

Some Aspects of the Property Rights Issue in China*

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These are some thoughts on the issue of property rights reform in China. I have no expertise in this area, but my work has occasionally touched on related issues and I put these thoughts down in the hope that they might stimulate discussion. There are several general areas that I briefly explore: (1) the debate that has occurred about the property rights question in China; (2) property rights in agriculture; (3) intellectual property rights; and (4) property rights in the environmental field.

Debate over Property Rights in China.

China famously lacks well-defined and legally protected private property rights. To some extent this problem is a sub-component of the general weakness of the “rule of law.” Rights such as freedom of speech that exist on paper in the Chinese constitution or in particular laws are readily violated by government officials. Trials may be dominated by state interests and a truly independent judiciary has yet to develop. But the lack of firmly established property rights also follows in part from the legal framework, itself. Or perhaps this is a misstatement, since economists tend to view property rights as being comprised of a variety of different kinds and degrees of control over property: “full ownership, different kinds of usership rights or specific and limited decision and disposal rights, defined by clauses in contracts or by internal rules in organizations” (Royal Swedish Academy). Thus, the property rights regimen for land in China gives ownership to the state or collectives while China’s farmers and other villagers hold only leased use rights. This question is taken up in the next section.

Famously also, however, China’s economy has forged ahead at record breaking tempo without having “solved” the property rights issue. Nobody, for instance, could quite identify the ownership régime of the “township and village enterprises” (tve’s) that made up the highly dynamic rural industrial sector in the 1980s and 90s. Were they collectively owned, or de facto private partnerships masquerading as collective to avoid the political penalties that used to punish the “private” sector; or some kind of joint venture between collective and private parties? The “fuzzy” nature of their property rights status, classically discussed by Weitzman and Xu (1993), did not seem to impede their economic dynamism, but rather enhanced it.

A debate has occurred in the literature over the explanation for China’s economic dynamism, especially in comparison with the experience of the EEFSU countries. On one side are many scholars who, knowing something about the country’s political economy and history, credit in part one or another aspect of China’s relatively gradualist, experimentalist approach to reform and restructuring. These include Keith Griffin, Aziz Khan, Justin Lin, Barry Naughton, Fang Cai, Larry Lau, Tom Rawksi, Gary Jefferson, Peter Nolan, Robert Ash, Weitzman and Xu, and others. A general insight that perhaps unites these disparate scholars

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and approaches is that successful market economies are always nested within a framework of institutions – including those that define, protect and limit the rights associated with property ownership – that inevitably take time to evolve. Such a view leads to an interest in the way these institutions come about, the context-specific nature of them, the ways in which countries and even localities may differ with respect to the exact shape of institutions.

The most famous examples of gradualist, experimental institutions in China are the *tve*'s and the dual track system, under which China in the 1980s permitted state enterprises to sell at market prices output produced above their plan quotas (which were sold to the state at low fixed prices). While predictably giving rise to a lot of corruption, the system also carried market incentives into the state sector, instilled some entrepreneurial instincts there and accomplished a kind of *de facto* price reform. But there are many other examples of the mixed and experimental nature of Chinese reform. Nolan and Wang (1999), for instance, arguing against the idea of a universal model of property rights that works under all circumstances, discuss how reform of large SOEs in China has been “developing new institutional forms that do not neatly fit into existing patterns” and conclude that “China is experimentally changing its institutions through a combination of central policy, local initiative and interaction with international investment.” In agriculture, despite the dismantling of the collectives twenty years ago, the state has retained a strong role. This is partly to further a collection of social goals tied to agriculture, including improving regional balance, raising farmer incomes, promoting modernization and improving environmental outcomes, which private small-scale agriculture by itself could not achieve. The state also remains the major provider of services to this sector where many services have a public goods character (Waldron et al., 2006).

On the other side of the debate are those who are impatient with “gradualism” and “experimentation” and who contend that incomplete formation of markets and private property has impeded China’s development, whatever the speed of growth. Wing Thye Woo and Jeffrey Sachs (2002) essentially argue that China’s success has been due to a combination of surplus labor and whatever privatization was allowed to happen. They argue that China’s institutional experiments with dual-track pricing, fuzzy property rights in township and village enterprises, etc., were “the product of political constraints and not of economic optimization [as if anyone had said they were!] , and hence were non-viable beyond the short-run..” But China’s “short run” has now lasted over a quarter century, bringing to mind J.M. Keynes’ most famous quip.

