



# China Property Markets Scorecard

# Conditions for Small Businesses



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# Introduction

Property rights are among the most fundamental principles enshrined in Article 17 of the United Nations' Universal Declaration of Human Rights and constitutionally protected in most states. Despite this worldwide legal recognition of the importance of property rights to building peaceful, democratic, and prosperous societies, access to and protection of property rights vary greatly in practice. What is more, in many countries understanding of property rights often remains limited to property titles, without deeper appreciation of the underlying and interconnected institutions that make property rights meaningful and allow property markets to function.

The International Property Markets Scorecard is a tool jointly developed by the Center for International Private Enterprise (CIPE) and the International Real Property Foundation (IRPF) in order to map the institutional components of property markets and evaluate their effectiveness. The Scorecard provides a methodology for property market system analysis to investigate the six core elements necessary for sustainable property market development – property rights laws and enforcement, access to credit by small businesses, efficiency of governance, rational dispute resolution, financial transparency, and appropriate regulations.

This approach not only illustrates the linkages between property market elements but also helps identify gaps where some of those important institutions remain weak, either due to lack of proper legal and regulatory framework or its weak implementation. Such gaps represent key areas that countries should prioritize when considering reforms to strengthen institutions that support healthy and inclusive property markets.

In China, CIPE and the Unirule Institute of Economics have been working together to use the Scorecard methodology to examine the strength of urban, commercial property markets in two major cities and highlight barriers that small businesses face, with the particular focus on property rights and access to credit. Similar efforts by CIPE and local partners are also taking place in Armenia, Kenya, the Philippines and Russia.

The Scorecard consists of two major levels of inquiry – desktop or secondary research and field assessments of actual property market conditions. Desk research is conducted using established indexes from multilateral development agencies such as the World Bank and the World Economic Forum as well as other publicly available sources. To maintain consistency and comparability the desk research remains consistent across each country. Given the unique character and background of each country, field assessments are more flexible.

Unirule tailored the fieldwork in China through a mix of focus groups and interviews to obtain the most accurate snapshot of the conditions entrepreneurs face in dealing with the government, banks, and professional services providers in the property sector. Although necessarily subjective, these views from small businesses have a unique power to illustrate key problem areas in property markets precisely because of the real, personal experiences they reflect. The result presented here is a report that explains and supplements the Scorecard findings, and provides reform recommendations.

# Section 1

# Country Context

China's economy has been liberalized to a notable degree since the late 1970s. Liberalization started with the introduction of economic reform in 1978 when China began to move toward greater openness and market orientation. Since then annual growth in Gross Domestic Product (GDP) has averaged 9.7 percent, leading to a more than 12-fold increase in real GDP per capita. Recently, China has become the world's second largest economy in terms of the size of its GDP.

## *Selective Move toward Private Enterprise and Private Property*

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China's economic "miracle" took place in an environment in which private ownership was essentially banned by the 1954 Chinese Constitution. Private companies began to emerge after passage of the 1982 Constitution that opened the path to limited private sector activity by allowing creation of private commercial companies employing up to seven people. Private enterprises with more than seven employees were allowed in 1988. Only with the constitutional reform of 1999 did private enterprise become fully recognized by an amendment to the Constitution as being a part of the "socialist market economy." However, discrimination against private ownership remains in the newest 2004 amendment of the Constitution, which states that China is still in the initial stage of socialism and that public ownership shall remain dominant while diverse ownership forms develop side-by-side.

At the same time, the 2004 amendment included a significantly improved provision protecting private property, stating that "legally obtained private property of the citizens shall not be violated."<sup>1</sup> The 2007 Property Law further provides for the equal protection of the property rights of the state, collectives, and private persons. It defines these property rights and rights derived from them, which is an important step toward property rights protection. Yet, state-owned enterprises (SOEs) remain favored. They are exempted from the Anti-monopoly Law that came into effect in 2008. Article 7 of that Law mandates that the state protect the lawful

economic activities of state-owned industries occupying a controlling economic position in the vital sectors of the national economy, or those related to national security. This in effect preserves state-owned monopolies in a wide variety of industries.

Another limitation of private property rights in China is the fact that private persons cannot legally own land. According to the Constitution, land in cities is owned by the state while land in the rural and suburban areas is mainly owned by collectives. Rural collectives are not allowed to transfer land ownership to other collectives or individuals. They can only transfer the land ownership to the state, with the local municipal government purchasing land as a monopoly and turning it over to a state ownership. Only the urban government is allowed to further transfer as a monopoly the related land use rights under a system of tenders, auctions and listing of land use rights. After that land use rights are transferrable among various actors in Chinese property markets, rather than true property rights. As a result, no organization or individual may appropriate, buy, sell, or transfer land in other ways.

What is more, the state may in the "public interest," which is often broadly defined by municipal governments, and in accordance with the provisions of laws and regulations, expropriate or requisition land for its use. Compensation is required but the adequacy of its amount often comes into question.

## *Property Right Violations as the Number One Concern*

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The government controls and selectively applies property rights protections in China. Accordingly, property right violations are pervasive. They include direct interference such as renationalization of private property, unjustified land taking, improper compensation for land takings and property demolitions, as well as price ceilings and size ceilings for housing properties. There are also indirect pressures on property owners

and private enterprises, such as heavy tax and fee burdens, administrative monopolies in major industrial sectors, government investments that crowd out private investments, state dominance in the banking and security market that restricts private enterprises' access to credit and securities issuance, and interest rate ceilings.

Those factors are compounded by inconsistent economic policy, inflation, and corruption. This dirigisme system, where the government exerts strong direct control over the economy, slows China's progress in

developing a market economy and free enterprise system.

In recent years, land-related disputes and resistance have become the number one source of social instability in China. Land takings and property demolitions continue to take place often without due process and proper compensation. In effect the government controls both the supply and the demand in property markets. Among enterprises, small businesses are especially vulnerable to government discretion and property market violations.

## Section 2

# Urban Commercial Property Markets

According to Chinese statistics, the investment in urban real estate development has risen steadily since 2001. It reached 4,825.94 billion yuan, or 17 percent of the total fixed asset investment in 2010.<sup>2</sup> The GDP of the real estate sector was 2,231.6 billion yuan, or 5.5 percent of the total GDP in 2010. The sales of commercial properties (i.e. properties developed by real estate developers and sold by them at market prices) have risen rapidly from 224.1 million square meters in 2001 to 1.05 billion square meters in 2010. The property market also drives the development of dozens of related industries and especially the land market in China. According to the data from the most recent China Statistical Yearbook, the building industry alone made up 6.6 percent of the total GDP in 2010.

### *Contribution to Government Revenue and Employment*

The real estate sector is one of the largest contributors to government revenue in China. Major tax revenues collected from the real estate market, such as urban land use tax, land appreciation tax, property tax, deed tax, business tax, real estate corporate income tax, and personal income tax relating to property transfer totaled 694.3 billion yuan in 2009, or 11 percent of the total tax revenue in China.<sup>3</sup> In addition, there are over 60 taxes and fees relating to the real estate sector. According to the Ministry of Finance, the land transfer revenue totaled 1,500 billion yuan in 2009. Put together, it is estimated that land transfer revenue, tax revenue, and fees collected by the government on average make up

around 49.2 percent of property prices in China. In Shanghai, Beijing, and Guangzhou, that share of property prices equaled 65 percent, 48 percent and 47 percent, respectively, in 2010.<sup>4</sup>

Accordingly, the number of employers, employees, and self-employed individuals directly involved in property markets is huge. According to statistics, there were 2.12 million people working in state, collectively-owned, and other real estate development companies in urban areas in 2010.<sup>5</sup> One should also keep in mind, however, the huge number of individual households in industry and commerce and private enterprises which are not included in the above mentioned employment number because they are not categorized as belonging to the real estate sector.<sup>6</sup> Given that fact, an equal if not greater number of people are employed in registered individual households and private enterprises that provide services to the real estate market. Although no hard numbers exist, a similar number of persons are estimated to be informal business service providers in the urban real estate sector.

The real estate sector has an enormous impact on the development and prospects of the private sector in general. Companies in every sector have to own or rent properties and the cost of owning or using commercial space is often a significant part of the total cost of running small businesses. Secure ownership, or use rights, of properties is therefore extremely important but still remains a problem, especially for many small businesses in China. Actors on both the supply and demand side

of the property market often engage in informal activities, regardless of whether they are registered or unregistered entities. This happens partly because of the heavy tax and fee burdens in Chinese property markets, as illustrated above.

## *Cities Studied*

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To support the findings from the desktop Scorecard study and to expand upon them, Unirule conducted field surveys in two select cities. The first city was Beijing, the national capital. It had a per capita GDP of 75,943 RMB in 2010 and falls into the high income category among Chinese provinces.<sup>7</sup> Beijing is among the cities that have achieved the best development and protection of the local property market due to the central authority's desire to showcase the most positive side of its regime.

The second city selected was Nanchang, the capital of Jiangxi province. It represents the average level of development and protection of the local property market among Chinese provincial capitals. The GDP of Jiangxi province falls into the low category (21,253 RMB in 2010) among China's 31 provinces.<sup>8</sup> However, Nanchang's per capita GDP and per capita real estate development investment was 43,700 and 4,582.4 RMB respectively in 2010, both ranking 14th among 31 Chinese provincial capitals (including Beijing, and excluding Tibet because of the lack of data).

## *Key Problems Faced by Small Businesses*

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Although most of them came to existence only in the last two decades, small businesses are increasingly important to the Chinese economy. In 2007, small and medium-sized enterprises (SMEs) accounted for more than 99 percent of all enterprises in China, generated at least 60 percent of the country's GDP, and created more than 82 percent of jobs. Among SMEs, small businesses accounted for 98 percent of all enterprises, generated nearly 24 percent of total earnings, and created 51 percent of employment.<sup>9</sup> While the definition of a small business varies by industry,<sup>10</sup> the focus of this report generally has been on businesses employing 50 people or fewer.

Small businesses in China face many problems in relation to property markets. First, they have difficulties with financing and refinancing property purchases and are not able to lease land under the current system of tenders, auctions, and listing of land use rights. The supply of leasable land is too limited, and the amount of funds needed for

leasing becomes larger and larger due to the urban property boom in recent years, not only in Beijing but also in smaller cities.<sup>11</sup> Even large real estate developers have to cooperate in co-financing a plot of leasable land because of high prices.

The government's tighter control of credit policy also makes access to loans for small businesses even more difficult. The requirement of prepaying 70 percent of the land lease fee after reaching the land lease deal makes the situation of small businesses much worse.

Small businesses face other challenges as well. For example, the government has recently abolished a policy that allowed for the sale of real estate prior to construction – a policy that was beneficial for purchasers because the properties sold in that way were cheaper than already built ones. It was also good for small businesses in real estate development since they received funding before construction.

Additionally, small companies' interest as property renters is currently inadequately protected. For instance, in land takings, the government provides insufficient protection for renters regarding the loss of value of their equipment and investment in immovable property. According to current government regulations, city governments negotiate only with owners. When tenants have to move to another location because of a land taking, some commercial equipment (including showcases and machines) loses value and the tenant receives insufficient compensation or none at all. Another example is that a notice period given by owners or primary renters is often too short so companies that are primary or secondary renters do not have sufficient time to find new suitable locations. They also have to pay new market rental prices for their newly rented business properties, which are often higher. There are no simple and quick dispute settlement procedures for dealing with such cases.

Finally, many small companies purchase land use rights to property or rent property from municipalities, township level governments, village committees, and developers with no official title. Such properties, known as "small title" properties, are mostly in rural areas or suburbs. Because these properties are considered illegal by the central government, small businesses cannot protect their interests in land taking cases.

Government policy also puts small businesses at a disadvantage in terms of market entry, little or no government subsidies compared to those for large companies, excessive registration and tax burdens, low

compensation in the case of land taking and property demolition, and an onerous requirement for annual verification of business qualifications and permits that opens the door for harassment and corruption.

