

Research Series on the Chinese Dream
and China's Development Path

Pengfei Ni · Linhua Zou
Guangchun Gao · Xuemei Jiang

Housing Reform and China's Real Estate Industry

Review and Forecast



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Research Series on the Chinese Dream and China's Development Path

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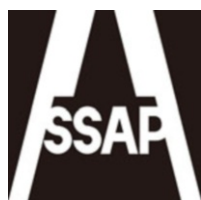
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Series Preface

Since China's reform and opening began in 1978, the country has come a long way on the path of socialism with Chinese characteristics, under the leadership of the Communist Party of China. Over 30 years of reform, efforts and sustained spectacular economic growth have turned China into the world's second largest economy and wrought many profound changes in the Chinese society. These historically significant developments have been garnering increasing attention from scholars, governments, and the general public alike around the world since the 1990s, when the newest wave of China studies began to gather steam. Some of the hottest topics have included the so-called China miracle, Chinese phenomenon, Chinese experience, Chinese path, and Chinese model. Homegrown researchers have soon followed suit. Already hugely productive, this vibrant field is putting out a large number of books each year, with Social Sciences Academic Press alone having published hundreds of titles on a wide range of subjects.

Because most of these books have been written and published in Chinese, however, readership has been limited outside China – even among many who study China – for whom English is still the lingua franca. This language barrier has been an impediment to efforts by academia, business communities, and policy-makers in other countries to form a thorough understanding of contemporary China, of what is distinct about China's past and present may mean not only for her future but also for the future of the world. The need to remove such an impediment is both real and urgent, and the *Research Series on the Chinese Dream and China's Development Path* is my answer to the call.

This series features some of the most notable achievements from the last 20 years by scholars in China in a variety of research topics related to reform and opening. They include both theoretical explorations and empirical studies and cover economy, society, politics, law, culture, and ecology, the six areas in which reform and opening policies have had the deepest impact and farthest-reaching consequences for the country. Authors for the series have also tried to articulate their visions of the “Chinese dream” and how the country can realize it in these fields and beyond.

All of the editors and authors for the *Research Series on the Chinese Dream and China's Development Path* are both long-time students of reform and opening and recognized authorities in their respective academic fields. Their credentials and expertise lend credibility to these books, each of which having been subject to a rigorous peer-review process for inclusion in the series. As part of the Reform and Development Program under the State Administration of Press, Publication, Radio, Film and Television of the People's Republic of China, the series is published by Springer, a Germany-based academic publisher of international repute, and distributed overseas. I am confident that it will help fill a lacuna in studies of China in the era of reform and opening.

Social Sciences Academic Press
Beijing

Xie Shouguang

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After a relatively short gestation period, the *Research Series on the Chinese Dream and China's Development Path* has started to bear fruits. We have, first and foremost, the books' authors and editors to thank for making this possible. And it was the hard work by many people at Social Sciences Academic Press and Springer, the two collaborating publishers, that made it a reality. We are deeply grateful to all of them.

Mr. Xie Shouguang, president of Social Sciences Academic Press (SSAP), is the mastermind behind the project. In addition to defining the key missions to be accomplished by it and setting down the basic parameters for the project's execution, as the work has unfolded, Mr. Xie has provided critical input pertaining to its every aspect and at every step of the way. Thanks to the deft coordination by Ms. Li Yanling, all the constantly moving parts of the project, especially those on the SSAP side, are securely held together and as well synchronized as is feasible for a project of this scale. Ms. Gao Jing, unfailingly diligent and meticulous, makes sure every aspect of each Chinese manuscript meets the highest standards for both publishers, something of critical importance to all subsequent steps in the publishing process. That high-quality if also at times stylistically as well as technically challenging scholarly writing in Chinese has turned into decent, readable English that readers see on these pages is largely thanks to Ms. Liang Fan, who oversees translator recruitment and translation quality control.

Ten other members of the SSAP staff have been intimately involved, primarily in the capacity of in-house editor, in the preparation of the Chinese manuscripts. It is time-consuming work that requires attention to details, and each of them has done this and is continuing to do this with superb skills. They are, in alphabetical order, Mr. Cai Jihui, Ms. Liu Xiaojun, Mr. Ren Wenwu, Ms. Shi Xiaolin, Ms. Song Yuehua, Mr. Tong Genxing, Ms. Wu Dan, Ms. Yao Dongmei, Ms. Yun Wei, and Ms. Zhou Qiong. In addition, Xie Shouguang and Li Yanling have also taken part in this work.

Ms. Yao Dongmei is the SSAP in-house editor for the current volume.

Our appreciation is also owed to Ms. Li Yan, Mr. Chai Ning, Ms. Wang Lei, and Ms. Xu Yi from Springer's Beijing Representative Office. Their strong support for the SSAP team in various aspects of the project helped to make the latter's work that much easier than it would have otherwise been.

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Last, but certainly not least, it must be mentioned that funding for this project comes from the Ministry of Finance of the People's Republic of China. Our profound gratitude, if we can be forgiven for a bit of apophasis, goes without saying.

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Introduction

Given the enormous complexity of China's real estate industry, it would be no easy task to get the whole picture at a glance. As a good starting point, however, we may look at the development trajectory of the industry in light of such factors as its relation with the macroeconomic environment, the performance of the housing market, real estate finance, public policies, and housing system. With the housing market at the core and the housing system as the basis, the book brings these five critical factors together to constitute a logical whole. It tries to present, within a targeted, integrated, and well-supported framework, a clear and concise overview of the industry, including its past, present, and future.

The Macroeconomic System and the Real Estate Industry

As an integral part of the economy that drives socioeconomic growth forward, the real estate industry is deeply affected by a country's socioeconomic conditions and how the economy grows and fluctuates as a whole. On the one hand, the equilibrium, growth, or fluctuations the economy is experiencing would all have an impact on the industry, while on the other hand, as it is such an important sector to the economy, the equilibrium, growth, and fluctuations of the real estate market are part of the equilibrium, growth, and fluctuations at the macroeconomic level. Closely related to many other industries, the real estate industry interacts in many ways with the rest of the economy, and its equilibrium, growth, or fluctuations would in turn affect the broader economic equilibrium, growth, or fluctuations.

Economists often use a three-sector model to help analyze the relation between the real estate industry and the economy or, to be exact, the interactions between output market, labor market, and real estate market. Often, changes in the financial market would cause direct changes in asset price, thus greatly affecting the real estate market. The macroeconomic environment affects real estate investment, demand, price, and supply in three ways: via changes in output growth, in commodity price,

and in financial market. In turn, the real estate industry, through changing investment, demand, price, and supply, affects the output growth, commodity price, monetary and financial markets, as well as other macroeconomic variables. This eventually results in a complex and dynamic interplay between the two.

Housing Market

The housing market is a good measure of how well the real estate industry is doing. Since a house is both a kind of durable goods and an investment, the production and price of which are jointly decided by the capital market and property market. Housing demand may be generated for consumption, investment, or speculative purposes, and the many factors that affect the demand may include the size and increase of the population, scale and growth of national wealth, housing price, interest rate, and market expectation. While a decrease in interest rate, a wealth increase, and rosy market expectation boost housing demand, an increase in interest rate, a wealth decrease, and gloomy market expectation dampen it. Apart from housing price, completed area, and vacancy rate, other factors affecting housing supply include interest rate on housing development loans and accessibility, market expectation, land price and accessibility, labor price and accessibility, and price and supply of building materials. Housing supply will increase when housing price goes up, vacancy rate drops, interest rate decreases, market prospects are good, and housing-related inputs are in ample supply and decrease when the indicators move in the opposite direction.

Another factor we need to take into account is the land market. Land is where economic and social activities occur and what is required to build any homes. In the housing market, a rising population would drive up housing price and demand, and the demand for land will also increase when the plot ratio is kept unchanged. Consequently land price will go up and more land will be needed. On the other hand, changes in the land market would also have an impact on the housing market. In the land market, the price mechanism plays a central role, in which the land price is decided by supply (including natural and economic supply) and demand. As land is a nonrenewable resource, its natural supply is certain but its economic supply is not, as a plot of land may be well shifted to other uses. A number of factors affect the economic supply, including land price, tax and other government policies, plans for land use, land development cost and opportunistic cost, and architectural technology. Factors that affect the land demand include land price, monetary income of consumers or investors, financing capability, demographic and family factors, consumer or investor preference, and market expectation.

Real Estate Finance

Real estate finance is an important condition for real estate development. Real estate industry features huge investment and long payback period, and its development is impossible without financial support. In the meantime, real estate finance is the most critical part of financial activities, and the two industries of finance and real estate are in a symbiotic relation of interdependence. The development of real estate finance guarantees real estate development, while the latter provides the condition and possibility for the former. Generally speaking, real estate finance market also functions based on market mechanism which is centered on the pricing mechanism. Assuming other conditions remain unchanged, a larger capital demand from the real estate industry will drive up interest rates, while the massive capital supply will drive them down. Capital supply comes from a number of sources, including monetary authorities, the government, financial institutions, enterprises and public institutions, residents and foreign businesses, as well as various types of deposits, credit expansion, and foreign investment. Capital demand from real estate industry mainly includes capital demand for real estate and land development and that for real estate consumption, investment and speculative purposes.

Public Policies on Housing

Public policies on housing and housing market are complementary to each other. A place of residence is a necessity for human survival and a basic right. In reality, however, many families do not own a place of residence because they cannot afford it and the government has an obligation to provide housing for them. To strike a balance between efficiency and fairness and ensure the healthy development of housing market on the one hand and universal access to housing by all families on the other, the government and the market should work together. Assuming that the market plays a fundamental role in resource allocation, the government should employ both market-based adjustment and administrative intervention in the housing market, make sure they complement each other, and produce optimal effects.

Specifically, a multilayered, differentiated system should be established to integrate the housing market and housing security. We can use income as the criterion. High-income groups should buy their homes on the market. Middle-income groups also look for homes on the market but the government should provide them with appropriate fiscal and financial subsidies according to their income level. Low- and middle-income groups should have their housing needs met through a combination of government aid, market, and mutual assistance. Housing for families below the low-income level should be supplied through government purchase or government-funded construction.

At different development levels and under different conditions, this portfolio of housing arrangement, either the income standard, ratio of combination, or degree of

security, changes dynamically. The general trend should be that with economic and social development, more families will rely on the market to buy their homes while housing security is continuously improved for families entitled to it.

Housing System

Housing system is the foundation for all housing-related activities in a specific society. It refers to laws, rules, and policies concerning the construction, distribution, transfer, management, and other matters about housing, the norms that are applied to adjust housing relations and restrict relevant behaviors, and the institutional arrangement whereby the society provides residents with housing that meets their basic living needs. Housing system mainly includes the approach of construction, investment, supply, distribution, security, and management of urban and rural housing. On the one hand, a good housing system should be capable of effectively overcoming market malfunctions such as asymmetrical information, negative external effects, market monopoly, and excessive use of public resources in the production, transaction, distribution, and consumption of housing. On the other hand, it should fully mobilize the resources of all parties, give play to the initiative of market players, and continuously improve housing conditions for urban and rural residents. Housing system should also consist with the nation's economic system, economic development level, history, cultural traditions, customs, and ethnic characteristics. Since the reform and opening up, China's housing system has evolved from welfare housing to commercial and diversified housing. The government is no longer fully responsible for housing construction and distribution, but lets the market play a fundamental role in housing resource allocation as much as possible. However, in case of market malfunction and social anomie, the government will exercise control through such leverages as financial and land policies and may impose administrative controls directly under special circumstances.

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Chapter 1

Real Estate Industry in the National Economy: History, Present and Future



Qingyong Zhang, Huanhuan Zheng, and Meng Nian

1.1 Review

The real estate industry has a long history in China and the industry in the modern age originated in Shanghai. After Shanghai opened its port in 1843, it gradually became the national center of foreign trade and the most important industrial manufacturing center. With the signing and revision of *The Shanghai Land Regulations*, foreigners controlled concessions in Shanghai in the form of perpetual leasing, and the title deed system (the basic land tenure system in Shanghai concessions, which was a private property right registration system) created the condition for foreigners to engage in real estate and paved the way for China's modern real estate industry and evolve to become the earliest professional real estate market in China. During the rebellion of Xiaodaohui (Small Swords Society) and Taiping Heavenly Kingdom (1851–1864), a lot of refugees and rich officials and merchants from Jiangsu and Zhejiang Provinces took shelter in the concessions, which led to the sharp rise of land price and rampant real estate speculation. It wasn't until the 1870s that real estate trade “was no longer speculative as in the wartime and a more standardized real estate market began to appear in Shanghai” (Lu Hanchao, 2004).

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Housing on lanes and alleys also “flourished around 1870 and kept expanding to all corners of Shanghai”. “They could generate 30–40% profits either leased or sold, which was more profitable and much safer than shipping goods overseas. Therefore, both foreign and Chinese merchants were eager to buy land and construct buildings on a large scale (Zhu Jiancheng, 1990). After that, modern real estate market began to mature in major cities.

After the People’s Republic of China (PRC) was founded in 1949, the real estate market and industry declined because of the implementation of the welfare housing system. Under this system urban residents all were provided places of residence, and the rent, already very low and kept dropping could not even cover maintenance costs. This condition lasted for quite some time, resulting in serious housing shortages. In 1977, the per capita urban living space in China was only 3.6 m², even less than the level in 1952, which was 4.5 m². About 6.26 million urban households did not have their own place of residence, accounting for about 37% of all urban households (Sun Shangqing et al. 1979).

The situation began to improve after the reform and opening-up was launched at the end of the 1970s. As a matter of fact, housing system reform has always been part of China’s reform and opening-up and continues today. At a meeting on urban housing construction held in 1978, Gu Mu passed on an instruction from Deng Xiaoping: “There should be more ways to supply housing. For instance, we can allow private investors to build residential buildings, provide them with government assistance and implement installment payment. This will encourage individual spending and the government can provide materials. There is a great potential in this area.” On April 2, 1980, Deng Xiaoping pointed out that “we should consider a series of policies regarding the construction and distribution of urban housing. Urban residents can buy houses or build them on their own. Both new and old houses can be sold, either by one-off payment or installments for 10 or 15 years. After housing trade is allowed, housing rent has to be adjusted. . .and when the rent goes up in the future, low-income employees should be subsidized. These policies have to be considered holistically. We can also encourage public-private partnership in housing construction or provide government assistance to private construction, and individuals can build homes independently too”. This set the housing system reform in motion. A national work meeting on urban planning was held in 1980, and minutes from the meeting stated “we should consider forming development companies to carry out comprehensive housing development”, whereupon the “unified construction offices” in different cities of China were transformed into real estate development companies step by step. The *Government Work Report* in 1984 stated that “pilot projects of commercial urban housing should be further promoted and real estate business should be developed”. In the same year, the *Classification and Code of Economic Industries* officially listed real estate as an independent industry. The 13th CPC National Congress in 1987 explicitly put forth the concept of real estate market by stating “the socialist market system. . .should comprise markets of production factors such as capital, labor, technology, information and real estate”. The *Government Work Report* in 1988 stated “we will accelerate the housing system

reform in cities, especially medium and large-sized ones, and gradually commercialize housing. . . We will develop the real estate market and implement paid transfer of land use right” (Zhang Qingyong 2008).

On July 3, 1998, the State Council issued the *Notice on Further Deepening the Urban Housing System Reform and Accelerating Housing Construction* (GF [1998] No.23), which called off housing distribution in kind and proposed to “apply different housing supply policies to families of different incomes. Minimal-income families can rent low-rent housing provided by the government or employer, low- and middle-income families can buy affordable housing, and high-income families can buy or rent commercial housing at market price”. The housing provident fund system was also comprehensively promoted and continuously improved. This indicated the beginning of China’s large-scale housing system reform, and then since, Chinese real estate industry has developed comprehensively and rapidly along with the country’s economic development and urbanization drive.

1.2 Is Housing Investment in China the Main Driver of Economic Growth?

China’s views on the relation between housing investment and economic growth changed over time. In the time of planned economy, China adopted the guideline of “production before living, large accumulation and low consumption”. At that time, housing was considered a pure consumption of resources and a nonproductive expenditure, housing construction was listed as nonproductive construction (or consumption-oriented construction), housing investment took a very small portion in annual plans, and it was often the first to be axed whenever investment was cut (Institute of Finance and Trade Economics of Chinese Academy of Social Sciences et al. 1996). The persistence long existence of this situation resulted in small per capita living area and serious housing shortage. In 1977, 6.26 million urban households didn’t have their own home, accounting for about 37% of all urban households, and per capita urban living space was only 3.6 m² (Sun Shangqing et al. 1979). After the reform and opening-up kicked off, the intentional suppression of housing investment changed, and the proportion of housing investment in GNP exceeded 7% almost every year in 1981–1989 as opposed to the average 1.5% in 1949–1978 (World Bank 1992). Meanwhile, housing industry and real estate industry took off again after reform and opening-up, and their position and role were positively commented on. For instance, a report by the Development Research Center of the State Council pointed out “if we take housing as a leading industry, it will not only drive the development of a series of labor-intensive industries, but also the development of a series of knowledge-intensive and capital-intensive industries” (Yang Lu and Wang Yukun 1992: 47). Government authorities in charge of housing construction accepted the theory that housing investment could drive economic growth and stressed real estate industry as a fundamental and leading industry of economic development and one of the nation’s pillar industries

(Ye Rutang 1994). In the meantime, some scholars argue that massive housing investment would divert significant capital from industry, agriculture and infrastructure construction toward housing construction and maintenance, hampering industrial and agricultural and infrastructure development, making economic development unsustainable (Shi Xiaokang 1991).

From 1996 to 1998, the Chinese government, in order to deal with the sluggish economy, stressed that housing construction “may give rise to new consumption choices that receive a lot of attention and new economic growth points” and “it is a new economic growth point that will drive economic development in the future”. Later studies were conducted that demonstrated the necessity and possibility of housing construction becoming a new economic growth point, and they even put forth the view that “housing construction has become an economic growth point in China in the past decade and more” (China Real Estate and Housing Research Association 1997). In February 1997, “a consensus has been reached in central and local governments on the necessity and possibility of making housing construction a new economic growth point and a consumption choice that receives a lot of attention” (Fu Lin and Hong Lin 1997). After that, a series of policies were issued to promote housing construction. For example, the State Council issued the *Notice on Further Deepening the Reform of Urban Housing System and Accelerating Housing Construction* in 1998, according to which one of the guiding thoughts on housing system reform was to “accelerate housing construction and make housing industry a new economic growth point”. The central bank also issued *Notice on Supporting Housing Construction and Consumption with More Housing Credit* in the same year. According to that document, “housing construction is a new growth point in the national economy. Its development is of great significance to efforts to adjust the economic structure, increasing effective demand, solving housing difficulty and ensuring the accomplishment of economic growth targets” and “all commercial banks should adjust their loan structure and actively support housing construction and consumption”.

A lot of policies in support of housing construction and consumption have been issued since then. Governments and departments on all levels rolled out various measures and opinions, and the idea that housing construction and consumption could drive economic growth and it must be promoted was so widely accepted and supported that it almost became an indisputable presupposition or common sense. Although policies have changed in recent years to regulate the real estate market, boosting housing construction and consumption is still an important aspect of the policies. However, the studies that supported the series of critical reform documents, policies and measures were either simple recounts of experience in several western countries or quotations from speeches of leaders, based on which they came to the conclusion that housing construction was able to drive economic growth and housing industry should become a leading or pillar industry. No data were ever collected to verify the relation between housing construction, investment and economic growth. We collected data of provinces from 1985 to 2009, municipalities and autonomous regions across China and used the panel error correction model (PECM) to find out the lead-lag relation between housing investment and economic growth.

We found that whether in the whole period from 1985 to 2009 or if we divided that period into two parts with 1998, the year when large-scale housing system reform began, as the boundary, and whether in the panel of all provinces and cities nationwide or that of regional ones, the unidirectional Granger causality that economic growth led housing investment was stable. This differed from the view upheld or implied by certain studies, policies and measures that housing investment led economic growth, which we couldn't find any evidence to justify.

1.2.1 Review of Literature

In the days of the Great Depression, Keynes wrote a letter to the US President Roosevelt on February 1, 1938, in which he suggested increasing investment in housing, public facilities and transportation to tackle the Great Depression. "Housing is by far the best aid to recovery because of the large and continuing scale of potential demand; because of the wide geographical distribution of this demand; and because the sources of its finance are largely independent of the stock exchanges. I should advise putting most of your eggs in this basket, caring about this more than about anything, and making absolutely sure that they are being hatched without delay" (Keynes 1982). Roosevelt agreed to the suggestion and replied to Keynes: "your stress on the need of stimulating housing construction is pertinent. I hope our efforts to clear obstacles for this industry to revive will be successful" (Roosevelt 1982).

But circumstances changed with the passage of time. The economic growth theory that was popular after WWII emphasized the critical importance of the formation and accumulation of capital in economic growth and held that housing was consumer goods, housing construction was of low productivity, housing industry was nonproductive, and housing investment should be squeezed as much as possible so that more money could be invested in production materials (Wheaton and Wheaton 1972). Proponents of this theory believed housing should be handled differently according to the stages of economic development. In the early stage, the majority of resources should be used to build factories and produce other necessary production materials, and housing should only be put on the agenda as productivity improved and problems such as unemployment and underemployment were solved (Howenstine 1957). In fact, as Gilbert and Gugler (1982) later pointed out, "at that time, housing investment was considered a typical approach that slows down economic growth and attracts a large number of people from the countryside to cities, thus aggravating urban problems". In face of capital shortage after WWII, both capitalist countries and those planned economies attached less importance to housing investment and invested almost all capital in industry and infrastructure which can directly bolster the industrial development (Wheaton and Wheaton 1972). In addition to the group that was critical of housing investment, there were also the moderates and supporters of housing investment after WWII according to Arku's (2006) research. The moderates thought little of housing's economic importance, but

believed it was feasible to invest in a certain number and specific types of housing under special circumstances when it was beneficial for industrial development, while the latter acknowledged housing's great importance for economic growth.

In the 1960s and 1970s, support for more investment in housing grew, and the idea that it could boost economic growth prevailed. But research shows that this change of popular opinion was not a response to evidence, but to changes in economic discourse, especially the introduction of the concept of human capital concept, and the strong endorsement for this view by international organizations such as the United Nations and the World Bank (Harris and Arku 2007).

Academics always argued about the relation between housing investment and economic growth, but no empirical studies were ever conducted until the 1980s when some literature that based the discussion on data. Boléat and Coles (1987: 134–135) made tables to compare the percentage of housing investment in GDP with the annual growth of per capita GDP in industrialized countries such as the UK, the US, West Germany, France, Italy, Canada and Japan in 1960–1983, and discovered a correlation between the two. They believed that housing investment was not likely to impede economic development, and the direction of causality showed that high-speed economic growth enabled those countries to invest more resources in housing. Greenwood and Hercowitz (1991) analyzed data on household consumer durables, housing investment and commercial investment in the US in 1954–1989, and concluded that housing investment led commercial investment and other macroeconomic variables.

Studies that used extended time periods for econometric test didn't appear until the late 1990s, and most of them were empirical studies on the relation between housing investment and GDP in the US. Green (1997), Coulson and Kim (2000) and Wen (2001) all found that housing investment was the Granger cause of GDP and it led economic cycle. Gauger and Snyder (2003) studied whether the relation between housing investment and macro-economy had changed since the US loosened financial regulation in 1980. They verified the conclusion drawn by Green (1997) and Coulson and Kim (2000) with quarterly data of 1959–1999, discovered that housing investment was more predictive of GDP performance after the financial deregulation, and pointed out that the housing market was worth more attention from policy makers or others who were interested in the general economic operation. Leamer (2007) wrote a paper titled "Housing IS the Business Cycle", in which he said of all components of America's GDP, housing investment was the best signal that warned against an economic slowdown. Except for the 1953 decline after the end of the Korean War and the Internet bubble in 2001, all the other eight post-WWII economic slowdowns in the US were preceded by huge problems in housing investment. Ghent and Owyang (2010) wrote another paper titled "Is Housing the Business Cycle", in which they used data of 51 big cities across the US, used construction permit as the proxy variable for housing investment and found it was a good leading indicator of employment, thus verifying Leamer's (2007) conclusion. We can see that different scholars conducted empirical studies on the interaction between housing investment and GDP in the US with different approaches and data from different periods, and they all came to the conclusion that housing investment led economic growth.

Nevertheless, many studies of housing market in other countries drew different conclusions than the one about the US. In South Korea, Kim (2002), in reference to Green's (1997) study, used quarterly data from 1970 to 2000 to compare the housing investment-GDP relation in the US and South Korea, and found that housing investment in South Korea was a follower rather than driver of GDP. When he used quarterly data from 1970 to 2002, Kim (2004) also found that housing investment in South Korea wasn't the Granger cause of GDP but fluctuated along with macro-economy. In comparison to Greenwood and Hercowitz's (1991) observations, Nahm (2002) used data from 1970Q1 to 1997Q3 to study whether housing investment in South Korea led output, and found the situation much different from that in the US. Moreover, the housing investment-output relation in South Korea changed over time – housing investment led output in the 1980s but the two changed together in the 1970s and 1990s.

The relationship between housing investment and economic growth varied from country to country, and this phenomenon was reflected in IMF's *World Economic Outlook 2008*. The IMF (2008, Chap. 3) discussed how the housing sector affected the economic cycle in 18 developed countries. They are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, the Netherlands, Norway, Spain, Sweden, Great Britain and the United States. It found that in most countries, housing investment did outrun economic cycle, but the situation in Germany, Italy, Finland, Sweden and Norway was different, and it worsened economic decline in the US, Ireland, Britain, Denmark and the Netherlands. On average, housing investment could explain the 10% GDP growth reduction before economic decline. IMF also pointed out that changes in the housing sector and its relation to economy were also discrepant in different countries, and the discrepancy largely depended on domestic factors that affected housing supply and demand. In countries whose labor market was less rigid and construction sector was highly labor-intensive, a changing demand would more deeply affect housing supply and employment in the construction sector, and housing investment contributed more to the GDP growth reduction before economic decline. Studies conducted by the central banks of Sweden and Italy in recent years respectively verified IMF's (2008, Chap. 3) finding. Walentin and Sellin (2010) found that the causality between housing investment and output in Sweden was exactly the opposite of that in the US. In other words, housing investment lagged behind output in Sweden and this relation was very stationary and not a special case during the study period. They attributed the difference to government intervention in Sweden and the long time lag from planning to construction. Bulligan's (2010) research showed that housing investment lagged behind GDP by two quarters in Italy.

The above overview of relevant literature shows that the argument about the interaction between housing investment and economic growth has never stopped since the 1930s and 1940s. The economic growth theory that was popular right after WWII held that increasing housing investment would slow down economic growth, but in the 1960s and 1970s, the view that housing investment could boost economic growth took the upper hand. Such a change of popular view, according to research,

wasn't effected by the accumulation of new evidences, but by the changed economic discourse system and the endorsement by international organizations like the UN and World Bank. According to the results of econometric tests conducted since the second half of the 1990s with data of long periods of time series, there isn't a standard lead-lag relation between housing investment and economic growth that applied everywhere in the world. It differs from country to country, it changes all the time, and it may be different within the same country at different times, so it should be analyzed on a case-by-case basis.

1.2.2 Data

Generally speaking, housing investment comprised three types of activities – construction of new residences and maintenance and renovation of existing ones (Nesslein 1998). From the early 1950s to the 1970s, China's statistics of fixed asset investment only covered capital construction. With the intensified retrofit and renovation of corporate buildings and the development of urban and rural construction with collective or individual investment, more statistical items were included in fixed asset investment: fixed asset investment by urban collectives was added in 1978, investment in retrofit and renovation was added in 1981, and investment by rural collectives and individuals as well as investment in housing construction by urban individuals were added in 1981. As a result, the statistics of capital construction investment was replaced by statistics of total fixed asset investment (Geng Chunpu 2002). At the same time, housing investment data in 1950–1979 only covered state investment in housing construction, but the data became comprehensive after investment in retrofit and renovation and housing investment by urban and rural collectives and individuals were added in 1981. Before the mid-1990s, total housing investment of the whole society was divided into three parts – investment by state-owned employers, investment by urban and rural employers of collective ownership and that by urban and rural individuals (based on different ownership of the means of production) or two parts – urban housing investment (including housing built by farmers in cities) and rural housing investment (based on urban or rural areas). Housing investment by state-owned employers consisted of four parts – investment in capital construction, that in retrofit and renovation, other fixed asset investments and real estate investment (added in 1986). Housing investment by urban and rural employers of collective ownership consisted of two parts – investment by urban employers and that by rural ones, and housing investment by urban and rural individuals also consisted of two parts – housing investment by individuals living in cities, counties, towns and industrial and mining areas as well as that by rural individuals. After the mid-1990s, investors became diversified and housing investment, according to economic types, comprised state investment, collective investment, private investment, joint investment, shareholding investment, foreign investment, investment from Hong Kong, Macao and Taiwan, and other

investments. In sum, the statistical item of “total housing investment” that China adopted in the early 1980s was basically the same concept as the housing investment traditionally used by statistical organizations and literature of main developed countries.

Some people made empirical studies on the relation between housing investment and economic growth in China, such as Liu et al. (2002) and Zheng Siqu (2003). Liu et al. (2002) used national annual data from 1981 to 2000 and Zheng Siqu (2003) used those from 1981 to 2001 to discuss the dynamic connection between China’s housing investment and GDP, and they all found that increase or fluctuation of housing investment had a major impact on GDP while GDP adjusted housing investment increase mainly through long-term equilibrium. However, their studies used short time series and the use of complicated estimation model with lags further narrowed down valid samples and consequently made the conclusion less reliable.

Chen et al. (2011) also discussed the relationship between China’s housing investment and economic growth to verify “the housing-led growth hypothesis”. They realized the importance of using accurate data but used investment in urban real estate development (including investment in housing, office buildings and commercial buildings) to represent total housing investment of the whole society. Conceptually speaking, this approach left out rural housing investment and housing investment by urban collectives and individuals, and counted in non-housing investment such as office and commercial buildings in cities. In terms of actual number, the growing or changing trend of total housing investment and urban real estate investment was different, and the ratio between them was non-stationary. The ratio of the latter against the former was only 13.8% in 1986 and 17.2% in 1987, about 23% in 1988–1991, ranged from 43% to 83% in 1992–2002, and was about 96% in 2002 and 2003. From 2004 to 2008, urban real estate investment was slightly more than total housing investment, and then in 2009, it was slightly less. Therefore, urban real estate investment wasn’t a good proxy variable for total housing investment either regarding concept or actual number.

The National Bureau of Statistics began to collect and publish data on total housing investment in 1981, so we could use the data directly without using urban real estate investment as a proxy variable. To overcome the problem of limited data due to the small number of years for which data are available, we collected data dated 1985–2009 across the country, and the final data we had spanned over 25 years and covered 31 provinces, municipalities and autonomous regions (except Tibet).¹ The data came from *China Statistical Yearbook*, *Statistical Yearbook of the Chinese Investment in Fixed Asset* and *Annual Statistical Report on the Chinese Investment in Fixed Asset*.

To eliminate price influence, we made 1985 the base period. To reduce data fluctuation, we used natural logarithm of GDP and housing investment, which was a common practice of handling data of economic time series. Hereinafter the natural

¹According to common practice, we incorporated the data of Chongqing after it became a municipality directly under the central government into the data of Sichuan province.

logarithm of GDP (unit: RMB100 million) will be denoted as GDP, and GDP's first difference or growth rate will be denoted as DGDP, while the natural logarithm of housing investment (unit: RMB100 million) will be denoted as HI and its first difference or growth rate DHI. Table 1.1 describes the statistical nature of panel data series.

According to the national aggregate data, the GDP-HI relation is shown in Fig. 1.1 and their corresponding growth rate in Fig. 1.2. Figure 1.1 roughly shows that national aggregate GDP and HI are non-stationary but with similar trend, while

Table 1.1 Descriptive statistics of GDP and HI

Variable	Definition	Max.	Min.	Average	Median	Standard deviation	Sample size
<i>GDP</i>	Gross domestic product	9.283	3.41	6.581	6.606	1.102	739
<i>HI</i>	Housing investment	6.678	0.679	3.983	4.017	1.218	735
<i>DGDP</i>	GDP growth rate	0.383	-0.117	0.099	0.1	0.045	709
<i>DHI</i>	HI growth rate	1.185	-0.56	0.114	0.117	0.166	705

Fig. 1.1 GDP and HI

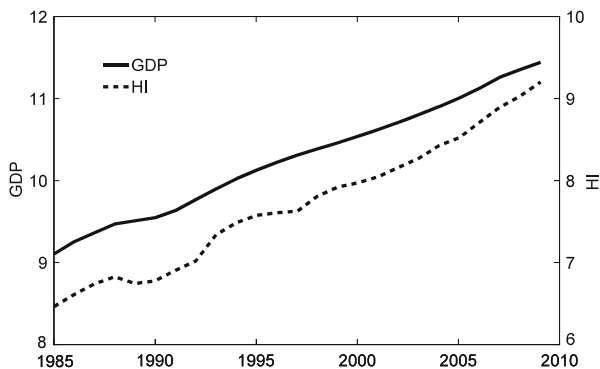


Fig. 1.2 DGDP and DHI

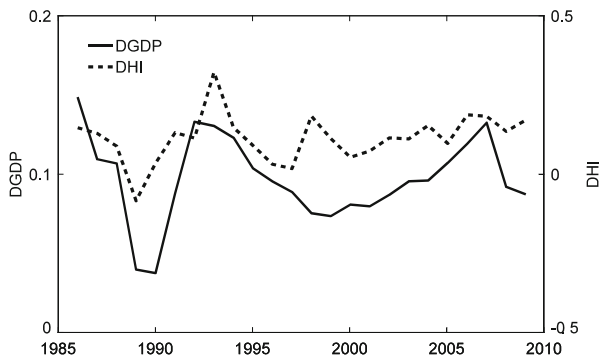


Fig. 1.2 shows that first difference of both GDP and HI is stationary and they may have co-integration of order 1. These hypotheses will be confirmed in the following paragraphs.

1.2.3 Metering Methods and Empirical Results

First of all, to test the Granger causality between housing investment and economic growth, we tested the stability of panel data with Maddala and Wu’s (1999) method. Table 1.2 lists the ADF test results of panel unit root and the corresponding p when the null hypothesis that “panel unit root exists” is tested. The results show that GDP and HI are non-stationary in all conditions (with constant term, trend term or drift term), but their first differences, namely DGDP and DHI, are stationary, which means the two panel series of GDP and HI are integrated of the same order I (1).

Second, as GDP and HI are both I (1.1), we continued to use Engle-Granger’s two-step method to test whether there was co-integration between them. We estimated the model (1.1) that reflected their long-term equilibrium, and then conducted panel unit root test on the regression residual e. As shown in Table 1.3, regression residual e is stationary, and we can draw the conclusion that GDP and HI have co-integration of order 1 CI (1,1).

$$GDP_{i,t} = \beta_i + \alpha_i HI_{i,t} + e_{i,t} \tag{1.1}$$

Table 1.2 Results of panel unit root test

Variable	With constant term	With trend term	With drift term	Test result
<i>GDP</i>	15.953	22.640	59.238	Non-stationary
	(1.000)	(1.000)	(0.504)	
<i>HI</i>	5.324	49.374	38.258	Non-stationary
	(1.000)	(0.835)	(0.987)	
<i>DGDP</i>	249.222	231.039	366.744	Stationary
	(0.000)	(0.000)	(0.000)	
<i>DHI</i>	495.970	481.403	528.118	Stationary
	(0.000)	(0.000)	(0.000)	

Note: *p* is in the parentheses

Table 1.3 Result of panel unit root test of regression residual *e*

Variable	With constant term	With trend term	With drift term	Test result
<i>e</i>	115.276	80.610	237.011	Stationary
	(0.000)	(0.039)	(0.000)	

Note: *p* is in the parentheses

Third, since GDP and HI have co-integration of order 1 CI (1,1), we couldn't use VAR model but had to use the vector error correction model (VECM) as shown in model (1.2) to test their causality.²

$$\begin{aligned} \begin{bmatrix} \text{DGDP}_{i,t} \\ \text{DHI}_{i,t} \end{bmatrix} &= \begin{bmatrix} \gamma_1 \\ \gamma_2 \end{bmatrix} e_{i,t-1} + \sum_{j=1}^l \begin{pmatrix} A_{11,j} & A_{12,j} \\ A_{21,j} & A_{22,j} \end{pmatrix} \begin{bmatrix} \text{DGDP}_{i,t-j} \\ \text{DHI}_{i,t-j} \end{bmatrix} \\ &+ \begin{bmatrix} \varepsilon_{1,i} \\ \varepsilon_{2,i} \end{bmatrix} \end{aligned} \tag{1.2}$$

In model (1.2), 1 means lag to include. Based on the regression result of model (1.2), we tested the two null hypotheses. Hypothesis 1 (H10) assumed that HI wasn't the Granger cause of GDP. If it were true, the coefficient of all DHI's lag terms would be 0 and γ_1 would be 0 in the DGDP regression model. Therefore, testing whether null hypothesis 1 was true was equivalent to testing H10: $A_{12, 1} = \dots = A_{12, j} = A_{12, p} = 0 = \gamma_1 = \gamma_1 = 0$. Likewise, null hypothesis 2 (H20) assumed GDP wasn't the Granger cause of HI, and testing that was equivalent to testing H20: $A_{12, 1} = \dots = A_{12, j} = A_{12, p} = 0 = \gamma_2 = \gamma_2 = 0$.

When 1, lag to include, goes from 1 to 6, the *F* and *p* value of the two null hypotheses are shown in Table 1.4. The results cannot reject null hypothesis 1 but reject null hypothesis 2 at 1% significance, and this conclusion remains stationary all the way as lag to include goes from 1 to 6. Therefore, GDP is the Granger cause of HI, meaning economic growth leads housing investment, not vice versa.

At last, according to AIC, BIC and the simplicity principle, we designated lag to include as 1 to estimate model (1.2) and calculated the impulse response function (IRF) on that basis. As shown in Fig. 1.3, DGDP shock of one standard deviation quickly affected DGDP and DHI in the current period and beyond for a long time. The amplitude of DGDP's response to this shock weakened in time, but it remained significant 9 years later. DHI responded to the shock in the current period and the

Table 1.4 Results of Granger causality test

Lag to include	H1 ₀		H2 ₀	
	<i>F</i>	<i>p</i>	<i>F</i>	<i>p</i>
1	0.576	0.562	121.36652	0.000
2	1.059	0.365	65.065	0.000
3	1.187	0.314	47.186	0.000
4	1.691	0.133	51.947	0.000
5	1.319	0.244	37.490	0.000
6	1.115	0.350	25.131	0.000

Note: Data in the table refer to *p*

²Panel VECM and impulse response analysis were conducted through RATS, and other econometric tests through STATA.

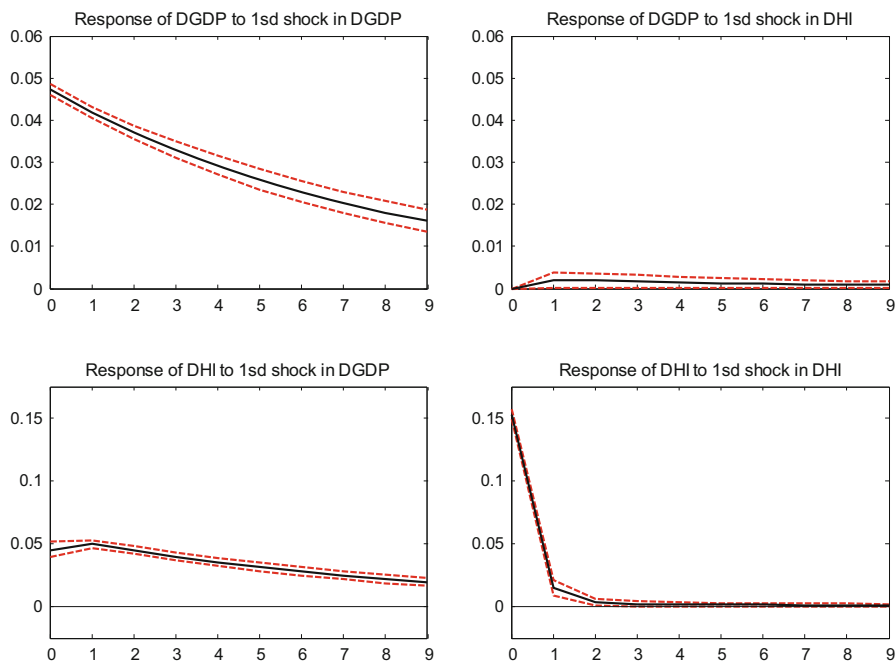


Fig. 1.3 IRF

response amplitude peaked a year later before it began to weaken. It's worth noting that DHI's response to this shock remained significant 9 years later, indicating that DHI's pulse response to DGDP was permanent. DGDP's response to one standard deviation shock of current DHI was weak and insignificant, and DHI's response quickly weakened till it almost disappeared 2 years later. This indicates that economic growth leads housing investment, and we cannot find any evidence to back up the view that housing investment leads economic growth.

1.2.4 Robustness Test

This part will test the robustness of the results in the previous part. The large-scale housing system reform kicked off in 1998, so we divided data into two time periods – data of 1985–1998 and data of 1999–2009 – to test if GDP and HI had Granger causality in both periods, and if they did, whether the direction of the causality was the same. We also divided national panel data into three parts – data of the east, central and west regions – to see if the Granger causality between GDP and HI would change from region to region.