The stylized view of the property rights issue sees the inviolability of private property as a *sine qua non* of development. The benefits of such a secure régime pertain to the basic issue of efficiency, to the incentive to invest, innovate and take risks, and to equity considerations. The efficiency argument goes back at least to the “Coase theorem,” in which clarity of property rights are a precondition for efficient allocation, regardless of how legal property entitlements are initially distributed.¹ Ironically, this demonstration was for Coase “only a

¹ “Coase showed that every given distribution of property rights among individuals tends to be reallocated through contracts if it is to the mutual advantage of the parties and not prevented by transaction costs, and that institutional arrangements other than contracts emerge if they imply lower transaction costs” (Royal Swedish Academy 1991).

hypothetical norm of comparison” that provided a baseline for his argument that transactions costs are in fact ubiquitous and do have a strong impact on economic institutions.

The incentive argument rests on the importance of the secure expectation that the profit of investment, innovation or risk-taking will be retained by the investor, innovator or risk taker. Of course, nowhere is this literally true. Taxes come between the act of investing, etc., and the reward of profit, as income is never caused solely by the acts that immediately generate it. The public infrastructure, hard and soft, the public education of workers, the safety of staff and workers from crime, etc. etc. are all crucial to the results, and all use resources that must be paid for. Moreover, last year’s US Supreme Court decision, *Kelo v. City of New London*, which validated the expropriation of private property by a city intent on turning it over to private development, shows that the inviolability of private property can be fragile even in this most conservative of nations. The majority opinion, written by Justice Stevens, stated that “[p]romoting economic development is a traditional and long accepted function of government” and that the Fifth Amendment’s requirement of a “public purpose” for condemning private property could be satisfied by the creation of jobs in a depressed city. In her dissent, Justice O’Connor complained, “Now...nothing is to prevent the State from replacing any Motel 6 with a Ritz-Carlton, any home with a shopping mall, or any farm with a factory.” Shades of China!

The above example speaks directly to the equity issue. In China (as elsewhere), the strength of property right protection tends to be related to class.² That is, in an increasingly unequal society, such rights are most clearly defined and protected for the economic elite, who often have family ties to the political elite. China’s impressive legal development, which has rivaled its economic development in the speed with which new laws and regulations have been produced during the reform period, has especially focused on the area of business law – and the institutions to implement it – that needed to be created in order to shape an enabling environment for foreign direct investors. On the other end of the spectrum, peasants who try to cite environmental laws to protect their lives, health and property against the toxic effluents of nearby chemical plants, like workers in export processing factories whose conditions of work violate numerous aspects of China’s labor laws, find they have little or no real legal protection.

A recent discussion in the pages of *China Quarterly* illustrates the equity problem in enterprise privatizations (Chen 2006). Case studies are presented of three former state factories in central China that underwent privatization. In all three cases, the workers rose up against the changes as illegitimate, successfully in one case. The privatizations were not announced as such but were disguised as other kinds of re-structuring. As Chen writes,

privatization in China has been carried out in opaque ways, with little regard to the principles of fairness and justice. The government has never made it an official national policy and no national

² In *Kelos v. City of New London*, the NAACP and Justice Clarence Thomas shared a rare moment of agreement in arguing that urban renewal in the US has often victimized the poor, minorities and the elderly. See Charles Lane, “Justices Affirm Property Seizures,” *Washington Post*, June 24, 2005.

legislation exists to dictate the process. There are only a few government guidelines, which are far from clear and whose enforcement is highly problematic. Local authorities and SOE managers are granted considerable discretionary power to decide how factory property is handled; workers, on the other hand, are totally excluded from the process.

