

China: Land Policy Reform for Sustainable Economic and Social Development

An Integrated Framework for Action

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Executive Summary

Over the past twenty-five years, China has undergone a profound economic and social transformation as it moves from a centrally-planned to a market-oriented economy. Land issues are implicated in this ongoing transformation in numerous important ways – as key factors in China’s quest for economic growth, national food security and social stability; as important influences in the rapid growth of China’s cities as well as the future of its agriculture; and as central features in local government finance and in the growth and stability of the financial and banking sector. It is clear that decisions concerning land – how it is allocated, how it is used, how it is governed, how it is administered and how it is financed – will play a central role in determining the shape and trajectory of China’s economic and social future.

Over the last year-and-a-half, the Development Research Center of the State Council (DRC) and the World Bank have been working together in support of the Government of China to develop a deeper understanding of the role of land and land policy, and to identify options for moving forward on key land-related problems and opportunities. This collaboration has entailed a number of interlinked activities, including in-depth analysis by a multi-disciplinary team of Chinese and international experts, and innovative field work in Zhejiang, Shaanxi, Guangdong, Jiangsu, Chongqing, Anhui, Henan and Beijing. As a starting point of reference, the DRC/World Bank collaboration has given particular emphasis to the role of land policy in the context of urban expansion, which over the last two decades has been one of the most prominent features of China’s ongoing transformation.

The purpose of this report is to present in a synthesised fashion the main lessons that have emerged so far from the DRC/World Bank collaboration, and on that basis to suggest concrete proposals for moving forward, in the short, medium and long term.

Land policy over the last few decades has continually evolved in response to China’s dramatic economic and social changes. In keeping with the emergence of a market economy, private rights in land have been significantly clarified and strengthened. In addition, land policy reforms have sought to put in place mechanisms, incentives and sanctions that would stimulate more rational allocation of land between competing land uses. Receiving particular attention from the central government in this respect has been the problem of accelerating conversion of agricultural land to urban uses.

The reforms so far, however, while laudable, have been partial, leaving in place some problematic aspects of land policy and practice that may be grouped under five basic challenges:

- ***The persisting duality of rural and urban land tenure systems, and the State’s monopoly of the primary market for urban land.*** A paramount feature of Chinese land policy is the continued strict separation in the treatment of urban and rural land. These spheres are subject to different rights regimes and are administered by separate institutions and rules. In addition, the sole mediator of the urban-rural interface is the government, which has exclusive power to acquire rural land and transfer it to urban users. These features, which are highly unusual by comparison to other major market economies in the world, are problematic in a number of ways. They *disadvantage rural land owners and users* in terms of being able to share in the appreciating value of their land as it enters the urban market; they lead to *inefficient forms of urban growth*, as the artificially low price of rural land encourages a more land-extensive investment pattern than would otherwise be the case; they encourage an *unhealthy reliance by local governments on land requisition and disposition both* as a way of obtaining extra-budgetary revenue, and of subsidizing development; and they create opportunities for *corruption*.
- ***The process of requisition and levels of compensation are often perceived as unfair to dispossessed rural land rights holders and users.*** The compulsory acquisition of land rights at the urban fringe by local governments is a very frequent phenomenon in modern China. Requisitions have often been a source of grievances that the Government has proactively been trying to

address. Five aspects current policy and practice warrant attention. **First**, there are few explicit limitations under Chinese law on the *purposes* for which government can use its powers of compulsory acquisition. By contrast, land acquisition laws in most mature market economies seek to limit the exercise of government's taking power to a range of circumstances. **Second**, frequent complaints of unfairness concerning the amount of compensation that is paid for requisitioned land underscore a need for re-examining the current *standards of compensation*. A **third** and closely related concern relates to the *distribution of compensation between collectives and farmers*, with the latter often complaining that compensation payments frequently do not reach them, and they rarely get the jobs or see the other benefits projected. **Fourth**, in practice there are not infrequent *variations in compensation depending on the purpose of the taking or the type of land*. And **fifth**, there are concerns about the *processes* by which requisition is conducted. To ensure that compulsory acquisition is fair and is perceived as such, attention is needed to developing better procedures that allow those who are affected a more meaningful opportunity to participate, easier access to relevant information and a realistic way of pursuing remedies if they are treated unfairly.

- ***The land rights of farmers remain weak.*** Farmers continue to have relatively weak rights over land, making them vulnerable to unequal treatment and limiting their ability to participate in economic growth. There are difficulties both in the implementation of rights as well as substantive limitations in the rights themselves. This is the case not only when it comes to compulsory acquisition compensation, but also in the way rural land rights are treated more generally, for example in the definition of rights and the regulation of land re-adjustment under the Rural Land Contracting Law. The relative absence of transparent and accountable governance structures at the level of the collective, and the weak knowledge among farmers of their rights means that the potential for abuse of power and corruption by more powerful actors is significant.
- ***There is an over-reliance by local governments on revenue from land transfers and land-related financing.*** The monopoly by government of the primary land market has stimulated a heavy reliance by local governments on the income generated from transfer fees to supplement regular budget funds and to finance urban expansion. At the same time, there has been an increasing reliance on mortgage loans by local governments using requisitioned land as collateral through the vehicle of "land banks". Both practices underscore the incentives that local governments have to pursue aggressively the requisitioning of rural land in a manner that is potentially risky, while contributing to potentially unsound forms of urban growth.
- ***Difficulties in reducing the rate of farmland conversion.*** The rapid outward spread of cities has led to increasing concern about the loss of China's farmland. Between 1996 and 2002, farmland disappeared at an average rate of 685,000 ha/year, and the rate is accelerating. The government has taken strong steps to impose tighter regulatory controls on farmland conversion, underscoring the immense national importance ascribed to this issue. However, research suggests that efforts to evade these controls will continue to be difficult to suppress if steps are not taken to alter fundamentally the economic incentive structures that help drive urban expansion at its current rapid pace.

DRC's in-depth research in three provinces – Zhejiang, Shaanxi and Guangdong – provides a closer look at the ground level manifestations and effects of these issues.

The first two provinces to be studied were selected in large part because of their dissimilarities. Zhejiang and Shaanxi are representative, respectively, of (a) an eastern area undergoing rapid industrial and commercial growth and (b) a western area in which the pace of economic growth is weaker and far more dependent on government-led investment.

As the research shows, because of the quite different economic profiles of the two provinces, there are important differences between them in terms of the way various land-related issues play out. But perhaps even more striking than the differences are the *similarities* that emerge from these two studies.

In both provinces, the overarching features of current land policy are essentially the same, and the effects, while differing in magnitude and details, are similar. The main shared feature, operating at the interface between urban and rural land, is *government's monopoly of the primary land market* – that is, the requirement that all land undergoing conversion to urban uses must be first be acquired by, and then reallocated by, government. Related to this feature are certain recurring and inter-woven themes: urban expansion that is driven in part by low rural land values and administrative incentives; heavy reliance by local governments on land transfer income and mortgage debt as a source of revenue, in the absence of value-based annual taxes; a sharp and artificial divide between urban and rural land markets, land values and property rights regimes, with particular disadvantages for farmers; and land acquisition practices that frequently result in an unfair outcome for land-losing farmers.

The Zhejiang and Shaanxi research also help identify in some detail various risks posed to local governments and to the provincial and national economies as a whole by the dramatically increasing reliance on land-based debt, including risks associated with the unclear legal status of the land banking sector and problems in its operation.

Despite the prevailing state monopoly of the primary market for urban land, there have been notable examples in some parts of China (particularly the most developed eastern provinces) where this monopoly has been loosened to a significant extent. This loosening has generally taken the form of collective owners avoiding the formal requisition process by dealing directly with enterprises for the use of collective construction land. The DRC research from Guangdong province focuses primarily on this phenomenon, with reference to other provinces where this approach is also common (in particular Jiangsu and Zhejiang provinces).

The DRC research into this phenomenon has identified a number of important *benefits*: First, it appears to have accelerated local industrialization and to have promoted rural economic transformation. Second, the long-term incomes for collectives and farmers are frequently higher than what could be obtained through requisition compensation, and the rental income is likely to go up over time. Third, it can apparently lead to a more appropriate role for local governments, with government no longer playing the role of investor and operator, but instead focusing on taxation and the provision of public services.

At the same time, however, there are significant *risks* involved: First, most of these arrangements operate on the margins of the law, if not in outright violation of the law. The absence of a strong legal foundation has consequences in terms of the security of the interests of both the collective and the investor. Second, governments also face dilemmas. If they decide to enforce the law through stopping these illegal or quasi-legal activities, they risk reducing economic growth. If, on the other hand, they would like to regulate these activities, they lack the legal tools to do so. Third, an excessive percentage of income from these arrangements tends to go to the collective, with farmers once again often losing out – a situation aggravated by the legal informality of the arrangements.

Despite these risks, the experiences of Guangdong and other provinces with these types of initiatives, holds sufficient promise to warrant further consideration and continued experimentation, which could form the basis for the eventual modification of national policies and laws.

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Meeting the challenges identified in this report effectively will require *coordinated* action to address how land is administered and managed in the economy, involving numerous agencies and different levels of government. It will also require an *integrated* approach, as the problem areas that need to be addressed are intricately bound together in terms of causes, ramifications and potential solutions, and cannot be effectively resolved in isolation from one another.

In elaborating proposals for moving forward, the following over-arching strategic consideration serves as a unifying thread connecting diverse recommendations:

Changes to land policy and practice should be guided by the overall goal of integrating the treatment of urban and rural land. Steps should be taken progressively to integrate urban and rural land markets, rights, planning and administration, including reducing the government's monopoly over the primary market for urban land.

Against the backdrop of this overarching consideration, nine long-term objectives, with corresponding actions, are proposed:

Objective 1: Clarify, secure and broaden the rights of landholders, and promote greater equivalence of rights over land within different contexts. Steps should be taken progressively to clarify, secure, broaden and harmonize the rights of rural and urban landholders, in order to allow greater freedom for landholders in all categories to participate more fully in economic growth through the sustainable use of property. Potential actions to support this objective include: a) evaluate and test the feasibility of making collective construction land marketable; b) evaluate and test the feasibility of allowing direct dealing by collective landholders in the case of conversions for non-“public interest” uses; c) strengthen legal provisions to ensure greater protection of rural contract holders from unfair or improper actions on the part of the collective management; d) introduce the right to mortgage farm land held under a 30-year contract; e) develop an efficient, accurate and usable registration system for all land rights, including farmers' agricultural land contract rights; f) evaluate and test the feasibility of granting secure and marketable urban land use rights generally to urban real property holders; and g) design and carry out poverty and social impact analyses to guide future policy decisions about increased marketability of rural and urban land.

Objective 2: Ensure fair treatment and adequate compensation for those affected by compulsory acquisition. Compulsory acquisition rules and methods require re-examination and revision, to ensure that compensation is adequate, that the process is fair and open, and that government's decision to requisition land is guided by appropriate standards. Potential actions to support this objective include: a) revise methods for the calculation of compensation to move towards more equitable, predictable and socially-acceptable standards; b) take steps to ensure that compensation reaches the dispossessed farmer; c) experiment with alternative forms of compensation; d) consider limits to the purposes for which land can be taken; e) establish better standards for compensation of urban land; and f) review experiences of other countries with respect to the above issues, to help inform policy decisions.

Objective 3: Promote more efficient use of farm land and urban land. More effective measures are needed to reduce the conversion of farm land and to improve the efficiency of use of urban land, through review of current incentives for land use conversion, better coordination of planning mechanisms and more efficient land use strategies. Potential actions to support this objective include: a) review the impact of subsidising land for industrial use by setting artificially low price ceilings; b) explore greater integration of urban and rural planning functions and objectives; and c) review international experience.

Objective 4: Enhance the role of land as a sustainable foundation for local government finances. The general level of local government finances' dependence on profits resulting from trading in land, in large part through land banking operations, is unsustainable and creates undesirable incentives which are resulting in extensive and inefficient use of land. Market value-based property taxes should be explored as a matter of urgency as an alternative source of local government finance. In time, this would provide a long-term sustainable substitute as receipts from land trading are reduced. This should be coupled with a general review and simplification of the overly complex current system of property based fees and taxes. Potential actions to support this objective include: a) design and implement pilots to test the feasibility of introducing property tax; b) re-assess the purpose and function of land banking; and c) undertake a review of other land-related taxes and fees to assess their continued relevance and to rationalise their use.

Objective 5: Rationalise the institutional framework for land. In the long term a natural

consequence of harmonising urban and rural land issues will be the extension of this harmonisation to the rationalisation of the institutional framework responsible for administration of some of these matters. Similar comments hold true in relation to the current distinction between land and buildings and how their recording is administered. Potential actions to support this objective include: a) harmonise and unify land and building registration; and b) harmonise and unify rural and urban registration.

Objective 6: Strengthen the overall legal framework and rule of law. Land-related laws and regulations need to be improved to ensure coherent legal support for land policy. At the same time, urgent attention is needed to the task of making relevant laws function in practice, especially by giving the intended beneficiaries of land rights the needed understanding and tools to use them. Potential actions to support this objective include: a) undertake a diagnostic review of the overall legal framework for land; b) begin immediate work to address specific identified gaps and weaknesses in the legal framework for land; c) give targeted attention to the legal implications of policy reform decisions; and d) take steps designed to empower farmers to understand and use their rights.

Objective 7: Build capacities for land administration. Capacity building in the skills and knowledge necessary for implementing this set of objectives will be essential to ensure that the planned outcomes are achieved. Potential actions to support this objective include: a) capacity building will be required in relation to critical skills and knowledge areas that reflect the movement towards market economy based land administration and management; and b) building capacity in each of these areas will need to follow a fairly standard sequence.

Objective 8: Ensuring protection of the environment. The rapidity of urban expansion and the increasing pressures deriving from market based solutions, which do not generally incorporate environmental requirements, will increasingly demand that appropriate planning/regulation and fiscal policies are put into effect to ensure adequate protection of the environment. Potential actions to support this objective include: a) research should be undertaken to identify appropriate legal, institutional and implementation frameworks to ensure the maintenance of appropriate environmental standards; and b) research should be undertaken to identify appropriate fiscal and other market based incentives to ensure the delivery of required environmental goods.

Objective 9: Create an adequate research basis to make appropriate policy decisions for the future. Piloting and research, both immediate into specific areas, and longer term monitoring of impacts, will be essential to support sound policy decision-making for the implementation of this set of land policy objectives. Potential actions to support this objective include: a) formulate and execute an integrated programme of pilot activities; and b) undertake research in critical knowledge areas that reflect the movement towards market economy based land administration and management.

I. Introduction

Over the past twenty-five years, China has undergone a profound economic and social transformation as it moves from a centrally-planned to a market-oriented economy. This transformation has resulted in significant structural changes, including the increasing role of markets in allocating resources, the expansion of urban-based economic activities and the accelerating movement of labour into urban areas.

Land issues are implicated in this ongoing transformation in numerous important ways. The allocation of land rights and the extent to which they are perceived as secure are key factors in China's quest for economic growth, national food security and social stability. Land use choices influence the shape and sustainability of China's rapidly growing cities, as well as the future prospects of its agriculture. Revenue generated from land plays a critical role in local government finances and affects the relationship between different levels of government. And increasingly, the growth and stability of the financial and banking sector are intimately linked to land-based transactions and financing arrangements.

Box 1: Understanding the linkages between land policy and other policy arenas – the example of land and banking crises

One important reason why policy in relation to land and buildings is critical to successful development is because land and buildings and how they are used impact on a wide range of other policy areas. Failures in such policy are likely therefore to be problematic, not just in relation to land and buildings which after all are usually reckoned to constitute between a half and three quarters of all assets in a typical economy, but also as contributory factors in relation to other areas of activity such as food security, urban development and the environment.

A valuable example of such an intersection is the relationship between land and finance/banking policy. Two regional examples – from **Southeast Asia** and the **Baltic States** – are presented in **Appendix A**, in order to illustrate ways in which weaknesses in the policy, regulatory and institutional frameworks governing land contributed to severe banking crises in the 1990's.

In short, it is clear that decisions concerning land – how it is allocated, how it is used, how it is governed, how it is administered and how it is financed – will play a central role in determining the shape and trajectory of China's economic and social future. Especially in the context of increasingly globalized markets, land policies and governance frameworks that are coherent, predictable and transparent will become ever more critical conditions for sustained and stable growth. An efficient, transparent, and equitable land administration and management system will be a key factor not only in the healthy development of land markets, but also an indispensable part of an overall governance framework which aims at providing high-quality public services with integrity.

The government of China increasingly recognizes the urgency of addressing land policy issues in order to achieve desired economic and social outcomes. Indeed, the recent history of land policy in China has been one of adaptation to rapidly changing circumstances: since the 1980's, the policy and legal framework for land has evolved in ways that reflect the emergence of a market economy and accelerating urban expansion, balanced with concerns over agricultural land protection, food security and equity. Yet at the same time, there is recognition that serious challenges remain, and that meeting these challenges is significantly constrained by a number of factors – by contradictions and fragmentation in the institutional and legal framework governing land; and by the absence of a unified and integrated vision of land policy to help negotiate between competing interests and pressures.

In response to these concerns, the Development Research Center of the State Council (DRC) and the World Bank have been working together over the past one-and-a-half years to develop a deeper understanding of the role of land and land policy in China, and to identify options for moving forward on key land-related problems and opportunities. This collaboration has entailed a number of interlinked activities. It has involved a process of identifying and analysing the main features of China's current land problems and accomplishments by a multi-disciplinary team of Chinese and international experts.¹ It has facilitated dialogue within and between different parts of government. And above all, it has involved innovative field research at provincial and sub-provincial levels, including in-depth studies completed by DRC in three provinces – Zhejiang, Shaanxi and Guangdong – and field work by a joint team of DRC/World Bank experts in Jiangsu, Chongqing, Anhui, Henan and Beijing.

As a starting point of reference, the DRC/World Bank collaboration has given particular emphasis to the role of land policy in the context of urban expansion. The spectacular growth of cities has been one of the most prominent features of China's ongoing transformation. From 1980 to 2004, the percentage of population classified as urban has grown from 19.4% to 41.8%.² The growth has also been spatially dramatic, with a very rapid conversion of previously agricultural land to urban uses as the lateral growth of cities accelerates at an extraordinary rate.

The decision to give special attention to the interface between urban and rural land is not intended, of course, to diminish the importance of land issues in older established urban centers or in rural areas not directly affected by urban expansion.³ Instead, the urban-rural interface has been featured precisely because it defines an arena that is ideal for examining the complex interplay of all of China's most pressing land issues, including those of special relevance to the agricultural sector. In particular, close examination of land policy at the urban fringe draws attention to a central theme of this report, namely, the sharp divide between rural and urban land in terms of rights, administration and use – a divide which persists notwithstanding a growing integration of urban and rural economies and increased social mobility in modern China. As will be argued below, this characteristic of land policy in China has increasingly problematic implications for urban and rural areas alike, as well as for those areas that are in the process of transition.

The purpose of this document is to present in a synthesised fashion the main lessons that have emerged so far from the DRC/World Bank collaboration, and on that basis to suggest concrete proposals for moving forward, in the short, medium and long term. The report is organized as follows.

Part II identifies and summarizes key challenges facing land policy in China at the present moment. Five inter-related subjects are discussed: (i) the duality of urban and rural land tenure systems, the monopoly of the primary market for urban land by the State, and the

¹ See "Integrating Land Policy Reforms in China: Challenges, Options and Possible Next Steps in Policy Development," (World Bank, 2004).

² If China maintains the average urbanization speed since 1995, China's urbanization will reach 64% by 2020 (Wang Mengkui, China Daily, May 11, 2005).

³ Notwithstanding high rates of urbanization, for example, it is anticipated that a very high percentage of China's arable land will need to remain in agriculture in order to achieve long-term food security goals. Thus, the issue of what mix of land tenure reforms and security-enhancing measures for farmers can best support the sustainable productive use of this land are issues of the highest priority, and are discussed at various points throughout this paper.

resulting economic and land use distortions; (ii) issues surrounding the requisition of rural land for urban expansion, including perceptions of unfairness in the payment of compensation; (iii) the continuing relative weakness of farmers' rights to land, despite important legislative achievements in this regard; (iv) the problematic nature of local governments' reliance on land related income and debt; and (v) difficulties in effectively reducing the rate of conversion of farmland to non-agricultural uses.

Part III continues the discussion of these issues with a closer look at the experience of the three provinces which so far have been the subject of DRC's in-depth research. In the case of Zhejiang and Shaanxi provinces, the research reported here spans the full spectrum of issues summarised in Part II. The findings help underscore that despite significant differences in the socio-economic profiles of these two provinces, there are important fundamental commonalities when it comes to the land problems faced in both settings and the implications of those problems for policy. The research from Guangdong, on the other hand, provides a more focused look at the specific issue of collective construction land. Stories of innovative approaches to the use and allocation of this land in Guangdong (as well as in a number of other provinces) provide important glimpses into the potential benefits of a more permeable boundary between rural and urban land markets and administrations. At the same time, the report sounds important cautionary notes about the risks of pursuing such innovations on essentially an *ad hoc* basis, in a situation where the legal framework is ambiguous and non-supportive, and where the rights of various stakeholders – especially individual farming households – are vulnerable to non-transparent agreements entered into by more powerful actors.

Part IV represents an attempt to look ahead: given the issues identified, how best can China move forward in addressing those issues, and how can its international partners be of greatest assistance in supporting China's efforts? Nine long-term objectives are proposed as a framework for action, and a series of interlinked short and medium-term steps for moving towards those objectives are outlined. Special emphasis is given to the testing of alternatives and lesson learning within an integrated framework of targeted pilot exercises, complemented by an emphasis on the important relevant lessons China could learn through more systematic and intensive examination of international experiences.

II. China's evolving land policy framework: achievements and continuing challenges

Generally speaking, recent reforms in China defining the rights and responsibilities of land users and the State have progressed along dual tracks for urban and rural land. The different starting point for these two categories of land are encapsulated in the 1982 Constitution, which establishes that urban land is owned by the State while collectives own rural land. Amendments to the Constitution in 1988 established that a land use right may be transferred in accordance with law, thus confirming that a land use right is divisible from land ownership.

