

Research on "land finance" in China

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Abstract: The topic of this paper is to study the land finance under the socialist system with Chinese characteristics. In addition, this paper simply explores China's unique land system environment and China's economic development environment. Through research, it is found that "land finance" not only promotes the development of China's industrialization and urbanization, but also exposes some problems existing in the process of economic downturn, such as heavy debt of local governments, waste of resources and so on. By studying land finance with Chinese characteristics, this paper facilitates readers to further understand the operation mechanism of land finance and its specific impact on the social economy, and at the same time provides an improvement basis for the Chinese government to guide the healthy development of land finance, avoid potential risks, and improve the downward situation of China's real estate industry, to further promote the sustainable development of cities and healthy economic development.

Keywords: The land finance, The public ownership of land, The reform of tax distribution system, The city Investment company, The local government debt.

1. Introduction:"Land finance"

Land finance refers to the fact that some local governments rely on income from the sale of land use rights to maintain local fiscal expenditure, which belongs to extra-budgetary income, also known as second finance [1]. The operational mechanism of land finance is as follows: First, local governments decide on land transfer and assign land transfer fees to land transfer income and land reserve value to land mortgage financing assets. The government uses this revenue to fund urban infrastructure through the City Investment Corporation. The economic growth brought about by urban infrastructure construction and the improvement of urban residents' quality of life are not only the criteria for the promotion incentive of local government officials, but also the result of land transfer and the capitalization effect [2].

2. The emergence of China's real estate industry and "land finance"

2.1. China's unique land system

The Chinese government not only affects the allocation of resources but also participates in their production. This is reflected in the real estate industry -land public ownership—that is, the state owns land ownership. Public ownership of land divides land into urban state-owned land and rural collective land. This land system represents that all land is owned by the state and urban land is

allocated by the government [3]. Based on this system, the government has issued a series of policies to support and guide the real estate industry. For example, after the reform and opening in 1978, the government supported the compensated transfer of land-use rights and the sale and purchase of houses, which laid the foundation for the formation and development of China's real estate industry.

2.2. Reform of the economic system

In the process of China's transformation from a planned economy system to a market economy system, houses are no longer only distributed as public welfare; the real estate industry gradually moves towards marketization, and houses begin to circulate in the market as commodities. Simultaneously, the improvement of the financial system and the innovation of financial instruments provide financial support for the development of the real estate industry. For example, the introduction of financial products such as bank loans and housing provident funds has provided financial support for the boom and development of real estate in China.

2.3. Increased demand for housing

As China's economy continues to expand and its population grows, there is a rising demand for housing among Chinese residents. This demand is particularly pronounced during the urbanization and industrialization process, as a significant number of individuals relocate to cities, creating a vast market space for the real estate development industry.

2.4. Financial distribution system reform: tax distribution system reform

China's economy in the 1980s was characterized by a period of "contracting," which was reflected in the real estate industry as "financial contracting." However, as the economy developed and market mechanisms were reformed, the Chinese government ended the "financial responsibility" in 1994 and initiated the "tax distribution reform." This reform increased the tax scale and extra-budgetary revenue of local governments.

China's tax distribution reform has two main characteristics. The first characteristic is that tax power is divided according to the size of the tax source. Small and scattered tax sources are assigned to local taxes, while large and concentrated tax sources are assigned to central taxes. This division of local taxes and central taxes enables local governments to obtain tax autonomy, increases the extra-budgetary revenue of local governments, and facilitates central government macro-control of the national economy [4].

The second characteristic of the tax distribution reform is the downward shift in government power. The reform of the tax distribution system assigns the right to collect and manage some taxes to local governments. Local governments can regulate the collection, reduction, and exemption of local taxes in real-time according to local characteristics and establish appropriate tax rates and collection scopes. This feature fully mobilizes the enthusiasm and initiative of local government management and promotes the generation of local land finance.

The two characteristics of the tax sharing reform not only strengthen the central government's financial macro-control ability but also increase the extra-budgetary revenue for local governments, marking the beginning of local "land finance."

