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Napat Jatusripitak
The Policy Process Perspective of the Residential Property Tax: Shanghai, Chongqing and Beyond

Abstract: The policy process of China's first residential property tax presents interesting center-local bargaining dynamics. In 2011, the Chinese government introduced a residential property tax in Shanghai and Chongqing in a concerted effort to curb high housing prices. The bubble inside the housing market that accounted for more than 10 percent of China's GDP in 2009 not only put the whole economy at risk but also exposed the inequitable housing situation where the upper class speculated the housing market while the middle class could not afford quality living space. Since a residential property tax can affect different entities differently though multiple channels, it creates conflicts of interest that put intense frictions on the policy process, potentially widening the gap between the desired policy outcome and the actual outcome through extensive bargaining. This paper analyzes the policy interests and bargaining strategies of the central government and the Shanghai and Chongqing governments and evaluates the policy outcome. Using Dr. David M. Lampton's work on bargaining strategies in policy implementation in an authoritarian state, this paper concludes that the residential property tax represents an unlikely case of coalition building and benefit sharing between the central government and the Shanghai and Chongqing governments achieved through bargaining. Although the resulting policy was left noticeably less stringent than originally proposed, the policy still achieved its main goal of reducing housing prices without being dangerously deflective due to bargaining.

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Comments on this draft may be addressed to the author, Napat Jatusripitak: napatjatusripitak@gmail.com.

INTRODUCTION

A residential property tax is a highly politically sensitive subject in China because it involves complex dynamics among China's increasingly pluralized entities and directly challenges fundamental determinants of the Communist Party of China's (CPC) legitimacy: social stability and economic growth. With the highly speculative nature of the Chinese housing market that accounts for more than 10.6 percent of GDP in 2009, a residential property tax can have an immediate impact on the livelihood of much of China's 1.3 billion people even if most do not necessarily pay the tax.[1] Because a residential property tax can affect different entities differently through a variety of monetary and non-monetary channels, it can also create conflicts of interest that put intense frictions on the policy process in this fragmented authoritarian state, where the society has become increasingly more heterogeneous and difficult to exert total control over. Despite opposition from public debates that long preceded the official discussion of the tax, the State Council unexpectedly approved the Shanghai and Chongqing trial-phase residential property tax on January 28, 2011.[2] This paper argues that the Chinese residential property tax represents an unlikely case of coalition building and benefit sharing between the central government and the Shanghai and Chongqing governments achieved through bargaining.

This paper is organized as follows. Section I describes the background and motivation behind the residential property tax; Section II explains the mechanics and the possible economic impact on the economy; Section III identifies policy actors and examines their interests and bargaining strategies; Section IV describes the actual policy and discusses the details of the tax; and Section V evaluates the policy outcome and provides conclusion.

SECTION I: ISSUES

The Housing Bubble

In 2010, China faced many challenging problems ranging from an imminent economic slowdown to intense international and domestic pressure on its environmental protection policy. Yet nothing concerned the Chinese policymakers as much as the health of its 3.78 trillion RMB housing market.[3] Rising inflation, sluggish economic growth, and increasingly demanding citizens recall the conditions that surrounded the Tiananmen Square protests in 1989.[4]

Since 2000, the Chinese housing market has recently exhibited several characteristics of a property bubble. Real housing prices in China have increased by roughly 225 percent over the

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[1] "China Statistical Yearbook 2010," National Bureau of Statistics of China, accessed November 28, 2011, http://141.211.142.26.proxy1.library.jhu.edu/member/yearbooknew/yearbook/Aayearbook.aspx?ybcode=F88F0ED0C6279E704E61E777B33E5ECA&key=en.

[2] Woke Li, and Ying Wang, "A tale of 2 cities for property tax reform," *China Daily*, January 28, 2011, accessed November 28, 2011, http://www.chinadaily.com.cn/cndy/2011-01/28/content_11930417.htm.

