Commercialisation of housing in China

Eric Carlson, IUBSSA special advisor, examines the enormous challenge facing the Chinese authorities in their task of improving the housing standards of the country's 1.2 billion people.

Since 1984 the International Union of Building Societies and Savings Associations (IUBSSA) has developed a special relationship with key authorities in the People's Republic of China concerned with the development of the housing sector and its financing. This has involved official visits, lectures and seminars conducted by former president Dr Willi-Dieter Osterbrauck and myself as special advisor to IUBSSA. These have been sponsored by the Ministry of Urban and Rural Construction and Environmental Protection (MURCEP), and provided the occasion to meet directors and leading officials of housing and urban development programmes in various cities of China.

IUBSSA has provided a grant for a research project on housing policy and finance in China which is being carried out in co-operation with the Institute of Public Administration of New York and the China Academy of Urban Planning and Design. The draft chapters of the book resulting from this project are currently being reviewed in Beijing. This article previews some of the issues and materials which will be covered more fully in the book.

Introduction

Housing finance policy has become the subject of special scrutiny and inquiry in China, a developing socialist country presently engaged in a vast process of growth and transformation. China is on target towards its goal of quadrupling its Gross National Product by the year 2000. The per capita income for its population of over 1.2 billion people will then have reached US$800. Though seemingly modest, the awesome effort means providing for 150 million more people than the 1985 figure of 1,046 million.

In spite of the success of the one child per family campaign, and a population growth rate of only 1.12% in 1985, new housing pressures will arise from a surge of newly-married couples over the next decade, an increasing rate of urbanisation, movement of peasants away from their traditional agricultural pursuits, deterioration of the existing housing stock, much of which is of poor quality and standard, and severe overcrowding.

Investment in housing is now about 7-8% of Gross National Product, and 12.6 million dwelling units were constructed in 1985. However, the lack of housing is still perceived as a major problem, and particularly so in urban areas. It is considered that major reforms are essential in matters of housing policy, finance and management if investment efficiencies are to be achieved and if there is to be substantial improvement in the housing stock.

The Seventh Five Year Plan, ratified in April 1986, takes account of the present situation and concludes:

"We should commercialise housing in the cities and towns and speed up the growth of residential construction industry, making it a pillar of the national economy..."

But how is the "commercialisation of housing" to be achieved in a developing socialist country of such dimensions as China, where low-rent, highly subsidised policies for housing have prevailed for more than 30 years? An active private sector in this field does not exist. Should housing be considered as a public service to which all are entitled? Is it a commodity to be acquired, bought and sold in the marketplace? Or is it a unique blend of various economic and social categories and considerations?

Housing in the economic context

In 1985, 130 million square metres of new urban housing was con-
structured representing an investment of 25 billion yuan (the official exchange rate in September 1986 was 3.7 yuan to the dollar). In the rural areas 770 million square metres of housing was built, for an estimated 9.6 million rural households. For urban housing, the state and other enterprises paid almost 6 billion yuan more in subsidies, representing estimated depreciation, maintenance, repairs, management and interest (based on the cost of construction) less rent paid.

The overall housing improvement goal for China’s population by the end of the century is for every family to have its own complete dwelling unit. The objective is to achieve overall average living space for each person of some eight square metres. This represents a considerable upgrading from the present situation of prevalent overcrowding. In 1982 the estimated average living space was 4.4 square metres per person, with wide differences between cities and regions. It has been rising slowly since that time, and the objective of eight square metres is now thought achievable.

This would mean some 200 million units, totalling 14.5 billion square metres, over the last two decades of this century — 25% in urban areas and the remaining 75% in the countryside. This scale of building is unprecedented in world history. However, there are also serious problems to be overcome. The Seventh Five Year Plan, adopted in 1985, assumes an average construction of urban housing of 150 million square metres per year. At 200 yuan per square metre, this investment amounts to 30 billion yuan per year, with another 10 billion yuan required for subsidies.

The state’s capital investment in housing, together with the continuing and growing subsidisation, is a large one. In the remaining years of the century, under present policies, public expenditure may total several hundred billion yuan. Yet the net economic return on the investment will be negative because the present system of rental payments does not cover costs, much less generate capital for the construction of new housing. Although some two-thirds of the urban inhabitants have benefited from the low-rent housing policies, at least one-third more are in need of new housing, and there are questions of housing inequality and other matters to be resolved.

Rural housing

“Commercialisation” of housing prevails in the rural areas: people can own their own homes, although not the underlying land which is retained in ownership by the collective. The individual dwellings become real property and can be handed down to descendants. Peasants have a long tradition of building houses for their children, especially before marriage. A wide variety of methods is used to build this housing, ranging from self-help and community assistance to arrangements with individual contractors.

