

# A BID FOR A NEW FUTURE: WHAT ARE THE EFFECTS AND CHALLENGES OF THE NEW NATIONAL PUBLIC BIDDING REGULATIONS ON LAND USE RIGHTS ASSIGNMENT IN CHINA?

## INTRODUCTION

Since opening up to market reforms in 1978, China has experienced tremendous economic growth. A significant part of the growth is attributable to various land use rights reforms that have allowed the previous land allocation system to move to a market-oriented approach.<sup>1</sup>

On July 1, 2002, a new set of Regulations regarding the acquisition of land use rights was promulgated.<sup>2</sup> The Regulations mandate national standardized procedures for the bidding, auction, and listing of land use rights.<sup>3</sup> The main purpose of the Regulations is to add transparency and fairness to the land use rights markets by establishing an “open, fair, and impartial land use system.”<sup>4</sup> The Regulations also mandate that *all* land use rights for business operations must be assigned by public bidding, auction, or listing.<sup>5</sup>

The new Regulations offer significant advantages over the previous approach to land use rights acquisition, but should be viewed with caution.<sup>6</sup> They mandate public bids, auctions, or lists in the assignment of land use rights and create a standardized set of acquisition procedures, adding transparency to the land use rights acquisition system.<sup>7</sup> Though

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1. THE IMPACT OF CHINA'S ECONOMIC REFORMS UPON LAND, PROPERTY, AND CONSTRUCTION 26 (Jean Jinghan Chen & David Wills eds., 1999).

As a part of the Chinese economic reform, land reform is necessary to change the previous allocation system to a market driven system . . . . As a result, successive reforms of China's land tenure system have been implemented, culminating in the establishment of a system of “land use rights” (LURs) which represents the equivalent of a leasehold system.

*Id.*

2. *Zhao Biao Pai Mai Gua Pai Chu Rang Guo You Tu Di Shi Yong Gui Ding* [Regulations Assignment of State-owned Land Use Rights through Inviting Bids, Auctions, and Listing], P.R.C. Ministry of Land Resources, July 1, 2002, art. 28 (2002) (P.R.C.), in Guowuy van Gongbao [State Council Gazette], available at [http://news.xinhuanet.com/zhengfu/2002-5/16/content\\_395800.htm](http://news.xinhuanet.com/zhengfu/2002-5/16/content_395800.htm) (last visited Oct. 22, 2004) [hereinafter Regulations].

3. *Id.* art. 3.

4. *Id.* art. 1. See also *China to Announce Revised Land-Use Policies*, XINHUA NEWS AGENCY, Sept. 16, 2002, [http://news.xinhuanet.com/english/2002-09/15/content\\_562814.htm](http://news.xinhuanet.com/english/2002-09/15/content_562814.htm) (last visited Oct. 22, 2004).

5. Regulations, *supra* note 2, art. 4.

6. David Murphy, *Big Deal: The Best Bid Wins*, FAR E. ECON. REV., June 27, 2002, at 28.

7. *Id.*

promulgated at the national level, implementation must be performed at the local level, which may prove difficult.<sup>8</sup>

The Regulations may pose serious dangers to local developers. Past Chinese urban and rural experiences with the Regulations' market-oriented approach may offer insight into its potential effects. Following a market-oriented approach to determine the price of land use rights promotes the impartial treatment of domestic and foreign enterprises in the acquisition of land use rights.<sup>9</sup> However, as prices for land use rights increase due to open competition, local investors lacking the deep pockets enjoyed by their foreign counterparts may be left out.<sup>10</sup>

Part I offers a general background on land use rights in China, and sets forth the differences among the types of land use rights and the various land use rights acquisition processes. Part II sets out the key aspects of the Regulations. Part III discusses the various effects of the Regulations. Part IV expands on the effects of the Regulations, based on past experiences with the market approach, in both the urban and rural landscape.

## I. BACKGROUND ON LAND USE RIGHTS

### A. *Land Use Rights Systems*

After the birth of the People's Republic of China in 1949, a socialist political and economic system was installed. This system provided for highly centralized management and public ownership of land.<sup>11</sup> For the next thirty years, land was progressively confiscated by the State and allocated administratively by various planning departments without payment.<sup>12</sup> Landholders of land under this system do not actually own the land;<sup>13</sup> rather, they hold an allocated land use right, or the right to use the

8. *Id.* at 28–29. “Lower down the administrative ladder, cities are passing various versions and interpretations of the national regulation.” *Id.* at 29.

9. *See China to Announce Revised Land-Use Policies*, *supra* note 4.

10. *Id.* “[T]he regulations will force Chinese enterprises to compete with powerful foreign counterparts in a more transparent and fair land market without the government protection they previously enjoyed.” *Id.*

11. PATRICK A. RANDOLPH, JR. & LOU JIANBO, *CHINESE REAL ESTATE LAW* 14 (2000). “As a part of this highly centralized and controlled economic system, China established its real property administration and management system.” *Id.*

12. Michael Hickman & Owen Cox, *Developing the PRC Property Market*, *HONG KONG LAW.*, Oct. 2002, at 32. *See also* Li LING HIN, *PRIVATIZATION OF URBAN LAND IN SHANGHAI* 31 (1996).

