Title of Dissertation: AN INSTITUTIONAL ANALYSIS OF THE CHINESE LAND CONVERSION PROCESS

Jianbo Ma, Doctor of Philosophy, 2009

Directed By: Professor Robert H. Nelson, School of Public Policy

Formally, China has a highly centralized system to control the conversion of farmland to non-farming uses. Its rigidity and other problems, however, have led to a large informal and decentralized market that serves to accommodate the demand for developable land. This dissertation, based on a case study in a county on China’s eastern coast, finds that the informal land market has played an essential role in promoting local economic growth, improving the financial situations of local governments and villages, and benefiting some low-income people. As far as economic efficiency is concerned, the Chinese land system functions reasonably well given the existing institutional arrangements, though at high transaction costs. However, the land conversion process, governed largely by the “law of the jungle”, is highly unfair because it favors the powerful, the bold and the wealthy.

The recent piecemeal policies by China’s national government to fix the system have produced few positive or even negative effects. The dissertation concludes that the success of future attempts to improve the land conversion system hinges on the willingness and capability of the national government to change the “rules of the game” in a fundamental way.
AN INSTITUTIONAL ANALYSIS OF

THE CHINESE LAND CONVERSION PROCESS

By

Jianbo Ma

Dissertation submitted to the Faculty of the Graduate School of the University of Maryland, College Park, in partial fulfillment of the requirements for the degree of Doctor of Philosophy 2009

Advisory Committee:

Prof. Robert H. Nelson, Chair
Dr. James R. Cohen
Prof. I. M. (Mac) Destler
Prof. Chengri Ding
Prof. Mengzhong Zhang
ACKNOWLEDGEMENTS

I wish to thank my advisor Prof. Robert Nelson for his advice and support all along, and Dr. James Cohen, Dr. I. M. (Mac) Destler, Dr. Chengri Ding and Dr. Mengzhong Zhang for serving on my committee and providing helpful comments.

I am also very grateful to a large number of people who assisted me with my field research. Regrettably, for confidentiality reasons, their names do not appear in the dissertation.

Last but not the least, I want to express my appreciation and gratitude to the School of Public Policy, University of Maryland at College Park for the quality education it offered and the financial support it provided to me.
TABLE OF CONTENTS

ACKNOWLEDGEMENTS........................................................................................................ II

LIST OF ABBREVIATIONS .................................................................................................. VI

LIST OF MAPS, FIGURES AND TABLES ........................................................................... VIII

GLOSSARY OF CHINESE TERMS ....................................................................................... IX

MAP OF CHINA...................................................................................................................... X

PREFACE................................................................................................................................. 1

1. Purpose of the dissertation.............................................................................................. 1
2. Approach of the dissertation ......................................................................................... 1
3. Main findings of the dissertation .................................................................................. 4
4. Organization of the dissertation .................................................................................... 5
5. Other explanations ........................................................................................................... 6

INTRODUCTION...................................................................................................................... 8

1. Drivers of land conversion in China .............................................................................. 8
2. Institutional setting for land conversion ....................................................................... 11
3. Key policy issues identified by the existing literature .................................................. 19
4. Conceptual analytical framework of the dissertation .................................................. 34
5. Introduction to the county selected for the case study .................................................. 43

PART I  THE PLAYERS AND THE REFEREES .................................................................. 52

INTRODUCTION TO PART I .................................................................................................. 53
CHAPTER 1 VILLAGE ............................................................................................................ 55
1. Introduction ..................................................................................................................... 55
2. Collective ownership of farmland .................................................................................. 56
3. Village leaders ............................................................................................................... 64
4. The financial situation of villages .................................................................................. 76
5. Summary ....................................................................................................................... 80
CHAPTER 2 FARMERS ......................................................................................................... 81
1. Introduction ..................................................................................................................... 81
2. Importance of farming ................................................................................................... 81
3. Compensation for compulsory land conversion ......................................................... 89
4. Strategies of farmers during compulsory land acquisition ......................................... 95
PART II  WORKINGS OF THE SYSTEM ................................................................. 209

INTRODUCTION TO PART II ........................................................................... 210

CHAPTER 7 IMPRACTICABILITY AND INCONSISTENCY OF THE PLANNING SYSTEM ......................................................................................... 212

1. Introduction ........................................................................................................... 212
2. Impracticability of the NGCLUP ......................................................................... 212
3. Impracticability of the CLUP of Dragon County ................................................... 217
4. Inconsistencies between Dragon’s CLUP and Urban Plans ................................... 221
5. Summary ............................................................................................................... 227

CHAPTER 8 INFORMAL MARKET AS A NATURAL RESPONSE TO A HIGHLY CENTRALIZED SYSTEM ................................................................. 229

1. Introduction ........................................................................................................... 229
2. Informal land conversions by local governments ..................................................... 231
3. Informal transfer of land use rights between villages and developers ....................... 241
4. Informal real estate development by villages ................................................................. 246
5. Summary .......................................................................................................................... 249

CHAPTER 9 GUAN XI AS AN INVISIBLE HAND OF THE INFORMAL MARKET ........ 250
1. Introduction .................................................................................................................... 250
2. Importance of Guan Xi to the Chinese society ................................................................. 251
3. Dragon’s Guan Xi networks ........................................................................................... 259
4. Implications of Guan Xi networks on the land conversion process ............................. 265
5. Summary .......................................................................................................................... 275

CHAPTER 10 CONTRIBUTIONS OF INFORMAL LAND CONVERSIONS TO GROWTH
VS. CRACKDOWNS BY HIGHER-LEVEL GOVERNMENTS ............................................ 277
1. Introduction .................................................................................................................... 277
2. Contribution of land conversion to local economic growth .......................................... 278
3. Unintended consequences of investment promotion through land conversion .......... 292
4. Crackdowns by higher-level governments .................................................................... 295
5. Summary .......................................................................................................................... 301

CHAPTER 11 EFFICIENCY AND EQUITY CONSEQUENCES ............................................ 303
1. Introduction .................................................................................................................... 303
2. Concepts of efficiency and equity .................................................................................. 303
3. Efficiency and equity consequences of the Chinese land conversion process ............ 308
4. Summary .......................................................................................................................... 341

PART III POLICY THOUGHTS .......................................................................................... 345

INTRODUCTION TO PART III .......................................................................................... 346

CHAPTER 12 KEY MESSAGES FROM THE CASE STUDY AND POLICY OPTIONS ................................................................................................. 348
1. Introduction .................................................................................................................... 348
2. Key messages from the case study .................................................................................. 348
3. Review of piecemeal fixes to the land system ................................................................. 352
4. Assessing a recent, more fundamental fix to the system ................................................. 355
5. Assessing other policy options ...................................................................................... 361
6. Summary .......................................................................................................................... 374

CHAPTER 13 FUTURE POLICY DIRECTION ..................................................................... 375
1. Introduction .................................................................................................................... 375
2. Dichotomy between efficiency and equity ................................................................. 376
3. Income disparity as a most important social problem ............................................... 382
4. Future policy direction ................................................................................................... 385

BIBLIOGRAPHY .................................................................................................................. 388
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAP1</td>
<td>Affordable Apartments Program I</td>
</tr>
<tr>
<td>AAP2</td>
<td>Affordable Apartments Program II</td>
</tr>
<tr>
<td>BLC</td>
<td>Bureau of Letters and Calls</td>
</tr>
<tr>
<td>BLR</td>
<td>Bureau of Land and Resources</td>
</tr>
<tr>
<td>BLT</td>
<td>Bureau of Local Taxation</td>
</tr>
<tr>
<td>BOC</td>
<td>Bureau of Construction</td>
</tr>
<tr>
<td>BOP</td>
<td>Bureau of Planning</td>
</tr>
<tr>
<td>BSI</td>
<td>Bureau of Supervision and Inspection</td>
</tr>
<tr>
<td>BST</td>
<td>Bureau of State Taxation</td>
</tr>
<tr>
<td>CCP</td>
<td>Chinese Communist Party</td>
</tr>
<tr>
<td>CLUP</td>
<td>Comprehensive Land Use Plan</td>
</tr>
<tr>
<td>CNNIC</td>
<td>China Internet Network Information Center</td>
</tr>
<tr>
<td>CUP</td>
<td>Comprehensive Urban Plan</td>
</tr>
<tr>
<td>DCP</td>
<td>Detailed Controlling Plan</td>
</tr>
<tr>
<td>DIC</td>
<td>Discipline Inspection Committee</td>
</tr>
<tr>
<td>EDNR</td>
<td>“Execute and Do Not Report”</td>
</tr>
<tr>
<td>EDZ</td>
<td>Economic Development Zone</td>
</tr>
<tr>
<td>EFRL</td>
<td>“Execute First and Report Later”</td>
</tr>
<tr>
<td>EOE</td>
<td>Export-Oriented Enterprise</td>
</tr>
<tr>
<td>FAGS</td>
<td>Financial Administration Guidance Station</td>
</tr>
<tr>
<td>FAR</td>
<td>Floor-Area Ratio</td>
</tr>
<tr>
<td>FPP</td>
<td>Family Planning Policy</td>
</tr>
<tr>
<td>FYP</td>
<td>Five-Year Plan</td>
</tr>
<tr>
<td>GHG</td>
<td>Greenhouse Gas</td>
</tr>
<tr>
<td>LC</td>
<td>Letters and Calls</td>
</tr>
<tr>
<td>IP</td>
<td>Industrial Park</td>
</tr>
<tr>
<td>MLR</td>
<td>Ministry of Land and Resources</td>
</tr>
<tr>
<td>MOC</td>
<td>Ministry of Construction</td>
</tr>
<tr>
<td>MSI</td>
<td>Ministry of Supervision and Inspection</td>
</tr>
<tr>
<td>NBS</td>
<td>National Bureau of Statistics</td>
</tr>
<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
</tr>
<tr>
<td>NGCLUP</td>
<td>National Guideline for Comprehensive Land Use Planning</td>
</tr>
<tr>
<td>NPC</td>
<td>National People’s Congress</td>
</tr>
<tr>
<td>OLC</td>
<td>Office of Letters and Calls</td>
</tr>
<tr>
<td>OPS</td>
<td>Ordinary Public School</td>
</tr>
<tr>
<td>PMC</td>
<td>Property Management Company</td>
</tr>
<tr>
<td>PMPS</td>
<td>Privately Management Public School</td>
</tr>
<tr>
<td>SEPA</td>
<td>State Environmental Protection Administration</td>
</tr>
<tr>
<td>SI</td>
<td>Supervision and Inspection</td>
</tr>
<tr>
<td>SLRC</td>
<td>State-Owned Land Reserve Center</td>
</tr>
<tr>
<td>SOE</td>
<td>State-Owned Enterprise</td>
</tr>
<tr>
<td>TB</td>
<td>Taxation Bureau</td>
</tr>
</tbody>
</table>
TVE Township and Village Enterprise
UP Urban Plan
LIST OF MAPS, FIGURES AND TABLES

MAP 1 ILLUSTRATIVE MAP OF DRAGON COUNTY AND DRAGON CITY (NOT DRAWN TO SCALE) ................. 46
MAP 2 ILLUSTRATIVE MAP OF DRAGON CITY (NOT DRAWN TO SCALE) ........................................... 48
MAP 3 ILLUSTRATIVE MAP OF THE PLANNED URBAN CLUSTERS WITHIN DRAGON COUNTY FOR THE
LONG TERM (NOT DRAWN TO SCALE) ........................................................................................................ 51
MAP 4 VILLAGES AND TOWNSHIPS COVERED BY THE STUDY .................................................................. 61

FIGURE 2 THE COMPREHENSIVE LAND USE PLAN OF MUNICIPALITY A (1997-2010) ......................... 16
FIGURE 3 CHINESE HIERARCHICAL POLITICAL STRUCTURE ................................................................. 17
FIGURE 4 CONCEPTUAL ANALYTICAL MODEL ..................................................................................... 35
FIGURE 5 THE PLAYERS OF THE LAND CONVERSION GAME AND THEIR “FORMAL” RELATIONSHIPS ...... 53
FIGURE 6 LAYOUT OF THE RESIDENTIAL AREA OF A TYPICAL VILLAGE WITH 30 HOUSEHOLDS ........ 55
FIGURE 7 CONFLICTING TARGETS FOR ECONOMIC GROWTH AND FARMLAND PROTECTION .......... 118
FIGURE 8 ILLUSTRATION OF THE BUREAUCRATIC STRUCTURE AT NATIONAL AND PROVINCIAL LEVELS 124
FIGURE 9 HOUSING DEMAND AND SUPPLY .......................................................................................... 166
FIGURE 10 WORKINGS OF THE LAND CONVERSION PROCESS ......................................................... 210
FIGURE 11 “LEEWAY” OF NATIONAL POLICIES .................................................................................... 233
FIGURE 12 DEMAND AND SUPPLY OF TRAIN TICKETS ....................................................................... 252
FIGURE 13 ILLUSTRATION OF DIFFERENCES IN MENTAL DEVELOPMENT ..................................... 259
FIGURE 14 THE POWER OF GUAN XI NETWORK .................................................................................. 260
FIGURE 15 OPTIMAL NUMBER OF SOCIALIZING DINNERS .................................................................... 264
FIGURE 16 FISCAL REVENUE OF DRAGON COUNTY, 1992-2006[1] ..................................................... 279
FIGURE 17 A TRADITIONAL FARMER’S HOUSE IN DRAGON COUNTY ............................................... 289
FIGURE 18 LAND RENT GRADIENTS OF DIFFERENT USES ................................................................. 304
FIGURE 19 EFFECTS OF THE EXTERNALITIES OF LAND USE ............................................................. 309
FIGURE 20 EFFECT OF LAND SUPPLY CONTROL ................................................................................... 310
FIGURE 21 ILLUSTRATION OF THE FREQUENCY AND INTENSITY OF CRACKDOWNS ..................... 321
FIGURE 22 TEMPORAL EFFECTS OF LAND USE .................................................................................... 325
FIGURE 23 RELATIONSHIP BETWEEN LAND PRICE AND DEVELOPMENT DENSITY ....................... 333
FIGURE 24 EFFECT OF MONOPOLY ON THE AMOUNT OF LAND MADE AVAILABLE FOR DEVELOPMENT 336
FIGURE 25 EFFECT OF MONOPOLY ON THE ALLOCATION OF LAND BETWEEN DIFFERENT USES .......... 338
FIGURE 26 A TYPICAL TEXTBOOK’S DESIGN OF A FAIR LAND CONVERSION GAME ......................... 346

TABLE 1 CLASSIFICATION OF THE ACCUSING PARTIES IN LAND DISPUTES ........................................... 33
TABLE 2 CLASSIFICATION OF THE ACCUSED PARTIES IN LAND DISPUTES ........................................ 33
TABLE 3 STRATEGIES USED BY VILLAGES IN DISTRIBUTING COMPENSATION .................................. 64
TABLE 4 BUDGETED EXPENDITURES OF DRAGON’S COUNTY GOVERNMENT, 2007 ............................. 143
TABLE 5 MAIN OUTLAYS AND REVENUES OF DRAGON’S COUNTY GOVERNMENT DURING LAND
CONVERSION ............................................................................................................................................. 147
## GLOSSARY OF CHINESE TERMS

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dan Wei</td>
<td>One’s employing organization or company</td>
</tr>
<tr>
<td>Ding Zi</td>
<td>“Nail”</td>
</tr>
<tr>
<td>Ding Zi Hu</td>
<td>“Nail Household”, a nickname given to households who do not comply with government decisions during compulsory land acquisition</td>
</tr>
<tr>
<td>Guan Xi</td>
<td>Personal connection between people or institutions</td>
</tr>
<tr>
<td>Hu Kou</td>
<td>The officially registered address of one’s permanent residency</td>
</tr>
<tr>
<td>Ji Dong Di</td>
<td>Reserve land</td>
</tr>
<tr>
<td>Kou Liang Di</td>
<td>Grain Land</td>
</tr>
<tr>
<td>Mu</td>
<td>Chinese measurement unit for area. 15 mu is 1 hectare.</td>
</tr>
<tr>
<td>Yuan</td>
<td>Chinese currency unit. Based on the exchange rate in 2008, 6.8 yuan is approximately 1 dollar.</td>
</tr>
</tbody>
</table>
MAP OF CHINA

(The map is taken from the website of the Society for Anglo-Chinese Understanding.)
PREFACE

1. Purpose of the dissertation

This dissertation examines the land conversion process in China, a country that is experiencing rapid urbanization, and assesses whether the resulting land use is efficient and equitable. Conceptually, “efficiency” means that land is put to its highest and best use so that it generates the highest rent over time; and “equity” means that the distribution of the benefits from land conversion is socially fair. In practice, both efficiency and equity are complicated to assess, as will be discussed in detail later in the dissertation.

The reason why land conversion does and should occur is that land can be put to higher and better uses and generate greater economic returns than before. Therefore, the process of land conversion entails net benefits for the society, and may be seen as a game played by various players - including farmers, developers and public officials, etc. - each trying to receive more benefits within the boundaries set by the institutional arrangements of a society. This dissertation aims to gain a deeper understanding regarding how the existing institutions may be improved in order to make the game of land conversion more efficient and fair.

2. Approach of the dissertation

The dissertation is based on a case study in a county of approximately 800,000
people on China’s rapidly developing eastern coast. In order to protect the human subjects involved in the study, the county will be given the fictitious name of Dragon. Many other names in the case study will also be kept confidential, and will be identified by their categories plus letters, such as “Industrial Park B”, “Village M”, “Leather Factory A”, and “Farmer E”, etc. In addition, some factual data about the county, such as location, population, area, and GDP, etc., are provided in approximate, rather than exact, terms, so that they do not lead to identification of the county. Otherwise, all information is authentic. Any quotes are taken directly from the interviews and have not been altered except to reflect the fictitious county and often names.

I paid seven visits to Dragon, each lasting one to three weeks, between July 2005 and February 2009, and collected data through document review, on-site observations and interviews. The documents reviewed included those publicly available in printed or electronic forms, such as the county’s Yearbooks and government reports, and non-confidential internal documents of the local governments obtained through private sources. On-site observations were made through a number of field trips, guided by local people, to specific sites covered by the study. The interviews took several forms: pre-structured interviews with individuals, focus group meetings, and conversations with local people that were not pre-structured. In total, I talked to at least 60 people, including farmers, developers, urban residents and local officials.

Although the data collected are sufficient for me to draw conclusions with confidence, I acknowledge that they fall well short of perfection for several reasons:
First, the local governments in China are very opaque, and much information is not available to the public. Second, the study unavoidably touched on the conflicts of interest among various players in land conversion. Some interviewees chose not to disclose certain sensitive information. Therefore, the data acquired on these issues were often incomplete. Third, the local statistical system is not credible, and much of the published official data on critical issues were fraudulent in the first place, as will be described in detail in the dissertation. In addition, some figures quoted in the dissertation are only approximate, often because they are only estimates made by local interviewees and it is impossible or difficult to verify them on a fully confident basis. Despite such uncertainty, these figures are used because they are believed to provide close approximations to actual situations.

The Chinese land system keeps evolving all the time. While I was writing this dissertation, some new polices were introduced by the Chinese government to improve the system. For example, the Chinese Communist Party Central Committee passed a resolution in October 2008 to deepen rural reform, including changes to rural land tenure and existing land market rules. The real effects of these new policies will not become clear immediately, and therefore cannot be assessed by the dissertation. However, wherever appropriate, their potential consequences are discussed based on the findings of the case study.
3. Main findings of the dissertation

Although a case study of one county only, this dissertation is more ambitious than most others because it undertakes to explore and analyze the Chinese land system as a whole, rather than focusing on any one player or limited area of land practice.

The study finds that a large informal local land market has developed in response to a rigid and highly centralized land use system. In general, the informal market improves land use efficiency by promoting local economic growth, creating employment opportunities for local people, and improving the financial circumstances of local governments, villages and individuals. Of course, there are also various forms of incompatible land uses - but many of them cannot be attributed to the informal nature of these land conversions per se, and some are probably not avoidable under any system. Yet, achieving economic efficiency through the informal market imposes high transaction costs on the players involved and the society as a whole.

This dissertation shows that all the players benefit from land conversion. Even farmers, as the weakest group, have experienced improved living standards, in terms of absolute income, after land conversion. Moreover, some low-income people working or living in the city benefit from the informal land market, which creates jobs and makes housing more affordable. This is not to say, however, that the distribution of the benefits from land conversion is equitable, because the process of land conversion is subject to the “law of the jungle” and favors the powerful, the bold and the wealthy.
Most of the recent efforts by the national government to fix the system focus on changing individual “policy acts”, not the “rules of the game”,\(^1\) and consequently have had little or no beneficial impact, and some may even have had the effect of decreasing efficiency without improving fairness by disrupting the informal market, which is essential to making the land system work.

Future policies to fix the system, if successful, will need to, essentially, formalize the informal market. However, the necessary conditions for doing this, such as transparency in the administration of public resources and accountability of public officials to citizens, are largely absent in the current political structure that stresses the centralized control of power. Therefore, the success of future policies to improve the system hinges on the willingness and capacity of the national government to reform the existing political and economic institutions in a fundamental way.

4. Organization of the dissertation

The organization of the dissertation resembles that of a book.\(^2\) Although a bit unconventional for a Ph.D. dissertation in this respect, this approach has the advantage of being able to present the case study and relate it to the larger picture in a coherent and interesting way.

The Introduction describes the main drivers of land conversion in China and the

---

\(^1\) This is a distinction drawn by James M. Buchanan, and will be discussed in the Introduction of the dissertation.

\(^2\) To some extent, the organization of the dissertation resembles that of Richard Babcock’s The Zoning Game (1966) or Marion Clawson’s Suburban Land Conversion in the United States (1971).
institutions that guide the Chinese land conversion process, discusses major policy issues identified by the existing literature, and introduces Dragon, the county selected for the case study. Part One describes the respective interests, strategies and behaviors of the various players in the land conversion process, and discusses the ineffectiveness of the referee institutions in ensuring fair play. Part Two assesses the workings of the system, including the impracticability of centralized planning, the central role of the informal market, the importance of personal relations to the informal market, the contribution of informal land conversion to local economic and social development, and the efficiency and equity consequences of the system. Part Three presents policy implications.

5. Other explanations

The dissertation often relates to parallel stories in other policy areas in order to provide a general political and social context for a better understanding of the Chinese land system. Moreover, although the case study focuses on Dragon County, it sometimes draws on the experiences of other regions, particularly County A, which is a neighbor county of Dragon. In addition, while the discussions center on the conversion of farmland to urban uses, they inevitably also address the conversion of land from one urban use to another.

Two key terms used in the dissertation are “formal” and “informal” land conversion. The former refers to land conversion carried out according to the official
procedures defined by the Chinese laws and policies, whereas the latter refers to land conversion without approval from the competent authorities. I try to avoid using the term “illegal”, which often conveys such meanings as “bad” or “immoral”, for the latter because such land conversion is often socially beneficial.
INTRODUCTION

This introduction sets the stage for a detailed description of the land conversion process in Dragon, the county selected for the case study, in the following chapters. It first explains why land conversion is so important for the Chinese society. Next, it introduces the institutions that guide the Chinese land conversion process, including land tenure, land market regulations, land use plans, and the Chinese bureaucratic structure, etc. This is followed by a brief description of key policy issues identified by the existing literature. Then, it discusses the conceptual analytical framework of the dissertation. Lastly, it introduces Dragon County, including its main economic and social indicators and a brief history of its urbanization process.

1. Drivers of land conversion in China

The conversion of rural land to urban uses is important for any society, but particularly for China. China’s population accounts for 22% of the world’s total; but its arable land, where most of the population and cities are concentrated, is only 7% of the world’s total.\(^3\) In 2005, arable land accounted for less than 15% of China’s territory;\(^4\) and the per capita arable land area in China was only 0.27 hectares, which was less than 40% of the world average, one eighth the U.S. level, and half the Indian level.\(^5\) Despite the scarcity of arable land in China, there is great pressure for the conversion of arable land to urban uses due to rapid urbanization, sustained

---

\(^3\) Xin Hua News Agency (Oct. 24, 2005)
\(^4\) CIA-the World Fact book about China
\(^5\) Xin Jing Bao (2006), Yingling Liu (2006)
population growth, and rapid economic development.

**Rapid Urbanization**

Chinese cities have been expanding rapidly, in both size and number, over the past two to three decades. Between 1978 and 2004, the level of urbanization in China increased from 18% to 42%, the number of people living in cities increased from 170 million to 540 million, and the number of cities increased from 193 to 661. In 1978, China had only 13 cities with a population of over 1 million, 27 cities with a population of 500,000 to 1 million, 59 cities with a population of 200,000 to 500,000, and 115 cities with a population of less than 200,000. By 2003, these numbers increased to 49, 78, 213 and 320, respectively.

Compared with other developing countries with similar economic levels, China's urbanization is about 10 percent lower. Some experts estimate that China’s urbanization level may reach 45% by 2010 and 65% by the middle of the 21st century. Other experts estimate that China’s urbanization will increase to approximately 60% within the next twenty years, resulting in almost 1 billion Chinese people living in cities by 2020.

**Population growth**

Population growth is another important contributing factor to the pressure for land conversion. Despite the Family Planning Program since the 1970s, China’s

---

6 In China, a city shall have at least 10,000 permanent residents (State Council 1986, 1993).
7 Xinhua News Agency (Nov. 9, 2005)
8 Xinhua News Agency (Nov. 9, 2005)
9 Li Shantong (2008)
10 Yang Chongguang (2003)
population is still growing rapidly, having increased from approximately 500 million in the 1950s to more than 1.3 billion now. According to an estimate by the Chinese Academy of Social Sciences, China’s population may reach approximately 1.45 billion in 2025-2030 before it starts to stabilize.\textsuperscript{12} Virtually all the population growth expected during 2000-2030 will be concentrated in the urban areas, due to rural-urban migration and the transformation of rural settlements into cities.\textsuperscript{13}

![Figure 1 China’s Population Growth between 1950 and 2005\textsuperscript{14}]

\textbf{Economic development}

China is in the process of rapid industrialization. Between 1979 and 2007, China's GDP increased at an average annual growth rate of 9.7 percent.\textsuperscript{15} Empirical evidence has shown that industrialization has been an important contributing factor to the conversion of farmland to non-farming uses,\textsuperscript{16} since many non-rural economic

\textsuperscript{12} Chinese Academy of Social Sciences (2005)
\textsuperscript{13} United Nations Population Division (1999)
\textsuperscript{14} Website of the National Population and Family Planning Commission of China
\textsuperscript{15} Wang Haibo (2008)
\textsuperscript{16} Zhang Xiaobo et al (2004)
activities require the use of land as an input of production. Moreover, industrialization, especially the rapid development of rural enterprises, offers more non-farm job opportunities, thus raising wages and making farming less attractive as surplus labor is exhausted.17 As the living standards of the Chinese people rise, there is a growing demand for better housing conditions. The per capita living floor area for urban residents increased from 3.6 m$^2$ in 1978 to 8.8 m$^2$ in 1997 and 23.7 m$^2$ in 2003, while that for rural residents increased from 8.1 m$^2$ in 1978 to 22.5 m$^2$ in 1997 m$^2$ and 27.2 m$^2$ in 2003.18

2. Institutional setting for land conversion

The Chinese land conversion process is guided mainly by the following institutions:

Land tenure

In China, farmland is owned by village collectives. A village often divides its farmland into two types: one is “grain land” (Kou Liang Dī), divided equally and contracted to all villagers for farming; and the other is “reserve land” (Ji Dong Dī), managed collectively by the village to accommodate population changes or rented to farmers in order to cover the village’s discretionary expenses such as infrastructure construction and maintenance. Farmers used to be required to pay an agricultural tax

based on the productivity of the farmland contracted to them, but have been exempted from it by the national government since 2004.\textsuperscript{19} The farmland contracted to individual farmers can be subleased or transferred to other farmers, provided it is still used for farming.

All non-agricultural lands are owned by the state - which means that the conversion of farmland to non-agricultural uses requires, as a first step, the transfer of land ownership from the village to the state. Developers who wish to obtain the use right to land must apply to the government. The duration of the use right to state land is typically 70 years for residential use and 50 years for industrial use.

\textbf{Land market regulations}

When acquiring land from a village collective, the government pays compensation to the village. According to the \textit{Land Administration Law} (2004), a compensation package typically consists of three parts:

- Compensation for the land, which is 6-10 times the average annual value of the produce on the land in the last three years before the land acquisition

- Compensation for farmers’ resettlement, which is typically 4-6 times the average annual value of the produce on the land in the last three years before the land acquisition, but sometimes based on per capita calculations

- Compensation for existing crops on the land, the level of which is set by the provincial government

In practice, the level of compensation varies from region to region, but usually stays relatively fixed within a particular jurisdiction. There are no legal stipulations

\textsuperscript{19} This will be described further in Chapter 2.
regarding how the compensation shall be distributed within a village collective, which is often a source of conflicts between village leaders and farmers, as will be discussed later.

After the ownership of land is transferred from the village to the state, developers acquire land use rights from the government through auctions or public tender. In some cases, a developer can obtain land through “negotiations” with the government, if the latter believes that the proposed project will be able to generate significant social benefits, such as job opportunities or technology spillover. The land use rights acquired in these ways are tradable on the secondary market, with permission from the government.

In addition, the government also “allocates” land directly for public infrastructure for whose construction the government is directly responsible. Some state-owned enterprises (SOEs) may also obtain land use rights through “direct allocation” or by paying prices that are lower than market prices. The land use rights acquired in this way are usually forbidden from being sold on the secondary market unless the shortfalls from the standard market land prices, assessed by the government, are paid.

A new policy has just been introduced in October 2008 that some collectively owned lands (mainly lands already used by township and village enterprises or occupied by farmers’ housing) will be allowed to enter into the land market directly, without the transfer of ownership to the state. The potential consequences of this policy are not yet clear, as will be discussed in Chapter 12.
Comprehensive Land Use Plans (CLUPs) and Urban Plans (UPs)

The amount of rural land that can be converted in a given period within a jurisdiction is limited, and is regulated by the Comprehensive Land Use Plan (CLUP). The CLUP defines the development functions of different regions in a jurisdiction, and sets up specific land use targets, i.e. the amount of land used for each purpose such as farming, urban development, roads, and water conservancy facilities, etc. Figure 2 is an example of what a real CLUP looks like. A most important feature of a CLUP is that it aims to control the supply of developable land and achieve a “dynamic balance”, which means that any farmland converted to urban uses must be made up for by reclaiming an equivalent amount of land elsewhere within the same province. The main reason for such a strict farmland protection policy is a concern by the national government for food security, as will be discussed in detail in Chapter 3.

CLUPs are developed, in a strictly top-down process, at five levels: national, provincial, municipal, county and township.\(^\text{20}\) (The Chinese hierarchical political structure is illustrated in Figure 3.) The CLUP of a jurisdiction must be based on that of the immediately higher-level jurisdiction. For example, a provincial CLUP sets developable land quotas for its municipalities; likewise, a municipal CLUP sets quotas for its counties.

A CLUP covers all aspects of land use within a jurisdiction, but has a high level of generality. It sets general land use objectives (such as farmland protection objective) and outlines regional land use functions in broad terms, but does not include detailed

\(^{20}\) National Land Administration (1997)
requirements for specific sites.

Land use on specific sites is regulated by the Urban Plans (UPs), which not only specify the types of use for individual land parcels, but also dictate building codes such as density and height – just like a U.S. zoning map. There are several types of urban plans for a city in terms of the level of details they regulate, as will be described in Chapter 7.
Chapter 1 Preface (1.5 pages): This explains the purpose of the plan.

Chapter 2 Planning objectives (1.5 pages): They mainly include: a) general economic and social development objectives, such as GDP, level of urbanization; and b) land use objectives, such as the amount of farmland that must be preserved, and the level of forest coverage, etc.

Chapter 3 Distribution of land among different uses (2 pages): This includes specific targets regarding the amount of land that may be used for different purposes, such as urban construction, roads, mining, and irrigation facilities, etc.

Chapter 4 Definition of the development functions of different regions (5 pages): This includes a) a definition of the development functions of various regions within the municipality, such as commercial and industrial centers, tourist centers, grain production areas, fruit production areas, and mining areas, etc.; and b) specific land use targets for agriculture, forestry, parks, urban areas, beach, and other uses.

Chapter 5 Land preservation objectives (1 page): This includes specific objectives regarding how much farmland shall be protected fully, and general requirements regarding the protection of landscape and historic sites.

Chapter 6 Land reclamation objectives (1 page): This mainly includes specific targets regarding how much land shall be reclaimed from un-utilized mountains or other sources for farming, parks or other uses.

Chapter 7 Land use by large public programs (1 page): This includes objectives of land use for roads, water conservancy, and ecological conservation, etc.

Chapter 8 Land use of coastal areas and islands (1 page): This includes general principles for the zoning of the coastal areas and islands.

Chapter 9 Land use by the counties under Municipality A (3/4 page): This mainly sets developable land quota for the counties.

Chapter 10 Implementation of the plan (1.5 pages): This includes general requirements for “conscientious” implementation.

Chapter 11 Supplementary provisions (1/4 page): This explains the attached maps and approving authorities of the plan.
China’s political structure and land administration system

China’s political system is dominated by the Chinese Communist Party (CCP). Nominally, the National People’s Congress (NPC) is the decision-making body of the...
government, and the People’s Courts can act independently. In practice, the CCP literally controls all three (executive, legislative, and judiciary) branches of the government. At any level, the highest-ranking public official is the secretary of the CCP Committee, not the mayor, although in some cases the same person holds both positions.

Higher-level governments have absolute authority over lower-level ones, whereas coordination among the agencies at the same level is generally weak. This is easy to understand because all public officials are appointed from the above, not elected. The only exception is at the village level where the leaders are elected, as will be described in detail in Chapter 1.

Most agencies in a local government are directed by the above through “dual tracks”. For example, a county’s Environmental Protection Bureau (EPB) is controlled by the mayor of the county on human and financial resources, but directed by the municipal EPB on technical matters. Some local agencies are designed to be relatively independent of local influence, and administered through “single track”. For example, a county’s Taxation Bureau (TB) is controlled by the municipal TB on both human and financial resources and technical matters, and is thus relatively free, at least nominally, from the control of the mayor of the county.

As far as land administration is concerned, the Ministry of Land and Resources (MLR) at the national level and the Bureaus of Land and Resources (BLRs) at local levels are responsible for the planning and administration of land resources, and for
supervising and checking illegal activities in land use. They are eligible to impose administrative penalties for illegal activities, or transfer those that constitute criminal offenses to judicial departments.

Prior to 2006, the BLRs were under “dual track”. In order to reduce the influence of the local governments during land use planning and the implementation of national land policies, the national government started to implement a so-called “vertical” land administration system in 2006. Under the new system, the director and vice directors of a county BLR are appointed directly by the municipal BLR, but the financial resources of the county BLR are still controlled by the county mayor.

In addition, in order to strengthen supervision over the provincial governments on land policies, the national government established the Land Supervision and Inspection (LSI) system in 2006. The LSI Headquarters, headed by the Minister of Land and Resources, are located within the MLR. Nine Land Supervision and Inspection Bureaus (LSIBs), which are directly under the leadership of the LSI headquarters at the MLR, are established in different regions of the country to oversee the implementation of farmland protection objectives and the enforcement of land use laws and regulations by provincial-level governments.

3. Key policy issues identified by the existing literature

The existing literature has identified two outstanding issues: one is that there exists a large informal land market, and the other is that farmers are, in general,
treated unfairly in the distribution of the benefits from land conversions.\textsuperscript{21}

\textbf{3.1 Existence of an informal land market}

Informal land conversion has been widespread in China since the so-called “Land Enclosure Movement”, which started in Guangdong Province in the early 1990s and extended rapidly to other regions. Various cities tried to copy the model of Shenzhen\textsuperscript{22} to establish “economic development zones (EDZs)” in order to attract foreign investment.\textsuperscript{23} According to the Ministry of Construction, when the national government started to check this problem in March 1993, China had had more than 6,000 county- or higher-level EDZs, covering a total area of 15,000 km\textsuperscript{2} - larger than China’s total urbanized area (13,400 km\textsuperscript{2}) at the time.\textsuperscript{24} A MLR survey covering 24 provinces showed that, by 2003, China still had 5,638 development zones of various types with a total planned area of 36,000 km\textsuperscript{2}, which was larger than all the existing developed urban land area of China, and 70% of which was developed insufficiently or held idle.\textsuperscript{25}

A salient feature of this enclosure movement was to “enclose” but not “develop”.\textsuperscript{26} During the enclosure process, local officials sold land use rights at low prices; and the prices of the land use rights on the secondary market were usually

\textsuperscript{21} Key cites will be given later in the text.
\textsuperscript{22} Shenzhen was a Special Economic Zone (SEZ) established by the national government in the early 1980s to serve as a “window” and model for opening up to the outside world.
\textsuperscript{23} He Qinglian and Zhang Xiangping (2000)
\textsuperscript{24} He Qinglian (1998)
\textsuperscript{25} Xie Yang (2006)
\textsuperscript{26} He Qinglian and Zhang Xiangping (2000)
multiples or even tens of times that on the primary market.\textsuperscript{27} He Qinglian (1998) notes that,

In the heat of the enclosure movement, developers colluded with government officials to acquire land, and then sold it on the secondary market…. People believed that one would become rich as long as one could acquire land. Chinese and foreign “investors” having strong personal relations with provincial, municipal or county leaders often went to the latter to ask for land bluntly. The land use planning agencies at the county and municipal levels existed in name only.\textsuperscript{28}

The informal land market has not subsided in recent years. An inspection by the MLR through satellite remote sensing showed that, between October 2003 and September 2004, 52.8\% (in terms of area) of all newly developed land in the 70 counties inspected had been converted informally; in some counties, informal land use accounted for 70-90\% of all new land development.\textsuperscript{29} A follow-up MLR inspection revealed again that, in some cities, up to 60-90\% of all land use was informal.\textsuperscript{30, 31} Between 1999 and 2005, more than 1 million informal land use cases were identified, involving over 5 million \textit{mu} (i.e. more than 300,000 hectares) of land.\textsuperscript{32} According to the statistics reported by the provinces themselves, in the first five months of 2005, there were more than 25,000 informal land use cases across the country, involving more than 10,000 hectares of land.\textsuperscript{33} In the first five months of 2006, 25,153 informal land use cases were identified by the MLR.\textsuperscript{34} Between October 2005 and October 2006, informal land conversion accounted for more than 80\% of all land conversion

\textsuperscript{27} He Qinglian (1998)  
\textsuperscript{28} He Qinglian (1998)  
\textsuperscript{29} Wang Yijuan (2006)  
\textsuperscript{30} Wang Yijuan (2006)  
\textsuperscript{31} Xinhua News Agency (June 6, 2006)  
\textsuperscript{32} Fei Yangsheng (2006)  
\textsuperscript{33} Zhao Wuming (2005)  
\textsuperscript{34} Xinhua News Agency (June 16, 2006)
cases in 17 of 90 selected cities monitored by the MLR using satellite remote sensing technologies. During a land use inspection campaign between September 15, 2007 and January 15, 2008, the MLR uncovered 31,700 cases of informal land use, involving approximately 3,364,000 mu.\(^\text{36}\)

The local governments have been widely blamed for the existence of the informal market. In an official statement\(^\text{37}\) made in June 2006, the MLR states that illegal land use has become more and more widespread, and, increasingly, the local governments are taking a leading role in colluding against the national government.

Specifically, the following two factors are thought to have contributed to the existence of the informal market.

**Political needs of local governments**

The interest of the national government in protecting farmland is not shared by local governments, since the external benefits brought by a local government’s effort to protect farmland will be shared by other jurisdictions.\(^\text{38}\) Local governments are more interested in promoting local economic growth, for which land conversion is often an essential condition. Growth has been the most important policy objective in China since Deng Xiaoping came to power in the late 1970s, and the economic growth rate has been the most important gauge for the performance of local officials. Other things being roughly equal, mayors who do better in stimulating the local

\(^{35}\) Beijing Youth Daily (Nov. 5, 2007)  
\(^{36}\) Ministry of Land and Resources (2008)  
\(^{37}\) Xinhua News Agency (June 16, 2006)  
\(^{38}\) Qian Wenrong (2004)
economy and creating employment opportunities have a greater chance of getting promotion. A high-level official from Yancheng Municipality, Jiangsu Province makes this point clearly and bluntly when interviewed by Outlook Oriental Weekly:

A number of departments and agencies (from the higher-level government) are responsible for evaluating the performance of local officials, including the Department of Organization (of the CCP Committee), the Department of Discipline Inspection (of the CCP Committee), the Bureau of Auditing, and others. However, it is the Department of Organization that makes promotion decisions, and its most important criterion has always been economic growth.\(^{39}\)

In addition to the GDP growth rate, another important measure of economic achievement is large development projects.\(^{40}\) Typically, the first thing that a new mayor does after taking office is to develop new urban construction plans with a view to leaving a legacy.\(^{41}\) Thus, selling land use rights becomes a convenient way of generating local revenue in order to execute such plans.\(^{42}\)

Local government officials are also more concerned with their present interests than with land use efficiency over a long term, and may therefore supply more land than optimal.\(^{43}\) They can artificially “create” demand for land in order to collect more land conveyance fees.\(^{44}\) The large difference between the cost of land acquisition from villages and the benefit from land conversion has provided strong incentives in that regard. Wang Meihan (2005) and Li Junjie (2006)\(^{45}\) note that land conveyance fees are, by nature, land rents for many years that are collected in \textit{lump sum} in

\(^{39}\) Hu Ruifeng (2004)  
\(^{40}\) Qian Wenrong (2004)  
\(^{41}\) Feng Yuan and Yang Xiaoyan (2004)  
\(^{42}\) Jiang Ping, Zhou Qiren, Bai Nansheng and Bai Nansheng (2005)  
\(^{43}\) Qian Wenrong (2004)  
\(^{44}\) Jiang Ping, Zhou Qiren, Bai Nansheng and Bai Nansheng (2005)  
\(^{45}\) Quoted in Fei Yangsheng (2006)
This means that a local government can collect, once and for all, the rents from land users who will use the land for the next 50-70 years. By collecting land conveyance fees, the current local governments are actually “over-drawing” the revenue of the succeeding governments. In some cases, future governments will have to be responsible for providing services for the land converted by the current governments, but are at the mercy of their predecessors regarding how much land conveyance fees are left for them to use.

Financial needs of local governments

A number of authors have written about the problems created by China’s financial reform in 1993-1994 for local governments. With the reform, China’s fiscal revenue has been concentrated towards the national and provincial governments, but appropriate transfer payment policies have been absent. Whiting (2001) notes that the financial reform forced local officials to “manipulate” their implementation of the taxation and credit policies made by the national government. This is in line with the theories put forward by some scholars on the behavior of local governments in China or other countries. For example, Jean Oi (1992) and Qiu et al (2004) think that China’s local governments driven by financial incentives after the financial reform demonstrate many characteristics of private firms. Andrew Walder (1995) argues that local governments have greater incentives than higher-level governments to seek benefits for themselves. Charles Tiebout (1956) and William Fischel (2001) make
similar point.

Not surprisingly, local governments often resort to land sale as a way of generating revenue.\textsuperscript{50} Ding (2007) notes that one of the most remarkable impacts that compulsory land acquisition and public land leasing has had is the creation of a new revenue stream for local governments. Typically, almost all the land conveyance fees are kept by local governments. In 2003, for example, the national government received only 2\% of the total revenue from the conveyance of state-owned land.\textsuperscript{51} Although local governments are required to pay certain fees,\textsuperscript{52} the level of these fees is minimal compared to the net benefits from land conversion. Moreover, the land conveyance fees are often not reflected in the “regular” budgets of local governments.\textsuperscript{53} Sometimes, they are simply used by local government leaders as “pocket money”, in the words of an MLR official.\textsuperscript{54} In many counties or cities in rapidly urbanizing regions, land sales account for up to 30-50\% of the total local revenue.\textsuperscript{55} In 2005, China’s total fiscal revenue exceeded 3 trillion yuan for the first time in history. During the same year, the revenue received by local governments from land sale that was not reflected in regular government budgets was as high as 550 billion RMB.\textsuperscript{56} Another estimate shows that, in 2007, the aggregate land conveyance fees across the country were 913 billion yuan, which was almost 30\% of

\begin{flushleft}
\textsuperscript{50} Nan Xianghong and Shangguang Ximing (2008)
\textsuperscript{51} Qu Futian et al (2005)
\textsuperscript{52} This will be described in detail in Chapter 4.
\textsuperscript{53} The difference between regular budget (Yuan San Nei) and extra budget (Yu Suan Wai) is that the former is the budget for a local government to maintain normal operations, while the latter can be used by a local governments for urban construction and expansion.
\textsuperscript{54} Ministry of Land and Resources Website (September 8, 2006)
\textsuperscript{55} Tao Ran and Xu Zhigang (2005); Chen Fang, Zhang Huaping and Zhang Honghe (2004)
\textsuperscript{56} Guo Wei (2006)
\end{flushleft}
the total fiscal revenue of the country.  

3.2 Distribution of the benefits from land conversion

Conflicts surrounding the distribution of the benefits from land conversion may impose a long-term threat to social stability, due to large number of land related disputes, as will be described later. The existing studies conducted in various regions have produced some common findings, which mainly include:

- The compensation to farmers is too low
- Local governments and developers get the largest share of the increased value of land, while farmers receive a minimal portion
- Farmers’ participation in the land conversion process is very limited
- Farmers often lack the capabilities to adjust to urban life, and the living standards have lowered for some farmers after land conversion.

Some of these findings are highlighted below.

On the livelihoods of farmers after losing land

The compensation received by farmers accounts for only a small proportion of the total benefits from land conversion. Guo Xiaoming (2005) documented that, in Chengdu Municipality of Sichuan Province and in Zhejiang Province, farmers received 5-10% of the benefits, villages 25-30%, and the government and developers 60-70%. Another study by Han Jun et al. and Li & Xu (2004) showed similar results.

57 Nan Xianghong and Shangguang Ximing (2008)
58 Ding (2007); Wang Hongru (2006)
59 Key cites will be provided later in the text.
A survey done by Yu Jianxing and Yang Shengyi (2003) in Ningbo Municipality, Zhejiang Province in 2002 showed that almost all the farmers surveyed thought that the compensation they received was far from enough to support their living, medical care or retirement. For many farmers, losing land meant losing their primary source of income. Gao Yong (2004) noted that the situation in the western regions was worse than in the eastern regions - because the level of compensation was usually lower, and there were fewer employment opportunities for farmers after they lost land. His study in the western regions showed that, in some areas, the highest level of compensation paid to farmers for both their land and their resettlement was 18,000 \(\text{yuan per mu}\) (i.e. 1/15 of a hectare), not including the compensation for the existing crops on the land. This was only equivalent to 1.5 times the average annual disposable income of local urban residents.

Many of the farmers who lose land have experienced a lowered income. A survey conducted by the National Bureau of Statistics (NBS) (2003) found that 46% of the urbanized farmers covered by the survey experienced a decreased net income after losing land. The farmers experiencing the greatest decrease were those who used to depend mainly on agriculture for income, particularly in less developed regions. In Yunnan Province, for example, the annual per capita net income of the urbanized farmers who had lost land decreased by 26%. A study by Wang Chunguang and Chen lei (2004) in Zibo, Shandong Province showed that the number of farmers who lost land was large, and these “urbanized” farmers were often concentrated in

---

62 Rural Survey Team of Yunnan Province (2003)
certain parts of the city. The compensation paid by the government for land conversion was mostly kept by the villages, but the village leaders were ineffective in managing collective resources due to corruption and unclear property rights. Consequently, about 20% of the farmers in the study area had difficulty in making a living.

Despite decreased net income, these farmers’ expenditures have increased in the meantime. Prior to losing land, these farmers produced many life necessities by themselves. Now, they have to buy them on the market. Those who move to cities also need to pay for heating, electricity and water, etc. According to a survey by the Ministry of Labor and Social Security (2004), the average living expenses for farmers increased by approximately 30% after losing land in most of the regions surveyed.\[64\] A survey conducted in Jiangxi Province in 2003 showed that about 30% of the urbanized farmers experienced decreased net income, while their living expenses increased by approximately 30%.\[65\]

Therefore, with decreased net income and increased living expenses, many farmers have experienced a significant decline in the quality of life. One survey in Zhejiang Province showed that 35% of the urbanized farmers reported difficulty in making a living.\[66\] Another survey in Jiangsu Province showed that, among the 2 million farmers who had lost land over the years, about 300,000 were below the poverty line.\[67\] The situation in the less developed regions could be even worse. For

---

example, one survey in Yunnan Province showed that 20% of the urbanized farmers depended solely on the compensation from land conversion for living, 26% faced food problems, and 25% had an annual per capita net income of 625 yuan or less. In addition, surveys in Tianjin Municipality and Nanjing Municipality showed that less than 20% of the urbanized farmers had any kind of insurance.

Moreover, many farmers have difficulty adapting to urban life. A survey of 58 villages by the Rural Research Center of the Ministry of Agriculture in 1999-2000 showed that approximately 34% of the urbanized farmers did not have jobs. Several surveys conducted in the early 2000s showed that, in Chongqing Municipality, the unemployment rate for farmers was 30%, 4 times that of the entire municipality; in Shannxi Province, only 38% of the urbanized farmers were able to find jobs; and in Ningxia Autonomous Region, 43% of the urbanized farmers were unemployed.

Apart from a lack of education and skills by the farmers, the high cost of hiring local farmers by employers was identified by Zhang and Liu (2004) as a reason for farmers’ difficulty in getting jobs. In some economically advanced regions, an employer had to pay a much higher cost to hire a local, urbanized farmer than a “non-local” person coming from other, poor areas. In Xiamen Municipality, Fujian Province, for example, employers were required to pay social security and other fees

---

68 Rural Survey Team of Yunnan Province (2003)
70 Fan Ping (2004)
73 Rural Survey Team of Ningxia Autonomous Region (2003)
for local employees, and the cost of hiring a local worker could be 4-7 times higher than that of hiring a temporary worker coming from less developed regions. Therefore, the local farmers who had lost land but lacked relevant skills were much less competitive than non-local people on the job market.

Even if some farmers do get employment, they face other problems. For example, Tangjun et al (2004)\textsuperscript{74} documented that, in Fengtai District, Beijing Municipality, the local governments typically required state-owned enterprises or organizations to provide jobs and be responsible for paying social security fees for the farmers who lost land due to compulsory land conversion. However, due to a lack of relevant training and skills, these farmers were more likely than others to be laid off if these entities were not doing well, and might therefore not be able to sustain paying for social security. Along the same lines, Zhejiang Rural Survey Team (2002)\textsuperscript{75} found that most companies were actually very unwilling to accept these farmers, who lacked the qualifications required by profit-seeking entities. Therefore, instead of finding entities to receive the farmers, most local governments would simply make \textit{lump sum} cash or in-kind compensation to farmers. Zhu Mingfen (2003) observed that, since many farmers were “near-sighted” in spending, such cash compensations were often not sustainable. However, presumption about farmers’ nearsightedness may serve as a justification for a low level of compensation.

It is worth mentioning in passing that, contrary to the existing surveys cited above, this dissertation finds that the farmers who lost land in Dragon City have actually

\textsuperscript{74} Tangjun and Zhang Shifei (2004)
\textsuperscript{75} Rural Survey Team of Zhejiang Province (2003)
experienced improved living standards. There are two reasons for this. First, Dragon County carried out a reform in 2005 on the compensation system for compulsory land acquisition. Now, the level of compensation is much higher than before, and a pension system has been established for the farmers who have lost land. Second, Dragon County has a relatively high economic level with booming industrial development, and farming typically accounts for an unimportant portion of a farmer’s total income. These will be described in more detail later.

**On land disputes**

Land conversion has been a major source of disputes.76 In 2003, land conversion related disputes accounted for 27% of all the appeals received by the Office of Letters and Calls (OLC)77 of the MLR.78 In some rural areas, these disputes have become so serious that farmers’ actions to appeal to the government are “organized, antagonistic and persistent”.79

In this regard, the Chinese Academy of Social Sciences and the National Soft Science Program jointly conducted a study between August 2003 and June 2004.80 They analyzed more than 60,000 phone calls and other voice messages received by a national media between January 1, 2004 and June 30, 2004, and found that about 15,000 (25%) were about rural land issues. (In China, newspapers and TVs serve as informal “referees” for disputes between individuals and the government, and

---

76 Lian Yuming and Wu Jianzhong (2006)
77 An OLC is an office within a government agency to receive letters or calls of complaints from the public against public officials, as will be described and discussed in Chapter 6.
78 Lian Yuming and Wu Jianzhong (2006)
79 Guo Xiaoming (2005)
80 Yu Jianrong (2005)
typically receive many letters or calls of appeals, as will be explained further in Chapter 6.) They also analyzed 4,300 appeal letters received by another national media since August 2003, and found that 1,325 (31%) were about rural land disputes. They surveyed 720 farmers who came to Beijing in person to appeal to the national government, and found that more than 70% of them had come for land disputes. They also surveyed 130 cases of rural “riots” involving police intervention, and found that 87 (67%) were caused by land disputes.

The study team randomly selected 837 out of all the appeal letters on land disputes received by the afore-mentioned national media, and found that 60% of them were about land acquisition. Among them, 277 (33%) were about compulsory land acquisition using force, 192 (23%) about low or even zero compensation, and 34 (4%) about resettlement arrangements. Among these 837 letters, almost 80% were sent by individual villagers, indicating that individual farmers were the most dissatisfied. Villager Groups and Villagers’ committees accounted for 19%, indicating that village leaders sometimes shared the same interests and might cooperate with farmers in order to protest against other players during land conversion (See Table 1). Among those being accused, local governments and village leaders accounted for the majority (See Table 2). The study team also found that county and municipal governments were blamed mostly for compulsory land acquisition, while township authorities and village leaders mostly for disputes related to farmland lease rights.
The study also found that conflicts were most frequent in the eastern coastal regions where economic growth was most rapid, particularly Zhejiang, Shandong, Jiangsu, Hebei, and Guangdong provinces. The conflicts often took the form of open protest or demonstration by farmers, and frequently developed into confrontation between the protestors and the police, causing significant social tension.

Another empirical study by He Jingxi (2006) in the rural areas of Chengdu Municipality, one of the most developed regions in western China, found that the frequency and intensity of land disputes were related to the role that farmland played...
in farmers’ livelihoods. Farmers with no alternative ways of making a living tended to expect higher compensation from land conversion, and were more likely to end up in conflict with the government. The study also found that farmers often did not think that compulsory land acquisition by the government was justified in the first place, which was a main cause for disputes. This is a key point. However, if paid more, farmers may actually favor conversion, as will be illustrated by the story of Dragon in the following chapters.

4. Conceptual analytical framework of the dissertation

This dissertation aims to develop some insights into the Chinese land conversion process through a case study. The author is modestly hoping that the readers of this dissertation will include not only scholars but also others who have a practical interest in the topic. In order to make the case study interesting to read, he deliberately postpones much theoretical discussions until the end of Part II of the dissertation. This may appear a bit “unconventional” for a dissertation, but has the advantage that some theoretical concepts can be explained and discussed in a more illuminating way after the story about the county selected for the case study has already been told.

The case study deals with a current, important and complex policy subject holistically; consequently, it appears as a broad, panoramic study rather than a microanalysis.\(^3\) It is thus useful to explain the analytical framework of the

\(^3\) This is a key feature of a qualitative study, as identified by Rossman and Rallis, 1998, quoted in Creswell 2003, P 182.
dissertation upfront, so that the reader will better understand how the author tries to weave the various “threads” of the case study into a comprehensive story that serves as a basis for answering the overall research question.

As already mentioned in the Preface, the research question of this dissertation is whether the Chinese land conversion process leads to efficient and equitable land use. The hypothesis is that the institutions guiding the land conversion process, as described earlier, are responsible for inefficient and inequitable land uses. Conceptually, there are two ways to test the hypothesis. One is to identify inefficient and inequitable land uses, then trace back to the causes; and the other is to identify potential weaknesses of the institutions, then find out if they have led to inefficient and inequitable land uses. This is illustrated in Figure 4.

Three distinctions critical for understanding the Chinese land conversion process

The Chinese land conversion process may be seen as a game played by various
players – such as the government, developers, the village, and farmers – who pursue their own interests based on the existing institutions. Three distinctions are important for understanding the complex interactions among these players.

A first distinction is drawn by James M. Buchanan between two levels of processes: one is the constitutional stage of decision-making, and the other is policy acts within the existing constitutional regime. The former provides the “rules of the game”, while the latter are the individual plays of the game. In different terminologies, Chairman Mao Zedong makes a similar distinction between “root causes” and “symptoms”. One of his famous admonitions to Chinese officials was that they should not “treat the head only for headache, and the feet only for foot-ache”, implying that, in addressing policy problems, one should aim to address the root causes (i.e. the “rules of the game”), not the symptoms (i.e. the individual plays).

Along these lines, this dissertation distinguishes between two types of institutions: those providing the rules which determine how the game shall be played, and those which are the outcomes of the actions taken by the players based on the rules. For instance, China’s top-down political structure for developing land use plans is a “rule of the game”, because it determines how the plans shall be made; whereas the CLUPs and UPs developed as such are “policy acts”, which are the results of the interactions of the players based on the constraints of the rules. Such a distinction is crucial for understanding the Chinese land system and other related policies. This dissertation will show that many Chinese land policies have failed because they try to address the

84 This is called “Tou Tong Yi Tou, Jiao Tong Yi Jiao” in Chinese.
“policy acts” that appear to have gone astray – without attempting to change the “rules” on which these policy acts are based.

A second distinction is between “formal” and “informal” institutions. Formal institutions typically take the form of laws or regulations designed for the entire country – or at least for an entire jurisdiction, and can be either “rules” or “policy acts”. This dissertation will illustrate that many of these institutions are designed to be vague or ambiguous, so as to maximize the power of the government. Viewed from a game theory perspective, they provide many opportunities for public officials and other players to pursue personal gains by engaging in rent-seeking acts.

There are also informal institutions, which are social customs or norms based on which people interact with each other. In particular, this dissertation will describe the central importance of personal relations networks to the workings of the Chinese land system and the Chinese society in general, and analyze the historical, economic and political context for this phenomenon. In many circumstances, informal institutions actually play greater roles than formal ones.

A third distinction is between “legality” and “legitimacy”. Legality means compliance with the formal institutions. However, if formal institutions are developed and enforced in a top-down manner with little or no public participation, there are good reasons to question their legitimacy. In other words, non-compliance with these institutions is not necessarily illegitimate. Moreover, when formal institutions are poorly designed, illegality may actually serve to make the system work. For instance,
this dissertation will argue that, if the Chinese farmland protection policy had been followed in a strict manner, China’s economic growth would not have been so rapid during the last decade. In this light, this dissertation may appear to be somehow “sympathetic” towards certain illegalities, because it views such behaviors as the “rational choice” of the players who try to maximize personal gains by taking advantage of the shortfalls in the institutions that are designed as such. This, of course, should not be misconstrued as meaning that all forms of illegality are good. Corruption, for example, is a widespread phenomenon in the land conversion process, and is morally bad.

**Some initial notes about efficiency and equity**

To analyze the efficiency and equity consequences of land conversion, the dissertation draws on various microeconomic tools and philosophical views, which will be discussed in theoretical terms in Chapter 11. For now, it is necessary to make a few initial notes.

First, efficiency and equity need to be assessed from both temporal and spatial perspectives. From a temporal perspective, what appears to be efficient or equitable land conversion at one point may turn out to be a poor decision in the long run. This dissertation analyzes the land use history of Dragon County between the mid-1990s and the late 2000s. Although this seems to be a reasonable length of time for the effects of some land conversion decisions to manifest, there are also many cases where the discussions about efficiency and equity consequences are just
“speculative”.

The spatial effects are much more complex, and can be viewed at three levels: local, national and international. At the local level, land conversion promotes economic growth, generates jobs, increases (or decreases in some cases) the value of the real estate properties in nearby neighborhoods, and even causes pollution, etc. At the national level, a central concern has been that China’s food security may be affected if an excessive amount of farmland is converted to non-farming uses.

