Introduction

I.1 A Market without Legal Titles?

Can a real estate market form in the absence of a supportive property law system? If so, how, and by what means does it operate? What would be the legal responses to such an extralegal market? How would the legal responses influence the evolution of the extralegal market and the underlying property arrangements?

The answer to the first question has conventionally been no. "Where do we record the relevant economic features of assets, if not in the records and titles that formal property systems provide? Where are the codes of conduct that govern the use and transfer of assets, if not in the framework of formal property systems?"[1] Hernando de Soto, by posing these rhetorical questions, implies that life in informal settlements, where formal property rights are absent, is nasty, brutish, and poor.[2] For example, according to a study on informal settlements in Lima, Peru, one adult must occupy the house twenty-four hours a day in order to prevent others from taking possession of it.[3] The presumption is that informal property rights must be uncertain and insecure, and, thus, transactions must be very limited. In de Soto's seminal works on the relationship between informal property rights and a market economy, *The Other Path* and *The Mystery of Capital*, de Soto discussed real estate transactions in seven pages in the former and not at all in the latter.[4] In the following years, most academic research has focused on calculating the value of legal titles – including topics such as how titling programs have increased tenure security, promoted investment, and

[1] Hernando de Soto (2000). *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* 46.
[2] *See* Hernando de Soto (1989). *The Other Path*, 17–57, 133–172.
[3] Winter King (2003). Illegal settlements and the impact of titling programs, 44 *Harv. Int'l L.J.* 433.
[4] De Soto, *supra* note 2, at 25, 30–33, 35, 54 (discussing illegal real estate transactions).

https://doi.org/10.1017/9781316810095.001 Published online by Cambridge University Press

increased the value of the property.[5] In "Hernando de Soto and Property in a Market Economy," a book consisting of essays by leading property law scholars, the editor writes in the introduction that,

> [I]t is important to distinguish between the two types of arguments that De Soto makes about property. *De Soto's arguments that formal property systems are* ***necessary*** *to the proper functioning of a market economy receive little, if any criticism*. In contrast, de Soto's apparent argument that property formalization is sufficient to bring the benefits of a market economy to the poor has received sustained criticism.[6] [emphasis added]

Real estate is the primary form of property and probably the most valuable asset to most individuals. Scholars assume that a real estate market cannot operate, nor even form, without property rights.[7] As a result, development scholars have seldom studied exchanges of untitled real property. To my knowledge, one significant exception is Annette M. Kim, who examines the housing market in Ho Chi Minh City, Vietnam, where the vast majority of private titles in urban areas had still not been distributed by the state.[8] Even this rare exception focuses on the value of a legal title, rather than the mechanism of property rights and market in the absence of a supportive legal system.

However, a well-functioning property law system should be the end – not the beginning – of discussions of property rights and economic development. Most developing countries are struggling to build a well-functioning property law system. Thus, it is crucial to explore how a market economy and the underlying property arrangements work in the absence, rather than the presence, of a well-functioning property law system.

[5] *See, e.g.*, Lee J. Alston, Gary D. Libecap and Robert Schneider (1996). The determinants and impact of property rights: Land titles on the Brazilian frontier, 12 *J.L. Econ & Org*. 25; Lee J. Alston, Gary D. Libecap and Robert Schneider (1995). Property rights and the preconditions for markets: The case of the Amazon frontier, 151 *J. Institutional & Theoretical Econ*. 89; Timothy Besley (1995). Property rights and investment incentives: Theory and evidence from Ghana, *J. Pol. Econ*. 903; Erica Field (2005). Property rights and investment in urban slums, 3 *J. Eur. Econ. Ass'n* 279; Erica Field (2007). Entitled to work: Urban property rights and labor supply in Peru, 122 *Q.J. Econ*. 1561; Sebastian Galiani and Ernesto Schargrodsky (2010). Property rights for the poor: Effects of Land titling, 94 *J. Pub. Econ*. 700.

[6] *Hernando de Soto and Property in a Market Economy* 2 (D. Benjamin Barros, ed.) (2010).

[7] Andrzej Rapaczynski (1996). The roles of the state and the market in establishing property rights, 10 *J. Econ. Perspectives* 87, 96–98.

[8] Annette M. Kim (2004). A market without the 'right' property rights – Ho Chi Minh City, Vietnam's newly-emerged private real estate market, 12 *Econ. Transition* 275–305.