Table 1.5 Unit root test of time-divided regression residual

Variable	1985–1998			1999–2009		
	With constant term	With trend term	With drift term	With constant term	With trend term	With drift term
<i>e</i>	90.928	76.075	197.207	74.900	44.544	166.358
	(0.006)	(0.079)	(0.000)	(0.126)	(0.954)	(0.000)

Note: p is in the parentheses

The first is the robustness test of co-integration.³ We still applied Engle–Granger’s two-step estimation model (1.1) to the time-divided data, and then conducted panel unit root test on residual e . As shown in Table 1.5, test results indicate that the residual e in 1985–1998 is stationary and remains so in 1999–2009 when drift term is included. Generally speaking, GDP and HI had co-integration of order 1 CI (1, 1) in both time periods.

We applied the same method to region-based panel data to test whether there was co-integration between GDP and HI. As shown in Table 1.6, residual e is stationary in 1985–2009 with drift term, which means GDP and HI have co-integration of order 1 CI (1, 1) in all regions. After we further divided all samples both by time and region, we found that regression residual based on model (1.1) was stationary when drift term was included, and GDP and HI had co-integration of order 1 CI (1, 1). In other words, the conclusion that GDP and HI had co-integration of order 1 CI (1, 1) remained robust whether data were divided by time, region or both.

The second is robustness test of Granger causality. We tested the Granger causality between GDP and HI according to regression results of time-divided data based on model (1.2). To save space, Table 1.7 only lists the p value for testing H10 (HI isn’t the Granger cause of GDP) and H20 (GDP isn’t the Granger cause of HI). Test results of time-divided national panel data showed that GDP was always the Granger cause of HI whether before or after 1998 when the large-scale housing system reform began, while HI wasn’t the Granger cause of GDP most of the time. The only exception was in 1999–2009, when lag to include was 2, and the results showed HI as the Granger cause of GDP.

After testing the time-based robustness of the conclusion, we further divided national panel data into those of the east, central and west regions to see if the conclusion would change with region. As shown in Table 1.8, the results indicated that the conclusion that “GDP is the Granger cause of HI” applied to all regions, but panel data for the central region didn’t completely support the conclusion that “HI is not the Granger cause of GDP”. In the central region, when the lag to include was 2, HI was the Granger cause of GDP, which meant sometimes HI could lead GDP a few years later in that region. We will further divide regional data into time periods to find the source of the Granger causality.

³Before verifying the co-integration, we conducted unit root test on each set of data when they were divided by time, region or both, and the results showed that GDP and HI were I(1) in all scenarios.

Table 1.6 Unit root test results of region-based regression residual

Region	1985–2009			1985–1998			1999–2009		
	With constant term	With trend term	With drift term	With constant term	With trend term	With drift term	With constant term	With trend term	With drift term
East	25.794 (0.261)	29.091 (0.142)	69.555 (0.000)	26.521 (0.230)	41.188 (0.008)	61.108 (0.000)	44.207 (0.003)	20.257 (0.567)	60.677 (0.000)
Central	44.182 (0.000)	15.965 (0.455)	77.414 (0.000)	24.887 (0.072)	12.049 (0.741)	56.129 (0.000)	11.932 (0.749)	9.099 (0.909)	38.344 (0.001)
West	63.652 (0.000)	35.668 (0.033)	109.617 (0.000)	45.073 (0.001)	16.148 (0.707)	80.818 (0.000)	22.626 (0.423)	12.184 (0.953)	59.881 (0.000)

Note: *p* is in the parentheses

Table 1.7 Results of time-divided Granger causality test

Lag to include	H1 ₀		H2 ₀	
	1985–1998	1999–2009	1985–1998	1999–2009
1	0.586	0.277	0.000	0.000
2	0.671	0.048	0.000	0.000
3	0.349	0.086	0.000	0.000
4	0.074	0.144	0.000	0.000
5	0.106	0.166	0.000	0.000
6	0.426	0.175	0.000	0.000

Note: data in the table refer to p

Table 1.8 Region-based Granger causality test

Lag to include	H1 ₀			H2 ₀		
	East	Central	West	East	Central	West
1	0.814	0.275	0.985	0.000	0.000	0.000
2	0.966	0.039	0.620	0.000	0.000	0.000
3	0.957	0.095	0.786	0.000	0.000	0.000
4	0.785	0.365	0.331	0.000	0.000	0.000
5	0.739	0.469	0.454	0.000	0.000	0.000
6	0.426	0.337	0.353	0.000	0.000	0.000

Note: data in the table refer to p

At last we divided national panel data both by time and region to test the Granger causality between GDP and HI in different situations separately. As shown in Table 1.9, regarding the null hypothesis 2 that “GDP isn’t the Granger cause of HI”, the p value in time-divided tests of all regional panel data was less than 5% regardless of the lag to include, and H2₀ was rejected at 5% significance level. This meant the conclusion that “GDP is the Granger cause of HI” was robust. Meanwhile, the conclusion that “HI isn’t the Granger cause of GDP” was very robust in most cases with a few exceptions. In the period of 1985–1998, when the lag to include was 2, test results of panel data of the central region rejected H1₀ at the 5% significance level, meaning HI in that region was the Granger cause of its GDP before the large-scale housing system reform began in 1998. In the period of 1999–2009, when the lag to include was 3–6, test results of panel data of the west region rejected H1₀ at the 5% significance level, meaning HI in that region was the Granger cause of its GDP after the housing system reform.⁴ In general, the conclusion that “GDP is the Granger cause of HI” is very robust, so is the conclusion that “HI isn’t the Granger cause of GDP” in most cases.

⁴Housing investment led economic growth in certain regions and specific time periods, indicating that even within an economy, the interaction between housing investment and economic growth might change with time in different regions. This is consistent with the conclusions drawn by scholars in different countries based on their empirical studies as mentioned in the literature review.

Table 1.9 Time-divided and region-based Granger causality test

Lag to include	1985–1998						1999–2009					
	H1 ₀			H2 ₀			H1 ₀			H2 ₀		
	East	Central	West	East	Central	West	East	Central	West	East	Central	West
1	0.875	0.744	0.844	0.000	0.000	0.000	0.681	0.066	0.540	0.000	0.000	0.000
2	0.773	0.028	0.875	0.000	0.000	0.000	0.162	0.314	0.127	0.000	0.000	0.000
3	0.950	0.081	0.618	0.000	0.000	0.000	0.317	0.157	0.041	0.000	0.000	0.000
4	0.572	0.206	0.095	0.000	0.000	0.000	0.158	0.103	0.015	0.000	0.000	0.000
5	0.484	0.170	0.087	0.000	0.000	0.000	0.165	0.246	0.039	0.000	0.000	0.000
6	0.623	0.413	0.178	0.001	0.000	0.000	0.149	0.291	0.027	0.001	0.000	0.000

Note: data in the table refer to *p*

The last step was further comparison of the lead-lag relation. Regarding the national panel data, GDP was the Granger cause of HI both before and after the large-scale housing system reform began in 1998, but not vice versa. Previously we analyzed GDP’s lead on HI in 1985–2009 with IRF, and now we will further compare whether this lead changes before and after 1998.

We did a regression with model (1.2) using time-divided national panel data, and the results are shown in Table 1.10. In the regression model with DHI as dependent variable, the coefficient of DGDP’s lag L.DGDP was 0.846 in 1985–1998, lower than its value 1.068 in 1998–2009. We could further show that this discrepancy was statistically significant, meaning DHI was more responsive to DGDP after the housing system reform began in 1998. However, if we determined DGDP’s lead on DHI with that coefficient alone, we would neglect DGDP’s positive effects on current DHI and their interaction. To further analyze how DGDP’s lead on DHI changed after the housing system reform, we compared the DHI’s IRF against DGDP before and after the reform began in 1998.

To facilitate the comparison, we fixed a base point for DGDP shock and analyzed DHI’s IRF to that shock. Figure 1.4 shows each IRF (left) and cumulative IRF (CIRF) (right) before and after the housing system reform. The left figure shows that

Table 1.10 Time-divided VECM regression result

Dependent variable	1985–1998			1998–2009		
	<i>L.DGDP</i>	<i>L.DHI</i>	<i>e</i>	<i>L.DGDP</i>	<i>L.DHI</i>	<i>e</i>
<i>DGDP</i>	0.834*** (29.373)	0.008 (0.545)	0.006 (0.638)	0.911*** (27.579)	0.014 (0.712)	−0.01 (−1.344)
<i>DHI</i>	0.846*** (7.792)	0.045 (0.798)	0.146*** (3.991)	1.068*** (11.799)	0.137** (2.526)	0.041** (1.979)

Note: *t* value is in the parentheses. Stars ** and *** mean the value is significant at the 5% and 1% level respectively

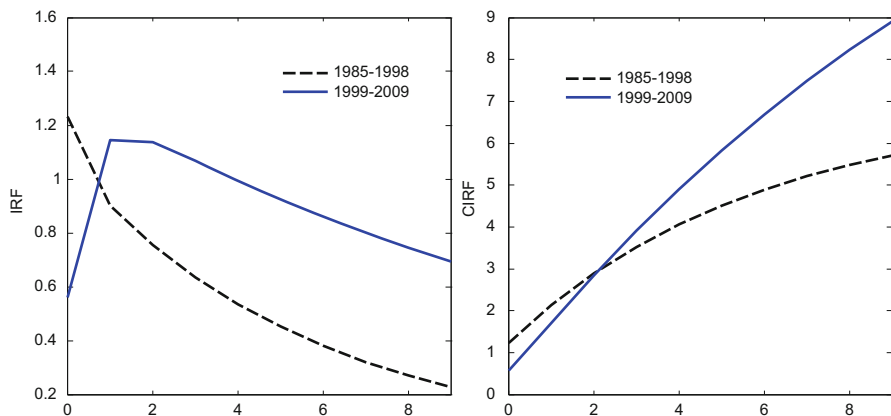


Fig. 1.4 Time-divided IRF

DHI was more responsive to DGDP in the current period before the reform than after, but the response weakened fast for years after the shock before the reform. In contrast, given the same shock, DHI's response to DGDP after the reform strengthened first, and then slowly weakened at a speed lower than before the reform. Eight years after the shock, DHI's response to DGDP before the reform was basically 0 but the response after the reform was as high as 0.7. The right figure shows that in the second year of the shock, DHI's cumulative response to DGDP was stronger after the reform than before, and the discrepancy widened as time went by.

This shows that economic growth gave a stronger impetus to housing investment after the housing system reform began in 1998. Based on the analysis above, we can see that the lead-lag relation between housing investment and economic growth didn't change before and after 1998 just because the government issued a lot of policies to promote housing investment in hopes of driving economic growth. As a matter of fact, economic growth has always led housing investment, even more so after the large-scale housing system reform started in 1998.

1.2.5 Conclusion

Since the mid-1990s, a lot of studies that were not proven by empirical tests held that increasing housing investment would drive China's economic growth, and the government made housing construction a new economic growth point and fostered housing industry and real estate industry as pillar industries for national economy. The series of policies and measures issued by the government to promote housing construction and consumption are still in effect today, and the notion that it must be promoted because it can drive economic growth is so widely and deeply acknowledged that it seems to have become a subconscious common sense. We collected provincial-level panel data in China from 1985 to 2009, and used panel VECM to test the interaction between housing investment and economic growth. We found that whether in the whole period of 1985–2009 or in the two periods divided by 1998, whether with panel data of each province and municipality across the country or with region-based provincial-level and municipal-level panel data, the unidirectional Granger causality that economic growth led housing investment was stationary, but no evidence could be found to support the view that housing investment drove economic growth.

We are not denying the role of housing construction in solving economic and social problems. Housing is a shelter, a private space, an investment instrument and, to some extent, a symbol of wealth and social status. Housing issues often overlap with issues like unemployment, poverty and inequality, and housing policies constitute an important part of social policies in all countries. But our studies based on historical data show that in China, it is economic growth that leads the increase in housing investment while housing investment never directly boosts economic growth, so the so-called "housing-led growth hypothesis" doesn't hold water in China. Results of empirical studies indicate that we have to reflect on policies since

the mid-1990s that strongly support housing investment in order to drive economic growth and take housing construction as a new growth point and pillar industry for national economy.

In terms of resource distribution, housing investment refers to the amount of resources a country invests in housing construction. Many researchers expressed concern about excessive housing investment (Mills 1987; Taylor 1998), and many countries attached great importance to the research on housing investment (Zhang Jin'e 1990). According to data in OECD Factbook 2009, the average housing investment-to-GDP ratio in the seven industrialized countries of Britain, the US, Italy, France, Japan, Canada and Germany from the 1970s to 2006 was 3.6%, 4.7%, 5.2%, 5.4%, 5.7%, 5.9% and 6.5% respectively, and that in transition countries like Poland, Slovakia, Czech, Estonia and Slovenia from 1995 to 2007 was 2.6%, 2.8%, 3.2%, 3.3% and 3.7% respectively. In comparison, this ratio in China was as high as 8.65% in 1981–2009, which kept rising every year since the housing system reform started in 1998 thanks to the series of government policies promoting housing construction and consumption, and it reached 10.7% in 2009. Although the situation in China was different from that in developed industrialized countries in the west and in transition countries in Central and Eastern Europe, and China had to make up for historical deficiency, it may be high time that we re-evaluated the massive housing investment that has lasted for more than 30 years.

Based on the empirical studies conducted in various countries since the 1990s, we summed up the literature and found that the relation between housing investment and economic growth differed from country to country and might change with time even in the same country. Empirical studies also showed that even within the same economy, the interaction between housing investment and economic growth might vary in different regions and even in the same region at different times. Why is this relation discrepant for different countries? IMF (2008) briefly explained the discrepancy among some developed economies but didn't get too deep into it. Why does it change with time in certain countries? In China, why hasn't housing investment been able to boost economic growth in general but has succeeded in doing that in certain regions during specific time periods? Will the relation change with time too in different regions of other countries? We look forward to finding the answers in future studies.

1.3 Does China's Real Estate Industry Have a High Level of Relevancy and Strong Driving Force?

In everyday life we often hear that the real estate industry has a long industrial chain, high level of relevancy and strong driving force, and is an important pillar industry of national economy. It is common to see such statements in textbooks, policy suggestions and government documents. For example, Gao Bo et al. (2007: 51–52) pointed out that “with a long industrial chain and high level of relevancy to related industries,

real estate can be a pillar industry that strongly drives other industries”, and “compared with other industries, real estate industry can make greater contributions to national economic growth”. Zhang Hong (2004: 76) wrote that “real estate is called the ‘locomotive industry’ because its development will drive the development of related industries such as building materials, cement, iron and steel, decoration, transportation and finance, and their development will in turn push real estate development too”. A report by the Development Research Center of the State Council stated “industries associated with housing include iron and steel, timber, cement, glass, plastic products, textile, and paper, chemical, leather and rubber products. Housing not only can drive the development of a number of labor-intensive industries, but also the development of many knowledge- and capital-intensive ones” (Yang Lu and Wang Yukun 1992: 47). In its 10th Five-Year Plan, Shanghai explicitly listed real estate as one of the six pillar industries to be developed energetically, 10 cities in the Yangtze River Delta explicitly or indirectly said they would make real estate a pillar industry, and other cities have attached great importance to real estate industry in their development plan and issued preferential policies for it (Lin Sugang 2008).

In the meantime, some scholars questioned the saying that real estate industry has a high level of relevancy, a strong driving force and should or has become a pillar industry of national economy. For example, Liu Weixin (1995) said the real estate craze in 1992–1993 had something to do with the fact that “some leaders and theorists improperly exaggerated real estate’s role in economic development”. He analyzed why they did that and “described real estate as a ‘basic industry’ or ‘pillar industry’ as if it has become the lifeline of national economy”, and objectively pointed out that “the position and role of real estate in economic development cannot be neglected, but exaggerating it is bad for economic development too”. In recent years, some researchers listed “real estate is the biggest and most important pillar industry for national and local economy” as No.1 of the top 10 lies about Chinese real estate industry (Wang Xiaoguang 2005). They said developed countries didn’t take real estate as a pillar industry in the process of industrialization and suggested not doing that in China anymore and changing the “preference for real estate” when making policies (taskforce of economic situation analysis at Academy of Macroeconomic Research, NDRC 2007). The *Annual Report on the Development of China’s Real Estate No.7 (2010)* stated that if real estate continued to be taken as a pillar industry, it would seriously affect the development of the real economy and the upgrade and adjustment of economic structure, and consequently exacerbate economic imbalance (Yuan Xiuming 2010).

This section is a study that is aimed to help understand the nature, position and role of real estate industry, and find out whether there is evidence to support the saying that “real estate industry has a long industrial chain, high level of relevancy and strong driving force, and is an important pillar industry of national economy”.

1.3.1 Real Estate and Real Estate Industry

When reflecting on the role of real estate industry, Taiwan scholars pointed out that “the biggest deficiency of literatures that support the theory that real estate industry has great backward linkage effects is that they don’t have a clear definition of ‘real estate industry’” (Wang Jian’an et al. 1996). We also believe that we should discuss the industrial chain, driving force, position and role of real estate industry only after we clearly analyze real estate and the industry.

Real estate refers to land, things attached to or associated with it and objects that cannot be moved according to law. It means “land and improvements, and the rights of use associated with the ownership” (McKenzie and Betts 2001: 3), and the “combination of physical objects, rights and interests, and location” (Chai Qiang 2007: 42). Real estate is also called immovable property or property. For example, it includes both immovable and movable properties according to the *Property Law*, the *Guarantee Law* provides that “immovable property in this law refers to land and attachments to it such as houses and trees”, and *Property Management Regulations* defines property as “housing, facilities and equipment fitted in it and related premises”.

The important position of real estate in human society is self-evident. William Petty said “land is the mother of wealth”. Housing is a shelter, a private space, a locational product, a combination of buildings and neighboring facilities, an instrument of investment and a symbol of social and economic status (Zhang Jin’e 1991). Commercial real estate provides the venue for the sale of goods and services, industrial real estate is the property that is used for industrial production or to serve it, and real estate like office building, hotel, restaurant, amusement park, farm, orchard, bus station or terminal also has obvious functions.

Real estate takes an important position in the national wealth of many countries. It is estimated that the total worth of US real estate reached USD8.8 trillion in 1990, which accounted for about 56% (the largest part) of America’s total wealth at that time, and it also made up the largest part in private net investment every year (DiPasquale and Wheaton 1996: 6–7). In China, Shen Yue and Liu Hongyu (2004) calculated that the value of real estate assets was 5.9 times as much as China’s GDP in 2001, and Zhang Hong et al. (2010) estimated that from 1999 to 2008, the value of real estate assets climbed up from RMB79.4 trillion to RMB187.6 trillion at the average annual growth rate of 10.1%.

Real estate made up a large part in the composition of family assets. Table 1.11 lists the proportion of housing in family assets in 12 countries in 2000, which shows that the proportion is highest (75%) in Finland and lowest (28%) in India. The proportion is 57% in China, ranking 5th among the 12 countries. Surveys in recent years have shown with similar findings. A survey of families conducted by the Institute of Economics of Chinese Academy of Social Sciences showed that from 1995 to 2002, the proportion of housing’s net value in the net value of China’s total properties increased from 35.4% to 57.9% and its proportion in the net value of urban residents’ total properties increased from 43.7% to 64.4%. Its proportion in the

Table 1.11 Proportion of housing in family assets: survey of 12 countries in 2000

Nation	Proportion (%)	Nation	Proportion (%)	Nation	Proportion (%)	Nation	Proportion (%)
Finland	75	Spain	58	Australia	54	New Zealand	37
The Netherlands	70	China	57	Indonesia	46	US	32
Italy	69	Japan	54	Canada	38	India	28

Source: Davies et al. (2009)

net value of rural residents' total properties was lower than that for urban residents, but it was rising and reached 43% in 2002, in which year land value accounted for 30.7% of rural residents' per capita properties (Luo Chuliang et al. 2009). The similar situation was discovered by Aordo Center during its 2005 and 2007 surveys and the survey of 12 provinces by the National Bureau of Statistics in 2009 (Liang Yunwen et al. 2010; Chen Binkai and Li Tao 2011).

However, real estate industry isn't a general term for all activities related with real estate production, circulation, consumption, management and service. An industry or a line of business is the combination of all units engaged in economic activities of the same nature. After the reform and opening-up was launched, real estate industry was listed in the tertiary industry as a sector that served production and living, which was consistent with international practice. The National Planning Committee, Economic Committee, Statistics Bureau and Standardization Bureau jointly issued the *Classification and Code of Economic Industries* (GB4754–84) in 1984. It put "industry of real estate management" under the "industry of real estate management, public utilities, resident service and consulting service", including "management and operation of housing and land and sporadic housing repair and maintenance undertaken by real estate developers and housing administration. (The industry of real estate management) doesn't include repair and maintenance companies (teams) of independent accounting affiliated to the housing administration, which are listed in the industry of civil engineering and construction".⁵ On that basis, the National Statistics Bureau divided the industries in March 1985 according to the classification by OECD and World Bank: primary industry was agriculture, secondary industry comprised industry and construction, and tertiary industry included all other industries. Tertiary industry was further divided into two parts and four layers, in which the second layer comprised sectors serving production and living, including finance, insurance, geological survey, real estate, public utilities, resident service, tourism, consulting information service and all kinds of technical services.⁶

The *Classification and Code of Economic Industries* was revised in 1994 and listed real estate industry as an independent category. In the latest *Classification of Economic Industries* (GB/T 4754–2011), real estate industry comprised real estate development and operation, property management, intermediary service, operation of self-owned properties and other real estate sectors. Among them, the last four were listed under service industry, but real estate development and operation was

⁵"Classification and Code of Economic Industries (GB4754–84)". Department of Rules and Systems of the National Statistical Bureau, ed. *Selected Documents of Statistical Systems and Methods (1950–1987)* (Beijing: China Planning Press, 1988).

⁶"Notice of the General Office of the State Council on Forwarding the Report by National Statistics Bureau on Carrying out Statistics of Tertiary Industry (April 6, 1985). Department of Rules and Systems of the National Statistical Bureau, ed. *Selected Documents of Statistical Systems and Methods (1950–1987)* (Beijing: China Planning Press, 1988).

likely to cause misunderstanding. The *Notes to Classification of Economic Industries 2011* formulated by the National Statistics Bureau set forth the scope of real estate development and operation: land development service (service for the transfer and leasing of land use right and other land development services), real estate development service (services for low-income housing, commercial housing, office building, commercial properties and other real estate development), and real estate operation service (services for the sale and leasing of low-income housing, for the sale of commercial housing and for the leasing of regular housing). The *Notes* specifically stated that real estate development and operation doesn't include engineering and construction of housing and other buildings, or services provided by construction companies of independent accounting (or separate accounting) operated by real estate developers themselves, family hotels, school dorms and campsites. It's clear that real estate development and operation falls under the category of service industry.⁷

But "some scholars have, either intentionally or unintentionally, confused the concept of real estate industry and construction industry" (Liang Yunbin 1996: 9). In spite of the explicit classification of economic industries mentioned above, the government department in charge of real estate industry seemed inclined to expand the scope of this industry and highlight its position. The *Report to the State Council on Developing Urban Real Estate Industry* submitted by the Ministry of Construction in 1987 stated that "real estate industry includes land development, housing construction, maintenance and management, paid allotment and transfer of land use right, sale and leasing of housing ownership, housing mortgage loan, and the resulting real estate market" (Construction Economy Committee of Architectural Society of China 1988: 313). The department in charge also strongly promoted the theory that "real estate is a basic and leading industry for economic development and one of the pillar industries in national economy" (Ye Rutang 1994), and put the statement that "real estate industry has a high level of relevancy and strong driving force and has become a pillar industry in national economy" in the No.18 document of the State Council drafted by it.

The first and second Bulletin of Main Data in National Economic Census listed the undertakers and their employees in 19 industrial categories. As shown in Table 1.12, regarding the distribution of industries undertakers, those engaged in real estate industry accounted for only 2.2% in 2004 and 2.8% in 2008; regarding the distribution of employees, those engaged in real estate industry accounted for only 1.8% and 2% of all employees of all industries. This shows that real estate industry was only a small one among the many industries of China's national economy.

⁷XuXianchun (2000:48) also pointed out that "real estate development and operation refers to commercial services undertaken by real estate developers and operators and other types of employers in the process of real estate development and operation. It doesn't include activities such as land leveling, improvement and housing construction because those belong to the construction industry."

Table 1.12 Real estate industry in 1st and 2nd national economic census

Year	Units of industrial activities		Private businesses		Employees	
	Number (10,000)	Percentage (%)	Number (10,000)	Percentage (%)	Number (10,000)	Percentage (%)
End of 2004	15.3	2.2	3.8	0.1	396.3	1.8
End of 2008	24.5	2.8	3.5	0.1	552.2	2

Source: 1st and 2nd Bulletin of Main Data in National Economic Census

1.3.2 Analysis of Industrial Relevancy

The input-output model has a wide range of uses in macroeconomic analysis, one of which is calculating influence and reaction coefficient, reflecting the forward and backward economic linkage of a category's influence, and measuring the position and role of different categories. Liu Qiyun (2002a) improved the traditional algorithm for influence and reaction coefficient. Based on the Input-Output Tables of China for 40×40 categories in 1997 and 42×42 categories in 2002 and 2007 and the Extended Input-Output Tables of China in 2000 and 2005, we applied both the traditional and improved algorithms for influence and reaction coefficient to analyze how real estate industry led and pushed national economy.⁸

Generally speaking, any change in the production process of an industry will affect other industries because of industrial relevancy. The spread effect imposed by a certain industry on others is called influence, whose degree is measured with influence coefficient. It means the ratio between the total output increment of all other industries and the average output of all industries when a specific industry produces one more unit of output. The spread effect felt by a specific industry from other industries is called reaction, whose degree is measured with reaction coefficient. It means the ratio between the induced output of a specific industry and the average output of all industries when all industries produce one more unit of output. Industries with large influence and reaction coefficient play a crucial role in economic development (Liu Qiyun 2002b: 171–172).

If an industry's influence coefficient is larger than one, it's more influential than the average of economic industries and exerts a greater impact or gives a stronger impetus to economic development (Liu Qiyun and Cheng Weiping 1998: 219). If its influence coefficient is equal to or smaller than one, it's equally or less influential than average. Similarly, if an industry's reaction coefficient is larger than one, it is more reactive than average, and if the coefficient is equal to or smaller than one, it is

⁸The division of economic industries has four levels – category, class, division and section, and real estate industry is a category, so it's better to be compared with other categories. Therefore, it's more appropriate to use the input-output tables for 40×40 or 42×42 categories than the tables for more than 100 divisions.

Table 1.13 Algorithm of influence and reaction coefficients

Coefficient	Traditional algorithm	Improved algorithm
Influence coefficient	$F_j = \sum_{i=1}^n \bar{b}_{ij} / \left(\frac{1}{n} \sum_{j=1}^n \sum_{i=1}^n \bar{b}_{ij} \right)$	$\widetilde{F}_j = \sum_{i=1}^n \bar{b}_{ij} / \left(\sum_{j=1}^n \alpha_j \sum_{i=1}^n \bar{b}_{ij} \right)$
Response coefficient	$E_i = \sum_{j=1}^n \bar{b}_{ij} / \left(\frac{1}{n} \sum_{i=1}^n \sum_{j=1}^n \bar{b}_{ij} \right)$	$\widetilde{E}_i = \sum_{j=1}^n \bar{b}_{ij} / \left(\sum_{i=1}^n \beta_i \sum_{j=1}^n \bar{b}_{ij} \right)$

Note: In $\alpha_j = y_j / \sum_{j=1}^n y_j$, y_j means the final quantity of products in industry j ; in $\beta_i = z_i / \sum_{i=1}^n z_i$

means the initial input by industry i . \bar{b}_{ij} is coefficient of Leontief Inverse Matrix

Source: Liu Qiyun (2002a)

equally or less reactive than average (see Table 1.13). In other words, the larger the influence coefficient, the more that industry leads other industries; the larger the reaction coefficient, the more reliant other industries are on that industry and the more it pushes other industries.

Let’s first discuss the influence coefficient of real estate industry. As shown in Table 1.14, it was 0.629 and 0.722 (traditional algorithm) and 0.61 and 0.701 (improved algorithm) in 1997 and 2000 respectively, ranking 39th and 37th in the 40 economic sectors. In 2002, 2005 and 2007, the coefficient was 0.657, 0.525 and 0.507 (traditional algorithm) and 0.636, 0.514 and 0.474 (improved algorithm) respectively, ranking 41st (the last but two) among the 42 economic sectors with both algorithms. In other words, whether according to traditional algorithm or Liu Qiyun’s (2002a) improved algorithm, the influence coefficient of real estate industry was far lower than average and it ranked low, almost at the bottom. This means real estate industry had a weak leading effect on the general national economy. Moreover, the coefficient dropped steadily since 2000, so did the ranking all the way to the last position but two and stayed there, indicating the leading effect was weakening. Therefore, the saying that real estate industry had a strong leading effect was groundless. On the contrary, real estate industry had a weak leading effect that was on the decline.

Now let’s take a look at the reaction coefficient of real estate industry. Table 1.15 displays the reaction coefficient of Chinese real estate industry calculated with traditional and improved algorithms and its ranking. According to traditional algorithm, the reaction coefficient ranked 33rd and 30th among the 40 economic sectors in 1997 and 2000, and 38th, 33rd and 29th among the 42 economic sectors in 2002, 2005 and 2007. According to Liu Qiyun’s (2002a) improved algorithm, the coefficient ranked 34th and 33rd in 1997 and 2000 and 35th, 38th and 38th respectively in 2002, 2005 and 2007, down 1, 3, 7, 5 and 9 spots respectively compared with the ranking based on traditional algorithm. This means that the reaction coefficient of

Table 1.14 Influence coefficient of real estate industry and its ranking 1997–2007

Algorithm	1997		2000		2002		2005		2007	
	Coefficient	Ranking	Coefficient	Ranking	Coefficient	Ranking	Coefficient	Ranking	Coefficient	Ranking
Traditional	0.629	39(40)	0.722	37(40)	0.657	41(42)	0.535	41(42)	0.507	41(42)
Improved	0.61	39(40)	0.701	37(40)	0.636	41(42)	0.514	41(42)	0.474	41(42)

Note: Total number of industries is in the parentheses

Table 1.15 Reaction coefficient of real estate industry and its ranking 1997–2007

Algorithm	1997		2000		2002		2005		2007	
	Coefficient	Ranking	Coefficient	Ranking	Coefficient	Ranking	Coefficient	Ranking	Coefficient	Ranking
Traditional	0.504	33(40)	0.502	30(40)	0.618	28(42)	0.491	33(42)	0.536	29(42)
Improved	0.678	34(40)	0.654	33(40)	0.615	35(42)	0.509	38(42)	0.547	38(42)

Note: Total number of industries is in the parentheses

real estate industry was also far lower than industrial average and the ranking was very low. Therefore, real estate industry had a small driving force for national economy and it could hardly push the overall economic growth.⁹

1.3.3 Conclusion

In recent years, statements like “real estate industry has a long industrial chain, high level of relevancy and strong driving force, and is an important pillar industry of national economy” are put in textbooks, policy suggestions and government documents, so much so that they almost become common sense. But some scholars questioned and objected to such statements. We believe that discussions about the industrial chain, driving force, position and role of real estate industry should be based on the clear analysis of real estate and real estate industry. Real estate is very important in human society, takes a critical part of national wealth, and has a large share in family assets too, but real estate industry isn’t a general term for all activities related with real estate production, circulation, consumption, management and service. It is only a small part of those activities, and is a tertiary industry that serves production and living.

The Input-Output Tables show that all sectors of national economy have long industrial chains and relate to other industries to varying degrees, so it’s hard to say which one has a longer industrial chain than others. To test whether real estate industry has a high level of relevancy and strong driving force, we calculated its influence and reaction coefficient with traditional and improved algorithms using the Input-Output Tables of China and Extended Input-Output Tables of China in 1997–2007. We found that the influence coefficient of real estate industry was far lower than the average and its ranking was very low, almost at the bottom, and the coefficient dropped steadily since 2000, indicating that the industry had a weak leading effect that was on the decline. Meanwhile, the reaction coefficient of real estate industry was also far lower than industrial average and the ranking was very low, indicating the industry had a small driving force for national economy and it could hardly push the overall economic growth.

This verified the findings of some studies. Kuang Weida (2006) calculated the influence coefficient and reaction coefficient of real estate industry in 1997 and 2000, and found that real estate industry had very limited relevancy. According to him, the traditional view that “real estate industry has a high level of relevancy” was improper in that people confused real estate industry with construction industry, and “as far as relevancy is concerned, the government should not make real estate industry a pillar

⁹From 1997 to 2007, the influence coefficient of the construction industry was slightly more than one and ranked around the 10th, but its reaction coefficient was lower than that of real estate industry, ranking the third from bottom in 1997 and 2000 and the second from bottom ever since 2002. This shows that the leading and driving force of construction industry isn’t as strong as people usually imagine.

industry in their policies”. Zhao Longjie and Yan Yongtao (2007) also found that real estate industry’s leading effect and driving force were weaker than average and it ranked among the last of all economic sectors, but they held that “with China’s industrialization and fast urbanization, real estate industry will become a pillar industry in national economy”. However, our studies showed that instead of being strengthened in the process of industrialization and urbanization, the leading effect and driving force of real estate industry has kept falling.

Our finding was consistent with the conclusion drawn by Taiwan scholars. Real estate industry used to be considered a “locomotive industry” with strong backward linkage effect in Taiwan, but many studies since the 1980s have challenged that traditional view, the most convincing one of which was the study conducted by Wang Jian’an et al. (1996) using the Input-Output Tables of Taiwan in 1971–1986 and the method of industrial relevancy analysis. They concluded that “there are not sufficient evidences to support the theory that real estate industry has strong backward linkage effects”, and suggested “the government not take real estate industry as the countercyclical policy to boost economy”, or “stimulate the real estate industry in order to recover the generally sluggish economy, or suppress real estate industry on the grounds of overheated general economy”. In response to the *Measures on Invigorating Construction Investment* issued by Taiwan authorities in 1998 and the eight measures rolled out in 2008 to save the real estate market, academics of real estate industry stated publicly that the industry wasn’t a locomotive industry and the measures to stimulate the real estate market only tackled the symptoms without addressing the root causes. They suggested the government abandon the view that real estate industry was the locomotive for economic prosperity and refrain from taking steps on false grounds.

The saying that “real estate industry is an important pillar industry for national economy” in the Chinese mainland is similar to the saying in Taiwan that “real estate industry is a locomotive industry”, both of which are “without rigorous academic proving”. As a part of national economy, real estate industry is of course an important industry, so are other industries. The government should not ignore an industry because it has a low level of relevancy and weak driving force, nor should it emphasize and highlight it or provide special favors or policies because it has a high level of relevancy and strong driving force. Our studies show that real estate industry has a low level of relevancy and weak driving force, its leading effect and driving force is on the decline, and the abovementioned saying is groundless.

1.4 Policy Forecast

Based on the above studies, we made the following predictions. First of all, policy makers may change their old view over time that housing investment can drive economic growth. The argument about the interaction between housing investment and economic growth has never stopped since the 1930s, and studies conducted in various countries showed that their interaction not only varied from country to

country, but might also change through time within the same country. In China, the unidirectional causality that economic growth leads housing investment is stable, but there is no evidence to support the view that housing investment drives economic growth. This common assumption and the idea that housing investment has to be promoted are groundless.

Second, policy makers may re-evaluate and adjust the policy that promotes housing investment to drive economic growth. Since the 1990s, China has taken housing construction as a new economic growth point, fostered housing and real estate industries as pillars of national economy and issued a series of policies and measures to boost housing investment. But the fact is that economic growth drives housing investment, not vice versa. Although China had to make up for historical housing deficiency, housing investment has always taken a large proportion in GDP since the reform and opening-up started. After the housing system reform was launched in 1988 and the government issued policies to promote housing construction, the proportion has risen every year and stayed above 10% for many years in a row, much higher than that in developed industrialized countries in the west and in transition countries in Central and Eastern Europe. It's high time to re-evaluate the high housing investment that has lasted more than 30 years.

Third, policy makers may change their old view that real estate industry has a long industrial chain, high level of relevancy and strong driving force. All industries of national economy have long industrial chains and are more or less related to other industries, so there is no reason to say that real estate industry has a longer industrial chain than others. Chinese real estate industry has a weaker leading effect and driving force than the average of all economic sectors, so the old view is groundless. Moreover, the industry's leading effect and driving force were continuously falling in 1997–2007 compared with other industries.

Fourth, policy makers may re-position housing investment and real estate industry under the background that Chinese economy has entered the new normal. Real estate industry is a small part of national economy and a tertiary industry that serves production and living. As a part of national economy, real estate industry is of course important, but so are other industries, and real estate industry is in no way more important than others. The government should attach equal importance to all of them, neither ignoring an industry because it has a low level of relevancy and weak driving force nor emphasizing it or providing special favors or policies because it has a high level of relevancy and strong driving force. The real estate industry has a low level of relevancy to other industries, so continuing the regulation of it won't affect the overall national economy very much. As Chinese economy has entered the new normal, Chinese government has lowered the economic growth target and focused on adjusting the economic structure and transforming the development model with a view to achieving high-quality growth. As a result, housing investment, real estate market and real estate industry will achieve long-term, steady and healthy development along with the general economy.

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Chapter 2

History and Outlook of China's Housing Market



Linhua Zou

2.1 A Brief History of China's Housing Market

According to market background, driving forces and development status, China's housing market development can be divided into three stages: the stage of slow release of potential demand driven by the housing reform (1978–2001), the stage of short supply and soaring housing price driven by fast urbanization and industrialization (2002–2013), and the stage when structural surplus and shortage co-exist (2014–present). The market-oriented reform in the first stage paved the way for fast housing market development in the second stage, which in turn laid the foundation for stock optimization in the third stage.

2.1.1 *Stage of Slow Release of Potential Demand Driven by the Housing Reform (1978–2001)*

Since the reform and opening-up started in 1978, the market-oriented housing reform in China has proceeded through several stages with careful explorations and trials: the trial home sale (1978–1985), raised housing rent + subsidy (1986–1990), home sale + rent (1991–1993), comprehensive promotion (1994–June 1998), and the replacement of welfare housing in kind with monetary housing distribution (1998–). As the market-oriented reform proceeded, the suppressed

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housing demand was continuously released and the housing market kept getting bigger. In 2001, national investment in commercial housing reached RMB421.668 billion, accounting for 67.34% of national urban housing investment (Fig. 2.1 and Table 2.1). However, China still didn't reach the threshold value for extensively improving housing conditions in the early twenty-first century because family income of urban and rural residents remained low. At that time, potential housing demand was released slowly, housing reform encountered difficulties, and the society didn't react strongly to the housing reform.

The period from 1978 to 1985 was the period of trial home sale, which was the beginning of China's housing reform. Full-price home sale was implemented on a trial basis in 1979. In June 1980, the CPC Central Committee and the State Council approved and forwarded the *Outline of the Report to National Work Meeting on Capital Construction* with the following instruction: "private housing construction, purchase and possession is allowed", thus officially approving the commercialization of housing. The focus of housing policy in 1979–1985 was trial housing sale, including full-price sale and subsidized sale, the former not going very well. Incomplete statistics show that at the end of 1981, only 3000+ apartments were sold in pilot cities, so full-price home sale was soon replaced by subsidized sale. In 1982, the State Council approved subsidized sale of newly built homes on a trial basis in four cities – Zhengzhou, Shashi, Changzhou and Siping, where the buyer had to pay only one-thirds of the housing price and the rest two-thirds was subsidized by the local government and the buyer's employer together. This was known as the "tripartite system". With this model, the housing price was higher than that in

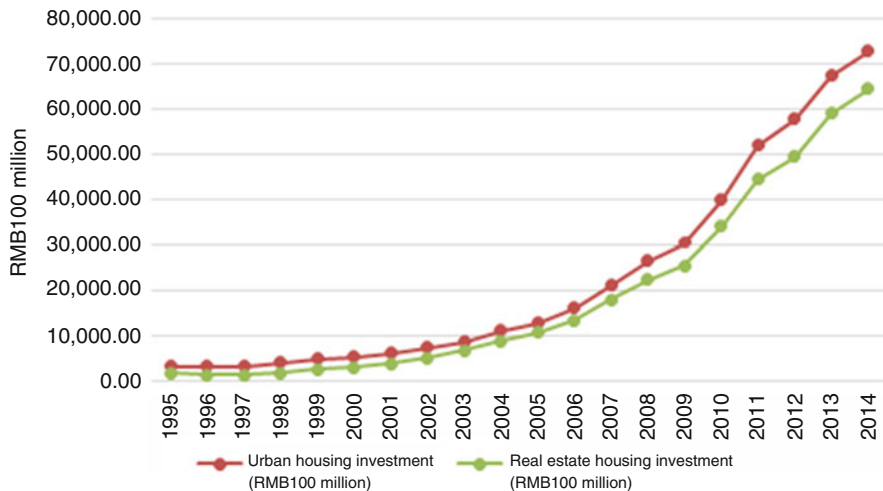


Fig. 2.1 Urban housing investment and real estate housing investment in China since 1995. (Source: National Bureau of Statistics)

Table 2.1 Urban housing investment and real estate housing investment in China since 1995

Time	Urban housing investment (RMB100 million)	Real estate housing investment (RMB100 million)	Percentage of real estate housing investment in urban housing investment (%)
1995	3278.19	1753.10	53.48
1996	3326.22	1699.17	51.08
1997	3319.67	1539.38	46.37
1998	4310.81	2081.56	48.29
1999	5050.88	2638.48	52.24
2000	5435.28	3311.98	60.93
2001	6261.52	4216.68	67.34
2002	7248.91	5227.76	72.12
2003	8624.83	6776.69	78.57
2004	11,010.13	8836.95	80.26
2005	12,825.76	10,860.93	84.68
2006	16,305.54	13,638.41	83.64
2007	21,238.29	18,005.42	84.78
2008	26,516.00	22,440.90	84.63
2009	30,512.74	25,613.69	83.94
2010	39,763.10	34,026.23	85.57
2011	51,773.37	44,319.50	85.60
2012	57,844.27	49,374.21	85.36
2013	67,483.36	58,950.76	87.36
2014	72,727.95	64,352	88.48

Source: National Bureau of Statistics

the full-price model, but since the government and employer paid two-thirds of the price, families of working class were under a much lighter burden, and usually a family could buy a regular new apartment with about 2 years' income. Therefore, this model was implemented quite smoothly, but it was strongly objected by enterprises and local governments because they had to pay two-thirds of the price (and subsidies by local governments were mostly transferred to enterprises). As more employees bought apartments, enterprises had to bear more subsidies, and housing capital couldn't be self-circulating. In the meantime, since the low-rent system was still in place, the majority of residents were unwilling to buy their own housing, so subsidized home sale was abolished in 1985 as a kind of low-price sale.

