

The Effects of Housing Reform on Property Markets in Inland Cities of China

– The Case of Wuhan

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Abstract

The allocation of public housing in urban China has been experiencing dramatic changes in recent years. Currently, it is at the transition from in-kind to monetary allocation. Compared with the developed coastal cities, housing reform and its impacts on the property market in inner cities have drawn less attention. Using Wuhan as a case study, the effects of the housing reforms on the property markets are analyzed to demonstrate the far-reaching impacts of the housing reforms. Qualitative interviews with 20 local officials in selected municipal or sub-municipal departments and ordinary residents were conducted, and documentary research using official materials, local newspapers and journals was carried out as a necessary supplementary method to case study and interview. The results indicated that housing reform measures have greatly encouraged the development of the property market of Wuhan. However, there are still uncertainties in the future development of the real estate markets as well as reform policies. This implies that property markets in inland cities may take a long time to develop towards maturity. The implications of these results provide useful information to both the policy makers in housing sector and the potential investors who are interested in China's future development.

Introduction

China, like countries with very different political regimes, has launched a series of economic reforms since 1978. These reforms allow market forces and private enterprises to play an increasing role in the production and consumption of goods and services. Chinese urban housing reform was carried out in this setting and precipitated by the rising housing problems from the late seventies to the early eighties. The role of the state in housing has been the subject of controversial debate in China. While many still emphasize its public goods character, many economists argue that the supply of housing should be left to market forces.

Various new policies were introduced from as early as 1979 designed to commercialize and reform the public sector-dominated housing system. In 1983, the State Council took further steps and guaranteed to protect private property rights. This paved the way for an

expansion of private investment in housing and property markets. At the same time, various experiments were carried out to commercialize the existing urban public housing sector (Badcock, 1986; Dwyer, 1986; Fong, 1988; Kwok, 1988; Kirkby, 1990; Lim and Lee, 1990). In 1988, the government initiated a further economic reform known as the Ten Year Reform Strategy. One of the major objectives was to encourage urban residents to buy their houses, to formulate housing finance arrangement and to restructure rents in the public sector (Liu, 1989). Since then, various central and local legislation and regulations on privatization of urban housing have been issued. Large quantities of houses were built by developers and many public-sector institutions and enterprises have produced plans to privatize their housing stock through sales to existing tenants or other employees.

These developments in housing policy have formed an important area for research and this has resulted in a large number of publications inside China. Unfortunately, very limited information is available to a wider audience outside the country, especially in terms of the impacts of urban housing reform on property markets in urban China. This paper draws upon data collected from Wuhan and attempts to examine the developing property markets in a historical perspective. The aim of this paper is to provide a review of housing reforms and a systematic account of the key features of the housing commercialization process. It will focus principally on the attempts to privatize public-sector housing in urban Wuhan – a typical city in inland metropolitan China. The paper is based on an analysis of interactive interviews with the local government officials, government legislation documents and relevant literature and press articles in Chinese, including local housing reform plans.

Housing Reform: Strategies and Practice

Wuhan's property market underwent three main phases after the establishment of People's Republic of China. The first phase was from 1949 to 1955. At that time, the Communists just came into power, and the property market not only continued to exist as before; it was also very prosperous. Housing sales and rental transactions were very active. The sales transactions were primarily in the form of public-sector purchase of private properties. However, the speculative activities were still prevalent and the Wuhan government started to intervene in the property markets from 1949. But it was only after 1956 that Wuhan's property markets stepped into the second phase with the extinction of property markets.

In this phase, land was distributed to state-owned enterprises by the government through administrative orders instead of according to market mechanisms, and the land market vanished. The proportion of private housing decreased from 84% in 1949 to 27% in 1958. Consequently, private housing was seldom rented out, and contemporaneously the distribution of public housing was in accordance with planned economy regulations in which the market forces were not considered. During the Cultural Revolution, the local government went so far as to confiscating most of the private housing, and the share of private housing was reduced to about 8% in 1975. Since public housing tenants paid only a nominal amount of rent to the local government, rental income was insufficient to cover

maintenance and management costs, let alone new investment in housing. The real estate market shrank and disappeared.

