

CHINA’S HOUSING PROVIDENT FUND: INEQUITABLE AND INEFFICIENT

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Abstract: The housing provident fund policy (HPF) is originally taken as a way for employee to apply for loans and withdraw the entire balance for purchase, construction, renovation or repair of an apartment of house, or upon retirement, incapacity, migration abroad, etc. However, based on existing research and data, some contradictions and complexities of both the content of housing provident fund policy and the means of implementation are revealed. Inequitable and inefficient are two main problems existing in the HPF policy. If the two main problems could not be solved, the HPF policy would be another failure during the housing reform in China. The aim of the research is not to discredit the housing provident fund idea, but to draw attention to potential policy failures in order to identify issues which need to be addressed by policy makers, implementers and researchers.

Key Words: housing provident fund; policy; China

1 Introduction

The housing provident fund (HPF) is a long-term, compulsory, indemnificatory and mutual aid housing fund. It is founded as a form of involuntary savings to assist home financing. Both the work unit and the individual would contribute to a common account. Designated banks would further supplement the fund with individual housing loans through a mortgage system. In 1990 the Chinese government began a program that encouraged occupants of public housing to purchase their homes. During 1998, the government announced that it intended to completely end the old housing allocation system. At that time employees had no money to purchase their private houses. The Chinese government has created the housing provident fund, a savings program for housing purchases that also helps fund retirement for its members. This program was learned from the Central Provident Fund in Singapore. The HPF was initially introduced as a pilot program in Shanghai in late 1991, and was extended national wide in 1995. The housing provident fund is one tool that the Chinese government has developed in its efforts to privatize housing that has previously been publicly owned. The initial aim of the program is to help the middle and low income groups to privatize housing. The program has had some success over the past decade in assisting in the privatization of the Chinese urban housing.

China is not alone in using a provident fund system to fund retirement and housing savings. A number of countries, including Singapore, India, and Thailand, have implemented such systems, with varying degrees of success. Although there are some common traits in each of these systems there are also significant differences among them in terms of their methods and goals. Some programs, such as the Chinese and Singapore plans, are compulsory for the majority of the population. Others, such as the Thai and Indian plans, are voluntary for large portions of the population. The Chinese and Indian programs pay a fixed rate of return on funds invested in the program; the Singapore and Thai plans allow the individual to invest in a variety of asset classes, including annuities, stocks, bonds, and gold.

Although the HPF policy made performance in helping some employees buy private houses, the problems and risks are still obvious. Some people even argued that the HPF policy is one of the failures during the housing reform process in China. The purpose of this paper is to analyze the existing and potential problems in the HPF system and present some suggestions to promote the system.

2 Main problems

In mid-August 2005, the Central Bank "2004 China Real Estate Financial Report" pointed out that the housing provident fund loans had limits and was difficult to apply, which led to the support for middle and low income workers is not obvious. On the one hand, sums of HPF are sleeping in the bank. On the other hand, people who really need houses have no money to purchase houses. The HPF has deviated from the initial aim of

equity, and act inefficiently in its implementation.

2.1 Inequitable

When the government designed the HPF policy, it aimed at solving the housing problem of the middle and low income groups. It was a policy to keep the equity of the society. However, to some extent the policy has increased the gap between the rich and the poor.

2.1.1 Join or not join

The government pointed out the housing provident fund is one mandatory social welfare and the participants of the housing provident fund must be civil servants, staffs in state-owned enterprises, collective enterprises, foreign-invested enterprises, private enterprises and other enterprises and institutions in urban area (hereinafter referred to as Danwei), not including self-employed workers, freelances, migrant workers and peasants.

In those who must join the HPF system, only parts of them actually participate. At the end of 2005, 63.297million people join the HPF system, accounting for only 60%. A great deal of staffs in private-owned enterprises did not join the system because the entrepreneurs do not want increase their costs to pay their staffs for the housing provident fund.

Indeed, those who join the housing provident fund system are often enterprises with better economic efficiency and administrative institutions. Enterprises with poor economic efficiency have difficulty in workers' salary, letting alone the housing provident fund. This makes the housing provident fund a higher income and stable fund for some staffs.

Some large state-owned enterprises or institutions have implemented a "binary model", which means formal staffs have the right joining the provident fund and the informal haven't the right. This is a typical discrimination.

