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Factors Affecting the Continuity of Public Policies: China's Real Estate Policy as an Example

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Abstract: China's real estate industry occupies an essential position in the Chinese economy and is greatly influenced by domestic policies. This paper mainly explores the factors that affect the continuity of China's real estate policy. China's real estate development is mainly cyclical, and policy pockets are vital in each cycle. The dependence on local finance in the real estate industry makes local governments try to use their power to safeguard local financial security. Real estate has played an essential role in economic development for a long time. The government has a path of dependence on the real estate industry and relies too much on real estate to develop the economy. COVID-19 has dealt a heavy blow to the real estate industry and significantly changed the basic situation of the real estate industry. The new balance of positive and negative feedback has made it difficult for real estate policies to continue. The policy's misjudgment of the real estate industry has made the situation of the real estate industry more severe. All the unbeneficial factors put China's real estate industry in a difficult situation.

Keywords: public policies, real estate, China

1. Introduction

Following the reform and opening up, the housing commercialization policy in China led to the development of the real estate industry. Domestic policies have greatly affected the growth of the urban housing industry, which has become an important pillar industry of the national economy since the reform of the urban housing system in 1998. Domestic policies' guidance and control of real estate have made the development of real estate out of the market rules to a considerable extent. Today's real estate market has grown, and policy intervention has played a more significant role. This paper uses China's real estate policy as an example to explore the factors that affect public policy continuity.

2. A Brief History of Real Estate Development in China

China's real estate has gone through six policy cycles, and the goals of each policy cycle can be summarized as stabilizing housing prices and promoting economic development. The process of each cycle is also very similar: when the economy is cold, the construction industry needs to drive the economy - real estate prices rise rapidly, and the economic driving effect is noticeable - real estate prices rise too fast, the country seeks to suppress housing prices - the real estate industry cools down

- the emergence crisis. Since the reform and opening-up, the real estate industry has been closely related to China's development.

China's first rapid real estate industry development was after Deng Xiaoping's South Tour speech. The real estate industry in mainland China ushered in its first outbreak. Real estate companies and real estate sales increased rapidly. However, in 1993, the State Council published a document proclaiming the end of the real estate companies' listing and full control over bank monies flowing into the sector. The real estate market experienced its first downturn. The economy proliferated after China acceded to the World Trade Organization, and the urbanization process accelerated. Many rural people moved to the city, and the real estate industry developed rapidly. In 2003, the People's Bank of China imposed restrictions on real estate loans, and the "SARS" virus broke out, and China's economic growth rate declined. The same year, the State Council issued a document that regarded the real estate industry as the primary industry for China's economic development, and the real estate industry recovered. From 2005 to 2008, the central government continued to issue documents to curb the excessive growth of the real estate industry. 2008, the US subprime mortgage crisis broke out, and the real estate industry fell sharply. In the same year, to stimulate the economy, the government launched a large-scale four trillion stimulus plan and fully relaxed restrictions on the real estate industry, allowing the sector of real estate to lead rapid economic development.

Before 2015, the country continued to curb the rapid development of the real estate industry. However, at this time, due to the high level of urbanization in China and the slowdown in urbanization growth, the real estate industry continued to develop rapidly in only first-tier and second-tier cities. In comparison, many vacant houses appeared in cities in the third and fourth tiers. At the end of 2015, the central government issued a document stating that it would reduce the inventory of houses and reduce outdated restrictive measures. There is a new speculative boom in the real estate industry. A year later, the central government issued another document stating that it would crack down on speculative real estate, and various localities introduced strict control measures.

After 2020, many real estate industries have fallen into a liquidity crisis due to the central government's restrictions on the scale of loans and debts, combined with the impact of the COVID-19 epidemic. Since the outbreak of COVID-19 in 2020, as of June 1, 2023, China's real estate sales have been in an overall downward trend. Due to the decline in real estate sales, many real estate companies have been significantly impacted. The well-known domestic real estate giant Evergrande owes 2.4 trillion yuan in debt and filed for bankruptcy; Country Garden has a debt crisis and cannot continue to pay interest.

3. Factors Influencing the Policy on the Industry

3.1. Local Governments Rely on Land Transfer Fees

First of all, local governments that mainly rely on land revenue are more willing to see the prosperity of real estate. Even if it is contrary to the central government's instructions, they must develop the real estate industry. Historically, the central government has often issued policies to control the growth of real estate prices, but often with little effect. One of the reasons is that local finances are highly dependent on real estate prices and have formed a confrontational relationship with the central government.

