

China's Urbanization: Consumption, Construction and Risks

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Importance of Urbanization in China

Urbanization is the most important social-economic phenomenon in China today. Xi Jin-Ping regime would focus on urbanization for the new growth momentum on one hand and cure for social instability on the other.

Urbanization rate will reach 70% until 2030 creating almost 20 million urban populations annually. It leads to the huge demand for consumption and construction with risks of restructuring.

History and Background

After the establishment of the People's Republic of China in 1949, urban migration caused by the heavy-industrialization policy initiated China's early urbanization. The Great Leap Forward and the Cultural Revolution which generated reverse migration, however, delayed the earnest onset of urbanization until the end of 1970s. Since the Reform and Opening, rural industrialization by TVEs and land reform expedited urbanization. In the 2000s, urbanization accelerated with deepening reform. Expansion of fixed assets investments led to development of urban areas and the increase in urban population.

Immediately following the start of the Reform and Opening, urbanization in China occurred among small cities and townships. From the 2000s, urbanization began to be perceived as one of the national strategies for economic development. The 11th five year plan had focused a city-cluster strategy which materialized in the 12th plan as 'Two Crosses and Three Ordinates' and the 'Self Functioning Region.' It is expected that China's urbanization rate will increase steadily albeit at a lower rate. Various calculations made in different researches reveal that China's urbanization rate would reach 60% in 2020 and 70% in 2030.

Urbanization and Economic Growth

We analyzed the relationship between urbanization and economic growth in China using regional data. Specifically, the Williamson Hypothesis which states that conglomeration into large cities could accelerate economic growth in the low income states, but actually slow it above a certain level of income, is verified. Cross section, dynamic and spatial econometrics models are adopted as methodologies. The empirical analysis results in policy implications as follows. First, the largest city in the region negatively impacts economic growth. For economic development, Chinese government would be better off creating several big cities rather than focus on one mega city. Second, urbanization itself obviously propels economic growth. In the cross-section and spatial econometric models, urbanization as a whole contributes to growth. In the dynamic model, however, only urban areas with a population of more than 750,000 do so. In sum, if we do not consider the spatial spillover effects among cities, hub and spoke urbanization would be the most favorable scenario; if we do

consider it, increasing urbanization as a whole could be applied for growth.

Urban Consumption Market

We examined the Chinese consumer market from the perspective of urbanization. The total size of the consumer market in 2011 had increased by 4.7 times since 2000. The consumption rate, however, had decreased steadily. During the same period, the urban share in the total consumption increased much, indicating that urban areas have led the growth in consumption as a whole in China. Observing changes in consumption according to income levels, we found that the upper 40% has contributed the most. We also found that as income increases, the share of basic consumption declines while service consumption grows. The share of service consumption is higher than that of Korea in 1990 when the income level was similar to China today.

Estimating urban consumption items in 2020, we found that basic consumption would be larger while new growth would mainly come from service. Based on comparison of consumer durables between China's average and Shanghai, we found that fastest growth would occur in potential markets in air-conditioner and color TV among other home appliances; and in computers, mobile phones and passenger cars. On the other hand, it is pointed out that the main obstacles in developing the urban consumption market are declines in labor's income share, deepening income gap, insufficient social security, and high housing and education costs.

Urban Construction Market

We examined the construction market related to urbanization. Urban construction invest-

ment grew steeply every year, reaching 19 trillion yuan or 41% of GDP in 2011. Shares of the individual sectors are: real estate 43%, transportation infrastructure 21%, irrigation/environment/ public infrastructure 16%, and electricity/gas/water 10.7%. Share of foreign investment takes up 4.7% in average; 9% goes to real estate.

It is expected that urbanization rate would reach at 70% in 2030, and we estimate that more than 5 trillion yuan will be invested in urban real estate every year until 2020 if the current level of investment per capita is sustained. In terms of space, urban areas occupy 4.71 million km², or about the half of total land area in China. In the 2000s, the administrative urban area basically remained unchanged, while actual urban districts increased steadily, accounting for 13.4% of the total urban area. Real estate investment per building site has also increased, reaching 1.2 trillion yuan/10 thousand km² in 2010.

