HOUSING REFORMS IN CHINA: A PARADIGM SHIFT TO MARKET ECONOMY

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ABSTRACT

The purpose of this paper is to examine the extent to which China has achieved the reform goals of marketisation and privatization of housing. The ‘low salary, low rent’ policy has resulted in severe shortage of housing supply and poorly maintained buildings. To tackle these problems, a number of reform measures are introduced to transform state provision of housing to a free market for housing. The transformation process from housing-in-kind to housing-in-cash has been gradual and slow. The paper concludes that after two decades of trial and error, housing reforms in China remain piecemeal and incomplete. No comprehensive housing reform policy has been laid down. The way forward for commodification of housing in China depends to a large extent on wage reforms, financial reforms and clarification of property rights.

Keywords: Housing reforms, housing policy, China

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INTRODUCTION

The aim of this paper is to examine the extent to which China has achieved the reform goals of marketisation and privatization of housing. The specific objectives are to examine the housing reform process from state provision of housing to a free market for housing, and to evaluate the housing reform measures. The transformation process from housing-in-kind to housing-in-cash has been gradual and slow.

The issues arising from the above discussion are generated by these questions: Why were housing reforms needed in China? Where did they go about doing the stitches? When did they start the revamp process? What are the outcomes? How about the way forward?

Under centrally planned socialist economy and ‘low income, low rent’ policy, there was not much choice for the urban work force other than to concentrate on industrial production and live on ‘work unit’ housing provided by state enterprises. People in the rural areas enjoyed more living space but simpler life and shouldered the responsibility of cultivating to feed the growing population (See Figure 1).

Figure 1
China: Per Capita Living Space (sq. m.)
Severe shortage of housing and the problem of dilapidated buildings cropped up (Figure 2). In the minds of the Chinese people in general and the leadership in Beijing in particular, social unrest might occur if people were not adequately housed. Therefore, paramount leader Deng Xiaoping championed a complete overhaul of the housing provision mechanism as early as 1980.

Figure 2: Housing Provision before reforms

State

Urban areas*

State enterprises (SE)

Rural areas

Production brigades (PB)

‘Work unit’ housing (mostly under-maintained)

Mainly self-built housing (rudimentary type, lack of facilities)
*As urbanization accelerates, the focus of this paper will be on housing reform in the urban areas.

Reform policies were first tested in big coastal cities of Shanghai and Guangdong because the progress and results could be monitored in these testing grounds before launching in other cities over the country. Apart from having the most urgent need for more housing so that young couples do not have to postpone marriages, these big cities also have the resources and scale to justify multi-facet reform measures in finance and protection of ownership rights. At the same time, wage reforms are needed to exclude enterprises from housing provision (Zhu, 2000). Without a generous wage reform and supply side measures to reduce costs, there will be far less demand for housing than is implicitly assumed by the government (Hamer and Steekelenburg, 1999).

Early attempts at reforms started in 1978 with the opening up of China, and foreign investment poured in mainly to the cities and has continued to play a vital role in urban development. These have been documented by Tolly, 1991; World Bank, 1992; Wang and Murie, 1996; Hamer and Steekelenburg, 1999; Zhu, 2000; Guan, Feng and Zeng, 2001 & Chiu, 2001a. The evaluation section of this paper touches on the outcomes of these various changes to the Chinese housing scenario.

The conclusion sums up the obstacles in this paradigm shift from a planned economy to a market-oriented one and points to the prospects ahead for a brave new world of housing in China.

OVERVIEW OF HOUSING CONDITIONS IN CHINA

In the early days of the People’s Republic from 1949 to 1978, private home ownership was seen as capitalistic. The government was keen on strengthening China’s industrial output. Urban housing was mainly provided by the dan wei or ‘work unit’ so that low wages were compensated for by cheap rental housing and rationed commodities. Under welfare housing policy, housing distribution was based on seniority and rank of the household head. However, rents were so low that maintenance was minimal, resulting in many sub-standard buildings.

Between 1949 and 1990, 1.98 billion sq. m. of housing were built in Chinese cities and towns: 1.73 billion sq. m. (87 per cent) were built by public and collective sectors and only 0.25 billion sq. m. (13 per cent) were built by individual families (Wang and Murie, 1996).

Senior leader Deng Xiaoping realized the need to raise rents to market levels to encourage home ownership. This could not be achieved unless wages were increased to allow the low-paid workers to pay the adjusted rents. He also championed the establishment of a housing market where market forces should determine housing prices. The government would help to start a secondary housing market to facilitate sale and purchase of dwellings.
At the beginning of this structural transformation of the housing sector, the state retained direct control over housing production and allocation through work units and local authorities. The housing sector was still under the system of a planned economy, but rents for ‘work unit’ housing were to be increased gradually to market levels. Higher rents would reduce the burden of housing subsidies by the work units and people should be prepared to pay more for rented housing. Higher rents would also induce people to buy rental properties, which would give rise to a rental housing market.

