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# The housing allowance scheme in Guangzhou

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## Abstract

Promotion of home purchase has been one of the major housing policies in China since 1979 and Guangzhou is one of the pioneers in formulating and establishing new housing policies. In 1997, the Guangzhou government announced an innovative housing initiative: the “Housing Allowance Scheme” (HAS). This scheme attempts to eliminate completely the welfare in-kind housing system by ceasing direct housing allocation. Civil servants appointed after 30 September 1997 would no longer receive housing from the State. Instead they were provided monthly housing allowances in cash. This paper is the outcome of a research project, funded by University Grant, to examine the feasibility of this new “Home Allowance Scheme” in achieving its objective of “Home Purchase” in Guangzhou. It first reviews welfare housing reform in the reformist city and examines the “Housing Allowance Scheme” against its objective of “Home Purchase”. More importantly, it highlights the inherent problems facing the government: such as lack of finance in both housing production and consumption. Finally, the concluding section gives suggestions for accomplishing the objective of “Home Purchase”. © 2000 Elsevier Science Ltd. All rights reserved.

*Keywords:* Home purchase; Housing allowance scheme; Guangzhou

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## 1. Introduction

Housing policy development has formed an important area of research in China. This has resulted in a large number of publications but mostly inside China. Unfortunately, there is little or no information specifically about the operation of the Housing Allowance Scheme (HAS) in Guangzhou (cf. Chu & Kwok, 1990; Chiu & Lupton, 1992; Wang, 1992; Lau, 1993). The establishment of the HAS, is consistent with the more general economic reform in China, in particular shifting part of the responsibility for housing the population from the State to the

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individual. However, persistent problems such as lack of mortgage loans and insufficient funding for housing construction, associated with implementation are substantial and have yet to be solved. This paper reviews the impact of the HAS on housing reform in Guangzhou.

Guangzhou is a large city in southern China, with a population of approximately 8 million. It has earned the reputation, along with Shanghai of being at the forefront of the economic reform programme of the Chinese government. The results of economic reform in Guangzhou may be seen as a bellwether for the rest of China.

The paper starts by reviewing the development of housing policy, housing need, housing investment and provision and affordability with reference to Guangzhou. Then, it examines the effectiveness of the HAS in achieving the goal of “home purchase”. The concluding section provides recommendations for policy change. The paper is based on an analysis of government legislation documents and relevant literature and press articles in Chinese, including local housing reform plans.

Providing the individual with “an equitable share of items of personal and collective consumption” is a fundamental belief of the socialist housing system (Sit, 1997, p. 201). The Peoples’ Republic of China inherited the Soviet model for centrally planned housing production and the “work unit” system to ensure that every urban resident would be looked after by the State. The “work unit” system refers to the practice of joining work and residence for employees in order to create social stability and solidarity. Every urban citizen is assigned to either a productive work unit such as a state enterprise or factory or a non-productive work unit such as a school, hospital, government department, etc. The work unit is also a multifunctional neighbourhood that plays a central role in organizing the activities of those employed there. From job offer to marriage, the work unit has a strong influence on the life of an employee (Whyte & Parish, 1984).

Under a centrally planned economy, the government plays a dominant role in housing, being involved in direct provision and welfare subsidies. In 1997, nearly 80% of the population lived in state-owned housing. In addition, each household received a subsidy of approximately RMB 1960 annually (approximately US\$180) representing 60% of households’ total welfare subsidization (Chen, 1997). Since 1995 the government has introduced two major housing policy initiatives with the purpose of encouraging individual home purchase. The “National Comfortable Housing Project” and the “Housing Provident Fund” were introduced in 59 major cities including Beijing, Shanghai, Tianjin, Guangzhou and Shenzhen.

The “National Comfortable Housing Project” targets the provision of low-cost housing for middle and low-income groups with a living area of less than 4 m<sup>2</sup> per capita. The “Housing Provident Fund”, a compulsory savings scheme for house purchase, was the result of a pioneering scheme in Shanghai. The scheme required employers and employees to contribute 5% of the employees’ salary into a personal housing savings account held at the China Construction Bank. The savings belong to the contributors and can be used for home purchase, self-building or renovation of currently occupied housing units. Most major cities, including Guangzhou have now established such savings schemes to enable state employees to accumulate capital for individual home purchase (State Land Administrative Bureau, 1997; Mao, 1997, pp. 32–35). However, little apparent progress has been made in terms of the rate of homeownership. According to an estimate by a research institution in Guangzhou in 1996, the rate of individual home purchase accounted for only 15% of all housing transactions.

