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A STUDY OF FOREIGN DIRECT INVESTMENT
IN CHINA'S REAL ESTATE MARKET
FROM A PROPERTY RIGHT PERSPECTIVE:
HONG KONG DEVELOPERS' PRACTICE

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PhD

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The Hong Kong Polytechnic University
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A Study of Foreign Direct Investment in China's Real Estate Market
from Property Rights Perspectives: Hong Kong Developers' Practice

Chen Xingguang

A thesis submitted in partial fulfilment of the requirements
for the degree of Doctor of Philosophy

July 2019

CERTIFICATE OF ORIGINALITY

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_____ (Signed)

CHEN XINGGUANG

ABSTRACT

Foreign direct investment (FDI) has played a key role in China's economic transformation. The real estate industry has been the second largest sector in China to attract FDI since the economy was opened up in 1978. For FDI flows into China or other developing countries, the advanced institutional arrangements of foreign capital have a 'demonstration effect' on the host country. On the other hand, the host country actively improves and perfects its institutional system in order to attract and exert the role of foreign investment. This thesis reviews the literature and regulatory frameworks of FDI and its performance in the real estate sector in China.

In China's forty years of reform and opening, the goal of its transformation has been to establish, step by step, an economic system of private ownership and property rights under the framework of the public ownership economy. As those responsible for the lion's share of the real-estate FDI flowing into China, Hong Kong-based real estate developers ('HK developers' hereinafter) have been the greatest contributors and have naturally played an important role in institutional change.

The Property Right Law (PRL) is an important legal basis for the healthy operation of the real estate market, and has had a long-term impact on the industry. Since the implementation of the PRL in 2007, the number and size of projects (in terms of gross floor area) acquired by HK developers in China has been greatly reduced. This unusual practice captured the author's interest and led to further discussions on three major problems encountered by HK developers in this thesis. These include: (1) investment strategy (2) getting land use rights (LURs) and (3) managing projects.

Using practical case studies of different types of projects (ten projects by four HK developers in seven different cities), this thesis examines in detail the arrangements adopted by major HK developers in representative first-, second- and third-tier cities in

mainland China. The analysis divides the projects into five categories according to different physical and institutional settings. Informed by the author's years of experience working and conducting research in the field and a regression analysis that takes on a large group of sample projects (including 354 urban development projects conducted by eleven main HK developers), the thesis presents observations, propositions and empirical findings that measure the impact of the PRL and clarify the importance of property rights for the practices of HK developers.

The discussion and analysis produce several interesting findings. First, the high entry barrier and transaction costs led HK developers, in order to offset the impact of indirect costs, to focus mainly on high-end projects in prime locations and well-developed areas in first-tier cities. After the implementation of the PRL, HK developers became more cautious about acquiring LURs given their relatively weaker competitive position in relation to mainland developers. Because of the uncertainties of the policy and the immense internal and external challenges, HK developers tend to seek more joint-venture arrangements with mainland developers to lower the risk and deal with certain issues that require local networks.

A second important finding is that the success of conducting real estate development projects in China relies greatly on good project management techniques. The main elements of these techniques are building design and engagement with and management of contractors and suppliers. An efficient contract management and procurement system includes adopting international contracts to minimise contracting costs and creating more direct contractual relationships by engaging more nominated subcontractors (NSC) and nominated suppliers (NS) arrangements.

The difficulties lie in internalities and externalities encountered by HK developers. A careful selection of investment projects and contractual arrangements is

essential. And in order to further stand firm in the mainland market, HK developers endeavour to design good products, attract international tenants and brands as well as establish efficient procurement and contract administration systems.

Although China is no longer short of capital or funds, it should recognise the importance of the introduction of FDI from the perspective of introducing advanced institutional arrangements, so as to promote the reform of China's market economic system and ultimately promote the country's further economic growth.

This thesis presents the development of FDI over the past thirty years and discusses institutional change and the relationship between FDI and China's transformation. Hopefully, it can serve as a useful inspiration for all parties.

Keywords:

FDI, real estate development, Property Right Law, Hong Kong developers, property investment, construction project management, contractual arrangement, externalities, internalities, changing rules

PUBLICATIONS

During the research process, the author published two articles as co-author:

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Yong Lia,⁴ Xingguang Chen,⁵ Bo-sin Tang,⁶ Siu Wai Wong.⁷ (2018). From Project to Policy: Adaptive reuse and urban industrial land restructuring in Guangzhou City, China. *Cities*, 82, 68–76.

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All errors, however, belong to the author, and the usual disclaimers apply.

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CHAPTER 1: INTRODUCTION

Economists need to study the work of the broker in bringing parties together, the effectiveness of restrictive covenants, the problems of the large-scale real-estate development company, the operation of governmental zoning and other regulating activities (Coase, 1960).

1.1: Introduction

In the past century, foreign direct investment (FDI) has been an important catalyst of economic growth in developing countries. While extensive studies related to FDI have been conducted for the national economies and their manufacturing sectors, little has been done to understand its roles in the real estate sector because of the relatively small amounts of capital involved in that sector in newly opened, developing economies. In contemporary China, however, the open-door policy that began in 1978 has enabled new studies of FDI in the real estate sector because of the sheer size of investment there compared to other developing countries. China's uniqueness in this regard can be attributed to, *inter alia*, the treatment of native Chinese from Hong Kong, Macau and Taiwan as foreign investors for historical reasons. The family roots of these 'foreign' investors in the mainland make concerns and barriers to investing in assets with low liquidity, such as land and buildings, relatively less challenging than for others. Systematic studies of capital inflows to this sector will provide new evidence that enables us to better understand the FDI markets at work.

A study of the real estate sector will also shed new light on the institutional context, especially concerning property rights. Urban land markets in China are characterised by an intertwining and complicated property rights structure involving dual

land markets (Yeh & Wu, 1996), informal institutions with de facto LURs users (Zhu, 2004), a shareholding structure among the residual rights claimants (Zhu, 2013), and the like. Apart from financial factors such as rates of returns, exchange risks and monetary and human capital costs, this study posits that the investment decisions of FDI players in the real estate market are also functions of the property rights constraints imposed on different participants, projects and market segments. This thesis attempts to investigate the institutional factors and arrangements pertaining to FDI in the Chinese real estate sector referencing Chinese experience, of which Hong Kong-based developers ('HK developers' hereinafter) have played pivotal roles. Before illustrating the research questions, the design of the empirical tests and the layout of this study, it is essential first to examine four key pieces of background information in chronological order, namely (1) China's open-door policy since 1978, (2) the 1988 land reform, (3) the return of Hong Kong's sovereignty in 1997, and (4) the enactment of the PRL in 2007.

1.1.1: The Open-door Policy since 1978

In 1978, the Chinese economy accounted for only 1.8% of the global economy. It was a laggard country which, despite its geographic enormity, appeared extremely poor and insignificant. It has been more than forty years since China began reforming and opening up its economy, which is now the second largest economy in the world, accounting for 14.8% of the world economy.

In the twenty years prior to 1978, urban housing was mainly a state investment. Built housing was not for sale, but was distributed to the workers, who waited in queues in accordance with their length of service, job position, education and other scoring factors. For the allocated housing, a nominal, near-free rent was charged. This kind of

housing system has been summarised as a ‘welfare housing system in which the state invests in housing and allocates it to workers to use almost free of charge’ (Zou, 2009).

Under this housing system, state investment in housing construction was ‘never returned’ (Zhou, 2009). Not only could housing not circulate and turn over, but the low rents charged were even not enough to pay for everyday maintenance and management of the houses. This type of distribution also inhibited personal spending on housing. In this system, housing construction, maintenance and management became a heavy burden on the country. A shortage urban housing was an increasingly prominent problem. The amount of living space in cities and towns had dropped from 4.5 square metres per capita in 1949 to 3.6 square metres. By 1978, 8.69 million households – nearly half (47.5%) of the total number of urban households at that time – lacked adequate housing. At that point, China had almost no real estate market and no real estate industry – only a construction industry.

‘Reform and opening up’ has been a slogan of China’s more than one billion people since the spring of 1978. It entails a series of reforms which realign property rights structures to restore incentives in the factor markets – namely, land, labour, capital and entrepreneurship. The reform led to the most phenomenal economic growth in human history – perhaps the industrial revolution is the only comparable event – at over 7% of GDP growth per annum for four decades.

In April 1980, Communist Party Chairman Deng Xiaoping discussed the basic trends of the urban housing system in his talk on construction and housing. Deng’s speech broke with the traditional view of public ownership and the housing welfare system, and outlined the basic blueprint of a new housing system. In June 1980, the central committee of the communist party of China and the state council formally proposed the implementation of the policy of housing commercialisation in the report

outline of the national capital construction work conference, allowing people to build houses, buy houses and own houses for private purposes. Not only new houses but also existing houses could be traded. This housing system reform enabled the real estate market to begin to take shape.

1.1.2: Separate Transferable Land Use Rights from State Ownership since 1988

Almost sixty years ago, Ronald Coase (1960) called for patient studies to work towards an understanding of how the market, firms and governments handle the problem of social cost in practice. He exemplified the problem with reference to urban development activities. Having grown sluggishly for decades before 1978, the urban development market in China did not take off until the implementation of the open-door policy and the land reform promulgated in 1978 and 1988, respectively. The former policy was advocated to experiment with a market economy and to lure foreign capital, while the latter aimed to separate transferrable LURs from state ownership.

This change marked a critical point in history. Countless examinations of the development of China's real estate industry have set the starting point of its real estate market at the land auction in 1987, which was won by the real estate company of the Shenzhen special economic zone with 1.41 million USD.⁸ The announcement marked the sale of China's first land by the then newly created Shenzhen special economic zone, an auction that clarified the separation of state land ownership and use rights and officially kicked off the development of the country's real estate industry.

In 1988, the people's congress of Guangdong province passed regulations on the administration of land in the Shenzhen special economic zone. They stipulated that LURs

⁸ 5.25 million yuan, 1 USD=3.72 RMB according to *China Statistical Yearbook*, 1987.

can be transferred with compensation. Four months later, Beijing adopted a draft amendment to the constitution that deleted the word 'lease' from the ban on leasing land, stipulating that 'the right to use land may be transferred in accordance with the provisions of the law'.

1.1.3: The Resumption of the Exercise of Sovereignty by China over Hong Kong in 1997

On 19 February 1997, Deng Xiaoping, who is known as the 'chief architect' of China's economic transformation, died. China's policy of economic reform and opening carried on unchanged and the system continues to develop. On 1 July 1997, the Chinese government resumed the exercise of sovereignty over Hong Kong, and the Hong Kong Special Administrative region of the People Republic of China was formally established. Hong Kong has become a 'domestic and overseas' special status under a regime of 'one country, two systems'. The return of Hong Kong to the motherland after a hundred years of vicissitudes marks the beginning of a new era in the relationship between Hong Kong and the mainland.

Following this sea change in 1997, Hong Kong real estate consortia began investing in the mainland on a large scale. According to the article 'Shenzhen introduced US\$0.7 billion of Hong Kong investment for residential development' in *China Real Estate Information* (1997), 400,000 square metres of residential land in Futian district, the key development area for Shenzhen in the future, was snapped up by several Hong Kong conglomerates that year (Wang, 1997). These HK developers see huge potential in Shenzhen's property development market and plan to invest US\$724 million to build

large residential complexes there.⁹ In fact, Hong Kong investors made many acquisitions in the mainland at that time.

Madariaga and Poncet (2006) believe that FDI has a key role to play in the transformation of China's economy, and so does the author of this thesis. The real estate industry has been the second largest sector in China to fetch FDI since the opening of its economy. Regarded as foreign investors both before and after the handover of sovereignty in 1997, HK developers have been the greatest contributors of this form of FDI. This thesis discusses the roles played by this group of Chinese enterprises in the transformation of China's economy. It also examines the major difficulties confronted by them in recent decades and how they overcame the problems through a variety of institutional arrangements.

1.1.4: The Enforcement of the Property Right Law since 2007

The development of the Chinese property rights system has been radical. From the planned economy before the reform and opening policy of 1978 to the basic market economy (the socialist economic system with Chinese characteristics), the property rights system has been evolving with the rapid development of the economy. The most important contribution to this process comes from FDI, of which a significant proportion is direct investment by HK developers. The enactment of the Property Right Law (PRL) in 2007 has a major impact on both local and FDI players in China's real estate market because of the many ambiguous issues that have existed since the 1988 land reform, the PRL has removed uncertainties concerning security of property rights and the tenure of the LURs acquired by the developers. In this study, I posit that the enactment of the PRL

⁹ 6 billion yuan. 1 USD = 8.29 RMB according to *China Statistical Yearbook*, 1997.

has imposed significant impacts on the investment strategies of FDI players. On the one hand, with better-secured rights they tend to increase their overall investment in China. On the other hand, they tend to lower the shareholdings of their investment at the project level, such that they can exercise a diversification strategy over different types of projects and market segments.

1.2: The Research Questions

The key research question that I attempt to answer in this thesis is: what are the institutional factors affecting FDI in real estate markets? China's market has provided ample opportunities for study, not only because a significant amount of the FDI is in the real estate sector, but also because of the institutional settings that enable systematic empirical tests to disentangle the effects of different types of projects and market segments. I make two key propositions of this study. First, under the slack protection of the formal institutions, FDI players strive to optimise their investments by taking account of the property rights structures, both internal and external, of the development projects ex ante. Second, FDI players tend to diversify their investments ex post with more formalised institutional protections put in place.

As the Chinese term for 'real estate industry' – 'non-moveable asset' – implies, its development is closely related to the system of the country, city and region where a project is located. When foreign investment enters a new environment, it certainly requires good property rights protection and intuitive understanding. A high proportion of equity or even wholly owned projects may provide better rights protection. However, to share the project risks, FDI players may engage local partners to remove the institutional barriers. I therefore posit that FDI players tend to have higher shareholdings

for projects with clear property rights in markets where formal institutions are inadequate to safeguard their interests. In the Chinese context, the enactment of the PRL in 2007 is a milestone for putting a formal institution in place to rectify property rights insecurity. During the ten years in which the Property Law has been implemented, the reconsolidation of the property rights system has meant that projects with unclear definition of property rights have needed to reduce transaction costs through cooperation. As a result of investment diversifications, FDI players thus tend to lower their equity ratios in their joint-venture projects with local partners.

1.3: The Empirical Study

This study is an outcome of a Teaching Company Scheme between HK PolyU and Sun Hung Kai Properties (SHKP). SHKP has been one of the most prominent FDI players in China in the past few decades. The company has been involved in a wide variety of FDI projects in multiple Chinese cities. This study documents the experience gained by the company and its fellow FDI players by reporting the lessons learnt through its case studies. To answer the research questions specifically, this study employs a sample of 354 FDI projects conducted by eleven key HK developers in cities categorised into four tiers. These projects are in turn classified into five different types with respect to property rights structures. They are also subject to various internal (e.g., contractual arrangements) and external (e.g., policies) institutional constraints. Multiple regression analyses have been conducted to test the hypotheses derived from the research propositions.

1.4: The Research Gaps to Fill

FDI in general has been extensively studied. Yet analyses of FDI in real estate markets are far from adequate. They tend to focus on capital inflow and the impact of real estate investment at the provincial level. Few studies have been conducted to investigate FDI in the real estate sector at the project level and few industry practitioners apply relevant project information and experience to relevant research. From the perspective of front-line real estate developing practitioners, this study attempts a microscopic approach, one which enables it to contribute a structured institutional analysis to FDI studies. The empirical tests also revise previous understandings of how the Chinese property rights system works. While there were abundant theoretical analyses of the PRL during the legislation process (2002–2007), few researchers have investigated its impacts on the project level ten years after its implementation. This study aims to fill these gaps not only for real estate studies but also for mainstream institutional analysis.

1.5: The Significance

As mentioned in the previous sections, this year marks over forty years of economic reform and opening in China, thirty years of real estate development in the mainland, twenty years since Hong Kong's return to the mainland, and the tenth anniversary of the implementation of the PRL. The thesis thus arrives at a timely moment for documenting the achievements and lessons learnt about this aspect of contemporary China.

The pace of Chinese economic development is no longer as rapid as when the policy of economic reform and opening was established. The reality that China has to

face now is that the Chinese economy as a whole is gradually losing its original low-cost advantage. Part of the reason is that competitive costs are rising. The other part is that there has been a significant rise in institutional costs and while a new unique competitive advantage has not yet been established, it is urgently needed.

All these years after the policy of economic reform and opening, China's economic volume has leapt to second place in the world. The reform has entered a new stage, but also needs new momentum.

My hope for this thesis is that it will emphasise and clarify the importance of an improved property rights system, and especially the importance for economic development of the policy of attracting foreign capital. At the same time, this thesis will serve as a reference for enacting a future development strategy for foreign investment in mainland China, and other rapidly growing developing countries, as well.

1.6: Thesis Structure

The structure of the thesis is as follows. The first part gives a general introduction, followed by an overview of FDI in China and a review of related literature. It then presents the key features of the land reform and the urban development market in China as well as the origin, development and implementation of the PRL. In addition, through a large number of case studies, it further discusses the constraints and problems encountered by HK developers and the corresponding institutional measures on which three major issues will be illustrated, namely investment strategy, getting development rights and managing projects.

CHAPTER 2: LITERATURE REVIEW

The decades of investment experience of Hong Kong property developers in mainland China are a direct reflection of the history of the development of FDI in mainland China under new institutional economics (NIE), the economics approach that incorporates a theory of institutions into neoclassical economics. To explore the issues and problems HK developers have faced and the countermeasures they have taken in this process, the first step is to understand the relationships between FDI, the NIE and the real estate market in mainland China. In this chapter, I will therefore begin by providing a general introduction to NIE and FDI and reviewing the important discussions on this topic in a variety of documents. It will then further elaborate on how NIE and FDI have influenced the mainland real estate market.

2.1: Foreign Direct Investment in China

In the decades since Hymer (1976) initiated the field of theoretical reflection on FDI, a large number of theoretical studies on FDI have emerged in the economic and management literature, and a relatively rich theoretical system has been developed. In this thesis, I use this theoretical system to analyse of a large amount of actual project data to help to fill in the gaps in this research area in the field of practice.

In this thesis, I employ the definition of FDI given by the International Monetary Fund (IMF), which uses it to refer to the direct investment fund from the exterior of a country which is recorded in the balance of international payments. One IMF report specifically defines FDI as cross-border investment by the investors of one country in order to obtain lasting benefits from the enterprise receiving the investment in another country (IMF, 2003). Such benefits usually include granting investors effective or

potentially effective power in the operation and management of the enterprise that receives the investment.

According to the United Nations, China was the third largest FDI recipient in the world in 2016. In 2003, it was ranked number one (see Table 2.1). In 2006, total FDI inflow to China had reached US\$133.7 billion (MOFCOM, 2017), which included contributions by over 100 countries and regions.

2.2: Hong Kong's Contributions to FDI in China

Hong Kong still remains the single biggest contributor to FDI in China (Table 2.2). Of every US\$100 in FDI received by China in 2016, Hong Kong investors paid more than US\$64, for a total of US\$81.5 billion.

Table 2.3 shows the forms of foreign capital inflow to China from 1979 to 2016. Contractual joint ventures (CJVs, e.g., licensing) were the dominant FDI arrangement in the early days, but have been replaced by equity joint ventures (EJVs) beginning in the mid-1980s. In the new century, wholly foreign-owned enterprises (WFOEs) have become the most common form of FDI in China.

