

# INFORMAL RULES, TRANSACTION COSTS, AND THE FAILURE OF THE “TAKINGS” LAW IN CHINA\*

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SUMMARY: I. *Introduction*. II. *Government Takings and Transaction Costs*. III. *Informal Rules that Contribute to the Failure of the Takings Laws*. IV. *Conclusion*.

## I. INTRODUCTION

On the morning of September 15, 2003, a man named Zhu Qingliang poured a bottle of gasoline on himself and proceeded to light the gasoline on fire. Instantly, he became a massive fire ball, lighting up Beijing’s Tiananmen Square.<sup>1</sup> Zhu’s tragic demonstration was a protest against the local government, which demolished his home without giving him proper compensation. A similar case happened in Nanjing three weeks earlier. There, a man named Weng immolated himself at the local demolition and relocation office, which had forcefully evicted his family and demolished

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<sup>1</sup> Xiaomei, Yan, Anhui Qingyang Xian Nongmin Zhu Zhengliang Ze Tiananmen Zifen Diaocha (Report on Mr. Zhu’s immolation in the Tiananmen Square), Dongfang ZaoBao (*East Morning News*), September 18, 2003. available at <http://um.people.com.cn/GB/1474/2095066.html> (last visited July 22, 2005).

his home without proper compensation.<sup>2</sup> According to a report by Xie and Chen, six deaths were attributed to a single demolition project in Beijing running from January to April 2003.<sup>3</sup> On January 9, 2005, two residents in Shanghai died in a fire deliberately set by a commercial developer attempting to scare and evict residents from the building.<sup>4</sup>

These tragedies were by no means isolated incidents. At the National Conference on the Management of Urban Demolition and Relocation, the vice minister of Construction revealed that similar incidents had resulted in 26 deaths and 16 injuries from January 2002 to July 2002. From January 2002 to August 2002, the Ministry of Construction received 1,730 in-office complaints, 70% of which concerned demolitions, and 123 group petitions, 83.7% of which concerned the same.<sup>5</sup> A similar trend was reported by the State Bureau of Letters and Visits.<sup>6</sup>

The tremendous harm inflicted on private owners can be directly related to China's furious economic development. Since the 1990's, China has witnessed large-scale demolition projects aimed at making room for commercial development.<sup>7</sup> To cut costs and gain maximum returns, commercial developers have been reluctant to provide residents with com-

<sup>2</sup> Cijiang, Wang, Chengshi Chaiqian, Sifa Heyi Quewai (Urban Demolition: lack of law and order), China Net, September 22, 2003, available at <http://www.china.org.cn/chinese/law/408670.htm> (last visited July 22, 2005).

<sup>3</sup> Guangfei, Xie, and Chen, Xiaofeng, Beijing Yeman Chaiqian Shijian Diaocha (An investigation on "Savage Eviction" in Beijing), Zhongguo Jingji Shibao (*China Economic News*), November 5, 2003. Available at <http://www.china.org.cn/chinese/2003/Nov/435359.htm> (last visited July 22, 2005).

<sup>4</sup> Yang, Jinzhi, Xu Shousong, Huang Tingjun, Shanghai Dongquian Shaosi Ren Yi'an (Arson Case in Shanghai Demolition and Relocation Project). *Xinhua Net*, August 24, 2005. Available <http://news.xinhuanet.com/legal/2005-08/24/content3397043.htm> (last visited August 24, 2005).

<sup>5</sup> Liu Zhifeng Fubuzhang Ze Quanguo Chengshi Fangwu Chaiqian Gongzuo Zhuotang Hui Shang de Jianghua (vice minister of Construction Liu Zhifeng's speech at National Conference of Urban Housing Demolition and Relocation, September 3, 2002) vice minister Liu's speech was archived in the Ministry of Construction's website at <http://www.cin.gov.cn/indus/speech/2002091601.htm> (last visited July 22, 2005).

<sup>6</sup> Niu Aimin, Anhui Nongmin Tiananmen Zifen Yuanyin Chamin: Chaiqian Jiufen Yinqi (The incident of self immolation in the Tiananmen Square was caused by disputes over demolition), *China Net*, September 17, 2003. Available at <http://www.china.org.cn/chinese/2003/Sep/405803.htm> (last visited July 22, 2005).

<sup>7</sup> Ling, Zhao, Chaiqian Shinian Beixi Ju (Happy endings became tragedies over 10 years) Nanfang Zhoumo, April 14, 2004. Available at <http://house.focus.cn/fvie.wmsg/1174/11266760.html> (last visited July 22, 2005).

pensation and relocation arrangements after demolishing old houses. The tension between residents and developers has seriously affected social stability. In order to strike a balance between economic development and private property protection, the Chinese lawmakers passed several laws to regulate government takings. In March 2004, a clause was added to article 13 of the Constitution, which requires the government to compensate private owners when their properties are taken for public use. However, the wide spread misuse of “public purpose” takings and forced evictions demonstrate that the newly enacted rules have failed to protect private owners.

The objective of this paper is to analyze why the enforcement of China’s new takings laws has failed. Many Chinese scholars argue that lackluster enforcement can be remedied by a well-drafted property code. However, this paper applies the New Institutional Economics (NIE)’s theory on institutions to the enforcement failure associated with the takings law. It draws attention to informal constraints, which may be the ultimate cause of failure in enforcing China’s takings laws. Part II of this paper examines the basic theories on government takings and the NIE’s view on the relationship between formal and informal constraints. Part III provides a detailed analysis of the major informal constraints that are detrimental to the protection of private property. Finally, this paper concludes that fundamental institutional changes are needed in order to establish a functional body of property laws in China. These changes will ultimately reduce transaction costs resulting from China’s economic development.

## II. GOVERNMENT TAKINGS AND TRANSACTION COSTS

### 1. *Justifications and Limitations of Government Takings (Eminent Domain)*

“Eminent domain is the power of the sovereign to take property for ‘public use’ without the owner’s consent”.<sup>8</sup> Even though the coercive use of private property can be traced to the days of the Roman Empire, the term “eminent domain” originated from Grotius’ work *De Jure Belli*

<sup>8</sup> 1A Nichols on Eminent Domain paragraph 1.11 (Sackman, Julius L. (ed.), 3rd ed. 2004) (hereinafter Nichols).

*et Pacis* in the seventeenth century.<sup>9</sup> Grotius believed that the state possessed the power to take or destroy property for the benefit of the social unit, but the state was obligated to provide compensation to the property owner for the loss.<sup>10</sup>

The fifth amendment to the United States Constitution provides that no private property can be taken for public use without just compensation.<sup>11</sup> This clause is often referred to as the “takings clause” or “eminent domain clause”. Eminent domain proceedings require that: 1) the property be put to public use; and 2) the owner of the property be provided with just compensation.<sup>12</sup>

Property taken through eminent domain proceedings has to be for public use according to law, even though the definition of “public use” is subject to debate.<sup>13</sup> It does not mean that all for—public—use projects automatically warrant invoking the power of eminent domain. If public land is suitable for building a public school, it is not necessary to acquire private property for the same purpose. Eminent domain proceedings are often used in situations where land assembly involves a market failure on the supply side.<sup>14</sup> For example, building a highway may require several adjacent parcels of lands, which are owned by different owners. If the government had no power to take the lands coercively, it would have to negotiate with each of the owners. If a single owner refused to sell her land to the government, the whole project would have to be scrapped. This leverage enables private owners to “holdout,” thus driving prices much higher than their normal market value. This so called “holdout”

<sup>9</sup> *Ibidem*, paragraph 1.12.