Nevertheless, housing reforms in China face institutional obstacles, such as the entrenchment of the “work unit” system and low affordability of households. “Work units” still bear the social obligation for housing their employees in return for a nominal rent. On the other hand, prices set for the Comfortable Housing Project, based on the cost of construction are too high to attract purchasers away from the very low-cost housing provided by their employers. Most households simply cannot afford to buy. The socialist housing allocation system and its limited financial assistance for households hinders the development of new housing programs (Zhou & Logan, 1996, pp. 400–421; Kong, Wong & Howes, 1997; Chen, 1997). The deficiencies in housing provision include insufficient investment, unfair distribution, the low rent system and poor management (Wang & Murie, 1996).

The Ninth National People’s Congress held in March 1998 recognized the housing market as “a key engine of growth” in China (South China Morning Post, 20 March 1998). Prime Minister, Zhu Rongji, announced that housing reform was one of the five major tasks of the State. He said that the government was determined to eliminate its in-kind welfare housing allocation system and identified home purchase as the major direction for housing reform. To this end, in-kind welfare housing would be replaced by the Housing Allowance Scheme, pioneered in Guangzhou, providing housing benefits (in cash), encouraging a shift away from the traditional housing allocation practice (Hong Kong Economic Times, 20 March 1998). At the same time other institutional changes, such as the privatization of state enterprises, were occurring as part of the process of economic reform. However, “work units” still retained their housing responsibilities.

Guangzhou formulated and established the “Housing Allowance Scheme” for the State. In 1997, the Guangzhou government announced that it would no longer allocate housing to civil servants appointed after 30 September 1997. This scheme was put into effect for the first time on 1 January 1998 with the aims of attenuating the responsibility of work units for housing provision and enhancing the affordability of homes to potential buyers. Instead of providing housing through the work units, the government would offer civil servants housing allowances in cash to help them purchase their home. Following Guangzhou, similar home purchase schemes have been put on the housing policy agendas of other major cities including Shenzhen, Beijing and Shanghai. The following section reviews the housing development in Guangzhou.

## **2. Review of housing development in Guangzhou**

### *2.1. Recent policy development*

The Guangzhou government, recognizing the deficiencies in the welfare nature of its housing system, carried out a series of housing reforms since 1988. In 1997 the city government announced proposals to accelerate the pace of housing reform by encouraging home purchase, with the aims of improving living standards; increasing provision and reducing its own welfare commitments. The current policy is principally focused on

1. The sale of public housing and
2. The promotion of homeownership.

## *2.2. Housing need and allocation*

In 1996, the official urban population in Guangzhou was 6.5 or 1.9 million households (unofficial estimates of the size of the population are considerably excess of this figure). The official urban working population was 2.03 million, of which 60% worked in state-owned enterprises (Statistical Yearbook of Guangzhou, 1997, p. 370).

In 1997, the average floor-space per household was 7.5 m<sup>2</sup> per person. 26,000 households in the middle and low-income groups, living in accommodation with less than 5 m<sup>2</sup> per capita, were referred to as “households with living difficulties”. Of these households, 25% were still waiting for accommodation to be provided by their respective work units. This is one of the target groups of the housing reform (Guangdong and Hong Kong Information Daily, 10 March 1997; Nan Fang Fang Di Chan, 1997, p. 10).

Part of the legacy of the planned socialist economy was that the Guangzhou government and local work units largely administered and controlled the housing provision to meet people’s need without reference to market forces. Power and personal status were essential for access to good-quality housing. In principle, the government and work units allocated housing units to employees according to their rank, years of service, family size and existing living area.

## *2.3. Housing provision and local government investment*

In 1996, the total area of residential floor space completed was 6 million m<sup>2</sup>, of which 43% (2.6 million m<sup>2</sup>) was built by state-owned enterprises. (Statistical Yearbook of Guangzhou, 1997, p. 222). On the other hand, the Government provided half of the total RMB 6.4 million investment in fixed assets (including housing investment) (Statistical Yearbook of Guangzhou, 1997, pp. 156, 159, 226).