2.5. The implementation of "tender-auction-listing" system

The implementation of land tendering, auction-listing system in 2001 has promoted the expansion of land finance. The land tendering, auction-listing system is about the transfer management system of China's state-owned land use right, which divides the transfer methods of China's state-owned land

use right into four kinds: bidding, auction, listing and agreement [5]. This has led local governments to gradually establish a development model that is based on land, combines land with finance, and is led by investment. This system not only helps standardize the land market, but also promotes the integration of real estate enterprises. At the same time, the system also promotes the separation of premises, improves the utilization rate of land development, and breaks through the geographical restrictions of real estate development enterprises.

3. The product of "land finance"

3.1. City investment company and land financial

Based on public land ownership, the Chinese government controls both land ownership and the financial system, so the government will participate in industrial investment no matter what. However, the investment process of industrial investment is irreversible, so to protect the basic interests, the Chinese government must intervene deeply. An important product of the government's deep intervention in real estate investment is local government financing vehicles, or urban investment companies in short.

According to relevant Chinese laws and regulations, local governments cannot borrow from banks and are not allowed to issue bonds until 2015, so local governments need to set up special companies, which are referred to as "local government financing vehicles", to finance investment. However, when referring to these companies, to highlight their investment performance, and there are many words of "construction investment" or "investment and development" in the name, they are also referred to as "urban investment companies".

From the characteristics of urban investment companies, land finance can also be regarded as "land finance," which is analyzed from the following points:

Initially, the Chinese government's unique structure and public ownership of land have enabled urban investment corporations to obtain a substantial number of land-use rights. These corporations generate income from the operation of these assets and financial support from the government and banks. This influx of funds has contributed to the rapid expansion of their businesses. It is important to note that a majority of the projects undertaken by urban investment companies are public welfare projects, which are evident in the fact that the projects they construct and operate primarily focus on urban infrastructure, thereby stimulating local economic growth to some extent. The Chengdu Culture & Tourism Group, for example, was established in 2007 with a registered capital of only 500 million yuan, and its primary project was to develop "wide and narrow alleyways." By 2018, the company's registered capital had increased to 3.1 billion yuan, and its assets were valued at 20.4 billion yuan. The company also had 23 subsidiaries and a considerable increase in the number of projects. The various projects undertaken by the Chengdu Culture and Tourism Group, particularly the "Wide and Narrow Alleyways," have significantly contributed to the local economy. In 2019, the attraction received 41.637 million visitors, representing a 32.8% year-on-year increase, while the total business generated amounted to about 1.211 billion yuan, reflecting a 42.9% year-on-year growth. Moreover, Shanghai City Investment (Group) Co., Ltd., has consistently enjoyed an average credit line of about 45.19 billion yuan from banks, and the bonds issued by the company have been rated AAA. These financial indicators demonstrate the company's financial stability and creditworthiness.

3.2. Local government debt (Abbreviation:“local debt”)

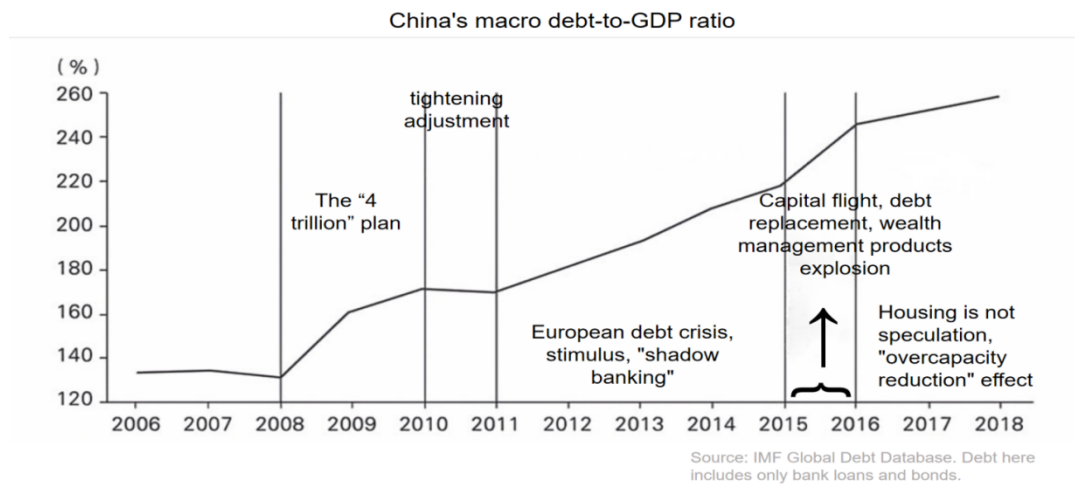


Figure 1: China's macro debt-to-GDP ratio.

