

**LAND MARKET IN CHINA'S
MODERNIZATION: REGULATIONS,
CHALLENGES, AND REFORMS**

SU Fubing

EAI Background Brief No. 418

Date of Publication: 11 December 2008

Executive Summary

1. China's land market has experienced very rapid development in the past two decades. Land traded in the market increased by almost five times from 1995 to 2006.
2. Under the planning system, land was not a commodity and land market did not exist. China's need to attract foreign investment forced pragmatic leaders to relax ideological restrictions. The separation of land ownership and land use rights finally gave birth to a vibrant market.
3. The current land market has three defining features: state or collective ownership; separation of urban and rural land; and local governments as the sole legitimate agent for transforming rural land for urban use.
4. Local government officials have three major channels for leasing land to commercial users: one-on-one negotiations, auctions, and public tenders. In the past, the overwhelming majority of land leases were awarded through the least transparent method.
5. China's active land development is mainly driven by rapid modernization, industrialization, and urbanization in China; local governments' need for more revenue; and local official's motive for promotion and career enhancement.
6. Land market development has contributed to the overall economic development, including the rapid growth of industries and services in the Chinese economy. Many farmers migrated to cities and worked in these sectors. Revenue from land leases has improved local governments' ability to accommodate these changes.
7. On the negative side, local governments' de facto monopoly of the market has created too many distortions, including over-development of industrial parks

and manufacturing industries, and sky-rocketing housing prices in urban areas. It was also a hotbed for black market activities and corruption.

8. Another major problem with the current land system is the disenfranchisement of farmers from the land bargaining process. Millions of undercompensated farmers petitioned local governments and even protested on the street. This has undermined rural stability.
9. Low acquisition costs have also contributed to the continual decline of farmland in China. It is not clear if this decline will lead to food shortage or crisis in the future. But the government has pledged to reverse this trend.
10. The Chinese leadership has made some attempts to rectify these downsides in recent years. In order to curb land-grabbing local officials, the central government established a centrally controlled State Land Supervision agency. This vertical design was supposed to ensure policy implementation of central directives.
11. The central leadership is not ready for total land privatization but is tolerating and even encouraging some local experimentations, such as listing rural land on the market directly (*nong di ru shi* 农地入市) and selling/buying farmers' houses on the market (*xiao chan quan fang liu zhuan* 小产权房流转). These local experiments hold the promise of a more developed and efficient land market in China.

LAND MARKET IN CHINA'S MODERNIZATION: REGULATIONS, CHALLENGES, AND REFORMS

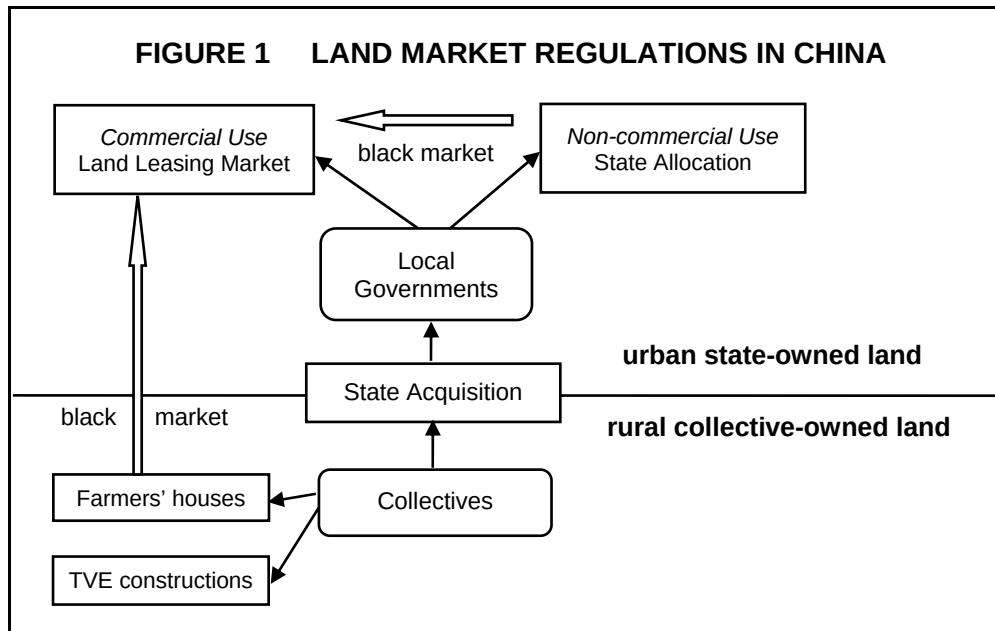
SU Fubing*

Land Market and State Regulations in China: some institutional background

- 1.1 Land market did not exist under the planned economy. Governments at various levels expropriated land and allocated it to users (state units and state-owned enterprises) free of charge or with some symbolic fees.¹ This system impeded efficient allocation of land in the economy. In 1987, China desperately needed foreign investments for its Shenzhen SEZ (special economic zone) and coined the new concept of land use rights. By separating use rights from ownership, pragmatic leaders effectively legitimized the transfer of land for commercial uses. Figure 1 sketches the structure of the current land management system.

