

# Regional Decentralization, Urbanization and Land Ownership in China

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## ■ **Organized by:**

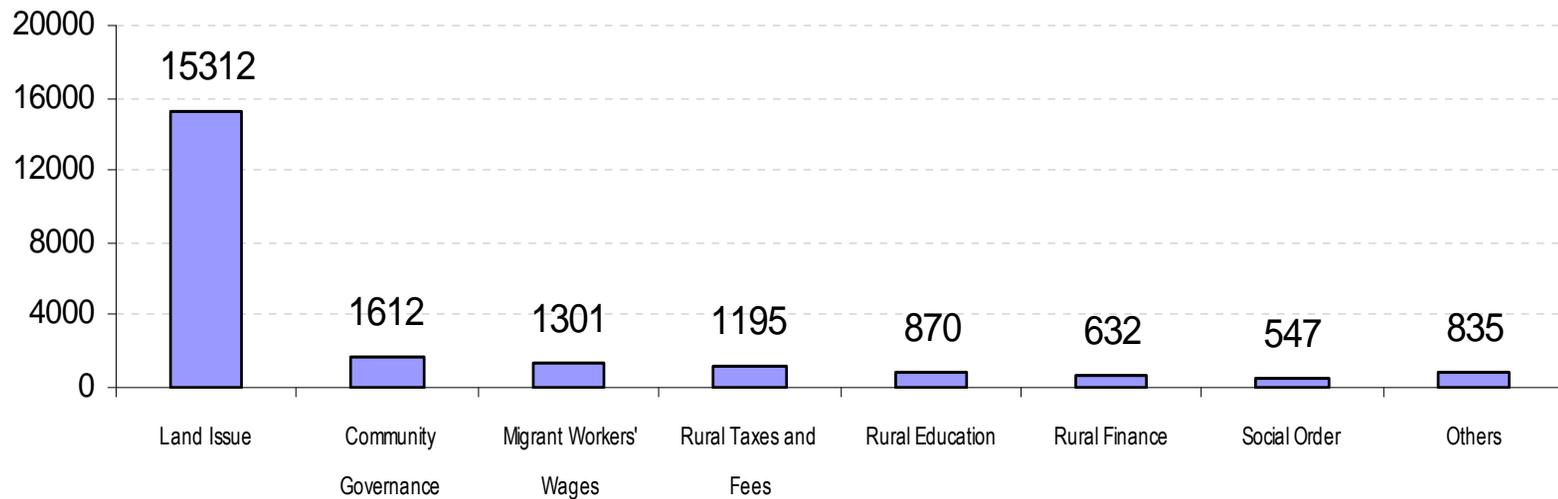
- **Initiative for Policy Dialogue, Columbia University, and**
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# Motivations

- 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.

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# 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
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# 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.)
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# 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
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# 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?
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# 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
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## Fiscal decentralization:

