

A China's Risk: The Big Inventory of Real Estates

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In 2015, Central Economic Work Conference put the problem related to real estate as the second priority in all five major economic tasks including reducing productivity, lowering the inventory of real estate, deleveraging, decreasing costs and promoting the development of slow industries.

Considering the massive pressure real estate problem brought to China's economy, it's necessary and timely to make such a decision. According to National Bureau of Statistics, the national inventory of commercial housing in the end of November 2015 is 6.96 billion square meters. Given the average price of commercial housing sales-6821 RMB per square meters-from January to November, total value of these properties for sale is 47,000 billion RMB. Less than one third of the investment in building these commercial housing is from property developers and the rest of the money all came from bank loan or financing of shadow banking. An inefficient or overdue capital return to the investment will shortly bring a big strike to China's financing system. So we can say that those unsold properties are indeed a potential disaster for our economy.

Even worse, the total area of commercial housing under construction has reached 72.4 square meters until the end of November 2015 which is nearly seven times the sales area of commercial housing from January to November 2015. This means a longer consumption cycle of property inventory because it takes as long as 7 years to sell all of the existing commercial houses. Besides, the big surge in China's property sales in 2015 was the result of incentives coming from numerous government policies. In 2015, from January to November, the sales of commercial houses is 10.9 billion square meters with an increase of 7.4 percent, which is just a little bit lower than the record high sales in 2013. It's hard to tell that such a positive sales of commercial housing will continue in the coming years since most of the necessary demand for properties has been met. Therefore, the big inventory of real estate will become one of the biggest concerns for China's economy in the future. Our studying team believes that the demand for improving housing conditions from current urban population has been very small.

The 34-35 square meters per capita in China's cities and towns equals to 28-29 square meters in the international standards, which is the same level as that of moderately developed countries. The figure of relatively

In today's China, the big inventory of real estate comes as a tricky issue. However, the real problem is not about the imbalance between supply and demand. Therefore, in order to promote China's economic development in new normal, what should we do?

developed countries in middle and East part of Europe and Korea is 26-27 square meters, which suggests that the demand for housing in China's towns and cities has been achieved in advance. And the amount of vacant housing in towns and cities has been increasing, most of which are newly built houses. According to estimation, 50% of these vacant houses are less than 10-year-old, 90% are less than 20-year-old and only 5% to 8% are old houses which are in desperate need of reconstruction.

Decreasing inventory of real estate means the necessity of reducing the productivity of real estate industry. In 2015, the investment in real estate has dropped dramatically in a lot of cities with a national increase of 1.3% from January to November, which was a record low rate since housing reformed policies had been issued. And the figure had been dropping since December 2013. Since 1.3% is calculated on the base of 2014's figure, which is in nature a big investment, we can see that investment in 2015 still means a large sum. From January to November in 2015, the investment into property building is 87,700 billion RMB, and the area of properties under construction is 14.06 billion square meters with a decrease of 14.7%. It would require more than 7 billion residents living in towns and cities to increase 2 square meters per capita per year in order to consume all of these additional newly-built houses. As I pointed out before, the demand for an improved housing condition from urban residents is small, so lots of people try to solve this problem by promoting new residents and migrant workers who are potential citizens to buy local commercial houses. However, with Chinese urbanization stepping into "deep water area", the number of new citizens has been declining and all of these people could only consume 7 billion square meters, thus urban residents still need to buy 1 square meter per capita to consume the rest.

But reducing productivity means to slow down the development of real estate industry, which will bring a bigger pressure to local fiscal taxation, especially considering the fact that lots of local governments' capability of debt payment is highly relevant to land-transferring fees, even tax revenue is much dependent on real estate industry. Members of our studying team once did a calculation about the dependence degree of local taxation on real estate industry in Jiangsu Province and they found that direct tax on real estate accounts for 27-28% of local revenue while that figure of indirect tax is 10-12% in recent years. So we can see that tax related to real estate industry has become a large part (38-40%) of local revenue in Jiangsu Province. Clearly, among all kinds of fields in Jiangsu, real estate has been the biggest contributor to local revenue. Apart from the shocking figure, the income growth effect resulting from taxes on estate is remarkable. According to estimation, elastic coefficient of direct taxes on real estate against GDP in Jiangsu Province is 1.73(1% increase in