A real estate market can form in the absence of a supportive property law system. According to the Chinese Ministry of Land and Resources, by 2007, Chinese farmers had built over 6.6 billion square meters of houses in evasion of the legal prohibition on private rural land development and transfer, resulting in a huge market of illegal houses. By way of comparison, in 2007, the total floor space of housing sold on the legal housing market was 0.76 billion square meters.[9] People in China call these illegal buildings "small-property houses" (*xiaochanquan* in Chinese)[10] because their property rights are "smaller" (weaker) than those on the urban/formal housing market, which have "big" property rights protected by the government. Shenzhen is the city with the highest ratio of small-property houses, which make up 47.57 percent of the city's total floor space, compared to 30 percent in Xi'An and 20 percent in Beijing.[11] These

[9] 小产权房存量66亿平米相当于十年房产成交量[Small-Property Houses total 6.6 Billion Square Meters, almost the same amount of Legal Housing Transactions within a Decade] www.china.com.cn/info/txt/2008-11/17/content_16779899.htm (last visited May 6, 2014).

[10] There is no general consensus on the translation. Fennel uses "small title" to describe the phenomenon; Chen use "housing with a petit title;" some others use "small property rights housing," "minor property rights," or "limited property housing." As this research shows, it is not a simple "title" problem, but a phenomenon we need to understand from the perspective of the evolution of the Chinese property system. "Property" is a more precise word than "title" because of its more encompassing meaning. People might worry about the conflation of *physical* property and property *rights* when I use "small property" as the translation. Here I refer to Alchian and Demsetz: "In its original meaning, property referred solely to a right, title, or interest, and resources could not be identified as property any more than they could be identified as right, title, or interest." Armen A. Alchian and Harold Demsetz (1973). The property right paradigm, 33 *J. Econ. Hist*. 16, 17. Under this understanding of the term "property," the word "rights" becomes superfluous. Accordingly, I use "small property" to depict the general phenomenon, and "small-property buildings," "small-property houses," or "small-property constructions" to refer to the physical constructions built under the general phenomenon. Also, "small" is more direct and neutral than "minor" or "limited." *See* Wang Lanlan, Tieshan Sun and Sheng Li, *Legal title, tenure security, and investment – An empirical study in Beijing*, HOUSING STUD.1 (2014); Li Lixing (2012). Land titling in China: Chengdu experiment and its consequences, 5 *China Econ. J*. 47; Wang Qianyi, Miao Zhang and Kee-Cheok Cheong (2014). Stakeholder perspectives of China's land consolidation program: A case study of Dongnan Village, Shandong Province, 43 *Habitat Int'l* 172; Lee Anne Fennell (2012). Options for owners and outlaws, 1 *Brigham-Kanner Prop. Rts. Conf. J*. 239; Ruoying Chen, Informal Sales of Rural Housing in China: Property, Privatization and Local Public Finance (2010) (unpublished Ph.D. dissertation, University of Chicago) (on Proquest).

[11] 宋林飞（全国政协委员、江苏省政府参事室主任）："小产权房没有转正"特区"，"人民论坛" 2012年7月4日[Song, Linfei, *No Special Economic Zone for Legalization of Small-Property Houses*, PEOPLE'S FORUM, July 4, 2012], http://theory.people.com.cn/n/2012/0704/c112851-18443279.html (last visited February 15, 2013).

illegal buildings, lacking legal titles and concentrated in 320 intracity villages, host most of the eight million migrant workers in Shenzhen and are the main livelihoods of the more than 300,000 local villagers. The market has developed in step with China's continuing struggle for a formal property regime, an effort that is still unfinished. According to an official at the Shenzhen Real Estate Ownership Registration Center, "Nobody cares whether they have legal titles or not. You say they are illegal, dare you void the contracts? You say they are legal, are you to grant them legal titles? The contracts are there – to void them, could you do that? It is a huge number of transactions – you say farmers cannot sell, it is illegal, but they do it privately with little ado. Are you to tell them whether it is legal or illegal?"[12]

The object of my study is the co-evolution of property law and norms in the formation, operation, and institutionalization of the small-property market in Shenzhen. This book is based on my eleven-month fieldwork in Shenzhen, during which I observed small-property transactions firsthand; interviewed real estate brokers, lawyers, buyers, sellers, and government officials and judges whose work was related to small-property houses; and participated in the formation of government policies addressing small-property houses. I collected government investigation reports, court files, village maps and records, transaction documents, and news reports that addressed small-property houses to further my research.