In 1994, the tax-sharing reform was officially implemented. The federal government drastically lowered the amount of local fiscal receipts after the tax-sharing reform. The federal government controls about 60% of the financial sway. However, many powers are given to local governments, which increases their workload and hinders their ability to function effectively, particularly grassroots governments, hence widening the funding and responsibility divide between central and local governments [1].

In order to make up for the financial gap, local governments monopolize the primary land market, obtain agricultural land at low prices, develop it flatly, and then sell it at high prices. They can obtain many land transfer fees and then use these funds to acquire new land to form a local fiscal cycle.

As an essential part of carrying land finance, The industry of residential property has a strong relationship between the price of houses and local governments' income. The increase in house prices means that at similar costs, the profit per unit real estate project will be higher, and the increase in profits allows local governments to obtain more revenue when they require land transfer fees. The central government's push to slow down housing price growth further reduces local income because the economy is developing, and consumers can still afford houses.

In addition, as the directly responsible persons and stakeholders of local finance, local governments have a more precise grasp of local-specific affairs and have greater political power in local areas. This allows local flexibility in understanding and implementing policies locally. When the central government's policies erode local interests, local governments can implement them flexibly according to their needs [2]. According to what Telen proposed, since local governments have relatively small veto power and relatively large discretionary power when implementing central government policies, local governments are inclined to "conversion", that is, to make some flexible changes under existing rules. The local government also finds other ways to pursue its finances [3]. For example, in 2007, while the central government issued intensive policies to control housing loans, the local government in Hohhot created market demand by intensifying the renovation of urban villages and old cities [4].

3.2. Real Estate Regarded as the Pillar Industry of China's Economic Development

China has long promoted the economy and subsidized finances through the real estate industry. Due to the positive response generated by the expansion of the industry of residential property, the government has grown increasingly reliant on it and is hesitant to alter. The development of China's economy depends heavily on the real estate industry. A sizable amount of GDP is made up by the real estate sector, which also significantly contributes to GDP expansion. The estimated 8,714.3 billion yuan in added value produced by real estate production activities in 2013 represented 15.3% of the GDP and contributed 29.4% to GDP growth [5].

Governments at all levels now place a high value on the real estate industry and see it as a vital tool for fostering economic growth as a result of the tremendous profits it has generated via development. For example, before the subprime mortgage crisis 2008, the central government took long-term measures to suppress housing prices. In 2005, the State Council stated it would "restrain the rapid rise of housing prices". In 2007, the central bank and the China Banking Regulatory Commission increased the down payment ratio of loans for buying second homes to more than 40% and raised the corresponding loan interest rates. However, after the subprime crisis broke out in the United States 2008, the government launched a large-scale four trillion stimulus plan to promote economic development. The rising trend of real estate prices accelerated.

For real estate companies, the effect of restrictive policies on real estate companies cannot be quickly revealed in the short term. Real estate companies will use commercial credit to offset the short-term lack of bank loans in the early stages of implementing restrictive policies. When real estate tightening policies continue, the commercial credit obtained by real estate companies will also decrease [6].

In other words, the real estate industry can be restrained if the policy can be sustained for a long time. However, because China has long regarded real estate as a pillar industry for China's economic development, governments at all levels, especially local governments with insufficient finances, are more accustomed to relying on real estate for development. All the long-term dependence on the real estate industry makes it difficult for the government to escape the influence of the real estate industry.

Pierson emphasized that the government has become path-dependent because the real estate industry can bring fiscal revenue and economic development. The positive feedback from the real estate industry makes the government reluctant to try to develop other industries [7]. Ultimately, the government was unrestrained in promoting the real estate industry, which caused the crisis.

3.3. The Impact of External Factors

Changes in the external situation have also caused changes and instability in real estate policies. Since COVID-19 in 2020, the domestic real estate industry has suffered a relatively significant impact, which can be seen from the government's land transfer fee income; land transfer fee income in 2020 was 8,414.2 billion yuan, and in 2022, it was 6,685.4 billion RMB yuan.

COVID-19 has impacted both the supply and demand sides of real estate: On the demand side, COVID-19 has hindered the circulation of all walks of life, leading to a decline in people's income. This has made many buyers who are willing to buy houses tend to reduce their purchases. In response to the epidemic, even if the COVID-19 epidemic is suppressed, the impact suffered by various industries cannot be recovered in the short term. Objectively, the reduction in buyers' income will continue.

