Regional Decentralization, Urbanization and Land Ownership in China

James Kai-sing KUNG
Hong Kong University of Science & Technology

Shouying LIU
State Council, PRC

Chenggang XU
London School of Economics, and HKUST

Feizhou ZHOU
Peking University

* The competent research assistance of Sun Xiulin is gratefully acknowledged.
Paper presented at China Task Force Meeting, Manchester 2007

- Organized by:
  - Initiative for Policy Dialogue, Columbia University, and
  - Brooks World Poverty Institute at the University of Manchester
  - July 4-5th 2007
Motivations

- Regional decentralization has played fundamental roles in Chinese reforms (Qian and Xu, 1993; Xu and Zhuang, 1998)
  - e.g., development of non-state firms, such as TVEs and private firms
- Massive privatization of non-state enterprises (esp. TVEs) initiated by regional governments by end of 1990s (e.g., Kung and Lin, 2007) but continuing private enterprise growth
- Local government’s incentives in “urbanizing” China (through infrastructural investments and farmland conversion)
  - Local government “revenue” perspective (e.g., Lin and Ho, 2005; Zhou, 2007b)
- Tradeoffs associated with regional decentralization
  - Escalating conflicts and disputes over property rights in land especially in rapidly developing coastal regions
  - Why state monopoly of land conversion and differential “status” of land ownership (collective versus state) matter?
Evidence on escalating land conflicts: Land issue accounts for 68.7% of total “three key rural issues” “SanNong Wenti (三农问题) problems, many erupted into violent conflicts.

CCTV Telephone Survey on Three Key Agrarian Issues
[YU, 2004]

Three Key Agrarian Issues[三农问题]: Agricultural production, Rural Governance, and Peasants’ Income.
Magnitude of “land-grabs” and reduction in arable land

- Land of an estimated 490 millions of farmers had been expropriated, many of whom are under-compensated (《财经杂志》, 14 May 2007)

- Illegal acquisitions of arable land by local government remained rampant in 2006; authorities vow to take measures to curb rampant exploitation of arable land by local governments on construction of villas, golf courses, and race tracks

- Majority of land disputes concentrated in rapidly developing coastal regions (Yu Jianrong, Oriental Outlook, 9/9/2004)
  - prevalent especially in Zhejiang, Shandong, Jiangsu, Hebei and Guangdong
  - forced eviction illegal conversion the main cause and county and municipal governments the primary target

- China now is left with just 20,000 sq. km. of land above the critical threshold (of 1,226,000) suitable for farming (Wen Jiabo’s government report 《温家宝政府工作报告》, March 2007), with about one-third of land lost in 2006 due to construction-cum-urbanization
Regional decentralization and economic reforms

- Provided incentives to local governments to develop local economies via:
  - Fiscal contracting system and development of township-village enterprises (as major source of extra-budgetary revenues)
  - Promotion based on local economic performance (per capita GDP, employment, FDI, etc.)
Regional decentralization and regional competition

- Regional yardstick competition works under conditions of regions being relatively self-contained and broadly comparable (Maskin, Qian, and Xu, 2000)
  - Personnel promotion and appointment of regional government officials are indeed based on regional economic performance (Li and Zhou, 2005)

- Fast development of non-state sector as a result of regional competition and regional experiments
  - Harder budget constraint of non-state enterprises
Regional decentralization and economic experiments

- Self-contained autonomous regions create conditions for regional experimentations for testing reform policies (Qian, Roland and Xu, JPE 2006)

- Region based reform experiments
  - property rights reform in agriculture (HRS)
  - setting up of Special Economic Zones
  - ownership transformation, social safety net, etc.

- Choice of experiments and developmental projects are determined by incentives of regional governments – race to the top/bottom?
Consequences of regional decentralization: empirical results

- Early surge of growth came primarily from non-state sector, such as TVEs
  
  - Lin-Liu (2000) use variations in fiscal retentions (1970-93) across province as proxy of regional decentralization and find positive contributions to economic growth
  
  - Jin-Qian-Weingast (2005) use 1980-93 data and find stronger fiscal incentives are associated with faster pace of non-state enterprise growth and SOEs reforms
Fiscal decentralization:

- Principal features of Fiscal Contracting System (财政包干制度)
  - Enterprise profit tax based upon administrative jurisdictions (county, township) and ownership (state-owned, collective)
  - Local governments were assigned the right to appropriate these taxes and were empowered with incentives to develop enterprises within their jurisdictions
Unintended consequences of fiscal decentralization: Decline of state fiscal capacity

- Under fiscal contracting central government unable to share benefits of enterprise growth to the same extent as regional governments (Wang, 1993, 1997)

  - local government understated profits of TVEs and maximized revenues from extra-budgetary sources

