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Asymmetric Property Rights in China's Economic Growth

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ABSTRACT

This paper highlights the difference between secure investor property rights and loosely defined individual property rights in China today. Globalization and fiscal decentralization have intensified this difference. On the one hand, in the presence of mobile foreign direct investments and under the arrangement of fiscal decentralization, local governments compete vigorously to offer various protections on the property rights of investors; on the other hand, local governments and developers attempt to acquire land at the lowest price possible by taking advantage of the loopholes inherent in the Chinese law. Secure investor property rights, together with weak protections on individuals' land property rights, are argued to be one of the major drivers of China's rapid economic growth. But the same factor can veer those individuals being deprived of land into violence and social unrest, which may undermine China's social stability and long-term sustainable growth.

ASYMMETRIC PROPERTY RIGHTS IN CHINA'S ECONOMIC GROWTH

Xiaobo Zhang[1]

I. INTRODUCTION

China's remarkable economic growth in recent decades, despite poorly-defined property rights and a relatively weak legal system, presents a puzzle to the general literature of law, finance and development. Clarke (1996) observes that, in China courts are rather weak and the judges not well trained. Allen, Qian and Qian (p. 9, 2002) quip that "there are currently 150,000 lawyers in China, roughly the same number of licensed attorneys as in the state of California." Apart from the low number of lawyers, China performs far below the average of the sample of countries in the paper by La Porta *et al.*, (1998) on creditor rights, shareholder protection, and corruption. How, then, has China achieved such notable economic growth?

In the economics literature, there is a broad consensus that *institutions* – which include *property rights* – are important to economic growth. Several theories and theoretical models have been proposed about the importance of property rights in economic growth. North (1990) argues that secure property rights are a necessary condition for economic development.

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Tests of the role and importance of property rights in economic growth vary from land investments in Ghana to regional economic growth in Russia.[2] Using cross-country data, the recent scholarship of La Porta, *et al*., (1998) shows that the origins of the legal system matter to economic growth and financial system. According to their analysis, the common-law system consistently outperforms the civil-law system in providing protection to minority shareholders and, hence, in facilitating dispersed ownership and economic growth. Dollar and Kraay (2000) claim that *property rights* and the *rule of law* are some of the most important aspects of good governance, and conclude that the effects of these two aspects on aiding poverty may be stronger than the effects of democracy. In the case of developing countries, Besley (1995) shows how secure property rights lead to better investment in land in Ghana. Jacoby, Li, and Rozelle (2002) empirically confirm the positive role of security of property rights on land investment using village data in China.

Most of these empirical studies emphasize the importance of state institutions. In developing and transition countries, a lack of well defined formal property rights and legal system is the norm rather than the exception. As shown powerfully by Dixit (2004), when formal institutions are lacking, the societies may attempt to evolve along the alternative existing institutions to protect their economic activities. Several case studies in the book edited by Rodrik (2003) underline that social arrangements can be equally

[2] See Aron (2000) for a general overview of the empirical work on the importance of institutions for economic growth, as well as a review of different ways to proxy for measures of institutional quality.

important as the state institutions, and that small institutional changes specific to the context can significantly affect growth.

The rapid growth of the town village enterprises (TVEs) in China in the 1980s and 1990s illustrates the above point. Although the TVEs did not have clearly defined property rights, the sector has achieved remarkable growth. To explain this puzzle, Li (1996) develops a model of how ambiguous property rights can lead to growth. Due to the lack of formal protections on property rights, the uncertainty related to engaging in business is very high. As a result, the transaction cost to write a complete contract is often prohibitive. In this context, the ambiguous property rights arrangement, which often involves local officials as shareholders of TVEs, may be a better option because it can help secure protections from the local government and reduce impediments to reform at the local level. In a word, high transaction costs provide an environment where ambiguous property rights can be *more* efficient under certain conditions than well-defined property rights. Che and Qian (1998), using township and village enterprises (TVEs) as example, further test the idea that in the absence of an impartial third party to enforce contracts, entrepreneurs may receive better protection by teaming up with local government than by operating as purely private enterprises which have to rely on the ill-functioning formal legal system.

The review indicates that growth can still take place amidst less clearly defined property rights because various social arrangements may provide an alternatively necessary protection of property rights to underpin economic activities. However, the

above arguments are not sufficient to explain why China has grown faster than many other societies with better-defined property rights. It seems that the nature of China's property rights arrangement has not been sufficiently uncovered to explain the observed growth patterns.

