

TAXATION LAW RESEARCH PROGRAMME (TLRP)
ASIAN INSTITUTE OF INTERNATIONAL FINANCIAL LAW
www.AIIFL.com
FACULTY OF LAW
THE UNIVERSITY OF HONG KONG

LAND REVENUE AND THE CHINESE DREAM

Richard Cullen

*TLRP Director and Visiting Professor
Faculty of Law, The University of Hong Kong*

TLRP Tax Comments No. 2

May 2016



© May 2016 the author. All rights reserved. Short text extracts may be quoted without explicit permission provided that full credit is given to the source.

LAND REVENUE AND THE CHINESE DREAM

Richard Cullen

ABSTRACT

President Xi, Jinping has defined the Chinese Dream as:

National rejuvenation, improvement of people's livelihoods, prosperity, construction of a better society and military strengthening.

For any Nation, if there is a serious ambition both to define a collective dream and then to work steadily towards its achievement, a crucial factor in successful implementation is soundly based, long-term, significant public funding. A strong and fair Market Economy can help move such a dream forward – but the foundations must be built by Government.

China is, potentially, particularly well placed to underpin funding of Government policies directed towards achieving the Chinese Dream using a most powerful revenue source effectively (and foolishly) long-ago discarded throughout most of the Developed World as a key source of public funding: Land Related Revenue (LRR).

I believe that the relevance of this argument is strengthened still further by the unprecedented level of urbanization now underway in China. Since the “Open Door” policy commenced over 30 years ago China’s urban population has risen by 500 million and by 2030, it is estimated that around 70% of China’s population – about 1 billion people – will be urbanized.

Moreover, China has a close at hand, tried and tested, overall, deeply successful working model to refer to. Hong Kong, now the HKSAR, has done a better job of using LRRs than any other single jurisdiction for more than 170 years.

BRIEF BIO

Richard Cullen joined the Faculty of Law, University of Hong Kong (HKU), as a Visiting Professor in August, 2006. He was previously a Professor at Monash University in Australia. He has spent around 20 years based in Hong Kong teaching and writing on Hong Kong and China. He has written and co-written several books and over 150 articles, notes and comments focussed on Tax Law, Public Law and Media Law. Richard Cullen completed his LLB at Melbourne University Law School in 1982 and his Doctorate at Osgoode Hall Law School in 1986.

THIS PUBLICATION

“Land Revenue and the Chinese Dream” was originally published in Chinese in (2014) (July & August) *China Policy Review (CPR)*, 33 & 43. This work was judged by the CPR as one of the Top 20 Economic Essays of 2014. The CPR is the monthly journal of the Mainland State Council’s Development Research Centre. The full article was also included in the 2014 Almanac of China’s Economy, an authoritative annual publication which has been recording changes in China’s national economy since 1981. A fuller, documented version of the article, entitled “Hong Kong’s Remarkable Land Revenue Regime”, was published in *The Asian Business Lawyer* in 2014, see: http://asianbusinesslawyer.korea.ac.kr/xs/index.php?mid=Archives&category=706&document_srl=979.

LAND REVENUE AND THE CHINESE DREAM¹

TABLE OF CONTENTS

- 1.0 INTRODUCTION
- 2.0 LAND, THE STATE AND THE PUBLIC INTEREST
- 3.0 LAND RELATED REVENUE: THE HONG KONG EXPERIENCE
- 4.0 MAINLAND CHINA: POLICY OPTIONS
- 5.0 CONCLUSION

¹ This article draws on and repeats arguments from other work by Richard Cullen, including “Far East Tax Policy Lessons: Good and Bad Stories from Hong Kong” (2014) 12 *eJournal of Tax Research* (forthcoming) available at: <http://www.asb.unsw.edu.au/research/publications/ejournaloftaxresearch/Pages/currentissue.aspx>

LAND REVENUE AND THE CHINESE DREAM

Richard Cullen

1.0 INTRODUCTION

The “Chinese Dream” is a term made popular – and defined - by President Xi, Jinping. President Xi began using this term widely in 2013. He has described the Chinese Dream as:

National rejuvenation, improvement of people’s livelihoods, prosperity, construction of a better society and military strengthening.