<sup>10</sup> *Ibidem*, paragraph 1.12 [1]. “[T]he property of subjects is under the eminent domain of the state, So that the state or he who acts for it may use and even alienate and destroy such property, not only in the case of extreme necessity, in which even private persons have a right over the property of others, but for ends of public utility, to which ends those who founded civil society must be supposed to have intended that private ends should give way. But it is to be added that when this is done the state is bound to make good the loss to those who lose their property”.

<sup>11</sup> United States Constitution, 5th amendment.

<sup>12</sup> Miceli, Thomas J., “The Economic Approach to Law 162”, *Stanford Economics and Finance*, 2004, p. 215.

<sup>13</sup> For discussion on what constitutes “public use” or “public purpose”, see Nichols, *op. cit.*, footnote 9, paragraph 7.02 [1].

<sup>14</sup> Miceli, *op. cit.*, footnote 13, p. 216.

problem in assembling land for public projects is analogous to monopolies in antitrust law.<sup>15</sup>

Eminent domain is designed to overcome the holdout problem as a result of market failure. However, one should not assume that eminent domain is cost-free. Sometimes, eminent domain is more costly than free market exchange.<sup>16</sup> According to Merrill, the administrative costs associated with eminent domain in the United States include:<sup>17</sup>

1. Costs to lobby the legislature to grant the power of eminent domain;
2. Procedural costs required by the Fifth and Fourteenth Amendments and state laws, “include[ing] drafting and filing [] formal judicial complaint[s] and service of process on the owner;”<sup>18</sup>
3. Costs associated with professional appraisal services;
4. Costs associated with the guarantee of condemnees’ rights, including public hearings on the condemnation’s legality and the amount of compensation required; and
5. If condemnees file law suits to block the project, the costs of a lengthy lawsuit.<sup>19</sup>

To determine whether the use eminent domain power is desirable, it is necessary to weigh the administrative costs of eminent domain against the transaction costs of market exchange.

## 2. *NIE, Transaction Costs and Informal Rules*

One of the New Institutional Economics (NIE)’s primary concerns is the interplay between transaction costs and institutions.<sup>20</sup> According to North,

Institutions are the rules of the game of a society and in consequence provide the framework of incentives that shape economic, political, and

<sup>15</sup> *Idem.*

<sup>16</sup> Merrill, Thomas W., “The Economics of Public Use”, 72 *Cornell Law Review*, 61, 1986, p. 77.

<sup>17</sup> *Idem.*

<sup>18</sup> *Idem.*

<sup>19</sup> Kelo vs. New London 2005.

<sup>20</sup> Drobak, John and Nye, John, *The Frontiers of the New Institutional Economics*, San Diego, Academic Press, 1997, p. xvi.

social organization. Institutions are composed of formal rules (laws, constitutions, rules), informal constraints (conventions, codes of conduct, norms of behavior), and the effectiveness of their enforcement. Enforcement is carried out by third parties (law enforcement, social ostracism), by second parties (retaliation), or by the first party (self-imposed codes of conduct).<sup>21</sup>

Institutions, such as property rights, have a great impact on transaction costs and thus on economic performance. “There is an intimate connection between the institutions and technology employed; the efficiency of a market is directly shaped by the institutional framework”.<sup>22</sup> Well-defined property rights provide certainty and encourage individual owners to participate in market competition and secure the return of their investments. An open and competitive market as a result of well-defined property rights is a powerful force to reduce transaction costs. On the contrary, if property rights are ill-defined, or not enforceable, individuals are less likely to make efforts to pursue long-term investments.<sup>23</sup> A good example of this correlation is the experience of developing economies, which seek foreign investment. A 1997 World Bank report indicated that “countries with stable governments, predictable methods of changing laws, secure property rights, and a strong judiciary saw higher investment and growth than countries lacking these institutions”.<sup>24</sup>

For developing economies, the implication of the NIE theory is that the first step to economic growth is to establish a well-defined and enforceable property rights framework. During this process, developing economies must be fully aware that while formal rules on property rights are relatively easy to establish (chiefly through legal transplantation), informal norms that create indirect property rights protections are not. Concerning the relationship between formal and informal rules, North pointed out that even in the most developed economies, formal rules only account for a small portion of the constraints.<sup>25</sup> On the other hand, informal rules play an important role in shaping the general climate in

<sup>21</sup> C. North, Douglass, Prologue, *See, Drobak, op. cit.*, footnote 21, p. 6.

<sup>22</sup> *Idem.*

<sup>23</sup> *See, Randall Peerenboom, China’s Long March toward Rule of Law, 453, United Kingdom, Cambridge University Press, 2002.*

<sup>24</sup> *Ibidem*, p. 450.

<sup>25</sup> C. North, Douglass, *Institutions, Institutional Change, and Economic Performance*, 45, Cambridge, New York, Cambridge University Press, 1990, p. 36.

which property rights are enforced. North further observed that “[t]he informal constraints that are culturally derived will not change immediately in reaction to changes in the formal rules. As a result, the tension between altered formal rules and the persisting informal constraints produces outcomes that have important implications for the way economies change”.<sup>26</sup> Therefore, the effectiveness of property rights protections depends not only on well-defined legal rules, but also on informal rules that either constrain or motivate behavior.<sup>27</sup>

Therefore, the task to build a functional system of property rights in China is an arduous one. Formal property laws, such as constitutional provisions and property codes, may be easy to enact, but informal rules are far beyond the lawmakers’ control. The deep-rooted bias against private ownership, a weak judiciary, the unrestricted powers of the government and widespread corruption problems are among the various informal constraints that render formal rules unenforceable. Part III of this paper identifies several informal constraints that are harmful to the protection of private property rights in the process of massive government takings.

### III. INFORMAL RULES THAT CONTRIBUTE TO THE FAILURE OF THE TAKINGS LAWS

#### 1. *Misuse of “Public Purpose”*

In 2004, a new clause was imbedded in article 13 of the Constitution of China. According to this new clause, private property may be expropriated or taken by the state, but the taking has to be for public use and with compensation.<sup>28</sup> This amendment became instant good news to residents who were struggling to keep their houses or wanted fair compensation. There were reports that residents posted copies of the new constitu-

<sup>26</sup> *Ibidem*, p. 45.

<sup>27</sup> Alston, Gary D., Lee J., Libecap, and Mueller Bernardo, “Violence and the Development” of Property Rights to Land in the Brazilian Amazon, in Drobak and Nye (ed.), *op. cit.*, footnote 21.

<sup>28</sup> Article 13 of the Constitution of China (Amended as of 2004) states: The lawful private property of citizens may not be encroached upon. By law, the state protects citizens’ rights to own private property and the rights to inherit private property.

tional clause on their front doors to defend their homes. However, the principle that the amendment set forth met harsh reality. Despite the amendment, developers carried out demolitions for commercial development as previously planned. Neither the People's Congress nor the Supreme People's Court issued any interpretations on the meaning of "public use". As a result, local governments simply took advantage of their inherent powers to over-stretch the scope of "public use". Chinese scholars analogized the term "public use" to a big "basket", into which local governments threw every conceivable project.<sup>29</sup> The reasons for the misuse of the "public purpose" are as follows:

### A. *GRC Doctrine*

In the 1990's, some coastal cities created the *GRC doctrine* (*Zhengfu Jingying Chengshi*), which means government officials run a municipality in the same way a CEO runs a large for-profit corporation. The major purpose of those cities was to attract foreign investment and increase local GDP. In those cities, the governments sold urban land-use rights, together with utility supplies and infrastructures to foreign investors. The proceeds from land sales became the major source of revenue in those coastal cities. To maintain a competitive edge, these cities sold to foreign investors the lands in the best locations with built-in utility lines and access to highways. In most cases, the best locations were in downtown residential areas. To make the land readily available, cities carried out massive demolition and relocation. In order to maximize gains from the land sales, cities often lowered compensation standards and shortened the time period for residents to seek remedies either through petition or litigation. At the same time, cities carried out public campaigns to persuade residents to make personal sacrifices in support of the city's decision to revitalize the local economy.