Furthermore, small businesses have enormous difficulties with accessing credit. Banks require mortgages and high levels of collateral or guarantees for small business loans. There are too few special financial institutions providing small businesses with financial services. The banking sector is dominated by state-owned commercial banks that tend to disburse loans mainly to state-owned enterprises or large state infrastructure

projects, at an interest rate only a fraction of market rate. Certainly small businesses can have their own problems with poor business planning, bookkeeping, and financial records, which affect the banks' assessment of their creditworthiness. However, excessive credit control by the government is detrimental to the stable investment and development of small businesses.

## Section 3

# Key Scorecard Findings

The following summary of key findings on the six Scorecard elements is largely based on secondary sources (see the Appendix for details). Those international surveys and rankings were subsequently supplemented by on-the-ground focus groups and interviews with small enterprises and experts conducted by Unirule in Beijing and Nanchang.

The initial findings of the Scorecard research, based largely on international indicators, showed strong support for the Property Rights and Access to Credit Core Elements. However, these findings were not borne out by examining the actual situation on the ground. For recent commercial developments by large, government-connected developers, property rights protection is clearly defined and strong. But a significant number of properties, particularly in rural and suburban areas where cities are expanding, are not yet formally recognized by the government. These properties do not have official use certificates and therefore can be taken by the government at any time with a very low compensation rate.

The same is true for access to credit. Banks lend primarily to large state-owned companies. Mortgage loans for purchasing commercial properties for large, established businesses (office, retail, industrial, and logistics) are much more easily available than for small businesses. Banks often do not look at the purchase prices of the

commercial properties, but the real value of the corresponding land use rights the companies possess. This puts small businesses that hold only "small title" rights at a disadvantage.

What is more, in start-up periods, the law explicitly disallows the disbursement of loans to small, newly formed companies because they have no financial records and little collateral to pledge for loans. It is also difficult to get loans backed by inventory, machinery, and equipment. As a result, most small businesses depend on their own capital and informal finance.

### *Property Rights – Weak*

There are two types of title in China: title that has been formalized by the government ("big title") and property on collectively owned rural or peri-urban land that has not been formalized ("small title"). Many owners of small title business properties do not feel secure in their property rights and do not trust government institutions to formalize this property fairly. When land takings occur, buildings have been arbitrarily destroyed without prior notification and the level of compensation to the owners has been inadequately low. This happened, for instance, during the new town construction in Yizhuang Town of Daxing District, Beijing.

Most small companies rent properties for commercial use. Most feel that as tenants they are not secure in their rights. There are cases where renters' rights were violated because of political pressure. In land takings, they often suffer the loss of value of their equipment and investment in the property they rent because city governments negotiate compensation only with the owners, not tenants.

Lease termination notice periods given to tenant businesses are often too short for them to find new suitable properties to rent. As they relocate, they also have to pay new rental rates, which are often higher than before given high price inflation. The precise design of a land lease contract also matters in dispute settlements. Meanwhile, many small businesses never enter into formal contracts and have no means of dispute resolution when their lease is improperly terminated.

Another common problem has to do with land takings that involve suburban factories. Village collectives in the suburbs often rent out standard factory halls to small companies. Such standard factory halls are "small title" properties without official use certificates. In land taking cases, the renters of such premises suffer great loss in terms of their investment in the improvement of the factory halls, their cost of moving equipment, and the loss of new orders.

There are also many cases of unregistered and/or illegal uses of commercial properties. For instance, there are many "small title" properties that are used for commercial purpose in the suburbs or neighborhoods within the downtown areas of cities. Some parts of buildings were illegally added or their structure was changed. Such phenomena are very pervasive. The presence of informal markets for goods is also common. The competition of small companies with informal firms, such as itinerate or unregistered vendors, is fierce especially in the mediation services often required for small businesses to participate in the real estate sector.

## *Access to Credit – Weak*

Access to loans is a big problem for small businesses. Only a small number of companies have access to loans from banking institutions. To receive loans, they must provide collateral or guarantees that many do not have. Small companies have to provide numerous documents and go through several procedures of loan approval. The time from application to approval is long (around 10 to 15 days) so most small businesses are reluctant to go through the process. Most small

businesses also believe that state-owned banks are not really interested in disbursing loans to them. Shareholding banks, credit cooperatives, and rural banks provide more lending to small businesses, including microloans.

The government has introduced a series of policies to support SMEs, including the State Council's "Opinions on the Support for the SME Development" of 2009 and the "Opinions on Promoting and Guiding the Healthy Development of Private Investment" of 2010 to create a better policy environment. However, problems exist with the implementation of these policies, such as regulatory standards that are too strict, improper, and not sufficiently tailored.

One alternative for small businesses seeking financing is for guarantees to be provided by private persons, other companies, and investment or guarantee companies. The guarantee companies charge borrowers around 1 percent of the loan or more.

In addition to obtaining loans, there are problems with small companies opening an account with commercial banks. According to some, banks will not allow a small company to open an account in Beijing if its registered capital is less than 500,000 yuan. If a small company has only a registered capital of 100,000 yuan, it has to go to a remote branch of the Rural Commercial Bank of Beijing.

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Many small companies are forced to borrow from friends, relatives, or informal lenders. This is a kind of relational banking based on the social network of the borrower. The advantage is that it is convenient to borrow and re-borrow from people the small business has relationships with. However, the annual interest rate for borrowing from an informal lender or other private person is around 18 to 36 percent and often much higher than rates for formal lending.

Venture capital remains concentrated in high-tech sectors. Less seed money and few angel investors are available for start-ups in other sectors. Small companies can check their credit information at the local branch of the Central Bank, but it is very difficult to have wrong information corrected.

### *Effective Governance – Weak*

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Corruption is pervasive in the land taking process, bidding for land use rights, and in property transfer procedures. In some cases, mediators have to be employed to deal with government officials. Because tax burdens are heavy, some small businesses find a way to build a good relationship (guanxi) with key tax officials so that tax burdens can be reduced. That often involves dinners, entertainment, vacations, or gifts. If companies do not have good relations with tax officials, tax bureaus may send inspectors to check a business's tax payment records. Usually they are able to identify some faults and charge fines. Similarly, one also has to build and maintain good relations with local officials in bureaus of industry and commerce, bureaus of health, bureaus of environmental protection, and others.

### *Rational Dispute Resolution – Strong*

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Most companies that have a "big title" feel that the ownership of business properties is quite secure and they trust government institutions to uphold the law and settle disputes justly. Most companies holding a "small title" do not. Conflict resolution involves informal settlement, the legal process, or mediation. If a conflict involves the government, an administrative lawsuit is the only option and if the suit involves property taking by the government, the case is usually refused by the court.

Small businesses are somewhat disadvantaged in dispute resolution in comparison with larger firms. Larger firms are equipped with more funds and influence, have a larger social network and often better connections

to local government, and can lobby the government more effectively for a favorable outcome.

While many feel that government compensation rates are too low and the land conversion system is unfair, there are also cases where owners abuse the system. Since compensation rates for land taking in the suburbs of major cities are quite attractive, some owners use the land taking as an opportunity to build additional levels to their buildings or add parts to the buildings so that they can receive more compensation.

### *Financial Transparency – Strong*

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There are many professional valuation institutions in each larger city. They are in principle independent of, or separate from, the government but some still have explicit or implicit government connections. There is a set of valuation criteria and standards that valuation institutions have to comply with: "Standard of the People's Republic of China for Valuating Real Estates" in effect since June 1, 1999. It is similar to the international standards.

Small businesses can obtain relatively fair valuations for property they want to buy or sell. There are also established baseline values relating to properties in different locations. However, whoever pays the valuation fee has a say in the determination of the final value of the property. A valuation institution will discuss with the payer the final value it assesses and often determine the value in favor of the fee payer.

### *Appropriate Regulation – Weak*

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When it comes to taxation laws and regulations, the tax and fee burdens of small companies are quite heavy. Consequently, some companies engage in tax evasion or avoidance. The tax law enforcement has become stricter. As with other officials, one has to keep good relations to avoid being targeted.

Last year the simplified sales tax rate for small businesses, regarded as small-amount taxpayers, was reduced in Beijing. However, the definition of small-amount taxpayers was also changed. A manufacturing company with sales volume exceeding 500,000 yuan is no longer considered a small-amount taxpayer in Beijing. Sales or trading companies, if their sales volume exceeds 700,000 or 800,000 yuan, are treated as general taxpayers and pay a much higher rate.

Property market service providers are relatively reliable since their information is proven by the market and can be checked by comparing information available through websites and listings in newspapers and other sources. However, some real estate agents use certain tricks in releasing their price information. For instance, agents often initially reveal a low price in relation to market price for customers purchasing or renting a property. If the customers call to follow up on that listing, they might say that that property is sold or rented already, and recommend other, higher priced properties instead.

Real estate developing companies frequently run their own property management companies that manage business properties sold to customers. These property management companies are often not trustworthy. For example, they may change part of the green spaces into parking areas, or change underground air defense facilities into shops or parking places to collect fees without the owner's knowledge or approval.

## Section 4

# Overview of the Fieldwork

To verify the initial findings of the Scorecard, the Unirule Institute of Economics conducted extensive quantitative and qualitative research using more than 30 additional sources. The findings showed the rights of small businesses in urban property markets are not the current focus of the authorities. As a result, small businesses tend to be neglected and discriminated against by the government. Current macro-control policies are very detrimental to the existence and development of small businesses, and small businesses are crowded out from private investment in property markets.

Government subsidies and tax benefits are distributed mostly to state-owned enterprises. The current system of tendering, auctions, and listing of land use rights is monopolized by local urban governments. Purchasing land use rights requires a high level of capital endowment, which small businesses are not able to comply with. In addition, the underdevelopment of smaller financial institutions and quasi-formal financial institutions is a barrier to small businesses' access to credit.

### *Interviews*

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From April to June 2011, Unirule interviewed small companies, property market and banking experts, and government officials in Beijing and Nanchang to gather first-hand insights on the barriers small businesses face in property markets. The interviews with small companies were conducted mainly in focus group discussions. Two focus group discussions

were held in Beijing with 17 participants in each. The first focus group included representatives from the high-tech and technology sector, the retail sector, and law firms. The second included participants from the publishing and printing sector and retail as well as wholesale, building material and real estate sectors.

There were 15 representatives of small companies such as clothing retail, lamp retail, and stationery shops in the first focus group discussion in Nanchang. In the second focus group there were 12 representatives of small companies from the construction sector, pharmaceutical companies, food processing companies, and manufacturing companies.

In addition to focus groups, the Unirule project team interviewed numerous banking and property market experts directly in both cities.

### *Differences in Findings between Beijing and Nanchang*

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Given China's unitary system of governance, the central government strives to impose a set of unified institutions and policies upon all the regions. However, because the economic and social conditions of various regions differ vastly, the central government often has to allow the provincial governments some discretion in the implementation of regulations. The willingness of local governments to comply with central government regulations differs, sometimes significantly.

Furthermore, the national capital Beijing and the provincial capital Nanchang have their own local acts and regulations. For instance, the government of Nanchang city started the restriction of housing property purchase on January 21, 2011, which took effect on February 1. The regulation provided that an urban resident who already owns one apartment in five designated districts (not including counties under the administration of the city) can only purchase one more apartment. If a resident already owns two apartments or more, or if a non-resident already owns one apartment or more, and cannot provide his proof of having paid personal income taxes or made social insurance contributions for one year or more, he is not allowed to purchase any more apartments. From March 1, 2011, yet another new regulation took effect and escalated the restriction. It extended the above mentioned provisions to all other districts (but still excluding counties). In addition to other restrictions, a non-resident is not allowed to purchase a second apartment within all the districts.

In contrast, according to the regulation of Beijing city released and in effect as of February 16, 2011, all residents of Beijing (including districts and counties) can only purchase one apartment more if they already own one apartment. A non-resident who already owns one apartment and can show evidence of having continuously paid personal income taxes or made social insurance contributions for 5 years or more enjoys the same treatment. If a resident already owns two apartments or more, he is not allowed to purchase more apartments. If a non-resident already owns one apartment or more and cannot not show that evidence, he is not allowed to purchase any additional apartments.

