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ASYMMETRIC PROPERTY RIGHTS IN CHINA'S ECONOMIC GROWTH

Xiaobo Zhang[†]

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I. INTRODUCTION

China's remarkable economic growth in recent decades, despite poorly defined property rights and a relatively weak legal system, is a puzzle to the general literature of law, finance, and development. China's courts are rather weak and the judges are not well trained.¹ The number of attorneys practicing in China is relatively low compared to other jurisdictions.² China also performs far below other countries in terms of creditor rights, shareholder protection, and corruption safeguards.³ These facts present the quandary: How has China achieved such notable

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1. See Donald C. Clarke, *Power and Politics in the Chinese Court System: The Enforcement of Civil Judgments*, 10 COLUM. J. ASIAN L. 1, 2, 10 (1996) (explaining that there is a low execution rate for judicial cases and that court officials are poorly educated).

2. Franklin Allen, Jun Qian & Meijun Qian, *Law, Finance, and Economic Growth in China*, 9 (Wharton Financial Institutions Center, Working Paper No. 02-44, 2002) (stating that there are 150,000 attorneys in China, which is roughly the same number of licensed attorneys as in the state of California).

3. Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Law and Finance*, 106 J. POL. ECON. 1113 (1998) (sampling various countries to assess creditor rights, shareholder protections, and corruption).

economic growth?

There is a broad consensus within economic literature that institutions such as property rights are important to economic growth.⁴ Economic scholars have studied the role and importance of property rights in economic growth.⁵ Further, empirical studies emphasize the importance of state institutions. Recent cross-country data shows that the presence of a legal system matters to economic growth and financial systems.⁶ Analysis arising out of this data reveals that a common-law system consistently outperforms the civil-law system in providing protection to minority shareholders, thereby facilitating dispersed ownership and economic growth.⁷ Property rights and the rule of law are some of the most important aspects of good governance, and their countering effect on poverty may even be stronger than the effects of democracy.⁸

In developing and transitioning countries, a lack of well-defined property rights and formal legal systems is the norm rather than the exception.⁹ When formal institutions are lacking, societies may attempt to evolve along with their alternative systems to protect their economic activities.¹⁰ Case studies show that social arrangements can be as important as State institutions in their ability to affect economic growth.¹¹ The economic impact of societal arrangements is demonstrated by the rapid growth of the township and village enterprises (TVE) in China during the 1980s and 1990s.¹² Although the TVE does not have clearly defined

4. See, e.g., DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (1990) (arguing that secure property rights are a necessary condition for economic development).

5. See Janine Aron, *Growth and Institutions: A Review of the Evidence*, 15 WORLD BANK RES. OBSERVER 99 (2000) (containing a general overview of the empirical work completed on the importance of institutions to economic growth, as well as a review of different ways to proxy for measures of institutional quality).

6. La Porta et al., *supra* note 3.

7. *Id.* at 1132.

8. David Dollar & Aart Kraay, *Property Rights, Political Rights, and the Development of Poor Countries in the Post-Colonial Period*, ECONOMIC HISTORY ASSOCIATION, 2000, http://www.j-bradford-delong.net/Logistics/eha_abstracts_fall_2000.html.

9. See Marcel Fafchamps & Bart Minten, *Property Rights in a Flea Market Economy*, 49 ECON. DEV. & CULTURAL CHANGE 229 (2001) (utilizing Madagascar as a case study to examine property rights).

10. See *id.* at 251 (discussing alternative contract enforcement methods where formal institutions fail to offer protections).

11. IN SEARCH OF PROSPERITY: ANALYTIC NARRATIVES ON ECONOMIC GROWTH (Dani Rodrik ed., 2003) [hereinafter IN SEARCH OF PROSPERITY].

12. YINGYI QIAN, *How Reform Worked in China*, in IN SEARCH OF PROSPERITY,

property rights, the sector has achieved remarkable growth.¹³

The lack of formal property right protections in China causes a high level of uncertainty associated with business engagements.¹⁴ As a result, the transaction costs associated with writing a complete contract are often prohibitive. But even ambiguous property rights within the TVE can offer a certain level of economic security.¹⁵ In fact, high transaction costs provide an environment where ambiguous property rights can be more efficient than well-defined property rights. In this context, ambiguous property rights in a TVE may be a better option for business arrangements.

Local officials often act as shareholders of a TVE.¹⁶ Thus, business endeavors can secure protections from the local government and reduce impediments to reform at the local level. In the absence of an impartial third party to enforce contracts, entrepreneurs may receive better protection by teaming up with local officials as opposed to operating as purely private enterprises that are forced to rely on China's ill-functioning formal legal system.¹⁷ China's experience shows that growth can still take place amidst less clearly defined property rights. Various social arrangements may provide necessary, alternative forms of protection for property rights to underpin economic activities.¹⁸

supra note 11, at 306; BEN CARVER ET AL., RENEWABLE LIGHTING FOR THE DEVELOPING WORLD (2003), http://cee45q.stanford.edu/2003/briefing_book/china.html#s4.1 (explaining that TVEs are defined as "rural, non-agricultural, non-State enterprises that are collectively or privately owned" and are "analogous to a corporation owned and managed by the local township or village").

13. QIAN, *supra* note 12.

14. *Id.*

15. David D. Li, *A Theory of Ambiguous Property Rights in Transition Economies: The Case of the Chinese Non-State Sector*, 23 J. COMP. ECON. 1, 15–16 (1996).

16. See Laixiang Sun, *Fading Out of Local Government Ownership: Recent Ownership Reform in China's Township and Village Enterprises*, 26 ECON. SYSTEMS 249 (2002) (explaining that local government ownership has dominated China's township and village enterprises).

17. Jiahua Che & Yingyi Qian, *Insecure Property Rights and Government Ownership of Firms*, 113 Q.J. ECON. 467 (1998).

18. Although there is a large body of literature addressing how land tenure arrangements affect agricultural investment and rural welfare in China, studies on the impact of land property rights on industrial development are more limited. For a discussion of land tenure arrangements see Hannan Jacoby, Guo Li & Scott Rozelle, *Hazards of Expropriation: Tenure Insecurity and Investment in Rural China*, 92 AM. ECON. REV. 1420 (2002); James Kai-sing Kung, *Choice of Land Tenure in China*, 50 ECON. DEV. & CULTURAL CHANGE 793, 795–98 (2002); Kalus Deininger & Songqing Jin, *Impact of Property Rights on Households*, 51 ECON. DEV. & CULTURAL CHANGE 851 (2003).

