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# Voice and Exit as Accountability Mechanisms: Can Foot-Voting Be Made Safe for the Chinese Communist Party?

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## Abstract

According to Albert O. Hirschman’s famous dichotomy, citizens can express their preferences with their “voice” (by voting with ballots to elect better representatives) and “exit” (by voting with their feet to choose better places to live). Suppose, however, that ballot-voting is ineffective: Can exit not merely aid but also replace voice? Using as a case study the People’s Republic of China, a party state without elective democracy, we argue that exit is not a substitute for, but rather a complement to, voice. China’s bureaucratic promotion system plays the role of local elections in the United States, promoting or replacing local officials based on their performance in office. In either regime, however, it is costly for local voters (in the United States) or the Chinese Communist Party (in China) to monitor and assess local officials. Attention to foot-voting in the legal design of local government can help reduce these costs. By evaluating cadres who run the lower levels of China’s local governments on the basis of how successfully they attract mobile households, the central CCP authorities could reduce the costs of monitoring these local officials and thereby reproduce, by bureaucratic means, some of the benefits of electoral democracy. Success in attracting foot-voters can be most cheaply measured by the Party’s evaluating cadres primarily on the basis of local land values which, because they are a product of foot-voters’ decisions about where to live, function like ballots insofar as they reflect the popularity of local cadres’ policy decisions with mobile Chinese households. For foot-voting to improve governmental accountability, however, the Chinese system of local government law requires some basic but politically feasible reforms -- in particular, the introduction of a local property tax system, the creation of a federated city system that grants power and autonomy to sub-city units, and the liberalization of China’s household registration system to make the population fully mobile across different jurisdictions.

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It is a familiar point that citizens can express their preferences either by voting with ballots or voting with their feet. When citizens vote with ballots, they collectively select policies or candidates governing the jurisdiction in which the voters reside. When they vote with their feet, citizens individually migrate to jurisdictions governed by the migrants’ preferred policies or

officials. Using Albert O. Hirschman's famous dichotomy, ballot-voting is described as the use of "voice," while foot-voting is described as "exit."<sup>3</sup> But the two mechanisms might be seen as simply different mechanisms for individuals to make collective choices – with ballots, of people and policies; with feet, of places.

The existence of these parallel mechanisms for revealing citizens' preferences suggests that exit might be a substitute as well as a complement for voice. Suppose that local elections are impractical or ineffective. Could one achieve some or all of the accountability that such elections are intended to achieve simply by giving citizens the power to shop around for a local government that suits their desires? Could foot-voting not merely aid but also replace ballot-voting?

The People's Republic of China presents an opportunity to investigate this question of whether foot-voting can be a substitute for ballot-voting. Although the ideology of the Chinese Communist Party ("CCP") permits "intra-party democracy" (*dangnei minzhu*, 党内民主), actual voting on rival candidates even at the local level and even within the Communist Party is strikingly rare in China.<sup>4</sup> In general, "cadres" – a term that, for the purposes of this article refers to CCP members seeking or holding public office – are assessed and promoted by the central CCP authorities without the intervention of any popular election. The CCP's ideology of democratic centralism, in other words, is more central than democratic, making any robust system of citizen voice difficult to install as long as the CCP is in power.

At the same time, CCP leaders are aware of the need to anticipate and address public complaints about air pollution, corruption, access to jobs and education, police brutality, and other failures of governance.<sup>5</sup> If there were an accurate way to measure public demand for various local public goods that did not pose a political risk to continued rule by the CCP, the CCP would have every reason to embrace the mechanism. Foot-voting by mobile Chinese

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<sup>3</sup> See ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* (1970).

<sup>4</sup> For brief summaries of the debate over the seriousness of intra-party democracy in China, see Joseph Fewsmith, *Intra-Party Democracy: Development and Limitations* (Brookings Working Paper, 2016), [http://archives.cerium.ca/IMG/pdf/Fewsmith\\_Inner-party\\_democracy.pdf](http://archives.cerium.ca/IMG/pdf/Fewsmith_Inner-party_democracy.pdf) ; For a full-scale defense of intra-party democracy from an insider, see YU KEPING, *DEMOCRACY IS A GOOD THING: ESSAYS ON POLITICS, SOCIETY, AND CULTURE IN CONTEMPORARY CHINA* (2009). For a description of various efforts to hold township elections to decide on cadre promotions, see JOSEPH FEWSMITH, *THE LOGIC AND LIMITS OF POLITICAL REFORM IN CHINA* (2012).

<sup>5</sup> See e.g., FRANCIS FUKUYAMA, *POLITICAL ORDER AND POLITICAL DECAY* 380 (2014); Bruce Gilley, *Legitimacy and Institutional Change: the Case of China*, 41 *COMP. POL. STUD.* 259 (2008); Stephen White, *Economic Performance and Communist Legitimacy*, 38 *WORLD POLITICS* 462 (1986).

citizens might be precisely such a mechanism by which (to borrow Yu Keping's phrase) democracy might be made safe for the Communist Party.<sup>6</sup>

We provide some cautiously optimistic arguments in favor of promoting exit as a way to improve accountability of local officials to Chinese citizens. The basic idea is that the CCP cadres who run the lower levels of China's local governments – in particular, the urban districts and counties rather than the provinces and prefectural-level cities – could be evaluated based on how successfully they compete with each other for mobile households choosing a jurisdiction in which to live. Such success would theoretically be reflected in the price of land, a price that would reflect (“capitalize”) local cadres' decisions about regulations, expenditures, and revenue-raising. Through the magic of such capitalization, central Party officials could evaluate which cadres were really enhancing social welfare by satisfying their citizens' preferences for public goods and which were instead wasting money on showy “face projects”<sup>7</sup> and pollution-generating industry the costs of which exceeds the benefits. In effect, foot-voting could instigate competition among cadres for migrants to bid up the value of their jurisdiction's land by attracting the “votes” of foot-voters, a competition that might be a form of “intra-party democracy” (or, at least, intra-party competition) safe enough for the CCP to adopt.

We caution that our defense of exit is contingent on the CCP's adoption of some incentive system to give local cadres proper incentives and tools for competing with each other for mobile households. At the most general theoretical level, exit cannot be a substitute for voice unless some mechanism gives subnational officials an incentive to care about attracting mobile citizens. In liberal democracies, local elections provide such a mechanism. In a Leninist system of democratic centralism, the official criteria for bureaucratic promotion play the role of elections. Rather than focusing on local GDP, local job creation, or local revenue generation, central CCP authorities ought to focus on local land prices, promoting cadres who improve the value of land by attracting more buyers. To facilitate citizens' foot-voting and inter-jurisdictional competition, we urge the introduction of a property tax system in Chinese cities, a system which could become the monetary voice of China's mobile citizenry. We also urge the

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<sup>6</sup> See Yu Keping (俞可平), *政治改革的合理路径* [*A Plausible Approach to Political Reform*], CHINA IN PERSPECTIVE (Feb. 25, 2012), <http://www.chinainperspective.com/ArtShow.aspx?AID=14389>.

<sup>7</sup> In Chinese, “face projects” or “mianzi gongcheng” (面子工程) refer to infrastructure that is showy but not useful. See e.g., 面子工程触目惊心, 有多少浪费可以重来 [*How Much Could We Waste On Face Projects*], <http://www.xinhuanet.com/fortune/by18.htm> (last visited August 2, 2016).

building of a federated city system that grants power and autonomy to sub-city units of proper size, and we recommend the further reform of China's household registration (hukou, 户口) system to make population fully mobile among different jurisdictions.

Beyond these specific suggestions for reform in China, this article also suggests a relationship between exit and voice in which each is not a substitute for, but rather a complement to, the other. Without voice, or a mechanism analogous to voice like bureaucratic promotion criteria, exit cannot function well as a system of accountability to mobile households, because subnational officials, angling for promotion, have no reason *a priori* to care about maximizing the value of local real estate. Our specific suggested reforms are an effort to enlist the CCP's bureaucratic promotion system to do the work that citizen voice performs in the United States and other liberal democracies. Whether that bureaucratic promotion system can bear such weight is an open question. We provide only an abstract theoretical case that foot-voting can be made safe for the CCP if the CCP makes Chinese local governments responsive to foot-voters.

Here is a brief roadmap of our argument. Part I addresses the paradoxical nature of the CCP's democratic centralism, a fundamental principle of the Chinese party state. Part II compares foot-voting in liberal democracies and authoritarian regimes and argues that bureaucratic promotion criteria in China are the necessary complement to exit-based control of local officials just as local elections are necessary for foot-voting in the United States. Part III proposes using land values as the main criterion in the CCP's cadre evaluation, because they are best proxy for foot-voter's choices. Part IV defends three feasible institutional reforms, namely property tax, federated cities, and household registration (hukou, 户口) reform, to improve government accountability through citizen mobility in China.

## **I. Lenin's Nightmare: How can the Center Control the Cadres in a Regime of "Democratic Centralism"?**

The benefits of exit depend on the costs of voice. If voters, aided by a vigorous press and competitive political parties, could easily choose officials who would truly enact those voters' preferred policies, then the relative benefits of facilitating citizen choice through migration would be reduced. Why rely on citizen mobility when electoral accountability can accomplish the same end without the hassle of migration? The answer is that sometimes there are impediments to effective voice. Local voters, for instance, might be rationally ignorant about political decisions that their vote has a minuscule chance of affecting and, therefore, be apathetic

or ignorant in casting their ballots. Local governments might also be dominated by a single political party or interest that suppresses genuine electoral choices. Confronted by such impediments to effective voice, one might try instead to elicit popular preferences through exit.

In China, citizens can use both voice and exit to control the government, but access to both is limited by ideological and legal constraints. We will discuss the institutional limits on exit in Part IV. Here, we describe both the power of, and limits on, citizens' voice under the principle of "democratic centralism." Those limits on citizen voice can be a substantial impediment to the CCP's effective monitoring and control of its cadres, suggesting a need for voice to be supplemented by exit.

### **A. An Overview of Democratic Centralism's Limits on Citizen "Voice"**

At the heart of the CCP's ideology is a contradictory attitude towards popular participation in government, captured by the phrase "democratic centralism" (minzhu jizhong zhi 民主集中制). Promoted by Lenin as a principle for governing the Bolshevik Party and eventually the Soviet state, democratic centralism has also been adopted as a governing principle of the CCP.<sup>8</sup> Democratic centralism suggests a contradiction, because it simultaneously encourages and limits popular criticism of the government.<sup>9</sup> On one hand, the idea of socialist democracy requires the CCP to "connect to the people closely" by keeping a close eye on popular opinion, soliciting popular views about the government's performance and responding to those views in the CCP's policy decisions. On the other hand, the actual governmental decisions must be "centralized," meaning that they must be made by the Party leadership, not by the people themselves or their elected representatives. Mao's description of democratic centralism as

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<sup>8</sup>On the origins of democratic centralism in the Bolshevik Party, see MICHAEL WALLER, DEMOCRATIC CENTRALISM: AN HISTORICAL COMMENTARY 31-32 (1981). Lenin provided his original statement of democratic centralism in Vladimir Lenin, *Freedom to Criticise and Unity of Action*, in VLADIMIR LENIN, COLLECTED WORKS 442, 442-43 (1965), available at <https://www.marxists.org/archive/lenin/works/1906/may/20c.htm>; see also Vladimir Lenin, Report on the Unity Congress of the R.S.D.L.P. (1906), available at <http://intersci.ss.uci.edu/wiki/eBooks/Russia/BOOKS/Lenin/The%20Congress%20Summed%20Up%201906%20%20Lenin.pdf>. He faced considerable internal and international opposition to his principle of democratic centralism, with Rosa Luxemburg's 1904 article being the most eloquent and well-known example. See Rosa Luxemburg, *Organizational Questions of the Russian Social Democracy* (1904), available at <https://www.marxists.org/archive/luxemburg/1904/questions-rsd/>. On the adoption of democratic centralism by the CCP in 1927, see Stephen C. Angle, *Decent Democratic Centralism*, 33 POL. THEORY 518, 524-25 (2005), citing ANTHONY SAICH, THE RISE TO POWER OF THE CHINESE COMMUNIST PARTY: DOCUMENTS AND ANALYSIS 259, 806 (1996).

<sup>9</sup>For a succinct account of the tensions implicit in the idea of democratic centralism, see Gang Lin, *Leadership Transition, Intra-Party Democracy, and Institution Building in China*, 44 ASIAN SURVEY, 255, 273 (2004).

“contradictory parts of an integrated principle” suggests the delicate balancing act that these two ideas require.<sup>10</sup> The Party listens to popular opinion in formulating policy,<sup>11</sup> but it is the Party, not majority voting by the people, that makes the ultimate decision based on popular input.

This idea of democratic centralism explains what to an outside observer can seem like a perplexing contradiction. On one hand, public debate in China is not merely outspoken but raucous. On the other, any effort to engage in collective action or social mobilization outside of the CCP is quickly and sometimes brutally suppressed. Consider, for instance, Chinese regulation of online speech here. With the rise of the Internet and new media platforms, more than 1.3 billion people can now broadcast their individual views.<sup>12</sup> Far from trying to eliminate such on-line discussions, the CCP has tolerated or even actively encouraged them,<sup>13</sup> For instance, by having governmental agencies set up their own Weibo accounts to publicize information, lead discussions, and facilitate citizen reports of cadres’ unethical behavior.<sup>14</sup> As soon as on-line discussants suggest or assist in collective action, however, they are quickly censored.<sup>15</sup>

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<sup>10</sup>Mao Zedong, *On the Correct Handling of Contradictions Among the People*, in *SELECTED READINGS FROM THE WORKS OF MAO TSE-TUNG* 432 (1971)

<sup>11</sup>张慕良, <民主和集中的主从关系是怎样形成的> (Zhang Muliang, *How Did the Subsidiary Relationship between Democracy and Centralization Form?*), 学习时报(STUDY TIMES) 2010年10月19日, available at <http://www.chinaelections.com/article/196/189241.html> (last visited July 22, 2016)

<sup>12</sup> Gary King, Jennifer Pan, and Margaret E Roberts, *How Censorship in China Allows Government Criticism but Silences Collective Expression*, 107 AM. POL. SCI. REV. 1 (2013).

<sup>13</sup> See e.g., Ya-Wen Lei & Daniel Xiaodan Zhou, *Contesting Legality in Authoritarian Contexts: Food Safety, Rule of Law and China's Networked Public Sphere*, 49 L. & Soc’y Rev. 557 (2015).

