

ILLEGAL

but

RATIONAL

Why Small Property Rights Housing Is Big in China

By Li Sun and Zhi Liu

“BEING A MIGRANT WORKER FOR 13 YEARS, I HAVE LONGED TO OWN A HOME AND LIVE A NORMAL FAMILY LIFE HERE IN SHENZHEN,” said Mr. Wang, a former farmer from Sichuan Province who now earns 3,100 yuan (US\$500) per month in the manufacturing sector of this sprawling city in South China. Wang recently purchased what is known as “small property rights” (SPR) housing—an illegal but widespread type of residential development built by villagers on their collectively owned land in peri-urban areas and urban villages, rural settlements surrounded by modern development in many Chinese cities. While no official statistics are available, the number of SPR units is estimated at 70 million—perhaps one-quarter of all housing units in urban China (Shen and Tu 2014). “Small property rights housing fulfills my need,” continued Mr. Wang. “It’s affordable. It is the best choice for me,” he says.

Sold primarily to individuals without local household registration, or *hukou* (box 1), SPR housing violates China’s Land Administration Law, which stipulates that only the state, represented by municipal governments, has the power to convert rural land into urban use. Unlike buyers of legally built homes, buyers of SPR housing do not receive a property rights certificate from the housing administration agency of the municipal government; they sign only a property purchase contract with the village committee. Because Chinese laymen often see the state as the “big” institution, housing units purchased from village committees are popularly called “small” property rights housing.

The widespread development of SPR housing raises a number of legal, political, social, and economic concerns that have prompted academic study and heated public policy debates (Shen and Tu 2014; Sun and Ho 2015). Why has SPR housing emerged in China where administrative control is generally considered tight?

Pingshan Village in Shenzhen has many small property rights (SPR) housing units, built and sold illegally on collectively owned land in this rapidly developing city. Credit: Zhang Xili

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What drove the village committees to develop SPR housing in violation of the Land Administration Law? Do SPR housing buyers worry about their tenure security? Why has the government so far tolerated SPR housing ownership? To find answers, one has to look at a number of factors contributing to the rise of SPR housing, including China’s land management system, municipal finance, and public attitudes toward laws and regulations.

The Rise of Small Property Rights Housing

The pace of China’s urbanization is unprecedented. Between 1978 when economic reform began and 2014, the urban population more than quadrupled from 173 million to 749 million, with average annual growth of 16 million. In official

BOX 1

CHINA’S *HUKOU* SYSTEM

China is phasing out its household registration system called *hukou*, which dates to the 1950s. *Hukou* identifies a citizen as a resident of a particular locality and entitles the *hukou* holder to the social security, public schools, affordable housing, and other public services provided by their district, township, or village. Many urban public services are available only to urban *hukou* holders. Because most migrant workers hold rural *hukou*, they are ineligible for many public services in the cities where they work and live. Moreover, they have to return to their registered places of residence to apply for marriage certificates, passports, personal ID card renewals, and other documents—a requirement that comes at significant cost and inconvenience.

counts, the urban population includes residents with *hukou* and, in recent years, migrants who stay in a city for more than six months. Amid such explosive growth, the government's institutional capacity to manage urbanization has often lagged behind, at best barely responding to emerging issues.

"The informal development of SPR housing is regarded as an extra-legal practice and a type of spontaneous urbanization," wrote Dr. Liu Shouying, a senior researcher with the Development Research Center of the State Council, in his newly published book, *Land Issues in the Transitional China* (Liu 2014).

"There is no law explicitly addressing the emerging issues of SPR housing," said Peking University Professor Zhou Qiren, a well-known property rights scholar in China (Zhou 2014).

LEGAL AND ECONOMIC FACTORS

Under China's dual land management system, urban land is owned by the state, and rural land is collectively owned by the villages (figure 1).

There is no private ownership. Only the state has the legal power to expropriate rural land and convert it to urban use. Villages have no land development rights. Compensation to villages for expropriated rural land is based on the land's agricultural production value rather than its higher market value.

When the state expropriates rural land for urban use, it allocates it to residential and commercial uses through concessions to real estate developers, who pay a fee for land use rights. This system allows municipal governments to expropriate rural land for industrial and urban development at low costs, and to generate handsome revenues from land concessions.

