

# Urbanization and the Banks

\* Note: A portion of material for this lecture was provided by Barry Naughton, University of California at San Diego

# China: Urban-Rural Dualism

## Has its Roots in the Socialist System:

- Fundamental Institutional Dualism
  - Nearly *all* institutions are different in rural vs. urban areas
  - Rural Collectives vs. Urban State Ownership: land, businesses, etc.
- Two types of “citizenship”?
  - Urban workers (proletariat) are the “vanguard” of the revolution.
  - Urban residents have entitlements, rural residents only rarely do.
- Controls on Mobility.
  - Great Leap Forward disaster leads to increasingly rigid controls on migration, increasingly division between urban and rural.
  - Cultural Revolution codifies this social structure, and gives it a new twist: “industrialization without urbanization”?
  - Relaxation finally begins after successful rural reforms (1979-1984), accelerates after mid-1990s.

# Structural Change: General Patterns of Developing Economies

- Share of primary sector (agriculture) declines throughout.
- Share of secondary sector (mining, manufacturing, and construction) rises through “middle income” stage (around USD. \$1,000 - 5,000 per capita), then declines.
- Share of tertiary sector (services) rises throughout.
- Potential Growth rates are at a maximum during the “middle income” stage.

# How does it take place?

Through rural-to-urban migration

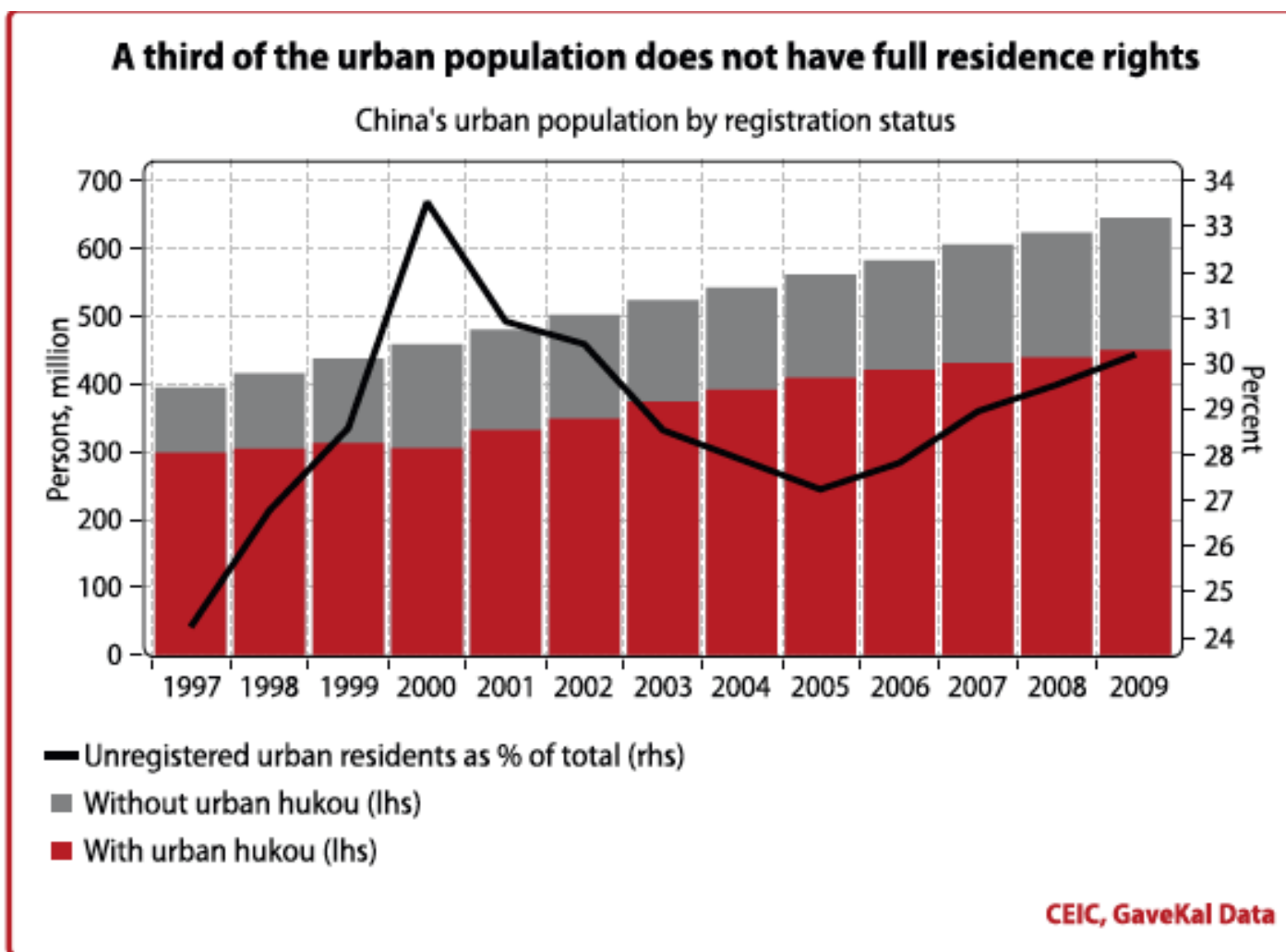
- Individuals leave their farms and villages and move to nearby towns and distant cities.
- Through the expansion of existing urban centers—  
“Sprawl” or “spillover”