I.2 The Market: A Bird's Eye View

I.2.1 Chinese Property Law Reform and Small Property Nationwide

In the early 1980s, the communist prohibition on land alienation proved to be inadaptable to a market-oriented economy with the experimentation and implementation of the "reform and opening-up" policy under the leadership of Deng Xiaoping. This inadaptability was most acute in the urban area, where both urban construction and cooperation with foreign investors could benefit greatly from land development and transfer. As a result, in 1988, China amended both the Constitution and Land Administration Law ("LAL"), stating that use rights to both state-owned and collective-owned land could be transferred "according to law."

[12] Interview with a city government official, in Futian District of Shenzhen City (June 7, 2012).

On May 19, 1990, the State Council promulgated detailed rules governing the sales of *urban* land use rights from the government and the transfer among land users.[13]

This urban land use reform not only built the legal basis for China's urban real estate market but also made land the most important source of revenue for Chinese local governments, which can requisition rural land at compensation equal to its agricultural value and sell the same land on the urban land market at fifty times or more of that value.[14] As a result, the more the urban real estate market develops, the more unlikely it is that the central and local governments would liberalize rural land development and transfer, since this would jeopardize their monopoly over land.[15]

Unsurprisingly, the corresponding legal authorization for the transfer of rural land use rights has never been promulgated. Instead, the Chinese government made a comprehensive revision to LAL that excluded the possibility of the transfer of rural land use rights in 1998. The 1998 revision also made it clear that rural-urban land conversion could only be legally achieved through requisition by the state.[16]

However, the rural land has not been insulated from the booming urban real estate market. The boom in China's urban real estate market began in 1998, when the central government decided to replace its housing allocation system with a housing market.[17] According to official statistics, from 1998 to 2007 the annual nationwide sales of residential houses grew tenfold.[18] Under such circumstances, rural land, especially land located near urban areas, has become attractive. Therefore, local governments have great incentives to seize rural land. The general mechanism is that the government requisitions rural land, converts it to urban

[13] For the history of Chinese property law, *see* Chapter 1.

[14] Compensation for the requisitioned rural land is mainly based on its agricultural output, but the government transfers it at urban land market prices. Chinese laws do say that land requisition should be "for the need of public interest." *See* art. 10 of the Chinese Constitution and art. 42 of the Chinese Property Law. However, as rural land requisition is the main legal way to satisfy the vast need for construction land in China's urbanization process, the above public interest requirement has been essentially moot. *See* Chapter 1 for a more comprehensive explanation.

[15] *See* Chapter 1. [16] *Id.*

[17] *See* 陈杰： "中国住房事业六十年：回顾与反思" [CHEN JIE, SIX DECADES OF CHINA'S HOUSING AFFAIRS], www.chps.fudan.edu.cn/cn/content.asp?id=50 (last visited February 3, 2014).

[18] 国家统计局： "2008年二季度经济述评：市场不支持高房价" [*Economic Review of the Second Quarter of 2008: Market Does Not Support High Housing Price*, XINHUA NET], http://news.xinhuanet.com/fortune/2008-08/05/content_8974798.htm (last visited December 10, 2009).

land (thereby qualifying it for various construction purposes), and then sells it to commercial land developers. Millions of acres of rural land have been urbanized in this way in China since the 1980s, creating more than 40 million landless farmers.[19]

One way Chinese farmers have responded to this unjust law is by evading legal prohibitions on rural land development and transfer. Farmers living in the periurban[20] areas of big cities often face large incentives to transfer their houses to urban residents who cannot afford a house in the urban area. While they cannot sell houses at prices comparable to those on the formal market due to the illegality of the transfer, they can still get much more profit than they could from using the land for agricultural purposes. Their illegal transfers of land for non-agricultural uses have created a huge informal real estate market in China.

The prices of small-property apartments are significantly lower than those of legal apartments, ranging from 20 percent to 60 percent of the price.[21] For better or worse, small-property houses have become a serious option for many Chinese residents. According to an investigation in 2011, 60.3 percent of the respondents viewed small-property apartments as an option for buying a house.[22]

I.2.2 Small-Property Market in Shenzhen

Shenzhen, a city in the southern part of southern China's Guangdong Province and situated immediately north of Hong Kong, has been the literal and symbolic heart of the Chinese economic miracle.[23] In many ways, Shenzhen epitomizes China's recent economic development: It is

[19] 新华网：“委员称失地农民超4000万人 过半人生活困难”，2011年3月9日 [*A CPPCC Member Revealed that There Were over 40 Million Landless Farmers, Over Half of Them Live in Hard Times*, XINHUA NET (March 9, 2011)], http://news.qq.com/a/20110309/001085.htm (last visited February 18, 2013).

