

**Residential Renewal in Old Chinese Cities Since 1979**  
**under the transition from central-planned to market-driven economy**

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(ABSTRACT)

This research paper examines the uprising residential redevelopment in old cities of China. China's redevelopment after 1978 has taken place under a shifting economic setting – from planned to market. With both forces influencing, conflicting initiatives have been striving to dominate the redevelopment process. This paper is to identify these underlying impetuses of residential redevelopment, to examine the trend and to propose strategies to alleviate the financial burden to the government and enhance benefits for the whole society.

This study involves mainly a comprehensive review of secondary source materials. In addition, the author's personal experiences in China are integrated. Based on these materials, policy implications for residential redevelopment in China's old cities are then extracted. Though the focus of this research is on old cities, some of the policies may serve the general purpose of urban residential redevelopment in China.

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## SUMMARY

Old Chinese cities are those formed over a long history. Economic reform since 1979, aimed at transforming from the central planned to a market oriented economy, has shifted the focus of urban development from new construction to renewal. Current redevelopment in old districts in China mainly includes two aspects, the decentralization of central city industries to suburban estates and renovation in old residential areas. These two processes are primarily isolated.

Maintaining the communist ideology, the shift to a market oriented economy has led to a two-track economic system, with market and central planning coexisting. Similarly, during the housing reform aimed at privatize public housing stocks, a two-tier housing market based on differences in residents' incomes, with a real market oriented for the rich few and a quasi market for the majority, has emerged. A two-track land allocation system has also been formed during the urban land reform aimed at restoring land value.

The two-track market is a compromise between market forces and the socialist ideology. The discrepancy between ideology and practical policies results in conflicting goals of the government and leads to practical difficulties in housing renewal projects. As the trend of advancing towards a market economy is irreversible, the socialist ideology may be ultimately abandoned.

The traditional welfare housing system adopted before the reform restrained housing construction and maintenance. This combined with large-scale, rural-urban migration aggravated urban housing situations and the pressure for urban renewal mounted.

The urban residential renewal in old Chinese cities has taken place under the transition from planned economy to market-driven and from welfare housing supply to commercial supply. Although real estate development companies, as business entities, have become a more and more important force, residential renewal so far has been primarily initiated by the government. Though the government's initiatives vary from city to city and from time to time, they primarily focus on: improving the living condition of residents; restoring the market value of land; controlling the scale of cities; and protecting historical, cultural traditions of old cities. The first two motives are generic to residential renewal in all Chinese cities, with the first expressing the socialist ideology and the second signifying market influences. The emphasis of the government has shifted from the first to the second during the redevelopment process.

Distinct motives of the government have led to varied styles of redevelopment. There are currently three basic types of redevelopment in Chinese old cities. The first is to demolish old housing and rebuild housing on the original sites, which characterizes most early renewal efforts in old cities. Next comes the idea of rehabilitating the old housing rather than completely demolishing it, which has gained some significance during the 1990s but whose application is restricted. The first two procedures of redevelopment are usually subsidized by the government, directly or indirectly. The third and latest is to demolish the old housing but construct new commercial buildings (retails, offices, hotels, etc.) instead of residential, which requires complete

relocation of the residents. Under the shift toward a market, this procedure has been gaining more and more importance due to its high profitability.

Some redevelopment calls for relocating previous residents. This often brings inconveniences to these people, such as impeding their access to jobs and amenities, segregating residents with different incomes, and breaking down social ties among the residents.

Policies for residential redevelopment in Chinese old cities should focus on two aspects – enhancing the financial feasibility of redevelopment projects and maximizing social benefits while minimizing the social costs of these projects. The policies suggested in this study are:

#### Financial Feasibility

- Upgrade rather than demolish;
- Develop for the highest and best use;
- Reduce regulatory risks;
- Invigorate competition;
- Moderate density and height control;
- Increase the incomes of residents.

#### Decrease Social Costs and Enhance Social Benefits

- Efficient mass transit system;
- Improve amenities;
- Coordinate the decentralization of industries and the relocation of residents;
- Promote maintenance;
- Monetize compensation;
- Encourage the market for the right of on-site replacement.

A two-tier housing market has been formed during the reform. Through reducing the administrative sector and expanding the market sector, China endeavors to convert the welfare housing system to a market-oriented one. The transformation to a real market will be gradual. The ultimate merging of the two tiers can only be attained when the real income of the majority of people increases and housing shortages are alleviated. At present, the government's involvement is still a necessity to facilitate these projects and to protect residents' interests.

## CHAPTER 1: INTRODUCTION

Old Chinese cities are those formed over a long history. Old districts in these cities were developed mainly before 1949. Before 1979, urban development policy in China was primarily focused on constructing new cities and expanding urban districts. Though the principle for old cities was “full utilization and gradual transformation,” only the full utilization was emphasized and renovations in the old cities were insignificant (Zhou 1988, 3). Due to the lack of proper maintenance and upgrading, many old urban districts became dilapidated. Since 1979, the emphasis has been shifted from developing new urban areas to renovating old districts. Various motives contributed to this change but the fundamental reason lies in the shift of the economic system from central planned to market driven. Economic reform not only enables the government financially to address the deteriorating housing problem, but also restores urban land values, which were dismissed during 1950s-1970s but are now drawing private developers to the renewal process.

Though the goal of economic reform in China is to shift to a market oriented economy, while maintaining the communist ideology, the reform is in no way integral. A two-track economic system, with market and central plan coexisting, has been adopted for this transitional phase. Similarly, the reform in housing has led to a two-tier housing market: the commodity housing market oriented to residents with higher income and the quasi market – with limited rights, little competition, heavy subsidies and strict regulations – to the majority of urbanites. This paper primarily focuses on the latter.

Current urban renewal in China has many aspects, from transforming dilapidated housing to relocating polluted and ineffective industries, from improving urban infrastructures to developing tertiary industries in the city center, and from extending urban green plots to protecting and renovating historical, cultural relics. This paper mainly addresses redevelopment in old residential areas. Some of these areas remain residential after upgrading or reconstruction, while others are converted to commercial or other uses.

This paper first reviews China's welfare housing system, then studies the general economic reform and specific reforms on housing and urban land, investigates major initiatives of the government, estimates implemented renewal projects and concludes by extracting policy implications of residential renewal in old Chinese cities.

## CHAPTER 2: FROM CENTRAL PLANNED TO MARKET ECONOMY

National statistics showed that from 1950 to 1977, the total urban housing floor-space constructed by state-owned units was 493.1 million m<sup>2</sup>, while this figure for 1978-85 was 624.1 million m<sup>2</sup>, more than the total of the previous 28 years (Kirkby 1988, 233). The major reason for the change lied in profound political and economical adjustments that began in the late 1970s, with the focus of the state government shifted from class struggle to rehabilitating economics, and economic policy shifted from central planning to market adjusting. In the transition to a market economy, central planning and market coexist, which is reflected by a two-tier housing market and a two-track land allocation system.

### FROM CENTRAL PLANNED TO MIXED, TWO-TRACK ECONOMY

Before reform, China operated a planned or command economic system with a whole set of strategies borrowed from the former Soviet Union. Under the system, public ownership dominated. Equity, instead of efficiency, was emphasized as an evidence of the “superiority of socialism”. Housing policies before reform were built on such grounds. Central planning, however, resulted in sluggish economic development.

Though the demand for reorienting Chinese development strategy was the rudimentary driving force behind the reform, the political shift in the late 1970s hastened the transformation (Naughton 1995, 59). In 1976 following Mao’s death, the Culture Revolution ended. The Cultural Revolution had resulted in such an immediate acute crisis in politics that modest changes were insufficient to restore political normalcy (Harding 1987, 39). By late 1978, Deng Xiaoping and his supporters won over their conservative rivals and reforms in economic sectors thus began.

The Third Plenum of the Eleventh Communist Party Central Committee held in December 1978 marked the decisive breaking from the past and the start of the reform era. Two specific steps were taken during 1978 – expanding enterprise autonomy and increasing use of economic levers. On July 13, five official documents were issued, which formerly stated that selected enterprises could retain a share of profits, enjoy accelerated depreciation and, more importantly, have the right to sell above-plan output (SRC 1984, 182-188).

This strategy marked the start of urban reform. One result of decentralizing power to enterprises and shifting investment to consumer goods was a drastic increase in housing investment by state-owned enterprises. The proportion of state enterprise investment in total housing investment increased from 62.7% of the total housing investment in 1980 to 71.0% in 1982, while at the same time the share of government direct investment decreased from 32.4% to 19.3% (table 1)<sup>1</sup>. Nevertheless, it indicated more active involvement of the private sector in housing construction. At the same time, reform took place in rural areas. Incentives for peasants’

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<sup>1</sup> During this period, the share of private housing investment also nearly doubled, from 4.9% in 1980 to 9.7 in 1982 (table 1). But because of the small basis of private housing investment in 1980, the real increase was not as substantial.

production were increased considerably and small-scale township and rural industries emerged in abundance. With the enhancement of productivity, rural surplus labor increased, which contributed to the large-scale rural-urban migration starting in the late 1970s.

**Table 1. Government and Private Housing Investment in 1980 and 1982**

Period	Government direct housing investment (%)	Government housing investment through Enterprises (%)	Private housing investment (%)	Total (%)
1980	32.4	62.7	4.9	100
1982	19.3	71.0	9.7	100

Source: McQuillan, D.A., pp. 2, 1985.

At this early stage of the reform, the idea of combining plan and market, first proposed by Chen Yun in March 1979, was well accepted by the leaders. Central planning was still considered the essence of the socialist economy and the market was intended to be limited to governing unimportant sectors of the economy as a subordinate means for planning (Naughton 1988, 109-111). Nevertheless, the procession towards a market became apparent. The October 1984 plenum of the Communist Party Central Committee showed a public consensus among top leaders that moving rapidly to a market was a necessity and expanding market forces became the major task of reform (Naughton 1995, 200, 201). Yet due to practical difficulties such as severe regional and sectoral discrepancy<sup>2</sup>, absence of an effective social security system and the lack of management experience under a market economy, abrupt changes were unattainable at that time and the co-existence of a planned economy became inevitable. The dual-track system, market hand in hand with plan, was thus fully in place and given legitimacy for the first time. The planned sector, with compulsory deliveries at state fixed prices, was to persist but its scope was clearly delineated. The market sector, with freely determined prices, was to cover the rest of the economy and was to grow steadily as the economy grew<sup>3</sup>. This dual track system was also echoed in the subsequent housing and land reform.

An official document of the Communist Party at the end of 1990 called for the elimination of the dual track system, but suggested that the way to do so was by a gradual shift (CCP 1991). In October 1992, the 14th Party Congress ratified the new reform agenda, which proclaimed that China would adopt a “socialist market economy” (Lam 1993). Rapid reform steps led to macroeconomic imbalance and inflationary pressures<sup>4</sup> and temporary

<sup>2</sup> Naughton (1995, 184-185) stated that the large variation of profits across different sectors of production and various geographic regions was the most important obstacle of price reform. Due to backward productivity, many producers, especially those of raw materials and mining, would be facing negative returns if price reform applied and profits of industries in old industries in inner land were much higher than those in the newly developed coastal cities.

