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The Institutional political Economy of state-led Economic Reform:

Early Urban Land Development and the Construction of Oriental Plaza in Beijing, China

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1. INTRODUCTION

> *The more I study ... the different forms that the right to property has taken and, whatever anybody says, still takes on this earth, I am tempted to the belief that what are called necessary institutions are only institutions to which one is accustomed, and that in matters of social constitutions the field of possibilities is much wider than people living in each society imagine.*
>
> *– Alexis de Tocqueville, 1893*

At the Third Plenum of the 11th Central Committee of the National Party Congress in 1978, Deng Xiaoping announced the beginning of a period of reforms intended to open China up to the rest of the world. After thirty years of rule, the country had tried unsuccessfully to create a vibrant centrally planned economy but instead had suffered from a series of economic initiatives which left the country debilitated and impoverished. Motivated by these failures and more than a century of embarrassing concessions to foreign powers, state leaders set off to implement a series of reforms to gradually integrate the market mechanism into its centrally planned economy in the hopes of repeating the economic successes which neighbouring East Asian countries had been experiencing after similar reforms (Wade 2004). As China approaches the thirtieth anniversary of its reform and opening (*gaige kaifeng*), the overall success of its transition toward a market economy is difficult to challenge.

The challenge lies in understanding the institutional environment under which these successes have occurred and how they might (or not) be able to be repeated in other developing countries. The ideological principles which helped the Chinese Communist Party rise to power in 1949 lie in stark contrast to the new market-based economic reforms, yet reformist leaders increasingly believed them to be necessary to maintain the future power of the Party. Overseeing such reforms while maintaining the state's political power required that changes to the economic and legal systems occur incrementally and be constantly equilibrated to the country's ideological and material needs (Potter 2004: 472-5). This balance required that the reforms influence new paradigm shifts but also have vestiges of the country's social and political legacy (Srinivasan 1990: 114). The slow evolution of the country's institutional environment, which one writer has termed "Confucian capitalism" (Crovitz 1992: 26), has caused scholars to speculate on the long-run efficacy and sustainability of the reforms. Proponents argue for its practicality in allowing the state to adapt the speed and direction of its reforms more flexibly over time and in different contexts, like groping for stones when crossing a river (Chai 2003; Peerenboom 2002). Skeptics, on the other hand, argue that the ambiguity of the institutional climate has made the reforms unenforceable and exploitative, locking the country into a trapped transition like a bird in a cage (Pei 2006; Lubman 1999) or worse positioning it for an inevitable economic collapse (Chang 2001; Goldstone 1995).

Representative of this debate has been the gradual development of the country's urban land market. Because land is one of the primary drivers of an advanced economy yet also an important symbolic factor of production for its relationship to basic livelihood, the commoditization of the land market sheds light on how Chinese institutions have evolved alongside the country's development. Existing literature on China's urban land-related institutions has tended to focus on 1) understanding the nature of China's institutional evolution in comparison to a set of "best practice" counterparts (Lin and Ho 2005; Zhang and Fang 2004; Qian 2003) or 2) analyzing how the given institutional environment has affected particular economic growth (Zhu 2004; Ling 1999). Instead, this study looks specifically at how different sectors have managed to negotiate the inherent uncertainties arising from these ambiguous economic and legal institutions, their varied success at doing so, and how these intersectoral relationships enable future institutional reforms. Section Two reviews key theories surrounding property rights, incentives, and the developmental potential for land. Section Three applies considers these theories in a case study of Beijing's urban land market. Section Four discusses some implications for different organizational players, and Section Five concludes.

The empiricism for this dissertation comes from an inductive historical analysis of the construction of Oriental Plaza, a high-profile mixed-use (retail, commercial and residential) complex in the heart of Beijing's Old City. Its construction spanned the greater part of the capital's early development of an urban land market in the 1990s and influenced many institutional reforms which now oversee urban land markets across the country. The case was chosen not only for its temporal appropriateness but for its locational appropriateness in a city where local and central state power dynamics intersect most directly and where land development must work in a context with a strong cultural and historic legacy. The study suggests that the creation of Beijing's urban land market has for the most part single-mindedly focused on rapid economic development at the expense of long-term sustainability. And while it shows that the structure of accountability and incentives responsible for this growth were sufficient for the time period, it also caused inefficiencies for the Oriental Plaza development, which started as a US$1.2 billion dollar project scheduled to be completed in 1997 but finished as an over US$2 billion dollar project in 2001 instead. While China's state-led economic development has led to rapid growth in an institutionally immature land market, this growth has been fragile and has demanded continued refinement of the institutional environment as the land market and overall economy matures.

2. THEORETICAL CONSIDERATIONS

2.1 Institutions, Property Rights, and Development

In its broadest sense, an institution is a right or obligation which defines one of the "rules of the game in a society or, more formally, …the humanly devised constraints that shape human interaction" (North 1990: 3). Because actors would otherwise have imperfect information when making decisions, institutions allow them to engage with other organizations or individuals in mutually beneficial exchanges based on commonly agreed upon formal or informal understandings. These agreements minimize the transaction costs involved with frequent interactions while allowing actors to benefit by cooperating in the execution of commonly held goals. Effective institutional arrangements depend on the creation of incentives which make this cooperation desirable and of enforcement mechanisms which make it credible. Thus, the perceptions that actors have of the institutional environment determines the ways in which they will cooperate with other actors. Institutions matter to development because of how these incentives and structures of accountability relate to growth. Because the appropriateness of these institutional arrangements changes over time and in different contexts, it is of limited use to focus on institutional quality from a static position or simply as an end game.

From among these existing arrangements, the institutions underlying a country's property rights regime are generally considered to be among the most intimately connected to economic growth. Property rights can be defined as the bundle of rights which gives an actor the ability to use a given resource, derive benefits from such use, change the way in which it is used, and transfer these rights to others as one sees fit (Demsetz 1997: 509-10). As a result, the way in which they are arranged and enforced can have powerful effects on improving a country's well-being or contributing to its unrealized developmental potential; however, transferring property rights based simply on the successful arrangements of previous countries can produce significantly different results depending on the different informal norms and rules which already exist (North 1994: 366). In addition, developing countries must also balance the costs, expertise, and unforeseen repercussions which are associated with the introduction of new formal institutions with their expected benefits if successfully incorporated.

Econometric analyses, such as Acemoglu et al (2001), explore the relationship between institutional quality and economic growth empirically but cannot measure for the context-specific and intertemporal issues which affect institutional transitions (Rodrik 2004). This limits their efficacy as guidelines for developing countries because they are limited to providing institutional “destinations” to developing countries when what they need is a road map.