[20] "Periurban" is defined as areas where the dynamic, interactive and transformative urbanization is happening and mixed features of the rural-urban spectrum are present in the background of developing countries. *See, e.g.,* David L. Iaquinta and Axel W. Drescher, *Defining Periurban: Understanding Rural-Urban Linkages and Their Connection to Institutional Contexts* (Paper presented at the Tenth World Congress of the International Rural Sociology Association, Rio de Janeiro, August 1, 2000).

[21] REICO工作室：“我国小产权房问题研究：现状与出路” [INVESTIGATION REPORT OF SMALL-PROPERTY CONSTRUCTIONS 12–13, REICO (2012)] (on file with author).

[22] 袁业飞：“禁？放？小产权房路在何方？——聚焦走到十字路口的小产权房”，“中华建设”，2011年第5期，6–15页[Yefei Yuan, *Whither Is Small Property?*, CHINA CONSTRUCTION, 2011(5): 6–15.]

[23] *See, e.g.*, Howard W. French, Chinese Success Story Chokes on Its Own Growth, *N.Y. Times* (December 19, 2006), www.nytimes.com/2006/12/19/world/asia/19shenzhen.html.

the starting point of China's transition to a market economy, the birthplace of China's urban land-use reform and modern real estate industry, and the city with the highest ratio of small-property houses in China. It is the ideal case study of the relationship between property rights and the market economy in China.

In 1980, Deng Xiaoping, the then-supreme leader of China, designated Shenzhen – then named Bao'An and a small agricultural county – as a "special economic zone" (SEZ) for piloting market-oriented reforms.[24] Within this SEZ, investment from overseas Chinese and foreign companies would be permitted and used for urban construction.

Since the establishment of the SEZ, Shenzhen has experienced miraculous economic growth and urbanization. In 1979, the urban population in Shenzhen was no more than 30,000, and all of the remaining population of 284,100 was rural.[25] Agriculture was the county's main and nearly only industry in 1979. There was no decent public infrastructure – not even a sewage system. From 1979 to 2010, the annual average growth rate of gross domestic product ("GDP") in Shenzhen was 25.3 percent.[26] The population of Shenzhen has grown from 314,100, of whom 312,600 have local *hukou* (household registration) in 1979 to 10,372,000 in 2010, of whom only 2,510,300 have local *hukou*.[27] Shenzhen ranked fourth in GDP and first in GDP per capita among mainland Chinese cities in 2009.[28] In 2010, the GDP of Shenzhen was over 958 billion RMB (1 RMB = 0.16 USD).[29] Shenzhen has ranked first since 1993 in the total value of exports among all mainland Chinese cities.[30] Moreover, the economies of Shenzhen and Hong Kong are closely interconnected; an integration plan has even been officially proposed.[31] More than half of the foreign direct investment in Shenzhen has been from Hong Kong.[32]

[24] *See, e.g.*, 江潭瑜主编："深圳改革开放史"，人民出版社2010年版 [THE HISTORY OF REFORM AND OPENING-UP IN SHENZHEN (Jiang Tanyu, ed., 2010).]

[25] 深圳市统计局、国家统计局深圳调查队："深圳统计年鉴（2011）"，中国统计出版社[SHENZHEN STATISTICAL Y.B. 2011, STATISTICS BUREAU OF SHENZHEN CITY & SHENZHEN SURVEY OFFICE OF THE STATE STATISTICS BUREAU 4, (2011).]

[26] *Id.* at 5. [27] *Id.* at 4.

[28] 乐正主编："深圳之路"，人民出版社2010年版，第16页[ZHENG LE, THE ROAD OF SHENZHEN 16(2010)]

[29] SHENZHEN STATISTICAL Y.B. 2011, *supra* note 25, at 5. [30] Le, *supra* note 28, at 121.

[31] Vaudine England, *Mega-City Plans for Hong Kong*, BBC NEWS (September 17, 2007), http://news.bbc.co.uk/2/hi/asia-pacific/6989473.stm.

[32] In 1986, 78.86% of foreign investment in Shenzhen came from Hong Kong; 63.47% in 1988; 64.49% in 1992; 71.69% in 1998; 53.91% in 2001; 53.05% in 2005; 63.75% in 2008. SHENZHEN STATISTICAL Y.B. 2011, *supra* note 25, at 284.

