

Land markets, property led growth and urban economic development: lessons from China¹

Cluster 4: Institutions for urban land management and economic performance

Albert Cao and Ramin Keivani

Jcao@brookes.ac.uk and rkeivani@brookes.ac.uk

Oxford Brookes University

This paper examines the role of land markets in urban economic development from the perspective of property led urban development in China. First, however, we will provide a brief review of the international debate on property led urban development, particularly in the context of UK.

The origins of property led urban development can be traced to the inception of regional policy in the 1930s in the UK for building industrial estates in peripheral regions but were taken up by local authorities in early 1970s (Jones, 1996). From 1979 to early 1990s, however, property led development became central pillars of urban policy, regeneration and city economic development in the UK and USA (see for example, Healey et al, 1992; Jones 1996; Fainstein, 1995). The emphasis, though, shifted from direct subsidised public provision to subsidising direct private provision with the aim of engendering a more sustainable private market involvement without public subsidy in the long run. The underlying economic rationale for property-led urban policy was to resolve property market deficiencies/failures (in terms of lack of supply of appropriate infrastructure and property) to bolster private sector confidence for investing in inner city/peripheral projects (Jones, 1996). However, the reasons for its wide adoption can be seen in several macro-economic and political developments.

Firstly, economic globalisation and the shift to a post-Fordist flexible service based economy led to major readjustment in the employment structure of urban economies and therefore urban development (Pugh, 1996; Sassen, 1991; Cullingworth, Nadin, 1994). A process that began in the early 1970s with closures of heavy industries in places like Pittsburgh, Ruhr and Glasgow reached a climax by the early 1980s with mass closures of much of the remaining heavy industries as well as other 'leading' manufacturing sectors such as the car industry affecting a larger number of cities. It is sobering to note that between 1971 and 2003 the contribution of the manufacturing sector to London's economy reduced from 25% of total employment to about 6% (Harris, 2006). During the same time the share of business and financial services increased from 16% to 33%. As a result of such readjustment large areas of cities, particularly in previously industrial and water front port locations (that were feeding these industries) lay blighted and derelict and cities faced mass unemployment.

Secondly, the rise of neo-liberal governments in the UK and US from the late 1970s with pro-market ideologies had a significant impact on reorienting city planning towards a more flexible commercial development agenda (Atkinson, Moon, 1994; Tewdwr-Jones, 1994). This was reinforced through rationalisation of local public finances, particularly caps on local public spending and revenue raising capacity. City authorities, therefore, were increasingly constrained in their ability for utilising direct

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public work programmes or local public investment in housing or other infrastructure activities for redevelopment of blighted areas. In addition the central government put in place several commercially oriented initiatives including creation of quango or parastatal organisations, e.g., Urban Development Corporations, Enterprise Zones. The 1980 Local Government and Planning Act in UK, which established the necessary legal framework for the creation of UDCs gave them the same powers as New Town Corporations but with the condition of principally operating in central city locations and no requirement for developing strategies in conjunctions with local authorities (Wilks-Heeg, 1996). These quangos either took charge of development of specific neighbourhoods above that of the local authority (e.g., the London Docklands Corporation) or acted on a more national level as a facilitator for the private sector to regenerate land and buildings (e.g., English Partnerships) (Swyngedouw, et al, 2002; Jones, 1996; Wilks-Heeg, 1996).

Third, liberalisation and deregulation of global financial markets and opening up of national economies during the 1980s further accelerated the economic globalisation process leading to highly mobile investment capital and intense competition between cities for attracting such investment. A condition that Sassen (1991) argued has led to a hierarchy of world cities with different but complementary functions in supporting the global economy. This entails a continuously shifting economic scene as many cities concentrate on higher value knowledge based and corporate service functions while shedding the older and lower value added heavier manufacturing and industrial functions to alternative locations. At the same time successful global cities have become characterised more as junctions of flow for capital, goods, ideas and people than in their old role as major industrial centres (Castells, 1996).

Fourth the combination of these circumstances led to the emergence of entrepreneurial local governments whose main task was to increase the competitive position of their cities by creating favourable institutional and physical conditions for attracting national and international investment as the major resource for economic development. An important tool for this was private led physical redevelopment of rundown neighbourhoods or other major urban development projects including prestigious development projects and landmark buildings (Loftman and Nevin, 1996, Swyngedouw, et al, 2002). Often these were carried out with large scale central/local government subsidies, e.g., gap funding, grants, loans and loan guarantees, rent guarantees, capital tax allowance, land acquisition, fast track planning, local rates relief, etc (Jones, 1996) and involved major change of use of derelict industrial land in to commercial, retail or leisure districts as an anchor for further private investment and for revitalising economic activities. It is pertinent to note that in UK the share of funding for Urban Development Corporations rose from 20% of overall expenditure of the Department of the Environment on urban programmes in 1981 to 60% by 1991 (Wilks-Heeg, 1996). Crucially these were given as grants in aid rather than long term loans creating the possibility of the UDCs receiving large scale public subsidy (ibid).

The attraction of property-led development to local authorities is that this is the arena where they have most power in terms of land use control and acquisitions. Therefore, Jones (1996) argues “these powers used in a proactive way in combination with land banks and subsidies provide a local authority with its greatest potential for influencing local economic development. They also have the attraction of creating (short term) local jobs in the construction industry which concentrated in less skilled occupations

of the unemployed” (p798).

Focusing on the cases of London and New York, Faintsein (1995), for example, notes that by the beginning of 1980s the governing regimes of both cities were increasingly relying on real estate development as their primary strategy for stimulating commercial growth. This was based largely on "addressing the office and housing needs of the upper echelons of the financial and advanced service industries participating in world economic co-ordination."

By the beginning of 1990s, however, orthodox Thatcherite policies of 'over-reliance' on the private sector and private market led urban development in the UK was coming under attack from several quarters. On the economic development front there was indeed evidence of local job creation. Jones (1996) points to research that showed enterprise zones in Cambridge had created 36,000 net additional jobs albeit with heavy subsidies of about £12,200 per job. However, others argued that much of the economic growth was in fact benefiting the region rather than the city and where growth was occurring in cities it was largely benefiting elite groups rather than poorer local residents (Loftman and Nevin, 1996). On the housing and social front liberalisation of markets had merely served to increase inequalities in the distribution of wealth and increase the levels of social problems in poorer neighbourhoods (Davoudi, Healey, 1995; Wilks-Heeg, 2000). On the property front excessive procedural flexibility in interpretation of the planning system had led to massive over-building in the late 1980s leading to a severe slump in the property market (Healey, 1992). On the environmental front there was a conflict between Thatcherite market oriented policies and the new emphasis of the environmental movement which had now gained additional importance to the government as a result of the Rio Earth Summit. This required sustainable development and absorption of ecological conceptions of constraints into planning criteria while having some consideration for global impact, capacities and limits (Healey and Shaw, 1993).

Such criticisms led to the amendment of the Town and Country Planning Act 1990 that effectively put greater weight to the significance of Development Plans in the determination of planning applications, i.e., it reflected the then government's view that the planning system should be plan-led. This, however, did not mean an end to property led-urban development in the UK. Indeed it has remained an important aspect of policies on urban economic development. The difference, particularly since the 1997 labour government election, has been in the promotion of a more comprehensive, integrated and inclusive approach where at least attempts have been made to include social aspects and community development as well as economic and physical renewal considerations. This is particularly evident in funding and promoting more inclusive partnership arrangements to include community and voluntary sectors for delivery of urban policy at neighbourhood and city levels (Brindley, 2000; Carley, 2000; Wilks-Heeg, 2000). However, bringing community sector on board as contractual partners has its own complexities in terms of functions, conflict of interests and integrity of purpose where the lobbying and advocacy role of the community sector effectively becomes compromised.

Importantly, we should also note that even during the 1980s property led urban development was not the preserve of the private sector. In addition to facilitating private development local authorities were also directly leading on a range of major prestige projects primarily targeted at civic boosterism. Loftman and Nevin (1996) note that

between 1986-1992 Birmingham city council spent some £331 million on prestige business tourism and sport complexes including the International Convention Centre. Looking at 13 major urban development projects across Europe Swyngedouw et al (2002) argue that in fact during the 1990s property led development and its underlying neo-liberal urban development model, for increasing urban competitiveness through major development projects, was not only alive and kicking but had come to be adopted by local regional and national governments across Europe irrespective of their ideological stripes and colours.

Globalisation and property-led development in the cities of the South

Property-led development has in fact spread far beyond continental Europe or the US. It is now a major driving force for urban change in many cities of the South that are emerging as international business and industrial nodes for attracting much of the relocated lower value added industries due to their comparative advantage in lower labour costs and yet developed infrastructure and transport capacities for supporting decentralized production and access to the world markets. At the same time many of these cities are also rapidly developing their institutional, infrastructure and human resource capacities to maintain and improve their competitive position not only in respect of industrial FDI but to climb up the hierarchy and becoming international nodes of higher value added functions in their own right.

The prime examples are Singapore and Hong Kong respectively shifting their economic base in successive phases from the sweatshops of the 1960s to becoming international centres of the high tech and information economy and regional HQ and export service centres of Asia (Macleod and McGee, 1996; Ho and So, 1997; Sim et al., 2003). To this we must add the small oil rich cities of the Persian Gulf, particularly Dubai in UAE and Manama in Bahrain, that are shrewdly utilizing their immense wealth and strategic location in an effective development strategy for becoming regional centres of HQ functions, IT, tourism and corporate and financial services for the greater Middle East largely on the back of imported expertise and rapid infrastructure and property development (Keivani et al., 2003; Parsa and Keivani, 2002; Stanley, 2002).

In addition to the noted city-states many major metropolises of the South are also rapidly rising as international business and industrial centres. In other Asian countries we are witnessing the rapid globally induced transformation of a number of metropolises from Bangalore to Shanghai and others in between including Jakarta, Kuala Lumpur, Manila, Mumbai and Taipei, in to regional commercial, financial, IT and/or industrial hubs leading to major changes in the socio-economy, demography and land use of these cities and their surrounding region (Benjamin, 2000; Wu, 2000; Douglas, 2000; Jones, et al., 2000; Firman, 1998; Murshidi, 2000; Shatkin, 2000; Grant and Nijman, 2002 and Aranya, 2003).

A unifying characteristic of all these cities is their reliance on property-led development in office, commercial, industrial and housing both within central locations and well in to their periphery to raise their competitive position. Many of these developments are in fact led by central/federal governments that have also set up special quango and parastatal organisations for facilitating the redevelopment work (see Keivani, et al, 2007 for greater discussion of this process, particularly in the context of Bangalore).

A similar but more exaggerated process is evident in the context Chinese cities where local governments have emerged as powerful entrepreneurial developmental states in their own rights (Zhu, 2004) and are yet protected from consequences of loss making behaviour due to soft budget constraints (Xu and Yeh, 2005). In an effort to increase the competitive position and economic performance of their cities Chinese local governments have increasingly adopted urban boosterism and pro growth strategies while utilising their land resources and manipulating planning procedures for attracting developers to engender a frenzy of physical development and infrastructure projects (ibid; Wu, 2000, 1998). We address this issue at length in the remainder of this paper.

A brief note on methodology

The conceptual approach underpinning this paper draws on the institutional the analysis of property led urban development and evolution of property markets in China. This is based on a concept developed by Kiser and Ostrom (1982) and elaborated by Cao (2003) in the context of China. This analytical framework conducts institutional analysis at operational, collective-choice and constitutional levels. The operational level (market) is the bottom level where individuals and firms make business decisions. The collective-choice level is the intermediate level where officials make decisions, which are rules bounding business decisions in a market. Officials' decisions are enforceable against non-conforming individuals in the market. The constitutional level is the top level, where decisions made by politicians in turn set the institutional arrangements for the collective choice level. Thus these decisions form the rules that officials must obey when they formulate rules for the market. Decision-making at any level is affected by the existence of contextual factors that are independent of the institutional arrangements surrounding the particular market. Institutional arrangements and their impact on transaction costs, property rights and incentives are analysed at each level and crossing levels.