In order to stay focused, this dissertation will address the local- and national-level effects only. Yet, it should be mentioned that the effects of land use changes go beyond national boundaries. A notable example is that China’s rapid industrialization, for which land is an important input, in the last several decades has given rise to serious air pollution problems, which are believed by many to have affected neighboring countries such as Japan and Korea. Another example more directly relevant to the topic of the dissertation is that land use changes affect global greenhouse gas (GHG) emissions in at least two ways. First, the conversion of farmland to industrial and commercial uses will inevitably lead to increased energy use and consequently more GHG emissions. Second, if China is to import more food from the international market as a result of farmland loss, the transportation of food will also lead to increased GHG emissions. The latter aspect is part of a complex issue regarding the effects of international trade on GHG emissions. As the Chinese

---

85 Japanese scientists have been studying this issue since the 1990s. This issue has also been a focus of attention from the media. A recent example of media report is “China’s pollution quietly takes its toll on Japan” by Kyoko Hasegawa, The Taipei Times, April 5, 2008.
economy expands rapidly, consumption in China will increase, so will be the demand for the import of goods which China does not have a comparative advantage in producing. Both the production and transportation of these goods will cause GHG emissions. As far as the current situation is concerned, China is also a large exporter of goods in which GHG emissions are “embodied”. For example, Weber et al. (2008)\textsuperscript{86} find that, in 2005, around one third (i.e. 1,700 Mt) of China’s CO\(_2\) emissions were due to production of exports, and this proportion had risen from 12\% (i.e. 230 Mt) in 1987 and only 21\% (i.e. 760 Mt) in 2002. In a case study about the carbon emissions “embodied” in the goods imported by Norway from developing countries, Reinvang et al. (2008) find that China is the developing country where Norway’s carbon footprint is largest and increasing most rapidly, almost tripling from 2.4 Mt in 2001 to 6.8 Mt in 2006.\textsuperscript{87} This means that, in 2006, each Norwegian emitted approximately 1.5 tons of CO\(_2\) on average by consuming goods imported from China. (China’s per capita carbon emission was only 3.2 tons in 2003.\textsuperscript{88}) Of course, global warming is not a focus of this dissertation. Yet, this is just one example showing how land use can be connected, directly or indirectly, to global issues that are very complex and challenging to deal with – as has been the case with international negotiations on climate change.

A second note is that both efficiency and equity are value-laden terms. In particular, a central question the dissertation addresses is whether the Chinese

\textsuperscript{86} Weber, Christopher; Peters, Glen P.; Guan, Dabo; and Hubacek, Klaus (2008)
\textsuperscript{87} Reinvang, Rasmus and Peters, Glen (2008)
\textsuperscript{88} Quoting Xie Zhenhua, Vice Chairman of the National Development and Reform Commission, by Jiang Baocheng and Li Baojie (2008)
farmland protection objective is economically efficient. An answer to this question, as will be illustrated through the case study, requires one’s assessment of the trade-offs between the economic benefits brought about by land conversion and the potential risks associated with a lack of ability for food self-sufficiency due to farmland loss. Farmland protection is not an end in itself, but a means to achieving an end. Yet, different players have different interpretations of the “end”. It is thus essential to assess efficiency based on a thorough review of the historical, political, social and economic context. As will be described and discussed in Chapter 3, there is now a debate in China regarding whether China should relax the farmland protection objective. This dissertation argues in favor of the current policy, but acknowledges that such a debate is likely to continue for a long time because people’s propositions on this issue depend on their personal interpretations of social values and that it is difficult – if possible at all - to find a clear-cut answer.

A third note is that a centrally planned system, as the Chinese land system clearly is, has the inherent disadvantage of being unable to allocate resources efficiently due to what is called the “economic calculation problem” by Ludwig von Mises – the impossibility of the government being able to make the economic calculations required to organize a complex economy.89 This dissertation will show that informal processes often serve to fix the problems in such a system, but through high transaction costs. In this regard, Mancur Olson, drawing on examples from the Soviet Union and other former communist countries, argues that informal processes have

89 Mises, Ludwig von Mises (1951): Socialism: An Economic and Sociological Analysis. In a similar way, János Kornai, in his 1988 book The Socialist System: The Political Economy of Communism, uses the term “shortage economy” to describe a centrally planned economy due to its inability for efficient resource allocation.
inherent limitations.\textsuperscript{90} His proposition is that the rulers of a highly centralized system lack a sufficiently “encompassing interest”,\textsuperscript{91} and thus have less incentives to define or enforce contract rights or property rights. Consequently, there are “self-enforcing transactions”, with goods exchanged on the spot for money or other goods. The credit market is lacking in these countries, so transactions over distance or time are risky. This means they cannot benefit from credit arrangements and other central features of modern economies. This dissertation shows that the lack of certainty in informal processes and of clarity in property rights in China have indeed incurred significant economic and social costs. But apart from that, it also shows that informal processes favor the wealthy more than the economically disadvantaged, and will lead to a widening of income disparity and increase social tension, making economic development unsustainable.

Transaction costs are critical for understanding the behaviors of both firms and public policies. Oliver E. Williamson\textsuperscript{92} argues that contractual arrangements developed by firms can be understood correctly only when interpreted in light of the real-world transaction costs that characterize particular business situations. In other words, contractual arrangements that appear to be inefficient may actually represent innovative and efficient ways of reducing transaction costs involved in business dealings. Echoing Williamson, Avinash K. Dixit argues that many apparently inefficient outcomes can in fact be understood as consequences of constraints

\textsuperscript{90} Mancur Olson (2000)
\textsuperscript{91} The bigger the majority in whose interests the government is ruling, the larger the encompassing interest.
\textsuperscript{92} Williamson, Oliver E. (1985)
imposed by various transaction costs, or as creditable attempts to cope with them.\textsuperscript{93}

In general, this dissertation finds these propositions apply to public policies as well. For example, a main conclusion of the dissertation is that China’s farmland protection objective, which appears to be “over-strict” and inefficient, is actually a wise way of dealing with widespread local non-compliance, which is an inevitable consequence of the existing Chinese political system.

Clearly, there is a need to minimize transaction cost by improving the institutions, such as establishing clear property rights. Yet, Douglas North explains that the state first maximizes returns for the ruler and then, subject to this constraint, tries to reduce transaction costs throughout the economy; and that where the ruler is an individual or the representative of a small group, the interests of rulers will not normally coincide with those of society as a whole.\textsuperscript{94} This dissertation delves into how China’s central policy-makers address land policy issues, and discusses what have constrained them from improving the existing institutions.

5. Introduction to the county selected for the case study

Most of the existing literature focuses on certain aspects of the land conversion process in the form of surveys, theoretical discussions, or news stories. I have found no empirical studies that look at the motives, strategies and behaviors of the various players and the efficiency and equity consequences of their dynamic interactions in a

\textsuperscript{93} Dixit, Avinash K. (1996)  
\textsuperscript{94} North (1981)
holistic way.

I choose Dragon County as the site for a case study that aims to fill this literature gap, for three reasons: First, it is a coastal county in China’s rapidly developing eastern part. Urbanization has been very rapid in the past 10-15 years, and will continue to be so in the future. Second, 87 percent of all the farmland in Dragon is “prime farmland” that is supposed to be protected fully, so the county faces the dual challenges of rapid urbanization and farmland protection. Third, the county is relatively small in size, which makes an in-depth case study manageable for a dissertation.

This section will introduce Dragon County and its capital Dragon City, including their main social and economic indicators, urbanization history, and future development plans.

**Dragon County**

Dragon County, as I will call it, is located on the eastern coast of China. For confidentiality reasons, the municipality to which Dragon County belongs will be called Phoenix Municipality, and the province to which Phoenix Municipality belongs will be called Province A.

Dragon County consists of approximately 1,000 villages in about 20 townships with a total area of close to 2,000 km² and a population of more than 800,000 in 2005. It has about 140 km of coastline, with more than 10 bays of various sizes and a few small islands. There are more than 100 rivers of various lengths running through the
county. The climate is temperate monsoon. On average, the annual temperature is 12℃, the number of non-frost days is more than 200 per year, and annual precipitation is almost 800 mm.

The topography of the county is a mixture of plains and hilly land. It has approximately 2.2 million mu (i.e. approximately 147,000 hectares) of crop, forest or grassland, among which about 1.1 million mu is cropland, and almost 600,000 mu is forested area. The county is rich in fishery resources. More than 260 types of fish and shrimps are found in its bays.

According to official statistics, in 2005, the county’s per capita GDP was 36,000 yuan, the average disposable income of urban residents was 11,000 yuan (i.e. approximately $1,600), and the per capita net income of farmers was close to 6,000 yuan. In terms of economic strength, the county was ranked among the top 100 in more than 2,000 counties in China. Agriculture, manufacturing and services accounted for 10%, 62%, and 28% respectively of the economic structure in terms of value added in 2005. Within the agricultural sector, farming, forestry, animal husbandry and fisheries accounted for 33%, 1%, 21% and 44% respectively in terms of value added.

The main products of manufacturing include rubber, textile machineries, home appliances, electronic parts, and food processing, etc. The main export products include home appliances, electronic parts and processed food, etc. Most new manufacturing companies are relatively large, with an initial investment of at least 5
million yuan, because, as will be explained later, it is more difficult for small companies to acquire land from the local governments.

Dragon has a highly educated local workforce. Almost all the workers below the age of 35 have received at least 9-12 years of formal school education. In addition, there is a large population of young people coming from other regions to run small trade businesses or seek jobs in Dragon.

The level of urbanization of the county was 50.6% in 2007, and the annual population growth rate is about 3-4%.
Dragon City

The case study focuses on Dragon City, the capital of Dragon County, although other areas of the county are also covered. Dragon City is located in the northeastern part of the county, facing the ocean on the east and surrounded by low hills or cropland on the other sides. Transportation to other regions from the city is very convenient by road. A National Road and a highway run through or by the city (See Map 1). It is 70 km to Phoenix City, the capital of Phoenix Municipality, by road, and about 20 km to a ferry station in County A, from where it takes about 20 minutes to go to Phoenix City by ferry.

Since the 1950s, the city has undergone great changes in size (See Map 2). In the 1950s and 1960s, the city was limited to a small area along Main Road A, which is the section of the National Road that ran across the city, and clustered around the long-distance bus station. In the 1980s and the 1990s, as the city became more populated, the section of the National Road that went through the city changed its route from Main Road A to Main Road B, which is about 1 km to the east, in order to avoid the crowded downtown. The city expanded eastwards accordingly, but was largely limited to the area between Main Road A and Main Road B. Since the early 1990s, the city has been growing more rapidly. By 1995, the city extended as far as Main Road D, which is about 1.5 km to the east of Main Road B. As a consequence, the Dragon City Section of the National Road had to change its route again to Main Road D.

95 A national road is a road that runs across provinces.
The most significant expansion of the city occurred after the late 1990s. In order to stimulate the growth of the city, the county government decided to implement an Affordable Apartments Program (AAP) on the eastern coast, about 7 kilometers from
Main Road A. Phase I of the program (AAP1) was completed in 1998. Approximately 2,500 apartments of various sizes were constructed, and sold to urban residents at a fixed price of 650 yuan (which was about $80 according to the exchange rate of the time) per m² of floor area. Incidentally, the so-called “sales price” of apartments or housing in China is, strictly speaking, “rent price”. This is because all land in cities is owned by the state, as mentioned earlier, and that individuals have only the use right to the land occupied by their apartments or housing for typically 70 years. Nevertheless, the price of these AAP1 apartments was unbelievably low. The main reason was that the county government wanted to attract a critical mass of urban residents to move to this coastal area in order to stimulate the development there. Phase II of the program (AAP2) followed shortly, with more than 3,000 apartments built, drawing more people to move to this new area.

In the meantime, in an effort to attract investment and thereby promote local economic growth, the county government established the Dragon Economic Development Zone (EDZ), which covered a large area between the eastern coast and the old city and was largely empty at the time. In order to stimulate the development of the EDZ, the county government moved the main government building and a number of government agencies from the old downtown to the EDZ in 2000.

As new investment projects filled up much of the land in the EDZ rapidly, the

---

96 In Chinese terms, this refers to sales price of per m² of “constructed floor area”, which equals the actual usable floor space within an apartment plus the floor space occupied by the walls of the apartment plus the total public space of the neighborhood divided by the number of apartments in it. Typically, for an apartment of 100 m² in terms of constructed floor area, the actual usable floor space within the apartment is approximately 60-70 m².

97 According to the Property Rights Law of China, passed in 2007, the users of residential land can, in principle, have the use right renewed after 70 years. However, the law does not state how this will be done.
county government decided in 2002 to establish Industrial Park A, located to the south of the affordable apartments and between Main Road D and the eastern coast, in order to accommodate more investment. In addition, a college town, located to the southeast of Industrial Park A, was planned to attract universities and colleges to establish campuses there. Then, in 2004, the county government decided to establish Industrial Park B, located to the north of the EDZ, to develop manufacturing industries, and in the meantime change the development focus of Industrial Park A to services and residential use.

In 2007, Dragon city covered more than 52 km\(^2\), and its population was 340,000. According to the Comprehensive Urban Plan of Dragon City, which will be described in detail in Chapter 7, Dragon City shall cover 48 km\(^2\) (which has already been exceeded) in 2010 when the population is expected to reach 400,000, and 70 km\(^2\) by 2020 when the population is expected to reach 600,000.

**Dragon County’s long-term urbanization blueprint**

According to the blueprint of the county, urbanization will continue at a rapid pace in the future, and three urban clusters shall emerge within the boundary of Dragon County in the long term (i.e. beyond 2020). As shown in Map 3, Cluster A shall include Dragon city and several satellite towns, and its economy shall depend mainly on high-tech and light industries, education-related services, and tourism. Cluster B shall consist of Township E - which is about 20 km to the south of Dragon City - and its surrounding areas, and shall be developed into a tourist and residential
center. Cluster C shall be made up of Township F - which is about 30 km to the south of Dragon City - and its surrounding areas, and shall become a heavy industry center.

In order to support the development of these three clusters, the county has been building a major road along the coast. The sections that pass through Dragon City have been completed for several years. The other sections are under construction but unfinished.
PART I  THE PLAYERS AND THE REFEREES
INTRODUCTION TO PART I

Part I of the dissertation will introduce and describe the motives, strategies and behaviors of the various players in the land conversion game, who mainly include:

- The village;
- Farmers;
- Higher-level governments, which refer to municipal, provincial and national governments;
- Local governments, which refer to county and township governments; and
- Developers, consisting mainly of industrial developers, commercial real estate developers, and land speculators.

Figure 5 is a graphical illustration of their formal relations, which, based on the existing Chinese institutions described earlier, are governed by a hierarchical structure: The higher-level governments set land use planning objectives for local governments; and the local governments are responsible for acquiring farmland from villages and...
farmers, and then sell the land use rights to developers. In the figure, the players are connected by downward arrows - representing top-down relations - with the exception that the village and the farmers have a two-direction relationship because village leaders are elected by and thus supposed to be responsive to the needs of the farmers. Land speculators are connected to local governments through a “dotted” downward arrow - representing an “informal” top-down relationship - because land speculation by private parties exists in practice but is not formally allowed, as will be explained later.

Part I will also describe and discuss the role of the referees, which mainly include the courts, the Offices of Letters and Calls, and the party’s Disciplinary Inspection Committee, etc. They are part of - and controlled by - the government, and therefore not shown in Figure 5.
CHAPTER 1 VILLAGE

1. Introduction

The village is China’s lowest-level jurisdiction. In Dragon County, a village typically has one hundred to a few hundred households, each consisting of 2-4 people on average. All households in a village live in a concentrated area, surrounded by farmland. Figure 6 shows the layout of the residential area of a typical village in Dragon with, say, 30 households.

![Figure 6 Layout of the Residential Area of A Typical Village with 30 Households](image)

This chapter will first discuss the inherent problems with the collective ownership of farmland by the village; then describe the decision-making mechanism of a village, and explain the complex relations between village leaders and farmers and between village leaders and the township government in administering collective resources; and lastly assess the importance of land to a village’s financial situation.
2. Collective ownership of farmland

The land tenure system is critical for understanding the village. This section will first review briefly the evolution of the Chinese land tenure system, and then discuss key issues identified through the case study in Dragon County.

Evolution of the Chinese land tenure system

The Chinese land tenure system has undergone many changes since ancient times. In Xizhou Era (11th-7th century B.C.), the king delegated land to his immediate subjects, but retained absolute power over all land. In turn, his immediate subjects could delegate land to their inferiors, but retained their control over the land. It was a multi-level ownership system: The king, his subjects and their inferiors co-owned the land, but lower-level owners had to defer to higher-level ones. Such a system often led to confusion in property rights and social conflicts.

By the Spring and Autumn Period (770-474 B.C.) and the Warring States Period (475-221 B.C.), the old land tenure system had broken down, and the king started to grant land directly to landlords or farmers. Private ownership became dominant. This was the beginning of the separation of private ownership from state ownership. The Qin and Han Dynasties (221 B.C. – A.D. 220) continued to see such separation. However, the state was weak in protecting private land property rights. Force was constantly used by some people to seize land from others, which was an indication of weak property rights.

98The following review of the Chinese land tenure history draws on Wei Tian’an (2003) and Luo Fuyong & Ke Juanli (2006)
Land property rights became better defined in the Xijin, Sui and Tang Dynasties (265-907). The state tried to protect the ownership of land by both “big” landlords and “small” farmers. However, the land owners of the time had to face many restrictions regarding the amount of land they were allowed to own, ownership transfer, and land reclamation, etc. Due to these limitations, transfer of land ownership was not common, and land property rights still remained largely unclear.

During these and the following feudal periods, the state was ineffective in protecting the economic interests of private land owners. The political power of individuals provided better guarantees of land ownership rights. Therefore, both big landlords and small farmers had strong incentives to seek political power or protection. This was an important phenomenon in the development of the land tenure system in China.99 In some ways, the informal land system today still reflects these ancient Chinese tendencies.

In the early 1900s, Sun Yat-sen led a revolution to establish the Republic of China (1912-1949). According to the statistics of the time, landlords and rich farmers, who constituted 15% of the population, owned 81% of all land; while most other farmers worked for the landlords as tenants. Sun Yat-sen put forward his “egalitarian land rights” policy in order to win political support from farmers for the revolution he led. Under this policy, landlords were required to report to the government the prices of the land they owned. The government could choose to buy the land if the reported prices were low, or levy taxes according to the reported prices if they were high.

99 Wei Tian-an (2003)
Through such a policy, Sun hoped to reduce the amount of land owned by big landlords. However, the policy was not implemented effectively, because the government did not have sufficient financial capacity to buy up much land from the landlords, and the landlords could shift the burden of land taxes to tenants.

By the time the People’s Republic of China (1949 to present) was established, landlords owned about 50-80% of all land in China, and “rich farmers” owned about 10-15%. The new regime carried out a land reform according to The Land Reform Law promulgated in June 1950. By the end of 1952, more than 300 million farmers who previously had no or little land were granted land to be owned privately. Then, in the late 1950s, the private ownership of land was abolished to make way for collective ownership, which has been in effect until the present day.

**Main problems with the collective ownership of farmland in Dragon County**

Like all other regions in China, Dragon County has had collective ownership of farmland since the 1950s. However, the way collective ownership is administered has changed dramatically over the years. In the 1960s and the 1970s, land was farmed collectively and the harvest shared by all villagers. This communist style of farming was nicknamed “eating out of the same big pot”. Following the economic reforms in the late 1970s under the leadership of Deng Xiaoping, the county started to implement the Household Responsibility System (HRS) in the early 1980s. Land was contracted to individual households for 15 years, and farmers were allowed to make independent farming decisions and keep most of the harvest for their own use.

---

100 Chen Jing (2005)
In 1994, the county underwent another rural land reform. Each village divided its land into “grain land”, contracted to individual farmers, and “reserve land”, to be administered by the village collective; and the term of farmers’ grain land contracts was extended by 30 years, on top of that of their original contracts signed in the early 1980s. (In October 2008, the CCP Central Committee passed a resolution to further extend the duration of farmers’ land use contracts by an infinite period. The likely effects of this new policy will be discussed in Chapter 12.) On average, each farmer in Dragon received approximately 1 mu (i.e. 1/15 of a hectare) of grain land.

This case study covers a number of rural villages in a few townships (see Map 4), and reveals three major problems with the collective ownership of farmland. A first problem is that the bundle of rights entailed in collective ownership is very limited, for two reasons, among others. First, as mentioned before, collectively owned farmland can be used for no other purpose than farming. Otherwise, it has to be converted to “state-owned” land first.101 Second, the state, represented by the government, has the power to acquire land from villages based on “public interest”. It is worth mentioning that full property rights to land - which would include exclusive ownership, absolute right to income from the property, and free transfer rights102 - do not exist in any modern society. A society always exercises some kinds of control over land property rights. Land ownership is exclusive, but not absolute.103 Even private land ownership in other countries has limitations. In the United States, for example,

---

101 This limitation has been relaxed a bit in Guangdong and other regions, as will be discussed in detail in Chapter 12.
102 Yuan Cheng (2004); Furubotn, Eirik G. and Richter, Rudolf (2000), p77
103 Barlowe (1972)
governments can limit land property rights in the interest of public health or safety, such as setting up soil conservation zones, or enforcing forest-cutting restrictions. Under eminent domain, governments can appropriate private property for public uses without the consent of the owner as long as the property is taken under due process of law and with the payment of just compensation.\textsuperscript{104} However, in China, the government monopolizes the land market through compulsory land acquisition – not only for public purposes but also for use by private parties.\textsuperscript{105} The concept of “public interest” is very vague in China, and its determination is largely subject to the will of government leaders who guide land conversion decisions, as will be discussed further later.

\textsuperscript{104} In the US, the state exercises five types of social control on property rights: police power, eminent domain, taxation, spending, and proprietary powers. The purposes of these social controls are, respectively, to limit property rights in the interests of public health or safety (such as setting up wind-erosion, soil conservation zones, or enforce forest-cutting restrictions), to appropriate private property for public uses without the consent of the owner as long as the property is taken under due process of law with the payment of just compensation, to collect revenue; to achieve particular objectives in land use, and to acquire and administering land resources for their own use (Barlowe P391).

\textsuperscript{105} Task Force on China’s Land Reform, State Council’s Development Research Center (2006)
A second problem with collective ownership is about the reserve land. According to a national government requirement, the reserve land shall not exceed 5% of all the land of a village. However, during the 1994 Land Reform, most villages set aside more reserve land. The village typically uses an auction process to lease its reserve land to farmers, usually for 10-20 years as a term. Whoever offers the highest price receives the contract. However, village leaders sometimes manipulate the auction process in favor of their relatives or close friends, as will be described with specific examples later in the chapter.
A third problem with collective ownership is its difficulty in accommodating population or land changes. Land tenure stability is important for long-term agricultural productivity, because farmers would not take as much care of the land if they cannot keep it for long. Therefore, the *Land Administration Law* stipulates that the current grain land contracts signed between farmers and their village collectives shall remain unchanged for 30 years - which, in principle, rules out the possibility of any redistribution of grain land within a village before the expiration of the current contracts.

However, the membership of a village changes constantly because there are often births, deaths, and new marriages, and that some people go to cities to attend college or work and do not return. Therefore, there is a need to accommodate such changes on a periodical basis. In theory, the reserve land of a village can be used to serve this purpose partially. In reality, the reserve lands are often not available because, as mentioned earlier, they are usually on rent for a term of 10-20 years.

There are generally two approaches in Dragon to deal with this problem. One approach, adopted by most villages, such as H, L, M and N (See Map 3), is not to allow any redistribution of grain land before the expiration of the current contracts - no matter what happens. This approach is called, in Chinese terms, *Zeng Ren Bu Zeng Di, Jian Ren Bu Jian Di*, which literally means “not giving land to new members, and not taking land away from those who are no longer members”. The other approach, adopted by some villages that have relatively more reserve land, is to turn some reserve land into grain land for some new members of the collective. However, even
these villages do not take land away from those who have passed away or left the village permanently.

These two different approaches have led to a practical problem: some farmers have two shares of grain land, whereas others have no land at all. For example, farmer D, who is from Village L but married to a man from Village I, has two shares of grain land because she is allowed to retain her grain land in Village L and has received a new share in Village I. (Incidentally, it is a general custom in most rural areas of China that women move to their husbands’ villages after getting married.) It is conceivable that, in the villages that do not allow any form of land redistribution, those who were born after the land reform in the early 1990s do not have any land.

This was not a big issue during the 1994 Rural Land Reform, for two reasons: First, as will be explained in detail in Chapter 2, farming was (and still is) not an attractive source of income. Second, despite the unattractiveness of farming, farmers who had grain land were required to pay agricultural tax at the time. However, two recent developments have made this issue a central concern for the farmers who do not have grain land. First, the exemption of agricultural tax since 2004 means that grain land is actually provided to farmers for free. Second, given the urbanization blueprint of Dragon County as described earlier, the farmers in the affected townships realize that their areas may soon become urbanized, which means that those having grain land now have a chance of receiving a decent amount of compensation for their land taken.

A related, albeit different, issue is what a village does if it has lost a portion, but
not all, of its land to compulsory land acquisition. Typically, the village distributes the
compensation for the land converted among the affected farmers only, so the other
farmers keep their land but do not receive any payments. However, a survey done by
Li and Xu (2004) in 17 villages in Anhui, Hainan and Guangxi Provinces has different
findings, as shown in Table 3. They note that Strategy 3, which is also the one adopted
by the villages in Dragon, is most welcomed by the farmers surveyed. Strategy 1 and
2 require a redistribution of the remaining land and therefore disrupt the stability of
the land use rights of farmers. Strategy 4 and 5 usually apply to reserve land only.

Table 3 Strategies Used by Villages in Distributing Compensation
in 17 Villages Surveyed by Li and Xu (2004) in Anhui, Hainan and Guangxi

<table>
<thead>
<tr>
<th>Strategies</th>
<th>No. of Land Conversion Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The village distributes the compensation to all villagers, then redistributes the remaining land among all villagers.</td>
</tr>
<tr>
<td>2</td>
<td>The village keeps the compensation, then redistributes the remaining land among all villagers.</td>
</tr>
<tr>
<td>3</td>
<td>The village distributes the compensation to the farmers who lose land without redistributing the remaining land among all villagers.</td>
</tr>
<tr>
<td>4</td>
<td>The village distributes the compensation to all farmers without redistributing the remaining land.</td>
</tr>
<tr>
<td>5</td>
<td>The village keeps the compensation without redistributing the remaining land.</td>
</tr>
<tr>
<td></td>
<td>Total cases of land conversion in 17 villages</td>
</tr>
</tbody>
</table>

3. Village leaders

The administrative power of a village resides in the villagers’ committee elected
by all villagers. A villagers’ committee can have a maximum of six members: the
chairperson who is also the legal person of the village, an accountant, a cashier, a
family planning officer, a dispute mediation officer, and an administrative assistant.

Each village also has a Chinese Communist Party (CCP) branch elected by all CCP members in the village. CCP members account for a small proportion of all villagers, typically about 5-10% in most villages in Dragon. In order to become a CCP member, one needs to apply to the CCP branch and show that he meets the necessary qualifications. On average, CCP members are more active and more highly educated than other villagers. Being a CCP member does not carry much personal benefits for a farmer, except that he may become a candidate for a member of the CCP branch, which is a paid job. (In cities, CCP members generally have better chances than non-members to get promotion at government agencies or state-owned enterprises, other things being equal. Therefore, people have greater incentives to become CCP members there.) A village’s CCP branch typically consists of a party secretary, an officer responsible for organizational matters, and an officer responsible for publicity matters.

Both the villagers’ committee and the CCP branch serve for 5 years as a term. In most villages in Dragon County, the members of the CCP village branch also serve as members of the villagers’ committee. One reason for this is that villagers’ committee elections are usually held after CCP branch elections, so the elected party officials are more likely than others to attract attention and be elected into the villagers’ committee as well. Another, and more important, reason is that villagers usually do not want to have too many officials, since they are paid by the village collective. Having the CCP branch members serve on the villagers’ committee as well can save money for the
village. CCP members who are also village committee members are typically not paid twice. In some small villages, there can be only three officials in total: a party secretary who is also the villagers’ committee chairperson, an accountant who is also the cashier, and an administrative assistant.

As already mentioned, the CCP controls tightly all levels of the Chinese bureaucracy at the township level and above. At the village level, however, the villagers’ committee does not need to defer to the CCP branch, because they are both elected. The study shows that villagers are generally confused about the respective roles of the CCP branch and the villagers’ committee. The villagers’ committee chairperson and the party secretary of a village do not always get along well. In some villages, there can even be confrontations between them regarding important decisions. However, in many villages, the villagers’ committee chairperson is also a CCP member, and should therefore have no problems – in principle - in deferring to the decisions by the CCP village branch.

On important issues, the party secretary of a village usually convenes “expanded meetings”, attended by all members of the CCP branch and the villagers’ committee, and by the representatives of other villagers. On issues such as the redistribution of land among villagers, a plenary meeting attended by all villagers is required.

Generally speaking, being a village official is an attractive job. It is only a part-time job, so the village officials can have time to take care of farming or other personal businesses. In the villages covered by the study, the monthly salaries of the

---

106 It is actually designed to be confusing, as will be discussed later.
party secretaries and villagers’ committee chairpersons range from a few hundred to 5,000-6,000 yuan. The salaries of other village officials are lower but, in general, are much higher than the average income of farmers from farming only. In addition, the position of a village official is usually a sign of social status in the village. In most cases, only those who are from widely respected families are competitive enough to win elections.

Competition for village officials is often very intense. Candidates adopt various strategies in order to win, including lobbying, bribing, or promising personal favors to voters. In Village I, township D, for example, candidates in a close competition typically pay 50-100 yuan to wavering key voters to vote for them. The study also shows that village elections are often subject to manipulation by big families, i.e. the offspring of one common ancestor. These families share the same family name and maintain closer relationship with one another than with others, so it is usually easier for a candidate from such families to receive more votes.

Such election problems are certainly not unique for Dragon County, but widespread in many other regions. An official from the Department of the Grass-roots Government and Community Building of the Ministry of Civil Affairs, makes the following comments when interviewed by the China Daily,

(There are various kinds of cheating by candidates and their supporters, such as) selling or buying votes, forging ballots, threatening, promising personal favors, preventing some voters from casting ballots… In some areas, some clan and even vicious forces have intervened. In order to ensure that their favorites succeed in the elections, they typically adopt measures such as threat, surveillance or even hiring hooligans to do physical harm to some people…

107 Han Xue (2007); Guan Xiaofeng (2007)
108 Guan Xiaofeng (2007)
Bribery… is becoming more and more common in village elections in recent years. There are practical difficulties in preventing or stopping bribery. One is that the anti-bribery law is mostly about “principles”, and often not feasible for implementation… A second difficulty is that it is difficult to collect evidence on bribery. Some villagers who report about bribery are not willing to serve as witnesses because they do not want to identify themselves or are afraid of being revenged against.

**Relations with farmers**

The relationship between village leaders and farmers is one of cooperation and conflict. On the one hand, village leaders want to pursue their own personal interests, provide favors to their relatives and friends, and fulfill the promises made to those who voted for them. On the other hand, they need to behave in a relatively “reasonable” manner so that they maintain a certain degree of authority in the village.

This can be illustrated with several examples. A first example concerns Farmer C from Village N in Township F. He and his wife, both about 60 years old, have been living in the village during their lifetime. In the early 1990s, he and his wife changed their *Hukou* (i.e. the address of one’s permanent residency registered with the government) to another township for some reason, although they still lived in the village. As a result, they were not able to receive a share of grain land during the 1994 Rural Land Reform, since only those whose *Hukou* was in the village were eligible. They did not take this very seriously at the beginning, but instead rented 2 *mu* of reserve land from the village at a price of 180 *yuan/mu/year*. Their net income from each *mu* of the land was only 300-400 *yuan* per year, but their main purpose was not to earn income, because their son and two daughters were all working in Dragon City with decent salaries and would send them enough money if needed. Instead, they just
wanted to “have something to do” because otherwise they would have nothing to occupy their time in a constructive way.

With the exemption of the agricultural tax and the anticipation that this area will be urbanized in the future, they now want to receive a share of grain land. The current party secretary (Party Secretary A) promised to them while running for election several years ago that he would help transform the 2 \textit{mu} of reserve land they were farming into “grain land” for them. Since land redistribution is not allowed by the village rules, he has been waiting for a good opportunity to do it. However, by now, this has turned out to be impossible: The village is located within the planned “Urban Cluster C” (see Map 3), and a section of the Coastal Road (which is less than 1 km from the village) is already under construction, so all other villagers have realized that the value of land is to rise. Therefore, if Party Secretary A does the favor for Farmer C, other households who lack land - due to birth, marriage, or other reasons - will surely make the same request. Farmer C comments that, “it looks as if he is not going to fulfill his promise, because he also needs to do his job.”

A second example involves Party Secretary B from Village L, Township E. The previous leases of several dozen \textit{mu} of reserve land of his village expired in 2004, and the village was about to auction the land. Party Secretary B’s brother-in-law from another village wanted him to help acquire as large a parcel as possible. Party Secretary B promised to help, but only to the extent that he did not embarrass himself in the village. His brother-in-law wanted to get all the reserve land available, but he deferred to a proposal made by the other members of the villagers’ committee that one
applicant receive 10 *mu* at a maximum. In the end, he successfully helped his brother-in-law win a bid for 10 *mu* at a reasonable price by choosing an early auction date on which several potential bidders were not able to show up at the auction.

A similar case involves the sale of two residential lots by Village I, Township D in 2007. The two lots were collective properties of the village, but had not been used for some years. Farmer E wanted to buy these two lots to open a roadside store, because the two lots faced the main village street. Both the party secretary and the villagers’ committee chairperson were close friends of his. Therefore, he lobbied them to sell the two lots. They agreed. He then lobbied them to sell the two lots in one bid, because he wanted to have them both in order to build a relatively large store and he figured that no more than several villagers could actually afford to buy the two lots together. The party secretary and the villagers’ committee chairperson disagreed, because other villagers objected strongly to that proposal. In the end, the two village leaders decided to help Farmer E by scheduling the auction just a few days after announcing the sale, so as to leave interested buyers unprepared. Eventually, Farmer E won the bid for one lot but lost on the other.

The case study in Dragon shows that the types of personal favors that village leaders can provide to villagers are limited, especially in remote, poor villages. Consequently, they have very limited control over the villagers, and are often incapable of enforcing village rules or implementing the policies of the government. A most telling example is about the collection of agricultural tax. Before the tax was cancelled in 2004, many villages had difficulty collecting it from farmers. Many
farmers simply refused to pay. In Village I, for example, one household owed as much as 40,000-50,000 yuan of the tax, and the villagers’ committee could not do anything about it. Farmer J comments that,

I still owe about 7,000 yuan to the village. At the beginning, I was paying as required. Then I found that others were not paying. So I stopped paying too. It would be too foolish to pay when others did not. In the end, nobody in the village was paying. What could the village leaders do? What could the government do? We simply said that we were too poor to pay. What do you think they could do to a poor farmer?

In some villages, the villagers’ committee has even encountered considerable difficulty in taking back reserve land from the farmers when their land use contracts expire. Some farmers simply refuse to return the land, and do not pay rent to the village.

**Relations with the township government**

Since village leaders are elected, it can easily be taken for granted that a township government has no direct control over the leaders of its villages. In reality, this is not the case, because a township government has several forms of leverage over village leaders.

One important form is that a township government determines how much village leaders are to be paid based on its evaluation of their performance on the job. The evaluation is conducted every year based on a “points system”. The evaluation criteria include tidiness of village streets, implementation of the family planning policy, maintenance of public infrastructure, public security, and investment promotion, etc. Leaders who receive more points than required are eligible to claim a “bonus” in the form of a monetary payment above their regular salary. The salaries and bonuses of
village leaders that are determined in this way are paid by the villages themselves.

This evaluation system has several problems. First, it is an open secret among local farmers and officials that village leaders often make up information in order to receive more points. Second, the salaries and the bonus are not paid by the township government, but out of the villages’ own pockets. Therefore, the township officials would be happy to grant bonuses to village leaders, who then are expected to provide personal favors to the township officials in return. Therefore, this evaluation system encourages collusion between village leaders and township officials.

Another form of leverage that a township government has is related to the administration of the financial resources of its villages. In the early 1990s, each village had an independent account, and had a financial management committee to oversee that the village leaders spend in a reasonable manner. Since 1996, most townships in Dragon County have set up a unit called “Financial Administration Guidance Station (FAGS)” to administer the accounts of villages. In principle, all the income of a village should go into the account administered by the township FAGS. A village has to apply to the township in order to use the money in its own account.

The FAGSs have played some supervisory role over the spending of village leaders. However, there are two problems: First, some FAGSs do not maintain a separate account for each village. Instead, they have one account for all villages. This makes it convenient for the townships to take advantage of a large pool of money. Sometimes, when a township government needs money urgently, it would simply use the money in the villages’ accounts without seeking permission from the villages.
Second, many village leaders have “secret pockets”, and much of their villages’ income is not reflected in the FAGS accounts – which, in the words of Local Official A, “explains why everybody wants so much to become a village leader, even in the villages which are seemingly too poor to cover even the basic salaries of village leaders”.

A township government sometimes also provides personal favors directly to village leaders. For example, it sometimes organizes “study tours” attended by the leaders of its villages. Such tours usually include mainly - if not “only” - visits to famous historic or scenic sites in other provinces or even foreign countries. The costs of the tours incurred by the village leaders (and often the township officials as well) are covered by the village collectives.

**Role in compulsory land acquisition**

The role of village leaders during compulsory land acquisition is very limited. As long as the government has made a decision, there is little village leaders and farmers can do to change it. A former Party Secretary of Village H comments that, “If the government wants to do something, who can stop it? There is nothing you can do (*but to defer*).” In most cases, village leaders’ role is limited to conveying the official notices of the government to farmers, and “assisting” the township government to “persuade” farmers to defer to the decisions made by the government.

Nevertheless, village leaders have considerable discretion over the distribution of the compensation received from the government. A few years ago, in most
compulsory land acquisition cases, both the township government and the village would take a slice off the compensation before it reached the farmers - even if the conversion involved grain land. During the process, it was also common for township officials and village leaders to try to conceal information from farmers. This used to be a major source of conflicts, but the situation has improved significantly in the last few years, as will be explained in the next chapter.

Due to the sensitive nature of the topic in Dragon, I was advised by my local contacts not to conduct an in-depth survey or investigation in the villages affected by compulsory land conversion, as originally planned, regarding how much of the compensation was intercepted by township governments and village leaders respectively. Doing so could perturb the local communities and attract unnecessary attention. Nevertheless, according to a limited number of interviewees who are familiar with these villages, the compensation distribution process in many villages in Dragon is to some extent similar to that described by other, existing studies, such as the one by Qi et al (2006) based on a survey in three villages in Hubei, Zhejiang and Jiangsu Provinces.

Qi et al find that, during compulsory land conversion, village leaders try to forge informal relationships with township leaders on the one hand and establish relations networks within their villages on the other. Village leaders often provide favors to the members of their networks, and are therefore not isolated in the village. They utilize their networks to prevent other farmers from uniting to influence the distribution of the benefits from land conversion. Villagers, on the other hand, realize that the
interest groups centered on the village leaders might have under-the-table deals in the distribution of compensation, and that village leaders’ control of information prevents them from knowing how much the compensation is. Therefore, they may organize themselves to protect their own interests. Their self-organizing activities take both “legal” and “illegal” forms. Legal forms mainly include appealing to the Office of Letters and Calls of the government, which might raise the conflict between them and the village leaders into a confrontation; while illegal forms mainly include “blocking land development activities organized by the government” or simply “trouble-making”. Village leaders, who do not want to see themselves confronted, would try to provide favors to the “elite” among these villagers so as to turn “enemies” into “friends”. If the threat from villagers appears to be getting out of their control, they may make concessions.

Whether village leaders are hardliners depends on whether they are “strong” by themselves in the village, which often depends on whether they are regarded as the most capable people in the village. Qi et al find that, in areas with rich resources, the positions of village leaders are usually taken by those who are not only capable but also skillful at establishing relations with upper-level officials. These village leaders are usually more “interest oriented”, and more strongly organized as a group. Since they are much richer than most other villagers, and because of conflicting personal interests between them and the villagers, these village leaders are usually hardliners. In villages which are poor and do not have valuable resources, the incentives of village leaders to compete for power are weaker.
Qi et al also note that land is the main connection between village leaders and villagers. The power of village leaders is mainly reflected in the redistribution of land within the village, the collection of agricultural taxes, and the administration of irrigation facilities. However, if all the collectively owned land of a village is converted to state-owned land, the most important connection between village leaders and farmers will no longer exist, and the power of village leaders over villagers will be significantly weakened. In such cases, land conversion is often seen by village leaders as a last opportunity to seek large personal benefits for themselves. Therefore, the scale and process of land conversion affect the strategies of village leaders directly.

In sum, the process is governed, to a large extent, by the “law of the jungle”, so to speak. This dissertation will show in the following chapters that this law applies to other sets of relations during the land conversion process and to the Chinese society at large.

4. The financial situation of villages

A village must have financial resources to take care of collective affairs, such as repairing roads and bridges, cleaning streets, and providing tap water, etc. Prior to the 1990s, the village collected land contract fees (i.e. the predecessor of the agricultural tax cancelled in 2004) from farmers, and each farmer was required to contribute 10-20 days of free labor each year to the collective - to offset a portion of the land contract
fees.

The situation has changed dramatically in recent years. In addition to the cancellation of the land contract fees, it has become increasingly difficult for the village to ask farmers to provide labor on a voluntary basis. As discussed earlier, village leaders have no direct control over farmers. As long as a farmer can take care of his own business and has no personal favors to ask for, he has no particular reason to defer to the village leaders’ request for free labor - except out of moral obligations. Therefore, many villages are having a difficult time managing collective affairs.

The case study finds that some villages, mostly located far from Dragon City and township capitals, are too poor to pay their leaders the salaries “promised” by the township governments. In some villages, the leaders are “owed” several thousand yuan of salary. In order to deal with this problem, some townships have implemented a transfer payment mechanism, through which the wealthy villages contribute a portion of their extra income to support the poor ones. Technically, this has been easy to do because, as mentioned earlier, a township government controls the accounts of all its villages through the FAGS. However, the problem is that, for some townships, most – if not all - villages lack sources of collective income such that this transfer payment system exists in name only.

In 2003, each village in Dragon County had about 130,000 yuan worth of debts on average. These debts mainly included two parts: The first part is loans from banks for running village-owned enterprises. The second part is borrowings from wealthy farmers in order to take care of collective affairs. The reason for borrowing from
private parties is that it is often difficult for villages to obtain loans from banks, which require a complicated procedure. Due to the informal nature – and thus higher risks - of these borrowings, the lenders often charge higher interest rates than a bank. Of course, some villages also have fixed assets such as village-owned real estate properties. However, it is fair to say that, in general, the financial situations of most villages in Dragon County are not great. Some villages even do not have any kinds of disposable assets or financial resources.

This is not to say, however, that all villages are poor. To the contrary, many villages are doing fine, and a significant number are very wealthy. The case study shows that geographical location seems to be the most important determinant of a village’s financial capacity. Villages located close to Dragon City or township capitals are generally much wealthier. One reason for this is that they cooperate with developers to engage in informal land conversions, as will be described in detail in Part II of the dissertation. Another reason is that their village-owned enterprises, such as construction companies and small manufacturing plants, are more likely to be successful due to proximity to transportation facilities and market. Most of these enterprises have been privatized by now, but they contribute tax or land use fees to the villages.

In addition to geographical location, the amount of reserve land also accounts for the variation of a village’s financial capability. Villages with more reserve land are in a better financial situation, other things being equal. The amount of reserve land is particularly important for the villages in remote areas because they have few - if any -
other sources of collective income, as explained by the Party Secretary of Village L:

Our village has 500 mu of farmland remaining, among which 300 mu is equally distributed to villagers as grain land and the rest (i.e. 200 mu) is administered by the village as reserve land. Some of the reserve land is rented to enterprises (for non-farming purposes), who pay higher rents than farmers. The rents from the reserve land are used to cover the cost of collective undertakings by the village. (Since the reserve land generates sufficient revenue for the village,) villagers do not need to pay for collective undertakings... The leaders of some villages (which have more reserve land) have much easier time than those of others (with less reserve land).

Natural endowments also contribute to the financial capacity of a village. For example, the coastal villages typically rent the beach to local farmers for fish or shrimp farming. The price is usually around 300 yuan/mu/year. Some of these villages also sell sand to construction companies. In China, sand is a state-owned resource, and selling sand without permission from the government is illegal. However, there is a large informal sand market in Dragon, because sand is an essential material for the making of concrete during construction, and is in high demand in Dragon and its neighboring counties with a booming real estate sector in recent years. Village I, for instance, made several hundred thousand yuan in 2006 by selling sand on its beach. Incidentally, although selling sand provided easy money for the village, it also caused significant environmental damage. The villagers complain that many of the conifer trees that used to grow very well in the sandy beach areas have been destroyed, and that the heavy-duty trucks loaded fully with sand have caused much damage to the road going by the village.

---

109 As mentioned earlier, renting land to enterprises for non-farming purposes is not allowed by the Land Administration Law.
5. Summary

Although the village is the owner of farmland, the bundle of rights that belong to it is limited. The government is given an upper hand by the Chinese law during land conversion, because it can take land from the village in the name of “public interest” without due process of law. In addition, the collective ownership of farmland has inherent difficulties in accommodating population or land changes, which is often a source of conflicts.

Village elections are often very competitive but are subject to manipulation by large families, and bribery is a common strategy by candidates. Elected village leaders pursue personal interests and provide favors to their relatives and friends, but also pay attention to the “public opinions” within the village. They are controlled, to a significant degree, by the township government, since the latter is in a position to grant legal status to the earnings and spending of the former. The role of the village leaders during compulsory land conversion is very limited, if any.

In general, the financial situations of many villages are not good. But some villages are doing much better, because they have a better geographical location, or set aside more reserve land during the 1994 Rural Land Reform, or are blessed with certain natural endowments.
CHAPTER 2 FARMERS

1. Introduction

Farmers account for approximately 50% of Dragon’s total population. A rural family typically consists of two parents with 1-2 unmarried children. Married children usually live separately from their parents, although in some cases they share the same house. According to official statistics, the average net income of farmers was close to 6,000 yuan (i.e. $800-900) in 2005. Their main sources of income include farming, animal husbandry, and working in towns or cities on a temporary basis. Farmers’ literacy rate is close to 100%, and most young farmers below the age of 40 have received at least 9 years of formal school education.

This chapter will first discuss the importance of farming to farmers; then explain the standard of compensation for compulsory land acquisition, and lastly discuss the role of farmers during compulsory land conversion.

2. Importance of farming

As mentioned earlier, each farmer in Dragon receives from the village approximately 1 mu (i.e. 1/15 of a hectare) of grain land. This means that the farmland of a village is divided into hundreds of small parcels, each farmed by a different farmer or household. The main crops in Dragon County include wheat, maize, beans,
potato, and peanuts, etc.

In addition to the grain land, each rural household typically also has a very small parcel of land, with a size of around 1/10 mu, for growing vegetables, such as cabbage, eggplant, tomato, and cucumber, etc. These vegetable lots usually occupy the lands immediately adjacent to the residential area of the village, because the villagers need to travel more frequently to these lots to take care of or harvest vegetables.

Before 2001, farmers were required to pay “land contract fees” for the grain land contracted to them. The rate was generally 200-300 yuan/mu/year. In addition, they had to shoulder some of the public expenditures incurred by the village collective or even the township. For instance, they were sometimes required to make compulsory contribution to fund-raising for the construction of major infrastructure projects such as roads and water conservancy facilities, etc.

In view of the relatively heavy burden on farmers, the national government implemented a reform in 2001 to cancel the land contract fees. Instead, farmers were asked to pay an “agricultural tax”, the rate of which was assessed based on farmers’ average income from agricultural production on the land during the previous three years. On average, the rate of the agricultural tax in Dragon was approximately 70 yuan/mu/year.

In 2003, the national government moved a step further, and exempted farmers from the agricultural tax. Now, farmers do not need to pay any fees or tax, and are entitled to subsidies for certain crops. In Dragon, there are two kinds of subsidies: For each mu of grain crops planted, a farmer receives from the government 16 yuan for
grain production plus 16 yuan for fertilizer. In other words, a farmer receives 32 yuan of agricultural subsidy for each mu of grain crops planted.

Despite the tax/fees exemption and the agricultural subsidy, farming is far from an attractive source of income for most farmers. According to local farmers, the net income from farming is 600-700 yuan/mu/year at most, due to the low prices of agricultural produce and the high cost of fertilizer and insecticides. In other words, a household with three members, each having 1 mu of grain land, will have a total income of approximately 2,000 yuan (i.e. less than $300) from farming each year. Not surprisingly, most farmers, particularly those living in the villages close to Dragon City or township capitals, do not take farming seriously, because working in the city or towns pays far better. Most farmers still do farming, but few on a full-time basis unless there is absolutely no alternative way of making a living.

This does not mean that farming is always unattractive for all farmers. Historically, some agricultural produces have been very profitable during certain periods. In the early 1990s, for example, many farmers in Township D made a fortune out of growing Fuji apple, which is a special type of apple introduced from Japan. Some households made as much as 10,000-30,000 yuan each year, which was a tremendous amount of money at that time - The average yearly net income was less than 1,400 yuan for urban residents and less than 900 yuan for farmers in Dragon County in 1990.110 One reason this type of apple sold so well was that its quality was far superior to that of other types of apples in terms of crispness, taste and looks.

Another reason was that the Chinese society has a long tradition of exchanging gifts on important holidays or for building up personal relations with others. Since the Chinese people were still quite poor in the early 1990s, a small box of Fuji apples was a relatively affordable, yet decent, “gift” for relatives or friends. Many companies or organizations typically also bought and gave high-quality fruits, such as Fuji apples, to their employees, many of whom would then give them to friends or relatives as gifts.

Of course, scarcity is always a most important condition for any commodity to be sold well. After other farmers learned about the profitability of growing Fuji apple, they followed suit immediately. It was very fortunate for the farmers in Township D that their apples remained profitable for a few more years because it took a considerable amount of time for the new apple trees of other farmers to grow up and bear fruits. However, by the late 1990s, growing Fuji apples was no longer profitable at all, and some farmers cut down the trees to make room for other crops.

The “Fuji apple case” is actually not an isolated phenomenon. A similar case involves building greenhouses to grow vegetables. Prior to the late 1990s, there were not many types of vegetables to buy in winter because it is too cold in Dragon for most vegetables to grow under natural conditions. Starting from the late 1990s, some farmers built greenhouses to grow such vegetables as tomatoes and cucumbers in winter. It was very profitable at the beginning, but, as more people engaged in it, the profit margin decreased over time. Now, these greenhouses are more popular in the remote areas where farming is still an important source of income. In the villages
close to Dragon City or township capitals, they are not very common because these greenhouses require intensive care whereas working in the city or the towns is often a better option for income.

A third example is that shrimp farming used to be a profitable business in Townships D, E and F in the 1990s, but is much less popular now. The reason is that shrimp farming is a “high risk, high return” business. Significant investment is required for renting the beach, building up the ponds, and buying shrimp fry. Farmed shrimps are also very susceptible to certain viruses. Absent proper disease control measures, the shrimps in a pond and even an entire beach area may die all together. Nevertheless, some farmers made much money from it. In a prosperous year, it was typical for a farmer who owned several farming ponds to earn more than 100,000 yuan. However, this business is much less profitable now due to increasing competition, particularly from specialized shrimp farming companies.

The profitability of farming is sometimes also susceptible to external shocks. In 2007, some farmers in Township D benefited from growing peanuts, whose price without shell was 8-9 yuan per kilogram. This was a result of high demand from both the international and the domestic market for oil products. However, in 2008, the price dropped to approximately 4 yuan per kilogram – partly due to increased supply but more importantly because of shrinking international demand as a result of the global financial crisis. Consequently, most farmers did not make much profit, and some could not even cover the costs (including fertilizer, pesticide, plastic film for agricultural use, and hiring of agricultural machines for sowing seeds, etc.).
In general, whenever a certain type of agricultural produce sells particularly well, the invisible hand of the market will increase its supply such that the profit margins for all produces tend to equalize, other things (such as the level of input and investment risks) being equal. There seem to be exceptions to this rule. For instance, a few farmers in Dragon County have recently been making large profits by planting some rare species of flowers, but not many farmers are following suit right now. Two factors are responsible for this: First, growing flowers requires much more technical know-how than other crops, such as temperature regulation, humidity control, and grafting techniques, etc. Second, one needs to have a land unit that is large enough to make flower growing economical – which is impossible for most farmers.

One message this section tries to convey by citing these examples is that, for farmers, no single farming option will remain profitable for long, due to a large surplus of rural labor which stands ready to go in for anything that is financially promising. A more important point to note, however, is that the first farmers to try new options are usually those who are open-minded, active, shrewd and, more importantly, already wealthy. For the farmers who are poor, farming has been - and will continue to be - an unattractive source of income, although they tend to rely on it more than others.

Due to the low profitability of farming, it makes economic sense to consolidate farmland into larger, more economical units. This is sometimes done by companies specializing in agricultural production. For example, Agricultural Company A from Phoenix City rents more than 500 mu of farmland from Village O, P, and Q in
Township D to grow blueberries. The company earns 600-800 yuan per mu in net income. Farmers who lease land to the company have priority in being hired by the company. The average salary level for these farmers is 500-700 yuan per month.

However, such consolidation of farmland is, in general, not very common. In Dragon County, farmland leasing is not rare, but mostly applies to reserve land. The leasing prices can be up to 200-300 yuan per mu per year, but are usually much lower than that. Individual farmers sometimes also lease the farming rights to their grain land to others, but a typical deal usually does not involve more than several farmers, for two reasons: First, with modern agricultural machines, farming is not as laborious as it used to be. Most families in the villages covered by the case study have or have access to tractors or other agricultural machinery. There are also insecticides and other techniques to relieve farmers of the drudgery of removing weeds by hand or hoeing. A second reason is that each farmer has only 1 mu of grain land on average. This amount is easily manageable. In Dragon, it is typical that the husband of a household works in the city for most of the year while the wife stays at home taking care of their child (children) and farming. The husband usually comes back during busy planting and harvesting seasons to help.

In October 2008, the Third Plenary Session of the Seventeenth CCP Central Committee passed a resolution to encourage the transfer of land contract rights among farmers. Since more detailed regulations are yet to be developed, the effect of the resolution remains to be seen. However, its likely impact on land conversion will be

111 Chinese Communist Party Central Committee (2008)
discussed briefly in Chapter 12.

In recent years, many people have seen the prospect of land value increase due to the county’s urbanization blueprint (See Map 3), and have tried to rent land from the affected villages in the hope of receiving compensation in the case of land conversion. For example, the brother-in-law of Party Secretary B, mentioned in Chapter 1, rented 10 mu of reserve land from Village L, Township E in 2004. The duration of the contract is 2004-2014, and the rent is 15,300 yuan in lump sum. He is now growing poplar on the land. The advantage of growing trees instead of crops is that the former does not require intensive care since the farmer’s own village is about 10 kilometers away. His main purpose for acquiring the land, however, is not to make money by growing trees. The land is located just a few hundred meters from the downtown of the capital of Township L, so he hopes that the area will be developed soon and that he can claim a significant amount of compensation for the trees and the land. Even if the area is not developed before the contract expires, he would not lose anything, because the trees he grows, when sold, should be about enough to cover the rent.

In a different case, Real Estate Developer A rented 300 mu of land in 2006 for 70 years at a price of 4.5 million yuan from a village located close to a military base to the east of Township D, because he had obtained confidential information that the area was to be developed by the military base soon. He has planted trees on the land, and is waiting for land conversion to occur.
3. Compensation for compulsory land conversion

The level and distribution of compensation for compulsory land conversion was a major source of social conflicts before 2005, but is attracting less attention now. This section explains why this is so.

3.1 Chaos before 2005

In general, the compensation system before 2005 was very confusing. A compensation package typically included two parts: compensation for land, and compensation for the existing crops on the land.

The compensation for land was delivered - via the township government - to the village, which then distributed it to the farmers. Its level was determined by the county government one-sidedly, and was constantly changing. Moreover, the township government and the village typically each cut a slice before the compensation reached farmers, as mentioned in Chapter 1. Local Official A explains with an example,

When the Coastal Road was under construction, the county government paid 18,000 yuan/mu (as compensation for land) to the affected villages. It was a uniform standard set by the county government, but some townships took a share from it. For example, one township gave only 15,000 yuan/mu to its villages. Some townships delayed paying the villages and some even used up all the compensation by themselves, because they were in financial difficulty. Later, the compensation standard was increased to 20,000 yuan, and subsequently 30,000 yuan.

The compensation for existing crops was given to farmers directly. Its level also varied from case to case, and changed over time. Moreover, according to the local policy, the compensation for trees was higher than for crops, because trees are worth
more than crops on the market. This seemingly reasonable policy led to great chaos.

In anticipation of compulsory conversion of their land, many farmers planted trees instead of crops, hoping to receive higher compensation. For example, Village H, located at the western fringe of Dragon City, had approximately 1,100 mu of farmland remaining in the early 2000s, but only 30 mu was used for growing crops and all the rest for growing trees. A former party secretary of the village comments that,

It was a great waste of land! Farmers just wanted to receive more compensation. They did not grow crops, but poor-quality peach trees. They were not interested in producing fruits … At the time, they were not even sure about when land conversion would happen, but were simply waiting…

Urban Resident A describes a typical scene during land conversion:

In one case, the farmers were “planting” trees ahead, and the officials (responsible for land acquisition) were behind them counting the number of the trees… Officials had to leave “one side of the net open” (i.e. be ‘lenient’) - Otherwise farmers would not give up the land.

Farmer H from Village H made the following observation regarding the confusion caused by this policy:

Most villagers had no objections (i.e. thought it was “useless” to object) to the compulsory conversions (that had occurred to the lands of the village). However, about 20 percent were not happy, (which was not necessarily because they objected to the land conversions per se, but that) they did not think the compensation they received was fair. In one case, some farmers were offered a rate of 120 yuan only for each tree that had been planted several years before, while others were offered 200 yuan for each tree that had just been planted. The only reason why the latter received more compensation was that their trees were larger in size (whereas the type and quality of the trees were not considered).

This “Tree vs. Crop” game does not apply to compulsory land conversion only, but other situations as well. Employee A from the county’s Water Company explains his experience as follows,

In order to lay (or repair) water pipes, we often need to destroy farmers’ crops on the land along the routes. According to the local water supply regulation, water pipes are buried 9 meters to the west or north of roads. Since laying water pipes
destroys crops, the company needs to pay compensation. It pays compensation to the township, which passes it down to the villages, which in turn pass it down to villagers. But each of them will cut a slice. The water company cannot give the compensation to farmers directly because they are too many. Therefore, when the compensation finally gets to the farmers’ hands, only a small portion is left. In one case, the farmers became very angry and surrounded the workers of the company while the latter were working, and blocked them from laying the pipes for several days. The government had to intervene and “persuaded” them to leave… Whenever the water company plans to lay pipes, it does not dare to give prior notice to farmers. Otherwise, they may plant tree seedlings on the affected land overnight, knowing that much higher compensation has to be paid for trees than for crops according to local official regulations.

3.2 The 2005 reform

In order to ease the growing number of conflicts surrounding the level of compensation, the county government of Dragon started to implement a compensation reform in 2005. The new compensation system includes a standard cash compensation package and a pension system, as described below:

Cash compensation package

Under the new system, a standard cash compensation package to villages includes two parts: The first part is the compensation for land and existing crops, which is 30,000 yuan per mu in lump sum. The second part is the compensation for crop production, which is 600 yuan per mu per year, paid in installments, for the remaining years before the expiration of the 30-year land contract signed in 1994. Paying the compensation for crop production in installments has several advantages: First, farmers have a stable source of income each year, avoiding the possibility that some farmers will use up the money rapidly in an un-planned way if they receive it in lump sum. Second, the government, which may be short of cash sometimes, does not
have to pay the compensation all at once.