<sup>3</sup> The two track strategy also has its drawbacks (Naughton 1995 228): foregoing tax and price reform for there is no level ground for developers to compete; corruption; and local government intervention and protection for enterprises and developers.

<sup>4</sup> The inflation rate in 1993 surged up to 22% on an annual basis.

macroeconomic austerity was resumed in 1993, marked by Zhu Rongji 's 16-point program. But the leadership had committed itself firmly and unambiguously to the goal of a market economy and the trend towards a market is irreversible (Naughton 1995, 305-307).

In the process of converting the planned system to a market-driven system, discrepancy between ideology and practical policy results in conflicting goals of the government and increases policy costs, which leads to some practical difficulties in housing renewal projects that will be discussed in more detail. Housing reform and land reform, as two indispensable components of the economic reform package, have profound influences on residential redevelopment in old cities during this transition period.

## **TRADITIONAL PUBLIC HOUSING SYSTEM AND HOUSING REFORM**

The traditional welfare housing system adopted since the 1950s as well as mass rural-urban migration had aggravated urban housing situations and the pressure for urban renewal had mounted. During the housing reform, a two-tier housing market grounded on citizens' incomes has emerged.

### **Historical Review Since 1949**

Before the reform, China adopted a public welfare housing system. Under this system, the state controlled all housing construction. Nevertheless, the old system failed to provide decent housing for all citizens and the demand for reform surged.

#### ***Public, Welfare Housing System***

Soon after socialism triumphed in China in 1949, concurrent with a low wage economy, a collective welfare system was provided to urban employees as a social wage, which covered healthcare, education, preschool care and most costly of all, urban dwelling. Since the early 1950s, the government had controlled all urban housing construction, either directly through housing bureaus of municipalities or indirectly through state-owned enterprises. In addition to investments in construction, urban housing allocation, management, maintenance and repair also became government's responsibilities. By the mid-1950s, a welfare housing system emphasizing equality had been established. Under the welfare housing system, rental fees were symbolic, usually around 2- 3% of the total consumption of urban household (Lee 1990, 36). Nevertheless, the housing stock was equally distributed<sup>5</sup> and household income was not directly related to the size or quality of allocated housing.

In the mid-1950s, private housing ownership was still allowed in urban areas, though considered a residual from the old society that would be ultimately taken over by the state (Kirkby 1988, 228). From 1958-1965, however, China began to nationalize the urban housing stock and encouraged state-owned work units (enterprises) to increase their housing construction in urban areas (Lee 1990, 69-70). Private housing ownership was totally disregarded in urban areas during the Cultural Revolution (1966-1976). Directed by an ideology emphasizing class struggle and absolute equality, the state mandated many urban housing owners to share their housing with other people or, in extreme situations, evicted them without compensation (Lee

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<sup>5</sup> The differences of housing among households were mainly determined by occupational rank, length of work, family size, age, current amount of living space and so on.

1990, 70). At the start of the housing reform, the proportion of privately owned housing in urban areas was marginal. In 27 old neighborhoods in Beijing, for example, official data indicated that private housing constituted 12.9% of total units in 1983 (Lu and Wang 1996, 161)<sup>6</sup>.

Though the proportion of private housing was low in China, the public housing occupants actually had extensive rights that are only available to owners in the U.S., including life-time occupancy rights, right to inherit, and near-impossibility of eviction<sup>7</sup>. These tenants' rights were often vague and state authority to act was unclear.

### ***Deterioration of Urban Living Conditions before the Housing Reform***

Three reasons contributed to the deterioration of housing by the eve of the housing reform: limited investments in new construction, lack of maintenance on existing stocks, and the climbing rural-urban migration since the late 1970s. The welfare housing system was responsible for the first two factors. Long term degradation of housing resulted in severe housing shortages in urban areas, and the surged demand of residents for improvements was an important reason for the housing reform.

#### *Limited Investments in New Housing Construction*

After the foundation of the People's Republic of China in 1949, the state borrowed its development model from Russia, which emphasized heavy industry and regarded housing as a nonproductive sector of economy. Under this model, the highest priority was assigned to the development of heavy industry, and investment in housing was kept low.

On the eve of the first Five-Year-Plan (FYP) during 1953-57, average per capita floor-space available in urban areas was 5.4 m<sup>2</sup> with a total population of almost 72 million. Seven years later, however, because of the Great Leap Forward and negligence for housing after 1957 (average 4.1% of all capital construction investments in the second FYP), the 130-odd million urban-dwellers had only 3.5 m<sup>2</sup> of housing each (Kirkby 1985, 77; *Ren Min Ri Bao*, 8 May 1981). The percentage of housing investment in total construction funds continued declining in the following years and reached its nadir during the Culture Revolution period (average 4.0% of total capital construction funds during 1966-70). Production was severely distressed and the total area built during 1966-70 was only 10.8 million m<sup>2</sup> (table 2). Partly due to the mass expulsion of city youth to the countryside, China's urban growth was slow from 1964 to the end of 1976, with the growth rate estimated to be 12%. Because of large-scale decentralization of city youth during 1964-1976 along with increased investment in housing during the fourth FYP (1970-75), the

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<sup>6</sup> This number may be higher than the average proportion of private housing on the municipal scale, because most of the traditional housing, privately owned before 1949, was concentrated in old neighborhoods.

<sup>7</sup> According to my own experience, three reasons may account for the extensive rights of tenants. First, employees usually took housing as a reward for their service and a compensation for low wages, therefore they felt that they should have certain command over the property. Second, almost all enterprises were state-owned and housing managers did not have personal interest involved other than benefiting from such a tradition as tenants themselves, therefore they had no strong incentive to restrict the extensive tenants' rights. More importantly, the relationship between the work unit, a major provider of housing, and its employees was not fully based on economic rules. The socialism ideology identified the employees as the owners of enterprises and housing provision to workers, often extending to their descendants, was regarded as an obligation of the enterprise.

overall average of urban per capita housing at the end of 1978 bounced back to 5.3 m<sup>2</sup> (Kirkby 1985, 176).

**Table 2. Non productive Investment, Housing Investment and Floor-space Produced, 1950-1985**

Period	Percentage of total capital construction investment		Average annual Urban housing Floor-space (million m <sup>2</sup> )
	Non-productive <sup>a</sup> (%)	Housing (%)	
1950-52 (Rehabilitation)	34.0	10.6	4.5
1 <sup>st</sup> FYP 1953-57	33.0	9.1	18.9
2 <sup>nd</sup> FYP 1958-62	14.6	4.1	22.0
Readjustment 1963-65	20.6	6.9	14.2
3 <sup>rd</sup> FYP 1966-70	16.2	4.0	10.8
4 <sup>th</sup> FYP 1971-75	17.5	5.7	25.2
5 <sup>th</sup> FYP 1976-80	26.1	11.8	47.0
6 <sup>th</sup> FYP 1981-85	42.4	22.0	88.3

<sup>a</sup> Non-productive investment is that part of the state's "basic capital construction" funds devoted mainly to urban utilities, cultural, educational and social services installations, public buildings, commercial enterprises and transport and communications constructions and housing.

**Source:** Statistic Yearbook of China, 1984, pp.323, 339, 357; Statistic Yearbook of China, State Statistic Bureau, Beijing, 1985, pp. 304, 331; for 1984's urban housing completion, *Beijing Review*, no. 12, 25 March 1985, p. VIII; for 1985's urban housing completions, estimated from figures in China Daily News, 26 November 1985, based on Kirkby, 1988, pp. 233, table 9.1.

### *Lack of Maintenance*

Official figures showed that from 1949 to 1980, gross urban housing floor-space grew by 469 million m<sup>2</sup>. Yet 675.4 million m<sup>2</sup> of housing was built during this period. With very little deliberate demolition to make way for new projects, it is estimated that within the 206.4 million m<sup>2</sup> of lost housing floor-space, nearly 150 million m<sup>2</sup> was gone simply because of neglect of simple repairs (Kirkby 1988, 230).

An important reason for government's neglecting housing repairs was the lack of housing funds. The welfare housing system, with average rent less than five cents per square meter (McQuillan 1985, 2), was inadequate to cover repair cost, let alone costs for management, maintenance and the expansion of housing stock. According to information from a national housing conference in 1977, in all the designated municipalities (*she-shi* in Chinese) as a whole the average annual bill, repair alone, of public housing stood at 2.1 *yuan* per m<sup>2</sup>, whereas the rental income was merely 1.09 *yuan* per m<sup>2</sup> (Kirkby 1988, 230). In Wuhan for example, 830,000 m<sup>2</sup> (about 13%) of the municipal housing stock required "large or medium-scale" repairs on average in the 1970s. However, the funds available for repairs could only be stretched to merely over one-third of this area (He 1980, 14).

Aggravating the situation, few incentives existed for dwellers to maintain and upgrade the public housing that they occupied. Under the old welfare system, residents improved their living conditions usually by moving to a larger and better dwelling rather than bettering the existing one. Often a household started with a one-bedroom apartment and ended up with a two- or three-bedroom apartment when the employee retired, where the upgrading process also ended. Therefore dwellers generally would not spend much to maintain and improve the transitory housing they occupied but the final one they could obtain. Additionally, since no penalty was charged for poor uses of housing and no bonus for proper uses, spontaneous housing maintenance totally relied on the morality of occupants.

#### *Rural-Urban Migration*

Another contributor to the deteriorated living conditions in urban areas was mass rural-urban (R-U) migration. At the end of 1977 China's total urban population stood at 116 million and by the end of 1982 it was up to 153 million, with a net increase of 24.4% in 5 years. Had there been no R-U migration, the large-scale housing construction since 1979 would have enhanced the average per capita space standards considerably – from the 5.2 m<sup>2</sup> of 1977 to 7.8 m<sup>2</sup> at the end of 1982. Instead, the improvement was limited to just 1.1 m<sup>2</sup> per person on average, with the figure in 1982 being 6.3m<sup>2</sup> (Kirkby 1988, 232). The rapid swelling of urban population outpaced housing construction, which resulted in crowding and more intensive use of the existing urban housing stock.

This surge of R-U migration in recent years is primarily due to the relaxation of the household registration (or "*hukou*" in Chinese) system adopted since 1958, which entitled urban dwellers to subsidized grain ration, employment, housing and other amenities denied to rural people. The economic reform starting in the late 1970s loosened the rigid control over R-U migration in several ways (Wong 1994, Xie and Yu 1992). First, with grain price liberated and the subsidized grain ration system dismissed, grain became available to people without urban *hukou*. Second, housing leasing was permitted and thus rural migrants could find dwelling in urban areas. Third, the reform in urban areas substantially enhanced economic growth, especially in coastal cities and "economic zones," which increased employment in these areas. The last but not the least, economic reform in rural areas enhanced productivity and resulted in a large number of rural surplus labors. Peasants were naturally attracted to the gravitational pull of jobs in urban areas, and in response to this trend, the state council in 1983 allowed rural households, without changing their residence, to take up cooperative ventures in market towns.

