than RM 25,000; 20% to be priced at RM 50,000 and less; and another 20% to be priced at RM 80,000 and less; and the balance of 10% to be allocated for low cost shops with price of less than RM 120,000 per unit.

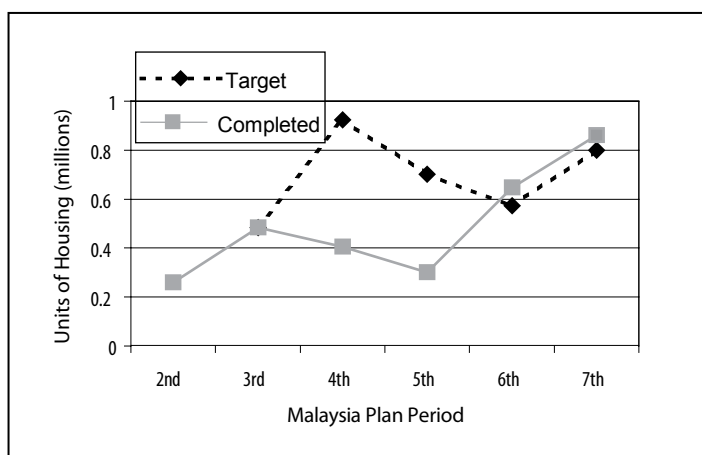
3. Housing performance from 1971-2000:Target and Achievement

a) Overall Performance

Government intervention in housing can be seen in the Five Year Malaysian Plans setting out target of housing planned since 1971. Table 3 showed that there was no particular trend and rationale in target setting of the housing unit from 1971-2000. It ranged from a total of 482,800 units to about 923,300 units for a five-year period. The percentage of achievement was rather low in both the Fourth and Fifth Malaysian plan. This is partly due to the high target set during those periods and also the mid 1980s recession. The achievement was impressive (i.e. more than target) during 1991-2000 involving the Sixth and Seventh Malaysia Plans. Malaysia built more than 1.5 million houses in the year 1991-2000 and these completed units are more than the stock completed in the 1971-1990.

Table 3: Overall Housing in Malaysia- Programmes and Performances 1971-2000

Year	Malaysia Plan	Target (Units)	Completed (Units)	% Completion Of target
1971-75	Second MP	259,810		
1976-1980	Third MP	482,800	484,190	100.3
1981-1985	Fourth MP	923,300	406,070	44.0
1986-1990	Fifth MP	701,500	300,928	42.9
1991-1995	Sixth MP	573,000	647,460	113.0
1996-2000	Seventh MP	800,000	859,480	107.4



Source: Various Malaysia Plans, Kuala Lumpur 1971-2000

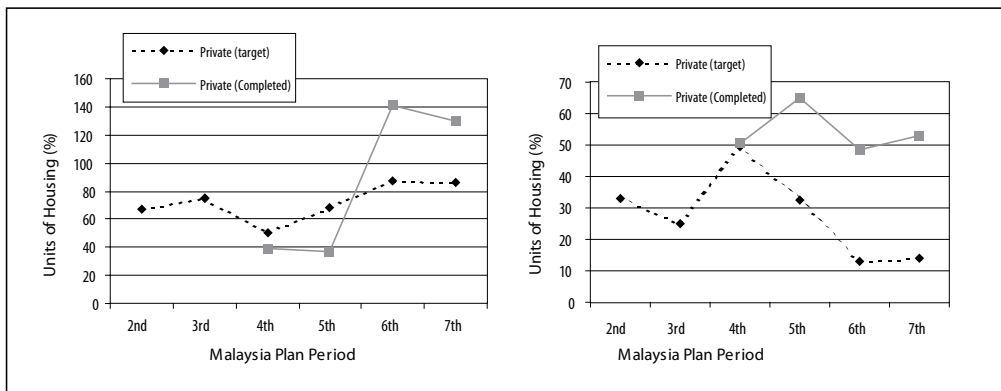
b) Housing Performance by Sectors

Table 4 shows the percentage of housing target by public and private sectors from 1971-2000. It shows a decreasing trend of the public contribution in housing supply. After the privatization program in the 1980s, private sector is assumed to play a key role in the range of more than 65% of the total planned housing units

In terms of the overall achievement of completed units, this was low for both sectors with percentage of achievement of less than 50% for the year 1980-1990. However, it achieved more than the target in the year 1991 to 2000 i.e. in the Sixth (1991-1995) and Seventh Malaysian Plan (1996-2000). The improvement in housing performance was contributed mainly by the private sector in the year 1991-2000.

Table 4: Housing in Malaysia by sector - Program and Performances 1971-2000

Five Year Malaysia Plan		% Share of completed units		% completed		% Overall
Year	Malaysia Plan MP)	Public (target)	Private (target)	Public (completed)	Private Completed	
1971-75	Second MP	33.1	66.9	n.a.	n.a.	
1976-80	Third MP	25.1	74.9	n.a.	n.a.	
1981-85	Fourth MP	49.7	50.5	50.6	38.9	44.0
1986-90	Fifth MP	32.3	67.7	65.2	36.9	42.9
1991-95	Sixth MP	13.1	86.9	48.6	141.1	113.0
1996-00	Seventh MP	14.2	85.8	52.9	129.4	107.4



Source: Various Malaysia Plans, Kuala Lumpur 1971-2000

c) Low Cost Housing

Table 5 showed the increasing role of the private sector in terms of low cost housing provision. Prior to 1980 or Fourth Malaysia Plan (1981-85), the provision of low cost housing lies solely as the responsibility of the public sector. The private sector involvement in low cost housing started from a total of 19,170 units in Fourth Malaysia Plan (1981-85) and increased to an impressive 129,598 units in the Seventh Malaysia Plan (1996-2000). Both the private and public sector have completed about 1 million of low cost houses out of a total of about 3.0 million units.

Table 5: Housing Performance by Housing Categories in Terms of Housing Units (1971-2000)

	MALAYSIA FIVE YEAR DEVELOPMENT PLAN							
	Five Year plan	RM-2	RM-3	RM-4	RM-5	RM-6	RM-7	Total
	Period	1971-75	1976-80	1981-85	1986-90	1991-95	1996-00	1971-2000
	PUBLIC SECTOR							
TYPE	For the poor						17,229	17,229
	Low	55,209	63,020	106,290	74,332	46,497	60,999	406,347
	Low Medium	30,867*	58,490*	95,610*	21,354	35,195	17,782	17,782
	Medium						21,748	78,297
	High				1,440	2,850	2,866	7,156
	Subtotal	86,076	121,510	201,900	97,126	84,542	121,624	712,778
	PRIVATE SECTOR							
TYPE	Low			19,170	90,064	214,889	129,598	453,721
	Low Medium	** 173,734	** 362,680	** 185,000			53,800	53,800
	Medium				95,428	247,241	206,208	548,877
	High				18,310	100,788	348,250	467,348
	Subtotal	173,734	362,680	204,170	203,802	562,918	737,856	2,245,160
	Total	259,810	484,190	406,070	300,298	647,460	859,480	2,957,308

Source: Various Malaysia Plans, Kuala Lumpur 1971-2000

Note *Implementation agencies were used to categories housing type instead of cost, i.e. Staff accommodation, Housing by commercial agencies and land development agencies

Note ** Developer category were used instead of cost i.e. private developers, individual and groups and co-operatives societies.

d) Housing Performance by Housing Categories (1991-2000)

Table 6 showed that the achievement of low cost house has improved significantly to more than 75% since 1990 i.e. in Sixth and Seventh Malaysia Plan (1996-2000)

Table 6: Housing in Malaysia by Housing Categories- Programmes and Performances (1971-2000)

Five year Plan		Target/Planned %			% Completed of the target	Medium	High
Year	Malaysia Plan (MP)	Low	Medium	High	Low	Medium	High
1971-75	Second MP	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
1976-80	Third MP	n.a.	30.9	n.a.	n.a.	n.a.	n.a.
1981-85	Fourth MP	54.6	38.8	6.6	33.3	n.a.	n.a.
1986-90	Fifth MP	40.4	43.6	16.0	33.2	64.9	75.2
1991-95	Sixth MP	60.0	35.0	5.0	76.0	140.0	62.6
1996-00	Seventh MP	29.4	60.0	10.6	88.4	62.6	413.1

However in the Seventh Malaysia Plan (1996-2000), the performance of the public sector improved to 101.7% and private sector achieved a 92.6% of the estimated target. It is also important to note that during this period, the Government focused on housing for the poor programme. (see Table 7)

The trend of this improvement can also be seen in other categories of housing such as medium cost and high cost housing in the Sixth and Seventh Malaysia Plan.

