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On ‘Land Finance’ in urban China: Theory and practice

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ARTICLE INFO

Keywords:

Land finance
Land banking
Strategic development partner
Nansha

ABSTRACT

Urbanisation in China since the economic reform and opening up of the country is characterised by an unprecedented amount of land development resulting from privatisation, marketization, and commodification of land in the urbanisation process. This study extends the focal points of speculative urbanism through an analysis of land finance, a phenomenon of the financing arrangement for urban development. It reviews and compares three different modes of land finance, and examines the interplays between agencies, focusing on the exchange of land resources for capital. The collaborative mode of land finance practised in Nansha Free Trade Zone that involves the participation of strategic partners, represents a new financing model which is encouraged by the Central People's Government as a solution to reduce local debts as well as to stimulate market incentives through direct or joint investment in the urban development process.

1. Introduction

Urbanisation in China since the economic reform and opening up of the country is characterised by an unprecedented amount of market-driven land development (Ma & Wu, 2005; Sun & Chan, 2016). As a result of the intergovernmental revenue sharing scheme under the 1994 tax reform, there was sharp decline in local revenue. Local spending responsibilities, however, remained unchanged. Apart from the fiscal pressure, local leadership was also concerned about the effect on the performances of local economic developments to which their promotion prospects were tied. To meet the expenditure and to enhance economic growth, local governments had to look to other revenue sources. Land is a ready and single solution to the problem. Income from land conveyances, not being a part of the budgetary revenues, does not have to be shared with the Central Government. The local governments have been allowed to generate revenue from the transfer of land use rights (LUR) of arable land to a different usage, and to keep the fees collected (Ding, 2003; Dowall, 1993; Ho & Lin, 2003, 2004; Xu & Yeh, 2005; Zhang, 1999; Zhu, 2004). Land revenue represents a major source of local revenue, accounting for some 60–80% of the local governments' total revenue. The income is turned into municipal investment and applied towards the building of urban infrastructure and upgrading of the built environment. Land has thus become the most valuable asset in cities. Through constant profit-oriented investment, land generates huge exchange value to meet the development needs of cities (Logan, 2008; Wu, 2015) and also serves as a medium for entrepreneurial governance (Sun, Lin, & Chan, 2017).

Land development and the associated land-based income characterise a distinct regime of capital accumulation in cities, and gives rise to a new form of urbanism in China. ‘Speculative urbanism’ in the context of China has been the subject of wide discussions. The emphasis has been on a strong state imperative in productive investment in the built environment, particularly fixed assets and commercial real estate projects (Shin, 2014). On the one hand, manufacturing or labour-intensive industries gradually give way to more profitable sectors, such as business, commercial and service sectors. This makes land the single most valuable asset for cities (Wu, 2002). On the other hand, new forms of urban governance have emerged. The entrepreneurial local statehood has prompted continuing marketization and decentralisation in the land development process (Wu, 2017).

While the financial arrangement for land development is an important aspect of land governance, and critical to the successful implementation of public-private partnership, there has been little theoretical and empirical study that compares the different modes of financing the land development process in China under different period of time. This paper provides a holistic review and comparison of the different modes of land finance. It examines the interplays between agencies, focusing particularly on the various forms of exchanging LUR for capital. It examines the new collaborative mode of land finance in Nansha District, a new Free Trade Zone (FTZ) in Guangzhou that was approved in 2015 and designated as one of the country's pilot regions. The interrelationship between the key stakeholders in the new development model, such as the Central and local governments, the state-owned enterprises and market investors, will shed light on the

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evolution of land finance as marking a new pathway for future land finance and land development. Importantly, the case study of Nansha reflects some future trends in institutional reforms of China's land market. Understanding the exchange of LUR, as well as the interplays between the authority and capital, is essential to providing evidence-based suggestions for China's new urbanisation strategy and the deepening of market reforms.

The paper is divided into four parts. It begins with a review of the general framework of the land driven finance operation in China, and its important backbone, the land banking mechanism. It is followed by a discussion of two conceptual models derived from the current financing arrangement for initiating and supporting the land development process. The third part examines the new mode of land finance that is practised in Nansha FTZ, and the underlying institutional and capital arrangement. The final part discusses the findings of our study, and concludes by highlighting specific aspects in which the findings can inform future territorial planning and land development in major Chinese cities.

2. Financing land development and land banking in China

2.1. Land finance

As with the experience of other developing countries, the investment strategy of the Chinese local governments since the 1990s has been to use revenue generated from land to finance urban infrastructural development. The term 'land finance' (*tudi caizheng*) refers to a widely-practised fiscal phenomenon, which is characterised by a heavy reliance of local governments on land leasing revenue or land conveyance fees as a source of local revenue (Ding, 2003). LUR are assigned by local governments to developers in return for the payment of land conveyance fees and taxes, which are then used to finance local infrastructural developments.