Table 2.1: Top 20 Countries/Regions of Inward FDI Flows, 1979–2016

Unit: US\$ billion

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2016												
Country/Region																																								
United States	8700	14918	25195	13810	11518	25367	20490	36145	59531	53571	69300	44542	22799	19222	50665	45185	33172	84455	102308	174454	282376	314307	158446	74467	51346	185206	104773	275196	316367	396366	149044	198849	292862	1095054	202862	177601	346460	391304		
China		57	265	430	916	1419	1956	2244	2514	3194	3320	3347	4366	11608	22515	33767	33767	41726	45287	65463	46739	46739	46739	55240	55240	60460	72466	72466	88231	106332	95000	114424	123395	121809	121809	128250	155610	155610		
Russian Federation																																								
Hong Kong, China	648	710	2863	1237	1144	1388	367	1888	6259	4979	2494	3375	1021	3387	6339	2328	6213	18468	11036	18288	19299	25255	34262	34262	34262	34262	34262	34262	34262	34262	34262	34262	34262	34262	34262	34262	34262	34262	34262	
Brazil	2408	1910	2322	3115	1376	1591	1418	317	1168	2095	1139	989	1102	2061	1294	2159	4405	10702	18995	28358	28378	22749	22749	16290	16290	18344	18344	15866	18322	24385	41063	25349	83749	96532	76008	51000	30886	42345	58680	
Singapore	816	1236	1660	1134	1302	1047	1710	2836	3655	2387	5575	4387	2294	4486	4386	4386	11946	11432	15702	18359	18359	15315	17007	6157	17051	24200	18000	36024	47733	12001	25021	55076	49156	56236	64465	70387	70379	61397	43271	33721
Canada	5205	5907	661	124	2002	4753	1372	2853	8115	6125	6100	1580	4294	4122	4122	4122	9235	9234	11235	20003	24744	66736	22586	7480	445	25692	60294	166321	166321	22700	23400	219669	45111	69391	59862	44530	40228	19477	48300	
Australia	1490	1866	2347	2286	2291	403	2099	5170	5191	8476	7296	7296	4053	5479	4053	4767	11679	5630	7782	5329	1347	14106	13825	14236	6329	29687	29687	26234	4409	46366	31667	36443	58908	59252	56203	40228	19477	48300		
Spain	1397	1495	1707	1783	1622	1772	1968	3451	4571	7021	8408	12294	16234	14929	9570	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273	9273
Mexico	555	2090	3076	1900	2102	1541	1984	2401	2635	2800	3176	2635	4761	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395	4395
United Kingdom	6469	10123	5379	5413	5179	347	5668	8175	14685	20567	28478	29461	14946	15473	14904	9253	10969	24455	33227	74321	87379	115334	35040	19883	16290	102208	142772	176039	92138	89709	59200	41200	41200	55446	51676	44321	33005	29326	25326	
Ireland	337	286	203	240	170	121	164	259	322	257	191	622	1462	1458	1078	857	444	2467	2329	8362	18211	25779	9453	29324	3176	10408	31693	5342	24707	16453	25715	42894	23245	46327	46327	31415	188327	22394		
Luxembourg																																								
India	49	79	92	72	6	19	106	118	212	91	282	237	73	252	532	874	2151	2325	3619	2623	2168	3338	5478	5430	4320	5778	7622	20228	25209	41329	35657	27407	24090	24090	24090	24090	24090	24090	24090	
Germany	1735	340	329	755	1711	534	875	2319	6250	1165	6328	2362	4727	2109	368	714	10025	6273	12244	34588	36705	198279	36402	55232	32277	10092	47409	56255	80212	81227	29066	65345	67254	28381	15273	3324	3324	9238		
Netherlands	1715	2095	1490	1157	794	701	1616	3356	2584	4732	7397	11065	6175	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202	6202
Chile	366	213	383	401	155	78	144	316	891	968	1284	661	823	955	1034	2359	2926	4935	5271	4628	8761	4800	4200	2459	4334	7201	7087	1406	12571	15318	12346	17207	17207	27046	19291	25334	15806	11266		
Indonesia	226	180	133	225	292	222	308	258	335	576	682	1092	1482	1799	2066	2101	4419	6245	4729	207	1338	4320	148	597	1064	8264	4914	6203	6318	4377	13771	19241	19138	18307	18307	18307	18307	18307	18307	
Colombia	117	157	265	366	618	584	1023	674	319	203	576	590	457	729	659	1446	948	3102	5242	3329	1308	2446	2154	1720	3106	10235	6251	8386	8386	8386	8386	8386	8386	8386	8386	8386	8386	8386	8386	
Italy	415	577	1227	617	1190	1231	1072	1172	2114	6001	2528	6346	2482	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210	3210
World	4187	8426	6280	3822	5083	54172	55347	86497	156309	144228	194639	294345	153773	162324	201110	254030	341237	308319	481499	694909	1074318	1304254	722283	944095	550464	691179	495236	1441177	1499124	1499124	1499124	1499124	1499124	1499124	1499124	1499124	1499124	1499124	1499124	1499124

References: UNCTAD (2016)

<https://unctadstat.unctad.org/wais/table/view/table?view=asin?report=fdi20>

Table 2.2: FDI Inflow to China from Top 15 Countries/Regions

Countries	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Up to 2015	
Unit: US \$1 million																											
Hong Kong	7,507	17,275	19,665	20,060	20,077	20,632	18,508	16,363	15,500	16,717	17,861	17,700	18,988	17,949	20,233	27,703	41,066	46,975	60,567	70,500	65,561	73,597	81,268	86,587	81,465	664,595	
	68.20%	69.80%	58.20%	53.50%	49.50%	45.60%	40.70%	40.60%	38.10%	35.70%	33.00%	33.10%	31.30%	29.80%	32.10%	37.10%	44.40%	51.10%	57.30%	61.10%	58.70%	62.40%	67.9%	68.4%	64.6%	64.6%	
Japan	709	1,324	2,075	3,108	3,679	4,326	3,400	2,973	2,916	4,348	4,190	5,054	4,562	6,330	4,598	3,359	3,662	4,105	4,084	6,330	7,382	7,038	4,325	3,195	3,195	3,096	94,143
	6.40%	4.80%	6.10%	8.30%	8.80%	9.60%	7.30%	7.40%	7.20%	9.30%	7.90%	9.40%	9.00%	10.80%	7.30%	4.80%	4.00%	4.60%	3.90%	5.30%	6.60%	6.00%	3.62%	2.3%	2.3%	2.4%	94,143
United States	511	2,063	2,491	3,083	3,443	3,259	3,898	4,216	4,384	4,453	5,424	4,159	3,941	3,001	2,865	2,616	2,944	2,555	3,017	2,469	2,598	2,820	2,371	2,089	2,386	2,089	70,084
	4.60%	7.50%	7.40%	8.20%	8.20%	7.20%	8.60%	10.30%	10.80%	9.50%	10.30%	7.80%	7.80%	5.10%	4.30%	3.30%	3.20%	2.80%	2.80%	2.00%	2.30%	2.40%	1.98%	1.65%	1.65%	1.89%	70,084
Virgin Islands	0	0	0	304	538	1,717	4,031	2,659	3,833	502	6,117	5,777	67,660	9,022	11,248	16,552	15,954	11,259	10,447	9,725	7,881	6,159	6,216	7,388	6,740	131,922	
	0.00%	0.00%	0.00%	0.80%	1.30%	3.80%	8.90%	6.60%	9.40%	1.10%	11.60%	10.80%	11.10%	15.00%	17.80%	22.00%	17.30%	12.30%	9.90%	8.40%	7.00%	5.20%	5.21%	5.85%	5.3%	5.3%	131,922
Taiwan	1,051	3,139	3,391	3,162	3,475	3,289	2,915	2,959	2,297	2,980	3,971	3,377	3,117	2,152	2,156	1,774	1,899	1,881	2,476	2,183	2,847	2,088	2,018	1,537	1,963	6,007	
	9.50%	11.40%	10.00%	8.40%	9.30%	7.30%	6.40%	6.40%	5.60%	6.40%	7.30%	6.30%	5.10%	3.60%	3.40%	2.40%	2.10%	2.10%	2.30%	1.90%	2.50%	1.80%	1.69%	1.2%	1.56%	1.56%	6,007
South Korea	119	374	723	1,043	1,358	2,141	1,803	1,275	1,490	2,152	2,721	4,489	6,248	5,108	3,895	3,678	3,155	2,700	2,692	2,551	3,088	3,054	3,946	4,054	4,751	55,847	
	1.10%	1.40%	2.10%	2.80%	3.30%	4.70%	4.00%	3.20%	3.70%	4.60%	5.20%	8.40%	10.30%	8.60%	6.20%	4.90%	3.40%	3.00%	2.50%	2.20%	25.70%	2.60%	3.32%	3.19%	3.7%	3.7%	55,847
Singapore	122	490	1,180	1,851	2,244	2,606	3,404	2,642	2,172	2,144	2,337	2,058	2,008	2,204	2,260	3,185	4,485	3,865	5,428	6,097	6,305	7,229	5,827	6,904	6,047	62,388	
	1.10%	1.80%	3.50%	4.90%	5.40%	2.80%	7.50%	6.60%	5.3	4.60%	4.40%	3.80%	3.30%	3.70%	3.00%	4.30%	4.80%	4.00%	5.10%	5.30%	5.60%	6.10%	4.87%	5.4%	4.80%	4.80%	62,388
United Kingdom	38	221	689	914	1,301	2,838	1,175	1,044	1,164	1,052	896	742	793	965	726	831	914	679	710	582	410	392	735	496	496	18,540	
	0.30%	0.80%	2.00%	2.40%	3.10%	6.30%	2.60%	2.60%	2.90%	2.20%	1.70%	1.40%	1.30%	1.60%	1.20%	1.10%	1.00%	0.80%	0.70%	0.30%	0.40%	0.30%	0.62%	0.39%	1.0%	1.0%	18,540
Germany	89	56	259	386	518	998	737	1,373	1,041	1,213	928	857	1,058	1,330	1,979	734	900	1,217	888	1,129	1,451	2,078	2,071	1,536	2,710	2,710	21,815
	0.80%	0.20%	0.80%	1.00%	1.20%	2.20%	1.60%	3.40%	2.60%	2.60%	1.80%	1.60%	1.70%	2.50%	3.10%	1.00%	1.00%	1.40%	0.80%	1.00%	1.30%	1.80%	1.73%	1.2%	2.1%	2.1%	21,815
Cayman Islands	0	0	0	0	0	158	324	378	624	1,067	1,180	866	2,043	1,948	2,095	2,571	3,145	2,382	2,499	2,242	1,975	1,668	1,255	1,444	1,444	5,151	
	0.00%	0.00%	0.00%	0.00%	0.00%	0.30%	0.70%	0.9%	1.50%	2.30%	2.20%	1.60%	3.40%	3.20%	3.30%	6.40%	3.40%	2.90%	2.40%	1.90%	1.70%	1.40%	1.0%	1.4%	1.4%	4.0%	5,151
France	0	0	0	0	0	141	192	287	424	475	715	884	853	532	333	456	388	654	1,238	769	682	732	712.07	1,223.9	869.75	12,911	
	0.00%	0.30%	0.60%	0.80%	1.00%	1.00%	1.60%	2.20%	2.10%	1.10%	1.10%	1.10%	1.10%	1.10%	0.60%	0.60%	0.60%	1.20%	0.70%	0.60%	0.60%	0.60%	0.60%	0.97%	0.69%	0.69%	12,911
Netherlands	28	84	111	114	125	414	719	542	789	776	572	725	811	1,044	941	617	862	741	914	761	1,144	1,275	639	732	556	556	14,079
	0.30%	0.30%	0.30%	0.30%	0.30%	0.90%	1.60%	1.30%	1.90%	1.70%	1.10%	1.40%	1.30%	1.70%	1.30%	0.80%	0.90%	0.80%	0.90%	0.70%	1.00%	1.10%	0.53%	0.60%	0.44%	0.44%	14,079
Macao	202	587	509	440	380	395	422	309	347	321	468	417	546	600	603	637	382	815	655	680	506	460	550.57	885.4	817.56	11,848	
	1.80%	2.10%	1.50%	1.20%	1.40%	0.90%	0.90%	0.80%	0.90%	0.70%	0.90%	0.80%	0.90%	1.00%	1.00%	1.00%	0.60%	0.90%	0.60%	0.60%	0.50%	0.40%	0.46%	0.70%	0.65%	0.65%	11,848
West Samoa	0	0	0	0	0	184	127	201	283	548	879	986	1,129	1,332	1,538	2,170	2,550	2,020	1,773	2,076	1,744	1,838	1,564	1,991	872	872	21,131
	0.00%	0.00%	0.00%	0.00%	0.00%	0.40%	0.30%	0.50%	0.70%	1.20%	1.70%	1.80%	1.90%	2.20%	2.40%	2.90%	2.80%	2.20%	1.70%	1.80%	1.60%	1.60%	1.31%	1.38%	0.69%	0.69%	21,131
Canada	58	137	216	257	338	344	317	314	280	441	338	504	614	454	424	397	343	862	655	468	485	536	353	224	282	282	9,290
	0.50%	0.50%	0.60%	0.70%	0.80%	0.80%	0.70%	0.80%	0.70%	0.90%	1.10%	1.10%	1.00%	0.80%	0.70%	0.30%	0.60%	1.00%	0.60%	0.40%	0.40%	0.50%	0.30%	0.18%	0.21%	0.21%	9,290
Total	11,008	27,515	33,707	37,521	41,745	45,257	45,463	40,319	40,715	46,878	52,743	53,505	60,620	60,235	63,021	74,708	92,396	90,033	105,732	116,010	111,716	117,586	119,582	130,266	130,001	1,412,215	

Reference: MOFCOM (various years)
China Statistical Yearbook 1997-2017
Finn et al (2002)

Table 2.3: Forms of Foreign Capital, 1979–2016

Year	Foreign Direct Investment											Total	External Loans	Other Foreign Investment	
	Equity Joint Venture		Contractual Joint Venture		Wholly Foreign-owned Enterprise		FDI Shareholding System		Joint Exploration		Others				
	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.				
1979	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	109	2,513	117	
1980	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	195	2,893	295	
1981	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	375	3,720	125	
1982	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	440	1,745	113	
1983	74	11.63%	227	35.69%	43	6.76%	15	1.19%	523	292	636	1,258	1,065	280	
1984	255	20.27%	465	36.96%	15	1.19%	13	0.78%	481	523	1,258	1,286	1,286	161	
1985	582	35.03%	585	35.22%	13	0.78%	16	0.85%	260	481	1,661	2,688	2,688	298	
1986	805	42.95%	794	42.37%	16	0.85%	25	1.08%	260	260	1,874	5,014	5,014	370	
1987	1,486	64.21%	620	26.79%	25	1.08%	226	7.08%	213	183	2,314	5,805	5,805	333	
1988	1,975	61.83%	780	24.42%	752	22.16%	371	10.93%	232	213	3,194	6,487	6,487	545	
1989	2,037	60.03%	752	22.16%	674	19.33%	683	19.59%	244	244	3,487	6,534	6,534	268	
1990	1,886	54.08%	674	19.33%	763	17.48%	1,135	26.00%	169	169	4,366	6,888	6,888	300	
1991	2,299	52.65%	763	17.48%	2,122	19.28%	2,520	22.89%	250	250	11,008	7,911	7,911	284	
1992	6,115	55.55%	2,122	19.28%	5,238	19.04%	6,506	23.65%	424	424	27,515	11,189	11,189	256	
1993	15,348	55.78%	7,120	21.09%	7,120	21.09%	8,036	23.80%	678	678	33,767	9,267	9,267	179	
1994	17,933	53.10%	7,536	20.08%	7,536	20.08%	10,317	27.50%	590	590	37,521	10,327	10,327	285	
1995	19,078	50.84%	8,109	19.43%	8,109	19.43%	12,606	30.21%	255	255	41,726	12,669	12,669	410	
1996	20,755	49.74%	8,930	19.73%	8,930	19.73%	16,188	35.77%	288	288	45,257	12,021	12,021	713	
1997	18,348	40.35%	9,719	21.38%	16,470	36.23%	16,470	36.23%	707	707	45,463	11,000	11,000	2,095	
1998	15,827	39.25%	8,234	20.42%	15,545	38.56%	15,545	38.56%	292	292	40,319	10,212	10,212	2,128	
1999	14,343	35.22%	6,596	16.20%	19,264	47.31%	19,264	47.31%	130	130	40,715	10,000	10,000	8,641	
2000	15,739	33.57%	6,212	13.25%	23,873	50.93%	23,873	50.93%	528	511	46,878	n.a.	n.a.	2,795	
2001	14,992	28.42%	5,058	9.59%	31,725	60.15%	31,725	60.15%	697	272	52,743	n.a.	n.a.	2,268	
2002	15,392	28.76%	3,836	7.17%	33,384	62.39%	33,384	62.39%	328	32	53,505	n.a.	n.a.	2,635	
2003	16,386	27.02%	3,112	5.13%	40,222	66.34%	40,222	66.34%	777	109	60,630	n.a.	n.a.	3,443	
2004	14,614	24.22%	1,831	3.04%	42,961	71.22%	42,961	71.22%	918	n.a.	60,325	n.a.	n.a.	3,480	
2005	14,378	22.81%	1,940	3.08%	46,281	73.44%	46,281	73.44%	422	n.a.	63,020	n.a.	n.a.	4,055	
2006	15,596	20.86%	1,416	1.89%	57,264	76.59%	57,264	76.59%	492	n.a.	74,768	n.a.	n.a.	3,572	
2007	17,318	18.74%	1,903	2.06%	72,315	78.27%	72,315	78.27%	859	n.a.	92,395	n.a.	n.a.	2,858	
2008	17,273	18.82%	2,034	2.22%	68,682	74.81%	68,682	74.81%	2,044	n.a.	91,804	n.a.	n.a.	1,771	
2009	22,498	21.28%	1,616	1.53%	80,975	76.58%	80,975	76.58%	646	n.a.	105,735	n.a.	n.a.	3,086	
2010	21,415	18.46%	1,757	1.51%	91,205	78.62%	91,205	78.62%	1,634	n.a.	116,011	n.a.	n.a.	1,687	
2011	23,772	20.22%	2,308	2.07%	86,132	77.10%	86,132	77.10%	1,570	n.a.	111,716	n.a.	n.a.	1,578	
2012	21,002	17.57%	1,633	1.37%	94,737	79.24%	94,737	79.24%	2,189	n.a.	117,586	n.a.	n.a.	1,134	
2013	25,885	20.50%	1,845	1.46%	95,285	75.46%	95,285	75.46%	3,251	n.a.	126,267	n.a.	n.a.	144	
2014	30,204	23.97%	830	0.66%	86,126	68.35%	86,126	68.35%	8842	n.a.	126,001	n.a.	n.a.	0	
2015															0
2016															0

Reference: Almanac of China's Foreign Economic Relations and Trade, various issues
 China Statistical Yearbook, various issues
 Fung, et al. (2002)

Table 2.4 depicts the distributions of FDI in China by sector. In 2016, the real estate sector accounted for 15.6% of total FDI inflow or US\$19.7 billion in total. It ranked second, behind only the manufacturing sector (28.2%). It is estimated that HK developers have contributed the lion's share (60% to 70%) of FDI in the real estate sector.¹⁰ In aggregate, according to the tables, for every US\$100 in FDI received by China, HK developers paid around US\$10. The company where I worked, Sun Hung Kai Properties (SHKP), has been a key player in this form of investment. The accumulated amount of investment in China made by SHKP has already exceeded US\$10 billion. It is estimated that SHKP has contributed about 10% out of the total investment made by all HK developers to China (SHKP, 2019)

¹⁰ This estimate is based on the figures for the total completed investment value by real estate development enterprises in 2004 (CRES, 2005). The ratio of investment funded by HK, Macao, Taiwan to overseas enterprises was about 70:30. Since total FDI from Macao and Taiwan (Table 2) is only about one fifth of HK's total contribution, we conceive that HK developers could have taken up 60% of FDI in the real estate sector.