### The Fiscal Contracting System (circa.1980-1993)

- 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
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## **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)
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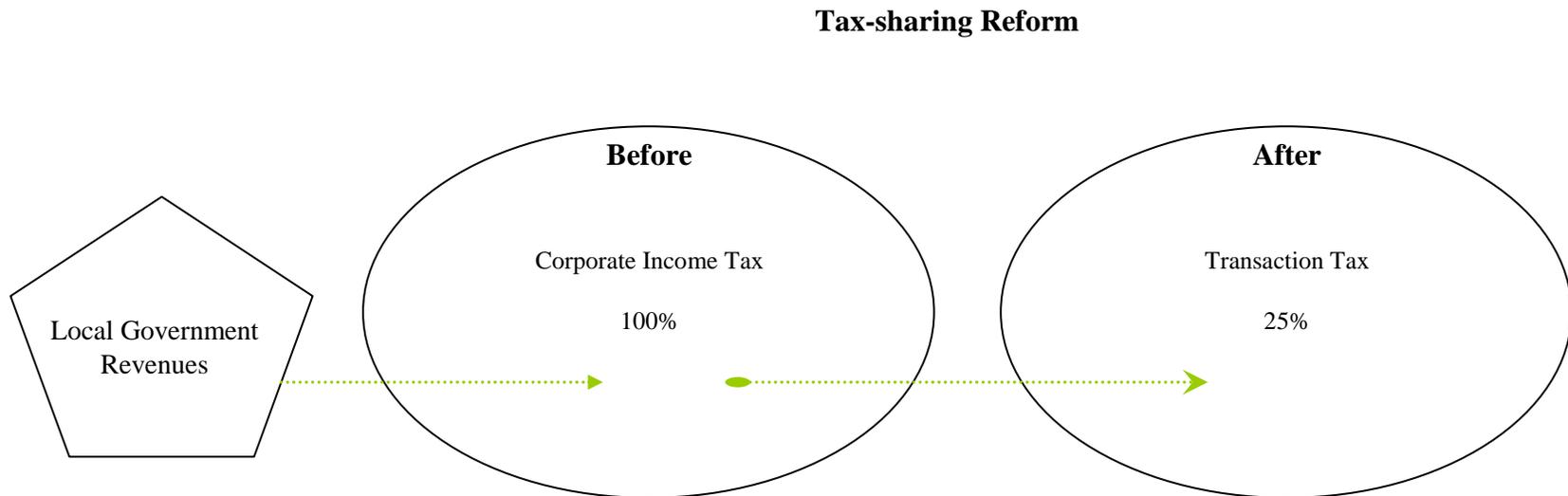
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# Fiscal Recentralization:

## 1994 Tax-sharing Reform (分税制改革):

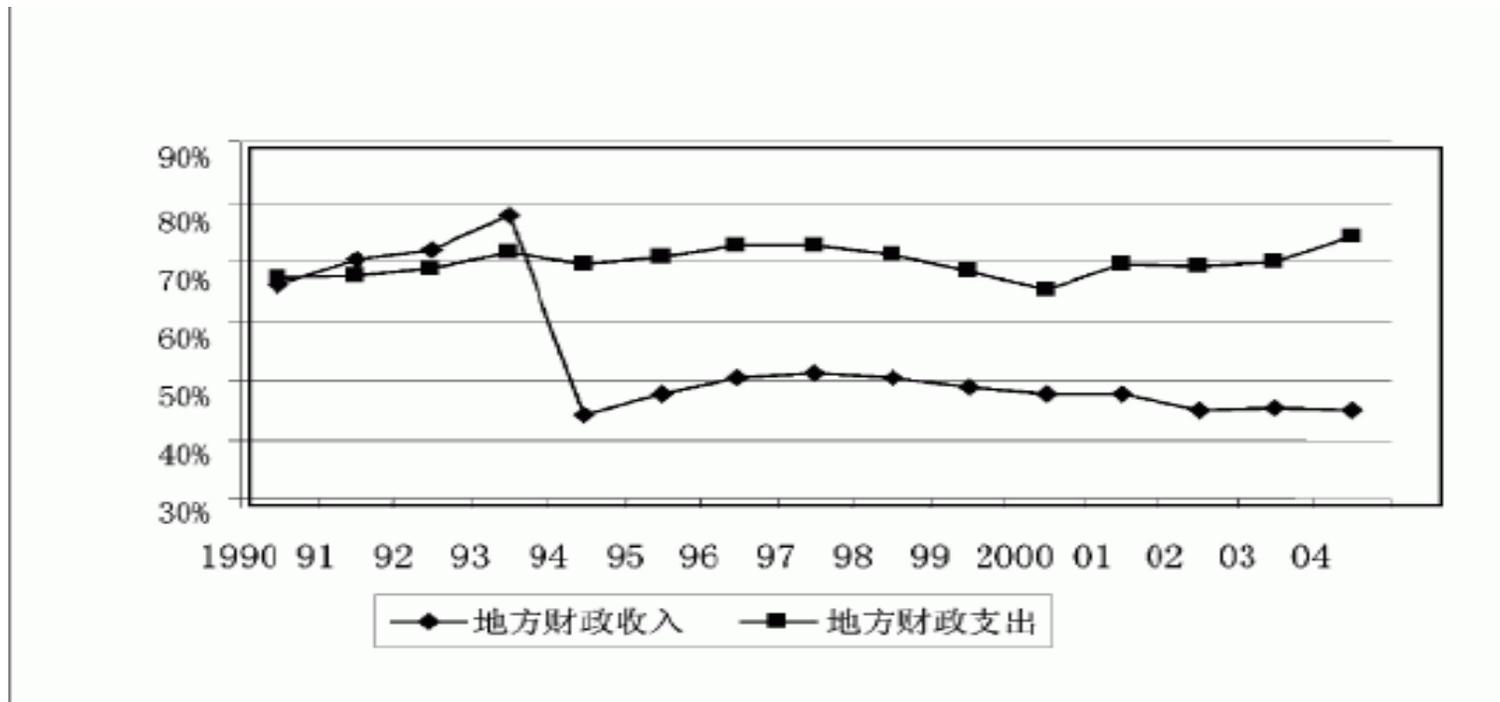
- Redefine tax rights: central government proposed to share 75% of transaction tax (增值税)
  - A new tax category not based upon enterprise jurisdiction (township/county) and ownership (collective/private)
  - Moreover, it does not vary with enterprise profitability (but based on volume of transactions 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)
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# Figure 1. Fiscal (tax-sharing) reform of 1994



