Government intervention and land misallocation: Evidence from China

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Abstract

Strong government intervention exists in China’s land market compared to other countries. This paper examines the effects of government intervention on land misallocation and identifies its source, based on Chinese prefecture-level cities’ panel data from 2003 to 2012. The empirical results show that local government’s distorted land-leasing price policy, by which it leases out industrial land at a lower price, and leases out commercial and residential land at a higher price, leads to land misallocation between the industrial and service sectors. Local governments’ revenue and political incentives also cause land misallocation. More land is leased to the industrial sector when local governments intervene more in land prices and rely more on investments, and when local officials have an incentive to signal performance in the early years of their tenure. The distorted land-leasing policy results from local governments’ attracting investments and land-financing incentives, which leads them to lower industrial land prices to attract investments, and to push up commercial and residential land prices in order to pursue revenue. Political cycles foster the effects of land price distortion on land misallocation. Reforms of China’s land-leasing system and central-local fiscal institutional arrangements are needed to reshape local governments’ land-leasing incentives and remove land price distortion.

1. Introduction

Government intervention in land market has long been the focus of land use policy and land economics studies. Some scholars support government intervention with respect to reducing the externalities of land use and regulating the land market (Brueckner, 2009); however, others suggest that this would induce distortion in the land market (Peng & Thibodeau, 2012; Glaeser & Ward, 2009; Jansen & Mills, 2011). Although government intervention is important for the land market, a distorted land policy, no matter how well intended or development oriented, would cause problems with unintended resource misallocation and productivity loss (Restuccia & Rogerson, 2013; Restuccia & Sантеулалія-Llopis, 2015).

China provides an ideal environment for studying government intervention and land misallocation. Compared to other countries, there is much more government intervention in the Chinese land market. The mechanism through which government intervenes in the land market differs from that of Western countries, where such intervention comes through land use regulation, including land development permits, urban growth boundaries, density limitations and zoning (Brueckner, 2009). However, state-owned land in urban China is controlled by local governments (Ho & Lin, 2003), which monopolize the land supply and land market through their monopoly rights to supply land for urban use and to lease land to developers (Deng, 2003; Lin & Ho, 2005). Local governments intervene in the land market by leasing land for various uses to different sectors, by manipulating the transaction method and distorting land prices (Lin & Yi, 2011; Yang, Ren, Liu, & Zhang, 2014).

Strong government intervention causes land misallocation. Compared to developed and other emerging-market countries, China’s urban land use structure has over larger share of industrial land and relatively lower share of residential and commercial land (Cai, 2011). The national average share of industrial land is 26%, and in some cities even 40%, which is much larger than that in cities of Western countries.¹ It is becoming more widely acknowledged by scholars and Chinese government that China’s urban land use structure is distorted, and that this is related to local governments’ land-leasing behavior (Tao, Su, Liu, & Cao, 2010).² The much lower share of residential land leasing results in high housing prices, distortion in land use structure, exacerbation of land misallocation, and a decrease in urban productivity (Bertaud, 2007).

Many studies of Chinese land markets have focused on the role of government in land supply. They have analyzed local governments’ land supply patterns (Tao et al., 2010; Yang et al., 2014), incentives for local governments’ land leasing (Lichtenberg & Ding, 2009; Cai, Henderson, & Zhang, 2013; Kung & Chen, 2014) and the impacts of government intervention on the land market and urban development.

² The problem of over-leasing industrial land and allocating less for residential purposes is increasing acknowledged by the Ministry of Land and Resources.
Du, Thill, and Peiser (2016) found that the Chinese government’s re-
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striction on negotiation in land leasing improves urban land productiv-
ity. Yang et al. (2014) found that in Beijing, local government land-
leasing policy significantly influences the land market, and that price
differences exist between listing and tender. Some scholars have stud-
ied Chinese local governments’ land-financing behavior and examined
t heir fiscal and political incentives (Wu, Li, & Yan, 2015; Kung & Chen,
2014). However, to the best of our knowledge, there have been few
studies on the causes and consequences of government intervention
in land leasing in China, especially from a resource misallocation
perspective.