<sup>14</sup> See e.g., *Architecture of Social Management: From E-Gov and Gov Weibo to Gov WeChat*, China US Focus (Sep. 4, 2015), <http://www.chinausfocus.com/political-social-development/architecture-of-social-management-from-e-gov-and-gov-weibo-to-gov-wechat/>; Angela Meng, *Beijing Still Struggles to Make Voice Heard Through Sina Weibo*, South China Morning Post (Mar. 03, 2014, 4:38 am), <http://www.scmp.com/news/china/article/1438896/beijing-still-struggles-make-voice-heard-through-sina-weibo>; Min Jiang & Jesper Schlæger, *How Weibo Is Changing Local Governance in China*, The Diplomat (Aug 06, 2014), <http://thediplomat.com/2014/08/how-weibo-is-changing-local-governance-in-china/>. On the use of the internet to facilitate citizen complaints, see the Central Commission for Discipline Inspection of the Communist Party of China (“CCDI”) Supervision Bureau Reporting Website: <http://www.12388.gov.cn/>. See also 我举报的问题查处了吗? ” 中纪委: 件件有着落 [Any Result of the Case I reported?” CCP Committee of Discipline: Following Every Case!], Xinhua (Feb. 4, 2016), [http://news.xinhuanet.com/legal/2016-02/04/c\\_128702525.htm](http://news.xinhuanet.com/legal/2016-02/04/c_128702525.htm); 中纪委“四风”监督举报平台背后故事: 每个线索都有专人处置 [The Story Behind CCDI “Four Trends” Supervision and Reporting Platform: Every Lead has Been Assigned an Agent to Handle], People (Feb. 05, 2016), <http://fanfu.people.com.cn/BIG5/n1/2016/0205/c64371-28112734.html>.

<sup>15</sup> See Gary King, Jennifer Pan, & Margaret E. Roberts, *Reverse-Engineering Censorship in China: Randomized Experimentation and Participant Observation*, Science (Aug. 22, 2014), <http://science.sciencemag.org/content/345/6199/1251722>; Gary King, Jennifer Pan, and Margaret E Roberts, *How Censorship in China Allows Government Criticism but Silences Collective Expression*, 107 Am. Political. Sci. Rev. 1, 14-15 (2013) (using statistical analysis of the public’s online commentary to show that, “[c]ontrary to previous understandings, posts with negative, even vitriolic, criticism of the state, its leaders, and its policies are not more



A similar distinction seems to guide the CCP's treatment of protests outside of cyberspace. Chinese citizens regularly and effectively engage in "mass incidents" to protest what they regard as corrupt or harmful governmental policies.<sup>16</sup> Consider, for instance, the protests of thousands of Chinese residents in 2011 against the siting of paraxylene ("PX") factories near to their residences and businesses. Riot police largely left the protestors alone, and local officials mollified them with conciliatory speeches -- suffering heckling from the crowds for their pains.<sup>17</sup> While tolerating such "mass incidents," the CCP has arrested human rights lawyers, labor activists, and feminists who file lawsuits or organize protests in the name of universal human rights.<sup>18</sup> To petition the CCP for a redress of personal grievances, even angrily, does not offend the idea of "centralism" (jizhongzhi, 集中制). To organize a public lawsuit or demonstration to vindicate the abstract values of human rights or feminism, by contrast, is a direct challenge to the primacy of the CCP over public policy.

## **B. How Democratic Centralism Weakens the Center**

From the viewpoint of the CCP, these limits on citizens' voice can impose substantial costs on China's governance. By excluding the more institutionalized forms of public input such as lawsuits before independent courts, op-eds from an independent press, or competitive elections of representatives, the "centralizing" side of democratic centralism weakens the constraints on the CCP's cadres, allowing them secretly to defy CCP policies, because neither the CCP leadership nor the disorganized and extra-institutional public is capable of monitoring

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likely to be censored" but that "censorship program is aimed at curtailing collective action by silencing comments that represent, reinforce, or spur social mobilization, regardless of content").

<sup>16</sup> See e.g., Kevin J. O'Brien, *Rightful Resistance*, 49 *WORLD POLITICS* 31 (1996); Tong Yanqi & Lei, *Large-Scale Mass Incidents and Government Responses in China*, 1 *INT'L J. CHINA STUD.* 487 (2010).

<sup>17</sup> See Jonathan Watts, *Tens of Thousands Protest Against Chemical Plant in Northern China*, *The Guardian* (Aug. 14, 2011), <https://www.theguardian.com/environment/2011/aug/14/china-protest-against-px-chemical-plant>.

<sup>18</sup> See Andrew Jacobs & Chris Buckley, *China Targeting Rights Lawyers in a Crackdown*, *N.Y. TIMES* (July 22, 2015), [http://www.nytimes.com/2015/07/23/world/asia/china-crackdown-human-rights-lawyers.html?\\_r=0](http://www.nytimes.com/2015/07/23/world/asia/china-crackdown-human-rights-lawyers.html?_r=0); Sui-Lee Wee, *China Arrests Four Labor Activists Amid Crackdown: Lawyers*, *REUTERS* (Jan. 10, 2016), <http://www.reuters.com/article/us-china-rights-idUSKCN0UO05M20160110>; Andrew Jacobos, *Taking Feminist Battle to China's Streets, and Landing in Jail*, *N.Y. TIMES* (Apr. 5, 2015), <http://www.nytimes.com/2015/04/06/world/asia/chinese-womens-rights-activists-fall-afoul-of-officials.html>. Didi Kirsten Tatlow, *In China, Relatives Await Word on Detained Rights Lawyers After a Year*, *N.Y. TIMES* (July 8<sup>th</sup>, 2016), <http://www.nytimes.com/2016/07/09/world/asia/china-human-rights-lawyers.html>

officials in China's tens of thousands of subprovincial governments.<sup>19</sup> In this respect, democratic centralism faces a paradoxical dilemma: The more that the CCP excludes private citizens from a formal and institutionalized role in controlling local cadres in the name of centralism, the more that local cadres will become a law unto themselves, secretly defying the leadership and thereby undermining the very centralism that the CCP sought to advance through tight control of public debate.<sup>20</sup>

The CCP's need for assistance in monitoring its local agents is not unique to China. It is a familiar problem of agency costs that afflict all large organizations, including congressional supervision of the bureaucracy in the United States. The problem arises from the informational advantages enjoyed by the bureaucracy implementing the central government's general programs that will typically know much more about the real costs and benefits of the programs they implement, precisely because they implement them.<sup>21</sup>

The challenge of supervising local officials pose a dilemma for the CCP's central authorities in which simplicity of evaluation criteria competes with such criteria's completeness. Too little information leads to administrative simplicity but also to promotions unrelated to cadre success in promoting citizen welfare. Too much information, however, creates opportunities for factions to manipulate the evaluation criteria to favor their own members.

Consider, first, the lemma of over-simplified criteria. The CCP's reliance on GDP growth as the major criterion for evaluating local leaders provides an example of the costs of clear but crude markers of cadre success.<sup>22</sup> GDP growth is easy to measure and clearly visible to

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<sup>19</sup>China has 41,636 township-level governments, 2,862 county-level units, 333 prefecture-level units, and 31 provincial-level units. Chenggang Xu, *The Fundamental Institutions of China's Reforms and Development*, 49 J. ECON. LIT. 1076 (2011) (data from 2006)

<sup>20</sup>For rich descriptions of this dilemma relating successful cadre evaluation to rule of law, see Murray Scot Tanner & Eric Green, *Principals and Secret Agents: Central versus Local Control Over Policing and Obstacles to "Rule of Law" in China*, 191 CHINA Q. 644 (2007); Carl F. Minzer, *Riots and Cover-ups: Counterproductive Control of Local Agents in China*, 31 U. PA. J. INT'L L. 53 (2009);

<sup>21</sup>For classic accounts of the costs faced by Congress in monitoring the bureaucracy in the United States, see, e.g., LAWRENCE C. DODD & RICHARD L. SCHOTT, CONGRESS AND THE ADMINISTRATIVE STATE 170–73 (1979); James Q. Wilson, *The Politics of Regulation* in THE POLITICS OF REGULATION 357, 388 (James Q. Wilson ed., 1980). For a discussion of oversight in different political systems, see SUSAN L. SHIRK, THE POLITICAL LOGIC OF ECONOMIC REFORM IN CHINA 57 (1993). As in the United States, informational obstacles to oversight in China can take the form of goal displacement (local bureaucracy implementing the "letter" but not the "spirit" of the central policy) or data falsification. See Alex Wang, *The Search for Sustainable Legitimacy: Environmental Law and Bureaucracy in China*, 37 HARV. L. REV. 365, 412 (2013).

<sup>22</sup>GDP has indeed been the primary criteria for cadre promotion since the 1990s. The unspoken rule is that if one does well on the economy, one has the prospect of becoming a central ministry official or joining the Politburo. See e, *The Search for Sustainable Legitimacy: Environmental Law and Bureaucracy in China*, 37 HARV. L. REV. 365,

supervising officials but also unrelated to social costs that do not affect economic productivity, including social and environmental costs like traffic jams, air pollution, loss of historic buildings, and destruction of socially cohesive neighborhoods.<sup>23</sup> The perverse incentives created by promoting cadres on the basis of local GDP is illustrated by the problem of so-called “ghost cities” – often enormous real estate developments promoted by local government officials but inhabited by virtually no residents. The famous ghost city Ordos in inner Mongolia presents a classic case.<sup>24</sup> One party secretary expanded the city boundary and built a lot of roads to the otherwise empty Kangbashi section of the jurisdiction and got promoted into the provincial-level inner Mongolia government. He was succeeded by a second party secretary who built a lot of skyscrapers and also got promoted. A couple of years after the development had been completed, it stood empty, and the third Party Secretary was stuck with the ghost city, to which no residents wanted to move.<sup>25</sup> In short, perverse promotion criteria seems to have induced the local Party leadership to inflate a temporary real estate bubble, creating construction jobs and GDP figures that they could tout as a basis for their promotion, passing on a real estate bomb to their hapless successor.

The problem of over-simplified and incomplete promotion criteria is not unique to the focus on GDP: Any “hard” numerical target will tend to squeeze out consideration of vaguer, less easily measurable criteria.<sup>26</sup> As a response to the “hard” target of energy usage reduction in the

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388 (2013) (quoting a central government official in stating that “[e]veryone sees this and knows the deal [that GDP is key]”).

<sup>23</sup> For a similar suggestion, see “Grossly Deceptive Plans,” *The Economist*, January 30<sup>th</sup>, 2016, available at <http://www.economist.com/news/china/21689628-chinas-obsession-gdp-targets-threatens-its-economy-grossly-deceptive-plans>. On the invisibility of environmental measures in a GDP-centered system, see See Alex Wang, *The Search for Sustainable Legitimacy*, 37 *Harv. Envtl. L. Rev.* at 388 (quoting a central government official in stating that “[i]n the past, if you spent a lot of money and effort on a wastewater treatment plant, the center would not see it (‘中央看不见， zhongyang kan bu jian’)).

<sup>24</sup> Jody Rosen, *The Colossal Strangeness of China’s Most Excellent Tourist City*, *N.Y. TIMES*, (March 6<sup>th</sup>, 2015), <http://www.nytimes.com/2015/03/06/t-magazine/ordos-china-tourist-city.html>

<sup>25</sup> Conversation with a Chinese economist who consulted with the Ordos government and whose name needs to be kept anonymous, November 19, 2014. For a stark photo portrait of Ordos, see Michael Christopher Brown, *Ordos, China: A Modern Ghost Town*, *TIME MAGAZINE*, <http://content.time.com/time/photogallery/0,29307,1975397,00.html> For a less negative assessment, see Eli Bildner, *Ordos: A Ghost Town That Isn’t*, *THE ATLANTIC* (April 8<sup>th</sup>, 2013), <http://www.theatlantic.com/china/archive/2013/04/ordos-a-ghost-town-that-isnt/274776/> (interviewing filmmaker about Ordos documentary showing “how optimistic people are there, and how hopeful they are”).

<sup>26</sup> See, e.g., Kevin J. O’Brien & Lianjiang Li, *Selective Policy Implementation in Rural China*, 31 *COMP. POLITICS*, 167, 173-74 (1999) (because of the difficulty in formulating measurable targets and lack of grass-root participation, local cadres have selectively implemented unpopular policies such as collecting taxes and enforcing birth control over nonquantifiable goals such as employing a democratic work style and respecting villagers’ rights).

Eleventh Five-Year Plan, for instance, local governments across the country deliberately imposed power outages, denying electricity even to hospitals, schools, traffic lights, and homes. These outages prompted private enterprises to use small-scale diesel fuel generators that defeated the pollution-reducing purpose of the hard target.<sup>27</sup>

Switching to the other lemma of more complex and contradictory evaluation criteria, however, does not solve the problem of information costs. The 2009 Experimental Regulation of the CCP Central Organization Department on the Evaluation of Local Leaders and Cadres<sup>28</sup> contain many contradictory goals that merely replace the problem of incompleteness with opacity. Contradictory criteria – say, environmental quality and job growth – are so indeterminate as to be uninformative, inviting each faction in the leadership to promote political allies rather than the truly more successful or qualified cadres.<sup>29</sup> The identity of the evaluator’s faction and the loyalty of the evaluated cadres to their patron then can play an important, sometimes more important, role than actual cadre performance.<sup>30</sup>

Democratic centralism reduces the capacity of the CCP to overcome this dilemma of information costs, by reducing citizens’ effective monitoring of local officials.<sup>31</sup> Local residents have immediate self-interest in efficient infrastructure, cleaner air, honest government, and other local public goods. Their organized, institutional resistance to local cadres could act as “fire alarms,” in McCubbins’ and Schwartz’s familiar phrase, allowing central authorities to economize on their monitoring efforts by focusing on those local jurisdictions where there is a

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<sup>27</sup> See Alex Wang, *The Search for Sustainable Legitimacy*, 37 HARV. ENVTL. L. REV. at 421-22.

<sup>28</sup> 中组部印发实施地方领导班子和干部考核试行办法 [*The CCP Organization Department Promulgated Implemenation Regulations on the Evaluation of Local Leaders and Cadres*], <http://politics.people.com.cn/GB/1027/4567774.html> The 2009 regulation evaluated cadres based on their success in promoting scientific development, including not only GDP but also education, health care, social safety, cultural activities; and sustainable development, carbon emission reduction, environmental protection; and improvement of living standards, and living environment, transportation.

