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Guanzhong James Wen
Trinity College, JAMES.WEN@TRINCOLL.EDU

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Why Is a Free and Competitive Land Market Indispensable for Resolving the Three
Agrarian Issues through Endogenous Urbanization?

Guanzhong James Wen

Trinity College, USA

Shanghai University of Finance and Economics

I. Introduction

China's current land system is a legacy from the era of the Central Planning System, when all the factor markets were eliminated as evils, and all the factors of production were nationalized or collectivized. In the absence of factor markets and private ownership, all the factors had to be allocated administratively. However, the belief that a government can use a Central Planning System to better allocate resources in a fairer and more efficient way than a market mechanism has been proven totally groundless by the glaring failures in all the nations that once experimented with this idea.

1.1 The fatal problem of Central Planning System

Ironically, compared with other economic allocation mechanisms, a Central Planning System, by its very nature, needs much more information for its alleged capability—to design a grand socio-economic plan to coordinate all the economic sectors in order to eliminate once and for all any forms of shortage and surplus. Obviously, as a precondition for such a mission, a Central Planning System must have not only comprehensive, but also constantly updated information before it can respond to the changes in demand and supply that often set the economy off equilibrium. Here exactly lies the fatal flaw of Central Planning System: it can never generate such information, because its very existence is built on the elimination of all the factor markets, the only

source of dynamically evolving and constantly updating equilibrium factor prices. With these prices gone, all the information that is crucial to the success of Central Planning System is lost too. These prices are irreplaceable, and formed only through the interaction of suppliers and demanders in the free and competitive market. They are self-correcting and self-updating automatically in response to all kinds of shocks, be it social, institutional, cultural, demographical, economic, political, or climatic. The price fluctuations represent markets' effort to quantify the otherwise unquantifiable impacts of these shocks. Without such fluctuations, there is no way a market can reach a new equilibrium that equates supply and demand under constantly evolving circumstances. Hence, by eliminating free and competitive factor markets, the only mechanism that can generate such information, the Central Planning System eliminates what it needs most—all the sources of information themselves. In the absence of adjustable equilibrium prices, how can a Central Planning System know how to design a grand plan that can equate supply and demand? Without equilibrium prices, how can a firm know if its production is earning profit or actually suffering from losses, and if it is properly rewarding its hard-working workers and innovative technicians? Also, in the absence of such information, how can a Central Planning System know how to discipline those who are either lazy with their jobs or slow in innovation?

By eliminating the market mechanism, all the governments that adopted the Central Planning System had to turn to political favoritism, cronyism, or nepotism to motivate workers, technicians and managers, or simply intimidate them by coercion, resulting in rampant waste, chronic shortage, technological stagnation, and deep resentment. The so-called grand plans that all the Central Planning Systems were once so proud of all

degenerated into top-leaders' whims, speculations, empty promises, arbitrary commands, and compulsion that were out of touch with the real needs of people.

In China's case, such a planning system brought China's economy to the brink of collapse in the early 1960s at the end of the Great Leap Forward Movement, and again in the late 1970s at the end of the Cultural Revolution. The fatal problem of the Central Planning System became clear: in the absence of free and competitive factor markets, Central Planning is nothing but a fantasy.

1.2 Reintroduction of market mechanism and the remaining problems

Fortunately by gradually moving away from the Central Planning System since the early 1980s, China has been nurturing the market mechanism and using price signals increasingly to coordinate production and to equate supply and demand. The result is spectacular. The chronic shortage and surplus of most products widely observed under the Central Planning System have mostly disappeared after using price mechanisms to coordinate production.

While China has made significant progress in using markets to coordinate its products, its factor markets, i.e., its land market, labor market, and capital market, have met strong resistance due to the various institutional barriers (World Bank, 2012). Its labor market is stratified in favor of urban population as a result of the Hukou system. Its capital market has been heavily intervened by the government through interest control and credit rationing in favor of SOEs. However, it is its land market has been experiencing most severe problems—it is completely monopolized by the state through administrative channel. Compared with other factor markets, land market has never got a real opportunity to develop.