Not only has the government not made privatization an official national policy, it has on numerous occasions condemned it. Jiang Zemin, speaking in 1995, for instance: “We ... are absolutely not going to practice privatization. This is a big principle from which we should never waver in the slightest degree” (quoted in Chen, p. 46). In one of the cases investigated by Chen, the factory was taken over by a self-proclaimed state holding company, Fenghua, which promised to resume production (halted because of pollution), pay back wages and restore social insurance programs. This met with both local government and worker approval. None of it happened, however. Instead, having acquired the factory, Fenghua announced that it would sell the site for real estate development and that workers below age 40 would be fired with a one-time severance package. Moreover, it turned out that Fenghua was not a state holding company at all, but a private company owned by the son of a big developer. Privatization had been carried out in the most opaque manner possible. Not only is inequity involved, but also firmer grounds for social instability: the absence of a clear and transparent policy regarding privatization has made it possible for affected workers to claim the high ground in attacking it accurately as illegitimate, exploitative and contrary to official Chinese policy and their leaders’ statements.

Property Rights in Agriculture.

One aspect of property rights has been particularly discussed in China, and that is the land ownership rights of farmers. As pointed out above, most farmers now have leasehold rights that last for 25-30 years. They cannot sell or buy land, but they can buy and sell the use of it. Moreover, despite leases land has sometimes been redistributed among villagers when demographic changes occur, which has kept the per capita distribution of land highly equal (more on this below). Studies of villagers’ reactions to this practice have found that it is not unpopular (Kung 2000). This is not a simple issue. There are arguments to be made on both sides of it.

On the side of strengthening private land ownership rights is the growing tendency of local governments to confiscate farmers’ land at nominal or greatly under-market prices in order to make it available for industrialization or development in an over-heated real estate market. Over 40 million farmers are said to have been expelled from their land already, a number that is growing by more than 2 million a year. Such landless farmers are often among China’s poorest [*Asia Times Online*, March 9, 2006]. The process is described by Xiaolin Guo (2001):

By law, the village collective has the right to use (*jingying*) and supervise (*guanli*) the use of land, but it has no right to transfer land for compensatory use. The state, on the other hand, “may, in accordance with the law, expropriate land which is under collective ownership, if it is in the public interest.” In this assignment of property rights, land development proceeds in two steps: land expropriation (*tudi zhengyong*) by the government from villages, and land transaction (*tudi churang*) between the government and potential land users. The latter procedure only involves a transfer of the user’s right priced according to the market value.

Land expropriation is, in a sense, a procedure by which all rights formerly held by the village collective are relinquished to the local government.

China's laws evidently stop short of requiring fair compensation when land is taken. The Land Administration Law requires that compensation to the former land-holders be six to ten times the value of the land's average annual output for the three years preceding the transaction. In the case studied by Guo (2001), the villagers were paid between 9,000 and 10,500 *yuan* per *mu* (one-sixth of an acre). The land rights were then sold by the local government for 200,000 *yuan* per *mu*.

The ability to engage in this kind of inequitable practice would be weakened if farmers' control of their land were more secure and they were able to resist expropriation or negotiate fair prices for their land. There would also be a social benefit in the heightened resistance to the alienation of farmland, whose social value as such is greater than its market value. That is, the market price of agricultural staples does not incorporate the social value of food security to a fifth of humankind. The argument here is not that no land should be lost to agriculture, but that the trade-off should be made at prices that more closely reflect the real overall importance of agriculture relative to, say, real estate speculation or toxic chemical production.

There is also an argument to be made that the mobility of China's surplus rural labor force would be enhanced by farmers' ability to sell their land at higher prices, although it is difficult to imagine an even larger scale of rural-urban migration than has actually been occurring, or that a larger scale would not create more problems than it solves.

On the other (i.e., negative) side of the question is the crucial role that the existing land tenure system has played in the prevention of even greater alienation from the land and consequent development of a class of poor landless laborers, as elsewhere in Asia. Khan and Riskin (2005) have found that farmland has been distributed extraordinarily equally and remained so from 1988 through 2002 (see Table 1 below).³

Table 1. Distribution of Per Capita Landholdings, Rural China

	1988	1995	2002
"Concentration ratio"			
Unadjusted land	0.021	0.001	-0.013 (-0.019)
Adjusted land	0.063	0.051	0.018 (0.012)

Note:

"Adjusted" land counts an irrigated acre as equivalent to two acres of unirrigated land. The "concentration ratio" is estimated from the Lorenz distribution of per capita land, in which individuals are ranked according to per capita income. Figures in parentheses for 2002 are estimates based on the same 19 provinces that were in the 1995 sample (excluding Xinjiang and Guangxi). For sources of the 1988 and 1995 estimates see Khan and Riskin *Inequality and Poverty in China*, p. 108.