# Trade-off of Costs and Benefits

- Agricultural workers will migrate to the cities until the following equilibrium condition is met (Harris-Todaro):  
Agricultural Income = Urban Wage \* ( 1 - u )  
where u is the probability of being unemployed in the city.
- Urban unemployment; informal sector as holding tank.

# But the dynamic process has been different in China, because of the way rural-urban relations are managed.

- Administrative barriers slow the pace of rural-to-urban migration.
- The gap between urban and rural incomes, and the gap between marginal product of labor is larger than it would be in an equilibrium.



# Big Urban-Rural Divide under Socialism

- Urban

- Job entitlement
- Public services (usually provided free)
- Grain rations
- Danwei system
- Government ownership of property, including land and businesses.

- Rural

- Agricultural labor
- Few public service entitlements
- No guaranteed food or services
- Collective ownership of property, including land.

# Today: Relaxation, but Controls are Still in Place

- Urban residence permit (hukou 户口) still significant.
- Many regions now grant permits routinely, especially small cities, and most medium-sized cities in Western China. However, most big cities still impose substantial restrictions.
- Discrimination is significant with respect to urban services, and especially education.



# Policy Turning Point

- State Council Directive, January 5, 2003
  - Rural migrants have a legal right to work in the city. Discrimination against rural migrants is “prohibited.”
  - Schools for migrant workers should now be recognized by urban education departments (but extra fees still charged to migrants who go to public schools).
  - Temporary residence permits should cost only 10 *yuan* (but additional fees and charges are common).
  - Migrants are vulnerable, can be victims of extortion and discrimination anyway. Reality lags behind the good intentions of policy.

# Differences are Now Less Important

## **Urban**

Permanent Employment system has vanished.

Urban unemployment is significant.

Increasing fees for social services (health).

## **Rural**

Access to land is still available to almost everyone.

Restrictions on migration have been relaxed.

Since 2008: New rural cooperative health care system.

