

The Issue of Land in China's Transition and Urbanization

Tao Ran

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Abstract

The paper first discusses the role of land as a key policy instrument employed by Chinese local governments and the impacts of “land finance” in shaping China’s growth pattern and urban development. This is followed by an analysis of the main challenges in the country’s land requisition system, rural collective construction land system as well as agricultural land tenure system. Finally, a coordinated policy reform package is proposed to address these challenges.

Keywords: People’s Republic of China, Development, Economic Development, Land Use, Land Regulation, Local Government, Public Policy, Urban, Urban Development, Tenure

About the Author

Dr. Tao Ran is a research fellow of Peking University–Lincoln Institute Center for Urban Development and Land Policy. His research focuses on topics related to China's ongoing economic transition and urban development. He is a professor in the School of Economics and the director of China Center for Public Economics and Governance at Renmin University in Beijing. A specialist in the Chinese economy, he has published on the political economy of China's economic transition, land and household registration reform in China's urbanization, local governance and public finance in rural China. His research has appeared most recently in the *Journal of Comparative Economics*, the *Journal of Development Studies*, *Land Economics*, *Urban Studies*, *Political Studies*, *China Quarterly* and *Land Use Policy*.

Tao Ran
Associate Professor
School of Economics
Renmin University of China
Room 1038, Minde Zhulou
No 59, ZhongguanCun Street
Haidian District Beijing 100872
Tel: (86)-10-82500195
Fax: (86)-10-62511091
Email: rantaol972@ruc.edu.cn

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1. Introduction

Land reform is a key part of contemporary China's economic transition and development. The reform and opening up process in China was initiated from rural land reform in the late 1970s and the early 1980s. With the introduction of the Household Responsibility System (HRS) in the early reform period, agriculture shifted from a collective-based farming system to a family-based one. This brought about robust growth in agricultural output and farmers' income throughout the first half of the 1980s (Lin et al. 2003; Huang et al. 2009). The rural land reform also laid a solid foundation for the fast growth of township and village enterprises (TVEs) afterwards. Without the success of rural land reform as the first push, one cannot even imagine the subsequent reforms in urban China that has generated the nearly double-digit growth rate in the past three decades. One cannot also think of China could shift from a closed plan economy to an increasingly open market economy.

Since the early 2000s, in particular after China's accession into the World Trade Organization in 2002, China's economic growth has entered a new phase. There has been a consensus in Chinese academia and policy circle that industrialization, urbanization and globalization have been the driving forces behind China's robust growth in this period. It is precisely in this period that land-related issues became prominent as China experienced fast urbanization and industrialization.

First, for industrialization and urbanization to happen, there needs to be conversion of agricultural land that allows the building of factories and urban housing and infrastructure. This would involve the displacement of farmers from land around the cities in the process of urbanization. Second, as industrialization and urbanization proceeds, it is also necessary that a set of institutions are in place to encourage farmers to move from rural to urban and from agriculture to manufacturing and service sectors. This would further require a way to finance such migration and insure the migrating farmers throughout what is inherently a risky process (Todaro 1969; Stark 1991). Land is an important element here since it is indispensable in providing decent and affordable housing for migrants so that they can settle down in cities on a permanent basis. Finally, since the process of industrialization and urbanization is a gradual and long one, the system must allow those who are left behind in the first wave of migration to be able to access to resources so that they can get themselves ready to move in the coming years either in this or even the next generation (Johnston and Mellor 1961).

However, precisely because there are inherent weaknesses in China's land system, land-related issues in China's fast urbanization become increasingly acute in the past decade. Under the current land requisition system, fast urbanization has led to tens of millions of dispossessed farmers left undercompensated. Under the current rural construction land management system, farmers are legally disallowed to develop their own land for non-agricultural purposes. This makes the provision of affordable housing with decent living conditions extremely difficult. The hundreds of millions of rural migrants have to live either in the employer-provided dorms or in the "urban villages" with poor planning and infrastructure. Unable to settle down in cities on a

permanent basis, the large number of migrants, who are already earning most of their incomes in the cities and are unwilling to return to the countryside, are still unwilling to give up their agricultural land. This, in turn, makes it difficult for those left behind in the countryside to expand their scale of agricultural production.

This report is to analyze the main challenges in China's current land system and propose a reform package to address these challenges. The rest of the report proceeds as follows. In Part II, we first discuss the role of land as a key policy instrument employed by the Chinese local governments in industrialization and urban development. We then analyze how this has shaped China's growth pattern and urbanization model as well as their economic, social and environmental implications. In Part III, we will discuss the main challenges in China's land requisition system, rural collective construction land system and agricultural land tenure system. In this part, we will also introduce the current reform initiatives both at the central and at the local level and analyze why they are inadequate to improve land use efficiency and to bring social justice for the country. In Part IV, we will propose an integrated reform package that includes land, *Hukou* and fiscal reforms to help China to complete its unfinished economic transition.

2. Land as a Key Instrument in China's Growth and Urbanization

Since the late 1990s, the Chinese economy has entered a new phase of industrialization and urbanization. In many ways, local officials across China have become more aggressive in pursuing industrialization and urbanization than they had been during the 1980s and the early 1990s. Fervor of "industrial parks" and residential complexes rampaged through the country's urban and rural landscapes. By the end of 2003, the total number of industrial zones and parks had reached 3,837. Among them, only six percent (232) had received approval from the central government. Provincial governments approved twenty-seven percent of them (1,019). Various city, county, and township governments had taken their own initiatives to get the vast majority of these zones (2,586) up and running. By 2006, the figure further jumped to 6,015 (Zhai and Xiang 2007). Developing and managing land has become a major business for local governments in many localities.

The fever of industrial parks and residential complexes since the late 1990s was closely associated with the "Tax Sharing Reform" introduced in 1994. This reform centralized revenue while leaving expenditure assignment intact.¹ Local governments in China, facing significant

¹ The tax sharing reform had fundamentally altered central-local fiscal relations. Before 1994, local share in total government revenues gradually increased. The new system assigned some major taxes to the central government, such as the consumption tax and customs duties. Among three major taxes (VAT, business tax, and enterprise income tax), VAT was classified as a shared tax but seventy-five percent went to the central government. Enterprise income tax was initially a local tax. As it ballooned, the center reclaimed fifty percent of it in 2002 and further increased its share to sixty percent in 2003. Business tax was assigned as a local tax. Other than this, tax bases for sub-national governments are mostly minor ones, such as urban maintenance and construction tax, vehicle purchasing tax, land use tax, , et al. Overall, the 1994 tax reform raised the central share in government revenues (World Bank, 2002). Local governments, on the other hand, found their share shrinking in the late 1990s and early 2000s. In addition to budgetary revenues, it became more difficult for local officials to divert revenues to extra-budgetary accounts. Their total resources could not keep up with the increasing financial obligations, including supporting retirees and laid-off workers from former SOEs and fulfilling various unfunded mandates from the center (Tsui and Wang, 2004). Business tax was assigned as a local tax. Other than this, tax bases for sub-national governments are mostly minor ones, such as urban maintenance and construction tax, vehicle purchasing tax, land use tax, et al.

fiscal pressure,² began to engage in a race-to-the-bottom style competition to enlarge local tax bases. This is done by competing fiercely for manufacturing investment and promoting actively local real estate development. As an important element in both industrial park construction and real estate development, land began to be used by local governments as a key policy instrument in local industrialization and urbanization drive.

