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NEW CHALLENGES IN URBAN GOVERNANCE AND FINANCE

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The recent urban problems has a lot to do with the urban governance structure...

My analytical framework is:

Structure => Incentives => Behavior => Outcomes



CHINA HAS A UNIQUE GOVERNANCE STRUCTURE...

- **Five levels of government:**

- I. Central;
- II. Provincial;
- III. Prefecture-level municipality;
- IV. District/county, and
- V. village/township

- **Function:** all-purpose government within the designated jurisdiction boundaries

- There is no single-purpose government for cross-jurisdictional functions such as metropolitan service districts

- **Horizontal coordination and dispute resolution:** handled through higher level government



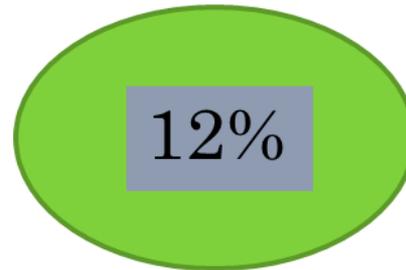
CHINA HAS A UNIQUE GOVERNANCE STRUCTURE...

- **Centralized political power and tax power, and decentralized public expenditures:** Central government appoints provincial top leaders (i.e. party secretary), and provincial leaders appoint municipal leaders and so on; local governments are not given tax power
- **Functioning like a GDP growth machinery:** National GDP growth target is achieved by all levels of local governments chasing the same target with whatever means feasible within the policy framework
- **Incentives :** Better GDP growth performance, better chance for political promotion
- **Behavior:** Competition among local leaders at the same level for the best GDP growth performance

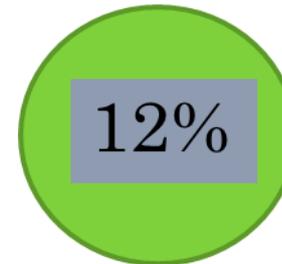
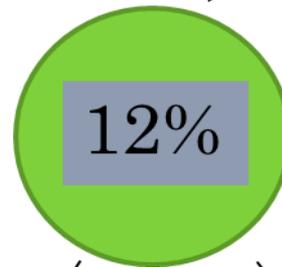


**NATIONAL GDP GROWTH TARGET WAS PRACTICALLY
ACHIEVED BY ALL LEVELS OF LOCAL GOVERNMENTS
CHASING THE SAME TARGET...**

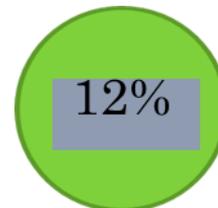
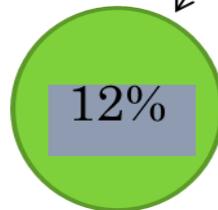
Central



Provincial



**Prefecture
and county**



CITY GOVERNMENTS RESPONDED TO INCENTIVES UNDER POLICY CONSTRAINTS...

- The main target of city governments was to boost GDP growth
- But city governments faced fiscal constraints:
 - No tax power
 - Not allowed to borrow directly
- Yet city governments found ways to raise funds
 - Raise fund through **land concessions**
 - Create urban development investment corporations (**UDICs**) as finance platforms to borrow, often using **land as collateral**
 - Boost local real estate businesses for tax revenues and GDP
 - Impose various charges and surcharges



MOBILIZING AND CAPITALIZING LAND RESOURCES THROUGH LAND CONCESSIONS HAS BEEN PART OF CHINA'S ECONOMIC GROWTH STRATEGY ...

