Do investment and improvement demand outweigh basic consumption demand in housing market? Evidence from small cities in Jiangsu, China

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A B S T R A C T

Housing problems in China have recently aroused wide range of interests of scholars. Housing demand, which is a classical discussing point in academia, also acts as reference for governments to enact loose, tense or neutral housing policies. However, studies scrutinizing the housing demand structure, particularly from consumption and investment perspectives are scant. Existing researches have mostly focused on the mature housing market in large cities in China, and the housing market in small cities has rarely been addressed. In this study, housing demand is deliberated in two respective dimensions of rent/own and consumption/investment demand. Price elasticities are obtained through formulating demand functions of each demand category with micro-data collected through questionnaire survey in small cities in Jiangsu. Underpinned by the set of elasticity coefficients, detailed housing demand structure can be calculated proportionately.

Results suggest that the improvement and investment housing needs have outweighed basic consumption demand in small cities in Jiangsu Province. Housing price rising has a promoting effect on residential housing demand, which is in stark contrast to the existing studies on price elasticity of housing demand in large cities in China. Factors of urbanization significantly influence the housing need of residents in small cities. Improvement of urbanization rate would contribute to the consumption demand booming while prosperity of tertiary industry would boost improvement and investment housing demand. Not only could the analytic methodology of housing demand structure demonstrated in this paper be referenced, but the empirical answers carry vital implications for governments implementing diverse policy design in large and small cities in China.

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1. Introduction

According to the official statistics, the urbanization rate reached 57.4% in China in 2016 (National Bureau of Statistic, 2017). Classified as a rapid development (Mulligan, 2013), this stage of urbanization is characterized by large while less-efficient consumption of non-renewable energy (Barros, Coira, de la Cruz López, & del Caño Gochi, 2015), construction waste mounting (Cucchiella, D’Adamo, Koh, & Rosa, 2015), inadequacy of equity in terms of public health service and community facilities distribution (Borgonovi & Compagni, 2013) and what is in the deepest interests of urban residents, fast growing demand of housing (Development Research Center of the State Council, 2007). To alleviate the increasingly severe population issues in large cities in China, small and medium cities will gradually accommodate more rural migrants. The “National New-Stage Urbanization Plan (2014—2020)” clarifies that the

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emphasize urban development will be converted toward small cities and a housing system will be established which is market-oriented and meets diverse needs (State Council of China, 2014). Therefore, it is imperative to investigate the housing demand in the growing small and medium cities, which are progressively playing a critical role in achieving healthy development in the housing market and consequently sustainable urbanization. Owing to the unique administrative system in China, housing market conditions vary significantly at different administration levels. Previous studies on housing demand focus more on large cities with prioritized level of development whereas small cities are largely overlooked.

Housing demand can be studied through different perspectives. In terms of property right, housing demand can be characterized by rent and own, which are commonly addressed in studies with tenure choice model adopted (Lee & Trost, 1978; Raya & Garcia, 2012; Blanco et al., 2016). Some scholars further combine dwelling types with tenure choice to examine the housing demand distribution by virtue of discrete choice modeling (Cho, 1997; Garcia & Hernandez, 2008; Yates and Mackey, 2006). However, according to property buyers' psychological preference and demonstrated decision-making behavior, some residents make the decision (i.e. rent or own a house) simply for settlement while others treat property as an essential part of investment portfolio. Thus, it is necessary to re-consider the housing demand from both consumption and investment perspectives. If the investment or even speculative demand goes far beyond the consumption counterpart, governments should be enlightened to enact policies to curb the irrational speculative demand. Previous studies on housing demand have identified the consumption demand for housing. Unfortunately, few studies attempt to distinguish the investment demand from consumption demand of housing. To fill this gap, this study aims to examine the housing demands in small cities in China from both consumption and investment perspectives.

2. Literature review

There is no lack of studies on the housing market. However, vast majority of these studies were undertaken within the mature housing market in western countries and market of large cities in developing countries. Existing studies have generally addressed the issue at two levels. First, at the macro level, studies, which commonly adopts empirical methods; analyze the influence of economic fundamentals on the housing market. These include the relationship between urbanization and the housing market (Chen, Guo, & Wu, 2011; Mankiw & Weil, 1989), the relationship between housing price and the macro fundamentals (Bakshi & Chen, 1994; Stuart & Joe, 1999; Wang & Zhang, 2015), the operating mechanism of the housing market and policy experiments (Hillebrand & Kikuchi, 2015; Kwoun, Lee, Kim, & Kim, 2013; Paciorek, 2013). Interestingly, scholars recently incline to adopt spatial econometric models revealing the spatial distribution of housing price and related influencing factors. Accessibility to and community facilities and public services would enforce a positive effect on housing price (Huang, 2017; Wen, Xiao, & Zhang, 2017; Wu, Ye, Du, & Luo, 2017).

