China's ongoing property crisis – The crony alliance between the government, developers, banks and property market agents

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In late summer a sudden surge in the number of couples seeking a divorce was reported in Shanghai. This was not due to a high number of relationships suddenly falling apart. Instead, rumours were being circulated that the municipal government would soon introduce new tougher restrictions for the purchase of property, which favoured first time buyers and so couples were rushing to get a so called "paper divorce" before the changes took effect, in the hope that they would still be able to buy a second home more cheaply. This drastic action by many couples in Shanghai to the potential change in legislation was not the first such response of its kind, but one which once again goes to highlight some of the absurdities of the property market in China.

Analysts have long warned of China's growing real estate bubble. On the one hand, reliance on huge overinvestment in property in order to sustain growth has resulted in China's infamous ghost towns, shopping malls which continue to stand empty, and incomplete or vacant flats and apartments. The extent of overinvestment has continued to mean that large numbers of flats remain unsold, particularly in lower tier cities. Meanwhile, although previously having experienced some decline, property market prices fuelled by speculation have recently continued to rise steadily to extremely high levels across higher tier cities. According to the National Bureau of Statistics, sales of floor space in residential buildings rose by 25.6% from the previous year in the first eight months of this year and by 40.1% in value. In Shanghai, the rumours about the new restrictions reportedly followed a 27.3% rise in July in the price of new homes when compared with the previous year [1].

Although in the Shanghai case, the new rules were not implemented at the beginning of September, as had been rumoured, and it was subsequently reported that several real estate agents had been arrested for spreading the rumours so as to drive up sales, in several other locations in China, regulations which on the surface are aimed at cooling the real estate market have been introduced by local governments. While the aims of such measures have supposedly been to limit illegal or malpractices by developers and tackle concerns related to runaway prices, the reality is that they do very little to address the underlying causes of the problems.

One problem is that any such measures to regulate further inflation of the bubble are necessarily hugely undermined by the existence and reliance on China's shadow banking system and its less regulated forms of lending. China's shadow financing is significant and has been estimated to have amounted to 54 trillion Yuan last year, equivalent to 79% of GDP [2]. Such shadow financing has funded overcapacity across different sectors of the Chinese economy and especially so in the real estate industry. On the other hand measures to control the real estate market have themselves been called into question.

Yi Xianrong, an economist and professor at Qingdao University, who has previously discussed the dangers of China's growing property market bubble, is an important example of someone who has questioned such measures. Earlier this year he drew attention to how GDP growth was mostly relying on government infrastructure construction and home sales spurred on by rising home prices.

He predicted that while this growth may continue for a year or so, it cannot keep on in this direction and may cause future problems. [3] In a more recent commentary [4], however, he has questioned several recent local government policies which are seemingly aimed at regulation and argued that they are not really policies aimed at control of the real estate market but are actually “real estate hunger marketing” policies. In other words, the policies rather than being designed to cool the market are actually intended to have the opposite effect and encourage further speculation.

Yi cites some specific examples of locations where the local government’s actions and intentions are questionable in this respect. In Shenzhen, for instance, he criticises the way that the Shenzhen municipal government’s attempts to investigate developers and monitor and reform property agents will not work due to the way that its approach fails to distinguish between individual consumers purchasing property and the investment companies which are a major cause of the out of control speculation in the property market. He therefore accuses the government of failing to deal with the problem while its attempts at real estate regulation are described as fake and only designed to allow the continuation of speculation. Likewise in Fuzhou, where the local government introduced policies to limit the price rise between different batches of the same development to 10% and stated that it wants to increase land supply for flats by 20% over the next three years, these measures he describes as being more directed at telling investors that the real estate market prices will rise, having the effect of encouraging them to buy housing more quickly. Furthermore in Nanjing, although temporary limits had been placed on loan applications, he criticises the loans for having previously promoted the further rise in the property market and how applying temporary limits only addressed one type of loan and was not a policy addressing the whole property market. Other policies were also criticised for encouraging an influx of real estate speculation into the markets, encouraging prices to further rise to even more highly inflated levels.

Such policies by local governments, as the rush to divorce in Shanghai illustrates, have also been further drawing the Chinese middle class into the property market, such that, according to Yi, they are becoming further trapped in the property bubble. He warns that in the future, when the market crashes, it may be much worse than the stock market crash in 2015, to such an extent that there may be no escape for the middle class this time.

