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# China's Housing Market: A Reflection of Domestic Investment Challenges

Hannah L. Randolph
Department of Political Science
University of Cincinnati
2600 Clifton Ave
Cincinnati, OH 45220 USA
Faculty Advisor: Dr. Thomas Moore

## Abstract

China's recent high rates of growth and economic transformation have produced much debate over the reasons for and sustainability of its success. In addition to questions pertaining to the effects of China's growing economy, many scholars and analysts are beginning to study how the Chinese economy functions. Given China's current and future importance to the world economic system, it is becoming more important to analyze China's economy, especially challenges that might potentially weaken or substantially change China's economic future. Such challenges include problems arising from continuing reforms of the old socialist system, from the transition to a more capitalistic system, and from the economic modernization that all developing nations experience. China's investment structure, particularly its domestic investment, is perhaps one of the most important economic areas in which these problems occur. The housing market in China is a microcosm of Chinese investment structure as a whole, and thus provides insight into the current state of the economy and its possible futures. The question thus arises, how does the housing market reflect wider problems in China's investment structure, and how might these challenges affect China's economic future? Using a case study of China's housing market, this paper explores the wider issues of China's investment structure and uses this exploration to partially explain the operation of domestic investment specifically and the Chinese economic system in general. This case study is drawn from academic and news articles, academic research papers, and economic data from governmental and non-governmental sources. Through examination of the investment structure of China, it is possible to see that restrictions on private investment and the heavily government-directed investment environment are distorting China's domestic investment opportunities and projects in comparison with other countries. Due to the privatization of the housing sector in 1998 and the high rate of urbanization that China has sustained in addition to distorted investment, China's households hold a disproportionate of their savings in housing. All of these factors have further combined to create rising housing prices, a shortage of affordable housing, and a dearth of other investment opportunities for Chinese households. These results have contributed to increasing wealth disparities and the possibility of a housing bubble that may cause global issues. Though these concerns do not necessarily indicate that China's growth is unsustainable, they do indicate wider problems in the Chinese economy that must be addressed in order to sustain Chinese growth. In accordance with these observations, the Chinese government would be wise to reform the investment system by further privatization of the system and the deregulation of private investment.

**Keywords: China, domestic investment, housing bubble**

## 1. Introduction

China's recent high rates of growth and economic transformation have produced much debate over the reasons for and sustainability of its success. In addition to questions pertaining to the effects of China's growing economy, many scholars and analysts are beginning to study how the Chinese economy functions. Given China's current and future importance to the world economic system, it is becoming more important to analyze China's economy, especially challenges that might potentially weaken or substantially change China's economic future. Such challenges include problems arising from continuing reforms of the old socialist system, from the transition to a more capitalistic system, and from the economic modernization that all developing nations experience. China's investment structure, particularly its domestic investment, is perhaps one of the most important economic areas in which these problems occur.

The housing market in China is a microcosm of Chinese investment structure as a whole, and therefore provides insight into the current state of the economy and its possible futures. The question thus arises, how does the housing market reflect wider problems in China's investment structure, and how might these challenges affect China's economic future? When used as a case study, China's housing market gives important insight into the wider issues of China's investment structure and partially explains the operation of domestic investment specifically and the Chinese economic system in general.

## 2. Investment Structure

### 2.1 Before The Reform Era

The current investment structure of China is somewhat complex, as it has been undergoing a process of privatization that will not be complete for many years, if ever. From the beginnings of Communist China until the Third Plenum of the Eleventh Central Committee of the Communist Party of China began the reform period in 1978, the Chinese economy was modelled after the Soviet centrally-planned economy. Chinese domestic investment was inefficiently government-directed, and any kind of foreign investment or private industry was unheard of. As Chairman Mao's goals included industrialization and economic success in China, he used socialist practices and public investment to build factories, train workers, and provide benefits for citizens. Since the investment system was not informed by any kind of free market, the companies and projects that received investment funds were not necessarily successful or profitable. These inefficiencies were reduced in the reform period, but some remain today.

