

# **The bubble, the state, and the crooked-mouthed monk : the Chinese property crisis and its culprits**

mercredi 24 janvier 2024, par [AU Loong-yu](#) (Date de rédaction antérieure : 1er décembre 2023).

**In its recent press release, the IMF slightly upgraded its gloomy forecast for China's growth next year from 4.2% to 4.6%, but warned about the continuing "weakness in the property sector." According to Bloomberg, between 2013 and 2022, the price of new homes sold in 300 Mainland Chinese cities trebled. The long boom in the property market has eventually promoted a big bubble that began to burst in 2021. Prices since then have been falling drastically, and developers are facing big difficulties paying back their loans.**

Sommaire

- [Who are the culprits ?](#)
- [Mainland and Hong Kong - \(...\)](#)
- [The state as a part of the](#)

We have already seen Evergrande, the biggest developer, back in court again in Hong Kong at the end of October, after its creditors filed a winding-up petition due to its failure to pay back loans. The property giant began its slow-motion collapse in 2021 when it could not pay its 2.43 trillion RMB (US\$340 billion) liabilities. This has been followed by another giant, Country Garden, also now struggling to pay its debts and to get new loans just to finish its projects. And many households have already made down payments and mortgage payments on these projects.

Listed developers now owe the people US\$960 billion in unbuilt homes, according to the Economist, comprising roughly 40% of all purchased but uncompleted homes. Since 2021, many developers no longer have the money to keep their construction projects going, because their sales have been plummeting. According to the *South China Morning Post*, the 100 largest developers in Mainland China saw their sales down by 41.3% in 2022 (nationally they dropped 26%). In July 2023 they fell a further 33.1% year-on-year.

Bloomberg gave us a glimpse of the potential knock-on effect of the crisis when it reported that, "an analysis of China's 186 listed developers shows that about 48% of total borrowing is held by companies that either already defaulted on public bonds... or are at 'significant' risk of missing repayment". This amounts to 13.6 trillion yuan of debt being at risk of default, or 12% of China's GDP.

The stakes are very high. According to a Project Syndicate report, "the value of China's housing market is four times the country's GDP, compared to 1.6 in the US and 2.1 in Japan. It accounts for more than one-quarter of all economic activity and two-thirds of household wealth". It would be catastrophic if the crisis is not contained in time, not just for China but also for the world economy.

It is true that the government has been vigilant in not raising a lot of foreign loans, and official

statistics show a low level of foreign debt. But the problem is that there are a lot of hidden foreign debts – local government and corporations have borrowed a lot from foreign banks or by issuing bonds. The Financial Times tells us that Evergrande alone was estimated to have \$19 billion in overseas liabilities. No one knows the actual figure of China's foreign debt, but Evergrande's default is enough to deal another blow to the already weak confidence of foreign investors in China's market.

There are multiple factors behind the fall in prices and sales, but the fundamental driving force is the excessive supply and over expansion of the market. The housing vacancy rate is 25%. Since 2009, so many new flats have been built that they are enough to house 250 million residents, in a country where 600 million live on a monthly income of 1,000RMB (US\$140). No wonder that, "70% of homes sold since 2018 were bought by people who already owned one". Xi Jinping certainly had a point when he said "houses are for living in, not for speculation". He has again proved that he is good at promoting slogans, but only slogans.

### **Who are the culprits ?**

Who is responsible for the property crisis ? Michael Roberts, a leftist economist, rebutted the Western mainstream's narrative (for instance, the *Financial Times*). This blamed the government for its heavy-handed or inappropriate regulations and for its failure to raise the level of consumption which is too low. His article argued that it is the fault of the capitalist market and the private sector, and that more Chinese state ownership and state intervention would be a remedy to market chaos.

I have no sympathy for the *Financial Times'* recipes, but I think Roberts' thesis is misinformed, to say the least. The fact that in general it is capitalist forces which created this crisis should not blind us to the other side of the coin – it has always been the state which has pushed for more capitalism, with Chinese characteristics – a crony, state-led capitalism. The top tier predator of this ponzi scheme is none other than the central government, followed by the collusion between local government and the developers (known as the "white gloves" of local officials). The three formed an unholy ponzi scheme alliance which has eventually led to the downfall of the property market.

The central government laid the groundwork for this ponzi property scheme from the very beginning of the economic programme "reform and open". The 1982 constitution stipulated that urban land belongs to the state and explicitly prohibited its sale. This was soon revised in 1988 to allow the sale of the right to land use for a certain period of time (50-70 years). This openly followed the example of colonial Hong Kong's practice of land tender, in the midst of the party's call for "learn from Hong Kong !" (to get rich).

Municipal governments and even small towns would soon massively *quandi* (圈地, enclose land) for *kaifaqu* (开发区, development areas), from theme parks to real estate. Many of these eventually went bust. This would further extend to rural land as well – with a stroke of the pen local officials could always change "agricultural land" to "non-agricultural land".

In response, the central government tightened control again – for a while. But its fundamental policy of allowing the commercialisation and speculation of state-owned land has never changed at all, paving the way for more rounds of enclosures and building booms in later periods. The 1994 tax reform gave local government a second opportunity to promote another round of property boom.

