

The Impact of China's Joining World Trade Organization on Chinese Real Estate: Opportunities and Challenge ?

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Abstract

Joining the WTO will not only provide opportunities for both Chinese and foreign real estate, but also bring about a rigorous challenge for Chinese real estate. With the further opening of China's market after its accession to the WTO, there will be a new wave of FDI and greater immigration from countryside to towns and cities countryside. Therefore, the urban population will certainly increase. All of these will create a new demand for housing and other kinds of real estate. It is no doubt that foreign real estate developers will become competitors of Chinese domestic real estate developers and fight for this huge market. It is argued in this article that because big cities in China lack large scale real estate developers, Chinese domestic real estate developers must reorganize themselves in advance to form some large scale real estate groups and establishing modern operating procedures in order to compete with its foreign counterparts.

In the meantime, a sound legal system, and a fair competition environment for both Chinese and foreign real estate enterprises are needed for tackling the challenge of China's joining of the WTO and its adverse impact on the real estate.

Key Words: the WTO, China's real estate, challenge and opportunity, competition, legal system, government intervention

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The date for China to enter the World Trade Organization (the WTO) is becoming nearer and nearer. After joining the WTO as a member, China will have to obey all the basic rules of the WTO. With the further opening of its market and the overall reduction of the tariffs, the competition will become more intense. This paper will outline the opportunities and new challenges for both Chinese and foreign real estate after its joining the WTO.

1. Joining the WTO provides opportunities for both foreign and Chinese real estate.

First of all, under the influences of many favorable factors, demand for real estate will increase after China entering the WTO. This will help the development of Chinese real estate. Such factors could be outlined as follows:

(1) New waves of FDI

Joining the WTO means China will become more open to foreign countries. It will attract foreign enterprises and human resources coming to China to engage in all kinds of business. All of these will create demand for large amount of offices, residential houses and supporting facilities. Especially, company such as Chinese headquarters of foreign banks, insurance companies, security companies are in great need of offices of good quality. It has been noted that there is an increasing trend that many big companies have began to separate their regional offices from their head-offices with head offices being still concentrated in the central commercial areas while their production, sales and after sale services located in places near their final customers. In addition to offices, the demand of managerial personnel for quality housing such as deluxe apartments and villas will also increase. Finally, the rapid development of electronic communication in IT industry

also needs first-class buildings with multiple functions.

(2) The increasing urban population

After joining THE WTO, the opening of Chinese agricultural product market will speed up the process of modernization in Chinese agriculture and promote the development of China's urbanization. It is reported that the overall average duty for Chinese agricultural products will fall from the current 22% to 17% in 2004. On some priority agricultural products, tariffs will drop from an average of 31% to 14.5%.¹ The inevitable outcome of this will be the reduction of the rural population since some inefficient farmers will be crowding out. But this will speed up China's urbanization. It is estimated that if China's urbanization degree can be raised by 10%, i.e., from its current level of 30% to 40% in 2010, there will be 12 million people immigrating from countryside to towns and cities (Economic Daily, 2000). The increase of urban population creates a new demand for housing and other kinds of real estate. We have calculated that if 20 square meters per capita is required as the basic living standard, China needs to increase 240 million square meters in housing, that is 24 million square meters needed per year. The completed housing floor space was 15.4 million square meters and 16.8 square meters in 1996 and 1997 respectively in China.² There were a considerable amount of vacant houses then (Sheng, et al., 1999). The speed up of the urbanization will not only fill the previous vacant spaces, but also need more different types of houses as described above.

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(3) Changing Governmental housing policy and the rising income

After joining the WTO, income of Chinese households will be raised because of the development of industrialization, the growth of labor productivity and the increase of export. In addition, since Chinese government carries out the new policy transforming households' income into currency, Chinese households' income will remain an ever increasing trend. This will encourage Chinese households to utilize more income to buy real estate, since buying houses is always considered to be an effective measure to counter inflation problem and protect the value for money. In recent years, Chinese government has greatly relaxed the "HU KOU" system. In big cities, any people buying a house worth more than 300,000 RMB (currently equivalent to £24,000) will be given a city "HU KOU", which allows the holders or their children to go to schools or find a job in cities.

(4) The intense competition will bring about the rationalization of Chinese real estate

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After joining the WTO, foreign real estate developers will enter into

¹ USTR News Letter, March 22, 2000.

² China Statistical Yearbook, 1997.