- **Open-door policy** to take advantage of globalization
- Use **cheap land**, cheap labor, and **improved infrastructure** to attract foreign direct investment
- Create special economic zones and **industrial parks**
- Use cheap domestic credits provided by the state banks



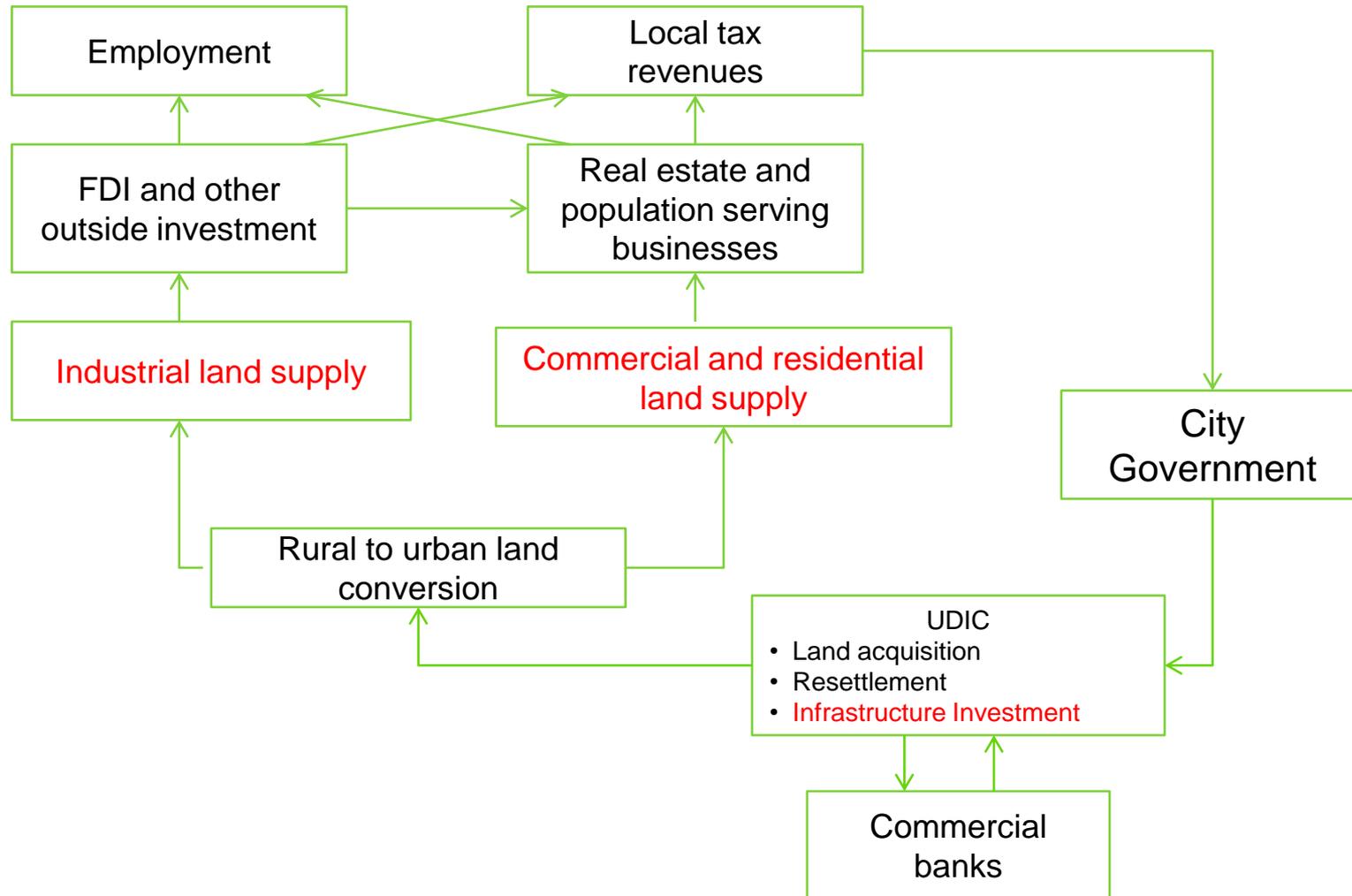
LOCAL GOVERNMENTS INCREASINGLY RELIED ON LAND CONCESSIONS FOR REVENUES...