*Many land takings take place without any notice or information on compensation rates. This is particularly common in villages adjacent to fast-growing cities where the demand for land is great.*

## *Communication and Legal Implementation Gaps*

There is a considerable gap between laws and regulations on the books and their actual enforcement. Many laws and regulations are not enforced or enforced only selectively. An ample illustration is the fact that no one in China can sue the government by resorting to the citizen rights contained in Constitution. When it comes to private property, the central government regulations on land taking and demolition in principle provide for the protection of the rights of property owners and spell out procedures for expropriation. However, in both cities, there are reported cases in which real estate developers demolished properties without following procedures and with support of local policemen and gangsters.

Many land takings take place without any notice or information on compensation rates. In some villages, villagers' committees and party secretariats do not inform the residents about the revenue from the transfer of the collectively owned land to state control, or underreport the amount, which violates the Villagers' Committee's Organizational Law. This is a particularly common occurrence in villages adjacent to fast-growing cities where demand for land is great.

For high-tech companies protection of intellectual property rights is also a crucial issue. Their rights are often violated when their innovations are pirated.

When it comes to access to credit and general conditions for conducting business, as mentioned before, the State Council released several documents promoting the development of SMEs. However, few of the clauses have been implemented. Although the government announced initiatives to ease small businesses' access to credit, credit control through raising the reserve ratio banks are required to hold has the opposite effect.

# Section 5

## Expert Roundtable Findings

Following the focus groups and interviews, Unirule organized an expert roundtable to verify the findings and formulate policy recommendations. It was held at Renmin University in Beijing on August 4, 2011. Twenty-eight participants including researchers from several universities and institutes as well as representatives from banks and law firms vigorously discussed the issues surrounding property markets and access to credit for small businesses in China. Despite some differences of opinion, all agreed that the current property rights protection system is inadequate. Property rights protection is compromised by political decisions, corruption, and a dual system where the ownership/use rights of legally registered properties enjoys robust protection while large amounts of collectively owned land has yet to be formalized.

Participants agreed that it is crucial to formalize all properties with “small title” and institute reforms dealing with rural land that is to be converted to construction land by the central government. Currently administrative power is overwhelming and rights to “small title” properties are ambiguously defined. Land use revenues drive city budgets so administrative bodies often engage in rent seeking rather than protecting rights.

### *The Need to Further Develop China’s Property Markets*

Participants agreed that the Scorecard project had high value, observing that this methodology provides a framework for research and shows the logical connections between different property market elements, such as between property rights and dispute resolution. The property rights protection system in China is not yet highly developed. A true market requires unrestricted supply and demand but the government currently controls the land supply. The government is also the only allowed buyer for agricultural land conversion.

Participants also emphasized that, despite improvements, many people still report stories of their property being demolished for little compensation. In one instance local officials told the owner that he could obtain more compensation if he demolished his house himself, so the owner began to tear down his own house. Due to a lack of understanding of their rights and the refusal of courts to accept any lawsuit against the government relating to land taking cases, most people do not even attempt dispute resolution.

Participants agreed that, despite challenges, China is moving from a state of no protection of property rights to some protection. The government has committed to a transition from an economy of administrative power to a more market-based economy. However, more reforms are needed to make property rights better protected and more accessible to small businesses.

When it comes to access to credit for small enterprises, participants noted that the most important thing is a better understanding of risk. Banks and the central government have historically been very prudent in avoiding financial risk and therefore lending to small businesses remained limited. The Scorecard findings show property market elements in a broader context and can therefore help better reflect risk – both transactional and systemic – so that there can be more progress toward a true market economy.

### **Consensus Issues**

- “Small title” property must be converted to regular title; otherwise no uniform property market will be possible. “Small title” is currently controlled by local bureaucrats who are primarily profit seeking. This compromises property rights protections for the majority of small businesses.

- Too much land falls under the “red line policy” provided by the Party’s 2007 No. 1 Document. The policy prevents the conversion of arable land to construction land in order to keep the total arable area above the “red line” of 1.8 billion mu (1 hectare is equal to 15 mu). This tends to drive up land prices and is not really serving the stated purpose of protecting food security.

- The land development and transfer policy is currently not rational but rather driven by political considerations, particularly at the local level.

## Section 6

# Conclusion and Recommendations

### *Conclusion*

In recent years, the government’s policy in dealing with the real estate sector has changed too often in an attempt to curb inflation.<sup>12</sup> Likewise, the credit control for real estate developers and property purchasers became tighter and tighter, as even some large real estate developers are facing liquidity problems. These changes are especially difficult for small businesses because they cannot have a stable expectation of the costs and benefits of their investments in property and in their own operations.

Moreover, there continue to be cases where properties are arbitrarily destroyed without prior notification, the level of compensation to owners is inadequate, and tenants are not protected. Small businesses also have problems with financing and refinancing and are not able to lease land under the current system of tenders, auctions, and listing.

Many small companies do not think it is necessary that urban land remain state-owned. Before 1982, urban land did not belong to the state. Only the 1982 amendment of the constitution turned urban land over to state ownership. The excessive control of the land supply increases the price of land use rights, which is detrimental to the development of small companies and a true market economy. City governments monopolize the primary land market. They also engage in excessive land banking – reserving expropriated land and constructing infrastructure on it, then holding that land and selling it piece by piece at higher prices. Cheating and insider control is also a problem. There is also an excessive number of taxes and fees in the real estate sector, which increases property transfer prices.

There is lack of government services for small businesses. Despite some national policies in this area, subsidies or tax benefits for small businesses are not being realized in municipalities and banks have not done enough to cater to small business needs.

Finally, law enforcement by local courts remains a problem. Some debtors hide funds and refuse debt repayment, which not only weakens the rule of law but raises the costs of borrowing for everybody. Local courts frequently are reluctant to enforce judgments. They often request a high amount of payment from the creditors, which can be higher than the debt amount.

### *Recommendations*

In consideration of the problems identified with small businesses’ operations in property markets and their access to credit, the project team makes the following policy and reform recommendations based on the Scorecard findings and fieldwork. These recommendations are meant to promote the overall property market development and improve the business environment for small enterprises:

#### **Titling and Land Reforms**

##### **Formalize all land titles**

The existing dual system of “big title” and “small title” properties must be unified. The current system encourages land banking and speculation by local municipalities in anticipation of formalization

by the central government. It also disproportionately hurts small businesses that usually hold only an insecure “small title” to property they own, or rent “small title” properties from which they can be easily expelled without proper compensation. A consultative process should be established and a target date set to complete the issuance of formal land use rights certificates for all properties.

### **Empower rural collectives and make construction land market more transparent**

Rural collectives should be granted an equal position in selling the use rights of the collectively owned construction land. More transparency would also help to reduce corruption, power abuse, and cases of illegal land takings. In spite of government information disclosure regulations, the central government and local governments release very limited information about land auctions so connected insiders often win bids at low prices. Few insiders’ collusions are investigated and punished properly.

As a part of the title formalization process, the National People’s Congress should also amend the Land Management Law to allow the use rights of rural and urban construction land to be directly transferred to developers under a more transparent system of tendering, auction, and listing. In addition, a more participatory urban planning process would help protect small businesses’ property rights.

### **Reform the “red line policy”**

In order to increase the amount of agricultural land available for conversion and construction, the “red line policy” mandating that a significant land area be set aside for agricultural purposes should be reviewed. The policy no longer fulfills its original purpose of providing food security and instead artificially restricts the amount of land available for other purposes.

## **Fiscal and Financial Reforms**

### **Lower the deed tax**

The burden of deed tax for property transfer in China is very heavy at 1.5 - 3 percent of the transaction value. The National People’s Congress should abandon the current Tentative Regulation of Deed Tax released by the State Council of 1988 and release a new law to either significantly lower

the rate or institute a fixed fee for a single unit of property, for instance 1,000 yuan for each property transaction. Many small companies feel that they would pay this and other taxes as required if the tax burden can be lowered.

### **Diversify financial institutions**

The China Banking Regulatory Commission (CBRC) should abandon the tight administrative approval for the establishment of new financial institutions. It is sufficient to create a set of minimal requirements for opening a financial institution with permission to operate across all regions of China. Banking institutions that operate within a single region can be regulated by provincial-level banking regulatory bureaus. Most importantly, the CBRC and local banking regulatory bureaus should encourage the establishment of special institutions delivering financial services to small businesses.

Larger financial institutions as well need to do more in terms of downscaling their products and services and simplifying their lending procedures for small businesses with tailored loan products and services. Such solutions could include repayment schemes that better fit the time horizons and cash flows of small businesses and easier processes for early repayment or extending loan periods according to their changing needs.

### **Liberalize interest rates**

There are currently lending rate ceilings for banking institutions and informal finance. The Central Bank sets large administrative discretion baseline deposit and lending rates which are not market based. Liberalizing interest rates would allow banks to base interest rates on risk. Many small businesses have difficulties with access to credit even if the expected rate of return on their capital exceeds the interest rate. As proven by the presence of widespread informal lending activity, they can often bear loans with high interest rates, especially short-term loans. Since small businesses are adept at finding their own funds and informal loans, formal loans at flexible rates should also be made available. Such a combination would lower the overall level of the cost of capital for companies. Deposit rates should also be liberalized, supported by introducing a deposit insurance scheme for all banking institutions.

## **Privatize state-owned commercial banks**

State-owned commercial banks currently dominate the banking sector. The majority of loans go to state-owned enterprises, local government companies, and large state projects. However, according to the SOE report of Unirule, state-owned industrial companies incurred huge losses between 2001 and 2009.<sup>13</sup> To improve their operations and sustainability, both state-owned commercial banks and state-owned enterprises should be privatized, at least to a degree where the state does not completely control them. This will render a level playing field for private banking institutions and private companies to compete and develop. Private banks – especially smaller ones – tend to provide better financial services to small businesses.

## **Develop the capital market and mutual funds for small businesses**

Apart from improving banking sector accessibility for small businesses, the government should also target improvements for market entry in the fields of bond issuance, initial public offering (IPO), and private equity investment so that those instruments may become more widely available to small enterprises. The government should also simplify the registration process for new non-banking financial institutions.

What is more, the central government and local governments should allow the establishment of mutual funds and mutual guarantee funds for small businesses so that members can have access to short-term mutual credit funds at a relatively low interest rate and better access to bank loans through guarantees.

## **Further develop microfinance companies**

The quota for the number of microfinance companies in each region should be abandoned by the respective provincial governments. The ceiling of registered capital and interest rates ceilings should also be removed to improve the availability of microfinance for small businesses. Currently they can only borrow from maximum two banks 50 percent of their net assets.

## **Judicial and Administrative Reforms**

### **Introduce circuit courts**

The National People's Congress ought to enforce judicial system reform and introduce a circuit court system to mitigate local protectionism and improve law enforcement, dispute resolution, and debt collection according to the court's judgment. The state should also provide strong legal support for the enforcement of contracts between companies.

### **Abandon administrative approval system**

The government should deregulate and open as many sectors as possible so that more investment channels become available and private capital can enter these sectors. A simple reform approach would be to abandon the administrative approval of market entry. The local bureaus of industry and commerce can instead establish a set of minimal requirements for market entry or business permits. Once an entity fulfills these requirements, business permits should be automatically granted.

### **Eliminate registration of fields of business operations**

Fields of business operations required in the registration of businesses can serve as useful statistical information. However, the government often takes this information as proof that a company operates within or outside of the allowed fields. This is very detrimental to the development of small companies since their business develops according to the demand of the consumers and other producers and SME resources need to be allocated where higher rates of return can be generated. The local bureaus of industry and commerce should thus abandon the registration of fields of business in the renewal of business licenses and ease the issuance or renewal of business licenses or permits.

### **Improve legal protections for tenants**

Given that small business tenants often suffer most as a consequence of land takings, there is a need for regulation mandating longer notice periods and better protection of the investments those businesses make in the equipment and improvements of properties they occupy. There is also a need for greater awareness among tenants on how to formalize a lease contract and how to structure it for maximum legal protection.

## **Competition Policy Reforms**

### **Empower private enterprises**

The government should limit the dominant role of state-owned enterprises in competitive and profitable sectors, especially in the real estate sector so that private companies gain a fair, level playing field and small businesses have more free space to grow. In principle, the government should remove itself from any competitive and profitable sector (including the land market, housing market, and oil and mining industry) to avoid crowding out private investment. To facilitate fair competition in all sectors, the government also needs to improve the protection of intellectual property rights and increase punishment for companies registering with false information.