Chinese market to engage in intermediary service of real estate development and property management. The impact of this will be several fold: firstly, it will undoubtedly add to some vitality to Chinese real estate and it will introduce more advanced technology? superior service and expertise of management to Chinese real estate. Secondly, Chinese real estate market will operate in a fairer competition environment. As a result, Chinese domestic real estate enterprises will have to improve their management, improve the quality of its service under the pressure of competition. Comparing with foreign countries, China is less developed in the areas of production technology, housing structure, models, building materials, function, quality and environment control. In the aspect of urban construction, China is also behind developed countries in city planning and development, environment quality and city management. Joining the WTO provides opportunities for promoting modernization of Chinese housing and real estate, promoting city planning, development, reorganization and management.

Fourthly, after joining the WTO, China will further open its service market, foreign companies of finance, insurance? intermediary service (include accountancy, lawyer, design, survey, assets appraisal and so on) will flood into Chinese market to provide financial service, including intermediary service. This will make it convenient for real estate and households to obtain more efficient but cheaper financial service, insurance service and all kinds of intermediary service when they build, buy and exchange houses. Generally speaking, the cost of raising capital for foreign companies is lower comparing to Chinese financial companies. Foreign insurance companies normally carry out the fund system or stock-holding system. So the policy-holders can get certain bonuses after paying the premiums. Competition in financial market and insurance market will reduce the financial cost and insurance premium rate in Chinese financial services.

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Finally, after joining the WTO, the tariffs of imported commodities will be reduced, foreign countries' construction materials, construction facilities? technologies and all kinds of decorative materials will enter into Chinese market. Foreign real estate developers will contract with Chinese in building construction. It will contribute to reduce construction cost, raise quality of real estate product.

2. Joining THE WTO provides rigorous challenge for Chinese real estate ?

Associated with the above mentioned opportunities, Chinese real estate also faces the challenge stemming from it joining of the WTO.

Firstly, foreign real estate enterprises will become competitors of

Chinese real estate enterprises and fight for the market. Foreign real estate enterprises, especially those large real estate enterprises have abundant funds, more advanced technology and plentiful management experiences. Some enterprises are multinational or trans-regional. They will take advantage of Chinese cheap land and labor to engage in real estate development and property management in China. While China and the United States was signing the mutual agreement on China's entering the WTO on the 1st of November, 1999, the US largest intermediary enterprises - *the 21 Century Real Estate of America* announced to enter into Chinese property management market. It is expected that there will be certainly more and more foreign real estate enterprises penetrating Chinese market. Some Chinese scholars warned that "Wolf is coming" is no longer a single frightened word, but a reality. Facing to this reality, the "flock of sheep" in China are faced with the problem of whether they can exist or not.

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Second, after joining THE WTO and the more competitive Chinese real estate market, the competitive means will also become more complicated. Foreign real estate enterprises may take all their advantages to engage in not only price competition to capture market, but also non-price competition including quality, real estate design, after-sale services and housing management to enlarge their market share. However, Chinese domestic enterprises can also take their advantages of familiar environment and local market and customers to compete with foreign enterprises. Who the winner is will depend on their overall strength, marketing and management strategy.

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Third, after joining the WTO, the intermediary services enterprises and related services enterprises of Chinese real estate will also face the challenges from their foreign counterparts. But, the intermediary services industry in western countries has a long history. It has a sound theoretical and practical experiences, It also has many experts in the field, a sound legal system and a well regulated operations. They can provide all sorts of intermediary services for real estate development, housing exchange, renting and research. When those foreign capital enterprises which provides real estate financial insurance and investment services enter Chinese market, they will compete with Chinese domestic financial companies. The real estate intermediary services market and related fields will no longer become monopolized by Chinese financial companies.

Fourth, after joining the WTO, there may be greater fluctuation in the development of Chinese real estate, which will challenged domestic real estate enterprises' competitiveness. In general, the property cycle is linked to the general business cycle. With Chinese economy becomes more integrated with world economy, the fluctuation of international economy or the financial crisis will have direct impact on Chinese economy and foreign trade. The reduced tariff and tax of Chinese commodities will

encourage more foreign enterprises to enter Chinese market, foreign products will grab more market share in China. For the same token, China can also occupy some of international market. Nevertheless, it takes a while for Chinese domestic enterprises to improve their competitiveness. At the beginning of joining the WTO, competition may have some adverse impact on Chinese real estate industry. Domestic enterprises will lose some of the market because of foreign enterprises' stronger competitiveness. There will appear some surplus in domestic capital and labor force in Chinese real estate.