13. RANDOLPH & JIANBO, *supra* note 11, at 86. The State or Agricultural Collectives owned all the land. *Id.*

land.<sup>14</sup> This right is not transferable or leasable, and is confined to narrowly described purposes.<sup>15</sup>

In 1988, China amended its constitution to allow for the transfer of land use rights in urban areas.<sup>16</sup> These transferable land use rights are termed granted land use rights.<sup>17</sup> Unlike allocated land use rights, granted land use rights are transferable, leasable, and have broader usage potential.<sup>18</sup> Granted land use rights were a product of China's market-oriented economic development in the coastal cities, which began in 1978.<sup>19</sup> Whereas under the allocated land use rights system, land and property only had a utilitarian function, under the granted land use rights system, land use rights became an investment medium.<sup>20</sup>

### *B. Land Use Rights Assignment Processes*

In China, land use rights can be assigned by the State via one of two processes. The first process is referred to as land use rights transfer by agreement.<sup>21</sup> Under the Regulations, this process no longer applies to land

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14. *Id.* "The term 'allocated land use rights' became part of the vocabulary of Chinese legal scholars when China began a policy of creating a different species of land use rights—rights for which the State demanded compensation and which did not have a definite term." *Id.*

15. *Id.* at 90. *See generally id.* at 85–123 (providing a detailed overview of allocated land use rights).

16. *Id.* at 125.

In 1988, as part of a general government program to "commodify" the productive economy—to establish market transactions as a means of resource distribution, China amended its Constitution to provide for the transfer of land use rights. The 1988 amendment permits the creation of a new form of land use rights. These rights are transferable and exist for a specified term.

*Id.*

17. *Id.*

18. *Id.* at 90. *See generally id.* at 125–58 (providing a detailed overview of granted land use rights).

19. JIEMING ZHU, *THE TRANSITION OF CHINA'S URBAN DEVELOPMENT: FROM PLAN-CONTROLLED TO MARKET-LED 2* (1999). In 1978, the Four Modernizations (agriculture, industry, science, and defense) policy was integrated into the new Constitution. Under this policy, China began participating in the world market after thirty years of self-reliance and inwardness. Major market reforms were primarily implemented only in the major coastal cities. *Id.*

The reforms were expected to stimulate the inactive urban economy, which had been, as believed, stifled by central planning. The new policies called for a shift of strategy from overemphasized self-reliance to participation in the world market and from inward-looking, self-sufficient production to outward-looking trading in the context of globalization.

*Id.*

20. *Id.* at 4. Under a "utilitarian" function, the land is used for a specified use only. As an "investment medium," land becomes a commodity that can be traded in the open market. *Id.*

21. *Id.* at 75.

Land prices would be negotiated between applicants and the local land bureau. The negotiated land prices usually cover at least the costs for green land acquisition from peasants who

use rights for business operations.<sup>22</sup> Before the promulgation of the Regulations, the land use rights transfer by agreement was reserved for business or development purposes that fell under specified categories, such as high-tech, capital-intensive manufacturing, or public-use facilities such as educational institutions or public housing.<sup>23</sup> Under this process the applicant and the local land bureau negotiated a purchase price.<sup>24</sup>

Most applicants are local real-estate companies that are property speculators with inside connections.<sup>25</sup> As a result, the purchase price is often heavily discounted by subsidies (available only to these insiders) at a price that usually covers only the government's costs for the land.<sup>26</sup> After the initial purchase, the assigned land use rights are then traded several times before the final buyer begins construction development.<sup>27</sup> As such, the accrued costs fall onto the final buyer.<sup>28</sup> This assignment process is one of the main reasons that property in Beijing and Shanghai is among the most expensive in Asia.<sup>29</sup>

The second process for land use rights assignment follows a market-oriented approach to determine the purchase price. Under the Regulations, this process now covers *all* land use rights assignments for business operations.<sup>30</sup> The market-oriented approach includes two different procedures for determining the market rate.<sup>31</sup> The first procedure is commonly referred to as land use rights transfer by bidding.<sup>32</sup> Bidding is traditionally reserved for land involving commercial development.<sup>33</sup> Under this procedure, applicants submit their bid package, which includes the bid

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collectively own the rural land, relocation of sitting tenants, and basic land development, which the government has paid for before it is ready for conveyance.

*Id.*

22. See *supra* note 5 and accompanying text.

23. ZHU, *supra* note 19, at 74.

24. *Id.* at 75. See also *supra* note 20 and accompanying text.