Apart from the property rights arguments, there has been a large body of literature examining the sources of economic growth in China, ranging from market-preserving federalism (Qian and Roland, 1998), the release of potentials of high quality human capital seeded in the planning era (Sen, 1999), the functioning informal finance market (Allen, Qian and Qian, 2002), realigning of comparative advantages in development strategy (Lin, 2003), increased input use (Young, 2003), to resource reallocation in the economic transition (Fan, Zhang and Robinson, 2003). As growth ultimately is cumulative of many factors, the above list is far from exhaustive. This paper extends the list by arguing that the divergence in degrees of protections of property rights between investors and individuals is another important contributing factor to China's rapid economic growth which has largely been under-researched in the literature and generally not well understood by Western observers of China's economy.

The next section reviews the literature on the regional property rights hypothesis in China. Section III highlights the divergence between investor property rights and individual property rights, which contributes to an understanding of the nature of the Chinese economic growth. Section IV stresses the negative consequence of this growth mode.

II. REGIONAL PROPERTY RIGHTS

"In viewing property rights, scholars have, along with Hobbes, referred to sovereigns; that is, they have focused on the national level" (p. 497, Bates, 2004). In China, the protections provided at the local level may matter more. Although China lacks clearly defined formal property rights and legal systems for their enforcement on the national level, some indigenous institutional arrangements can provide substitute functions. Granick (1990) makes clear that because of its hierarchical governance structure, property rights at the level of local government in China are rather secure. Luo (1995) was one of the first to attribute the origin of secure regional property rights to inter-judiciary competition. Qian and Roland (p. 1144, 1998) formalize the idea that fiscal decentralization together with mobile capital results in a hard budget constraint for local governments and prevents them from bailing out failing state-owned enterprises:

> *"Decentralization of fiscal authority to local governments together with mobility of nonstate capital across regions may be effective in hardening the budget constraints of enterprises under local governments' control. This is because competition among local governments in attracting capital to their region creates an externality which increases the opportunity cost of subsidizing inefficient enterprises, which in turn reduces the incentives for bailouts."*

Under fiscal decentralization, local governments are responsible for raising revenues to provide most local public goods and services. Because township and village enterprises are the major sources of local revenues, it is to the interest of local

governments to promote the growth of these enterprises. In this regard, their interests are closely attuned to each other. Although the ownership of township and village enterprises are not standard, they work well in an environment where the formal protection on private property rights was not in place (Qian, 2003).

Rodrik (2004) articulates the view that legal institutions themselves do not really matter for growth; it is what investors perceive about the safety of their property rights that really counts. He compares China and Russia, which have poor and good legal property rights, respectively, and finds that China has succeeded in business growth while Russia has not. Rodrik concludes this is due to the success of China's TVEs and their sharing of profits with local government, ensuring owners that the government will not take their land away despite a lack of property rights. It is along this line of analysis that the present paper makes a contribution, by exploring the differences between China's *de jure* and *de facto* property rights.

With China's opening up to the global market, foreign direct investment (FDI) has become one of the key drivers of economic growth (Zhang and Zhang, 2002). FDI will not only generate local revenues through tax and fees, but also is used as a key evaluation criterion for promoting government officials. Because of its high stake, local governments actively compete for FDI. This competition leads local governments to compete vigorously to create a business-friendly investment environment. Common practices include establishing special zones, granting favorable tax breaks, and allowing free use of land for a certain period of time.

In effect, although investors lack the formal protection of courts and other legal systems to secure their property rights, they benefit from the implicit *instrumental* protection provided by local governments within their jurisdiction. The order, stability and predictability that local governments grant are important ingredients of the *de facto* property rights system in China. In Coffee's words:

> *"The point here is not that law does not matter, but that partial functional substitutes for formal legal requirements are both feasible and spreading." (p. 77, Coffee, 2001).*

In sum, the regional property hypothesis underlines the importance of the *de facto* property rights as a functional substitute for weak formal property rights. The *de facto* property rights at least partly satisfy investors' demands by providing adequate protection. The regional property hypothesis suggests that it is possible for growth to take place under the current institutional arrangements. Despite a lack of well-defined *de jure* property rights and a weak legal system, China ranks the highest in terms of firms' confidence and satisfaction with regulatory interpretations and confidence in the judicial system (**Table 1**), providing preliminary evidence of a chasm between China's *de jure* and *de facto* institutional arrangements.