* Dr Su Fubing is an assistant professor of political science at Vassar College and a visiting research fellow at EAI in the summer of 2008. After graduating from the University of Chicago, he taught at Brown University as the Joukowsky postdoctoral fellow. His main research interest is political economy with specific reference to China's transitional economy. He is currently working on several projects, such as village election, rural tax reform, land development, central-local political and fiscal relations. He would like to thank Prof John Wong going through the drafts of this background brief and for his helpful comments.

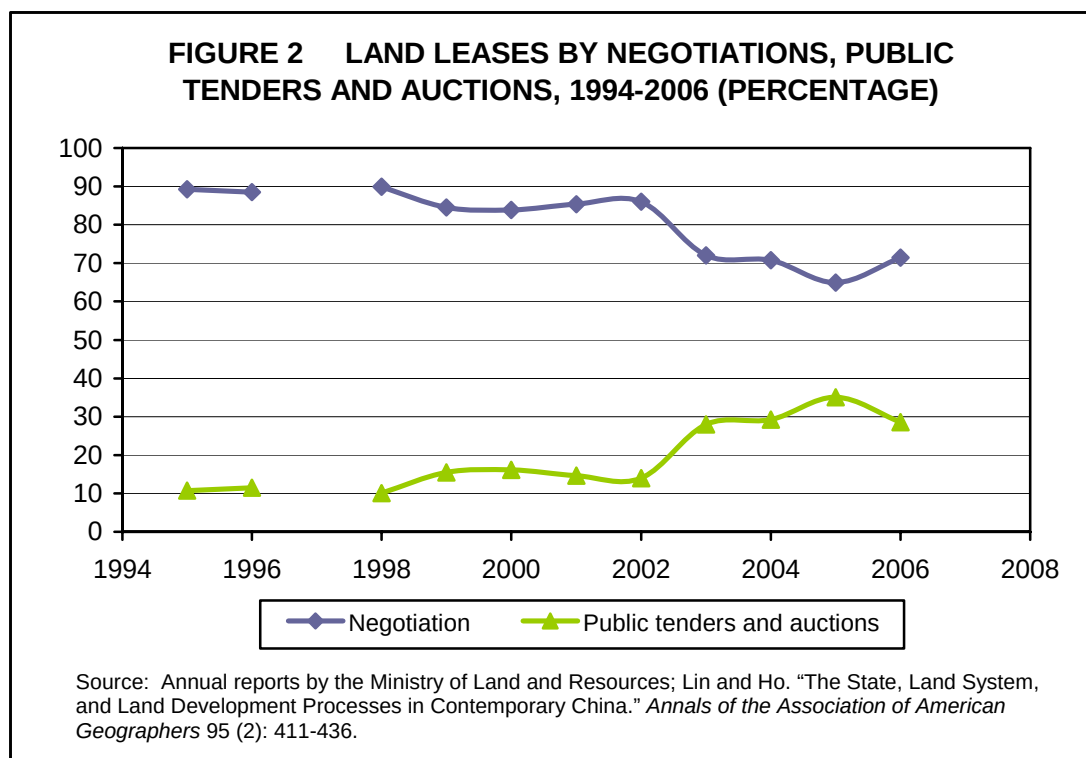
¹ John Wong and Liang Ruobing. 2006. "Changing Land Policies: Ideology and Realities." In John Wong and Lai Hongyi (ed.) *China into the Hu-Wen Era: Policy Initiatives and Challenges* (World Scientific). C. Cartier. 2001. "Zone Fever, The Arable Land Debate, and Real Estate Speculation: China's Evolving Land Use Regime and Its Geographical Contradictions." *Journal of Contemporary China* 10 (28): 445-469. Ho P. 2001. "Who Owns China's Land? Property Rights and Deliberate Institutional Ambiguity." *The China Quarterly* 166: 394-421.