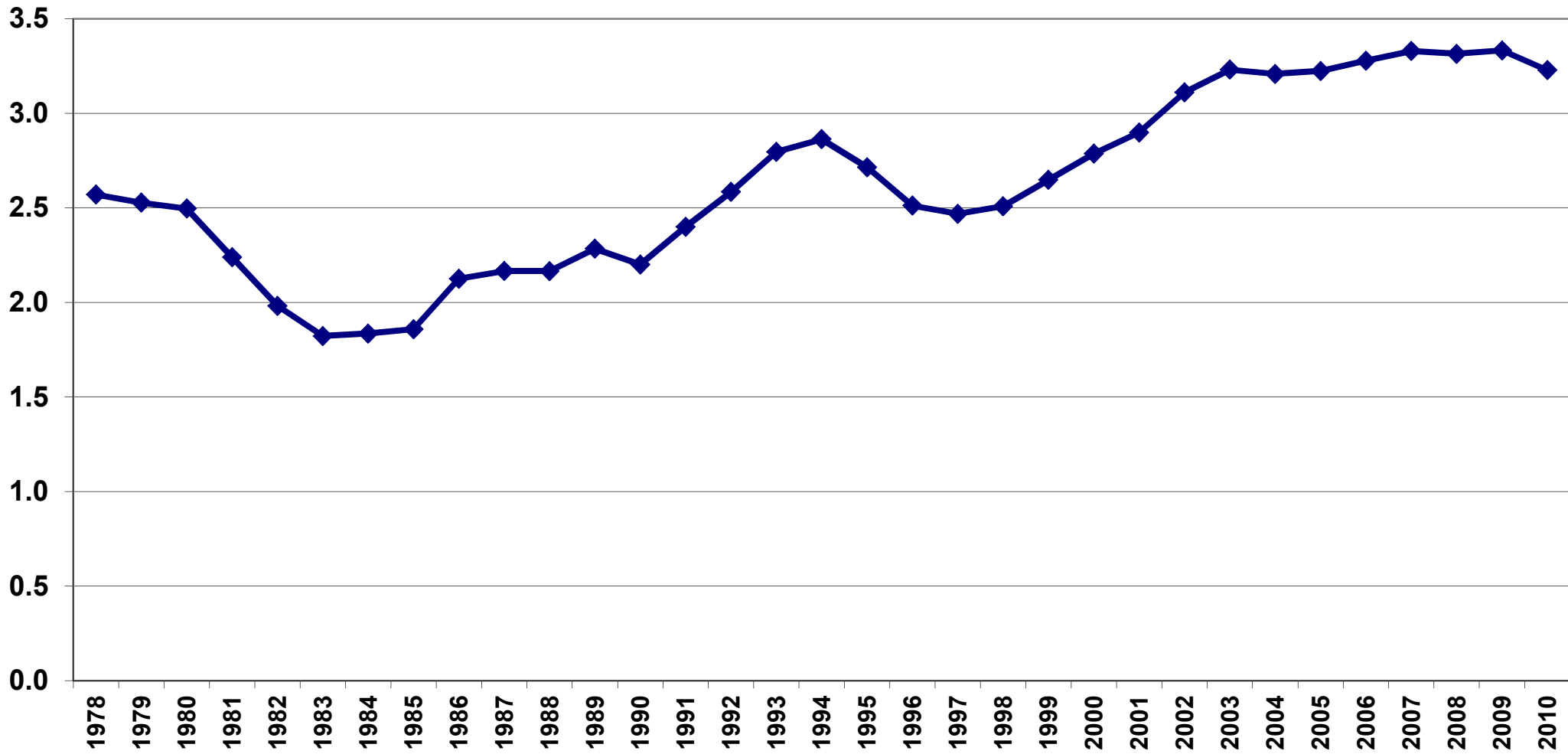
# But New Differences Still Matter:

- Most urban-dwellers received title to their housing at subsidized costs; big wealth transfer.
- Many urbanites were able to retire young, most (but not all!) with full pensions. Average age of retirement in 2002: 53 years old.
- Urban-dwellers in big cities are admitted to local universities with lower college test scores than rural people in other provinces.
- Moreover, the sheer economic dynamism of the urban economies continues to support and even enlarge economic disparities.

# Economic Development = Structural Change

- Economic development is identical to the process of transformation in which low productivity agricultural economies become high productivity urban economies.
- The two most characteristic aspects of this process of change are:
  - Urbanization
  - Industrialization and the shift to a service economy.
- These processes are common to all developing countries but take a special institutional form in China.