But the ambiguous property rights offered by social arrangements are not sufficient to explain why China has grown faster than many other societies with better-defined property rights. Apart from the property rights argument, there is a large body of literature examining other sources for economic growth in China, including market-preserving federalism,¹⁹ the release of high quality human capital seeded in the planning era,²⁰ the functioning informal finance market,²¹ substantial total factor productivity growth due to the high level of human capital,²² realigning of comparative advantages in development strategy,²³ increased input use,²⁴ and resource reallocation in the economic transition.²⁵ As economic growth ultimately results from the accumulation of many factors, the above list is far from exhaustive.

The nature of China's property rights arrangement has not been sufficiently uncovered to explain its remarkable growth patterns. This paper extends the list of factors affecting China's economic growth to include the diverging degrees of property rights protections held by investors as opposed to individuals. This consideration has largely been under-researched and is generally not well understood by Western observers of China's economy.

The next section reviews the regional property rights hypothesis in China and explores the *de jure*²⁶ and *de facto*²⁷ property rights that are present in China.²⁸ Section III highlights the divergence between investor property rights and individual property rights, which contribute to an understanding of the

19. See, e.g., Yingyi Qian & Gerard Roland, *Federalism and the Soft Budget Constraint*, 88 AM. ECON. REV. 1143 (1998) (discussing federalism in China's economic growth generally).

20. AMARTYA SEN, *DEVELOPMENT AS FREEDOM* 143, 143-45 (1999).

21. Allen et al., *supra* note 2, at 9.

22. See Gregory C. Chow & Kui-Wai Li, *China's Economic Growth: 1952-2010*, 51 ECON. DEV. & CULTURAL CHANGE 247 (2002).

23. See Justin Yifu Lin, *Development Strategy, Viability, and Economic Convergence*, 51 ECON. DEV. & CULTURAL CHANGE 277 (2003).

24. See Alwyn Young, *Gold into Base Metals: Productivity Growth in the People's Republic of China During the Reform Period*, 11 J. POL. ECON. 1220 (2003).

25. Shenggen Fan, Xiaobo Zhang & Sherman Robinson, *Structural Change and Economic Growth in China*, 7 REV. DEV. ECON. 360 (2003).

26. *De jure* rights exist by right or according to law. BLACK'S LAW DICTIONARY 458 (8th ed. 2004).

27. *De facto* rights exist in fact and have effect even though they are not formally or legally recognized. BLACK'S LAW DICTIONARY 448 (8th ed. 2004).

28. See *infra* Part II.

nature of Chinese economic growth.²⁹ Section IV stresses the negative consequence of this growth mode.³⁰ Finally, Section V concludes with a discussion of the internal conflict between China's economic growth and the deprivation of individual property rights.³¹

II. REGIONAL PROPERTY RIGHTS

Historically, scholars have focused on the sovereign, national level in assessing property rights.³² But in China, the protections provided at the local level may matter more. China lacks clearly defined, formal property rights and the accompanying legal system required for their enforcement on the national level.³³ Thus, the country lacks a purely de jure property rights system.

The regional property hypothesis suggests that it is possible for growth to take place under China's current institutional arrangements.³⁴ This hypothesis underlines the importance of the de facto property rights offered at the regional level and suggests that they function as substitutes for weak, formal property rights. De facto property rights partly satisfy investor demands by providing adequate protections.³⁵ Investors benefit from the

29. See *infra* Part III.

30. See *infra* Part IV.

31. See *infra* Part V.

32. Robert H. Bates, *On The Politics of Property Rights by Harber, Razo, and Maurer*, 42 J. ECON. LITERATURE 494, 497 (2004) (book review) ("In viewing property rights, scholars have, along with Hobbes, referred to sovereigns; that is, they have focused on the national level.").

33. See *supra* Part I.

34. See Xiaobo Zhang & Kevin H. Zhang, *How Does Globalization Affect Regional Inequality Within a Developing Country? Evidence from China*, 39 J. DEV. STUD. 47, 49–51 (2003). Between 1978 and 1998, real gross domestic product grew 9.63% in China. *Id.* at 50.

35. See Dani Rodrik, *Getting Institutions Right*, Apr. 2004, http://ksghome.harvard.edu/~drodrik/ifo-institutions%20article%20_April%202004.pdf (explaining that although China has no formal property protections, investors seemingly felt more protected than in Russia, which does have formal property protections). Rodrik articulates the view that legal institutions themselves do not really matter for growth, rather it is the investors' perceptions regarding the safety of their property rights that really count. *Id.* He compares China's "poor" legal property rights to Russia's "good" legal property rights, and finds that China has succeeded in business growth while Russia has not. *Id.* at 7. Rodrik concludes that the disparity is due to the success of China's TVE and their sharing of profits with local governments, which assures owners that the government will not take their land away despite a lack of property rights. *Id.* at 8–9.

implicit instrumental protections offered by local governments.³⁶

The order, stability, and predictability that local governments provide are important ingredients to a de facto property rights system. The hierarchical structure of China's local governments secures property rights at the local level.³⁷ Fiscal decentralization combined with mobile capital results in a hard budget constraint for local governments and prevents them from bailing out failing state-owned enterprises.³⁸ Under fiscal decentralization, local governments are responsible for raising revenues to provide most local public goods and services.³⁹ Consequently, local governments have an interest in promoting the growth of the TVE because it is a major source of local revenues.⁴⁰ In this regard, the interests of the TVE and local governments are closely attuned to each other. Although the ownership of a TVE is not standard, they work well in an environment where formal protections of private property rights are not in place.⁴¹

Local governments also actively compete for foreign direct investment (FDI).⁴² This competition leads local governments to vigorously pursue the creation of a business-friendly investment environment. Common practices include establishing special zones, granting favorable tax breaks, and allowing free use of land for a certain period of time.⁴³ With China's opening up to the global market, FDI has become one of the key drivers of economic

36. *Id.* at 7–9.