In terms of the fieldwork the paper conducts a detailed archival search on evolution of policy and related analysis on development of Chinese property markets and its application in urban development. In addition we have conducted an extensive interview and focus group programme in four main case study cities of Beijing, Shanghai, Guangzhou and Chongqing. The interviews were semi-structured in nature allowing for maximum objectivity yet encompassing the desired flexibility for iterative development and exploring issues in a deeper qualitative manner during the study period. The programme was designed to be comprehensive in its scope covering the full range of identified key actors. It therefore aimed to interview an average of 50 informed respondents in each city, with the target for Beijing being 60 given the city is the capital and that for Chongqing being 40 given it has a smaller property market with a shorter history. The interviewees are drawn from a range of actors including high ranking public officials at city, provincial (as in Guangdong) and national levels (as in Beijing), professional organisations and research and academic institutions and the private sector (major international, national and local developers, investors, banks and agents). Table 1 provides the detail of the interviewed respondents in China.

Table 1: The interview programme in China

Cities	Total number interviewed	Category			Typical length (hours)
		Private	Public	Legal	
Beijing	62	44	14	4	1.5
Shanghai	53	40	10	3	1.25
Guangzhou	50	39	9	2	1.5
Chongqing	39	28	8	3	1.5
Total	204	151	41	12	

The focus groups were a complementary tool to the interview programme to discuss emerging issues in greater detail and gain additional insights in to the operation of the property investment market. In total we conducted 5 focus groups in china. The main objective of this focus group was to gain an insight in to the current thinking and perceptions of international actors on property investment market in China and its inherent risks and opportunities.

Table 2: Focus Groups in China

Cities	Nature of participants	Number of participants	Date of meeting	Time (hours)
Beijing	Domestic & foreign	13	20 September 2005	2.5
Shanghai	Mainly domestic	12	13 September 2005	2.5
Shanghai	Mainly foreign	7	26 September 2005	2
Guangzhou	Domestic & foreign	16	16 September 2005	2.5
Chongqing	Domestic	18	23 September 2005	3
Total		73		

The preconditions to property led development in China

Examining property led development and its impact on city economies in China requires us to consider changes in urban governance and development of land markets that have created the pre conditions for the current emphasis on property led development.

The changing context of local governance

Urban governance refers to the process of formation and implementation of urban policy at the local level by government, non-governmental institutions and the civil society. These components in society wield power and authority, and influence and enact policies and decisions concerning public life, and economic and social development. Governance is thus a broader concept than government and involves interaction between these formal institution and those of civil society (GDRC, 2006).

In China, a system of socialist governance was developed from the need to organise the society for industrialisation from 1949, with the party-state, the work units² system and household registration as the pillars (Wu, 2002). Under the command economy, the actions of all units were strictly under orders from above. Cities were

² In China, a work unit could be a company, a government agency or a semi-governmental institution. All units were part of the state system.

stringently governed by plans featuring their positions within the hierarchy, and materials were allocated according to the levels of administrative power. In such a system, the scale of cities corresponded highly to their administrative ranks and administrative centres coincided highly with economic centres. Urban growth and locational decisions were entirely dependent on the behaviour of the government. The engine for urban growth was external and urban development was pushed by administrative power in a top-down manner.

As part of the reform process this system has been gradually transformed to a mixed system of urban governance with administrative and market forces interacting to determine urban growth and locational decisions. The breakthrough occurred in the 1980s in the industrialisation of the Pearl River Delta where foreign capital played a major role and in the Yangtze River Delta (excluding Shanghai) where township enterprises played the major role. The constitutional level adapted to this change with devolution, i.e. the delegation of power to administer local affairs to the local governments. However, the local governments at collective-choice level were subjected to different magnitudes of market forces and thus reacted to the devolution differently, with different operational rules for non-governmental elements to participate in local governance. Depending on the nature of the operational rules, a continuum of models has emerged with Beijing at the administrative end and some small-to-medium size towns and cities in both Deltas at the market end³.

Through trial and error, the state has re-established its power in urban governance. Wu (2002) argues that the major change in urban governance in the reform era is a shift from a system based on the party-state, the work units and household registration to one led by the local state. The major cause underlying the change is the vacuum in governance created by the economic reform, with local governments acquiring most of the power on local issues, including planning, infrastructure and attracting inward investment. The outcome of change is different from the formation of a new civil society. Rather, the state re-establishes its contact with many spontaneous changes outside the state, i.e. foreign investment, migrant workers and laid-off workers, by re-defining urban communities on a territorial basis in an attempt to maintain a governable society and provide services to the newly formed marginal groups. The all-important party-state system is reconsolidated through the establishment of the link between workplace-based and community-based party branches⁴. Thus, the state has been able to take advantage of the market to develop more localised governance that expands its capacity to address major challenges in terms of economic growth, job creation and urbanisation.

The dominance of the local state in urban governance has important ramifications to the future of Chinese cities. One ramification is on the formulation and implementation of a city's master plan. Wei (2005) argues that Chinese city Master Plans are "quickly outdated and unable to function effectively to guide the development of cities". The current planning regime has created a situation where "each time a new local leadership emerges, new projects and initiatives are launched,

³ An example of a town developed fully by the market is Longgang, an administrative town in Chuangnan County, Wenzhou City, Zhejiang Province. It was established in 1984, and fully built by the farmers responding to market forces. Its population grew from 7,000 in 1984 to 280,000 in 2005. At present it is the economic centre of Chuangnan County, a model town in the Country, and is referred to as China Printing Town and China Gift Town.

⁴ Party branches are being created in some foreign firms operating in China.

often without careful planning, research and project evaluation, and beyond the scope of existing master plans” (Wei, 2005). This is the result of a constitutional level rule that top local officers are assessed by their ability to promote local economic growth and are given the power to do so. Local top officials, in turn, sustain the operational rule that allow the local planning authorities to adapt the urban plan to suit their initiatives. Indeed as Xu and Yeh (2005) argue entrenched ‘socialist’ institutions of rule by party decree and powerful political elites still persists in Chinese society. As such the Mayor has great discretion and is the ultimate authority in urban development and planning including changes and amendments to master plans and final decision on major projects. Similarly other key local official are appointed cadres that are similarly evaluated based on visible outputs. The operation of the administrative hierarchy, therefore, is such that it is in the interest of all local public actors to show high growth in both economic and physical development to advance their career. The emphasis, therefore, is on projecting continuous physical and economic growth to increase GDP during their term in office with out regard to master plans.

A related issue here is that of soft budget constraints of the local governments. Essentially this means that poor performance and investment failures of local government are not a matter of life and death as long as they lead to boosting local GDP figures at least in the short term (Xu and Yeh, 2005). This situation is created by a number of factors. Firstly, local authorities can often postpone or delay costs of their development activities (E.g., compensation to land owners, provision of infrastructure) to the terms of future officials rather than during their own tenure. Secondly, through formation of parastatal organisations such as local International Trust and Investment Corporations (ITIC) and UDCs they have been able to raise funds from local and global financiers. This allows them to overcome statutory limitations on their own fiscal activities that prevents loans from banks or selling bonds. However, unlike most other countries these parastatal organisations are under the control of the local government and can be used to incur debts that the local government is effectively spending but is not officially accountable for while behind the scenes various mechanisms including central government channels are utilised to bail them out. Third commercialised local banks are often too willing to refinance failed projects or provide loans for projects supported by the local governments. This has led to a situation where almost 30% of non-performing loans of Chinese banks are due to failed development projects supported by local governments. At the end, however, this situation is only allowed to continue due to the acquiescence of the central government that in some form inevitably bails out the banks or the local government as in providing US \$45 billion in 2004 to bail out the Bank of China and the Construction Bank (Xu and Yeh, 2005).

The combination of factors noted has contributed to the breathtaking speed of urban and economic development in many cities. It has, however, also caused substantial waste of resources if the initiatives turn out to be impractical and if a conflict exists with the previous urban plan. An example of the consequences of the rapid change in urban plan is that a nearly finished 18 storey residential building in Heifei, Capital of Anhui Province, had to be blown up to make way for a new road⁵ (People, 2005).

⁵ This incident occurred on 10 December, 2005, in Hefei, the capital city of Anhui Province. The residential building, No 1 building at Vienna Garden at Huangshan Road, had a gross external area of 18,284 square meters. It is obvious that the plan for the new road was made very recently after the residential project, Vienna Garden, was

More over as we shall see in the following sections the emergence of the all powerful local government and local officials in China has not only led to ‘isolated’ planning disasters due to arbitrary decisions but coupled with reforms and development of land market and a weak planning environment it is the main cause of adoption of an exaggerated property led development model primarily aimed at engendering rapid urban economic growth.

The strongest beneficiaries of devolution of power from central government are undoubtedly provincial and municipal (metropolitan) levels of government. However, devolution is not limited to these levels but also goes through to the district levels in each city leading to major inter-district competition. In fact the district governments need approval from the municipal level to proceed with their development plans. However, they have strong direct representation and lobbying power at the municipal level and are able to push their individual district level interests in council decisions. This is positive in terms of nurturing local initiatives and supporting local responses for urban and local economic development. Nevertheless the downside is that the governance structure necessitates political compromises that can lead to excessive intra-city competition leading to duplication and wastage of resources.

Table 3: The five layers of government in China

Levels of government	Government organisations (authority: high to low)
Central	State Council, commissions, ministries, bureaus
Provincial/municipal	Provincial governments, commissions, departments, bureaus
Municipal	Municipal governments, bureaus
County/District	County governments, bureaus
Township	Township governments

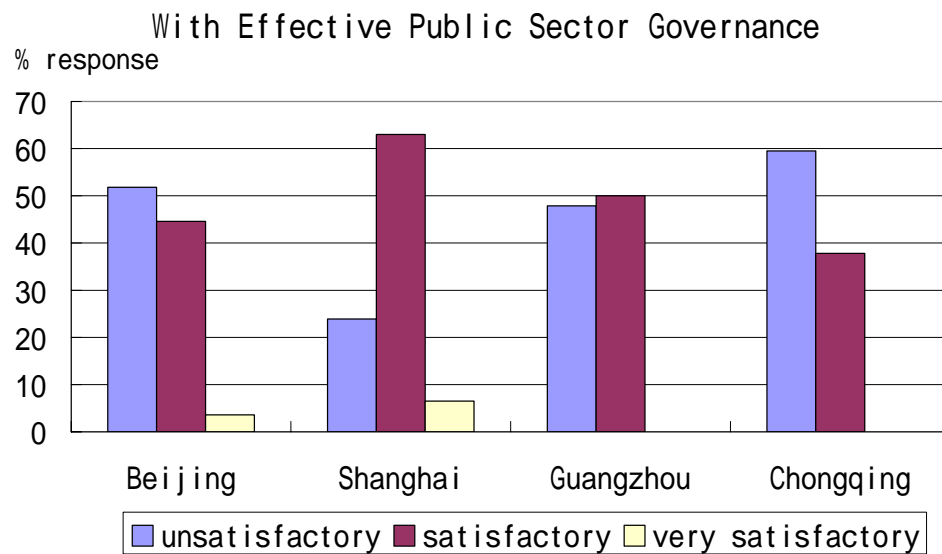
This is highlighted in our fieldwork results where about half of the respondents in Beijing, Guangzhou and Chongqing are not satisfied with public sector governance, mainly the operation of the government (Figure 1). Some of the problems were identified as too much administrative intervention, inadequate rule of law, in-fighting, drive to quick success, deception and too much focus on GDP. Shanghai again is perceived most favourably, but still 23.9% of respondents are dissatisfied. Several respondents in Shanghai pointed out that districts competed with each other in development projects, resulting in a decentralised planning process and a muddled pattern of real estate development. Using the example of Xintiandi, which is an innovative urban conservation project with the creation of an artificial lake, one respondent described what this competition is like: “when you come back two years later Shanghai will have 8 more lakes, because the city has nine urban districts.”