1.3 Structure of the paper

In what follows, Section II discusses the initial benefits generated from the current land institutions; Section III discusses the consequences of the distortions in the absence of land market; Section IV discusses possible solution; Section V concludes the paper.

II. Initial Benefits Generated from the Current Land Institutions

2.1 Evolution of China's land tenure system

According to Article 10 of China's Constitution adopted in 1982, all the non-farmland, including all the urban land, is owned by the state, and most farmland,¹ including rural residential sites, is owned collectively but prohibited for sale.² The same article also stipulates that the government is allowed to take land from rural collectives to pursue public interest. The two stipulations of the same article are self-contradictory. The second one limits government land taking to circumstances where the government can prove its land taking is for public interest. However, the first one allows a city government to nationalize all the surrounding rural land where it expands. It is based on this interpretation that the local governments have been busy converting into urban land all the farmland within its fast expanding urban boundaries, be it for public interest or for commercial use.

¹ A small amount of farmland is owned by the state and farmed by the state-run farms, most of them are located in China's remote border areas.

² See **Article 10 of the 1982 Constitution. It reads as follows, "Land in the cities is owned by the state.** Land in the rural and suburban areas is owned by collectives except for those portions which belong to the state in accordance with the law; house sites and private plots of cropland and hilly land are also owned by collectives. The state may in the public interest take over land for its use in accordance with the law. No organization or individual may appropriate, buy, sell or lease land, or unlawfully transfer land in other ways. All organizations and individuals who use land must make rational use of the land." See <http://english.people.com.cn/constitution/constitution.html>

Since 1982, despite numerous regulations and policies have been issued to regulate the land use in response to accelerating urbanization, the above self-conflicting constitutional stipulations remain unchanged. The ownership of farmland can neither be traded among peasants, nor among rural collectives or between rural and urban sectors without being initiated first by the government. At all localities the government views farmland requisitioning as one of the main sources of local finance and makes no distinctions between public and commercial interest when land taking from rural collectives occurs. Therefore, the constitutional stipulation that land taking should be in public interest has been totally ignored by the government.

In 1984, the No. 1 Document of the CPC finally endorsed the secret experiments undertaken in some remote and poor areas since 1978 by officially returning exit rights from the communal production to peasants. Once given by this option, the vast majority of the peasants chose to leave the compulsory collective production. They regained the exclusive land use rights and restored the long tradition of organizing production on individual household basis. Thus, the commune system was basically dismantled except for a few localities by 1984 out of peasants' own choice, and replaced by the Household Responsibility System (HRS). Under the new system, village land is still collectively owned, but peasants obtain the use rights to his or her share in village land proportionate to the population share. The peasants still do not have exit rights from the collective land ownership, but by the exclusive use rights to their land and their residential sites, they become residual claimants of their production.

As the Township and Village Enterprises (TVEs) became a main force of industrial production after the middle 1980s, rural collectives were allowed to designate a certain

amount of farmland for non-farming activities. These plots are called collective construction sites and used by rural collectives to pursue industrial or commercial interest. Most of them become idled after the Asian Financial Crisis of 1997 that resulted in sharp decline in TVEs except for coastal and suburban areas. The geographical proximity to transportation hubs makes these areas the favorite destinations for FDIs seeking cheap land and labor.

2.2 The dividends derived from the current land tenure system

The capability of China's agricultural sector to provide enough food to feed the population had been one of the top concerns of Chinese leaders since the early 1960s when China experienced a severe famine, followed by chronic nationwide food shortage throughout the 1960s to the early 1980s. The low productivity and limited food output relative to China's growing population under the commune system made it a must to impose ruthless restrictions on the pace of industrialization and urbanization. Now under the HRS, the rampant food shortage has been replaced by abundant food supply. China is in a position for the first time in its modern history to be able to focus wholeheartedly on industrialization and urbanization. China's rural areas not only provide an increasing amount of output, but also provide an increasing number of surplus laborers to non-farming sector. Currently, around 260 million migrant workers are working in urban areas and most of them are from rural areas. These workers constitute the backbone of China's powerful export-oriented manufacturing sector and explain to a great extent why China can turn itself from a basically autarkic economy with a trivial share in the world total trade into the second largest economy, the largest trading nation, as well as the largest holder of foreign reserves in the world in about 30 years.