- 1.2 Land is now publicly owned and no private ownership is allowed. In the countryside, rural collectives own land and have the power to expropriate land for local public projects, township and village enterprises, and village housing. In urban areas, land belongs to the state. Local governments allocate land for non-commercial uses, such as school buildings, highways, railroads, etc. They may lease land for other for-profit uses. For residential land use, the lease is 70 years. The lease is shorter for industrial and commercial usages (50 and 40 years, respectively). The demand for commercial land use skyrocketed in the early 1990s. With limited supply of urban land, local governments had to expand into neighboring rural land, most of which were farm land. According to the 1998 Land Administration Law, local governments can acquire land from rural collectives on the basis of “public interest”. This concept is hard to define but the ambiguity allows local governments to bend the rules easily and convert rural land for commercial development. In fact, under the system, local state acquisition is the only legitimate means for crossing the urban/rural land divide.
- 1.3 Naturally, local governments have turned this monopolistic power into a revenue-generating business. The Land Administration Law stipulates that local governments must compensate rural collectives and peasants for land

acquisitions based on the following: a) compensations for land (six to ten times the average annual output value of the land); b) resettlement funds (four to six times the land productivity); and c) compensations for lost crops. A policy by the Ministry of Land Resources further caps the compensation at not more than thirty times the derived land productivity. Even these moderate compensations are compromised in practice. Local governments routinely undervalued the land yield and underpay the farmers. When land is leased out in the primary market, land users must pay the expropriation fee. They also pay various stipulated land fees incurred in the transaction and a conveyance fee.

- 1.4 The last item constitutes the net profit for local governments. As de facto monopolists in local land markets, officials can rake in exorbitant revenues. In Fujian province, for example, one local government paid 10,000 Yuan per mu (亩) to farmers and collected 200,000 Yuan per mu from industrial users and 250,000 Yuan from residential developers (1 mu = 1/15 hectare). Systematic data are hard to come by, but according to some statistics available for 1998, China collected 49.95 billion Yuan and \$98.31 million dollars from both domestic and international land developers. Some scholars estimated that forty-nine percent were conveyance fees.
- 1.5 Local governments can lease out land through three mechanisms. They may negotiate with investors in one-on-one sessions (协议 xieyi) and come up with prices and other conditions. Alternatively, land leases may be awarded in more open processes, such as public tenders (招标 zhaobiao) and auctions (拍卖 paimai). The central government encourages the utilization of the latter two mechanisms but, until recently, local governments showed a strong preference for less transparent negotiations (Figure 2).



1.6 There are three major reasons behind the booming land market in China. First, Chinese economic development is built on export-oriented industries. To attract these footloose capitals, China must make large amount of cheap land available. Land fervor first started in some coastal provinces, like Guangdong and Fujian. Once these places took off, land development spread to other parts of the country. In addition, industrial wealth tends to increase demand for services, which further require land.

1.7 Second, local governments have strong financial incentives to lease land. During the 1980s, the central government implemented fiscal decentralization.² To regain financial control, the central leadership introduced a tax-sharing system in 1994. Among the three major taxes, local governments claimed only the business tax, but had to share the Value-Added Tax and the enterprise income tax with the central government. They started to face serious

² J Y Lin, and Z. Liu. 2000. "Fiscal Decentralization and Economic Growth in China." *Economic Development and Cultural Change* 49 (1): 1-23.

financial shortages in the second half of the 1990s.³ For these revenue-thirsty governments, land was probably the last untapped source for revenue growth.