HOUSING REFORM PROCESS: A TRANSITION FROM WELFARE HOUSING TO COMMODITY HOUSING

The Housing Reform Plan 1988

From 1978 to 1988, the housing reform process was cautious. To encourage people to own homes, rents were increased and there were heavy subsidies in the selling of public rental housing in 1984. At the 1988 National Housing Reform Conference, it was recognized that housing reform could bring economic and social benefits. Therefore the overall objective of housing marketisation became central government policy in 1988, which sought to continue raising rents to competitive level and begin implementing sale of public sector housing.

Green Light for Housing Reform 1990

In tandem with the 8th Five Year Plan (1991-1995), the State Department endorsed the Shanghai Housing Reform Plan in May 1991. Based on the former subsidy model, it was characterised by such innovative device as the Housing Provident Fund, rent subsidy, and housing bonds. Thus, there was a shift of housing finance burden from central government and work units to individuals and the market. Housing development aimed at continuous improvement of urban living standards, with a new per capita living floor space target of 7.5 square metres by 1995 (Actual 8.1 sq m, see Figure 3). The aim was to commercialize housing by the end of 2000.
In 1994, the State Department issued a policy called ‘State Department’s Decision on the Deepening of City and Township Housing Reform’ in a bid to push ahead the housing reform process towards the market. Five policy measures were proclaimed:

1. Co-ownership of Housing Responsibility: where housing responsibility would be shared by the state, work unit and the individual, as illustrated by the tripartite relationship below:

   Figure 4: Co-ownership of housing responsibility
2. Housing Provident Fund as a Cornerstone in the Reform: the state made use of the Housing Provident Fund to assist home finance. Both the work unit and the individual would contribute to a common account. Designated banks would supplement the fund with individual loans through a mortgage system.

3. Socialization and Professionalization of Housing Management – diminishing role of the state and work unit in housing production and allocation. The housing stock would be managed by professional bodies.

4. Selling of Former Public Rental Housing to Sitting Tenants: the state would progressively sell all existing public housing stock to sitting tenants at a discount rate of 50% and down payment should not be less than 30% of the purchase price.

5. More Housing for Middle-and Low-Income Groups: the state would continue to produce economic comfort housing for those groups who could not afford to buy. The annual production of these houses must be less than 20 per cent of total housing production of any city or township (Lee, 2000).

Thus in the process of housing marketisation, the state no longer bore full responsibility of housing provision and the state was to disengage from public housing through the promotion of home ownership.

Housing Subsidies in Cash

The 1994 policy provided a framework for monetarisation of housing subsidies in 1998. It involved termination of welfare housing allocation, which would be replaced by direct housing subsidies in cash. The government paid the workers money to allow them to buy or rent from the market. In this case, Guangzhou in southern China is a good example. In response to Premier Zhu Rongji’s macroeconomic policy directive, Guangzhou started housing monetarisation in March 1998. Workers employed before September 1997 could choose to remain in the old welfare housing system. New staff joining government after September 1997 would get monetarised housing subsidy for up to 25 years, paid into the staff subsidy account. But staff who had received monetarised housing subsidy would no longer be eligible for buying or renting heavily subsidized welfare housing.

With more freedom to buy or rent property and improved access to home ownership, a secondary market for public flats and market housing was established in Shanghai to promote commodity housing. The government encouraged banks like the Bank of Construction to provide mortgage facilities to home buyers. For the first time in China, individual home buyers had been treated as customers by banks.
Housing Provident Fund

After 20 years of experiment, the Chinese government came to realize that the only effective way to sever state responsibility in public housing is to encourage home ownership. In the 1980s, rent increase was not entirely successful because of the low wage system. The question of how to help people finance their own home was a major issue in the 1990s. One way to deal with this was to create a new financial instrument to provide direct assistance to home buyers. Modeled after Singapore’s Central Provident Fund, the Housing Provident Fund (HPF) scheme in China was to concentrate on housing contributions only. Over 33 cities in the country have adopted the HPF scheme, with Shanghai being the most successful in implementing the scheme for its entire population. However, only a small proportion of the funds were for home finance since most loans were used for home construction by work units.