The municipal governments' ability to expand the urban land supply is heavily limited, however, by China's strict farmland preservation requirements. Under this policy, 1.8 billion *mu* (equivalent to 1.2 million sq. km) of high-quality agricultural land nationwide must be reserved for food security. The Ministry of Land and Resources annually approves the amount of urban land for



Most of the residential construction in Shenzhen's urban villages (rural settlements surrounded by modern development in Chinese cities) is SPR housing. Credit: Zhi Liu

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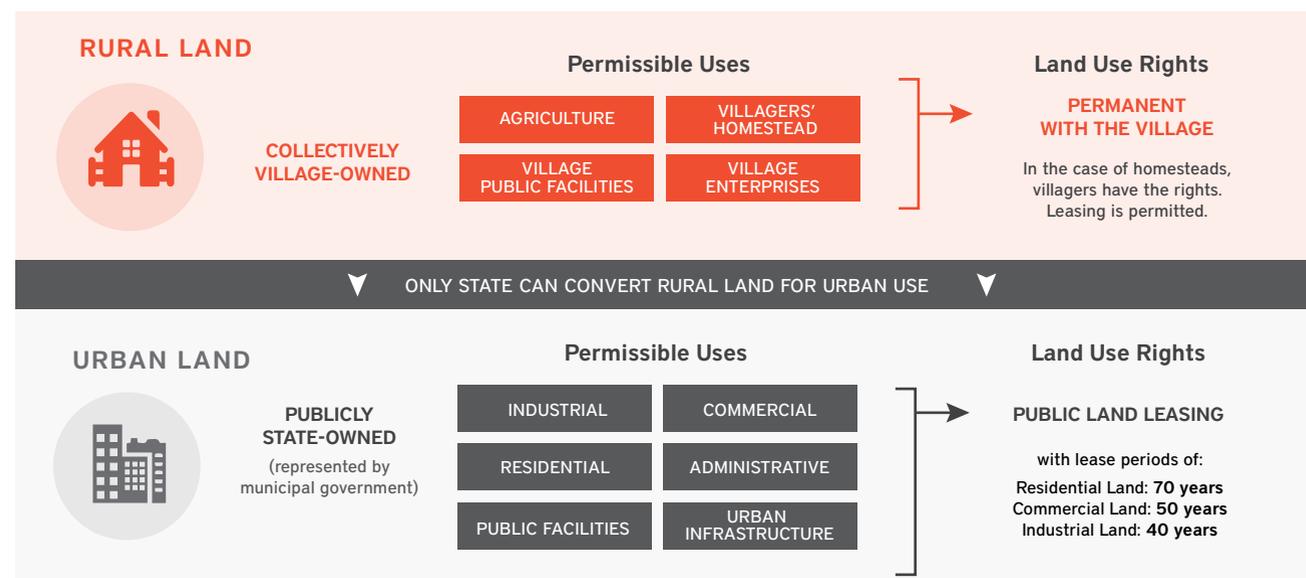
each city, and the municipal government then allocates this supply to various purposes, leaving a small fraction (usually around 30 percent) for residential development. Given the limited supply of residential land in the major cities, prices are bid up very high.

By contrast, most cities offer industrial land to manufacturing firms at very low and subsidized prices in order to compete for investment and employment. They expect these firms to yield jobs, economic growth, and tax revenues for the municipality, and then for those new jobs to generate increased demand for housing and services—in turn creating more jobs, economic growth, and tax revenues. As a result, the price for residential land is up to 15 times higher than the price of industrial land (figure 2).

Over the last few years, concession fees from commercial and residential land were typically as high as 40 to 60 percent of municipal tax revenues. With these revenues, municipal governments not only subsidize industrial land, but also fund public investment in infrastructure and other services. Because farmers' compensation was only a tiny fraction of the value created from the state-monopolized development rights, they were keen to find ways to share in these revenues, setting the stage for SPR housing.

