

The Role of Local Government in China's Urbanization: The Relationship Between  
Local Land Finance and Government-led Urbanization

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## **Abstract**

Over the past several decades, dramatic growth and institutional reforms have taken place in Chinese economy and society. Accompanying this is accelerated urbanization. However, rather than being a natural consequence of economic development, and a complex outcome of a reasonable combination of population urbanization and land urbanization, China's unique urbanization is characterized by being local government-led and by the blind pursuit of land expansion. The relationship between rapid government-led urbanization and the phenomenal land expansion needs to be understood in the particular fiscal, land management, and political context. The Tax-sharing system introduced since 1994 has led to a huge fiscal gap for local governments to provide local public services. As part of compensation, the monopolistic land management authority has been devolved to local governments, which in turn provides local governments with substantive power to pursue local land finance by leasing land-use rights to private developers. With fiscal incentives and exclusive land administration power, plus the top-down economy-focused cadre evaluation, local officials are motivated to compete with each other, leasing as much urban land as possible. Obviously, China's government-led and land-centered urbanization has been a serious fiscal, social, and political problem that is extremely harmful to landless farmers and general residents. The urgent and also the realistic step to change China's acceleration of urbanization should start with replacing the monopolistic land management system by a pluralistic land planning decision-making arrangement. Such experience can be learned from Canada, where there are independent appeal bodies to offer the public a substantive and legal channel to protect their property interest.

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## **Chapter 1: Introduction**

### **1.1 Background**

The world trend of urbanization has been irreversible since the second half of the 20<sup>th</sup> century, with the level of urbanization closely correlated with the level of economic development (Chen, Liu, & Tao, 2013). Over the past decades, there has been a significant and sustained economic growth in post-reform China, with about 10 percent annual increase (Fan, 2012). Accompanying the fast economic development as well as the strategy of urbanization acceleration, China's urbanization from 1980 to 2012 has increased from 19.4 percent to 52.6 percent of the country's population (Yang X. J., 2013). Urbanization in China is defined as a complicated and multifaceted process, which involves population migration from the rural areas to the urban areas, land expansion, spatial reconfiguration of settlements, and transforming governance (Gu & Wu, 2010). Compared to other countries, the growing rate of urbanization in China is much faster than the rate of economic development, and a concern about relative over-urbanization had emerged (Chen, Liu, & Tao, 2013) (Yang X. J., 2013). Scholars identify the notion of "over-urbanization" as excessive-urbanization with the most noticeable evidence of the dramatic increases in urban land and over-investment in real estate industry (Chen, Liu, & Tao, 2013). As a consequence, the imbalance between the level of urbanization and the economic growth would cause a series of social issues, including environmental damages, shortage of rural labor, pressure of the urban social services, and even crime. Against this background, it is high time that China should rethink the over-urbanization and should examine the rationale behind local governments' pursuance of urbanization.

Throughout China's developing models of urbanization, there are three main stages. The first one is the stage of "Urbanization of Small Towns", which happened

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during the 1980s to the 1990s. It started with the rural economic reform, contracting the land to the household to stimulate the efficient use of the agricultural land. Along with this was the emergence of the Township and Village Enterprise (TVE) that was directly invested in by local governments (i.e. the town government). During this period, the level of urbanization grew from 17.9 percent to 27.5 percent (Zhou W. , 2014). Secondly, from the 1990s to the 21st century, China has experienced the stage of “Pursuing Increasing Size of Large and Medium Cities”, in which industrialization has played a key role in promoting the process of urbanization. Specifically, land commercialization was a tool, with which local governments managed their budget and local economies, as well as being a means to pursue the increased GDP. In this situation, the level of urbanization has reached around 27.5 percent to 39.1 percent (Zhou W. , 2014). Currently, local governments tend to pursue the increased urbanization of the urban agglomerations, such as Yangtze River Delta and Pearl River Delta regions. Instead of relying on the industrialization generated from the Town and Village Enterprises (TVE), local governments depend on raising revenue from local land. And the level of the urbanization was about 51.3 percent in 2010 and around 54.77 percent in 2014 (Zhou W. , 2014) (Yang X. J., 2013). (National Bureau of Statistics of China, 2015)

Additionally, urbanization means both the massive construction and expansion of urban centers and millions of new urbanites (Rithmire, 2015, p. 188), involving two dimensions: (1) population urbanization (new city residents), and (2) land urbanization (new urban areas). During the period from 2000 to 2009, the urban area grew from 2.24 million hectares to 3.81 million hectares (Tang, Zhou, & Shi, 2014). Comparing to the annual urban population growth rate of 3.55 percent, the annual urban land expansion rate is 6.20 percent (Fan, 2012), which indicates that the land

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urbanization is much faster than the population urbanization (Tang, Zhou, & Shi, 2014). Therefore, China's urbanization is characterized by increases in urban land led by local governments (Liu & Yin, 2013). And in the process of China's recent accelerated urbanization, the key problem is the local governments' pursuance of land urbanization, thereby creating an imbalance between the urban population growth and the urban land expansion, as well as the phenomenon that the urbanization is far ahead of the economic development. Local government obtained monopoly control over land and played a key role in land planning, infrastructure construction, and resident management (Wang & Xiao, 2011).

Against this backdrop, this research examines the rationale behind the local government's pursuance of urbanization, and its deep relationship with fiscal reform, local land management, and the political performance evaluation system of local cadres by central officials. This paper argues that rather than being a natural consequence of the economic development and a complex outcome of a reasonable combination of the population urbanization and the land urbanization, China's urbanization in recent decades, especially since the fiscal reform in 1994, can be identified as a local government-led development (Oi, 1995), deriving from the municipality's fiscal incentives, land monopoly authority incentives, and political incentives. That is to say, while urbanization seems to be an inevitable trend of economic development, it is actually driven by an unsustainable accumulation regime that prioritizes the needs of local land fiscal income, real estate development and GDP growth at the expense of the balance between the level of urbanization and the economic development, as well as the balance between the population urbanization and the land expansion.

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## 1.2 Literature Review

Local government has been seen as the executive, planner, and the guide in accelerating the process of urbanization through the local land finance, and urbanization has made a huge contribution to China's economic development during the period of social transformation. As the result, urbanization, local land finance, and the role of local government have attracted great scholarly attention.

First, in the aspect of the process of China's urbanization, scholars observed that China's rapid urbanization has developed far ahead of the economic growth, which has caused the over-urbanization (Chen, Liu, & Tao, 2013; Yang X. J., 2013; Zhang, 2008). And it is continuously urbanized in accordance with a distinctive feature that is identified as "land urbanization" (Zhang, 2008; Liu & Yin, 2013; Tang, Zhou, & Shi, 2014; Ye & Wu, 2014; Lin & Yi, 2011). He, Zhou, & Huang define "land urbanization" as to land conversion from agricultural production to urban development (2016). That is because this kind of land conversion could generate revenue from local land finance for local governments, and cities with stronger economy and higher real estate investment would push more aggressively for land urbanization (Ye & Wu, 2014). This phenomenon has caused the imbalance between the land urbanization and population urbanization (Xie, 2016).

Second, as for local land finance, which means local revenues that are generated out of land directly or indirectly, including (1) land leasing income, (2) tax revenue generated directly from land use and development (e.g., urban land-use tax, land Value-added Tax and so on), and (3) tax revenue generated indirectly from land use and development (e.g., corporate tax and income tax paid by the housing and construction industries) (Lin G. C., 2014). It has been widely recognized by Chinese scholars that local land finance has become "the second finance", accounting for

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nearly 40 percent to 60 percent of the general budget revenue at the local level (Liu & Feng, 2010; Lin & Yi, 2011; Zhou, 2014). Ong (2014) points out that there is an increasing reliance by local government on land fiscal income and financing of urban infrastructure by the local land-leasing revenue. Rithmire (2015, p.1) even shows that the major political and economic change in China during the last century is actually a series of land reforms. All these studies can show the significance of land management and land finance to local governments. And the relation between the land finance and the acceleration of urbanization is obviously positive as shown in Zhou's (2014) study on "Causes and Governance of Local Government Land Financial Problems in China". Zhou reveals that the level of urbanization and the local land finance are mutually dependent, in that the process of urbanization needs land for industrial, business, and residential usage and vice versa. Local land finance enables the urban fixed investment on infrastructures designed to attract more people (2014).