This was followed by the 2008-9 global financial crisis, which created conditions for a third wave building boom : central government handed out matching funds of 30% to local municipalities to build more infrastructure, so as to boost domestic demand and save the economy. The municipalities

raised the rest of the money from their LGFVs (Local Government Financial Vehicles), borrowing from the banks or issuing bonds to fund these projects. These huge infrastructure investments usually came with development plans for residential areas or industrial parks/commercial hubs etc. By then, local municipalities had made themselves increasingly dependent on land sales and the property market - ultimately accounting for one third of their revenue.

The fourth wave was again provided by the central government when it rolled out its 2013 “new model of urbanisation” policy. This further pushed up house prices, with no regard to the bubble which was already forming. Some of them would eventually become “ghost towns” or lanweilou (烂尾楼, unfinished buildings).

The other side of the story was that a lot of people lost their homes in the midst of massive land grabbing all over the country and across both rural and urban land. There was also strong resistance, the most famous of which was the Wukan struggle.

### **Mainland and Hong Kong - a comparison**

This leads us to the issue of corruption with Chinese characteristics. Why were ghost towns possible? Didn't the municipal governments and developers study the projects' feasibility before launching them? Why would developers be allowed to sell off-plan properties (properties that had not yet been built) when China was still far from being a rich country, and when even Xi Jinping recognised the seriousness of China's corruption? While the government is such a control freak concerning the people, why couldn't it assert equally effective control over the developers and the mad financialisation of the property market? Especially when urban land is state-owned (which implies that the government can always unilaterally set the terms)?

In colonial Hong Kong, all undeveloped land was also under state ownership, or “crown land”. While the colonial government did allow the developers to unjustly enrich themselves immensely, since the 1970s it was also able to provide affordable public housing to half of the population there. By contrast, the mainland's mega property bubble was only possible after the party finally officially discarded the physical distribution of houses to workers in state-owned or collectively owned enterprises (of which most small and medium ones were privatised) in the late 1990s.

Looking back over the whole period of “reform and open”, it is clear that the CCP was tilted from the very beginning towards enriching local officials, developers and the upper middle class, at the expense of the lower middle class and the poor.

There are of course all kinds of housing projects to help the poor, but how they are implemented is the biggest problem and also a carefully guarded secret, not to mention that their scale is small. In a state where the officials are entirely free from any kind of scrutiny from the people, they can always make the policies work for their own enrichment. No wonder the reports about public housing or accessible housing for the poor often ending up in the hands of local officials. The National Audit Office found that 30% of 290,000 rented public flats were “violating the rules” and were “abused”. In the “old” Hong Kong period, when it still enjoyed autonomy, its media often ran reports like this - a township Vice Party Secretary alone would own 192 units of housing. It's not clear how many were public or private houses, but the number is staggering.

## **The state as a part of the problem**

It does not matter at all to the bureaucrats if the newly built towns are not eventually completed - local municipalities got their revenue from land sales, corrupt officials got their commission or a share of the booty, the developers got revenue from selling the flats and with the help of local officials also their loans from state banks.

This leads us to another facet of the bureaucracy - its dysfunction caused by the constant conflict between official rules and the terrible corruption within the hierarchy of the bureaucracy. The case of the Qinling illegal villas allows us a glimpse of the tug of war between local bureaucrats and the central government and with... Xi Jinping. The local bureaucrats broke the law to build their villas in an environmentally protected area. When this was reported to Xi he ordered their demolition in 2014. But the local officials resisted stubbornly for four years, through lies and tricks, before they finally did their jobs when hard pressed. But Xi had to issue six instructions before it was done.

On top of the complete degeneration of party bureaucrats into a bourgeoisified bureaucracy, there is also the factor of a particular political culture - or the lack of it - in the party. The practice of diyibashou (□□□□, the top party leader or the bosses of their respective departments) making irresponsible decisions over "economic development", often in defiance of professional advice or dissident party leaders, has been innate to the CCP since 1949. The most horrible example is the Great Leap Forward.

When these two factors coincide, the scale of corruption becomes unimaginable. The toxic environment within the party state also prompts corrupt officials to make big money as soon as possible (and many will move their money abroad afterwards), lest the party leadership suddenly changes course again and closes down their window for graft. This is reflected in the jingle "the communist party is similar to the moon, whose shape is constantly changing". Fundamentally speaking, the culprit of this man-made crisis is nothing else but the party state. We should not forget that Beijing's capitalist roader has been assisted by Wall street all along the way. Without the latter's help in promoting Chinese corporations' IPO in Hong Kong or the Wall street they would not have grown into such giants in so short period of time. But China is no regular banana country. It has been the party's conscious choice and in its own interest that it has turned China into a fiercely capitalist state all the way through.

When Roberts sees a remedy in the party state, he forgets that it is never neutral ; instead the bureaucrats have long hijacked the state for their own material interests, and consciously pursued more, through larger and larger dosages of privatisation and commercialisation of land use. Far from being a part of the remedy, the party state is a big part of the problem. Another Chinese jingle (quite popular during Mao's rule) gives us a more accurate picture of the party bureaucrats than Roberts' narrative - waizui heshang nian wajing (□□□□□□, crooked-mouthed monk chants scriptures crookedly). Buddhism may be the Truth, but you cannot rely on a wry-mouthed monk to chant its scripture. State intervention could be useful, but you can't rely on a corrupted party to implement a good policy. You may get the opposite of what you wish for.

*December 2023*

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(Note : This article is first published in the South African journal **Amandla**, issue 90-91, December 2023, p. 43. It was slightly edited by the author for this reposting.)