Even beyond those middle class families who have been seeking investment opportunities and rushing to divorce in order to buy a second or third home, the effects of rising housing prices have further serious social and economic consequences. The levels of speculation, involving investment companies buying up hundreds of units of houses in the hope that they will make huge profits creates huge inequalities. In another article[5], Yi criticises the greater resulting unfair distribution of social wealth caused by speculation in the property market, making home ownership much more out of reach of lower income households. He also additionally observes that with the real estate market mostly led by speculation rather than consumers this negatively impacts on consumption –something which has been considered increasingly another key pillar of China’s economic growth – as such high prices, for those that can afford to purchase homes nevertheless increases the debt burden from mortgages and loans meaning that this can seriously squeeze their overall household consumption. Thus this potentially compounds further risks to the vitality of the Chinese economy.

But why does the government not address the underlying issues? Another significant part of the problem relates to land ownership and usage in China today. In China all land is owned by the state or by collectives. In practice today this means that use of land is controlled by the government, which sells land usage for designated periods of time. Often land is sold in this way by local governments through land auctions, with the land going to the highest bidder, or to developers with who the local governments have close connections. In many cases land is expropriated by the government from locals, supposedly in the name of “public interest”, so that it can be sold on to developers for the purpose of profit, providing the government with a significant percentage of its revenue (sometimes up to 50%) and significantly contributing to GDP.

Such practices over land use have not always been the case. Indeed in this respect China has learned from Hong Kong. Before 1988, the Chinese constitution stipulated that urban land was state owned, while rural land was collectively owned. Clauses prohibiting the buying, selling or renting of land applied to both categories. But the founding of special economic zones (first in Shenzhen in 1980), had already begun to shake up the nationalisation or collectivisation of land. As these zones aimed to attract foreign direct investment, the renting of land to foreign capital became necessary and since then the practice of renting out state owned and collectively owned rural land (with token compensation for the latter) became widespread despite the clause in the constitution. Many cities learned land auction practices from Hong Kong in order to promote the commodification of land. All Hong Kong land belonged to the crown at that time and the colonial government used crown land to make money by auctioning out land and handing out land to the highest bidder. The Chinese municipal governments began to adopt the Hong Kong approach and people like CY Leung, who himself is a professional surveyor, went to Mainland China to teach municipal governments about land auctions and how to promote the property market in general.

The central government was impressed by these experiments and in 1988 the CCP amended the clause in the constitution on land to legalise land sales. In this way it copied Hong Kong's crony alliance between the government, developers, banks and property market agents, who all profit from this monopolizing and commodification of so called state or collective land. This regime also determines that the continuous rise of the property is an innate interest of all the participants of the alliance. Allowing developers to then sell on the real estate at high prices ensures that they will continue to buy up land from the government, and so the incentive to fully address the problem of speculation in the property market is not in the interest of local officials. This means that any measures which only aim to address issues related to demand in the property market but avoid targeting the auctioning of "state or collectively owned land" to the highest bidder will never work for long.

Overall, China's property crisis is an ongoing crisis for those who want to or cannot afford to buy a home to live in, and even more so for those who have been displaced by development projects, as well as a deepening crisis for the middle class as they are encouraged to invest in second or third properties. Continuing in this way fuelled by speculation and government complicity in aiding the enrichment of the developers, it may also have the potential to deeply destabilise China's economic system when the bubble bursts.

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P.S.

* NOVEMBER 12, 2016. BORDERLESS MOVEMENT:
https://borderless-hk.com/2016/11/12/chinas-ongoing-property-crisis/

Footnotes

[1] China's Property Policies Drive Divorce, Underscore Market Excesses, Michael Lelyveld
http://www.rfa.org/english/commentaries/energy_watch/property-divorce-09192016141600.html

[2] Shanghai divorces highlight China’s property conundrum:
https://www.ft.com/content/42b56cfc-87d6-3554-aab0-bbaffe0dca6f

[3] Yi Xianrong–Correctly assessing China’s current economic growth:
http://mikenormaneconomics.blogspot.hk/2016/05/yi-xianrong-correctly-assessing-chinas.html

[4] “□□□□”□□□□□□□□□□□, Yi Xianrong

http://yixianrong.baijia.baidu.com/article/645545