Since the end of 1990's, cities have become accustomed to selling the best locations to foreign investors and other commercial developers.

<sup>29</sup> Linxing, Zhu, Qieshi Guifan Jiti Tudi Zhengshou Zhengyong Zhidu (Ways to improve land acquisition system), Ribao, Jiefang, *Liberation Daily*, January 24, 2005. Available at <http://www.jfdaily.com.cn/gb/node2/node4086/node6038/userobjectai78651.htm> and <http://www.jfdaily.com.cn/gob/node2/node4074/node4086/node6038/userobject-lai780651.htm> (last visited July 23, 2005).

The *GRC* doctrine is widely adopted among local leaders throughout the country. The major reason is that selling land to commercial developers is the most expedient way to increase local GDP. In recent years, local GDP has become an overwhelming standard for assessing the ability of the local officials. Under the centralized system, the appointment to key posts of local officials is decided by the government at the higher level rather than by local constituencies. Consequently, the basic criteria for reappointment or promotion is how well the local officials could implement high orders from the top, not how well they served the local people. As a result, local governments have put sole emphasis on economic growth and paid less attention to social issues, such as forced evictions.<sup>30</sup> In addition to selling land for commercial development, local leaders found that engaging “showcase projects” or “legacy projects” (*Xingxiang Gongcheng*), such as building gigantic squares and widening streets can also bring their cities to the national spotlight. All these showcase projects involve either massive demolition of residential houses or the imposition of heavy taxes on urban residents.<sup>31</sup>

What happened in Jiahe illustrates how a local government can aggressively engage in a demolition and relocation under the guise of a “public project”. The Jiahe incident was the first reported case after the

<sup>30</sup> See, Liu, Chenglin, *Chinese Law on SASRS*. (New York: Hein Co. 2004). When SARS broke out, the local governments’ first reaction was to assess how the disease would affect the image of the local region and hurt the local economy. During the news conference, Guangdong health officials told the reporters that three hundred and five SARS cases were not too many so they did not think it was necessary to release the information. Apparently, the dollar value that the local government put on people’s health was far less than that of the protection of local image and economic growth. Solving social problems that concern the local people most, such as increasing input to health care system, upgrading medical facilities, and improving networks for screening infectious disease, is unlikely to get officials the credits for promotion or reappointment, because the results of those efforts are intangible in economic sense.

<sup>31</sup> Guanzuo, Sui, Liaoning Pinkun Xian 800 Wan Xiu Huaohua Guangchang Yangbuqi Caoping Gaizhong Xiaomai (An undeveloped county spent RMB 8 million building a luxury square), Beijing Qingnian Bao (*Beijing Youth Daily*), September 8, 2004. Available at <http://www.china.org.cn/chinese/2004/Sep/654970.htm> (last visited July 23, 2005). In order to build a showcase, a poor county in Liaoning province invested RMB 8 million to build a huge square in the center of the city. When the square was finished, there was no fund left for planning grass. So the county leaders decided to grow wheat in stead in the Square. To build the square, a People’s Liberation Army memorial site was demolished and relocated to the suburban area.

urgent notice was issued. Despite the strict rules placed on the national media,<sup>32</sup> some devoted journalists made great efforts conducting investigations into the Jiahe Case.<sup>33</sup> A series of investigative reports were circulated on the Internet and national newspapers.

In 2004, the Jiahe County Government decided to build the Pearl Spring Commercial Mall (the Pearl Spring) in the center of the downtown area in order to attract investment and improve local economy. With the government's full support, an overseas company obtained the no-bid contract at a surprisingly low price-RMB 30 per square meter.<sup>34</sup> The whole project covered 120,000 square meters in an area, where more than 7,000 residents lived in 1,100 residential units.<sup>35</sup> Since the total population in Jiahe city proper was around 30,000, 25% of the city residents were affected by the project.

Cheap land deals do not necessarily satiate developers' greediness. Once it comes to demolition, relocation and compensation, the developers are extremely tightfisted. In Jiahe, the developer's registered capital was only RMB 10 million, while the required budget of the project was well over RMB 1 billion.<sup>36</sup> The inadequate funding for the project meant that it was impossible for the developer to properly compensate the affected residents. The County Government was fully aware of the diffi-

<sup>32</sup> The first intensive investigation of this case was released by Chinese Central TV. Other news outlets reprint this report and conducted their own investigations. *Sina.com* and *Sohu*, the two prominent websites created their special editions report Jiahe case. See generally, <http://news.sina.com.cn/z/hnjiahe/index.shtml> China official postal also has a compilation of news sources "Facing Demolition" <http://www.china.org.cn/chinese/zhuanti/dhcq/417954.htm>

<sup>33</sup> *Idem*.

<sup>34</sup> China Central TV: Hunan Jiahe Chaiqian Diaocha 2: Yin Yang Hetong (Investigation report on demolition and relocation in Jiahe, Hunan Province 2: *Yin Yang Contract*), May 14, 2004. Available at <http://news.sina.com.cn/c/2004-05-14/112032286.shtml> (last visit February 3). (Hereafter "*Yin Yang Contract*").

<sup>35</sup> China Central TV: Hunan Jiahe Chaiqian Diaocha: Chaiqian Nenggou Zhulian Jiuzu ma? (Investigation report on demolition and relocation in Jiahe, Hunan Province: Shared liability among family members?), May 14, 2004. Available at <http://news.sina.com.cn/c/2004-05-14/11113228504.shtml> (last visit February 3, 2005) (Hereafter "shared liability").

<sup>36</sup> Zeng Pengyu, Hunan Jiahe Beibu Chaiqian Hu Huode Guojia Peichang Meiren Yue RMB 1700 (Condemnees who were arrested during demolition received state compensation in the amount of RMB 1,700/per person), Beijing Qingnian Bao (Beijing Youth Daily), June 28, 2004. Available at <http://news.sohu.com/2004/06/02/28/news220352857.shtml> (last visited July 23, 2005).

culties it would face in carrying out the demolition and relocation work. Therefore, the government utilized all powers at its disposal, to clear the way for commercial development.

After selling the land, the Jiahe county government launched a series of propaganda campaigns. Red banners flew over the major streets saying, “Those who are against the Pearl Spring project for a few days will be affected by the county government for a life time”.<sup>37</sup> During a county-wide meeting, the secretary of the political and legal committee shouted that those who were against the project were counter-revolutionaries,<sup>38</sup> a radical term used in the Cultural Revolution in 1996.<sup>39</sup> By referring to the radical terms, the county leader tried turn compensation disputes into a political issue. All residents affected by the project had to sacrifice personal interests for the “common good” of the county.

On August 7, 2003, the Jiahe County Communist Party Commission and People’s Government jointly issued a normative document Jie Ban (2003) notice number 136 (Notice 136). Notice 136 required that all county employees make four guarantees:

1. To persuade family members (family members includes extended family members)<sup>40</sup> to accept the official appraisal within the time limit;
2. To persuade family members to sign the demolition, relocation and compensation agreements;
3. To persuade family members to hand in all necessary housing certificates and assist with relocation;
4. To prevent family members from obstructing the demolition process, participating in class action suits, or filing petitions with the governments at the higher levels.

For those who failed to fulfill the above guarantees, their jobs and salaries were to be suspended. Employees who did not prevent their rela-

<sup>37</sup> See Jiehe Investigation, *op. cit.* footnote 33.

