

China's Paradoxical Reforms on Land and Real Estate Property Markets

Richard Hu*

University of Canberra, Australia



Abstract

This paper aims to analyse the law reforms on land and real estate property in contemporary China and point out the paradoxical nature of these reforms. This paper makes an in-depth observation of China's land and real estate property market development through an examination the relevant law reforms, and an analysis of their inherent problems. Based on scrutinising the historical evolutions and analysing China's contemporary political-economic contexts, this paper predicts the privatisation of land 'with Chinese characteristics' as a strategic solution to the paradoxical land and real estate property markets.

1. Introduction

Real estate property has arguably been the most contested issue during China's transformation towards a market economy. It touches the very heart of China's socialist doctrine: the state/collective ownership of land. This paper analyses the evolutions of land and real estate property laws in contemporary China including their outcomes and implications for overseas investors. Real estate property fixed on land has been mostly privatised during China's unprecedented process of urbanisation along with its market economy reforms. Driven by the dual tropes of market economy and urbanisation, China's government has reformed laws to 'marketise' real estate property for investment, ownership and transaction and the reforms have differentiated implications for different social groups. There are constantly new winners and losers. The drivers of and impediments to these reforms are identified including the inherent political paradoxes embedded within them: state/collective ownership of land vs. market transaction of land use right; state ownership of land vs. private ownership of real estate property fixed on the land. The paper argues that these paradoxes are challenging China's socialist system of public ownership and the

* Richard Hu, Faculty of Business and Government, University of Canberra, Australia, Correspondence address: Faculty of Business and Government, University of Canberra, Bruce, ACT, 2601, Australia

continuing legitimacy of the Communist Party of China (CPC). Leaving them unresolved may provoke a pessimistic tenor to China's buoyant expectations of growth in its developing market economy. However, judging from the historic tracks of China's reforms towards a market economy and its current dilemma, China is very likely to further reform its laws on land and real estate property in a manner 'with Chinese characteristics'.

2. Law Reforms on Land and Real Estate Property

China's land market and real estate market have been developing concurrently since China's 'reform and opening up' (*gai ge kai fang*) in 1978. Strictly speaking, China does not have a land market. Constitutionally the land ownership belongs to the state in urban areas and the collectives in rural areas. When people talk about China's land market, they actually refer to China's land use right market. China's land market reform and real estate market reform are naturally interlinked given their inherent bondage that real estate property is fixed on land. However, the two concurrent and bound reforms have been proceeding along different tracks in the past three decades. For the land market, the overarching reformist theme is being from non-transferable land use right to transferable land use right; for the real estate property market, the overarching reformist theme is being from public provision and ownership to privatisation.

Land is a particularly important issue in China's contemporary political and economic context. Public ownership of land is one of the few fundamentalist principles of the CPC. Land reform which was marked by confiscation of private lands for redistribution in rural areas appealed to peasants and played an important role in the CPC's victory over the Chinese Nationalists (*guo ming dang*) in the civil war before 1949. Based on the ideology that all land was common property, the large-scale nationalisation was carried out after the People's Republic of China (PRC) was established. For this purpose, the PRC Land Reform Law was announced in June 1950 with a focus on land confiscation and redistribution mainly in rural areas. In the same year, the Regulation on Urban and Urban Fringe Land Reform stipulated that urban land was to become state land and would be managed by city governments. This nationalised urban land system was in force from the early 1950s until the mid 1980s. During the period between the 1950s and the 1980s, China's urban land system was characterised by three features as summarised by Li (1999):

- The administrative allocation of land: Land was allocated for purposes determined by the administrative authorities. Land users such as the state authorities, army, schools or state enterprises could lodge land use applications to the relevant levels of governments. Land was then granted when the land use application was approved.
- Land use without charge and compensation: When land was granted through the administrative allocation, no charge or compensation was made for land use. The

period of land use was not specified either. Theoretically the users could occupy the land for an unlimited time unless future state construction was going to take place on the same site.