Table 2.4: Distributions of FDI by Sectors

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Primary Industry	672.6	623.8	710.2	675.9	898.7	1,027.6	1,000.8	1,114.3	718.3	599.5	924.1	1,191.0	1,428.7	1,912.0	2,008.9	2,062.2	1,800.0	1,522.3	1,533.9	1,897.7
	1.4%	1.4%	1.8%	1.7%	1.9%	1.9%	1.9%	1.8%	1.2%	1.0%	1.2%	1.3%	1.6%	1.8%	1.7%	1.8%	1.5%	1.3%	1.2%	1.5%
Agriculture, Forestry, Animal	627.6	623.8	710.2	675.9	898.7	1,027.6	1,000.8	1,114.3	718.3	599.5	924.1	1,191.0	1,428.7	1,912.0	2,008.9	2,062.2	1,800.0	1,522.3	1,533.9	1,897.7
	1.4%	1.4%	1.8%	1.7%	1.9%	1.9%	1.9%	1.8%	1.2%	1.0%	1.2%	1.3%	1.6%	1.8%	1.7%	1.8%	1.5%	1.3%	1.2%	1.5%
Secondary Industry	32,569.9	31,327.5	27,779.8	29,575.0	34,798.0	39,464.9	39,179.2	45,463.1	44,692.4	42,507.6	42,861.1	53,256.2	50,075.8	53,860.4	53,748.7	52,458.0	49,568.9	43,943.3	43,594.8	40,212.9
	72.0%	68.9%	68.9%	72.6%	74.2%	74.8%	73.2%	75.0%	74.1%	67.5%	57.3%	57.6%	55.6%	50.9%	48.1%	47.0%	42.2%	36.8%	34.5%	31.9%
Manufacturing	28,119.8	25,824.4	22,603.3	25,844.2	30,907.5	36,800.0	36,933.7	43,017.2	42,452.9	40,076.7	40,864.8	49,894.8	46,771.5	49,590.6	52,100.5	48,865.5	45,555.0	39,938.7	39,542.9	35,492.3
	62.1%	56.3%	56.1%	63.5%	65.9%	69.8%	69.0%	71.0%	70.4%	63.6%	54.7%	54.0%	51.9%	46.9%	44.9%	43.7%	38.7%	33.4%	31.3%	28.2%
Construction	1,437.8	2,064.2	916.6	905.4	806.7	708.8	611.8	771.6	490.2	688.0	434.2	1,092.6	691.7	1,460.6	916.9	1,181.8	1,219.8	1,295.5	1,558.8	2,477.4
	3.2%	4.5%	2.3%	2.2%	1.7%	1.3%	1.1%	1.3%	0.8%	1.1%	0.6%	1.2%	0.8%	1.4%	0.8%	1.1%	1.0%	1.0%	1.2%	2.0%
Electric Power, Gas and Water	2,071.9	3,102.8	3,702.7	2,242.1	2,272.8	1,375.1	1,295.4	1,136.2	1,394.4	1,281.4	1,072.6	1,696.0	2,112.1	2,124.8	2,118.4	1,639.0	2,429.1	2,202.9	2,250.2	2,146.8
	4.6%	6.8%	9.2%	5.5%	4.8%	2.6%	2.4%	1.9%	2.3%	2.0%	1.4%	1.8%	2.3%	2.0%	1.8%	1.5%	2.1%	1.8%	1.8%	1.7%
Mining and Quarrying	940.3	578.1	557.1	583.3	811.0	581.1	336.4	538.0	355.0	460.5	489.4	572.8	500.6	684.4	612.8	770.8	365.0	562.2	242.9	96.3
	2.1%	1.3%	1.4%	1.4%	1.7%	1.1%	0.6%	0.9%	0.6%	0.7%	0.7%	0.6%	0.6%	0.6%	0.5%	0.7%	0.3%	0.5%	0.2%	0.1%
Tertiary Industry	12,059.5	13,511.5	11,828.8	10,463.9	11,180.9	12,230.3	13,324.6	14,022.6	14,914.0	19,013.6	30,982.8	37,948.2	38,328.2	49,962.9	58,233.4	57,196.0	66,217.3	74,055.9	81,137.9	83,890.9
	26.6%	29.7%	29.3%	25.7%	23.9%	23.2%	24.9%	23.2%	24.7%	31.6%	41.4%	41.1%	42.8%	47.3%	50.2%	51.2%	56.3%	62.0%	64.3%	66.6%
Real Estate	5,169.0	6,410.1	5,388.3	4,657.5	5,136.6	5,662.8	5,235.6	5,950.2	5,418.1	8,229.5	17,088.7	18,590.0	16,796.2	23,985.6	26,881.5	24,124.9	28,798.1	34,626.1	28,994.8	19,655.3
	11.4%	14.1%	13.9%	11.4%	11.0%	10.7%	9.8%	9.8%	9.0%	13.1%	22.9%	20.1%	18.7%	22.7%	23.2%	21.6%	24.5%	29.0%	23.0%	15.6%
Social Service	1,988.0	2,963.2	2,550.7	2,185.4	2,594.8	2,943.5	3,161.0	3,823.1	4,565.3	5,554.3	5,783.2	6,567.3	8,508.1	10,117.9	11,108.9	10,077.1	11,790.3	13,854.2	11,205.0	16,987.2
	4.4%	6.5%	6.3%	5.4%	5.5%	5.6%	5.9%	6.3%	7.6%	8.8%	7.7%	7.1%	9.5%	9.6%	9.6%	9.0%	10.0%	11.6%	8.9%	13.5%
Transportation, Storage, Postal and Telecommunications Services	1,655.1	1,645.1	1,551.1	1,011.9	908.9	913.5	867.4	1,272.9	1,812.3	1,984.9	2,006.8	2,851.3	2,573.3	2,243.7	3,190.8	3,473.8	4,217.4	4,455.6	4,186.1	5,089.4
	3.7%	3.6%	3.8%	2.5%	1.9%	1.7%	1.6%	2.1%	3.0%	3.1%	2.7%	3.1%	2.8%	2.1%	2.8%	3.1%	3.6%	3.7%	3.3%	4.0%
Wholesale and Retail Trade	1,401.9	1,181.5	965.1	857.8	1,168.8	932.6	1,116.0	739.6	1,038.5	1,789.4	2,676.5	4,433.0	5,389.8	6,595.7	8,424.6	9,461.9	11,511.0	9,463.4	12,023.1	15,870.2
	3.1%	2.6%	2.4%	2.1%	2.5%	1.8%	2.1%	1.2%	1.7%	2.8%	3.6%	4.8%	6.0%	6.2%	7.3%	8.5%	9.8%	7.9%	9.5%	12.6%
Other Sectors	1,845.5	1,311.7	1,773.5	1,751.2	1,571.9	1,798.0	2,944.7	2,266.9	2,079.8	2,355.5	3,427.6	5,506.7	5,306.8	7,020.1	8,647.6	10,058.3	9,900.6	11,696.6	24,728.9	26,288.8
	4.1%	2.9%	2.9%	4.3%	2.9%	3.4%	5.5%	3.7%	3.4%	3.7%	4.6%	6.0%	5.9%	6.6%	7.5%	9.0%	8.4%	9.8%	19.6%	20.9%
Total	45,257.0	45,462.8	40,318.7	40,714.8	46,877.6	52,742.9	53,504.7	60,680.0	60,324.7	63,020.6	74,767.9	92,395.4	90,032.7	105,735.2	116,011.0	111,716.1	117,586.2	119,561.5	126,266.6	126,001.4
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Reference: China Statistical Yearbook 1997-2014
MOPCOM (various years)

In recent years, China's investments in the tertiary industry sector have been increasing significantly. The reason may be that investment in the tertiary industry has a wider sphere of influence, and that it is more flexible than investment in primary industry and manufacturing, that it involves a shorter investment period and less risk, and that the investing country's profits from the tertiary industry are more guaranteed. Moreover, from the host country's point of view, the primary industry and the secondary industry have been developing for a long time, and when they have developed to a certain degree, it is necessary to develop the tertiary industry to a higher level. Only by elevating the tertiary industry can a country keep up with the pace of the world, and every country must improve the efficiency of all kinds of trade, tourism and logistics services and the like, so that it is possible for the country to expand itself. Under the joint effect of the needs of both the investing country and the host country, foreign investments in the service industry have poured into China, to its benefit.

From a microscopic perspective, Table 2.5 shows the completed values of real estate investment projects carried out by foreign enterprises. A few trends are noteworthy.

First, although the total value of foreign investment projects has increased over time, the proportion of the national figure going into real estate has been decreasing. Foreign direct investment in the real estate market dropped from 22.3% in 1999 to 14% in 2007 and 7.5% in 2016 (see Table 2.5).

Second, EJVs remain the dominant type of contractual arrangement (about or above 40% from 1999 to 2006 except 2004), a steady increase in WFOEs has been observed over the past years, overtaking joint ventures. It became the dominant sector for the first time in 2007, and has consistently exceeded 50% since 2009.

Third, the distribution of FDI is still highly concentrated in Guangdong Province (where the majority of Hong Kong citizens originate), Beijing, Shanghai and Fujian Province, yet significant increases in real estate investment are observed in fast growing areas like Jiangsu, Liaoning, Zhejiang, Shandong and Chongqing (see Tables 6a and 6b).

With the gradual enhancement of China's control over the real estate industry, however, the proportion of foreign investment that is actually utilised in China's real estate industry has shown a downward trend in recent years.

Table 2.5: Completed Investment Value and Profit by Types of Real Estate Enterprise

Unit: US \$ Million

Type of Real Estate Enterprise	2011		2012		2013		2014		2015		2016		2017		2018		2019		2020		2021		2022	
	Total	Of which: Completed	Total	Of which: Completed	Total	Of which: Completed	Total	Of which: Completed	Total	Of which: Completed	Total	Of which: Completed	Total	Of which: Completed	Total	Of which: Completed	Total	Of which: Completed	Total	Of which: Completed	Total	Of which: Completed	Total	Of which: Completed
Average of Real Estate Enterprises	107.83	47.16	115.15	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84
Hotels/Resorts	39	23	39	23	39	23	39	23	39	23	39	23	39	23	39	23	39	23	39	23	39	23	39	23
Commercial/Industrial	34.2	2.3	34.2	2.3	34.2	2.3	34.2	2.3	34.2	2.3	34.2	2.3	34.2	2.3	34.2	2.3	34.2	2.3	34.2	2.3	34.2	2.3	34.2	2.3
Subtotal Enterprises	107	47	115	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42
Specialized Enterprises	2	0	2	0	2	0	2	0	2	0	2	0	2	0	2	0	2	0	2	0	2	0	2	0
Others	4	0	4	0	4	0	4	0	4	0	4	0	4	0	4	0	4	0	4	0	4	0	4	0
Average of Real Estate Enterprises	107.83	47.16	115.15	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84
Hotels/Resorts	107	47	115	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42
Commercial/Industrial	107	47	115	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42
Subtotal Enterprises	107	47	115	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42
Specialized Enterprises	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Others	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Average of Real Estate Enterprises	107.83	47.16	115.15	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84	119.8	41.84
Hotels/Resorts	107	47	115	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42
Commercial/Industrial	107	47	115	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42
Subtotal Enterprises	107	47	115	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42	119	42
Specialized Enterprises	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Others	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Source: Data in 2021 are available

- Average Exchange Rate of RMB Yuan against US Dollar (Market Rate in 1994) (USD1 = RMB 7.9373)
- Average Exchange Rate of RMB Yuan against US Dollar (Market Rate in 2004) (USD1 = RMB 7.9373)
- Average Exchange Rate of RMB Yuan against US Dollar (Market Rate in 2014) (USD1 = RMB 7.9373)
- Average Exchange Rate of RMB Yuan against US Dollar (Market Rate in 2014) (USD1 = RMB 7.9373)
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- Average Exchange Rate of RMB Yuan against US Dollar (Market Rate in 2014) (USD1 = RMB 7.9373)
- Average Exchange Rate of RMB Yuan against US Dollar (Market Rate in 2014) (USD1 = RMB 7.9373)

Reference: China Real Estate Statistics Yearbook

Table 2.6(a): Completed Investment Value by All Foreign Real Estate Development

Enterprises, 1995–2005: Top 15 Regions

Unit: US\$ 1 million

	Guangdong	Beijing	Shanghai	Fujian	Jiangsu	Shandong	Zhejiang	Shanghai	Hubei	Sichuan	Henan	Tianjin	Jiangxi	Anhui	Nanjing
1999	2,351.8	1,882.0	1,745.7	907.5	559.4	444.0	220.5	230.5	305.2	453.4	248.5	240.5	99.7	93.9	11,029.5
	21.32%	17.06%	15.83%	8.23%	5.07%	4.03%	2.00%	2.09%	2.77%	2.14%	2.25%	2.18%	0.90%	0.85%	100.00%
2000	2,439.4	1,914.5	1,255.5	1,025.5	534.5	519.4	203.0	298.6	261.1	369.9	243.2	129.9	125.9	122.9	10,994.5
	22.19%	17.41%	11.42%	9.33%	4.86%	4.72%	1.85%	2.72%	2.37%	3.36%	2.43%	1.18%	1.15%	1.12%	100.00%
2001	3,226.8	2,013.9	1,117.6	1,066.8	504.3	543.2	303.8	395.7	354.5	307.2	286.5	150.2	161.8	106.2	11,907.3
	27.10%	16.91%	9.39%	8.96%	4.24%	4.56%	2.55%	3.32%	2.98%	2.41%	2.41%	1.26%	1.36%	0.89%	100.00%
2003	3,407.3	2,248.2	1,784.5	1,386.8	977.6	775.9	545.7	668.9	348.8	357.7	256.8	206.0	323.8	181.2	15,386.8
	22.14%	14.61%	11.60%	9.01%	6.35%	5.04%	3.55%	4.35%	2.27%	2.32%	1.90%	1.34%	2.10%	1.18%	100.00%
2004	3,070.1	2,065.4	4,253.0	1,013.2	1,857.1	1,857.1	1,591.7	1,035.2	1,334.4	501.9	606.7	658.6	373.9	575.4	25,393.2
	12.09%	8.13%	16.75%	3.99%	6.97%	7.31%	6.27%	4.08%	5.25%	2.12%	2.39%	2.59%	1.47%	2.27%	100.00%
2005	3,941.9	2,836.7	2,238.4	1,923.7	2,415.4	1,957.6	984.6	890.2	672.6	879.2	483.1	297.2	505.6	496.6	23,753.7
	16.59%	11.94%	9.42%	8.10%	10.17%	8.24%	4.15%	3.75%	2.83%	3.70%	2.03%	1.25%	2.13%	2.09%	100.00%
2006	4,836.5	3,417.5	2,692.3	2,790.7	3,287.5	2,577.3	1,431.8	1,452.7	703.2	1,021.9	1,564.5	802.5	632.1	836.3	31,765.1
	15.23%	10.76%	8.48%	8.79%	10.35%	8.11%	4.51%	4.57%	2.21%	3.22%	4.93%	2.53%	1.99%	1.52%	100.00%
2007	8,270.1	4,303.6	3,323.4	2,828.1	5,128.1	4,374.9	2,135.4	1,953.2	1,235.1	1,105.3	3,147.9	1,122.2	693.1	1,354.9	46,439.9
	17.81%	9.27%	7.16%	6.09%	11.04%	9.42%	4.60%	2.66%	2.38%	2.38%	6.78%	2.42%	1.49%	2.92%	100.00%
2008	10,869.0	2,917.9	4,250.4	3,374.9	7,504.5	7,112.7	2,349.9	2,137.0	2,470.3	3,744.8	1,180.2	1,145.7	767.9	1,950.7	58,919.0
	18.45%	4.95%	7.21%	5.73%	12.74%	12.07%	3.99%	3.63%	4.19%	1.99%	6.36%	2.00%	1.94%	3.31%	100.00%
2009	9,380.8	2,492.0	3,798.4	2,971.2	5,804.7	9,652.9	2,958.2	2,741.9	2,717.3	1,540.6	2,978.5	1,141.6	1,284.0	894.0	59,145.2
	15.86%	4.21%	6.42%	5.02%	10.35%	16.32%	5.00%	4.64%	4.59%	2.60%	5.04%	1.93%	2.17%	1.51%	100.00%
2010	12,421.4	2,357.1	4,905.7	4,400.7	7,970.6	11,713.8	3,617.2	3,354.3	3,916.1	1,186.0	4,320.6	1,657.6	1,186.4	1,052.9	74,717.3
	16.62%	3.15%	6.57%	5.89%	10.67%	15.68%	4.84%	4.49%	5.24%	2.93%	5.78%	2.22%	1.59%	3.11%	100.00%
2011	14,463.4	3,484.7	5,076.2	4,334.0	10,882.5	16,510.4	5,042.9	4,264.6	3,556.1	2,412.2	5,358.7	1,896.1	1,927.7	1,068.6	92,972.8
	15.56%	3.75%	5.46%	4.66%	11.71%	17.76%	5.42%	4.59%	3.82%	2.59%	5.76%	2.04%	2.07%	1.15%	100.00%
2012	16,299.8	3,359.7	4,941.3	4,694.7	13,259.3	17,218.1	7,622.1	4,896.2	5,229.5	2,697.3	7,036.8	1,888.1	1,043.8	2,492.1	108,053.2
	15.09%	3.11%	4.57%	4.34%	12.27%	15.93%	7.05%	4.43%	4.84%	2.50%	6.51%	1.70%	0.97%	2.31%	100.00%
2013	18,080.3	4,852.7	6,447.6	6,076.0	16,090.2	19,273.1	11,218.7	5,323.2	6,552.5	2,759.7	6,075.4	1,802.1	2,517.9	1,158.0	125,324.5
	14.43%	3.87%	5.14%	4.85%	12.84%	15.38%	8.95%	4.25%	5.23%	2.20%	4.85%	2.01%	0.92%	2.18%	100.00%
2014	20,085.2	3,194.6	9,894.4	7,920.4	19,040.7	17,229.7	12,495.4	5,816.6	7,752.1	4,531.7	5,541.4	1,474.7	3,057.5	1,075.7	137,441.1
	14.61%	2.32%	7.20%	5.76%	13.85%	12.54%	9.09%	5.64%	3.30%	4.03%	1.07%	2.22%	0.78%	2.40%	100.00%
2015	20,927.6	2,914.8	10,777.4	6,602.5	16,149.5	10,645.5	11,158.9	4,858.6	9,516.4	4,843.2	4,908.5	4,000.5	981.0	3,834.6	129,721.4
	16.13%	2.25%	8.31%	5.09%	12.45%	8.21%	8.60%	3.75%	7.34%	3.73%	3.08%	3.08%	0.76%	2.96%	100.00%
2016	21,559.7	1,699.3	9,990.3	6,449.9	16,042.1	5,265.1	10,865.5	5,954.0	8,551.8	2,825.8	3,874.9	1,275.5	3,984.2	819.2	116,409.1
	18.52%	1.46%	8.58%	5.54%	13.78%	4.52%	9.33%	5.11%	7.35%	2.43%	3.33%	1.10%	3.42%	2.16%	100.00%
1999-2016	175,631.0	47,954.6	78,492.2	59,766.7	127,920.4	127,670.7	74,745.2	46,271.4	55,502.5	29,792.9	50,960.4	17,946.3	24,428.8	11,627.9	27,231.7
(except 2002)	16.27%	4.44%	7.27%	5.54%	11.85%	11.83%	6.92%	4.29%	5.14%	2.76%	4.72%	1.66%	2.26%	1.08%	100.00%

*Hong Kong / Macao / Taiwan Enterprises included.

The Data in 2002 is not available

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References: China Real Estate Statistics Year Book