The fact that land can be used as a local development instrument has to do with the emerging land markets in China and the country's land management system. Land market did not exist under the plan economy. Governments then requisitioned land and allocated it to users with minimum fees. The need to court foreign investors in Shenzhen SEZ in 1987 midwived land use rights (Lin and Ho 2005; Po 2008). By separating use rights from ownership, local governments effectively legitimized the transfer of land for commercial uses. China has since revised the contradicting clause in the constitution and promulgated laws to regulate this new market.³ As industrialization and urbanization took off in the 1990s, the demand for commercial land skyrocketed. Local states expanded into neighboring villages and claimed part of the rural land, most of which being farmland. According to the Land Management Law (LML), local governments can acquire land from rural collectives on the basis of "public interests." This ambiguous concept allows local governments to bend rules and to convert rural land for commercial development. Under this system, local state acquisition is the only legitimate means for crossing the urban/rural land divide (World Bank 2005).

After acquiring the land from farmers, local governments can then lease it for various purposes through either one-on-one negotiations or more open auctions. However, local governments' strategy of leasing land raises some interesting puzzles. Since public auctions include multiple bidders, they usually garner higher prices for the government. According to official statistics, local governments raked in CNY 1.69 million Yuan per hectare through negotiated land leasing while public auction raised that number to CNY 5.67 million Yuan in 2003. Despite this huge price advantage, only a small percentage of land was actually traded in the more competitive fashion. In 1999, public auctions accounted for only fifteen percent of all land leasing deals in the country. Since then, the central government has demanded more transparency in this process. Four years later, still only twenty-seven percent of land leases were awarded through auctions (Tao et al. 2010). To understand this phenomenon, we need to examine local governments' revenue incentive as well as their outside constraints.

From a fiscal perspective, land leasing generates two revenue streams for local governments. In the current period, they receive a lump sum payment of conveyance fees. As owners of land, both the central and local governments should share these incomes. In practice, conveyance fees are pocketed by the particular local government which mediates the transaction. Since these fees are local extra-budgetary incomes, local officials have full discretion in the spending. Another

² In the late 1990s and early 2000s, sub-national governments accounted for more than seventy percent of total public expenditure, while collecting less than fifty percent of total government revenues. Social service spending was decentralized further down to the county level with the sub-provincial tiers financing seventy percent of social services, provincial and central governments making up the other twenty and ten percents respectively (World Bank, 2002).

³ Under the current system, land is still publicly owned. In the countryside, rural collectives own land and have the power to requisition land for local public projects, township and village enterprises, and village housings. In urban areas, land belongs to the state. Local governments can allocate land for public uses, such as school buildings, water projects, etc. They may lease land for other for-profit uses (industrial, commercial, and residential projects).

source of revenue derives from future taxes. After businesses start to operate, local governments can collect various formal taxes, such as VAT from enterprises, business tax from services, income tax from profits, etc. These budgetary incomes must be shared with the central government. Therefore, local officials need to maintain a balance between these two streams. Conveyance fees are sizable and their impacts are also immediate. But, once the transaction is over, this stream dries up. Formal taxes, on the other hand, generate a steadier stream. Local governments, in their drive to maximize revenues, must mix auction and negotiation mechanisms strategically. One-on-one negotiations do not fetch high conveyance fees. But, if this method can generate a steady revenue stream down the road, local officials will still opt for negotiation.

This logic becomes clearer when we bring industrial attributes of investments into the analysis. Local officials have been dealing with two kinds of investors. The first is commercial and residential businesses, including retailers, real estate developers, etc. The other is manufacturing enterprises, such as shoe, toy, and household appliance factories. From a tax perspective, these two types of businesses exhibit quite different dynamics. Commercial and residential businesses tend to generate a spurt of taxable incomes for local governments in the short run. House sales, in particular, lead to high business taxes. Unlike many developed countries, China has not introduced property tax. Once the sales are done, local governments' revenues drop quickly. Commercial and residential businesses will continue to provide some level of taxes, but they stabilize at a lower level after the spurt. Manufacturing enterprises, on the other hand, tend to have a longer take-off period. Once the factories are up and running, taxes increase gradually. More importantly, manufacturing industries have a large spillover effect on the rest of the local economy. Factory workers and management have need and financial means for various services, such as banks, real estates, retailers, restaurants, and barbers. In this sense, manufacturing and service industries complement each other. From a taxation perspective, manufacturing enterprises are desirable not only because they generate value added tax (though local governments can only share 25 percent of it), but also because the development of manufacturing sectors would promote demand for local service sectors, which implies higher local business tax revenue and extra-budget revenue from leasing land for commercial and residential purposes.

However, manufacturing investments have one special attribute, i.e. location non-specificity. Most manufacturing factories are not mainly producing for local customers but sell their products to neighboring regions to the national market, and to the rest of the world. These businesses are extremely sensitive to production costs. Non-specificity also means that they can move to other areas and set up production facilities with relative ease, which greatly empowers these footloose investments vis-à-vis local governments. In response to this mobility, local officials have to offer attractive packages, including tax breaks for the first few years, low- or zero-priced land leases (usually through one-on-one and behind-the-closed-door style negotiations), etc. Neither contributes much to local coffers in the short run. Since preparing land for business can be costly, local governments may actually run a deficit in these deals. Fortunately, commercial and residential businesses play a useful complementary role. Unlike manufacturing, these businesses provide locality specific services to residents in one particular region. They cannot service their customers without physically being there. This attribute turns the table in favor of local governments. As the sole legitimate supplier of commercial land, local governments can raise land prices by rewarding the highest bidders in open auctions. A revenue maximizing government may intentionally tighten local land supply to service-oriented

businesses to garner a premium. On the other hand, since these service providers produce non-tradable goods, they can pass these costs on to consumers by raising prices. In this sense, open auctions will not deter commercial and residential investors.⁴

Overall speaking, since the late 1990s, the fiscally-strapped local governments in China have increasingly turned to land (Yang 2004). On the one hand, they lease land to manufacturing investors mostly by negotiation and at subsidized prices. Local governments usually incur net loss in leasing land for manufacturing users. By providing land at negotiated and usually very low leasing prices, local governments strived to attract industrial investors through “site-clearing” style packaged development. Usually at only nominal prices or even the so-called “zero price”, the prepared land was leased out for 50 years. Since local governments need to finance the land requisition costs (compensation to dispossessed farmers) and infrastructure preparation costs (costs in building roads and providing access to electricity, water, heating et al) ex ante, leasing out industrial land at low or even zero price inevitably means local governments are incurring net loss in the process.

