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Land use rights reform and the real estate market in China: a synoptic account of theoretical issues and the property rights system

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Abstract

Is China's "land use rights" legislation which distinguishes transferable "land use rights" and inalienable "land ownership", a novel concept unknown to human kind before, or a pragmatic reversion to the private property rights system abolished by the communist revolution? Advocates the view that the latter is a more correct interpretation. As part of a "going capitalist" economic reform programme, such a reversion is manifested in the legal recognition of the leasehold tenure after the "responsibility system" in privatizing agricultural production had proved to be successful. As the development of private property rights is a prelude to market transactions, the Chinese land use rights reform should be conducive to the success of the economic liberalization policy of China, provided that there is a contemporaneous advance in the development of the rule of law and technical know-how, such as valuation and land surveying.

Introduction

China, in territorial terms, is the second largest country in the world after Canada. It is also the most populous state on earth with an estimated population in 1990 of 1.1 billion people. Under socialist rule, China adopted a closed-door policy for almost 30 years from 1949. This closure rendered non-China-based research on the Chinese economy an almost exclusive domain of a few "China experts" whose opinions were regarded as being authoritative. The opening of the country and the resulting rapid economic progress under the leadership of Deng Xiao Ping on the one hand, and the collapse of the communist regimes of the Soviet Union and the Warsaw Pact states on the other, have kindled great academic interest in the economic reforms of China. In the context of improved accessibility to reliable data under the liberalization policy, the scope of academic research in the Chinese economy is immense. Research on the real estate market of China, in particular, is driven by both theoretical and practical interests.

Many scholars are interested in knowing whether the so-called "go capitalist" economic attempts of China are consistent with the official adherence to the socialist political stance. In terms of practice, practitioners in the rapidly expanding Chinese property market require better informed analysis beyond official propaganda or mere "facts" gathering.

The literature generated reveals a number of theoretical issues which reflect on the infancy of the field resulting from past neglect. While some of the issues identified may be a matter of semantics, most of them are likely to be the result of the absence of paradigms for theoretical articulation. This article gives a synoptic account of some theoretical issues identified in the literature and some property rights aspects of the "land use rights" reform of the real estate market in China. This may help in stimulating more rigorous academic inquiry into the subject area.

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Theoretical issues

The existing academic literature on China's real estate market available to the English-speaking world is extremely scarce. Most of the leading works are articles in academic journals and text books written by the academics of the University of Hong Kong [1-7].

However, many other Hong Kong-based academics and practitioners have expressed views on the phenomena and policies towards the real estate market in local professional journals, financial magazines, newspapers and Chinese books which are closely monitored by the Chinese authorities. Such views are worth attention as they exert considerable influence, not only on the policy makers and politicians, but also on students.

Walker and Li [5, p. 210], in their paper on land use rights reform, consider that "to conclude with any hint of certainty on [the property market of] China is to show extraordinary arrogance. It is too vast, too complex and currently subject to too many changes". Similarly, McKinnell and Walker argue that "attempting to put anything in print about China and its land reforms is extremely dangerous because the system is so dynamic that whatever one may have written is probably well on the way to being out of date and secondly because things are never quite as they seem" [7].

Indeed, the hectic mass media in Hong Kong frequently reports opinions about economic analysis of the Chinese economy which echo such a prudent view. At one extreme, there is the view that western economic theories are categorically deceptive propaganda which fail to explain the economic phenomena in China. This idea is predicated on the erroneous reasoning that "western" economic theories (in fact, price theory) would work only under conditions of perfect competition and the absence of government intervention. As the economic reality of China (and indeed, of the world) is replete with "imperfections", and world trade is everywhere ordered by protectionism, *laissez-faire* policy prescriptions based on the static laws of demand and supply and comparative advantage must be wrong.

One can vaguely depict from such a view a Lange [8] model of "market socialism" which envisages micro economic liberalization within a state governed under a macro-economics planning framework, a line of thought underlying the economic ideology of some conservative Chinese leaders. Such an extreme view is definitively unacceptable to the professional economist.

At another extreme stand the views of those economists trained in the neoclassical tradition who are bewildered by the observation that China is "too vast, too complex and currently subject to too many changes". They avoid making any theoretical generalizations and resort to "culture" or to "ideology" to explain eco-political phenomena.

While "culture" and "ideology" as forms of institutions are parameters or constraints for economic behaviour [9], there is a danger that such cultural explanations may degenerate into *ad hoc* theories with limited predictive value or testable implications expected of empirical economic reasoning. In the final analysis, culture and ideology themselves need explanation.