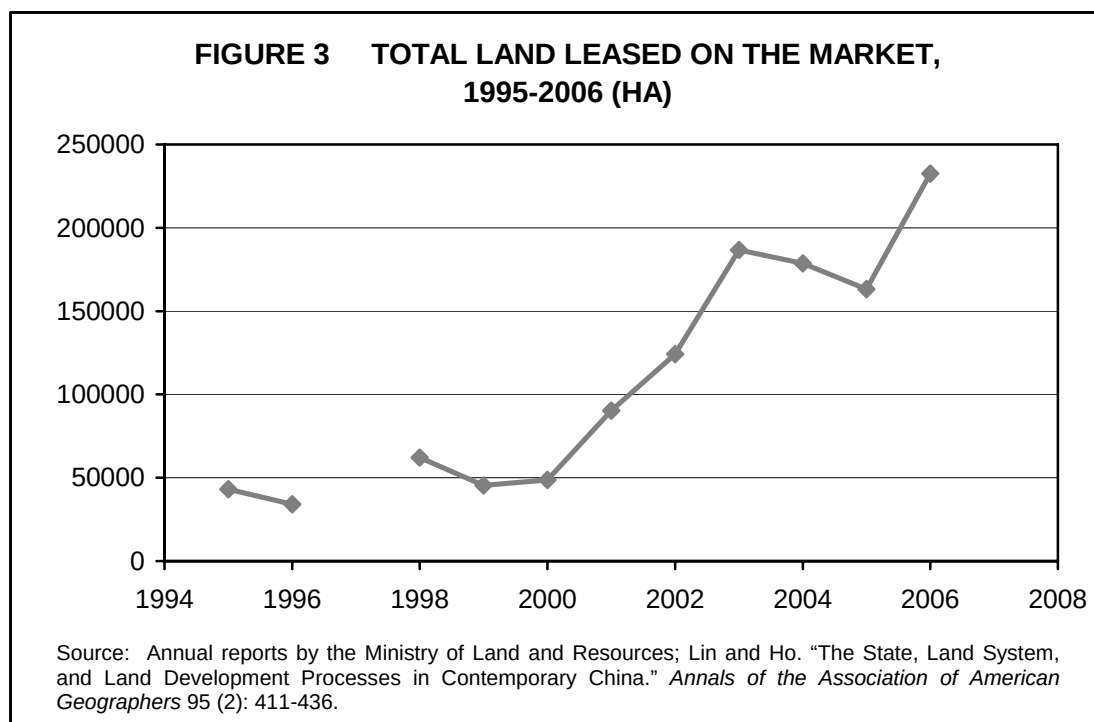
- 1.8 Finally, local officials are also motivated by career concerns. Since the early 1990s, the central government routinely set numerous policy targets, such as school enrollment, telephone coverage rate, hard-surfaced roads, etc.⁴ Local officials who could not meet these targets would face possible punishments. Several key economic indicators, like GDP, budgetary revenues, and foreign direct investments have assumed practical importance. It was common knowledge that local cadres who could promote faster growth in these categories had a better chance of being promoted. Local officials were eager to under-price land to win over foreign and domestic investors to their jurisdictions.

Land Development: some positive and negative consequences

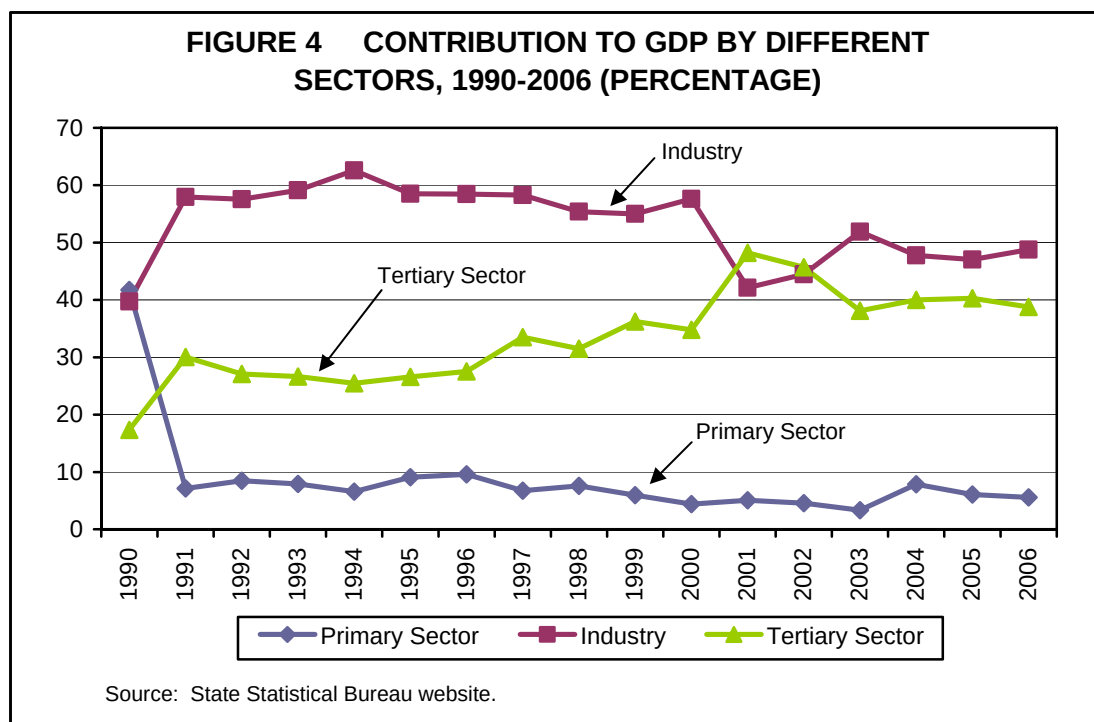
- 2.1 For economic, fiscal, and political reasons, local cadres developed land markets with great enthusiasm. In 1995 when official statistics about land leases became available, they showed that about 43,000 hectares of land were leased by various governments in the country. By 2006, that figure jumped to 232,500 hectares, a five-time increase in about ten years (Figure 3). Rapid marketization has led to some important changes in China's economy, society, and politics.