For any Nation, if there is a serious ambition both to define a collective dream and then to work steadily towards its achievement, a crucial factor in successful implementation is soundly based, significant long-term public funding. A strong and fair Market Economy can help move such a dream forward – but the foundations must be built by Government.

What I argue in this article, is that China, perhaps uniquely amongst the World’s major economies, is, potentially, particularly well placed to underpin funding of Government policies directed towards achieving the Chinese Dream using a most powerful revenue source effectively (and thoughtlessly) long-ago discarded throughout most of the Developed World as a key source of public funding: Land Related Revenue (LRR).

I believe that the relevance of this argument is strengthened still further by the unprecedented level of urbanization now underway in China. Many commentaries have taken note of this – see, for example, detailed coverage in April, 2014 in the leading economic journal, *The Economist* (“Building the Dream” and “Urbanisation: Where China’s Future will Happen”). The journal notes that since the “Open Door” policy commence over 30 years ago China’s urban population has risen by 500 million and that by 2030, it is estimated that around 70% of China’s population – about 1 billion people – will be urbanized. (A month later, in May, 2014, *The Economist* noted how, around 30 years ago, China and India had the same GDP per head; today China’s GDP per head is more than 4 times that of India (“Narendra Modi’s Amazing Victory Gives India its Best Chance Ever of Prosperity”)).

Moreover, China has a close at hand, tried and tested, overall, deeply successful working model to refer to. Hong Kong, now the HKSAR, has done a better job of using LRR than any other single jurisdiction over the last 150 years plus. LRR continues to support Hong Kong’s economic success and its low rate, simple tax system. The LRR system in Hong Kong has evolved based on practical fiscal experience, as we shall see, rather than being “book or theory” driven in its development.

There are, however, strong theoretical perspectives to back up the approach developed within Hong Kong, which are discussed in Part 2, directly below. After this, the Hong

Kong LLR experience is examined in some depth in Part 3. In Part 4, the resulting policy options for Mainland China are considered. Part 5 of this article is the Conclusion.

But before we begin this analysis, I would like to refer briefly to two recent, relevant examples from Australia.

In March, 2014, the State Government of New South Wales (NSW) announced that it was planning to sell off (absolutely) a most valuable parcel of publicly owned land on Sydney's waterfront very close to the central city. Two months earlier, in the State of Victoria, the State Government announced plans to raise up to US\$7 billion by disposing of State-owned seaport assets in Melbourne and nearby. This time, however, the State Government was *not* considering any sort of absolute sale of this real estate: only fixed term leaseholds (up to 99 years) would be sold. A Government spokesman explained that, "In 99 years, there is no way that the best use of the [Port of Melbourne] land will be as a working port. [To sell these ports outright] would be quick money now but at a massive cost to this State [long term] in terms of economic potential and liveability." This long-term thinking – up to 100 years ahead - In Victoria, is, I argue, notably more sound than the short-term, "sell, sell, sell" approach being taken in NSW.

2.0 LAND, THE STATE AND THE PUBLIC INTEREST

Henry George, the 19th century American economist and social reformer long advocated the introduction of a single tax on the unimproved value of all land to replace all other taxes. A Henry George follower Lizzie Magie, created the precursor to the board game Monopoly in 1904 to demonstrate his theories

The work of Henry George has had, over a long period, some limited influence. It has also been subject to significant criticism. Henry George's argument that land is part of the "common heritage" of humanity has a coherence which is easily overlooked, however. This is especially the case in jurisdictions where almost all land of significant economic value has effectively (and, typically, long ago) been disposed of absolutely by the State. Almost all of the Developed World falls into this category.

More recently, some Property Law theorists have argued that individual ownership of land, especially, is qualified by a powerful "social-obligation norm". This concept stresses obligations owed (by property owners) to other members of various communities. This concept can also be employed to stress that such obligations can be met by conceding rights to the State to hold a perpetual, core proprietary interest in all land for the purpose of protecting and enhancing the public interest. At a practical-political level, this is particularly so when the State has retained significant rights over most or all land in a given jurisdiction.