In Beijing, a number of respondents insisted that Beijing’s administrative reform lagged behind economic reforms and resulted in unnecessary market intervention from time to time. A respondent argued that “the existence of many central government agencies has affected the governing ability of the Beijing Municipal Government, leading to inconsistencies in policies and their implementation”. In Guangzhou, a few respondents complained that the municipal government put too much emphasis on the speed of development instead of quality: “Deadlines are often set that developers have to compromise on quality”. Another respondent in Chongqing

given go-ahead.

indicated that “Chongqing is in the process of growth and development and that the perceptions, policy choices and behaviour of officials need to improve”.

Figure 1: Effectiveness of public sector governance



Development of the land market

Definition The land market in China consists of the government sale of new leasehold interests on state-owned land, referred to as the granting of Land Use Rights (LURs) in land and the transaction of existing leasehold interests on state-owned land, referred to as Granted Land Use Rights (GLURs). After nationalisation and collectivisation of land in the 1950s, two forms of public land ownership, i.e. state-ownership of all urban land and some rural land and collective ownership of most rural land, were established and legalised by the 1982 Constitution⁶. In April 1988 the 1982 Constitution was amended to legalise “trading of land titles according to law”. The “law” was first enacted as Decree 55 (State Council, 1990a) and later as the 1994 Urban Real Estate Administration Law. Since 1990 only LURs and GLURs have been allowed to be traded, which effectively confine the land market to the urban area.

The maximum terms of LURs, first specified by Decree 55, are 70 years for residential use, 40 years for commercial use, 50 years for mixed use and all other uses. According to Decree 55 (State Council, 1990a), the terms of GLURs are those of the original LURs minus the number of years the GLURs have been in existence. For example, the remaining term of a residential GLUR, granted 10 years ago at a term of 70 years, is 60 years.

Stages of development The development of the land market can be broken down in to three stages. The first stage witnessed the application of the pay-for-use principle to land and the re-discovery of the value of land. Several considerations were applied to this principle. First, due to lack of capital, the government allowed land to be priced

⁶ The People’s Republic of China, since its foundation in 1949, has promulgated four versions of the Constitution. The 1982 version, with several amendments, is currently in use.

as input into joint ventures from 1979. Second, domestic firms were required to pay a land use fee, later called a land use tax, for using land. Third, leasehold interests in land were sold in trials to some developers and land users, both domestic and foreign. However, no legal titles were available and the sites bought rarely changed hands.

Table 4: The three stages of land market development in China

	Main developments	Time scale
Stage 1	Some payment required for the use of land; no legalised market for land exchange	1979-1990
Stage 2	Open and secret markets for LURs; Secret conversion of allocated land to GLURs; open market for GLURs;	1990-2001
Stage 3	Open market for LURs; End of conversion of allocated land to GLURs	2002 onwards

The second stage saw the gradual transition of land pricing at the discretion of government to the open market. The sale of LURs started with the enactment of Decrees 55 and 56 from 1990 (State Council, 1990a; 1990b). The rising market at the time enabled huge profits to be made by selling GLURs in the open market. Similarly market oriented property development also generated huge profits. The demand for LURs and GLURs, therefore, was very high.

To ensure fair prices were paid for the land, the national land administrator, the State Land Administration Bureau, developed a set of benchmark land prices to guide the sale of LURs. However in reality the second stage witnessed major infringement of the rules. LUR transfers largely lacked transparency and were offered at heavily discounted prices particularly for state developers and local and foreign firms with state connections. This opened the route for corrupt practices and profiteering by local officials and many state and private developers.

For example, an ordinary staff member in a Guangzhou official Real Estate Trading Centre was found to carry out 10 valuations of LURs in favour of developers from 1995 to 2003, and was paid nearly \$100,000 in return (MDE, 2006). Another example was the intervention by a Deputy Mayor of Shenzhen in 1997 to reduce the price of a piece of LUR by \$15 million to favour his daughter's real estate firm (PXOL, 2002). The mayor was later prosecuted for his crime in 2001.

In addition Some powerful state and well-connected private developers could delay the payment of already discounted land prices for a maximum of ten years. For example, a survey covering 80 housing projects by 31 development companies, conducted by the Guangzhou Municipal Land and Building Administration Bureau in 2004, found that 46 projects, started from 1993 to 1998, had outstanding LURs payments (EID, 2004).

The story for the industrial land market is different. To attract inward investment, local governments set up thousands of development zones (mainly industrial use, but also with other uses). Out-of-town development zones grew from 117 in 1991 to 1,951 in 1992 (SLAB, 1995). By 1996, there were 4,210 development zones in the country and only 1,128 zones were set up legally in terms of having approval from either provincial governments or the State Council. These zones had a total planned area of 1,235,681 hectares, total occupied area of 232,244 hectares and total built up

area of 185,224 hectares. In Shanghai alone, 207 development zones were established but only 11 were approved legally (Yin, 1999). With such ample supply, local governments had to compete with each other, with heavy discounts of land prices against the benchmark prices. As a result, the market for industrial land was distorted and prices and rents were basically controlled by local governments.

The transition of the LUR sale market from government to open market pricing was given a major boost in 1997 when the municipal government of Guangzhou decided to sell all LURs in the open market. Guangzhou was the first major city to embrace a full open land market, and the much bigger revenues generated from LURs sales helped the city to invest heavily into infrastructure and city image building projects. The huge benefits of open land market to local governments, as demonstrated in Guangzhou, encouraged more local governments to follow suit, and eventually lead to a national institutional change in land acquisition, which was referred to as the 'second land revolution'.

The third stage started with three major institutional changes in the way local governments administer land sale. Firstly, Decree 11 enacted in May 2002 banned all forms of secret LUR sales, advocating instead public tender, auction or listing (MLR, 2002). Secondly they have audited the state of industrial parks revoking the licence of 4,735 planned states or roughly two thirds of all estates (MLR, 2003). Third the government required developers to complete purchase of options on public land allocation and their previously agreed deals by 31 August 2004 (MLR, 2004). Any plots without proper payment on that day could be repossessed by the Ministry of Land and Resources (MLR) without compensation.

As a result the market for LURs has become open and non-discriminating to land buyers without connection to the government. This has made the operations of non-local developers easier and greatly facilitates the national operations of the country's biggest developers.

Market indicators

The annual changes of land prices according to use types are shown in Fig 2. It can be seen that the prices of residential land have the biggest changes, reflecting that the demand for housing has been strong and sustained in the last seven years. The prices of industrial land have started to change more rapidly since 2003, which is due to tighter control on industrial land sale and the fact that industrial land supply in major cities like Shanghai has been nearly depleted.

Land sale data from the former State Land Administration Bureau (SALB) and MLR (Fig 3) provide an illustration of the expansion of the LUR market and the receipts by the local government's coffer. A large proportion of land sale revenues has been used to fuel the infrastructural development boom. In particular, the steep rise in revenues since 2002 characterises the gradual formation of open market in LUR disposal throughout the country in stage 3 of land market development, with more and more sites being sold by competitive open bidding. Fig 4 shows that the share of open market LUR sale in area and revenue of total LUR sale actually went down in 2001 when the market upturn encouraged demand for LURs but the means of disposal went

backwards towards secret pricing deals. This trend was checked by Decree 11, which required open market disposal of LUR. It is also obvious from Fig 4 that as more LURs are sold in the open market, the local governments could earn more income from land sale to finance the current expansion of urban infrastructure at a greater scale.

One should note of course that land sales provide only one avenue for funding infrastructure development in Chinese cities. Local governments gradually have switched their capital investment from state enterprises to infrastructure and to fund urban infrastructure projects from budgetary and extra-budgetary allocations (Zhu, 2004), foreign loans with state sponsorship, loans from state policy lenders like China Development Bank⁷, funds from state bonds, and most of all government sponsored loans from state commercial banks that carry the highest load for infrastructure financing (Yusef and Nabeshima, 2006). Heavy investment in urban infrastructure since the 1990s has contributed to both economic growth and rapid improvement in urban infrastructure in many major cities. At present enthusiasm in infrastructure development shows no sign of abating. An indicator of the rush towards more and better urban infrastructure is that 25 cities in China have made plans to build 5,000 kilometres⁸ of mass transit railway systems⁹. Seven cities already have mass transit railways operating and 3 more cities¹⁰ are to start building their system in 2006. Dollar et al (2003) find that the 23 Chinese cities they studied have built urban infrastructure to a point where shortages no longer constrain the performance of firms.

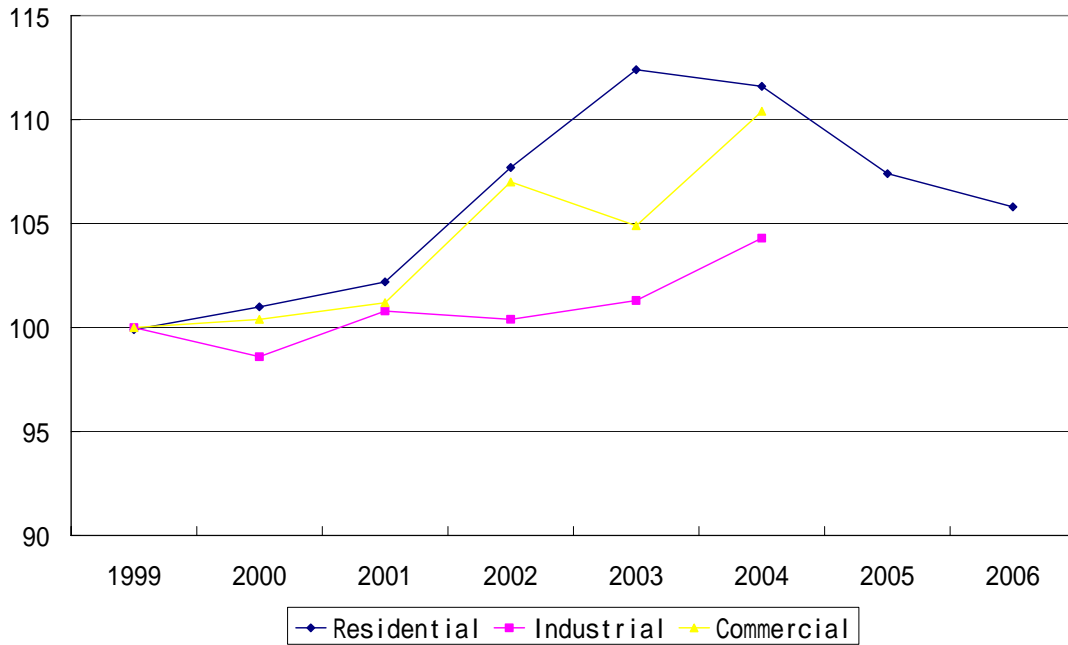
Figure 2: Annual growth of land prices (different uses) by REPI 35/70

⁷ For example, the China Development Bank is very active in supporting urban infrastructure projects, with balance of loans standing at RMB226.9 billion (USD28.3 billion) at the end of 2003 (Chen, 2003).

⁸ This figure was released by the Urban Mass Transit Railway Investment and Financing Models Seminar held in Shenzhen in December 2005. However, the figures are by no way exhaustive.