## 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)



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## **Regional decentralization is still the fundamental institution even under fiscal recentralization**

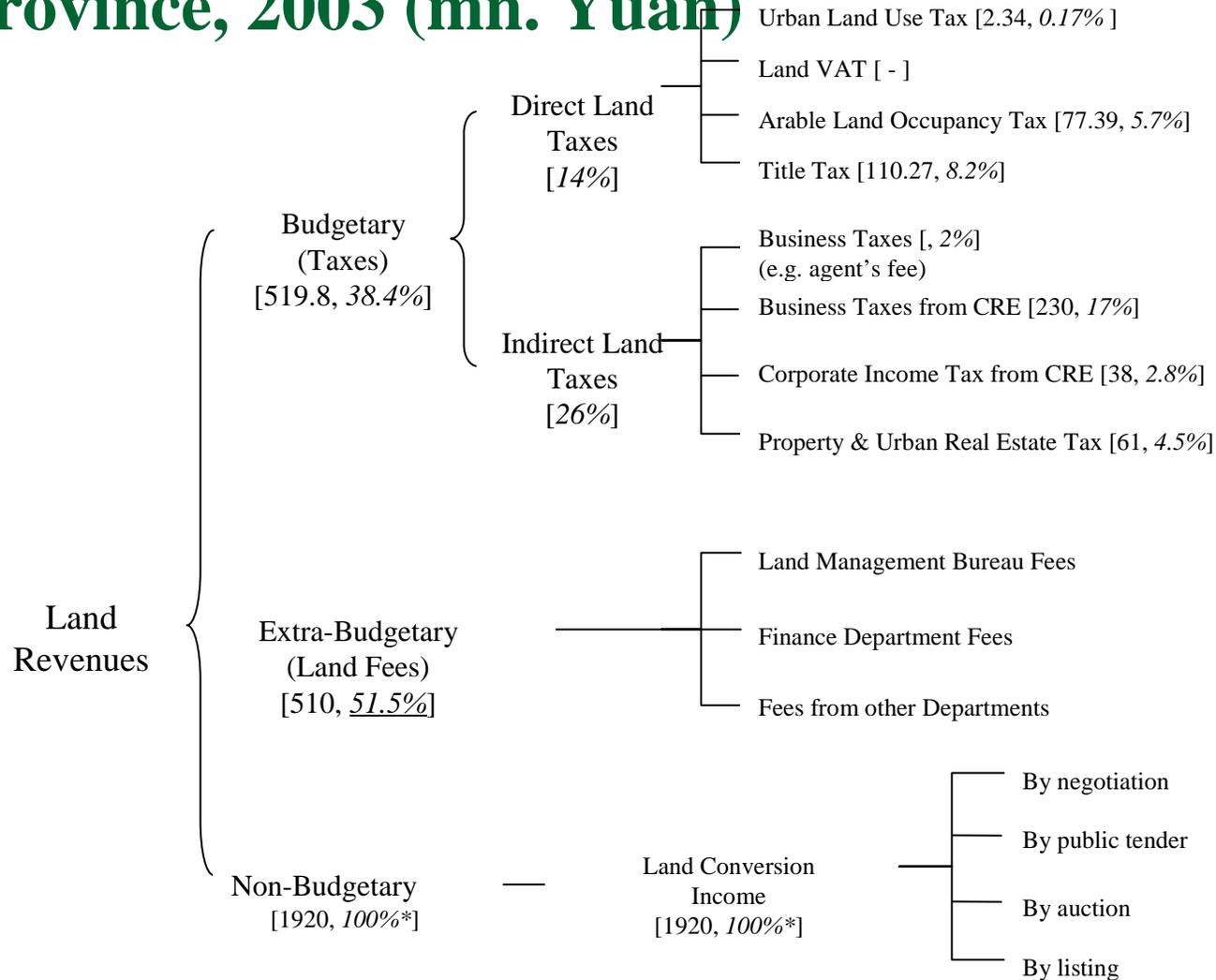
- Regional governments enjoy residual control rights over land within their jurisdictions
  - Control rights over land are used by regional governments for regional developments and generating revenues
  - Revenue creation is effective for only the relatively more developed regions where land prices 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
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## An Anatomy of Local (municipal/county) Finance

