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**Central-local authority relationships
and the institutional process of city creation**

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UrbaChina

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Central-local authority relationships and the institutional process of city creation

By Ai Chi-han, Miguel Elosua and Li Shantong

Abstract

As one of the fastest-growing economies in the world, China is experiencing the largest scale of urbanisation in human history. More and more land is required to support this massive urbanisation. However, rural land acquisition and compensation to the changes in farmers' household registration (*hukou*) are complex issues in the process of urbanisation under the dual land tenure between city and rural areas in China. Furthermore, local government has been under increasing financial pressure after the tax sharing system was implemented in 1994. To raise funds and develop urban construction, various cities have undertaken different strategies of land development during their ongoing urbanisation, which is also discussed in this study. Urbanisation is a process of expanding urban space with a view to develop the land efficiently. Therefore, the objective of this study is to introduce the dual land system in China, the evolution of farmers' collective land ownership, and the process of governmental land acquisition. Subsequently, we will examine the case of the case of Shanghai Pudong New Area, which develops land with an insufficient financial support and its corresponding solutions. Finally, the authors highlight problems in the process of land acquisition and land development.

Keywords: urbanisation, China, *hukou*, tax sharing, land development

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Introduction

Article 10 of the Constitution of the People's Republic of China states that:

Land in the cities is owned by the State. Land in the rural and suburban areas is owned by collectives except for those portions which belong to the State as prescribed by law.¹

In other words, two different land tenures exist in China, for cities and rural areas: state-owned land and collectively-owned land. This dual system was put into place after the Chinese government the land reforms of the household responsibility system (家庭承包制) and the lease of urban land. Today, the Chinese land system separates right of land ownership (state-owned and collectively-owned) from the right of land use. This means that the right to use state-owned land can be transferred and traded, while for collectively-owned land, the right to use and manage the land belongs to individual farmers.

Under the rapid expansion of Chinese cities, local governments must expand urban space through land acquisition. However, some issues require clarification. What is the process of land acquisition? What financial budget do local governments' have for land acquisition? What process follows land acquisition and what problems are encountered then? These questions are addressed in the following first section.

I. Urbanisation, land development and central-local relations

a) State-owned land and collectively-owned land

China's dual land tenure system is related to land-use right, put into place after the 1978 economic reform. The government created a system in which only state land was liberalised, rather than the whole land market. The market for land was not liberalised in

rural areas because the assumption was that granting full ownership rights to farmers (with power of disposal) would have consequences such as (i) farmers' losing their land by disposal at will in the case of any economic shortage, (ii) the loss of utilised arable land, therefore jeopardising country's food security (it is often cited that China counts 22% of the world's population with only 7% of its arable land), and (iii) the creation of slums as a consequence of the influx of surplus labourers to the cities. Underlying the academic discussions was a constant fear of returning to the pre-revolutionary situation where land was held in the hands of a few, which, according to Marxists, constitutes one of the great contradictions of capitalism.

In 1982, the Constitution (now in force) sanctioned the collective as owner of China's rural land. The term "collective" refers simultaneously to three administrative levels: (i) the rural district (*xiang/zhen*), (ii) the administrative village (*xingzheng cun*) and (iii) the natural village or group of villages (*nongcun jiti: ziran cun* and *cunmin xiaozu*, respectively). In theory, land ownership is given to the natural village, which exercises its land ownership rights through the village committee (*cunweihui*, 村委会). In practice, it is the government institutions at the higher levels (rural district and administrative village) that wield effective power. This also shows the continuity with the system practiced until 1978, when the communes and brigades (now townships and administrative villages) administered land arbitrarily without respecting the natural village. The latter usually acts as a contributor to the fulfilment of the objectives of the local government.

The government gave the farmers' collective land use rights; therefore, only rural collective land can be used freely, while urban land can only be developed after a series of governmental procedures.

b) Rural collective land use rights

The collective distributes land use rights to households either for private farming or for home construction, theoretically allocating the rights free of charge and on an egalitarian basis. The distribution (and redistribution) of farmland to households is also known as the House Responsibility System (HRS), the original name when the scheme was launched at the outset of the economic reform, and which was later sanctioned by the 1982 Constitution. Households

¹ Article 10 of the Constitution of the People's Republic of China. 中华人民共和国宪法.
http://www.octs.org.hk/e_ConstitutionLaw.htm#Chap1.
(accessed 25 May 2013).

receive farmland without compensation in return (an application of the land to the tiller principle). Likewise, the collective allocates land for construction, ensuring farmers the right to adequate housing (*zhaijidiqian*, 宅基地权). This way, the government answers two basic needs of every individual: shelter and livelihood.