The period from 1986 to 1990 was the period of raised rent and subsidy. As full-price home sale and subsidized home sale both failed, relevant departments began to study the possibility of adjusting the rent of public housing. In fact, this idea was put forth almost at the same time as trial housing sale, but it involved more aspects, had greater social effects and had to overcome stronger resistance, so it wasn't officially rolled out until the mid-1980s when subsidized home sale was abolished.

In early 1988, the State Council held the first national work meeting on housing system reform, and printed and distributed the *Implementing Plan for Housing System Reform in Cities Nationwide by Stages and in Groups* (GF [1988] No.11) that February, announcing to reform the housing system by stages and in groups as part of the central and local reform plan. In the first step, housing rent was raised across the board to support housing expense and boost housing purchase, so as to realize the benign cycle of housing capital and suppress unreasonable housing demand. In the second step, the relation of distribution was straightened out (subsidy was listed under salary and counted as corporate cost) to make housing more affordable for employees, and more efforts were made to commercialize housing and make the housing market more professional.

This reform achieved good results in Yantai, Bengbu, Tangshan, Shenzhen and Chengdu. Unfortunately, China experienced serious inflation soon afterwards, which might worsen and further drag down the economy if the reform of public housing rent was continued due to its effect in driving up the housing cost. Meanwhile, the raised rent was objected by some executers because it harmed some people's interests, so this plan, which was scheduled to be completed in 3–5 years, was aborted before it unfolded in full swing.

The period from 1991 to 1993 was the period of “home sale + rent”. In June 1991, the State Council issued the *Notice on Actively and Properly Continuing the Reform of Housing System* (GF [1991] No.30). While calling for continuous efforts to reasonably adjust public housing rent and sell public housing, the *Notice* stressed new policy for new housing, meaning the old housing system would not apply to newly built housing, thus facilitating the future housing system and housing reform. Policy at that time was guided by a new philosophy. Policy makers wanted to avoid the resistance to raising rent on existing housing by applying a new policy to new housing, so that the new housing system could gradually evolve and quantitative changes would lead to a change in quality. In October 1991, the second national work meeting on housing system reform was held. On October 17, the State Council approved and forwarded the *Opinions on Comprehensively Promoting the Urban Housing System Reform* drafted by the leadership group of housing reform, and proposed to replace the current housing distribution system in kind with the system in cash, starting with the reform of low-rent public housing. Meanwhile, local governments began to implement the policy that employees could buy public housing at cost price or normal price (normal price means the price of public housing determined according to the average economic bearing capacity of local low- and middle-income working families, and the housing involved in this policy was called reform housing). However, this policy was implemented in a standard way in big cities but not so much in medium and small ones. As a result, the housing discount was increased all the time, and underselling public housing became prevalent again, the third time that housing reform got trapped in that vicious cycle. In June 1992, the State Council demanded once again to stop underselling public housing at the national work meeting on housing reform.

The period from 1994 to June 1998 was the period of comprehensive promotion. In July 1994, the State Council issued the *Decision on Deepening Urban Housing*

System Reform (GF [1994] No.43), which proposed to comprehensively promote the housing provident fund system, actively push the rent reform, steadily sell public housing, and accelerate the construction of affordable housing. According to the *Decision*, housing was sold to families in different income ranges at different prices. Low- and middle-income working families could buy public housing at cost price and normal price system could be adopted as a transition in cities (counties) with substantial difficulties. Major progress was made on establishing housing provident fund, raising public housing rent and selling public housing in this period. At the end of June 1998, the national aggregate of housing provident fund stood at RMB98 billion. At the end of 1997, the average public housing rent in 35 large and medium-sized cities was RMB1.29/m², much higher than before, and the rent was basically equal to the cost in cities like Shenzhen. The sale of public housing also progressed quickly after 1996. In mid-1998, privately owned housing in cities accounted for over 50% of all housing nationwide, even more than 60% in some provinces and cities. The Comfortable Housing Project also made quick progress, as 71.59 million square meters were built by the end of 1997, which provided housing for 650,000 urban households, and the construction plans made in the first half of 1998 in two steps amounted to 106.49 million square meters. The aggregate already exceeded the construction volume originally planned for the project.

The period from 1998 to 2001 was the period when welfare housing in kind was replaced by monetary housing distribution. To stimulate domestic demand and cope with the Asian financial crisis, the State Council issued the *Notice on Further Deepening Urban Housing Reform and Accelerating Housing Construction* (GF [1998] No.23) in June 1998. The *Notice* included the following contents: “housing distribution in kind will stop in the second half of 1998 and monetary housing distribution will be implemented gradually”; “after housing distribution in kind stops, newly built affordable housing, on principle, will only be available for purchase but not for renting”; “efforts will be made to develop housing finance and cultivate and regulate the housing market”; and “housing loans will be made available to more people, all commercial banks will be allowed to grant personal housing loan in all cities, no cap will be put on the loan, and its term will be appropriately lengthened”. This meant that welfare housing that had been implemented for decades was replaced by commercial housing, and a multi-layered urban housing supply system focused on affordable housing was established.

2.1.2 Stage of Short Supply and Soaring Housing Price Driven by Rapid Urbanization and Industrialization (2002–2013)

The demand for urban housing generally outstripped supply after 2002 driven by fast urbanization and industrialization. This set the background for China's housing market development in that period. On one hand, a lot of rural residents poured

into the city and created tremendous rigid housing demand. From 2002 to 2013, Chinese urban population increased by 250.47 million people, averaging 20.87 million per year, which was equivalent to creating a new Beijing every year. The proportion of urban population rose from 39.09% in 2002 to 53.73% in 2013, when it surpassed rural population for the first time in history (Fig. 2.2). On the other hand, the rapidly rising family income resulted from robust industrial development and economic take-off gave rise to a large demand for improving the living conditions. The per capita GNP in 2002 was RMB9,450, which increased by 4.6 times to RMB43,320 in 2013. The percentage of value added from secondary and tertiary industries in GDP rose from 86.6% in 2002 to 90.6% in 2013, while the percentage of value added from the primary industry in GDP dropped from 13.4% in 2002 to 9.4% in 2013 (Figs. 2.3 and 2.4). However, Chinese cities at that time featured small scale and old housing, so they couldn't meet the fast-growing housing demand.

To address the short housing supply, China's housing market increased supply through multiple approaches in that period to fulfill its main historical mission of ensuring access to housing for as many people as possible. In August 2003, the former Construction Ministry issued the *Notice on Promoting the Sustained and Healthy Development of Real Estate Market* (Document No.18), in which the definition of affordable housing was changed from "main form of housing supply" to "policy-based commercial housing aiming to provide housing security". The *Notice* defined real estate as a pillar industry for national economic development, further weakened the status of affordable housing as the main form of housing supply, and replaced it with general commercial housing. China's housing development made great achievements in that period. Most urban families had more than one

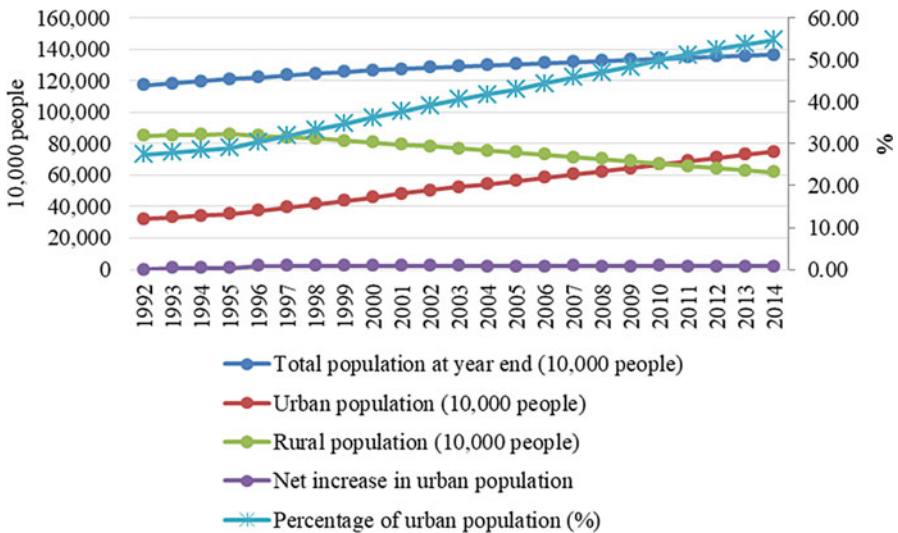


Fig. 2.2 Urban and rural population in China since 1992. (Source: National Bureau of Statistics)

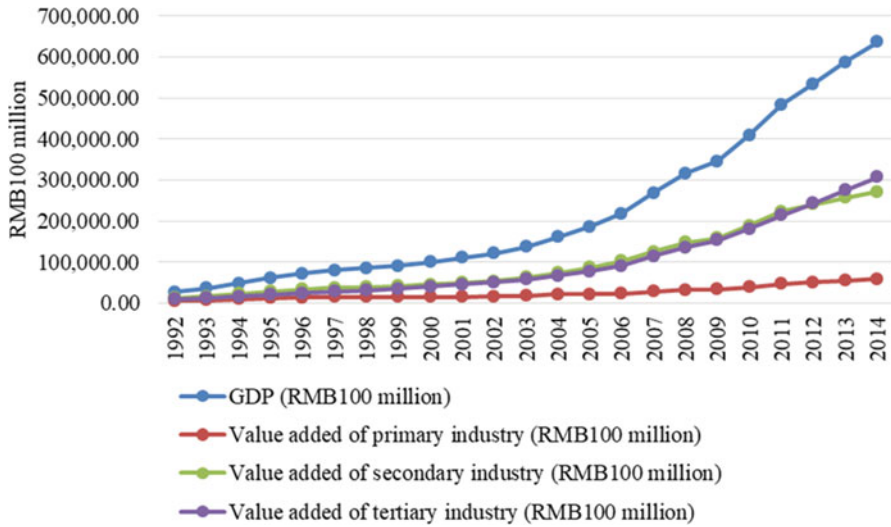


Fig. 2.3 China's GDP and its composition since 1992. (Source: National Bureau of Statistics)

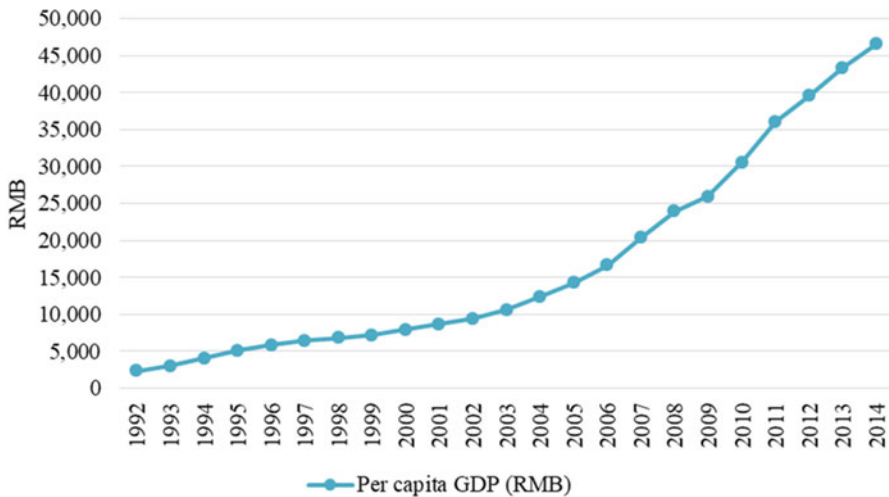


Fig. 2.4 Per capita GDP in China since 1992. (Source: National Bureau of Statistics)

commercial housing unit, many had several, and a lot of rural families that worked in cities also bought more than one commercial housing unit in the county or prefecture-level city of their hometown. But some prominent negative effects ensued, such as soaring housing prices, housing speculation and piled-up housing market bubbles, which were criticized by many.

China's home sale skyrocketed since 2002 and residents' desire for housing purchase remained strong. In 2002, 237.0231 million square meters of commercial

housing were sold, up 18.88% from the previous year, but in 2013, the sales area reached 1157.23 million square meters, up 17.52% from the previous years, indicating an increase of 4.88 times and an average annual growth rate of 17.2% from 2002. In 2002, the sales volume of commercial housing in China was RMB495.785 billion, up 23.29% from the previous year, but in 2013, the sales volume reached RMB6769.494 billion, up 26.61% from the previous year, indicating an increase of 13.65 times and an average annual growth rate of 29% from 2002 (Figs. 2.5 and 2.6).

Home prices in China saw continuous and rapid increase since 2002 with a brief dip in 2008. In 2002, the average sale unit price of commercial housing was

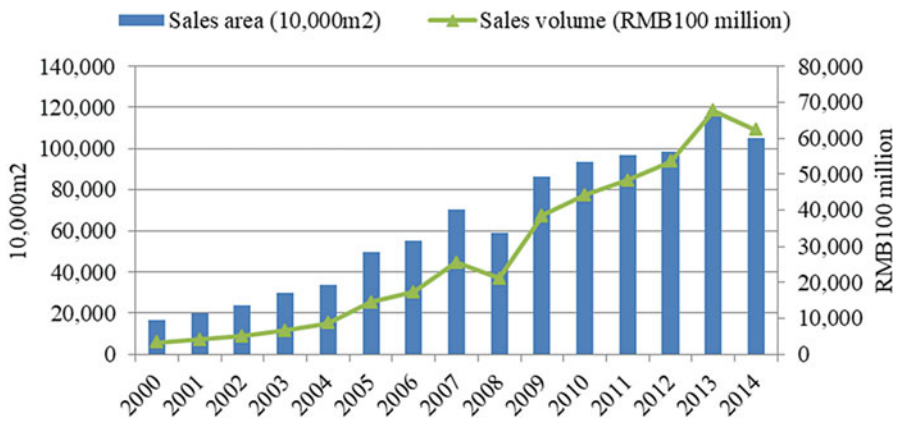


Fig. 2.5 Sales area and volume of commercial housing in China since 2000. (Source: National Bureau of Statistics)



Fig. 2.6 Year-on-Year (YoY) growth rate of sales area and volume of commercial housing in China since 2001. (Source: National Bureau of Statistics)

RMB2,092, up 3.72% from the previous year, but it reached RMB5,850 in 2013, up 7.73% from the year before, indicating an increase of 2.80 times and an average annual growth rate of 9.50% from 2002 (Fig. 2.7).

Housing investment in China also maintained steady and rapid growth since 2002. It stood at RMB522.8 billion in 2002, up 24.00% from the previous year, and reached RMB5895.1 billion in 2013, up 19.40% from the previous year, indicating an increase of 11.28 times and an average annual growth rate of 24.76% from 2002 (Fig. 2.8).

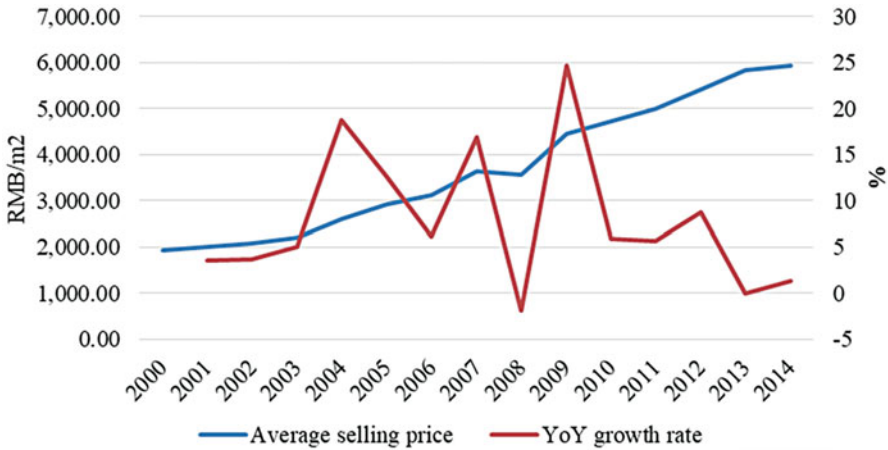


Fig. 2.7 Average sales price of commercial housing in China and its growth rate since 2000. (Source: National Bureau of Statistics)

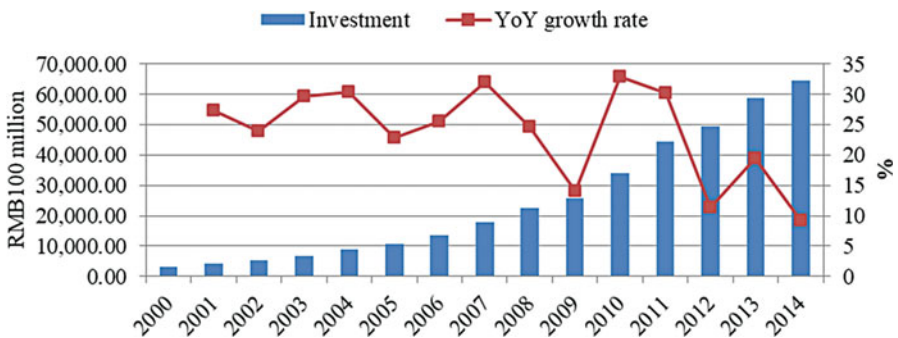


Fig. 2.8 Commercial housing investments in China and its YoY growth rate since 2000. (Source: National Bureau of Statistics)

2.1.3 Stage When Structural Surplus and Shortage Co-exist (2014–present)

China's real estate market has been going through profound changes since 2014, amid which the "co-existence of structural surplus and shortage" replaces "short supply" to become the general background for China's real estate market in the decade from 2014.

The age of "short supply" is replaced by the age of "structural surplus". Urbanization and industrialization, which served as super drivers of China's housing market development in the past 10 years, are both losing steam, economic growth has entered the so-called "new normal", and urban economic structure is facing tremendous pressure for transformation and upgrade. As income increase decides the flow of population, economic deceleration means cities are losing their appeal to migrants. While the total demand is decreasing, the urban housing stock in China is huge and is still growing at the same high speed as before. Overstock of commercial housing is particularly serious in tier-3 and tier-4 cities. Although the government loosened the management and control of housing demand in 2014, the housing market still slowed down, indicating that the overall short supply in the housing market was replaced by structural surplus.

However, quality homes will still be in "structural shortage". In terms of quantity, urban commercial housing in China is in structural surplus, but in terms of quality, many families still live in poor conditions, and small and old apartments or those without kitchen and/or lavatory take up a large part of the housing stock. As people make more money and have higher requirements for living conditions, the demand for quality housing will increase steadily and such housing is still in short supply.

As "the co-existence of structural surplus and shortage" replaces "overall short supply" to become the background of China's real estate development in the next decade, people's demand for "good housing" will replace that for "housing" to become the main theme of China's housing development in the next 10 years. According to the general law of consumption, the demand for high quality will increase after the overall short supply is solved, and the focus of urban residents' housing consumption will shift from the possession of commercial housing to the continuous improvement of current living conditions. The per capita housing area in Chinese cities is more than 33 m², but most people are not satisfied with their living conditions. Compact apartment buildings remain the main form of urban housing stock, several generations living under one roof remains a common phenomenon, and people have an urgent need to improve their living conditions. Those crowding in small apartments want to move into big ones, those living with other generations hope to live separately to avoid family frictions, those living in apartments wish to live in villas, those living in common communities yearn for premium ones, those living in remote suburbs want to live near the workplace in order to cut the commute time, and those having housing in the city want a vacation housing closer to nature – all these constitute the potential demand for housing improvement.

It's worth noting that residents' wish to improve living conditions cannot be understood simply as the wish to replace small apartments with big ones. Personalized and user-friendly environment, intelligent and environment-friendly facilities and the optimization of interior space are all part of housing improvement. If residents replace small apartments with big ones, which sometimes means they will live farther away from the city center and the family's cost of household chores will increase considerably. Given the trend of family downsizing, a larger housing area doesn't mean a larger family. In the modern society, several generations living under one roof is just an ideal, while such a living mode actually gives rise to a lot of family frictions and is hardly harmonious. Based on Japan's experience, after the housing market bubble broke in the early 1990s, the housing area per household didn't increase and residents didn't change into bigger apartments when the housing price went down. Instead, they tended to spend money on making better use of the interior space. This means that housing consumption became more rational in Japan after the housing market cooled down.

The high-speed housing sales growth in China is changing, and commercial housing sales in some medium and small-sized cities have been dull since 2011, so has the sales in big cities since 2014. Both the sales volume and sales revenues have seen major negative growth nationwide. In 2014, 1051.82 million square meters of commercial housing were sold, generating RMB6239.6 billion revenues, down 9.1% and 7.8% YoY respectively (Figs. 2.5 and 2.6).

As the national housing transaction shrank notably, housing stock kept rising. At the end of December 2005, 85.64 million square meters of newly built commercial housing were for sale in China, down 0.4% YoY, but at the end of December 2013, 324.03 million square meters were for sale, up 37.2% YoY, and it increased by 25.6% YoY to 406.84 million at the end of December 2014 (Fig. 2.9).

The drastic housing price hike in big and medium-sized cities in the second half of 2012 and 2013 resulted in the rapid increase of investment in housing development. The new housing supply became available after 2014 and led to the current

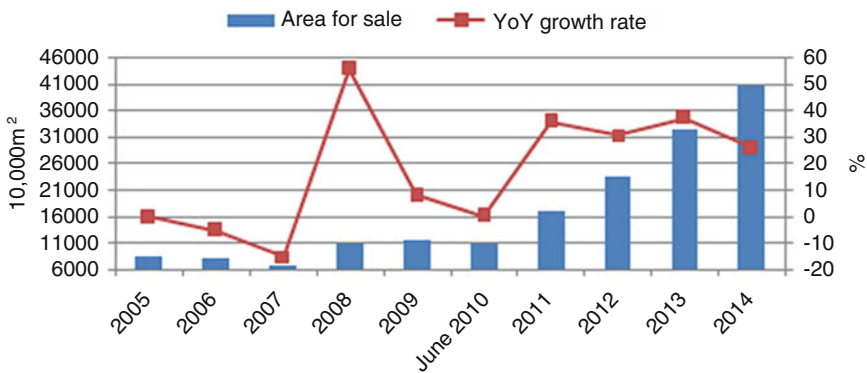


Fig. 2.9 Commercial housing area for sale in China and its YoY growth rate since 2005. (Source: National Bureau of Statistics)

excess in those cities. The high-speed increase in housing supply caused proactive adjustment of housing market in big and medium-sized cities in the first half of 2014, where the pervasive and fast housing price hike turned into general price drop, and the number of cities registering housing price drop increased quickly. In January 2014, 62 of the 70 big and medium-sized cities registered month-on-month housing price rise, two registered stable price and only six registered month-on-month price drop, but in June that year, only one city registered month-on-month housing price rise, three registered stable price and 66 month-on-month price drop. The price drop was also steeper. In December 2014, 68 of the 70 big and medium-sized cities saw YoY housing price drop and only two saw YoY rise (Figs. 2.10 and, 2.11).

Chinese housing industry shifted from high-speed growth to low-speed growth after 2014. As housing sales across the country remain sluggish and housing price in

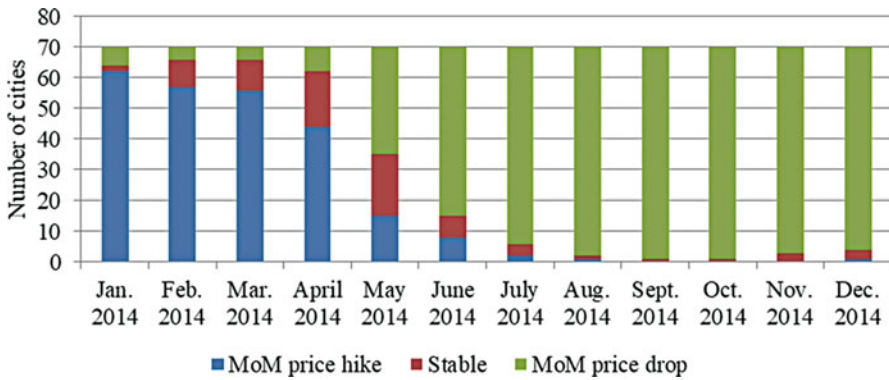


Fig. 2.10 The Number of big and medium-sized cities in China that registered MoM price hike, stable price and price drop on newly built commercial housing in 2014. (Source: National Bureau of Statistics)

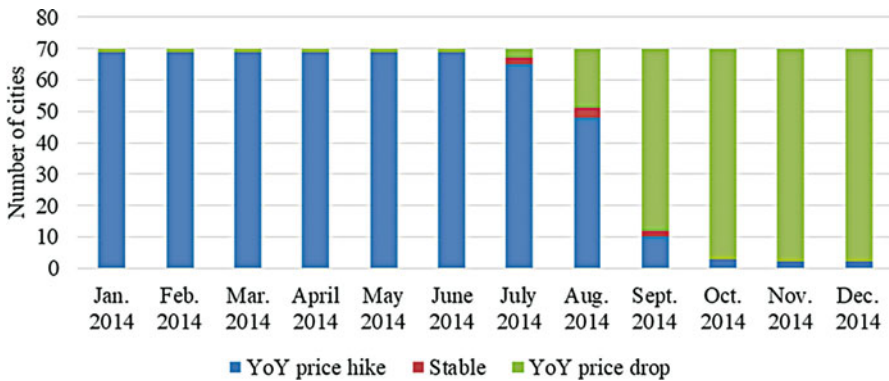


Fig. 2.11 The Number of big and medium-sized cities in China that registered YoY price hike, stable price and price drop on newly built commercial housing in 2014. (Source: National Bureau of Statistics)

big and medium-sized cities drops slightly, real estate developers recover their capital much more slowly and housing investment grows at a slower pace too. In 2013, RMB5895.1 billion was invested in commercial housing development in China, up 19.4% YoY. In 2014, RMB6435.2 billion was invested, and the YoY growth fell to 9.2% (Fig. 2.8).

This round of housing market adjustment is fundamentally different from the adjustment in 2008 or 2011 in that it is driven by the market itself, while the adjustment in 2008 and 2011 took place under the impact of external factors, such as the financial crisis in 2008 and the housing purchase restriction policy implemented in big and medium-sized cities in 2011. The market-initiated adjustment indicated that the housing market in big and medium-sized cities is shifting from short supply to periodic and structural surplus.

2.2 Problems and Challenges: Weaker Driving Forces and Prominent Structural Surplus

As the background for housing development shifted from “short supply” to “structural surplus” and the main theme from meeting people’s demand for “housing” to meeting their demand for “good housing”, the Chinese housing market will face the following prominent problems in the next decade.

First, how to digest the structural surplus of housing stock and deal with “ghost cities” and “empty cities”? China’s industrial mix will go through profound changes in the next decade. Tertiary industry will take up an ever larger share in economic aggregate while secondary industry will take up a smaller share. Since tertiary industry is focused on tier-1 and tier-2 cities and secondary industry is an important economic pillar in tier-3 and tier-4 cities, the transformation of industrial mix actually reflects the future distribution of population in cities. Going forward, tier-3 and tier-4 cities will continue to witness population outflow while tier-1 and tier-2 cities will continue to see population inflow in general. As overstock and sluggish sales of commercial housing is already serious in tier-3 and tier-4 cities and their population will continue to go out in the future, their structural housing surplus will become more conspicuous. In the meantime, local governments built a huge amount of new cities in the past decade, such as “new city of high-speed railway”, “financial center” and “riverside new area”, some of which were developed as image project or to hype up the real estate market. They were based on fictitious urban development vision or blind optimism without the support of any concrete industry, and some of them are bound to become ghost cities or empty cities as the real estate craze ebbs.

Second, how to deal with the possibility that residential communities may have no property management? It will be very common for property management companies to “abandon” residential communities, which will be a serious social problem. In the age of massive housing development, developers usually subsidized property management of their apartment buildings out of their own pocket in order to promote

sales, creating the illusion of premium buildings. As that age passed, some developers no longer sold apartments in certain regions and they didn't have to promote the sales of new buildings by subsidizing property management of old ones. Without developer's subsidy, the residential community could no longer maintain the previous property management and it's possible that nobody will be responsible for property management anymore. Another reason for this is that residential communities in China are usually of a large scale, and big apartment buildings of more than 5000 households are very common, which leads to the problem of "free ride" in property fee. This means that some property owners would refuse to pay the property fee on various excuses, thus indirectly transferring the property management cost to those who have paid the fee. This behavior will be infectious and more property owners will refuse to pay the fee. Generally speaking, if more than 30% of property owners refuse to pay property management fee, the property management company will hardly sustain and have no choice but "abandon" the community.

The third point is that how to address the low quality of the housing stock. There are reasons for the low quality of the housing stock in China. China spent 10 years or so building housings that would have taken other countries decades or over 100 years to complete, so it's inevitable that it didn't fully estimate the change of social conditions. One of the objective reasons for low housing quality is that standards for housing construction weren't updated in time and couldn't catch up with people's rising demand, and the subjective reason is that when housing was in short supply, developers were not motivated to improve quality because commercial apartments were always sold at a high price. As housing will be in overstock, low housing quality will receive more attention. It is reflected in a wide range of aspects, including the lack of necessary elevator, absence of accessible facilities for the elderly and children, no heat insulation, rain leak and water seepage of the outer wall, insufficient parking spots, irrational apartment layout, and inadequate amenities. The lack of architectural originality will also be a problem. To save cost, buildings in the same residential community, including premium villa community, look exactly the same. People wouldn't care about the lack of originality or beauty when housing was scarce, but since it is not in short supply now, monotonous housing appearance, while unpleasant to the eye, also gives off a sense of inexplicable anxiety.

2.3 Outlook on Future Trend

2.3.1 Residents' Demand for "Housing" Is Replaced by the Demand for "Good Housing", and Housing Price Won't Experience General Collapse

People still have a strong motivation to improve their living conditions and a notable macro inflection point hasn't appeared in population flow, so China won't usher in the age of general housing surplus yet and housing price won't collapse in general.

On the one hand, people's demand for "a place of residence" is replaced by the demand for "a comfortable place of residence", and their desire to improve living conditions is far from being fully satisfied. The per capita housing area in Chinese cities is around 33 m², but most people are not satisfied with their living conditions. Compact apartment buildings remain the main form of urban housing stock, several generations living under one roof remains a common phenomenon, people still have a strong wish to improve their living conditions, and the housing market carries Chinese people's dream for moderate prosperity. Therefore, the housing market in China won't see a demand nosedive in the foreseeable future, but it may go through substantial structural adjustment.

On the other hand, the macro inflection point in population inflow to cities hasn't appeared yet. China is a big country of uneven development, where some people move from small cities to big ones while others move from city centers to suburbs at the same time. The outburst of "big city diseases" will make local rich families loathe the city and create the motivation for suburbanization of big cities, but a lot of people still move from medium and small-sized cities to big ones for high income and high-quality public services, filling the space left by those rich families that moved to the suburb. As some people move to big cities and some move from the city to suburbs, a macro inflection point in population flow doesn't exist at the moment.

2.3.2 Short Supply Is Replaced by Structural Surplus and Structural Adjustment of Housing Price Is Unavoidable

Although Chinese housing market hasn't come to the stage of general surplus, it's in the stage of structural surplus and structural adjustment in the short term is unavoidable. In the national market, housing shortage caused by fast urbanization and high-speed income increase is coming to an end, most cities see housing surplus and the real estate market remains sluggish. In tier-1 and tier-2 cities, the sharp housing price rise in the early stage triggered the launch of a lot of new apartment buildings, so periodic excess supply appeared and housing price dropped without government intervention. To digest the structural housing surplus and periodic excess supply, housing price will experience structural adjustment.

In tier-1 and tier-2 cities where housing price shot up too quickly earlier on, housing price will enter the period of adjustment. There are several direct reasons for that. The first is that drastic housing price rise impairs people's ability of housing payment. The second is that when housing sales recorded eruptive growth in 2013, the demand for owner-occupied housing was largely released and satisfied, so housing demand lacks growth momentum if the purchase restriction policy doesn't change. The third reason is that developers' scramble for land from the end of 2012 to 2013 predicted that housing supply will increase considerably later. In the long

term, rigid housing demand in tier-1 and tier-2 cities may continue to increase, so the short-term adjustment is mainly to address periodic and relative surplus.

Housing market in tier-3 and tier-4 cities will remain bleak and “ghost city” phenomenon may spread. The extensive “new city” campaign in tier-3 and tier-4 cities resulted in a huge housing supply, which, combined with population outflow, made the “ghost city” phenomenon likely to spread. Unlike in tier-1 and tier-2 cities, the rigid housing demand in some tier-3 and tier-4 cities will contract in the long term, so absolute housing surplus is possible.

Chapter 3

Real Estate Finance in China: Evolution and Prospects



Guangchun Gao

3.1 Institutions

After the People's Republic of China (PRC) was founded, it, under the leadership of the CPC, implemented the planned economic system and promoted the welfare housing system, the basic principle for which was distributing housing based on administrative level, and all administrative bodies, public institutions and enterprises established and operated according to the planned system adopted the housing model of centralized construction and distribution. All units, irrespective of their nature, built and distributed housing in a centralized way with capital granted according to the nation's overall plan. Such a housing system had no financial need. Housing finance came into being along with the housing commercialization reform in China, and financial institutions for housing, generally speaking, were created because of this reform when the national government was under tremendous financial pressure. Housing finance has passed several stages in its evolution, from policy-based housing finance to cooperative housing finance and eventually to commercial housing finance, the last one gradually taking a predominant position.

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3.1.1 *Origin and Evolution*

According to mainstream views, China's housing commercialization reform dated back to Deng Xiaoping's talks about housing in 1978, and the reason was that the government could no longer bear the fiscal burden. The reform started on a trial basis in 1978 and was promoted across the country in 1997. There were several ways of housing payment at that time: (1) lump sum cash payment by individuals; (2) payment shared by national finance and individual; (3) payment shared by national or local government finance, workplace and individual. But those payment approaches had several drawbacks. The first was personal affordability. Regarding the lump sum cash payment by individuals, individual income was so low that individuals couldn't afford the housing even though it was sold at cost price. The second was fiscal subsidy. The government was under a heavy fiscal pressure because of the housing subsidy, which reached RMB58.368 billion in 1988, 11 times as much as in 1978 and accounting for 22.55% of the total fiscal revenues (RMB258.782 billion) that year. Because of these drawbacks, the idea of seeking financial support came to the fore.

Lump sum cash payment by individuals; payment shared by national finance and individual; and payment shared by national or local government finance, workplace and individual – these cash payment approaches encountered difficulties such as payment and subsidy feasibility during implementation. After nearly 10 years of hard explorations, the “personal income + fiscal subsidy” approach in support of housing commercialization came to an end, and Chinese governments at all levels began to try housing commercialization with financial support. In the mid- and late 1980s, housing finance in China began to explore diverse ways of supporting the real estate industry, including commercial, cooperative and policy-based financial support, which was called the “exploration of diverse paths”. Later commercial financial support began to take a leading role and was excessively relied upon, which was known as the “predominance of unitary path”.

Beijing Savings Bank, founded in 1908, was the first cooperative financial institution in China before the founding of the PRC, and the first housing financial institution with cooperative features set up after that was Yantai Housing Savings Bank founded in December 1987. According to the *Provisional Methods of Yantai Housing Savings Bank for Housing Saving and Loan* and other information about that bank, it not only engaged in contractual housing deposit/loan business like that undertaken by Germany's housing savings bank, but also in policy-based and commercial deposit/loan business such as housing fund deposit, loan to real estate developers, and housing purchase/construction loan to companies. It also engaged in settlement businesses such as bank draft, commercial bill, cashier's check, check, remittance and settlement and entrusted collection, as well as intermediary businesses such as payroll credit, agent stock trading, public utility fee collection, deposit, entrusted loan, insurance, leasing, and consulting and assessment services focused on real estate business. This shows that Yantai Housing Savings Bank drew on Germany's model of housing savings bank, namely the cooperative finance

model, while having the characteristics of policy-based and commercial finance as well.¹ The Bengbu Housing Savings Bank that was established almost in the same period adopted a similar operation model. Therefore, China explored cooperative housing finance at an early date as it tried to establish the housing finance system.

China's exploration for commercial housing finance started in 1991, when China Construction Bank (CCB) and Industrial and Commercial Bank of China (ICBC) successively set up the Real Estate Credit Department and began to undertake personal mortgage loan business, the former granting RMB4.6 billion personal mortgage loans that year and the latter RMB189 million. However, for various reasons, commercial housing finance, especially finance for commercial housing consumption, developed very slowly before 1998, a year when the total balance of personal mortgage loan of all banks in the country was only RMB19 billion, whereas the balance of real estate development loan that year was RMB202.892 billion. But after 1998, commercial housing finance saw eruptive growth. According to a study report by the People's Bank of China titled *Real Estate Development and Its Financial Support in China*, personal mortgage loan increased by 26.64 times from 1998 to 2003, accounting for 75–97% of personal consumption loan. Meanwhile, housing development loan reached RMB665.735 billion in 2003, 3.2 times as much as in 1998 and the growth rate was notably higher than the general loan increase of all financial institutions in that period.

Policy-based housing finance was believed to grow faster than commercial housing finance, and the most important and influential exploration was the introduction of housing provident fund that is still implemented today. According to the three guiding documents on housing reform continuously issued by the central government, all local governments began to set up the three-layer housing provident fund covering city government, workplace and individual in 1988. Shanghai municipal government took the initiative. On February 19, 1991, the Shanghai Municipal Committee of Institutional Establishment approved to set up the Shanghai Municipal Housing Provident Fund Management Center, which was a public institution with 40 employees, and 10 of them were transferred from the Municipal Housing Reform Office. On May 18 that year, CCB Shanghai Branch was entrusted by Shanghai Municipal Housing Provident Fund Management Center to put together the first housing provident fund, and the system spread across China within several years and became a main policy-based housing financial instrument. According to the *Regulations on Management of Housing Provident Fund* revised in March 2002, the fund would be managed in the following manner: provident fund management committee makes decisions, the management center operates it, banks set up special accounts for it, and national financial regulator implements supervision. Housing provident fund policies are formulated by the construction department in the State Council in conjunction with the financial department and the People's Bank of China (PBC), and policy implementation is also supervised by them. The deposit rate and loan rate of housing provident fund is proposed by PBC and submitted to the State Council

¹Baidu: *Provisional Methods of Yantai Housing Savings Bank for Housing Saving and Loan.*

after soliciting opinions from the construction department. The housing provident fund management center is an independent non-profit public institution directly under the municipal government. Although housing provident fund is a financial instrument, the organization in charge of it isn't a financial institution, and the management center is actually an administrative body of the government.

The exploration for a diversified housing financial system in China matched China's housing reform in which commercial, low-income and mutual-aid housing were developed in parallel, but the housing reform took a drastic changeover after 2003. The diversified housing supply system gradually shifted to a system dominated by commercial housing. Accordingly, the diversified real estate financial system was replaced by an almost unitary housing financial landscape in which commercial housing finance had absolute domination.

First of all, Yantai Housing Savings Bank and Bengbu Housing Savings Bank, the two cooperative housing financial institutions mentioned above, were not specialized (in cooperative housing finance) like housing savings banks in Germany or the US. They had policy-based, cooperative and commercial businesses all at once, which was a disadvantage and also an important reason why they shifted to the unitary commercial model. In August 2003, Yantai Housing Savings Bank came to an end despite the praises that accompanied it all the way, based on which an allegedly brand new national commercial bank was established, namely Hengfeng Bank. Bengbu Housing Savings Bank was closed even earlier when it was merged with Bengbu Urban Credit Cooperative into the Bengbu Urban Commercial Bank, which was a 100% local commercial bank.

But explorations for cooperative housing finance didn't stop. In the beginning of 2004, the Sino-German Bausparkasse (SGB) co-invested by CCB and Bausparkasse Schwäbisch Hall was established in Tianjin, which was said to be a German-style housing savings bank in the real sense, but it deviated from specialized operation over time. At the end of 2013, SGB announced on its website that it was the first and only commercial bank in China integrating the three housing financing businesses of housing savings, commercial mortgage loan and provident fund loan. In the second half of 2014, SGB showed signs of returning to specialized operation.