The growth of incomes in many rural areas has brought with it a wave of investment by rural people for

Housing under construction in one of Shanghai’s 12 new towns.
housing construction and improvement of existing dwellings. Often, the peasant house serves also as part of a workplace or production centre, so such investment has additional importance. The fact that people can own their own homes in the rural areas is a tremendous incentive for their construction and improvement. It has also served to open up large markets for building materials, products, accessories and technical services for planning, design and construction.

In 1985, rural bank deposits amounted to 72 billion yuan, 18.1 billion more than in 1984. Rural people are expected to invest up to 200 billion yuan in new housing between 1986 and 1990, and are now spending an average of 16% of their annual incomes on housing improvements compared to 5% in 1980. When peasant families become richer, surveys show that their percentage of expenditure on housing rises sharply, and may even approach one-third of incomes.

Much new rural housing construction is of a high standard. In 1985 60% of the new housing was of brick and tile, and 15% was in two or three storey houses. Since 1979 an estimated 50 million rural households have moved into new homes, out of the total of 180 million rural households.

That the pace of rural housing construction and improvement will continue for some time is indicated by the estimates that annually some 15% of rural households are in need of building new homes or renovating old ones, while only 5% of the households are able to improve their dwelling conditions because of shortages of building materials and equipment, especially steel, cement and glass.

The rural reforms and the rise of the responsibility system for agrarian production have resulted in a substantial growth of income for the peasants in many rural areas. The fact that they are choosing to invest so much of this in housing of good standard and high quality, often superior to typical urban dwelling units, bodes well for the basic stability of the countryside.

A growing number of peasants are moving from their farms to nearby towns and townships and marketing centres. Peasants who relocate in this way generally bring with them their own capital and food and are prepared to engage in new productive endeavours. Such moves tend to alleviate the great pressures on the cities to receive rural migrants, and are helping to create a more rational urbanisation pattern.

So a scenario exists for an extension of the owner-built and owner-occupied housing in the rural areas and the country villages of China to similar patterns for these towns and townships. The highly subsidised and controlled low-rent policies of the cities could then be avoided. It would be necessary to have new emphasis on the importance of planned development, the rationalising of infrastructure, and the provision of other services and amenities, including commercial, industrial and cultural facilities.

Fortunately, much is being achieved along these lines, and reportedly there are now construction plans for 85% of the country’s five million villages, and 84% of the 54,000 rural towns. More than 500,000 newly-trained rural planners and surveyors have worked on such planning with the help of urban experts.

Urban housing commercialisation

At the end of 1985 212 million people lived in the country’s 333 cities; an increase of 110 million in the urban population is forecast by the year 2000.

China’s official policy is to balance urban and rural development and it is adhering to a policy of controlling the growth of big cities, moderately developing medium-sized cities, and actively promoting small cities. In general, people are restricted in their movement of location of residence, and it is difficult to obtain legal occupancy in the cities, the more so when the provision or assignment of housing is usually tied to the work unit or place of employment.

There is increasing evidence of slippage, or “slip-through”, however, and it is estimated that there are 3.21 million temporary residents in China’s 10 largest cities. Some of this is the result of bringing to the cities contract labour from the provinces for construction projects. A good part of the migrant population is not officially sanctioned, and there is clearly a problem of registering non-permanent urban residents. In Shanghai alone, the temporary residents were estimated at 1.1 million by the end of 1985, 2.5 times the number of 1983. This is one reason among several why housing remains in such short supply in spite of the very considerable investment in housing construction. Other symptoms are reported in the press: the sale and rental prices of private houses in Beijing are now sometimes 10 times legal levels; because young, newly-married couples find it virtually impossible to secure housing through their work units, several cities have constructed special buildings to house such couples, providing them with minimum space and facilities, but strictly limiting the time they may remain in the accommodation; many cities now periodically sponsor housing exhibitions for helping in the sale or exchange of different types of apartments through photos, designs, models, and written notices and descriptions. Reports indicate that these events are thronged with people seeking more adequate or convenient housing, and that some do succeed in these efforts, though at a cost.

The origins of China’s present urban housing situation lie in the neglect of the urban housing sector during the 10-year cultural revolution, ending in 1976. During 1977-
the government began to deal with the problem.

Efforts were focused on how to speed up housing production and how to improve the living conditions of urban residents. It was necessary to mobilize the initiative of the central and local authorities as well as that of state enterprises and individuals. Home building was to be given special importance as a demonstration of the objectives of socialist production and "the people's government's" concern for the people, and to achieve the "dialectic relationship between production and livelihood, and between accumulation and consumption."