³ The numbers in the table are "concentration ratios" or "pseudo-Ginis," which express the distribution of land over all rural income recipients (not just land holders). A value of 0 means that all income classes have equal access to land. A negative value (as in 2002 for "unadjusted land") signifies that lower income people were getting more land than higher income ones. The explanation for this particular case probably lies in the fact that farms in the poorer upland and northwest regions tend to be larger than in richer, more fertile areas.

These data indicate that in 2002, inequality among different income classes in access to land was essentially absent. This was a major factor in making income from family farming the most equally distributed component of rural income, which in turn limited the otherwise increasing inequality of rural income distribution. Equality of land access dates back to the egalitarian methods used to distribute collective land among households when the rural communes were dismantled in the early 1980s. The universality of access has not only been an impediment to the development of a class of landless rural laborers, it has also provided a working substitute for a non-existent rural social insurance system. Migrant workers who lose their jobs can and do return home to survive off their land until the next job is found. Aged or injured farmers can get by in part by leasing out their land. The disappearance of the equalizing and social security features of China's current land tenure arrangements, without provision of alternatives, would be a step backward in terms of human development. Clearly that is happening as the inherited equality of land ownership gives way before the soaring commercial value of land and the growing power of market incentives, and ever more farmers are deprived of their land.

Policy to address the property rights issue concerning land should take both aspects of this complicated issue into account. That is, greater protection of farmers' property rights vis a vis local governments is important, but so is protection of the role of land access as the rural population's sole means of social security and as a bulwark against the impoverishment that can stem from landlessness. How this can be done is a matter for thought and discussion, but it might be worth observing that the role of the collective is involved in both aspects. It is the collective that has maintained equal land access over more than two decades, and it is the legal expropriation of the collective's ownership of the land by the local government that is the first step toward depriving the farmers of its use.

Intellectual property

The subject of intellectual property rights and China's manner of dealing with them has of course figured prominently as a bone of contention in US-China relations. The list of foreign (especially American) complaints against the Chinese IPR protection régime includes "inadequate IPR laws on the books, inadequate and expensive enforcement of existing laws, lack of Chinese government cooperation and transparent administrative and judicial procedures, local protectionism, lack of IPR awareness and education among the general population, and lack of training and experience among judicial and administrative enforcement personnel" (Clarke, 1999). This is a vast area and one in which my own knowledge is quite limited, so I can offer only a couple of thoughts.

First, the very concept of IPR and its protection is a new one in China. The establishment of a legal and administrative IPR system began only around 1980 and a perusal of the latest official White Paper on IPR protection (Government of China, 2005) indicates the great progress that has occurred since then in establishing such a system. Of course, the opening up of China's economy and the multiplication of temptations to engage in copyright and software piracy especially has progressed at least as quickly.

Second, the discussion of the issue vis a vis China has tended to focus on China's transgressions and the complaints of US IPR holders. Elsewhere, the discussion has been

somewhat broader, including a conceptual debate about the appropriate nature of IPR and extent of its protection and over the possible conflicts between it and development, efficiency, competition, public health and the public interest more broadly conceived. There has thus been debate over whether the TRIPS agreement (Agreement on Trade-Related Aspects of Intellectual Property Rights under WTO) privileges powerful corporate interests in the developed world over the interests of poor countries and people, unfairly restricts competition and efficiency, and illegitimately extends IP rights into the realm of living organisms (Harvard University 2004).

