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# The Division of Labor and Cooperation between Market and Government in the Unified Urban and Rural Construction Land Market

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**Abstract** In the process of establishing the unified market of construction land between city and countryside, both of the market mechanism and the government mechanism are indispensable to the allocation of resources, but they are both powerless in some ways. This paper starts from the related theory of economics, and draws a conclusion that the unified market of construction land between urban countryside will be established unless the market mechanism and the government mechanism work collaboratively. Finally, the paper puts forward the recommendations for ensuring the coordination between market mechanism and government mechanism: reforming the agricultural land property rights system; reforming the existing land law system; establishing the modern land tax system; transforming the government functions.

**Key words** Unified urban and rural land market, Market mechanism, Government, Resource allocation

## 1 Introduction

Undoubtedly, through 30 years of rural reform in China, the household contract responsibility system has been fully established and farmers have been entitled to more property rights. The growing realization of farmers' property rights infuses new life into the development of agriculture, farmers and countryside. This is mainly due to production incentive and resource allocation efficiency improvement brought about by the market-oriented reforms. However, it should be noted that over the 30 years, although the related policies and legal systems have evolved in the direction towards strengthening the protection of agricultural land ownership and land marketization, it has not solved the adverse impact of urban-rural dual land system on farmers' land property rights as well as many resulting social conflicts. Since the Third Plenary Session of the 18th CCP proposed the establishment of a unified urban-rural construction land market, the academia and government decision-makers have been engaged in a fierce debate. There are three different perspectives about the allocation of land resources in rural areas. One view is that in the process of land resource allocation, the market can not play a decisive role, because the land factor market is different from other resource factor markets and the land use must go through classified management in accordance with the planning [1-2]. Some scholars believe that due to the strong externalities of land resources, even in developed market economies, the definition of land use and construction land use can not be determined by property owners themselves or free market negotiations between property owners [3]. Some scholars believe that the main reason for some prominent problems in the allocation of land resources in rural areas lies not in the inadequate marketization but in the lack of rigid constraints on the government planning and use control [4]. The second view is that the market is

a decisive institutional arrangement to efficiently allocate land resources. In this regard, some scholars maintain that China's land use is irrational, and the key lies in the lack of regulation of land resource allocation by price [5]. Some scholars hold that the spirit of market-oriented reform is to make rural land and urban land have equal access to the land market transactions [6]. The third view is the compromise between the above-mentioned two views, believing that during the establishment of a unified urban-rural construction land market, both market mechanism and government mechanism are indispensable resource allocation methods. Some scholars believe that in a unified construction land market, the market allocation of land resources has played a decisive role, but the government regulation of the land market is necessary and it is limited to the macro guidance and management to correct the possible deviation [7-8]. Some scholars think it is necessary to play the dual role of market and government in the regulation in the process of unifying land markets [9]. This paper believes that a unified construction land market should be a market combining effectiveness of market and orderliness of government plan. For the study of this market, there is a need to solve the problem of division of labor and cooperation between market and government.

## 2 The role and failure of market mechanism in unified urban and rural construction land market

**2.1 The role of market mechanism in land resource allocation** In market economy, all economic activities are directly or indirectly in market relations, and all the factors of production and labor products are allocated by the market mechanism. At present, the rapid development of urbanization and industrialization as well as food security poses a need to retain high-quality farmland, so the non-farm construction land is bound to become a scarce resource. In this sense, when a resource becomes an endogenous variable of economic development, the sustained economic development will begin to be bound by such resource. In the market economy, when a factor becomes scarce and the prices rise, it will

prompt people to save this factor from input-output costs and benefits. Therefore, in the establishment of a unified construction land market, the market mechanism can play an active role in effectively revealing and finding the market price of land in the form of tender, auction, etc., so that it can reflect the scarcity of land resources from economic aspects, and promote conservation and intensive use of land resources, thus contributing to the establishment of a unified urban and rural construction land market.

