

Unit 6: Trade-off between Efficiency and Equity

Objectives:

Students will be able to:

1. identify the issue of efficiency and equity on the use of a scarce resource in Hong Kong context;
2. analyse the effects of a decision on the use of scarce resources on efficiency and equity;
3. understand the trade-off between efficiency and equity in a public decision;
4. understand the effects of a public decision on the use of scarce resources on different stakeholders;
5. evaluate the decision on the use of public resources in respect of efficiency and equity;
6. review critically the trade-off relationship between efficiency and equity;
7. understand and appreciate the needs and expectations of different stakeholders on the issue of income inequality.

Time allocated:

110-140 minutes

Learning activities:

Four learning activities

Remark:

For activities 3 and 4, due to the imperfect information of full cost and benefit, it may be difficult to reach a definite conclusion whether the case can achieve efficiency or not. Students should be reminded that this is a usual difficulty in empirical studies. Given this limitation, students should be encouraged to (i) analyse the cases on the basis of the available information, (ii) think of the qualifying conditions upon which their conclusions are found, and (iii) think of the effects of different measures or policies on different stakeholders in the society.

Activity 1: Analysing the use of the former North Point Estate

A. Objectives:

- To learn the trade-off between efficiency and equity from analysing the use of the former North Point Estate.
- After the activity, students will be able to:
 1. analyse the effects of, and hence evaluate, a decision on the use of public resources on efficiency and equity;
 2. examine the trade-off between efficiency and equity in a public decision;

B. Time required: 50 minutes

C. Prerequisite knowledge:

The meaning of efficiency and equity; services and operation of public housing in Hong Kong.

D. Materials needed:

Information sheet on the case of the former North Point Estate.

E. Teaching plan and instructional procedures:

| Teacher Activities | Student Activities | Time (mins) | Target Content/ Skills | Remarks |
|--|--|-------------|--|--|
| 1. Supervise reading of the information sheet. | Read the information sheet. | 8 | Reading skills and the ability to identify the issue of efficiency and equity on the use of public resources. | <ul style="list-style-type: none"> *Applicants of public rental housing, well-off tenants of existing public rental housing, local property developers and economists • First base group, then expert group, then base group • It is more effective to have two expert groups on each role, i.e. eight expert groups. |
| 2. Assign different roles* to the students. | Listen to instructions. | 2 | | |
| 3. Ask each role to form two groups of four or five and discuss the questions stated in part F. | Form groups and discuss. | 20 | Analyse the effects of a decision on efficiency and equity. | |
| 4. Select randomly one representative from each group to report and put their points on the blackboard. | Revise views in the light of the reporting of other groups. | 10 | | |
| 5. Discuss with the class whether the points presented are related to efficiency or equity. Then lead them to think about the trade-off between efficiency and equity. | Revise views in the light of the reporting of other groups and teacher's comments. | 10 | <ul style="list-style-type: none"> • Understand the trade-off between efficiency and equity. • Evaluate the decision on the use of public resources in respect of efficiency and equity. | |

F. Activities:

Students in different roles form groups and discuss among themselves the following issues:

- (i) **propose a use of the site that you think the best. State the criteria by which you evaluate your proposal;**
- (ii) **suggest a (or some) stakeholder(s) in society that will be worse off under your proposal;**
- (iii) **do you think that your proposal is an efficient way of using scarce resource? If yes, in what sense it is efficient? If not, what makes you think that your proposal is more preferable to the “efficient” way of using the site?**

G. Teaching materials:

Information sheet on the case of the former North Point Estate (2007 Sept)

Background information of North Point Estate:

1. The former North Point Estate locates at the waterfront of North Point on Hong Kong Island. It was a large low-rent public housing estate built in 1957. The housing estate was demolished in 2000 and made available an area of about 300,000 sqft. The site has been vacant since 2002.
2. The site was originally planned to be redeveloped together with the government land nearby to produce subsidised home ownership flats and private residential flats. However, the plan was suspended in 2002 because the Government decided to stop building subsidised home ownership flats.

Background information of the Housing Authority (HA):

1. The Housing Authority (HA) got \$34 billion from the sale of the retail and car-parking facilities of the public estates in 2005, and held \$57 billion in 2006.
2. The Government has promised to provide enough free land to the HA to build public rental housing for the needy. The average waiting time for public rental housing is about three years and there are 110,000 applicants on the waiting list.
3. According to the private surveyor's evaluation, the current market value of the site ranges from HK\$14.5 billion (HK\$6,800 per sqft) to HK\$27 billion (HK\$12,600 per sqft).