<sup>38</sup> *Idem.*

<sup>39</sup> In Cultural Revolution era (1966-1976), “counter-revolutionary” was the most threatening term. Persons who were officially put into that category were facing public humiliation, torture, and labor camps. Their family members were socially isolated by the community. Around 30 million “counter-revolutionaries” died during the Cultural Revolution.

<sup>40</sup> See Jiahe Investigation, *op. cit.* footnote 33.

tives from obstructing demolition and relocation projects were to be dismissed or sent to remote areas to work.<sup>41</sup>

Even though the Notice was nonsensical, officials in Jiahe faithfully enforced the Notice. Some 160 county employees were officially notified to guarantee their relatives to move out of the demolition zone within the time limit set by the government. A number of employees were either dismissed or transferred to the countryside for failing to persuade their family members in this way. As a result of such practices, on the same day two sisters divorced their husbands in protest. Their father owned a four-story building along the busiest street in Jiahe but which was designated within the demolition zone. Due to its ideal location, Mr. Li turned the first floor into profitable shops. Not satisfied with the low compensation given him, Mr. Li refused to sign the deal and vacate the building. Because both his daughters' husbands were county employees they were obligated to guarantee their father-in-law to move out of the demolition zone. The sisters hoped that their divorces would save their husbands' jobs. However, the divorce strategy did not work. Further, because the sisters were English teachers they were also considered county employees. Soon after their divorces, the sisters were notified that they were to be transferred to schools in remote areas. The government believed that the two sisters deserved demotions because they had set bad examples by deliberately avoiding their responsibility to facilitate the Pearl Spring project.

In addition, the county government mobilized a large number of police force and judicial officers to deal with the "holdouts". On April 24, 2004, when the government carried out a forced eviction, an old couple stood on the roof and refused to move. The couple was arrested by Jiahe Police on the charges of resisting official eviction and disturbing public order. The couple was held in prison for 17 days until the State Council Investigation Team intervened. However, the county police refused to admit any misconduct.<sup>42</sup>

<sup>41</sup> *Idem.*

<sup>42</sup> See Zeng, *op. cit.*, footnote 37. Under pressure from the national media and the Central Government, the Police released Mr. Li and his wife and paid RMB 1,700 per person as compensation for emotional distress.

## B. *Unenforceable Zoning Law*

Among other factors, an unenforceable zoning law is attributed to local officials having the unlimited power to authorize massive demolition and relocation projects.<sup>43</sup> The Urban Zoning Law (UZL) was passed in 1989 and took effect in 1990. The objective of the UZL is to rationalize limited land resources in urban areas. The law requires that the State Council draw a plan for national land use and local governments draw respective plans for local development. According to the UZL, a local land-use plan is subject to two levels of approval. First the plan should be submitted to the local people's congress for approval. Second, the local government should send the plan to the government at the higher level for approval. Large cities with a population of over ten million should submit their land-use plans to the State Council. The reporting and approval requirement is used to institute a system of checks and balances. However, the system fails to achieve its intended result, mostly because the law does not specify legal liabilities for those government officials who fail to observe city planning. Furthermore, because China does not have a separation of powers, the local people's congress is a branch of government, rather than an independent political entity, which is vested with the power to exercise effective supervision over the government.

Consequently, like any other laws that were designed to impose constraints on government, the UZL became unenforceable as soon as it was promulgated. A high official from the Ministry of Construction admitted, "Some cities do not have a zoning plan, or if there is one, it is not enforced at all. In those cities, normative documents from the local government take precedence over zoning plans".<sup>44</sup> In April 1999, in an effort to enforce the UZL, the State Council promulgated the Outline of National Land Use Plan (1997-2010) (the "Outline"), which set land use quotas

<sup>43</sup> Chaiqian Jiufen Benke Bimian Chengshi Guihua Ying Zhuzhong Baohu Gongquan (Disputes over demolition is avoidable if urban zoning plan embraces public input) *Zhongguo Gongshang Shibao* (China Industry and Commerce Daily), November 16, 2004. Available at <http://www.bjhouse.com/xwpd/dczx/200411695404.htm> (last visited July 23, 2005).

<sup>44</sup> Fu Bochang, Jianshe Bu Zhuzai Si Fu Si Zhang Jiedu Chengshi Fangwu Chaiqian Guiju (Official of the Construction Ministry explains rules on demolition), *Renmin Ribao People's Daily*, July 23, 2004. Available at <http://big5.china.com.cn/chinese/2004/Jul/617397.htm> (last visited July 23, 2005).

for local governments. However, the Outline has been largely ignored by local governments. Some wealthy provinces used land quotas at an enormous speed. By 2004, Shandong province had used up to 80% of its land quotas. Jiangsu province used almost its entire quota six years ahead of schedule.<sup>45</sup> Some Chinese scholars observe that city planning is like a scribble on local leader's drawing board it can be easily changed according to city leaders' preferences.<sup>46</sup>

Without taking the zoning law into consideration and being accountable to the local Congress, local leaders have the freedom to authorize new development projects at will. As previously discussed, in order to be promoted or reappointed, local leaders are eager to engage so called "showcase" or "legacy" projects. Because it is considered politically unwise to continue a predecessor's project, most projects start when a new leader takes office and end when he leaves office. As a result, city development is often in the state of uncertainty. Even though the 2001 Regulations provide that the Demolition Bureaus abide by local city planning and applicants submit zoning certificates among other documents in order to obtain a demolition license,<sup>47</sup> both the Demolition Bureau and applicants do not take this provision seriously. It takes only a special note or phone call from high officials to set aside this requirement.<sup>48</sup>

The following case illustrates how volatile a zoning plan can be in a well-developed metropolitan area.<sup>49</sup> On March 26, 2005, 80 owners of an apartment complex in Wuhan, the capital of Hubei province, suddenly received an eviction notice stating that their apartment building was in the redevelopment zone and would be demolished. The owners were shocked by the eviction order because the building was recently built in 2002. All the owners had official documents to prove their ownership,

<sup>45</sup> Wang Libin, Tudi Guihua Geng zhe "Shui" Ze Zou? (Forces behind zoning plan), Xinhua Net, May 12, 2004. Available at [http://news.xinhuanet.com/house/2004-05/12/content\\_1464972.htm](http://news.xinhuanet.com/house/2004-05/12/content_1464972.htm) (last visited July 23, 2005).

<sup>46</sup> Zhang Qinhu, Zhongguo Tudifa Caozuo Shiwu (Di er ban) (Practical Manual of China Land Law, 2nd edition). Law Press China, 2004, p. 194.

<sup>47</sup> 2001 Regulations, article 7.

<sup>48</sup> Wang Cailiang, Fangwu Chaiqian Jiufen Jiaodian Shiyi (Guide to Solving Disputes Over Urban Housing Demolition) (Beijing: Falu Chuben She, *Law Press China*, 2004), pp. 18-19.

<sup>49</sup> Xifang Queyao Chaiqian! (Demolishing New Houses!) Xinlang Wuhan Fangchan (Xinlang Wuhan Real Estate), April 19, 2005. Available at <http://wh.house.sina.com.cn/sye/fcbgt/2005-04-19/15098181.html> (last visited July 23, 2005).

which included the building authorization certificate issued by the City Zoning Office. The owners did not receive any information about the rezoning until they noticed an eviction order posted on their front doors.