37. DAVID GRANICK, CHINESE STATE ENTERPRISES: A REGIONAL PROPERTY RIGHTS ANALYSIS (1990). Others have traced secure regional property rights to inter-judiciary competition. See Xiaopeng Luo, *Regional Competition and Property Rights: The Logic of Chinese Economic Reform*, 2 MODERN CHINA RES. 1 (1995).

38. Qian & Roland, *supra* note 19, at 1144 (explaining that “competition among local governments in attracting capital to their region creates an externality which increases the opportunity cost of subsidizing inefficient enterprises, which in turn reduces the incentives for bailouts”).

39. See World Bank Group, *Decentralization and Subnational Regional Economics*, <http://www.worldbank.org/publicsector/decentralization/fiscal.htm> (explaining that decentralized functions require local governments to raise adequate levels of revenue).

40. BEN CARVER ET AL., *supra* note 12 (commenting that a primary objective of the TVE is to increase local revenues).

41. Yingyi Qian, *How Reform Worked in China*, in IN SEARCH OF PROSPERITY, *supra* note 11, at 297.

42. See Li, *supra* note 15, at 6 (stating that local officials are promoted to higher ranks when the local economy excels).

43. See Symposium, *The Role of Incentives in Foreign Direct Investment*, 23 LOY. L.A. INT'L & COMP. L. REV. 605, 612–15 (2001).

growth.⁴⁴

Even without a well-defined de jure property rights system, China ranks the highest in terms of investor satisfaction with regulatory interpretations and confidence in the judicial system as shown in Table 1.⁴⁵ Thus, preliminary evidence illustrates a chasm between China's potential for economic growth and the necessity of a de jure property rights system. Yet the regional property hypothesis is not sufficient to explain why the current system of de facto property rights should perform better in China than the well-functioning de jure and de facto rights that exist in many other countries. Functionally, the regional property rights hypothesis explains the similarities between China's de facto property rights and the de jure property rights in other countries, showing that the system in China could work. But the hypothesis does not explain why China performs so well compared to many other countries that have both a formal property rights system and a functioning legal system. Certainly, there could be other reasons why China has outperformed many other developing countries.⁴⁶ This paper focuses on the question through the lens of property rights.

III. UNBALANCED INVESTOR AND INDIVIDUAL PROPERTY RIGHTS

An examination of the bargaining costs associated with formal property rights and legal systems provides a basis for understanding China's strong economic growth. The procurement of land through a formalized property rights system entails certain negotiation and bargaining costs.⁴⁷ Large decisions like land procurement go through a long procedure of negotiations,

44. See Zhang, *supra* note 34, at 49–51. Foreign direct investment generates local revenues through taxes and fees. Foreign investment also provides “new technology, managerial skill, and training for labor.” GREGORY C. CHOW, CHINA'S ECONOMIC TRANSFORMATION 305 (2002).

45. World Bank Group, *Investment Climate Survey Online* (2005), <http://iresearch.worldbank.org/ics/jsp/index.jsp>.

46. See *supra* Part I (listing a series of explanations for China's economic growth).

47. See NORTH, *supra* note 4. But see R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960). R. H. Coase maintains that if property rights are well defined and the parties can negotiate free of cost, then economic agents can resolve conflicts through bargaining to achieve an efficient outcome. *Id.* But efficient bargaining under Coase's theory can be difficult to achieve in the political economy domain due to a lack of commitment. See Daron Acemoglu, *Why Not a Political Coase Theorem? Social Conflict, Commitment, and Politics*, 31 J. COMP. ECON., 620, 622–23, 633–38 (2003).

bargaining, and hearings involving relevant interest groups.⁴⁸ China's informal, de facto property rights system allows the government and investors to largely avoid these bargaining costs and procedures, thereby promoting investments and economic growth.

In democratic countries, it often takes years for different interest groups to reach an agreement on land acquisition.⁴⁹ Interest groups provide a system of checks and balances for one another. This prolonged negotiation process impedes the speed of both public and private business investments. In this context, democratic regimes can be rather rigid to reforms because certain interest groups can effectively block and prolong any significant changes, even when the changes may be good for the society as a whole.⁵⁰ Thus, the functioning of well-defined property rights entails significant negotiation costs.

In contrast, an authoritarian regime may have certain advantages in prompting growth when its decisions are in line with the public interest.⁵¹ Under an authoritarian regime, it may be easier to complete land transactions because of reduced efforts to balance conflicting interests held by interest groups.⁵² As a result, an authoritarian regime is likely to create a more business-friendly investment environment.

The negotiation costs for land procurement in China are much lower than in many other countries with well-defined property rights. Lower negotiation costs arise from China's unique practice of recognizing varying degrees of property rights

48. See NORTH, *supra* note 4.

49. See *PMC Land Acquisition Moves at Snail's Pace*, TIMES OF INDIA, Nov. 4, 2004 (discussing India's administrative and governmental delays in land acquisition).

50. See MANCUR OLSON, THE RISE AND DECLINE OF NATIONS: ECONOMIC GROWTH, STAGFLATION, AND ECONOMIC RIGIDITIES 57 (1982) ("After taking the time needed to arrive at their own decisions, cartels and lobbies sometimes then need more time to deal with their partners and antagonists The lobbying organization must, besides agreeing on its own policies, go through the compromises and procedures needed to change government policy. All this makes decision-making still slower.").

51. SEN, *supra* note 20, at 149. But when the authoritarian regime makes mistakes, sometimes the consequences can be disastrous, like the Great Famine in China. *Id.* at 150. Without enough checks and balances, the likelihood of making unforgivable mistakes is higher than in democratic regimes. *Id.*

52. See Jennifer Windsor, *Democracy and Development: The Evolution of U.S. Foreign Assistance Policy*, 27 FLETCHER F. WORLD AFF. 141 (2003) (suggesting the argument that authoritarian regimes are better able to utilize scarce resources and create economic growth).

attributable to investors as opposed to individuals. China provides effective protections for capital investments in many regions in spite of the absence of well-defined, formal property rights and legal systems.⁵³ But the property rights of individuals, including workers and farmers, are more loosely defined.