In spite of the serious efforts of the Government, the performance of the public sector was still below 40.0% of estimated target as compared with the achievement of 99% of the private sector in the Sixth Malaysia plan.

Table 7: Private and Public Housing Performance in terms of Percentage of Completion (1991-2000)

MALAYSIA FIVE YEAR DEVELOPMENT PLAN							
	Five year Plan	RM-2	RM-3	RM-4	RM-5	RM-6	RM-7
	Period	1971-75	1976-80	1981-85	1986-90	1991-95	1996-00
PUBLIC SECTOR							
TYPE	For the poor						49.2
	Low	30.0	36.0	40.4	61.5	36.7	101.7
	Low Medium						17.1
	Medium			130.9	76.5	78.9	108.7
	High				720.0	109.6	57.3
	Subtotal	86.0	55.0	50.6	65.2	48.6	52.9
PRIVATE SECTOR							
TYPE	Low			21.3	24.1	99.9	92.6
	Low Medium						22.4
	Medium			33.0	62.7	158.6	187.5
	High				70.2	386.2	435.3
	Subtotal	Na	na	38.9	36.9	141.1	129.4
	Total	Na	na	43.9	42.9	113.0	107.4

Source: Various Five Year Malaysia Plans, Kuala Lumpur 1971-2000

5. Issues Related to the Government Intervention in the Housing Market

Until 1977, housing demand is higher than supply due to the high urbanization rate. Its progress has been gradual and impressive. Constraints and weakness have hindered the achievement of housing targets, especially that of low cost housing. The Government takes a bold approach on intervening in the housing sector, especially in low cost housing.

The Government intervention in housing market by urging the private sector to take the leading role in the provision of low cost houses and deregulation of approval of large massive housing projects in the 1990s have brought about several issues and problems related to the mismatch of housing demand and supply, housing delivery and built environment.

a) Lessons Learned from Special Low Cost Housing Programme (SLCHP) and Abandoned Housing Projects

In order to correct the mismatch of housing supply and demand, Government intervention in the housing market by encouraging private sector to provide low cost houses in the urban areas. SLCHP was an example of special low cost housing programme launched in 1986. It also acts as part of anti-recession measures to stimulate the economic growth of the economy and also to increase the supply of low cost housing. This two-prong strategy received an overwhelming response from private developers by attracting a total of 334,600 units registered for construction compared with 240,000 units targeted under the Fifth Malaysia Plan (1986-1990). The optimistic view of developers towards the housing demand has contributed towards a large scale of housing development. This has also involved land conversion of large agriculture plantation of more than 500 ha into mixed housing estates or even a new township (Ho 1994). The large tract of land conversion in the mid 1980s and early 1990s has also contributed to the property overhang situation in Malaysia.

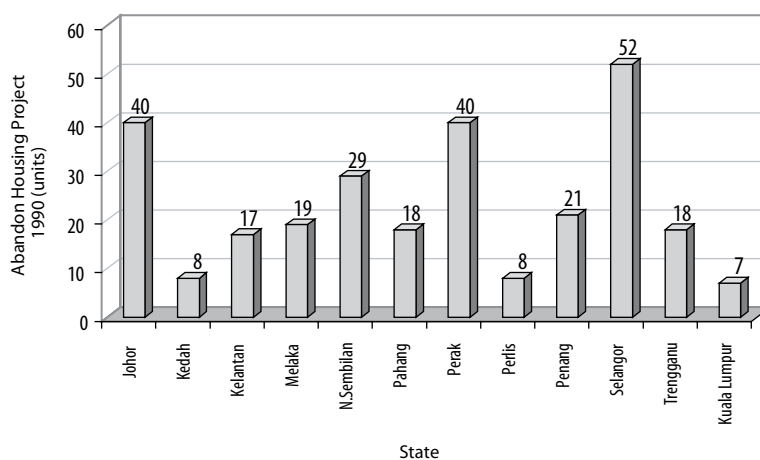
However, due to the problems of unsuitability of locations, financial and management problem of developers, misuse of funds collected from house buyers, incompetent contractor and delays in getting plan approval have resulted in many housing projects being delayed or abandoned. Under the SLCHP programme, only 83,940 units or 35% were completed (Fifth Malaysia Plan 1986-1990).

Before 1985, abandoned housing project was a relatively new term in the Malaysian housing market since there had always been a shortage of housing in the market previously. Abandoned housing herein defined as projects, which are abandoned by the developers who had collected payments from the buyers that usually had secured financing from bank or financial institution. There were a total of 277 abandoned housing projects in Peninsular Malaysia in 1990 comprising 63,560 units with a value estimated at RM3.6 billion (Fifth Malaysia Plan 1990). Out of the total, the highest number was recorded in the State of Johor - a southern state in peninsular Malaysia (Table 8).

Table 8: Abandoned Housing Projects by States (1990)

State	Project	Houses	Buyers	Estimated Values (RM million)
Johor	40	14,747	10,472	733
Kedah	8	2095	1,259	81
Kelantan	17	1942	946	113
Melaka	19	3544	2,310	176
N.Sembilan	29	6264	3,450	310
Pahang	18	2610	1,625	124
Perak	40	8177	4,482	472
Perlis	8	1012	499	64
Penang	21	4692	1,819	366
Selangor	52	13,640	7,435	777
Trengganu	18	374	326	46
Kuala Lumpur	7	4463	1,507	368
Total	277	63,560	36,130	3630

Source: *Fifth Malaysia Plan (1986-1990) pp 367*



Several actions, such as Housing Developers Regulation (Housing Development Account), were taken by the Government to prevent abandoned housing projects. This regulation prevents the misuse of money from the mal-practices of developers in the future.

To date, many of the abandoned housing projects have been revived with the intervention of the State Government and Ministry of Housing and Local Government. The situation was complicated because many of the developers were insolvent and could not be

traced and house-buyers were usually required to agree to a new house price with an appointed new developer.

b) Asset Inflation and Foreigner Ownership

Property market in Malaysia has been on the upward trend since 1980s until the 1997's Asian financial crisis. This phenomenon is evident in the three major metropolitan areas with an index of 170 to 210.3 as shown in Table 9. Among these three metropolitan areas, Johor Bahru city has the highest housing price index in 1997. The proximity of Singapore to Johor Bahru is the obvious reason for the high increase in the price during the 1997 peak. During the 1990s, foreigners especially the Singaporeans bought properties in Johor Bahru because of strong Singapore currency, relatively low price and also attractive investment yield.

The lifting of ban for foreigner ownership in residential property by the State Government in 1984 also contributed to the rapid increase in housing price in Johor Bahru city. 1994-1995 was a landmark year when the Foreign Investment Committee (FIC) reported that the total value of properties (5,502 units) purchased by foreign interest amounted to RM 1.4 billion. This showed an increase of 32.4% in terms of value and 36.8% increase in terms of units transacted over a period of one year. In terms of total transaction, foreign purchases account for about 11.1% in 1994. This increase of foreign purchase and bright economic outlook has pushed property prices up with the average Malaysia price index moving from 159.3 to 188.5. In late 1995, the government intervened to

safeguard the interest of local property purchasers by introducing several measures to curb speculation and price inflation. Among the measures are impositions of RM 100,000 levy on every purchase of real estate by foreigners. A rather high real estate gain tax of 30% was also imposed on profits when investors disposed their property. In addition, foreigners are also restricted to purchase houses with prices below RM250, 000 (upper medium cost house in metropolitan areas). This also has impact on the property price performance especially in major cities like Kuala Lumpur, Penang and Johor Bahru. The effect of the policy is especially felt by Johor Bahru city where it is adjacent to the island state of Singapore.

