Zhi Liu Keynote

10-11
October 2014
www.ufsc2050.ics.ulisboa.pt
ROLE OF URBAN GOVERNANCE AND FINANCE WILL BE CRUCIAL FOR AN URBANIZED CHINA...

- **Share of urban population**: 54% in 2014, 60% in 2020, and 75% in 2050

- **The central question for this presentation**: What will be the most likely scenario of urban governance and finance in 2050

THE SCENARIO DISCUSSION IS BASED ON THREE CONSIDERATIONS...

- **History** is important as urban development is path-dependent

- **The effort of society** is expected to steer the course of urbanization towards a vision

- **Foreseeable constraining factors** are expected to influence the course of urbanization
The recent history...

1990

2013

Shanghai Pudong
SHENZHEN

1980

2013

UNDER THE URBAN MIRACLE ARE A NUMBER OF ECONOMIC AND SOCIAL PROBLEMS TODAY…

- Urban housing prices: increasingly unaffordable
- Urban housing vacancies: 65 million vacancies in 2012 (unofficial data)
- Growing local debts: 18 trillion RMB (US$2.9 trillion) or 32% of national GDP in 2013
- Growing social tension: arising from rural to urban land conversion
- Over conversion of farmland to urban use and inefficient use of urban land
“Ghost Towns”

Why did all these happen?

- We need to revisit the national economic growth strategy, governance structure, tax sharing system, urban GDP growth strategy, land concessions, land supply, and housing market.
Mobilizing and Capitalizing land resources has evolved to become part of China’s economic growth strategy since 1978...

- Open-door policy to take advantage of globalization
- Learning from Singapore, Taiwan, and Hong Kong
- Cheap land, cheap labor, and improved infrastructure to attract foreign direct investment
- Special economic zones, industrial parks
- Cheap domestic credit provided by the state banks

China has a unique governance structure...

- Rules: Central government appoints provincial top leaders (i.e. party secretary), and provincial leaders appoint prefecture leaders and so on; local governments are not given tax power
- Mechanism: National GDP growth target is achieved by all levels of local governments chasing the same target with whatever means feasible within the policy framework
- Incentive and behavior: Competition among local leaders of the same level for the best GDP growth performance in exchange for better chance for political promotion
National GDP growth target is practically achieved by all levels of local governments chasing the same target...

Tax sharing system was introduced in 1994...

- **Tax revenues** in 2012 (totaling RMB11.7 trillion):
  - Central 48% (71% of which were inter-governmental transfers)
  - Local 52%
- **Expenditures** in 2012:
  - Central 15%
  - Local 85%
CITY GOVERNMENTS RESPOND TO INCENTIVES UNDER POLICY CONSTRAINTS...

- City governments face fiscal constraints:
  - No tax power
  - Not allowed to borrow directly
- But city governments found ways to raise funds
  - Raise fund through land concessions
  - Create urban development investment corporations (UDICs) as finance platforms to borrow
  - Boost local real estate businesses for tax revenues and GDP
  - Impose various charges and surcharges

LOCAL GOVERNMENTS INCREASINGLY RELIED ON LAND CONCESSIONS FOR REVENUES...

<table>
<thead>
<tr>
<th>Year</th>
<th>National Fiscal Revenues</th>
<th>National Fiscal Revenues as %</th>
<th>Central Fiscal Revenues</th>
<th>Local Fiscal Revenues</th>
<th>Land Concession Revenues</th>
<th>Land Concession Revenues as %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>2,172</td>
<td>985</td>
<td>542</td>
<td>55.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>2,640</td>
<td>1,189</td>
<td>641</td>
<td>53.90%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>3,165</td>
<td>1,510</td>
<td>588</td>
<td>39.00%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>3,876</td>
<td>1,830</td>
<td>808</td>
<td>44.10%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>5,132</td>
<td>2,357</td>
<td>1,222</td>
<td>51.80%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td>6,133</td>
<td>2,865</td>
<td>1,026</td>
<td>35.80%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2009</td>
<td>6,852</td>
<td>3,260</td>
<td>1,718</td>
<td>52.70%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>8,310</td>
<td>4,061</td>
<td>2,747</td>
<td>67.60%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>10,387</td>
<td>5,255</td>
<td>3,213</td>
<td>61.10%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>11,725</td>
<td>6,108</td>
<td>2,690</td>
<td>44.00%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Official statistics.
**But the mechanism of land finance is more complicated…**