Third, there is great debate and controversy in the role of local governments in post-reform China. For instance, Su & Chen (2005) point out that there are two major roles of local governments in the history of land management. Before the 1980s, local government was the agent of the central state, following the central order and assisting the implementation of land-related policies. But since the year of 1992, local governments have been granted the authority of land expropriation and its role has shifted to that of a corporation that seeks its own interest (Su & Chen, 2005). Jean C. Oi shows that granting property rights to local government distorts the role of the latter as the agent of the central government, and then she introduces the notion of "Local State Corporatism" to see local governments as a rational actor pursuing revenue while the local official is a political entrepreneur. With the shift from

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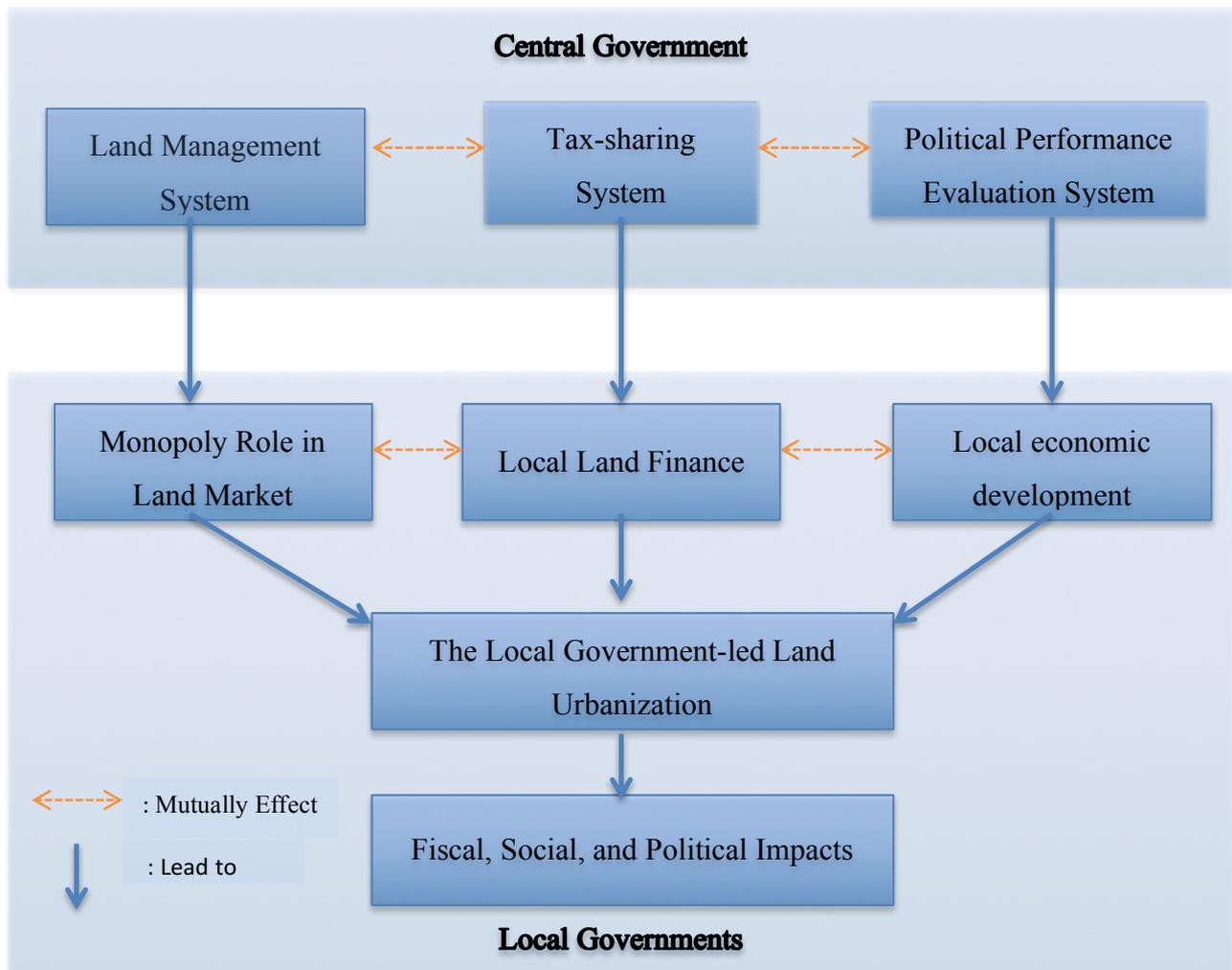
administrators to entrepreneurs, local governments are changing from regulators to advocates of their local enterprises (Oi, 1995). This theory has emerged in China's specific fiscal context, which creates the specific fiscal incentives for local governments to generate local revenue as much as they can. Accompanying the fiscal reform in 1994 has been the decline of the notion of "Local State Corporatism", but Zhan (2015) demonstrates that the incentive of local governments to pursue revenue has not gone away. Instead of the relying on the Town and Village Enterprise (TVE), local government has explored a new method to generate local revenues, that is by expropriating rural land and selling it to developers in the city. This method is now called local land finance (Zhan, 2015).

### **1.3 Structure of the Paper**

The remainder of this paper is organized as follows, depicted in Figure 1 in below. It starts with a descriptive analysis of the "transformation of fiscal incentive", as a general context for understanding the most significant reason for China's local governments to move on to relying on local land finance to pursue urbanization. It includes a brief comparison between the Fiscal Contracting System and the Tax-sharing System and the different powerful effects they had on local governments in developing the local economy. In the next section, the paper explores the local land management system and demonstrates the monopoly role of local government in changing rural land into urban land, which provides the possibility for local governments to finance urban infrastructures from the city's land-leasing income (Ong, 2014). This is followed by a clarification of the political incentive in the pursuance of the land urbanization, further explaining why local officials choose to accelerate land development and urbanization. After the exploration of the logic of the local government-led land urbanization, this paper looks into the impacts of this

imbalanced urbanization process in China, not only from the resource-erosion and violation of farmers' property rights perspectives but also from the standpoint concerning the social, fiscal, and political issues (Kung, Xu, & Zhou, 2013). And then, this paper discusses what China can learn from Canada when local governments in both countries are faced with common dilemmas, such as fiscal constraints and heavy reliance on land-related revenue. The last gives conclusion.

Figure 1: Structure of the paper



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## Chapter 2: Transformation of Fiscal Incentive

In the process of China's urbanization, a shift of development focus happened at a time when major institutional changes were made to restructure the fiscal system, which can also be seen as the main tool that is used to formulate the fiscal relationships between the central and local governments. This intergovernmental fiscal relationship determines the capacity of local finance. Since the founding of the People's Republic of China, the development of financial systems can be divided into three major phases, shown in Figure 2 below. At the beginning of China's Reform and Opening in 1978, the revenue collection was highly and strictly centralized by the state, leaving local governments no particular incentives to enhance their local finance. In this fiscal system, local government was the taxation-collecting agency of the state at the local level, and most of local tax incomes and profits had to be remitted to the central government. Meanwhile, local expenditures were heavily relying on financial transfer from the national budget (Tsai, 2004). During the time period of 1978 to 1993, a revenue-sharing system called the "Fiscal Contracting System" was introduced through the fiscal reform, which focused on the decentralization and fiscal bargaining between the central and subnational governments. This system was designed to devolve the responsibilities of revenue generation and remittance to local governments. Because the "lump-sum remittance" was fixed for a long time, this system had created great incentives to local governments for revenue generation, through which they could make more surplus revenue to be retained at the local level (Lin & Yi, 2011). In 1994, due to the declining national share of the budget revenue, the central government sought to re-boost the state fiscal revenue by implementing a "Tax-sharing System" (*fenshuizhi*) (Tsai, 2004; Luo, 2010), in which there are three categories of revenues: central fixed revenues, local fixed revenues, and shared

revenues. This fiscal system required local governments to pay a tax proportional to their local revenues, rather than a fixed, lump-sum remittance (Lin & Yi, 2011).

Figure 2: Three major phases of China's fiscal reforms since 1978

Year	Tax System	Description	Effects on Local governments' incentive
Pre-1978	Centralized	Centralized revenue collection and transfer	No particular incentive to boost revenue collection
1978-1993	Fiscal Contracting System	Decentralization & Revenue-sharing	Generally increased revenue collection incentives, especially for wealthier provinces
After 1994	Tax-sharing ( <i>Fenshuizhi</i> )	Increasing the center's share of budget revenue	Reclassification of most shared taxes to local fixed revenues increases collection incentive

Source: Summarized from (Tsai, 2004)& (Luo, 2010).

By comparing the latter two fiscal systems in China, this chapter will further investigate the extent to which the powerful incentives within the different fiscal systems induce local governments to change their development focus from industrializing the city to urbanizing it.

## 2.1 From Fiscal Decentralization to Fiscal Re-centralization

Since the 1980s, an overriding goal of China's reform has been to improve the economic efficiency. The Chinese government achieved this essential goal via regional decentralization. First, the central government downloaded some rights to local governments to directly set up, invest, and manage enterprises that were appropriate to their levels, and have them compete with each other on a regional basis (Kung, Xu, & Zhou, 2013). Second, the fiscal reform introduced in 1978 played an important role. Under the "Fiscal Contracting System", local governments were granted authorities to retain both revenues and profits generated within their own

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jurisdictions. Local governments were entitled to keep that portion of the revenue in excess of the remitted amount that they negotiated with the state (Kung, Xu, & Zhou, 2013).

The turning point was in 1994 when the central government decided to reshape the fiscal relationship between central and local governments, and introduced the “Tax-sharing System” to replace the previous “Fiscal Contracting System” (Lin & Yi, 2011). This new fiscal reform happened because of the severely weakened central state fiscal capacity in the 1990s. Specifically, the central government’s share of revenue in overall budgetary revenue had dropped to 22 percent in 1993 from 40.5 percent in 1984 (Kung, Xu, & Zhou, 2013). With the purpose of redefining the fiscal responsibilities between the central and local governments, lowering the financial deficits and raising revenue for the central government, standardizing the fiscal system, and increasing transparency (Lin & Yi, 2011), the “Tax-sharing System” was seen as a reform to re-centralize the intergovernmental fiscal relationship. As we mentioned above, there are three categories of revenues, in which Sales Tax is the central fixed revenue and Business Tax is the local fixed revenue. The Value-added Tax (VAT), one of the biggest taxes, is categorized as shared revenue, with 75 percent of the total VAT income remitted to the central government and 25 percent kept by local governments. Another important type of shared revenue is the Income Tax, of which 60 percent belongs to the central state and 40 percent remains in city governments (Lin & Yi, 2011). After this re-centralizing fiscal reform in 1994, the central government witnessed a great increase in its share of total fiscal revenues, from 22 percent in 1993 to 55 percent in 2002 (Tsai, 2004). In contrast, the local ratio of total fiscal revenues experienced a huge decline since 1994, from nearly 80 percent in 1993 to around 45 percent in 2002 (Tsai, 2004). However, local governments’

expenditure burden for providing public services and public goods did not decline with their fiscal power and finance capacity (depicted in Figure 3 below). The central government is responsible for national affairs relating to national defense, armed police, foreign affairs, and macroeconomic control. Jurisdiction over local administration expenditures and urban construction and maintenance is vested in local governments. While the ratio of local fiscal revenues accounting for total fiscal revenues kept falling, the ratio of local fiscal expenditures to total fiscal expenditures has remained at about 70 percent. Therefore, the allocation of local revenues and local expenditures was becoming more and more imbalanced.

