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Editorial

Empty buildings, shrinking cities and ghost towns

Three years ago, we flew from Shanghai on a trip to the Yellow Mountain, a little over 300 kms west of the city. The plane landed an hour or so later at a small airport in a fairly rural part of Anhui province in the area of Huangshan, a couple of hours drive from the mountainous landscape that we were visiting. We were met by a translator who could speak perfect English but had never been out of China and rarely out of the region itself. As we drove towards the granite peaks, the first village we encountered was dominated by grey forbidding-looking high-rise towers, some 30 stories in height, arranged in serried ranks along the highway. A year ago after my trip to Wuhan, I wrote in this journal about the property bubble in China (Batty, 2014), referring to the fact that after the Credit Crunch in 2007–2008, China reflated its economy through massive lending, which went largely to build infrastructure such as the kind of housing we encountered. I referred then to Robert Peston's (2014) incisive documentary on the scale of this investment and all the worry it might bring if the Chinese economy slows with demand for its products declining worldwide. Another credit crunch of the kind seen in the west nearly a decade ago but of a different genesis will then be upon us. With this debt now rising at 15% of GDP each year and with the proportion of such debt already more than 200% of GDP (Xie and Cao, 2015), the consequences for China and the world economy could be dire. Peston (2015) has more recently followed up his documentary with another article, where he recounts that slowing growth in China now looks as though it could spark such a bust as credit is squeezed and debts are called in. Interestingly, the Chinese government has chosen in fact to lower interest rates which would appear to be akin to keeping the boom alive, with all the predictions that the crash will be so much greater once it happens. Of course, the notion of a crash is extremely controversial with bankers and government alike arguing that China is the first country, perhaps the only country ever, to defy or to be able to defy the laws of financial gravity!

Back to Huangshan. I asked the translator what the high rise were to be used for expecting the answer that they were new housing development but she simply replied 'investment'. I have mused on this reaction since then for although my translator was an intelligent young lady, she must have been somewhat conditioned by urban development in China during her life-time to think of such development differently from those of us in the west who always assume that anything built will be lived in or used in some way, quite quickly after construction has finished. Not so in China and particularly not so in the last decade since their great wave of domestic construction began which could be purchased by ordinary Chinese nationals. It is worth noting that until about 20 years ago, there was no such thing as property ownership in China and even now, if one examines the banking and taxation systems, it appears that there is a massive amount of cross-subsidy with respect to what ownership actually means. The debt generated to fund construction in the domestic sector is in fact generated by banks that are largely part of the state apparatus and those who purchase and invest in housing are simply paying back monies to these banks which is a kind of taxation or a subsidy by the people to the State to enable this massive urbanisation to take place. A very different feature of the Chinese economy from those in the west is that the State desperately do not want a property crash and perhaps, just perhaps, they have the wherewithal to avoid it.

There any many reasons why buildings remain empty, and we can identify at least three major forces that lead to this. First, buildings might remain empty until market conditions reach the point where demand rises to meet supply and usually this is assumed to be fairly rapid. This is not new but in the west, it mainly relates to properties for commercial use which are built speculatively and acknowledge some form of business cycle. This is quite characteristic, for example, of developments in large central business districts in world cities where vacancy rates can be as high as 10% in a building downturn but the norm is usually about 5%, and this is often assumed to be due to the kind of flexibility that is needed to keep the market working and responsive. In fact in China's top tier cities like Beijing and Shanghai, rates are similar but at the next level of city – so called tier-2 cities – rates are all above 20% and in places like Chengdu, they rise to 40% (Chen, 2014). When it comes to housing, however, vacancy rates in the west are much lower than commercial rates, something in the order of 2%–5%, but in China, they are a staggering 20% if not more. The causes of such high rates involve a second factor or force and that is investment.

Shepard (2015) in his recent book *Ghost Cities of China* tells the fascinating story of development after development, all constructed since the year 2000, which are largely unoccupied, and usually unfinished meaning that their interiors and some exteriors are not fitted out. These which comprise everything from commercial blocks and housing to hospitals and shopping malls, await people and activity to come to them, which the Chinese seem to assume with supreme confidence will happen. The assumption is that the State will prevail and China's continued urbanisation will generate activity that will ultimately provide the rationale for these developments. The argument is that if this is what all the stakeholders in the development process want, it will come to pass in such a tightly controlled financial nexus. In societies where development is largely driven from the bottom up, by some semblance of demand mirroring supply and vice versa, it is impossible to avoid the kind of speculation that leads to booms and busts. But in a world where peoples have undying faith in the government and in each other to keep the world ticking as they want it, then it is just possible that all these ghost developments will ultimately yield the investments that have been made, will be occupied and active and will ride out any bubbles that would appear to be endemic to every process of development.