#### *Severe Housing Shortages*

Because of neglected housing construction and maintenance since 1949 along with the immense R-U migration since the late 1970s, the grown baby-boomer generation in Chinese cities is facing severe housing shortages in spite of the large-scale construction in recent years.

A survey in Beijing in 1987 of the youth between 25 to 35 gave a glimpse of the severity of the problem. The largest proportion (32.2%) of the respondents had to cramp into housing assigned to their parents, 10.7% lived in self-built housing without adequate basic facilities and only 27.3% lived in housing assigned by either the husband's or wife's work unit. The proportion living in private housing accounted for not more than 12.6% and another 8.0%

without their own housing at all had to live with friends or in other temporary shelters such as hotels or offices (table 3).

**Table 3. Sources of Accommodation between Age 25-35**

Accommodation	Person	Percent (%)
Public housing assigned to parents	105	32.2
Public housing assigned by wife's work unit	59	18.1
Public housing assigned by husband's work unit	30	9.2
Self-built housing	35	10.7
Private housing	41	12.6
Housing administration bureau	15	4.6
Without own housing	26	8.0
Other	15	4.6
Total	326	100.0

Source: Sha, Yin. "A Survey on Marriage and the Family in Beijing." in *Women of China, New Trends in Chinese Marriage and the Family*, Beijing: China International Book Trading Co. (Guoji Shudian). 1987. 116 (Quoted from Lee 1990, 30, table 2-8).

In Shanghai, 800,000 (16%) people of a total urban population of around five millions were judged to be in "severe housing difficulty" (Wang 1985, 22)<sup>8</sup>. In smaller cities, the situation was not much better. A survey in 1978 of 192 smaller, non-municipal urban settlements and designated municipalities found that the average living space was only 3.6 m<sup>2</sup> per person, in contrast to the 4.5 m<sup>2</sup> of 1952. Further, this survey discovered that around one-third had severe housing problems (Zhang 1985, 32)<sup>9</sup>.

As housing shortages were aggravated under the welfare housing system, self-built, informal housing had become a spontaneous resort for urban dwellers to improve their living conditions. In Beijing's old neighborhoods for example, by the end of 1985 about 28% of the total 17.12 million m<sup>2</sup> of one-story housing was units built after the 1950s, mostly self-built units crammed into the traditional courtyard housing (Lu and Wang 1996, 159,160). Self-built housing was often of low quality and lacked basic facilities such as heating and running water. Such housing was often used as storage space or as an extension of the kitchen. However, a survey on young people in 1987 in Beijing discovered that 35 out of the 326 people sampled reported to be living in self-built housing (table 3), flagging a severe housing shortage.

<sup>8</sup> "Severe housing difficulty" is referred to the occurrence of one or more of the following situations: per capita housing under 2 square meters; grown-up children of different sexes sharing the same sleeping space; two couples of different generations sharing the same room; young people of marriage age (at that time 27 for men and 25 for women) still on the housing waiting list (Wang 1985, 22).

<sup>9</sup> For instance, 1.83 million families were housed in warehouses, corridors, factory workshops, classrooms and offices, 1.89 million families had three generations sleeping in the same room and several million young people were unable to marry because they had no place to live (Zhang 1985, 32).

## **Housing Reform**

After more than twenty years of welfare housing, deteriorated living conditions in Chinese cities aroused residents' demand for improvements<sup>10</sup>. Nevertheless, the low rent, welfare system had exhausted the government's funds. Thus, the widened discrepancy between housing demand and supply propelled the government to address the housing problem.

Additionally, as the enterprise reform deepened, the traditional bond between enterprises and housing for workers had become a bottleneck to the overall reform. For enterprises to enhance productivity to compete in a market economy, it was necessary to liberate them from the burden of providing housing to all employees. As the unemployment rate increased as work units restructure themselves to conform to new situations, traditional connection between work units and housing would fetter these surplus workers from shifting to new occupations or locations (World Bank 1992, xi-xiii).

Two important talks of Deng Xiaoping in 1978 and 1980 initiated the housing reform as a part of the entire reform. His major points included: urban residents may construct their own housing; urban residents may buy their own housing and the state may sell existing and newly built housing to individual households; and individuals may be encouraged to buy housing by raising rent (Gu 1994, 74). The First National Academic Conference on Urban Housing in 1984 clarified the necessity of reform and converted the focus from theoretical debates to concrete measures for the implementation (Zhou 1985). Two major strategies of housing reform were increasing rent and selling the existing public stock, with both aimed at promoting private ownership.

### ***Raising Rent***

As early as April 1982, the Chinese State Council officially approved a pilot program to reform the housing systems at four medium-sized inland cities: Changzhou, Shashi, Siping and Zhengzhou, followed later by Yantai, Tangshan, Shenyang, Shanghai, Beijing and many other cities. Three forms of housing rent increments were attempted in these pilot cities. The first approach was to increase rent in one or more steps to the "real cost," calculated from depreciation, maintenance, investment interest, management expenses and property taxes. This was the most prevalent strategy for the rent reform. The second required that households deposit a certain amount of money as a condition of renting, and the principle was to be refunded when the housing unit was returned. The third strategy was to charge high rent for the part of living space that was above the officially acknowledged level for a family (Gu 1994, 81). In March 1988 the central government issued a nationwide housing reform plan to adjust rent to a rational level, with a national average of 1.56 *yuan* per square meter calculated. Despite the government's policy, large-scale implementation of rent reform did not start until 1990, with major cities raising rent first. By 1994, almost all of the cities had raised rent but most of the rent increment had not reached the planned level (Gu 1994, 84).

None of these rent enhancement approaches was based on the market value of housing. The rent increase was usually restrained because of the limited affordability of residents and

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<sup>10</sup> Nevertheless, under the welfare system housing was provided at negligible price, the demand of citizens' was basically disconnected with affordability, which sometimes led to unrealistically high demands.

accordingly, incentives for residents to purchase housing were not substantially enhanced. Nevertheless, the pseudo market rent managed to shift part of the burden off the state and, more importantly, it signified the first step away from the old welfare procedure and towards a new housing market.

### ***Privatizing the Public Stock***

The first attempt of selling new housing was initiated as early as 1979 in Xi'an and Nanning, with the price based upon full costs<sup>11</sup>. The first trial failed due to the destitution of citizens. From 1979 to 1982, only 3% of housing units were sold to individual households while the other 97% were sold to the state and collective enterprises. Subsequently, the state resumed to subsidize a proportion of the cost-based price and during 1982-1986 private transactions increased substantially in experimental cities<sup>12</sup>. The rights of owners to transact and sell these subsidized units were usually restricted. The first sale of "commodity housing" was initiated by the Shanghai Municipal Housing Bureau in 1984. The rights of owners of "commodity housing" were much extended, with free transaction and sale allowed in most cases (Liu 1994, 46-47). By January 1987, the construction of commodity housing was officially put into the state plan (Liu 1990, 30). At this stage, the housing price was largely based on full costs due to the immaturity of the market. But as the market for commodity housing grows, demand has become an important consideration for setting prices.

The most serious problem of the trial sales of public housing was the discrepancy between steep housing prices and low average wages. In February 1989, 350 apartments were on sale in Beijing, with the market price reaching 1,700-1,900 *yuan* per m<sup>2</sup>. Out of Beijing's 400,000 registered "households with housing difficulty," only 300 applied to buy the commodity housing. Similarly in Shanghai in 1988, three real estate fairs were held with 12,000 apartments available for sale, but the high price – raised from 300 *yuan* per m<sup>2</sup> in 1982 to 1,000 *yuan* per m<sup>2</sup> in 1988 – prohibited most individual buyers. Only 5.9% of the housing units were sold, of which two thirds were purchased by work units rather than individual households.

Though low rent and the traditional concept of welfare housing played parts in hindering people from buying housing, the major reason of limited purchases was that the price of housing far exceeded the affordability of the majority of households (Liu 1990, 33). In Beijing, a worker earned an average of 650 *yuan* (US\$80) a month while the price of commodity housing, catering to the high-income stratum, was 6,000 - 8,000 *yuan* (US\$722 - 963) per m<sup>2</sup>. This situation was aggravated by stringent mortgage policies that required 30% down payment and allowed a loan term of 10 to 15 years rather than the typical 25 to 30 years in developed countries (World Bank 1992, xiv)<sup>13</sup>.

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<sup>11</sup> Full costs include construction costs, land costs, costs for demolishing old housing and compensations for former residents.

<sup>12</sup> By 1984, 2,410 new units were sold at subsidized prices in Changzhou, Shanghai, Siping and Zhengzhou, with the buyer paying one-third of the construction cost, and the state and work units sponsoring the rest. The amount paid to the state went to funding new housing constructions (Badcock 1986).

<sup>13</sup> In fact at the end of 1996, more than 50 million square meters (537 million square feet) of commodity residential housing lay vacant, while an increasing number of households desiring improvements in their housing could not afford them (Reuters World Service May 18, 1997).

Based on incomes, households have been segregated into two tiers. On one stratum, the very rich few are able to purchase commodity housing from a real market, enjoying higher standards of construction and the free choice of location. On the other stratum, the majority of citizens, with limited incomes, still rely on subsidized public and semi-public housing in a pseudo market.

The privatization of housing ownership should proceed with caution. The current strategy to enhance private ownership by increasing rent is not sustainable, for rent increment is limited by real income. Additionally, selling existing stock at a very low price will result in loss of state assets. Finally, a favorable effect of privatization, habitants' enhanced incentives for housing upgrading, may be restricted due to the previous *de facto* rights of occupants.

### ***Housing Reform in General***

Through raising rent and privatizing public housing stocks, the housing reform is a process of adjusting housing value to the market value so as to keep up with the shift to a market economy. It is a bold leap towards the market economy and is critical for the success of the overall reform.

Similar to that for products of state-owned enterprises, a two-tier housing market has formed. Nevertheless, because housing has a longer life span than most other commodities and has social as well as economic characteristics, the transformation to a real market will be gradual. The two-tier housing market, with a real market oriented for the rich few and a quasi market for the majority, will continue to exist for a considerable period of time. Despite market forces, the state should remain to subsidize the majority of housing until the real income of the majority of people increases and, to forestall unreasonable profits, until housing shortages are alleviated. Even when the two tiers merge ultimately into a real market, public housing will still be necessary for the extremely poor. To solve the conflict between the government's housing fund shortage and citizens' increasing demand, a tentative solution may be to lower the basic standards of housing in order to conform to the affordability of residents.

## **URBAN LAND REFORM**

Urban land reform is an important component of the overall economic reform and is closely related to housing reform. Though it started late compared with other reforms, land reform has been implemented with full vigor and is becoming a dominant force transforming China's cities. Though urban land is still owned by the state, the use right of land became tradable. Similar to that in housing reform, a two-track land allocation system has been formed in land reform at the transitory stage. The emergence of real estate development companies, either out of government branches or from foreign counties, has unbounded the state to provide all dwellings and have pushed housing supply to merge into the market.