As it happens, Governments in numbers of developed jurisdictions, which have allowed the full or near complete alienation of surface rights of economically valuable land – particularly in urban and near-urban areas - have moved to retain ownership or economic control of sub-surface rights (mineral rights, service-tunnelling rights etc). When they do this, the justification is typically that the relevant Government is acting to preserve a common public heritage.

3.0 LAND RELATED REVENUE: THE HONG KONG EXPERIENCE

Introduction

According to conventional modern measures, Hong Kong is frequently said to have a narrow tax base. If, however, we consider the full *revenue base* of the HKSAR, the picture changes markedly. When LRR is factored in to the public revenue calculation, it turns out that Hong Kong has, in one important way, a far more broad revenue base than probably any other (non-oil-based) developed jurisdiction. Thus, in the HKSAR Forward Estimates for 2013-2014, land revenue was estimated to be 16% of total Government revenues. Such revenue has exceeded 20% of total revenues in the relatively recent past. This is essentially just the sum for land sales and lease modification premiums (see further below). It does not include Stamp Duties and the Income Taxation closely related to the real estate sector. Several decades ago direct funding from LRR sources exceeded 30% of all Government revenues.

So how has the Hong Kong Revenue Regime come to take this form?

Historical Development

At the heart of the LRR system in Hong Kong is the fact that all Hong Kong Governments since 1842 to the present day have retained a perpetual, core proprietary interest in virtually all real estate in Hong Kong. This policy emerged, initially, from practical concerns about basic public financing of the new colonial outpost (influenced by lessons learned from the, failed, British, North American colonial experience). As it proved its worth, the policy has been developed further – and has become entrenched as a key aspect of the Hong Kong Revenue Regime.

The opium-reliant revenue policies set down during the first 50 years of the British Hong Kong colonial era proved to be – more indirectly than at first expected - remarkably strong. For several decades, direct revenues from Government-licensed, opium-retailing proved to be quite disappointing. The massive growth in the opium trade strengthened the British Hong Kong economy rapidly and significantly, however. Given the very tight supply of land initially available on mountainous Hong Kong Island (Britain's first (1842) Hong Kong acquisition) this, in turn, indirectly strengthened LRR system.

Only leasehold sales (often for 99 years, sometimes longer) were allowed by the British – and the relevant leases laid down strict conditions about what could be built on the newly leased land. The result was rapidly growing revenues derived, firstly from land sales and, later, from lease modification premiums which typically had to be paid if an owner wished to upgrade or replace any building erected on their leasehold land.

The Modern Revenue Regime

The LRR system proved to be so successful that it has remained a mainstay of the Hong Kong fiscal regime to this day.

These foundations were also fundamental in allowing the colony to thrive without need to resort to any sort of direct income taxation for around 100 years – and when such taxes came (effectively in 1947, in the Inland Revenue Ordinance) they were kept low and simple. Today, about 60% of wage and salary earners (and most small businesses) are not liable to pay any direct tax on earnings in the HKSAR. Less than 2% of those liable to Salaries Tax actually pay at the maximum rate which is capped at a flat 15% of total income.

The success of this LRR system has always been driven by Hong Kong's remarkable economic success especially in trade and, until World War 1, by the trade in opium above all. Successive Hong Kong Governments have managed the system so as to maximize its revenue generating capacity. They have deliberately restricted the supply of land. They have also, historically, tightened the system so as to enhance and make still more secure, the Government core-interest in all land in Hong Kong.

This, in turn, has notably encouraged the regular *re-development* of land originally released for residential, commercial and other uses. Because of the (highly conditional) leasehold system, any such redevelopment almost always requires the redeveloper to pay the lease modification premiums noted above. These continuing premium payments are rarely modest and can be very high indeed. This aspect of the system ensures that the Government continues to collect public revenues at regular (redevelopment) intervals based on enhanced land values, indefinitely. (For example, the Hong Kong Government sold a lease to Lot 129 on the island of Ap Lei Chau (adjacent to Hong Kong Island) for industrial use in 1995 for US\$30 million. Developers bought this waterfront lease in 2005 for around \$US74 million with a view to building an up-market residential project. The Government charged approximately US\$504 million simply to modify the lease terms to allow residential use of Lot 129.)