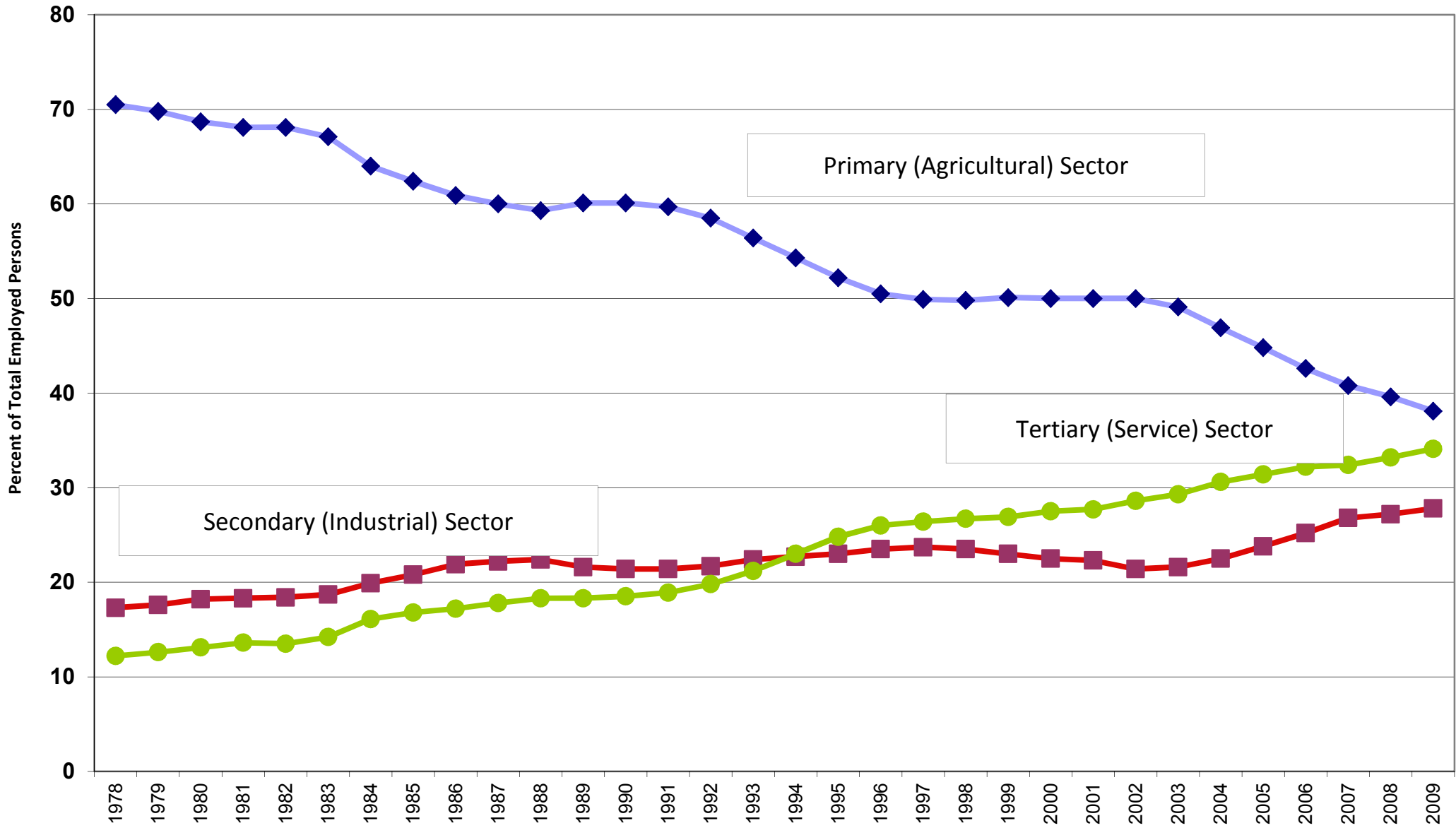
# Ratio of Urban to Rural Per Capita Incomes