It is probably due to the influence of the above ideas that even formal academic papers in some real estate journals tend to adopt an eclectic approach in interpreting real estate affairs in China. The resulting theoretical issues are as follows. First, there is an absence of paradigms or theoretical frameworks which are essential for generating holistic views or testable hypotheses typical of a mature academic field. Second, there is a tendency to invoke concepts of contradictory ideologies without specifying one's position. Marxist economic concepts are problematic in terms of the received price theory; for instance, notions like socialist central planning displaces not only the market but also the law of demand and supply, and goods without "prices" have zero value. These notions are often mixed up with a "free marketer's" critique of the socialist system for being "inefficient" or "wasteful", a comment which makes little sense for ignoring the relevant constraints of the socialist system. (If "efficiency" is defined as constrained maximization [10].) Third, most authors do not make any reference to the huge body of literature on land tenure and urban development, or compare the land use rights reform to the method of land allocation and management practised in Hong Kong, on which the Chinese reforms model themselves. (Evers [11] made a similar comment about development in the Third World two decades ago.) Such a comparison could be more effective in initiating the interest of a foreign reader who would be more familiar with the Hong Kong system firmly based on common law and the market economy. Some commentators apparently have over-emphasized the "uniqueness" of the Chinese economy and hence the alleged impossibility of generalizing the Chinese reforms.

Instead of dwelling on individual theoretical problems identified in the aforesaid literature, the rest of this article is devoted to characterizing the nature of China's real estate market and the land use rights reforms in terms of the property rights paradigm as developed by Coase[12,13] and Cheung[10, 14-17], making comparisons with the Hong Kong system where appropriate. The hypothesis is that the scale, complexity and speed of real estate development does not entail that theorization is impossible.

The property rights aspects of the China real estate market and the land use rights reforms

The “dark age” before the communist take-over of 1949: prevailing private property rights over land

With two brief exceptions one as an alien force (imperialism) and the other a brief period in the end of the Qing Dynasty [early 20th century] where a capitalist structure briefly emerged in an embryonic form China has never known Capitalism[2, p. 59].

It is incorrect to argue that China had little experience of capitalism until the economic reforms of Deng Xiao Ping, if the ambiguous word “capitalism” refers to “a form of market economy based on private property rights”. Indeed, imperial China was the first country in the world to use paper currency and cheques (Marco Polo was a witness to these instruments) which are basic elements of a market economy. As far as landed property was concerned, the establishment of private property rights predated the emergence of the English freehold system. An elaborated system of land title and use registration was devised as the basis of taxation to support the expenses of the absolute and centralized monarchy. If “capitalism” refers to the modern factory system using western technology and financial institutions, it took root in the ports and cities where western powers obtained extra-territorial privileges in the late nineteenth century. Official Chinese history has been describing China under the Nationalist rule as a “nationalist” capitalist regime. Shanghai in the twentieth century before the communist take-over of 1949 had all the symptoms of “capitalism” denounced by the Marxist economist: hyperinflation, capital-labour conflict, speculations on shares and property, etc. The communists publicized all social institutions prior to the Revolution, including private property, as phenomena of a

dark age characterized by internal oppression and foreign expropriation.

In any event, it is an important fact to note that the Chinese people had a long history of private property rights in land, unlike many other “developing world” countries which have, to date, retained different forms of communal or customary land tenure inhibiting development. The question of tackling the problems posed by communal or customary land tenure has remained an important policy consideration in many developing world countries. Customary land tenure is a viable and rational economic, social and environmental solution to the “tragedy of the commons” (common property) for a small-scale subsistence economy. However, such a communal property rights system is far too uncertain and constrained for a growing population and the development of a market economy based on sophisticated division of labour.

Under communal rights, the individual's freedom to use, derive income from and transfer or subdivide use and income rights is either denied or subject to a collective decision, which involves huge and prohibitive transaction costs. Some colonial powers like those in Latin America and Australia successfully displaced the indigenous communal land system by a private property system in the form of freehold tenure. Many others allowed the customary system to operate in the rural areas while implanting private property in the form of freehold or leasehold in the urban cores, in order to pacify the indigenous people.

To pave the way for economic development, many colonial governments took the opportunities of constitutional change of forthcoming independence to carry out land reforms by replacing the customary land tenure, which was believed to be a hindrance to incentive. For instance, the Report of the East African Royal Commission recommended the granting of individual freehold titles of land to replace the communal systems in the East African colonies[18,19].