According to Article 10 of China's 1982 Constitution, the State owns the land in cities, while land in rural and suburban areas belongs to the collectives—except the land which already has been defined as State-owned.⁵⁴ In other words, Chinese law prohibits private land ownership.⁵⁵ Yet individuals are allowed to possess the user rights, which are separated from the ownership right.⁵⁶ These long-term land user rights can be sold, rented, and used as collateral.⁵⁷ The contract term of land-use rights for housing can last up to seventy years, and land-use rights for industrial, public, and commercial purposes can last up to fifty years.⁵⁸ Nominally, the State cannot take the land away within the contract term except under special circumstances when the land is reclassified for public use.⁵⁹

There are at least three ambiguities in the law. First, the definition of public interest is rather vague. For example, universities in general are considered public although they charge high tuition fees and operate like a commercial entity.⁶⁰ In recent

53. See *supra* Part II. Although investors lack the formal protection of courts and other legal systems to secure their property rights, some indigenous institutional arrangements can provide functional and feasible substitutes. See John C. Coffee, *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 *YALE L.J.* 1, 77 (2001) (“The point here is not that law does not matter, but that partial functional substitutes for formal legal requirements are both feasible and spreading.”).

54. XIAN FA art. 10 (1982) (P.R.C.).

55. *Down on the Farm: A Rural Crisis Is Forcing Beijing to Reconsider the Idea of Private Property*, *NEWSWEEK INT'L*, May 15, 2006 (acknowledging that China “still lacks private-property rights” and that “Chinese cannot legally own land”).

56. See XIAN FA art. 10 (1982) (P.R.C.) (amended 1988) (“[N]o organization or individual may appropriate, buy, sell or otherwise engage in the transfer of land by unlawful means. The right to the use of land may be transferred according to law.”).

57. Benjamin Robertson, *China: Selling Out the Family Farm*, *FAR E. ECON. REV.*, Oct. 26, 2005, at 48–51.

58. Stephen Wong, *Chinese Fear Homes Are Castles in the Air*, *ASIA TIMES ONLINE*, Oct. 3, 2006, http://www.atimes.com/atimes/China_Business/HJ03Cb01.html.

59. See T. Oliver Yee, *A Bid For a New Future: What Are the Effects and Challenges of the New National Public Bidding Regulations on Land Use Rights Assignment in China?*, 4 *WASH. U. GLOBAL STUD. L. REV.* 447, 448–49 (2005).

60. The Langfang Dongfang University town presents an example of how

land is initially procured under the guise of “public use,” but quickly transforms into a commercial enterprise. Langfang City belongs to Hebei Province, but is located right between Beijing and Tianjin, the two largest cities in northern China. *Langfang*, CHINA DAILY, July 16, 2004, http://www.chinadaily.com.cn/english/doc/200407/16/content_349131.htm. In order to take advantage of its geographical location, and in response to a campaign to turn high education into an industry, the Langfang Economic Development Zone decided to build the largest university town in China. Cf. Shi Jiangtao, *Cadres Disciplined Over University Land Scam*, S. CHINA MORNING POST, Dec. 31, 2004, at 12 (explaining that Langfang became one of fifty-four cities to develop universities in response to the central government’s education expansion plan). With the nationwide zeal of turning universities into enterprises, Langfang City expected to use the land as a bait to attract investors to build in the town. See Pamela Pun, *University Housing Scam Exposed*, STANDARD (China), at A01, translated in WISENEWS, available at <http://www.hkbu.edu.hk/~cstafrep/wnews/wisenews040527.html>. Cf., Jiangtao (stating that many university plans “turned out to be commercial property developments”).

As a signature project, the university-town project easily obtained a permit acquiring 5,728 mu of farmland for public use. See *Big Problems with Some Chinese College Cities*, Official, PEOPLE’S DAILY ONLINE (China), July 1, 2004, http://english.people.com.cn/200407/01/eng20040701_148143.html (stating that arable land was obtained through illegally signed land contracts). The university town paid farmers 55,000 yuan per mu in accord with the official price of land for public use. See *Illegal Land Acquisition in Dongfang University Town*, PEOPLE (China), Feb. 17, 2004, <http://www.people.com.cn/GB/jiaoyu/1054/2342990.html>. But the market value of the land was eventually estimated at 300,000 yuan per mu. *Id.* The land was inevitably used for commercial purposes, building commercial apartment buildings, villas, stores, and golf courses. See Jiangtao; see also *A Disturbingly Luxurious Golf Course*, PEOPLE (China), 2004, <http://www.people.com.cn/GB/jiaoyu/1054/2347970.html>.

The university town did not need to contribute much money in advance. Yang Bo & Du Zhen, *The Alarming Debt Black Hole*, PEOPLE (China), 2004, <http://www.people.com.cn/GB/jiaoyu/1054/2340954.html>. The bidding construction companies were required to self-finance for the first three years before receiving a payment by the fourth year. *Id.* But the actual enrollment turned out to be far lower than expected. See Chan Siu-sin, *University Town Gets Blasted by Auditor: Developments Bypassed State Council Land-Use Approval and Abused Credit*, S. CHINA MORNING POST, June 2, 2005, at 4 (stating that loans may not be repaid because student enrollment remained lower than expected). By the end of 2003, the university town had to default on its payments to the construction companies, who in turn defaulted on their loans to the banks and put workers’ wages in arrears. Yang Bo & Du Zhen, *The Alarming Debt Black Hole*, PEOPLE (China), 2004, <http://www.people.com.cn/GB/jiaoyu/1054/2340954.html>. The crisis was not exposed to the media until one of the contractors took sleeping pills in an attempt to commit suicide in front of the university town managers and city leaders in protest of the overdue payments. See Su Wei, *No Way to Get Paid: University City in Langfang Stuck in Deficit*, BEIJING TODAY, Apr. 2, 2002, <http://bjtoday.yinet.com/article.jsp?oid=2949742&pageno=1>. His life was saved and his brave behavior helped his workers get some of their wages in arrear. *Id.* For additional insight into the Langfang Dongfang University see *Shockingly Illegal Land Acquisitions*, PEOPLE (China), 2004 <http://www.people.com.cn/GB/jiaoyu/1054/2342990.html>; *The Secrets of Instantly Gaining Wealth*, PEOPLE (China), 2004, <http://www.people.com>.

years, many universities have expanded their campuses.⁶¹ By labeling the land in the interest of the public, the universities can obtain land-use permits, which allow them to acquire land from farmers at a much lower price than for commercial purposes.⁶²

Second, the law does not specify, in detail, how to compensate those being deprived of land. It loosely states that developers should grant a certain amount of compensation based on the years of actual use by the farmers in the land and the land development situation.⁶³

Third, the law does not stipulate a relationship between collectives and peasants for rural land. In rural areas, collectives refer to villages where a village committee normally exercises executive power.⁶⁴ Therefore, in reality, local governments only need to deal with the village committee during the land procurement process. In bypassing farmers, the local governments and developers can significantly reduce the negotiation cost. Sometimes, they collude to extract as much rent as possible from farmers' land.⁶⁵ To a large extent, farmers do not have much voice in the land procurement process.⁶⁶ They are rarely informed of the purpose of land procurement or the terms of compensation until the arrangements are finalized and officially announced.⁶⁷ Moreover, individuals usually must vacate their house or property

cn/GB/jiaoyu/1054/2345093.html.