  - share of central government revenue in total government revenue was 46.8% in 1979, but decreased to 31.6% in 1993 (Wang Shaoguang, 1997)
Fiscal Recentralization:
1994 Tax-sharing Reform (分税制改革):

- Redefine tax rights: central government proposed to share 75% of transaction tax (增值税)

- A new tax category not based upon enterprise jurisdiction (township/county) and ownership (collective/private)

- Moreover, it does not vary with enterprise profitability (but based on volume of transactions using vouchers [发票])

- Marginal gains from TVEs expansion reduced as risks/costs (e.g. loans default) become fully borne by local jurisdictions, whereas benefits significantly diluted (due to sharing)
Figure 1. Fiscal (tax-sharing) reform of 1994

Before
- Corporate Income Tax
  - 100%

After
- Transaction Tax
  - 25%

Tax-sharing Reform

Local Government Revenues
Did fiscal recentralization stifle local economic initiatives?

- Local fiscal revenues plummeted from 80% in 1990 to 45% in 1994 and became stabilized since (Zhou, 2007a)
Regional decentralization is still the fundamental institution even under fiscal recentralization

- Regional governments enjoy residual control rights over land within their jurisdictions
- Control rights over land are used by regional governments for regional developments and generating revenues
- Revenue creation is effective for only the relatively more developed regions where land prices have increased
- For more developed coastal provinces, revenue loss from fiscal recentralization is more than compensated by land and tax revenues from government-led urbanization
An in-depth case study of 3 municipalities/counties in Zhejiang Province shows that (using S-county as example):

- Taxes related to land, construction and real estate development accounted for close to 40% of the budgetary revenues.

- Land-related fees roughly one-half of extra-budgetary revenues.

- Land conversion income—a new income category—made up 100% of “non-budgetary” revenue, and is about twice the size of budgetary and extra-budgetary revenues combined.
Profits from Land Revenue in S County, Zhejiang Province, 2003 (mn. Yuan)

Budgetary (Taxes) [519.8, 38.4%]
- Direct Land Taxes [14%]
- Indirect Land Taxes [26%]

Extra-Budgetary (Land Fees) [510, 51.5%]
- Urban Land Use Tax [2.34, 0.17%]
- Arable Land Occupancy Tax [77.39, 5.7%]
- Title Tax [110.27, 8.2%]
- Business Taxes [2%]
  (e.g. agent’s fee)
- Business Taxes from CRE [230, 17%]
- Corporate Income Tax from CRE [38, 2.8%]
- Property & Urban Real Estate Tax [61, 4.5%]

Non-Budgetary [1920, 100%*]
- Land Management Bureau Fees
- Finance Department Fees
- Fees from other Departments

Land Conversion Income [1920, 100%*]
  - By negotiation
  - By public tender
  - By auction
  - By listing

Note: CRE = Construction and Real Estate
% of budgetary revenue;
% of extra-budgetary revenue;
%* of non-budgetary revenue.
Budgetary Revenues

- **Business taxes** (营业税), an indirect land tax from construction and real estate had grown the fastest (100% and 40% between 2002 and 2003). Ditto property tax.

- Also the largest tax category among both direct and indirect taxes

- Why? 100% of Business Tax appropriated by local governments, whereas 40% of corporate income tax* goes into the central government’s coffers

- Explains construction and infrastructure development boom

* Effective from 2002
Share of land revenue in Extra-budgetary revenue

- land revenue (fees) accounts for 60-80% of total extra-budgetary revenue [Zhou, 2007b]

<table>
<thead>
<tr>
<th></th>
<th>S County</th>
<th>J City</th>
<th>Y City</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Million Yuan RMB</td>
<td>%</td>
<td>Million Yuan RMB</td>
</tr>
<tr>
<td>Administrative fees</td>
<td>480</td>
<td>16%</td>
<td>1,360</td>
</tr>
<tr>
<td>Government Funds</td>
<td>510</td>
<td>18%</td>
<td>100</td>
</tr>
<tr>
<td>Land Conversion Income</td>
<td>1,920</td>
<td>66%</td>
<td>2,000</td>
</tr>
<tr>
<td>Total Extra-budgetary Revenue</td>
<td>2,910</td>
<td>100%</td>
<td>3,460</td>
</tr>
</tbody>
</table>
Land Conversion Income

- Not a tax but a rental fee/income provided by the user to the government for converting land into non-arable use

- Came into existence in 1989 under a shared arrangement* but from 1994 center allowed local governments to retain 100% for incentive reason

- Became the single most important source of “extra” or non-budgetary income for local governments

- Land conversion income began to assume importance only after 2000
  - of the 10 billion yuan received between 1992-2003, 9.1 billion was accounted for between 2001-2003