For rural land, the emphasis has been on stimulating productivity, investment and social stability through enhancing farmers' security of tenure over the lands they cultivate. While the framework of collective ownership has been maintained, legislative measures have progressively strengthened the position of individual farming households within that framework. Amendments to the Land Administration Law in 1998 provided for the issuance of 30-year contracts to individual farmers, along with the requirement that the land rights be defined in written, registered documents. This reform was reinforced and deepened by the Rural Land Contracting Law of 2002, which essentially elevated the household land contracting right to the status of a property right, provided that such rights should be for a minimum of 30 years and virtually eliminated the right of the collective to carry out land readjustments except in limited circumstances. The law allows contract holders to engage in certain transactions with their rights and provides important protections against arbitrary or unjustified contract termination. In the case of urban land, land is owned by the State, but the legal basis for a market in land use rights has been firmly established. Currently, a new draft Property Law is under consideration which would help consolidate and expand a number of the legal advances that have taken place so far – the draft Law would, if adopted, represent a major step forward in clarifying and strengthening property rights in support of economic growth and social stability.⁴

In addition to clarifying and strengthening private rights in land, reforms over the last two decades have sought to put in place mechanisms, incentives and sanctions that would stimulate more rational allocation of land between competing land uses. Of particular concern to the central government has been the accelerating conversion of agricultural land as the result of rapid urban expansion. As discussed in E, below, the government has put in place a number of restraints on conversion, including the designation of "basic farmland" as a specially protected percentage of land; various controls on conversion under the Land Administration Law designed to ensure no net loss of farmland; and the establishment of planning quotas for conversion at provincial and sub-provincial levels.

The reforms so far, while laudable, have been partial, leaving in place some problematic aspects of land policy and practice that will need to be addressed in coming years if China is to have a land policy framework that truly supports its aspirations regarding social and economic development. These problem areas may be grouped under five basic headings:

- The persisting duality of rural and urban land tenure systems, and the State's monopoly of the primary market for urban land

⁴ See Appendices K and L for discussion of certain aspects of this proposed law, including some suggestions on how it could be strengthened.

- Unfair requisition and compensation practices
- Weak land rights of farmers
- Over-reliance by local governments on revenue from land transfers and land-related financing.
- Difficulties in reducing the rate of farmland conversion

A. *The persisting duality of rural and urban land tenure systems, and the State's monopoly of the primary market for urban land*

The continued separation between rural and urban land rights, and the associated phenomenon of the State's monopoly of the primary market for urban land, creates significant economic distortions and may stimulate unsound forms of urban growth.

In an era characterized by unprecedented urban growth and increasing integration of urban and rural economies, the paramount feature of Chinese land policy is the continued strict separation in the treatment of urban and rural land. These spheres are subject to different rights regimes and are administered by separate institutions and rules.

As one major consequence of this separation, the sole mediator of the urban-rural interface is the government, which has exclusive power to acquire rural land and transfer it to urban users. Under current laws, all land entering the urban market must first be requisitioned by urban authorities before being re-allocated through one of several transfer mechanisms to urban users. There is, in other words, essentially no avenue for direct dealing between those holding rights over rural land and those who ultimately acquire it for new urban uses. This is true whether land is destined for public, quasi-public or even clearly private uses.

This feature is very unusual by international standards – no other major market economy in the world maintains as absolute a split between urban and rural land rights, administration and markets as does China. Indeed, worldwide the trend is in the opposite direction. Countries increasingly recognise that the growing integration of urban and rural economies, the speed of urban growth and the mobility of people and capital makes the separate treatment of land anachronistic and counterproductive. While different types of land may certainly require different planning approaches and varying degrees of regulatory and economic intervention, it is increasingly clear that this is not best accomplished through a rigid division of urban and rural land into completely separate spheres.

In recent years, given the accelerating pace of urbanization, the ramifications of China's approach have come increasingly to light. These can be grouped into five basic areas of concern:

- ***Inequitable treatment of rural land users.*** The current approach disadvantages rural land owners and users, because it makes it impossible for them to share in the real value of their land as recognised by the urban market. On the one hand, they are prevented from participating in the market directly. At the same time, the compensation they are entitled to receive is tied to the use of land for cultivation, and hence is usually many times lower than the value of the land in its new urban form. The perceived unfairness of this imbalance has been a growing source of social tension, well-recognised by government, as has what in some instances may be an

even greater problem that compensation paid to the collective frequently does not reach the individual farming households that have been dispossessed. (See section B, below, for more on this subject).

- ***Inefficient forms of urban growth.*** The artificially low price of rural land encourages a more land-extensive investment pattern than would otherwise be the case.⁵ It creates incentives for inefficient use of land, including an emphasis on the outward spread of cities rather than the more efficient use of existing urban space (which may also be reinforced by the current tenure situation in urban areas). The demand for new land on the urban fringe for real estate and other commercial development is to some extent artificial, promoted by the ready availability of cheap rural land. This, among other things, makes it difficult to design and implement successful measures for the conservation of agricultural land. (See section E, below).
- ***Over-dependence by local governments on requisitions for revenue and for subsidies.*** The current approach fosters an unhealthy reliance by local governments on land requisition and disposition both as a way of obtaining extra-budgetary revenue, and of subsidizing development.

As far as the *extra-budgetary* revenue function is concerned, governments depend on the transfer to urban users of a portion of land – usually for commercial or housing purposes – at so-called “market” rates using an auction system. Although comprising a relatively small percentage of total requisitioned land (usually on the order of 10-20%), these transfers nevertheless serve as a lucrative source of revenue for local governments who are otherwise largely dependent on central government transfers and a very under-developed local taxation system characterized most significantly by the absence of a property tax.

The *subsidy* function is played by the majority of requisitioned land, which is not priced with reference to the urban market, and hence is not used for the same revenue raising purposes. Instead, land is passed on either to other government units for the construction of infrastructure, or to industrial users at artificially low prices in order to attract industry in a context of intense inter-regional competition. The State Council, in Document 28, has tried to curb this practice, by seeking to discourage attempts to attract private investment by offering land at low prices; standard minimum prices, it urges, should be established and observed. It is unclear to what extent this exhortation will be successful.

- ***Inefficiencies and lack of coordination in land administration.*** As described in Box 2, below, the institutional structure of land administration in China reflects the overall split in the treatment of urban and rural land and is subject in some cases to confusion and overlap in terms of the mandates of different institutions.
- ***Creation of opportunities for corruption.*** The existing system encourages the development of corrupt practices – in particular the fact that the margin between compensation paid to farmers and land value in urban use is substantial, that only a

⁵ In an article on modifying China’s economic growth model, published in China Daily on May 11, 2005, Mr. Wang Mengkui, Chairman of DRC, pointed out that low land prices led to a huge waste of precious land resources. Based on a survey conducted by the Ministry of Land and Resources, about 43% of requisitioned land is left for idle.

relatively small proportion of land acquired from agricultural use is subject to open auction requirements, and that there is a lack of transparency and accountability in many areas of land administration, including land use planning and valuation.

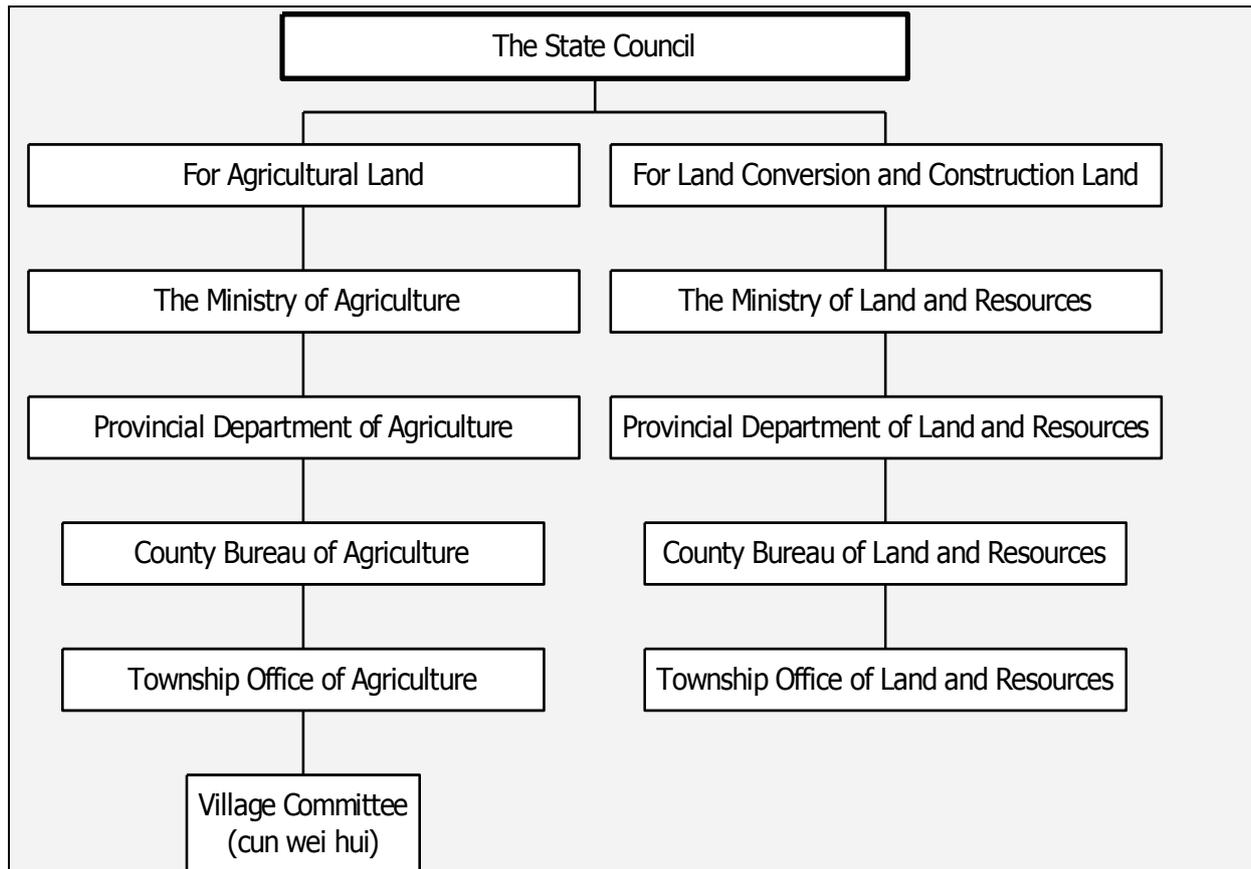
In short, the sharp divide between urban and rural land rights and the unique role of government in controlling the primary market for land at the rural-urban interface have multiple repercussions and overlap with other important land policy considerations. They both strongly contribute to, and at the same time are further entrenched by, other important problematic features of the land policy framework, as subsequent sub-sections will examine in more detail.⁶

Box 2: The institutional framework for land administration in China

Corresponding to the dual system of land rights, China's land administration is characterized by a dual nature. Separate institutional frameworks govern agricultural land, on the one hand, and land conversion and construction land on the other.

In order to enhance land management and protection, China established the State Bureau of Land Management in 1987, and then upgraded it to the Ministry of Land and Resources in 1998. Since then, the Ministry of Agriculture manages agricultural land, and the Ministry of Land and Resources manages construction land (i.e., land for nonagricultural purposes) and is responsible for cultivated land protection. The chart below shows the current institutional framework of land management in China:

⁶ There have been, it should be noted, a number of intriguing experiments in recent years with direct dealing in land use rights across the urban-rural divide, primarily with respect to collective construction land. Some of these are discussed in the summary of the Guangdong research in Section III.B, below. While there are significant variations in the way these arrangements have played out, in general (unlike requisition) they have involved the transfer of the land use right following negotiation, under a contract between the collective and the enterprise for the use of village construction land. The Central Government itself has encouraged exploring the potential benefits of these approaches (though without giving formal sanction under Document 28), and has supported a number of pilot efforts. But a number of serious constraints in pursuing these approaches are clear. Most of them, for example, seem to be extra-legal – ie, condoned in practice but without any secure legal basis. Furthermore, the frequent absence of transparent and accountable governance at the village level means that individual farmers may, in practice, be no better served by this approach than they are by the more standard practice of government requisition.



For agricultural land, at national level, the State Council makes policy while the National People's Congress issues land laws such as Rural Land Contracting Law. The Ministry of Agriculture is responsible for the implementation of national agricultural land policies and land contract regulations. At the local level, provincial governments make detailed regulations for implementation of national laws based on their own situations. The county and township governments are responsible for the implementation of agricultural land contracting and management of land contracts in their administrative area. The county government issues the certificate of land contracting title. In some regions, the township government may re-allocate village farmlands for structural adjustment or set up development zones. At the village level, although the village collective organization is not involved with the cultivation of agricultural land, there are many management responsibilities concerning collective lands it undertakes – for example, land contracting with farmers, managing land contracts, reallocating collective land in some years to reflect changes in village population, managing the village's pre-reserved land (ji dong di), retracting some farmers' contracts when they leave the village for various reasons (attend university, become non-agricultural residents, etc), and gathering some lands for plant building or land renting to other members.

For land conversion and construction lands, at the national level, the central government not only makes relevant policies and issues land laws, such as the Land Administration Law, and Regulation on Basic Farmland Protection, but also controls land conversion. For example, in order to protect farmland, where it is proposed to convert basic farmland in excess of 35 ha, or to convert any farmland in excess of 75 ha., State Council permission is required. Similarly, conversions in provinces, autonomous regions, and municipalities directly under the central government's general land utilization plan require permission from the State Council, and the cities in which the provincial or autonomous region governments are located, or with a population of more than 1 million, must have their general land utilization plan approved by the State Council.

The Ministry of Land and Resources, as the national administrative authority for land management, is responsible for national land management and supervising local government's action on land use. It examines and approves the volume of farmland conversion reported by provincial government, checking the dynamic balance between the total volume of cultivated land at provincial level, distributing the quotas of construction lands among provinces, confirming the standard of land

compensation and their enforcement, and investigating illegal land-use behaviour at local levels.

Although China is committed to a strict policy of farmland protection, local government has extensive powers for land conversion and the utilization of construction land. In order to develop local economies, local governments frequently find methods to move beyond the constrictions imposed by their overall land utilization plan, through techniques ranging from adjusting the location of basic farmland to implementing land conversion unlawfully before the central government has actually permitted such conversion. Local governments become the actual landowners as land is transferred from agricultural use to non-agricultural use. They draw up land utilization plans and city development plans while proceeding with land requisition and implement land compensation for dispossessed farmers. The county bureau of land and resources and the township office of land and resources simultaneously have responsibility for land management and protection of agricultural land, on the one hand, and on the other, the taking over of farmland and the selling of that land to developers.

There are also some institutional conflicts among different departments whose responsibilities for different aspects of land administration and management apparently overlap. For example, there are two departments (the department of agriculture and the department of forest) that manage land contracts; there are two departments (the department of agriculture and the department of land and resources) that manage farmers' lands for house building; there are two departments (the department of land and resources and the department of construction) that manage the construction lands within a city.

B. *Unfair requisition and compensation practices*

The process of requisition and levels of compensation are often perceived as unfair to dispossessed rural land rights holders and users.

As described above, the principal method by which rural land is incorporated into growing urban areas is through the acquisition of that land from collective owners by the State, and its subsequent transfer to urban users. Hence, the compulsory acquisition of land rights at the urban fringe by local governments is a very frequent phenomenon in modern China.

In virtually all countries, governments have the power to acquire land on a compulsory basis in certain circumstances and subject to certain conditions. In China, the scope of this power is unusually wide by international standards and its use by government has been very extensive, particularly given its central role in the phenomenal growth of cities. Because of this, the impacts of government land acquisition practices are not relatively localised and isolated as they might be in some countries, but instead have widespread and significant social and economic consequences. In operation, requisitions have on a number of occasions been a source of grievances that the Government has proactively been trying to address.

China's land acquisition policy and practice is best evaluated in terms of five elements:

- the purposes for which land can be taken by government;
- the standards used to determine compensation;
- the distribution of compensation among affected parties, in particular as between collective owners and farmers;
- the uniformity of compensation as between land taken for different purposes or different categories of land; and
- the procedural rules and safeguards that apply.

Purposes. There are few explicit limitations under Chinese law on the purposes for which government can use its powers of compulsory acquisition. Article 10 of the Constitution refers to the government's right to take land in "the public interest," but this concept is not subsequently defined or narrowed by law. By contrast, land acquisition laws in most mature market economies seek to limit the exercise of government's taking power to a range of circumstances. There are wide variations between countries in how these circumstances are defined and limited (see Appendix F). In some countries, laws may provide an itemized list of land uses that fall within the definition of public purpose or public interest. In other instances, more room is provided for discretion and interpretation of these terms. But an overarching principle in most cases is that government's taking powers are *extraordinary* powers that are intended to meet public needs that are not well-addressed through the operation of the market. Hence, it is not typical for laws to allow governments to use compulsory acquisition as the normal means of assembling land for purposes that are clearly commercial or industrial alone.

The absence of such limitations in China is an obvious artefact of the government's monopoly over the primary market of land entering into urban uses – as long as government is the sole supplier of new urban land and the sole mediator of the barrier that separates urban and rural land markets, it is to a certain extent inevitable that the acceptable purposes of compulsory acquisition are broadly defined. Tighter constraints on the use of this power – while ultimately desirable as China's land markets mature – will need to go hand-in-hand with allowing the emergence of market mechanisms that span the urban-rural divide.

Standards of compensation. Complaints of unfairness concerning the amount of compensation are often related to frequently large differences in the amounts paid to rural land owners and the resulting value of land once it has been transferred to urban users.⁷ There are perceived to be substantial profits as a result of the requisition in which dispossessed collectives and farmers do not get to share.

Underlying the problem of compensation is the discrepancy between the rights held in urban and rural land and their marketability, which is the basis for the significant difference in rural and urban land values. While farmers, under the Rural Land Contracting Law, now have a substantial interest in land which logically should be an object of compensation, this is not taken into account in the formula set forth in the Land Administration Law, and indeed, it is unclear that the "value" of such rights would provide a fair guidepost for the setting of compensation in any event, given the effective absence of a market.

Under the Land Administration Law, the value of land in terms of its eventual urban status is not relevant for compensation purposes. Instead, the standard for compensation is tied to a multiple of the average annual agricultural output over three years.⁸ In the case of land destined for commercial uses, this is likely to be significantly less than what the government

⁷ Based on the statistics provided by the Ministry of Land and Resources, about 70% of the complaints received by the Ministry in recent years are related to the disputes resulting from the land requisition process and low compensation standards.

⁸ Compensation currently consists of three legally required payments: (a) A compensation fee for land, six to ten times the average annual output value of the land for the three years prior to the requisition. This is paid to the collective owner, not the villagers who hold farmland contracts; (b) A resettlement subsidy, again paid to the collective. The standard subsidy is four to six times the average annual output value, with a maximum of fifteen times the average annual output value; and (c) compensation fees to households for structures and standing crops. Land Administration Law, Art. 45.

will receive as a transfer fee from the end user. The stated objective of the Law is to ensure that existing living standards are maintained.⁹ While this objective is unexceptional in terms of international practice, it is problematic in a context where the differential between urban and rural incomes and livelihoods is so large and growing, and where this differential itself is in part reinforced by the strict separation of rural and urban land markets.

Distribution of compensation between collectives and farmers. The issue of compensation and its adequacy is complicated by the fact that in the case of rural land, there are three levels involved: government, collective and individual farming households. Even if the quantum of compensation were theoretically adequate, there are still important issues concerning whether those funds reach the farmers. The practice has been for much of this compensation to be taken by the collective and invested in ways that might ultimately provide alternative employment for those who have lost their farmland. But farmers have often complained that they rarely get the jobs or see the other benefits projected.

Responding to the difficulties stemming from current practice, the central government through Document 28 has urged local governments to focus efforts on improving compensation. It seeks to refocus land compensation on the farmers. It provides that the relevant people's government should work out procedures for the distribution of the land compensation within the rural collective economic organizations on the basis of the principle of "land compensation being primarily used for the farmer households whose land is taken over."¹⁰

While restating the standard of maintaining existing living standards, Document 28 stipulates that farmers should be resettled on alternative land, elsewhere if necessary, or given urban status with social security and jobs. Compensation should be sufficient to sustain the original living standards of the farmers whose land has been taken and to pay the social security costs of the landless farmers as a result of land acquisition. If it is not, the people's governments of the province, autonomous regions and municipalities should approve an increase in the resettlement and rehabilitation subsidies. When the aggregate amount of land compensation, resettlement and rehabilitation subsidies reaches the legal ceiling, and still cannot ensure land-taken farmers to sustain their original standard of living, the local people's governments may use the revenues from the paid use of public land to subsidize them. It must be noted, however, that this allows urban local governments to provide better compensation; it does not require them to do so, and while some urban local governments may prove responsive, others are likely to ignore the option.

Variations in compensation depending on purpose or type of land. Another set of concerns relates to variations in how the quantum of compensation is determined, depending on the purpose of the requisition. The Land Administration Law sets maximum limits on compensation, but allows variations within those limits. Hence, local governments have significant latitude in determining compensation in different cases. In some cases, this allows for negotiation on compensation to take place between affected rural communities and local government, informed by the desire to avoid the popular unrest which has occurred over inadequate compensation in some areas. In many instances, as the case studies in Part III demonstrate, the level of compensation is linked to the eventual use of the land – land destined for administration transfer for infrastructure projects, for example (and hence little if

⁹ However, according to the National Bureau of Statistics, the income of farmers whose lands were requisitioned for urban development has plummeted by about 46% (Wang Mengkui, China Daily, May 11, 2005).

¹⁰ See further discussion of these issues in section C, below.

any transfer income for government) may result in relatively low compensation, while compensation may be much higher for land similarly situated but intended for commercial use. Where compensation differs depending upon the purpose of the requisition, the principle of equitable treatment of landholders may be compromised.