Figure 3: Comparison between local fiscal revenues and local fiscal expenditures

Year	Local fiscal revenues		Local fiscal expenditures	
	Billion Yuan	Local fiscal revenues/ Total fiscal revenues (%)	Billion Yuan	Local fiscal expenditures / Total fiscal expenditures (%)
1993	339.14	78	333.02	71.7
1994	231.16	44.3	392.96	69.1
1995	298.56	47.8	482.83	70.8
2004	1224.11	45.8	2059.28	72.3
2005	1488.42	47.4	2515.43	74.1
2006	1830.36	47.2	3043.13	75.3
2007	2356.5	45.9	3812.04	76.9

Source: China's Statistical Yearbook in 2008, organized by Yang & Lu (2010).

## 2.2 From Rural Industrialization to Land Urbanization

The fiscal reform concerning the intergovernmental relationship has changed from decentralization to re-centralization. It has also transformed local governments' development focus, from rural industrialization to land urbanization. In the context of

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the “Fiscal Contracting System”, local governments had great fiscal incentives to generate revenues, especially from non-agricultural enterprises, of which Town and Village Enterprises (TVEs) were a key component. That is because, as we mentioned above, since the 1980s, the central government downloaded property rights to local governments and the latter can directly set up, invest, and manage enterprises that were appropriate to their levels, and have them compete with each other on a regional basis (Kung, Xu, & Zhou, 2013). Not surprisingly, under the “fixed finance remittance” fiscal system, local governments could benefit from the development and expansion of TVEs by collecting taxes. Actually, TVEs were once an engine of growth of China’s economy during the period of the 1980s to the 1990s (Kung, Xu, & Zhou, 2013). Evidence shows that from 1981 to 1990, the total industrial output of TVEs increased at an average rate of 28 percent, and the productivity of TVEs was higher than that of State-owned Enterprises (Kung, Xu, & Zhou, 2013). All these incentives made local governments (especially the county-level and town-level governments) focus on rural industrialization and rely on the revenue generated from TVEs.

However, in the process of the re-centralized fiscal reform since 1994, the state government changed the claims of local governments over tax revenue generated by their non-state, non-private enterprises (i.e., TVEs). To re-boost the state fiscal capacity, the “Tax-sharing System” has reduced the share of local governments’ entitlement to several important tax sources (Kung, Xu, & Zhou, 2013). By re-allocating tax categories and assigning tax rights based no longer on who owns an enterprise, the fiscal reform in 1994 was essentially characterized by a greatly reduced of share of revenue for local governments (Kung, Xu, & Zhou, 2013). For example, the central government reclassified a hefty 75 percent of the Value-added Tax (VAT)

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to itself (Kung, Xu, & Zhou, 2013). And the VAT is one of the most important taxes to be collected from enterprises and individuals engaged in a market transaction (Lin & Yi, 2011). The same principle was suitable to Income Tax. And the changing relative significance of these two taxes in overall budgetary revenues of local governments was reflected in the growing share of Business Tax that is assigned as the local fixed revenue, from 20 percent in 1994 to 25 percent in 2003 (Lichtenberg & Ding, 2009). Moreover, the construction and real estate (CRE) industries have been a major contributing source of Business Tax revenue. For example, in a county in Zhejiang province, the Business Taxes levied from the CRE industries accounted for 17 percent of the land-related budgetary revenues, which in turn took up nearly 40 percent of total budgetary revenues (Lichtenberg & Ding, 2009).

This re-centralization of fiscal resources has provided local governments with great fiscal incentives to engage in construction and infrastructure projects in China's process of accelerating urbanization. And for local governments, the benefits of pursuing the urbanization strategy are not only limited to enhancing residual claims on the Business Tax. But it is the monopoly right over land planning and development that gives local governments a more powerful fiscal incentive to urbanize China (Lichtenberg & Ding, 2009). In order to compensate local governments for the loss that has resulted from the Tax-sharing System, the State Council issued the Urban Real Estate Management Law in 1994 and clearly designated city governments as the "landlord" (Kung, Xu, & Zhou, 2013) (Rithmire, 2015, pp.56-57). In particular, the central policy-makers allowed the local land-lease fees to be included into revenues for local budget. Therefore, as with the powerful fiscal incentives of the Fiscal Contracting System on the explosive growth of TVEs in the 1980s (Kung, Xu, & Zhou, 2013), the strong fiscal incentives provided by the Tax-sharing System in 1994

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are the shift of development focus from industrialization to urbanization, as well as local governments' pursuit of local land finance. Land-related income has become one of the most important sources of local revenue generation, and it is under the direct control of city and county governments (Lin & Yi, 2011).

### **2.3 Local Land Finance in China**

Local land finance (*tudi caizheng*) has been seen as a unique term in China, and it has been a fact that China's local governments attempt to increase land finance revenues to deal with the growing responsibilities and liabilities of social and economic development (Lin G. C., 2014). In recent years, the land finance has become "the second finance" of local governments, and it has taken up nearly 40 percent to 60 percent of the overall budgetary revenue at the local level (Liu & Feng, 2010). Specifically, as shown in Figure 4, the revenues collected from land lease (to be discussed more in next chapter), which is monopolized by local governments have contributed to the biggest source of unregulated and unshared revenues for many local governments in China (Kung, Xu, & Zhou, 2013). The ratio of land leasing income to local government total revenue grew from 16.6 percent in 2001 to more than 50 percent in 2007 (Liu & Feng, 2010). In turn, local governments are heavily relying on and focusing on construction and real estate industries. It is reported that real estate investment funds invested in the development land and property have grown from 2 percent of GDP in 1992 to about 13 percent in 2011 (Rithmire, 2015, pp. 31). In other words, land commodification has made a great contribution to municipal finance.

Figure 4: The ratio of the land-leasing income accounting for the total local revenue

<b>Year</b>	<b>A: Nationwide land-leasing income (Billion Yuan)</b>	<b>B: Nationwide total local revenues (Billion Yuan)</b>	<b>Ratio (A/B) (%)</b>
<b>2001</b>	129.6	780.3	16.6
<b>2002</b>	241.7	851.5	28.4
<b>2003</b>	538.5	985	54.7
<b>2004</b>	589.4	1189.3	49.6
<b>2005</b>	550.5	1510.1	36.5
<b>2006</b>	767.7	1830.4	41.9
<b>2007</b>	1194.8	2357.3	50.7

Source: Liu & Feng, 2010, Taxation Research.

Actually, local land finance is a by-product of the Tax-sharing System, as well as a key contribution to local governments' pursuit of land urbanization. Based on the general contours of the Tax-sharing System, it is easy to understand that, because of the decreasing share of local revenues plus increasing responsibilities of providing local public goods and services, local governments are faced with an enormous fiscal gap. That is to say, with the devolution of fiscal power from the central government to cities, many of the central government's responsibilities, including providing the urban public goods such as health, education, and transport, were also downloaded to cities. So municipal governments have to meet their expenditures from their own-source revenues (Wang, Zhang, Zhang, & Zhao, 2011). To deal with this dilemma, most localities eventually prefer to rely on land finance by accelerating land urbanization.

Depicted in Figure 5 below, as Luo (2010) points out, to fill the fiscal gap, local governments normally have two alternatives: one is to enhance the budgetary revenues, and the other is to gain the extra-budgetary revenues. On the one hand, as