Table 2.6(b): Completed Investment Value by Hong Kong Macao and Taiwan Funded

Real Estate Development Enterprises, 1999–2005: Top 15 Regions

Unit: US\$ 1 million

	Guangdong	Beijing	Shanghai	Fujian	Jiangsu	Shandong	Chongqing	Hubei	Sichuan	Henan	Tianjin	Jiangxi	Anhui	National		
1999	2,138.1	1,308.2	1,151.5	694.1	401.1	265.6	166.2	174.6	178.3	289.7	166.9	196.3	88.0	102.7	68.9	8,071.5
	26.49%	16.21%	14.27%	8.60%	4.97%	3.29%	2.06%	2.16%	2.21%	3.34%	2.07%	2.43%	1.09%	1.27%	0.85%	100.00%
2000	2,298.6	1,385.0	763.9	658.1	335.9	289.4	118.9	175.2	215.9	185.8	170.7	98.3	74.3	74.3	94.0	8,015.6
	28.68%	17.28%	9.53%	8.21%	4.19%	3.61%	1.48%	2.19%	2.69%	3.49%	2.32%	2.13%	1.23%	0.93%	1.17%	100.00%
2001	2,994.0	1,438.0	641.0	761.0	369.0	299.0	158.0	250.0	293.0	248.0	227.0	146.0	106.0	106.0	50.0	8,895.0
	33.66%	16.17%	7.21%	8.56%	4.15%	3.36%	1.78%	2.81%	3.29%	2.65%	2.79%	1.64%	0.71%	1.19%	0.56%	15386.80%
2003	2,940.6	1,407.9	1,021.2	908.1	694.1	249.2	350.7	271.6	470.3	163.5	179.2	244.7	101.1	101.1	119.6	10,414.8
	28.23%	13.52%	9.81%	8.72%	6.66%	2.39%	3.37%	2.61%	4.52%	1.59%	1.72%	2.35%	0.97%	1.15%	1.15%	100.00%
2004	2,505.8	994.2	2,519.9	400.9	1,250.9	1,103.8	1,385.6	1,260.3	748.6	344.7	252.6	392.6	270.3	545.1	412.3	17,736.2
	14.13%	5.61%	14.21%	2.26%	7.05%	6.22%	7.81%	7.11%	4.22%	1.94%	1.42%	2.21%	1.52%	3.07%	2.32%	100.00%
2005	3,140.7	1,397.8	1,056.4	1,295.4	1,473.4	1,021.7	607.4	627.9	624.3	442.1	593.3	152.1	246.8	152.3	276.5	14,722.5
	21.33%	9.49%	7.18%	8.80%	10.01%	6.94%	4.13%	4.26%	4.03%	3.00%	4.03%	1.03%	1.68%	1.03%	1.88%	100.00%
2006	3,704.3	1,715.3	1,321.5	1,894.4	1,867.7	1,221.9	805.2	820.7	561.6	724.5	866.5	253.5	226.5	365.1	536.1	18,947.0
	19.55%	9.05%	6.97%	10.00%	9.86%	6.45%	4.25%	4.33%	3.82%	4.57%	1.34%	1.20%	0.79%	1.93%	2.83%	100.00%
2007	5,487.9	2,379.0	1,624.3	2,011.8	2,430.7	1,961.8	1,019.3	1,312.9	944.9	663.2	1,730.7	387.0	208.9	545.0	827.0	26,275.6
	20.89%	9.05%	6.18%	7.66%	9.25%	7.47%	3.88%	5.00%	3.60%	2.52%	6.59%	1.47%	0.79%	2.07%	3.15%	100.00%
2008	6,841.9	1,736.6	2,073.9	2,498.5	3,973.1	3,987.0	1,990.7	1,189.8	1,670.7	555.1	2,153.2	375.2	240.4	534.2	1,273.1	33,747.9
	20.27%	5.15%	6.15%	7.40%	11.77%	11.81%	3.23%	3.53%	4.95%	1.64%	6.38%	1.11%	0.71%	1.58%	3.77%	100.00%
2009	6,216.0	1,644.7	2,207.6	2,116.7	3,351.7	5,487.6	1,558.8	1,739.4	1,881.4	1,052.4	1,183.8	443.2	675.1	729.4	1,363.6	35,363.1
	17.58%	4.65%	6.24%	5.99%	9.48%	15.52%	4.41%	4.92%	5.32%	2.98%	3.35%	1.25%	1.91%	2.06%	3.86%	100.00%
2010	8,486.1	1,756.5	2,679.2	3,364.4	5,103.9	6,832.4	1,741.0	2,258.2	2,696.2	1,221.6	1,835.6	764.3	345.4	816.3	1,265.8	45,395.3
	18.69%	3.87%	5.90%	7.41%	11.24%	15.05%	3.84%	4.97%	5.94%	2.69%	4.04%	1.68%	0.76%	1.80%	2.79%	100.00%
2011	10,085.2	2,835.6	2,789.5	3,221.3	7,079.4	11,090.5	2,756.2	3,246.4	2,447.5	1,304.2	2,400.4	986.6	792.6	703.9	1,380.6	60,296.9
	16.74%	4.70%	4.63%	5.34%	11.74%	18.39%	4.57%	5.38%	4.06%	2.16%	3.98%	1.64%	1.31%	1.17%	2.29%	100.00%
2012	11,305.3	2,032.9	2,630.3	3,846.2	9,371.8	11,278.3	5,546.0	3,383.4	3,496.3	1,997.8	3,499.8	977.1	823.6	755.9	1,583.1	71,598.3
	15.79%	2.84%	3.67%	5.37%	13.09%	15.75%	7.75%	4.73%	4.88%	2.79%	4.89%	1.36%	1.15%	1.06%	2.21%	100.00%
2013	12,176.4	3,202.4	3,770.6	4,732.0	10,590.0	13,342.8	8,560.0	4,214.6	4,037.0	1,958.2	2,665.2	1,119.1	1,200.6	833.6	1,829.6	83,832.4
	14.52%	3.82%	4.50%	5.64%	12.63%	15.92%	10.21%	5.03%	4.84%	2.34%	3.18%	1.33%	1.43%	0.99%	2.18%	100.00%
2014	13,522.4	2,323.8	7,008.2	5,429.7	13,367.5	13,209.0	9,492.0	4,342.8	5,771.7	3,524.7	2,819.6	955.8	1,796.8	831.1	2,396.9	98,129.6
	13.78%	2.37%	7.14%	5.53%	13.62%	13.46%	9.67%	4.43%	5.88%	3.59%	2.87%	0.97%	1.83%	0.85%	2.44%	100.00%
2015	15,028.6	1,481.5	8,421.6	5,430.2	11,048.5	7,357.6	8,644.4	3,969.3	7,697.5	3,893.2	2,939.0	1,271.3	3,069.1	859.1	3,216.1	96,257.8
	15.61%	1.54%	8.75%	5.64%	11.48%	7.64%	8.98%	4.12%	8.00%	3.05%	1.32%	3.19%	0.89%	0.89%	3.34%	100.00%
2016	15,327.4	1,023.8	8,066.7	5,230.4	11,320.2	3,229.3	8,710.1	4,483.4	6,865.9	2,129.0	2,510.7	943.2	2,996.1	759.0	1,882.3	87,178.5
	17.58%	1.17%	9.25%	6.00%	12.99%	3.70%	9.99%	5.14%	7.88%	2.44%	2.88%	1.08%	3.44%	0.87%	2.16%	100.00%
1999–2012 (except 2002)	124,209.1	30,063.1	49,747.3	44,493.3	84,029.0	82,226.9	52,710.6	33,720.4	40,621.3	20,818.5	26,216.6	9,794.1	13,468.9	8,814.0	18,575.6	724,878.0
	17.14%	4.15%	6.86%	6.14%	11.59%	11.34%	7.27%	4.65%	5.60%	2.87%	3.62%	1.35%	1.86%	1.22%	2.56%	100.00%

Remarks: The data in 2002 is not available
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2.3: The Evolution of FDI Policy in China

A quick walkthrough of the evolution of FDI policy in China will help the reader understand the subsequent discussions.

After almost three decades of isolation from the world economy, China announced its open door policy, which is an integral part of the economic reform promulgated in 1978.¹¹ The first piece of legislation to facilitate foreign investment and the establishment of Sino-foreign joint ventures was enacted in 1979.¹²

In 1980, four special economic zones (SEZs), namely Shenzhen, Zhuhai, Xiamen and Shantou,¹³ were designated in the southern coastal regions, wherein foreign partners

¹¹ The policy was advocated in the Third Plenary Session of the Eleventh Central Committee of the Communist Party of China held from 18 to 22 December 1978.

¹² Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, enacted in July 1979.

¹³ Chan et al. (1995) believe that the selection of the four SEZs was intended to pave the way for the reunifications of Hong Kong (close to Shenzhen), Macau (close to Zhuhai) and Taiwan (close to Xiamen and Shantou).

could enjoy preferential treatment,¹⁴ although stringent approvals to set up joint ventures¹⁵ and currency controls¹⁶ were required.

To expedite the opening of the economy, in 1984 the State Council further designated fourteen Open Coastal Cities,¹⁷ wherein foreign investors could enjoy tax incentives,¹⁸ although it was slightly less preferential than the SEZs. Beihai, one of the fourteen Open Coastal Cities, was chosen to set up an economic and technological development zone (ETDZ). Investors in the ETDZ could enjoy tax concessions equivalent to those in SEZs if they brought in advanced technology. Many ETDZs were

¹⁴ The standard income tax rate was 33%. Income tax was exempted in the first year and reduced 50% in the second and third year if the project was intended to last more than ten years. A further fifteen top 30% reduction was given to operations located in remote areas. The tax rate in the SEZs was reduced to 15% in 1984. For materials imported into the SEZs, a 17% of value-added tax (VAT) was levied. Merchandise exported would get a 13% VAT refund. The exemption of VAT on imported capital equipment was eliminated gradually beginning in 1996 (Broadman and Sun, 1997).

¹⁵ Approval was still required from the Foreign Investment Control Commission.

¹⁶ All foreign exchange earned had to be kept in a Bank of China account. Repatriation of earnings or transfer of the earnings for repayment of paid-up capital required the approval of the State General Administration of Exchange Control. On top of the income tax, a 10% levy was charged on the remittance, which was subsequently waived, in 1991.

¹⁷ The fourteen cities were Beihai, Dailian, Fuzhou, Guangzhou, Lianyungang, Nantong, Ningbo, Qingdao, Qinguandao, Shanghai, Tianjin, Wenzhou, Yantai and Zhanjiang.

¹⁸ The income tax rate was up to 80% of the standard rate of 33%.

then set up in other Open Coastal Cities. Another city given special attention was Shanghai. Although the city had given away preferential terms to foreign investors comparable to the SEZs since 1985, a rapid increase in FDI did not take place until the Pudong New Area was set up in 1990.

In 1985, the boom in foreign investment was further fuelled after the opening of three ‘development triangles’, namely the Yangtze River Delta in the middle region, the Pearl River Delta in the southern region and the Xiamen-Zhangzhou-Quanzhou triangle in the southeast region. This push was ended in the same year, however, due to relatively high inflation (Sun et al., 2002). In order to regain the momentum, policy changes¹⁹ promulgated in 1986 had demarcated a new stage for foreign investment, which extended the maximum duration of joint-venture agreements to fifty years and allowed the operation of WFOEs. In 1988, the second biggest island in China, Hainan, was designated a new province and the fifth SEZ.

Following a few key legislative amendments in 1990 and 1991,²⁰ FDI began to grow sharply in the 1990s. Total FDI increased six fold from US\$4.36 billion to US\$27.5 billion between 1991 and 1993, and reached the ‘local maximum’ of US\$45.5 billion in 1998, a year after the outbreak of the Asian financial crisis. The amendments included the protection of nationalisation of joint ventures, decentralisation of authority to vet foreign investment, relaxation of rules against appointing foreign partners to chair the

¹⁹ Law of the People’s Republic of China on Foreign Enterprises in April 1986 and Provisions for the Encouragement of Foreign Investment promulgated by the State Council in October 1986.

²⁰ Law of the People’s Republic of China on Joint Venture in 1990 and Law of the People’s Republic of China on Income Tax of Foreign Funded Enterprises in 1991.

boards of directors and the elimination of levies on the remittance of profits earned. The rebirth of Shanghai as the ‘Pearl of the Orient’ in 1990 after the designation of Pudong New Area was also an impetus for the rapid growth of FDI. Liberalisation of foreign trade and investment was further promoted after 1992. Since then, various forms of open cities had been set up, and now there are fifteen free trade zones, thirty-two state-level ETDZs and fifty-three high-tech industrial zones established in various regions in China. In sum, Cheng and Kwan (2000) found that the SEZs enjoy the most favourable preferential treatment, followed by the Open Coastal Cities and ETDZ and then various forms of open cities.

FDI in China resumed its growth trend after the country’s accession to the World Trade Organisation in 2001, which required the lowering of tariffs on imported goods and the opening of various industries²¹ to foreign investors in accordance with a pre-agreed schedule. To revitalise Hong Kong’s economy after the outbreak of an epidemic,²² China embarked on a so-called Closer Economic Partnership Agreement with Hong Kong in 2003, which aimed to fully implement a zero tariff arrangement²³ by January 2006 and relaxed restrictions on the import of services.²⁴ These initiatives fuelled a

²¹ The list includes the banking, insurance and construction sectors.

²² Severe Acute Respiratory Syndrome (SARS) caused almost 300 deaths in Hong Kong in the first half of 2003.

²³ Goods originating in Hong Kong are charged no tariffs. This arrangement has also extended to the freight trade, transportation, construction and tourism industries.

²⁴ This includes banking, RMB-related businesses and services provided by professional bodies in Hong Kong.

record high flow of FDI into China in 2006, totalling US\$63 billion. According to the Ministry of Commerce (Table 2.2), the total accumulated FDI in China as of 2006 had already exceeded US\$1.4 billion since the opening of the economy.

However, because foreign capital²⁵ is invested in China in the hope that the country's currency, the RMB, will appreciate, measures²⁶ have been imposed in recent years which primarily aim to curb speculation. Still more severe controls have also been introduced which restrict certain types of FDI inflow. For instance, the development of high-end hotels, offices and villa type residential developments with foreign capital have been restricted since 2004.²⁷ Beginning in December 2007, the restrictions have further extended to tract developments, exhibition centres, golf courses, estate brokerage operations and the mining of scarce and non-renewable materials. In addition, the maximum shares of insurance, stock brokerage and financial investment businesses owned by foreign joint-venture partners have been limited to 50%, 33% and 49%,

²⁵ Mainly through Qualified Foreign Institutional Investors (QFII) schemes and other official and unofficial channels.

²⁶ For instance, foreign funded banks with domestic operations are not permitted to convert debts contracted in overseas countries into RMB. Remittance of FDI capital can only be converted to RMB with proof of domestic payment orders.

²⁷ Specified under the Foreign Investment Industrial Guidance Catalogue promulgated by the Ministry of Commerce and the National Development and Reform Commission (NDRC) in November 2004, No. 24 [2004]. In addition, according to the Interim Provisions on Approving Foreign Investment Project promulgated by the NDRC, approvals should be sought from either the NDRC or local development reform authority, depending on the total investment amount.

respectively. China's ranking among the world's FDI recipients table (Table 2.1) slid from the top place in 2003 to fifth in 2006, but returned to second in 2016.

2.4: Review of the Literature on FDI in China

The amount of literature relating to FDI in China is vast. In order to facilitate the discussions to follow, I attempt to summarise the findings of the literature into three major areas: (1) the contributions of FDI to the Chinese economy, (2) determinants of FDI and spillover effects and (3) choices of contractual arrangements.

2.4.1: Contributions of FDI to the Economy

The relationship between FDI and economic growth has always been a controversial issue in academic circles. The theoretical explanation of the relationship between the two can be traced back to the neoclassical growth model. The 'two-gap' model derived from the Harrod-Domar model holds that the inflow of foreign capital has a positive effect on growth by relaxing constraints on savings and foreign exchange, but such positive effects can be achieved only when the conditions of the consumption ratio of imports, the saving substitution effect and absorptive capacity are satisfied. The Solow Model (1956) holds that FDI only increases capital accumulation, and thus can only affect short-term economic growth.

Demello (1999) has found that FDI had a positive impact on the growth rate of output no matter whether the host country is a leader or a follower in terms of technology. Zheng et al. (2002) have analysed the aggregate of time series data from China and twenty-three other developing countries, finding that GDP and FDI have an interaction of mutual promotion.

Kamath (1990) has identified the major objectives of FDI policy in China, namely stimulating economic growth, diversifying the industrial base, increasing technology transfer and upgrading managerial and labour skills. While Griffin (1970) and Weisskopf (1972) have argued that foreign capital inflow tends to substitute for rather than supplement domestic savings, thereby negatively affecting economic growth, Tseng and Zebregs (2002) have contended that foreign capital contributed almost 3% (0.4% in capital formation and 2.5% in total factor productivity) to China's economic growth. Kamath (1990) has argued that the relatively slow growth of FDI in the early 1980s could be attributed to the inwardly oriented goals of the SEZs, the lack of clear delineation of private property rights and the inaccessibility of local markets. He conjectures that Hong Kong had been the key player in FDI in China because of the anticipation of being able to access Chinese markets after 1997. Pomfret (1994) has criticised Kamath (1990) for giving a partial picture focused solely on the early 1980s. Evidence from the late 1980s showed that the SEZs were export-led, and the major obstacle to FDI was the inconvertible currency. He argued that the decentralisation of the FDI approval process, the allowing of trading of foreign currency at negotiable rates and the amendments of laws in 1986 signalled improvement in the protection of private property rights. Re-joining arguments over inconvertible currency, Head and Pie (1996) have also accused FDI policy in the early days of requiring joint ventures to balance total receipts and uses of foreign exchange. While Parnell (2002) has found that German enterprises were in general contented with their investments in China, they did report major problems, including worries about unclear property ownership, lack of market transparency, experiences of deception and exploitation, vanishing profits and official chicanery.

Naughton (1996) has shown that Hong Kong and Taiwan played a key role in FDI in China, as was evidenced by their substantial shares in total FDI and the imbalanced distribution of FDI concentrated in Guangdong and Fujian provinces. Sun et al. (2002), however, have argued that the FDI contributed by Hong Kong and Taiwanese investors could hardly be an engine of economic growth because it had few spillover effects that benefitted other provinces. Hong Kong's round-tripping problem has further complicated the issue. Tseng and Zebregs (2002) have estimated that capital from China that also returned to China yet was designated as foreign capital took up 25% and 7% of total FDI in 1992 and 1996, respectively.

Huang (2003) has put forward the idea that FDI in China has by and large reflected a distortion of the financial market because the credit constraints confronted by domestic private enterprises have led them to look for foreign investment. Havrylchyk and Poncet (2006) have conducted an empirical test and have confirmed this hypothesis, as have Hericourt and Poncet (2007). A study conducted by the World Bank (2000) has also indicated that 80% of enterprises in China were credit-constrained compared with the median figure of 38.5% among ninety-four countries. China was ranked number one in this survey. In fact, Chinese state banks had been accused of lending money for political rather than commercial motives (Park and Sehart, 2001). However, Prasad and Wei (2005) have doubted the validity of Huang's (2003) argument for explaining the massive inflow of FDI to China in recent years, given that domestic private enterprises have become less and less credit-constrained.

In the long run, the extent to which FDI affects output growth is limited. The endogenous economic growth theory represented by Romer (1986) and Lucas (1988) has relaxed the hypothesis of exogenous technology, and holds that technological progress is endogenous and is the main factor that affects the economic growth of a country. The

sources of technological progress can be divided into independent innovation and introduction, imitation and learning from outside. As an important channel for the diffusion of foreign capital and international technology, FDI not only increases the capital stock of the host country, but also brings a package of spillover effects to that country, including technology, knowledge and management experience. The theoretical analysis of FDI's role in promoting economic growth has evolved from the pure effect of making up for the capital gap or past capital accumulation to the effect of bringing 'compound products' to the host country in the present stage, including capital, technology and management (systems). The effect of FDI on institutional change has been gradually acknowledged in theory Kamath (1990).

2.4.2: Determinants of FDI and Spillover Effects

The second area of broad discussion concerning FDI in China are on the major determinants and the spillover effect. Compared with the service industry in the host country, transnational direct investors' face relative disadvantages and a number of challenges. First, there are differences in language, law, system, culture and so on. Since they are not familiar with the investment policies and other aspects of the investment environment in the host country and are unable to accurately master its political situation, foreign investment tends to be burdened with enormous risks, which hinder the potential benefits to a large extent.

At the same time, however, foreign businessmen also have comparative advantages in terms of their command of management concepts, financing methods, technical abilities, international marketing channels and capital adequacy, among other factors. These disadvantages and advantages work together to influence foreign investment in China and make it different from domestic investment enterprises. FDI can

achieve the transnational flow of factors (money, investment, technology, managerial method, and so on), and it involves a longer investment period and a relatively large investment risk. As identified by Cheng and Kwan (2000), the major determining factors of FDI in China were the size of the regional market (+ve), infrastructure investment (+ve), preferential policies (+ve) and wage cost (-ve). Chen (1996), however, has rejected the possibility of wages affecting FDI in China, finding that regional factors such as transportation linkage and technological filtering were more important.

To add to this list, Havrylchyk and Ponet (2006) have also found the agglomeration effect (+ve) and labour productivity (+ve) to be significant factors shaping FDI. Sun et al. (2002), however, have discarded the agglomeration effect and found evidence that cumulative investment of a region could have a negative impact on efforts to lure additional capital inflow, which suggests that foreign investors might prefer a less competitive environment. Demello (1997) has envisaged that the causal link between FDI and growth depended largely on the nature of the determinants of FDI, the endowment effect and the scale effect. He reckoned that the more the determinants are associated with growth, the bigger the probability that growth causes FDI, not the other way round.

While the agglomeration effect caused a very high concentration of foreign investment in Guangdong and Fujian provinces in the early days, Madariaga and Poncet (2006) have also found a significant spillover effect. They have shown that for each increase of one standard deviation in FDI in surrounding regions, there was a 5% increase of FDI in the locality. On the other hand, the opposite effect was discovered by Hu and Jefferson (2002) in the electronic industry, although it was not significant in the textile industry.

Hu and Jefferson (2002) have also contended that the productivity of domestic firms receiving FDI would be enhanced in the short run at the expense of the credit constraints burdening firms not receiving FDI. In the longer run, however, all firms will benefit from the transfer of technological and management know-how. These authors have, in fact, confirmed the ‘market-stealing’ hypothesis put forward by Aitken and Harrison (1999), who demonstrated that there was no spillover effect on non-FDI receiving firms in Venezuela. All net social benefits created by FDI seemed to be captured by the FDI receiving firms alone.

In a study of spillover effects in Lithuania, Javorcik (2004) has argued that the effects appeared to occur via backward linkages. While there was no evidence of spillover for FDI projects carried out by wholly foreign-owned firms, the effect only happened through joint-venture arrangements, and mainly benefitted upstream sectors. He found that for a one standard deviation increase in foreign presence in the downstream sector, a 15% increase in output in the supplying industries would be observed. This argument also appears to be valid in the real estate development industry in China, in which domestic building contractors greatly benefitted from FDI projects in recent decades.

2.4.3: Choices of Contractual Arrangements

Last but not least, contractual arrangements for FDI are also a major problem in the previous literature. Modes of direct investment include greenfield projects, joint ventures and acquisitions and mergers of existing enterprises across borders. It may take the form of a joint-stock company or other forms in which one party usually invests in the form of the ownership of the land or buildings. Direct investment includes not only the agreements signed when an investor and investee establish a relationship of direct

investment, but also other subsequent agreements signed between them or their subsidiaries. In other words, the direct investment relationship includes the cooperation between the subsidiaries of the investor and the investee. Once a direct investment relationship is established, the investor can make additional investments in a variety of forms, including securities, reinvestment of earnings and reinvestment of profits, as well as the extension of new or existing loans between the companies, which also constitute the capital stock. Such investment agreements include part of the funds available to the investee enterprise, while such an enterprise can also obtain financing from local or international capital markets.

The contractual arrangement of FDI is also a major concern in the existing literature. A survey of 551 Sino-British joint ventures formed between 1983 and 1996 has shown that more than 60% of the British companies did not possess controlling shares in their China projects (Li & Clarke-Hill, 2004). A separate survey, of 111 Taiwanese real estate firms (Hsieh, 1997) conducting development projects in China has suggested that WFOEs were the least favourable arrangement (attributing this to the cross-strait political tensions). In addition, compared with EJVs and CJVs, WFOEs were concerned more with the benefits offered by the local governments and the political environment at the time the investment decisions were made.

