

# Factors Affecting China's Economic Growth: Land Policy Changes and Real Estate Market Development in China

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## ABSTRACT

Land policy and the real estate market have exerted a significant influence on the Chinese economy since the reform and opening up. The land finance model, whereby local governments sell land, once provided strong financial support for the take-off of China's local economy. However, as China's economy has transformed and society has progressed, the long-term problems that land finance has caused for the Chinese economy have become more and more apparent. The real estate market in China has formed a huge bubble effect, which poses a huge hidden danger to the long-term healthy development of the Chinese economy. This paper tries to answer some questions by comparing the differences given by previous studies, such as the reasons behind each change in China's land policy, how the land finance model is formed, how the bubble in China's real estate market is formed. Conclusions show that China urgently needs a thorough and effective reform to adjust the relationship between land policy and the real estate market and the national economy, so that they can return to a normal track.

**Keywords:** Economy, Land Policy, Real Estate Market, The marketization, economic reform

## 1.INTRODUCTION

China's land policy and real estate are two important parts of the study of the Chinese economy that cannot be avoided. Since China's reform and opening-up, China has become an important economic entity in the world economic system today thanks to its large market share. A growing number of foreign economists, particularly from the Western world, are studying a variety of topics connected to the Chinese economy. However, they rarely focus on the changes in China's land policy and the development of the real estate market. Typically, they are more interested in macroeconomic indicators and economic factors such as currency. At present, it is mostly Chinese scholars who are conducting research on China's land policy and real estate market and trying to explain to the outside world the important impact they are having on the Chinese economy. This includes many topics such as the share of the real estate market in the overall economy, the relationship between the evolution of land policy and the urban-rural divide, and the relationship between land policy and the urbanization process in China. Many of them also involve discussions and recommendations on China's land policy.[1]

This paper will synthesize a number of published papers and use a cross-sectional comparison of findings between different texts on the same issue in an attempt to sort out the various mainstream views on the impact of China's land policy and real estate market on China's economic growth and to provide a comprehensive conclusion on some of the issues in this issue. This has had a positive effect on the elaboration of this issue and the development of subsequent research. It will also give researchers who do not understand the Chinese context an initial overall picture of the issue. It will help researchers to conduct further and more in-depth research on the subject.

## 2.CHINA'S LAND POLICY AND ITS IMPACT ON THE CHINESE ECONOMY AND REAL ESTATE MARKET

The study found that China's real estate market, especially after the economic crisis of 2008, has become an important part of the Chinese economy.[2] To study Chinese land policy, one must first understand the importance of land to the Chinese people. China has a long history of agrarian civilization. The agricultural

population has long accounted for a large proportion of the country's total population. As the world entered the industrial age, the proportion of the population engaged in agricultural production gradually declined in countries that began industrialization. Even so, China's industrialization was slowed by a late start and by historical events such as wars that were detrimental to industrialization. Not only was the level of industrialization low for a long period of time, but the layout of industry was also very uneven across the country. China is a vast country with a large population base, so the proportion of people engaged in agricultural production has always been high. Due to the low level of mechanization, agricultural production in China has for a long time been based on the model of smallholder self-employment. This has established the importance of arable land for a peasant family. It was their main source of income and the basis for a range of other activities. Therefore, an important task for every regime that has ruled China from ancient times to the present day, in order to ensure the stability of the regime, has been to ensure that the peasants have the right to own and dispose of the land.

In the early years of the People's Republic of China, the Chinese government under the leadership of the Communist Party also adopted the approach of returning land to the peasants in order to meet their demand for land. As the socialist transformation of Chinese society took place, all land came under state ownership as a result of the requirements of the socialist system, known as public ownership of land. Before the start of China's reform and opening up, the state had a firm grip on a

number of key land-related rights, including the ownership and use of land, through various forms. This policy brought the new regime into line with the requirements of socialism in the short term and ensured absolute control of the government and political parties. At the same time, the establishment of the people's commune system, modeled on the Soviet collective farm system, increased the mechanization of agriculture and production efficiency to a certain extent, increasing agricultural output and having a positive impact on national economic growth. But it didn't last long, and the drawbacks of this series of policies where the state had absolute control of the land soon became apparent. The inability to effectively transfer land as an important element in the production chain makes farmers less motivated to produce and the economy never grows at a high rate.

Thus, after the reform and opening up, the central government followed the example of the then Hong Kong government, which retained the central government's ownership of the land while leaving a range of rights such as the right to use the land to local governments and allowing it to be bought and sold through the market within certain limits. Since then, land has begun to play an important role in China's post-reform and post-opening economic development. Meanwhile, the housing price has been soaring continuously. Shenzhen, one of the pilot cities for economic reform in China, was the first to introduce commercialization of land, but the effect of the reform fell short of the government's expectations and gave birth to the land finance system.[3]



**Figure 1** Problem of China Housing Price

### 3. THE FORMATION AND IMPACT OF THE LAND FINANCE SYSTEM

The land finance system is a unique local government finance system in China. The emergence of the land finance system can be traced back to the 1994 tax reform. The 1994 reform of China's tax-sharing system was an important point in time. This reform led to a significant reduction in tax-based revenues for local governments compared to the past and a significant reduction in fiscal autonomy. Local governments needed the approval of the Central Development and Reform Commission whenever they needed large sums of money. The autonomy of local finances was significantly reduced. The funds that local governments can invest to support economic construction are becoming increasingly scarce. In order to have more funds to support local economic development, land finance was created. In this case, the biggest bargaining chip that the government left in exchange for funds is land and its ancillary interests. As a result, the government often uses land as security to obtain funds from bank loans or simply takes equity in the land and sets up local investment companies. This is where the government takes on a large part of the debt. Banks also have a performance in their lending business. This model allowed the government to obtain sufficient funds in the short term, but has to some extent created a bubble in the real estate market. As there is a virtual