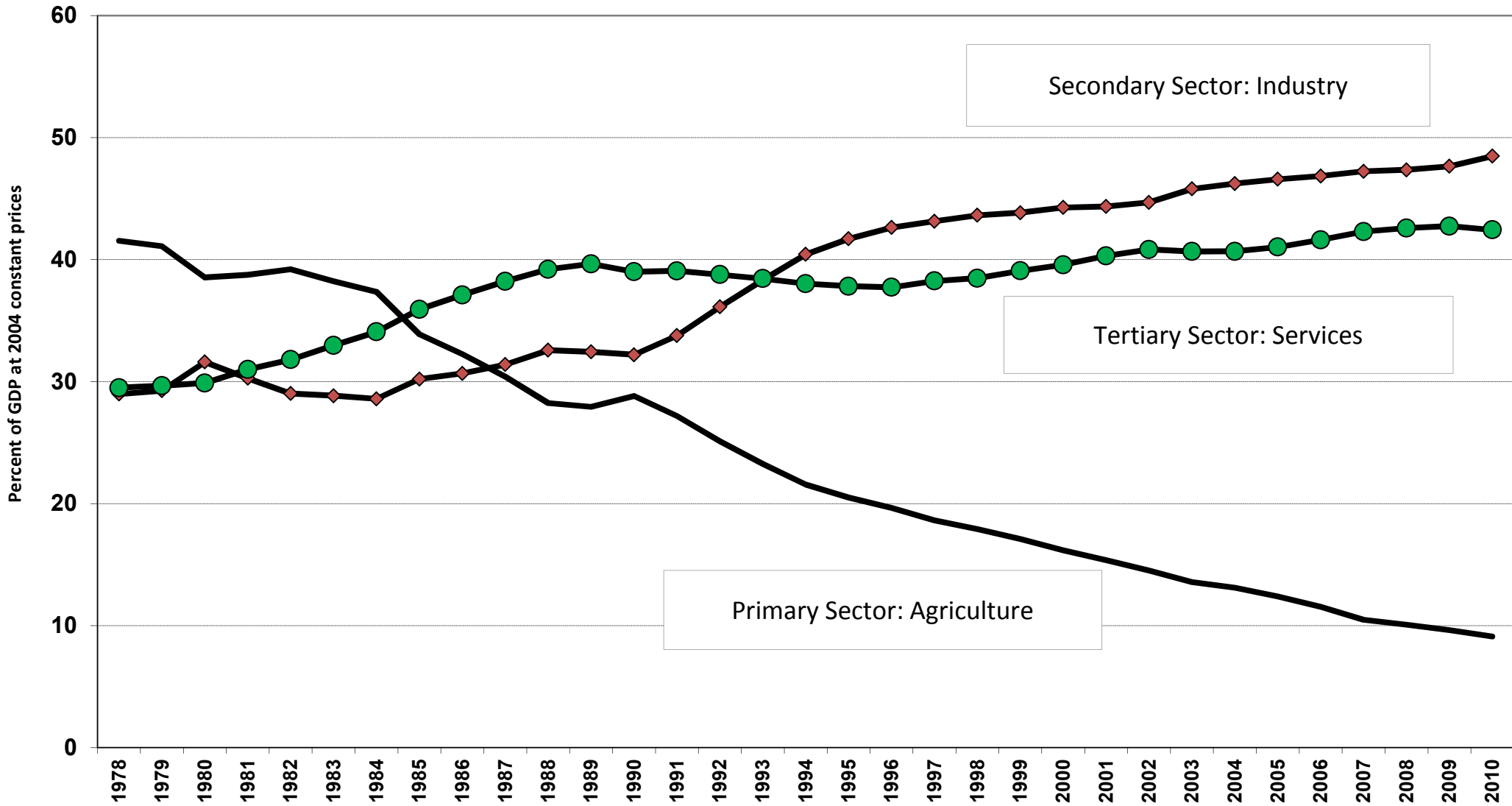
# Urbanization Rates Higher than Reported