[3] Author's calculation based on data from the National Bureau of Statistics of China

[4] Kenneth Lieberthal, Governing China: From Revolution Through Reform (New York: W. W. Norton & Company, 2004), 143.

past decade.[5] In Beijing, real constant quality land values increased over 750 percent from 2003, with half of the rise occurring between 2008 and 2010 alone.[6]

The central government may also be a factor in the formation of the housing bubble. Academic studies have empirically linked this sudden price escalation during 2008 to 2010 in property prices with the 4 trillion RMB stimulus program. Wu, Gyourko and Deng showed that state-owned enterprises (SOEs) played a significant role in this price escalation because prices on average were 27 percent higher on the parcels they won at land auction compared to counterfactual scenarios with the same parcels but different investors.[7] In the first quarter of 2010, the SOEs that were controlled by the central government purchased about 50 percent of the total floor area of land compared to only about 25 percent in 2007. Deng, Morck, Wu and Yeung also argue that the housing market became an outlet for the central-controlled SOEs' executives who were evaluated by their ability to follow the commands from the top and to generate unusually high returns on investments in the housing market by drawing on state-owned bank funds amidst the global financial crisis.[8]

Urban Development and the Social Harmony Concept

The uncontrollably high housing prices in major urban cities have put intense pressure on the central government to correct the inequitable housing situation where the upper class speculated the housing market, and the middle class could no longer afford quality living space. China's rapid growth in urban population that has more than tripled since 1980, from about 200 million to approximately 665 million people, and the rise of its middle class further expedited the need for affordable, safe, and high-quality housing.[9] In fact, the central government recognized this immense pressure and highlighted in its 12th Five-Year Plan that it will complete the construction of 36 million new housing units to increase the availability of affordable housing within 5 years and start building 10 million housing units by the end of 2011.[10] Although the new social welfare targets in the 12th Five-Year Plan demonstrate an improvement in the responsiveness of the central government, they can never be achieved without other measures to eliminate the heavy fiscal constraints on the local governments who are responsible for providing most of the newly proposed urban development projects.

Residential Property Tax: A Gateway to Central-Local Public Finance Reform

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[5] Jing Wu, et al., "Evaluating Conditions in Major Chinese Housing Markets," *National Bureau of Economic Research* Working Paper No. 16189, (July 2010), accessed November 14, 2011, http://www.nber.org/papers/w16189.
[6] Wu, et al., "Evaluating Conditions in Major Chinese Housing Markets."
[7] Wu, et al., "Evaluating Conditions in Major Chinese Housing Markets."
[8] Yongheng Deng, et al., "Monetary and Fiscal Stimuli, Ownership Structure, and China's Housing Market," *National Bureau of Economic Research* Working Paper No. 16871, (March 2011), accessed November 21, 2011, http://www.nber.org/papers/w16871.
[9] "The World Factbook: China," Central Intelligence Agency, last modified November 10, 2011, accessed November 14, 2011, https://www.cia.gov/library/publications/the-world-factbook/geos/ch.html.
[10] Joseph Casey and Katherine Koleski, "Backgrounder: China's 12th Five-Year Plan," *U.S.-China Economic & Security Review Commission*, June 24, 2011, accessed November 28 2011, www.uscc.gov/researchpapers/2011/12th-FiveYearPlan_062811.pdf.

Property taxes have been part of the Chinese tax system since 1951.[11] However, there has been no residential property tax, a major source of local government revenue to fund urban development projects in Western countries such as Canada and the United States, in China until recently.[12] Malme and Youngman note that other former socialist countries, such as the Czech Republic and the Russian Federation, encountered difficulties during the process of implementing a market-value-based residential property taxation system.[13] The reason for such difficulties may lie in the fact that, historically, the land has belonged to the state rather than to private owners. Private citizens do not feel obliged to pay a tax that is levied on something they do not own. Without the sense of ownership, any residential property tax in China can only be rationalized if and only if the homeowners recognize that they are paying for future public goods that will benefit them.

Prior to January 28, 2011, the Chinese property tax system possessed a number of fundamental weaknesses, such as a narrow tax-base, a non-market-value-based tax rate, and an excessively centralized revenue-sharing arrangement.[14] Pre-existing property taxes usually exempted a substantial number of entities, such as government-related agencies and household residents. The assessments of these taxes were also mostly based on the original values of the property such as book values, historical values, and land areas. None of these criteria reflected current property values.

After the major fiscal restructuring of 1994, moreover, the new revenue-sharing arrangement recentralized tax revenue collection and left local governments with less revenue and even more expenditure responsibilities.[15] Because of these weaknesses, the Chinese local governments have been struggling financially to provide urban development projects such as the social housing project. Despite a booming housing market, Chinese local governments received land and property tax revenue that accounted for only 8.2 percent of total local government revenue in 2008, which is among the world's lowest, with only Argentina (5.0 percent) and Nicaragua (6.4 percent) below this level.[16] The extreme disparity between revenue and expenditure has driven local governments to seek other extra-budgetary revenues as a major source of revenue from activities such as land sales.