While most of the debate with regard to compensation has focused on farmland, there are other important areas that require review and legal reform:

- The Land Administration Law sets no clear standard for compensation when urban land is requisitioned for the public welfare; the Law simply states that the user should be compensated “appropriately”;
- Some collective farmland is taken by the rural collective itself to become collective construction land, in which case farmers have again generally not received compensation beyond that for structures and standing crops;
- There are large classes of rural land which are explicitly excluded from the standards of the Land Administration Law, including Forest Land and Grassland;
- Less generous compensation levels for medium and large water conservancy or hydroelectric projects are stipulated by the State Council, separately from those stipulated in the Land Administration Law

The process of requisition: To ensure that compulsory acquisition is fair and is *perceived* as such, it needs to be conducted in accordance with transparent procedures that allow those who are affected a meaningful opportunity to participate and to have access to relevant information. In the case of China, the 1998 Land Administration Law revisions demand a higher degree of transparency than before, requiring that local government must make public the resettlement plan and receive comments from the collective organizations and peasants living on the requisitioned land. However, it is noteworthy that this takes place only *after* the requisition has been approved – there is no explicit requirement that collectives or farmers be advised of the requisition ahead of time and be given an opportunity to react to the proposal.

In 2004, the Ministry of Lands and Resources promulgated new Regulations on Land and Resources Hearings, which state that a hearing must be held where basic agricultural land is to be converted to non-agricultural uses, and in other cases of requisitioning land, the parties affected must be informed of their right to a hearing on compensation standards and the resettlement package before these are submitted for approval, and such a hearing must be held if requested within five days after the parties are informed. Document 28 takes this further and states that before the requisition is submitted for approval, its purposes, location, compensation standard and resettlement and rehabilitation measures should be made known to farmers whose land is to be taken, and the results of the survey on the existing situation of the land proposed to be taken should be confirmed by the rural collective and farmer households.

In short, important steps have been taken towards improving the process of requisition from the standpoint of both the collective owner and the farmer. However, further refinements in the relevant regulations are recommended (see Part IV) and, more importantly, attention needs to be given to building the capacity of affected landowners and farmers to actually use the procedural safeguards that are available.

C. Weak land rights of farmers

Farmers continue to have relatively weak rights over land, exposing their vulnerability to unequal treatment and limiting their ability to participate in economic growth.

The problematic relationship between collective management and farmers when it comes to the distribution of compensation leads necessarily to the broader problem of which it is a part – namely, the continuing relative weakness of farmers' land rights.

As discussed above, land policy change over the last two decades has been characterized by a progressive enhancement of the land rights of farmers, based on a recognition that security of tenure for farming households is a critical condition for food security and for growth in agriculture. It is this vision that has guided adoption of the Rural Land Contracting Law and related measures.

On the other hand, this vision so far has only been partially realised. Farmers' rights remain limited and vulnerable to a number of influences, stemming both from difficulties in the implementation of rights as well as substantive limitations in rights themselves. We have seen this already in the case of compulsory acquisition, and where procedural and legal safeguards to ensure fair treatment of affected land users are often quite limited, at least in practice.

These types of concerns also arise in the case of the regulation of land re-adjustment under the Rural Land Contracting Law. Protecting farmers against the insecurity caused by frequent use of readjustments by the collective is a core objective of the new law – the practice of readjustment is, indeed, inconsistent with the new types of rights that the law creates. The law makes a major advance by prohibiting readjustments in most cases.

Despite the general thrust of the Law, however, there are important qualifications on the protections it provides, due to ambiguities in drafting and loosely defined exceptions that could be interpreted to allow the practice to continue on a more-than-exceptional basis. For example, re-adjustments are allowed in "special circumstances." While the rationale for this type of exception can be appreciated, in the absence of a very clear and narrow definition of the term "special circumstances" there is a danger that it could be interpreted broadly to support a wider range of readjustments than was intended or that could be considered within the spirit of the law.

An example of this may be found, again, in the context of the allocation of compensation after a requisition. The practice in some areas has been for collectives to use the taking of a portion of collective land as a pretext for engaging in a major readjustment. Thus all farm lands in the collective are reduced in order to compensate for the taking, without special consideration for the farmers specifically affected by the taking and any improvements or investments they may have made in their land. The danger is that this practice will continue to be condoned under the Rural Land Contracting Law as a "special circumstance" unless specifically prohibited, with detrimental effects on security of tenure.

This again, is one species of a larger problem which concerns the very nature of farmers' land rights as being nested within the relationship between individual farmers and the collectives of which they are members. The relative absence of transparent and accountable governance

structures at the level of the collective makes it hard for land contracting farmers to ensure that, where collective management has discretion to make decisions that affect their land rights, that discretion is exercised wisely. The potential for abuse of power and corruption in this context is significant.

Aside from issues concerning potential misapplication because of ambiguities and loopholes, there are formidable challenges in implementing this law and related laws such as the Land Administration Act in a manner that truly promotes the objective of strengthening farmers' rights. As worldwide experience confirms, successful implementation of any law designed to create or enhance rights depends to a great extent on the capacity of intended beneficiaries to know, understand and use the law. New rights are unlikely to be defended vigorously by Government or respected by third parties unless the rights holders themselves are in a position to assert them. This means that they need to know that the rights exist, and they need to understand them. It also means that they need practical and effective mechanisms for defending their rights when they are threatened, such as access to dispute resolution mechanisms or efficient administrative channels for registering complaints and obtaining redress. These points seem self evident, yet it is because of inattention to such issues that laws frequently fail.

Research has shown that in the case of farmers rights under the Land Administration Law and the Rural Land Contracting Law, knowledge among farmers about their rights remains quite weak. Implementation so far has not entailed the establishment of any easy-to-use process by which farmers could bring violations to light or could challenge the actions of collective land owners.¹¹ Overall, the progress of developing detailed implementation regulations under the Rural Land Contracting Act has been disappointingly slow.

Effective implementation of land rights also requires some degree of clarity about the location and extent of the land to which the rights apply, a principal reason for land registration programmes. In the case of individual farming parcels, boundaries are often unclear and undocumented, which can make it difficult to resolve disputes, to enforce 30-year contract rights and to identify those whose lands are affected by requisition, readjustment or other actions. The Government has recognised this problem and the potential role of registration in addressing it, and a pilot programme to test methods and feasibility of registering rural land is being launched soon. More reliable, precise and accessible records concerning the location of parcels and who has what rights to a given parcel should help considerably in strengthening the sense of security of contract owners, reduce disputes, and allow for the more efficient implementation of land administration laws.

On a fundamental level, of course, the legal rights of farmers are most obviously limited by the absence of rights associated with markets in land – the power to sell is limited, for example, and the power to mortgage is absent. As will be suggested in Part IV, there are interim measures that can be explored that could enhance the decision-making power of land users and allow them to realise more fully the value of their asset in the context of the wider economy, while at the same time maintaining some of the “brakes” on the full-scale emergence of a rural land market that may be perceived as important.

¹¹ Reported by the Rural Development Institute (Seattle) in various studies.

D. Over-reliance by local governments on revenue from land transfers and land-related financing.

The nature of local governments' reliance on land related income and debt is potentially unsustainable and risky.

The monopoly by government of the primary land market has stimulated a heavy reliance by local governments on the income generated from transfer fees to supplement regular budget funds and to finance urban expansion.¹² At the same time, there has been an increasing reliance on mortgage loans by local governments using requisitioned land as collateral through the vehicle of “land banks”. Both practices underscore the incentives that local governments have to pursue aggressively the requisitioning of rural land in a manner that is potentially risky, while contributing to potentially unsound forms of urban growth.

Local governments have two core elements of locally-sourced income. These consist, firstly, of the budget fiscal revenue which comprises the local government income raised from fees and taxes, in part sourced directly from land and real estate. Secondly, it includes income generated by local governments from extra-budgetary sources, of which the larger part is in relation to land and real estate activities.

As clearly demonstrated in two of the provincial reports discussed in Part III, the different taxes, charges and fees on land and real estate are limited in their incidence, and are complex. They are predominantly based either on transactions, or on statutorily fixed, usually cost-based assessments, and thus do not relate to current market values of assets. They fail, therefore, to provide the sound, asset-based tax source for local government revenue that is provided in many countries by market value based property taxes. It is understood that, in China, a large proportion of households do not pay any tax on the residential property that they occupy.

On the other hand, local government extra-budgetary income, which derives largely from the profit made by the land banking sector (e.g., when converting agricultural land to urban land from collective to state ownership), is typically very substantial. In many cases, the extra-budgetary income derived from this source may equal or exceed the local government's total fiscal revenue.

Although the nature of the property market in China in recent years, dominated as it is by the state's monopoly on land supply, the local government's access to development land at agriculture-related values and the sustained buoyancy of the economy of China, has made this an area of relatively risk free involvement for local government, it is nonetheless an area of speculative activity. The substantial possible risks taken by local governments include that they are not in a position to determine final demand for land, and that they are exposed to interest rate fluctuations, particularly in view of the fact that the land banking and development structures set up by local governments borrow substantially against the

¹² Different studies consistently show that land transfer fees account for at least 20-30% of total sub-national government revenues. Based on a report from the Xinhua News Agency issued on June 24, 2004, total revenues from the land use right transfer fee were as high as RMB910 billion in the past three years (about US\$110 billion); and in some provinces, the transfer fee revenues were higher than the governments' fiscal revenues.

appraised “market value” of the land. The nature of the rules governing the property market massively distort local government incentives, both at the institutional and personal levels, encouraging the conversion of agricultural/collective land into urban/state land as swiftly as possible. The rates of growth of the urban areas in recent years revealed by the surveys, and further evidenced by the rate of increase in investment in fixed assets both tend to confirm this.

The potential volatility of local government income from this area and its sustainability in the event of significant changes in the factors affecting market demand, the finite nature of the land resource for expansion, and interest rate fluctuations are major concerns that go significantly beyond local government in their potential implications. In addition, while it is understood that both fiscal budgets and extra-budgetary resources are subject to audit and monitoring, there is less accountability and transparency in relation to extra-budgetary resources, their administration and expenditure.

Property taxation and local government finance are at the critical juncture of several administrative and jurisdictional boundaries, and have important policy ramifications. These range from the effects of mortgage finance on local governments’ (often speculative) land banking activities and the stability of the banking system, to the national policy of farmland preservation and food security.

The State Tax Administration is exploring alternative approaches to property taxation and pilot activities in selected districts of six cities are to be scheduled, although specific plans for their implementation have not been formulated yet. The Administration is considering the most appropriate type of land and property tax to introduce, particularly in relation to standard bases for assessment of value, the frequency of revaluations and the appropriateness of mass valuation approaches. The implications of such a transition and the lack of appropriate staff and expertise were observed by the Administration, together with the need for appropriate capacity building and an appropriately phased transition.

Finally, reference must be made to the evolution of land banking in the Chinese context. From being essentially a *planning* tool, devoted to the timed and targeted release of surplus government land in support of overall planning objectives, land banks have become largely a conduit for requisitioned lands that are slated for disposal through auction, devoted to profit maximization and to securing land-backed loans. Land banks are mortgaging the land they hold to state banks, for periods of one, two and up to ten years, and investing the loaned funds in urban development. (Government itself cannot borrow from banks.) The land banks invest the proceeds of the loans in urban infrastructure and development, through public or quasi-public enterprises such as urban construction companies and urban transport companies. The scale and intensity of the activity is not typical of land banking elsewhere in the world, and while comprehensive data on the volume of such lending is not available, it is understood that the volume of lending may be large and could create a serious exposure for state lending institutions. In the long-run, both local finance and banking stability may be jeopardized.

There is no national law or national regulation on land banking, though the practice is referred to permissively in some government documents. The lack of specification of roles and parameters for the land bank institution in national law or regulation has allowed municipalities to develop this institution in unexpected ways, some of them potentially alarming. In a few cases there appear to have been efforts at provincial level to regulate land banking, for instance in Henan, where land banks can now borrow against only 80% of the

value of the land they hold, but urgent consideration should be given to a national law on land banking. (For more detailed discussion of this issue in the context of two provinces, see Part III(A), below.)

E. Difficulties in reducing the rate of farmland conversion

Regulatory measures to restrict farmland conversion have not been fully effective in the face of strong contrary incentives.

The rapid outward spread of cities has led to increasing concern about the loss of China's farmland. This concern is underscored by the relatively small percentage (14%) of land that is arable and the country's long-standing commitment to achieving food security. Between 1996 and 2002, farmland disappeared at an average rate of 685,000 ha/year, and the rate is accelerating.¹³

In response to these trends, the central government has put in place a number of important restraints on the conversion of agricultural land. "Basic farmland" was designated in 1995 as a category of land that requires special protection. By law, this category is set at a minimum of 80% of cultivated land; in some areas, basic farmland comprises up to 85-90% of agricultural land. Document 28 reaffirms a strict approach to non-conversion of this land, referring to its borders as "a red line" that must not be crossed, and reemphasizing the importance of basic farmland to China's food security.¹⁴

The Land Administration Law (Arts. 31-42) also imposes legal controls on conversion by providing for protection of all farmland. Any cultivated land used for other purposes must be replaced with other land of similar size and quality. There should be no net loss of farmland, and any farmland must be converted to other uses only in accordance with planning quotas. In addition, the approval of the State Council is required (Article 45) for requisitioning of a) basic agricultural land, b) 35 hectares or more of cultivated land, or c) 70 hectares or more of other land.

Planning quotas for farmland conversion were set in 1997 covering a 13 year period up to 2010. Quotas are established at the provincial level, and within provinces at various sub-provincial levels. The pace of conversion in some provinces, however, has been so high that some provinces and sub-provincial units have already used up their quotas – this is true, for example, in Zhejiang province as a whole and in Xi-an City in Shaanxi province, as the DRC case studies report. Areas exceeding their quotas must either purchase quotas from other areas (allowed within a province but not between provinces), or intensify land reclamation. Land can be reclaimed from defunct TVEs, from riverbank land, or from land around brick kilns. This can also be done by bringing abandoned or unutilized land under production, by retaking land not used by right-holders for 3 years, or through land consolidation exercises.

¹³ Based on the statistics provided by the Ministry of Land and Resources, the loss of arable land was 260,000 ha in 1998, 430,000 ha in 1999, 1,000,000 ha in 2000, and 1,670,000 ha in 2002. It should be noted that there are different reasons for the loss of arable land, such as land retirement programs, restructuring agricultural production, and urbanization. Based on available data, it is estimated that about 27% of loss of arable land resulted from urbanization.

¹⁴ Based on 2004 China Statistic Yearbook, China has 130 million ha. arable land. If the goal of food self-sufficiency is set at 95% (i.e., 95% of food consumption must be produced domestically), China must maintain arable land at 123 million ha by 2030; if the goal is set at 90%, China must maintain 117 million ha by 2030.

Monitoring and enforcing the proper implementation of conversion controls is a complex and difficult task, and a number of evasion techniques are known to be widely practiced by local officials. These include (i) replacing converted farmland with smaller amounts and with poorer quality land, despite the Land Administration Law's standard of replacement with "land of similar quality and quantity" (Art. 31); (ii) altering of land use plans after approval, and (iii) acquiring farmland in blocks of less than 35 hectares each to avoid the matter going for State Council review.

These types of practices are noted and specifically prohibited by Document 28 and strict enforcement ("severe investigation and prosecution") is urged. More generally, Document 28 withdraws final approval of land requisitioning from local governments, pulling it back to provincial level. This means the decisions will be taken at a level without such a direct financial interest in the outcomes. Document 28 also seeks to ensure more effective use of the planning process by urging stricter use of the pre-review to catch projects without properly planned-for quotas, and by announcing that those units that exceeded their quotas for 2004 but cannot pay the cost of replacement will find their allocation for 2005 postponed.

The efforts of Government to impose tighter regulatory controls on farmland conversion underscore the immense national importance ascribed to this issue. It remains to be seen to what extent the latest measures will be effective. Ultimately, as Part IV will discuss, evasive techniques will be difficult to suppress if steps are not taken to alter fundamentally the economic incentive structures that help drive urban expansion at its current rapid pace.

III. A Closer Look: the Findings of Three Provincial Reports

As noted above, DRC and its partners have initiated a programme of research at provincial levels and below, in order to explore the critical land issues facing China in greater depth and specificity. Three provincial studies were completed in 2005 – Zhejiang, Shaanxi and Guangdong. These studies, summarized below, provide unique insights into the dynamic relationship between China's urban growth, and the assortment of regulatory mechanisms, administrative structures and economic incentives that together comprise China's current land policy framework. Notwithstanding important regional differences, the research completed so far suggests that there are core aspects of land policy reform and implementation that will have wide-spread relevance across regions.

A. Land issues in Zhejiang and Shaanxi: contrasts and commonalities

The first two provinces to be studied were selected in large part because of their dissimilarities. Zhejiang and Shaanxi are representative, respectively, of (a) an eastern area undergoing rapid industrial and commercial growth and (b) a western area in which the pace of economic growth is weaker and far more dependent on government-led investment. As will be illustrated below, because of the quite different economic profiles of the two provinces, there are important differences between them in terms of the way various land-related issues play out.

But perhaps even more striking than the differences are the *similarities* that emerge from these two studies. In both provinces, the overarching features of current land policy are essentially the same, and the effects, while differing in magnitude and details, are similar. The main shared feature, operating at the interface between urban and rural land, is *government's monopoly of the primary land market* – that is, the requirement that all land undergoing conversion to urban uses must first be acquired by, and then reallocated by, government. Related to this feature are certain recurring and inter-woven themes: urban expansion that is driven in part by low rural land values and administrative incentives; heavy reliance by local governments on land transfer income and mortgage debt as a source of revenue, in the absence of value-based annual taxes; a sharp and artificial divide between urban and rural land markets, land values and property rights regimes, with particular disadvantages for farmers; and land acquisition practices that do not result in a fair sharing of the increasing value of land.

Contrasting profiles: Although a detailed presentation of the economic, demographic and geographic profiles of Zhejiang and Shaanxi is beyond the scope of this paper, some basic points of contrast are worth noting as a framework for the discussion that follows.

Zhejiang is economically one of the powerhouses of China. As such, both household incomes and the overall financial health of local governments are above the norm [See Table 1]. It is a highly urban province, with an urbanization level of 54%. This urban growth has been driven and accompanied by high rates of growth in industry and commerce, and has been characterized by the emergence of substantial urban centers spread out around the province, rather than concentrated exclusively in one or two places. There is a very high level of investment in real estate, reflecting relatively high and growing purchasing power among the urban population.

By contrast, Shaanxi is a significantly poorer province and its local governments are correspondingly less robust financially. While the pace of urbanization is brisk, the province remains more rural than Zhejiang, with only 35% of the population classified as urban. Unlike Zhejiang, urban growth has been very concentrated, primarily in Xi-an. To a very significant extent, urbanization in Shaanxi has not been accompanied by the kind of industrial growth witnessed in eastern provinces, but has instead been driven primarily by large government investment in infrastructure, mainly by virtue of the West Regions Development Strategy. There has been relatively less expansion, therefore, in commerce. There has been a big investment in real estate construction, but without sales to support it.

Table 1: Major Social and Economic Indicators for Zhejiang and Shaanxi Provinces in 2004

Indicator	Zhejiang Province	Shaanxi Province
Total land area <u>km²</u>	101,800	205,800
Total population <u>million</u>	47.1957	37.0520
Urbanization degree	54%	32.98%
Disposable income per capita of urban resident <u>RMB</u>	14546	7492
Net income per capita of rural resident <u>RMB</u>	6096	1867
Economic growth rate	14.3%	12.9%
GDP <u>billion RMB</u>	1124.30	288.35
First industry	7.26%	13.70%
Second industry	53.77%	49.14%
Third industry	38.98%	37.17%
GDP per capita <u>RMB</u>	23942	7757
Gross value of imports and exports <u>billion USD</u>	85.230	3.643
Imports <u>billion USD</u>	27.070	1.246
Exports <u>billion USD</u>	58.160	2.397
Total local government revenues <u>billion RMB</u>	80.6	21.5
Per capita local government revenues <u>RMB</u>	1707	579

Factors driving conversion – industry vs. infrastructure: A key difference between the two provinces relates to the main motivations underlying the rapid conversion of agricultural land, which in turn is related to the different engines of development that dominate in the respective provinces. In Zhejiang, industrialisation has been responsible for a relatively high percentage of requisitions. By contrast, Shaanxi has seen a relatively higher allocation of land to infrastructure uses, reflecting the fact that economic growth in the province has been very heavily dependent upon central government investment in the West Regions Development Strategy. These differences have a number of implications in terms of consequences for those who lose land and in terms of the relative benefits gained by local governments and economies. One difference relates to the relative contributions land use investments make in terms of job growth. The heavy entry of government into land requisition for infrastructure in Shaanxi, for example, has apparently few sustainable long-term benefits in this regard. There is a temporary boom for the construction industry, but few industry or commerce related jobs, and hence little overall boost to spending power or to the tax base. By contrast, the emphasis on industry in Zhejiang has contributed to job creation, which in turn to some extent also softens the blow for dispossessed farmers – there are at least alternative potentially attractive economic opportunities for farmers, which do not exist to the same extent in Shaanxi, where land loss also often leads to unemployment.

Comparing rates of land conversion: As in all parts of China, rapid urban growth in Zhejiang and Shaanxi has depended heavily on government requisition of agricultural land and its conversion to construction land.

In Zhejiang, conversion has taken place at rates far faster than anticipated even a few years ago. By 2003, the 1997-2010 provincial quota for the conversion of agricultural land to construction land set by central government had almost been exhausted. Between 1997 and 2003, Zhejiang converted 974.9 thousand mu out of the total thirteen-year quota of one million mu. The Zhejiang experience also illustrates the inventiveness of local governments when faced by high pressure for construction land on the one hand, and by the limits imposed by quotas on the other. In addition to quota land, governments in Zhejiang have aggressively assembled construction land through so-called “reclamation” procedures – ie, the taking of abandoned land, the use of land of defunct state enterprises and related techniques. Over the same six year period, an additional 936.9 thousand mu were added via reclamation to the total stock of construction land in the province. As part of this complex of techniques, local governments have used various ways of creating “new” farmland to offset land used under the quota.