According to contents of the large symposium in celebration of the 10th Anniversary of Housing Savings in China published on SGB website, the bank had an obvious inclination for "de-commercialization" and "de-policy-orientation" regarding its positioning and operation model. (1) In terms of positioning, SGB defined itself as a professional bank "focusing on housing finance and savings" and serving low- and middle-income residents who bought medium- and small-sized and medium- and low-price housing. (2) In terms of its role as a housing financial institution, SGB could effectively link commercial financing and policy-based financing.² (3) In terms of product positioning, SGB showed obvious features of

²This functional positioning is clearly described in a statement by Wang Hongzhang, chairman of CCB, the Chinese shareholder of Bausparkasse. "On one hand, a large "sandwich class" will face "difficult and expensive housing loan" during urbanization. Tens of millions of rural people will

the German model. “We will make housing saving our main business. Based on the German shareholder’s advanced technology and experience, we will develop basic products with deposit/loan maturity and interest rate that better suit Chinese people’s consuming habits, and customize the ‘housing for all’ savings program to meet the personalized needs of urban residents”.

SGB still doesn’t have a clear positioning 10 years after it was established, indicating that cooperative housing finance hasn’t found its place in the Chinese housing financial system yet.

In the meantime, exploration for policy-based housing finance progressed slowly. On one hand, housing provident fund was severely criticized in implementation. For instance, the system design had inherent defects; its administrative nature resulted in the abuse, embezzlement and inefficient use of capital; its localization made it a tool for interest groups rather than a security fund that it should be; and rules on its collection and use made it hard for those really in need to access the provident fund and made the fund actually inequitable. The improvement and reform of housing provident fund system was in a dilemma. On the other hand, exploration for professional policy-based housing finance just started. Although we could draw reference from the mature systems in developed economies, this system was absent in China for a long time. It wasn’t until July 2014 that the China Development Bank (CDB) was approved to set up the Housing Finance Department, which specialized in the financing for rebuilding rundown urban areas³ and engaged in the following businesses for that purpose: (1) Loan for projects rebuilding rundown city areas included in the national plan and relevant infrastructure construction in cities; (2) Recovery and re-lending of soft loan within the approved quota, which was earmarked for projects rebuilding rundown city areas included in the national plan and relevant infrastructure construction in cities. That marked the first small step in China’s efforts to establish policy-based housing financial institutions, but the goal of establishing a systematic policy-based housing financial system was a long way off.

While neither cooperative nor policy-based housing finance developed very well, commercial housing finance developed rapidly in China, and main commercial banks all made it a main business. In the credit mix, housing related loans (including development loan and mortgage loan) took up a large proportion in most key commercial banks, and housing loan balance and increment both made up more than 25% for many years. The combination of development loan and mortgage loan accounted for more than 40% of real estate developers’ capital.

move to cities, most of whom don’t have bank credit, so it will be hard for them to obtain mortgage loan from commercial banks, and they have no housing provident fund. Housing savings can fill that gap. On the other hand, housing savings can connect with low-income housing finance on the supply side. To be more specific, state developmental financial institutions will support the construction of low-income housing by providing construction capital. Housing savings help low- and middle-income families to make independent housing purchase plan, facilitate the payback of low-income housing investment, effectively balance housing supply and demand, and promote a benign capital circulation for the housing security system”.

³Reply of CBRC on Setting up the Housing Finance Department in China Development Bank (YJF [2014] No.498).

In sum, housing financial institutions in China shifted from a diversified to a unitary landscape in the process of evolution. In the credit financing of real estate developers and personal mortgage loans, commercial credit made up over 80% whereas policy-based and cooperative housing loan accounted for less than 20%.

3.1.2 Main Problems

The uneven structure of housing financial institutions led to insufficient housing finance for low- and middle-income group. The characteristics of the “dominance of unitary path” reflected the uneven structure of housing financial institutions in China. It’s true that in the past year, policy-based and cooperative housing financial institutions made progress after long years of stagnation, but that wasn’t enough to shake the absolute dominance of commercial housing financial institutions, or to provide effective financing support for housing construction for and consumption by low- and middle-income group. An important consequence of such a structure was that in the process of meeting the financing demand for housing consumption, especially that of low- and middle-income group, administrative approach was usually adopted to make commercial financial institutions support their financing needs with favorable interest rate and low down payment, but those institutions were reluctant to do this because of the lack of corresponding policy-based credit guarantee. As a result, housing credit measures targeting low- and middle-income group such as favorable interest rate and low down payment could not sustain, and favorable credit policies were either poorly implemented or simply cancelled for various reasons. Therefore, given the uneven structure of housing financial institutions, making commercial institutions serve the public product function of offering favorable interest rate and low down payment couldn’t effectively meet the diversified housing financing needs, especially that of low- and middle-income group.

Commercial financial institutions faced pressure in reducing the weighting of housing loan. As mentioned above, partly as a result of the dominance of unitary path commercial financial institutions granted too much of their credit to real estate, but the “new normal” economic growth in the past 2 years required the reduction of housing loan weighting. Some observable indicators show that real estate credit in 2014 indicated a declining trend. For instance, real estate development loan lagged behind loan for non-financial enterprises in increment and growth rate, but the pressure of structural adjustment was still huge. A lot of indicators, such as growth rate of sectoral loan balance, industrial loan balance and increment’s weighting, and weighting of housing loan in the financial institutions’ loan mix, all indicated that financial institutions moved very slowly in granting more credit to non-real-estate sectors, and a heavy pressure remained in reducing the weighting of real estate credit.

Quality of housing loan was worrisome. Based on NPL (non-performing loan) ratio, real estate loans were of better quality than the general loans granted by financial institutions, so they were good for improving the general loan quality.

But other real estate loan indicators were troubling. One was loan concentration risk. Nearly 90% of real estate loan was concentrated in commercial financial institutions, which obviously caused real estate loan concentration risks for them. The second one was default risk. Because of the continuous housing price hike in the past decade and more, repayment of real estate loan didn't seem a problem, but it will be under growing pressure with dropping housing price and default risk will increase. Although continuous housing price decrease doesn't seem likely for the moment due to a variety of factors, China will have to face it and the subsequent housing loan default sooner or later. The third indicator was the housing loan yield risk amid interest rate marketization. Experience from mature economies shows that interest rate marketization and fluctuation or even loss in housing loans are usually coexistent. China has taken faster steps in interest rate marketization in recent years, which naturally imposed pressure on housing loan yield expectation.

3.1.3 Outlook

In the economic “new normal” of structural adjustment, real estate industry doesn't occupy a position as important as before but remains a key force for stabilizing growth. Therefore, “stability” will be its basic characteristic in the next 5–10 years, and minor fluctuation will likely be its usual state. It can be inferred that the evolution of real estate financial institutions will display the following features: structural adjustment will become obvious and housing loan preference will decline. The most obvious reflection of structural adjustment is the possibility of a low-income housing financial system, and commercial housing financial institutions will try harder to reduce the housing loan percentage in its credit portfolio, which means real estate credit will keep flowing to non-real-estate sectors, either in terms of balance or increment.

Low-income housing financial institutions become systematic. First of all, financial institutions specializing in low-income housing will be established. With CDB setting up the Housing Finance Department as an opportunity, value added from the housing provident fund, net profits from land grant fee and capital from other channels will be further integrated to form policy-based financial platforms that support the construction of low-income housing. Meanwhile, as CDB's Housing Finance Department also serves the function of financing major infrastructure projects, which means the possible risk of squeezing out low-income housing financing, so this function might be transferred to CDB, and the Housing Finance Department could focus on policy-based financial support for low-income housing.

Second, financing institutions targeting the demand for indemnificatory housing will be established, a goal that will probably be realized by restructuring the housing provident fund. On one hand, the existing provident fund management system will be restructured to abolish “local coffers” and form a unified national provident fund management and operation platform. On the other hand, the current administrative management platform will be replaced by a financial management platform. A China

Housing Provident Fund Bank will be formed to carry out professional management and operation of the fund. Besides, the model and procedures of provident fund payment and use for people in the lower-middle and lower income range will be improved to enable provident fund to truly perform its security function.

At last, to encourage commercial financial resources to support the construction and consumption of low-income housing, policy-based credit reference organizations will be formed, such as policy-based financial institutions engaged in the guarantee, warranty and insurance for low-income housing financing.

Financial institutions' preference for real estate credit will keep weakening. There are several reasons for this. (1) Regarding housing system design, real estate will no longer be considered a pillar industry for national economy. In other words, real estate development will no longer be measured by GDP but by its contribution to people's livelihood, and this change will push financial institutions to channel their loan to non-real-estate sectors. (2) The future taxation system reform will change the asymmetry between local governments' authority and responsibility so that they will no longer rely on land finance. Against such a trend, commercial banks will lower their expectation for real estate profitability and consequently reduce the weighting of real estate credit. (3) The new normal will keep driving the economic restructuring and the change of economic growth model, and weaken real estate's role in economic growth. This will effectively guide financial institutions to grant loans to innovative industries with higher value added.

3.2 Market

3.2.1 History

This paper will analyze the formation and evolution of the housing finance market from two perspectives – the structure of housing finance market, namely the structure of credit (indirect financing) market and capital (direct financing) market; and real estate capital market.

The evolution of the structure of real estate finance market. Similar to the history of real estate finance institutions, the real estate finance market also started with exploration for diversified paths but a unitary path eventually became dominant. Almost at the same time in the early 1990s, both the credit market and capital market were opened to real estate industry. In 1991, CCB and ICBC successively set up the Real Estate Credit Department to handle personal mortgage loan business. Real estate companies entered the capital market for listing and financing a little earlier. In 1990, Century Garden became the first real estate company that had an IPO, followed by Vanke and Gettel in 1991 and 1992. The establishment of China's housing finance market started with diversified financing, but later real estate financing in the capital market was of a much smaller scale than that in the credit

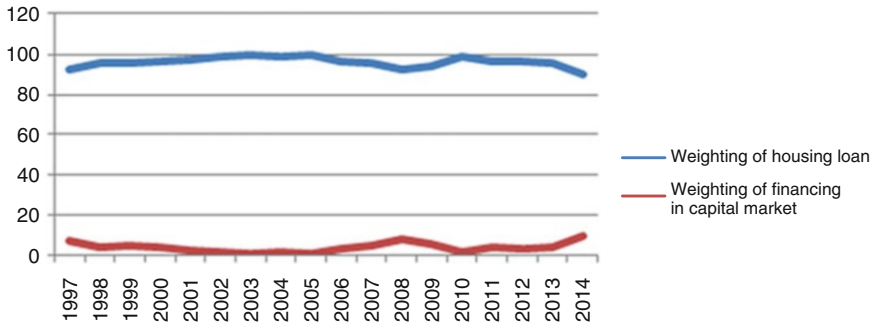


Fig. 3.1 Structure of housing finance market (%). (Source: organized based on information from China Real Estate Information website and Wind)

market, so a real estate financing landscape took shape in which indirect (credit) financing was absolutely dominant (Fig. 3.1⁴).

The evolution of real estate capital market. In the early 1990s, Century Garden, Vanke and Gettel were among the first real estate companies that benefited from China's stock market and also the first that benefited from the reform and opening-up of Chinese financial market. But the good beginning didn't lead to the steady and sustained development of this market, which, instead, went through constant ups and downs, a process that could be roughly divided into the following periods.

1991–1993: the first IPO boom for Chinese real estate companies. Because of the political turmoil in 1989, China's reform and opening-up drive that started at the end of the 1970s went through a serious setback in 1990–1991, during which Chinese economy slowed down quickly and Chinese people were once again standing at a crossroad. In 1992, Deng Xiaoping, the chief designer of China's reform and opening-up, gave the famous Southern Tour Speeches that rekindled the flame of reform and opening-up across China. Chinese economy quickly picked up speed with the real estate industry being a torch bearer. Within several years, a lot of real estate companies entered the capital market through listing, amounting to nearly 30 at the end of 1993, and their performance reached a peak. In 1993, the average earning per share (EPS) of those companies was RMB0.79, and the stock price of most of them exceeded RMB30 thanks to investors' enthusiasm, the stock price of Gettel at Shenzhen Stock Exchange even reaching the record RMB86.19 per share.

⁴The Chinese economy became overly reliant on real estate after 2003. The *Blue Book of China's Economy* issued by the Chinese Academy of Social Sciences (CASS) in 2010 revealed that of the 20 industries categorized by the Shenzhen and Shanghai stock markets, 18 of them, except real estate and finance and insurance, had companies engaged in real estate business. Among them, 802 listed companies (including real estate ones) were directly involved in real estate by means of equity investment and association, accounting for 60.53% of the over 1300 A-share companies listed in Shenzhen and Shanghai. Some expert called this phenomenon the comprehensive reliance on real estate of Chinese economy. Some companies that went public before 2003 were categorized in the real estate industry because of their involvement in it. Therefore, statistics show that there were real estate IPOs in 1996 and 1997.

But the fast development of real estate soon led to economic overheating in China, so decision makers began to adopt cooling-off measures in 1994, and real estate companies' development investment growth dropped drastically to 31.8%. However, more real estate companies continued to go public, including eight in 1994, accounting for 8% of all listings that year.

1996–1998: the first blow to the listing of Chinese real estate companies. The wild growth of real estate companies quickly increased China's GDP but also caused its overheating. Decision makers started taking measures in 1994 to rein in the rampant real estate industry, making it clear that listing of real estate companies was not encouraged. In 1995, the government issued an explicit decree that IPO applications aimed to raise money to build villa-like premium residences, resorts, premium apartment buildings, office buildings and more-than-4-star-rated hotels and restaurants would not be approved. More drastic measures were adopted in 1996 and 1997, when China Securities Regulatory Commission (CSRC) issued continuous notices that IPO applications from real estate companies wouldn't be dealt with for the moment.⁵ Furthermore, the central bank launched the appropriately tight monetary policy in 1997 and made real estate industry a key target of regulation. The series of policies and rules put real estate development investment almost on hold, and real estate industry was at a low tide in general, having its first negative growth in 1997 since the early 1990s. Listed real estate companies also suffered falling performance. The annual report in 1998 showed that the EPSWA of the whole industry was RMB-0.09 and ROE was -4.08%, a poor performance in the stock market. In the same period, the EPSWA of companies listed at Shenzhen and Shanghai stock exchanges was RMB0.20 and ROE was 7.97%. GDP slid too in that period, registering continuous negative YoY growth from 1994 and down by six percentage points accumulatively in 1998.

1999-January 2010: real estate financing in the capital market became a common phenomenon. Under the dual pressure of China's sustained deflation and the Southeast Asian economic crisis in 1998, the importance of real estate industry was recognized again, and the Chinese government took it as the new growth point of national economy for the first time. The "freeze" on the listing of real estate companies began to thaw in 1999, when Chinese government allowed leading ones to go public on a trial basis, but this did not become a reality until almost 2 years later. In early 2001, Beijing Tianhong Group was the first Chinese real estate company to return to the capital market through IPO.

In the next decade or so, Chinese economy and real estate industry had a meandering journey with major fluctuations in 2007–2009 particularly, but the real estate capital market, especially IPO, never had a "freezing" again, and real estate financing in the capital market became a common phenomenon (Table 3.1).

February 2010: IPO freezing again, bond financing heated up. In 2009, both housing price and land price in China shot up crazily, average housing price in the

⁵*Notice on Several Provisions Concerning Stock Issuance* by CSRC in 1996 and *Notice on Stock Issuance Work* in 1997.

Table 3.1 Real estate financing in the capital market (2001–2009)

	Number of real estate companies raising money in the capital market (including IPO, follow-on offering, share placement, debt-to-equity and bond issuance)	Scale (RMB100 million)
2001	16	76.16
2002	11	65.13
2003	8	42.83
2004	9	62.96
2005	4	55.53
2006	24	306.35
2007	42	575.23
2008	27	948.84
2009	67	1259.89

Source: Wind

Table 3.2 Real estate financing in the capital market (2010–2014)

	Number of real estate company	IPO	Follow-on offering	Share placement	Bond issuance	Convertible bond	% (bond issuance)
2010	23	1	3	0	19	0	82.61
2011	43	0	8	0	35	0	81.40
2012	70	0	3	0	67	0	95.71
2013	103	0	1	0	102	0	99.03
2014	362	0	21	0	340	1	93.93

Source: Wind

country increased by more than 20%, and top land bidders appeared one after another. While the real estate stock market, especially IPO and share placement, had a severe recession, bond financing for real estate companies kept heating up, which accounted for nearly 90% of real estate financing in the capital market in 2010–2014 and almost 100% in 2013 (Table 3.2).

3.2.2 Main Problems

Real estate financing is too concentrated in the indirect financing market. As mentioned above, the housing finance market went through a process from diversified structure to unitary dominance, the outcome of which was that real estate financing was too concentrated in the indirect financing market (Fig. 3.1). This will increase the asset risks of indirect financial institutions, especially those of banks, and is bad for banking financial institutions to create a sound asset-liability structure and for the stability of the financial system.

Risks in housing finance market are worrisome. First of all, the high concentration of real estate financing market put mounting pressure on the maturity and risk mix management of relevant financial institutions' assets/liabilities. Second, the maturity mismatch in personal mortgage loan posed risks. The current balance of personal mortgage loan is close to RMB10 trillion, and most of the corresponding deposits have mismatched maturity, leading to the maturity mismatch risk and eventually interest rate risk. China has moved faster to promote interest rate marketization in recent years, and the subsequent risk that mortgage loan cost cannot be covered by asset yields is called interest rate risk.

3.2.3 Outlook

Direct financing will take a larger proportion in real estate financing. There are several ways to do this. One is that real estate financing in the capital market will keep increasing, first and foremost the weighting of real estate stocks and debt financing. The second is securitizing the real estate credit assets. The third is increasing the weighting of real estate investment fund.

Real estate financing risks will be solved through multiple means. (1) The high concentration of real estate financing structure will be diluted through direct financing and securitization. (2) Effective economic restructuring can promote the restructuring of banks' credit mix and lower their preference for housing loan, thus reducing the proportion of real estate credit in real estate financing structure. (3) The interest rate risk of real estate loan will be mitigated through asset securitization of personal mortgage loan.

3.3 Policies

This chapter will look at housing finance policies from a functional perspective. Housing fundamentally has two functions – commercial and security, the former meaning that the demand for housing consumption, investment or speculation is satisfied through the market; and the latter meaning housing consumption demand is satisfied through policies. Correspondingly, housing finance policies based on the commercial function are those that regulate the supply and demand of commercial housing financing, while housing finance policies based on security function are those that regulate the demand for low-income housing financing. An effective policy system can balance the demand for commercial housing financing and that for low-income housing financing. The evolution of China's housing finance policies can be divided into three stages. The first stage, from the early 1990s to 2003, was focused on meeting diversified housing financing needs; the second stage, from the No.18 Document in 2003 to 2008, was mostly regulating the commercial

housing financing needs; and the third stage, since 2008, featured the re-emphasis on and re-establishment of low-income housing financing policies.

3.3.1 Evolution History

Early 1990s–2003: policy regulation aimed to meet diversified housing financing needs. These policies were based on the housing system reform aimed to meet housing consumption demand. Many people agreed that the curtain on China's housing system reform was lifted in 1980 by Deng Xiaoping, the chief designer of China's reform and opening-up, when he talked about the position of construction industry and the housing policies. Based on relevant documents in the 1980s and the early 1990s, the goal of housing reform was to meet the diversified housing needs. There were two representative documents. The first was the *Notice of the State Council on Continuing the Reform of Urban Housing System Actively and Prudently* (GF [1991] No.30), in which article 4 stated that “the system of joint investment in housing construction by the country, collectives and individuals should be promoted, housing construction based on fund raising and cooperation should be actively organized, affordable commercial housing should be strongly boosted, and housing should be provided first and foremost to those without it or living in poor conditions. Governments at all levels should provide support in terms of land use, planning, materials, credit and tax. Planning and land use management of self-built housing by individuals should be enhanced. Abuse of official power for personal gains is prohibited and anyone in violation will be investigated and severely dealt with.” The second document was the *Decision of the State Council on Deepening the Reform of Urban Housing System* (GF [1994] No.43), which clearly stated the goal of housing reform was “to establish the affordable housing supply system with the nature of social security targeting low- and middle-income families and the commercial housing supply system targeting high-income families”. The document also stipulated that “we will establish the housing provident fund system, develop housing finance and insurance, and set up a housing credit system comprised of both policy-based and commercial credit.”

Housing finance policies in that period were also diversified, and regulations on commercial and low-income housing financial policies were put forth in almost the same period of the 1990s. Regarding low-income housing financial policy, the *Notice of the State Council on Continuing the Reform of Urban Housing System Actively and Prudently* (GF [1991] No.30) stipulated that “housing capital should be raised in multiple forms and through multiple channels. Governments at all levels should well transfer housing capital and set up a housing fund. Capital obtained by workplaces by selling public housing should be deposited in financial institutions designated by the local government as housing fund. Its right of use will not change, and it will be used for housing construction and repair only”. The *Decision of the State Council on Deepening the Reform of Urban Housing System* (GF [1994] No.43) explicitly stated that “housing provident fund system will be implemented

comprehensively” and laid down specific provisions regarding the nature, payment, management and use of the fund.

Almost in the same period, specific provisions were set down on real estate development loan and personal mortgage loan. Article 6 of the *Notice of the State Council on Continuing the Reform of Urban Housing System Actively and Prudently* (GF [1991] No.30) stated that “housing finance and deposit and loan business for personal housing purchase and consumption will be developed. The system of housing mortgage will be implemented, and measures will be taken in terms of deposit/loan interest rate and repayment term to encourage employees to buy housing or participate in collective housing construction.” Article 8 of the *Notice of the State Council on Several Issues Concerning Real Estate Development* (GF [1992] No.61) stated that “special banks are allowed to grant real estate development loans. Banks’ loan scale and bond issuance quota should be listed in their credit, securities and investment plans to control the aggregate.”

Other documents in that period also contained contents concerning cooperative housing finance and real estate financing in the capital market.

This shows that in the early stage, diversified housing finance policies were implemented in parallel, including commercial, policy-based and cooperative ones.

3.3.1.1 No.18 Document in 2003–2008: Commercial Housing Financing Demand Was Regulated

The *Notice of the State Council on Promoting the Sustained and Healthy Development of Real Estate Market* (No.18 document of the State Council) issued in 2003 clearly states that real estate is a pillar industry of the national economy. While according to *Notice of the State Council on Further Deepening the Reform of Urban Housing System and Accelerating Housing Construction* (No.23 document) released in 1998 affordable housing was to dominate housing supply, the new document calls for meeting the country’s housing needs mostly through the “guaranteed supply of policy-backed commercial housing”. This change played a significant role in causing over-commercialization in China’s housing reform and development.

As such, an imbalance in the relationship between the commercial and security functions of housing finance policies emerged and worsened over time, with the commercial function overwhelming the security one. This was mainly reflected in two aspects.

First, differentiated loan policy, which was issued in 2003 and intended to effectively balance the security and commercial functions, existed in name only in certain periods. In June 2003, the PBC issued the *Notice on Further Intensifying Real Estate Credit Management*, which stipulated that the minimal down payment for the first owner-occupied apartment was 20% and interest rate for mortgage loan was reduced by 10%, but for borrowers who bought premium commercial housing, villa or second (or more) homes, the down payment ratio should be properly raised and the loan interest rate published by the PBC in the same period and on the same level should be implemented instead of the favorable rate. In September 2007, PBC

and China Banking Regulatory Commission (CBRC) jointly issued the *Notice on Intensifying Commercial Real Estate Credit Management*, which stipulated that for the first owner-occupied housing with the construction area of less than 90 m², down payment should be no less than 20%; for the first owner-occupied housing with the construction area of more than 90 m², down payment should be no less than 30%; for those who already bought a house on loan and applied to buy a second (or more) homes, down payment should be no less than 40% and loan rate should be no less than 1.1 times the base rate in the same period and on the same level published by PBC. But the differentiated housing loan policy usually failed against special background. When the local government took real estate as a means to stabilizing GDP, the policy was basically abandoned. A typical example was that to cope with the sub-prime crisis originating in the US, the Chinese government actually abandoned the requirements on down payment and loan rate for buying second (or more) homes at the end of 2008.

Second, the upper limit on monthly payment of personal mortgage loan was 50%. According to international practices, the appropriate monthly payment of personal mortgage loan is 30% of the buyer's monthly income. If the percentage is higher, the buyer is under payment pressure; if the percentage reaches 50%, the buyer is under a lot of pressure. But the *Notice on Intensifying Commercial Real Estate Credit Management* (YF [2007] No.359) stated that "the borrower's monthly payment of mortgage loan should be no more than 50% of his/her monthly income." Such a provision was obviously based on commercial considerations.

2008-present: re-emphasis on and re-establishment of security housing financing policies. Relevant documents show that the Chinese government issued some security housing financing policies from 2003 to 2007, but they were very weak both in form and in effect due to the excessive commercialization of real estate industry and the strong commercial financing policies. Therefore, starting from 2008, the Chinese government began to issue stronger security financing policies and worked hard on their implementation.

(1) Step up the construction of low-income housing and broaden the capital sources for them. *Several Opinions on Promoting the Healthy Development of Real Estate Market* (GBF [2008] No.131) stated that efforts would be made to basically solve the housing problem for low-income urban families and rebuild rundown urban areas within 3 years. Housing provident fund would be used for housing construction on a trial basis in some eligible areas, which meant part of the idle local provident fund would be used to build affordable housing and other housing types on the premise of ensuring capital safety. The Ministry of Housing and Urban-Rural Development (MOHURD) was demanded to work out the trial plan in conjunction with relevant departments. (2) Issue special documents on rebuilding rundown urban areas and set up special financing organizations. *Guiding Opinions on Promoting the Renovation of Rundown Areas in Cities and State-owned Industrial and Mining Areas* (JB [2009] No.295) stipulated that "capital should be raised through multiple channels, including fiscal subsidy, bank loan, corporate support, crowd funding and market financing". In July 2014, CDB was approved to set up the Housing Finance Department to provide professional financing support

for rebuilding rundown urban areas. (3) Greater efforts were made to implement differentiated loan policy, which were mainly reflected by relevant policies issued in 2010. First, the policy on dynamic and differentiated housing loan was launched in mid-April, which included the following contents: for the first owner-occupied housing with the construction area of more than 90 m², down payment should be no less than 30%; for buying a second home on loan, down payment should be no less than 50% and loan rate no less than 1.1 times the base rate; for the third or more homes on loan, down payment and loan rate should be raised considerably. Then a new policy, commonly known as “second regulation”, was launched at the end of September to improve the policy in April. It mainly included the following contents: commercial banks should stop granting housing loan to families for buying the third or more homes and to non-local residents who couldn’t provide the certificate of more-than-1-year local tax payment or social insurance payment. Down payment for commercial housing on loan was raised to 30% and above, and for families that bought a second home on loan, the policy about 50% down payment and 1.1 times of the base rate should be strictly implemented. All commercial banks should strengthen the management of consumption loan and prohibit it from being used for housing purchase. Those that didn’t implement the differentiated loan policy strictly would be seriously dealt with. Real estate developers’ loan demand for undertaking medium- and low-price and medium- and small-size commercial housing projects and participating in low-income housing projects should be supported.

The re-emphasis and promotion of low-income housing financial policies since 2008 has in a way restored the balance with commercial financial policies.

3.3.2 Main Problems

Systematic security financial policies haven’t been established. (1) Professional policy-based financial platform for low-income housing construction is absent. (2) Professional policy-based financial platform for housing consumption is absent. (3) A credit reference system for the financing of low-income housing construction and consumption is absent.

The current housing provident fund policy can hardly serve the security function. The *Regulations on Management of Housing Provident Fund* revised in 2002 stipulated that the fund served all urban employees who paid housing provident fund, but practices show that high-income group who were better able to buy housing actually had easier access to the fund, whereas the 40% lower-middle-income group, rather-low-income group and low-income group could hardly obtain it.⁶ This indicates that the biggest defect of housing provident fund is the absence of security function or the loss of this function during implementation.

⁶The National Bureau of Statistics divides the income groups into the low-income group (including those with sustenance difficulty), lower-income group, lower-middle-income group, middle-income group, upper-middle-income group, higher-income group and high-income group.

3.3.3 Outlook

Future housing finance policies will focus on re-establishing policy-based housing financial resources and management and operation models and setting up a system of low-income housing financial policies. (1) CDB's setup of the Housing Finance Department will be taken as an opportunity to further integrate value added from the housing provident fund, net profits from land grant fee and capital from other channels, and build policy-based financial platforms to support low-income housing construction. (2) The housing provident fund management and operation model will be revolutionized to break through the restrictions imposed by interest groups, and a China Housing Provident Fund Bank will be formed to carry out professional management and operation of the fund. (3) A credit improvement mechanism for commercial loan will be established.

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Chapter 4

Housing Security in China: History and Future Trend



Xuemei Jiang

With the social development and the progress of human civilization, the issue of housing for disadvantaged groups has evolved from the level of poverty alleviation to that of social security, and housing right has become a basic right for urban residents and a human right that draws international attention. At the International Symposium on Housing and Urban Issues held in London in April 1981, the Declaration on Housing Right was passed that stated that “it is a basic human right for all residents to enjoy a pleasant environment and livable residence”.

The housing security system has developed and evolved constantly along with social changes. A multi-layered security system has taken shape, and the focus of housing security policies has shifted to fostering and improving a system that improves the paying capability of low- and middle-income groups. The old model that the government built housing and rented it at low price is replaced by the model that residents buy housing on installment payment while the government provides rent subsidy and favorable financial and tax policies. In this process, the government plays the dual role of a participant and a regulator, and the regulatory role gradually becomes dominant as the security system is improved.

4.1 Evolution of Housing Security System in China

From the establishment of the People’s Republic of China to the present day, the urban housing system in China has roughly gone through the following four periods.

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4.1.1 The First Period (1949–1978): Welfare Housing Was Distributed at Low Rent

After the People's Republic of China was founded, it implemented the low-rent public housing system. Before the reform began, China was a society of highly planned economy, in which housing was distributed as a kind of benefit and the government, enterprises and public institutions invested in urban housing construction in a centralized manner. In 1949, the central government issued the *Decision on Implementing Centralized Management of Public Housing and Assets*, which defined urban housing as publicly owned and under centralized management. Later the land reform movement was launched, whereby the CPC and the government took over a large amount of housing left by the old government and foreign powers, and renovated the private housing previously owned by land owners and bureaucratic capitalists, which constituted the earliest public housing in China (Liu 2009). However, as the housing was publicly owned and China implemented a strict planned economy, they were not available in the market, so government investment was the only way of new housing development and construction. At that time, housing was an indispensable living material, and the investment in its development and construction either came from government finance or the welfare fund of enterprises and public institutions.

Under the philosophy of “production before consumption”, housing production and supply was in serious shortage. Regarding housing supply, the welfare housing distribution in the period of planned economy was arranged under national finance in a centralized way. Welfare housing was built by many employers with government fund and its distribution had to be approved by the government as well. Since housing construction was categorized as non-productive construction (urban construction includes productive and non-productive construction), China invested RMB37.4 billion in housing construction accumulatively in the almost 30 years from 1949 to 1978, averaging less than RMB10 per person per year, and 530 million square meters of housing was built in that period. In 1978, the per capita construction area was 6.7 m², 0.9 m² less than in 1949, and 8.69 million households didn't have housing, accounting for 47.5% of the total urban households at that time (Ma 1995).

Regarding the distribution of public housing, employees on different levels were entitled to public housing of different standards. Welfare housing was a basic benefit granted by the government and enterprises to employees given the low salary in the planned economic system, and its purpose was not solving employees' housing difficulties. Welfare housing was distributed only to employees and the recipients and order of housing selection were determined based on conditions such as title, position and years of work, while families' housing difficulty wasn't a main consideration. Besides, the criteria for welfare housing distribution were not unified but varied largely from industry to industry and from one employer to another.

The operation and management cost of public housing was high and couldn't be covered by the rent income. Rent on welfare housing was determined and adjusted by the government without considerations for such factors as housing location, construction standards, floor and the direction a building faces or the income difference among individuals and families. Self-managed housing (owned by the employer) and directly managed housing (owned by the housing authority) took up 80% of all public housing, and public housing rent took up only 1% of personal salary. All these resulted in the serious shortage in housing repair capital and the vicious cycle in public housing operation.

Under such circumstances, housing demand was suppressed. For a very long time after the People's Republic of China was founded, housing for urban residents was completely distributed according to centralized government plan, and everyone had to wait for it to be distributed by the government or employer. Once they lived in public housing, the recipients only had to pay very little rent to live in it indefinitely and could even pass it on to their children and grandchildren.

Welfare housing distribution was an inevitable outcome of the socialist public ownership and a planned economy implemented in China. Such a housing security system basically ensured housing for all urban employees, but it had the following problems:

First, centralized housing investment resulted in national financial strain. Under the welfare housing system, most of the housing fund, from construction to maintenance, was allocated from national finance (usually more than 90% and the rest was raised by the employer), putting a huge burden on it. Public housing, as immovable property, became a heavy burden on the country (Ma 1995).

Second, low distribution efficiency couldn't effectively meet residents' housing demand. In the highly centralized planned economic system, private investment couldn't access the real estate sector and public housing operation was in a vicious cycle, so no more public housing could be supplied, but residents had no other choice but to wait until units of housing became available.

Third, there was no legislation for the housing security system, and unequal housing distribution for urban residents could lead to power rent seeking and corruption. Employers of different nature and position had different degrees of occupation and control of resources, thus leading to unequal housing distribution among them. According to a questionnaire survey of 1000 households in Beijing conducted by China's social survey system in 1988, housing distribution varied greatly between employers owned by the whole people and those of collective ownership, the former with a per capita usable area of 6.75 m² and the latter 5.65 m².

In the period of welfare housing distribution, there was too little housing but too many employees. The biggest drawback of this system was that it provided benefits for a small number of people, which implied serious inequality and dampened employees' enthusiasm. Since the "benefit" was reflected through housing, those

who got it had the benefit whereas those who didn't lost the benefit. This created the space for people who were responsible for housing distribution to seek personal gains and consequently resulted in corruption and serious inequality in the process.

The welfare housing system in China before the reform and the housing benefit in western countries were both secondary distribution of "counter-market" nature, so they both carried the "non-capitalist" or "socialist" elements but with drastic differences. In China, most farmers and employees engaged in secondary light industry were not entitled to welfare housing, and the commitment to providing housing for employees in large- and medium-sized state-owned enterprises (SOE) was mostly not honored. The real beneficiaries of the welfare housing system were Party, political, military and educational personnel. The housing system in European and American countries followed the principle of "ensuring housing for the disadvantaged and prioritizing those most in need" whereas the principle in China was "guaranteeing housing for the advantaged and prioritizing those on top".

Fourth, the system seriously impeded corporate development. Enterprises had to build, buy and distribute housing and were also responsible for their management and repair. This impaired SOE's capability to compete with enterprises of other ownership and impeded their development.

Besides, the land tenure system then was another important reason for the housing problem. Land transaction of any kind was prohibited at that time according to the old Constitution.

4.1.2 The Second Period (1979–1997): Market-Oriented Institutional Reform

The conflict between housing demand and supply became sharper because of the drawbacks of two welfare housing system, which was worsened by the massive return of educated youths from the countryside to cities in 1979. Therefore, the reform of housing system was put on the agenda, especially housing construction and supply. The central government began to make great efforts in 1978 to solve the housing problem for urban residents. In August that year, a central meeting on urban housing construction was held, at which Vice Premier Gu Mu passed on Deng Xiaoping's instructions on that issue, namely the problem could be solved through multiple approaches, including allowing individuals to build housing via installment payment with or without public aid. This lifted the curtain on China's urban housing system reform and initially pointed out the direction for it.

Self-built housing was encouraged: to promote the sales of public housing and private housing construction to main cities around China, Deng Xiaoping pointed out in April 1980 that urban residents could buy or build housing, both new and old housing could be sold, and buyers could make lump-sum payment or 10-year or 15-year installment payments.

In June 1980, the State Council approved and forwarded part 7 of the *Outline of the Report to National Capital Construction Meeting* drafted by the National Construction Committee Party Group, which called for efforts to accelerate urban housing construction, allowed employees to build or buy and possess their own housing, and officially announced to implement housing commercialization policies, lifting the curtain on China's urban housing system reform. There were mainly four ways of private housing construction. (1) Individuals built housing with public aid. (This meant individuals were responsible for part of the capital and materials and the housing bureau or enterprise provided some capital for the construction or renovation of the original residence. Or the government allocated land in a centralized way and unified the design, and individuals raised money to build their own housing according to the plan. The government was responsible for the expenses on land requisition and public facilities and the individuals' employer provided assistance). (2) The authority built housing with private aid. (This meant those who lived in public housing helped the housing authority to renovate or expand the public housing they lived in by providing part of the capital and labor force required, which would be calculated to offset the rent. Or the housing authority collected money from residents to build new housing and then prioritized the investors when distributing it). But the property right of such housing belonged to the government. (The investment by residents would be refunded within several years or used to offset rent). (3) Individuals built housing through mutual help, (meaning with the help of relatives and friends). (4) Individuals built housing with self-raised money.

In 1983, the State Council issued the *Regulations on Private Urban Housing*, which encouraged urban residents to build housing themselves and advocated housing construction through capital raising and cooperation.

Public housing sold at full price or with subsidy: in 1979, the State Administration of Urban Construction earmarked funds from the national subsidy for housing construction to Shaanxi and Guangxi to build housing in such cities as Xi'an, Nanning, Liuzhou, Guilin and Wuzhou and then sell them to private buyers at the full price of RMB120-150/m² on a trial basis. There weren't many buyers due to the low salary, low rent and the absence of related home sale policies back then.

In 1980, Deng Xiaoping outlined the framework of housing system reform, namely urban residents could buy public housing and private real estate development should play the central role. In April 1982, the State Council approved on principle the *Report on the Symposium of Trial Home Sale* submitted by the National Construction Committee and State Administration of Urban Construction, and decided to try this work in the four cities of Changzhou, Zhengzhou, Shashi and Siping. This time urban housing was sold with subsidy instead of being distributed. By early 1984, 12,140 apartments were sold with subsidy in the four cities, totaling the construction area of 114,500 m² and investment of RMB16.4 million. About 30% of the investment was recovered and there was more demand than supply.

As the State Council approved the *Report on the Symposium of Trial Housing Sale*, the sale of newly built housing at cost price basically stopped, and the policy of subsidized home sale was implemented on a trial basis. This meant that the government, employer and private buyer were each responsible for one-third of the housing

price that was determined based on the civil engineering cost. It was provided that construction cost of public facilities, construction tax and energy and transport fee shouldn't be included in the cost, so the housing price was RMB150-200/m², and the part borne by private buyers was only twice as much as the annual family income.

However, as the old system of public housing rent wasn't abolished and the salary system wasn't reformed, the rent-price ratio wasn't reasonable, individuals had no motivation to buy housing and housing construction fund wasn't circular. Therefore, the subsidized sale of public housing was called off in 1985, and housing reform shifted to the study and design of renting system reform.

Subsidized rent increase: the reform of salary system was launched in 1985, and the government began to reform the low-rent housing approach in 1986 and implement the policy of subsidized rent increase on a trial basis. In 1986, the State Council set up the Leading Group of Housing System Reform and its office, which met for the first time on July 25 that year to discuss the reform plan. At that meeting, it was decided that the focus of housing reform for a certain period to come was gradually increasing the rent (first to cost level and then to commercial level), and the contents of the reform included housing supply, distribution and consumption. Cities including Yantai, Tangshan, Bengbu, Changzhou, Jiangmen and Shenyang were selected as pilot cities to carry out the reform, which was referred to as "subsidized rent increase, rent + sale, promoting sale with renting and auxiliary reform measures", before it was promoted nationwide. The monthly rent was raised from RMB 0.07-0.08/m² to more than RMB1/m², which was equivalent to 70-80% of the cost (comprising the five items of repair fee, management fee, depreciation fee, investment interest and housing property tax). Public housing was sold at the standard price that included construction cost, land requisition cost and compensation for demolition. The Shenyang-based Northeast Pharm implemented the policy of "higher rent, higher salary", whereby rent was increased from RMB0.17 to RMB1.42/m² but extra housing subsidy that was 22% of the basic salary was also provided. The company could recover RMB1.25 million through rent every year, which was used to build more housing, thus realizing a benign cycle. As of 1987, the company sold 150 newly built commercial apartments to employees and more than 500 employees applied to buy housing.

On the basis of the trial reform, the State Council printed and distributed the *Plan for Gradual Promotion of Housing Reform in All Cities and Towns Nationwide* in February 1988, which stated that the government would promote the reform nationwide within 3-5 years from 1988. The low-rent public housing system would be reformed, whereby housing distribution in kind would be replaced by monetary distribution, residents could obtain the ownership or use right of housing through the exchange of goods, and housing, as a bulk commodity, could enter the consumer market. As a result, a benign cycle was created between housing input and output. Not only was the housing problem for urban residents solved and employees were better able to afford the housing, but the housing commercialization and socialization (the first overall housing reform plan issued by China) was also advanced. From then on, housing system reform in China evolved from trial

implementation to nationwide promotion and corresponding financial measures were adopted (Kang 2013).

A serious inflation hit China in 1988, when the general retail price index (RPI) increased by 18.5%, bank reserves began to drop and national finance was unable to provide the start-up capital for rent and salary increase. In fact, during the housing system reform, public housing was sold at a very low price to recover capital. Incomplete statistics show that 6.54 million square meters of old public housing was sold that year, and only RMB65.7 was recovered per square meter. The implementation of “subsidized rent increase” encountered major difficulties, the housing reform plan to be promoted in 3–5 years failed, and housing reform was basically in a halt in the next 3 years.

From 1979 to 1990, local governments reformed the original housing system by increasing rent, selling welfare housing that was originally distributed to employees, and encouraging employees to buy new housing directly. For the first time in history urban residents could obtain housing in the market. However, as their income was generally low at that time, they couldn’t obtain the full property right through purchase, so in most areas, individuals only had to bear part of the housing price (about one-third to one-half while the rest was subsidized by the employer and the government). The housing system reform in this period was of a strong security nature and should be viewed as a transition (Jin 2004).