61. *See id.*

62. *See id.*

63. *See* XIAN FA art. 13 (1982) (P.R.C.) (amended 2004) ("The State may, in the public interest and in accordance with law, expropriate or requisition private property for its use and shall make compensation for the private property expropriated or requisitioned.").

64. *See Farmers to Choose New Villagers' Committees*, CHINA DAILY, Mar. 21, 2005 (explaining that a villagers' committee is a governmental organization that manages the village's affairs).

65. *See* Xiaokai Yang, *Theories of Property Rights and China's Reforms*, 4 CHINA ECON. REV. 195, 207 (1993) (stating that local governments attempt to assist investment firms). This agency-like relationship can be seen as a "positive development because the local governments are strongly geared to assist development of local firms instead of making troubles for them. On the other hand, of course, this generates rampant corruption." *Id.*

66. Mark Magnier, *Land Grabs Pit Farmers Against Developers*, L.A. TIMES, Apr. 19, 2006 (expressing farmers' resentment over the lack of hearings and opportunities to negotiate fair land prices and further describing their protests against land grabs).

67. *See Farmland in Capital Illegally Cleared for Golf Course*, S. CHINA MORNING POST, July 9, 2000, at 9 (explaining that farmers were not consulted before a tourism board signed an agreement renting their land for use as a golf course).

on the land under a short notice, otherwise the state can use force to demolish the property by exercising the power of law.⁶⁸

The ambiguities inherent in China's current laws allows developers and local governments to acquire a land-use permit for developments in the public interest but then develop some of the land for commercial purposes. This creates a strong incentive for local governments to grab land. This is why there has been a nationwide "development zone fever" and "real estate fever" since Xiaoping Deng called for more "openness" during his famous tour in the South in 1992.⁶⁹ The current political environment allows these so-called development zones to easily be labeled as in the public interest.

Strong regional protection for investors' rights together with a weak protection of individual rights lowers the cost of doing business. In turn, the process of land procurement is eased and local governments economically prosper. Land is an important source of local revenues.⁷⁰ With increasing industrialization and urbanization, the demand for land drives up land values.⁷¹ Although severe competition for mobile capital restrains local governments from over-taxing the industrial sector, land values nonetheless create a source of income for local governments. The more development there is in a region, the higher land price becomes and the more local governments come to rely on land for local revenues. Naturally, land becomes a target of revenue for local governments.⁷² Figure 1 reveals a clear positive correlation

68. See *Eviction Was Belated for Project in China*, SEATTLE TIMES (Wash.), June 9, 2006, at A2 (commenting on a building commission's eviction and demolition orders).

69. John Gittings, *Phoney Deals of 'Development Fever' Take Toll*, GUARDIAN (London), June 23, 1998, at 20; *New Rules Aim to Cool Development Zone Fever*, CHINA DAILY, June 12, 1995, at 1; Kent Chen, *Development Zones 'Wasteful'*, S. CHINA MORNING POST, March 30, 1993; *Taiwan Paper Publishes 'Gist' of Deng Xiaoping's Classified Speech on Reform*, BRITISH BROADCASTING CORP., March 11, 1992.

70. See Chengri Ding, *Effects of Land Acquisition on China's Economic Future*, LAND LINES (Lincoln Inst. of Land Pol'y, Cambridge, MA), Jan. 2004, <http://www.lincolninst.edu/pubs/PubDetail.aspx?pubid=872> (stating that a local government's revenue-raising capability is rooted in China's land ownership structure).

71. See Xiaobo Zhang, Timothy D. Mount & Richard N. Boisvert, *Industrialization, Urbanization, and Land Use in China*, (Int'l Food Policy Research Inst., Environment and Prod. Tech. Div., Discussion Paper No. 58, 2000) (explaining that industrialization and urbanization increase land scarcity).

72. See Ding, *supra* note 70.

between land revenues and economic development.⁷³ In addition to being a revenue source, local governments also use land as an instrument to acquire loans to finance infrastructure development.⁷⁴ Once land is acquired, local governments and developers can then use the State-owned land as collateral to directly seek credit from State banks.⁷⁵

The inequitable distribution of security between investor and individual property rights represents a unique feature of China's property-rights system. On the one hand, local governments provide strong protection for business investment, particularly in regions with a large FDI presence.⁷⁶ The highly conducive investment climate and strong de facto property rights help to explain how China has managed to grow so fast.⁷⁷ Table 2 compares China with its peers and provides strong evidence of an exceptionally conducive investment climate in China.⁷⁸ On the other hand, local governments take advantage of the loopholes in the law to seize land from farmers without sufficient

73. CHINA STATE STATISTICAL BUREAU, CHINA COUNTY PUBLIC FINANCE STATISTICAL YEARBOOK (2001).

74. WORLD BANK, CHINA: LAND POLICY REFORM FOR SUSTAINABLE ECONOMIC AND SOCIAL DEVELOPMENT (2005).

75. Swati Lodh Kundu, *Rural China: Too Little, Too Late*, ASIA TIMES ONLINE, July 19, 2006, http://www.atimes.com/atimes/China_Business/HG19Cb01.html (explaining that the State uses requisitioned land as collateral for bank loans).