Rural land use rights are uniquely associated to the collective identity. To be entitled to farmland (or land for home construction) a person need only be a member of the collective. The requirements to become a member of the collective are vague and imprecise, and are often a source of disputes in rural China. It is usually the agricultural registration or *nongye hukou* (imperative to every household) that qualifies a household for collective membership, although in some cases it is not sufficient.

The collective economy was set up in order to guarantee that every household had access to work and to adequate housing. Therefore, the collective identity is at the centre of land use right. This is important to note since the now promoted circulation of land rights outside the collective implies the detachment of this nucleus for the first time since its inception.

c) The process of governmental land acquisition

Within this dual land tenure, when urban development reaches a certain scale, more land is required. Therefore, the government levies collectively-owned land in rural areas and compensates the owners, then converts the land into state-owned land to facilitate city construction. Subsequently, the government conducts the primary land development, which is the process of investing in and developing the land before it is contracted to developers, commonly known as changing “raw land” into “cultivated land”.

Primary land development includes land acquisition, land consolidation, and land reserve. These three processes are needed to satisfy the requirements of municipal infrastructure indicators and urban planning guide for demolition, land levelling and construction of public facilities to achieve the standards for land transfer.

The executive units of primary land development are the local government or the companies specified by the local government, such as urban investment

companies and land reserve institutions, which are supervised by the government. After primary land development, ‘cultivated land’ can be traded in the land transaction centre. The government holds auctions where developers can participate in bidding. Developers are attracted to the profits they can make from developing this land. Meanwhile, the government can improve existing urban infrastructure using the funds collected by land auctions. Therefore, expansion into suburban rural land and the re-development of existing urban land are complementary activities.

After the implementation of the tax-sharing system in 1994, local finance was substantially affected, which allowed the central government to handle the majority of tax levies. As a result, land auctions became an important source of revenue for the local government. The government expected these auctions to increase land price, providing a greater budget for ongoing urban land development. According to the Eleventh Five-Year Guideline², land transaction revenue grew rapidly from 767.7 billion RMB in 2006 to 2,911 billion RMB in 2010. The increase rate is approximately 35% that of the central government and 71.7% that of the local government.

Also, according to the statistics of the land management department, the ratio of land conveyance income to local financial revenue from 1999 to 2009 had risen from 0.092: 1 to 0.437: 1, the ratio of land conveyance income to local non-budgetary income had risen from 0.163: 1 to 1.942: 1 (see Table 2).

As a part of extra-budgetary funds, land conveyance income is called “the second financial revenue” and its proportion in local financial revenue is gradually increasing. In some places, the land conveyance income exceeds other kinds of financial revenue, and has become the main source of revenue (see Table 3).

As a result, land prices soar. Before 1992, the market economy was not established, and the compensation the government gave to the owners of collectively-

² Woguo xiao chanquan fang wenti yanjiu: Xianzhuang yu chulu 我国小产权房问题研究：现状与出. REICO 工作室. <http://wenku.baidu.com/view/be3c12282af90242a895e53d.html> (accessed 5 February 2013)

owned land was merely a formality. The government compelled the transfer of ownership. After 1992, once the market economy was established and developed, urban land prices increased. The significant difference between the price of collectively-owned land in rural areas and the price of land in the city, created several problems, such as violent land acquisition and forced demolition of farmers' property. Collectively-owned land cannot be developed directly, therefore, it is necessary to transform collectively-owned land into state-owned land. However, farmers still received little compensation, while the bidding for the rural land levied by the government tended to reach a sum tens or hundreds of times their compensation. The farmers felt that the government neglected their interests. As a result, a number of farmers are reluctant to sell their land, thereby resulting in obstacles and problems for urban development.

As one of our interviewees stated:

Before 1992, all lands in China were owned by the state. But the regime changed in 1992. It decided to divide the ownership of lands: lands in the city belong to the state but rural lands are owned by the farming communities. If the government needs the land expansion for urbanisation, it must first expropriate lands from the farming communities.

As for the expropriation of land, the government gives a symbolic amount of money incomparable to the actual market value. In other words, the compensation is still meagre. Now the situation has changed; farmers come to realize their loss in the transfer of their lands to the state. Thus, farming communities become unwilling to give their lands to the government. This obliges the government to tear down houses or to take strong measures to enforce the expropriation. Although the government does increase the compensation in recent years, there is still a huge discrepancy between the actual market price and the price submitted by the state³.