In addition to output and labor, the current land tenure system also provides cheap and abundant supply of industrial land in two ways. First, it is easy for the government at various localities to requisition farmland from rural collectives, because rural collectives are not allowed to sell their land to anyone else but to the government. With this monopsony position, the government does not have to pay high compensation to local peasants. Second, as mentioned above, rural collectives are also allowed to designate a certain amount of their own land for industrial and commercial activities at very low rentals and very loose environmental codes and enforcement.

The government then allocates only a small part of it for residential use, leaving most for industrial use. While the firms, especially those of FDIs can get cheap land thanks to this policy, the small supply of residential land means that there will be excess demand for residential sites. The developers have to bid for the limited supply of residential land at the government controlled land auction market. The government thus can reap most of the steep appreciation of the land through fierce bidding war among developers. The huge amount of land wealth collected by the government from this channel then can be used to finance the investment in local infrastructures and other urban renovations. Here lies the secret why China can change the skylines of its urban areas so rapidly. In the last 20 years since the early 1990s, China has renovated most of its cities. It is the largest government-initiated and government-led urbanization ever taking place in human history.

III. Negative Consequences of the Current Land Tenure System

3.1 The tasks that the current land tenure system has failed to deal with

However, serious problems have been accumulated under the current land tenure system. As pointed out, the main features of the current land tenure system was determined in 1982 when a new Constitution was adopted in the wake of the Cultural Revolution and when China was focusing on reforms in rural areas where the commune system was not yet replaced by the HRS. Therefore, the land tenure system stipulated by the Constitution did not take into its consideration the following formidable tasks that soon arose inevitably. The followings are some of the tasks.

- 1) To gradually transfer all the farmland, all the rural residential sites with the housings above, and all the collective construction sites to those who choose to remain to be farmers as urbanization deepens;
- 2) To convert the suburban farmland into urban land efficiently and peacefully;
- 3) To absorb gradually most of the rural population through urbanization;
- 4) To maintain the stable production of agriculture during this period;
- 5) To prevent the urban/rural income disparity from worsening;
- 6) To make sure that the remaining farmers are those who are not only most efficient but also those who choose to do so with their own will.

These tasks involve at least 1.8 billion mu of farmland, at least 500 million rural residents,³ hundreds of thousand villages, and thousands of towns and cities. No one has the full information how to coordinate the transfer of land and people in rural areas and between rural and urban areas, especially in a peaceful, efficient, and voluntary manner. However, given the restrictions of the current land tenure system, all these transfers will not happen. The government

³ At the current official urbanization level of 52%, there are still 6.5 hundred million rural residents. Suppose China can retain one hundred million farming population, given that China has 1.8 billion mu of farmland, each of them will only have 18 mu, or little more than 3 acres of farmland. The rest of the farming population has to leave the farming sector to make a living.

has to intervene directly. This means that all the land and population in rural areas have to be allocated administratively in a way that is exactly what we saw under a Central Planning System. Such an allocation method is doomed to fail sooner and later after some glorious moments. If there are land markets plus free migration policy across the nation, they will take care of the allocation of the land and houses on the daily basis through voluntary and peaceful process at mutually acceptable prices that emerge at the land markets and labor markets.⁴ But under the current land tenure system, no such transactions can happen beyond the boundaries of a village without the initiation of the local government. All the transfers of rural land and houses are illegal if one party of the transaction is from outside of a village.

3.2. No solutions in the absence of a land market.

In the absence of a real land market, there are no solutions to the following thorny problems.

- 1). It is impossible for more efficient farmers to emerge and to become owners of modern farms by taking over the land of less efficient farmers. Actually the most capable peasants, being unable to expand their land operation scale in an institutionally secured way through fair competition and land acquisition, choose to leave rural areas. This is why China's farming sector is now run increasingly by the aged, weak, sick, female, and handicapped. As a result, modernization of agriculture remains to be a remote dream to China.
- 2). It is impossible to fairly compensate those farmers whose land is taken by the government because there is no objective reference of market equilibrium price.
- 3). It is impossible to use land efficiently among farmers because tenants, even most efficient ones, have no secured tenancy rights. The land they rent in can be taken back often by those who return from cities for various reasons.