25. David Murphy, *China's New Rules on Land Sales Boost Access*, WALL ST. J., June 27, 2002, at A18. "Many of the tens of thousands of real-estate companies in China are property speculators. Part of a well-connected circle, they acquire parcels of land from government entities relatively cheaply." *Id.*

26. ZHU, *supra* note 19, at 75. "The negotiated land prices usually cover at least the costs for green land acquisition from peasants who collectively own the rural land, relocation of sitting tenants, and basic land development . . . Hence, the government can recover development expenses." *Id.*

27. Murphy, *supra* note 25, at A18.

28. *Id.*

29. *Id.*

30. See *supra* note 5 and accompanying text.

31. ZHU, *supra* note 19, at 75.

32. *Id.*

33. *Id.*

price and development proposal, to a bid evaluation group.<sup>34</sup> After consultation, the group determines a winner who bids the highest price while still satisfying the bid criteria.<sup>35</sup> The second procedure is commonly referred to as land use rights transfer by auction.<sup>36</sup> Auctions are traditionally reserved for land plots in a prime location for commercially profitable uses.<sup>37</sup> The bottom-line (minimum) price for both bidding and auction procedures is determined by the local land bureau.<sup>38</sup> As of the date of promulgation of the Regulations, July 1, 2002, bidding and auctions were extremely rare and most land acquisitions were performed by agreement.<sup>39</sup>

## II. THE REGULATIONS

### A. Purpose and Coverage

Article 1 clearly states the three main purposes of the Regulations. First, the Regulations “regularize the behaviors of assignment of the state-owned land use rights.”<sup>40</sup> Second, the Regulations “optimize the allocation of land resources.”<sup>41</sup> Finally, the Regulations “establish an open, fair, and impartial land use system.”<sup>42</sup>

In order to fulfill the purposes set forth in article 1, all assignments of state-owned land use rights through bidding, auction, or listing are governed by the standardized process laid out in the Regulations.<sup>43</sup> Furthermore, the Regulations require that all land for business operations be assigned through bidding, auctions, or listing.<sup>44</sup> Consequently, land use

34. *Id.* The bid evaluation group usually consists of the assignor’s representative as well as other parties that are deemed experts regarding the land being conveyed. *See* Regulations, *supra* note 2, art. 13, § 3.

35. *Id.* art. 14.

36. ZHU, *supra* note 19, at 75.

37. *Id.* Market prices in these areas tend to be unknown because few transactions have occurred. The rate fetched at auction can serve as a market benchmark price for other similar land plots. *Id.* at 76.

38. Regulations, *supra* note 2, art. 10.

39. Murphy, *supra* note 6, at 28. “To date, open auctions are rare and the vast bulk of land transfers take place in back-room deals that lead to agreements between the landholder and developer.” *Id.*

40. Regulations, *supra* note 2, art. 1.

41. *Id.*

42. *Id.*

43. *Id.* art. 2.

44. *Id.* art. 4.

rights transfer by agreement no longer applies to land use rights for business operations.<sup>45</sup>

### *B. The Acquisition Process*

The acquisition of land use rights proceeds as follows:

1. **Planning**—Municipal or county level administrative departments make plans for the assignment of land use rights, and publish these plans for the benefit of the public upon approval by the municipal or county governments.<sup>46</sup>

2. **Announcement**—The assignor publishes a public announcement of sale at least twenty days before the date of bidding, auction, or listing.<sup>47</sup> The announcement must include the details of the land being assigned, the qualifications of the bidders, and the place, time, and method of bidding, auction, or listing.<sup>48</sup>

3. **Opening Price**—Local and municipal administrative departments determine the opening price and bottom-line bid price based on land appraisals.<sup>49</sup> The bottom-line bid price remains confidential.<sup>50</sup>

4. **Bidding, Auction, and Listing**—The Regulations detail a standardized procedure for bidding, auction, and listing.<sup>51</sup> In the case of bidding, a bid evaluation group, consisting of the assigner and relevant experts,<sup>52</sup> evaluates the bids and determines the winner.<sup>53</sup> In the case of auctions, the final bidder is the winner.<sup>54</sup>

5. **Publishing of the Results**—Within ten working days of the completion of the bidding, auction, or listing, the assignor publishes the corresponding results.<sup>55</sup>

45. See *supra* notes 22–23 and accompanying text.

46. Regulations, *supra* note 2, art. 5. Plans for assignment of land use rights are made in accordance with the government planning for economic development, industrial policies, annual plans for land use, city planning, and market conditions. *Id.*

47. *Id.* art. 8. The assignor is the seller or previous owner of the land use right. The State owns all urban land. RANDOLPH & JIANBO, *supra* note 11, at 62, (quoting article 10 of the Chinese Constitution. *Zhonghua renmin gonghequo xianfa* [PRC CONST.] art. 10 (2004)).

48. Regulations, *supra* note 2, art. 9.

49. *Id.* art. 10.

50. *Id.*

51. For the bidding procedure, see *id.* art. 13. For the auction procedure, see *id.* art. 15. For the listing procedure, see *id.* art. 17.