### C. Corruption

Bribes from land sale deals account for the major source of corruption, which is a widespread problem in China. The estimated loss of revenue from the nationwide sale of state owned lands reaches hundreds of billions of RMB each year.<sup>50</sup> In recent years, foreign countries have become a safe haven for Chinese corrupt officials. The exact number of the officials who fled with state money overseas is not clear. In 2004, the Ministry of Public Security estimated that some 500 corrupt officials had fled China with state property totally approximately RMB 70 billion (USD 8.45 billion).<sup>51</sup>

The close relationship between commercial developers and government officials is an open secret. While there is no clear indicator of whether developers or government officials are first to reach out to the other, one thing is certain, developers cannot make a profit without the government support. The local government is the sole entity entrusted to manage and sell state-owned land. The local government has the power to promulgate and enforce city zoning plans and approve urban construction. If the construction involves demolition and relocation, the developers need to seek approval from the government. The government also decides how the developers compensate residents and adjudicate disputes between them. Finally the government has the power to authorize forced eviction. However, this does not mean that developers have nothing to offer to the government. Under the current political system, local officials are appointed by the government at the higher levels. The officials are evaluated on how well they promote the local economy.<sup>52</sup> In order to pursue higher growth, local leaders have made great efforts turning old

<sup>50</sup> *Idem*.

<sup>51</sup> Woguo Muqian Waitao Jingji Fanzui Xianyi Ren 500 Duo, She'an Jin'e 700 Yi (China currently has 500 suspects fleeing abroad with RMB 70 billion) Renming Ribao, *People's Daily*, September 10, 2004. Available at [http://news.xinhuanet.com/fortune/2004-09/10/content\\_1964988.htm](http://news.xinhuanet.com/fortune/2004-09/10/content_1964988.htm) (last visited July 22, 2005).

<sup>52</sup> Daniel C. K., Chow, *The Legal System of the People's Republic of China in a Nutshell* (St. Paul: Thomson West, 2003) p. 439.

city districts into shopping malls and drawing foreign investments.<sup>53</sup> Commercial developers are essential to the carrying-out of leaders' political ambitions. Close relationships between local leaders and commercial developers are mutually beneficial.<sup>54</sup> Without a system of checks and balances, these kinds of relationships are tainted with corruption.<sup>55</sup> Developers offer huge gifts to local officials in order to purchase land at extremely low prices and gain government's full backing for forced eviction.

## 2. *Lack of Compensation*

Grossly inadequate compensation was the major source of confrontation between developers and residents. Having realized this problem, the Ministry of Construction issued the Guiding Opinions on the Appraisal of Urban Housing Demolition (the "Opinions") on December 1, 2003, which took effect on January 1, 2004. The Opinions set forth detailed guidelines on the procedure to conduct appraisal of urban housing.

### A. *Government Price Listing vs. Market Value*

The major difference that the opinions have made is that all demolition appraisals will be based on the market value of affected houses, rather than the replacement value at the time the houses were built. While this change has been hailed as a fundamental step towards fair compensation, the opinions fail to take the opportunity to clarify this market value oriented approach. Instead, the opinions lay out two parallel benchmarks for appraisal—the prices annually announced by the government and the prices indicated by the real estate market. As to which benchmark carries more weight and how to deal with situations where a considerable discrepancy between the two benchmark prices occurs, the Opinions offer no guidance. Scholars have questioned the credibility of

<sup>53</sup> For detail discussion about legacy projects, see Xingxiang Gongcheng Baihuai Xingxiang (Legacy projects smeared image), Xinhua Net, July 14, 2004. Available at [http://news.xinhuanet.com/form/2004-07/14/content\\_1596024.htm](http://news.xinhuanet.com/form/2004-07/14/content_1596024.htm) (last visited July 23, 2005).

<sup>54</sup> See Zhang, *op. cit.*, footnote 47, p. 51.

<sup>55</sup> *Idem.*

the official prices announced by the government.<sup>56</sup> It is not a novel requirement that governments publish housing market prices. Article 32 of the Law on the Management of Urban Real Estate in the PRC (1994) (the “Urban Real Estate Law”) provides that housing replacement prices be published periodically. However, local governments do not take this provision seriously. In Mr. Weng’s case, the only available government price listing, on which the compensation was based, was outdated by five years.<sup>57</sup> It is doubtful that the local governments will be able to keep up with the volatile real estate market.

According to experts, a list of market prices of urban housing is more complex to compile than the replacement value list mandated by the 1994 Urban Real Estate Law.<sup>58</sup> While the easier one has not been kept up, it is unrealistic to expect that the complex list could be compiled objectively and timely. In addition, who should be responsible for the financial cost of the compilation? Furthermore, the Opinions were promulgated by the Ministry of Construction, which is at the same administrative rank with local governments. As a result, the effectiveness of the requirement for publishing housing prices is largely undercut because the local governments often ignore the administrative orders from the Ministries.

Taking one step back, suppose that the local governments overcome all the hurdles and publish the price list of urban housing annually, questions still remain. If there is a housing market free from government interference, it is meaningless to maintain a government price list independent of the data from the market. Fair market value should be “the amount of money which a purchaser willing, but not obligated, to buy the property would pay to an owner willing, but obligated, to sell it,” taking into consideration other factors.<sup>59</sup> Therefore, the information should

<sup>56</sup> See Wang, *op. cit.*, footnote 49, p. 69.

<sup>57</sup> Yang Jiang, Yieman Chaiqian Niangcheng Canhuo, Nanjing Chaiqian Hu “Zi-fen” Shijian (Salvage demolition caused deadly incident: a condemnee set himself on fire). Dahe Bao, *Big River Daily*, September 1, 2003. Available at <http://news.sina.com.cn/w/2003-09-01/0601666041s.shtml> (last visited July 22, 2005).

<sup>58</sup> Yang, Jinsong, Tiantao Chengshi Fangwu Chaiqian Buchang Jiage Chaozuo Moshi (Study on an operational models of urban housing demolition appraisal). Zhongguo Fangdichan Pinggu Shi (Journal of China Real Estate Appraisers), March 19, 2004. (Analyzing what constitute real estate market prices).

<sup>59</sup> See, Nichols, *op. cit.*, footnote 9, at 12.02, 1, 12-60 to 12-67. “Fair market value” means the amount of money which a purchaser willing, but not obligated, to buy the pro-

come from the market place, not from the government. In practice, the opinions give the local government too much leeway to manipulate the market price in favor of the developers.<sup>60</sup> The provision mandating government price lists reflects the notion that the law makers are still under the shadow of a planned economy. One expert accurately pointed out that the government price listings have substantially suppressed the appraisers' most important function as determiners of market price. As their hands are tied by the official price listings, the appraisers' job is reduced to simply applying predefined formulas and benchmark prices in calculating compensations.<sup>61</sup> Experts have even raised questions over the legitimate need for the appraisal profession.<sup>62</sup>

### B. *Biased Appraisers*

Besides the problems caused by government price listings, the impartiality of the appraisers has also been called into question.<sup>63</sup> According to the Opinions, the selection of an appraisal firm is either through residential voting or by drawing lots. This provision seems to warrant an open and transparent environment in appraiser selection. However, the Opinions also provide that choices can only be made among the appraisers recommended by the City or County real estate bureaus. The bureaus' endorsement is crucial for the appraisal firms to stay in business. In order to be on the list, appraisal firms are vying for the favor of the bureaus, which also authorize condemnations. Consequently, no matter how open the selection process is, the end result will not ensure the impartiality of the appraisers. The reason is that the appraisers are suscepti-

erty would pay to an owner willing, but obligated, to sell it, taking into consideration all uses for which the land was suited and might be applied.

<sup>60</sup> See A-3 in this paper for the reasons why the local governments tend to side with developers and developers.

<sup>61</sup> Yang, Jinsong, Tiantao Chengshi Fangwu Chaiqian Buchang Jiage Chaozuo Moshi (Study on an operational models of urban housing demolition appraisal). Zhongguo Fangdichan Pinggu Shi, *Journal of China Real Estate Appraisers*, March 19, 2004. (Analyzing what constitute real estate market prices).

