AN ANALYSIS OF THE RELATIONSHIP BETWEEN THE
HOUSING REFORM PROGRAMME AND HOUSING INDUSTRY
DEVELOPMENT IN CHINA

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Supervisor: Professor. Richard Haines
To

My beloved daughter, Niuniu. 婧儒
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- All my friends who have supported me throughout these years in good and bad times.

- Thanking the Lord for giving me the strength to reach this goal.
DECLARATION

I, Yu Mei Zhang declare that AN ANALYSIS OF THE RELATIONSHIP BETWEEN THE HOUSING REFORM PROGRAMME AND HOUSING INDUSTRY DEVELOPMENT IN CHINA is my own work and that all sources used or quoted have been indicated and acknowledged by means of complete references, and that this research project was not previously submitted by me for a degree at another university.

Yu Mei Zhang:

November 2006
ABSTRACT

The purpose of this study was to establish a common understanding of the implementation of urban housing reform in China and to examine the trends in housing development in China and its relationship with the national economy. The crucial role of the Chinese government in the development of housing, the necessity of government intervention in China and whether it should be involved in housing development at all, were also explored in this study.

In order to achieve the aims and objectives of this study, it was necessary to analyse the success and failure of the urban housing reform implemented in a particular period in China, and to investigate the challenges and problems existing in housing development. As regards the significant contribution of the housing development to the national economy, Rostow's stages of economic growth were used to investigate the relationship between the housing industry and the national economy in China. This model shows that the housing industry could become a leading sector in the Chinese national economy. The housing industry in China has not yet reached maturity, and direct regulation by government is still necessary.

In an attempt to address the research problem and to fulfil the research objectives, an in-depth and comprehensive literature study was undertaken to provide a basic framework and conceptualization of the housing industry in China. The international scope of the findings, as well as the insights that were gained through the study, contributed largely to solving the identified research problems. The normative and positive nature of the study made it possible to recommend solutions for the problems in the development of housing in China.
Recommendations were made with regard to sustainable and healthy strategies, regulatory instruments, housing finance, and the utilization of lightweight materials in housing development in China. Although Rostow’s model is one of the more structuralist models of economic growth, it de-emphasizes any differences in how leading sectors develop in free and controlled markets. However, Rostow’s consideration of non-western cases such as China show that, to some extent, modernization can be achieved in different ways, through a free market or controlled economic means, and still fit into his model.

KEY WORDS

Affordable housing, work units, public housing accumulation fund, public welfare housing system, three-way partnership, housing saving bank.
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CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION

In daily human life there are usually four basic needs: food, clothes, housing and transport. A house as a basic human need is different from other economic issues in many ways; for example, housing cannot be substituted by other goods (Cullingworth 1967: 27). Housing is thus a subject requiring both discipline-based and as well as interdisciplinary study and would seem particular well suited for the field of development studies.

This research contends to build a framework that housing development is not only a social issue, but also is an economic subject to be addressed. Based on an analysis of the implementation of the urban housing programme in China, this study also investigates the contribution of the development of the housing sector to the national economic development. This study indicates that housing development is a key stimulant for economic development of a country.

Economic development, as Kindleberger and Herrick (1977: 20) describe, focuses largely on materially oriented issues, such as output, employment, incomes and composition of production. Development in its totality deals with changes in the human condition. A vision of development includes social and political changes as well as the economic transformation.

Josef Gugler (1997: 3) suggests that urbanization is seen as a prerequisite for development. The more urbanized countries tend to be more developed, whether measured in terms of economic output or human welfare. The quality
of life is thus a highly visible dimension of measuring the economic and social development for a society. Correspondingly, provision of adequate housing for urban households becomes a key element in buttressing the human being from life-threatening or health-threatening events (Hardoy & Satterthwaite 1997: 265).

Hardoy and Satterthwaite (1997: 265) reveal that the last four decades have brought remarkably little progress in improving housing and living conditions in most urban centres of Africa, Asia and Latin America. However, the housing shortages and overcrowding are still serious problem facing by governments in developing countries as well as former socialist countries (Mathéy 1997: 285).

Zhang and Yi (1995) maintain that almost all former socialist countries are marching towards a market economy. The “Big bang” and “gradualism” have been identified as the two polar-cases of this transition. The East European countries and the former Soviet Union have taken more or less a “Big Bang” approach, while China has taken gradualism. Gradualism is considered better for the country since transitional costs can be spread over a long period. It is thus more feasible, both politically and economically.

China has made some progress towards achieving other characteristics of successful market economies. For example, the Gross Domestic Product (GDP) in China has been kept at an average growth of eight percent for the past 20 years (Zhu 2003: 142). However, China still has many of the detrimental characteristics of command economies, in particular, as regards the housing sector.

As Sherman Maisel (1967: xii) puts it, housing as a basic human need plays a crucial role in people’s daily life. Critical is the fact that houses are large,
complicated, durable and consequently expensive. There is probably no single major city in the world without some form of “housing problem”. The housing sector in China is also facing many economic and social problems such as shortages and overcrowding in the urban areas (Zhang & Yi 1995).

Chen and Gao (1993) suggest that, in socialist economies, housing was considered as a welfare issue but not as a commodity. In accordance with the socialist ideology of “production first, consumption second”, all available resources in the country should be put into productive use by the state. The Chinese government monopolized the limited urban housing investment through administrative planning. The Chinese government also treated urban housing as a heavily subsidized welfare item. The rents that were charged by work units were extremely low. These low rents were not even enough for maintenance of the housing.

These policies resulted in capital investment in urban housing in China not yielding any returns. As a result housing construction and provision in China have failed to eliminate the serious urban housing shortages or to provide for the rapid growth of the population in urban areas. The inadequate housing in China has become a serious problem that needs to be urgently solved (Song & Chu 2000).

According to Edward Gu (2002), urban housing reform in China started in the early 1980s and was then implemented nationwide in 1988. The aim of urban housing reform in China is the commercialization of housing, which implies developing an institutional structure in which the production and consumption of housing are mainly driven by market forces.

As Youqin Huang (2003) explains, urban housing reform in China does not focus only on improving urban household living conditions, but also
emphasizes the housing industry’s contribution to the national economy. The housing industry in China has grown out of nothing through urban housing reform. The great potential of the housing industry for development has gradually been recognized by the Chinese government. Although the urban housing reform programme in China was successful in improving the living standards of urban households and had a momentum for national economic development, yet, housing development in China travelled a winding path in the early 1990s. Housing development has experienced overheating, recession and recovery. An analysis of the trends in the housing industry in China and its relationship with the national economy becomes an important subject on which to focus.

This study proposes to examine the success and failure of the different urban housing reform programmes implemented in a particular period in China and their impact on the housing industry. By analysing housing industry development in China, it will be seen that the housing industry in China has the potential to become a leading sector and make a contribution to national economic development. In addition, the role of the Chinese government’s intervention in housing industry development has also been examined in this study. The findings of this study suggest that sustainable and healthy housing development in China should be in line with national economic development as a whole. This chapter first looks at a description of the housing situation.

1.2 DEFINITION AND PHYSICAL ATTRIBUTES OF THE HOUSING

According to Robert Wiley (1977) and Yong Tu (2003: 38), housing is a complex commodity and type of real estate which is erected on the land. Housing is often called ‘shelter’, particularly in textbooks on economics. Some general physical characteristics or attributes of houses can be described as follows:
Spatial immobility: This implies that the characteristics associated with a location are inherent in the bundle of attributes of a dwelling found at that location. These locational attributes include the socio-economic status of the neighbourhood, its physical condition, as well as wider notions of accessibility to any desired destination, in terms of jobs, relatives and friends, private goods or public facilities. All of these attributes contribute to differences in housing quality and housing prices across locations. Therefore, the value of the house is subject to change as its surrounding environment changes.

Durability: Housing is also durable, and has a relatively high purchase price involving the need for extensive mortgage borrowing. It is also common for dwellings to experience long-term price appreciation. The investment aspect of owning a home is likely to make housing a principal personal sector financial asset. The quality of a housing unit can be either improved through modifications or reduced in value through depreciation over time at any location.

Uniqueness: Every house is unique. This refers to the intrinsic variation found across housing types, sizes, ages, building materials, exterior or interior structures, and architectural designs, as well as different forms of land leasing. This attribute reflects the tendency for housing markets and housing financing to be decentralized, or localized;

Wallace Smith (1970: 14) also mentions that there are some relatively obscure terms which often occur in the discussion of housing economics, for example the economic life of the housing, rent, externality, as well as the housing status. The following section looks at these concepts in turn.
Firstly, Smith (1970: 14) states that the economic life of housing can be explained by housing being a durable capital good, and its durability raises a host of difficult economic and business questions. Unlike fruit or a gallon of gasoline, ordinarily consumed within a short space of time, a housing unit continues to perform valuable economic services to consumers over an extended period.

One consequence of durability is that when the commodity is created or sold, its value must be estimated by forecasting its earning capacity over an extended future period. The present value of a dwelling is not the simple sum of future rents or the sum of future housing services, but rather an amount derived by the process of capitalization from expected future receipts (Smith 1970: 16).

Secondly, the term of rent can be defined as the payment made by a tenant for the right to live in a dwelling which belongs to another. As Smith (1970: 18) explains it, rent has been considered as the price of a commodity which is fixed in supply by economists. Housing is relatively fixed in supply, which means the size of stock changes very slowly with regard to the durability of housing. Rent should be paid because the owner of a house considers that rent collection is only a fair return on the investment costs paid for the building.

Thirdly, Smith (1970: 21) remarks that externality refers to some of the benefits or inconveniences associated with certain types of goods which escape the consideration of people engaged in buying or selling those goods. Such costs of benefits are external to the market transaction though they significantly affect the efficiency of economic life as a whole. The significance of externalities in housing activities requires the economist to give attention to
factors other than market events in judging the performance of the housing market.

Smith (1970: 23) suggests that housing status means the whole complex of activities, satisfactions, rights, obligations, conveniences, and expectations surrounding the use of a particular dwelling unit by a particular household. In turn, both the community and the individual household participate in determining what this housing status will be. The housing status of that household is arrived at by both the community and individual households. The accompanying diagram suggests in broad outline what it is that makes up housing status and what the effects of this status are.

Figure 1.1
Components and effects of housing status

* Effects which are external to individual decision

Source: adapted from Smith, W.F. 1970. Housing: the social and economic elements
The aggregate of the components in Figure 1.1 is the household’s housing status. This status is an assemblage of physical, financial, legal, and social elements of considerable complexity existing in great variety. In addition, housing status is not inert. That a particular household occupies a certain dwelling does not end the matter, either for that household or for the community (Smith 1970: 27).

The multiplicity of effects makes the housing sector something more than just a means to shelter people from the rain and wind, but also contributes to the national economic development by as providing jobs and enlarging the GDP. Housing is not the only product which influences by its form and use the quality of community life, but provides a momentum stimulating the economic growth of the country in any particular period. The next section explains how important housing development is in the national economy.

1.3 THE IMPORTANCE OF HOUSING

Housing is the foundation for many basic human needs: survival, safety, pleasure and dignity. C.F. Swart (1981: 72) explains that housing is one of the basic needs of humans, the most important after the provision of food and water. Section 26 of the Constitution of the Republic of South Africa, Act 108 of 1996, declares that everyone has the right to adequate housing. As stated in the preamble of the Housing Act, Act 107 of 1997, the South African Parliament recognises that housing fulfils a basic human need, and housing is a product of human endeavour and enterprise.

There is no doubt that housing plays a potentially important role in improving quality of life at all levels and in every country. The role of housing in human life and human society determines that its distribution can affect the social and economic structure. The availability and quality of housing are major
indicators of a society’s standard of living and level of economic and social
development (Salam 1978: 3).

Housing and the housing industry have a direct and substantial impact on any
national economy. Housing development does more than shelter people from
wind and rain. For example, housing development in the USA (United States
of America) in 2002 helped the country’s economy out of an economic slump
(anon 2002: 11). The housing market continues to perform an important role
in its economic activities.

As Wiley (1977) puts it, housing contributes to a wide spectrum of benefits for
individual households, communities, and businesses, as well as the national
economy. The housing sector has important linkages to virtually all
macroeconomic sectors, for instance, interest rates, savings, inflation rates,
unemployment, wage rates and even the balance of payments. Housing is
recognized by the World Bank as a key component of the economy in
developing countries (White Paper 2005).

Housing development is not only related to economic development, but also
connected with social development. It is evident that housing development in
China can provide a better life for its citizens besides making a contribution to
national economic development.

1.3.1 The importance of the housing sector in China

A communist government has ruled China since 1949 and oversaw the
application of a Soviet-style central planning model to the country’s national
economic development (Gu 2002). The ideological principles of the housing
industry in China were: 1) housing should be a general provision as a welfare
issue; and 2) housing as a commodity should be discontinued. Based on
these ideological principles Chinese governments took full responsibility for meeting the housing needs of urban households.

As Huang (2003) states, the welfare urban housing system in China provided the basic living conditions for urban households after the new China was founded in 1949. Accompanying the limited capital investment in urban housing and a rapid growth population in China, the disadvantages of the original housing system in China not only created difficulties and inequalities in the provision of housing, but also hindered further development. The urban housing system in China failed to eliminate serious urban housing shortages and to provide for the rapid growth population in urban areas.

China like most socialist economies has been in a process of transition from a central-planned economy to a market economy since the early 1980s (Gu 2002). Urban housing reform in China as a major component of overall economic reform began in 1984 (Kim 1990). Urban housing reform does not focus only on improving urban household living conditions, but also emphasizes the housing industry’s contribution to the national economy. The housing industry has grown from nothing through urban housing reform. The great potential of the housing industry for development has gradually been recognized by the Chinese government.

Gu (2002) suggests that in a transition economy the housing sector in China had an even more important role to play in the national economic development. There is no doubt that the housing sector in China has been given momentum to develop and contribute to national economic growth. For example, the housing industry has been a key factor in keeping the average growth of GDP at eight percent in the past 20 years (Zhu 2003: 142).
1.4 CHALLENGES IN HOUSING DEVELOPMENT IN CHINA

A home, a roof over one’s head, is a necessity, but for the average household it is an expensive necessity (Needleman 1965: 10). The difficulty of creating sufficient individual units is compounded by growing urbanization in almost every country, especially developing countries. Currently, the major housing problem is the shortage of affordable accommodation for the urban poor, the low-income majority (Willis & Tipple 1991: 2).

Housing development in China cannot be separated from the period that the Soviet central planning model was applied to development. The background of central planning for the economy in China was an obstacle for housing development. Shortages and overcrowding in urban housing in China have been recorded since the 1970s in the media. The amount of living space per person in most major cities was an average of 3.6 m² in 1978 (CSSB 1994).

After economic reform was launched in China, major progress was made in low-income housing construction. The completed floor space reached 425 million square metres and provided housing for more than four million medium- and low-income urban households during 1998 to 2001 (World Bank 2004). At the same time, old-city renovation in China also picked up, with clusters of old dilapidated houses being torn down and new houses being built to relocate tenants.

According to the World Bank (2004: 3), despite the marked improvement in the housing condition such as the quality of housing and the living environment for urban residents, China is still at a low level of housing development compared with developed countries due to its huge population and the background of central planning for the economy. At present, 150 million square metres of dilapidated old housing remain to be rebuilt, 1.56
million households are still in need of housing and 350,000 households’ per capita floorage is less than eight square metres (World Bank 2004: 3).

As well as shortages and overcrowding in urban housing, the high housing price and low income are still problems which cannot be neglected. This means that urban households in China with low incomes are willing to buy houses but cannot afford them. In addition, housing construction is at a resource-depleting stage with a low level of industrialization and productivity. For example, China’s labour productivity in the construction industry is less than one fifth of that in developed countries. Furthermore, science and technology contribute less than 30 percent to the development of the housing industry (World Bank 2004: 3).

Based on the impact of these factors on housing in China, the price of an apartment in China remains unaffordable to most urban households. There are many problems in the provision of housing that needed to be solved by increasing low wages, reducing down payments, lowering interest rates and improving productivity in housing construction. China is the most highly populated country in the world and for every urban household to own a flat with basic amenities is still a big challenge being faced by the Chinese government.

1.5 HYPOTHESES IN THIS STUDY

This research proposes three hypotheses with regard to urban housing sector development in China. Firstly, the research hypothesizes that the urban housing welfare system implemented in China seriously impeded the development of the housing industry. The socialist housing access and allocation systems continue to affect housing development, even though they
are no longer as important as in the socialist era. The housing policies have to take a larger market-orientation.

According to Ivan Szelenyi (1983: 28), urban housing in socialist China was considered a welfare benefit. It was felt that housing as a commodity should be stopped and the capitalist housing system should be abolished. The Chinese government took full responsibility for meeting the housing needs of urban households. Under the public ownership of housing, the state itself monopolized land use and housing investment. By the early 1960s a work-unit-based housing allocation and investment system in China had been established for the construction and provision of housing.

George Tolley (1991) reveals that the central government allocated housing investment by means of work units and municipal housing bureaus. Urban public housing was charged at a low rent which only constituted two percent of monthly incomes. The rents charged by the work units were not even enough for the maintenance of the housing. Low-rent systems led to the fact that investment in housing was unable to provide for any further construction.

Although urban households in China benefited from the low rents, the houses provided by such work units would take three to five years to build due to the limited capital investment in housing construction. In addition, urban households in China not only had to wait for houses in a long queue, but also need to satisfy a set of criteria such as seniority, job rank and marital status. Furthermore inequality also existed among the work units in the provision of housing. For example, workers in state enterprises enjoyed better housing conditions than employees in other sectors (Gong & Li 2003).

Urban housing reform in China has been underway since 1978 as a major component of overall economic reform (Wang & Murie 1996). The goal of
reform in China is to develop an institutional structure in which the production and consumption of housing are mainly driven by market forces. The housing industry in China has also been boosted through urban housing reform.

After urban housing reform was launched in China, the policy makers in China adjusted the housing investment structure and gave priority to affordable housing. The living standard of urban households in China has improved since urban housing reform took place. The housing industry in China displayed a rapid development that had never been seen before. As regards the different housing policies implemented in particular periods, problems have also arisen during the reform process. This has made a difficult situation in the provision of housing to urban households. Consequently the trends in housing industry development in China are a matter of concern for both the government and individuals.

Secondly, this research hypothesizes that the housing industry could become a leading industry in China. A leading industry would be one that contributes significantly to the growth of the national economy at a particular period and has a rapid growth rate transcending the sector itself.

All countries go through stages of economic growth fairly linearly, and there are a number of conditions that are likely to occur in investment, in consumption and in the social trends at each stage. The take-off consists of the achievement of rapid growth in a limited group of sectors where modern industrial techniques are applied. Therefore, rapid growth of a country’s economy will depend on the repetition of a series of the leading sectors. The housing industry in China satisfies the basic characteristics of being a leading sector.
In the ongoing dramatic social, political and economic transition of China, the housing sector has an even more important role to play. This is because the housing sector itself has to drastically endure a systematic transformation. In addition, economic reform in China is reaching a critical point.

Impacted by the East Asian economic crisis and the heavy flooding in 1998, the Chinese economy experienced an ordeal. Domestic consumption was sluggish and unemployment was rising. The central government of China had to adopt a series of policies to increase investments, stimulate consumption and enhance domestic demand so as to ensure steady economic growth. One major strategy was to invigorate urban housing development.

The citizens in China, especially urban residents, were adequately satisfied in regard to food and clothing in the middle of the 1990s. This resulted in a decrease in demand from the relevant industries. Investment in the housing industry could drive the consumption of huge amounts of construction materials and create employment opportunities. Considering all these factors, it is possible for the housing industry in China to become a leading sector in the national economy.

Finally, the research hypothesizes that the housing development could be affected by government intervention. The Chinese government formulated a series of policies to solve the housing problems and adopted different kinds of measures to ensure the implementation of these policies, such as the Welfare Housing project, the Affordable Housing policy and Low-rent Housing policy. The macroeconomic regulations became the instruments that adjust the developing scale and speed of the housing industry.

The role of the state in promoting or retarding development has been given increasing emphasis since the 1970s. The form and function of the state in
developing countries has been the concern of social scientists such as Gunnar Myrdal (in Martinussen 1997: 221), and Anthony Giddens (1998, 2000). There is now a greater appreciation of the potential role of the state in providing an enabling environment and intervening in coherent fashion to stimulate and guide economic development. The question remains whether housing should be the recipient of major interventions by government.

Housing is different from other economic issues in many ways. A house is extremely costly compared with other household purchases, and a house as a basic human need cannot be substituted by other goods. It is recognized that poorer households in any society find it very difficult to afford adequate housing. In addition, housing has many of the characteristics likely to generate market failure in production and allocation. Therefore, government intervention will be necessary to achieve allocative and productive efficiency in a market system.

1.6 OBJECTIVES OF THE STUDY

This study aims to establish a common understanding of the urban housing reform implementation in China. In addition, the trends of the housing development in China and its relationship with the national economy are also examined in this study. The objectives include the following:

- To study the literature on the housing sector, especially the background of a Soviet central planning model used for development in China and the different urban housing reform programmes launched in China.

- To examine the success and failure of the urban housing reform implemented in any particular period in China, and to investigate the challenges and problems existing in housing development.
To discuss the reason why the housing sector should become a leading sector in China through an analysis of the process of housing development in China and its relationship with the national economy.

To measure the necessity of government intervention in China and whether government should be involved in housing development.

To develop techniques for solving these problems and challenges, and to draw conclusions to recommend solutions.

1.7 ASSUMPTIONS

The proposed research is based on the assumption that urban housing development in China is confronted by problems and challenges in the provision of adequate housing for urban households and its contribution to the national economy. These problems and challenges in housing development in China have a negative impact on improving living standards for the contribution of urban households and housing to the national economy.

The researcher intends to investigate the validity of the assumption, which is based on the policy documents in the urban housing reform programme and the role of the government in housing in China, including relevant statistics, department reports and national policies.

1.8 RESEARCH DESIGN

In an attempt to address the objectives of the study, the following procedures have been undertaken:
A comprehensive literature study was undertaken to provide a basic framework and conceptualization of the housing industry in China, inclusive of journals, publications, speeches, articles, documents and electronic sources. These will be used to identify the challenges confronting China, in an effort to find solutions.

Data collection methods were based on the literature survey and the empirical study. The data were obtained from the Department of Construction of Shenyang, the China Urban Statistic Yearbook, the People’s Bank of China and Finance Yearbook of China.

The leading industry theory and macroeconomic policy methods were utilized to generate hypotheses and predictions to compare with what the data indicated.

The study uses economic theory and development principles to explain how the housing industry's performance in China during the transition period.

1.9 METHODOLOGY

Three different methods of analysis are being used to test the hypotheses in this research. Firstly, the study focuses on an historical review of Chinese urban housing reform programmes and the process of the housing development in different periods. The process of urban housing reform in China should be seen as going through five phases in regard to the particular policies. In the historical analysis, deficiencies in housing policies adopted in different periods of reform will be elaborated on.
As well as the urban housing reform, housing development in China is also divided into different stages. Accompanying the implementation of the urban housing reform programme, the background of the housing industry in China was traced since a Soviet central planning model applied to the national economy. The housing development in China has been influenced by implementation of government’s policy in different periods would also be relevant.

Secondly, Walt Rostow’s (1964) leading sector theory has been introduced to generate predictions about the housing industry in China. Rostow’s (1960) model of the stages of economic growth would be studied. Rostow’s stages of growth are defined as follows: the traditional society, the preconditions for take-off, the take-off, the drive to maturity, the age of high mass consumption, and beyond consumption. These stages assume that, at particular periods, different sectors of the national economy will each play a strategic role in the determination of the overall growth rate of an economy.

Rostow’s model is one of the more structuralist models of economic growth. Rostow’s thesis assumes a strong bias towards a western model of modernization. It de-emphasizes any difference in how leading sectors develop in free and controlled markets. However, Rostow’s consideration of non-western cases such as China shows that, to some extent, modernization can be achieved in different ways and through a free market or controlled economic means and still fit into his model.

According to Rostow (1964: 9), a leading sector has three kinds of spreading effects, namely backward effects, lateral effects and forward effects. Based on these effects, predictions have been generated about the housing industry in China, against which the results of a data analysis can be compared.
Finally, this study seeks to assess the government intervention that influenced the developing scale and speed of the housing industry in China. A government may have various reasons for being involved in the housing industry, such as the maintenance of social order, promotion of quality for the population, encouragement of self-development, economic planning and collective equalization.

With regard to the reasons for government intervention in the housing industry as mentioned above, there are various regulatory measures that state intervention may take through provision, subsidy and regulations. Among the regulatory measures, the effects of housing finance on housing development in China have also been more significant.

As well as the three methods used in this chapter, there are also other theories involved in this study to analyse the economic phenomena in the housing industry in China:

(1) the supply and demand model is used to explain two housing system’s co-existence in the housing market in China;

(2) the business cycle theory is used to measure housing development in China and how it should adjust itself to national economic development; and

(3) PEST analysis and Porter’s Five-Forces model are used to examine the external environmental factors in housing industry development in China.
1.10 CHAPTER OUTLINE

The study is divided into six chapters. **Chapter 1** describes the motivation for doing this research. The definition of housing and its physical attributes are also introduced by the researcher in order to provide a basic understanding of what housing is. This chapter gives the rationale for housing as being very important in people’s daily life. Therefore, providing adequate housing for urban households is a major task faced by governments, especially in China.

In addition, based on the problems and challenges in the provision of housing in China, the welfare urban housing system should be reformed in order to adapt itself to the national economy. This study then proposes three hypotheses to analyze the urban housing reform in China and trends of housing industry development. The methodology to test the hypotheses is also discussed. The objectives of the study and a description of the sources used in this study are explained.

The literature review is discussed in **Chapter 2**. The housing sector has been an important research subject in social sciences, and a large volume of literature has been generated, particularly in market economics. This chapter looks at the current research situation as regards housing development. The research looks at: the function of the housing, the housing cycle, supply and demand in housing, housing finance, government intervention in housing and urban housing reform in China.

A historical review to explain the importance of the urban housing reform and trends in housing development in China is the subject of **Chapter 3**. The background of a Soviet central planning model applied to development in China is first explained in this chapter. The disadvantages of the urban housing system in China provide a reason why this system should be
reformed. The impact of the process of urban housing reform on housing development in China is also relevant.

As regards the great potential for the housing industry to develop, the trends in housing development in China are also looked at in Chapter 3. The trends in housing industry development in China are determined by both industrial and external environmental factors. The analysis of urban housing reform in China gives an understanding of the industrial environmental factors in housing industry development. An analysis of housing industry development affected by external environmental factors is then presented in this chapter.

Rostow’s model of the stages of economic growth is used in Chapter 4 to measure housing development in China and its relationship with the national economy. Rostow believes that, at particular periods, key sectors of the national economy will each play a strategic role in the determination of the overall growth rate of an economy. The key sectors are indicated by Rostow as the leading sectors.

As regards Rostow’s model and the current situation in Chinese economic development, the housing industry in China could become a leading sector, which would drive the economy forward. In addition there is also a cyclical nature to other businesses as well as to housing development. A comparison of the business cycle and the housing cycle will also be included in this chapter.

Housing is different from other economic issues, and housing is more likely to generate market failure. Therefore, mainstream economics provides a typology of the rationale for government intervention to achieve allocative and productive efficiency in a market system. Chapter 5 provides a discussion of
the government’s positive intervention in housing industry development in China.