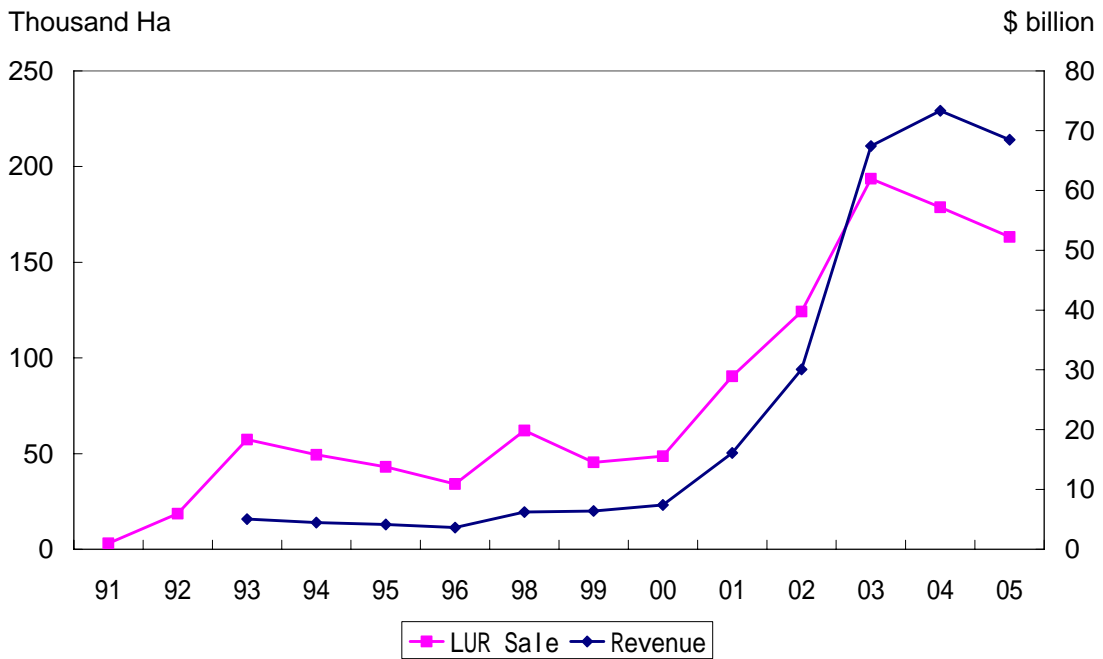
⁹ In China, constructing a mass transit railway system requires the approval of the central government, the State Council. Some cities, like Qingdao, have been applying for approval over a decade without success. It is estimated that only a small percentage will actually be built in the next five years.

¹⁰ Chengdu, Wuhan and Shenyang.



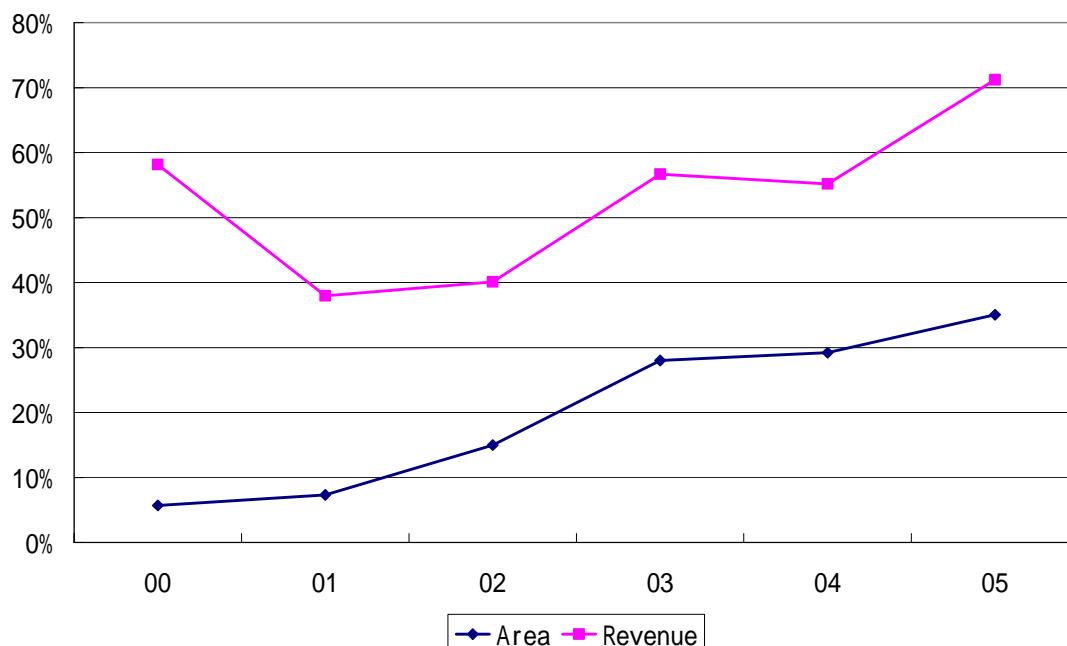
Source: CNBS (www.stats.gov.cn), various years
 Note: 2006 data representing first quarter

Figure 3: Total land sale in area and receipts in China



Source: SALB and MLR, various years

Figure 4: Share of open market LUR sale in area and revenue of total LUR sale



Source: SALB and MLR, various years

Property led development

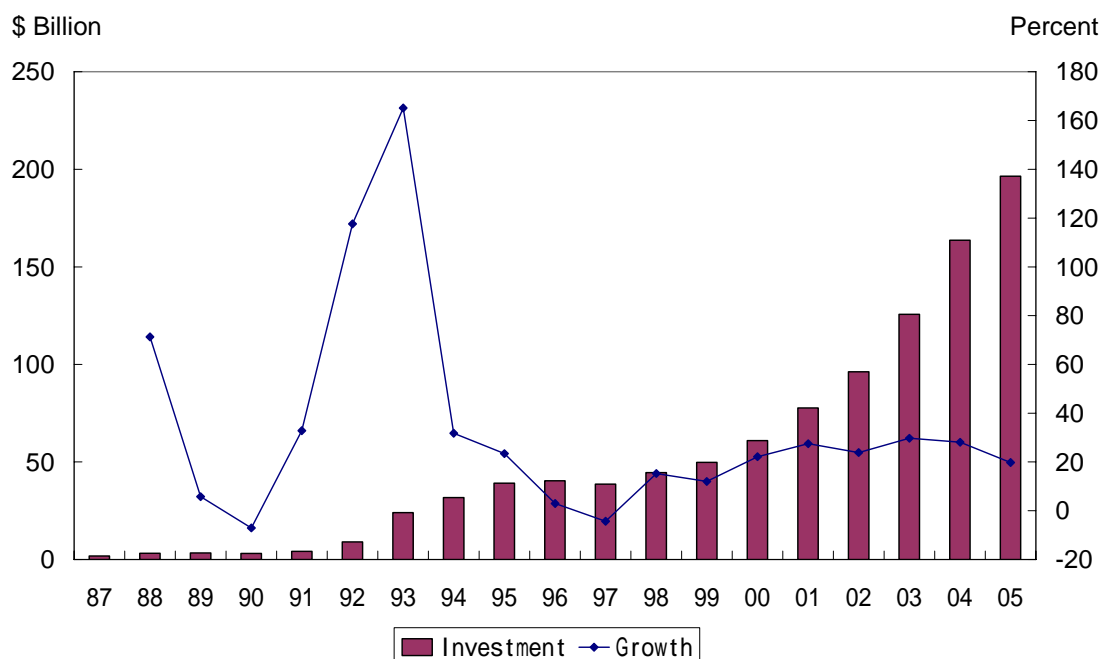
The Chinese government’s policies towards the property industry have been primarily based on facilitating rapid economic growth. In the “Decision on Speeding Up the Development of Tertiary Industry”, enacted on 16 June 1992 by the Central Committee of the Communist Party and the State Council (State Council, 1992), real estate was identified as an industry that required only a little investment, was quick to produce results, created many jobs and had close links to economic growth and peoples’ livelihood, and thus its development should be speeded up.

Following an initial incipient phase of market emergence with little market activity between 1983-1990 the real estate sector quickly became a driver of the economic growth from 1991 onwards. This is illustrated in table 5. The second stage of property market development saw a huge expansion of market activities in housing and office sectors, and a resumption of market activities in retail and industrial sectors. It featured heavy foreign investment, mainly from Hong Kong but also Taiwan and Southeast Asia, main economic regions, and front page reporting by newspapers throughout the country. The regions involved were firstly the Pearl River Delta, Hainan Province, and Beihai City in Guangxi Province. Later, the property market boomed in the Yangtze River Delta with Shanghai at its core, Beijing and other major cities throughout the country.

Table 5: The three stages in China’s property market development

	Upturn	Downturn
Stage 1	1983-1988	1989-1990
Stage 2	1991-1995	1996-1997
Stage 3	1998-	

Figure 5: Investment in real estate development



Sources: CNBS, various years

The second stage has a number of characteristics that are different from the first one. First, there was substantial foreign investment from Hong Kong Chinese involved in the property market, which was actually responsible for starting the upturn in the Pearl River Delta and important in the property market in major cities like Beijing, Shanghai and Guangzhou. Second, much of the nation's funds, designated for other uses, found their way into market-oriented property development, resulting in year-on-year growth rates of 117% and 165% in investment in property development in 1992 and 1993 (Fig 5). The capital flight from other sectors to property development resulted in drains of funds for other projects and imposed high risk on the country's financial system. Third, some local governments orchestrated city-wide and even province-wide speculative property development, with stark consequences. For example, a 54 storey office building was planned and foundation laid down in 1994 in the Guangzhou's Haizhu District, which was far away from the city's business district. Lack of demand and financing delayed the project for 10 years, leaving a ten story high concrete frame, an eyesore in the city. In 2004, the building, now renamed Hong Kong and Macao Jiangnan Centre, was eventually restructured financially and building work resumed in 2005. However, the location, although improved by the new underground railway which has a station across the road, is still marginal and thus its rental value is unlikely to be very promising. Similarly we can note the example of Zhongcheng Square in Guangzhou's CBD. This is a massive project boasting a total gross floor area (GFA) of 232,766 square metres. It has, however, taken 15 years since inception and is only now scheduled to be completed by the end of 2007. The project has been dogged by lack of sufficient demand and financing by developers forcing change of hand on two occasions to bring it to fruition. Another example is Beihai City in Guangxi Province (see Box 1), Huizhou City in Guangdong and the whole of Hainan Province that were once economic super stars in the country, having dynamic property markets in 1992-1993, but are now burdened with large numbers of failed projects, some of which still remain unfinished today. Shanghai, Guangzhou and

Chongqing also had many failed projects, with some remaining as eyesores for a decade. Fourth, despite collapsing in some areas the property market spread out to all major cities in the country, forming a national property market and paving the way for a national property boom in stage three.

Box 1: Local government directed land speculation in Beihai

Beihai, one of the two port cities in the relatively poor Guangxi Province in Southern China, was a beautiful city inhabited by 200,000 people. It had remained unknown to most people in China until 1992, when its land market became almost as hot as the Shanghai Stock Exchange. Its population soared to over half a million by mid 1993.

Inspired by the land market in the Pearl River Delta, the Municipal Government of Beihai pursued a low land cost strategy to woo investors and sold LUR indiscriminately. The average price for LUR in the primary land market was only RMB375,000 (US\$68,000) per hectare¹¹. From August 1992 to early 1993, 80 square kilometre of development land, which was 7 times of the size of the existing built area, was sold as a result. The income for the government was only RMB3.09 billion (\$560 million), far from enough to provide infrastructure for the land sold. Furthermore, the government substantially reduced the transaction costs of land transfers, and created the most active secondary land market in the country, with prices rising 10 to 30 times in ten months.

Large amount of investment went in from all over the country, with the number of property development firms increasing from 6 in early 1992 to 1056 in early 1993. However, the macro economic control started in July 1993 forced developers to withdraw capital¹² from the market, resulting in GLUR prices to fall by 50% in three months (Xu, 1993). The short-lived boom eventually left behind 136 unfinished projects, 1.11 million square metres of vacant buildings and over 2,100 hectares of derelict land (Xinhua, 2005).

With a central government policy to exempt Business Tax and Stamp Duty at property transfer in the city, effective from 1st January 2003 to 31st December 2006, Beihai's campaign to save the unfinished projects achieved remarkable success by June 2005, with construction resuming for 92% of the unfinished projects.

The third stage (Table 5) started when the 'final phase' of housing reform commenced in July 1998 (State Council, 1998). Central government measures included promoting mortgage finance on a large scale, and ending welfare housing allocation. In addition Shanghai Metropolitan Government took the lead to drop many conditions on re-sale of privatised public housing, enabling many families to sell their acquired public housing and use the receipts to finance purchase of better quality commodity housing in the market. This policy has rejuvenated the largest component of the real estate sector, the housing industry. From then on, the real estate sector has officially become a key driver of economic growth, and the property industry has been argued to be a pillar industry in a modern economy. Thus the above policy, designed to speed up

¹¹ In 1992 the exchange rate between RMB and the US Dollar was 5.5149 to 1.