In more recently decolonized countries in the South Pacific and in Australia, there is a recent revival of, or reversion to, customary land tenure[20]. “Independent governments in Melanesia have begun to roll the process of alienation back, by returning government and even private freehold land to the descendants of the people thought to have lost it. The Fiji government, for example, recently announced it would be returning land it owned” [21,

p. 45]. In Australia, the Native Title Land Act established the communal rights of the Aborigines and Torres Straits Islanders, against freehold and leasehold interests created by colonialists[22].

This revival or reversionary process is partly due to the growing concern for democracy, human rights, cultural rights and local participation by the ex-colonial overlords. The result is that modern market, transactions and planning are becoming more and more constrained by communal interests and the ensuing transaction costs of bargaining.

While criticizing the Chinese land market at present for “the irrational and profligate way in which the property rights system has been operated” [23], the commentators have omitted the fact that the current land rights system in China is far less uncertain than the customary land tenure system prevailing in many other developing countries because of the early inception of private property rights, as mentioned above, and the great reduction in the transaction costs of land assembly and measurement owing to the high-handed policies of the socialist government.

Like the English proprietor possessing a freehold estate, the China proprietors before the communist take-over had, subject to the law and policies of the day, the three characteristics of private property rights identified by Cheung[14], namely:

- (1) freedom to use land for whatever purpose;
- (2) freedom to derive income from the land uses chosen;
- (3) freedom to alienate, transfer, subdivide or agglomerate the use and income rights[24,25].

Voluntary contracts were the basis of the rights transfer.

Under Imperial and Nationalist rule, most land rights transfer needed to be evidenced in writing and/or registered if they were to be enforced at court. While such a land system did exist in a period labelled as “feudalism” by the dogmatic Marxist scholar of history, it was definitely the precondition for a market transaction of land, according to “Coase Theorem” expressed in Coase’s article, “The federal communications commission” [12]. This theorem reads “the delimitations of rights is an essential prelude to market transaction”. However, like many countries with a freehold system, China’s private land, notably rural land, before the Communist Revolution was under fragmented ownership. In addition, agricultural

land parcels in China were typically irregular in shape. These conditions created huge transaction costs for land assembly and measurement. With hindsight, the post-revolution collectivization of rural land bluntly transformed fragmented and irregular rural land holdings into consolidated and more rectilinear land lots[26-28]. The drastic reduction in transaction costs of land assembly and measurement allows for the speedy development of large-scale, comprehensively-planned residential estates today.

Replacement of private property rights by socialist rank hierarchy

The communist takeover in 1949 soon led to the “nationalization” of urban land during the “Great Leap Forward” (1957-1962) and the “Cultural Revolution” (1966-1978) and the “Collectivization” of rural land (1963-1965). Few authors, however, clearly explained the meaning of these propagandized policies. What is the difference, for instance, between “nationalization of development rights” in the UK under the post-war town and country planning reforms and “nationalization of urban land” in China? What is the difference between “nationalization” of land in Hong Kong, which has a leasehold instead of a freehold system, and “nationalization” of land in China? What is the difference between urban land “nationalization” and rural land “collectivization”? More importantly, what is the fundamental alteration to the pre-existing “ownership” rights? Attempts to answer these questions by many authors, such as Selden[25], often create more confusion (see Evers[11]). Cheung’s[14] three private property rights characteristics referred to above provide a powerful and convenient analytical framework to address these questions in a theoretically more consistent and useful way.

Communist ideology condemns property ownership for being the basis of class exploitation. Ownership of landed property by the original proprietors was accordingly abolished.

However, in practice, it is a myth that landed property therefore became “common property”, in the sense that no one had any rights over the property so that they were open to appropriation by anyone “according to needs” in the communist utopia as envisaged by Marx. The reason is simply that this scenario of “common property” would, under competition, reduce the worth (economic rent) of the property to zero. In terms of economic jargon, this process is called “rent dissipation”. Private property

rights is in fact a system of rules constraining competition. (For an empirical study of the economic impact of assigning exclusive property rights over a “common” resource, see [29].) Competition is a social concept because it cannot occur when there is only one person in the world. The concept of “ownership” is a social means to deal with competition. It denotes certain rules delineating the relationship between the “owner” and the rest of the world with respect to an object or property. The concept of ownership is unintelligible without reference to relationships among people.

As private property rights, as a system of rules constraining competition, was abolished, the new communist government had to devise an alternative system to take its place to avoid full rent dissipation. The solution of the communist regime was to reassign some of the three elements of rights enjoyed by the proprietors to the party members in charge of land matters.

The decisions of these party members, however, was not unrestrained. As market transactions, based on the freedom of contract, were completely superseded by central economic planning, the rights of party members in respect of land uses and the generation of income were restricted, and the transfer of such rights became almost completely dependent on state planning. Comprehensive planning, of course, was just an impossible ideal, and there were certainly many grey areas over which a party member had to exercise discretion.