- No transfer right: Land users had no right to transfer the land through selling, leasing, mortgaging, donating, or exchanging. Constitutionally land could not be transferred in any form. Land had to be returned back to the relevant levels of government agents if land users did not need any particular piece of land, though this seldom occurred.

China's current land system has been resulting from a series of land law reforms from the early 1980s, moving from allocating land use rights administratively to a hierarchical system of primary and secondary land use markets (Ho & Lin, 2003). The breakthrough was the amendment to the Article 10 of the Constitution which added the clause that 'the right to use land may be transferred in accordance with the provisions of law' in 1988. This was aimed to eliminate the constitutional binding on land use for private purposes such as foreign or private enterprises and private real estate development. It separated the ownership and use rights pertaining to urban land in order to establish a land use right market for private purposes (Hsing, 2006). Thus a 'dual track' land use system is in practice in China determined by the purposes of the land: Allocation (*hua bo*) is used to grant land use rights to state or non-profit users; Conveyance (*chu rang*) is used to transfer land use rights to commercial users for fixed terms (40 years for commercial land, 50 years for industrial land and 70 years for residential land). Major land reforms have been centred on defining and granting land use rights through the second track of conveyance.

There are two tiers of land use right markets in China. The allocation and conveyance of land use rights from the state form the 'primary market' (*yi ji shi chang*) of land use rights. Land use rights through allocation are obtained by paying an 'allocation price' consisting of three major parts: the expropriation fee of land (*zheng di fei*); stipulated land fees (*tu di gui fei*); and allocation fee (*hua bo fei*). Land use rights through conveyance are obtained by paying a 'conveyance price' consisting of three major parts too. The first two parts are identical to those in the allocation price. The third differentiating part is a conveyance fee (*chu rang jin*), which is the largest as well as the most important portion of price paid to obtain land use rights through conveyance. The conveyance fee is supposed to be the market price of land use rights which could be determined by negotiation (*xie yi*) or tender (*zhao biao*) or auction (*pai mai*). As a counter measure to curb corruption in determining the conveyance fee through negotiation between the government and the land users, in 2002 the State Council promulgated the Regulation of Granting State-Owned Land Use Rights by Tender, Auction and Quotation (also known as No. 11 Decree) to put an end on obtaining land use rights through negotiating the conveyance fee.

Land use right holders who have obtained the land use rights through paying the conveyance fee in the primary market can transact or circulate (*liu zhuan*) their land use rights through

transfer (*zhuan rang*), rent (*chu zu*) or collateral (*di ya*), forming a secondary market of land use rights. Circulating land use rights in the secondary market adds significant value to the land use rights. But land use rights obtained through allocation in the primary market cannot be circulated in the secondary market.

Land market reforms directly impacted on the formation and evolution of the real estate market. China's real estate market has also developed along two tracks, but in a different sense from the land market. One track has been developing in parallel with the land market evolution as described above. The commercialisation of land use rights was the first step to build a real estate market. The land use rights for real estate development can be obtained in both the primary land market and the secondary land market. Real estate developers can be public (state enterprises) or private (private investors from home or overseas). The other track has been the process of privatisation and marketisation of housing, which represented a transition from an administrative system to a market system under a top-down reform package (Lee, 2000; Zhang, 2000). There was not a housing market in China before the early 1980s. Housing was provided by the state as a social welfare through the work units (*dan wei*) for which individuals worked. The ownership of housing belonged to the state and could not be circulated or transacted. Public provision of housing proved to be a major barrier to alleviating financial burdens on the state or state enterprises and enhancing residents' living conditions. The solution was dual: on the one hand, the public owned housing were privatised; on the other hand, real estate development through multiple modes of investment was allowed and encouraged. This extensive housing privatisation was then supported by a system of urban housing property rights and a growing mortgage financing (Stephens, 2010).