This level of compensation, if paid in full to individual farmers, is not insignificant - compared with a net income of 700 yuan at most per year from one mu of land if used for farming, as mentioned earlier. However, after land conversion, the cost of food for a farmer may rise significantly. In Dragon County, most rural households do not need to buy much grain or vegetables on the market, since they can produce them on their own land. They do buy some for diversity, but the spending is usually not much. If a household loses all its land and buys everything on the market, the extra cost could be around 100 yuan per month per person even if one lives a frugal life. With this being taken into account, the amount of *lump sum* cash compensation - though higher than before - does not seem to be very large. Moreover, it is typical for the village to keep a portion of the cash compensation, so what is received by individual farmers is usually less than amount stated above. Yet, what really makes the new compensation reform attractive is the pension system, as will be described below.

**Pension system**

Although farming is an unimportant source of income for most farmers and the level of cash compensation for land conversion is higher than their income from farming, many farmers still do not want to lose their land. This is largely because land provides a kind of “psychological” insurance for farmers. Like most other regions in China, Dragon County does not have a social safety net for the rural population, and land has served as a proxy for social safety. Recognizing this character of land, the
The county government also set up a pension system for the farmers who lose land.

Males over the age of 45 and females over 40 who have less than 0.3 mu of land are eligible to participate in the pension system on a voluntary basis. An eligible farmer contributes a small amount of money to his private pension account from the age of 45 (for male) or 40 (for female), to be matched by contributions from the village, township government and county government. The farmer will start receiving pension payment at the age of 60 (for male) or 55 (for female).

The maximum contribution a farmer can make to his pension account each year is 6% of the average net income of the county’s rural population in the previous year. (The maximum contribution in 2006 was about 340 yuan.) The village, the township government and the county government each contributes approximately the same amount. The level of the pension benefits a farmer receives after he reaches retirement age depends on the total amount of contribution in his/her private pension account.

The formulas for the calculation of a farmer’s monthly contribution to his/her pension account and the pension benefits he/she is to receive are a bit complicated. In a simplified way, if a 45-year-old male farmer makes a fixed contribution of 340 yuan each year to his pension account, he would receive 240 yuan per month as pension benefits after he reaches the age of 60. (In reality, he would receive more because his contribution should generally increase each year rather than stay fixed.)

Farmers who have already reached the age of 60 (for male) or 55 (for female) can pay a certain amount of contribution in lump sum and receive pension benefits immediately. For example, a 60-year-old male can make a contribution of
approximately 5,000 yuan in lump sum, and receive immediately pension benefits in the amount of approximately 240 yuan per month.

3.3 An illustrative example of compulsory land conversion

The new compensation system sounds a bit complicated. In practice, it is relatively easy to implement, and actual compensation packages may be different from the standard one described above. An illustrative example involved the acquisition of a large lot by the county government from Village H for the construction of a garbage disposal plant. Nominally, the total value of the compensation package offered by the county government was 60,000 yuan to the village for each mu of the land acquired, including 30,000 yuan for the land and existing crops and 30,000 for future crop production and pension. In practice, the compensation for the land and existing crops was all given to the affected farmers; whereas the compensation for future production and pension was not provided to the farmers right away, but kept by the local government in order to pay 600 yuan/mu/year to the farmers and to pay for the farmers’ pension benefits. Incidentally, the farmers in this case realized afterwards that a garbage disposal site could cause pollution to the village’s groundwater, on which they depend for drinking water, because the village is on the downside. Fortunately, the garbage disposal site has not been put into use for some reason, and the farmers have come back to the land to plant crops again, although the village collective no loner owns the land.
4. Strategies of farmers during compulsory land acquisition

The role of farmers during land conversion is very limited. As mentioned in Chapter 1, as long as the government has made a decision to convert a particular land area, there is virtually no room for negotiation by villages and farmers. This, of course, is not a phenomenon unique for Dragon County. Other, existing studies have revealed that farmers are generally helpless during compulsory land conversion\textsuperscript{112}. For example, Li Ping and Xu Xiaobai (2004) did a field survey in 17 villages in Anhui, Hainan and Guangxi provinces, and found that farmers were not consulted at all during the decision-making process, but were simply informed of which land parcels were to be acquired, what the purpose was, and how much compensation farmers were to receive, etc. Moreover, the notices to farmers were mostly oral: Among the 17 villages surveyed, only two had the government’s official notices posted in the offices of the villagers’ committees.

This dissertation finds that farmers typically adopt the following strategies in dealing with local governments during compulsory land conversion:

Complying

Most farmers in Dragon County choose to defer to the government during the land conversion process. Two reasons are mainly accountable for such an attitude. First and foremost, the government is too powerful. Farmers know very well that the land they farm belongs to the state, that “collective” ownership is a nominal thing, and

\textsuperscript{112} Su Hong et al. (2005)
that it is impossible for them to change or even influence the decisions made by the government. Another reason is that, from a psychological perspective, many Chinese people are used to deferring to the government. In ancient times, the emperors taught the people to be loyal to the royal families. If an emperor wanted someone to die for “the good of the dynasty”, the latter should do so with a sense of glory. In modern times, the government has been trying to promote similar teachings, such as “the government will always serve the needs of the people”, “the government is trustworthy, even if it makes mistakes sometimes”, and “under no circumstances should the leadership of X be questioned”, etc. For many people, especially those who experienced Chinese politics in the pre-reform era, deference to the government is almost “customary”, so to speak. In modern Chinese history, for example, there are numerous examples of people making self-sacrifices due to an artificially cultivated inclination to defer to the government. Unconditional deference is clearly essential for achieving collective goals under certain circumstances. For instance, soldiers on the battlefield must follow the orders of their commanders, even if it means loss of their lives. The problem with unconditional deference in a non-war environment, however, is that the leaders may abuse their power for their own interests. This has come to the realization of more and more people as China becomes increasingly open to the outside world, but the effects of the old teachings are still evident in the minds of many people.

A typical example involves the construction of the Coastal Road in Township D in 2006. In order to build the road, a cemetery on the route had to be relocated. The
cemetery included tombs for the ancestors of some villagers from villages I, R and S. The compensation was 300 yuan for a one-coffin tomb and 500 yuan for a two-coffin tomb. It is worth noting that, in the local society, the location of tombs is very important. Most people do not necessarily believe that a good location will bring good luck for the offspring or the relatives of the ones who have passed away; yet, many people care much about it out of respect for the dead – if not for other, superstitious reasons. However, despite the relative insignificance of the compensation, the affected farmers from these three villages gave no objections. Farmer E from Village I comments that,

I heard that some people (i.e. the township government) had already cut a slice from it. The compensation should be 500 yuan for a one-coffin tomb, 800 yuan for a two-coffin tomb, and 1,100 yuan for a tomb with three or more coffins. We deferred to the government. Otherwise, what can you do about it?

Making up information

As described earlier, many farmers play the “tree vs. crop” game. This strategy is not just used by farmers in Dragon County, but also in other regions. In some cases, farmers and their village leaders even cooperate with local officials in order to receive more compensation. For example, a report by Liu Heng\textsuperscript{113} in The City Evening News (November 29, 2008) revealed that, in Fuyu Village, Nanguan District, Changchun Municipality, Jilin Province, the party secretary led some farmers to plant tree seedlings overnight on lands acquired by the government for a large road project. They also reported false information regarding the area of the lands. This case was discovered accidentally by the mayor of Changchun Municipality who was on a field

\textsuperscript{113} Liu Heng, et al. (2008)
trip to the project, because the seedlings had been planted in such a hurry that some did not even stand firm in the field. It was cold winter and the land was frozen, so the farmers had had to use stones to support the trees so as to prevent them from falling. The villagers and the local officials involved had received more than 1.6 million yuan of extra compensation. Eventually, more than ten people involved in the case were found guilty of criminal charges. The responsible district official was sentenced 15 years in prison, and the village party secretary 3 years in prison.

Cheating is not something that should be encouraged. However, it reflects serious problems created by an unfair compensation system for compulsory land acquisition. A fixed compensation standard leaves little – if any - room for negotiation by the village and farmers, so they often have no choice but to cheat.

**Being a nail**

“Nail” (Ding Zi) is a nickname given by local governments to a household which does not give in to the government unless their conditions are met - just like a nail, which is difficult to be pulled out once hammered into something. There have been nail farmers/households (Ding Zi Hu) in some large compulsory land conversion projects, and the local governments have had to devote great effort to “digging them out”. One example is Farmer F from Township C. His land was planned to make way for a big investment project in 2004. He, like all other farmers, was initially offered 20,000 yuan for each mu of the land farmed by his family. He refused, even though all the other farmers had accepted. He was then offered 25,000 yuan/mu, 35,000 yuan/mu, and 45,000 yuan/mu in sequence, but he rejected them all. At last, the township
officials had to ask how much he really wanted. He said $75,000 yuan/mu$. In response, the officials made a final offer of $65,000$ and told him that it would be the final offer - whether he accepted it or not. In order to have him agree, the township government asked his brother-in-law, who was the director of the township agricultural machinery station, to “persuade” him. The township government told the brother-in-law that he would be fired if he could not “convince” Farmer E. Farmer E accepted the last offer. The other farmers, who had previously accepted $20,000$ yuan per mu, were angry because Farmer E obtained a much better deal simply because he was tough. Some farmers sent appeal letters or made calls to higher-level governments, but these resulted in nothing because $20,000$ yuan/mu was already higher than the official standard of the time.

Being a nail is often not the dominant strategy for farmers. For example, during the construction of a large development project in the Economic Development Zone, Farmer G, whose house was supposed to make way for a road, had been such a hard nail in trying to negotiate for more compensation that the officials became very angry and decided to have the road take a detour to get around his house. The house now stands in complete isolation and in close proximity of a noisy road, and has lost most of its value.

Another example is that, during the widening of the National Road in 2001, Farmer Z refused to give up a small facility he owned on the roadside. The government offered a compensation of $3,000$ yuan, but he asked for $50,000$ yuan. In the end, the government used the police to surround the land, and destroyed the
facility by force. The government eventually paid the farmer 5,000 yuan.

Creating “trouble” or protesting in an organized way

It is common for unhappy farmers to get together to protect physically their lands from being taken or block the roads leading to their lands. This typically escalates into confrontation between the farmers and local authorities. For example, when the Coastal Road was under construction, some farmers who were not satisfied with the compensation they had received went to a construction site to prevent the construction workers from taking down their fruit trees. The local government used force to take the farmers away from the site. It does not require a lot of brain power to imagine what a scene it was.

There are of course other, similar cases in Dragon County. As a matter of fact, such cases are widespread across the country. Due to their high-level of political sensitivity, local governments typically make great efforts to keep such stories from appearing on the public media. Despite this, it is not rare to come across media reports about such confrontations. For example, during a short period between October 15, 2008 and November 5, 2008, at least five different cases in various regions became known: The Jinghua Times (October 15, 2008)\textsuperscript{114} reports that more than 200 farmers from Taipingzhuang Village, Nankou Township, Changping District, Beijing Municipality blocked the roads leading to a construction site of the new Beijing-Baotou Highway. The cause of their action was that the government offered to pay them 60,000 yuan for each mu of land, but they insisted on receiving 70,000 yuan.

\textsuperscript{114} Zhou Yu (2008)
The New Legal News (October 27, 2008)\textsuperscript{115} describes a situation where farmers from Qinghu Village, Hekou Township, Qianshan County, Jiangxi Province were not happy with the level of compensation they received for their land and blocked a construction site. The confrontation developed into a serious physical fight, resulting in some farmers and construction workers seriously injured. The Chuncheng Evening News (October 27, 2008)\textsuperscript{116} tells a story that some farmers from Zhaotong, Yunnan Province suspected that the local government intercepted a large portion of the compensation for their lands. After the local government turned a deaf ear to their appeals, they organized a number of “trouble-making” activities including blocking local roads, leading to 15 farmers being detained by the local police. The Finance and Economics (November 3, 2008)\textsuperscript{117} reports that some farmers from Langfang, Hebei Province gathered at a construction site of the Beijing-Shanghai High-Speed Railway and staged a confrontation with the construction workers. The Jing Times (November 5, 2008)\textsuperscript{118} reports that some farmers from Dangshan County, Anhui Province were not satisfied with the level of compensation paid to them, and had clashes with the local police, resulting some farmers being arrested.

Aside from blocking roads, farmers sometimes also try to attract attention through demonstrations. In Dragon City, it was not a rare scene in the early 2000s that some people gathered in front of the main county government building where the County Party Secretary and the County Mayor had their offices. Often, they asked to

\textsuperscript{115} Li Jing and Xu Xiaoming (2008)  
\textsuperscript{116} Su Zhong and Shen Xixun (2008)  
\textsuperscript{117} Lan Fang (2008)  
\textsuperscript{118} Jing News (November 5, 2008)
meet with the relevant county leaders in order to have their “problems” solved; but sometimes, they were there just to attract attention. These people were mainly composed of two groups. The first group included those laid down by state-owned enterprises (SOEs), or workers who could not receive salaries on time because their SOEs were not doing well. The second group were farmers whose land had been taken by the government.

This was a big headache for the county government. Trouble-making activities or demonstrations without prior permission from the government are against the Chinese law – which is why such cases often escalate into confrontations between the farmers and the police. However, farmers were generally not very afraid of the government, because they had little to lose. The protests did result in some – though certainly not all - disputes being investigated or resolved. This usually applies to cases where the compensation promised to farmers had been intercepted on its way down the various levels of the government. It is fair to say that farmers’ protests served as the most important driver for the 2005 reform as described earlier.

These protests reflect the lack of an effective referee system during the land conversion process. Farmers have to resort to informal means to attract attention from the public and sometimes the media so as to exert pressure on the government. However, such protests are not always easy to organize because, as indicated earlier, the government is so powerful that most farmers would think that challenging the government is not worth the trouble. In order to organize a protest, a few determined nail farmers have to take the lead, so that others could follow them. In a similar way,
if the nail farmers withdraw, the others typically would follow suit. As will be discussed in Chapter 4, local governments are actually very good at dealing with nail farmers.

The case study shows that the number of protests has decreased sharply after the 2005 reform, indicating that Dragon’s local governments do a reasonably good job in this respect.

**Appealing to higher-level authorities**

Of course, unhappy farmers always have the option of appealing to the higher-level governments or going to the court, but this will be discussed in Chapter 6.

**5. Summary**

Farming is an unattractive way of making a living, and accounts for a small proportion of farmers’ total income. Some farming options have been profitable during certain periods for certain farmers, but the profit margin for most farmers has been - and will remain - small. Farmland leasing is not rare in Dragon, but seldom on a large scale.

As the compensation policy for compulsory land conversion caused great chaos before 2005, the county government has established a new compensation standard and a pension system for the farmers who lose land, which are welcomed by farmers. However, farmers have virtually no say during compulsory land conversion. In some
cases, some individual farmers stand up to resist government decisions, but the psychological stress is usually very high and many do not succeed.
CHAPTER 3 HIGHER-LEVEL GOVERNMENTS

1. Introduction

Higher-level governments refer to national, provincial and municipal government. This chapter will focus on the national government. The provincial and municipal governments will not be discussed at length because they are responsible for implementing the policies dictated by higher authorities and their concerns are similar, though at a different scale, to those of the local governments in Dragon - which will be described in Chapter 4.

This chapter will first describe the national farmland protection policy, then explain and discuss four other policy objectives of the national government: promoting economic growth, centralizing political power, centralizing financial authority and delegating administrative responsibilities, and controlling housing prices. It argues that the so-called “most stringent farmland protection policy in the world” conflicts with the other policy objectives, and is impracticable.

2. Protecting farmland

Since the early 2000s, China has been implementing what it calls “the most stringent farmland protection policy in the world”. The main reason is that, as mentioned in the Introduction of the dissertation, China’s farmland resource is very
scarce. Approximately 70 percent of China’s farmland is located in mountainous and hilly areas or on plateaus, whereas only 30% is on plains or in basins. Only 40 percent of all farmland is free from water irrigation problems, with the other 60 percent having low productivity. In addition, 90 percent of China’s farmland is located in humid and semi-humid areas, and mostly concentrated in the Pearl River Delta, the Yangtze River Delta, central-north provinces, and the northeastern provinces - where economic growth is most advanced and the demand for land conversion is huge.

Most of China’s land resources are already being utilized fully. In 2003, the amount of land that could potentially be reclaimed into new farmland was approximately 13 million hectares. Assuming that 60 percent of these areas can actually be reclaimed into farmland, it will add 8 million hectares, or only 8.4 percent, to the existing stock of farmland. Much of this land is located in remote and economically disadvantaged regions in the northwest, northeast and Inner Mongolia, often without convenient access to water supply.

In addition, a significant portion of the existing farmland stock has been reclaimed from forest or grassland on slopes. In 2003, there were 6 million hectares of farmland on slopes of greater than 25°, and 12.5 million hectares of farmland on slopes of 10°-25°. Vegetation destruction and soil erosion resulting from such land reclamation have been recognized as a primary cause of the flooding problems of China’s major rivers in recent years, particularly of the flood in the Yangtze River

119 All the figures in this and the next two paragraphs are drawn from Hao et al (2003), unless stated otherwise.
Basin that killed several thousand people in 1998. In view of this, the national government has been implementing a policy since the late 1990s to convert such farmland back to forest or grassland in order to protect ecological quality. This has constrained the existing farmland stock even further.

Since the 1990s, China has been losing farmland to urbanization at a rapid pace. According to a national survey by the MLR on land use changes, China’s arable land decreased by 120 million mu (i.e. 8 million hectares), or 6 percent of China’s total arable land area, between 1996 and 2005. According to the same survey, China’s farmland was 1.83 billion mu at the end of 2005, a decrease of 5.42 million mu from 2004. Among the lost farmland in that year, 3.18 million mu was converted for development purposes, and the rest was either lost to land degradation or converted to forest or grassland for the purpose of ecological conservation. In recent years, an average of approximately 3 million mu of farmland has been converted to non-farming uses each year. (However, Lichtenberg and Ding (2008) note that a lack of consistent, reliable data makes it difficult to identify trends in farmland loss with much precision, and that official figures published by the National Statistical Bureau are known to have underreported farmland by a substantial margin, at least up until the mid-1990s.)

Since ancient times, Chinese leaders have always attached a great deal of importance to food self-sufficiency. The Book of Rites, written in the fifth century

---

120 CCICED (2001)
121 Xin Jing Bao (March 16, 2006)
122 Mu is a Chinese measurement unit. 15 mu = 1 hectare.
123 Li Chenggui and Wang Hongchun (2002)
BC, cautioned Chinese rulers that, “less than nine years of grain stocks were insufficient; less than six years of reserves created a tense situation; and less than three years of stocks pointed to a government in decline”.  

The main unfavorable factors for China’s grain supply in recent years include reduction of arable land, water shortage, inadequate investment in agricultural research, unfavorable agricultural policies (such as pricing), and a conflict between the need to conserve the ecology and the pressure for intensive farming.

In 1995, Lester Brown, an American researcher, voiced the concern that China might not be able to feed itself in the future, and the rest of the world would not be able to feed China either, such that China would make the rest of the world hungry. Brown's report put into grave doubt China's capacity to feed itself, particularly by the year 2030 when China's population is expected to reach its peak. He also predicted, in 1995, that China’s grain production would decrease by 20 percent by 2030 due to loss of arable land and other factors, and that, even if the existing Chinese diet did not change, China would need to import 200-369 million tons of grain in 2030, which was equivalent to the total amount of grain available for international trade in the world.

Lester Brown’s views attracted high attention from China’s top leadership, but the issue is highly controversial. For example, Frederick Crook, an agricultural economist at the US Department of Agriculture thinks that Brown, in his predictions, did not

---

125 Li Chenggui and Wang Hongchun (2002)
126 Brown (1995)
128 Quoted in Wu Zhihua and Hu Xuejun (2003)
consider the self-correcting mechanism of the market economy, since it is obvious that the Chinese government, the producers and the consumers will respond to changing grain market conditions by increasing the efficiency of production. Other experts, such as Shirayishi Kaziyoshi, a Japanese scientist specializing in Chinese problems, and Lin Yifu, now Chief Economist of the World Bank, have similar views and think that China has the capacity to produce enough grain to feed itself. The World Bank also commissioned research on China’s food security, and concluded that, by 2020, China’s demand for grain would be more than 6 billion tons, over 90 percent of which can be produced by China itself through improving agricultural infrastructure, and increasing investment in agricultural research, land conservation and irrigation facilities.129 Despite opposing views about food demand and supply in China for the next 30 years,130 many researchers think that the rapid loss of arable land to development and degradation are reducing China’s grain production capacity,131 and food security considerations are the main basis for China’s farmland protection policy.

According to the existing Chinese farmland protection policy, a minimum of 80 percent of all farmland within a province shall be designated as “prime farmland” that shall be protected fully in principle. Prime farmland includes the following types: farmland within grain, cotton or oil crop production bases designated by county-level governments or higher; farmland with good water conservancy facilities; vegetable

129 This paragraph draws from Wu Zhihua and Hu Xuejun (2003)
130 Brown, Lester (1995); Jikun Huang and Scott Rozelle (1995)
131 Gardner, Gary (1996); Rozelle, Scott, Gregory Veeck and Jikun Huang (1997); Li Xiubin and Sun Laixiang (1997)
production bases; farmland for agricultural research or teaching experiment activities; and, other farmland designated by the State Council.

In principle, each province is required to make sure that there is no net loss of farmland within its jurisdiction. Provinces experiencing a net loss of farmland will be required by the State Council to reclaim an equivalent amount of new farmland of equivalent quality. Provinces unable to fulfill this requirement due to land resource constraints must apply to the State Council for special arrangements whereby they can be allowed to reclaim farmland in other jurisdictions.

According to the *Land Administration Law* (2004), developers of new projects that involve farmland conversion should, in principle, reclaim an equivalent amount of the farmland converted. Those who are not able to do so are required to pay “farmland reclamation fees”, and the collected fees will be earmarked for reclaiming farmland.

This farmland protection objective comprises the most important component of the National Guideline for Comprehensive Land Use Planning (NGCLUP), which is a basis for the provinces to develop their respective CLUPs. The components of the NGCLUP are similar to those of a local CLUP, such as the one presented in Figure 2. The existing NGCLUP, developed in the mid-1990s, designates the maximum amount of developable land allowed for each province between 1997 and 2010. A detailed assessment of its implementation will be made in Chapter 7.

The farmland protection policy has been questioned by some scholars. For
example, Lichtenberg and Ding (2008) think that a substantial share of China’s farmland loss does not represent a reduction in food production capacity, that increases in other factors of production can compensate for farmland losses, and that farmland protection is not the most efficient - or even a necessary - means of meeting China's food security goals. Mao Yushi, Director of the Beijing-based Tianze Economic Research Institute, argues that the Chinese farmland protection objective is too strict and will constrain China’s economic development.132 In December 2008, Mao and his institute released a 224-page research report entitled “Farmland Protection and Grain Security”, which concludes that food security is not a solid basis for the current farmland protection policy. This report incurred strong reactions from some policy makers and the public on the media. There was even a torrent of invectives – sometimes with name-calling – directed at Mao. Mao replied in his personal blog by saying that he did not care about those words because he had heard “far more and far worse words during the Cultural Revolution”. Back in 2007, Mao argues in an article133 that farmland protection is a presumption for many people:

If you ask someone whether farmland should be protected, the reply will typically come instantaneously: “Yes, of course.” If you follow up by asking why, the reply is like to be: “Because it is a national policy that must be adhered to.” If you go on to ask him to explain the basis of this national policy, he is likely to say that farmland is lacking in China and therefore must be protected in order to produce enough food.

… The importance of farmland protection has been advocated (by the government) so repeatedly that it has become a presumption… (Many people hold on to this presumption) without even giving thought to it and thus have deviated from the correct logic.

The findings of the case study in Dragon County supports this proposition. Almost all

---

133 Mao Yushi (2007)
the local officials interviewed regard farmland protection as a “principle”, the logic of which should not be questioned, although at the same time they are very keen on engaging in informal land conversions. Even the farmers interviewed say that they are strongly supportive of farmland protection, although they also acknowledge that farming is very unattractive and that they very much look forward to their areas being urbanized.

This dissertation concurs with Mao in that the Chinese farmland protection objective is too strict, but concludes that such a seemingly inefficient policy is actually a wise way to achieve land use efficiency given the existing political institutions. This theme will be developed in the following chapters.

3. Promoting growth

Growth has been China’s single most important policy objective since the late 1970s. For the CCP leaders, growth is not just an economic issue, but a political one as well. Deng Xiaoping, the late Chinese leader between the late 1970s and the early 1990s, explained this point in 1990 as follows:134

Why are people supporting us (i.e. the party)? The reason is that our economic growth has been rapid and visible in the past decade. What would happen if we experience no development, or slow development, for the next five years? What would be the consequences? This is not just an economic issue, but also a political one… Why did some countries experience problems? The fundamental reason was that their economy was not performing well, such that their people had had food problems, clothing problems, inflation and decreased living standards for a long time.

134 Deng Xiaoping (1993), Volume 3, P. 354
It should be noted immediately that, in the language of green economists, “development” and “growth” can have different connotations: the former may entail the concept of sustainable development and thus means more than the latter. However, it is apparent that, in the quotation above, “development” simply refers to “growth”. As will be seen from the other quotations below, these two terms are often used in an interchangeable way by the Chinese leaders.

Deng thought that China faced many kinds of complex challenges along the “socialist path”. Some challenges were economic and technological, and others were about maintaining social and political stability, realizing national unification and strengthening national defense. Among all these challenges, growth was the single most important one, because it was the key to solving all other problems.

Deng’s thoughts were upheld by his successor Jiang Zemin. Jiang put forward a new concept called the “scientific development outlook”, the gist of which was that growth should be based on sound analysis so as to be sustainable. In 2002, he emphasized that seeking development is the first priority of the party. In his work report to the 16th Congress of the CCP in 2001, Jiang emphasized that the party must regard economic development as the most important task in order to “shoulder the historical responsibility of promoting social progress and revitalizing the country”, and reiterated that economic development would have a direct impact on the level of public support received by the party. The concept of scientific development has been developed further by Hu Jintao, Jiang’s successor, with a new concept called

---

135 This mainly refers to the unification of mainland with Hong Kong, Macao, and Taiwan.
136 Deng Xiaoping (1993), Volume 3, P265
137 Jiang Zemin (2002a)
138 Jiang Zemin (2002b); People’s Daily (February 19, 2003)
“social harmony”, which includes harmony among the people within a society, and between human beings and nature.

Clearly, the recent party leaders have recognized the need to improve the quality of growth. However, an essential precondition for improving quality is that quantity shall not be sacrificed to any significant extent, for two reasons: First, as mentioned, growth is thought to be the most important basis for the party receiving public support. Second, and equally important, the Chinese have learned a hard lesson from its history that economic strength is essential for preventing them from being bullied by others, as explained by an editorial in The People’s Daily, the party’s most influential official newspaper, on Feb 19, 2003.\textsuperscript{139}

“Development is an un-compromisable principle” (Fa Zhan Shi Ying Dao Li) is a simple sentence, but reveals a hard lesson that China has learned from history. As known to all, China was once the most advanced country in the world… Since the end of the 18\textsuperscript{th} century, however, the complacent feudal rulers of China adopted a closed-door policy, leading to slow progress in productivity. In the mean time, the capitalist countries in Europe and North America took advantage of the technologies resulting from the Industrial Revolution, and developed rapidly, leaving China far behind. As a consequence, China, a fallen feudal empire, became a target for invasion. In the face of strong warships and powerful canons of the western powers, the corrupt and incapable government of the Qing Dynasty was helpless, allowing a great country with thousands of years of splendid history to suffer for many years to come.\textsuperscript{140}… “We were bullied because we were weak” – this is a miserable memory and a painful lesson that we have learned from the contemporary Chinese history.

The bloody lessons of the past made the Chinese aware of a simple truth: We must become strong in order to survive… The founding of the People’s Republic of China and the establishment of a socialist system created unprecedented opportunities for rapid economic and social progress… However, (\textit{during the Great Leap Forward and the Cultural Revolution}), China’s focus of attention deviated from economic growth, leading to a widened gap with developed countries in terms of economic strength.

\textsuperscript{139} People’s Daily (February 19, 2003)

\textsuperscript{140} After the 1840s, China was invaded by western powers a number of times: By UK and France twice in 1840 and 1860 respectively, by Japan and Russia respectively in the 1890s, by eight western powers in 1900, and by Japan during World War II.
Since the Third Meeting of the 11th Congress of the Party\textsuperscript{141} in 1978, we have been holding on, tightly and unswervingly, to the central theme of economic development, and made great achievements...

History and reality have proven, time and again, that, only if we stick tightly to the promotion of economic growth as the single most important task... can we fulfill the wishes of the Chinese people in a fundamental way... and retain independence in the world that is becoming increasingly competitive.

Moreover, growth is also an “urgent” task, because China’s top leaders see the first 20 years of the new century as an “important and strategic” period for the country’s revitalization, as explained by Premier Wen Jiabao in an article published on February 26, 2007:\textsuperscript{142}

The first 20 years of the new century presents an important and strategic opportunity... It is of utmost importance that we make the best use of this period...

In China’s contemporary history, there have not been many great opportunities for development. \textit{(Between the 18th century and the middle of the 20th century),} China lost valuable opportunities for development to closed-door policies and various invasions by western powers... \textit{(After the founding of the People’s Republic of China.)} We made some big mistakes, particularly the 10-year Cultural Revolution, leading to loss of another important opportunity period...

Opportunities are rare and usually do not stay for long. In the past 28 years since we adopted open and reform policy, the Chinese economy has been growing in a sustained way, which is a miracle. Will we continue to have such an opportunity period, and for how long? I think the answer to the first question is yes, but the length of the period depends, to a great extent, on our ability to handle domestic and international policies.

Currently, the international situation is undergoing deep and complex changes, and has exhibited many new characteristics. However, in general, the external environment is favorable for us, and the theme of the time is still peace and development. We do not foresee large-scale wars in the world for the time being. Therefore, it is possible for us to have a peaceful international environment and maintain good relations with neighboring countries for a relatively long time. History has taught us that we will be looked down upon and bullied unless we

\textsuperscript{141} This meeting formally adopted the “open and reform” policy, and was therefore a milestone in China’s modern history.

\textsuperscript{142} Wen Jiabao (2007)
become strong. Therefore, we must take advantage of the current favorable international environment to speed up our development…

These thoughts do not belong to the top leaders at the national government only, but are actually the most important tenets of the party that all party members are obliged to study and master.

Since the 1990s, China has been allowing the market to play an increasing role in its economic growth. However, the old planning system is still at work to a significant extent. In particular, the Five-Year Plans (FYPs) continue to guide the workings of the economy at the macro level. There are two types of FYPs: the master FYP, and the sector-specific FYPs.

The master FYP, developed by the National Development and Reform Commission (NDRC) on behalf of the State Council, is an all-encompassing plan covering all the important aspects of economic and social development, such as macro economic objectives, generation of employment opportunities, technological development, regional coordination, and environmental protection, etc. For instance, the 10th FYP (2001-2005) set the following objectives for economic and social development indicators:

- Annual economic growth rate: 7%
- GDP by the end of 2005: 12.5 trillion yuan (based on 2000 prices)
- Per capita GDP by the end of 2005: 9,400 yuan
- Number of new employment opportunities in cities and towns: 40 million
- Registered unemployment rate in cities and towns: below 5%
- Price level: stable
- International balance of accounts: balanced

The sector-specific FYPs are developed by various ministries based on the guidelines set by the master FYP. For example, there are FYPs for transportation, forestry, environmental protection, and land administration, etc.
Although most of the macro control objectives set by the FYPs are not compulsory, they are important indicators for evaluating the performance of local governments. Therefore, local officials take these objectives – particularly the growth objectives - very seriously, and the competition for growth is so intense that many local governments resort to making up numbers in order to impress their bosses at higher-level governments. This is clearly the observation of some officials from Dragon County. Local Official A comments that,

The official statistics are not credible. Whatever kind of data the higher-level governments will be pleased with, the local governments can make up. This is a national phenomenon… I doubt how much of the national statistics is reliable. The data about population and weather may be credible, but I am suspicious about the reliability of other data… One example is that, at the end of 2005, the National Bureau of Statistics “reduced” (artificially) the GDP of (Province X) by 40 billion, and “increased” the GDP of (Province Y) by 70 billion. The NBS had to do this, because otherwise the GDP of (X) would be higher than that of (Y). (It is a well-known fact that Y is wealthier than X.) The most important reason for this kind of fraudulence is that local government leaders need to score politically.

Along the same line, Village Party Secretary B from Township E comments that,

(In Township E), the median annual income of farmers should be approximately 3,000-4,000 yuan, but the official figure is 7,000 yuan. A township official once scolded me for telling the truth to a county official… The annual growth rate of per capita income has to be at least 5%... What we need to do is make up numbers for sheep, cows, and fruit trees, etc., and make sure that the numbers match each other.

Developer E, who owns an export-oriented bio-chemical plant in Township D, comments,

When my plant was doing well (i.e. before it was affected by the financial crisis that started in 2008), its annual gross sales value was approximately 12 million yuan. However, the township official wanted me to report more than 100 million yuan (so that the figure would be more impressive)… At the beginning, I dared not do this, because there might be tax issues involved: If my sales volume had been so large, I would have had to pay a lot more tax… Eventually, after they assured me that tax would not be a problem, I reported as they wished.
The worship of growth has created great demand for land conversion. Land is an essential input for economic growth, since all economic activities have to be based on land. Therefore, a land supply constraint, if binding at all, will essentially restrict economic growth. However, as will be explained in Chapter 11, it is impossible to know precisely how much farmland needs to be protected; so the farmland protection target has to be based on the political will of individual leaders, not on economic analysis of any kind. In other words, the national government does not – and cannot - know how to balance economic growth and farmland protection. To deal with this difficult issue, the national government chooses to tell the local governments that it wants both. The situation is illustrated in Figure 7, in which AB represents the total existing farmland stock, AD represents the annual farmland protection target, and BC represents the amount of farmland that needs to be converted annually in order to achieve the desired growth target.

![Figure 7 Conflicting Targets for Economic Growth and Farmland Protection](image)

This dissertation will show in the following chapters that Figure 7 does reflect reality. For now, it is useful to quote the following statement from a study by a special task force commissioned by the MLR in 2002 regarding the relationship between
economic growth and farmland protection.\textsuperscript{143}

Rapid economic development is making an increasingly greater demand for developable land. The national government has developed many strategies or programs to promote economic development, such as “Accelerating Urbanization”, “Developing Small Cities and Towns”, “Western Development\textsuperscript{144}”, “Enabling Eastern Provinces with Good Conditions to Realize Modernization in Advance”, etc. All these programs require large-scale land conversion, which will aggravate the scarcity of land supply, particularly in the eastern regions where economic development is more advanced. In some regions, it has become increasingly difficult to start new development projects if the developable land quotas are to be fulfilled.

For example, Shannxi Province has proposed to build more than 3,400 km of highways in order to establish a highway network centering on Xi’an City (which is the provincial capital)… and most of the land to be converted will be high-quality farmland in Guanzhong Plain…

(A second example is that) Jiangsu Province has planned to increase the level of urbanization from 34.9% in 1999 to 50% in 2010, and has proposed an urbanization strategy called “Promoting the Development of Mega and Large Cities Actively, and of Small Cities\textsuperscript{145} Rationally”. According to the plan, the number of mega cities will be increased from 2 to 5, large cities from 3 to 6, and medium cities from 10 to 38 during this period. The province will also implement the national strategy of “Promoting the Development of Small Cities and Towns”… During the urbanization process, smaller towns will merge into larger ones… These plans will require converting a large amount of land… There is a large difference between the available land quota and the actual need.

Needless to say, the local governments are very perplexed by the conflicting national policies. The choice, however, is not as difficult as it appears to be. The reason is that, in the minds of local officials, economic growth is definitely a higher priority than farmland protection. Imagine how a local government leader is to interpret the following words by Premier Wen Jiabao in an important editorial\textsuperscript{146}:

\textsuperscript{143} Ministry of Land and Resources Special Task Force (2002)
\textsuperscript{144} “Western Development” is a program to facilitate the development of the western regions, which have been lagging behind the eastern regions in economic growth.
\textsuperscript{145} A mega city has a population of more than 1,000,000, large city 500,000 – 1,000,000, medium city 200,000-500,000, and small city less than 200,000 (State Council, 1986, 1993).
\textsuperscript{146} Wen Jiabao (2007)
There are big and small principles. The small principles should serve the big ones. Our central task is to achieve socialist modernization, which is our big principle, and which everyone must abide by…

It is obviously not difficult to figure out which of the two, growth or farmland, is a more direct contributing factor to modernization.

Of course, the national government has different interpretations regarding the connotations of “socialist modernization”. In recent years, it has recognized the importance of ecological conservation and restoration to the sustainability of economic growth and people’s livelihood. For example, the Program of “Converting Slope Farmland Back to Forest or Grassland”, as mentioned earlier, aims to stop unsustainable farming practices on slope land, which are thought to be a major cause of soil erosion and ecological degradation. However, the afore-mentioned special MLR task force (2002) comments that,

The western provinces are actively implementing the program of slope farmland conversion… The reason why they are so active is that the national government provides decent compensation for such land conversion… All farmland on slopes of greater than 25º is required to be converted, and selected farmland on slopes of 15-25º will be converted too… In addition, some jurisdictions have planned to build greenbelts around their cities and along major roads, which will require converting more farmland… These planned farmland conversion programs have far exceeded the farmland conversion quota allowed for these regions…

Incidentally, a lack of coordination among different land-related agencies during the implementation of this program is also identified as a major issue:

The forestry authorities, agricultural authorities, and land administration authorities all intervened… They lack coordination with each other… and there have been double-counting problems such that the statistics do not reflect true farmland changes.147

147 Ministry of Land and Resources (2002)
In addition, in order to improve the livelihood of the rural population, the national government has been encouraging structural adjustment to agricultural production by developing high value-added agricultural practices and diversifying the use of farmland. As a result, some farmland that was used for grain production is now used for growing fruits or as fish ponds, which has reduced farmland stock. In 1998 and 1999, for instance, the conversion of farmland to orchids and fish ponds accounted for 12.3% and 12.7%, respectively, of all farmland loss.\footnote{Ministry of Land and Resources (2002)}

Therefore, it is fair to say that, as far as the national government is concerned, “socialist modernization” is an all-encompassing concept, including GDP growth, ecological conservation, and adjustment of the existing economic structure – and farmland protection may well be part of it. However, the various national policies mentioned above often conflict with one another and are clearly not achievable at the same time.

Such a conflict will likely become more intense in the face of the economic crisis that started in 2008. On November 5, 2008, the State Council passed a resolution on an economic stimulus package with a planned investment of 4 trillion yuan by 2010. The package aims to stimulate domestic demand and increase the income of urban residents and farmers - which, of course, requires the generation of more jobs. An important component of the package is the construction of infrastructure, such as highways, railways, airports, affordable housing, and wastewater treatment plants, etc, which all require land conversion. The overall macro objective set by the State
Council is that the Chinese economy shall grow by at least 8% in 2009. Conceivably, land supply constraints often have to give way to the need for growth. As will be described in Chapter 8, Dragon County already has a large iron and steel project approved as a part of the overall economic stimulus program, posing more demand on the local land supply.

4. Centralizing political power

China has a highly centralized political system. At the national level, the highest bureaucratic authority is the State Council, which consists of the Premier, 3-5 Vice Premiers and 5 State Councilors. Vice Premiers have the same bureaucratic status as State Councilors, but with more responsibilities. The State Council delegates the responsibilities of the national government to about 30 specialized ministries or central agencies. The Premier is in charge of the overall performance of the national government, whereas each Vice Premier or State Councilor is responsible for directing and overseeing a few ministries and central agencies. The bureaucratic structures at provincial, municipal, county and township levels are similar. At the provincial level, for example, the Governor and Vice Governors delegate specific responsibilities to specialized bureaus, which are set up to match each and every ministry or central agency at the national level. Figure 8 is an illustration of the bureaucratic structures at national and provincial levels.

As mentioned in the Introduction of the dissertation, there are “dual track” and

---

149 Quoting Wen Jiabao, Premier of China, by Zhang Yixuan (2009)
“single track” agencies. In Figure 8, Bureaus A-D are “dual track” agencies. The dotted lines connecting them with the matching ministries at the national level indicate that the latter do not have direct control over the former except on technical matters. Bureau E is a “single track” agency. At least nominally, the provincial governor has no direct authority to appoint officials or control the financial resources of Bureau E. The provincial BLR is a special case, because its director and deputy directors are appointed by the MLR directly but its financial resources and staff are controlled by the provincial governor. In Figure 8, the dotted line connecting the provincial governor and the BLR indicates some degree of direct control by the former over the latter.
Although a highly centralized power system makes it convenient for the CCP to control the ideology of the bureaucracy, such a system is inherently weak in both vertical supervision and horizontal coordination.

In terms of vertical supervision, a first problem is that some national policies may not receive support from provincial governments. According to the Chinese bureaucratic rule, a minister at the national government does not have the authority to direct a provincial governor, since they have the same level of ranking. A minister can “advise” a provincial governor on national policies developed by his ministry, but does not have the authority to impose a penalty if the governor chooses to ignore
these policies, because only the State Council is eligible to order a governor to do things. What a ministry is eligible to do without resorting to the State Council is to ask its matching provincial bureau to implement its policies. This is where the implementation of many national policies goes astray, because national policies often do not coincide with local interests and therefore lack support from provincial governors. The implementation of the farmland protection policy at the provincial level is one such example. Clearly, absent true support from the provincial governor, it is impossible for a provincial BLR to carry out the farmland protection policy strictly - even if the BLR director and deputy directors are appointed by the MLR directly.

A second problem is that it is very difficult for the national government to monitor the local implementation of national policies due to so many levels of the government and so many different agencies at each level within a hierarchical system that is very opaque. For example, as far as land conversion is concerned, it has been impossible for the national government to monitor the collection and use of revenues from land conversion, and there are many private deals between local governments and developers, causing significant loss of public revenue. Between 2003 and 2006, for instance, the National Auditing Bureau uncovered 60 cases of illegal land conveyance at prices that were abnormally low in 87 EDZs in Shanghai, Tianjin, Jiangsu, Zhejiang, Jiangxi and Sichuan Provinces/Municipalities, resulting in approximately 5.6 billion yuan of loss in public revenue. It is fair to assume that many more such illegal cases actually went unnoticed.

150 Qian Wenrong (2004)
151 Chen Fang, Zhang Huaping and Zhang Honghe (2004)
152 Fan Lixiang (2006)
It should be noted that, despite being a source of corruption, the lack of vertical supervision is not necessarily always a bad thing. It is clearly impossible for a highly centralized system to respect local conditions that are very diverse and changing constantly. Therefore, weak vertical supervision may actually be a blessing for local governments, which are in a better position to respond to local needs, as will be discussed further in Part II of the dissertation.

In terms of horizontal coordination, the agencies at the same level or ranking are traditionally competitors rather than partners. A first reason is that individual agencies are primarily - if not “only” - concerned with their own political achievements, and thus have a strong interest in evading the policies of other agencies. This is not difficult to understand. Suppose, for example, the MLR tries to coordinate with its line ministries regarding their compliance with the national farmland protection target. However, the Ministry of Transportation wants to build railways and roads, the Ministry of Construction wants to implement affordable housing programs and control rising housing prices, and the National Development and Reform Commission wants to achieve macro economic objectives, etc. As long as the farmland protection target is binding at all, the line ministries will try to evade it. Although the State Council is responsible for overall coordination, each ministry knows clearly that it cannot afford to sacrifice its own political achievements for the sake of complying with the policies of other ministries. Otherwise, it will be deemed “incapable” because, in the end, a minister’s performance is evaluated based on what he has achieved, not what he has not.
A second problem with horizontal coordination is that the leaders of an agency typically face pressure from their staff to compete for more administrative authority with other agencies. The reason is that, in China, administrative power carries many types of personal benefits for the officials responsible for delivering the public services. These benefits may sometimes be simply psychological, providing a sense of “being important”; but are often more tangible, taking the form of gifts, cash, or personal favors, as will be discussed further in Chapter 9.

5. Centralizing financial authorities and delegating administrative responsibilities

From the 1950s to the 1970s, China copied the former Soviet system of public finance. The national government was in control of the national budget and the budgets of the provincial governments. Under this highly centralized financial system, provincial and lower-level governments served as agents of the national government, and provided public services according to the directions of the latter\(^\text{153}\). In the 1970s, the provincial governments started to have some degree of autonomy. For example, they were able to decide on their own budgets within certain limits and keep some surplus revenues.

This soviet-style public finance system was reformed in the 1980s. The national government still maintained unified control of the budgets of local governments, but each level of local government is responsible for having balanced revenues and

\(^{153}\) Naughton & Yang (2004); Zhang Runlong (2006)
expenditures. This reform allowed local governments to participate actively in financial administration, and provided incentives for them to promote local economic growth so as to generate local revenue.\textsuperscript{154}

The current system is the result of another reform in 1994, which made the national and local governments responsible for covering expenditures on different matters. The national government is responsible for national security, diplomacy, operation of the national government, national economic structural adjustment, regional coordination, and the public utilities directly administered by the national government, etc.. Local governments are responsible for their own operations and local social and economic development. Accordingly, there are three types of taxes: state taxes, local taxes, and taxes shared by the national and local governments. State taxes are collected for national security and national-level macro control; shared taxes are collected for expenditure on matters directly related to economic development; and local taxes are administered by local authorities. Within each local government above the county level, there is a Bureau of State Taxation (BST) and a Bureau of Local Taxation (BLT). The BST is responsible for collecting state taxes and shared taxes, and the BLT for local taxes. The national government returns portions of the taxes collected by the BSTs to local governments, and also provides financial support to economically disadvantaged provinces or regions through transfer payments.

Despite these reforms, financial conflicts have existed between the national and

\textsuperscript{154} Yang Zhigang (2004)
local governments and between various levels of the government since the 1980s.\footnote{Zhang Runlong (2006)}

In the 1980s and the early 1990s, the national government adopted various kinds of measures to increase the share of the national government in the total budget. In some cases, local governments had to pay for expenses incurred by the national government.\footnote{Wong (1992)} In the meantime, local governments also devised various strategies directed against the national government.\footnote{Wong (1992, 1995)} Their respective behaviors increased their vigilance and alertness against each other, and there was increasing competition between various levels of the government for financial resources.\footnote{Yan Bin (1991), Zhang Runlong (2006)}

Under the existing financial system as a result of the 1994 reform, 75% of the VAT goes to the national government, and only 25% is returned to local governments. In recent years, some income taxes whose revenue is growing rapidly have been changed into shared taxes,\footnote{Nan Xianghong and Shang Guan Ximing (2008)} making the financial situation of local governments more difficult. Between 1994 and 2005, the fiscal revenue of the national government accounted for 52% of the nation’s total, whereas provincial and lower-level governments accounted for 48% only; on the other hand, the national government shouldered only about 30% of the total fiscal outlays, whereas provincial and lower-level governments shouldered approximately 70%.\footnote{Ye Tan (2007)} In 2004, the fiscal revenue of the national government accounted for 55% of the nation’s total, but the provincial and lower-level governments paid 14 times, 7 times and 10 times more than the national government in supporting public education, social insurance, and

agriculture respectively.\textsuperscript{161}

Moreover, the various levels of local governments follow the example set by the national government to centralize the power of revenue collection, such that the lower the level, the more authority in revenue collection it loses. On the other hand, there is no clear division of spending responsibilities, such that each level tries to delegate spending responsibilities to lower-level governments.\textsuperscript{162} In particular, county- and township-level governments face serious shortages of financial capacity to accomplish their spending responsibilities.\textsuperscript{163}

Thus, under the five-level hierarchical public administration system, the lower the level of government, the more exploitation it is potentially subject to.\textsuperscript{164} In particular, the municipality has been identified as a level of government that contributes to this problem. The original purpose of having a municipal-level government between the province and the county is that a municipality has a wider tax base than a county and is better positioned than a provincial government to provide support, when necessary, to financially disadvantaged counties, which have narrower tax bases. The actual situation, however, is that a municipality typically intercepts financial resources appropriated to its counties from the provincial government on the one hand, and “exploits” the own financial resources of the counties on the other hand.\textsuperscript{165}

The financial situation of most counties is not favorable.\textsuperscript{166} Although it is

\textsuperscript{161} Kong Shanguang (2006)
\textsuperscript{162} Jiang Changyun (2004); Wang Shaoguang (2006)
\textsuperscript{163} Jia Gang & Bai Jingming (2002)
\textsuperscript{164} Jia Kang (2005) and Wang Shaoguang (2006)
\textsuperscript{165} Wang Shaoguang (2006)
\textsuperscript{166} Li Peng (2004), Li Hailong (2005); Wang Shaoguang (2006)
common knowledge that the debts of local governments are very large, nobody can
tell their size with confidence – because local governments are very opaque and
typically conceal information from their higher-level governments.¹⁶⁷ Some experts
think that the risks posed by the debts of China’s local governments have become the
most important influencing factor for China’s economic and social stability. The debts
of local governments are of many types, and in amounts that are beyond control and
growing at an increasing rate. Provincial, municipal, county and township
governments all borrow in various forms; and the lower the level of government, the
higher the pressure to borrow.

Various local governments also compete against each other financially through
adopting such strategies as local protectionism and implementing repetitive
construction projects in order to increase tax revenue.¹⁶⁸ Starting in 1994, land
conveyance fees are no longer turned in to the national government, and have
naturally become a main source of income for local governments.

6. Controlling housing prices

Prior to the recent financial crisis, the rapidly rising housing prices in many
Chinese cities had been a great concern to the public, especially low-income groups.
According to the National Bureau of Statistics (NBS), the average sales prices of new
housing in 70 cities surveyed increased by 12.9% between the first seven months of

¹⁶⁷ The remainder of the paragraph draws on the research of the State Council’s Development Research Center,
quoted in Li Peng (2004).
¹⁶⁸ Shen Kunrong (2005)
2003 and those of 2004; 12.5% between the first quarter of 2004 and that of 2005; 5.5% between 2005 and 2006; 5.4%, 6.4%, 7.1%, 7.5% and 8.2% respectively between April, May, June, July and August of 2006 and the same periods of 2007; and 10.2% between May 2007 and May 2008.  

It is worth noting that these figures are often the “average” of the sales prices of new housing, and must have underestimated the actual situation in most Chinese cities to a significant extent. The reason is that the average price of all housing ignores the effect of location, which is often the most important influencing factor for housing prices. Newer housing is usually located further from city centers or on less expensive sites, because more central and valuable sites are often occupied first. My personal estimate is that, in Beijing, Shanghai, Phoenix City, and Dragon City, the actual increase in housing prices was at least 100% between 2003 and 2007. In this regard, Shen Xiaojie (2007) discusses several indications that the government manipulates data on housing prices. First, the statistics provided by different agencies often conflict with one another. For instance, a report by the Bureau of Land, Resources and Housing Administration (BLRHA) of Guangzhou Municipality, Guangdong Province on April 13, 2007 stated that the average prices of new housings in Guangzhou decreased from 7,729 yuan/m² in February 2007 to 7,029 yuan/m² in

---

169 *China Land and Resources News* (2004); Fang Ye et al. (2005); *Chinanews* (March 15, 2007); Xinhua News Agency (June 19, 2007); *Qingdao Finance Daily* (October 3, 2007); National Development and Reform Commission and National Bureau of Statistics (June 13, 2008)

170 In China, different jurisdictions have different institutional arrangements regarding the housing administration authority. In most Chinese jurisdictions, the housing administration authority belongs to the Bureau of Construction. For example, at the national level, the Ministry of Construction (MOC) was responsible for housing administration before March 2008. (After March 2008, MOC has changed its name to Ministry of Housing and Urban and Rural Development, but its responsibilities remain the same.) The institutional arrangement is similar in Dragon County. However, in some Chinese regions, the housing administration authority belongs to the land administration agency, and is called BLRHA.
March 2007. The municipal government of Guangzhou used this as evidence to assert that “housing prices will definitely be put under control as long as the government is determined”. Four days later, a report by the NDRC showed that, in March 2007, new housing prices in Guangzhou increased by 1.2% over the previous month and 8.6% over the previous year. Second, the official figures are often a far cry from people’s intuitive observations. For example, a joint report by the NDRC and the NBS in March 2007 stated that housing prices increased by 5.9% over the previous year and 0.6% over the previous month in the 70 cities surveyed. However, Shen notes that few people in these cities would believe that the housing prices in their cities had increased by single digit only. In many of these cities, the housing prices should have increased by 20%-30% over the previous year.

The NBS and the MOC thought that the following factors contributed to the skyrocketing housing prices:\textsuperscript{171} First, the demand for housing had been strong because of rapid urbanization and people’s improved living standard. Second, the cost of housing construction had increased due to the higher cost of acquiring land and higher prices of construction materials. Third, the supply of housing was limited in some cities. Last but not the least, people generally anticipated that housing supply would continue to be restricted. Buying housing became a way of storing wealth. Many people chose to buy larger houses than they actually needed, or speculated on housing. Since housing prices rose so rapidly, many developers were deliberately holding land or slowing down construction for larger profits in the future - which

\textsuperscript{171} Ministry of Construction (2004); China Land and Resources News (October 9, 2004); Chinanews (March 15, 2007); Qingdao Finance News (October 3, 2007)
contributed further to rising housing prices.

The rapidly rising housing prices made housing unaffordable to many people, and might have contributed to a widened income disparity because land and housing speculation generally benefits the wealthy, not the poor. The national government took it very seriously, and adopted a number of measures to increase housing supply or provide affordable housing for the poor. In particular, the national government required large cities to implement affordable housing programs for low-income groups.

In general, there are mainly three types of affordable housing in China.\textsuperscript{172} The first type is “affordable rental housing”, which is owned by the government but rented to the lowest-income groups at a rate that is much lower than market rates. In some cases, the government provides a subsidy to the lowest-income groups so that they can afford to rent housing on the market directly. The second type is “affordable ownership housing”. In some cases, the government provides free land to developers to build housing to be sold to low-income groups at a rate much lower than the market prices. Typically, the government designates a maximum profit margin, say 3% in some cities, for the developers of such housing. In other cases, the government requires commercial real estate developers to devote a certain portion of the land they acquire from the government to developing affordable ownership housings. Such a requirement often serves as a precondition for a developer to acquire land from the

\textsuperscript{172} This information is based on a workshop on urban regeneration and affordable housing organized by the Ministry of Housing and Urban Rural Development (HOHURD) in Beijing on June 23, 2008 – which I attended.
government. The third type is “limited-price housing”, which are sold to low- and medium-income groups at a price that is usually about 20% lower than market prices. Typically, the government provides the land to commercial housing developers at a favorable price so that the latter can devote a portion of their projects to developing limited-price apartments.

Several problems have existed with the affordable housing programs in various cities. One problem is that there is a lack of an effective information management system for checking the eligibility of the buyers of affordable housing. Many buyers are actually well-off families, and there has even been an active informal market for the transfer of second-hand affordable housing. Another problem is that local governments are often not enthusiastic about such programs. On the one hand, their ability in stabilizing housing prices and solving housing problems for low-income groups is an important aspect of the evaluation of their performance by the higher-level governments. On the other hand, affordable housing programs tend to make land supply even scarcer and do no contribute much to local revenue or GDP.

For example, in August 2008, the State Council approved 28,817 hectares of developable land for 84 cities. Among all the land approved, almost 80 percent is for infrastructure and housing development; and among the land approved for housing development, 79.64 percent is for affordable rental housing, affordable ownership housing, or limited-price housing - indicating that the “official” supply of land for

---

173 Wu Haibua and Zhang Jiaqi (2005); Xie Wei and Rong Ancai (2005)
174 Deng Yuwen (2005)
175 Zhang Jing (2008)
other development purposes is very limited. This will actually force local governments to resort to informal land conversion to meet their other needs, as will be described in Part II of the dissertation.

The recent financial crisis has led to widespread speculation that housing prices may fall significantly. A dramatic fall in housing prices may lead to bad loans and thus contribute to further financial instability. Since China lacks a credible official statistical system for housing prices (as discussed earlier) and that it is now still too early for the effects of the crisis to manifest fully, the dissertation will not delve into this issue. However, the effects of the crisis on the prices of housing in Dragon County will be described briefly in Chapter 5.

7. Summary

Growth is the single most important objective of the national government. It is practically impossible to strike a proper balance between economic growth and farmland protection. Consequently, the local governments are receiving conflicting signals from the national government regarding the choice between growth and farmland.

The existing bureaucratic structure is designed for the national government to control political power tightly, but has inherent weaknesses in vertical supervision and horizontal coordination, and provides a breeding ground for corruption due to a lack of transparency. On the other hand, the delegation of spending responsibilities and the
Centralization of financial resources have led to financial difficulties for many local governments.

The land supply constraint also leads to widespread land and housing speculation, contributing to rapidly rising housing prices, which may potentially increase public discontent and threaten the control of political power by the national government.
CHAPTER 4 LOCAL GOVERNMENTS

1. Introduction

In this chapter, local governments refer to the county and township governments unless stated otherwise. The county is the lowest level of government in China that has independent authority to appoint officials and appropriate financial resources. In Dragon County, the highest-ranking official is the County Party Secretary. The County Mayor, who is also a County Deputy Party Secretary, is the second-ranking official. The two key agencies with land use planning authorities are the Bureau of Land and Resources (BLR) and the Bureau of Planning (BOP). The BLR is responsible for developing and implementing the county’s land use plans, and the BOP for urban plans.

The institutional arrangement at the township level is similar. The only difference is that township-level governments and their agencies do not have as much independent decision-making authority. Their main responsibility is to implement the decisions made by the county-level government and its agencies, not to make decisions by themselves.

This chapter will first describe the financial situation of Dragon’s local governments, then discuss the role of land conversion in the county’s public finance, and lastly explain the strategies of Dragon’s local governments in dealing with villages and farmers during compulsory land conversion.
2. Financial needs of local governments

The financial administration structure of Dragon County consists mainly of two sets of financial relations: one is between the county and the township governments, and the other is between the county and the higher-level municipal government. Since these two sets of relations are similar, only the former will be described here.

The existing financial relations between the county and township governments started in a reform in 1992. During the reform, the county government delegated spending responsibilities to the townships but maintained control over their financial resources. Specifically, the financial arrangements were made in the following way:

The county government first assessed the financial situation of each township, including revenue and expenditure. Then, taking 1990 and 1991 as benchmark years, it figured out the difference between a township’s annual revenue and expenditure. If the difference was positive, a township would be asked to turn in the same amount to the county government in the following year; if negative, the county government would make transfer payment in the same amount. For example, a township whose average annual revenue was 5 million yuan and expenditure was 4 million yuan in the two previous years before the reform would be asked to turn in 1 million yuan to the county government in 1992. In a different case, a township whose average annual revenue was 7 million yuan and expenditure was 10 million yuan in the two previous years before the reform would receive transfer payment from the county government.
in the amount of 3 million yuan in 1992.

Moreover, if a township turned in surplus $X_1$ to the county government in the first year after the reform, it would be asked to turn in $X_1 \times (1 + r_1)$ in the following year, where $r_1$ is a growth rate set by the county government. If a township received transfer payment $X_2$ from the county government in the first year after the reform, it would receive $X_2 \times (1 - r_2)$ in the following year, such that the township would not receive any transfer payment three years after.

The revenues of the townships mainly come from taxes and fees. The fiscal revenues of a township are administered by the county government. A township has a financial office, but does not have a treasury. All the taxes and fees collected in the townships shall go to the county treasury first. The county’s Finance Bureau then appropriates financial resources to the townships’ Finance Offices based on the financial arrangements described above.