³ R. Bahl. 1998. "Central-Provincial-Local Fiscal Relations: The Revenue Side." In D.J.S. Brean, (ed.), *Taxation in Modern China*. Routledge: New York; London. X. Huang. 2007. "Exploring the Institutional Foundations of Land Issues in China." [in Chinese] *China Taxation* 2: 46-47.

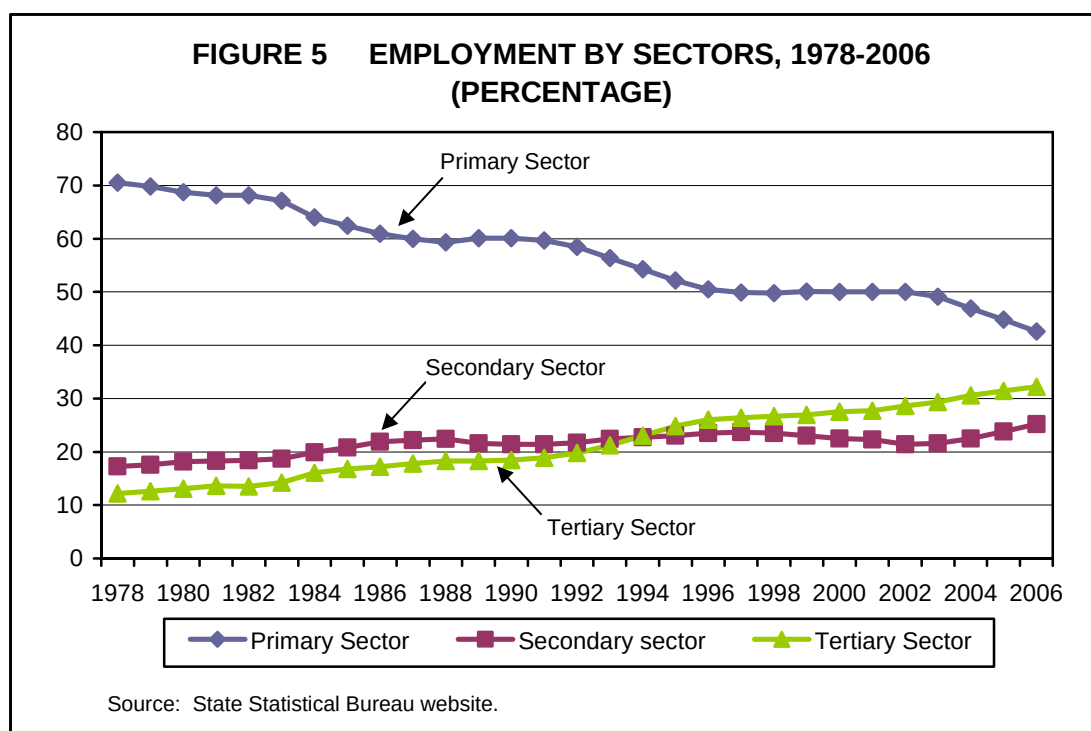
⁴ M. Edin. 2003. "State Capacity and Local Agent Control in China: CCP Cadre Management from a Township Perspective." *China Quarterly* 173: 35-52.



2.2 On the positive side, it has facilitated industrialization and urbanization and improved local public finance. First, rapid growth of industries and services. Land market in China has allowed land to be used in more productive sectors. Figure 4 shows the relative contributions to GDP by different sectors. Since 1991, both industries and services have maintained a huge margin over the primary sector (mostly agriculture). There are many factors behind the rapid development of these sectors but land should be one of them in this complicated process.



2.3 Second, fast urbanization. Industrialization needs not only land but also labor. Hundreds of millions of farmers have left their rural homes and migrated to urban areas. They worked in factories, construction sites, restaurants, hotels, and the service sectors. In 1978, 70% of the Chinese labor force was in the primary sector. By 2006, the majority had shifted to industries and services (Figure 5). This migration allowed rural labor to benefit from the modern economy. Migrants could not permanently settle down in major cities, like Beijing and Shanghai. But many small cities have relaxed Hukou regulations. Urban residency increased from 18% in 1978 to 44% in 2006. Many rural people gained access to basic education and health facilities in a modern society.