Yet it is not sufficient to explain why the current system of *de facto* property rights should perform better in China than the well functioning both *de jure* and *de facto* property rights that exist in many other countries. In other words, the hypothesis explains

the functional similarities between China's *de facto* property rights and the *de jure* property rights in other countries, showing that the system in China could work.

However, it does not explain why China performs so "well" compared to many other countries that have both formal legal and property rights systems. Certainly, there could be other reasons why China has performed better than many other developing countries as shown in the literature review in the introduction. This paper mainly looks at the question from the lenses of property rights.

Table 1. Firms' Responses

	Consistency of officials' interpretations of regulations[a]	**Confidence in the judiciary system[b]**
Brazil	34	60.4
China	**66.3**	**82.5**
India	35.9	70.6
Indonesia	44	59.2
Philippines	50.9	66.2

Source: World Bank Investment Climate Survey (2005).

Note: a) Percentage of firms that agree with the statement: "In general, government officials' interpretations of regulations affecting my establishment are consistent and predictable." b) Percentage of firms that agree with the statement: "I am confident that the judicial system will enforce my contractual and property rights in business disputes."

III. UNBALANCED INVESTOR AND INDIVIDUAL PROPERTY RIGHTS

To answer the above question, the cost of formal property rights and legal systems is first examined. Coase (1960) maintains that if property rights are well defined and the parties can negotiate at least cost, then economic agents can resolve conflicts through bargaining to achieve an efficient outcome. However, in reality, bargaining involves large costs. For example, in democratic countries, such as OECD and India, it often takes years for different interest groups to reach an agreement on land acquisition. Even for the purpose of applying to host the 2016 Olympic Games in Delhi, the *Times of India* observed that "it's a marathon task" for the government to acquire land (*Times of India*, November 2, 2004). The prolonged negotiation process impedes the speed of both public and business investment.

In a democratic country, various interest groups provide checks and balances to each other. Large decisions, like land procurement, go through a long procedure of negotiations, bargaining, and hearings involving the relevant interest groups. Olson (1982) argues that a democratic regime can be rather rigid to reforms because some interest groups can effectively block and prolong any significant changes, even when the changes may be good for the society as a whole. Acemoglu (2003) further shows how difficult it is to achieve efficient Coasian bargain solutions in the political economy domain due to lack of commitment. In a word, the functioning of well defined property rights entails significant costs.

An authoritarian regime may have certain advantages in prompting growth compared to a democratic system with well functioning property rights and rule of law when their decisions are in line with the public interest.[3] Under an authoritarian regime, it may be easier to get things done because of the reduced effort needed to balance conflicting interests between interest groups representing the underlying ownership structure. As a result, it is likely to create a more business-friendly investment environment. Not only are *de facto* property rights apparently strong in China, but the highly conducive investment climate helps explain how China has managed to grow so fast. Whereas in the 1950's India and China were nearly on par with each other, China's growth in recent years has far overtaken that of India. **Table 2** compares China with her peers and provides strong evidence of an exceptionally conducive investment climate in China.

The agricultural subsidies in India vividly illustrate this point. India provides free or subsidized electricity to farmers. Because it is free or subsidized, farmers tend to overuse it, contributing to an overstressed power system and frequent power outages in many rural areas. Although politicians are fully aware of the problem, few dare to propose a change in policy for fear of losing the popular support of farmers (Gulati and Narayanan, 2003). Power outages take a toll on the growth of Indian economy (*Economist*, 2005). The problem of inadequate infrastructure more than offsets Indian advantage in having a well-defined property rights system.

[3] However, when the authoritarian regime makes mistakes, sometimes the consequences can be disastrous, like the Great Famine in China. Without enough checks and balances, the likelihood of making unforgivable mistakes is higher than in democratic regimes, as Sen (1999) has argued.

Table 2. Business Indicators for Select Countries

		Brazil	**China**	India	Indonesia	Philippines
Starting up	Number of procedures	17	**12**	11	12	11
	Duration (days)	152	**41**	89	151	50
Registering property	Registering property - number of procedures	14	**3**	6	6	8
	Registering property - time (days)	42	**32**	67	33	33
Getting credit	Cost to create collateral (% of income per capita)	21.4	**0**	11.3	2.5	8.3

Source: World Bank Business Indicators (2005).