- 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
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# Profits from Land Revenue in S County, Zhejiang Province, 2003 (mn. Yuan)



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

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# 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

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## Share of land revenue in Extra-budgetary revenue

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

	S County		J City		Y City	
	Million Yuan RMB	%	Million Yuan RMB	%	Million Yuan RMB	%
Administrative fees	480	16%	1,360	39%	500	20%
Government Funds	510	18%	100	3%	500	20%
Land Conversion Income	1,920	66%	2,000	58%	1,500	60%
Total Extra-budgetary Revenue	2,910	100%	3,460	100%	2,500	100%

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# 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》)

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# 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
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## Differences in land price between industrial and commercial usage [*mu*, 10,000 yuan]

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

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# 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)
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# Total costs of land conversion: an example

Land Seizure Costs for Land Reserve Center in S County, 2003

(Units: Mu, Million Yuan RMB)

Land Use	Area of Land Acquired	Cost of Obtaining Land			(4) Land Total Price	Percent of Costs in Total Land Price (%)		
		(1)Compensation for Land and Buildings	(2)Government Tax Fees	(3)Total Costs		Compensation (1)/(4)	Tax Fees (2)/(4)	Total Costs (3)/(4)
Commercial Use	62.85	1	1.97	2.98	62.84	1.59	3.14	4.75
Mixed Use	419.1	11.53	15.88	27.41	299.40	3.85	5.31	9.16
Residential Use	2,715	120.27	95.93	216.20	1,562.29	7.70	6.14	13.84
Total	3,196.95	132.81	113.78	246.60	1,924.54	6.90	5.91	12.81

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## 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”。)

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## Low compensation part of institutional design

- 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
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## 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
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## 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)
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## **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
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## **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
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## “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
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## 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.
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## Limitations of “Nanhai Model”