## 2.2 The failure of market mechanism in land resource allocation

Due to the public goods property of land, a major problem is the land use externality. In the market without taking into account the externality of land assets, land prices only reflect the economic value of agricultural land, and ignore the ecological environment, landscape function and food security values of land, making the prices significantly undervalued, leading to excessive agricultural land in the market, as shown in Fig. 1. In Fig. 1, curve  $AC$  represents the market demand curve in a unified construction land market;  $MPC$  represents the marginal private cost in a unified land market;  $MSC$  represents the marginal social cost. Based on profit maximization, the market only determines the transaction price and trading amount when it is at equilibrium according to the point of intersection ( $E_2$ ) between  $MPC$  and  $AC$ . In this case, the trading price of agricultural land determined by the market is  $P_2$ , and the trading amount of agricultural land is  $Q_2$ . However, if it is based on the goal of social welfare maximization, the price  $P_1$  and amount of unified urban and rural land market should be price and trading amount  $Q_1$  determined by the point of intersection ( $E_1$ ) between  $MPC$  and  $AC$ . At this point, the maximum total social welfare  $OCE_1$  is realized. Clearly, the transaction price of agricultural land ( $P_2$ ) purely determined by market mechanisms is significantly lower than the price ( $P_1$ ) formed in the social welfare maximization conditions. The low price of agricultural land will inevitably lead to land units' preferences for the excessive purchase and extensive use of agricultural land, thereby making land trading amount ( $Q_2$ ) in a unified land market much larger than land trading amount ( $Q_1$ ) under the goal of social welfare maximization. The land trading amount under pure market mechanism is  $Q_2 - Q_1$  larger than the land trading amount  $Q_2$  under the goal of social welfare maximization, thereby leading to a loss of efficiency in resource allocation on the land market. If we want to achieve the land trading amount under the goal of maximizing social welfare, there is a need to place the land price on the level of  $P_3$ . Obviously, the price under the market mechanism for the same land trading amount is  $P_2$ , far below  $P'_2$ , and the total loss of social welfare is  $E_1E_2E'_2$ . This shows that there is a huge efficiency loss in the purely market-driven construction of land market, which is caused by the market failure during the establishment of a unified urban and rural construction land market.

## 3 The role and failure of government in a unified land market

### 3.1 The role of government in a unified land market

The "decisive role" of market mechanism is also limited in the re-

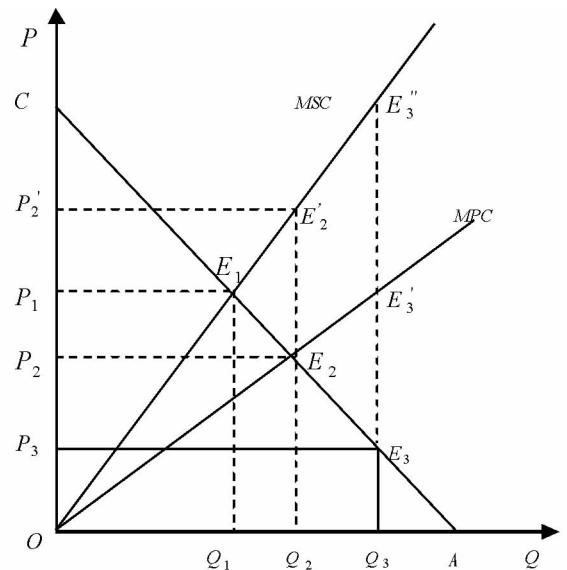


Fig. 1 The role and failure of market mechanism in unified urban and rural construction land market

source allocation. Economic theory suggests that a full market mechanism will generate Pareto optimality, and this spontaneous behavior does not require the intervention of any public policy. However, if the conditions required for the normal operation of the market mechanism can not be met, it often causes the reality to deviate from theory, resulting in market failure. There is a need to introduce the external force to correct the market failure, and it is government intervention. In a unified urban and rural construction land market, the government's intervention in the land market is necessary and effective. Government can use its functions of public administration, coordination and information provision to give play to its role in dominating the allocation of public agricultural land during the establishment of a unified market, which can effectively compensate for deficiencies of the market mechanism.

## 3.2 The failure of government in a unified land market

The efficiency loss of government regulation is reflected in three aspects. First, if government excessively intervenes in the land market, it is likely to forcibly push agricultural land into market in pursuit of political achievements, and in this case, the unequal trade will inevitably distort agricultural land prices. In Fig. 1, the government's mandatory behavior makes the agricultural land price decline from  $P_2$  to  $P_3$ , and agricultural land trading amount increase from  $Q_2$  to  $Q_3$ . However, in this case, the resource allocation efficiency of land market is lowest, and the total social welfare loss is  $E_1E_3E''_3$ , greater than the social welfare loss  $E_1E_2E'_3$  under pure market mechanisms. For the direct users of the land, the direct welfare losses also reach  $E_2E_3E'_3$ , and the land trading amount under government intervention is  $Q_3 - Q_1$  more than that under social welfare maximization, and even  $Q_3 - Q_2$  more than the amount of excessive land trading caused by market failure. Thus, compared with the pure market mechanism, the government-led agricultural land resource allocation is not improved and the effi-

ciency losses are larger. Second, the Chinese government's farmland protection policy will result in government failure. The prevention of excessive agricultural land into market is essentially a TR"quantity control", and there will be "rent" at this point (Fig. 2). In Fig. 2, the land management departments try to reduce the land use amount from  $Q_m$  to  $Q_e$ , however, there will be the rental rate of  $P_e - P_m$  in this case, and the entire amount of rent caused by the quantity control is about the shaded part in the figure. Finally, the inefficiency of government regulation will also come from the inequality brought by the land use planning to collective economic organizations. Under the current institutional arrangements of the land, the relevant government departments develop the land use plans before land use, resulting in inequality in land rights and interests between different collective economic organizations, so planning has become a resource monopolized by government and provided a rent-seeking opportunity.