Sources: 1. Standard, 14 September 2007; 2. Ming Pao, 14 September 2007

Additional information for teacher's consideration of different roles:**Role A:**

The applicants of public rental housing would like to live in urban districts at low rent. If the former North Point Estate is developed into public rental flats or home ownership flats, they would be more likely to rent or buy the flats there.

Role B:

The well-off tenants of existing public rental housing would like to buy a flat at a rate lower than the market price in urban district or to live in new public rental housing in urban district even at a higher rent. They would apply to move there or to buy the flats by returning the current flats to HA.

Role C:

The local property developer wants to have the site for private estate. He would prefer to buy the site at public auction and make a big profit because there is a high demand for private flats in the area.

Role D:

The academic may either consider using the scarce resources more efficiently, i.e. to auction the land for private property developers. Or he may consider building public flats for sale so that existing tenants of public flats would improve their living conditions and feel more satisfied with the government. His consideration is shaped by his academic background or philosophy.

Activity 2: Debate on the proposal for Home Ownership Scheme (HOS)

A. Objectives:

- To evaluate the effects of a decision on using public scarce resources on efficiency and equalising income distribution.
- After the activity, students will be able to:
 1. analyse the effects of building HOS on different stakeholders;
 2. evaluate critically different proposals of providing public housing in regard to efficiency and equalising income distribution

B. Time required:

40-50 minutes (depending on the number of rounds of the debate)

C. Prerequisite knowledge:

1. Meaning of efficiency and equalising income distribution.
2. Services and operation of public housing in Hong Kong.

D. Materials needed:

Information sheet on HOS for students

E. Teaching plan and instructional procedures:

The thesis of the debate: **“Proposal 1 is more advantageous than proposal 2”**

| Teacher Activities | Student Activities | Time (mins) | Target Content/ Skills | Remarks |
|---|--|-------------|--|--|
| 1. Ask students to form four-person base groups and assign positions. # | Form pairs/ trios (base groups) and take a position. | 2 | Collaboration skills. | <ul style="list-style-type: none"> • # Some groups may consist of a combination of pairs/trios. • ## Teacher may decide the length/ depth of debate and time according to the guidelines on mini-debate. |
| 2. Go over the objectives and steps of debate. ## | Listen to instructions. | 3 | | |
| 3. Supervise reading and forming responses. | Read and formulate responses. | 8 | Analyse the benefits of HOS to various stakeholders. | |
| 4. Oversee students sharing views in expert groups according to the guidelines. | Share views in expert groups according to the position and guidelines. | 10 | | |

| | | | | |
|--|---|----|---|--|
| 5. Supervise the first round of debate within the base groups. | Debate within base groups following the mini-debate guidelines. | 12 | Evaluate critically the effects of different proposals. | • ### Optional, depending on the abilities and involvement of students. |
| 6. Supervise the second round of debate between two base groups. ### | Review and formulate new points for debate. | 10 | | |
| 7. Collect reports. | Submit reports on the choice of proposal with reasons. | 5 | Writing skills. | |

F. Teaching materials:

“Home Ownership Scheme (HOS): let it rest forever or revive it?”

Source I

Background information on HOS

1. The Hong Kong Government launched HOS in 1976. Under the scheme, flats were sold to those (middle class) whose income exceeded the criterion for public rental flats but could not afford private flats.
2. The scheme has been implemented by the Housing Authority (HA). The buyers were those living in public rental flats or whose income or asset value was lower than the prescribed level. The selling price of a HOS flat was as low as 60%-70% of the market price.
3. In 2002, the Government announced the decision to stop building HOS flats as it wanted to withdraw totally from private flats market. At that time there were about 56% families living in self-owned flats.

The Choices of the Planning Committee of the Housing Authority (HA)

In a review and brainstorming session in October 2007, the planning committee of the HA gathered the following data:

1. 90% of the available sites for building public flats are in urban districts.
2. A tenant of public housing flat who buys a HOS flat is required to return the rental unit to the HA for relocation. 5% of the public housing tenants (30,000 households) want to buy self-owned flats. In a public demonstration, a strong demand was made to the HA to build and sell new HOS flats to tenants of public housing.
3. HA has 50 billion cash which can support the daily operation and building plans for the next 10 years.
4. In the past, selling HOS flats provided the major recurrent income to HA.
5. The number of well-off households paying double rent grew 100% in three years.
6. The waiting list for public rental housing rose from 91,000 in 2004 to 108,000 in 2007. The government agreed to provide enough land to HA to build public rental housing so that the average waiting time for a qualified applicant will be three years. (The current waiting time is less than three years.)
7. The prices of private flats (400-700 sqft) ranged from \$3,200 in the New Territories to \$5,900 per sqft on Hong Kong Island. The average price of private flats was about 60% of that in 1997. A private flat (400-700 sqft) in a new town usually costs 1.2 to 2 million (such as Tseung Kwan O and Tin Shui Wai).
8. 80% of public housing tenants are paying less than \$1,800 a month.
9. The building cost of a HOS flat is double that of a public rental flat.