The banking system in China before the reform period was very distinct from the current banking system. The system consisted mainly of the People's Bank of China, a mono-bank, and banks incorporated by the Ministry of Finance. Loans and financial activity dropped sharply under the People's Republic before the reform era, which created a "primitive" banking system.[1] As with investment and state-owned enterprises, the banking system was designed to pursue policy goals and fund government projects.

There was also a substantial difference in public investment in rural and urban areas during the period before liberalizing investment reforms. The focus in rural areas was mainly on research and development, irrigation, and infrastructure before the reform period, while in urban areas it was on strengthening the manufacturing sector.[2] These differences in foci have contributed to the difference in economic growth rates and patterns between urban and rural China, contributing to further divides. Differences between the two emerging from the pre-reform era have also been attributed to the hukou system, which classified Chinese citizens as either rural or urban residents and prevented them from changing their classification easily.[3] This system made benefits such as subsidized housing available only to urban residents, furthering the gap between public investment in rural and urban areas.

### 2.2 During And After The Reform Era

During the reform era that began in 1978, China gradually decentralized economic power from the central government to regional governments, state-owned banks, and state-owned enterprises (SOEs).[4] Private property and contracts were also reinstated, motivating private citizens to accumulate assets and invest their savings. As these reforms have occurred, the economy is widely seen to have become more efficient, and has prospered as a result. Most recently in the realm of investment reform, the Chinese government instituted what they call the New 36 Clauses in 2010. "Several Opinions on Encouraging and Guiding the Healthy Development of Private Investment," the document's full name, was written to further develop ideas to encourage, develop, and regulate private investment, although some fear that the difficulty of implementation and the heavily entrenched state-owned enterprises will leave little chance for new private investors to make much of a mark.[5] For policies such as this to succeed, it is necessary that government makes efforts not only to declare policy, but also to implement it.

As the State Council attempts to implement reforms such as the New 36 Clauses, many are increasingly concerned over the government's apparent inability to enforce these policies.[6] This has raised further concerns that the government truly is losing power as it liberalizes the market, making it harder for Chinese officials to pass and implement liberal economic policies. Even after liberalizing reform, the Heritage Foundation's Index of Economic

Freedom rated China 25 out of 100 for investment freedom, citing it as "non-transparent and inefficient."[7] This almost certainly refers to the continued indirect government direction of domestic investment through state-owned enterprises and regulation of the private investment market.

Though encouragement of private investment may be somewhat ineffective, total investment rates have been extremely high in China both under government direction and after liberalization of the investment market. China has had rates of both fixed asset investment and gross fixed capital formation investment of about one-third since the late 1980s, and these are conservative estimates.[8] Investment of this kind allows for infrastructure development, industrialization, growing industrial and agricultural sectors, and, most importantlyfor the purposes of this paper, high rates of urbanization and housing investment as part of infrastructure development.

Even with high levels of investment in all areas of China, the difference in development between rural and urban China during and after the reform period is striking. Urban China has received significant public investment funds in pursuit of specific policy goals in infrastructure and the industrial sector, but public investment has been less directed in rural areas. However, the Chinese government has had success in reducing poverty with agricultural-based investment, education, and infrastructure development.[9] The development of private property and private incomes have also pushed growth in rural areas, as their relative inefficiency before the reform era was mostly due to collectivization and unreasonable government expectations of the move away from agriculturalism.

## 2.3 The Role Of Government In Investment Since The Reform Era

Though high investment rates are partially due to the high rates of saving in China, they are also a result of continued government direction of investment. Since liberalization, the Chinese government has continued to exert influence through state-owned banks and state-owned enterprises. In particular, some argue that since the world financial crisis, China's government has increased its role in business to bring about stability more quickly.[10] This also has the side effect of effectively reversing some of the liberalization in the Chinese economy, as continued government involvement weakens the movement away from state-owned enterprises and toward a truly privatized market. Due to this reversal, it is possible that China will experience slowed growth if investment capital is unwisely allocated by the government, although by this time the government has much experience with this sort of direction.