<sup>29</sup> See Charles N. Halaby, *Bureaucratic Promotion Criteria*, 23 ADMIN. SCI. Q. 466, 468 (1978)(discretionary criteria place control of career opportunities in the hands of administrative officials).

<sup>30</sup> Victor Shih, Christopher Adolph, & Ming Xingliu, *Getting Ahead in the Communist Party: Explaining the Advancement of Central Committee Members in China*, 106 AM. POL. SCI. REV. 166 (2012). For argument and data suggesting that patronage plays a more ambiguous role in cadres’ careers, see Jinghan Zeng, *What Matters Most in Selecting top Chinese Leaders? A Qualitative Comparative Analysis*, 18 J. CHIN. POL. SCI. 223 (2013), available at <https://www.researchgate.net/file.PostFileLoader.html?id=56b018c05e9d9700a48b4575&assetKey=AS%3A324512594235392%401454381239176>

<sup>31</sup> See Huang Yanzhong, *The State of China’s State Apparatus*, 28 ASIAN PERSPECTIVE 31, 47 (2004) (lower-level officials can fool higher authorities more easily than their counterparts in liberal democracies because of the lack of oversight from citizens).

higher risk that local cadres are under-performing.<sup>32</sup> The CCP recognizes the advantages of citizens' assistance in governance, making use of devices like "democratic appraisal meetings" (minzhu pingyi, 民主评议) in which lower-level cadres anonymously evaluate their superiors as a complement to the usual top-down evaluations.<sup>33</sup> Democratic centralism, however, weakens these popular controls by limiting the degree to which citizens can organize institutions for independent collective action. Providing unstructured venues for individual citizen complaints – for instance, "appraisal meetings," websites through which lone individuals can report local corruption, or a bureau of letters of complaints<sup>34</sup> (guojia xinfang ju, 国家信访局) -- is no substitute for private organizations like newspapers, unions, and organized interest groups. Such civil-society organizations can shoulder the costs of acquiring legal, accounting, and economic expertise and overcome "free rider" problems of public action that isolated individuals cannot or will not bear.<sup>35</sup>

The CCP's suspicion of such an institutionalized, collective role for private citizens in the name of democratic centralism, therefore, is actually decentralizing, not centralizing, because such suspicion empowers local cadres at the expense of the central CCP. In this sense, democratic centralism is literally self-defeating if it excludes all institutionalized and organized input from the public, demanding citizen passivity or merely individual complaints and petitions rather than active collective engagement.

## **II. The Limits and Promise of Foot-Voting in Liberal Democratic and Authoritarian Regimes**

If citizen voice is muted by democratic centralism, why not rely on citizen exit? Both voice and exit, after all, are means by which citizens can select the local officials who govern them. Could foot-voting, therefore, make up for the limits on ballot-voting in China?

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<sup>32</sup> Mathew D. McCubbins & Thomas Schwartz, *Congressional Oversight Overlooked: Police Patrols versus Fire Alarms*, 28 AM. J. POL. SCI. 165, 171-76 (1984).

<sup>33</sup> See Maria Edin, *State Capacity and Local Agent Control: CCP Cadre Management from a Township Perspective*, 173 CHINA Q. 35, 42-43 (2004) (evaluating the cadre management system and arguing that the Chinese party-state has the capacity to be selectively effective in implementing its priority policies)

<sup>34</sup> On the Chinese tradition of "letters and calls" by which individual citizens can petition for redress of grievances, see Carl F. Minzner, *Xinfang: An Alternative to Formal Chinese Legal Institutions*, 42 STAN. J. INT'L L. 103, 176-77 (2006).

<sup>35</sup> For the classic account of the costs of collective action, see, e.g., MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* (1965). For an account of how private interest groups overcome such collective action problems, see, e.g., LAWRENCE ROTHENBERG, *LINKING CITIZENS TO GOVERNMENT: INTEREST GROUP POLITICS AT COMMON CAUSE* (1992)

As we explain below, exit cannot be a substitute for voice, but it can be a supplement. It is a fallacy to assume that local officials somehow naturally seek to enlarge their tax revenue or any other resources that such migration might produce.<sup>36</sup> The “market” for local governments, therefore, cannot arise unless some specific mechanism exists to make local officials care about attracting foot-voters. Incentives to care about foot-voters ordinarily take the form of some sort of “voice” – that is, some mechanism by which local officials’ superiors (either local voters or bureaucratic superiors) self-consciously supervise, reprimand, promote, or demote local officials. In this sense, the efficacy of exit is always dependent the efficacy of voice that commands local officials to care about whether their communities are attractive to migrants.

The absence of local elections does not mean that Chinese local officials can never have incentives to cater to foot-voters. We suggest that China’s criteria for bureaucratic promotion can be enlisted to induce local cadres to care about households’ foot-voting just as local elections are used in the United States to force politicians to campaign on boosting home values. Our argument hinges on an analogy between what William Fischel has called “homevoters” – that is, the property-owning electorate of a local government in the United States -- and the CCP’s bureaucratic evaluators of cadre performance. In liberal democracies, homevoters vote against locally elected officials who do not enact policies attractive to homebuyers. This electoral link induces local politicians to care about making their jurisdiction attractive to homebuyers. In China’s system of democratic centralism, the central authorities can play the role of homevoters by withholding promotion from local cadres who fail to make their jurisdiction attractive to Chinese households. As the example of market-preserving federalism suggests, if local cadres are evaluated by how effectively they attract private investors into their jurisdictions, then cadres will pay close attention to the interests of those investors.

We will defer until Part III our exposition and defense of a cadre evaluation system rooted in the value of local land, the criterion that we take to be the most faithful measure of success in attracting foot-voters. In this section we make the more basic case that citizen exit can help fix shortcomings of citizen voice only if the authoritarian analogue to local elections – bureaucratic promotion -- is revised to make exit relevant to local leaders.

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<sup>36</sup> On the dangers of analogies between public and private organizations that ignore their differing incentives, see Daryl J. Levinson, *Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs*, 67 U. CHI. L. REV. 345, 345 (2000) (“But government does not internalize costs in the same way as a private firm”).

## A. The Fallacy of Simple Analogies Between Private Markets and Local Governments

At least since the work of Charles Tiebout was introduced into the legal academy in the late 1970s, it has become commonplace for legal scholarship to analogize local governments to private firms that market public goods to “citizen-consumers.”<sup>37</sup> On this view, foot-voting citizens shop among local governmental “firms” looking for the best mix of price and quality in governmental services. Local officials cater to these mobile “citizen-consumers,” because those officials want to maximize the value of local real estate.

This firm-government analogy is flawed, because it ignores the need for some feedback mechanism to induce local officials to care about attracting foot-voters. Those officials, after all, are not owners of the real estate, entitled to appropriate the gains in value from attracting buyers. Moreover, powerful ideological constraints in both liberal democracies and authoritarian regimes like the CCP’s China prevent such officials from simply being transformed into real estate developers with rights to appropriate such gains in real estate values for personal use. Absent such personal incentives, however, why should one assume that local officials will care about attracting foot-voters? Foot-voters would be effectively “voting” for officials who did not care about winning the “election.” For such migrants, exiting one badly governed jurisdiction in favor of another would be a trip from the frying pan into the fire: Indifferent to whether their communities grew or shrunk, officials would have no reason to be honest or competent as a way to attract migrants.

The fallacy of arguing that citizen mobility can be a substitute for defective voice is illustrated by Professor Ilya Somin’s argument that citizen mobility can be a cure for voter ignorance. Professor Somin reasons that, because citizens who vote with their feet reap all of the gains from their migration, they avoid the well-known incentives for rational ignorance about

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<sup>37</sup> Charles Tiebout’s seminal article, *The Pure Theory of Public Expenditures*, 64 J. POL. ECON. 416 (1956) did not have much impact on economic scholarship until Wallace Oates demonstrated that Tiebout’s theoretical mechanism of citizen mobility had the practical effect of causing the price of land to reflect the quality and tax price of local public goods. Wallace E. Oates, *The Effects of Property Taxes and Local Public Spending on Property Values: An Empirical Study of Tax Capitalization and the Tiebout Hypothesis*, 77 J. POL. ECON. 957 (1969). It took another decade for Tiebout’s ideas to penetrate legal scholarship. For a brief history of Tiebout’s influence in legal scholarship, see Roderick M. Hills, Jr., *Compared to What? Tiebout and the Comparative Merits of Congress and the States in Constitutional Federalism*, in *THE TIEBOUT MODEL AT FIFTY: ESSAYS IN PUBLIC ECONOMICS IN HONOR OF WALLACE OATES* 239 (William A. Fischel, ed., Lincoln Institute of Land Policy, 2006). For a survey of Tiebout’s influence on economists, see Wallace Oates, *The Many Faces of the Tiebout Model* in *THE TIEBOUT MODEL AT FIFTY* at 21-33.

politics that afflict ballot-voting.<sup>38</sup> The difficulty with Professor Somin's theory is that, in denigrating citizens' capacity for intelligent exercise of the franchise, he has also undercut the incentives for local officials to care about attracting migrants. Even if there is high demand among such migrants for honest and competent governance, why would any politician care about meeting this demand? By Professor Somin's own hypothesis, voters are rationally ignorant about those politicians' success in boosting local property values. If the local governments do not care about the migrants, then why should the migrants invest much effort in comparison shopping among the local governments? Professor Somin assumes that local governments compete with each other for migrants, because "[s]tates and localities seek to attract new residents and businesses as sources of tax revenue," but his argument that voters are irredeemably ignorant about politics undercuts this assertion about subnational politicians' incentives.<sup>39</sup> If voters do not pay attention to politics, then why should canny politicians care about gaining tax revenue? As Albert Hirschman noted, local officials governing a passive population might actually want to deter immigration of a more demanding lot of citizens.<sup>40</sup> If ease of exit rids an organization of pesky squeaky wheels while leaving the more quiescent members in place, then the organization managers will encourage exit and provide low-quality services to the passive citizenry who are left behind.<sup>41</sup> The electoral incentive, therefore, might actually create incentives for local officials to reduce the attractiveness of their communities and thereby drive away potential political opponents, such as members of a different ethnic group.<sup>42</sup>

Professor Somin's theory of local governments' competing for a mobile populace, in short, depends on a theory of informed local voters that the rest of his book rejects. In this respect, Professor Somin's theory of exit is similar to more formal economic models. Like Professor Somin, early exit-based theories of local government simply assumed away the problem of a feedback mechanism through which local officials would have incentives to attract the optimal

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<sup>38</sup> See ILYA SOMIN, *DEMOCRACY AND POLITICAL IGNORANCE: WHY SMALLER GOVERNMENT IS SMARTER* 137 (2d ed. 2013).

<sup>39</sup> *Id.* at 145.

<sup>40</sup> See ALBERT O. HIRSCHMAN, *EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES* 124 (1970) ("[M]anagement will," Hirschman argued, "strain to strip the members-customers of the weapons which they can wield, be they exit or voice, and to convert, as it were, what should be a feedback into a safety valve.>").

<sup>41</sup> Consider, as an example of such an argument, the common complaint that "school choice" undermines public schools' quality by making it easy for the most vocal parents to leave, depriving the parents who stay behind of political clout and sophistication. See James S. Liebman, *Voice, Not Choice*, 101 *YALE L.J.* 259 (1991).

<sup>42</sup> Edward L. Glaeser & Andrei Schleifer, *The Curley Effect: The Economics of Shaping the Electorate*, 21 *J. L. ECON. & ORG.* 1 (2005).



number of migrants. Charles Tiebout's landmark article, *A Pure Theory of Local Public Expenditures*,<sup>43</sup> for instance, provided a model under which, by moving to a particular jurisdiction, migrants reveal that they value the services provided by the jurisdiction at the jurisdiction's average cost of providing those services. The model explicitly rested on the assumption that the local managers sought to maximize the value of local real estate by maintaining the community at its optimal size "to lower average costs" of providing local goods.<sup>44</sup> Economists building on Tiebout's model maintained this assumption without defending it, essentially assuming that mayors were *ipso facto* entrepreneurial real estate developers seeking to get the highest return on land sales.<sup>45</sup> But local officials are emphatically not real estate developers: Unless they are corrupt, they derive no automatic benefit from appreciating land prices, and they might very well be disadvantaged by the arrival of nosy, vocal homebuyers into their jurisdiction. Why, then, should they try to make their jurisdictions appealing to these foot-voting migrants?

## **B. Feedback and Foot-Voting: Electoral Voice and Bureaucratic Promotion as Necessary Complements to Exit-Based Control of Local Officials**

Theories of exit, in short, require some mechanism aside from the threat of exit itself to motivate local officials. In liberal democracies, that mechanism is the ballot: Local officials care about maximizing local property values, because local voters punish them when home prices go down. In authoritarian regimes, the necessary mechanism is bureaucratic promotion by CCP superiors. What reason is there to believe that either voters or CCP superiors are either willing or able to enforce their criteria for promotion and demotion against local officials?

### **1. The Homevoter Hypothesis as Feedback Mechanism Linking Ballot-Voters and Foot-Voters**

Consider, as an example of such an amalgamation of exit and voice in liberal democracy, William Fischel's influential "homevoters hypothesis," in which local voters' *inability* to exit forces them to participate effectively and intelligently in politics. "Homevoters," in Fischel's

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<sup>43</sup> Tiebout, *A Pure Theory of Local Expenditures*, *supra* note 37.

<sup>44</sup> *Id.* at 420 ("The last assumption is that communities below the optimum size seek to attract new residents to lower average costs. Those above optimum size do just the opposite. Those at an optimum try to keep their populations constant").

<sup>45</sup> See, e.g., J.C. Sonstelie & P.R. Portney, *Profit Maximizing Communities and the Theory of Local Public Expenditure*, 5 J. URB. ECON. 263 (1978).

lexicon, are simply local residents who are held hostage to their local government's decisions affecting local real estate's value, because they purchased that real estate before the decision was made. Because homebuyers will take into account the predicted effect of those decisions when making their bid, homevoters cannot escape the value-lowering decisions of incumbent politicians by selling their land. They must stand and fight – and they fight hard, overcoming the ignorance about politics that normally affects their ballots, because a huge and uninsurable portion of their assets are tied up in their land investment, making such ignorance less rational.<sup>46</sup> Because homebuyers pay more for low taxes, value-enhancing zoning regulations, and high-quality (mostly educational) services, the value of the political decisions creating such conditions will be “capitalized” into the value of the homes that homevoters have purchased, giving every homevoter an incentive to show up at planning commission hearings and city council meetings even if they do not have kids in school. Under Fischel's model, in other words, local politics (“voice”) depends on a combination of homebuyers' freedom of movement (“exit”) and homevoters' *lack* of exit. The former gives local voters information about how local decisions affect net welfare. The latter gives local voters incentive to pay attention to this information.