## **Civil Society Policy Reforms**

### **Develop voluntary business membership organizations**

The government should allow and encourage the registration of business associations and chambers of commerce organized from the bottom up. These organizations are more responsible to their members than government-sanctioned business organizations and can provide them with better services. Business membership organizations can also help small businesses receive professional guidance on how to improve their accounting records and business plans, which in turn would improve their credit worthiness.

China still faces huge reform challenges in developing a true property market in the broader context of building a market-oriented economy. However, over the last several years, much progress has already been made. The government must stay on the path toward more and more private ownership. The steps listed above are practical, incremental changes that flow naturally from the direction already established by the Property Law of 2007 and can help to further develop a prosperous society as China continues on its growth path to become the world's largest economy.

# Endnotes

1. "China Business Laws," World Law Direct, <http://www.worldlawdirect.com/article/3128/china-business-laws.html>.
2. National Bureau of Statistics, China Statistical Yearbook, from 2002 to 2011, various years.
3. Liu Zhifeng, "The Housing System Reform I Experienced," Zhonggu Real Estate Lawyers Net, February 15, 2011, <http://news.9ask.cn/fcjf/lunwen/201102/1084694.shtml>.
4. Chamber of Commerce for Real Estate of the All-China Federation of Industry and Commerce, Report of the Research on the Cost of Real Estate Development of Chinese Real Estate Development Companies, 2010. See [http://news.dichan.sina.com.cn/2011/04/07/299848\\_2.html](http://news.dichan.sina.com.cn/2011/04/07/299848_2.html).
5. National Bureau of Statistics, China Statistical Yearbook, 2011.
6. Individual households in industry and commerce ("ge ti hu") are quasi-company entities registered with a local bureau of industry and commerce. They employ up to 7 employees according to Chinese law (in reality, one household might employ more). Private enterprise ("siying qiye") is also a registered form of business that employs more than 7 workers. In 2010, there were over 42 million individual industrial and commercial households and private enterprises in China, according to Wang Wenbiao, member of National Political Consultative Conference. See: [http://news.ifeng.com/video/detail\\_2011\\_03/06/4998284\\_0.shtml](http://news.ifeng.com/video/detail_2011_03/06/4998284_0.shtml).
7. China Statistical Yearbook, 2011.
8. Data are collected from websites of provincial governments.
9. Liu Xiangfeng, "SME Development Policy in China: A Policy Perspective on SME Industrial Clustering," *ERIA Research Project Report 2007 No. 5: ASEAN SMEs and Globalization*, <http://www.eria.org/research/images/pdf/PDF%20No.5/No,5-2-China.pdf>.
10. The criteria for categorizing SMEs were revised in June 2011 by the Regulations on the Standards for Classification of Small and Medium-sized Enterprises. The Regulations divided SMEs into three categories: medium, small, and mini. These categories vary by sector and depend on the number of employees, operating revenue, and total assets (source: [www.china-briefing.com/news/2011/07/07/china-issues-classification-standards-for-smes.html](http://www.china-briefing.com/news/2011/07/07/china-issues-classification-standards-for-smes.html)). The statistics cited in previous footnote are based on the 2003 definition of SMEs given that more up-to-date figures are not yet available.
11. Matthew E. Kahn, "Can China's workers keep up with China's real estate boom?" *Christian Science Monitor*, 15 March 2010, <http://www.csmonitor.com/Business/Green-Economics/2010/0315/Can-China-s-workers-keep-up-with-China-s-real-estate-boom>.
12. Most of those policies pertain to the housing market. Upon order from the central government, governments in first-tier cities had to introduce a size quota for purchasing housing properties in the first half of 2011, and those in second- and third-tier cities where housing prices went up rapidly had to introduce a size quota in the second half of the same year.
13. The booking value of their profits was huge in that period. However, in comparison with private enterprises, they paid less or nothing for land, or other resources while receiving huge subsidies from the government. The sum of lower payments and government subsidies is much larger than the booking value of their profits. See Project Team of Unirule Institute of Economics: "The Nature, Performance, and Reform of the State-Owned Enterprises," July 12, 2011.



The Scorecard reflects the status of the six Core Elements necessary for transparent and efficient property market development. Each Core Element includes three Lead Indicators that are further divided into Sub-Indicators. Colors signify the strength of institutions that support market development – very strong, strong and weak. No color indicates that institutions are very weak. Gray indicates more information is needed for an objective determination.

## *Acknowledgement*

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**The Unirule Institute of Economics was the in-country partner for this China Scorecard. Prof. Feng Xingyuan contributed greatly to the research results.**

## *For Education Purposes Only*

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While great care has been taken to provide accurate and current information, neither the Center for International Private Enterprise, the Unirule Institute of Economics nor its editors, staff or contractors assume responsibility for the accuracy of the data contained herein. Further, the general principles and conclusions presented in the text are subject to significant market fluctuations over time as well as local, state, and federal laws and regulations, court cases, and any revisions of the same. This publication is distributed for education purposes with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional service.

## *Scorecard Methodology*

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The International Property Markets Scorecard is a systems analysis tool to measure the strength of institutional support for transparent, rational and effective property markets. It provides stakeholders with a visual representation of the status of the core elements necessary for sustainable property markets that help to distribute power and economic opportunity.

Quantitative and qualitative measures are taken from established international economic development organizations (information current as of October 2011) and paired with on-the-ground assessments of market participants. Unless otherwise specified, answers to Survey Questions (SQ) and Field Questions (FQ) come from the interviews and focus groups conducted by Unirule in May 2011 in Beijing and Nanchang.

The purpose of the Scorecard is to bring about an awareness of the interconnections between the microeconomic factors necessary for development and provide advocates, policymakers, and development groups with clear, actionable goals for continuous improvement.

Property markets are inherently local and can vary widely from one city to another, even from one block to the next. The Scorecard is meant to measure how policy decisions and levels of implementation affect property markets. It is not meant to provide specific guidance, measures or predictions of individual property performance and is only valid in the cities where field assessments have occurred. For detailed information on Scorecard methodology please contact [forum@cipe.org](mailto:forum@cipe.org).



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# Property Rights

**Goal – Property rights that are legally protected, secure, recorded in a single, accurate, widely accessible electronic registry and that lead to high levels of formal ownership for all citizens**

## 1.1 Legal Protection

**Core Question:** Does an effective and sufficient legal framework exist to protect property rights for all citizens? **No – Weak. While many new laws have been passed recently, all land in urban areas remains the property of the state with only land use rights granted for limited duration. Rural land is owned mainly by villages or villagers' groups. However, they are not allowed to sell the land directly on the market. Many properties in rural and peri-urban areas do not have land use certificates and titles.**

### Legal Framework

1.1.1 Are property rights clearly defined and protected by law? **No – Weak – Ranking 41st out of 142; Score 5.04 out of 7 Trend ↓ Property rights are clearly defined in Chinese constitution and Property Law. However, they are not properly protected. While the legal framework is ranked highly at the World Economic Forum, in practice local protectionism, party discretion, and judicial corruption hinder law enforcement.**

### Security of Tenure

1.1.2 Can citizens challenge the legality of government takings? **No – Weak – 44th out of 142; Score 3.9 out of 7; while procedures are clear for properties with formal government recognition, many properties have not been formalized. Also, most cases against government takings are not accepted by the courts.**

**Source:** Global Competitiveness Report 2011-2012 – World Economic Forum, [www.weforum.org/issues/global-competitiveness](http://www.weforum.org/issues/global-competitiveness)

## Bundle of Rights

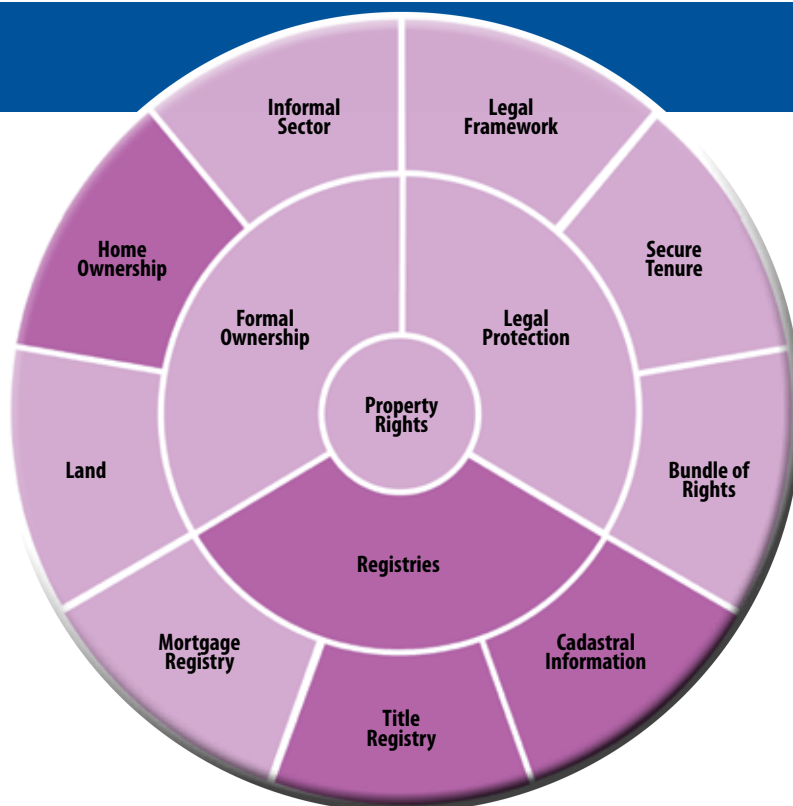
### Survey Question

**SQ1:** What is the bundle of rights (group of rights such as occupancy, use and the right to sell or lease) associated with both residential and commercial property ownership? **Weak – Land in rural areas is mainly collectively owned, all other land is state-owned. Individuals and firms may own and transfer long-term leases on land and buildings, but not true ownership.**

**Source:** Land Administration Law, Ministry of Land and Resources [www.mlr.gov.cn/mlrenglish/laws/200710/t20071011\\_656321.htm](http://www.mlr.gov.cn/mlrenglish/laws/200710/t20071011_656321.htm); Rural Land Contracting Law of the People's Republic of China

## 1.2 Registries

**Core Question:** Does a reliable property registry exist including cadastral, title and mortgage lien information? **Yes – Strong, over the last 20 years the system of cadastre, land use rights registration, and mortgage registry have continually improved.**



1.2.1 Cadastral Information  
**Status – Strong**

### Survey Questions

**SQ2:** Is cadastral information (information about the dimensions and location of land parcels) accessible to the public? **Yes**

**SQ3:** Is zoning/permitted use information included and are use regulations respected and enforced? **Yes, generally. However, there are many new buildings that do not match zoning/use information.**

**SQ4:** Are Geographic Information Systems (GIS) including Global Positioning Satellite (GPS) information used to create and update the registry? **No, most information still comes from physical survey.**

**Source:** State Bureau of Surveying and Mapping <http://en.sbsm.gov.cn/>  
*Civil Society Resource: Chinese Society of Geodesy, Photogrammetry and Cartography*

1.2.2 Title Registry

**Strong – Ranking – 40th out of 183 Trend ↓ procedures, time, and costs are low but many properties lack official ownership certificates**

1.2.2.1 What is the number of procedures required to register the transfer of a property from one owner to another? **4**

1.2.2.2 What is the duration of time in calendar days that it would take to complete the transfer? **29**

1.2.2.3 What is the total cost of the transfer including all fees, taxes, etc. expressed as a percentage of the value of the property? **3.6%**

**Source:** Doing Business 2012 – Registering Property, World Bank [www.doingbusiness.org/data/exploreeconomies/china](http://www.doingbusiness.org/data/exploreeconomies/china)

1.2.3 Mortgage Registry  
**Status – Weak, the mortgage market is still relatively new in China.**

### Survey Questions

**SQ5:** The mandatory use of notaries or similar officials slows down and adds cost to the process. Does a notary need to be involved in the registration process? **Yes**

**SQ6:** Is information in the registry available electronically? **Yes, available from the local property administration.**

**SQ7:** Title insurance is indemnity insurance against financial loss from defects in title and from the invalidity or unenforceability of mortgage liens. Is title insurance available to lenders? **No, however, home owners must have property insurance before receiving a loan.**