The Shanghai HPF was established in 1991 and the contributions to the fund were managed by the Shanghai Housing Provident Fund Management Centre with the Bank of Construction as its fund manager. A new housing organisation, the Shanghai Housing Authority, was also set up. Like its Hong Kong counterpart, the housing decision-making function was shared by lay people and professionals and not just in the hands of government officials. Therefore, there witnessed a gradual shift from collectivized state provision of housing towards highly individualized market-oriented housing consumption (Lee, 2000). The Shanghai experience represented a more innovative approach to the reform process.

Shenzhen wei li (low-profit) housing

Shenzhen in southern China was chosen as a Special Economic Zone in 1980 mainly because of its proximity to Hong Kong. Since 1988, Shenzhen had replaced direct housing welfare provision by housing subsidies. With its fast economic growth, rent increases were made substantially and quickly from 0.14 yuan to 2.06 yuan per square metre (Lee, 2000). These workers had enormous difficulties in finding the most basic form of housing. Other employees were only eligible for wei li (low-profit) housing, which was more costly than welfare housing. Government workers were eligible for welfare housing of much higher quality.

To subsidize or not to subsidize?

All along Chinese workers spent 1 to 2% of the average household income on rents (Fong, 1989). Low rent was regarded as a subsidy for prevalent low salary. At the beginning of the housing reform, rents were gradually raised but with concurrent direct subsidy in salary. In Beijing, rents were raised to 1.8 yuan per square metre in 1998 with the aim of achieving an increase to 3.86 yuan by 2000 through a series of administrative adjustments. This level of rent would represent 15 per cent of a household’s income and is regarded as the optimum level (Lee, 2000). However, the rent increase was not very successful because the increased rent was much lower than the average mortgage level, so there was little incentive for workers to give up renting and move to home ownership. As the state expects the enterprises to pay for the rent subsidies (currently at 24 per cent of average salary), enterprises with balance sheets in the red would find the rent subsidies a heavy financial burden on them.
ANALYSIS OF HOUSING POLICY FRAMEWORK

China is the world’s fourth-largest country (after Russia, Canada, and the United States). The size and regional variations form a very complex system of local characteristics and resources requiring different initiatives in different cities. Nevertheless, it is evident that there is a shift from ideological approach to a more pragmatic approach and willingness to accept reforms in a market mechanism. The shift has been cautious and gradual, with policies tested and assessed at various places before being adopted. The initiatives begin with statements and experiments as shown in Figure 5.

Figure 5: Formulation of Housing Policy
Government retains control over basic questions, but local variations in practice have been encouraged. Thus, under the Chinese system regulations are introduced by the State Council, then by provinces and cities. With the exception of broad policy areas, different approaches by different cities have been adopted. After further experiments regulations are firmed up by government, resulting in strong centralized bureaucracy and the tradition of experiment and local variation (Wang & Murie, 1999).

The sheer vastness of China has called for different policy approaches and practices in different cities like Guangzhou, Shenzhen, Beijing and Shanghai. Shenzhen is a new city in a Special Economic Zone of south China. Its convenient position as a neighbour of Hong Kong and the Special Economic Zone status has allowed building for economic expansion rather than solving the existing problems of an old city.

Shanghai has experienced many of the key housing reform polices and the Housing Provident Fund is so vital to future housing investment. The divergent pattern of needs and the resources available affect the options and strategies appropriate for different provinces and cities. So the legislative and regulatory framework has guided the direction of reform in Shanghai, shaped by differences in practices and local policy.

Shanghai and Guangzhou, however, valued the housing provident fund scheme. Based on the Singapore experience, Shanghai pioneered the scheme before formulation of regulations. Shanghai also developed a different organization, the Shanghai Housing Authority, involving a lay committee (like the Hong Kong Housing Authority) to guide housing reform, while reform in Guangzhou addressed housing problems of targeted groups. As a result, Guangzhou had achieved an average per capita living area of 9.3 sq m in 1994, higher than the more developed Hong Kong’s 8.3 sq m per capita in 1994 in terms of housing space standard.

Owing to their strategic location, Beijing, Shanghai and Guangzhou witnessed large-scale expansion of the commercial sector. Reform policies in those cities had much to do with housing market finance and housing mortgage services to individual buyers. New policies were tested in these few large cities before applying to other smaller cities. This avoided social instability but had resulted in slow development progress of the reforms.
EVALUATION OF HOUSING REFORM MEASURES

To what extent is the housing reform in China successful? There is no simple answer to this question. It depends on the overall success in developing and expanding the economy and in the detail of housing reform itself.

Figure 6: Socialist framework of housing provision

Within the socialist framework (Figure 6), the individuals only play second fiddle to the State and work units in housing provision and allocation. In the early days of the People’s Republic, industrial production and economic growth took precedence over housing reforms, which tended to concentrate on improvement in housing and living standards.