For real estate companies, the impact of COVID-19 has hindered logistics flow and slowed the distribution of materials. The tightening of policies in the early epidemic also shadowed real estate investment. Financing channels for real estate developers have tightened, and financing costs have increased, putting real estate developers under financial pressure. The combination of these factors will slow the speed of real estate companies to withdraw funds, put real estate developers under cash flow pressure, and cause real estate developers to be under excessive pressure or even go bankrupt. In 2020 and 2021, China's COVID-19 has been relatively well controlled, and real estate development has not declined significantly. The government has also launched the "three red lines" policy to reduce land sales and limit loans. In 2021, land transfer fee income Compared with 2020 it has increased to 8,705.1 billion yuan.

However, in 2022, the impact of COVID-19 will be significantly increased. Many areas have been severely affected by the COVID-19. In this case, real estate has been dramatically affected. The COVID-19 epidemic has brought real estate in various places to a standstill, and because it has lasted for nearly a year, many real estate projects have been suspended for a long time, real estate developers cannot quickly recover funds, and many real estate companies are in trouble. For instance, China Evergrande Group, a major player in the real estate industry, had to file for bankruptcy.

In late 2022 and 2023, to save the economic difficulties in 2022, the central government began to emphasize real estate's role in revitalizing the economy. However, the reduction in income in the previous one or two years has been unable to support the vast real estate market. Therefore, after discovering that the real estate market cannot be entirely borne, the government gradually accepted this fact. Instead of using policies to encourage acquisitions, it respected market choices. As Baumgartner, F. and Jones, B. mentioned, when the original stable system parameters are changed by an external force, a new equilibrium will be reached by positive and negative feedback mechanisms [8].

The government hopes to use real estate to boost the economy again, but the cost of saving the real estate industry needs to be lowered. The government has to consider whether real estate can still be the core of promoting economic development and the cost of forcibly saving real estate. Under the combined effect, the government gradually cleared real estate companies through the market.

3.4. Government Policy

The control of the market by the central government itself is also a factor influencing policy. 2015, China's real estate industry suffered a cold, and many houses were in stock. The government has issued several policies to reduce real estate inventory and remove some restrictive measures. One of the representative measures is when the government presides over the demolition of houses. The compensation to the homeowners is not in kind but in the form of monetary payments. This has brought a huge demand to the market. Under the impetus of the state, the real estate market is scorching, and housing prices in various places have experienced large-scale or even doubled growth. This is also the root cause of the overheating of China's real estate industry since 2015. One year later, at the end of 2016, the government issued another policy, saying it would crack down on speculative housing purchases and make houses mainly for living. After the end of 2016, the central government insisted on limiting the overheating of the real estate industry, but the effect was limited. In 2020 and 2021, the government believed that the economy was running well and that COVID-19 could not pose a more significant threat and could continue to restrict the real estate industry. Therefore, it issued policies to reduce loans to real estate companies and further restrict the expansion of the real estate market. However, in 2022, many real estate companies will go bankrupt due to a liquidity crisis. Corporate bankruptcies have resulted in many unfinished buildings and unpaid debts in China. Evergrande Group alone has 2.4 trillion yuan.

Some actual estate-related public policies have made extreme or unpredictable mistakes. In 2015, policies were so radical that they caused the real estate industry to overheat. In 2020 and 2021, the policies lacked predictability, and restrictive solid measures were rashly adopted without making plans for the outbreak of the COVID-19 epidemic.

In addition, when formulating policies, there is a lack of understanding of the status of real estate companies in various places. Since 2010, the radical "high debt, high leverage, high turnover" development and operation model has generally prevailed in China's real estate industry, compressing project development based on increasing financial leverage. The pursuit of expanding sales scale also brings enormous potential risks to the financial market. Weaver believes that policy will not only strengthen itself, but negative policy feedback will lead to the collapse of the policy [9]. In 2023, policy controls on the real estate industry will be relaxed to help companies withdraw funds and solve the problems of high corporate debt and poor development. Due to the introduction of public policies, the resources in the real estate market cannot be well allocated in accordance with market demand, and a certain degree of chaos has emerged.

4. Suggestions

In response to the above problems, some measures can be considered.