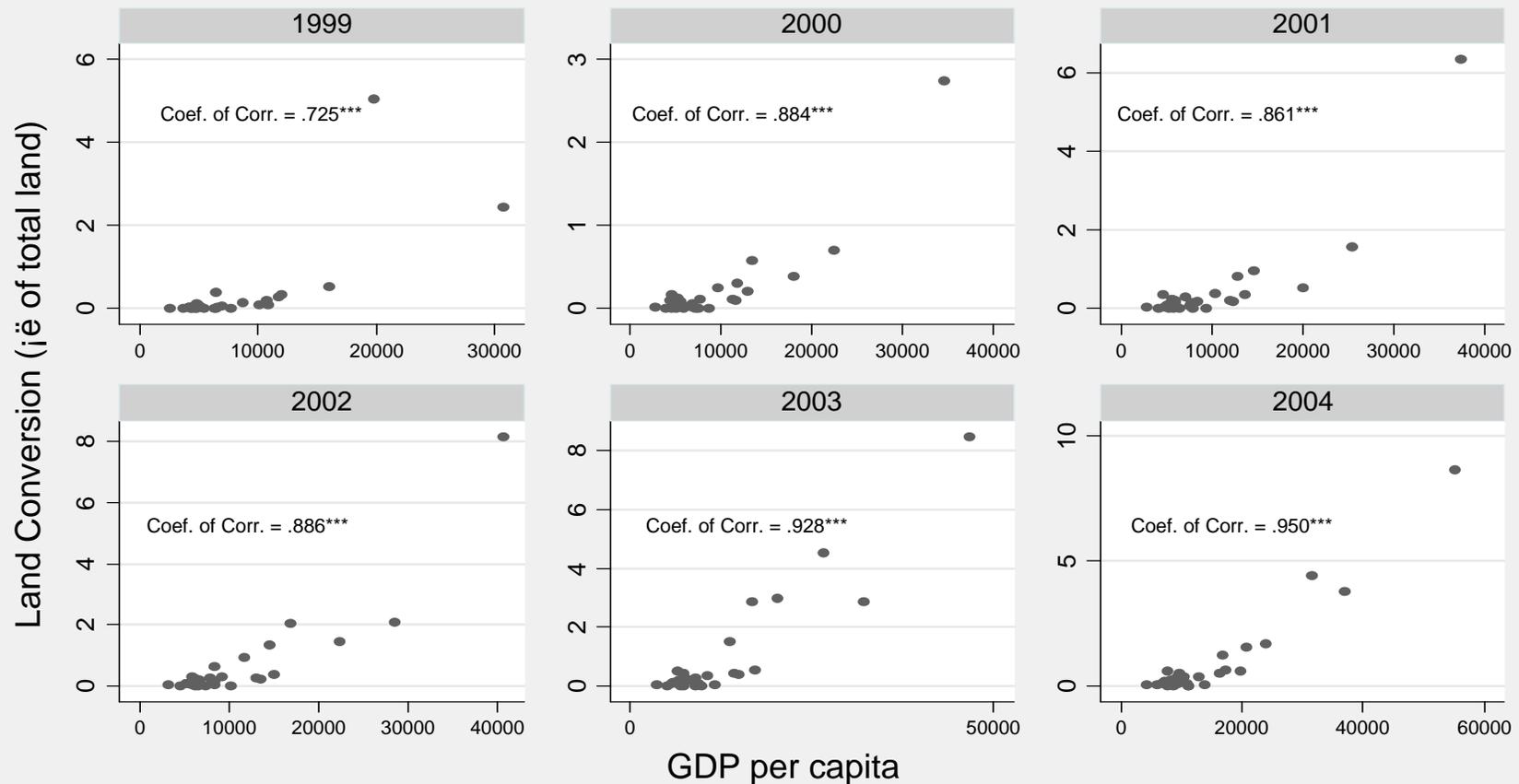
- Shares are based upon community membership and exhibit characteristics similar to those of land:
    - equal entitlement
    - differentiated according to age and adjusted for changing residential/occupational circumstances
  - Shares cannot be transferred, bequeathed, inherited or pledge as collateral
    - 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.....
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## 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
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# Relationship between per capita GDP growth and total land conversion, by province