### **From Planned to Two-track Land Disposition System**

The most significant change in the land system since economic reform has been that state ownership was recognized by law. The constitution passed in December 1982 stipulated that: "Urban land belongs to the state. ... No organization or individual is allowed to occupy, sell, lease or illegally transfer land in any way." (Institute of Finance and Trade Economics, etc. 1992,

187). Nevertheless, since 1982, market forces have seeped into all aspects of the economy, and people's demand to establish a market of production elements, including urban land, has accelerated. Thus in 1988, the 1982 constitution was amended and the language "land use rights can be transferred according to the law" was added (Institute of Finance and Trade Economics, etc. 1992, 188). The strategy of separating ownership and use right was thus established, which has become the major guide of China's reform on urban land property system<sup>14</sup>.

Since the reform, China has adopted a two-track land disposition system, the plan and the market. The Planning Committee continues to play the decisive role in the land disposition process and approvals from all levels of economic planning agencies are still required to use land for capital construction. Seemingly, the planning sector still has absolute control in land disposition. However, the state statistics showed that since 1980, the planned investment scale has been surpassed almost every year. For example, during 1985, 1986 and 1987 actual investment by state-controlled enterprises exceeded planned limits by 27%, 44% and 30% respectively (Institute of Finance and Trade Economics, etc. 1992, 210). This shows that the authority of planning is actually being encroached by market forces. By influencing the execution and implementation of land planning, land users – enterprises, public agencies, residents and most significantly, real estate development companies – have begun to play a significant role in land disposition. In response to such situations, when formulating land utilization plans, the state has started to consider independent activities of land users. When implementing land utilization plans, the state no longer relies on pure administrative orders; rather, it uses more frequently economic leverages, such as use price, rent and taxes (or fees) (Institute of Finance and Trade Economics, etc. 1992, 35-53).

In practice, the land use market after the reform has three key characters (Morgen 1988): land is allocated or sold with compensation; lease rights are basically transferred freely but with controls on speculation; land is allocated by the market, either through tender, auction or private treaty. At present, private treaty is still the major transfer method, but the proportions of tender and auction are increasing<sup>15</sup>.

In a short decade since the start of the land reform, the real estate market has seen abrupt ups and downs. In September 1987, the land-use rights of the first plot of state-owned land were transferred to a developer in Shenzhen<sup>16</sup>, which marked the beginning of the land reform. The estate sector boomed in the years that followed, but rapid increases in investments led to overheating of the economy. The year 1993 flagged a turning point from the overheated development to an abrupt recession in the real estate industry, with Jiang Zemin's 16-point austerity plan on July 3 being the direct reason. The real estate industry did not begin to recover until 1995. Demand and supply struck a balance only in 1995 and 1996 (*Asia Pulse*, March 21 1997). The undulation of the estate market partly lies in the inexperience of developers. A more

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<sup>14</sup> Though the state is the unique owner of urban land, ownership of the building on the ground is available to private entities.

<sup>15</sup> Private treaty restricts full competition and does not reflect true market price, but it is expected that local governments have an indicator of the market value through auctions and public tenders (Morgen 1988).

<sup>16</sup> Shenzhen is a special economic zone in the south of China.

fundamental cause, however, is the uncertainty of government policies, alternating between indulgence and austerity. In China important policies are usually contrived by the central government, which cannot respond quickly to situations at the bottom level. Often policies are not made until the problem gets really severe, when radical steps have to be taken. The shifting of policies increases risks for developers and ultimately raises costs to consumers. A tentative solution is to decentralize power to lower level governments, so as to shorten the decision-making cycle.

### **Real Estate Development Companies**

Real estate companies as business entities have become the most notable force in the growing land and housing markets. Though these companies appeared in China only after 1980, they have become the most active ingredients of the land and housing supply markets.

Some of these companies grew directly out of government offices and others were founded by private investors, including foreign entrepreneurs. To alleviate the severe shortage of urban infrastructure and housing, municipal governments began to set up "Unified Construction Offices" in the late 1970s to coordinate land allocation and housing construction and distribution (Institute of Finance and Trade Economics, etc. 1992, 229-230). In 1980, the National Conference on Urban Planning Work proposed that "City Construction and Comprehensive Development Companies" be organized. Those former "Unified Construction Offices" thus changed their names and became real estate development companies. Being still highly administrative in operation, these companies were called "Administrative Development Companies". In 1984, a government document, "Temporary Measures for Urban Construction and Comprehensive Development Companies," urged that the then existing "Administrative Companies" become autonomous enterprises with independent management operations and budgets (Institute of Finance and Trade Economics, etc. 1992, 230). Foreign investors are another important source of development companies. Issued in May 1990, the "Interim Regulations of the People's Republic of China Concerning Administration of Investing, Developing, and Managing Sizeable Land Areas by Foreign Investors" finally loosened restrictions on the entry of foreign entities. This was followed by a fever of foreign investment in the real estate sector (Potter 1991)<sup>17</sup>.

High profitability in real estate development in China, averaging 20-25%, attracted domestic and foreign investors. Thus it is not surprising to find that by early 1996, China had more than 20,000 real estate development companies up from almost zero in 1979, including over 4,000 Sino-foreign joint adventures and over 800 solely foreign-funded ventures (*Asia Pulse*, March 21 1997). In fact, real estate development companies have controlled real estate development activities in cities. For example in 1982, the value of housing developed by these companies accounted for 82.5% of fixed assets completed in urban development for that year (*Asia Pulse*, March 21 1997).

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<sup>17</sup> The total amount of foreign investment used in real estate sector reached US\$700 million in 1992, US\$2.265 billion in 1993 and about US\$4 billion in 1994 (*Asia Pulse*, March 21 1997).

Despite that some of these companies have never been clearly cut from the government branches<sup>18</sup>, the rise of real estate development companies has resulted in profound impacts on urban land-use pattern in China. Driven by profits, these companies have to develop land according to the need of the society and thus optimize the disposition of land resources and increase the land supply needed by society. Further, the presence of these companies creates further division of labor in real estate development and enhances the specialization and the economy of scale (Institute of Finance and Trade Economics, etc. 1992, 231). Moreover, the emergence of real estate development companies – though still not fully independent – marks the end of the government being the unique supplier, and enables competition that activates the market.

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<sup>18</sup> Because of many of these companies have grown out of government offices, they often get advantages in acquiring land, getting land use permits and obtaining government funded projects.

## CHAPTER 3: RESIDENTIAL REDEVELOPMENT IN OLD CITIES

Before 1980, the emphasis of development in cities was primarily on construction of new cities and new urban districts while renovations in old urban districts were only sporadic. The old districts suffered more severely “urban diseases” such as housing shortages, traffic congestion and environmental deterioration due to their old age or simple negligence. Since the economic reform began in 1978, the local government has gained more strength to address this problem, and focus has shifted to the renewal of old districts.

Current redevelopment in old districts in China mainly includes two aspects, the decentralization of central city industries to suburban estates and renovation in old residential areas. These two processes are primarily disconnected. Though attempts to combine the two processes have been made in some industrial relocation projects, because the quality of amenities in the suburbs is generally lower, employees of the relocated industries often choose to commute from their old urban residence rather than move to the new suburban residence. This chapter will focus on residential redevelopment only.

Different from that in countries with a developed market, the residential renewal in China has been primarily initiated by the government rather than spontaneous market forces. Distinct motives of the government have led to varied styles of redevelopment. Some types of redevelopment call for relocations of previous residents, which sometimes bring inconveniences to these people. In the end, strategies for converting the two-tier housing market to a real market are discussed.

### GOVERNMENT S INITIATIVES

The urban residential renewal processes took place under the transition from a planned economy to market-driven and from welfare housing supply to commercial supply. Different from that in a full-fledged market economy, the Chinese government, rather than private developers, plays the major role in the renewal process. The government initiates renewal projects, determines sites, provides funds and subsidies, and secures the interests of original residents. Private developers, nevertheless, have recently been pulled in by the potentially high profits – due to the differential land prices – and are becoming a notable force in the renewal process. Though the government’s motives vary from city to city and from time to time, the government is primarily interested in: improving the living condition of residents; restoring the market value of land; controlling the scale of cities; and protecting historical, cultural traditions of old cities. The first two motives are generic to residential renewal in all Chinese cities, with the first expressing the socialist ideology and the second signifying market influences. The emphasis of the government has shifted from the first to the second during the redevelopment process.

#### **Improving the Living Conditions of Residents**

As mentioned before, due to years of negligence on housing construction and lack of maintenance and upgrading, the overall quality of urban housing in China is low. Due to the old

age of housing and deficiency of modern facilities, the living condition in old districts is even lower. During the 1980s, housing construction increased substantially, but almost all the new constructions were on the outskirts of the city; the old residence in the central city remained poor.

First, housing in the old districts is often overcrowded. In Beijing for example, there were around 200,000 urbanites with less than 4 square meters' living space per capita by 1994 (Huus 1994). In addition, Lu (1993a) noted that most of the households living in crowded conditions were in the city center, or the old districts. The mayor of Beijing observed in 1990, "solve the dilapidation and you've solved the overcrowding," (Lu 1994, 34). Second, because many of the housing units in the old districts were built before 1949, they often lack basic facilities such as toilet, kitchen, heating, gas, water and sewer. Building codes mandate these facilities in all newly built housing. This makes the relative conditions of housing in old districts appear worse and dissatisfactions of residents in the old districts have risen. Finally, due to the lack of maintenance and the age of the structures, many housing units in the old districts are in poor condition and some are even dangerous to live in. In Beijing, 20 percent of the courtyard housing units in old districts is dangerous, flooded or leaking (known in Chinese as "*Wei, Ji, Lou*" housing). As the residents' demand for improved living conditions surges, the government is driven to solve this problem. In fact, the initiative for improving living conditions of residents constitutes the major theme for the government to redevelop the old districts, or at least so in early stages.

### **Restoring the Market Value of Land**

The value of urban land was recognized in the 1980s. By introducing market mechanisms into the land disposition system, the government hopes to enhance the efficiency of land use as well as to enhance revenues. Because food prices were opened to market adjustments in late 1980s, the government's subsidies for food to urban residents increased substantially, which in turn led to considerable fiscal deficits. Charges on the use of land would be a handy resource for the central government to reduce deficits as well as creating development capitals for local governments. Another concern is to optimize the land use structures in urban areas so as to facilitate economic development<sup>19</sup>. Though nominally all urban land belonged to the state before the reform, land had been provided to industries and residents for free, which resulted in urban land being underused. By charging land-use fees and encouraging competition, more efficient use of will be attained.

Land leasing, through tender or auction, has appeared in China. Though today the amount of land leased only accounts for a small proportion of the total land distributed and the government still has strong control over the distribution, land leasing has become the trend for future development.

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<sup>19</sup> For example, the 1992 master plan of Beijing calls for: constructing the central business district (CBD); increasing the land use for foreign commerce and tertiary industries; reducing the land use for secondary industries and warehouses in the city center; and properly increasing the land use for clusters of development along the periphery of the urban district (Fan 1994).