There are also many obstacles to the privatization of investment besides those posed directly by the Chinese government. Private firms receive harsher borrowing terms from banks than do SOEs, and many also receive less money from the government in the form of subsidies.[11] This has created an environment that discriminates against private lenders and blocks them from key sectors. Instead, these sectors are dominated by SOEs and lending by state-owned banks.

The Chinese government has taken steps to liberalize the parts of the economy most beneficial to their policy goals, such as the deregulation and even encouragement of foreign direct investment. As discussed above, FDI is much more open than private domestic investment. In fact, some government banks and SOEs have participated in significant amounts of FDI in other countries, most notably Singapore, South Korea, and Taiwan.[12] Even private firms have engaged in significant amounts of outward FDI since its legalization in 2003. This has increased China's interdependence with other countries and somewhat changed its trade balance, although foreign investment in China far exceeds outward FDI.

As GDP in China rises at a prodigious rate, the functioning of the investment system depends more and more heavily on the banking system. Some would argue, especially those in the Chinese government, that using the banking and investment system to pursue policy goals is very effective, and that it has gotten China where it is today. Though it has worked well for China, it is also impossible to tell what the outcome would have been had China deregulated its banking and investment sooner and more completely. However, banking efficiency has also increased since banking reforms were implemented in 1995.[13] This is one example of deregulation moving China toward further efficiency.

Though China has been implementing reforms in the banking system, the largest four banks, referred to as the Big Four, are still state-owned. These four commercial banks are the Bank of China, the China Construction Bank, the Industrial and Commercial Bank of China and the Agricultural Bank of China, and each has a specialty more or less indicated with its name. Furthermore, the Big Four are the least efficient banks, while foreign banks are the most efficient banks currently operating in China.[14] Other Chinese banks include policy banks (development banks) and second-tier commercial banks. As the drivers of domestic investment, these banks are inefficient mainly because they are state-owned, and are therefore used to pursue policy goals and fund SOEs rather than pursue the most efficient market outcome.

## 2.4 Differences In Treatment Of Domestic And Foreign Firms

In China, foreign-invested enterprises (FIEs) operate under different laws than do domestically-owned private firms. As explained by Huang, foreign direct investment (FDI) was first allowed in 1979, and was then encouraged by laws starting in 1986. Chinese legislation continued to lift restrictions and add benefits for FIEs engaging in FDI throughout the 1990s, culminating in China's accession to the World Trade Organization in 2001. In fact, FIEs face lower corporate taxes than SOEs do, which sometimes makes them more able to make a profit.[15] Thus, the history of FDI and FIEs in China over the last thirty to forty years has been one of liberalization and increasing openness, creating hopes that China will eventually liberalize completely.

However, "compared to the FIEs, the legislative and regulatory treatments of domestic private firms have been far less transparent and more restrictive."[16] For example, although FIEs have been constitutionally protected since 1982, China has yet to institute any such protections for domestic private enterprise. This tends to give foreigners an edge over private domestic businesses, although this is not what the policy is designed to do. Policies that differentiate between FDI and domestic investment are not meant to favor foreign companies, but to separate Chinese companies from foreigners. By doing so, the government can continue its partial direction of domestic investment while maintaining a more liberalized foreign investment market. With its international critics satisfied by the apparent liberalization, China's second of two investment worlds also maintains vestiges of socialism and a centrally planned economy.

Although foreign direct investment occurs under different laws than private domestic investment does in China, the solution is not necessarily to curtail FDI in favor of using more domestic investment. FDI in China between 1988 and 2003 was highly correlated with economic growth and, more importantly, to higher rates of domestic investment.[17] This means that any problems involving these three factors (domestic investment, foreign direct investment, and economic growth) is not the result of competition between domestic investment and FDI, but rather the result of certain components of domestic investment instead. These components include government direction of domestic investment, restrictions on private domestic investment, and a dearth of sufficiently stable private investment opportunities.