Since that time building more homes for the people has been one of the major items in China's economic readjustment, and the proportion of capital investment devoted to housing has steadily increased, amounting recently to over 25%, though it has declined somewhat in the past two years.

The government department responsible for studying and dealing with housing questions is the Ministry of Urban and Rural Construction and Environment Protection (MURCEP), which was established only recently, in 1982. MURCEP has broad powers, and its scope of work includes the formulation of policies, laws, decrees and regulations concerning urban housing development and administration; the working out of long-term programmes and annual plans and inspection of their implementation; promotion of the interchange of advanced experience and techniques, including through relationships with professionals and institutions in other countries; and organizing training courses for cadres responsible for the development and administration of housing in different regions and localities.

MURCEP's officers have been in the forefront of analysing information and the results of experience regarding housing and urban development in China, and in developing reform proposals.

Rent policy

Many of the problems are of long standing and are therefore politically sensitive and difficult to resolve. A prime example was the early decision by the new Chinese government in the 1950s to implant and to maintain a policy of very low rental for the existing housing stock as well as for new housing. Apart from helping to establish legitimacy for the newly-formed government, the reasoning was that housing in a socialist state should be considered as basically a public service. Since then, rents have been lowered over the years and are still maintained at very low levels.

For example, in the city of Wuhan in the early 1950s the rent for an average family amounted to about 14% of the household's income. Subsequently, the proportion of household income devoted to rent decreased to about 8% in 1957 and to 5% in 1970. In 1974, when the government began to subsidise one-third of a household's rent, the rent was reduced to what was virtually only a nominal fee. A 1980 survey of the Wuhan City Realty Company reported that an average household paid only 2.3% of its monthly income for its housing. The under pricing of urban housing units has led to two serious consequences: poor housing conditions and inadequate new housing.

Urban housing reconsidered

In the current debate and discussions regarding China's housing policy, it is argued that residential buildings should be considered as commercial commodities in China's socialist economy. To correct the housing shortages, anomalies and inequalities, the urban housing sector needs to be commercialised, rents should be gradually increased, and the sale of housing to individuals should be officially permitted, to foster more widespread home ownership for urban residents. In this process, the urban housing sector could become financially more healthy and self-sustaining, and less of a burden on the state's investment resources.

The sale of urban housing received official blessing in early 1980 when the State Council announced that urban residential units should gradually be commercialised. In 1982 a demonstration project for housing commercialisation was initiated in your cities: Changzhou, Zhengzhou, Siping and Sashi. Under this programme a small number of new residential units are sold to individuals; the majority, however, are still being kept for distribution through the usual bureaucratic channels. From mid-1982 to end-1983 a total number of 1,746 residential units were sold to individuals in the four cities, albeit at prices lower than their costs.

Typically, an individual pays one-third of the construction cost of a residential unit, with the government and the buyer's work unit each paying an equal share of the outstanding balance. Thus, only one-third of the initial investment is being recovered through this subsidised sale programme, for reinvestment in more housing.

In October 1984 this scheme was officially extended to more than 80 cities. In 1985, 5% of Shanghai's new housing stock and 20% of Beijing's were set aside for subsidised sale to individuals. But while the government has proceeded carefully on a limited basis to permit the sale of housing, it has not yet attempted to adjust the rents or restructure the rental subsidy programme. So the problems persist and grow more serious.

The sale of a limited number of new housing units benefits a few households and really hurts none. But a rent increase or a restructuring of the rental subsidy programme could mean a total rearrangement of the economic system, and raises fears that the beneficiaries of the old system will be hurt. Stable rents, like stable food and commodity prices, are considered essential to preserv-
ing the overall economic well-being of the population. But the state does need some return on its substantial and growing investment for urban housing because there are always pressures on it to relinquish such investment without return in favour of providing for more productive investment in such sectors as industry, agriculture or energy.

As the present rent subsidy system is clearly neither rational nor advantageous for the development of China’s economy, various proposals have been made for the introduction of major reforms. One line of approach proposes that older state-owned housing should be sold to existing tenants at a discount, on favourable terms comparable to their present rents, thus permitting them to assume home ownership status and for the state then to eliminate its rental subsidy.

Another proposal suggests that the existing rental system could be reformed by establishment of a two tier system of hidden and open subsidies. Rents would be raised to a closer approximation of the real value of the housing space utilised. There would be a compensating subsidy for all urban dwellers on an open basis, but those occupying larger units would not receive additional subsidy for such larger units. There could be differentials depending on the income level of residents as well as the quality standard of the housing, to be treated separately and categorised for rental charges. However, this would all perpetuate and expand a complicated bureaucratic apparatus which would still exert state control over management of the housing stock without adequate bottom-line return.