## **2. *Cadre Promotion Criteria as the Feedback Mechanism Linking the CCP and Foot-Voters: The Case of “Market-Preserving Federalism”***

What analogous mechanism provides feedback in authoritarian systems, where local officials are not responsible to local homevoters through elections? One mechanism is bureaucratic promotion criteria. To the extent that an official's chance of promotion is enhanced by the official's attracting migrants to his or her jurisdiction, that official will have incentives to cater to foot voters just as much as if the migrants actually enjoyed the ballot, for the foot-voting migrants would hold the fate of the official in their collective hands. In effect, the central CCP authorities would play the role of homevoters in Fischel's system, judging the performance of local cadres by their proficiency in attracting homebuyers.

Would local cadres really cater to foot-voting households if the criteria for promotion in China's cadre evaluation system (ganbu kaohe zhidu, 干部考核制度) were more closely tailored to cadres' proficiency in attracting homebuyers? Just as local voters might be indifferent to local elections, so too, CCP superiors in Beijing might be indifferent to official promotion

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<sup>46</sup> See WILLIAM FISCHEL, *THE HOMEVOTER HYPOTHESIS* 39-72 (2001).

criteria, relying instead on personal ties and factional loyalties between local officials and CCP leaders.<sup>47</sup> On the other hand, it is also possible that central authorities might care about official promotion criteria at the middle levels of subnational government such as prefecture-level cities, urban districts, and counties, where familial connections to the highest CCP elites in Beijing are rare but the positions are also too removed from the highly localistic kinship networks that control subcounty politics.<sup>48</sup>

Both anecdotal and more systematic evidence suggests that, at least for those mid-level subnational posts, the official promotion criteria matter: When those criteria require local cadres to compete with each other to appeal to private actors like private investors or tourists, cadres aggressively conform to those criteria.<sup>49</sup> Consider, for instance, the idea that the Chinese system of subnational government is “market-preserving” in that it is responsive to the demands of mobile capital. Most famously defended by Montinola, Qian, and Weingast in the mid-1990s,<sup>50</sup> the “market-preserving” theory of federalism is rooted in the hypothesis that subnational officials will abstain from predatory expropriation of investment capital if they are evaluated on the basis of their jurisdiction’s GDP and revenue. Official promotion criteria have historically emphasized a local government’s GDP and revenue generation,<sup>51</sup> and the link between both of these criteria and private investment in land is plain enough. Moreover, the evidence suggests that Chinese local officials seeking promotion aggressively protect the interests of the owners of

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<sup>47</sup> See Victor Shih, Christopher Adolph, & Ming Xingliu, *Getting Ahead in the Communist Party: Explaining the Advancement of Central Committee Members in China*, 106 AM. POL. SCI. REV. 166 (2012).

<sup>48</sup> See, e.g., Li Xing *et al.*, *Political Competition at a Multilayer Hierarchy: Evidence from China*, in THE CHINESE ECONOMY: A NEW TRANSITION 259 (M. Aoki *et al.* eds., 2012), [http://link.springer.com/chapter/10.1057/9781137034298\\_12](http://link.springer.com/chapter/10.1057/9781137034298_12); Zhou Li-an (周黎安), 晋升博弈中政府官员的激励与合作—兼论我国地方保护主义和重复建设问题长期存在的原因 [*The Incentive and Cooperation of Government Officials in the Political Tournaments: An Interpretation of the Prolonged Local Protectionism and Duplicative Investments in China*], 6 经济研究 [STUD. ECON.] 33. For a study on subcounty official positions dominated by local elites, see Feng Junqi (冯军旗), 中县干部 [*Party Cadres in Central County*] (June 2010) (unpublished PhD dissertation, Peking University).

<sup>49</sup> For a humorous example of such competition, consider the reality TV show “Sights of Shanxi,” in which Chinese mayors are evaluated before a studio audience by their superiors on their capacity to attract tourists to their cities. The mayors vie with each other to sell their cities, making often colorful pitches and earning tough public criticism from a panel of judges when their pitches are rejected. See *You’re Stir-Fried Squid*, THE ECONOMIST (June 18, 2016), <http://www.economist.com/news/china/21700687-youre-fired-chinese-officials-meet-apprentice-youre-stir-fried-squid>

<sup>50</sup> See Gabriella Montinola, Yingyi Qian and Barry R. Weingast, *Federalism, Chinese Style: The Political Basis for Economic Success in China*, 48 WORLD POLITICS 50 (1995).

<sup>51</sup> See PIERRE F. LANDRY, *DECENTRALIZED AUTHORITARIANISM IN CHINA: THE COMMUNIST PARTY’S CONTROL OF LOCAL ELITES IN THE POST-MAO ERA* (2008). Economic growth has been the major evaluation criterion in the handbook of the CCP Central Personnel Department (中组部).

mobile capital just as they are instructed to do by the official criteria favoring economic growth.<sup>52</sup>

GDP and revenue, as noted above, are only imperfectly related to the welfare of Chinese households. The responsiveness of local cadres to foot-voting by owners of investment capital, however, suggests that, just as competition for promotion induces cadres to cater to the needs of investment capital, so too cadres might be induced to promote Chinese households' interests if households' foot-voting was made a central criterion for bureaucratic promotion. As we explain below in Part III, one way to align cadres' incentives with the foot-voting choices of households is to base bureaucratic promotion on the value of land within a local cadre's jurisdiction.

### **III. Using Land Values as the Best Proxy for Households' Foot-Voting**

How can bureaucratic promotion criteria best be aligned with the choices of China's foot-voting households? We suggest that the link is best expressed by a simple, single number: the change in a local government's aggregate land prices over the period for which a local cadre is being evaluated. Land prices that rise suggest that the local government is attracting mobile households, while falling land prices suggest that foot-voting households are choosing other jurisdictions. In liberal democracies, "home voters" – meaning residents who elect local officials – use this price signal as a guide for re-electing or throwing out incumbent officials. In authoritarian regimes, the ruling regime's bureaucratic evaluators of local officials can likewise use land values as a yardstick by which to measure official performance. In response, local officials will plausibly respond by trying to boost land values. We argue that this incentive will generally induce such officials to make their jurisdictions attractive to home buyers – in effective, campaigning for re-election before a constituency of foot-voters.

#### **A. The Basic Defense of Land Values as the Best Proxy for Foot-Voters' Choices**

Why should land prices rather than a jurisdiction's net population gain or loss constitute the best measure of a local government's ability to attract foot-voters? The reason is that land prices provide more information about citizens' preferences. As early as 1979, Arnott and Stiglitz noted

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<sup>52</sup> For a survey of evidence that local officials compete for investment to obtain promotions, see Chenggang Xu, *The Fundamental Institutions of China's Reform and Development*, 49 J. ECON. LIT. 1076 (2011), [http://www.sef.hku.hk/~cgxu/04\\_Xu.pdf](http://www.sef.hku.hk/~cgxu/04_Xu.pdf). For evidence that success in winning revenue actually earns promotions for county-level officials, see H. Li & Li'An Zhou, *Political Turnover and Economic Performance: The Incentive Role of Personnel Control in China*, 89 J. PUB. ECON. 1743 (2005).

that “the practice of inferring individual valuations of public goods from land values is now widespread.”<sup>53</sup> As Anup Malani has noted, the amount by which a bid on a house in one jurisdiction exceeds bids on identical houses in other jurisdictions is a measure of how much more the bidder values the more expensive jurisdiction.<sup>54</sup> Such relative desirability is influenced by local officials’ decisions about education, traffic regulation, crime control, and overall governmental efficiency, which are reflected – in economic jargon, “capitalized” – in real estate prices. If land prices in one jurisdiction are much higher than land in neighboring jurisdictions, then this difference is an indication that the former’s land is much better governed. If one is interested in the intensity as well as the direction of citizens’ preferences, then higher land prices are superior to demographic growth as an indication of what and how much foot voters value the amenities offered by a local government.<sup>55</sup>

Land prices shaped by citizens’ foot-voting help solve the dilemma of democratic centralism outlined in Part I above – the dilemma of administratively simple yet substantively complete promotion criteria. The CCP wants to take into account all aspects of cadre performance that affect citizen welfare, but the CCP also needs to have criteria that yield some definite result when rival local officials compete for a promotion. How, then, to rank cadres who score differently on different criteria? How does one decide to award a promotion in a contest between the most frugal mayor, the mayor with the environmentally cleanest city, the mayor with the highest employment, and the mayor with the best educated children? Each excelled the others in some respect but not in others: The CCP needs a simple bottom-line factor that will aggregate each of these values in a way reflective of citizen preferences. Because homebuyers take into account every aspect of a jurisdiction’s quality when making a bid, land prices should “capitalize” otherwise incommensurable aspects of governmental performance into a single number. Unlike numerical weights that the CCP assigns to different aspects of cadre performance, land prices are not arbitrary decisions by the CCP but instead reflect the collective ranking of these aspects by millions of foot-voting citizens. Land prices, therefore, put the “democratic” back into

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<sup>53</sup> See Richard J. Arnott & Joseph E. Stiglitz, *Aggregate Land Rents, Expenditure on Public Goods, and Optimal City Size*, 93 Q. J. ECON. 471, 471 (1979).

<sup>54</sup> This point is ably defended by Anup Malani. See Anup Malani, *Valuing Laws as Local Amenities*, 121 HARV. L. REV. 1273, 1273 (2008). In general, our argument in this section is consistent with and relies upon Malani’s argument.

<sup>55</sup> The defense of land prices over simple demographic change, therefore is analogous to the defense of the single transferable vote over first-past-the-post plurality elections.

“democratic centralism,” allowing the CCP to infer what citizens really value from what they are willing to pay.<sup>56</sup>

Instead of land prices informed by citizens’ foot-voting, one might attempt to rely on survey instruments to rank cadres on their effectiveness in satisfying their constituents, as suggested by Li and Liang.<sup>57</sup> But such direct measurement of satisfaction imposes enormous information costs on cadres’ supervisors. As Li and Liang acknowledge, “[c]ompared with economic growth, inhabitants’ satisfaction is more difficult to measure.”<sup>58</sup> They suggest that inhabitants of local government score their officials on various indices related to health, education, the environment, etc. There is little reason to believe, however, that mere public opinion surveys are an effective way to discern what citizens really want. As Professor Ilya Somin notes, however, even with all of the safeguards of liberal democracy -- an independent press, competitive political parties, organized interest groups -- voters are afflicted by political ignorance and collective action problems that depress turnout and lead to uninformed voting.<sup>59</sup> Mere public opinion polls would suffer from proportionately greater problems of rational voter ignorance and collective apathy, because essential devices for organizing and informing voters (for instance, independent newspapers and interest groups) are missing in China.

Land prices informed by citizens’ foot-voting, by contrast, provide an indication of citizens’ preferences that is not only simple and relatively accurate but also ideologically safe. Homebuyers make individualized rather than collective judgments about the value of real estate. The individualistic character of their home-purchasing decisions alleviates collective action problems faced by voters (or citizens being polled) in acquiring information, because each homebuyer faces large stakes and reaps all of the gains from their research into the competing merits of local governments.<sup>60</sup> At the same time, such individualistic household choices do not announce to the world any abstract normative principles that compete with the CCP’s own ideology. The private and self-interested character of their foot-voting, therefore, minimizes the chance that their judgments could constitute the spark that sets off a prairie fire of revolution

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<sup>56</sup> See Malani, *supra* note 54 at 1309-1311.

<sup>57</sup> See Shujuan Li & Yan Liang, *Competition Model and the Change of Local Governments’ Behavior – and Governance of China’s Local Government Debt*, 49 CHINESE ECON. 199 (2016) provides such an argument for tournaments between local officials who are assessed by the relative satisfaction of the citizens that they govern.

<sup>58</sup> *Id.* at 207.

<sup>59</sup> See Somin, *Democracy and Political Ignorance*, *supra* note 38, at 117-18.

<sup>60</sup> Somin, *Democracy and Political Ignorance*, *supra* note 38, at 138-145.

against the CCP. Homebuyers on the move do not congregate in crowds, wave placards, shout angry slogans, or burn police cars. From the point of view of civic participation, these traits are strikes against foot-voting. From the point of view of the CCP, however, the private and individualistic character of house shopping is not a bug but a feature: The bids on real estate of mobile foot-voters provide much of the same information that actual elections would provide without the risk that a narrow vote on garbage collection or quality of schools will suddenly and unexpectedly become a referendum on the legitimacy of CCP rule.

## **B. Refinements and Qualifications**

The basic idea that land prices should play a central role in the evaluation of cadres is simple enough – in fact, too simple. Below, we offer some refinements and qualifications.

### ***1. Henry George to the Rescue: Measuring land prices rather than real estate prices***

First, why focus on land prices rather than the price of real estate generally? The focus on land adds an administrative headache to the evaluation process, because it requires the evaluators to determine the share of real estate's value contributed by lots as opposed to structures. Nevertheless, land prices have an advantage over real estate prices: As most famously noted by Henry George, the 19<sup>th</sup> century American journalist and reformer, the supply of land's inelasticity limits the deadweight loss that results from governmental policies' affecting the supply of housing. Henry George was interested in avoiding the deadweight loss of property taxes' discouraging construction of structures. By taxing only and all the value of the land itself, government would avoid such disincentives, because landowners could not reduce the supply of parcels in response to the tax (say, by taking the land out of the taxing jurisdiction).