2.1.2 More or less

Even in those groups who join in the housing provident fund, there also exists unfairness. It is known that Danwei and individual put parts of the basic wage into HPF at a certain ratio, ranging from 5% to 20%. Different region have different HPF ratio. In the same region, each Danwei and individual can adjust their ratio according to their situation. That is to say, high-wage Danwei and individual pay their provident fund more, low-wage Danwei and individual less. For example, in Beijing, some have 200 yuan HPF per month and some have more than 1000 yuan. In foreign invested companies, the amount is higher.

It is known that the housing provident fund is exempt from individual income tax. Some Danwei and personnel having excessive amount housing provident fund have been suspected of tax avoidance. From May to July 2005, the Auditing Bureau in Zhuhai had been audited the use of the housing provident fund. The officers in the bureau surveyed 25 samples. It was showed that 11 of them had 2000-5000 yuan of HPF per month, 3 of them 5000-10000 yuan and 5 of them more than 10,000 yuan.

All of the above suggested that the vast majority of ordinary people are hard to enjoy the benefits of HPF in the cumbersome procedures. Whereas some people are able to make HPF as a second wage and their monthly HPF amount are higher than general staffs' wages. This will further widen the income gap between urban residents.

2.2 Inefficient

At the end of 2005, 63.29 million employees have their HPF account. The sum of the HPF is about 625.95 billion yuan, but 165.6 billion yuan was deposited in the bank and not used. The low efficiency make the necessity of HPF doubted.

There are three investment channels for the housing provident fund——bank deposits, purchase of

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government bonds, loans to individuals for housing mortgages. The three investment channels have different interest rates. Comparing the three investment channels, risks and benefits are in proportion. The individual housing loans have the highest interest rate. Logically speaking, individual housing loans is the first choice for the HPF management centers. However, at the end of 2005, 63.297 million people join in HPF system, but only 8% enjoy HPF loans.

Table 1 The conditions of the HPF in 31 provinces in China (2004)

	Provinces	Accumulated Colletion of HPF funds(billion yuan)	Total Sum of HPF Individual Housing Loans(billion yuan)	Households granted HPF loans	Sum of Deposited HPF funds (billion yuan)
1	Beijing	52,154	30,474	171,258	7,595
2	Tianjin	21,815	13,427	180,732	3,993
3	Shanghai	73,677	59,678	697,883	3,509
4	Chongqing	6,270	973	23,224	3,563
5	Hebei	17,268	2,342	38,143	10,005
6	Shanxi	9,474	953	25,369	5,986
7	I.Mongolia	6,479	2,846	81,553	2,961
8	Henan	15,021	1,533	33,918	9,763
9	Liaoning	28,368	12,551	155,034	9,171
10	Jilin	10,806	2,348	39,912	5,717
11	Heilongjiang	15,714	3,074	63,148	7,704
12	Shandong	35,180	5,927	90,136	17,914
13	Jiangsu	48,845	22,432	335,266	12,937
14	Anhui	12,159	2,838	67,595	5,166
15	Zhejiang	35,518	24,606	261,499	8,012
16	Jiangxi	5,881	2,680	63,797	2,579
17	Fujian	17,546	7,971	162,928	6,238
18	Hubei	16,505	5,758	96,969	6,797
19	Hunan	12,370	3,893	106,152	5,366
20	Guangdong	35,501	10,324	108,725	13,437
21	Hainan	1,861	138	3,664	1,077
22	Guangxi	9,766	1,805	31,540	4,292
23	Sichuan	14,300	3,537	68,497	6,933
24	Guizhou	4,184	424	13,093	2,577
25	Yunnan	10,629	4,000	141,117	3,987
26	Shaanxi	10,920	1,587	20,856	5,013
27	Gansu	8,025	1,562	68,925	4,734
28	Ningxia	2,735	929	29,844	1,369
29	Qinghai	3,070	1,630	39,952	1,084
30	Xinjiang	11,914	1,748	66,429	6,490
31	Tibet	1,436	101	1,875	1,140