In developed countries, property right security covers both investors' and individuals' rights, though the literature typically does not explicitly distinguish between the two. In China, the degrees of security for the two types of property rights are not identical. As illustrated in the last section, China provides effective protection on capital investment in many regions in spite of the absence of well defined formal property rights and legal systems. However, the rights of individuals, including worker's rights and farmers' land property rights, are more loosely defined. This is a unique feature of China's property right systems. Yang Xiaokai (page 207, 1993) has commented:

"... local governments act as agents for local firms. They try their best to do whatever the local firms want them to do. On the one hand, this is a positive development because the local governments are strongly geared to assist development of local

firms instead of making troubles for them. On the other hand, of course, this generates rampant corruption."

According to Article 10 of the 1982 constitution, land in rural and suburban areas, except those which already have been defined as state ownership, belong to the collectives, while the state owns the land in cities. In other words, Chinese law prohibits private land ownership. Yet, individuals are allowed to possess the user right, which is from the ownership right, and long-term land use rights can be sold, rented, and used as collateral. The contract term of land use rights for housing, industrial, public, and commercial purposes can last up to 70, 50, 50, and 50 years, respectively. Nominally, the state cannot take the land away within the contract term except under special circumstances when the land is reclassified for public use.

There are at least three ambiguities in the law.[4] First, the definition of public interest is rather vague. For example, universities in general are considered public although they charge high tuition fees and operate like a commercial entity. In recent years, many universities have expanded their campuses.[5] By labeling the land in the interest of the pubic, the universities can obtain land use permits which allow them to acquire land from farmers at a much lower price than for commercial purposes.

[4] See Yu (2003) for an excellent discussion.
[5] See the case study on Langfang University Town in the **Appendix**.

Second, the law does not specify in detail how to compensate those being deprived of land. It loosely states that developers should grant a certain amount of compensation based on the years of actual use by the farmers in the land and the land development situation.

Third, the law does not stipulate the relationship between collectives and peasants for rural land. By and large, in rural areas the collectives refer to villages in which the village committee normally exercises executive power. Therefore, in reality, in the process of land procurement the local governments need only deal with the village committee. By bypassing farmers, the local governments and developers can significantly reduce the negotiation cost. Sometimes, they collude to extract as much rent as possible from farmers' land. To a large extent, farmers do not have much voice in the land procurement process. They are rarely informed of the purpose of land procurement or the terms of compensation until the arrangements are finalized and officially announced. Moreover, individuals usually must vacate their house or other property on the land under short notice. Otherwise, the state can use force to demolish the property by exercising the power of law.

In effect, under this arrangement, the negotiation costs for land procurement in China are much lower than in many other countries with well-defined property rights. Because of the ambiguities inherent in the current laws, developers and local governments can often first acquire a land use permit for developments in the public interest but then develop some of the land for commercial purposes. This creates a strong

incentive for local governments to grab land. This is why there has been a nationwide "development zone fever" and "real estate fever" since Mr. Deng called for more openness during his famous tour in the south in 1992. These so-called development zones can be easily labeled as in the "public interest" under the given political environment. The strong regional protection of investors' rights together with weak protection of individual rights lower the cost of doing business and fuel the economic growth.

Land is also an important source of local revenues. Because of the severe competition for mobile capital, local governments are restrained from over-taxing the industrial sector, particularly in regions receiving foreign direct investment (FDI). Consequently, local governments are forced to search for other sources of revenue. With increasing industrialization and urbanization, the demand for land drives up land values (Zhang, Mount, and Boisvert, 2004). Naturally, land becomes a target of revenue for local governments.

Figure 1 depicts the relationship between revenues from land and economic development level at the county level in 2000. The horizontal axis is the value of per capita gross agricultural and industrial output in logarithmic form, while the vertical axis represents per capita tax and other fees collected from land use. The figure reveals a clear positive correlation between land revenues and economic development. The more development there is in a region, the higher the land price and the more local government relies on land for local revenues.

In addition to generating local revenues, land is also used as an important instrument for local governments to acquire loans to finance infrastructure development (World Bank, 2005c). Once land is acquired, local governments and developers can then use the "state-owned" land as collateral to directly seek credit from state banks. Land banking is one of the major drivers of the rapid growth in infrastructure investment in China.