Revenues from Land Concessions (billion RMB)					
Year	National Fiscal Revenues	Central Fiscal Revenues	Local Fiscal Revenues	Land Concession Revenues	Land as % Local
2003	2,172	1,187	985	542	55.00%
2004	2,640	1,450	1,189	641	53.90%
2005	3,165	1,655	1,510	588	39.00%
2006	3,876	2,046	1,830	808	44.10%
2007	5,132	2,775	2,357	1,222	51.80%
2008	6,133	3,268	2,865	1,026	35.80%
2009	6,852	3,592	3,260	1,718	52.70%
2010	8,310	4,249	4,061	2,747	67.60%
2011	10,387	5,133	5,255	3,213	61.10%
2012	11,725	5,618	6,108	2,690	44.00%

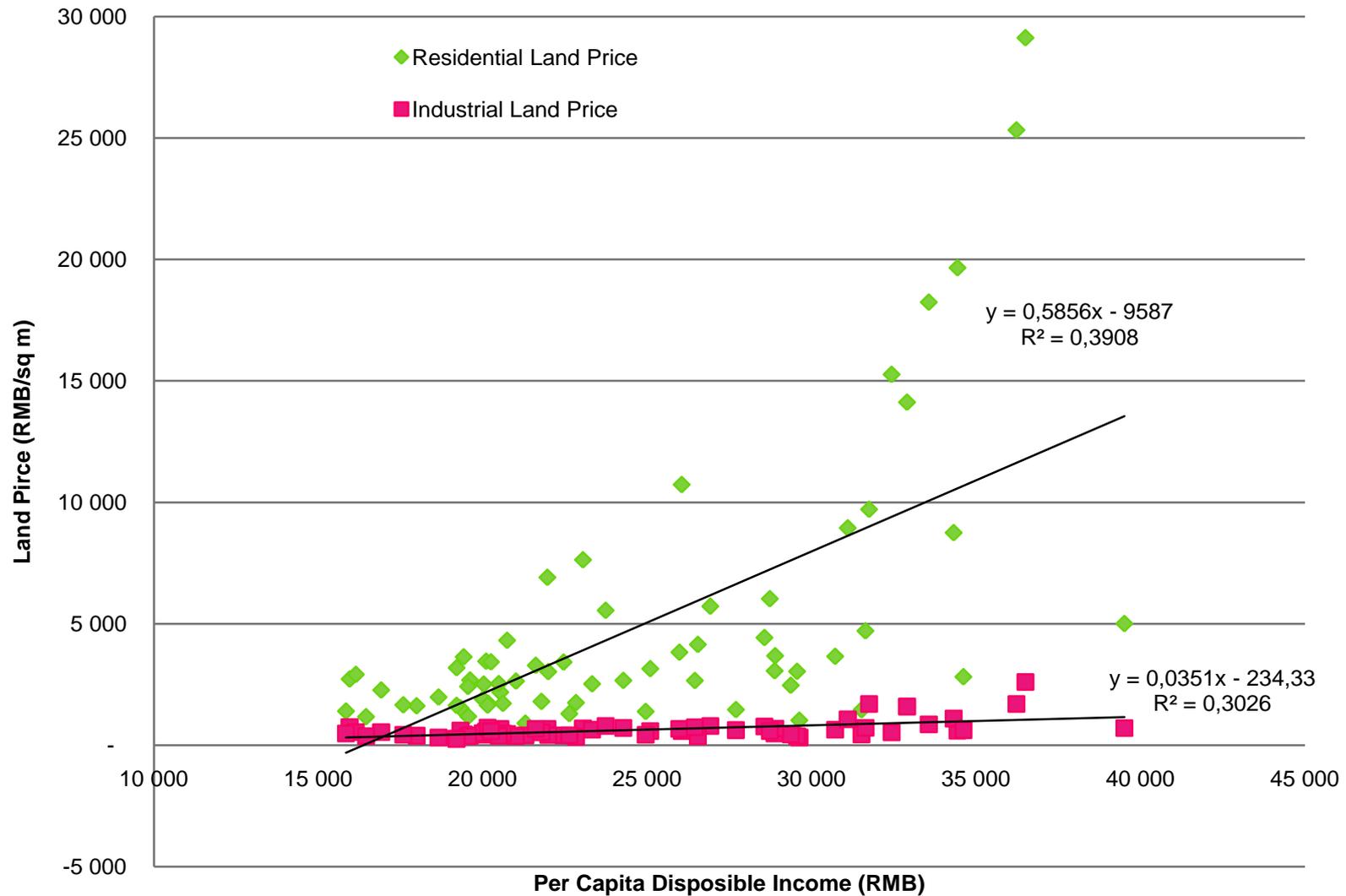
Source: Official statistics.