In terms of share structure, Chadee and Qiu (2001) have found that there were fewer foreign holdings in the joint-venture projects in Beijing, Shanghai and Tianjin were than in the SEZs and Open Coastal Cities. This may be attributed to the greater bargaining power of the local governments there. In general, the Singaporean investors held higher shares than investors from the United States and Hong Kong. These authors found that since project size was inversely related to the share of foreign holding, European investors held the least shares because they were usually involved in bigger

projects. Project duration, however, was positively related to proportion of foreign holdings. Although the same correlation among project duration and foreign share has been observed by Hu and Chen (1993), in contrast, they showed that the level of foreign shares moved in the same direction as project size. Pan (1996) has further added factors like culture distance (+ve), competitive intensity (+ve), advertising intensity (+ve), state owner partnership (-ve) and number of local partners (-ve) to explain the level of foreign shareholding. He has found that Japanese investors held higher shares than European and Hong Kong enterprises at that time. He has claimed that it was because investments from Japan were less affected by country risk in China. Contrary to the earlier findings by Gomes-Casseres (1989) and Hennart (1991), which have shown that EJVs and CJVs were the preferred arrangements, Pan (1996) found that foreign firms had gained more favourability over WFOEs or majority shares in joint ventures so as to protect and exploit ownership advantages.

Broadman and Sun (1997) have depicted a global FDI distribution by investment sectors, in which China displayed a distinct pattern. 32.6% of FDI in China had been channelled into real estate, far exceeding the overall figure of 4.79% and those in the developed economies (10.09%), Asia (1.99%) and Latin America (1.21%). Jiang et al. (1998) has claimed that it was counterintuitive that China had brought in huge amount of FDI to the real estate industry given the stagnant technology innovation and relatively low R&D expenditure in the sector. These authors have contended that FDI real estate investment in China was a substitute for financial investment given the immaturity of the stock market. The distribution of FDI in fact reflected the imperfections in China's capital market.

2.5: New Institutional Economics

When studying the connection between FDI and the Chinese mainland market, the discussion of new institutional economics (NIE) cannot be avoided since the Chinese policy environment under NIE directly determines how FDI decisions are made for the mainland market.

New institutional economics first originated as a research field in approximately the 1930s and had become almost mature by the 1970s. Many economists, including Ronald H. Coase, Oliver E. Williamson, Harold Demsetz and Douglass C. North, have integrated their own theoretical viewpoints and opinions into NIE. There are connections and differences between NIE and neoclassical economics. The similarity between the two is that the central issue they study is how to allocate resources and promote economic efficiency on the basis of market mechanisms. The difference is that NIE introduces some institutional variables and amends the hypothetical conditions of economics. At the same time, it puts forward new economic concepts such as property rights, transaction costs, contracts by adopting new means, methods and techniques of economic analysis. It also elaborates systematic explanations and demonstrations of the origin, development, change and economic performance of the real institutional world from a point of view that is entirely new in comparison with neoclassical economics.

New institutional economists (represented especially by Coase) argue that institutions are more important than technology for economic development and economic performance, and suggest that it is the primary factor affecting economic development and economic performance. The contribution of China's economic reform and opening and FDI in China's economy and the process of real estate development in the same period discussed above have been described and confirmed the relationship between institutional change and economic development.

Akerlof (1989) regards the lack of institutional arrangements as a major constraint for economic development in general. The institution promotes the economic development of a country at both the macro and micro levels. In the past, people greatly underestimated the role of institutions in economic and social development. The difference between developing and developed countries mainly refers to the difference in institutions, and institutional bottlenecks make it impossible for various factors in developing countries to be allocated in an effective way through market mechanisms. In essence, economic development is a process of institutional change in which resources are more effectively utilised. In the same way, the rapid economic development in China in the forty years since the implementation of economic reform and opening is also a process of institutional change.

2.5.1: Property Rights

New institutional economists generally argue that property is a right, a social relation and a rule that regulates mutual behaviour and relationships between people. Alchian (1965) holds that ‘A property right for me means some protection against other people’s choosing against my will one of the uses of resources’, which reveals that the essence of property rights is social relations. New institutional economists also believe that property rights are essentially a set of incentive and restraint mechanisms, that the arrangement of property rights directly affects the efficiency of resource allocation, and that a society’s economic performance ultimately depends on the incentives provided by the arrangement of property rights among individuals. In the seventy years since the founding of New China, and especially in the forty years since the economic reform and opening, positive growth has been accompanied by the continuous tremendous changes in the property rights system. The property rights law discussed in this chapter is the

product of and an important milestone in the development of the property rights system in China.

2.5.2: Transaction Costs

Transaction costs (Coase, 1937) are broadly defined as the costs of exchange, which include the cost of measuring, defining and protecting property rights, the cost of discovering transaction objects and transaction prices, the cost of bargaining, the cost of concluding contracts, and the cost of supervising the strict implementation of contractual terms. The essence of the transaction cost theory is to study how resources are allocated and how to maximise economic efficiency under established property rights. However, in the process of real estate development, since it is immovable property, there may be more reliance on local institutions and their arrangements.

Real estate is a special product because both the land and buildings on it are immovable. Real estate projects are fixed in terms of physical characteristics, as they have to occupy a certain position and space and cannot coexist in the same place. In addition, there are some derivative rights, such as lighting, ventilation and foundation stability. Real estate commodities therefore cannot complement each other in the market as other general commodities can, and reach equilibrium in the market as a whole, thus creating a condition of scarcity.

In most real estate projects, the adjacent construction land is likely to be similar, but is unlikely to be exactly the same. The exclusiveness of real estate products in space and their monopolistic locations lead to monopoly, which determines that the exchange between real estate products is completely different from that of other general commodities, making it impossible for the real estate market to be a completely competitive market, but is rather a regional and monopolistic market with relatively high

transaction costs. Monopoly will lead to externalities on consumers (buyers, tenants, etc.) and producers (developers), an issue which will be discussed in Section 3.3 of the next chapter.

2.5.3: The Nature of the Firm

Coase (1983) believes that market mechanisms are a means of resource allocation and that the firm is also a means of resource allocation, and that the two are interchangeable. This theory was a pioneering explanation for the fact that firms and markets coexist in the real world, which expands the single production system of neoclassical economics, a market mechanism, into a dual production system in which there are substitution relations between firms and markets. In Coase's view, the operation of the market mechanism comes at a cost. By forming an organisation and allowing an authority (entrepreneur) to control resources, some market operation costs can be saved, and the savings in transaction costs are the only driving force for firms to produce, exist and replace the market mechanism. Coase's theory of the firm provides us with a new perspective to understand its nature. Through a thorough study of the reasons for the existence of enterprises and the motive force for development, it is found that the saving of transaction costs can achieve its purpose through certain organizational, governance and internal management arrangements, under the established property rights constraints and in accordance with the coordination mechanism of transaction costs.

HK developers, the object of this study, develop projects in mainland China as enterprises. In the early stage, the policy for inviting outside investment by the Chinese government was an effective means of resource allocation for the society at that time. However, with the changes in the development stage and transaction costs, HK developers also change their strategies to enter the mainland accordingly.

2.5.4: Institutional Change

The term *institutional change* mainly refers to a process of institutional replacement and transformation, and it can also be understood as the replacement of an old institution by an institution with better benefits. The change must be an evolution towards a more efficient institution. Institutional change theory is a dynamic institutional theory, and it can be regarded as an attribute of the institution in a sense.

The theory of institutional change is an important part of NIE. One of its representatives is Douglass C. North, an American economist who emphasised that technological progress and innovation are the main manifestations of economic growth, and that the main driving force is the human impulse to engage in institutional change. The establishment of a series of institutions, such as property rights institutions, legal institutions and social norms consolidates the achievements of technological innovation and provides a source for the long-term development of human society and steady economic growth. At the same time, North (1994) also believes that the institution plays a decisive role in promoting a country's economic growth and social progress. When society and economy develop to a certain point, the efficiency of institutions is bound to begin to progressively decrease. When the efficiency of the institution is reduced to a certain point, it becomes inevitable that the institution will change. One of the main driving forces and objectives of institutional change is to save transaction costs, which reduces institutional costs and improves institutional efficiency. Institutional change can therefore be understood as a stage or process in which a more effective institution replaces a less effective one.

In the previous chapter, I reviewed the relationship between FDI and the institutional change of property rights. FDI is a carrier and catalyst, and also reflects the dynamic attribute of institutional change. Cheung (1990), in particular, has argued that

open policies, including the attraction of FDI, are likely to reduce the cost of institutional change in China, since the increase in competition may lead to the restructuring of the original property rights institution into a private property rights institution with a large public sector. Davis and North (1995) have pointed out that borrowing similar arrangements from the outside can shorten the time required for institutional innovation. Borner et al. (1995) have noted that the most serious obstacle to policy reform was an uncertain institutional environment. Nicaragua is a typical case of the failure of reforms in developing countries. The author's analysis of the reasons for the failure of Nicaragua's reform shows that the arbitrariness of government policies, especially in the protection of property rights, leads to the instability of the institutional environment, which affects the confidence in investment and ultimately hinders economic development. Hans-Werner et al. (1997) have studied the relationship between FDI, political hostility and the process of privatisation in Central and Eastern European countries. They point out that in order to solve the political hostility caused by FDI inflow and accelerate the process of privatisation, there is an urgent need for institutional innovation.

2.6: Gaps to be Filled

The literature reviewed in this chapter suggests that FDI has been an important catalyst for the economic growth of China since the opening of the economy.

This is similar to the situation in Vietnam. Thanh, Erwin and Ary (2014) have pointed out that when Vietnam's economic reforms began in the late 1980s, just like many other precedents, the real estate market developed rapidly during the transformation from a central planning economy to market economy. However, it also had the problem of vague definition of property rights. This problem persists today.

China's policy of economic reform and opening, by contrast, began earlier. China also has a more open policy on FDI, which gives it a larger role in the mainland market. Nonetheless, in the whole development process, uncertainties about the PRL have always affected the development of FDI.

At the same time, Thanh, Erwin and Ary (2014) have pointed out that foreign investors bring funds and experience with technology, while local developers have more local connections and are more adept at dealing with government relations. Because of the limitation of policies, most of the FDI in Vietnam's housing market was established in the form of JVs with local investors. To some extent, it contributed to a complementary relationship between the strengths of the two sources of capital (FDI and local players).

These kinds of complementary resources can also be found in the early stage of the 'Reform and Opening Up' of mainland markets. But after years of development and with relatively more open policies, HK developers have independently developed and successfully run several projects in mainland China. However, the problem of lacking a relatively fair environment of competition between the two sources of capital cannot be ignored.

In exploring the difficulties and considerations encountered by HK developers in the process of property development in mainland China from the perspective of real estate developers in this study, I hope to provide some inspiration for creating a fairer and more open market environment.

Unlike other developing economies, FDI has played a key role in the real estate market in China, and thus provides ample empirical cases for scholarly studies. Yet most studies of FDI in the Chinese real estate market deal with the flow of capital, and hence the impacts on real estate investment at the provincial level. Analysing FDI macroscopically does not explain investment decisions *per se*. A microscopic study

identifying all relevant factors of each project, on the other hand, will help us understand the investment strategies and concerns of FDI players. Adding institutional dimensions into the study, it will help explain the interactions between property rights systems and investment decisions, which in turn may fill gaps in mainstream economics, as well. This study will go on to conduct a series of empirical tests by analysing the parameters of 354 FDI projects carried out by eleven key HK developers. The results will help answer this study's central research questions, which concern the behaviour of FDI players with respect to both the internal and external property rights structures of the investment projects.

CHAPTER 3: HYPOTHESES ON INSTITUTIONS AND THE FDI REAL ESTATE MARKET IN CHINA

A detailed illustration of the land reform and urban land market in China will help explain the problems and constraints that HK developers have encountered in carrying out FDI real estate projects in the mainland. It will also help explain the formulation of hypotheses, as well as the design of the empirical tests and interpretations of the results in the subsequent chapters.

3.1: Land Reform, the Urban Development Market and Related Laws in China

Land reform is a process that China has been undergoing for thousands of years. In this thesis, the changes that have occurred in the seventy years since the founding of New China in 1949 are broken down into the following six stages.

3.1.1: The Publicly Owned and Administrative Allocation Stage

Provisional regulations of the People's Republic of China concerning title deed taxes, promulgated by the State Council in April 1950, stipulated that all organisations and the people shall pay the deed tax for the sale, pawn, gift, or exchange of land and housing. Urban private land was made available for sale, rent, shareholding, pawn, gift, or exchange. Real estate retained certain property rights in private markets.

In January 1956, however, decisions on the basic situation of private urban properties and socialist transformation issued by the Secretariat of the Central Committee of the Communist Party stipulated that all privately owned urban open space, residential land, and other real estate was to be turned over to the state through appropriate measures. With that act, the comprehensive nationalisation of urban land was achieved. The document also provides for the use of urban land, which was to be allocated free of

charge by the local government. This process transformed private property rights into a form of public property that is difficult to quantify.

During the period from the issuance of the document in January 1956 to the reforms of 1978, the system of the use of urban land was free of charge with indefinite duration and no transactions were allowed. Urban housing was mainly financed and built by the state. Built housing was not for sale, but mainly allocated by organisations to their employees in order of their length of service, position, education, and place in line. For the allocated housing, only a low, nominal rent, close to zero, was charged. This housing system is usually summarized as a welfare housing system in which the state covers the investment and construction of the housing, and allocates it to employees in kind, so that they can use it almost free of charge.

In this housing system, not only did investment in housing construction ‘have no return’ as the Chinese proverb would have it, and is unable to be recycled and circulated, but the low rent collected was not enough to pay for the daily maintenance and management expenses of a house or building. Housing construction, maintenance, and management costs had become a heavy burden on the country. At the same time, this mode of guaranteeing housing allocations also inhibited individual investment in housing, thus making the problem of the lack of urban living space increasingly prominent. Data from the Ministry of Housing and Urban-Rural Development shows that per capita living space in cities and towns decreased from 4.5 square metres in 1949 to 3.6 square metres in 1978, with 8.69 million households lacking adequate housing accounting for 47.5% of the total number of urban households at that time.

Such an institutional arrangement, with the obvious characteristics of a planned economy, is conducive to concentrating on major events and preventing speculation.

However, the complete exclusion of market mechanisms from the allocation of land resources does have great shortcomings.

On the one hand, despite the fact that the state is the owner of all urban land, land is allocated for free and can be used for a long time, and thus governments at all levels are unable to directly achieve economic returns. At the same time, however, it is necessary for them to invest in land consolidation. In this process, governments at all levels solely invest in the land without any return. In such a welfare housing system, there is hardly any real estate market or real estate industry in China; there is only the construction industry. The concept of property rights is vague and difficult to define.

On the other hand, due to the free allocation, long-term use, and the low cost of occupancy on urban land, there was an unreasonable expansion in the demand for urban land, while some organisations acquired far more land than they actually needed. In addition, land could not be transferred, resulting in some organisations having idle land, while others were in urgent need of land but unable to acquire it, leading to low efficiency of land use. It also had a huge transaction cost for the society.

3.1.2: 1978 to 1987: The Theoretical Breakthrough Stage

On 18 December 1978, the Fourth Plenary Session of the Eleventh Central Committee of the Communist Party made clear that China had begun to implement a policy of reform and opening to the outside world. In April 1980, Deng Xiaoping acknowledged the basic features of the urban housing system in his address on housing and the construction industry. Deng Xiaoping's speech broke with the traditional view of public ownership and the housing welfare system, and offered a basic blueprint of a new housing system. In June 1980, the Central Committee of the Communist Party and the State Council promulgated the approved 'Report Outline of the National Conference

on Infrastructure Construction’, which formally proposed the implementation of the policy of housing commercialisation and allowed individuals to construct, purchase and own their own houses. It also stipulated that not only could new houses be sold, but existing ones could also be sold. At that point, the housing system reform and the real estate market in China began to take shape.

After the economic reforms of the late 1970s, a unified housing development office was set up throughout the country. The establishment of the China National Real Estate Development Group Corporation on 16 January 1981 meant that China had the first housing development company and that it was able to begin developing real estate projects. Of course, none of this changed the essence of the planned era within the system.

In the same period, in 1980, the first group of HK developers entered mainland China. These companies were Sun Hung Kai Properties (the enterprise where the author is currently employed, New World Development Company Limited, CK Asset Holdings Limited, and Henderson Land Development Company Limited (I study these four companies in this thesis), Hopewell Holdings Limited and Sun Hung Kai Securities. They built the ‘China Hotel’, a Marriott Hotel in Guangzhou, and the first Sino-foreign joint venture hotel in mainland China.

Four years later, in 1984, Shui On Land Limited, one of the companies I study here, set up a mainland company. A year later, Kerry Group, another object of this study, cooperated with the State Economic and Trade Commission, investing US\$380 million to build the China World Trade Centre in Beijing.

In the 1980s, it was technically impossible to clearly define the structure of property rights over the land market in China when the country was undertaking a transition from a planned to a market economy. The country’s constitution stipulated that

all urban lands belonged to the state and all rural lands to collectives. Urban lands were granted mainly through ‘administrative allocation’ (Yeh & Wu, 1996) to state-owned enterprises (SOE) and work units (known as *dan wei*) at zero cost and indefinite tenure. The property rights structure had three key elements, as defined by Cheung (1974): exclusive rights to use, exclusive rights to receive income and exclusive rights of transfer. Rapid urban development started to take off only after a 1988 amendment of the constitution²⁸ and the subsequent enactment of laws²⁹ allowing the separation of ownership and LURs through the granting of ‘leased land’.

The following discussions will use Shenzhen as an illustration because by and large the experience of land reform in Shenzhen was followed by almost all rapidly developing cities in China. Shenzhen was the first city in China to experiment with economic and land reform. In 1980, two years after the country’s leader Deng Xiaoping announced the adoption of the open door policy, the Shenzhen SEZ was established. While the small region (397 sq km) enjoyed relatively liberal economic policies, financial resources for urban development were limited. State owned development

²⁸ The First Plenary of the Seventh National People’s Congress on 12 April 1988 abolished the rule enacted in a 1982 amendment of the constitution in 1982 that ‘no leased land could be granted’.

²⁹ The ‘Interim Regulations of the People’s Republic of China on Granting and Transfer of the Right of State-owned Urban Land’ promulgated by the State Council in May 1990, No. 55 [1990], and the ‘Law of the People’s Republic of China on Administration of Urban Real Estate’ promulgated by the Standing Committee of the National People’s Congress effective from January 1995.

companies were set up for land and infrastructure development, and in some cases for property development. These development companies, however, could only charge the ultimate users on a cost-plus basis. Since the state owned these SOEs and *dan wei* entirely, the allocation and reallocation of the lands could be coordinated internally as if under the control of a single big firm.

In fact, some experiments with land leasing and attracting FDI had been carried out before the Shenzhen SEZ was created. The first allocation of a piece of land for foreign investment in contemporary Chinese history took place in March 1979. It was a tract development located in the Shekou Industrial Zone³⁰ which was granted to the Hong Kong Merchants Group.³¹ In December of the same year, a residential development was granted to a Hong Kong-based manufacturer through a compensation trade agreement.³² After the establishment of the Shenzhen SEZ and the levelling of the Luohu District in 1981, lands were massively granted to the state-owned development companies on which premises were built for occupation by Hong Kong and overseas enterprises.

³⁰ The land is 666,677 square metres in size. With a fifteen-year tenure, the annual rental was HK\$4,000. Income tax for the first three years could be exempted.

³¹ The Hong Kong Merchants Group is in fact one of the biggest SOEs based in Hong Kong. The round-tripping problem may be a factor.

³² The name of the development is Donghu Liyuan. It is located in Huaqiao New Village. It was developed by the Hong Kong Miaoli Group, a leading leather products manufacturer at that time, with the Shenzhen Real Estate Co. Ltd., the SOE set up by the Shenzhen Municipal Urban Construction Commission to oversee land development projects.

Inspired by the leasehold system that operated for almost 150 years in Hong Kong – a British colonial city at that time, just a river away – the Shenzhen government decided to experiment with granting development rights through market mechanisms in 1987. The experiment took place before the country amended its constitution to allow the leasing of land. A few months after granting a piece of land to an SOE for a hostel development through a private treaty³³ and a public tendering,³⁴ a public land auction was held in the Shenzhen City Hall on 1 December 1987. With a 50-year lease term, the land held for auction was about 8,588 square metres in size and was designated for residential development.³⁵ Fearing that the central government might object to this experiment, the Shenzhen government did not name the public land auction as land sales but rather ‘competition for land’ (known as *tudi jingtou*). The auction turned out to be a big success. There were about seven bidders, mainly SOEs, and the final bidding price, RMB 5.25 million, was about twice the appraisal price.

³³ The party which entered into the agreement was China Aviation Technology Import-Export Corporation. The development is known as CATIC Northern Garden. The agreement was signed on 9 September 1987.

³⁴ The successful bidder was Shenzhen Shenhua Engineering Development Corporation. The development is known as Wenhua Garden. The tender was announced in late September 1987 and closed on 28 November of the same year.