Take the Pearl River Delta, one of China’s most dynamic manufacturing centers as an example, in the late 1990s and early 2000s local governments there at the city, county and township level offered “zero land price” to compete for industrial developments (Wei and Cong 2005). In another developed province of Zhejiang located in the Yangtze River Delta, in the early 2000s the provincial average costs of land requisition and land preparation was as high as CNY 1.5 million per hectare, while the average leasing price is less than RMB 1.3 million per hectare. For about one fourth of the industrial development zones, the land leasing price is less than half of the land requisition and preparation costs. In Suzhou city of Jiangsu Province, one of China’s most successful city of attracting FDI, the average leasing price in the early 2000s was CNY Y 2.25 million per hectare. However, the average land requisition and preparation cost was as high as 3 million per hectare. To compete FDI with Suzhou, Wujiang city and Wuxi city of the same province offered industrial investors land at the average leasing prices as low as RMB 750,000 and RMB 300,000–450,000 per hectare. Since the land requisition and preparation costs are similar in these regions, it is easy to see how much net costs were incurred in such investment competition (Huang 2007).⁵

On the other hand, local governments lease most of the commercial and residential land out by auction and public tender so as to earn as high extra-budget revenue utilizing their monopolistic position in urban land leasing markets. In practice, almost every cities have set up one or several industrial parks that supply cheap land to industrial users while most cities have also set up “land

⁴ In short, different leasing strategies reflect industrial attributes and fiscal impacts on local revenues. Manufacturing capitals generate sustainable taxable incomes and spurt the growth of services in the long run. Because of the mobility, local governments must sacrifice conveyance fees and reduce leasing prices through negotiations. They can raise conveyance fees by auctioning off land for commercial and residential businesses. By mixing these two strategies, local governments in China can maximize overall revenues. Moreover, subsidizing land leasing to manufactures with high conveyance fees from services also evens out the ups and downs and generates a steady revenue stream in local public finance.

⁵ In the past three years, we carried out extensive field work in some less-developed coastal areas such as Northern Jiangsu and Southern Shandong, as well as several inland provinces such as Hunan, Hubei, Sichuan and Chongqing. We find these less developed localities are now imitating the practices of the relatively developed coastal localities by offering cheap land to attract manufacturing investment. A wave of industrial parks and development zones are now emerging in many less developed parts of the country.

reserve center” that would prepare land for residential and commercial use, and then auction off the land to commercial and residential developers for profit. In many regions, the revenue from land leasing, especially the fees from commercial and residential land leasing, have become the single most important source of local extra-budget revenue. Studies consistently show that land transfer fees account for some 30–50 percent of total sub-provincial government revenues and in some developed regions, it amounts to 50–60 percent of the total city revenue (World Bank 2005).⁶

In 2007 alone, local governments in China made 226,500 hectares of land available for commercial and industrial use. Of this land, a total of 115,300 hectares of land (50.9 percent of the total land let, up 20.4 percentage points from 2006) were auctioned off. For the whole year, land sales generated close to CNY one trillion Yuan (913 billion for Jan–Nov period.), up from 767.7 billion Yuan in 2006 and only 49.2 billion Yuan in 2001. Simply put, local authorities have become hooked on land revenue as virtually a “second budget” (Tao et al. 2010).

Though China’s land-based industrialization and urbanization has brought about the impressive growth in the past decade, the economic and social costs are also very high. The provisioning of cheap land as a policy instrument in regional competition for investment has contributed to the investment-driven growth in the past decade. When land as a key production input is under-priced, the overall investment, especially the investment in the manufacturing sector, would be higher than socially optimal. This would lead to an over-industrialized economy as well as relatively low returns in industrial investment.⁷ Since the over-capacity in China’s manufacturing sector cannot be consumed by domestic demand, the Chinese government has to artificially depress the RMB so as to dump the Chinese products into world market. This inevitably leads to current account surplus and the pour in of hot money from global financial markets. The Central Bank of China then has to print more and more RMB to sterilize the ever-growing foreign exchanges. When excessive liquidity in the economy is combined with the under-supplied commercial and residential land in cities, bubbles in real estate are doomed to emerge.

The great Chinese land grab has especially soured urban-rural relations. A research report (Unirule Institute 2007) estimates there were over 40 million dispossessed farmers due to urban expansion and transportation projects. For a host of reasons but primarily because local governments tend to underpay, especially in light of soaring urban land prices, farmers losing their land are often dissatisfied with the amount of compensation. Moreover, under-compensated farmers who have lost their land easily become unemployed but generally have limited access to urban welfare benefits. A 17-province, 1,962-farmer survey conducted in China in 2005 shows that the number of land-related incidents increased more than 15 times during the past 10 years and appeared to be accelerating. As a matter of fact, land-related issues arising from state

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⁷ As Blanchard and Giavazzi (2005) observe, there are signs of too much investment in China’s manufacturing for export, so investments on the margin have low returns. From 1990 to 2003, the manufacturing sector’s share of China’s GDP grew from 43 to 52 percent, while in 2003 this share was only 28 percent for the world average and the average share for all middle and high-income countries was 41 percent. Many economists studying China’s macro-economy agree that after the middle 1990s China’s high growth has been largely investment-driven. The contribution of TFP in overall economic growth has been declining since the middle-1990s which implies significant capital-deepening in the economy as a whole, as well as in manufacturing (Zheng and Bigstein, 2006).

expropriations or acquisitions have become the top cause of rural grievances and protests (Zhu and Prosterman 2007). In the first nine months of 2006, China reported a total of 17,900 cases of “massive rural incidents”, in which a total of 385,000 farmers protested against the government. Approximately 80 percent of these incidents were related to illegal land-takings.

3. Main Challenges in China’s Land System

If we agree that the land-based industrialization and urbanization discussed in Part II is not sustainable in economic and social terms, a natural conclusion is that China’s land system must have some fundamental problems. This part is to analyze the main challenges in three major aspects of China’s land system, i.e., the land requisition system, the rural collective construction land management system and the agricultural land tenure system.

3.1 Land requisition system

Under the current land requisition system, local governments in China have the power to expropriate land from farmers and lease the land either to manufacturing land users at subsidized prices, or to commercial and residential land users at higher prices. This could happen because local governments are empowered by the present land requisition and public leasing system almost as the monopolistic player in land taking, preparation and leasing process. An amendment to the *Constitution* in 2004 provides that the state may carry out land requisition to serve the public interests in accordance with the law and appropriate compensation shall be made. However, the concept of “public interests” has not been clearly defined by relevant laws and regulations, such as the *Constitution* and the *Land Management Law*. In practice, not only the land used for urban infrastructure construction needs to be requisitioned from rural collectives, but also land for industrial, commercial and residential development are prepared through government requisition. In the process, local governments generally have the power to decide the compensation standards. Concerning the compensation for land taking, both the owners (rural collectives) and the users (individual rural households) of the rural land are in a weak position.