<sup>62</sup> *Idem.*

<sup>63</sup> Da, Wang, Chengshi Fangwu Chaiqian Gujia Wenti Tiansou (A study on urban housing demolition appraisal). Zhongguo Fangdichan Pinggu Shi, *Journal of China Real Estate Appraisers*, August 4, 2004.

ble to the pressure inserted by the real estate bureaus and the developers.<sup>64</sup> In addition, since demolitions are usually carried out in large scales,<sup>65</sup> it would be nearly impossible to have effective communication among residents. In China, concerted efforts to protect private properties are rare. Individual residents are reluctant to rally neighbors to conduct background checks of the listed firms. The final choice of appraisers will be invariably favorable to the developers.

The impartiality of appraisers is also affected by the lack of an effective review process. According to the Opinions, unsatisfied residents can appeal the appraisal results up to two times. The first review is conducted by the original firm or a new firm. The final review is conducted by expert committee. However, the Opinions are not clear about the composition of the expert committees. From the wording of the Opinions, the expert committees are *ad hoc* in nature. The committees consist of appraisers, who hold full time appointments in the government. Therefore, the independence of the expert committees is not guaranteed.

The problem has further been exacerbated by the lack of serious legal liabilities for appraiser misconduct.<sup>66</sup> As stated in the previous section, in relation to other rules and regulations, legal sanctions offered by the Opinions are extremely lenient. For example, if an appraiser is found to have conspired with developers with intent to cause damage to the resi-

<sup>64</sup> *Idem.*

<sup>65</sup> Guo, Zhongkui, Nie, Qibo and Li, Guoqing, Lun Fangwu Chaiqian de Shichang Jiage Pinggu Fangfa (Comments on the methods in defining market value in urban housing demolition appraisal) (*Journal of China Real Estate Appraisers*), August 4, 2004. For example, in 2003, there were 115 projects involving 179 square meters, 24,000 households in Nanjing.

<sup>66</sup> In the last section, the Opinions lay out liabilities for appraisal firms or appraisers. The punishable acts include: issuing false appraisal reports, conspiring with developer causing damage to residents, obtaining appraisal projects by illegal means (such as offering kickbacks), allowing others to engage in demolition appraisal projects using their names, transferring appraisal projects to others under disguise, or repeatedly being reviewed and found incorrect or in violation of the Standards of Real Estate Appraisal and other regulations. However, the Opinions do not prescribe corresponding legal responsibilities for each of the above acts. Instead, the Opinions refer to other laws and regulations: the Regulations on the Management of Urban Housing Real Estate Agents (2001), the Measures on the Management of the Registration of Real Estate Appraisers (2001), and the Criminal Law (1996). Because the wording of the Opinions does not exactly square with the relevant clauses in other laws, it is disappointing that the liabilities for illegal acts in the Opinions are not clear.

dents, the appraiser is fined less than RMB 30,000 (USD 3,600). This small amount of fines cannot serve as a deterrent, as appraisers can receive much higher commissions from massive demolition projects, which usually involve hundreds of millions of RMB.

### 3. *Lack of Due Process*

#### A. *Short Notice*

After granting demolition, the Demolition Bureau is required to make a public announcement of its decision regarding the name of the licensed developer, and the scope and duration of the demolition. In addition, the Demolition Bureau and the licensed developer are obligated to inform affected residents of the demolition project and offer an explanation of the nature of the project.<sup>67</sup> The purpose of this provision is to increase transparency and reduce confusion and confrontation. However, this requirement is rather a recommendation than a legal provision, because there is no legal penalty if a Demolition Bureau or a demolition unit fails to do so.<sup>68</sup> Among the local rules enacted to implement the Regulations, very few require the time period of the announcement. The Nanjing rules provide that upon receiving a license for demolition, the demolition unit should publicly announce the decision to the affected region 30 days before carrying out the demolition.<sup>69</sup>

In practice, the requirement for communicating with residents is largely ignored by many Demolition Bureaus and developers. For developers, it is crucial to keep the announcement period as short as possible. The reason is that a longer period will enable residents to communicate with each other and to take collective action against the project, which increases costs. Consequently, cases, such as that which happened in Tianjin, are not uncommon. After returning from a vacation in April 2004, a man named Mr. Wang was surprised to see that his Tianjin neighborhood, where he owned one of the 2,000 residential units, had been leveled to ground. He could not even identify where his house for-

<sup>67</sup> 2001 Regulations, article 8.

<sup>68</sup> See chapter 4 of the 2001 Regulations.

<sup>69</sup> See article 8, Nanjing Chengshi Fangwu Chaiqian Guanli Tiaoli (Nanjing Rules on Urban Housing Demolition and Relocations).

merly was. According to a former neighbor, the Court posted an eviction order on the front door of Mr. Wang's house on April 16, 2004. The next day, the house was completely demolished. In the same neighborhood, a Mr. Zhang had no chance to remove his belongings before his house was demolished. Mr. Zhang's family had to live in public baths, schools, and even on the streets. Some demolitions were even more dramatic. After sending his daughter to school in the morning, Mr. Chen found his house flattened in the afternoon. His belongings and cash had also disappeared.<sup>70</sup>

### B. *Forced Agreements*

After being granted a license for demolition, the next step for the developer is to enter agreements with residents on the way and amount of compensation, place of relocation, duration of relocation, and transitional period.<sup>71</sup> According to article 16 of the Regulations, the Demolition Bureau is the only entity that may arbitrate disputes between residents and developers with regard to compensation and resettlement. Most residents distrust the Demolition Bureau as an impartial arbitrator. The obvious reason is that the Demolition Bureau has already examined and approved the compensation standard and resettlement plan in the process of granting the demolition license to the developer. It is unlikely that the Demolition Bureau would rule against its own decision. In addition, as a regular department, the Demolition Bureau leaders are beholden to the government for their appointments and promotions. It is impossible for the Demolition Bureau to be immune from external interferences, especially from government officials who have close ties with developers. According to a 2001 survey conducted by a Chinese scholar in five cities, the odds of a resident winning an arbitration adjudicated by a Demolition Bureau was 1 in 37.<sup>72</sup>

In order to restore public trust in the Demolition Bureau and maintain social stability, the Ministry of Construction enacted the "Administrative

<sup>70</sup> Xingling, Li, Qiangzhi ChaiQian Fangzhu Jing Buzhi (Forced eviction carried out without owners' notice) Zhongguo Qinan Bao, *China Youth Daily*, May 14, 2004. Available at <http://zqb.cyol.com/gb/zqb/2004-05/14/content869728.htm> (last visit February 1, 2005).

<sup>71</sup> 2001 Regulations, article 13.

<sup>72</sup> See Wang, *supra* note 49, p. 100.

Arbitration Procedure for Adjudicating Disputes Arising from Urban Housing Demolition (Arbitration Procedure)",<sup>73</sup> which took effect on March 1, 2004. The Arbitration Procedure spells out new requirements in the arbitration process. For example, a public hearing should be held if a large proportion of residents refuse to agree with a compensation package,<sup>74</sup> and developers are forbidden to enforce eviction orders by cutting water and electricity.<sup>75</sup> However, there are no new measures in the procedure to guarantee the impartiality of the Demolition Bureau, which is the key for rendering a fair decision. Therefore, the Arbitration Procedure has not substantially altered the imbalance between private owners and commercial development.<sup>76</sup> The chances of a resident winning arbitration before the Demolition Bureau remains slim.