- 2.4 Third, improving local public finance. Rapid urbanization puts a strain on local infrastructures and requires more public investments. Revenues from land leases have partly mitigated this difficulty. Some researchers reported that land related revenues accounted for up to sixty percent of local government income. Data limitation does not permit a comprehensive assessment of the full fiscal impacts on local governments, but the contribution is substantial.
- 2.5 On the other hand, land marketization also brought with it a number of undesirable developments. First, land market distortions. While generally improving economic efficiency, the current land market is also distorted. Local governments are monopolistic suppliers of land in their own jurisdictions. To raise leasing prices, some local governments limited the total supply of land. Businesses and real estate developers were willing to go along because, as providers of non-tradable goods, they could pass the costs to local consumers. Local officials' strategy to manufacturing businesses was just the opposite. Since these enterprises were footloose, local governments had to lower land prices, including offering totally free land, to lure them. This

competitive land devaluation might be rational because manufacturing enterprises generate higher GDP growth and steady tax revenues. They also stimulate service sectors in the local economies.⁵

2.6 In each case, the distorted land supply led to negative consequences. Signs of over-investment in manufacturing started to appear in some regions. Abundant cheap land has worsened power shortage and increased pollution. In other areas, low compensations encouraged excessive land acquisition and under-utilization of land. Limited land supply has contributed to skyrocketing housing prices in many cities and the birth of vibrant black markets. Local government agencies transferred their state-allocated land to commercial users. Rural collectives, even farmers, bypassed state expropriation and rented their land and houses on the market. These activities disrupted normal functioning of the market and provided ample opportunities for corruption. In recent years, many major corruption cases were associated with land transactions.⁶

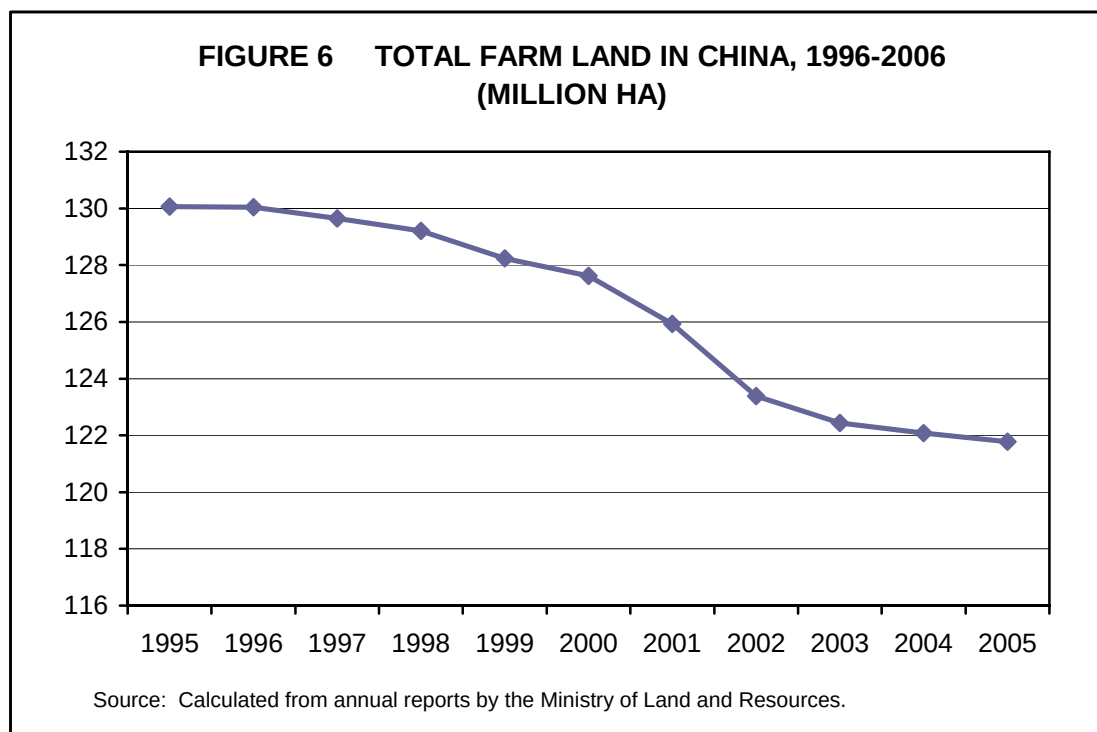
2.7 Second, under-compensation for farmers. Because land belongs to the collectives in the countryside, farmers are disenfranchised from the land conversion process. Local governments usually negotiated with rural collectives and paid only moderate compensations to land owners. This enabled local governments to compete with other regions in lowering leasing prices for manufacturing users. In some cases, even these moderate compensations did not all go to the farmers. As legal agents of rural collectives, local cadres seized part of the proceeds legitimately as collective revenue or embezzled the money. In the end, farmers only received very meager payments.⁷