- Employment
- FDI and other outside investment
- Industrial land supply
- Rural to urban land conversion
- UDIC (Urban Development Investment Corporation):
  - Land acquisition
  - Resettlement
  - Infrastructure Investment
- Commercial and residential land supply
- City Government
- Local tax revenues
- Real estate and population serving businesses
- Commercial banks

**Industrial land prices are way below residential land prices…**

*Equations:*

- Residential Land Price: $y = 0.5856x - 9587$, $R^2 = 0.39077$
- Industrial Land Price: $y = 0.0351x - 234.33$, $R^2 = 0.30257$
CITY GOVERNMENTS CONTROL URBAN LAND SUPPLY BY TYPE OF USE: THE CASE OF BEIJING

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>hectare</td>
<td>%</td>
<td>hectare</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>1,100</td>
<td>16.9%</td>
<td>1,180</td>
</tr>
<tr>
<td>Industrial</td>
<td>1,000</td>
<td>15.4%</td>
<td>1,100</td>
</tr>
<tr>
<td>Commercial</td>
<td>550</td>
<td>8.5%</td>
<td>350</td>
</tr>
<tr>
<td>Public and Administrative</td>
<td>1,300</td>
<td>20.0%</td>
<td>1,370</td>
</tr>
<tr>
<td>Residential</td>
<td>2,550</td>
<td>39.2%</td>
<td>1,700</td>
</tr>
<tr>
<td>of which:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Affordable housing</td>
<td>1,330</td>
<td>—</td>
<td>650</td>
</tr>
<tr>
<td>Commodity housing</td>
<td>1,220</td>
<td>—</td>
<td>850</td>
</tr>
<tr>
<td>Total</td>
<td>6,500</td>
<td>100%</td>
<td>5,700</td>
</tr>
</tbody>
</table>


MANY FACTORS AFFECT URBAN LAND SUPPLY…

- National policy for agricultural land conservation: 1.8 billion mu as a national fixed constraint which is balanced at the provincial level
- Industrial land supply at low prices or even with subsidies, as part of the strategy to attract industries for local economic growth
- Supply of land for infrastructure, affordable housing and administrative purposes also at low prices
- As a result of the above factors, the supply of land for commodity housing is very limited, which pushes up residential land prices
- This plays well for the city governments in terms of land concession revenues
NEW HOME PRICES ARE POSITIVELY CORRELATED WITH RESIDENTIAL LAND PRICES...

\[ y = 0.7485x + 5026.1 \]

\[ R^2 = 0.78741 \]
REAL ESTATE INVESTMENT CONTINUES TO BE STRONG DESPITE HIGH PRICES...