76. See *supra* Part II.

77. In the past, China and India had similar levels of economic growth. See S. Venkitaramanan, *Two Emerging Giants: The Global Debate*, BUS. LINE (Hindu), May 9, 2005 ("In the 1970s when the two countries started growing, their gross domestic product per head at common international prices were broadly similar."). But China's economic growth in recent years has far exceeded India's own economic growth. Kevin Rafferty, *India Fails to Realize its Democratic Advantage*, GULF NEWS, Sept. 23, 2003. Subsidies in India vividly illustrate how a country with formal institutions can be hampered by its own internal policies. ASHOK GULATI & SUDHA NARAYANAN, SUBSIDY SYNDROME IN INDIAN AGRICULTURE 90 (2003). Electricity is free or subsidized. *Id.* Consequently, farmers tend to over-consume the electricity, thereby contributing to an overstressed power system and frequent power outages in many rural areas. *Id.* at 90–91. Although politicians are fully aware of the problem, few dare to propose a change in policy for fear of losing the popular support of farmers. *Id.* at 122–36. Power outages take a toll on the growth of India's economy. David Dollar, Mary Hallward-Driemeier & Taye Mengistae, *Investment Climate and Firm Performance*, 54 ECON. DEV. & CULTURAL CHANGE 1 (2005); *India's Electricity Reforms: Underpowering*, ECONOMIST, Sept. 24, 2005, at 83–84. The problem of inadequate infrastructure more than offsets India's advantage in having a well-defined property rights system. *Id.*

78. World Bank Group, *Doing Business: Comparing Business Regulations*, 2006, <http://www.doingbusiness.org> (providing insight into the investment climates of China, India, Indonesia, and the Philippines).

compensation.⁷⁹

IV. LAND RIGHTS: FUEL OF GROWTH AND VOLCANO OF SOCIAL CONFLICT

Easy access to land facilitates capital investment, which in turn prompts industrial growth. About one-fourth of China's dramatic economic growth in recent decades stems from capital accumulation.⁸⁰ Table 3 shows that the growth rate of fixed asset investment in China is over five percent higher than the growth rate of per capita consumption, indicating that the pace of fixed-asset investment significantly exceeded the rate of per capita consumption.⁸¹

Fierce regional competition encourages local governments to seek credit to develop their local economy. Before 1994, it was common practice for local governments to force banks in their jurisdiction to extend them credit, creating serious inflation in the early 1990s.⁸² Since 1994, however, the central government has

79. Jim Yardley, *The Great Divide: Suddenly Landless Farmers Being Moved Aside By China's Real Estate Boom*, N.Y. TIMES, Dec. 8, 2004, at A1. Weak individual rights also apply to workers. For example, migratory workers do not have access to education, healthcare, and jobs. Sarah Carr, *Millions of Migrant Workers Moved to Chinese Cities Seeking Opportunity, but Their Children Are Falling Through the Cracks of the Education System*, MILWAUKEE J. SENTINEL (Wis.), Jan. 4, 2007, at A1. With cheap labor and land, generous tax breaks, good infrastructure, and a predictable investment environment, it is not surprising that China attracts considerable foreign direct investment.

80. Shenggen Fan, Xiaobo Zhang & Sherman Robinson, *Structural Change and Economic Growth in China*, 7 REV. DEV. ECON. 360, 374 (2003).

81. Per capita consumption and fixed asset investment data is from the China Statistical Yearbook. CHINA STATE STATISTICAL BUREAU, CHINA STATISTICAL YEARBOOK (2004). See also Xiaobo Zhang & Kong-Yam Tan, *Blunt to Sharpened Razor: Incremental Reform and Distortions in the Product and Capital Markets in China*, (Int'l Food Policy Research Inst., Dev. Strategy and Governance Div., Discussion Paper No. 13, 2004) (discussing, in detail, the causes of discrepancy between consumption and investment data in GDP statistics). Justin Yifu Lin attributes China's deflation from 1998 to 2002 to excessive production capacity, which was caused by the overwhelming expansion of fixed asset investment in relation to income growth. Justin Yifu Lin, *Is China's Growth Real and Sustainable?*, 12 (China Center for Economic Research, Peking University, Working Paper No. E2004003, 2004). Lin, however, does not offer any further explanation as to why the growth of fixed asset investments surpasses consumption by so much.

82. See Ya-Hwei, *Development and Financial Problems in China's Financial System*, 2004, <http://www.tsc.nccu.edu.tw/2004conference/%B7%A8%B6%AE%B4f.pdf> (stating that China's financial system "has been under full government control [for many years], where the government alone decided which direction private funds should go" and that since 1988, the economy has suffered from inflation

reasserted its control over the banks and has separated bank branches from local governments.⁸³ But despite an initial slow-down, the growth rate of fixed-asset investment has accelerated.⁸⁴ Theoretically, if the monetary authority is centralized, fiscal decentralization should not lead to credit expansion.⁸⁵ But why then did fixed-asset investment increase rather than slow down in China after the separation of bank branches from local governments in 1994? The answer is related to land banking.

The ambiguous law on land use gave local governments leeway in obtaining land-use permits within their locality. Having received a land-use permit, local governments can easily procure land from farmers at a low price and turn the ownership from collectives over to the State.⁸⁶ Local governments could continue obtaining credit from State banks even after bank branches were separated from local governments in 1994.⁸⁷ Nominally centralized monetary systems still have loopholes.⁸⁸ Functionally speaking, the monetary system is not independent from the land grabs of local governments. This theory helps explain why the current interest rate policy is not sufficient to cool down the demand for fixed asset investment.

Despite the benefits of growth, the current land fever also has negative consequences. Nearly thirty-four million mu of farmland were converted to urban and industrial development from 1987 to 2001, and about thirty-four million farmers lost land.⁸⁹ The Ministry of Land and Resources reported that "China's cultivated land is dwindling owing to construction recently, leading to a serious contradiction between land and population."⁹⁰ The

due to overheating).

83. *Id.* (explaining that in 1994, the government established "national policy banks to be in charge of policy-oriented financial business").

84. *China's Economy Slows but Still Grows 8.5 Percent*, PAC. SHIPPER, Apr. 20, 2006.

85. See Qian & Roland, *supra* note 19.

86. The Langfang University Town experience provides a vivid example on the mechanism of land grabs. See *supra* note 60.

87. See Ya-Hwei, *supra* note 82 (commenting that local governments still enjoy wide discretion in administrative decisions).

88. The arguments here do not invalidate the insights of Yingyi Qian and Gerard Roland on the role of an independent monetary system.