**Source:** Financing Homes 2008, World Bank and International Housing Finance Corporation [www.ihfc.org/ihfcext/sme.nsf/AttachmentsByTitle/financinghomes/\\$FILE/FinancingHomes.pdf](http://www.ihfc.org/ihfcext/sme.nsf/AttachmentsByTitle/financinghomes/$FILE/FinancingHomes.pdf)

## 1.3 Formal Ownership

**Core Question:** Do citizens understand and trust property rights institutions and avoid the informal sector? **No – Weak – conflict between formally recognized “big title” property and “small title” properties without ownership and use certificates creates a dual system.**

### Survey Questions

1.3.1 Land

**SQ8:** What is the status of land ownership? **Weak – although the Property Law of 2007 does**

**establish the concept of private property rights (Chapter V, Article 64), private ownership of land is still excluded.**

**Source:** Property Rights Law of the People's Republic of China [www.lehmanlaw.com/fileadmin/lehmanlaw\\_com/laws\\_regulations/Propoerty\\_Rights\\_Law\\_of\\_the\\_PRC\\_LLX\\_03162007.pdf](http://www.lehmanlaw.com/fileadmin/lehmanlaw_com/laws_regulations/Propoerty_Rights_Law_of_the_PRC_LLX_03162007.pdf)

### 1.3.2 Home Ownership

**SQ9:** What is the percentage of formal home ownership?  
**89.3% of the properties in urban areas belonged to private persons at the end of 2010 – Strong**

**Source:** Chinese Government Statistics

### Informal Sector

1.3.3 What is the percentage of service firms that report competing with unregistered or informal firms? **Large – Weak, the presence of informal markets for goods is pervasive. Also, informal activities by formal firms are widespread.**

**Source:** Interviews with small businesses.

## In-Country Assessment Information

**Field Question (FQ) 1: Even if legal provisions exist, what is the actual status of property rights and ownership for small businesses?**

While property rights are clearly defined in the Constitution and other laws, public ownership still has priority over private ownership, especially when it comes to land takings. All land remains the property of the state in urban areas. Small businesses can own commercial properties but land use rights for those properties last only for max. 50 years (70 years for residential, 30 years for farm land). Courts do not support property owners in the case of government takings, especially for properties that have not been granted ownership certificates. Owners of properties purchased from more recent commercial real estate developers have a better position in challenging government takings. The general position of the government and the courts is that “public interest” takes precedent over private property. Many takings are not really in the public interest since the land ends up in the hands of connected commercial developers. Many cases against government takings are not allowed to proceed. Often administrative regulations and discretion are more detailed and restrictive than the Property Law

to the disadvantage of private property owners.

**FQ 2: Are standard leases used for commercial space? If not, what is a typical arrangement for rental?**

Standard forms of lease contracts are available for leasing commercial space. However, there are sometimes informal arrangements in which the rental was understated in the contract so that the owner does not have to pay too large an amount of taxes and fees. A small company can sublease from an existing lease holder through a legal process.

Most small businesses feel that as tenants they are not secure in their rights. Some believe renters can protect their interests by formulating better clauses to avoid the property owner changing the contract, especially to increase rent. Some renters of business properties say it is a common practice to pay rent upfront first and for renters to also pay the tax the owners owe the government. Villages in suburbs often rent out standard factory halls to small companies.

**FQ 3: What are the processes for government expropriation of property especially notice and due process for owners? Are those followed or do expropriations happen by collusion between officials and connected elites?**

There is no independent judiciary and the law enforcement system does not work well. Sanction mechanisms are also lacking to deal with judicial corruption or judicial inaction. There have been extreme cases of individuals committing suicide to protest unfair government takings. Rural land is mainly collectively owned and cannot be sold directly into the market. Municipal governments monopolize the purchase of rural land for urban expansion, but only tolerate “small title” properties that are not recognized by the central government. There have been cases of land taking in which “small title” properties were destroyed without prior notification and the level of compensation to the owners was inadequately low. The new land taking regulation, State Council’s “Regulation on the Expropriation of Property on State-owned Land and Compensation Therefore” of January 21, 2011, improved the land taking procedures.

**FQ 4: Are businesses owners compensated fairly when their property is taken for public use?**

In land takings, the government provides insufficient protection of the interests of renters from the loss

of value of their equipment and their investment in the immovable property. City governments negotiate compensation only with the owners, not renters. With their forced move to another location, renters report that some commercial equipment (including showcases, machines, etc.) lost value without any or insufficient compensation. If there was compensation, it was made by the property owners who got an overall compensation from the government. Representatives of small companies believe that such problems exist and are more severe outside of Beijing and Nanchang.

**FQ 5: What protections do businesses have who lease space from arbitrary eviction by owners?**

Notice is often too short in advance on the part of the owners or the primary renters so that companies as (primary or secondary) renters do not have sufficient time to find new suitable locations. They also have to pay current market prices for their newly rented business properties, which are often higher than before. Small businesses reported that, in land taking cases, some renters of standard factory halls suffer losses in terms of their investment in the improvement of the premises, cost of moving equipment, and loss of some new orders.

**FQ 6: What is the actual experience of transferring a property, accessing the registry and dealing with registry officials?**

The registration of a transfer of property ownership is in general quite efficient in urban areas. If all the necessary certificates and required documents are complete, the transfer can be done within the same day in Beijing. However, if the necessary certificates and required documents are incomplete, the transfer cannot be done easily. Small businesses report that some companies have registered their ownership of business properties with the Real Estate Bureau but have not received the title yet because of incomplete certificates and documents.

**FQ 7: How large is the presence of informal markets for goods, i.e. itinerate vendors?**

There are many unregistered companies, and many informal deals and services in the property market. Most small companies compete with itinerate or unregistered vendors. Individuals of many registered big or small companies are also frequently involved in providing or receiving informal deals and services.

# Access to Credit

**Goal – An efficient, transparent financial sector that provides a broad range of citizens with access to multiple forms of competitive credit so that they can start businesses, build wealth, and purchase property**

## 2.1 Banks

**Core Question:** Are traditional banking services robust and extensive enough to serve the needs of the population to help them build wealth and purchase property?

**No – Weak, the state directs the allocation of credit and the big four state banks lend primarily to state-owned enterprises and finance large public projects.**

### Access

2.1.1 How easy is it to obtain a bank loan? **Weak – Ranking 45th out of 142; Score 3.14 out of 7. While ranked high by the large enterprises surveyed by the WEF, access for small businesses is very limited.**

### Soundness

2.1.2 How sound are the country's banks? **Strong – Ranking 64th out of 142; Score 5.33 out of 7.**

**Source:** *The Global Competitiveness Report 2011–2012*, World Economic Forum, [www.weforum.org/issues/global-competitiveness](http://www.weforum.org/issues/global-competitiveness)

## 2.1.3 Microlending

**Status – Strong, there are numerous microfinance institutions, village banks, and rural mutual fund associations.**

2.1.3.1 Microfinance allows citizens without traditional creditworthiness to build a credit history. How many microfinance institutions are operating in the country? **At least 8,500 registered in 2011, including 3,027 microcredit companies, 9 credit companies, 400 village banks and 39 rural mutual fund associations. Many rural credit cooperatives, rural commercial banks and rural cooperative banks have microcredit schemes. There are many other microfinance projects run by the government, non-governmental organizations, and private persons.**

**China Foundation for Poverty Elimination** [www.cfpa.org.cn](http://www.cfpa.org.cn)

**Chifeng Zhaowuda Women's Sustainable Development Assn.**

**Postal Savings Bank of China** [www.psbcc.com](http://www.psbcc.com)

**Wansui Microfinance Company** [www.wsmicrofinance.com/index.asp](http://www.wsmicrofinance.com/index.asp)

**Binhe Village Bank of Wuzhang City**

2.1.3.2 What is the number of active borrowers per institution?

**China Foundation for Poverty Elimination 36,080**

**Chifeng Zhaowuda 7,299**

**Postal Savings Bank of China 1,569,900**

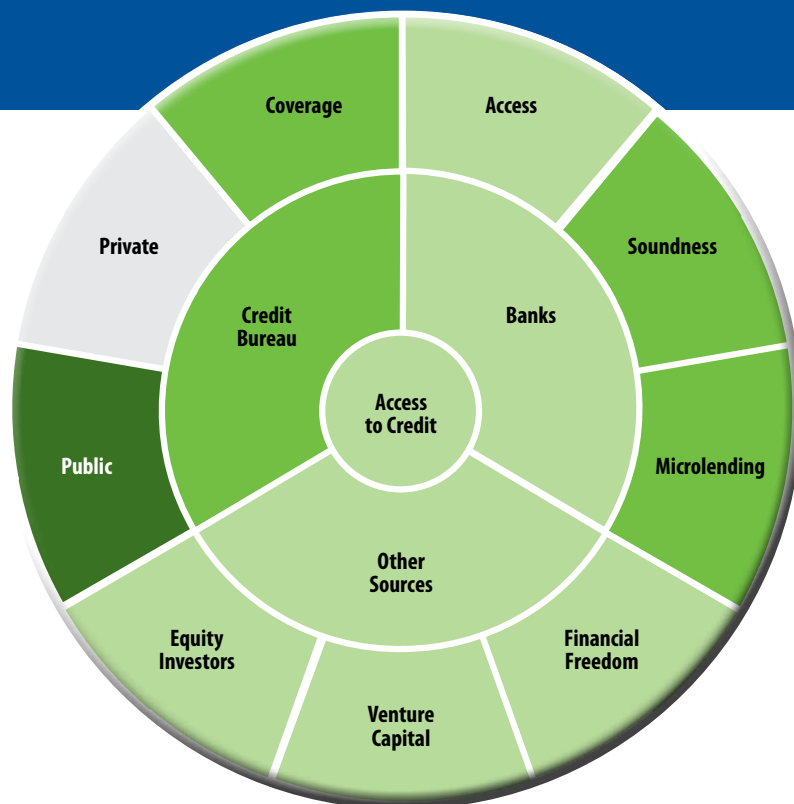
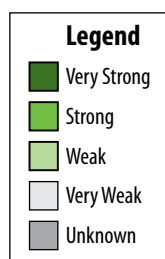
**Wansui Microfinance Company 771**

**Binhe Village Bank of Wuzhang City 2,000**

**Source:** Microfinance Information Exchange [www.mixmarket.org/mfi](http://www.mixmarket.org/mfi); Statistics of China Banking Regulatory Commission; China Investment Consultancy Net [www.ocn.com.cn](http://www.ocn.com.cn)

## 2.2 Other Sources

**Core Question:** Are entrepreneurs free to raise



capital outside the banking system including venture capital and/or by issuing stock in a well-regulated stock exchange? **No – Weak, large state-owned companies still dominate the stock market and the threshold for market entry is high. Venture capital is primarily concentrated in the high-tech sector.**

### Financial Freedom

2.2.1 How much control does the government exert over financial services? **Weak for entrepreneurs – Score 30 out of 100 – Considerable government control, including in banking and insurance sector, stock market, approval of debt securities, managed foreign exchange system, and control of capital accounts.**

**Source:** *Index of Economic Freedom 2011*, Heritage Foundation [www.heritage.org/index/Country/China](http://www.heritage.org/index/Country/China)

### Venture Capital

2.2.2 How easy is it for entrepreneurs to find venture capital? **Weak – 22nd out of 142; Score 3.5 out of 7; it is difficult for small entrepreneurs to raise venture capital, especially outside of the high-tech sector.**

### Equity Investors

2.2.3 How easy is it to raise money by issuing shares on the stock market? **Weak – 46th out of 142; Score 3.96 out of 7, the minimum equity required for the initiating of a company and the total assets for an IPO are extremely high.**

**Source:** *The Global Competitiveness Report 2011–2012*, World Economic Forum [www.weforum.org/issues/global-competitiveness](http://www.weforum.org/issues/global-competitiveness)

## 2.3 Credit Bureau

**Core Question:** Is comprehensive credit information

available through public and private credit bureaus? **Yes – Strong. However, the coverage is still not complete, the use of credit information is still very low, and not all financial institutions or quasi-financial institutions have access. Information on informal loans is not included.**

**Overall Ranking 67th out of 183 Trend ↓**

### Coverage

2.3.1 What is the depth of information available in credit bureaus? **Strong – Score 4 out of 6 with a higher number indicating more information is available. Information on informal loans is not included.**

### Public

2.3.2 What is the extent of public credit registry coverage? **82.5% – Very Strong**

### Private

2.3.3 What is the extent of private credit registry coverage? **Very Weak – not available publicly but information is available within the banks**

**Source:** *Doing Business 2012 – Getting Credit*, World Bank [www.doingbusiness.org/data/exploreeconomies/china](http://www.doingbusiness.org/data/exploreeconomies/china)

## In-Country Assessment Information

**FQ8: How available are mortgage loans for purchasing commercial property (office, retail, industrial and logistics), who is the typical user and what are the prevailing trends?**

The access of small companies to mortgage loans is a big problem. A down payment of 50% is required in Beijing and the loan rate is 10% higher than the baseline rate set by the Central Bank. Only a small part of SMEs have access to loans from banking institutions. To receive loans, they must be able to

provide mortgage, collateral, or guarantees. In the startup periods, most small companies rely on their own capital and some informal finance. A small company has to provide a number of documents and go through a number of procedures to have its loan application approved by banks. Small businesses believe that the time from the application to its approval is too long (around 10 to 15 days).