4.1.2.1 The Period of Overall Auxiliary Reform: Subsidized Rent Increase and Housing Provident Fund Pushed Housing Commercialization

The housing system reform began to unfold in full swing in 1991, meaning housing distribution was more market-based and subsidy from the government and employer decreased step by step. In June 1991, the State Council issued the *Notice on Continuing the Reform of Urban Housing System Actively and Prudently* (GF [1991] No.30), which rolled out a series of measures, including increasing the existing rent on public housing to cost level according to the plan step by step, selling public housing, applying new system to new housing, and building housing through capital raising or cooperation.

The State Council issued the No.11 document in 1988, according to which the housing reform would be promoted to the whole nation by stages and by batches, and the main measure to change the old system was placing equal stress on renting and sale, namely subsidized rent increase and sale of public housing. This policy was promoted throughout the decade from 1988 to 1997, although subsidized rent increase was prioritized before 1992 while the other was prioritized after 1993.

In the transformation from planned economy to market economy, housing construction was sure to be governed by market rules. In the late 1980s, China’s housing system reform came to the stage of overall design and comprehensive implementation, a period when policy-based welfare housing took up a large proportion and commercial housing increased gradually.

In that period, urban housing reform took initial effects, and the approach of urban housing supply by the government alone was changing into one “dominated by government supply and complemented by market supply”.

In 1991, Shanghai launched the new housing provident fund system and adopted a series of measures including paying housing provident fund, subsidized rent increase and home sale at favorable price. Housing provident fund was used to grant loans for housing construction projects, provide the capital for housing construction for employees, and consequently mitigate the conflicts resulting from short housing supply. Cities like Beijing, Tianjin, Wuhan and Nanjing followed in Shanghai’s steps from 1992. In January 1992, Tianjin launched the housing provident fund system, and at the end of March that year, more than 2.2 million employees working at 14,300 enterprises and public institutions across the city had opened housing provident fund accounts at CCB and nearly RMB30 million funds had been paid.

The subsidized rent increase and initial housing provident fund system implemented in this period made housing a more commercial, socialized and professional work, and made people begin to accept the notion that housing was also a commodity. Pushing housing into the consumer market through the exchange of goods in a way realized a benign cycle between housing input and output.

Most of the capital for housing construction was raised by enterprises and public institutions themselves, but those organizations had different economic conditions, so their housing gap widened. Public housing, although being sold, was still considered a kind of benefit to a large extent, and low-price sale emerged several times. Meanwhile, the ancillary systems weren’t reformed accordingly, and the real estate market was far from being standard, so the economy got overheated and real estate industry had a bubble boom.

During the reform and opening-up and in the new stage of socialist modernization, urban housing policies went through constant explorations and changes, from allowing individuals to build housing themselves, selling public housing at full price or with subsidy, to subsidized rent increase and then the equal emphasize on that and the housing provident fund system. In this process, housing became increasingly commercialized.

Article 2 in the Constitutional amendment on April 12, 1988 provided that “the right of land use can be transferred according to law”. In December that year, the *Land Law* was revised according to the amendment and the system of paid use of state-owned land was implemented. On May 19, 1990, the State Council issued the *Provisional Rules on the Grant and Transfer of the Use Right of State-owned Urban Land*. On July 25, 1994, the standing committee of the National People’s Congress (NPC) issued the *Law on Urban Real Estate Management*, and in the same year, the State Council issued the *Decision on Deepening the Reform of Urban Housing System*, which specified the goal of housing reform. It was to establish a new urban housing system consistent with the socialist market economy, commercialize and socialize housing, accelerate housing construction and improve living conditions, so as to meet the growing housing demand of urban residents.

After the trial housing reform in the early 1980s and its deepening in the 1990s, housing changed from a benefit distributed by the government into a commodity that individuals could buy from the market freely.

4.1.3 The Third Period (1998–2007): The System of Monetary Housing Distribution

The State Council issued the *Notice on Further Deepening the Reform of Urban Housing System and Accelerating Housing Construction* in July 1998, which determined that the reform should be centered on housing monetization. The *Notice* stated that “housing distribution in kind should be stopped and gradually replaced by monetary housing distribution. A multi-layer housing security system with affordable housing in the center will be established and improved, and efforts will be made to develop the financial market and cultivate and standardize the housing market.”

As the system of monetary housing distribution was implemented in 1998, China began to establish the housing security system, including comprehensively implementing housing provident fund, affordable housing and low-rent housing.

The housing provident fund system is a policy-oriented financing channel adopted by the Chinese government to solve the housing problem for employees and a compulsory security system for individuals. In the *Decision on Deepening the Reform of Urban Housing System* issued by the State Council on July 18, 1994, it is stated that housing provident fund system should be promoted nationwide across the board. In 2002, the State Council revised the *Regulations on Housing Provident Fund*, printed and distributed the *Notice on Further Strengthening Housing Provident Fund Management* and a series of guiding documents such as *Guiding Opinions on Several Specific Issues Concerning Housing Provident Fund Management* and *Notice on Several Specific Issues on Housing Provident Fund Management*. The Ministry of Construction, Ministry of Finance, People’s Bank of China (PBC) and China Banking Regulatory Commission (CBRC) successively printed and distributed documents, such as *Methods of Administrative Supervision of Housing Provident Fund* and *Methods of Performance Assessment of the Housing Provident Fund Management Center*, to standardize the fund management according to law and push the fund’s sustained and healthy development.

Affordable housing and price-capped housing are policy-oriented commercial housing with security function targeting low- and middle-income families.

The security function of affordable housing is reflected by favorable government policies, such as land allocation, tax break, and limitation of construction standard, target of supply and sales price. In the *Notice on Continuing the Reform of Urban Housing System Actively and Prudently* issued by the State Council in June 1991, it is stated that “affordable commercial housing should be developed and provided first and foremost to those without housing or living in poor conditions”, which primarily positioned affordable housing on the state policy level. The *Decision on Deepening the Reform of Urban Housing System* issued by the State Council in 1994 made it clear that development and construction of affordable housing should be accelerated. Then in July 1998, the State Council issued the *Notice on Further Deepening the Reform of Urban Housing System and Accelerating Housing Construction*, which called for the establishment and improvement of a new nationwide housing supply system that was centered on affordable housing. In 2004, the Ministry of

Construction, National Development and Reform Commission (NDRC), Ministry of Land Resources and PBC jointly issued China's first *Regulations on Affordable Housing*, which defined affordable housing as "policy-oriented commercial housing with security function" mainly targeting low- and middle-income groups. In August 2007, the State Council issued *Several Opinions on Solving Housing Problem for Low-income Urban Families*, which stipulated the "limited" property right of affordable housing and conditions for it to enter the market. In December 2007, the Ministry of Construction, NDRC, Department of Inspection, Ministry of Finance, Ministry of Land Resources, PBC and State Administration of Taxation jointly issued the *Regulations on Affordable Housing*, which set down rigorous construction standards and entry and exit mechanism, and incorporated housing construction by employers through fund raising or cooperation in the scope of affordable housing management for the first time.

Price-capped housing came into being against the policy background of stabilizing housing price and "developing real estate through public bidding on the basis of limited apartment size and price and competition in land price and housing price" as stated in the *Opinions on Adjusting Housing Supply Structure and Stabilizing Housing Price* (May 2006).

Low-rent housing means that to ensure housing for families in need, local governments build this type of housing mainly with government fiscal budget while raising money through multiple channels. There are several approaches of this system, namely housing rent subsidy (the main approach), rental housing in kind and rent reduction (the auxiliary approach).

The Ministry of Construction issued the *Regulations on Urban Low-rent Housing* and *Housing Regulations for Minimal-income Urban Families* in April 1999 and November 2003 respectively, according to which low-rent housing would be provided to the minimal-income group. *Several Opinions of the State Council on Solving Housing Problem for Low-income Urban Families* issued in August 2007 stressed stepping up this effort and prioritized low-rent housing as a way of housing security. The *Methods of Low-rent Housing* and *Regulations on Low-rent Housing Fund* issued in September and November 2007 respectively specified the targets, standards and approach of low-rent housing and the source, use and management of low-rent housing fund, further improving the policy system.

However, the housing security system still had much to improve, problems such as limitation of household registration and poor implementation existed, and low-income housing was in serious shortage. To address them, great efforts were made to improve and increase low-income housing.

4.1.4 The Fourth Period (2008–Present): Establishment of a Housing Supply System with Equal Stress on Security and Commercial Housing

Several Opinions of the State Council on Solving Housing Problem for Low-income Urban Families issued in August 2007 stressed accelerating this work and prioritized low-rent housing as a way of housing security. This indicated that China's urban housing system reform proceeded from the stage of housing commercialization, socialization and marketization to the new stage of establishing a housing supply system with equal stress on security and commercial housing. The government and the market would re-adjust their position and role in housing supply.

The *2008 Work Plan for Low-rent Housing* made it clear that by the end of 2008, low-rent housing should be provided to all urban households receiving subsistence allowances and having housing difficulties. This goal was achieved on time and low-rent housing was provided to 4.88 million eligible households.

In 2008, the Ministry of Construction issued the *Guiding Opinions on Making Overall Plan and Annual Plan for Housing Construction*, in which low-income housing was the focus. At the end of 2008, MOHURD put forth the "900-billion housing security program", according to which two million low-rent apartments and four million affordable apartments would be built in the next 3 years (Zhang 2009).

In May 2009, three ministries including MOHURD issued the *Low-rent Housing Security Plan 2009–2011*, which set the goal of solving the housing problem for 7.47 million low-income households with housing difficulties by the end of 2012. On December 14, 2009, the State Council executive meeting decided that "efforts should be made to basically solve the housing problem for 15.4 million low-income households with housing difficulties by the end of 2012".

According to the 12th Five-Year Plan, 36 million sets of low-income housing would be built in the next 5 years. From 2011 to September 2014, 31.08 million sets started construction, accounting for 86.33% of the goal, and 22.41 million sets were basically completed.

4.2 Problems

After the reform and opening-up started, China's urbanization drive picked up speed and the ratio of urban population increased from about 18% in 1978 to about 49.7% in 2010. If it is to exceed 75% in the next 30 years, more than ten million farmers will enter cities every year in that period. The rising urban population in the urbanization process results in a growing housing demand and land finance, which, combined with the imperfect housing security system, leads to the rapid increase of housing price in China, and more residents have housing difficulties, especially the low-income group. As migrant workers are the low-income group in cities, they can only live in low-rent housing that is far away from the city proper and in poor

conditions. The *2009 Survey Report on Migrant Workers* by the National Bureau of Statistics showed that 17.1% of migrant workers rented housing independently in 2009, and only 0.8% of them bought housing at the place where they worked.

In the current housing security system, low-rent housing, affordable housing and price-capped housing are for residents with urban household registration only, and resettlement housing and housing for rundown and old urban area renovation are mainly for local residents. Local governments have adopted the “laissez-faire” approach toward urban housing for migrant workers, a problem that is not tackled by the urban housing security system. With the rapid increase of housing price and rent, housing actually begins to impede urbanization, and to achieve the new type of urbanization, not only the housing security system has to be improved, but more efforts should be made to provide low-income housing.

The current housing security system has the following problems.

4.2.1 First, Unitary Security Model and Household Registration Discrimination

Low-rent housing, affordable housing, price-capped housing, resettlement housing and housing for rundown and old urban area renovation are only for people with local household registration or living locally and not accessible to migrant population without local urban household registration. Meanwhile, the current housing security system focuses on the unitary model of low-income housing with property right. Of the 10 million sets of low-income housing that started construction in 2011, for example, 1.65 million sets were low-rent housing, 2.27 million were public rental housing, 1.1 million were affordable housing, 830,000 were price-capped housing, and 4.15 million were housing for rundown urban area renovation; 60.8% were low-income housing with property right. Such a housing security model further intensified household registration discrimination. At present, most cities are working hard to ensure housing for people with local urban household registration, but China is in a period when urbanization is proceeding at a faster pace, urban residents increase sharply, population is more mobile and population structure is changing. The housing security system has to adapt to such social changes and needs.

4.2.2 Second, The Housing Security System Isn't Systemic Enough and Has Major Loopholes

There is a wide variety of forms of housing security at the moment, including low-rent housing, public rental housing, affordable housing, price-capped housing, resettlement housing and housing for rundown and old urban area renovation, but low-income housing with property right is dominant. However, the form of housing

security doesn't match the per capita income distribution. For example, for low-income housing projects for rundown and old urban area renovation, a universal subsidy standard is adopted instead of a differentiated one based on family income. The inclusive housing provident fund has a low coverage ratio and is preferential to the high-income group, and price-capped housing, affordable housing and low-rent housing all have an income criterion. Meanwhile, the access threshold to different low-income housing forms is not well-aligned and has wide gaps, making it hard for the "sandwich class" to access low-income housing, and how to guarantee their housing remains a big problem. Regulations issued by different places on low-income housing are neither well developed nor systemic, and governments are still exploring on specific matters such as the target of housing security, supply standard, capital raising and implementation.

4.2.3 Third, The Generally High Rent for Public Rental Housing Easily Leads to Effects That Cannot Meet Expectations

A major characteristic of public rental housing is that it sets no limitation on household registration and migrant workers are also covered. According to the *Guiding Opinions on the Construction and Management of Low-income Housing Projects*, public rental housing is accessible to lower-middle-income urban families with housing difficulties, newly employed employees without housing and migrant workers with stable employment in the city. Therefore, the rent should be bearable by the sandwich class and be set according to the target group's income range, but the reality is that in some cities, the rent for public rental housing is only slightly lower than that for nearby commercial housing and is unaffordable for the sandwich class. It actually makes public rental housing inaccessible to the low- and middle-income group, especially migrant workers.

4.2.4 Fourth, Uneven Coverage of Low-Income Housing in Different Regions Leads to Unfair Income Redistribution

According to the *Guiding Opinions on the Construction and Management of Low-income housing Projects* issued by the General Office of the State Council, by the end of the 12th Five-Year Plan period, the national coverage of low-income housing will reach 20% or so, and housing difficulties of lower-middle-income and low-income urban families will be basically solved. As one of the effective ways of income redistribution, housing security should be implemented according to actual needs and difficulties. The affordable housing coverage in Urumqi, Xi'an, Harbin,

Taiyuan and Hohhot was higher than 20% in 2009,¹ but in 2011, some of them undertook a heavy task of low-income housing construction and consequently got more central subsidies for that, which was obviously unfair for residents in other cities. Housing security must be promoted across the country, the central government should grant subsidy according to actual needs, and local governments have to keep the housing supply structure balanced. The construction of low-income housing should effectively solve housing difficulties nationwide. Its effect shouldn't be gauged by quantity alone, but also by how well its distribution meets effective demand. Therefore, while a lot of low-income housing had to be built, it didn't have to be built on such a large scale in all cities, but should be based on the construction volume in previous years. During the 12th Five-Year Plan period, cities with high or low affordable housing coverage should decrease or increase the construction of low-income housing respectively, and enclosed management should be intensified to ensure the source of low-income housing and their security capability.

4.2.5 Fifth, Low-Income Housing Is Concentrated and Mostly in Suburbs

A lot of low-income housing is built in far suburbs because of the low land cost. As a result, low-income group lives in relative concentration and are separated from middle- and high-income groups. This, combined with poor auxiliary facilities, forces low-income group to live far away from the suitable employment market, reduces their job opportunities and increases commute cost. This doesn't help them increase the income. Instead, it may cause living segregation. If active efforts are not made to develop communities, those low-income housing neighborhoods may degrade to new ghettos and directly affect social stability.

4.2.6 Sixth, Low-Income Housing Is Under Heavy Capital Pressure

Local governments are under capital pressure for low-income housing construction in general. They have to invest a lot of money in urban infrastructure and also have to

¹Coverage rate of affordable housing in 2009=(completed area of affordable housing 1999–2009)/(completed housing area 1999–2009) × 100%. At the end of 2008, more than 18 million households in the country lived in better conditions thanks to affordable housing, of which more than 5 million households were low-income families. This means that the coverage rate of affordable housing partially reflects the strong efforts of the government have been made in housing security for low- and middle-income residents.

provide capital for education, medical care and other livelihood projects, so they have a wide capital gap. Deficient capital will affect the progress on low-income housing construction and may cause “unfinished buildings”.

In the next 20 years, China not only has to solve the housing problem for 400 million migrant workers, but also to repair and manage the existing low-income housing, which means an immense capital demand both for construction and management. However, there are very few financing models for low-income housing at the moment, mostly government investment and bank credit with very little private investment.

4.2.7 Seventh, Massive Construction Has Quality Hazards

Because of the lack of planning and construction experience and the difficulty in regulation, low-income housing has revealed a lot of problems. Although local governments were firm about the quality of low-income housing project and took many quality-guaranteeing measures, regulation seemed very weak against the background of “massive construction on a tight schedule”. As a result, quality problems such as subgrade caving, wall cracking and water leak appeared one after another in low-income housing. “Longer and thinner rebar” was used in low-income housing in Guangxi and Hainan, and the Ming Yue Wan project in Jiugong Town of Beijing’s Daxing District was ordered to be rebuilt due to outrageous quality problems.

4.2.8 Eighth, Some Low-Income Housing Gets Cold Shoulder and Fair Distribution Faces Challenge

Low-rent housing, affordable housing, price-capped housing, resettlement housing and housing for rundown and old urban area renovation are only for people with local household registration or living locally and not accessible to migrant population without local urban household registration. However, low-income housing with property right takes up a much larger proportion than rental housing, but only the latter is accessible to population without local household registration. The result is that while household registration is used as a threshold to the distribution of low-income housing, some low-income housing gets cold shoulder. In March 2012, only 210 of the 913 public rental apartments located in Nanhu New Area in Wuhan were occupied, while the rest 700-plus apartments were left vacant. The first two public rental housing projects built in Shanghai under government leadership had 5100 apartments in total, but only about 2000 applications (less than 40%) were filed. To address this, cities like Beijing, Shanghai and Wuhan have issued the subsidy standard for public rental housing.

Under an unsound credit system, low-income housing distribution saw a series of malpractices such as violation of rules, fraudulent purchase or rent and sub-letting or sub-sale. For example, six affordable housing applicants in Wuhan had “housing purchase license with continuous numbers”, and in Xinzhou city of Shanxi Province, Meixian County of Shaanxi Province, Changsha County of Hunan Province, Haikou city of Hainan Province and Rizhao city of Shandong Province, low-income housing almost became the welfare housing for civil servants.

4.2.9 Ninth, Low-Rent, Low-Quality Low-Income Housing Is in Short Supply and Rental Low-Income Housing Is of a Small Proportion

The key to housing difficulty doesn't lie in the inability to buy it, but the inability to rent it. China has to solve the housing problem for 400 million migrant workers and their families from 2010 to 2030. Most migrant workers who just come to the city have low skills and low income. They cannot afford urban commercial housing, and the market doesn't provide low-rent low-quality housing that fits their needs, but they can make more money and live in a better environment by improving their working skills. Therefore, the government should provide transitional rental low-income housing for them, so they can have a stable living space, improve their skills, and consequently earn more and move for better housing. However, housing with property right makes up the majority of the 36 million low-income apartments, while rental housing only takes a small part. In 2010, 400,000 new public rental apartments were planned nationwide, accounting for about 7% of the total 5.9 million low-income apartments. In 2011, 2.2 million public rental apartments were planned, 22% of the total 10 million low-income apartments, and in 2012, 2.3 million rental apartments were planned, about 33% of the total 7 million low-income apartments. This shows that rental low-income housing takes up a small proportion in general.

After rounds of urban construction and renovation, there is very little low-quality housing. As both housing price and rent are going up, the financing for low-rent and low-quality low-income housing will be a real challenge.

4.2.10 Tenth, Housing Statistics and Long-Term Housing Security Plan for a New Type of Urbanization Are Absent

At present, we have no statistics of the income distribution of urban residents or the housing statistics, so it's hard to accurately grasp the actual situation of housing deficiency and take targeted measures and make long-term plans. Housing security

system should be a medium- and long-term basic system that is adjusted according to economic and social changes rather than a 3–5-year plan. Although most cities have established a multi-layered housing security system, it mainly serves people with local household registration. With social development, we should break the limitation of household registration, work out various housing security systems that cover all families of general income, lower middle income and low income, improve corresponding policies and measures, and guarantee their earnest implementation, so as to provide better social benefits for urban residents.

4.2.11 Eleventh, New Ghettos and Community Management Problems May Appear

The concentration of low-income housing has largely increased the density of low- and middle-income residents in a certain area. If we only focus on improving the living environment and pay no attention to income increase, those low-income housing communities will degrade to be new ghettos. The high-density concentration and separation from other communities is bad for communication among neighbors, and can easily create blind spots in social supervision and court crimes.

4.3 Future Trend

In light of the requirements of a new type of urbanization, a transparent and equitable new-type low-income housing system that focuses on monetary subsidy to consumers, features multi-layer and multi-channel housing sources and capital input and covers all population will be established. According to the theory of rational urban growth under urban growth management, urban growth should observe the following principles: creating multiple housing opportunities and options, making urban housing more affordable, fostering pedestrian-friendly neighborhoods, cultivating characteristic and attractive communities with a strong spatial appeal, setting community development and construction standards, achieving fiscal profits, environmental quality and health benefits all at once, and reinforcing the development of existing communities.² Therefore, the new-type low-income housing system should serve the sustainable economic, social and environmental development of a new type of urbanization.

As shown in Fig. 4.1, the current housing security framework only covers people with local household registration and focuses on low-income housing with property

²Qian, Yingying, and Wang, Zhenshuai (2009). “Strategy for Sustainable Development of Low-income Housing according to Urban Growth Management Theory.” *China Real Estate*, 3, 58–61.

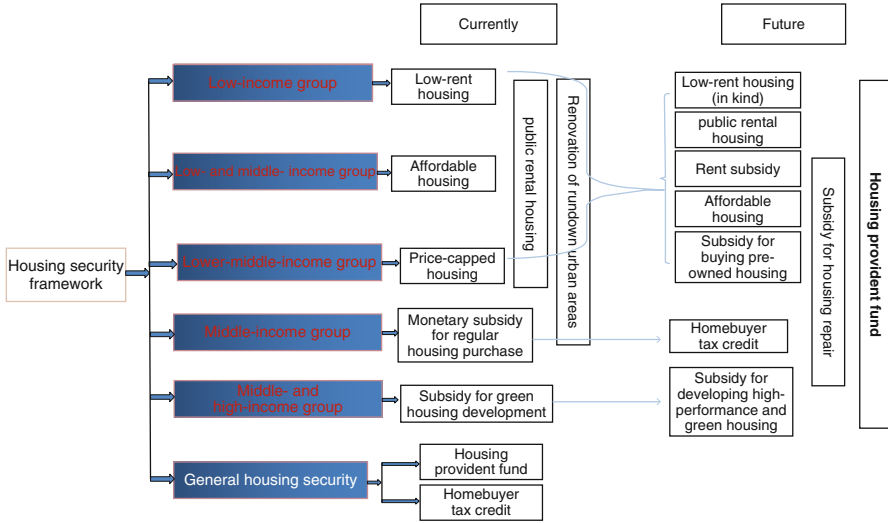


Fig. 4.1 Housing security framework

right, meaning that the main approach is the subsidizing the supplier. It consists of several housing forms: low-rent housing for low-income group, affordable housing for low- and middle-income group, price-capped housing for lower-middle-income group, and public rental housing and rundown urban area renovation housing for the sandwich class. A long-term and stable execution mechanism isn't in place yet for policies on regular housing purchase subsidy targeting middle-income group. Instead, invisible benefits such as tax credit are implemented, which are in conflict with the current policy on housing purchase restriction, but they were once adopted anyway by cities like Changsha as a countermeasure against the financial crisis. Moreover, subsidy for green housing development targeting middle- and high-income groups is too limited in scope, and housing provident fund, although it's an inclusive housing security policy, has a very low coverage rate.

Based on the historical trajectory of housing policies, the housing security system in Europe and America has evolved dynamically along with social changes, and a multi-layered security system has gradually taken form with expanding coverage. At first the government built public housing for low-income group directly, but after decades of development, consumer subsidy became the mainstream housing policy, and policies were aimed to gradually establish and improve a system that can enhance the paying capacity of low- and middle-income groups. In that process, the government served the dual role of a participant and a regulator, and its objective stepped up from guaranteeing housing for all citizens to providing "decent and comfortable housing" and "sustainable community environment" for the residents to help eliminate poverty.

As mentioned above, the execution of China's housing security policies in the urbanization process was completely different from, even opposite to that in

developed countries. In developed countries, a lot of public housing was built in step with urbanization, and then reform was launched to gradually reduce public housing. But in China, the system of housing distribution in kind was replaced by monetary housing distribution when urbanization picked up speed, the housing market was completely open, private housing especially leasing of private housing played a leading role, and cities were run based on “land finance”. As a result, housing became overly commercialized and its function as a livelihood commodity for social security was neglected.

As low-income housing was built massively and housing inventory increased during the 12th Five-Year Plan period, the conflict between housing supply and demand is no longer a problem in the 13th Five-Year Plan period, and housing quality will become a new focus of concern. Therefore, the main models of housing security will change, the housing security framework will be more mature, and the system will be further improved and refined.

China will improve the all-inclusive housing security framework step by step, establish a multi-layered and multi-channel housing security system whereby people in all the low-, middle- and high-income ranges can enjoy the benefits of social development, and improve the living environment in order to make sure “all Chinese people live in their own housing” and in a “decent and comfortable” environment. It will make full use of the 36 million low-income apartments to be built during the 12th Five-Year Plan period as well as existing ones, improve the housing filtering mechanism, and encourage stepped housing consumption. China will strive to not only guarantee housing for low-income group, but also improve the living environment for most residents, achieving the goal of “housing for all” and “decent and comfortable” living environment.

Low-income housing, primarily rental housing, will be open to all local residents (including migrant workers and other floating population) regardless of their household registration status. With a broader eligibility range and a housing provident fund that is expanded to cover the entire workforce, an equitable and more affordable system will be put in place to ensure access to housing for all. Existing low-income housing programs will be optimized and integrated. The new schemes will pay closer attention to the roles and effects of market, providing subsidies to low-income households who choose to live in public housing (including low-rent housing) or affordable housing units. Government will provide more subsidies and tax incentives to a wider range of tenants and pre-owned home buyers, allowing them more choices on where to live. Subsidies will also be provided to developers of high-performance and green housing, to encourage these projects to be built with higher construction and environmental standards, and to cater to the varying needs of buyers. Households in the lower or lower-middle income range will, too, receive subsidized assistance to help them maintain their housing units on a regular basis. This will not only prolong the life of buildings, but also save on resources and provide a better environment for people to live in. These and other policies will be implemented to ensure the sound interaction between the housing market and housing security programs, and ultimately promote social sustainability.

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Chapter 5

Urban and Rural Housing Systems in China: Evolution and Future Prospects



Pengfei Ni

5.1 History

Housing in urban and rural areas in China has been different in many ways since the PRC was founded. First, cost is different. The cost for urban housing is high and that for rural housing is low. Second, construction standards are different. Urban housing features apartment buildings and rural housing courtyard structure. Third, quality and functions are different. Compared with urban housing, rural housing features low quality and low complete set ratio. Fourth, environment is different. Compared with urban housing, rural infrastructure is poor, the living environment is disorderly and public services are of a low level. Fifth, as a sub-system of the general economic system, China's urban and rural housing systems, like many others, differ from place to place and segmented.

5.1.1 History of Rural Housing System in China

China's rural housing system has almost stayed the same since its establishment and its basic characteristics can be summarized into the following four points. First, one rural household can get a plot of housing land (homestead). Second, rural residents

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have the property right of their housing and the use right of housing land (homestead). Third, the ownership of housing land (homestead) belongs to the collective rather than the rural household, and the housing isn't a commodity (but can be sold and leased) or mortgage or pledged goods. Fourth, rural housing is built by rural residents with self-raised money, and occupied, maintained and managed by themselves. Such an inclusive housing system of security nature ensures housing for all rural residents and social stability in rural areas.

Chinese rural residents experienced four house-building waves since the reform and opening-up: from adobe housing to brick-and-tile housing in the 1980s, from brick-and-tile housing to brick-and-rebar housing in the 1990s, from brick-and-rebar housing to storied housing in the 2000s, and from storied housing to urban housing in the 2010s. The per capita rural housing area increased from 9 m² in 1978 to 42.4 m² in 2010.

5.1.2 Old Urban Housing System in China

Under the planned economic system, China's urban housing system is a welfare system that featured centralized and free housing distribution by the state, low rent and limitless use. It had the following main contents: first, the state and the employer were responsible for financing the housing construction. Employers built, distributed, repaired and managed their housing in a centralized way. Second, housing was distributed in kind as a form of welfare. Third, housing was provided to employees at low rent and the state was responsible for its repair and maintenance. The disadvantages of such a system were that construction investment was never recovered, so there wasn't a benign input-output cycle, which impeded housing development and resulted in extreme housing shortage and the reduction of per capita housing area. The rent was so low that it couldn't cover housing upkeep, so housing was in poor condition and a lot of dangerous and dilapidated housing wasn't renovated, not only endangering the residents but also heavily burdening the state. This system couldn't fairly and effectively solve the housing problem for urban residents, and per capita housing area was only 7.18 m² in 1980.

5.1.3 Reform of Urban Housing System in China

In light of those defects, the Chinese government began to reform the old housing system in 1979 in five ways: raising the rent for existing public housing and selling it to employees, carrying out monetary housing distribution, establishing the market for new and old housing, and creating the housing security system and housing provident fund system. A series of reform steps were taken.

Public housing was sold to employees on a trial basis in 1979. The CPC Central Committee and the State Council approved and forwarded the *Outline of the Report to National Capital Construction Meeting* in 1986, which formally put forth the policy of housing commercialization, including “allowing individuals to build, buy and possess their own houses”. At the third State Council’s work meeting on housing system reform in 1993, a new plan was proposed that “focused on the sale of public housing complemented by housing leasing and construction”. The State Council issued the *Decision on Deepening the Reform of Urban Housing System* in 1994, which proposed to establish a new urban housing system consistent with the socialist market economy and implement housing commercialization, housing security system, and professional and market-based housing operation. In 1998, the State Council issued the *Decision on Further Deepening the Reform of Urban Housing System*, which explicitly stated that housing distribution in kind should be stopped completely, monetary housing distribution would be implemented, and a housing supply system focused on affordable housing and the housing provident fund system would be established. In 2003, the State Council issued the *Notice on Promoting the Sustained and Healthy Development of Real Estate Market* (GF [2003] No.18), which pledged to enable “most families to buy or rent common commercial housing step by step”. It then issued the *Several Opinions on Solving Housing Problem for Low-income Urban Families* in 2007, which stated that a multi-layered housing security system would be established.

After the series of reform measures were adopted, a new urban housing system consistent with the socialist market economy was basically established in China, which featured a multi-layered housing supply system, private property right, diversified investment, professional production, market-based services and exchange, monetary distribution and household consumption. The per capita living area of urban residents, housing quality and complete set ratio were all largely increased, and housing facilities, public services and living environment were greatly improved.¹ Based on population with household registration, the per capita housing area of urban residents increased to 28.36 m² in 2010.

5.2 Problems

Although the rural housing system once suited the national situation of China and the urban housing system went through in-depth reform, the current systems won’t adapt to China’s integrated urban-rural development in the future for the following reasons.

¹Taskforce from the National Academy of Economic Strategy of CASS. (2012). “General Conception on Deepening the Overall Reform of Urban Housing System in China,” *Finance & Trade Economics*, 11, 100–109.

5.2.1 Urban and Rural Housing Markets Are Separate

First of all, urban and rural housing is of different standards. There is no definite standard for per capita housing land and living area in urban and rural areas, let alone a unified system. Generally speaking, it is larger in rural areas than in urban areas. Second, urban and rural housing follows different plans. Their planning and layout are separate. There is no housing plan in 49% of the countryside, and in some rural areas, there is no systematic layout or clear functional division of housing. Third, urban and rural housing is under different management. In urban areas, there are specific administrations and public institutions in charge of housing approval and regulation covering planning, development, property right, transaction, operation and service, but the situation is different in rural areas. On one hand, only 30% or so rural residents obtained approval for their housing construction due to the lack of government management; on the other hand, the government interferes too much. In some places, it forces rural residents to live collectively or move into apartment buildings.

5.2.2 Urban and Rural Housing Supply Systems Are Different and Not Well Developed

On one hand, urban housing is over-commercialized. The market-oriented housing reform in China leaves housing for the majority of urban residents completely to the market, and all urban housing is developed by real estate companies. This results in monopoly in housing development and market and the fast-rising housing price in cities. On the other hand, rural housing isn't commercialized at all. Most rural residents, upon the approval of township governments, can use for free the homestead that belongs to the collective, and build their own housing with self-raised money or government aid. Rural housing is essentially low-income housing, of which rural residents don't have full property right, so they cannot sell or mortgage it but can inherit it. At last, urban and rural housing markets are separate. Urban residents cannot buy or build housing in rural areas, nor can rural residents enjoy the same favorable land, tax and financial policies enjoyed by urban residents in purchasing houses.

5.2.3 Basic Urban and Rural Housing Systems Are Different and Not Well Developed

First of all, regarding property right, the property right of security commercial housing in cities is not clear, nor is the property right of housing built by rural residents themselves. Second, regarding housing leasing, an effective system to

protect the tenants' interests is absent in cities, only a very small proportion of urban families rent housing, while a large amount of suburban housing with limited property right is leased illegally. Third, regarding housing distribution, a monetary housing distribution system is in place in cities, but the monetary subsidy doesn't automatically and proportionally increase along with the rise of housing price, and the existing subsidy isn't enough for buying or renting commercial housing. In rural areas, the better-off and privileged class occupies more homesteads, but some rural residents cannot obtain legal homestead to build their own house, and some living in the suburb make unfair profits by selling housing with limited property right. At last, regarding housing consumption, a housing tax system is absent both in urban and rural areas, particularly housing possession tax, so the occupation of housing resources is neither regulated nor restricted.

5.2.4 Housing Auxiliary Systems in Urban and Rural Areas Are Different and Separate

First of all, the urban and rural land tenure systems are different and separate. Urban land belongs to the state and can be used at a price and freely transferred, while rural land belongs to the collective and can be used for free but not transferred. Collectively-owned land in urban planned areas can become state-owned through enforced requisition by the government, and the government then grants its use right at a price, but the ownership can only go from the collective to the state, not the other way around.

Second, the urban and rural housing financial systems are different and not well developed. The urban housing provident fund is far from enough to cover all urban families in need of housing security, especially low-income families, self-employed businesspeople and migrant population. The system is designed in such a way that housing subsidy is proportional to income and fund payment, which is unreasonable, and the housing provident fund is separate from other security funds. Residents rely on commercial loan for housing purchase but the interest rate isn't market-based and the loan-deposit interest rate gap is wide, and there isn't a basic commercial or policy-oriented housing financial system for the countryside. Since rural land cannot be mortgaged, rural residents cannot obtain commercial loan or other financing, and rural housing is mainly built by rural households themselves with family investment or private financing, which leads to big housing differences due to family conditions and financing ability.

Third, urban and rural housing security systems are different and not well developed. The housing security system for urban families in and below the middle-income range is non-existent. Only 7% or so of the total population was covered by urban housing security system in 2010. The 12th Five-Year Plan set the goal of providing security housing to 20% of urban families by 2015, but low- and middle-income residents, the newly employed and migrant workers, who accounted for more than 50% of urban population but couldn't afford housing on their own,

were excluded. Besides, the existing urban housing security system has a spate of problems such as diverse forms, unclear boundary and standards, the lack of a sound access, waiting and exit mechanism, and the lack of a sustainable mechanism for investment, financing, construction, operation and management. Moreover, the housing security system in the countryside is non-standard even though rural housing is generally of a security nature. There is no official homestead and housing standard or charging and tax rules for exceeding the standard. As a result, the high-income and privileged rural stratum obtains more benefits.

At last, the urban and rural real estate tax systems are neither unified nor reasonable. In urban areas, a general tax system that can adjust income distribution hasn't been formed, the scope of real estate tax is too narrow while that of tax exemption is too wide, and real estate tax isn't differentiated or accumulative. Besides, there are too many taxes and fees for the circulation of housing but too few for the possession of it, and stable, standard and sound tax break policies on low-income housing investment, financing and consumption are lacking. In rural areas, a general tax system including real estate tax hasn't been established.

5.3 Current Situation and Trend of Housing for Urban and Rural Residents in China

5.3.1 Current Housing Status for Urban and Rural Residents in China

The 6th economic census showed that in 2010, urban and rural housing areas in China totaled 44.95 billion m², total population reached 1.34 billion and per capita housing area was 33.5 m². Among that, per capita housing area for rural population was 42.4 m², much higher than that for residents with urban household registration, which was 28.36 m². Urban housing supply was in general shortage while a lot of rural housing was vacant. However, rural housing was of much poorer quality than urban housing regarding cost, construction standard, function and auxiliary facilities.

5.3.2 Basic Housing Status for Rural Residents in China

The distribution of rural housing is seriously uneven. As shown in Table 5.1, 80% of rural residents build their own housing, and 36% of them work or live in cities, leaving 60 million houses idle. Rural residents living in the suburbs and urban villages (villages inside cities) of urban-rural integration areas account for 10% of all rural population, and they have an extra 6.6 billion m² of suburban housing with limited property right, so their actual per capita living area is 74 m². Meanwhile, about 10% of rural residents have housing difficulties with the per capita living area of only 20 m².

Table 5.1 Estimated housing status of rural population in China

Type of residents	Type of housing	Per capita housing (m ²)	Self-occupation (100 million m ²)	Tenant (100 million m ²)	Landlord (100 million m ²)	Total (100 million m ²)	Percentage of population (%)	Total population (100 million people)
Rural residents	Self-built, self-occupied	43	153.5	0	0	153.5	44	2.97
Migrants in cities	Self-built, self-occupied	43	140.2	0	0	140.2	36	2.43
Those living in the suburb and urban villages	Housing of limited property right	74	33	0	33	66	10	0.67
Poor population	Self-occupied or supported	20	17.8	0	0	17.8	10	0.67
Subtotal	Rural housing	42.4	344.5	0	33	377.5	100	6.74

5.3.3 Basic Housing Status for Urban Residents in China

Urban residents consist of two groups: permanent population with urban household registration and those without, the former reaching 440 million and the latter 220 million in 2010. Of the first group of 440 million people, 52% have basically solved the housing problem, including 45% with the per capita living area of more than 40 m², 2% (low-income group) living in low-rent public housing, and 5% (low- and middle-income groups) living in affordable housing. Students in junior colleges or technical secondary schools, who accounted for 10% and had collective household registration, lived in dormitories. On the other hand, 48% of the population with urban household registration hasn't solved the housing problem yet, including the 20% middle-income group who had no housing. The 10% families that bought public housing at cost price or standard price according to relevant housing reform policy needed better housing since their current per capita living area was only 20 m², the 10% students in junior colleges or technical secondary schools needed housing in the future, the 5% high-income group who had no housing needed to buy housing in the future, and the 10% residents in rundown urban areas and 3% low-income group had housing difficulties (see Table 5.2).

5.3.4 Future Trend of Urban and Rural Housing in China

China is in a period when globalization, marketization and urbanization are all picking up speed. Going forward, more people will move from the countryside and small towns to big cities and migrate from one city/region to another unevenly and frequently. Population in rural areas and areas with poor natural conditions will continue to decrease.

According to the estimation by the National Health and Family Planning Commission, Chinese population will reach 1.48 billion in 2020, when urbanization rate will hit 60%. There will be 888 million urban residents, a net increase of 228 million from 2010, and 592 million rural ones, a net decrease of 80 million from 2010 (while the actual decrease is more than 300 million considering the 220 million migrant population without local household registration that has moved to urban areas). To meet the goal of "housing for all", the general per capita construction area in both urban and rural areas should reach 39 m² in 2020, 35 m² for urban residents (1.2 units per household) and 45 m² for rural ones (1.5 units per household). By 2020, the total housing area should reach 57.72 billion m², an increase of 8.29 billion from 2010. Among that, 13.98 billion m² of new housing will be built in cities, actually more than that if we take into account housing demolition and other factors, but total rural housing areas should be reduced by 1.2 billion m². In the meantime, efforts should be made to integrate, connect and facilitate the infrastructure in urban and rural areas and improve public services.