It was therefore more accurate to say that the private property rights of the original proprietors were transformed into the discretionary rights of the party members to direct the uses of resources within a central economic planning system. The extent of such discretionary rights depended entirely on their rank in the party hierarchy.

As certain rights were not clearly specified, a degree of rent dissipation was inevitable. When compared to the private property rights systems, such dissipation could be said to be “inefficient”. However, in terms of the newly adopted system of central economic planning and the socialist rights system, “inefficiency” did not exist because under a different set of objective constraints, including ideology, the system had already adopted the best possible arrangement to avoid total chaos and famine. Such an arrangement was upheld at great political transaction costs: frequent indoctrination, periodic purges, constant monitoring of expression of ideas and social behaviour and the restriction in the liberty of movement and child bearing.

It should not be presupposed that because the price mechanism was displaced by planning, as suggested by Walker and Li [5], land became valueless or ceased to be a factor of production. That such values were not allowed to be reflected in terms of price signals does not mean that they disappear. Value exists so long as there is competition over scarce land resources. One major source of competition is the choice between industry and agriculture. Prioritizing these competing sectors not uncommonly led to disputes among leaders and were resolved by political struggles.

The fact is that price allocation based on voluntary contract was superseded by non-price allocation by the plan, as implemented at the discretion of the party comrades in charge of land resources. Typically, planning standards were employed to resolve competing claims for land resources and their use.

According to the “invariance” version of the Coase Theorem enumerated in “The problem of social cost” [13], the resource allocation implications and “efficiency” attained by central economic planning would be the same as those for a free market “capitalist” system if transaction costs are zero and rights are clearly delineated.

Precisely because the transaction costs of a planned economy are greater than a market economy [15] and the rights of the party members over resources are not clearly specified, the socialist land use rights system produces results which, from the market economy’s view point, are “inefficient”. For instance, massive areas of land were formed but became vacant because planned development could not materialize because of slippages in planning, buildings not properly managed or maintained, and the like. Therefore, land use rights reforms formed part of the economic reform packages of the Deng Xiao Ping era.

Reversion to private property rights

The “hot” issues in the development of the real estate market in China in recent reform years include:

- the legislative innovation of transferable “land use rights” as distinct from inalienable “land ownership” [5];
- the establishment of the institution of land auction, tender and grant [6];
- the hectic construction and sale of residential units in the Pearl River Delta and in major cities, notably Beijing, Shanghai, Guangzhou and Shenzhen [30];

- the listing of state enterprises with huge land holdings on the Hong Kong Stock Exchange[1]

It has been argued by Ratcliffe[23] that “land use rights” were separable from “land ownership” or “ownership rights” and hence tradable by auction, tender, negotiation and private treaty. The relevant legal provision is contained in Clause 4 of Article 10 of the Constitution of the People’s Republic of China, which was last amended in April 1988 to read:

no organization or individual may appropriate, buy, sell, or lease or unlawfully transfer land in other ways. The right of land use can be transferred in accordance with the law.

Many scholars brought up in the common law systems interestingly adhere to a literal interpretation, which is indeed also the official rationalization, of this amended clause. They regard it as having the effect of retaining the “ownership” of land in the hands of the state (or “the people”), upholding therefore the socialist doctrine of nationalization of the “means of production” (land resources in this case). This is the view of Walker and Li[5] and was explained in greater detail by Ratcliffe[23]:

The focus being on separating land ownership from the rights to occupy and use land lies at the core of urban land use system reform in the PRC. The problem being not so much the public ownership of land itself, but the irrational and profligate way in which the property rights system has been operated. Thus, the path of land system reform will not alter the basic principle of public land ownership, but rather revise and improve the system of property rights in terms of such matters as the most suitable legal representatives of *public ownership*; the separation of *land ownership* and *land use*; and the identification of clear relationships between the various parties concerned defining their rights, responsibilities and interests [author’s italics].

Such views confuse the reader and have a lot of theoretical problems. First of all, if “ownership” and “rights” were separable, then one would have to accept an absurd legal concept of X having “ownership” of land without any “rights” in it (the same logic applies equally to the conventional distinction between “ownership” and “possession”). As argued above, “ownership” signifies a social relation. “Rights”, denoting the nature of certain social relations, are indeed the substance of “ownership”. In other words, “rights” and “ownership” are conceptually inseparable. The doctrine of “estate” in the English land law embodies such ontological concepts.