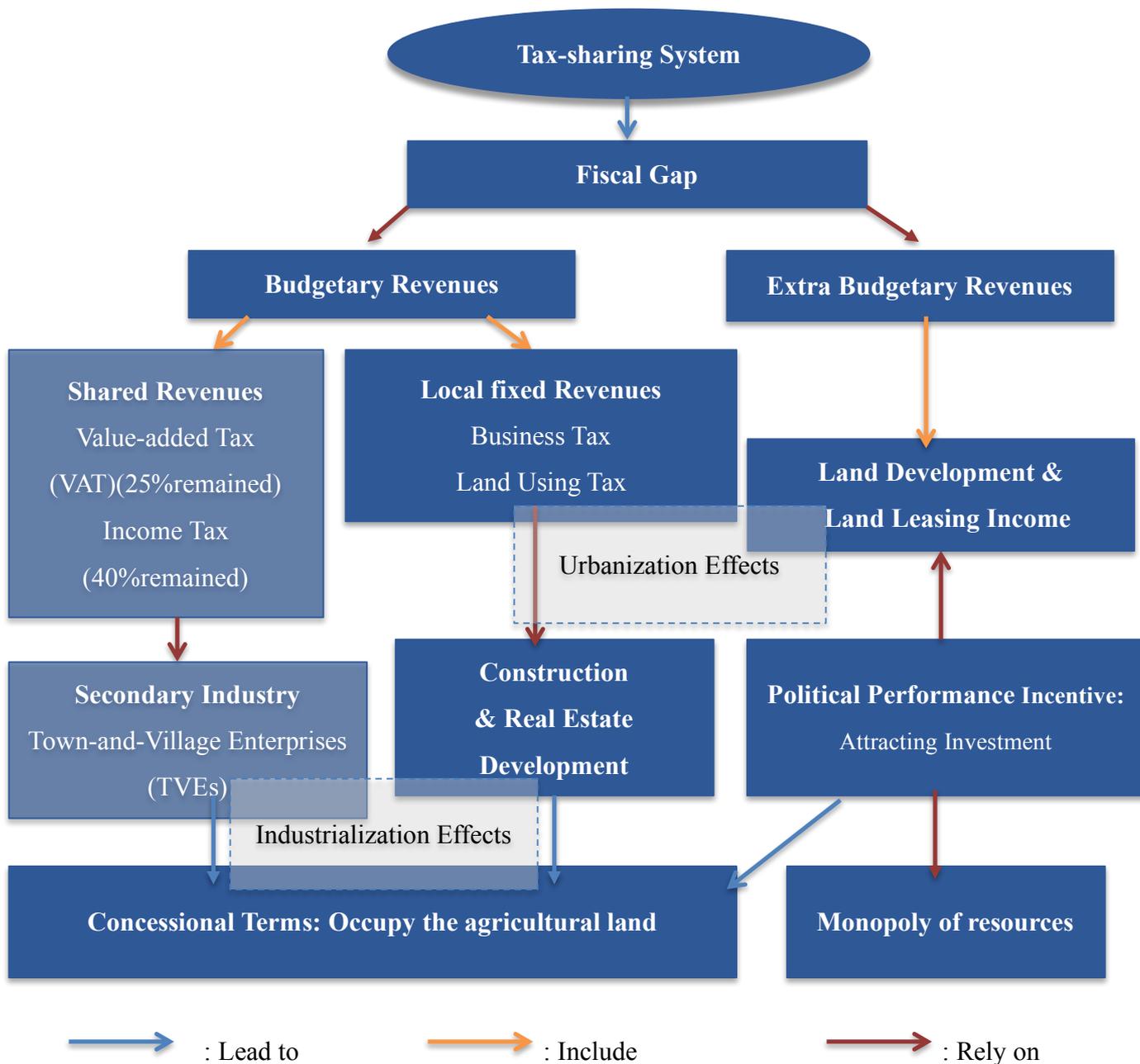
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demonstrated on the left side of Figure 5, in order to enhance budgetary revenues, local governments can achieve this goal by increasing the shared revenues that contain the Value-added Tax (VAT) and the Income Tax, etc. These two types of taxes both depend on the secondary industry that is also in line with the growth of GDP. The problem is that to develop the secondary industries, resources like capital and land are necessary. To attract more industrial investment, local officials tend to offer concessions (i.e., low-cost expropriated land from rural areas), ignoring the market principles of land management. Considering that only 25 percent of the Value-added Tax and 40 percent of the Income Tax remain with cities, it is difficult for local governments to make up for the lost revenues only by expanding the shared revenues. Within the budgetary revenues, the Business Tax has replaced the Value-added Tax and Income Tax, becoming an important source of local revenues. As we discussed above, the Business Tax consists primarily of taxes collected from the construction and real estate sectors in the acceleration of land expansion (Kung, Xu, & Zhou, 2013). To be more specific, there is a growing share of Business Tax accounting for the local total revenues, slightly increasing from 20 percent in 1994 to 25 percent in 2003 (Lichtenberg & Ding, 2009).

On the other hand, illustrated on the right side of Figure 5, as the Tax-sharing System is a re-centralized fiscal reform that is aimed to enhance the central fiscal capacity, it is still hard to close the financial gap only by increasing the budgetary revenues. Therefore, pursuing the revenue out of the budget, which also means being under less supervision of the central government, turns out to be the most common instrument for a municipality to deal with fiscal constraints. And in the extra-budgetary revenues, local land-leasing income has taken up the biggest part, an income stream over which it has been assigned exclusive rights by the central

government (Lichtenberg & Ding, 2009). This part of extra-budgetary revenues can indeed be substantial, and can make up for the loss revenues that have been remitted to the central government as a result of fiscal reform in 1994 (Lichtenberg & Ding, 2009).

Figure 5: Tax-sharing System, local land finance, and land urbanization



Source: Author summarized and re-organized based on Luo's Research (2010).

For some cases, the land-leasing income is even categorized as non-budgetary revenue, which leaves local authorities great fiscal capacity. For example, according to the study conducted by Kung, Xu, & Zhou (2013), in S county in Zhejiang province, profits made from land revenues consist of three categories (shown in Figure 6 below): (1) budgetary revenues (i.e., taxes) including direct land taxes and indirect land taxes (i.e., Business Tax collected from construction and real estate industries), (2) extra-budgetary revenues (i.e., land fees), and (3) non-budgetary revenues (i.e., land leasing income). In S county, land-leasing income becomes the sole source of non-budgetary revenues that are under little central supervision. And the profits made from land lease are much more than the sum of profits made from budgetary and extra-budgetary land revenues.

Figure 6: Profits made from land revenues in S county in 2003

**Profits made from land revenues in S county in Zhejiang province**

Category	Profits (Million Yuan)	Item	Ratio
Budgetary revenues	519.8	Direct Land Taxes	14% of budgetary revenues
		Indirect Land Taxes	26% of budgetary revenues
Extra budgetary revenues	510	Land fees	51.5% of extrabudgetary revenues
Non-budgetary revenues	1920	Land leasing income	100% of non-budgetary revenues

Source: (Kung, Xu, & Zhou, 2013)

Actually, the central government has realized the irregularity of local land finance and has tried to standardize it. In 2006, the State Council issued a notice to regulate the local management of the land-leasing income. According to Article 4 of this notice, all the amount of incomes and expenses for land lease shall be incorporated into the budget (General Office of the State Council, 2006). Additionally,

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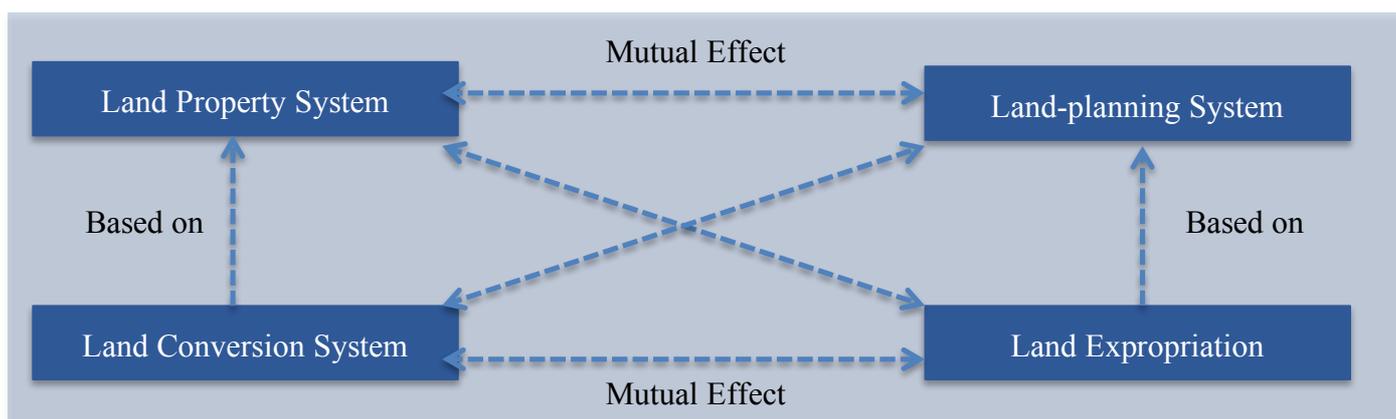
according to Article 4 of the Budget Law of the People's Republic of China (2014 Amendment), all government revenues and expenditure shall be included in a budget. Given the elastic land prices during the land-leasing process, it leaves local governments some room to implement over budget. Most importantly, the fiscal incentive for local government to pursue land finance still keeps unchanged.

Therefore, since the Tax-sharing System reform in 1994, the profits generated from land lease by local governments have been set as the main source of the local revenues for cities (Liu & Feng, 2010). Local governments' exclusive fiscal power over land finance is a by-product as well as a "compensation" of the fiscal reform in 1994. However, the fiscal incentives of local governments in promoting land urbanization could only be feasible in a monopolistic environment of local land management. These fiscal incentives and monopoly incentives encourage and empower local officials to accelerate land urbanization to fill the fiscal gap.

### Chapter 3: Monopoly Incentive: Land Management System

Land management is an important administrative activity, aimed to protect property rights and organize land-use planning. Actually, from 1949 to 1978, to be consistent with the highly centralized Planned Economy System, China's land distribution was mainly conducted by administrative allocation controlled by the state, for an unlimited period of time, and free of charge (Cao F. , 2013). Since the reform and opening in the 1980s, land commercialization has been introduced in China. The land-use is no longer free of charge and the duration of the land-use right is limited depending on the usage of land. With the development of the high-speed economy and unprecedented restructuring of rural and urban areas, scarce land resources have become a crucial instrument and an easy way for local governments in China to generate revenues. As shown in Figure 7 below, China's current land management system contains four main sections: land property system, land-planning system, land conversion system, and land expropriation. They mutually affected each other.