Table 5.2 Estimated housing status of people with urban household registration in China

Type of residents	Type of housing	Per capita housing (m ²)	Self-occupation (100 million m ²)	Tenant (100 million m ²)	Landlord (100 million m ²)	Total (100 million m ²)	Percentage of population (%)	Total population (100 million people)
Students in junior colleges or technical secondary schools	Dormitory	5	0	0	2.2	2.2	10	0.44
Private housing owners	Private housing	40	13.2	0	0	13.2	5	0.22
Relocated households	Resettlement housing for land requisition	60	17.6	0	4.4	22	10	0.44
Minimum income + no house	Rental private housing	10	0	1.32	1.32	1.32	3	0.132
Minimum income + no house	Low-rent public housing	20	0	1.76	1.76	1.76	2	0.088
Low income + housing difficulty	Rundown urban areas	20	4.4	0	0	4.4	10	0.44
Low and middle income + having a house	Affordable housing	30	4.4	0	0	10.56	5	0.22

(continued)

Table 5.2 (continued)

Type of residents	Type of housing	Per capita housing (m ²)	Self-occupation (100 million m ²)	Tenant (100 million m ²)	Landlord (100 million m ²)	Total (100 million m ²)	Percentage of population (%)	Total population (100 million people)
Low and middle income	Public housing bought by individuals	20	17.6	0	0	17.6	10	0.88
Middle and high income + having a house	Public housing bought by individuals + commercial housing	50	17.6	0	4.4	22.	10	0.44
Middle income + having a house	Commercial housing	40	17.6	0	0	17.6	10	0.88
Middle income + no house	Rental commercial housing	20	0	4.4	0	0	10	0.44
High income + commercial housing	More than two commercial apartments	60	17.6	0	8.8	26.4	10	0.44
High income + no house	Rental private housing	20	0	8.8	0	0	5	0.22
Subtotal		28.36	110	16.28	22.88	139.04	100	5.28

Source: Estimated based on the 6th population census, China statistical yearbooks and relevant surveys

5.4 Reform and Prospects

China will be a country of integrated urban-rural development in the future, when urban and rural infrastructure is integrated, everyone has equal access to public services, and urban and rural areas have integrated markets and follow unified rules. In view of the current problems in urban and rural housing systems and the future trend of economy and urbanization, we have to increase the total housing supply and adjust its structure according to the total demand and structural changes. More importantly, we need to comprehensively deepen the reform of urban and rural housing systems and auxiliary systems, and establish an urban-rural integrated housing system featuring the combination of government management and market force, and a differentiated housing supply system that has targeted measures for each income range as well as auxiliary systems. We should also create a flexible mechanism to facilitate free circulation of urban and rural housing and achieve a dynamic balance between housing supply and demand across the country.

5.4.1 Establishing a Urban-Rural Integrated Housing System

First, a scientific and holistic plan will be made for urban and rural areas covering economic, social, environmental, population, resource and housing development as well as spatial layout. Local regions should work out their specific plans of the same kind. Second, urban and rural housing will be registered and managed on the following principle: unified platform, separate implementation, independent coding, closed-loop operation, opening for linkage and gradual transition. Third, the urban and rural commercial housing markets will be unified. Rural residents will be able to rent or buy housing in cities and urban resident can do the same in rural areas. But rural housing should first have full property right before it can be traded legally in the market. Fourth, housing security will be integrated for urban and rural areas. Low-income housing for urban residents can be built in rural areas as long as the plan permits, and rural residents will be entitled to urban low-income housing when migrating to cities. Fifth, a mechanism will be put in place to balance population and housing between urban and rural areas. When urban population increases and rural population decreases, housing and construction land in cities should be expanded and that in rural areas be reduced accordingly.

5.4.2 Establishing Urban-Rural Integrated Housing Supply System

An integrated market system and housing security mechanism will be established so that urban residents can buy commercial housing in rural areas and have access to rural housing security and vice versa. Given the income difference between urban

and rural residents, the housing supply system should consist of three layers. In urban areas, there should be premium housing for high-income group (subject to financial and tax adjustment), common housing for those in and below the middle-income range (supported by favorable land, financial and tax policies), and policy-oriented low-income housing for low-income and minimum-income groups (entitled to land, financial and tax security policies). Correspondingly, in rural areas, there should be housing for low-income and minimum-income families built by collective organization or/and with state investment, the property right of which belongs to the collective (entitled to land, financial and tax security policies); self-built housing by rural residents for the majority of middle-income families (supported by favorable financial and tax policies), whose homestead can be used freely as long as the housing standard is observed; and commercial housing either built by the occupants themselves or by constructors (with higher homestead standard than stipulated) for the few high-income families, whereby homestead and rural construction land in excess of government standards for self-occupation should be paid for, and the housing can either be occupied by the owner or sold to urban residents (subject to land, financial and tax adjustment).

5.4.3 Establishing a Urban-Rural Integrated Basic Housing System

First, a property right system focused on private property right will be established. There are several forms of property right of urban and rural housing, including complete self-owned property right, shared property right, corporate property right, collective property right and state-owned property right. Considering the global trend and Chinese traditions, private property right can be the main form for urban and rural housing in China. Second, a diversified and competitive housing development system will be established. Housing development monopoly will be broken and a diversified development system will be formed where various development approaches compete with each other, including urban-rural integrated development by the government (or entrusted by the government to developers), by collective organizations (or entrusted by them to developers), by developers, housing cooperatives and the owners themselves. Third, a housing exchange system with equal stress on leasing and sale will be put in place. The urban-rural housing exchange system should consist of two parts too – leasing and sale, but the proportion of people leasing and buying housing will vary between urban and rural areas, among different regions and residents of different income ranges and ages. Fourth, a housing distribution system involving both in-kind and monetary distribution will be created. Urban and rural housing will be distributed either in kind or in monetary approach, but the ratio between the two approaches can be different in urban and rural areas. Fifth, a housing consumption system ensuring “one apartment per household” will be established. Urbanization is proceeding ever faster in China,

and a lot of rural families are moving to cities, so housing consumption policies must ensure “one apartment per household”, allow “two apartments for one household” and prohibit “multiple apartments for one household”. Of course the specific standards can vary between urban and rural areas and from region to region.

5.4.4 Establishing Urban-Rural Integrated Auxiliary Housing Systems

First, an urban-rural integrated housing land tenure system will be created. Efforts will be made to gradually set up a system where the ownership of urban and rural land belongs to the state and its use right belongs to legal and natural persons. Urban land for commercial housing should be paid for, that for low-income housing can be used for free or at a favorable price; rural homestead for self-occupation and rural land for low-income housing can be used for free, and excess homestead should be paid for. Urban and rural housing land across the country should follow the principle of “cap control, structural adjustment, equal land reclamation for farmland occupation, and market exchange”, and “housing land quota should follow the flow of population”. An integrated and vertical land regulation system will be established.

Second, an urban-rural integrated housing financial system will be established. Efforts should be made to improve the macro-financial system, build the municipal bond financing platform for local governments, and improve the system for individuals to participate in public service investment and financing. The systems of financial markets, financial institutions and financial policies for urban and rural commercial and low-income housing should all be established, and the housing finance regulation system should be improved. Third, a unified real estate tax system will be promoted to cover all urban and rural areas, with tax break to varying degrees available for real estate of a special nature and for special purposes. The real estate tax system and tax levy and management mechanism will be reformed, and the tax system to adjust commercial housing consumption and investment as well as tax break system for the investment, development and consumption of low-income housing will be established. Fourth, a fiscal and taxation system featuring “reasonable division of duty and matching rights and responsibilities” between central and local governments will be put in place, whereby the central government will undertake more public services and local governments will enjoy a larger part of tax and fee revenues. An urban-rural integrated household registration system, social security system and income distribution system will be established step by step, and social security and public services will follow the flow of population.

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Chapter 6

Urban and Rural Land Tenure Systems in China: History and Future



Pengfei Ni

6.1 History Land Tenure System

6.1.1 *Evolution of China's Basic Urban and Rural Land Tenure Systems from the Founding of PRC to the Reform*

6.1.1.1 Evolution of Rural Land Tenure System

After the PRC was founded, rural land moved from farmers' private ownership to collective ownership.

First, feudal land ownership was replaced by farmer's land ownership. Soon after the PRC was founded, the central government issued the *Law on Land Reform*, which abolished the feudal land ownership featuring the landlords' exploitation and adopted farmers' private land ownership. Farmers not only obtained land, but "had the right to operate, transact and lease" the land they owned.

Second, farmers' private land ownership was replaced by collective ownership. During the socialist reform from 1954 to 1956, the government retrieved land ownership, and a socialist land tenure system was established in the process of agricultural reform. Land that used to be owned by farmers, could be invested as equity and was operated in a centralized way was now owned by the collective.

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Third, collective land ownership was replaced by three-level collective ownership. A land reform was carried out from 1957 to 1978 that led to a system where land was owned by collectives on three levels, namely people's commune, production brigade and production group. All collective members worked on publicly-owned land and they had no private land of any kind.

6.1.1.2 Evolution of Urban Land Tenure System

Land was privately owned in the old China, and urban land was owned by bureaucratic bourgeoisies, feudal landlords, national bourgeois entrepreneurs, individual laborers and foreigners. After the PRC was founded, urban land became state-owned step by step based on different nature of the ownership.

Later state ownership and private ownership of urban land existed at the same time. When the PRC was first founded, the governments of different cities took over the urban land that used to belong to the KMT government, and confiscated a large amount of urban properties originally owned by the imperialists and bureaucratic bourgeoisies. Those land and properties belonged to the state from then on, but private land owned by national bourgeois entrepreneurs, individual laborers and urban residents was still acknowledged. Up until 1956, privately owned urban land could be traded, leased, invested as equity, pawned, presented or exchanged.

Urban land became state-owned and was used for free. The Secretariat of the CPC Central Committee issued the *Opinions on Current Situation of Urban Private Housing and Its Socialist Transformation* in 1956, which stated that "all urban clearings, streets and other land properties that are currently owned by individuals should be nationalized through proper means", thus comprehensively nationalizing urban land. Regarding the use of state-owned urban land, "local government should appropriate land for free without charging rent." As a result, the urban land use system under China's planned economy was established, featuring free use, limitless term of use and no circulation.

6.1.2 Characteristics and Problems of China's Basic Urban and Rural Land Tenure Systems from the Founding of the PRC to the Reform

6.1.2.1 Urban and Rural Land Tenure Systems

In the period after the PRC was founded and before the reform and opening-up, all land in China was under socialist public ownership, but urban land and rural land were of different nature, purpose and characteristics. Regarding nature, rural land belonged to the collective and urban land to the state; regarding purpose, rural land was used for agricultural production and farmers' housing, and urban land for

non-agricultural construction, none being a commodity; regarding characteristics, urban and rural land was separated, couldn't flow freely and had to be allocated according to centralized plan. While collectively owned rural land could become state-owned urban land through free requisition, the change of ownership didn't work the other way around.

Generally speaking, urban and rural land had such problems as unclear property right, inability of free circulation as commodity, zero value, free use, planned allocation, urban-rural duality and one-way flow. The land use system completely rejected the laws on land rent and the adjustment by market mechanism, resulting in the waste of resources, low efficiency and difficulty for land to play its due role. In the meantime, concrete and effective land use regulations were lacking. Under such circumstances, a series of bad phenomena emerged. For instance, a lot of land was occupied but only little was used, good land was put to poor use, and occupied land was left to idleness, causing a serious waste of land resources.

6.1.2.2 Urban Land Tenure System

Urban land belonged to the state but could be used freely and indefinitely by employers and individuals. It wasn't a commodity, was distributed through administrative allocation according to the central plan, and its use right couldn't be transferred as a property right. As to the management of urban land, property right management and administrative management were combined. As part of urban land, urban housing land was allocated by the government to enterprises and public institutions free of charge.

This system had the following drawbacks. First, free use of urban land made it impossible for the state to economically realize its ownership. Since land-using employers and individuals didn't have to pay anything for the state-owned land they used, the state was just a nominal owner while it didn't get any economic benefits. Second, the unreasonable expansion of urban land demand and low efficiency of land utilization caused immense waste of land resources. Third, land users left large areas of land to idleness and waste, and employers' occupation of land was uneven. Fourth, free use of urban land couldn't establish a benign cycle of urban construction fund and impeded the economic and social development of cities.

6.1.2.3 Rural Land Tenure System

Rural land belonged to the collective. It is run and disposed by the collective, and the collective gain profits from the land. It wasn't a commodity, was distributed according to the central plan, and was under state administration and collective property right management. Rural homestead also belonged to the collective but rural households could use it freely and indefinitely. One homestead per household was ensured with roughly the same area. To obtain the right to use the homestead, rural households needed to apply to the township government for approval and register at the county government. The use right of homestead couldn't be

transferred, it couldn't even be inherited in certain conditions, and urban residents couldn't buy rural homestead.

This system had the following drawbacks. The free and limitless use of rural land and loose management of its use resulted in unchecked increase of homestead and random occupation of farmland. Since rural land wasn't a commodity, it couldn't be transferred, traded or mortgaged, and only played the role of security but couldn't play a bigger and flexible role in economic development.

6.1.3 Reform and Evolution of China's Urban and Rural Land Tenure Systems Since Reform

After the reform and opening-up began, the traditional urban and rural land use system could no longer meet the demand for development. The reform of rural land tenure system started with land contracting and fixing farm output for each household, while the reform of urban land tenure system started with paid use of land and aimed for market-based distribution of land resources.

6.1.3.1 Reform of Rural Land Tenure System

Household contract responsibility system that linked remuneration with output was implemented. Starting from 1983, rural land was contracted to households for operation on the premise of maintaining its collective ownership, and this new approach was promoted in all rural areas across the country. At the end of 1983, about 98% of rural households contracted a fixed amount of farm output, and 97% of the total farmland was contracted to households, thus successfully separating the ownership and use right of land.

"New land reform" allowed land transfer. At the third plenary session of the 18th CPC Central Committee held in 2013, it was proposed to separate the ownership, contracting right and operation right of collectively owned land, and allow the free circulation of collectively owned construction land in the market.

6.1.3.2 Paid Use of Urban Land

The system of paid use of urban land was established (1979–1988). On July 26, 1980, the State Council issued the *Provisional Regulations on Construction Land of Chinese-Foreign Joint Ventures*, which pointed out that "Chinese-foreign JVs should pay a fee for the land they use whether it's newly requisitioned or inherited from the predecessor." On September 7, 1988, the State Council issued the *Provisional Regulations of the People's Republic of China on Urban Land Use Tax*, which stated that land use tax would be levied on urban land based on their different levels from November 1 that year.

The system of urban land circulation was established (1988–2000). In April 1988, the first session of the 7th National People’s Congress (NPC) passed the *Amendments to the Constitution of the People’s Republic of China*, which stipulated that “the right of land use can be transferred according to law”, providing the legal basis for the land owner to grant or land user to transfer the use right of state-owned land. In May 1990, the State Council issued the *Interim Regulations Concerning the Assignment and Transfer of the Right to the Use of State-Owned Land in Urban Areas*, which laid down specific provisions for the grant, transfer, leasing, mortgage and termination of the use right of state-owned land.

The reform of urban land use system was deepened (2000–2009). The central government and legislature of China issued a series of laws and regulations from 2001 to 2008 to establish the bidding and auction system for land transaction. This set up the market-based land distribution system on the legal level, whereby the use right of state-owned construction land was granted through public bidding or auction, and pushed forward land marketization. Because of those systems, market mechanism played a bigger role in land distribution, the market-oriented reform of urban land tenure system was further advanced, and the reform of urban land use system was deepened.

6.2 New Characteristics Land Tenure System Since Reform and Opening Up

6.2.1 *Characteristics of Urban Land Tenure System Including Housing Land Tenure System*

Property right: ownership and use right are separated, and profit-oriented land is used at a price and for a certain period of time.

Transaction: the land market is established and the right of land use can be granted and transferred at a price. The market competition mechanism is continuously improved and the system of “land bidding, auction and listing” is implemented and promoted. State-owned urban land is more and more distributed through the market.

Distribution: land profits belong to local government. Proceeds from urban land include land grant fee, administrative fees and land holding and transaction tax. The central government has gradually put in place a system whereby land proceeds mainly go to the local governments.

Purpose: urban land is managed by way of overall city plan and land use plan. If the land user needs to change the purpose of the land as stated on the contract granting the right of land use, he/she should obtain permission from the granter and approval from the departments responsible for land management and city planning, sign a new contract according to relevant rules, adjust the fee for granting the land use right, and register the change of land use.

Management: the central government intensifies land regulation and sets up relevant bodies. Land authority in local governments above county level is in charge of supervising and inspecting the grant, transfer, leasing, mortgage and termination

of land use right, and land and housing property authorities are responsible for registration of such grant, transfer, leasing, mortgage and termination as well as the buildings and other attachments on the land according to laws and relevant State Council regulations. County-level government, as the land owner, exercises the duty of land ownership management.

A new system is established whereby land is distributed through the market, used at a price and for a certain period of time, and can be circulated freely. Basic land market system and government regulation system are also established.

6.2.2 Characteristics of Urban Housing Land Tenure System

Urban housing consists of commercial housing and low-income housing, and urban housing land consists of commercial housing land and low-income housing land. As the use right of state-owned land is reformed, a dual-track housing land tenure system is established.

Property right: the ownership and use right of commercial housing land are separated and it is used at a price and for a certain period of time; the ownership and use right of low-income housing land are integrated and it can be used freely and indefinitely.

Profit distribution: on one hand, proceeds from commercial housing land are used by local governments for urban construction and housing security. On the other hand, local government not only has to provide low-income housing land for free, but is also partially responsible for the cost of land expropriation, demolition and resettlement, and land development.

Operating mechanism: the use right of commercial housing land is a commodity that can be freely distributed on the market through bidding, auction or listing; low-income housing land is provided by the government for free and distributed by means of administrative allocation according to overall plan.

Purpose: the use of land is managed by district. Both commercial housing land and low-income housing land should comply with the overall city plan and land use plan, and annual plans are made for land supply, all of which should be submitted to national and provincial authorities for approval. As to specific projects, housing developers should obtain the land use license and construction permit.

Management: the same management system for urban land is applied. The operation, regulation and administration of housing land are unified.

6.2.3 Characteristics of Rural Farmland Tenure System

Property right: ownership, the right of contracting and the right of operation are separated. Ownership belongs to the collective, contracting right belongs to rural households and operation right can be transferred to professional operators.

Profit distribution: a definite system is established to distribute the proceeds from agricultural land among the land operator, rural household, the collective and the state. A rational distribution system for added values arising from collectively owned rural construction land is established, which specifies that the added values are mainly used to build community infrastructure and improve public services.

Operating mechanism: multiple steps are taken to promote market-based land distribution. The market for the operating right of contracted rural land is established and efforts are made to circulate such right in a wide scope based on market demand, explorations are made to set up a transaction center for collectively owned rural construction land, and land operation on a proper scale is encouraged. The institutional foundation is laid for pushing collectively owned rural construction land to the market.

Purpose regulation: to protect farmland, the red line of 1.8 billion *mu* of farmland (1 *mu* is about 666.67 m²) should by no means be crossed, and the most rigorous farmland protection system is implemented, including approval of the level and quota of land use and balancing farmland occupation with compensation.

Management: the state has ultimate ownership of rural land and implements classified administrative management of it. The collective owns rural land, and exercises property right management of it and the property right and operation management of construction land. Rural households have the operating right of rural land and operate and manage it.

Reform measures aimed to promote the circulation of land contracting and operating right are beneficial for achieving large-scale and high-efficiency land operation, and consequently accelerating the concentration of agricultural production factors and the development of modern agriculture. They can also help achieve the goal of enabling and empowering the farmers and provide the institutional guarantee for increasing their property income.

6.2.4 Characteristics of Rural Homestead System

The system of rural homestead use can be summarized as follows. First, homestead belongs to the collective but can be used by rural households freely and indefinitely. Second, each household has a homestead with roughly the same area. Third, to obtain the right to use the homestead, rural households need to apply to the township government for approval and register at the county government. Fourth, the use right of homestead can't be transferred and can't even be inherited in certain conditions. Fifth, urban residents can't buy rural homestead. Currently the housing of both urban and rural residents is personal property.

6.3 Problems Land Tenure System Since Reform and Opening Up

Since the reform and opening-up was launched over 30 years ago, China's urban land use system has undergone tremendous changes and passed two stages – one of free land use and one of paid use. Today an urban land management system that suits the market economy has primarily taken form, in which the market plays the fundamental role in land distribution. The urban land market and operating mechanism are also established, which plays a positive role in meeting the land demand for boosting economic and social development and improving the living conditions for urban and rural residents, and promoting sustained, rapid and sound economic growth.

6.3.1 Duality of Urban and Rural Land Tenure Systems

Urban land and rural land are of different ownership, the former belonging to the state while the latter to the collective. They differ in the right of use, exchange and disposal, profit distribution and price of exchange. They feature a one-way flow, meaning that while collectively owned rural land can be requisitioned and become state-owned land whose use right can be granted at a price, state-owned land cannot become collectively owned. Given the dual economic structure between China's urban and rural areas, the use of urban and rural land follows different systems, the rules and approaches of their transaction are different, and state-owned and collectively owned construction land is of different rights and prices. All these are caused by unreasonable institutional arrangement and land markets that are yet to be unified. Such a phenomenon is bad for the rational flow of production factors between urban and rural areas and the economical and intensive use of urban and rural land.

6.3.2 Absence and Ambiguity of Basic Systems

First of all, ownership exists nominally only. The ownership of collectively owned rural land is unclear because it is actually split by government departments and controlled by proxies of collective organizations, while state-owned urban land is actually owned by local government departments. Second, the right of disposal is lacking. The use right of collectively owned rural land cannot be granted, transferred or mortgaged, but that of state-owned urban land can. Third, the right of development is limited. On one hand, rural land cannot be used for non-agricultural construction; on the other hand, plans for the use of urban and rural land are not earnestly implemented. Fourth, the right to profits is inequitable. Reasonable profits from collectively owned rural land cannot be guaranteed due to the lack of clear

institutional restrictions. Meanwhile, when collectively owned land becomes state-owned and is developed, added values from the land isn't equally distributed among the local government, developer, collective organization and rural residents, and rural residents' reasonable profits cannot be guaranteed.

6.3.3 Monopoly in Land Operation

First, land market isn't well developed. (1) The market of land ownership hasn't been formed yet. Although collectively owned rural land can become state-owned through administrative requisition, its ownership and the ownership of state-owned urban land cannot be traded. (2) There isn't a market for rural land. Not only is the ownership non-tradable, but the use right cannot be traded freely either. (3) Trade of the use right of urban land is monopolized by local government, the "buyer". Second, price mechanism isn't sound. Collectively owned rural land can be used free of charge, but when it becomes state-owned land, it is priced by the government. Due to supply monopoly, the price of state-owned urban land for commercial and residential purpose is extraordinarily high while that of industrial land is extremely low. Third, a market exchange mechanism hasn't been established. Land supply and demand among different regions, industries and market players is based on planned distribution, and administrative land quota is broken down level by level without inter-regional coordination. Fourth, the mechanism of fiscal and tax adjustment isn't set up. The system of land tax and fee isn't well developed, land idleness tax isn't levied, and land use tax is extremely low.

6.3.4 Unsound Management System

The land administration is responsible for administrative regulation, market operation and property right management all at once. First, the government-market relation isn't standardized. The government serves as market supervisor, macro-regulator and land operator. It operates land by exercising administrative power. Second, the system of land use management isn't strict enough. Third, there isn't a clear line between the owner and the regulator. (1) Land administration plays the dual role of regulator and owner. (2) The system of land property right management is unsound, and a thorough system of state-owned land asset management hasn't been formed. (3) Relations inside the government are unsmooth. As functional departments, land authority, either of a higher or the same level, cannot supervise the local CPC Committee or government.

The unclear property right results in unfair profit distribution and aggravates social conflicts. Because of the lack of a well-developed market mechanism, a lot of land in the countryside, industrial and development zones and less developed areas in central and western China is idle, uncultivated and wasted, while land for

commercial and residential purpose and in developed areas in eastern China is in serious shortage. It also leads to the over-reliance on land finance for economic and social development, bubbles in land and housing price and an economy too heavily centered on real estate. Because of the unsound management system, illegal land occupation is prominent, and power rent-seeking is serious in the land business. These seriously impede and threaten China's economic and social development, and obstruct the healthy progress of urbanization.

6.4 Deepening the Reform Land Tenure System and Future Prospects

The reform of urban and rural land tenure systems will be deepened in order to adapt to the socialist economic system. Although arguments still exist on the design of specific systems, a consensus has been reached on the basic framework.

6.4.1 Establishing an Urban-Rural Integrated Land Tenure System

An urban-rural integrated land property right system will be established, so that urban and rural land will have the same nature, right and price in terms of ownership, right of use, right of disposal and right to profits. An urban-rural integrated land market mechanism will be formed, so that the use right or even ownership of land can be freely transferred in the city, in the countryside, between urban and rural areas and among different regions. An urban-rural integrated land management system will be created. A unified land authority will regulate both urban and rural land, the land operator will have the operating right, and the true land owner will either manage land property right by him/herself or entrust the management to an agency according to standard procedures.

According to the purpose of land, agricultural land belongs to the state and farmers can either use it freely for a long period or transfer it at a price. Of non-agricultural land, the government obtains non-profit land through administrative requisition at a price close to market price and allocates it to the user for free use within a designated period. When that period expires, the government will retrieve the land, and the department in charge of the property right of state-owned land will either grant it as profit-oriented land at market price or continue to allocate it as non-profit land. Profit-oriented land can be traded freely in the market, and the government should regulate it and levy tax on it according to law. The system that agricultural land can be requisitioned and used as profit-oriented land will be abolished.

6.4.2 Establishing a Clear Basic System

First, both urban and rural land will become state-owned step by step. Second, the use right of urban and rural land will belong to legal person or natural person step by step. Rural households will have the use right of agricultural land freely and indefinitely; residential land will be used freely and indefinitely but with a quota; and excess homestead and urban and rural construction land will be used at a price and for a specific period of time. Third, the system of land disposal right will be established and improved, so that the use right of urban and rural land can be granted, transferred and mortgaged over time. Fourth, the land profit distribution system will be reformed, and a system that includes rent, tax and fee at the same time will be put in place. The sharing system of state-owned land profits will be established gradually, in which the central government gets absolute rent, local government gets differential rent I and land users get differential rent II. Two land grant fee systems will be formed. When the use right of state-owned land is granted for the second time after the term of the first grant expires, the grant fee will be charged in installments, namely in the form of annual rent. Special land finance account and land profit fund will be opened both in the central and local governments.

6.4.3 Establishing a Market-Based Land Operation Mechanism

First, a comprehensive land market system will be established, in which the operating right of agricultural land can be transferred freely and the use right of profit-oriented non-agricultural construction land can be transferred freely between urban and rural areas, regions and economic entities at market price. Second, the land requisition system will be reformed. For collectively owned construction land (including homestead) that complies with the urban and rural plan and land use plan, its use right can be traded after it becomes state-owned and the land use grant fee is submitted to the state. Third, a price adjustment mechanism for land market will be put in place, and both urban and rural land will be used at a price. Fourth, a free exchange mechanism will be built. The administrative planning system will be abolished, and entities in different regions, industries and markets will achieve land supply-demand balance through the market. Fifth, a sound fiscal and tax mechanism will be formed. The land tax and fee system will be improved, and land idleness tax and land use tax will be levied.

6.4.4 *Establishing a Smooth Management System*

First, the urban land management system will be reformed. Land authorities on all levels are responsible for formulating rules, policies and plans, protecting land resources and supervising the market. Second, state-owned land asset management committee should be formed on all levels to manage land for public welfare construction projects and profit-oriented land of enterprises in the jurisdiction. Third, the system of land use management will be improved. The *Criminal Law of the People's Republic of China* and relevant laws and rules will be revised to pursue the criminal liability of land law breakers.

The prospective profits from land tenure system reform will guarantee and materialize the interests of property right owners and users, ensure fair distribution of land proceeds and narrow the income gap between urban and rural areas, among regions and residents. After the reform, land resources will be rationally allocated and put to the best use on the basis of full and free flow, thus raising the efficiency of land utilization and mitigating the bubble in land and housing price. The reform will also put a brake on illegal land occupation, power rent-seeking and corruption in the land business, guide the development on the right track and prevent development risks, and promote sustainable and healthy economic and social development and a new-type of urbanization.

Chapter 7

Land and Property Taxation and Fiscal Reform and Land Market Control



Zaifu Tang

Land market is an important part of the real estate market and plays a foundational role in its development. Land system in the broad sense refers to the system that encompasses all land-related matters, including all land relations formed on the basis of land ownership and use under specific socioeconomic conditions. In the broad sense, land tenure system covers ownership, use, land, protection, requisition, taxation and management, whereas in the narrow sense, it includes the system of ownership, use and management. There are three levels of land market: level 1, level 2 and level 3, and the main approach of land market regulation shifted from administrative and planned management to economic and legal means. A thorough analysis of the land tenure system reform in the Chinese mainland and the difficulties in land market regulation is important for finding solutions to the problems and promoting the stable and balanced development of the real estate market.

7.1 Evolution of Land Management System

The land tenure system is an important system that reflects the relation between people and between people and land. It is both an economic and a legal system, the legal reflection of land-based economic relations and an integral part of the upper

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structure. For a very long time after the PRC was founded, people habitually thought of land tenure system in its narrow sense due to historical reasons. After the reform and opening-up was launched, especially after the socialist market economy was implemented, people's understanding of the land tenure system in the Chinese mainland has deepened and evolved along with the constant changes and developments in China's socioeconomic system. The new view was no longer limited by old ideological restrictions. While stressing land tenure system in the broad sense, which included the system of land ownership, use and management, it also paid attention to new contents deriving from new land relations, such as the system of land utilization, transfer, farmland protection and management of land use purpose.

In history, urban land in China was basically owned by individuals. The land reform in the 1950s was limited to traditional countryside, while urban and suburban land remained under the pre-PRC land ownership, and private land ownership was maintained. There were policy reasons for this. On April 25, 1949, Mao Zedong and Zhu De signed the *Bulletin of the People's Liberation Army* that stressed that "urban land and housing shouldn't be dealt with in the same way as rural land." Article 3 of the *Common Programme*, the interim *Constitution* adopted in September 1949, stated that "economic interests and private properties of workers, farmers, petty bourgeoisie and national bourgeoisie should be protected" and the "private properties" included private land.

7.1.1 Rural Land Tenure System

At present, rural land in the Chinese mainland is of collective ownership. Rural households contract and operate farmland and the remaining collective land can be leased to other employers or individuals by means of agreement, bidding or auction. The current land transfer model came into being through a series of social changes after the PRC was founded and experienced four stages.

In the first stage, the socialist land tenure system focused on farmer's land ownership took primary shape, which was symbolized by the issuance of the *Law of the People's Republic of China on Land Reform* in June 1950. After the land reform was completed, farmers became the owner and user of small plots of private land, which greatly stimulated their enthusiasm and quickly recovered the rural economy. The issuance of "land certificate" in 1951 during the land reform gave farmers land ownership. On November 25, 1950, the Internal Affairs Department of the central government promulgated the *Notice on Filling in and Issuing Land and Housing Ownership Certificate*, in which Article 1 went as follows: according to Article 27 of the *Common Programme* (farmers' existing ownership of land should be guaranteed) and Article 30 of the *Land Reform Law* (the people's government should grant land certificate after the land reform is completed), land and housing ownership certificate should be granted to farmers, regardless of whether their land was newly obtained or in their possession originally, in areas where land reform was completed, so as to guarantee the land and housing ownership of people in all classes

and consolidate their production enthusiasm after the reform. Certificate should also be granted to landlords for land and housing allocated to them after the reform. According to Article 30 of the *Land Reform Law*, all land deeds concluded before the land reform would become null and void and should be submitted and destroyed when the new certificate was issued. In other words, the “land certificate” issued to farmers in 1951 was aimed to guarantee their “ownership” of the land allocated to them.

In the second stage, farmers’ private land ownership was replaced by the system whereby “rural land belongs to farmers but is operated and used by the collective in a centralized way”, followed by the system of mutual-aid teams and elementary agricultural producers’ cooperative. The *Work Regulations on Rural People’s Commune* (also known as the “60 Agricultural Articles”) (draft amendment) completed the “collectivization” of rural land, and institutions were designed to prevent the trade of rural land. A very popular reason for opposing land privatization today is that farmers may blindly trade their land once they own it. The Chinese government had such concerns too when they issued the “land certificate” in 1951 to guarantee farmers’ land ownership, so they adopted a series of institutions to prevent land trade, an important one of which was the *Notice on Transfer and Deed Tax of Rural Land* issued by the State Council on May 7, 1955. According to the Notice, “although trading rural land isn’t prohibited by law, efforts should be made to prevent farmers from unnecessarily selling or pawning their land. Therefore, trade, pawn and other forms of transfer of rural land should be submitted to the township-level people’s committee for review and then to the sub-county administrative office or sub-county people’s committee for approval (county or municipal people’s committee if no sub-county is established). The sub-county administrative office or sub-county people’s committee (county or municipal people’s committee if no sub-county is established) should issue a letter of introduction so that deed tax procedures can be carried out. The bodies mentioned above should investigate the matters over which they will issue the letter of introduction and handle them accordingly. If farmers sell or pawn their land due to production and living difficulties, they should help them solve the problems and prevent the sale and pawn. If farmers exchange land for distance or quality reasons in order to facilitate production, they should approve the transaction. If land buyers intend to lease the land for exploitation or if farmers sell or pawn the land for survival because they have no proper employment and don’t work, they shouldn’t issue the letter of introduction.”

In the third stage, the land tenure system featuring “private ownership by farmers and centralized operation and use by collectives” was replaced by one where “rural land is owned, operated and used by the collective”, as symbolized by the “60 Agricultural Articles” that turned private ownership of rural land into collective ownership. In June 1956, the third session of the first National People’s Congress (NPC) passed the *Bylaws of Advanced Agricultural Producers’ Cooperative*, which signified the shift from private land ownership to collective ownership. In the advanced cooperative, land was collectively owned and operated and could no longer generate dividend as a private property. Later the people’s commune movement was launched, which upheld “large commune and high level of common

ownership”, and eventually replaced private land ownership with collective ownership on different levels, including townships and villages. As a result, the right of land ownership and use was highly concentrated and land couldn't be leased or traded.

After the people's commune movement was launched in 1958, the central government didn't formulate and issue a national charter governing the work of people's communes, which was an important reason for the chaos in rural policies and the spread of “five poor work styles” (premature communism, exaggeration, forced order, blind command and privileges for cadres). The *Letter of Emergency Instructions* that included 12 articles in 1960 failed to turn the tide in the countryside. Therefore, Tian Jiaying's suggestion on formulating the work regulations for people's commune caught Mao Zedong's attention and was adopted. In March 1961, the central government held a work meeting in Guangzhou, and the key topic was drafting, discussing and passing the *Work Regulations on Rural People's Commune (draft)*, which later became known as the “60 Agricultural Articles”.

The “60 Agricultural Articles” defined three levels of people's commune organizations: commune, brigade and production team, to flatten the commune hierarchy, and specified their duties, rights and interests. It emphasized that private plots could be used by commune members for a long time, and agricultural produce from private plots were not included in the collectively allocated output and ration and were not requisitioned or purchased by the state. Generally, the commune could use no more than 2% of the brigade's labor force, and the brigade could use no more than 3% of the production team's labor force. In the next few years, the commune should use less of the production brigade's public fund or not use it at all. If it had to use the fund, the ratio of use should be approved by county-level people's committee. The brigade gave the production team an output quota and a fixed amount of work-points (a measurement of remuneration) and expenses, and the production team would be rewarded if it exceeded the output quota and the excess output and expenses were at its own disposal. The quota should be rational and achievable, and most or all of the excess output should be left to the production team. Commune cadres at all levels should be practical and report the true situation, and they were prohibited from beating or cursing people or exercising corporal punishment in any form, or punishing commune members by denying them “meals at the commune canteen”, threatening not to “grant ration” or deducting their work-points at will. These regulations were highly targeted at that time.

The draft “60 Agricultural Articles” laid down the following rules: the people's commune on all levels, especially the production brigade, should not be too large, so as to avoid equalitarianism among brigades of too large economic differences. The two-layered ownership based on production brigade's ownership was the fundamental system of current people's communes. Of the cash and materials allocated by the production team (including canteen) to commune members, general salary should take up 70% at least while the ration 20% at most. Production teams should make great efforts to develop public canteen wherever possible. The draft went through several rounds of discussion, revision and trial implementation, and eventually the partial ration system and public canteen that farmers were generally opposed to were cancelled.

The central government held a work meeting in Beijing from May 21 to June 12, 1961, at which the “60 Agricultural Articles” were revised, public canteen was dissolved and ration system was abolished. Regarding public canteen, Article 36 of the draft “60 Agricultural Articles” amendment provided that “commune members will discuss and decide whether the production team should run the canteen.” “Ration for commune members should be provided to each household and be disposed of by commune members themselves whether the canteen is operated or not. The ration can be allocated at one time after harvest or in installments.” Regarding the ration system, the draft amendment cancelled provisions on the ratio of ration (30%) and salary (70%) for commune members, and provided that their income “should be based on work-points”.

Poor and employed farmers wouldn’t treasure the “land deed” for long. The socialist transformation changed the old rural land ownership into collective ownership. Article 21 of the “60 Agricultural Articles” stated that “all land within the scope of the production team belongs to it, and these land, including private plot, mountain and homestead of commune members, cannot be leased or traded. Land owned by the production team cannot be occupied by any employer or individual without the review and approval by people’s committee above county level.” It must be pointed out that it was improper to take this provision as the legal basis that rural land thoroughly shifted from private ownership to collective ownership, because the “60 Agricultural Articles” was nothing more than “regulations” from the beginning to the end, and draft regulations for that matter.

In the fourth stage, China launched the reform and opening-up in 1978, resumed farmers’ private right of land use, and implemented the system that rural land was owned by the collective but contracted to rural households for operation. First of all, the household contract responsibility system was implemented in the countryside, thus separating land ownership from land use right. After the third plenary session of the 11th CPC Central Committee, economic development made remarkable progress, people’s lives were considerably improved and there was a heavier pressure on land demand, exposing more land-related problems. Therefore, the fourth *Constitution of the PRC* issued in 1982 laid down express provisions on land: “urban land belongs to the state”, “rural and suburban land belongs to the collective unless they are stipulated by law as belonging to the state, and homestead and private plot and mountain also belong to the collective”. Considering how important land factors were for national economic development, the *Constitution* also provided that “the state can requisition land according to law for public interests” and “no organization or individual should encroach upon, trade, lease or illegally transfer land in any other way”. Limited by the subjective and objective conditions then, the government didn’t realize the commodity attribute of land yet, so land transaction was prohibited. The NPC passed the constitutional amendment on March 29, 1993, which stipulated that farmers’ use right of land was mainly contracting right. When the *Constitution* was amended again in 2004, it laid down provisions on the requisition or purchase of collective land. Item 3 of Article 10 in the old *Constitution* stated that “the state can requisition land according to law for public interests”, and it was revised into “for public interests, the state can collect or requisition land and provide compensations

according to law”, stressing the necessity of compensations for requisitioned land. In March 2007, the *Property Law* specified the free renewal of residential land, and the renewal of construction land for other purposes should be handled according to law. It also specified that relevant rules on the use right of collective land, such as investing it as equity or mortgaging it, would be worked out according to law and the change of situations.

7.1.2 *Urban Land and Housing Property System*

- The *Constitution* of 1954 made it clear that urban residents’ ownership of housing should be protected.

Regarding urban land, the 1954 *Constitution* deleted the article that “economic interests and private properties of workers, farmers, petty bourgeoisie and national bourgeoisie should be protected” that was expressly stated in the *Common Programme*, and declared to “gradually eradicate the exploitation system and establish a socialist society through socialist industrialization and transformation”. But it also stated that “the state protects the handicraftsmen’s and other non-agricultural laborers’ ownership of production materials” and “capitalists’ ownership of production materials and other assets according to law”, and “the state also protects citizens’ ownership of legal income, savings, housing and living materials”. In other words, urban residents’ ownership of land, whether the land was taken as production or living material, was still acknowledged and protected by the 1954 *Constitution*.

The 1954 *Constitution* protecting urban residents’ housing ownership was also reflected in actual data. “According to relevant documents, private housing still took up a large part of the total real estate in cities by 1955, even up to 86.14% in Suzhou. Free housing trade among urban residents was very popular then. In the early and mid-1950s, some cultural celebrities bought housing in Beijing to stay there. For example, Wu Zuguang bought a quadrangle courtyard including land and housing for about RMB10,000–20,000, and such private property was protected by the 1954 *Constitution*.”

- Reform of private housing: “nationalization” through “state operation and leasing”

On January 18, 1956, the CPC Central Committee endorsed and forwarded the *Opinions on Current Situation of Urban Private Housing and Its Socialist Transformation* submitted by the No.2 office of its Secretariat. The *Opinions* proposed to carry out socialist transformation of private housing under the “general guideline of intensifying national control. First the leasing of private housing should completely follow state policies, and then the ownership of private housing should be changed step by step”.

There were two ways of transformation. One was state operation and leasing, namely “the state would lease, distribute, repair and maintain the housing in a centralized way and provide the housing owner with reasonable profits”. Today, such state-operated, state-leased private housing is a serious “problem left from history”. The other was public-private partnership, namely “private real estate companies and large housing owners can set up real estate companies through public-private partnership”. The first approach was absolutely dominant.

State operation and leasing of housing was implemented not just to take away the owners’ independent right of operation and share their rent, but also to eventually change the ownership of the housing. Therefore, it was provided that “for housing that is operated and leased by the state, . . . the owner can only obtain a fixed rent but cannot take back the housing”, and “housing owners that believe that although the housing is operated and leased by the state, it still belongs to the owner and not the whole people” were seriously reprimanded. In other words, “state operation and leasing is just a means to putting urban private housing under state ownership by force but avoiding the term nationalization”. On September 18, 1964, the Supreme People’s Court issued the *Reply to the Matter that State-operated and Leased Housing Cannot be Inherited* (FYZ No.80), which stated that “the owner of state-operated and leased housing has de facto lost ownership of the housing, so the housing cannot be inherited by family members after the owner passes away.” However, loss of ownership in this way didn’t hold water from a legal point of view, so state-operated and leased housing that originally belonged to Guangdong-based overseas Chinese was returned on a large scale from 1997 as a sign of respecting private property. At the end of 2007, the Supreme People’s Court abolished the judicial interpretation contained in the *Reply* mentioned above.

– The *Constitution* of 1982 completed “nationalization” of urban land.