52. *Id.* The Regulations do not state who the “relevant experts” will be. However, the panel will likely include land appraisers and other government administrative officials.

53. *Id.* art. 13, § 3. The bid evaluation group is not mandated to automatically choose the highest bidder as the winner. See *id.* art. 14.

54. *Id.* art. 15, § 8.

55. *Id.* art. 12.

6. Fraud—The Regulations address and detail consequences for three potential instances of fraudulent activity that might arise from the assignment of land use rights. First, if an administrative department assigns land use rights by agreement that should have been, instead, assigned by bidding, auction, or listing, it will receive administrative sanctions.<sup>56</sup> Second, a bid that wins by means of bribery or malicious collaboration is invalid.<sup>57</sup> Finally, any administrative department that is negligent in performing its duties under the Regulations, abuses its authority, or practices favoritism will be subject to disciplinary sanctions.<sup>58</sup>

7. Implementation—Local and municipal administrative departments are in charge of drafting and implementing the land use rights assignment schemes in accord with the Regulations.<sup>59</sup>

### III. EFFECTS OF THE REGULATIONS

#### A. Predictability

A primary purpose of the Regulations is to create a predictable and standardized land use rights assignment process.<sup>60</sup> Before promulgation of the Regulations, local land administrative authorities followed varying land use rights acquisition processes.<sup>61</sup> One of the main complaints of foreign land and property developers in China is the complexity of the land use rights assignment process.<sup>62</sup> The standardized procedures laid out in the Regulations should unify the local land use rights acquisition process, providing investment predictability.<sup>63</sup> Mr. Wang Shouzhi, Deputy

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56. *Id.* art. 24.

57. *Id.* art. 25.

58. *Id.* art. 26.

59. *Id.* art. 6.

60. *See supra* note 40 and accompanying text.

61. Hickman & Cox, *supra* note 12, at 32.

62. *Id.*

Many foreign investors in China have failed to understand China's complex land system and some have seen their investments lose substantial value as a result. China's present land system can be difficult to fathom. There are many national laws and regulations, supplemented by a host of local regulations and practices, some of which seem inconsistent with the national regulatory regime.

*Id.* *See also* Yang Li, *Land Auctions Allow Real Estate Firms to Expand Biz Nationwide*, BUS. WEEKLY, Feb. 11, 2003, available at [http://www.chinadaily.com.cn/en/doc/2003-02/11/content\\_155099.htm](http://www.chinadaily.com.cn/en/doc/2003-02/11/content_155099.htm) (last visited Nov. 17, 2004). "Before the land auction system was introduced nationwide last July, most land transactions were made privately. In Beijing, 95 percent of the land transactions were private." *Id.*

63. *China Issues New Regulations for Public Bidding of Land Use Rights*, AGENCE FRANCE-

Director of the Ministry of Land and Resources' Department of Land Utilization Management explains: "After [the Regulations become] effective on July 1, investors should no longer find our land bidding procedure puzzling . . . [and] foreign investors should find the Chinese market similar to the world market instead of a strange one filled with confusing stipulations."<sup>64</sup>

### *B. Transparency*

Another primary purpose of the Regulations is to create a fair and impartial land use rights assignment process.<sup>65</sup> The Regulations address the issue of fraud and mandate disciplinary sanctions against administrative authorities that abuse their power.<sup>66</sup> Although the severity of the sanctions is unknown, the declaration of sanctions nonetheless makes it clear that corruption in assigning land use rights will no longer be tolerated. The Regulations also require publication of the bidding results within ten days of sale.<sup>67</sup> Through this feature, bids will be public knowledge and administrative authorities can be held accountable for any improprieties in the result.<sup>68</sup>

The incidence of corruption in the assignment of land use rights is a particularly acute problem under the land use rights transfer by agreement process.<sup>69</sup> Because the purchase price is privately negotiated,<sup>70</sup> good *guanxi* (relations) between the purchaser and government officials is an absolute necessity.<sup>71</sup> However, this opens the door to bribery and favoritism.<sup>72</sup> By mandating that all land use rights relating to business operations are to be assigned via the bidding, auction, or listing process, local insiders no longer garner the benefits of privately negotiated, back-

PRESSE, May 16, 2002, available at 2002 WL 2408359.

64. *Id.*

During a four-year pilot phase to mobilize local governments to transfer the right to use state-owned land through public bidding, the ministry allowed different regions to design their own bidding procedures under the country's Land Law and the Law of Urban Real Estate Management. But the procedures varied from one region to another and investors were constantly having to adapt.

*Id.*

65. See *supra* note 42 and accompanying text.

66. See *supra* notes 56–58 and accompanying text.

67. See *supra* note 55 and accompanying text.

68. Murphy, *supra* note 25, at A18.

69. Murphy, *supra* note 6, at 28.

70. Under the land use rights transfer by agreement process, the purchase price is privately negotiated between the local land bureau seller, and the purchaser. See ZHU, *supra* note 19, at 75.