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3. The Countermeasures It May Taken

Faced with opportunities and challenges provided by entering the WTO, it could be suggested that Chinese real estate should analyze the prevailing market conditions and work out countermeasures to take the opportunities and tackle the challenge. In our opinion, the following countermeasures may be taken :

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(1) Chinese domestic real estate enterprises should be reorganized with explicit right and duty. The rights of the enterprises should be distinguished from the government. A modern management system for Chinese real estate should be established with the clear property rights. Up to 1996, China has 21,269 real estate developers (China's Statistics Yearbook, 1997), with a total investment of 300 billion per year (Maolu Zhou & Zhiming Gu, 2000).³ However, scale of each developer is quite small. For example, the average investment for each developer is only 1,500,000. The average registered capital of a real estate developer is 30 million. Most developers are state-owned which is either funded by the municipal or local government. It has been reported that the first ten biggest real estate only has 15% to 22% of local market share due to the lack of funds (Yuan Ke, 2000). Therefore, big cities in China need a lot of large scaled real estate developers. It may also argue that those small scaled domestic real estate developers should be reorganized through merge or requisition to form some large scaled stock-holding groups. Every big city should have several transformed large scaled real estate developers. These real estate enterprises may apply to become listed companies in stock market. Only after establishing modern management system, enlarging enterprises' operation scale and raising enterprises' competitiveness, can they compete with foreign capital real estate enterprises and meet the needs of the development of Chinese real estate.

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(2) Changing the means of raising capital and optimizing the structure of the Chinese real estate are the important measures to expand Chinese real estate developers' operational scale and improve their competitiveness. There are some problems in the present capital structure of Chinese real estate developers. Large amount of capital needed by

³ The average foreign exchange of Sterling and Chinese Yuan is 1:13 in 1996.

developers are financed through bank lending. High assets and liability ratio of many developers result in a heavy burden of paying interests. If the commercial housing built can not be sold, the developers and bank have to bear the investment risk. This investment system is not convenient to form the mechanism to restrain investment. In order to optimize the capital structure of developers, reduce the rate of debts for enterprises, spread the investment risk, Chinese developers should mainly raise funds from the capital market through issuing bonds and stocks. Needless to say, issuing bonds and stocks must go through the appropriate credit rating and legal procedure.

(3) All the real estate developers should change their methods of operation and establish the efficient decisive system to adapt to market economy. Actions such as investment decision, housing design, housing development, marketing and should all serve for the markets. It is necessary to establish and improve motivational system, competitive system, innovative system and efficiency-enhancing system. It's also necessary to establish and improve income distribution system of enterprises and other kinds of management system.

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(4) Trade associations should play an important role in real estate industry. After joining the WTO, the real estate trade association may act as an organization, which will provide services in information exchange, research and development, and training and education, consultancy. Therefore, the association of real estate could promote the cooperation of the developers in real estate industry.

Second, after joining the WTO, Chinese government may take following measures to guarantee the sustained development of Chinese real estate in an equitable, open and fair environment for all real estate enterprises.

(1) The government should improve China's legal system for both Chinese and foreign real estate developers to compete in a fair environment. China's legal system is far from perfect in many areas including real estate development, financing of real estate, real estate intermediary service, real estate credit, real estate insurance, real estate tax system and housing management. In order to provide legal guarantee for Chinese and foreign enterprises and households, it is argued that an increased transparency of law and policy is also needed.

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(2) The government should deepen reform and provide sustained motivation for the development of Chinese real estate. With the further opening of Chinese market; it is crucial to deepen reform of the economic system especially the urban housing system. In the meantime, it should speed up the process of monetarising housing distribution and housing income, improve social

security system.

(3) The government should create and improve real estate market system. The whole real estate market system consists of real estate development market, housing market, housing management, real estate intermediary service market, land market, real estate financial market and so on. In order to get into track with international market after joining the WTO, it should improve the whole real estate market system further as well as each sub-system. We should regulate the market behavior, improve the management of real estate market, create a good competitive environment which is equitable, open, fair both for Chinese and foreign real estate enterprises.

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(4) Normalize and optimize the intermediary service.

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After joining the WTO, China will open real estate intermediary market first to introduce foreign countries, advanced experiences. In order to normalize and improve the real estate intermediary service, China should create a qualification-authentication system of employees who are engaged in intermediary service and unify the technology standard including the commission and fees-collecting standard; create a system of liability to pay compensation and liability insurance of intermediary industry.

(5) Lessen tax burden.

The government should reform tax and fees system of real estate, lessen the burden on developers, reduce the numbers of taxes and tax rate in the process of housing purchase. It is equally important to treat domestic capital enterprises and foreign capital enterprises without discrimination in terms of the taxation.

In conclusion, in order to face opportunities and challenges after joining the WTO, it may argue that Chinese domestic real estate developers must reorganize themselves to form some large scaled real estate groups and establish a modern operating system in order to compete with its foreign counterparts and provide more efficient services. The Chinese government should make good preparation in the aspect of legal system, management system, market regulation and supervision. Government should also provide information service and unified tax burden in order to provide an equitable, more open and fair competitive environment which follows the WTO's basic rules.

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