For the interests of their own, local governments inevitably have incentives to set low compensation standards. Our fieldwork in recent years revealed that even in some developed areas dispossessed farmers only get very low cash compensation while at the same time there is no social security provided for them. Since a fair number of dispossessed farmers are poorly educated, they may easily get unemployed after land requisition. Even in areas where social security is provided to the dispossessed farmers, the standards of social security are still largely decided by local governments while the dispossessed farmers have almost no saying in the process. In some localities, providing social security for dispossessed farmers has even become a means for local governments to evade short-term expenditure: by committing to provide certain level of social security to the dispossessed farmers in the future, local governments can pay even less cash now.

Over the past decade, many cities in China have witnessed a great leap-forward style expansion of urban space. It is estimated that each year about 2.5–3 million farmers are losing their land. By the year of 2006, the accumulated number of dispossessed farmers exceeded 40 million and

may growth further to 70 million in the next decade or so (Unirule Institute 2007). Inadequate compensation for land requisition has become the primary cause of rural petition against local governments to the higher authorities (Yu 2006). In some areas, disputes over land requisition even developed into mass incidents.⁸

In the past several years, the State Council and the Ministry of Land and Resources have introduced a series of policies and regulations to constraint local abusive land requisition, such as closing some development zones, strengthening supervision over land conversion and requesting local governments to lease land by more market-oriented approach. For example, the 2006 “State Council Notice on Strengthening Land Use Regulations” (well-known as the State Council Policy Document No. 31) mandates that “all land must be leased by public tender, auction, and listing. However, our fieldwork in recent years indicates that this central policy has not been well implemented at the local level. This has to do with the intense regional competition for manufacturing investment. Local governments often counter act through a policy known as “public tender tailored for qualified investors”, namely, the competition between potential land users can be significantly minimized by setting non-price conditions for potential land users. It often ends up that the only qualified land user is the firm that already reached private agreement with local government beforehand. As a result, industrial land is still leased out by negotiation though in procedure it looks like a marketized process.

The latest development of land requisition reform is the amendment of Land Management Law. In 2009, the Ministry of Land and Resource came up with a highly controversial draft of LML amendment.⁹ In the draft, the articles related to land requisition have been amended significantly. Compared to the existing “Land Management Law”, a new chapter on “land expropriation and requisition” is added to standardize the scope and procedure of land requisition. The key idea is to restrict government power and narrow the scope of land requisition, as well as providing social security for dispossessed farmers. These changes demonstrate government’s determination to improve the current land requisition system.

However, in this draft amendment of “Land Management Law”, it is still prescribed that “within the urban construction area defined by the Master Land Planning, the state can requisition collective land for construction use according to the city planning”, whether the land is used for public purposes (such as land for infrastructural development) or it is used for non-public purposes (such as land for industrial, commercial and residential use). Only in areas beyond “the urban construction area defined by the Master Land Planning”, rural collectives can develop land for non-public purposes on their own.

Such constraint on rural land development is inevitably problematic. First, it implies that the vast majority of rural land with high value for non-agricultural use would still need to go through the land requisition process even if the land is used for non-public purpose. As a matter of fact, this

⁸ According to a statistics in 2005, the mass incidents in which farmers protest to protect their rights accounted for 30 percent of nearly 80,000 cases of mass incidents in China, of which those caused by unfair land compensation accounted for 70 percent. Among the 74,000 mass incidents recorded in telephone in CCTV “Focus” program of 2005, 5312 cases related to land issues. 60 percent of the incidents were due to conflicts brought by unfair government land expropriation actions (Yu, 2006).

⁹ It is expected that soon the draft will be submitted to the State Council Legislative Affairs Office before it is submitted to the NPC for deliberation.

is in line with the interests of local government. If such definition has not been made, local government would only be able to requisition the land that serves public interests such as the land used for infrastructure development, public education and public health institutions. Then local governments would no longer be able to requisition land from farmers and lease them out for industrial, commercial and residential purposes.

Moreover, local governments may easily expand the “urban construction area defined by the Land Master Plan” by adjusting land-use planning. This is evident in the implementation of 1997–2010 Master Plan: the more economically developed one locality is, the more frequent there are planning adjustments. Although in principle the preparation, implementation and adjustment of the Land Use Planning needs to go through a public hearing process, in reality there has been little public participation. If this aforementioned article of LML amendment is adopted, it would be very difficult to convince farmers who live within the “urban construction area defined by the Land Use Master Plan.” This, in turn, would result in confrontations between local governments and farmers (Wang and Tao 2009).

3.2 Rural collective construction land management

Reducing the scope of land requisition and allowing rural collectives to develop land for industrial, commercial and residential uses on their own are two sides of one coin. If the rural collectives and farmers are allowed to develop rural land on their own, it would imply that such land development does not need to go through the process of state requisition-preparation-leasing. Therefore, progress in land requisition reform largely determines progress in rural collective land reform.

For a long time, the Chinese academia has been arguing for granting rural collectives and farmers the rights to develop the collective land for non-public purposes. In 2007, China enacted a “Property Law.” The law has some element of providing “equal property rights protection for both the rural collective land and the state-owned land.” However, if no fundamental reform is to be carried out in China’s land requisition system, it would be extremely difficult to imagine rural collective land can ever enjoy an equal treatment in development. In this sense, land requisition system reform is a prerequisite for rural collective construction land reform.

Under current system, markets for urban and rural land have been artificially divided. A market-oriented reform for rural collective land is badly needed to improve both efficiency and equity in China’s land use. The rising illegal use of land throughout the country and the spontaneous emergence of rural construction land market in many localities indicate that the current land management system is no longer functioning under an increasingly market-oriented economy (Han 2003).

Special attention needs to be paid to China’s rural residential land that accounts for a majority of China’s rural construction land. Under China’s land management system, every rural household is eligible to apply for one and only one, piece of residential land on which a house can be built for accommodation purpose.¹⁰

¹⁰ From the late 1990s, particularly since 1998, in order to further strengthen farmland protection, China began to manage impose strict rules on rural residential house building and residential land management. In the 1998 “Land Management Law,” the

Given the huge number of rural households (around 200 million) in China, residential land constitutes one of the most important land use types in rural China, only next to farmland. According to the first national land cadastral survey conducted in 1996, rural settlement occupied 164,558 hectare of land, which was 6.21 times as high as urban settlements and which accounted for 68.4 percent of all settlement and industrial/mining land (240,753 hect.) (Lin and Ho 2005). A more recent census data also showed that total area of rural residential land reached 166,000 ha by the end of 2004, 4.88 times of the land taken by the urban construction uses (34,000 ha). This implies that per capita rural residential land holdings is 214 square meters, 64 square meters higher than the standard defined by the National Village and Township Planning Standards.