### **Controlling the Size of Cities**

Since 1949, urban growth mainly occurred in cities with a population over 500,000, including many old cities that had been industrial or commercial centers before 1949. Further congregation of population and industrial activities in these cities resulted in disequilibrium. In 1982, fifty percent of the nation's industries were located in the top 48 largest cities. Actually, the top 220 cities, consisting of only 10% of the total population, contributed to 75% of the total industrial outputs of the country in 1982 (Mcquillan 1985, 4). Due to improper planning policies over the years and the reduced control on rural-urban migration since the reform, over concentration in large cities has further aggravated overloaded urban infrastructures, depleted limited water and energy resources and intensified congestion and pollution. Consequently, the government adjusted urban planning policies in the 1980s, aimed at restoring the equilibrium by directing growth away from large cities. Restricting the size of large cities is the most important strategy for this goal, which calls for downsizing of population and relocating certain industries away from large cities. To alleviate pressures on large cities, satellite cities in the vicinity of these cities are motivated. At the same time, moderate development in medium-sized cities and full development in small ones are promoted (Mcquillan 1985, 4-5).

### **Protecting Historical and Cultural Cities**

The long history of China has established rich architectural forms and planning theories, which are well represented in old cities. A few examples are Beijing's symmetric royal palaces and orderly courtyard housing for commoners, Suzhou's ancient miniature gardens and elegant multi-story residence, Tianjin and Shanghai's colonial styles and Lhasa's religious castles. Many culturally important structures were destroyed during the Culture Revolution, considered as remnants of Feudalism. Since the end of the 1970s, the value of these cultural relics has been restored and the government has promulgated laws and regulations to protect them.

### **IMPLEMENTATION OF RESIDENTIAL RENEWAL IN OLD CITIES**

Although the government rather than market forces has initiated most of the residential renewal programs, some phenomena during the process, such as decentralizing residents with limited incomes, resemble those that took place earlier in developed counties. This is because market forces have come to be a major concern of the government for redevelopment since the reform. Nevertheless, because the Chinese government has not been completely cut from the socialist ideology and improving residents' living remains an important goal, subsidies from the government have enabled residential renewal in areas where the breakeven point would not have been reached with market forces alone. With the land value restored, the government has tried to attract private developers into residential redevelopment to adjust the structure of urban economy and relieve subsidy burden. As the highest and best use of urban land is not necessarily residential, many old residential areas have been transformed to commercial uses in recent years.

There are three basic types of redevelopment in the old residential districts in China nowadays. The first is to demolish old housing and rebuild housing on the original sites, which characterizes most early renewal efforts in old cities. Next comes the idea of rehabilitating the old housing rather than completely demolishing it, which has gained some significance during

the 1990s but whose application is restricted. The first two procedures of redevelopment are usually subsidized by the government, directly or indirectly. The third and latest is to demolish the old housing but construct new commercial buildings (retails, offices, hotels, etc.) instead of residential, which requires complete relocation of the residents. Under the shift toward a market, this procedure has been gaining more and more importance due to its high profitability. All three types are in use today, sometimes jointly.

### **Residential Redevelopment by Demolition**

Demolishing the deteriorated old housing and constructing new, higher-standard housing on the original site has been the most prevalent strategy of redevelopment in China's old cities and has been practiced in cities such as Beijing, Shanghai, Tianjin, Guangzhou, Shenyang and Harbin. The following focuses on Beijing's Old and Dilapidated Housing Renewal (ODHR) program that is distinctive due to its large scale. Despite Beijing's eminent role as the capital and a historical city, problems encountered in the ODHR program are generic for this type of redevelopment.

#### ***Beijing's Old and Dilapidated Housing Renewal Program***

On April 30, 1990, the municipal government of Beijing decided to accelerate the rate of renewal and commissioned the Beijing City Planning Institute to draw up a master plan for central city districts. Two major objectives marked the beginning of the ODHR program: (1) aspiration of citizens to improve their housing conditions; and, (2) resolution of the municipal government to achieve a moderate level of living by the end of this century<sup>20</sup> (Lu 1993). Improving the living conditions for residents in the old neighborhoods was the first and foremost goal. Reports showed that by April 1992, just two years later, the ODHR program had been initiated in eighteen city districts and counties throughout the municipality and 1,500,000 square meters of new floor area had broken ground, of which 500,000 square meters had been completed and 16,000 families (around 50,000 people) had been re-housed (Lu 1993).

In 1987 the Beijing's municipal government committed to construct five pilot projects in old city districts (Juer *Hutong*, Xiaohoucang, Caochang Toutiao, Dongnanyuan and Chunfeng *Hutong*). In April 1990, the municipal government declared the ODHR program to be under way and from then on, the renewal process has accelerated. These projects were dominated by district-level government and all except Chunfeng *Hutong* were directly developed by the local District Housing Management Bureaus or companies established especially for this purpose by the bureaus. Project costs were reduced through relief from tax or infrastructure fees, and all the projects were developed at a loss or at negligible profit (Abramson 1994).

The chief aim of the early pilot projects was to improve the housing conditions of the residents of dilapidated buildings. Generally residents received new units with at least the same living area and similar or better solar orientations. In each place except Juer *Hutong*, policy required that all of the original residents be able to move back to the rebuilt housing on the

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<sup>20</sup> Beijing want to double the average ---- 7.7 square meters per capita ---- by the year 2000 (Huus 1994). This is correspondent with the goal of China for the year 2000 on housing in urban areas, which is, to achieve an average a living space of 8 square meters per capita and a single dwelling unit per household (the Main Points of the Technical Policies for Urban and Suburban Housing Construction, quoted from Tan 1994).

original sites. Despite the improvements in living conditions, rents of the new housing were not different from the basic rent collected throughout Beijing: 0.13-0.16 *yuan* per square meter, adjusted slightly according to housing quality (Abramson 1994). These projects attempted to promote home ownership by offering original residents new units at preferential prices equal to the basic construction costs, about 10% of market prices. The purchasing household had the right to bequeath their units to younger generations or exchange their units with others elsewhere but there were limitations on selling. In addition, four of the five pilot projects attempted some innovation in architectural design trying to find a form compatible with Old Beijing's traditional space and life style.

However, as shown in more recent projects, the focus of the renewal projects has shifted to "raising the site density, accommodating mixed uses on a large scale, and differentiating between commodity housing and housing for returning original residents" (Abramson 1994, 50). The proportion of commodity housing in the total on-site rebuilt housing has increased, while that percentage for returning residents has dropped. To balance the social impacts on residents and the economic benefits of developers, the Beijing ODHR Office has set a general goal of accommodating at least 30% of sitting residents on site. However, interviews with both government officials and developers shows that this rate is actually negotiable for any particular projects (Leaf, 1995). In addition, developers have found their own way to influence the return ratio. They require all families who hope to come back to fulfill three conditions: (1) They must buy their new apartments; (2) must shelter themselves elsewhere during the construction which usually takes about 1 or 2 years; and, (3) must pay the market price for any extra living space which exceeds the original space (self-built area not included). Along with that the preferential price has risen from 350 *yuan* per square meter to 600-800 *yuan* per square meter, thus fewer and fewer families can afford to move back (Tan 1994).

### ***Emergence of a Market in Redevelopment***

It should be noted that a market that trades the right for on-site compensation has emerged. Unable to afford moving back, old households exchange the right to buy on-site housing at a preferential rate with other people. The original household gets housing elsewhere and the newcomer pays at a semi-preferential rate, higher than the preferential price but lower than the market one, for a unit in the city center. As a result, the developer can increase profits while still achieving the required ratio of on-site replacement (Tan 1994). The shift of the guidance from residents-oriented in earlier projects to economic-oriented in more recent ones marks the infiltration of the market force into the renewal program.

The negative correlation between the proportion of housing assigned for returning residents and the profit rate seems consistent among redevelopment projects (Dowall 1994). The larger portions of the rebuilt structures designated for returning residents, the lower the return rates. Nevertheless, Xiaohougang project is an exception. While having all residents return to their original site, Xiaohougang project still achieved the break-even point and even made modest profit. The major reason for the higher return rate is that in Xiaohougang project, a proportion of the newly built space was assigned to commercial use rather than residential (Huang and Shi 1991). By subsidizing the residential section with the commercial section, co-

development of residential and commercial space is a potential means for residential renewal projects to be financially feasible, especially when a certain ratio of on-site replacement is mandated.

### **Residential Redevelopment by Rehabilitation**

Rehabilitation is an alternative redevelopment strategy attempted in Shanghai, Suzhou and some other old cities. Rather than total demolition of the old housing, rehabilitation projects emphasize more on upgrading the existing stock.

#### ***Rehabilitation in Shanghai and Suzhou***

Different from Beijing, Shanghai had been the center of trade and light industries before 1949 and was the most capitalized city in the old China. Therefore, different from most other old Chinese cities, it has a denser urban core, which better resembles a city under a market economy. “Lane houses,” mostly built during the 1920s and 1930s for workers, characterizes most old urban residential areas. Small lanes, 3 to 4 meters’ wide, join the side street with densely packed buildings of two- or three-story high. Nearly half of the population of Shanghai lives in such buildings. Due to the lack of maintenance and population growth, the old residence has been overcrowded. In addition, such housing often lacks basic facilities such as a toilet, bath and kitchen. Improper maintenance has further aggravated the situations. Nevertheless, these buildings in the old districts are often physically well built and frequently of notable architectural styles. The attitude towards old housing changed during the late 1980s, especially among the professionals and administrators, and emphasis has shifted from total demolition to the combination of selective demolition with systematic rehabilitation and upgrading (McCallum 1993). By the early 1990s, the government in Shanghai, both at the municipality level and the local level, had launched a variety of pilot projects for redevelop old residential districts.

The earliest attempt was on Lane 303, Penglai Road in early 1980s, followed by those in Yutian New Neighborhood in Hongkou District, Futian Terrace in Jing’an District, Neighborhood 44 in Luwan District, and Lane 252, Penglai Road in Nanshi District in the early 1990s. All of these pilot projects added kitchen and toilet/bath facilities in each housing unit and some projects increased the living area for each household. To increase the total floor space, an extra one or two stories were squeezed into the existing building by either heightening the roof or lowering the ceiling<sup>21</sup> of each story. There was no significant relocation except in Luwan, where after renovation only 670 suites were provided for the original 900 households. The displaced households were relocated outside of Luwan district in the downtown (McCallum 1993). The renovation of 3,000 square meters in Jing’an used funds of over 1 million *yuan* (US\$ 120,000). Luwan District, with 8,000 square meters transformed, cost 7 million *yuan* (US\$ 840,000). Nanshi District spent 1.47 million *yuan* (US\$ 177,000) on revamping 4,000 square meters of old housing (Chen 1996).

Large-scale refurbishing of housing has taken place since 1996. One half (55.5%) of the total 110.49 million square meters of housing had no private toilets and kitchens by 1996. The government plans to revamp some 2 million square meters of housing between 1996 and 2000. In 1996 only, Shanghai planned to revamp 120,000 square meters of old housing to add private

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<sup>21</sup> To prevent further deterioration of sun-lightning, the increase in height of roof was limited in some projects.

toilets and kitchens<sup>22</sup>. The cost for 1996 was estimated to be 290 million *yuan* (US\$ 35 million), which would call for 200 million *yuan* of government loan (US\$24 million) and the involvement of 14 districts (Chen 1996)<sup>23</sup>.