In his historical analysis of institutional formation, Chang (2002) argues that the institutions which are now pushed on developing countries were not present at similar periods in the now developed countries’ development cycles. Allowing for incremental reform in adapting to large-scale, rapid changes to their institutional frameworks instead can allow late (and late-late) developers to be more flexible and responsive throughout the various stages of their development, which has become increasingly difficult to manage in a more globalized world (Perraton et al 1997). Incremental reform moderates the short-term losses which some groups experience as a result of the reforms while fueling the economic growth required to undertake and enforce further institutional improvements. It also gives informal institutional networks (such as civil society) more time to internalize the reforms that are being implemented so that they can be understood more widely and not be as easily usurped by an elite class (Putnam 1993).

Nonetheless, institutional change will never be Pareto efficient since it inevitably involves a redistribution of power. Because power is by definition a relational phenomenon signifying one's ability to influence the way that others act, redistributing this power will always make someone worse off than before. But institutional change does not simply result in zero-sum redistributions either. Rather, it is "a resource that –like wealth—also grows or withers" (Kohli 2004:20), making institutional reform more comprehensively an exercise in quantifying, classifying, and reallocating power and thus the nature of a country's development.

2.2 Incentives and Accountability in State-led Economic Development

Although the economic benefits lie in more efficient allocation of resources, the challenge of reforming economic institutions often lies in how existing power relationships are given incentives to accept them. For this reason, debates about the role of the state in the market are centered on whether this arrangement can cause this economic development to be achieved more rapidly and sustainably than in pure market conditions. Nonetheless, a minimal role for the state in the market is not controversial. The state must be willing and able to create a space where the market can function, force the market to internalize the externalities of market transactions, and enforce the outcomes of these market transactions (Esman 1991; Friedman 1982). As a corollary, the state must then also have the capability and desire to perform these tasks. It acquires this capability by claiming a monopoly on the legitimate use of force in a society to oversee the productive formation of capital, which it then takes advantage of to exact taxes on this production in return for protection. In doing so, "coercion becomes productive when it is employed not to seize or destroy wealth, but rather to safeguard and promote its creation" (Bates 2001: 102). By continuing to protect more efficient capital investments, the state in turn maximizes the long-term returns it receives and maintains its legitimacy.

More orthodox economic theories claim that market-based competition creates efficient allocations of resources which maximise growth and make society as a whole better off (Lal 1985). They view state involvement as distortionary to the results which this arrangement will produce of its own accord. While the market does not always act perfectly, the line of reasoning follows that its imperfections over time will be fewer and less severe than the alternatives that would be produced by an active state. More heterodox theories argue that this framework is overly dichotomous and that the two sectors are fundamentally linked (Chang 2003). This school argues that since the theoretical assumptions of free markets often do not hold true empirically and because it is a construct of the state anyway, the state can and should address market inefficiencies through regulatory measures in order to limit these possible negative effects on growth. These state institutions, in turn, can systematically affect the ways that actors participate in the market and redistribute wealth to produce more developmentally progressive outcomes.

The extent to which states should seek to limit market failures as opposed to actively prevent them depends on the institutional arrangements which govern their interaction. If conditions allow it, state-led economic development can generate rapid economic growth sustainably, but the nature of the growth can be less stable and less accountable to those whom it affects most directly. Past evidence from developing countries suggests that success relies on creating "a meritocratic bureaucracy with a strong sense of corporate identity and a dense set of institutionalized links to private elites" (Evans 1989: 561). If the state has both the intention and capacity to pursue rapid economic development, it can limit the amount of potential conflicts of interest which arise between private economic actors and apply its power toward putting resources in the hands of productive users more easily (Wade 2004: 27). These states, which Kohli (2004) refers to as "cohesive-capitalist states", require a highly centralized source of power and limited intervention, both of which allow them to credibly precommit to reforms (Bardhan 2000) while maintaining their position of power.

Because this close alliance between the state and the economy typically requires authoritarian political arrangements, these state types also challenge the extent to which democratic governance should participate in developing countries' early economic development (Brett 1999: 7). As democratic systems require the state to maintain its legitimacy through popular democratic support, government policies try to appeal to large constituencies of often conflicting sources of power. As a result they may produce decreased levels of economic growth in the short-term in exchange for the preservation of their political legitimacy (Kohli 2004: 11). At the same time, this need for continued legitimacy also limits possible abuses of power by allowing voters to hold governments accountable to the more complex and variable developmental demands of the population (Shafer 1990: 127). Alternatively, in authoritarian states, citizens' ability to hold the state accountable is highly restricted, and the state has more flexibility in pursuing long-term interests without fear of reprisal. In terms of its relationship with the private sector, the democratic state must be concerned with "discovering when and why an industry (or other group of like-minded people) is able to use the state for its purposes" (Stigler 1971: 2) while the authoritarian state can concern itself more with how it might be able to use industry for *its* purposes.

2.3 Urban Land Management and Development

Since land lies at the foundation of all material wealth (Simpson 1976: 3), releasing its economic potential can have profound effects on economic growth in developing countries, which can benefit from increased employment, wages and social spending. De Soto (2000) estimates that the developing world holds enough wealth in its uncapitalized land to be able to solve its own economic problems – if it could release this "dead capital" into the economy. Clarifying a country's property rights structure could enable actors to make appropriate long-term investments in their land and give them access to further capital for investments based on their land's collateral value. It would also enable governments to collect taxes and provide services more efficiently. Creating a viable land market also facilitates the exchange of land to actors able to use it most productively. Coase's theorem (1960) suggests that in an environment with costless transactions, ownership will evolve to users who will derive the most benefit from the property since they are able to compensate less productive owners with part of the increased returns. De Soto argues that government bureaucracy is what is holding this process of capital formation back.

Nonetheless, market forces alone do not ensure that the release of this dead capital is executed in a way that maximizes productivity. To start, market land transactions are not costless and require strong property rights regimes to support large injections of capital and enforce the owner's use right once improvements have been made. Because these exchanges ultimately still rely on imperfect knowledge, exchanges present risks which some actors respond to more adversely than others. In addition, current owners may hold out from the "rational" sale of their land because of its perceived speculative value. Potential buyers with the most productive plan for the land may not have adequate capital to purchase and develop the property or be unable to make accurate projections of what level of revenue it will garner.

In addition, land ownership has tendencies to accumulate in the hands of an elite, usually with strong political or economic affiliations which protect their interests. Because of land's limited supply, these owners can seek rents which exceed the theoretical dictates of a free market. Operating under quasi-monopolistic conditions, these owners can reduce land's productive potential indefinitely. Because of land's fixed nature, owners can also thwart efforts to combine parcels for larger private projects or important public projects. For these reasons, land ownership structures can often lead to Pareto inefficient outcomes.