Land finance in China has received considerable academic attention. Thus far, the studies have largely focused on its political and economic background and future implications (Zhao, 2014), and the structural and functional characteristics of land revenue and local fiscal system (Lin, 2014; Lin, Li, Yang, & Hu, 2015). It is argued that land finance is underpinned by an interwoven fabric of economic and political considerations, and a pattern of reciprocal relationships between the local government and the market. It is also observed that fiscal decentralisation has led city governments to rely on land finance to defray the costs of urban development and to meet government expenditure. Land finance plays a critical role in the local economy. The returns from the expansion of urban built-up areas, which account for the bulk of the funds for urban construction and maintenance, is an important incentive motivating the local governments to turn to land finance (Lin & Yi, 2011). Its impact on the performance of the local economy, in turn, carries implications for the local leadership's performance, promotion and tenure (Wang & Ye, 2016).

The review of land finance literature reveals three interrelated gaps. In the first place, most research studies on land finance adopt a case study approach; there is a lack of comparative studies on the various land finance models that have been applied to different institutional settings and partnership conditions. Existing studies also tend to assume that LUR transactions in the land conveyance market (also known as the primary land market) are, without doubt, highly profitable given that the prefectural and county governments effectively monopolise the market. They have not considered the complex process of land banking (*tudi chubei*), including the varying partnership conditions and issues of sustainability. Second, there has been little analysis of land finance from an institutional perspective, that is, the involvement of different types of stakeholder within a specific type of institutional structure, under which LUR is exchanged for vast amount of capital to initiate the land development process. Third, previous studies on land finance have not explored possible directions for further institutional innovation to

meet the new challenges presented by the Central Government's tightened control over farmland conversion and the huge increase in the amount of compensation paid for land acquisition.

2.2. Land banking

Since the promulgation of the 2002 regulations¹ by the Ministry of Land and Resources (MLR), assignment of LUR to be used for profitable purpose, such as commercial land, tourism land, entertainment land and commercial residential land, must be carried out publicly in the market by means of bid invitation, auction or quotation. In 2007, the regulation was amended to extend its application to industrial land. The regulation has paved way for local governments to generate huge land revenue through controlling the supply of land for residential, commercial and industrial use, and thereby effectively monopolising the primary land market.

However, commodification of urban land and generation of land revenue could not have been achieved by a single policy order. The backbone of the land financing operation in China is the land banking mechanism. Land banking first emerged in the 1990s with the introduction of an urban land market. It has since become common practice across China (Table 1). As Fig. 1 shows, land banking is a complex, costly and time-consuming mechanism. It can be divided into four stages: (1) land acquisition; (2) land holding, (which covers two sub-stages i.e. (a) holding of raw land, and (b) holding of 'ripe' or prepared land); (3) site preparation, (which involves land preparation work consisting of infrastructural development and construction of public facilities); and (4) land disposition. The mechanism entails injection of capital funding, exchange of LUR, upgrading of the built environment and lastly, realisation of land-based revenue. An examination of this important mechanism will shed light on the underlying rationale of the land finance phenomenon.

Healey's triadic framework on land development offers an important angle to the discussion of land banking in China, having regard to the complexity of the financial arrangement and the changes to the LUR involved. According to Healey (1992), three aspects of implications underpin the land development process: (1) conversion of property rights, (2) improvement of built environment and (3) change in land value. These are explained as follows.

2.3. Conversion of property rights

In terms of transformation of the property right structure, there are three possible means of making land become state-owned and ready for urban construction. Under current practices, three types of lands can be put into the land market, namely, state-owned land that has been resumed or land acquired through purchase, pre-empted land, and agricultural land that has been acquired and converted to construction land. These three types of land can be further categorised into two sub-groups: newly added construction land and land lots for redevelopment. Newly added construction land, in most cases, is agriculture land owned by rural collectives. Rural land can be transferred upon the central government approving the land conversion in accordance with the top-down construction land quota allocation system. When this happens, the affected villages will be entitled to a compensation package. In the case of land lots for redevelopment, they are acquired and prepared from existing built-up areas in old urban districts, closed down factories and villages-in-the-city. While it does not require conversion approval under the construction land quota, the process of negotiations with the original property owners can be tortuous. Researches show that reaching consensus in land development is socially and politically costly, and negotiations with the stakeholders are

¹ Regulations of the Ministry of Land and Resources on assignment of state-owned construction land -use rights through bid invitation, auction and quotation.

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