71. See Murphy, *supra* note 6, at 28.

72. See *id.*



room deals.<sup>73</sup> A Beijing-based real-estate developer describes this welcome change: “Developers will be able to go straight to the land bureau and will no longer have to curry favor with the mayor, department heads, and other officials who have control over the scores of licenses needed before construction gets under way.”<sup>74</sup>

#### IV. LESSONS FROM SHANGHAI AND THE WASTELAND

##### A. *The Shanghai Experience*

In 2001, the Shanghai municipal government issued land use rights assignment regulations that became the model for the national policy.<sup>75</sup> Like the national Regulations, the Shanghai regulations mandate assignment of all business operations land use rights via bidding, auction, or listing.<sup>76</sup> The effects of the Shanghai regulations on the Shanghai land use rights market offer important lessons at the national level.

After the Shanghai regulations took effect in July of 2001, implementation had a seemingly quick start as designated parcels of land in Shanghai were sold by open bidding to both foreign and domestic developers.<sup>77</sup> However, upon further examination, the success of the implementation of the Shanghai regulations is questionable.<sup>78</sup> Most of the land parcels subject to the new assignment process are located in the urban fringe areas, while valuable land parcels in the inner city remain available for sale only by the land use rights transfer by agreement process.<sup>79</sup> These valuable inner-city parcels fall under a special exception as part of an urban renewal project and are not available under the open bidding process.<sup>80</sup>

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73. *Id.*

74. *Id.*

75. Hickman & Cox, *supra* note 12, at 32. “In mid-2001, the Shanghai Municipal Government issued three regulations as a precursor to the national regulations. Together these regulations unified the previously separate domestic and foreigner’s housing markets and introduced a tender and auction system for granting land use rights.” *Id.* Previously, urban housing was divided between domestic commodity housing and housing for sale to foreigners. Typically, housing for sale to foreigners is much more expensive. *Id.*

76. *Id.* Cf. Regulations, *supra* note 2, art. 4.

77. Andrew Ness, *Land Grant System Set for Overhaul*, S. CHINA MORNING POST, Sept. 25, 2002, available at 2002 WL 26305176. From July 2001 to September 2002, twenty-seven parcels of land were to be sold under the new system. *Id.*

78. *Id.*

79. *Id.* Of the twenty-seven parcels, sixty percent are located in the suburban areas of Shanghai. *Id.*

80. *Id.*

Moreover, the twenty-seven parcels that were sold under the market-oriented approaches did not necessarily go to the highest bidder.<sup>81</sup> The tender evaluation committee based its decision on various other factors that were not made public.<sup>82</sup> After publishing the results,<sup>83</sup> a minor uproar within Shanghai property development circles ensued.<sup>84</sup> The controversy forced the Shanghai Municipal Tender/Auction Bureau to halt temporarily the policy of publishing bidding results.<sup>85</sup>

The experience in Shanghai has also exhibited how local “insider” property developers were able to preempt the regulations.<sup>86</sup> Local developers bought up the last remaining prime inner-city sites just prior to when the Shanghai regulations took effect.<sup>87</sup> The land use rights of these prime sites were assigned via the land use rights transfer by agreement process at a heavily discounted price.<sup>88</sup>

Those sites that were assigned via market-oriented approaches garnered significantly higher prices.<sup>89</sup> Although local developers had an advantage before the regulations took effect, they could not stop the influx of foreign demand for the few Shanghai land use rights made available in the open market.<sup>90</sup> Winnie Mak, a property analyst for HSBC in Hong Kong,

81. *Id.*

82. *Id.*

83. *Id.* Like the Regulations, the Shanghai regulations also require publication of the results after bidding. *Id.*

84. *Id.*

Shanghai has also served as an example of how a small group of determined local developers, fortified by good market intelligence concerning the impending regulatory moves, succeeded in circumventing the system, at least in the short term. They moved in to scoop up a number of the last remaining prime inner-city sites by private treaty, just before the new regulations came into effect.

*Id.*

85. *Id.* The Bureau made no indication as to when publication of bidding results would resume.

*Id.*

86. *Id.*

87. *Id.* “This was done on the understanding the action was sufficient to allow them to be exempted from having to surrender their recently acquired site to the government, with the sole comfort of having an option to re-acquire it through tender by invitation.” *Id.* “According to the procedures issued by the Shanghai municipal government, land is exempt from open bidding if the developer of a given site has already obtained planning approval and the necessary documentation to undertake construction in phases before implementation of the new tender system.” *Id.*

88. *Id.*

89. Murphy, *supra* note 6, at 28. In a Shanghai auction for a forty-eight hectre site, a Guangzhou real estate firm outbid two local firms, paying \$381 million. *Id.* at 31. Initial signs indicate that “[g]reater openness is releasing pent-up demand among outsiders and forcing prices up.” *Id.* See also Chen & Wills, *supra* note 1, at 68. In Shenzhen, in 1991 and 1992, the price per square meter of land use rights assigned by bidding or auction was over five times that of land use rights assigned by agreement. *Id.*