Hong Kong's LRR played a key role in building up very significant public reserves within 50 years of the founding of British Hong Kong. Today those reserves total well in excess of US\$300 billion. Around US\$85 billion are official Fiscal Reserves available, *prima facie*, for high-priority immediate spending by the Government. These Fiscal Reserves have been used, for example, to defend the HK Dollar most successfully (in 1997-98) and to fund significant deficit budgets over several years with zero recourse to borrowing.

Another notable feature of Hong Kong's LRR is the way in which it has operated in an open way, largely free of serious corruption. Given the immense sums involved, this is an important achievement. The predominantly "clean" market-driven operation of the system has been another key to its success. A combination of factors explains this outcome. There is no space here to detail them all. In summary, the role of Hong Kong's Independent Commission Against Corruption (ICAC) has been significant. It is also the case that the system has been built so that most all stakeholders have developed a vested (financial) interest in maintaining its basic integrity. (Note: another key factor which helps maintain powerful support for the system is the *de facto* warranty

given by pre-and-post-1997 Hong Kong Governments that: (A) expiring leases will be renewed at minimal cost – provided the building-usage remains unchanged; and (B) any Government Rent charged on all leases will be maintained at a very low rate.

The ICAC was established in 1974 as a very well resourced, fully independent anti-corruption authority. As the ICAC explains:

Hong Kong was in a state of rapid change in the sixties and seventies. The massive growth in population and the fast expansion of the manufacturing industry accelerated the pace of social and economic development. The Government, while maintaining social order and delivering the bare essentials in housing and other services, was unable to satisfy the insatiable needs of the exploding population. This provided a fertile environment for the unscrupulous. In order to earn a living and secure the services which they needed, the public was forced to adopt the “backdoor route”. “Tea money”, “black money”, “hell money”- whatever the phrase - became not only well-known to many Hong Kong people, but accepted with resignation as a necessary evil.

In 2012, the HKSAR maintained its strong reputation for a low corruption jurisdiction ranking 14th in the Transparency International Corruption Perception Index, ahead of both the USA and the UK.

This comparatively low corruption environment has also been very good for doing business and for ordinary residents, simply “living life”. Business and ordinary residents are both firm supporters of the HKSAR’s low rate, minimalist Income Tax system. The second significant positive lesson which Hong Kong offers is, thus, that it is possible to maintain, in the modern era, a highly effective Revenue Regime which is minimalist, clear and easy to comply with. This second positive example depends greatly on the first policy innovation – the LRR system (although other factors also are important).

Hong Kong’s LRR system also means that the effective monopoly supplier of land, the Government, has a powerful vested interest in maintaining high land prices. Two of the most clear adverse, on-cost consequences of this are: high (often very high) entry prices to achieve any sort of home ownership; and an inflation impact on the provision of most goods and services due to the high costs of renting or buying business premises.

A major housing crisis has been avoided, though, above all by the Government building Public Rental Housing (PRH) and subsidized owner-occupied housing on a massive scale. This programme began in earnest in the mid-1950s after a major fire in a squatter settlement in Shek Kip Mei left some 50,000 people homeless in December, 1953. It gained real momentum in the early 1970s when the Government announced plans to house or re-house around 2 million people within 10 years. All these flats are small (or very small) typically providing less than 50 square metres to house a growing family. But the Housing Estates are typically well run, well maintained and generally safe for tenants of all ages.

The Hong Kong Housing Authority, created in 1972, remains the primary body responsible for running this system and for building new public housing. The total capital expenditure for the Housing Authority in the 2013-2014 financial year was US\$1.5 billion approximately. Total cash and investment reserves for the Housing Authority at the close of the same year were estimated at US\$8 billion. The total stock of existing (low

rent) PRH flats is over 760,000 – and this number is once more being added to by new PRH building . Moreover, since 1978, over 465,000 Government-subsidized flats have been sold to low and middle income households in Hong Kong. Over 50% of Hong Kong's population, thus, still lives in PRH or subsidized owner-occupied housing.