89. Han Jun, *Jiang Tudi Nongmin Jiti Suyou Dingjie Wei An Gufen Gongyouzhi* [*Change Collective Land Ownership into Shareholder Ownership*], *Zhongguo Jingji Shibao* [CHINA ECON. TIMES], Nov. 11, 2003 [hereinafter *Change Collective Land Ownership*]. One mu is equivalent to one-sixth of an acre. Yardley, *supra* note 79.

90. Ministry of Land and Resources, *Some Facts About the Land and Resources of*

compensation received by farmers accounts for only a fraction of the total market value.⁹¹ Clearly, local governments and developers appropriate a large fraction of the land rent.

Aside from paying low compensation for land acquisitions, local governments and developers often provoke additional outrage by using the land for commercial purposes in violation of the original public purpose intent.⁹² When facing unfair compensation and broken promises, individuals can, in principle, file a lawsuit with the courts. But the local courts rarely take cases pertaining to local government.⁹³ As a result, aggrieved individuals often end up having to appeal to the county-level government, provincial party leadership, central government, the media, or whoever else will listen to them. This may be why the Ministry of Construction received three times as many complaints about land disputes in the first quarter of 2004 as in the same period during 2003.⁹⁴ According to their statistics, by the end of June, 4,000 groups and 18,600 individuals had lodged petitions over allegedly illicit land confiscations.⁹⁵ Another recent study also shows that land disputes top the list of farmer petitions, accounting for approximately sixty-three percent of total complaint letters.⁹⁶

A dramatic increase in the number of media reports on corruption within the banking and real estate sectors also

China, 2007, <http://www.ml原因.gov.cn/pub/gtzyb/mlenglish/facts/index.htm>.

91. *Change Collective Land Ownership*, *supra* note 89; *see also* Yardley, *supra* note 76 (explaining that local officials offered farmers sixty dollars per mu for Xisha land and then leased the same land to developers for fifty times that amount).

92. During land grabs, tension rises to the point of riots and protests between farmers and local governments. *See* Yardley, *supra* note 79 (“Riots and protests over land seizures and inadequate compensation have erupted across China for much of this year.”).

93. *See Housing Disparity Highlights Need for Even Playing Field*, S. CHINA MORNING POST, Apr. 3, 2006, at 2 (discussing social land conflicts, stating that the resolution to such conflicts in China will be “brutal” because “[i]n other countries, independent courts and a democratic process provide avenues to resolve conflicts, but these are missing in China”).

94. *See* Li Jing, *Freeze Extended on Demolishing Firms*, CHINA DAILY, July 12, 2004, at 3 (“The complaints related to demolished homes filed at the Ministry of Construction in the first half of [2004] are more than those in all of 2003. . . . In the first quarter of this year, the number of complaints tripled the number in the same period last year.”).

95. Edward Cody, *China’s Land Grabs Raise Specter of Popular Unrest*, WASH. POST, Oct. 5, 2004, at A1.

96. Jianrong Yu, *How Peasants Lose Their Land Ownership?*, 2003, <http://www.ccrs.org.cn>.

highlights the seriousness of nationwide rent seeking.⁹⁷ With globalization, it is much easier to move capital across borders. This creates an opportunity for corrupted officials to hide their rents overseas, making it harder to fight corruption in the financial and land sectors.

Exchanges involving an asymmetric relationship between parties usually bring about negative externalities.⁹⁸ In China's case, land grabbing is likely to plant the seeds of hatred, which may be a vehicle for future social unrest. The clashes between local governments and farmers over land grabs may veer into violence and riots, particularly when coupled with other political and economic shocks.

In the short run, the weak protection of individual property rights may fuel economic growth because it reduces the transaction costs of acquiring land, a must for business investment. But in the long run, it may cause profoundly negative consequences. On the economic front, the land-grabbing fever may result in excess production capacity and deflation.⁹⁹ On the political side, it creates new powerful political interest groups, which make future reforms more difficult. Peasants deprived of their land often do not have a viable alternative livelihood and are therefore more likely to organize and fight with the authorities.¹⁰⁰ This increasing potential

97. Some of the recent reports on rent-seeking activities in the banking and real estate sectors include illegal land grabs by local governments in Shaanxi and the Fujiang and Guangdong Provinces. See Edward Cody, *China's Land Grabs Raise Specter of Popular Unrest*, WASH. POST, Oct. 5, 2004, at A1 (Fujiang and Guangdong Provinces); Jim Yardley, *Farmers Being Moved Aside by China's Real Estate Boom*, N.Y. TIMES, Dec. 8, 2004, at A1 (Shaanxi). Yang Xiuzhu, vice chief of the construction department of Zhejiang Province, extracted bribes from property developers and disappeared. Peter S. Goodman, *From Rags to Riches to Arrests in Booming China*, WASH. POST, Dec. 5, 2003, at E1. Chen Kai, a local government official of Fuzhou, Fujian Province, borrowed an estimated fifty million dollars from six state banks and provided kickbacks of around five percent of the loans to the lending officers. John Pomfret, *Chinese Officials Held in Regional Corruption Probe*, WASH. POST, Dec. 17, 2003, at A39. Shanghai real estate tycoon, Zhou Zhengyi, was implicated in an array of illegal loans coupled with default on statutory compensations for relocatees whose homes were improperly demolished for redevelopment projects. See Miao Ye, *Investing in Misery*, ASIA TIMES ONLINE, Dec. 18, 2003, <http://www.atimes.com/atimes/China/EL18Ad02.html>.

98. Ravi Kanbur, *On Obnoxious Markets*, in GLOBALIZATION, CULTURE, AND THE LIMITS OF THE MARKET: ESSAYS IN ECONOMICS AND PHILOSOPHY 39 (2004); see also *Housing Disparity Highlights Need for Even Playing Field*, S. CHINA MORNING POST, Apr. 3, 2006, at 2.

99. Lin, *supra* note 81.

100. See William Barnes, *Farmers Threaten Land Grab*, S. CHINA MORNING POST,

for conflict may jeopardize social stability, which has been a major asset for China's favorable investment environment.

V. CONCLUSION

The intent of this article was to examine why outside investment and growth in China have been so strong, despite the existence of a relatively weak de jure property rights system for investors. As a country in transition, China faces many institutional constraints including less-defined property rights. Decentralization and globalization have created strong regional competition for private capital in China, leading local governments to protect the property of private investors.