⁵ Gao L. and Cao Y. 2003. "Low-Pricing in Land Transfers Won't Work: Investigations and Reflections on Land Leasing." *China Land* [in Chinese] No. 2.

⁶ World Bank. 2005. "China: Land Policy Reform for Sustainable Economic and Social Development." Washington.

⁷ Zhou. F. 2007. "Making Good Money: Governments and Peasants in Land Development and Transfers." *Sociological Studies* [in Chinese] No. 1.

- 2.8 Hangzhou city, for example, paid relocated farmers about 12,000 to 30,000 Yuan per person in 2002. According to the city's own social welfare department, at least 60,000 Yuan per person was required for these people to get a minimum monthly social security payment. Disgruntled farmers brought law suits to local courts and petitioned upper level government offices. Land development has forced 2 to 3 million farmers off land every year, making the situation in some areas quite explosive.
- 2.9 Third, farmland preservation. Insatiable hunger for land has also decreased China's stocks of farmland (Figure 6). Between 1995 and 2005, total farm land dropped by 6.4%. The rate might not sound big but for a regime that was traumatized by starvation during the Great Leap Forward, the leaders were quite alarmed by this trend. In 2007, Premier Wen Jiabao pledged to stabilize farmland to 120 million hectares. Further decrease was believed to undermine China's food security. Some food experts have challenged this claim of looming crisis. But it has become a sensitive political issue.



Building an Efficient Land Market: local experiments and central responses

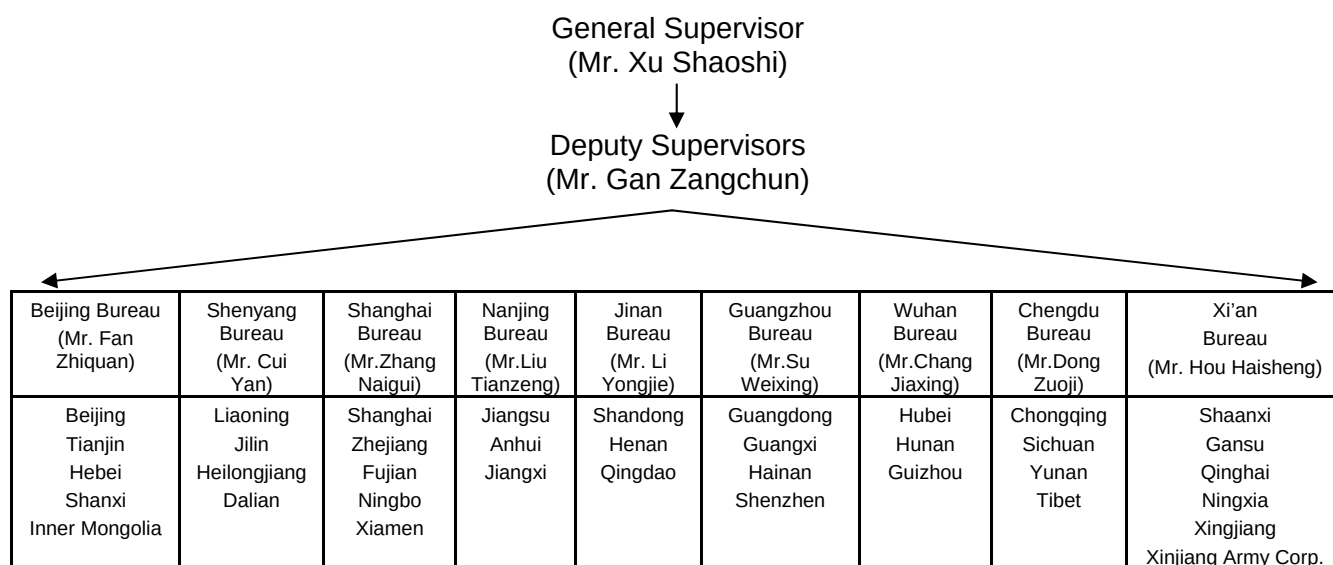
- 3.1 In the past few years, the central government has tried to rationalize this market. Given the huge uncertainties, the top leaders decided to take a gradual approach and encouraged local experimentations first. In the case of farmland protection, however, it adopted a top-down and more intrusive policy.