The third phase started in 1979. Private construction and sale by developers were legalized, some of the confiscated private dwellings were returned, and there was a shift towards the renting and selling of public housing. These measures led to an increase in the proportion of private housing in the total housing stock and the recovery and development of private renting markets.

Rent increase

Large-scale implementation of rent increase in urban Wuhan began in 1988 following the first National Urban Housing Reform Conference where experiences from experimental cities and various concerns were discussed. The conference proposed that housing reform be implemented step by step and group-by-group across the country under the guidelines of 'rent increase with subsidy, rent with sales, and promote sales by rent increase'. The Wuhan government issued the 'Wuhan housing reform implementation plan' in which public housing rent should rise from less than 0.1 yuan to 0.32 yuan per m² and *danwei*¹ provide certain amount of housing subsidy to employees. In 1995, the average rent was further increased to 0.88 yuan per m². Rent was increased to encourage sales of former public housing and create a favorable environment for developing Wuhan's property markets.

Sale of public housing to individuals

This policy forms a very significant part of 'housing commercialization' (*Zhufang Shangpinhua*). The commercialization of housing means that the state defines housing as a commodity that can be purchased, rented, owned and transferred through the market. Several adjustments are required. Firstly, the state adjusts its relationship with public employees. Housing expenditure is added to the employee's salary as an essential part of labor cost. In other words, the state no longer deducts money from employee salaries as a basis for provision of low rent housing. Instead, employees receive a consolidated salary for their work and assume housing responsibility themselves. Secondly, public housing is sold to reduce the burden on the state and recoup the investment for more housing construction. Finally, before the wage system is reformed, subsidy is provided to employees who pay commercial rent or buy houses at market prices. However, some *danweis* sold public housing at extremely low prices, thereby contributing to severe housing deficits incurred by the national and local governments.

Monetary distribution of housing

¹ A work-unit (*danwei*) generally refers to a specific kind of workplace in the context of state socialism where the workplace becomes an extension of the state apparatus and undertakes the function of social organization and control. *Danweis* are subject to commands from supervisory government agencies. Their function in a planned economy is far beyond that of production organization. For more details, see Xiaobo Lu and Elizabeth J. Perry, (eds), *Danwei: the changing Chinese workplace in historical and comparative perspectives*, 1997.

In 1994, new policies were introduced to stop the sale of existing public sector housing at low prices. Three different price mechanisms were subsequently proposed. First, market prices should be applied to high-income homebuyers. High-income families were defined as those who can afford to purchase a two-bedroom apartment from the market on 5-6 times annual family income. Secondly, a price based on costs would be applied to low and middle-income families. This price should recover seven cost elements: the costs of land acquisition and compensation, pre-construction costs, building, neighborhood public, facilities, management, interest on loans and tax. Thirdly, a standard price, which takes into consideration costs and affordability, was proposed as a transitional mechanism if the basic cost price causes financial difficulties to families. This was the first time that the affordability and family financial circumstances have been included in formulating sale prices. The standard price would include two elements: affordable price plus 80% of housing savings including the contribution from employer over a period of 60 years. This increased price and the complex formula slowed down the sale process but ensured higher levels of receipts that are more compatible with reinvestment objectives.

Compulsory savings

The compulsory savings scheme in Wuhan requires all urban residents in employment to save part (5%) of their salary through the *danwei* as long-term housing savings. The employer (whether public or private) must contribute a similar proportion to the employee's account each month. The savings will be held by a bank on behalf of each account holder (the employee) and managed through the employer collectively. The bank could only lend the money for housing development. The account holder could withdraw the money from the bank for approved housing spending including purchasing and major repairs during his/her employment. The evaluation and approval are to be made by the employer. The money could also be withdrawn when the account holder retired. The purpose of this policy was to accumulate housing development funds and gradually increase household purchasing power by limiting spending on other consumer goods. By allowing account holders to use the money after retirement, the government anticipated that this saving would subsidize pensions when housing becomes less of a problem. As a result, rising incomes could be channeled into the housing sector and also inflationary pressures would be partially offset.