The operation of "land finance" has promoted the development of industrialization and urbanization, but also caused local governments to accumulate huge debts. The key to this mode of operation is the price of land. In the period of economic upturn, continuous investment and construction will bring about sustained economic development. However, in the period of economic downturn, economic growth slows down, land prices fall, land leasing income decreases, and local governments' extra-budgetary income will also decrease accordingly.

The main reason for real estate debt is the increased contradiction between the unlimited purchasing power created by banks and the limited supply of urban land.

The implementation of land finance has a great role in promoting the real estate industry in the period of economic development, but it will bring serious real estate debt crisis in the period of economic downturn. With the implementation of "land finance", land is used as collateral assets to drive the accumulation of bank credit and other funds, thus grafting the capital market, coupled with the role of leverage, "land finance" is generated. "Land finance" not only drives the rapid economic expansion, but also makes the debt of local governments gradually increase.

As show in figure 1, in 2008-2009, China's government implemented the "4 trillion yuan" plan in response to the negative impact of the US subprime mortgage crisis. This program was necessary at the time, but it also resulted in a high level of local government debt that had yet to be resolved, and local debt began to accumulate; in the following years, as housing prices continued to rise, the scale of local debt also expanded, and debt risks continued to accumulate.

When the Chinese government became aware of this situation, it took measures such as supply side structural reform in 2012 and the concept of 'no speculation in housing' in 2018. These measures have effectively curbed rising housing prices in the short term, reduced investment demand, and effectively controlled the debt risk of Chinese real estate enterprises. However, by 2020, the outbreak and deterioration of COVID-19 had significantly hindered the development of China's national economy, and the housing purchase demand and investment demand of Chinese residents had declined significantly [6].

4. The impact of "land finance"

4.1. Positive impact

4.1.1. Promoting urbanization

The formation and operation of land finance make China's urban construction develop rapidly. Among them, Chinese city governments have accumulated a large amount of construction funds through land management and rationally allocated these funds to urban infrastructure construction, which has led to the rapid development of urban economy and the steady improvement of urban residents' quality of life. At the same time, it also drives the transformation and development of the surrounding rural economy, attracts many farmers to the city, and promotes the rapid development of urbanization.

4.1.2. Help local investment, stimulate the development of local real estate industry

The implementation of "land finance" has driven local governments and real estate enterprises to attract investment. First, the implementation of "land finance" provides suitable land transfer price concessions for qualified construction projects. For qualified investment promotion projects, the evaluation can be used as the reference price, and the local government can determine the base price of the transfer, and then the transfer to the enterprise through the way of "tendering-auction-listing." In addition, "land finance" also provides preferential treatment of land use fees for enterprises. These preferential land policies have effectively reduced the land cost of real estate enterprises and other enterprises, improved the efficiency of attracting investment, and thus promoted the development of local economy.

4.2. Negative effect

4.2.1. Caused a serious waste of capital and resources

The implementation of "land finance" has brought about serious waste of funds and resources. The land leasing revenue is collected and paid by local governments themselves, but due to the lack of standardized and perfect supervision mechanism for a long time. Some local governments have created many "achievement projects" that are not practical, wasting both land and government revenue. In addition, in this process, some government officials are corrupt, and it is not uncommon for them to use public funds as personal income.

4.2.2. The focus on production leads to the neglect of people's livelihood

Government investment in "land finance" has a significant impact on industrial restructuring and exacerbates overcapacity. More specifically, the government injects a substantial amount of capital into a particular industry, playing a crucial role in guiding the transformation of industrial structure. In recent years, most local governments' land transfer revenues have been channeled into urban development projects, leading to a boom in the construction and real estate sectors [7]. Consequently, property prices have skyrocketed, prompting a surge in real estate investments by both businesses and residents, resulting in severe overcapacity issues. Furthermore, the excessive expansion of the real estate and construction industries has consumed a significant portion of social resources, with land profits predominantly concentrated in urban areas. This has widened the urban-rural divide, exacerbated national income inequality, and neglected the welfare of the populace.