SECTION II: MECHANICS OF PROPERTY TAX

The impact of the new residential property tax on house prices, both the newly generated local property tax revenue and the projected revenue from future land sale activities, and national economic growth is extremely difficult to accurately estimate even by experts. While the impact

[11] Bo-sin Tang, et al., "Institutions, Property Taxation and Local Government Finance in China," *Sage Publication*, March 15, 2011, accessed November 28, 2011, http://usj.sagepub.com/content/48/5/847.

[12] Bo-sin Tang, et al., "Institutions, Property Taxation and Local Government Finance in China."

[13] Jane H. Malme and Joan M. Youngman, "The development of property taxation in economies in transition - case studies from Central and Eastern Europe," Washington, DC: The International Bank for Reconstruction and Development, the World Bank, September 30, 2001, accessed November 28, 2011, http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2002/03/21/000094946_02032104041341/Rendered/PDF/multi0page.pdf.

[14] Bo-sin Tang, et al., "Institutions, Property Taxation and Local Government Finance in China."

[15] Joyce Yanyun Man and Yu-Hung Hong, "Local Public Finance in China: An Overview," in *China's Local Public Finance in Transition,* ed. Joyce Yanyin Man and Hung Hong Yu (Cambridge: Lincoln Institute of Land Policy, 2011) 5.

[16] Joyce Yanyun Man and Yu-Hung Hong, "Local Public Finance in China: An Overview."

can also depend largely on public expectation and the specifics of the tax such as the tax rate and tax base, systematically mapping out the possible outcomes as a result of the residential property tax.

In a highly speculative climate, a residential property tax can effectively curb the housing market if and only if the central and local governments exceed public expectation in their strong commitment to battle the housing bubble. However, the strong commitment comes with a potentially high price because an overly strict tax rate could send the housing market, an integral part of China's economy, into a downward spiral by triggering a sharp selloff in the housing market. The lower house prices would also negatively affect local governments' land sale revenues. Homeowners, who may not have been speculating, would also suffer from a sudden and an unacceptably large capital loss. A residential tax has to be carefully formulated in order to produce positive outcomes.

In addition to the specifications of the tax, the success of the residential property tax also depends on how the taxpayers view the utilization of the tax revenue. Hong and Brubaker's projection of four possible long-run scenarios of the impacts of a residential property tax on leasehold revenue for the local governments and land values demonstrates the degree to which the impacts on the economy as well as the impacts on local government land sale revenue can vary.[17] Based on their demand and supply analysis, whether or not land values and leasehold revenue will increase in the long run depends ultimately on the taxpayers' perception of the utilization of tax revenue. If the taxpayers are willing to pay for what they want in return, land values and leasehold revenue will eventually rise.[18] This theoretical result marks an important mechanism that may convince local governments who fear the reduction of their most important source of income to fully cooperate with the central government if such tax were to be imposed in their areas. The possibility of developers passing the tax onto the buyers and reinforcing the bubble further complicates the calculation of prospective policy outcomes. Overall, there are many possible outcomes, all of which that are difficult to anticipate.

SECTION III: ACTORS

Three primary actors that played key roles in shaping the policy outcome for the two pilot cities: the central government and the local governments of Shanghai and Chongqing. Because of the many risks associated with the tax and its uncertain outcomes, the central government viewed the residential property tax as a second-best or even a third-best policy option to achieve price stability in the housing market. However, pro-property tax local governments such as Shanghai and Chongqing governments expressed a strong demand for it because they saw an opportunity for a new steady stream of income and needed to also stabilize housing prices. While the central government clearly has more resources at hand than local governments in making a national policy, there is room for bargaining because the central government's survival also depends on the success of its property cooling measures as well as the completion of its social housing projects that are carried out by the financially constrained local governments. Once the resulting impact becomes more visible and the policy victims become more homogenized, other players

[17] Yu-hung Hong and Diana Brubaker, "Integrating the Proposed Property Tax with the Public Leasehold System," in *China's Local Public Finance in Transition,* ed. Joyce Yanyin Man and Hung Hong Yu (Cambridge: Lincoln Institute of Land Policy, 2011) 171.
[18] Yu-hung Hong, and Diana Brubaker, "Integrating the Proposed Property Tax with the Public Leasehold System."

such as current homeowners and other local governments will have greater influence in the later stages of policy development.