In summary, the local government retains a monopoly in deciding whether land development is in the public interest and how much farmers should be compensated. This section has highlighted a unique feature of the property rights systems in China, i.e., the inequitable distribution of security between investor and individual property rights. On the one hand, local governments provide strong protection for business investment, in particular in regions with a large FDI presence. On the other hand, local governments take advantage of the loopholes in the law to seize land from farmers without sufficient compensation. Weak individual rights also apply to workers. For example, migratory workers do not enjoy any social welfare once away from their original homes and they often have trouble collecting their pay.[6] With cheap labor and land, generous tax breaks, good infrastructure, and a predictable investment environment, it is not surprising that China attracts considerable FDI.

[6] See Luo and Kelly (2004) for a more vivid discussion. *The Washington Post* (November 27, 2004) reports an increasing number of walkouts by migratory workers.

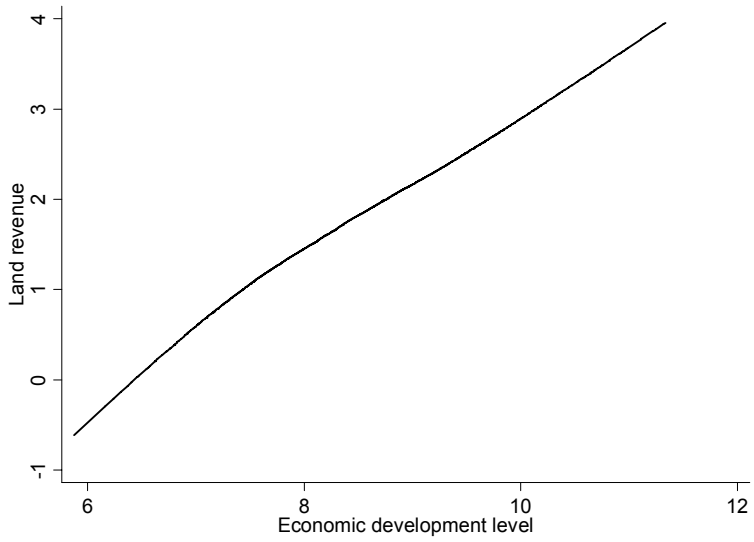

Figure 1: Economic Development and Land Revenue

Note: The horizontal axis represents per capita gross output value of agriculture and industry while the vertical axis stands for per capita revenue collected from land. Both variables are in the logarithmic form.

Source: China County Public Finance Statistical Yearbooks (China State Statistical Bureau).

IV. LAND RIGHTS: FUEL OF GROWTH AND VOLCANO OF SOCIAL CONFLICT

Industrial development requires more land. An easy access to land facilitates capital investment, which in turn prompts industrial growth. According to Fan, Zhang, and Robinson (2003), about one fourth of China's dramatic economic growth in recent decades stems from capital accumulation. **Table 3** presents per capita consumption and fixed asset investment from 1985 to 2003. The growth rate of fixed asset investment is more than five percentages higher than that of per capita consumption, indicating that the pace of fixed asset investment significantly exceeded that of per capita consumption.[7] Lin (2004) attributes China's deflation from 1998 to 2002 to excessive production capacity, which in turn is caused by the overwhelming expansion of fixed asset investment in relation to income growth. However, he does not offer further explanation as to why the growth of fixed asset investments surpasses consumption by so much.

Having shown the patterns of fixed asset investment, how it is financed can now be examined. Fierce regional competition encourages local governments to seek credit to develop their local economy. Prior to 1994, it was common practice for local governments to force banks in their jurisdiction to extend them credit, creating serious inflation in the early 1990s. Since 1994, however, the central government has reasserted its control over the banks and has separated bank branches from local governments. Yet, despite an initial slowing down, the growth rate of fixed asset investment has accelerated. According to the argument of Qian and Roland (1998), if the monetary authority is

[7] Zhong (2004) discusses in detail the causes of discrepancy between the consumption and investment data in the GDP statistics.

centralized, fiscal decentralization should not lead to credit expansion. If so, then why did fixed asset investment not slow down in China but instead took off after the separation of bank branches from local government in 1994?

Table 3. Per Capital Consumption and Fixed Asset Investment

Year	Per capita consumption (yuan)	Fixed asset investment (billion yuan)
1985	437	254
1986	485	312
1987	550	379
1988	693	475
1989	762	441
1990	803	452
1991	896	559
1992	1,070	808
1993	1,331	1,307
1994	1,746	1,704
1995	2,236	2,002
1996	2,641	2,291
1997	2,834	2,494
1998	2,972	2,841
1999	3,138	2,985
2000	3,397	3,292
2001	3,609	3,721
2002	3,818	4,350
2003	4,089	5,557
Annual growth rate (%)	13.23	18.70

Source: Per capita consumption and fixed asset investments are from *China Statistical Yearbook* 2004 (SSB).