A freeholder has a seisin in land rather than “owning” land. According to the Osborn’s Concise Law Dictionary, “seisin” means “the relation in which a person stands to land or other hereditaments, when he has in them an estate of freehold in possession”. To recapitulate, the proprietor in a private property rights system, has three types of exclusive rights: rights to use, to derive income and to transfer. All such rights, notably the rights to transfer, are now legally valid in China. The Provisional Regulations on Granting and Assigning Land Use Rights in Urban Areas in the PRC promulgated by the State Council in May 1990 form the basis of the “land use rights” reform in practice. These regulations provide a basis for the granting and assigning of leaseholds in urban state-owned land across the country. Land users, including state enterprises, must hold leaseholds before their interests in land may be assigned, leased or mortgaged. The terms of the lease are normally 70 years for residential, 50 years for industrial, educational, scientific and technological, culture, public health and sports, 40 years for commercial, tourism and recreational; and 50 years for combined or other purposes.

Walker and Li[5] are correct in saying that the “land use rights” reform creates the PRC-equivalent of the Hong Kong leasehold system, a point first recognized by Cheung[15]. They could indeed take one step further affirming that “this is a legal reversion to private property rights”. Leasehold, like freehold, as a form of land tenure is full private property rights, bearing the three characteristic rights. The difference between leasehold and freehold is that the rights of the former are exercisable within a pre-determined period (i.e. the term of years) whereas the rights of the latter are exercisable within a period which is not pre-determined (but which is determinable by eminent domain[31]) where the state sees fit.

In fact, before such *de jure* private property rights were recognized by edict, China had, since the inception of the liberalization policy, adopted *de facto* private property rights for rural land by replacing the compulsory commune and production team systems by a voluntary “responsibility system”[32] under which a peasant family could, after paying its due to the state (i.e. a kind of tax), retain income derived from agricultural uses chosen freely by the family.

Cheung[15] argues that with the current legal establishment of tradable land use rights, and official attempts to re-allocate “national-

ized land” by the market mechanism of auction and tender, China is clearly on the road to capitalism based on private property rights. The fact that this material reversion to pre-revolution private property rights, official rhetorics notwithstanding, is replete with problems, should not confuse the basic direction of change. The growth of the property market as indicated by the volume and speed of land and unit transactions[30], is strong evidence of the re-establishment of private property rights. The booming manufacturing industries built on such landed property are reminiscent of those in Charles Dickens’ novels.

Instead of expending energy in artificially juxtaposing or attempting to reconcile logically untidy and incompatible “mixed ideology” concepts, the researcher would do better to focus on the evolution of the institution of private property rights in land and their prerequisites.

One key prerequisite is the rule of law, as property rights delineated need to be duly interpreted and enforced. The Chinese Government’s success in reverting to private property rights is largely in the sphere of initial delineation and legal recognition of such rights. The subsequent reassignment and enforcement of these rights remain a big problem area.

Another prerequisite for the operation of private property rights is the technical measurement of rights. This aspect entails huge transaction costs in real estate surveying, valuation and registration. Mckinnell *et al.*[2] remind the reader that “ideologies die hard”. This is quite true. However, if ideologies are interest-based, then this reminder is but a reminder that the law of economics is always at work! Whether the Chinese “road to capitalism” will end up as a “passage to India” [15, 16] characterized by a system of endemic corruption, would not alter the fact that it is re-establishing a system of private property rights, be it in India or Hong Kong.

Conclusion

As Coase[12] pointed out, clear delineation of private property rights is the prelude to market transactions. The “land use rights” reform of China is in substance seeking to re-establish the abolished private property rights system in the form of leasehold tenure. This endeavour, however, is often overlooked because of a confused interpretation of official socialist jargons. Researchers in property valuation and management interested in the

Chinese property market should, in this context, pay particular attention to the development of the rule of law in this country, as private property rights cannot function efficiently in the absence of a well established legal system. Besides, the history and procedures of the leasehold system of Hong Kong, and its supporting common law system, should provide the Chinese reformers with many useful insights and examples.

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- 24 Many authors put a lot of stress on "possession" as a separate kind of right. Cheung's three rights imply possessory rights but not vice versa. The "right" to "possess" or "own" without the rights to use, derive income or transfer are void concepts. Selden's[25] five-fold categorizaion for rights is too complicated. Selden lists five distinctive Chinese land rights: formal ownership; use; transfer; product; labour rights.
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- 32 This is actually a system of sub-contracting, "whereas it has taken a revolution to abolish private property, the process in reverse may be done through contracting" (see Cheung[16, pp. 586-7]). "The so-called 'responsibility contract', if reduced to its simplest and therefore most perfect form, is equivalent to the granting of private property through a state lease of land" [15].

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