This study aims to examine the effects of a particular type of govern-
ment intervention arising from a biased land-leasing price policy on
land misallocation, and to identify the sources of land misallocation
and local governments’ intervention. It provides new insights into
how well-intended government intervention in the form of a develop-
ment-oriented land-supply policy could lead to land misallocation
through distorting land-leasing structures.

The next section reviews the background of China’s urban land sup-
ply system. The subsequent section presents the model of local govern-
ment behavior in the Chinese land market and describes our empirical
framework. This is followed by the empirical results and discussion.
We provide further regression results and robust checks in the addition-
al evidence and robust analysis section. Conclusions are made in the
final section.

2. China’s urban land supply system

2.1. Context of urban land supply in China

Land is not just a fundamental production factor, but an important
policy tool for local governments to stimulate economic growth in
China (He, Huang, & Wang, 2014). The existing dual land property rights
system and segmented urban and rural land markets offer great potential
for government intervention in land supply. In China, urban land
owned by the state is allowed to trade on the open market, while
rural land owned by rural collectives is prohibited from being traded,
except within the village in which it is located. Local governments
have monopolized the requisition of rural land and the supply of land
for urban construction (Zhu, 2004; Zhu, 2005), and rural land cannot
be used for commercial purposes until it has been requested by local
governments and transferred from collective to state ownership.
China established the urban land market in 1988, since then local gov-
ernments have been able to lease urban land for compensated use.
Local governments also have a monopoly on leasing out land to devel-
opers and other commercial users. Without clear individual land prop-
erty rights, local governments can easily intervene in land leasing and
make it an important extrabudgetary revenue source (Wang, Wang,
Su, & Tao, 2012).

The 1994 centralized fiscal reform had a radical impact on local gov-
ernments’ fiscal revenue. It sharply cut local governments’ budgetary
revenue, but without correspondingly changing their expenditure re-
sponsibilities (Xu, 2011; Zhan, 2013). Suffering from poor fiscal condi-
tions, local governments resorted to land leasing as a new source of
revenue (Cai, 2011; Kung & Chen, 2014). This became an increasingly
popular tool for local governments to gain extrabudgetary revenue and
finance infrastructure and urban construction (Cao, Feng, & Tao,
2008).

Since the 1994 fiscal reform, local governments have transferred
from intervening enterprise to expropriating land under increasing fis-
cal pressure (Zhan, 2013). They can expropriate rural land at a low price
and then lease it out to potential users at a much higher price for resi-
dential and commercial use (Ding, 2003). China’s regional decentraliza-
tion reform has greatly motivated local governments to compete hard
for outside investments and promote business development in their
jurisdictions (Jin, Qian, & Weingast, 2005; Cai & Treisman, 2005). As a
fundamental production factor controlled by them, local governments
can lease out industrial land at a very low price for attracting investors
(Tao et al., 2010). This land-centered development mode is an import-
tant element in China’s economic growth miracle of the last 30 years
(Wu et al., 2015; Xu, 2011).

2.2. Local government land-supply behavior

Local governments lease out land to commercial users through four
methods: negotiation (xiyej), which is a nonmarket transaction; and
tender (zhaobiao), auction (paimai) and listing (guapai), which are mar-
ket transactions and entail leasing out land in a more competitive and
transparent way. The price gap between market and nonmarket trans-
actions is quite significant, and a competitive market pushes up the
land-leasing price (Tao et al., 2010).

Local governments generally prefer to lease out industrial land by
means of negotiation, and commercial and residential land via open-
market transaction. Most industrial land leased out via the negotiation
method at a lower price is used to attract manufacturing investments
and to promote industrial development (Huang & Du, 2016). Most of
the land leased through market transactions was residential and com-
mercial land, and has been leased out at a higher price in order to gain
extrabudgetary revenue to finance infrastructure. Although the Chinese
Ministry of Land and Resources issued Document No. 2007]78 de-
manding that industrial land be leased out by transparent market
means (including tender, auction and listing), local governments con-
tinue to lease industrial land at low prices via negotiation or disguised
cas market transactions.

Considering the functions of the various land uses, local govern-
ments allocate land quotas and lease out land between the industrial
and service sectors. Their land-leasing behavior is restricted by the
land quota system, which the Chinese central government designed to
protect farmland and to limit the land quota that local governments
could lease out annually. However, local governments have enough au-


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