There is an analogous advantage to focusing on land value for bureaucratic promotion. Cadres who wanted to drive up the price of housing could do so by using zoning regulations to restrict the production of housing or by holding state-owned land off the housing market. If demand for housing in those cadres' jurisdiction was price-inelastic, then the price of housing would be boosted, but foot-voters would be left unsatisfied, prohibited from migrating to a jurisdiction by an artificial housing shortage. By focusing on the value of land in such a

jurisdiction, one avoids this perverse incentive to engage in such exclusion, as the value of restricted lots would fall with the rise in the price of permitted housing.<sup>61</sup>

## **2. *Comparing Apples to Apples: Measuring change in local governments' land prices relative to land price change in the metropolitan area***

Not all regions are equal. Weather, natural features like harbors and rivers, geographic proximity to population centers, and economic activity, and many other features give some regions an inherent advantage over their rivals that no amount of expertise in government can eliminate. The mayor of Ma'anshan in the inland province of Anhui cannot move his city closer to the Pearl River Delta, no matter how brilliant he is in allocating and managing his city's money and rules. Competition for foot-voters between Ma'anshan and the City of Guangzhou, therefore, is a rigged race: Such a competition would not give any incentive to the inevitable losers to improve their performance. To the contrary, as Cai and Treisman note, competition for mobile investors between jurisdictions with such different inherent endowments could lead to a "polarization effect" in which foot-voters all favor the better endowed while "[p]oorly endowed units, knowing they will lose, simply give up."<sup>62</sup>

To insure fair comparisons, therefore, cadres ought to be compared not on the basis of the absolute aggregated value of land in their jurisdiction but rather on the basis of in the *change* in that land's value during the relevant period of evaluation. If the mayor of Ma'anshan has managed to increase land values in his jurisdiction by a higher percentage than the percentage increase achieved by mayor of Guangzhou, then it would be odd to say that the latter outperformed the former merely because Guangzhou land prices were higher than Ma'anshan land prices.

Likewise, cadres' success or failure in raising land values should be assessed by comparing land in their jurisdiction only with land within the same metropolitan area. Factors beyond any local government's control – say, global warming and rising sea levels or central government spending in a particular area -- might affect the value of land. Mayors who outperform their metropolitan areas should not be punished simply because their region happens to fall behind rival regions because of these extra-local factors. By narrowing the range of competing local

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<sup>61</sup> See Malani, *supra* note 54 at 1293-94.

<sup>62</sup> Hongbin Cai & Daniel Treisman, *Does Competition for Capital Discipline Governments? Decentralization, Globalization, and Public Policy*, 95 AM. ECON. REV. 817, 828 (2005).



governments and focusing on change in value regardless of starting or ending values, the central evaluators of local officials can narrow (although not entirely eliminate) endowment advantages.<sup>63</sup>

### 3. *Avoiding short-term bubbles with medium-term land values and fiscal constraints*

In using land prices to evaluate cadres, it is important to avoid creating incentives for cadres to inflate short term land bubbles in order to win promotion. There are, of course, ways in which local officials can temporarily increase the price of land without improving its governance. Simply by subsidizing land purchases with low-interest loans, a local government could pump up a real estate bubble that would deflate as soon as the subsidies ran out. More generally, the CCP's practice of rotating local officials through several subnational jurisdictions for very short (less than five-year) tenures in each jurisdiction can reduce local officials' incentives to attend to the long-term consequences of their decisions.<sup>64</sup>

One way to lengthen local officials' time horizon is to tie cadres' fate to the medium- and long-term value of land in the jurisdictions that they govern is to tie their promotion to the rolling average of changes in the price of land over several years. Such evaluations could give cadres incentives to care about the long-term consequences of their policies by tying cadres' evaluations not only to changes in the price of land in jurisdictions that they currently manage but also the price of land in jurisdictions where they were formerly assigned. The longer the period of time over which the average land price change was calculated, the more the cadre would have incentives to adopt policies that would create lasting values rather than short-term bubbles.

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<sup>63</sup> The evaluation criteria for an official governing Local District (LD) located in a Metropolitan Area (MA) can be expressed in the following formula. For each LD<sub>n</sub>, calculate ratio<sub>1</sub>, Δ total land value in LD<sub>n</sub>/Δ total land value in MA<sub>n</sub>. Denote ratios as ratio<sub>1</sub><sup>1</sup>, ratio<sub>1</sub><sup>2</sup>...ratio<sub>1</sub><sup>n</sup>, where n is the number of districts within the metro area. Standardize these ratios as: ratio<sub>1</sub><sup>i</sup><sub>s</sub>=[ratio<sub>1</sub><sup>i</sup>-mean(ratio<sub>1</sub>)]/std(ratio<sub>1</sub>), i=1,2...n where mean(ratio<sub>1</sub>)=(ratio<sub>1</sub><sup>1</sup>+ratio<sub>1</sub><sup>2</sup>+...+ratio<sub>1</sub><sup>n</sup>)/n. std(ratio<sub>1</sub>) is the standard deviation of ratio<sub>1</sub>.

<sup>64</sup> As indirect evidence of the costs of rapid turnover of officials, consider evidence that enterprises postpone investment and banks were more reluctant to loan money to local governments during the turnover period. Yang Haisheng *et al.*, 政策不连续性与财政效率损失——来自地方官员变更的经验证据 [*Discontinuation in Policies and Loss of Financial Efficiency—Empirical Evidence from the Change of Local Officials*], MGMT. WORLD (MONTHLY) (Dec. 15, 2015), <http://www.mwm.net.cn/d277131452.htm>; Luo Danglun & She Guoman, 地方官员变更与地方债发行 [*Change of Local Officials and Issuance of Local Debt*], ECON. RES. J. (Oct. 13, 2015), <http://www.cesgw.cn/cn/NewsInfo.aspx?m=20100914093049340648&n=20151013142944963970>. Homebuyers seem to share the same concern about short-tenured mayors as investors and banks. Thousands of Citizens of Datong City, Shanxi Province, stopped Yanbo Geng, the Chinese mayor featured in a BBC documentary, on his way out of the city for a better position because they were concerned that Geng's urban redevelopment projects and policies would not be continued by his successor. THE CHINESE MAYOR (Zhaoqi Films 2015)

Suppose, for instance, that cadres were evaluated on the basis of a five-year rolling average of land prices, using land in not only current but also former jurisdictions to calculate such averages. Under such an evaluation procedure, a cadre who had served for three years as a county party secretary after formerly serving as a township party secretary for the previous three years would be evaluated not only on the basis of the three-year performance of land in his county where he was an incumbent but also on the basis of the performance of land prices for the previous two years in his former township -- two years *after* he left township office. Faced with the prospect of being evaluated by changes in land prices in jurisdictions following the end of their tenure in such jurisdictions, outgoing local officials would have incentives to install supporters in key positions so their value-enhancing reforms could continue past the end of their term.<sup>65</sup>

To further avoid short-term bubbles, the central government should incorporate local debt burdens into local government leaders' evaluations. A local leader can manipulate public investments to maximize land value during his term but compromise a city's long-term growth potential. Considering the importance of local government finance and the time bomb of huge local government debt in China, additional safeguards are in order where local governments' debt is concerned. In theory, bondbuyers and homeowners might together punish local officials who incur excessive debt by bidding lower amounts for land and bonds. In practice, however, the likelihood that the central government will bail out local governments before they go bankrupt encourages local officials to incur excessive debt based on the national government's credit.<sup>66</sup>

#### ***4. Protecting Workers: Qualifying land values with rent-income ratio ("RIR")***

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<sup>65</sup>Leaders at the county/urban district level or below have the power to recommend and evaluate their potential successors according to Article 25 of the 2009 Work Regulations on Promotion of Party and Government Leaders.

<sup>66</sup>For a general discussion of the tendency of subnational governments to impose external costs on the budgetary commons by borrowing on the *de facto* credit of the national government, see JONATHAN A. RODDEN, HAMILTON'S PARADOX: THE PROMISE AND PERIL OF FISCAL FEDERALISM (2005). For the challenges of imposing a hard budget constraint ex ante on local officials in China, see Jing Jin and Heng-fu Zou *Soft Budget Constraints and Local Government in China*, in FISCAL DECENTRALIZATION AND THE CHALLENGE OF HARD BUDGET CONSTRAINTS 289 (Jonathan A. Rodden et al. eds. 2003). As Arnott and Stiglitz argued, the idea that local public goods are capitalized into land rents does not insure that cities will compete for the optimal number of residents, because the Arnott-Stiglitz model's equilibrium is partial insofar as it does not incorporate any local government budget balance constraint. See Arnott & Stiglitz, *Aggregate Land Rents*, 93 Q.J. ECON. at 491.

The CCP has goals aside from encouraging value-maximizing governance. They are, after all, communists with presumptively egalitarian priorities. They are also practically wary of unrest brought about by rapidly escalating rents and stagnant wages. The mayor who managed to boost land values through superb governance but also displaced his city's working-class residents through escalating rents would inspire popular riots rather than official plaudits. To insure that local officials minimize the disruption and unfairness of rents' outstripping wages, therefore, the central evaluators ought to consider the ratio of rents to income in making promotion decisions. Local officials who preside over rising ratios in which residents pay an ever-higher percentage of their income for rent should not be rewarded regardless of how much their jurisdiction's land prices appreciate relative to land prices in their metropolitan area. Indeed, the CCP already takes into account the "property-income ratio" in making promotions.<sup>67</sup> This qualification on the use of land values, therefore, simply preserves a bit of the *status quo*.

One might protest that there is an inherent contradiction in rewarding mayors for increasing land prices but punish them for escalating rents and falling wages. After all, an influx of homebuyers to a jurisdiction will *ceteris paribus* predictably cause rents to rise and wages to fall.<sup>68</sup> Why does not the criterion of a steady rent-income ratio simply cancel out the criterion of appreciating land values?

The reason is that matters are not *ceteris paribus*: the enterprising local official should fight rising rents with more housing. As more foot-voters pour into a popular jurisdiction, local officials can increase the supply of housing by increasing the density and quantity of residentially zoned land. If supply of housing matches the demand, then rents should stay steady even as prices of a unit of land appreciate, because more people will live on the same amount of land. Local officials can, in short, simultaneously attract new homebuyers and make room for them by expanding the housing supply.

There are admittedly limits on the degree to which the technology of housing density can match rising demand. Higher densities can erode demand for land, because density sometimes has costs, especially where the supply of land is tight, such as crowded sidewalks, shadows from

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<sup>67</sup>See Chen Qinggui, 考绩“房价收入比”须把握三个关键 [Three Keys for Incorporating Price-Income Ratio in Evaluation], CHINA NEWS (Jan. 24, 2011), <http://www.chinanews.com/estate/2011/01-24/2806953.shtml>; 今日聚焦: 房价收入比纳入官员考核靠谱吗? [Today's Focus: Is It Plausible to Incorporate Price-Income Ratio in Cadre Evaluation?], SINA (Aug. 1, 2016), <http://dichan.sina.com.cn/sh/zt/136guanyuan/>

<sup>68</sup> See Malani, *supra* note 54 at 1280-90.

tall buildings, and the like. These features of density make land less attractive and force local officials to choose between raising housing supply but reducing demand (i.e., making their jurisdictions marginally less attractive to foot-voters) or protecting land values but displacing wage-earners who cannot keep up with the rising rents.

This dilemma, however, might be more theoretical than real. Chinese local governments tend to control large territories with plentiful non-residential land.<sup>69</sup> There would not likely be many circumstances in which the only way in which extra foot-voters could be housed would be to build skyscrapers next to scenic views or demolish historic districts. Even when such a conflict between increased supply of and demand for housing arose, however, the dilemma could be solved simply by evaluating officials on a weighted average of each value. Under such a dual-factor system, each local government would be rated not only on the basis of the change in land prices within their local government relative to land prices in their metropolitan area but also on their local government's change in the rent-income ratio relative to changes in the metropolitan rent-income ratio. Officials who scored well on attracting foot-voters but poorly on increasing housing supply would lose out in such a tournament to officials who took a more balanced approach to development.<sup>70</sup>

#### **IV. Foot-Voting with Chinese Characteristics: Three Feasible Institutional Reforms to Improve Citizen Mobility**

The defense of foot-voting and land values offered above ignores the specifics of local governments' design. Those details, however, matter. The size, number, and powers of local governments dramatically affect the capacity of citizens to vote with their feet. For foot-voting citizens to make meaningful choices among competing jurisdictions, there must be a sufficient number of jurisdictions among which to choose. The citizens' choices should also not be muddied by radical differences among the competing jurisdictions' private goods like higher wages and job opportunities. Moreover, citizens' migration must trigger not only the right to

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<sup>69</sup> On the large amounts of rural land within prefectural-level and county-level cities, see Kam Wing Chan, *Urbanization and Urban Infrastructure Services in the PRC*, in *FINANCING LOCAL GOVERNMENT IN THE PEOPLE'S REPUBLIC OF CHINA* (Christine P.W. Wong ed. 1997).

<sup>70</sup> Again, the criteria can be expressed by a simple formula similar to the ratio set forth *supra* at note 63. This second ratio<sub>2</sub> compares the RIR in Local District (LD<sub>n</sub>) to the RIR in that LD's metropolitan area (MA). Calculate a standardized ratio<sub>2</sub>,  $\Delta \text{RIR in LD}_n / \Delta \text{RIR in MA}$ , and denote them as ratio<sub>2</sub><sup>1</sup><sub>s</sub>, ratio<sub>2</sub><sup>2</sup><sub>s</sub>...ratio<sub>2</sub><sup>n</sup><sub>s</sub>. The weighted average this standardized ratio with the ratio of LD to MA land prices set forth in *supra* note 63 is  $a * \text{ratio}_1^i \text{ _s} + b * \text{ratio}_2^1 \text{ _s}$ , where  $a+b=1$ .

receive local services but also the obligation to pay for them; otherwise, such migration does not reveal that the citizens value governmental services at the cost of supplying them. Local officials must have the power to respond to migrants' demands by extending services to newcomers and charging those newcomers for the services' costs. In this section we address three institutional obstacles to foot-voting, namely limited fiscal instruments, improper size of local governments, and the hukou system, and provide practical remedies to each of them.

### **A. The Problem of Limited Fiscal Instruments**

Foot-voting reveals that a citizen values the benefits of public services net of those services costs only if the foot-voting citizen is liable for those costs. The decision to migrate to a jurisdiction, therefore, should trigger not only the right to receive services offered by a local government but also the obligation to pay for them. Chinese local governments, however, cannot easily maintain such a link between the right to receive and the obligation to pay for public services, because Chinese law severely limits local governments' fiscal instruments. The result of such fiscal inflexibility is not only that local governments frequently gain no additional revenue from new migrants but also that local officials cannot improve land values by supplying services at lower costs than neighboring jurisdictions. Both limits prevent good governmental policies from being reflected in land prices.

The obvious solution is to broaden the range of local governments' taxing powers – and, in particular, to give local governments the power to impose property taxes. Proposals to vest local governments with property-taxing powers have been broached before, but the tax has not been popular with the CCP because of its potential to trigger urban unrest among aggrieved property owners. We argue below, however, that such a tax is politically feasible if it is tied up with more autonomy over tax revenues and more influence by taxed interests over the expenditure of those revenues to enhance local property values.