Data from the Ministry of Construction P.R.China

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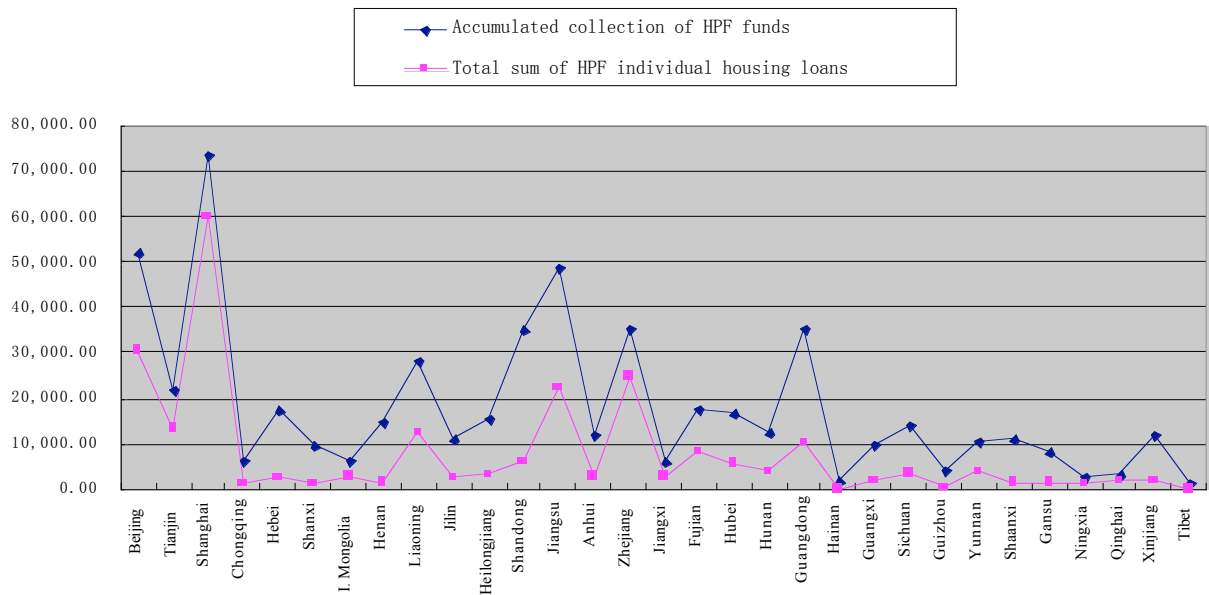


Figure 1 Total Sum of HPF and HPF Individual Housing Loans in 31 Provinces at the End of 2004

2.2.1 Limited sum

Compared with the housing prices and residents' income, the sum of the HPF housing loans is limited. As Chongqing for example, the average housing price was 2184 yuan per square meter in 2004. A house of 80 m² would cost 170,000 yuan. Whereas the limited sum of HPF housing loans was 70,000 yuan at that time. Until 2005 the sum increased to 150,000 yuan. This phenomenon is common in every region of China. The limited sum of HPF housing loans can not meet the need and a great deal of property buyers resort to the commercial bank loans.

2.2.2 Cumbersome procedures

Compared with commercial loans the HPF loans have more complex procedures, longer approval time and higher transaction costs. Because the HPF management center is not a financial institution, it must commission commercial banks to offer loans. First the commercial banks collect information of the loan applications. Second the HPF management centers censor all the information like the applicants' identity, the reimbursement capacity, the line, the guarantee, and time limit. Then the HPF management center, the commercial bank and the borrower sign a tripartite agreement. During this commission-agent process, the efficiency losses and transactions costs increase.

2.2.3 Risks

Although individual housing loans is comparatively safe, it still has risks, including systematic risk and non-systematic risk. Systematic risk is from the economic cycle. The real estate market is overheating in China. Once the slowdown in macroeconomic development is coming, large scale of default may occur. Non-systematic risk primarily refers to management risk, mainly due to the information asymmetries between borrowers and lenders. Every year not less than 60% of HPF benefits will be put into the loans risk reserve. Because the establishing time is not long, the risk reserve is small in most area and not enough to resist risks.