90. See Murphy, *supra* note 6, at 28. Outsiders are not only foreign (non-Mainland Chinese) developers. They also include developers from other regions across the Mainland. *Id.*

explains the outsider demand phenomenon: “Because outsiders didn’t have rich land resources in the past, they are now playing catch-up.”<sup>91</sup>

### *B. Lessons from Shanghai*

Although the Regulations were promulgated at the national level, implementation will be left to the local and municipal governments.<sup>92</sup> Shanghai and Beijing have passed their own laws that mirror the Regulations,<sup>93</sup> yet, both cities have experienced setbacks in the implementation process.<sup>94</sup> While transparency in the land use rights assignment process is a main goal of the Regulations, it will take some time before local authorities will be able to implement them fully.<sup>95</sup> Selected site application (non-universal application to all business operations land use rights), failure to publish bidding results, and regulatory preemption are all potential setbacks to implementation that other cities may expect, given the effects in Shanghai.

In addition to implementation delay, foreign developers should also be wary of the insider advantages local developers may continue to hold in the Chinese property market.<sup>96</sup> Naturally, local developers that previously enjoyed insider advantages will not surrender to outsiders.<sup>97</sup> For instance, in Shanghai, local developers have been attempting to preempt the regulations by buying early, before the law changes.<sup>98</sup> Even after the Regulations take effect, these local developers will continue to search for loopholes, and will benefit from their established connections within the local government.<sup>99</sup> Since the local government wears two hats—one as

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91. *Id.* at 31.

92. *See supra* note 59 and accompanying text.

93. *See* Ness, *supra* note 77, at 4. On June 28, 2002, the Beijing municipal government issued a memorandum mandating an end to the land use rights transfer by agreement process. *Id.*

94. *See supra* notes 79–80 and accompanying text. Beijing is in the process of establishing a “land bank” that will serve as a central repository for land use rights sites. Ness, *supra* note 77, at 4.

Due to the slow progress to date in establishing this municipal land bank, intended as the central repository of the sites to be offered for sale on this open and competitive basis, Beijing still has some way to go before a balance can be achieved between the interests of the municipal government, state-owned enterprises possessing land-use rights for central-city sites and local development interests.

*Id.*

95. Murphy, *supra* note 6, at 28.

96. *Id.*

97. *See supra* note 73 and accompanying text.

98. *See supra* notes 86–88 and accompanying text.

99. Murphy, *supra* note 6, at 29.

regulator and the other as seller—the potential for corruption will continue to be high.<sup>100</sup>

While local developers may have a “home-field” advantage, they will face a stiff challenge both from other domestic developers throughout mainland China and from foreign developers—both with deep pockets.<sup>101</sup> Large Hong Kong and Singapore-based developers have been active in the Shanghai land market since the early 1990s and have learned important lessons from their experience handling the local market.<sup>102</sup> Other foreign developers have been increasingly active in buying property, and have made significant inroads toward becoming serious players in the Shanghai property market, especially in the secondary market.<sup>103</sup> As foreign developers become more accustomed to the local landscape, they will

100. *Id.* at 28. This situation occurred in Hong Kong. A “cozy” relationship between the Hong Kong government and large property developers aided in maintaining extraordinarily high land prices. *Id.*

101. See *supra* note 90 and accompanying text. See also, *Developer Hails New Land Policy*, THE STANDARD (Hong Kong), July 9, 2002 (on file with The Washington University Global Studies Law Review).

102. Murphy, *supra* note 6, at 30. Large Hong Kong developers are known to have underperformed. *Id.* Nonetheless, because of past difficulties, they are now more aware of how to handle the local market. *Id.*

Nobody knows that better than Hong Kong and Singapore-based developers who have learned from some of their mistakes in China. Cash-rich Hong Kong developers in particular were a principal source of investment in China’s real-estate booms in the early 1990s. But they focused heavily on acquiring land and overlooked marketing and tailoring their product to local needs, say developers and real-estate analysts. In China, Hong Kong developers overall are judged to have badly underperformed.

*Id.*

Many overseas Chinese developers got into China early, believing they had an advantage over both locals and Westerners. Some, especially those from Hong Kong, fell victim to the Chinese Communist Party bureaucracy. For example, Kerry Properties of Hong Kong paid heavily in 1993 for land near Shanghai’s railway station after being told by government officials that it was the only land available in that part of town . . . Only after committing to the investment did the company discover that sites were being released for development along the city’s Nanjing and Huahai Roads. It had paid top rates for second-tier land.