The dominant role played by the government in financing and provision of housing places great pressure on the government’s financial budget. Even so, there remains a persistent gap between the supply of housing and the amount needed to meet shortages and improve the quality of the existing stock of housing. Very low rents; the poor quality of new housing and poor management of existing stock are contributing to the continuing imbalance between supply and need.

Statistics in August 1997 showed that 2700 work units had sold 17 million m<sup>2</sup> of public housing units to sitting tenants, representing 58% of the saleable public housing stock. By August 1997, 6900 work units with 1.02 million staff participated in the Housing Provident Fund, which accumulated RMB1.6 billion (approximately US\$200million). (Nan Fang Fang Di Chan, 1997, p. 10).

## *2.4. Affordability*

In 1998, the sale of Comfortable Housing Project units became a focal point of housing reform in Guangzhou. In March 1998, “Comfortable Housing” prices ranged from RMB3,000 (approximately US\$430) per m<sup>2</sup> to RMB3,500 (US\$500) per m<sup>2</sup>, compared to the “market” level of RMB 4400 (US\$630) per m<sup>2</sup>. According to the 1997 statistics, the annual income level of middle and low-income groups ranged from RMB8,000 (US\$1,150) per capita to RMB13,000 (US\$1,900) per capita. The average annual income level in Guangzhou was RMB10,300 (US\$1,450) per capita. In

other words, the annual income of a household with three members was approximately RMB 30,000 (US\$4,300) (Yang Chen Wan Bao, 1998).

Assuming that wage rates and housing prices remain stable over time, consider a couple with a child in the middle and low-income groups. Their annual household income is RMB26,000 (US\$3,750) (RMB13,000 × 2). The cost of a housing unit of 60 m<sup>2</sup> at RMB3,000 (US\$430)/m<sup>2</sup> will be RMB180,000 (US\$26,000). This is seven times their annual household income. Understandably, without any mortgage loans, it is hardly possible for a household to buy the unit outright.

The Guangzhou government has realized the difficulty of reconciling these related difficulties. It decided to reconstruct its existing in-kind welfare benefits scheme by introducing the experimental “Housing Allowance Scheme” (HAS). Initially, all civil servants joining government after September 1997 would be entitled to cash housing allowances as compulsory housing benefits in lieu of in-kind subsidies. The following section will provide the details of the Scheme.

### **3. The housing allowance scheme (HAS) — a new housing initiative**

The objectives of the HAS were to sever the link between work units and housing provision and to encourage homeownership. Civil servants who joined the government after 30 September 1997 were no longer entitled to housing units from government but were entitled to a housing allowance instead. The amount of the allowance for which a civil servant is eligible is determined by several factors such as their rank. At the present time, there are 2000 civil servants participating in the new housing program. All civil servants and staff of government-funded institutions are entitled to the housing allowances. The following section discusses the key features of the HAS.

#### *3.1. Eligibility*

1. The scheme applies to civil servants appointed after 30 September 1997.
2. Civil servants appointed before 30 September 1997 are given the option of joining the HAS or to continuing to enjoy previously existing housing benefits.
3. The allowance is subject to rules preventing double housing benefits (i.e. if the husband has applied his wife is not permitted to do so).
4. Civil servants appointed before 30 September 1997 and who have not received housing benefit are eligible for the purchase of “Comfortable Housing” at a discount.
5. Civil servants appointed before 30 September 1997 who have received housing benefits may, subject to certain conditions, switch to the new scheme.

Note: There is no clear rule on housing allowance for unmarried employees. According to government officials, the benefits to unmarried employees depend on their ranking and position.

In parallel with the HAS, the Guangzhou Government has issued a new housing directive that work units are no longer required to build houses for their employees. Instead, the government would provide new housing. Work units were permitted to allocate housing units built before the date of the directive at the existing rent levels, until 31 December 1999. Sitting “tenants” are allowed to purchase their units at a discount. Starting from 1 January 2000, housing prices and rent levels should be set in line with the construction cost of Comfortable Housing Projects. This

evidence shows clearly the Guangzhou government's efforts in housing reforms, in an attempt to shift away from its in-kind welfare benefit system and rent policy to the Housing Allowance Scheme.