Whether a township can generate sufficient revenue to cover its expenditure depends largely on the performance of its economy. Not surprisingly, various townships have had very different financial situations since the reform. Before 2005, some townships did not even have enough money to pay salaries to their employees. Consequently, many people, especially the public servants working in the townships whose financial situation was not good, complained about the system. A public servant working in a remote township was actually “making a sacrifice for the society”, but earned much less. In extreme cases, the difference in the average salaries
of public servants working in different townships could be 2 to 1.

In order to address this problem, the county government carried out another reform in 2005. Under the new system, all public servants and public school teachers are paid at levels no lower than the “basic salary standards” set by the county government. The county government will make transfer payment if any townships do not have the financial capacity to pay the full amount according to the basic salary standards.

The 2005 reform was on the “basic salaries” of public servants and teachers only. A township government is still responsible for paying bonuses to these people by itself. In Dragon, it is typical for a public servant to receive bonus, which can account for up to 40% of his total salary in a rich township and 20% in a poor township. Teachers typically do not receive bonuses.

Despite this reform, some township governments still have financial difficulties. Moreover, as mentioned earlier, the financial relation between Dragon County and the municipal government of Phoenix is similar to that between the county and the townships. Therefore, the county government also faces similar financial pressures, as will be explained below.

The county’s budgeted fiscal revenue has been increasing at a rapid pace in recent years, from 100 million yuan in 1992 to approximately 2 billion yuan in 2007. However, its financial situation is not promising. Industrial enterprises have been a major source of tax. However, most of them are labor or resource intensive companies
that produce such products as automobile tires, textile machineries, casting machineries, and home appliances, etc. These enterprises are at the “lower reaches” of the industrial chain and rely heavily on energy and raw materials. Due to rises in the prices of energy and raw materials in recent years, the cost of processing and manufacturing has increased, and these enterprises are generally not very profitable. Consequently, the contribution of these enterprises to local revenue is limited.\textsuperscript{176}

In general, the service sectors in Dragon are lagging behind manufacturing. So far, the real estate sector has been a major stimulus for the development of service sectors. The wholesale and retail businesses in Dragon are doing reasonably well, but do not contribute much to the county’s fiscal revenue. Other service sectors, such as material flows and tourism, are not doing well. The material flow businesses are not good because Dragon is not a transportation center, with no railway station and being a bit too far from the airport. Tourism businesses are not successful in most seasons. Some tourists come to Dragon, but few stay for more than one day, so Dragon does not benefit much from related services such as recreation, shopping and hotels, etc.

In addition, the county has been losing significant revenue after a tax reform in 2002. Before 2002, income taxes from foreign enterprises counted as state taxes, whereas those from Chinese enterprises were local taxes. After 2002, income taxes from “new” Chinese enterprises count as state taxes - which has led to a significant loss of revenue for the county because only a small portion (25%) of state taxes are returned to the county government.

\textsuperscript{176} Internal policy paper by the county BST
On the other side, the fiscal outlays of the county have always been larger than budgeted revenues in recent years. In 2007, for example, the budgeted expenditure (shown in Table 4) was 3 billion yuan, which was more than 1 billion yuan more than the budgeted revenue.

Table 4 Budgeted Expenditures of Dragon’s County Government, 2007

<table>
<thead>
<tr>
<th>Categories</th>
<th>Expenditure (million yuan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic expenditures (salaries, government operations, loan repayment)</td>
<td>2,200</td>
</tr>
<tr>
<td>Regular government programs (such as education, telecommunications and transportation programs)</td>
<td>320</td>
</tr>
<tr>
<td>Key government sponsored projects</td>
<td>500</td>
</tr>
<tr>
<td>Total</td>
<td>3,020</td>
</tr>
</tbody>
</table>

Apart from basic expenditures (such as salaries, government operations, and loan repayment), an important part of the fiscal outlays by the county government have been incurred by what are called “image projects”, which are projects supported by the county leaders in order to impress people, especially their bosses at higher-level governments, with “visible” achievements. A typical example is a major beautification project for River A in the mid-1990s. The project included building stone banks, rebuilding several bridges, and planting trees and flowers on both sides of the river. As shown on Map 2, the river runs across Dragon City, and is just several hundred meters to the south of the old county government building. The cost of the project was tremendous. The county government did not have enough money to pay for it, and forced all the people receiving salaries from the county government to contribute approximately 1,000 yuan each on average. The contribution was deducted directly from their salaries. It was a considerable burden on many people, because the average
monthly salary for a government employee at the time was only several hundred yuan. These personal contributions have never been paid back.

A second example is the construction of the Coastal Road. The road was designed to be wide, with two vehicle lanes and a bicycle lane in each direction for most sections. The project was started even before the land use application was approved by the provincial government. The county government did not have enough money to compensate the affected villages for the land occupied, and set the level of the compensation to be very low, giving rise to protests by some farmers, as mentioned in Chapter 2.

The reason why the county government is enthusiastic about such construction projects is that they are more visible compared with other types of projects. They are not necessarily bad projects. Some, such as the beautification of River A and the construction of the Coastal Road, have actually produced desirable social or economic effects. However, it is fair to say that the money spent on many such projects could probably have been spent in other and better ways.

A smaller-scale, yet more telling, example of image projects is the pavement of some streets for some villages along the Township D section of Main Road G leading to Historical Site A, the county’s best-known resort area located in Township E. In 2006, the government paid to pave for these villages all the streets within one block from Main Road G, but left all other streets unpaved. Farmer D from village I comments that,
We are not sure why they did it. Some say it was because some military vehicles (from Country X) were to pass though the villages (along Main Road G) during the joint marine maneuver by China and (Country X), and that the unpaved streets would not look good (thus leaving a bad impression on the foreign soldiers). Others say it was because the provincial governor was to come (to Historical Site A), and the county government wanted to leave him with a good impression. We are quite disappointed, because our village has only three blocks from west to east but they paved one block only… (Incidentally.) I should mention that the cement they used was very inferior in quality, and some sections of the pavement have already been damaged.

There is also non-construction type of “image-building” efforts. For example, the county government organized a concert televised across the country by the China Central Television (CCTV) in 2006. Each year, CCTV would televise many such concerts, hosted by different cities and usually featuring some of the best-known singers and other celebrities in China. Local leaders are very keen on hosting these concerts, which they think can help make the names of their cities known to the entire country. However, the cost of hosting these concerts is usually very high. Local Official B comments that,

I think the concert cost at least several million yuan, but the county government did not have the money to pay for it - The county treasury is empty. Some enterprises were asked to pick up the bill (as sponsors). Which enterprise would dare say no if asked by the county government (for a favor like that)?

Incidentally, it is not rare for enterprises to pick up bills incurred by local governments. The enterprises, which see it as an opportunity to advertise themselves or simply to establish or strengthen relations with the government, may actually be happy to do it. Conceivably, such close relations between local governments and private enterprises often give rise to corruption, as will be discussed further in Chapter 9.
3. **Role of land conversion in local public revenue**

Land plays a vital role in the public finance of Dragon County, and contributes to revenue generation in two ways: First, the county government sells land use rights to real estate developers. Second, it promotes investment through land conversion, thereby generating revenue through tax collection.

**Land sale**

In general, selling the use right to state-owned land to commercial real estate developers is a lucrative business for the county government. During the land conversion process, a county government needs to pay compensation to farmers, the cost of preliminary land development before land sale, and the “user fee for newly converted developable land” to higher levels of government. In return, the county government collects land conveyance fees (tu di chu rang jin), land value increment fees, urban land use tax or land use fees, and farmland occupation taxes, etc. These fees and taxes are complicated to explain. In a simplified way, Table 5 lists the main outlays and revenues of a county government from land conversion.
Table 5 Main Outlays and Revenues of Dragon’s County Government during Land Conversion

<table>
<thead>
<tr>
<th>Category</th>
<th>Types of Taxes/Fees</th>
<th>Explanations</th>
<th>Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Outlays</td>
<td>Compensation to villages</td>
<td>Paid by county government to villages</td>
<td>30,000 <em>yuan/mu</em> in lump sum, 600 <em>yuan/mu</em> per year, plus contribution to the pension fund for farmers, as discussed in Chapter 2</td>
</tr>
<tr>
<td></td>
<td>Preliminary land development</td>
<td>County government typically provides road and utilities before land sale</td>
<td>Total cost may be up to 70,000 to 80,000 <em>yuan/mu</em>, including road, electricity and water, etc. in Dragon, but some sites already have access to roads and utilities.</td>
</tr>
</tbody>
</table>
|                               | User fee for newly converted developable land | Defined as the “average net benefit” of land that conversion brings about. Its rate is assessed by the provincial or national government, and paid by county government to provincial and national governments | Before 2006: 3,335 – 46,690 *yuan/mu* in lump sum  
Since 2007: 6,670 – 93,380 *yuan/mu* in lump sum  
Determination of the exact rate is based on location, land price level, local farmland availability, and local social and economic characteristics |
| Revenues                      | Land conveyance fee                      | Paid by developers; almost all is kept by county government                                       | More than 1 million *yuan/mu*, in lump sum for most sites in Dragon City after 2005.        |
|                               | Land use fees                            | National government receives 30%, provincial and municipal governments 30%, and county 40%.       | Ranges from 10 to 140 *yuan/m²*, based primarily on location. This revenue is earmarked for farmland protection and other land-related matters. |
|                               | Farmland occupation tax                  | Local tax collected from land users that use land converted from farming to non-farming uses.   | Less than 3,335 *yuan* per *mu* in lump sum, collected according to the amount of farmland converted and the applicable tax rate (which is set according to average per capita farmland availability of the county where the land is located). |

Thus, land sale provides a convenient way for the county government to generate

---

177 The information contained in the table is based on the interviews in Dragon County.
revenue directly to meet financial needs. A typical example concerns the No. 1 Middle School, the best middle school in Dragon County. Before 2000, it was a public school, and the county government was responsible for paying the teachers and all school expenses. In order to relieve itself of a financial “burden”, the county government changed the school from an “ordinary public school (OPS)” to a “privately managed public school (PMPS)” in 2000. According to a provincial policy, an OPS cannot charge a student more than 1,600 yuan per year for tuition, whereas a PMPS can charge much higher tuition but is also responsible for paying the teachers and school expenses by itself. The school’s old campus was located in a central location, just opposite to the long-distance bus station, in the old downtown of Dragon City. Due to the rapid growth of the student body in the late 1990s, the old campus became too small. In 2004, the school moved to the current site in the northeastern part of the Dragon EDZ. The land of the new campus, covering 500 mu, was provided by the county government for free, and the school had borrowed almost 100 million yuan from a commercial bank in order to build the campus. However, the loan was so large that it was impossible for the school to pay back to the bank. Therefore, the county government had to change the school back to an OPS and took over all the loans. Being short of financial resources by itself, the county government decided to sell a portion of the campus land to repay the loans.

A second example concerns Dragon’s Paper Making Company and a construction materials plant, located adjacent to each other in the Dragon EDZ. The construction
materials plant, which was an investment promotion project of township G\textsuperscript{178}, was not earning profit in the early 2000s, and therefore unable to repay a loan in the amount of 20 million yuan it had borrowed from a local bank. The county government decided to intervene, and asked the Paper Making Company, owned by the county government, to acquire the plant and take over the debts. In return, the company was allowed to sell the land of the construction materials plant for real estate development. The total revenue from the land sale was several hundred million yuan, which was kept by the Paper Making Plant. It is worth reminding that this kind of land sale would not have been possible without permission from the county government, because it involved a change in land use type from industrial to commercial. The county government has been very generous to the Paper Making Company for two reasons: First, the county government controls the majority of the company’s shares and is therefore the owner of the company. Second, the company contributes about 30 million yuan of tax revenue each year to the county government.

The revenues generated from land conversion as such are usually not reflected in the county’s regular budget. As will be described later, this kind of land conversion is very un-transparent, and typically involves confidential agreements between the county government and developers. Although such revenues are supposed to be reflected in the county’s “extra budget”, it is difficult for outsiders to know how much contribution land sale actually makes to the county’s overall budget. However, it is believed by the local officials interviewed that land sale accounted for at least 50% of

\textsuperscript{178} Township G is not shown on Map 4.
the county’s extra revenue (i.e. revenue not reflected in the official regular budget) in most years between 2002 and 2007. In 2006, for example, the extra revenue was around 1 billion yuan,\(^\text{179}\) accounting for at least one third of the county’s total fiscal revenue.

Within the BLR, there is a unit called State-Owned Land Reserve Center (SLRC), which has two nominal responsibilities: First, it is responsible for taking back and selling the use rights to state-owned land. Second, it is responsible for acquiring rural land. Theoretically, it is possible for the county government to manipulate the temporal allocation of scarce land resources in order to maximize revenue. In practice, this does not seem to be the case, as will be discussed further in Chapter 11. The SLRC is responsible for managing procedural matters only, and does not have real decision-making power regarding land acquisition or sale.

Incidentally, some local governments in other regions even use state-owned land as collateral to obtain loans from commercial banks, in order to finance infrastructure development or other government-sponsored projects\(^\text{180}\). In such cases, the local governments may face additional pressure to sell more land in order to pay back the loans.

**Investment promotion**

Dragon’s local governments have devoted a tremendous amount of effort to

---

\(^{179}\) Report on the Finances of Dragon County, 2006

\(^{180}\) One such example is Tianjin Municipality - based on a conversation with some local officials I met at a conference on affordable housing organized by the Ministry of Housing and Urban Rural Development on June 23, 2008 in Beijing.
attracting investment since the 1980s. However, these efforts were not very successful until the late 1990s. Some companies were attracted to the area, but the total amount of investment was relatively small and the economic and social benefits they generated were not very large. This was attributable to several factors. First, Dragon was a small city with a small population at the time, and not known to investors from the outside. Second, transportation from Dragon City to other cities was not very convenient. It took several hours to go to Phoenix City, the capital of Phoenix Municipality and the economic center of the region, by road. It generally took less time to go to Phoenix City by ferry, but the waiting line and time could be long during peak hours on peak days. The nearest railway station was about 40 kilometers away. The nearest airport was almost 100 kilometers away, with no highway connecting it with Dragon.

Nevertheless, the county government spent much effort, and assigned specific “investment promotion tasks” to each township. The ability of township officials to attract investment became - and remains - a most important indicator in the evaluation of their performance by the county government. Township governments were ranked according to the amount of investment they attracted, and township leaders whose performance was highly rated would receive bonuses awarded by the county government. Consequently, township governments were very enthusiastic about potential investment projects. They treated investors like kings, and usually took care of all the paper work regarding business and land use license applications.

In turn, the township governments assigned tasks to individual officials, and
encouraged village leaders to help promote investment. Villages leaders unable to attract investment from the outside were encouraged to “tap their own villages’ potential”, such as encouraging wealthy villagers to establish factories or roadside stores. Farmer H from Village H describes this fervor as follows:

In response to a call by the township, the party secretary of our village convened a meeting (on a day in the mid-1990s) attended by all the party members of the village. He conveyed the message from the government, and asked young party members to take the lead in attracting or making investment to the village …

As a young party member, I was assigned a task of making “some kind” of investment. I was not prepared but had to take on the task by agreeing to register a construction company. To have such a company approved, I was required to show to a designated bank that I had 500,000 yuan, which I did not have. I borrowed money from the village to put into my bank account. After the bank verified that I “indeed” had enough money in my account and the company was approved, I returned the borrowed money to the village.

I intended to use a land parcel with the size of 33*33 m² for the “company”. However, the village leaders thought it was too small, and requested me to use 60*60 m². I was afraid that I could not accept so much land since the total land rent would be higher. According to the contract, land users should pay 500 yuan per mu per year of land use fees directly to the village plus 100 yuan per mu per year of agricultural tax. The total was 600 yuan per mu. (The agricultural tax had not been exempted at the time.)… So I had to invite the village leaders to my house for dinner to ask them for the favor of reducing the land use target for me. They finally agreed.

Incidentally, Farmer H realized a few years later that his rejection of a larger land parcel was the biggest economic mistake he had made, because land prices started to skyrocket in the early 2000s.

Despite such efforts, significant progress in investment promotion was not made until the late 1990s and the early 2000s when several things happened: First, the transportation facilities between Dragon City and Phoenix City were improved significantly. Highways were built to connect Dragon City with Phoenix City and
with the airport. It now takes about one hour to go from Dragon City to the airport and one and half hours to Phoenix City. A tunnel under the ocean will be built soon to connect Phoenix City and County A. Upon its completion, it will take less than 40 minutes to go from Dragon City to Phoenix City via County A. Second, it has been planned that Dragon County will become a district, rather than a county, of the Phoenix metropolitan area in the near future. Surrounded by mountains on the north and the west and the ocean on the east, Phoenix City can only expand southwards to the direction of County A, (which is separated from Phoenix by a bay) and Dragon County. As mentioned, three urban clusters have already been planned within Dragon County. Third, Dragon became increasingly known to the outside world. It is a pretty city with moderate and pleasant weather, a nice beach, and a relatively well-educated labor force – all of which are attractive to investors.

More importantly, the county government established the EDZ, Industrial Park A and Industrial Park B, which possess a few very important advantages for promoting industrial development from the perspective of Dragon’s local governments. First, the cost of providing infrastructure facilities and services (such as water, electricity, and wastewater treatment) for a concentration of enterprises is lower than for enterprises in diverse locations. Second, industries that are related through material flows have convenient access to one another. Third, it is conducive to preventing urban sprawl and controlling pollution. Fourth and most important, the county government provides each township with some land parcels in the EDZ and the industrial parks where any new investment attracted by the towns may be located. If not for this kind of
arrangement, the townships in the remote parts of the county would have had little hope of attracting external investors, for lack of convenient transportation, infrastructure and educated labor. Despite these advantages, some townships have not been very successful in attracting investment, or, the enterprises attracted by them are not doing well or even run into debt. In such cases, the land is often converted into real estate development, subject to agreements among the county government, the township governments and the enterprises using the land regarding how the benefits from such conversion shall be divided.

The EDZ and the two industrial parks were all established prior to – or without - obtaining formal approval from the higher-level governments. The EDZ was established amidst the nation-wide Land Enclosure Movement, mentioned in *Introduction*, in the 1990s, but gained recognition from the provincial government later. Industrial Park A was established in 2002, and has never received formal recognition from the higher-level government – the reason being that the national government realized in the late 1990s that the Land Enclosure Movement caused great chaos in land use at the local level and tightened control over applications for new EDZs or industrial parks. The park was initially designed for industrial use. However, after much of the land had already been sold or leased to investors, the county government decided to change the planning focus of the park from industrial to residential and commercial use. There are two reasons for this change: First, the new party secretary of the county, unlike his predecessor, did not think that an area so close to the beach should have been used as an industrial site. Second, the county
established Industrial Park B in 2004, so that much of the industries could be located there.

Industrial Park B was also established well before its approval by the provincial government in 2005. Now, its approved size is 4 km² only, but it has already been planned to cover 30 km², divided into four zones: an export-oriented industrial processing zone (18 km²), an electronics processing zone (8 km²), a storage and material flow area (2 km²), and a central service area (2 km²). The designed focus of Industrial Park B was to provide services and products for Phoenix Port, one of the largest ports in China. This sounds like an “acceptable” reason for establishing an industrial park. Nevertheless, it is a bit complicated to explain why Industrial Park B was approved whereas Industrial Park A rejected. It suffices to say that, in an opaque system, one cannot always figure out everything for sure.

The county government provides very favorable tax and other policies for investors, particularly foreign investors - who are believed to possess more advanced technologies. For example, the investors in Industrial Park B are eligible for the following, among other, benefits: First, foreign manufacturing companies receive a 24% exemption on income tax payments. Second, knowledge-intensive projects or foreign companies investing at least 30 million yuan receive a 15% exemption from income taxes. Third, companies planning to maintain operations in the park for more than 10 years are exempted from income taxes for the first two years, and half the income tax from the 3rd to the 5th year. Fourth, foreign enterprises adopting advanced technologies enjoy additional tax exemptions. Fifth, foreign enterprises in the park
receive a 40% exemption from business taxes, 12.5% from VAT, and 20% from income taxes between the time they move into the park and the end of 2008. Sixth, foreign manufacturing enterprises are exempted from all “fees” collected by the county government. Seventh, certain projects that are deemed by the county government to be able to make major contribution to local economic and social development, such as automobiles, shipping, electronics and new materials projects, are eligible for additional favorable treatment, the terms of which are negotiated between the county government and the enterprises on a case-by-case basis.

Of course, such favorable policies are not unique to Dragon County. Similar policies are adopted by other jurisdictions as well because inter-jurisdictional competition for economic growth is very intense. An incidental example to show inter-jurisdictional competition involves the respective local fishing policies of Dragon County and County C (which is a neighboring county to the south of Dragon County). According to the national policy, fishing is banned in the seas during some seasons in order to protect the fish population. However, the local fishermen in Village V, a coastal village in Township E, have never stopped fishing. Of course, they run the risk of being caught by the authorities. Typically, the penalty is 10,000 yuan if caught by the authorities of Dragon County, 30,000-40,000 yuan by the authorities of Phoenix City, and 40,000-50,000 yuan by the authorities of County C. The County C authorities used to be very strict with enforcing the ban. After catching illegal fishing boats, they would pull the boats onto the beach, overturn them, and expose their bottom under the sun, which was very damaging to the boats, until the penalty was
paid. As a consequence, few fishermen dared venture into its jurisdiction. By contrast, the Dragon County authorities typically turn a blind eye to illegal fishing. They are sometimes pressed by the higher-level authorities to crack down on illegal fishing activities, but usually allow local fishermen to get away with a low penalty, for two reasons: First and foremost, illegal fishing contributes significantly to the local economy. Second, the fishermen who are caught would typically ask their friends or relatives who know the responsible officials to talk to the latter for the favor of not being strict. As a result of such deliberate “leniency” by Dragon County, County C has relaxed its control over illegal fishing by the fishermen from its own jurisdiction, too.

To return from this digression, the EDZ and the industrial parks favor big investors. In Industrial Park B, for example, investors with the following qualifications are eligible for priority treatment by the county government: First, the amount of investment is large. To establish a business in the park, a Chinese investor needs to invest at least 50 million yuan, and a foreign investor needs to invest at least USD 5 million (approximately 35 million yuan). Second, high-tech investors have priority. Third, enterprises having the potential to stimulate the development of related sectors also have priority. Enterprises that meet all these qualifications are called “Dragon Head” enterprises, because they are supposedly able to lead the development of other enterprises. For very large projects, the county government even provides infrastructure and sometimes land for free. In general, the larger the amount of investment, the lower the land leasing price.
Much of the planned area for Industrial Park B is yet to be filled up, but the developed area has already far exceeded 4 km$^2$, the size approved by the provincial government. The park authority, on behalf of the county government, is responsible for acquiring land from villages, and then selling or renting it to companies. The park authority also builds many workshops, which it then leases to investors. In order to manage the park affairs effectively, the county government has set up a government-owned entity, called Industrial Park B Property Management Company (PMC), to provide logistical support for the enterprises in the park and to manage the park properties, such as leasing workshops to investors. An advantage of having the PMC is that it makes it convenient for potential investors to obtain loans from banks. A new Chinese investor often needs to borrow from local banks, because few investors can afford to pay cash all by themselves to start new businesses in the park. The loan application procedure can be complicated for investors from other regions. In such cases, the PMC will rent workshops to them first and, using the workshops as collateral, help them acquire loans in the name of the PMC.

It has not been easy to attract big investors due to intense inter-jurisdictional competition. Therefore, the county government and the PMC have to be very proactive. A typical example is that the county government successfully attracted Home Appliances Company A, one of the largest home appliances manufacturers in China, to locate a large plant in the park in 2005. The total investment of the project was 800 million yuan. The plant, which covers about 250 mu of land, has a designed annual manufacturing capacity of 1.6 million television sets, 1 million air conditioners,
1 million washing machines, and 1 million microwave ovens/water heaters, etc. A cooperation agreement was signed between the county government and the company in February 2005. The details of the agreement, such as the price of the land and the terms of preferential tax treatment, etc, were not available to the public, but it was apparent that the county government made a very attractive offer. At the time, the company did not have enough cash to build the plant. Therefore, the county government paid to have all the workshops built for the company. In order to do this, the county government used up all the financial resources it had at the time, such that it had to borrow, for two consecutive months, from a neighboring county in order to pay salaries to its public servants and teachers on time. Despite such difficulties, it took as little as four months to finish the construction of all the buildings and workshops, put in all the public utilities, and install all the manufacturing facilities. The plant formally started its manufacturing operations in June 2005.

4. Strategies in dealing with nail farmers during compulsory land conversion

The local governments play a dominant role during land conversion, and are very “effective” in dealing with “nail” farmers during compulsory land conversion. As Local Official K comments, “If you (i.e. farmers) agree (to compulsory land conversion), it is very fine; if you do not agree, you will still give consent in the end.”

A most common strategy used by local governments is persuasion. During compulsory land conversion, each relevant township official is assigned to persuade
specific individual households, with assistance from village leaders. These township
officials will visit potential nail households to explain the government’s decisions and
the potential benefits of land conversion. As mentioned in Chapter 2, the township
officials will sometimes ask the nail households’ relatives or close friends working for
the government to help persuade. Such persuasion can be very powerful because, as
will be elaborated in Chapter 9, personal relations often matter much more than
money in the Chinese society. Most farmers would rather defer to the local
governments than suffer the tremendous psychological stress from confronting
officials or embarrassing their own relatives and friends.

Dragon County is certainly not the only place where such a strategy is used. In
Kaifeng City, Henan Province, for example, the local government has a policy that
those receiving salaries from the government will lose their jobs if their family
members or relatives refuse to defer to the government’s compulsory land acquisition
decisions.181 Similar practices existed or still exist in some areas in Hunan Province
and Jiangxi Province.182

As mentioned in Chapter 2, the local governments may occasionally promise a
higher level of compensation or other types of personal favors to some nail
households in order to get them out of the way. However, such secrets are usually
difficult to keep, and may cause other farmers to come back and ask for more. It
would also set a precedent for other farmers to be “nails” too during future
compulsory land conversions. Therefore, the local governments usually do not offer

181 Qiu Feng (2008)
182 Qiu Feng (2008)
different levels of compensation to different farmers for the same type of land. Once a compulsory land conversion decision is made, the government would send a notice to the villages and farmers and start land development right away. Typically, most farmers would comply. In the end, the nail farmers will be isolated, making it easier for the government to adopt relevant measures to “dig” them out.

If some nail farmers are too persistent to give consent, a last resort by the local government is to use force to take the land, as described in Chapter 2. Use of force per se is not necessarily illegitimate. Imagine a nail farmer who would decline any level of compensation offered by the government intending to develop a large project believed to benefit the local society tremendously. Ultimately, the only way to get the farmer out of the way is to take his land by force, as long as compensation is paid based on due process of law. However, the problem is that, in the Chinese society, nobody knows for sure what “due process of law” for settling land conversion disputes is. It is convenient for a local government to argue that it is certainly observing the law if it carries out land conversion based on official land use plans and compensates the affected farmers at a level equal to or higher than official standards. A fundamental weakness of this argument is that farmers, being excluded from the land use planning and legislation processes, do not necessarily think that the land use plans and the official compensation standards are fair or legitimate in the first place.

Due to the sensitivity of this topic to the local community, it is not the intention of this dissertation to describe at length the confrontations between Dragon’s local governments and farmers during land conversion. However, as described in Chapter 2,
it is certainly not rare to come across, on newspapers or the internet, vivid stories from other Chinese regions in this regard. It is important to note that it is not fair to put all the blame on local officials for these confrontations. Rather, the blame should be placed on the “rules of the game” that are very unclear and ambiguous. The use of force shall be viewed as a “rational” choice made by local officials in pursuing their own interests, given the existing rules of the game. From a policy perspective, we have to presume that the players are “rational”, and must not expect that they will act in an “ethical” manner even if the rules do not explicitly require them to. This point will be discussed further in Chapter 6.

Despite the dominant role of the local governments, compulsory land acquisition is very time consuming. Whenever possible, they will try to avoid the land for which they have to pay higher compensation or where they expect to meet with strong resistance. Relatively speaking, it is much easier to acquire “reserve land” than “grain land” from villages, because the farmers renting the former on a temporary basis do not expect to have the same level of legal protection as those farming the latter.

5. Summary

Facing great financial pressure, Dragon’s local governments use land conversion as a means of generating revenue directly or through investment promotion. The local governments play a dominant role during land conversion, and typically use
persuasion or force to have farmers comply with compulsory land acquisition decisions.
CHAPTER 5 DEVELOPERS

1. Introduction

The developers in Dragon County fall into three broad categories: commercial real estate developers whose primary interest is to make a profit out of commercial land development; entrepreneurs who engage in manufacturing but require land as an input; and land speculators who acquire the use right to land at a low price and sell it at a high price. This chapter will first describe the housing market in Dragon since the 1990s, and then discuss the respective interests and strategies of the three types of developers during the land conversion process.

2. Housing supply and demand in Dragon

Real estate development has been a booming business in Dragon County since the late 1990s, and served as a main driver for land conversion in Dragon. To help understand this, it is worth explaining briefly the history of the housing market in Dragon.

Prior to the 1990s, there was no marketable housing in Dragon. Housing was provided to individuals for free by their Dan Wei (which is a Chinese term for one’s employing organization or company) as part of their employment benefits. At the time, most Dan Wei had an internal evaluation system to determine which employees were
eligible to receive housing, and what size of housing they were to receive. This evaluation system was based on a number of criteria such as one’s position and service years in the Dan Wei, number of children, and other factors. While the criteria were relatively objective, the leaders of Dan Wei had significant discretion and often used housing assignments as a way of seeking personal benefits for themselves or providing favors to their favorites. As a result, this old socialist system provoked many conflicts between Dan Wei and individuals and among individuals.

The situation can be illustrated using Figure 9. Suppose the total amount of housing provided by Dragon County each year was $Q_1$, in terms of $m^2$ of floor area\textsuperscript{183}. Nominally, the housing was offered to employees for free. However, an individual usually still needed to pay a price, denoted by $P_1$, in order to win favor from the leaders of Dan Wei. The price might take the form of personal favors, gifts, or even cash to Dan Wei leaders. The level of $P_1$ varied from case to case, but usually accounted for a very small proportion of the real price of the housing, denoted by $P_2$, for two reasons: First, Dan Wei leaders usually had to provide favors to their favorites based on the general framework of the official evaluation system. They had some, but often not complete, discretion. Second, it was illegal to take bribes, and most Dan Wei leaders dared not take high level of bribes.

Since $P_1$ was much lower than $P_2$, the housing provided by Dan Wei was always in short supply. Yet, another important reason for the housing supply scarcity was that

\textsuperscript{183} This ignores differences among various Danwei.
the *Dan Wei* had to pay for all the construction cost, denoted by $C_1$, by itself.\(^{184}\)

Therefore, if the leaders of a *Dan Wei* were already living in large apartments, they would have much weaker incentives to build more housing, which would be for other employees only. Of course, building new housing always provided opportunities for *Dan Wei* leaders to receive gifts or personal favors during the distribution process. However, housing was such an important determinant of one’s quality of life that everybody stood ready and firm to defend his/her own legitimate interests - which forced *Dan Wei* leaders to be as seemingly fair as they could in the distribution of housing. To put it in a simple way, in some cases, *Dan Wei* leaders would rather not receive any gifts or personal favors from their favorites in order to relieve themselves of the pressures from others.

\[\text{Figure 9 Housing Demand and Supply}\]\(^{185}\)

\(^{184}\) Although the recipients of housing paid a price of $P_1$, it went into the private pockets of *Dan Wei* leaders, not the public purse of *Dan Wei*. Therefore, $P_1$ is not deducted from the construction cost.

\(^{185}\) This is an over-simplified illustration - which ignores such important influencing factors of housing prices as location.
Recognizing such problems associated with the old socialist housing system, the Chinese government started to implement a housing reform in the late 1990s. Now, employees no longer receive “free” housing from Dan Wei, but have to buy commercial housing on the market.¹⁸⁶

For simplification, suppose the demand curve remains the same as before, and that the cost of housing development is now $C_2$. The reason why $C_2$ is higher than $C_1$ is that developers now need to pay for the cost of land whereas the Dan Wei received land from the state for free during the planning era. Therefore, the profit that a developer makes is $P_2 - C_2$.

Let us assume further that $Q_1$ is the maximum amount of housing allowed by the developable land quota assigned to Dragon by the higher-level governments. As discussed earlier, prior to the reform, the leaders of Dan Wei often had weak incentives to build housing for their employees, let alone engage in “informal land conversions” by building more housing than $Q_1$. The situation has changed dramatically after the housing reform. Now, developers are making good profits out of real estate development, and naturally want to acquire more land in order to build more housing as long as $P_2$ is higher than $C_2$.¹⁸⁷ (Of course, $P_2$ will also change if $Q_1$ changes.)

In a competitive real estate market, if the amount of housing built is limited to $Q_1$ and the profit margin ($P_2 - C_2$) is large, the cost of land will increase. This is because

¹⁸⁶ Actually, some Dan Wei still provide housing to their employees - at a price that is usually lower than the market price.
¹⁸⁷ Again, this is over-simplified. In reality, developers need to take into account the risks of real estate development, such as housing not being able to be sold on time. Therefore, a real estate developer may stop investing before $P_2$ is equal to $C_2$. 
developers will bid up the price of land to the extent that \( P_2 = C_2 \). In reality, the price of land in Dragon has increased by a significant margin, denoted by \( C_3 - C_2 \), but not up to a point such that the price of housing is equal to the total cost. The reason for this is incomplete competition on the land market, as will be explained later in this chapter.

As the cost of land rises by \( C_3 - C_2 \), the total cost of housing increases from \( C_2 \) to \( C_3 \). Since the profit margin \( (P_2 - C_3) \) is still large, developers have strong incentives to engage in informal land conversions.

Suppose the quantity of housing built due to informal land conversions is \( Q_2 - Q_1 \). Then, the price of housing is expected to drop to \( P_3 \). However, this is not what has happened in Dragon in practice. On the contrary, Dragon’s housing prices had skyrocketed between the early 2000s and 2008, as will be described in detail later. The main reason is that Figure 9 is an over-simplified illustration, assuming that the demand curve remains unchanged over time. In reality, the demand curve had shifted upward to a significant extent during this time due to several factors.

First, urbanization has been accelerating in recent years in Dragon. The population of Dragon City increased from 280,000 to 340,000 within four years between 2003 and 2007 according to official statistics. In particular, the rapid expansion of Dragon City to the eastern coast and the establishment of Industrial Park A and B have attracted workers from the rural areas and business people from other regions to work and live in Dragon City.

\(^{188}\) Again, this is over-simplified, as explained above.
A second reason is that the residents of Dragon City generally expect that housing prices will continue to increase in the future due largely to land supply restrictions imposed by the national government. It is very common for a local middle-class urban household to have more than one apartment, and many households have made a fortune out of speculating on apartments. Urban Resident B explains why:

In the late 1990s, I already had a nice apartment of 68 m\(^2\) in the old downtown. Then, I bought another apartment with a size of 70 m\(^2\) from the AAP1 in 1998 at a price of 800 yuan/m\(^2\) only. The total price was 56,000 yuan. We (i.e. my husband and I) did not have that much money, because our salaries were very low at the time (and it was difficult to obtain loans from a bank at that time.) We borrowed money from our relatives and friends. In 2003, the price of our second apartment increased to approximately 2,000 yuan/m\(^2\). We decided to sell it and buy two larger ones. We sold it for about 150,000 yuan, and used the money as down payment to buy two other apartments of 110 m\(^2\) and 130 m\(^2\) respectively. The total price of the two new apartments was 480,000 yuan. We had to borrow a large loan from the bank, but it was worth it. By now, they are worth more than 800,000 yuan.

A direct result of widespread housing speculation is that many new apartments are unoccupied. According to rough estimates by local residents, the vacancy rate of all the new apartments built in the last 7-8 years can be as high as 40%. Specifically, the vacancy rate for AAP1 apartments\(^{189}\) is roughly 20%, AAP2 apartments\(^{190}\) 60%, new apartments in the old downtown 20%, new apartments on the southern side of River A 50%, and new apartments to the west of Main Road A 40%. A main reason why so many apartments are left vacant rather than rented is that the rental rate is generally not attractive. For an apartment of 70 m\(^2\), the rent is less than 500 yuan per month in a central location. On the other hand, the cost of renting out an apartment is significant:

\(^{189}\) These refer to the apartments built in Phase I of the Affordable Apartments Program in the late 1990s, as mentioned in the Introduction of the dissertation.
\(^{190}\) These refer to the apartments built in Phase II of the Affordable Apartments Program in the late 1990s, as mentioned in the Introduction of the dissertation.
Most of the new apartments are unfurnished, so significant investments need to be made before they become livable. Some new apartments are immediately livable, but many owners think that the rent may not be worth the wear-down of the furnishings. In addition, the owner does not need to pay for centralized heating if an apartment is left vacant, but has to pay if it is rented. (The formal rule is that the owner of an apartment has to pay for centralized heating even if he does not live there. However, since the vacancy rate of new apartments is so high, it is impossible for the heating company to sue all those who do not pay. Therefore, it has become an informal rule that unused apartments are exempted.) The cost of centralized heating is more than 1,000 yuan per year for an apartment of 100 m². More importantly, most apartment speculators in Dragon are not poor, and many think that a rental rate of a few hundred yuan per month is not worth the trouble.

A third reason why the demand for housing has increased dramatically is that people now have much higher living standard than before, and demand larger living space. In the late 1990s, the largest apartment that one could receive from Dan Wei was about 90 m², for which only some Dan Wei leaders were eligible. Now, 80-100 m² is about the median size of all new apartments in all locations, and a significant portion of new apartments are larger than 120 m². Moreover, for many people, living in a large apartment is an indication of one’s social status.

A fourth reason is that, unlike in the past, people can now conveniently borrow loans from commercial banks to pay for new apartments. In Dragon, the down payment requirement is usually 30% of the housing price, and the term of mortgage is
typically 5-20 years. People are generally not too worried about repaying the loans because they are optimistic about the economy and assume that housing prices will continue to rise. Of course, they may be wrong, because the high vacancy rate of new apartments seems to suggest there is already a speculative housing bubble.

The recent global financial crisis is having a strong effect on Dragon’s local economy, as will be described later. However, its impact on the housing market remains to be seen. The housing sales prices in Dragon City have been relatively stable since the beginning of 2008. Several reasons may help explain why they are not dropping in the face of such a serious external shock. One is that the local people are optimistic about a continued rapid growth of the city due to the county’s urbanization blueprint as described in the *Introduction* of the dissertation. Another reason may be that people generally believe that the restrictions placed by the national government on land supply will continue to be tight. Despite this, the rental housing market does seem to have been affected to some degree. According to the local interviewees, the rental rate of residential housing may have dropped by as much as 20% between the end of 2007 and the beginning of 2009.

3. Commercial real estate companies

Dragon County has more than 100 real estate companies, most of which have existed for less than 10 years. The people who created these companies mostly fall into the following two broad categories:
The first group of people used to be the leaders of construction companies. Prior to the late 1990s, there were many construction companies in Dragon County. The leaders of these companies were responsible for obtaining contracts and hiring workers to do the construction work. Almost all the construction workers were farmers specializing in construction or carpentry. These construction companies were typically owned by townships, but it was impossible for the township governments to control them. The reason was that the leaders of the companies were in direct contact with clients (who were mostly from other areas such as Dragon City and Phoenix City) and gradually developed their own business networks. By the late 1990s, most of these leaders disassociated with the township governments, and ran the businesses on their own.

In general, these companies did well, for two reasons: First, the cost of labor was low. Before the late 1990s, there were not as many alternative sources of income for farmers as there are now. For many young farmers, the construction companies provided the only opportunity to earn extra income. They were paid low wages, and often not paid until long after the completion of construction projects. Second, the construction market was not as developed as it is now, but had been booming since the 1980s following the national open and reform policy. Most construction contracts came from the government or state-owned enterprises. The leaders of the construction companies were typically good at establishing personal relations with public officials responsible for offering construction contracts. Bribery was certainly something that could be heard of frequently.
In Dragon County, the leaders of the construction companies did not have a high reputation. They were often viewed as “people who became wealthy by exploiting construction workers”. Moreover, the local communities in Dragon are very traditional, and value highly such moral principles as frugality, modesty, and loyalty to one’s spouse, etc. Some construction company leaders were criticized for their extravagant living style or for being disloyal to their wives. Last but not least, they often delayed paying construction workers, because they sometimes could not receive payment from their clients in time in the first place. It is a bit complicated to explain the complex relations between construction companies and their clients, but it suffices to say that the Chinese credit market was - and still is - very under-developed, and it was common for one organization or company to owe money to others for services provided. To be fair, the construction company leaders should not take all the blame for owing to construction workers, because they were often victims themselves. The construction workers were often angry, but most of them had no choice but to work for the construction companies for lack of alternative employment.

Over time, the profit margin of the construction companies decreased to some extent, because competition on the construction market became more intense and the cost of labor became higher as farmers started to have other alternative sources of income. It was fortunate for the construction companies that the housing market was liberalized in the late 1990s, such that the demand for construction increased dramatically. Naturally, some of the construction companies have turned into real estate companies by now, so that they are not just receiving construction contracts
from others but are acquiring land directly from the government for real estate development.

The second group of real estate developers used to engage in industrial or other businesses, but shifted to the real estate business due to its high profit margins. Though not specializing in construction at the beginning, they typically have strong ties with the local governments, and therefore are very competitive on the real estate market.

A real estate developer must have sufficient funds to manage cash flow. In a mature market, he would need to acquire land, buy construction materials, and hire construction workers; but his economic return could not be realized until the project is completed and sold. Most of the real estate developers in Dragon County did not possess such financial capacity at the beginning, but were able to prosper for two reasons: First, in the late 1990s and the early 2000s, the land market was not as formal as it is now. Developers obtained land through government ties at low prices, rather than through open auctions. Second, it was a common practice in Dragon before the early 2000s that the buyers of new housing were required to pay before the housing projects were finished or even started. The buyers did not have much choice, because the housing market had just been liberalized so that the demand for housing was far greater than the supply. The real estate companies benefited tremendously from the informality of the real estate market. Employee A from Real Estate Company A comments that, “At that time, the real estate companies made their fortune with

---

191 This phenomenon is still widespread in many other cities in China.
almost nothing. *(The profit margin was so large that)* most of them accumulated sufficient capital *(for further development thereafter).*

In Dragon County, there are only three to four very large real estate companies with comparable financial capacity. The small ones are gradually being driven out of the market, due to several developments: First, a developer is now required to deposit a large amount of money in the county’s Bureau of Construction prior to obtaining the ‘construction license’ that is necessary for starting a construction project, in order to ensure that the construction workers will be paid in time. Second, a developer can no longer sell housing that has not been finished. Housing buyers now usually have multiple housing projects to choose from, and always have the option of buying second-hand housing. Third, a real estate developer now has to acquire land through public auctions, leading to a sharp increase in the cost of land. Small developers are generally not capable of acquiring large land lots, which significantly constrains their capacity to grow or even survive.

The cost of real estate development mainly includes the cost of land and the cost of construction. Depending on location, the cost of land ranged from 700-2,500 *yuan* per m$^2$ of constructed floor area in 2006 and 2007. *(The reason why land price is a matter of constructed floor area is that the former depends to a large extent on the Floor-Area Ratio (FAR) requirement set by the County’s Bureau of Planning, other things being equal.)* For instance, the price of auctioned land was equivalent to approximately 2,300 *yuan* per m$^2$ of constructed floor area in the AAP area, and 1,200-1,300 *yuan/m$^2$ in Industrial Park A and the northern part of the Economic
Development Zone. The size of land is also an important determinant of price. Since only the largest developers have the financial capacity to bid for very large land parcels, the bidding prices of these plots tend to be lower.

According to the local developers interviewed, in 2007, the cost of construction, including the cost of construction materials and labor, was 500-600 yuan per m$^2$ of constructed floor area for 3-story buildings, 600-800 yuan/m$^2$ for 6-story buildings, and 1,000-1,200 yuan for buildings with 12-18 stories. Most of the apartments built in Dragon have 6 stories. Therefore, the approximate total cost (i.e. the cost of land plus the cost of construction) of apartment buildings was 3,000 yuan/m$^2$ in the AAP area, and 2,000 yuan/m$^2$ in Industrial Park A and the northern part of the EDZ. Of course, the cost of construction is changing all the time due to the fluctuating prices of iron and steel, concrete, bricks, sand, and human labor, etc. According to the local developers interviewed, the cost of construction rose significantly in early 2008, but dropped again to the 2007 level by the end of 2008 due to the global financial crisis.

Apart from the cost of land and construction, there can be other costs involved in real estate development. In Dragon, auctioned land usually already has access to roads, electricity and water, but a developer needs to pay for some taxes and fees before a construction project can start. However, these taxes and fees typically do not account for a significant portion of the housing cost.

In 2007, the prices of new apartments in Dragon city ranged from 2,700-5000 yuan/m$^2$, depending on location. For example, it was more than 4000 yuan/m$^2$ in the AAP area, and more than 3,000 yuan/m$^2$ in Industrial Park A and the northern part of
the EDZ.

Therefore, in general, the profit margin for a developer was at least 1,000 yuan for every m$^2$ of floor area constructed. According to an estimate by Employee A from Real Estate Company A, one of the largest local real estate companies, the profit margin of a developer is about 30-50% of its total investment.

One example of real estate development is Commercial Housing Project A, located to the south of the Bus Station of the Capital of Township E and covering several dozen mu of land. The land was acquired by Real Estate Company A in 2005 at a price of approximately 200,000 yuan per mu through an auction process to develop two-story residential houses, each covering 150 m$^2$ of land. The compensation paid to the village that had owned the land was 36,000 yuan per mu, all of which was kept by the village because it was “reserve land”. All the rest (200,000 – 36,000 = 16,400 yuan/mu) was kept by the township government. The price of the houses built was 1,500 yuan per m$^2$ of land covered by the houses and their courts. The total sales value for each mu was more than 900,000 yuan$^{192}$. The net profit that Real Estate Company A received was more than 400,000 yuan per mu.

This profit margin seems significant, but a developer also faces various risks related to the real estate market - such as rises in the prices of construction materials, uncertainty of housing prices, and whether the housing built can be sold in a timely manner so as to recover costs rapidly, etc. However, prior to 2007, a developer’s profit margin typically was much larger than it appeared to be, due to the increased value of

$^{192}$ $1,500 \text{ yuan/m}^2 \times (667 \text{ m}^2/mu \text{ minus the area covered by public lanes in terms of } mu)$
the land between the time of land acquisition and the time of housing sale. In other words, the apartments made available for sale now are actually built on land obtained by developers at least 1-2 years ago, and the prices of the land were significantly lower back then. One such example is Commercial Housing Project B, located in Village R to the south of the College Town. Real Estate Developer A acquired 200 mu of land at 25,000 yuan per mu in 2000. The price of the land was so low because the area was completely undeveloped at the time, and the project was introduced as an “investment promotion project” by the county government. (If auctioned in 2006, the same land would cost 700,000-800,000 yuan/mu.) The developer planned to develop the land right away, but was not able to because the navy stationed in the area claimed that a portion of the land parcel acquired by the developer actually belonged to them. The dispute lasted for several years. Eventually, the developer won the dispute, and the project was completed in 2006. The prices of the apartments built by the developer were 2,800-3,200 yuan/m². The developer received at least 2,000 yuan of profit for every m² of the apartments sold. (If he had built and sold these apartments in 2000, the sales price would have been less than 1000 yuan/m².)

It has been a common practice in many regions across the country that developers hold land and wait for its value to increase. A study by the Financial Research Center of Beijing Normal University in 2007 predicted that the amount of land held up by developers was approximately 1 billion m², which would be sufficient for them to use for 3-4 years. In Dragon, land speculation is a widespread phenomenon.

193 State Council (January 7, 2008); Ren Zhiqiang (2007); Zhong Wei (2007)
194 Zhong Wei (2007)
However, most of the land for speculation has been acquired for industrial use, as will be described later. Commercial real estate developers have much less incentives for land speculation for several reasons. First, land for commercial real estate development has to be acquired through competitive auctions, so the cost of acquiring land is usually very high. Holding land for future development will incur great opportunity cost, since the cost of land cannot be recovered until a real estate project is completed and sold. Second, informal real estate development on industrial land is widespread, as will be discussed in the following section, making the profitability of the formal real estate development market unpredictable. Theoretically, a developer who acquires land through competitive auction process may not benefit too much from land speculation. The reason is that if land speculation is profitable, then its value will be reflected in the prices of the land.

Auctioning processes are essential to ensuring competitiveness for the primary land market. However, auctioning did not start in Dragon County until around 2001. Between 2001 and 2006, land prices rose sharply. In the Dragon EDZ, for example, the prices of the land transferred through auctioning were generally 600,000-800,000 yuan per mu in 2002, but increased to approximately 1.5 million yuan per mu by 2004, and were as high as 2 million yuan per mu by the end of 2006. Land prices were relatively stable in 2007. Since the end of 2007, the local land market has not been active. In 2008, only one land auction was arranged by the BLR, but not a single land parcel was sold because no developer was willing to offer a price higher than the reserve price. There were several reasons for this: First, housing prices had not
increased as much as land prices since the end of 2007; so the profit margin of commercial land development went down, and developers were more careful in offering high bids. The global financial crisis that started in the second half of 2008 had further contributed to their caution in acquiring more land. Second, the big developers typically had already obtained a large amount of land that would be enough for them to develop in the next few years. Much of their land reserve was actually acquired in the early 2000s when land auctioning had not or had just started. Prior to the start of formal land auctions, land prices were only around 80,000 yuan per mu, and many developers acquired large land lots at that time. Most of the lands auctioned after 2002 were actually small parcels. Currently, almost all the large real estate development projects in Dragon City are on land acquired before the early 2000s.

Some problems have existed regarding the transparency and fairness of land auctions. A number of interviewees comment that developers typically engage in collusion among themselves during land auctions. For example, Local Official K states the following:

There are certain taciturn rules among these companies regarding what they can or cannot do… The big real estate companies all know each other – It is a small city after all. They need to cooperate with each other because everyone has to plan for the long term (i.e. A developer who tries to win a bid by breaking the rules thereby making others angry will lose in the future in a society where personal relations are critically important). Often, those who really want to win a bid need to do a lot of “homework” (i.e. persuasion or private deals with other developers) in advance.

This may well have been the case in the early 2000s when the land market was much less mature than it is now. It is conceivable that if all the developers
participating in a land auction are from the same city and know one another very well, it would be desirable for those who really want to win a bid to talk to others in advance. Otherwise, even if one is financially capable of winning the bid, he is likely to make others unhappy if he keeps pushing up the price. Therefore, if one wants to win a bid, he should at least make it known to others. Employee A from Real Estate Company A provides an example,

In 2004, our company was determined to win a bid for several land parcels to the north of (Hotel A). We wanted to win because we had already had a project in the same area and hoped to develop a contiguous neighborhood there, which would save costs for us. We raised the price to 1.4 million (yuan per mu) on the first call to show our determination, and won the bid.

By now, it has become more difficult to manipulate land auctions, because the number of real estate companies participating in the auctions is large, including some from other regions. Therefore, although it may be useful sometimes to do “homework” before land auctions, those wanting to acquire land badly have to prepare for real competition. Nevertheless, the local interviewees generally think that collusion of one kind or another still exists during the auctioning processes.

4. Industrial developers

Industrial developers play a critical role during the land conversion process, because investment promotion is a main driver for land conversion since the 1990s, as discussed in Chapter 4. In general, the existing industrial land users in Dragon fall into the following three groups:
The first group are private or state-owned enterprises coming from other regions or even foreign countries. In Chinese, there is a saying that “a monk from another temple can read the Buddhist teachings better”, which means that there is more to learn from someone coming from another region or country than from a local person. In a similar way, investors from other Chinese regions or countries are often venerated more than local investors, because the former are often believed to possess advanced technologies and management experiences. In particular, foreign investors are often provided with favorable conditions, as described in Chapter 4. However, prior to the late 1990s, most big foreign investors chose to go to the EDZ of Phoenix City, where transportation was much more convenient. Those who did come to Dragon County mostly set up small or polluting enterprises that did not have the potential for technology spillover effect at all. It was not until recently that some large companies with advanced technologies have been attracted to establish plants in Dragon.

The second group used to be the managers of local state-owned enterprises (SOEs), most of which were privatized in the 1990s during a nation-wide privatization move. The purpose of the move was to promote the efficiency of the SOEs, many (if not most) of which were not profitable at the time. In Dragon, the privatization process was often manipulated by the SOE managers in cooperation with the local governments. For example, Local Official F talks about the privatization process of a local chemical plant:

The enterprise was sold to the current Chairman of its Board of Directors at 50 million yuan. The plant was actually worth much more than that (but the government offered a much lower price because the Chairman had personal ties with the local government.) According to the rule, the Chairman had to use his
own money to buy the enterprise. But he did not have that much money. He borrowed 50 million yuan from a local paper making plant (which was another SOE), promising that he would return the money once he had bought the chemical plant. He was able to do this because he knew the general manager of the paper-making plant very well. As soon as he acquired the chemical enterprise, he was able to repay the paper making plant by obtaining a loan in the name of the enterprise he had just bought.

This was not an isolated case. During the privatization move, most SOEs in Dragon were changed into share-holding companies. The prices of the shares were very low, and the enterprise leaders, who had been appointed by the government, received most of the shares, and often did not have to use their own money to buy these shares. Ordinary enterprise workers received a minor portion of the shares. Local Official A comments that,

A number of my former colleagues are now wealthy “entrepreneurs”. They used to be civil servants, just as I am. They became the owners of their enterprises during the privatization process, and are now very rich.

It is a consensus among Dragon’s local residents that privatization has helped these enterprises become more efficient, create more job opportunities, and stimulate the local economy. However, it is also true that the privatization created an elite group of entrepreneurs who not only took over the assets of the SOEs at a low cost, but also have been able to see the value of their enterprises rise sharply due to skyrocketing land prices since the late 1990s.

The third group of industrial land users are villagers’ committees or individuals running small enterprises. In the 1980s and the 1990s, villages and townships were encouraged to establish industrial enterprises, called township and village enterprises (TVEs), on the collectively owned lands of villages in order to create alternative
sources of income for farmers, as mentioned in Chapter 4. By the late 1990s, most of these TVEs had been privatized or contracted to individuals; but they typically still maintain some kind of relationship with the villages because their lands are still owned by the village collectives.

All these three groups of industrial land users have prospered in Dragon. However, their prosperity is not necessarily due to their success with manufacturing or service businesses, but often because of the land they occupy. Local Official C explains,

> What do you think has made the industrial enterprises prosper? Many are actually not doing well with their industrial businesses. The reason for their prosperity is that the value of the land they use has increased by many times.

Along the same lines, Local Official D comments that,

> Nowadays, the profit margin of manufacturing is actually very small (due to a very competitive market). However, what matters more for many industrial enterprises in Dragon is that the land they use has become their most important asset.

Most of the industrial enterprises established in Dragon before 2004 are located in the Dragon EDZ and Industrial Park A. By now, these sites have become central locations, so there is a strong demand for the conversion of these sites into housing and commercial development. Such conversion is carried out in two ways. The first way is for the county government to acquire the sites from the existing industrial land users, and then auction them for real estate development. Since the existing land users typically have close personal relations with the local governments, the conversion is often based on confidential agreements regarding how the benefits shall be divided between the current land users and the county government, as mentioned in Chapter 4.

The second way is for the existing land users to convert their sites into higher
uses directly. According to the law, land can only be used for the purposes designated by the Comprehensive Land Use Plan and the urban plans. However, violation of this rule is not rare in Dragon County. A common strategy by the violators is to develop commercial housing in the name of building workshops or “dormitories” for the staff or workers of their enterprises. Nominally, the land is still used for an “industrial” purpose. In reality, these so-called dormitory buildings are for sale to all people. This strategy is nicknamed “edge ball” by the local people. An edge ball is a ball that hits the edge of the table during a table tennis game. It is considered a good ball, but on the verge of being a bad ball. When applied to a social phenomenon, it refers to an act or behavior that is not strictly, but appears to be legal.

One edge ball project is located close to Main Road D on the northern side of River A. The apartments built on this industrial site were available for sale in 2006 at a price of approximately 1,500 yuan/m², which was only about half the normal market price for this location. There were three reasons why the price was so much lower. First, the cost of the project was much lower than that of normal real estate projects, because the prices of industrial land are much lower than those of the land for commercial real estate development. Second, the duration of the use right to industrial land is typically 50 years, whereas it is 70 years for land zoned for real estate development. Third, since the land was not zoned for real estate development, each individual buyer of the apartments could not have a separate property rights certificate. Instead, all apartment owners had to share one certificate with the developer - which was a significant limitation on property rights. Nevertheless, these apartments were
very attractive to low-income people and those who had come to Dragon from other regions to do business, because many of them could not afford to buy “legal” apartments.

Another example is Neighborhood A, located on the west of AAP1 and consisting of six apartment buildings built in 2001. The land was zoned for industrial use and belonged to a casting machinery factory owned by Village A. Urban Resident C, who bought a second-hand apartment of approximately 130 m$^2$ in this neighborhood, tells about her experience regarding the property rights of her apartment:

I bought this apartment in 2003 at a price of 330,000 yuan. It was a good bargain because the price also included a storage room of about 4 m$^2$ and a garage of more than 10 m$^2$ on the first floor. We received property rights certificate for the apartment at the time. However, soon after that, the government forbade all the apartments in the neighborhood from going onto the secondary market.

The reason was that these apartments had been built (on industrial land) in the name of workshops, and were not (strictly) legal. I do not know exactly why they (i.e. the government) issued property rights certificates to apartment owners at first but changed their minds later. Apparently, the villagers’ committee (of Village A, which was the developer of these apartment buildings) did a good job in dealing with the government at the beginning (and had it agree to grant “legal” status to these apartments), but screwed up the relationship later. Some people say that the government had asked the villagers’ committee to pay a large amount of fee, but the villagers’ committee refused.

This has had a significant impact on the apartment owners. Some people who had bought their apartments in this neighborhood (for speculation purpose) are dismayed, because these apartments can only be sold at a low price to people who are willing to buy an apartment with no legal property rights certificate. We are not sure whether and when the problem will be resolved.

It is worth noting, in passing, that edge ball players have to devote much effort to building up good relations with the government in order to obtain its explicit or implicit approval, as will be discussed in detail in Chapter 9.

195 In Dragon, the first floor of apartment buildings is often used as garage or storage rooms, and not counted as a “floor”. Therefore, what is called a “six-story” apartment building actually consists of seven floors.
5. Land speculators

As mentioned earlier, land speculation has been lucrative in Dragon. This provides opportunities for many people who have strong personal ties with the local governments to make a fortune out of land speculation. Typically, these people would acquire land from the local governments at low prices, and then set up plants or factories that exist in name only and do not produce anything. Unlike the “edge ball” players mentioned earlier, land speculators do not engage in real estate development by themselves. Instead, their primary intention was to wait for the land value to increase before selling it.

One such example involves a “vehicle assembling plant” occupying a land parcel of approximately 200m×60m located about 500 meters to the west of the new main government building. The land has been idle since 1999. Although a few workshops have been built within the enclosed premises, the plant has never been used for any industrial activities. The land was acquired at a price lower than 100,000 yuan per mu, but was worth at least 1.5 million per mu in 2007. Local Official C comments that,

The county government has tried to do something to that piece of land (because the national government did not allow land to be left idle for more than two years\textsuperscript{196}) but is not successful, because the guys behind the scene are from Phoenix City and have a very powerful background.

A second example involves a large land parcel in Industrial Park A, covering more than 1,000 mu. Local Official C comments that,

It was acquired by a relative of a high-level official from Beijing for a big oil

\textsuperscript{196} This policy will be explained and discussed later in this section.
company from the United Arab Emirates intending to invest in this area. But nothing has happened (regarding the expected investment by the oil company), and the land has been left idle for quite a few years.

Land speculation is actually very common in Industrial Park A. According to local officials, much of the land has already been sold to “investors”, but only some of them have established businesses there, and much of the park looks empty.

