

Carefully designed property tax needed

The challenge for China's leaders is to contain housing investment demand that could cause overbuilding

By **DING SHUANG**

Urbanization and upgrading needs will create an estimated demand for 6 billion square meters of housing from 2017 to 2021. This will keep the investment in housing growing at around 5 percent in real terms over the next five years. Investment demand, however, may lead to overbuilding and derail China's rebalancing and industrial upgrading agenda. The Chinese leadership therefore needs to promote reforms by introducing a property tax, which will be an integral part of any long-term solution, preferably implemented in a revenue-neutral manner.

Housing investment has grown rapidly over the past two decades, leading to a significant improvement in living conditions in China. Housing reform introduced in the 1990s allowed the development and sale of homes based on commercial principles. In the past two decades, the investment in residential housing development has grown by an average of 19.2 percent per year. As a result, the urban living area per capita more than doubled to 36.6 sq m of gross floor area in 2016 from 17 sq m in 1996. With per-capita living area increasing by about 0.8 sq m each year, China can close the gap with the average in the European Union in five years.

The housing sector has become

too big to fail. Real estate investment accounted for over 10 percent of the economy last year. The International Monetary Fund has estimated that the real estate and construction sectors together contributed 33 percent of China's GDP growth in 2013 if upstream and downstream sectors are included. Bank lending to the real estate sector totaled 26.7 trillion yuan (\$4 trillion) last year, or one-fourth of banks' total credit outstanding. In addition, real estate is used extensively as collateral for corporate borrowing, and a major housing market correction could undercut the value of the collateral.

Signs of property bubbles have prompted the government to introduce tightening measures since the fourth quarter last year, likely to lead to slower housing investment in the near term. Following the stock market correction in 2015, housing prices soared by about 30 percent in Tier-1 cities last year. The government adopted city-specific measures late last year to contain property bubbles through restrictions on purchases, sales, prices and mortgages. Price increases have moderated in recent months, but at the cost of suffocating market activity.

Real demand, however, can sustain decent housing investment medium-term. Urbanization continues to bring roughly 20 million people from rural to urban areas each year. Many existing migrant workers

are living in very poor conditions. Most of the homes built before the 1990s lack modern amenities, and the demand for upgrading remains strong. We estimate that urbanization and upgrading needs will create at least 6 billion sq m of housing demand from 2017 to 2021.

We expect residential housing investment to grow by at least 5 percent per year over the five years. Demand is likely to be met by existing housing inventory and new commercial and social housing. At the end of last year, the total residential gross floor area waiting to be sold was roughly 400 million sq m. We forecast that 6.5 million units of social housing will be completed each year, based on the average of the past three years. Our calculations suggest that about 4.4 billion sq m of living area needs to be completed by developers in order to meet demand over the next five years, which requires new starts to grow by an average of 6 percent and gross floor area under construction to grow by about 5 percent each year, according to our residential housing investment model.

The challenge is to contain investment demand that may cause overbuilding. Given China's relatively closed capital account, housing remains the preferred investment vehicle for households. The risk-adjusted return from housing investment has been much higher than from other forms of

investment, such as stocks and bank deposits. This has fueled households' desire to own multiple homes. This has artificially increased housing demand, pushing prices higher and stimulating investment.

Excessive housing investment, however, could derail China's rebalancing and industrial upgrading agenda. Building homes and keeping them empty represents a waste of natural and human resources, to say the least. More important, with resources flowing unduly to the construction sector, China's ambition to become a world leader in innovation and high-end manufacturing may be thwarted.

A multifaceted approach is needed to address the risk of property bubbles in China. The government has pledged to introduce long-term solutions to ensure the healthy development of the property market. We think long-term solutions should include a tighter bias for monetary and credit policy, more supply to meet real demand, and more importantly a nationwide property tax to contain investment demand. The benefits of the property tax go beyond the property sector since, as a recurrent tax, it increases the cost of holding multiple homes; as a dedicated local tax, it helps to put local government finances on a sustainable path; and as a direct tax levied on assets, it can mitigate the concentration of wealth.

Ensuring revenue neutrality

could lower resistance to the introduction of a property tax. Local governments are generally reluctant to introduce a property tax for fear that it would discourage property investment and slow economic growth. For households, an additional tax burden on top of already high home prices is difficult to swallow, given that households acquire only 70-year land-use rights when they purchase a home. Thus the tax needs to be carefully designed and accompanied by supporting measures.

We believe the following elements are important: A minimum living area per capita should be defined and exempted from the property tax, with the purpose of sparing a large portion of the population, presumably the less wealthy. Some of the existing property-related taxes can be merged into the property tax. Rates on other taxes — such as income tax, value-added tax and consumption tax — could be lowered to offset the impact of the property tax, leaving total tax revenue unchanged in principle. Adoption of a property tax needs to be accompanied by the granting of greater asset rights to households. In other words, the renewal of land-use rights after they expire in 70 years should be guaranteed.

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China model allows long-term vision

With Western political systems mired in inefficiency, the world is looking for improved global governance

By **SONG LUZHENG**

The year 2016 might go down in history as a watershed moment for the global economy. Not only did the United Kingdom decide to leave the European Union, but also a globalization skeptic was elected president of the United States. And, in stark contrast to these inwardly looking events, China stepped forward as the champion of globalization and improved global governance.

Shortly after he assumed power, Donald Trump overruled major legacies of his predecessor by pulling the US out of the Trans-Pacific Partnership agreement, and seeking to repeal the Paris Agreement on climate change and the Affordable Care Act, known as Obamacare. He

is not alone in putting short-term personal influence before long-term national interests, which explains why a slew of economies in the West are either heavily indebted or suffer from waning competitiveness.

What makes China stand apart is its institutional efficiency, which has evolved from its political and cultural traditions, as President Xi Jinping concluded three years ago. At the macro level, the system allows China to make long-term plans and carry them through — an unlikely scenario in Western politics due to the constant reversal of policies whenever there is a change of government.

As a result of the wide solicitation of public opinions and thorough consultation with representatives from all walks of life, China's five-year plans ensure the country

remains on the right track without being subject to changes in leadership.

Western general elections, meanwhile, which are designed to enshrine the principle of "one person, one vote", have also led to notable wastes of talent. Political leaders are supposed to be chosen primarily based on their capability, yet the outcomes of general elections in Western countries are often determined by other factors including race, gender, appearance, religious belief, even eloquence.

Poor choices of political leaders aside, partisanship in many Western economies means talented members of the opposition do not have the opportunity to contribute to the ruling administration.

China's success in electing eligible leaders has a lot to do with

its capability-oriented recruitment system, in which all candidates have to go through decades of service in different local governments. These down-to-earth posts not only offer firsthand experience of social governance but also help them promulgate targeted policies when in office.

Unlike China's democratic centralism, the Western political systems subject political power to voters and capital, which leads to inefficient governance and political shortsightedness.

Former US president Barack Obama was known as an enthusiastic advocate of high-speed rail before he took up residence in the White House in 2008. His administration's 2009 stimulus bill allotted billions for high-speed rail projects, which were rejected or stalled after domestic airlines, expressway com-

panies and citizens refusing relocation opposed them. Most of the federal funds have been used for upgrades to existing services such as the Amtrak rail network.

China, now a pioneer in high-speed rail construction, has managed to press ahead with similar projects, which has actually prompted airlines and expressway companies to improve their services and lower their prices.

China also dwarfs many Western nations in its ability to mobilize and coordinate public participation in the face of emergencies and natural disasters, further evidence that China's development path should not be scorned.

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