### 3.2. Subsidy payments and space entitlements

Under the HAS, the housing allowance is payable for a period of 20 years. The rates of allowance are determined by the rank of the applicant. Table 1 summarizes monthly allowances and the space entitlement by rank. For example, a junior staff member with 20 years of government service can receive RMB83,280 ( $\text{RMB}347 \times 12 \times 20$  years) and  $34 \text{ m}^2$  ( $1.7 \text{ m}^2 \times 20$  years). The entitlement is based on the status of household head: it is not assessed in relation to the housing need of the family. Nor does it bear a direct link with the person's income or housing situation. As a result, this system tends to give the greatest benefits to those with highest status. That is, the higher rank and longer years of service, the better off the civil servant is, in terms of both the space entitlement and monthly allowances.

If the accumulated allowance to which an employee is entitled is insufficient to purchase the space to which he or she is entitled, they must either wait until they build up enough "credit" or make up the balance themselves.

The scheme contains several areas of uncertainty, for example, if the participant moves do they lose their allowances? Money for these subsidies has come mainly from the government budget allocated to housing maintenance and housing management, now, the money is used as "Housing

Table 1  
Rates of housing allowances and space entitlement

| Rank          | Standard space entitlement<br>( $\text{m}^2$ )<br>(a) | Additional space entitlement<br>(according to rank)<br>( $\text{m}^2$ )<br>(b) | Space entitlement for each year of service<br>( $\text{m}^2$ )<br>(c) | Monthly housing allowance<br>(RMB)<br>(d) | Cumulative housing allowance<br>(over 20 yrs)<br>(RMB)<br>= (d) $\times$ 12 $\times$ 20 yr | Space entitlement for home purchase<br>( $\text{m}^2$ )<br>= (c) $\times$ 20 yr |
|---------------|-------------------------------------------------------|--------------------------------------------------------------------------------|-----------------------------------------------------------------------|-------------------------------------------|--------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------|
| Junior staff  | 1.5                                                   | 0.2                                                                            | 1.7                                                                   | 347                                       | 83,280                                                                                     | 34                                                                              |
| Manager       | 1.5                                                   | 0.4                                                                            | 1.9                                                                   | 388                                       | 93,120                                                                                     | 38                                                                              |
| Vice-head     | 1.5                                                   | 0.6                                                                            | 2.1                                                                   | 429                                       | 102,960                                                                                    | 42                                                                              |
| Head          | 1.5                                                   | 0.8                                                                            | 2.3                                                                   | 470                                       | 112,800                                                                                    | 46                                                                              |
| Vice-director | 1.5                                                   | 1                                                                              | 2.5                                                                   | 510                                       | 122,400                                                                                    | 50                                                                              |
| Director      | 1.5                                                   | 1.2                                                                            | 2.7                                                                   | 551                                       | 132,240                                                                                    | 54                                                                              |
| Vice-chief    | 1.5                                                   | 1.4                                                                            | 2.9                                                                   | 592                                       | 142,080                                                                                    | 58                                                                              |
| Chief         | 1.5                                                   | 1.6                                                                            | 3.1                                                                   | 633                                       | 151,920                                                                                    | 62                                                                              |
| Vice-mayor    | 1.5                                                   | 2.1                                                                            | 3.6                                                                   | 735                                       | 176,400                                                                                    | 72                                                                              |
| Mayor         | 1.5                                                   | 2.6                                                                            | 4.1                                                                   | 837                                       | 200,880                                                                                    | 82                                                                              |

Source: Real Estate in Southern China (1997a, b) Guangzhou: Guangdong Real Estate in Southern China Press, No. 10, p. 9.

Allowance”. Both the government and work units have to make contributions at a rate of 57 and 43%, respectively, calculated on the product of the housing price and the space entitlement. The housing price is based on the price level of “Comfortable Housing” in 1997, i.e. 3500RMB per m<sup>2</sup>.