Penetration rate of tap water and gas are relatively high, 96.7% and 92%, and road density is not low relative to the international standard. However, sewage disposal rate is a rather low at 82.3% and much investment is expected in this sector. Refuse disposal rate is 90.7%; another area with room for improvement. Observing region by region, an inverse correlation is revealed because the regions with higher penetration rates are investing more. This is because maintenance and upgrading require as much investments as building new ones.

Risks: Production Environment and Urban Fiscal Health

We investigated potential risks of urbanization in labor supply, land management, municipal finance and migrant workers. Until 2010, the productive population has increased rapid-

ly, with abundant labor for the workforce. Surplus labor in rural areas moved to cities and supplied labor for workforces in manufacturing and services. Although labor shortage has appeared recently in some coastal areas, it will not become a general phenomenon for China as a whole in the short term, as there is still a labor surplus in the primary industry and the urban population will keep increasing for the time being. The labor shortage reported recently is actually the result of the imbalance of labor supply and demand between regions and businesses. It is expected that enterprises' share in financing social welfare will increase and wages will also rise due to government policy, thus transferring the cost of urbanization to the enterprises. If that happens, the production environment would eventually worsen.

As for the supply of urban land for construction, the 'requisition-selling' system has been established as the pre-dominant mode. But the current system cannot be sustained for long because the amount of land available is limited, thus putting land finance in jeopardy. As of 2010, about half of the funds for urban infrastructure building were produced by selling land and the share has been increasing since. This means shortage of land would likely result in shortages in municipal budgets. The current system allow farmers whose lands are requisitioned only marginal compensation while local governments and land developers enjoy excessive profits, leading to shortsighted maximization of income via land sales. By doing so, the increase in urban land under construction outpaces the increase of urban population. Recently, several changes have occurred such as introduction of the property tax, development of collectively-held farmland, auctioning of manufacturing sites, and legalization of unregistered property/houses. Hence, compensation for requisitioned farmers would rise, land auction for business would become

wide-spread and the land cost would increase. However, the current land selling system will not be substituted easily and the local government would likely resist the central government plans to introduce property tax. In addition, self-development by farmers would become widespread, resulting in diversification of land management units.

Local governments' account balance in building urban infrastructure has generally been profitable. However, high percentage of land sales and ambiguous loans by various financing platforms reveal very significant risks. It is expected that high rates of land sales in certain areas would eventually decline to the level of Beijing or Shanghai. Naturally, the amount of ambiguous finances in big cities will decrease in the future. At the same time, the rate of land sales in underdeveloped regions could still increase.

As of 2011, more than 20 provinces have announced consolidation of the rural-urban family register system. The perfectly equal treatment, however, has yet to emerge. Most advanced cities would not dare to begin the process of consolidation, as it would mean 250 million migrant workers will become official city residents, and cost the cities about 20 trillion yuan which represents up to one-half of China's total GDP in 2010. However, the central government is not likely to retreat in the reform in migrant worker and will force the issue in efforts to suppress their total numbers.

Implications for Investors

Based on the analyses above, we deduce the policy implications as follows. Core consumption class in China's consumption market in China is the upper 40% and they should be considered as the main targets in marketing. Until 2020, the basic consumption market

would expand by 2.4 times whereas the service market will expand by 3.6 times, implying the importance of the service market. To access the 'large consumption market' in coastal regions for which competition is fierce, careful analysis on income/class composition and popular items is war-ranted. In this respect, 'potential consumption markets' in inland regions with large populations could also become a major target.

Central and local governments in China have shown interest in designing the cities utilizing advanced foreign concepts and technologies, and these represent important elements in accessing China's urban development market. The Korean government can establish and diversify inter-government cooperation channels. The Korea-China FTA could be the stepping stone for access into China's construction market. Korean-style urban models such as environment-friendly cities, smart grids, and administrative capitals could have some appeal. New investments in sewage among others are expected and would draw the attention of city planners. Different regions should be accessed differently with respect to their urban infrastructure market, as investments would likely be for maintenance in China's east coast, for new construction in mid-west regions while western regions have yet to witness the initiation of full-scale building.

Urbanization and increase of income would lead to increases in production costs. But this does not necessarily mean the manufacturing sector would eschew China. Alternative production sites such as inland, mid-western regions or specialized industrial complexes could be sought. Considering that the productive population would decrease and the pace of urbanization will experience a slowdown around 2020, responses must be in advance.

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