Finance and insurance

These strategies aim to establish a new housing finance and insurance system where the state is no longer the only provider of housing capital. Most housing investment will come from market borrowings. The banks will an active role in accumulating funds for housing construction. Housing insurance will be introduced to protect developers and homebuyers through mortgage arrangements.

Development of housing market

Once in-kind distribution of housing is replaced by monetary distribution and public housing is privatized, a housing market will be gradually developed to enable free

housing exchanges. Maintenance and repairs will be dealt with by individual owners and private firms. The elements of Wuhan's housing reform program in 1995 include some aspects that were overlooked in previous reforms, such as the provision of social housing and the restricted role and price for public-sector housing sales. The new strategy aims to establish a new housing system in which both the rich and the poor have access to housing, rather than a narrow privatization. In the future, it is hoped that all state-owned enterprises and institutions will produce a housing reform plan to include the above elements. The reform involves gradual change over a long period and current 'transitional' arrangements may remain for a considerable time. Where sales remain a key element within circulation and changing ownership, the emphasis has shifted to other elements – compulsory savings to maintain investment and measures to develop a property market.

Effects on Wuhan's Property Markets

Implementation of main policy initiatives in diverse and complicated political and economic situations has been institutionalized by the CPC through approaches such as 'group-by-group', 'step-by-step', 'try and see', and 'wait and go'. Like many other cities, before the formal introduction of reform policy, experiments on Qingshan district began soon after commercialization was proposed in Wuhan. After having widely implemented the reform measures for ten years in all districts of urban Wuhan, the local government officials have gained valuable experience. The major changes of Wuhan's property markets include the following.

Land reform activated the land market

Basically, the land reform in Wuhan followed a top-down process. An amendment to the 1982 Constitution approved by the National People's Congress on 12 April 1988 reads: "The right of land use can be transferred in accordance with the law." The land use fee was fully implemented in Wuhan only after June 1992 to establish and legalize the commercial relationship between the government as the landowner and private land users as tenants.

Therefore, compensatory transfer of land use right has become legalized. The land use right can be transferred to developers or land users for a fixed period after payment of rental in a lump sum. Land use right can be acquired through bidding, auction, or negotiation. Purchasing by negotiation is a market allocation with government subsidies through which local government apparently implements its policy of facilitating targeted industries. The previously implicit land market has become explicit, and property rights are clarified.

Although the urban land management reform has so far been confined only to land-use-right transfer, while land-ownership remains a state monopoly, it cast a dramatic impact on the urban economy. First, it facilitates the introduction of market forces into the urban economy as well as into urban development. Second, it is the first step towards the commercialization and land and property development, which allows the state to quit its omnipotent position in physical development and reestablish its role as a regulator. Third,

the problem of under-investment in infrastructure will be alleviated by guaranteed income from land sales. Finally, the urban land use pattern will undergo radical changes as market competition replaces administrative allocation.

Development of real estate markets

The housing market in Wuhan emerged during the middle and late 1980s. Commercial housing includes residential housing, commercial housing for business purposes and office. The number of property developers increased sharply from less than 100 in the late eighties to 909 by the end of 1998. The volume of real estate transaction was enlarged year by year (see Table 1). For example, in 1998, Wuhan sold 635,900 m² of commercial housing, of which 590,400 m² (98.2%) consisted of residential housing.

Table 1 Commercial housing sales in urban Wuhan, 1991-1999

unit: 1,000 square meters

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
597.2	491.9	407.9	695.0	498.7	903.9	1,095.5	1,662.2	2,634.8	2,531.3

Pluralized rental market

Compared with the property transaction market, the rental markets are more active and pluralized. Renters include the following: institutions, organizations, army, schools, state-owned enterprises, private companies, self-employees, and individual citizens of Wuhan. Landlords are composed of the following: state-owned enterprises, organizations, as well as self-employees, private firms and investors from outside Wuhan.

Property markets: from ‘craze’ to rationality

When China started to carry out housing market reforms, the endeavor to implement policies often resembles a person who, in the Chinese phrase, ‘feels for stone to cross a river, walking one step and looking for the next.’ Deng Xiaoping’s 1992 ‘south tour’ and his speech triggered real estate development countrywide. The large scale of property development activities brought the Wuhan government considerable land transfer income because Wuhan was one of the ‘heated points’ of real estate investment.