However, different from the urban housing properties, the rural residential properties, including the land and the housing unit, are still strictly regulated and cannot be traded freely on the market. The policies of allocating a piece of residential land for every rural household but disallowing trading beyond village are alleged to help secure farmer's housing rights in an egalitarian way while at the same time to protect the country's limited arable land resources. Given the sheer size of total rural residential land in China and the rural housing building craze in the reform era, both the government and the academia have expressed a continuous worry that rural residential land and its expansion "may have contributed greatly to the loss of farmland in China" (Sargeson 2002; Lin and Ho 2003; Lichtenberg and Ding 2008). Since village housing accounted for about 5 to 6 per cent of the total area forfeited and the area lost to new housing was greatest in the central eastern provinces—traditionally a highly productive agricultural region (Sargeson 2002; Ash and Edmonds 1998)—these worries are perfectly reasonable. As a result of policy tightening, rural residential land transactions beyond village boundaries have been completely prohibited after 1998. If any such transaction occurs, it would be illegal and thus no land and housing certificates would be issued.

The current policy framework on rural residential properties has brought up policy debates in Chinese academia and policy circles. While some are in favor of lifting the ban on rural residential property trading, most others believe that the impacts of allowing free trading of rural residential properties would be disastrous. In their view, once the rural housing market are opened up, some rural residents would inevitably end up as homeless if their properties are sold but they cannot make a living in cities. Moreover, farmers would rush to convert rural arable land into commercial housing properties and make a profit by selling them or letting them out. Therefore, maintaining restrictions on rural residential property trading is necessary to help to protect the disadvantaged group in the countryside while at the same time serve to protect China's arable land stock, a top policy priority of the central government.

However, the strict regulations on residential land use and transactions have met serious challenges in policy implementation. The main challenges come from the country's large-scale migration and fast urban expansion, which generated land use problems both in China's vast

original article 41 of 1988 "Land Management Law" (provision that had allowed urban residents to acquire rural residential land under certain circumstances) was removed. Rural residential land can only be transferred between rural households within the same village. Villagers who have sold or rented their house are ineligible to apply for additional residential land. Three further policy documents, i.e., Strengthening the Management of Land and Prohibiting Land Speculation, 1999 by the General Office of the State Council; Strengthening Land Management by the State Council, Oct, 2004; and Strengthening the Management of Rural Residential Land by the Ministry of Land and Resources Nov, 2004, were promulgated. The PRC Guarantee Law in 1995 also stipulates that rural residential land use rights cannot be mortgaged.

agriculture-based countryside and in the fringe of cities where urban expansion is fastest and where demand for residential land is intensive. In the agricultural-based areas far away from the city, such challenge is mainly manifested in that residential land continues to encroach arable land while at the same time residential land use efficiency turns out to be low since a large number of farmers leave their housing idle, i.e., the phenomenon of “hollow villages.” In the suburban areas and even within cities, many “suburban villages” and “urban villages” have emerged and provided affordable housing for a great number of migrants.

Idle House Sites and Hollow Villages in Pure Farming Areas

Between 1996 and 2006, rural residential land account for 80 percent of the 1 million mu (1/15 hectare) newly occupied arable land due to rural construction. In the context of urbanization, although an increasing number of farmers are earning higher incomes through off-farm employment, they are still unable to settle down in cities on a permanent basis under China’s household registration system (*Hukou*).¹¹ Since rural population cannot be effectively reduced through permanent migration while at the same time rural residential land cannot be traded freely beyond villages, local governments and rural community organizations have to allocate more land for residential housing construction when new families are formed in villages. This usually implies occupation of existing farmland. At the same time, a significant share of existing rural residential property are either under-utilized or left totally idle as a large number of migrants go to cities. In many of the agriculture-based regions one can find “hollow villages.”

Between June and October 2008, we carried out a large sample survey in 119 villages, 59 townships, 30 counties across six provinces including Jilin, Hebei, Shaanxi, Sichuan, Jiangsu and Fujian. The survey collected information about rural residential land use for more than 2,230 rural households.¹² Among the surveyed 2,230 rural families, 34 families (1.52 percent) have no residential properties, 1,965 families (88.1 percent) own one residential property. Although the government policy states that one and only one rural residential property can be allocated to every rural family, our survey shows that 231 families (10.36 percent) possesses two and more

¹¹ The rural migrant workers, commonly called nongminggong (farmer-workers), are rural people working outside of agriculture and dependent on their wages for their livelihood. The 2000 National Population Census indicates that by 2000 there were already 121 million migrants (defined as individuals who had migrated for at least 6 months in the past year) in China, of which 90 million were found in urban areas and 88.4 million originated from rural areas (NBS, 2002). The recent years have witnessed an acceleration of rural-urban migration. Though estimations vary, it is widely believed that over 110 million migrant workers from the countryside are now working in cities. In 2006, for example, the National Statistical Bureau (NSB) reported that rural-to-urban migrants totaled 132 million, while the Ministry of Agriculture reported 115 million (Han Jun, ed., *Diaocha Zhongguo Nongcun* (Surveying the Chinese Countryside), (Beijing: Zhongguo Fazhan Chubanshe, 2009), Vol 1, p. 451–452.) The most recent 2008 NSB report gives 140 million (NSB, “2008 Nianmo Quanguo Nongmingong Zongliang Wei 22542 Wan Ren (The National Total of Migrant Workers at Yearend 2008 was 225.42 million),” 25 March 2009, http://www.stats.gov.cn/tjfx/fxbg/t20090325_402547406.htm.)

¹² We first divided the country into six large regions and randomly picked one province in each: Shaanxi (Northwest), Sichuan (Southwest), Hebei (North), Jilin (Northeast), Jiangsu (East), and Fujian (Southeast). All counties in each province were categorized into five quintiles in order of their per capita gross value of industrial output. In each quintile one county was randomly selected. This step generated 30 sample counties in total. From these counties, 60 sample towns were randomly selected from all eligible towns which were grouped into two groups based on per capita net income of rural residents. The same stratification method was further applied to select total 120 sample villages. In each sample village, 20 rural families were then randomly selected for face-to-face survey with one adult randomly selected from each sample family (aged 18 years or older). Due to the earthquake in Sichuan which brought severe damage to one sample townships that we could not reach and some of the sampled interviewees either could not respond or could not respond properly, the total valid survey questionnaires we were able to collect were 2,234 from 6 provinces, 30 counties, 59 townships and 118 villages.

residential properties. Provincially speaking, Hebei and Fujian provinces had more families with multiple residential properties than the rest of the provinces. In rural China, the change of family structure, the heritage relationship, or illegal land taking for residential construction all contribute to the formation of the families with multiple housing properties.

Our survey also shows that average area of the land occupied by residential property in rural China is 288 square meters per residential property. Jilin Province had the largest size of the residential land (511 square meters per residential property) on average, followed by Hebei Province (347 square meters per residential property). Jilin Province also experienced a steady increase in the average land area for rural residential property, with more than 45 percent increase from 1978 to 2008. As for the whole nation, the survey data revealed that average size of the land taken for residential use had dropped slightly from 1980s to 1990s, but increased about 9 percent afterwards in spite of the implementation of so-called “the strictest” regulation for farmland protection in China.