- Local governments, under pressure to report high GDP growth per capita, generally use the registered population as the denominator. But the “floating” population is generally at least 30% as high as the registered.

# Structural Change in Employment

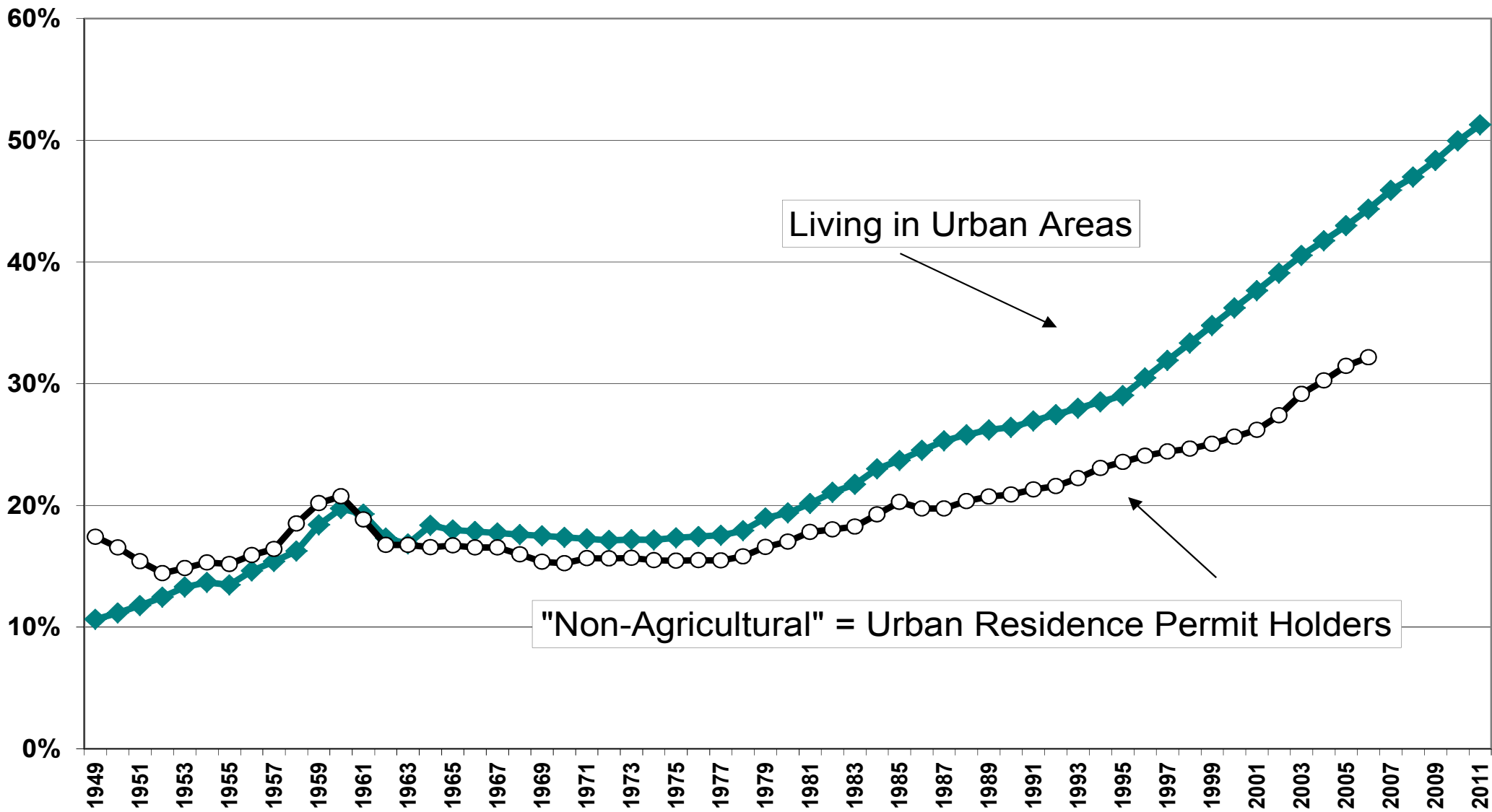


# Composition of Chinese GDP





# Urban Share of Total Population





- China maintains a divide among land types: urban construction, rural construction, agricultural, and forest
- 1980s: First began to decollectivize, providing 15-year cultivation contracts to farmers and allowing them to swap.
- Instituted land rights “auctions”
- 2006: Implemented the “red line” policy to maintain 250 m hectares of agricultural land



## The Reality

- To avoid confiscating land directly, villages form a “local government investment company” and get collectives to transfer the land. Then they swap it for land in a more remote area.

# Hukou Reform

- The profitability of the land swaps for local governments persuaded them to accelerate hukou reform. But cities do not have a means for paying for the influx of migrants.
- Meanwhile, many peasants do not want urban hukou. Giving up land is tantamount to giving up their own food security.
- In the meantime, cities engage in slum clearance and building new housing

# The Chengdu Experiment

- Registered and catalogued plots of land
- Established a swap market, where farmers could buy and sell use rights to particular plots for limited periods of time
- “Guagou”: Government builds new housing for peasants and knocks down the old, larger home, creating an arable land “credit.” This meets the “red line” requirement and enables the government to convert a portion of the land to more valuable urban land.

# Development Zones

- Starting in 1980, China began establishing special zones with policy benefits, including reduced income taxes, reduced tariffs or product taxes, improved infrastructure, cheap land, and streamlined bureaucratic approvals.
- The zone managers, who hold civil service ranks, are advanced or rewarded on the basis of meeting short-term bureaucratic targets
- Exports:
  - In 2005, out of a nationwide workforce of 752 mln, 24 mln workers in FIEs accounted for 58% of exports. Within the special zones, where taxes are lowest, the skew is even more evident: in 2004, just 4 mln workers accounted for 13.5% of China's foreign trade volume. The 54 nationally approved special zones in 2004 paid 4% of national tax revenues, even though these 54 have been established the longest of China's zones and are viewed as the most successful. Nationally, all types of tax revenues in 2004 amounted to 52% of the value of China's exports for 2004 nationwide. But tax revenues from the 54 special zones in 2004 amounted to 15% of export value.

# Extending Exports to Domestic Development

- In 2000, the export zone concept was extended to high tech industries
- With the land appreciation craze starting in 2006, governments started extending the “development zone” concept to any industrialization plan.