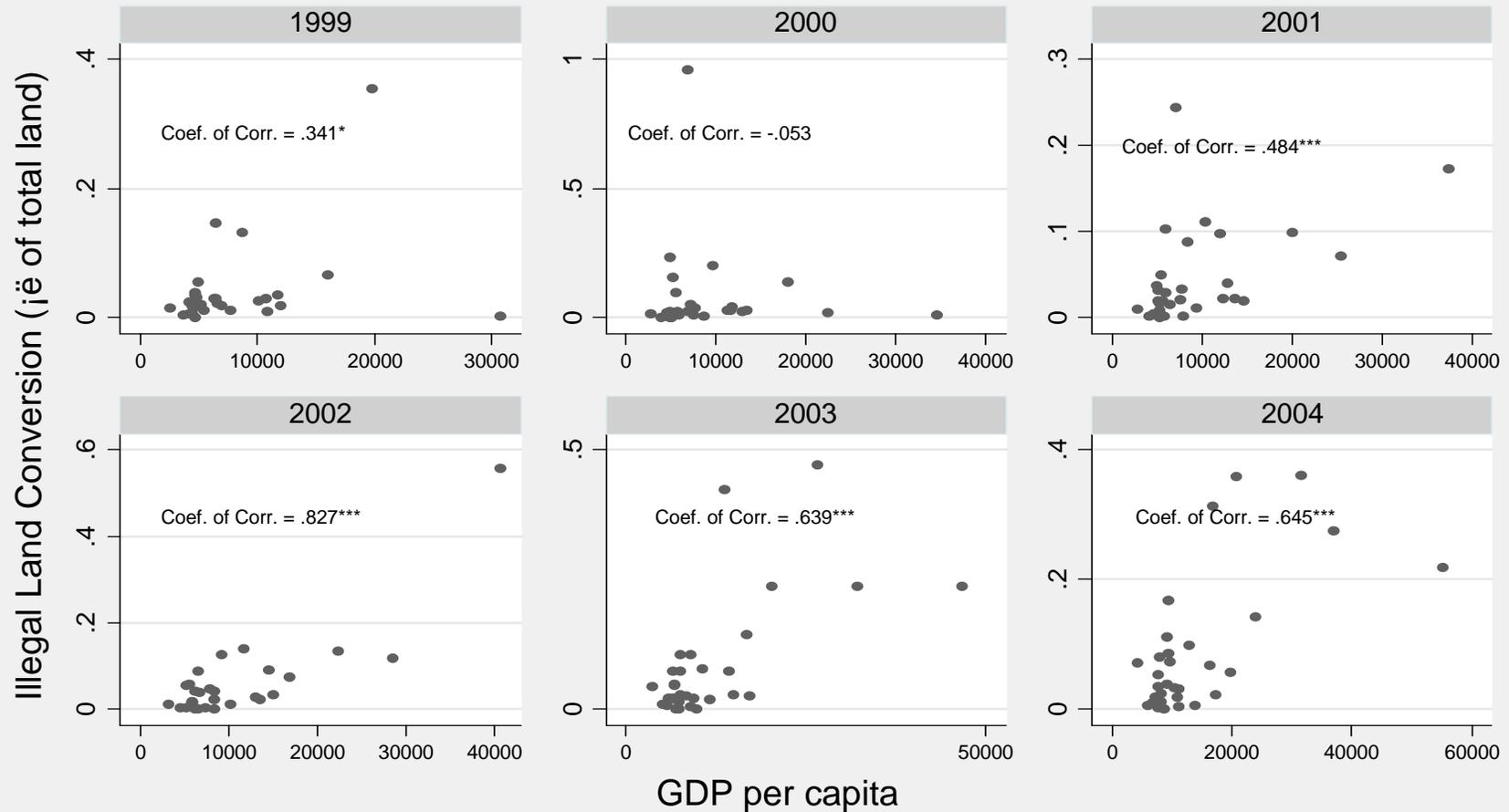


Graphs by year

\* 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

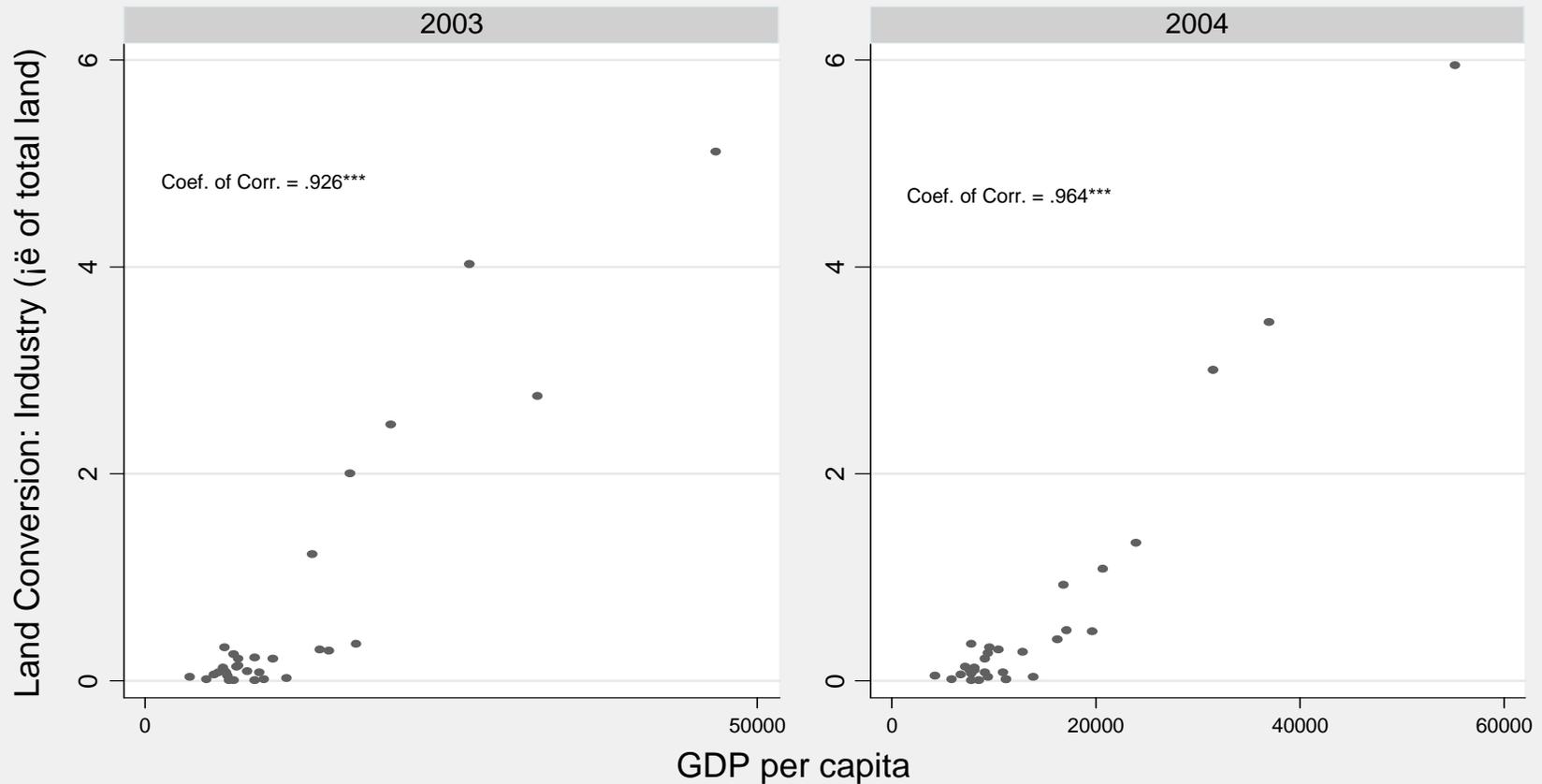


