

**Commentary: Property Taxes, the Right to Relocate, and Economic Development****Li Wei**

On 22 December 2022, Economics Nobel laureate Paul Krugman wrote in the New York Times that China's economy was "wildly imbalanced", blaming low consumption rates among the population. He said, "There has been a reluctance to allow the full benefits of economic growth to pass down [to the people]." In light of his comments, institutions have lined up to lower their expectations for China's economic prospects.

The ideas expressed in the opinion piece are nothing new. In fact, Chinese and foreign economists have discussed the issues raised by Krugman at length. The crux of the problem is that the market has already shown a conservative attitude towards the development of China's economy, and this attitude was "heretical" just a year ago. Although Krugman's remarks are a bit of a cliché, they give us pause to think: What is the point of economic development? In layman's terms, we believe it is to allow people to eat, drink and be merry, or more officially put, to increase residents' consumption. We no longer need to ask ourselves if China's domestic consumption rate is low, but instead, why this has come to pass? As with many things in China, the answer is in structural issues.

Currently in China, local governments operate as dispatch agencies of the central government, and are assessed as such on the basis of their performance. The assessment standard is mainly GDP growth. Under normal circumstances, when the GDP growth rate is fast, local officials are likely to receive promotions. Investment is the easiest way to bring about GDP growth, and China's economy has been mainly driven by investment in the long run. To achieve higher GDP growth, local governments have to invest more in the local economy. But to invest, you must find an investor. That's why almost all local officials tout nearby investment schemes. Under the pressure of performance appraisal, local governments look for resources to invest in construction, collecting hidden taxes from residents through land transfers and other means to boost development. For public services that don't generate as much revenue – such as medical care, education, and pensions – they simply "save as much as possible."

An important point to bring up here is infrastructure. This is indeed a part of public services, but even if it loses money, local governments are happy to make an effort here, in stark contrast to their attitudes towards medical care, education, and elderly care. The reason why local governments do this is that although infrastructure may not in itself bring benefits, especially short-term benefits, it carries with it investment and therefore is conducive to economic growth. Building subways lead to local promotions. The assessment standards are the same. Infrastructure investment increases the value of neighboring plots of land and the attractiveness of the city, leading to population inflows. This aligns it with the role of public services such as medical care, education and elderly care. However, the existing system tends to lead to excessive infrastructure construction, and excessive infrastructure construction leads to three potential problems. One is diminishing marginal utility.

Two, massive investments in infrastructure crowd out other public service projects. It is easy to understand that if more money is spent on infrastructure, there will be less money for other public services. Three, it will create an enormous debt burden. Infrastructure construction tends to rely on highly leveraged operations. When the economy grows fast, these debts are not important, but when economic growth slows down, these debts burden local financial resources and can cause systemic risks. Therefore, the effect of infrastructure on local economies and people's lives is relatively complicated, and the key is a matter of degree.

But this doesn't stop us from drawing an important general conclusion, namely that the most important reason for the lack of certain public services in China is not financial dislocation, meaning that local governments receive too little fiscal revenue, but that public services are provided on the whole by local governments. There is a distinct mismatch between financial power and actual power. The fiscal misplacement theory is relatively one-sided. According to the above description, the root cause of missing public services such as medical care, education, and elderly care that are meant to be offered by local authorities is a lack of enthusiasm. In economic terms, we are talking about a lack of incentives.

Local governments collect hidden taxes from residents through land transfers and other methods. When this happens, residents' disposable income falls, and spending power reduces. The lack of public services such as medical care, education, and elderly care makes people nervous to spend their reserves, as they need to save for all eventualities. How would it ever be possible for consumption rates to increase?

To change this situation, we need three types of reform: weakening the central government's GDP-based assessment of local governments. This is a necessary condition, but not a sufficient condition.

The second is to gradually reduce local officials' income from land transfer fees, cut down on monopolistic land trading by local officials, allow collective land to list freely on the market, and introduce property taxes. Reducing the monopoly of local governments on the primary land market can help liberalize the land market, which will improve efficiency and benefit the entire economy, while reducing the hidden tax revenue of local governments. The people will benefit too. And to replace land transfer fees, property taxes will bring in fresh revenue. Such taxes will make providing public services a benefit to local officials. Once property taxes are levied, people coming into the area will increase the demand for local housing, raising local housing prices, increasing the local property tax revenue. More people mean more money. One of the best ways to increase the attractiveness of an area to residents is to provide better public services, which includes not only infrastructure, but also health care, education and elderly care. This way, local governments have an incentive to provide public services.

The third is to allow free movement of the population. Property taxes can increase the enthusiasm of local governments to provide public services, but there is a prerequisite. This is to allow free movement. To this day, China still has not completely removed such restrictions on its people. The

household registration system (hukou) still exists. If the population cannot relocate at will, people will have no leverage to make the authorities provide better services.

Furthermore, this also hinders the possibility of local governments to provide diversified public services. Specifically, each place has different attributes. Some are blessed with a good environment, some have a better economy, some have high-quality education, and some have strong medical capabilities. Different places have different advantages. From the perspective of residents, when choosing a place of residence, people will rationally optimize taxation, public services, and living costs, and this will have an impact on land prices. Leaving aside considerations such as taxation and cost of living, we can take public services as an example. When people can choose where they settle, every place will try its best to develop its comparative advantages in order to attract incomers. In this way, it will be easier for local public services to gain their own characteristics, providing choice and better welfare.

Finally, we should keep one thing in mind: In economic development, people are the purpose, not the tool. As mentioned above, the ultimate goal of economic development is enabling people to spend more, and investment should aim for the same. Only this can enable the Chinese nation to flourish and its people to live a better life.

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