The above section introduced the government land acquisition process and the contradictions and problems of urban development in China. In the

following section, the example of Shanghai will be used to explain the relation between urban expansion and land finance, and the importance of land finance to the local government.

II. A special model of land development in Shanghai

The relation between land expansion and local tax revenue has already been described, as well as the process of governmental land acquisition. However, there exists a special model of land development in the development zones of Shanghai (including Jinqiao, Lujiazui, Waigaoqiao, and Zhangjiang), different from those of other cities in China. The creation of this model is to avoid dependence on local finance.

In these development zones of Shanghai, the Pudong New Area government is in charge, not the Shanghai city government. Because the Pudong New Area government is responsible for promoting investment and setting up infrastructures with limited financial resources, the government has designed a special model to finance and build the development zones. This land development model is called the "land rolling development model".

First of all, the Pudong New Area government evaluates the price of rural collectively-owned land, and then pays 30% of the estimated price as the "land pre-acquisition costs" to the rural collective land owner to convert the land into state-owned land. "Land pre-acquisition costs" cover the transfer of land ownership and land management. Then, the Shanghai Municipal Finance Bureau sets up the Development Zone Company. The funding provided to the company equals the estimated price of the rural collectively-owned land. When the Development Zone Company receives the fund, it purchases the development zone land from the Land Authority of Shanghai and signs the land use contract, thus acquiring the right to use the land. Next, the land ownership and the land management are transferred to the Development Zone Company. In this process, the flow of capital between the government and the Development Zone Company is counterbalanced. The land is transferred to the Development Zone Company without payment. In addition, the Development Zone Company may

³ Interview of 15 March 2012, Kunming

mortgage the land in order to receive loans to be used for the construction of the development zone. With the land loan, the Development Zone Company will need to pay only 70% of the property price to procure full ownership of the land and to develop it.²

This “land rolling development model” enables the Pudong New Area government to raise funds and build the necessary infrastructure within the development zone. This model can reduce the dependence of regional development on the local government. However, in the total cost of urbanisation in Shanghai, land development accounts for a major part of local fiscal spending.

Tax distribution and the reform of income tax-sharing have put a certain strain on the fiscal revenues of local governments, forcing them to find new fiscal sources by developing the construction industry and adding off-budget revenues. The reform of the urban housing system and enacting of the Law of Land Management in 1998 triggered the rapid rise of businesses’ and residents’ needs for urban land development. Accordingly, after the tax distribution system was adopted, the area of leased land in Shanghai increased considerably and its fiscal revenues also rose rapidly. In this context, land leasing and acquisition have become the major source for local governments to increase their budget and off-budget revenues. This way, land development and fiscal revenues in Shanghai form a mutually beneficial cycle. By using the large sum of revenues from land leasing and acquired urban land for development, local governments can pledge or guarantee their fiscal revenues to get larger financial loans for urban development. This way, land revenues, bank loans and land acquisition have become a constantly expanding cycle. This process has not only helped build the current urban landscape in Shanghai, but also brought about important sources of income for the Shanghai Municipal Government. At the same time, the mammoth wealth also influences the relations between the central government and local governments.

III. Problems encountered in the land development process

The process of urbanisation in China clearly depends heavily on land development and local fiscal financing, and there are several notable problems in the land development process.

a) *The issue of migrant workers*

The Chinese household registration (*hukou* system) divides rural and non-rural household registrations. Changing household registration is not allowed in most Chinese cities. However, people’s social security, children’s education, etc. depend on which system they fall under. Rural workers who move into the cities for work are not considered urban citizens, and therefore cannot benefit from urban welfare. After the economic reforms and opening up policies in China, foreign direct investment caused an increased demand for labour. This situation drove millions of rural workers to move into the cities without the urban *hukou*: these people are referred to as “migrant workers”.

Two phenomena contributed to the existence of migrant workers: active and passive migration. Active migration means that rural workers move into cities with the intention of finding a job with a salary high enough to offset their rural income. Because these workers keep their rural *hukou* identity, their social security and children’s education are subject to the administration of their original *hukou* system. These workers still possess a homestead (宅基地) and farmland in rural areas; however, they do not have a residence in the city. They usually have to live in a collective dormitory provided by their employer or rent a house of their own. By contrast, passive migration refers to the situation in which rural residents, who originally reside in the city suburbs, are absorbed by the city as a consequence of urban expansion. However, due to the previously mentioned restrictions to acquiring the urban *hukou* in large-sized cities, these new “urban peasants” keep their rural *hukou*.