In considering government activity in China in housing development, different measures have been employed: economic, legislative, administrative, informative and guidance measures. This chapter looks at each measure separately. With regard to the importance of finance as an instrument in housing development, the forms of housing finance in China will be detailed in this chapter.

On the basis of the analysis of the urban housing reform in China and trends in the housing industry and its relationship with the national economy, Chapter 6 presents a summary of the most important findings of the study. Recommendations and suggestions for future studies are outlined in this chapter.

1.11 CONCLUDING REMARKS

Housing is a difficult phenomenon to theorize about. An inherently complex commodity, with spatial fixity a defining characteristic, and asset, investment and consumption dimensions to account for, the economics of housing remains a challenge to those who seek equity and efficiency improvements for society to this day.

There is probably not a single major city in the world without some form of “housing problems”. The housing sector in China has also experienced many economic and social problems such as shortages and overcrowding in urban areas. China has the biggest population in the world and for every urban household to own a flat with the basic amenities is still a big challenge faced by the Chinese government.
This study proposes to conduct research into the relationship between housing development and the national economy. It intends to test how the housing industry in China has reacted to national economic development. A historical review will first be undertaken to examine how the urban housing welfare system implemented in China has seriously impacted on the development of the housing industry.

Secondly, Rostow's stage of economic growth model is introduced to generate predictions about the housing industry in China. Rostow believes that key sectors of the national economy will each play a strategic role in the determination of the overall growth rate of an economy. The key sectors indicated by Rostow are in fact the leading sectors. This study then hypothesizes that the housing industry in China can become the leading sector in Chinese economic development.

Thirdly, this study assumes that government intervention should be involved in the housing development in China. The aim is to ensure that government intervention would be necessary to achieve allocative and productive efficiency of the housing in a market system. To understand the role of the government in housing development, various government regulatory measures have been employed in this study to examine this hypothesis. In addition, housing finance in China as a regulatory instrument is also explained in this study.

The platform has been set for the next chapter to present a literature review on housing development from the international stage and nationwide. The theories used in this study will be explained in each relevant chapter.
CHAPTER 2
LITERATURE REVIEW

2.1 INTRODUCTION

The roots of housing economics can be traced back to the classical and neoclassical pioneers of economic theory. The economists first turned their attentions to the pressing issues of social policy after World War II and focused on the work of the economics of poverty, transport, education and health. As O’Sullivan and Gibb (2003) explain, housing economic studies as a separate and recognized area emerged only in the second half of last century. For example, the interest in housing as a proper area for study in the UK began to develop from the 1970s (O’Sullivan & Gibb 2003: 1). Housing as a formal field of study in China attracted attention in the 1980s after economic reform was initiated.

Joochu Kim (1990) and Edward Gu (2002) point out that the housing industry in China is an infant industry although it existed before the liberation. China applied the Soviet model to develop the national economy. Privatization in housing in China was gradually eliminated and the housing market was also discontinued. Because the housing industry in China no longer existed in a substantive economic sense, the study of housing development in China was neglected by economists and planners.

After economic reform was launched in China in 1978, especially after the Southern Inspection Speech by Deng Xiaoping, the former premier of China, the housing industry recovered and showed rapid development that had not been seen before. Accompanying this soaring demand for housing development in China, research in the housing field was encouraged by both
international and domestic economists and certain social scientists (Gu 2002).

Based on the problems and the objectives of this study, the literature review will consider both the international and domestic aspects of the following: urbanization and development studies; the function of housing; the housing cycle; supply and demand in housing; housing finance; and government intervention in housing and urban housing reform in China. The section below looks at these in turn.

2.2 THE LITERATURE ON URBANIZATION AND DEVELOPMENT STUDIES

Kindleberger and Herrick (1977: 20) maintain that development in its totality deals with changes in the human condition. In their view, a vision of development includes social and political change as well as the economic transformation. By contrast, economic development focuses largely on materially-oriented issues, such as output, employment, incomes and composition of production.

Gilbert and Gugler (1992: 7) argue that urbanization as the process of development has become a world-wide phenomenon since 1950. The more urbanized countries tend to be more developed in regard to economic output and human welfare (Gugler 1997). The countries of the Third World has also been urbanizing rapidly.

Gugler (1997) discusses the relationship between housing and the environment and give the suggestion on building the future city. In addition, Gilbert and Gugler (1992) reveal that housing is a highly visible dimension of
poverty. This is why housing constitutes an emotive issue in so many Third World cities.

2.3 THE LITERATURE ON HOUSING

A general belief exists that the importance of housing has been recognized by all individuals and governments in the world. For example, Duncan Maclennan (in O'Sullivan & Gibb 2003: 2) shows how the housing market worked in Britain in the 1970s. Maclennan examines the spatial aspects explicitly through the early exploration of the concept of housing sub-markets, and uses the urban level of analysis as the implicit focus for microeconomic models of tenure choice, search and housing choice.

There were also specialists and scholars in China researching the function of real estate in the Chinese economy. For instance, Zonghua Bao (1994) investigated the role of real estate in the economy, and the economic bubble that existed in real estate in the 1990s in China. Meng and Liang (1998) and Kunhua Yin (1998) showed that housing could become a new engine for the Chinese economy.

In addition, Quanji Wang (2000) undertook research on why housing in China could drive national economic growth. Zhifeng Liu (1999) analyzed the importance of housing in the Chinese economic structure. Fulong Wu (2001) maintained that the role of housing in the Chinese economy was influenced by the marketing of land and housing, as well as globalization.

There is no doubt that the housing industry in China could become a leading sector and a pillar of the economy. It is evident that the housing industry in China could be a new engine and give momentum to national economic growth.
2.4 LITERATURE ON THE HOUSING CYCLE

Anthony Downs (1991) argues that there is also a cyclical nature in other businesses as well as in real estate development. Real estate depends on activity in other sectors of the economy for its motivation. Real estate tends to lag behind upward movement in the general economy. Also, real estate tends to exceed the heights of the peaks and depths of the troughs in the general business cycle.

John Quigley (1999) provides an important analysis of the relationship between real estate prices and the business cycle. He argues that the real estate cycle, like the business cycle, has four components: recession, depression, recovery and prosperity, which generally follow their business counterparts. When these components change, real estate prices are influenced by the business cycle and go up or down.

In China, Yuanrui Zhang’s (2000) study of the cycles in real estate finds that the real estate cycle in China is about four to six years. Wang and Tang (2000) investigate the relationship between real estate investment and the real estate cycle. A positive correlation between real estate investment and real estate cycle is found in their study. In addition, these studies conclude that the real estate cycle was similar to the business cycle.

2.5 LITERATURE ON SUPPLY AND DEMAND IN HOUSING

Lionel Needleman (1967) distinguished housing need from housing demand, and then considered methods of determining future housing needs in terms of the numbers and sizes of dwellings required as well as for the replacement of old dwellings. Needleman pointed out that building costs influence the supply
of housing. He suggested raising productivity in house-building in order to reduce house prices.

The unsatisfied effective demand in housing in China has been examined in many studies. For example, Chengxiao Jin (1998) shows that the effective demand of housing in China was influenced by political and economic environmental factors. Ling Zuo (2001) maintains that housing prices are high in comparison with the low wages paid in China.

The effective demand in China can be explained by various reasons, such as the background of the Soviet central planning model applied to development in China, the rapid growth in population that started in the second half of the last century, and the cumbersome nature of structure housing supply. Ling and Shi (1999) show why there was a price gap between the demand and the supply in housing in China. In addition the study by Hongyun Li’s (2000) of the consistency of house prices in China and suggests a deduction in the unreasonable fees in house prices, for example, infrastructure fees in house prices.

2.6 LITERATURE ON THE HOUSING FINANCE

A home, for the average householder, is an expensive necessity. Without outside financial aid, few families could buy a house out of their savings (Needleman 1967). Wiley (1977) then claimed that mortgages are the most suitable legal instruments used in financing the acquisition of real estate.

Roger Tym (1984) argues that affordability is very important in the provision of housing. The standard of shelter provision needs to ensure that what is provided is within the reach of the financial resources of the poor. The shape
and form of financing has to be considered in the search for successful programmes in the provision of housing.

Tym (1984) and Hanzhang Fan (2000) analyzed the consistency of consumer finance in China. Housing mortgages are the largest among all the major consumer finance products. However, compared with a bank’s total lending business or China’s Gross Domestic Product (GDP), housing mortgages still represent only a negligible proportion. The analysis of housing finance in China shows that the operation of the financial system in China still needs expanding and promotion.

2.7 LITERATURE ON GOVERNMENT INTERVENTION

Writing in the early nineteenth century, Wolfram Fisher (1964) showed that the state played an active part in fostering economic progress in Germany. Christine Whitehead (2003) suggested that government intervention can achieve allocative and productive efficiency in a market system. In Whitehead’s *The Economics of Social Housing* (2003), he remarks that housing also has many of the characteristics that can generate market failure. All types of government intervention have to be applied to its provision.

J.B. Cullingworth (1967) showed that government action is required to ensure an adequate supply of housing in order to maintain socially acceptable standards and to provide financial assistance to families because of the high capital cost of housing, for example subsidization in the housing.

Jane Darke and Roy Darke (1988) gave reasons why the state should be involved in the provision of housing. These are summarised as follows: maintenance of social order, promotion of quality for the population,
encouragement of self-development, economic planning and collective equalization.

Ping Li (2001) and Shijun Luo (1996) investigated why the Chinese government should give attention to the housing sector. As regards the background of housing development in China, the Chinese government needed to use macroeconomic regulatory measures to ensure sustainable and healthy housing development in China.

2.8 LITERATURE ON URBAN HOUSING REFORM

The literature on urban housing reform in China falls into three categories. Firstly, studies published by Western scholars such as Kim (1990), Wang and Murie (1999a). These studies provide a broad historical overview of China’s urban housing policies and conditions throughout the mid-1980s. They acknowledge that housing shortages in China were improved by the recent construction boom. A major conclusion of these studies is that reform has not resolved such critical problems as housing affordability and inequity.

The second type of research features published reports by analysts currently or formerly affiliated with the United Nations, the World Bank and other independent organizations, like Tolley (1991), Gong and Li (2003). These studies provide a social economic analysis of the advantages and disadvantages of urban housing reforms with regard to housing finance, property rights, rent calculation, tenure choice and real estate development.

The third category of research, including numerous articles published in Chinese language journals such as China Reconstructs, Urban Economics, City Planning Review and Urban and Rural Construction, examines housing
reform policies and programmes either at the national level or in specific cities (Chen & Gao 1993).

The Chinese government documentation on the provision of housing has also been reflected in this paper. These are presented as follows:

(1) State Council:
   1994  A Decision from the State Council on Deepening Urban Housing Reform, No 43.
   1996  State Council Office Notification on Re-issuance of ‘Suggestions on Improving Housing Provident Funds Management’ by the State Council Leading Group of Housing System Reform, No 35.
   1998  A Notification from the State Council on Further Intensifying Reform of the Urban Housing System and Accelerating Housing Construction, No 23.
   1998  The Regulations on Speeding Affordable Housing Development, No 54.


(3) Ministry of Construction:
   1999a  A Temporary Regulation on the Resale of Purchased Public Housing and Affordable Housing, No 69.
   1999b  Regulations on the Management of Urban Cheap Rental Housing, No 70.
2.9 CONCLUDING REMARKS

This chapter has reviewed the studies on housing in both the international and domestic arenas. The importance of housing in both improving the people’s living standards and contributing to national economic growth has been gradually recognized by economists and policy makers, especially in the developing world.

Housing can also generate market failure, and this study has suggested that government intervention should therefore be involved in the provision of housing. Considering the high capital cost of housing, financial support must be provided to people who are willing to buy a home but cannot afford one.

This chapter has also shown that the provision of adequate housing for most urban households in China is still a big challenge faced by the Chinese government. The Chinese government is confronting a difficult situation in the provision of the housing. The background of the Soviet central planning model applied in China cannot be ignored.

The next chapter will provide a platform for examining the process of housing development in China. In Chapter 3 this study firstly explains the welfare housing system implemented in China under socialist ideology. The background of housing development in China gives a basic understanding of why the welfare housing system should be reformed in order to adapt itself to the national economy.

Urban housing reform in China has taken a random route. This means that there is general uncertainty as to its direction. This has resulted in many problems that have appeared during the different periods of urban housing
reform. These will also be examined as regards the various reform programmes implemented in particular periods in China.

Housing industry development is another subject that will be discussed in Chapter 3. An analysis of housing development as influenced by both industrial and the external environmental factors will be presented in Chapter 3.
CHAPTER 3

URBAN HOUSING REFORM IN CHINA AND TRENDS IN HOUSING DEVELOPMENT

3.1 INTRODUCTION

Antonin Kerner (1988: 75) argues that the practice of building up socialism in former socialist countries was based on Marx’s thesis that in order to abolish exploitation, one had to abolish the market economy. As John Rapley (1997: 44) points out, the principle underlying socialist central planning in Soviet model was that the economy should be organized to serve people, and not people the economy. The state, as the representative of the people, was the agent that should perform this task.

The Chinese economy before 1979 was developed on the basis of central planning and public ownership along statist lines (Zhu 2003: 144, Kerner 1988: 75). The Chinese state capacity (the state capacity here refers to the state’s capacity to govern the domestic economy) was exercised through relatively simple techniques of political control rather than via sophisticated economic instruments (Zhu 2003: 144).

Zhu (2003: 144) stresses that the record of socialist central planning in China was not impressive, especially with regard to economic matters and quality of life. This system prohibited foreign investment, and left foreign trade highly centralised. There were no new firms entering the industry to compete for its profits under the state’s monopoly over industry (ibid). The central planning system also caused social problems such as overcrowding and housing shortages in the urban areas in China (ibid.).
According to Zhu (2003: 145), the welfare housing system began to reform in 1979, initiating an ‘open-door’ policy. The open policy and economic decentralisation gradually dismantled the planning economy model in China. Correspondingly, the previous forms of state structures and practices also gradually declined. Meanwhile, certain new structures and approaches, consistent with those of a neoliberal state, such as the capacity for microeconomic adjustment, saw a remodelling of state-society relationships.

Housing plays a very important role in human life and human society. As Swart (1981: 72) explains, housing is one of the basic needs of humans, the most important after the provision of food and water. The availability and quality of housing are major indicators of a society’s standard of living and level of economic and social development (Salam 1978: 3). In 1987 the United Nations General Assembly resolved to formulate the Global Strategy for Shelter to the Year 2000 to encourage government creation of the conditions needed for adequate shelter production for demand sectors (Willis & Tipple 1991: 2). The aim was to improve the quality of life at all levels and in every country.

The difficulty of creating sufficient individual units is compounded by growing urbanization in almost every country (Maisel 1967: xiv). The challenge is particularly in urban areas where populations were projected to grow a total of less than 300 million in the second half of the last century (Willis & Tipple 1991: 2). This means that more complex units must be built to satisfy town or city living at an affordable level. Currently, the major housing problem is the shortage of affordable accommodation for the urban poor, the low-income majority. Governments in the developing world are facing one of the major challenges of housing the poor in urban areas. China is the most populated country in the world and for every urban household to own a flat with the basic amenities has become one of the major tasks for the Chinese government
As Song and Chu (2000) remark, a housing shortage and crowding in urban China have been recorded in the media since the 1970s. With regard to the socialist ideology of ‘production first, consumption second’, all available resources were to be put into productive use by the state. Housing in China was considered a welfare issue, but construction only received limited financial resources from the government. As a result, housing construction and provision in China have failed to eliminate serious urban housing shortages and to provide for the rapid growth population in urban areas (Gu 2002).

In China the housing market was also discouraged by central government (Song & Chu 2000). Housing in urban China was constructed and managed by the work units or danwei (discussed in detail later in this chapter), which include state-owned enterprises, collective enterprises, and local government authorities. Urban households were expected to obtain houses by their work units at extremely low rents. The rents charged by work units were not even enough for housing maintenance. There is no doubt that government and the work units in China carried a heavy burden in both the production and the provision of housing. The disadvantages of the original housing system in China not only created the difficulties and inequalities in the provision of housing, but also hindered development. The housing system should be reformed in order to solve the existing housing problems and promote housing’s contribution to the national economy.

China like most socialist economies has been in a process of transition from a central-planned economy to a market economy since the early 1980s (Gu 2002). Urban housing reform in China as a major component of overall economic reform began in 1984 (Kim 1990). The Chinese government
adopted various policies in the construction and allocation of housing. Housing policies in different periods will be discussed in this chapter.

According to Huang (2003), urban housing reform in China does not only focus on improving urban household living conditions, but also emphasizes the housing industry’s contribution to the national economy. The housing industry in China has grown from a virtually nothing through urban housing reform. The great potential for the housing industry to develop was gradually recognised by the Chinese government. However, development in China went through a convoluted path in the early 1990s. Housing industry development has experienced overheating, recession and recovery. An analysis of the trends in the housing industry development in China follows. These trends will play an important role in improving the quality of life and will make a contribution to the national economy. Consequently, the effects in housing development from external environmental factors will also be presented in this chapter.

3.2 INTRODUCTION OF PRE-REFORM PUBLIC HOUSING IN URBAN CHINA

Tolley (1991) describes a situation where urban housing (also called public housing) in socialist China was considered a welfare benefit. The central government allocated housing investment by means of work units (danwei) and municipal housing bureaus. Urban public housing was charged at a low rent which only constituted two percent of monthly incomes. The rents charged by the work units were not even enough for the maintenance of housing. Low-rent systems meant that investment in housing was unable to provide for any further construction (Urban Housing Reform 1999).

Although urban households benefited from low rents, the houses provided by
such work units would take three to five years to build due to the limited capital investment in housing construction. Correspondingly, urban households had to wait for houses in a long queue based on a set of criteria such as seniority, job rank and marital status (Tolley 1991). Furthermore, inequality also existed among the work units in the provision of housing. For example, workers in the state enterprises did not enjoy better housing conditions than the employees in other sectors (Gong & Li 2003).

The section below recounts the characteristics of the pre-reform public housing system in China. The operation of the housing system before economic reform and housing inequality will also be commented on in this section.

3.2.1 The characteristics of the pre-reform public housing system in urban China

Gu (2002) summarized pre-reform housing system in urban China as:

(1) Housing as a welfare issue but not a commodity;

(2) State monopoly over housing investment and construction; and

(3) A work-unit based administrative system of housing allocation.

These three characteristics were also common in other communist countries such as Cuba, North Korea, and Vietnam (Rapley 1997). These countries had tried to apply the Soviet model to develop the national economy and improve people’s living conditions. China had also experienced this process nearly 30 years after the foundation of the new China in 1949 (Kim 1990, Gu 2002, Gong & Li 2003).
In China, the communist government has ruled the country since 1949 (Gu 2002). A Soviet central planning model was applied to Chinese economic development. The government of China took over the majority of private housing by various means throughout the 1950s and the early 1960s.

As Szelenyi (1983: 28) explains that the ideological principles of the housing policy in China were: 1) Housing should be a general provision as a welfare issue; and 2) the nature of commodity of housing should be discontinued. Based on these ideological principles Chinese governments gradually abolished the capitalist housing system and took full responsibility for meeting the housing needs of urban households.

Under the public ownership of housing, the state monopolized land use and housing investment (Bian et al 1997: 228). By the early 1960s, a work-unit-based housing allocation and investment system in China had been established in construction and provision of housing. This system in China only operated in urban areas and citizens living in rural areas had to build houses with their own money.

The welfare housing system in China had been implemented for years before economic reform was launched in 1978 (Song & Chu 2000). Housing was mainly provided at low rents by various work units and municipal housing bureaus. Although urban residents in China benefited from low costs in the provision of housing, urban residents were placed on long waiting lists because of the limited capital investment in housing construction. The reasons why housing provision in China could not satisfy the needs of urban households will be presented in the following section.
3.2.2 Capital investment in housing during the pre-reform urban housing system implementation period

In the Soviet model, the state took full control of the economy and compelled the available resources to be put to productive use (Rapley 1997: 44). With the socialist ideology of ‘production first, consumption second’, a country’s scarce resources should be concentrated on the construction of factories and office buildings. Housing construction in China has only received limited financial funds from the government (Butterfield 1982; Kim 1987).

As Chen and Gao (1993) suggest, the welfare urban housing system in China impeded the further development of housing and failed to eliminate serious urban housing shortages. There were several causes. First and foremost the financing of urban housing construction by central government, had been decreased compared with the rehabilitation period (1948-1952). During the period of readjustment (1963-1965), the investment of housing construction was higher than the previous period, but this number was decreased again in the third five-year period. These broad trends are presented in Table 3.1 (see next page).
Table 3.1

Proportion of investment for China’s urban capital construction

<table>
<thead>
<tr>
<th>Implementation of particular housing systems.</th>
<th>Period</th>
<th>% of Non-productive investment</th>
<th>% of housing construction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existence of public ownership and private ownership.</td>
<td>Rehabilitation (1949-1952)</td>
<td>33.1</td>
<td>10.3</td>
</tr>
<tr>
<td>Work-unit-based welfare housing distribution system. State monopolized the construction and provision of housing.</td>
<td>First 5-Year Plan (1953-7)</td>
<td>28.3 (5,013 million yuan)</td>
<td>9.1</td>
</tr>
<tr>
<td></td>
<td>Second 5-Year Plan (1958-62)</td>
<td>13.2 (4,806 million yuan)</td>
<td>4.1</td>
</tr>
<tr>
<td></td>
<td>Readjustment (1963-5)</td>
<td>17.0 (2,787 million yuan)</td>
<td>6.9</td>
</tr>
<tr>
<td></td>
<td>Third 5-Year Plan (1966-70)</td>
<td>10.6</td>
<td>4.0</td>
</tr>
<tr>
<td></td>
<td>Fourth 5-Year Plan (1971-5)</td>
<td>13.4 (3,677 million yuan)</td>
<td>5.7</td>
</tr>
<tr>
<td>Market principles were introduced to direct the development of housing.</td>
<td>Fifth 5-Year Plan (1976-80)</td>
<td>- (94.23 billion yuan)</td>
<td>21.8</td>
</tr>
<tr>
<td></td>
<td>Sixth 5-Year Plan (1981-5)</td>
<td>- (94.23 billion yuan)</td>
<td>21.8</td>
</tr>
</tbody>
</table>

Note: Total investment figures for certain periods are not available.
Sources: adapted from Kim, 1990. Housing development and reforms in China.

As shown in Table 3.1, investment decreased gradually compared to the earlier period of social reconstruction. This trend was finally reversed after the 1978 reform movement. For example, investment ranged from 5,013 million yuan in the first Five-Year Plan (1953-7) to 2,787 million yuan during the Readjustment period (1963-5). The proportion of housing construction decreased from 9.1 percent in the first Five-year Plan to 5.7 percent in the fourth Five-year Plan. This ratio improved to 11.8 percent in the fifth Five-year Plan after economic reform was launched in China (Kim 1990: 105)

Housing costs of a household’s expenditure represented only two or three
percent of a household’s monthly income (Urban Housing Reform 1999). Compared with 10 percent in the lowest income countries and 25 percent in middle to high-income countries, this was extremely low and it was not even enough for the maintenance of housing (Chen & Gao 1993).

The low rent system in China meant that investment in housing was unable to fund further construction. Capital investment in housing was not increased by the central government of China, but instead gradually decreased in the government’s budget as mentioned above. The living space of urban residents in China was inevitably impacted by this low investment in housing (Kim 1990).

According to Kim (1990), the average living floor space was about 4.5 m² per person in urban China before 1952. With less and less investment spent in new housing construction the proportion of total capital construction funds invested in the urban housing sector decreased from 9.1 percent in the mid-1950s to 6.9 percent in the mid-1960s, and to 4.0 percent in 1966-1970 in the government budget (CSSB 1985). The amount of living space per person in most major cities gradually decreased to an average of 3.6 m² in 1978 (CSSB 1994).

After economic reform was launched in China, the downward trend of low housing investment saw a reversal in the late 1970s. The proportion of total capital construction funds invested in urban housing rose to 10 percent in 1992 and 1993 (CSSB 1995). The per capita living space increased from 3.6 m² in 1978 to 6.1 m² in 1986 (Kim 1990). However, compared with other countries the average living floor space in China was still far behind. This is shown in Table 3.2 (see next page).
Table 3.2
Comparison of average living area in different countries

<table>
<thead>
<tr>
<th>Country</th>
<th>m²/person</th>
<th>Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>6.1</td>
<td>1986</td>
</tr>
<tr>
<td>West Germany</td>
<td>25.0</td>
<td>1978</td>
</tr>
<tr>
<td>USA</td>
<td>18.0</td>
<td>1976</td>
</tr>
<tr>
<td>Singapore</td>
<td>15.0</td>
<td>1980</td>
</tr>
<tr>
<td>Yugoslavia</td>
<td>13.6</td>
<td>1979</td>
</tr>
<tr>
<td>France</td>
<td>13.0</td>
<td>1976</td>
</tr>
<tr>
<td>Japan</td>
<td>13.0</td>
<td>1978</td>
</tr>
<tr>
<td>USSR</td>
<td>12.7</td>
<td>1978</td>
</tr>
<tr>
<td>Romania</td>
<td>9.6</td>
<td>1977</td>
</tr>
</tbody>
</table>

Source: adapted from Kim, J., 1990 Housing development and reforms in China.

The average living space in China in 1986 was only 6.1 m² per capita which had been improved from 3.6 m² since economic reform was launched in China. However, this figure still lagged behind other countries. For example Japan, one of the most densely populated nations, enjoyed a living space in 1978 which was more than twice that of China in 1986. Living space in West Germany was 25 m² per capita in 1978, which was four times that of China in 1986.

Thirdly, continued rapid growth of the urban population in China since the mid-1950s further burdened the housing system. According to Chen and Gao (1993), there were 3.23 million households in China’s cities in 1977 lacking sufficient living space. These households accounted for 17 percent of the total number of households. In spite of decreased financial investment in urban housing, the urban population in China virtually tripled during the period
1953-982, even with the existing set of controls imposed by a household registration system (Chinese Population Year Book 2003).

In general, people with urban *hukou* (the household registration system) are qualified to obtain state welfare benefits such as subsidized housing, free medical aid and pensions (Huang 2003). The household registration (*hukou*) system in China was developed in the 1950s especially to limit migration flows from rural areas to urban centres. However, this system has not helped to improve the living conditions of urban residents due to the limited financial funds for housing construction and the rapid growth of the urban population (Huang 2003).

Kim (1990) notes that total population in China increased about 91 percent during the 35 years after the Revolution (1949-1983). Meanwhile, the increase in the urban population was estimated at 183 percent (Kim 1990). The existing control of a household registration system was less effective for this rapid growth of urban population, as shown in Table 3.3.

### Table 3.3

**Urban population in China 1953-1995 (10 000s)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Urban population</th>
<th>Rural population</th>
<th>% Urban population in total population</th>
<th>%Rural population in total population</th>
</tr>
</thead>
<tbody>
<tr>
<td>1953</td>
<td>7725</td>
<td>50535</td>
<td>13.3</td>
<td>86.7</td>
</tr>
<tr>
<td>1964</td>
<td>12374</td>
<td>56748</td>
<td>17.9</td>
<td>82.1</td>
</tr>
<tr>
<td>1982</td>
<td>20631</td>
<td>79761</td>
<td>20.5</td>
<td>79.5</td>
</tr>
<tr>
<td>1990</td>
<td>29651</td>
<td>83397</td>
<td>26.2</td>
<td>73.8</td>
</tr>
<tr>
<td>1995</td>
<td>35714</td>
<td>85947</td>
<td>29.0</td>
<td>71.0</td>
</tr>
</tbody>
</table>

In Table 3.3, urban population in China in 1953 was 77.25 million, which consisted of 13.3 percent of the total population. In 1982, urban population in China had reached 206.31 million, which was 267.07 percent of that in 1953. In 1995 the ratio of urban population in China was 462.32 percent of 1953, and reached 357.14 million.