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Table 2 Income of urban household (2005)-by provinces
Average annual per capital and household earnings and their housing purchasing power

	Provinces	Per Capita Annual Income of Urban Household	Couple average annual household earnings (yuan)	Time needed to purchase a 300000 yuan apt. Entire HH earnings (years)	Time needed to purchase a 300000 yuan apt.30% HH earnings (years)	Time needed to purchase a 300000 yuan apt.50% HH earnings (years)
1	Beijing	15637.84	31275.68	10	32	19
2	Tianjin	11467.16	22934.32	13	44	26
3	Hebei	7951.31	15902.62	19	63	38
4	Shanxi	7902.86	15805.72	19	63	38
5	I.Mongolia	8122.99	16245.98	18	62	37
6	Liaoning	8007.56	16015.12	19	62	37
7	Jilin	7840.61	15681.22	19	64	38
8	Heilongjiang	7470.71	14941.42	20	67	40
9	Shanghai	16682.82	33365.64	9	30	18
10	Jiangsu	10481.93	20963.86	14	48	29
11	Zhejiang	14546.38	29092.76	10	34	21
12	Anhui	7511.43	15022.86	20	67	40
13	Fujian	11175.37	22350.74	13	45	27
14	Jiangxi	7559.64	15119.28	20	66	40
15	Shandong	9437.80	18875.6	16	53	32
16	Henan	7704.90	15409.8	19	65	39
17	Hubei	8022.75	16045.5	19	62	37
18	Hunan	8617.48	17234.96	17	58	35
19	Guangdong	13627.65	27255.3	11	37	22
20	Guangxi	8689.99	17379.98	17	58	35
21	Hainan	7735.78	15471.56	19	65	39
22	Chongqing	9220.96	18441.92	16	54	33
23	Sichuan	7709.87	15419.74	19	65	39
24	Guizhou	7322.05	14644.1	20	68	41
25	Yunnan	8870.88	17741.76	17	56	34
26	Tibet	9106.07	18212.14	16	55	33
27	Shaanxi	7492.47	14984.94	20	67	40
28	Gansu	7376.74	14753.48	20	68	41
29	Qinghai	7319.67	14639.34	20	68	41
30	Ningxia	7217.87	14435.74	21	69	42
31	Xinjiang	7503.42	15006.84	20	67	40
	Average	9204.35	18408.71	17	57	34

On the one hand, individual housing loans are hard to advance. On the other hand, the HPF management centers fear of risk. All of these make them to choose the other two investment channels. As the government bonds are limited each year and not easy to purchase, the first choice is bank deposits. A certain time in the past, some HPF management centers especially those in counties even make a living on the difference between interest of bank deposits and interest paid to the HPF participants. With interest rate adjusted by the Central Bank in 2005, interest inversion occurred. The HPF management centers can not live until they change their previous ways.

2.2.4 Relationship with various actors

Commercial banks

The HPF management center is not a financial institution, so it must commission the commercial bank to loan. Whereas the commercial banks also have individual housing loans. There are actually competition among commercial banks and the HPF centers. In this competition, the commercial banks are the winner. The commercial banks have many branches, large sums of money and vigorous clients all together.

Real estate companies

Real estate developers' enthusiasm for HPF loans is generally not high. "We usually do not recommend people to use HPF loans because the procedures are too cumbersome and need long processing time. Funds have time value and we have no time to wait". One developer said.

HPF participants

Since propaganda is weak, some HPF participants are misled by commercial banks and real estate developers and know little about HPF loans. Even some of them know the policy, but they think the procedure too cumbersome and not are willing to try.

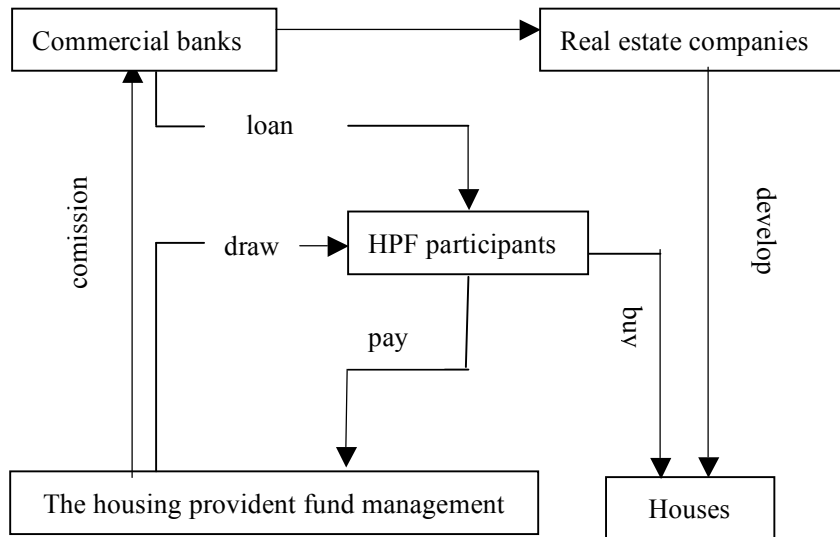


Figure 2 Different actors in the operating circle of HPF funds

2.2.5 Closed operating circle

As different region has different economic condition and housing demand, the rapid urbanization area such as Beijing, Shanghai and Zhejiang run faster in individual housing loan business. Emergence of lack of funds even occurred in recent years in these provinces and municipalities. However western region still lags behind and has large fund sedimentation (Figure1).