Three decades ago, most of the land in Shenzhen was rural and collectively owned by the farmers of the respective villages. Urban (state-owned) land made up a little more than three square kilometers in Shenzhen in 1980. The Shenzhen government has since converted most of the rural land to urban land under its jurisdiction. Villages that used to be located on the outskirts of the city are now surrounded by urban buildings, many of which are skyscrapers. In the urbanization process, the Shenzhen government requisitioned most of the rural land (mostly farmland) and converted it to urban land, preserving only the rural land on which residential homes and village factories had been built because of the higher social and economic costs of requisitioning those plots. These remaining villages are called "intracity villages" (*chengzhongcun* in Chinese). Though located in the midst of the urban area, land in intracity villages is still rural, which makes it subject to the legal prohibition on rural land development and transfer. Among the total 1,993 square kilometers of land in Shenzhen, the government failed to convert over 300 square kilometers of rural land to urban land, on which there have been 356,852 illegally-built buildings, totaling 392 million square meters and making up 47.57 percent of the total floor space of Shenzhen (Table I.1).[33]

In the periurban area, the actual problem is not to find a small property, but to find a legal property. Small-property buildings were intended for a variety of residential and industrial uses, as well as for use as shopping malls, offices, and public facilities such as primary

Table I.1 *Illegal buildings in Shenzhen*[34]

	Number of buildings	Total floor area
Illegal Buildings	356,852	392 million
Total Buildings	620,800	824 million
Illegal Buildings (% of Total Buildings)	57.49	47.57

[33] Shenzhen City Gov., Investigation Report on Illegal Buildings in Shenzhen 26 (2010) (on file with the author).
[34] *Id.* at 11.

schools, hospitals, and even government buildings. This differs from the conventional view of informal settlements presented by de Soto and many others. In a report on small property in Shenzhen, a journalist found that even an official building of a sub-district government had no legal titles.[35] Table I.2 shows the different uses of small-property buildings the information of which has been reported to the government–that is 348,400 of the 356,852 buildings.[36]

Many of these small-property buildings are of decent quality and are not "small" at all. According to an official from the Bureau of Construction of the Shenzhen city government, "The illegal buildings built after 2000 were designed and built under professional supervision; they also used high-quality steels; the qualities of these buildings

Table I.2 *Uses of small-property buildings in Shenzhen*[37]

Uses	Number of buildings	Ratio (%)	Total floor space (millions of square meters)	Ratio (%)	Land area (millions of square meters)	Ratio (%)
Residential	234100	67.19	149	38.70	33	25.58
Industrial	83400	23.94	166	43.12	70	54.26
Commercial or Office	9400	2.70	20	5.19	12	9.30
Public Facilities	4300	1.23	6	1.56	4	3.10
Multiple Uses	10400	2.99	41	10.65	8	6.20
Other Uses	6800	1.95	3	0.78	2	1.55
Total	348400	100.00	385	100.00	129	100.00

[35] 庄浩滨："深圳违建一线报告:旧改谝生十几个亿万富翁"，《南方日报》2009年7月10日[Zhuang Haobin, *Frontier Report of Illegal Buildings in Shenzhen*, NANFANG DAILY, July 10, 2009], http://news.dayoo.com/shenzhen/200907/10/67208_9881497.htm (last visited September 10, 2013).

[36] Shenzhen City Gov., *supra* note 33, at 13. [37] *Id.* at 38.

https://doi.org/10.1017/9781316810095.001 Published online by Cambridge University Press

Table I.3 *Number of floors of small-property buildings in Shenzhen*[38]

Number of floors	Number of buildings	Ratio (%)	Total floor space (millions of square meters)	Ratio (%)	Land area (millions of square meters)	Ratio (%)
1 or unknown	94100	27.02	21	5.51	29	22.65
2–4	118600	34.03	121	31.35	53	41.35
5–6	69500	19.95	104	27.04	25	19.05
7–10	58500	16.77	94	24.54	15	11.73
11–14	5800	1.67	23	5.95	5	3.47
15 or more	1900	0.56	22	5.61	2	1.74
Total	348400	100.00	385	100.00	129	100.00

are above the median."[39] As shown in Table I.3, many small-property buildings are typically five to ten floors high. The tallest may reach fifteen floors or higher.

De Soto suggests, with no empirical backup, that both the selling and the renting of the illegal buildings would be limited because of the lack of legal titles.[40] Below, I present some statistics from the Shenzhen government to discuss the scale of the market, which is not limited to exchanges between villagers and their acquaintances.