In addition to the limited investment in housing and the rapid growth of the urban population in China, inequalities also occurred in the provision of housing. In socialist China the central government allocated housing investment according to work units and distributed this to workers. However this work-unit-based housing system in China caused inequalities in the provision of housing among individuals (Gong & Li 2003). This will be explained in the following section.

3.2.3 Inequality in the provision of housing in the work-unit-based housing system

As Bian, Logan, Lu and Pan (1997: 228) mentioned above, under public ownership of housing, the state monopolized land use and housing investment. A work-unit-based housing allocation and investment system had been established since the early 1960s. The work unit served as the organizational basis of the state socialist welfare system.

Work units, as Kim (1990), Gu (2002), Gong and Li (2003) described, in urban China, were organizations where people work such as: enterprises, retail shops, hospitals, schools, government organs, and the like, and are generally called danwei, which literally means ‘workplace’ or ‘work units’. The public housing system in China was a major constituent part which the work units served. The standards of qualifying for housing allocation were very strict among different work units. The type and size of the work units, political status,
education and family backgrounds and marriage status are factors that might influence the allocation procedures. This thus inevitably caused inequalities in the provision of housing both in work units and to individuals.

In China most work units differ in size, resources and administrative levels. The availability of housing depended on the resource capacity of the work units (Gu 2002). Work units with more resources were able to provide more houses to employees. In contrast employees who were unfortunately working in a “poor” work unit with less housing resources had to wait a long time to get apartments, averaging three to five years. Employees in different positions had difficulty in obtaining houses (Gu 2002).

Gong and Li (2003) state that employees of larger work units in positions of higher authority were more likely to get larger and better-equipped flats. In addition, Communist Party members were privileged in obtaining good quality housing. The employees of the institutional organizations in China could also enjoy better housing facilities than those who worked for enterprises. The danwei system no doubt contributed to inequality within the urban housing structure (Gong & Li 2003).

The welfare housing system suited the situation when the People’s Republic of China was being established in the 1950s. It guaranteed a basic living condition for residents (Urban Housing Reform 1999). However, under socialist ideology, the market economy was abolished. In addition, housing was considered as a welfare item, and consequently housing as a marketable commodity was also stopped by the Chinese government. These factors restricted housing development in China. As a result government could not solve the problem of urban housing shortages and crowding by implementing this system. The disadvantages of this housing system can be summarized as follows (Xie 2000):
Firstly, housing investment by the state could not be paid back and this impeded new housing construction. Under the traditional welfare distribution system the rents were only symbolic. Investment in housing construction per year expected no returns at all. As a result such a system could only be maintained by increased investment by state.

Secondly, the traditional low rent system made people willing to wait in queues for distribution rather than buying the houses with their own money. Housing costs counted for a small percentage in the monthly consumption of the urban resident. This stimulated an extravagant demand for houses and caused unhealthy trends in housing distribution.

Thirdly, the distribution of the houses was an in-kind distribution and lacked any effective administrative restriction or a monitoring system by the public. Housing distribution based on rank in an organization rather than needs, generated inequalities in the provision of housing units. In addition, there was an increase in corruption in the implementation of the welfare housing system.

Finally, the original housing construction funds were merged with monies intended for general production. Under the ideology of “production first, consumption second”, the housing construction received less and less financial investment. The quantity, equality and efficiency of housing allocation could not be realized under this system. In addition, the commercialization of housing, and the development of the housing industry, could not progress without economic reform being extended nationwide.

The disadvantages of the welfare housing system analyzed above showed that the traditional housing system in China impeded any further housing development. With advent of economic reform launched in China in the late 1970s, the living standards of people urgently needed to be improved after
food and clothing had largely been satisfied. In addition, the housing sector as a key component of the economy can also contribute to a wide spectrum of benefits to individuals and businesses, as well to the national economy (White Paper 2005). Therefore, this housing system in China should be reformed in order to meet the goal of national economic development.

3.3 URBAN HOUSING REFORM IN CHINA: 1980-2003

Urban housing reform in China has been underway since 1978 as a major component of the overall economic reform (Wang & Murie 1996). The goal of reform in China is to develop an institutional structure in which the production and consumption of housing are mainly driven by market forces. Policy-makers of China have formulated a series of policies to solve existing urban housing problems in order to meet this goal.

According to the World Bank (1992), housing reform in China allows enterprises to retain a proportion of profits for housing construction and maintenance at the beginning of reform and grants local authorities more autonomy in housing provision and investment. Urban housing reform also allows market forces and private enterprises to play an increasing role in urban housing development. Work units and housing bureaus are gradually giving up responsibility for housing provision and public housing stock is being privatized.

To understand the process of urban housing reform in China, the reasons for the reform programme launched in a particular period should be explained and the results in different periods of policy implementation should also be examined.

Generally urban housing reform in China has experienced five phases: a
three-way partnership programme; raising the rents and increasing the salaries; the sale of public houses; a public housing accumulation fund and the abolition of the welfare housing distribution. The following section looks at each phase separately.

**Phase One: The Three-way Partnership Programme 1980-1985**

Chinese society experienced a period of the most devastating disaster during the ten years of the Cultural Revolution from 1966 to 1976 (Kim 1990). The national average per capita living space decreased to 3.6m² in 1978 (CSSB 1994). One of the major problems faced by the Chinese government was to raise the residents’ living standard in urban areas.

In June of 1980, the Central Committee of the Communist Party (CCCP) and the State Council issued the National Infrastructure Construction Conference Report (Wu & Guo 1999). In this report, the Chinese government pointed out that China would commercialise housing from being just a welfare benefit. The urban housing reform in China had opened its first page.

According to Wu and Guo (1999), the state was challenged by a budget deficit, and could not invest enough capital funds in the new housing construction because of financial pressure. The investment in housing construction independent of the government needed to be turned into a diversified one involving central government, local authorities, enterprises and individuals. The state was willing to share some portion of the total housing cost with the work units and urban households (Kim 1990). With regard to encouraging residents to solve their housing problems through personal savings, the state recommended that work units construct new houses for employees and asked work units to sell these houses to urban households. A programme of three-way partnership was developed in 1981.
In this three-way partnership programme, an individual who qualified for housing was required to make a down-payment of one-third of the housing price when purchasing occurred. Meanwhile, the work units and local government financed the remainder equally between them. The sale price of housing was set up at half the cost of housing construction as a subsidy. The state regarded this type of private partnership as a much-needed beginning to alleviate the present urban housing investment crisis (Kim 1990).

This programme was initially implemented in four experimental cities: Changzhou, Siping, Zhengzhou and Shashi. There were about 1746 housing units sold between 1982 and 1983. The total construction area was 92000 m² and the total investment was about 13.3 million yuan (Kim 1990).

According to Xianqiu Zhang (1986), although capital investment in housing construction could yield a return in the short-term, maintenance was up to buyers. However, the sale prices of houses were set lower and lower during this programme of implementation. This led to large amounts of the state’s assets being given to individuals due to low sale price, sometimes at only one-third of the construction cost (Zhang 1986).

Meanwhile houses were bought by employees who were already living in them, as opposed to purchasing new ones. This means that living conditions of urban households had not been improved. In contrast, persons in higher positions or with stronger connections to the authorities tended to get the largest and the best-equipped flats. The disadvantages in this programme led to the Chinese government no longer implementing this policy after 1985 (World Bank 1992: 26).
Phase Two: Raising the Rents and Increasing the Salary 1986-1990

The State Council established the Department of Urban Housing Reform Leading Group in February of 1986 and stated pilot experimental projects (Chen & Xing 2000). The projects aimed to increase rents gradually in the public housing sector while raising the income of employees. Housing allowances were shifted from in-kind houses in a low-rental system to direct cash payments to employees with high rents. The government expected to stimulate housing sales through raising the rents. This was the first time that reform policy directly targeted the low-rent welfare housing system. It was considered as a key link in the housing reform programme (Chen & Xing 2000).

In 1987 the first experiments in China with the reform of the low rent system were conducted in Yantai in Shandong Province, Tangshan in Hebei Province, and Bengbu in Anhui Province (Shaw 1997: 204). The programme was initiated and carried out smoothly in Yantai, and so this programme in China has been widely recognized as the ‘Yantai Model’.

This programme ensured increasing rents as an important strategy in housing reform. Both government and urban households were required to respond to the rising rents (Chen & Xing 2000). On the one hand, urban households had to increase their household expenditure on monthly consumption. On the other hand, the government would improve the employee’s income level.

At the beginning of 1988, based on pilot experiments in urban housing reform, the State Council issued The Programme of the Implementation of the Housing Reform in Urban China in order to extend the ‘Yantai Model’ to other cities (Shaw 1997: 204). The central government expected that the nationwide reform of the low rent system could be completed within three to
five years and China would achieve the completed commoditization of public housing.

This programme in China has not been implemented because China was confronted with unprecedented inflation. According to the World Bank (1992: 26), inflation in China was rising at annualized monthly rates of 10 to 15 percent in early 1988 and soared to almost 80 percent in August of that year.

During this period in China, the utilisation of housing resources became more efficient in the initial stage of the implementation. For example, some people returned the extra houses and some others moved from the big flats to smaller ones as a result of higher rents. Meanwhile, unreasonable housing demand and corruption in housing distribution were restrained. However, the affordability of housing for residents was assessed too low. The scope of the rising rents was within a narrow range. Residents’ expenditure on rising rents was almost compensated for by the work units’ increased wages. The central government and work units had shifted the burden onto themselves once more (World Bank 1992: 26, Shaw 1997: 204).

Due to the budget deficit in China in the late 1980s, and the loss incurred in state-owned enterprises, this programme was not implemented in many areas (World Bank 1992). Meanwhile, urban households in China withdrew their money from the bank and kept large amounts of cash in hand during the period that inflation occurred. As a result the financial situation of the state further worsened. The state urgently needed to sell public houses in order to yield a return on their housing investment funds.


The economic reform in China eventually developed into a socialistic market
economy through the three years’ (from 1989 to 1991) national economic adjustment. Urban housing reform in China had been shifted once again from the increase in rents to the promotion of home ownership (Gu 2002). The previous urban housing reform phases had focused on getting rid of financial burdens to the state and its enterprises, such as housing construction investment, allowance on subsidies, maintenance and administration by the state and its enterprises. New housing reform programmes sought to improve housing consumption through the privatization of the housing system and to create a housing market (Huang 2003).

As Jun Mao (1999) summarises it, the goals of this housing reform programme could be described as follows: alleviation of the urban households’ living difficulties; improvement of living conditions; guidance of consumption; gradual realization of commercialisation, socialization of houses and the development of the housing industry.

Mao (1999) also explained that the main reform methods in this phase were:

1. Raising the rents of public housing in order to encourage home ownership;
2. Shifting house distribution from in-kind to a cash allowance;
3. Adhering to principles of implementation of rent and sale concurrently;
4. Joining the government, enterprises and individuals to respond on housing provision;
5. Launching new rules on the building of new houses; and
6. Prohibiting the cheap sale of state-owned houses.
This urban reform programme in China had been implemented for about two years. The reform was plagued by "real estate overheating". The "real estate overheating" caused a sudden huge increase in housing prices. Meanwhile the urban households' income level still remained low level as it was. The ratio of housing price compared with the urban household’s income was very unreasonable. This made the urban housing system even more difficult to reform further.

**Phase Four: The Integration of Urban Housing Reform in Both Commercialization and Socialization of Housing 1994-1997**

In July of 1994, the Urban Reform Leading Group issued The Decision about Furthering the Reform on the Housing System (Li 1999). The missions of the reform were described as following:

- To spread the accumulation of the housing funds system nationwide;
- To carry forward the rents reform;
- To implement a stable sale of the public houses;
- To establish a housing institution matching the market economic system;
- To realize the commercialization and socialization of urban housing.

According to Zhan Li (1999), this housing reform phase entailed:

- Pushing forward rental reform of urban housing. The rents charged by public houses should comprise 15 percent of the income in a double-employees household in 2000.
The sale of houses at both market prices and cost prices should be implemented in every city in China.

Spreading the housing accumulation funds system countrywide.

Implementing the affordable houses (Anju) project and the social security provision of commercial houses.

In this phase of the urban housing reform in China the focus was on both housing finance and the special group who were suffering housing difficulties such as state-owned enterprises and schools. The public housing accumulation funds and Anju projects were the most important programmes issued by the Chinese government during this period (Urban Housing Reform 1999).

As Gu (2002) points out, the housing accumulation funds system was based on the Singaporean model which was adopted by Shanghai in late 1991, and later widely called the ‘Shanghai model’. The housing accumulation funds system is a long-term forced saving system. It requires both the employer and the employee to hand in every month a certain amount of money based on the salary (Urban Housing Reform 1999). The housing accumulation funds are the funds used particularly for the housing purchase. The funds could also be used to construct or repair the houses and to pay back the house mortgage loans. The setting up and developing of the housing accumulation funds is a helpful way to finance people who are willing to buy their own houses.

The Anju project was launched by the Chinese government in 1993 (Urban Housing Reform 1999). This programme’s aim was to accelerate the steps for solving the housing difficulties for families who had inadequate living space. Under the same conditions the houses were preferentially sold to retired
workers and teachers who had housing difficulties. The major tasks of the Anju project were: it would take five years (from 1995 to 2000) to build 150 million m² of living space to solve the housing difficulties of low-income families, and ensure the accomplishment of the goal of well-off housing so that each person has a living space of 8 m² on average by the end of the 20th century (Urban Housing Reform 1999).

According to Meisheng Nie (2004), the Anju projects have many favourable policies on land, tax, and interest rates. The cost price of houses in the Anju project consisted of basic expenses such as: a land acquisition fee and compensation for demolition and moving; survey, design and a pre-construction fee; the cost of construction and allocation; the cost of construction concerned infrastructure facilities in residents’ quarters; a one to three percent management cost; loan interest and tax. The prices for the Anju project are much lower than the commercial houses. This alleviated the economic burden for urban households who were willing to buy houses.

During the Anju project’s implementation period the success of this programme was partial, and did not meet the expectations of many people. Although the Anju project has solved housing problems for some families, other problems presented themselves. For example, household incomes were not transparent; the monitoring system was not effective and the houses in some regions were constructed beyond the standard. As a result, high-income households were hiding their incomes in order to buy houses at cheaper prices in the Anju project. This obviously threatened the benefits of low-income households.

Reform in this period had progressed in the field of the housing accumulation funds system and the Anju project. In addition Anju projects were further institutionalized to indicate the general direction of urban housing reform in
China. However, there were still some problems such as an unreasonable proportion between renting and sale, the unclear ownership of the public houses, and the continued existence of the welfare housing distribution system. Most employees were still waiting for the distribution of houses by the work units and neither wanted to buy a house or could afford one.

**Phase Five: The Abolition of The Welfare Housing Distribution 1998-**

According to Gu (2002), the low rental and welfare housing distribution systems in China hindered the commercialisation and socialization of housing. In January of 1997 a working conference on national housing reform took place in Chengdu of China. The conference proposed the cancelling of the welfare distribution system of the houses in a planned way, step by step. The reform of rentals for public houses improved.

The State Council released the “Notice of the State Council about Furthering the Reform on the Housing System in Cities and Towns and Quickening the Construction of Houses” (Wang 2001). The new housing reform policy was publicized in July 1998 and comprised four major components as follows:

1. Eliminating the welfare public housing allocation system by the end of the year;

2. Establishing a supply system of affordable housing for low-income families;

3. Simplifying regulations concerning mortgages;

4. Developing a market for second-hand housing exchange.
The first goal of the 1998 housing policy package was the key to speeding up urban public housing reform (Gu 2002). The major institutional obstacle to the commercialization of housing was the continuation of the allocation system of state-subsidized welfare public housing. With the introduction of a new housing system, work units would no longer be built. Instead the purchasing and allotting of houses to employees was stated, and work units would turn the original funds for housing construction and purchase into various forms of housing allowances which should be paid directly to employees either on a monthly basis or in a lump sum. Employees would go to the market to buy or lease a house according to the family’s economic situation.

According to Yaping Wang (2001), the policy makers in China have adjusted the housing investment structure and given priority to affordable housing. As Nie (2004) explains, affordable housing refers to commercial housing giving social security and featuring economy and applicability. Economy means house pricing is moderate and affordable for middle-income and low-income urban households compared with the market price. Applicability means the emphasis is on the effect of housing utilization in housing design and building to standard specifications rather than lowering the building standard specification. Affordable housing belongs to common housing constructed by the state government to solve the housing problems of middle-income and low-income households. Therefore, the housing provision system focused mainly on affordable housing. This policy was proposed to realize the commoditization and socialization of houses in urban China.

The new housing policy applied in China has adopted the following instruments (Wang 2001):

(1) Abolishing the welfare housing distribution and implementing the monetization of housing distribution. The allowance is only issued when
the housing is bought.

(2) Encouraging urban households to buy the houses. The Chinese government has focused on affordable housing for low-income urban households. Urban households in China can buy affordable housing of good quality and low price compared with the market price.

(3) Establishing the housing market in China. The second-hand houses like public housing and affordable housing that have already been sold can be traded in the market. Urban households can adjust their housing needs to the market based on families' economic situation.

(4) Developing a housing finance system to support urban households buying houses. For example, the public housing accumulation funds, housing bonds and home mortgage implemented in China can help urban households to obtain houses in the market.

Gu (2002) suggests that the new housing system, in reality, is not totally new. The new housing policy has worked for a decade in Shenzhen, the largest special economic zone in China. Under a comprehensive housing reform plan which took effect in 1988 enterprises or companies paid state-subsidies for housing to employees and employees had to take care of housing needs themselves. Currently the real estate market in Shenzhen is mature, and the city has achieved the commoditization of housing. This is because Shenzhen was established on the basis of a market economy and it was easy to adopt new institutional arrangements.

Other cities in China, however, did not feel the same way due to the welfare housing system of nearly 30 years as mentioned above (Gu 2002). This inevitably caused many problems in the process of urban housing reform and
problems also occurred in housing industry development. The next section will analyze the problems in urban housing reform. The housing industry development during this period will also be described.

3. 4 THE ANALYSIS OF THE INCONSISTENCY IN PROCESSES OF URBAN HOUSING REFORM IN CHINA AND HOUSING INDUSTRY DEVELOPMENT

According to Shiming Yuan (2000), the living standard of urban households has improved since urban housing reform in China took place in 1980. Correspondingly, problems have also arisen during the reform process. For example, the problems include: imbalances in the total amounts and structure of the houses; the poor quality of the houses; the high price of houses compared with the households' income; the fact that the estate management and agencies service lagged behind. This has made a difficult situation in the provision of housing to urban households. Urban residents in China were facing a shortage of adequate housing while housing markets were overstocked due to high prices.

The key reasons why the urban housing reform had not provided adequate living space for urban residents includes: two housing provision systems co-existing in the housing market and the housing price exceeding the affordability of households. These were the cause of urban housing reforms in China experiencing a difficult time. The follow section looks at these problems in turn.

3.4.1 Two housing provision systems co-existing in the housing market

As Yuan (2000) summarized, on the one hand, the weakness of the housing
market and the overstock of commodity apartments meant that the billions of investment failed to yield returns. On the other hand, the shortages of the urban residents' living spaces were acute. Urban households in China desired to buy houses but they were unable to afford one due to financial difficulties. The key reason was that there were two kinds of housing markets co-existing in China during this period: the outside open market and the inside invisible market.

The outside open market referred to everyone who was willing to buy or rent at the market price. The inside invisible market referred to employees buying or renting at a lower rate that offered by the work units. The employees enjoyed the housing subsidies which were provided by work units (Yuan 2000).

The housing market in China faced the phenomenon of "double surplus" due to the existence of two markets. In the inside invisible market, shortages of housing and residential crowding were common before housing reform, and the rents and purchasing prices for public houses were both lower than the housing market during the processes of housing reform. These resulted in huge demands for housing that could not be satisfied due to financial resources in both government and work units being very limited. Therefore, a "demand surplus" existed (Yuan 2000, Gu 2002).

In the outside housing market, the huge housing demand and the high housing prices attracted developers to invest more in housing construction, especially in the construction of top-grade houses. As a result, most of the households were willing to buy but could not afford one because of the low salary system. This caused overstocking for commodity housing and a "supply surplus" was formed. The equilibrium of supply and demand as an economic model can display these two kinds of surplus situations. See Figure
In Figure 3.1, S and D are the supply and demand gradients under general market economy conditions. The point "e" where the supply gradient S and demand gradient D intersect is the equilibrium point. The price Pe is the equilibrium price at which the producers will be willing to supply Qe units and this price will be accepted by buyers for their demand.

As Ling and Shi (1999) describe that, in the inside invisible market, the houses as welfare products its price elasticity is zero. This meant that the supply amount is constant and will not be changed by the fluctuations of the price. It is shown as a supply curve Sn, and the supply amount kept on Qs level. At the same time, in the inside invisible market, the employees get the houses at price P1 that is lower than market equilibrium price Pe. Under this lower price level residents have huge housing demand Qd, but cannot be satisfies by either the government or the work units. The AB line segment in
Figure 3.1 consists of “demand surplus” and its quantity is Qd minus Qs.

In the outside open market, huge demand attracts real estate developers to increase the supply of houses. The reasons can be explained from two aspects. One is that there is a demand gap in the inside market. Another is that employees of non-state enterprises such as overseas-funded enterprises and private enterprises will solve housing problems differently in the open market. Meanwhile, because of the limited quantity of usable land, over-high construction expenses and taxation, the high profit rate set by the high consumption of building materials, the price of house is raised to level Ph. However, the supply amount of Q's under the condition of Ph prices is beyond the bearing purchasing ability of the residents. As a result, there occurs the "supply surplus" of CF and its quantity is Q's minus Qs (Ling & Shi 1999).

The "double surplus" phenomenon is the source of the existence of the double housing distribution system. Therefore the urban housing system in China should be reformed completely in order to adapt itself to the market mechanism. As Nie (2004) mentions, the monetary housing reform programme was issued in the Notice of the State Council on Further Deepening Urban Housing System Reform and Speeding up Housing Construction in the second half of 1998. This was the signal to end the internal and invisible housing market.

In spite of the “double surplus” existing in the urban housing system, the housing purchasing ability of urban households in China is another reason that the living standard is lower compared with other countries such as Singapore, Japan and West Germany. The following section explains this problem.
3.4.2 House purchasing ability in China

In general, the ratio of house prices to household annual income in China is about three to six times higher based on the standard of the World Bank (Li 2000). This standard has become an important reference of countries all over the world when analyzing the housing price compared with the annual household income. However, the proportion between the housing price and the household income in China was about 10 to 20 times which was far beyond the standard of the World Bank (Li 2000).

The reasons for the high housing price are twofold: one was that the prices of the houses included many unreasonable factors, such as the infrastructure construction cost, the fee for water and electricity, heat provision and gas provision, etc. At the same time, some matching facilities of the housing construction, such as the stores, schools and creches, etc. were also calculated into the prices of the houses. In addition, unreasonable apportioning and fees from government agencies were also added to the price. All these made the housing price reach a very high figure (Tang & Luo 2000).

Another reason was the real estate surge (over-heating) in China between 1992 and 1993 (Li 2000). There was an economic bubble that existed in the housing industry. As a result, house prices have risen too high. Furthermore, prices rise easily but it is not easy to reduce them due to the inflexibility of the prices. The prices thus remained comparatively high.

As regards household income, China implemented a policy of low salary and welfare distribution of housing for nearly 30 years as mentioned above (Li 2000). In addition, employees’ medical aid, pensions and education were also provided by the government or work units. This meant that urban households
were willing to buy houses but could not afford one after the urban housing reform due to their financial difficulties.

According to Zuo (2001), however, there were also data pointing out the problem caused by the counting method. Generally, only the visible income such as the salary and bonus were counted into the household income. The invisible income (also called the gray income), such as the welfare benefit, allowance, extra work wage and the income from a second occupation were not included. The calculated income was actually lower than the real income.

As to the housing price, in some developed market economic countries such as America, the calculation of the housing price is the weighted average (with condition) of the new and second-hand houses. In China, the real estate market in respect of second-hand houses was underdeveloped and only the prices of the new houses were calculated. The prices for housing calculated in China were higher than the prices calculated based on the international statistic standard (Zuo 2001).

As to the housing standard, in a country with low household incomes like China, the standard area of 60 m² seems a little high (Zuo 2001). With the shrinkage of the denominator (the annual household income) and the increase of the numerator (the housing price), the proportion of housing price to household income was comparatively high.

When calculating the ratio of housing price to the household income, the house prices are counted on 20 percent less. This represents the weighted average of the new and second-hand houses. The residential area was decreased from 60 m² to 45 m² and the household income was calculated 20 percent more. Even in this case the conclusion was that the households with middle-income and below still cannot afford to buy houses (Zuo 2001).
3.4.3 The trend in urban housing reform in China

The aim of the monetarization of the housing distribution was to push forward housing consumption into the housing market. The work units in China were giving up the responsibility of housing provision for employees (Huang 2004). The investment, construction and maintenance of the houses were undertaken by specialized real estate enterprises. This could enhance efficiency and economize resources as well. The policy could also reduce the burden borne by the enterprises and eliminate the inequalities in housing distribution. After implementing the monetarization distribution in urban housing and socialization, the procedure with housing consumption is shown in Figure 3.2.

Figure 3.2
Housing consumption processes

Source: adapted from Zhao, G.L. 2000. The analysis of the potential needs in the real estate.
In Figure 3.2 consumers (individuals) could buy or lease the houses offered by real estate developers. The consumers would no longer rely on enterprises or government agencies for such consumption. Real estate developers or the consumers obtain the using right of the land from authorized land administrative departments of governments at all levels, and pay for the cost of using the land. The right to use land is transferred on payment of the costs from the administrative department of land, using a method of agreement for bid and auction (Zhao 2000).

Real estate developers and other enterprises pay the tax revenue to the government. The government then distributes the fiscal revenues to the non-profit organizations such as the military, government and institution agencies and so on. The employees earn a salary from their employers like the enterprises or other non-profit organizations. This includes the part for house consumption (Zhao 2000).

In the house market, individual consumers determine whether to buy or lease the house according to personal income, preference and other factors. The supplier offers the houses according to the capacity and market demand. Selling or renting out the houses is set up at the market price. For extremely poor residents, the government may take such welfare measures as to reduce or exempt the rental to solve the housing problems.

In order to make such a housing consumption structure more into a benign cycle, three key problems need to be solved:

(1) Set up reasonable housing rates and a proper ratio of sale and renting

The housing reform programme implemented before had reduced taxation and adjusted the rental a few times as mentioned above (Gu 2002, Huang
However, the policies had not set up a rational house sale and rent price. During the process of urban housing reform in China, raising the rent in urban households’ monthly housing consumption had been compensated by the government or work units. In addition, some unreasonable factors were included in the house price and this had no doubt aggravated the financial burden to urban households. Therefore, setting up the reasonable sale or rent price for housing is one key link to solving urban households’ housing problems. Urban households in China have been allowed to make a choice to buy or rent houses based on their own economic situation (Ling & Shi 1999).

(2) Reform of the low salary system implementation in China and increasing the housing consumption expenditure of the urban households.

