11.S945 Urbanizing China

Financial and Land Institutions in China

Liyan Xu, Jinhua Zhao
9/16/2013
Basic Structure of Governance in China

PRC

Central Government

Local Governments

Provincial Government

Prefectural Government

County Government

Township Government

Villagers’ Committee

Province (34)

Prefecture (~300)

County; District (~3,000)

Township (~30,000)

Village (~500,000)
Country
Provinces
Prefectures
Counties
### Fiscal Federalism with Chinese Characteristics

#### Income

<table>
<thead>
<tr>
<th>To Central Gov’t</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Tariff;</td>
<td></td>
</tr>
<tr>
<td>• Profit from designated State-run firms;</td>
<td></td>
</tr>
<tr>
<td>• Sea Oil Tax;</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Shared Revenue Sources (C/L)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• VAT(75/25);</td>
<td></td>
</tr>
<tr>
<td>• Income tax/40);</td>
<td></td>
</tr>
<tr>
<td>• Stamp tax on securities transactions (97/3);</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>To Local Gov’t</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Business tax;</td>
<td></td>
</tr>
<tr>
<td>• Other resource tax;</td>
<td></td>
</tr>
<tr>
<td>• Other stamp tax;</td>
<td></td>
</tr>
<tr>
<td>• Vehicle&amp;Boat tax;</td>
<td></td>
</tr>
<tr>
<td>• Contract tax;</td>
<td></td>
</tr>
<tr>
<td>• Tobacco tax;</td>
<td></td>
</tr>
<tr>
<td>• Urban land use tax;</td>
<td></td>
</tr>
<tr>
<td>• Land VAT;</td>
<td></td>
</tr>
<tr>
<td>• Property tax;</td>
<td></td>
</tr>
<tr>
<td>• Land grant fees;</td>
<td></td>
</tr>
</tbody>
</table>

#### Expenditures

<table>
<thead>
<tr>
<th>From Central Gov’t</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Central gov’t operating;</td>
<td></td>
</tr>
<tr>
<td>• Defense;</td>
<td></td>
</tr>
<tr>
<td>• Diplomatic expenditures;</td>
<td></td>
</tr>
<tr>
<td>• T-Bill payments;</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Shared Expenditures (Primarily Local)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Law enforcement;</td>
<td></td>
</tr>
<tr>
<td>• Health care;</td>
<td></td>
</tr>
<tr>
<td>• Agriculture;</td>
<td></td>
</tr>
<tr>
<td>• RID;</td>
<td></td>
</tr>
<tr>
<td>• Universities;</td>
<td></td>
</tr>
<tr>
<td>• Infrastructure investment;</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>From Local Gov’t</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Local gov’t operating;</td>
<td></td>
</tr>
<tr>
<td>• Compulsory Education;</td>
<td></td>
</tr>
<tr>
<td>• City maintenance;</td>
<td></td>
</tr>
<tr>
<td>• Militia;</td>
<td></td>
</tr>
</tbody>
</table>
Financial Crisis of Local Governments

• Fiscal gap for local governments
  o Mismatch between revenues and expenditure obligations

• Absence of other financing vehicles
  o Local governments cannot raise taxes w/o the central government’s permission
  o Until very recently, they cannot issue debts either

• => Financial Crisis

• Solution: extra-budgetary revenues <-> land grant fees (long-term land development rights lease)
“Municipal Land Finance” in China

Municipal Budget: NYC vs. Beijing

New York City Revenues 2011

- Real estate taxes: 27%
- Other taxes: 31%
- Intergovernmental: 35%
- Charges for services: 4%
- Other revenues: 0%
- Bonds: 2%

Beijing Revenues 2011

- Land Grant Fees: 58%
- Other taxes + Intergovernmental: 14%
- Charges for services: 2%
- Other revenues: 26%

Source: New York City CAFY 2011; Beijing Budget Report 2012; Both figures only reflect the operating budget.
Difference?

- Property tax: land rent for that year;
- Land grant fees: land rent for 70 years!
A conversation between a communist prime minister (left) and a capitalist developer (right) in 1981

- Prime Minister Zhao Ziyang (赵紫阳): “we lack capital for city developments.”
- Dr. Huo Yingdong (Henry Fok, 霍英东) the capitalist in Hong Kong: “how come you lack capital if you have land?”
- Prime Minister Zhao Ziyang: “We can’t charge people for using land. That’s capitalism.”
- Dr. Huo Yingdong: “Well, even capitalism has got some merits.”