The year of 1998 was a dividing line in the evolution of China's real estate market. The State Council issued the Notice on Further Deepening Urban Housing Reform and Accelerating Housing Construction to formally cease all forms of public provision of housing as a form of welfare from work units (both government departments and state enterprises). The Notice marked a complete transition to the provision of market based housing (Ye, Wu, & Wu, 2006). To purchase from the market thus became the only source to obtain housing. This was a significant impetus to the real estate market in China to sustain a property boom for almost two decades. It needs to be pointed out that the property boom mainly refers to housing development, while in some leading cities (Beijing, Shanghai, Shenzhen, Guangzhou, and etc.), it also includes commercial property development such as office, hotel, and retail. Commercial property boom more reflected the macro economic growth in China in order to provide facilities for economic activities.

3. Drivers and Impediments

China's land and real estate property law reforms were facilitated by economic drivers while its further reforms are restricted by political impediments.

The economic driver is a dual process interwoven with non-state investment and urbanisation. The non-state investment refers to both foreign investment and domestic private investment. One important aim of the ‘opening up and reform’ policy in the early 1980s was to attract foreign investment as well as so called ‘advanced technology and management experience’ to grow Chinese economy first in the coastal cities. Foreign investment in China in the 1980s mainly came from Hong Kong, Taiwan, and Singapore which had traditional links with mainland China in the beginning, and then from other East Asian countries like Japan, South Korea, and some Southeast Asian countries, and lastly from North American and European countries. The first problem arising from the foreign investment in China was related to the land use right and real estate property right, may it be the enterprises completely invested by foreign investors or joint ventures shared between foreign investors and Chinese partners. In the early stage, one common practice was that the Chinese local governments provided land use rights as contribution and share in the joint ventures with foreign investment (Wu, Xu, & Yeh, 2007). However, to clarify and define the land use rights as well as the real estate property on the land in relation to foreign investment made it an urgent law reform issue in the early 1980s.

Domestic private investment in China constituted the other important part of China’s non-state investment. In the 1980s, domestic private investment did not impose a strong push on law reforms on land and real estate property in China because it did not evolve into a power force in the politic-economic sphere in terms of scale or influence yet. Private investment was mostly made in the form of individual household business (*ge ti hu*) largely of vendor retailing or small scale manufacturing workshops. In the 1990s, especially after Deng Xiaoping’s Southern Tour Talk in 1992, private investment grew massively along with foreign investment. Two factors well justified the rapid growth of private investment in the 1990s. First is the favourable and encouraging investment policies carried out by all level of governments after Deng’s pro-market ‘theory of building a Socialist market system with Chinese characteristics’ was enthroned as the CPC’s ideological doctrines. Secondly, some individual household businesses which commenced and accumulated in the 1980s were able to improve their strength and scale at an accelerating speed in the 1990s. Coupled with those who could access power in the transition from a planned economy system to a market economy system to grasp their ‘first bucket of gold’ (*di yi tong jin*), the domestic private investors were able to invest in enterprises with scales which involved land use rights and real estate property, such as factories, farming, and real estate development projects. Thus domestic private investment joined the force requesting law reforms on land and real estate property.

The other driver of China’s law reforms on land and real estate property was its massive urbanisation process. China’s urbanisation rate was 45 per cent in 2008 growing from 20 per cent in 1980, while the central government’s target was set to be 60 per cent in 2020 (Hu,

2008). The magnitude and speed of China's urbanisation were unprecedented and unparalleled in its 'ambition of urbanism' (Campanella, 2008). China's urbanisation is a concurrent dual process of urban population growth and urban construction growth. Urban population growth has been largely a result of rural population moving into cities for employment, education and residence under the context of macro economy boom. Urban construction growth has been more than a process of providing accommodation for the burgeoning urban population. It was first of all to provide spaces for production and business activities in factories, offices and commercial facilities of hotels, exhibition and conference centres, and etc, in addition to the infrastructures which support the urban systems. It then involved the massive urban housing construction to provide shelters for people who work and live in cities. For local governments, one important fiscal source has been from leasing land for urban housing development to fund the expanding public services since the 1980s (Tang, Wong, & Liu, 2010). This is a factor of urban growth driven by local governments.