*Id.*

103. *Id.* “[F]oreign institutional investors are also beginning to make their presence felt. They want Grade-A buildings in prime locations with sitting tenants . . . And overseas institutional investors and developers now exist in sufficient numbers for a nascent secondary market among foreign players to be emerging.” *Id.*

In the “secondary” market, the seller has obtained the land use rights from the government and is selling the assigned land use rights to another buyer. These transactions are the next round of sales, after the initial land use rights assignment. *Id.* at 28. “The sale of nonperforming loan portfolios, including property, by state asset-management companies is also likely to contribute to the growth of another secondary market. It’s still at an early stage but buyers look for a quick turnaround and do not want to become long-term investors in property . . .” *Id.* at 31.

certainly seek to expand beyond the secondary market and take advantage of the market oriented approaches in land use rights assignment.<sup>104</sup>

### C. *The Luliang Prefecture*<sup>105</sup> *Experience*

The rural regions have been slow to adopt market-oriented approaches in land use rights assignment.<sup>106</sup> The Luliang prefecture, in contrast, has been at the forefront in applying a market-oriented approach in land use rights assignment, auctioning rural wasteland land use rights since the early 1980s.<sup>107</sup> Luliang formalized its auction process in 1992, thereby becoming the first prefecture to adopt a prefecture-wide process for the auctioning of wastelands.<sup>108</sup> The effects of the auction process undertaken in Luliang offer important lessons at the national level.

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104. *Developer Hails New Land Policy*, *supra* note 101. See also Murphy, *supra* note 25, at A18.

In October [2001], Hines, Lowe Enterprises and investment firm Trust Company of the West, both of the U.S., paid \$95 million to South Korean conglomerate Hyundai for a 24-story office tower in Beijing. In June, Rodamco Asia NV of the Netherlands paid a subsidiary of Singapore-listed CapitalLand \$23 million for a 72% stake in a 27-story serviced-residence complex in Shanghai. And in 2000, Hong Kong Resorts bought a Shanghai apartment complex from Kerry Properties Ltd. of Hong Kong.

*Id.*

105. "A prefecture is the largest political subdivision below the province level." Tim Hansted & Li Ping, *Land Reform in the People's Republic of China: Auctioning Rights to Wasteland*, 19 LOY. L.A. INT'L & COMP. L. REV. 545, 548 n.16 (1997).

106. RANDOLPH & JIANBO, *supra* note 11, at 147. "Rural areas have been slow to move to auctions, perhaps because of concerns about whether there is an adequate base of bidders, or because of a perceived need to use the negotiation process to squeeze the greatest return from the developers who are available." *Id.* at 147-48.

107. Hanstad & Li, *supra* note 105, at 548. Luliang prefecture is located in Shanxi Province, along the Yellow River, and is 500 km southwest of Beijing. It is one of the poorest regions in China, with an average annual income of U.S. \$90. Wasteland covers about thirty-seven percent of its total land area. *Id.* "Wasteland" is a term used to describe uncultivated (non-arable) land that is deemed "reclaimable," or open for sale by the collectives for agricultural development. *Id.* at 546-47.

The sale of wastelands is part of the 'de-collectivization' efforts by the central government to promote rural farmers' Land Use Rights. *Id.* The central government does not have specific guidelines relating to the assignment of wastelands. *Id.* at 547. This allows local governments to experiment with various assignment processes, such as auctioning. *Id.*

Developing this wasteland for agricultural production and forestation holds tremendous economic and ecological potential . . . Despite this tremendous potential, the Chinese government has not addressed wasteland development in its policy-making agenda. Due in part to the absence of uniform central government guidelines, various regions throughout the PRC have conducted experiments with waste land use rights, including auctions.

*Id.*

108. *Id.* at 548. "Luliang began sporadically auctioning wasteland in the early 1980s, formalized wasteland auctions in 1992, and was the first prefecture in the PRC to adopt a prefecture-wide program of wasteland auctions." *Id.* "There are no national rules for land auctions. Although recent policies have been announced prohibiting party officials, government organizations and their affiliated units favor participating in auctions. Most provincial or local governments will have established their own formal procedures." RANDOLPH & JIANBO, *supra* note 11, at 148.

In Luliang, a “village auction leading group” determines the sites offered for auction, as well as the starting bid price.<sup>109</sup> Auction information is posted throughout the village one month before the auction date,<sup>110</sup> and the auctions may be either closed or open.<sup>111</sup> In some villages, when villagers show interest in bidding on a site, a closed auction is used that limits bidding to villagers only.<sup>112</sup> In other villages, if it is likely the site can command a significantly higher bid from outsiders, an open auction is used and outsiders are invited to bid, regardless of villager interest.<sup>113</sup> In wasteland auctions, government employees are not allowed to make bids.<sup>114</sup> Not surprisingly, these auctions are very competitive, with most purchasers paying three to six times the starting bid.<sup>115</sup>

Hanstad and Li make several key observations based on their fieldwork in Luliang.<sup>116</sup> First, they point out the open auctions are dominated by wealthy, outsider landholders.<sup>117</sup> Hanstad and Li recommend that closed auctions should be promoted to encourage local, rather than outsider ownership.<sup>118</sup> Second, there is no limit on the amount of wasteland a single individual can purchase,<sup>119</sup> and this absence intensifies economic inequality between large landholders and poor, local farmers.<sup>120</sup> Third, purchasers must pay in one lump sum.<sup>121</sup> Hanstad and Li suggest promoting the use of installment payments in order to extend the pool of potential purchasers.<sup>122</sup> Indeed, several farmers interviewed had a keen interest in bidding, but did not have the financial resources for a single lump sum payment.<sup>123</sup>

109. See Hanstad & Li, *supra* note 105, at 550. The group consists of the village cadre as well as other village representatives. *Id.* The group’s decisions are subject to the approval of the villagers. *Id.*

110. *Id.*

111. *Id.* at 549.