Besides these market inefficiencies, the management of land poses developmental challenges since it serves not only as a factor of production in economic growth but as a basic source of security and welfare as well (Deininger and Feder 1998: 14). These livelihood issues are exacerbated in urban areas, where land is particularly valuable and in short supply (Zetter 2004: 1-3). Nonetheless, urban land markets have been key in creating capital for financial markets and fueling forward and backward linkages which drive further growth (*ibid*: 4). The institutions which oversee the functionality of these urban land markets ultimately determine the scope and the direction of the productivity gains which may be realized. The ease with which land can be exchanged, the costs involved with these transfers, and the efficacious enforcement of these rights is determined by the legal, political, and social institutions which govern the market (Deininger and Feder 1998: 1). Many countries which have abundant quantities of land or natural resources remain underdeveloped because their governments lack either the intentions or the capacity to adequately guarantee tenure security and transferability. This problem intensifies as the economy becomes more articulated and competitive since the investment size and payback schedule of investments often increase with more complex, technology-dependent projects (*ibid*: 7, 10).

For these reasons, land markets can be highly inefficient and developmentally unsound if they are not regulated by the state to some extent. The degree to which the state should involve itself depends on how well existing institutional arrangements sustain productive levels of economic growth. Where existing institutional conditions actually prevent the commoditization of land by private actors, the role of the state in gradually introducing market reforms is even more challenging. As the following case study demonstrates, the state can effectively introduce such reforms gradually while maintaining its position of power, yet it must effectively govern how the new reforms are weaved into the existing institutional fabric before being reformed further.

3. LESSONS FROM BEIJING AND ORIENTAL PLAZA

3.1 Marx and the Market for Land

Under the principles of Marxism-Leninism and Mao Zedong Thought, the three principal factors of production – land, labor, and capital goods– were to be placed under the control of the state as the vanguard of the proletariat. Because the rents from private ownership would demand surplus labour from workers on the other end, the state monopolized the ability to collect rents for the public good. As Marxist theory explains,

> the self-preservation of capital is its self-realization. If capital also had to work in order to live, then it would not maintain itself as capital but as labour. Property in raw materials (such as land) and instruments of labour would be merely *nominal*; economically, they would belong to the worker as much as to the capitalist, since they would create *value* for the capitalist only in so far as he himself were a worker (Marx 1978: 248).

To ensure that this property would be equally accessible for all productive uses, the Chinese Communist Party established a centrally planned economy with plans for rapid modernization and industrialisation. With little experience in going about such reforms, a cooperative campaign of joint ownership between the state and private sector was created, but was annulled shortly thereafter due to increased demands for fuller collectivization (Lieberthal 1995: 103). Henceforth, all urban land became state-owned and was allocated in a two-step process, which first required approval of an enterprise by an economic planning board before the allocation of an appropriate parcel by the local land bureau (Ho and Lin 2003).[1] Land was issued without cost, for indefinite time frames, and with little future accountability on efficient use. These resulting inefficiencies stymied the urban economy and monopolized resources through hierarchical channels in the state instead of through market mechanisms (Zhu 2002: 44).

This system persisted until the start of the reform era in 1978. In one of its first moves, the state decentralized fiscal authority to local governments in order to create the incentives and autonomy needed for them to initiate the reforms locally. Likened to western-style federalism (Weingast et al 1995), local governments received virtually all tax revenues generated within their jurisdictions in return for remitting fixed amounts back to the central government (Qian 2003: 313-16). As the new residual claimant, local governments willingly monitored local productivity and invested in the necessary inputs (e.g., infrastructure projects) to drive that productivity (Alchian and Demsetz 1972: 783). Around the same time, the state-owned enterprise system was reformed so that it would become gradually more competitive and profitable by restructuring management's role to contain both administrative and business functions (Chai 2003: 52). Thus, managers would continue to be appointed by the state and have preferential access to state resources but were now expected to

[1] State-owned enterprises and agencies represented the vast majority of these claims although social organizations and private enterprises rarely received them as well (Farvacque-Vitkovic and McAuslan 1992)

create stricter budget constraints and streamline production costs. Similar to other successful East Asian reforms, this reform was intended to expose state-owned enterprises to market-based competition while giving them some leeway to learn slowly by doing (Amsden 2001).

In tandem, these two reforms created the preconditions for the creation of urban land markets: demand for increased local productivity and easier access to a supply of land. In a local experiment, local officials of the Shenzhen Special Economic Zone (SEZ)[2] sold land-use rights to private commercial investors on 9 September 1987, in direct violation of Article 10 of the Constitution which stated that "no organization or individual may appropriate, buy, sell, or *lease* land, or unlawfully transfer land in other ways" (Chen 1999:; italics mine). This action was an economically motivated response to the common perception among foreign investors that a lack of property rights left fixed asset investments too vulnerable to arbitrary state requisition (Ho and Lin 2003: 685-6). The unique combination – clearly defined use rights while reserving state ownership – gave economic agents sufficient incentives to exploit the land more efficiently but preserved the ideological vestige of state ownership of the means of production. This new framework could unburden the state from the perverse incentives it had to keep urban housing poorly maintained and short-supplied. It could also create a new enabling environment for urban economic growth just as rural Township-Village Enterprises were beginning to experience diminishing productivity gains after driving much of the country's economic growth throughout the 1980s (Woo 1998). For these many reasons, the state strongly supported the Shenzhen legislation and drafted a new Land Administration Law seven months later to incorporate these reforms nationally. At the same time, it amended

[2] Four SEZs were established in 1979 and given greater economic autonomy and special tax incentives to attract foreign investment, particularly from neighbouring Hong Kong and Taiwan.

Article 10 of the Constitution so that organizations and individuals could take part in the land market "in accordance with the provisions of the law" (Chen 1999: 336).[3]

Under this new institutional framework, local governments could designate parcels of urban land to be redesignated from the existing system's "allocated" land use to a new system of "granted" land-use rights, which were to be purchased competitively and openly through auction, tender, or special negotiation (Chao and Kitchen: 2001: 2). The local government would first determine the land's rational use in line with broad economic plans and then offer it to developers, who could then mortgage it or on-sell the use rights (or part thereof) in the secondary market after developing it. Initially, the length of these use rights varied from lease to lease, but new State Council regulations in May 1990 established standard periods of 70 years for residential, 50 years for industrial, and 40 years for commercial uses respectively (Chen 1999: 338).

While "granted" use rights were supposed to be bought on the open market, many land-rich state-owned enterprises colluded with local officials for preferential treatment in converting the land they already controlled to "granted" use rights. They then quickly converted the state-owned enterprise into a real estate development corporation before selling the land at tremendous profits to other developers. Alternatively, the local government itself could requisition land from state units for the public good if it compensated them appropriately.