Overall, the rate of conversion has been slower in Shaanxi – as of 2003, a total of 412.3 thousand mu had been converted out of a total quota of 800,000 mu, leaving about half of the quota unused. However, the locus of conversion has been highly concentrated geographically, in line with the disproportionate concentration of urban growth around Xi-an. By 2003, conversion of land to construction use in Xi-an had already reached 171.3 thousand mu, exceeding by 35 thousand mu its total quota up to the year 2010 of 135 thousand mu.

Requisition methods: The variety of techniques used by governments in both Zhejiang and Shaanxi to transfer requisitioned land to end users reflects the dual role that such land plays in local government finances: as a subsidy for urban development and as a source of revenue.

In both provinces, the great majority of land serves the prior function, as evidenced by the fact that most land is transferred administratively or through a so-called “contract” approach. *Administrative* transfers are to government users, for the construction of infrastructure or for the pursuit of some other government function. This transfer method obviously brings in the lowest (if any) returns to the transferring government. Approximately 35% of transferred construction land between 1998 and 2003 in Zhejiang falls into this category, compared to 50% in Shaanxi, reflecting the relatively heavy focus on support to infrastructure development in the latter province.

By contrast, *contract* transfers are used in the case of industrial land, entailing direct negotiation between government and a prospective industrial user (45% of construction land in both Zhejiang and Shaanxi from 1998-2003). Here as well, the price charged for the land is not related to any market value, but instead typically reflects the effort of governments to attract industries through reduced transfer fees. According to the Zhejiang study, concerted efforts have been made to ensure that the price of such transfers remains low by placing a ceiling on the contract price for land. As a result, the transfer price for industrial land is frequently lower than the costs incurred by Government in acquiring and preparing the land, and estimated to be several times lower than what could have been obtained through auction. Only recently, in response to supply constraints triggered by the “land freeze” imposed by central government’s macro-economic policy, has this approach been modified to require that if there are two or more contenders for the land, an auction approach must be used.

It is only a relatively small amount of land in both provinces (20% for Zhejiang and 5% for Shaanxi for 1998-2003) that is disposed of by government through *market or quasi-market mechanisms*, such as auction. This is land that is slated primarily for commercial or real estate developments. It is noteworthy that the use of this technique in Shaanxi began only in 2002, thus significantly later than in Zhejiang, once again underscoring the differences between the two provinces in terms of the drivers of urban growth.

While the overall percentage of construction land transferred through auction is small, the financial benefits that local governments receive from such transfers are substantial, as is the extent to which governments have correspondingly become dependent on such benefits. Both phenomena are supported by detailed data in the provincial reports, and replicate broadly the patterns reported elsewhere in the country.

Local government finances and the role of land: The dependence of local governments on land transfer income as a source of extra-budgetary revenue is related to a number of factors. Local government budgets, comprising transfers from central government, and an array of fairly minor taxes and fees, are reported in both provinces to be barely sufficient to the task of supporting the running of the administration; in the case of Shaanxi, governments are sometimes not even able to cover the costs of wages, which were in arrears up to 2000. In neither province are regular budgets able to support to any significant degree the large costs associated with urban expansion.

The nature of local taxation and the sharing formula between local and central governments of those taxes that are to some degree significant in terms of revenue, are major factors in this budgetary weakness, as has been reported more generally above. The overall tax base for Zhejiang is stronger than for Shaanxi, due to a higher level of industrialisation and commercial development; in Shaanxi, a heavier reliance is placed on taxes on the construction and real estate development industries, both of which to a certain extent profit from the process of urban expansion itself. But VAT and corporate income tax are shared with the central government to such an extent that their overall contribution to local revenue is limited. In Shaanxi, “a dual loss of cultivated land and revenue” is reported, because so much of the requisitioned land is used for government projects, and such projects are frequently supported not only by land subsidies, but by the waiving of various taxes such as the “cultivated land occupation tax.”

Both provinces have in place myriad fees and taxes directly on land, though these are generally minor in nature, and are for the most part one-off charges payable on transactions, land use changes, registration and the like. They are not reliable sources of predictable levels of revenue over time. This relatively weak contribution of land-based taxation to local coffers, coupled with the very heavy dependence on land transfer income from requisitions, once again brings into glaring relief the absence of a property tax, as discussed at various points throughout this paper.

Land banking and land-secured debt. The nature of land banks and land-banking practices as reported in these two provinces provides additional insights into the scope and significance of local government’s dependence on the requisition process, both as a source of extra-budgetary revenue as discussed above, and as a vehicle for acquiring loans to further meet the financial demands associated with infrastructure development.

In both provinces, land banks have been established in virtually every locality. The original idea of land banks was to handle land held in government reserves (land of obsolete state enterprises, etc.) Now, as also has been reported in other parts of China, a very high percentage of the land held by land banks is directly requisitioned land. In Zhejiang, this figure is 75%. In Xian-yan in Shaanxi, 92.2% of the land bank's land reserve comes from collective lands, 87% of which was directly requisitioned. In short, from being essentially a *planning* tool, devoted to the timed and targeted release of surplus government land in support of overall planning objectives, land banks have become largely a conduit for requisitioned lands that are slated for disposal through auction, devoted to profit maximization and to securing land-backed loans.

The provincial reports provide important detailed insights into the now very significant role of land-secured debt in local government finances, as urban governments struggle to meet the costs associated with rapid urban growth.¹⁵ As a percentage of total city construction capital in major urban parts of both provinces, bank loans play an increasingly dominant role. For example, in S County in Zhejiang, of a total 6000 million Yuan invested in city infrastructure in 2003, 63.87% came in the form of loans, as compared to 32% from land transfer revenue. Even more dramatic percentages apply to J City over a four-year period from 2000, where 72.9% of the total city construction investment was loan proceeds, against 14.3% from land transfer revenue. In Shaanxi province overall, the reliance on loans has also dramatically increased; about 50% of all construction costs are now covered by mortgage loans.

Land banks are central players in this process. Due to applicable laws, governments themselves cannot mortgage their own land; for land to be eligible as collateral, an urban land use certificate must have been awarded to a transferee of the state. Hence, mortgage loans are typically secured by land held by, or in the process of being requisitioned by, a land bank (or some analogous entity such as a government finance company or industrial park company), to which a land use certificate can be issued.

In fact, land in the two provinces is used to secure two types of loans. One is a straight mortgage loan, typically for a term of 1 to 2 years. The other is a so-called "income pledge loan", which is a loan secured by the future income from a piece of land, which may already be construction land or is in the process of being converted. The latter is more heavily used in economically weaker regions such as Shaanxi, where the land market suffers from a weakness in demand, and the turnover rate for land held by land banks is low – as reported for Shaanxi, most of the land reserved by the land banks in that province between 2000 and 2004 continue to be held in stock due to low demand. By contrast, where turnover is rapid and the land market is active, as in Zhejiang, the use of straight mortgages in this context is the norm.

The Zhejiang and Shaanxi research helps identify in some detail various risks posed to local governments and to the provincial and national economies as a whole by the dramatically increasing reliance on land-based debt:

- First, there is the risk to banks of default by borrowers, a risk that is higher in areas where market demand for commercial land is weak, thereby threatening the ability of land banks to service loans through the raising of funds from land transfer fees. This risk may be exacerbated in wake of the central government's land freeze policy.

¹⁵ Reliance on loans is also in part entrenched by restrictions on local governments issuing securities.

- Second, there are risks associated with the unclear legal framework that governs these transactions. Multiple laws and regulations exist, issued by different parts and levels of government, with varying and uncertain legal status. Inconsistencies and uncertainties in this framework thus make it difficult to determine applicable rules and apply them in a predictable and appropriate way, or to monitor their implementation.
- A third set of risks concerns the legal status of the land banking sector and problems in its operation. There is a serious lack of equity in the land banking sector, which poses serious risks to the loaning banks. In addition, there is often a time gap between when the loan is obtained and when the land use right is actually obtained by the land bank, given the frequent practice of using loan proceeds to finance the requisition – in such cases, mortgage registration technically happens only after the loans have been made, further adding to the risks of banks. Finally, as land banks in essence increasingly play the role of real estate developer, there are all the usual risks associated with that role in a very volatile and unpredictable land market setting.
- Fourth, land banks as a subsidiary government institution are subject to government interventions and operations that can pose risks. One is related to the fact that land transfer fees go not directly to land banks, but instead through government financial departments first, with potentially long delays that can have serious consequences for the land bank's ability to meet its loan obligations in a timely fashion. Another is more broadly related to the heavy overall role of government in the land market, and the fact that government policy objectives as expressed through that role can result in substantial reductions in land prices generally, again putting at risk the land banks ability to repay its debts. In S County in Zhejiang Province, net income from land transfer revenue had fallen to 250 million Yuan in 2004 from 400 million the year before, while the government's planned investment in infrastructure is expected to require capital in the amount of 1000 million.
- Fifth, there are special risks associated with land income pledges. The legal status of this type of loan is very unclear, due to the fact that the Guarantee Law makes no specific mention of it, and there are a number of legal loopholes. In addition, there is no specific agency responsible for registering this type of pledge, with the result that the same borrowing entity may borrow against the same land income multiple times with different banks without the respective lenders necessarily being aware of the others' interests.

The significance of these threats is difficult to quantify at this stage, but at a minimum, they warrant serious attention through monitoring and clarifications to the legal framework. In the long run, they are best addressed by finding sustainable solutions to the revenue problems of local governments that will wean them of the current lop-sided dependency on loans and transfer fees.

Effects on dispossessed farmers. Thus far, this summary of the Zhejiang and Shaanxi research has focused on the role played by requisitioned land in local government finances and land market development. But what about the other side of the equation – ie, those individuals, households and entities most directly affected by requisition practices, the farmers and the collectives to which they belong?

As the reports make clear, in both provinces the fast pace of requisition over the last decade has had profound effects on those who own or use rural land. Over a 3 year period from 1999 to 2002, nearly 1.7 million farmers were affected by requisitions in Zhejiang province. The rate was smaller but none the less significant in Shaanxi, where 980,000 farmers have lost land over the last decade. In Zhejiang, it is suggested that the opportunities provided by a booming economy have to some extent helped absorb displaced farmers into alternative livelihoods. The Shaanxi report provides a less positive picture of the effects of requisition in a less vibrant economic context. Of those displaced over the last decade, it is estimated that 35% are still in agriculture, 19% remain in rural areas but in non-agricultural occupations, 19% have migrated, while 26% are “home and idle.”

In both provinces, land requisition has occasioned a significant and increasing number of complaints over the years filed by farmers with state land departments and other government branches. In Zhejiang province, the statistics kept by the state land department reveal a range of complaints – about unfair levels of compensation, the manner in which it has been distributed, and the process by which requisition has been conducted. It is difficult on the basis of available statistics to gauge how deep the perceptions of unfairness run and to assess the relative weight and legitimacy of their varying causes. Nevertheless, the evidence of discontent on this score in Zhejiang and Shaanxi echoes a trend that has already been noted on a national level and to which the central government has alluded in Document 28 and other documents.¹⁶

While the standard formula for calculating compensation applies as set forth in the Land Administration Law, the provincial research provides insights into how this is applied in practice in various different situations.¹⁷ One such insight concerns the variations in the amount and timing of payment. In theory, compensation is not affected by the ultimate sales price to the end user. On the other hand, evidence from Shaanxi shows that compensation tends to be lower when the end use is not one that is profitable for government – hence, in practice if not in theory, there is a link at times between end price and compensation, though usually in a negative sense (ie, there is more likely to be a lower price or delayed payment of compensation because government is cash poor and the land is being transferred administratively; there is less likelihood that compensation will go up significantly where the opposite is true, though there are exceptions.)

Another area of concern relates to process. The Shaanxi research reveals that on some occasions farmers have noted that they are excluded from participating in the process of reviewing the area to be acquired ahead of time, and of applying the calculation to that particular area. The result is that farmers had no opportunity to present their own interpretation of the various measures that go into the calculation, and were also less able to prevent compensation being directed to collective management rather than reaching to the level of individual farmers. Interestingly, there is anecdotal evidence that the introduction of a standardized calculation in the Land Administration Law (aside from whatever the merits of

¹⁶ Based on information provided by the Department of Land of Zhejiang Province, the number of complaint letter related to land requisition and compensation received by the Department increased from 512 in 2000 to 1058 in 2002. Of those processed letters, about 60% focused on the issue of low compensation, 15% focused on the issue of unfair distribution of compensation fee within collectives, and 13% focused on the lack of legality of requisition procedures.

¹⁷ In both provinces, the formula for compensation is based on a multiple of the annual production value of the land over the previous three years, up to the limit set by the Land Administration Law. In the case of Zhejiang, compensation to the Collective is calculated by using a multiple of between 6 and 10. The resettlement subsidy, which theoretically goes to the individual farmer, is calculated using a multiple of between 4 and 6.

that formula might be) has influenced the process of requisition in a way that some farmers find unfair, because it has reduced the interaction and “bargaining” between farmers and local officials that used to take place.

Importantly, however, the provincial research also provides interesting examples of genuine efforts by governments to respond to perceptions of unfairness, and of *ad hoc* experimentation with various techniques that are intended to increase the share of farmers in the rising value of land in the context of rapid urbanization. These have taken various forms:

- The most direct method has been to introduce fixed increases to the calculation of compensation. Thus, in S County of Zhejiang Province, the county adjusted the standard for calculating the value of annual output with the result that compensation increased by 23%. In J City, average compensation per mu increased by 30% because of an adjustment in 2004.
- Another approach tried in Zhejiang has been to reserve a portion of requisitioned land as construction land for the benefit of the affected village. There are examples of this producing quite significant returns in some Zhejiang townships. The land can be used by the village for the building of factories, office buildings and the like, and the village will retain rent and other revenues. Alternatively, the land can be disposed of at market value and the village will be entitled to use the proceeds for its own investments.
- In some cases, an effort has been made to re-arrange the use of remaining land after a requisition so that affected farmers can make more valuable use of that land. For example, there have been experiments in Zhejiang with promoting the building and subsequent market rental of larger houses in villages on the urban fringe.
- Finally, from Shaanxi comes quite important examples of inventive use of collective construction land, reference to which shall be made in connection with the more detailed examination of this issue in the context of Guangdong (see Section B, below).

These types of experiments need to be further studied and built upon as the search continues for innovative ways to ensure that China’s farmers share more fully in the increased value realised by government through the requisition of their land.

In short, one can summarize the variations encountered in the ways these two provinces deal with compensation issues as follows:

With respect to the quantum of compensation paid, in Zhejiang, farmers tend to be successful in obtaining compensation according to the standards set under the law, and overall, the standards used in the province have been rising in recent years. In Shaanxi, by contrast, the prevailing actual rate of payment is frequently below the minimum legal standard, influenced (though not justified) by the fact that a high percentage of the acquired land is transferred to infrastructure uses, with a correspondingly lower return to local government.

With respect to the pursuit of alternative methods of improving the overall compensation package, Zhejiang has employed a number of institutional innovations, such as reserving a portion of requisitioned land for the collective to use, or supporting the development of house rental schemes to enhance farmers’ incomes. In Shaanxi, the exploration of these innovations

has been much less extensive due to the weaker state of government revenues and under-development of the land market.

B. Guangdong and the innovative use of collective construction land: opportunities and risks

As noted earlier in this report, despite the prevailing state monopoly of the primary market for urban land, there have been notable examples in some parts of China (particularly the most developed eastern provinces) where this monopoly has been loosened to a significant extent. This loosening has generally taken the form of collective owners avoiding the formal requisition process by dealing directly with enterprises for the use of collective construction land. The research from Guangdong Province focuses primarily on this phenomenon, with reference to other provinces where this approach is also common (in particular Jiangsu and Zhejiang provinces).

Basically, these approaches entail the *de facto* leasing or transfer of land use rights over collective construction land, notwithstanding legal prohibitions, through various devices. Collectives, having the right to establish their own enterprises on collective construction land, may instead enter into an agreement with an enterprise interested in developing the land. One variation of this, for example, is when a collective informs government that it intends to establish a particular project, and thus obtains approval for converting agricultural land to collective construction land and a use certificate in the name of the collective is issued. The actual cost of setting up the plant is paid by the party who wants to rent the land. The collective thereupon enters into a “leasing contract” with that party, which is not disclosed to government. There are numerous other variations on this theme.

Where these techniques are wide-spread, they play an important part in the local economy, and are widely condoned – at least tacitly – by governments. Some indicative statistics reported from a number of places helps illustrate the local significance of these approaches:

- As of 2000, in Nanhai City, 73 thousand mu out of a total of 150 thousand mu of industrial use land was collective construction land, a figure which still does not include a substantial amount of other land that was converted by collectives to non-agricultural uses.
- In Dongguan City, non-agricultural construction land amounted to 1.03 million mu in 2002, of which collective granted land constituted almost 51%.
- In the entire Zhujiang Pearl River Delta Area, it is estimated that collective construction land constitutes nearly 50% of the total quantity of construction land.

The DRC research into this phenomenon has identified a number of important benefits:

First, it accelerates local industrialization and promotes rural economic transformation. Average land use prices from the Pearl River Triangle indicate that land obtained through these methods is usually considerably cheaper than through the formal route of state requisition and transfer. By 2002, in Nanhai City, Shunde City, Dongguan City and Zhongshan City, the ratio of agricultural product values to economic gross product was less than 10%, with 90% of the labour force transferred into the second and third industry.

Second, the long-term incomes for collectives and farmers are frequently higher than could be obtained through requisition compensation, and the rental income is likely to go up over time (In addition, collectives and farmers retain reversionary interests upon the expiry of the lease.)

Third, it can apparently lead to a more appropriate role for local governments, with government no longer playing the role of investor and operator, but instead focusing on taxation and the provision of public services.

At the same time, however, there are significant risks involved:

First, most of these arrangements operate on the margins of the law, if not in outright violation of the law. The absence of a strong legal foundation has consequences in terms of the security of the interests of both the collective and the investor. This is particularly true when conflicts arise, which apparently is frequently the case – as the contract is technically illegal, there is no established procedure for resolving disputes according to the rule of law. In the absence of a legal framework, parties are often stimulated to breach or find loopholes in their agreements. Finally, the enterprise is not entitled to a land use certificate, and hence cannot count the land right amongst its assets, nor can it use the land for securing a mortgage.

Second, the current state of affairs poses dilemmas for governments. If they decide to enforce the law through stopping these illegal activities, they risk reducing economic growth. If, on the other hand, they would like to regulate these activities, they lack the legal tools to do so. So in practice, they tend to “look the other way”. The result is that there is often an excessive supply of collective construction land which lowers land prices, with consequent losses for both government and collectives, and a relatively chaotic land market.

Third, an excessive percentage of income from these arrangements tends to go to the collective, with farmers often losing out – a situation once again aggravated by the legal informality of the arrangements. While in the best situations, the farmers may receive a good dividend, the problems associated with management of the collective economy, such as over-sized bureaucracy, excessive administrative expenditures, non-separation of collective’s administrative functions from economic functions, and lack of supervision over the power of insiders, result in low efficiency of using the income from the leasing, and a certain amount of the income will in effect be transformed into non-performing capital.

In response to these types of problems, some local governments have taken steps to develop their own regulatory framework for these types of lands. Guangdong province itself has promulgated a *Notice for Provisional Practicing Rural Collective Construction Land Use Right Flow* in June 2004. Conceptually, this policy represents a major step towards achieving parity between collective and state land rights. It –

- allows the leasing, transfer and mortgaging of collective construction land;
- establishes the same time frame for such transactions as apply in the case of state land;
- stipulates planning and registration requirements;

- establishes procedural protections to ensure that individual farmers can participate and that collective decision-making is transparent; and
- regulates the usage of income to ensure a percentage is distributed to farmers.

According to DRC research, the response in Guangdong to this new policy has been very enthusiastic. However, despite the advance represented by this policy, it remains only a local policy and one that is in a number of respects in conflict with the Land Administration Law. Hence, until the basic legal framework is revised accordingly, the extent to which the promise of provincial initiatives such as this can be realised is limited. The Guangdong initiative does, however, point the way for the eventual modification of national laws.

IV. Moving Forward

A. An integrated approach to improved land policy

As this report has shown, accelerating economic growth and urbanization in recent years have gone hand-in-hand with economic liberalisation and a number of fundamental land policy reforms instituted by the Government of China. Important measures have been put in place, for example, to strengthen progressively the tenure security of farmers and urban dwellers, to reduce the pace of farmland conversion and to enhance the marketability of urban property.

At the same time, as outlined in Part II and as further illustrated by the case studies of Zhejiang, Shaanxi and Guangdong provinces, critical challenges remain.

Meeting these challenges effectively will require *coordinated* action to address how land is administered and managed in the economy, involving numerous agencies and different levels of government. It will also require an *integrated* approach – as the discussion in Part II has demonstrated, the problem areas that need to be addressed are intricately bound together in terms of causes, ramifications and potential solutions, and cannot be effectively resolved in isolation from one another.

Finally, moving forward requires defining *desired objectives* and identifying short and medium term *actions* for achieving those objectives. This in itself is a major exercise, requiring considerable testing, research and consensus-building beyond that which has already been completed. It would therefore be premature at this stage to propose a comprehensive reform agenda. However, it is possible and useful to propose a framework to guide the development of such an agenda. That is the purpose of this Part.

B. Policy vision

To guide consideration of the action and sequencing suggestions below, an overarching vision of the long-term goals of land policy in the context of modern China is required. Based on the analysis and research summarized earlier in this report, we recommend the following formulation of such a vision as a starting point for discussion.

Land policy should aim at:

- 1) Supporting the agricultural sector by preserving farmland, fostering market-led transfers for efficiency of agricultural production and supporting rural-urban demographic change including social safety nets for individuals adversely affected by these changes;
- 2) Promoting the expansion of the manufacturing, service and housing sectors by making land available for urban growth through market-based mechanisms within an economically, socially and environmentally sound planning framework;
- 3) Supporting government revenues, particularly at local levels, to use land assets as a basis for sustainable public revenue to fund public services and investments;
- 4) Facilitating the use of land as capital through mortgage markets in order to increase the pool of assets available to back financial system growth;

- 5) Supporting land use planning decisions which are compatible with rapid economic growth in a market-led context and which appropriately address and safeguard the environment; and
- 6) Increasing coherence and integrity of land rights and administration to ensure increasingly secure access to land.