¹² Money for land purchase and development projects was from funds already allocated for other uses by state banks and state firms.

housing reform and boost economic growth in the face of the East Asia financial crisis, has been implemented as a property-led economic growth policy.

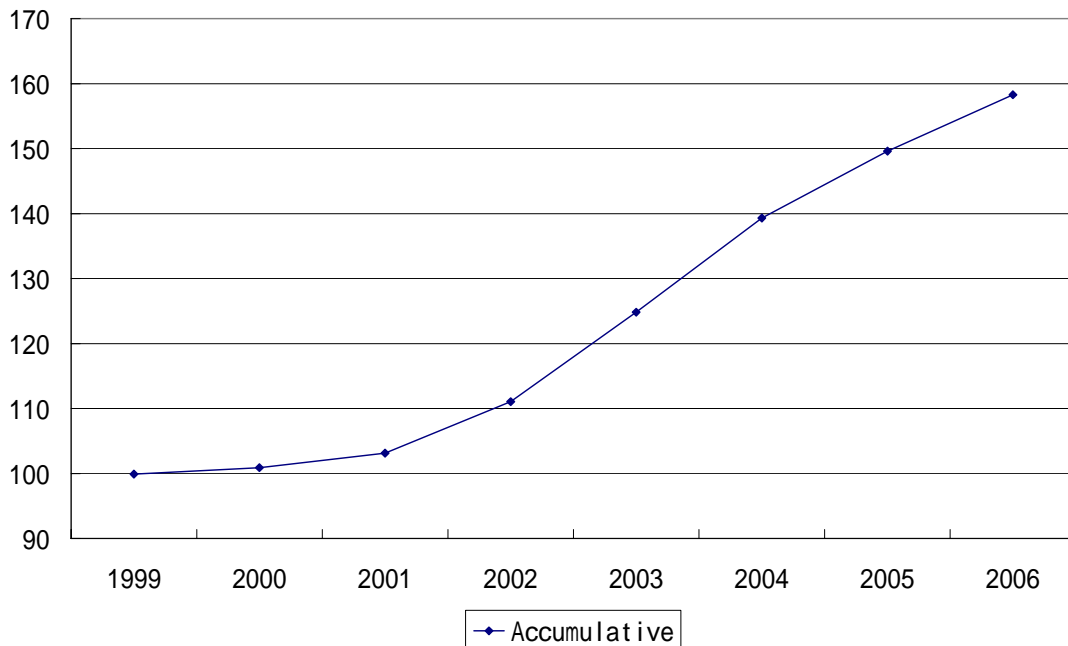
In addition to the housing market this stage also embraces dynamic market activities in office, retail, industrial and other sectors. It is characterised by heavy foreign investment, firstly from Asia and then western countries, national market activities, continued institutional change to facilitate transaction and ownership, and full participation of businesses and people from every segment of the country. Investment in property development has been growing at 22% since 1998 (Fig 5). Unlike the second stage where market expansion was driven by the supply side, stage three has been mainly demand-driven which to some extent has outpaced the industry's ability to supply, causing price inflation in most cities and in most sectors.

Overall, however, while the lessons from the second stage, in the form of unfinished buildings, are still visible in many cities, developers and their financiers again have been committing huge amount of capital to projects of similar or bigger scale due to encouragement from their local governments, in the form of reduced LUR prices, waived taxes, investment, loan guarantees and other promises.

By the end of 2005, there were already 59 buildings (including some hotels) taller than 190 metres in 15 cities, which comprise cities where qualified tenants, mainly large foreign companies, are small in number, and 39 buildings taller than 200 metres under construction in 18 cities, including those where qualified tenants are likely to be very scarce (WSWIRE, 2006). For example, a 68 storey building, called World Trade Centre, is being built in Wenzhou, Zhejiang Province, a medium size city famous for its economic dynamism but in a very poor location in terms of office development. Another example is a 61 storey building being built in Humen Town, Dongguan City in Guangdong, a city famous for its foreign invested and export-oriented factories situated in the middle of Guangzhou and Shenzhen. With conventional wisdom one would predict that low returns, if not negative returns, will be almost certain for at least some of these projects.

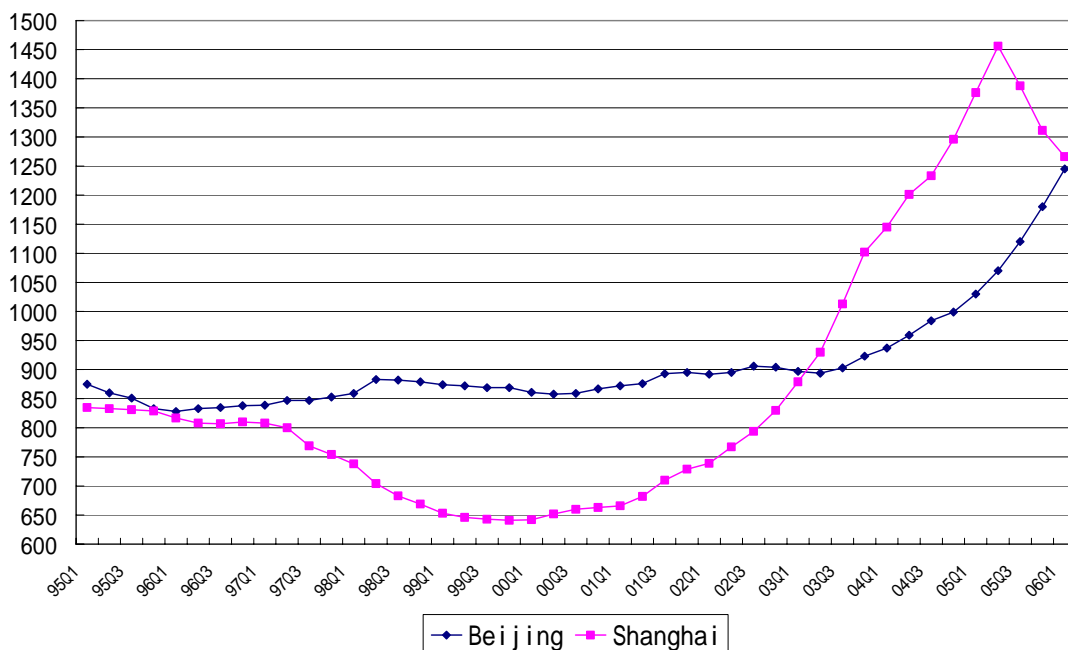
The main concerns of the property-led growth model during its third stage, however, have surfaced in the housing sector. Here there has been such rapid growth that there is a genuine fear of runaway speculative house price increases forming bubbles that will cause major harm to urban and national economies of China in the long run. Average national housing prices rose by 60% between 1999-2006 (see Fig 8). Note that this would be much higher in the major urban centres and is exemplified by runaway housing prices of nearly 40% in Shanghai in only one year between 2003 and 2004 (Fig 9).

Figure 8: Cumulative change of housing prices nationally by REPI35/70



Source: CNBS, various

Figure 9: CREIS housing index on Beijing and Shanghai



Source: Sofang Research Institute, various years

As a result the central government has intervened in the housing market on several occasions in 2004, 2005 and 2006 to dampen the rapid price rises and bring a measure of stability. The People's Bank of China (PBOC) introduced successive rises in interest rates (see table 6) and advised Banks to raise down payments from 20% to 30% for mortgage applications. The second front by the PBoC was to further tighten credit to developers requiring them to contribute their own equity at not less than 30% of the total investment of projects before being qualified for borrowing (PBoC, 2003).

As a result, development finance became much more difficult, which reduced new starts and slowed progress of construction, leading to reduced supply. Ironically, however, these measures are generally regarded as causing housing prices to rise.

Table 6: Interest rates of mortgage loans in China, set by PBoC

Terms of loan	Before 29/10/04	29/10/04	17/03/05		28/04/06	
			Lower limit	Upper limit	Lower limit	Upper limit
1-3 years	4.77%	4.95%	5.18%	5.76%	5.43%	6.03%
3-5 years	4.77%	4.95%	5.27%	5.85%	5.51%	6.12%
5 + years	5.04%	5.31%	5.51%	6.12%	5.75%	6.39%

Source: PBoC, various years

The Ministry of Land and Resources (MLR), the country's land administrator, also acted to further tighten land supply in the hope to reduce the level of activities in the property development sector. Reduced supply, coupled with greater adoption of open market disposal of LURs, increased the bid prices by developers. Overall, however it meant reduced supply and increased costs of land and in turn higher prices of new housing.

However, local governments have been reluctant to impose control on housing prices, as rising housing prices have led to higher taxes and LUR sale receipt, and expanded real estate development activities that have contributed to local GDP. As one respondent in the Shanghai Focus Group meeting pointed out the prosperity of the Shanghai real estate market gave the city a rare opportunity to advance its economy to the level of an international business centre. "Such a situation embodied the hard-work of many people and carefully formulated and implemented policies and is not easy to achieve". The reasons for Shanghai to rely on the property industry were that "rising costs have eroded the competitiveness of Shanghai in manufacturing, and the institutional arrangements in China do not allow Shanghai to become a national financial centre". Through a dynamic real estate market, "Shanghai could replace its 1930s infrastructure with a 21 century one, provide quality space for international business activities and, more important, attract money and attention from the world." For these reasons, Shanghai did not follow the central government's measures full-heartedly and could not prevent another round of housing price inflation. From quarter three 2004 to quarter two 2005, the CREIS Shanghai Housing Index rose 21.2%, indicating that the macro economic control, introduced by the central government in mid 2004, failed to check the rapid housing price inflation in Shanghai.

Nevertheless rising prices and lack of affordable housing has compelled the Shanghai Municipal Government (SMG) to act. On 5 March 2005, the SMG enacted a number of measures to Promote the Healthy and Sustainable Development of the Property Market (SMG, 2005). Then The Shanghai Building, Land and Resources Administration Bureau and Shanghai Local Taxation Bureau imposed a set of rules on housing transaction to reduce demand for housing and enhanced policy-oriented supply (Table 7), with the new tax effective on the day of announcement.

Table 7: New rules adopted by Shanghai government to tackle high housing prices

	New rules
Taxation	5.55% Business Tax on the difference between purchase price and sale price of housing bought within one year, effective on the day of promulgation
Mortgage	Mortgage fully repaid for housing held less than one year before permission to sell
	Time of transaction elongated from one week to one month, even with mortgage fully repaid
New supply	20 million square metres new housing for households relocated for major infrastructural projects and verified as low-income

Sources: various government documents

The State Council and central government agencies followed suit with policies and detailed measures to curb housing price inflation with new measures in March and May 2005 and finally May 2006. These are aimed at providing fiscal and planning incentives for provision of more affordable ‘Ordinary’ housing, introduction of business tax on houses sold less than 2 years after purchase and increased transparency in the market.

As noted in the literature property-led economic growth policy is particularly attractive to growth oriented local government agendas. Many of these also apply to China. First, real estate resources in both quantity and quality were inadequate to accommodate the demand in a new round of economic expansion at the turn of the century, as indicated by quick take-up of office space in Beijing and Shanghai in 1999 and 2000, and the nationwide housing price inflation. Second, compared to other industries, the real estate industry is easier to take the lead to promote economic development as local governments have total control of land resources and substantial amount of financial resources. Skilled construction workers are abundant and new supply is plentiful. Land sale revenues and taxes from property development and sale are important sources of funds to upgrade infrastructure. Third, property-led development provides many cities with the necessary developments to attract footloose national and international investment and thus contributes to the rapid development and modernisation of urban fabric of cities. Many new projects substantially change the competitiveness of cities.