For residential buildings, about 34 percent of the current owners were not original villagers, the only category of legal owners. For non-residential buildings, 60.75 percent of the current owners were not village co-ops, the only category of legal owners.[41] Regarding the land used for small-property buildings, for residential buildings, over 43 percent of the land had been transferred to non-villagers. For non-residential buildings, over 30 percent of the land had been transferred to non-villagers (Table I.4).[42]

The Shenzhen government also investigated small-property high-rises, buildings of fifteen floors or more that were mostly built after 2000 in

[38] Shenzhen City Government, *supra* note 33, at 70.
[39] Interview with a city government official, in Bao'An District of Shenzhen City (June 29, 2012).
[40] De Soto, *supra* note 2, at 25. [41] Shenzhen City Gov., *supra* note 33, at 66–67.
[42] *Id.*

https://doi.org/10.1017/9781316810095.001 Published online by Cambridge University Press

Table I.4 *Illegal transactions of land and buildings*[43]

	Owner	Land
Residential Buildings	34% were not original villagers	43.53% had been transferred to non-villagers
Non-Residential Buildings	60.75% were not original village co-ops	30.2% had been transferred to non-villagers

response to the high demand for residential housing in Shenzhen. The total floor area of these buildings totaled 21,598,800 square meters,[44] about one-third of the total area of legally developed residential houses for sale built in Shenzhen from 2000 to 2009.[45] The Shenzhen Urban Planning and Design Institute conducted a questionnaire survey of small-property apartments in these high-rises. Among 334 buyers, 278 used their apartments for self-living; 56 used their apartments for renting or investment.[46] Regarding the size of their apartments, 36 were less than 70 square meters; 96 were between 70 and 90 square meters; 172 were between 91 and 140 square meters, and 30 were more than 140 square meters.[47]

There is no comprehensive data available on the total number of small-property transactions, but according to a government official in Bao'An, one district of Shenzhen, the number of illegal sales of small-property apartments was about half that of sales of legal/big-property apartments (there were about 1,400,000 sales of legal apartments in 2011 in that district).[48] These transactions are not limited to villagers and their personal contacts; rather, they happen daily between strangers. Village co-ops, real estate brokers, land developers, and other stakeholders have formed a network to support this small-property market.[49] Small-property apartments can be used and rented freely, sold and mortgaged subject to some constraints, and

[43] *Id.* at 49, 65. Some sold land directly; some sold buildings and the land was not sold.
[44] *Id.* at 77.
[45] From 2000 to 2009, the official market of residential houses supplied 59,220,000 square meters of housing in total. 黄珽主编："深圳房地产年鉴（2011）"，海天出版社，第151页[SHENZHEN REAL ESTATE YEAR BOOK 2011 151 (Huang Ting, ed. 2011).].
[46] SHENZHEN URBAN PLANNING & DESIGN INSTIT., SURVEY ON UNIFIED-CONSTRUCTED BUILDINGS (2012), on file with the author.
[47] *Id.*
[48] Interview with a city government official, in Bao'An District of Shenzhen City (June 26, 2012).
[49] *See* Chapter 2 for more details.

https://doi.org/10.1017/9781316810095.001 Published online by Cambridge University Press

compensated according to comparable standards of big-property apartments when requisitioned by the government.[50]

I.3 Piercing the Market: Structure of the Book

Chapter 1 investigates the history of land use reform in China and reveals that the so-called rural land problem is the consequence of China's partial land use reform. In 1988, the Chinese government chose to conduct land use reform sequentially: first urban and then rural. It was a pragmatic move because it would focus the reform and would provoke much less resistance. A consequence was that local governments in China became the biggest beneficiary and supporter of the partial reform. However, as a beneficiary of partial reform, local governments do not necessarily support further reform because of the excessive rents available between the market of urban real estate and the government-controlled rural land system.[51] The central government, in particular its agency in charge of land administration (the former Bureau of Land Administration, which has been elevated to the Ministry of Land and Resources), also has interests embedded in this regime. In contrast, Chinese farmers and other relevant groups have no voice or power in the political process of the reform, which makes it difficult for the central government to achieve an agenda that balances the interests of all parties.