**FQ9: What are the interest rates, term and loan-to-value ratios?**

The interest rates are affordable for most small companies that borrowed bank loans (starting at 7%). Many owners of start-up businesses need to borrow from the informal financial sector or rely on their own capital. Banks are banned by the China Banking Regulatory Commission from disbursing loans to start-up businesses since they have no financial record to be used to borrow funds. The commercial interest rates in informal finance (often between 20%-30% or more) are much higher than in formal financing. For guarantee or investment companies, one has to pay some guarantee or consultancy fee.

**FQ10: To what extent are microenterprises (5 or fewer employees) active in the country? Approximately what percentage are formally registered firms?**

Microenterprises are active in Beijing and Nanchang. Many microenterprises, such as minibuses and tricycle transport providers, are not registered. Vendors sell goods at the entry of subway stations. Unregistered taxi drivers provide taxi services. Many unregistered service providers are also

present in the real estate sector. It is difficult to estimate the percentage of formally registered firms among small businesses. Some experts find it is a part larger than that of unregistered firms. Others find that the opposite is true.

**FQ11: What services other than loans such as insurance, funds transfers, and business development training are available from microfinance organizations for formal businesses?**

Savings and funds transfer are available in some microfinance organizations (Postal Savings Bank); some provide business development training as well.

**FQ12: What professional financial services are available outside state-owned banks including insurance, credit cards and investment management?**

Government dominates in the banking and insurance sector, but savings, loans, insurance, credit cards, debit card, and investment managements are available outside of state-owned banks. Foreign bank branches in China are not allowed to issue credit cards to Chinese.

**FQ13: What has been the appreciation (or depreciation) rate for commercial property over the last several years?**

The prices of commercial properties for office, retailing, and industrial use have all surged in China. The increase in housing prices has been even more significant, often more than doubled during 2008-2010, 150% and 120% in Beijing and Nanchang respectively in regard to some high-end properties.

The price of commercial properties for office and retail use has increased around 40%-50% in large cities of China. The increase in prices of commercial properties in Beijing in that period has been 23% while that in prices of office space 33%. There is no significant increase in prices of commercial properties for manufacturing use in China since the supply is large and local government subsidies are heavily involved.

**FQ14: How available is seed money or angel investors for the startup of small businesses?**

Very limited. Normally, a small business has to rely on its own capital and borrowing from relatives and friends. The borrowed funds are not supposed to be allowed as registered capital; however, many entrepreneurs use borrowed funds as part of their registered capital. One reason is that the required capital for opening a limited liability corporation or share-holding corporation is relatively large and entrepreneurs often lack enough of their own funds.

**FQ15: Do small businesses have access to credit information about potential customers?**

No. They must ask bank officials to help them collect credit information.

**FQ16: Can businesses gain access to information about them contained in credit bureaus and correct inaccuracies?**

Yes, they can gain access to information; however, they cannot easily correct inaccuracies. They can apply for a correction at the banks that provided the information. If there are disputes, they can sue banks to correct inaccuracies.

# Effective Governance

**Goal – A popularly elected government free of corruption and functioning efficiently and transparently enough to guarantee economic freedom to individuals and support equitable property markets**

**3.1 Democratic Representation**

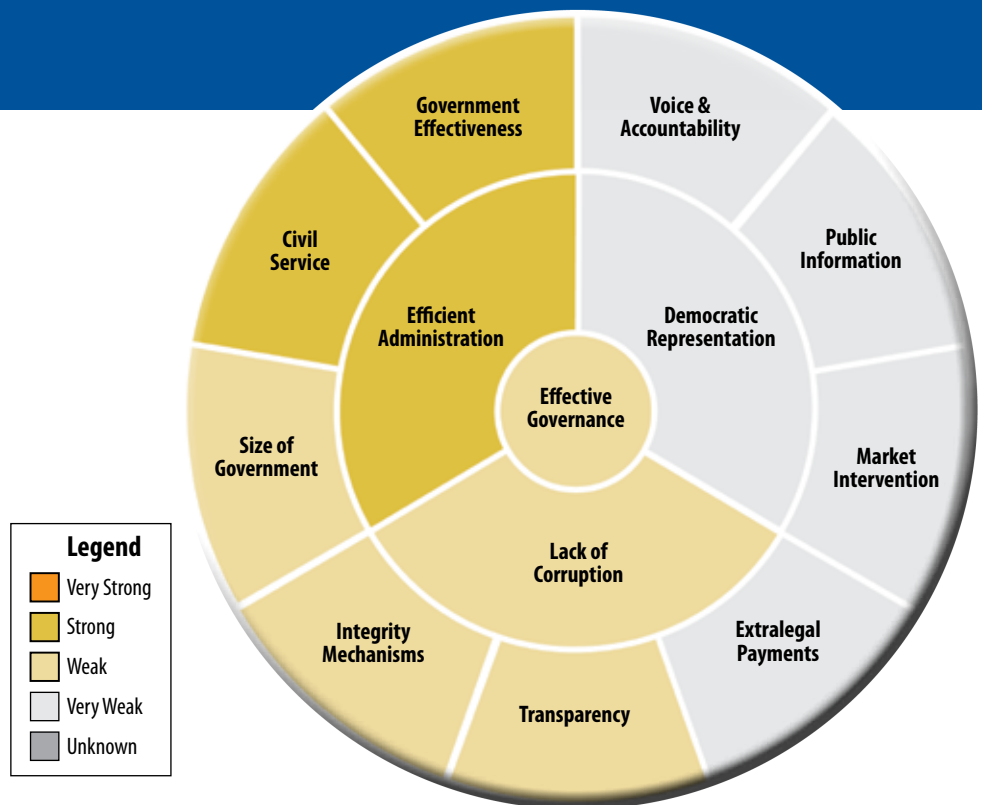
**Core Question:** Does the country have free and open elections for the leadership and can citizens engage in free enterprise? **No – Very Weak, the state still directs most economic activity and the Communist Party, while allowing some response to market forces, still maintains ultimate authority over economic decisions.**

**3.1.1 Voice & Accountability**

3.1.1.1 Are citizens able to elect their government and do they enjoy freedom of expression, association and a free media? **No – Very Weak – Percentile Rank – 5.2 Trend ↓**

**Sources:** *Governance Matters 2010*, World Bank [http://info.worldbank.org/governance/wgi/sc\\_chart.asp](http://info.worldbank.org/governance/wgi/sc_chart.asp)

3.1.1.2 Are citizens free to form political and civic organizations free of state interference and surveillance? **No – Very Weak – Score 1.18 out**



of 10, the formation of political organizations is forbidden. The registration of civic organizations is subject to difficult procedures.

**Overall Ranking – 136th out of 167**

**Source:** *The Economist* Intelligence Unit Democracy Index 2010 [http://graphics.eiu.com/PDF/Democracy\\_Index\\_2010\\_web.pdf](http://graphics.eiu.com/PDF/Democracy_Index_2010_web.pdf); Assessment by Unirule Institute of Economics

### 3.1.2 Public Information

**Overall Ranking – Very Weak; Score 60 out of 100 (2009)**

3.1.2.1 Are there regulations governing conflicts of interest in the executive and legislative branches of government?

**Yes – Executive Score 49 out of 100 – Very Weak; Legislative Score 31 out of 100 – Very Weak. The enforcement is also very weak. Party decisions take precedent over regulations.**

3.1.2.2 Can citizens access legislative processes and documents? **No, Very Weak. Citizens cannot hear legislative debates and do not have access to the legislative processes and draft legislation.**

**Source:** *Global Integrity Report* – <http://report.globalintegrity.org/China/2009>; Assessment by Unirule Institute of Economics

### 3.1.3 Market Intervention

**Overall Ranking – Very Weak 140th out of 179 Trend ↓**

3.1.3.1 To what extent does the government intervene in the private sector including state-owned industries? **Score 87 out of 100 with a higher score indicating less intervention. There has been a trend toward re-nationalization, and interventions have increased since 2003.**

3.1.3.2 To what extent does the government control prices? **Score 75.3 out of 100 with a higher score indicating less control. The government sets ceilings for the price increase of some goods. State-owned enterprises monopolize essential sectors such as railways, civil aviation, petrol industry, coal mining, etc.**

**Source:** *Index of Economic Freedom 2011* – Heritage Foundation [www.heritage.org/index/Country/China](http://www.heritage.org/index/Country/China); Assessment by Unirule Institute of Economics

### 3.2 Lack of Corruption

**Core Question:** Is the public sector transparent and free of corruption? **No – Weak, anti-corruption efforts in China are at a crucial juncture, with certain progress already made but facing a long road ahead.**

#### Transparency

3.2.1 What is the perceived level of corruption in the country? **Ranking – 78th out of 178; Score 3.5 out of 10 – Weak, Trend = The government continues to deny the necessity of building checks and balances into political and administrative systems, to the detriment of further taming unchecked power and the related corruption.**

**Source:** *Corruption Perception Index 2010*, Transparency International [www.transparency.org/policy\\_research/surveys\\_indices/cpi/2010/results](http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results); Assessment of Unirule Institute of Economics, 2011

#### Integrity Mechanisms

3.2.2 A National Integrity System is a framework where the principle institutions that contribute to integrity, transparency and accountability in a society can

address corruption in a systematic way. Does a National Integrity System exist? **Weak. There are anti-corruption bureaus under people's protectorates, courts of audit, and party discipline committees but a proper and effective anti-corruption framework has yet to develop.**

**Source:** *National Integrity System Assessment*, Transparency International [www.transparency.org/policy\\_research/nis/nis\\_reports\\_by\\_country](http://www.transparency.org/policy_research/nis/nis_reports_by_country)

#### Extralegal Payments

3.2.3 How often do companies report that officials and/or companies expect additional payments to “expedite” services or gain business? **Pervasive. According to a 2003 survey of the World Bank 72.5% of firms say they are expected to make unofficial payments – High Occurrence – Very Weak.**

**Source:** *Enterprise Surveys*, World Bank 2003 [www.enterprisesurveys.org/ExploreEconomies/?economyid=42&year=2003](http://www.enterprisesurveys.org/ExploreEconomies/?economyid=42&year=2003).

### 3.3 Efficient Administration

**Core Question:** Are quality services and qualified civil servants available to the public through the efficient use of public money? **Yes – Strong, there has been improvement in recent years. More and more officials are increasingly accountable for their decisions.**

#### Size of Government

3.3.1 What is the size of government relative to GDP? **Around 31%-33% during recent years – 25 to 30% considered optimum – Weak, 19.9% in terms of the budgetary revenue as a ratio of GDP. However, if including budgetary revenue, government funds, extra-budgetary revenue, land transfer revenue, and social security funds, the size has reached 31%-33% during recent years, which reflects a truer size of government.**

**Source:** *Index of Economic Freedom 2011*, Heritage Foundation [www.heritage.org/index/Country/China](http://www.heritage.org/index/Country/China); Annual Report of Institute of Finance and Trade, Chinese Academy of Social Sciences, 2010.