As Kim (1990), Song and Chu (2000), and Huang (2003) describe, a low wage system was implemented in China after the foundation of the new China, which had not included money for housing. Because of the monetarization of housing distribution, money for housing consumption had been included in the salary. This means that the existing low wage level would have to be improved in regards to the commercialization of housing.

According to Yang, Feng and Liu (2000), the proportion of housing consumption expenditure to the total consumption of a household should be at a reasonable level, which keeps abreast of the gross domestic production (GDP) and the Engel coefficient. The housing consumption expenditure in China has reflected a stable increase since economic reform. For example, the housing expenditure was 1.87 percent in 1991 to 3.99 percent in 1998 (Yang et al 2000). However, compared with GDP per capita and the Engel coefficient, the proportion of housing consumption expenditure in China was still on the low side. This is shown in Table 3.4 (see next page).


Table 3.4
The correspondence connections of GDP per capita and the Engel coefficient with the proportion of housing expenditure

<table>
<thead>
<tr>
<th>Gross domestic production per capita (US$)</th>
<th>Proportion of housing expenditure ( % )</th>
<th>Engel coefficient ( % )</th>
<th>Proportion of housing expenditure ( % )</th>
</tr>
</thead>
<tbody>
<tr>
<td>250</td>
<td>8.66</td>
<td>60</td>
<td>7.43</td>
</tr>
<tr>
<td>500</td>
<td>9.04</td>
<td>55</td>
<td>7.87</td>
</tr>
<tr>
<td>750</td>
<td>9.30</td>
<td>50</td>
<td>8.33</td>
</tr>
<tr>
<td>1000</td>
<td>9.50</td>
<td>45</td>
<td>8.81</td>
</tr>
<tr>
<td>1500</td>
<td>9.83</td>
<td>40</td>
<td>9.32</td>
</tr>
<tr>
<td>2000</td>
<td>10.10</td>
<td>35</td>
<td>9.86</td>
</tr>
<tr>
<td>5000</td>
<td>11.29</td>
<td>30</td>
<td>10.45</td>
</tr>
<tr>
<td>10000</td>
<td>12.79</td>
<td>25</td>
<td>11.11</td>
</tr>
<tr>
<td>20000</td>
<td>15.39</td>
<td>20</td>
<td>11.87</td>
</tr>
<tr>
<td></td>
<td></td>
<td>15</td>
<td>12.83</td>
</tr>
<tr>
<td></td>
<td></td>
<td>10</td>
<td>14.16</td>
</tr>
</tbody>
</table>

Source: adapted from Yang et al. 2000. The analysis of housing consumption expenditure in China

In Table 3.4, GDP per capita in China was 7543 yuan in 2001 (CSSB 2002), about $ 900. Based on Table 3.4, the house expenditure in China could be 9.3 percent to 9.5 percent. Chinese urban households’ Engel coefficient was 37.9 percent in 2001. The house expenditure of urban residents could be 9.32 percent to 9.86 percent. With regard to standards, the proportion of residents’ housing expenditure against the family’s total consumption expenditure could rise to 9.5 percent in China, which was relatively reasonable (Yang et al 2000)

(3) Developing housing finance in China

The common international method of analysis used to measure the house purchase ability is the house price relative to the income of the household (Meen 2003: 99). Generally, the price of the house should be three to six
times that of the annual income of the household. However, this ratio in China is much higher than international standards, which means the house purchasing ability in China is lower (Zhang 2001). The reasons in spite of high price of housing, the low wage system implementation in China have also led to the low house purchasing ability.

- Xingquan Zhang (2001) and Yanling Liu (2000) suggest that the process of salary reform in China needs time to meet the goal. In addition, it is impossible to expect salaries to rise a short term to the level of matching the purchasing power. Therefore, China should develop housing finance in order to strengthen housing credit. Urban households in China could purchase the house through finance support such as the public housing accumulation funds and a bank mortgage loan. In addition, the risk of mortgage loans for financial institution is smaller than the risk of loans to real estate developers (Liu 2000).

The housing financial market links the financial institutions, house developers and the house consumers. The financial market should reflect the financial policies of the Chinese government, and such policies should also guide the flow direction of personal saving (Roulac 1996).

Developing a housing financial market and encouraging housing consumption in China could expand domestic demand. This would not only improve the living standard for urban households, but would also give momentum to housing industry development. The housing industry in China could become the new engine of national economic development. The follow section will look at housing industry development in China during the process of urban housing reform.
3.5 THE PROCESS OF HOUSING INDUSTRY DEVELOPMENT IN CHINA

The housing industry in China is an infant industry although it existed before the liberation. China applied the Soviet model to develop the national economy. Privatization in housing was gradually eliminated and state ownership was set up (Kim 1990, Chen & Gao 1993, Gu 2002, Huang 2003, 2004). In the Soviet-style model, urban housing was considered a welfare item but not a commodity. As a result, the housing industry in China no longer existed.

After the economic reform launched in China, especially after the Southern Inspection Speech by Deng Xiaoping, the former premier in China, the housing industry displayed a rapid development that had never been seen before (Gu 2002). In the past decade housing industry development in China has experienced three phases: The recovery of the housing industry, a speedy development period and a stable development phase. These will be presented in turn:

**Phase One:** The Recovery of The Housing Industry 1984-1989

In June of 1979 the city of Fuzhou in China took the initiative of abolishing the prohibition that individuals were forbidden to build houses. This regulation was issued in the late 1950s (Urban Housing Construction 2000). Diversified ways of house construction have emerged across the country since then. With the first tract of state-owned urban land bestowed in the Shenzhen Special Zone in 1984, the housing industry in China was initiated.

There were few real estate developers in China at first. There were mainly allocated in the special economic zones in the east or the cities along the seashore (Real Estate Year Book 2003). There was almost a blank in the
middle and western areas of China. Correspondingly, the construction projects were mainly focused on the construction of factories and apartments for foreigners.

**Phase Two: The Speedy Development Period 1990-1993**

According to Liu and Song (2000), in the early of 1990s, the 14th meeting of the Communist Party in China issued a crucial strategy. This was about the establishment of a socialistic market economic system. Real estate developers in China experienced a phase of speedy development. This was mainly characterized as follows:

(1) The scale of the housing industry enlarged step by step and spread all over the country;

(2) The number of real estate developers rose rapidly to a total of 12,000, among which companies with sole or partial foreign capital amounted to 6908, more than half of the total;

(3) The total investment by various real estate companies amounted to 102700 million yuan from 1990 to 1993, an average annual increase of 117.4 percent. Meanwhile, the surge of setting up economic developing zones everywhere further heated real estate development. The housing industry development was focusing on top grade apartments and this led it into an unaffordable situation.

The main reasons for the overheated development of the housing industry in China could be generalized into two parts: one was the pull of demand and the other was the push of reform (Liu & Song 2000).
(1) Pull of the demand

After Deng Xiaoping's Southern Inspection Speech of 1991, the national economy in China enlarged its investment and equipment in every industry, which speeded up the pace of economic development. The housing industry was requested to construct more complex apartments to meet the needs of housing demand along with the economic development and income increases (Liu & Song 2000).

During 1989 to 1991 the annual finished construction area was only about 100 million m² due to the reduction of the construction scale. The shortages and crowding of housing in urban areas of China urgently needed to be sorted out. The huge demand for housing thus motivated real estate developers to increase their capital investment in housing construction (Liu & Song 2000).

(2) Push of the reform

According to Yunchang Gu (1999), this was due to the fact that the reform in both the land usage system and financial system encouraged the heating of the housing industry. Land reform in China resulted in urban land coming quickly into the market, and the use of land resources in urban areas were being effective and efficiency. The great market demand, the land available, the capital available and the high profits all pushed the housing industry into a process of speedy development.

During this period of rapid housing development there also occurred the negative effects because of overexpansion. This is explained as follows:
The loss of control of the scale of real estate development

Real estate investment increased rapidly in the early 1990s. In 1992, 73200 million yuan was invested in real estate, an increase of 117 percent compared with previous year. The increase in the Hainan province of China even reached 211 percent. In 1993, this number stood at 165 percent. The increase rate was impossible for any country's economic ability able to sustain. This inevitably caused the economic bubble phenomenon in real estate (Gu 2002).

Furthermore, great amounts of land in China were transferred during this period. For example, in 1992, the transferred land all over the country was 22 000 hectares, which was 11 times that of the previous year. Of this more than 90 percent was transferred on agreement with low transparency and free charges (Real Estate Year Book 2003). Selling urban land at low prices in China had caused the loss of the land benefits.

Meanwhile, the developing zones were set up one after another. According to CSSB (1990-2000), at the end of 1992 there were 1951 different developing zones all over the country, 15 times the number of the previous four years. The land area occupied by the developing zones was far beyond the developing ability of the real estate industry in China at that time. The arable land was improperly occupied and there was phenomenon of land left unused everywhere. The problem of wasting land resources was very serious.

The imbalance of the investment structure in real estate

According to Bao (1994), at the end of 1992 there were 13566 real estate development companies in China, 2.6 times those of the previous year and in the first part of 1993 the total had reached nearly 20000. However, the
companies with highly qualified and large-scale were fewer. This meant that real estate development could not be reached the economy of scale.

Bao (1994) also suggests most companies focused interest on the high profit projects such as the construction of office buildings, shopping malls and top grade apartments. Seldom would the company show any interest in affordable housing that was much in demand but producing low profit. Furthermore, the economic development in China was in an imbalance with regard to the geographical difference, where the coastal regions in China developed fast while the inland areas developed slowly due to less investment (World Bank 2003).

- The market behaviour in real estate was not disciplined.

In the real estate market, speculation occurred on the land due to a lack in the macroeconomic regulation system. According to Bao (1994), in Shenyang and Hainan of China, a tract of land was sometimes transferred seven or eight times before it was developed by people who gained huge profit by speculating on land. This led the price of urban housing to rise to unreasonably unaffordable levels.

**Phase Three: The Stable Development of The Housing Industry 1994-**

Overexpansion in real estate had caused high inflation while driving real estate development. For example, the inflation rate reached 31 percent in the third quarter of 1994 (CSSB 1995). The Chinese government had to control strictly the amount of currency issued and the scale of investment in real estate construction. The Administrative Law of Urban Real Estate issued by the Chinese government was intended to control the overexpansion in real estate.
The Administrative Law of Urban Real Estate was published and the implementation of the regulations recorded that the housing industry in China had entered a phase of steady development (Real Estate Year Book 2003). This was expressed as follows:

(1) Capital investment in some developments had been trapped and could not be withdrawn due to the great amount of houses that were left on stock. As a result, newly constructed commercial houses minimized and development was slowed down. The trading amount decreased and quite a few economic bubbles twist (Real Estate Year Book 2003).

(2) More than 2000 hectares of land that was not developed in time were taken back (Real Estate Year Book 2003). After the implementation of the regulation, the number of economic developing zones all over the country had also reduced to less than a half. This helped in cooling down the previously overheated development in real estate.

(3) Although new real estate developers were set up, the total number was reduced through the government’s intervention. Some companies went bankrupt or left for other trades because of the lack of capital resources (Real Estate Year Book 2003).

(4) The construction projects in real estate had become more reasonable. The proportion of investment in housing had increased. The proportion of new housing construction in real estate had risen to 80 percent. The regulations in real estate improved and the behaviour of the market was standardized (Real Estate Year Book 2003).

Housing industry development in China had undergone a complex process as discussed above. The living standard of urban households in China had
improved since the urban housing reform launched in China. Commercialization and socialization of urban housing in China will play an important role in the national economic development. Therefore, an analysis of the trend in the housing industry should help promote the housing industry’s development.

The trend in housing industry development in China is determined by both industrial and external environmental factors. The analysis of urban housing reform in China gives an understanding of the industrial environmental factors in housing industry development. An analysis of housing industry development as affected by external environmental factors has now become necessary and significant.

The political, economic, socio-cultural and technological (PEST) analysis (Jobber 1998, Cant 2004) and Porter’s Five-Forces Model (Porter 1980) which defines as potential entrants, suppliers, buyers, substitutes and industry competitors will be used to examine how the external environmental factors affect housing industry development in China. The section below looks at PEST analysis and Five-Forces Model separately.

3.6 THE EXTERNAL ENVIRONMENTAL FACTORS IN HOUSING INDUSTRY DEVELOPMENT IN CHINA

According to Kim (1990), housing industry development in China has been influenced by the processes of urban housing reform. Although the living standard of urban households in China has improved since the urban housing reform, however, compared with developed countries such as America, West Germany and Japan, the living space per capita in China is still lagging.
The population in China has grown rapidly since the second half of the last century. The shortage and overcrowding in urban areas is still a problem faced by the Chinese government. Proving affordable housing for low-income urban households has still got a long way to go (Gu 2002). Consequently, a sustainable and healthy development in the housing industry is a crucial subject to deal with. This chapter has already presented the industrial environmental factors in housing industry development. Housing industry development impacted by the external environmental factors has great potential for further analysis.

As Michael Cant (2004) puts it, there are factors or variables in the external environment over which the industry has no control and on which it has little effect. These factors influence businesses, and need to be constantly monitored as they continually change. The result of this interaction is often a new business environment with new opportunities and new threats.

According to David Jobber (1998), the external environment of the housing industry like other businesses such as the food industry and manufactures has also consisted of actors and forces that affect the industry’s capability to operate effectively in providing products and services to its customers. These factors can be classified under micro-environment and macro-environment. The macro-environmental factors mainly include economic factors, social factors, political factors and technological factors (Jobber 1998, Cant 2004). Micro-environmental factors consist of suppliers, buyers, competitors, substitutes and potential entrants (Porter 1980). The follow section will firstly use PEST Analysis to explain macro-environmental factors in housing industry development in China.
3.6.1 PEST Analysis in housing industry development in China

As Jobber (1998) and Cant (2004) remark, a PEST Analysis looks at the external business environment. PEST stands for political, economic, socio-cultural and technological. The analysis examines the impact of each of these factors on the business. Each PEST factor is considered since all play a part in determining the overall business environment. The section below discusses how these factors separately influence housing industry development in China.

3.6.1.1 Political and economic factors

According to Jobber (1998), political factors can have a direct impact on the way business operates. Decisions made by government affect everyday lives and can come in the form of a policy or legislation. For example, government introduction of a statutory minimum wage affects all businesses, as do consumer, health and safety laws.

Economic factors involve an understanding of how people produce, distribute, purchase and use goods and services. These factors have a critical impact on the success of companies through their effect on supply and demand (Jobber 1998). Table 3.5 (see next page) shows examples of political and economic factors.
Table 3.5
Examples of political and economic factors

<table>
<thead>
<tr>
<th>Political factors</th>
<th>Economic Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environment regulations and protection</td>
<td>Economic growth</td>
</tr>
<tr>
<td>Tax policies</td>
<td>Interest rates &amp; monetary policies</td>
</tr>
<tr>
<td>International trade regulations and restrictions</td>
<td>Government spending</td>
</tr>
<tr>
<td>Contract enforcement law, consumer protection</td>
<td>Unemployment policy</td>
</tr>
<tr>
<td>Employment laws</td>
<td>Taxation</td>
</tr>
<tr>
<td>Government organization/attitude</td>
<td>Exchange rate</td>
</tr>
<tr>
<td>Competition regulation</td>
<td>Inflation rates</td>
</tr>
<tr>
<td>Political stability</td>
<td>Stage of the business cycle</td>
</tr>
<tr>
<td>Safety regulations</td>
<td>Consumer confidence</td>
</tr>
</tbody>
</table>


Table 3.5 reveals how political factors consist of environmental regulations and protection, employment laws, tax policies and competition regulations. Policies issued by government can influence marketing decisions by determining the rules by which business can be conducted. For example, the housing industry in China grew out of nothing due to implementation of urban housing reform policies (Kim 1990, Jobber 1998).

As Chen and Gao (1993), Gu (2002) and Huang (2003, 2004) remark, the urban housing policy in China replaced the welfare housing distribution system with low rents with the monetarization distribution system based on one’s contribution to work. Correspondingly, monetary policy and financial
policy were also reformed by government. For example, reduced interest rates in both saving and loans, decreased the down payment when purchasing houses, and alleviated the financial burden for urban households by giving a 20 year loan. These policies encouraged urban households in China to buy adequate houses in the housing market, thereby, meeting the goal of urban housing reform.

In Table 3.5 economic growth and employment, interest rates, exchange rates, inflation rates and business cycles are involved as economic factors. As Cant (2004) explains that the general state of a nation’s and the world’s economy can have a profound effect on an industry’s prosperity. For example, the business cycle as an unavoidable objective phenomenon has a significant influence on the supply of and demand for housing (Burns 1969).

Downs (1991) describes how as a result of the economic prosperity, occupancy is high, rents are rising, income and consumption levels are raised, the demand for houses accelerates and new construction is needed to meet the increased demand. Conversely, during an economic recession, vacancies increase, delinquencies rise in mortgage and rent payments, and housing sales decline both in numbers of sales and in prices. New construction slows and numbers of mortgage loans and currency values decline.

In addition, the income level also has an influence on the housing market (Downs 1991). When personal income increases the Engel coefficient decreases, there is a tendency to spend that income on durable consumable goods such as buying a more luxurious car, paying more in rent for a larger apartment, or purchasing a house.

Zhang (2001) and Liu (2000) suggest that the process of salary reform in China needs time to meet the goal. In addition, it is impossible to expect
salaries to rise in the short term to the level of matching the purchasing power. This means that the urban households in China with low incomes are willing to buy houses but cannot afford one. The reasons why effective housing demand in China is insufficient fall into two categories:

(1) The ratio of housing price to income is much higher than international standards, as mentioned in the early part of this chapter. Urban households in China cannot afford to buy houses due to financial difficulties;

(2) As regards economic reform launched in China, housing reform, education reform, employment reform and pension reform have appeared one after another. The expenditure of urban households has increased while income reduced beyond the expectation. This caused urban households in China to prefer saving for old age to buying houses.

Consequently, housing development in China is not only dependent on economic development, but also needs support from the policy makers. Sustainable and healthy housing development is impossible without positive government interventions and economic measures.

### 3.6.1.2 Social and technological factors

According to Jobber (1998) and Cant (2004), social environmental factors refer to two key social forces: the changes in the demographic profile of the population and cultural value differences within and between nations. Demographic forces concern changes in population such as: population growth, the changing age distribution and the rise in the number of two-income households. Cultural values can be defined as beliefs shared by a large number of people in a society, which lead to common patterns of
behaviour.

Technological factors, as Jobber (1998) put it, have a substantial impact on people’s lives and economic development. Technological developments within an industry can spell the demise of products. Monitoring the technological environment may result in the spotting of opportunities and major investments in new technological areas. New advances in the sciences and social systems will lead to a better world for everyone. Table 3.6 shows what has been involved in social and technological factors.

Table 3.6
Examples of social and technological factors

<table>
<thead>
<tr>
<th>Social</th>
<th>Technological</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income distribution</td>
<td>Government research spending</td>
</tr>
<tr>
<td>Demographics, population growth rates, age distribution</td>
<td>Industry focus on technological effort</td>
</tr>
<tr>
<td>Labour/social mobility</td>
<td>New inventions and development</td>
</tr>
<tr>
<td>Lifestyle changes</td>
<td>Rate of technology transfer</td>
</tr>
<tr>
<td>Work/career and leisure attitudes, entrepreneurial spirit</td>
<td>Lifestyle and speed of technological obsolescence</td>
</tr>
<tr>
<td>Education</td>
<td>Energy use and costs</td>
</tr>
<tr>
<td>Fashion, hypes</td>
<td>Information technology</td>
</tr>
<tr>
<td>Health consciousness &amp; welfare, feelings on safety</td>
<td>Internet</td>
</tr>
<tr>
<td>Living conditions</td>
<td>Mobile technology</td>
</tr>
</tbody>
</table>


In Table 3.6, population growth rate and age distribution are key forces in
social factors. Song and Du (1998) suggest that China has the largest population in the world. The household size has been developed to miniaturization and the urbanization level is improving constantly. All these could make the housing market in China have enormous demands now and potential demands for the future. The goal of an average living area of 13 m² per capita in 2010 would need an average annual increase of 341 million m² in housing construction. This inevitably gives motivation and momentum for housing industry development in China.

The technological environmental factors mainly consist of new inventions, rate of technology transfer, and technical development trends in the country or the area as shown in Table 3.6. As Rong Feng (2000) describes, housing construction in China is still at the stage of handicraft or half-handicraft. This can be explained as follows:

1. Most employees in construction come from the countryside. These workers left home due to the limited land for cultivation. The education levels of these employees are very low, which means they are not qualified for the job. Employers hire these workers without any training at low wages. This is not only a problem in project quality, but means a high safety risk in the process of construction;

2. Technology transferred to productivity in construction lags behind compared with the situation in developed countries. The project planning, facilities, construction and management in housing construction are not implemented according to standards and are not modernized. For example, the construction period is three to five times more than in developed countries, and the cost of energy, material and land resources is three times that of developed countries. In addition, the quality of housing is lower, which cannot satisfy the consumers’ requirements. The
growth model of the housing industry in China could be "low speed, high investment, low quality and low profit".

PEST analysis concerns the macro-environmental factors in housing industry development. However, housing development in China is not only based on the macro-environment, but also affected by micro-environmental factors such as suppliers, buyers and threats from other industries. Therefore, the following section will apply Porter's Five-Forces Model to explain how micro-environmental factors function in housing development in China.

3.6.2 Porter’s Five-Forces Model

An industry is a group of firms that supply products and services in the market. There is a tool used by individual firms to evaluate the competitive environment, namely the Five-Force Model. In *Competitive Strategy*, Michael Porter (1980: 3) introduces this model to analyze the competitive environment of a firm. Although the relevant environment is broad, competition in an industry is rooted in its underlying economic structure and goes well beyond the behaviour of current competitors.

The state of competition in an industry depends on five basic competitive forces, which are shown in Figure 3.3 (see next page).
In Figure 3.3, the five basic competitive forces are identified as: potential entrants, suppliers, buyers, the threat of substitution and industry competitors. The collective strength of these forces determines the competitive situation of a particular industry (Porter 1980: 4). However, each individual industry has its own specialty, and the strength of the five competitive forces differs from one industry to another.

According to Wiley (1977), housing is immobile in contrast with other commodities. Housing is visible and fixed and cannot be moved from one city to another. In other word, houses cannot be substituted with other goods. As
discussed earlier, the Chinese government plays an important role in housing industry development. Its specific legislation and regulatory programmes add to consumer prices and skew the costs of doing business. With regard to the significant role of government function in the housing industry, the threat of substitution is shifted to a threat of government. This will be discussed in turn.

**Force One: The Intensity of Rivalry among Existing Competitors**

According to Porter (1980: 17), rivalry among existing competitors takes the familiar tactics such as price competition, advertising battles, product introductions, and increased customer service or warranties. Rivalry occurs because one or more competitors feel the pressure or see the opportunity to improve their position. In most industries, competitive moves by one firm have noticeable effects on its competitors and this may incite retaliation or efforts to counter the move.

Rivalry in the housing industry takes the form of prices, quality, quantity and design. Mingquan Jin (1996) and Fan (2000) describe a situation whereby the housing industry in China is still at a low level compared with other developed countries. In spite of housing development being influenced by the policies imposed by government, the low rate of technology transfer, unqualified work and the lack of large-scale enterprises are also key factors.

In addition, the housing industry in China is facing foreign investment participating directly in the competition (Fan 2000). Foreign competitors have advantages such as capital, advanced technology and sale experiences. These all accelerate the competition in the housing industry. Therefore, Chinese firms should strengthen their competitive capacity in order to keep their market shares. For instance, capacity must be added in large increments in order to realize economies of scale.
Force Two: The Bargaining Power of Suppliers

As Porter (1980: 27) puts it, suppliers can exert bargaining power over participants in an industry by threatening to raise prices or reduce the quality of purchased goods and services. Powerful suppliers even can squeeze profitability out of an industry unable to recover cost increases in its own prices.

Suppliers for housing construction in China mainly include three key inputs: land, capital investment and construction material as Fan (2000) suggested. Correspondingly, government, financial institutes and manufactures of construction material provide these inputs. Because the land in China belongs to the state, real estate developers pay for the right to use land in a particular period, normally 50 to 70 years. This is dependent on the categories of property.

According to Jin (1996), urban land for housing in China can be gained by real estate developers in the form of an agreement with the municipal land bureau, and real estate developers obtain urban land for free. This caused corruption and speculation in the provision of urban land. As mentioned earlier in this chapter, a tract of land can even be speculated on more than four times in some provinces. This was no doubt made possible because of inequality in the competition. Currently, the competitive-bidding system and auctioning become the major forms of land transfer. Transparency and equality will be improved during the process of land transfer. Enterprises with large-scale, good brand names and qualified staff will possess an advantage in the competition.

Fan (2000) reveals that real estate developers can obtain funds from their own capital, bank loans, foreign capital investment and housing sales in
advance. Currently, by transferring ownership of housing from the government to the citizenry, China seeks to stimulate the domestic demand for housing (Ministry of Construction Industry 1999a, 1999b). In addition, entry of foreign financial institutions in the Chinese financial market provides an external environment for real estate developers in the form of the capital. These factors can offer an opportunity for housing development in China.

As regards building material manufactures, Fan (2000) suggests that building material of a new type and good quality imports from overseas can stimulate competition in the market share. This is not only lowering the development costs, but also improving housing quality.

**Force Three: The Bargaining Power of Buyers**

Porter (1980: 24) comments that buyers compete with the industry by forcing down prices, bargaining for higher quality or more services, and by playing competitors off against each other – all at the expense of industry profitability. The power of each of the industry’s important buyer groups depends on a number of characteristics of its market situation and on the relative importance of its purchases from the industry compared with its overall business.

Housing is extremely durable and expensive compared with other commodities (Wiley 1977). Real estate developers are required to supply products with good quality and service at a reasonable price for target group (Meng 1996). The adequate housing structure is one key reason with regard to housing development in China.

Xiaosu Meng (1996) mentions that new housing construction in China will keep averaging three billion square metres every year from now to 2010. This
huge housing demand in China will no doubt offer a big opportunity for housing industry development. This will not only improve living standards of urban households, but also contribute to the national economic development.

**Force Four: Government Intervention**

In general, as Porter (1980: 23) puts it, firms in an industry are competing with industries that produce substitute products. The specific physical attributes of housing such as immobility and uniqueness determine that housing cannot be substituted by other goods (Wiley 1977). With regard to housing development in China the government plays a crucial role by the policies it adopts.

In considering government activity in China, government in housing development will be distinguished by three different functions (Chen & Wu 2000):

(1) Government acting in the macro-economy. This refers to government regulating the economy through economic, legislative, and administrative instruments.

(2) Government acting in the micro-economy. State-owned enterprises participate in the competition for housing which can be considered as government’s micro-economic regulation and influences the micro-economy.

(3) Government acting in the provision of urban land. In China, urban land belongs to the state, which means government has a monopoly in the land market. Government plans land use at different levels of the land bureau.

The analysis above reveals that government function in housing is more
important than in other industries.

According to Chen and Wu (2000), government’s macro-economic regulation in housing can be described as follows:

(1) Regulation in demand and supply. This requires that government regulations not only balance the total supply and total demand in housing, but also keep housing construction at a reasonable level. Government activity can adjust the housing demand through stimulation or restriction consumption and investment. Government can also control provision of urban land to influence housing supply.

(2) Regulation directly and indirectly. Housing has a strong influence in economic development and people’s daily lives. Government should not give up direct housing regulation while indirectly regulating through tax, price, finance and investment in housing. Particularly, housing development in China has not yet been in a mature period, so direct regulation by government is still necessary.