There are a number of ways in which eligible civil servants can use their housing allowances:

1. Private tenancy: Eligible civil servants may draw a monthly housing allowance to rent private accommodation.
2. Housing savings: They can open a housing allowance savings account and pay in their monthly contribution, for an agreed period of time. Upon maturity, say 20 years, they can draw the housing allowance to pay for their housing in full payment.
3. Housing finance: The eligible staff can apply for a government loan to cover the down payment of up to 30% of the property price. The loan should be repaid to his/her work units from the monthly housing allowance.

Housing allowances are administered by a housing management center, which is financially independent and self-sustained, under the control of the local government. Like a privately funded company, it can use the funds to invest in the financial sector of the market in order to gain profits. The government has commissioned the China Construction Bank to provide normal banking services for individual savings accounts. However, the bank does not participate in making decisions on the spending of the funds.

### *3.3. Problems associated with the HAS*

The establishment of the HAS in Guangzhou represents a notable step in shifting housing provision away from the in-kind housing welfare system. The Guangzhou government believes that the HAS is playing a positive role in restructuring the existing housing sector. It is fair to say that, during the implementation of the HAS, the government has made efforts to minimize possible adverse effects. However, the HAS still faces important difficulties that policy makers may need to address, if the scheme is to achieve its objectives. These problems are; low affordability; lack of a second-hand market for ownership or rental, and insufficient housing supply.

#### *3.3.1. Low affordability*

Now that the State will no longer allocate housing units to employees, the financial capacity of employees to purchase property becomes a critical factor in solving the chronic housing problem. Ordinary households in Guangzhou, like many other places, cannot afford to buy their home outright. It is expected that to be successful, the HAS needs to work with appropriate mortgage packages. Without such arrangements, the HAS might not achieve its inherent objective of home purchase among the mass population. Such a shortcoming may have an adverse effect upon two groups of employees: (i) those newly appointed and (ii) those have not yet enjoyed any housing benefits. If they do not have access to substantial sum of start-up money, they might not be able to buy a shelter at all. Under normal circumstances, full payment for housing units seems rather impossible for these two groups of people.

To further illustrate the affordability problem, consider a newly married couple in the middle to low-income groups. If their annual household income is RMB16,000 (RMB8,000 × 2) and both were appointed after 30 September 1997, and they wish to buy a housing unit of 34 m<sup>2</sup> (i.e. the

suggested housing area for the rank of junior staff) at RMB3,500 per m<sup>2</sup>, the housing price will be RMB119,000. The 30% down payment will be RMB35,700. If the husband works as a junior civil servant, he is entitled to receive a housing allowance of RMB347 a month, or RMB4,164 a year. If the couple has, in addition, participated in the Provident Fund Scheme, they will get another 10% of annual salary for housing savings (RMB1,600). Therefore, their total annual amount for housing savings will be

$$\text{Housing allowances (RMB4,164) + Provident Fund Scheme (RMB1,600) = RMB5,764.}$$

According to the requirements of the China Construction Bank, households are not qualified to take out a loan from the bank until they have 30% of the property price in their housing savings account. Given the allowances available, the couple in our case has to save money in the bank for more than 6 years before they are qualified for any housing loan. Despite being civil servants, the applicants are in a poverty trap and face the prospect of 6 years of homelessness. The chances of renting space on the second-hand housing market are very limited and, clearly, make the prospect of saving the necessary deposit even more remote.

There is no market for mortgages and mortgage-backed securities in China, or in Guangzhou. According to the World Bank, this will undermine the ability of the HAS to accumulate capital funds. Except for the China Construction Bank, there is little or no channel for housing finance (World Bank, 1992, p. 132). Our family mentioned above, has little chance of seeking alternative funding for a housing unit and the prospect of securing housing in the open market is also remote.

These factors inhibit the development of a second-hand housing market. Furthermore, the tradition of housing maintenance in China is not well developed among the Chinese population. Second hand property can be in a very poor condition and the cost of remedying such poor condition simply adds to the cost of home ownership.

Investment in housing production is traditionally the role of governments or individuals. Commercial investment in residential accommodation is rare. In a stable market economy, financial institutions are prepared to finance individual purchases because they perceive that individuals will attempt to maintain the value of their property. Furthermore, provided that there is a healthy second-hand market, banks and lending institutions have confidence that the collateral value of the property against which they lend will provide them with security in the event of default on the loan. They also know that most governments will manage the macroeconomy in ways that minimize economic shocks to individual taxpayers. In other words their investment is long term and secure.