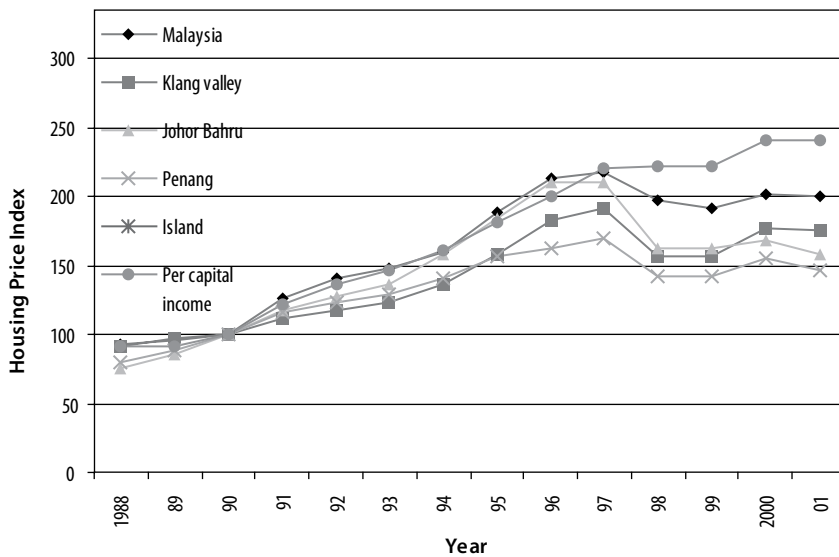
The lifting of the levy on foreigner ownership in August 1997 and Promotion of Silver Hair program have attracted overseas investors. Recent report (Economic Report 2001/2002) showed that there was a favorable trend in the purchase of properties by foreigners in 2001, total purchase by foreigners has increased by 30.5% to RM394 million as compared with RM 302 million in 2000.

The Property Report (2000) showed the overbuilt situation still persisted in the residential sector although the sectors, such as retail, office, hotel and industrial sectors, are worse off. Table 9 shows that the house price index rises during 1988-1997 and falls about 7.9% from 212.8 in 1996 to 199.7 in 2001. The market did pick up from 1999-2000 and but was unable to sustain the increase.

Metropolitan Areas in Malaysia

Year	1988	89	90	91	92	93	94	95	96	97	98	99	2000	01
Malaysia	92.2	96.1	100	125.5	140.7	147.5	159.3	188.5	212.8	216.8	196.4	191.8	200.8	199.7
Klang valley	92.0	96.4	100	111.8	118.1	123.8	136.7	158.4	183.2	191.4	157.0	157.0	176.5	175.9
Johor Bahru	75.7	85.3	100	116.7	127.7	136.3	157.6	183.8	210.0	210.3	162.9	162.9	167.4	157.3
Penang Island	79.5	88.0	100	115.5	123.6	129.2	140.5	156.2	163.0	170.1	142.7	142.7	154.5	146.5
Per capital income	90.7	91.1	100	122.3	135.7	146.2	161.5	181.2	200.0	220.8	221.4	221.4	241.3	239.9

Source: Malaysia House Price Index H2 2002, Ministry of Finance Malaysia



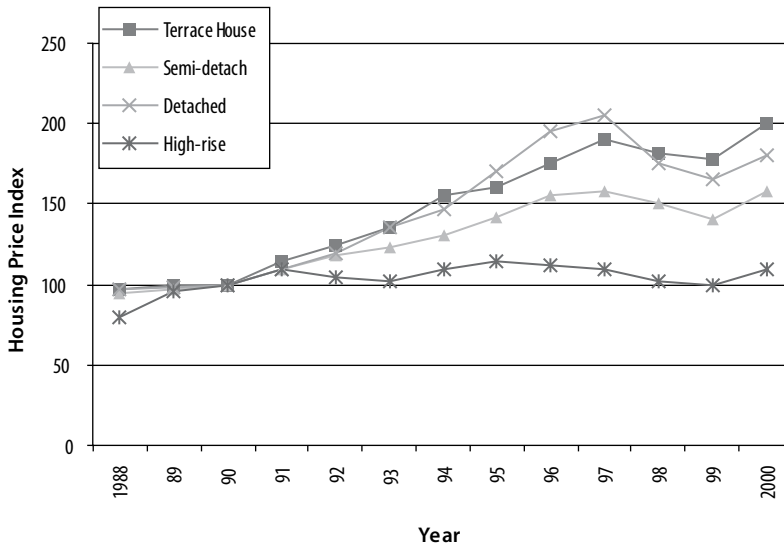


Table 10: Housing Price Index 1988-2000 by Housing Types

Year	1988	89	90	91	92	93	94	95	96	97	98	99	2000
Terrace House	97	99	100	115	125	135	155	160	175	190	182	178	200
Semi-detach	95	97	100	110	118	123	130	142	155	158	150	140	158
Detached	97	98	100	110	120	135	147	170	195	205	175	165	180
High-rise	79	96	100	110	105	102	110	115	112	110	102	100	110

The housing price index by housing type showed generally all the residential properties experienced an increase of one and half to twice the price from 1990 to the peak in 1996 /1997 and began to fall until year 2000. In general, landed property registered a higher increase as compared with apartments/flats. Among the landed properties, the detached houses and terrace houses have a higher increase of housing price from 1988 to 1997.

c) Property Overhang

Property Overhang is defined as unsold property that had been offered on the market and remaining unsold for more than 10 months. In order to overcome the problem of property overhang, the Government intervened by extending the waiver of ad valorem stamp duty of houses purchased from developers. In addition, efforts to attract foreigners to buy property of the upper end of more than RM250,000 are also promoted.

Volume of property overhang has fallen for the residential and shopping complex as compared with industrial units, retail shops and purpose-built offices from the year 1999 to March 2002 (refer Table 11)

Table 11: Volume of Property Overhang by Sector (1999-2001)

Sector	Dec 1999	Dec 2000	Dec 2001	Mac 2002	% change 1999-2002
Residential (units)	53,066	51,348	40,977	43,541	-17.9%
Industrial (units)	1,441	3,196	2,686	2,453	70.23%
Retail shops (units)	5,000	7,507	7,601	7,999	59.98%
Shopping Complex ('000sq m)	1,422.4	14,62.3	1,410.5	1,395.2	-3.27%
Purpose built office ('000 sq m)	2,251	2,458.7	2,701.3	2,720.46	20.86%

Source: Property Overhang -Valuation and Property services Department, 1999, 2000, 2001 and 2002 Ministry of Finance Malaysia Q1 2002

The constant mismatch between housing demand and supply is reflected in the total number of unsold residential properties continued to decrease by 17.9% i.e. at total of 53,066 units in 1999 to 43,541 units in March 2002. This represents about 22.5% of the total stock launched.

The performance of overhang rate by States was mixed. States with large metropolitan areas and active transactions such as Kuala Lumpur, Selangor, Johor and Penang have moderate property overhang rate of 15.5% - 25% as compared with the lesser active state of Perlis and Kelantan.