There is even a sense in China that the current state of the property market does not resemble a bubble ready to burst and that the idea of a bubble is a particularly western way of looking at the world. This would be a tenable conclusion if there was some grand plan for how the Chinese economy and its property markets might develop but it is clear that no such plan exists. With China the biggest single source of cheap manufactured goods consumed in the west, the scale of the budget surpluses in national, regional and the largest city economies has lead to a massive growth in disposable income for the emerging middle classes and property has become one obvious source for these funds in a world where the kind of consumerism associated with west does not yet exist. The obsession with buying property and the belief that prices will rise forever is nicely described by Lesley Stahl (2013) in her CBS Report for *60 Minutes* which exposes the fact that many of these developments are simply located in places where there is no considered analysis of whether or not any demand for them will be forthcoming. In fact many if not most are characterised by a complete lack of any strategic assessment or planning. To an extent, these views might be tempered when the longer term urbanisation of China is considered but as we imply below, the notion of forced relocation is something that is becoming increasingly difficult in China (Justin, 2014).

This all turns on how much one believes that culture determines economy. For may own part, I tend to follow the Robert Peston's (2014, 2015) line that the laws of financial gravity – what goes up must come down or some version thereof – are hard if not impossible to buck. There will of course be some developments in China where people do not want to live and where the government cannot dragoon people into living. The China of Mao is long gone at one level and forced migration is more problematic now than ever before there. It is unlikely too in the next two decades or so that migration into China will resolve this development bonanza, and it is hard to see populations from overseas taking up these developments either to live or work or for investment. So if these ghost towns and cities are to be filled, it must come from continued economic growth and urbanisation based on the notion that urbanisation itself is an investment for growth. This may be the case in China so far, but it is certainly not the case in many rapidly developing urban areas in the developing world where growth can mean increased poverty.

The worrying feature of the idea that empty Chinese developments are somehow part of the Chinese way of doing things is that this has occurred only in the last 20 years or less. It is not as though China has any history of dealing with development where buildings are created with little thought to whether there is any demand for them or not. If we could point to long-lived experiences where such developments were ultimately colonised by a growing and mobile population, then there might be more confidence in their ability to develop infrastructure well in advance of its use. I am quite willing to consider the possibility that in China, the laws of demand and supply might be somewhat different from western capitalism because in some senses, the modern history of Communist China reflected this suspension of disbelief. But the process of urban development under way this past 20 years is much closer to the way such development is financed in the west where bubbles in housing and other property and land markets have dominated the last 200 years. If the demand for Chinese goods were really to go into free fall, from low growth in productivity in the west, massive second order automation of jobs in professional and tertiary industries as well as a reluctance of the Chinese to spend rather than save, the world economy could well be thrown into a somewhat different but deep seated recession once again. It only takes a switch in direction to enter a period when foreign capital in western markets is realised and withdrawn, for property prices to begin to fall, and it could well be that the first signs of a China crisis could begin in the west where there have been big purchases of property and industry in the last 10 years.

This second force is essentially a situation where demand for the supply of buildings does not yet exist or is well in advance of any demand that might arise. Supply without demand implies ghost towns and empty buildings. In fact, a third force is the same situation – supply without demand but this time, the demand has already been taken up and has simply dissolved away. The best examples of such emptiness pertain to towns founded on the rapid extraction of resources – boom towns created by the discovery of gold or oil – and demand for these towns and their buildings is only as long as the resources are available. In California and the American west, there are many examples of such structures which now exist as empty shells where the population has long gone. Perhaps, one of the most dramatic of all such empty towns is Detroit where some of its economic rationale has drained away, but this has been aided and abetted by chaotic city government as well as racial divisions. In some respects, the wider economic basis for the city still exists as it still the home of the US motor industry. It is much more likely to see towns becoming empty with their population dropping more slowly as their economic rationale changes, and as they find it hard to recapture the dynamics of growth that led to their establishment in the first place. Cities in America's rustbelt, Britain's northern industrial cities, the Ruhr in Germany and some cities in the former eastern Germany fall into this category (The Economist, 2015).

To an extent, this Chinese experiment in urbanisation is now being paralleled by other experiments in getting the population to engage in consumption and to move away from saving. This is likely to be a much harder goal to achieve for the growth of infrastructure depends on savings, whereas for the economy to remain vibrant, resources need to be transferred from savings to consumption to bolster Chinese industries. This is likely to be much harder to sustain because there is bound to be a major impact on the value of these developments.

China still remains a fascinating experiment in urban development and we can learn much about urban dynamics from the way these cycles play out during the next two decades.

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