monopoly on land rights, the government has a huge say in price setting. The government is bent on inflating the fair value of land in order to get more money. This caused the cost of real estate developers to rise dramatically and the price of commercial properties to go way up. Meanwhile, problems such as loss of social equity, socioeconomic conflicts, and government corruption also emerged.[4] The rise in land prices in turn led directly to a significant increase in the price of commercial housing. The study found a long-term link between the land and property markets in China. People who cannot afford to buy a house must apply to the banks for a large purchase loan, and the collateral with a large market value that is used as security is almost always the commercial property itself. This means that the basis of value credit for this whole cycle is the fair value of land, which is set by the government. When the fair price of land fluctuates, this local economic system is subject to unpredictable and high-risk movements. At the same time, the huge size of the real estate market and the high returns lead to a large amount of capital flowing into the property market. This provoked upstream and downstream industries but created a serious oversupply. This imbalance between supply and demand has increased the bubble effect of the real estate market, putting the entire national economy at great risk. This is how land finance links government debt, the banking system and the common man. It is also how it indirectly created a bubble in the real estate market.

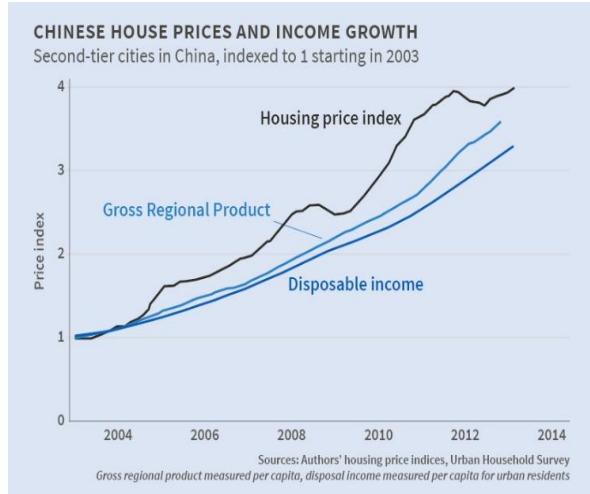


Figure 2 Housing Price and Resident Income

### 4. CONCLUSION

The researcher believes that as China's economy enters a new period of development, the country's real estate market should also consider its future prospects.[5] The development of China's land policy and real estate market has been almost a microcosm of China's economic development since the reform and opening up. The onlooker can almost see in their development the main characteristic and problem exposed by the Chinese

### LOCAL GOVERNMENTS: LARGE EXPENDITURE RESPONSIBILITIES, INADEQUATE REVENUES

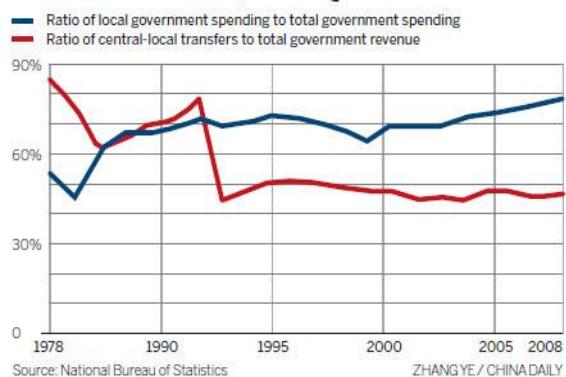


Figure 3 Central and Local Government Budget

economy after undergoing market-oriented reforms and integration into the global economic system, which is the rapid growth of a problematic but reckless economy. The reasons for this pattern of development are complex and varied. From since the founding of the People's Republic of China, the Chinese economy has always been a closed and backward economy before the reform and opening up. When the reforms began, what China needed most was to quickly break away from its immediate backwardness, even if it had to make some sacrifices for

its long-term interests. This led to both central and local governments, and even ordinary citizens, being prone to the mistake of being greedy and prone to neglecting the protection of long-term interests. At the same time, capital is naturally profit-seeking, and with poor management systems and perceptions, free market transactions are driven by human selfishness to make decisions that maximize short-term perceived benefits. Furthermore, despite the market reforms, the shadow of the planned economy is everywhere. The central government still gives local governments economic development tasks and corresponding targets. The results of these indicators are directly related to the political future of officials. This led to a short-sightedness on the part of some officials who will do whatever it takes to complete their economic development tasks and leave the problems to their successors. All these reasons have led to a constantly changing land policy and an explosive growth in the real estate market.

Today, the existence of a bubble in the Chinese real estate market from an accepted fact by many experts studying the Chinese economy. Research confirms that while China's CPI and GDP have barely maintained long-term equilibrium in terms of growth rates since reform and opening up, there has always been an excess of uneven land sales.<sup>[6]</sup> Practical and effective reforms are imperative. The researcher believes that it is no longer appropriate for China's real estate market to expand significantly in size and that more attention should be paid to land utilization and the rational allocation of capital.<sup>[7]</sup> The government has to address the problem of inflated land and commodity property prices on the one hand, while not allowing prices to fall back quickly on the other. The real estate market is already linked to the local government, the financial system represented by the banks, the general public and countless companies in related industries. The bursting of the bubble would only lead to a complete collapse of the economic order. The most prudent approach is to adopt a slow regulatory approach, allowing prices to come down over several economic cycles. At the same time, it is necessary to get rid of the over-dependence of national economic growth on real estate, accelerate structural transformation and constantly look for new economic growth points. This cycle will be painful and long, as it will involve the redistribution of vested interests, which will inevitably increase the resistance to reform. But it is also necessary, and this reform will put the Chinese economy on a healthier path in the future.

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