Once the Government had settled on this policy, it was able to provide all the necessary land for building without any direct acquisition costs. Moreover, the LRR system was a major factor in, initially, funding this massive new building programme (today the Housing Authority funds its own building - see above – but it relies on the Government for new land provision).

The very high densities of residential accommodation in Hong Kong (public and private) have been fostered significantly by the LRR system. By restricting land supply, the Government has husbanded its “land bank” and helped ensure the best price for all released land (and high redevelopment premiums). This system has also ensured that residents enjoy one of the very best, low cost public transit systems in the world – with the Mass Transit Railway (MTR) as its centrepiece. Moreover, communications systems are first rate and access to health, hospital, educational, recreational and shopping etc facilities are also highly regarded. A further advantage is that almost all Hong Kong residents live within a relatively short, regular-service bus ride to hillside country parks. Beaches are readily accessible, too.

The MTR system subsidizes its transport service through development rights it enjoys which are typically linked to newly built MTR lines and stations. The very high densities (and low car usage due to high garaging costs, inter alia) help build in viability for the extensive bus, mini bus and taxi networks. The Government also subsidizes all bus and taxi services through fuel excise relief mechanisms.

The lack of any need to pay direct taxation for thousands of small businesses combined with the wide availability of convenient (if cramped) low cost housing also helps to keep overall living costs affordable for average consumers – the majority of whom also pay no direct taxes, as noted above.

The success of this evolved-innovation also underpins the primary, bad aspects of the HKSAR RR, however. Two stand out. Broadly stated, these are notable revenue policy inflexibility and the high on-cost effects of the land-based, revenue system.

Briefly, habits of wariness about long-term Revenue Policy planning shared over many decades by both Government and, especially, big business and its advisors are well entrenched in the HKSAR. On the positive side, many argue with some cogency, that the long-term, “keep it simple” approach has worked so remarkably well, there is no need for complex forward planning in this area. This perspective is reinforced by the view that the time-proved, preeminent mode of planning for the future is to save with gold medal vigour, which is just what Hong Kong has always done. There is no doubt, however, that these political-economy realities have led to a notable lack, over many decades, of serious, long-term Tax Policy planning in Hong Kong.

Next, all goods and services provided in Hong Kong have a higher than usual rent-recovery component. Hong Kong has thus had, it is fair to say, a *de facto* general consumption tax particularly since World War 2, when ground rents began to fall in

significance and the up-front land premiums grew and grew as the economy (usually) boomed.

Poverty in the HKSAR

Hong Kong continues to experience major problems with poverty and income disparity. A 2012 HKSAR Government report showed that around 20% of Hong Kong people (about 1.3 million residents) lived below the new, official poverty line. By some measures, this figure has eased by a small margin in recent years – but it remains very high for a jurisdiction enjoying such a high per capita GDP (often ranked equal to the USA). The Gini-coefficient, which measures income inequality in a society (the higher the number, the greater the raw gap between rich and poor) was 0.525 in 2001, 0.533 in 2007 and 0.537 in 2011. This figure (for the HKSAR) is one of the highest in the developed world and is comparable to the wealth disparities in nations like Paraguay and Papua New Guinea. Comparable (World Bank) figures for the UK and the USA are 0.34 (2005) and 0.45 (2007), respectively.

The Residual Welfare State

Hong Kong Governments have historically been able to control expenditure quite effectively. Cultural-economic reasons provide an important part of the explanation for this. Briefly, Hong Kong people have long relied heavily on family and related networks to cope with a multitude of life's exigencies. Moreover, from the 1960s until the 1990s, Hong Kong maintained high economic growth rates sustaining full employment. Also important was the long established reluctance of the Government to introduce more comprehensive programmes to tackle endemic social justice deficiencies within Hong Kong.