Government function is mainly reflected in macro-economic regulation in housing which determines the success and failure of real estate developers’ operation. In addition, state-owned enterprises participate in competition and government’s monopoly in the provision of urban land also affects housing development. The conclusion can be drawn that scientific and reasonable government activity is essential to sustain healthy and rapid housing development in China.

**Force Five: The Threat of Entry**

Porter (1980: 7) explains that new entrants to an industry bring new capacity,
the desire to gain a market share and substantial resources. The threat of entry into an industry depends on the barriers to entry that are present, coupled with the reaction from existing competitors that the entrant can expect. Generally, an industry with high profit always attracts firms from other industries to enter into competition with existing firms.

According to Chen and Wu (2000), the housing industry should have an average profit level in developed countries. However, the housing industry in China yields high returns compared with others. High returns will attract firms from other industries into getting involved in the housing industry. Foreign firms will also be attracted into the housing market in China because of high profits. Competition in the housing industry will cause some firms with disadvantages to go bankrupt. Aggravated competition in the housing industry in China can raise the level of real estate developers as a whole.

This analysis shows how the five forces have impacted the housing industry in China. As regards urban housing reform implementation in China, the welfare housing distribution system has been abolished. Employees have to solve their own housing problems in the housing market. This will alleviate the financial burden on both government and on the work units in the provision of housing to employees. Meanwhile, laws and regulations in China have been improved, which should eliminate any threat of government involvement.

In addition the pressure from buyers in the short-term seems not to predict increase with regard to its huge demand in housing. Correspondingly, despite the scarcity of land, the financial environment will ease and building material enterprises will also be strengthened to meet the demand for housing development. Competition among firms in the housing industry will depress profits to average levels. Because of the characteristics of large capital investment and returns over long periods of existence in the housing industry,
new entrants will be restricted from the housing industry by these barriers.

The analysis of these five forces has shown that opportunities and threats coexist in the housing industry in China. The huge housing demand in China will stimulate housing development and its contribution to the national economy. However, foreign firms entering the housing market will aggravate the competition. There is no doubt that some real estate developers in China with small scale and low technology will be hurt. Sustainable and healthy housing development in China is an important subject to focus on.

### 3.7 CONCLUDING REMARKS

This chapter has reviewed the welfare housing distribution system implemented in China since the CCP took power. In the pre-reform period, urban housing distribution in China was under a work-unit-based system. The government of China had a monopoly in housing construction investment. Work-units and municipal housing bureaus responded to the supply of houses for employees at low rent, which accounted for two percent of monthly income of employees. The rent paid by employees was not even enough for housing maintenance.

In addition, China applied a Soviet model in its national economic development before the economic reform launched in 1978. Under socialist ideology housing was considered as non-productive goods and only received a limited investment for housing construction. As regards the rapid growth of the population in China, the shortages and crowding in housing started in the 1970s. The living space in China was only 3.6 m² per capita in 1977 the year before economic reform. The urban welfare housing system in China failed to meet the housing needs of urban households.
Urban housing reform in China was started by the central government in 1984. The process of urban housing reform in China was distinguished by five different phases analyzed earlier in this chapter. The success and failure of the reform programme in different periods was also explored. During the urban housing reform in China real estate development suffered from over-expansion, a double surplus in the housing market and low house purchase ability that impeded housing development. This situation eventually was reversed in 1998, during which year the welfare housing distribution system in China was abolished.

Urban housing reform in China provided the stage for housing industry development. The housing industry in China has grown from virtually nothing since the urban housing reform implementation. Housing development in China has experienced recovery, speedy development and stable development periods as mentioned in this chapter. The urban public housing accumulation fund, affordable housing and the Anju projects implemented in China have also been discussed as has their contribution to commercialization and socialization of urban housing.

Apart from the impact of various policies in housing, this chapter has also looked at the effect of the external environmental factors in housing development. PEST analysis and Porter’s five forces model have been used to measure the external environmental factors’ effect in housing development in China. As regards the physical attributes of housing and government’s important role in housing development in China, the threat from substituted goods was replaced by government’s function to analyze macroeconomic environmental factors in housing development in China.

Based on the analysis in this chapter, housing industry development in China has not only improved the living standard of urban households, but also plays
an important role in national economic development. The availability and quality of housing are major indicators of a society’s standard of living and the level of economic and social development (Salam 1978: 3). Housing demand can only be achieved by sustainable and stable economic growth. Chapter 4 will look at the relationship between housing development and the national economy.
CHAPTER 4

THE RELATIONSHIP BETWEEN HOUSING DEVELOPMENT AND THE NATIONAL ECONOMY

4.1 INTRODUCTION

In Chapter 3, the dynamics of housing development in China since 1949 were discussed. The course of housing development in different periods and the implementation of different policies were also analyzed. Supply and demand theory explained how the housing market performed in China. This chapter examines the relationship between housing development and the national economy.

Housing and the housing industry have a direct and substantial impact on any national economy. Housing development does more than shelter people from wind and rain. For example, housing development in the USA (United States of America) in 2002 pulled the country’s economy out of an economic slump (anon 2002: 11). The housing market continues to perform an important role in economic activities, and the booming housing industry in China is a key factor keeping the average growth of the GDP at eight percent over the last 20 years (Zhu 2003: 142).

In this chapter Rostow’s (1960) model of the stages of economic growth will be used to measure housing development in China. Rostow’s stages of growth are defined as follows: the traditional society, the preconditions for take-off, the take-off, the drive to maturity, the age of high mass consumption, and beyond consumption. These states assume that, at particular periods,
different sectors of the national economy will each play a strategic role in the
determination of the overall growth rate of an economy.

Rostow believes that all countries go through each of these stages fairly
linearly, and he has mapped a number of conditions that are likely to occur in
investment, in consumption and in the social trends at each stage. Rostow
recognizes that in terms of human motivation, many of the most profound
economic changes must be viewed as the consequence of noneconomic
human motives and aspirations. Rostow insists that although his “stage of
growth” is an economic way of looking at whole societies, it does not imply
that the worlds of politics, social organization, and of culture are a mere
superstructure built upon and derived uniquely from the economy (Meier 1989:
70).

According to Gerald Meier (1989: 71), “Stage-making” approaches are
misleading when they succumb to a linear conception of history and imply that
all economies tend to pass through the same series of stages. A country may
attain a later stage of development without first having passed through an
erlier stage, as stages may be skipped, and different types of economies do
not have to succeed or evolve from one another.

As Meier (1989: 72) expressed, the “analytic backbone” of Rostow’s argument
is “rooted in a dynamic theory of production”, and he believes that his set of
stages reveals a “succession of strategic choices” that confronts a country as
it moves forward through the development process. Rostow’s thesis assumes
a strong bias towards a western model of modernization. It de-emphasizes
any differences in how leading sectors develop in free and controlled markets.

However, Rostow’s consideration of non-western cases such as China shows
that, to some extent, modernization can be achieved in different ways and
through free market or controlled economic means and still fit into his model (anon 2006). Based on Rostow's view, this chapter discusses why and how the housing industry in China could be a leading sector in the national economy.

In general, business activity is cyclic in nature (Downs 1991). Periods of economic expansion or contraction may be short-lived or go on for many years. A series of troughs and peaks represents the business cycle over time. There is also a cyclic nature to other businesses as well as to housing development. Because housing is included in the real estate business cycles, a comparison of the business cycle and the real estate cycle will also be included in this chapter.

4.2 THE STAGE OF ECONOMIC DEVELOPMENT

As mentioned above, Rostow (1960: 307) suggests that countries pass through the following six stages of economic development: the traditional society, the preconditions for take-off, the take-off, the drive to maturity, the age of high mass consumption, and beyond consumption (the stage of take-off is recognized as a crucial and tough period for economic development). The following section looks at each stage separately.

Stage 1 The Traditional Society

In this stage the central economic fact of traditional societies is limited production functions. The economy is dominated by subsistence activity where output is consumed by producers rather than traded. Any trade is carried out by barter where goods are exchanged directly for other goods. Agriculture is the most important industry and production is labour intensive,
using only limited quantities of capital. Resource allocation is determined very much by traditional methods of production (Rostow 1960: 311).

**Stage 2  The Preconditions for Take-off**

The initial preconditions for take-off were created in Western Europe. The gradual evolution of modern science and the modern scientific mindset with its lateral innovation came with the discovery of new lands and the rediscovery of old lands. Meanwhile, increased specialization generated surpluses for trading (Rostow 1960: 312).

Technically, the preconditions for sustained industrialization have generally required radical change in three non-industrial sectors. Firstly, the society builds up the transport infrastructure to support trade. Secondly, a technological revolution is implemented in agriculture. Thirdly, an expansion in imports is financed by the more efficient production. Furthermore, as incomes, savings and investment grow, entrepreneurs emerge. External trade also occurs, concentrating on primary products (Rostow 1960: 312).

An example of a nation in the second stage of the Rostow model is the Philippines. However, the economy still needs more development in order for it to be self-supporting. For a nation to have a self-sustaining economy (the third stage of the Rostow model), an increase in secondary sector employment leading to an increase in development within the country is necessary (anon 2006).

**Stage 3  The Take-off**

Take-off occurs when sectors-led growth becomes common and society is driven more by economic processes than by traditions. At this point
industrialization increases with workers switching from the agricultural sector to the manufacturing sector. Growth is concentrated in a few regions of the country and in one or two manufacturing industries. The level of investment reaches over 10% of GNP (Rowtow 1960: 317).

In the take-off stage investment acts as a stimulus for more investment and leads to strong growth in foreign investment with foreign investors taking advantage of the low wage rates. The economy begins to diversify and secondary sector employment increases dramatically but there is still limited growth within the service industry (Rostow 1960: 317).

There is an increase in government expenditure and this leads to large-scale investment in infrastructure, which in turn increases the economic stimulus. Vietnam and Thailand are good examples of nations currently in the take-off stage of the Rostow model (anon 2006).

Economic transitions are accompanied by the evolution of new political and social institutions that support industrialization. Sustained economic growth depends on the repetition of a series of leading sectors. Growth is self-sustaining as investment leads to increasing incomes, in turn generating more savings to finance further investment (Rostow 1960: 318).

By and large, the maintenance of momentum for a generation helps a society to grow and to concentrate its efforts on extending modern technology beyond the sectors modernized during take-off.

**Stage 4  The Drive to Maturity**

In stage 4 the economy of a country is diversifying into new areas. The society has effectively applied the range of modern technology to the bulk of its
resources. Technological innovation is providing a diverse range of investment opportunities and the economy is producing a wide range of goods and services with less reliance on imports (Rostow 1960: 318).

During the drive to maturity new leading sectors gather momentum to supplant the older leading sectors of the take-off. The reason is that former leading sectors have increasingly slowed the pace of expansion (Rostow 1960: 318).

As societies move to technological maturity the proportion of the population in agriculture and rural life decreases. In addition, within the urban population the proportion of semi-skilled and white-collar workers increases (Rostow 1960: 318).

The fourth stage of development within the Rostow model is a clear move towards a nation eventually having a self-supporting economy. In this stage the economy becomes increasingly diversified and is less reliant foreign investment because there is enough capital formation within the country (Rostow 1960: 318).

The character of leadership in industry begins to change as well. The take-off is usually managed by relatively modest, creative men with an insight as to how output in any sector can be radically expanded. In this stage men take over with more grandiose visions with a more acute sense of scale and of power (Rostow 1960: 318).

The multiplier effect also becomes active within the fourth stage which means that there is an increase in government expenditure to enlarge industries and attract similar industries for industrial agglomeration. Rapid urbanization occurs and there is a significant decrease in the rural population. Malaysia,
China, Argentina and Chile are all countries within the fourth stage of the Rostow model (anon 2006).

**Stage 5  The Age of High Mass Consumption**

In the fifth stage of economic growth a country’s economy is geared towards mass consumption. The consumer-durable industries flourish. The service sector becomes increasingly dominant. This stage of the Rostow model is the stage in which a country has a self-sustaining economy (Rostow 1960: 325).

**Stage 6  Beyond Consumption**

Societies in stage six pay more attention to the quality of life rather than other societies. Compound interest is bringing some societies, for example, USA, Japan, close to this point. The pursuit of food, shelter, clothing, as well as durable consumer goods and public and private services no longer dominate people’s lives. A new and revolutionary set of choices is being offered, or is a mere generation or so over the horizon (Rostow 1960: 326).

**4.3 TAKE-OFF AND THE LEADING SECTORS**

The stage of take-off consists of the achievement of rapid growth in a limited group of sectors where modern industrial techniques are applied. Agricultural processing, oil, import-substitution industries, ship-building, and rapid expansions in military output help to provide the initial industrial surge. Therefore, rapid growth of a country’s economy will depend on the repetition of a series of the leading sectors. For example, in Great Britain, leading sectors such as cotton, pig iron, steel and engineering industries repeated each other’s contribution to the country’s economic development.
4.3.1 The stage of take-off

Of Rostow’s (1960: 317) six stages of economic growth, take-off is regarded as the most crucial in the process of economic development. In Rostow’s view take-off is defined as an industrial revolution. This process is tied directly to radical changes in method production over a relatively short period of time (1964: xvii).

The three common characteristics of the take-off stage explicitly listed by Rostow (1960: 280) are:

- A rise in the rate of productive investment from five percent or less to over 10 percent of national income (or net national product);

- The development of one or more substantial manufacturing sectors with a high rate of growth;

- The existence of political, social or institutional framework which exploits the impulse to expansion in the modern sector as well as the potential effects of the take-off on the external economy which maintains ongoing growth.

Rostow (1964: xvii) expresses the opinion that ‘the rapid growth of one or more new manufacturing sectors is a powerful and essential engine of economic transformation. The new productions’ functions of high productivity that grow in such sectors not only raise output per head but also plough it into highly productive investment’. Countries such as Great Britain, Germany and America have examined Rostow’s contribution to the countries’ economic development.
In Rostows’ view, the take-off stage requires enlarged urban areas whose population and market organization help to make industrialization an ongoing process. Eventually, the process helps to produce new leading sectors when the initial impulse of the take-off’s leading sectors begins to wane (Rostow 1960: 280).

4.3.2 The essentials of the leading sectors

In Process of Economic Growth Rostow (1960: 261) reveals two simple facts in the growth patterns of economies:

(1) Growth rates in the various sectors of the economy differ widely over any given period of time.

(2) Over all growth appears to be based at certain periods on the direct and indirect consequences of extremely rapid growth in certain particular key sectors.

Sustained economic growth can be held constant by the introduction of new production functions. This means that the performance of an economy imparts rapid growth to a limited number of sectors. The particular sector plays a disproportionate role in growth. In this view there are three characteristics of the leading sector:

(1) It effectively absorbs the new technology;

(2) It has a highly increased rate itself; and

(3) It drives the growth of the rest of the economy spreading beneficial effects.
There are three spreading effects to meet the conditions of being a leading sector. These effects are: backward, lateral and forward (Rostow 1964: 3).

**Backward Effects**

The development of the new leading sector sets up requirements for new inputs of raw materials and machinery. For example, modern cotton textiles stimulated the manufacture of textile machinery and steam engines.

**Lateral Effects**

The lateral effects are defined as those in a society affected by the development of the leading sector. The leading sector will induce around it a whole set of changes which tend to reinforce the industrialization process on a wider front. The entrance of a new leading sector can often transform the whole region. The cotton textile revolution transformed Manchester and Boston, while the automobile industry transformed Detroit. As a result urbanization is accelerated during the take off as lateral effect.

**Forward Effects**

New industrial activity, new technology, new material and new energy were introduced by the leading sectors. The leading sectors created incentives and open up possibilities for a wide range of new economic activities. Sometimes the leading sectors could set the stage for the next major leading sector. The expansion of the cotton textile industry in the eighteenth century in Britain directly and powerfully increased incentives to free cotton manufacture from its dependence on water power. This process thus increased the incentive to develop the transportation industry (Rostow 1964: 6).
The combination of these three types of spreading effects from rapidly growing sectors resulted in new production functions. Repetition of the leading sectors ensured sustained economic growth. These effects also justify empirically the notion of “leading” sectors in economic growth.

4.4 HOW THE HOUSING INDUSTRY COULD BE THE LEADING SECTOR

The analysis of the take off stage explored the importance of this set of leading sectors in sustained economic growth. Three basic characteristics have to be satisfied by leading sectors, namely backward effects, lateral effects and forward effects. These spreading effects thus provide an assessment of the housing industry as to whether or not it is a leading sector. The three spreading effects in the housing industry are displayed in the following diagram.

**Figure 4.1**

The spreading effects of the housing industry

Source: adapted from *China State Statistic Bureau 1998*
Firstly the backward effects in the housing building industry could be explained as followings: for example the housing development stimulates demands for steel, cement, timber, chemicals, petroleum, mechanical engineering, light industry and metallurgy industries, etc. These drive the development of those industries as well. Meanwhile, the requirement for quality in the houses stimulated development of new products: thermal insulation material, protection against radiation, waterproofing material and fire-retardant material. These industries thus go through the rapid growth process.

A rapid increase in output results from a decrease in the costs of production of an old product or the introduction of a new product with high price (or income) elasticity of demand. These industries move on to absorb and apply new production functions – progressively spreading the techniques that modern technology can offer. As a consequence, the housing industry increases its ability to absorb new technology.

Secondly, the lateral effects of the housing industry cause: 1) an improvement of the people’s living conditions; 2) an upgrading of the shopping and travelling environment; 3) the stimulation of urbanization (for example, housing development created new cities such as Shenzhen and Haikou, and renewed old cities like Beijing and Tianjin); and 4) an enhancement of the civilization levels of society (through a densification of social and human capital); 5) leading to more individualistic and socially fluid ways of thinking.

Finally, the forward effects are manifested in the housing industry as an accelerated development of the building industry, transportation industry, communications industry, finance industry, services industry, and entertainment industry so on.
After analyzing the above principles and combining the characteristics of the housing industry, the conclusion could be drawn that the housing industry should become the leading sector.

4.5 **THE HOUSING INDUSTRY COULD BE THE NEW ENGINE OF THE NATIONAL ECONOMY IN CHINA**

According to Rostow (1964: 9), if a society is to sustain a high average rate of growth, it must engage in a series of endless leading sectors against deceleration. The flow of modern science and technology may offer the potentiality for fend off diminishing returns. The society which wishes to exploit this potentiality must repeat the introduction of new production functions as the old leading sectors decelerate. In this sense sustained growth requires the repetition of the take off process.

4.5.1 **The reasons why China needs to foster a new growth engine**

In the ongoing dramatic social, political and economic transition of China, the housing sector has an even more important role to play. This is because the housing sector itself has to drastically endure a systematic transformation. In addition, the economic reform in China is reaching a critical point.

Impacted by the East Asian economic crisis and the heavy flooding in 1998 (anon 2005), the Chinese economy experienced an ordeal (1998-2001). Domestic consumption was sluggish; unemployment was rising and so on. The central government had to adopt a series of policies to increase investments, stimulate consumption and enhance domestic demand so as to ensure steady economic growth. One major strategy was to invigorate urban housing development (anon 2005).
The former premier, Zhu Rongji, who made housing reform a top priority, was hoping a newly emergent private housing market would stimulate domestic demand (anon 2005). As a public policy to stimulate domestic consumption and recover the stage of the economic cycle the housing development is very significant to the national economy in terms of its share of GDP.

In Figure 4.2 Sally Goerner’s S-curve concept fully explains economic performance in China. This theory analyses how natural energy accumulates, grows and breaks at the turning point. The economic activities could go through two routes after the fragility zone. The system either reaches a new level and becomes a more intricate organization or breaks into parts and the system collapses (anon 2005).

**Figure 4.2**

*Sally Goerner’s S-curve Concept*

Source: adopted from *China’s urban housing reform – with specific emphasis on property ownership* 2005
As a subsystem of the Chinese economy, the housing sector is a critical component in the process of driving the Chinese economy to reach a new level. The economy in China struggled in the fragility zone in 1998 and extra energy was necessary to push the system onto a new level. Activities in the housing sector could play an important role (anon 2005).

4.5.2 The housing sector could be the new engine of the national economy in China

According to Meng and Liang (2000), there should be increased investment in order to sustain rapid economic growth. In China there are two fields to implement momentum of investment: firstly there is infrastructure construction; and secondly there is housing development.

Infrastructure construction includes railways, highways, bridges, large-scale water conservancy facilities and power stations. The investment in all these categories will provide a strong momentum to drive national economic growth. However, the problem is that the capital invested in infrastructure will take years before yielding a return. Furthermore, the large amounts of capital investment are supported by the banks. This inevitably causes bad debt and financial risk. However, raising prices would contribute to a higher inflation rate (Meng & Liang 2000).

Investment in the housing industry could drive the consumption of huge amounts of construction materials and create employment opportunities in areas such as railways, in highways and in water conservancy. In addition, housing construction is able to yield investment returns in a short period depending on the housing market. This need not necessarily cause high inflation while realizable a circle in virtuous funds performance (Wang 2000).
In daily human life there are usually four basic needs: food, clothes, housing and transport. Consumption of these is another aspect of momentum driving economic growth. In China, in the early days of the economic reform period, economic growth mainly depended on satisfying citizens’ needs for “food and clothes” which are basic needs for people’s survival. Demands for these kinds of goods are enormous. Therefore, the large-scale demands have sustained economic growth at a high average rate since economic reform (economic reform started in 1978) in China.

The citizens in China, especially urban residents were adequately satisfied in regard to food and clothing in the middle of the 1990s (Yin 1998). This resulted in a decrease in demand from the relevant industries. The situation could be expressed by the Engel coefficient decreasing. Table 4.1 shows what the relationship is between the Engel coefficients with housing consumption at different levels of the GDP.

Table 4.1
GDP per capita and the relationship between the Engel coefficients and percentage of housing spending

<table>
<thead>
<tr>
<th>GDP</th>
<th>Housing spending ( % )</th>
<th>Engel coefficients ( % )</th>
<th>Housing spending ( % )</th>
</tr>
</thead>
<tbody>
<tr>
<td>250</td>
<td>8.66</td>
<td>60</td>
<td>7.43</td>
</tr>
<tr>
<td>500</td>
<td>9.04</td>
<td>55</td>
<td>7.87</td>
</tr>
<tr>
<td>750</td>
<td>9.30</td>
<td>50</td>
<td>8.33</td>
</tr>
<tr>
<td>1000</td>
<td>9.50</td>
<td>45</td>
<td>8.81</td>
</tr>
<tr>
<td>1500</td>
<td>9.83</td>
<td>40</td>
<td>9.32</td>
</tr>
<tr>
<td>2000</td>
<td>10.10</td>
<td>35</td>
<td>9.86</td>
</tr>
<tr>
<td>5000</td>
<td>11.29</td>
<td>30</td>
<td>10.45</td>
</tr>
<tr>
<td>20000</td>
<td>12.79</td>
<td>25</td>
<td>11.11</td>
</tr>
<tr>
<td>15.39</td>
<td>20</td>
<td>11.87</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>15</td>
<td>12.83</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>14.16</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: adapted from Muradzikwa, Smith and Villiers (2004). The international comparative analysis in housing spending
The German statistician, Engel (Muradzikwa et al 2004: 190) developed the income - consumption curve. The curve explains how the quantities of inferior goods (for example, food) will be exchanged at different income levels of the consumer. In other words, consumer spending on inferior goods would decrease when income increases. In Engel’s Law, the relationship between income and food consumption is that when a person’s income increases, the proportion spent on food will be decreased. According to Engel’s Law, the ratio of the food expense to the total expenses in one family or nation is the prime dimension to measure how rich the country is.

In 1995 the urban residents’ Engel’s coefficient was 52.25 percent. In 1998 this number fell to 44.8 percent and to 37.9 percent in 2001 (Yang et al 2000). As Swart (1981: 72) explains, housing as one of the basic needs of humans is also one of the most important indicators of a person’s standard of living or social wellbeing. After people are satisfied as regards food and clothes, housing would be next important thing needed to be possessed, and the percentage of the spending on housing will be increased.

Table 4.2
Percentage of population at midyear residing in urban areas in some countries: 1950-2030

<table>
<thead>
<tr>
<th>Counties</th>
<th>Percentage of urban population in total</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1950</td>
<td>1970</td>
<td>2000</td>
<td>2030</td>
</tr>
<tr>
<td>China</td>
<td>12.5</td>
<td>17.4</td>
<td>35.8</td>
<td>60.5</td>
</tr>
<tr>
<td>Japan</td>
<td>34.9</td>
<td>53.2</td>
<td>65.2</td>
<td>73.1</td>
</tr>
<tr>
<td>Germany</td>
<td>71.9</td>
<td>79.6</td>
<td>87.5</td>
<td>91.9</td>
</tr>
<tr>
<td>United States America</td>
<td>64.2</td>
<td>73.6</td>
<td>79.1</td>
<td>86.8</td>
</tr>
<tr>
<td>World</td>
<td>29.1</td>
<td>36.0</td>
<td>47.1</td>
<td>60.8</td>
</tr>
</tbody>
</table>

Urbanization as the process of agglomeration of people and resources contributes to economies of scale and economic efficiency (World Bank 2003). The rural population of the world continues to be concentrated in developing countries. China has the biggest population in the world. The growth rate of the urban population of China is far lower if compared with more developed regions. The diagram above shows the rate of the urban population in China 1950-2030 in comparison with other countries.

The benefits of urbanization in China could create a favourable environment for housing development (Yin 1998). Housing the migration (rural to urban) is the huge challenge for China at present and in the future. This is the reason why the housing sector has become the new engine of the economy.

According to Yin (1998), the new engine of the economy refers to one leading sector or sets of leading sectors in any period of the national economy. The development of these sectors could drive the high momentum essential to propel rest of the economy to long-term growth.

Evidence shows that housing development pervades the economy over a wide front (Meng & Liang 2000). The gap in the GNP per capita between $300-1000 turns the housing industry into a rapid-growth phase. Housing development thus upgrades the national economy. In 2001 the GNP per capita in China was 7543 yuan, about $900, at the right stage of the rapid-growth phase of housing industry development (CSSB 1998). According to Meng and Liang (2000), in China, the housing sector invests every 100 million yuan and this will affect 23 relevant industries and increase investment by 147.9 million yuan. This indicated the housing sector with the great backward effects.
Housing development has a positive impact on employment levels. The provision of low-income housing is especially labour-intensive employing workers from the surplus of unskilled labour in China. The housing sector has substantial multiplier effects as it largely uses locally produced materials. On the aspects of the balance of payments the housing sector also has an influence through imports used directly in housing construction (White Paper 2005).

Developed countries like the U.S.A (United States of America) take advanced modern industries such as the information and network sectors as their leading sectors. The reason is that the housing, automobile, electrical household appliances and highway industries etc. used to be the leading sectors during the process of the economic development in the U.S.A last century (Fan 2000). Currently, the demand for these productions has been largely satisfied. Economic growth has become stagnant due to a drop in demand. However, China is a developing country whose economy is going through the take-off stage. The housing sector could become the leading sector to sustain economic growth in this situation.

### 4.5.3 The housing sector could become the pillar industry of the national economy

The pillar industry and leading industry have different meanings. The leading industry relates to a country in which demand price and income elasticity of demand are much higher. Furthermore, the sector will induce a whole set of changes which in turn will tend to reinforce the industrialization process on a wider front (Rostow 1964: 5). A pillar industry refers to a few industries which hold a crucial place in the national economy. In addition, the industry in GNP possesses a relatively major proportion of the economy. The leading sector
emphasizes the leading and spreading effects, while the pillar industry underlines the proportion and share of the industry in the national economy.