The massive and rapid process of urbanisation imposes imperatives on law reforms on land use and real estate properties in two senses. One is related to urban housing which was previously provided by the state as an in-kind welfare for workers, but now is privatised and commoditised. Private ownership and transferability of real estate properties required that relevant law reforms must be made. The other is related to the private corporate subjects which invested in the urban properties for business purposes, may the investment be foreign or domestic. As part of the corporate assets, the real estate property as well as the land which they invested in, occupied and used needed to be legally clarified and defined. Therefore, for either individual subjects or corporate subjects in China's urbanisation, it was very important to reform land and real estate property laws to adapt to new economic settings and actors.

However, there are a few deeply-rooted impediments restricting further law reforms on land and real estate properties which are mostly political factors in China. The first impediment is the practice of the rule of party (the CPC) despite the rhetoric of the rule of law. People, including cadres and ordinary citizens in China, tend to attribute Chinese contemporary problems to so called 'systematic problem', which is essentially about the centralised governing system by one party. After an attempt to liberalise the political system in the late 1980s which culminated in the Tiananmen Square Incident in the spring of 1989, the CPC tightened its control in the political sphere throughout the 1990s, and encroached into the economic sphere too in recent years as seen in the strengthened dominance of the state-owned enterprises in Chinese economy. The effort to build a market economy and the rhetoric of the rule of law are not the ultimate aims of the CPC, but means for the CPC to justify and sustain its rule. The rule of party in political, economic and judicial spheres fundamentally restricts further law reforms on land and real estate property which are supposed to be geared towards the rule of law, transparency and accountability as characterised in a market economy system.

The second impediment is the ambiguity in the interpretation and implementation of the rule of law in China. This ambiguity is partly related to the first impediment of the rule of party as stated above. Without logically sound philosophy and well accepted doctrines, the CPC is at ideological crossroads which are caught between its forward vision and its historical links. This is evident in the fact that every generation of CPC leaders had to generate their own governing ‘concepts’ and ‘theories’, like the Mao Zedong Thought, the Deng Xiaping Theory, the Three Represents Theory, and the Scientific Outlook on Development. The party’s ideological variation and oscillation has impaired the rule of law as both rhetoric and practice. In 2001, Jiang Zeming, the CPC’s Secretary General and China’s National president then, expanded the rule of law (*yi fa zhi guo*) to incorporate the rule of virtue (*yi de zhi guo*) so as to ‘run the country by combining the rule of law with the rule of virtue’. This statement was highly praised by the mainstream media as it has always been the case in the CPC’s propaganda mechanism, however, some independent intellectuals alluded that it was very problematic since the criteria of virtue could be very arbitrary. Feeling the contradictory nature between the rule of law and the rule of virtue, the latter has been subtly underplayed in the mainstream propaganda since the present generation of CPC leaders headed by Hu Jintao went into power in 2002. Without a clear cut definition and adherence to the rule of law, future law reforms on land and real estate property in China could be in uncertainty.

The third impediment is the power-wealth coalition which has been developing along with China’s economic growth in the past three decades. As vested interest groups, this power-wealth coalition grew through corruption and illegal power rent during China’s transition from a planned economy to a market economy. The centralised power structure and liberalised market reform have enhanced the possibility and profitability of transactions between power and wealth. The formation of such a power-wealth coalition has been accelerating during the last decade since both parties had completed their primitive accumulation of power or wealth. It is generally acknowledged that the power-wealth coalition has been firmly established in contemporary China, which is regarded as the largest barrier to further reforming China’s political-economic structures. The power-wealth coalition is an exclusive force and tries to protect what they have obtained, while its legitimacy is problematic and often challenged. The members of the coalition access and control the power and wealth which could be changed under pressure from other social groups, however, they are unwilling to let it happen. A good example is that a few numbers of the current CPC leaders are the offspring of the older generation of leaders, including Xi Jinping, the current National Vice President, who is likely to succeed Hu Jintao as the CPC Secretary General and China’s National President, Bo Xilai, the Party Secretary of the Chongqing Municipality, Wang Qishan, the Vice Premier, and Li Xiaopeng, the Vice Governor of the Shanxi Province, to name only a few. They are so called ‘Prince Party’ (*tai zi dang*) and are appointed to occupy top political positions to guard their vested interests. With these people in power now and in the future, it is not easy that China will deepen its law reforms on land and real estate property which might impair their vested interests.