Sources:

1. Apple Daily, Tai Kung Pao, Sing Pao Daily News, Sing Tao Daily, The Standard, 5 October 2007
2. Ming Pao, 15 June, 5 October 2007

Source II

The planning committee made two proposals to achieve the following two objectives:

- A. Stable source of income for building plan and daily operation.
- B. Building enough public rental flats to maintain the average waiting time at three years.

Proposal 1

Build a small number of HOS flats (3,000-5,000) every year in urban districts. The majority (80%) of new HOS flats are to be sold to the existing public housing tenants and the remaining to those who cannot afford private flats and are not eligible for public rental housing.

This proposal can achieve the following objectives:

- a. Sale of HOS flats provides stable source of income.
- b. Old public rental flats are released for waiting applicants so that the average waiting time can be kept at three years.

Proposal 2

Return the sites in urban districts to the Government and put them up to auction for the property developers to build private flats. The Government then gives part of the auction revenue to the HA and allocates enough sites for building rental flats for potential applicants. Well-off tenants of public flats are required to pay a higher rent or choose to buy private flats with low-interest loans from the HA.

This proposal can achieve the following objectives:

- a. The Government gets stable income from the sale of sites.
- b. Sufficient public rental flats can be built with full support of the Government.

G. Guideline on discussion in expert groups:

Evaluate the two proposals in regard to the efficient use of scarce sites in urban districts and equalising income distribution.

1. Who will gain and who will lose in the proposals?
2. Which proposal will lead to a more efficient use of scarce sites? In what way it is more efficient?
3. Which proposal will lead to a more equitable income distribution? In what way it is more equitable?
4. If your objective is to help the low-income group to live in public rental flats, which proposal would you opt for? Support your decision with economic reasoning.
5. If your objective is to help the well-off tenants of public flats, which proposal would you opt for? Support your decision with economic reasoning.

Activity 3: Pair discussion and individual written report on Health Vouchers Scheme vs Half Medical Charges

A. Objectives:

- To compare the effects of the selected medical schemes on efficiency and equity.
- After the activity, students will be able to compare the effects of the selected medical schemes on the efficiency of using scarce resources and on equalising income distribution.

B. Time required: 10-20 minutes

C. Prerequisite knowledge:

Basic facts about provision of medical services in Hong Kong.

D. Materials needed:

Information sheet on Health Vouchers Scheme Vs Half Medical Charges for the elderly

E. Teaching plan and instructional procedures:

| Teacher Activities | Student Activities | Time (mins) | Target Content/ Skills | Remarks |
|--|--|-------------|---|--|
| 1. Ask students to form pairs/trios. | Form pairs/trios. | 2 | | <ul style="list-style-type: none"> • *This can be a home assignment, in which case these two parts can be omitted. • This activity helps students in written assignment. |
| 2. Go over the objectives and working steps. | Listen to instructions. | 2 | Compare the effects of the selected medical schemes on efficiency and equity. | |
| 3. Encourage students to discuss. | Read the information and discuss. | 6 | | |
| 4. Supervise writing up of responses.* | Each to write up responses either in class or at home. | 8 | | |
| 5. Collect reports from students.* | Submit reports. | 2 | | |

F. Teaching Material:**Health Vouchers Scheme vs Half Medical Charges****Source I**

The Chief Executive proposed to launch a three-year trial scheme of Health Care Vouchers Scheme for the Elderly in his Policy Address in October 2007.

The Scheme has the following features:

- a. All persons aged 70 or above will be given annually five health care vouchers worth \$50 each.
- b. The vouchers can be used for western and Chinese private practitioners, dental services, preventive services (e.g. medical examination and vaccination) and therapeutic services.
- c. Users can use the vouchers by showing the identity cards. Medical practitioners will deduct the number of voucher used through a central internet system. Users cannot get the change for cash and need to pay the outstanding balance.
- d. Users can use any number of vouchers in one service, or leave them for next year. But they cannot use the vouchers in advance.

Source II**Charges for different medical services:**

- a. Charge of public clinic is \$45.
- b. Charge of private (western) clinic ranges from \$180 to \$250.
- c. Charge of private (Chinese medicine) clinic ranges from \$15 to \$100.

Source III**Reduction of medical charges for the elderly at public hospitals:**

Hundreds of the elderly marched to the Government Offices and asked for a cut of medical charges for the elderly at public hospitals with a slogan: “Charges by half – Happiness doubled for Elderly” (Suppose they ask for a 50% cut of medical charges at public clinics.)