After the reform and opening-up was launched, while the agricultural land tenure system was reformed, explorations were made regarding the use of urban state-owned land and the general direction was that free allocation would be replaced by paid use. With the deepening of reform and opening-up and the establishment of market economic system, the use right of state-owned land shifted from free allocation to paid grant and transfer. As a result, the level-1 and level-2 land markets were formed gradually, and the framework of land resource circulation was established.

The earliest known policy document that called for nationalizing all urban land once and for all was the *Record of the Reply to the Request for Instructions on Nationalization of Urban Land* issued by the State Housing Administration and the Taxation Administration under the Ministry of Finance on November 4, 1967. In 1956, the CPC Central Committee endorsed and forwarded the *Opinions on Current Situation of Urban Private Housing and Its Socialist Transformation*, which had an article that said “all privately owned urban clearings, streets and other land properties should be nationalized through proper means”. The *Record* explained that “streets and other land properties should include urban private homestead on which housing is built”, and stressed that “all clearings (including banner land) and land (including

that owned by exploiters and laborers) should be nationalized". This lifted the curtain on the nationalization of urban private homestead. However, although the *Record* was issued, the private ownership of urban land wasn't abolished from a legal point of view, so the urban land ownership system where state, collective and private ownership co-existed was maintained at least nominally until the 1982 *Constitution* was promulgated.

On December 4, 1982, the new *Constitution of the People's Republic of China* was passed at the fifth session of the fifth NPC, and item 1 of Article 10 made a succinct and definite provision: "urban land belongs to the state". The book titled *Land Economics* published by China Agriculture Press in 1989 included the following descriptions about this epoch-making change. "China never officially announced to nationalize all urban land before the 5th session of the 5th NPC in 1982. Although most of the urban land already belonged to the state, a small quantity of it still belonged to collectives and individuals, so for a very long time, state, collective and private ownership of urban land co-existed, state ownership being in a dominant position. According to a survey of 226 cities in the country conducted in 1982, there was 7,438 km² of built-up areas in cities and about 335 km² of collective and private land, accounting for 4.5% of the total. Collectively owned urban land mainly referred to the land that was invested by self-employed workers as equity when they formed cooperatives and used as the premises, and privately owned urban land mainly referred to owner-occupied housing and the homestead of owner-leased housing below the threshold of socialist transformation. According to Article 10 in the *Constitution of the People's Republic of China* passed at the 5th session of the 5th NPC in 1982, 'all urban land belongs to the state'. This not only clarified the ownership of old state-owned land, but also pronounced through legislation the remaining non-state-owned urban land as state-owned. Land nationalization like this was not paid for, but it didn't cause any trouble because the land concerned was of a very small area, and there were always rigorous restrictions on private land, which could only be used but not traded, leased or transferred in any other way. Private land ownership was incomplete long ago."

In the early stage of the socialist market economy, people gradually realized that socialist public land ownership didn't reject the commodity attribute of land. To break the land monopoly under the traditional land use system and eliminate idle land and unfair competition caused by it, the first session of the seventh NPC passed a constitutional amendment on April 12, 1988. Item 4 of Article 10 of the *Constitution* stated that "no organization or individual should encroach upon, trade, lease or illegally transfer land in any other way", which was revised into "no organization or individual should encroach upon, trade or illegally transfer land in any other way, but the land use right can be transferred according to law." Therefore, the separation of land ownership and land use right was recognized and protected by the *Constitution*, which pushed the land commercialization reform comprehensively.

The current *Constitution* specified the two forms of socialist public land ownership, namely state land ownership and farmers' collective land ownership, and divided their scope on principle. Main contents were as follows: (1) rules on land requisition were provided to coordinate the two forms of socialist public land

ownership; (2) encroachment, trade or illegal transfer of land in any other form was prohibited in order to preserve the socialist public land ownership; (3) land use right could be transferred according to law in order to promote the rational allocation of land resources; (4) land should be used rationally in light of the national condition of a large population and limited land, and the state should conduct centralized land planning to control and regulate its use.

After the *Constitution* laid down the basic principle of public land ownership and its forms, departmental laws, according to the values reflected in the *Constitution*, crystallized the principle with necessary supplements. For example, relevant articles in the *Property Law* stipulated state and collective land ownership and the subjects thereof, and specified the use right of state-owned land, right of contracting and operating collective land, and state-owned land users' obligation of managing, protecting and rationally using the land. The *Law of Land Management* stipulated land ownership, requisition, transfer and paid use, clearly divided state-owned and collective land, further clarified the subject of collective ownership, confirmed the separation of land use right and ownership, specified the right of contracting and operating state-owned and collective land, and provided the procedures for handling land right disputes. The *Law of Urban Real Estate Management* included the following provisions: the system of paid use of state-owned land for a certain period should be carried out, and free and indefinite use of state-owned land should be strictly controlled; collective land couldn't be granted until it was requisitioned to be state-owned, and the land use right should be granted through proper means (auction, agreement or bidding); land use right granted to the user usually could be renewed when the term of use expired; and a time limit should be put on real estate development after land was secured.

Article 10 of the current *Constitution* provided that "urban land belongs to the state. Rural and suburban land belongs to the collective unless they are stipulated by law as belonging to the state, and homestead and private plot and mountain also belong to the collective. For public interests, the state can collect or requisition land and provide compensations according to law. No organization or individual should encroach upon or trade land or otherwise engage in the transfer of land by unlawful means. Land use right can be transferred according to law. All land users, be it organization or individual, must make reasonable use of land." Article 2 of the *Law of Land Management* stipulated that "the PRC implements socialist public land ownership, meaning ownership by the whole people and workers' collective ownership." This pointed out the two basic forms of socialist public land ownership, which, from the ownership perspective, referred to state land ownership and farmers' collective land ownership. There is no other form of land ownership.

The reform of the state-owned land use system in the Chinese mainland was based on the system of land property right. At first, when the *Constitution* specified state and collective land ownership, it also made clear that "no organization or individual should encroach upon, trade or lease land or otherwise engage in the transfer of land by unlawful means". But with the reform of China's economic system, the economic value of land was re-recognized. Under the market mechanism, land users urgently needed a sound system clarifying their right and power in

order to effectively promote the circulation of land resources. Therefore, the *Constitution* in 1988 confirmed that “land use right can be transferred according to law”, which separated the right of land use from land ownership and specified what was tradable. On May 19, 1990, the State Council issued the *Provisional Regulations of the People’s Republic of China on Granting and Transferring the Use Right of State-owned Urban Land*, which provided that “for state-owned urban land that is obtained legally, its use right can be transferred, leased, mortgaged or used for other economic activities within the term of use, and the legitimate rights and interests arising therefrom are protected by law.” This further established land use right as an independent economic right. The *Law of Land Management* after two recent revisions stated that the State Council was the representative of state-owned land and exercised the ownership on behalf of all people. The process of establishing the property right system for state-owned land in the Chinese mainland showed that continuous improvement of land property right system was the precondition for reforming the land use system and the foundation for the healthy development of land market, while land market development could in turn boost the establishment and improvement of land property right system. The Chinese mainland also made a point of protecting the socialist public land ownership with the *Criminal Law*. The *Constitution* prohibited any encroachment or damage of state and collective properties (Article 12). Therefore, the *Property Law*, *Law of Land Management* and *Law of Urban Real Estate Management* all stipulated that encroachment of property, impairment of social order and dereliction would be held criminally accountable according to relevant articles of the *Criminal Law*.

7.2 Functions and Evolution of Land Fiscal and Tax Systems

7.2.1 Basic Structure of Land Tax System

Land tax system is an important part of land tenure system and a functional system and transmission mechanism for government regulation of the land market. In countries of market economy, the tax system has a major impact on the use of land resources and real estate development and consequently on the overall operation of national economy. Therefore, to push forward land management innovations in the Chinese mainland and improve government administration of land-related revenues and expenditure, we must start with the land tax system, make overall considerations for the use of land resources, property management and tax regulation, and set up a long-term mechanism to strike a dynamic balance among them.

The land tax system refers to the government’s division of right and authority regarding land-based income and land-related revenue and expenditure, and the institutional arrangement for budget management. To be more specific, it includes the division of government power over land matters and responsibility for land

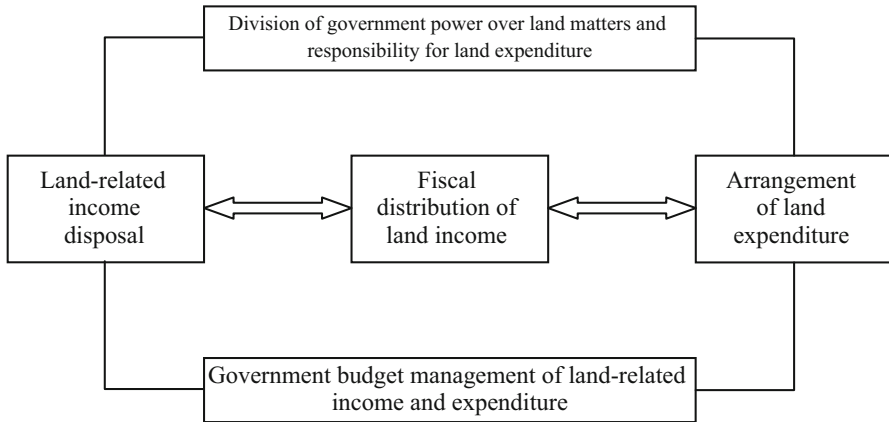


Fig. 7.1 Basic structure of land tax system

expenditure, authority arrangement regarding the management of state-owned land property and handling of income from that, division of authority regarding land-related tax and fee, and corresponding budget arrangement.

1. Division of government power over land matters and responsibility for land expenditure. For the sake of information symmetry and administrative efficiency, land-related public products and services and the construction of auxiliary facilities are usually undertaken by low-level governments, and high-level governments only coordinate cross-regional and cross-watershed matters and major administrative steps about land and environment. Accordingly, the right to dispose land-related income mainly rests with local governments too in most countries, although the ratio of income sharing between high-level and low-level governments varies from country to country based on the type of tax and nature of income. In some countries, the central government collects part of the land income for land maintenance, environmental protection and equitable development nationwide (Fig. 7.1).
2. Division of government authority over land-based income. In the Chinese mainland, government authority in this respect consists of three parts: (1) authority over land tax income, including legislative power of land-related tax, right of tax levy and fiscal distribution of tax income; (2) right of levying and adjusting land fee; and (3) right to exercise the ownership of state-owned land and dispose the revenues from it. In countries such as the U.S., the federal, state and local governments all have their own land, and the state-owned land (asset) authority on all levels exercise the land ownership and dispose land revenues. In the Chinese mainland, state-owned land belongs to all the people, and the State Council exercises the owners' rights on their behalf, but it has to entrust lower-level governments to exercise the rights and dispose the equity income from state-owned land. This gives rise to the issue of authority division between central and

local governments, which is about the right of taxation and charge in countries that implement private land ownership.

3. Arrangement for the disposal of land revenues. In the current fiscal system in the Chinese mainland whereby the authority and expenditure responsibility of governments on different levels are clearly divided and their fiscal revenues are allocated based on taxes, local governments have limited financial resources and few ways of financing. To cover expenditure and achieve faster development, most local governments use their dual identity as the public land manager and state-owned land owner to broaden the sources of income, and land revenue consequently becomes a crucial source of income for local governments, including land tax, land fee and equity income from state-owned land.

The first is land tax. Currently there are five independent land taxes across the world, namely income tax (individual or corporate income tax), property tax (realty tax, inheritance tax and gift tax), turnover tax (value-added tax and business tax), action tax (vacant land tax, idle land tax, farmland occupation tax and urban land use tax), and resource tax (tax on water, forest and mineral resources). When land and housing are taxed together, it's usually called realty tax or housing tax, and there is also deed tax and stamp tax in land transaction. Based on different tax types, real estate tax in different countries can be divided into three types: one focused on income tax, one on property tax and one on both (with no principal tax in other words) (Fig. 7.2).

The second is land fee. Apart from land tax, there are two types of land fees. One is regulatory fee, which refers to the handling charge and production cost charged by government bodies on residents or legal entities for providing specific services or fulfilling certain functions. This includes production cost for certificates or licenses, property right registration fee, and notarization fee. The other type is benefit charge, which refers to the compensatory charge paid by land and housing owners or users for directly or indirectly enjoying various facilities or services. It is equivalent to the payment for products or services, including funds collected by the government to develop specific social undertakings, and monitoring, surveying and supervision fee paid to public institutions for their services. There is also land use fee of the nature of land rent.

The third is equity income from government land. This refers to the income from selling government-owned land or leasing or granting its use right, as well as dividend from using the use right as equity or investment. Selling state-owned land is prohibited in the Chinese mainland, so there is only income from leasing (granting or transferring) its use right.

Government budget management of land-related income and expenditure includes the budgetary control of land-related government revenues, sharing and allocation of the revenues among governments on different levels, and budgetary planning, approval and execution of fiscal expenditure. Generally speaking, land tax is put under unified fiscal budget management in all countries, but they have different practices regarding regulatory charges and equity income from state-

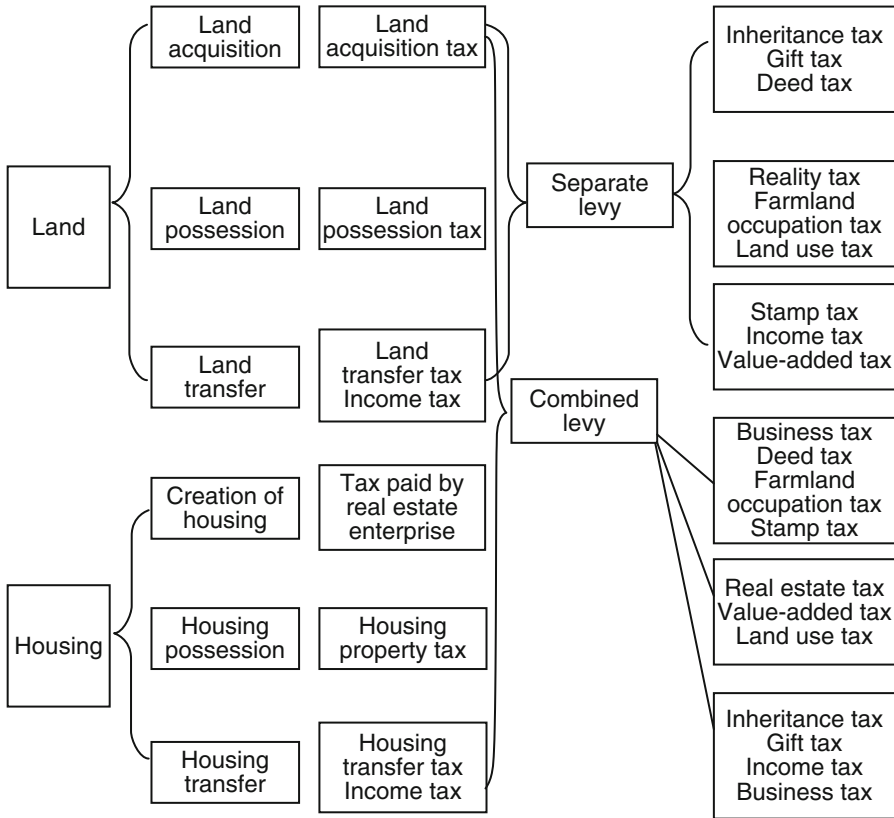


Fig. 7.2 Land-related taxes

owned land. Some put it under unified fiscal budget but others implement fund budget.

Due to the special nature of land resources, the land tax system is designed to serve multiple purposes and functions. As an important means for the government to dispose income and adjust revenue distribution, land tax system first and foremost serves as a fiscal means. It is also an economic instrument that participates in macroeconomic regulation and adjusts the utilization of land resources. To be more specific, it serves the following functions (Fig. 7.3):

1. Function of resource allocation. In conditions of market economy, the government allocates resources with income and expenditure of public finance to push socioeconomic development in the desired direction. The function of resource allocation is mainly reflected in substitution effect, namely light tax is applied to encourage land use for certain purposes and heavy tax to restrict land use for others, thus controlling land use to some extent. Common taxes to do that include progressive tax and punitive tax, whose effects lie in the following three aspects.

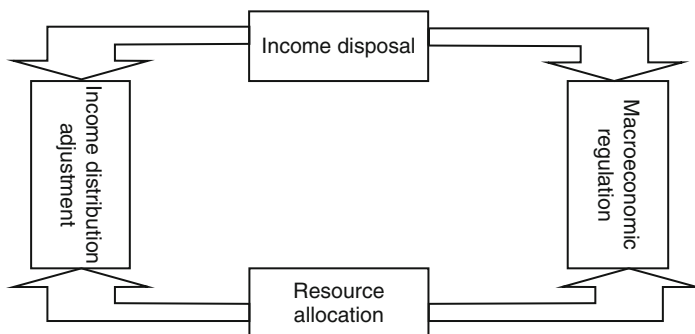


Fig. 7.3 Functions and purposes of land tax system

They promote the intensive and efficient utilization of land resources, restrain land speculation and avoid unreasonable land idling. Land tax system, as a major economic leverage, can be combined with administrative measures to substantially promote the rational utilization of land resources, either at the macro, meso or micro level. For example, wasteland tax on farmland that is left to waste for no good reason can reduce the occurrence of such behavior, tax reduction or exemption on land suitable for farming can promote agricultural development and stabilize grain output, and land VAT can not only curb land price hike to some extent, but also restrict land speculation. High vacant land tax and raised income tax rate on short-term land transfer naturally put a wet blanket on land resale and speculation.

They promote the rational allocation of land resources, improve the structure of land use and meet people's diversified land demand. The land tax system is designed to adjust the cost for using different types of land, so that a reasonable ratio can be achieved between agricultural and urban land, between land of high and low economic benefits, and between profit-oriented land and non-profit land. This can help to implement the land use plan and achieve conservation of nature, environmental improvement and resource utilization at once. Some states in the U.S. levy forest output tax, which means annual tax is exempted for immature forests and timber products are only taxed at the time of harvest, so as to encourage long-term afforestation. Tax is also exempted on forests for water and soil conservation, which has obviously promoted environmental protection and the sustainable use of land resources.

Adjustment of land tax can affect real estate price and consequently change the structure of resource use and direction of investment. A common practice is adjusting tax to encourage or restrict investment in a certain area. For instance, Finland used tax to encourage the construction of land drainage facilities, Chile levied punitive tax on newly built vineyard to prevent further increase of grape output, and some states in the U.S. used tax to restrain margarine and protect the production and sales of butter. As to real estate adjustment, all countries around the world adjust land tax to increase or decrease the cost and sales price of specific types

of real estate, so as to dampen the overheated real estate investment and guarantee the healthy operation of national economy.

2. Function of income distribution. It means the government designs the land tax system in such a way as to distribute land-related revenues among itself, individuals and different groups, change the existing income distribution, and consequently change the distribution of resources among various social sectors and regions. The goal is to further coordinate the production structure, consumption structure and the relation between production and consumption, so as to boost economic growth and social equity. First of all, the state centralizes part of the land income by means of political power, and distributes the income between itself and the market. Second, after the government collects the added land value, it uses it to promote social equity through fiscal expenditure, and distributes land-related income among different groups. Third, a reasonable land tax system can change the occupation of land and housing and boost social equity. Moreover, given the state ownership of land in the Chinese mainland, the government employs the tax system to dispose land income to compensate farmers that lose land and relocated residents and invest in land development. Its direct participation in market-based distribution of land-related income has actually contributed to adjusting wealth distribution.
3. Function of macroeconomic regulation. As the Chinese government has institutional conditions to monopolize the level-1 land market, it can achieve goals of macroeconomic regulation through land regulation, and boost balanced and healthy economic growth. By means of administrative approval, land planning and land purpose control, the government can control land supply and project investment and forcefully adjust land increment and resource allocation. Usual approaches are as follows (Fig. 7.4):

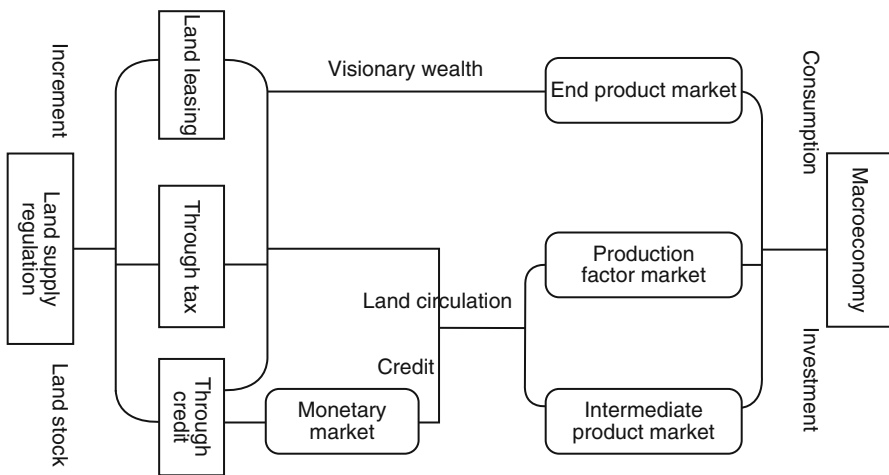


Fig. 7.4 Effect of exercising macroeconomic management through land regulation (Tang, Zaifu. (2010). *Land Finance and Real Estate Regulation*. Beijing: China Yan Shi Press)

First, regulate land supply to directly control overall demand and get the same effects as implementing financial policies. During economic decline, steps are taken to increase land supply in the market, lower land use cost and stimulate investment in real estate and other industries, thus directly boosting the overall demand and driving economic growth and employment. Likewise, during fast economic growth, land supply is tightened to drive up land price and restrict investment, so as to mitigate inflation and prevent economic overheating.

Second, regulate land supply to control credit scale, affect investment and consumption demand, indirectly affect the overall demand and get the same effects as implementing monetary policies. For instance, during economic decline, more land is supplied or more land credit is provided, and enterprises can get loan with land and real estate property as mortgage to launch projects. Banks or other financial institutions further enlarge credit supply through asset securitization. As a result, increase in the land supply stimulates increase in the monetary supply, which drives the overall demand and boosts economic growth. When the economy is overheated, however, the exact opposite measures are adopted.

Third, regulation of land supply creates wealth effects. During economic decline, more land is supplied through tax and credit means to stimulate the real estate and housing market, drive up land rent and price, raise people's expectations for future return, create the illusion of wealth increase, and stimulate consumers' desire to spend, thus expanding the overall demand and boosting economic growth. During economic overheating, land supply is tightened to curb the real estate and housing market, change the price trend, lower people's expectations for the price of their immovable property, create the illusion of wealth contraction and dampen their desire for consumption, thus reducing the overall demand and stabilizing economic growth.

4. Function of income disposal. One of the functions of land tax system is to financially enable the government to perform its functions. To exercise its administrative power, the government needs to gather social wealth to ensure its normal operation and performance of duties. With stable source and fixed tax base, land tax is the main source of fiscal revenues for local governments in many countries. As a matter of fact, after the Chinese mainland launched the tax system reform (tax was shared between central and local governments based on their types) in 1994, a principal local tax was never established, and over 30% of local government's usable finance comes directly or indirectly from land tax, and the ratio is up to 60% in urban governments. Of all the taxes, land VAT, deed tax, farmland occupation tax, urban land use tax and realty tax all take a rather large proportion. In 2006, altogether RMB23.1 billion land VAT was collected nationwide, RMB17.7 billion urban land use tax, RMB51.5 billion realty tax, and more than RMB100 billion farmland occupation tax and deed tax after it reached RMB87 billion in 2005. Moreover, the national revenues from land grant fee reached RMB767.7 billion and net earnings over RMB280 billion in 2006. Land-related income was the main source of income for local governments.

7.2.2 *Development History of Land Tax System*

The current institutional arrangements in the land management and land tax in the Chinese mainland are strongly targeted for the current development stage and times. To accurately understand and properly handle its problems, we must take a look at the development history of the land tax system, come to the right conclusions and find out what we should work on in the future. The current land tax system has passed four stages of development.

In the first stage, explorations were made to establish the mechanism of paid land use and collect urban land use fee.

In light of the socioeconomic development then and explorations in certain places, at the national work meeting on urban planning held in 1980, comprehensive development of urban construction land and collection of urban land use fee were officially put on the table and recorded in the meeting minutes that was approved and forwarded by the State Council. After the meeting, local governments in many places worked out charging methods on urban land use based on local conditions and began active explorations in that direction. Shenzhen formulated the *Provisional Regulations on Land Management* in 1981 and began to charge urban land fee in 1982 based on different land grade.

Later the National Construction Committee and State Administration of Urban Construction drafted the *Opinions on Levying Urban Land Use Fee* to standardize this practice in the country. The *Reply of the CPC Central Committee and State Council to Beijing's Overall Planning for Urban Construction* issued on July 14, 1983 stated that "land use fee should be charged on land users". In 1984, the State Council issued a notice approving and forwarding the report by the Ministry of Finance on *Implementing the Second Step of Profit-to-Tax Reform in State-owned Enterprises*, in which it agreed to keep the land use tax.

Hefei, Guangzhou, Shenyang and Fushun levied land use fee around 1983 in succession. In March 1986, the CPC Central Committee and State Council issued the *Notice on Strengthening Land Management and Prohibiting Random Farmland Occupation*, which pointed out that "land management should be strengthened through economic means in particular". The *Notice* proposed that land tax and land use fee of various levels should be levied based on the purpose and grade of land, and the added values of agricultural land when it was converted into non-agricultural land and benefits arising from different land grades between different cities or between different locations or industries in the same city should be collected by the state. After that, more explorations were made on paid use of construction land, the form of land use fee was diversified, and fiscal revenues increased as a result.

In the second stage, the adjustment of the land market was standardized and paid grant and transfer of land use right was confirmed through legislation.

Collecting urban land use tax and fee changed the traditional system of free land use but didn't touch upon the issue of circulating land in the market as a production factor. As the reform deepened, how to circulate the use right of state-owned land in

the market was put on the agenda. In March 1987, Gu Mu, a member of China's central leadership in charge of opening-up and urban construction, suggested "transferring the land use right while maintaining land ownership in open coastal cities where infrastructure investment is immense" and "implementing this in economic development zones on a trial basis." In July, he gave the following instructions on relevant documents: "(It) can be implemented on a trial basis... The Legislative Affairs Bureau of the State Council and State Land Administration should coordinate relevant parties to study and work out specific measures and submit them to the State Council for approval before trial implementation." In September, the State Land Administration held a work meeting on the pilot reform of land use system to study the pilot reform plan and steps, and in November, the State Council approved its plan for Shenzhen, Shanghai, Tianjin, Guangzhou, Xiamen and Fuzhou to be the pilot cities. In 1988, China amended its *Constitution* to allow the grant and transfer of land use right for a certain period. A year later, the State Council issued the No.55 decree titled *Provisional Regulations on the Grant and Transfer of Use Right of State-owned Urban Land*, which put the reform of land use system on the track of law-based management. Quicker steps were taken to foster the land market in the Chinese mainland and the reform of land use system came into full swing step by step.

From the end of the 1980s to the early 1990s, the progress on reform made people quickly realize the asset benefits of land, but relevant regulations were not issued in time. As a result, employers and individuals began to illegally transfer the use right of the land allocated to them against laws and rules, and a "hidden market" other than the normal real estate market appeared in many cities for the transaction of the use right of state-owned land. There were several ways of the illegal transaction. (1) Land use right was traded or leased in the disguise of housing trade or leasing; (2) Land use right was invested as capital for joint construction or operation or as equity for dividend; (3) Land was traded or leased directly or bartered for land too; (4) Land use right was mortgaged to pay off debt. Such illegal transaction, which was in large quantities, was aimed to evade tax and fee, which caused the loss of control over state-owned land asset transactions and the loss of tremendous benefits.

In the third stage, economic bubbles were dealt with and land market management was tightened.

After Deng Xiaoping made the speech during his inspection tour in south China in 1992, the reform and development in the Chinese mainland broke new ground, and the market system, including land market, developed quickly. However, under the combined effects of multiple complicated factors during the transitional period, local governments began to lose control of land leasing and management and malpractices occurred extensively amid the "development zone craze" and "real estate craze". Those economic bubbles not only caused the massive loss of benefits from state-owned land, but also corrupted a number of cadres and impaired the long-term economic development and social stability in certain areas. In the early summer of 1993, the CPC Central Committee and State Council vowed to intensify macro-regulation. In the following years, the economy in the Chinese mainland had a successful "soft landing", economic bubbles, especially real estate ones, were

squeezed out, and local management of land market was reinforced. In 1998, the second session of the ninth NPC Standing Committee issued the *Law of the People's Republic of China of Land Management(draft amendment)* to solicit opinions, and it was passed at the fourth session of the ninth NPC on August 29, 1998 to be implemented on January 1, 1999, followed by the *Implementing Regulations for the Law of Land Management* soon afterwards. The law and its implementing regulations both specified that "land use right can be transferred according to law" and "the system of paid transfer of state-owned land is implemented according to law". Correspondingly, the *Criminal Law* included specific provisions on cracking down on and punishing such behaviors as the illegal transfer and resale of land use right by employers and individuals and illegal grant of the use right of state-owned land at a low price. A series of major improvements on the land management system were also carried out. For example, the expropriation of basic farmland had to be approved by the State Council or authorized local government, and 30% of the land use fee for new construction land had to be submitted to central finance and 70% could be kept by local government, both for farmland development.

In the fourth stage, efforts were made to promote the balanced use of land resources with a view to socioeconomic sustainability.

Around 1999, relevant departments formulated the *Regulations on Basic Farmland Protection* according to the *Law of Land Management*, issued methods to standardize the disposal of land use right during SOE reform, and revised and improved a series of documents including the *Regulations on the Review and Approval of Construction Land*, *Regulations on Annual Land Use Plans*, *Regulations on Disposal of Idle Land*, *Several Rules on Distribution Management of Land Grant Fee and Profits from Selling Pre-owned Public Housing and Affordable Housing*, and *Several Opinions on Standardizing the Leasing of State-owned Land*. The purpose was to achieve coordinated economic and social development and improve relevant systems and mechanisms on land resource management. Explorations were also made on fiscal budget management, including issuing the *Provisional Methods on Financial Management of Land Use Fee for New Construction Land* and *Several Opinions on Land Development*. However, as land finance took up an excessively large proportion in local finance and there was no alternative source of income, problems such as extensive land resource utilization, excessive land supply and sharp farmland decrease appeared across the country in the 3 years after 2000. The general situation of land resource utilization got increasingly serious.

To deal with those problems, the State Council adopted a series of measures. First, it straightened out development zones nationwide and seriously dealt with land violations. A national land market shakedown was carried out to straighten out development zones. There were 6866 such zones of various types in total, covering a planned area of 38,600 km². With Jiangsu's Tieben event (Jiangsu Tieben Iron & Steel Co., Ltd. illegally occupied land without approval, which made a lot of farmers homeless) as a typical case, the central government seriously dealt with cases where local governments and relevant departments approved land requisition beyond their authority or implemented land requisition, demolition and resettlement against rules.

Second, it further standardized the way of granting land use right. The Ministry of Land Resources and Ministry of Supervision jointly issued a notice that requested all local governments to close all historical land issues before August 31, 2004, after which the use right of profit-oriented land should be sold in market approaches such as open bidding, auction and listing. Third, it deepened land management reform. On April 29, 2004, the State Council issued a notice to suspend the approval of using agricultural land for non-agricultural purposes, the approval of revising the overall plan for land utilization, and the revision of plans involving the adjustment of basic farmland protection area. Half a year later, the State Council promulgated the *Decision on Deepening Land Reform and Tightening Land Management* to intensify and improve land management and consolidate the results of macro-regulation. It also issued several auxiliary methods, such as *Guiding Opinions on Improving the System of Compensation and Resettlement for Land Requisition*, to guarantee the implementation of the *Decision*. Fourth, it adopted vertical management of land resource authorities below provincial level. In April 2004, the State Council and the Organization Department of CPC Central Committee successively issued notices to carry out vertical management of land resource authorities below provincial level, with the aim to clear the channel of land regulation and enhance the execution of central policies on land regulation. Fifth, it stepped up disposal of idle land. Starting from May 2006, relevant departments including land and planning departments stepped up the supervision of land for real estate development. For land where construction didn't begin 1 year after the contractual construction date, high land idleness fee should be charged and the developer would be requested to begin and complete the construction on a specific date. For land where construction didn't begin 2 years after the contractual construction date, the land use right should be retracted for free. For land where construction began on the contractual date but the developed area was less than one-third or investment was less than one-fourth of the contractual volume, and the construction was suspended for a continuous year without approval, the land should be dealt with as idle land.

While employing administrative means to strengthen land resource management, China also tried economic and legal means to regulate the land market. On August 31, 2006, the State Council issued the *Notice on Relevant Matters of Strengthening Land Regulation* to lay down more specific provisions on a series of matters, including farmland protection, control of construction land increment, approval for land use plan, using agricultural land for non-agricultural purpose, and ensuring the livelihood for farmers whose land had been requisitioned. The *Notice* also stressed the land accountability system and made definite requirements on reforming the management of land income and expenditure and the policies on construction land tax and fee. On that basis, relevant departments issued policies in succession.

First, from June 1, 2006, if individuals sold their housing that was bought within the past 5 years, business tax would be levied based on the full sales price. If individuals sold their regular housing bought 5 years ago or longer, business tax would be exempted. If individuals sold their non-regular housing bought 5 years ago or longer, business tax would be levied based on the difference between the sales price and the original housing price.

Second, from January 1, 2007, the annual tax per square meter of urban land would be tripled from RMB0.5–10 to RMB1.5–30 in big cities, RMB0.4–8 to RMB1.2–24 in medium-sized cities, RMB0.3–6 to RMB0.9–18 in small cities and from RMB0.2–4 to RMB0.6–12 in counties, towns and industrial and mining areas. Foreign enterprises, either with foreign investment or directly operated by foreigners, also had to pay urban land use tax.

Third, fee for the use of new construction land should be paid according to the area of new construction land, grade of land and tax standards, including illegally used land upon verification. From January 1, 2007, the tax standard would be doubled and 70% of locally collected tax should be submitted to provincial treasury.

Fourth, from February 1, 2007, the pre-project levy of land VAT would be replaced by post-project levy based on the actual profits. Land use cost would be unified for domestic and foreign enterprises. According to the newly adopted *Property Law* and *Law of Corporate Income Tax*, foreign enterprises would no longer be entitled to preferential treatment and had to pay urban land use tax, income tax and realty tax like their domestic counterparts did.

7.3 China's Unique Land Finance and Its Risks

In the Chinese mainland, land finance refers to the phenomenon that local governments rely too much on land-related revenues such as land grant income. As land grant income increased rapidly in recent years, land finance has been seriously criticized. Compared with public budgetary revenue, the land grant income isn't much either in terms of size or relative proportion, but in general, land rent, tax and fee take up a large part of the financial resources actually employed by local governments, and it is a fact that local socioeconomic development, especially infrastructure construction, highly relies on land grant income and land mortgage loan.

7.3.1 Meaning of Land Finance

Historically speaking, land finance in China is the outcome of China's special institutional environment and the economic development stage. It essentially means the nationalization of collectively owned land and faster capitalization of state-owned land against the background of China's socialist public land ownership, and factors such as promotion in the political system and insufficient compensation for the cost of land requisition, demolition and resettlement also contribute to its formation.

The system of paid land use in China came into being in the early stage of the reform and opening-up, and the land grant system officially came into use in the late 1980s. Over the more than 30 years of development, during the early stage, land

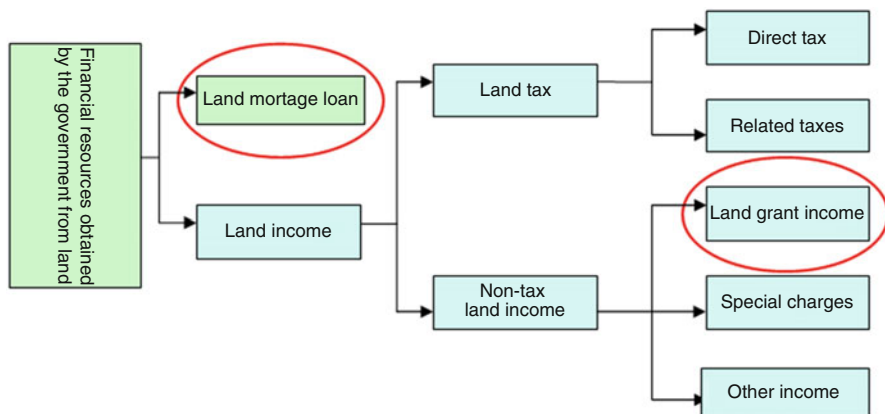


Fig. 7.5 Potential risks of land finance (Tang, Zaifu. (2012). “Study of Basic Theoretical Issues of China’s Land Finance: Origin, Nature, Risk and Future of Land Finance.” *Economic Survey*, 2, 140–145)

grant income was of a small scale due to restrictions on the way of land grant and the amount of land supply, so local government didn’t rely much on that income and it was common to trade the use right of state-owned land directly for foreign investment. In the twenty-first century, land grant system is continuously improved, land supply quickly increases, the management of land income and expenditure is standardized, and land grant income increases dramatically. As a result, local governments become more reliant on this income, but their rising reliance on land income and land financing causes general concerns. Will this kind of income be sustainable? Will it be a reliable source of capital for basic public services and infrastructure in the future? What’s the future trend of land finance? What risks and challenges will it face? How will the trend affect the financing for and overall progress on the urbanization drive? As these questions concern the steady progress on the new-type urbanization, they have to be analyzed in depth and be given clear and definite answers.

Of land-related financial resources actually employed by the government (land tax, non-tax land income and land mortgage loan), land finance risks are concentrated on land grant income and land mortgage loan (Fig. 7.5). The main reason is that land capitalization is too fast in China, and local governments are too reliant on those two sources of income, which may lead to government revenue-expenditure conflict and debt risk in the future.

7.3.2 Risks of Land Finance

While highly relying on land grant income, local governments are already faced with the risks and challenges of land finance, which are reflected in the following aspects:

First, land finance is unstable and unsustainable.

In the current land leasehold system, no matter how local government grants the land use right, it obtains lump-sum land profits for 50–70 years every time it sells a plot, which motivates it to “create wealth through land”. Even if we don’t take into account meeting the grain demand of 1.3 billion people and the limited farmland that can be requisitioned and non-renewable resources, the market itself has a cycle and real estate market experiences periodic fluctuations, which means we cannot expect land price to be so high forever. When market dynamics change, short supply will be replaced by excess supply, failed land auction and price reduction will be inevitable, and land finance will be hard to sustain.

Moreover, land finance may trigger financial risks. In land finance, a large part of the capital for urban construction is bank loans secured with government credit, and the loan term is usually no more than 2 years. If land can be granted smoothly at a high price, the local government can repay the loan with the bountiful land grant fee, but if land price is low, the local government has to obtain fiscal revenues through other means to repay the loan. In fact, loans secured with government credit are usually more than the local government’s fiscal revenues, creating the possibility of financial risks.

The increase of land grant income is unsustainable. Land is a resource whose total volume is limited within a certain period no matter in which way it is developed, which decides that the high-speed growth of land grant income is unsustainable. The land income obtained by local government through accelerated land capitalization can meet its current capital demand, but after a certain period, the high-speed growth of land income will hardly sustain, which will lend a heavy blow to local government that has become too reliant on land income for expenditure. In particular, part of the land income was incorporated in fiscal budget in recent years for expenditure on areas such as livelihood, so if land grant income decreases sharply, it will cause fiscal risks.

The rapid expansion of land mortgage financing increases potential risks of government debt. Land mortgage financing is generally supported by local government’s promise of repayment, namely government credit, and the ability to repay such loans depends on the future land income. Since the new round of proactive fiscal policies was implemented in 2008, land mortgage financing by local governments has increased quickly and magnified local government’s debt risks. Once new land grant decreases, economy slows down and the real estate market slumps, and local government’s land income isn’t enough to pay government debt, debt risks will emerge.

Land tax system is weak in adjusting wealth distribution and impairs social equity. At present, China only levies a symbolic and fixed amount of land use tax on land possession, realty tax has a narrow applicability range and doesn’t apply to residential housing, the collection of land VAT that is aimed to adjust differential land income is poorly implemented and managed, and land added values are pocketed by a small group of people. This causes negative effects in two aspects. First, it leads to serious land and real estate speculation and creates a lot of real estate

bubbles. Land and housing properties are hoarded in large quantities and realty price is far beyond people's actual buying power. Second, the principle that "revenues from land price hike belong to the government" cannot be put into practice. A lot of land profits that should have been submitted to the government are taken by few people, causing unfair distribution. In the early stage of massive land requisition, demolition and resettlement, the interests of farmers and residents whose housing was demolished were not well protected, and those people are now under heavy pressure of employment, old age care and medical care and some of them cannot even meet basic living needs. With the reform of land requisition, demolition and resettlement policies in recent years, the compensation and resettlement standard is raised, and the government spends more money on employment, housing and social security. However, the compensation and resettlement standard is so much higher than before that people whose land was requisitioned earlier demand more compensations, and this, if not handled properly, can easily lead to instability factors and the government will have to pay a higher price.

The institutional arrangement for land requisition puts more expenditure responsibility on the government. Local finance has to bear the social cost caused by land issues, so the government has to spend more on resettling land-losing farmers, dealing with issues when farmers become urban residents, and ensuring housing for people as land and housing price goes up. Nowadays mortgaging the right to land profit is the main approach of government financing, which creates a direct linkage between land finance and government debt and magnifies fiscal risks while local government uses land as a financing leverage.