³⁵ The successful bidder was Shenzhen Special Economic Zone Real Estate (Group) Co. Ltd. The development is known as Dongxiao Garden.

The success of this land auction expedited the amendment of the constitution, although a second land auction held in Shenzhen was a failure.³⁶ The amendment of the constitution and the enactment of law facilitated the separation of ownership and LURs and allowed the paid transfer of LURs (known as *tudi youchang zhuanrang*), which means that lands can be freely transacted if the LURs have been paid up. Lands granted by public tendering, auction or private treaty with paid transfer of LURs are known as ‘market allocation’ lands or leased land. The standard tenures of leased land for residential, industrial and commercial developments are seventy, fifty and forty years, respectively.

3.1.3: 1988–1996: The Start-up Stage

Beginning in 1988, except for military, strategic and special usages, the Shenzhen government gradually phased out new grants of administrative allocation land to SOEs and *dan wei*. It continued to grant lands to them through private treaty, however, and converted the administrative allocation lands granted before 1988 into market allocation lands. In addition, the SOEs and *dan wei* – and sometimes even the foreign investors and private enterprises – were allowed to ‘encircle’ lands to which no parties had yet claimed development rights. They were only required to pay a nominal fee at the outset. Premiums would be charged through private treaties by the time the development projects were carried out. Land would be forfeited if no development was carried out within a certain period of time.

³⁶ The four pieces of land were successfully bid for at unexpectedly high prices by the same company, which was then unable to pay up the outstanding payments. All deposit monies were forfeited.

In 1988, the Guangdong Provincial People's Congress adopted the Regulations on Land Administration in the Shenzhen Special Economic Zone of Guangdong Province, which stipulated that the right to use land could be assigned or transferred for compensation. Four months later, Beijing adopted draft amendments to the constitution, which deleted the word 'lease' from the prohibition on the lease of land and stipulated that 'the right to use land can be transferred in accordance with the provisions of the law'.

In the same year, Dongxiao Garden was built on the first plot of auctioned land in China. A total of 154 houses were sold in an hour. 'The housing price was US\$430 per square metre, far below the prevailing market price.'³⁷ Despite such low prices, the company still made a new profit of nearly US\$41 million',³⁸ according to Luo Jinxing, General Manager of Shenzhen Special Economic Zone Real Estate & Properties (Group) Co., Ltd.

In November of the same year, the State Council listed some coastal cities, such as Shenzhen, Shanghai, Tianjin, Xiamen and Fuzhou, as pilot cities for the reform of the land use system. In accordance with the principle of the separation of land ownership and rights use in each pilot city, local governments may assign the right to use the land for a certain period of time by means of agreement, bidding and auction on the premise that the ownership of urban land vests in the state, and the units that acquire land may transfer, lease or mortgage such land unless they are using it themselves.

As Liu Xiaoguang, the head of the Beijing Municipal Planning Commission, recalled, 'Since 1987, there has been the concept of real estate development in China,

³⁷ 430 USD, 1 USD = 3.72 RMB according to *China Statistical Yearbook*, 1988.

³⁸ 1 million USD, 1 USD = 3.72 RMB according to *China Statistical Yearbook*, 1988.

but it does not formally enter the era of large-scale real estate development. At that time, there were some business outlets for the first time, and then there were some residential buildings. What I feel most is that living has changed China, and that living has provided the people with a right of property that can be inherited’.

The report of the National Bureau of Statistics shows that the unit price of houses in 1987 was US\$110 per square metre,³⁹ with a sales area of 26.97 million square metres and a sales volume of US\$3 billion,⁴⁰ and most of the houses were office and commercial buildings. In 2016, the sales area of commercial buildings was 1,573.49 million square metres, fifty-eight times more than the sales of thirty years prior. The sales volume of commercial buildings was US\$1,771.49 billion,⁴¹ 590 times higher than thirty years ago.

In 1988, it was confirmed that the land could be circulated in the form of legislation. Amendments to the constitution adopted in April of that year changed the original provision that ‘the land concerned shall not be transferred’ to ‘the right to the use of the land may be transferred in accordance with the provisions of the law’. The ‘Law of Land Administration’ was also amended in accordance with amendments to the constitution, which guaranteed the assignment and transfer of the right to use land at the legal level.

By May 1990, the State Council had promulgated the ‘Interim Regulations of the People’s Republic of China Concerning the Assignment and Transfer of the Right to the Use of the State-owned Land in the Urban Areas’, which expressly stipulated the assignment and transfer of the right to the use of land in the urban areas.

³⁹ 408 Yuan, 1 USD=3.72RMB according to *China Statistical Yearbook*, 1987.

⁴⁰ 11 billion Yuan, 1 USD=3.72RMB according to *China Statistical Yearbook*, 1987.

⁴¹ 11,762.7 billion Yuan, 1 USD=6.64RMB according to *China Statistical Yearbook*, 2016.

The establishment of the land circulation system has provided the efficiency of land as a factor of production, and also provided a new funding channel for local governments to conduct infrastructure construction. However, during this period, there are still many problems to be solved in the urban land supply system.

First of all, the administrative allocation of land supply and the double track system of paid assignment coexist. In practice, the two do not have clear boundaries, so that the land users try to acquire the land through administrative allocation, while paid assignment accounts for a smaller proportion, which has done great harm to the interests of the state.

Second, in the form of paid assignments, agreement-based assignment accounts for a higher proportion. In cases in which local governments intend to attract investments, coupled with rent-seeking, the paid assignment of urban land is less marketized, and the right to use land is mostly assigned by means of agreement.

Third, urban land is provided by various parties, and local governments have relatively weak control of its total amount. Local governments can control the supply of new land, but some organisations acquired land beyond their actual demand during the period when the land was free of charge with indefinite duration and no fluidity, so that they have some idle land in stock. These enterprises may trade the right to the use of land by means of supplementary formalities, joint housing construction, and the exchange of land for housing and so on. Therefore, in fact, these enterprises are also land suppliers.

The spring breeze of 1992 awakened China. In January of this year, the southern tour started quietly. Nobody could predict that a revolution would sweep across the whole country. The idea of 'being more daring and moving ahead faster' proposed by Deng Xiaoping became a street slogan that was known to everyone. By the end of that year, in the Fourteenth National Congress of the Communist Party, the Central

Committee solemnly declared that the reform goal of China's economic system is to establish a socialist market economic system, which is another great initiative in the development process of China, and is of epoch-making historical significance. The pace of a new round of economic reform and opening was thus greatly accelerated.

3.1.4: 1997–2000: The Development Stage

In order to enhance the government's ability to control the primary land market, reduce the disturbance of large-scale construction land in stock and improve the efficiency of the use of such land, the land reserve system, a monopolistic means of managing urban land, came into being after some explorations.

In 1996, Shanghai Land Development Centre, the first land reserve institution in China, was established, and then Hangzhou Land Reserve Centre was established in 1997. The pilot programme achieved good results and was promoted nationwide. In the five years after the establishment of the Shanghai Land Development Centre, 669 counties and municipalities in China set up the land reserve system.

The mode of land reserve system is that, under the premise of state-owned urban land, the land administration departments authorise the land reserve institutions to centralise incremental land and stock land by means of requisition, recovery and replacement, and to organise the development or re-development of the land in a unified manner, to transform 'raw land' into 'mature land', and then to launch the land in the market in batches in accordance with the land supply plan. Compared to the previous mode of land supply by various sides, the government's ability to monopolise the primary market for land has been enhanced significantly under the land reserve system, which is also the premise of the operation of land finance.

On 19 February 1997, Deng Xiaoping, chief architect of the economic reform and opening, passed away. However, the general policy of economic reform and opening in China remained unchanged and the system had been continuously developing. On 1 July of the same year, the Chinese government resumed the exercise of sovereignty over Hong Kong and the Hong Kong Special Administrative Region of the People's Republic of China was formally established. Hong Kong has taken on the special identity of being both 'domestic and overseas' under the motto 'one country, two systems'.

In 1997, for example, Hong Kong real estate consortia began investing in mainland China on a large scale. An article titled 'Shenzhen introduced the funds of six billion from Hong Kong to develop residential buildings' in the journal *Real Estate Information of China* describes the news: 'the new CBD in Futian District, Shenzhen is the focus of Shenzhen's development in the next few years, where the residential land of 400,000 square metres has been snapped up by several Hong Kong real estate consortia this year. These consortia intend to invest USD\$770 million building large residential complexes. They hold that Shenzhen is the city nearest to Hong Kong, where there is huge potential for the development of the real estate development market'. In fact, there were numerous cases of investments by HK developers in mainland China at that time.

In 1993, Sun Hung Kai Properties formally entered the mainland by itself through the reconstruction project of Dongan Plaza on Wangfujing Street in Beijing. In 1997, it focused on the cities around the Pearl River Delta with Guangzhou as the core, the cities around the Yangtze River Delta with Shanghai as the core, as well as Beijing, Chengdu and other quickly developing cities to develop high-end complexes in the mainland. In the coming year, the New Dongan Plaza, jointly developed with Beijing Dongan Group, will open soon, and its first project in Shanghai, Shanghai Central Plaza, will be launched in two years.

I agree with Madariaga and Concet (2006) that FDI plays a key role in China's economic transformation. The real estate industry is the second largest contributor to the GDP in China. Around the transfer of sovereignty over Hong Kong in 1997, HK developers had been the largest contributors to such FDI. The later history also confirmed that in 1997, it was on the eve of great changes in China's real estate industry. According to statistical yearbook of China, twenty years ago, the real estate industry nationwide has achieved a total operating income of US\$26.8 billion and 21,286 real estate development companies have been set up with 683,200 employees. And the sales area of housing in the real estate industry nationwide has been 78.6 million square metres, and the sales income has been US\$17 billion. The two figures reached 1.573 billion square metres and US\$177 trillion in 2016.

1997 is a year of great significance. This year, the Hong Kong real estate consortium accelerated its entry into the mainland real estate market after the return of Hong Kong. That year, the Asian financial crisis whistled in, striking a violent blow against the Chinese economy and casting a shadow on the recovering property market. The tide of the foundation of real estate enterprises in the mainland continued to rise, and a large number of domestic brand developers were established one after another. The real estate industry was still struggling to find a way out. Fortunately, the wheel of history was about to enter the great track towards the abolition of the welfare-oriented public housing distribution system in 1998.

In 1998, the Central Committee officially promulgated a circular on further deepening the reform of urban housing system and accelerating housing construction, which ordered a halt to the distribution of housing in kind from that year and to establish a new housing system with the monetisation of housing distribution, and the commercialisation and socialisation of the housing supply. On 19 March, Zhu Rongji,

the newly appointed Premier of the State Council, made it clear in response to a journalist's question about the reform of the housing system that 'Housing construction will become a new growth point of China's economy. We are ready to introduce a new policy in the second half of this year, to stop the welfare-oriented public housing distribution system and the allocation of all houses will be changed to a mode of commercialisation'. In May of the same year, the People's Bank of China promulgated the 'Measures for the Management of Personal Housing Loans', which advocate the purchase of housing by loans, while the breakthrough significance of the document is self-evident. China had entered the era of housing commercialisation in an all-round way.

3.1.5: 2001 to 2007: The Maturation Stage

While the amounts of premium levied on the private treaty grants were not made known to the market, it was speculated that the amount would be far below (80% lower) than it would be if granted through public channels (Zhu, 2002). A dual land market system therefore emerged in which both administrative and market allocation lands coexisted. A black market was created since there were option values for those administrative allocation lands (Yeh & Wu, 1996). In addition, it is increasingly reported that the administrative allocation lands have become obstacles in urban development and redevelopment as the lands may not be used in the most optimal manner (Zhu, 2004, 2005).

Because of the relatively low costs, getting administrative allocation land held by the SOEs and *dan wei* has become one of the major sources of land for foreign investors and domestic private enterprises in recent years. However, the unclear property rights assigned to the SOEs, *dan wei* and also to the sitting tenants who had the *de facto* rights of residence in the encirclement areas had made many parties the residual claimants of

the potential urban development projects. As has frequently been reported by the media, an astonishingly high amount of compensation was requested by the sitting tenants, which caused delays and problems for many urban development projects.

Although public channels had been made available, the majority of new lands in Shenzhen, on top of the conversion of administrative allocation lands, were granted through private treaty grants in the past century. As a result, private treaty grant had been the dominant type of land grant in Shenzhen since the land reform. According to the Shenzhen government, more than 98% of land was granted through private treaties from 1988 to 2005 (SREY, various issues). In 2001, the Shenzhen government adopted a new policy to stop granting private treaties for new land and also denying the conversion of administrative allocated land to market allocated land for ten selected types of land uses. All transactions since then have had to be made through one of three market channels – tendering, auction and listing-for-sale (known as *zhao pai gua*) for open bidding. Five transaction centres were set up for centralised listing of landed properties. From 2005 onwards, all lands for industrial usage must be granted through market channels. This policy has already been extended to cover all types of land use in Shenzhen.

The goal of the urban land system reform is to allocate land resources in a market-oriented manner. The land reserve system has strengthened the government's control over land supply, but the right to use land is still dominated by agreement-based assignment, and the allocation of land resources is greatly influenced by administrative forces. The pricing mechanism mostly belongs to the pattern of administrative pricing, but it is unable to fully tap the market value of land as a factor of production.

In 2001, the State Council began to carry out the bidding and auction of the right to use land nationwide. In April of that year, the State Council promulgated a Circular on strengthening the management of state-owned land assets, which required that, in

order to embody the principles of market economy and ensure the openness, equity and justice of the transactions concerning the right to use land, tenders and auctions for LURs were to be vigorously carried out throughout the country. The supply of state-owned construction land had to be disclosed to the public, except those involved in the requirements of national security and confidentiality. After the announcement of plans for the supply of the land used for the development of commercial properties and for the supply of other land, one block with two or more persons who intend to use it was to be provided by the competent administrative authorities of the people's governments at the municipal and county levels by means of tenders and auction, in accordance with the law.

In July 2002, the Ministry of Land and Resources promulgated the 'Rules on the Assignment of the State-owned Land Use Right by Means of Bid Tendering, Auction and Quotation', which stipulated that, for the land used for business, tourism, entertainment and other operating purposes and the land used for commercial housing, the right to use state-owned land was to be assigned by means of bid tendering, auction and quotation. The Rules also systematically provide for the principles, range, procedures and legal liabilities of the assignment of the state-owned LURs.

In 2003, the Ministry of Land and Resources issued the Rules on the Agreement-based Assignment of the State-owned Land Use Right, which require that the agreement-based assignment of the land shall be made known to the public and that the market competition mechanism shall be introduced. In 2004, the 'Decision of the State Council on Deepening the Reform and Rigidly Enforcing Land Administration' called for accelerating the market-oriented allocation of industrial land. The 'Circular of the State Council on Intensifying the Land Control' issued by the State Council in 2006 stipulated that industrial land must be assigned by means of bid tendering, auction and quotation,

and that the price of assignments shall not be lower than the published minimum price standard.

At this point, the system of monopoly of the primary land market through the land reserve system and the assignment of business land, residential land and industrial land by means of bid tendering, auction and quotation had been almost established and has been in use to the present.

In 2004, after housing prices had been rising for a year, macroeconomic control was further strengthened, and the State Council announced that the excessive growth of investments in real estate would be curbed through the strict control of two gateways: land and finance. ‘Decree No. 71’ stipulated that from 31 August 2004, a system of land assignment would be implemented for all six types of land, that is, the land would be assigned by means of open bid tendering, public auction and open quotation.

The significance of the ‘Maximum Restrictions on August 31’ was that the land assignment was to be fair, just and open from then on. At that point, the agreement-based land assignment system which had been carried out for decades had been completely dismantled, effectively protecting state-owned assets and enabling the healthy development of the real estate industry. At the same time, the policy also requires future developers to pay the land assignment fees on time, and that the government may recover the land in the event that it is not developed within two years.

Since 2006, subject to the control of the macroeconomic policies of the state, foreign investment in real estate has gradually developed from high-speed growth to moderate adjustment. The constantly rapid development of the real estate industry in China has brought about excess profits, and coupled with the huge demand for funds, international hot money has entered rapidly and its scale has increased rapidly. In order to reduce the risk of real estate and regulate its development, state policy has begun to

make strict supervision of foreign investment in real estate. What is more notable is the introduction of the ‘Opinions Concerning Regulating the Access to and Administration of Foreign Investment in the Real Estate Market’ (No. 171 [2006] of the Ministry of Housing and Urban-Rural Development) in September 2006, which had a serious impact.

In the ten years from 1997 to 2007, China’s real estate and housing market has made great progress, with a rapid growth rate of 10% to 20% per year. Construction of urban housing also developed rapidly in that period. In 1997, it had just exceeded the figure of 400 million square metres, but only two years later, in 1999, it broke the threshold of 500 million square metres. Then, in 2001, the figure reached a new record of 600 million square metres. At the same time, the volume of commercial housing transactions jumped from ninety million square metres in 1997 to 120 million square metres in 2007, and the proportion of added value in the real estate industry to GDP rose to 4.2%, which has played an obvious role in stimulating the national economy, the Chinese government’s goal.

3.1.6: 2008 to the Present: The Institutionalised Stage

By 2008, the aggregation effect of national macro-control policies on the real estate industry gradually appeared and, coupled with the spread of the financial turmoil triggered by the sub-prime crisis from the United States to the rest of the world, the development of the real estate industry in China shifted from a boom to a depression. In order to attract foreign investment and reverse the situation in the real estate industry, the slogan ‘Cut Back on Foreign Purchases’ was put out in some cities, particularly Beijing, in early 2009. In January 2009, the ‘Cut Back on Foreign Purchases’ campaign was suspended for one year. In order to strengthen the regulation and control of the property market, the ‘Notice of the Ministry of Housing and Urban-Rural Development and the

State Administration of Foreign Exchange on Further Regulating the Administration on House Purchase by Overseas Institutions and Individuals' (No. 186 [2010] of the Ministry of Housing and Urban-Rural Development) was issued on 15 November 2010. However, affected by international hot money, the property market bubble continued to intensify. Lacking any other means, a new 'Cut Back on Foreign Purchases' campaign was begun. As of 13 March 2015, with the special approval of the State Council, the National Development and Reform Commission and the Ministry of Commerce jointly promulgated the 'Catalogue of Industries for Guiding Foreign Investment' (2015 Revision) (Decree No. 22), which greatly relaxed the 'Cut Back on Foreign Purchases' campaign. On the one hand, this meant that the threshold of access to the domestic real estate market by foreign investment would be greatly reduced. On the other hand, it meant that there will be significant ebbing in domestic real estate investment. Foreign investment in real estate has also entered a relatively calm stage, which is constantly adjusted in accordance with the market conditions.

The main features of this institutionalised stage are as follows. First, although the growth rates in the scale, speed and depth of foreign investment in real estate are all similar, they are greatly influenced by changes in the policy environment. Second, China's policy on foreign investment in real estate has gradually changed from macro adjustment to market adjustment. We may catch a glimpse of this stage through the *China Statistical Yearbook* over the years. The *Yearbook* shows, for example, that the amount of actually paid-in foreign investments in real estate amounted to US\$17.89 billion in 2007, \$18.6 billion in 2008, \$16.8 billion in 2009, and \$24 billion in 2010, \$26.9 billion in 2011, \$24.1 billion in 2012 and \$28.8 billion in 2013.

In 2007, with the formal promulgation of the Property Law of the People's Republic of China, the definition and protection of real estate titles had reached a new

mature level of sophistication, as the property law regulates the ownership of tangible property, stipulating the ownership system, the usufructuary rights system and the security interest system, thus providing a basic guarantee for regulating the relationship between capital use and land use under the modern market economy. At the same time, it expressly states that, for the expropriation of land, housing and other real estate, compensation fees shall be paid in full according to the law, and defines the right to use construction. It emphasises that when there are more than two persons that intend to use the same land, the land shall be assigned by means of bid tendering, auction and other public bidding ways, and the right to use construction land shall be strictly confined to allocation by the state. At the same time, the power of automatic renewal of the right to use the land for personal housing construction at its expiry is clearly defined.

The property rights system in China has developed and changed significantly through this process. The newly stable clarity of the property rights system has enabled foreign businessmen to have a clearer legal protection of their rights when they acquire land in the mainland real estate market for building projects. With the rapid development of the economy, the property rights system has been constantly iterated through considerable practical experience. Especially in the early days, when the domestic real estate market was very immature and HK developers had just come to the mainland, the concept of property rights was constantly being revised and upgraded in the exploration and trial and error of numerous practices, and every improvement was more conducive to the standardised development of the real estate industry. During this process, FDI from Hong Kong made a great contribution to the upgrading and updating of the property rights system.

Before discussing the problems encountered by HK developers in developing projects in the mainland and the solutions to them, I will review the implementation of

the Property Right Law and the current problems arising in the development of real estate within that framework.

3.2: The Property Right Law of 2007

I will now discuss the important laws and regulations that have embodied institutional change in China's property rights regime in recent years, above all, the 'Property Right Law' (PRL), as it is termed in Chinese state publications in English. Since its drafting in 1998, the PRL has attracted wide public attention. During this period, the PRL has undergone seven deliberations, and was finally adopted by a large margin of votes at the fifth session of the Tenth National People's Congress on 16 March 2007. It was implemented on 1 October 2007.