112. *Id.*

113. *Id.*

114. *Id.* at 549–50.

115. *Id.* at 556. In one village, the wasteland price appreciated ten times over a two-year period. *Id.*

116. *Id.* at 554, 566–69. In 1995, Hanstad and Li, with the assistance of the Ministry of Agriculture’s Research Center of Rural Economy, conducted research on rural wasteland auctions in the Luliang prefecture. *Id.* at 548. They were briefed by Luliang government officials on the prefecture assignment process and also interviewed both successful and unsuccessful bidders. *Id.* at 554.

117. *Id.* at 567.

118. *Id.*

119. *Id.* “[S]ome households have contracted as much as 10,000 mu [555.7 hectares] of wasteland through auctions.” *Id.*

120. *Id.*

121. *Id.* at 568.

122. *Id.*

123. *Id.*

#### *D. Lessons from Luliang*

These observations from auctions in Luliang parallel effects witnessed in Shanghai, and suggest potential recommendations for national-level regulations.<sup>124</sup> The open auction process mirrors the move by Shanghai and the national government to inject openness and competition in the assignment of land use rights. When the open auction process was used, wealthy outsider landholders were quick to purchase property that would otherwise likely remain in the hands of local individuals.<sup>125</sup> In Shanghai, a similar phenomenon occurred when the market approach to land use rights assignment was mandated.<sup>126</sup> If these effects hold true at the national level under the less restrictive land use rights assignment process, wealthy foreign developers with deep pockets should hold a comparative advantage over their local counterparts. Hanstad and Li's recommendations for curbing outsider ownership entail pulling back from the market approach,<sup>127</sup> favoring in its stead a closed and preferential system as the better solution.<sup>128</sup> Shanghai and the national government, through the Regulations, have mandated an open system through the market approach for the assignment of land use rights. The Regulations, however, spell bad news for local developers, who will find it difficult to effectively compete with the wealthy outsiders who invade their markets.

#### CONCLUSION

For foreign developers, the Regulations are a welcome event as they can now refer to a standardized procedure for land use rights assignment. The experience in Shanghai and Luliang indicates that the market approach for land use rights assignment benefits outsiders by eliminating back-room dealing and advantages held by locals. Luliang's dual approach of open and closed auctions allows locals to continue participating in the wasteland acquisition process. However, regarding state-owned land use rights at the national level, local developers will not have the luxury of a preferential process under the Regulations.

Nonetheless, foreign developers must approach the Regulations with caution. The experience in Shanghai demonstrates the importance of full

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124. *Id.* at 577.

125. *See supra* note 117 and accompanying text.

126. *See supra* notes 102–04 and accompanying text.

127. *See supra* notes 117–23 and accompanying text.

128. *Id.*

local implementation and the obstacles to achieving that end.<sup>129</sup> Indeed, it should be expected that local developers who have enjoyed preferential treatment in the past will fight hard to hold on to their markets.<sup>130</sup>

On balance, the Regulations are a step in the right direction. Equal treatment of both domestic and overseas enterprises and less government intervention are critical steps toward creating a transparent and predictable land investment environment. Under the Regulations, local developers lose their preferential treatment and will be forced to compete effectively in the marketplace in order to survive,<sup>131</sup> thus making them leaner and stronger competitors.<sup>132</sup> Yue Xiaowu, Director of the Property Division of the Land Use Management Department of the Ministry of Land and Resources, describes this bright future paved by the Regulations: “The abolition of some preferential policies is nothing more than an essential improvement in China’s investment environment . . . . Nothing is more valuable than a set of transparent, fair and consistent game rules governing the market, that is free from government intervention.”<sup>133</sup> The regulations have provided the necessary competitive, market-oriented approach in the land use rights arena, while also serving as a model for regulatory reforms in other spheres of the Chinese economy.

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129. See *supra* notes 78–80 and accompanying text.

130. See *supra* notes 86–88, 96–100 and accompanying text.

131. Tang Min, *Land-Use Rights: Revision on Books*, CHINA DAILY, Sept. 16, 2002, available at [http://www.chinadaily.com/cn/en/doc/2002-09/16/content\\_136275.htm](http://www.chinadaily.com/cn/en/doc/2002-09/16/content_136275.htm) (last visited Nov. 17, 2004).

132. *Id.*

133. *Id.*

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