Though the Chinese government has continued significant direction of the investment market, there is hope that they are encouraging more private enterprise. During the reform era, many government entities were transitioned to state-owned enterprises, which are allowed to make profits and are generally controlled by loyal members of the Communist Party of China. Now that China has continued its liberalizing reforms, many SOEs are once again making a transition, this time to government-link companies (GLCs). GLCs differ from SOEs in many ways, but mainly in the level of government involvement. Where most SOEs have boards appointed by government officials and have government involvement in many day-to-day operations, GLCs have some functional distance from policy goals and instructions.[18] While possibly removing some of the advantages of direct government connections, these transitions could make companies more profitable as they pursue efficiency rather than effectiveness of policy implementation.

## 2.5 Treatment Of Private Citizens

As restricted as some aspects of FDI and SOE investment are, the restrictions on Chinese citizens' investment are even stricter. Private investment firms are often crowded out of investment opportunities by SOEs.[19] This means that there is a lack of investment opportunities for Chinese citizens in China itself. Though higher returns and safer investments are available overseas, Chinese citizens are subject to overseas capital account transaction limits and limited access to investment products.[20] As a result of this particular combination of restrictions, Chinese citizens must resort to semi-legal or illegal means of investing overseas or hold their wealth in assets like housing.

Though SOEs dominate many markets, the private sector in China is still very successful. As a result of the tough restrictions discussed above, private investment accounts for very little of China's booming private sector. Most funding for the private sector comes not from private investment, but from state-owned banks and foreign direct investment. Private investment accounts for only 9.6 percent of fixed-asset investment in the financial industry, and just 13.6 percent in parts of the power sector.[21] This has come about mostly as a result of somewhat unofficial discrimination against private investment in favor of government funding and direction.

## 3. The Housing Market

### 3.1 Trends

As the private investment structure of China changes, it is difficult to see the immediate effects and implementation of new policy. Such changes and effects are seen more readily in the housing market, which can be used to draw more general conclusions about the state of China's private domestic investment.

The recent trends in China's population regarding housing are especially telling. Before 1998, China's housing market was government-owned. Both before and after its privatization, urbanization grew at prodigious rates, causing a sharp increase in both the need for and price of urban housing after privatization. A study done by World Bank researchers indicates that China's rapid economic growth and urbanization have caused a significant decrease in urban poverty, although it is likely that poverty has not been alleviated in rural areas.[22] This increase in urban jobs due to economic growth has provided many Chinese citizens with the means to pay ever-increasing housing costs, and even give them excess money that they must invest.

Due to the investment restrictions outlined above, Chinese citizens have few private investment opportunities. Furthermore, the stock market and other means of holding private savings are underdeveloped and underperforming due to the transition between central and market economies.[23] Housing is seen as one of the most reliable and lucrative investments that Chinese citizens can make. As a result, housing was 65% of China's household balance sheets in 2011, while insurance equity and bonds were 15%. In comparison, the balance sheets of U.S. citizens contained 20% in housing and 60% in insurance equity and bonds.[24] Since housing is an even larger holder of private investment in China than it is in the United States, it follows that weaknesses in the housing market are even more threatening to China's economy than similar weaknesses are in the United States.

Though the fact that housing is a large part of current private investment in China is important, it is perhaps even more important to understand why this occurs and what happens as a result. As described above, private investment has been regulated and crowded out of the investment market to the point that housing is the best option for China's private individuals. Stocks and bonds are less established, and investment abroad is severely restricted, leading to the current balance of individual investment.[25] As a result, many individuals and families do not stop at buying just one residence; when enough money has been saved, many buy a second residence, since housing has been proven to hold its value by the ever-increasing price of housing in China.