3.2.1: Objectives in the Real Estate Sector

The formulation of the PRL is meant to safeguard the basic economic system of the state, maintain order in the socialist market economy, clarify ownership, and protect the property rights of the title holders. The real estate industry is one important area covered by the PRL, which ensures equality, fairness and impartiality among rights, and is the essential legal foundation for the healthy operation of the real estate market. It not only provides a clear legal basis for the definition of ownership and the protection of property rights involved in the field of real estate, but also provides an opportunity for the steady development of the real estate industry.

Prior to the promulgation of the PRL, the legislation governing China's real estate industry was imprecise and lacked detailed provisions. Only the laws that had previously covered real estate were the 'Law of Land Administration', the 'City Planning Law' and

the ‘Law on Urban Real Estate Administration’, and these three laws were too narrow in scope of adjustment and not powerful enough to protect holders of property rights. The PRL, to a certain extent, focuses on adjusting the property-based legal relationships of real estate, changing the current situation of the legal system of real estate, which is dominated by adjusting the legal system to the requirements of the administration. It indicates that China’s legal system of real estate will enter a new era which not only attaches importance to administrative management, but also focuses on the protection of private property. The PRL is mainly involved in three aspects of real estate: development management, transaction management and property management.

3.2.2: Predicted Impacts of the PRL on the Real Estate Sector

As one of the most important concepts of civil law, ‘property rights’ were long in need of clarification in China. In the ‘General Principles of the Civil Law’ enacted in 1986, ‘property rights’ were replaced by the expression of ‘ownership of property and related rights’. The recognition of ‘property rights’ and the adoption of the PRL indicates that the development of a socialist market economy has promoted and realised a major breakthrough in the original legal system and ideology. The most important is that the PRL has changed the past practice of protecting the property of the state, collectives and individuals, respectively, which highlights the equal protection of public and private properties. This major change is of important practical significance for promoting the sustainable development of a market economy alongside social stability and harmony.

The PRL stabilises the real estate market in three important ways. First, giving private property equal status with the property of the state and collectives is conducive to realising the protection of private property in the field of real estate. The legislation of the PRL lies in the equal protection of the property rights of the state, the collectives and

individuals. Individual property embodies personal interests, public property embodies public interests, and private property and public property are equally protected. The interests of public property rights and those of individual property rights are thus of equal importance. The idea that the interests of public property rights are higher than those of individual property rights is contrary to the legislative spirit of the PRL. Real estate is a key area affected by property rights. Activities such as land expropriation and inadequate compensation for demolition and relocation involve encroachment on personal property interests. Therefore, the principle of equal protection of the property of the state, collectives and individuals stipulated in the PRL will help to realise the protection of private property in the field of real estate.

Second, the clear definition of the ownership relationship of real estate will be conducive to resolve disputes. PRL is a basic civil law that regulates property relations – the civil relations arising from the ownership and use of things, including the definition of property rights of the state, the collective, individuals and other owners. The PRL plays the function of a basic law for the market economy, and clearly defines the ownership relationship of land and housing, so that the real estate market can operate on the basis of clear and distinct property rights. For example, as more and more urban residents own their own homes, and a large number of them are concentrated in residential areas, the condominium ownership of the owners' buildings has become an important right in the property rights of individuals. Starting by safeguarding the legitimate rights and interests of the owners, the PRL expressly stipulates that owners have rights of ownership over proprietary parts of buildings, and rights of co-ownership and co-management of the common parts. The relevant provisions of the PRL provide a clear basis for the definition of the ownership relationship of houses and help to settle disputes.

Third, the PRL helps to institute a change away from administrative management as the core of the protection, promotion and utilisation of the private property of citizens. It restricts the abuse of ‘public rights’ by defining ‘private rights’. The long-standing planned economic system and the ideology of emphasising public property and belittling private property in China have led to the fact that the current legislation and predominant ideas mainly highlight the administrative management of the state. In the future, we should not think solely in terms of administrative management, but also in terms of civil rights, and it is necessary to break through the existing concept of administrative management as the core, and change from administrative management to the legal protection, promotion and utilisation of citizens’ private property.

At the time of its implementation, investors had generally positive expectations for it. And the PRL does guarantees the rights and interests of all parties concerned, which will increase confidence in investment.

3.2.3: Three Major Provisions on the Real Estate Sector

The provisions of the PRL concerning the real estate sector are mainly concentrated in three areas. The first is the registration of real estate property rights. The second is property rights in relation to land expropriation and house demolition. The third is property rights in relation to property management.

In terms of the registration of property rights of real estate, the law clearly establishes a unified registration system for real estate. It stipulates that ‘the state shall implement a unified registration system for real estate’, and clearly stipulates that ‘the scope of registration, registration institutions and registration methods shall be unified’. This system, however, it is still being perfected. There remain inconsistencies in three areas. First, the real estate belonging to different industries complies with the provisions

of those industries. Second, the law separates land registration and building registration. Third, it has a dualistic structure of property management in urban versus rural areas. The registration of urban housing titles is regulated by the ‘Measures on the Administration of the Registration of Urban House Title’, but the registration of rural housing titles has developed unevenly. Some places in China implement title management of rural housing in accordance with the ‘Measures on the Administration of the Registration of Urban House Titles’. In other places, despite the promulgation of these measures, the registration of house title has yet to be carried out.

Second, in terms of land expropriation and house demolition, the former can only be carried out in the public interest, while the parties concerned should negotiate on an equal basis on demolition for private interests. Expropriation refers to the state’s compulsory acquisition of the title to the property of collectives, units and individuals by administrative power and reasonable compensation for the purpose of social and public interests. The PRL stipulates that the state may levy the houses of units or individuals in the public interest in accordance with the authority and procedures prescribed by law, and then demolish and relocate them after the levy. The two prerequisites for levy are clarified. The first is the purpose of a public interest. The second is the implementation in accordance with statutory authority and procedures. The principle of equal consultation between the parties concerned is to be applied to the demolition for non-public interests.

Third, in terms of property management, the law makes clear that the owners have the right to share and manage the common part of the building. Regulations on Realty Management have no provisions on ‘common rights’, but only stipulate that the owners have the right to know and supervise the use of the common parts, facilities and related sites of the property, but do not stipulate the right to share and manage the

property jointly. The PRL stipulates that three kinds of rights should be distinguished on buildings: the exclusive right to the proprietary parts of all the buildings, the common right to the common part, and while the condominium owners have administrative rights to the latter. In particular, the PRL stipulates that the owners shall have the right of joint management in the common part of the property.

The enactment of the PRL in 2007 has removed a lot of institutional barriers to FDI players concerning ambiguities of property rights and tenure of their premises. A sensible investment strategy in relation to the enactment of the PRL is diversification, which will enable FDI players to finance a wider variety of projects, which was not feasible before the enactment of the PRL. A diversification strategy enables developers to work on more projects, but the overall investment portfolio is relatively fixed. Investing in more projects can result in lower shareholdings per project. I therefore propose the following hypothesis:

Hypothesis 1

H1: Average shareholdings in FDI projects decrease after the enactment of the PRL.

3.3: Certainty and Clarity of Property Rights

The PRL is, in essence, an affirmation of property rights and a clear definition of the institutional arrangement government those rights. Before the implementation of the PRL, the definition of property rights was relatively vague and there was no effective enforcement mechanism. The ambiguity of property rights has created new and more intense contradictions in the definition of land ownership and use rights, as well as the property rights of the housing, the buildings or private property on other land. For

example, a constant stream of delays have developed over the past ten years, and the problem of external infringement is even more prominent. I will next elaborate on from the externalities encountered in the process of real estate development, the property rights within a site and the relevant policy changes.

3.3.1: Externalities

Externality, also known as external economy, refers to the situation in which the actions or decisions of a person or group of people either damage or benefit another person or group; this is positive externality or negative externality. The effect is not part of the terms of the market trading. The cause of externality can be traced back to the lack of definition of property rights, which comes from the lack of clear ownership of property rights in some economic resources. Moreover, externalities occur frequently in the activities of real estate development. For example, if the government charges for a real estate project that is adjacent to the public green space in the surroundings so as to gain better air quality, the project will have to pay additional economic costs in order to benefit from the green space, while other real estate projects far from the green space do not need to pay such fees. In the end, the extra fees offset the additional benefits of the project adjacent to the green space, and then the project is unable to get more benefits from the public green space than can other projects far away from the green space. In this case, the external economy will be eliminated. If, on the contrary, the fresh air of the public green space is shared by people at no cost, externalities will arise. According to Coase (1960), clearly defined property rights can eliminate externalities, but in real life it is rather common for prohibitive high transaction costs to hinder the elimination of externalities.

For example, due to an improper choice of site, a real estate project may affect the lighting and ventilation of residents in adjacent buildings. In theory, the affected residents can request compensation from the real estate developers. But, limited by the relatively weak influence of a small number of residents, it is likely that their claim for compensation will be unable to receive a positive response. If we want to mobilise all residents to ask for compensation jointly, there may be some practical difficulties, such as a lack of organisation, difficulties in coordination, a lot of effort and time spent by organisers without compensation, which will make it too difficult for the transaction between affected residents and developers of real estate projects and cause excessively high transaction costs, leading to a failure to eliminate the externalities.

In mainland China, the common externalities are as follows:

a) Public facilities

Existing and planned public facilities can have a direct impact on a project site. Public facilities, including but not limited to educational institutions, such as day care facilities and schools, institutional buildings including libraries and hospitals, transportation infrastructure including public transport interchanges and railway stations and emergency services, such as fire stations.

b) Heritage

Heritage protection is always considered to be both an opportunity – it is what makes the site unique – and a constraint for a project. There is the risk of unforeseeable heritage discoveries during the investigation stage. Heritage impact assessment is important for sites which have a specific cultural history.

c) Environmental protection

Environmental protection is commanding rising attention in mainland China today. For sites that are adjacent to areas of high ecological value, such as natural

streams, mangroves or other woodlands, the potential impact and mitigation measures for sensitive elements of the environment must be considered.

d) Pollution violations

Pollution violations from adjacent areas, such as air pollution from fossil-fuel power stations or landfill sites, or noise pollution from highways or airports, will have long-term adverse impacts on project development. Objective assessment and mitigation measures can sometimes help. Effective noise barriers between sites and highways are beneficial, for example.

e) Infringement on neighbourhoods

Infringement on neighbourhoods (e.g., the right to a view) has had a significant impact on projects in downtown areas. With the development of cities, building density is increasing and it is hard to avoid the impact to adjacent buildings caused by sunlight block issues. To solve the problem, it requires government to further clarify property rights issues.

f) Political effects

Unexpected political effects (e.g., adjacency to government offices, military sites, religious facilities, and the like) usually turn into adverse impacts when the project is launched. The special use of the adjacent land is one of the most common political effects. Adjacent land may have allocated by government authorities, military bases or religious institutions, for example. All of these unexpected changes will have an unfathomable impact on project development.

g) Other externalities

Other externalities can include the land belonging to one production unit but enclosed in that of another, limited air rights and access threshold, and the like.

Although the above analysis and examples mostly capture negative effects of externalities, positive effects cannot be completely ignored. The good neighbourhood and the added value of heritage around the land all have a positive impact on the development of the project, and also influence the percentage of shareholding for foreign investment to some extent.

At the same time, however, it should also be noted that these positive externalities are not so representative (there are few projects with heritage benefits and additional protection cost rise for projects with heritage), and those more general benefits would normally be relatively trivial (environmental advantages are often cancelled out by the disadvantages and projects that completely satisfy all needs remain rare). It seems also that the negative influence brought by externalities can directly determine the percentage of shareholdings.

FDI players treat externalities as institutional barriers because generally they do not have the local knowledge and expertise that their mainland counterparts do to overcome such issues. For reasons of risk aversion, they tend to lower their shareholdings in FDI projects that involve externalities. I therefore propose the following hypothesis:

Hypothesis 2

*H2: FDI players lower their shareholdings in projects involving externalities.*⁴²

⁴² Considering the relationship between externalities and the establishment of the PRL, I believe that the PRL helps by providing more certainty and clarity of property rights, which can result as a higher institutional cost for investing in China. This is a different prospective from externalities.

3.3.2: Internalities

In addition to externalities, there are also a number of internal problems in the project site that can result from the acquisition of LURs, the whole process of development and the operation phase after completion. They are known as ‘internal concerns’ or ‘internalities’ in this thesis, the counterparts to externalities. Internalities represent long-run transaction costs (Williamson, 1985) that were not taken into account when the decision to start a project was made.

The common internalities within a project site are as follows:

a) Joint ventures

Especially in the case of cooperation with state-owned enterprises, cooperation agreements can fail to have accurate, detailed and forward-looking descriptions concerning all kinds of possible or actual problems encountered in the development process, and many original problems encountered in the development process. Joint ventures are sometimes a problem and can impact a project’s long-term operations. Although some of these problems can be avoided by drafting relevant clauses when binding the contract, there are still many details that cannot be elaborated accurately and more unexpected divergences emerge with the deepening of cooperation. These kinds of problems draw special attention during cooperation with SOEs, when, as time goes on, it is common for the two parties to have different ideas about the development direction and strategy due to the inherent features of SOEs’ enterprise structure and administration issues. I discuss this further below.

b) Urban renewal

During the urban renewal process, including renovation and demolition within a project site, problems caused by unclear property rights issues often severely block the project process. Especially in recent years, with city upgrading projects in the mainland,

there are more and more disputes caused by unclear property rights which lead to delays and deferrals of construction.

c) Public facilities

Requirements for public facility inside the project area often disturb developers. Since the government normally won't give clear, specific requirements on public facilities at the beginning, it is hard for developers to deliver the facilities in one go; the more common situation is for developers to keep amending the design to facilitate changing requirements from government.

d) Heritage

The protection of heritage inside a project site is relatively special, from the protection of original plant and building to ancient tombs encountered during the excavation process, many issues need to be considered. Sometimes the project will allow a contingency cost to counter this kind of issue, but still the developer may feel troubled due to the huge uncertainty. Despite the uncertainty raised by heritage, proper protection and modification may add value to the heritage and even to the whole project. An example of a successful case would be Guangdong Huiguan in Sino-Ocean Taikoo Li Chengdu, which turned the heritage issues to its advantage.

e) Environmental protection

Requirements for environmental protection in project sites present another internality. Besides issues from the external environment, environmental protection concerns inside a site area can also be considerable. From requirements on green space ratios and the use of environmentally friendly material to limitations on dump trucks and many other details, environmental protection issues are taking on a more and more important role in planning concerns.

f) Other internal factors

Other internalities can include the land belonging to one production unit but enclosed in that of another, limited air rights and access thresholds, and the like.

To save the transaction costs that may arise from *ex post* contractual hazards, FDI players tend to choose lower shareholdings *ex ante* for projects that are suffered from internalities. I therefore propose the following hypothesis:

Hypothesis 3

H3: Lower shareholdings are associated with FDI projects that suffer from internalities.

3.3.3: Special Policies

As I discussed in chapter 2, China adopted a number of new policies and measures to attract investment during the process of economic reform and opening. The first piece of law to facilitate foreign investment was enacted in 1979 and was followed by special regions and cities designated in 1980s. The special preferential policies in these areas were designed to attract FDI. This strategy seems very successful and produced a boom in FDI after the opening of the three ‘development triangles’ with a large number of beneficial policies in 1985.

Special policies allow foreign investors to enjoy more tax incentives and subsidies, so it seems reasonable to assume that FDI players would tend to take more shareholdings in such cases. In the later data analysis, however, the conclusion is not so simple. After the preferential policy completes the task of attracting capital, foreign investment in the mainland is also affected by many internal and external factors, which will be further discussed in the subsequent data analysis and in chapter 5, section 2.3. I therefore propose the following hypothesis:

Hypothesis 4

*H4: Higher shareholdings are associated with FDI projects which benefit from special policies.*⁴³

3.3.4: Changing Rules

Policies of special zones or development zones were created to serve as an attraction for FDI developers. However, these measures tend not to be laws or terms written in black and white, but rather a form of guidance that conforms to the situation at that time. As a result, policy in such a particular area often has a short lifespan, and will vary with the changing environment. In the field of real estate development, the micro-policies of such changes often have negative natures. In these areas, the local government is more active in intervening. Many policies, especially regional administrative instructions or periodic policies, increase risk during the development period.

These policy changes are often related to internal factors and externalities, but most of them are dynamic and arise from the administration of the government. Furthermore, changes in these policies cannot be predicted by enterprises when they acquire the right to use the land, which is a kind of information asymmetry. Influenced by policy changes, property rights are also damaged in a sense, which will also increase

⁴³ ‘Special policy’ refers to any kind of locally initiated supportive policy that has a promotional effect. The implementation of the Property Right Law can also be regarded as a type of special policy. A special policy can continuously adjust to the business environment, which commonly has a positive effect on the market.

transaction costs. Common policy changes developers encounter during project development include:

a) Policies for regulating the real estate market

Government regulation on real estate market is the most common policy changes factor. Almost every policy released lately will affect a developer's strategy. These regulations can include restrictions on sales, restrictions on purchases, restrictions on prices, restrictions on mortgages and restrictions on foreign investment. Developers often need to adjust their strategies to cope with different regulation controls, which brings uncertainty to project development.

b) Planning adjustments

As a macro-level controlling factor, planning adjustments affect project density and building height, which completely changes the design scheme and cost valuation. Once this kind of planning adjustment has happened, developers need to expend great efforts to negotiate with the government in order to solve the problem. The 'Two Increases and Two Reductions' regulation to be discussed in later paragraph is a typical example for this kind of policy change.

c) Policies on idle land

Government policies on idle land – commonly seen in urban renewal projects in the downtown areas and in large-scale suburban projects – normally affect the major developers. Under the market economy, some of the majors will not start the development process until the government finishes upgrading the surrounding amenities. The Type 2 and 5 projects discussed later are especially affected by this factor.

d) Policies on environmental protection

As the conflict between environmental protection and economic development becomes increasingly prominent, government regulations on environmental issues

strongly affect the development process. Various requirements, including the carbon emission index and other new macro requirements for environmental protection which may be imposed in the course of project development, present new challenges for developers.

- e) Changes in financing policies (in response to changes in the market environment, the government adjusts monetary and fiscal policies, which are mostly the tightening of financing for particular types of projects.

Among various regulations imposed on the real estate sector by the government, controlling measures on the economic sector is as important as direct control on project planning. The government may adjust monetary and fiscal policies according to the changing market environment. Policies tightening financing on certain types of projects may severely affect project development.

- f) Other policy changes

Besides the changing policies mentioned above, there are also some unexpected factors including unknown political factors, restrictions in development process and the adjacent building used as government official's residence.

Since FDI players do not have an advantage in dealing with policy issues in the mainland in comparison with their local counterparts, they tend, for reasons of risk aversion, to take lower shareholdings in projects susceptible to changes in local policies.

I therefore propose the following hypothesis:

Hypothesis 5

*H5: Lower shareholdings are associated with FDI projects susceptible to change of municipal policies.*⁴⁴

3.3.5: Other Factors – Land Price and Unit Housing Prices

When developers taking shareholdings, land prices are often an important concern. Land costs have a direct impact on project income and investment strategy. Meanwhile, excessive land cost will also constrain the capital allocation of FDI players to some extent. Clearly, the price of land is an unavoidable topic when discussing strategy and shareholdings.

On the other hand, with the deepening of the economic reform and opening, China's economic environment and economic volume have taken a big step forward, although the scale of FDI is increasing, and more rapidly rising land prices have brought new challenges to foreign investors. When land becomes too costly, in order to reduce risk and share costs, joint ventures have been put on the table. HK developers who used to be big fans of taking high percentages of shareholdings need to revisit the issue.

Rapidly rising land prices also naturally lead to soaring housing prices. When the overall land prices and housing prices are continuously rising, the difference in price

⁴⁴ Policy changes mainly refer to official changes in relation to how markets behave and government direction, such as double-increasing and double-decreasing (in the Type 3 Shanghai X2 case), sales and price restrictions, and idle land policies. Compared with special policies, policy changes adjust with market factors, and often bring with negative effects and situations to the market.

levels between different cities will also become an influencing factor. Based on this, I make the following assumption about the relation of the percentage of shareholdings with the land and unit housing price:

Hypothesis 6

H6: FDI players take lower shareholdings in projects with higher land prices and higher unit housing prices.

In next section, I will elaborate on the problems mentioned above and their effects, citing practical examples.