The institutional problems in China may be summarized as

- No tradition of property ownership;
- No tradition of the pride of ownership that encourages the maintenance of the condition or value of residential property.
- No tradition of institutionalized funding for home ownership.

Both the HAS and the “comfortable housing” scheme have created poverty traps that deprive junior employees of access to decent housing.

The shift in the responsibility for providing housing represents a major cultural shift. There is little evidence that the resources for the construction of new housing that was provided to work units, either directly or indirectly by the use of the revenue generated by work units themselves, is

being fully and efficiently redistributed to the new housing initiatives. This is, of course, one of the “loose ends” of economic reform in China that if pursued leads to the center of the institutional problems of switching from a planned socialist economy to a “socialist market economy”. The institutional architecture of the “old” system may be obsolete but it is still comprehensive enough to create a substantial degree of inertia that weaker individual members of society are powerless to overcome. Nevertheless, their frustration at the finding themselves in a new poverty trap will be real enough.

#### **4. Conclusions and recommendations**

It is easy to appreciate the desire of the Chinese government to shift the responsibility of housing provision from the state to the individual. The Chinese government is not alone in this: many western governments have been dismayed at the rising costs of state welfare provision. The purchase of a home is the single greatest expenditure of most households. Providing the means to enable this purchase to be achieved is complex.

The Chinese government has introduced three major schemes designed to encourage this process. They are the “National Comfortable Housing Scheme”, the Housing Provident Fund and, following the experience of the city of Guangzhou, the Housing Allowance Scheme. These schemes are providing a new pathway to the acquisition of a new home. However, they also incorporate significant barriers to entry for households on the lower rungs of the housing ladder.

If the aim of these schemes is to provide all employees with the opportunity to acquire their own homes, the provisions of the various schemes must be designed to enable that to happen. Many young families are incapable of generating sufficient revenue achieve this aim. Rather than prevent them from obtaining satisfactory housing it would be preferable to design extra policy mechanisms for them to occupy the housing that they need but deferring the need to find the down payment until they are in a position to afford it. For example, if they undertake to purchase a property, they could be allowed to pay “rent”, some or all of which, could contribute to the 30% of the “equity” in the property. Once they had achieved this equity threshold, their “rent” payments could switch to the home purchase scheme. This would have the advantages of:

1. Diminishing the real prospect of several years of homelessness;
2. Committing them to the responsibilities of home ownership;
3. Encouraging the development of a rented sector.

The rental sector serves a good buffer and provides another tenure choice. The rental sector should be preserved for those newly appointed staff who are unable or unwilling to purchase housing. A monthly housing allowance could be used to rent accommodation. This would encourage the development of a second-hand market. In addition, the second-hand market could attract those who may wish to buy “better” (newer or larger) housing units. (Buckley, 1996, p. 38–41).

A market for mortgages finance and more channels for housing loan should be provided (World Bank, 1992, p. 132). Mortgage contract terms should be redesigned; extending the period for repayments to 20–25 yearly installments would improve the affordability of the people.

Construction sources of the government should be diversified in order to facilitate housing development. In March 1998, the People’s Bank of China relaxed restrictions on the amount of

loans to construction under the Comfortable Housing scheme. Banks are now allowed to provide loans to development companies if a company has 60% of the construction finance in hand and the sale of housing reaches 75% (Sing Dao Daily News, 27 March 1998). This may help encourage participation of private developers in comfortable housing development. Although the banks offer favorable terms, private development companies for public housing construction should be selected through tendering, instead of negotiation.

In short, the Chinese government can be seen to be taking positive steps to implement their policy to move away from reliance on state provision of housing. This shift represents a major challenge and must overcome major institutional hurdles. The HAS indicates the willingness of the government to develop new policy options. Although major difficulties remain, it is becoming easier to isolate areas of particular difficulty (for example the problems of young employees in securing satisfactory accommodation for the needs of their family). New policy initiatives can become more focussed to address particular areas of difficulty. Considering the magnitude of the problem that China faces in establishing an effective, market-based approach, the pace of change is rapid. The HAS constitutes an important landmark in this progress and Guangzhou continues to maintain its position at the forefront of this evolution of housing policy.

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