Figure 7: China's current Land Management System



Source: Re-organized based on the study conducted by Liu, Su, Long, & Hou (2013)

Local land finance is built on the dualistic structure of land rights as well as local governments' monopoly authority over land administration (Zhou W. , 2014). In this

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situation, local governments not only have fiscal incentives to pursue land finance by accelerating land urbanization but also have the exclusive power to do so. Therefore, urbanization can be seen as a multidimensional phenomenon that is unique in terms of the speed, scale, and government-driven nature (Ye & Wu, 2014). In this chapter, the author will discuss more of China's land management system, focusing on the monopoly role of local governments in the process of transforming rural lands into urban lands.

### **3.1 Dualistic Structure of Land Rights: Rural and Urban Areas**

In China, reflecting in the land property system, all land is formally under public ownership. The distinction between the land ownership and land-use right is the most outstanding point that distinguishes China's land management system from western countries. To be more specific, as stated in the *Constitution of The People's Republic of China*, land in cities is owned by the state while land in rural areas is owned by the collective (National People's Congress, 1982). An organization or individual is not allowed to buy, sell or otherwise engage in the transfer of land by unlawful means (National People's Congress, 1982). But the right to the use of land can be transferred according to law (Wang W., 2013). Additionally, "the state may, in the public interest and in accordance with law, expropriate or requisition land for its use and make compensation for the land expropriated or requisitioned" (National People's Congress, 1982). Based upon the Constitution, the legal framework that further shapes the land-use rights is the 1988 Land Administration Law, which was first drafted in 1986 and then revised in 1988 (Ding, 2003). In this fundamental land management law, the public ownership of land means that the State Council, as the representative of the state, has the authority to exercise the ownership of the state-owned land (Wang W., 2013). However, in real life, this authority is devolved to subnational governments to

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implement the right of land planning, land expropriation, land leasing, and other land-related activities. In order to provide legal guidance, the State Council issued the *Provisional Regulation On the Granting and Transferring of the Land Rights over the State-owned Land in Cities and Towns* in 1991, in which land users of the urban state-owned land are allowed to transfer, rent, and mortgage the land-use rights (Ding, 2003). In contrast, the rural collective-owned land is forbidden to enter into the land market directly. For example, it cannot mortgage the land. Rural collective-owned land can only be used for non-agricultural use or transferred in the land market when it has been expropriated as the urban state-owned land by local governments.

Thus, when the conversion of rural collective-owned land is still under a stringent administrative restriction that is monopolized by local governments (Lichtenberg & Ding, 2009), the Law has legalized private organizations or individuals to access the state-owned land in the attempt to develop the land market (Ding, 2003). This legal and regulatory system, to some extent, makes local governments the sole institution that combines the right of ownership, the authority of operation, and the power of management (Wang W. , 2013).

Furthermore, the urban land belongs to the state and is under the administration of city governments that lease out the land-use rights to private developers under long-term (40 to 70 years) contracts. The village collectives own rural land and have the authority to allocate land for rural housing and village public works in addition to agriculture. Any other use of rural land requires a change in status from collective-owned to state-owned, accomplished by a process of land expropriation (Lichtenberg & Ding, 2009). This dualistic structure of land rights between rural areas and urban areas is the premise of the land conversion system and affects both: (1) holder of the property right, and (2) access to the land market.

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On the one hand, rural land (except some specific areas of land such as those used by the military) belongs to rural collectives, mainly including the village committees and villagers. However, it is very ambiguous to define who exactly the collective is (Luo, 2010). Within the municipal planning areas, village institution “on behalf” of villagers makes decisions on land expropriation (Li, Xu, & Li, 2010). Farmers, as nominal owners, tend to lose their legal protection from being expropriated by local officials, especially when they are faced with the land acquisition in the public interest. Individuals have no substantial power to negotiate.

On the other hand, property rights of the rural collective-owned land cannot be exchanged directly in the market. That is to say, the rural collective property cannot be transferred, converted, and leased out for non-agricultural use. Against such a backdrop, the process of developing rural land for urban development has to start with the land expropriation led by local governments in their land-use plans, transforming the nature of the land from rural collective-owned land to urban state-owned land. The restrictions on the conversion of collective property mean that local governments play a monopolistic role in the land market, excluding the rural collectives from the market place for land (Luo, 2010). So the property rights over urban lands can be transferred at a market price while rural lands are still regulated under the mechanism of “the planned economy” (Li, Xu, & Li, 2010).

Therefore, the dualistic structure of land rights between rural areas and urban areas is unfair for farmers. Unlike urban individuals who have the full property rights of state-owned land, farmers only have limited property rights of rural collective-owned land (Li, Xu, & Li, 2010). These imbalanced, ambiguous, and limited land rights of peasants easily make them become victims of so-called “public interest” in the process of land expropriation. In addition, the dualistic structure of

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land rights has engendered a special procedure of land conversion from rural land to urban land, which leaves local governments a huge amount of land rent residuals.

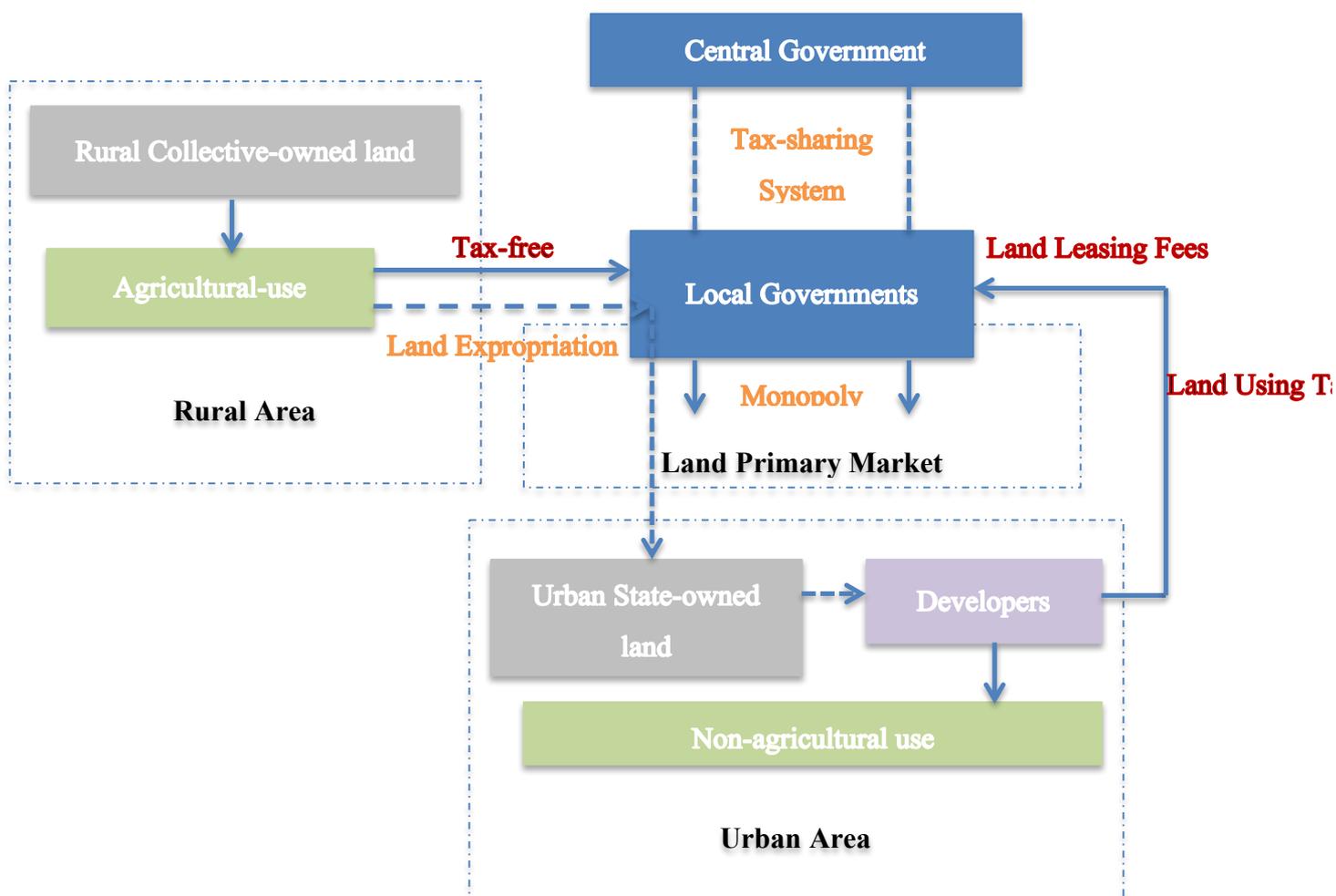
### **3.2 How Rural Land Becomes Urban Land?**

For local governments, selling the use right of state-owned land to private developers makes a great contribution to raising finance funds for urban construction in cities (Wang, Zhang, Zhang, & Zhao, 2011). The inevitable expansion of urban land has been noted. For one thing, with the abolition of the agricultural tax in 2006 to relieve peasants' burdens, local governments were forced to eliminate another significant source of fiscal revenue (Rithmire, 2015, p. 181). Local governments, in pursuit of both economic growth and fiscal revenues, are interested in expropriating rural land for urban use. The compensation paid to farmers is based on the value of crop production and determined by an administrative formula. It is meager compared to what local governments would obtain in selling these expropriated land rights in the land market (Kung, Xu, & Zhou, 2013). For another, with the development of the local economy and city sprawl, the demand for urban state-owned land used for city construction in the process of urbanization has experienced a soaring increase in past decades in China. Meanwhile, the existing stock of urban land could not meet the development needs. Occupying the rural land has been an inevitable instrument for local governments to finance urban services and development projects (He & Wu, 2008) (Tang, Zhou, & Shi, 2014).