All of these rehabilitation projects in Shanghai were initiated by municipal or district Housing Administration Bureaus. Residents were required to contribute partially to the renovation only in two of the projects, with a lump sum of 10,000 *yuan* (US\$1750) in Futian and 2000 *yuan* (US\$350) in Luwan and rent increase after renovation was insignificant (McCallum 1993). Though in some projects, a limited number of units were sold at a highest possible “market price” to cross subsidize the renovation work in the rest of the neighborhood<sup>24</sup>, these projects are not financially profitable and rely heavily on subsidies.

Suzhou is a famous historical city, distinctive for its charming old gardens and graceful traditional residence. The State Council instructed that “the style and features of Suzhou should be protected as much as possible.” (Sun, Gong and Luo 1990, 37). The consideration of preserving historical features naturally leads to the approach of restoring old residents rather than demolition.

No. 50 Shizijie, constructed at the end of Qing Dynasty, was chosen for a pilot project of “remolding old houses, while maintaining the traditional mood and building modern facilities” (Qu, Jin and Feng 1991). This site occupied four rows of houses with the floor area of 931.23 square meters on a site of 816.77 square meters (FAR = 1.14). It was not only a typical copy of the traditional residence, two-story buildings with white-painted brick walls and dark tile roofs, but also a representative of a large amount of old, deteriorating housing in Suzhou. This property belonged to the Housing Management Office of the city and was rented by the Surgeon Medical school for their employees. The rehabilitation was completed by the end of 1989 and there was no significant relocation of residents in this project.

The total investment for renovation was 154,342.06 *yuan*, and the average cost per square meter was 167.77 *yuan*, of which construction cost constituted 73% and electricity and water supply fees made up the rest. Compared with the cost of demolishing and redeveloping the site, which would be 362.51 *yuan* per square meter, more than 200 *yuan* per square meter was saved (table 4). Construction fees and construction tax contributed to the majority of the saving and construction materials saved per square meters included 76.75 kg of cement, 13.98 kg of steel and 0.0116 kg of wood (Qu, Jin and Feng 1991).

The funds for this project were from two sources. One was from the work unit of the residents, the Surgery Medical School, and the other was from government subsidies for residents who did not have a job. Because the work unit was state owned, in fact all the funds came from the government.

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<sup>22</sup> The actual area completed in 1996 was 150,000 square meters (Chen 1997).

<sup>23</sup> He Zhuin, an official from Shanghai Housing and Land Bureau, estimated the cost of renovating one square meter of housing ranging from 600 to 1000 *yuan* (US\$ 120) (Chen 1996).

<sup>24</sup> 1400 *yuan* (US\$250) per square meter or 70,000 *yuan* (US\$12,400) for a 50 square meter suite was marked in Yutian Neighborhood (McCallum 1993).

**Table 4. Cost Analysis of Renovating Building No.50 Shizijie Street**

Item	Cost analysis of renovation		Cost analysis of rebuilding	
	price(yuan/m <sup>2</sup> )	percentage(%)	price(yuan/m <sup>2</sup> )	percentage(%)
Money spent before and after the project	8.23	5.09	10.10	11.17
Construction	117.88	72.87	230.00	63.45
Water and electricity	26.08	16.12	35.00	9.65
Increase water and electricity capacity	7.47	4.61	8.00	2.21
Others	2.11	1.31	18.47	5.09
Construction tax			30.55	8.43
Total	161.77	100.00	362.51	100.00

Source: Qu, Jin and Feng, 1991, Table 3, pp. 58.

### ***The Advantages of Rehabilitation***

In general, rehabilitation of the old residence is an attempt to upgrade housing of relatively good quality. This procedure has several advantages: reducing construction cost and saving materials, maintaining the traditional building style and minimizing relocation of sitting residents. However, experiences in this field show that such projects can hardly be financially profitable and subsidies from the government are necessary.

Because labor cost is relatively low in China while materials cost high, rehabilitation saves the costs of reconstruction. An estimate in 1981 showed that of the 80 percent of total building production costs, labor accounted for only 7 percent, machinery 4 percent, miscellaneous 2 percent and materials 67 percent (McQuillan 1985, 18). By rehabilitation rather than rebuilding, valuable materials such as steel, cement, timber, clay bricks will be saved and construction costs will be substantially lowered. However, this cost calculation does not include the cost for land acquisition, which was simply dismissed in the early redevelopment projects but which has been a more and more significant factor in recent projects.

Though successfully applied in some middle and small sized cities, where differential land rents are not substantial, it should be noted that rehabilitation has been rarely practiced in Beijing. The high land prices in the center areas in Beijing require high density of construction. However, different from that in Suzhou and Shanghai, the density of old residence in Beijing is extremely low<sup>25</sup>. There would not be enough space for improving the living conditions for the sitting residence, let alone for constructing commodity housing to recover the investment. Even in Shanghai, the application of rehabilitation is limited. The open of the land leasing market soon pushed the land price radically high in the city center. The tremendous discrepancy of land price between the city center and the suburbs has been propelling the residential use for common citizens out of the city center.

<sup>25</sup> Because the old courtyard houses in Beijing are all of one-story, the FAR is always less than 1 even when self-build constructions are counted.

### **Conversion of Residential to Other Uses**

The third type of redevelopment in old residential areas is where the old residence is demolished to make space for new uses, namely infrastructure expansions and commercial uses.

#### ***Infrastructure***

To improve the investment environment and living conditions of residents and to maintain long-term sustainability, many municipal governments have concentrated efforts on a number of important infrastructure projects.

For example, in Shanghai alone, infrastructure projects planned for the 1990s include Huangpu River bridges, phase I subway, comprehensive development of north-south thoroughfare, aqueduct mains, sewage mains, extension and renovation of telephone system, development of big electric power plant and ultra high pressure power line system, etc. (Master Plan of Shanghai, 1990). Many of these infrastructure projects call for demolition of residences. In Beijing, 8,000 people had their homes torn down in Ping'an Avenue Expansion project (China Daily, February 5 1998). Usually the government would provide compensating housing at other locations, often in the city fringe or the suburbs and/or a certain amount of cash.

Compared with infrastructure expansion, the growth of tertiary industries in the city center is a more notable trend, where the involvement of market forces is more distinct.

#### ***Commercial Development***

As early as the beginning of the residential renewal process, opinions with regard to the future characters of the reconstructed central city areas were diverse. Some specialists argued that the reconstruction of dangerous and dilapidated buildings should reserve their residential nature in general, due to the following reasons: (1) the majority of the existing target buildings being used for housing; (2) favorable to the traffic in the inner-city; (3) facilitating the control over the height of the old city; (4) coherent with the wishes of the people and facilitating administration. Nevertheless, others insisted that residents in dangerous and dilapidated buildings should be encouraged to move to the suburbs, and their reasons were: (1) the land could be used for residence in the city center being limited; (2) to realize the control of the overall population in downtown areas; (3) to make room for the construction of those large public buildings which are in keeping with the function of a capital city; (4) economically worthwhile ("Research and Discussion Held on the Relationship between Reconstruction of Dangerous and Dilapidated Buildings in Beijing and Preservation of the Style of the Ancient Capital" 1991). The first view was concerned with the needs of residents, while the second was guided by the rules of the market. At the initial stage of residential redevelopment, the first view dominated, while more recent projects have seen a shift to the second.

In recent years, more and more private developers have been involved in the renewal and relocation process in old urban neighborhoods. In 1994 in Beijing, for instance, an estimated 180 projects or at least 2 million square meters floor space were under construction, which were mainly luxury villas and apartment projects, shopping complexes and office space, aimed at foreign companies and encouraged by high profits. According to Alfred Lai, deputy managing director of First Pacific Davies in Hong Kong, developers of these luxury projects expected returns of 50-85% (Huus 1994). With office space in the center of Beijing selling for US\$4,000

per m<sup>2</sup> and villas for US\$3,500 per m<sup>2</sup>, and those in Shanghai even higher, prices in the two major Chinese cities ranked the third and the fourth high in Asia, following Hong Kong and Tokyo (Huus 1994).

This new strategy enhances the speed of suburban housing construction and relocation. The 114 hectares' business center in Changning District in Shanghai led to the relocation of 2,000 households (Shanghai Star May 13, 1997). Shanghai plans to raze some 540,000 square meters of dilapidating housing by the end of this century, mostly along the Huangpu River – one the most potential sites for development in Shanghai, which will call for the relocation of 28,800 families (*China Daily* November 17, 1997). In Beijing, Financial Street, one of the biggest projects in the city, called for demolition of 20,000 homes. Even a small project will result in resettlement of 200-300 families (Huus 1994).

Because all urban land is owned by the government, and the development projects are mainly negotiated between the government and developers, sitting residents actually have little say in the redevelopment process. Disputes do occur when residents are not satisfied with relocating terms.

On one hand, the involvement of real estate development companies solves the fund shortage problem of the government for reviving dilapidated old districts. Private developers reconstruct highly profitable commercial spaces in the city center and cross subsidize suburban housing, while relocating original residents out of the city center. On the other hand, profits rather than residents' benefits have become the foremost consideration in these redevelopment projects. The shift from early government initiated projects to those funded by commercial developers is the shift from goals to improve the living conditions of residents to the typical behavior under the market economy – seeking profits.

### **Influences on Residents**

Though the benefits of the renewal program to old residents is obvious, often with living area enlarged and facilities enhanced, there are some undesirable impacts on these people when relocation occurs. Different from that in developed countries, China's renewal process is often mandated by the government. Because the government owns all urban land, once a renewal project is decided, residents can choose neither whether to move, nor where to move. When the private sector is involved, the government and developers negotiate a land-use price that includes the cost of resettlement, while the residents are totally excluded from the process (Huus 1994). As relocation is becoming the new trend of the residential renewal process, these influences merit more examinations.

### ***Access to Work and Amenities***

In the renewal projects initiated either by the government or by private developers, the biggest worry of relocated residents is the isolation from jobs in the city. Though the government suggests that relocation be within 10 kilometers of the original site, there are no procedures to secure its implementation. In the Financial Street project in Beijing, for example, residents reported new housing assignments as far away as 20 kilometers (Huus 1994). Along with the goal of decentralizing population, the 1990s' master plan of Beijing suggests that manufacturing industries move out of the city center. However, relocation of industries and residents are two

separate processes and most relocated residents will continue to work in the city. Moreover, because only a tiny percentage of residents own private cars, most citizens in the old cities rely heavily on an inefficient bus system<sup>26</sup> and a grossly inadequate road system for suburban-urban transit. The commute time for the relocated people will thus greatly increase.

Access to amenities, such as schools, health care, shopping and entertainment, is another problem disturbing the relocated residents. Though in many cases settlements on new sites are equipped with basic amenities, choices are often limited. Many relocated residents would continue to go back to the city center for better services. In addition, since in most cases children are only permitted to go to schools within the district where they live and the education level in different districts varies substantially, parents with young children often worry about schooling at the new site.