#### ***1. How Lack of Taxing Power Impedes Foot-Voting***

Most local taxes in China are skewed towards business-derived revenue, such as value added taxes, corporate income taxes, and business taxes, and taxes on housing ownership have not been

substantial<sup>71</sup> Local governments that provide excellent services and thereby attract new migrants may find that these new homebuyers crowd schools and roads without providing a commensurate gain in the government's capacity to pay for them, reducing local land values instead of increasing them.

The lack of taxing power results in local officials running counter to citizens' foot-voting. Local officials have an incentive to exclude new migrants even if the economy of a jurisdiction would benefit from more people. There is evidence that the population of Chinese cities is too small insofar as Chinese labor would be more productive if it were located in more densely populated jurisdictions where the labor has its highest value.<sup>72</sup> Yet the leaders of Chinese cities often complain about new migrants, egged on by angry residents fearful that newcomers will crowd schools and roads. Such complaints make sense to the extent that local governments cannot recover the costs of service provision from new migrants because they are legally disempowered from imposing taxes on residential property.

In theory, local governments' ground leases of state-owned land to private lessees might mitigate or even eliminate these perverse fiscal incentives. As a concession to local governments, the central government gave its share in land sales revenue to local governments in the 1998 revision to the Land Administration Law.<sup>73</sup> Since then with the rise of Chinese real estate market, land sales revenue has become an important source of revenue for local governments, ranging from 28% to 72% of local budgets from 2002 to 2010, and 34.9% of the revenues of prefectural-level cities.<sup>74</sup>

Such ground leases offer important advantages over local governments' other sources of revenue, because they give local officials the flexibility and incentives to tailor revenue, regulations, and expenditures to foot-voting lessees. Because lessees might be expected to pay more for land that is well-governed, ground leases give local officials a fiscal incentive to maximize the value of land in their regulatory decisions.<sup>75</sup> The long terms of ground leases,

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<sup>71</sup> Local governments also derive revenue from property-related taxes including the urban maintenance and construction tax, urban and township land use tax, farmland occupation tax, and land appreciation tax. The revenue derived from these taxes, however, comprises only a small proportion of local governments' total revenue.

<sup>72</sup> See Chun-Chung Au & J. Vernon Henderson, *Are Chinese Cities Too Small?* 73 REV. ECON. STUD. 549 (2006).

<sup>73</sup> Qiao Shitong, *The Politics of Chinese Land: Partial Reform, Vested Interests, and Small Property*, 29 COLUM. J. ASIAN L. 70, 90-103 (2016).

<sup>74</sup> See ASIAN DEVELOPMENT BANK, LOCAL PUBLIC FINANCE MANAGEMENT IN THE PEOPLE'S REPUBLIC OF CHINA: CHALLENGES AND OPPORTUNITIES 23 (2014).

<sup>75</sup> See Montignola, Qian, & Weingast, *supra* note 50, at 58.

however, make them an extraordinarily inelastic device by which to recover the revenue needed to run a local government. The leases give the local government no capacity to recover additional revenue from lessees during the life of the lease based on the local government's success in attracting new migrants and thereby enhancing the value of leased land. A new mayor whose city's land has already been leased out cannot recover revenue from the lessees to improve the city with new post-lease amenities, even if those amenities are precisely what foot-voters are currently seeking. In calculating the lessee's payment at the outset of the lease, therefore, local officials will somehow need to predict their government's financial needs and the likely benefits of the local government's expenditures over the several decades of the life of a lease – a challenge in prophecy that might intimidate even the most prescient gamblers. The uproar occasioned by the City of Wenzhou's charging lessees substantial sums to renew their land leases demonstrates the risk of disconnecting government's land revenue from private property value.<sup>76</sup>

Chinese local governments also do not control the rate and base of the fiscal instruments from which they derive their revenue. Because the rate and base even for "local" taxes is defined by national law, subnational governments cannot compete with each other by offering a reduced tax burden to prospective homebuyers.<sup>77</sup>

## ***2. How to make a local property tax politically feasible***

There is an economically obvious, normatively appealing, but politically challenging solution to local governments' limited fiscal instruments. The National People's Congress could enact a law conferring on local governments the power to levy a tax on real property.<sup>78</sup> Although this solution is politically challenging, we argue below that it is also politically feasible.

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<sup>76</sup> See e.g., Ren Wei, *China's Grey-Area For Property Buyers: Homeowners Face Doubts Over Renewing Land-Use Leases*, S.CHINA MORNING POST (Apr. 19, 2016), <http://www.scmp.com/news/china/economy/article/1936991/chinas-grey-area-property-buyers-homeowners-face-doubts-over> ; Stuart Leavenworth & Kiki Zhao, *In China, Homeowners Find Themselves in a Land of Doubt*, N.Y. TIMES (May 31, 2016), [http://www.nytimes.com/2016/06/01/business/international/in-china-homeowners-find-themselves-in-a-land-of-doubt.html?\\_r=0](http://www.nytimes.com/2016/06/01/business/international/in-china-homeowners-find-themselves-in-a-land-of-doubt.html?_r=0); Lucy Hornby, *China Lease Expiries Prompt Property Rights Angst*, FT (May 2, 2016), <https://next.ft.com/content/952be9a4-0abe-11e6-b0f1-61f222853ff3>.

<sup>77</sup> According to Article 8 of the Law on Legislation, such a property tax can only be legislated by the NPC or NPC Standing Committee. See 中华人民共和国立法法 [Law on Legislation of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 15, 2000, effective July 1, 2000, 2000 Standing Comm. Nat'l People's Cong. Gaz. 112).

<sup>78</sup> See *id.*

The property tax solution is economically obvious: a property tax would give local officials a revenue incentive to put out the welcome mat for newcomers, because growth would pay its own way. In effect, a property tax coupled with local governments' already-broad power to regulate land use behaves as a user fee, in which new migrants receive the benefit of local public goods only if they pay their share of those goods' average cost.<sup>79</sup> So long as the goods are not congested by additional users, old-timer residents should welcome the revenue that the newcomers bring.

The property tax solution is also normatively attractive, because it would mobilize local homeowners into monitoring local affairs. By making more visible the cost of governmental services, property taxes would force local cadres to justify those costs.<sup>80</sup> By making public expenditure more visible, the property tax can give property owners incentives to review local governments' spending. Moreover, local leaders seeking to raise property taxes for new projects will have an incentive to assuage local homeowners with opportunities to review budgets and comment on expenditures.<sup>81</sup> Once the property tax becomes the main source of local governments' revenue, the English history as described in Douglas North and Barry Weingast's "constitution and commitment" can be repeated in China.<sup>82</sup>

For all of its economic and normative appeal, however, the property tax solution, is politically tricky, because property taxes have historically inspired popular resentment and even mass incidents. The agricultural tax was abolished in 2007 in large part because of farmers' resistance.<sup>83</sup> Recent narrow experiments with property taxes in Chongqing and Shanghai have

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<sup>79</sup> See Bruce W. Hamilton, *A Review: Is the Property Tax a Benefit Tax?*, in LOCAL PROVISION OF PUBLIC SERVICES: THE TIEBOUT MODEL AFTER TWENTY-FIVE YEARS 85 (George R. Zodrow ed. 2013); Bruce W. Hamilton, *Zoning and Property Taxation in a System of Local Governments*, 12 URBAN STUD. 205 (1975) (arguing property tax is an efficient tax for public service). See also William A. Fischel, *Homevoters, Municipal Corporate Governance, and the Benefit View of the Property Tax*, 54 NAT'L TAX J. 157, 157 (2001) (arguing local property taxes are benefit taxes).

<sup>80</sup> See Fewsmith, *supra* note 4 at 34-38 (noting that experiments in local elections were driven, in part, by the need to raise revenue through the direct route of taxes rather than through the indirect financing through the governmental marketing of peasants' grain). "In this way," Fewsmith notes, "the costs of village government, previously hidden, became very visible, and peasants resisted paying the taxes to cadres." See *id.* at 34.

<sup>81</sup> In the past decade public participation has been adopted in many Chinese local governments regarding public utilities (water, gas, etc.) and urban planning. Analogous interests in winning public buy-in can drive local governments to promote public participation on revenues and expenditures derived from taxation.

<sup>82</sup> See Douglass C. North and Barry R. Weingast, *Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England*, 49 J. ECON. HISTORY 803 (1989).

<sup>83</sup> See John James Kennedy, *From the Tax-For-Fee reform to the Abolition of Agricultural Taxes: The Impact on Township Governments in North-West China*, 189 CHINA Q. 43 (2007); Shitong Qiao, *Governing the Post-Socialist Transitional Commons: A Case from Rural China*, 24 COLO. J. INT'L ENVTL L. & POL'Y, 117, 130 (2013). For more



yielded insubstantial revenue and exempted most property.<sup>84</sup> Circumstantial evidence suggests that the CCP leadership has been concerned with the political risk while agreeing on the desirability of property tax. The Chinese Minister of Finance said recently “property tax reform is a conundrum... but has to be done discarding hesitation.”<sup>85</sup>

Nevertheless, we believe that broad authorization for property taxes is now politically feasible, because property tax burdens are a more predictable and more elastic source of revenue than ground lease rents. As ground leases expire in cities across China, the terms under which such leases will be renewed will become increasingly prominent. As the controversy surrounding Wenzhou’s charging of a stiff fee to renew such leases indicates, homeowners dislike the unpredictability of these rents.<sup>86</sup> As noted above, such ground leases are an inelastic instrument for raising revenue, because the local government is forced to cover a multi-decade period of expenditures with a single, large lump-sum amount of rent. Why not, then, trade the right to charge high fees for ground lease renewal for the right to impose property taxes? From the lessee’s point of view, the trade would allow them to amortize their rent over many years by making quarterly or annual property tax payments rather than a single up-front rent payment. Moreover, precisely because they are levied for shorter intervals of time, lessees have more opportunities to contest the amount of the taxes, demanding equivalent returns in services. To sweeten the pot for homeowners, the National People’s Congress could make a local government’s authority to impose property taxes contingent on the local government’s assurance to lessees that no further fees or rents, beyond the property tax, would be imposed as a condition for renewal of the ground lease, eliminating the uncertainty of title from which ground lessees suffer in a system of multi-decade renewals. Moreover property-related taxes now paid by real estate developers actually constitute from 50 to 60 percent of property prices and therefore are paid indirectly by property buyers.<sup>87</sup> Replacing these fragmented property-related taxes with a

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details about agricultural tax burden and rural resistance in China, see Lu Xiaobo, *The Politics of Peasant Burden Reform in China*, 25 J. PEASANT STUD. 113, 117–121 (1997).

<sup>84</sup> See Asian Development Bank, *supra* note 74.

<sup>85</sup> See 楼继伟: 义无反顾推进房地产税制改革 [Lou Jiwei, *Pushing Forward Real Estate Tax Reform without Hesitation*], XINHUA (July 24, 2016), [http://news.xinhuanet.com/fortune/2016-07/24/c\\_129172837.htm](http://news.xinhuanet.com/fortune/2016-07/24/c_129172837.htm).

<sup>86</sup> See Stuart Leavenworth & Kiki Zhaomay, *In China, Homeowners Find Themselves in a Land of Doubt*, N.Y. TIMES (May 31, 2016), [http://www.nytimes.com/2016/06/01/business/international/in-china-homeowners-find-themselves-in-a-land-of-doubt.html?\\_r=0](http://www.nytimes.com/2016/06/01/business/international/in-china-homeowners-find-themselves-in-a-land-of-doubt.html?_r=0)

<sup>87</sup> See Chen Shaoying (陈少英), 论我国物业税的立法目标 [On Legislative Objectives of Real Estate Tax in Our Country], 74 EASTERN CHINA UNIV. POL. SCI. & L.J., (2011), available at [http://article.chinalawinfo.com:81/article\\_print.asp?articleid=61964](http://article.chinalawinfo.com:81/article_print.asp?articleid=61964).

uniform property tax therefore would not increase the burden of property buyers, but simply make their contribution to the government finance more visible, giving them more leverage in urban governance.<sup>88</sup>

In short, the gradual expiration of ground leases across dozens of Chinese cities, in particular, provides a golden, once-in-a-generation opportunity for the National People's Congress to replace an inelastic, politically contentious, and unpredictable source of revenue with a system of property taxation that will allow local officials to compete with each other on their ability to cut tax burdens as well as provide services.

## **B. The Problem of Excessive Size**

Related to the problem of local governments' limited fiscal instruments is the problem of local governments' excessive size. A relatively tiny number of local governments have final and pervasive power over immense amounts of land, making it difficult for any homebuyer practically to shop among competing providers of local public goods. Such territorially immense local governments effectively operate as local monopolies, extracting locational rents from homebuyers who, because of employment and family ties, cannot exit an entire metropolitan area in order to seek a better deal from a competing local government. As with the limits on fiscal instruments, however, there is a politically palatable fix well within the pale of Chinese political traditions – the fix of a federated city.

### **1. Chinese Cities as Leviathans: The Costs of Unified Metro Government**

A brief overview of local governments in a single province illustrate the vastness of the territory governed by Chinese cities. The province of Guangdong, for instance, contains 108 million residents<sup>89</sup> but only 21 sub-provincial cities.<sup>90</sup> Its capital city, Guangzhou, has eleven urban districts each of which governs over a million population on average but are simply subsidiaries of the city government lacking independent zoning power. By contrast, New York State, with a population roughly one and half the size of Guangzhou City, contains within its borders 932 towns, 551 villages, and 62 cities. There are 48 towns, cities, and villages in

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<sup>88</sup> See *id.*

<sup>89</sup> See 广东省 2015 年全国 1% 人口抽样调查主要数据公报 [Guangdong Province National Population 1% Sampling Survey Statistics], GUANGDONG BUREAU OF STATISTICS (MAY 11, 2016), [http://www.gdstats.gov.cn/tjzl/tjgb/201605/t20160511\\_327841.html](http://www.gdstats.gov.cn/tjzl/tjgb/201605/t20160511_327841.html).

<sup>90</sup> *General Information*, PEOPLE'S GOVERNMENT OF GUANGDONG PROVINCE (Jan. 21, 2016, 10:05 AM), [http://www.gd.gov.cn/gdgk/sqgm/201501/t20150121\\_208192.htm](http://www.gd.gov.cn/gdgk/sqgm/201501/t20150121_208192.htm).

Westchester County alone, all of which are within a practical commuting distance from New York City. Each of these local governments can make independent decisions about zoning, expenditures, and taxation levels.