Source: Henry Fok’s Memoir
A Compromise Solution: The Land Transfer System

• 1988 - Amendment to the Constitution
  o Reiterating the state’s absolute ownership of all city land, the amendment made the use rights of land transferable;

• 1988 (later) – Revision to the Law of Land Administration

• 1990 - Interim Regulations of the People’s Republic of China Concerning the Assignment and Transfer of the Right to the Use of the State-owned Land in the Urban Areas
## Urban/Rural Dichotomy of Land Property Rights

<table>
<thead>
<tr>
<th></th>
<th>Rural Land</th>
<th>Urban Land</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership</td>
<td>Rural collectives</td>
<td>The State</td>
</tr>
<tr>
<td>Use Rights</td>
<td>Households with rural Hukou</td>
<td>Anyone</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Individuals (city residents, villagers, migrant works, foreigners, etc.)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Firms</td>
</tr>
<tr>
<td>Use Rights Transferability</td>
<td>Transferable for agricultural use ONLY</td>
<td>Transferable (usage subject to zoning regulations)</td>
</tr>
<tr>
<td>Developability</td>
<td>User cannot develop on the land, unless</td>
<td>User can develop on the land</td>
</tr>
<tr>
<td></td>
<td>• For own household use (need approval by the villager’s committee); OR,</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• It’s transferred as urban land (via local governments)</td>
<td></td>
</tr>
</tbody>
</table>
## Differential Financial Obligations

<table>
<thead>
<tr>
<th></th>
<th>Rural land</th>
<th>Existing urban developments</th>
<th>New urban developments/urban redevelopments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property tax</td>
<td>No</td>
<td>No</td>
<td>No (except for commercial developments, which are subject to an one-time tax; and for a few recent experiments in Shanghai and Chongqing)</td>
</tr>
<tr>
<td>Land transfer fee</td>
<td>No</td>
<td>No</td>
<td>Yes (except for some State-run developments)</td>
</tr>
</tbody>
</table>
How is Land Finance Possible?

![Diagram showing Land Rent Appreciation](image)

- **Land Rent Appreciation**
- **Distance from city center**
- **陸地租金的可能方式**
- **距离市中心**
Splitting the Cake: Free Market with Government

- Compensation: to land owners
- Profit: to the developer
- Tax: to the city government

Land Rent

Distance from city center

a

b

b'
Splitting the Cake: City Government’s Ideal Scenario

- City government’s ideal: take it all

![Diagram of land rent vs. distance from city center]
City’s Government’s Strategy

• The golden rule: buy low sell high

• The procedure
  o Buy land from villages; compensate them at the agriculture rent level
  o Build infrastructures
  o Sell the ready-to-develop land to real estate developers

  Done! Enjoy!

• Not really selling – 70/50/40 year-leases
Splitting the Cake: the Shenzhen Variation

- Reality: other stakeholders; need negotiation
- The Shenzhen context: strong village collectives vs. weak government
The Shenzhen Variation

• **Urban villages as bulk of housing supply**
  - Laissez-fair. Landlords (villagers) get all.
  - Village Collectives as infrastructure investment companies
Splitting the Cake: the Chongqing Variation

- Institutional Innovation: Land–quota exchange

![Diagram showing the distribution of land rent.](image-url)

- To the city government
- To the land owners (villagers)
- To government-run developers
- To other villagers (through land-quota exchange)

Axes:
- Land Rent
- Distance from city center

Note: The diagram illustrates the distribution of land rent across different zones, emphasizing the varying benefits to different stakeholders.
The Chongqing Experiment

• Measures
  o Urban Construction Land Quota Exchange
  o Share of appreciation value between the government, the land owners, and other farmers living in remote areas
  o Land as assets of government-run infrastructure investment companies

• Assumptions
  o Enough government land reserve (~30 years)
  o Sustainable land appreciation
  o Efficient government; no corruption
Situations vary across cities; actual distribution of rent depends on the relative power of the players.

However, in most cases, the local governments get the largest part, thus the land finance is possible.
• Agenda
  o Role playing game
  o Debates on the land finance system
Role Playing

- Stakeholders
  - Suburban farmers (*de facto* original land owners)
  - Village collectives (via the villager’s committee; *de jure* original land owners)
  - City residents
  - Migrant workers
  - Other farmers (living in remote, “real” rural areas)
  - City government
  - Real estate developers
  - Central government
Debate

• The land finance system: merits and disadvantages
  o The moral dimension
  o The practical dimension

• Overarching issues
  o Government-lead vs. market oriented
  o Efficiency vs. equity
  o Short run vs. long run
Concluding Remarks
Debates – the moral dimension

• Georgism
  o People own what they create, but that things found in nature, most importantly land, belong equally to all.
  o Single tax on land

• Supporters and critics
  o Pro: Joe Stiglitz; Winston Churchill; Martin Luther King, Jr. Frank Lloyd Wright, Leo Tolstoy; Sun Yat-sen
  o Con: Karl Marx; most neoliberal economists

This image is in the public domain.

Henry George
American Economist (1839-1897)
Debates – the practical dimension

- Corruption: room for rent-search
Example: the Wanliu Project

Map data ©2013, AutoNavi, Google. All rights reserved. This content is excluded from our Creative Commons license. For more information, see [http://ocw.mit.edu/help/faq-fair-use/](http://ocw.mit.edu/help/faq-fair-use/).
Zhou Liangluo, then-mayor, arrested for land-related corruption in the Wanliu Project in 2006.
Debates – the practical dimension

• Sustainability through growing
  o Demands for construction land have been high
  o Land value appreciation appears forever
  o So far so good

• However, in the long term...
  o Cities cannot expand forever
  o Incremental land development will eventually diminish
  o What next?
What Next?

• Ongoing experiments
  o Municipal debt
    • Ubiquitous
    • Financial risks
  o Property tax
    • Limited cities (Shanghai, Chongqing)
    • Political risks

• Other proposals?