The answer is related to land banking. Because of the ambiguous law on land use, local governments have some leeway in obtaining land use permits within their locality. Having received the land use permit, they can easily procure land from farmers at a low

price and turn the ownership from collectives to the state.[8] Using land banking practices, local governments could continue obtaining credit from state banks even after bank branches were separated from local governments in 1994. The arguments here do not invalidate Qian and Roland's insight on the role of an independent monetary system. The author's point is that the nominally centralized monetary system still has loopholes. Functionally speaking, the monetary system is not independent from the land grabs of local governments. The theory can also help explain why the current interest rate policy is not sufficient to cool down the demand for fixed asset investment.

Despite the benefits for growth, the current land fever also has negative consequences. According to Han (2004), 33.95 million *mu* (Chinese acre) of farmland were converted to urban and industrial development during 1987 – 2001, and about 34 million farmers lost land. The most recent figure released by the Ministry of Land Resource Management reports that China lost 38.01 million *mu* of farmland in 2003 alone. Han (2004) estimates that, on average, the compensation farmers received accounted for only about five to ten percent of the total market value. Clearly, a large fraction of the land rent is appropriated by local governments and developers.

Aside from paying low compensation for land acquisitions, local governments and developers often provoke additional outrage by using the land for commercial purposes in violation of the original public purpose intent. When facing unfair

[8] The first study on Langfang University Town in the **Appendix** provides a vivid example on the mechanism of land grabs. The article in *New York Times* (December 8, 2004) illustrates the tensions between farmers and local governments on land grabs.

compensation and broken promises, individuals can, in principle, file a lawsuit with the courts. But the local courts rarely take cases pertaining to local government. As a result, aggrieved individuals often end up having to appeal to the county level government, provincial party leadership, central government, or the media, – or whoever else would listen to them. This may be why the Ministry of Construction received three times as many complaints about land disputes in the first quarter of 2004 as in the same period of 2003. According to their statistics, by the end of June, 4,026 groups and 18,620 individuals had lodged petitions over allegedly illicit land confiscations, compared to 3,929 groups and 18,071 for the entire year of 2003. Another recent study (Yu, 2004) also shows that land disputes top the list of farmer petitions, accounting for 63.4% of total complaint letters.

A dramatic increase in the number of media reports on corruption within the banking and real estate sectors also highlights the seriousness of rent-seeking nationwide.[9] With globalization, it is much easier to move capital across borders. This

[9] Some of the recent reports on rent seeking activities in the banking and real estate sectors include illegal land grabs by local governments in Shanxi (*New York Times*, December 8, 2004) and in Fujiang and Guangdong Provinces (*Washington Post*, October 5, 2004); Yang Xiuzhu, vice chief of the construction department of Zhejiang Province who extracted bribes from property developers and disappeared (*Caijing*, July 23, 2003); Chen Kai, a local government official of Fuzhou, Fujian Province, who borrowed an estimated $50 million from six state banks and provided kickbacks of around 5 percent of the loans to the lending officers (*Washington Post*, December 17, 2003), Shanghai real estate tycoon; Zhou Zhengyi, who was implicated in an array of illegal loans coupled with default on statutory compensations for relocatees whose homes were improperly demolished for redevelopment projects (*Shanghai Daily*, September 6, 2003). Numerous Communist Party officials have also been ousted for accepting bribes involving property and real estate projects. They included former CCP general secretary of Guizhou province, Liu Fangren; former CCP general secretary of Hebei province, Cheng Weigao; former Minister of Land and Resources, Tian Fengshan, as well as a former vice mayor of Shenzhen Cty and the former mayor and a vice mayor of Shenyang City.

creates an opportunity for corrupted officials to hide their rents overseas, making it harder to fight corruption in the financial and land sectors.

Kanbur (2004) has warned that exchanges involving an asymmetric relationship between parties usually bring about negative externalities. In China's case, landgrabbing is likely to plant the seeds of hatred, which may be a vehicle for future social unrest. The clashes between local governments and farmers over land grabs may veer into violence and riots, particularly when coupled with other political and economic shocks.