As for the subsidised housing sale programme, it is argued that such a strategy cannot be maintained for any period of time because it still requires a large government subsidy. Moreover, many enterprises are reluctant, for various reasons, to contribute their share for house purchase or credit in relation to their total income or must find the resources for their one-third payments in other ways.

Proposals for commercialisation of housing must take into account several factors which differentiate the urbanisation pattern in China from that in many other countries. There tends to be a checkerboard pattern of land use, with industries, housing and farming still found side by side, not just on city fringes but in the city core. As land is unpriced, factories or enterprises do not pay land rent, and there results a pronounced misallocation of the use of land.

With a target of 200 million dwelling units by the year 2000, there should be ample scope for innovative approaches to urban housing, design initiatives, new organisational forms, and the opening up of alternative channels for housing construction, finance, investment and management. Competitive marketing concepts might well be encouraged and established.

One such possibility could be a system of open housing co-operatives with appropriate technical service organisations in each large city. These could be vehicles for accepting new applicants for housing, initiating savings deposit systems for such housing, developing new projects, and organising the residents for management responsibility and participation. Such a system of housing co-operatives could work in tandem with the municipal bodies for housing, with the appropriate modus operandi to be developed in each city.
Savings mobilisation for housing

The World Bank Report, *China: Long-Term Development Issues and Options*, points out that the percentage of gross domestic savings from households in China (29% in 1981), is considerably smaller than in neighbouring countries such as Japan (54%); South Korea (38%), and India (65%). The Bank's report states:

"In the future, the greater part of China's investment in urban housing could be financed by personal saving (partly through housing cooperatives), with far less provision of workers' housing by enterprises. The Government might provide housing directly only to the minority or people unable to pay, but could assist others by selling off more existing urban housing, as well as by 'sites and services' projects — planning and providing basic utilities for new, individually constructed housing — coupled with technical assistance and limited subsidies or tax concessions to housing co-operatives. (These could partially replace the large existing housing subsidies, which would need to be reduced or eliminated to provide an incentive for tenants to become owners.) Experience elsewhere suggests that such a system would be a powerful stimulus to household saving, as well as to better construction standards and maintenance."

The Bank's report also urges the establishment of alternative channels of investment flows, particularly horizontal flows, increasingly to supplement the largely vertical investment flows in the traditional socialist system. This means the establishment of a variety of new financial institutions, which could mobilise investment funds from individuals, collectives, state enterprises and local governments, by accepting deposits and by issuing financial instruments such as bonds (either by themselves or on behalf of the users of capital). They would have to offer an interest rate or other return that reflected the scarcity of investment funds in the economy.

The funds raised could be provided as loans, with fixed rates of interest and payment periods, but at least some financial institutions should be able to provide ownership capital. In such cases, the financial institution would be an investor itself, much as local governments, bureaux, state enterprises and collectives now participate in joint investment projects. As the World Bank report states, "These institutions would in effect create a socialist market for investment funds."

China began to diversify its financial system in 1979 and there are now many different forms of financial institution — banks, credit co-operatives, investment trusts, insurance and pensions funds, and so on. In rural areas some of the economic institutions of the former communes and brigades, which still exist following the reorganisation of local government administration, could be transformed into financial entities. Such township banks or investment companies could mobilise investment resources from collective enterprises to establish new enterprises, helping existing enterprises to expand and modernise and to support agricultural development.

It is generally agreed that commercialisation of housing in China can take place only if there are adequate provisions for credit and long-term finance capabilities to extend housing loans or mortgages to potential home buyers. Considerable progress has been made in overall financial reforms in China in recent years, and it is in this context that the present situation and potential for development of an effective institutional system for housing finance is examined.

The People's Bank of China exercises overall supervision over the banking system in China, and serves as the Central Bank for the government. It was on 1 January, 1984, however, that the People's Bank

*Typical old-style terraced housing in Shanghai.*
transferred its business of industrial and commercial credit and savings deposits to the newly-created China Industrial and Commercial Bank (CICB). The other main specialised banks are the Agricultural Bank, the People’s Construction Bank of China and the Bank of China. The People’s Bank sets the loan quotas for these specialised banks, which can raise money in various independent ways.

New banking control regulations, adopted by the State Council on 7 January, 1986, explain how the banking system is to operate. There is to be close co-operation and a more clear-cut division of functions between the People’s Bank and the specialised banks and other financial institutions. But there is also to be considerably more flexibility with respect to banking operations generally. Foreign banks are also permitted to establish and operate under prescribed conditions.