Local governments are forced by the market to offer de facto protections for investors' property. In order to raise revenue and provide land to investors, local governments have taken advantage of weaknesses in the existing land laws that allow local governments to procure land from private individuals for public purposes.¹⁰¹ Land is being taken at a fraction of its market value for supposed public purposes, and then being provided to private investors to promote local economic growth.¹⁰² Local governments also provide favorable tax breaks to investors.¹⁰³ These protections serve as a substitute for the weak formal property rights and legal systems that prevail in China, and have helped to fuel rapid economic growth.

But this behavior imposes a high cost on those individuals who lose their land and associated livelihoods. Forty million farmers have already lost land to takings by local governments.¹⁰⁴ The legal system seems unable to resolve land-taking conflicts when they arise, and affected farmers are increasingly organizing to protest and petition for change.¹⁰⁵ Two possible outcomes seem likely.

Jan. 27, 1999, at 10 (discussing the possibility that farmers may attempt to seize national forest land in response to their joblessness, despite opposition from the government).

101. See *supra* Part III.

102. *Id.*

103. See Anthony Harrington, *Tax Breaks Aiding Inward Investment*, SCOTSMAN (Scotland), Nov. 21, 2006, at 7 (“[T]he Chinese government has not been shy about using tax incentives to try to direct inward capital flows.”).

104. Jim Yardley, *Premier Says China Beset by Corruption and Rural Land Issues*, Mar. 14, 2006, at A5 (“Government studies show that at least 40 million farmers have been left landless in recent years, often because of illegal seizures by local officials who exploit the current policy.”).

105. *Housing Disparity Highlights Need for Even Playing Field*, *supra* note 93.

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The central government could enact additional political reforms to grant farmers more secure property rights and to hold local governments more accountable for their actions. Or, more farmers will join the army of the landless and a time may come when a volcano of hatred toward governments and developers will erupt, provoking unmanageable riots and social unrest.

Social conflict could prove disastrous for China's continued economic growth. On the positive side, social unrest may also serve as a pressure point for political reform. In the long run, as a country gets rich, people tend to demand more secure protections for individual property rights. Whether China can sustain its economic growth depends upon its ability to respond to emerging conflicts with continuing institutional innovations. The key is for the government to be adaptive enough to navigate the bumpy road ahead.

TABLE 1. FIRM RESPONSES REGARDING CHINA'S REGULATIONS AND JUDICIARY

	Consistency of officials' interpretation of regulations	Confidence in the judiciary system
Brazil	34.0	60.4
China	66.3	82.5
India	35.9	70.6
Indonesia	44.0	59.2
Philippines	50.9	66.2

The first column of data represents the percentage of firms that agreed with the statement: "In general, government officials' interpretations of regulations affecting my establishment are consistent and predictable." The second column of data represents the percentage of firms that agree with the statement: "I am confident that the judicial system will enforce my contractual and property rights in business disputes."¹⁰⁶

106. See *supra* note 45 and accompanying text.

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TABLE 2. BUSINESS INDICATORS FOR SELECT COUNTRIES¹⁰⁷

		Brazil	China	India	Indonesia	Philippines
Starting up	Number of procedures	17	12	11	12	11
	Duration (days)	152	41	89	151	50
Registering property	Registering property - number of procedures	14	3	6	6	8
	Registering property - time (days)	42	32	67	33	33
Getting credit	Cost to create collateral (% of income per capita)	21.4	0	11.3	2.5	8.3

107. See *supra* note 78 and accompanying text.

TABLE 3. PER CAPITA CONSUMPTION AND FIXED-ASSET INVESTMENT¹⁰⁸

Year	Per capita consumption (yuan)	Fixed-asset investment (billion yuan)
1985	437	254
1986	485	312
1987	550	379
1988	693	475
1989	762	441
1990	803	452
1991	896	559
1992	1,070	808
1993	1,331	1,307
1994	1,746	1,704
1995	2,236	2,002
1996	2,641	2,291
1997	2,834	2,494
1998	2,972	2,841
1999	3,138	2,985
2000	3,397	3,292
2001	3,609	3,721
2002	3,818	4,350
2003	4,089	5,557
Annual growth rate (%)	13.23	18.70

108. See *supra* note 81 and accompanying text.

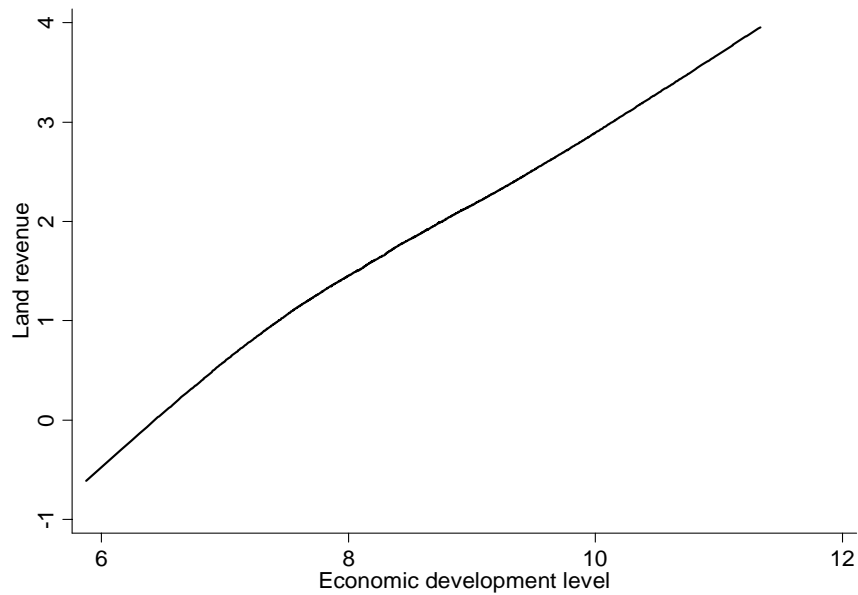
FIGURE 1. ECONOMIC DEVELOPMENT AND LAND REVENUE IN CHINA

Figure 1 depicts the relationship between revenues from land and economic development at the county level in 2000. The horizontal axis represents per capita gross output value of agriculture and industry. The vertical axis indicates the per capita revenue collected from land use. Both variables are in the logarithmic form.¹⁰⁹

109. See *supra* note 73 and accompanying text.