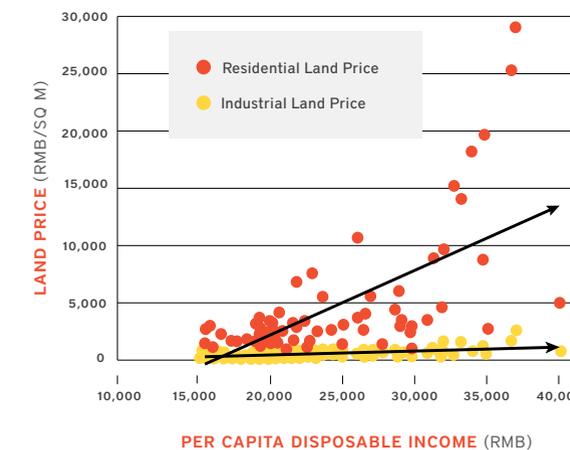
There are three types of rural land in China: one is used for agriculture, one is used for construction, and the third is unused. SPR housing units are usually built on rural construction land, which allows for villagers' residential plots and public facilities. While strict enforcement of the national farmland preservation policy generally prevents conversion of agricul-

FIGURE 1
LAND OWNERSHIP AND PROPERTY RIGHTS IN CHINA



Source: Li Sun and Zhi Liu

FIGURE 2
COMPARISON OF INDUSTRIAL VS. COMMERCIAL AND RESIDENTIAL LAND PRICES IN 70 MAJOR CITIES IN 2013



Source: Liu and Wang 2014

tural land into construction land, villages are not explicitly prohibited from using construction land for village industries, restaurants, hotels, warehouses, rental plants, and rental housing. Indeed, property rental businesses have existed in rural areas for many years. For example, rural households living in urban villages and at the rapidly growing urban fringe have built multi-story housing on their residential plots and rented the units to migrant workers.

SPR housing units are typically 40 to 60 percent cheaper than comparable formal housing in the same location.

When urban housing prices started to soar in the mid-2000s, the villages saw opportunities to make handsome profits from building and selling homes. Each year from 2006 to 2014, house prices climbed about 20 percent in Beijing, 18 percent in Shanghai, 17 percent in Shenzhen, and 11 percent in Chengdu (PLC-HLCRE 2014). The rapidly rising prices of residential land drove part of these increases.

Demand for home ownership in China remains strong, thanks to the growing urban population, rising household incomes, high savings rates among urban households, and lack of alternative household investments. And SPR housing units are much less expensive than comparable formal housing units in the same location. Indeed, their prices are typically 40 percent to 60 percent cheaper, because villages do not pay land concession fees as the urban real estate developers do, and the administrative costs of providing SPR housing are also lower. Thus, SPR units became the rational housing choice for many migrant households, and even for some urban households with *hukou* in their city of residence.

SOCIAL AND CULTURAL FACTORS

The village committees understood that building and selling SPR housing violated the Land Administration Law and the associated local land regulations, but the lure of profits drove them to test the legal limits. And once a few villages

started selling SPR housing, others were quick to follow. The central government responded by issuing a series of administrative circulars calling for a halt, but took little action due to the lack of legally effective and socially acceptable measures to put an end to the practice.

Meanwhile, given the lack of legal protections, one might ask why SPR housing buyers do not opt for rental housing. The answer is that the rental market in urban China is poorly regulated, and contract enforcement is weak. Tenants often face the risk of unexpected rent hikes and premature termination of leases. In addition, participation in the affordable housing programs run by the municipal governments is not an option for most migrant workers because they do not have local urban *hukou*.

At the same time, Chinese households strongly prefer home ownership for a number of social and cultural reasons. Most households consider a stable home essential to their lives. As Dr. Sun Yet Sen (1866–1925) famously said: “Every household ought to have a home.” The Chinese word for “family” (*jia*) is literally the same as the word for “home,” both in written form and speech. Most Chinese think that an ideal home is a secure place for the family, and the most secure home is a self-owned one. One SPR housing buyer in Shenzhen said, “With my newly purchased SPR housing unit, I don’t have to worry about being forced out of the rented unit any more, and I could make my own place a real home.”

Because healthcare and educational opportunities are better in cities than in rural areas, many migrant workers purchase SPR housing units so that their families can take advantage of these services. And for young men, buying SPR housing units is a way to improve their chances in the highly competitive marriage market, where men outnumber women by 34 million, according to the National Bureau of Statistics. Moreover, herding behavior—where everyone wants to do what everyone else does—is a significant factor, and the housing purchases of some buyers heavily influence the purchase decisions of others.