At the present stage, local governments want to acquire the land of passive migrants and to increase their taxes, which results in “hurrying farmers to move to high-rises (赶农民上楼)”. This in turn means increasing land benefits by forcefully acquiring farmers’ collectively-owned land and moving the residents into urban high-rises. However, the main problems concerning migrants are caused by active migrant workers’ housing problem, social security issues, etc. Therefore, the way governments help migrants integrate the city after the acquisition of passive migrant worker’s land and improve active migrant workers’ housing situation remains an important issue to resolve.

b) Soaring land prices

After acquiring, demolishing, and levelling the land, the government trades it at the land transaction centre. According to Articles 4 and 27 of the *Regulations for State Owned Land Bids, Auctions, and Quotations* published by the Ministry of Land and Resources of the People’s Republic of China, “certain types of land use (commerce, tourism, entertainment, and commodity housing) must be sold through bidding, auctions, or quotations.” Under this system, construction land can therefore only be obtained through these methods organised by the government. However, the auction system stimulates land prices to rise and influences the housing price decided by developers.

c) Small property right housing

Generally, collectively-owned land cannot be developed into commodity housing until it is changed into state-owned land. However, in recent years, because urban land and housing prices have climbed, small property right housing is being built on collectively-owned land. By selling small property right housing, farmers and the community can share the value-added benefits of the land. However, this type of housing is approved only by the township government or the village committee, not the central government. This is a clear sign of the lack of consistency in policy between the local and central government.

d) Farmers’ family register problems after their residence transferred from rural to state-owned urban land

As previously stated, differences exist between state-owned land and collectively-owned land in the Chinese land ownership system. In addition, there are difference between rural and urban family registers, as specified by the Chinese family register system.

However, when a farmer’s residence is transferred to state-owned land and as the city takes over the land, the farmers are forced to integrate into the city. In China, changing family register is strictly forbidden. Rural workers therefore cannot easily acquire the urban family register. This hinders population mobility and free migration between cities, which affects rural housing, free medical treatment and social insurance.

According to Tang Mahuan⁴, employees whose family register is in Shanghai usually have pensions, unemployment insurance, medical insurance and a fund for their social insurance. Although the employees must pay a portion of the insurance premium, which is respectively 6%, 1%, 2 %, and 7% of their monthly income, their company pays a greater share, accounting for 22.5%, 2%, 12%, and 7 % respectively. However, the employees with a rural family register can only have medical insurance premium taken based on their monthly average income of the previous year, accounting for 2 to 3%. The farmers also pay social insurance for their pensions. In social assistance, urban family registers can have a minimum subsistence support of 3360 RMB per year, which is 1360 RMB higher than rural family registers. Additionally, urban family registers receive unemployment benefits, but rural family registers do not.

e) Problems of migrant workers’ citizenisation

A complex relationship exists between citizenisation of migrant workers and urbanisation, because rural workers generally have a lower education than urban residents do, and their life styles differ as well. When the land is levied by the government, farmers are

⁴ Tang Mahuan (2008) *Study of problems and government countermeasures in the process of urbanisation: the case of Qingpu District in Shanghai*. Master thesis, Shanghai Jiaotong University, Shanghai.

forced to enter the city, yet they keep the rural register, which influences their medical benefits and their children's education. The *hukou* system has been eased somewhat by the Chinese government in recent years to enable migrant workers to benefit from urban social security, but the cities where it is eased are mostly small- and medium-size. The reason the government cannot liberalize the *hukou* completely in large cities is because this would bring a huge, and sudden, burden to their social insurance. Governments need to be extra prudent dealing with this reform. Helping the citizenisation of migrant workers and their integration into the city will be a crucial problem in China's near future.

f) *The contradiction between protection of basic food and urbanisation*

Because of urbanisation, the government takes over agricultural land, which impacts agricultural production. Therefore, the Ministry of Land and Resources of the People's Republic of China regulates each city's development to protect a certain area of agricultural land. However, each city has their position and strategy regarding development. Protecting agricultural land ensures the basic food supply, of course, but it obstructs the progress of urban development. One of our interviewees said, "*the Shanghai government wants to reserve a portion of the farmland, but this policy should vary from city to city. We communicated the idea to the State Council, but the council did not agree.*"