Figure 7: Market housing model (diminishing role of the State)

* Property rights under privatization of housing, but full maintenance and repair responsibilities.
With the gradual shift to market-oriented economy as depicted in the Market Housing Model in Figure 7, the State has played a diminishing role in housing provision. Under privatization of housing, individual home buyers acquire not only property rights but also maintenance and repair responsibilities.

As housing reforms involve structural change of cities from ‘work based’ community to ‘residence based’ community, the reform will create new social divisions and newly divided cities. These differences create an intricate property market that is complicated by the continuing State ownership of urban land. China has adopted a pragmatic approach in the transition to a market system. In short, the repercussions of housing reform are complex and their contributions to overall economic development of the Country remain to be seen.

Criteria to assess and analyse the successfulness of housing reform in China

Objectives of Housing Reforms at a Glance:

<table>
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<tr>
<th>OBJECTIVES</th>
<th>ACHIEVED</th>
<th>NOT ACHIEVED</th>
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<tr>
<td>• To reduce state subsidy on housing</td>
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<td>• To relieve government of the burden on housing provision</td>
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<td>• To facilitate circulation of housing capital</td>
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<td>• To increase household spending on housing</td>
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<td>• To rationalize housing consumption</td>
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<td>• To promote home ownership</td>
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<td>• To set up a secondary market for housing</td>
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<td>• To resolve the problem of housing shortage</td>
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<td>• To tackle the housing affordability issue</td>
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<td>• To make housing equally accessible to people of low income</td>
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<td>• To rid the city areas of poorly maintained buildings</td>
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<td>• To increase wages so as to cope with rent increases</td>
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<td>• To clarify property rights</td>
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ACHIEVED:

Reduction of State subsidy on housing

In March 1988, Premier Zhu Rongi brought an end to ‘work unit’ housing and encouraged the sale of housing stock to existing tenants. From 1988, state enterprises
would no longer construct housing for employees. This had greatly reduced the amount of State subsidy on housing.

Relief of government burden on housing provision

Under socialist economy and ‘low income, low rent’ policy, housing was provided by State enterprises and was a real burden to the government. As a result of poor management, there were severe shortages of housing and the problem of dilapidated buildings. Since 1988, work units either contracted out housing production or bought units in the market and sold them to employees at discounted prices. This had absolved the government from maintenance expenses for the lifetime of the ‘work unit’ housing.

Increased household spending on housing

Under ‘work unit’ housing allocation system, workers paid only 1-2 per cent of salary on rents. Since the reform and opening-up policies in 1978, foreign investment was permitted in the special Economic Zones of China’s southern provinces. As part of the economic development of China, housing reforms in the form of rent increases were carried out. This resulted in the National Housing Reform Plan of 1988, which promoted the sale of public housing. The increased revenue generated from adjusted rental income would provide the much needed funding for new housing construction to meet the demand for housing consumption.

Circulation of housing capital

Chinese households were formerly beneficiaries of welfare housing. With increasing household investments in housing, they had become an economic resource for housing development. With contributions to the Housing Provident Fund schemes, purchase of commodity housing was made possible; thus facilitating the circulation of housing capital. In Shanghai 3.07 billion yuan had been drawn from the housing provident fund by mid-1995 to finance the construction of 2 million housing spaces for re-housing overcrowded households, contributing to one-quarter of the total investment in housing construction for that period (Chiu, 2001b).

Promotion of home ownership

To encourage people to buy public housing, rents have to be increased to market level. As rents had been raised closer to market levels, a lot of sales of apartments to sitting tenants were made in the early 1990s; some with discounts at one third of the production costs. Further discounts were made according to seniority and ranking. For Chinese people, owing a home was no longer a dream.

Rationalization of housing consumption

Under welfare housing system, tenants have user rights but not ownership rights. To avoid speculation, the government requires home owners to own a home for at least 5 years and to possess a valid ‘ownership certificate’ before they can sell it. These restrictions will be relaxed in some places to facilitate the establishment of a
Setting up a secondary market for housing

By bringing in market mechanism, housing reforms have great impacts on housing consumption. From 1998, commodification and marketisation of housing became the drivers for economic modernization of China. Rent reforms and increased wages had provided the incentives for home owning. A secondary housing market came into being as people buy and sell houses, notably in Shenzhen of southern China (Fieldwork, December 2002).

Problem of housing shortage

From 1988, State employers sold State-owned living quarters to employees at discounted prices and many Chinese have bought their homes in recent years. Despite efforts in reforming the welfare-housing system, 1.56 million households still do not have enough living space (China Daily 08/21/2002).