Sources: 1. 2007-08 Policy Address; 2. Ming Pao, 25 June 2007

The task:

Suppose the Hong Kong Government would spend HK\$5 million on either one of the schemes (i.e. Health Vouchers Scheme and Half Medical Charges). Compare these two schemes in regard to the efficient use of scarce medical resources and equalising income distribution.

Activity 4: Review of the trade-off: the Case of Microloan

(For more able students)

A. Objectives:

- To examine the trade-off between efficiency and equity.
- After the activity, students will be able to aware that efficiency and equity may not be contradictory in some cases.

B. Time required: 10-20 minutes

C. Prerequisite knowledge:

Meaning of efficiency and equity.

D. Materials needed:

Information sheet on Microloan Foundation for students

E. Teaching plan and instructional procedures:

| Teacher Activities | Student Activities | Time (mins) | Target Content/ Skills | Remarks |
|--|--|-------------|--|--|
| 1. Ask students to form pairs/trios. | Form pairs/trios. | 2 | | <ul style="list-style-type: none"> • *This can be a home assignment, in which case these two parts can be omitted. • This activity helps students in written assignment. |
| 2. Go over the objectives and working steps. | Listen to instructions. | 2 | Consider the trade-off between efficiency and equity critically. | |
| 3. Encourage students to discuss. | Read the information and discuss. | 6 | | |
| 4. Supervise writing up of responses.* | Each to write up responses either in class or at home. | 8 | | |
| 5. Collect reports from students.* | Submit reports. | 2 | | |

F. Teaching material:**Information sheet on Microloan Foundation (MLF):****Big Changes with Micro Money -The Work of Microloan Foundation****Some features of the operation of MLF:**

1. It provides microfinance services in Malawi (South Africa) and the Philippines. With a lot of committed volunteers, some of them are professionals, its operating costs are very low in the UK. This means a large percentage of the donations go directly to the needy.
2. It lends money (microloans of HK\$234 to \$2,880) to women (10-18 persons each group) to help them build sustainable businesses (farming, fishing, market trading) and provides meaningful training and ongoing mentoring support to them.
3. Loans are made on a four-month period and normally a member could receive up to four loans. Repayments of loans are made every two weeks by each group member.
4. It now has eight offices with 49 workers in Malawi and has made microloans to over 7,000 women. It made out 11,000 loans at a total value of HK\$8.3 million in 2007. The interest rates range from 20% to 24% and the rate of repayment is 95%. The Foundation is self-sufficient at the moment.
5. “I feel happy and relieved that I don’t have to be worried about financial problems. I feel I have independence.” said Joice Chibwe, a MLF client.

Source: www.microloanfoundation.org.uk

Guidelines on discussion

1. Is the cost of running MLF high or low? What is the evidence?

The explicit administration cost of MLF is low because most of the work is done by volunteers, enabling large proportion of donations to be used by borrowers and MLF to be self-sufficient. However, taking into the consideration of the implicit cost (i.e. time cost) of the “committed volunteers” who are likely to be professionals, the running cost may not be as low as it appears.

2. What is the scarce resource used in the scheme? Is it efficiently used? What is the evidence?

The scarce resource used in this scheme are the money from donation and the human resource from the volunteers. The loans have high interest rate of about 20-24% and the rate of repayment is 95%. The scheme is likely to be efficient as it is rather difficult to find investment opportunities elsewhere having such a high rate of return.

Alternative answer:

The scarce resources are natural resources and capital goods used by borrowers to produce services to earn money. The use of these resources is efficient for the rate of return is considered to be high. (The return can support an interest rate of 20-24% and 95% of repayment.)

Alternative answer

It is uncertain. Without the information about the total opportunity cost (the sum of the implicit and explicit costs) of running the scheme, it is difficult to judge whether the total benefit of the clients can cover the costs or not even though the rate of return is high (20-24%).

3. How does the income of the poor change? Explain with evidence.

The income of the poor has increased. The loan clients reported that they can sustain the living expenses without any other assistance, i.e. they have a better living /economic well being.

4. In this case, is there a trade-off between efficiency and equity? Why?

In this case, if the benefit gained by the clients of the scheme can cover the total opportunity cost of the scheme, there may be no trade-off between efficiency and equity because the scarce resource is used efficiently and the income of the poor increases at the same time, it is a win-win situation.

G. Teacher's reference:

1. Microloan Foundation, www.microloanfoundation.org.uk
2. Rebecca M. Blank, 2002, *Can Equity and Efficiency Complement Each Other?*
Paper prepared as the Adam Smith Lecture, European Association of Labour Economists.