This elaboration of a policy vision, it is suggested, is useful for two reasons. First, it captures the specific needs of China as it seeks to adapt land policy to its unique situation at this point in its history. Second, it aptly sums up the accumulated learning of other major market economies around the world which have themselves grappled with understanding the role and importance of land policy in support of economic growth and poverty alleviation.

The research undertaken so far, given its special focus on land policy in the context of rapid urban growth, also makes it possible to articulate another over-arching strategic consideration, one that needs to be taken into account if the above five-point vision is to be realised:

Changes to land policy and practice should be guided by the overall goal of integrating the treatment of urban and rural land. Steps should be taken progressively to integrate urban and rural land markets, rights, planning and administration, including reducing the government's monopoly over the primary market for urban land.

In no other major market economy in the world does there exist as significant a separation in the treatment of rural and urban land as in China. These spheres are subject to different rights regimes and are administered by separate institutions and rules. At the rural-urban interface, the sole mediator is the government, which has exclusive power to acquire rural land and transfer it to urban users. As we have seen, this acute separation leads to a number of undesirable consequences including unequal treatment of urban and rural land users, distorted land prices and incentives for undesirable forms of urban growth. *The importance of progressively addressing the urban-rural divide, thus, serves as a unifying thread connecting the diverse recommendations below.*

C. Proposed long-term objectives and interim actions.

This section puts forward for consideration nine long-term objectives to guide the ongoing adjustment of China's land policy. These objectives are as follows:

- Objective 1: Clarify, secure and broaden the rights of landholders and promote greater equivalence of rights over land within different contexts*
- Objective 2: Ensure fair treatment and adequate compensation for those affected by compulsory acquisition*
- Objective 3: Promote more efficient use of farm land and urban land*
- Objective 4: Enhance the role of land as a sustainable foundation for local government finances.*
- Objective 5: Rationalise the institutional framework for land*
- Objective 6: Strengthen the legal framework and rule of law for land*
- Objective 7: Build capacities for land administration*
- Objective 8: Strengthen protection of the environment*

Objective 9: Create an adequate knowledge base through piloting and research

The first four objectives deal with specific issues that need to be addressed, while the last five relate to cross-cutting considerations (development of the institutional and legal framework; capacity building; environment; piloting and research) that have broad application to each of the first four substantive objectives.

For each long-term objective, actions are suggested that can be taken in the short and medium term to move towards the objective, while at the same time testing and evaluating the soundness of the objective itself and the possible need for re-formulation. Efforts are made throughout this Part to provide illustrations from international experience that may be useful as China considers the desirability and appropriate shape of future actions.

Again, it must be stressed that all these objectives are closely inter-related – while they are useful as a way of organizing discussion about next steps, success in the long-run will require integrated and sustained action across all nine objectives.

Long-Term Objective 1: Clarify, secure and broaden the rights of landholders, and promote greater equivalence of rights over land within different contexts.

Steps should be taken progressively to clarify, secure, broaden and harmonize the rights of rural and urban landholders, in order to allow greater freedom for landholders in all categories to participate more fully in economic growth through the sustainable use of property.

This first long term objective is at the core of the issues to be addressed and has implications both for the legal framework and for the administrative frameworks in rural and urban areas. Over time, sustained and appropriate attention to this objective will be a key factor in:

- reducing incentives and market distortions that stimulate the inefficient use of both urban and rural space, including those associated with the state monopoly of the primary land market;
- reducing unequal treatment of land rights in different contexts and the associated disadvantages of those land users in both rural and urban areas whose ability to share in economic growth is constrained by unclear and weak rights;
- facilitating the emergence of a fairer, more rational and more uniform standard for assessing property values.

Addressing this objective requires attention to different categories of land rights – those held by collectives, farmers and urban users, as well as the interests retained by the State – and the interplay between these categories. This last point is worth emphasising as it again highlights the importance of an integrated approach. Incremental improvements can no doubt be accomplished by focusing narrowly on a specific category of rights, but a proper understanding of the need and opportunities for more profound change requires a systematic appreciation of how different land rights interact and affect one another.

This objective also entails an assessment of each category of right with respect to a number of criteria:

- **Clarity:** Are rights and associated responsibilities clearly articulated in laws and regulations? Are there gaps or uncertainties that create mixed signals to rights holders as to what they can and cannot do with their land, or that over-expose the exercise of rights to administrative discretion or corruption?
- **Security:** Are rights adequately protected by law and by the operation of legal and administrative institutions? Or are they overly vulnerable to being withdrawn, terminated or changed?
- **Scope:** Are the rights associated with a particular land category sufficiently broad so that rights holders have appropriate flexibility to make choices about land uses or to engage in transactions? Where such choices are limited by law, are such limits directly related to a clear, rational and important policy objective?

At present in rural areas, it is clear that the rural collective and the farmers together have the right to use and, as permitted by the law, deal with the land for agricultural purposes. These rights do not include any development rights that may affect the value of the land, including changes to another use or the use of land as collateral for bank loans, other than in relation to collective construction land (and even here, as shown in Part III, the legal framework is severely under-developed). Although the Rural Land Contracting Law is intended to provide greater security to the farmer, this appears to be solely in relation to the agricultural use of the land.

The rural collectives appear to retain clear rights in relation to land in use as collective construction land. In order to allow the collectives and, by extension, their membership greater flexibility and the opportunity to participate more fully in the economic development in China, it is suggested that the collective construction land should be marketable, and recommendations in this direction are spelled out below.

The legal position of farmers with respect to their individually possessed land has improved incrementally over the years, most recently with the passage of the Rural Land Contracting Law. But areas of vulnerability remain, which are particularly acute for farmers in areas undergoing rapid change, where their land is likely to have attracted the interest of a number of more powerful actors. Hence, as we have seen, dispossessed farmers are frequently the greatest losers in the process of state requisition of farmland, or in the conversion of farmland to collective construction land by the collective leadership. In addition, the limited nature of farmers' interests, along with limitation on farmers' flexibility to market or mortgage land or to use land for non-agricultural purposes, constrains their chances to realise the full potential value of their property.

Although specific research has not been undertaken so far on the issue under this project, it is understood that the urban population does not at present enjoy rights to compensation in respect of land rights in urban areas, which introduces an incentive structure where the value of land is not an issue.

It is appreciated that these are complex and contentious issues that still require study and consensus building in order to define the appropriate path forward in detail. Nevertheless, some interim steps could be taken to help move forward, test options and derive lessons to guide future planning and policy development (including the finalisation of the draft Property Law – see Box 3 and Appendices K and L). It should be noted that while most of the steps below focus specifically on a particular category of land rights, the above-mentioned importance of an integrated approach needs to be kept in mind even in undertaking these initial targeted steps.

Potential actions in the short- to medium-term in support of Objective 1 include:

- a) *Evaluate and test the feasibility of making collective construction land marketable.* As ongoing government pilots and widespread *ad hoc* practices in a number of provinces have shown, there are

significant potential benefits to be gained by allowing some degree of marketing of collective construction land as an alternative to direct government requisition. More testing is required, lessons need to be systematically gathered and evaluated, and, above all, the legal and regulatory implications need to be addressed. One aspect that requires attention here, as it does more generally in the area of compensation for government land requisition, is defining and protecting the interests and tenure security of individual farmers vis-à-vis the collective. Transparent processes in making decisions and in accounting for and sharing receipts/income will be important to ensure the full and appropriate participation of individual farming households in the benefits that accrue. There is also a danger that new marketing opportunities may encourage collectives to find ways to assemble and convert farmland without due regard to the existing contractual rights of farmers, and appropriate approaches will need to be designed to prevent this happening. Finally, as the Guangdong experience shows, there are significant risks associated with the dubious legal foundation for the innovations already underway in some parts of the country. These inadequacies in the legal framework will need to be addressed before the potential benefits of this type of reform can be explored on a wider and more systematic basis. Nevertheless, the recently drafted policy document in Guangdong provides a useful starting point for considering the formulation of a national legal framework on this subject.

- b) *Evaluate and test the feasibility of allowing direct dealing by collective landholders in the case of conversions for non-“public interest” uses.* As mentioned earlier,

Box 3: Continued limits on the marketability of rural land rights under the draft Property Law.

The Draft Property Law confirms both the marketability of some land use rights and significant limits on marketability. Construction land (urban or rural) can be leased, exchanged, assigned or mortgaged without official approval (Art. 149). By contrast, while rural agricultural land and rural residential sites may be leased or exchanged without approval, they can be assigned only with the consent of the community and a rural residential site can be assigned only to someone who would qualify for a residential right in the community in their own right (Art. 162). This results in an extremely circumscribed market in these rights. Moreover, neither rural agricultural land nor rural residential sites may be mortgaged (Art. 206(2)).

These restrictions on commercialization of use rights in rural agricultural and residential sites are arguably unnecessary. They will certainly limit investment for development of that land and also growth in its market value.

China is virtually unique among modern market economies in the monopoly use of compulsory land acquisition not only where land is destined for a public use (however defined), but also when the ultimate use will be generally private. There are many different philosophies worldwide as to where the line between public and private use or interest should be drawn for purposes of government takings (as discussed under Objective 2, below). Nevertheless there comes a point toward the “private” end of the spectrum where it becomes harder to identify a specific “public” interest, and difficult to distinguish government’s motivations from those of a private property entrepreneur. Such instances might provide interesting and appropriate opportunities for testing mechanisms for direct interaction between collective landowners and private investors.

Obviously, this approach will need to be pursued in parallel with actions proposed under Objective 2. Experimentation with this approach will require, in essence, drawing a legal distinction between actions that are in the public interest and those that are not – a distinction that is currently not spelled out in Chinese law, as already noted. As in a) above, it will also be important to give attention to safeguards for individual land users within the collective, particularly as in this case the experiments would presumably not be limited to already-defined collective construction land. Affected individual farmers would need to be directly involved in decision-making and in sharing benefits – in other words, this should not become a mechanism by which the power of compulsory acquisition for an eventual private use is simply moved from government to the collective leadership. Finally, it is recognised that widespread use of this approach is unlikely to be acceptable to local governments so long as they continue to rely heavily on transfer payments from the requisitioning of commercial land for extra-budgetary revenue.

c) ***Strengthen legal provisions to ensure greater protection of rural contract holders from unfair or improper actions on the part of the collective management.*** Over the long term, the question of how best to strengthen the land rights of farmers is wrapped up in the fundamental issue of whether these rights will continue to be a derivative of collective land rights, or will eventually be reformed in a way that gives them greater parity with urban land use rights. For the present, however, continued attention is needed to building safeguards that protect farmers’ interests within the framework of collective land governance. Numerous steps in this regard could be taken, including:

- Further efforts to reduce the vulnerability of farmers to re-adjustments, by the development and implementation of narrow and clear guidelines specifying when the exceptions on the prohibition of re-adjustment can be invoked, and/or by reforming the Rural Land Contracting Law itself to prevent abuse due to vagueness;
- Designing and implementing procedures to ensure that land-losing farmers receive compensation rather than it remaining in the hands of the collective (see Objective 2, below);
- Developing and testing new land governance frameworks at the collective level that could help ensure better transparency and accountability of

collective management with respect to the full spectrum of land issues affecting collective members;

- Helping farmers understand, pursue and defend their rights more effectively (see Objective 6, below).

d) **Introduce the right to mortgage farm land held under a 30-year contract.** The Rural Land Contracting Law, while providing greater transactional freedom for contracting farmers, does not provide a legal basis for the mortgaging of contract rights. The prohibition of such mortgages also features in the draft Property Law currently under consideration. Allowing such mortgaging to take place would enable farmers more fully to realise the potential economic opportunities associated with strong and secure land rights, and again move rural rights towards greater parity with urban rights. As international experience has shown, mortgage systems have been successfully introduced into property law situations analogous to rural China, where farmers' rights are derived from land ownership vested in a traditional community or collective body.

Box 4: Introducing mortgages in rural land markets – comparative experience

Mortgage of agricultural land requires legislation that allows mortgage and foreclosure of agricultural land, secure land rights and a relatively free land market. Few landowners in the **Eastern European** countries use land as security for loans. Even when these requirements are in place, mortgaging still needs to be a part of a larger scheme of providing credit to farmers. These conditions include willing and competent lenders; financial terms attractive to farmers; support services that can help ensure success in agricultural innovation; a political and legal situation that permits foreclosure if necessary; and prices for produce that permit recovery of costs of an investment. Various national experiences – some positive and some negative – are described in **Appendix B**.

A frequent concern when introduction of agricultural land mortgages is being considered is that the lure of credit, coupled with the threat of foreclosure, will undermine tenure security and result in displacement of poorer agriculturalists. There are regulatory and practice measures that can be taken to reduce the risks of delinquency and foreclosure, as **Appendix C** elaborates with respect to the United States experience.

e) **Develop an efficient, accurate and usable registration system for land rights, including farmers' land rights.** China would benefit greatly from a more coordinated, unified, modern and efficient approach to the registration of land rights. A more efficient, reliable registry that reduces the time, cost and risks associated with conveyancing is urgently needed in areas where a vigorous market in land rights already exists or is emerging. At the same time, attention is needed to the registration of rural land rights, including the land contract rights held by farmers under the Rural Land Contracting Law. In the case of such land, the implementation of a registration system (which is contemplated by the RLCL and regulations thereunder) will be an important step in the gradual enhancement of those rights in terms of clarity, security and freedom from interference, as well as in improving the accountability and transparency of land-related decision-making at all levels, from the collective upward. The current institutional confusion regarding registration is discussed under Objective 7, below. The principle of a unified, conclusive registry system for property rights is stated in the draft Property Law, although as discussed in **Appendix L**, certain ambiguities in

the draft need attention. As noted, Government is already embarking on a pilot exercise to develop an appropriate approach to the registration of rural land, including land held under contracts for cultivation. There is very significant international experience with such systems, yet the most important lesson from such experience is that a viable and useful system needs to be carefully adapted to the unique circumstances of the country. Care will need to be taken to examine the costs and benefits to landholders and the country as a whole of creating and maintaining a system, and design decisions made accordingly.

- f) Review and analyse the current status of urban land use rights and the rights of urban real property holders to compensation when real property is compulsory.* The nature of urban land use rights and how they can be used determine the ability and incentives of urban real property holders to use urban space more efficiently/intensively, thus potentially decreasing pressure on urban sprawl and taking up of agricultural land.
- g) Design and carry out poverty and social impact analyses to guide future policy decisions about increased marketability of rural and urban land.* The development of detailed short and medium term options will create a phased approach to increasing the marketability of land, and to the legal, institutional and planning framework within which this operates. Staging these developments will enable monitoring and evaluation to be undertaken to better understand the social and economic impacts of these policy changes in the unique circumstances of China. This will, in turn, provide the best guidance to policy development in the medium to long term.
- h) Review relevant international experience.* A range of international experience would be useful to assist in policy formulation in these areas. There are important examples of transitional economies dealing with the change from state ownership to other regimes, and confronting the whole array of legal and institutional reforms needed for the establishment of strong, clear and uniform private rights in land and their administration. Each has dealt with issues of registration, mortgages, etc that arise with the transition to a market economy, in their own way, but generally following fairly common principles. In the longer term, looking at the different modes of operation of the established market economies provides some indications for a long term vision of how state and private ownership can be dealt with. These range from those regimes that effectively now only nominally derive their ownership from the State/Crown, such as the United Kingdom, to the remaining long leasehold systems of Crown/State land of Australia and New Zealand. See also **Appendix I** for an example from Botswana, involving the gradual upgrading and strengthening of rural land rights in a dual tenure system not unlike China's.

Long-Term Objective 2: Ensure fair treatment and adequate compensation for those affected by compulsory acquisition.

Compulsory acquisition rules and methods require re-examination and revision, to ensure that compensation is adequate, that the process is fair and open, and that government's decision to requisition land is guided by appropriate standards.

As China's government has recognised, land acquisition rules require re-examination in many respects. Current compensation rates matched with widespread powers to requisition land have led both to social unrest and excessive use of takings powers by government. In the long-term, ensuring fair treatment of dispossessed landholders by applying a standard of compensation that truly reflects the market value of land will depend upon the emergence of a real market for rural and urban land – something that cannot happen so long as the marketability of rural land is restricted, the dual system for urban and rural land tenure is retained. In the short- to medium-term, however, concrete steps could be taken both to improve the fairness of compensation and to improve the process by which takings occur.

Potential actions in the short- to medium-term in support of Objective 2 include:

- a) **Revise methods for the calculation of compensation to move towards more equitable, predictable and socially-acceptable standards.** As discussed earlier, many argue that the standard of compensation set out in the Land Administration Law is outdated,

based as it is on a multiple of the average value of agricultural output over three years. It is apparent that the process of acquisition and compensation is widely seen by farmers as unfair, and is a common source of legal proceedings against local governments.¹⁸ The perception of unfairness is exacerbated by the differential between the requisition price and the transfer price realised upon conversion, at least when land is sold by auction. In

Box 5: What is “just compensation?” Perspectives from international practice.

The underlying goal of just compensation is to leave the owner of the expropriated land in the same economic circumstances as before the expropriation. How this standard is expressed in specific formulas for determining compensation in individual cases varies greatly from country to country, even among countries in which land markets are well-developed. **Korea** takes into consideration a complex array of factors, including the utilisation plan for the land, the “fluctuation” rate of the price of land, the rate of increase of wholesale land prices, the location and shape of the land, and the rental value of the land and neighbouring land. **Appendix D** provides further illustrations of the approaches used in these and other countries, including the United States, Italy, Brazil, Singapore, El Salvador and Poland.

addition, the agricultural production of land may have declined due to off-farm earning opportunities that decreased the amount of time actually spent in cultivation. While Document 28 has allowed increasing flexibility for local governments to pay compensation in excess of the Land Administration Law stipulation, this is discretionary and is applied unevenly.

In the long run, the emergence of a more developed land market in China will provide much of the information necessary for calculating fair levels of compensation. In the absence of an acceptable market-based method for calculating compensation, an alternative formula is required in the short-term to deal with social justice issues. To arrive at an appropriate formula, detailed study and analysis is needed, but some general principles and suggestions can be put forward:

¹⁸ “For instance, Zhejiang province alone has more than 2 million farmers who have lost their farmland. In 2002, more than 80 percent of legal cases filed by peasants against governments in the province were related to land acquisition.” Ding, Chengri Effects of Land Acquisition on China's Economic Future, Lincoln Institute for Land Policy, Cambridge, Massachusetts, Land Lines: January 2004, Volume 16, Number 1

- To ensure equity, it is important that the level of compensation not be tied to the intended use of the requisitioned land. It is unfair for landowners similarly situated to be treated differently because one parcel of land is destined for non-remunerative infrastructure use, while another is slated to be sold for a large profit at auction. Yet such treatment often occurs in practice as the provincial studies indicate.
- It is possible that an appropriate benchmark may in the medium-term be provided by an emerging market price for collective construction land. That is to say, if marketing of collective construction land is allowed (Objective 1), this may provide the basis for a method whereby the compensation value of farmland is derived from assumptions on what value the land would have had if it had been collective construction land. Market evidence of value for this use would appear to be the highest potential use under present conditions that can be achieved for land in rural areas.

Box 6: Compensation dynamics in England and Wales.

Politics, economies and societies change, and with them, people's expectations: the definition of what is appropriate as the measure of compensation for compulsory acquisition is dynamic. The past half century in **England and Wales**, for example, has seen some key developments of the compensation code reflecting massive changes in mobility and transportation and in demographics, the latter stimulated by the rise of commuting and, to an extent, by policies in relation to new towns and urban regeneration. This led in the 1970's, for example, to a recognition that people should be allowed compensation for certain types of injuries to their property caused by public transportation developments (through noise, vibration, light, dust, etc) even where their land was not taken. This process of re-evaluation and adjusting standards to modern circumstances has continued to this day, as the Government continues to attempt to devise a compulsory purchase and compensation system in harmony with modern society's expectations. Despite the need for such adjustments over time, what remains constant is the need for a clear legal code and procedures for dealing with compensation and other aspects of compulsory acquisition, and reasonable confidence that the system will provide an equitable result, wherever it is applied. See **Appendix E** for further details.

- It is important that any new formula that is more closely aligned with present-day perceptions and realities be spelled out in law, rather than stated as an optional exception to the standards set forth in the Land Administration Law, to be used or not used by local governments at their discretion.

b) ***Take steps to ensure that compensation reaches the dispossessed farmer.***

At present the persons most affected by the process of compulsory acquisition have the least input into it. It is no coincidence that this lack of

input, which extends from the original planning of developments to the negotiation and distribution of compensation, results in high levels of complaints against the administration. It is also no coincidence that the main complainants are understood to be the farmers, given that their entitlement is a residual determined in large part by the rural collective administration.

Steps that should be considered to address these problems, based on international best practices, include:

- Legislating for a minimum proportion of compensation to go to the farmers whose lands are taken. At present, despite exhortations by Document 28 to focus compensation on the dispossessed farmer, this is not directly required by law, nor are farmers' contract rights under the Rural Land Contracting Law treated as legally compensable interests.
- Similarly legislated standards are required for situations in which the rural collective itself takes farmland to become collective construction land, in which context it appears that the farmer is usually only compensated for structures and standing crops.
- Specifically prohibit the use of land readjustment in the case of land takings and conversions to collective construction land. This is related to the recommendation under Objective 1, above, that the Rural Land Contracting Law's allowance of readjustments in "special circumstances" needs to be narrowly defined or removed. Collectives have been known to use the

Box 7: Compensation for takings by the State: a comment on the draft Property Law

China's Constitution requires compensation when the State compulsorily acquires land and land rights in the public interest. Confidence that fair compensation will be paid in this circumstance is a key element in creating security of tenure. If not, landholders are at risk of losing the benefit of their investments and bearing too much of the cost of public projects, a cost that should be shared broadly among the public. This undermines both their incentives to invest and Government's reputation for fairness.