The second strand of the literature focus on the micro level, e.g. individual consumer's characteristics of housing demand behavior. The consumer choice theory in neoclassical economics is the most common theory adopted in such group of studies, which combine economic analysis with empirical study. These aggregate the tenure choice (Lee & Trost, 1978; Raya & Garcia, 2012; Blanco et al., 2016), estimates of demand elasticity (Chow & Niu, 2010; Eppe & Sieg, 1999; Eppe, Peress, & Sieg, 2010; Harmon, 1988), the choice of dwelling types (Cho, 1997; Garcia & Hernandez, 2008; Yates and Mackey, 2006), the choice of housing location (Hui & Liang, 2015; Wen, Zhang, & Zhang, 2014; Yi & Lee, 2014).

A large number of studies introduce demand factors to examine dynamics of housing price. Housing demand is therefore treated as intermediate to analyze the fluctuation of housing price (Kenny, 1999; Wang & Zhang, 2015). Similarly, a lot of studies investigate the residential housing demand from population and demographic perspective at household level. Stuart and Joe (1999) found that the variables of population migration and urban structure had a rather high explanatory power for changes in housing prices in California. Eichholtz and Lindenthal (2014) stated that age and other demographic attributes significantly determined the housing demand. In addition, other factors such as household permanent income, hedonic house price index are widely discussed in the literature concentrating on the housing demand functions. Income elasticity and price elasticity can be essential being generated from demand equation. The income elasticity was found ranging from 0.787 to 1 whereas the for housing market price elasticity varies from −0.5 to −0.9 (Chow & Niu, 2010; Eppe & Sieg, 1999; Eppe et al., 2010; Harmon, 1988; Polinsky & Ellwood, 1979).

Housing demand can be examined from the tenure choice perspective. The results of tenure choice serve as own-rent structure in market (Alex, 1985). Scholars tend to determine the determinants of tenure choice, analyzing housing characteristics, existing housing level and macro-economic context into consideration. Dispasquale and Wheaton (1996) pointed out that high-income households would choose to own a house with relatively high probability. Blanco et al. (2016) examined the role of household income in housing tenure choice in Latin American cities. Gan, Zuo, Chang, Li, and Zillante (2016) explored the determinants of migrant workers' tenure choice towards sitting in public rental housing considering socio-economic characteristics of tenants as well as housing adequacy. Similarly, tenure choice can be affected by administrative region characteristics and accessibility to private loans (Lee, Ho, & Chiu, 2016). Raya and Garcia (2012) compared various approaches been used in economic studies related to individual's housing tenure choice. Coupled with dwelling types, more complicated models have been developed to investigate residents’ housing demand. Cho (1997) developed an integrated model of tenure and dwelling type via a multinomial logit framework. Though housing demand is detailed by researchers from the tenure choice and dwelling type perspective, very few studies shed light on demand from consumption and investment perspectives (Yates and Mackey, 2006). Influential works on the specified topic are found by Ioannides and his colleagues. Henderson and Ioannides (1983) argued that the gap between the investment demand and the consumption demands presents the driving force of housing ownership decision. Ioannides and Rosenthal (1994) subsequently tested this theory via an ordered probit model of four categorized sub-tenure choices.

Integrating influences of urbanization into the housing market analysis framework plays a crucial role to highlight special social and economic background in a given period. Studies have been conducted to investigate the relationship between urbanization and housing price (Bakshi & Chen, 1994; Chen et al., 2011; Mankiw & Weil, 1989; Zeng, 2010), housing investment (Barot & Yang, 2002; Long & Wu, 2003; Tobin, 1969; Xiang & Lee, 2007), and housing demand (Desai, 2012; Edward, 1972; Xiang, Ren, & Liu, 2008). On one hand, urban housing price is the key economic variable which restricts individual's achievement of permanent citizenship. High housing price is the dominant factor for large cities that repel migrants (Chen & Liu, 2016; Lee, 2008). Research Group on China’s Economic Growth (CASS) (2011) finds that although China has achieved the land urbanization, the high housing price has prevented the flow of population, thereby adversely affecting the process of urbanization. On the other hand, the hiking of housing
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