In Industrial Park B, some enterprises, such as Home Appliances Company A, Electronic Equipment Company A, Pharmaceutical Company A and Garment Company A, have established manufacturing businesses, and are contributing to local revenue and have provided employment opportunities for local residents. However, some factories have built workshops, but have never gone into operation. Developer C comments that

Many people assume that real estate companies are most profitable because of the booming housing market. However, what they do not know is that the construction, in itself, does not bring that much income for a developer nowadays. Rather, what makes the real estate business lucrative is the difference between the current market value of land and the price at which one acquires the land.

To some extent, the land market in Dragon is similar to the booming Chinese stock market in 2006-2007. For land speculators, holding a piece of land is just like holding a stock whose value keeps skyrocketing. The only difference is that the holders of land seem to be much less concerned about risks than stockholders because of the scarcity of land supply. (Of course, these people may be wrong, since there already seem to be indications of a housing bubble in Dragon, as mentioned earlier.)

Recognizing that land speculation is a widespread phenomenon across the country, the national government has required that any developable land acquired by private parties cannot be held idle for more than two years - Otherwise, the land will
be taken back by the government.\textsuperscript{197} The intention of this policy is to increase land supply. However, compliance has been poor. Local Official E comments that,

It is difficult to comply with this policy. Once land is sold (\textit{to private parties}), it is difficult to take it back \textit{(because most of those private parties have ties with the government in one way or another)}. Other counties and regions are not complying with this policy either. As far as I know, the only city that has implemented the policy strictly is Xi’an.\textsuperscript{198}

A former party secretary of Village H comments that,

Much land is simply enclosed, and then not used... In the suburbs, land that is enclosed but not used for two years can sometimes be re-used by farmers for farming. In the urban setting, however, if a land parcel is enclosed, then nobody else can touch it. It makes our hearts ache to see such waste of land.”

Some land dealers do not simply leave the land empty. Though having no intention to carry out business operations, they have built workshops on the land in order to assert that the land is actually not held idle, or at least does not look so. For instance, a small “factory” in Industrial Park B started to build its workshops in 2002, but had not finished by 2007. Normally, it takes a few months at most to build workshops for a factory of that scale.

It is worth noting that the descriptions above are not meant to say that land speculation is bad. On the contrary, it can be good and socially beneficial, as will be discussed in detail in Part II of the dissertation.

\section*{6. Summary}

There has been a booming real estate market in Dragon ever since the

\textsuperscript{197} This requirement was reiterated in a circular by the State Council issued in January 2008, which stipulates that developers who leave land idle for more than a year but less than two years shall pay a fee at a level equivalent to 20\% of the land conveyance fees, and that any land that is left idle for more than 2 years shall be taken back by the government.

\textsuperscript{198} Xi’an is the capital of Shaanxi Province in northwestern China.
liberalization of the housing market in the late 1990s, due to rapid urbanization, improved living standard of the urban population, and people’s anticipation that land supply will continue to be restricted.

The profit margin for real estate developers is typically large, and there was incomplete real estate market competition before the early 2000s. A more lucrative business, however, has been to acquire land in the name of establishing industrial enterprises, and then use it for real estate development through various means.
CHAPTER 6 THE REFEREES

1. Introduction

The referee institutions of the Chinese land conversion process mainly include the courts, the Letters and Calls system, and the Supervision and Inspection system. This chapter will describe their respective roles, followed by a brief discussion of the role of the media and the public in supervising the workings of the government.

2. The courts

In China, the courts are part of the government. Each level of government at township level or higher has a court. Nominally, the president of a court is elected by the same-level People’s Congress; actually, he (or she) is appointed by the government. All other officials and judges of a court are appointed or hired by the government. In general, the courts are very ineffective in dealing with disputes related to land conversion, for the following reasons:¹⁹⁹

First, going to court is very time consuming. After a plaintiff submits a case, the court will collect evidence, establish the case, transfer it to the tribunal, notify the defendant, and set up a date for a trial. Usually, for a civil case, the court will try to mediate first. If mediation is not successful, the court will proceed to try the case and

¹⁹⁹ The following discussions are based on the consultation with Local Judge A and his colleagues
make a ruling. If the defendant or the plaintiff is not satisfied with the ruling, he may appeal to a higher-level court, and much of the same process will be repeated. Sometimes, this may take 1-2 years.

Second, the types of land conversion cases that can be brought to a court are very limited. The main reason is that court rulings have to be “evidence-based”. Many land conversion dispute cases cannot be accepted by the court, for lack of “evidence”. For example, a court usually does not accept cases related to the level of compensation farmers receive for land conversion, because there are usually no written contracts among farmers, villages and the government. As long as the compensation paid to farmers is higher than the prescribed official standard, a court will not be responsible for determining whether a farmer is eligible to receive more, unless there is a contract between the relevant parties specifying clearly a higher level of compensation. In Dragon County, the official grain land contracts signed between farmers and villages are very vague, containing only the location and size of the land and the contract duration. There is no written agreement whatsoever regarding how farmers shall be compensated if the land is taken for “public interest”. During land conversion, a local government usually just issues a written or even oral notice to tell the villages the level of compensation. This means that, basically, farmers are under no judicial protection for land conversion.

In addition, a court does not have the authority to determine whether the original distribution of land property rights is just. The reason is that the distribution of land property rights has to respect historically given conditions, of which the court is not
capable of collecting evidence. Therefore, for any disputes related to land property rights, villages or farmers have to resort to the county- or higher-level governments for resolution. However, the court does accept cases related to the transfer of land use rights from one individual to another.

Moreover, a court cannot accept cases in which a farmer sues a local government directly for land disputes. The reason is that farmers’ land use contracts are signed with their villagers’ committees. Therefore, a farmer is only eligible to sue the villagers’ committee. He cannot sue the government because there is no contract between them.

The third reason why the court system is ineffective is that it is generally incapable of dealing with ultra vires by local governments. Ultra vires are almost never brought to the courts for trial. Instead, officials who support informal land conversions without authorization from higher-level governments usually receive the party’s disciplinary penalties or administrative penalties, as will be discussed later. The role of the courts is limited to trials of officials found to have benefited personally from land conversion by, say, taking bribes.

Due to the ineffectiveness of the courts, people often feel helpless when they have disputes with local governments or entities supported by local governments. One example is the case of Chemical Plant A in County A. This Korean-owned company was established in 2003 as an investment promotion project supported by a former Party Secretary of Phoenix Municipality. Its main products are p-xylene, benzene and toluene. It was built on land reclaimed from the sea, and located adjacent to two large
residential neighborhoods with thousands of households. The local residents living close by have been complaining about the air pollution problem caused by the plant. However, according to the monitoring by the local environmental protection bureau, the local air quality meets the required standards. But the residents do not believe that it is safe, because they can smell the odor from the plant during nighttime. Moreover, they are afraid that there may be leakages from the plant in the future.

Since the establishment of the plant, the housing prices of the apartments in the two neighborhoods have dropped significantly, and are now about 1,000 yuan/m² lower than apartments of equivalent quality in comparable locations. The residents affected have been blaming the plant for this. Urban resident D comments that,

I have an apartment, about 120 m² in floor area, in one of the two residential neighborhoods. The total value of the apartment has dropped by at least 100,000 yuan. I am a doctor and am familiar with the potential effects of the chemicals that may be leaked from a chemical plant like that.

Urban Resident E, who lives close by, comments that,

The local residents seem to have a psychological problem. The chemical plant may not be as harmful as people think, but the people are very afraid. Many people in the two neighborhoods have moved out.

The value of the apartments has dropped to a significant extent, but the real problem is that nobody wants to buy these apartments. So, although the market price of the apartments is now “estimated” to be more than 2,000 yuan/m², the demand for these apartments is almost zero at that price. I guess some people could sell their apartments at lower prices, but they don’t want to sell it too cheaply.

Before the plant was established, the local residents were very resistant. However, it was an investment promotion project by the municipal government of (Phoenix). They couldn’t do anything about it. Some residents voluntarily organized to appeal to Beijing and some media, but it resulted in nothing. Some people tried to ask their friends who had personal relations with the national government, but they were not helpful either. It is so difficult for individuals to appeal against the government.

Actually, many employees of Power Plant A (which is the main local power supplier) also live in the two neighborhoods. The Power Plant organized efforts to
appeal to the government, but it was not useful either. Many of them have now moved out of that area.

Of course, a natural question to ask is why the local residents do not resort to the court to solve a dispute like that. Local Judge A explains that,

I am sure that the court will not accept a case like that. The court serves the local government… It belongs to the party… (Chemical Plant A) is supported by the municipal government and is such a big taxpayer. I don’t know their contribution to local tax revenue, but I heard that the profit of the plant was as high as 20 million yuan in the very first quarter in its very first year, and 40 million in the second quarter…

3. The Letters and Calls system

The Letters and Calls (LC) system is an important channel through which the public can report their complaints against the government, individual public officials, or even private entities. At each level of government above county level, there is a Bureau of Letters and Calls (BLC). Moreover, within each individual government agency, there is an Office of Letter of Calls (OLC). For example, in Dragon County, the BLC is an agency having the same political status as the Bureau of Land and Resources (BLR) and the Bureau of Construction (BOC). Moreover, there is an OLC within the BLR, the BOC and each other county bureau respectively.

Relatively speaking, the LC system is able to facilitate dispute resolution rapidly without the kinds of complicated procedures required for a court. Local Judge A explains that,

Some disputes can even be resolved right away. For example, it is a common phenomenon in this region that some construction companies do not pay their workers on time – which has been a major source of disputes. If the construction
workers choose to go to the court, it could take as long as 1-2 years to have a final decision. Besides, the construction workers often do not have any paper documents (*such as a contract*) showing that they are owed money, which makes it hard for the court even to accept the cases. If, instead, the construction workers go to the BLC, the BLC will transfer the cases to the Bureau of Construction (BOC). An official from BOC can simply call the managers of the construction companies to come to pay. The latter may make the payment to the construction workers right away (*because these construction companies cannot afford to displease the BOC, which is responsible for overseeing the quality of their construction projects*). It is as simple as that. In this case, no hard evidence will be required from the construction workers.

Actually, the failure - or inability - of private entities or individuals to honor commercial agreements is an issue that the OLC has to deal with repeatedly.\(^{201}\) In this regard, one specific example concerns Professional School A located in Industrial Park B. It is a private school established by Developer E in 2007. Developer E signed a one-year contract with the Industrial Park B Property Management Company, which rented the campus to the school. The school did a very good advertising job, and had more than 1,000 enrolled students by 2008. However, the school had been started prior to obtaining permission from the Provincial Education Commission, which is the competent authority for approving new professional schools. Developer E had obviously received strong support from the county government, but underestimated the chance of not being able to obtain provincial approval. In 2008, his application for the school was rejected firmly. Consequently, the school had to be disbanded one year after it was established. Developer E encountered a serious financial problem, and was unable to pay salaries to the teachers he had hired. Since Developer E refused to pay (or perhaps was not able to at the time), the teachers decided to go to the OLC of

\(^{201}\) Incidentally, as mentioned in the *Introduction* of the dissertation, the inability of some countries to honor commercial agreement was thought by Mancur Olson - in his posthumously-published book *Power and Prosperity* - to be a major constraint of these countries to achieving greater economic prosperity.
the county government to exert pressure on Developer E. One of the teachers describes his experience at the OLC as follows:

It was quite a scene! There were so many people in front of the building (where the OLC office is located). It was the end of the (Chinese lunar) year, which is typically the best time for people to ask for their money long due. We (i.e. teachers) were a large group. (We had to go together in order to make our voice louder.) But we were not the only ones. Some workers from the paper-making company were also there. We really had a very impressive presence there.

The relevant officials treated us with patience. They promised that they would take our problem very seriously, but also explained to us that they were actually in a very difficult situation. It was not a prosperous year, because a number of companies became bankrupt due to the global financial crisis and therefore were not able to pay their employees. (It was extremely difficult for the OLC to deal with so many cases at the same time.)

Of course, we did not just go to the OLC. We managed to get the telephone numbers of the County Mayor, the Municipal Mayor, and the Director of the Municipal Education Bureau; and called their offices. We also contacted some media. (We made such a noise that,) later, a journalist from a provincial-level newspaper came to the school to investigate the case. Regrettably, all the teachers were already gone because the school had been closed for a while… Nevertheless, we got paid eventually (due to the pressure placed on Developer E by the local government).

Incidentally, the disbanding of this school actually turned out to be a good thing for other professional schools in the county, because they were able to receive most of the students abandoned by Professional School A - and hence more tuition payments.

In general, the Letters and Calls system, which is less formal than the court system, is very effective in handling certain disputes between individuals and private entities. However, it also has serious limitations, especially in dealing with disputes between individuals and local governments, for the following reasons:

First, The BLC/OLC does not have the authority, like a court, to resolve a dispute by itself, and therefore has to transfer the case to the relevant authorities for
consideration. Its responsibility is simply to record the appeals, convey them to the relevant agencies, and track the dispute resolution process. For example, if the Phoenix Municipal BLC receives a letter or call of complaint against Dragon County’s BOP, the former will then transfer it to the municipal BOP, which will then require the Dragon county BOP to examine the case and report back regarding its settlement decision. This can be an effective mechanism sometimes, because local governments have to take the requests from higher-level authorities very seriously. However, it does not always work, because dispute settlement decisions are often subject to the influence of complex personal relations networks (called “Guan Xi” networks in Chinese as will be explained in Chapter 9). Dragon’s Local Official M comments,

Most of the cases are transferred back to the local governments. The internal workings (i.e. interactions of personal relations) within the government are so complicated that it is impossible for all cases to be handled in a fair manner.

Of course, Guan Xi networks do not always work. In general, the higher the level of government to which an appeal is made, the more pressure there is on a local government to take the appeal seriously. A main reason is that the influence of Guan Xi networks becomes weaker as it goes up the level of government.

A second limitation of the LC system is that it is not helpful at all in ensuring that farmers receive a fair share of the benefits from land conversion. As mentioned, the national compensation standard is lower than Dragon’s local standard. Therefore, even if villages or farmers feel strongly that they deserve more, they are unlikely to be supported by higher-level governments.

A third limitation of the LC system is that it plays a reactive, not an active, role in
supervising the workings of local governments. For example, as far as the land conversion process in Dragon is concerned, the system exerts some pressure on local governments to reduce the number of disputes with farmers and villages, but is ineffective in preventing collusion between officials and developers.

Due to these limitations, farmers in Dragon County typically resort to two means of making their voices heard and exerting pressure on the government. A first means is to protest. As mentioned in Chapter 2, some township governments and villages used to take a share from the compensation to farmers. This led to a number of protests. According to local residents, before 2005, there used to be protestors in front of the county government building frequently. They were mainly composed of two groups of people: workers laid off from state-owned enterprises, and farmers who had disputes with local governments or village leaders regarding the compensation for land conversion. According to the law, open protests or demonstrations on the streets require application to the government in advance; otherwise, the police are in a position to take the protestors away or even arrest them. In reality, however, it was often difficult for the county government to use force, because doing so could lead to unnecessary escalation of the conflicts. Besides, the farmers had nothing to lose anyway. These protests contributed directly to the reform on land conversion compensation in 2005, as described in Chapter 2.

A second means for a farmer to make his voice heard is to go to higher-level governments, sometimes even the national government in Beijing, directly to hand in their letters of complaint in person. However, this is usually not a dominant strategy
for farmers. Suppose, for example, a farmer wants to go to the MLR in Beijing to make an appeal. He has to take into account a number of factors. First, he has to pay for travel and hotel. (Many farmers in Dragon have never traveled beyond the boundary of Phoenix Municipality during their lifetime.) Second, he is not sure whether his appeal will be accepted or, even if accepted, how it will be handled. Third, even if his complaint is taken seriously, he is unlikely to receive a level of compensation that is higher than what the local standard because, as mentioned before, the national compensation standard is actually lower. Moreover, even if the appeal leads to local officials involved being scolded or removed from office (which is usually very unlikely), the farmer will not benefit directly except to fulfill a sense of justice.

Therefore, most farmers will think that making appeals in this way is not worth the trouble. The farmers who did make such attempts were either those who had been treated too badly by the local governments or the ones who had an exceptionally strong sense of justice. Local governments are usually nervous about these farmers because they cannot control the results of such appeals. Therefore, they make great effort to forestall such appeals. In doing so, they often need to anticipate which nail households are likely to make appeals, and then adopt relevant measures, such as persuasion and threat (as described in Chapter 4), to prevent them from doing so. Another common strategy adopted by local governments in dealing with these farmers is to “bribe” them not to do so. As Local Official J from County A comments,

Sometimes, when county officials learn about a farmer going to Beijing to make
an appeal, they would prevent them by paying them or promising other favors. Most farmers would accept. Otherwise, they may receive less even if they win the case. In addition, what is the use of embarrassing local officials? They are still going to live in this area for the rest of their life, and who knows that they are not going to require help from local officials in one way or another in the future?

In addition, each county government has a permanent office in the provincial capital and in Beijing respectively. The main function of this office is to provide logistic support for county officials coming to the provincial or national capital for public, or private, affairs. This office is often involved in “handling” people coming from its own jurisdiction to make appeals to the provincial or national government. However, it is not an easy job because it requires, in the first place, information about which farmer plans to make appeals and when. It has been a “big headache” for local governments, in the words of some local officials. It is also conceivable that some farmers who do not intend to make appeals to higher-level governments may intentionally threaten to do so in the hope of receiving additional favors from the local governments.

The last few years has seen a sharp decrease in the number of protests and appeals. The introduction of the new compensation standard and the pension system, as described in Chapter 2, has played a major role in it, but there are other reasons as well. Local Official S explains the reasons as follows:

Farmers (can be quite a headache if they are not happy, because they) go anywhere to report their complaints… They often do not follow the rule that appeals shall be made level by level. They may even go directly to Beijing… Most of the township governments and villages (located within or on the outskirts of Dragon City) no longer intercept the compensation paid by the county to farmers (because they are afraid of protests or appeal by farmers). These townships and villages do not lack money. They collect rents from the companies renting their land. Township governments usually share the rents with villages.
Some of them also rent the beach to farmers for fish farming… Other township governments (which are located in remote areas and are poor) may still take a share out of the compensation to farmers; but, overall, the situation is much better now than before.

4. The Supervision and Inspection System

The Supervision and Inspection (SI) system includes the Ministry of Supervision and Inspection (MSI) at the national level and the Bureaus of Supervision and Inspection (BSI) at local levels. In parallel, each level of the party’s branch has a Discipline Inspection Committee (DIC), which actually shares much of the same staff as the BSI but has a different name. Typically, a BSI works under the leadership of the same-level DIC, because the DIC Chairman is typically a higher-ranking party leader than the BSI Director.

The DIC and BSI are responsible for supervising and inspecting public officials. They are eligible to give disciplinary penalties to those who do not observe disciplines, and transfer those that constitute criminal offenses to procurators. They have a very high profile, and are relatively free from the penetration of local Guan Xi networks due to tighter control by the party. In recent years, they have played an important role in combating corruption. For example, between June 2006 and April 2007, a number of officials were removed from office or put into jail due to land related or other charges, including: Liu Zhihua, Vice Mayor of Beijing Municipality; Li Baojin, Chief Procurator of Tianjin Municipality; He Minxu, Vice Governor of Anhui Province; Wang Bingyi, Director of the BLR of Fuzhou Municipality; Lizhong, Director of the
Imagine a public official having opportunities to engage in misconduct by seeking personal benefits using his power. Assuming “rationality” in his behavior, the official’s decision regarding whether to engage in misconduct or not depends on three factors: a) the level of potential benefits from misconduct, b) the perceived probability of getting away with misconduct, and c) the penalty to be received if caught (which does not just include an economic penalty, but also psychological stress from losing freedom or even life in the case of imprisonment or capital punishment). In other

\[\text{Market News (Aug. 25, 2006); Li Le and Wang Qiming (2007)}\]
words, even if the potential benefits from misconduct are large, an official will refrain from it if he perceives that the chance of getting away is very small and the penalty will be severe.

The biggest shortcoming of the Chinese anti-corruption laws and policies is that they react and penalize only, but do not aim to establish an effective check and balance system so as to increase public officials’ “perceived” probability of getting caught for corruption. To illustrate the consequences of this shortcoming, it is useful to draw an analogy to the recent legal case of *Xu Ting vs. Guangzhou Commercial Bank*. Xu Ting was a 24 year-old man coming from Shanxi Province to work as a guard for an organization in Guangzhou City, Guangdong Province. On April 21, 2006, he went to an ATM of the Guangzhou Commercial Bank to withdraw some money from his bank account, which had a total balance of 176 yuan. He intended to withdraw 100 yuan, but received 1,000 yuan from the ATM. He was puzzled, checked his bank account, and discovered that only 1 yuan had been deducted from his bank account. He tried again, and received another 1,000 yuan, with only 1 additional yuan deducted from his bank account. Therefore, he tried again and again until he had withdrawn 175,000 yuan from the ATM, and ran away. He was caught a year later, and sentenced to life imprisonment by the Intermediate Court of Guangzhou in November 2007.

This case invoked much discussion on the media. Xu Ting was a naive young man from a remote area, had just been in a large city for several months, and was still very unfamiliar with the complexities of urban life. Apparently, he did not know that
the bank could easily identify him by examining the ATM transaction records or the video recording. It was very unfortunate for him that the bank neglected – or perhaps did not think it was necessary – to put up a sign beside the ATM to caution its customers about a high probability of getting caught if they take advantage of potential technical problems of the ATM. If Xu Ting had seen such a reminder, he would probably not have done what he did.

The *Xu Ting vs. Guangzhou Commercial Bank* case was re-examined by the High Court of Guangdong Province, which changed Xu’s sentence to five years in prison in March 2008. Even so, there is a good reason to be sympathetic towards Xu Ting, because he would probably be still enjoying freedom had the bank taken all the measures necessary to “prevent” him from committing the misconduct. Of course, a major difference between Xu Ting and a public official arrested for corruption is that the former mistakenly thought that the probability of getting caught was low, whereas the latter typically knows for sure that it is indeed very low in most circumstances.203 However, they are both very “unfortunate” in the sense that, if the society had taken all the “precautionary” measures to try to prevent their misconduct, they both would probably have avoided ending up in prison.

By not having in place an effective check and balance system, many public officials are “encouraged”, so to speak, to behave in a corrupt manner. Indeed, they

---

203 Actually, the number of corruption cases investigated has been increasing slightly in recent years (Ma Huaide, 2008). For example, in 2003, the Supreme Court and the Supreme People’s Procuratorate reported 12,830 criminal cases involving county- or higher-level officials; in 2008, the number increased to 13,929 (Ma Huaide, 2008). The fact that so many people engage in corruption deeds but do not get away reflects two things: First, the probability of getting caught for corruption must be low – otherwise, it would be irrational for so many people to do it if they knew they could not get away easily. Second, the potential benefits from corruption could be very large in some cases where the risk of getting caught is relatively high.
would appear “irrational” if they did not. Of course, some are more risk averse – or morally committed - than others, and therefore less corrupt. However, the anti-corruption policies of a society must not be based on the assumption that all people should be morally committed. Otherwise, most public officials will get away with corrupt activities, with only a few falling “victim” to these inappropriately designed policies by being caught due to mere “bad luck”.

5 The media, NGOs and the public

The media, NGOs and the public are potentially important supervisors of the land conversion process. But, in reality, their roles are very limited. In Dragon, there are virtually no NGOs of any kind, and the public is generally excluded from the land conversion process, as described earlier.

Relatively speaking, the media are more important, because public officials are always nervous about their misconduct being exposed to the public through newspapers or the TV. In China, all media are subject to close surveillance by the government - so they need to be careful in reporting on important but sensitive issues. In addition, local media cannot be free from the influence of local Guan Xi networks, which, as will be discussed in Chapter 9, are very powerful.

A few national newspapers are known to have been “bold” in reporting misbehavior or corruption by public officials, for several reasons: First, they are relatively free from the influence of local governments. Second, reporting against
individual public officials helps keep up the popularity of the media, other things being equal. Last but not the least, the national government actually needs a few newspapers like these for anti-corruption purpose.

Nevertheless, the influence of these national newspapers is, in general, minimal, for three reasons: First, their number is very limited. Second, they are relatively free to report against low-level officials, but have to be very careful when dealing with cases involving high-level ones. Third, the media need to have sufficient evidence in order to report something – but collecting evidence by journalists can be difficult.

Potentially, the internet is a convenient channel through which people can acquire information and make their voices heard. According to a survey by the China Internet Network Information Center (CNNIC), the number of people in China having access to the internet increased from 103 million in June 2005 to 253 million in June 2007.\footnote{China Internet Network Information Center (CNNIC) (2008)} The internet has already become one of the most influential forms of media in China.\footnote{China Internet Network Information Center (CNNIC) (2008)} Another survey by the Chinese Academy of Social Sciences in 2004 shows that the Chinese people having access to the internet have a strong expectation regarding the role that the internet can play in political supervision.\footnote{Chinanews (January 15, 2004)}

The internet has one advantage over other, conventional forms of media: It is much more difficult for the government to control the flow of information or exercise censorship. However, the case study in Dragon County shows that, although internet use is popular among the younger generation in Dragon City and the towns, very few farmers choose to use the internet in order to acquire information or even as a form of
entertainment. Nationwide, only 19 percent of the Chinese population had access to the internet by June 2008.\textsuperscript{207} In addition, the internet has a serious limitation in exercising public supervision, since it is a general perception in China that much of the information on the internet lacks credibility.\textsuperscript{208} For example, a CNNIC survey shows that approximately half of all the people surveyed think that the internet is an unreliable source of information.\textsuperscript{209}

\textbf{6. Summary}

The formal referee institutions, such as the courts, the Letters and Calls system and the Supervision and Inspection system, all belong to the government, and therefore cannot ensure impartiality in supervising the land conversion game, of which the government is the dominant player. They also tend to be reactive, not active, towards settling disputes or combating corruption. Informal referees, such as NGOs and the media, are either non-existent or controlled by the government.

\textsuperscript{207} China Internet Network Information Center (CNNIC) (2008)  
\textsuperscript{208} Wang Qian (2005)  
\textsuperscript{209} China Internet Network Information Center (CNNIC) (2005)
PART II  WORKINGS OF THE SYSTEM
INTRODUCTION TO PART II

As described in Part I, the Chinese land conversion process is governed, officially, by a hierarchical top-down structure. In practice, there exist various sets of bottom-up relations, through which individuals can influence the government. In Figure 10, the bottom-up relations are represented by dotted lines, because they work in informal manners through personal relations networks. In the meantime, there also exist informal horizontal relations between villages and developers and between farmers and developers. These relations give rise to a local informal land market.

Figure 10 Workings of the Land Conversion Process
(Dotted arrows represent informal channels to influence other players)

Part II of the dissertation will explain, in detail, how these informal relationships make the system work, and assess their efficiency and equity consequences. Chapter 7 will discuss the impracticability and inconsistency of the planning system. Chapter 8 will explain how the informal market has served to make the system work. Chapter 9
will discuss the central importance of personal relations in allocating land resources.

Chapters 10 will describe the contribution of the informal market to local social and economic development, and two crackdowns by the higher-level governments. Chapter 11 will evaluate the efficiency and equity consequences of the system.
CHAPTER 7 IMPRACTICABILITY AND INCONSISTENCY OF THE PLANNING SYSTEM

1. Introduction

As mentioned before, the National Guideline for Comprehensive Land Use Planning (NGCLUP) serves as a basis for local jurisdictions to develop their Comprehensive Land Use Plans (CLUPs) and Urban Plans (UPs) to guide land conversion. This chapter will discuss the impracticability of the NGCLUP and the inconsistency between the CLUP and UPs of Dragon County.

2. Impracticability of the NGCLUP

As mentioned in Chapter 3, the most important feature of the NGCLUP is that it sets farmland protection objectives and developable land quotas for various jurisdictions. However, the quotas are always exceeded in reality. Many jurisdictions used up their 10-year land quota within five years. For instance, by the end of 2003, Beijing had used up more than 100% of its quota for all years before 2010, Shandong Province had used up 80%, and Zhejiang Province 99%. An official from the MLR makes the following comments regarding the implementation of the system.210

210 Hong Jianrong (2006)
According to the Land Administration Law, the CLUPs are legally binding. In reality, they (i.e. the zoning maps) are no more than something that we draw on paper and then hang on the wall. The CLUPs are usually adjusted to meet the land use requirements of specific projects (rather than the other way round).

Yan Jinming, a member of the Expert Team for National Comprehensive Land Use Planning and a professor at Renmin University, observes that, “the implementation of the existing CLUPs is, in general, a failure”.\textsuperscript{212}

In many regions, the CLUPs are ignored by local governments in developing urban plans. Shu Kexin, Deputy Director General of the Land Use Department of the MLR, describes the national situation as follows:

According to our planning principle, we should first draw a big “circle” – which is the comprehensive land use plan. Within the boundary of the big circle, urban planners can draw smaller circles – which are urban plans. Lastly, developers or public utilities agencies can draw even smaller circles – which are their business plans or land use plans for public utilities. The real situation, however, is that the sequence is reversed.\textsuperscript{213}

One reason for such disrespect for the existing CLUPs is that they cover the period of 1997-2010 only, whereas many jurisdictions have developed urban plans for 2020 or beyond.\textsuperscript{214} More importantly, as will be discussed later, the developable land quotas received by local governments are not practical.

Now that non-compliance with the existing CLUPs is so widespread, a natural question to ask is whether the national government intends to have the existing NGCLUP revised in order to make it more practical. The answer is clearly

\textsuperscript{212} Wang Libin (2004)  
\textsuperscript{213} Wang Libin (2004)  
\textsuperscript{214} Wang Libin (2004)
negative.\textsuperscript{215} The State Council has recently directed the MLR to develop a new NGCLUP (2006-2020),\textsuperscript{216} in which the amount of the developable land quota will become even more restrictive, despite projected higher demand for land conversion in the future.

This new NGCLUP has not come about easily. Its first draft was submitted to the State Council by the MLR before October 2006.\textsuperscript{217} In it, the MLR proposed to the State Council that a maximum of 2.8 million \textit{mu} (i.e. approximately 190,000 hectares) of farmland be allowed for conversion each year. This objective was set based on the target that the national farmland stock should not be lower than 1.8 billion \textit{mu} (i.e. 120 million hectares) by 2010, which had been set by the National Guidelines for the 11\textsuperscript{th} Five-Year Plan (2006-2010). The reason for such a target is that, if China’s farmland stock stays at more than 1.8 billion \textit{mu}, its annual grain production will be at least 500 million tons, which is approximately the level of its annual grain consumption. In other words, a farmland stock of 1.8 billion \textit{mu} is about enough to ensure grain self-sufficiency.\textsuperscript{218} In 2005, China’s farmland stock was 1.83 billion \textit{mu}. Therefore, to meet the target of 1.8 billion \textit{mu}, a maximum of approximately 6 million \textit{mu} could be developed each year on average. However, in order to take into account overuse through non-compliance, the MLR proposed that the objective be set at 2.8 million \textit{mu} per year. (Incidentally, this implies that non-compliance with the national target is unavoidable, and is actually allowed, albeit implicitly, by the national

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{215} Li Le (2006)
\item \textsuperscript{216} The new NGCLUP has 5 overlapping years with the old one.
\item \textsuperscript{217} The following description of the process is based on Li Le (2006) – unless noted otherwise.
\item \textsuperscript{218} Yan Wenyu and Li Pingping (2008)
\end{itemize}
\end{footnotesize}
government.)

During the development of the draft, the aggregate request for developable land quotas by various jurisdictions was more than 135 million mu, far exceeding the maximum quota (i.e. 2.8 million mu/year for 15 years) intended by the MLR.219 Therefore, the MLR had to go through intense negotiations with the provincial governments regarding how the quotas should be distributed.220 In one case, the MLR intended to assign different quotas to two provinces with comparable situations. The province that was to receive less insisted that it be given the same amount as the other province. Eventually, MLR had to increase the quota for this province while reducing the quota for the other. It was also common during the negotiations for local governments to report fraudulent information about their farmland stock. The MLR discovered that many local governments had reported prime farmland as ordinary farmland or even wasteland, so that they could have more flexibility. Zou Yuchuan, Chairman of the Chinese Land Academy and former administrator of the National Land Administration Agency (which was one of the predecessors of the MLR), makes the following comments regarding the difficulties faced by the MLR in distributing the developable land quota among various agencies and jurisdictions for the draft NGCLUP: 221

Ideally, (in land use planning,) the various agencies that are responsible for urban construction, industrial development, water conservancy, power plants, and transportation respectively should sit together and figure out the amount of land

---

220 Developable land quotas are not only assigned to local jurisdictions, but also to some national-level agencies, such as the Ministry of Transportation and the Ministry of Construction, which are responsible for the construction of infrastructure, such as roads and railways.
they really need. The real situation is different. Every agency or jurisdiction is inclined to exaggerate its demand… Some regions in the western provinces will actually have more than enough land quota to use, but they would not acknowledge it. Why so? Because they are afraid that the national government will reduce their quota, and they are afraid of being ridiculed for being incapable of promoting local development.

Therefore, the MLR felt that the target of 2.8 million mu/year was already over-restrictive. However, the State Council still rejected the proposal in October 2006 for “not being strict enough”, and clarified that the 1.8 billion mu target for protection should be for 2020, not 2010.

The NGCLUP was subsequently revised based on the new requirement, and received approval from the State Council in August 2008. According to the new NGCLUP (2006-2020), China’s farmland stock shall be at least 1.818 billion mu by 2010 and 1.805 billion mu by 2020. According to the MLR, the reason for setting the target for 2020 to be 5 million mu more than 1.8 billion mu is to leave some room for “changing situations”. The new NGCLUP maintains a strict restriction on inter-provincial trading of developable land quotas. A high-level MLR official predicts that this restriction is unlikely to be lifted in the next few years or even after 2020.

It is an interesting question why China’s top leaders intend to continue with a farmland protection policy that has proven to be clearly impracticable, and even want to make it more stringent in the future. One plausible explanation is that they know clearly local evasion will be unavoidable under the existing institutional arrangements

---

222 Actually, this is impossible to do in practice.
223 Liu Zhanchao (2008)
224 Liu Zhanchao (2008)
even if the farmland protection target is set at a much lower level, and that an over-strict target will actually help protect more farmland than a seemingly “reasonable” one. Also, an over-strict quota system makes local officials subject to the arbitrary power of higher-level officials, because the former must always break the rules.

3. Impracticability of the CLUP of Dragon County

The existing CLUP\textsuperscript{225} of Dragon County, developed in 1995 and covering the period between 1997 and 2010, has two key components: First, it defines the characteristics of the county’s future land use by dividing, in broad terms, the county into various zones, such as agriculture, industry, forestry, etc. Most important of all, it designates 67,048 hectares, or 88% of all the farmland in the county, as prime farmland to be protected fully. Incidentally, the municipal prime farmland ratio is 85%. The reason why Dragon’s target is 3% higher is that Dragon was a major grain-producing area during the last national land use survey conducted in the late 1970s - so most of the farmland in the county was already regarded as prime farmland back then. Second, the total amount of farmland that may be converted to development is set to be approximately 28,000 \textit{mu} (i.e. 1,867 hectares) during the planned period (1997-2010). Of course, the loss of farmland needs to be made up for by reclaiming at least an equal amount of farmland elsewhere.

\textsuperscript{225} It is expected that Dragon County will soon start developing a new CLUP covering 2006-2020. However, this will take some time since the NGCLUP was just approved in August 2008.
Dragon’s CLUP has two problems: First, the zoning requirements do not provide much restriction on actual land use. Land conversion is based more on actual demand than on the zoning requirements prescribed by the planners. In order to reflect the difference between actual land use and the zoning requirements, the county BLR conducts an assessment each year, and makes changes to the CLUP according to actual land use. Local Official B comments that,

The developable land quota is a requirement that we are supposed to meet in a strict manner, but the zoning requirements are more flexible… Each year, we assess the changes to the CLUP based on actual land use. It means that we will make 15 changes to the CLUP during the 15 years’ duration of the CLUP. By the end of the 15th year, the actual land use may be completely different from the original design.

This phenomenon is, of course, not unique to Dragon. The situation is similar in most other regions in China. A high-level MLR official comments that,226

China’s current land policies have “loopholes”. According to the Land Administration Law and the Regulations on Prime Farmland Protection, any conversion of prime farmland shall be approved by the national government, whereas municipal and lower-level CLUPs can be approved by provincial governments. Therefore, when local governments want to convert prime farmland, they usually do it by making changes to the CLUP, such that they can avoid seeking approval from the national government. It may be said that the prime farmland protection policy is largely a nominal thing… and the implementation of the CLUPs developed by local governments has been ineffective.

The second problem with the CLUP is that the developable land quota, determined in a strictly top-down manner, is practically impossible to fulfill. As mentioned earlier, the developable land quota for Dragon during 1997-2010 was initially set to be approximately 28,000 mu by the CLUP, which means that the average annual quota for farmland conversion was only about 2,000 mu. In practice,

the total developable land quota received by Dragon County has been approximately 3,600 mu – including farmland and other types of land - each year in the past few years. However, the demand for land is much greater.

In order to deal with this problem, the provincial government used to allow its jurisdictions to trade developable land quotas in the early 2000s. Municipalities and counties that wished to have more developable land could buy quotas from less developed regions within the same province where the demand for land conversion was lower. Dragon County, for example, used to buy quota from Municipality B at a price of 4,500 yuan per mu. This provided a flexible mechanism that served to alleviate, to some extent, local demand for land. However, this trading mechanism was abolished a few years ago, because it was thought that the economically advanced regions might take advantage of their economic power to abuse the use of quota and that their farmland would not be protected. This has made land supply in Dragon even scarcer.

It is difficult to have a good estimate of how much land is actually converted in Dragon each year, because non-compliance with national policies is usually accompanied by deliberate concealing of information. However, according to some local interviewees, Dragon converted at least 6,000-7,000 mu each year in recent years. In addition to buying land quotas from other regions, the county has managed to make up, partially, for the land shortage through land reclamation and under-reporting of land use data to higher-level governments, as will be explained
Dragon County is a relatively densely populated area, and does not have much un-utilized land. However, a portion of the over-used land has been reclaimed from the sea during the expansion of Dragon City to the eastern coast. In the past, when the tide rose, sea water would come up to reach parts of the land of Village A and Village B. The beach land was once thought to have little or no economic value. However, in the early 1990s, people started to use these beach areas to farm shrimps, crabs or fish. Since there were no clearly defined property rights for the beach areas, whoever occupied the land first became the *de facto* owners of the use right. Following the Affordable Apartments Program in the late 1990s, many of these beach areas were acquired by the county government from local farmers, and reclaimed for development. A more recent land reclamation project from the sea is the Water City, which is located to the east of the new county government building and designed to be a large commercial and recreation center for attracting businesses or tourists from other regions. Land conversions that occur on such reclaimed land do not require approval from higher-level authorities. The county government needs only to pay compensation to the farmers for their fish farming ponds and other facilities or buildings.

Some land located close to rocky hills that are not suitable for farming has also been converted to urban uses. Such land used to be regarded as useless, and is often not recorded in the official land use statistics kept by the higher-level governments. Therefore, local governments are relatively free to convert such land, and some
individuals take advantage of their personal relations with local officials to acquire such land at low cost for development or speculation purpose. For instance, Education Service Company A is located at the foot of a rocky hill at the urban fringe of Dragon City. According to official records, it occupies less than 150 mu of land only. In reality, it covers close to 300 mu, more than half of which is rocky land that is not counted as “land” in official land use statistics.

The county sometimes under-reports land use data to higher-level governments. As a result, a small portion of Dragon’s farmland is not known to higher-level governments, such that Dragon’s county government has complete discretion over such land.

Despite these strategies to increase land supply, it has been impossible for Dragon County to meet the increasing demand for land except to engage in informal land conversion, as will be described in detail in Chapter 8.

4. Inconsistencies between Dragon’s CLUP and Urban Plans

Compared with the CLUP, the urban plans of Dragon City have played a more important role as far as the physical growth of the city is concerned. The reason is that, as mentioned before, the CLUP outlines land uses in a very general way, and does not prescribe details regarding land use on specific sites. In contrast, the urban plans not only specify the types of use for specific land parcels, but also dictate the kinds of buildings that may be constructed in terms of density and height.
There are four levels of urban plans for Dragon City: the comprehensive plan, specialized plans, detailed controlling plans, and construction & repair plans. Each lower level contains more detailed information, and is approved by a lower-level authority.

The first level is the comprehensive urban plan (CUP), approved by the provincial government. According to the current CUP of Dragon City developed in 2005, the city’s population is projected to reach 400,000 by 2010 and 600,000 by 2020, and the planed area shall be 48 km$^2$ and 71.8 km$^2$ respectively. The CUP also prescribes the growth pattern of the city in the near future. Specifically, it defines the city’s “backbones”, which include “Two Axes” (Main Road D and Main Road F), “One Belt” (coastal landscape belt, which is the area between Main Road F and the ocean), and “Four Zones” (Industrial Park A, Industrial Park B, the downtown, and the college town). The CUP also includes a long-term blueprint with three major urban clusters covering a total area of 384 km$^2$, as shown on Map 3.

The second level includes specialized plans for the Industrial Parks, the Economic Development Zone, and major roads, developed on an ad hoc basis. The plans for Industrial Park A\textsuperscript{227}, Industrial Park B and the Economic Development Zone require approval from the provincial government; whereas those for major roads can be approved by Phoenix Municipality.

The third level is “detailed controlling plans (DCPs)”, which specify the density

\textsuperscript{227} Actually, Industrial A was established without approval from the provincial government. – but this will be explained later.
and height of buildings, and infrastructure requirements such as hospitals, schools, streets, water and electricity, etc. The county government has the authority to approve the DCPs. Two important parameters used in the DCPs are “building density” and “floor-area ratio (FAR)”. Building density refers to the ratio between the area of the land occupied by buildings and the total area of a land parcel. FAR is the ratio between the total floor area of the buildings and the total land area. The purpose of having these two parameters is to regulate the distance between and the height of buildings. In most parts of Dragon City, buildings can have six stories at a maximum. Recently, 12-18 stories have been encouraged in the newly developed coastal areas. According to the technical staff of the BOP, the most important consideration in determining building height is whether it makes the city look good, but sometimes land value considerations are also taken into account. For example, buildings with 12 to 18 stories are encouraged in some areas close to the beach for two reasons: First, tall buildings make the city look more like a “modern” city. Second, tall buildings make better use of the land that is expensive. A disadvantage of tall buildings near the ocean is that they block views of others – but this is not an explicit consideration in Dragon. After building height is determined, planners would build sand tables to find out what is an appropriate distance between buildings such that they do not block each other’s sunlight, thereby calculate FAR.

The fourth and lowest level of urban plans are those for the construction or repair of specific buildings. These plans can be approved by the county BOP. As will be

---

228 It is worth noting that “looking good” is a legitimate consideration, because it also has economic value.
discussed in Chapter 9, this approving authority makes the BOP a powerful local agency, because building designs can affect the profits of developers to a significant extent.

The urban plans are legally binding documents. They can be adjusted based on actual needs, but such changes need to be approved by qualified authorities. For example, changes to the CUP must be approved by the provincial government, whereas changes to the DCPs can be approved by the county government. This implies that the zoning functions of land are relatively “inflexible” requirements,\textsuperscript{229} because they are defined by the CUP and changes to them require provincial approval whose procedure is complicated; whereas building density and FAR are relatively “flexible” requirements, since the county has the authority to change them by itself.

A most outstanding issue with the UPs is that they are not consistent with the CLUP. Local Official B comments that,

The CLUP is supposed to be the “master plan” that guides urban plans. The CLUP should be ‘hard’, meaning that its principles and targets are not to be compromised. The urban plans should be ‘soft’ and subordinate to the CLUP… In reality, the opposite is true. This phenomenon is not difficult to understand. As mentioned earlier, the CLUP is developed in a strictly top-down manner. In particular, the farmland protection target and developable land quota are rigid and impractical. In contrast, the urban plans, developed by local governments, are relatively more responsive to local needs and based on superior local knowledge.

\textsuperscript{229} They are inflexible in a relative sense. In reality, they are also subject to constant changes, as will be described in the following chapters.
Another important reason for the inconsistency is that the urban planners are apparently very confused about the land supply control requirement of higher-level governments and, in order to promote local growth, have chosen to ignore the availability of developable land as a major constraining factor. Local Official G describes the planning process of the CUP as follows,

The CUP of Dragon City was designed by the Provincial Urban and Rural Planning and Design Institute (PURPDI – which is a technical body that belongs to the provincial BOP and has the technical authority to approve Dragon’s CUP on behalf of the provincial government.). The reason why the County government asked an external institute to design the CUP for its capital was that Dragon did no have the technical qualifications by itself… During the design process, the PURPDI used such methods as focus group meetings, field visits, document review, questionnaires, and statistical surveys of transportation volumes, etc. to obtain information about land use and other local concerns… PURPDI first used statistical models to predict population growth, then determined the amount of land required to accommodate population growth according to an official planning guide from the national government prescribing the amount of land a city needs for each person added to the city (referred to as “coefficient” below). Dragon City was predicted to have 400,000 people by 2010, and the coefficient given by the official planning guide that applies to Dragon is 120 m² of developable land for each person. Therefore, the planned urban area for Dragon City in 2010 is 48 km². Incidentally, this has already been exceeded, because the city already covered more than 50 km² in 2006… In a similar way, the population is predicted to reach 600,000 by 2020, and the coefficient for the added population is 119 m² of developable land for each person. Therefore, the planned urban area for 2020 is 71.8 km².

During the planning process, the county BOP chaired a committee, composed of major county government agencies, to provide guidance. Even though the BLR was a member of the committee and therefore had opportunities to “inform” the PURPRI and the BOP of the restrictions imposed by higher-level governments on developable land, it was apparent that the BLR played an unimportant role in it. A calculation

---

230 The coefficient becomes smaller as a city become larger.
shows that Dragon city is planned to expand by 23.8 km$^2$ (71.8 km$^2$ - 48 km$^2$) between 2010 and 2020. This is equivalent to 3,568 $mu$ per year on average. However, as mentioned earlier, Dragon County now receives a quota of about 3,600 $mu$ annually, and may receive even less in the future according to local officials. This means that the quota for the entire county is barely enough to accommodate the growth of Dragon City alone. This is impossible because the various townships also need to grow and the county needs to build roads and develop tourism, which all require land.

Moreover, according to the CUP, the planned area of Urban Cluster A centered around Dragon City shall cover up to 384 km$^2$ in the long term (i.e. beyond 2020). However, the total existing urbanized area, including Dragon City and the capitals of the townships covered by the cluster, is less than 80 km$^2$. Assuming that Dragon receives approximately 2.4 km$^2$ (i.e. 3,600 $mu$) of developable land quota each year as it does now, it would take 120-130 years (i.e. 384 km$^2$ minus 80 km$^2$, then divided by 2.4 km$^2$/year) to develop the cluster fully, even if all other townships do not develop at all. Local Official C comments that, “It is “ridiculous”! How can it be as large as 384 km$^2$ (if the current land policy remains as it is now)? We cannot have so much developable land quota in the first place!”

Despite of its inconsistency with the CLUP, the CUP was approved by the provincial government. The planning and approval process of the CUP indicates at least two things: First, the county government did not believe that the developable land restrictions were practical, and the county BLR had a limited - or perhaps indifferent - role in influencing the urban planning process. Second, the fact that the
CUP was approved shows that the provincial urban planning authorities were also confused about the land supply restrictions. Moreover, it is fair to say that even the national planning authorities were confused – otherwise they would have revised the afore-mentioned official planning guide in the first place.

This is not to say, however, that Dragon’s urban plans reflect local needs well. They may reflect the needs of the county government, but not necessarily those of the public. Urban planning is an internal process of the local governments, and public participation remains nominal. Before an urban plan becomes “official”, it is usually made available to the public for 15 days for comments by being posted on three bulletin boards in three different locations of the city and on the website of the county BOP, which few people - among a relatively small proportion of the local population having access to the internet - know of. A public hearing, attended by local officials and experts from the relevant government agencies or institutions, is usually also held, but with almost zero public participation.

5. Summary

The national farmland protection objective, set by the NGCLUP, is intended to be “over stringent” in order to allow room for local non-compliance. This is a smart strategy by the national government given the existing top-down system, because a seemingly “reasonable” objective would not serve to stop non-compliance anyway.

The developable land quota received by Dragon County falls far short of demand,
and Dragon has tried to make up, partially, for the shortage through land reclamation and under-reporting of land use data.

The local planning system in Dragon is inconsistent. The urban plans are more responsive to local demand than the CLUP, but neither is able to take into account the demand by non-government players.
CHAPTER 8 INFORMAL MARKET AS A NATURAL RESPONSE TO A HIGHLY CENTRALIZED SYSTEM

1. Introduction

As discussed before, the land supply in Dragon falls far short of demand. Moreover, the official approval procedure for land conversion is very rigid. According to the Land Administration Law, Dragon County must apply to the provincial government for development permissions although in some cases the provincial government delegates the approval authority to the municipal government. In addition, approval by the State Council is required for the conversion of prime farmland, of non-prime farmland covering more than 35 hectares, or of other types of land covering more than 70 hectares.

There are two types of applications by a county government for the conversion of farmland to urban uses. The first type is called “group applications”, through which the county government seeks approval for converting land intended for multiple projects. Group application can only be made at designated times once or twice a year. Each year, before submitting group applications to higher-level governments, the county BLR will ask all the relevant county agencies, including the Public Roads Bureau, the Investment Promotion Bureau, the Tourism Bureau, and the Construction Bureau, etc., to predict the amount of land that will be required in their respective sectors and make requests to the county government. Individual developers are not
involved in this consultation process in a formal way, although those having ties with
the relevant agencies may influence the decisions of the latter. The county government
shall make sure that the aggregate amount of the land requested by these respective
agencies does not exceed the developable land quota allowed by the higher-level
governments. However, Local Official E comments that,

The aggregate amount of the land requested by these agencies always exceeds the
developable land quota allowed by the province. To resolve this issue, the BLR
chairs a committee, consisting of the representatives of these agencies, to
examine the requests and reach a compromise.

This process is, therefore, one for distributing the developable land quota within the
county through political bargaining, without formal involvement of developers,
villages and farmers.

The second type of application is for individual projects. These applications are
usually limited to large projects only, and the process is very complicated. Local
Official S comments that,

It is very complicated. According to the regulation, a land conversion application
(for an individual project) cannot be made unless a contract has been signed
between the developer and the village(s) affected. The application will be
examined by many levels of authorities, including township, county, municipal,
and provincial governments. Since the approval process is lengthy, many projects
are simply put into operation before approval is granted or even sought for.

A special report by the MLR concurs and points out that,\footnote{Ministry of Land and Resources Special Task Force (2002)}

The applications need to go though many steps at each of the multiple levels of
the government, so the procedure is very complicated… The supporting
documents required for an application usually becomes thicker and thicker as it
goes down the levels.

Therefore, in response to an overly strict developable land quota policy and very
complicated land use approval procedures, an informal land market has existed in
Dragon County to help make the system work. This chapter will describe various forms of informal land conversion carried out by various players.

2. Informal land conversions by local governments

Local governments can provide services more efficiently than do higher-level governments because the former have superior local knowledge and a stronger pressure to meet local needs. Given the rigidity and impracticability of centralized planning, it is natural that local governments have tried various ways to engage in informal land conversion. Their strategies in this respect have much to do with their interpretation of the policies of the higher-level governments. It is fair to say that Dragon’s local governments are very confused about the conflicting national policies. On the one hand, they know very well that controlling land supply tightly will not only impose a direct negative impact on the local financial situation and economic growth, but also affect their own career in a negative way because, as mentioned before, GDP growth is the most important criterion for the evaluation of their performance by the higher-level governments. On the other hand, ignoring the farmland protection requirements may embarrass their bosses at higher-level governments and consequently themselves.

If left to itself to choose between farmland and growth, a local government would definitely select the latter, since the economic and social benefits of its farmland

---

232 Tiebout (1956) and Fischel (2001) argue that this is also the case in the US.
protection efforts will be shared by other jurisdictions as well. In other words, whenever possible, a local government would want to evade the national farmland protection policy. In fact, they would look foolish if they do not. As described before, informal land conversion is widespread across the country. If most others are doing it and not receiving due punishment, those who are not will be ridiculed.

The key question for a local government leader is to guess how far he can go with informal land conversions such that his bosses at the higher-level governments do not get embarrassed. This is illustrated in Figure 11. The law defines a boundary (i.e. the smaller circle), going beyond which is illegal in a strict sense. In the context of land conversion, this boundary refers to the developable land quota assigned by the national government level by level down and the corresponding zoning requirements defined by the CLUPs. In practice, however, few local governments stay strictly within this legal boundary because the economic incentive to go beyond is high. The national government, which either is unsure by itself about whether the legal boundary it has set is practicable or thinks that it is impossible to crack down on so many trespassers, chooses to allow, albeit implicitly, some “leeway”, denoted by the shaded area in Figure 11, for local governments.
It is important to note that the outer boundary of the shaded area is neither clear-cut nor fixed, but depends on the wavering political will of the national government. Therefore, local governments, in seeking maximum benefits, should make, on a continual basis, the best guess it can about the size and boundary of the shaded area. A risk-taking local government will venture as far as it can from the legal boundary in order to maximize its own benefits, but in doing so runs the risk of being picked out by higher-level governments for a crackdown. This is because the national government needs, from time to time, to crack down on certain risk-takers in order to warn everybody else not to go too far, as will be elaborated with specific examples in Chapter 10. A risk-averse county mayor, on the other hand, will stay close to the legal boundary in order to be safe, but may be considered “incapable” by the local residents within his jurisdiction and, more importantly, by his own bosses as he is not able to promote local economic growth as much as his counterparts in other counties.

In general, Dragon’s county leaders have dealt with this dilemma in an adroit way. Their main strategy has been to carry out informal land conversions first, then
determine whether to refrain from or continue with them based on the reactions of the higher-level governments. As mentioned before, the Dragon EDZ, Industrial Park A and Industrial Park B were all established without approval from the higher-level authorities at the beginning. Of course, whenever the higher-level governments do become serious and intend to crack down on some trespassers, it is important that a local government show a good spirit of cooperation. For example, when Dragon’s application for establishing Industrial Park A was rejected by the provincial government, the county government “deferred”, and cancelled the park. However, the reality was that, by the time of the official rejection, much of the land had already been filled up. Now, the area is no longer called an “industrial park”, but has become part of the EDZ. (For the sake of convenience, it is still called Industrial Park A in this dissertation.) During such a process, the county leaders run no significant risk of being punished by the higher-level governments in any serious manner, as long as they are “cooperative” and not found to have benefited personally in a direct way from such informal land conversion.

This kind of strategy is called “Execute First and Report Later (EFRL)”\textsuperscript{233}. The term originated in China’s feudal times, and referred to special circumstances where an official decided to execute a criminal before asking the emperor for approval because prior reporting might result in the criminal being let loose. The term did not necessarily refer to the execution of criminals, but to carrying out tasks in general without reporting to the emperor according to normal official procedures. There were

\textsuperscript{233} It is called Xian Zhan Hou Zou in Chinese
mainly two reasons for EFRL: First, the official, without modern communication methods, was too far from the capital to report to the emperor, and the matter was extremely urgent. Second, the official wanted badly to do something but presumed that the emperor would not agree to his decision if prior reporting were to be given but that, if he just did it, the emperor would give him a minor penalty only, if any. When applied to land conversion, EFRL simply means carrying out land conversion first and seeking approval from higher-level governments later.

A variation of EFRL is “Execute and Do Not Report (EDNR)”,\(^\text{234}\) which means that local governments or individuals carry out land conversion without even attempting to seek approval from higher-level governments afterwards. The phenomenon of EFRL or EDNR in Dragon reflects a deep local distrust towards national policies. Dragon’s officials and developers blame higher-level policy makers for not understanding the local “subtleties” very well. Developer C comments that,

> The policies (from higher-level governments) are simply not practicable. If we are to follow their policies strictly, then we cannot do anything (i.e. there would not be much business opportunities since they require land as an input).

Along the same lines, Local Official A comments that,

> How can they know the real situation at the local level? When they (i.e. policy makers from the national government) come down to do research for policy-making, they are always accompanied by officials from various levels (i.e. provincial, municipal, etc.), and treated like kings. The local officials would tell them the good things only… Policies made in such a way are often misleading.

Such a perception of the national policy makers may not be fair because, as discussed before, the reason for the system to be impracticable is not that the national policy makers do not understand the local situation well, but that they have intentionally

---

\(^{234}\) It is called Zhan Er Bu Zou in Chinese
made it to be over-strict.

Most land conversions in Dragon have been either EFRL or EDNR cases. This section will describe a few. A first example is the construction of an iron and steel production plant in Township F and I. Starting from the early 2000s, the state-owned Phoenix Iron and Steel Company had been planning to move its main manufacturing facilities from the current site, which is close to downtown Phoenix City, to a suburban county due to environmental considerations. The county government of Dragon was very enthusiastic about attracting the company to locate its new plant in Dragon. The company was interested, and selected a coastal site covering a number of villages in Township F and Township I. Following the signing of a Memorandum of Understanding in 2003, the county government started to carry out compulsory land conversion right away. In the meantime, the company and the county each sent representatives to Beijing to lobby the relevant national government agencies for approval of the project. These central agencies included the MLR, which is responsible for approving unplanned land conversions; the National Development and Reform Commission (NDRC), which is responsible for approving large investment projects by state-owned enterprises; and the State Environmental Protection Administration (SEPA), which is responsible for environmental impact assessment for large projects.

The land intended for use by the company was acquired successfully from the villages by the county and township governments. During the land acquisition process,

---

235 Township I, which is not shown in Map 4, is located on the southwest of Township F.
236 SEPA has recently been elevated to be the Ministry of Environmental Protection.
the local governments met with some resistance but the local farmers were generally pleased with the opportunity of receiving a decent amount of compensation and looked forward to having such a big project that would provide them with jobs. In total, 2,000 to 3,000 mu of land was acquired and made ready for use.

Unfortunately, the project was rejected in 2007 by NDRC, although both MLR and SEPA approved. The reason for the rejection was that a relocation of the company would require a tremendous amount of investment, which NDRC was not willing to support. As a result, the land conversion process had to be stopped.

In order to attract the company, Dragon’s county government had paid for all the costs related to land acquisition, including the compensation to local farmers and the cost of the preliminary land development. Local Official L from Township F comments in 2007 that,

I do not think that the construction of the project will be resumed. It was supported by (a former party secretary of Phoenix Municipality). Since he left office, this project has lost key support from the municipal government. Of course, the land that has already been acquired from the villages will not be wasted, because it is in a very good location along the coast and is ideal for manufacturing companies as it is convenient to discharge wastewater into the ocean.

Before the project was rejected, some companies specializing in harbor management and materials flow came to Township F to evaluate the prospect of investing in the area. However, because the project has been rejected, these and other potential investors have also been lost… In order to attract investment, you must have “dragon head” enterprises first. If the iron and steel project had been approved, it would have been a great stimulus for the local economy.

This dissertation has no intention to evaluate whether the rejection of the project is a good decision or not – doing so would require a very complicated assessment of the expected costs and benefits by consulting various stakeholders, which is clearly beyond the scope of a dissertation. The purpose of citing this case is to illustrate two
points: First, local governments are very eager to attract investment by offering favorable conditions including land use. Second, given intense inter-jurisdictional competition, local governments often do not have much choice but to engage in EFRL in order to promote local economic growth. As Local Official J puts it,

If a local government wants to abide by the formal land use approval procedures strictly, it will be left behind in investment promotion. *(To put it in a different way,)* a local government that does well in investment promotion must have violated the formal rules.

Local Official H comments that,

Many projects are like that - start off the project first, and seek approval later… As long as a local government thinks that a project is good (*i.e. able to contribute to local growth*), it is usually very happy to provide land for it, and will help the project go through the complicated application procedures for official land use approval.