### *C. Forced Eviction*

To residents, losing to developers in Demolition Bureau arbitration is disastrous. Even though residents may choose other channels to challenge a Demolition Bureau's arbitration decision, they have to deal with an immediate forced eviction by the winning developer with the Demolition Bureau's backing, or sometimes even with judicial force. According to article 16,2 of the Regulations, if either of the two parties is not satisfied with the Demolition Bureau's decision, the unsatisfied party (in almost all cases the unsatisfied party is the resident) may appeal the Demolition Bureau's decision to the People's Court. However, the Demolition Bureau's decision is enforceable while the case is pending before the Court.<sup>77</sup> This means that even if residents win their case in the Court, their only remedy is monetary damages. Regardless of whether the de-

<sup>73</sup> Chengshi Fangwu Chaiqian Xingzheng Caijue Gongcheng, Promulgated by the Ministry of Construction on December 30, 2003. The act took effect on March 1, 2004 (hereafter "arbitration procedure").

<sup>74</sup> *Ibidem*, article 7.

<sup>75</sup> *Ibidem*, article 24.

<sup>76</sup> Tang Yan, Chaiqian Xu Pingheng Siren yu Gonggong Liyi Chaiqian Zhengdi Jidai Lifa (It is necessary to strike balance between private property and public interests in the process of demolition. Law on condemnation and land acquisition are needed). *Zhongguo Qingnian Bao, China Youth Daily*, January 12, 2004. Available at <http://www.china.com.cn/chinese/zhuanti/dhcq/478124.htm> (last visited July 23, 2005).

<sup>77</sup> 2001 Regulations, article 16 (2).

molition project is for a real public purpose, or for commercial development, injunctive relief has never been an option.

During executing forced eviction orders, cutting off water and electricity, verbally threatening, physically assaulting residents, and sending thieves around to break into homes are among various means utilized by condemnors to drive residents away. Violence eviction (also called savage eviction) has deeply affected people's life and resulted in social unease. A chilling news report regarding how a family was forcefully evicted published in the *China Economic News*<sup>78</sup> and subsequently was reprinted in other news sources across China. At midnight on September 19, 2003, five people smashed windows and broke into Mr. Wang's apartment. The men brandished large sticks, using a torch to blind Wang's eyes and asking the family not to make any noise. Wang, his wife and their nine year old son were forced to the ground. After badly beating the family, the men tied up their legs and hands, put blindfolds on their eyes, gagged them with cloth, and threw them outside. A few minutes later, some 20 to 30 men showed up to the building with a huge bulldozer. While Wang and his family were lying on the ground terrified in the chilly night, his apartment building was leveled to the ground. The group of men left the scene quickly. Wang and his family were finally rescued by a garbage collector. After sending his son to a relative's house, Wang called the police. To his surprise, the police would not confirm that this was even a crime. Strangely enough, this happened only 300 meters away from the district government and police station in Haidian, a northwest district of Beijing.

#### D. *Lack of Remedies*

Facing a forced eviction order, residents have two channels to challenge it within three months after receiving the order.<sup>79</sup> The first is to file a petition with the government for administrative reconsideration of the order. If residents are not satisfied with the result of administrative consideration, they can appeal the case to the government at the higher level

<sup>78</sup> Wang Xiaoxia, Huanyi Baoli Chaiqian, Beijing Yi Jumin Zao Kunbang Mengmian Fangwu Beichai (Suspected violent eviction, after a resident in Beijing was tied up and blindfolded, his house was demolished). *Zhongguo Jingji Shibao*, *China Economic News*, September 24, 2003.

<sup>79</sup> See arbitration procedure, *op. cit.*, footnote 74, article 16.

for further administrative reconsideration or to the Court for administrative adjudication. The other is to take the case directly to the Court.<sup>80</sup> If residents are not satisfied with the Court's decision, they may appeal the case to the Court at the higher level. Whether residents can receive fair reconsideration or adjudication for their cases depends on whether the administrative review board or Court is independent and competent. Because administrative law in China is a new area, in which much work needs to be done, winning an administrative reconsideration or litigation is extremely difficult.

Administrative reconsideration is carried out within the government structure. The purpose of administrative reconsideration is "to prevent or rectify illegal or inappropriate administrative actions and safeguard citizens, legal persons, and other organizations' lawful interests".<sup>81</sup> However, administrative reconsideration has not proved an effective means for residents to challenge forced eviction orders for two reasons. First, the ARL does not require that an independent review body be set up to handle administrative reconsideration cases. As a result, the responsible entity for reviewing Demolition Bureau's decisions is usually a part of the land administration bureau, which oversees the Demolition Bureau. Because of close relations between the review entity and the Demolition Bureau, it is impossible to ensure objectiveness in the reconsideration process. Second, the ARL requires that only concrete administrative act be reviewable. Residents have no way to challenge abstract acts, such as the legality of local regulations, rules and measures on which the forced eviction order was based. As a result, frustrated residents have rarely taken their cases to the government for administrative reconsideration.

As administrative reconsideration is unlikely to offer adequate remedies, those determined to challenge an eviction order must pursue administrative litigation in the courts. However, due to various constraints, the courts are not immune from the influences of government officials on behalf of developers or from developers themselves. Under the centralized system, the courts in China are not an independent entity. Rather, they are integral parts of the governments, which are accountable to the corresponding levels of governments. The courts are beholden to governments for funding and basic facilities such as court buildings, computers

<sup>80</sup> See the Administrative Reconsideration Law (ARL) (1990), articles 15 and 16.

<sup>81</sup> *Ibidem*, article 1.

and other necessities.<sup>82</sup> Judges are elected by the corresponding people's congresses, which, in fact, are controlled by the local party committees and governments. Judges do not enjoy life tenures and are treated the same as other government officials, who are elected or appointed to their posts for five years but may be reappointed for an additional term. Further, judges in the lower courts are often recent law school graduates, largely directed and influenced by the higher level courts. Therefore, judges are susceptible to various influences from party and government officials. Because commercial developments are directly beneficial to a local leader's political future and personal gain, they utilize all disposable powers to clear the way for commercial development. For example, in the Jiahe incident,<sup>83</sup> the county government instructed the county court to send over 200 judicial policemen to enforce eviction orders.<sup>84</sup> In addition, lower courts are subject to directions from higher courts. In 2003, the Guangxi High People's Court Guangxi Supreme Court issued an internal circular (also referred as the number 180 document) requiring local courts not to take-on a series of sensitive cases. The number 180 document listed 13 types of sensitive cases that could cause class action lawsuits and social instability. Cases involving demolition and relocations were third on the list.<sup>85</sup> As a result of the weak position of the judicial system in the overall government structure, the effectiveness of seeking relief through administrative litigation is very limited.<sup>86</sup>

According to the ALL, the courts can only review the legality of concrete acts preformed by governmental agencies.<sup>87</sup> Courts have no power

<sup>82</sup> Li Fujin, Ma Liping, Guanyu Dui "Renmin Fayuan Zuzhi Fa" Xiugai de Jidian Sikao (Several thoughts on the reform of the law of PRC courts) <http://www.dffy.com/faxuejieti/zh/200311/20031118152714.htm> (last visited July 23, 2005).

<sup>83</sup> For details of Jiahe incident, see II, B-1 in this paper.

<sup>84</sup> Wang bin, Fayuan Bu Ying Chengwei Chaiqian de Maqianzu (Court should not be involved in illegal demolition). Zhongguo Jingji Shibao, *China Economic Times*, December 22, 2004. Available at [http://news.xinhuanet.com/house/2004-12/22/content\\_2365597.htm](http://news.xinhuanet.com/house/2004-12/22/content_2365597.htm) (last visited July 23, 2005).