### 3.2 Rising Prices

Increased demand for housing has important implications for the price of housing, and even more importantly, for the possibility of a housing bubble. The rising prices of housing in China are being driven by increased residential demand.[26] This makes it even more likely that prices will fall quickly when something upsets the market, such as a sudden lack of funding for housing or a demand shock. Rising prices also contribute to the attractiveness of investing in housing, a cycle that may contribute to heightened prices and confidence in the value of housing. As students of the U.S. financial crisis are aware, these conditions can prove dangerous under certain circumstances.

Prices may also be driven by the double market for housing in China caused by the transition from a planned economy to a market economy. Although housing is provided through a private market, it retained vestigial characteristics of a government-run housing market based on work units through the late 1990s and early 2000s.[27] This resulted in multiple housing prices, as commodity housing was purchased by work units and rented to workers at a price substantially below that of the private market, essentially creating in-kind subsidies to workers. Though these subsidies have fallen by the wayside as fewer and fewer workers live in work units and urbanization continues to privative the demand for housing, the effects of this remnant of the central economy continue to create difficulties in pinning down an exact market price for housing. Furthermore, as the government is used to regulating housing prices through these work units, they are just now developing the means to regulate such prices under the new market system.

### 3.3 Regional Differences And Income Disparities

Even as demand for housing rises, housing market statistics also indicate growing wealth disparities in China, as in many developing countries. Such statistics indicate the Gini ratio, which measures income inequality on a scale of zero to one, was about 0.40 in China in 2000.[28] Furthermore, these disparities form a sharp contrast between rural and urban residents, with the same authors explaining that rural income was about thirty-five percent of urban income in 2000. This reflects one of China's persistent economic problems: the dichotomy between rapid growth and prosperity in the wealthier urban population and the slower growth and relative poverty of the rural population.

This disparity is caused in part by the difference in treatment of rural and urban areas in government policy. In Maoist China, economic development was pursued through industrialization. This led to both the development of the hukou system, described above as creating a divide between rural and urban residents, and an underfunded and distorted agricultural market. Income in rural areas was low, and rural residents did not receive the same government benefits available to urban residents, such as housing.[29] The difficulties in moving between urban and rural residence caused by the hukou system has sharply divided opportunities for income and subsidized housing ever since.

In rural areas, income is considerably lower and economic growth substantially slower. Although the government has made attempts to integrate rural areas into the whirlwind of Chinese growth, many of these attempts involve simply encouraging relocation of rural workers to urban areas. China has substantially lowered poverty rates, even in rural areas, by contributing massive amounts of public investment funds to alleviate regional inequality.[30] Despite these efforts, rural performance is consistently lower than that of urban areas, due in part to the Chinese government's focus on the manufacturing rather than the agricultural sector.

Investment in rural areas of China consists mostly of public investment in education, infrastructure, and agriculture. As in the United States, Chinese agriculture does not attract much private investment on its own, since there are higher rates of return to be found in industrial enterprises. Unlike the United States, however, Chinese agriculture is mainly a small-business venture, making private direct investment even more difficult to arrange. As a result, agriculture in particular is heavily subsidized by the government.

Housing trends in rural areas have also been very different from those in urban areas. In Maoist China, rural land was initially redistributed among farmers and slowly collectivized.[31] However, rural housing, unlike in urban China, had been mainly an inherited asset, and did not change substantially until the 1980s. When reforms re-introduced private property rights, the authors further explain that rural China experienced a housing boom caused by increased income and housing shortages. This boom was mostly privately financed out of private investment, and such construction of new housing and rebuilding has served as the rural version of buying a second home to hold savings. Since the privatization of housing, the rising price of housing has forced poorer rural citizens to continue to live in rural areas, where housing is cheaper, yet work in urban areas, where higher-paying jobs are available.[32] China's "floating population" is yet another symptom of regional disparities in China.