#### Civil Service

3.3.2 What is the quality of the civil service? **Strong – Score 71 out of 100**

**Source:** *Global Integrity Report* – <http://report.globalintegrity.org/China/2009>

#### Government Effectiveness

3.3.3 What is the overall effectiveness of the government? **Strong – Percentile Ranking – 59.8 Trend =**

**Source:** *Governance Matters 2010*, World Bank [http://info.worldbank.org/governance/wgi/sc\\_chart.asp](http://info.worldbank.org/governance/wgi/sc_chart.asp)

### In-Country Assessment Information

**FQ17: What is the actual experience of small businesses in dealing with the government, particularly the number and complexity of required procedures and the prevalence of extra payments to facilitate services such as licenses or permits?**

Small businesses have very little protection from government appropriation of property. While overt payments are decreasing, officials often expect to be treated to dinner or presented with

a gift or entertainment. Some small companies report having to make extra-legal payments to go through simple administrative procedures. Tax burdens imposed upon many small businesses are heavy. Therefore, many small businesses find a way to build up a good relationship (guanxi) with key tax officials so that tax burdens can be reduced. If companies do not have good relations to tax officials, tax bureaus might send tax inspectors to check on the business and its tax payment records. Normally they will identify some faults and charge fines. Similarly, one has also to build up and maintain good relations to some officials in bureaus of industry and commerce, bureaus of health, bureaus of environmental protection etc. Some companies invite credit officials to dinners, entertainment, or vacations, and present gifts to credit officials. Small businesses also have problems with dealing with city governments when it comes to property transactions. City governments monopolize the primary land market. They reserve parcels of land after the land taking, construct infrastructure there, and resell these parcels for profit. They are price makers. Although the use rights of such land are transferred through a system of tender, land auction, and land listing, urban governments control land supply to increase the selling prices. Such a system involves plenty of cheating and insider control problems. Also, government collects many taxes and fees from the real estate sector. This contributes to the increase of the property prices, which is detrimental to the development of small companies.

# Rational Dispute Resolution

**Goal – An efficient institutional framework that balances the rights of the public, owners, lenders and borrowers in the event of a dispute or loan default**

## 4.1 Rule of Law

**Core Question:** Do all market participants abide by the rule of law and have confidence in the courts and the ability of police to control crime? **No – Weak, relevant regulations are not strong enough. Some judges have various kinds of connections with law firms or other private businesses. Cases of police abuse take place in every city.**

### Impartiality

4.1.1 What is the confidence level of the strength and impartiality of the police, courts and contract enforcement? **Weak – Percentile Ranking – 44.5 Trend ↓**

**Source:** *Governance Matters 2010*, World Bank  
[http://info.worldbank.org/governance/wgi/sc\\_chart.asp](http://info.worldbank.org/governance/wgi/sc_chart.asp)

### Independent Judiciary

4.1.2 Can members of the judiciary be held accountable for their actions? **No – Score 46 out of 100 – Very Weak, there is strong Party control and interference from the local administration.**

**Source:** *Global Integrity Report 2009* – <http://report.globalintegrity.org/China/2009>

### Costs of Crime

4.1.3 What are the business costs of crime and violence? **Moderate Costs – Ranking 55th out of 142 – Score 5.1 out of 7, Strong.**

**Source:** *The Global Competitiveness Report 2011-2012*, World Economic Forum  
[www.weforum.org/issues/global-competitiveness](http://www.weforum.org/issues/global-competitiveness)

## 4.2 Enforcement of Contracts

**Core Question:** Are systems in place for timely and efficient enforcement of contracts?

**Commercial – Yes – Strong, contract enforcement has improved dramatically in urban areas. However, there is strong local protectionism in the judicial branch in Chinese regions.**

### 4.2.1 – Judicial Enforcement

**Commercial – Strong – Ranking 16th out of 183 Trend ↓; while costs are relatively low, many cases, especially dealing with land disputes, are refused by the courts.**

4.2.1.1 What is the number of procedures involved in resolving a commercial dispute? **34**

4.2.1.2 What is the time between the filing of a lawsuit and resolution in judicial enforcements? **406 days**

4.2.1.3 What is the cost of judicial enforcements as a percentage of debt value? **11.1%**

**Source:** *Doing Business 2012* – [www.doingbusiness.org/data/exploreeconomies/china](http://www.doingbusiness.org/data/exploreeconomies/china)

### 4.2.2 – Summary Proceedings

**SQ 10:** Summary proceedings are alternative dispute resolution processes where creditors can apply for a direct court order in property disputes. What is the time between notice of intent to foreclose and loan collection in summary proceedings if available to lenders? **Not available – Very Weak**

**SQ 11:** What is the cost of summary proceeding if

available to lenders as a percentage of property value? **Not available – Very Weak**

### 4.2.3 – Power-of-Sale

**SQ 12:** Power-of-sale agreements give creditors the power to sell properties after notice to the borrower without court intervention. What is the time between notice of intent to sell and loan collection for power-of-sale agreements if available to lenders? **Weak – provided for in the Property Law (Chapter XVI, Article 191), but little used due to low volume of transactions. Also, creditor must find first alternate living space for owners.**

**SQ 13:** What is the cost of power-of-sale agreements if available to lenders as a percentage of property value? **Unknown**

**Source:** *Source: Property Rights Law of the People's Republic of China*  
[www.lehmanlaw.com/fileadmin/lehmanlaw.com/laws\\_regulations/Property\\_Rights\\_Law\\_of\\_the\\_PRC\\_LLX\\_03162007.pdf](http://www.lehmanlaw.com/fileadmin/lehmanlaw.com/laws_regulations/Property_Rights_Law_of_the_PRC_LLX_03162007.pdf); Assessment of Unirule Institute of Economics, 2011.

## 4.3 Commercial Dispute Resolution

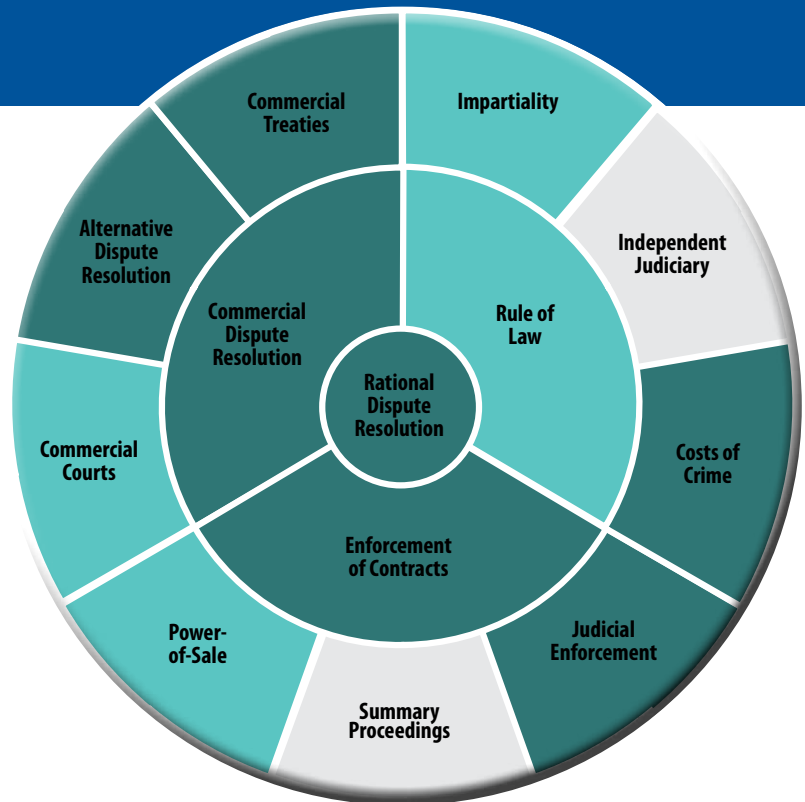
**Core Question:** Can commercial disputes be resolved efficiently and fairly without exorbitant expense and delay? **Yes – Strong for large companies. Most small businesses use trusted partners to avoid the court system and use alternative methods when a dispute arises.**

### Survey Questions

#### Commercial Courts

**SQ 14:** Do specialized commercial courts exist for the handling of property disputes and foreclosures? **No – Weak, commercial cases are handled in the Basic Level People's Court, which often has an economic tribunal.**

**Source:** [www.olemiss.edu/courses/pol324/chnjudic.htm](http://www.olemiss.edu/courses/pol324/chnjudic.htm)



### Alternative Dispute Resolution

**SQ 15:** Are alternative dispute resolution mechanisms in place including commercial arbitration, private mediation and community based processes? **Yes – Strong, arbitration is the preferred method of dispute resolution in China.**

**Source:** U.S. Department of Commerce  
[www.export.gov/china/exporting\\_to\\_china/disputeavoidanceandresolution.pdf](http://www.export.gov/china/exporting_to_china/disputeavoidanceandresolution.pdf)

### Commercial Treaties

**SQ 16:** What bilateral, regional and international commercial treaties exist concerning business between countries? **ASEAN, Thailand, Niger, Chile, Pakistan, New Zealand, Peru, Singapore, Costa Rica, Hong Kong; Asian-Pacific Trade Agreement; Double taxation treaties exist with more than 80 countries – Strong**

**Source:** China FTA Network, Ministry of Finance  
<http://fta.mofcom.gov.cn/english/index.shtml>

### In-Country Assessment

**FQ18:** To what extent do small businesses trust public institutions to support contract enforcement?

Land leasers who purchased land use rights and built factories have to make great efforts in claiming their rights, in spite of the fact that they signed a use contract that refers to the compensation in the case of land taking. In some cases they do not receive any compensation from the land lessors who were given compensation by the local government. Small businesses are disadvantaged in regard to legal protection and dispute resolution in comparison with larger firms. Larger firms are equipped with more funds, influence, a larger social network, and often better connections to local government, and can lobby the government and the judiciary for favorable decisions.

# Financial Transparency

**Goal – A well developed and transparent financial system that includes strong supporting institutions and highly trained and ethical professionals that contribute to effective financial intermediation and deep and broad access to capital and financial services**

## 5.1 Market Stability

**Core Question:** Are market risks sufficiently transparent and diversified so that efficient capital allocation can occur? **Yes – Strong, China's strong growth has continued and the government constantly monitors and regulates macroeconomic performance.**

### Financial Reporting

5.1.1 What is the strength of the country's auditing and reporting standards? **Strong – 61st out of 142; Score 4.78 out of 7. Strong for listed companies, however, cheating and falsifying financial reports are common for non-listed companies.**

### Financial Services

5.1.2 Does the financial sector provide a wide variety of financial services to businesses? **Strong – 60th out of 142; Score 4.74 out of 7**

**Source:** *The Global Competitiveness Report 2011-2012*, World Economic Forum  
www.weforum.org/issues/global-competitiveness; Assessment by Unirule Institute of Economics

### Insolvency Process

**Strong – Ranking – 75th out of 183 Trend ↓**

- 5.1.3 What is the average time to complete bankruptcy proceedings? **1.7 years**
- 5.1.4 What is the cost of bankruptcy proceedings as a percentage of the estate? **22%**
- 5.1.5 What is the recovery rate of bankruptcy proceedings? **36.1 cents on the dollar**

**Source:** *Doing Business 2012 – Closing a Business*  
www.doingbusiness.org/data/exploreeconomies/china

## 5.2 Independent Asset Valuers

**Core Question:** Do trained, independent and ethical asset valuers exist for all types of assets? **Yes – Strong, numerous large native and international valuation firms are active, but few independent appraisers support land owners in government takings.**

### Survey Questions

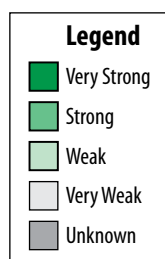
#### Standards

**SQ 17:** How easy is it to find a valuer who implements International Valuation Standards? **Strong – Valuation Standards Committee is included in the Ministry of Finance and has a member on the IVSC Board of Trustees.**

#### Training

**SQ 18:** What is the level of training of valuers? **Very Strong – Licensing exam is very difficult and many valuers hold internationally recognized qualifications.**