Table 12: Overhang Rate and Value of Unsold Residential Property by States in the Year 2002

State	Unsold	Units launched	Overhang Rate	Estimated Values (RM million)
Kuala Lumpur	1,986	12,842	15.5	526.47
Selangor	8,328	36,021	23.1	935.45
Johor	11,044	46,282	23.9	1,636.02
Penang	4,664	18,685	25.0	577.5
N Sembilan	4,617	27,982	16.5	511.16
Perak	2,716	13,013	20.9	307.92
Melaka	2,381	8,192	29.1	204.26
Kedah	3,371	11,126	30.3	397.76
Pahang	1,260	6727	18.7	119.89
Trengganu	119	615	19.3	14.3
Kelantan	325	790	41.1	29.49
Perlis	532	878	60.6	53.84
Sabah	989	3530	28.0	224.16
Sarawak	1,209	7173	16.9	180.39
Total	43,541	193,856	22.5	5,719.55

Source: Property Overhang -Valuation and Property services Department, Ministry of Finance Malaysia Q1 2002

In terms of types of property in the housing market, the least popular was townhouses that recorded the highest overhang rate of 52%, followed by 2-3 storey semi-detached houses of 34%. However, in terms of value of houses unsold, the 2-3 storey terrace and condominium had the most severe overhang problem because of the higher numbers of units launched in the housing market (Table 13).

Table 13: Overhang Rate of Residential Property by Housing Type in the Year 2002

State	Unsold property	Units launched	Overhang ratio	Value
1 story terrace	8,034	40,338	19.9	750.15
2-3storey terrace	11,200	45,403	24.7	1,768.24
1Semi-D	1,608	6,535	24.6	184.41
2-3 semi-D	1,382	4,009	34.5	385.13
Detached	3,594	12,626	28.5	627.65
Town house	674	1,296	52.0	147.89
Cluster	27	356	7.6	6.53
Low Cost House	1,844	8,544	21.6	69.71
Low Cost Flat	3,034	18,002	16.9	107.68
Flat	3,514	14,676	23.9	252.36
Condominium	8,630	42,071	20.5	1,419.84
Total	45,541	193,856	22.5	5,719.55

Source: Property Overhang -Valuation and Property services Department, Ministry of Finance Malaysia Q1 2002

In terms of housing category, on the contrary the lower and the upper end housing showed a higher percentage of unsold residential units (Table 14). This is particularly apparent for houses with price of less than RM 50,000, RM 50,001-100,000 and houses of more than RM250, 000, which have 62.2%, 59.7% and 55.5% of total unsold houses for more than 24 months respectively. Detailed data showed that developed states such as Selangor and Johor have a higher percentage of lower end housing (< RM100, 000).

Table 14: Number and Percentage of Unsold Property by Price Range and 24 Months Offered in the Market

House price	More than 10 months offered in the market		
	Units unsold for more than 24 months	Total number of property overhang	% share of unsold property
<RM 50,000	3,670	5,898	62.2
RM50,001-100,000	9,098	15,250	59.7
RM100,001-150,000	3,754	10,596	35.4
RM150,000-200,000	1,636	5,599	29.2
RM 200001-250,000	907	3,166	28.6
More than RM 250,001	1,684	3,032	55.5
Total	20,749	43,541	47.7

Source: Property Overhang -Valuation and Property services Department, Ministry of Finance Malaysia Q1 2002

The findings from property overhang of the lower end houses showed that there is a mismatch of supply and demand of houses. Data tends to show properties with prices between RM100, 000 and RM 250,000 have a higher percentage of unsold units for more than 24 months. In addition, it also shows that pricing and affordability aspects may not be the reasons of the unsold houses. Hence it is important for the government to intervene into aspect of location, quality and type of property. As pointed out by property consultants before, key considerations for the low-income home purchasers are location, accessibility and availability of public transportation. (The Edge, Malaysia April 2002)

5. Conclusions

It is timely for the Government to reconsider its role in the provision of low cost housing as well as monitoring overhang property. The Government needs to have a comprehensive step to formulate its National Housing Policy. Presently, the policy is elucidated by the Five Year Malaysian Plan may not be effective as it is more of a number game rather than policy direction to improve the quality of life and sustainable housing in the long term. Apart from the number game of achieving target, the importance of quality and environment of low and medium cost housing should be emphasised. It is of equal importance to protect housing buyers through proper regulation enforcing and controlling standards.

Although some researchers argued that Malaysian housing industry is over-regu-

lated and complex where it is governed by over 30 sets of legislations ranging from laws on land, building environment to workers' safety and infrastructure. The recent amendment on the Housing Developers Act 1982 to Housing Development Act has rectified many of the weaknesses aimed at protecting the housing buyers.

The problem of property overhang reflects a clear mismatch of demand and supply situation. The recent formation of National Property Information Center (NAPIC) will be able to disseminate up-to-date property information of housing supply to developers, investors and local authorities. It will be able to help developers and approving authorities with better decision to launch a housing project and identify effective demand by market segments.

The impact of government intervention in low cost housing provision has contributed to a large pool of social housing. Most of these housing units which are incorporated in a township or medium size project are self-contained in facilities and amenities. Some of the larger township or housing estates may also have employment areas within the housing scheme. The indirect implication of low cost housing in a larger settlement enables a more healthy racial harmony as it has the multi-ethnics and also the mixture of the poor and medium as well as high income population.

In terms of quantity, over the last 20 years, both the private and public sectors have built about a million houses with decent quality and fulfilling the government building by-laws as well as proper infrastructure. It has also created a new generation of new housing estates with mixed housing

category and multi ethnic residents. This is part of a social engineering to achieve the goal of racial unity and equity in property ownership.

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CHAPTER 5

PUBLIC INTERVENTION IN THE HOUSING MARKET IN INDONESIA: Who gets to benefit?

Introduction

During the economic boom in Indonesia between 1970s and 1990s housing development gained its momentum. Residential land development companies were mushrooming. Housing market was blooming. It was recorded that during the time the number of registered land development companies were almost tripled from 907 companies in 1990 to 2312 companies in 1997 (Simanungkalit, 2001). In Jabotabek a metropolitan area of Jakarta, for instance, the private sector has urbanised 16.6 thousand hectares of rural land far away from the built-up area of Jakarta, selling around twenty five thousand housing units annually (Winarso and Firman 2002; Winarso and Kombaitan, 2001).

The number of houses sold was remarkable from only 90.8 thousand units in 1990 to 250 thousand units in 1997 (Simanungkalit, 2001). Financial market also developed rapidly. But, this was followed by the increasing size of the loans for property development. It was recorded that the housing loans had reached almost 40 percent of total loans in Indonesia and was in potentially bad debt. This, combined with the other external factors (i.e. the depreciation of Rupiah to US

Dollars) has triggered the economic crisis in Indonesia (Winarso and Firman, 2002) and culminated in the social-political turmoil of the country in 1998. As a result, housing market was at the bottom with almost no activities detected. Efforts to recover from the economic calamity have been developed; government has tried to intervene to gear up the housing market with several policies.

In light of the above background, this chapter attempts to evaluate the effectiveness of the government intervention in the housing market particularly after the 1997/1998 financial crisis. The chapter argues that the government intervention has never been effective particularly because the socio-political and economic condition of the country is still uncertain. Under these circumstances it seems that the intervention benefits only small minority developers and ignoring the large majority of low-income potential buyers. In doing so the chapter is presented in five parts, Part one is the introduction, Part two discusses the housing market in Indonesia before the economic crisis. Part three highlights the effort of the Government to

intervene in the market; Part four discusses the effectiveness of the intervention; at the end, a conclusion is drawn out from the discussion.

1. Housing Policy and Development in Indonesia before the Economic Crisis

In Indonesia, where the total population has reached 206.6 million (BPS, 2000), those living in urban areas, were 42.0 per cent of the total population in 2000 (BPS, 2000). Almost 71 per cent of the urban population were those from the middle-low and low-income groups. The current median monthly household incomes (50th percentile) for urban areas with and without DKI Jakarta are Rp.950,000 and Rp.892,000, respectively. The median household income in rural areas is Rp.579,300 (Hoek-Smit, 2002). The urban population growth rate, which was estimated at 3.5 per cent per annum during 1990 to 2000, is considered high. It accounts for about two-thirds of the total population growth from 1980 to 2000. Meanwhile the population living below the poverty line is estimated to reach 27% in late 1998 right after the crisis (World Bank 2001). And only about 15% of urban population afford to buy better house¹⁴. The large majority (45%) can only buy simple and very simple house through subsidised loan scheme. This pictures the significance of housing development to house the ever-increasing population.