Sites for relocation often have inferior accessibility to both job and various amenities provided in the city center. This not only costs relocated residents' time and money, but also intensifies the use of already overloaded transportation facilities. Currently these social costs are largely neglected when planning a residential renewal project.

### ***Segregation***

Being sold commercially, a standard Chinese apartment within the third ring road in Beijing ran 4,000-6,000 *yuan* (US\$ 482 – 723)<sup>27</sup> a square meter in 1994 (Huus 1994), and the price within the second ring road was even higher. Moreover, housing prices have been increasing year by year. Comfortable “old” neighborhoods will be out of reach. A traditional 2,300 square foot courtyard house in the west city district in Beijing slated for preservation sold for about 23 million *yuan* (US\$2.77 million) (Huus 1994). With an average monthly income of around 400 *yuan*, citizens can hardly afford to buy housing, especially when the mortgage system has not been well developed.

Many of the newcomers to the redeveloped residential areas are employees of prosperous enterprises that can afford to buy commodity housing for their employees, and individual buyers include business persons, new industry owners and some employees of foreign companies. Even when some old residents do manage to return to the original site after the renewal process, housing for returning residents is of lower standards and/or of less desirable solar orientation in some recent projects. In addition, the preferential price for the old residents is applicable only to the original area<sup>28</sup> and they have to pay a much higher price on any enlarged area. Moreover, requirements on those who want to come back are strict, such as that they have to shelter themselves during the period of reconstruction and have to buy the rebuilt housing.

At the same time, those relocated far away from their original neighborhoods have moderate incomes and cannot even afford the preferential price at one tenth of the market price. For these people, security and management in the suburban residence are often poor; and since

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<sup>26</sup> A bus trip to the southern suburbs can cost 4 *yuan* and take 90 minutes, and the commute can gobble up a large amount of one's monthly income, not to mention a lot of time (Huus 1994).

<sup>27</sup> The rate used here is US\$1 = RMB8.3.

<sup>28</sup> Self-built living area is not counted as original area.

these projects are nonprofit, developers skimp on construction quality, site furnishing and landscaping (Lu 1994; Tan 1994).

In the residential renewal process in old Chinese cities, the relative low- or middle-income residents in the city center are being replaced by the very rich. If this process continues, the result will be that the more affluent occupy the city center while the relatively poor are pushed to the city fringes and the suburbs. Because now the incomes of the majority of Chinese people are moderate and the very rich constitute only a tiny proportion, the segregation problem in China today is not as pointed as in some developed countries where the income discrepancy is severe. Nevertheless, as economic reform deepens, the differences among people's incomes will be further widened, and the separation based on income differences, often detrimental to the psyches of the poor, may lead to political instabilities.

### ***Breakdown of Social Ties and Influences on the Elderly***

Since residence in the old districts was formed over a long period of time, the households there often have developed cooperative interrelationships and a strong social identity. There is a popular saying in China, "Distant relatives are not as dear as close neighbors," which reveals the importance of "neighbors" in one's everyday life. However, in more recent renewal projects, more and more old dwellers have been relocated to suburban estates, and strong ties among households in the old district have thus been broken. Though often the original residents of the same neighborhood are relocated to the same site in the city fringes and the suburbs, the multi-floor design of new buildings often impedes social activities among them. According to Lu (1994b), poor security in new suburban estates is partly due to the weakened links among households.

The elderly, who are most attached to the old neighborhood, have keenly sensed the loss. In the old neighborhoods, since the young have gradually moved out after marriage, the percentage of the elderly is higher than the city average (Tan 1994). A survey in Beijing's old neighborhoods showed that elderly people were likely to be the last who wanted to leave a familiar physical and social environment and it seemed difficult for them to adjust their life to living in a multi-story apartment block (Tan 1994). The separation from their familiar contexts will certainly have some psychic effects; moreover, multi-story housing style and inadequate maintenance characterizing most suburban estates may even cause physical injuries<sup>29</sup>.

## **ROAD TO MARKET**

China's efforts to convert the traditional welfare housing to commodity housing consist of two interrelated sides: to reduce the administrative sector and to expand the market sector. Such efforts are also illustrated in residential redevelopment programs.

### **Reduce Administrative Interference**

According to his investigation on residential redevelopment, Dowall (1994) concluded that four administrative characteristics distinguished China's housing renewal programs, which are as follows:

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<sup>29</sup> It is reported that an old lady fell down dark stairs and died afterward in one new building for relocated residents (Abramson 1994).

- In-kind versus cash compensation for housing;
- Maximization of on-site provision of replacement housing;
- Developer exaction for the provision of community facilities; and
- Imposition of fees and taxes on redevelopment projects.

He pointed out that these mandatory factors increased the cost for redevelopment and contributed to financial infeasibility.

Nevertheless, transformations are taking place. First, cash compensation is being used as a substitution for in-kind compensation. For example, in Ping'an Avenue Expansion project, residents were given the choice of either moving to new government-provided housing or taking cash compensation varying from 150,000 *yuan* (US\$ 18,000) to 250,000 *yuan* (US\$ 30,000), based on their former homes and the number of people in their families (*China Daily* February 5, 1998).

Second, the proportion of on-site provision of replacement housing has been shrinking. In the ODHR program in Beijing, this rate has decreased from 100% at the beginning to the later 30% requirement, and now even the 30% rate can be further adjusted. In Shanghai, to attract investments to renovate the rundown area, the government allows developers themselves to relocate residents (Zheng 1996).

Last but not least, China's efforts on cutting excessive taxes and fees are substantial. To lower the cost of construction and in turn drive down housing prices, China had scrapped 48 descriptions of fees collected on real estate projects by early 1996. In addition, to encourage foreign investment in ordinary residential construction, China allows foreign investors to invest in such projects in either hard currencies or the local currency. If their return on capital does not exceed 44%, the land value increment tax will be exempted (*Asia Pulse*, March 21 1997). In order to encourage renovation of the city's 3.65 million square meters of dangerous and shabby housing in the old districts, Shanghai planned to cut charges on 13 items to help reduce the development costs, including administrative fees for housing demolition, construction license and residents' relocation (Zheng 1996).

### **Building a Market**

Four features characterize a market of perfect competition: enough number of competitors, free entry and exit, complete information and homogenous products (Pearce 1981, 329-330). Housing, being perhaps the most complex commodity, varies in design, construction quality and above all, location<sup>30</sup>. Therefore the concept of "homogenous product" is usually not appropriate for housing. Moreover, despite its economic characteristics, housing also has social and political characteristics, which further prohibit the housing market to be a completely free one. Nevertheless, the guidelines of a market of perfect competition help to define the transformation of China's residential renewal process.

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<sup>30</sup> Location decides not only the accessibility to amenities and work, but also the prestige and spirit of a residential area.

### ***Number of competitors***

Though at present, the government and state-owned enterprises remain the major force of housing development, real estate development companies have controlled real estate development activities in cities. By early 1996 China had more than 20,000 real estate development companies, including over 4,000 sino-foreign joint adventures and over 800 solely foreign-funded ventures (*Asia Pulse*, March 21 1997). In 1988, the value of housing developed by these companies accounted for 82.5 percent of fixed assets completed in urban development of that year (Institute of Finance and Trade Economics, etc. 1992, 49). In the past, these developers focused mainly on commercial development and luxury hotels, offices and villas. Recently, however, due to the large demand and favorable provisions from the government, such as low-interest loans and tax exemptions, some developers have come to deem it profitable to invest in affordable housing and residential renewal projects aimed at the majority of citizens. Hong Kong's New World Development, for example, was reported a 15% net profit, with the municipal government providing land and New World the capital (Huus 1994). In a competitive market, return on investments in housing should be comparable to that in other sectors of real estate of similar risks. This indicates it may be necessary for the government to subsidize redevelopment projects to make them attractive to investors. The rise of real estate development companies, though still often connected with government agencies, marks the end of the government being the unique supplier and enables competition to stimulate the market.

### ***Entry and exit***

The entry of non-state developers is a crucial part of the overall process of marketization. Non-state developers account for the bulk of the commodity housing market and are critical in ensuring the healthy development of the market sphere. Vigorous growth of the non-state sector is crucial in converting the commodity housing market into a viable part of the economy as a whole. Drawn disproportionately into high-profit sectors, new entrants are crucial in driving market prices towards a pattern more consistent with scarcity costs. On the supply side, the state has softened the constrictions on the entry of private and foreign investors. Though the state and state-owned enterprises remain to provide housing for the majority of citizens, a commodity housing market, driven simultaneously by rapidly growing start-up private development companies and recently allowed foreign investors, has been burgeoning. Another important force in the supply pool, though still insignificant in quantity, is the individual household. The regulation, Management Measures for Private Housing Construction in Towns and Cities, was implemented in 1983, which states that people who have permanent formal residence permits to live in cities and towns, and who are short of housing can apply to build housing. Applications are to be approved by the corresponding housing and land management agency as well as by the urban planning agency. However, housing construction has an upper limit in area of 20 square meters per person and residents' land use behavior is limited to self-use and to sites determined by urban planning agencies only. Though these limitations restrict the capacity and incentives of residents to develop land and construct residential buildings, the proportion of residents' construction in total residence completed has been swiftly increasing in recent years. For

example, this ratio increased from 3.9% in 1980 to 13.5% in 1984 (Institute of Finance and Trade Economics, etc. 1992, 52-53).

### ***Information***

The most important step in the development of market information is that the China Real Estate Index (CREI) system was officially started in late 1994, to record price fluctuations and inform and advise property developers. The National Census is another aid to clarifying the demographic characteristics of demand. Also, a geographic information system has been introduced into the real estate sector, to store, update and manipulate land and housing information. Various media, such as newspaper, magazines, television and broadcasting have all been adopted for the propagation of housing and real estate information. Even an official internet page was launched by Beijing United Net of Real Estate in 1996 (Business Week December 1, 1996).

### **Market Force vs. Socialist Ideology**

The two-track market, distinguishable in China's economic reconstruction and housing and real estate reform, also characterizes the residential redevelopment process. Commodity housing, oriented to the few with high incomes, is built on the site of old, dilapidated housing, while subsidized housing, more and more often built on suburban sites, is still provided for sitting residents of limited income. Nevertheless, despite that the administrative sector retains its control over the redevelopment process, the trend moving towards a market economy is apparent. Emphasis of residential redevelopment has been shifted from enhancing the living conditions of citizens to reviving the economics of municipalities by restoring land value and developing tertiary industries, corresponding with the driving force shifted from government agencies to private developers.