This combination of factors meant that the Government was put under (and placed itself under) significantly less pressure to develop a “welfare state” of the complexity typically encountered in most other developed economies. What evolved is a system which has been aptly described as the “residual welfare state”. Hong Kong is characterized by a somewhat paradoxical combination of heavy public involvement in financing and provision of direct public goods, especially housing plus educational and health and general infrastructures - while at the same time maintaining comparatively low overall government spending (compared to revenues).

This direct provision of public goods and services – and especially low cost basic but decent housing – has significantly moderated the impact of aggregate inequality in Hong Kong. The poor who are still waiting for PRH are, without question, the most grossly disadvantaged sector of the HKSAR population, however.

4.0 MAINLAND CHINA: POLICY OPTIONS

Introduction

The discussion above has set out key aspects of the development of Hong Kong's rather usual Revenue Regime. We have also taken note of certain negative aspects of that system. Overall, the "Report Card" on this system remains remarkably positive – particularly when one compares the HK Revenue Regime to those prevailing in most of the Developed World.

In this Part, we will consider how lessons based on the Hong Kong LRR experience might be acted upon in Mainland China, especially in urban areas – as the PRC investigates how best to give real form to that Chinese Dream.

State Retention of a Core Proprietary Interest in Land – Policy Realities

We should reconsider some key elements – outside of the revenue collection system itself – which have helped ensure the remarkable success and durability of the land-based revenue regime in Hong Kong. These factors are highly relevant in terms of adapting and applying the Hong Kong LRR experience within Mainland China over the long-term and on a large scale.

The Hong Kong Government has dealt effectively with the immediate housing-crisis threat posed by such a system, particularly when it is premised on a high-density, high-price model. The massive intervention of the Government into the market through the supply of low-cost (small but decent) public housing has been vital to the success of the system. It has done this by building (and continuing to build) Public Rental Housing on a vast scale and by subsidizing the means-tested purchase of owner-occupied housing by the less-wealthy, accounting (in combination) for around 50% or all housing in Hong Kong, still.

The high density (public and private) housing model has resulted in smaller living spaces – but it has also enabled provision of world-class, low-cost public transport and communication services coupled with, usually, good-excellent access to all services, including schools/education, health care/hospitals, recreational amenities and excellent shopping facilities. This development model also facilitates easy access to extensive country parks and other green areas for residents, which is hard to find in any other city of comparable size.

Next, the model has been developed so that most all the stakeholders have come to see that they have a vested interest in maintaining the governance-integrity of the system. The very effective work of the ICAC, constantly "riding shotgun" around the system (for around four decades, now) has helped significantly in convincing players - and maintaining their perception - of this vested interest. This "must-have-stick" has been deeply supported by the "carrot" of the low rate, simple Tax System, which has significant roots in the land-based revenue regime. Within this framework, an often pulsating free market normally operates at both wholesale (developer) and retail levels – ensuring market mechanisms largely remain vital in allocating scarce land resources.

The system has been crucial in building up Hong Kong's very significant Fiscal Reserves. What is clear, however, is that these massive savings have never been allowed to become a general "Slush Fund", still less, a "Rolex Reserve Fund" – that is a fund the use of which systemically lacks transparency the better to allow industrial-scale, organized political pocket-lining.

Finally, the British had established a pattern of sound training, pay and career path opportunities for its Colonial Civil Service by the early 19th century. This policy approach served Hong Kong well from the outset. It became entrenched within the general governance systems and it now a highly valued legacy enjoyed by the HKSAR. This strategy for limiting systemic, high level (and later, all-level (with the help of the ICAC)) public corruption was maintained and continues to be maintained in Hong Kong. It is an important component in the achievement of continuing low-corruption scores for the HKSAR in international comparative studies.

State Retention of a Core Proprietary Interest in Land – Policy Possibilities

First, we should note some basic parameters and some clear human development trends. Total World population reach 7 billion in 2011. Although population growth has slowed somewhat, it is still expected to reach 8 billion by 2025 and over 9 billion by 2050. In the early 20th century, 20% of the World's population lived in urban areas. By 1990, the figure was less than 40%. By 2010, it exceeded 50%. By 2050, it is estimated that 70% of the World's population will be urbanized.