4. Paradoxical Issues

What is a concern for investing in Chinese real estate property, may it be foreign investment and domestic investment, is the paradoxical issues which are inherently embedded in the Chinese land and real estate property law system. One paradoxical issue is the state/collective ownership of land and the transferability of land use rights in the market. As stated in the very beginning, strictly speaking China does not have a land market but a land use right market since only land use right within certain amount of years can be transacted in the market depending on the categories of land uses. The current land occupiers do not really own the lands, but the land use rights, that is, the land occupiers rent the lands by paying land allocation fees and land use fees. The land use rights can be transferred in the primary land market which involves transactions between the government and the land users and the secondary land market which involves transactions between different land users. No matter how the land use right is transacted and who owns the land use right, the land ownership remains to be with the state. This separation between land ownership and land use right is a fundamental legal problem in the Chinese land system. This problem is well understood and debated, however, it has not eventuated since Chinese land reforms were carried out in the past three decades and none of the land use right contracts has expired yet. How to terminate or renew the land use right when the land use right terms expire is not legally clarified and defined. How to address the real estate property fixed on the land when the land use terms expire is not clarified and defined either. This leads to the second paradoxical issue.

The second paradoxical issue in the Chinese land system is the relationship between the state ownership of land and the private ownership of real estate property fixed on the land. One central theme of Chinese housing reform in the past three decades is privatisation. Nowadays, most housing provision is privatised and belongs to private ownership, which can be transacted freely in the market. However, the housing owners do not really own the land where the property is fixed, but rent the land use right for certain years as discussed above. This separation of ownership of the land and ownership of the real estate property is legally problematic. For example, the land use right for residential land use is 70 years, but for a residential unit which is transacted in the 20th year, the new owner will only have a land use right of 50 years though the new owner has full ownership of the residential unit. The Property Law released in 2007 echoes the long standing principle in the Chinese Constitution that land belongs to the state or collectives (Wong & Arkel, 2007). It stipulates that the land use right for residential will automatically renew when the 70 years of land use right term expires, but it leaves open the issue of land premiums for such renews (Howlett & Hong, 2007). How to renew the land use rights for other land use types are not clarified either. Like the first paradox, the second paradox has not eventuated either since none of the land use right terms has expired yet.

These paradoxical issues inherent in Chinese political and legal systems with regard to land and real estate property constitute an intrinsic barrier for foreign investment to come into China. Here it is necessary to differentiate the foreign investment between those areas which have traditional links with China and those which do not have traditional links with China. The former refers to the countries or areas which have Chinese cultural roots and speak the same languages with China, such as Hong Kong, Taiwan and Singapore. They are active actors in the Chinese real estate market as foreign investors given their natural advantages over other foreign investors. The latter category of foreign investment refers to the investment from countries which do not have Chinese cultural links and do not share common political systems with China, such as American and European countries. It is for this category of foreign investment that Chinese paradoxical legal systems on land and property form an intrinsic barrier. Given different cultural traditions and political systems, it is very hard for this category of foreign investors to understand and feel confident of the assurance of property rights in China. There is commercial investment in the Chinese real estate property in the form of real estate investment trust (REIT) out of this category of foreign investment, however, they are short-term investment performances aiming at profits for overseas investors. They are very cautious of holding and owning real estate property in China in a long term either as end users or strategic investors.