Second, land finance restrains the new-type of urbanization.

Due to the lack of qualified evaluation organizations, some local governments don't have full and complete information on land value and repayment capability, and the process of granting land use right is opaque. Besides, land grant income is far more than land cost, and land expenditure is mostly outside the public budget and managed in a much more extensive way. These institutional and behavioral problems result in the absence of financial accountability, and some government officials and public institutions use public land to seek gains for individuals and agencies. The twisted incentive mechanism in land development has caused many problems.

It results in extensive land resource utilization and prevents the quality improvement of urbanization. The reliance on land grant fee drives cities to expand blindly, which increases the cost for infrastructure construction and maintenance. To boost industrial investment, local government has to increase the area of development zones and grant land for free. To make up for the cost, it has to more energetically promote real estate industry and obtain massive land grant fee in order to cover the cost for industrial land and infrastructure. As a result, urban development has got on the track of 2D expansion through land grant, but the larger cities become, the more capital is needed for infrastructure construction and maintenance, and this vicious circle results in serious reliance on the current land tenure system.

The extensive urban expansion caused by the land tenure system seriously restricts the development of the service industry and affects the establishment of

auxiliary urban functions. The history of urban development is the process in which service industry gradually develops. Based on the experience of developed countries, service industry will take a dominant position when urbanization rate exceeds 50%, and it will have high-speed growth when the urbanization rate exceeds 60%. At that time, the proportion of service industry in the general economy will be two to three times more than the proportion of industry and become the main job creator. However, the current land tenure system leads to over-reliance on industrial development. As service industry is seriously underdeveloped and employment in this industry is extremely insufficient, the government has to rely on traditional industry to increase fiscal revenues and job opportunities. Even in developed coastal areas where urbanization rate is well above 60%, local governments still stress industrialization as the main drive for development. Although this industry-dominated development model emphasizes industrial upgrade, it limits the renewal of industries because it requires cheap land. Meanwhile, the consistent reliance on industrial growth also leads to environmental pollution and the sharp increase of migrant population, which courts hidden hazards for the cities' sustainable and low-carbon development in the future. The development of service industry requires a high density of urban population and the scale merit per unit time within the service radius. The sprawling cities, however, largely lengthen the service radius and raise the cost of service industry. The 2D expansion of Chinese cities has seriously restrained the development of service industry.

Land grant system restrains the reform of infrastructure and financing management. Revenues from the ongoing pilot reform of real estate tax cannot make up for the immense cost for urban infrastructure construction, and past profits from selling requisitioned land were spent on urban infrastructure as a kind of benefit for urban residents. As such benefits become routine, reform gets more difficult. According to common practice in the world, the capital for the construction and operation of urban infrastructure mainly comes from market investors and financial institutions, and the establishment of the repayment and profit distribution mechanism has to be underpinned by realty tax, an efficient infrastructure management mechanism, and a rational price mechanism. Although more cities have carried out pilot real estate tax reform, the inefficient national system of infrastructure management won't have a thorough improvement in the short term. As infrastructure is built as a benefit for residents, increasing the charge for its use will lead to public doubt and challenge, and reform in this aspect will be very hard.

In the long term, land finance goes counter to scientific development and is bound to cause inequity between the preceding and succeeding governments, and consequently the unfair utilization of land resources between the preceding and succeeding generations. The requirement for lump-sum payment of land grant fee for the term of 70 years at most actually demands the land profits for many years to come, whereas infrastructure expenditure is shared by governments at different periods. Once the speed of urbanization slows down, the model that the preceding government sells land and makes profits but the succeeding one pays for infrastructure will not sustain.

Third, land finance leads to other negative effects.

The process of how land finance emerged and evolved reveals its essence, which is the faster capitalization of construction land, and the risk lies in that land resource risks become fiscal risks and consequently public risks. While land resource risks evolve into fiscal risks during land capitalization, a range of factors, such as the structure of land ownership, the nature of land as a production factor, the pillar position of real estate industry and the public attributes of residential products, may magnify them into public social risks, which will impose a major impact on scientific development and social harmony.

Land finance has affected the transformation of economic development model. From an overall perspective, land finance concerns the selection and change of the path and model of local economic and social development. In the process of government-led industrialization and urbanization, a lot of infrastructure has to be built in a short period, the industrial mix has to be established and adjusted by changing the land use structure, and the huge investment has to be raised by land finance. Therefore, land resource utilization and land finance play a major role in industrial development, cities' spatial layout and the cultivation of income sources. The positive effects of land finance and the challenges it faces epitomize China's industrialization and urbanization in a specific period and also affect the selection of socioeconomic development model. The current land grant system stimulates local government to take short-term actions because the annual payment of land grant fee enables it to obtain a huge amount of quick profit through cheap land requisition. During its term, local government can justify the officials' performance-oriented decisions and actions with immense land income, so the urban development model becomes superficial and focuses on short-term interests but ignores the long-term public interests, the renovation of old towns and infrastructure input concerning public health and security. Since a mechanism to restrain and rectify the government's short-term actions is lacking, the succeeding government will continue to rely excessively on land income.

Land finance aggravates social conflicts. In terms of interest distribution, land finance is a government-led and land-based fiscal activity and is actually an adjustment of the interest distribution among relevant stakeholders. As a basic production factor, land is the foundation for agricultural and industrial development and the precondition for people's consumption (homestead for farmers and housing property for urbanites). All stakeholders, including governments on all levels, enterprises and residents (farmers and urbanites), are closely linked together through land distribution. Therefore, the distribution and re-distribution of land is not only a process of realizing and deepening land capitalization, but also a process of the adjustment and evolution of interest relations and social structure. The current land requisition system aggravates the conflicts between the government and the farmers whose land is requisitioned. During the massive demolition and construction and forced requisition, people see real estate developers making exorbitant profits, and the serious interest imbalance causes psychological imbalance in land-losing farmers.

Their dissatisfaction with the interest distribution gives rise to constant vicious collective and individual cases that create many negative social impacts.

Land finance threatens sustained and healthy economic and social development. The conflicts and problems related with land finance will impact China's development progress if not handled properly. When China achieves leapfrog economic and social development in the 30 years of reform and opening-up, all local governments develop land resources, especially construction land, in high intensity and on a large scale. Under China's special land and tax systems, intensive land utilization in short period results in accelerated land capitalization and a tremendous flow of fiscal capital, which underpins the high-speed socioeconomic development. However, such concentrated and intensive land utilization is inevitably accompanied by non-sustainability in land aggregate and structural irrationality. Non-sustainability in land aggregate will lead to unsustainable increase in land income, so fiscal revenue may suffer a dramatic dive in future, which will cause prominent revenue-expenditure conflict if fiscal expenditure still relies on land finance. Meanwhile, irrational land use structure may lead to an irrational industrial structure (such as over-reliance on real estate and construction industries) and irrational fiscal revenue structure (such as over-reliance on non-tax income). As a result, the structural risks in resources will turn into fiscal risks. Interest conflict at any link may evolve into social conflicts if not handled properly, and the risks with land and fiscal income and expenditure will turn into social risks and threaten the overall sustainability and stability of China's development.

7.4 Main Problems in Current Land Management System

In the Chinese mainland, only the central government has the legislative right over land taxation, and local government only has the right to determine specific tax rate to varying degrees. Of land-based revenues, only individual income tax and corporate income tax are shared between the central and local governments at a certain ratio, and the rest is basically at the disposal of local government. Land grant income used to be divided between the central and local governments at the ratio of 30:70, but the ratio for the central government was reduced over and over later until all land grant income was kept by the local government in 2004. As to land charges, the fees for the use of new construction land is divided between the central and local governments at the ratio of 30:70, and the rest is completely at the disposal of local government. Regarding the division of authority over land-related matters, local government is responsible for such matters as land maintenance, development and consolidation, and construction and maintenance of urban/rural infrastructure following the principle of information advantage and efficiency. The central government, on the other hand, is responsible for land use planning, river governance, management of major land resources and farmland protection across the country. Land-based fiscal revenue consists of three parts – rent, tax and fee. The specific revenue entries are listed in Table 7.1.

Table 7.1 Land-related revenue entries in the Chinese mainland

Tax revenue	Non-tax revenue			
	Government fund	Administrative charges	Payment for the use of state-owned resources	Other revenues (collected on behalf of relevant authority)
Business tax, corporate income tax, individual income tax, urban maintenance and construction tax, stamp tax, urban land use tax, land VAT, farmland occupation tax, deed tax	New vegetable plot development fund, local educational surtax, agricultural development and construction fund, revenue from granting the use right of state-owned land, fee for using new construction land	Farmland cultivation fee, land rehabilitation fee, land idleness fee, (requisitioned) land management fee, land registration fee	Return on state investment in real estate industry, revenue from granting property right, fee paid by foreign-funded enterprises for using premises	Land compensation, resettlement fee, compensation for attachments to or green crops on the land, demolition compensation

Before 2006, land-related income and expenditure in the Chinese mainland involved the three ways of fiscal budgetary management. Except land tax that was put under general budgetary arrangement, land rent and land charges were managed in three ways. First, they were submitted to the national treasury and incorporated in government budget. This part included some government funds, educational surtax and other land-related administrative charges. Second, they were submitted to capital accounts for special purposes and incorporated in departmental budget for centralized arrangement and management. This included administrative land charges and specific fees charged by the land authority, including management fee, production fee and handling fee. Third, they were managed by government departments on various levels that were not covered in the fiscal budget. This included urban housing fund managed by relevant functional department, and departmental charges, raised fund and apportionment outside the government finance.

Of land tax and non-tax revenues, the first part mentioned above is incorporated in public finance under unified budgetary management. The second part nominally applies “separate income and expenditure management under special capital accounts”, but in reality, the revenue is returned to the charging units in full or in part while the right to dispose the revenue stays with the ultimate collector – land resource department. The third part is mainly collected, used and managed by local land department and is completely outside fiscal supervision and administration. It is a non-standard management model and an important reason for the chaos in the government’s land income and expenditure.

Generally speaking, in government management of land income and expenditure, tax revenue is the only part under standardized management. Other than that, land grant income is under chaotic management either regarding the purpose of

expenditure or management procedures, and both income and expenditure are rather random. As to land charges, land rehabilitation fee and farmland cultivation fee are at the disposal of land resource department. Moreover, farmland occupation tax and the use fee for new construction land are managed as government fund, the former managed as part of the agricultural development fund and the latter used for land development and consolidation. Whether those expenditures are managed in a standard way decides the efficiency of capital use, and fiscal department has to intensify the supervision of them. Regarding land compensation, resettlement fee, compensation for attachments to or green crops on the land and demolition compensation that are collected on behalf of relevant authorities, there are so many intermediate links that farmers finally get much less money than what is paid in the first place. Theoretically, to fundamentally solve these problems, we must incorporate all land income and expenditure in general fiscal budget. But land grant income is largely susceptible to the land market and is unstable and uncertain, so its inclusion in the general budget management will easily cause budgetary fluctuations, which is bad for steady budgetary execution. In consideration of this, the State Council issued a notice in December 2006 that incorporated land grant income and expenditure in fund budget. All income was submitted to the provincial treasury and all expenditure was arranged through fund budget, thus completely separating their paths. Special accounts were set up in local treasury to check land grant income and expenditure. Compensations that should be paid to farmers whose land was requisitioned must be guaranteed and earmarked in particular. In the long term, land-related income and expenditure should all be put under government budgetary management in order to enhance the integrity and solemnity of fiscal budget and make the operation of government finance more scientific and standard.

Due to institutional legacy, path dependence and many other factors, China's land tax system today carries strong characteristics of the times. The entire institutional arrangement, including the division of government authority, clarification of expenditure responsibility, revenue disposal and expenditure management, carries marks of the transitional period and "dual" structure, which gives rise to many problems with land management and related income and expenditure management.

7.4.1 Division of Government Authority Over Land-Related Matters and Responsibility for Land Expenditure Is Unclear

In many countries around the world, the authority over land-related matters mainly rests with local governments, and the boundary between government and market and the government setup on different levels vary from country to country. Government in some countries has limited authority over land-related matters, but in other countries it has much authority in that respect. In the Chinese mainland, the division of government authority over land-related matters and clarification of land

expenditure responsibility is far from satisfactory. First, the government either exceeds its authority or falls short of its duty in land management. The provision of public services such as land use planning, regulation of land use, and statistics and release of land market information is insufficient, auxiliary public facilities and infrastructure are not well developed, and government expenditure responsibility is poorly performed in general. Meanwhile, some local governments are keen on using land to invite business and investment, build wide roads and large squares for political performance and image's sake, and even directly engage in land transactions and interfere in matters that should have been left to the market. Second, division of authority between governments on different levels should be further clarified and standardized. At present, state-owned land is actually possessed by local government, which exercises the land owner's right (granting large quantities of land and receiving land rent), but it doesn't fulfill the corresponding obligations of land development and consolidation and building public facilities, and often applies projects to the central government for money on all excuses. Third, the government doesn't serve its function of managing state-owned land property. Local government is satisfied as long as it has land to grant, but doesn't have systematic plan and arrangement for state-owned land management, and it is common that more land is used than planned.

Especially after the tax system reform, the main content of which was tax distribution (including sharing and division) between central and local governments, was launched in 1994, county- and municipal-level finance was responsible for more expenditure. To mitigate fiscal pressure and speed up local economic growth, local governments generally used land to boost investment growth. On one hand, they attracted investment by supplying cheap land, approved the grant and use of land beyond authority and even supplied land for free. But there wasn't enough capital for land development and maintenance, so they had to solicit private investment in disguise. The poor performance of government function resulted in extensive and inefficient use of land resources. On the other hand, local government invested land grant income in construction projects that should have been left to the market to varnish their performance sheet. According to a survey by the Development Research Center of the State Council, taxes from construction and real estate industries made up more than 37% of local taxes, net revenue from land grant fee made up over 60% of extra-budgetary revenue, and land-secured bank loan made up over 70% of urban infrastructure investment.

Furthermore, many local governments take the land resource department as one purely for revenue arrangement, but its function of macro land management is ignored. After land resource departments are put under the vertical management of the Ministry of Land Resources, local government's function in land resource management will weaken, but the desire for profit-oriented land transaction will remain. If this desire isn't properly released, the central government can only rely on local land resource departments to manage and control land transactions, but the management won't be very effective without a definite legal definition. Therefore, the division of government authority over land-related matters and government responsibility for land expenditure should be further clarified.

7.4.2 Systematic Structure of Government Land Income Arrangement Is Irrational

In terms of the income arrangement system, there is a large variety of land rent, tax and fee entries on the acquisition, utilization and transfer of land use right, but they are not evenly distributed. First, regarding the acquisition of land use right, the government monopolizes the level-1 land market and grants the use right of state-owned land through “bidding, auction and listing”. The land price is finally formed through market competition, which, combined with other taxes and fees, leads to a high land cost in the level-1 market. Second, the tax and fee on land and real estate development and utilization is high, including business tax, income tax and land VAT. Third, there is deed tax, stamp tax and income tax on the transfer of land or real estate. If land VAT is also employed as an auxiliary adjustment, the tax and fee systems on this link will be quite sound.

But the tax structure is irrational and tax burden too light on the possession of land or real estate. (1) Real estate tax (property tax), a leading tax for adjustment, is absent. The existing taxes are designed for land and housing property separately. For land, there is urban land use tax, which later is also applicable to the use of collectively owned land. Foreign-invested enterprises don't pay this tax, but they have to pay land use fee. For housing property, there is housing property tax or urban real estate tax, which is collected in the same way in many places, just under different names. The separate land and real estate taxes can hardly achieve their original goal and effect without coordination. (2) The existing housing property tax and urban land use tax are not designed to have regular reevaluation. The main purpose and fundamental function of tax on land possession is to adjust the increased value of land and housing property, so that “natural value increase will go to the government”. However, the two taxes today don't have the arrangement to regularly reevaluate the land and housing property price, and the separate taxation on land and real estate makes it difficult to know the real situation of taxpayers. As a result, the scope of tax exemption is expanded out of proportion, and many taxes on land possession that should have been levied are not. (3) Land VAT has never been strictly liquidated, which magnifies tax imbalance in land possession. When land VAT was put forth, it adopted the four-interval progressive tax rate with the aim that when land grant fee wasn't collected in full according to market price, it could adjust differential land income and nationalize the high added values. But after the *Regulations on Land VAT* was promulgated, land VAT was always collected in advance due to various reasons and was never liquidated, making the last tax adjustment on land and real estate possession nominal. The burden of real estate tax and fee mainly lies in land acquisition, transfer, development and construction, and the burden on land possession is quite light, which is exactly why the land tax system is unable to bridge the poor-rich gap and the government cannot have even inflow of fiscal revenues. Tax imbalance also gives rise to a lot of speculative demand for land. Enterprises all try hard to obtain land, but they are in no hurry to develop or transfer it, leading to extensive use of land resources and serious land idleness. The massive

enclosure of land and inefficient use of it disrupt the normal operation of national economy.

7.4.3 Government Budgetary Management of Land-Related Income and Expenditure Is Not Standardized

As analyzed before, the Chinese government's management of land-related income and expenditure has prominent problems. (1) Budgetary management doesn't have a good control of the fairly random income disposal. The models of government management of land-related income and expenditure are not unified, so they cannot comprehensively and objectively reflect the whole picture in that area. Particularly, policies on land rent revenue, which is the leading source of income, are unstable, and the volume of land rent revenue changes greatly every year, so an accurate budget is difficult. (2) The distribution of land revenue is fixed, and it's hard to standardize the revenue and expenditure management. The land charges of varied amount collected by local governments and land authorities are always outside fiscal supervision, and the expenditure of them varies greatly in different places. Besides, fiscal expenditure has formed path dependence, which is hard to address and must be solved while broadening the sources of fiscal revenue. (3) Procedures of income and expenditure management are non-standard and the supervision and restriction mechanism isn't sound. In many places, land income and expenditure is not put under budgetary management, and the department that has the right to dispose the capital doesn't manage actual expenditure in a strict and standard way, so expenditure isn't transparent, standardized or efficient. The part of revenue in land grant fee that is collected on behalf of relevant authorities (including land compensation, resettlement fee, compensation for attachment to and green crops on the land, and demolition compensation) was advanced by land user in the past. The management of its expenditure wasn't standardized, the interests of disadvantaged groups weren't effectively protected, and that caused social problems and conflicts.

7.4.4 The Tax System's Adjusting Function Is Seriously Restricted

At present, the dual land tenure system in urban and rural areas has caused urban-rural differences in land tax and compensation for land requisition, demolition and resettlement. As urbanization and industrialization go deeper, some regulations of the dual system have caused many problems and conflicts.

The urban-rural dual land tax system can no longer meet the demand for development. Today property tax is levied on land and housing property separately and only on urban state-owned land and attachments to it without spreading to the

countryside. The collectively owned land in Chinese countryside belongs to rural villages and towns. After agricultural tax was abolished, the state neither levied tax nor collected rent on this part of land (including villagers' homestead and buildings on it), and the existence of such tax-free area isn't consistent with modern tax system or beneficial for fostering rural residents' tax awareness. As rural land is exempt from tax, many enterprises move from cities to the countryside, and many new ones are built there, leading to the occupation of a lot of agricultural land, especially farmland. Furthermore, as urbanization proceeds, it's very hard to separate urban suburb from the countryside, and more housing is being built on collectively owned rural land to be let and sold. According to the survey conducted by the Ministry of Land Resources, there was 51 million *mu* of urban state-owned construction land nationwide in 2005, and 240 million *mu* of rural collectively owned construction land, much more than the former and becoming the focus of land supply control. As more pilot projects on trading collectively owned construction land in the market were launched in recent years, unifying the land tax system in urban and rural areas is a pressing issue now.

Favorable land tax policies are not standardized and the co-existence of land acquired with favorable policies and that acquired without caused de facto unfair competition. The grant of the use right of state-owned land is gradually standardized, and grant through "bidding, auction and listing" develops rapidly in the land market, but inviting business and investment with favorable land policies and "trading land for investment" remains a widespread and chronic phenomenon, and land granted in this way is in large quantities. Usually preceding governments pledged to reduce the land grant fee and other taxes and fees to varying degrees, but such non-standard fiscal favors led to the wide cost gap between land acquired with favorable policies and that acquired without, caused unfair competition and disrupted the normal order in the land market. Especially after 2000, the price of land use right kept rising. For land acquired without favors, the buyer, after paying the land grant fee, also has to pay business tax during land development and utilization based on the magnified base number, land VAT on the increased value, and income tax on the final profits. As a result, the gap in land rent, tax and fee between land granted through "bidding, auction and listing" and that granted through allocation (without no or little land grant fee) or agreement widened quickly and drastically.

The overlapping of the new and old land requisition systems caused "tax and fee paid by the government to the government" and chaos in budgetary entries. In the old land requisition system, usually when an enterprise or public institution wanted to buy a rural collectively owned plot, the two sides would consult for an agreement, report the deal to the land resource department for approval, and then the land user had to pay grant fee, land management fee, farmland cultivation fee, new vegetable plot development fund, and farmland occupation tax to the land resource department. Land compensation was collected on the farmers' behalf and usually advanced by the user. On December 17, 2006, the General Office of the State Council issued the *Notice on Standardizing the Income and Expenditure Management for Granting the Use Right of State-owned Land* (GBF [2006] No.100), which incorporated all land grant income and expenditure in the budget and implemented "separate income

and expenditure management”. After that, land could only be requisitioned by the government (employers were not allowed to pay advances), which then organized the land grant, the income from which was fully submitted to provincial treasury, and the taxes and fees mentioned above would be disbursed to land resource department from the fiscal budget. The land user only had to pay deed tax, land grant fee and annual land use tax, while all other taxes and fees for the initial acquisition of land were “paid by the government to the government”, namely disbursed from the provincial treasury to the land resource department. Therefore, the co-existence of two land requisition systems caused chaos in the management of budgetary entries. Since the land requisition system and income-expenditure relation changed, budgetary management should be adjusted timely and accordingly.

7.5 Outlook on the Reform of China’s Land Management System

While promoting the new type of modernization at a faster pace, we must improve the socialist institutional system with Chinese characteristics, modernize the state governance system and governing capability, solve problems for the purpose of achieving the ultimate goal, reform the land tenure system and related management institutions and mechanisms, and let market play the decisive role in land resource allocation, so as to strongly push and support the new-type of urbanization and promote sustained and healthy economic and social development. To achieve the general goal for land tenure system reform, we, in accordance with the theoretical model of “three-dimension integration”,¹ should make overall plans for reforms in such areas as land factor market, land tax system, land finance transformation and land use plan, with a view to addressing problems in the land management and land tax systems. To be more specific, first, we should gradually improve the land factor market, stabilize market expectations and promote the orderly circulation and efficient utilization of land resources. Second, improve the land tax system, reasonably adjust the distribution of land profits, properly handle the interest relation among the government, social investors and residents, and promote social fairness and justice. Third, push for land finance transformation, stabilize fiscal revenues, and strengthen investment and financing management to meet that demand for urbanization. Fourth, tighten land planning and management, rationalize the structure of resource utilization and meet the diversified needs for economic and social development. Limited by the length of the paper, this section will focus on the first three reforms from the economics perspective, namely reform of the land factor market, land tax system and land finance transformation. The purpose of the reforms is to

¹Tang, Zaifu, and Feng, Lihong. (2014). “China’s Land System Reform Against the Background of a New-type of Urbanization (Part 2),” *Journal of Hunan Agricultural University (Social Sciences)*, 5, 70–76.

establish a unified land factor market for urban and rural areas, improve the land tax system, rationally adjust the distribution of land profits, effectively prevent fiscal and economic risks, and promote the new-type of urbanization drive and sustained and healthy economic and social development.

7.5.1 Establish a Unified Land Factor Market for Urban and Rural Areas

The third plenary session of the 18th CPC Central Committee decided to “improve the institutions and mechanisms for the sound development of urbanization”. It decided that “we should stick to the path of a new-type urbanization with Chinese characteristics, push forward people-centered urbanization, coordinate the development of megacities, mid-sized cities, small cities and small towns, promote the integrated development of industries and cities, and advance urbanization and the building of new rural areas in a coordinated manner. We will improve the urban spatial layout and management pattern and enhance the comprehensive carrying capacity of cities.” It also proposed to “form a unified construction land market for both urban and rural areas, allow rural collectively owned profit-oriented construction land to be granted, leased and invested as equity on the premise of conforming to the land plan and land use requirement, and ensure that rural land can enter the market with the same rights and at the same prices as state-owned land.” Efforts were called for to “set up a rural property rights transfer market, and promote the open, fair and procedure-based operation of rural property rights transfer” and “promote equal exchanges of production factors and balanced allocation of public resources between urban and rural areas”. These requirements pointed out the direction of land tenure system reform against the background of pushing forward the new-type of urbanization.

In light of the new requirements for new type of urbanization, the primary task of land tenure system reform is, under the guideline of improving the basic economic system and the socialist market economic system, to build a unified, open market system of orderly competition, reform land grant system and related tax system in a coordinated way, establish a unified land factor market for urban and rural areas, and stabilize market expectations. Details are as follows:

- Improving the system of land users’ property rights.

First, the use right of state-owned land will automatically renew for free upon expiry. The central government drew on the experience of the Hong Kong SAR, improved the land management law and other laws and regulations under public ownership, and made it clear that when the use right of state-owned land expires, the user can apply and renew the use right for free upon approval unless the land is re-planned for public use. The state only adjusts premium profits through tax. Meanwhile, value-added profits from real estate transfer will be adjusted more

through tax, so the government can make up for the reduced land grant income with taxes. Second, collectively owned construction land can be traded in level-1 market directly. Under the supervision and management of county and township government, collectively owned construction land will be traded on a unified transaction platform according to land plan and annual land use plan, and its use right will be renewed for free upon expiry just like with state-owned land. The government will adjust the value-added profits arising from the grant and circulation of collectively owned land with land VAT and income tax. Third, the scale of land requisition by the government will be strictly controlled. A clear line will be drawn between the government's and market's role and non-profit and profit-oriented land will be clearly divided, which will lay the foundation for reforming the land requisition system and defining the scope of land requisition. Situations where the government can requisition or allocate land should be listed in relevant laws, and land requisition and allocation outside the list is strictly prohibited. All profit-oriented land should be granted in open and transparent ways such as bidding and auction, so as to maximize the market's role in land resource allocation. Fourth, unify the land property right and land tax system in urban and rural areas. Apart from regulating the purpose of land use, the state will integrate the urban-rural land and housing property tax system. Homestead in a certain scope and buildings on it can be exempted from property tax, but all other construction land has to go through unified land use procedures, and the state will effectively adjust the premium income from land possession, leasing and transfer with real estate tax, land VAT and income tax.

– Managing land resources scientifically.

We will improve the system of land use planning and land purpose regulation, and form a land resource management system that features clear ownership, definite rights and responsibilities and effective oversight, with the aim of establishing a regulatory system that facilitates balanced use of resources. By drawing on international experience, we will build a scientific policy system of land use planning and management, implement regional plans and specific land use regulation, and improve the system of intensive land use. We will make better land use plans and annual plans, keep land supply well-paced, and make the use of land resources more efficient while effectively meeting the diversified needs for economic and social development. Public opinions and expert consultations will be solicited when land use plan is formulated, and the plan will be reviewed by the people's congress and CPPCC and, once approved, released to the society for public supervision. Municipal or county government's annual land use plan should be jointly put forth by land resource, planning and tax departments within the overall land use plan. We should make sure that key indicators, such as land requisition, use of agricultural land for non-agricultural purposes and land supply in level-1 market, don't exceed the plan, and the annual plan should include detailed land income and expenditure estimation. After the land use plan is reviewed and approved by higher-level land resource department, its quantitative indicators will be included in the *Report on National Economic and Social Development (draft)* and the estimation on land income and expenditure included as an appendix to the *Report on Fiscal Budget and Final*

Statement (draft). They will be reviewed at the annual people's congress and CPPCC for all-round supervision. The focus of government management of level-1 land market will shift from land requisition and grant to controlling total land supply and the pace of supply. When land requisition and purchase or the change of planned land purpose result in new construction land, the collective owner, according to the overall plan, can transfer the new land on government-provided transaction platform through open competition. This will make land grant and transfer more transparent, and every municipal and county government will supply land in the level-1 market openly and regularly every year.

We will improve the farmland protection and management policies. We will endow farmers with "permanent tenancy right" by revising and improving relevant laws and rules, and extend the term of contracted farmland operation to more than 75 years, so that farmers don't have to worry about the change of land use right for one generation, and will be motivated to invest more in fostering the land fertility. Farmland's function in maintaining social stability will be given play, some flexible farmland will be reserved in towns or villages, and farmers' right to farm where their permanent residence is registered will be protected. For special land resources like farmland, an upper limit will be set on how much an individual or family can use, and enterprise's large-scale operation has to be supervised to make sure that farmland is evenly distributed and can continue to serve the function of social stability. The government will specify the per capita area of free farmland based on local conditions. Farmland within that limit will be exempted from use right rent, but a rent will be charged on the excess land at the rate determined by the county government. The township government and village committees will organize open bidding and auction to transfer the use right of flexible farmland. Farmers no longer engaged in farming are entitled to a certain area of farmland when they come back, so that those willing to farm will have land to work on, which can guarantee their basic sustenance and serve as a safety net.

– Strengthening land asset management.

We will improve the system of land asset regulation and further intensify the operation and management of the rights and interests of collectively owned and state-owned land. Regarding asset management of collectively owned land, we will endow farmers with more property rights, protect their right of land contracting and operation according to law, and safeguard their rights and interests as members of collective economic organizations. We will ensure the usufruct of their homestead, and steadily and prudently push forward the mortgage, guarantee and transfer of farmers' housing property rights on a trial basis, thus institutionally creating more ways for farmers to increase property income. As to state-owned land, we will improve the entrustment and agency system, whereby municipal and county government exercises the right of land owner, while provincial government maintains the approving right of major land project and the responsibility for making overall land use plans and balancing farmland aggregate in the whole province. The central government is responsible for major resource management matters including farmland protection, river governance and oversight of key eco-zones, and formulating

policies and measures for state-owned land asset management and guiding their implementation.

We will set up government organs on county or municipal level in charge of state-owned land asset management. Land resource, planning and tax departments will all participate in planning management and coordinate the management of state-owned land assets and the handling of rights and interests thereof. Local tax department should play its role in state-owned land asset management and cooperate with the land resource department in planning the annual land supply to ensure balanced and orderly increase of land income and in formulating the annual budget of land income and expenditure to facilitate the review, approval and supervision by the people's congress. Through the close cooperation between land resource and tax departments, we will make better annual plans for land supply and carry out accurate income and expenditure accounting, laying the foundation for standardizing fiscal income and expenditure in this area. We will tighten income and expenditure management related with land requisition and purchase, protect the interests of disadvantaged groups, and standardize the procedures for land requisition and compensation according to law. Before land requisition is submitted for approval, rural collective organizations and farmers whose land is to be requisitioned should be notified in written form of the purpose and location of the land in question, the compensation standard and resettlement approaches. When programs concerning farmers' immediate interests are determined, such as land requisition, compensation and resettlement, opinions and suggestions from the land-losing farmers should be taken into account, and we will improve the compensation mechanism to help them increase their income. Efforts will be made to standardize the operation and intensify supervision in this process, and set up a special account for land compensations amid the "make government affairs transparent" campaign on village (township) level. Any behavior that causes the loss or waste of land compensation, such as interception, embezzlement, withholding or making decisions against rules, will be investigated and seriously dealt with.

– Intensifying and improving macro land regulation.

We will make the land market more uniform, liquid and competitive by reforming the land tenure and tax systems, so as to realize the free circulation and optimal allocation of land resources, promote their efficient and sustainable use, and facilitate sound economic and social development. We will further clarify land suppliers in the level-1 market and their authority, and give provincial and county governments duties, rights and interests in land management by delegating power, so that they will earnestly fulfill their responsibilities. We will enhance the government's function in macro management and reduce its micro-management of the land market. The central government will be focused on macro planning, farmland protection, oversight and administration, etc., while local governments, according to their designated authority, will work out plans according to law, organize their implementation and reinforce supervision and service. We will straighten out the policy transmission mechanism, foster a mechanism for land market's self-adjustment, and control abnormal fluctuations of real estate price. We will strive to create a sound market

environment where price signals are truer and the land market is better at self-adjustment.

7.5.2 Improve the Land Tax System to Meet the Requirements of Modern State Governance

Land tax system directly affects the distribution of land profits among the government, collectives and individuals. It plays an important role in guiding the behaviors of market players and local governments and is a key institutional foundation for the orderly flow of land factors. Given the problems in the current land tax system and the distribution and use of land income, we, following the guideline of stabilizing general tax burden, distributing revenues fairly and standardizing income and expenditure management, will further improve the tax arrangements and lay a solid institutional foundation for the smooth progress of the new type of urbanization.

– Improving land tax structure.

By designing reasonable taxes on construction, land transaction and possession, we will make real estate tax the principal tax for cities and counties and provide local governments with sustained and stable sources of fiscal revenues, so that they will rely less on land income and put in place a long-term mechanism beneficial for the healthy development of the real estate market.

First, we will unify the urban and rural land tax systems and create a level playing field. Before real estate tax is levied, urban land use tax, land VAT, housing property tax, urban infrastructure fee and the like will be applied to collectively owned construction land, so it will have the same right, price and tax burden as urban land. Meanwhile, income from granting collectively owned construction land will be subject to land VAT, deed tax and income tax, so the approach of income sharing currently implemented in pilot areas will be replaced by standard taxation. These will pave the way for collectively owned construction land to be traded directly in the market. Since collectively owned land involves little front-end cost, it can be deducted at a certain ratio prior to taxation in order to guarantee the owners' interests.

Second, we will levy real estate tax at an early date and implement dynamic tax evaluation. On the principle of “reducing tax entries, broadening tax base, rationalizing tax rate and carrying out scientific collection and management”, we will promote the real estate tax reform across the board, make tax base cover the whole real estate sector, and make overall considerations for real estate taxes and fees. We will also rationalize the tax rate structure, and improve the property registration and management system and regular evaluation system, so as to realize scientific and standardized tax collection and management and pave the way for real estate tax in the real sense. To be more specific, the following steps will be taken. First, the

National People's Congress will legislate to integrate the existing urban land use tax, housing property tax, land VAT, urban construction and maintenance tax and urban infrastructure fee into the real estate tax, in which housing and land taxes are integrated. Provinces or cities with independent planning status will decide, within the designated scope, when to levy the new tax and the applicable tax rate based on local conditions. This is called "legislation before implementation". Second, land or the buildings on it will be evaluated (for the profits they may generate if leased), and the evaluation will be taken as the tax base. All business and residential housing will be registered and evaluated, and real estate tax will be levied on them at a certain percentage, but basic residential housing and housing of public departments and welfare organizations will be exempted. This is called "tax on all housing with extensive exemption". At last, a unified real estate registration and evaluation system will be established nationwide and be re-evaluated regularly for dynamic management. This is called "centralized registration and regular evaluation".

Third, we will solve historical issues such as housing with limited property rights. While improving the tax system, we will work out unified and standard methods to address housing with limited property rights, rural homestead and buildings on it. For example, housing with limited property rights can be put in the land market through a combination of approaches, including the collection of a proper amount of land grant fee, tax on its added values and real estate tax.

– Standardizing management of land income and expenditure.

The general goal is to centralize part of the land grant income in central finance, improve its regulatory capability, and promote the reasonable distribution of land profits and balanced and effective use of resources.

The central finance will collect part of the income from granting state-owned land. Before 1994, it was stipulated that central finance would share 50% of land profits, but the ratio was reduced several times later. As land income was managed under a special account at that time, the policy of income sharing between central and local governments wasn't well implemented, so from January 1, 1994, land grant income was at the full disposal of local government, while central finance only collected a small amount of land use fee for new construction land and irrigation and water conservancy construction fund. At present, land grant income is completely placed under fund budget management, which makes it technically feasible for central finance to share in the land income. From a legal point of view, since state-owned land belongs to the whole people, profits from it should be shared by them all too. Therefore, the policy of 50:50 land income shared between central and local governments should be resumed. Annual land income should be submitted to central treasury, and central finance will allocate it between the central and local governments. To be more specific, a certain proportion (e.g. 20%) of land income can be shared to meet the requirement that profits from state-owned land should be shared by all people. The part collected by central finance will be used to set up a land fund. Land income won't be collected and spent in the same year, and the annual spending plan in future years has to be approved by the NPC and the expenditure will be managed as part of public fiscal budget, mainly to bridge the inter-regional financial

gap and support major cross-regional infrastructure projects. As to the part kept by local governments, cost expenditure will be included in government fund budget, and the remainder will be put under public fiscal budget.

We will standardize the distribution of income from granting collectively owned construction land. Collectively owned construction land is currently traded on a trial basis, and the profits from it are distributed in different ways in the pilot areas, causing non-standard income and expenditure management. Some areas consist of two levels: township and village, but there are no specific rules on income distribution on the village level and supervision and management is a blank. As a matter of fact, if the existing land VAT and income tax can extend to cover the circulation of collectively owned construction land, the government will be able to standardize the profit distribution through taxation. To that end, we suggest levying land VAT, deed tax and income tax on the income from granting collectively owned construction land after appropriate cost deduction or tax credit, and the remaining income will be left to land owners for local infrastructure construction, social security, and so on and be further distributed to individuals at a proper ratio.

We will abolish some policies on withdrawing government fund and capital. The government will make overall arrangements for capital used for the original purpose, such as agricultural land development, construction of low-rent housing, irrigation and water conservancy construction, and education, which will be funded by central finance through transfer payment. A number of government funds of varying sizes will be abolished when conditions are ripe, including special fund for new wall materials, special fund for bulk cement, and new vegetable garden construction fund. Expenditure of central land fund will be put in central fiscal budget, cost expenditure on land grant by local government will remain in government fund budget and the income will be put under public fiscal budget. Project management will be strictly carried out, which means that detailed project budget has to be developed before expenditure occurs, and capital allocation in the name of special fund is prohibited. Budget management of land related income and expenditure should be further straightened out with the aim of establishing the modern fiscal system.

– Improving land-related debt management system.

We will improve the government debt management system, and include land-related government debts in budget management while trying to establish the full-caliber budget supervision and management system. We will carry out standard planning and management of government debts, and all debts that the government is responsible for repaying will be placed under it. Changes to existing debts and new debt-raising plans in the current year have to be reviewed and approved by the people's congress and also put under standard planning and management. On the basis of developing standard income and expenditure plan for local government debts, we will intensify the oversight of how government debt is used to make it more efficient and reinforce budgetary restriction. We will make the budget more detailed, tighten its execution, and standardize debt management of land mortgage loan, so that the fiscal department will be able to comprehensively and effectively oversee the income and expenditure of land-related debts.

7.5.3 *Open Sources of Local Fiscal Revenue Focused on Land Tax*

In sum, in light of problems in the land management system and relevant tax systems in the context of a new-type of urbanization, we have to make overall arrangements for the supply of collectively owned and state-owned construction land, keep the supply of rural collectively owned construction land well-paced, and form, step by step, a unified and open construction land market for urban and rural areas featuring orderly competition. Based on the existing land resource management system, we will clearly define the budgetary authority and responsibility for land capital, and create a top-down, comprehensive and effective system of land ownership management and control with matching responsibilities and rights. Local people's congress, CPPCC and the public will supervise land management closely, which can help strengthen land planning, land use planning and management, and control of land purpose, and reinforce the supervision of land-using behaviors. As a result, land grant income can be obtained in a balanced way, the pace of land use and capitalization of land resources will be well controlled, and land resource development and utilization will be more efficient. We will further clarify the boundary between government and market, promote the combination of government input with market capital, and leave projects that are traditionally carried out with government financing to social investors while the government only bears limited risks according to their agreement. This will reduce the government's investment pressure and debt scale and reinforce the budgetary management and investment management of government debts, thus substantially raising capital efficiency. We will get an idea of the total scale of financing by mortgaging state-owned land, conduct timely and effective evaluation and monitoring of land financing risks, and improve the mechanism of government credit rating and risk management, so as to prevent land financing risks from causing a government credit crisis. We will push for the transformation of land finance and open sources of local fiscal revenues focused on land tax to stabilize the flow of local finance.

Land is the foundation of the governance.² The Chinese mainland will transition from middle-income to high-income status around 2020, when the state governance system with Chinese characteristics, including the land tenure system, will be well developed and basically mature. Such a goal forces us to speed up the reform. To advance land tenure system reform in the phase of new-type urbanization relates not only to the improvement of land, fiscal and tax systems, but also to the distribution of land profits and construction of independent financial resources of local governments, which is of great importance for transforming the governing concept and the economic and social development model. To meet the requirement on modern state governance and establish a land tenure system that conforms to the market economy and public finance, we must fundamentally remove the institutional obstacles that

²*Guan Zi-on Horse* by Guan Zhong (719–645 BC).

impede the free circulation of land resources and the reasonable distribution of land profits. As land tenure system reform is of significant importance and involves a wide range of aspects, overall planning and coordination are necessary during the reform. While adhering to the reform direction of socialist market economy and pushing forward the reforms of the land tenure system, administrative system, relevant tax system and government debt management system, we should also step up legislation such as *Land Management Law* and *Law of Urban Real Estate Management*. We will improve the system of government performance assessment and evaluation, and work hard in key aspects such as controlling land plan and annual land use plan, contracting the scope of land requisition, levying real estate tax and enhancing social security for land-losing farmers. The purpose is to make sure that reforms in different fields and stages can proceed in a coordinated way and form synergy effects, land resources can be smoothly circulated, reasonably allocated and effectively utilized, and the general public can share more benefits brought by China's urbanization and modern governance.