In the developed jurisdictions of the World, the opportunities to apply lessons drawn from Hong Kong are greatly limited because of the long-term transfer of land – and particularly urban land – almost entirely, prima facie, into private hands. Similar political-economy realities apply, also, in many developing jurisdictions. More often, perhaps, massive (often fundamental) legal uncertainties also apply in many developing countries with respect to the ownership of land, not least in urban areas.

These fundamental barriers to developing a strong LRR do not, however, apply in Mainland China. Since the establishment of the PRC in 1949, all ultimate ownership of land (urban and non-urban) has passed into the hands of the State – or its formal offspring (Rural Collectives, State Owned Enterprises, Municipalities, etc).

The complex tensions – and abuses of (land grabbing) power – in the PRC since the first moves to "privatize" (to a degree) land-usage rights following the commencement of Deng, Xiaoping's major economic reforms in 1978 have created immense ongoing political, social and economic problems. At the same time, new urbanization on an unprecedented scale has also been achieved and is ongoing. China had less than 11% of its population living in urban areas when the PRC was established in 1949. By the time Deng's "opening up" reforms commenced, in 1979, that figure was still under 19%. Today over 50% of all citizens live in urban areas in China and by 2030, it is expected that China may have 1 billion urban residents.

The post-Deng land reforms which have underpinned this vast shift from non-urban to (typically) high density urban living are significant in this discussion. What urban private land-holders enjoy, largely, in the PRC today, are "land use rights" nominated for periods of between 40-70 years. One pays a purchase price for these now normally transferable

rights – and mortgage purchase-loans are fundamentally secured against these rights. The State ultimately holds the core interest in the relevant land. Rights (and modes) of “lease” renewal remain less than clear.

In short, this means that in China, given the retention of the core-title by the State, there is real potential to apply much of what Hong Kong has tested and has shown to work in terms of retaining land as a fundamental and significant, long-term source of public revenue.

The catalogue of challenges facing China as it urbanizes at a rate never before seen anywhere else is formidable, however: some prime examples:

- There has been massive corruption and social disruption in the process of development-land acquisition and disposal of wholesale (especially) land-usage rights. The scope for significant levels of such corruption to persist remains very great.
- Too rapid urban growth and lack of sometimes basic urban planning have also, already, left many Chinese cities grappling with major urban, basic housing, environmental and infrastructure problems.
- China is also faced with the huge challenge of reforming the nationwide, *Hukou*, household registration system. There is wide agreement about the need for reform – not least to reduce the inequalities (burdening migrant workers and families, above all) which the system, today, amplifies. Managing this transition will be difficult – yet it has to be done. (Arguably, the *hukou* system is one reason why China has avoided the terrible massive urban-slum developments which are so evident across India where there is no nationwide system of a formal rural-anchor to moderate internal migration patterns.)

Nevertheless, albeit on a much smaller scale, Hong Kong has shown how, over time, such challenges can be overcome.

What the Hong Kong experience shows, is that for an LRR system to function with the greatest effectiveness (over the long-term) you need the following, at least:

- Government must retain a legally clear, enduring core proprietary interest in all land.
- Government should then dispose of land using a high-integrity long-term leasehold system (Government generally *should not ever dispose of land under its control to private interests absolutely*).
- Government needs to stipulate very specifically what building/usage rights are permitted in each lease – so that redevelopment, often decades later, can be approved, subject to Government drawing on new revenues resulting from agreed lease changes.

- Government also needs: to address directly (and very effectively) the inevitable, amplified need for low-cost public rental and subsidized owner-occupied housing.
- Government needs to put in place a raft of full-bodied measures to address the many civil and criminal fraud and related hazards such a system generates.

If you can put in place a robust and comprehensive governance and market framework, this sort of system works. It can deliver decent housing, potentially for all. Basic suitable housing must surely be part of any plan to allow the Chinese Dream to be shared across all segments of society. Moreover, a well designed LRR system can keep delivering significant public fiscal benefits indefinitely.

