Executive Briefing

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Implications of China's new property tax   Audio

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FROM CHINA EUROPE INTERNATIONAL BUSINESS SCHOOL (CEIBS)

In this audio, recorded in February 2011, CEIBS Professor of Economics and Finance and Department Chair for Economics and Decision Sciences Dr Xu Bin shares his views on what China's trial version of a property tax in Shanghai and Chongqing will mean for the real estate sector.

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Audio summary

China's real estate market has been increasing too fast. It is threatening not only the macro stability of the Chinese economy but also the social stability of China. So I think most economists would say that China's property prices -- especially those in big cities -- have to be contained one way or another. So, in principle, I think the government has an important role to play.

However, there are many tools that the government can use to contain property price bubbles. We need to understand the source of this crazy increase in property prices and, as we learn from macroeconomics, the source, in the end, is too much money supply. Of course we understand that during the global financial crisis of 2009 to 2010 it was necessary to increase money supply in order to rescue the economy. But the consequence is that it adds a lot of liquidity to the economy. And because China did very well in this global financial crisis, relative to other countries, it also makes China a destination of foreign shorter run capital -- sometimes we call this hot money.

Although China has capital control, still there are many windows through which foreign capital can enter China. So that money -- from inside and outside -- chases the assets of China, especially real estate in cities. In order for China to return to a healthy economic growth mode, you need to reduce money supply considerably. The crisis is behind us so we need to return to normal status. Also you need to manage the imbalance in the growth rates between China and the advanced countries. That has to be managed also.

So I think there's no question that some significant tools need to be used.

Now going back to your question, this real estate tax. We all know that in advanced countries property tax is quite normal and it is also a significant source for local governments. But in China we did not have any tax on home ownings. You raised an interesting question with regard to the ownership of property in China. Under current Chinese law, the land is owned by the government and the real estate developer and the person/family who buys that piece of real estate has right to use that piece of land for 70 years. So it is very clear in the contract of the purchase of the apartment that there is a period of time in which you are entitled to use this apartment. Although it is 70 years and, theoretically speaking, in the end of this contract the apartment, the piece of land on which the apartment is built, needs to go back to the government.

Seventy years is quite a long time, at least from the perspective of many young purchasers of these homes. Because China only started to have this home purchasing in the recent 10 years (in the past it's allocated by the government). So with 10 years, you do not (think about) what is going to happen in the future. Therefore, you do not worry about that. So we do not really think about that in an explicit way, but the issue is there. Of course many people are optimistic, saying that when the time comes it's going to be extended so you need not worry about the possibility, the theoretical possibility of the apartment going back to the government. But the legal foundation for raising this real estate tax becomes ambiguous when there is an issue of ownership, I think that is clear.

But in China, which is not only an emerging economy but also a transition economy -- from planned economy to market economy -- there are many such ambiguities. Therefore I don't think we need to clarify everything in order to implement certain policies. The policies will (co-exist) with the ambiguity of certain legal issues and we just look at the effects of such policies without getting too much into certain unsettled issues.

But if you look at real estate taxes which are implemented in Shanghai and Chongqing as testing cities, they are very small in size -- no comparison with those tax rates in the United States, for example. Also they are, in Shanghai's case, only levied on new homes, it's not on existing homes. In Chongqing, there are a lot of exemptions on the tax to be levied: you can own certain large amount of real estate, then you are subject to real estate tax. So the current version of real estate taxes really does not have much impact because of its size and because of a lot of exemptions on the property market.

It has a symbolic effect. I think it shows that China is going to move towards that direction in policy design (for) the real estate (sector). I think that in the future the local governments of China will have to find a new source of income. In the past, they relied very much on selling land but now the central government is controlling the land sale, and also there is a limited amount of land to be sold by local governments. Therefore in the future, I think, taxes on property would become an important source of (revenue for) local governments. So these small, baby steps right now in Shanghai and Chongqing imply/illustrate the future path. But although it's insignificant currently, in the longer run it should be quite significant.

So I think the more significant short term tools that the government is using (include) limits on home purchases in major cities. Now you are not allowed to purchase the third unit; that is very significant. And the mortgage down payment for the second unit is raised to 60% -- so those policies are containing the hot real estate market more effectively, much more effectively than the real estate taxes that have been introduced.

So overall I think this is the right direction, and I was saying at the beginning, given distortions in the Chinese economy, it is justified for the government to act in the real estate (sector). It does not solve the fundamental issues but it does help, a lot, to offset the distortions actually created by the government itself in money supply and also international inflow of capital seeking real estate price increase in China. So I think now we need to balance this back to the normal situation. So I view all those tools to be quite useful and positive.

China Europe International Business School (CEIBS)

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