These processes allowed both local officials and enterprise managers to take advantage of the institutional ambiguities of the early market; the former could collect bribes from developers for access to choice land or approval of construction plans while the latter benefited from huge market-rate salaries based solely on rent-seeking.

[3] Significantly, rural land was excluded from this reform as land ownership remained with the collective, rather than the state. A fairly successful earlier rural reform had given rural families greater individual tenure security, but had been inconsistently enforced (Ho 2006: 44-69; Brandt et al 2002).

The endless possibilities for commoditization of the land market created easy sources of wealth which many in power scrambled to secure for themselves. In the Beijing municipality alone, output value for construction projects more than doubled from 4.4 billion Yuan in 1985 to 9.5 billion Yuan in 1990, of which the urban share had risen to 84.4 per cent (Beijing Statistical Yearbook 1991: 53)

3.2 Raising Capital, Razing the Capital

Newly incentivized by this institutional environment in the late 1980s, the Beijing government began experimenting with urban renewal projects in order to improve and expand existing housing for urban workers, which had been poorly maintained and undersupplied during forty years of state control (Wu 1999). Since the late 1970s, existing housing had been reconfigured to accommodate the capital's growing population and extra families were forced to share space in units that had previously been designed for single families (Gaubatz 1995: 86). Arguing that these conditions created a threat to public safety, the local government initiated the Old and Dilapidated Housing Redevelopment (ODHR) programme so that the units could be rebuilt and sold under market conditions, with previous residents either able to purchase into the building or accept compensation and new accommodation in the periphery of the city. However, with the increasing value of land, the programme quickly morphed into an excuse for government officials to seize valuable land in the city center and then sell the use rights at market rates to developers (Fang and Zhang 2003). Central government regulations which dictated that land was to be transferred "according to the law" was interpreted in Beijing's 1992 Implementation Guidelines as "prescribed by the Beijing municipal government" (*ibid*: 155). This created accountability problems since local officials acted both as representatives of the state in the capacity of landowner but also as sole beneficiaries of redevelopment profits.

In early 1992, the local government seized the Dongdan state-owned housing unit and market under the purview of the ODHR programme. The site sat on one of Beijing's most prime locations of real estate. To the west lay Wangfujing Street, often cited by state news sources as "Beijing's most fashionable shopping street" popular with foreigners and dating back to imperial times when visiting dignitaries could purchase presents for the Emperor there before holding court at the nearby imperial palace (Gaubatz 1995: 79-81). To the south of the site lay Chang'an Boulevard (Boulevard of Eternal Peace), which was the city's only east-west access road at the time and ran along the northern side of Tian'anmen Square just two blocks away (see Appendix One). A system of traditional houses along traditional alleyways (*hutongs*) dating back to the Ming and Qing dynasties currently existed there, and the government claimed their lack of modern facilities and inconvenient design required demolition instead of updating, forcing residents to leave (Wang 2006).

Typically, the Beijing government evicted residents with little warning and relocated them to sites in the city's periphery that had little or no access with public transportation and few public services (Fang and Zhang 2003). As these residents typically worked for the state-owned enterprises which had provided them with their housing and urban household registration (*hukou*), they had few options but to accept the relocations and commute to work. The latent value of the Dongdan land was so profitable though that Beijing Mayor Chen Xitong was rumored to have given the first 1000 residents who willingly left a new car per family to expedite the relocation (O'Neill 1998: 7); others were moved forcibly (Wang 2006). In late spring 1992, a group of Beijing officials went on an investment mission to Hong Kong to solicit interest from developers for the parcel. The use rights were negotiated in a closed process and sold to two Hong Kong development companies, the first led by Li Ka-shing and the other by Robert Kuok on 29 June 1992 (Briefing 1992: 73). Over the following two years plans were drawn up and approved by the local planning authority to partition the site in two; Kuok's Sun Hung Kai Holdings was to develop one site while the other (arguably better) site was reserved by Li Ka-shing, who eventually partnered with Tung Chee-hwa's Orient Overseas International to develop it. Instead of new housing, the site was to be developed into a modern mixed-use project of retail mall, commercial center and luxury hotel, and serviced apartments that would be called Oriental Plaza. Li had a 63 per cent share, Tung a 23 per cent share, and the remaining 14 per cent held by the Bank of China (Quak 1996: 17).

Inconveniently, the most valuable piece of the parcel was still occupied by a McDonald's restaurant. The McDonald's Corporation, along with its Chinese joint venture partner, had negotiated a 20-year lease with the Beijing government only two years prior for the previously unused parcel which had sat next to the Dongdan site. After already successful launches of franchises in Shenzhen, the restaurant had moved to enter the Beijing market early despite the recent crackdown of student protesters on Tiananmen Square in June 1989. Because of the political commotion, it is believed to have received a good deal on the land-use rights and a quick approval of its license and building permits (Trouillaud 1992) because the city hoped to use the restaurant as a symbol of the city's embracing of its economic reform agenda. At its own expense, McDonald's had built its largest restaurant in the world, a 2500 square-meter, two-story building that loomed over the housing block occupying the rest of the block. With an operational staff of almost 1000 Chinese employees, its opening day in April 1992 broke the record for single day profits, surpassing the record that the new Moscow McDonald's had set the previous year ("World's Largest" 1992; "McDonald's Makes" 1992).

Nonetheless, in the eyes of local officials, the restaurant’s use was prohibiting further economic development (and opportunities for graft), and issued the McDonald’s Corporation an eviction notice in November 1994 despite almost 18 years of its 20-year contract remaining (“McDonald’s Beijing” 1994). McDonald’s representatives issued a press release shortly thereafter claiming that they “believe[d] (they) ha[d] a legal right to be at this location, and d[id] not want to move” (“Trade Briefs – Gets an Order” 1994). Despite months of negotiations offering compensation or alternative locations, the restaurant refused to compromise and threatened to seek a resolution through the courts (“McDonald’s Beijing” 1994; Kurtenbach 1994). In the eyes of foreign media and investors, the outcome of the McDonald’s dispute would serve as “the litmus test on China’s commitment to long-term contracts with foreigners” (Lee 1995: 22). To exacerbate investor insecurity further, a series of high profile debt defaults and broken contracts with foreign investment banks were making many foreign investors reconsider their investments in China and causing journalists to ponder whether “the China fever ha(d) turned into a damp chill” (Sender 1995b: 64). Several credit-rating agencies even threatened to reduce the country’s investment-grade rating as a result (Sender 1995a: 12).