However, this is not to say that a country, even without a democratic political structure, would necessarily be trapped in the partial reform equilibrium. In the China case, Chinese farmers challenged the existing system by forming a huge small-property market, around which social groups disadvantaged by the partial reform, mainly Chinese farmers and the middle-and-low income urban population, present their interests and their capacity to counteract the goals the central and local governments hope to achieve through the existing system. This has led to adaptive policy changes. Recent news demonstrates that Chinese land reform is moving in a direction that would address Chinese farmers' concerns, though much work is still needed to unify the small-property market and the legal real estate sector.

[50] *Id.*

[51] Under the current dual land system, which is the result of this partial reform, the government can requisition rural land at compensation equal to its agricultural value (because rural land sector is not liberalized for construction or commercial uses) and sell the same land on the urban land market (which is monopolized by the government) at prices according to its construction or commercial value, which is often fifty times or higher of the agricultural value. *See* Chapter 1 for a comprehensive discussion.

Based on my fieldwork in Shenzhen, Chapter 2 presents the factual situations and mechanisms of the small-property market in Shenzhen. The main participants in the market are legitimate and include village co-ops, real estate brokers, lawyers, a local bank, and even the local government branches and agencies, which from time to time choose to acquiesce to the development of the small-property market. Although they are legitimate actors, they are not constrained by legalities. They have developed a network to support the operation of the small-property market. The formal property law has been ambiguous and subject to change and inconsistent enforcement, and, thus, it has had limited prohibitive force.

Chapter 3 models the formation and operation of the small-property market as coordination games and demonstrates that a focal point of rural land development and transfer coordinates players' expectations to converge on the same equilibrium. It investigates the historical, political, and other contextual factors that not only structure the interactions of relevant parties but also influence their expectations.

Chapter 4 focuses on the Shenzhen government's policies addressing small-property houses. To demolish them has proven an impossible mission. To legalize them would encourage more illegal buildings. I frame this small-property conundrum as an adverse possession question and resolve it by utilizing the optional law framework developed by Professor Ian Ayres. I find that in an effort to grandfather in existing small-property constructions and deter further development of small property, the Shenzhen government has spent the last three decades adopting land use policies that can be neatly categorized into the five rules of legal entitlements under the optional law framework. The only missing rule, Rule 5, also provides a solution to a certain type of cases. Evidence from my fieldwork shows that Rule 2, the liability rule in which entitlement is assigned to the government, subject to taking by residents willing to pay the government, is most successful. I make a general argument in this chapter that the allocation of initial options matters as much as the allocation of initial entitlements and that options should be granted to parties with the best information to make decisions, which in the small-property case, are the individual owners rather than the government.

Chapter 5 explores two distinct outcomes for small-property villages. Some villages successfully gain government recognition of their real estate business by making use of various government policies created in response to the widespread small-property constructions. In contrast, other villages have given up any legal dialogue with the official system and resorted mainly to bribes and even violence to maintain their

small-property business. One reason for these vastly different outcomes is the layering and fragmentation of the legal system, which makes the choice of different social control systems more nuanced than the existing theories portray. Built on a multiple-network evolution model, I investigate the three identities of village co-ops in the triple-system of social control (market, community and law) and how the three identities influence each other and the systems in which they are embedded and ultimately lead to each village's outcome.

Chapter 6 examines the Chinese judiciary's responses to small property. Despite variations across courts in different parts of the country, represented by Beijing and Shenzhen, this chapter reveals that Chinese courts share the same bottom line: make no changes to the status quo or minimize the negative impacts of illegality when it must be confirmed. This chapter supplements the argument that social norms are more responsive to social development than is the law by extending the discussion from property laws and regulations to judicial decisions. It concludes that the Chinese judiciary is reactive and responsive to social change rather than leading it. It thus represents neither a hindrance to nor engine of social change.

The last chapter concludes with a critique of the residual legal centralism embedded in the existing research on law and social norms and argues that property norms can precede property law in the context of market transition and serve as a catalyst for legal change, which would be achieved through a reconstitution of law and social norms. It also clarifies that the focus of my research is the co-evolution and interaction mechanism of property law and norms, different from de Soto's focus on the formalization of informal property systems.

I.4 Property Law and Norms in Temporality

A well-functioning property law regime, albeit beneficial to the development of a market economy, may be a long time in coming for many transitional countries. Through this original case study, I propose a theory that provides an option for transitional countries during their long march toward rule of law:

- Stage I: Property law reform trapped in partial reform equilibrium;
- Stage II: A network of institutional innovators invented a market under the focal point of market transition;
- Stage III: Pragmatic/ad hoc legal responses;

- Stage IV. Reconstitution of layered and fragmented law in local communities, which in turn can be catalyst for legal change.