**Civil Society Resource:** International Valuation Standards



**Council** [www.ivsc.org](http://www.ivsc.org) and China Institute of Real Estate Appraisers and Agents [www.cirea.org.cn/](http://www.cirea.org.cn/)

### Ethics

**SQ 19:** Are opinions offered by valuers free of influence from parties to the transaction? **Yes – Strong, effective valuation associations are active for all types of assets. In land taking cases, valuers are often recruited by local the government. The valuation result is in favor of the local government but it is kept within the limit allowed by their profession.**

**Civil Society Resource:** China Appraisal Society [www.cas.org.cn/](http://www.cas.org.cn/)

## 5.3 Data Standards

**Core Question:** Is accurate property information available electronically in formats that are consistent with international standards? **Yes – Strong, rapid improvements have occurred over the last several years.**

### Survey Questions

#### Sales & Operating Data

**SQ 20:** A multiple listing service is an electronic exchange system where brokers and agents can widely share contracted real estate listings of properties that are for sale. Do multiple listing type services exist? **No – Weak, dedicated Internet sites are starting to emerge, but a standardized listings service is not available.**

**Source:** <http://soufun.com/>; [www.ehousechina.com/](http://www.ehousechina.com/)

**SQ 21:** Do resources exist for obtaining building income and expense estimates? **No – Weak**

**Civil Society Resource:** Shanghai Weston Real Estate Management Institute [www.westonedu.com/](http://www.westonedu.com/)

#### Interchange Formats

**SQ 22:** Do electronic data interchange formats conform to

international standards (ebXML – electronic business using extensive markup language)? **Yes – Strong, ebXML was introduced as a standard in 2003 and real estate data firms are developing.**

**Civil Society Resource:** Open Standards Consortium for Real Estate International [www.oscre.org](http://www.oscre.org)

### Technical Standards

**SQ 23:** Do building codes and office building measurement standards (ANSI/BOMA Z65.1) conform to international standards? **Yes – Very Strong**

**Civil Society Resource:** Chinese Office Building Owners and Managers Association <http://bj.house.sina.com.cn/biz/boma/index.html>

## In-Country Assessment

### Valuation Profession

**FQ19:** How many independent valuers exist in the market? Can small businesses obtain fair valuations for property they want to buy or sell?

There are many professional valuation companies in Beijing and Nanchang. The competition among them is quite fierce. They are in principle independent of the government, but some still have explicit or implicit close connections to government officials (they were initially associated with and later separated from the government). Small businesses can obtain relatively fair valuations for property they want to buy or sell.

**FQ20:** What are the valuation standards and do they conform to international and regional standards?

There is a set of valuation standards which the valuation institutions have to comply with or they will lose their license. There is also a set of baseline

values relating to properties in different locations. Based on these values, the appraisers assess the market values of properties. However, the client has a say in the determination of the final value of the property. The respective valuation institution will discuss the final value with the client and determine the value in favor of the fee payer. So the values the appraiser stated are not too far away from what the client thinks it should be.

**FQ21: What valuation methods and techniques are used in the market?**

The values of some properties can be sometimes quite subjective, depending on how the payer or evaluator expects its use and appreciation in future. The valuation institutions, if their evaluation tasks are assigned by the government, refuse to add this part in their valuation of properties in land taking cases.

**Data Availability**  
**FQ22: How available is information for commercial properties that are for sale or that have been sold?**

Small companies can find information relating to the purchase and rental of commercial properties from newspapers, journals, and websites. Professional journals and websites are very important for purchase and rental of sector-specific properties. Relating to the purchase of land use rights, one can check the price on a special government website devoted to the system of land tender, auction, and listing. There are also many special applets on land and housing information that can be installed in smart phones.

## Appropriate Regulation

**Goal – A comprehensive regulatory regime that is transparent, efficient, simple in its implementation and that leads to accurate reporting of property values and prudent protection from market risks**

### 6.1 Fair Tax Regime

**Core Question:** Do market participants feel the overall tax rate is fair and participate in formal transactions?

**Weak – business tax rates are high and Land Value Appreciation tax, reintroduced to cool down the real estate market, adds to the tax burden. Also the deed tax per transaction is perceived as high (3% of the contract value). Underreporting of contract values is pervasive to lessen taxation.**

#### Transfer Tax

6.1.1 What is the total property transfer tax including all duties and payments? **3.6% - Strong**

#### Overall Tax

6.1.2 What is the overall tax rate on entrepreneurs (as a percentage of profits)? **63.5% – Ranking – 122nd out of 183, Weak – Trend ↓**

**Source:** *Doing Business 2012 – Paying Taxes & Registering Property*, World Bank [www.doingbusiness.org/data/exploreeconomies/china](http://www.doingbusiness.org/data/exploreeconomies/china)

#### Divestment

### Survey Question

**SQ 24:** What is the tax on profits for foreign investors when divesting property? **20% capital gains tax + land value appreciation tax of 30% or more – Weak**

**Source:** State Administration of Taxation [www.chinatax.gov.cn/n6669073/n6669088/6888416.html](http://www.chinatax.gov.cn/n6669073/n6669088/6888416.html)

### 6.2 Professional Services

**Core Question:** Are the professional services necessary for efficient and transparent property markets available and appropriately regulated and supervised?

**No – Weak, the profession is relatively new and untested by a severe downturn.**

#### Asset Valuers

### Survey Questions

**SQ 25:** Are property valuers licensed and/or certified by the government? **Yes – Strong.**

**SQ 26:** How effective are mechanisms in place to discipline valuers who engage in misconduct? **Strong – valuers do not want to lose their government license, so**

**they generally do not engage in misconduct.**

**Civil Society Resource:** China Institute of Real Estate Appraisers and Agents [www.cirea.org.cn/](http://www.cirea.org.cn/)

#### Brokers & Agents

### Survey Questions

**SQ 27:** Are real estate brokers and agents licensed and/or certified by the government? **Yes – Weak, licensing of agents is relatively new. There are many unlicensed brokers and agents.**

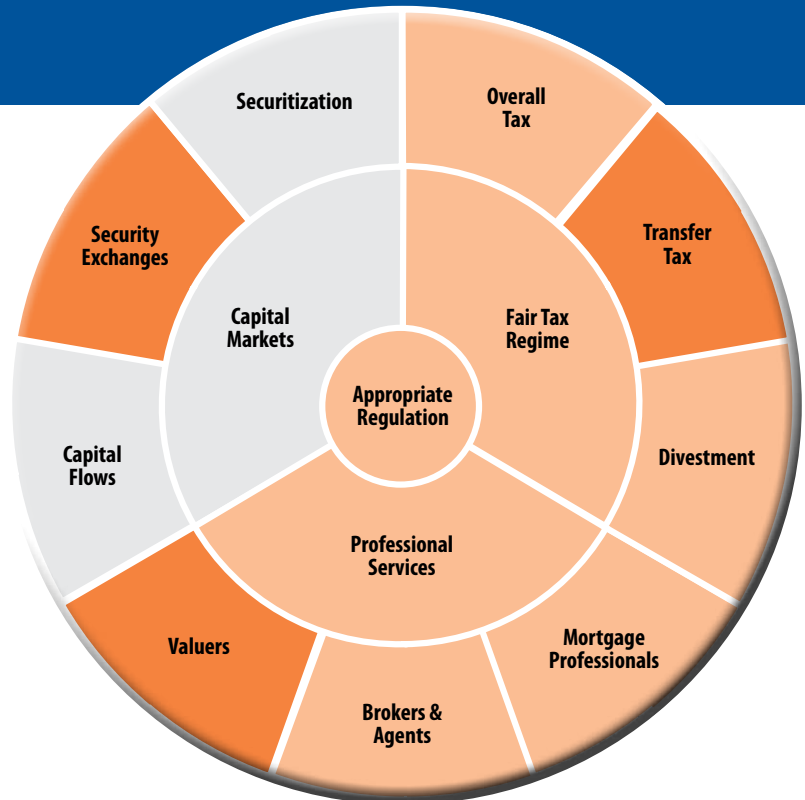
**SQ 28:** How effective are mechanisms in place to discipline brokers or agents who engage in misconduct? **Weak, very few sanction mechanisms are in place.**

**Civil Society Resource:** China Institute of Real Estate Appraisers and Agents [www.agents.org.cn/](http://www.agents.org.cn/)

#### Mortgage Professionals

### Survey Questions

**SQ 29:** Are mortgage professionals licensed and/or certified by the government? **No – Weak, it is not a separate profession outside traditional banks.**



**Source:** China Banking Regulatory Commission [www.cbrc.gov.cn/english/index.html](http://www.cbrc.gov.cn/english/index.html)

**SQ 30:** How effective are mechanisms in place to discipline mortgage professionals who engage in misconduct? **Unknown.**

### 6.3 Capital Markets

**Core Question:** Are capital markets well-regulated and diversified enough to provide financial resources to private-sector entrepreneurs and innovators? **No – Very Weak, investors face regulatory non-transparency, and complex and inconsistently enforced laws and regulations. The capital market was developed for fund raising for SOEs and is still biased in favor of SOEs or large public projects.**

#### Capital Flows

6.3.1 How restricted is the flow of capital into and out of the country? **Very Weak – Score 25 out of 100, capital account transactions are tightly regulated.**

**Source:** *Index of Economic Freedom 2011*, Heritage Foundation [www.heritage.org/Index/Country/China](http://www.heritage.org/Index/Country/China)

## Security Exchanges

6.3.2 Is the regulation of securities exchanges transparent, effective and free of influence from government and industry? **Yes – Strong, Ranking 53rd out of 142; Score 4.52 out of 7**

**Source:** *The Global Competitiveness Report 2011-2012*, World Economic Forum [www.weforum.org/issues/global-competitiveness](http://www.weforum.org/issues/global-competitiveness)

## Securitization

6.3.3 What is the depth of asset-backed securities, mortgage-backed securities, high-yield bonds and highly leveraged loans? **Very Weak – 55th out of 57 countries**

**Source:** Financial Development Report, World Economic Forum [http://www3.weforum.org/docs/WEF\\_FinancialDevelopmentReport\\_2010.pdf](http://www3.weforum.org/docs/WEF_FinancialDevelopmentReport_2010.pdf)

## In-Country Assessment

### Taxation

**FQ23: What is the level of taxation for small businesses? Are any of those taxes an excessive burden on small businesses? Are any tax discounts provided for small businesses?**

There are more than 60 different sorts of taxes and fees for real estate sector in China. Including all the taxes and fees such as those associated with profit from sale, land transfer revenue, etc. businesses can pay close to 50% of the sales price in taxes and fees. For small businesses: 3% VAT without any tax base deduction; 25% corporate income tax and some further surcharges. Tax burden of small scale tax payers is normally lower than regular tax payers. However, many market participants find that the tax and fee burdens of small companies are quite heavy, if they pay taxes and fees (including social insurance fees) according to laws and regulations. Some companies engage in tax evasion or avoidance, although the tax law enforcement has become stricter than before. Small businesses have to keep good relations with the tax officials and other government departments, including the city management inspectors (cheng guan). At the same time, they feel that they are imposed with taxpayers' liability without enjoying taxpayers' rights.

### Professional Services

**FQ24: What is the experience of small businesses in dealing with professional property market service providers such as real estate agents, brokers and valuers?**

These property market suppliers and service providers are relatively reliable since their information has to be to some degree in accordance with the real place and time information on properties. However, they use certain tricks in releasing their price information. They often quote a quite low price for customers purchasing or renting a property. If the customers inquire further, they might say that that property is sold or rented out already, and then recommend other, pricier properties. They sometimes provide biased information and hide some real information on sales situation. For instance, they might tell a buyer that the desired property is unavailable even if that is not true in order to wait for a better time to sell to them at a higher price. Or they may say that this is the last apartment available – even if that is not the case – to negotiate a higher price. Real estate developing companies also often run often

their own property management companies that manage business properties sold to customers. Those companies frequently pursue their own interests at cost of the property owners' interests and are generally not trustworthy. The government entrusts only large and certified valuation companies with work. Fearing potential punishment from the government (withdrawing the license etc.) most large companies perform well. However, they have to discuss the values of the assessed properties with the government. Therefore, values are relatively reliable but in favor of the government.



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