Over the previous few years, the central government had already been working hard to curb rising inflation rates and stabilize the rapid appreciation in the urban land market, whose office rates in Beijing had increased 45 per cent in 1993 alone (Kwong 1994: 5a). To try to balance the macroeconomic effects of such a rapid increase in construction projects, the Central Bank had launched a marginally successful 16-point austerity plan in mid-1993 to adjust and control these inflationary pressures (Keesing’s 1993: 39558) and a comprehensive taxation system reform to increase its share of total revenues, which had decreased from 26.7 per cent in 1979 to 15.8 per cent of GNP in 1991 (*ibid*). After only marginal success, central Party members emphasized that the "extensive and profound social change currently taking place in China" demanded that the Party "do better in upholding and improving democratic centralism" (Keesing's 1994: 40181). In 1994, the State Council passed a new Urban Real Estate Law which aimed to make urban land transactions more transparent and accountable and created a series of regulations on how local governments were to interpret and implement it (Sun and Ren 1997: 144). Despite these efforts, by the first quarter of 1995, inflation had hit more than 22 per cent nationally and more than 30 per cent in Beijing (Gittings 1995). Meanwhile in the same period, Beijing's Department of Urban and Rural Construction watched as foreign or joint ventures in construction projects jumped from 1,217 to 11,202 in the six-year period leading up to 1995 (Zhou 1998: 432). Beijing's office rents had quickly become the fourth highest in the world at around US$80 per square meter (Chan 1995: 1) as supply struggled to keep up with demand coming from increased market liberalisations. The rapid growth had meant that many early developers had already realized full returns on their investments after only two or three years (Zhou 1998: 432).

If McDonald's followed through on its threats to take its lease rights to court, the state would be put in a disadvantageous position regardless of the result because it would force them to clarify the intentional ambiguities of the institutional environment prematurely. If the local government won the case, it would create the perception among foreign investors that investments in China were too risky, particularly if important international players such as McDonald's were not protected in the market. If McDonald's won the case, it would undermine the authority of the state and its ability to guide the scope and direction of future developments as flexibly. At the same time, McDonald's executives were not interested in provoking local officials whose positions of power influenced the ease with which the restaurant chain would be able to participate in the market. The company, by then with 27 outlets in China and seven in Beijing alone, had already drafted plans to open 10 more in the capital and 30 more restaurants nationally by the end of 1995 ("Trade Briefs – Outlets in China" 1994; Mufson 1994) in an effort to capture further market share in an industry which was worth US$2.8 billion at the time with growth projections of 20 per cent growth annually ("Golden Arches" 1994).

In the end, the McDonald's opted to cooperate with the Oriental Plaza redevelopment plan, but only after receiving a highly favorable compensation package. In addition to undisclosed compensation for the improvements it had made to the land, the restaurant would be given a prominent position in the Oriental Plaza development along Wangfujing Street, and Li Ka-shing would give them the use rights to another parcel in Beijing where they could construct a second restaurant ("Intelligence" 1995: 12). The deal was quite advantageous for McDonald's, whose sales would have been hurt by the surrounding construction anyway. It also kept them in a favourable position with local officials who controlled the bureaucratic apparatuses necessary for doing business in the city.

3.3 Governing Supply and Demand

While the McDonald's dispute was resolved without major incident, it caused the central government to reevaluate the systemic institutional ambiguities which had both allowed and, in part, caused local governments' ruthless push toward urban development. As a result, the State Planning Commission declared a moratorium on approvals for future construction projects in Beijing so that it could investigate the allegations of corruption surfacing in the aftermath of the Oriental Plaza debacle. It also turned over regulatory oversight of the Oriental Plaza development directly to Li

Peng, the current Premier of the State Council (Lee 1995: 22). With new central government involvement in the project, prominent individuals and civic groups began to voice their discontent with the site's design plans more openly in an effort to have them changed to fit in better with the cultural and architectural heritage of the area. A January 1995 edition of a Chinese news magazine *Outlook* argued that the project's design threatened the integrity of "the surroundings that make people marvel the very throne of Eastern culture" (Schoof 1995).

The original plans for Oriental Plaza, which had been approved by Beijing Mayor Chen Xitong in 1993, consisted of a box-like steel and glass building 78 meters tall and with 1.3 million square meters of total floor space (Gilley 1996a: 44). The planned building height was more than four times the legal limit (18 meters) for construction within the Old City according to the city's master plan and still more than double the 30-meter variance typically given for special projects such as these (Zhou 1998: 431). Architects argued the site did not incorporate any Chinese elements in its design and could have been a building anywhere in the world. Preservationists argued that it did not fit the scale of the community and would cast permanent shadows on many surrounding buildings, some of which were the residences of prominent central government officials. Communist Party groups complained that it would tower above neighbouring historic and political landmarks such as the Forbidden City, Tian'anmen Square and the Great Hall of the People (Schoof 1995; see Appendix One).

As a result of these concerns, the State Planning Commission forced the initial Oriental Plaza designs to be amended and rescaled. The project was redesigned to have a retail mall at its base with a series of towers above, which were grouped in three clusters of varying heights of 49, 59, and 68 meters moving away from the city center (O'Neill 1998). Adjusting the height and building composition reduced the total floor space by a third (Gilley 1996a: 44) and allowed the clusters of towers to simulate the traditional courtyard structures predominant in Chinese architecture ("Architecture" 2006). At one later point, central officials even debated requiring the project to change its name, since the Chinese term *guang chang*, which in English is possible to be translated as "plaza", is the same term used to describe the space of Tian'anmen Square, a fact that made the commission fear the project might challenge its ideological prominence in the city ("Beijing Oriental" 1996).

Largely because of this enquiry, the central government also accelerated an anti-corruption campaign in February 1995 in order to find the officials who had signed off on the designs (and others like it) and hold them responsible for their actions. The Party's Central Discipline Inspection Committee began an investigation of the Beijing Planning Commission and quickly saw the resignations or arrests of more than 60 Beijing officials or employees (Keesing's 1995: 40500). In the following days, the chairman of the Beijing Planning Commission committed suicide after allegations of corruption, later estimated at US$37 million ("Beijing Oriental" 1996). In addition, Beijing mayor Chen Xitong stepped down from office citing failures to adequately oversee the commission's activities. Central government officials replaced him temporarily with Wei Jianxing, a former chairman of the committee now leading the corruption investigation. Three months later, this same committee successfully sought Chen's dismissal from his positions in the Party. State newspapers reported how he had "led a dissolute life, extravagant life, abused his power to seek illegal interests for his relatives and accepted valuable gifts for his own use," which included an estimated net worth of over US$2 billion dollars and a luxury villa in the Beijing suburbs filled with young Chinese concubines (Fewsmith 2001: 72; Keesing's 1995: 40725).