BUT THE MECHANISM OF LAND-BASED FINANCE IS MORE COMPLICATED...



INDUSTRIAL LAND PRICES ARE WAY BELOW RESIDENTIAL LAND PRICES...



THE CURRENT URBAN GOVERNANCE AND LAND-BASED FINANCE HAVE RESULTED IN A NUMBER OF PROBLEMS...

- Growing **local debts**: 18 trillion RMB (US\$2.9 trillion) or 32% of national GDP in 2013
- Growing **social tension**: arising from rural to urban land conversion
- **Over conversion of farmland** to urban use and inefficient use of urban industrial land
- **Urban residential land prices**: skyrocketing
- **Urban housing prices**: increasingly unaffordable
- **Corruption** from land concessions

- **Strong consensus that the urban governance and finance system is not sustainable and has to be reformed**



The on-going structural reform...



2014 WAS THE FIRST YEAR OF DIFFICULT REFORM...

- China started a difficult **structural reform** while the economic growth shifted gear to the “**New Normal**,” a new conservative growth target no more than 7% a year.
- Among the **comprehensive reform directions** are a few directly related to urban governance and finance, designed to correct various policy distortions in the urbanization process and build a new governance system for a more urbanized China.



REFORM DIRECTIONS RELATED TO URBAN GOVERNANCE AND FINANCE

- **Hukou**: (gradually) relax controls on farmers settling in cities and towns
- **Land**: form a unified urban and rural construction land market, and limit the rural scope of land appropriation
- **Taxation**: raise share of direct taxation, improve local tax base, and accelerate **property tax** legislation
- **Financial market**: accelerate interest rate liberalization
- **Role of government**: shift to service-type government, and form a comprehensive assessment system for officials' performance to rectify the one that overemphasizes GDP growth



KEY EXPECTED RESULTS OF THE REFORMS...

- Strengthened **role of market** in urban economic growth, implying that the government will mainly facilitate the market
- No hukou barriers for rural to urban **migration**
- Benefits of **development rights** shared to farmers through the unified rural and urban construction land market
- New source of municipal finance from domestic capital market (such as **municipal bond market**)
- New source of municipal revenues from **property tax**
- **Participation** of municipal residents in municipal budget and expenditure decision making
- **Improved responsiveness** of municipal governments to the public service need of municipal residents



The new challenges...



CHALLENGE 1: WILL THE REFORM ACTIONS BE IMPLEMENTED AND HOW SOON?

- The structural changes may slow down the economy in the short-run before paying dividend
- But the economy is sluggish
- “Micro-stimulus” to maintain employment



CHALLENGE 2: THE DEVIL IS IN THE DETAILS...

- While the reform directions were set, the detailed reform roadmaps and sequential actions are yet to be worked out
- The largest cities are not ready to abandon the hukou system
- Unifying urban and rural construction land market depends on the coverage of urban planning and land use planning
- It will take years for property tax to generate considerable revenues
- It will also take some years to establish municipal bond market and for cities to become credit-worthy



CHALLENGE 3: WHAT WILL BE THE SUITABLE URBAN GOVERNANCE STRUCTURE?

- **City leaders:** Will they be locally elected and mainly respond to the need of the city residents?
- **Checks and balance:** Will city leaders be subjected to the monitoring of the city people's congress that has full representation from the residents
- **Metropolitan-wide regional governments:** Will some forms of metropolitan government be allowed?
- **Grass-root governance arrangements:** Homeowners associations have emerged to protect collective property rights, but their legal status is unclear



EMERGING HOMEOWNER ASSOCIATIONS FOR PROTECTION OF COLLECTIVE PROPERTY RIGHTS



Thank You!