Housing affordability issue

Economy housing turns out to be unaffordable in China today. In Beijing, 60 per cent of economy housing cost 300,000 yuan (1 yuan = $0.22). At the moment, 4.37 million square meters of housing are under construction in the Capital, amounting to a total investment of 15 billion yuan. Many medium-income and low-income families are literally ‘homeless’ as last year (2001) alone, 15 per cent of affordable housing was snapped up by medium to high-income families. 70 per cent of Beijing people look for affordable housing of below 300,000 yuan price-tags and over 90 per cent of them are after housing spaces of under 1,000 square meters. 60 per cent of economy housing in Beijing are priced over 300,000 yuan because most flats are up to 150 square meters (costing as much as 600,000 yuan to 700,000 yuan, but purchased by high-income people as investment). Two-bedroom flats of 70 square meters account for a small proportion of the housing stock, thus rendering it difficult for low to middle-income people to afford a home of their own. This happened not only in Beijing, but also elsewhere in the country (Oriental Daily, 18 December 2002).

Accessibility of housing to low-income people

In 1998 the government introduced a three-tier housing supply system to meet the needs of people with different income streams. Within this framework, the lowest-income groups will be provided with low-rent houses or given rent subsidies; medium-income families have the choice of economy housing sold at prices set by the government; and commodity homes targeted at high-income families will be sold at market prices. According to the Beijing Municipal Bureau of Statistics, the average annual wages in Beijing in 2001 was 19,155 yuan (US $2,310). The current (2002) average housing price in the city is 4,883 yuan (US $590) per square meter, according
to figures released by the National Bureau of Statistics. In some cities, there are no low-rent housing schemes. Even in cities with such schemes, the number of people eligible far exceeds the number of houses available. In Beijing, for example, 294,000 people live in the minimum living allowance and have a living space of less than 7 square meters per capita. But only 396 households have received the 500 yuan (US $60) monthly rent supplement from the municipal government (Xinhua News Agency, August 2002).

Getting rid of poorly maintained buildings

As a testing ground for urban renewal in China, Shanghai underwent significant changes in land acquisition, clearance and compensation legislation in November 2001. Highlights of State council’s directives were:

- Compensation mechanism based on market rates;
- Smooth transition for clearance by means of minimum subsidies of 20% of the price of houses in the same district;
- Stipulation of the rights and obligations of the parties involved in clearance exercises; and
- Better management of clearance activities.

Nevertheless, of the 2,015 square meters of shanty houses in Shanghai (or 3,050 hectares of land), only 453 square meters (22.4%) were cleared in 2001 (Shanghai Economy Yearbook 2002).

Wage levels not at par with rent increases

Rents in public housing have been increased to cover part of the production costs. The 1994 document on the “Deepening of Urban Housing System Reform” gave the directive of greater rental increases and set the target of a rent-income ratio of 15 percent by the year 2000 (Guofa, 1994, no.3; Chiu, 2001b).

Clarification of Property rights

With the introduction of a secondary housing market, full property rights are possible (see Figure 8). However, it will take a long time for a mature secondary housing market to develop. In view of the unfair allocation of public housing in the past, it is extremely difficult to take possession of public housing that had been in the wrong hands. By legitimizing the sale of public housing, in time fairer allocation of housing resources will be dictated by the market.
CONCLUSION

China recorded an economic growth rate of 7.3% in 2001. With China’s accession to the World Trade Organization and Beijing’s successful bid to host the 2008 Olympic Games, China’s economic growth rate will keep at 7% to 7.4% during the period 2002-04 (Beijing Review, 2002). Urban property development will continue to assume its growth momentum in the Chinese economy. Investment in housing will increase, so will improvement to the existing housing stock. But the scale of investment in new housing will depend on the demand side factor and availability of funds. With rapid urbanization more people are flocking to the cities where demand for housing will be high. Both government work units and commercial developers will respond to this demand. However, the availability of funding for housing will depend on direct government subsidy, the housing provident fund and increasingly, private institutional finance. Meanwhile, savings in the housing provident fund form the backbone of successful housing development. By the end of June, Shanghai alone had granted 42 billion yuan (five billion US dollars) in loans from the fund to 510,000 ordinary families (Xinhua, 2002).

As far as full commodification of housing is concerned, at least three obstacles remain: Wage adjustments, improvement of the finance system, and protection of property rights. Upward wage adjustments are necessary to enable workers to pay market rents and to facilitate home ownership. Improved access to more finance options is needed because an active financial market will provide funding for house construction and home loan mortgages. More comprehensive legislation protecting property rights will give a sense of security to home owners which in turn will help create responsibility and stability in society.
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