# Depleting Arable Land

- Since 2009, the official figure for the total area of cultivated land has remained steady at 121.73 million hectares, but the real number is clearly lower.
- Land quality has been deteriorating: High-quality arable land accounts for only 33% of cultivated land, paddy fields account for 26% of cultivated land, while arid land accounts for 50%. Moreover, high quality land is generally found in highly developed areas, leaving much of this land under cities. (China Land Resources Survey, 2009)



# Financing the LGFVs

- **Commercial Loans**
  - The Big Four commercial banks plus local commercial banks have aggressively extended credit to local financing platforms against land collateral. According to the PBOC, the credit represents 30% of the banks' lending capital.
- **Local Bonds**
  - Since Shanghai issued the first local “quasi-bond” in 1993, China's central government has been issuing bonds “on behalf of” local governments, with the amount originally averaging about 200 billion RMB per year but now rising to over 600 bln.
- **Trusts**
  - Initiated back in 1979, trusts were originally deployed by governments to lend to preferred construction projects. They tend to derive their revenue from dedicated investment projects.
  - Locally owned trusts are often put together by state enterprises within that locality, which contribute share capital.
  - The proportion of new trust funds dedicated to real estate investment has shot up

# Financing the LGFVs cont.

- **China Development Bank**
  - The China Development Bank, originally a department of the State Planning Commission and later an investment company under the Construction Bank until it split off in 1999, is tasked with funding infrastructure development. Its capital derives from bond sales. China Development Bank financing comes on preferential terms, with low rates, lax collateral requirements, and terms of up to 15 years.
- **Investment Companies**
  - Investment companies can be a way to bypass loan caps: they can raise investment capital from companies, or they can get loans from the commercial banks, lend the money on at a higher rate, and then sell the loans back to the banks, where the loans become part of the treasury function and are no longer counted against the bank's lending quota.
- **SME Finance Platforms**
  - Small and Medium Enterprise offices or associations under city governments certify companies eligible to participate in these collective lending schemes. Members that meet the requirements issue low-interest bonds, which are usually further subsidized by the local government and that provide a source of loans for smaller enterprises in the locality. In some cases, local financing platforms qualify as "SMEs" and can get these loans.

# Emergence of the General Purpose LGFV

- 1992: The General Corporation of Shanghai Municipal Property was created to manage the finance of all the special-purpose vehicles.
- Corporation was assigned fiscal revenues and also could raise debt
- Hugely widened the scope of LGFVs. By 2009, LGFVs had at least 5T in bank loans. But from late 2009, the attracted 40% of bank credit. But almost nothing was known about them.

# Role of the Banks

## New Credit Facilities

- Rural Credit Cooperatives
  - Originally established to finance rural construction
  - Actually managed as capital pools for local governments, bias toward large borrowers and government projects
- Chinese “Monolines”
  - Several companies exist to provide bond insurance, credit enhancement, and local municipal credit guarantees—which typically make up about 80% of these companies’ portfolios.

## Fast Accumulation of Debt

- By 2010, LGFV debt was 80% from commercial banks.
- LGFVs by end 2010 have 10.7T in debt—263% of their own revenues, acc to national auditors
- 27% of GDP