State Land Supervision system

- 3.2 From the central government's perspective, overzealous local officials were a major cause of problems in the rural areas. The center decided to establish the State Land Supervision (SLS) system in 2004 (Figure 7). This agency commands nine regional offices. In terms of institutional control, these offices are independent of the Land and Resources bureaus at various levels. This autonomy allows SLS inspectors to implement central policies more faithfully. Inspectors are charged with two main tasks. The first is to enforce farmland protection quotas signed between the central government and various local governments. The second is to supervise land market transactions and punish local officials who violate existing rules. In its first year of existence (i.e. 2007), SLS reclaimed lots of illegally occupied land and punished hundreds of local officials.⁸ Apparently, SLS tried to use this exposure to deter local transgressions.

⁸ State Land General Supervisor. 2008. *State Land Supervision Notice* (No.1). Available at SLS official site.

FIGURE 7 ORGANIZATIONAL STRUCTURE OF THE STATE LAND SUPERVISION SYSTEM, 2007



Source: No.1 notice issued by the State Land General Supervisor.

Land rights to farmers

3.3 Limiting local discretion from above is helpful. But it is equally, if not more, important to check their power from below. Enfranchising farmers in the land conversion process can weaken the local state's monopoly. One solution is to privatize farmland so farmers can negotiate with industrial users and real estate developers directly. This is not feasible in the current political environment. But many local governments have experimented with different methods of overcoming this restriction. Two models have received wide attention in recent years.

Nong di ru shi (农地入市 listing rural land on the market directly)

3.4 State expropriation applies to not only farmland but also farmers' housing plots and rural collectives' construction land. In 1995, Suzhou city of Jiangsu province first experimented with listing some rural land directly on the

market.⁹ Strictly speaking, it was against state laws. On 1 October, 2005, Guangdong became the first province to adopt this formula. It triggered a national debate but the central government endorsed it in 2006. The rural collectives turn themselves into share-holding corporations, with land as their assets and farmers as shareholders. The collectives then lease land to investors for development. The annual rents go to the shareholders. In some places, the rents go to the newly established farmers' social security funds first and the rest is allocated to the shareholders.¹⁰

Xiao chan quan fang liu zhuan (小产权房流转 selling/buying farmers' houses on the market)

3.5 Due to legal restrictions, the status of farmers' houses on the market has been quite controversial. The booming housing market has attracted many farmers to rent out their own houses to city residents. Some more entrepreneurial farmers and villages built new houses on their housing lots and sold them to urban dwellers. Since they did not pay conveyance fees, the prices were significantly lower. Due to the illegal status, however, the owners' property is not protected. Many owners of these houses as well as farmers and villages have fought to legalize these transactions. On 20 June, 2007, the Ministry of Construction issued a directive forbidding these deals. Interestingly, on 17 June, 2008, Beijing municipal government opened the possibility of selling farmers' houses on the market. It is too early to tell the fate of these houses because many local governments still upheld their early bans.

3.6 These experiments institutionalized farmers' participation, giving them an opportunity to benefit from the modernization process. Some analysts are proposing more reforms to further develop the land market, including some innovative concepts like land tickets (地票 di piao), land rights-welfare package swap (土地福利包置换 tu di-fu li bao zhi huan), and total land

⁹ J. Han. 2003. "Change Collective Land Ownership into Shareholder Ownership." *China Economic Times* [In Chinese] November 11.

¹⁰ C. Ding. 2003. "Land Policy Reform in China: Assessment and Prospects." *Land Use Policy* 20(2): 109-120.

privatization.¹¹ To rationalize the land market, Chinese leaders must address local governments' concerns. The local governments are the biggest winners of the current regime. By giving more rights and power to farmers, further marketization will undermine their ability to raise revenues. One possible solution is to introduce property tax and/or land appreciation tax. Once local governments develop a reliable source of revenue, their resistance to change may be mitigated.

¹¹ K. Zhu, and R. Prosterman. 2007. "Securing Land Rights for Chinese Farmers: A Leap Forward for Stability and Growth." *Cato Development Policy Analysis Series*, No. 3. Tao R. and Xu Z. 2007. "Urbanization, Rural Land System and Social Security for Migrants in China." *Journal of Development Studies* 43 (7): 1301-1320.