In our fieldwork, we find that the higher share of out-migration in a village, the more likely the village to have higher ratio of vacant residential properties. This relationship tends to be consistent with the general observations in the reality that people who left their villages for urban jobs may leave their housing properties under-used or even idle in the villages. Our survey indicates that the average ratio of vacant residential properties was as high as 7.5 percent for the six provinces. Among all of the 119 villages, there are total 14 villages which had vacant rates higher than 20 percent, and 7 villages with vacant rates even higher than 30 percent.

While there are significant shares of vacant housing in rural villages, new residential house building continues to occupy arable land. Since 1978, on average the share of residential housing built by occupying arable land has been over 20 percent of all the new residential building and this share was still as high as 23.4 percent during the 1999–2008 period. In other words, on average, more than one-fifth of the residential housing construction in rural China occupied arable land.

“Urban villages” and “small-property-rights housing”

In contrast to “hollow villages” and inefficient residential land use in China’s agriculture-based areas, many “urban villages” and “small-property-rights housing” have emerged in China’s suburban areas and even within cities. These are the locations where the value of rural collective land appreciates fastest due to booming demand for housing. Under the current law, only the state has the right to expropriate the collectively owned rural land and then lease it to urban users. Since expropriation of rural collective land by the State is often carried out with very low compensation, it is no strange that farmers and village collectives in urban fringe have strong incentives to engage in rent competition with the urban state that monopolizes urban land supplies (Zhu and Hu 2009). Informal land developments thrived in China’s urban fringes, including the rapid development of housing rental market targeting migrant farmers in urban villages and the fast growth of “small-property-rights” housing.

Housing rental markets in urban fringes boomed largely due to an influx of floating population of migrant workers. Being limited by the *Hukou* system, the floating populations have no access

to public housing, neither are they eligible to the urban affordable housing programs that target urban permanent residents. Though in theory purchasing the urban commercial housing is an option, rural migrants usually cannot afford the high prices. Moreover, without urban *Hukou* many of the floating population regard their presence in the cities as temporary. Therefore they tend to minimize their living expenditures in cities, thus renting and sharing housing in the urban villages and suburban areas become their major housing choices. As a result, many suburban villages in China have become the so-called “migrant enclaves”, or urban villages in which migrant workers from the countryside concentrate. It is estimated that at present around half of the 140–150 million migrant workers are living in around 50000 urban and suburban villages in cities.

Overall speaking, under current land and *Hukou* system, fast migration inevitably leads to a large population of migrants living in “urban villages.” The landlords of the urban villages (farmers who own the residential properties) can earn considerable incomes by renting out their houses. In this sense, the urban villages have played significant roles in China’s urbanization process. They not only provide affordable housing when urban governments fails to provide housing security for migrants, but also generate incomes for the landlords in urban villages whose arable land have already been requisitioned by local governments in urban expansion. This largely offsets the negative impacts of land requisition that usually pay inadequate compensation. Therefore, one needs to recognize the important values of urban villages for two most vulnerable groups in China’s urbanization, i.e. the floating population and the dispossessed farmers. For sure, the emergence of urban villages may have some negative consequences. Since local governments cannot obtain revenue from such land and housing development projects, they have no incentive to improve the infrastructure and public service in urban villages, thus environmental conditions in these localities are usually very poor and sometimes crime rates are also very high compared to other urban space under government control.

Precisely because urban villages provide dispossessed farmers with considerable incomes, urban redevelopment and renovation projects that targets these urban villages is usually very difficult to implement. When the compensation to landlords in urban villages fails to reflect the opportunity costs of their rental income, strong opposition to local government move to demolish and redevelop urban villages occurred. Unfortunately, as housing prices rocket in Chinese cities in recent years, many city governments and real estate developers now find demolishing urban villages an increasingly profitable business. Urban village demolition is being carried out in many cities across the country. Social unrests due to unfair compensation easily follow. The questions to ask then are: if urban villages are demolished, how can the dispossessed farmers (the landlords of urban villages but who already lost their arable lands) make a living since they would no longer have the rental income to maintain their livelihood? Moreover, where can the large number of migrants find shelter if they are forced out of urban villages? Besides urban villages, small-property-rights housing is also booming in China’s city fringes. Small-property-rights housing is the commodity housing developed either by village collectives or by farmers themselves that does not have ownership certificates issued by the urban state. These housing units could not be legally transacted on market. Small-property-rights housing could either refer to the large-scale apartment buildings developed on rural land for sale, or the small-scale rural residential housing properties owned by individual rural households and then

sold to people from outside villages.¹³ As a result of local governments' monopolized land supply in urban areas, land and housing prices have rocketed in the past decade. It is natural for the rural collectives and farmers to start commercial real estate development on collectively owned land for profit. Though there is no legal protection and the government has issued many prohibitive policy documents, the growth of the small-property-rights housing is just amazing. By the end of 2007, an estimate of the total construction area of small-property-rights housing is 6.4 billion square meters, accounting for 17 percent of the country's total urban housing stock (Wang and Wang 2009).¹⁴

Local Rural Collective Land Reform: Progress or Not?

On the basis of the previous discussions, we can see that reducing the scope of government land requisition and allowing rural collectives to develop collective construction land on their own would not only contribute to limit the development zone craze witnessed across the country and enhance land use efficiency in China's urbanization, but also help farmers in city fringes to have a larger share of benefits due to land development. However, our fieldwork in the past several years in the Yangtze River Delta, the Pearl River Delta, North China Plain and Chengdu-Chongqing area indicates that the opposite is happening now. Indeed, local governments in many localities, rather than limiting the scope of land requisition, begin to demolish existing urban villages and requisition more land from urban suburbs so as to continue the distorted land-based urbanization. Acquiring more land from urban villages to be leased to real estate developers not only generates substantial land revenue for city governments, but also helps to improve the physical image of the cities. For sure, these requisition and demolition actions are often met with serious confrontation between farmers and the local state.

In fact, demolition of rural residential housing occurs not only in the city fringes where space is needed in urban expansion, it also occurs in some pure agricultural areas far away from cities. In the latter case, farmers are asked to leave their old rural residential housing and are relocated to apartment buildings provided by local governments in nearby townships or central villages. To see why this happens, a better understanding of China's farmland protection system and construction land use quota system is needed.

As is well-known, the Chinese central government adopts a "toughest" policy to preserve farmland in the country. The 1998 Land Management Law provides a clear regulatory

¹³ Since the small-property-rights housing do not pay various taxes and fees to the government, the price is often one-third or one half of the commercial residential housing in comparable locations. This is the by far the most important reason why the small-property-rights housing is popular even if there is no legal protection for this type of housing (Wang and Wang, 2009). Due to lack of legal property ownership certificate, small-property-rights-housing cannot be used for mortgage. Moreover, the transactions of small property rights housing generally requires a one-time payment.