# People are increasingly unhappy as the wealth divide becomes enormous

**Shanxi wedding**

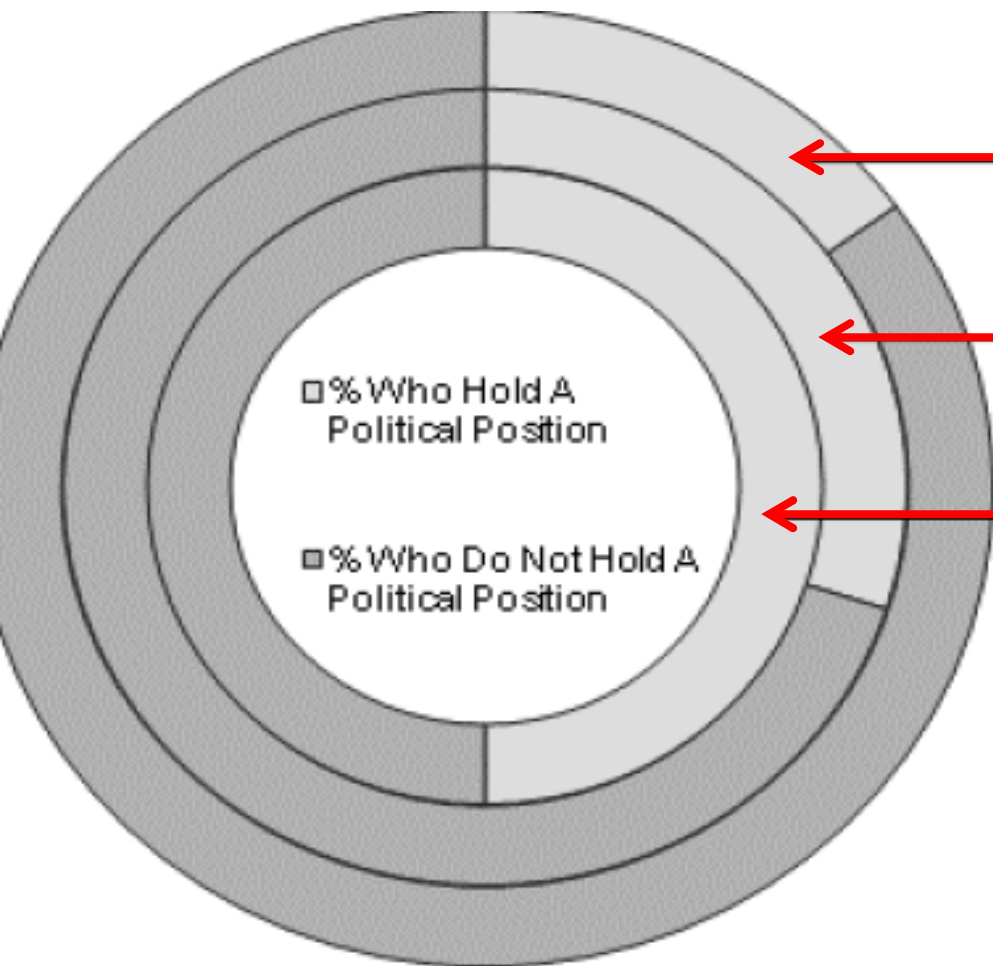


**Shanxi coal worker's home**



# Wealth concentration ... and po

*China has historically been an efficient concentrator of wealth*



- Top 1000 have US\$1 T in wealth, 14% of GDP
- Of top 1000, over 90% are CCP members or officials
- Of top 1000, 14% have significant political roles
- Of top 50, 30% have significant political roles
- Of top 10, 50% have significant political roles

Sources: Business Monitor International, Hurun Rich List, Deloitte China

# The Siege of Wukan



# The Chongqing Model

- “Dipiao” based on surveys of rural land yield 15 bln in loans to farmers
- 21 urban districts establish hundreds of LGFVs, which collateralize land for borrowing
- Huge investment, well in excess of city GDP, generates growth over 18% annually
- But ...
  - Farmers complain that they are not consulted when their land is traded, until the bulldozers turn up
  - No clear road to paying the mounting debt
  - There are no clear options for replacing agricultural employment



# Revenue from Residential Land Sales

## (bln RMB)

Month	Beijing	Shanghai	Tianjin	Chongqing	
<b>Jan-Feb 2010</b>		<b>27.25</b>	<b>38.171</b>	<b>9.281</b>	<b>14.078</b>
Mar-10		20.125	16.62	7.826	11.682
Apr-10		54.431	69.761	16.201	26.794
May-10		31.744	31.419	18.887	22.359
Jun-10		61.268	87.194	23.124	37.446
Jul-10		42.286	41.565	23.868	31.665
Aug-10		72.856	111.021	28.727	47.361
Sep-10		62.095	72.846	32.99	47.238
Oct-10		93.313	134.605	36.178	64.822
Nov-10		80.568	84.722	43.816	65.031
Dec-10		125.484	154.813	63.211	96.033
<b>Jan-Feb 2011</b>		<b>25.755</b>	<b>29.188</b>	<b>11.09</b>	<b>21.59</b>
Mar-11		10.811	15.856	9.247	17.981
Apr-11		36.557	42.888	19.151	35.027
May-11		21.649	35.763	19.774	31.066
Jun-11		50.34	62.514	26.81	50.911
Jul-11		35.326	58.424	25.5	44.676
Aug-11		63.767	77.517	36.115	62.606
Sep-11		46.813	72.408	38.538	61.163
Oct-11		75.518	89.616	47.908	76.41
Nov-11		57.684	83.99	47.697	76.71
Dec-11		102.92	114.201	76.53	105.831
<b>Jan-Feb 2012</b>		<b>10.608</b>	<b>19.517</b>	<b>12.41</b>	<b>20.049</b>
Mar-12		13.233	13.169	7.966	17.171
Apr-12		25.139	34.443	18.954	35.375
May-12		33.063	31.894	18.202	31.929
Jun-12		48.168	59.399	27.919	52.326

# Unhealthy Incentive Systems Create Miserable Cities



- Heavy pollution
- Unlivable cities, with needlessly wide avenues, unwalkable streets, few local services, and incongruous, monumental architecture