Urban areas, on the other hand, have received large amounts of investment funds throughout China's recent history. The difference in the reform era has been that such funding is increasingly the result not of direct government investment, but either public investment directed by state-owned enterprises and banks or direct private investment in the form of residential investment. Thus, urban residents either build a second home or buy one to hold their surplus wealth and make some return on it.

No matter the region, the wealthiest in China still hold the most economic power. Even with increasing consumption, as income rises Chinese citizens must hold their savings in one form or another. Holding savings in the form of housing, especially as the value of housing continues to go up, is an important form of private investment in China. However, many question whether the housing market can sustain the rapid growth in prices that it has been experiencing. Comparisons have been made to the U.S. housing bubble, which raises the question of a possible market or banking system failure.

## 4. Housing Bubble

The possibility of a Chinese housing bubble is controversial and difficult to navigate. Some feel that rising prices are unsustainable, and furthermore that these prices are not reflective of the true value of housing. Others feel that calling it a bubble now is perhaps alarmist, and prefer to cautiously monitor the situation further.[33] However, few can deny that the rising cost of housing is indicative not only of economic growth, but also of the possibility that China's current level of economic growth is unsustainable.

## 4.1 Definition, Controversy, And Comparison

One of the main problems in considering a housing bubble in China is the definition of a housing bubble. Economists lacks a specific definition, and researchers are in considerable disagreement over what might indicate that such a bubble does indeed exist. However, researchers have indicated that high growth rates of price-to-income ratios and price-to-rent ratios of 70% point to fundamental problems in the housing market, even if these problems may not amount to a bubble depending on what definition is applied.[34] This problem indicates arbitrary rises in housing costs that are due to rises in housing demand, not in the actual value of the property.

Of course, there are also substantial arguments that the current situation in China does not constitute a housing bubble. Most of the price increases in housing have been substantiated by the value of housing, and do not pose a significant risk of dropping suddenly as the result of a shock to the market.[35] Furthermore, the *Wall Street Journal* recently revealed that the oft-cited "empty cities" of China, such as Ordos and Zhengzhou, are perhaps not the indicators of a housing bubble that they are often taken to be.[36] These cities, and more importantly their empty housing units, are sold off when almost completely unfinished. The source reports that it takes an average of three years for owners to move into their new residence. Since these units are in transition, it is still unclear whether or not these cities will prove to represent the full truth. These arguments have merit, but may not fully explain the number of empty residences and rising housing prices.

Though new residences that sit empty for years are an uncommon sight in the United States, empty old residences are not so rare since the collapse of the U.S. housing bubble. The difference in these empty units is in the roles each play in their respective countries. In China, empty units are a representation of private investment and a way for owners to hold and profit from their savings. However, in the United States such units are more often those which lost enough value in the housing bubble to be worth less than their mortgages. Though these are two extremes, it is possible that China's new units might become its old, foreclosed units if the bubble bursts.

## 4.2 Consequences And Government Response

The consequences of such a bubble could potentially be catastrophic. As in the United States, unsustainable housing prices would cause high rates of foreclosure and loan default, which could domino through the entire financial system. As China's interdependence with foreign nations such as the United States increases, international critics are increasingly concerned with the possibilities of such a housing bubble in China, and what such a bubble could do to the international financial system.

If the housing bubble in China were to collapse, the government would step in, though in a different way than the government did in the United States. The government has many courses of action available, although it is unclear whether or not it could completely mitigate the consequences of such a market shock. Since China retains a larger amount of its government control over the economy than does the U.S., the immediate situation might be more easily contained. Though China has been liberalizing, the government also retains a significant amount of control over the economy, especially in the banking and investment sectors. As it has already done, the Chinese government might easily pass legislation limiting housing prices, supporting the banking system despite high rates of loan default, and mandating higher property taxes. These actions, although not in the interests of developing a system more dependent on market outcomes, would control the situation more quickly than the U.S. government had the power to do.