4.2.3. Increased the burden on farmers

The land finance mechanism has seriously damaged the legal land rights and interests of farmers, and is not conducive to the protection of cultivated land. Land finance makes local governments excessively dependent on real estate developers for their revenues, but according to China's national conditions, collective land cannot be used for real estate development, which makes existing real estate developers in a monopoly position. To maximize profits, real estate developers are likely to bid up the housing price, which will increase the housing burden for farmers with low income.

5. Proposals for continued reform and develop of "land finance"

5.1. Continue to promote reform of land and factor markets

To continue to deepen the reform of land and factor markets, we must first strive to achieve the deep integration of "efficient market" and "effective government". The government should gradually improve and optimize the basic system of market economy such as property rights protection, market access, fair competition and social credit, to play the role of regulating market economic activities, reduce the misallocation of land factors and labor among regions and industries, reduce government corruption, improve production efficiency, promote the reasonable distribution of land transfer income, and reduce the difference in production efficiency. Secondly, we should continue to promote the market-oriented allocation of land factors in the unified urban and rural areas [8]. Accelerating the market-oriented reform of land factor allocation can release the growth potential of the current national economy. At the same time, continuous improvement of the land testing index system can also make the government's pilot reform work gradually promoted. To sum up, continuously deepening the market-oriented reform of land and factors can reasonably allocate production capacity and effectively improve the serious waste of capital and resources.

5.2. Continue to implement the "Five Overall Plans"

The "five balances" specifically refers to the integration of urban and rural development, regional development, economic and social development, harmonious development between man and nature, domestic development and opening. To continue to advance the "five balances", we must first balance the relationship between the government and the market, and stick to the direction of socialist market economy reform. Local governments should continue to optimize the ecology of industrial development, promote the efficiency and level of financial services for the real economy, vigorously cultivate innovative, applied and skilled personnel, build industrial development on the support of science and technology, and promote the allocation of factor resources to maximize benefits and efficiency. We will uphold the leading position of enterprises, stimulate the driving force and vitality of the development of all kinds of enterprises, vigorously build world-class enterprises and specialized and innovative enterprises, and promote the integrated development of large, small and medium-sized enterprises. In addition, we should gradually change the urban-rural dual economic structure, promote balanced development between urban and rural areas, and ensure people's livelihood while focusing on production.

5.3. Promote the reform of rural taxes and fees

The main contents of rural tax and fee reform can be summarized as: "three cancellation, two adjustment, one reform". "Three cancellation" refers to the cancellation of administrative fees, government-managed funds and fund-raising specially collected from farmers, such as rural pooling and fund-raising for rural education; Abolishing the abattoirs tax; Abolish the uniform provisions of

accumulated labor and compulsory labor. The "two adjustments" refer to the adjustment of the current agricultural tax policy and the adjustment of the agricultural special tax policy. "One reform", refers to the reform of the current village retention levy use method. Continuous promotion of rural tax and fee reform can effectively solve the tax and fee arrears incurred before the reform. At the same time, the rural tax and fee reform can increase the reform of the transfer payment system of the grass-roots government, to ensure the special use of funds and realize the rational allocation of funds. In addition, the continuous promotion of rural tax and fee reform further standardizes rural tax collection behavior, which can greatly reduce the burden of farmers.

5.4. Continue to promote reform of transfer payments

To continue to advance the reform of the transfer payment system, we should improve the legal system of transfer payment, establish and improve the classified management mechanism of transfer payment, improve the budget preparation of transfer payment, strengthen the distribution and use of transfer payment and performance management, and further advance the reform of the transfer payment system below the provincial level. To promote the reform of the transfer payment system and implement it at both urban and rural levels can not only promote the reform of rural taxes and fees, optimize the use of land, improve the utilization rate of land, and promote the development of rural economy; It can also clarify the distribution, use and management of land transfer revenue, thus ensuring the rational use and protection of land resources [9].

6. Conclusion

Based on China's actual national conditions, the emergence and development of land finance is inevitable. Especially during the economic upturn, "land finance" has greatly promoted the vigorous development of the real estate development industry, but at the same time, it has accumulated a large amount of local debt. The impact of the products of "land finance" in different periods of economic development has both advantages and disadvantages [10]. However, based on the current economic decline, the drawbacks of "land finance" have gradually emerged, so "land finance" needs further reform and improvement. But in general, the most important thing for the development of "land finance" is to ensure people's livelihood while promoting production.

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