As acting mayor, Wei Jianxing then met with Oriental Plaza's lead developer Li Ka-shing who had personally flown up from Hong Kong to assure state officials he had not known about the controversy. For Li, Oriental Plaza was an important reflection to shareholders of his larger portfolio of projects in the Chinese market (Gilley 1996a: 44), and Wei dutifully announced publicly that Li and his project had not been part of the scandal ("Wei Says" 1995). Although unlikely that Li's company had not paid local officials off, the central government did not want to dissuade him from continuing his business of property construction and infrastructure in parts of the country.

The downfall of Chen Xitong was as much symbolic as it was substantive. The central government intended to send clear signals to local government officials that even high-powered cadres were not above accountability (Fewsmith 2001: 72). It also demonstrated to investors that the state would not tolerate corruption and would enforce legal reforms blindly. Interestingly, Chen's trial was postponed for more than three years once the corruption campaign died down, and although he was sentenced to 16 years in prison for his abuse of power, he served only eight years before being released because of reportedly ill health. To those inside the state, the likely reason for Chen Xitong's purge was linked to his earlier vocal opposition to then President Jiang Zemin, who had been chosen by Deng Xiaoping to become the new Party Secretary (and implicitly his successor as elder statesman) in the aftermath of the Tian'anmen Square student protests. This was despite the fact that many had predicted that Chen would be the Deng's named successor for this position as he was already mayor of Beijing and member of the Central Politburo.[4] After consolidating his power by filling central government positions with former Shanghai colleagues, Jiang personally aimed to punish Chen for his earlier defiance and more generally reassert the central government's position of supremacy vis-à-vis the local government.

3.4 Pushing Forward Again

Because Oriental Plaza had become so controversial and public, its proper oversight became extremely important to the central government for political reasons. After rectifying the design problems, central government officials announced ambitious plans in spring 1996 to have Oriental Plaza ready in time to celebrate the fiftieth anniversary of the rise of the Communist Party, only a little more than three years away. Officials of the Chinese Olympic Committee also wanted to push its completion forward so that it could be shown off as part of the country's bid to host the 2008 Olympic Games after a failed attempt to secure them earlier in the decade. By guiding the construction of the project in the heart of the city, it would exemplify the state's ability to capably oversee the type of large-scale infrastructure projects required of Olympic host cities.[5]

In contrast to this newfound fervor, Beijing's land market itself was already beginning to suffer price corrections as large numbers of construction projects, which had been funded speculatively to meet previous demands, finally reached completion and glutted the supply of commercial and retail space in urban areas across the country. In China, 290 million square meters of commercial space had been built

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[4] For more on the rationale of Deng's decision, see Lieberthal 1995: 220-231 and Jeffries (1996: 656-7).

[5] In later preparations for an International Olympic Committee visit to the city, state officials placed a bust of Pierre de Coubertin, the founder of the modern Games, at the entrance of Oriental Plaza (DiManno 2001: A01)

between 1991-1995, of which 80 million square meters were from 1995 alone (Sun and Ren 1997: 147). Land prices were falling quickly from their 1995 highs and growing percentages of Beijing's market were lying vacant due to insufficient demand. Undeterred, construction on Oriental Plaza pushed forward under the direction of the central government and the new Beijing mayor, a puppet of the Party who had been appointed to replace Chen Xitong.

In the summer of 1996, bulldozers finally arrived to demolish the McDonald's restaurant and begin the extensive excavation work necessary to prepare the site for construction ("Beijing Oriental" 1996). Soon after they began excavations, a group from among the 13,000 workers on the site uncovered an archaeological treasure under the site where the McDonald's restaurant had stood with more than 2,000 bones and stone tools dating back to the late Paleolithic period more than 20,000 years ago. As the oldest archaeological site ever found in Beijing (or in any other modern capital), the discovery allowed researchers to understand more about the daily activities and settlement patterns of the region's earliest settlers, and it helped them reverse the prevailing perception that man at that time had been unable to move from the mountains around Beijing and settle in the plains of modern Beijing (Xu et al 1999). Archaeologists and historians from around the world called for the site to be fully excavated, and construction on the site was halted yet again to determine a course of action. After a private meeting between Li Ka-shing and the Beijing mayor, state officials announced publicly that "excavation (of the archaeological site) will not affect the construction of Oriental Plaza" (Leicester 1997) and that the nature of the relics did not warrant a postponement of the construction timetable (O'Neill 1997). Instead, it had been agreed that the existing relics already uncovered from the site would be displayed in a 400-square-meter museum for shoppers inside the project's retail mall upon completion ("Ancient Cultural" 2001). Archaeologists from local universities salvaged what they could in the interim but work continued within a few weeks.

China's land market continued to be overinflated from previous speculative and insufficiently monitored construction projects. It was further affected by the East Asian financial crisis of July 1997, which made Western investors generally more wary of emerging market investments and which temporarily crippled the health of many neighbouring Asian economies, on whom China had been depending for capital investments, expertise, and increased tourism (O'Neill 1998: 7). The Oriental Plaza budget had almost doubled by this point due to the construction delays, and there was growing speculation that the two Hong Kong developers wanted to divest their stake in the project. In closed negotiations later that year, the state agreed to extend its interest in the project from 14 per cent to 40 per cent by instructing two Chinese financial institutions to restructure the Bank of China's interest and each assume 20 per cent minority shares in the project. This decreased the share of Tung's Orient Overseas International from 23 per cent to 8 per cent and of Li's Cheung Kong Holdings from 63 per cent 52 per cent ("Intelligence" 1998: 8). This bailout from the state was typical of many other East Asian countries who experienced similar problems from speculation in the real estate market and who helped provide emergency relief to key projects to maintain macroeconomic stability (World Bank 1993: 213-14). Still, many believed that Tung's timing had not been accidental as he had recently become Hong Kong's first Chief Executive in July 1997 after the British handover and had relied heavily on the support of both the Party in Beijing and from Li Ka-shing for his victory (Gilley 1997: 82).

The average price of prime office rentals in Beijing continued to decline another 10.8 per cent in the first half of 1998 and average vacancy rates in prime commercial locations was 32 per cent (O'Neill 1998: 7). As a result, the city's overly dependent tax revenues were US$1 billion (15 per cent) short of the minimum levels that the city had estimated it would need to cover basic needs like heating, electricity, road maintenance, and sewage treatment throughout the municipality ("Beijing – A New" 1998).