Article 49 of the Draft Property Law provides that compensation shall be as stipulated by the State and that if no such provisions exist, compensation shall be "reasonable". With regard to land contractors, Article 137 requires that contractors who lose their rights must receive "reasonable" compensation. This does not do as much as might be hoped to make meaningful the Constitution's guarantee of compensation for takings of property. It is important that the Property Law go further and establish a general standard for reasonableness of compensation, a standard against which more detailed provisions in other laws or regulations may be tested for consistency. See **Appendix K** for further details.

occasion of a takings to keep the compensation paid and spread the loss amongst all the farmers in a village through a readjustment.¹⁹ Until this practice is specifically prohibited, there is good reason to expect it will continue.

- Mandating procedures that ensure that adequate and timely notice is given to affected farmers, that they receive complete information about the proposed taking and the compensation being proposed, and that they have an opportunity to be heard during the finalisation of the transaction. The existing regulation on land and resources hearings issued by the Ministry of Land and Resources in January 2004 provides a good starting point in this regard. However, as noted already, this regulation appears to provide officials with discretion as to whether hearings are needed or not in particular situations, and appears to require that specific requests be made before hearings will be convened. Significant awareness raising amongst potential users of this regulation will be needed before it can be expected to be a useful tool for protecting their interests.
- Establishing a mechanism whereby aggrieved farmers are entitled to bring complaints before a dispute-resolution forum, which can expeditiously dispose of those complaints and order corrective action where needed.
- Taking proactive measures to inform potentially affected farmers about their rights under the newly-established procedures, and to assist them to use those procedures. In this regard, significant progress could be made by promoting legal aid schemes, as discussed in more detail under Objective 6

As will be seen, the measures proposed here are a subset of the mechanisms discussed under Objective 5, which are focused on the effective realisation of farmers' land-related rights in a number of ways that go beyond the issue of compensation.

- c) ***Experiment with alternative forms of compensation.*** Alternative forms to cash for compensation appear to have been used with success in some jurisdictions, as the research carried out by DRC and its partners reveal (and as particularly discussed at length in the DRC research report from Shaanxi). Review of these should be undertaken to identify which are the most appropriate in which circumstances with a view to establishing sound practice, and to assess the equivalent value when seeking to identify appropriate norms and standards under a). But again, caution is required before embracing these alternatives uncritically. Not infrequently, for example, impressive sounding schemes for using compensation payments to establish enterprises have failed to produce the promised benefits in terms of profits or jobs, due to poor business acumen or corruption on the part of promoters. These types of risks are exacerbated by a general absence of transparency, accountability and democratic decision-making processes at the collective level. Attention is needed to developing safeguards that ensure that a land-losing farmer's participation in such schemes is voluntary and based on informed consent, and that there are remedies available in case the scheme in question is improperly managed and his or her interests are damaged.

¹⁹ Based on research conducted by the Rural Development Institute.

- d) **Consider limits to the purposes for which land can be taken.** As a medium-term priority, China should consider limits on the purposes for which compulsory acquisition powers can be used. Among countries with modern market economies, China is unusual in essentially imposing no effective limits on the purposes for which land may be taken. It is recognised that it may be problematic to impose such limits broadly until alternative mechanisms for land to enter the urban market have become operational – however, the process can and should get underway of attempting to define a boundary between public and private interest that is more compatible with the needs of a modern market economy.

Box 8: Defining the “public interest”: lessons from international experience

There are many approaches around the world to defining the appropriate scope of government’s power to take property. A significant number of national laws have very detailed lists of purposes that can be considered in the “public interest”; others establish only broad principles and leave much up to the discretion of officials. What is clear from international experience is that compulsory acquisition law needs to be clear, with sufficient detail and precision so that people know where they stand and official discretion is structured and controlled. This is particularly true in societies where land markets exist or are developing. Once society recognises and protects private rights in land, and facilitates dealings with those private rights in the market place, the law has to be much more specific, detailed and clear. (See **Appendix F** for further discussion of this topic).

- e) **Establish better standards for compensation of urban land.** As noted in Part II(B), the treatment of urban land with regard to compensation is problematic. Under the Land Administration Law, the standard for compensation is simply that the user must be compensated “appropriately” – this standard needs to be spelled out, and in the urban context (as opposed to rural land), an existing market for use rights should at least provide a starting point for establishing standards.
- f) **Review experiences of other countries with respect to the above issues, to help inform policy decisions.** Many countries have addressed the developmental stage (if not at the same scale and speed) that China currently is in, and it is a common feature that the necessarily rapid expansion of infrastructure and urbanisation bring with them demands for land which cannot be rationally realised through the market in a market economy context. Where China arguably differs is in the complex situation of an economy in the process of transition between a command economy and a market economy, particularly where the issue of land tenure remains largely a state monopoly. Notwithstanding these differences, the features that China’s present direction has in common with other international experience are probably more substantial than the differences. Reviewing the experiences of countries in relation to procedures and assessment of compensation will therefore be of great assistance to China in resolving the appropriate direction to take. Considerable comparative work has been compiled by a number of China’s international partners,²⁰ and this work, supplemented by direct consultation with relevant countries, including both the developed market economies for the long term, and the transitional economies for the current and shorter term perspectives, should form a productive basis for this type of review. See **Boxes 5, 6 and 8** and associated **Appendices**.

²⁰ See RDI, Land Takings in China: Policy Recommendations (2003); FAO, Compulsory Land Acquisition: A Principled Approach (draft, 2005).

Long-Term Objective 3: Promote more efficient use of farm land and urban land.

More effective measures are needed to reduce the conversion of farm land and to improve the efficiency of use of urban land, through review of current incentives for land use conversion, better coordination of planning mechanisms and more efficient land use strategies.

Attempts to protect China's farmland have focused on progressively stricter measures to limit its conversion. The results of these measures are mixed, given the immense pressures of urban expansion and the incentives that various actors have to promote rural land requisitions. In this respect, achieving this objective is once again related to many of the others, in particular rationalising the role of land taxes and transfer fees in local government finances (Objective 4). Restrictions on local government behaviour, as imposed by Document 28, are unlikely to be effectively enforced at local levels so long as economic and administrative incentives for conversion remain strong.

It is also suggested, however, that a more rounded approach to this problem is needed, one that complements strict sanctions on farmland conversion with attention to the incentives and planning approaches that currently help stimulate such conversion. The approach advocated is to have (a) a balanced and measured reduction in the existing distortions in economic incentives, coupled with (b) the development of planning mechanisms that address communities' preferences for development in a balanced way, taking into account both rural and urban priorities, and (c) the promotion of policies and practices that enable and stimulate efficient land use within both urban and rural areas.

Improving land use efficiency in urban area can reduce the pressure on farm land preservation; at the same time, better land use efficiency in rural areas can also release more land for urbanization without jeopardising national food security. The proposed actions under Objective 1 provide the basis for improving the efficiency of land use in both rural and urban areas as they will result in a substantial shift in the incentive structures. Giving force to this change will, however, need other issues to be addressed, particularly in the contexts of land administration and market information, both of which are long term adjustments.

Potential actions in the short- to medium-term in support of Objective 3 include:

- a) ***Review the impact of subsidising land for industrial use by setting artificially low price ceilings.*** The existing evidence indicates that land acquired by local administrations destined for industrial use is made available to industrial developers at substantially below what the market would bear. While subsidies of this kind are a common feature for attracting industrial development in a number of countries, the provincial level research conducted so far suggests that in China it is a tool that is very widely used, to the extent that market-based transactions for industrial use are highly exceptional. At present, the general impact of such subsidies, in a situation of very rapid urban growth may be simply to generate extensive and relatively inefficient use of land. It is therefore suggested that the impacts of this approach should be reviewed and considered in the light of possible alternative approaches.
- b) ***Explore greater integration of urban and rural planning functions and objectives.*** There is an important need to see planning as an exercise that transcends the

rural/urban boundary, thus requiring a closer correspondence between the planning activities of rural and urban areas and the respective agencies responsible. Currently, land use planning as promoted by the central government focuses more on farmland preservation than provision of adequate land at reasonable prices to fuel urban development, while planning by local government is often driven by the goal of winning approval to continue urban expansion, sometimes through such devices as exaggerating likely population growth in order to qualify for higher quotas. Within the urban boundaries, departments of construction decide the types and intensity of land use, with little consideration to markets. Ironically, there is little communication or coordination between these respective departments, and given rapid economic development and urbanization, it is not surprising to see the emergence of either present or potential conflicts between institutional preoccupations with farm land preservation on the one hand and urban growth on the other. As noted in Section III above, these conflicts are more evident in faster growing regions (e.g., Zhejiang Province), where the supply of developable land cannot match increasing land demand for urban growth. Better coordination between agencies, and more important, the negotiation of a shared planning vision, will be crucial for finding an appropriate and realistic balance between urbanization and farm land preservation.

- c) **Review international experience.** The experience of closer integrating rural and urban areas in the context of administration, planning and markets is one that several countries have been through, both historically and recently, and such experience may provide lessons (both positive and negative) of relevance to China. In particular, the experience over a long period of the UK in addressing these issues in a systematic way from the 1940's is an interesting parallel. The recent experience of the Central and Eastern European countries is relevant and it is suggested that an appropriate review should be carried out to bring valuable lessons to China's thinking on this.

Long-Term Objective 4: Enhance the role of land as a sustainable foundation for local government finances.

The general level of local government finances' dependence on profits resulting from trading in land, in large part through land banking operations, is unsustainable and creates undesirable incentives which are resulting in extensive and inefficient use of land. Market value-based property taxes should be explored as a matter of urgency as an alternative source of local government finance. In time, this would provide a long-term sustainable substitute as receipts from land trading are reduced. This should be coupled with a general review and simplification of the overly complex current system of property based fees and taxes.

As explored in Part II(D), and in the case studies of Zhejiang and Shaanxi Provinces, a substantial proportion of local government revenues has been derived in recent years from the requisition of rural land and its conversion into urban land. While a relatively small proportion of such land is sold on the open market either directly at auction or increasingly in recent years through the operations of locally constituted land banks, the revenues typically form a major part of all local government financial resources. Such revenues are, however, unsustainable, as the land will eventually run out, or demand will fall. These revenues also create incentives which encourage the local administrations to develop land without due consideration of scarcity, resulting in very extensive and inefficient patterns of development. At present there are virtually no annual taxes on real property at all. In many countries such

taxes form a significant element of local government revenues. The State Administration of Taxation is, however, currently considering pilot activities to explore the implementation of such taxes, and it is understood that such a pilot may be commencing in the near future. At the same time, real property, particularly in relation to transactions, is subject to a range of minor fees, taxes and charges. These should be reviewed to make recommendations for their substantial simplification.

Potential actions in the short- to medium-term in support of Objective 4 include:

a) *Design and implement pilots to test the feasibility of introducing property tax.*

Working with the State Administration of Taxation and its partners, pilots should be designed and implemented to test the option of market value-based property taxation as the foundation on which to create an equitable, stable and sustainable basis for local government revenue. Experience in starting to implement such taxes is available in several countries within the East Asia region. Hong Kong has a very efficient and long standing system of property taxation. The Philippines, by contrast, is currently starting a process of major upgrading of its property taxation. Pilots have been

undertaken, using an appropriate valuation approach, to test the feasibility of proposed standards and approaches, which are expected to form the basis of larger scale implementation under phase two of the Government of the Philippines/World Bank/AusAID financed Land Administration and Management Project. More widely, there is a great range of experience of different systems globally, and selected countries could be the source of very valuable experience to help identify what could be most appropriate approach for China.

The experience of the pilot activities in developing sustainably functioning systems of local government finance would form the basis for developing and implementing a strategy for the general introduction of such a market value-based property tax. This involves designing a sequence of initiatives to enable efficient and effective introduction; however, there is considerable international experience that can be used as the basis for moving forwards. (See Objective 9 for further discussion of a possible pilot activity).

Box 9: Implementing property taxes: international illustrations

Effective implementation of a property tax is a complex task, and even in well-established property tax systems, significant reforms are often required. Recent international experience with such reforms provides some guidance on the necessary preconditions for effective implementation of property tax, whether one is reforming existing systems or contemplating the introduction of a new system.

The key elements that have to be in place for property tax reform depend to an extent on what aspect of the system is being reformed. The existence of adequate technical expertise is necessary for assessments. Appropriate land records and administration are required as the basis for the property lists. Sufficient flexibility to allow the phasing in of major changes is essential to forestall challenges and resistance to changes. Political understanding and will are perhaps the most critical preconditions if the substantial challenges of implementing a highly visible, difficult to evade, tax, are to be overcome.

These issues are illustrated in more detail in **Appendix G**, with reference to the experiences of **Canada, Hungary, Indonesia, the United Kingdom, Colombia and Kenya**.

b) ***Re-assess the purpose and function of land banking.***

The practice of land banking by entities created under the local administrations has grown phenomenally in recent years and is now an ubiquitous feature of the landscape. As noted under Objective 6 and discussed in the case studies in Part III, this is an area where more effective regulation is urgently needed, as land banking practices may be of a sufficient scale across the country to have serious implications for the economy generally, and particularly in the banking and finance sector. A national law on land banking is urgently needed. At the same time, there is a need to review the extent to which land banking in China has moved away from what was arguably its original purpose – to

provide a mechanism for the planned and sequenced release of surplus government land – and the desirability of that evolution. A review of international practice in this area is to be undertaken, but it will be necessary to adjust such findings on practices to the circumstances of China. When reassessing the purpose and function of land banking in the light of this, due consideration will also need to be given to the strategic programme for local government finance regarding the possible introduction of market value based property taxes.

- c) ***Undertake a review of other land-related taxes and fees to assess their continued relevance and to rationalise their use.*** Land related taxes and fees have grown in an *ad hoc* way during the past two decades in response to specific stimuli. As the property market in China matures and the need to simplify transactions becomes apparent, it is clear that it would be appropriate to review these taxes and fees to identify how they can be rationalised to ensure that any such taxes fulfil their particular purpose and do not have an adverse effect on the developing real estate market.

Box 10: National practices in land banking

Acquiring land in advance of actual needs, land banking, is a commonly used strategy to assemble sites to improve the quality of land holdings, to enable extensive (re)development to take place and to allow for orderly planning and use of resources. International experience confirms that there is no fixed recipe for success; appropriate mechanisms need to be designed with the skills and capacities necessary to be able to achieve the defined objectives. A land banking system should be properly founded within an appropriate legal framework in compliance with relevant accounting (including valuation) and administration standards. Successful implementation requires clearly defined purposes and objectives, coupled with flexibility in the face of dynamic realities. It is generally at its most effective when used selectively and when due regard is paid to transparent assessment of the true costs and benefits. Most of the problems in land banking arise from scale. Where a government becomes the major land owner, it may jeopardise the achievement of its own goals. Its policies may prove to be unsustainable and may result in unpredictable and unwanted outcomes.

There are stories of successful land banking, and instances where serious problems have arisen. A general view would be that public land acquisition should be used very carefully, with many concluding that large-scale government intervention has, in general, not been very successful, particularly in developing countries. For illustrations from international experience, see **Appendix H**.

Long-Term Objective 5: Rationalise the institutional framework for land.

In the long term a natural consequence of harmonising urban and rural land issues will be the extension of this harmonisation to the rationalisation of the institutional framework responsible for administration of some of these matters. Similar comments hold true in relation to the current distinction between land and buildings and how their recording is administered.

It has already been identified that there is a need to reduce the artificial distinctions and boundaries between rural and urban designated land. For example action c) under long-term objective 3 is to improve coordination of the planning functions of departments of land and resources and departments of construction. While it may not be necessary or effective to merge these two planning functions into one agency for the foreseeable future, other functions would certainly benefit from having such a vision in place at the outset. In particular those functions that deal with the administration of real estate assets should initially harmonise their activities, with a view to unification in the long term.

In terms of international comparisons and experience, there are many useful examples covering each of these, from the East Asia region, from the transitional economies of Central and Eastern Europe and the Former Soviet Union and from the developed market economies. The different stages of development of such integrated systems and their transition are probably best shown in selected examples from the former two regions.

Potential actions in the short- to medium-term in support of Objective 5 include:

- a) ***Harmonise and unify land and building registration.*** Registration of rights in land and buildings is currently complex. In urban areas, land use rights deriving from grants and allocations are frequently, though not always, the responsibility of different agencies than those responsible for buildings. In rural areas, rights of farmers under the Rural Land Contracting Law are under the responsibility of the Ministry of Agriculture, while the rights of the rural collectives in relation to rural land are also under the Ministry of Land and Resources. Rights to buildings in rural areas may again be separately registered. In practical terms this complex and non-uniform set of arrangements creates confusion for those increasing numbers of people and organisations that wish to use the system. The diversity of responsibility raises the probability of serious errors and divergences in approach, which will become particularly apparent when the designation of land areas changes. It also generates duplication and wastage of resources. The continued splitting of land rights from buildings will also cause increasing difficulties in land administration as financial operators in the real estate market create their own pressure for harmonisation with international norms. Initially therefore the current situation should be reviewed in order to identify how harmonisation can be planned which will lead to unification of land and buildings registration.
- b) ***Harmonise and unify rural and urban registration.*** Registration of rural land contracts and urban land use rights is currently carried out, respectively, by two different ministries; Agriculture, and Land and Resources. Functionally the activities that need to be carried out to perform these responsibilities effectively are the same. Very similar arguments to those under 5 a) therefore lead to the conclusion that this is an area of activity that it would be good to see harmonised and ultimately unified.

Long-Term Objective 6: Strengthen the overall legal framework and rule of law.

Land-related laws and regulations need to be improved to ensure coherent legal support for land policy. At the same time, urgent attention is needed to the task of making relevant laws function in practice, especially by giving the intended beneficiaries of land rights the needed understanding and tools to use them.

The need for attention to legal reform and review has been explicitly mentioned in connection with a number of actions above, and is implicitly required by most of the others. It is obvious that the substantive contents of the rights and responsibilities expressed in various land-related laws need to be assessed in order to ensure that they effectively support the policy objectives for which they are designed. Hence, complementary amendment or replacement of existing laws or regulations may need to be undertaken in connection with actions that focus on enhancing and strengthening land rights, improving land registration, designing proper standards for compensation in the context of a taking, promoting a more integrated approach to land use planning, introducing new forms of taxation, etc.

But it is also necessary to look more generically for gaps, overlaps and inconsistencies in the legal framework, that may have the effect of obstructing the achievement of policy objectives or the pursuit of desirable activities by various actors. International experience shows that, whatever the wisdom of the policies on which they are founded, land legal frameworks (in common with any other area of law) may function poorly for a wide-range of reasons, including:

- *Gaps in coverage*, meaning that important areas of activity lack the guidance provided by clear and appropriate rules and procedures. The absence of national regulations on land banking is a specific example of this problem in present day China, as noted above, but there are others as well, from gaps in the laws governing mortgages to incomplete and inadequate regulations under the Rural Land Contracting Law.
- *Unclear rights, responsibilities and powers*. One aspect of this problem has been alluded to under Objective 1. It may also express itself in the unclear or inconsistent spelling out of the mandates of different institutions responsible for aspects of land administration or management, leaving both institutional actors and their clients uncertain as to the state of play.
- *Excessive regulation*, resulting in unnecessary and duplicative bureaucratic steps, and contributing to high transaction costs and the potential for rent seeking.
- *Poor synchronisation* between different laws, a particular hazard where related legal reforms are driven by different institutions within government and the need for coordination is not given proper attention.
- *Capacity problems*. Often there is a mismatch between capacity required for the efficient implementation of a particular law and the capacities that actually or prospectively exist within government.
- *Lack of stakeholder ability to understand or use the law*. This has already been alluded to in the case of some implementation aspects of the Rural Land Contracting Law, but it is a problem that is likely to be relevant with respect to many component parts of the land legal framework.

These types of issues and their resolution require a holistic legal review that goes beyond the more focused legal work associated with specific policy reforms.

Potential actions in the short- to medium-term in support of Objective 6 include:

- a) ***Undertake a diagnostic review of the overall legal framework for land.*** This comprehensive and systematic review should be designed with the types of issues listed above in mind. It should be undertaken by a team of legal experts, preferably representing a range of different specialities. It must also be done in close consultation with those responsible for or affected by the way in which the various laws are implemented on a day-to-day basis – in other words, this type of diagnostic review cannot be limited to the analysis of legal texts but must extend to law-in-action.
- b) ***Begin immediate work to address specific identified gaps and weaknesses in the legal framework for land.*** As already noted, the draft Property Law would overall represent a significant strengthening of the legal framework for land, provided a number of weaknesses in the current draft are addressed (including those referred to in Appendices K and L). Nevertheless, as a framework law, it does not deal with a number of legal issues that continue to require urgent attention. While it is not possible to give a complete list of such issues, urgent attention, it is possible on the basis of the analysis in this paper to put forward the following indicative list:
 - (i) The current absence of a regulatory framework for land banking. As discussed in Part III, this poses quite serious risks both for the land banking sector and banking more generally. A national law is urgently needed.
 - (ii) Confusion and overlap in the laws applicable to the mortgaging of urban property. Again, the discussion in Part III underscores the need for this. Related to this should be attention to the current absence of regulations covering the use of income pledge loans.

- (iii) Needed improvements to land acquisition practices, as discussed under Objective 2.
- (iv) Modifications to strengthen the Rural Land Contracting Law and completion of implementing regulations.
- (v) Introduction of mortgage rights for rural contracted land.
- (vi) The virtual absence of a legal framework covering current practices on collective construction land (see Part III).

c) ***Give targeted attention to the legal implications of policy reform decisions.*** As actions are undertaken in relation to the various objectives, timely attention to legal implications will be important. This means that legal experts should be working side by side with policy makers from the beginning, first to ensure that the opportunities and constraints provided by the existing legal framework are clearly understood, and then to identify appropriate points of entry for needed changes.

d) ***Take steps designed to empower farmers and other rights holders to understand and use their rights.***

As noted in Part II, the level of knowledge by farmers of their land rights under relevant laws is extremely limited, adding to their overall vulnerability. Rights that are not understood and exercised by their intended beneficiaries are, in the end, ineffective rights, and the objectives of the law are thwarted. Hence, it is in the best interests of the nation for government to pro-actively encourage education campaigns designed to make farmers aware of their rights; to support the provision of legal aid in

Box 11: Building capacities to “make rights a reality”

In the last decade, several very important and innovative policies and laws have been passed in all regions of the world designed to strengthen rights of people – especially the rural poor – to land. There have been notable examples where people have genuinely benefitted from the new rights available to them. Yet in many cases, these laws have not lived up to their promise.