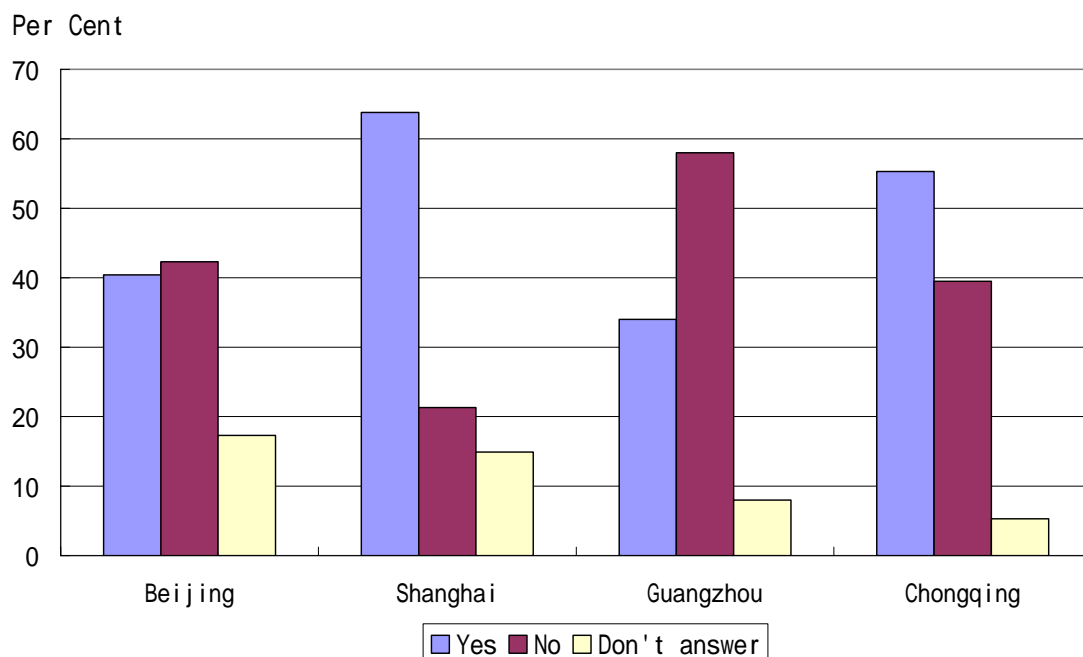
The property-led economic growth model has had significant results in generating economic growth. According to the economic census conducted in 2005, the output of the property industry in 2004 accounted for 5.2% of the total output of the economy, which was much higher than the 1.7% in 1997 (CNBS, 2005a; 2005b).

On the other hand, the downside of this policy is also obvious. First, the property-led economic growth model often equates to city-wide development speculation, imposing huge risks on cities and on the national scale. Such risks are currently hidden by the economic boom but would become apparent when a slow-down, let alone a downturn, occurs. The lessons in the 1990s, still visible in many major cities of China, are reminders of the risks. This is particularly worrying as many of the cities in the west of the country have no significant industries except the property industry. Yet demand for space in those cities is small given the lack of related industries, skilled labour and markets. Once oversupply reaches a certain level, the property

market, and in turn the urban economy in those cities, will collapse.

The interview respondents in three out of the four case study cities regarded that local government policies and intervention contribute to overheating of the property market (Fig 10). In Shanghai, in particular, far more interview respondents believed this to be the case, which could be linked to Shanghai's policies to boost the property sector for fiscal revenues from land sale and economic activities generated by property development, transaction and investment. Similar policies are also practiced in Chongqing. In Guangzhou, however, a lower number of respondents thought that there is a link between government policy and overheating. This may be because the Guangzhou property market had been calm for several years including 2005, when the interviews were conducted.

Figure 10: Link between overheating and local government policies and intervention



Second, the policy has given those carrying out developments, in particular, developers, too much leeway, leading to a number of problems. Planning control, already weak in China, has often been bypassed to speed up development starts to allow fast GDP growth. The root of the acute problems in the housing market is poor planning control to structure a balanced housing supply. Existing oversupply of office space in Beijing and the looming oversupply in Guangzhou are further examples. Real estate development in the last several years also contributed to excessive loss of cultivated land, and acute social tension due to forced land acquisition by local compulsory purchase orders, issued without sufficient consultation and/or compensation.

Third, the hype surrounding property-led development detracts attention from other industries that may be in particular need of attention. For example, the agricultural sector has suffered due to the loss of arable land and has received lower priority by some local governments. Moreover there was a sentiment in the Shanghai focus group that a number of local governments, including Shanghai did not care enough to foster the growth of some indigenous firms in the industrial sector, leading to big expansion

of foreign firms. One interview respondent with close access to the Ministry of Construction commented that the minister was now a “fireman charged with putting out real estate related fires”. This implies that too much time is taken up by real estate related issues with other much-needed strategic considerations and policies being overlooked.

As already noted from 2003, the thriving real estate industry became a major contributor to the overheating of the economy and since 2004 the government has been working hard to slow down the growth of the industry to avoid bubbles from developing. However, the outcome has been very limited due to the fact that the collective-choice level could distort or even nullify the policies at the constitutional level, as the problem in Shanghai’s housing market attests.

Doubts on the status of real estate industry as a pillar industry, the key argument of the property-led economic growth policy, has been in existence for sometime. Such doubts have increased substantially since the macro economic control targeted at the housing sector in April 2005. This has culminated in a nationwide debate on the status of the industry. In a widely circulated article¹³, the stance taken by the central government, which again called the property industry a pillar industry in the New Eight State [Council] Articles (State Council, 2005), was questioned. The article points out that the status of the property industry as a pillar industry has been used by local governments and developers as excuse to resist, either overtly or covertly, the macro control measures aimed to reduce speculation and malpractice and maintain the rapid house price inflation. Others have followed suit similarly questioning the favoured status of the industry and arguing for an abandonment of the property led growth model (Wang, 2005).

Developments in the housing market after the implementation of the New Eight State [Council] Articles in June 2005 seem to confirm the arguments against a pillar industry status for real estate in that a new round of rapid inflation occurred in early 2006 and fuelled more attack on the property-led growth policy. The authors note that the phrase ‘property industry as pillar industry’ did not appear in the Six State [Council] Articles (State Council, 2006).

Urban Planning

Urban development plan for cities and towns in China is referred to as urban planning, which is executed by the local urban planning bureaus, some of which are also under an urban planning committee (eg. Beijing) for major decisions. In the absence of the urban planning committee, the mayor or the local party secretary makes the final decisions.

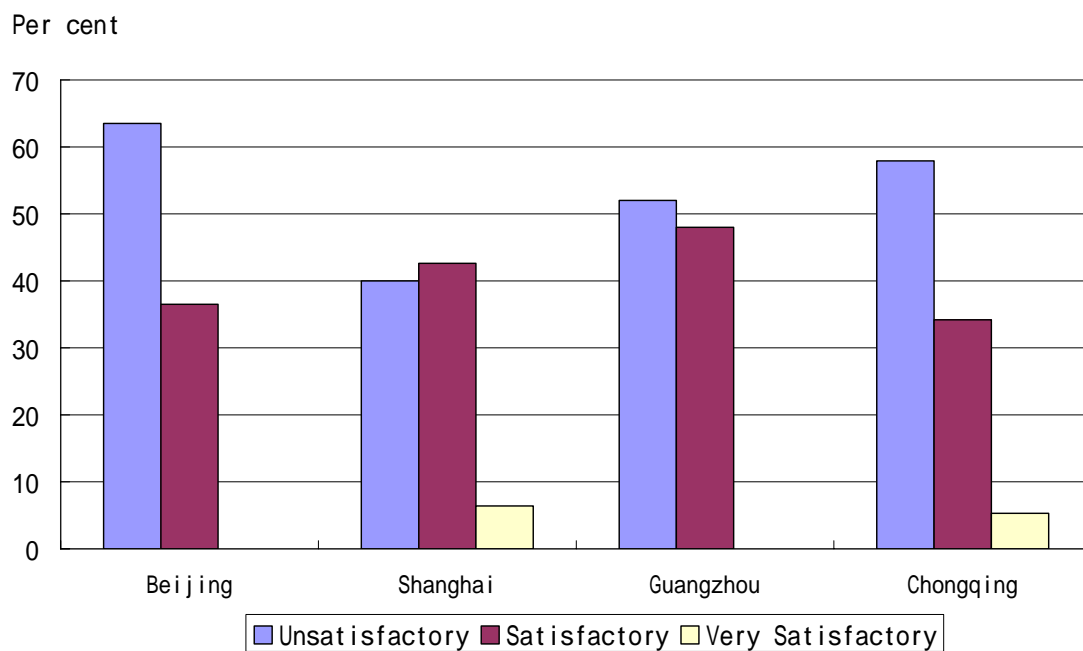
The Chinese urban planning process consists of plan formulation and planning control. In the plan formulation phase, the urban planning bureau produces a master plan, which is a strategic plan for a period of up to 20 years, and a set of detailed plans, which are short-term plans based on the master plan. The urban planning bureaus then implement planning control according to the detailed plans. A planning consent

¹³ See ‘Should the real estate industry be the pillar industry in the national economy?’ by Yu Fenghui, first seen in the official People’s Daily website (<http://opinion.people.com.cn/GB/1036/3442156.html>) on 3 June 2005.

contains three certificates issued at different stages of property development. The first certificate, Site Planning Consent, specifies use, plot ratio, building density and greenery ratio of the site. The second certificate, Building Planning Consent, covers the details of the design of the buildings and other improvements. The third certificate, Building Construction Consent, authorises the construction work on the site according to the approved design. When construction work is completed, a Building Completion Certificate is issued if the new buildings pass the completion inspection.

We will consider impact of property along three main issues dealing with transparency, participation and development. The fact of the matter is that the urban planning process in China was never a transparent and/or participatory even before the full adoption property led urban development in its current form (Ng and Wu, 1995). However, the situation has not been helped since then. Interestingly even many of our interview respondents who were drawn from the private sector involved in real estate activity considered that the planning process was largely opaque. We therefore see that 50% to 60% of respondents were not happy in Beijing, Guangzhou and Chongqing. For Shanghai, which publishes both master and detailed plans and has an urban planning exhibition centre to show the plans, 40% of respondents were still not satisfied.

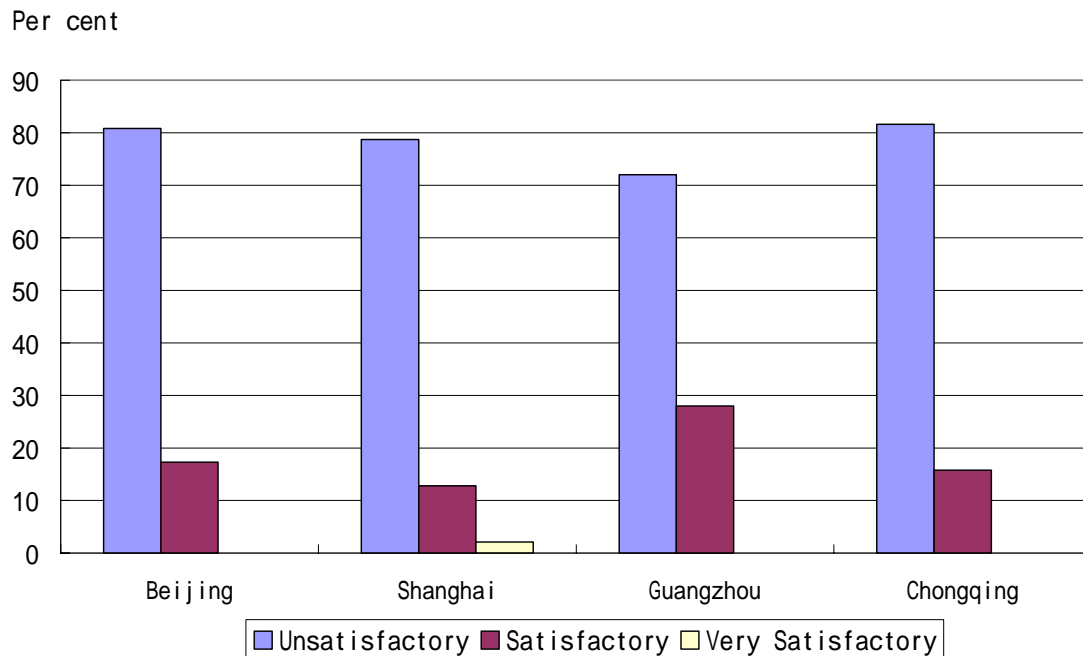
Figure 11: Transparency in urban planning system



In terms of participation the situation is far worst and 70% to 80% of the respondents in all four cities were not satisfied. A respondent in Shanghai emphasised that “decisions are made by the top officials”, implying that even with public participation the decision making process remains the same. Two respondents indicated that “people are not active in participation. Perhaps they know it is not very useful”. However, one respondent, a director in a foreign property consultancy, said “there is some participation as we act as consultant to some major re-development projects”. Ironically another respondent in a foreign development company said “there is too much public participation which actually slows down economic growth”. To some degree the position of this developer is not surprising given their profession. However,

the resounding negative response across all cities shown in figure 12 and the majority of other comments indicates the true situation for public participation is rather bleak instead of being too much.