<sup>85</sup> Luo Changping, Guangxin Fayuan Xiawen Bu Shouli 13 Lei An'jian (Guangxi high court required lower courts not to accept 13 types of cases), Xin Jing Bao, *New Beijing News*, August 12, 2004. Available at <http://www.china.org.cn/chinese/law/633142.htm> (last visited July 23, 2005).

<sup>86</sup> See, Peerenboom, *op. cit.*, footnote 24, p. 420.

<sup>87</sup> ALL, article 11.

to review the appropriateness of an act.<sup>88</sup> The law also provides that courts should not review general legislation, such as administrative regulations, rules, and measures.<sup>89</sup> In addition, orders targeting indefinite groups or individuals are not reviewable. The narrow scope of the ALL substantially discourages aggrieved residents to challenge local normative documents, which are inconsistent with national laws. This limited scope allows governments the vast discretion to craft local rules to set compensation and resettlement standards below market value.

#### IV. CONCLUSION

##### 1. *Transaction Costs*

Private housing owners and commercial developers came into existence at about the same time the land and housing reforms began in China. They were intended results perceived by the reformers. For the government, housing reforms significantly relieved its burden for providing public housing to urban residents. For residents, it was an opportunity to own a home, a dream quietly cherished by generations of Chinese. For developers, the reforms created an unprecedented opportunity to profit from construction projects. However, the seemingly win-win-win scenario soon met harsh reality. Only a few years into the reforms, new homeowners found that their properties were obstructions in the way of commercial development. In the unbalanced tug-of-war between individual homeowners and deep-pocketed developers, the government sided with the latter by changing zoning plans to fit commercial development, authorizing forced evictions, deploying judicial police to execute eviction orders, lowering compensation standards, instructing courts not to hear cases involving demolitions, blocking class actions, etcetera. Chinese scholars pointed out that “the government has inappropriately become both a player and referee at the same time”.<sup>90</sup>

<sup>88</sup> *Idem.*

<sup>89</sup> *Idem.*

<sup>90</sup> Zhang Hui, Chaiqian Biancheng Raomin Gongcheng, Zhengfu Ying Zhuaxin Danghao “Caipan Yuan” (Demolition infringed upon private property rights. Government should offer protection), Beijing Wan Bao, *Beijing Evening News*, April 2, 2004.

The rationale for local government giving commercial development full support is invariably to reduce “transaction costs”, increase local Gross Domestic Product (GDP), and improve local image. Because transaction costs are often narrowly construed as the sheer costs for developers, the value of private property is left out of the equation. In the absence of a system of enforceable property rights, powerless private owners are unfairly forced to bear the cost of economic development. This is similar to the situation where a local government relies on the revenues generated by heavy polluting industries, thus creating environmental costs.

What constitutes transaction costs for economic development? The analysis in part III of this paper shows that the lack of protection for private property rights results in several indirect transaction costs. The first cost is a loss of confidence by residents towards the government. Without strictly enforced zoning plans and public consultations, virtually all residential houses are at risk of being demolished for commercial development. Even developers themselves are at risk of losing their investments if one day a more well-connected and powerful developer enters the market to exercise eminent domain power. Lack of certainty and predictability will discourage long-term investment and eventually hinder economic development.

The second cost is the loss of *momentum* for building property law. Building property rights is a systematic process. While legislative activities are important, it is more important to create a climate in which property rights are well-respected. “For a new property to exist, the owner must possess ‘the consent of fellow men to allow him to act in a particular way. An owner expects the community to prevent others from interfering with his actions, provided that these actions are not prohibited in the specification of his rights’”.<sup>91</sup> When a local government arbitrarily permits forced evictions for commercial development, it sets a bad precedent, and has chilling effect on property ownership. It will take a long time and extra effort to restore the social environment for property protection.

The third cost is the negative impact on law enforcement in general. Without public representation and consultation, the decisions to grant demo-

Available at <http://news.xinhuanet.com/news.xinhuanet.com/nwecenter/2004-04/02/content1398552.htm> (last visited July 23, 2005).

<sup>91</sup> Jean Ensminger, “Changing Property Rights: Reconciling Formal and Informal Rights to Land in Africa”, in Drobak, *op. cit.*, footnote 21, p. 168.

lition licenses and forced eviction orders are often made in secrecy. As a result, the enforcement of those orders has met furious resistance from property owners. The disrespect of government action and police power has a spill-over effect, which has made normal law enforcement more costly.<sup>92</sup>

The fourth cost is the enlarged gap created between the rich and poor as result of demolition projects. Development projects often take place in the center of downtown areas which are heavily occupied by low-income residents. These so called “golden spots” offer employment opportunities to residents, especially laid-off workers. Residents often turn their apartments into street-side shops to make a living. However, when these buildings are demolished, the owners are only compensated under the reduced residential price, rather than the commercial business price. This is a major source of confrontation between residents and developers. The new development actually further marginalizes those disadvantaged groups. The enlarged gap between the rich and poor has given rise to a host of social problems.

If the above factors are counted as transaction costs and reflected in the government’s decision making process, the developers are likely to find that it is more costly to evoke the power of eminent domain than to negotiate with owners on a consensus basis and purchase land-use rights from the open market.

## *2. Informal Constraints*

Based on New Institutional Economics (NIE), property rights are viewed as institutions, which are composed of formal rules, informal constraints and enforcement characteristics. In most of the cases, the three elements of the institutions are not compatible with each other. As doctor

<sup>92</sup> For example, on July 1, 2005, fourteen law enforcement officers in Chongqing were burnt in a clash with the occupants of a temporary building in the demolition process. Seven of the officers were in critical conditions. Unlike other demolitions for commercial development, this action was for clearing the road blocked by the temporary building. The occupants illegally erected the building on a sidewalk and refused to move. After several notices, the government issued forced eviction order. See Liu Zhan, Chongqing 14 ming zhifa renyuan chaiqian shi beiren yinran qiyou shaoshang (14 law enforcement officers were burned in the process of demolition), Zhongguo Guangbo Wang, *China Broadcasting Net*, July 1, 2005. Available at <http://www.china.org.cn/chinase/law/904368.htm> (last visited July 23, 2005).

North observed, “[w]hile the formal institutions may be altered by fiat, the informal institutions are not amenable to deliberate short run change and the enforcement characteristics are only very imperfectly subject to deliberate control”.<sup>93</sup> Therefore, a mere enactment of property law is unlikely to be sufficient to offer adequate protection for private property rights. As analyzed in this paper, the challenges facing the lawmakers in China are not only how to formulate property rules, but, more importantly, how to respond to and eventually alter the informal constraints that are hostile to weak property owners.

While it is not perfectly clear about how informal rules work in a formal context, they do impose severe constraints on the ability to effectuate changes. North and Thomas pointed out that “[p]roperty rights are always embedded in the institutional structure of a society, and the creation of new property rights, demands new institutional arrangements to define and specify the way by which economic units can cooperate and compete”.<sup>94</sup> In order to reduce transaction costs in the development process and make property rules effective, the following changes of informal rules are necessary. First, the government’s discretion in altering zoning plans and authorizing takings must be restrained. This can be done by increasing local congress’s involvement and requiring public hearings. Second, without independent appraisal, it is impossible to ensure just compensation. Therefore, the ties between appraisal firms and developers must be cut off. In order to do so, unethical appraisers must be held accountable. Legal liability must be increased to deter false appraisals. Third, the state should make efforts to promote judicial independence, which is essential for limiting the opportunities for government to abuse its powers.

<sup>93</sup> North, Douglass, C., *Understanding the Process of Economic Change*, 157, Princeton, Princeton University Press, 2005.

<sup>94</sup> Ensminger, see Drobak, *op. cit.*, footnote 21, p. 167.