



Are local governments maximizing land revenue? Evidence from China[☆]



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ABSTRACT

This paper examines how political considerations affect local officials' revenue maximization behaviors in the context of urban land conveyance in China. Particularly, we analyze government intervention based on local officials' choice of two land auction types, namely, "English auction" and "two-stage auction". The latter presumably serves as a tool of government intervention. We aim to address the research question: "Are local governments maximizing land revenue?" The major findings are threefold. First, for cities with higher housing prices, two-stage auctions are adopted more frequently than English auctions. In addition, land parcels in these "hot" cities adopt two-stage auctions more frequently during sensitive political events, suggesting that local officials respond positively to the real estate regulation policy from central government. Second, when city leaders are more incentivized to promote economic performance, they respond less positively to rises in housing prices. Third, such interventionist behavior results in a significantly depressed land price and housing price. Despite its intention of improving public welfare, this interventionism can susceptiblely cause problems of misallocation and corruption.

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1. Introduction

Previous studies on political economics show that fiscal decentralization in developing countries often has a positive impact on economic growth (Jin, Qian, & Weingast, 2005; Qian & Weingast, 1997). A typical strand of those studies has recognized that fiscal incentives are the key to understanding China's economic miracle in the post-Mao era (Xu, 2011). In the context of China, tax-sharing reforms in 1994 and 2002 divert more fiscal revenue from the local to central government, and in return local governments are entitled to enjoy revenue from urban land leasehold. From 1999 to 2013, the ratio of land conveyance fee (which is classified as extra-budgetary revenue) to the local budgetary revenue has risen from 9% to 60% (See Fig. 1.). As a result, literatures find a strong incentive among local officials to promote the real estate sector so as to maximize land revenue (Han & Kung, 2015). Such phenomenon is widely defined by the literature and news reports as "land finance" (e.g. Fu, 2015; Wu, Feng, & Li, 2015; Pan, Huang, & Chiang, 2015; Wu, Li, & Yan, 2015). Moreover, some studies argue that the increasing dependence of "land finance" is a driving force of China's recent soaring housing prices (e.g. Pan et al., 2015). This paper attempts to uncover a "yet-to-know" mechanism in local officials' land conveyance behaviors in China. In view of the political considerations

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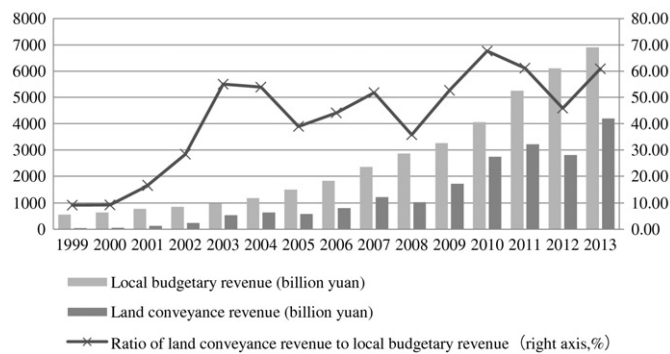


Fig. 1. Land conveyance revenue and local budgetary revenue: 1999–2013.

of local governments, we hypothesize that apart from maximizing local revenue, local officials will respond to the real estate regulation requirement, both from the public and the central government. This means in land conveyance, they will strike a balance in their decision between revenue maximization and price regulation.

We exploit two variations to identify that mechanism. Variations in housing prices across cities generate the first difference. During 2003–2013, housing prices had risen rapidly in China with the annual growth rate reaching 10% on average. Housing prices have been skyrocketing in some major cities. For example, three first-tier cities, *Beijing*, *Shanghai* and *Guangzhou*, had seen an annual growth rate of 14%–16% over the same period. This has given rise to grave concern over the existence of bubbles and housing affordability among residents (Ren, Cong, & Yuan, 2012). Consequently, taming the soaring housing prices has become one of Chinese government's most urgent political tasks since 2003 (Hui & Wang, 2014). A series of regulatory policies has been issued by the central government, of which land market regulations were much emphasized. Based on the prefecture-level panel data, we will investigate if higher housing prices would significantly increase the likelihood of government intervention in land conveyance. We hypothesize that cities with a higher housing price and growth rate face a greater pressure from both residents and central government, thus may result in more intervention in land conveyance.

The second difference is provided by variations in local officials' career concerns. Since its post-reform era, China has adopted a GDP-centered cadre evaluation criterion and the likelihood of cadre promotion is demonstrated to be strongly related to local economic performance (Li & Zhou, 2005). In this sense, "land finance" is essentially linked to city leader's promotion incentive in that land revenue is crucial to promote local economic growth (Cai, 2011; Kung & Chen, 2013). Previous studies on political cycles further point out that the local official's incentive structure varies in different stages of career (Guo, 2009). Generally, leaders with shorter tenures are more incentivized to promote economic performance due to their larger probability to get promoted (Zhou, Zhao, & Li, 2013). In such a context, we hypothesize that local officials with shorter years in office tend to value more on land revenue maximization (in promoting economic growth) than those with longer tenures.

We further estimate the price distortions caused by government intervention in land conveyance. The dataset used for estimation comprises comprehensive parcel-level transaction records covering almost all cities during 1998–2012. We can exploit the parcel-level dataset to correct for the potential selection bias issue using the Propensity Score Matching and Treatment effect model. We also examine the effect of land conveyance intervention on housing prices.

By analyzing an important public policy issue—land conveyance in China—this paper provides a new understanding of local officials' incentives. We show that the misaligned incentives of governments can lead to direct land intervention and a distorted land price. This paper also contributes to the existing literature on real estate regulation by analyzing a new, distinctive intervention regime. Traditionally, land use regulation usually takes the form of urban planning, such as urban growth boundaries, minimum lot sizes, density restrictions and so on. Many scholars show that those regulations have an indirect effect on real estate prices by changing the elasticity of house supply (Gyourko & Molloy, 2014). We look into a rather different yet important form of regulatory regimes in the context of land supply monopolization, which directly distorts land prices. In order to measure the extent of such a regulation, this paper exploits local governments' choice between two different land auction types—English auction (*Paimai*, in Chinese) vs two-stage auction (*Guapai*, in Chinese). While the former type has an open bidding process, the latter typically involves an under-the-table negotiation between local government and land buyers. Presumably, the two-stage auction serves as a tool of manipulating the land auction process (Xu, Yeh, & Wu, 2009). Therefore, we can define the adoption of two-stage auction as an indicator of government intervention.

The remainder of the paper is organized as follows. The next section provides a brief institutional background of China's land market. Section 3 presents the data sources and empirical specifications. The next two sections identify the causes and effects of land conveyance intervention. Section 4 examines the determinants of the adoption of two-stage auction using both the prefecture-level panel data and parcel-level data. Section 6 estimates the effects of two-stage auction adoption on individual parcel prices and local housing prices, employing both a parcel-level and the prefecture-level dataset. Concluding remarks are in Section 6.

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