The nature of HPF determines the main objective in HPF operation is to ensure financial security and stable

profits. This operation objective leads to closed operating circle in each administrative area. Although the closed operating circle guarantees the stability of the housing provident fund, it limits the profit and value increment. Bank funds are mainly from various savings and regulated by headquarters. While the housing provident fund is entirely dependent on self-adjustment and no borrowing money among different HPF management centers occurs.

3 Discussions

The contradiction in the housing provident fund is becoming more and more prominent and urgent. “Now only little sums of the housing provident fund are for housing loans, large sums are sleeping as pensions for the clients in the HPF management centers. The complicated procedures coupled with limited sum make many people flinch. People did not enjoy the convenience of the housing provident fund, but a number of the funds are used to feed the clients in the HPF management centers. If the housing provident fund system maintains the status quo, it should be eliminated”, said Qifan Huang, the deputy to the national people's congress. Every coin has two sides. Actually the initial aim of the housing provident fund policy was good and played a certain role in helping people purchase private houses. We can not completely deny the performance of the HPF, but reform is imperative.

3.1 How to make equity

As the target of the housing provident policy is to help the middle and low income group purchase houses, the equity is the first index to measure the policy successful or not.

3.1.1 Widening the beneficiary group

The equity of the housing provident fund policy determines that the main beneficiary group of the HPF is the middle and low income people. Therefore laid-off workers, self-employed workers and migrant workers should not be excluded from the HPF system.

In April 2005, the Ministry of Construction P.R. China announced that in good-conditioned regions migrant workers employed by enterprises may join the HPF system and individual industrial and commercial households, freelance staff may apply for the housing provident fund subscribers. Early in this year, the Shanghai municipal government adjusted Provident Fund policy in a timely manner, launched *the housing provident fund implementation method for individual industrial and commercial households and employers, freelances* to expand the coverage of the provident fund. However, this policy is only implemented in some cities like Shanghai and not nationwide.

3.1.2 Setting the upper limit

If the upper limit of HPF for staffs is not controlled, the income gap between rich and poor would become wider and intensify social contradictions. After July 1, 2006 the individual HPF per month will have an upper limit in Guangzhou province. The upper limit will prohibit the high wage staffs taking the HPF as a second salary and avoiding individual income tax.

3.2 How to raise efficiency

The low efficiency is the fatal shortcoming of current HPF implementation. The deep-seated reasons for low efficiency are vague position of the HPF management center and closed operating circle. Unless reposition the HPF management center and break closed operating circle, there will never be high efficiency.

3.2.1 A clear position

In current institutional arrangements, the HPF management center is neither a local government department nor a financial institution, but an institution under local government department. This wrong position leads to a series of problems such as increasing transition costs, not competitive and poor in risk resistance. It is time to change this embarrassing position and restructure the HPF management center as a real policy-oriented financial institution, characterized by credibility of government guarantees and domestic policy objectives for government services. It enjoys government preferential policies, such as subsidies or tax relief for interest, and is different from ordinary commercial finance. Based on the preferential policies, the HPF management center would concentrate on the middle and low income households and not use low-interest loans or mortgage to compete with commercial banks unfairly. There will be specific credit policy, such as low interest for low-income families' house purchasing. Thus create domestic financial policy coordination with commercial banks and realize "win-win" situation.

3.2.2 Regional cooperation

Closed operating circle limits the housing provident fund to circulate among different area and to break the imbalance. We can break the closed operating circle by regional cooperation, which means learning from inter-bank borrowing and permitting transfer among HPF management centers. This will not only increase the efficiency of funds, but also be conducive to forming more flexible HPF lending policies and mobilizing the enthusiasm of participants in housing provident fund system.

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