GDP, 1.73% increase in direct taxes on real estate); elastic coefficient of indirect taxes on real estate against GDP in Jiangsu Province is 2.07(1% increase in GDP, 2.07% increase in indirect taxes on real estate); and elastic coefficient of total revenue against GDP in Jiangsu Province is 1.83, which is way higher than that (1.2%) of taxes on other industry or field.

Direct taxes on real estate include: tax on urban construction and maintenance, tax on real estate, tax on the use of urban land, land VAT, tax on field occupation and tax on deeds. Indirect taxes on real estate include: business tax, income tax paid by developers. Meanwhile, the slack in real estate industry brought a big damage to the development of other industries in the same industrial chain such as steel, coal, cement, construction materials and furniture etc. So local governments, facing the high inventory of commercial houses, are now in a dilemma: maintain house prices or maintain property productivity? Keeping house prices means reducing productivity which will shortly damage the economy; keeping property productivity requires the same or further development of real estate industry, which is going to disturb the unsteady price of commercial houses. Such a dilemma is originally the bad result of the development of traditional urbanization.

More importantly, a huge spatial imbalance exists between real estate demand and supply. The demand for commercial houses from new citizens during urbanization mainly comes from first-tier and second-tier coastal cities on eastern part of China where the inventory of real estate is not really an issue, even some real estate markets are required to make up the inventory in order to counter with the surging housing price. But the situation is totally different in third-tier and fourth-tier cities where the inventory is indeed a big issue. So it's much more difficult to tackle with this inventory problem.

According to statistics from the sixth national population census in 2010, the national population growth from 2000 to 2010 is up to 73.89 million people, among which the population of Guangdong Province accounts for 24%, Zhejiang 10.4%, Shanghai 8.5% and Beijing 7.8%. We can see that population growth from these four provinces and cities accounts for more than half of the national population growth. In terms of cities, population growth from migration in Shanghai, Shenzhen, Beijing, Dongguan and Guangzhou is 34.7 million people. Besides Chengdu and Wuhan, cities which rank before 20th in terms of population growth from migration are all coastal cities with a total growth of 64.83 million people.

In our team's opinion, the essence of supply side reform is to increase the allocation efficiency of factors. Thus, an important task is to improve the spatial allocation efficiency especially the spatial efficiency of land. The

imbalanced spatial distribution of land is the result of China's planned economy, which is the origin of high inventory of properties in third-tier and fourth-tier cities. We should make good use of market mechanism while following the rules of city development and population migration to deal with the problem.

On December 2015, the first necessity released by the Central Urban Work Conference is to follow the rule of urban development. Our research team believes that the law of aggregation is the most important one among rules of urban development, and we need to realize the development of local industrial specialization, and further achieve a balanced regional development. A balanced regional development is necessary for the achievement of an inclusive and balanced development, and necessary for economical development in new normal. However, the purpose of regional balance is not the balance between population and economical scale but the realization of balanced income per capita in different areas, which depends on the flow of population and labor force. In the past, local governments on eastern part of China overlooked population growth from migration and surging housing price while making policies towards regional development. Practices adopted by local government like decreasing land for construction and drawing a clear line of urban space were contributors to the surge of rent and house price, which put a huge damage to the economical scale and urban competitiveness in eastern metropolises. In contrast, local governments in middle and western part of China still maintain a big supply of land for construction while overlooked local population decreasing from migration, which results in a huge amount of vacant commercial houses.

We believe that the real problem in China is not about the shortage of demand but about the fact that our supply cannot satisfy our demand including the demand for a people-oriented urban development. According to necessities released on the Central Economic Work Conference on December 2015, the supply side reform is to supplement the shortage of supply, and to meet the demand, in real estate and land, which means that the supply of land for construction should be based on the demand from migration growth, rather than defying the law of urban development.

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