Throughout this slump in the land market, the Party had continued its incremental reforms of the overall economy. Most importantly, it had been patiently reshaping the economy in preparations for admission into the World Trade Organisation. In the end of 1995, Jiang Zemin had announced a package of trade reforms which included reductions in tariffs and elimination of certain quotas (Keesing's 1995: 40825). In 1996, it introduced new market-oriented reforms of the state-owned enterprise system which included, among others, discontinuing state-owned enterprises from using land-use rights that had been allocated by the state (not the market) as equity in joint ventures (Chen 1999: 341). In April 1998, it streamlined the organization of state ministries to reduce administrative inefficiency and streamline approval processes for foreign investments in many industries ("Overhaul of" 1998: 8). These reforms, and others like it, culminated in the successful negotiation of the U.S.-China Bilateral Trade Agreement in November 1999 which all but secured the country's imminent accession to the WTO (Yang 2000: 4).[6] This watershed agreement between the two countries reinvigorated foreign business interest in the Chinese economy, with Beijing seeing particularly strong growth from non-governmental organizations and international agencies looking to

[6] China officially entered the WTO in December 2001 after a record-long fifteen years and five months of negotiations.

base their new operations in the capital. From their 1999 low point, commercial rents in the capital doubled within a year (Forsythe 2000) with expectations that would continue to grow in following years to match the surge in demand. Beijing developers again began racing to secure land use-rights for construction projects, and they faced new competition in a city where the ratio of market-granted land to allocated land was already 1.59 (Li 1999: 29). In response, they continued to devise new approaches for negotiating the slightly more nuanced, albeit still ambiguous, institutional environment of Beijing's urban land market.

Oriental Plaza began leasing the first phase of its mixed-use project in the spring of 2000 and completed its final phase several years later, more than half a decade behind schedule.

4. DISCUSSION

4.1 The Central State: Powerless or Permissive?

The ability of an authoritarian state to oversee rapid economic development depends on its ability to preserve its power relative to other sectors. This facilitates the state's ability to implement necessary market-based reforms into the economy and prevent (or repair) some of the inherent inefficiencies that such newly formed market conditions can create. Because the state is not distracted with creating or maintaining any sort of democratic legitimacy for its power, it is not forced to concede to political compromises which satisfy conflicting constituencies but can impede short-term levels of economic growth. This power also allows the state to have greater flexibility in determining the scope of its economic development.

Nonetheless, the organization of authority contained in such myriad and complex state systems cannot be presumed to be strictly hierarchical. Rather, the state can find creative ways of preserving the locus of its power in the direction of its reforms while effectively delegating many of the administrative powers and responsibilities necessary to oversee their diligent implementation. The strategic composition of the Chinese state allows it to balance its goals of rapid economic growth and stable macro-conditions. Rather than hurting the success of its economic reforms, this tension between the central and local state has helped to maintain consistent growth for over thirty years by creating an informal accountability system *within* the state which is grounded on maintaining the stability of the reforms rather than their direction.

By decentralizing fiscal authority early on, the central government intentionally created the necessary incentives to make its reforms successful politically at the local level. Local governments cooperated because of the potential for increased tax revenues, and they in turn created incentives for local officials by condoning and insulating a highly organized system of corruption, which was kept in check only to the extent that it was limited to "skimming the cream from the top of the milk" of the growth.[7] These administrative changes allowed the central government to concentrate more objectively on the sustainability of the economy's growth through the creation of macroeconomic policy. But the inadvertent consequence of the fiscal decentralization was the resulting experimental applications of the market-based national reforms in local contexts, particularly in the more developed markets along the eastern seaboard. These experimental institutional interpretations allowed the central government to understand the possible strengths and weaknesses of new reforms in more localized settings and then flexibly respond with appropriate reforms to refine them and push the reform agenda forward as a whole.

[7] And as the case of Beijing mayor Chen Xitong demonstrates, the central government would intervene in local affairs if local leaders themselves did not keep this balance sufficiently in check.

Successful economic reforms also cause existing supplies of power to expand. If existing institutional arrangements do not adequately dictate how this new power is to be distributed, different actors must jockey for a new position until a new equilibrium is reached. The more disruptive these struggles are, the longer it can take for this equilibrium to be achieved and the more the private sector might question the security of its investments in a given context. Whether these worsened perceptions are based on factual evidence or simply speculation, they cause the credibility of the property rights regime to erode and can have strong tendencies for path dependence if the state does not respond quickly and credibly to restore it. For this reason, the central government acted so definitively in its investigation of corrupt Beijing officials, whose bold illegal eviction of McDonald's from the Oriental Plaza site had caused huge insecurities in the eyes of investors.

The ambiguities in the Chinese institutional framework were not arbitrary. Gradual institutional change reduces the potential for disruptive power struggles in exchange for increasing the frequency at which minor ones occur. Particularly in authoritarian states, this approach helps existing political institutions negotiate these byproducts of reforms more flexibly while preserving their position of power more readily. By initially launching reforms that are anticipated to have fewer acts of resistance from existing institutional players, the state can minimize early opposition and allow the underlying principles behind the reforms to penetrate deeper into the informal norms of the society; this can make it easier to introduce less popular reforms further along in the reform process. The Chinese state did this through its gradual reform of state-owned enterprises, many of which had been able to quickly capitalize on their access to valuable parcels of land before the state withdrew their preferential access and let many of them fail.

The state can also intervene if the effects of the reforms cause unexpected or overly unstable repercussions. The Chinese central government's willingness to restructure the ownership shares of the Oriental Plaza project after the economy had stalled in the late 1990s demonstrates this idea well. Thus, incremental change can minimize the political costs of reforms as it continues to enable an institutional environment receptive to continued growth.

4.2 Constructive Destruction or Destructive Construction?

In authoritarian state-led economic reforms, the most imminent insecurity is not the state's ability to execute its desired reforms but its ability (or desire) to determine what type of reforms produces sustained economic growth. In democratic arrangements, systems of accountability allow the majority of the population to voice their opinion through elected officials (Hirschman 1970), and vulnerability lies in failing to recognize certain rights of the minority. In authoritarian arrangements, it is the rights of the majority that go unrecognized as a small minority of state officials control the direction and pace of economic reforms.

Civil society therefore wields only soft power and must rely on indirect methods to have its interests represented. When conflicts of interest arise between state organisations, civil society members can ally themselves with one side to boost its position relative to the other. In the Oriental Plaza case, this occurred when the central and local governments clashed over the appropriateness of the project's design plans. Often, however, these state conflicts do not arise, and civil society groups have few options at their disposal other than protest or acquiescence. When the original residents of the Oriental Plaza site were evicted from their residences, they had no real choice but to be relocated. Similarly, when important archaeological relics were uncovered at the site, preservationists and scholars could only voice their disdain and scramble to collect what they could before excavations continued.