Chinese cities containing so much land control the entire economy of a metropolitan area where many mutually dependent businesses congregate to take advantage of “agglomeration economies” – that is, the benefits of locating near to other similar businesses.<sup>91</sup> Such businesses and their employees cannot freely shop among metropolitan areas for the best providers of public services, because some areas will have built-in advantages – inherent “endowments” in Cai and Treisman’s phrase – that defeat rival jurisdictions’ efforts to attract investment through superior governance.<sup>92</sup> If local officials were promoted based on their success in increasing the price of housing, then local officials controlling such immense quantities of real estate would have incentives to behave like Brennan and Buchanan’s “leviathans” rather than like competitive businesses: they would extract locational rents from captive land buyers by reducing housing supply.<sup>93</sup> The price of housing might increase in such a jurisdiction, but these increases would not reflect social benefits but rather deadweight costs of frustrated demand, as workers were deterred by governmental policy from migrating to the areas where their labor is most productive. The demand for land within such immense jurisdictions is predictably price-inelastic, because, for many households, there are few adequate substitutes for all of the land in an entire metropolitan area. It has long been argued by economists that the inelasticity of supply of local governments insures that pure citizen mobility can never fully replace citizen voice.<sup>94</sup> The large physical size and arguable under-population of Chinese cities suggests that this theoretical objection to foot-voting has practical application in China.

The obvious solution to the problem of excessive size is to delegate land-use planning powers to smaller scale units of local government that can be clustered into a single metropolitan

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<sup>91</sup> For an overview of the idea of “agglomeration economies,” see MASAHISA FUJITA, PAUL KRUGMAN & ANTHONY J. VENABLES, *THE SPATIAL ECONOMY: CITIES, REGIONS, AND INTERNATIONAL TRADE* 1 (1999); EDWARD L. GLAESER, *CITIES, AGGLOMERATION AND SPATIAL EQUILIBRIUM* 1 (2008).

<sup>92</sup> See Cai & Daniel Treisman, *supra* note 62 at 828 (noting that “poorly endowed units, knowing that they will lose [in the competition for investment], simply give up”).

<sup>93</sup> On the idea that non-competitive governments engage in predatory behavior, see GEOFFREY BRENNAN & JAMES M. BUCHANAN, *THE POWER TO TAX: ANALYTICAL FOUNDATIONS OF A FISCAL CONSTITUTION* (2006); Qiao, *supra* note 73 (describing how Chinese cities use their control over the conversion of rural land to urban use as a device to reduce the supply of land and thereby maintain higher land prices).

<sup>94</sup> For an economic model showing that politics must supplement mobility where the supply of local governments is inelastic, see Dennis Epple & Allan Zelenitz, *The Implications of Competition among Jurisdictions: Does Tiebout Need Politics?*, 89 J. POL. ECON. 1197 (1981).

area. Assuming some transportation network that permits employees of any business in the area to live within any of these local governments and commute to work, no household would ever be forced to choose between the benefit of higher wages and the benefit of better public services in such a governmentally fragmented urban area. Local governments within the United States frequently achieve such densities. The result is that households tied by employment or family to a particular commutershed can nevertheless shop among dozens of competing providers of local public goods. None of these tiny governments controls enough land to increase housing prices by restricting supply.

Extreme decentralization of zoning and taxing authority, however, is hardly a panacea. Because tiny local governments cannot capture the benefits of regulatory programs that extend throughout a commutershed, local officials in charge of those governments tend to neglect those programs. Again, Westchester County provides an illustrative case. The individual towns and villages within the County zone their residential land primarily for single-family detached houses, excluding multi-family housing affordable by working class families.<sup>95</sup> Although local governments may have several motives for such exclusion of affordable housing, one reason is fiscal: Property taxes levied on multi-family housing often do not cover the costs of educating the children residing in such housing. Affordable housing is beneficial to industrial and commercial employers who need to attract employees with affordable rents, and commercial and industrial uses often generate tax revenue in excess of the costs of services. The local governments that do not host the industrial or commercial uses, however, have no power to tax those uses to cover the costs of educating the employees' children. In effect, local governments in Westchester County face a collective action problem: Each wants to host and tax non-residential uses that depend on affordable housing that each would prefer other jurisdictions to host and provide with services.<sup>96</sup>

In choosing local governments with the right physical size, therefore, Chinese law-makers face a dilemma.<sup>97</sup> If the local governments are too physically large, then they will create a

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<sup>95</sup> See Mark Lungariello, *Westchester Still Segregated Despite Lawsuit, Group Says*, LOHUD (May 13, 2016), <http://www.lohud.com/story/news/local/westchester/2016/05/13/adc-affordable-housing/84285490/>; Jarrett Murphy, *Advocates Wary of Lawsuit Over City's Affordable Housing Preferences*, CITYLIMITS.ORG (Apr. 27, 2016), <http://citylimits.org/2016/04/27/advocates-wary-of-lawsuit-over-citys-affordable-housing-preferences/>; Sam Roberts, *Westchester Adds Housing to Desegregation Pact*, N.Y. TIMES (Aug. 10, 2009).

<sup>96</sup> Roderick M. Hills, Jr., *Saving Mount Laurel?*, 40 FORDHAM URB. L.J. 1611, 1614-18 (2013).

<sup>97</sup> Following Mancur Olson, this dilemma can be characterized as the "dilemma of fiscal equivalence," with fiscal equivalence standing for a matching of the obligation to raise revenue with the right to spend such revenue. See

“leviathan effect” by extracting locational rents rather than competing for new residents, but, if they are too small, then they will not capture the benefits of the uses that they regulate.<sup>98</sup>

Extremely large territories relative to population, soaring urban property prices, and under-populated Chinese cities all suggest that, in China, the “leviathan” effect predominates.<sup>99</sup> The question remains whether the Chinese system of local government can be reformed in a politically feasible way to balance successfully these rival risks.

## ***2. The Solution of the Federated City***

We suggest that China’s current multi-layered system of local government provides the CCP leadership with ample opportunities to experiment with what we call “the federated city,” a metropolitan organization that can simultaneously avoid the leviathan effect and still capture regional economies in the production of laws and infrastructure. Our basic proposal is that sub-city governments ought to be given more functionally specialized taxing, spending, and regulatory powers that are tailored to their geographic scope. Urban districts embedded in cities, for instance, ought to have the power to tax land in their territory to finance the infrastructure and regulation primarily beneficial to district land. Cities, in turn, ought to have primary responsibility for that infrastructure with primarily regional public goods. On this division of responsibilities, Pudong District, a subdivision of Shanghai, would be responsible for imposing taxes on its own real estate to finance Century Park, the 140-hectare park located in Pudong’s new area that likely increases the value mostly of land located in Pudong. By contrast, the Shanghai government would be responsible for financing Pudong International Airport, because the entire region is served by such large-scale transit infrastructure.

Is such a suggested reform of metropolitan government politically feasible in China?

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Roderick M. Hills, Jr., *Federalism and Public Choice*, in RESEARCH HANDBOOK ON PUBLIC CHOICE AND PUBLIC LAW 207, 208-09 (Daniel Farber & Anne Joseph O’Connell eds. 2010) (describing Mancur Olson’s “dilemma of fiscal equivalence”).

<sup>98</sup> For literature suggesting the ambiguous effects of fragmenting metropolitan areas among many local governments, see George W. Hammond & Mehmet S. Tosun, *The Impact of Local Decentralization on Economic Growth: Evidence from U.S. Counties*, 51 J. REGIONAL SCI. 47-64 (2011) (finding that fragmentation increases economic growth in metropolitan but not non-metropolitan counties); Arthur Nelson & Kathryn Foster, *Metropolitan Governance Structure and Income Growth*, 21 J. URB. AFF. 309 (1999) (finding that the presence of a metropolitan government improved income growth in fragmented urban areas); Dan Stansel, *Local Decentralization and Local Economic Growth: A Cross-Sectional Examination of US Metropolitan Areas*, 51 J. URB. AFF. 47 (2004) (finding negative relationship between the central-city share of metro area population and economic growth and a positive relationship between both the number of municipalities per 100,000 residents and the number of counties per 100,000 residents and economic growth).

<sup>99</sup> On the under-population of China’s cities, see Au & Henderson, *supra* note 72.

Debates about the proper scale of local government in China are hardly novelties, dating back at least to the Qing Dynasty, when the emperor rejected the creation of townships for fear that they would add to residents' tax burden.<sup>100</sup> More recently (between 1993 and 1997), China has experimented with allowing counties to apply to become "county-level cities" ("CLCs") with greater access to revenue and regulatory powers than ordinary counties.<sup>101</sup> The central authorities abandoned the creation of new CLCs in 1997, perhaps motivated by the absence of evidence that CLCs actually outperformed ordinary counties<sup>102</sup> and also by the additional costs that such CLCs imposed on the central government.<sup>103</sup> There is, however, little doubt that the Chinese leadership has the political will to experiment with delegations of greater powers to smaller units. The political feasibility of such a reform might increase to the extent that the newly empowered units were expected to pay their own way with own-source tax revenue.

Would devolution of power to smaller units improve metropolitan governance? There is circumstantial evidence that prefectural-level cities' productivity increases if they contain more than a single urban district, with the benefits peaking at 3 districts per city with 1.28 million residents.<sup>104</sup> It is difficult, however, to assess the relative performance of unified versus fragmented metropolitan areas in China, because China has not delegated the sort of broad regulatory or taxing powers that we recommend to the subdivisions of cities.<sup>105</sup>

In absence of firmer evidence, pilot programs are in order to test the benefits and costs of fragmentation. Facilitating foot-voting requires some strengthening of sub-city units to enable citizens to shop within a single metropolitan area, but Chinese reformers are already experimenting with such devolution.<sup>106</sup> Such a devolution needs not result in under-sized urban

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<sup>100</sup> See WILLIAM T. ROWE, *CHINA'S LAST EMPIRE: THE GREAT QING* 50 (2009) (describing emperor's rejection in mid-18<sup>th</sup> century of proposals to create township-level government below the traditional county magistracies).

<sup>101</sup> See Shenggen Fan, Lixing Li, & Xiaobo Zhang, *Challenges of creating cities in China: Lessons from a short-lived county-to-city upgrading policy*, 40 J. COMP. ECON. 476, 478-80 (2012) (describing process by which counties could enlarge their powers through becoming county-level cities).

<sup>102</sup> See *id.* at 489

<sup>103</sup> See Li Lixing, *The Incentive Role of Creating "Cities" in China*, 22 CHINA ECON REV. 172, 174-75 (2011).

<sup>104</sup> See Bindong Sun, Tinglin Zhang, Yinyin Cai, & Rui Wang, *Government Fragmentation and Metropolitan Economic Performance: Evidence from China* (UCLA Ziman Center for Real Estate Working Paper, 2014), available at <http://www.anderson.ucla.edu/Documents/areas/ctr/ziman/2014-06WP.pdf>.

<sup>105</sup> See Jae Ho Chung and Tao-chiu Lam, *China's "City System" in Flux: Explaining Post-Mao Administrative Changes*, 180 CHINA Q. 945, 958 (2004) (urban districts do not constitute a level of fiscal authority). The urban districts are otherwise delegated a wide range of responsibilities including judicial and civil administration, public health and security, industry and commerce, education, and cultural issues. See Him Chung, *State Regulation and China's Administrative System: A Spatial Perspective*, 8 CHINA REV. 201, 225 (2008).

<sup>106</sup> In 2015, for instance, the National Development and Reform Commission promulgated a plan to experiment with township-level cities in Dongguan to grant more autonomy to township governments in the city. See "撤镇设市"东

districts' imposing external costs on their neighbors or neglecting externally beneficial infrastructure, because cities in which these subunits are embedded could pick up the regional slack. In particular, tax revenue from large-scale businesses employing commuters from the entire region could be redistributed to those urban districts that provide housing and services such as schools for workers at such enterprises, avoiding the collective action problem confronted by small local governments competing for business but shunning the housing needed to attract workers.

### **C. Reforming Hukou to Facilitate Foot-Voting**

The power of Chinese citizens to vote with their feet is limited by China's system of household registration system (hukou). Inhabitants without hukou do not get the benefits of local medical, educational, and other social services provided by the local government. To what extent are such impediments to free mobility an obstacle to the sort of foot-voting that we defend?

#### **1. *The Obstacle of Hukou to Foot-Voting***

There is no doubt that hukou poses a major obstacle to Chinese citizens' foot-voting. It is a paradox that the more migrants a city attracts, the more reluctant a city government is to open its social welfare system to such migrants. Beijing, Shanghai, Shenzhen and Guangzhou -- all Chinese mega cities and economic engines that are the most popular destinations for migrant population -- are also the most aggressive in strictly limiting their schools and social security systems to people with hukou. Although the central government has pushed hukou reform across the country, it has accommodated the largest cities' desire to exclude persons without hukou, adopting instead the policy of "open[ing] the hukou system in towns and small cities *comprehensively*, open[ing] the hukou system in medium-size cities *orderly*, in big cities *reasonably*, and *strictly* control[ing] the population of especially big cities."<sup>107</sup> The State Council has defined "especially big cities" as cities with more than five million population, which<sup>108</sup> would exclude essential reforms in most of the fast-growing cities. The number of

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莞先试 对中山有何启示? [*Replacing Townships with Cities First Experimented in Dongguan: What's the Lesson for Zhongshan?*], PEOPLE (Feb 12, 2015), <http://cpc.people.com.cn/n/2015/0212/c87228-26551285.html>.

<sup>107</sup> 中共中央关于全面深化改革若干重大问题的决定 [The CCP Central Committee Decision on Several Important Issues of Comprehensively Deepening Reform], November 12, 2013, *available at* [http://news.xinhuanet.com/politics/2013-11/15/c\\_118164235.htm](http://news.xinhuanet.com/politics/2013-11/15/c_118164235.htm).

<sup>108</sup> 关于进一步推进户籍制度改革的意见 [Opinions on Pushing Hukou Reform Forward] (promulgated by State Council, July 30, 2014) 2014 Guofa 25.



people excluded from local services by the hukou system is staggering, constituting huge percentages of the residents in China's "mega-cities."<sup>109</sup>

The basic motivation for hukou is the absence of an effective mechanism by which cities can charge migrants with the costs of the services that these migrants consume. City mayors view the migrant population as a pure burden, because they cannot impose property taxes on new residents. Lacking a direct and simple way to tax residential development, local officials rely on complex formula for awarding hukou to migrants likely to add to a city's economic productivity and not tax city services. Despite some differences in details, Chinese mega cities have granted *hukou* to migrants based on education, wealth, skills, and youthfulness.<sup>110</sup> The essentially fiscal character of hukou is revealed by the bonus points awarded to outside investors who create above a certain number of job opportunities and pay above a certain amount of taxes.<sup>111</sup> Such a complex mechanism for rationing hukou excludes many citizens from receiving services who might be willing and able to pay for them.