In the short run, the weak protection of individual property rights may fuel economic growth because it reduces the transaction costs of acquiring land, a must for business investment. But in the long run, it may have profound and negative economic and social consequences. On the economic front, the landgrabbing fever may result in excess production capacity and deflation, as shown in Lin (2004). On the political side, it creates new powerful political interest groups which make future reforms more difficult. Peasants deprived of their land often do not have a viable alternative livelihood and are therefore more likely to organize and fight with the authorities. This increasing potential for conflict may jeopardize social stability, which has been a major asset for China's favorable investment environment.

V. CONCLUSIONS

As a county in transition, China faces many institutional constraints. The less defined land property rights are one of them. Decentralization and globalization have created strong regional competition for private capital in China, leading local governments to protect the properties of private investors. This protection has served as a substitute for the weak formal property rights and legal systems that still prevail in China, and has helped fuel rapid economic growth. Strong regional competition also means that local governments cannot easily tax private investment such as FDI, hence, they must look for other sources of local revenue. They must often also provide favorable tax breaks and even free land to investors. In order to raise revenue and provide land to investors, local governments have taken advantage of weaknesses in the existing land laws that allow local governments to procure land from private individuals (mostly farmers) for public purposes. Land is being taken at a fraction of its market value for supposed public purposes, and then being provided to private investors to promote local economic growth.

However, this behavior has a high cost to those individuals who lose their land and associated livelihoods. Already some 34 million farmers have lost land to such local government land taking. The legal system seems unable to resolve land taking conflicts when they arise, and affected farmers are increasingly organizing to protest and petition for change. Two possible outcomes seem likely. Either the central government enacts additional political reforms to grant farmers more secure property rights and to hold local governments more accountable for their actions, or, as more farmers join the army of the

landless, a time may come when a volcano of hatred toward governments and developers erupts, provoking riots and social unrest. Social disorders could prove disastrous for China's continued economic growth. On the positive side, social unrest may also serve as a pressure device for political reform. So is the role of rising income. In the long run, as a county gets rich, people tend to demand more secure protections of individual property rights as shown in the experience of Korea and Taiwan. Whether China can sustain its growth or not to a large extent depends upon its ability to respond to the emerging constraints with continuing institutional innovations. The key is for the government to be adaptive enough to navigate the bumpy road right ahead.

APPENDIX

A Case Study on Langfang University Town[10]

Langfang City belongs to Hebei Province but is located right between Beijing and Tianjin, the two largest cities in northern China. In order to take advantage of its geographical location and in response to the campaign "turning the high education into an industry" in the 1990s, Langfang Economic Development Zone decided to build the largest university town in China, with target enrollment numbers up to half a million students drawing from universities nationwide. In less than five years, the university town with 11,000 mu of land and 1.65 million square meters of construction area has been built up from scratch. Ironically, the university town includes not only classrooms, but also apartment buildings, villas, stores and even a golf course. The golf course is reported to be the largest one in Asia with 6,640 *mu* of land.

Initially, as a signature project of Langfang City, the university town project easily obtained a permit to acquire 5,233 *mu* of farmland for public use, but eventually it used 11,000 *mu* . With the nationwide zeal of turning universities into enterprises at that time, Langfang city expected to use the land as a bait to attract investment to build the university town. The university town paid farmers 55,000 yuan/mu according to the official price of land for public use. However, when the commercial apartment buildings, villas, and stores went for sale, the market value of the land was estimated at 300 thousand yuan/mu. The golf course was built for commercial purposes, with a

[10] The case study is mainly drawn from several reports at www.people.com.cn/GB/jaoyu/B216/32021/index.html.

membership fee ranging from 70,000 yuan to 270,000 yuan depending upon the course chosen.

The university town did not need to put much money in advance. All the bidding construction companies were required to self-finance for the first three years before receiving a payment by the fourth year. However, the actual enrollment turned out to be far worse than expected. By the end of 2003, the university town had to default its payments to the construction companies, which in turn defaulted their loans to the banks and put workers' wages in arrear. The university town registered a total amount of capital at 100 million yuan in 1998. By 2004, the university town has accumulated a debt of 2.2 billion yuan.

The crisis was not exposed to the media until one of the contractors took sleeping pills in an attempted suicide in protest of the arrear payment in front of managers of the university town and some leaders of the city several days before the 2004 Chinese New Year. His life was saved and his brave behavior helped his workers get some of the arrear wages so that they could go home to celebrate the New Year.

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