The Central Government

The central government's primary objective in this policy debate is to curb excess price inflation in the housing market and to bring price stability back as soon as possible. Premier Wen Jiabao stressed this priority in his speech at the World Economic Forum event on September 13, 2010, stating that "to stabilize the housing price and ensure housing availability is an important responsibility of governments at all levels."[19] His concern is clearly demonstrated by the Chinese arsenal of cooling measures. Even before any speculation about the new residential property tax, the central government recognized the threat of the real estate bubble and released rounds of cooling measures to increase the cost of holding, buying and selling properties by speculators since 1986.[20] As speculation in the housing market intensified in 2007, the central government aimed to curb housing prices even more by tightening credit, setting tougher property ownership rules, creating more land supply, and increasing the cost of speculating properties.[21] Since 2007, the key measures were three hikes in the interest rate and six hikes in the required reserves ratio, several bans on land-hoarding loans, and a frequently updated required minimum rate of down payment for second homes that currently stands at 60 percent.

These measures were further reinforced by the New National Eight, the eight key measures to cool the Chinese housing market, confirmed by Premier Wen Jiabao during the State Council executive meeting on January 26, 2011. The New National Eight emphasizes even greater responsibility for local governments to ensure stable and healthy development of local property markets. The local governments now need to publicize their annual price target for new housing, ensure that at least 70 percent of land supply should be used for building small to medium sized flats, and promote the use of price ceilings in land auctions.[22]

It was evident that all of the above policies were carried out before the formulation of the residential property tax policy on January 28, 2011. After all, it was the Shanghai government that took the initiative, and pushed forward for China's first residential property tax.

There were several reasons why a residential property tax, a macroeconomic policy tool that could prove immensely useful, remained on the shelf for so long. First, the central government was unwilling to loosen its grip on power. A public statement on May 17, 2010, by the spokesperson of the State Administration of Taxation confirmed such unwillingness: "the ultimate decision must come from the central government, and the local governments have no

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[19]Jiabao Wen, "Keynote Speech," World Economic Forum Annual Meeting of the New Champions 2010, Tienjin Meijiang Convention Center, Tianjin, September 13, 2010, accessed November 28, 2011, http://news.xinhuanet.com/english2010/china/2010-09/13/c_13493041.htm.
[20]Bo-sin Tang, et al., "Institutions, Property Taxation and Local Government Finance in China."
[21] Mathew Veedon,"Timeline: Important Changes in China's Property Policy" *Reuter,* August 23, 2010, accessed November 28, 2011, http://www.reuters.com/article/2010/08/23/us-china-property-policy-idUSTRE67M16820100823.
[22] Mr. China, "How New National Eights can Cool China Property Market," last modified February 17, 2011, accessed November 28, 2011, http://mrchinablog.blogspot.com/2011/02/how-new-national-eight-can-cool-china.html.

right to interpret property tax policy."[23] Since 1994, the central government successfully maintained fiscal superiority over the local governments. Diffusing its power and gradually turning the country into a more federation-like system does not align with the Party's objective.

Second, taxing homeowners can be a significant risk to the political system. From the homeowner's point of view, the idea of paying a very high price for a house, seeing the post-property tax price of their house tumble down and having to pay an extra tax that may only go to help other people does not sound attractive. Most importantly, the government still owns the property. The homeowners are just "renting" at a very high price for a period of 70 years.

Third, a successful implementation of market-based residential property tax requires a sophisticated group of institutions that are capable of maintaining a nationwide database of standardized housing statistics, accurately appraising properties, collecting taxes and enforcing penalties, and resolving legal disputes.[24] With the current public institutions incapable of doing any of the above, the likelihood of success appears to be low. The private appraisal institutions are also not independent from the central government because they rely on the qualification system for professional property appraisers and the grading of the appraisers is done by the Ministry of Construction and the Ministry of Land and Resources. Although unlikely, the central government will need to loosen its influence on private appraisers in order to restore their credibility in appraising properties for tax purposes.