* “Temporary regulation on the Transfer of Use Rights of State-owned Land in Towns and Cities” (《城镇国有土地使用权出让和转让暂行条例》)
Singular importance of commercial usage in land conversion income

- Public welfare projects (公益事业项目): road, water education, healthcare, etc. typically require government subsidies to developing land

- Industrial land use also not profitable due to competition

- Profits come mainly from commercial and residential development (conveyance fee)

- Net profits from a county in Zhejiang as large as entire budgetary revenues in 2003

- Provides powerful motivations for local governments to engage in land expropriation – both legally and illegally
### Differences in land price between industrial and commercial usage [{\textit{mu}, 10,000 yuan}]

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Industrial</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Area</td>
<td>909</td>
<td>2597</td>
<td>1215</td>
<td>4602</td>
<td>4220</td>
<td>N.A.</td>
</tr>
<tr>
<td>Land Price</td>
<td>13</td>
<td>15</td>
<td>14</td>
<td>12</td>
<td>13</td>
<td>N.A.</td>
</tr>
<tr>
<td>Total Price</td>
<td>12259</td>
<td>40377</td>
<td>17063</td>
<td>54076</td>
<td>53008</td>
<td>N.A.</td>
</tr>
<tr>
<td><strong>Commercial</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Area</td>
<td>214</td>
<td>196</td>
<td>392</td>
<td>268</td>
<td>3170</td>
<td>633</td>
</tr>
<tr>
<td>Land Price</td>
<td>59</td>
<td>74</td>
<td>34</td>
<td>182</td>
<td>64</td>
<td>239</td>
</tr>
<tr>
<td>Total Price</td>
<td>12510</td>
<td>14615</td>
<td>13620</td>
<td>47719</td>
<td>192454</td>
<td>138770</td>
</tr>
</tbody>
</table>
Costs of land conversion

- Profits from land conversion income = revenues from properties development, minus costs
  - land conversion fees (to government departments and special funds)
  - land compensation fees (to the farmers)
  - land development costs (roads, water, electricity, sewage, telecommunications, etc.)
  - “service fee” paid to land management bureau (2% of conversion income)
Total costs of land conversion: an example

Land Seizure Costs for Land Reserve Center in S County, 2003
(Units: Mu, Million Yuan RMB)

<table>
<thead>
<tr>
<th>Land Use</th>
<th>Area of Land Acquired</th>
<th>Cost of Obtaining Land</th>
<th>Percent of Costs in Total Land Price (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>(1)Compensation for Land and Buildings</td>
<td>(2)Government Tax Fees</td>
</tr>
<tr>
<td>Commercial Use</td>
<td>62.85</td>
<td>1</td>
<td>1.97</td>
</tr>
<tr>
<td>Mixed Use</td>
<td>419.1</td>
<td>11.53</td>
<td>15.88</td>
</tr>
<tr>
<td>Residential Use</td>
<td>2,715</td>
<td>120.27</td>
<td>95.93</td>
</tr>
<tr>
<td>Total</td>
<td>3,196.95</td>
<td>132.81</td>
<td>113.78</td>
</tr>
</tbody>
</table>
A case study indeed confirms:

- Land expropriation in Maichen Township, Xuwen County, Guangdong Province (Zhou Qiren, 2004)

- Compensation fee is 40 thousands per mu, and so total cost of expropriating 90 mu of land is 3.6 million yuan

- But average selling price is 880 thousand yuan per mu, which means the township can recover the cost from selling only 4 mu

(source:〈生活时报〉1998年12月24日，焦辉东：“徐闻县迈陈镇愈演愈烈的征地纠纷”〈南风窗〉2001年12月10日，记者章文、陈勇：“失地之痛——迈陈镇违法征地纠纷案四年回顾”。)
Expropriation/Compensation fee is the fee paid by the state unit to the collectives upon land expropriation (Land Management Law of 1986 土地管理法). Representing a tiny fraction of local government’s conveyance fee, it consists of:

- land compensation fee: 6-10 times the average output (based upon original usage) from previous 3 years
- resettlement allowance: 4-6 times average yield of former 3 years on that plot
- crop compensation fee: varies according to province, municipality or autonomous region
So is state monopoly

- Whenever farmland is to be converted into non-farm usage land it has to undergo ownership change—from collective to state.

- The law empowers the local government to requisition land “within limits” (subject to quantity constraint and pretty insubstantial compensation).

- That explains why land is increasingly converted from the peasants’ collective farmland—from 32% in 1999 to 76.5% in first nine months of 2004 in Land Reserves in S County.