In response to the problem of local governments' over-reliance on the real estate industry, local financial and administrative powers should be matched, taxes should be reduced, and local governments should be guided to develop diversified industries. Oates' fiscal federalism believes that public goods provided by local governments can achieve better results [10]. Local governments are under pressure from the mismatch between financial and executive powers. They have to choose the simple path of obtaining funds through selling land to subsidize their finances. Tax reductions and exemptions allow local governments more financial autonomy so they are not subject to financial pressure and can develop industries suitable for themselves based on local conditions. Based on developing their industries, various cities can form an excellent competitive relationship to attract talent. Cross-regional competition can promote local government innovation and responsibility to residents.

Although there are theories that in developing countries, centralization can better utilize economies of scale in public goods and services, China's current public goods and services are already at a relatively complete level, and it is not easy to continue to use centralized finance. Scale effects create much wealth. At this time, each locality should be allowed to act more closely with local interests according to its characteristics.

Because of the government's dependence at all levels on the real estate industry, the driving role of the stock market in development can be considered. China relies on the real estate industry to develop its economy because it has a strong driving effect on GDP. Numerous businesses, including metallurgy and decoration, can grow as a result of the real estate market's expansion. Other industries cannot drive large-scale industries like the real estate industry because the scale of other industries is relatively small, and the industrial chain is relatively short. To eliminate dependence on real estate, it is essential to improve the utilization efficiency of funds and reduce the allocation cost to make investing funds in other industries easier. China's stock market has been relatively stable for a long time without growth. A considerable part of the reason is that the stock market management is relatively chaotic, and various systems are imperfect. This makes a considerable number of people in the stock market make profits through speculation rather than investing in companies based on whether the company is good or bad to make profits. By reforming the stock market, the stock market's direction will be changed from speculative profit to investment profit, thereby replacing the dominant position of the real estate industry.

Public government should be more predictable and consistent. Taking 2015 as an example, when monetizing shantytown reforms, if there is a comprehensive investigation and study on the amount of money issued and the range of people, the overheating of the real estate industry can be avoided to a certain extent. In addition, "path dependence", that is, making decisions based on the old methods of the past, should also be avoided. Like what Baumgartner, F. and Jones, B. said, long-term inertia will occur after changes that deviate from the original policy, preventing the new policy from being well applied [11]. The government should adapt to the changed form as soon as possible, learn information from multiple aspects, and formulate policies consistent with the current situation.

5. Conclusions

The expansion of the real estate market is mainly cyclical. Prices will rise rapidly whenever China's economy needs real estate to drive. After the rapid development, the country seeks to curb housing prices, and the real estate industry will experience a downward trend and even a crisis. China's real estate industry has gone through six cycles, and each cycle is greatly affected by domestic policy factors. As of 2023, Chinese policies will still play a vital role in regulating real estate. Generally, China's policies are closely related to economic development and the real estate industry. China is highly dependent on the real estate industry to develop its economy, and the real estate industry is also strictly restricted by policies.

There are many reasons why government policies rely on the real estate industry, the first being the dependence of local governments on land transfer fees. After the reform of the tax-sharing system, local finances are highly dependent on the real estate industry. The higher the housing prices, the more fiscal revenue the local government can obtain by monopolizing land resources and selling land. When the government seeks to lower housing prices, its fiscal revenue is undoubtedly reduced. In addition, the autonomous power possessed by local governments gives local governments more discretion when facing central policies, which makes them more independent. Policies make it challenging to achieve good results.

Real estate has long been an essential tool for China's economic development and has become path-dependent. The real estate industry plays a vital role in developing China's economy and drives the development of many industries. The growth of several businesses can be influenced by the industry of real estate, thereby driving the development of the overall economy. The government has responded to multiple crises in the real estate industry, gradually forming a path dependency, making it difficult to use other means to solve the crisis.

The COVID-19 has created policy uncertainty. COVID-19 has long-term impacted countries worldwide, and China is no exception. On the demand side, COVID-19 has made people's lives tighter, reducing their need to buy property. For real estate companies, the company's financing cost has risen, which has brought massive pressure on the company's cash flow. Under such circumstances, even if the government introduces policies hoping to revive the real estate industry to drive the economy, the COVID-19 epidemic will also weaken the effect of the policies.

Some policies need an understanding of the real estate industry and an in-depth investigation into the turnover of real estate funds. After years of development in the real estate industry and significant changes in external conditions, the government's one-sided understanding of real estate has led to massive turmoil in the real estate industry.

In response to some existing problems, the government can consider matching local financial and administrative powers, reduce taxes, and think more about the role of the stock market. Moreover, policies should be more predictable.

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