The Chinese government realized that ‘productive’ investment was affected by the flow of capital flowing into real estate. In June 1993, the State Council announced ‘macro adjustment and control’ to channel the flow of capital back into industry. This led to a sudden fall of confidence and property prices. Many building projects were halted, and developers could not sell their properties.

Characteristics and Problems

Wuhan's property markets are developing rapidly. Although the overall trend is positive, there are still some issues that need to be highlighted.

Non-standard land market

After the introduction of land-use fees in Wuhan in the early nineties, land leases were negotiated between interest parties and the local government. Bidding or auction was seldom adopted. This practice gives rise to under-table transactions and the government as the landlord does not appear to benefit directly from the booming property market due to the low negotiated land price arising from the *guanxi*² between participants. The management of the leased land is also very loose, and some developers, after obtaining the land, trying to sell out for capital gain rather than develop the property.

High prices of commercial housing

The prices of commercial housing are too high for many potential buyers. The price for each m² reached 1,000 yuan by the end of 1980s, and continued to rise by a substantial margin during the boom of 1992. According to the statistics, the selling price of residential commercial housing in urban areas of Wuhan was between 2,000-2,500 yuan in 1992, commercial housing for business purposes was between 2,800-3,200 yuan, and the commercial housing for business purposes in downtown Wuhan was a staggering 5,000-10,000 yuan. The high prices retarded the government's efforts to commercialize former public housing. Meanwhile, developers are facing a high vacancy rate for the properties they are holding and risk failure.

Disordered property market

Theoretically, due to changing equilibrium between demand and supply, any appreciation or depreciation in the capital value of property should be attributed primarily to the land where the building stands. Accordingly, the state as the statutory landowner should gain from property booms or suffer from property declines. However, by alienating land leases at subsidized rates in large quantities, the landlord does not fully capture the gain from land sales. Thus, in the context of China's incremental reforms, who has actually benefited from the gradual urban housing reforms? We observed that developers and investors of subsidized land are the prime beneficiaries.

The high prices of commercial housing and relatively low rents for public housing have led to various forms of 'black transactions' that resulted from ineffective management. The entire housing market is still in disorder as incomplete delineation of property rights led to various forms of wealth capture in the public domain.

² *Guanxi* was a defining trait of Chinese society even before the Communist Revolution. Personal relationships are the basis for a 'Communist neo-traditional' mode of authority dominant in Chinese *danweis*. Good relations with one's supervisor or *danwei* leader and ties to important people through relatives and friends are crucial in obtaining scarce resources.

Lack of inner driving forces

Lack of effective demand, insufficient support from financial system, high commercial housing prices, the inharmonious relationships among renting, selling and construction markets and inefficient real estate market management are the unfavorable elements of the present Wuhan's property market. This combination of all factors restrains the development of real estate market.

Conclusion

In China's context, the relationship between housing reform and the development of the property market in inland cities is inextricably linked together. We can put it in this way: there would be no property market if the housing reform had not been launched; meanwhile, without fair and effective property markets being developed, the on-going housing reform would likely be a failure.

The reform program has changed the public's perception of state housing provision and introduced many new elements in housing provision such as rent increase, sale of public-sector housing, compulsory housing savings and commercial housing development and distribution. It has diversified housing provision and investment and brought a major expansion in the urban housing market. With the opening up of the commercial property development market, even some overseas investment has been attracted to Wuhan's property markets, particularly in the commercial centers. Housing reforms have solved some problems, but at the same time have created new problems. As a very important link of China's economic reform, housing reform is undoubtedly connected with state-own-enterprise reform, salary reform, financial system reform and is constrained by the implementation of these reforms. Unlike many eastern European countries, the reform program in China has been carried out within the Communist framework amid a web of old institutions. In a larger social context, material affluence and legal protection are necessary and important for establishing property markets. As the Chinese economy takes time to prosper and the Chinese political system faces uncertainty, housing reform and its profound effects on property markets remain to be observed and studied as an open-ended process.

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