Addressing these paradoxes lies in privatisation of land and transferability of its ownership in the land market. The discussion of the possibility and feasibility of privatising Chinese land has been going on among academics, but its eventuation will not be as easy as people expect. This is because privatisation of the land is fundamentally contradictory to the ideological foundation of the CPC, that is, the public ownership system. Land is the pivotal part of the public ownership system. Privatisation of the land will mean the collapse of one ideological fundamentalism on which the CPC and the current central government are based. However, this should not necessarily be interpreted as zero possibility of land privatisation in China. Like the housing privatisation and constitutional recognition of private property ownership which were thought of as unimaginative 30 years in China, land privatisation is possible in the long run. This optimism is supported by two arguments. One is that all stakeholders in the Chinese political-economic sphere are fully aware of this problem and are trying to find out constructive solutions, among which, land privatisation is one of the consensuses in principle. The other is the flexibility of the CPC in adjusting its ideological doctrines to justify its legitimacy to continue to govern. The CPC could carry out an essentially capitalist reform in the name of building a 'Socialist market economy with Chinese characteristics'. It may also carry out a reform of 'privatisation of land with Chinese characteristics' (in another euphemism of course).

5. Conclusion

China has made significant law reforms on land and real estate property since its genesis of the 'reform and opening up' policy three decades ago. These reforms have been centred on the thematic thread of privatisation of housing and real estate property ownership, transferability of real estate property and the land use rights in the market. They are a giant step liberalising Chinese land market and real estate market from its planned economy under the Stalinist style of governance. China's law reforms on land and real estate property has been an important facilitator of China's rapid economic growth and social and political transformation in the post-reform era. However, these law reforms are far from complete yet. Fundamental paradoxes exist in its current land and real estate property law system which is still in a transitory state. However, the further the reforms proceed, the closer the reforms will touch upon the core contradiction embedded in Chinese legal and political system: privatisation of land vs. public ownership system. Privatisation of land is required by the increasingly liberalised market economy – so called 'Socialist market economy with Chinese characteristics' in Chinese discourse. However, the public ownership system with public ownership of land as a pivot remains to be the CPC's ideological fundamentalism though it has been reinterpreted and readjusted constantly. Any attempt to essentially solve this problem needs political courage and even boldness as well as creative institutional arrangement, and creative phrasing 'with Chinese characteristics'. It is not an easy task for Chinese future law reforms to aim at privatisation of land. However, optimism should be attached to this vision judging from the consensus on the nature of the problem among stakeholders and the CPC's track record of flexibility in adjusting its ideologies and policies to fit the new socio, economic and political settings.

References

- Campanella, T. (2008). *The Concrete Dragon: China's Urban Revolution and What It Means for the World*. New York: Princeton Architectural Press.
- Ho, S., & Lin, G. (2003). Emerging Land Markets in Rural and Urban China: Policies and Practices. *The China Quarterly*, 681-707.
- Howlett, A., & Hong, L. (2007). The New Property Law in the People's Republic of China. *The Real Estate Finance Journal*(Fall), 1-3.
- Hsing, Y. (2006). Land and Territorial Politics in Urban China. *The China Quarterly*, 575-591.
- Hu, R. (2008). China's Urban Age. In C. Johnson, R. Hu & S. Abedin (Eds.). Sydney: Metropolis Congress 2008.
- Lee, J. (2000). From Welfare Housing to Home Ownership: The Dilemma of China's Housing Reform. *Housing Studies*, 15(1), 61-76.
- Li, L. H. (1999). *Urban Land Reform in China*. London: Macmillan Press.

- Stephens, M. (2010). Locating Chinese Urban Housing Policy in an International Context. *Urban Studies*(June), 1-18.
- Tang, B., Wong, S., & Liu, S. (2010). Institutions, Property Taxation and Local Government Finance in China. *Urban Studies*(July), 1-29.
- Wong, H., & Arkel, A. (2007). China's New Property Law: Practical Issues. *China Law & Practice*(June).
- Wu, F., Xu, J., & Yeh, A. (2007). *Urban Development in Post-reform China: State, Market, and Space*. London & New York: Routledge.
- Ye, J., Wu, D., & Wu, J. (2006). A Study on the Chinese Housing Policy during Social Transition: Practice and Development. *Housing Finance International*, 20(3), 50-58.
- Zhang, X. Q. (2000). Privatization and the Chinese Housing Model. *International Planning Studies*, 5(2), 191-204.