Concededly, some sort of link between revenues and expenditures is necessary not only for economic efficiency but also for foot-voting democracy.<sup>112</sup> In order to cast an intelligent "foot-vote" on both expenditures and revenue-generation, citizens' choice of a jurisdiction as their residence must trigger not only the right to receive local benefits but also the obligation to pay for those benefits. Otherwise migration does not reveal that the citizen values the benefit at its cost of production. Given the limits on local taxing powers, the *hukou*-awarding system in Chinese big cities is actually quite rational as a way of matching revenues and expenditures. But a mechanism like Shanghai's that rates migrants by a complex mix of factors is nevertheless a crude mechanism by which to assess migrants' willingness to pay.

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<sup>109</sup> Among 13.5 million population in Guangzhou, only 8.5 million have hukou; among 23 million population in Beijing only 13 million have hukou; among 24 million population in Shanghai only 14 million have hukou; among over 12 million population in Shenzhen only three million have hukou. See 去年广州户籍人口为近三年来最高 [Last Year Population with hukou in Guangzhou the Highest in Recent Three years], IFENG (Apr. 14, 2016), [http://news.ifeng.com/a/20160414/48450684\\_0.shtml](http://news.ifeng.com/a/20160414/48450684_0.shtml)

<sup>110</sup>The four main sections of the Shanghai *hukou* point-accumulation system (积分落户制度) are age, the younger the better; education, the more educated the better; expertise and professional skills, the higher the better; and length of paying social security in Shanghai, the longer the better. See 2016 年上海积分落户制度细则 [2016 Shanghai Detailed Rules of Point-Accumulation System of Receiving Hukou], available at <http://www.hukoushanghai.com/shhkxzc/550.html>

<sup>111</sup> See *id.*

<sup>112</sup> For a concise statement of the argument that economic efficiency requires that local governments generate the revenue from their own residents the revenue that they spend on those residents, see Richard Musgrave, *Combining and Separating Fiscal Choices: Wicksell's Model at its Centennial*, in PUBLIC FINANCE IN A DEMOCRATIC SOCIETY: VOLUME III. THE FOUNDATIONS OF TAXATION AND EXPENDITURE 31, 101 (Edward Elgar 2000).



Whether a migrant worker would contribute to a city economy sufficiently to cover the costs of local services that the migrant receives should be decided on a far simpler basis -- whether he or she has a job the wages of which suffice to cover the costs of the services that he receives. If there is demand for the migrant's labor within a jurisdiction sufficient to cover both the public and private costs of the migrant's working in that jurisdiction, then why should the city government deter the migration by withholding local services? One need to (and we do not) endorse the view that cities will inevitably reach their optimal population through private migration decisions just so long as migrants pay the average cost of the public services that they consume.<sup>113</sup> The justification for restricting city size, however, should be rooted in some specific analysis of a market failure in private locational decisions, not in local governments' arbitrarily limited choice of fiscal instruments. The challenge of hukou reform is to figure out how local governments can more directly charge migrant workers for the costs of the local public services that they consume as a result of their decision to migrate.

## ***2. Reforming the Hukou System through broader fiscal instruments and federative local governments***

We urge that hukou within a jurisdiction be based exclusively on the migrants' purchase or rental of real property in the jurisdiction providing the service for which hukou is sought. Our proposal for hukou reform, however, is contingent on the adoption of our two previous recommendations for the broadening of smaller local governments' taxing and regulatory powers in the context of a federated metropolitan area. At its most basic level, we urge that the migrant's willingness to pay the price of renting or buying land *presumptively* indicates that the migration is cost-justified, just so long as local governments have broad powers to charge new migrants for the services that they consume and are small enough not to act as little leviathans, extracting locational rents by restricting housing supply. Further refinements of migration

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<sup>113</sup> The question of whether and under what conditions free migration results in optimally populated cities is a complex one. Under reasonable assumptions, "competition neither leads to, nor sustains, cities of optimal size." Arnott & Stiglitz, *supra* note 53 at 498. For an early argument that migration leads to excessively populated cities because migrants pay only average costs rather than marginal costs of their migration, see George Tolley, *The Welfare Economics of City Bigness*, 1 J. URB. AFF. 324 (1974). For an argument that certain cities' locational advantages and incentive effects of national taxes lead to suboptimally small cities, see David Albouy & Nathan Seegert, *The Optimal Population Distribution across Cities and the Private-Social Wedge* (Working Paper 2010), available at [http://homedev.business.utah.edu/u0908787/papers/OptimalPopulationDistributionacrossCitiesandthePrivateSocialWedge\\_AlbouySeegert.pdf](http://homedev.business.utah.edu/u0908787/papers/OptimalPopulationDistributionacrossCitiesandthePrivateSocialWedge_AlbouySeegert.pdf).

incentives, we suggest below, can be managed by the federated metropolitan areas described and defended in Part IV(B)(2) above.

Our proposal does not eliminate hukou. Under our proposal, cities can still withhold services from citizens who neither rent nor buy real estate within the service-providing jurisdiction. In this respect, our proposed form of hukou resembles the concept of “bona fide residency” in U.S. constitutional law.<sup>114</sup> If we treat hukou as a shorthand for eligibility to enjoy the public services and urban governance provided by a particular jurisdiction, then, under our proposal, each city would have its own hukou system in which residents who own or rent an apartment in a city are “granted hukou” – that is, made eligible to receive the package of local public goods provided by the local government. The local government’s power to exclude persons who have not invested in local real estate distinguishes our proposal from alternative recommendations that abandon the hukou system completely by delegating to the central government the task of guaranteeing every citizen equal access to the same “basic” public services across different local governments.<sup>115</sup> Our justification for rooting hukou in the purchase or rental of land requires the adoption of our previous proposals calling for territorially smaller local governments to exercise a broader set of taxing powers. If local governments can re-capture the value they confer on land through their services, then the price of that land should presumptively reflect both the value of the services and the burden of the taxes needed to finance them.

Would a property-based hukou system exclude middle-and-low income population from a city? We think not. Consider the example of so-called “left-behind children” (liushou ertong, 留守儿童). Parents seeking higher wages in a productive city where they lack hukou must now leave their children behind in the village where they have hukou so that their children can attend

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<sup>114</sup> For an explanation of how lack of “bona fide residency” is a sufficient basis under the U.S. Constitution for local governments to withhold basic educational and other local services, see Roderick M. Hills, Jr., *Poverty, Residency, and Federalism: States’ Duty of Impartiality Toward Newcomers*, 1999 SUP. CT. REV. 277, 281-83, 288-98, 301-309, 312-26. For an example of the U.S. Supreme court’s upholding a school district’s exclusion of a child from its public schools because the child was not a bona fide resident of the school district, see *Martinez v. Bynum*, 461 U.S. 321 (1983).

<sup>115</sup> See Wang Ling, 户籍制度改革推进缓慢 学者建议改革机制 [Reform of the Household Registration System has Moved Forward Slowly; Scholar Suggests Reform Mechanisms], YICAI (May 27, 2015), [http://news.xinhuanet.com/fortune/2014-07/31/c\\_126819302.htm](http://news.xinhuanet.com/fortune/2014-07/31/c_126819302.htm) (stating that the central government has the power to design the system); Kam Wing Chan, *The Household Registration System and Migrant Labor in China: Notes on a Debate*, 36 POPULATION AND DEV. REV. 357, 361 (one stream of reform proposals is concerned with making the hukou system more “humane,” for example, offering urban hukou to migrant workers’ children and parents).

school.<sup>116</sup> Such family separations can be emotionally painful and logistically difficult.<sup>117</sup> Because migrant workers frequently rent housing where they work, however, our proposal would entitle them to bring their children with them.

Secondly, would local governments be incentivized to limit development density to insure that each migrant pays the average per capita cost of local services? Because property taxes are typically levied on the value of land and improvements, landowners who squeeze more people into a less valuable structure pay less taxes per unit of service consumed than landowners who develop land at a lower density with more valuable structures. Therefore local governments might be incentivized to impose a prohibition on high-density development, a form of “fiscal zoning,” thereby transforming the property tax into a benefits charge under which each resident is forced to pay a minimum tax price sufficient to cover her consumption of services like education for her children.<sup>118</sup>

We believe that the danger of fiscal zoning is mitigated by the weakness of urban districts and the supervisory role of prefectural-level cities, characteristics that avoid both “leviathan” effects and externalities. Urban districts are too small to enjoy monopoly over an entire metropolitan area’s land. They are, however, also large enough to capture many of the external benefits conferred by affordable housing on commercial, office, and industrial uses. The urban district and county, therefore, resembles what Professor William Fischel calls the “concentrated” metropolitan area -- an area with enough local governments to avoid “monopoly pricing” for land yet not so many that such competition leads to free-riding and collective action problems excluding affordable housing necessary to attract employers on the theory that neighboring

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<sup>116</sup> See e.g., Lizzie Dearden, *Four Siblings “Kill Themselves” After Being Abandoned by Parents in China*, INDEPENDENT (June 13), <http://www.independent.co.uk/news/world/asia/four-siblings-kill-themselves-after-being-abandoned-by-parents-in-china-10317720.html>; John Sudworth, *Counting the Cost of China’s Left-Behind Children*, BBC (Apr. 12, 2016), <http://www.bbc.com/news/world-asia-china-35994481>.

<sup>117</sup> *Juvenile Res. Center, Communist Youth League of China, 农村留守儿童存在的九个突出问题及对策建议* [Nine Prominent Problems of “Leftbehind” Children and Proposed Solutions], PEOPLE (June 19, 2015), <http://theory.people.com.cn/n/2015/0619/c40531-27180206.html> (reporting higher rate of psychological issues existing in “leftbehind” children).

<sup>118</sup> The theory that the property tax becomes a benefit charge with combined with restrictive zoning was most famously set forth in Bruce W. Hamilton, *Zoning and Property Taxation in a System of Local Governments*, 12 URB. STUD. 205 (1974). The theory has been challenged by Peter Mieszkowski, Peter & George R. Zodrow, *Taxation and the Tiebout Model: The Differential Effects of Head Taxes, Taxes on Land Rents, and Property Taxes*. 27 J. ECON. LIT. 1098 (1989), who argued that only “perfect zoning” that prevented any sort of value-lowering alterations and structures would transform a property tax into a benefits charge. William Fischel has responded to this argument against the “benefit” theory of taxation in ZONING RULES!: THE ECONOMICS OF LAND USE REGULATION 145-52 (2015)

jurisdictions could provide such housing.<sup>119</sup> Even though current interjurisdictional competition in China focuses on investment, we have seen evidence that local governments open public services and provide residential land to increase their competitiveness.<sup>120</sup> Moreover, we note that the devolution of taxing and regulatory power to urban districts leaves in place prefectural-level cities' powers to correct external economies between districts. In a federative metropolitan area, the prefectural-level city could be given control over business-oriented taxes imposed on industrial and commercial uses, redistributing some share of this tax revenue to districts that provide the housing and educational services needed by those employers' workers.

## Conclusion

By promoting local officials on the basis of local land values, Chinese law could give them an incentive to cultivate allies who would protect those values on which the officials' careers rested. These allies would not be motivated by high-minded ideals of democracy and human rights but selfish and grubby preferences to safeguard their down payment. Precisely for that reason, the CCP could tolerate the sorts of participation that these foot-voters-turned-homevoters would foster. Compared with the exercise of ballot-voting on more abstract and edifying issues, such local participation on garbage collection and school performance might seem like small potatoes. But those are the only potatoes on offer in China in the current regime. We suggest that such improvements, small as they are, are worth advancing, both for CCP leaders intent on promoting their own legitimacy and assuaging Weibo anger, and for democratic reformers who would like to see a foot-voting mechanisms that could imitate ballot voting.

Inter-jurisdictional competition has been a familiar theme in Chinese law and politics. During the Great Leap Forward from 1959 to 1961, over thirty million people died from starvation in part because provincial leaders competed for Chairman Mao's favor by delivering ever-higher grain quotas to the central government.<sup>121</sup> On the other hand, the Chinese economic miracle in

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<sup>119</sup> William Fischel, *Political Structure and Exclusionary Zoning: Are Small Suburbs the Big Problem?*, in FISCAL DECENTRALIZATION AND LAND POLICIES 111, 120-22 (Gregory K. Ingram & Yu-Hung Hong eds. 2008).

<sup>120</sup> See Celine Ge, *Housing Crisis in China's 'Silicon Valley': Huawei, Other Hi-Tech Giants Head for Cheaper Cities as Rising Costs Deter Talent*, SOUTH CHINA MORNING POST (May 30, 2016), <http://www.scmp.com/news/china/policies-politics/article/1952617/housing-crisis-chinas-silicon-valley-huawei-other-hi>.

<sup>121</sup> Xu Chenggang (许成钢), *地方竞争的困境* [Dilemma of Local Competition], CHINA REFORMS (Sep. 1, 2011), <http://www.ckgsb.edu.cn/uploads/professor/201607/15/19.pdf>.

the past thirty-six years is also attributed to subnational leaders' interjurisdictional competition, this time, to attract investment capital. These two different stories tell us that the voice to which local officials respond crucially affects the consequence of inter-jurisdictional competition. Our proposal endeavors to transform competitions for the favor of supreme leaders or capital investors into competitions for the favor of the Chinese people. This would not be the final step of China's democratization, but it would nevertheless be a crucial step towards increasing local government accountability. Once local officials begin to solicit the "foot-votes" of migrants, they also will have incentives to promote internal procedures to protect those foot-voters' investment. Such procedures might logically and eventually include ballots.

The Chinese case also reveals the nuanced relationship between voice and exit. Just as we say exit is foot-voting, exit is voice in the most essential way. Scholars have sometimes assumed away the political mechanisms by which exit converts into a plausible complement for voice. Neither foot-voting nor ballot-voting is a silver bullet to government accountability. As we show in the Chinese context, it requires proper examination of the size of local governments, the fiscal system, and the immigration system, among many other aspects of public law. Is democracy possible in China? We do not know: it depends on your definition of "democracy." But can government accountability in China be improved through household mobility? Our answer is yes.