¹⁴ The places where the small property housing flourishes most are in the fringe of large cities such as Beijing and Shenzhen where high commodity housing prices drive farmers to build the small-property rights housing. A survey on more than 400 estate development projects in Beijing conducted by Zhongda Hengji real estate marketing research center in 2006 indicates that small-property-rights housing for sale accounted for 18 percent of the total housing for sale in local market. The average price of small-property-rights housing for sale was CNY 3344 Yuan per square meter in 2006, merely 38 percent of the average price (CNY 8792 Yuan per square meter) of housing for sale in Beijing. A survey conducted by Shenzhen Municipal Bureau of Land Management in 2007 demonstrates that the number of small-property-rights housing in Shenzhen was more than 350,000. The total construction area of these buildings was as high as 120 million square meters, accounting for 49 percent of the city's housing stock. (Wang and Wang 2009)

framework for this policy to be implemented. Land Use Master Plan (*tudi liyong zongti guihua*) and the Annual Land Use Plan (*niandu tudi liyong jihua*) are two major instruments to achieve the ultimate goal of farmland preservation. The Master Plan sets long-term (usually 10–15 years) regulations on both the quantity and spatial distribution of agricultural land in a locality that is allowed to be converted to construction land (*jianshe yongdi*, referring to land for non-agricultural use). The Annual Land Use Plan breaks down these long-term objectives for each year. Each level of government, from the center to the township, must formulate and observe their land use plans. The first National Land Use Master Plan was made in 1997 and set the primary goal of preserving 120 million hectares of farmland by 2010. All local and annual land use plans ensued to specify the details in the following years (Wang et al., 2010).

These land use plans rely mostly on a set of quantitative measures. The most important one is the “planned farmland conversion quota” (PFCQ) (*nongyongdi zhuanrong guihua zhibiao*). It regulates the total farmland that can be converted for non-agricultural use over the entire planning period. The annual plan further specifies land use regulation on each individual lot. For any agricultural land, PFCQ must be acquired through the Master Plan and the Annual Plan before conversion could take place.¹⁵

However, for localities where planned quotas and annual quotas could not satisfy local land use demand, the regular arable land constitutes a potential source for urban expansion. However, it is also very difficult for a city to simply convert the regular farmland since, under the Master Plan; this type of land is still designated for agricultural purposes. To convert this type of land legally, some extra quotas must be generated and the Master Plan has to be revised.

One approach is to reclaim rural construction land (i.e. land for rural housing and industries) into arable land. This could be done by demolishing the sparsely distributed rural residential houses and relocating farmers to a more densely built residential area. Local governments could obtain an equivalent amount of extra construction land quotas if certain amount of non-agricultural land within their jurisdictions was reclaimed to farmland. Inevitably, residential land reclamation involves paying for the relocation of farmers from their original residential housing to more densely build houses or apartment buildings. Local governments could recover this cost easily from land leasing fees since now they have more construction land use quotas and can convert more arable land in city fringe into urban construction land. This approach is in accord with the central government policy and the Ministry of Land and Resources in fact used this reward quota as an incentive for land reclamation (Ministry of Land and Resources 1999).¹⁶ This clearly incentivized local governments to carry out residential land reclamation in their jurisdictions.

¹⁵ Farmland conversion is further regulated through two other means: “replacement farmland quota” (*buchong gengdi liang*) and “prime farmland preservation ratio” (*jiben nongtian baohuly*). Even if PFCQ is available, a locale must fulfill its “replacement farmland quota.” The same amount of new farmland must be cultivated, either through land consolidation or reclamation of waste or construction land, to compensate for the lost farmland. Each region must achieve a “dynamic balance” (i.e. no net loss) of farmland. Like PFCQ, this replacement quota is also handed down in conjunction with the land use plans from the central government. Finally, all local governments must preserve more than 80 percent (mostly around 85 percent) of its total arable land as prime farmland (defined as the farmland reserved for agricultural use only). This land should be clearly marked in the Master Plan as well as in its physical location. Conversion of prime farmland to non-agricultural use is highly restricted, if not totally prohibited. In short, by setting these quantitative targets and centralizing land approval authority, the top leaders hope to control the pace of development and preserve sufficient amount of farmland for food production.

¹⁶ This approach was primarily based on a 1999 policy document by the Ministry of Land and Resources. The document states that “in areas where conditions permit, farmers can be relocated to key villages and towns and township and village enterprises

Under such a background, a wave of rural residential housing demolition and relocation was started. In localities such as Tianjin municipality, Chongqing, Chengdu Municipality and some cities in Zhejiang province, demolishing and reclaiming farmers' residential housing and relocating farmers to apartment buildings in nearby townships now become the main work focus for local governments there.

Though it is undeniable that in some localities these reclamation and relocation initiatives help to improve rural living conditions since better infrastructure are now installed in the relocation sites, our fieldwork in Tianjin and Chengdu indicates that these initiatives are still essentially local governments' actions to generate new construction land use quotas. In many cases, both the level of compensation for the old rural residential housing demolition and the standards of new housing in the relocation sites are unilaterally decided by local governments. Farmers involved usually have no much saying in the whole process. In some occasions farmers are forced to live in the apartment buildings that are very far away from their farming land. This inevitably leads to dissatisfactions. In Tianjin, for example, the 12,000 mu (1/15 hectare) farmland and the residential housing area of 12 villages in Huaming Township were taken away by local government and all the farmers are relocated to the central township of Huaming. Many angry farmers are now appealing to the upper level governments for better arrangements.

4. Land Reform and Coordinated Reforms for a Harmonious Society

The discussions so far show that the challenges in China's land system are not only very complicated, but also relate to problems in China's local public finance system and household registration system. Therefore, a well-designed and coordinated reform package is absolutely needed for China to overcome the existing challenges.

4.1 Reforms in Land Requisition System

The reform of China's land requisition system needs to be carried out based on a clear and strict definition of public and non-public land use. In other words, land should be requisitioned only when it is used to serve public interests. Though in practice it is not so easy to define exactly what are the land use types that serves public purpose and such definition may change over time, it is still evident that land used for industrial, commercial, residential and tourism development should not be included.

After giving a clear definition of land use types that serve public interests and mandating that only the land used for public purposes can be requisitioned, in land requisition government still need to compensate farmers according to the market value of the expropriated land. In another word, citizens have no obligations to suffer financial losses in the process. The principle that compensation for land requisition should reflect market value is an internationally accepted practice. The following can be considered in the coming land requisition reform:

can be relocated to industrial parks. The new site [...] if it is absolutely necessary to occupy some farmland [...] can use some quotas generated by such land reclamation." In 2005, the Ministry of Land and Resources put forward a policy of "coupling of urban construction land increase with rural construction land reduction" so that if in one locality a unit of new arable land generated by rural residential and industrial land reclamation implies an equivalent unit of land use quotas in urban expansion.

1. The provincial governments, rather than the city and the county governments, need to be responsible for setting up the minimum compensation standards in land requisition for cities and counties within their jurisdiction. Such minimum compensation standards need to reflect the principle of equal treatment for the state owned land and the collectively owned land, though they can vary to some extent by local conditions such as land endowment, economic development level and location et al.
2. A negotiation mechanism between land users and the village collectives needs to be set up so that the two sides can negotiate freely on the compensation and a piece of land cannot be used unless an agreement is reached.
3. A coordination and arbitration mechanism for land requisition procedures and compensation level is needed. In particular, the power of arbitration are to be placed at the governments of provincial level rather than those at the city and county level since the latter themselves are the key players in the process of land requisition.