⁴ As mentioned above, due to the Hukou system, the labor market is also not working properly. But this topic deserves a separate paper and will not be fully discussed here.

4). It is impossible to find out the true opportunity cost of a plot of land that is to be converted to urban land. In the absence of land market, therefore, land allocation cannot be efficient.

5). It is impossible for a city to grow endogenously⁵ and to determine its natural physical boundary. Without allowing try and error at the land market to exhaust the agglomeration effects, the land price and housings price are doomed to be seriously distorted and the expansion of the city cannot be determined by the drive to exhaust the agglomeration effects, but by the drive to reap the monopoly rent on land. Therefore, the urbanization is pushed exogenously by the government and the urbanization of land is much faster than the urbanization of rural population.

5). Impossible to know the true value of a piece of land or a property because of the seriously inflated land price. Therefore, there is no solid ground to calculate property taxes and other land related taxes. Since all the land is either owned by the state or collectives, there is no legal basis to impose property taxes that otherwise can replace the current unfair and wasteful land financing through land selling.

6). Impossible to prevent land and housing bubbles from bursting. Because of the monopsony in getting rural land from farmers and monopoly of the urban land by the government, one of the two root causes⁶ of the housing bubble, as long as the numerous government regulations issued in recent years do not touch this root cause, they are doomed to fail in controlling housing price as the government intends.

7). It is impossible to reduce the rural-urban income disparity, given urbanization becomes so exclusive as a result of the hukou system and particularly the prohibitively high housing price relative to the meager income of migrant workers from rural areas.

⁵ By endogenous, I mean that the expansion of a city is mainly driven by agglomeration effects, not by distorted factor prices or government expenditures and subsidies. Firms and population are attracted to flow to the city because they can reduce their average production cost or enhanced their household income and welfare.

⁶ Another one is the oversupply of money, that, in turn, is caused by greatly inflated foreign reserves under a managed exchange rate regime.

8). It is impossible for the rural finance to emerge and grow normally because the ownership and property rights of rural land are not well defined, thus, cannot be used as collaterals.

9). It is impossible for more efficient cooperatives to emerge to replace the less efficient ones because peasants are forced to stay in their current collectives, no matter how inefficient and corrupt these collectives are, or simply lose they land share if they choose to quit from the current ones.

10). It is hard to booster domestic consumption because people's purchasing power is seriously eroded by the prohibitively high housing price in urban areas.

11). It is impossible to stop local governments from land taking for non-public interest projects. They are so busy with such activities that they can hardly focus on its own designated job—providing public service.

12). It is impossible to provide the most important opportunity of social mobility to rural population—to absorb and integrate them into urban communities to benefit from the agglomeration effects.

13). It is impossible to obtain useful information about how, where, and for whom, and how many low rental apartments should be built even if the government has the money, land and will to do so. Lack of information has already led government-sponsored low-rental housing projects to be located in areas where few would like to live despite the overall strong demand for such housing. It is impossible to overcome the coexistence of ghost towns and overcrowded urban villages. Consequently, the urban-rural divide will continue,

14). It is impossible to effectively reduce the friction or confrontation between the government and the famers as long as land taking is still conducted in the current way that basically ignores

farmers' rights to their own land and ignores the fairness of compensation for land loss in the absence of a true land market.

15). It is impossible to legalize the emerging underground land markets and housing markets and to eliminate the potential clashes between the formal and informal land markets and housing markets. Despite the fact that urban villages that are growing and thriving across all the urban areas, and the fact that they become de facto the main source, often the only source, of low-rental housing to migrant workers and low-income urban residents, the residents there continue to face the uncertain legal status of their housing, because their housings are illegal and can be demolished any time by the government according to the current land tenure system.

16). It is impossible for China to claim to be a nation of law that respects and protects people's properties. Most land takings violate China's own constitutional stipulation that no land taking should take place unless it is done in the name of public interest.