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Capital Investment (billion RMB)</th>
<th>Annual Growth Rate</th>
<th>Real Estate Investment (billion RMB)</th>
<th>Annual Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>3,292</td>
<td></td>
<td>498</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>3,721</td>
<td>13.0%</td>
<td>634</td>
<td>27.3%</td>
</tr>
<tr>
<td>2002</td>
<td>4,350</td>
<td>16.9%</td>
<td>779</td>
<td>22.9%</td>
</tr>
<tr>
<td>2003</td>
<td>5,557</td>
<td>27.7%</td>
<td>1,015</td>
<td>30.3%</td>
</tr>
<tr>
<td>2004</td>
<td>7,048</td>
<td>26.8%</td>
<td>1,316</td>
<td>29.7%</td>
</tr>
<tr>
<td>2005</td>
<td>8,877</td>
<td>26.0%</td>
<td>1,591</td>
<td>20.9%</td>
</tr>
<tr>
<td>2006</td>
<td>11,000</td>
<td>23.9%</td>
<td>1,942</td>
<td>22.1%</td>
</tr>
<tr>
<td>2007</td>
<td>13,732</td>
<td>24.8%</td>
<td>2,529</td>
<td>30.2%</td>
</tr>
<tr>
<td>2008</td>
<td>17,283</td>
<td>25.9%</td>
<td>3,120</td>
<td>23.4%</td>
</tr>
<tr>
<td>2009</td>
<td>22,460</td>
<td>30.0%</td>
<td>3,624</td>
<td>16.2%</td>
</tr>
<tr>
<td>2010</td>
<td>27,814</td>
<td>23.8%</td>
<td>4,827</td>
<td>33.2%</td>
</tr>
<tr>
<td>2011</td>
<td>31,102</td>
<td>11.8%</td>
<td>6,174</td>
<td>27.9%</td>
</tr>
</tbody>
</table>

Source: National Economic and Social Development Statistics.

WHY HOUSING DEMAND REMAINS HIGH?

- Housing supply increases with high sales prices
- But why demand remains high when prices are so high?
  - Households purchase houses as a way of investment
  - Urban household saving rate remains high at about 25-30%
  - Inflation has been high over the last few years (see earlier slide for CPI), and liquidity is plenty
  - Interest rates of savings accounts are low due to lack of competition in the banking sector
  - Stock market is under-developed and poorly regulated, and has been running down for 6 years
  - Demand ahead of time due to “mother-in-law factor” (Wei and Zhang, 2012)
The pivotal time...

NEW REFORM DIRECTIONS ANNOUNCED BY THE CPC 18TH CENTRAL COMMITTEE’s THIRD PLENARY SESSION ON NOV. 12, 2013

- **Hukou**: (gradually) relax controls on farmers settling in cities and towns
- **Land**: form a unified urban and rural construction-land market
- **Taxation**: raise share of direct taxation, improve local tax base, and accelerate property tax legislation
- **Financial market**: accelerate interest rate liberalization
- **Role of government**: shift to service-oriented government, and de-link performance from GDP growth
Vision of Urban China 2050 and its constraints...

Vision for Urban China 2030 and beyond...

- Vision: Efficient, inclusive, sustainable urbanization
- Possible if the new reforms get implemented and achieve intended outcomes by 2020
- Key constraints
  - Increasing labor cost
  - Productive capacity surplus
  - Aging of population
  - Shortage of water
  - Scarcity of land and natural resources
  - Climate changes
  - No timetable for political reform
Likely scenario of urban governance and finance...

**KEY EXPECTED RESULTS OF NEW REFORMS...**

- Strengthened role of market in urban economic growth
- No hukou constraint for households
- Unified rural and urban construction land market
- Fair compensation to farmers for land takings
- Interest rates liberalized, and RMB internationalized;
- Stock and bond markets better developed and regulated, transparent
- Prices of urban services more closely reflect the social and environmental costs
KEY ELEMENTS OF URBAN GOVERNANCE AND FINANCE...

- **Role of city governments**: to manage and finance the growing expenditure need for public infrastructure and public services
- **Main sources of municipal revenues**: broad-based income tax, consumption tax and property tax
- **Land-based financing**: a viable land value capture tool for financing of public infrastructure
- **Local borrowing**: City governments allowed to raise fund from the capital market
- **City leaders**: locally elected and mainly respond to the need of the city residents
- **Checks and balance**: Local leaders subjected to the monitoring of the city people’s congresses that have full representation from the residents
- **Metropolitan-wide regional governments**: some forms may emerge
- **Grass-root governance arrangements** (such as homeowners associations): will emerge to protect collective property rights commonly seen in urban settings

Let’s discuss...

Thank You!