Fourth, the residential property tax, which involves registering properties into a database for appraisals, may expose property holdings of the State-owned enterprises and the Party's cadres. A residential property tax would not only expose the central government to risks of being accountable for the housing bubble but also put the fiscal situation of the SOEs who had invested in the housing market at greater risk if house prices fall sharply. There is also extensive literature on land transaction-related corruption because of lack of oversight and its off-budget nature.[25] Exposure of cadres owning properties beyond their salaries may lead to the public's perception of corruption within the Party, making the central government's ongoing effort to crack down on corruption in vain.

If all the other cooling policies prove insufficient to control the property-led inflation, the central government will need to cooperate with the pro-property tax local governments and approve a residential property tax that minimizes its four risks discussed above. Its primary strategy will be to err on the less stringent side and to favor policies that target only the minority rich in order to minimize the fiscal autonomy of local governments and to shield the central government from severely negative public opinions. It would also start implementing the tax in provinces that are more ready to install capable institutions that can facilitate the new market-value-based property tax system. Framing the residential property tax as "necessary to ensure a healthy property market, which could further boost income distribution adjustment and economic restructuring" was also another strategy pursued by China's Ministry of Finance to maintain social stability.[26] If

[23] Youbin Bao, "Tax Agency Clarifies Property Tax Issue," *Caixin Online*, May 18, 2010, accessed November 28, 2011, http://english.caixin.cn/2010-05-18/100144952.html.
[24] Bo-sin Tang, et al., "Institutions, Property Taxation and Local Government Finance in China."
[25] Hongbin Cai, et al., "China's Land Market Auctions: Evidence of Corruption," *National Bureau of Economic Research* Working Paper No. 15067 (June 2009), accessed November 28, 2011, http://www.nber.org/papers/w15067.
[26] Xinhua, "Residential property tax 'necessary' for healthy market: ministry," *China Daily*, October 1, 2010, accessed November 28, 2011, http://www.chinadaily.com.cn/bizchina/2010-10/01/content_11372577.htm.

the central government can ensure that the policy outcome will minimize the four risks, it will be better off with a more controlled property market, higher likelihood of achieving social housing targets, and more supervision of the local governments' new budgetary tax revenue.

The Pro-Property Tax Local Governments

A residential property tax could be a new revenue opportunity for some local governments because they are in need of a steadier stream of revenue to finance the increasingly overwhelming social projects assigned by the central government. In 2006, almost 80 percent of total expenditure responsibilities were for local governments while these governments account for less than 50 percent of total national revenue.[27]

However, a residential property tax can be a double-edged sword for some local governments. On one hand, a high tax rate with an overly large tax base may cause a deep plunge in local property values, induce tax evasion, and provoke local unrest, leading to an even worse fiscal situation. On the other hand, a reasonable tax rate that only targets a minority group of residents, the speculators, would alleviate those shortcomings. The optimal tax rate that can offset the diminished extra-budgetary revenue from land sales is still difficult to decipher by local governments, or even by experts. Some local governments may not even be willing to take the risk because they rely heavily on revenue from land sales. In 2008, land transfer fees were 43.5 percent of total local budgetary revenue across China.[28]

Some other local governments, however, would strongly favor the residential property tax because they may not heavily rely on land revenue or they may have little land left to lease. Having such a tax would not only give them more fiscal autonomy but also help ensure price stability within the region. In 2007, the Shanghai government's land revenue was only 5.5 percent of the total local budgetary revenue.[29] On January 21, 2011, Shanghai's mayor Han Zheng emphasized his city's goal to be a global center for finance and that he cannot let house prices "drive away talent, as people fear being 'slaves of their house'."[30] From 2003 to 2010, Shanghai housing prices have risen more than 150 percent.[31] Not surprisingly, the Shanghai government drafted a proposal and submitted it to Beijing even if its initial statement was publically rejected. While the original proposal remained undisclosed, the Shanghai government stated that the tax was to be around 0.8 percent of property values and that the tax will only be levied on homeowners whose apartments are larger than 200 square meters or if the average per capita floor space surpasses 70 square meters.[32]