State-owned enterprises can raise money by issuing stocks and bonds. With permission of the People’s Bank, stocks offering dividends and voting rights may be sold by enterprises to other businesses and individuals. The specialised banks may issue savings bonds to the public to finance loans to enterprises. All can issue bonds and offer house-buying savings accounts. The CICB and the Agricultural Bank can open savings accounts in foreign currency. In general, it is expected that the specialised banks should develop into financially independent entities responsible for their own operations. Five cities have been selected for a programme of implementation of banking reforms over the next five years — Changzhou, Chongqing, Guangzhou, Shenyan and Wuhan. The bank branches in the five cities may lend and borrow from each other and perform a variety of financial transactions. It is expected that they will offer cheque and money order services, as well as personal and travellers’ cheques. Trust and investment companies for commercial credit, leasing, insurance and consultancy services are also being established.

Although there has been a considerable growth of savings deposits, the main message from the People’s Bank of China, through its president, Ms Chen Mu Hua, is that banks must still try to boost the savings deposits, that more savings banks should be opened, and more computers should be used.

China’s national banks can now also lend against fixed assets. This has been the main function of the People’s Construction Bank of China (PCBC). But, in 1985, excessive lending and credit for capital projects, some of which were not of priority, led to shortages of building materials and an overheating of the economy. Instructions were therefore issued to tighten fixed asset investment in state-owned industries. Some projects were stopped or suspended in the effort to reduce inflationary effects. The currency was also devalued, from 2.8 yuan to 3.2 yuan to the dollar, with a further devaluation to 3.7 to the dollar taking place in July 1986.

The PCBC has been an active player in the housing finance field. To date, in 1986, it has loaned 3.9 billion yuan for private housing projects and various enterprise urban development projects. About 56 million square metres, or one million flats, have been built with loans from the bank, of which 48.5 million square metres have been sold. The Bank attracts savings from individuals and enterprises for lending for home ownership. In 1986 it was announced that the Bank had one billion yuan
available for land development and private housing.

The CIBC has an extensive branch and office network, some 14,000 savings offices, about 400,000 employees and over 200 million individual savings accounts. By the end of 1985 it had savings deposits totalling 89.5 billion yuan or about US$28 billion. The target for 1986 is to increase savings deposits by 25 billion yuan. Loans for durable consumer goods and housing are growing rapidly. The Bank grants such loans linked to urban savings deposits. It grants loans for housing, including building, buying and improvement.

Typically, loans are from five to eight years and carry an interest rate which is established from time to time (in 1983 it was 6.82%). Loans to individuals for new housing are made on the basis of linkage with savings deposits, which should amount to between 30 and 50% of such loans. The Bank has given some construction loans for private development and made loans to enterprises for housing construction.

Although the CIBC is attracting a considerable volume of savings, a recent study by the Bank showed that the full potential is not being achieved. A survey of 11.6 million self-employed in nine major Chinese cities reported that only 6% had opened deposit accounts in the Bank or in local credit co-operatives. Among the reasons given were fear of sudden economic changes; a reluctance to disclose their economic means; inadequate services of the Bank; and interest rates on deposits were not keeping up with inflation.

Rural savings are growing at a fast rate, and at the end of 1985 the balance of personal deposits totalled some 56.5 billion yuan. About 80% of rural households belong to the credit co-operatives, which were established in the 1950s and which are under the supervision of the Agricultural Bank of China. To what extent the rural credit co-operatives make funds available for home improvement loans is not known.

The importance of a nationwide social security and pension system in China is increasingly being recognised. Already there are an estimated 100 million people of retirement age (60 for males, 55 for females), but only 12 million had actually retired by the end of 1985. The circumstances vary between cities and enterprises. In Shanghai, for example, all sino-foreign joint ventures are now required to contribute 30% of salaries to the Shanghai Branch of the People's Insurance Company of China, for the pension fund. In state-run units in other places, the percentage of staff payroll contributions for pension purposes may range from 12.5 to 25%. These funds are usually passed on to the local governments for administration, to reach the retired individual.

In view of the nature and the long-term character of pension funds, housing in many countries offers a major and appropriate investment opportunity for the resources in such funds. This can be on a direct basis, for funding of individual projects, or for investment in the secondary markets of mortgage securities and bonds, to free more resources for more direct and primary investment by organisations engaged in housing and building projects.

As China develops the basis for a nationwide system of social security and pension funding, it seems logical that investment for housing finance be one of the leading permitted investment objectives of such funding. This will add to the resources for building the nation's capital stock, help in its modernisation, and create employment on a sustainable basis, as well as providing for many other economic, social and environmental benefits.

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