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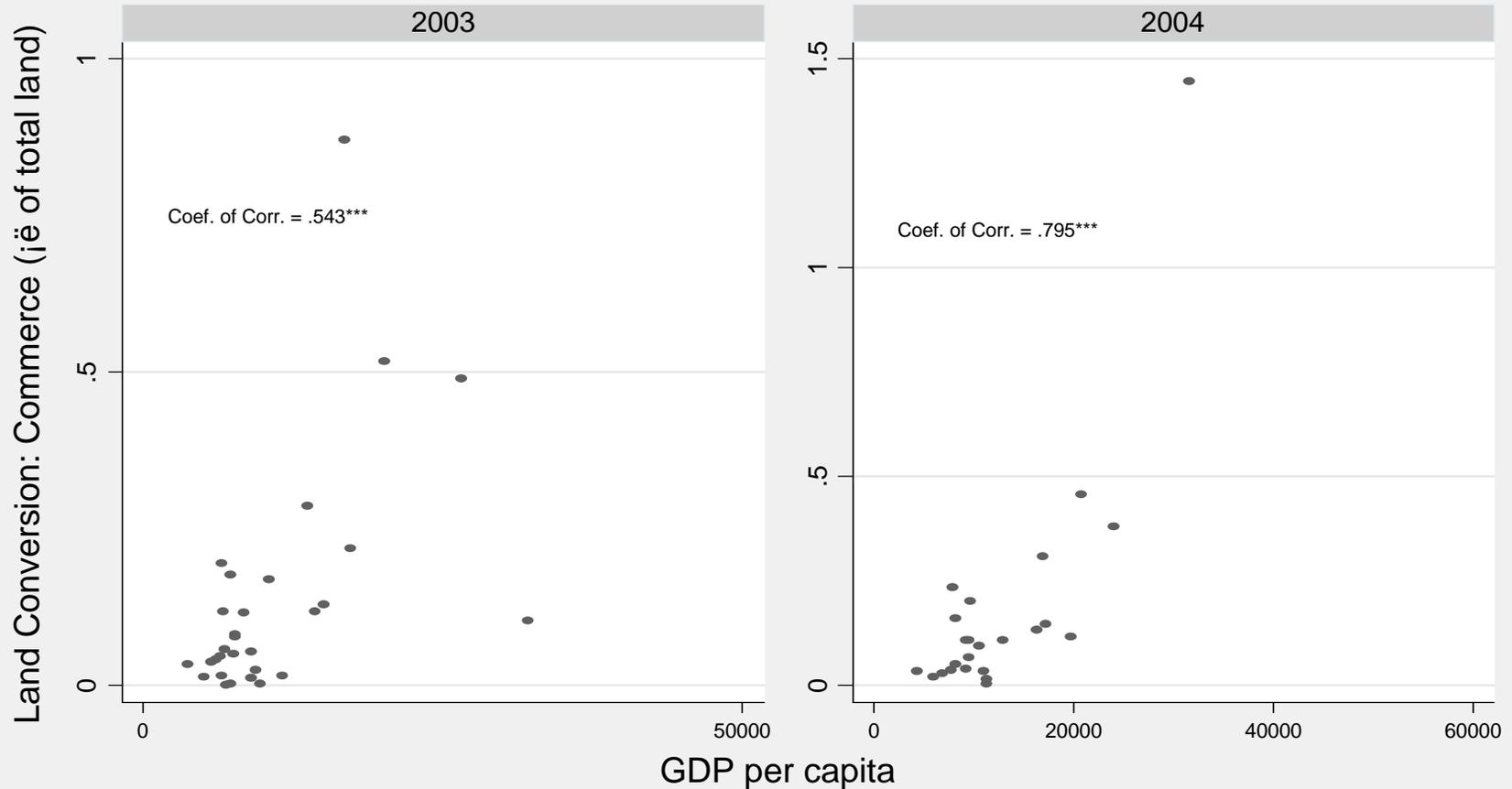
Source: Almanac of China's land and resources [中国土地资源年鉴].2000-2005

# Relationship between per capita GDP growth and industrialization, by province



Graphs by year

# Relationship between per capita GDP growth and commercialization, by province



Graphs by year