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[27] Li Zhang, and Xinye Zheng, "The Determinants of Intergovernmental Transfer," in *China's Local Public Finance in Transition*, ed. Joyce Yanyin Man and Hung Hong Yu (Cambridge: Lincoln Institute of Land Policy, 2011) 193.
[28] Joyce Yanyun Man and Yu-Hung Hong, "Local Public Finance in China: An Overview."
[29] Joyce Yanyun Man and Yu-Hung Hong, "Local Public Finance in China: An Overview."
[30] James Areddy, "Shanghai Looks to Tax to Cool Housing Prices," *The Wall Street Journal*, January 22, 2011, accessed November 28, 2011, http://online.wsj.com/article/SB10001424052748704115404576095752660774230.htm.
[31] David Barboza, "Market Defies Fear of Real Estate Bubble in China," *The New York Times,* 4 March 4, 2010, accessed November 12, 2011, http://www.nytimes.com/2010/03/05/business/global/05yuan.html.
[32] Shanghai Securities News, "Shanghai Submits Property Tax Proposal," *cnstock.com*, November 23, 2010, accessed November 28, 2011, http://english.cnstock.com/realestate/respecial/201011/1004450.htm.

The Chongqing government, whose land revenue was 40.18 percent of its local budgetary revenue in 2007, proposed a different tax.[33] Chongqing's mayor Huang Qifan stated that his government aimed to impose a 1 percent tax on houses that are three times the average market price. The motivation behind the luxury property tax proposal could be its plan to stabilize and finance 13.5 million square meters of affordable houses. He estimated that the tax revenue would be approximately 200 million RMB.[34]

SECTION IV: RESULTING POLICY

The resulting policy of January 28, 2011, is in the Appendix. It is evident that the final policies are far less stringent than Shanghai's and Chongqing's proposals. The resulting policy for Shanghai taxes only second-home buyers who purchase properties after January 28, 2011. Even though Chongqing's result appears to be more stringent than that of Shanghai, the tax still targets only the most luxurious properties. The nature of the issue and the resulting policy suggest that the strategies pursued by the two local governments belong to the "a little bit of something for everyone" and the "foot-in-the-door" categories.[35] The complexity of the effects of a property tax and the tax's intrinsically unpopular image made it impossible for them to pursue other strategies such as winning support from the public or providing credible information and evidence supporting the implementation of the tax.

In the midst of uncertainty, the residential property tax may represent the unlikely case of coalition building between the central government and the local governments. In essence, the residential property tax gives a shared benefit to both players: price stability. Its large scale and complexity scare away other potential players. Benefits from this policy can be negotiated and shared more easily with just two strategic players. The local governments of Shanghai and Chongqing gained an important new source of revenue. The central government gained a new cooling measure with the rates and details tamed down to reduce its four risks. A tax that heavily focuses on luxurious properties can also encourage developers to build more affordable housing units; thus, helping the central government satisfy the demand from its emerging middle class.

While the resulting policies appear unexpectedly soft, Shanghai and Chongqing recognize that this is only the pilot-stage. Once property tax facilities such as the database center and appraisal institutions are established or the nationalization of the residential property tax is in progress, they will have the opportunity to employ the sunk-cost strategy to justify taking their local tax reform to the next step by raising the tax rate even higher or widening the tax-base. If the current tax proves insufficient to control housing prices, they will have an even stronger argument for expanding their existing tax scheme.

SECTION V: EVALUATION

Effects on the Housing Market

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[33] Joyce Yanyun Man and Yu-Hung Hong, "Local Public Finance in China: An Overview."
[34] Ju Li-Chyun, "Luxury Home Taxes Proposed For Chongqing and Shanghai," *Want China Times*, January 10, 2011, accessed November 28, 2011, http://www.wantchinatimes.com/news-subclass-cnt.aspx?id=20110110000010&cid=1102.
[35] David M. Lampton, *Policy Implementation in Post-Mao China* (Berkeley: University of California Press, 1987).

The residential property tax had an immediate effect on the housing market since the day of its implementation. On January 28, 2011, an index of Chinese property stocks lost 0.1 percent. The real estate industry index declined by 28 percent.[36] In October 2011, the cooling measures and the residential property tax proved effective in curbing house prices. Prices of newly built homes in the biggest 70 cities fell 0.13 percent on average compared to the previous month, the worst performance since the implementation of arrays of cooling measures.[37] Although the true impact of the trial residential property tax alone on house prices remains to be empirically tested, the implementation of the long awaited tax unquestionably contributed to this important decline in house prices.

Social Repercussions

While the residential property tax achieved its primary objective in contributing to the decline in housing prices in October 2011, it generated unintended consequences that could potentially undermine the nationwide development of a new property tax system.