Why is this, and what can be done about it? There are many possible answers concerning causes. Some observers would point to conceptual weaknesses and ambiguities in the laws themselves. Others emphasise a lack of political will and financial resources to actually implement the laws.

But still another set of factors contributing to the “under-performance” of these laws and policies concerns various weaknesses in the capacities of a wide diversity of stakeholders to understand, use and/or administer them. The list of these factors is a long one, and ranges from simple to complex. Understanding of rights and responsibilities, and what they could mean for their lives is weak among large segments of the rural population. Intended beneficiaries lack the skills, tools and confidence to assert their rights or to assess the risks and benefits of different courses of action. Judges, prosecutors, administrators, traditional authorities, private sector investors and many others who are key to the law working in practice often have only vague and frequently wrong understandings. Overall, capacity within both civil society and government to “make rights a reality” is also constrained by a failure to monitor and assess systematically the use and abuse of the laws, to learn from successes and failures, and to use that learning to make better laws and processes.

Hence, increasing attention in many parts of the world is being given to increasing the capacity of key players to understand, use and apply their rights and responsibilities under the law. This takes the form of

- legal literacy campaigns
- provision of legal aid for those unable to afford them, both with respect to resolving conflicts and in connection with helping people find their way through the procedural complexities of a transaction, a subdivision or inheritance
- targeted training for judges and administrators on land rights issues
- implementation of monitoring methods to ensure that the law is working

rural areas so that farmers have access to affordable professional advice and assistance; to test new and more efficient methods of resolving land related disputes, through the creation of such institutions as land tribunals, and to ensure functional avenues for pursuing complaints and obtaining redress are available. The positive experience of a number of other countries in experimenting with initiatives such as these could provide important insights applicable in the Chinese context. See Box 11.

Long-Term Objective 7: Build capacities for land administration.

Capacity building in the skills and knowledge necessary for implementing this set of objectives will be essential to ensure that the planned outcomes are achieved.

China is undergoing a transition from a system that focuses on state *management* of land to one that focuses more on the *administration* of land and land markets. The skills and capacities needed are considerably different. Identification of actions to support the achievement of this long term objective is complex as each of the long term objectives identified has correlative capacities that need to be built for their successful fulfilment. At this stage it is not appropriate, or possible, to specify in detail exactly what will be required and when. It is possible, however, to indicate the broad areas in which skills and knowledge will need to be generated and at what sort of levels, and the sequence that should be followed to assess the most appropriate and economical way to ensure that such capacity building is appropriately institutionalised. It is clear, even at this stage, that China's many excellent universities are already addressing many of these issues.

Potential actions in the short- to medium-term in support of Objective 7 include:

- a) ***Capacity building will be required in relation to critical skills and knowledge areas that reflect the movement towards market economy based land administration and management*** These skills are expected to include in relation to legal, planning and valuation activities.
- b) ***Building capacity in each of these areas will need to follow a fairly standard sequence which is likely to include at least some of the following stages:*** Identifying which of these skills currently exist, which may need supplementing and at which levels may require needs assessment (identification of existing relevant capacities, of existing and expected requirements), strategy for meeting needs, implementation of strategy.

Long-Term Objective 8: Strengthen protection of the environment.

The rapidity of urban expansion and the increasing pressures deriving from market based solutions, which do not generally incorporate environmental requirements, will increasingly demand that appropriate planning/regulation and fiscal policies are put into effect to ensure adequate protection of the environment.

The unprecedented rapidity of China's urbanisation and industrialisation is creating great challenges for the protection of the environment. As these processes continue to develop it is essential that appropriate research is put in place in relation to land policy to enable appropriate policies to be put in place to protect the environment.

Potential actions in the short- to medium-term in support of Objective 8 include:

- a) ***Research should be undertaken to identify appropriate legal, institutional and implementation frameworks to ensure the maintenance of appropriate environmental standards.*** Certain issues are necessarily addressed through legislative and regulatory processes. Given the extent of the growth taking place, it is considered likely that these areas of concern will need to be addressed. Appropriate research in this area was not included in the current project activity, and is needed.
- b) ***Research should be undertaken to identify appropriate fiscal and other market based incentives to ensure the delivery of required environmental goods.*** The transfer to market economy relations should open the opportunity for the development and use of fiscal and market-based tools in support of environmental protection and enhancement. Again, appropriate research in this area was not included in the current project activity, and is needed.

Long-Term Objective 9: Create an adequate knowledge base through piloting and research.

Piloting and research, both immediate into specific areas, and longer term monitoring of impacts, will be essential to support sound policy decision-making for the implementation of this set of land policy objectives

Each of the long term objectives identified above has testing and research requirements that need to be undertaken to support sound policy making. Pilots are critically important, when developing and implementing policy, for testing options and identifying efficient approaches to large scale implementation. They are also essential for ensuring that social, economic and environmental impacts are objectively assessed to enable appropriate policy judgements to be made. In order to achieve this, it is essential that the pilot projects are carefully designed, that regular, appropriate reporting mechanisms are put in place to ensure effective feedback into large scale implementation design, and that there is consistent and thorough monitoring of quality in implementing the pilots.

The pilot projects proposed in the text should therefore be designed as rigorous tests to ensure that well researched approaches are used as the basis for large scale implementation.

In conjunction with pilot activities it is also possible to indicate broad areas in which research will need to be generated. It is clear, even at this stage, as with capacity building that China's many excellent universities are already addressing many of these issues.

Potential actions in the short- to medium-term in support of Objective 9 include:

a) Formulate and execute an integrated programme of pilot activities. These pilot activities could be clustered around broader themes.

Theme	Specific pilot issues
Land markets	Collective construction land Mortgages and rural property Urban land markets
Land and property rights	Urban land rights Farmers' land rights Requisition and compensation
Local government finance	Land banking Property taxation Valuation
Planning	Land use planning Environmental sustainability
Institutional harmonization	Record harmonization and sharing Functional reviews

While it is not practical in a report of this nature to spell out in detail the proposed pilots, the following is offered by way of example:

Sample Pilot -- Brief elaboration of pilot project on Local Government Finance

The pilot project on local government finance would emphasise the learning and innovation requirements of how to address the complex issue of developing a sustainable, cost-effective financial base to enable municipal administrations to fulfil their local responsibilities. It would be designed as a phased activity to provide solid data as the basis for sound decisions on the optimal course of action and the detailed design of the implementation phase. The design of the pilot project would have regard to and incorporate the valuable experience of the State Administration of Taxation in its investigations on property taxes with the Lincoln Institute.

In the first phase, the project would form detailed assessments at the national level and for selected pilot municipalities of the volume and degree of dependence of the municipal finances on receipts generated from the development of urban land and the conversion of agricultural land. This would involve a close examination of the practice of land acquisition and conversion and of land banking and the uses to which these receipts are put by the municipal administration. At the same time, assessments would be made of the feasibility and practicality of instituting a local property tax, based on the market value of the property. Pilot project sites would be selected and preliminary simulation activities begun. The end product of this phase would be

detailed analysis of the overall national picture by province. For the selected pilot municipalities, this phase would generate a set of targets for implementation, including policy, etc, targets, legal and institutional changes, property taxation virtual pilot/simulation activities, and of requirements for capacity building, equipment, etc, together with detailed plans for implementation.

The second phase, based on the conclusions, recommendations and plans identified in the first phase, would implement the piloting of these selected activities. These would include in the selected pilot municipalities alterations to the framework within which land banking operates and the implementation of the selected property taxation system. The second phase would also include the preparation of detailed proposals for the planned up-scaling of the project approach more widely.

The municipalities selected for this pilot should represent a range of sizes and of economic characteristics in order to allow reasonable conclusions to be drawn as to possible nation-wide application of lessons learned.

Appropriate mechanisms for monitoring and evaluation would be put in place as a part of the project to ensure that critical social, economic and other impacts are assessed to form a part of the input into design of possible nation-wide application of lessons learned.

b) Research will be required in relation to critical knowledge areas that reflect the movement towards market economy based land administration and management

This research will include both single item issues, such as that necessary to inform policy decision-making in relation to land banking, and longer term monitoring of change such as the effect of allowing the rural collectives to deal directly with collective construction land.

Note the following research activities are already identified in the preceding long term objectives:

- a. Design and carry out poverty and social impact analyses to guide future policy decisions about increased marketability of rural and urban land
- b. Review the impact of subsidising land for industrial use by setting artificially low price ceilings
- c. Review international experience of closer integration of rural and urban areas in the context of markets and planning
- d. Review experiences of other countries with respect to compensation issues, to help inform policy decisions.
- e. Re-assess the purpose and function of land banking
- f. Undertake a review of other land-related taxes and fees to assess their continued relevance and to rationalise their use
- g. Diagnostic review of the overall legal framework for land
- h. Research should be undertaken to identify appropriate legal, institutional and implementation frameworks to ensure the maintenance of appropriate environmental standards.

- i. Research should be undertaken to identify appropriate fiscal and other market based incentives to ensure the delivery of required environmental goods

Appendices: Guides to relevant international practice and experience

Appendix A. Intersections of land policy: land and banking crises

One important reason why policy in relation to land and buildings is critical to successful development is because land and buildings and how they are used impact on a wide range of other policy areas. Failures in such policy are likely therefore to be problematic, not just in relation to land and buildings which after all are usually reckoned to constitute between a half and three quarters of all assets in a typical economy, but also as contributory factors in relation to other areas of activity such as food security, urban development and the environment.

A valuable example illustrating such an intersection is the relationship between land and finance/banking policy. Real estate industry and real estate markets are inherently cyclical, especially commercial real estate. In **Thailand** the real estate boom of the mid-1990's was built on sound growth fundamentals until about 1992-93. Outdated banking practices and weak credit risk management in the rapidly growing financial sector created great stress in the real estate sector such that, in 1995, oversupply, severe asset deflation, non-performing real estate loans and over-valued real estate collateral generated a series of banking failures and a devastating portfolio of non-performing loans. The crisis in Thailand was a function of both the dynamics and regulation of the property market and of the relationship between banks and real property assets. A flawed property valuation system allowed the banking sector to lend on expectations of asset appreciation instead of cash flow from completed projects. The lack of independent valuation capacity or professional norms allowed banks to accept highly overstated valuations. The impact of this was amplified as developers leveraged new loans with over-valued properties on a small number of highly exposed institutions.

A similar story, with different antecedents, emerged in the transitional Baltic States at about the same time. Banking crises, mainly involving private banks, surfaced in **Estonia** in 1992, in **Latvia** in early 1995, and in **Lithuania** in late 1995. There were many causes, some of which had been eating away at the fabric of these banking systems for some time. Four systemic causes included: poor regulation and supervision, poor accounting and excessive taxation, inadequate legal infrastructures for lending, and pervasive corruption coupled with weak banking skills and mismanagement. Critical aspects of these related to the lack of appropriate legislation relating to bankruptcy and the use of land and buildings as collateral, and the lack of properly functioning property title, mortgage and pledge registers. In short there was not a properly functioning market for land and real estate. The lack of skills among bank managers and other staff also led to inappropriate and poor decision making. Owners and managers of banks tried to make quick profits by making, inter alia, high risk loans secured against land and buildings. The fact that the supervisory authority was inexperienced and understaffed, and lacked effective enforcement powers only encouraged such behaviour.

Sources

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Appendix B. Challenges for mortgages in transitional economies

Mortgage of agricultural land requires legislation that allows mortgage and foreclosure of agricultural land, secure land rights and a relatively free land market. Even when these requirements are in place, mortgaging still needs to be a part of a larger scheme of providing credit to farmers. These conditions include willing and competent lenders; financial terms attractive to farmers; support services that can help ensure success in agricultural innovation; a political and legal situation that permits foreclosure if necessary; and prices for produce that permit recovery of costs of an investment.

So what was the experience of the transitional economies of Central and Eastern Europe as at October 2001? In several, such as **Russia, Ukraine, and Belarus**, either legislation allowing mortgage of agricultural land did not exist or it forbade its mortgage. In these situations the policy options were to pass legislation allowing agricultural land to be used as collateral for a loan while enacting reasonable restrictions on the foreclosure of agricultural land and to implement pilot projects to understand and eliminate problems with the newly enacted mortgage system.

Elsewhere, land-based lending was limited because agricultural land was not valuable due to a slow land market. In these circumstances, establishing and encouraging credit cooperatives was one option, although it was clear that credit cooperatives can only be a starting place and are not capable of fully funding the agricultural sector. They have been successful for at least short-term loans in some **Eastern European** countries and can help farmers establish a track record for repaying loans.

The State can provide incentives to agricultural credit lenders by selecting appropriate banks through a competitive process and by providing incentives through budget support and tax relief to these banks. State guarantees for mortgages on agricultural land could encourage mortgage lending. State guarantee programs exist in the **Czech Republic, Latvia, Poland, Hungary** and **Slovakia**, for example. The risk with state guarantee programs is that the payback rate is often very low because either the banks or the farmers do not bear enough risk. If such a state guarantee program is implemented, the guarantee should not reach 100%, and both the banks and farmers should share an adequate risk for credits.

Weak mortgage legislation and poor performing land institutions have reduced the interest of lending institutions in accepting land as collateral in some countries. Independent insurance companies can be encouraged to deal with the problem of slow registration of mortgages by guaranteeing the banks' security interest between notarization and registration, for a small fee (1% of the loan amount has been typical in **Poland**). The priority of mortgages needs to be made consistent in all legislation including the Commercial Code, the Bankruptcy Code, the Banking Law, and the Mortgage Law. Banks should also be allowed to hold land for a period of time (at least 2 years, and perhaps longer, if there is not yet an active land market) if the land does not sell for the unpaid value of the loan at auction.

Sources

Rural Development Institute, *Land Reform in Eastern Europe*, Report prepared under FAO contract by Renee Giovarelli and David Bledsoe, RDI (2001)

Appendix C. Reducing farm mortgage risks

To reduce delinquency and avoid foreclosure in farm mortgages, a number of measures may be considered, and have been tried in various countries around the world:

1. Designate certain financial institutions with agricultural lending experience to engage in mortgage lending.
2. Prescribe a range of productive investments, including acquisition of rural land rights as well as long-term land or business investments, which are eligible for mortgage loans. Mortgage for consumption or ceremonial purposes is not permitted.
3. Require the potential mortgagor to produce a business plan and mandate lending institution to carefully review the business plan to ensure the purpose of the loan is right and a sufficient cash flow is likely to be generated to repay the loan.
4. Monitor and inspect the use of mortgage loans by the lending institutions, once they is approved, in order to ensure the loans are spent in conformity with the approved purpose and the business plan.
5. Appropriate mortgage loans in installments, rather than a lump sum, in proportion to the financial needs at different stages of the approved productive purpose, and stop such appropriation at any time when an abuse of mortgage loans is found.
6. Designate as non-mortgageable a certain portion of farmland that will meet the maintenance needs so that each farmer will always keep a portion of his land for producing enough for self-consumption.
7. Mandate foreclosure by judicial sale and require financial institutions to sell the land rights obtained from foreclosure to farmers within three years.
8. Require the mortgagee to give written notice to the mortgagor of the default and its possible consequences at least 60 days in advance when the debt is defaulted for 90 days.
9. Allow the mortgagor to have a further 90 days to cure the default before any foreclosure proceedings can begin.
10. Allow the mortgagor to have an additional grace period for up to 1 year before the start of foreclosure proceedings if default is due to any kind of natural disaster which has affected the mortgagor's crops.
11. Require a mediation process monitored by local courts before a foreclosure sale, in which both the mortgagor and the mortgagee will discuss alternatives to foreclosure on terms acceptable to both the mortgagor and the mortgagee.
12. Require any moneys received in excess of the mortgage principal and interest upon foreclosure sale to be paid over to the mortgagor.

In the United States, the total amount of farm mortgage loans increased gradually from \$97 billion in 1980 to \$116.3 billion in 2003. In 2003 alone, farm mortgage loans jumped 4.9%

over 2002. At the same time, the agricultural mortgage delinquency rate has been reduced, from 5.5% in 1992 to 1.8% in 2002. Of the 13 billion of farm mortgage loans held by insurance companies, one of the largest group of financial institutions involving in farm mortgage lending, the total amount of delinquency in 2003 was \$234.3 million. Only a small portion of farm mortgage delinquencies actually went into the foreclosure process. In 2001, agricultural mortgage loan foreclosures totalled \$61.6 million. The number of farm mortgage loans filed for foreclosure was also low. For the first 6 months of 2002, only 57 mortgages were subject to foreclosure, decreasing from 322 mortgage loans filed for foreclosure in the second half of 1992.

Source:

Economic Research Service, USDA. *Agricultural Income & Finance Outlook/AIS-80*, March 11, 2003. Available online at <http://usda.mannlib.cornell.edu/reports/erssor/economics/ais-bb/2003/ais80.pdf>; U.S. Census Bureau, *Statistical Abstract of the United States*, 2000. Accessed August 11, 2005. Available online at www.census.gov/prod/2001pubs/statab/sec16.pdf.

Appendix D. What is “just” compensation?

The underlying goal of just compensation is to leave the owner of the expropriated land in the same economic circumstances as before the expropriation.

In the **USA**, the principle for determining just compensation is the full market value of the land to be taken – the amount a willing buyer would pay a willing seller, with compensation, paid in cash. This market value, however, cannot reflect changes in the value of the property arising from the taking itself. **Italy** has a unique method of calculating compensation that is calculated to give strong incentives for rural landowners to accept the compensation offered and not challenge it. The basis for calculating compensation in Italy is the Agricultural Middle Value (VAM). This value is established annually for each agrarian region in the nation and is linked to the regions’ soil fertility and crop production. The VAM is intended to be roughly equivalent to the market value of the expropriated land. The exact amount of compensation then varies according to land owner. Non-cultivating landowners are entitled to 1.5 times the amount of the VAM. Tenants are entitled to 2 times the VAM, and owner-operators are entitled to 3 times the VAM. If the landowners are not satisfied with the amount of compensation, they can appeal to the civil courts, and a decision is made by the Provincial Expropriation Committee, which consists of farmers’ union officers, representative agents of agricultural cooperatives, and regional executives. The deliberations of this group are closed to the public, and land owners do not have the right to present testimony.

Brazil’s 1956 Expropriation Law sets out the following determinants of “just compensation”: assessed value for tax purposes; acquisition costs of the property; profits earned from property; location of the property; state of preservation of the property; insured value of the property; market value over the past five years of comparable property; and valuation and depreciation of remaining property after the sought land is taken. Other nations, such as **Mexico, Singapore, El Salvador** and **Guatemala**, use tax valuation as a guide for compensation – the landowner is entitled to the value of the property the owner has declared the property to be worth for tax purposes. This system neatly uses the landowners’ (often low) self-professed value of the land to determine fair compensation. In **Korea**, the amount of loss to be compensated is decided on the basis of the market price of the property at the time when expropriation or use of land is approved. The amount of compensation to be awarded should be estimated from the base date of public announcement of the compulsory acquisition and should take into consideration: the utilization plan for the land under the relevant acts and subordinate statutes; the fluctuation rate of the price of land determined by the presidential decree; the rate of increase of wholesale land prices and other indicators including location and shape of the land, surroundings, and status of usage; and the rental value of the relevant land and of neighbouring land.

In **Poland**, the value of compensation is calculated in terms of the circumstances of the land on the day that the expropriation ruling was made, unaffected by changes in value due to initiation of the expropriation procedures. When necessary, experts are called in to determine property value, on the basis of the land’s location, quality of soil or timber, presence of equipment/facilities that promote agricultural production, and its degree of development, among other measures. (Article 56(3)). If an owner so requests, compensation can take the form of substituted real estate rather than cash, with the value of the substituted real estate corresponding to the value of the expropriated real estate, with differences in value equalized

through cash compensation. (Article 61 (1-2)). Poland's law also entitles owners of agricultural land under cultivation being expropriated to lost profits on the projected harvest, calculated according to the current market prices of the crops planted. (Article 59(1)). For perennial crops, a variety of factors are taken into consideration. Due to its inclusion of detailed compensation and negotiation procedures, Poland's law has been considered to provide better tenure security to land owners than surrounding nations.

Sources:

Nichols' *The Law on Eminent Domain*, Matthew Bender & Company, Inc (2004)

R Prosterman and T Hanstad, (eds) *Legal Impediments to Effective Rural Land Relations in Eastern Europe and Central Asia, a Comparative Perspective*, World Bank Technical Paper No. 436 (1999)

Appendix E. Compensation dynamics in England and Wales

Politics, economies and societies change, and with them, people's expectations: the definition of what is appropriate as the measure of compensation for compulsory acquisition is dynamic. The past half century of steady, if not spectacular, economic growth in **England and Wales**, for example, has seen some key developments of the compensation code reflecting such changes. Significant extensions to entitlements to compensation during this period have resulted in particular from massive changes in mobility and transportation and in demographics, the latter stimulated by the rise of commuting and, to an extent, by policies in relation to new towns and urban regeneration. With the decline of the railways, the growth of private and commercial motor vehicle transport and the associated development of new infrastructure and motorways resulted in huge requirements for the acquisition of land. This parallels the first great period of development of the compensation framework in the mid 19th century, when the expansion of canal and railway development spread rapidly across the whole country.