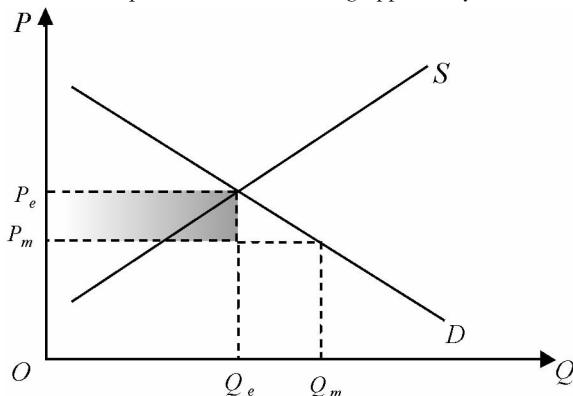


Fig. 2 The government inefficiency under land regulation

#### 4 Coordination between market mechanism and government regulation

In fact, whether it is the operation of land market led by market mechanism or government regulation, the complexity of market economy needs the effective coordination and cooperation between market mechanism and government. As put by Samuelson: "The market and government are two essential parts and the economy can not work without government or market economy." A unified construction land market allows the collective construction land use right to directly transfer into the market and continues to retain collective land ownership, which is a way of land resource allocation in line with the internal operating rules of economy, conducive to the total amount control of construction land and farmland protection and regulation of land market order. In the unified urban and rural construction land market, the main role of the government is to use appropriate institutional arrangements to limit the economic activities of various economic players involved in the agricultural land transaction, while the role of market mechanism lies in efficiently allocating the land resources under these restrictions. For the large-scale occupation of land having a significant impact on local economic development, the local governments and various stakeholders should raise the land prices to the social price level that can contain social and ecological value on the basis of

market prices. In the public rural land allocation, the government mechanism should play a leading role, and rely on the market mechanism and third-party mechanism to amend its failure. However, in determining the total amount control and social base price of non-farm construction land, it needs the coordination between government and market. Thus, only when the market mechanism and government regulation jointly play the role can the unified urban and rural construction land market be established and developed.

#### 5 The security mechanism for synergy of market mechanism and government regulation

##### 5.1 Reforming the agricultural land property rights system

The integration of urban and rural areas requires the free flow and reasonable configuration of rural land, which is inseparable from the support of land ownership system. Clear land property relations and clearly defined subject are the basic premise for the market to play a basic role in allocating resources. It is necessary to build the rural collective land ownership system that can adapt to marketization of property rights in accordance with the requirements of establishing unified urban and rural construction land market, and use laws to endow the farmers with rural land property rights consistent with urban land property rights.

**5.2 Reforming the existing land law system** Existing laws and regulations restrict the transfer of rural collective construction land, leading to unsound development of urban and rural land market and damage to the interests of farmers, thereby hindering the role of market mechanisms. It is necessary to amend the land use regulations in *Land Management Law* and introduce the regulations concerning the transfer of rural collective construction land to fully protect farmers' benefits from collective construction land transfer and ensure that farmers become the main beneficiary.

**5.3 Establishing the modern land tax system** It is necessary to establish sound modern land tax system and properly regulate land subject's interest and behavior relations. According to the principle of equality, there is a need to carry out the market transaction of land property rights and use standardized tax tool to adjust the market relations and earnings. The government should set up a certain percentage of land tax, property tax or some policy taxes to correct market failures, and provide adequate financial support for the local governments to protect the welfare of landless farmers.

**5.4 Transforming government functions** To make up for the failure of the market mechanism and ensure an orderly and healthy unified urban and rural construction land market, the government must change its functions, shift from the role of real estate operators to regulators, truly maintain and promote the public interest, and use comprehensive economic and legal means to effectively perform macro-control over unified urban and rural construction land market.

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and evaluation of citizenization level of new generation migrant workers, and there are also certain differences in relevant urban environment and policies and measures, thus it is unrealistic to design a universal evaluation indicator system for all policies and environment. In actual operation, it is feasible to take this indicator system as basis, combine specific environment and evaluation characteristics, and consider measurability of relevant indicators, and availability of relevant data, in order to flexibly increase or decrease indicators, and make proper adjustment of indicators weight.

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