4.2 Reforms in Rural Collective Construction Land System

The Third Plenary Session of the 17th CCP Congress issued an important decision to gradually allow free transactions of collective construction land. However, the present draft of LML Amendment still prohibits such transactions within “the urban construction area defined by the Master Land Plan.” As discussed earlier in this report, this would effectively exclude the majority of rural construction land with high market values from free market transactions. The LML Amendment also continues to prohibit the use of collective construction land for commodity housing development. From the perspective of the state, the main concern is the loss of control over construction land supply and thus the loss of government revenue from public land leasing. A second concern is the loss of control in farmland protection. However, it is difficult to believe that such prohibition would work. In the past several years, the “small property-rights housing” have boomed despite government prohibitions. If this prohibition policy is to be continued, governments would not be able to constrain small-property-rights development and would only lose tax revenues that could have been obtained if the “small-property-rights housing” is legalized.

In our view, legalizing the small-property-rights housing and allowing collective construction land to be developed for commodity housing would not only help to protect the interests of rural collectives and farmers, but also help to improve China’s land use efficiency. Only by allowing rural collectives and farmers to negotiate land compensation with land users directly, would it be possible to correct the serious distortions witnessed in China’s urban land markets. With multiple suppliers of urban residential land, local governments would no longer be able to monopolize the supply of residential land, thus helping to reduce the bubbles in China’s housing market. When rural collectives and farmers can negotiate land compensation with industrial land users, the development zone craze in China can be effectively cooled down since farmers would not give up their land at negative or zero prices. Therefore, such reforms, if implemented, would not only help to alleviate the macro-economic imbalances discussed in Part II, but also help to reduce the serious social conflicts caused by abusive land requisitions witnessed in contemporary China. As long as the “small-property-rights housing” development conforms to the Land Use Master Plan

and the Urban Planning, equal treatment in market transactions should be granted to the collective construction land and the state-owned land. Under such a circumstance, industrial, commercial and residential land users would carry out land transactions directly with the village collectives and farmers.

The issue of redeveloping “urban villages” deserves more elaboration. At present, the common practice in most cities is to demolish these villages and lease the land out to commercial and residential developer after requisitioning the rural collective land as state-owned land. This not only easily lead to social conflicts in urban village redevelopment programs, but also drive away the migrant workers who find urban villages the only affordable housing sites in cities. Therefore, it is hardly a sustainable model of urban village redevelopment.

An alternative approach is to draw some successful experiences from Taiwan, South Korea and Japan through “land readjustment.” A land readjustment scheme is typically initiated by the municipal governments designating an area which is about to be developed. A subdivision plan is developed for a unified planning of the area. Provision of infrastructure and services is financed by the sale of some of the plots within the area, often for commercial activities. The original landowners are provided plots within the reshaped area which, although smaller in size, now have access to infrastructure and services.¹⁷

The redevelopment and renovation of China’s urban villages can draw on these successful international land readjustment experiences and further innovate by taking into account China’s specific needs to provide affordable housing for migrants from the countryside. This can be done by requiring, through urban planning, the landowners of urban villages to develop rental housing rather than commodity housing. The floor-area ratio can be lifted in these readjustment projects in urban planning so that the supply of rental housing can be adequate and the rental prices can be kept reasonably low even after urban village renovation. In this way, affordable housing for the large number of floating population can be provided through the market rather than through direct government provision.

4.3 Coordinated Tax Reform

If reforms on land requisition and rural collective land system proposed in earlier sections can be carried out, it would enable the rural collectives and farmers to reap more benefits from land conversions and transactions. However, if rural collectives and farmers keep all of the benefits, local governments would barely have any incentive to push forward such reforms. Moreover, since theoretically speaking the land value appreciation in rural-urban land conversion can be largely attributed to the “positive externality” generated by urban growth and infrastructure investment, there is an economic rationale to install a value added tax in the process. The tax is to be levied on the difference between the market value of land after readjustment (or conversion) and the value before readjustment (conversion).

¹⁷ A definition of the technique is provided by Archer (1987): “Land readjustment is a technique whereby a group of neighboring landowners in an urban-fringe area are combined in a partnership for the unified planning, servicing and subdivision of their land with the project costs and benefits being shared between the landowners.”

Second, a property tax on urban housing stock can be introduced to further consolidate local tax bases. Since 2003, pilot programs for property tax simulations (without real tax collection) have been in place in Beijing, Liaoning, Jiangsu, Shenzhen, Chongqing, Ningxia, Fujian, Anhui, Henan and Dalian. On the basis of these pilot programs, a comprehensive property tax reform can be introduced in the next few years to provide local governments with stable streams of tax revenue.

If the land value-added tax and the property tax can be installed in China's local tax system, they would more than compensate the financial loss caused by the land requisition and collective land reforms proposed earlier. More important, property tax and land value-added tax are more formal and sustainable sources of revenues for local governments. When local governments stop relying on the unsustainable land leasing fees for local infrastructure development and public services, China would no longer need to pay for the high social and economic costs caused by abusive land requisition and distorted land leasing actions that we see today (Tao and Xu 2007).

4.4 Coordinated *Hukou* Reform

Finally, *Hukou* reform is needed for the large number of rural migrant workers to settle down in cities on a permanent basis. As a matter of fact, *Hukou* reform can be coordinated with land reform to make each other less difficult. As explained in section 4.2, China needs to allow rural collective construction land to directly enter the primary urban land market so that rural collectives in urban fringes can develop commodity housing and rental housing on their own. This would help to reduce the commodity housing prices and the rental prices in cities significantly. Affordable housing for migrant workers can then be provided through market mechanism. In another word, the institutional innovations in urban collective land system would help to bring about breakthroughs in *Hukou* reform, i.e., the government does not need to directly provide housing for migrant workers. When progress is made in *Hukou* reform so that an increasingly number of rural migrants can settle down in cities on a permanent basis, some land in the migrant-sending areas, both residential and agricultural, would then be released for those who are left-behind in the urbanization process. A condition of obtaining an urban *Hukou* can be set, for example, as the following: a rural migrant who wants to be get an urban *Hukou* has to give up their agricultural land to his or her rural collective, while she is free to sell his/her residential property (Tao and Xu 2006). Under such a circumstance, rural collectives in migrant-sending areas would gradually have some extra agricultural land to be allocated to the newly increased population in village, thus easing the pressure of administrative land reallocation due to demographic changes across families in the village. This would result in more stable agricultural land tenure security. For residential land and housing, a privatization can be carried out along with *Hukou* reform. As rural migrant settle down in cities, some of them would sell their residential property to the newly formed families in the countryside. Then the existing stock of rural residential property can be more efficiently utilized. As such, China will be able to improve the following situation: a significant share of rural residential land in the countryside is left idle or underutilized while newly built housing continue to encroach the country's limited arable land.

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