- Worse (than compensation being low), many failed to get the compensation:
  - some due to outright corruption of village cadres
  - in others the funds are earmarked for old-age pension expenditures.
Interdependence between land and industrialization/urbanization

- Regional industrialization/urbanization depends in part on land allocation
- Regional land price depends on regional industrialization/urbanization
- For industrialized regions
  - Land as “second financial system” (第二财政): sizeable, with residual control (outside the budget)
  - “First financial pillar is industry, second is land” (第一财政靠工业、第二财政靠土地)
Regional governments’ reactions to fiscal recentralization

- Fiscal recentralization predisposed local governments to shut down TVEs and small SOEs and turned to developing land and related activities as an alternative income source.

- Within budget emphasis placed on business taxes related to construction and infrastructural development.

- Exceptionally strong incentives to enlarge income source outside of budgetary scrutiny—land conversion fees.
Property rights: what happens to peasants’ contractual rights when landownership is converted?

- Nature of property rights also change from collective usage (agriculture) to state (industrial, commercial, etc.)

- Peasants’ contractual rights are terminated upon ownership change/usage conversion as they are originally assigned with bundle of rights (use, income, limited transfer) confined only within agricultural production

- Bundle of “contractual rights” replaced by one-time compensation (far below the value of long-term use right?)

- Any increase in the value of land—be it due to industrialization or commercial use—the peasants won’t benefit from the process
“Nanhai Model” as partial solution to protect peasants’ collective rights in land?

- Geographically belongs to fertile PRD region in southern Guangdong Province

- Faced with an influx of capital from Hong Kong and domestic private enterprises for land after 1992, local government decided to (re-)establish “cooperatives”

- Reconsolidate/recollectivize farm holdings from the households and divide them into three distinct usages (zones): agricultural, industrial, and commercial/residential

- In exchange for shares from which dividends, accounted for 49% of the rental revenues, are distributed (the other 51% earmarked for local public goods provision)

- Dividends account for an important share of farm household income as long as industrialization continues
Advantages of Nanhai model

- Promote industrialization at costs much lower than those necessitated by conversion into state ownership*

- Permit peasants to retain their income right associated with original (agricultural) contractual arrangements

- Moreover, to benefit from the higher income resulting from a different—industrial—usage (“differential land rents”)

* Land conversion fee typically constitutes the single largest item of payment; plus there are arable land occupancy tax, land management bureau fee, irrigation construction fee, agricultural insurance and rehabilitation funds, and such cost items to be reckoned with.
Limitations of “Nanhai Model”

- Shares are based upon community membership and exhibit characteristics similar to those of land:
  - equal entitlement
  - differentiated according to age and adjusted for changing residential/occupational circumstances

- Shares cannot be transferred, bequeathed, inherited or pledge as collateral
  - closed to only community members and as such discourage physical mobility of people and capital

- Community members focus singularly on dividends growth, yet supply of land (for industrial use) is running out………
Property rights remain at odds with the law (despite cooperation between local cadres and peasants)

- **Contravening the Law**: 1998 Land Management Law stipulates that peasants’ collective land cannot be sold (出让), transferred (转让), or rent out for non-agricultural construction (出租用于非农建设).

- Guangdong provincial government responded with “Management Regulations governing Transfer of Use Right of collective land in Guangdong Province”, according to which:
  - there is no need to convert the collective farmland into state ownership for non-agricultural purposes
  - as such owners of collective land are able to continue enjoy income rights associated with ownership, including the value-added created as a result of changing usages
Relationship between per capita GDP growth and total land conversion, by province

Graphs by year

- 1999: Coef. of Corr. = .725***
- 2000: Coef. of Corr. = .884***
- 2001: Coef. of Corr. = .861***
- 2002: Coef. of Corr. = .886***
- 2003: Coef. of Corr. = .928***
- 2004: Coef. of Corr. = .950***

* significant at 10%; ** significant at 5%; *** significant at 1%.

Source: Almanac of China's land and resources [中国土地资源年鉴].2000-2005
Relationship between per capita GDP growth and illegal land conversion, by province

Graphs by year

- **1999**: Coef. of Corr. = .341*
- **2000**: Coef. of Corr. = -.053
- **2001**: Coef. of Corr. = .484***
- **2002**: Coef. of Corr. = .827***
- **2003**: Coef. of Corr. = .639***
- **2004**: Coef. of Corr. = .645***

* significant at 10%; ** significant at 5%; *** significant at 1%

Source: Almanac of China’s land and resources [中国土地资源年鉴].2000-2005
Relationship between per capita GDP growth and industrialization, by province

Graphs by year

- **2003**
  - Coef. of Corr. = .926***

- **2004**
  - Coef. of Corr. = .964***
Relationship between per capita GDP growth and commercialization, by province

Graphs by year

2003

Coef. of Corr. = .543***

2004

Coef. of Corr. = .795***