Conclusion: Overemphasis on the benefits of land development leads to the neglect of the rights of farmers

After the implementation of the tax-sharing system in 1994, local finance was substantially altered, which enabled the central government to handle the majority of tax levy. As a result, land auctioning became an important source of revenue for the local government. The government expects to increase land prices thanks to these auctions, providing a greater budget for their current urban land development. Therefore, the main objective of

China's urbanisation is to develop the economy and raise land prices. This process requires the industrialisation and the development of real estate. Industrialisation attracts foreign investment, which helps increase the GDP of a region. Development of real estate helps raise the price of land, which provides indirect revenue for the local government.

However, this pattern of urbanisation lacks sustainability in China, because it entails several conflicting situations.

First, this pattern directly influences the real estate industry. It has resulted in the high price of real estate, which may cause a property bubble. Furthermore, the effect of urbanisation may go well beyond the housing market. When a city is filled with expensive houses, the high cost of living may push away talented employees, preventing companies in the city from recruiting them. Also, the high price of real estate may increase companies' production cost. I could also cause the appearance of "ghost towns". Worse, this situation could lead to a decline of competitiveness in the manufacturing industry.

Secondly, the government also relies on the development of real estate to boost overall economic development, and financial benefits obtained in this way are used to build infrastructure and to invest in economic projects. The objective of urbanisation, however, is not to improve residential quality. In other words, there are two dynamic directions present in China's urbanisation: impetus and traction. Impetus is mainly a result of labour flooding in from outside the city and work in industry; migrant labour encourages urbanisation in China. Traction results from industrialisation and economic growth, which helps promote urbanisation in China. However, China has focused on technical innovation and has neglected the quality of human capital, thereby preventing urbanisation from being sustainable at the present stage.

Thirdly, after the government acquires land, farmers are forced to enter the city, without then receiving a new urban register. The government does not have comprehensive measures to take care of rural workers' medical benefits or their children's education. This in turn causes an inequality of quality of living between urban citizens and the rural worker living in urban areas.

There are solutions to the problems mentioned above. First, the fiscal system in China should be reformed to help coordinate local governments' financial demands and their plans for infrastructure (China's current fiscal system works this way: the local government pays a certain percentage of the levied tax to the central government, but the needs of the

local government for the funding of infrastructure is not taken into account). Second, the land system should be reformed. Currently, the government has a monopoly on land, and auctions it off on the market, thereby generating high and competitive prices. The real estate industry should also be reformed along the same lines.

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Tables and figures

Table 1. Land revenue during the Eleventh Five-Year period in China (billion yuan, %)

Year	Land transaction revenue in China	National fiscal revenue	Ratio of land transaction revenue to national fiscal revenue	Local fiscal revenue	Ratio of land transaction revenue to local fiscal revenue
2006	767.7	3,876.0	19.8%	1,830.4	41.9%
2007	1,300.0	5,132.2	25.3%	2,357.3	55.1%
2008	1,037.5	6,133.0	16.9%	2,865.0	36.2%
2009	1,424.0	6,847.7	20.8%	3,258.1	43.7%
2010	2,911.0	8,308.0	35.0%	4,061.0	71.7%

Table 2. State-owned land transfer income turnover and compare with local finance income and local non-budgetary income: 1999-2009 (billion yuan)

Year	Turnover	Local fiscal revenue	Local non-budgetary income	Ratio of Land transfer income to local fiscal revenue	Ratio of Land transfer income to local non-budgetary income
1999	51.43	559.487	315.472	0.092	0.163
2000	59.56	640.606	357.879	0.093	0.166
2001	129.59	780.33	395.3	0.166	0.328
2002	241.68	851.5	403.9	0.284	0.598
2003	542.13	984.998	418.743	0.55	1.295
2004	641.22	1189.337	434.849	0.539	1.475
2005	588.38	1510.076	514.158	0.39	1.144
2006	807.76	1830.358	594.077	0.441	1.36
2007	1221.67	2357.262	628.995	0.518	1.942
2008	994.39	2770.342	n/a	0.359	n/a
2009	1423.97	3258.074	n/a	0.437	n/a

Table 3. Twenty cities with the highest land conveyance income in 2009 (billion yuan)