This unique case study can shed some light on the evolution of property rights. In his 1967 path-breaking work *Toward a Theory of Property Rights*, Demsetz offered before-and-after snapshots of the evolution of property rights, but left the actual process that leads from one state to another as a black box.[52] The Demsetz thesis is very concise: "[P]roperty rights develop to internalize externalities when the gains of internalization become larger than the cost of internalization." This portrays the evolution of property rights as happening automatically in response to new cost-benefit possibilities, regardless of the social and political processes. This is, of course, oversimplified. Comparing to Demsetz's solo emphasis on economic constraints, Ostrom focused on the communal settings in which resources are governed.[53] In recent years, there has been increasing interest in the political process of property rights. Levmore argues that "the prevailing arrangement of property rights may be the product of politics and interest-group activity."[54] According to him, interest groups, including coordinators and beneficiaries of emerging property rights, such as entrepreneurs, play a key role in the evolutionary process of property rights. Anderson and Hill, Epstein, and Banner arrive at similar conclusions through their separate case studies.[55] Wyman emphasizes the political character of property rights by studying the case of New York taxicab medallions[56] and the evolution of individual tradable rights in US coastal fisheries.[57] China's market transition provides an opportunity to observe the co-evolution of property law and norms, which are shaped by economic constraints, communal settings, and interest group

[52] *See* Thomas W. Merill (2002). Introduction: The Demsetz Thesis and the evolution of property rights, 31 *J. Legal Stud.* S331, S336.

[53] *See* Elinor Ostrom (1990). *Governing the Commons: The Evolution of Institutions for Collective Action.*

[54] Saul Levmore (2002). Two stories about the evolution of property rights, 31 *J. Legal Stud.* S421, S427.

[55] Terry L. Anderson and Peter J. Hill (2002). Cowboys and contracts, 31 *J. Legal Stud.* 489; Richard A. Epstein (2002). The allocation of the commons: Parking on public roads, 31 *J. Legal Stud.* S515; Stuart Banner (2002). Transitions between property regimes, 31 *J. Legal Stud.* S359.

[56] Katrina M. Wyman (2013). Problematic private property: The case of New York taxicab medallions, 30 *Yale J. on Reg.* 125.

[57] Katrina M. Wyman (2005). From fur to fish: Reconsidering the evolution of private property, 80 *N.Y.U. L. Rev.* 117.

politics, calling for an integrated theory about the evolution of property rights.

Moreover, by revealing the dynamic process of the evolution of property rights in China, in particular considering the bottom-up institutional exploration, this research can contribute to resolving the so-called China problem – why China has enjoyed almost four decades of rapid economic growth with a weak legal system.[58]

Lastly, this research also has broad implications for research on law and economic development. It treats an informal (bottom-up) market economy as a positive change toward a modern market economy, not simply as an anomaly. Therefore, rather than focusing on the lack of or need for legal property rights, a focus on the mechanics of informal markets could shed light on the way forward for transitional market economies. Scholars have referred to exchanges of untitled real property in their studies of Chinese Rural Land Reform,[59] property reform in Vietnam,[60] squatters in Hong Kong,[61] the Brazilian Amazon,[62] and the US frontier history.[63] Systematic case studies of informal real estate markets around China and the world would greatly enrich our understandings of law and economic development.

[58] *See, e.g.*, Victor Nee & Sonja Opper, *Capitalism from Below: Markets and Institutional Change in China* (2012); Donald C. Clarke (2003). Economic development and the rights hypothesis: The China problem, 51 *Am. J. Comp. L.* 89; Frank K. Upham (2010). From Demsetz to Deng: Speculations on the implications of Chinese growth for law and development theory, 41 *N.Y.U. J. Int'l L. & Pol.* 551.

[59] Chen, *supra* note 10. [60] Kim, *supra* note 8.

[61] *See* Alan Smart (1986). Invisible real estate: Investigations into the squatter property market, 10 *Int'l J. Urb. & Regional Res.* 29.

[62] *See* Lee J. Alston, Gary D. Libecap and Bernardo Mueller (1991). *Titles, Conflict, and Land Use: The Development of Property Rights and Land Reform on the Brazilian Amazon Frontier*.

[63] Terry L. Anderson and P. J. Hill (1978). An American experiment in anarcho-capitalism: The not so wild, wild west, 3 *J. Libertarian Stud.* 9, 19.