14 Simple house is a 36 square meter house constructed on 60 square meter plot priced at around Rp. 25 million. While very Simple house is a 21 square house constructed on 60 square meter plot priced at around Rp. 20 million

Formal housing policy in Indonesia just started some 20 years ago with the birth of the National Housing Authority in 1974¹⁵. This birth cannot be separated from the more powerful advent of World Bank into the field of urban development around the 1970s. The works of John Turner on the self-help housing (Turner, 1976) and the works of Otto Koenigsberger (1964) in urban development planning have undoubtedly influenced the concepts for housing development and housing policy in Indonesia.

In 1974, following a National Housing Workshop, the Government created three important institutions to address housing problems systematically. These institutions are National Housing Authority (Badan Kebijakan Perumahan Nasional) which is responsible for formulating the overall housing policy; National Urban Development Corporation (PERUM PERUMNAS) which is responsible for providing houses, particularly for low-income people; and State Saving Bank (BTN) which was restructured to provide mortgage finance. The creation of these institutions was a response to the ever-increased demand for housing particularly for low-income people. For the middle and high-income people, the private sector had already started to provide houses since 1971 (Winarso, 2002).

15 One of the reasons was the high economic growth experienced in those years. During 1971 to 1981 the Indonesian economy grew at an average rate of 7.7 per cent. In the second half of 1973 the international petroleum price quadrupled, conferring massive windfall revenue gain in Indonesia (Hill, 1996; Winters, 1991). The urbanisation rate also increased as an indirect cause of the economic growth. Private sector development flourished due to the increased demand for offices and houses for the employees.

This marked the beginning of the creation of a formal housing market in Indonesia. Private sector housing developers had also established an association in 1972 labelled REI (Real Estate Indonesia). A private mortgage institution, PT Papan Sejahtera (PTPS) was also established later in 1980 to serve the private sector housing development. To further co-ordinate the various agencies involved in housing production, the Ministry of Public Housing was created in 1977.

The work of Turner in Lima, Peru, and his famous book "Housing by People" (1976) has made Popular Housing Development become one of the accepted concepts for housing provision. This is what really has been happening in developing countries. In the case of Indonesia, the popular¹⁶ housing provision, the informal market, had, on the one hand, covered over 80 per cent of all housing needs (Struyk, Hoffman and Katsura, 1990). The formal system, on the other hand, had covered only the remaining 20 per cent. This latter system, which is often heavily subsidised, through a subsidised low interest mortgage system, provides housing for the moderate to high-income people.

Basically the Government of Indonesia has since 1974 adopted two policy tools to address housing shortages. First is the direct government intervention by providing housing through development

16 In Indonesia, the production of urban housing is largely done by popular and professional house builders. Popular housing is the one being developed by individuals without reliance upon either Government or formal private sector institutions. While the professional are those created by private or Government owned companies (Struyk, Hoffman and Katsura, 1990). Formal housing development has to comply with certain building standards set up by the Government.

of new houses by PERUMNAS. Second is the indirect intervention by encouraging the people to build or upgrade their own houses through programmes like KIP, and mortgage finance by State Saving Bank (BTN) and the Housing Finance Corporation (PTPS - PT Papan Sejahtera). This latter strategy virtually had been ahead from what was known as 'enabling strategy' promoted by the World Bank in 1990 (UNHCS 1990).

Another indirect policy instrument to ensure the provision of low-income housing is by setting a requirement to have a ratio of 6 small houses and 3 medium houses for every large or luxury house built by a private developer, which later became known as 1:3:6 ratio. The requirement was stipulated in the decree issued by the National Housing Authority on 12 September 1974. In 1992 the rule was further reinforced by an Inter-Ministerial Decree signed by the Minister of Public Works, Minister of Home Affairs and Minister of Public Housing. This Inter-Ministerial Decree stipulates that private developers who carry out land development on an area of 200 hectares or more, have to build houses in 1:3:6 ratio in their areas, whilst development of smaller than 200 hectares can develop the 6 portion in other areas, but in the same *Kabupaten*¹⁷.

With this strategy the Government sets a target to build 500,000 to 600,000 simple housing units in the sixth five-year Development Plan starting in 1995. In practice, however, this strategy has never been smoothly implemented. The fact that the regulation needs to be reinforced in 1995

17 Kabupaten is an administrative area under Province

also shows the difficulty in implementing the regulation. One survey indicates that REI Developers have long tried to resist this 1:3:6 requirement (Leaf, 1991). One of the reasons stated by a developer is:

"It is difficult to find land suitable for simple houses with the Government's fixed price..." (Properti Indonesia, August 1995).

These two policies were effectively started in 1974 and theoretically could address all levels of income: KIP, Land Consolidation, Inner city redevelopment would provide housing for low-income level; PERUMNAS would provide housing for the low-middle income level. NGO and co-operation would provide housing for low and middle-income level; Private developer BTN would provide housing for middle-high income level and REI/PTPS would provide housing for the high-income level plus some for other levels.

Government's policy on housing finance is focused on the formal finance system, although it also encourages the informal system because this system obviously serves the majority of the homebuyers particularly the low-income people. The formal housing finance basically relies on the BTN and PTPS. These two banks enjoy Government's support to obtain funds below market price so that they can provide mortgage at a subsidised interest rate to encourage the people to buy houses through a Housing Ownership Loan (KPR – Kredit Pemilikan Rumah) Scheme. With this scheme the Government gives financial assistance with subsidy component to house buyers to acquire houses in regularised and serviced plots developed by PERUMNAS or private developers. BTN

would finance up to 95 per cent of housing price, repayable within 5 to 20 years at a subsidised interest rate below the market. The remaining 5 per cent is to be paid to PERUMNAS in instalments within 12 to 24 months without interest. Private developers who develop middle and high income housing obtain short-term construction loan from commercial banks. Re-financing is done through BTN or PTPS. Buyers make down payment as equity at minimum 10 per cent of house price; the remaining 90 per cent is to be paid on mortgage at the subsidised interest rate. The emergence of financial market in the 1980s developed further the housing finance in Indonesia especially for formal housing development for middle to high-income levels. The financial market provides funds needed by the private residential developers to finance their large residential projects.

Together with the significant economic growth enjoyed by the country, the overall policies have geared towards the formal housing market. Later in the 80s, with a series of deregulation policies in Indonesia during the years 1983 –1988¹⁸, the housing market started to flourish and massive housing development began. The deregulation policies aimed at improving domestic savings, improving resource allocation and developing a framework for monetary management, in particular through indirect intervention rather than direct regulatory control (Hill, 1996). The most important deregulation policy was

18 Winters (1991) dissertation provides a good account of this series of deregulations. He put it under "Jaman Deregulasi" in which he analysed the dynamics power involved in the deregulation. More detailed analysis of the reform can be seen in Hill (1996) and Booth (1992).

perhaps the 1988 financial, monetary, and banking reform¹⁹.

This was of particular assistance to the development of real estate industries. The policy enabled the entry of more foreign banks in the form of joint ventures and thus encouraged genuine competition (Hill, 1996:36). The banking system expanded as a result of the competition. Hill (1996) noted that between March 1989 and June 1993, the number of private banks' branches almost doubled, while the state bank in the same period expanded only 24 per cent. (Winarso and Firman 2002)

To cut a long story short, this policy had made the housing development, particularly for the middle and high income segments of the people, mushrooming. However, these developments were not managed properly. At the end this excessive housing development had been the trigger of the monetary crisis of the country (Winarso and Firman 2002) and caused calamity of the country as a whole.

The banking sector which was one of the important institutions contributed to the growing housing market was in disarray. These banks have made excessive loans to property firms, which many of the firms were their own business groups (Winarso and Firman 2002). Firman (2002) wrote that the total loans in 1998 was recorded as much as Rp. 545.6 trillion, out of this amount loan allocated for property development was Rp. 545.6 trillion (13.3%), and

almost three-fourth of which were non performing loans. Adding with the foreign loans for the property, which were mostly short term and unhedged, made the situation very volatile.