Yet, the story of the iron and steel project did not stop there. At the end of 2008, the project received unexpected approval as part of the government’s economic stimulus package in response to the financial crisis that started in the second half of the year. Along with the iron and steel plant, a seaport will be built in order to transport raw materials such as iron ores and coal to the plant. A railway line for freight transport has also been planned for the area. Construction activities commenced immediately. This will be a big boost for the local economy, and there will be a large amount of new jobs for the farmers in the surrounding areas.

A second example is a golf course, covering about a few hundred *mu*, on the western side of the Coastal Road in Industrial Park A. According to the CUP of Phoenix Municipality, no development shall be allowed within 500 meters of the Dragon City section of the Coastal Road. This is a one-size-fits-all policy, whose main
purpose is to protect the coastal scenery because the road runs along the coast. It was a good decision by the county government to build the golf course because the land had not been used for farming or any other purpose anyway. If the county government had followed the municipal policy, the best that could have been done was to plant trees or grass on it. A golf course not only contributes to coastal scenery, but also provides a unique attraction for local people - particularly entrepreneurs who regard playing golf as a way of socializing with others in addition to a form of entertainment. Therefore, a golf course may help the city improve the “business environment” for potential investors.

The county government built the golf course without seeking approval from higher-level governments, because it knew that approval would not have been possible. Apart from the no-development requirement by the municipal government mentioned above, the national government had a policy that restricted new golf courses across the nation – because golf courses occupy large areas of land and many local governments had built golf courses as “image projects”.

Unfortunately, this project was made known to the higher-level governments through a journalist. An inspection team was sent by the provincial government to investigate the case. The result was that the county government was “criticized”, but the golf course was allowed to remain.

A third example is that, while the Coastal Road was under construction without official approval, the provincial government learned about it, and demanded that a
county leader be held responsible. Eventually, a vice mayor received “party’s
disciplinary penalty”, a dishonor within the party carrying no legal consequences.
Construction of the coastal Road was suspended, but resumed some time later.
Apparently, if anyone were to be held accountable for this project, it had to be the
mayor or the party secretary, because nobody else within the county government had
the authority to make a final decision on a large construction project like that. The fact
that the mayor and the party secretary were excused indicated that a nominal penalty
on a vice mayor was largely a political token to show that the matter had been taken
“seriously”. The vice-mayor should not be viewed as a loser, because he took a blame
that should have been placed on the party secretary or the mayor, who would naturally
feel obliged to compensate him in other ways in the future. Actually, other local
beneficiaries from the project should also be grateful to him, too.

Typically, when “caught” by higher-level governments for informal land
conversions, a local government would be asked to pay a fine. However, the level of
the fine is often negotiable. Local Official J from County A comments that,

I heard that, in one case, the provincial government asked County A to pay a fine
of 50 million yuan. In the end, only 2 million was paid. It was negotiable -
County A did a good job in public relations. I think (Dragon) was fined (for
illegal land conversions and had to negotiate) too… What else could a local
government do? If they follow the formal procedures (for land conversion)
strictly, they would definitely be left behind by other jurisdictions in investment
promotion.

Informal land conversion projects are relatively safe as long as nobody makes a
fuss by reporting them formally to higher-level governments or the media. Even if
they do attract attention from higher authorities, projects with strong backing by the
county government usually face much lower risks than projects supported by township governments only. Not surprisingly, the informal projects by the townships in Dragon are usually of much smaller size and limited to industrial uses only.

3. Informal transfer of land use rights between villages and developers

It is common for industrial developers to rent or buy the use right to land from villages or farmers directly, instead of acquiring it through the government as required by the law. Such informal transfer of land use rights usually takes one of the following two major forms: (For simplification, all the examples provided in this section are from Village H, unless specified otherwise.)

The first form is called, in Chinese, Yi Zu Dai Zheng, which means “renting farmland to industrial developers directly for non-farming uses without transferring the ownership of the land from the village collective to the state”. Typically, the annual rental rate for one mu of land was approximately 300 yuan in 2000, 500 yuan in 2003, and 800-1,000 yuan in 2007. The rent is usually divided between the village and the affected farmers. Normally, the village receives one fourth, and the affected farmers receive three fourths. (This is the situation in Village H. The distribution pattern is different from village to village.) The township government collects a land use tax from the industrial developers at a rate of 9 yuan per square meter per year. 70 percent of the tax revenue is kept by the government, and 30 percent is returned to the village to contribute to farmers’ pension. It is thus clear that local governments are a
part of such informal land conversions - they must be involved because their implied permission or silence is essential.

For instance, a brick kiln was established on the land of Village H a few years ago. It now covers almost 200 mu, the “formal” use right to which belongs to many farmers. The owner of the kiln now pays 1,200 yuan per mu per year to the village and the farmers. The deal was reached through consensus among the kiln owner, the village and the farmers. It is a good deal for the brick owner, because brick making is a profitable business in Dragon due to a booming construction sector. Farmers are also happy because they retain the formal use right to the land, but receive more from renting the land than doing farming by themselves.

The rent paid by enterprises to villages can be significantly lower in areas far from Dragon City. For instance, in Village L, one of the four villages that comprise the capital of Township E, some reserve land is rented to several small enterprises at 80 yuan/mu/year. Of course, the rent is not the only form of benefits for the village, because the enterprises also provide jobs and pay taxes.

Another form of informal transfer of land is called Fan Bao Wei Zu, which means, literally, “(a developer) buying out a farmer’s formal land use contract and then renting the land from the village”. For example, Farmer K contracted 700 mu of wasteland from Village H in the early 2000s at a total rental rate of 1,700 yuan per year. The rate was so low because it was rocky land considered to be “useless” at the time. He received the contract through a bidding process within the village. In 2006, Developer D intended to acquire the land, and made the following offer to Farmer K
and the village: He would pay 1,700 yuan per year to Farmer K and 12,000 yuan per year to the village; in return, the use right to the land should be transferred from Farmer K to him. A deal was reached for a contract of 70 years. It was a win-win-win deal: Farmer K would receive 1,700 yuan per year for 70 years; the village would receive a much higher rent from Developer D than from Farmer K; and Developer D intended to develop the land on a gradual basis. The land has not been zoned for non-agricultural use. However, the developer is not too worried because, as indicated before, the zoning requirement is largely a nominal thing as long as he maintains good relations with local governments.

A second example involves a land parcel covering 5.8 mu. It had been contracted by Farmer L at a rate of 300 yuan per mu per year. Developer D took over the land in 2006 by offering to pay 80,000 yuan in lump sum to Farmer L and 300 yuan per mu per year to the village. This price was for the land only. Developer D also paid compensation to Farmer L for his crops and buildings on the land by drawing reference to, but at a level slightly higher than, the official compensation standard for compulsory land conversion. The compensation usually has to be higher than the official standard - otherwise it would be difficult for a developer to have farmers agree. The duration of the contract was 70 years. Again, the land was not zoned for non-farming use, but developer D is holding it for future development opportunities.

A third example involves a land parcel located on the east of Professional School B, which is privately owned. The land covers approximately 30 mu and was farmed by more than 10 households who had previously contracted the land from the village
at a rate of 200 yuan/mu/year. The school took over the land by offering to pay 200 yuan/mu/year to the village and 600 yuan/mu/year to the farmers. In addition, it paid 30,000 yuan in lump sum to compensate the farmers for the existing crops. The duration of the school’s new contract with the village is 50 years.

Negotiations between developers and village/farmers are not always easy, especially when many farmers are involved. The utility of land is different for different farmers, so it is natural for some farmers to expect more compensation than others. Developers have adopted smart strategies to deal with this issue. A developer would usually negotiate with each individual farmer separately. As soon as one farmer agrees, the developer would sign a contract with him, so that the former cannot come back and ask for more even if others have received more. On the other hand, a developer usually does not offer different prices to different farmers in order to avoid potential conflicts. Occasionally, however, a developer also needs to strike secret deals with individual farmers so that they could make way for his project. During the process, a developer typically maintains good personal relations with village leaders, whose support is crucial. Village leaders have a personal interest in attracting investment for the village, as discussed before, and often serve to facilitate such negotiations or even as go-betweens for developers and farmers.

Of course, negotiations are not always successful. For instance, Professional School B intended to acquire approximately 3 mu of land from Farmer M, because the former planned to build a small water supply facility, but the land stood in the way between the school and the facility site. The school offered 30,000 yuan per mu in
lump sum to Farmer M, but the latter asked for 500,000 yuan per mu. The expectation of Farmer M was so high that the school had to give up and acquire a neighboring land parcel to allow a detour to the reservoir. This was a lose-lose situation for the school and the farmer. The school had to pay a higher cost for the detour. The farmer is growing some trees on the land, which is not profitable in any significant sense. Moreover, it is now more difficult for the farmer to access his land, because the water supply facility blocks the way. Apparently, the farmer miscalculated the situation and mistakenly thought that he had a dominant strategy. Of course, the market value of the land in this location, if auctioned by the government for real estate development, should be much higher than 500,000 yuan per mu. However, a farmer can use the land for no other purpose than farming, and will be eligible to receiving only a small portion of the benefits from land conversion if the land is taken by the government.

Incidentally, soon after Farmer M and the school broke up their negotiations, the former encountered a robbery and had his leg injured. He suspected without any evidence that it had been committed by someone hired by the school, causing a big fuss in the area.

Basically, three things could happen to a farmer’s land: First, the land continues to be used for farming. Second, the government acquires the land in a formal manner, and compensates the farmer according to the official standard. Third, a developer rents or acquires the land in an informal way, and compensates the farmer at a level that is higher than the official standard. Apparently, the third option is the best for the farmer, because he receives the greatest economic benefits. In addition, his village
will retain the ownership of the land. On the other hand, developers typically are capable of obtaining “implied” permission from local governments to carry out informal conversion. Even if such informal land conversion entails significant risks (i.e. from crackdowns by the higher-level governments) in some cases, developers have much greater financial capacity to withstand potential economic loss than farmers. Thus, the informal transfers of land use rights between farmers and developers are mutually beneficial, though not to the same degree.

4. Informal real estate development by villages

Many villages have developed informal real estate projects on their land in two forms: The first form is to build workshops or office buildings, and then rent or sell them to private enterprises or companies. Some villages have benefited immensely from this kind of practice. For example, Village D, which is located in the old downtown area and became fully urbanized in the early 1990s, built many workshops in the 1990s, and is now receiving approximately 2 million yuan per year by renting them. A retired party secretary from Village H comments that,

(Such practices were illegal, but) they just did it. The government could not do much about it. What can the government do to you if you (as a party secretary) are doing something for the collective? … By doing so, they (i.e. the villages) have (become wealthy and) been able to provide pension benefits for all the villagers. Our village should do the same; otherwise, it would be difficult for us to solve pension problems for our villagers.

A second form is to develop commercial real estate projects directly. For example, as mentioned in Chapter 5, it is a common practice for developers or village-owned
enterprises to develop edge-ball real estate projects in the name of “dormitory buildings” on land zoned for industrial use. This not only exists in the fully urbanized villages that have become parts of Dragon City, but also in the villages that constitute the capitals of townships - since the demand for land there is also high. For instance, the party secretary of Village M that constitutes part of the capital of Township E talks about why and how his village engaged in informal land conversion:

Among the 59 villages in our township, about three fourths have financial difficulties, and fewer than 10 villages have enough money to pay salaries to the members of their villagers’ committees. In many villages, money has to be borrowed from elsewhere in order to pay villagers’ committee members 500 yuan as their monthly salary… Many things require money. Road lamps need maintenance, village offices need repairing… Our village does not have a stable source of income. We (i.e. the village) have some trees, but they need about 10 years to become mature… We had a lot of debts. Last year (i.e. in 2006), we made about 200,000 yuan by selling some land parcels to those who wanted to build larger houses. We did not apply to the government for permission. If the use of land is to be changed (from farming to housing), the application procedure is too complicated. We simply decided to do it. We figured that if we did not make a lot of noise, and the villagers simply built two-story houses, nobody would care. The township government (turned a “blind” eye to it, but) came right away to collect fees. The rate was 8 yuan per square meter. They collected 1,000 yuan from each housing site. Everything was informal, but we were able to pay back the debts.

Another example is that Village L, which is also a part of the capital of Township E, sold approximately 30 housing sites, each covering 120 m², at a price of 120,000 yuan each in 2005. Most of the buyers were “speculators” who had no intention to live in the area but expected the value of the land to increase dramatically in the future because, as mentioned before, the township is at a central location in the planned Urban Cluster B. The township government gave “consent” to the project by remaining silent. Pretty two-story houses were built on these sites, with uniform design by the village. After this case was “discovered” by the county government, the
party secretary of the township received “party’s disciplinary penalty” in 2006 due to this and several other charges, and the village was required to pay a fine.

Dragon’s county government has chosen to allow, or turn a blind eye to, these land conversions. The primary reason is that they make a tremendous contribution to local development, as will be discussed in detail in Chapter 10. In addition, Many township governments benefit from these land conversions by sharing land rents with villages. The land rents are usually not reflected in the regular budget, and can therefore be spent with considerable discretion by the local government leaders. Some well-off township governments do not collect land rents, but still benefit from the tax revenue generated through land conversion.

Such informal land conversions by villages are certainly not unique to Dragon County, but a widespread phenomenon across China.237 In Dragon County, some party secretaries were found to have benefited personally from these land conversions. For example, a former party secretary of Village A was removed from his position because some villagers reported to the government about his illegal gains from land conversion. Local Official A comments that, “Quite a few party secretaries in the urbanized villages or villages at the urban fringe did not stay very long on their posts due to their ‘bold deeds’”. The reason why many people engage in corruption deeds is that the probability of getting caught is relatively low while the benefits from corruption are large – which is a key point made in Chapter 6.

237 Ministry of Land and Resources (2005); Xinhua News Agency (June 16, 2006); Xinhua News Agency (September 14, 2006); Wang Yijuan (2006);
5. Summary

An informal market exists in Dragon County to alleviate local demand for land, because the national land policy is unreasonably strict and very rigid. Dragon’s local governments have been smart and active in carrying out informal land conversion projects. Two common strategies used are “Execute First and Report Later” and “Execute and Do Not Report”. Informal transfer of land use rights between developers and farmers is common and beneficial to all the parties involved. Some villages even engage in informal real estate development themselves.
CHAPTER 9 GUAN XI AS AN INVISIBLE HAND OF THE INFORMAL MARKET

1. Introduction

A most important reason why the informal market exists at all is that the national government cannot monitor everything that a county does, and the provincial and municipal governments are often sympathetic because they share much of the same interests as local governments. However, two important questions demand attention: The first one is how land resources are allocated on the informal market. The second one is how the people engaging in informal land conversions avoid - or minimize - penalties, since it is clearly impossible for all informal conversions to escape the attention of the relevant authorities. To understand these questions, it is critical to have an understanding of the central importance of Guan Xi for the informal market.

Guan Xi is a Chinese term for “relations”. When used alone, it usually refers to one’s personal relations with other people. The case study in Dragon shows that Guan Xi plays a central role in the operations of the local governments, in the implementation of policies, and in the daily life of the local people. This chapter will explain why this is so. Some of the examples cited in the chapter may not relate directly to land conversion per se, but help explain a social phenomenon that is central to the general context under which all informal markets, including the informal land market, operate.
2. Importance of Guan Xi to the Chinese society

Guan Xi is important for any society, particularly non-democratic societies. In China, political power generally prevailed over the law and economic power in ancient times, and provided a better guarantee for property rights (such as land ownership) than the law, as mentioned in Chapter 1. Therefore, building up Guan Xi with those having political power was a most important means of protecting one’s interests or seeking benefits which otherwise would have been impossible to receive.

The importance of Guan Xi did not vanish after the CCP came into power in 1949. In particular, the planned economic system before the 1990s provided a fertile breeding ground for Guan Xi. When supply fell short of demand and the price was fixed (which was a common phenomenon of a planned economy), Guan Xi played a central role in distributing scarce goods or services. This can be illustrated with the example of long-distance train tickets. Before the late 1990s, trains were the only affordable means of traveling long distance for most Chinese, but the demand for train tickets was almost always far greater than the supply. In particular, train tickets were most scarce before and after the Chinese New Year, which is the most important Chinese holiday and a time for family reunion. There were many types of train tickets in China. For simplification, they could be divided into two broad categories: One was for cars that allowed both “sitting tickets” and “standing tickets” holders and were usually fully packed and very uncomfortable. The other type was for cars with

---

238 Wei Tian’an (2003)
comfortable seats or sleeping beds that did not allow “standing tickets” holders. Not surprisingly, the Type II tickets were almost always in short supply. In Figure 12, the price of the Type II train tickets was fixed at $P_1$. At this price, the demand for train tickets was $Q_1$. However, the capacity of the trains was limited, and only $Q_2$ tickets were available. Therefore, $(Q_1 - Q_2)$ people were unable to obtain train tickets. Nominally, tickets were sold on a “first come, first serve” basis. In reality, of course, those having *Guan Xi* with railway officials did not have to queue in long lines while worrying whether there would be any tickets left when their turn came.

![Demand and Supply of Train Tickets](image)

*Figure 12 Demand and Supply of Train Tickets*

Of course, the importance of *Guan Xi* was not limited to acquiring train tickets, but applied to the provision of almost all goods and services during the planned era.

In essence, *Guan Xi* was important because there was not an equitable and transparent system to distribute scarce goods or services that were undervalued, and that the public officials responsible for the distribution took advantage of their power to first
meet the needs of those with whom they had *Guan Xi*.

Since the 1990s, China has been allowing the market to play an increasing role in its economy. Now, it is largely the market, not *Guan Xi*, that is responsible for the distribution of many goods and services. However, *Guan Xi* continues to be of central importance to the Chinese society for the following reasons:

**A large public sector**

The state continues to influence the way the Chinese economy grows by its Five-Year Plans (FYPs), which set targets for economic and social development. It still owns many large-scale industrial enterprises (such as petroleum, natural gas, and iron & steel companies), almost all banks, most insurance companies, most telecommunications services, the railway, public utilities, most schools, and almost all hospitals, etc. In order to correct market failures, the state is also responsible for regulating the use of natural resources including land.

In any society, the state is in a better position to provide certain services (such as public utilities) because the private sector is either not capable of providing them or cannot provide them in an efficient way. However, in a highly centralized and un-transparent political system, such as the Chinese one, the power of public officials can be abused easily, and there are many opportunities for corruption, of which *Guan Xi* is a critical part.

**Leeway of laws and policies**

It has been discussed in Chapter 8 that local officials have considerable leeway in implementing national land policies. This is unavoidable, because China is such a
large country that national policy-makers cannot predict all local situations and therefore have to allow some local discretion. In terms of the degree of leeway allowed, China’s national policies and laws may be classified into the following three broad types:

First, some policies and laws are meant to be implemented strictly and do not allow any leeway. One such example was the Family Planning Policy (FPP) in the 1980s and the 1990s. The specific rules of this policy are complicated and will not be explained here, but its purpose is to limit the number of children each married couple is allowed to have in order to control the country's total population. The implementation of this policy met with strong resistance from the public in the 1980s, but the national government was extremely determined, and put the population growth rate under control successfully. Apparently, apart from a firm determination of the national top leaders, another important reason for the effectiveness of the FPP was that population growth was relatively easy to monitor.

Second, some policies and laws do not allow leeway explicitly, but non-compliance will not be punished as severely as for the first type of policies and laws described above, or may even be allowed implicitly in some cases. The most important characteristic of these policies is that their objective is usually over-ambitious. The reason is that, since it is often impossible to supervise local implementation, an over-strict target will not only leave room for non-compliance but also help achieve the “real” policy target. As illustrated in Figure 11, although the “outer boundary” is the intended policy objective, the “legal boundary” has to be
much smaller in order to allow trespassing. In this sense, it is inappropriate to say that the Chinese farmland protection policy is a “failure” simply because its local implementation is poor. The policy is not meant to be implemented strictly in the first place.

Another example is that the national government has announced some ambitious plans for controlling pollution and improving energy efficiency. For instance, the 11th FYP (2006-2010) sets the national objective of reducing the energy consumption of per unit GDP by 20% and the total pollution load by 10%. If achieved, it will be a tremendous contribution to improving the quality of the environment in China and mitigating global greenhouse gas emissions. However, it is very clear that these targets were not set based on sound policy analysis - otherwise they would not be in the form of such neat numbers in the first place. As a matter of fact, few officials or researchers from the Ministry of Environmental Protection (MEP)\textsuperscript{239} or the NDRC know for sure how these figures were derived.\textsuperscript{240} The China Council for International Cooperation on Environment and Development, a high-level advisory body to the Chinese government, thinks that these objectives are very difficult – if not impossible - to achieve,\textsuperscript{241} given that the Chinese economy is predicted to continue growing at a double-digit rate. Of course, this was by no means the first time for the national government to announce such plans. For instance, the 9th FYP and the 10th FYP each included an ambitious target regarding the amount of investment in pollution control,

\textsuperscript{239} MEP is the successor of the State Environmental Protection Administration (SEPA). SEPA was changed to MEP during a restructuring of the government in 2008.

\textsuperscript{240} This is based on several conferences organized by the MEP that I attended in person.

\textsuperscript{241} First Finance News (November 14, 2006)
but neither was achieved.\textsuperscript{242}

As a matter of fact, even the Family Planning Policy has started to allow some leeway, albeit implicitly, in recent years. Now, it is not rare for wealthy people to have more children than allowed. The penalty a couple will receive for violating the FPP rules is that they will be required to pay a fine and will lose their jobs in the public sector – which, literally, allows wealthy people working in the private sector to have more children. The case study in Dragon and Phoenix Municipality at large has found a few such cases. Such violations would have been impossible before the 1990s when punishment was very severe, often involving forced abortion. The reason for the relaxation is that the population pressure is not as high as before, and that the current population policy, if unchanged, will eventually lead to a net decrease of the Chinese population. (The current policy allows each couple to have less than two children on average. However, for the population to stabilize eventually, each couple should have two children\textsuperscript{243} on average.) Understandably, it is still too early to relax the FPP entirely due to the current demographic structure and growth rate. However, the implementation of the policy in recent years has been very unfair.

The third type of policies and laws are intended to be vague and allow leeway explicitly. Clearly, the vague concept of “public interest”, based on which compulsory land conversion can be carried out, is such an example. Yet, no other example is more telling than \textit{The Criminal Law of the People’s Republic of China (1997)}. Article 359 of the law, for instance, states the following regarding the crime of bribing

\begin{itemize}
\item \textsuperscript{242} A point made by Ma Zhong from the School of Environment, Renmin University, at a conference I attended in person.
\item \textsuperscript{243} Actually, it should be approximately 2.1, taking into account immature deaths.
\end{itemize}
government officials:

Those found guilty of bribing will be sentenced to less than 5 years of imprisonment; those found guilty of bribing in order to seek illegal benefits and resulting in serious damage to national interest will be sentenced to 5-10 years of imprisonment; and extraordinarily serious bribing cases will be subject to 10 years or more or even life imprisonment... Bribers who report voluntarily their bribing activities may receive lighter or even be exempted from penalties.

This, of course, is one of many articles that contain similar vague language. Local Judge A from County A comments that,

This leaves a lot of room for Guan Xi. If one knows the judge or other public officials who can influence the judge’s decisions, one can receive a lighter or even no penalty.

Accordingly, Local Official N from Phoenix Municipality makes the following comment:

I think the police, the courts and the procurators’ office are three of the most “powerful” agencies (because they have considerable discretion in making or influencing decisions concerning people’s freedom - or economic interests at least).

Conflicting policies

As discussed in Chapter 3, horizontal coordination among various government agencies is weak, and consequently the policies made by them often contradict each other. A good example is the inconsistency between the Comprehensive Land Use Plans and the Urban Plans of Dragon County, as described in Chapter 7. Sometimes, public officials may even make conflicting or bad policies intentionally in order to allow room for Guan Xi. Dragon County’s Local Official S provides an example:

The Public Security Bureau (of Dragon County) has a rule that if one wants to become an official villager of a village, one needs to prove that he already owns a house in that village. However, the Housing Administration Bureau has a rule that, in order to buy a house in a village, one needs to prove that he is already an official villager of the village.

This has been a very important issue for the villages located within or close to Dragon
City because, as will be described in the next chapter, these villages are very wealthy and typically provide special benefits for the villagers. Needless to say, the only way for one to become an official villager of a village is to resort to Guan Xi.

Such conflicts do not just exist in the policies made by different agencies, but also in those made by the same agency. For example, in many Chinese cities, the education agency forbids public junior middle schools from admitting primary school graduates, whose average age is around 12, based on their test scores. Instead, students shall attend the public junior middle schools that are close to where they live. This policy sounds reasonable, because test scores reflect the current level of a student’s mental development, but not his development potential. In Figure 13, for instance, Student B lags behind Student A before the age of 15, but will eventually catch up and excel later on. Thus, admission decisions based on test scores are not fair to some students. However, some cities allow each junior middle school to have one or two so-called “experimental classes”, whose students can be admitted by the school based on its assessment of students’ merits in specific areas (particularly math, English, music and sports). Since the admission process is not transparent, Guan Xi has been playing a major role in it. The parents who do not have powerful Guan Xi have to press their kids to work exceptionally hard in order to acquire “merits” in those subjects so as to get into a better school.
Of course, this is just one of many examples of a similar nature. In China, it is common for an agency to make a rule, but then allow exceptions under “certain” circumstances. Agency leaders typically have significant - if not complete - discretion in determining who shall qualify for the exceptions. Such policies may not always have been made intentionally to conflict with each other. However, it is obvious that public officials are among the biggest beneficiaries, and thus have a weak incentive to make them consistent.

3. Dragon’s Guan Xi networks

In general, people use Guan Xi in order to obtain two types of benefits: “illegitimate” benefits that are impossible or difficult to obtain through normal means, or benefits which one is entitled to but which may slip away because ineligible people are using their Guan Xi in order to receive them. When one receives a favor from another person, the former is often, though not always, prepared to return a favor in

![Figure 13 Illustration of Differences in Mental Development](image-url)
the future. For this reason, the more powerful a person is, the greater the chance he will receive favors from others – because powerful persons are more capable of returning favors.

Guan Xi networks can be very powerful, as illustrated in Figure 14. For simplification, suppose Person A has two friends (B and C), who each have two friends (D, E, F, G), who each have two friends (H-O). Therefore, A has at least 14 direct and indirect Guan Xi. Of course, this is just an illustration. In reality, each person should have more than two friends (i.e. direct Guan Xi) on average – So the number of direct and indirect Guan Xi one has can be very large. Theoretically, Guan Xi networks are capable of connecting all the people in a city in one way or another, because everyone has relatives, friends, classmates and neighbors, each of whom is connected to a different group of people – and so on.

Figure 14 The Power of Guan Xi Network

However, indirect Guan Xi is not as reliable as direct ones. (B and C are direct Guan Xi, and D-O are indirect Guan Xi of A.) The best way for A to overcome this
problem is to make friends with D, E, F, G through B and C, and then with H-O through D-G. On the other hand, any of A's indirect Guan Xi (D-O) may want to make friends with A too – because everybody wants to have more direct Guan Xi.

A most common means for realizing this in Dragon is to socialize through dinners. Suppose D organizes a dinner, and invites B, H and I. It is not rare in Dragon that B will bring one or two of his friends (such as A), and H and I may also bring their friends. In this way, A, B, D, H, I will get to know each other, and may become friends after having met at several of such socializing dinners. In the future, A may bring his other friends, such as C, to such dinners. It is possible that, in the end, everybody (A through O) gets to know everybody else, thus forming a Guan Xi network. Local Official M comments that, “(It is common for people to bring their friends to these dinners, because) it is not simply a way of introducing their friends, but sometimes also a way of showing that they are important because they have important friends.”

Some Guan Xi networks, formed in this way, have relatively stable membership consisting of people with similar social status and background, and organize socializing dinners on a regular basis. Other networks are relatively loose, and exist on an ad hoc basis only.

In general, the members of a Guan Xi network are expected to take turns hosting or paying for these dinners. Those who host or pay more often are deemed more respectable, and are mostly people who hold important positions in the government or
large enterprises or can have the dinner bills reimbursed by their organizations in the name of “business dinners”.

Concerning the importance of these socializing dinners, Local Official M comments that,

You need to know a lot of people. The more people you know, the easier it is to do certain things. You never know which of your friends may help you… If you violate traffic regulations and get caught, your friend from the traffic police department may use his Guan Xi to excuse you from penalty. If you want your kid to enter into a good school, your friend from the education department may help you…

Urban Resident B comments that,

Some of those who have no dinners to go to may even be deemed “incapable” and looked down upon by their wives. It is one thing that you are invited but choose not to go, it is quite another that you are not invited at all.

Of course, not all the wives take the same view. Many wives actually hate these dinners because they keep their husbands from coming back home on time and often make them drunk – which, incidentally, is a major cause of quarrels between husbands and wives. In addition, the frequency of these dinners is very high. Local Official K comments that,

Some people seldom have meals at home. If you have an important position in the government (or enterprises) and if you want, you will have dinners to go to for all days. It is very difficult to refuse invitations. If your boss asks you to go along, you have no choice. How can you not go? If your other friends invite you, it will be okay to refuse them once or twice. Yet, if you refuse them often, they will no longer invite you. But, in that way, how can you make new friends? We live in a society where Guan Xi is essential for a lot of things. Besides, (if you do not attend these dinners), people will think that you are difficult to get along with.”

These dinners are very burdensome to many people, for several reasons: First, they usually require drinking of spirit, and the amount of spirit one drinks is often
taken as an indicator for the degree of one’s sincerity towards friends – a custom that applies not only to Dragon, but also many other regions in China. It is therefore common that people become drunk at these dinners. Second, the dinners are very time- and energy- consuming. A significant proportion of local officials spend at least half of all evenings on these dinners. Many are unable to spend time with their families at leisure. Most local interviewees feel that these dinners are too many - but the problem is that they have no choice but to attend. For example, Urban Resident C explains the situation of her nephew, a teacher at a local professional school who spends at least 10 evenings each month with his friends, as follows:

You bet that he does not like to drink so much spirit. He sometimes has to take turns to pay the bills, too. His wife quarreled with him a number of times for that. But what can he do? In his school, one’s performance is evaluated not only by his boss, but also by his fellow teachers. Therefore, he has to maintain good relations with them (in order to make sure that they do not make negative comments in their evaluation of him). Besides, he has other friends in addition to his school colleagues.

Third, these dinners are usually organized in single rooms in relatively expensive restaurants, and therefore very costly.

Yet, from another perspective, the fact that these people have “no other choice” but to participate in these time-consuming and costly dinners indicates that the potential benefits from these dinners are at least equal to the costs, as illustrated by Figure 15. Of course, the benefits include, in addition to psychological benefits (for those who find these dinners entertaining), the potential favors that are to be expected from the Guan Xi developed through these dinners.
Of course, these socializing dinners are by no means the only way for building up Guan Xi networks. There are various other ways, such as home visiting and gift exchanging - which are easy to understand and will not be discussed here. Guan Xi does not refer to relations between individuals only, but also to relations between organizations or agencies. For example, enterprises need to maintain good Guan Xi with the relevant government agencies; one agency needs to maintain good Guan Xi with others; and lower-level governments need to maintain good Guan Xi with higher-level governments. It is important to note that inter-organizational Guan Xi is much more powerful than inter-personal Guan Xi, because organizations are capable of mobilizing larger amount of resources in order to build up Guan Xi networks.

The above descriptions should not be misconstrued as meaning that the people in Dragon are morally corrupt. On the contrary, they are kind and trustworthy in general. The point this section tries to make is that the individuals in Dragon, in order to pursue their own interests, have no other rational choice but to conform to a social
custom resulting from an un-transparent political system with conflicting or bad policies. Conceivably, most people would be better off if nobody engaged in these burdensome socializing dinners – but this would not be possible unless the macro-level political system is reformed. To put it in a different way, the people in Dragon do not believe that the law and other public institutions are capable of protecting their legitimate interests - Therefore, they have to resort to personal relations in order to protect themselves, or even take advantage of the system so as to achieve illegitimate interests.

4. Implications of Guan Xi networks on the land conversion process

The implications of Guan Xi networks on land conversion are not difficult to understand. Local Official A makes the following comments regarding local officials working in the county BLR and the county BOP:

They are not separate from the society. They all have families and relatives (and therefore need to seek favors for them using Guan Xi). How can they pretend that they are not part of this? They have to live in this city…

As indicated throughout the dissertation, a precondition for Dragon’s local governments, villages and developers to engage in informal land conversion is to maintain good Guan Xi with the relevant agencies or officials. To simplify the discussion, this section will focus on the Guan Xi between developers and public officials only.

Imagine a developer who wants to engage in an “edge ball” land conversion
project, and needs to receive approval from the county government. For him, approval would be practically impossible through normal channels. Therefore, the only way to obtain approval is to get to know a key official responsible for granting approval. The developer has two options. The first option is to go to the official’s office, introduce himself, and then bribe him. This option seldom, if ever, works because public officials usually do not dare to take bribes from people they do not trust. The second, and preferred, option is to find out if any of his Guan Xi knows the official. Suppose one of his Guan Xi is a powerful person and knows the official well. When asked by the developer for the favor of introducing the latter to the official, the Guan Xi may or may not agree, depending on how close they are and whether he thinks the official will be able and willing to help.

For simplification, let us assume that the Guan Xi agrees to introduce the developer to the official, and that the official agrees to help the developer. The developer will then provide gifts or other favors to the official in order to thank him. (Of course, the developer needs to thank his Guan Xi, too.) The official may even accept cash if he and the developer have developed an intimate relationship during the process.

A most important point to remember is that, in this case, if the developer’s Guan Xi is powerful enough, the official will not have much other choice but to help the developer unless he is not able to. Otherwise, he could distance a very powerful Guan Xi, whose help he may need for himself in the future.

Of course, the importance of Guan Xi is not just limited to approval for edge ball
projects. There are various other aspects regarding which a developer needs to resort to Guan Xi in order to maximize his profit. A first aspect relates to the location and size of the land made available by the government. If the government offers large parcels only, small developers may not have sufficient capital to participate in bidding for the land, whereas large developers will be in an advantageous position and engage in strategic behaviors. This is of crucial importance to developers because they need to operate their businesses continuously in order to achieve economic efficiency, and therefore hope to have a continuous supply of land. Conceivably, large developers have greater influence than small ones on the government in this regard.

A second aspect relates to the provision of public utilities and services provided by the government. For example, the costs of servicing raw land are an important consideration in the financial calculations of developers. In China, there is no clear regulation regarding what kinds of services are required for developable land. The government is the sole provider of public services, such as transportation, sewer and pipelines, for newly developed land. Though developers can put in local streets and water lines within their projects, they must negotiate with the government regarding external public services.

This can be a critical issue for some developers. Developer C, for example, established a private professional school in Township C in 2003. The Government of Township C helped Developer C acquire the land from Village H, because it was an

---

244 Public utility companies are responsible for building gas pipes or water lines, and charge fees to developers. It is part of the negotiation process.
245 According to local officials and developers, the cost of land preparation in Dragon is about 70,000-80,000 yuan per mu, including road, lights, and water, etc.
important investment project for the township. The school now has more than 2,000 students and is doing very well. However, the greatest difficulty for the school is that it does not have access to tap water. The reason is that it is built on rocky land at the foot of a hill, and that the tap water provided by the Water Company, owned by the county government, does not reach that altitude. The school has drilled a few wells, but no groundwater is accessible. It will cost several million yuan to build the facilities necessary for bringing tap water up to the school. The Water Company has been unwilling to make the investment, because the school is the only client requiring the service at the time. The school, on the other hand, does not have the financial capacity to do so by itself. The main source of water for the school is a small reservoir about 200 meters to its south, but the reservoir sometimes runs out of water. For a few days in 2006, the school had to buy bottled water for the students to drink and wash, and banned the students from taking showers at the school. This makes the students and their parents very unhappy. It also makes the owner of the school very nervous because the school may lose students if the water problem remains unsolved. For the time being, it is negotiating with the county’s Bureau of Water Conservancy to expand the capacity of the reservoir. For the long term, however, the school is hoping that the surrounding areas are developed soon, so that it becomes easier for the school to negotiate with the county’s Water Company to bring tap water up.

In general, it is easier for big developer to negotiate with the government regarding provision of such services. In some cases, they may even be able to install infrastructure, such as external road and water pipelines, by themselves. Small
developers depend more heavily on the government for such services, but usually have weak negotiating power.

A third aspect relates to a developer’s compliance with planning details. Before starting a project, a developer needs to send its design to the Bureau of Planning (BOP) for approval. The BOP has an evaluation committee composed of 5 people, including a vice mayor, the director and a vice director of the BOP, and two other planning officials. They vote to determine whether approval can be granted. A key criterion for their evaluation is whether a developer’s design complies with the designated building density and FAR requirements. In addition, the Detailed Controlling Plans (DCPs), developed by the BOP, includes such details as the distance between a proposed project and the adjacent existing buildings.

Such planning details can affect a developer’s profits to a significant extent, but are often negotiable between a developer and the planning officials. For example, if the DCP prescribes that a proposed building must be at least 10-15 meters from the fence of an adjacent entity, then it is up to the developer, who wants to build a larger building, to negotiate with the planning officials so that the latter could allow him to use the 10-meter limit. Moreover, a shrewd developer can go a step further and argue that the 10-meter minimum limit applies to the distance on the ground only, and that the second floor and above of the proposed building should be allowed to protrude out for 1 meter.

Therefore, a developer who wishes to make the most out of the land must develop or maintain good relations with the planning officials. As Real Estate Developer B
Actually, the “official” procedure for obtaining approval for the design of a development project is not complicated at all. The government now provides what it calls “one-station service”. All the government agencies have service desks in a large hall. One can go there and submit an application conveniently. Approval by the BOP could take as little time as one week. In some cases, it takes more time, because the evaluation committee of the BOP sometimes waits until it has received a minimum amount of applications.

However, if one applies for permission that way (by going through the formal procedure only), his chance of obtaining approval is limited. One definitely should do a lot of “preparations” before going to the one-station service (to submit the official application). They need to “know” you. At least, the director or a deputy director of the BOP and the director of the BOP’s Planning Division need to know you in person.

There is a lot of leeway with planning - that is why it is important to “talk to” them.

Incidentally, according to the Beijing Evening News (October 28, 2008), eight senior officials in Chongqing Municipality responsible for granting planning approval were arrested between 2007 and 2008 due to corruption, and most of them had been involved in taking bribes from developers who wanted to have higher FARs. Corrupt acts like these are, of course, immoral. However, they may actually serve to improve the affordability of housing, and hence benefit home buyers, as will be discussed further in Chapter 11.

The government also has other forms of control over developers. For example, the Bureau of Construction (BOC) is responsible for granting construction approval certificates to real estate developers. One condition for receiving the certificate is that a developer needs to make a deposit in the BOC to make sure that the construction workers hired by the developer be paid in time. The reason for such a requirement is

\[246\] What he means is that the approval procedure for construction design is not very complex. As mentioned before, the approval procedure for land use is very complicated.

\[247\] Huang Huo (2008)
that, as mentioned in Chapter 5, it used to be common in Dragon for developers to delay paying or, in some cases, not to pay hired construction workers, leading to numerous disputes. A prior deposit in the BOC could prevent developers from doing so. However, the amount of deposit a developer has to make is often open to negotiation.

Not surprisingly, private deals between developers and public officials are common and widely recognized as a major problem during the land conversion process. Public officials are usually very careful in accepting personal benefits. Small gifts are acceptable, but accepting valuable gifts and cash is in violation of the Criminal Law and therefore risky. However, developers are typically good at making public officials accept the personal benefits they provide. This is explained by a former party secretary of Laoshan District, Qingdao Municipality, Shandong Province, who was interviewed after being arrested in 2006 for taking nearly 5 million yuan worth of bribes, among other charges. During the interview, he confessed that there were many opportunities for corruption during the land conversion process and that developers gave bribes in such “tactful” and seemingly “well-intentioned” manners that it was often “difficult” for officials to resist. A portion of his confession is presented below:

The procedure for approving development projects seems to be very complicated: A developer needs to submit a land use application to the District Administrator; the administrator then passes the application to his deputy who then delegates the case to the Bureau of Land and Resources; then, the Director of the BLR delegates the case to the Land Division within the BLR; the Land

---

249 Song Zhenyuan and Zhang Xiaojing (2006)
Division, after examining the case and completing relevant forms, reports level by level back to the District Administrator\textsuperscript{250}…

However, as a matter of fact, at each stage of this examination and approval process, only the No. 1 leader has real say. In general, I, as the highest leader of the district, could do whatever I wanted to. It is actually very easy for government officials to “scoop” money during land use planning and approval processes…

Not many officials dare to take bribes from developers whom they do not know well. Therefore, developers usually need to get to know the officials first through their Guan Xi, invite them to dinners, and make ‘friends’ with them… This is a “typical” step-by-step approach by developers that would eventually turn officials from strangers to ‘friends’.

In most cases, it is the dominant strategy for both developers and government officials to keep bribery a secret among themselves because both taking and giving bribes are in violation of the law - which implies that the probability of getting caught on bribery is relatively low.

Another example involves an anonymous developer from a city in Heilongjiang Province, reported by the Xinhua News Agency (which is China’s largest official news agency).\textsuperscript{251} This developer established a real estate company in 2002 with a partner. In order to develop a project, the company was required to deposit 15 million yuan in the government as “project guarantee deposit” according to the local regulation. However, if the company had done it, it would not have sufficient funds left to carry out the construction. Therefore, the company provided an official with personal favors including cash and gifts, and was allowed to reduce the deposit to 5 million yuan. After acquiring the use right to a land parcel through auction, the

\textsuperscript{250} Nominally, the procedure is the other way round: An application is often submitted to BLR first, then reported level by level up for approval. The procedure described in the quote refers to actual circumstances where cases are brought to the district administrator directly.

\textsuperscript{251} Cheng Zilong (2007)
company was required to pay the land conveyance fees, which were 11 million yuan, immediately. However, his partner had a close relationship with a high-level local official – so the company was not only allowed to postpone paying the fees, but also not to pay the full amount. In addition, the company was required to pay, before receiving the construction approval certificate, approximately 11 million yuan for the provision of infrastructure and utilities by the local government. However, after “talking” to an official, the company was allowed to pay the fees after the construction started, and not in full amount.

Given the obvious reluctance of developers to speak openly, I did not attempt to investigate the private relations between developers and public officials in Dragon County. In addition, some first-hand information acquired during the field research in Dragon cannot be reported in this dissertation, due to its high level of sensitivity. Nevertheless, it suffices to say that developers maintain close personal - as well as business - relations with relevant public officials. A typical example involves a housing project located on the western side of a main road within the planned urban area of Dragon City. According to a local planning regulation approved by the People’s Congress of Phoenix Municipality, no development project can be allowed within 500 meters of that road. The project was suspended several times during its construction, because it had been started without official approval. However, it was completed in 2006 and is now one of the most expensive neighborhoods in Dragon City due to its proximity to the beach. It consists of a number of 6-story apartment
buildings in the south dwarfed by two 18-story apartment buildings in the north. Local Official A comments that,

I am sure that he (i.e. the developer) finally obtained approval through his Guan Xi with higher-level governments. Dragon County did not have the authority to approve it, because the regulation was passed by the municipal People’s Congress. Only the municipal or higher-level government has the authority to approve a project like that. It was not designed according to the urban plan of the city either, because the urban plan was that there should have been no development projects in that area. Therefore, I do not think there was actually even a requirement for the project regarding building height or floor-area ratio.

As expected, there are many local “rumors” about developers. It is beyond the scope of the dissertation to verify these stories. However, the fact that these and many other rumors of similar nature are widespread among Dragon’s local officials and residents indicates that the land conversion process is very un-transparent, and that it should not be surprising if they reflect some truth.

A first rumor involves a land parcel, zoned for industrial use, located to the southwest of the new government building. It used to belong to Party A, who was a “land dealer”. Party A had no intention to carry out industrial operations on it, and sold it to Party B for 6 million yuan. Party B was not interested in carrying out industrial operations either, but bought the land because he had strong ties with the government and was capable of having the use of the land changed from industrial to real estate development. Party B reached a deal with the government. The latter auctioned the land for real estate development for 18 million yuan, most of which was returned to Party B.

A second rumor involves a land parcel located in Village S. It was sold to
Company A at an abnormally low price by the county government. The reason was that, a few years ago, the county government had a financial dispute with an external construction company that undertook a large construction project for the county government. The wife of the Chairman of the Board of Directors of Company A was the president of the court where the case was tried, and used her personal influence to handle the case to the satisfaction of Dragon’s county government. This land parcel was, in a sense, a favor in return.

A third rumor involves a factory owned by Village R, located in the Dragon Economic Development Zone. The factory borrowed a large amount from a bank, but was not performing well and was on the verge of defaulting. The party secretary of the village, who knew a county leader well, lobbied the county government, and was allowed to use the land of the factory, which was zoned for industrial use, for real estate development. This enabled the village to repay its debts and make a large amount of money out of it.

5. Summary

During the planned economy era, Guan Xi was essential for allocating scarce resources. Nowadays, Guan Xi is still critical to the Chinese society, due to a highly centralized system, a large public sector, significant discretion of public officials in implementing laws and policies, and conflicting policies.

Many people in Dragon devote much time and energy to building up Guan Xi
networks. This is a heavy burden to some people. However, most local people are trapped in it, because they cannot afford not to do it. Building up good Guan Xi networks is a precondition for carrying out informal land conversions by local governments, villages and developers. Developers are particularly good at building up Guan Xi with public officials, and there are many local stories in this regard.
CHAPTER 10 CONTRIBUTIONS OF INFORMAL LAND CONVERSIONS TO GROWTH VS. CRACKDOWNS BY HIGHER-LEVEL governemnts

1. Introduction

This dissertation looks at economic growth as a benefit for the various players in Dragon County. Some economists might question this premise, because they view the economic system as a subsystem of the sustaining and containing global ecosystem and think that continued physical economic growth is not possible since eventually the costs imposed by growth on the sustaining system become greater than the benefits of that growth.252 This dissertation shares such a global concern, but holds that, from the perspective of a county in a developing country, the quest for economic growth is a “rational” choice and has benefited the local people tremendously.

Most existing land conversions in Dragon have been informal at the beginning. Many have obtained legal status by now, but most of them did not receive such status until long after they had already occurred. Dragon receives about 3,000-4,000 mu of developable land quota each year, but much of the quota is used for accommodating land conversions that have taken place in previous years, not the current year. This chapter will assess both the positive and negative contribution of land conversion to Dragon’s economic growth and social development, and describe two campaigns by the national government to crack down on the informal land market.

252 Herman Daly and Joshua Farley (2004), P57.
2. Contribution of land conversion to local economic growth

Due to limited, unreliable local statistics, it is impossible to quantify the contribution of informal land conversions to local economic growth. However, it is a consensus among the local interviewees that Dragon would not have achieved such rapid growth if it had followed the national land policy in a strict manner. Although there is no feasible way to isolate the contributions of informal land conversions to growth from those of formal ones, it is fair to say – based on the discussions in the previous chapters – that the informal market accounts for much of the economic benefits achieved by Dragon County in the past decade.

Contributing to the county’s fiscal revenue

Dragon County’s fiscal revenue has increased rapidly and steadily in the past decade - from less than 100 million yuan in 1992 to almost 1.6 billion yuan in 2006, as shown in Figure 16. There are mainly two sources of fiscal revenue in Dragon: First, the fees collected by various local government agencies accounted for almost half of the local fiscal revenue in 2006. Second, taxes accounted for more than half of Dragon’s local revenue in 2006 and up to two thirds in previous years. They included local taxes (which accounted for about two thirds to three fourths of all tax revenue) and state taxes returned to Dragon by the state (which accounted for one fourth to one third).
The fees include various types. For example, the Public Security Bureau collects fees for various licenses it issues, the Transportation Bureau collects toll fees, and the BLR collects land conveyance fees, etc. In general, the fee collection process is not transparent, and the publicly available official figures are inconsistent. For example, according to estimates by the local officials interviewed, land conveyance fees alone account for at least one third to half of the county’s revenue in some years, but most of them are not reflected in the published official figures.

Relatively speaking, the official statistics on tax revenue are more reliable. According to estimates by the local officials interviewed, industrial enterprises account for approximately two thirds of all the tax revenue of the county. Moreover, industrial enterprises located in Dragon City account for more than 90% of all the tax revenue from all industrial enterprises, and the majority of the former are located on land converted in the past decade. In 2006, the 14 largest enterprises accounted for

---

Source of data: Dragon’s Yearbook 2006; Report on the Finances of Dragon County, 2006
54.3% of the total contribution of state taxes to local fiscal revenue. In particular, the three largest enterprises, including Home Appliances Company A, High-tech Company A and Milk Product Company A (none of which had obtained land use approval from higher-level governments at the time they started business in Dragon), accounted for 27.5% of the entire contribution of state taxes to local fiscal revenue in 2006. Of course, the contribution of these enterprises is not limited to tax payments. The social benefits they generate are also large. Home Appliance Company A, for example, employs several thousand local workers, and supports a number of smaller enterprises that provide parts or services for it.

**Improving the financial situation of villages and townships**

The villages have benefited immensely from informal land conversions. A good example is Villages A, B and C. Village A is located in the Affordable Apartments area, B in the Dragon EDZ, and C to the north of Village A. 15 years ago, the villages were completely rural, and most villagers were engaged in fishing, aquaculture or agriculture. Among the three villages, the land of Village A was developed first (because of the Affordable Apartments Program), Village C later, and Village B last. As mentioned in Chapter 8, these villages typically rent land or workshops to enterprises and collect rents from them. They also built office buildings jointly with private companies. For example, Real Estate Company A built a large nine-story building on Village A’s land without going through the “official” land conversion procedure. (The building has been granted official status by now.) Now, the company owns the 3rd-9th floors of the building, and Village A owns the first two floors and
rents them to the County’s Bureau of Water Conservancy and several private companies as offices. Village A also has partial ownership to several other office buildings. According to an estimate by Local Official I, who once served in Village A’s villagers’ committee, the annual collective income of Village A is approximately 4 million yuan. Villages B and C are even more wealthy than A, because they were developed after Village A, and the land value had increased by several fold by the time they started to be developed.

As the villages now have strong financial capabilities, they are able to take better care of collective affairs. It is typical for the villagers’ committees of the urbanized villages to provide their villagers with free flour, edible oil or moon cakes for the Spring Festival, Mid-Autumn Festival and other important Chinese holidays.

Some villages have even devoted efforts to improving the housing conditions of their villages. Although most villagers have their own houses, their living conditions are not necessarily great. Many young married couples have to live with their parents, because they cannot afford to buy new apartments. Village A, therefore, built two 4-story apartment buildings on the village’s land for its villagers in 2001. Those who did not have housing of their own were eligible to buy these apartments at a price of less than 1,000 yuan/m².

The urbanized townships have also strengthened their financial capacity, not least because their tax revenue from an increasing number of new enterprises is significant. Now that they do not need to worry too much about their own financial problems, some start to pay more attention to farmers’ welfare. For example, Township B started
to implement an affordable apartments program in 2006 for the urbanized farmers in Villages A, B and G who do not have housing of their own. The site on which the apartment buildings were constructed used to be an industrial site. The first phase of the program, which consists of several hundred apartments, was completed in 2007, and the second phase is under construction. Most of the finished apartments are smaller than 90 m², and sold at a price of 1500 yuan/m² to eligible farmers.

Even if this price was only about half the market price for the same location, many farmers had difficulty in paying, because they were among the low-income groups. For example, Farmer I and her husband, who had been living with her parents in Village A after getting married, bought such an apartment. It cost her 170,000 yuan in total, including buying the apartment, doing furnishing and buying furniture. She and her husband did not have so much money. Her father helped them make most of the payment. (In China, it is common for parents to help their children pay for housing.) Farmer I’s father earns about 700-800 yuan per month - including 400 yuan as a guard for a residential neighborhood and 300-400 yuan for helping the township government collect taxes - in addition to his regular income from pension and from renting several rooms in his house. Nevertheless, Farmer I thinks that she is very lucky because most young urban residents cannot afford to buy such nice apartments.

A different interpretation of the intention of the township government in implementing this affordable apartments program is that it also wants to make money out of it. Since the cost of construction is approximately 800 yuan/m² for this type of apartments and that the village does not need to pay land conveyance fees for its own
land, there is a considerable margin of profit even if all other costs are taken into account.

Incidentally, Dragon City, like most other small Chinese cities, does not have any of the three types of affordable housing described in Chapter 3. (The so-called “AAP apartments”, built in the late 1990s, were actually sold mostly to the middle class, and therefore were not “affordable housing” in its usual sense.) Dragon’s county government has allowed, though perhaps unintentionally, the informal market to provide housing, typically on land zoned for industrial use, for low-income groups through “edge ball” projects, as indicated in Chapter 5. This has turned out to be a desirable arrangement. Had the county government kept this role to itself, it would have been unlikely to have as much affordable housing. It is a usual practice in China that affordable housing is provided to a city’s permanent residents only. In Dragon, the “permanent residents” mainly include those working in the public sector and those from the urbanized villages. These people typically do not have serious housing problems. Those who need affordable housing the most are actually the so-called “mobile” population, i.e. those who have come to Dragon City from the rural villages or other, less developed regions. They typically work in the private sector and do not have official permanent resident status of the city.

Generating jobs

As mentioned in Chapter 2, the majority of a farmer’s income is from sources other than farming. According to the estimates by local farmers, more than 80% of the
rural households do not depend on agriculture for their living. For many families, agriculture is only for the provision of grain or crop fuels.

In the past, when Dragon City was small and under-developed, most rural workers went to Neighboring County A, which had been developed much earlier than Dragon County, and Phoenix City to work as construction workers or in foreign ventures. However, employment opportunities were limited, and it was not convenient to commute between home and work. The situation has changed dramatically in recent years, largely due to the rapid urbanization process spurred by land conversion.

The real estate business itself has provided many jobs. In general, real estate development can be divided into three stages: preliminary land development, main construction activities, and interior furnishing. During preliminary land development, the relevant infrastructure needs to be put in place, such as roads, water pipes and power supply. The construction of buildings requires not just construction workers and carpenters, but also raw materials such as brick and iron & steel. Moreover, interior furnishing has been a booming business in Dragon. Typically, each urban household spends tens of thousands of yuan on the interior furnishing of their apartments. This requires furnishing workers and various kinds of raw materials such as wooden products, brick products, glass, alloy, kitchenware, toilet products, and heating pipes, etc. Therefore, the amount of jobs generated for the design, construction and furnishing of buildings and for the manufacturing of raw materials is very large. In addition, the real estate business has stimulated related services, such as housing sales agents and raw materials sales agents. In effect, the real estate business
has served to set the local economy going. As Urban Resident A describes the situation,

In the past, each household typically put all its savings in banks, because there was no way for individuals to spend money. Now, many people have bought new and larger apartments. (Since their own savings are not sufficient,) some have borrowed money from their relatives or friends, some from banks. Most of the people I know do not have much money left in banks.

It is not difficult to figure out what such an influx of investment means to local growth and job creation.

The enterprises attracted to the city through investment promotion have also provided many employment opportunities for rural and urban workers, as described in Chapter 4. According to the local interviewees, as long as one is willing to work hard, it is usually not difficult to find a job that pays better than farming. The problem is that many locally born young people are not willing to take the jobs that require them to work too hard. Many jobs that require manual hard work are actually taken up by young people coming from the northeastern provinces, which are much less developed than Dragon County.

A typical example is Village H, which has 340 households. Approximately 60 percent of all villagers still engage in agricultural production, but only 30 percent at a maximum rely on agriculture as an important source of income. Some villagers work in the enterprises that rent land from the village, because there is an agreement between the enterprises and the village that people from the village have priority in getting hired. Some work in other enterprises located in Dragon City. In addition, many engage in transportation services, including privately owned public transport (such as mini-bus and taxi) and freight transport. In total, the village has 170
transportation vehicles. On average, one out of every two households has a vehicle.

Some urbanized villages, such as Village E and Village F, have created considerable employment opportunities by themselves. The leaders of these villages are either exceptionally capable or have a relatively strong sense of responsibility towards villagers. They use the villages’ collective financial resources to run village businesses, and are doing very well. The party secretary of Village F, for example, ran a small village enterprise at the beginning, which has developed into one of the largest real estate enterprises in Dragon by now.

Another example to show the contribution of informal land conversions to local economic development is the private professional school owned by Developer C mentioned in Chapter 9. The school was established in 2003 by acquiring land directly from Village H, and did not obtain official land use approval until 2006. The school now has more than 2,000 students, and benefits many people. First, it provides an opportunity for many junior middle school graduates from Dragon and other regions to receive further education. In China, all students are entitled to receiving nine years of education (i.e. primary school and junior middle school education). However, not all junior middle school graduates are qualified to continue formal education. Second, the school provides a number of short- and long-term jobs for farmers from Village H and nearby villages, including construction workers, chefs, drivers, and cleaning workers, etc. The school’s retail store, which is contracted to a farmer from Village H, is a good business that sells to a large student body. Local hotels and restaurants also benefit, because parents sometimes come to visit the
school from other regions. On weekends, students often need to take a mini-bus or taxi to go to the downtown, which is a few kilometers away, thus providing more jobs.

In general, the investment promotion efforts by the county have helped Dragon City open up to the outside. In the city, one can hear all sorts of accents, because people have come from all over China to work in the city. As several interviewees observe, in the past, people flocked to Shenzhen\textsuperscript{254} for employment opportunities; but now, many young people from the northeastern and other less developed regions come to Dragon to do business or seek job opportunities. Within the old downtown area, there is even a Wenzhou Industrial Park, where all the business people from Wenzhou, a Chinese city whose people are famous for being good at doing business, locate their companies.

Despite the success of investment promotion, Dragon County’s job market has two problems. The first problem is that the wage level is relatively low. Typically, a 30-year-old worker with nine years of formal school education earns 600-1,200 yuan per month, which is much better than farming but 2-3 times lower than the salaries of civil servants and teachers. Therefore, young people who wish to receive higher wages have to go to larger cities or even foreign countries. For example, since the 1990s, many young farmers in Dragon County have worked in South Korea, Japan and Singapore. These countries offer a special type of visa to enable young Chinese farmers to work in their countries for several years. Although they typically have to work very long hours, the payment they receive is as high as 10,000-30,000 yuan per

\textsuperscript{254} As mentioned before, Shenzhen is a new city built by the Chinese government in the 1980s to attract foreign investment.
month, depending on which country they go to and what type of jobs they do. One interviewee’s sister worked in Korea for several years. Her job was dish washing in a restaurant, and the payment was more than 10,000 yuan per month. Another interviewee, who was a welding technician, worked in Japan for one year in 2007, and earned more than 20,000 yuan per month. This level of payment is very attractive to young Chinese farmers. However, since the second half of 2008, there has been a dramatic decline in the demand for such “imported” labor by these countries due mainly to the global financial crisis.

Of course, the proportion of young people working in big cities or foreign countries is small. Most people stay in Dragon County. Therefore, the supply of highly-paid jobs always falls short of demand, which explains why the wage level is so low. The recent financial crisis has had a strong impact on the county’s job market. As foreign demand declines, many export-oriented Chinese enterprises, such as electric appliances companies and food processing companies, are having a difficult time. As mentioned before, there are also a number of foreign ventures in Dragon County, which enjoy preferential treatment regarding tax and fees payment. However, these enterprises have suffered the most. By the beginning of 2009, more than ten foreign enterprise owners had stopped their production lines and left the county. Therefore, many people who used to work in the city have lost jobs and returned to their homes in the villages.
Increasing the value of farmers’ housing

Due to rapid urbanization spurred by widespread land conversion, the value of farmers’ houses has increased dramatically. As mentioned in Chapter 1, all the households of a village live in a concentrated area. Each household receives a land parcel of 12×16 m² on average (with some variations), on which they build houses by themselves. Usually, five to six attached households form a unit. A village is composed of many such units, laid out in rows and blocks (See Figure 6).

A traditional-type house for a rural household typically includes four rooms on the north, two to three rooms on the south, and an open court in the center (See Figure 17). Since land value has increased dramatically in Dragon City in recent years, most households in the urbanized villages (i.e. Villages A-G on Map 4) have re-built their houses in such a way that there is little or no open court left. This is particularly true for houses facing main streets or avenues.