Table 4.3
The percentage of the housing industry in GDP in 1998

<table>
<thead>
<tr>
<th>Countries and regions</th>
<th>United Stated America</th>
<th>Japan</th>
<th>Britain</th>
<th>French</th>
<th>South Korea</th>
<th>Tai Wan</th>
<th>Hong Kong</th>
</tr>
</thead>
<tbody>
<tr>
<td>proportion</td>
<td>11.4</td>
<td>10.4</td>
<td>12.2</td>
<td>10.8</td>
<td>8.0</td>
<td>10.9</td>
<td>19.0</td>
</tr>
</tbody>
</table>


In the Chinese *Ninth Five-year Plan and The Outline of Prospects in 2001* it was stated that the housing industry should be turned into the pillar industry (CSSB 1998).

There are four characteristics of being a pillar industry (CSSB1998):

(1) The products are of vital importance to the nation’s economy and the people’s livelihood;

(2) The demand for the products is sustained and huge;

(3) The industry’s backward and lateral spreading effects pervade the economy over a wide front, and

(4) The contribution to the economic growth is great (the percentage of GDP about 10-15 percent, illustrated in Table 4.3) and can offer great accumulation for the country (Chinese Statistic Year Book 1987-2002).
The housing industry in China could meet the first three conditions. The proportion in GDP is lower, about 2 percent as shown in Table 4.4 (Chinese Statistic Year Book 1987-2002). However, the proportion of the housing industry should show great improvement during the processes of industrialization and urbanization. This is exactly why the housing industry is taken to be a pillar industry.

Table 4.4

<table>
<thead>
<tr>
<th>Year</th>
<th>Tertiary industry/GDP</th>
<th>Housing industry/ Tertiary industry</th>
<th>Housing industry/GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1988</td>
<td>26.0</td>
<td>4.5</td>
<td>1.17</td>
</tr>
<tr>
<td>1989</td>
<td>28.1</td>
<td>4.2</td>
<td>1.185</td>
</tr>
<tr>
<td>1990</td>
<td>31.3</td>
<td>5.6</td>
<td>1.80</td>
</tr>
<tr>
<td>1991</td>
<td>33.4</td>
<td>5.1</td>
<td>1.70</td>
</tr>
<tr>
<td>1992</td>
<td>34.3</td>
<td>5.7</td>
<td>2.00</td>
</tr>
<tr>
<td>1993</td>
<td>32.7</td>
<td>5.7</td>
<td>1.80</td>
</tr>
<tr>
<td>1994</td>
<td>31.9</td>
<td>5.8</td>
<td>1.90</td>
</tr>
<tr>
<td>1995</td>
<td>30.7</td>
<td>5.9</td>
<td>1.80</td>
</tr>
<tr>
<td>1996</td>
<td>29.8</td>
<td>5.6</td>
<td>1.705</td>
</tr>
<tr>
<td>1997</td>
<td>32.1</td>
<td>6.1</td>
<td>2.00</td>
</tr>
</tbody>
</table>


* Housing industry in China is placed in the tertiary industry

4.6 THE FUNCTION OF THE HOUSING INDUSTRY

The housing sector is considered as the basic and leading sector in national economic development. Therefore, the housing industry could become the pillar industry and new engine of the economy. Housing contributes to a wide spectrum of benefits to the individual household, communities, businesses, as
well as to the national economy. Types of benefits that stem from housing investment include (White Paper 2005):

- Better health, due to improved living conditions
- Improved labour productivity regarding absorption of new technology
- Leading to further investment in the maintenance and upgrading of housing and the related infrastructure
- An increase in household’s privacy and an improved quality of life
- Creation of employment opportunities
- The creation of stable communities, contributing towards improved safety and security.

The housing sector is influenced by the broader economy of the country through its effects on the demand and supply of housing. The way in which the housing sector is critically linked to other economic sectors and role players can be described in three ways:

Firstly, real linkages refer to linkages between the housing sector and other sectors of the economy. Housing investment has real impacts on economic indicators such as fixed investment, savings, outputs, employment and prices. On the other hand, changes in these indicators also have a real impact on the housing sector and its performance.
Secondly, financial linkages are associated with the financing of housing and the related infrastructure through financial institutions. The inflation rate and real interest rates determine the supply of finance.

Finally, fiscal linkages concern taxation and the subsidization of housing and are the most direct means whereby state policy affects the performance of the housing sector.

These linkages mean that whatever happens in housing has a profound effect on what might happen in the other sectors of the national economy, and vice versa. The specific linkages in relation to the business cycle become relevant when considered in terms of the housing sector performance in the national economy as a whole.

4.7 THE RELATIONSHIP BETWEEN THE REAL ESTATE CYCLE AND THE BUSINESS CYCLE

The business cycle is represented by a series of troughs and peaks over time. Periods of economic expansion or contraction may be short-lived (a few months), or may go on for many years. One region of the country or the world will be affected more than another.

There are generally four successive stages in the business cycle – recession, depression, recovery and prosperity. The first two stages are considered the process of the expansion while the other two stages are indicated as the phase of the contraction (Downs 1991). Slowing business activity as a downward slope is a period of recession; a deep trough indicates depression. Beginning growth or recovery (an upward slope) culminates in prosperity (the peak).
In the market economy, the theory of demand and supply indicates that: when supply \(<\) demand \(\rightarrow\) the price increase \(\rightarrow\) make the profit \(\rightarrow\) stimulate enlargement of the investment \(\rightarrow\) expand production scale \(\rightarrow\) supply exceed demand \(\rightarrow\) price fall down \(\rightarrow\) profits are replaced by losses \(\rightarrow\) restrict investment \(\rightarrow\) decrease distribution of the products \(\rightarrow\) supply < demand. These various periods of inflation and deflation of an economy are known as the business cycle (Liu 1999).

According to Downs (1991), real estate is a significant portion of GNP. Real estate includes not only the housing sector, but also other categories of properties such as offices, schools and hospitals. The trend and prospect of housing development cannot be discussed without being affected by the others. First and foremost, real estate should be measured as a whole in its performance in the business cycle.

4.7.1 The business cycle and the real estate cycle

There is a cyclic nature to other business; there is also a cyclic nature to real estate which follows business counterparts. Like the business cycles discussed earlier, the real estate cycle has four components: recession, depression, recovery and prosperity.

Real estate demand depends on activity in other sectors of the economy for its motivation. As a result, real estate tends to lag behind the upward movements in the general economy (Downs 1991). Real estate also tends to exceed the heights of the peaks and depths of the troughs of the general economic cycle. This process of the interacting between the business cycle and real estate cycle will be shown as Figure 4.3 (see next page).
In Figure 4.3 the solid line indicates the business cycle; the broken line shows the real estate cycle which follows it. Slowing business activity (a downward slope) is characteristic of a period of recession. A deep trough indicates depression. An upward slope signals the beginning of growth or recovery. In the real estate cycle this reflects accelerated demand for rental space and increased new construction. The business cycle culminates in prosperity (the peak) which leads to new levels of overbuilding.

In the real estate cycle new construction declines is a result of overbuilding (a peak). During the process of overbuilding demand begins to decline, absorption slows and rents weaken further as building peaks. Recovery and prosperity are reflected in high occupancy levels, high rental rates, strong real sales, large amounts of money available to lend at acceptable interest rates.

and large volumes of new construction. Overbuilding is a consequence of prosperity which cannot last forever, and precedes and then coincides with recession.

During periods of economic recession and depression the real estate market thus undergoes adjustment – demand continues to decline both in numbers of sales and in prices while vacancies increase occupancy. Therefore, new building is decidedly slowed. Meanwhile the numbers of mortgage loans and currency values decline during periods of recession and depression. This is followed by stabilization in which demand begins to increase despite declining new construction. This makes inroads into the excess supply.

This coincides with the depths of recession or depression and is the real estate equivalent of recovery. The last stage is development. Prosperity returns to the rest of the economy. As a result occupancy is high, rents are rising and absorption levels are high. Demand accelerates and new construction is needed to meet the increased demand (Downs 1991).

The investment capital in real estate is a primary source of real estate development. This determines the level of real estate development. The section below analyzes the increase rate of investment in real estate and the increase rate of GNP also shows their cyclical nature.

In order to eliminate the seasonal changing, long-term and the irregular changing factors in the time series, three years movement average of the increase rate of investment in real estates and the increase rate of GNP will be calculated as shown in Table 4.5 (see next page).
### Table 4.5
The increase rate of the investment in real estate and the increase rate of GNP in China: 1987-2001

<table>
<thead>
<tr>
<th>Year</th>
<th>The increase rate of investment in real estate (%)</th>
<th>GNP increase rate (%)</th>
<th>The increase rate of investment in real estate (three years movement average (%))</th>
<th>GNP increase rate (three years movement average (%))</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987</td>
<td>48.4</td>
<td>11.5</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>72.0</td>
<td>11.3</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>9.4</td>
<td>4.2</td>
<td>43.3</td>
<td>9.0</td>
</tr>
<tr>
<td>1990</td>
<td>-7.1</td>
<td>4.2</td>
<td>24.8</td>
<td>6.6</td>
</tr>
<tr>
<td>1991</td>
<td>32.7</td>
<td>9.1</td>
<td>11.7</td>
<td>5.8</td>
</tr>
<tr>
<td>1992</td>
<td>117.6</td>
<td>14.1</td>
<td>47.7</td>
<td>9.1</td>
</tr>
<tr>
<td>1993</td>
<td>164.9</td>
<td>13.1</td>
<td>105.1</td>
<td>12.1</td>
</tr>
<tr>
<td>1994</td>
<td>31.8</td>
<td>12.6</td>
<td>104.8</td>
<td>13.3</td>
</tr>
<tr>
<td>1995</td>
<td>23.3</td>
<td>9.0</td>
<td>73.3</td>
<td>11.6</td>
</tr>
<tr>
<td>1996</td>
<td>2.1</td>
<td>9.8</td>
<td>19.1</td>
<td>10.5</td>
</tr>
<tr>
<td>1997</td>
<td>-1.2</td>
<td>8.6</td>
<td>8.1</td>
<td>9.1</td>
</tr>
<tr>
<td>1998</td>
<td>13.7</td>
<td>7.8</td>
<td>4.9</td>
<td>8.7</td>
</tr>
<tr>
<td>1999</td>
<td>13.5</td>
<td>7.2</td>
<td>8.7</td>
<td>7.9</td>
</tr>
<tr>
<td>2000</td>
<td>21.5</td>
<td>8.4</td>
<td>16.2</td>
<td>7.8</td>
</tr>
<tr>
<td>2001</td>
<td>25.3</td>
<td>7.0</td>
<td>20.1</td>
<td>7.5</td>
</tr>
</tbody>
</table>


In Table 4.5 the increase rate of investment in real estate was 48.4 percent. In 1990 this number fell to minus 7.1 percent. During periods of economic recession and depression the real estate market thus undergoes adjustment – demand continues to decline both in numbers of sales and in prices while vacancies increase occupancy. Therefore, new building is decidedly slowed. In 1993 the increase rate of investment in real estate was 164.9 percent. During the process of overbuilding demand begins to decline, absorption slows and rents weaken further as building peaks. The diagram (see next page) below shows the increase rate of investment in real estate and the GNP’s cycle performance.
Figure 4.4
Comparison of the increase rate of real estate investment and GNP

Source: adapt from CSSB. *China State statistic bureau 1998*

In Figure 4.4, A refers to the curve of the three-year average of the increase rate of investment in real estate. B indicates the curve of the three-year average of the increase rate of GNP. The real estate cycle is a part of the business cycle and shows the same curve approximately as the GNP does. The direction of the fluctuation is the same and the length of the cycle is roughly the same. The real estate cycle however displays different characteristics in terms of the fluctuation scope. The fluctuation scope in real estate is larger than in GNP.

It is evident that the real estate development slows down while investment capital fluctuates sharply. Therefore the objectives of macroeconomic policies are to diminish the fluctuation in order to sustain stable socio-economic development. The macroeconomic policies primarily seek a dynamic balance between demand and supply.

4.7.2 An analysis of the housing industrial cycle

The section above discussed real estate performance in the national economy, considering that the housing industry is a significant part of real
estate. Annual house sales will be investigated in which the cyclic nature of the housing sector in the economy will be demonstrated.

According to Wu, Ye and Zhou (2002), the characteristics of the housing industry in China are explained as shown below:

- The average growth was 15.9 percent of the annual house sales during 1987-2001, which is higher than the growth rate of GNP (average 8 percent).

- The housing industry showed a cyclic fluctuation as shown in Figure 4.5. The fluctuation period was 6 years from 1991 to 1997. Housing development was in a trough in 1997. The recovery started in 1998 with the launching policies of privatization in public housing.

- Increasing house sales did not mean a rise in the housing cycle such as occurred in 1990 and 1991.

**Figure 4.5**

The cyclic curve of the housing industry

Table 4.6

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual sales</th>
<th>Annual sale exponential function</th>
<th>Annual sales fluctuation</th>
<th>Annual sales fluctuation rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1987</td>
<td>2627.24</td>
<td>2147.44</td>
<td>549.80</td>
<td>0.256</td>
</tr>
<tr>
<td>1988</td>
<td>2927.33</td>
<td>2517.48</td>
<td>409.85</td>
<td>0.163</td>
</tr>
<tr>
<td>1989</td>
<td>2855.36</td>
<td>2951.32</td>
<td>-95.96</td>
<td>-0.033</td>
</tr>
<tr>
<td>1990</td>
<td>2871.54</td>
<td>3459.90</td>
<td>-588.36</td>
<td>-0.170</td>
</tr>
<tr>
<td>1991</td>
<td>3025.36</td>
<td>4056.13</td>
<td>-1030.67</td>
<td>-0.254</td>
</tr>
<tr>
<td>1992</td>
<td>4288.86</td>
<td>4755.09</td>
<td>-466.23</td>
<td>-0.098</td>
</tr>
<tr>
<td>1993</td>
<td>6687.91</td>
<td>5574.51</td>
<td>1113.40</td>
<td>0.200</td>
</tr>
<tr>
<td>1994</td>
<td>7230.35</td>
<td>6535.13</td>
<td>695.22</td>
<td>0.106</td>
</tr>
<tr>
<td>1995</td>
<td>7905.94</td>
<td>7661.29</td>
<td>244.65</td>
<td>0.032</td>
</tr>
<tr>
<td>1996</td>
<td>7900.41</td>
<td>8981.51</td>
<td>-1081.10</td>
<td>-0.120</td>
</tr>
<tr>
<td>1997</td>
<td>9010.17</td>
<td>10529.24</td>
<td>-1519.07</td>
<td>-0.144</td>
</tr>
<tr>
<td>1998</td>
<td>12185.33</td>
<td>12343.68</td>
<td>-158.35</td>
<td>-0.013</td>
</tr>
<tr>
<td>1999</td>
<td>14556.53</td>
<td>14470.79</td>
<td>85.74</td>
<td>0.006</td>
</tr>
<tr>
<td>2000</td>
<td>18637.13</td>
<td>16964.46</td>
<td>1672.67</td>
<td>0.099</td>
</tr>
<tr>
<td>2001</td>
<td>22411.90</td>
<td>19887.84</td>
<td>2524.06</td>
<td>0.127</td>
</tr>
</tbody>
</table>

Source: adapted from China Statistic Yearbook, 1987-2002. (10 thousands)

A crisis in the housing market often breaks out sooner than in other markets. The situation in the housing cycle thus offers a warning signal for the national economy (Quigley 1999). The signals by international convention include:

(1) Supply far exceeds demand; vacancy rate is higher than 10 percent (the international standard considers that the warning line of the vacancy rate
is 10 percent of the total supply in three years). The unmarketable houses in Bangkok (capital of Thailand) were up to 44,390 units during the financial crisis in 1997. This number was more than 60 percent of the 73,550 new building units (Zhou, X & Zhou, L 1998).

(2) The ratio of rents to sale prices increases greatly. For example, in 1996 sale price increases were far ahead of rent increases (Quigley 1999).

4.7.3 Housing development coincides with national economic development

The development of the housing sector is closely related to national economic development. Housing is the barometer of the national economy. The relationship between housing development and economic growth is shown in Table 4.7 (Luo 1999).

<table>
<thead>
<tr>
<th>The economic growth rate</th>
<th>The real estate development</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; 4 %</td>
<td>Downturn</td>
</tr>
<tr>
<td>4-5 %</td>
<td>Stagnation</td>
</tr>
<tr>
<td>5-8 %</td>
<td>Stably development</td>
</tr>
<tr>
<td>&gt; 8 %</td>
<td>High speed development</td>
</tr>
<tr>
<td>10-15 %</td>
<td>Take-off</td>
</tr>
</tbody>
</table>


According to Longchang Luo (1999), the first industry to develop is the housing sector as the economy of a country enters prosperity. When the
economic depression appears in a country the housing industry and the construction industry are the first to suffer.

As Luo (1999) describes, the national economy of China experienced the average growth rate 8 percent (average growth rate 9.7 percent from 1979 to 1998, currently about 8 percent) since the economic reform. This evidence shows that the housing development in China is going through the stage of the rapid development as regards in Table 4.7.

Housing industry development is ahead of national economic development because the housing industry provides the infrastructure and properties for the rest of the economy. However, housing sector development should not only focus on rapid growth per se, but also adapt itself to other industries. In addition, housing development needs to consider the capacity of the economy. One of the most important objectives of housing development is to ensure healthy and sustainable economic development.

Housing development should coincide with development in the national economy as a whole. Housing development should not only take the development of scale and speed into accounts, but also consider the balance between supply and demand. There are various ways to achieve a balance between total supply and total demand and whereby stimulate or restrict capital investment and increase or decrease interest rates.

4.8 CONCLUDING REMARKS

The most cursory examination of the growth patterns of different economies reveals two simple facts regarding the general historical information to be found (Rostow 1960). Firstly, growth rates in the various sectors of the economy differ widely over any given period of time. Secondly, in some
meaningful sense, at certain periods, overall growth appears to be based on the direct and indirect consequences of extremely rapid growth in certain particular key sectors.

The key sectors in *The process of economic growth* are indicated by Rostow (1960) as the leading sectors. The leading sectors drive the economy as a whole forward. Sustained economic growth depends on a limited number of sectors, which manage to keep the average level of growth relatively steady on the momentum of individual sectors.

The housing industry in China could become the leading sector in economic development in the prevailing economic circumstances. However, the living standard of people urgently needs to be improved within the economic reforms taking place in China. As a result, the demand for housing will increase rapidly. In addition, the spreading effects of the housing sector will enable the housing industry to be the leading sector, while old leading sectors like exportation will experience.

The business cycle is best regarded as the direct and secondary consequence of surges forward in certain leading lines of investment in the national economy. Observing how housing development performs in the business cycle has shown that the housing sector adapts itself to national economic development. Housing development is not only concerned with the speed and scale of development. The marketplace is subject to the laws of supply and demand. Most important in the process of development is to balance supply and demand.

There are many factors that influence housing development. Changing the money supply to the volume of houses available for purchase affects the economy overall. The policies in the housing sector also have the power to
accelerate or decelerate housing development. It is evident that the government can play an important role in housing development. The effects of government intervention in the housing industry of China will be discussed in depth in the next chapter and relevant financial instruments will be explained interpreted in detail.
CHAPTER 5

THE ROLE OF THE GOVERNMENT IN THE HOUSING INDUSTRY

5.1 INTRODUCTION

In Chapter 4 Rostow’s (1960) model of the stages of economic growth was firstly used to interpret the crucial function of the leading sector in the national economy. In Rostow’s view, at particular periods, different sectors of the national economy will each play a strategic role in the determination of the overall growth rate of an economy. A sustained economic growth is dependent on the repetition of a series of leading sectors in the national economy. This model can also be used to explain the process of economic development in China.

Based on Rostow’s definition, the housing industry in China could become a leading sector and give momentum to economic growth. Because the housing industry in China is a leading sector, its relationship with the national economy is an important subject to deal with. In addition, housing development depends on activity in other sectors of the economy for its motivation. A comparative analysis of the business cycle and the housing cycle was examined in Chapter 4 to show how housing development is stimulated or restricted by national economic development.

In spite of the national economic development affect housing development in China, political factors as another aspect of macro-environmental factors can also influence housing development. As mentioned in Chapter 3, political factors can have a direct impact on the way business operates. Decisions made by government affect everyday lives and can come in the form of a policy or legislation, especially in housing development. For example, the
housing industry in China grew from nothing due to the implementation of urban housing reform policies.

The analysis of government function in housing is more important than in other industries discussed in earlier in this study. Government intervention in housing in China is one reason for fluctuating housing development. Also, housing development in China has not yet been in a mature period, so direct regulation by government is still necessary. The object of this chapter is to focus on the role of the Chinese government in housing.

According to Martinussen (1997), the role of the state in promoting or retarding development has been given increasing emphasis since the 1970s. More specifically, the form and function of the state in developing countries has been analyzed with greater conceptual specificity by social scientists. Development discourses and interventions are seen to be conditioned significantly by political processes and vested interests. The notion of a “soft state” was introduced originally by Gunnar Myrdal in the late 1960s (in Martinussen 1997: 221). The notion of soft state refers to the lack of social discipline within state and society in different ways:

- Deficiencies in legislation and in law observance and enforcement;
- Disregard by public officials at various governmental levels of the rules and directives handed down to them; and
- Collusion between public officials and powerful persons and groups, whose conduct these officials ought to regulate.

As Turner and Hulme (World Bank 1997: 183)) put it, there was a widespread brief among neo-liberals during the 1980s and 1990s, especially at an
international level. The state was considered as overextended and inefficient in the third world, which means its scope and operations needed to be reduced. However, the structural adjustment programmes for cutting state expenditure did nothing to improve state efficacy and often led to cuts in essential services. Also, the accompanying macro-economic policy perspectives tended not to supply the anticipated stimulus to the national economy; market forces proved more elusive than had been expected.

The East Asian experience shows that cutting back on the state and relying more on the market for solutions would not solve problems. The social scientists were motivated to reassess the role of the state in economic development in the mid and late 1990s. In this context, Giddens’s (1998, 2000) proposal of an alternative “Third Way” has been particularly influential.

There is now a greater appreciation of the potential role of the state in providing an enabling environment and intervening in coherent fashion to stimulate and guide economic development. This trend is in line with the World Bank’s 1997 World Development Report (World Bank 1997), where that institution introduced a change in the conception of the role of the state in economic development, stressing the need for the state to act as a key agent for development. The question remains whether housing should be the site of substantial intervention by government, especially in countries experiencing a process of transition of their economy.

Housing is different from other economic issues in many ways (Cullingworth 1967: 27). A house is extremely costly compared with other household purchases, and a house as a basic human need cannot be substituted by other goods. The large capital investment needed for new dwellings creates major difficulties for individuals. It is recognized that poorer households in any
society find it very difficult to afford adequate housing (Needleman 1967: 119).

In addition, housing has many of the characteristics likely to generate market failure in production and allocation. Therefore, mainstream economics provides a typology of the rationale for government intervention to achieve allocative and productive efficiency in a market system (Whitehead 2003: 138).

As Whitehead (2003: 139) describes it, the housing market does suffer from significant market failures, at least at the bottom end of the market. The most important sources of such failure are seen as arising from externals. The majority of direct externals relate to health matters since poor housing can encourage the spread of disease, although only at standards well below those prevalent in advanced countries. In this context much of the emphasis has been on a government regulatory framework that applies to all sectors. This helps determine location, density, design, building materials and occupation levels.

Maisel (1967: xvii) also mentions that the importance of government intervention in housing. As Maisel (1967: xvii) expressed it, housing may be regarded as a social issue whose ‘consumption’ should be subsidized. Housing is also a collective item whose impact extends far beyond the family circle. Therefore a public policy may be required in order to align differing private and social value judgments. This is why government in almost all countries has accepted that it has some responsibility for trying to overcome housing shortages and raise standards of accommodation.

Consequently, Darke and Darke (1988: 45) suggest that a government may have various reasons for being involved in the housing industry, such as the
maintenance of social order, promotion of quality for the population, encouragement of self-development, economic planning and collective equalization.

With regard to the reasons for government intervention in the housing industry as mentioned above (Darke & Darke 1988: 45), there are various regulatory measures that state intervention may take through provision, subsidy and regulations. For example there are economic measures, legislative measures and administrative measures. Among the economic measures, housing finance is a key factor for dealing effectively with the demand for housing

It is evident that housing development in China was influenced by the macroeconomic policies implemented as described in Chapter 3 and Chapter 4 (Kim 1990, Huang 2003, 2004). China had applied the Soviet model to develop the national economy from 1949. The state had a monopoly in the provision and allocation of housing. State intervention in housing was overextended and inefficient. This is why China launched its economic reform, which aimed to change the socialist economy into a market economy (Gu 2002). In the transition economy, the role of government in the national economy shifted away from full control to one of stimulating and guiding economic development through regulatory measures.

As Willis and Tipple (1991: 2) remark, housing development is not only measured by the numbers of buildings constructed, but also by its contribution to the economy as a whole. Government is encouraged to assist the current participants in housing production and to create conditions for the adequate production of shelter for all demand sectors. Therefore positive government intervention in the housing industry in China became necessary to ensure a healthy and sustainable national economic development.
In considering government activity in China in housing development, different measures have been employed: economic, legislative, administrative, informative and guidance measures (Adams & Watkins 2002, Fischer 1964, Dinc 1978). This chapter will look at each measure separately. In addition, with regard to the importance of finance as an instrument in housing development, there are three forms of housing finance in China: bank mortgage, the public accumulation system and the housing saving bank. These will also be detailed in this chapter.

5.2 STATE INTERVENTION IN SOCIAL AND ECONOMIC DEVELOPMENT

Classical political economists such as Malthus, Ricardo, Say and also Smith have stressed the role of the free market and individual liberty in economic success (Rapley 1997: 7). In a classical market economy individuals are encouraged to pursue self-interest. As a result society benefits inadvertently and government regulations are minimal or nonexistent (Downs 1991: 25).

Because the free market was seen to be self-regulating, Smith (in Nevitt 1967: 7) identified only three functions for the state to perform: defense of national sovereignty, the protection of citizen’s rights against violation and the provision of public or collective goods. Classical political economists considered the capitalist system as a complex and delicate mechanism. This system could easily break down once the state started meddling with it. Even when the free market appeared to have broken down, it was regarded as still functioning and would repair itself naturally.

Classical thinkers insisted that it is not the task of the state to redistribute resources to equalize society. This not only expands inequality, but is also perceived as a threat to social order (Darke & Darke 1988: 44). However, the
operation of the free market was not as successful as expected. Keynes thus advised governments to intervene in the market economy (Rapley 1997:9).

According to Rapley (1997: 1), in development theory the terms “left” and “right” distinguish competing sides of any debate in terms of attitude to the state’s role in the development process. In the twentieth century, the left – which included not only socialists and communists but also sections of modern liberals – generally favoured using the state as an agent of social transformation. The state could both develop economies and alter societies in such a way as to make them suit human needs. The old right also favoured strong states but held an equal suspicion of the market throughout the post-World War II period.

After World War II, there existed a broad consensus that economies needed more state intervention than before. The depression and postwar political developments had given Keynesian economics pride of place in both academic and policy circles in the Third World. This was further reinforced by the emergence of structuralist economics. The state could overcome the imperfections in the market and global capitalism. Therefore, the state was assigned a leading role in the economy (Rapley 1997):

(1) In the First World intervention took the form of generous welfare legislation, nationalization of private industries and immense public programmes.