Figure 12: Public participation in urban planning



On the effectiveness of urban planning control, over 70% of respondents in Beijing, Guangzhou and Chongqing were not satisfied. In Shanghai, there were also over 40% who were not satisfied.

In Shanghai, interview respondents' comments on this issue include: "poor" and "needing strengthening". One respondent disclosed that "no developers actually comply with the specified plot ratio and the planning bureau knows that. The bureau only fines developers." Another respondent revealed that "[planning control] could be effective since the government is so powerful. Of course in the completion inspection many projects are found to exceed the plot ratio, [indicating the control as not effective]. [The violations] were all supported by some government departments or individual officials [rendering the planning control ineffective]". Nevertheless, as Figure 13 shows Shanghai's planning control process is deemed far superior than the other studied cities, the interference from government departments and officials thereby highlighted the weakness of urban planning control in Chinese cities in general when even the most successful city is seen as having problems on enforcing control.

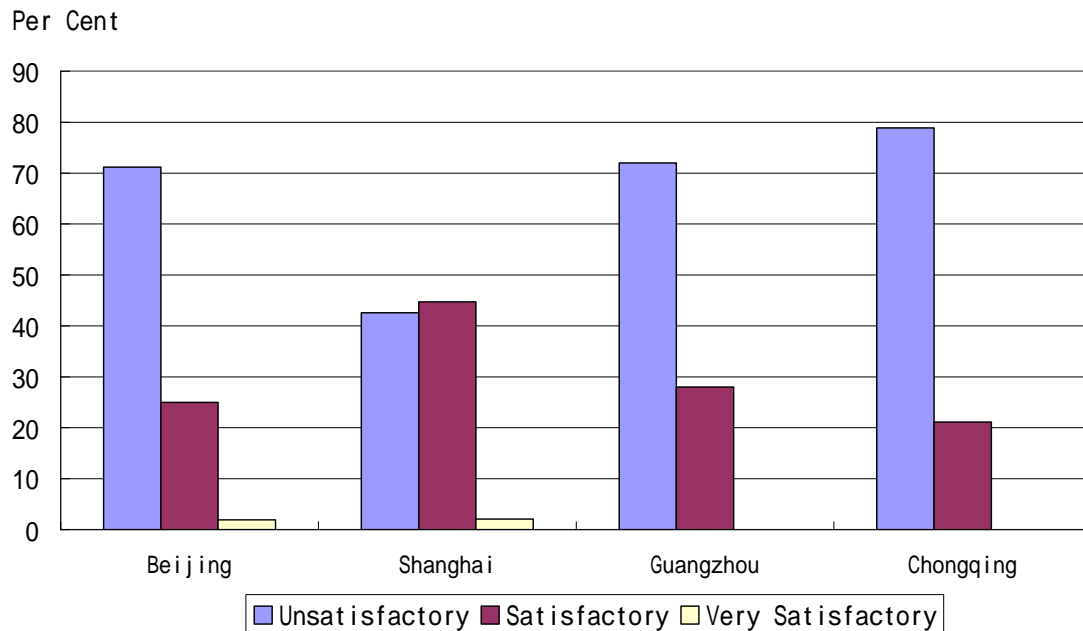
In Guangzhou, respondents' comments were that the urban plan "change as fast as you can imagine", and "a bit out-of-control".

The focus group meeting in Guangzhou had an interesting debate on planning control. One participant claimed that planning in Guangzhou was chaotic and cited the example of the so-called "South China Tectonic", a huge area of spontaneous housing development without prior master planning. To attract buyers, each of the housing estates built a primary school, with the outcome that school places became oversupplied. Another participant contended that the problem should better be termed

“lack of vision”, because real estate development simply outpaced planning. The third participant argued that the fact that real estate development outpaced planning was a perfect example of poor planning control. A fourth participant reasoned that the problem actually had two dimensions. One related to weak planning control in terms of existing regulations and the second related to the inability of planners to foresee and plan for the rapid pace of development. Then he argued “the city always repeats the scenario of building a bridge to ease traffic jam for a year and build another for another year.”

In Beijing, respondents commented that there are “obvious violations”, “causing huge wastes [to rectify violations]”, “not effective”. In Chongqing, respondents’ comments were that planning control “is not yet effective”, “requiring major [positive] changes”, “basically fine but somewhat losing control”,

Figure 13: Effectiveness in urban planning control



The problems in the planning system have long been recognised by the Ministry of Construction, the national administrator of urban planning, which is currently working to revise the 17 year old Urban Planning Law. Mr Qiu Baoxing, vice-minister, regarded that some local governments were in an impetuous mood in pushing forward urbanisation and local urban development, showing lack of foresight in respect of many developments which led to development imbalance and chaos (CBT, 2006).

Mr Qiu illustrated a number of problems in the formulation and implementation of urban plans. First, many cities blindly raise their status in the urban hierarchy. Among the 661 cities in the country, 183 proposed to build their cities into “international metropolises” by the end of 2004 and more than 30 wanted to build modern state-of-the-art Central Business Districts (Nanfang, 2005). This is to say that even medium-sized cities at weak locations and without sound economic bases like Sanya and Huizhou¹⁴ have made such proposals. This means the urban planning regime has

¹⁴ One of the authors has visited these two cities, which lack everything except ambition to become international metropolises.

failed in these cities to enforce Article 13 of the Urban Planning Law 1989 which states “The formulation of urban plan must be based on the reality and scientific prediction of the future development needs of the city and should make city’s scale, construction specifications...appropriate for local and national economic and technological levels”.

The causes for this failure are linked to the ineffectiveness of the institutional arrangements for formulating and enforcing urban plans. The constitutional level rules of the current planning regime allows provincial governments at the collective-choice level the power to approve urban plans of cities with less than 1 million population. Provincial governments abuse their power to approve the ambitious urban plans of small to medium-sized cities. This is an example of non-compliance by the collective-choice level without penalty. For cities with more than 1 million people and other cities specially designated by the State Council, their urban plans have to be scrutinised by the Ministry of Construction and approved by the State Council, both of which stick to the rules when scrutinising and approving the plans. As note, already, the problems however occur in terms of implementation of the plans and the local powers for subsequent change, adaptation and non-compliance. Furthermore, China has no regional plans that bind the local governments. The Pan-Pearl River Delta Region (PPRD), the most high-profile regional plan at the time of writing, is a voluntary regional assembly with no binding effect on its members.

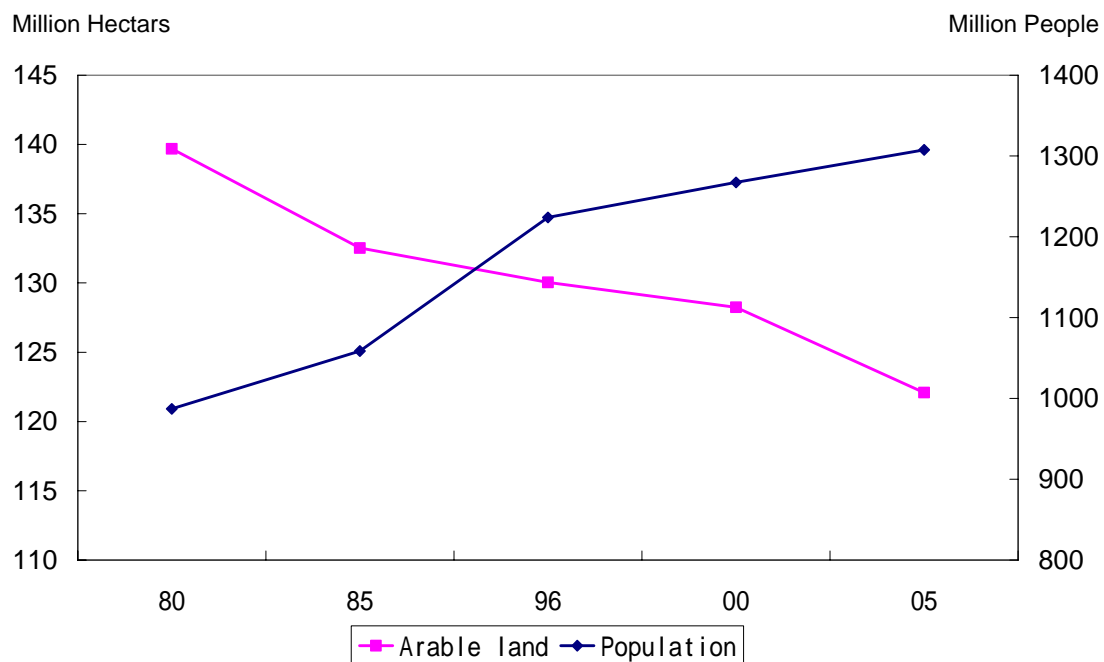
One important reason for many local governments to obtain the status of international metropolis is that they could inflate their land use plan to obtain more land to sell and generate revenues. This is particularly so for Huizhou and Sanya Cities which had sold much of their urban land stock in the property boom in 1992 and 1993. By expanding the size of the designated urban area, the municipal government will be able to convert cultivated land into urban land for development, thus avoiding the rules on land conversion from non-urban to urban uses, which are strictly enforced by the Ministry of Land and Resources (MLR). However, MLR discovered this issue when scrutinising the land use plans and sent out warning signals, prompting the Ministry of Construction to review its rules of urban plan formulation.

Second, many cities blindly expand the size of their population, because a bigger population will bring a bigger urban area and more land under their control. One way to increase the size of urban residents is to give those who purchase commercial housing local citizen or quasi-local citizen status. This explains why some local governments are so supportive of commercial housing development.

Protecting arable land China is the third largest country in terms of area and largest in terms of population. However, much of China’s land is not suitable for farming and human habitation. In 2005, China’s cultivated land, orchards and urban and industrial area accounted for 12.27%, 1.20% and 2.71% of the total land area (MLR, 2006). The rest of the land is not suited for agricultural use. As a result, expansion of the urban area is often at the expense of the country’s cultivated land and orchards. Urbanisation from 1980 has already consumed a substantial amount of cultivated land (Fig 14). Further decline in the area of cultivated land in China would damage the country’s ability to maintain self-sufficiency in food supply.

Unfortunately, the pattern of urban expansion in China takes the form of expansion of existing urban areas, with the best cultivated land at their fringe being converted into built-up area. In 2004 and 2005, against all measures to contain the loss and to reclaim cultivated land elsewhere, there were net losses of 803,000 and 361,600 hectares, respectively, equivalent to 0.63% and 0.3% of the total cultivated land stock in the same years (MLR, 2006). As a result, MLR has been enacting and implementing more restrictive land policies, which push up the prices of property, as the market envisages reduced supply in the future. Rising property prices, in turn, further increase the demand for land, leading to illegal land use by developers and local government tolerance of unauthorised land uses. For example, the MLR found out in 2005 that 73,400 hectares of cultivated land was converted into construction sites without their knowledge (MLR, 2006). We are, therefore, faced with a paradox where action for protecting arable land in fact leads to opposite effects. This essentially stems from the property led growth model and the way it is tied to local economic development and governance. As such public and private interests combine at operational and collective choice levels combine to undermine efforts at constitutional level.