These issues have not been prominent in the discussion about China, perhaps because of the overwhelming interest of US businesses in the patent/copyright protection problem, and because, for whatever reason, the single most prominent issue in the global debate has been largely absent, and that is the issue of high cost patented pharmaceuticals for prevention or treatment of epidemic diseases, especially HIV/AIDS. Although China has progressed from the days of denying the extent of the spread of HIV/AIDS there, the provision of anti-retroviral drugs (ARVs) is still severely limited and it appears that China has not taken advantage of the opportunities legally available to it under TRIPS to produce and distribute the most effective ARVs.⁴ The only hint in the White Paper of a critical attitude toward the global IPR protection régime as it stands is the statement that “China has devoted great efforts to adjusting and improving international rules regarding IPR protection in order to let all countries of the world share the fruits and benefits brought about by the progress of science and technology.” There is no doubt more going on in this arena than I am aware of, however.

In short, it would be desirable to couch the discussion of IPR protection in China in a broader and more comprehensive context than it has enjoyed up to now.

Environment and property rights.

China’s rapid economic growth has come at the expense of the natural environment. Not only are resource depletion and degradation monumental problems in much of the country, but the health consequences of pollution are truly calamitous with tens of thousands of premature deaths annually ascribed to air pollution alone.⁵ The property rights question comes up in relation to this huge environmental problem. When environmental concerns were absorbed into economics, they tended to be pigeon-holed under the label of “externalities,” of which pollution and resource depletion were classic examples. Damage to the natural environment and resulting damage to health and well-being occurred outside the purview of market discipline, which opened up space for public policy. The fact that these

⁴ See WHO (2002), a report outlining in very basic and general terms the various options available to the government for provision of cost-controlled ARVs. The valuable China AIDS News information service reports that “WHO ‘essential drug’ ARVs [are]not available in China” and that, although China has the right under the WTO TRIPS agreement to override patents on first-line treatments by issuing compulsory licenses, it has not done so. See China Aids Info.

⁵ The World Bank has estimated that outdoor air pollution is responsible for some 178,000 premature deaths per year and indoor pollution from particulates associated with coal combustion causes at least 111,000 premature deaths per year. See World Bank, 1997.

problems loom so large in contemporary China⁶ implies that this space is quite substantial there.

Environmental degradation had begun in China under private ownership in the decades and centuries before the mid-1950s, continued and grew worse under state and collective ownership from then until roughly 1980, and continues to worsen under the changing mixed ownership array of the past quarter century. No ownership system is by itself a sufficient condition for an end to such degradation. But property rights questions are inevitably involved. Sometimes the problem has been lack of better-defined private property. For instance, the initial de-collectivization of pastoral lands in the early 1980s privatized the animals but not the grazing land, which produced a classic “tragedy of the commons” experience until the land, too, was divided among households. Even then, difficult and expensive problems of monitoring and enforcement emerged.

However, an implication of the externality nature of environmental problems is that their solution is likely to require re-defining property rights to encompass pollution restrictions in the interest of the broader society. Such is true for the many cases in which villagers have publicly protested the establishment of local chemical factories whose effluents have poisoned their water supply, sickened them and destroyed their land. My impression is that both private and collective factories have been involved, and perhaps even local state factories. The basic issue here is the imposition of appropriate restrictions on the nature of whatever kinds of property rights might be present.

The growing popularity in China of the use of market-based incentives (such as use of tradable pollution permits) to control pollution also has property rights implications. The right to pollute, and restrictions put on it by law or regulation, can be seen as parts of a defined property rights regimen. How to structure this regimen to best achieve a socially desirable result (reduced pollution)? One way is for government to set a maximum pollution target below existing levels, distribute to enterprises only enough pollution permits to reach this target, and leave it to the market to allocate the permits, and hence the permitted pollution, among enterprises. Under optimum conditions, this approach would minimize the cost of achieving the desired reduction in pollution. However, there is a question whether the institutional conditions needed to make effective use of this method – including an understanding of basic market principles among environmental officials, the existence of strong information databases and effective monitoring capabilities -- exist in China as yet (*China Human Development Report 2002*). Alternatively, a different property rights regimen, limited by “command and control” methods, such as those widely used in Europe and the US (e.g., outlawing of toxic dumping, mandated installation of catalytic converters on cars and scrubbers in smokestacks) might be more effective because easier to enforce and monitor. The property rights aspect of environmental policy is thus an important component of both the property rights and the environment discussions in China.

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⁶ See World Bank, 1997; *China Human Development Repots*, 1997 and 2002; Smil 1993 and Smil 2004.

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