As some newspaper interviews and Internet surveys reveal, buyers generally do not worry about being prosecuted for living in SPR housing.

They do not believe that the government would attempt to enforce the law on millions of citizens. There is a popular saying in the Chinese legal enforcement tradition: *fa bu ze zhong* (the law does not punish everyone). If many people violate a law or a regulation in China, people often consider the law itself flawed.

Indeed, over the history of economic reform in China, there are celebrated cases in which mass violation of a law drove change, resulting in legalization of formerly prohibited activities. Based on this history, many SPR housing buyers expressed confidence that the government would not evict them from their homes. This confidence is evident from the fact that SPR housing owners often spend a substantial amount of their incomes, savings, or borrowed money on home improvements such as interior decoration and furnishings.

Many SPR housing owners feel that they are already a large enough group to defy any government actions that penalize them. Eviction is highly unlikely, given that the Chinese government’s top priority is maintaining social stability. One SPR housing owner in Beijing said, “I am sure that the government will not evict us from our homes. If it happens, where should we live? In front of the municipal hall?”

A Major Challenge to Government

Enforcing the law against SPR housing development on millions of households would indeed be politically unwise. Doing so would likely trigger social unrest—the last thing the government wants to see. However, amending the law is not easy, and for some time the central government seemed unable to come up with a land management system suitable for an urbanized China. Without a clear solution, the central government thus tended to tolerate SPR housing.

Local governments, however, were more uncomfortable with the growing numbers of SPR housing units because they reduced demand for government-supplied residential land and therefore revenues from land concessions. But again, the fear of social unrest left most



The shorter buildings in the foreground here are SPR housing built by villagers on their residential plots in Shenzhen, while the high-rises are SPR housing built by the village collective corporation, whose members share the profits. Credit: Zhi Liu

local governments with nothing to do but repeat the central government’s rhetoric about its illegality. Government tolerance also reflects the fact that SPR housing developments afford shelter for many lower- and middle-income groups that the government and the market have been unable to provide. In the public debate, the argument for SPR housing is that it serves an important social function by housing the large number of migrant workers essential to China’s rapid urban economic growth.

CONTINUED ON P. 34

Perhaps the bigger concern for government is the impacts of SPR housing development on real estate markets, municipal finance, and future urban forms. As it is, the formal urban housing market is already in over-supply. Additional provision of SPR housing units would further weaken formal market demand and increase bank credit risk. Moreover, China's city planning efforts do not cover rural land outside designated planning areas. The spread of SPR housing in these areas would therefore lead to undesirable urban development patterns.

Recommended Reforms

In recognition of the root causes of SPR housing development, the Third Plenary Session of the Communist Party of China's 18th Central Committee issued a document in November 2013 spelling out directions for a set of reforms directly related to land, *hukou*, and municipal finance.

On land: Integrate the urban and rural construction land markets. Allow the sale, leasing, and shareholding of rural, collectively owned construction land under the premise that it conforms to planning.... Reduce land expropriation that does not promote public welfare.

On *hukou*: Accelerate the reform of the *hukou* system to help farmers become urban residents.... Efforts should be made to make basic urban public services (such as affordable housing and the social safety net) available to all permanent residents in cities, including rural residents who have migrated to cities.

On municipal finance: Improve the taxation system and expand the local tax base by gradually raising the share of direct taxation (mainly the personal income tax and property tax).... Accelerate property tax legislation.

These reform efforts aim to dismantle the dual system of land management, allowing villages to share in the benefits of land development and raising the transaction costs of land expropriation. The *hukou* system will be phased out gradually, starting in the smaller cities. While detailed actions on these two reform fronts are now being worked out or tested in pilot programs, municipal finance reform remains a major concern. If the scope of land concessions is reduced and the *hukou* system is dismantled, cities will see significant reductions in land sales revenues and increases in public expenditures for providing services to migrant workers and their families.

While residential property taxes are expected to become a new source of municipal revenues, this change will not occur immediately. Indeed, the central government is currently drafting the property tax law, and it may be at least two years before its passage by the National People's Congress. Since it will also take a few years for cities to establish assessment systems, residential property taxation will not support municipal budgets for some time. Nevertheless, there is hope that this new round of policy reform will properly address the critical issue of SPR housing. □

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