The world knows now that economic crisis which started in Thailand had also swept away the promising high economic growth and blooming housing market enjoyed in Indonesia before the crisis. It undoubtedly created great losses to the Indonesian economy. Furthermore, the crisis has made a number of major banks collapse and have been closed down or put under the surveillance by the government (Firman, 2002; Rachbini, 2001). Suddenly the housing market is in chaos.

2. The Government Intervention

2.1 Model of Government Intervention

Although neo-classicalist belief is that market will resolve the problems in the market and that government intervention could distort the market and its performance in the long run (Bradbury, et al, 1982), this belief is not without flaw. This is because a perfect market will never exist (Evans, 1985). Due to restricted information, developers in Jabotabek, Indonesia for instance, operate in a highly uncertain investment environment (Winarso, 2000). Experimentation, monitoring and learning thus become important, and that makes a 'process view' more appropriate than a 'market view' on land development (Monk et al., 1991). The tendency of monopoly or oligopoly market is also the reality in the

19 The package was aimed at increasing economic growth, non-oil export and to expanding job opportunities. This deregulation was also aimed at encouraging mobilisation of funds, efficiency of banks and non-banks institutions, and to developing capital markets (Winters, 1991).

housing market (Mansfield, 1991; Winarso, 2002). Thus, government regulations and interventions are necessary to ensure the well being of the market, particularly to solve conflicts and achieve desirable social goals (Zhu, 1997). However, due to the lack of knowledge on the operation of residential market, intervention will, sometimes create unjust and unfair residential market. It is also observed that government interventions are motivated by political targets, to serve the interest of politically influential groups (Dunkerley, 1983; Gilbert and Ward, 1985; Thirkell, 1994).

To demonstrate the possible intervention, scholars have tried to construct models to illustrate the linkage between state and the other institutions involved in the land development process. (Kaiser and Weis, 1969; 1970; Evans, 1987; Drewet, 1973; Bryant et al, 1982; Massey and Catalano, 1978, Ambrose, 1986, Zhu; 1997). However, such a model should be looked at cautiously if it is to be used to explain the housing market in developing countries, particularly because the links among the state, the construction industry and the financial sector in developing countries are not as straightforward as implied by the model. The links will include formal and informal processes which hardly appear in the model. The informal processes may be the result of the immature planning and housing policy instruments (Rakodi, 1996, Baken and Van der Linden, 1992) and they enable market institutions to take place outside the legal system (Angel et al., 1983). It is acknowledged, however, that this informal process which produced an informal economic sector kept the developing economies afloat during the 1980s (Jones and Ward, 1994). Moreover, it was

believed that this informal system housed millions of urban dwellers (Jones and Ward, 1994; Struyk, Hoffman and Katsura, 1990; Baken and Van der Linden, 1992). However, the informal sector rising from institutional and political constraints on the formal sector, gave place to bribery, corruption, evasion of legal restrictions and the arbitrary use of power (Jones and Ward, 1994).

The relationships among the financial sector, the state and the construction industry and relationships within the construction industry itself could be established through informal processes, particularly when dealing with the regulation of land development. A formal action which is supposed to be conducted according to certain laws and regulations could become informal because of political interest, bribery and corruption (Server, 1996). Lee (1994), for instance, argued that in developing countries people have three choices when dealing with the laws and regulations: to obey the law, and to incur the financial cost that implies; to pay bribes so that laws are suspended or ignored; or simply to break the law and, as a consequence often to be obliged to live outside it, permanently.

In Indonesia, based on the Equilibrium models²⁰, the linkage between state action and market force can be demonstrated (see Figure 1).

20 Healey (1991), grouped models on land development process into four. i.e.: (1) Equilibrium models, which assume that the development activity is structured by economic signals about effective demand. This derives directly from the Neo-classical tradition of economy. (2) Event-sequence models, which focus on the management stages in the development process. (3) Agency models, which focus on actors in the development process and their relationship. These have been developed to describe the development process from a behavioural or institutional point of view. (4) Structure models, which focus on the forces,

The model shows that residential land market is closely linked to finance industry and the Government. The Government provides regulations and policies to the housing industry and finance industry. Finance industry supports the housing industry with the needed capital. The growth of the housing industry, in return, will further develop the finance industry, particularly by selling the portfolio in money market. It should be noted here that, together with the formal process as illustrated by the model, the informal processes also take place, particularly in the housing industry and in the relationships between the housing industry and the government. For this industry, the informal process, through lobbying is, in some cases, more important than the formal process itself.

As shown in the model, the government has the possibility to intervene in the market through financial regulation, fiscal policy, housing policy, investment policy, land policy, planning policy and standard, spatial planning and permit systems. However, these intervention tools are under the responsibility of different institutions. After several changes in the Indonesian administration since the economic and political turmoil in 1998, housing development is put under a new department called Department of Settlements and Regional Infrastructure (KIMPRASWIL). Although this department, the only institution that formally has direct responsibility for housing development, has launched its housing and settlements policy and strategy for 2000-2004 (Departemen Permukiman dan Prasarana Wilayah, 2001), in practice, there have been no systematic integrated interventions made to recover the condition of formal housing market.

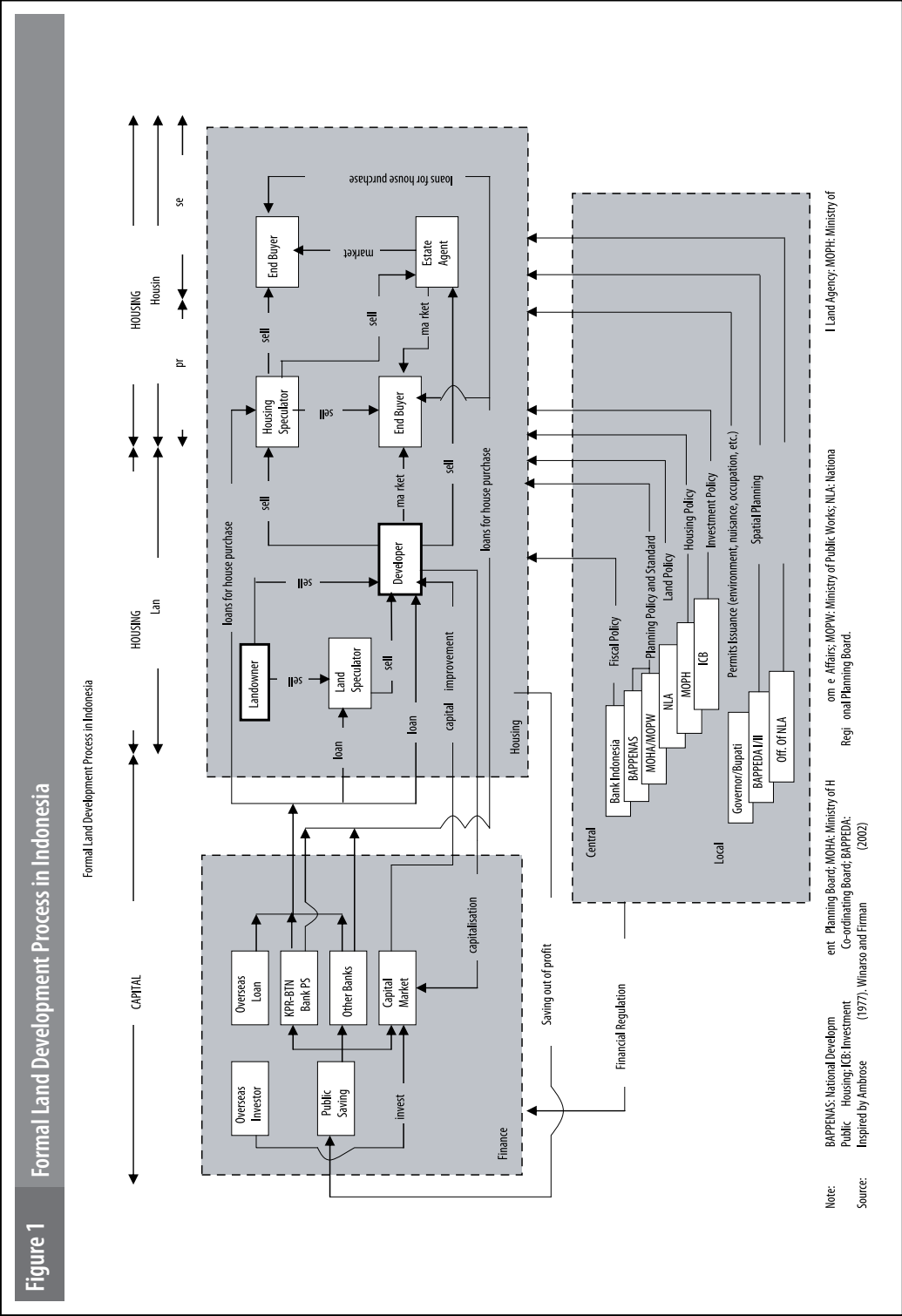
What has been done so far are partial interventions that could have impacts on the formal market. These interventions among others are the creation of IBRA and intervention to overcome the economic crisis through a series of financial policies.