In China, this somewhat arbitrary power has made it difficult to understand fully the causality between institutional quality and economic growth.[8] True, the creation of urban land-use rights and the gradual reforms to the property rights structure have inspired unprecedented levels of investment in Chinese cities, but the local government abided by these use rights rather indiscriminately as the McDonald's eviction represents. While McDonald's was able to use its international reputation to stir enough media attention to stop the eviction, other less conspicuous investors did not fare as well against local governments. Nonetheless, by maintaining the *perception* of institutional quality, the state has been able to maintain levels of investment which have not directly matched the true security of its property rights structure.

In its early institutional development, the state found creative and practical solutions to begin introducing market reforms throughout their economy. While these initial reforms were not fully efficient, they succeeded in incorporating themselves into the ever-changing institutional environment and found sufficient acceptance from various actors in different sectors (Lau et al 2000). As the reforms continued to evolve, the state was able to draft policies which have become much closer to first-best arrangements. These decisions have required patience and a willingness to accept the difficult trade-offs of rapid economic development. Losers in the reforms have faced diminished livelihoods in the periphery of the city. Traditional *hutongs* have for the most part been cleared to continue the development of more highly efficient land uses. In a way, the fact that the local government has been incentivized

[8] While no known sources offer this explanation with regard to China's urban land market, similar theories have been proffered in relation to the institutions governing rural land. See Ho 2006: 2; Whiting 2000; Oi and Walder 1999)

to pursue development so blindly has caused a version of the Hardinian tragedy of the commons whereby cultural heritage loss and environmental degradation are shared by everyone in the country, but the local tax revenues and bribe money is gained only by them. The lack of accountability on local Chinese governments in their pursuit of their rational economic incentives has reduced their idea of sustainable development to sustainable *economic* development (Chan and Ma 2004).

Despite these setbacks, China's gradual market reforms have succeeded in transforming urban cities across the country into full-fledged market economies. Since the start of the land market reforms, more than 40 per cent of Beijing's city center has been reconstructed (Wang 2006), an almost Herculean accomplishment and a lesson to other developing countries that state-led reforms can achieve economic growth if the institutional environment is engaged along the way.

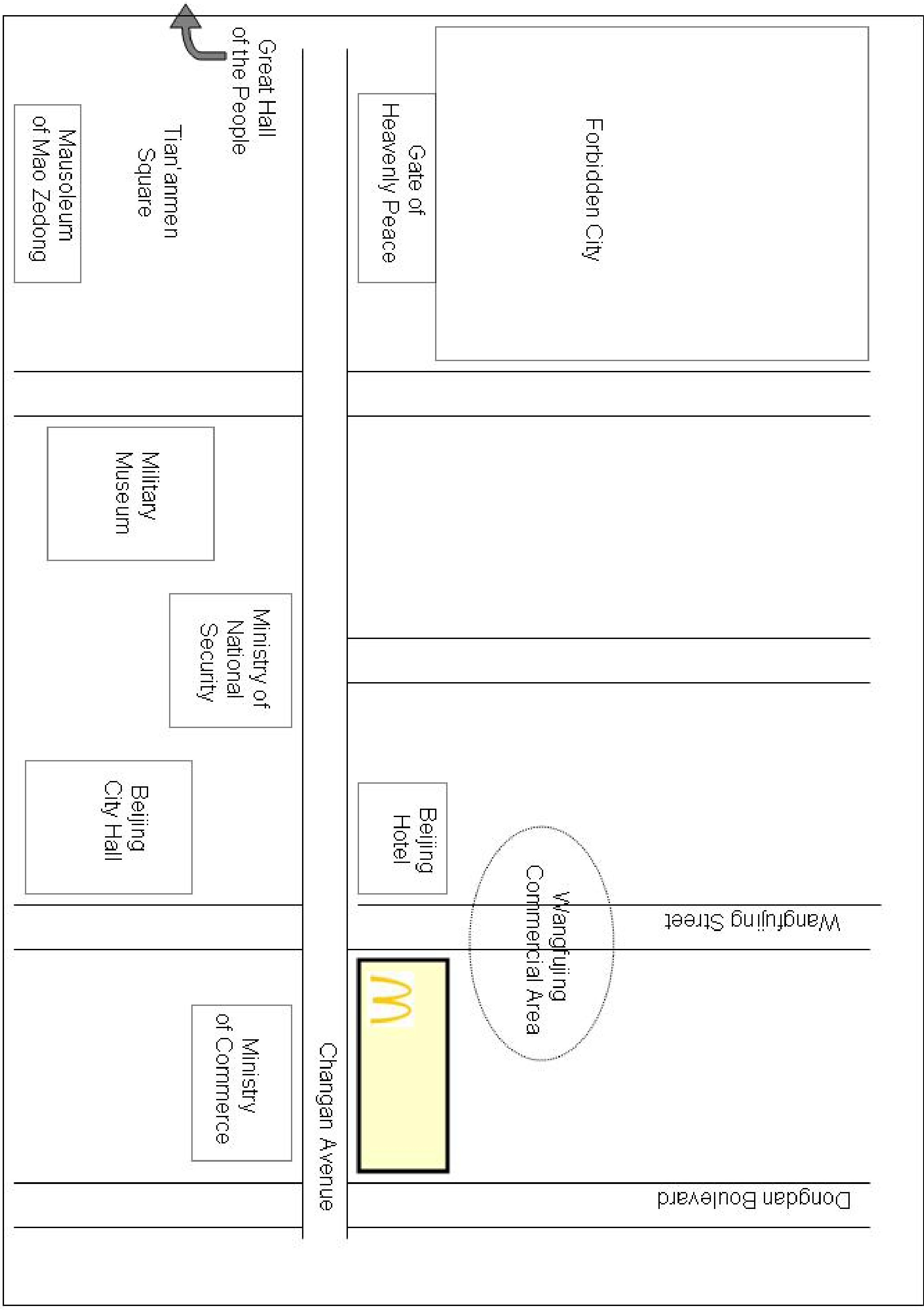
5. CONCLUSION

This essay has focused on contextualising how formal economic and legal reforms can be incorporated into the greater institutional framework in which they must operate to be successful. In doing so, it has also tried to understand the rationale behind how (or not) different organizations within that existing structure have been given incentives to accept these reforms and how these evolving power relationships have in turn affected the creation and integration of future reforms.

The case of Oriental Plaza demonstrates the tender touch required to place market-based economic and legal reforms into a previously planned central economy. The Chinese land market appears to be moving gradually toward an institutional arrangement of empty state ownership where all rights are credibly assigned to other users, a concept referred to in Roman law as *proprietas nuda* (Simpson 1976: 7).

Ultimately though, the actual quality of those land rights still rests on the credibility of the state which enforces them.

APPENDIX ONE



Appendix One: Map of Oriental Plaza Site (in bold) and Environs

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