As depicted in Figure 8 below, the process of transferring the rural collective-owned land into urban state-owned land starts with land expropriation led by local authorities. Although only provincial governments are empowered to convert the status of land, city governments often seek to influence provincial authorities to approve the land-use plan for the public interest (i.e., public infrastructure, urban

transportation). In this phase, farmers are passive when their lands are expropriated for the public interest, and they are too weak to protect their land-use rights through their limited property rights. Basically, local governments can expropriate any piece of rural collective-owned land. Even though compensation is required, it is not based on market prices. “The compensation is determined by an administration formula based mainly on agricultural productivity and also including the payment for land, crops currently in cultivation, attachments to land, and the land improvements” (Lichtenberg & Ding, 2009). Normally, the compensation made for the conversion of rural farmland is much lower than that of urban land.

Figure8: The process of changing the rural land into urban land in China



Source: Organized by the author.

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After being expropriated by local governments, the former rural-collective-owned land flows into the land primary market<sup>1</sup> that is monopolized by local authorities. In this stage, city governments sell land-use rights to developers for urban construction projects (i.e., commercial, residential, and industrial programs) for a fixed period of time. This process of land leasing must go through public tender and auction at a market price (Lin & Yi, 2011). Once developers obtain the use-right to develop the newly converted urban state-owned land, they need to pay relevant taxes to local governments, including land leasing fees, construction fees, and land-using tax (Ding, 2003), which will cover compensation for farmers and cost of newly built urban infrastructures (Su & Chan, 2006).

It is not surprising to find that local governments have great fiscal incentives to change the rural collective-owned land into the urban state-owned land. Compared to the tax-free policy for agricultural use land in rural areas, revenues generated from urban state-owned land become the main source of local finance. China's special land market tends to appreciate the value of urban state-owned land but depreciates the value of rural collective-owned land.

### **3.3 Monopoly Role of Local Government in the Land Market**

As we discussed above, in China's land management system, local governments combine multiple roles, including substantive land ownership, land-use planning, and land leasing. As the representative of the state, local governments possess a significant monopoly role in the land market.

First, in the aspect of land expropriation, local governments can requisition almost any piece of rural land in the name of the public interest. The definition of "public interest" is so vague that local governments are free to expropriate agricultural land

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<sup>1</sup> Primary land market: platform used for the transaction of land-use rights

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whenever they want (Ong, 2014). As the leading institutions, local governments even determine the compensation for farmers. Given that the compensation is based on crop productivity rather than the commercial value, local governments and private developers will gain great profits in land development.

Second, in terms of land-leasing process, local governments are in an absolutely dominant position. The primary land market would be monopolized and controlled by local governments, which are the exclusive owners of the land (Rithmire, 2015, p.53). Indeed, to avoid the secret transaction of land, the land leasing must be undertaken through a more transparent “market transaction”, such as public tendering, auctioning, and listing (Lin G. C., 2014). However, local governments, as the only “landlord”, have formed an artificial natural monopoly over the land transactions. The introduction of these means of market transaction has not changed local governments’ monopoly role in operating the urban state-owned land. They can still easily raise land-leasing prices. It is reported that land related cost (i.e., land leasing fees, land using tax, construction tax) takes up nearly 65 percent of a commercial housing price (Su & Chen, 2005).

Third, from the perspective of the usage of land-leasing income, local governments have a monopoly role in allocating revenues from local land finance. According to central regulation, there should be at least 10 percent of land-leasing income that is used for public housing or affordable housing fund. However, in China's 22 cities, including Shanghai, Beijing, Chongqing, and Chengdu, the ratio is much lower than the requirement (Yang J. , 2011). Local governments have great autonomy in allocating the land-leasing income, which comprises about 45 percent of the total local revenues (Su & Chen, 2005). Therefore, local governments have the monopolistic authority over the conversion of land-ownership rights from collective to state

ownership, the rights to convert from agricultural to non-agricultural use, and the influence on local land finance including land-leasing income and compensation for land expropriation.

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## **Chapter 4: The Political Incentive and The Cadre Evaluation System**

The fiscal incentives brought about the “Tax-sharing System” and the monopoly incentives from the land management system could only be applicable under China’s special context of political centralization. At the state level, the central government has the authority to appoint local officials directly and to control local personnel arrangement. At the subnational level, local cadres are empowered with great autonomy and authority in developing the economy within their jurisdictions. They can easily affect local policy decisions. Even though constitutionally China is defined as a unitary state, when measured by the authority of managing the local land resources as well as the extra-budgetary revenue, China is currently the most decentralized country in the world (Ong, 2011).

And these two aspects above are linked together by the top-down cadre evaluation system. So the political incentive, which is embedded in local cadres’ career development, is another significant element that accelerates local governments’ pursuit of land urbanization. This section discusses the major features of China’s cadre evaluation system and explores the relation between local officials’ promotion and land urbanization.

### **4.1 Economy-focus and Regional Competition**

The main content of China’s cadre evaluation system is the political performance evaluation of local cadres by central officials, which is characterized by top-down centralization. For one thing, through the appointment and removal of local officials that are dominated by the central government, local governments remain subject to central control (Zhou W. , 2014). For another, the political performance measurement guarantees the achievement of goals set by the central government, especially the

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economic development goals. In particular, the target-based responsibility system (TRS) is the main performance measurement system that is used to monitor and manage local officials' implementation of central policies. Obviously, there is a positive correlation between the career prospects of local cadres and their achievement of required policy goals (Gao, 2015).

As local governments are mainly under the oversight of upper-level governments rather than the horizontal supervision of local people or mass media (Zhou L. , 2007), to get promoted, local officials need to hand in a good performance to the upper-level leaders during their tenure. Among the performance indicators, the growth of per capita GDP, employment rates, and tax revenues are the most important metrics, on which local officials' political careers within the Party and government crucially depend (Kung, Xu, & Zhou, 2013). And these performance indicators totally reflect the target-based responsibility system (TRS). For example, 60 percent of targets required of local officials in cadre evaluation system are related to economic construction (Kung, Xu, & Zhou, 2013). Compared to the qualitative indicators, such as social stability and local residents' happiness, these economy-focused indicators are more measurable and comparable. It provides local cadres with strong political incentives to accelerate economic growth (Zhou L. , 2007).

Regional competition is another unique feature of China's cadre evaluation. As a unitary state, China's administrative structure is in the form of a pyramid. Local officials have to compete with each other to get promoted. It means that when upper-level leaders measure the political performance of local cadres, they tend to compare within the regional jurisdiction. The comparison is a powerful informal pressure on local cadres. For instance, top-ranking township cadres have a high opportunity to be promoted at the county level while well-performing municipal

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officials are more likely to be transferred to other provinces as governors (Kung, Xu, & Zhou, 2013). In this context, local officials not only need to focus on increasing the local GDP but also should pay attention to improving the regional rank (Zhou W. , 2014). It is undeniable that the regional competition has enhanced local cadres' focus on the local economy and has made a great contribution to China's rapid economic development. It is estimated that every 15 percent increase in the likelihood of local officials' promotion will bring a 0.06 percent growth of local GDP (Liu, Wu, & Ma, 2012). But it has also led to a series of distortionary consequences (Zhou L. , 2007), among which the most serious one is the acceleration of imbalanced land urbanization.

#### **4.2 Local Officials' Promotion and Land Urbanization**

Under the great pressure of closing the fiscal gap since 1994 and the regional tournament competition, local officials are pushed to take on the role of land developers, using their exclusive power over land management to promote economic growth and meet the development targets (Lichtenberg & Ding, 2009). Two main incentives for local officials to accelerate land urbanization are revenue generation and investment attraction, and both of them are accompanied by GDP growth.

To be more specific, firstly, as we discussed above, land urbanization is widely seen as the key to generating revenues. On the one hand, as the most important tax category, the Business Tax has been a driving force in local land urbanization. Nearly 50 percent of these revenues are generated from the construction and real estate (CRE) industries (Kung, Xu, & Zhou, 2013). Furthermore, the CRE helps spur local GDP growth, which will also enhance the career prospects of local officials. According to one estimate, residential property construction alone contributes to around 10 to 12 percent of country's GDP (Ong, 2014). On the other hand, considering the limited stock of urban land, plus the high compensation paid for urban land demolition, urban

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expansion, and accompanying land expropriation and land leasing are another major drivers of increases in revenues and local GDP. So, as we discussed above, local governments can gain substantial revenues from the conversion of the nature of the rural land, and these conversions are preconditions of any property development (Ong, 2014).

Secondly, urban land is a crucial tool to attracting investment. Since the opening and reform, the state has devolved economic discretion to local governments to improve the effectiveness and efficiency of local development. This economic decentralization promotes the investment-driven economic growth model in China. Therefore, in the regional tournament competition, attracting investment has been the most significant mechanism for local officials in enhancing the local economy (Zhang, Wang, & Xu, 2011). Additionally, to compete for advancement with officials from other localities, investment attraction also gives local cadres access to sources of wealth and power within their local communities (Lichtenberg & Ding, 2009). In the game of attracting investment, urban land is not only seen as the fundamental resource but also a special means used for preferential policy. For example, some local governments may lower the compensation paid to farmers, to reduce the cost of land expropriation. Or, some other local officials may commit to giving developers land-related tax exemptions to invite investment. In turn, the investment will enlarge the tax base, increase GDP, and promote the local employment (Qu & Li, 2010).

