Attempts to slow China's housing construction expose other problems

Ghost cities full of empty apartment blocks are evidence of the central government's failure to slow booming house construction in the People's Republic of China.

Conflicting incentives for local government officials, and a lack of alternative investments in China, have meant even the toughest of restrictions haven't been able to stop developers building ever more houses.

The housing industry is a big part of China's economy. Real estate accounts for one-sixth of its GDP, a quarter of total fixed asset investment, 14% of urban employment, and 20% of bank loans.

Research done for the Asian Development Bank Institute finds that the central government has maintained a firm hand on the sector for the 20 years or so since widespread property ownership was first permitted.

Xiaping Cao of Lingnan College, Sun Yat-sen University, Bihong Huang of the Asian Development Bank Institute, and Rose Neng Lai of the University of Macau argued such a policy loosens or tightens various control measures depending on whether the government wants more or less growth in the sector.

The overall direction of the market has continued sharply upward.

Between 2005 and 2011, house prices rose in China by 16% a year. In comparison, prices in the leadup to the housing crash in the United States rose by only 13% a year between 2000 and 2005.

Worried that the market had entered a potentially dangerous bubble, the central government enacted various cooling measures around 2010. Among other things, it raised the amounts needed for downpayments, demanded higher mortgage rates for second-house purchases, and raised taxes on capital gains.

Once the impact of those measures had faded, the central government turned to what the authors of the ADBI paper call a "heavy-handed" policy known as home purchase restrictions. That set strict limits on who could buy houses. Prospective buyers needed to be official residents of the cities where they were buying or needed to show records proving they had lived and worked in the cities for the previous 5 years.

Local governments could choose whether to enact the policies. Starting with Beijing in 2010, 46 major cities in China adopted the scheme.

The measures did have a temporary dampening effect on prices and the number of housing sales taking place, but not on the number of houses being built.

Builders knew the buyers would eventually be back.

Real estate the first choice for investors in China, given the lack of safe alternatives.

Real estate has made up more than 60% of China's household assets since 2008, dwarfing the 48% in the United Kingdom, 32% in Japan, and 26% in the United States.

For local officials, the sale of land for housing construction is the main way they raise funds to pay for projects they are ordered to undertake by the central government. In 2010, land sales made up about 80% of local government revenue, up from virtually nothing 10 years before.

Around the same time, as worries about a housing bubble peaked, the central government was pushing its local counterparts to spend on infrastructure projects that were designed to insulate China from a global downturn that was itself spawned initially by the US housing market collapse.

Local government officials had to choose between circumventing the central government's desire to slow housing construction or ignore orders to spend on infrastructure, and most chose to keep the bulldozers in business.

That episode was based on research done for the Asian Development Bank Institute by Xiaping Cao of Sun Yat-sen University, Bihong Huang of ADBI, and Rose Neng Lai of the University of Macau.

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