IV. The Way Out

4.1 The current land tenure system is killing any hope for a true land market.

Compared with labor market and capital market, the least developed is the land market. The labor market and capital market, imperfect as they are, at least play an important role in allocating labor and capital respectively. In sharp contrast, one could hardly say that China has a land market in its true meaning. As is discussed above, land is de facto allocated exclusively through direct administrative efforts. According to the current land tenure system, no individual farmers are allowed to own land. All the farmland is owned by rural collectives, but the latter have no rights to buy and sell land to other rural collectives, let alone to anyone from non-farming sector. They are only allowed or forced to sell to the government for the purpose of urban and industrial development. Under this

stipulation, the government is the de facto monopsony at the primary land markets because only the government has the right to purchase farmland and to convert it for urban use. The government is also the monopoly at the secondary land markets that auction leaseholds to developers. Hence, the government is the only legal demander for farmland. It is also the only legal supplier of urban land. All the other potential suppliers of land for urban expansion, mostly individual farmers and their collectives, are illegal under this land tenure system, and facing crack-downs frequently.

By design, the current land tenure system totally insulates the supply of urban land (in this case the rural collectives) from its demanders (in this case the migrant workers and the urban families and firms), leaving the government as the only intermediary between the supply and demand. The spontaneous interaction between supply and demand through price signals is impossible.

In this sense, the significance of the decision made by the third plenary of the 18th congress of CPC cannot be overemphasized. This important decision defines the direction of future reform in the following language: “[t]he basic economic system should evolve on the decisive role of the market in resource allocation.”⁷ This is the first time that CPC makes it so clear that all the resources should be allocated decisively by market instead of the government. CPC urges that the economic institutions should be evolved in this direction. By saying this, China implicitly admits that up to now its factor markets have not fully developed. Remember this is the main argument of most of the developed nations based on which they refuse to give market status to China despite the latter has

⁷ <http://www.chinausfocus.com/china-news/the-decision-on-major-issues-concerning-comprehensively-deepening-reforms-in-brief/>

been urged them strongly to do so. This very honest assessment of the status of China's factor markets represents a huge step for China to address this issue.

4.2 Face the reality—no escape from land market

The essence of using markets to allocate resources lies in the fact that all the resources have to be allowed to enter markets freely and to be traded without institutional discrimination before equilibrium prices can be generated and supply and demand can be equated. The equilibrium prices are the indications of the opportunity costs of those that are being transacted. Only when we know the opportunity cost of each thing, we can know how to allocate it efficiently and rationally. Without knowing its opportunity cost, how could one know if it should be treasured or trashed?

Equilibrium prices can only be generated through repeated trade. If a priori something is excluded from being traded at market, then there is no way to reveal its real value. Only through the interaction of supply and demand, a mutually acceptable price will emerge to reflect its true value. In this sense, it is hopeless for a true land market to emerge under the current land tenure system.

In the absence of a true land market, both the old and newly acquired urban land is allocated through direct administrative method, causing all the efficiency problems and social justice problems. The same phenomena observed under the Central Planning System now can be seen everywhere: i.e., the coexistence of chronic surplus and chronic shortage. We see rampant short supply of residential land, ordinary residential housings, especially the low rental housings and cheap apartments. At the same time we see chronic surplus of industrial parks, idling collectively owned construction sites, and unoccupied

luxury apartment buildings, empty supermarkets, and deserted stores in numerous ghost towns mushrooming across the nation.

China is in a dead end in the evolution of its land tenure system. This system prevents a real land market from emerging. Without government direct intervention, land demand cannot interact with land supply. In the absence of a true land market, land prices and housing prices are inevitably distorted. When there is no reliable price reference for land allocation, efficient and fair allocation of land is beyond China's reach.

The lasting distortion in land supply and land prices cannot be corrected automatically, threatening to derail China's urbanization at a time when China not only urgently needs to integrate more than 200 million migrant workers, but also needs to urbanize most of its rural population.

As the housing bubble is looming bigger and bigger, the Central Government feels more and more pressure to intervene administratively the land supply and housing demand by issuing an increasing number of often inconsistent rules and regulations with little effect. If such situation continues, China will rely more and more on administrative allocation of land, drifting further away from its original goal of nurturing a truly competitive nationwide land market.