Compared to population urbanization that is less related to economic development, land urbanization would bring a large amount of revenues and investments, along with a higher GDP in a short period (Zeng, 2016). Therefore, to obtain a greater opportunity of promotion, local officials are indeed strongly motivated to accelerate land urbanization (Kung, Xu, & Zhou, 2013).

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## **Chapter 5: Impacts of the Government-led land urbanization**

Based on what we discussed above, it is obvious that China's acceleration of urbanization is land-centered (i.e., pursuing local land finance) and government-led (i.e., local officials leading and guiding the process of land conversion). In this unique process, China's has experienced great economic growth as well as a huge urban sprawl. However, as the most important engine of urban development, the government-led land urbanization has several negative impacts. Actually, these disadvantages penetrate the Tax-sharing System, land management system, and cadre evaluation system, which can be reflected in aspects of fiscal concerns, social issues, and governmental problems.

### **5.1. Unstable Local Fiscal Revenues**

Unstable local fiscal revenues result in both unsustainability and unpredictability. On the one hand, land-leasing income, as the main source of local fiscal revenues, heavily relies on the limited land resources. If the resource of land itself is not sustainable, neither is the land-based fiscal revenue (Choa & Choi, 2014). On the other hand, without a market-oriented land-leasing procedure between local authorities and real estate developers, land finance income can be seen as an invisible revenue monopolized by city governments. This paves the way for local governments to commercialize regional land under less supervision from the central authority. Specifically, the non-institutionalized profit distribution among stakeholders (i.e., city governments, real estate developers, farmers of expropriated rural land, and urban housing buyers) makes the land finance more unstable due to its unpredictability (Choa & Choi, 2014). From a long-term perspective, these invisible land revenues, especially extra-budgetary revenues, should be standardized by the state in the future.

## 5.2. Loss of Farmland

The extraordinarily strong fiscal, monopolistic, and political incentives for local governments to boost land urbanization have caused serious consequences, especially involving the loss of farmland. According to official statistics from China's Ministry of Land and Resources, from 1996 to 1999, urban land has witnessed a growth at an average of nearly 213,000 hm<sup>2</sup> per year. And this annual increase reached about 262,000 hm<sup>2</sup> during the period from 1999 to 2004 (Lichtenberg & Ding, 2009). Additionally, the urban built-up area was 2.24 million hm<sup>2</sup>, 2.8million hm<sup>2</sup>, and 3.81 million hm<sup>2</sup> in 2000, 2007, and 2008 respectively (Tang, Zhou, & Shi, 2014) (Zhao & Zhang, 2009). Among these new urban built-up areas, land converted from rural land has taken up the biggest part. From 2002 to 2008, the annual construction land occupied the arable land is about 224,000 hm<sup>2</sup>, with the nationwide land expropriation rising from 196,000 hm<sup>2</sup> in 2004 to 451,000 hm<sup>2</sup> in 2009 (Tang, Zhou, & Shi, 2014). As shown in Figure 9, the proportion of arable land in the land expropriation for urban expansion has remained around more than 40 percent from 2003 to 2008.

Figure 9: Ratio of arable land to land expropriated for urban expansion

Year	2003	2004	2005	2006	2007	2008
Ratio	49.1%	38.3%	47.8%	48.7%	36.8%	45.9%

Source: (Zhou W. , 2014)

To protect the farmland, the central government has fixed a minimum of 120 million hm<sup>2</sup> of the cultivated field as the “red line” limit. However, this restriction is just a palliative remedy and seems to have little effect on local governments (Zhang, Wang, & Xu, 2011). Local officials can always find a way to maximize land for lease (more details in this chapter below).

### 5.3. Violation of Farmers' Land Rights

As the nominal owner of the rural land, farmers' land rights are vulnerable. Once land use is changed and ownership transferred (from collective to state), farmers' land rights cease to exist. The violation of their land rights can be found in three major aspects. First, as we discussed earlier, city governments are empowered to expropriate rural land in the public interest, and farmers tend to have no choice when their lands are "spotted" by local authorities. It is not surprising that violent conflicts between villagers and local authorities over land disputes repeatedly occurred in the process of urban expansion (Kung, Xu, & Zhou, 2013). To some degree, this is the only way for farmers to protest. Second, farmers of expropriated land have no power to negotiate compensation with local authorities. The disproportionate allocation of the land profits in the process of land expropriation has made farmers become the biggest victims (shown in Figure 10).

Figure 10: Profit allocation among stakeholders in land expropriation

Stakeholders	Local Governments	Real Estate Developers	Village Committees	Farmers
Ratio	20%-30%	40%-50%	25%-30%	5%-10%

Source: (Zhao & Zhang, 2009)

Only 5 to 10 percent of the profits made from the expropriated land belongs to farmers, while 20 to 30 percent of that flows into local governments' fiscal revenues (Zhao & Zhang, 2009). Third, without the arable land, some farmers lose the main resource that enables them to make a living. In the long term, landless farmers face with various social problems, such as unemployment and difficult in educating their descendants (Su & Chen, 2005). In part because of China's *Hukou system*, a system that makes it impossible for villagers with rural resident status to freely enjoy urban public services. For example, according to the National Bureau of Statistics, among

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2670 land-expropriated farmers from 16 provinces, about 46 percent of them experienced a decline in income after the land acquisition (Zhao & Zhang, 2009).

#### **5.4. Unreasonable High Housing Price**

Accompanying the land urbanization is the excessive investment in the real estate and construction industries, which could easily cause bubbles in the property market. As a matter of fact, urban housing prices in China's many large cities have experienced an extraordinary growth since 2003 (Choa & Choi, 2014). For instance, in Beijing, Shanghai, Shenzhen, and Guangzhou, housing prices in the open market have at least doubled in the last 5 years. The main reason for such an increase is the rapid growth of the cost of land-use right in the primary land market monopolized by local governments. To gain more revenues from land leasing, local governments can easily manipulate the price of urban land by controlling the supply of the usable state-owned land. Furthermore, they can also influence the housing prices by adjusting land-related taxes. For example, during the financial crisis in 2008, to protect the real estate and construction industries, which are the main source of local fiscal revenues, some local governments even canceled the Business Tax to encourage people to buy a house (Wanf & Yang, 2012).

#### **5.5. Short-sighted Behaviour of Local officials**

Stimulated by the huge amount of land leasing residuals, as well as the career promotion incentive, land urbanization may result in local officials' short-sighted behaviors. To win the regional tournament competition, most of China's local cadres set promoting economic growth and accelerating urbanization as the highest priorities (Lichtenberg & Ding, 2009). The most important things that local officials care about are how to generate revenues and boost the local GDP in a short time (Chen Y. , 2014). Therefore, they will lease as much land-use right as possible to private

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developers (Cao, Feng, & Tao, 2008). This government-led land urbanization will not be beneficial for the optimization and standardization of land use in the long term (Zhang, Wang, & Xu, 2011).

### **5.6. Abuse of Public Authority and Loss of Public Trust**

Monopoly power is always the breeding ground for corruption, so is local governments' exclusive authority over urban land management. In China, land finance is seen as one of root causes of the chaos of land market, illegal land use, and local corruption (Zhou W. , 2014). As the only "landlord", local governments in China can easily seek rents in the process of land urbanization (Zhou W. , 2014). To be precise, in 2003, there were 168,000 cases involving in illegal land use that were investigated, among which almost all of them were related to local officials (Su & Chen, 2005). In 2004, in Guangdong province, there were more than 2000 cases of illegal land use. In the 8 typical cases that were reported and investigated by Provincial Land and Resources Office, 3 of them were related to town governments' illegal land acquisition and 4 of them were related to village committees' illegal land occupancy (Su & Chen, 2005). In 2008, the central government classified the field of land as one of the six key areas in commercial bribery (Chen Y. , 2014). In this situation, growing local corruption has destroyed the credibility of local governments.

### **5.7. Antagonism Between the Central and Local Government**

Land urbanization has resulted in antagonism between the central and local governments, regarding the quota of land expropriated for non-arable use, the development of real estate and construction industries, and the supply of affordable housing. For one thing, realizing the potential value of land development, the Ministry of Land Resource imposed a land control hierarchy that would use land as a tool to regulate the macro economy. The central government determines how much land

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would be available for local governments to lease to urban development in the various regions and in the country as a whole (Rithmire, 2015, p. 61).

The 1998 revision of the Land Management Law established quotas of land available for development for every level of government from top down, requiring that all local governments preserve more than 80 percent of the total arable land under their respective administration and receive approvals for conversion of farmland into land for urban construction (Rithmire, 2015, p. 62).

However, in practice, there is always a way for local governments in China to maximize land for lease and urban expansion while also keep their assigned quotas (Rithmire, 2015, p. 62). For example, they can transfer development rights among jurisdictions to preserve quotas at a higher (e.g., provincial or state) level; they can even choose the “village redevelopment project” that can consolidate villagers into high-rise housing to maximize the amount of transferred land (Rithmire, 2015, p. 62).

In the aspect of the development of real estate and construction industries, while the central government continues to issue suppression policies to control the urban housing price, local governments tend to favor the real estate developers. For example, some cities provide private developers with concessions in the process of land leasing, such as prolonging the deadline for land-leasing payment (Yang & Lu, 2010).