(2) In the Third World intervention took the form of legislation to nurture emerging industries and to create public sectors where the private sector had failed to do so.
In socialist countries the economy which implements the Soviet model was directed from a central-planning office of the state government (Rapley 1997: 46). In addition, the Soviet interpretation was to abolish the market economy. Therefore the state took full control of the economy and compelled all available resources to be put to productive use. Socialist central planning countries such as China, North Korea and the Eastern Euro Bloc were not successful with regard to economic matters. As a result, socialist countries had already started pushing for reform in order to adapt to the market economy. The government intervened to shift either supply or demand to meet this goal through regulations, legislations and financial measures (Nevitt 1967: xix)

From classical economy to modern market economy, the role of the government in the process of economic development is enhanced through macroeconomic regulations. The characteristics of both the market mechanism and the role of the government are shown in Table 5.1 (see next page).
### Table 5.1

The characteristics of both the market mechanism and the role of the government

<table>
<thead>
<tr>
<th>Phases</th>
<th>The classical market economy (the free, laissez-faire market economy)</th>
<th>The modern market economy (the market economy with macro-economic regulations)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Items</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The characteristics of the market mechanism</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Mode</td>
<td>Spontaneous, laissez-faire</td>
</tr>
<tr>
<td></td>
<td>Regulation pattern</td>
<td>Self-regulating market</td>
</tr>
<tr>
<td></td>
<td>Function</td>
<td>Comprehensive and full exertion</td>
</tr>
<tr>
<td></td>
<td>The relevant change of the role and function of the government</td>
<td>Changing of the government role</td>
</tr>
<tr>
<td></td>
<td>Governement function</td>
<td>Weak</td>
</tr>
<tr>
<td></td>
<td>The goal of government intervention</td>
<td>Protects economy (external variables)</td>
</tr>
</tbody>
</table>


### 5.3 REASONS FOR STATE INTERVENTION IN HOUSING

A home, a roof over one’s head, is a necessity, but for the average householder it is an expensive necessity (Needleman 1965: 119). The difficulty of creating sufficient individual units is compounded by growing urbanization in almost every country, especially developing countries. Currently, the major housing problem is the shortage of affordable accommodation for the urban poor, the low-income majority (Willis & Tipple 1991: 2).
Most developed countries recognize the responsibility of government to provide housing for its citizens. How, and to what extent, government should intervene in the housing sector is an issue of considerable debate. The disagreement is extremely profound when the attitude of government towards “housing markets” is under debate. In order to find a point of departure for the subsequent discussion, the two different types of opinion in this field will be characterized by tracing their economic implications (Karyd 1988: 61).

Market believers can be defined as: those who believe that “almost every kind of services and goods are available on a market which means that there are sellers as well as buyers. The need for housing will be satisfied by the forces of the market – demand and supply.” Compared to these forces, the power of government is small. Considering its limited power, the market is the best way to distribute housing and the role of government should be confined to lubricating and facilitating activities in the markets (Karyd 1988: 61).

Market opposers can be defined as: those who believe that “adequate housing is a basic human right, not merchandise. The influence of markets over such an essential sector of human life should be removed or at least rendered harmless. Government should excise control over the physical planning, construction of new housing, rent levels and price levels. In general, housing should be subsidized to prevent people from choosing inferior housing conditions, and then the money can be used for other kinds of consumption (Karyd 1988: 61).

According to Barr (in Whitehead 2003: 138), housing lies somewhere along the spectrum between private goods, where the market can be expected to work well, and public goods – where the market will generally not provide effectively. The most superficial glance at 20th century housing history clearly reveals the inability of a market left to its own devices to provide adequate
housing for the poor. As a consequence, mainstream economics provides a well-defined typology of the rationale for government intervention to achieve allocative and productive efficiency in a market system.

In principle the state should have an interest in becoming involved in housing provision. Darke and Darke (1988: 43) suggest various possible reasons for government intervention in housing as follows:

- Firstly, inadequate housing may be an actual or perceived threat to social order.

- Secondly, there is a desire on the part of the state to produce a better quality for the population.

- Thirdly, there is an idea linked with various forms of partnership between the state and households to do with “housing as a verb”, namely, that the process of producing, acquiring or managing housing can empower the individual and engender new capacities and skills.

- Fourthly, the state may sometimes use housing production as a tool of macroeconomic policy. This has more often taken the form of cutting production at times of economic difficulties, than being a positive element in employment planning.

- A final possible motive for state intervention, more characteristic of government representing the interests of the working class or the economically weaker groups, is an objective to reduce inequalities in housing standards and to apply the resources of the state for collective benefit. In countries where collective financing of housing and social equalization through housing provisions are part of the state’s objectives,
housing intervention will probably be accompanied by extensive
intervention in health care and education.

These five motives for state intervention can be summarized as: maintenance
of social order, promotion of quality for the population, encouragement of
self-development, economic planning and collective equalization. The section
below looks at why the government of China should be involved in the
housing industry.

5.4 THE NECESSITY OF GOVERNMENT INTERVENTION IN ASPECTS
OF HOUSING IN CHINA

Turning to Third World countries, the pattern of state intervention is very
different. Concern with the objective of maintaining social order is often
significant for governments in the developing world although social unrest is
rarely precipitated by poor housing conditions alone (Friedrichs 1988: 52).

After World War II, the two parties (the National Party and the Communist
Party) in China began a civil war in 1946. The Communist Party gained the
victory and founded the new China in 1949 (Huang 2003). The state then
applied a socialist central planning model to develop the national economy.
Investments, wages and prices for commodities were set directly by
government. Resources were allocated by government for productive usage.
Non-productive goods could only receive limited investment under the
socialist ideology (Rapley 1997: 45).

In socialist China housing was considered a welfare benefit. Under the
socialist ideology of “production first, consumption second”, housing
construction and provision were maintained at a minimum level until 1978,
when economic reform was launched (Huang 2003: 591). Economic reform introduced some market elements into housing development. Housing is no longer considered as welfare issue.

Housing reform in China has been under way since 1984, the overall aim being the commoditization of housing. The provision and consumption of housing are mainly driven by market forces. Housing has many of the characteristics that can generate market failure. The state may sometimes use housing production as a tool of macroeconomic policy. The role of the government in the transitional period (from socialist economy to market economy) is described below (O’Sullivan & Gibb 2003, Li 2001, Friedrichs 1988, Luo 1996, Nevitt 1965, Willis & Tipple 1991).

Firstly, the possibility of market failure is enough to support macroeconomic regulations in housing. China is a developing socialist market economy. The market economy can regulate itself based on supply and demand, the price trend, and information feedback. This kind of adjustment could not avoid shortcomings such as being negative, passive and lagging behind. The government may now hope to improve forecasts and market behaviour, since the free market, as a rule, lacks adequate knowledge.

In China housing provision activities involve many departments in a municipality, which have a direct and significant influence on housing construction. These departments only concern their own benefit when dealing with construction projects. Real estate developers are confused by orders from different developments. This problem can only be avoided by government itself in ensuring cooperation between the various departments. Furthermore, the dissensions in the market economy must be solved through negotiation, mediation, arbitration and lawsuits. Making the relevant parties
reach an agreement by the government is a very important way of solving problems (Luo 1996, Li 2001).

Secondly, housing development needs to adapt itself to the national economy. During the period when China used the Soviet Model, the government abolished the market economy and negated the commodity attributes of land and housing. This not only limited housing development, but also influenced the development of relevant industries such as the construction industry, building materials, electrical appliances and estate management. The housing industry could become the leading sector in China (discussed in Chapter 4), and housing development should be central in efforts to sustain healthy and stable economic development.

Thirdly, the aim of government intervention in the housing industry is to shift either supply or demand to better meet its goals. It is evident that a market economy can self-regulate when aggregate supply and aggregate demand are within a certain scope. Nevertheless, the market cannot realize self-regulation by itself while the difference between aggregate supply and aggregate demand surpasses a certain level. The reason is the long delay between the time when the first signs of demand appear and the time when the final supply has been met to fill these needs. Considering the current high vacancy rate in China, the government desires to use macroeconomic regulations to intervene in the aggregate supply and aggregate demand in order to sustain healthy and stable housing development (Luo 1996).

The role of the government in regulating the housing industry assumes a counter-cyclical form (Downs 1991). The government should implement restrictive measures when housing development is overheating. This adjustment helps the housing industry development to stabilize. The housing industry in China experienced a period of overbuilding from 1992 to 1993.
During this period the government instituted policies for reducing the money supply and decreasing investment to cool down housing development. These instruments then prevented the national economy from collapsing (Cao, Cai & He 1999). When the housing industry is in a situation of underdevelopment government should adopt policies to stimulate housing development, such as lower interest rates and reduced taxes on property.

Finally, government action is commonly required to ensure an adequate supply of housing, to maintain socially acceptable standards and to provide financial assistance and affordable accommodation for the urban poor, the low-income majority. China as one of the most overcrowded countries has a housing problem that is even more serious. For example, the living space per capita in China was only 3.6 m² in 1977. Although the living space per capita in China had reached 6.1 m² in 1986, this was still far behind other countries like the USA, France and Singapore (Kim 1990).

Satisfying the housing needs for middle income and low income groups is the responsibility of the Chinese government, especially for low-income families. It reflects a desire on the part of the state to produce a better-housed population in order to protect human rights. China has implemented the same programmes in the provision of housing for urban households, for example the Anju Project. The aim of the Anju project is to focus on housing problems existent in middle income and low income urban households.

With regard to the motivations of government in the housing industry such as: raising the living standard for urban households, securing social order and stimulating economic growth, there are also various regulatory measures that state intervention may take through the provision of subsidies and regulations. The section below looks at what forms of state intervention have been employed by the Chinese government.
5.5 FORMS OF STATE INTERVENTION IN HOUSING IN CHINA

It has been suggested that the aim of macroeconomic regulation in housing is to sustain healthy and sustainable housing development and to contribute to the national economy as a whole. Three objectives should be included for achieving this goal (Adams & Watkins 2002, Fischer 1964, Dinc 1978):

(1) Housing development needs to develop at a reasonable scale and speed;

(2) Housing development needs to balance the aggregate supply and the aggregate demand; and

(3) Demand and supply should match each other.

These objectives can only be achieved by state intervention through regulatory measures such as legislation, administration, financial measures and information and guidance measures. The intervention system in housing in China is shown in the diagram (see next page) below.
As shown in Figure 5.1, government intervention in housing development is to adapt itself to the national economy. In addition, by optimizing the structure, real estate developers should adjust the supply to meet the demand regarding the consumption level and target groups, and then realize an effective supply. Furthermore, the vacancy rate must be limited to a reasonable level through balancing aggregate supply and aggregate demand.

There are numerous ways in which the government has an impact on the economy. Its impact is felt at many levels. Sometimes government competes directly with private businesses, as when state-owned enterprises perform in the market economy. On the other hand, specific legislation and regulatory programmes add to consumer prices and skew the costs of doing business (Downs 1991: 25).
As Nevitt (1967: xiv) explains, government is also required to make a decision as to what levels of payment are appropriate for housing. For example, if market costs in housing are larger than a family can afford, methods must be devised to lower the amount the family is required to pay. Government may attempt to deal with financial support through subsidies or a mortgage system. These cannot only be achieved by the market mechanism but also by official action.

According to Nevitt (1967: xvi), government action at present affects housing in many ways. Included among the typical government policies which influence housing are:

(1) Taxation of property, of income, and of capital gains;

(2) Interest rates;

(3) Land development;

(4) Efforts to increase or curtail investments; and

(5) Programmes having to do with the ability of labour, wages and prices.

In some countries there is a permanent commitment of government to a more active role in all spheres of economic and domestic policy. Considering the course of housing development in China, the four regulatory measures will be discussed in the following discussion, namely legislative, administrative, economic, and information and guidance measures.
5.5.1 Legislative measures

Economic development is based on the economic activities operating within the legal system. The setting up of legislation is essential for maintenance of the market order. Allocation of resources is more effective through market forces. Legislation measures refer to the government’s intervention to regulate and restrain various economic bodies through laws and acts (Fischer 1964: 84). The economic bodies include real estate developers, government agencies, relevant organizations and consumers. The benefits of these economic bodies are guaranteed depending on the legality of their behaviours. As a consequence, housing is able to provide healthy and sustainable development.

According to Yue-man Yeung (1973: 27), within the democratic world there are close parallels among the housing laws in many countries. For example, the Town and Country Planning Acts in Britain reinforce the effectiveness of central policy directions while aiming to ensure that the system has the flexibility demanded by the need to react to the dynamic process of urban change. These Acts have had far-reaching effects on planning legislation in many countries. The planning process and legislation in Singapore is one example of the emulation of the British model.

As Yeung (1973: 28) expresses it, there are also various laws in Singapore such as: Governor-in-Council in August of 1958, the Planning Ordinance 1959, Housing and Development Board Ordinance 1959, Controlled Premised Act 1969, and Land Acquisition Act 1966. The planning laws have had profound repercussions on the urban development of postwar Singapore.

Increasingly, the important role that law plays in the development process is recognized and emphasized, especially in the developing countries. It is
advocated that the promotion of economic growth entails a revision of the law, not only as a consequence of economic change, but, more important, as a precondition for it (Yeung 1973: 28).

After the economic reform launched in 1978, China accelerated the institutionalization of laws and acts regarding economic activities including the housing sector. The Administrative Law on Urban Real Estate in the People’s Republic of China promulgated in 1994 is the most basic law to adjust the economic activities in the real estate industry. Up to now China has basically formed a real state legal framework. Although this legal framework is still in the process of being perfected it has begun to take shape (Zhang, B & Zhang, D 1996).

According to Baidong Zhang and Dong Zhang (1996), China performs on two levels of a central state and local authority legislation system. The central legislation makes up the most basic and primary law and regulation, such as the Law of Land, the Administrative Law of the Land, the Administrative Law of Real Estate, the Urban Planning Law, the Residence Law, the Law on Value-added Tax on Land, the Law of Construction and the Law of Real Estate Management.

Local authorities make up local regulations and rules based on the relevant laws made by the central legislation to adapt to the local situation. These laws and regulations provide the basis for the legal foundation of macroeconomic regulations on the housing industry. However, the administration of justice is the key to legal administration in the housing sector; it should also strengthen the legal consultation service in the housing industry. The aim of these laws and regulations is to achieve legality of behaviour in housing development (Zhang & Zhang 1996).
5.5.2 Administrative measures

The administrative measures refer to the government as it launches and implements the policies, planning, programmes, administrative orders and instructions in the economic activities of housing (Zhang & Zhang 1996). The administrative relations between central and local government exert considerable influence over housing programmes, especially low-income housing programmes. In theory the simplest systems should be found in one-purpose organizations with a simple hierarchical command and accountability structure (Amos 1984: 165).

According to Fancis Amos (1984: 161), in the case of urban housing, the administrative practicality has been worked into an efficient piece of government machinery. There is the inevitable tension of the centre seeking to maintain consistency and planned resources to the delivery of housing. The administrative measures mainly consist of the policy, planning and programme instruments.

5.5.2.1 Policy instrument

The policy instrument contains the two aspects of industrial policies and regional economic policies. The housing policies in China strive to eliminate the housing shortages which in the past affected most strongly the low-income, poorly qualified and socially underprivileged classes. China has explicitly proposed that the housing industry is the new engine of the national economy. This creates opportunities for further housing development in China (Urban Housing Construction 2000).

The Urban Housing Construction & Ninth Five-Year Plan of Real Estate and the Prospect in 2010 anticipated the scale and speed of real estate
investment, the proportion of industry in GDP and employed population in the industry. With economic development and reform in the urban housing system and the financial system, housing development will be accelerated further. The responsibility for government is to provide for a free and equitable competitive environment for economic activities (Urban Housing Construction 2000).

According to Tu (2003), the regional economy is the foundation of the real estate economy. Housing is a complex commodity with one of the physical attributes being that of spatial immobility. In other words, the houses are found only at their location. These locational attributes include the socio-economic status of the neighborhood, its physical conditions, as well as wider notions of accessibility to any desired destinations, in terms of jobs, private goods or public facilities.

The economic development level in a particular region determines the demand structure and demand quantity. In addition, the form of the housing is dependent on the residents’ income and prospects of the city. Furthermore, the component of the properties in areas is different even in one city, which is affected by the development attributes of the area, such as an industrial zone or a business centre.

Housing development is requested to adapt itself to regional economic development. Expensive apartments and houses are developed in areas where low-income groups are most found. This is not only wasteful of resources, but does not solve housing difficulties for residents. Therefore, regional economic policy is not only subject to national and industrial policy, but also concerned with the regional economic situation. This then brings housing into play as a key pillar of regional economic development.
5.5.2.2 Planning and programme instruments

The formulation and implementation of housing development planning is a common practice of various countries in the world. There is broad agreement among economists about the nature and direction of the effects of planning and land use regulation in the housing market, based on economic theory (Bramley 2003). According to Bramley (2003: 193), local political control over planning may create systematic biases in land supply for different activities thus affecting overall competitive performance.

As Adams and Watkins (2002: 97) put it, housing planning policy operates through the framework provided by the development plan system, where development plans are a generic term covering a number of separate plans such as the structure plan and local plan. The structure plans provide broad strategic statements of counties’ intentions, while the local plans translate the statements into land-use policies within the districts including the allocation of sites for housing development. During the 1990s the system was broadly ‘plan led’ in that development in accordance with the plan was allowed. Local and regional considerations were set within national planning policy priorities established through planning policy guidance notes.

Adams and Watkins (2002: 97) also mention, in the context of planning for housing, that the objective for local planning authorities is to plan to meet the housing requirements of the whole community. This process is to consider those who need affordable or special needs housing and an expectation that authorities will seek to provide wider housing choices, a better mix of size, type and location of housing than currently available. The objective for local authorities translates into a requirement to provide sufficient housing land, while giving priority to the reuse of previously developed land within urban
areas, using empty homes and converting buildings previously in other uses in preference to using greenfield sites.

Zhang and Zhang (1996) reveal that planning in China is usually distinguished by three forms: long-term planning, mid-term planning and short-range planning (or annual plans). The long-term plan is the prospective strategic plan of housing industry development, mainly proposing the housing development strategic target, priorities and step and the development speed and scale. For example, China has formulated the Ninth Five-Year Plan of Real Estate Industry and the 2010 Prospect, which plans the overall development of the Chinese real estate industry.

Zhang and Zhang (1996) explain that the mid-term plan mainly predicts the conditions for achieving a developmental goal within the planning. In addition, considering the objectives of the planning, the important measures that will be adopted by the planning in order to implement the plan. The short-range plan or annual plans are the bases of the mid-term plan, even the long-term plan. The annual plans mainly include the planning for land and funds. The land and funds are the necessary conditions within housing development. Planning for both sides is significant to balance supply and demand.

Programmes are also initiated in housing development such as: the Urban Renewal Program in Singapore (Yeung 1973). This program aims to solve the problem of overcrowding in the central city areas of Singapore. Also, the Anju Programme implementation in China concentrates on eliminating housing difficulties of particular groups such as employees of state-owned enterprises and educational systems (Urban Housing Reform 1999).

Policies, planning and programmes relating to the provision and construction of housing are prioritized by government. These interventions can be defined
as an inventory of means and methods applied by any society to achieve
certain goals in the sphere of housing. Administrative measures in the field of
housing are important in the utilization of land resources, and continued
recourse to regulation and planning in housing development, and also in
responding systematically to the social needs of different groups in the
population. Considering the macroeconomic unregulated problems of housing
development, administrative measures cannot be substituted by others.
These measures can regulate, control, and negotiate any special and urgent
problems in the short term.

5.5.3 Information and guidance measures

According to Liu (2000: 3), information and guidance measures refer to the
government’s influence on housing investment, consumption and the
behaviour of each benefit-relevant body by means of propaganda, education,
public opinion, information guidance and consultation. Propaganda and
education could provide information for the housing market. Based on this
information the relevant bodies then reassess the risk and opportunity of their
behaviour in order to adapt in the market.

As Huang (2004: 45) remarks, China implemented a welfare housing system
from the foundation of the People’s Republic of China (1949 – 1978). All
urban houses were supplied by the government and state-owned enterprises.
Therefore, people had to wait in a queue for houses. With urban housing
reform the information was passed to residents that their housing needs could
be satisfied in the market. As a consequence, the urban residents in China
could give up waiting.

In addition to its participation in the economy, government collects information
on wholesale and consumer prices, interest rates, the money supply, levels of
production and the consumption of goods, construction starts and permits issued and sales of new and existing homes. Trends and changes in these indicators are used to chart economic growth and inflation (Downs 1991: 27).

National governments and local authorities could also use guidance measures to balance supply and demand. The information announced from relevant departments of government such as: land prices, and average purchasing prices for properties may change market behaviours. This spurs the developers to adopt a supply structure to meet the demand (Cai 1993: 151-152).

In a market economy, the aim of all bodies is to pursue their own benefit through economic activity. Although these measures are not easily enforceable, the effects of these measures are importance for every relevant body.

5.5.4 Economic measures

The housing sector is influenced by the broader economy of the country through its effects on the demand and supply of housing. The low income housing sector is often perceived as being an important component of the social welfare system. However, the housing sector is also a significant economic sector with crucial real, fiscal and financial links to the overall economic performance of the national economy (White Paper 2005).

According to Wiley (1977: 7), considering that housing construction and provision are market behaviour, one of the objectives of government intervention in this field is to reduce inequalities and achieve redistribution. From an investment standpoint an important aspect of the various
governmental restrictions on housing use is that they can significantly affect the income generating potential and hence the value of property.

Downs (1991: 40) states that local governments tax housing on the basis of its value – ad valorem taxes. The tax burden affects the value of land and this affects investment in the housing industry. The Government regulations that affect financial transactions have an impact on the housing market. Acceptable interest rates and availability of funds for mortgage loans determine how much can be borrowed. In addition high interest rates discourage borrowing by both developers and individuals.

Of all the functions of government, taxation, regulation of banking and control of interest are among those of the greatest interest to housing development. The way in which the housing sector is critically linked to the economy and role players can be described in three ways; they are: 1) a financially linked instrument; 2) a fiscally linked instrument; and 3) price controlling instruments.

5.5.4.1 Fiscal linkage instrument

According to Wiley (1977: 7), there are two aspects of government fiscal policy that can have important consequences for the housing investor; namely the raising of public funds through taxation and the spending of public monies. At the local government level, taxation on housing takes the form of a direct tax on capital, with the amount of tax based on the property’s assessed valuation. The so-called property tax or real estate tax has reached very high levels in many communities and represents the largest single operating expense for many real estate investments.

Wiley (1977: 8) explained that the spending side of government fiscal policy influences housing values in a variety of ways; for example, the government’s
decisions on the placement of roads, schools, airports, parks, landfills and other public facilities will have a direct impact on the value of neighboring properties. More indirectly influencing the general level of real property values are the government’s expenditures made to help support housing construction and the mortgage markets.

The various functions of government, including the services it provides, have inherent costs. In order to pay these costs, the government must have income. Government derives its income from various sources, the most significant of which is taxes. The central government taxes the incomes of individuals and businesses. Provincial and local governments impose taxes primarily on property (Downs 1991: 27).

The fiscal and taxation instrument is mainly used to influence various economic activities of the housing industry through budget reallocation and increasing or decreasing taxes. The impact on housing may be positive or negative depending on the way they are financed and the form in which they are distributed (White Paper 2005).

The government can stimulate or restrict housing development through the fiscal instrument, such as: increasing or decreasing the budget on housing expenses, encouraging or constraining investment on public facilities construction, setting up or abolishing the tax category and raising or lowering the transfer tax. In addition, government can regulate the investment scale and structure through the issue the housing bonds and domestic borrowing. Subsidies and taxes can also regulate the demand for housing. These fiscal regulatory measures thus adjust the supply and demand structure of housing in order to balance the aggregate supply and the aggregate demand (White Paper 2005).
5.5.4.2 Financial linkage instrument

Financial linkages are associated with the financing of housing and related infrastructure through financial institutions. The inflation rate and real interest rates determine the supply of finance. High inflation and negative real interest rates decrease the amount of finance available for securing housing, thereby lowering the affordability of homes. Another factor which influences the supply of finance is the level of domestic savings. The effects of monetary and fiscal policy on the capacity of the financial sector can make finance available for housing (White Paper 2005).

According to Wiley (1977: 7), monetary policy relates to the government’s actions designed to influence the market rate of interest. The government can achieve such influence over interest rate levels as has been shown in the past. The reason is that interest expense is one of the major expense items for most housing investment returns and property values. Interest rate levels also have a direct bearing on the number of people able to purchase homes. Lower interest rates and more appropriate terms of repayment will allow more families to enter the home owner market.

In South Africa (White Paper 2005), the majority of low-income households eligible for subsidized housing (about 90 percent) that cannot afford homes will not be severely influenced by the high interest rates on mortgage bonds. However, the market in mortgage substitutes is growing rapidly. Lower interest rates on micro loans would make housing much more affordable.

As Needleman (1967: 18) explains, the social concept of housing “need” has to be distinguished from the economic concept of housing demand. The effective demand relates to the accommodation for which people are able and willing to pay. In China, the situation is that effective demand for housing
cannot be satisfied due to high prices in housing compared with low incomes of urban households. This takes no account of personal aspirations that cannot be fulfilled due to lack of money. Therefore, stimulation and support of the investment and consumption of housing through financial instruments is crucial for housing development (Xu & Fang 2000: 8).

According to Xu and Fang (2000: 12), at present the housing credit in China comes mainly from the Housing Accumulation Fund, formal banking loans, enterprise housing fund and urban housing savings. The current situation in regard to housing credit is that most funds are invested in the production sector. The consumption sector, especially the individual householder, gets a lower proportion of funds. For example, the individual housing mortgage in Hong Kong was about 30 percent of the total banking loans in 1996. In America, the number reaches 20 – 40 percent of America’s total banking loans. However, the proportion of the individual housing mortgage in the total banking loans in China is only three percent.

China might simplify the procedure for individual housing mortgage loans and lower the down payment to release housing credit. This would satisfy the capital needs for housing development.

5.5.4.3 Price controlling instrument

The price is the main basis for the allocation of resources. The price distortion and false pricing can create ineffectiveness in the market self-regulation. Therefore government regulation of prices becomes very essential. In China false pricing in housing is displayed in two aspects: 1) the land price has a rather subjective nature, and the market price is in disorder; and 2) the formation of the prices of various properties is not strictly controlled and various expenses are included in it (Deng 1999: 28).
In China there are two types of land provision systems co-existing: one is the provision of free land through agreements; another concerns the planning gain (Zhou 2000). The agreements take the form of a contract, usually between the planning authority and developer without capital cost. Many lands sales contain a subsidy due to the fact that true land costs are allocated in the government budget. The aim is to supply affordable houses for low-income groups.

Large numbers of land for housing projects may reduce the direct costs in the provision of the affordable housing. This thus results in a beneficiaries’ speculation on land (Zetter 1984: 226). After a few periods of speculation, the price of land is far higher than the initial concept of ‘free’ land. The cost of land is shifted as raise housing price by the developer to the target group, the low-income households. Consequently, the price of the affordable housing is much higher than what the low-income families can afford. This means only few people who involved in land speculation benefited from the free land.

According to Bramley (2003: 197), land use regulation is a legal or administrative issue that prescribes what type of use is permitted on any given parcel of land. Considering the current situation of the land market in China, the government should regulate land use by setting the standard for the planning gain. In addition the land market also can be regulated by a state-set price and state-guided price. For example, in Japan, the government announces land prices regularly every year.