4.3 Historical lessons

Here some review of history are very relevant. During the peak of the commune movement from 1958 to 1961, there was a tendency to share properties, grain output, income, and land ownership without compensation across different production teams, or even across different production brigades within a commune. In most provinces, peasants were even forced to join the communal dining halls under which peasants even lost the

control over their own grain rations, let alone their own products. This extreme egalitarianism deprived peasants of any incentive to work hard, resulting first in free ride problem and rampant food waste while food was still available in the fall of 1958, then in sharply declined production and sharply rise in death toll in 1959 and 1961. The deteriorating situation eventually led the government to permit peasants to decide on their own whether they wanted to leave the communal dining halls or not in May, 1961. Of course, farmers chose to exit from the compulsory dining halls immediately, and the famine ended abruptly in the same year, despite that fact that the per capita grain consumption in rural areas reached the lowest since 1958. It was indeed a miracle that China could overcome the great famine when the per capita grain consumption fell to its lowest level since 1949. The main reason that China succeeded in ending the famine should be attributed mainly the rights that the Chinese peasants regained to exit the compulsory, wasteful, and inefficient communal dining halls. What should be pointed out emphatically is, the promise to allow the peasants to exit was not empty. The peasants were allowed to line up in front of the communal warehouses to claim back their food rations, no matter how meager they were. The free sharing of food among different households and villages was effectively stopped and the rampant free ride problem was mitigated to a great extent. By giving peasants the free exit right from the communal dining halls also avoided an unnecessary debate over whether the communal dining was more socialist over the private kitchens in a time when the communal dining halls had been equated to communism in the previous years and many were already penalized politically for being opposed to this radical institution.

Lessons also can be learned from how the commune system was formally abolished nationwide in 1984. The peasants started to exit secretly from the compulsory collective production since late 1970s in some remote and poor rural areas by returning to household-based production. As this practice spread to more and more places because the peasants were allowed to keep more of the above quota products as a result of its much higher efficiency, eventually the CPC and the Chinese government endorsed this rural reform in 1984. By giving peasants the exit rights from the compulsory collective production, the commune system was deserted in most places automatically except for Nanjie Village in Henan province and Huaxi Village in Jiangsu province. The exit right this time is also not empty promise. The formerly collectively used land was divided up among peasants on the per capita basis. The peasants are allowed to have the exclusive use rights to their land and to organize their production on the family basis or group basis. In retrospect, one can see that by emphasizing exit rights, one can avoid the controversy of whether the commune system was socialist or not, and emphasize instead that even if it is a good system, it still should be formed by peasants' own free choice. One thus can avoid the sensitive question of whether allowing the privatization of land use rights represented an effort to go back from socialism to capitalism. At the time Deng Xiaoping's advice to reformists was, do not get into ideological debate. This is wise because many of the defenders of the commune system could use the prevailing orthodox ideology to their advantage. By giving the exit right back to peasants, a move backed by CPC's own principle of voluntarism, the key point in the debate now is no longer about whether socialism is better than capitalism, but whether one should force peasants to do what they dislike. If the commune system were really efficient and beneficial to the

peasants, why the majority of the peasants would not have chosen to retain it? By emphasizing exit rights, one also can avoid forcing some peasants to abandon their collectives, such as the above-mentioned Huaxi Village in Jiangsu province and the Nanjie Village in Henan province. Giving exit rights to the peasants means that the government should respect peasants' own choice. It is alright if the local peasants decide to retain the commune system. Thus the Chinese government skillfully avoided a potentially treacherous ideological debate in the wake of the Cultural Revolution when the leftist radicalism was still rampant.

The result of allowing peasants to exit from the commune system is spectacular both in term of TFP growth and in total output (Wen 1993). In less than 10 years since this institutional innovation, China was able to abolish its long dependence on food coupons to ration food among urban residents. Despite the fact that China's population has almost doubled since the late 1960s and its fast growing per capita income has led to more meat-based dietary, and China's farming is mainly undertaken by those who are mostly aged, weak, sick, female, and handicapped on a shrinking acreage of arable land due to urbanization and industrialization, food supply is abundant everywhere in China. Based on the brief review above, we can see exit rights play a crucial role in improving production efficiency, rural income, and nation-wide food security and provide a solid foundation to industrialization and urbanization.