Figure 17 A Traditional Farmer’s House in Dragon County
Most of the houses have one story only, but there are also some gigantic two- or three-story houses. Farmers are generally free to build large one-story houses, but two-story or higher houses are, in principle, no longer allowed in the urbanized villages for two reasons: First, since all houses are attached to others, it does not look good if rich farmers build multiple-story houses while poor ones do not. Higher houses also block the views and sunlight of the lower ones – which has actually been a major source of conflicts among farmers in many villages. Second, and more importantly, it is foreseeable that, as the city continues to grow and land value keeps increasing, it would become economically desirable sooner or later to convert low-density farmers’ houses into higher-density residential or commercial buildings. When this happens, the farmers will have to be re-located, and compensation paid to them. The current local policy in Dragon is that the compensation paid to the existing house owners will be assessed according to market housing prices and the number of rooms or floor area of the existing houses or buildings. Therefore, in order to avoid paying too much compensation in the future, the county government forbids multiple-story houses in these urbanized villages.

Most of the existing multi-story houses were built in the late 1990s and early 2000s. Many of the owners of these gigantic houses are actually not native to these villages. In the late 1990s, when Dragon City was expanding eastwards to the coast, many people who worked in the city saw the potential benefits of becoming “official” villagers of these villages, and transferred their Hu Kou (which, as mentioned before, is one’s “official” permanent address) to these villages. In order to solve housing
problems for these people, the villages sold residential lots to them as well as to some existing villagers who wanted to build larger houses. The villages were keen on this, because they could make some money out of it. In Village A, for example, several dozen such houses were built, and many of them have three stories and are worth at least 1 million yuan by now.

Almost all the owners of these one- or multi-story houses have rooms to rent. Room renting is very popular because, as mentioned, the prices of housing have increased dramatically in the past 6-7 years. Many low-income people working or doing business in the city who cannot afford to buy their own homes choose to rent housing.

The rental rate of a room ranges from about 100 yuan to more than 1,000 yuan per month, depending on location, size and the quality of interior furnishing. (It is mentioned in Chapter 5 that many new apartments bought for speculation purpose are left unoccupied. However, the farmers’ houses are more popular because their rental rates are lower.) Some households receive more than 2,000 yuan per month from renting their houses. Each household in Village A, B and C receives at least a few hundred yuan. Houses not facing main roads or streets are usually rented for residences, while those facing main roads or streets are rented for commercial uses such as construction materials stores, restaurants, mobile phone stores, barbers, groceries, glassware stores, and homemaking materials stores, etc.
3. Unintended consequences of investment promotion through land conversion

The investment promotion efforts by the local governments have also produced some unintended effects. One major problem is tax evasion by the enterprises attracted to the county. As described in Chapter 4, Dragon’s county government provides preferential tax policies for new or foreign enterprises as a means of attracting investment. However, many enterprises take advantage of the loopholes in this policy. For example, some old enterprises have “transformed” themselves into “new” enterprises through internal reform or by establishing new operations with new names, which is a tactic called “cicada sloughing off its shell” by Sun Tzu in his famous book *Sun Tzu on the Art of War* meaning “creating a false appearance to mislead the enemy”. Likewise, some Chinese enterprises transformed themselves into “foreign” enterprises in order to receive favorable treatment with regards to urban construction taxes, education surtax and land use taxes, which foreign companies were not required to pay before 2007 according to Dragon’s local policy.

Large companies usually have plants in more than one location, and it is natural for them to devise tax management strategies such that they pay as little taxes as possible. For example, they can “make” their profits occur in locations where local tax polices are most favorable. Many large companies are capable of doing this because they supply most of the parts or even raw materials by themselves for their final products, and therefore can manipulate their records of costs and benefits. In order to encourage tax payment, Dragon has a local policy to allow a portion of the taxes paid by an enterprise to be returned to the enterprise. These returned taxes are
called “bonus”, which is meant to be a reward to enterprises for their contribution to local economic growth. However, the rate of such returns is confidential and only known to the leaders of the county government and the managers of the affected companies. This, of course, is a potential source of corruption.

Moreover, some enterprises attracted to Dragon have even had a negative impact. The best-known case is Fiber & Cloth Making Company A. The company, whose main manufacturing facilities are located in County B of Province X, established a factory in the Dragon EDZ in 1996. Dragon did not benefit much from the tax payment by the company, because the latter made most of its tax payment to County B where tax policies were more favorable. The main problem with this company, however, was not its tax payment, but the wastewater it discharged into River A. The water pollution and smell created by the plant were so serious that there were loud complaints from the residents living nearby. Eventually, the county government had to shut down the plant in 2006. This company did not lose, because it received a large amount of compensation for the land and other properties.

Fiber and Cloth Company A is not an isolated case. Most of the enterprises that came to Dragon in the 1990s were relatively small in size, and some caused serious environmental problems. Since the city tightened environmental regulations a few years ago, a number of these enterprises have been relocated to the suburban townships. For example, in Village T, which is adjacent to the capital of Township D, a considerable amount of land is occupied by polluting enterprises, mainly rubber and leather factories that are no longer allowed in Dragon City. The same situation also
applies to some villages close to the capital of Township E. In the townships, environmental standards are lower, and the cost of labor is less. Moreover, these enterprises receive great hospitality from the township governments because, as mentioned in Chapter 4, the ability to attract investment is an important criterion used by the county government to assess the performance of township officials. However, some enterprises in the townships have also adopted strategies to evade tax payment, in the same way as the large ones in Dragon City. For instance, Dragon County has had a local policy since the early 1990s that export-oriented enterprises (EOEs) are eligible for favorable tax rates or even tax exemption. Therefore, many enterprise owners use their Guan Xi to obtain “EOE” status in order to save on taxes.

These unintended effects are not necessarily attributable to the informal nature of land use per se. However, they illustrate the point that, although the informal land market makes the land system more responsive to local needs, it is clearly necessary, from the perspective of policy makers, to regulate informal land conversions for the good of the society. Otherwise, as will be explained later, the majority of the benefits from these informal land conversions will go to enterprise owners or local governments, whereas the environmental and social costs of the investment are borne largely by the society, particularly the people living where such negative effects are felt.
4. Crackdowns by higher-level governments

Although informal land conversions play a critical role in promoting growth, the MLR will organize crackdown campaigns from time to time – the reasons for which have been explained in Chapter 8. This section will describe two such crackdowns, in 2003 and 2007 respectively, and discuss their impacts on Dragon County.

During the first crackdown in 2003, a number of informal land conversion cases were identified, and the developers involved were “penalized” by being forced to pay fines. The penalty, however, turned out to be a blessing for these developers, because their projects were granted “legal” status, as a natural consequence, after the fines had been paid. The amount of fines usually accounted for a minor portion of the actual benefits from the land conversions, and was often negotiable. Local government officials received no serious penalty of any kind.

Therefore, the 2003 crackdown was a de facto amnesty for “illegal” land users. It is easily conceivable that an amnesty was perhaps the best strategy the national government could think of. Given the fact that informal land conversions had been so widespread, it would have been practically impossible to impose heavier penalties because, as an old Chinese saying goes, “the law cannot punish the public” (Fa Bu Ze Zhong). The MLR might be hoping, secretly, that, by granting an amnesty, it could enforce the developable land quota system more easily from then on, because it might then become practically possible to punish new violators, whose numbers would
presumably be much smaller. A direct result of the 2003 crackdown, however, was that more informal land conversions were encouraged, because people presumed that another amnesty would be given again sooner or later. Therefore, informal land conversions remained prevalent in Dragon and across the country after 2003.

The second major crackdown campaign by the national government was more serious. In 2007, the MLR selected 90 cities, most of which were located in the economically advanced eastern regions where the demand for developable land was the greatest, to inspect their performance on farmland protection. Dragon was one of the cities selected.

The objective of the 2007 crackdown was to identify “illegal” conversions of prime farmland and demolish the “illegal” buildings resulting from these conversions. The MLR compared satellite pictures taken in 2003 and 2007 respectively to identify land use changes on prime farmland during this period. However, not all the land use changes identified in this way were illegal, because some had been approved officially and some caused by uncontrollable reasons. Also, in many areas of Dragon County, farmers had built greenhouses to grow vegetables, which appeared to have caused land use changes on satellite pictures. Therefore, the MLR had to rely on Dragon’s county government to figure out which changes were legal and which were not. The county government designated a vice mayor to be responsible for the campaign, assisted by the BLR, the BOC and the Bureau of Public Security.

Dragon’s county and township governments were in an awkward position during the campaign, because many of the informal land conversions since 2003 actually had
received permission from them. In such cases, the county government had to compensate the investors for their economic loss. However, it was obvious that the county government, facing financial pressure itself, was not capable of paying sufficient compensation if all the illegal buildings were to be demolished. Moreover, such compensation could seldom be in cash, because it was obviously in violation of government rules to make such payments out of the official budget. Conceivably, the compensation would include promises of personal favors to be provided by local governments in the future. Thus, it was in the best interest of the county government to devote much effort to lobbying higher-level governments in order to have as much leeway as possible during the execution of the campaign.

On the other hand, the county government understood very well that it would not be able to get away easily this time unless it could convince higher-level governments about its “conscientiousness” in carrying out the crackdown. Therefore, it had to make some real efforts to assert its “support” for the policy. Although “covert” disobedience to central policies is a most salient feature of a top-down political system, “overt” resistance is seldom, if ever, a smart strategy for local officials who are most concerned about their personal political career.

As expected, the crackdown campaign met with strong resistance from the affected land users. Most of the illegal buildings were located at the outskirts of Dragon city and of the township capitals. Some buildings were demolished, but most were kept. Which buildings were to be kept and which demolished depended on the personal relations of individual land users with local officials, and on whether a
building was a visible target that could be noticed easily by the inspectors from higher-level governments. In some cases, local governments and land users cooperated to avert the national policy. Local Official A comments that,

There is always a way for a local government to avert national policies… Suppose a factory has workshops covering approximately 1,000 m$^2$ and a walled open court covering 2000 m$^2$. The factory could demolish the walls only and reclaim the court into farmland, so that it would look as if the factory has been demolished. (*The factory’s operation would not be affected significantly, since the workshops are kept.*)

It was apparent that the higher-level governments actually did not expect all illegal buildings to be demolished, and the amount of illegal buildings that had to be demolished depended on the extent to which they were satisfied with the efforts made by the local governments to execute the policy. As Local Official A comments,

I do not think they actually expected all of the buildings to be demolished (*because they knew very clearly that it was impossible*), but they might, secretly, have set a minimum percentage (*below which they would assume that the local governments had not tried hard.*)

The greatest resistance to the campaign came from the farmers who had built workshops or houses on their own land or on land leased directly from villages. A typical example involved Township H, one of the most developed townships in Dragon County located to the north of Dragon City. The farmers living close to the township capital have a national reputation for being good at manufacturing textile machinery. They built workshops or large houses on land leased from villages, and were doing well with their businesses. They were angry after being told that their buildings were illegal and had to be demolished. Local Official F observes that,

These farmers were very angry for a good reason. Last year, they were praised by the government for having set up a model for building up “New Socialist Countryside”, and their success stories were televised on the county’s official

---

255 Which is a national program whose objective is to improve the living standard of farmers.
television. Just one year later, the government went there to tell them that their buildings were actually illegal and had to be demolished. The farmers were not only angry, but also puzzled by the government’s dramatic change of heart.

The confrontation between the local governments and the affected farmers during the crackdown became very severe. The county government had to send the police in some cases to take down illegal buildings by force. Farmers threatened local officials responsible for the crackdown by saying that they would do “anything” to protect their properties. It was no joke, because some farmers had invested their lifetime savings in these buildings, and some had borrowed money from relatives. Therefore, the local governments were very concerned about potential escalation of the confrontation, which was likely to result in injuries or even deaths.

It was thus not surprising that most of the buildings had to be allowed to remain. For example, in Village L, most of the houses built on prime farmland were fined 15 yuan for every m² of land area occupied, and were allowed to continue to exist. Even so, the owners of the houses were very displeased. Farmer E comments that,

The construction of these houses had been encouraged by the township government. The project had been regarded as an “investment promotion project”. Some of the owners of these houses had even received a certificate from the township government for their contribution (to the local economy) and an award of 5,000 yuan. They did not understand why the government had changed their mind so soon, and were puzzled about who should represent the government. I heard that the relevant township leaders were “punished” for their lack of supervision by being assigned to similar positions in other townships…

As a usual practice, some county-level leaders had to be “scapegoats” in order to show that the campaign had achieved expected outcome. A Vice Major, a former Vice Mayor, and the Director of the County BLR each received party’s disciplinary warnings; but, other than that, their political careers were not affected. As a matter of fact, the county government of Dragon was thought to have done such an excellent...
job in cooperating with the higher authorities during the crackdown campaign that the Director of the County BLR was invited to a national land administration conference - as the representative of a “model” county for land administration - to introduce the successful experiences of Dragon County in implementing national land policies.

From a national perspective, the 2007 crackdown campaign issued a serious deterrent, but could not be effective in correcting informal land conversions, for several reasons: First, only fewer than 100 out of at least 600-700 Chinese cities were inspected during the campaign. Second, the campaign targeted informal conversion of prime farmland only, whereas other types of informal conversion were unaffected. Third, the national government had to rely on local governments to execute the crackdown. The incentives of local governments to cooperate became weaker level by level down, allowing for much room for lobbying. In addition, local governments could always figure out ways to avert national policies.

This crackdown campaign was also incapable of demonstrating the “determination” of the national government to implement the farmland protection policy in a strict manner. It is easily conceivable that if the national government had been really determined, a much more effective way would have been to hold local mayors and party secretaries accountable, and remove them from office if necessary. The fact that this was not done showed, again, that the national government wanted to continue to leave some leeway for local governments.

From a local perspective, the campaign had some consequences. First, it created social tension between the affected land users and the government. Second, it had a
negative impact on Dragon’s local economic and financial situation. Third, it was likely that the county and township governments promised personal favors to some existing users so as to take down their buildings in order to fulfill the requirements by the national government. This might give rise to corruption problems in the future. Fourth, the political careers of the relevant local officials were not affected, but the campaign served as a deterrent against informal conversion of farmland. In the future, incidence of informal farmland conversion is expected to be significantly lower, but will depend on people’s assessment of the probability that they may get away and the level of potential benefits they can receive from such land conversion. Conceivably, this crackdown will effectively deter small developers or farmers who do not have strong backing from local governments. Therefore, a direct result may be that land supply will become more scarce in the future, allowing only those with strong political backing - and thus lower risks - to engage in informal land conversion and receive even greater benefits.

5. Summary

The informal land market in Dragon has been critical for the rapid economic growth of Dragon County in recent years. Local government leaders, developers, villages, farmers and urban residents all benefit from informal land conversion.

Two crackdown campaigns by the national government, in 2003 and 2007 respectively, had different consequences - the former being largely nominal, and the
latter more decisive and serious - but neither stopped, or was meant to stop, informal land conversion.
CHAPTER 11 EFFICIENCY AND EQUITY CONSEQUENCES

1. Introduction

This chapter summarizes the efficiency and equity consequences of the Chinese land conversion process, and concludes that, given the existing political institutions, the land system functions reasonably well as far as economic efficiency is concerned, but is highly inequitable.

2. Concepts of efficiency and equity

Efficiency and equity are the two policy objectives of land administration. They are interwoven rather than separate. This section explains these two concepts and their relationship.

Efficiency

As mentioned in the Preface, efficiency means putting land to its highest and best use. The concept of efficiency for land use is based on that of “land rent”, which was explained by Ricardo in terms of differences in land fertility in Principles of Political Economy and Taxation (1817). In the Ricardian theory, there is a fixed total supply of land, but the land varies widely in quality, relative to the purpose. It is the differences in quality that give rise to the rents.
Von Thunen (1826) developed a complementary land rent theory that explained rent in terms of locational differences with respect to a central market. Figure 18 shows the land rent gradients of commercial, residential and agricultural land uses. To the left of distance A, land should be put to commercial use which produces the highest land rent; whereas to the right of distance B, land should be used for agricultural purpose. In other words, if market price could accurately reflect the value of land, land should be put to the use that gives the highest market price.

Of course, this is an over-simplified model based heavily on agricultural productivity in Ricardo’s case and transport considerations in Von Thunen’s case. In reality, land value is affected by many other factors, such as the quality of the neighborhood, and proximity to public transport, parks, good schools, or beaches, etc. Moreover, in a dynamic world, land value changes over time. What appears to be the highest and best use at one time may turn out to be inefficient over the long term.

![Figure 18 Land Rent Gradients of Different Uses](image-url)
Equity

In general, public dialogues regarding distributive justice revolve around the categories of equality, need, desert, and choice.\textsuperscript{256} However, there is no consensus among philosophers regarding an appropriate balancing of all these factors and what distributive justice really is.\textsuperscript{257}

Utilitarians are concerned with the maximization of the total benefits, not the distribution. The maximization of benefits may require taking away from someone and giving to someone else. Individual people are means, not ends. Rights are not necessarily inviolable, except in so far as they promote a greater total good. The implication of this view for land conversion is that the interest of some people can be sacrificed for a larger public interest.

Libertarian liberals, such as Kant and Nozik, think individuals cannot be sacrificed for the sake of a general good. People are treated unjustly if their rights are violated. In their view, if the original acquisition of a holding is right, and the transfer is right, then the subsequent acquisition of that holding is just, and no one else is entitled to that holding. The implication of this view for land conversion is that if the process is just, then the result is justified.

Egalitarian liberals, such as Rawls\textsuperscript{258}, think that inequality can lead to stigmatization and unfairness in the political process, and therefore public policies should favor the least advantaged. The implication of this view for land conversion in

\textsuperscript{256} Bill Galston (2002)
\textsuperscript{257} The summary of philosophical views in this section draws on John Arthur and William H. Shaw (1991); Jean Hampton (1997); and James Rachels (2002)
\textsuperscript{258} John Rawls (1971)
the Chinese context is that farmers, or the economically disadvantaged, are entitled to preferential treatment.

Some philosophers, such as Rachels, think that, in determining whether people are treated justly, we need to consider both rights and what people deserve. They think that what people deserve depends on their past actions. The implication of this view for land conversion is that the owners of land are not entitled to all the increment in land prices, which is largely due to urbanization.

**Relationship between efficiency and equity**

From a societal perspective, land use efficiency requires that the aggregate rents of all land shall be the highest over time. However, land use has “externalities” i.e. land use in one area may affect the value of land in other areas. For example, a landfill may lower the value of its neighboring residential land, whereas a park does the opposite. Therefore, various governments typically use planning as a tool to regulate land use.

However, in his 1960 article “The Problem of Social Cost”, Ronald Coase argued that, if property rights are clearly defined and there are no transaction costs, a private market can in fact deal with externalities. If one is negatively affected by the action (i.e. an “externality”) of another, the former can always pay the latter to stop it. Such bargaining will always lead to efficient outcome regardless of the initial allocation of property rights. So, at least in theory, the main problem of externalities may be equity.

---

259 Rachels (2002)
rather than efficiency. In practice, the Coase Theorem often does not hold because some externalities involve so many parties with poorly defined property rights that trading through Coasian bargaining becomes impossible. Nevertheless, a private market is capable of addressing at least some local externalities. Therefore, it is desirable for government to clarify property rights and create institutions that minimize transaction costs so as to allow misallocation of resources to be corrected as cheaply as possible.

The Coase Theorem also applies to the trading of land use rights between farmers and developers during the land conversion process. A developer can buy land use rights from a farmer so as to put the latter’s land to a higher and better use. Coasian bargaining will make both parties benefit and lead to efficient allocation of land resources, provided that trading in land use rights is possible and there are no transaction costs. In reality, the bargaining process is more complex because it typically involves intervention by planning authorities. In the Chinese context, the government serves as the agent between developers and farmers. As described before, it buys land at fixed prices from farmers, but allows developers to bargain with it. (This monopoly power by the government may be changed soon. As mentioned, the CCP central committee just passed a resolution in October 2008 to allow some collectively owned lands to enter into the land market directly. This will be discussed in Chapter 12.) The following section will discuss the effects of this process.
3. Efficiency and equity consequences of the Chinese land conversion process

This section summarizes the efficiency and equity consequences of the Chinese land conversion process from the following aspects: land supply control, informal land market, land speculation, quality of land use plans, information asymmetry, competitiveness of the land market, Guan Xi networks, and the complicated procedures for seeking development permission, etc.

3.1 Land supply control

As suggested earlier, the reason for the state to control land supply is that the externalities (whether negative or positive) of various land uses are often not captured by market rent prices. This is illustrated in Figure 19.\(^{260}\) Suppose the total amount of land available (AB) is divided by two uses, urban and rural. (For simplification, this ignores quality and transportation differences among different pieces of land.) The market demand curve for urban use is \(D_{\text{urban}}\), and the market demand curve for rural land is \(D_{\text{rural}}\). If left to the market without government intervention, the efficient market equilibrium will be C: the amount of land for urban use will be AC, and the amount of land for rural use will be BC.

\(^{260}\) Figures 19, 22, 23 and 25 are used in Evans (2004a)
However, land use has externalities. For example, farming contributes to food self-sufficiency, employment in the agricultural sector, prevention of urban sprawl, and protection of rural and environmental amenities, etc.\textsuperscript{261} If these positive externalities were internalized, the demand curve for rural land in Figure 19 would become $D'_{\text{rural}}$. Urban land uses contribute to local fiscal revenue, generate employment opportunities, and ease housing prices in cities, etc., but may also lead to pollution and traffic congestion. Suppose the net externalities of urban land use are positive and, if internalized, shift the demand curve of urban land use to $D'_{\text{urban}}$. Therefore, the amount of land for urban uses should be $AC'$, and the amount of land for rural uses should be $BC'$. In reality, of course, most of these externalities of land use cannot be internalized in market land prices, so there is a need for the state to allocate the amount of land for different uses. China’s farmland protection policy can

\textsuperscript{261} Gardner (1977) in Goetz (2005)
be seen in this light. In theory, it is an effort by China’s policy makers to try to achieve land use efficiency through imposing a limit on the amount of developable land and thereby correcting market failures in allocating land resources.

**Efficiency consequences**

Figure 20 shows the effect of land supply control. (Again, this is a simplified model, based heavily on transportation considerations and ignores differences in land.) It restricts the amount of land permitted for urban uses to OY₂, and raises the price of urban land from P₁ to P₂. The key question for policy makers to consider is how much OY₂ should be, or how large the difference between P₂ and P₁ should be.

![Figure 20 Effect of Land Supply Control](image)

Theoretically, this can be calculated. An efficient outcome of land conversion requires that

Rent of urban land (P₂) + Net benefits of the externalities of urban land uses = Rent of agricultural land (P₁) + Net benefits of the externalities of agricultural land uses

Therefore, (P₂ – P₁) should be equal to the net benefits of the externalities of agricultural land uses minus those of urban land uses.
Regrettably, most externalities are extremely difficult – if possible at all – to quantify. Although economists may use certain methods such as Contingent Valuation Models to estimate the benefit and cost of some externalities, the results of such estimates are almost always controversial. In all likelihood, a giant model devised for the purpose of determining a land supply control target for a large country like China would be too complex and controversial to be of much - if any - practical value to policy makers. Moreover, each local area is a special case, so a model is needed for each place.

Thus, although there is a theoretical basis for land supply control, it is impossible in practice to base such policies on a scientific analysis. Consequently, policy makers end up having to determine a land control target in a highly arbitrary manner. For the same reason, it is impossible for this dissertation to evaluate in an accurate manner whether the Chinese farmland protection objective is set at a reasonable level.

Nevertheless, it is useful to compare the market values of urban and agricultural lands at the urban fringe. This, as said, may not enable the dissertation to draw a firm conclusion regarding whether the farmland protection target is too tight or too loose, but will provide a background for a discussion of the efficiency consequences of the other aspects of the land conversion process.

In Dragon, the market prices of land for real estate development were at least 600,000 yuan/mu for any location at the urban fringe of Dragon City in 2005. (This is a very conservative estimate. Actually, in most locations in the Dragon EDZ, the
prices have been more than 1.5 million yuan per mu since 2006.) As mentioned, the duration of the use right to the land auctioned for real estate development is typically 50-70 years. Assuming a low discount rate of 0.03 and 70 years of use right, the annual net income from the land is at least 20,000 yuan per mu.\(^{262}\)

As regards the value of farmland, there can be two measures. One is the net income from farming, which, as described in Chapter 2, is about 600 yuan/mu at most in Dragon County. According to this measure, the price difference between land for real estate development and farmland is about 30 times (i.e. 20,000 yuan/mu divided by 600 yuan/mu) at least. It should be noted that, when the farmers in Dragon County say that their net income from farming is 600 yuan/mu, they typically do not regard their own labor as a cost. Otherwise, their net income from farming will be even less. Another measure of the value of farmland is leasing prices, which, as mentioned in Chapter 2, are usually less than 300 yuan/mu in Dragon County. According to this measure, the price difference between land for real estate development and farmland is at least 60-70 times (i.e. 20,000 yuan/mu divided by 300 yuan/mu). This creates presumption, if not proof, of inefficiency.

The case study in Dragon also shows that land supply control has had two other visible effects: First, it has had a significant impact on people’s expectations about future land scarcity, leading to widespread speculation on land and housing. As described in Chapter 5, many apartments are left unoccupied, which is clearly inefficient.

\(^{262}\) Assuming a discount rate of 0.05 and 70 years of use right, the annual net income from the land would be at least 30,000 yuan per mu.
Second, it serves to prevent urban sprawl. Most new developments are concentrated in Dragon City and the township capitals. There are not many scattered or leapfrog developments except in Industrial Park A and B. Commercial, residential and retail developments are usually mixed, thereby reducing the need for transportation. Except in villages, there are hardly any single-family houses on large lots. Given China’s land scarcity, such compactness of development can be viewed as an indication of efficiency, because it promotes high-density development and saves land for higher and better uses in the future. Three factors seem to have contributed to such relatively compact development: First, informal land conversions have to occur at locations close to Dragon City or the township capitals. Otherwise, they would be too visible and thus become easy targets for crackdown by higher-level governments. Second, most investors and developers would not choose to locate their projects at isolated sites, which usually lack public infrastructure (such as tap water, power and sewer system) and related services. Third, single-family housing is, in principle, forbidden by the national government due to land scarcity. This, however, should not be construed as meaning that there is no low-density development in Dragon. As will be discussed later, the density of some development projects could have been higher so as to make more efficient use of land. However, it is fair to say that, other things being equal, a land supply control is conducive to promoting high-density development.

In this respect, it is worth mentioning that there are some existing international
studies dealing with the effects of land supply control on the prices of land and housing in other countries, such as the US, European countries, Japan, and South Korean. One of the most studied topics is the effect of Urban Growth Boundary (UGB) on land value in the US. UGB is a line that separates urban land from rural land. Land within UGB can be developed, while land outside the UGB may not. Its main purpose is to encourage compact urban development. The UGB is updated periodically in order to accommodate development needs. Since 1973, UGBs have been implemented in some US cities, particularly in the State of Oregon, which is seen as a land use laboratory and where a number of empirical studies have been conducted on the impacts of the UGB on land value. Nelson (1985, 1986) finds that land values outside the UGB were lower than inside, and Knaap (1982, 1985) concludes that the effects of the UGB were significant in the Portland Metropolitan Area. Knaap and Nelson (1992) argue that an UGB, if appropriately determined, could improve short-term efficiency, because information about future land use policy is capitalized into land values and market participants react accordingly in order to avoid bad investment decisions caused by lack of information about future development.

Of course, in addition to the UGB, there are other types of zoning requirements in the US. These zoning restrictions typically contribute to higher land and housing prices. Theoretically, they would have to – unless they are not binding. Empirical studies by Glaeser et al (2002, 2003) show that zoning restrictions often have a

---

264 Knapp and Nelson (1992)
265 Knaap and Nelson (1992), P63
significant effect on housing supply and hence housing prices, and measures of zoning strictness are highly correlated with high housing prices in US cities.

Land supply restrictions that are similar to the UGB in the US also exist in other countries, such as Japan, Korea, the Netherlands and the UK. In Japan, according to the Urban Planning Act of 1968, most cities and the surrounding areas were delineated into “urbanizing areas”, which should be developed within approximately 10 years after the delineation, and “urbanization-curbing areas”, where development should be curbed. Korea also imposes stringent controls on land use. In Korea, only about 5 percent of the land surface is in any urban use, whether housing, commerce, or any other urban type. In particular, green belts are set aside to restrict urban development. This has had an impact on land value. Between 1962 and 1993, the land prices for Korea’s 12 largest cities increased by 791 times. The average annual inflation adjusted increase in urban land values in Korea during this period was 11.3%. In the UK, virtually all “developments” have been subject to planning permission, and applying for planning permission often proves to be a lengthy and costly process. In the Netherlands, in order to prevent inundation of the land caused by sea erosion and sinking ground levels, the national planning authorities forged links with provincial and local planning authorities under which the municipalities act as both planning authorities and the supplier of building land at the

266 Mori (1998)
268 Lee (1997), P. 1072
269 Barlow (1993); Bramley (1993); Evans (1991); Adams et al. (1992); Mori (1997)
local level.\textsuperscript{270}

Some existing international studies also document a large difference between the values of land for urban uses and those for agricultural use in these countries. For example, Mori (1997) notes that the difference in Japan is about 50-150 times in 1993, as compared with 50-400 times in the UK in the 1980s and 129 times in the southeast of England in 1991. Evans (1991) notes that such large differences in land values are a form of inefficiency, and that land supply restrictions serve to “preserve millions of acres unspoiled for the few and spoil the urban environment for the many”.\textsuperscript{271} He also notes that, as obtaining planning permissions becomes financially profitable, it leads to rent-seeking expenditures that results in “no useful economic benefits, only a deadweight loss”.\textsuperscript{272}

**Equity consequences**

The distributional impacts of land supply control are not even across all the players in Dragon, as summarized below:

First, farmers do not receive a fair share of the increased benefits from land conversion. The prices paid to farmers whose land is converted are not determined through bargaining, but are set by the government and stay relatively fixed at a low level. However, one reason why most farmers choose to defer to the government during compulsory land conversion is that farming is a very unattractive means of making a living. Some “nail” farmers may receive more by adopting appropriate

\textsuperscript{270} Needham (1995); Badcock (1994); Mori (1997)
\textsuperscript{271} Evans (1991), P861
\textsuperscript{272} Evans (1991), P869.
strategies. However, if too much resistance from farmers is anticipated, the local
governments may choose to avoid certain locations or use force to suppress nail
farmers.

Where land is not converted due to land supply control, the farmers do not receive any compensation for protecting farmland. In general, the villages located close to Dragon City are much wealthier than those in remote areas. In particular, farmers in the urbanized villages have benefited from the increased value of their houses, because they can rent rooms to people working in the city who cannot afford to buy apartments. The benefits from room renting are not insignificant, but modest. The reason is that, as discussed in Chapter 10, the local governments forbid farmers from building new multiple-story houses in order to avoid paying too much compensation to these farmers should it become necessary to convert their houses to higher-density development in the future.

The dissertation finds that working or living in the city provides psychological benefits for many people. Historically, there has been a large gap in the quality of life between cities and rural areas. Cities provide much convenience that rural areas do not have, such as proximity to schools, hospitals, shopping malls, and recreation facilities, etc. Therefore, farmers living far from Dragon City or township capitals look forward to urbanization.

Second, land supply control favors big developers. Due to limited supply of land, the cost of establishing businesses increases for industrial developers as land is more
expensive. It is very difficult for small businesses to acquire land, unless they have Guan Xi with key officials in the local governments. On the other hand, large enterprises often acquire land at a low cost and receive favorable tax treatment because they are deemed capable of making greater contribution to local economic growth.

Real estate developers are affected by land supply control in two ways. First, since land price is higher, they have to substitute land with capital. Second, it is difficult for them to have a succession of land supply so as to keep labor and manage cash flow more efficiently. Before the early 2000s, the land market was much less mature, so the real estate companies having close ties with the local governments were able to make a fortune with low cost and accumulate sufficient capital for future development. By now, the land market has become more competitive because all land for commercial real estate development is sold through open auctions. It is thus less easy for them to make large profit, even for those having close ties with the local government.

Third, land supply control makes planning officials very powerful since development permissions are scarce. Most public officials are cautious in take bribes in the form of cash or valuable gifts, but are practically safe to accept certain types of personal favors in return for those they provide to others. The case study in Dragon did not attempt to investigate exchanges of personal favors between public officials and developers. However, it is obvious from the discussions in Chapter 9 that personal gains in one form or another by public officials are a natural consequence of land
supply control.

Fourth, land supply control creates a public anticipation about rise in housing prices, leading to widespread housing speculation by Dragon’s urban residents, as described in Chapter 5. This contributes to sharp rises in housing prices since the late 1990s, making housing unaffordable to low-income urban residents. On the other hand, many smart middle-class people have benefited significantly from housing speculation.

Lastly, most of the developable land quota received by Dragon County is kept for Dragon City. As described in Chapter 4, each township receives some land in the EDZ or the two industrial parks to locate its “investment promotion projects”. Despite being a good way of promoting economic efficiency, this investment promotion model may have contributed to a widened gap between Dragon City and the remote townships, for two reasons: First, farmers living far from Dragon City do not have convenient access to employment opportunities offered by new investment. Although it is common for young people from remote townships to work in Dragon City, many people over the age of 50, particularly married women, stay at home. In contrast, farmers living close to Dragon City, regardless of age and gender, are much more likely to be employed in non-farming sectors due to more job opportunities and proximity to the workplace. A second reason is that the remote townships are losing young and educated people to Dragon City and other more advanced areas. Due to a lack of infrastructure and educated labor, these townships may have been caught in a “poverty trap”. Moreover, some of them have even become new locations of
heavy-polluting enterprises, as described in Chapter 10.

3.2 Informal land conversions

Figure 21 is an illustration of the workings of the informal land market in Dragon. The higher-level governments undertake crackdown campaigns on the informal market from time to time. Each campaign typically lasts for a few months, but is denoted by a single time (\(T_1\), \(T_2\) or \(T_3\)), for simplification. The amount of land conversion decreases significantly following each crackdown, but increases gradually over time. The timing, frequency and intensity of each crackdown depend entirely on the wavering political will of the national government, and therefore are not predictable to the local governments or other local players.

Each crackdown effort does not last for a long time for two reasons: First, The relevant authorities usually do not have the financial capacity or human resources to sustain such crackdown efforts, because non-compliance is by no means unique to land policy only, but is a general phenomenon across many policy areas. Once a critical mass of violators has been formed in multiple policy areas, it is very difficult and costly to crack down on all of them. Second, such crackdowns serve as a deterrent for potential trespassers in the future, but are not intended to eliminate the informal market entirely, as discussed in Chapter 10.
Efficiency consequences

The efficiency consequences of the informal market are as follows: First, *Guan Xi* is partly a substitute for pricing, and provides a channel for individuals to influence the local governments, making a rigid planning system responsive to actual needs and thus more efficient. However, people have to devote much time and financial resources to building up and maintaining *Guan Xi* networks, which is very burdensome. Many people would definitely be better off if nobody engaged in such efforts. In this sense, *Guan Xi* networks are inefficient.

Second, in order not to attract attention, the private parties engaging in speculative or “edge ball” activities often have to do silly things to assert that they are not doing what they are doing. For example, as mentioned in Chapter 5, some land speculators have built workshops that are completely useless except to help them
pretend that they are not what they are. This is clearly inefficient. In some cases, edge ball players have to develop commercial or residential projects according to the density requirements made for industrial use, thus preventing some land from being put to higher-density use.

Third, the crackdowns, whose purpose is, in Chinese terms, to “kill a chicken to frighten the monkeys”, has had a negative effect on Dragon’s local economy and reduced the welfare of a large group of beneficiaries of informal land conversions. Therefore, the crackdowns are economically inefficient in themselves. A more serious consequence of these crackdowns is that they bring down the supply of land to lower levels and widen the gap between demand and supply. Insofar as the beneficiaries of the informal market are concerned, it is fortunate that each crackdown effort does not last for long due to a lack of resources and particularly of determination by the national government, such that the informal market may resume soon after.

**Equity consequences**

Almost all the local players have benefited from the informal land market, but to varying degrees. First, villages benefit from renting land to industrial enterprises. Other things being equal, a village’s financial situation differs tremendously depending on whether and how the village engages in informal land conversion, as discussed in Chapter 10. When informal conversion involves reserve land only, the village collective typically keeps all the benefits. The village leaders are supposed to report any earnings of the collective to the township, but are generally thought to have benefited personally in one way or another from informal land conversion.
Second, farmers benefit from the employment opportunities generated by informal land conversion by villages. In particular, the farmers living close to Dragon City have benefited the most. Wealthy villages are also able to take better care of collective affairs, improve infrastructure, and even provide affordable housing for farmers. Nevertheless, farmers are the most vulnerable players during land conversion. A first reason for this is that, absent an independent judicial system, farmers do not have the political or financial capacity to seek political protection should there be any disputes between them and the other players. A second reason is that individual farmers have to rely on capable village leaders to build up Guan Xi with the local governments in order to enjoy the benefits of informal land conversion. Some individual farmers do engage in informal land conversion themselves by building up workshops or large houses, but often become the easiest targets for crackdown by higher-level governments, for lack of political backing, as described in Chapter 10.

Third, developers need to maintain good relations with local governments in order to receive permission or political protection for informal land conversion. Theoretically, the greater the probability of receiving development permission or political protection, the more time and financial resources a developer is willing to spend on building up Guan Xi with public officials – and vice versa. Thus, big developers have an advantage because they have more resources. They may not be always successful in trying to obtain permission or political protection, but will benefit in the long term from the sum of all their efforts. Small developers, on the other hand, are less capable of diversifying risks, and are thus constrained to devote a
large amount of resources to building up Guan Xi if the probability of receiving development permission is low.

Fourth, since the other players depend on their support – or at least their implied permission for informal land conversion, government officials typically receive personal favors. In addition, informal land conversion helps promote local economic growth and make Dragon a modern-looking city. This is an important political achievement for local government leaders, who are generally regarded as being “bold” and “capable” by their bosses at provincial and municipal governments and by Dragon’s local officials and developers.

Fifth, informal land conversions have played an essential role in building Dragon into a vibrant city with modern infrastructure, wide roads, and nice-looking buildings – which people enjoy working or living in. They also make housing more affordable. In particular, some low-income urban residents benefit from “edge ball” housing projects, which have much lower prices than “official” ones. Moreover, the people running restaurants or gift shops benefit from the socializing dinners or gift exchanging activities aimed at building up Guan Xi networks.

Sixth, the informal land market also has inter-jurisdictional consequences. The jurisdictions whose political leaders are more bold and more adroit at building up Guan Xi with their higher-level bosses typically benefit more.
3.3 Land speculation

As mentioned, the concept of “highest and best use” must be seen in a temporal context. What appears not to be the “highest and best use” at one time may turn out to be the desirable land use option from a long-term perspective. This is illustrated in Figure 22. Before $T_1$, farming is the best use for land. As the city expands to the rural area, industrial use starts to generate higher rent than farming from $T_1$. However, land may continue to be used for farming until $T_2$ when it will be converted to residential use. The reason is that, as the place becomes more and more densely populated, residential use will eventually produce higher rent than industrial use at $T_3$. The decision will depend on land speculator’s expectations of the future rents of various uses and his calculation – discounting rents in future years at an appropriate interest rate - of which use can produce the highest aggregate rent across all years, and also depend on the costs of one use toady changing to another use tomorrow.

As a result of urban and economic growth, the price of land generally increases over time. Price changes reflect two things: One is transition of land from lower to
higher uses; the other is higher density (i.e. land is substituted with capital). However, construction cannot easily be built and demolished soon after. Therefore, holding land out of development, in some cases through private speculation, has a role to play.

In the Chinese system, the temporal allocation role is designed to be played by no one but the government. In particular, the national government does not allow developable land to be held idle by a private party for more than two years. However, as described before, this policy is not followed in Dragon and many other Chinese cities. In Dragon, private parties typically acquire land at low cost in the name of “investors” through Guan Xi. Since the land acquired in this way is usually zoned for industrial use, the speculators need to wait for a good opportunity in order to develop “edge ball” real estate projects on the land by themselves or to sell the land back to the government at a higher price for real estate development.

It is fair to say that, to a large extent, the local governments in Dragon have allowed, though perhaps not intentionally, private parties to take over the temporal allocation role. In general, private land speculators have improved land use efficiency through saving land for higher uses. One such example is Industrial Park A, which, as mentioned, was planned for industrial use at the beginning but has been re-zoned for residential and commercial use. Most of the land in the park had been sold to “investors” before the re-zoning, but the park is still largely empty because most of the so-called “industrial investors” are actually land speculators and have saved the land from immediate industrial development.
Another example is the Dragon EDZ, which has a mixture of industrial, residential and commercial developments. Many of the industrial enterprises established in the late 1990s and the early 2000s have become “out of place” by now. Fiber & Cloth Making Company A and some rubber making companies, for example, have been shut down or relocated to suburban townships. Some enterprises, such as the Dragon Paper Making Company, have even affected negatively the housing prices of nearby neighborhoods and the quality of the life of the residents living close by, as will be described later. Some do not have negative externalities, but are not making the best use of the land, which could already be put to higher uses. In contrast, most of the “holes” (i.e. undeveloped land) in the EDZ are land acquired by private parties for speculative purpose. From an economic perspective, these holes serve to meet an increasing demand for residential and commercial development, due to the rapid expansion of the city, without requiring demolition or relocation of existing developments.

In general, private parties should perform better than the government in playing the temporal allocation role, other things being equal. The main reason is that private parties have much stronger incentive than the government to maximize benefits from land conversion. In addition, public officials usually do not stay in the same positions for long, due to promotion or shifting of jobs within the government. They are primarily concerned with their own present political interests, rather than the interests of their successors in the future.
However, private speculators face serious constraints in trying to achieve efficiency. Since private land speculation is illegal, they need to wait for convenient opportunities to realize their profits. Sometimes, even if the timing of land conversion seems not to be optimal, they have to hasten their decisions simply because there is a “political” opportunity available. For the same reason, they may have to postpone their decisions at other times. To put it in a different way, the decisions of private speculators regarding the timing of land conversion often have to be based on when they can obtain sufficient support from the government through *Guan Xi* networks, not on when they think their profits will be the greatest.

The equity consequences of land speculation in the Chinese context are also clear. By allowing private land speculation, local governments give away a large portion of the land conversion benefits to developers. The reason behind this must be that public officials benefit more from giving this role away to their *Guan Xi* than from retaining it for a public purpose.

3.4. Effects of the quality of land use plans

The quality of Dragon’s land use plans (i.e. the CLUP and urban plans) has affected efficiency and sometimes equity in two ways: a lack of a long-term vision, and the degree of detail.

**Lack of a long-term vision**

The importance of long-term certainty provided by land use plans can be
illustrated using Figure 22. A developer who is confident about the long-term plan of an area would choose to convert farmland to residential use at $T_2$ in order to achieve long-term efficiency. Absent a long-term plan with a reasonable degree of certainty, the same developer may have to pursue short-term gains by choosing to convert the farmland at $T_1$.

As described in Chapter 4, Dragon’s land use plans lack a long-term vision, and are subject to constant changes. Consequently, incompatible land uses are not rare in Dragon. Some of them are probably unavoidable, because it is impossible for planners to predict future demand for and supply of land in an accurate enough manner and the implementation of land use plans is always influenced by the political processes of a society. However, many of the incompatible land uses might well have not occurred if the county government had been more forward-looking under an improved institutional structure.

Incompatibility is most evident in the Dragon EDZ, where residential and industrial sites are mixed. As mentioned, the current EDZ area was largely undeveloped before the mid-1990s. In order to promote investment, the county government provided much land in the EDZ to investors at low prices. By the time the county government made up its mind to develop a new city center on the eastern coast by implementing the AA1 and AA2 programs in the late 1990s, industrial sites already accounted for much of the land, and many of them were at some of the best locations in the EDZ. It is apparent that at least some of these locations should have been reserved for residential or commercial, rather than industrial, purposes, had the county
government of the time had a clearer vision about the city’s growth. As the value of the land occupied by these industrial enterprises has increased rapidly, it has already become economically desirable to convert these sites to higher uses, but this is often difficult because the government needs to pay a large amount of compensation to the existing land users in order to buy out their land use contracts.

Perhaps the best example to illustrate the efficiency consequences of incompatible land uses in the Dragon EDZ is the Dragon Paper Making Company, a government-owned enterprise located about 1 km to the east of Main Road D on the northern side of Main River A. Before 1994, the company’s main manufacturing plant was located on the western side of Main Road B on the outskirts of the old downtown. As the city expanded eastwards rapidly and people became aware of the pollution problems caused by the plant, the county government decided to move the plant to its current location, which had been bought by the company from Village B at a price of approximately RMB 30,000 per mu. A portion of the old site was auctioned by the county government for real estate development in order for the company to cover the cost of the relocation.

It has turned out to be a bad decision to have selected this site, which is now a densely populated residential area. However, at the time, the area around the site was almost completely empty, and the county government did not expect that it would decide by itself soon after to develop this area into a new downtown. After the relocation, the company continued to cause water and air pollution. Several years ago, in response to higher environmental standards and mounting complaints by the
residents living close by, the county government required the company to build a wastewater treatment plant. The plant is financed partly by the company and partly by the county government, and is used to treat both the company’s and municipal wastewater. Therefore, water pollution seems not to be a problem any longer. However, the smell from the pulp making process persisted for some time longer, and affected the value of the real estate properties in the neighboring areas to a significant extent. According to local residents, the prices of the apartments in the immediately adjacent areas of the plant were, on average, approximately 700-800 yuan/m² lower than apartments in comparable locations. The apartments located on the north of the plant suffered the most, because the wind mostly comes from the south, which is the direction of the ocean. The situation has improved by now because the company has been buying, instead of making, pulp since 2007. Incidentally, the company’ business has been declining since then - partly because buying pulp is more costly than making it. The recent financial crisis has made the situation even worse, and many workers have been laid off by the company.

Incompatible land uses like this are both an efficiency and an equity problem. It is an efficiency problem because the total economic value of the real properties in the area is lowered due to the existence of the plant. It is also an equity problem because an industry creates a local externality but the public has to bear the social cost. In theory, the paper making plant should compensate the affected neighboring community for their losses. However, Coasian bargaining does not occur in this case because the plant does not need to receive permission from the people living nearby in
order to discharge pollution and, as discussed in Chapter 6, the courts are almost useless in resolving disputes like this.

Incompatible land uses also exist in the Affordable Apartment Program (AAP) area. As mentioned, the AAP apartments were built in the late 1990s by the county government in order to attract people to live in the EDZ. Some of the apartments face the beach directly. As the land value in the area skyrocketed in recent years, a number of high buildings with more than 12 stories have been built, dwarfing the 6-story apartment buildings. There are already discussions regarding whether the first two to three rows of the AAP apartments facing the beach shall be removed to make room for higher-density and higher-value commercial development. However, this seems to be unlikely in the near future because of the high cost of compensating the existing apartment owners.

The recent planning for the “Three Urban Clusters” by Phoenix Municipality provides a long-term vision, and has the potential of improving land use efficiency. However, this long-term plan does not contain much detail and is no more than three circles drawn on the map. Even the county BOP officials have no idea how the clusters are to be developed. In addition, the plan has a very high degree of uncertainty, because it is impossible for Dragon to receive enough developable land quota to develop these areas unless the existing national land policy is changed.

Degree of detail

As discussed, Dragon County’s CLUP and CUP have a high level of generality
and vagueness. However, the Detailed Controlling Urban Plan contains such detailed land use requirements as types of land use, development density, building height, FAR, and infrastructure requirements, etc. These planning details provide some degree of certainty for developers and speculators, but may also reflect mistakes that require inefficient development actions. One example is building density and height. As illustrated in Figure 23, land with higher prices usually has higher development density and building height, since developers will substitute capital for expensive land. Therefore, density or height requirements should be seen from a temporal perspective. As land value increases as a result of urbanization, height and density requirements need to be adjusted in a timely manner to reflect such changes.

![Figure 23 Relationship between Land Price and Development Density](image)

In Dragon, economic factors are not an explicit consideration, though often taken into account intuitively, by planners in determining density and planning details. Currently, almost all the residential buildings in Dragon have six stories, even in the EDZ and the AAP II areas, which have the most expensive land in the city. Now, the
The local planners are responsible for determining planning details for Dragon City. However, developers, in pursuit of profit maximization, typically use their Guan Xi to negotiate with the planners for higher-density developments, as described in Chapter 9. Such negotiations may involve corruption, but often have a practical effect of improving land use efficiency by making development density more reflective of actual demand.

3.5. Effects of information asymmetry

Information asymmetry is a key source of inefficiency in land use because it prevents the affected parties, particularly developers and land speculators, from making the right calculations for profit maximization. It also affects equity because some parties can take advantage of their superior information to receive more benefits. The case study in Dragon shows that information asymmetry exists in three sets of relationships due to a rigid top-down system:

First, it exists between different levels of government. As discussed before, local governments have to guess about the extent to which informal land conversions are allowed by the higher authorities. This has resulted in some land conversion decisions having to be reversed during the crackdown campaign of 2007 - which is clearly inefficient.
Second, information asymmetry exists between developers and local governments. Developers who engage in edge ball or EFRL/EDNR projects have to guess about the possible reactions of the local governments to their projects. Typically, they need to use their Guan Xi to confirm their guesses, or lobby the relevant public officials not to “pay attention”. The time, energy and even money involved in such efforts could surely have been spent in other, more constructive ways. In addition, developers have to be responsible for acquiring, from the local governments, land use planning information, which is not publicly available in any useful form. For example, the Detailed Controlling Urban Plan of Dragon City is a most important document for developers. However, it is a very thick document, and the entire county has three copies only, all kept within the county BOP.

Third, information asymmetry also exists between farmers and the other players. Unlike developers, farmers generally do not have the awareness or capacity to acquire land use planning information from the government in an active way. This has had some efficiency consequences. For example, as described in Chapter 10, some farmers in various townships built workshops on their own land without knowing for sure the level of risks associated with such informal land conversion. They face much greater risks of being cracked down upon by higher-level governments. Another example is that, as mentioned in Chapter 2, many farmers from Village H assumed that compulsory land conversion would take place on their land but did not know when, and planted poor-quality trees instead of crops in order to wait to receive more compensation.
3.6. Effects of the degree of competitiveness of the land market

The government controls - at least nominally - the land conversion process. Therefore, if the sole purpose of the government is to generate revenue, it is possible for it to exercise monopoly power, such that the amount of land made available for development is less than the socially optimal level. In Figure 24, the socially optimal amount of land made available for development is $Q^*$. However, since the marginal revenue curve of a monopoly lies below the demand curve, the optimal amount of land made available for development by the monopoly is $Q^m$, which is less than $Q^*$. 

![Diagram]

Figure 24 Effect of Monopoly on the Amount of Land Made Available for Development

In reality, the county government of Dragon does not seem to have engaged in such strategic behavior, mainly for the reason that the developable land supply quota received by Dragon County always falls short of demand. Therefore, the county government often has no choice but provide to developers all the land that is available.
Another possible form of strategic behavior is that the county government may deliberately change the mix of urban land uses such that they generate the largest amount of revenue. As mentioned in Chapter 4, there are two means of revenue generation through land conversion: selling land for real estate development through auctions, or providing land to industrial investors with a view to generating tax revenue. Relatively speaking, the former generates revenue in *lump sum* rapidly, whereas the latter yields tax revenue slowly but for many years. This is illustrated in Figure 25. Suppose all the land on a local market is divided between commercial and industrial use. The demand curve for commercial use is $D_1$, and the demand curve for industrial use is $D_2$. On a competitive market, the allocation should be $AY_1$ for commercial use and $BY_1$ for industrial use, such that the price of the land is $P_1$. If the government has monopoly power, the optimal mix of land use for it would be $AY_2$ for commercial use and $BY_2$ for industrial use, because the marginal revenue curves ($D_1'$ and $D_2'$) of a monopoly for these two types of land uses lie below the demand curves ($D_1$ and $D_2$). Therefore, in theory, if one could figure out the demand curves for various land uses in an accurate manner, it would be possible to compare the actual supply of land for different uses with their socially optimal levels.
In practice, it is very difficult to do a quantitative analysis on this. Moreover, the case study in Dragon indicates that the local governments are unlikely to have supplied less land for commercial development in a deliberate manner, for two reasons: First, it is clear from the discussions in Chapter 9 that a public official often has a higher incentive to serve the needs of his Guan Xi than the collective needs of his institution, such that the government – as an institution – has weak control over the informal land market, and therefore is incapable of influencing land prices at will.

Second, facing financial pressure, a local government has incentives to sell more land for real estate development because, by doing so, it collects land rents in lump sum for the next 50–70 years. Industrial and infrastructure development contributes to local economic growth, but does not generate revenue rapidly or directly. Since the land to be auctioned for real estate development must already have been approved by
higher-level governments, local governments tend to use as large a part of the developable land quota as possible for real estate development while allowing the informal land market to satisfy the demand for industrial or infrastructure development.

On the other hand, it is obviously also difficult for a county government to engage in strategic behavior by supplying too much land for commercial real estate development, for two reasons. First, land supply is very scarce. Second, selling land for commercial development through public auctions requires approval from the higher-level governments, which is complicated and time-consuming. In general, the decisions of the county government on when and where to sell land for commercial real estate development are often *ad hoc*.

Of course, this does not mean that the land market in Dragon is fully competitive, because only big real estate developers and those having *Guan Xi* with the government are capable of surviving and making a large profit on the market. However, the case study in Dragon does suggest that it is not easy for a few developers to dominate the land market due to a large number of competitors – including those from other regions - at land auctions. More importantly, the composition of real estate developers is very complex, including formal real estate companies, edge ball players, and even villagers’ Committees - who are impossible to control.
3.7. Effects of complicated development approval procedure

As described in Chapter 8, the procedures for obtaining development permissions are very complicated and slow, which is a key reason for EFRL. Many EFRL projects are able to receive permission in the end, but some are not so fortunate and rejected. Although approval from higher-level authorities is not a precondition for an EFRL project to continue to exist, this has led to inefficient land use in some cases. For example, the proposed iron and steel project in Township F and I, described in Chapter 8, was initially rejected and stopped by higher-level governments although all the land required had been acquired and undergone initial development. If not for the recent global economic financial crisis, this project would not have received approval. Before its final approval, the land was held idle by the local governments for a couple of years – which was clearly inefficient because it should have continued to be used for farming. The ownership of the land had been transferred from villages to the government. The local governments did not allow farmers to come back to farm the land, because the former were afraid that the latter might refuse to leave when the land was to be needed by the government again. This project had also put a significant financial pressure on the county government because, as said, it had paid for land acquisition and initial land development but could not hope to recover the cost in the near future.

Relatively speaking, the approval procedure for real estate development on the land acquired through auctions is much simpler. The reason is that land auctions cannot be organized unless approval has already been given by the relevant
higher-level authorities; therefore, the land acquired in this way is granted land use
approval automatically. However, as described in Chapter 9, a developer still needs to
talk to the county BOP and BOC regarding development designs and
construction-related issues if he wants to maximize his benefits.

In terms of equity, complicated procedures tend to favor big developers over
small ones, since the former have great financial capacity to sustain business
operations and manage cash flows. Moreover, big developers typically have stronger
Guan Xi with planning authorities and can thus obtain approval more easily.

4. Summary

The efficiency consequences are difficult to assess due to many variables and
their complex interactions. Overall, the system seems to be doing reasonably well in
terms of pure economic efficiency, mainly for three reasons: First, the informal
market serves to make the system respond to local needs through Guan Xi networks,
and contributes greatly to local economic and social development. Second, the land
supply control imposed by higher-level governments has had the practical effect of
preventing urban sprawl and promoting high-density development. In this regard, the
Chinese farmland protection policy has served similar functions to those of the Urban
Growth Boundaries that exist in Oregon and some other regions of the US. Third, the
Chinese law sets a uniform standard regarding compensation to affected farmers
during compulsory land conversion. Such a law, when implemented by a powerful
government, raises serious equity concerns, but on the other hand has had the effect of minimizing transaction costs. Therefore, many large-scale infrastructure projects are able to be carried out and generate social benefits rapidly. Fourth, there is no clear indication of monopoly on the land market by local governments or developers, due partly to widespread informal land conversion activities and partly to the scarcity of land supply.

However, the case study also reveals various forms of inefficiency. Many of them are probably unavoidable under any system, but some can clearly be prevented had the system been designed in a better way. First, from a societal perspective, efforts to build up Guan Xi networks represent an economic loss, because most people would be better off had such efforts been unnecessary. Second, crackdowns on the informal market are necessary, from the perspective of the national government, to preserve the authority of national policies, but have had a practical result of disrupting a mechanism that serves to fix the shortfalls created by existing policies. Third, due to the informal nature of private speculation, private parties face political constraints regarding the optimal timing of land conversion, and often have to do silly things to assert that they are not doing what they are. Fourth, the land use plans of Dragon County lack a long-term vision and are subject to constant changes, leading to incompatibility and other forms of inefficient land uses in Industrial Park A and the Dragon EDZ. Fifth, information asymmetry exists between levels of the government, and between the government and the other players. This has resulted in significant efficiency consequences, such as the economic loss caused by the crackdown
campaigns by the national government in 2007. Sixth, the procedure for seeking development permission is very complicated, representing another form of inefficiency.

The case study also suggests that all the players including farmers - the most disadvantaged group - have benefited from land conversion. However, the distribution of the benefits is highly unfair, for several reasons: First, the stronger receives more. Due to the absence of any independent referees, the land conversion process is governed largely by the “law of the jungle”. The stronger and the tougher glean more benefits. Specifically, three groups benefit the most: The first group includes those who are either powerful or have powerful “direct Guan Xi”. They acquire land at low costs and benefit from speculation or by engaging in edge ball projects. The second group includes those who are shrewd, bold, or lucky. They understand very well that a best way to make a fortune rapidly is to exploit the “opportunities” that are only possible under an opaque political system. In the 1990s, they rented land directly from villages because they wanted to do business or that they saw the potential to make a fortune out of the land. Later, when the value of land increased dramatically, they managed to develop sufficient Guan Xi to formalize such land use, and then either sold the land back to the government for real estate development or engaged in “edge ball” real estate projects by themselves. The third group includes the so-called “middle-class” people, consisting mainly of company managers, self-employed business people, some teachers, and some public servants. They do not have the
financial or political capacity to acquire land, but are able to benefit from housing speculation.

Second, the public, particularly farmers, are excluded from the land use planning process and land conversion negotiations. Village leaders often have stronger incentives to collude with township officials than represent farmers, as discussed in Chapter 1. Local governments carry out compulsory land conversions in the name of “public interest”, the determination of which is at the complete discretion of individual government leaders. Farmers do not have a final choice - to sell or not - regarding land conversion decisions.

Third, the public revenue from land conversion lacks accountability. As mentioned earlier, the increases in land value are mostly a result of urbanization, so private land owners are not entitled to all the benefits from land conversion. Therefore, the government has a legitimate role to play in distributing the benefits of land conversion. However, under the existing Chinese political structure, there is not an effective accountability system to supervise the spending of the public revenue generated from land conversion. Land conveyance fees are often not reflected in the regular budget of the government, and local officials care more about satisfying the needs of their own Guan Xi and impressing their bosses at higher-level governments with “image projects” than about responding to the needs of the people they are supposed to serve.
PART III POLICY THOUGHTS
INTRODUCTION TO PART III

As discussed in Part II, the existing system for land conversion relies heavily on informal Guan Xi networks to respond to local needs, and is socially unfair. A typical textbook's design of an institutional framework to improve the system in a fundamental way would look like Figure 26. Under such a new system, the various players are empowered to influence each other through effective “formal” channels: the government works in a decentralized and transparent manner; an “independent” judicial system is responsible for settling disputes; and, the media, the civil society and the general public supervise the system by exercising the right to free speech.