In fact, the two-track market is a compromise between market forces and the socialist ideology, which in theory upholds the rights of the mass citizens and justifies the existence of the party. Under the socialist ideology, housing has been treated as a social right rather than a commodity. All the reforms taking place so far are within this political ideology, even though most of the specific strategies have little difference from those under a capitalist ideology. Up to now, as the government remains highly involved, improving the living conditions of the residents in the old neighborhoods continues to prevail in the redevelopment process. Many privileges are provided to the residents, such as preferential price at one tenth of market price, priority of purchase, permission to exchange preferential tickets with others, etc. In most cases the physical living conditions (living areas, basic facilities, etc.) improve greatly. Nevertheless, there is a concern that, as the market force takes more and more stake, the government will still actively protect the interests of sitting residents as long as the political stability is not endangered. The inability of the government to protect the rights of the mass citizens, however, will in turn put the very existence of the socialist party at risk. How the party will deal with the conflict is unknown. But if the trend of advancing towards a market economy is irreversible, the socialist ideology may be ultimately abandoned.

## CHAPTER 4: CONCLUSION

Residential redevelopment is an important ingredient of the entire urban renewal process sprouting in China's old cities. Redevelopment varies in motive, pattern, and scale from city to city and from time to time. Nevertheless, the transformation from the planned economy to a market one has created certain similarities among these cities, which has also distinguished the renewal processes in China from that in other countries.

The transitions taking place in the economic system and housing and land sectors have shattered the traditional welfare housing system and a two-tier housing market has been formed. The final merging of this dual track market relies on improving the income levels of the majority of citizens. At present, the government's involvement is a must.

The government's involvement has two functions. One is to directly subsidize these projects and, more importantly, to create an environment for them to be financially successful. Financial feasibility is the bottleneck of these renewal projects in Chinese old cities and, up to now, most of renewal projects have been subsidized to break even. The other function is to control the overall social effects of renewal projects, especially to protect the basic rights of original residents. Because all urban land belongs to the state and, in most cases, housing is not owned by its occupants, residents have little power to bargain with developers. Moreover, these residents usually cannot afford commodity housing at a market price. Without the government's interference, they will be exposed completely to the mercy of profit-driven developers.

Policies for residential redevelopment in Chinese old cities should focus on two aspects – enhancing the financial feasibility of redevelopment projects and maximizing social benefits while minimizing the social costs of these projects.

### **FINANCIAL FEASIBILITY**

To enhance the financial feasibility of redevelopment projects, one can either reduce costs or increase return. The following strategies are suggested to advance these ends.

#### **Release the requirement for on-site housing replacement**

Dowall's (1994) study, confirmed by the experience in ODHR program in Beijing, shows that there is a consistent negative relationship between the proportion of on-site housing designated for original residents and the financial rate of return. When land rent is much higher in city centers, even after providing the suburban housing almost for free to the relocated residents, developers can still make a profit by selling the central city housing at a very high price. However, in cases when developers have to compensate sitting residents with on-site housing at a considerably reduced price, the return they make will decrease substantially. The drawback of this strategy is that sitting residents will have to be relocated to sites far from the city center, which will not only introduce many inconveniences to these people but also likely result in gentrification.

### **Reduce fees, taxes and public utility charges**

Land taxes, fees and utility charges account for 60 percent of the cost of urban housing on average (South China Morning Post November 18, 1996)<sup>31</sup>. Of the ten redevelopment projects Dowall (1994) studied, two had fees and taxes below 1 percent of the total project cost, three fell between 5 - 10 percent, three between 10 - 15 percent and the other two above 15 percent. The fee and tax standards vary by city and in some cities the charges may be too high. In addition, public facilities, which can take up as much as 40% of the net increase in constructed area (Dowall 1994), are exacted by the government from developers. By reducing fees, taxes and public facility provision, the government will certainly lower the cost of redevelopment projects and thus make these projects more competitive in attracting funds from commercial sources. Nevertheless, it should be noted that the reduction in tax, fee and facility provision would lead to a redistribution of proceeds among the central government, the municipal government and developers.

### **Upgrade rather than demolish**

As discussed before, because of the cheap labor and expensive materials in China, the cost of redevelopment will be widely reduced if upgrading is adopted instead of demolishing and rebuilding. However, this strategy is applicable only to old housing of considerable quality. The other drawback is that in cases of upgrading, the floor area that can be added to the existing stock is usually modest. Therefore, the capability to expand the living space of sitting residents is often restrained. Moreover, there will only be very limited space, if any, available for commodity housing or commercial uses, which is often the major source of return in redevelopment projects.

### **Develop for the highest and best use**

Xiaohuocang project in Beijing's ODHR program was the only one that reached the breakeven point while maintaining 100 percent on-site replacement. This project designated part of the land for commercial use. Because housing may not be the most profitable use on the central city site, developing the land according to its best and highest use will bring the highest return, and thus enable the developer to subsidize housing on a relocation site. This strategy may require the assistance of the planning department for converting land uses.

### **Reduce regulatory risks**

As mentioned before, China's real estate market has experienced radical undulations since it was initiated in 1987, mainly due to policy shifting. Regulatory risk may be the most important risk for investors in China. "Chinese property market has always worked on leverage rather than commitment, letters of intent rather than firm contracts, options rather than obligations" (Sender 1993, 69). By decentralizing power to local governments, the policy making cycle will be shortened. More importantly, in the long run, by clarifying and simplifying the application and inspection procedure, formalizing the process of trading, and building an appropriate legal support system to enforce contracts, the Chinese government should turn eventually from the reliance on policy to law, so as to reduce the instability caused by shifting policies.

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<sup>31</sup> It should be noted that this figure might have included compensation fees for former users.

### **Invigorate competition**

Encouraging competition among suppliers will help establish market rate profits for developers and lead to higher efficiency. This requires the government to facilitate the entry of developers and establish effective information channels. To facilitate entry, the competitive ground for both public and private developers needs to be leveled and restrictions on eligibility for development should be moderated. Effective information channels call for complete publication of information, in which China has much to improve.

### **Moderate density and height control**

Strict density and height control, such as that applied in Beijing, have bounded developers' potential to increase the floor area rebuilt on central city sites, and thus restrict the available area to sell as commodity housing. This has contributed to the financial failure of many redevelopment projects in Beijing, where land rent discrepancy between the city center and the suburbs is fairly high. As situations permit, the government may want to consider loosening the standards a little so as to ease the financial status of redevelopment projects. This strategy should be applied cautiously because it may conflict with the goal of protecting historical and cultural cities.

### **Increase the incomes of residents**

By increasing the incomes of residents, housing demand will increase, and more demand implies greater returns. Housing can also be made more affordable by establishing an effective housing mortgage system that expanding the ability of residents to purchase. The housing mortgage was first adopted in Shenzhen in 1992 by the People's Construction Bank of China and has later been provided in other places ("Mortgages Come to Shenzhen" 1992). The loan amount has been set up to 70 percent of the value of housing being purchased and the loan period has been extended to 15-20 years.

## **DECREASING SOCIAL COSTS AND ENHANCING SOCIAL BENEFITS**

Social as well as economic costs and benefits should be considered when implementing a renewal project. The most substantial social costs or benefits in redevelopment projects involve the satisfaction of the sitting residents. Despite the improvements on physical living conditions, residential redevelopment in Chinese old cities frequently calls for large-scale decentralization of population as a result of the rise of market forces to restore land value and develop tertiary industries in city centers. In the decentralization process, most of the relocated citizens still prefer to live in the city center due to better amenities and job opportunities. In some cases, sitting residents are so unwilling to move away that developers have to resort to legal procedures to solve these disputes<sup>32</sup>. Nevertheless, despite the unfavorable impacts of gentrification, it seems the decentralization process will continue as the market gains power. One possible way to alleviate the negative effects of relocation on residents is to enhance the attraction of the city fringes and suburbs, through high-speed transit, improving amenities and, most importantly,

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<sup>32</sup> In fact, the first lawyer hired by an enterprise in Beijing was to solve a dispute on relocating residents in 1980 (Xinhua General Overseas News Service, April 19, 1985).

providing jobs. Also, by monetizing the in-kind compensation, residents will have more flexibility to choose the location.

### **Efficient mass transit system**

Transportation played an indispensable role in accelerating the decentralization in the US after WWII. In China, however, the level of productive forces is still low, and the average income of citizens is moderate. Moreover, China has the largest population in the world, and domestic resources per capita are limited. It is therefore not feasible for China to develop the private car as a major transit tool and the express mass transit system may be a better solution. Efficient mass transit will not only greatly reduce commuting times and enhance the accessibility of suburban sites, but also increase the long-term competitiveness of the city. Hopefully, high-speed transit, combined with cheaper land prices and a better environment, will attract citizens and industries out to the suburbs. Despite the budgetary limitation of municipal governments, express mass transportation should be a priority of development.

### **Improve amenities**

Although in recent projects, it is required by planning ordinances to develop a certain number of complex facilities in residential areas based on total population, the quality of these facilities is often doubtful. This is an important reason that relocated residents are often more attached to the old sites in the city center. Securing amenities of comparable quality in addition to quantity should be a major consideration in the planning of future relocation projects in suburban areas.

### **Coordinate the decentralization of industries and the relocation of residents**

In China today, along with superior amenities and infrastructures, the city still provides the majority of employment, despite the government's effort to remove secondary industries out of the city proper, policies to decentralize industries and decentralize population are uncoordinated in Chinese old cities today. Thus some people whose workplace moved to the suburbs still live in the city, while others who moved to the suburbs have to work in the city. This not only increases avoidable wastes of time and energy, but also aggravates the overloaded transportation system and the fragile environment. One's workplace and settlement should be planned adjacent to each other so as to reduce the commute distance. Coordinating the decentralization of population and that of industries is essential to ensure the success of either of these two processes.

### **Promote maintenance**

The poor maintenance of suburban sites is also a problem. Public facilities, such as elevators and lights, are inadequately maintained. In addition, due to the lack of social ties among neighbors, safety is sometimes a problem. Because developers usually cannot make any profits from the housing for relocation, they have no incentive to improve the maintenance of the housing. When housing goes into the market and the supply is obligated to respond to the demand, this phenomenon will naturally disappear. It may be difficult to enforce developers to ensure proper maintenance because this increases costs to them. An alternative is to organize citizens themselves, with each household contributing a share to fund the costs for public facilities and for hiring someone in charge of the security of the neighborhood.

**Monetize compensation**

To compensate relocated residents with money rather than in-kind housing will increase the flexibility of the residents. They can choose in the market the location and type of housing they want, so that higher efficiency will be achieved. Again, this strategy has its risk. When the housing market is not yet mature and the price of commodity housing is distorted, it may endanger the interests of relocated residents by simply offering them a certain amount of money that cannot parallel the price of the commodity housing on the market.

**Encourage the market for the right of on-site replacement**

In cities where a certain rate of on-site replacement is still mandated, the government should normalize the procedures used for trading the right of on-site replacement. In doing so, the satisfaction level of both the seller and the buyer will be enhanced and higher efficiency will be obtained.

This paper gives an overview of the extensive process of residential relocation arising in China's old cities. Though the focus of this research is on old cities, some of the proposed policies may serve the general purpose of urban residential redevelopment in China. Continued research is needed on social changes caused by large-scale relocations, on the relationship between housing and land reform and redevelopment, on the coordination of the public and the private sectors, on the full utilization of the non-profit cooperatives into the renewal process, and on the balance between the social benefits and economic profits.

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