The price of properties, especially housing prices, mainly consists of the investment cost and profits of the developer. The land price, taxes, construction cost and others are included in the investment cost. At present, the land price, taxes and profits of the developer are rather higher while the proportion of the construction cost is lower. Moreover, the quality of housing is
mainly impacted by the construction cost. This results in low quality with high costs for housing construction (Zhou 2000). This is shown in Table 5.2.

Table 5.2

A comparison of housing construction in China with the international level

<table>
<thead>
<tr>
<th>Items</th>
<th>Country &amp; explanation</th>
<th>China</th>
<th>International level</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land price and taxes / the housing cost</td>
<td></td>
<td>45%</td>
<td>20%</td>
<td>The high land price and taxes are main reasons that housing costs constantly increase.</td>
</tr>
<tr>
<td>Construction expenses / the housing cost</td>
<td></td>
<td>40%</td>
<td>72%</td>
<td>The construction industry’s low productivity, with the long cycle of construction, while the technical competence is far lower than the international level</td>
</tr>
<tr>
<td>Others expenses / the housing cost</td>
<td></td>
<td>15%</td>
<td>8%</td>
<td>Lacking adequate knowledge and other non-economic factors affect the housing cost</td>
</tr>
<tr>
<td>Profit ratio of investment</td>
<td></td>
<td>20~ 30%</td>
<td>6~10%</td>
<td>Compared with international levels, the profit ratio of investment in China is inevitably higher.</td>
</tr>
<tr>
<td>The housing price / annual income of individual household</td>
<td></td>
<td>10~ 20 times</td>
<td>3~6 times</td>
<td>The house – purchasing ability in China is far behind that in the developed countries</td>
</tr>
</tbody>
</table>


Zhou (2000) explains that regulation in the price of housing may be done by adjusting the expenses and taxes on housing. For example, in the ‘Anju Project’ and ‘Affordable Housing’, the government adopts the tax policy (reduced or free tax) and regulates the construction cost in order to meet the purchasing ability of the target people. By contrast, the price of luxury apartments can be regulated by market forces.
The results of this analysis clearly imply that government intervention may be most urgently ‘needed’ in rapidly developing countries where the balance between needs and resources is most unfavourable. The total effect of government intervention in the housing field may contribute to the national economy on a wider front. The regulation of the whole housing programme leads the government into an increasingly comprehensive involvement in all the functions of the housing industry. This sustains healthy and stable housing development.

5.6 HOUSING FINANCE IN CHINA

Feins and Lane (1984: 1) remark that people have to decide how apportion their limited resources among their needs for food, housing, clothing and other goods and services. For home-buyers rising prices, interest rates and property taxes combine with utility costs to increase almost daily the expense of becoming an owner.

Needleman (1967: 119) maintains that housing is a necessity, but for the average householder it is an expensive necessity. Without outside financial aid the percentage that can afford to buy out of their income is much smaller still. For the mass of people the problem of the high capital cost of getting a home can only be overcome by the provision of long-term credit. This will thus allow an individual to rent a house or to buy it on a mortgage.

In China the government has launched programmes to solve the housing problem and to ensure suitable housing for different income groups. While the mortgage is the most familiar of the legal instruments used in financing the acquisition of housing, the public accumulation system and the housing savings bank are also used (Nie 2004, Wiley 1977: 166).
5.6.1 Product structure in China’s consumer finance

According to He and Fan (2002: 12), consumer finance as a core element of the banking business is relatively new in China. By the end of 1997 Chinese banks were reported to have provided consumer financial services for domestic customers to a total amount of 17.2 billion yuan. Compared with total lending business of these banks this figure represents a negligible proportion. In May 1998 the People’s Bank of China issued a document entitled Methods of Management of Personal Housing Loans. In February 1999 certain Guidelines for Conducting Personal Consumer Credit were issued by the People’s Bank of China. These documents required banks to increase their exposure in home mortgages and auto loans. China’s consumer finance has recorded a fast growth since 1998 as shown in Figure 5.2.

![Figure 5.2](image)

**Consumer loans outstanding in China in 1997 and 2001**


Among all the major consumer financial products, housing mortgages are the largest as shown in Figure 5.3. Auto loans have been the second largest, though much smaller than housing mortgages. Education loans as well as credit provided to students enrolled in universities and colleges, accounted for
quite a small proportion of China’s consumer financial market. In addition, Chinese banks have provided various other credit services for personal customers, including credit card operations (He & Fan 2002: 12).

**Figure 5.3**

*China’s consumer loans: major products outstanding in 2001*


An analysis of the housing mortgages in China shows its development has been faster than before. However, compared with other developed countries and regions, the percentage in total outstanding is still far lower. This means that government activities can still promote housing mortgages development. Banks can provide more mortgages to households that want homes but cannot afford one.

### 5.6.2 The housing public accumulation fund system

China’s housing accumulation fund system was first set up in Shanghai in 1991. On November 23, 1994, the Ministry of Finance, the Housing System Reform Leading Group of the State Council and the People’s Bank of China jointly issued Provincial Regulations on the Establishment of a Housing Public
Accumulation Fund. This embodied the implementation of a housing public accumulation fund system in China (Nie 2004).

According to Nie (2004), the housing public accumulation fund refers to the long-term housing savings that are deposited by state agencies, state-owned enterprises, other urban enterprises and public organizations. Housing public accumulation funds consist of two parts: one is deducted from the employee’s wages and deposited monthly as required; another is deposited by employers monthly. Housing accumulation funds are only used for an employee to purchase a house and are paid off over time. Otherwise, the funds will be returned to the employee when they retire.

This housing financial system plays an important role in housing finance, especially for low-income families. The individual household not only gets a mortgage from the bank, but can also obtain financial aid from employers. This encourages the residents to purchase adequate housing with an improved living standard.

5.6.3 The housing savings bank

In December 2003 the first housing savings bank – Sino (German Housing Saving Bank) was established. The bank introduced housing savings products oriented toward individuals. ‘Deposit before loan’ is the feature of this housing saving service. The annual interest rate is about 3.3 percent, which is the lowest amongst various domestic individual housing loan rates (He & Fan 2002: 12).

According to Huang (2003) and Nie (2004), with the Chinese saving is a high priority. People in China save a greater percentage of their income than most of their foreign counterparts. The housing savings bank provides opportunities
for people to deposit savings in their bank. They can thus not only get a mortgage loan, but can also enjoy lower interest rates.

Housing finance in China still has a long way to go. Housing development in recent years has been successful. For example, the per capita living space in 1998 was only nine square metres, and more than seven thousand urban households with inadequate housing have been able to solve their housing problem every year since 1997 (CSSB 1990-2000). However, apartment prices in China still remain unaffordable to most urban households. The subsidy system should be implemented for low-income groups who cannot compete in the housing market with their own resources. In addition, financial tools in the housing sector must be focused on a target population that can benefit from finance. All these instruments and measures should be integrated by the Chinese government in order to remove housing difficulties for urban households in China.

5.7 CONCLUDING REMARKS

Housing the poor in the developing world is one of the major challenges for governments. Currently, the major housing problem is the shortage of affordable accommodation for the urban poor, the low-income majority. The large capital investment needed for new housing creates difficulties for both government and individuals. These may hope to be fully achieved either through the market mechanism or through official actions.

As mentioned earlier in this chapter, housing lies in the spectrum between private goods, where the market can be expected to work well, and public goods where the market will generally not provide effectively. As a result government intervention in the housing field can be considered necessary in a mainstream economy. The forms of government intervention have varied
widely. A tremendous number of regulatory measures are based upon the economic, legislative, administrative, information and guidance measures.

Among the regulatory measures in the housing sector, land-use planning, interest rates, taxation, price control and subsidization can all become instruments to affect housing provision and development. However, government intervention sometimes can also result in negative effects, such as corruption, speculation or wasting of resources. Government intervention in the housing field, as in other economies, should avoid such negative consequences to ensure housing development moves in the correct direction. Therefore a government may use housing provision to achieve allocative and productive efficiency in a market system by means of intervention.

The analysis of housing finance in China shows that the operation of the financial system in China still needs expanding and promotion. Most urban households in China cannot afford to buy houses without financial support. Despite bank mortgage loans and public accumulation funds, the housing savings bank as a new form of housing finance tool in China should be given momentum for its development. The aim of all of these financial tools in the housing field is to ensure housing provision for all demand sectors and every urban household.

Housing development is not only related to economic development, but also connected with social development. On the basis of the discussion in other chapters of this study, housing development in China can provide a better life for its citizens besides making a contribution to the national economic development.

Housing development in China cannot be separated from urban housing reform implementation in any particular period. The background of central
planning for the economy in China has caused an obstacle for housing development. However, the shortages and overcrowding in urban housing have also given the potential for housing development. Accompanying the national economic adjustment in China, the housing industry has become one of the major leading sectors to ensure sustainable national economic growth.

This study has explored the process of urban housing development in China since the Communist Party took over in China. Housing provision under the socialist ideology in China as the background of urban housing reform was also investigated in this study.

The housing industry can become one of the leading sectors in China to measure the relationship between housing development and the national economy. In spite of the national economic development affect housing development in China, political factors as another aspect of macro-environmental factors can also influence housing development. As mentioned in Chapter 3, political factors can have a direct impact on the way business operates. Decisions made by government affect everyday lives and can come in the form of a policy or legislation, especially in housing development. For example, the housing industry in China grew out of nothing due to implementation of urban housing reform policies.

The analysis of government function in housing is more important than in other industries that discussed in the early of this study. Government intervention in housing in China is one reason for fluctuating housing development. Particularly, housing development in China has not yet been in a mature period, so direct regulation by government is still necessary.

The role of government intervention in housing development has also been examined in this study. The aim is to ensure housing provision with both
allocative and productive efficiency in a market system by means of intervention. In the following chapter consideration will be given to the conclusion and recommendation arising from this study.
CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

The purpose of this chapter is to draw final conclusions from all the preceding chapters. These conclusions are followed by recommendations for overcoming constraints in the development of the housing industry in China and for improving its relationship with national economic development on a sustainable basis. These recommendations are offered in the categories of: 1) strategies, and 2) regulatory instruments, followed by 3) finance and 4) technology.

Each recommendation cannot be specifically linked to a constraint or a specific area of underperformance in housing development, because of the integrated and comprehensive nature of the recommendations. Furthermore, neither the functions of national, regional, metropolitan and project specific agencies, nor the functions of role players, are categorized, in view of the categories already indicated.

6.1 CONCLUSIONS

Providing adequate housing for urban households has always been a challenge for every government in the world, especially in China with the largest population in the world. Under the socialist ideology in China that focused more on production than on consumption in regard to development, housing shortages and overcrowding in urban China were serious problems. This was due in large pressure to the limited financial resources for the construction of housing in a rapidly growing population.
The pre-reform public housing system as part of the state socialist welfare system had operated in urban China for almost forty years. Housing in China was no longer a commodity under the Soviet model applied to development. The majority of urban households were beneficiaries of public housing which was allocated by work units to their employees as welfare benefits related to their employment. The rent level of public housing was so low that the state’s investment in housing could not be recovered to build new housing. China therefore suffered a tremendous housing shortage during the period of this socialist welfare system implementation.

After economic reform was launched in China in 1978, the Chinese government greatly increased its investment in housing in order to enhance the regime’s legitimacy by improving people’s standard of living. The government efforts to raise the level of housing investment met with fiscal constraints. The authorities had to initiate housing reform. There were various policies and programmes issued during different periods of the urban housing reform.

The initial steps in housing reform in 1980s included rent increases and the diversification of housing investment. Work units, in particular state-owned enterprises, had to bear a greater financial burden in offering housing subsidies to their employees after the rent for public housing was raised. In the meantime, the diversification of the housing investment as an initial institutional change in the housing system has greatly hindered any further reform by separating public housing from work units.

Previous efforts at housing reform led to a situation in which work units became major investors and owners of public housing. Public housing units continued to be allocated to employees as welfare tenants in the state sector. The privatization of existing public housing to current tenants would lead to an
unjustifiable situation in which the state would have to constantly build new housing units and sell them to state employees.

After two decades of reform the core part of the urban welfare housing system in China has undergone little change. The commoditization and socialization of urban housing as policy goals of housing reform are still remote targets. The nationwide implementation of the new housing policy of 1998 eventually abolished the welfare housing system and developed an institutional structure in which the production and consumption of housing are now mainly driven by market forces.

Urban housing reform in China also emphasizes the housing industry’s contribution to the national economy while focusing on improving urban household living conditions. Housing was considered as a welfare item which was mainly supplied by the government agencies and work units while the Soviet model was applied. As a result, the housing industry in China was depressed. This situation was eventually reversed after urban housing reform was launched in China. The great potential of the housing industry for development has gradually been recognized by the Chinese government.

As regards urban housing reform as implemented in China, the role of the Chinese government in the provision of urban housing has shifted from taking the full responsibility (monopoly in investment and allocation of the urban housing) to using regulatory instruments. Consequently, positive government intervention in the housing industry in China is still necessary in the current situation pertaining to housing development.

The urban housing reform programme in China was successful in improving the living standards of urban households. The development of the housing industry also had some momentum for national economic development, which
was examined via Rostow’s stage of economic growth model. Development in China nevertheless travelled a winding path in the early 1990s. There are still constraints that influence housing industry development in its attempts to achieve a healthy and sustainable base. These have been described in the foregoing chapters.

This research has proved that there is still much room for improvement in housing development in China. The followed section offers recommendations for development of the housing industry in China. These recommendations contribute towards overcoming the identified constraints and improving the underperformance in housing development.

6.2 RECOMMENDATIONS FOR SUSTAINABLE AND HEALTHY HOUSING DEVELOPMENT IN CHINA

This section provides recommendations for sustainable housing development in China. The aim is to overcome the existence of constraints and improve underperformance in the housing industry in China. Recommendations for sustainable housing development are presented below in the categories of recommendations on strategies, instruments, and the strategies of finance and technology.

6.2.1 Recommendations on strategies towards sustainable development

Strategies should be aimed at stimulating the effective demand and supply of housing as described in the foregoing chapters. Urban households in China are willing to buy houses but cannot afford them as a result of insufficient effective demand and inadequate housing supply structure. Therefore strategies which support a more rapid growth in income levels and access to
mortgage finance for low-income urban households have a higher potential for correcting housing inequalities. In order to stimulate the demand for housing it is essential to devise strategies that will increase the income of households and the availability of finance.

Essential elements to facilitate housing supply include the provision of adequate infrastructure, nationalization of the legal and regulatory framework and ensuring that the provision of housing is affordable for the target population group. This has to be achieved through housing inputs such as land, infrastructure, entrepreneurship, finance, labour and building materials. In addition the role of the monitoring system in the provision of housing cannot be ignored.

Only if the supply components are sensitive to housing demand will effective demand translate into an increased number of housing units, improved quality and increased earnings and employment. Rigidity in supply will simply cause price increases. Appropriate institutional and regulatory frameworks are needed to support strategies for both the demand and supply of housing. The following recommendations on housing strategies are also aimed at improving the effective demand and supply of housing in China.

6.2.1.1 Improving the income level for urban households in China

China implemented a policy of low salaries and welfare distribution of housing for nearly 30 years as mentioned earlier in this study. This resulted in urban households being willing to buy houses but unable to afford them even after urban housing reform due to their financial difficulties. Consequently, the effective demand for housing requires that the incomes of urban households in China should be increased to a reasonable level compared with housing prices.
6.2.1.2 Extending the “Public Housing Accumulation Fund” to the non-state-owned sectors

A certain number of customers of housing mortgages were financed by what is called the ‘Public Housing Accumulation Fund’, a mechanism designed for those employed in the state sector. The scheme has an obvious inequality for those who work in the private sector. Employees in the private sector cannot expect funding from this programme when they attempt to purchase in the commercial housing market. This financial support must be provided for every household purchasing house no matter who they work for.

6.2.1.3 Enhancing the monitoring system in the provision of low-income housing

The aim of a low-income housing programme, such as the Anju project in China, was to accelerate steps for solving the housing difficulties of families who had inadequate living space. Prices for the Anju project are much lower than those of commercial houses. However, during the Anju project’ implementation, high-income households were hiding their incomes in order to buy houses at cheaper prices. This obviously threatened the benefits of low-income households. The monitoring system must be improved in order to avoid this problem.

6.2.2 Recommendations on regulatory instruments in housing development

Housing development instruments should support strategies, enhance the effective demand and supply and maximize the efficiency of the supporting institutional framework. Some of the most important instruments are covered in the following recommendations.
6.2.2.1 Conducting urban planning on an integrated macro-scale

Urban planning on a macro-scale could receive attention and be regarded as more important in China. Urban planning should be done on a rational and sustainable basis. The importance of urban planning is to provide direction for housing development as regards matters such as number forecasting, housing market boundary identification and tenure choice issues.

An important process in urban planning in China is the land use ‘planning system’. This is also a responsibility of local government. The land planning system will help in using land resources effectively and efficiently in the provision of housing.

6.2.2.2 Rationalising the legal and regulatory framework

The legal and regulatory framework for land use and building can have major impacts on house prices and on the responsiveness of housing supply. Delays of two or more years in obtaining permission to establish new housing have been common in China in the past. The land and housing costs have been pushed up by unreasonable fees such as infrastructure construction costs and the fees for water and electricity. The Chinese government has to eliminate these unreasonable fees in order to achieve affordability in housing.

6.2.3 Recommendations on housing finance

Finance has always been one of the key components for successfully operating for both governments and individuals. It can also be used as an instrument for addressing economic imbalances. Therefore, it is appropriate to consider innovative forms of financing, extending access to finance and other related matters.
6.2.3.1 Utilising finance as an instrument to address the unequal distribution of wealth

One of the major issues in housing finance is to utilise it to address the existing inequalities in home ownership. Mortgage loan corrective actions that have been taken in China to overcome financial difficulties for urban low-income majorities are recommended. These actions include:

(1) Promoting housing mortgages development;

(2) Extending the Public Housing Accumulation Fund to every urban household in both the state and the private sector; and

(3) Providing momentum to the housing savings bank for its development.

6.2.3.2 Increasing the availability of finance

It is essential to increase the access to finance of the low-income groups for the following two reasons. Firstly, personal housing loans in Chinese banks represent only a negligible percentages; and (2) insufficient bank mortgages together with the inability to recover property under foreclosure in the event of mortgage defaults are still major stumbling blocks for financial institutions in expanding their lending patterns.

6.2.3.3 Providing rescue financing

In situations where a household cannot continue with bond payments, financial institutions should rescue them without them having to vacate the property. This can be done by purchasing the property at a reasonable market price and letting it to the household at a more affordable rate. The household
is granted the first option to buy back the property within the first ten years from the date of transfer.

6.2.4 Recommendations on housing technology

The provision of adequate housing for urban households depends on the competitive response of the building industry. Housing construction in China is still at a resource-depleting stage with a low level of industrialization and productivity — China’s labour productivity in the construction industry is less than one fifth of that in the developed countries. Furthermore, science and technology contributes less than 30 percent to the development of the housing industry. These disadvantages in housing construction must be worked out in order to provide housing effectively and efficiently.

6.2.4.1 Educating the unskilled people who mainly come from rural areas

Most employees in construction come from the countryside. These workers leave home due to limited land for cultivation. The education levels of these employees are very low which means they are not qualified for the job. This is not only a problem in project quality, but also entails a safety risk in the process of construction. Therefore, unskilled workers must be trained with related skills by the construction company in order to enable them to do job satisfactorily.

6.2.4.2 Utilising lightweight materials

It is recommended that lightweight aerated concrete blocks and panels be tested in the market for use as wall material. They have a number of advantages, such as easy handling, fast construction, strength, durability,
good temperature control, acoustic and waterproofing characteristics, and 30 percent cost-saving potential. They are being increasingly used in construction in China and have great potential in housing construction.

6.2.4.3 Establishment of ‘middle and small towns’ as integrated accommodation, development and productive living environments

The patterns of urbanization in China do not mean people should go to mega cities seeking jobs. This would accelerate the gap in economic development between the city and countryside, but also exacerbate the burden for large cities to settle big numbers of migrating people. This is why the Chinese government issued a policy to develop middle and small towns. People from the countryside need not go far away from their home town looking for a job. Rural jobs help to realize the integration between city and countryside.

6.3 RECOMMENDATIONS FOR FURTHER RESEARCH

Housing must be recognized as being only one component in the whole process of improving the quality of life of individuals, communities and society as a whole. It can therefore not be treated as a single issue, but should be integrated with health, education, creation of employment opportunities, addressing poverty and building the economy. The process of development has also become as important as the provision of housing – especially in the Chinese context where housing shortages and overcrowding were serious problems faced by the Chinese government under the socialist ideology. Therefore research on housing industry development in China has great potential in improving people’s living standards and contributing to national economic development.
(1) The implementation of each of the instruments described in this dissertation can be further investigated. Once implemented, their performance in housing development in China can be monitored regularly.

(2) The constraints such as discrimination between the state and private sector in gaining financial support should be given more attention in regard to achieving the aim of ‘Housing for All’ of the World Bank’s programme.

(3) Co-operation between government agencies should be enhanced to eliminate contradictory orders being passed to developers.

All the conclusions and recommendations serve to underline the fact that with determination and purposeful action a way forward can be found to overcome constraints in housing development and improve national economic health in China.

6.4 FINAL CONCLUSIONS

This study emphasized the implementation of an urban housing policy and the development of the housing industry in China. Firstly, this research reviewed the processes of the urban housing reform in China. There were five phases in the urban housing reform in China regarding the various policies implemented in different periods. The development of the housing industry in China has also experienced three phases. This study contributed a basic understanding of why and how the urban housing reform performed in China and its impact to the development of the housing. The success and failure in different periods of the housing policies implemented in China were examined by the researcher.
Secondly, this study provided an analysis of the constraints in the development of housing in China. The housing industry was influenced by the housing policy in China. Under the Soviet model applied in China, the housing industry was depressed nearly for 30 years. The housing industry recovered after economic reform took off in China and showed a growth that had not been seen before. The development of housing has taken a winding path since the inception of urban housing reform. Housing development in China still has great potential for the national economy, especially as regards the commercialization and socialization of housing in China.

Thirdly, an investigation of the relationship between the development of the housing industry and national economic development in China was also examined in this study. Rostow’s Stages of Economic Growth model was then used to show how the housing industry in China could become a leading sector in its contribution to the national economy.

Finally, this study has also considered the government’s intervention in the development of housing in China. The various instruments that related to housing development were described in the study. As well as the impact of various policies in housing, this study has also looked at the effect of the external environmental factors in housing development. PEST analysis and Porter’s five forces model have been used to measure the external environmental factors’ effect in housing development in China. By housing’s very nature, housing is a commodity without close substitutes. For example, one can drink tea when coffee is scarce, but if housing is scarce, no other category of consumption goods can even approximately replace it. As regards the government’s important role in housing development in China, in Porter’s five forces model, the threat from substituted goods was replaced by government’s function to analyze macroeconomic environmental factors in housing development in China.
This study contained an integrated investigation into the various aspects of urban housing policy after the new China was founded. Under the Soviet model implied in China, the housing was considered as a welfare benefit but not commodity. Provision of housing in China monopoly took over by the government at extremely low rent which was not even enough for housing maintenance. Housing industry in China was depressed for nearly 30 years. Demand and supply of housing in China were not driven by the market power. Limited financial funds for housing construction with rapid growth population in China caused serious crowding and shortage of housing in urban areas. This was the reason why the Chinese government started to reform the welfare housing system.

Housing as a commodity was recognized by both government and individuals since the urban housing reform started in China. Correspondingly, housing market was also recovery. The provision of housing became an issue that government, private sectors and individual households all participated for its successful. Demand and supply of housing should subject to the law of market. The urban housing reform in China provided the stage for the development of housing industry.

In order to understand how important of housing policies impacted the development of housing, this study analyzed the process of the housing development in China. Because the economic reform in China have not been conducted according to a well-defined and time-consistent objective model, various policies issued during urban housing reform touched off some problems while gave momentum for development of housing. This does not necessarily mean that the Chinese reform has been objectives. Rather, the objective model of the reform has been under continuous re-adjustment during the reform process, from “planning economy with some market
adjustment”, to “socialist planned commodity economy”, to “socialist market economy”.

The development of the housing industry has experienced processes of the recovery, speedy development and stable periods. The negative impact for the development of the housing in the different periods of urban housing policies implementation was clearly described. An analysis of the success and failure of urban housing policy implemented in China gave an important suggestion for policy makers in the orientation of the development of housing in China.

In tandem with accompanying the economic reform that spread nationwide, reforms in housing, education, health care and pensions were also launched in that order of priority in China. Monthly’ expenditures of urban households in China have to include the spending on the education for children, pensions for old age, and housing mortgages. This undoubtedly exacerbated the burden for urban households in China. The policies makers in China are still under pressure in regard to the provision of affordable housing for majorities.

Through this study, the development of housing as a complex issue has been shown in both economic and social development in China. The development of housing is of vital importance in the national economy, while it is a crucial aspect of people’s living standards in a country. This study has shown good reasons for the claim that housing development has a great potential for national economic development.

As well as the development of housing, China needs other aspects of reform, such as low salaries, medical aid and pensions. Therefore, to realize sustainable and healthy development of housing and improve the living standard for urban households in China is still a big challenge for the Chinese
government in the present and will be in the future. This situation also offers an opportunity for specialists and scholars researching the development of housing in China as regards the speed, scale, supply and demand in the housing construction industry.

With regard to analyse the Rostow’s stages of economic growth, the housing industry could become a leading sector in China and its great contribution to the national economy has been gradually recognized by the Chinese government. This research has proved that there is still much room for improvement in housing development in China. This is no doubt that housing development in China will be considered as one of most important industries to the national economy. The government and private sectors in China must pay great attention to the housing development and its benefit in both the national economy growth and standard of living improvements.

This study was limited in its data collection on the analysis of the relationship between the development of housing and the national economic development. The reason is that the housing development is very difference between the regions in China. For example, the house prices along the coast regions are much higher than inner cities. However, the data collected by this study only showed the average in China. With regard to the imbalance of regional development in China, this study did not compare the diversities of housing industry development in different regions. The shortcomings in this study will be addressed in a future study.
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Using Rostow's model as a basis what are the stages in development a country needs to become a self-sustaining economy.


LIST OF ANNEXURES

ANNEXURE A: MAP OF PEOPLE’S REPUBLIC OF CHINA


Geography – note
world’s fourth largest country (after Russia, Canada, and US); Mount Everest on the border with Nepal is the world’s tallest peak

Population:
1,306,313,812 (July 2005 est.)

GDP - per capita
purchasing power parity - $5,600 (2004 est.)

GDP (purchasing power parity)
$7.262 trillion (2004 est.)
Labor force & Labor force - by occupation
760.8 million (2003), agriculture 49%, industry 22%, services 29% (2003 est.)

Population below poverty line
10% (2001 est.)

Household income or consumption by percentage share

ANNEXURE B: MAP OF JIANGSU PROVINCE (CITY: CHANGZHOU)
ANNEXURE C: MAP OF JILIN PROVINCE (CITY: SIPING)
ANNEXURE D: MAP OF HENAN PROVINCE (CITY: ZHENGZHOU)

The capital of Henan Province; an important inland city opening to the outside world and also a well-known historical and cultural city in China.
ANNEXURE E: MAP OF HUBEI PROVINCE (CITY: SHASHI)
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