As for the supply of affordable housing, the state proposed the establishment of affordable housing in 1998, but it was not until 2005 that local governments began the construction of it. At the local level, the proportion of affordable housing occupying the urban residential construction is far below the central requirement (Yang & Lu, 2010).

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## **Chapter 6: What can China learn from Canada?**

As we all know, no matter the political environment, the fiscal system, or the local authority and autonomy, Canada and China are completely different. It is impossible and unrealistic to make China copy the Canadian model exactly. However, to a certain extent, local governments in these two countries are faced with the common dilemmas, such as fiscal constraints and heavy reliance on land-related revenues. Therefore, this chapter chooses a specific perspective of Canada's pluralistic decision-making system to make it transferable and realistic for China to learn. That is to say, even though, local governments in China cannot change the land ownership system instantly, it is highly valuable and urgent for them to alter the monopolistic decision-making situation and to offer the public an independent, legal, and substantive channel to protect their property interest.

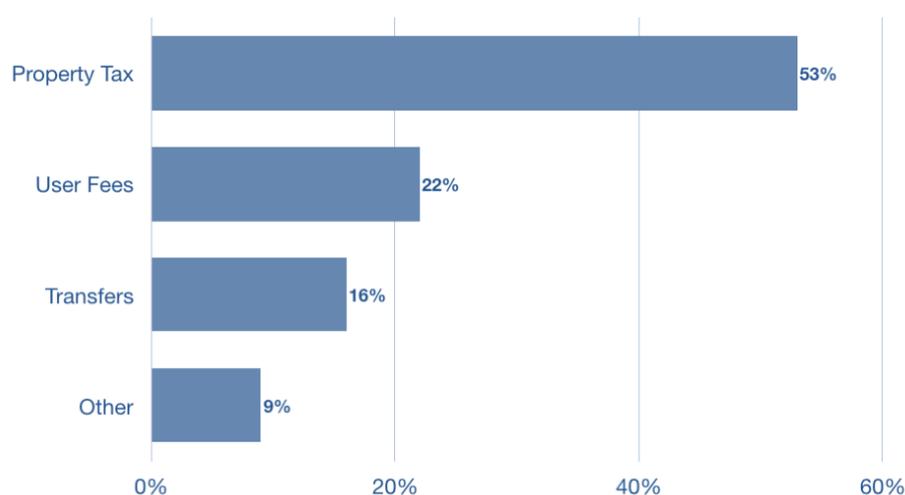
### **6.1. Different Contexts but Common Dilemma**

Unlike China, the context in Canada is totally different. Above all, Canada is one of the most urbanized countries in the world. From 2005 to 2015, the percentage of the Canadian population that lived in "urban areas" as defined by Statistics Canada has remained stable at around 80 (World Bank, 2016). Although China has a different definition of "urban", government statistics in 2014 classified about 54.77 percent of the population as urbanized (National Bureau of Statistics of China, 2015). In comparison, Canada is primarily an urban nation (Sancton, 2011) and has stepped into the stable phase. Consequently, there is no particular performance burden for municipalities to pursue urbanization.

Next, as "the creature of provincial governments", municipalities in Canada are under provincial jurisdiction with limited power in making by-laws and managing

financial resources (Sancton, 2011, p.27). Specifically, “provincial legislatures approve laws that specifically authorize certain forms of local taxation, the levying of user charges, and formulas for the transfer of money from the provincial treasury to local governments” (Sancton, 2011, p.34). Instead of offering municipalities the access to Income and Sales Tax, provincial governments have preferred to share revenues from these sources by means of grants (Graham, 2006). For example, in 2008, local general government revenue across Canada was totaled about \$73.76 billion, including \$15.83 billion transfers (general and specific) and \$36.52 billion in property and related taxes (Statistics Canada, 2009). It is clear that, except these transfers, the property tax is the most important own-source revenue for Canadian local governments (Sancton, 2011, p.289). As shown in Figure 11, the property tax accounts about half of the local revenues (Taylor, 2016).

Figure 11: Canadian local revenues



Source: (Taylor, 2016)

Considering the historical decline in intergovernmental transfers to local governments since the 1980s, plus the downward pressure on local service levels (Horak, 2016), similar to China's local governments, Canadian municipalities are confronted with great fiscal constraint. Moreover, due to the heavy reliance on

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property tax, which is a type of land-related taxation, there is a fiscal incentive for local governments in Canada to have a policy bias in favour of land development (Horak, 2016). In some cases, compared to property owners, property developers may have more substantial political influence in local land issues. However, as the city council is elected by and responsible to the public, and the upper-level governments have no authority to control local officials' career promotion, one of the biggest differences between Canada and China is that Canadian local leaders are under no motivation to pursue personal career improvement at the expense of the public interest and general residents' demands.

Also, land-use planning is one of the most fundamental responsibilities of local governments in both China and Canada. Unlike China, Canadian provincial governments strictly control the land use authority that granted to municipalities. For instance, in Ontario, the municipalities conduct land-use planning under the control of Planning Act, Provincial Policy Statement(PPS), and the Ontario Municipal Board at the provincial level (Environmental Commissioner of Ontario, 2011). Although city governments also want to enhance local economic development by supporting real estate developers, there is no monopolistic authority for local officials to realize it. And this limited, transparent, and pluralistic land decision-making system of local governments in Canada is the key element that China needs to learn.

## **6.2. Pluralistic Planning Decision-making System in Urban Land Issues**

Chinese local governments monopolize the power of making decisions in urban land issues. In contrast, Canadian municipalities, citizens (sometimes appearing in the form of neighbourhood associations), experts, private developers, and some other stakeholders (i.e., quasi-judicial appeal bodies) share the authority in the pluralistic planning decision-making system.

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On the one hand, opening the process to public engagement in urban land issues is mandatory. City councils are required to hold public meetings especially referring to land-use planning. For example, in Ontario, according to the Planning Act, “information and material that is required to be provided to a municipality or approval authority under this Act shall be made available to the public” (Government of Ontario, 1990). It is this kind of substantive and legal requirement for public participation in land-use planning that makes municipalities’ decision open, transparent, and accountable. Such openness helps limit the capacity of the real estate and construction industries to influence unduly the policy decisions of local governments. In contrast, in China, given that local authorities are able to expropriate rural land for the alleged purpose of public interest, it much more necessary to respect public opinion in land-use planning.

On the other hand, provincial appeal boards are another important factor that stops municipalities in Canada from being captured by interest groups. Taking the province of Ontario as an example, the Ontario Municipal Board is an independent provincial planning appeal body, which has wielded major influence on the urban development (Moore.Aaron.A, 2013). It is a powerful court-like tribunal, with the primary function of hearing an appeal on disputes concerning land-use planning (Moore.Aaron.A, 2013, p.38). Local residents or neighbourhood associations can appeal city councils’ decision, and the OMB hearing would judge the planning merits of the proposal instead of the legal grounds for a council’s decisions (Moore.Aaron.A, 2013). In other words, the OMB can ignore municipalities’ stance and override their official plans (Moore, 2013, pp. 5). With the introduction of the Ontario Municipal Board, urban developers and citizens are equipped with a new approach to express or fight for their interests. It makes contributions to building a pluralistic planning

decision-making system. For contemporary China, to stop local governments' blind pursuit of the land urbanization, the first step is to break the existing monopolistic planning decision-making system. The introduction of an independent appeal body will erode the local cadres' monopolistic authoritative decision-making right.

## Conclusion

Based on all the analysis above, there are three conclusions that can be drawn. One is that the re-centralized Tax-sharing System, the monopolistic land management system, and the top-down economy-focused cadre evaluation system are inappropriate incentives for local governments in China to pursue urbanization. In the process of local officials' blind accelerated urbanization, the crucial problem is their exclusive power over urban land administration and the accompanying local land finance. Local cadres rely heavily on leasing urban land to private developers to gain more revenues, and to make themselves outstanding in the regional competition.

The second one is that the government-led land urbanization has caused countless negative impacts. Ironically, pursuing land urbanization, which is intended to boost local fiscal income, turns out to result in an unstable revenue source. Local governments should realize that they cannot count on the limited land resources forever. Otherwise, the loss of farmland is not only a kind of violation of farmers' interest but also a threat to a country's basic food supply. What is more serious is that a large amount of land leased to real estate developers does not follow market rules, which should lower housing prices for general citizens. The unreasonable high housing price is in part because of local governments tending to increase the cost of land to earn more land-leasing income from the private developers. Clearly, the land-centered urbanization has caused an inevitable tension between the state and local governments.

Finally, to completely stop China's acceleration of land urbanization, the central government should conduct a series of reforms concerning the fiscal system, the property system, and even the political evaluation system, which is obviously

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unrealistic and impracticable. Actually, since the beginning of the 21<sup>st</sup> century, there has been an active discussion about introducing a Property tax based on western countries' experiences. And it was first initiated in Shanghai and Chongqing as the pilot program in 2011, with characteristics of low tax rate (0.6% in Shanghai and 0.5% in Chongqing) and property assessment depending on the original price of houses (Choa & Choi, 2014). Due to limited support from local governments, this pilot failed to be extended to the entire nation (Choa & Choi, 2014). Local officials feared that adding the Property tax would discourage people from buying houses, which in turn would depress the demands for urban land from private developers. Apparently, local governments prefer not to lose the handy source of land leasing income. Therefore, under China's current special context, the urgent and transferrable point that can be learned from Canada relates to the pluralistic planning decision-making system. To focus on protecting local residents' property interests, the state should introduce an independent appeal body to erode local governments' monopolistic land decision-making authority.

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