Such measures would ease the effects of a housing bubble failure, and could possibly prevent it from spreading to the world financial system. However, in the long run, these short-term solutions might cause problems with excessively depressed home prices, downward pressure on GDP growth, and high rates of loan default by residential development companies.[37] Though China has advantages over the United States in terms of government power to soften the effects of a housing bubble collapse, these advantages also come with unintended risks and likely consequences.

Despite debate over the exact nature of the housing price problem in China, the Chinese government is already taking measures to counteract the deleterious effects of this problem. Current measures focus on the demand side of the housing market and include mandated increases in down-payment requirements, restrictions on citizens' ability to buy more than one housing unit, and restrictions on buying non-local property.[38] These will work to decrease demand and hopefully slow the growth of housing prices. The authors go on to say that in the future, the government may need to focus on the supply side of the market in order to increase the housing available. However, such measures would necessitate more rather than less government involvement in the housing market, which many researchers see as a strengthening of government-directed investment over the opportunities and direction of private domestic investment.

### 4.3 Reflection On Economy As A Whole

The housing market reflects many of the same problems affecting China's entire economy, such as sustainability, income disparities, disparities between rural and urban growth, and problems caused by partial liberalization. These similarities can be pinpointed by specific characteristics of the housing market. For example, though there are cities in China, such as Zhengzhou, that are called "ghost cities" due to their large number of empty residences, there is also a dearth of low-income housing. This has led to a large number of people unable to find housing, and also a large number of people who keep their savings in the form of a second home. Much like the housing market, the wider Chinese economy contains vast and growing income disparities.

Also contained within the housing market is the possibility of a bubble caused by private investment with nowhere else to go. This may indicate a lack of openness in China's economy that will have to be addressed soon. Without further opportunities to invest in lucrative and reliable projects, wealthier citizens will continue to buy housing to hold their savings. This will not only artificially drive up the price of housing, but will create a misalignment between the projects that China's economy needs, such as low-income housing, and the projects for which funds are available, such as high-income housing.

Much like the housing market, China's economy has misalignments caused by market distortions. These distortions are partially caused by government direction of investment, which crowds out private investment and limits private investment opportunities. As discussed above, SOEs and FIEs are given preferable terms over privately owned Chinese companies, leaving Chinese citizens with few investment opportunities or means of holding their wealth. This discrepancy in the investment market reflects wider disparities in the Chinese economy. Though government direction has encouraged high rates of growth, Chinese firms are disproportionately protected and capital flows are highly regulated. Though the opening of certain markets was part of the terms of accession to the WTO, other domestic markets are set up so that SOEs can depend too heavily on state-owned banks and government regulation to make them successful. Furthermore, the unofficial discrimination against private companies, though they are the drivers of Chinese growth, casts doubts on China's international competitiveness with foreign private companies.

## 5. Conclusion

China's housing market has many problems. The crowding-out of private investment from other areas of investment has created a large amount of residential investment that is reflected in the housing market with rising prices and a lack of low-income housing. As in many nations, rapid growth and distortions in the housing market have caused an excess of higher-income housing, while many rural residents and poorer urban residents are unable to afford the housing they need in order to live where they can find work. Through these problems, the housing market mirrors wider problems of market distortion, regulation of private industry and investment, and income and allocation disparities in China's economy.

Though many of these problems arise from the continuing transition from socialism and a centrally-planned economy to a liberalized economy, they will have to be addressed in the near future. The possibility of a housing bubble threatens the relatively new strength and stability of China's financial system, and this problem can only be alleviated by increased private domestic investment opportunities elsewhere in the economy. Allowing citizens a wider scope for investment could lessen the pressure that the current limitations place on the housing market. Although the government can attempt to regulate the bubble in order to prevent it from crashing, it is more likely that measures will have to be taken to further liberalize the private domestic investment market.

China's economy is extremely important to the world's future, and becomes more and more so as it grows. As such, it is important that China resolves current threats to the stability of its economy. As China continues to transition its economy from the old central model to the new market model, it will have to remember the possible long-term consequences of retaining vestiges of its centrally-planned economy.

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