Two areas of new entitlement resulting from these changes were introduced in the Land Compensation Act, 1973, to accommodate political pressures for fairer approaches to compensation. A prevailing feature of the new transportation developments, particularly of motorways, is their capacity to adversely affect properties where no land has been taken through noise, vibration, light, dust and other forms of pollution. In the past this was not a major issue affecting large numbers of people. The development of urban motorways and the enormous increase in road traffic starting at this time, however, resulted in sustained pressure to allow the compensation for injurious affection to properties where no land is taken provided in this law. The 1973 law also enacted a change to the general entitlement to compensation, reflecting the fact that people are generally considerably disadvantaged in a host of uncompensable ways by the compulsory taking of property. The 1973 law recognised and provided for this by formally allowing an additional element of compensation, over and above the existing statutory claims, under Home Loss and Farm Loss payments.

This process of accommodation continues today. The Office of the Deputy Prime Minister announced in June 1998 that part of the Government's 'Modernising Planning' initiative would include a Fundamental Review of the Laws and Procedures relating to Compulsory Purchase and Compensation. The Review aimed to devise a compulsory purchase and compensation system that would be more efficient, more effective and fairer than at present. This remains a live issue on the political agenda today with the Law Commission and professional bodies calling for urgent reform. Their report finds that the complexity and inaccessibility of the current system is now so great as to be at unacceptable levels, and that as a consequence, it makes it much more difficult for claimants to receive the compensation that they are entitled to. It recommends wide ranging changes to the system, to make it easier to understand, to facilitate and expedite the negotiation of settlements that are fair to both parties.

The approach to, and measure of, compensation are therefore dynamic in all societies, resulting from a range of pressures expressed through the political system. What should be constant is the need for a clear legal code and procedures for dealing with this, and reasonable confidence that the system will provide an equitable result, wherever it is applied.

Sources

Maddison, A., *The World Economy, A Millennial Perspective* Paris, OECD (2001)

http://www.odpm.gov.uk/stellent/groups/odpm_planning/documents/; and <http://www.rics.org/Environmentalandlandconsultancy/Planninganddevelopment/Compulsorypurchaseandcompensation/Law>

Appendix F. Defining the “public interest”

Compulsory acquisition law should be clear, with sufficient detail and precision so that people know where they stand and officials have structured and controlled discretion. A more detailed and specific list of “public interest” purposes meets due process requirements and contributes to tenure security.

There are broadly two styles of drafting land law; the detailed and precise, and the broad and general. The former sets out the law clearly and in some detail so that the citizen, officials and judges know what their rights, liabilities, powers and obligations are, what they have to do and how they have to do it. The latter concentrates on principles and allows those implementing and interpreting the laws considerable latitude. More detailed and precise compulsory acquisition laws are generally more successful where land markets exist or developing. A land law conferring broad powers with few controls on officials may be adequate when the main thrust of the law is about administrative power, and where few private rights are involved. Once society recognises and protects private rights in land, and facilitates dealings with those private rights in the market place, the law has to be much more specific, detailed and clear.

Poland provides a good example of a detailed law in a transitional economy. The constitution states that “expropriation may be allowed solely for public purposes and for just compensation.” Article 46 of the Expropriation Law, 1991, provides that expropriation of agricultural land should only be used “in cases in which public welfare cannot be promoted without curtailing or revoking the right to the ownership of real estate...and real estate cannot be contractually acquired.” It limits the purposes to construction and maintenance of roads and public transport facilities, structures and installations needed to operate communications systems, environmental protection, premises for public offices, communal water intakes, liquid waste treatment and flood banks; construction and maintenance of elementary schools, hospitals, nursing homes, sanitary facilities and cemeteries; construction and maintenance of structures and facilities indispensable to national defence and to assuring public safety, including construction and maintenance of prisons and institutions for juvenile delinquents; construction of organised multifamily housing; and other obvious public goals.

At the other extreme, the Lands Acquisition Act 1970 of **Zambia** and the Land Acquisition Act, 1947 of **Trinidad and Tobago** give wide administrative discretion in defining the “public interest” to the Presidents of those countries. In Zambia, the President may compulsorily acquire any property of any description whenever he/she is of the opinion that it is desirable or expedient in the interests of the Republic. The President of Trinidad and Tobago may do likewise whenever any land is likely to be needed for any purposes which, in the opinion of the President, are public purposes. There is a partial check on the President’s power, in that this must be approved by Parliament. No definition of public purpose is, however, provided for in either Act. The citizen has to resort to the courts to try and control any abuse of power, and courts may be more likely to apply a margin of judgement to governments.

In 1985 Kitay¹ noted common themes in countries where the law provides for specific purposes: transport; public buildings; military purposes; public utilities; parks; and physical planning were frequently provided for in connection with urban development. Agrarian reform featured in rural development. Where a general “public purpose” doctrine was relied on he commented that “Efforts in various countries to produce workable general rules (as

opposed to specific list provisions) appear to have been less than fully successful in terms of avoiding disputes and litigation.”

In 1999, Schwarzwald² came to much the same conclusion and set out a similar list of common specific purposes for which compulsory acquisition is permitted. Non-exclusive lists combining general guidelines and lists of public purposes were considered to be preferable both to exclusive lists that were too inflexible (unless combined with special powers to allow rapid acquisition), and to broad guidelines that, without further clarification and definition through judicial interpretation, give “government entities wide discretion to expropriate land without checks on their power.”

Sources:

¹ M. Kitay, *Land Acquisition in Developing Countries: Policies and Procedures of the Public Sector*, Lincoln Institute of Land Policy (1985)

² B. Schwarzwald Compulsory Acquisition Chap 11 in R Prosterman and T Hanstad, (eds) *Legal Impediments to Effective Rural Land Relations in Eastern Europe and Central Asia, a Comparative Perspective*, World Bank Technical Paper No. 436 (1999)

Appendix G. Implementing Property Taxes

Recent international experience in property tax reform provides some guidance on the necessary preconditions for reform and on the impacts of those reforms.

The key elements that have to be in place for property tax reform depend to an extent on what aspect of the system is being reformed. The existence of adequate technical expertise is necessary for assessments. Appropriate land records and administration are required as the basis for the property lists. Sufficient flexibility to allow the phasing in of major changes is essential to forestall challenges and resistance to changes. Political understanding and will are perhaps the most critical preconditions if the substantial challenges of implementing a highly visible, difficult to evade, tax, are to be overcome.

The impacts of reforms are similarly, in part, a function of what they have addressed.

The reforms in **Ontario**, Canada, have resulted in greater equity within the residential property class, but have not addressed the relative inequities between property classes (residential, industrial and commercial), or within the non-residential property classes. The system is, however, more complex than ever. Stability of the property tax system has been achieved at the expense of equity and simplicity. The political will to undertake the reforms was a critical requirement. Taxpayer resistance prevented progress for thirty years, so it was vital to ensure taxpayer confidence in the system of assessment and appropriate phasing in to ease the impact of the changes.

In **Hungary**, the lack of local administrative capacities in tax administration coupled with weaknesses in the legislation and fragmentation of, often incomplete and non-computerised, property information between two levels of government create real challenges. In practice, although legislation was drafted in 1996, there has not been sufficient political will yet to implement property taxation.

In **Indonesia**, property tax reform resulted in increased revenues, with the newly adopted policy and administrative framework delivering reduced administrative and compliance costs. Careful introduction of the changes minimised taxpayer and bureaucratic resistance. Again political will was a paramount requirement for such a major adjustment. It is an interesting example of a property tax that used its own fiscal cadastre rather than being based on the legal cadastre. Although there were pre-existing property taxes, dramatic adjustments were required to deliver the administrative and policy changes. These were carefully piloted to test and improve procedures, to train staff and identify taxpayer responses to the changes. As a measure of the capacity building exercise required by these changes Indonesia's tertiary educational institutions now train about 600 property tax administrators a year.

In the **United Kingdom**, the adoption of a banding system of assessment greatly simplified the process of assessment, reducing its costs, but freezing differentials over time and thus somewhat reducing equity between taxpayers. The approach was widely accepted because it was simple, easy for taxpayers to understand and easily predictable.

Colombia's use of self-assessment has resulted in an increased tax base and revenues and has allowed the cadastre to be updated.

In **Kenya**, the primary obstacles to property tax reform have been lack of political will and weak administration. Taxpayers need to perceive the linkage with improved local services and also need to be confident of fair administration.

Sources

Bird, R. M. and Slack, E. *Land and Property Taxation: a review*, Workshop - Innovations in Local Revenue Mobilisation, 2003, World Bank, (2002)

Appendix H. National practices in land banking

Acquiring land in advance of actual needs, land banking, is a commonly used strategy by individuals, companies, municipalities and national governments to assemble sites to improve the quality of land holdings, to enable extensive (re)development to take place and to allow for orderly planning and use of resources. When used by governments, the primary purposes of land banking may include: to influence the pattern of development in accordance with overall planning objectives, to control the land market, to prevent land speculation, and to recapture some of the 'betterment' created in connection with rural-urban land development. Land banking has been adopted in many countries, particularly in urban fringe areas where large agricultural areas are typically purchased at the value of current permitted land use. China is no exception in this. Land acquired for such banking purposes can be purchased compulsorily, where appropriate powers are available to the land banking institution, non-compulsorily, or, in some cases, through powers of pre-emption when land comes to the market. There are stories of successful land banking activities, and stories where serious problems have arisen.

Large scale land banking is a feature of both developed and developing countries. Although there has been limited systematic international analysis of land banking, international experience does confirm that there is no fixed recipe for success; appropriate mechanisms need to be designed with the skills and capacities necessary to be able to achieve the defined objectives. A land banking system should be properly founded within an appropriate legal framework in compliance with relevant accounting (including valuation) and administration standards. Successful implementation of land banking in addition at least requires clearly defined purposes and objectives, coupled with a measure of flexibility in the face of dynamic realities. Experience suggests that it is at its most effective when used selectively in a well targeted way and when due regard is paid to transparent assessment of the true costs and benefits.

International experience also suggests that most of the problems in land banking arise from scale. Where a government becomes the major land owner, such as in **Sweden** in the 1960's, it may jeopardise the achievement of its own goals. There is a high risk that its policies may prove to be unsustainable and may result in unpredictable and unwanted outcomes. Public land acquisition has to be used very carefully, and many have concluded that large-scale government intervention has, in general, not been very successful, particularly in developing countries.

The widespread use of land banking in modern Europe was pioneered by Sweden in the early 20th Century. Its public acquisition programme of the 1960's when land banking was at its peak, resulted in one of the most extensive programmes in the world, both in terms of its country-wide adoption by municipalities and the amount of land held, and at the time it was widely held to be a success. By the end of the 1970's public disapproval of insensitive developments for which there was little market demand and the insulation of the monopolistic land banking process from any true market pressures led to open criticism and popular rejection.

In the **United Kingdom**, land banking has been used less extensively, but in a focussed manner, initially in the creation of New Towns, and later as a tool in the regeneration of large-scale urban areas. The London Docklands Development Authority (LDDA), for example, transformed almost 8.5 square miles of London's East End, designated as an Urban

Development Area, into a thriving office and residential community. During the 1980's and 90's the LDDA attracted UKL1.6bn of public and UKL7.7bn of private capital.

The developing countries of Asia have many land banking bodies. In **India**, the land bank operations of the municipal Delhi Development Authority (DDA), for example, developed during the 1950s and 1960s to implement the planned development of the city. Problems caused by lack of clear definition of objectives, acquisition, disposal and development policies meant that the land bank was not an efficient land management tool. DDA is empowered to take control over all land designated for urban development. The acquisition process is, however, cumbersome and expensive and is based on the value of the land at the date of notification - which can be 20 years before the actual transfer takes place. Most land was disposed of by auction, which was characterised by high prices and cumbersome administrative processes. Land, disposed of by other means than auction, was sometimes subject to inappropriate allocation procedures favouring more influential population groups. Although one objective of the DDA was regulating land values, these actually increased considerably since the introduction of the scheme. In addition, DDA has failed to keep pace with the demand for affordable housing as a result of its rapid urban growth.

Sources

London Docklands Development Authority, *Attracting investment – Creating capital* (1998)

UNESCAP, *Municipal Land Management in Asia* (1995)

Appendix I. Upgrading Rural Land Rights in Dual Tenure Systems: A Successful Strategy from Botswana

Botswana is consistently cited by international agencies as having perhaps the most effective land administration system in sub-Saharan Africa. The system provides an example of how, on a selective basis, tenure upgrading can be managed in previously rural communities which are developing rapidly in suburban and other situations.

Like China, Botswana has a system of land tenure consisting of lease and use rights from the national and local governments. Like China, Botswana has a dual tenure system, with different forms of land tenure available in urban and rural areas, and with rural land administered by local communities and urban land administered by central government, which delegates this authority to municipalities. Rural land is administered by local Land Boards consisting of both local officials and elected community members. These Land Boards administer both customary and formal land rights. In towns and other rapidly developing areas, including those at the edge of urban areas such as Gaborone, the formal land rights have become increasingly important. Since the creation of the Land Boards in 1968, those desiring to engage in commercial or industrial land uses have been able to apply to the local Land Board for formal tenure, in the form of a long-term lease.

These leases are subject to maximum terms which vary depending upon the nature of the land use, and are both inheritable and renewable. They do not fundamentally alter the underlying land right, which remains in the local community. On surrender, termination or expiration without renewal of a lease, the tenure status of the land reverts to customary holding from the community.

Initially, in 1968, these leases could only be given to members of the local community, and all such leases needed the consent of the Minister of Lands. Transfers of the leases required approval of the Land Board. In reforms in the 1990s, eligible land uses for leases were expanded to include residential land; outsiders were permitted to obtain leases, and the requirement of the ministerial consent to leases was eliminated (both for locals and outsiders), as was the requirement that the Land Board approve transfers (so long as the land to be transferred has been developed).

Today, commercial banks in Botswana routinely provide credit against these leases. The remaining term of the lease secures the loan. The bank will usually seek confirmation of the leasehold right from the Land Board, but do not require its permission for the mortgage, and the free marketability of the leasehold right has both increased the value of the leases and made the lease attractive to banks as security, because funds can be realized from the lease by their sale of the remaining term in the market.

The experience of Botswana illustrates a viable incremental approach to tenure change, one in which both forms of tenure are available from one local institution. It highlights the feasibility of using leases as security for loans, and the conditions under which banks are interested in leases as security for loan: a secure form of tenure, well-documented, with a substantial unexpired term remaining, and the marketability needed to give leases market value, including a lack of barriers to marketability such as required consents from officials.

Appendix J. Land policy and its implementation in Vietnam

Under the Land Law 1993 (revised 1998 and 2000) land is held in **Vietnam** under long term use rights, subject to land holding ceilings in rural areas and administrative approval of sales. There is no state guarantee of the right, and only urban land can be mortgaged, where it has a land use certificate.

Vietnam allocated and documented land distribution locally, which successfully provided a relatively high degree of security of tenure in rural areas in a quick and inexpensive way. Land can still be subject to allocation readjustments and the sale of use rights to state land is generally not transparent.

There are approximately 105 million land parcels held under land use certificates. Of these, 90 million, 86%, are registered. These comprise around 90% of all rural parcels and 15% of all urban parcels. At least 11 million, multiple parcel, land use certificates have been issued. This is therefore a very different approach to the systematic adjudication and registration techniques used in several other countries in the region. The Vietnamese system does not easily support subsequent transactions; it takes on average 60 days to transfer a property (compared with around 2 hours in Thailand). Taxes on transfers are relatively high, at \$4.50 plus 1% of the value. The country is only in the early stages of developing the necessary valuation skills and capacities, thus undermining many public and private functions relating to land and its use.

Land market operations are predominantly informal in character, with AusAID estimating that 95% of all transactions are unregistered. There is, however, a reasonably active land market. The most recent figures available (1998) indicate that about 15.3% of land was leased out and, in an interesting assessment, the research indicates that generally households leasing their land from owners are more efficient at farming. About 9.5% of households sold land in 1998, and 2.5% bought land, with distress sales in the Mekong delta reportedly increasing landlessness.

The strong preference for informal transactions reflects the problems associated with the official land administration system. Informal transactions avoid transfer fees and taxes and are concluded quickly, but provide insufficient security against third party claims, leaving buyers vulnerable to fraud and discouraging would-be investors and financial institutions from getting involved in informally transacted properties.

Vietnam's property market is largely based on household savings, so it poses little risk for the country's financial institutions at present, as these are largely disconnected from the asset base of land and buildings.

Sources

EASRD, *Regional Study on Land Administration, Land Markets, and Collateralized Lending*, World Bank (June 2004)

Appendix K. Compensation for takings by the State: a comment on the draft Property Law

China's Constitution requires compensation when the State compulsorily acquires land and land rights in the public interest. Confidence that fair compensation will be paid in this circumstance is a key element in creating security of tenure. If not, landholders are at risk of losing the benefit of their investments and bearing too much of the cost of public projects, a cost that should be shared broadly among the public. This undermines both their incentives to invest and Government's reputation for fairness.

Article 49 of the Draft Property Law provides that compensation shall be as stipulated by the State and that if no such provisions exist, compensation shall be "reasonable". With regard to land contractors, Article 137 requires that contractors who lose their rights must receive "reasonable" compensation. This does not do as much as might be hoped to make meaningful the Constitution's guarantee of compensation for takings of property. It is important that the Property Law go further and establish a general standard for reasonableness of compensation, a standard against which more detailed provisions in other laws or regulations may be tested for consistency.

"Market value" is used in most market economies to calculate compensation for land that is taken through compulsory acquisition. With its burgeoning market in land rights, China should take the opportunity provided by the formulation of a new Property Law to establish "market value" as a key feature in the determination of "reasonable" compensation.

At the same time, however, market value alone is not sufficient for establishing the proper amount of compensation. Even in economies where land markets are well-established, market value is usually not sufficient to cover certain costs that people suffer as a result of their land being taken – hence, compensation standards routinely include additional elements designed to cover disturbance, improvements, resettlement and other costs. Such elements would be especially important in the context of China because the market value of certain types of land rights are significantly depressed by the restrictive legal regimes to which they are subject. Particularly in the case of agricultural land contract rights, payments based on market value alone would be inadequate to compensate the use rights holder for the often substantial livelihoods disruption that they encounter and to ensure (as called for by Document 28) that their original living standards are sustained.

The draft Property Law should, it is suggested, therefore be amended to:

- Provide that all stipulations of compensation or compensation awarded in the absence of stipulations must be "reasonable".
- Provide that "reasonable" compensation should be sufficient to compensate those affected by a taking for their loss of land use rights, disturbance and livelihood.
- Provide that the package of compensation due to use right holders should be paid directly to them.
- State that the basis for calculation of reasonable compensation shall include the following elements:
 - the market value of the use right or ownership right.
 - compensation for disturbances suffered as a direct result of the taking of the land, including, inter alia, for loss of standing crops and of the value of any improvements.

- compensation for the loss of livelihood resulting from the taking of land. For agricultural land this should be expressed as a multiple of the average annual value of agricultural production of the land (in accordance with a formula to be specified in detail in regulations).
- State clear assumptions about what use may be assumed for the land acquired for the purposes of assessment of compensation.
- Provide, where possible, that those receiving compensation for land and buildings for which there is no effective market, should have the option of equivalent reinstatement. Rural land claimants should, where possible, have compensation options of a) comparable land to farm or b) cash compensation.
- Provide for the establishment of a specialist valuation tribunal to decide on compensation claims, and allow challenges to compensation awards in this tribunal once administrative review options are exhausted.
- Allow no taking to proceed unless agreed-upon compensation (or in the case of a dispute, the minimum required compensation) has been paid.

Appendix L. Property rights, transactions and their registration: a comment on the draft Property Law

The Draft Property Law confirms both the marketability of some land use rights and significant limits on marketability. Construction land (urban or rural) can be leased, exchanged, assigned or mortgaged without official approval (Art. 149). By contrast, while rural agricultural land and rural residential sites may be leased or exchanged without approval, they can be assigned only with the consent of the community and a rural residential site can be assigned only to someone who would qualify for a residential right in the community in their own right (Art. 162). This results in an extremely circumscribed market in these rights. Moreover, neither rural agricultural land nor rural residential sites may be mortgaged (Art. 206(2)). These restrictions on commercialization of use rights in rural agricultural and residential sites are arguably unnecessary. They will certainly limit investment for development of that land and also growth in its market value, and should be loosened further.

To protect those engaging in permissible transactions in land rights, the Draft Property Law provides for a unified national system of registration of rights in land and buildings (Art. 10). It is suggested that some provisions in the draft could use clarification regarding which categories of use rights require that require registration and if for some categories registration is optional, as suggested by the Rural Land Contracting Law. There is a fundamental issue here: Is a fully unified system of registration of property rights indeed being created?

The protections provided for registered right holders by the draft are valuable, and in many cases will allow a potential buyer to deal in confidence with the person shown as the right-holder on the register. There are however three provisions of the draft law which might warrant amendment to strengthen that confidence:

- Article 4 seems to provide that the legal effect of registration of a property right is only to create a presumption that the registered holder is actually the legal holder, one which can be rebutted by proof to the contrary. It would be better if stronger and clearer wording such as “a conclusive presumption” or “a presumption rebuttable only by proof of fraud”. Also it would be useful to expand this article to include a clear statement (clearer than that in Art. 111) that a subsequent registered transaction prevails over a prior unregistered transaction.
- The draft law protects the registered right “unless the right holder described in the register has knowledge of or should have knowledge of defects existing in the property right at the time of acquiring it” (Art. 23). What a buyer “should have known” is hard to say. The risk created that the registered right holder is not the actual right-holder means that those acquiring the right run an unnecessary risk. This wording would best be dropped. If it is not dropped, it should be made more specific, for instance stating that the right holder should have had knowledge of a defect only if it would have been evident had he visited the property.
- The draft law provides that an interested party can apply for correction of errors, which can be made by the registration agency if there is evidence that the registration is wrong (Art. 20). International best practice is that registry officials should be empowered to correct only errors not substantially affecting the interests of anyone, or where all interested parties agree. In all other cases, an error should only be corrected by order of a court. Giving registry officials broad power to correct errors leads to corruption of registry

staff, and registered right holders must fear unjustified “corrections”. This undermines their security of tenure and the register is rendered less reliable.