Unfortunately, such an institutional framework is not practical in China, at least in the near future, for two reasons: First, such a reform would fundamentally weaken
or even threaten the political power of the existing regime. Second, from the perspective of the existing regime, a fair and participatory policy framework will inevitably increase transaction cost and thus have a negative impact on economic efficiency - the single most important policy objective of the regime.

Part III will discuss these issues in China’s historical policy context based on the findings from the case study in Dragon County. Chapter 12 will summarize the main lessons from the case study, and assess policy options. Chapter 13 will discuss the tradeoffs between efficiency and equity in a historical context but with a view to the future.
CHAPTER 12 KEY MESSAGES FROM THE CASE STUDY AND POLICY OPTIONS

1. Introduction

The Chinese land policies appear to be “too stringent” and “over-centralized”. In reality, they do a reasonably good job in responding to local needs and achieving economic efficiency – but at the cost of fairness. This chapter summarizes key messages from the case study in Dragon and assesses various policy options for fixing the system. It argues that any attempt to fix the system is unlikely to be a fundamental solution unless the existing political institutions are reformed.

2. Key messages from the case study

The national government imposes a very stringent land supply constraint, creating a large gap between demand and supply. Guan Xi networks serve as an invisible hand to alleviate the high demand for land through an informal market, and thereby improve the efficiency of land use. The case study identifies many forms of inefficiency due to such factors as the lack of a long-term vision and information asymmetry, but many of them are probably not avoidable under any system. The purpose of the periodic crackdown campaigns by the national government is not to eliminate the informal market, but largely to warn the players not to go beyond certain
However, the distribution of the benefits from land conversion is highly inequitable, because the process is subject to the “law of the jungle”, favoring the powerful, the wealthy and the bold rather than those who are poor, needy and compliant.

In particular, the following themes arise repeatedly throughout the dissertation:

**Growth vs. conservation**

In essence, the conflicts surrounding the farmland protection policy are about the choice between growth and conservation. Conceptually, these two policy goals may be balanced. In practice, it is impossible to know what an efficient allocation of land is. The national government sets a farmland protection target, but is actually confused about its own decisions. The local governments are even more confused, but have an easier choice from their perspective between the low profitability of farmland and the large benefits from land conversion.

**Centralized planning vs. local non-compliance**

The case study shows that local non-compliance with national policies is inevitable, for two reasons: First, compliance is impossible, because the national policies for promoting growth and for protecting farmland conflict with each other. Second, non-compliance is so widespread that the national government often has to acquiesce. Consequently, it would be foolish for a local government to comply with the national policies in a strict manner.
Widespread local non-compliance has had two consequences: First, the farmland protection target has to be set at an “over-strict” level, in order to allow room for local non-compliance. Second, there is information asymmetry between the national government and the local players. The national government deliberately does not state its policy objectives in an explicit way, whereas the local players collude to conceal information about informal land use.

The case study also shows clearly that, under a highly centralized system, higher-level governments have tight control over the appointment of local officials, but not over the complex and omnipresent local Guan Xi networks. Therefore, although individual officials have much power, the government - as an institution - is incapable of achieving certain designed policy objectives or combating corruption.

**Market economy vs. opaque political system**

An opaque political system does not get along with a market economy. The reason is that government intervention is necessary to correct market failures (i.e. the inability of the market alone to deal with “externalities”)\(^{273}\), but such intervention is typically subject to the manipulation by public officials and their Guan Xi who pursue their own interests. The liberalization of the housing market in the 1990s has created a huge demand for land and given rise to a booming real estate industry. However, the control of scarce land resources by the government has led to a host of private deals between public officials and developers.

---

\(^{273}\) As discussed before, Coase argued in his famous 1960 article that the market can actually address at least some local externalities. But government intervention is necessary in situations where transaction costs are high and property rights are poorly defined.
Ambiguity of policies vs. abusing of power by public officials

Ambiguity is a key feature of many Chinese policies, including the land policies - such as the comprehensive land use plans, the legal stipulations regarding land property rights, and the concept of public interest. There are mainly two reasons for this: First, it is difficult to prescribe all situations, which vary significantly across regions and change over time, for policy implementation. Second, and perhaps more importantly, clarity in policies will reduce the power of public officials and the government in general. If, for example, the concept of “public interest” were specified in a meticulously detailed way and that there existed an independent judicial system to ensure strict implementation, the government might lose much of its current power during compulsory land conversion. It is easily conceivable that, in a society where everything is governed strictly by laws that are not subject to personal interpretation by public officials on ad hoc basis, political control by a particular group would be very difficult. To put it in a blunt way, vague policies and laws give some people a most powerful tool to control others.

Exclusion of the public from policy making vs. distrust towards the government

During the land conversion process, appointed public officials have absolute power, with the public excluded from decision making in any formal way. In many ways, the Chinese political system is designed to resemble the state described by Thomas Hobbes - who thinks that the world is a state of nature in which people are self-regarding and therefore in constant conflict with each other, and that there shall
be a master with absolute power to rule. The problem is that such a state may not be regarded as legitimate by those being ruled. The case study in Dragon County reveals a deep distrust by the public towards the local governments. The omnipresence of Guan Xi networks indicates that political power often provides better protection for property rights than the law. The deference of the farmers to compulsory land conversion decisions often represents helplessness and even indifference, whereas the resistance by the “nail” households is a form of open defiance against the legitimacy of public decision-making.

3. Review of piecemeal fixes to the land system

The previous chapters have described a number of policies attempted by the national government in the last few years to fix the land system. Most of these policies, which all seem to have good intentions, have had limited or even negative impact, for two reasons: First, as discussed earlier, in a highly centralized system, policy-making is one thing, but compliance is quite another. As a famous Chinese saying goes, “whenever there is a policy from above, there is always a countermeasure to evade at the grass-root level”. Second, and more importantly, these policies typically address individual “plays”, not the “rules of the game”. It is also important to remember that the informal market, which is essential for making the existing land system work, is a very complex and dynamic system governed by both formal rules and informal Guan Xi networks. Therefore, isolated attempts to

---

274 This is called “Shang You Zheng Ce, Xia You Dui Ce” in Chinese.
address single surface problems may mess things up or make the system unworkable.

Below is a brief review of the recent piecemeal fixes, followed by a brief discussion of an un-regulated area identified through the case study.

**Increasing the level of compensation to farmers**

Dragon’s county government increased the level of compensation to farmers for compulsory land conversion, and established a pension system for those who lose land. This may be seen as a local response to the pressure from higher-level governments to reduce the number of land conversion related disputes. The compensation reform has reduced, to a significant extent, the number of protests by farmers, but also made it easier for local government to take land from farmers.

**Requiring “open” and “transparent” land sale**

The requirement that the use right to land for commercial development must be sold through “open” and “transparent” auction processes has increased competition among developers, and reduced their collusion with local governments. However, another recent requirement that industrial land shall also be leased through similar processes is clearly impracticable. The reason is that, as mentioned in Chapter 4, the qualifications of industrial enterprises do not depend on land lease prices only, but more on their potential contribution to local economic and social development, which essentially requires subjective judgment by local officials.

**Reforming the land administration system**

The transformation of the local BLRs from “dual-track” into “single-track”
agencies aims at reducing the influence of local government leaders on them. However, as the case study in Dragon County shows, the reform has produced no remarkable effect due to the omnipotence of local Guan Xi networks.

**Efforts to reduce land speculation by developers**

The policy that land, once acquired by developers, cannot be held out of development for more than two years aims to increase land supply so as to ease housing prices, but has had the practical effect of forcing land speculators to adopt socially inefficient approaches to evade the rules, as discussed in Chapter 11.

**Strengthening supervision over land conveyance fees**

A recent national policy requires that land conveyance fees must be turned in to the official treasury first before being used by a local government. This may prevent irresponsible spending by local governments to a certain extent, but are unlikely to stop or reduce corruption in a fundamental way unless the system becomes transparent.

**Crackdowns**

The periodical crackdowns on the informal market are essential for the national government to assert its authority in a central planning system, but have produced undesirable efficiency and equity consequences, as discussed in Chapter 11 and 12.

---

275 Ministry of Finance (2006)
276 Lu Jun (2006)
An un-regulated area

So far, the distribution of the benefits from the conversion of land from one urban use to another has been an unregulated area. The main reason is that such conversion is a local matter, and varies from case to case. For example, the relocation of some large industrial enterprises from the city to the suburb may result in many people becoming unemployed. Therefore, the level of compensation paid by the government to these enterprises has to be high, in order to compensate the unemployed workers and pay the cost of relocating the manufacturing facilities and constructing new infrastructure such as roads. In other cases, the conversion of the land occupied by “land speculators” may require a much lower level of compensation.

From a local perspective, the lack of regulation in this area has resulted in some “edge ball” housing projects, benefiting the existing land users and some low-income people. Attempts to regulate this area will eliminate an important source of affordable housing for low-income groups, and will therefore require the government to establish a formal affordable housing program to make up for it.

4. Assessing a recent, more fundamental fix to the system

In October 2008, The Third Session of the 17th CCP Central Committee passed a resolution to deepen rural reform. The most important measure of the reform is that farmers’ grain land contracts with their collectives shall remain unchanged for an

---

277 Chinese Communist Party Central Committee (2008)
“infinite” period.\textsuperscript{278} This new policy aims to give farmers more land tenure security, so that land can be taken better care of and the transfer of land use rights can be promoted.\textsuperscript{279} However, transfer of rural land use rights shall not involve changes in collective ownership or land use type. There are two primary drivers for such a policy: First, there have been an increasing number of farmers working in cities, so there is an urgent need to create a market to enable them to transfer their farming rights to others easily. Second, it makes economic sense to consolidate small units of farmland into larger ones so as to improve agricultural efficiency. The real effects of this new policy remain to be seen. As discussed in Chapter 2, the transfer of farming rights has actually been happening in Dragon County for a number of years, but is not a widespread phenomenon for certain reasons.

The CCP resolution also states that, in carrying out compulsory land acquisition, the government will distinguish between public interest and commercial development. Land acquisition for the purpose of commercial development will gradually be more restricted, and the existing compensation system for compulsory land acquisition shall be improved. While the language of the resolution is vague and detailed regulations need to be developed, this policy reflects the CCP’s recognition of the seriousness of the social tensions created by compulsory land acquisition as described in this dissertation.

Another important reform introduced in the resolution is that collectively owned lands located outside planned urban areas and already used for non-farming

\textsuperscript{278} Chen Xiwen, quoted in \textit{Guangzhou Daily} (October 27, 2008)
\textsuperscript{279} \textit{People's Daily} (October 23, 2008)
development will be allowed to be traded on the land market directly, without requiring the transfer of ownership from collectives to the state. According to Chen Xiwen, Director of the General Affairs Office of the CCP Central Committee’s Leading Group on Rural Development, such lands mainly refer to those occupied by Township and Village Enterprises (TVEs) established in the 1980s and the 1990s. Since some of these TVEs have been out of business by now, some of their lands are either left idle or not made best use of. Therefore, it is desirable that such lands be allowed to enter into the formal market. However, Chen Xiwen acknowledges that detailed regulations need to be developed in order to put this new policy into practice. For example, one issue is how to define TVE. According to The Law on Township and Village Enterprises, a TVE is an enterprise established by a rural collective or farmers.

In reality, however, there are not many such enterprises. Most enterprises in rural areas are actually joint ventures with investors from cities or even foreign countries. The policy should also apply to the collectively owned lands occupied by farmers’ houses located outside planned urban areas, but, again, relevant laws and regulations are yet to be worked out.

This new policy is not surprising. Starting in the late 1990s, the MLR has organized a series of surveys to study the feasibility of allowing collectively owned lands to enter into the primary land market directly. Since 2002, the MLR has approved six regions in several southern provinces, where economic development is most rapid and the demand for land is very large, to pilot this new mechanism. In

---

280 The remainder of this paragraph is based on Chen Xiwen, quoted in Guangzhou Daily (October 27, 2008)
281 Ding Kai (2005)
particular, Guangdong Province passed a draft regulation on June 23, 2005 to allow the transfer of collective lands on the primary land market directly at a provincial scale.\(^{282}\) Earlier, the MLR had submitted a legal proposal for promoting this new mechanism at a national scale to the National People’s Congress (NPC) in 2003. The NPC rejected it for being in conflict with the existing *Land Administration Law*, according to which collectively owned lands can be used for three “non-farming” purposes only – the enterprises run by village collectives, the public infrastructure of villages, and farmers’ housing. Despite such legal obstacles, the MLR seems to be confident that the existing laws will be revised sooner or later, and thus has been promoting the piloting of this new mechanism in a proactive manner.\(^{283}\)

Zhou Qiren, a professor from Beijing University, describes two approaches adopted by some villages or farmers in some southern provinces to get around the legal obstacles.\(^{284}\) In the first approach, adopted in Nanhai municipality of Guangdong Province, some villages have built workshops on their land and rented them to industrial enterprises, and the rental fees are divided between the collectives and the farmers. In this way, the collective becomes a *de facto* “share-holding company”, and the lands of the farmers become the “equities” of the company. In other words, the farmers who contribute land are the company’s shareholders, and thus have the right to claim the yields of their shares. In the second approach, adopted in some areas in Kunshan Municipality of Jiangsu Province, the villages lease their lands to farmers, who then raise funds by themselves to build workshops to be rented

\(^{282}\) Guangdong People’s Government (2005)
\(^{283}\) Liao Yonglin (2008)
\(^{284}\) Zhou Qiren (2005a)
to industrial enterprises. The rents are then divided by the village and the farmers. Both approaches enable collectively owned lands to go onto the primary land market directly, but appear to be used by “village-owned enterprises” and therefore in conformity with the Land Administration Law. (Such approaches are certainly not unique to these regions only. For example, Dragon is not a pilot region of the proposed mechanism, but some variations of the same practices exist on an informal basis, as described in Chapter 8.)

Some scholars believe that the existing land system will be significantly improved if this new mechanism is allowed at a national scale, and have proposed that collective-owned land shall entail the same property rights and have the same prices as state-owned land. Such a reform has two major advantages: First, it will break up the monopoly of the government on the primary land market, and allow developers to negotiate directly with villages and farmers on a formal basis. Consequently, farmers would have more say. Second, since only the use rights to land are transferred, village collectives will retain the ownership. This means that, in the case that the land were to be privatized in the future, farmers and villagers’ committees would still be guaranteed a voice regarding the initial distribution of the land.

Despite these advantages, such a reform cannot be a cure for most of the problems identified through the case study in Dragon, due to several limitations: A first limitation is that it is unlikely for collectively owned land to be allowed for

---

285 Zhou Qiren (2005b) and Zhang Shuguang - quoted in Lv Qin (2007)
286 Called “Tong Di, Tong Quan, Tong Jia” in Chinese
commercial real estate development. For example, the pilot program in Guangdong Province has effectively liberalized the conversion of collectively owned land from farming to industrial use, but does not allow such land to be used for real estate development.\(^{287}\) The reason for this is easy to understand. The conversion of industrial sites to commercial uses provides a major source of revenue that is much needed by local governments. Therefore, the proposed reform, even if approved by the NPC, would probably do no more than formalize what has already existed in practice on an informal basis.

A second limitation is that government officials will not lose much of their power, because they will still dominate the land conversion process through assigning developable land quotas, making zoning requirements, approving construction designs, and imposing environmental standards, etc. Without the personal support of the relevant public officials, any direct negotiations between developers and farmers would result in nothing but “informal” deals.

A third limitation is that the government can still take land from villages in the name of public interest.\(^ {288}\) As indicated by the case study in Dragon, the users of the land acquired by the government include both public and private entities. In the case that a land parcel is acquired in the name of “public” interest but then used by a private party, it is difficult to determine whether the actual land use complies with the intended “public” interest or to separate the motives of the government from those of

\(^{287}\) Guangdong People’s Government (2005)
\(^{288}\) Guangdong People’s Government (2005)
Therefore, the reform cannot prevent the government from acquiring land for the purpose of satisfying the private motives of public officials or their Guan Xi.

5. Assessing other policy options

This section discusses a few policy options for the future, and argues that their success will be contingent on reforming the existing political institutions as a first step.

Relaxing the farmland protection target

As mentioned in Chapter 3, a main basis for China’s stringent farmland protection policy and the developable land quota system is grain self-sufficiency considerations. Actually, the debate over whether it is acceptable for one country to import grain from others has had a long history. In 1815, the British Government feared that relying on imported grain would be dangerous for Britain - lower prices would reduce laborers' wages, and manufacturers would lose out due to the fall in purchasing power of landlords and farmers\(^{290}\) - and passed the Corn Law to protect domestic grain prices against competition from less expensive foreign imports.\(^{291}\) When the Corn Law was abolished in 1846, it contributed greatly to the industrial expansion of the nation. Britain's dependence on imported grain in the 1830s was 2%; in the 1860s it was 24%;

\(^{289}\) Task Force on China’s Land Reform, State Council’s Development Research Center (2006)

\(^{290}\) Woodward (1962), P61

\(^{291}\) Wikipedia: Corn Laws
in the 1880s it was 45%.\textsuperscript{292} By 1881, the number of urban laborers had increased by 53,496 since 1871.\textsuperscript{293} Many of these were previously farm workers who migrated to the cities to find employment, despite agricultural laborers' wages being the highest in Europe.\textsuperscript{294}

Similarly, some Chinese economists have questioned grain self-sufficiency as a reasonable or desirable policy goal for China, for at least two reasons: First, China does not have a comparative advantage in grain production, and therefore should consider importing grain. Second, with a large trade surplus, China needs to import more. Mao Yushi (2007) summarizes these points as follows:

Why are we so hypersensitive towards food security? A plausible explanation is that the great famine of the early 1960s was too scary to us… (However,) one reason for the famine was that (the regime of the time) chose not to resort to the international market. Grain was in very short supply at the time, but, instead of importing grain, the regime exported in 1959 more than 4 million tons of grain, which would have been sufficient to feed 20 million people for a year.

In case our grain falls short of supply in the future, we can surely resort to import. Some people say that import is not reliable. However, more than 60% of the grain consumed by the Japanese is imported, and they do not feel that it is not reliable… Assuming that we import 30 million tons of grain, which will be a record-high amount, the cost will be $4.5 billion. (In 2006,) we had an export volume of $ 970 billion. This means that we only need 0.5 percent of the export volume to import grain. Some people are worried about a possible grain ban on China imposed by other countries. I would say that, if that happened, we must have done something against the wishes of the entire world - in which case, the Chinese people would not be able to live a good life anyway even if we have grain to feed ourselves. In practice, a shock to the import of oil would be far more disturbing to China than that of grain. The reason is that we have built many grain depots, and we have abundant grain reserve. However, we have almost no oil reserve. The new oil reserve we are trying to build up will not be available for use within three years. We are exporting grain, but need to import 40% of the oil we use. (If we can manage our oil supply,) it is groundless for us to be worried about food security.

\textsuperscript{292} Ensor (1936), P116
\textsuperscript{293} Census of UK (1881)
\textsuperscript{294} Ensor (1936), P117
As mentioned in Chapter 3, the Tianze Economic Research Institute, headed by Mao Yushi, released a report entitled Grain Security and Farmland Protection in December 2008.\textsuperscript{295} The report argues that the world as whole has sufficient grain supply. During the last 50 years, the world population has increased by approximately 150\% and per capita grain consumption has increased by 17\%, but grain prices have deceased by half. The report also points out that China’s year-to-year grain production fluctuates by approximately 3-4\%. Even in the worst possible (i.e. once-in-a-hundred-years) case, China needs to import only 11 percent of its total grain consumption, which is around 50 million tons – about 10 percent of world’s annual grain trade volume.

Along the same lines, Li and Wang (2002) think that China’s accession to the WTO provides opportunities for China to utilize the international grain market and specialize in areas where it has comparative advantage:\textsuperscript{296}

(China’s accession to the WTO provides opportunities for it to combine) the import of land-intensive food products with the export of labor-intensive agricultural products (so as to) make full use of the world market… and improve the allocation of domestic resources. The international division of labor, according to the principle of comparative advantage in international trade, is likely to make China a big grain importer, but not a big food importer. Net import of grain is likely to be offset by a net export of other food products. The argument for grain self-sufficiency is understandable but not acceptable in the new era.

Besides, a grain self-sufficiency strategy means that China needs to have a large domestic grain reserve, which is costly and inefficient… To rely more on the international market would be more effective than having a massive reserve.

Despite such counter-arguments, grain self-sufficiency stands firm as a basic national policy. One concern of the Chinese policy makers is that the international

\textsuperscript{295} Tianze Economic Research Institute (2008); Mao Yushi (2008)
\textsuperscript{296} Li Chenggui and Wang Hongchun (2002) - I made some improvements on the English composition of the quote.
food market may not be reliable if China does become a large grain importer. The sharp rises in food prices on the international market in the last few years seem to have contributed further to this concern. According to a World Bank report\textsuperscript{297}, by the end of February 2008, the international wheat prices had increased by 181% and the prices of food in general increased by 83% during the previous three years. The Food and Agriculture Organization points out that 37 countries have experienced food crises, and the World Bank President Robert B. Zoellick warns that rising food prices on the international market may make 100 million people in the developing world even poorer.\textsuperscript{298} Food crop prices are expected to remain high in 2008 and 2009 and then begin to decline as supply and demand respond to high prices\textsuperscript{299}; however, they are likely to remain well above the 2004 levels through 2015 for most food crops.\textsuperscript{300}

Many factors affect the demand for and the supply of food, such as population growth, changing diet and natural disasters. In addition, some countries are developing bio-fuel due to energy security considerations, further constraining the global food crop supply.\textsuperscript{301} The UN Secretary General Ban Ki-moon said in June 2008 that global food output should rise by 50 percent by the year 2030 to meet the rising demand and as much as 15 billion to 20 billion U.S. dollars would be needed yearly to boost production.\textsuperscript{302}

A second argument for food self-sufficiency is that food is different from most

\textsuperscript{297} Yan Wenyu and Li Pingping (2008)  
\textsuperscript{298} Yan Wenyu and Li Pingping (2008)  
\textsuperscript{299} Actually, food prices have been declining in the second half of 2008.  
\textsuperscript{300} World Bank (2008)  
\textsuperscript{301} World Bank (2008)  
\textsuperscript{302} Xinhua News Agency (June 5, 2008)
other commodities including oil, because food crises tend to have a stronger impact on the poor. People are affected to different degrees by rising grain prices, depending on whether they are producers or consumers, how much they produce or consume, and their ability to withstand grain price inflation. In general, poor people, especially those in urban areas, suffer more from rising food prices. For example, a recent World Bank paper analyzes the impacts of higher prices of key staple foods on poverty, taking into account direct impacts from changes in commodity prices and impacts through changes in wage rates for unskilled labor. The results show that, in six of the eight countries considered, price increases for staple foods were associated with a significant rise in poverty. Averaging across these eight countries, the increase in food prices between 2005 and 2007 is estimated to have increased poverty by 3 percent.

Due to a fear of inflation induced by rising food prices, the Chinese government has been controlling grain prices tightly. Although this has benefited the poor in urban areas, the Chinese farmers are not able to benefit from the rising food prices in recent years. This, together with the rising costs of agricultural production, contributes to the low profitability of farming and thus a lack of incentives for farmers to engage in farming. Many farmers simply leave their land idle. The grain reserves are intended to ensure grain security in case of natural disasters or public emergencies, but are often used for the purpose of keeping grain prices at a level much lower than

303 World Bank (2008)
305 The remainder of this paragraph draws on Deng Delin (2008) and Yan Wenyu & Li Pingping (2008).
those on the international market.\textsuperscript{306} For example, the difference in grain prices between China and the international market is so remarkable that grain smuggling from China to other countries has been widespread since early 2008.\textsuperscript{307}

Another argument for food self-sufficiency is that a food crisis may not necessarily incur greater economic impact than an oil shock, but is more likely to trigger panic and even social turmoil. So far, China is producing enough for itself. China’s grain reserve-consumption ratio is much higher than 17-18\%, the level deemed by the international community as desirable for food security.\textsuperscript{308} However, if a food crisis does strike, the political as well as economic risks may be tremendous. For example, during a rice crisis in early 2008, some rice exporting countries such as Cambodia, Vietnam and Egypt banned all or part of their rice exports, causing significant panic for some rice importing countries.\textsuperscript{309} Although China was not affected by this crisis in a significant way, there is a concern that similar food crises and panic could occur in China if it relaxes its efforts in ensuring grain self-sufficiency.\textsuperscript{310} This is clearly a biggest concern of China’s top leadership. China’s Minister of Agriculture Sun Zhengcai recently commented that “China has such a large population that no other country will have the capacity to help China if a real food crisis occurs in China.”\textsuperscript{311}

Nevertheless, the international experience shows that flexibility in meeting the

\textsuperscript{306} Deng Delin (2008)
\textsuperscript{307} He Tao and Yin Yunwei (2008)
\textsuperscript{308} Zeng Liying, Deputy Administrator of the National Grain Administration, quoted in Yan Wenyu and Li Pingping (2008)
\textsuperscript{309} Lin Yifu, quoted in Yan Wenyu and Li Pingping (2008)
\textsuperscript{310} Lin Yifu, quoted in Yan Wenyu and Li Pingping (2008)
\textsuperscript{311} Mr. Sun made these remarks at a bilateral meeting with UK’s Secretary of State for the Department of Environment, Food and Rural Affairs on November 10, 2008.
demand for food is positively correlated with per capita income.\textsuperscript{312} In other words, the higher the per capita income, the greater the flexibility in meeting the demand for food. No modern economy has ever failed to meet the demand for food by its people.\textsuperscript{313} Moreover, China could utilize the international food market to diversify the types of food imported from various countries to minimize the risks associated with domestic supply fluctuations due to natural disasters.

In sum, the debate over food self-sufficiency is about the trade-offs between reducing the risks associated with possible food crises and saving land for uses that are higher than food production. Nevertheless, as far as its relevance to farmland protection is concerned, such a debate is relatively unimportant. In other words, even if there are good reasons to question food self-sufficiency as a reasonable or desirable policy goal, they shall not serve as a sufficient basis for relaxing the current farmland protection target, for two reasons: First, although the existing farmland protection target appears to be over-stringent, the actual amount of farmland converted is much more, due to widespread local non-compliance. Relaxing the control on developable land supply may lead to another round of “land enclosure movement”,\textsuperscript{314} exceeding any seemingly “reasonable” farmland protection target. Second, the case study in Dragon indicates that stringent land supply control actually promotes compact development, which, from a long-term perspective, is economically efficient.

\textsuperscript{312} This paragraph draws on Li Chenggui and Wang Hongchun (2002)
\textsuperscript{313} Li Zhou (1997), quoted in Li Chenggui and Wang Hongchun (2002)
\textsuperscript{314} Liu Yunzhou (2007)
Privatizing farmland

It has been a hot issue in recent years whether China should privatize farmland. The proponents generally think that land privatization will improve agricultural productivity and promote the urbanization process. For example, Steven N.S. Cheung from Hong Kong University\(^{315}\) thinks that it is important for the surplus rural labor to move to cities. There has already been massive migration from the rural areas to the cities; but it is far from enough, because a country with a high percentage of rural population cannot be wealthy, and that farmers cannot be wealthy if they stay in the rural areas. An easy way to tackle this problem is to grant private land ownership to farmers, and allow them to sell their land so that they can have money to go to the city to try their “luck”. Then, it will be the market - not the government - that will take care of them.

However, the opponents of land privatization argue that a rushed massive migration of farmers to cities will create slums at the urban fringe and consequently many social problems. Wen Tianjun, Dean of the School of Agricultural and Rural Development, China Renmin University, explains this view as follows:\(^{316}\)

In many developing countries, urbanization is being achieved through large-scale slums… Poor people from the rural areas go to cities and live in crowded slums. For example, in India, many farmers who have lost land lack the basic conditions for survival. The proportion of the rural population living under the poverty line is as high as 36%. Some of them have migrated to the slums in cities, but still lack basic conditions for survival…In cities, farmers cannot enter into private lands… and therefore have to live on public lands adjacent to roads, railways or rivers. India needs to develop infrastructure, but a practical difficulty is how to deal with the slums where millions of people live. The difficulty of land

\(^{315}\) Cheung, Steven (2001)
\(^{316}\) Ma Ya (2008)
acquisition and the resulting conflicts are easily conceivable… (Similar situations exist) in other developing countries, such as Bangladesh, Mexico and Brazil. I have visited many slums in a number of countries in the last few years. The living conditions there are unbelievable. Many people have criticized me (for being against privatization) in recent years… The reason is that they have not seen (the miserable living conditions in the slums) by themselves

In fact, there are already some slums in China. For example, there are such places at the fringe of Beijing. Some scholars may argue that this is an inevitable effect of urbanization, and is a “normal phenomenon”. However…a concentration of millions of poor people will inevitably lead to social turmoil…

This argument is based on the assumption that a farmer is more likely to lose land under private ownership than collective ownership, because farmers tend to sell their land if they need money. This, the opponents fear, will contribute to a widening of income disparity, and cause social stability.

Yang Xiaokai, another proponent of land privatization, thinks that these concerns are counter-intuitive.\(^{317}\) He argues that land privatization will only abolish the privileges of village leaders in the administration of collectively owned land, but will definitely not make the farmers poorer. Under the current system, when some farmers move to cities, they have no choice but to give up their shares of the collectively owned land. If unwilling to give up the land, they need to come back periodically. Therefore, the collective ownership of land binds the farmers up, and hampers urbanization and industrialization, which is neither efficient nor equitable. If land is privatized, farmers will be free to sell the land. Since the prices of the land that is freely transferable will be much higher than the current levels, land privatization will actually make farmers better off.

\(^{317}\) Yang Xiaokai (2002a)
As regards the fear that farmers may end up in slums, Yang Xiaokai argues that land privatization cannot make the situation worse. When a farmer moves to the city, he does not even need to sell his land. He could lease the land to others, so that he could not only collect rents, but also retain the right to taking the land back in case he is not successful in the city. He could also use the land as collaterals to obtain loans from banks in order to do business.

Along the same lines, Qin Hui, a professor from Tsinghua University and a proponent of land privatization, also thinks that it is illogical to predict that farmers will be worse off if their land is privatized: \(^{318}\)

It is illogical to argue that the use right will provide more guarantee for farmers than the ownership to farmland. What (the opponents) actually mean is that the owners of land will have less rights than the tenants. This is nonsense… As is known to all, the so-called ownership includes a bundle of rights, including the right to use (among others). In other words, ownership entails the use right to land, but not vice versa. If a farmer has ownership to a piece of land, he naturally is guaranteed the use right to the land. Even if he voluntarily transfers the use right to others, he is free to take it back. However, if a farmer has the use right to a piece of land only, the bundle of rights is more limited, because the owner of the land can take it back… (This is so obvious,) but some people want to make us believe that giving the ownership of land to farmers will cause them to lose land while (giving them the use right only) will provide them with more guarantee.

The tenancy system that existed in (the first half of the 20\(^{th}\) century) has been most terrifying to (many people). People generally assume that the tenancy system was caused by the merging of lands due to the private ownership of land and the free transfer of land rights, and that the tenancy system was largely responsible for the social crisis and farmers’ uprisings of the time. This argument may be one of the strongest by the opponents of land privatization. But how much do they really know about the history of China and of the land tenure system? … We often (say things) without doing quantitative analysis… There exist various samples of land rights distribution in various regions during the 1930s and the 1940s… According to my analysis, the Gini Coefficient for the concentration of land rights was 0.53 in China before the Land Reform (in the 1950s). A

\(^{318}\) Qin Hui (2006)
horizontal comparison shows that almost all other countries had a higher Land Rights Gini Coefficient than China. In other words, the level of land rights concentration in China was among the lowest. There were indeed social crises at the time, but how can you say that it was because of the over-concentration of land resulting from private land ownership?

Most of these discussions cited have been “underground”, so to speak. Open debate on land privatization is a still largely a taboo on official media or formal journals. The reason is that land privatization conflicts with the socialist ideology, an important basis of which has been public ownership.\textsuperscript{319} China has already privatized many state-owned enterprises, as mentioned in Chapter 5, and recently passed the Property Rights Law\textsuperscript{320}, which deviates from the traditional socialist ideology by providing a legal basis for the protection of private properties including real properties. However, the private ownership of land is obviously a very different matter, because it will essentially lead to a loss of control by the government over the farmers, who account for more than 60% of China’s population. Moreover, land privatization will inevitably make compulsory land acquisition more difficult, because the compensation standards and the costs of negotiating with many private land owners will presumably be much higher than their current levels. This will have a significant impact on the ability of local governments to generate revenue through land conversion. Therefore, from the perspective of the government, private land ownership will be a serious constraint to growth and thus unacceptable. It is easily conceivable that land privatization will require a fundamental transformation of the Chinese public finance system. The attitude of the CCP leadership on this issue seems

\textsuperscript{319} Huang Xingwen (2008)
\textsuperscript{320} Passed on March 27, 2007
to be very clear. Chen Xiwen, Director of the General Office of the CCP Central Committee’s Leading Group for Rural Development, stated at a press conference in January 2007 that, “I do not see the prospect of land privatization in China”.321

Even if the ideological and public finance obstacles are overcome, land privatization cannot be a fundamental solution to farmers’ problems, given the existing political system. The reason is that public officials will still abuse their power to carry out compulsory land conversion in the name of “public interest”.322 To deal with such a problem, Qin Hui (2006) suggests that the bundle of land rights granted to Chinese farmers shall be larger, and the power of the government to acquire land from farmers shall be more restricted than in other countries. However, this, again, would essentially limit the capacity of local governments for revenue generation, making it politically unacceptable.

Moreover, it would be difficult and tricky in practice to determine the initial distribution of land ownership. If the existing users of land were to become the owners – which is probably the easiest way for initial distribution - then land privatization would become a process of granting land ownership to those who have taken land from farmers in a highly unfair manner through informal means. In addition, the reserve lands, which account for a large proportion of collectively owned lands, may become easy targets of those who are powerful enough to manipulate the privatization process. Fairness in the initial distribution of private ownership rights

321 Xinhua News Agency (January 30, 2007)
322 Qin Hui (2006)
will have to be contingent on having a transparent and participatory political system in the first place.

**Decentralizing land use planning and administration authorities**

Much has been said about the impracticability and lack of responsiveness of central planning. An alternative to this kind of one-size-fits-all approach would be to delegate authorities to local governments so that policies can respect local situations more. Unfortunately, local officials in China are accountable to their higher-level bosses only. Therefore, a centralized system is essential for checking the powers of local officials. Absent political control and supervision from above, corruption by local officials might be even more prevalent, contributing to a faster concentration of wealth into the hands of the powerful and the rich. On the other hand, the party and the national government are presumably very reluctant to decentralize, because doing so will weaken their political control over the bureaucracy and hence the people.

**Establishing an independent judicial system**

An independent judicial system for land conversion is out of the question, for two reasons: First, those who exercise the law cannot be free from the influence of *Guan Xi* networks. Second, for an independent judicial system to be effective, there should be clear policies and laws. However, as described earlier, many Chinese laws and policies are intended to be vague or ambiguous. Moreover, as discussed in Chapter 6, no society can rely on its judicial system alone to protect the rights of its citizens, because the judicial process is reactive only.
6. Summary

Although being unfair and sometimes inefficient, the Chinese land conversion process is actually a reasonably well-functioning system, given the existing political institutions. The recent attempts to fix the system have had limited or even adverse effects because they address the symptoms, not the causes, of the problems.

A recent trend to formalize direct negotiations between developers and villages & farmers seems to be a feasible approach to address certain problems, but is certainly not a fundamental solution. The success of future policies will hinge on the willingness and capability of the existing regime to carry out substantive political reform that can make the government more transparent and accountable.
CHAPTER 13 FUTURE POLICY DIRECTION

1. Introduction

The land conversion process in Dragon provides an illuminating example of public policies trying to achieve efficiency at the cost of equity. China’s national leaders have recognized – correctly - that economic growth is essential to the rejuvenation of a country with more than 1.3 billion people and an unhappy modern history of national humiliation, as described in Chapter 3. The massive resources that the nation was capable of mobilizing in its relief efforts for the devastating earthquake disaster that occurred in Sichuan Province in May 2008 were a clear indication of the importance of economic growth to the country and its people.

Unfortunately, the case study in Dragon also shows that efficiency and equity often come into conflict under the existing political system. The centralization of power is necessary for the national government to maintain political control - which means that informal markets favoring the powerful and the wealthy have to be allowed for the sake of economic efficiency. As has been discussed in Chapter 12, the success of future attempts to address this dichotomy - such as rationalizing policy objectives, clarifying property rights, decentralizing authorities, or establishing an independent judicial system – is at least partly contingent on a fundamental political reform as a precondition.
This chapter will discuss briefly the impacts of this tension, and argue that the current utilitarian approach of pursuing economic efficiency at the cost of equity is not sustainable. Ultimately, the solutions to the problems identified by the case study in Dragon County lie in establishing an effective check-and-balance political system as a first step.

2. Dichotomy between efficiency and equity

In Chinese history, many uprisings occurred because farmers were unable to make their ends meet, and the leaders of these uprisings typically advocated “robbing the rich and helping the poor”. The CCP was not an exception to this. During the vying for power with the nationalists between the 1920s and the late 1940s, the CCP won support from the farmers and the working class, which accounted for the majority of the Chinese population, with its egalitarian doctrine. Soon after the establishment of the P. R. China in 1949, the CCP re-distributed land to farmers on an egalitarian basis. The “ideal” communist society, pictured by the CCP, was one having such abundant resources and goods that everyone could take whatever he needed and that even egalitarian distribution would become unnecessary. According to the standard political science textbooks for middle-school students prior to the 1980s, the rich acquired their wealth through exploiting the poor; thus, wealth was often associated with evil, and poverty deserved sympathy and conveyed a sense of glory.

Of course, the egalitarian approach was neither equitable nor efficient, because it
ignored desert and discouraged hard work. To overcome this problem, the CCP devoted much effort to propagate the doctrine of “self-sacrifice” for the common goal of communism. Applications of the doctrine included the people’s communes prior to the late 1970s, the program of migrating young people from cities to rural areas in the 1960s, and the family planning policy since the 1970s. A main problem with this communistic approach has been that the so-called “public interests” often reflected the narrow interests of individual political leaders only, sometimes resulting in tremendous suffering by the Chinese people. As a result, the Chinese economy stagnated and lagged farther behind developed countries.

In the late 1970s, the late Chinese leader Deng Xiaoping abolished the egalitarian doctrine. He was well aware that a large gap in the level of economic development between China and developed countries would ultimately weaken the CCP’s political control, and that economic growth was an essential condition for the party to retain its political power. He established the Household Responsibility System and gave farmers the right to make their own farming decisions on an individual basis. In order to promote growth, he encouraged “a small group of people to become rich first”. China opened up to the outside world and allowed the market to play a role in allocating private goods and services. These policies deviated from the traditional egalitarian doctrine of the socialist ideology. In order to deal with this inconsistency, the CCP argues that the socialist ideology has to adjust to changing situations, and calls the new market-based approach “Socialism with Chinese Characteristics”.

The economic reform since the 1980s has promoted economic efficiency greatly.
Between 1978 and 2006, China’s GDP grew at an average annual rate of 9.67%, which was much higher than the world’s average level of 3.3%; the per capita disposable income increased from 343 yuan to 11,759 yuan for urban residents and from 134 yuan to 3,587 yuan for rural residents; and the national fiscal revenue increased from 113 billion yuan to 3.93 trillion yuan.\(^{323}\)

However, in the meantime, the Chinese leaders have been very reluctant to carry out political reforms, which is understandable because any political reform, if effective, would challenge the party’s rule. This practically means that economic efficiency has to be achieved at the cost of equity, as illustrated by the case study in Dragon.

This tension between efficiency and equity is by no means limited to the land conversion process, but exists in almost every economic area where the government has a role to play. It is obviously impossible - and indeed unnecessary - for this dissertation to provide an exhaustive list of all the areas where unfair activities are prevalent. However, for the purpose of illustration, a few examples are given below.

The privatization of some SOEs in the late 1990s and the early 2000s has served to improve economy efficiency, but turned out to be a process of fortune making for a small group of people, as mentioned in Chapter 5. There are, of course, many other ways for SOE managers or powerful officials to “launder” public resources. For example, they typically establish their own private companies, jointly with or in the

---

\(^{323}\) Liu Zheng (2007)
name of their relatives, friends or other Guan Xi, so that they can use their economic or political power to transfer public resources from the SOEs to their private hands through “formal” business transactions.\textsuperscript{324}

Another area is the construction of public infrastructure. During the planned era, the government was responsible for the planning, construction and operation of infrastructure. However, public infrastructure was always in short supply, as indicated by the example of train tickets in Chapter 9. Now, the government is still responsible for planning, but typically contracts the construction and often the operation of public infrastructure to the private sector. Compared with the past, this is a significant improvement in economic efficiency, and has contributed greatly to infrastructure development. For example, by the end of 2005, China’s total mileage of highways reached 41,000 km, which was the second longest among all the countries in the world.\textsuperscript{325} According to the planning by the Ministry of Communications, China will invest 2 trillion yuan to build 51,000 km of new highways between 2005 and 2030.\textsuperscript{326} The highways have contributed greatly to economic growth. However, corruption has been prevalent at each and every stage of highway development and use, such as project approval, fund raising, contracting, quality checks and toll fee collection.\textsuperscript{327} Many public officials have been arrested due to corruption charges, including provincial-level transportation bureau directors and vice directors, project leaders, and other officials responsible for tendering, contracting or construction supervision; and

\footnotesize{\textsuperscript{324} Quoted in Yang Guang (2004) \\
\textsuperscript{325} China Investment Consultation Network (2006, 2007) \\
\textsuperscript{326} China Investment Consultation Network (2006) \\
\textsuperscript{327} Hong Kong Commercial Daily (March 10, 2008); Chen Feng (2008); Law Evening News (August 27, 2004)}
some have even received capital punishment.\textsuperscript{328} A main form of illegal benefits for transportation officials is the “commission” paid by the private companies who want to obtain contracts. Since the investment in a highway project is typically in the magnitude of at least hundreds of millions of \textit{yuan}, the commission received by the officials is often in the amount of tens of millions of \textit{yuan}.\textsuperscript{329} It is also common for the private companies to use raw materials of inferior quality in order to save costs for themselves and for building up \textit{Guan Xi} with the relevant officials. The spending of the toll fees collected from highway users often lacks supervision, and is another source of corruption.

Similar acts are also common during public procurement. China has a very large public sector, so the amount of money involved in public procurement is very large. However, it is an open secret that public officials often receive personal favors from the private providers of goods and services.\textsuperscript{330}

Often, those with political power even develop poor regulations deliberately so that they can benefit personally. A typical case is the public health system in Dragon County. Prior to the 1980s, each township in the county had a public hospital managed by the government, and each village had a rural doctor (nicknamed “bare-feet doctor”) paid by the government. Now, the township hospital, though still publicly owned, is responsible for its own revenue and expenditure; and the bare-feet doctors are allowed to set up their own clinics in their villages. This has improved the

\textsuperscript{328} \textit{Hong Kong Commercial Daily} (March 10, 2008)
\textsuperscript{329} \textit{Law Evening News} (August 27, 2004)
\textsuperscript{330} He Yonghai (2007); Shen Lianqing, quoted in Economics Advisory News (March 19, 2007); Chang Yiqing (2007)
efficiency of the public health system. However, there has been competition between
the township hospital and the village clinics for patients. In general, the village clinics
are doing reasonably well, because villagers typically do not want to travel to the
township hospital except for relatively serious diseases. However, the township
hospital has the authority to supervise the operations of the village clinics. In order to
increase their own benefits, the hospitals of some townships require the village clinics
to buy medicines from them only. Consequently, the village clinics have to pay prices
that are much higher than the prices at which they can buy medicines directly from
other certified medicine suppliers. This has reduced the profits of the village clinics to
a significant degree. The bare-feet doctors are unhappy, but have no choice but to
defer.

In a research paper, a ministerial-level study group receiving training at the
Central Party School, which is the CCP’s highest-level training school for senior
leaders, states the following in 2006.\footnote{Lou Jiwei (2006)}

Most serious is inequity in the process.\ldots The income of those working in the
“monopoly” sectors\footnote{The monopoly sectors refer to coal, oil, power, and to some extent telecommunications and banking sectors. The enterprises are mostly state-owned, and have monopoly on the market.} (particularly high-level managers) is too high; enterprises with different ownership structures receive differential treatment in paying income taxes; there have been collusions between SOE leaders and public officials during the privatization of SOEs; some people make a large fortune by taking advantage of “inside” information or spreading fraudulent information; some exploit the farmers through land acquisition or acquire state-owned land through \textit{Guan Xi} or bribery; and, farmers (who work in cities) often do not get paid...

Inequity in access to the market is often reflected in the setting or the
implementation of the relevant rules. Overall, the rules are often set to be
over-strict, but their implementation tends to be loose. The level of strictness
often depends on who are involved. For example, *(if a self-employed person)* intends to set up a small enterprise, the rules are very strict... and many unnecessary administrative licenses are required *(due to the rent-seeking intent of those who make the rules)*. *(A different example is that)* the exercise of discretionary authority in granting approval or making court decisions is, to varying extent, influenced by *Guan Xi* or the economic (and social) status of those involved... and is usually associated with corruption...

It is worth reminding that corruption is often a necessary condition for efficient allocation of public resources in the Chinese society. However, other things being equal, those who are powerful or already wealthy benefit more than others. Therefore, widening of income disparity is inevitable.

### 3. Income disparity as a most important social problem

Prior to the 1980s, income disparity was not a serious issue, not only because of the party's egalitarian approach, but also because, under a planned economy, the elite groups of the Chinese society used their *Guan Xi* networks mainly for acquiring scarce public services and not so much for direct economic benefits. The situation has changed dramatically with a liberalized economy: Public officials can now translate their political power into direct economic benefits for themselves or their *Guan Xi*.

The gap between the rich and the poor in China is widening.333 According to the World Bank’s Development Report 2006, China’s Gini Coefficient increased from 0.16 in the pre-reform era (i.e. the late 1970s) to 0.47 in the new century. Among the 127 countries surveyed by the World Bank, only 29 countries had a higher Gini

---

333 Lin Yifu, quoted in *People’s Daily* (January 14, 2008); Pan Yan (2008)
Coefficient than China – and among them, 27 were from Latin America and Africa, and only 2 (i.e. Malaysia and the Philippines) from Asia. Some scholars estimate that the actual Gini Coefficient could be at least 10 percent higher than the official statistics,\textsuperscript{334} due to the existence of “invisible” income. Invisible income often takes non-monetary forms, such as medical care, access to education resources, and unemployment insurance, etc.\textsuperscript{335} Moreover, as discussed in Chapter 9, people within Guan Xi networks often exchange personal favors, much of which are unlikely to be reflected in the official statistics on income.

According to the statistics by the National Development and Reform Commission, China’s fiscal revenue increased by 32.4% and the profits of enterprises by 36.7% between 2007 and 2008, while the disposable income of urban residents grew by 12.2% only and the average net income of rural residents by 9.5% only.\textsuperscript{336} Even though these figures may not be precise (due to fraudulent statistics as discussed in Chapter 3) and are just approximations of the real situation, they indicate that the working class is receiving an increasingly smaller share of the total national income. Many public officials, scholars and others echo this point. For example, Zhang Xiangping, Member of the NPC and Director General of the Department of Labor and Social Security of Hunan Province, comments that,\textsuperscript{337}

The share of workers’ income in the total national income is decreasing continuously, and has already reached the warning line… The income gap is widening between regions, between sectors, and between enterprises.

\textsuperscript{334} Li Shi and Yue Ximing (2004)
\textsuperscript{335} Li Shi and Yue Ximing (2004)
\textsuperscript{336} Xinhua New Agency (Mar. 7, 2008)
\textsuperscript{337} Xinhua New Agency (Mar. 7, 2008)
Lin Yifu, Member of the NPC and currently Chief Economist of the World Bank, points out that.\textsuperscript{338}

I think the most outstanding structural problem is that the structure of income distribution is not reasonable, and the polarization trend will continue. The structure of the national income is such that the income from capital is going up whereas the income from human labor is going down. Currently, many conflicts and problems during the economic development process have resulted from this phenomenon.

Pan Yan, a journalist from the \textit{Liao Wang} Magazine who has been reporting widely on issues related to income disparity in China, makes the following statement in an article on January 14, 2008,\textsuperscript{339}

Compared with the “upstarts” whose wealth accumulates so rapidly, such as real estate developers and the middle- and high-level managers in the “monopoly sectors”,\textsuperscript{340} even the so-called “middle class”, who are highly educated and working hard and honestly in the competitive sectors, are feeling that they are continuously sinking down the social “pyramid”, let alone the working-class people whose number is almost limitless.

It is also important to note that the existing income gap has been developed within a very short period. Therefore, compared with the countries with a level of income disparity that is similar to that of China but has evolved through many generations, China faces much greater challenges.\textsuperscript{341}

The Chinese government has clearly recognized the seriousness of the issue, and is trying a number of policies, such as designating minimum wages for urban workers, establishing a social safety net, and limiting maximum wages for the monopoly sectors. The 17\textsuperscript{th} Congress of the CCP, held in 2007, points out that the trade-offs

\textsuperscript{338} Lin Yifu, quoted in \textit{People’s Daily} (January 14, 2008)
\textsuperscript{339} Pan Yan (2008)
\textsuperscript{340} As noted before, monopoly sectors refer to such sectors as power, oil, natural gas and telecommunications where state-owned enterprises exercise market monopoly. In China, those working in these sectors earn much more than the average income of others.
\textsuperscript{341} Lou Jiwei (2006)
between efficiency and equity shall be dealt with appropriately in both primary and secondary distribution, and that secondary distribution shall focus more on equity.\textsuperscript{342}

Along the same lines, the Report of the Government to the 11\textsuperscript{th} National People’s Congress states that the government will develop relevant policies to increase the income of farmers and the working class, and establish a mechanism to ensure transfer payment for the poor.\textsuperscript{343}

It is easier said than done. These policies, even if developed appropriately and implemented effectively, are incapable of narrowing the gap between the rich and the poor. The reason is obvious: if a society allows burglary but in the meantime asks the burglars to share some stolen goods with others, the burglars will either conceal what they have stolen or simply steal more.

4. Future policy direction

The case study in Dragon County suggests that, although the Chinese publics show a deep distrust towards the government, their dissatisfaction is diluted to a significant degree by the improved living standards they have experienced in the past three decades or so due to rapid economic growth. For the same reason, the existing regime seems to be hoping that, as long as the economy keeps growing at a rapid speed, there would be no serious threat of uprisings. In other words, given its unwillingness and perhaps inability - due to potential strong resistance from the

\textsuperscript{342} Hu Jintao (2007)  
\textsuperscript{343} Wen Jiabao (2008)
beneficiaries of the existing system - to carry out political reforms, the existing regime thinks that the best way to retain political control is to sustain rapid economic growth. However, the danger of this strategy is that, with prevalent corruption and rapid polarization, the pressure from those living at the bottom will keep building up.

China’s current economic situation may be seen as a fast-moving vehicle, a slow-down of which may trigger many social conflicts to manifest themselves - a situation similar to the one depicted in Jan De Bont’s film *Speed*, in which a bomb on a city bus will be triggered to explode if the speed of the bus drops below 50 miles per hour. The recent financial crisis is a potential trigger for social turmoil. As mentioned in Chapter 3, the national government has set a target that the economic growth rate in 2009 shall be at least 8 percent. It is feared that a growth rate of lower than 8 percent may bring some social conflicts to the surface.344 As a precautionary measure, the Ministry of Public Security (MPS), which is China’s police headquarters, announced in February 2009 that it would send inspection teams to various regions to ensure social stability.345 Surveillance by the police is no doubt essential for maintaining social order under certain circumstances, but clearly cannot be the ultimate solution.

As far as future policy direction is concerned, the existing regime of China has two options: The first option is to reform the existing political institutions, and establish a system that is similar to the one depicted in Figure 26. However, such a reform will not come about easily due to the complexities of overhauling the existing

---

344 Based on the author’s interactions with Chinese officials who are familiar with the thoughts of the China’s top leadership.
345 Zhang Jingyong (2008)
system. The second option is to maintain the sole focus on economic efficiency without attempting to eradicate the roots of potential social conflicts - which is clearly not sustainable. Just as a bus has to stop at crossroads or for fuel, an economy has to slow down or even stagnate at some points due to various internal or external shocks. Ultimately, the social pressure that builds up has to be released in one way or another. When that happens in an eruptive manner, the consequences can be very disruptive to the Chinese economy and society, as has happened numerous times in the Chinese history.
BIBLIOGRAPHY

(For the Chinese literature, the original cites are attached to their English translations.)


Babcock, Richard (1966): The Zoning Game. Lincoln Institute of Land Policy


Beijing Youth Daily (June 28, 2006): Li Jinhua Says That 60 EDZs Are Involved in Illegal Land Conveyance, Causing An Economic Loss of 5.565 Billion Yuan. (李金华：60个开发区违规出让土地，少收55.65亿。《北京青年报》2006年6月28日)

Beijing Youth Daily (Nov. 5, 2007): The Ministry of Land and Resources Says that Light Penalty for Illegal Land Use Has Led to Negative Consequences. (《北京青年报》2007年11月5日：“国土部：土地违法查处偏轻产生负面效应”)


Chinese Communist Party Central Committee (2008): Decisions by the Chinese Communist Party (CCP) Central Committee on A Number of Key Issues Regarding How to Promote Reform and Development in Rural Areas. Approved by the Third Plenary Session of the Seventeenth CCP Congress on October 12, 2008. (《中共中央关于推进农村改革发展若干重大问题的决定》。中国共产党第十七届中央委员会第三次全体会议 2008 年 10 月 12 日通过）


Coase, Ronald (1960): The Problem of Social Cost


Guangdong People’s Government (2005): Regulations on the Transfer of the Use Right to Collectively Owned Land in Guangdong Province. (《广东省集体建设用地使用权流转管理办法》: 2005年5月17日广东省人民政府第十届六十六次会议通过，2005年10月1日起施行。)

Guangzhou Daily (October 27, 2008): Chen Xiwen Says That The Existing Rural Land Contracts Shall Remain Unchanged for An Infinite Period. (《广州日报》2008年10月27日：陈锡文：现有农村土地承包关系“长久不变”)


Hobbes, Thomas, The Leviathan, Part I.

要难产，部门利益博弈是主因。(法制网 2006 年 7 月 7 日)

Hong Kong Commercial Daily (March 10, 2008): Highways Shall Not Become “Corrupt Ways”. (《香港商报》3 月 10 日：不允高速公路成为腐败路)


Jiang Guocheng and Li Baojie (2008): China’s total GHG emissions are large but per capita emissions are low. （江国成、李宝杰: “中国温室气体排放总量大但人均水平较低”。新华网 2008 年 10 月 30 日）


Jing News (November 5, 2008): Land Acquisition Disputes Led to Confrontation between Farmers and Police, Resulting in Some Famers Being Detained. (《竞报》2008年11月5日：县政府征地致警民冲突，农民因反对卖地被拘留)


http://www.mof.gov.cn/caizhengbuzhuzhan/zhengwuxinxi/diaochayanjiu/200805/t20080519_20448.htm (财政部网站转载)


http://www.guoxue.com/economics/ReadNews.asp?NewsID=1292&BigClassID=16&SmallClassID=16&SpecialID=70

Li Zhenhua (2005): The Transfer of land Rights in China’s Rural Areas: A Legal


Ministry of Finance (1992): Circular on the Promulgation of the Provisional Regulations on the Collection of Land Conveyance Fees and the Provisional Regulations on Fiscal Administration of Land Conveyance Fees. (财政部关于颁布
《关于国有土地使用权有偿使用收入征收管理的暂行办法》和《关于国有土地使用权有偿使用收入若干财政问题的暂行规定》的通知，1992 年 9 月 21 日


Ministry of Finance (2006): Circular on Integrating the benefits from Land Conversion Received by Central Government Agencies or Organizations into Their Regular Budgets. (财政部：《关于将中央单位土地收益纳入预算管理的通知》，2006 年)


Ministry of Land and Resources (2002): Regulations on Tendering and Auctioning the Use Right to State-Owned Land. (国土资源部：《招标拍卖挂牌出让国有土地使用权规定》，2002 年 7 月 1 日)


Ministry of Land and Resources Department of Land Use Administration (2006): Rules and Regulations on the Conveyance of the Use Right to State-Owned Land,


*People’s Daily* (January 14, 2008): Lin Yifu Says That the Most Outstanding Structural Problem Is Unfair Income Distribution. (《人民日报》2008年1月14日：“林毅夫：最突出的结构问题是收入分配不合理”)

http://news.xinhuanet.com/fortune/2008-01/14/content_7415131.htm

*People’s Daily* (October 23, 2008): Rural Land Administration Shall Be Strengthened – A Reading of the Decisions by the CCP Central Committee on A Number of Key Issues Regarding How to Promote Rural Reform and Development, Part Three (《人民日报》2008年10月23日：农村土地管理要严格规范 — 解读《中共中央关于推进农村改革发展若干重大问题的决定》之三)


*Qingdao Finance Daily* (October 3, 2007): The National Bureau of Statistics Says That the Growth Rate of Housing Prices Has Been Accelerating Month by Month. (《青岛财经日报》2007年10月3日：国家统计局分析房地产市场，房价涨幅呈逐月加快)


Rural Survey Team of Yunnan Province (2003): The Livelihood of Farmers Who Have Lost Land In Yunnan Province Shall Be Taken Seriously (云南省农调队: 《云南省失地农民生产生活现状不容忽视》, 2003)


State Council (1987): Regulations on Farmland Occupation Tax. (国务院：《中华人民共和国耕地占用税暂行条例》，1987 年 4 月 1 日)

State Council (1988): Provisional Regulations on Urban Land Use Tax. (国务院：《中华人民共和国城镇土地使用税暂行条例》，1999 年 9 月 27 日)


State Council (2006-a): *Circular on Issues Related to the Establishment of the National Land Supervision and Inspection System.* （国务院办公厅：《关于建立国家土地督察制度有关问题的通知》, 2006年7月13日）

State Council (2006-b): *Circular on Strengthening Land Regulation and Control.* (国务院：《关于加强土地调控有关问题的通知》，2006年)

State Council (January 7, 2008): *Circular on Promoting Intensive Land Use.* (国务院办公厅：《国务院关于促进节约集约用地的通知》，2008年1月7日)


9, 2006. （国务院发展研究中心"中国土地政策改革"课题组：中国土地政策改革：一个整体性行动框架。《国土资源》2006年第9期）

Thunen, J.H.Von (1826): The Isolated State.


http://news.xinhuanet.com/newscenter/2004-05/12/content_1464696.htm


Xinhua News Agency (June 16, 2006): The Ministry of Land and Resources Is Determined to Crack Down on Illegal Land Use. (国土资源部：处罚到位 将查处土地违法进行到底。新华网 2006 年 6 月 16 日) http://news.xinhuanet.com/politics/2006-06/16/content_4708518.htm


Xinhua New Agency (Mar. 7, 2008): Members of the National People’s Congress Comment on Income Distribution. (新华网记者王优玲、周英峰、刘铮：让发展成果全民共享 — 代表委员热议收入分配。新华网 2008 年 3 月 7 日)
Xinhua News Agency (June 5, 2008): World Leaders Hammer out Common Response to Food Crisis, June 5, 2008


http://shipin.people.com.cn/GB/7183167.html


http://www.xslx.com/htm/jjlc/ljllj/2002-3-21-12632.htm


Yang Zhigang (2004): China’s Fiscal Institutions: History and Prospect. (杨之刚：中国财政体制改革：回顾和展望)


Zhang Jing (2008): 84 Cities Received Approval for Their Land Use Applications, and 79% of the Approved Land Use Will Be for Affordable Housing. *Xin Min Evening News*, August 5, 2008. (张静: 国土部:84个城市用地获批, 79%用于廉租房低价房。《新民晚报》2008年8月5日)


以下政府间关系的演变 — 对 20 世纪 80 年代 A 省财政体制改革中政府间关系变迁的个案研究。《社会学研究》2006 年第 3 期)