Whether or not the residential property tax played any part in the recent decline in housing prices, homeowners would still strongly oppose it. The tax would be an easy culprit to blame for the decline in their home values because it is the boldest and the most controversial measure prior to the price decline. The widespread discontent in the increasingly stratified society in China will be a major obstacle for the Party to maintain its legitimacy. With a macroeconomic policy such as the new tax, it cannot selectively help one group of people without hurting others. Protecting the middle class then becomes a challenge when part of the group owns houses and the other does not. The protest of 400 homeowners in Shanghai on October 25, 2011, may just be the beginning.[38]

The residential property tax may also face stiff opposition by other local governments whose interest in keeping land revenue high aligns with their homeowners' interest. *Shenzhen Daily* ran a headline that represents a sentiment shared by many of its city leaders, that Shenzhen "has no need to try out a property tax."[39] The complete failure of a land auction for a prime site in Guangzhou on November 1, 2011, also signifies another obstacle for further implementation of a property tax in regions that have important land projects. Of fifteen plots of land, the Guangzhou government managed to sell only the three smallest plots, all of which attracted only one bid.[40] Guangzhou is not the only place that will face financial difficulties. Many local governments will

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[36] Zhang Dingmin, "China Approves Property Tax Trials to Curb Prices," *Bloomberg*, January 28, 2011, accessed November 28, 2011, http://www.bloomberg.com/news/2011-01-28/china-approves-property-tax-trials-in-shanghai-chongqing-to-curb-prices.html.
[37] "China Statistical Yearbook 2010."
[38] Esther Fung, "Shanghai Homeowners Smash Showroom in Protest Over Falling Prices," *The Wall Street Journal*, October 25, 2011, accessed November 28, 2011, http://blogs.wsj.com/chinarealtime/2011/10/25/shanghai-homeowners-smash-showroom-in-protest-over-falling-prices/>.
[39] The Economist, "Protecting the middle class" *The Economist*, February 3, 2011, accessed November 28, 2011, http://www.economist.com/node/18070364.
[40] Enid Tsui, "Guangzhou: prime land auction flops," *Financial Times*, November 2, 2011, accessed November 28, 2011, http://blogs.ft.com/beyond-brics/2011/11/02/guangzhou-prime-land-auction-flops/#axzz1f1n01qDw.

not be able to pay back their debts, let alone build even more affordable houses. Hangzhou, for example, is counting on land sale revenue to finance 82 percent of its debt.[41]

CONCLUSION

The trial-phase of the Chinese residential property tax achieved its short-run objective in contributing to a decline in housing prices but also produced unintended consequences that may stall the much-needed central-local fiscal reform. The complexity, uncertainty of outcomes, and the scale of the policy limited the number of potential major players in the debate to just the central government and the governments of Shanghai and Chongqing. After the bargaining process, the resulting policy was left noticeably less stringent. If the decline in housing prices proves only transitory, or conversely, the other local governments cannot fund their projects, the policy process in China will be harshly criticized as dangerously deflective, failing to achieve the national primary objective. However, the trial-phase residential property tax still marks an important next step in the political development of China. With overwhelming demands stemming from different entities, the central government now realizes that it needs to expand its institutional capacity to meet them. Without local public finance reform, its promises to its citizens can hardly be kept. Because of the multi-dimensional disparities across China, further development of this policy in other regions of China and the final property tax policy in Shanghai and Chongqing will offer valuable insights into China's policy process.

[41] Richard Borsuk, "Chinese cities fret as land sales fall," *Reuters*, November 2, 2011, accessed November 28, 2011, http://in.reuters.com/article/2011/11/02/idINIndia-60266420111102.

APPENDIX

	Shanghai **Result**	Shanghai **Proposed**	Chongqing **Result**	Chongqing **Proposed**
Assessment	0.6% for second-home buyers and 0.4% if property price less than 2 times the market average	0.8% of market value	0.5% and 1% for second-home buyers if property price between 2-3 and 3-4 times the market average respectively. Maximum rate is 1.2%	1% of market value
Details	Only levied on new purchases after January 28th 2011. Exempted only up to 60 sq meters per family member	Levied on homeowners with property larger than 200 sq meters of if property area exceeds 60 sq meters per family member	Levied on both existing and new purchases	Homeowners with property price greater than 3 times the market average