4.4 Endogenous urbanization must be guided by factor markets

The outdated land system is one of the two most important root causes of why China's urbanization is government-driven instead of market-driven, and why it is exclusive to rural population. Another root cause is China's hukou system. In this sense, China's

urbanization is not endogenous and sustainable because it is not based on the net gains of agglomeration effects, but based on the government expenditures financed by the underpaid land requisitions and overcharged leasehold auction. Under this model, urban sprawling, driven by seeking land transfer fees and GDP growth, becomes a serious problem. If the trend of exclusive urbanization continues, the already extremely high rural-urban income disparity can hardly be reduced.

An endogenous urbanization should be driven by net gains from agglomeration effect. As long as the agglomeration effects have not been exhausted, firms and individuals have incentive to move in to reap such potential net gains. However, in order to achieve endogenous urbanization, the net gains of agglomeration effects must be based on undistorted prices of all factors. The interest rate at the capital market, wage rate at the labor market, and land rental at the land market should all be determined through free and open competition. When factor markets are free, open, and competitive, possible deviation of factor prices from their long-term equilibrium level can be more easily corrected to prevent lingering and continuously inflating bubbles.

It becomes obvious that not only the current land system has many serious shortcomings, but also represents a dead end that prevents self-evolution in a market compatible way.

This is because it neither allows the peasants to exit from the compulsory collective land ownership, nor allows peasants to enter collectively into non-farming sectors using their land as assets. Under this land tenure system it is illegal even for the peasants to supply land collectively to urban sector on their own terms and provide housing to urban people at the market price. There is no any room for a real land market from emerging and growing. The urban areas can expanding only when the government allows, because

only the government can take farmland from peasants, and only the government can own and supply urban land. If a real land market cannot emerge, then the so-called land price and housing price cannot be the prices determined by the land supply and land demand. In order to let a true land market to emerge, the only way is to abolish it.

V. Conclusion

In summary, we can see that giving exit rights from the communal dining halls ended immediately the famine that China was still suffering in 1961 when its rural population's per capita grain consumption fell to the lowest point since 1949. The exit right also boosted the production since then. However, this exit right was limited to the communal dining halls, not the communal production itself. With this limited exit right, the famine ended, but the nationwide rampant food shortage lasted for more than 20 years until when peasants regained the right to exit from the collective production in the early 1980s. Once the exit rights from the compulsory collective production are given to peasants, both the agricultural production and productivity increased dramatically. However, the peasants are not allowed to exit from the compulsory collective land ownership. This incompleteness in the exit rights leads to all kinds of serious issues such as rural-urban income disparity, land disputes among peasants, frequent clashes and confrontations between peasants and the local governments, underground land and housing markets (housing with incomplete property rights or Xiao Chanquan Fang), greatly inflated land and housing price in urban areas, and the low capacity of urban areas to absorb rural surplus population.

From the lessons we reviewed above, a two-stage exit strategy can be designed to make the transition from current land tenure system to a market-oriented land tenure system as smooth as possible with minimum shock. First, exit rights should be given to peasants who choose to leave the collective land ownership by entitling them the full ownership of the plots that have been under their use since 1980s or since the most recent land adjustment or land reallocation. The peasants can choose to stay, but they have the full right to leave the current collective land ownership. Second, exit rights should be given to those peasants who want to further exit from the farming sector. If they choose to do so, they can sell either to other farmers for farming purpose, or to urban developers directly as long as zoning and urban planning permits.

This will allow a plural land ownership and a true competitive land market to emerge where the state-owned land, collectively owned land, and privately owned land will be competing equally at the same land market. The government monopsony and monopoly in land demand and supply, and the discrimination against the non-state owned land and non-urban land will be brought down. A unified nationwide land market will finally emerge to provide more reliable land price and housing price, which in turn provide the sound basis for land allocation across the nation, especially for sustainable and endogenous urbanization.

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