2.2 The Creation of IBRA

There were no direct interventions of the government to speedy recovery of the housing market at least until the end of 1999. The government actions were focused on overcoming the negative impact of the economic crisis, particularly for social and political concern²¹. The important intervention made by the government that could have impact on the housing market is the creation of an ad hoc Institution, insisted by the IMF, labelled Indonesian Banking Restructuring Agency (IBRA) in January 1998. Under the Presidential Decree No. 27 of 1998 on The Establishment of IBRA, IBRA's main task is to restore the condition of the national banking sector and to pay back the state fund formerly extended to the banking sector.

The idea of this policy is merely to deal with the substantial amount of non-performing loans. The Non-performing loans would be transferred from the falling financial institutions or banks to IBRA which would package and resell at a discount on the market. To accomplish its mission, IBRA is supported by a special mandate and authority with the Presidential Decree No. 34 of 1998 on the Duty and authority of IBRA, as the legal basis of operations.

21 In particular, the government launching a social safety net program with the assistance of World Bank and the International Monetary Fund. (Firman, 2002)



The Banking Law specifies three fundamental duties of IBRA, namely: restructuring the banks transferred to IBRA, recovering bank assets including both physical assets and loans, and recovering state fund formerly disbursed to the banking sector.

With such a power, IBRA has taken over almost all unhealthy banks and their assets and up to March 1998, 54 banks had been kept under IBRA's surveillance (Rachbini 1999), In 2001, total property assets under IBRA management is Rp. 70 trillion (Simanungkalit, 2001). Out of that Rp. 45 Trillion is non-performing loans and Rp. 25 Trillion is in forms of land and buildings. So far the loan restructuring process is slowly progressing, it is predicted that out of Rp. 70 trillion property assets under IBRA management, only Rp. 15 Trillion could be returned to banking systems. The remaining Rp 55 trillion will be sold. This undoubtedly will influencing the formal housing market as most of the assets under IBRA are in form of land and buildings (including housing). In its first Property Assets Disposal Program (Program Penjualan Aset Properti =PPAP), 4,994 bidders participated to buy real property assets such as lands, shop-houses and houses (Property Indonesia, December 2002).

Table 1: Non-performed Loan under the Asset Management Credit of IBRA in 2001

Property Sector	Outstanding debt	%
Hotel	17,553	37
Housing	9,320	20
Office Buildings	6,869	14
Apartment	5,107	11
Land bank	3,3287	7
Others	2,449	5
Retail	1,835	4
Industrial Estate	1,230	3
Total	47.678	100

Source: IBRA, December 2001 quoted by Simanungkalit, 2002

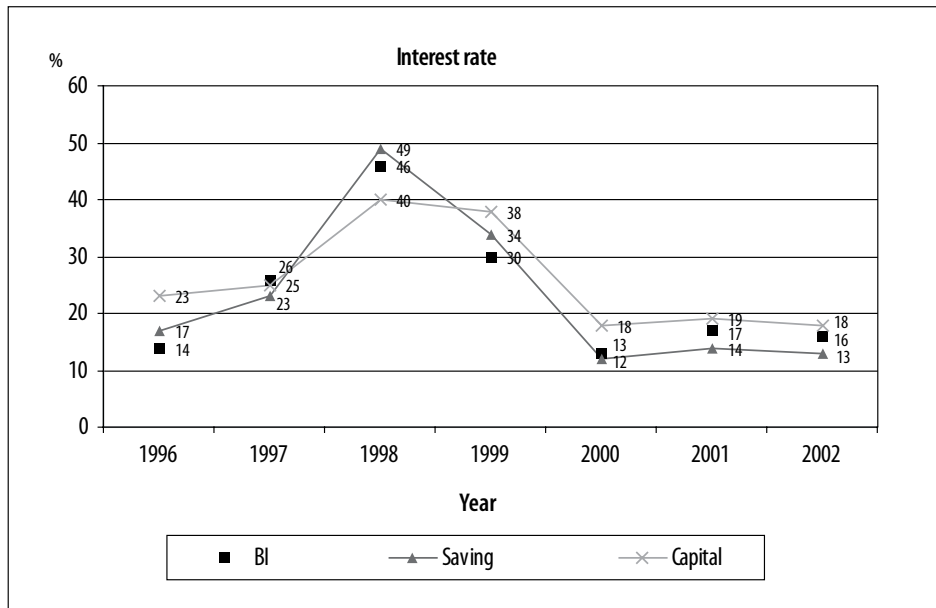
Under the last chairmanship²², through the second PPAP, IBRA will sell part of its assets at the value of Rp. 2.4 Trillion in mid 2003 (Properti Indonesia, December 2002). This certainly will affect the housing market considering that the properties offered consist of various types including housing, apartments, and ready to build plots in strategic locations.

2.3 Financial Policy

Financial and bank sectors in Indonesia are the institutions hit severely by the economic crisis. Until March 1998, 54 private banks had been taken over by IBRA to be restructured. Non-performing loans in IBRA increased considerably, from 9.021 billion Rupiah in 1997 to 128.305 billion Rupiah in 1998 (Rachbini, 2001), an increase of 1322.29 percent.

²² Within three years five persons have chaired IBRA.

Figure 2 The Fluctuation of Interest Rate in Indonesia 1996-2002



Source: Adapted from PSPI, 2002

The non-performing loans from the property sector reached 67.55 percent of the total bad debts. This condition is certainly not conducive for the housing market. As shown in the model, housing market is always influenced by finance, i.e. the availability of capital or funds for producing and buying houses. The availability of loans is important to induce the housing market. Parallel to the creation of IBRA the government has also been evaluating the macroeconomic condition of the country. The government increased the SBI (Sertifikat Bank Indonesia = Bank Indonesia Certificate) interest rate and controlling the supply of money. The interest rate for savings was at the peak at around 40% in mid 1998 right after the crisis then slowing down to reach 12% in the year 2000.

Meanwhile the supply of money is also controlled in order to stabilise the money supply (see Figure 2)

This apparent decreasing interest rate was the impact of government policies in the financial sector. However as the crisis is a multi-dimensional one, the lowering interest rate did not cause the housing market to work well. Thus, to reduce the burden of the developers who develop simple houses, in April 2001 (Kep.01/K.KSK/04/2001) the government made a policy which enables developer who develops simple houses to cut up to 50% of their debt, However, at the same time the government also reduces the subsidy for simple houses for almost 50 %, from Rp. 956 billion in 2000 to Rp. 479 billion in 2001 (Simanungkalit, 2002) and as part of the IMF agreement,

Bank Indonesia (BI) liquidity funding for housing loan (KPR) subsidies was ceased and the Ministry of Finance had to carry the subsidy on its budget. It is phased out in 2004. This means that in 2002 the government could subsidise the consumers of very simple houses only for two years. This new policy would have impact on the housing market particularly the simple and very simple housing because the consumers have to get housing loans with market rate interest, which is beyond their affordability.