Ranking	City	2009 ⁵	Comparison with 2008	2008	Comparison with 2007	2007
1	Hangzhou	105.4	2.38	31.2	0.63	64.6
2	Shanghai	104.3	1.72	38.2	0.3	80.3
3	Beijing	92.8	0.85	50.3	1.12	43.8
4	Tianjin	73.2	0.67	43.9	0.89	38.8
5	Guangzhou	48.9	3.01	12.2	0.51	32.3
6	Ningbo	48.8	6.17	6.8	8.41	5.2
7	Chongqing	44	2.76	11.7	0.4	31.4
8	Wuhan	36.1	3.45	8.1	0.35	26.7
9	Foshan	33.2	3.9	6.8	0.54	21.6
10	Chengdu	32.4	3.89	6.6	-0.18	39.6
11	Wuxi	31.5	2.78	8.3	-	1.6
12	Xiamen	30.3	4.75	5.3	-0.14	35.2
13	Shenyang	29.5	0.93	15.3	-0.06	31.3
14	Suzhou	27.5	3.26	6.5	-0.35	42.2
15	Dalian	26.2	0.79	14.6	4.55	4.7
16	Nanjing	24.2	0.66	14.6	-0.37	38.3
17	Jinan	18.3	3.6	4	5.15	3
18	Changzhou	17.6	2.62	4.8	1.87	6.1
19	Qingdao	15.5	0.56	9.9	0.47	10.5
20	Hefei	15.4	1.37	6.5	0.79	8.6

Data sources: China's real estate index system database⁶

⁵ This table shows the land conveyance income between 2007 and 2009. Hangzhou has the highest land conveyance income in 2009, 105.4 billion yuan, and the growth rate is 2.38. In 2008, the growth rate is 0.63.

⁶ <http://www.docin.com/p-343486287.html>

Figure 1. Process of governmental land acquisition

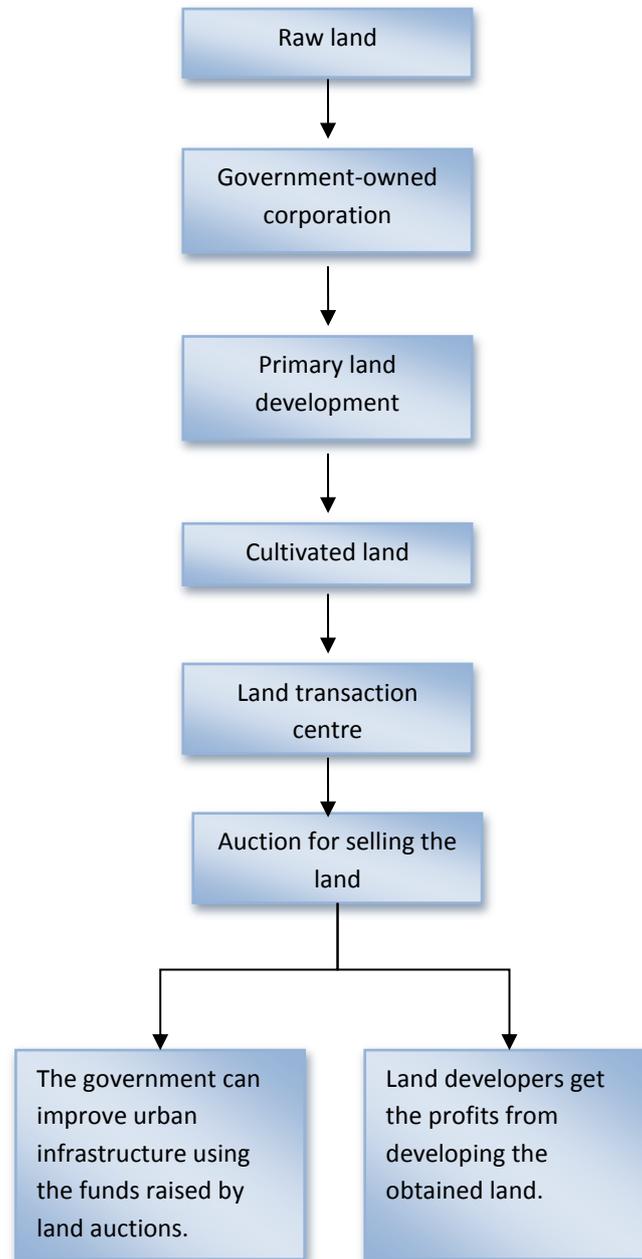


Figure 2. "Land rolling development model" in Shanghai