Figure 14: Trends of population growth and cultivated land decline in China



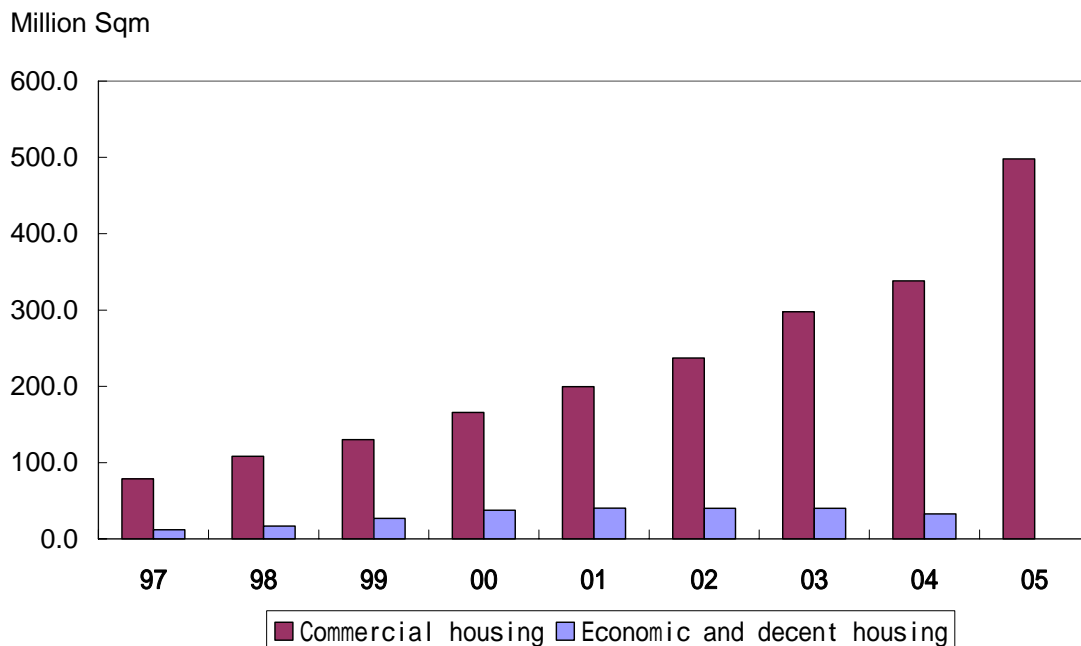
Source: MLR and CNBS, various years

Impact on social housing provision One of the main consequences of property led development has been its negative impact on social programmes. This is particularly evident in the decline of social housing which can be through Housing Provident Fund, Economic and Decent Housing (EDH)¹⁵ and Cheap Rented Housing. All three involve an element of subsidy either in terms of provision of subsidised mortgage through provident fund, subsidised housing sale to lower-middle classes through means testing (EDH), or basic subsidised rental housing for the very low income.

¹⁵ This is translated from the term “jingjishiyong fang”. It is sometimes translated as ‘affordable housing’, but the authors considered ‘Economic and Decent Housing’ more closely conveys its meaning of cheap but still suitable decent homes.

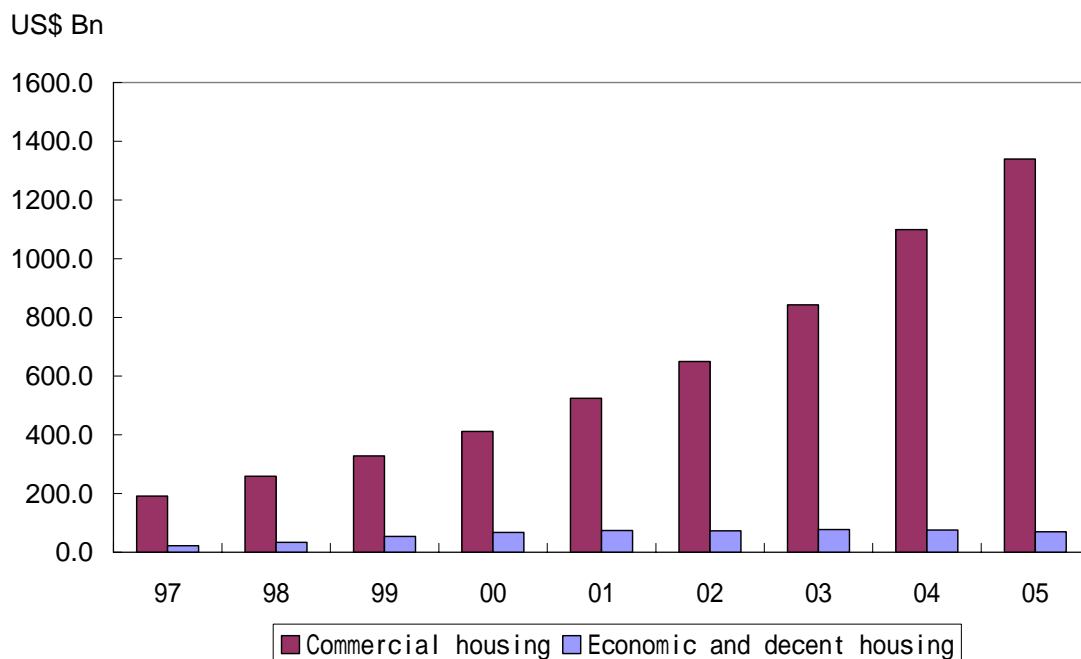
The irony is that China has shifted from a country of total public provision to one of almost total private market provision. In the process, however, it has increasingly left large sections of the lower income groups with inadequate, substandard housing conditions. Figures 15 and 16 show the levels of sale and investment in commercial and EDH housing. In both cases we can see rapidly increasing commercial housing but almost static lines for EDH.

Figure 15: Sale of commercial housing and Economic and Decent Housing



Source: CNBS, various years

Figure 16: Investment into commercial housing and Economic and Decent Housing



Source: CNBS, various years

The last category of social housing is the Cheap Rented Housing (CRH), designed for very poor families. However, the supply of CRH is either extremely limited or not available. A circular from the Ministry of Construction indicated that 13 provinces had not seriously implemented this scheme (Shang, 2006). For those local governments that implemented the scheme, the supply was very low. For instance, Shanghai had only 13,500 units at the beginning of 2005 as CRH against a population of local citizens of 13.5 million (SMG, 2005), a ratio of 1 unit for 1,000 people who could qualify¹⁶. In Beijing, the first purpose-built CRH project was completed at the beginning of 2004, providing 400 units with internal size from 30 to 60 square metres. Overall, however, 11,000 households have been receiving rent exemption or reduction since 2000 (CCTV, 2004). The CRH section in Beijing is again very small, compared to its population of 11 million local citizens.

For some cities, the undersupply of social housing is linked to established local government policies. One Shanghai focus group participant, an official, argued that the Shanghai housing policy was to maximise market allocation and the government's role was to assist low-income families to meet their housing needs through the market. As a result, only those with very low income were able to live in CRH. This explains why Shanghai government does not operate the EDH project and the CRH is so small.

Conclusion

Greater decentralisation of administrative power and reform and development of the land market have been the two crucial institutional changes that have underpinned China's economic success since the economic reform program started in 1979. In the last 28 years, local governments have been generating the lion's share of fixed asset investment and promoting export-oriented projects, which are two major drivers of the Chinese economy.

Recently property-led growth has also been powered by local governments. However it has also increased differences in policy agendas among different levels of governments. The different approaches in respect of the current macro economic control to curb the overheating economy are the latest example of this difference. This has partly led to a shift back towards a more hierarchical regime and re-centralisation of power, in that provincial level top officials and increasingly municipal level top officials are staffed by non-locals through appointment by higher level governments since the mid 1990s. However, the conflicting context of local and central policy realms have proved more enduring and difficult to harmonise through such re-centralising actions in such a short time period.

The macro economic control since 2004 is a current example. Local governments, in a race to develop their local economy, largely ignored the first attempt by the central government to slow down the economy. In particular, the housing market has been a major driver of local economic growth for most, if not all, localities; and local governments generally pursue a different policy agenda from that of the central government. By 2005, the central government had to impose very tough policies, in the form of the two Eight State [Council] Articles, to force local governments to apply

¹⁶ Non-local citizens are not qualified for CRH, regardless of their income status.

the centrally designed measures to cool down both the supply and demand of housing. The impact of the two Eight State [Council] Articles has been limited, prompting a new round of central government policy, i.e. the Six State [Council] Articles, to be issued. However, the authors still could not identify any full-hearted cooperation from local governments. The ability of the central government to fully impose these measures is put to test in the following months to come.

The causes for this situation lie in the rules at the constitutional level and collective-choice level. The constitutional level rule on the assessment of local top officials revolves around local economic development, which is the most important criterion for appointment of officials and assessment of performance. In China, GDP is the most widely used available indicator of local economic development and thus top officials in local governments try their best to maximise GDP in the term of their tenure. The upside of this has been the remarkable growth record, but the downside has been short-termism, neglect of environment, and insufficient protection of the rights of those affected by the development projects.

Another issue in the constitutional level rules is that too much power is given to the local government, especially to the top local officials. The advantage of this concentration of power in local governments is high efficiency in decision making and resource mobilisation for economic development. The disadvantage, however, is that top local officials could exert too much influence on the path, or even the details of, development. For example, it is not too difficult for top local officials to change the master plan of a city at will, thus altering the path of development of the city. Another example is that top officials could dictate the progress of some projects, such as imposing an arbitrary time limit, for them to be completed.

In addition there are no clear rules on penalties for on non-compliance of local officials with national policies and directives from higher level of government. There are no laws stipulating the powers and responsibilities of local governments and local top officials. There are also no clear written rules spelling out the penalties. To achieve higher GDP, officials then tend to act for the 'good' of the locality regardless if national or other non-local interests or 'non priority' objectives are infringed upon. For example, thousands of development zones were set up without proper authorisation from either provincial or central governments. Yet few local top officials, whose consent is necessary for zones to be set up, were penalised when thousands of such zones were cancelled by the central government. Similarly we can see the severe decline in social housing provision and loss of arable land due to rapid and officially sanctioned urban expansion as these are seen to have less priority and a drain in terms of GDP growth objectives.

The collective-choice level rules, on the other hand, are ill-equipped to guide and regulate market behaviour. An example is that too much freedom is given to developers to decide what should be built on a site. To aggravate the situation, officials at the collective-choice level often leave rules un-enforced, further encouraging improper market behaviour. For instance, cheating by developers has been outlawed by most locally enacted regulations, but enforcement, if any, has remained far from adequate. Thus goes the claim that local governments actually side with the developers, as property development still provides the shortcut to showing high GDP rates on a city's balance sheet.

In short, therefore, the property led urban growth model in Chinese cities has been a mixed blessing. On the one hand we have seen rapid GDP growth and infrastructural development. On the other social objectives have been sacrificed and environmental concerns largely ignored. This points to the long term un-sustainability of the current model and is a recipe for major social and environmental conflicts that will undermine the economic benefits gained. There is therefore a need for major re-evaluation.

Here we can only provide general pointers in respect of some of the main issues for instituting a more sustainable urban growth model. This in our view requires firstly shifts in policy at the constitutional level for downgrading the property industry from a pillar to an important industry and for instituting more comprehensive measures for assessing cadre performance based on principles of sustainable urban development rather than the current over reliance on GDP growth. These will provide the basis for a shift to a more balanced and sustainable plan-led urban growth model at the collective choice level. This needs to be reinforced by clearer rules of operation and enforced penalties for non-compliance at constitutional and/or collective choice levels as the case may be to regulate local government and market activities at the operational level.

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