3. The Effectiveness of the Interventions

What should be noted here is that all the government efforts, if any, to recover the housing market is done in a condition that is not different from that of the old 'new order'. Corruption remains at the public concerns. In 2000, Indonesia was at 85th on the list of the country in relation with corruption incidences as surveyed by Transparency International (<http://www.transparency.org/cpi/2001>). In 2001 the position was even worst. It was ranked at the 88th out of 91 countries surveyed. The macroeconomic indicators also show un-promising situations, It is said that in longer term perspective, the cumulative impact of the crisis on Indonesia's growth has been significantly greater than that for other countries in the region, except for Thailand (Athukorala, 2002). Politically, the condition is also still uncertain, within a few years after the collapse of the Suharto regime, four presidents have been in the Indonesian administration with a harsh transfer of power.

Although the spirit of the reform era was to tackle the corruption problems, nevertheless, the new administration is unlikely to be less corrupt than the previous one (Dick, 2001). No hard evidences show that the public intervention in housing market now is contaminated by cronyism, collusion and corruption, however, as IBRA manages such a huge amount of government's assets. IBRA may have attracted for corruption. As Redway (2002) said: since IBRA lacks the operational expertises to manage the assets under its control, it must continue to rely upon the former owners and management loyal to the former owners. Such a condition could open for lobbies which will benefit the former owner.

The creation of IBRA is not directly intended to recover the housing market, it is much more intended to recover the banking sector which in turn is hoped that the housing market will benefit from the recovery of the banking sector. Critics have been addressing this IMF promoted programme, mostly blaming IMF for not properly analysing the nature of the economic and political problems of Indonesia (For instance. Rachbini, 2001). If the 'culture' of lobbying and corruption were still intake, whatever the policy of the government is, it would always fail. A prominent business magazine "Investor" in its article reporting that there is a possibility that the debtors of the non-performing loans which their assets are under the management of IBRA will get their own assets at much cheaper prices (Investor, July 2002). This will hamper the just and fair and sound housing market.

The financial policy that has direct impact on the housing market is the correction on

the banks' interest rate. If the interest rate is low, it will induce more investments in the housing and could attract potential individual lenders to buy house in a loan scheme. The policy that reducing housing loan subsidy, as insisted by IMF, has burdened the low-income people to buy houses so that the construction of simple and very simple housing are far off the target set by the government. Up to October 2002 only 23,123 units were constructed out of 130,000 units targeted (Properti Indonesia, December 2002). A recent housing studies in Indonesia (Hoek-Smith, 2001) reported that the high interest rates (20 percent) and high down-payment requirements for mortgage lending will affect the affordability of low-income people. Moreover, the borrower is constrained by the lack of down-payment support for mortgage lending.

The latest available data on the transaction of housing shows an unbalanced transaction between the simple housing and the large housing. The data shows that the value of transaction and the absorption of houses for types of simple and very simple

houses are still lower than before the crisis (See Table 2 and 3). The table shows that, although the total transaction increased for 47% in 2002, which could be due to the inflation rate, the total numbers of housing units sold in 2002 still accounted for 32% of the total housing units sold before the crisis.

Even worse, the table also shows that the market for simple and very simple houses has not recovered yet. It shows that the market absorption for simple and very simple houses is still decreasing, which implies that the majority of the low-income people are still untouched by the intervention of the government. Meanwhile, the medium and the large houses have shown a trend for recovery which perhaps is a speculative move by large developers to gain profit in the near future. The table clearly shows that the policy is more effective to push up the middle and large houses for the minority people who could afford to buy such types of houses. While the majority, which is the poor, could not afford to buy even the very simple houses.

Table 2: Housing Absorption by Market Segment in Indonesia 1998-2002.

Market Segment	Sold (unit) x 1000								Change in Selling (%)	
	1998	1999	2000	2001	2002	Total	%	2001	2002	
Very Simple house-BTN	42.2	13.3	29.3	9	5	98.8	17%	-79%	-88%	
Simple House -BTN	72.6	40.4	68.5	32.2	20	233.7	41%	-56%	-72%	
Other house - BTN	8.5	1.5	5.6	18.2	27.6	61.4	11%	114%	225%	
Simple House -Private	15	14	22.3	29.1	45.5	125.9	22%	94%	203%	
Medium House	6.4	4.8	6.9	8.7	9.4	36.2	6%	36%	47%	
Large House	1.4	1.3	1.9	2.3	2.9	9.8	2%	64%	107%	
Total	146.1	75.3	135	99.5	110.4	565.8	100%	-32%	-24%	

Source: PSPI (2002)

Table 3: Housing Transaction by Market Segment in Indonesia 1998-2002

Market Segment	Transaction Value (1 Billion Rupiah)								Change in Transaction (5)
	1998	1999	2000	2001	2002	Total	%	2001	2002
Very Simple house-BTN	267.7	85.9	221	62.3	35	671.7	4%	-330%	-38%
Simple House -BTN	789.2	511.1	1187	530.2	362.2	3379.2	19%	-49%	4%
Other house - BTN	200.9	36.4	176	631.6	1073	2117.6	12%	68%	94%
Simple House -Private	472	457.8	803	1150	2025	4907.9	28%	59%	60%
Medium House	871.1	591.3	705	915.7	1024	4107.2	24%	5%	35%
Large House	431.9	310.5	405	494.7	630	2271.7	13%	13%	37%
Total	3032.8	1993	3496	3785	5149	17455	100%	20%	47%

Source: *PSPI (2002)*

Conclusion

Literature on housing market in developing countries mostly focuses on the low-income segments of the market including that which is informal (for example, Angel et al., 1983; Turner, 1967, 1972; Payne, 1977; Baros and van der Linden, 1990; Baken and Van der Linden, 1992), on the role of the State/Government and the issues of access to land for the poor (Angel, et al., 1983; Durand, 1990; Farvaque and McAuslan, 1991; Devas and Rakodi, 1993), or on policy instruments for land management (Archer, 1992, 1994; Devas, 1983, Yap and Angel, 1992; Dowall, 1991), it provides evidence that there are many informal activities and that the land development process can easily be subverted to serve the interest of politically influential groups (Dunkerley, 1983; Gilbert and Ward, 1985; Thirkell, 1994)

The literature also suggests that the informal processes in land development in developing countries may be the result of the immature planning and housing policy instruments (Rakodi, 1996, Baken and Van der Linden, 1992). This informality has been associated with those activities in the land development process which takes place outside the legal system (Angel et al., 1983). As noted by Jones and Ward (1994), the informal process often means bribery, corruption, and evasion of legal restrictions and the arbitrary use of power.

In Indonesia the informal activities have influenced the public intervention in housing market. In the beginning it speeds up the growth of the market. But it is the informal activities that also caused the collapse of the market and created a financial

and political crisis. Now, a few years after the crisis, the informal activities seem to be still intake in the relation between actors in housing market.

Under these circumstances, whatever government policies will not be effective and it will not achieve what it was intended. Not to mention the fact that there is no integrated policies aimed to recover the housing market. The government's intervention by creating IBRA and lowering interest rate benefit only a small minority of developers and ignoring the large majority of low-income potential buyers.

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The diversity of Asia provides unique opportunities for examining the effectiveness of different policies and instruments. The Asian financial crisis reveals our ignorance of market operations and makes us to rethink the Asian economic miracles and to re-examine the Asian political and economic environment in which the markets operate and the performance of particular sectoral markets. Housing markets are very important areas. Better policy design relies on better understanding of housing markets. The impact of sub-prime housing mortgage lending in USA on the global capital market and global economy further illustrates the importance of housing issues. This report examines the operation and performance of housing markets and particularly the impact of government intervention on the performance of housing markets in Asia. It presents different approaches and instruments used by different countries to deal with similar housing issues. The Asian experiences and practices can provide inspiration for other parts of the world to design effective and equitable housing instruments and policies.

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