It is not hard to imagine a range of vested interests ready to voice strong opposition to such a system – not least within Mainland China. But it is worth remembering that in Hong Kong, there has never been any real outcry about this retention of core Government proprietary interests, even from very large and powerful private owner-stakeholders.

Key explanations for this private-stakeholder support would appear to be that, over time, the system has proved, if anything, ever more beneficial to private landholders in terms of gains in value (and scope to trade in land profitably), plus it has ensured the retention of a low rate, simple Tax System which finds favour across almost all interest groups

In Mainland China, there also exists a potentially very powerful “selling tool” for introducing a comprehensive LRR regime. A strongly organized, robust LRR system could be linked directly to a clear reform of the current title land-title registration. Such a reform could serve a number of worthwhile purposes, including:

- Confirm individual ownership robustly and plainly – with a clear economic benefit for each owner.
- Banks / Lenders would enjoy greater security for mortgage loans.
- The ready tracing of beneficial ownership in land would be enhanced (most useful, amongst other things, for tracking down possible corrupt accumulation of assets).

5.0 CONCLUSION

It is hard to see an alternative, better, tried and tested model, which could help cope with the consequences of the coming vast, world-wide urbanization in a more practical and humane way than the LRR system as it has evolved in Hong Kong - that is, where adopting a Hong Kong style model is still legally and politically possible.

We know the essence of the formula which has made the Hong Kong LRR system so effective, overall. Above all, Government must retain a perpetual, core proprietary interest in all land. Also Government needs to stipulate very specifically what building/usage rights are permitted in each lease. Government also needs: to address

directly (and very effectively) the inevitable, amplified need for low-cost public rental and subsidized owner-occupied housing; and to put in place a raft of full-bodied measures to address the many civil and criminal fraud and related hazards such a system generates.

The Developed World has largely lost sight of the fundamental public revenue potential of land. The primary reason for this is that the State has, long ago and almost everywhere, sold off the absolute title to all urban land and much rural land. In due course, you simply do not notice the absence of what you no longer possess. Moreover, after you move to such a stage, neither Land Tax nor Zoning Charges can, typically, do much more than raise minimal revenues. A measure of the accuracy of this view is the lack of evidence of any example using such measures, which has shown itself to be capable of producing anything like the LRR revenues enjoyed in Hong Kong, now, for around 170 years.

The relative “invisibility” of land as a fundamental source of public revenue is also evident in a recent “best seller” book on economics (and inequality), *Capital in the Twenty-First Century*, by Thomas Piketty. Briefly, Piketty argues persuasively, based on some of the most extensive relevant research ever, that private wealth typically grows at a faster rate than economic output. This helps amplify social inequalities – and social instability. Piketty’s primary solution is to strive towards the imposition of a global tax on wealth – a solution which he accepts is most difficult to implement.

Because of the “invisibility” and “too late” factors just noted, it is perhaps not surprising that another, quite hard-nosed and practical way for (fortunate) Governments to moderate inequality is not canvassed. Where a State can and does retain a core proprietorial interest in all land it will retain a significant share, held in the public interest, in the primary store of (private) wealth in a given jurisdiction – which share can be used to help address social inequalities.

China’s political history, post-1949, is what has created a striking opportunity to develop and implement a comprehensive LRR system within the PRC – based on the Hong Kong model. In this regard, Mainland China stands out, amongst all major jurisdictions, both developed and developing,

Introducing such a system in the PRC will take time, patience great political resolve - and it will be most testing. The potential rewards are very great at so many policy levels, however. Apart from the powerful pragmatic-political reasons for implementing such a policy, there are strong political and fiscal theory foundations for moving forward towards a serious LRR system, too.

China could - and should – set about building its own LRR system as part of the continuing, vast move to urban living within China - and as a key component in securing a share in the Chinese Dream for all PRC citizens. An LRR system offers a method to share the benefits of collective effort more equitably – by ensuring that the State retains, *in the public interest*, a continuing core share in the most important store of accumulated wealth: land.