3.4: The Definition of ‘Hong Kong Developer’ in this Study

Broadly speaking, HK developers can be classified into three types. The first is comprised of home-grown real estate development companies based in Hong Kong.⁴⁵ Most of them have gone public and have a diversified business strategy across other industries, such as trading, public utilities and telecommunications. This group of companies has undertaken urban development projects in China since the early 1990s. The second type of HK developer originates in the mainland, with their core businesses

⁴⁵ Including but not limited to Cheung Kong and Hutchison Group, Hang Lung Properties, Henderson Land, Hong Kong Land, Kerry Properties, New World China, Shui On Group, Sino Land, Swire Properties, Sun Hung Kai Properties and Wharf Group.

being based in various cities in China.⁴⁶ But they went public through Hong Kong's stock market in the late 1990s. Although this group of developers has been classified as foreign investors after a recent official investigation by the central government, I exclude it from my analysis in this thesis because of its strong mainland background. The third type of HK developer is the state-owned companies set up in in the early 1980s in Hong Kong in order to stabilise the handover of sovereignty.⁴⁷ In order to avoid the round-tripping problem, this group of developers is also excluded from my analysis.

Although HK developers have made a significant contribution to FDI in China's real estate sector, Tang and Liu (2005) have found that their return-on-equity was inferior to that of domestic players. They posited that this poor performance can be attributed to a few causes, namely (1) the motive to hoard lands for appreciation, (2) incapacity of human resources, (3) inadequate interest in teaming up with local partners, (4) the pitfalls of project management, and (5) inadequate connections with local frontline authorities. In this thesis, however, I attempt to postulate that the performance and behaviour of HK developers in the mainland are largely fettered by the various institutional constraints they are confronting. I argue that the relatively higher transaction costs and the unclearly delineated property rights in the urban land market in China have dictated the formulation of investment strategies, selections of projects and choices of contractual arrangements by HK developers. Notwithstanding these problems, HK developers have made significant contributions to the transformation of China's economy. The next

⁴⁶ Including but not limited to Agile Property, Country Garden, Greentown Group, Hopson Development, KWG Property, R&F Properties, Shanghai Forte Land, Shimao Group and SPG Land.

⁴⁷ Including but not limited to China Overseas Holdings and China Resources Land.

section will discuss major issues encountered by HK developers in China in different project types with respect to internalities, externalities and policy changes. The following illustrations will form the base of the design of the empirical tests.

3.5: Types of Projects Conducted by Hong Kong Developers

The choices of contractual arrangements and shareholdings made by HK developers in getting LURs are largely influenced by two major issues: the presence of residual claimants and unclearly delineated property rights in the land market. I identify five different types of urban development projects (Types 1–5), each of which possesses different physical and institutional settings. I attempt to look into the detailed arrangements adopted by HK developers in addressing the thorny issues of each type.

SHKP (where I have worked for many years) has undertaken a few projects in mainland China which can serve as examples to explore. I have been privileged to have been involved in several. The following sections will present a detailed analysis. Neither the successes nor the problems faced by SHKP are exclusive to the company. Other developers in Hong Kong also run into similar situations and follow similar reasoning when making decisions. Therefore, in the following case study, other projects from peer companies are also included as a contrast. While not necessarily covering all of the details, the general logic and considerations are similar. The following presents the observations, propositions and empirical findings, measuring the impact of the PRL and clarity of property rights' importance by HK developers' practices.

The classifications of the types of projects are featured by the property rights structures embedded in the development. Generally, FDI players prefer projects with clearer delineations of property rights over those with ambiguities. They tend to take

higher shareholdings in projects that are less suffered from disputes about property rights-related issues. I therefore generally hypothesize that:

Hypothesis 7

H7: FDI players take higher shareholdings in projects in which property rights are clearly delineated.

3.5.1: Type 1 – Prime Sites in Downtown Surrounded by Built-Up Areas

Type 1 projects are those located in older town centres and surrounded by well-developed areas. It is intuitive that municipal governments may prefer rejuvenating older town centres over developing new areas because of the massive infrastructure investment, time and efforts they must pour into the latter. However, the assignment of *de facto* property rights to the occupants of the town centres before the land reform has hindered the transformation of townscapes. Three possible arrangements can be devised to renew the older town centres. First, SOEs and *dan wei* could redevelop sites on their own if they were less credit-constrained. Second, local developers could acquire the sites but the increment of transaction costs with respect to the site areas is exponential. Not only do they need to negotiate and compensate the residual claimants, they also need to handle the relationship (known as *guanxi*) problems particularly with the government organisations, business partners and related parties of the staff members who are occupying units in the redevelopment areas. Third, the local government may take up site clearance and sell off the sites through public channels or business invitations. Transaction costs can be substantially lowered through this kind of government-led

institutional arrangement.⁴⁸ It is intriguing, however, that accusations of collusion may result if the sites are sold to domestic developers. These developers may be SOEs or private enterprises that the general public may associate with municipal officials. Projects will perhaps ironically face less resistance from local citizens if they are designated for foreign investors, which, on the one hand, can bring in foreign capital and, on the other, new urban forms. The urban form being promoted lately for the older town centres is known as ‘comprehensive development’ (*zong he xiang mu*), which is perceived to be better carried out by HK developers than by domestic firms. HK developers appear to be the lower social cost bearers of government-led urban renewal projects in China.

Notwithstanding that HK developers also prefer urban development projects located in prime locations in city centres, they also face certain institutional constraints. First, their transaction costs will be prohibitive if they are required to deal with the residual claimants directly. Second, the unclearly delineated property rights structure in the urban land market may compound project challenges by internalising externalities created of the surrounding areas. Two measures, however, could protect their interests. The first would be to select projects that are free of residual claimants. They may tend to engage in projects obtained through public channels, local governments’ business invitations and joint ventures with local partners who are contractually obligated to undertake site clearance. The second measure is to select sites surrounded by well-

⁴⁸ This is the institutional model adopted by the Singaporean government in carrying out urban renewal projects, which requires a very stringent underlying legal framework. Hong Kong followed suit after further strengthening the legal status of the Urban Renewal Authority in the early 2000s.

developed areas, such that the potential externalities problems could be minimised. Because it is less costly to safeguard property rights through the well-organised immediate surrounding neighbourhoods, following *Hypothesis 7*, it is postulated that HK developers tend to possess higher shareholdings for Type 1 projects.

3.5.1.1: Clear and Well-defined Property Rights

Type 1 projects involve land with clear definitions of real rights, which have been more welcomed by foreign enterprises since the implementation of the property law. As explained above, the law has strengthened the definition of the property rights of the original owners or units of the land blocks and the developers of the newly purchased projects. The process of land transfer thus needs to clarify more issues left over from history, resulting in cleaner and clearer property rights.

At the same time, however, because of its superior geographical location and high commercial value, along with improvements in infrastructure this kind of land has attracted more domestic and foreign institutions to participate in bidding. This directly reduces the future transaction costs that clear ownership avoids, and immediately raises the land price in the bidding process. Also, the local governments, in order to give these precious downtown lands a higher level of development, rather than simply hoping that those with high prices will get it, tend to set up more barriers to land transfer to attract more international players that have done similar projects or firms with high capital requirements and low leverage, while increasing the terms of the restricted or self-holding ratio. These measures, in turn, often support and encourage foreign investors, especially Hong Kong businessmen, to compete for projects at higher but relatively reasonable prices.

Next, I will take two Hong Kong business projects as an example. One is one of the largest downtown commercial complexes sold by mainland first-tier cities since the implementation of the PRL in 2007. The other was developed in the 1990s by Hang Lung Properties.

3.5.1.2: Shanghai Xujiahui Centre (Shanghai ITC)

Located at the core of Xujiahui Commercial Circles, the Shanghai International Trade Centre (ITC) is near Xujiahui Station, which is the junction of Metro Line 1, Line 9 and Line 11. It is known as ‘the largest and last prime site in downtown Shanghai’. Sun Hung Kai Properties invested a total of more than HK\$40 billion in it after acquiring the land by quotation in 2013, and planned to develop it into a large, world-class complex project integrating five functional forms of office, hotel, service apartment, commercial retail and cultural entertainment. The outside world is following its development closely and has high expectations for it.

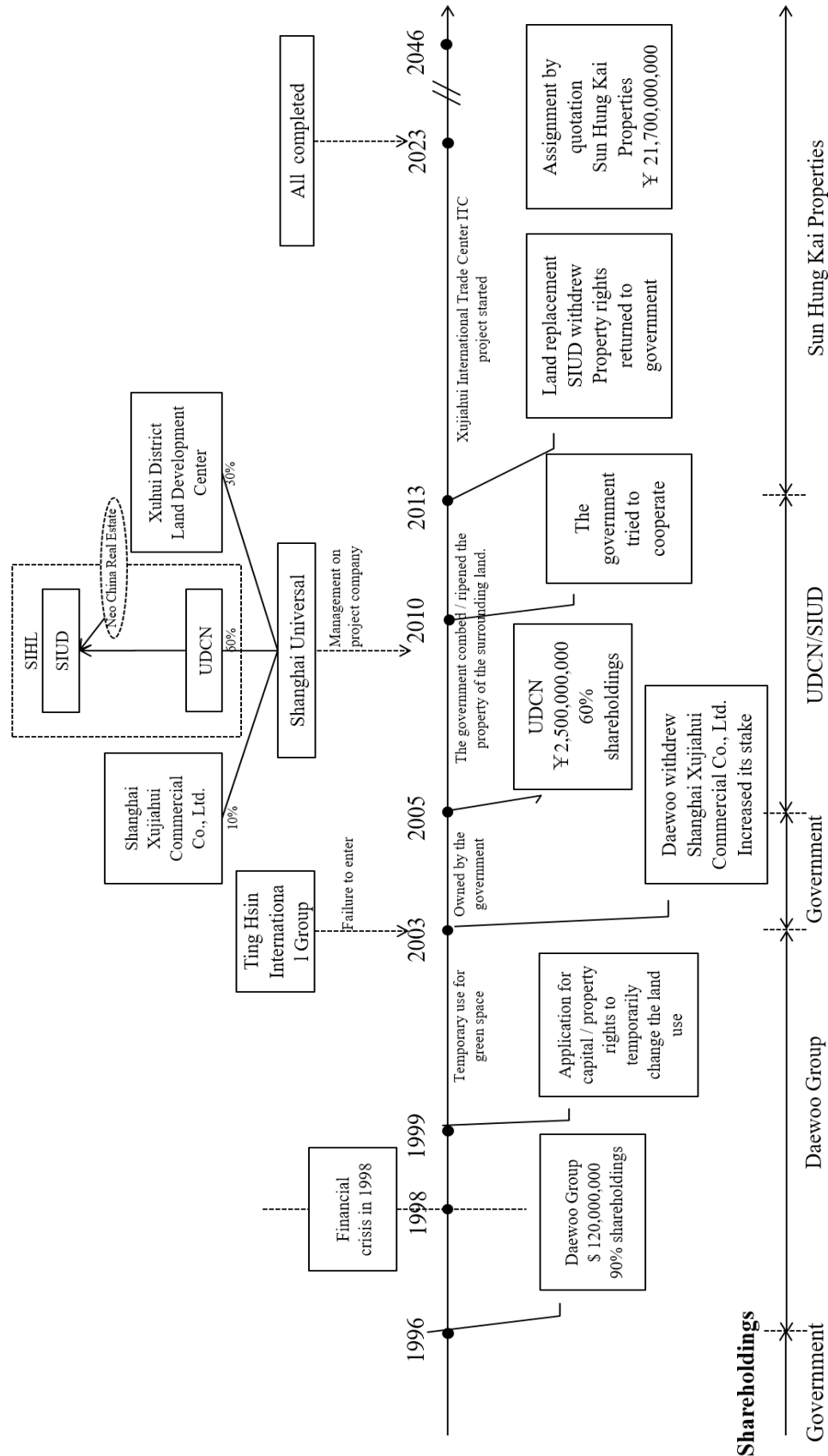
According to the Shanghai Municipal Administration of Planning and Land Resources, the project covers an area of 99,188.80 square metres, consisting of six exploitable blocks, with a planned construction area of 584,200 square metres and an underground commercial area of 120,000 square metres, which is equivalent to the total commercial and office area of Xujiahui Commercial Circles in 2013. Sun Hung Kai Properties plans to design a project consisting of Tower 1, Tower 2, a hotel and a podium. Tower 1 is 220 metres high, with forty-three floors above ground and six floors underground. Tower 2 is 370 metres high, with seventy floors above ground and six floors underground. The hotel is 76.5 metres high, with fifteen floors above ground. The podium is 56.5 metres high, with seven floors above ground. The high-rise Tower 2, with a total height of 370 metres, is expected to be the tallest building in Puxi when completed.

At the same time, it is more noteworthy that the development of the block since 1996 has been a tortuous process of transformation from Type 2 development (to be explained below) to Type 1. The gradual clarification of property rights in the process of transformation is the decisive factor in changing the block into a Type 1 development. The land was finally developed after eighteen years of ups and downs, because of several changes in ownership and other problems.

It is located in the heart of Xujiahui, the block where Huge Cultural Plaza used to be located. Daewoo Group first acquired the land in 1996 and founded POSCO DAEWOO Shanghai Co., Ltd. in cooperation with Shanghai Xujiahui Commercial Co., Ltd., which is subordinated to Shanghai Xuhui District People's Government, in order to build the tallest building in Puxi. At that time, Daewoo acquired 90% of shares in the project at a price of US\$90 million (the remaining 10% was held by Shanghai Xujiahui Commercial Co., Ltd.). At the same time, it invested US\$30 million to cover the assignment fee, relocation fee and the construction expenses for the municipal supporting facilities of US\$95 per square metre.

At that point, however, the 1998 financial tsunami sent Daewoo Group into financial difficulties. At the same time, because the block is a typical Type 2 development, and because of the property rights and illumination of the surrounding blocks, POSCO DAEWOO Shanghai Co., Ltd. had to sign a supplementary agreement with the Shanghai Municipal Bureau for Housing and Land Administration to change the block into a temporary green space in 1999. 'Block No. 88 of Xujiahui International Trade Centre (ITC) Project' passed its initial period of eight years in this way.

Figure 3.1: Development Process of Shanghai Xujiahui Centre (source: author)



At the end of 2003, Daewoo decided to transfer its shares on the block, and Shanghai Xujiahui Commercial Co., Ltd., holding the other 10% of the shares, wanted to buy Daewoo's 90% stake at a price of \$51,000,000. But they failed to reach an agreement because of the gap between the buyer's and seller's price expectations. A few months later, Ting Hsin International Group signed a transfer agreement with POSCO DAEWOO Shanghai Co., Ltd. to acquire the 90% stake in the corporation held by Daewoo Group at a transfer price of US\$90,000,000, as well as to assume the liabilities of POSCO DAEWOO at about US\$30 million. Ting Hsin International Group planned to build its Shanghai headquarters on the block.

This did not go well, however. According to the provisions of a joint venture, after either party signs an equity transfer agreement with a third party, it must notify the other party, which can exercise its pre-emptive rights under the same conditions. After Daewoo Group notified Shanghai Xujiahui Commercial Co., Ltd. (owner of the 10% stake) of the transfer agreement with Ting Hsin International Group, Shanghai Xujiahui Commercial Co., Ltd. decided to exercise its pre-emptive rights under the same conditions, that is, to transfer the 90% stake at a price of US\$90 million. But Shanghai Xujiahui Commercial Co., Ltd. was unable to afford the transfer huge costs. Because the sources of its funds was a government guarantee from Shanghai Xuhui District People's Government to the Bank of Shanghai, in the name of the Land Development Centre of Xuhui District, it purchased 5% of its original 10% of shares from Shanghai Xujiahui Commercial Co., Ltd. and transferred the government-guaranteed loans and provided financial support to Shanghai Xujiahui Commercial Co., Ltd. At this point, 5% of the ownership structure of the land belonged to the Land Development Centre of Xuhui District, 95% belonged to Shanghai Xujiahui Commercial Co., Ltd. (a district-owned

enterprise). ‘Block No. 88’ was formally returned to the Shanghai Xuhui District People’s Government.

In 2005, after a series of changes, the block was acquired by Shanghai Urban Development (Holdings) Co., Ltd. from the government by way of equity transfer at a price of US\$0.3 billion. At this point, the shares of Shanghai Universal Project Development Co., Ltd., were held by Shanghai Urban Development (Holdings) Co., Ltd. at 60%, the Land Development Centre of Xuhui District at 30% and Shanghai Xujiahui Commercial Co., Ltd. at 10%. Since Shanghai Urban Development (Holdings) Co., Ltd. acquired the land in 2005, Shanghai Industrial Holdings Limited acquired 40% of the equity of Shanghai Urban Development (Holdings) Co., Ltd., and then acquired the majority ownership of the Xujiahui International Trade Centre (ITC) through further acquisition. Subsequently, Shanghai Industrial Holdings Limited acquired Neo China Real Estate, a company listed on the Hong Kong Stock Exchange, and injected 59% of the shares of Shanghai Urban Development (Holdings) Co., Ltd., and then Neo China Real Estate was renamed Shanghai Industrial Urban Development Group Limited (‘SIUD’). In 2010, the right to use the land was eventually attributed to the Shanghai Universal Project Development Co., Ltd. of Shanghai Industrial Urban Development Group Limited.

Until 2012, Shanghai Universal Project Development Co., Ltd. did not construct any building on the ground or develop any project on ‘Block No. 88’. Shanghai Industrial Urban Development Group Limited blamed the delay in starting construction of Xujiahui International Trade Centre (ITC) to a series of problems around property rights, such as metro development, urban planning and the progress of demolition maturation. The relevant responsible person in Shanghai Industrial Urban Development Group Limited stated frankly that ‘the policy and planning of Xujiahui International Trade Centre (ITC)

have changed, and it has been delayed for a long time. Therefore, our company has not been able to determine the start time of the development project'. Thus it can be seen that, although the block of Type 2 development is located in the core advantageous position, it involves a number of problems in property rights, and the government does not have a clear plan, so that the construction process tends to be easily affected, thereby constantly delaying the time for development.

During the period from 2005 to 2013, the government also made a series of efforts to sort out the property rights problems. There are five blocks near 'Block No. 88' (now called Block No. 1), which used to be dormitories for the teaching and administrative staff of a university, and other buildings that have been put into use. Due to the influence of development and sunshine blockage factors, the government invested resources and energy to take the lead in the relocation and resettlement of the affected land property, property rights recovery and other procedures for land maturation. Moreover, the government continued to formulate and implement relevant programs in land planning, metro construction planning and other policies. In 2010, the government also made an attempt to partner with state-owned enterprises, but it failed in the end.

In 2013, the Shanghai Xuhui District People's Government recovered the property rights of the core Block No. 1 by means of land replacement, that is, reaching an agreement with Shanghai Industrial Urban Development Group Limited to adjust its Block No. 1 in Xujiahui International Trade Centre to four blocks of land located on the riverside of Shanghai, while supplementary funds were required for the land adjustment, and the area of the new land (83,200 square metres) is more than twice that of the original area (35,300 square metres). The relevant responsible person of Shanghai Industrial Urban Development Group Limited expressed satisfaction with the adjustment: 'Xujiahui International Trade Center is located in a block with fifty years of property

rights, but the land was approved as early as 1996, while the block on the riverside is a completely new block, and its property rights is fifty years in full'. At this point, after the problems in property rights were solved and relevant blocks were matured, the comprehensive block of Xujiahui International Trade Centre, which was packaged by six blocks and centred on Block No. 1, had been cleaned up as a whole, and our orientation against the block from Type 2 to Type 1.

After eighteen years of ups and downs, in July 2013, the comprehensive site of the 'Xujiahui International Trade Centre Project' returned to the market for public tendering, auction and quotation at a starting total price of US\$2.83 billion.⁴⁹ Compared with the price of the first transfer to Daewoo Group of US\$120 million (agreement-based transfer price), there was a difference of nearly twenty-three times the total price. In September of the same year, after 208 rounds of raising the paddle, the comprehensive site of the 'Xujiahui International Trade Centre Project' was finally won by a wholly-owned subsidiary of Sun Hung Kai Properties with a price of US\$35.17 billion⁵⁰ and a premium rate of 24.4%. The whole site will be built into Xujiahui International Trade Centre (ITC), with a gross floor area of more than 700,000 square metres. This world-class, large-scale complex project, composed of grade-A office buildings, high-quality shopping malls and luxury hotels, is scheduled to be completed in stages by 2023.

3.5.1.3: Shanghai Hang Lung Plaza 66

The Shanghai Plaza 66 Phase I is another example of a Type 1 project. Developed by Hang Lung Properties, it is an office premises completed in 2001. By the time the

⁴⁹ 17.526 billion RMB, 1 USD = 6.19 RMB according to *China Statistical Yearbook*, 2013.

⁵⁰ 217.7 billion RMB, 1 USD = 6.19 RMB according to *China Statistical Yearbook*, 2013.

project was built, the eastern, southern and western boundaries abutting the site had already been developed. The developer had also ascertained and acquired the development rights of the site located to the north of the subject premises. Externalities created by the immediate neighbourhood, such as sunshine problems, were minimal. The developer obtained the land through business invitations and held 89% of shareholding in the project.

3.5.2: Type 2 – Prime Sites in Downtown not Surrounded by Well-Developed Areas

The second type of project concerns developments located in prime locations in town centres but are not entirely surrounded by well-organised surrounding areas. The adjacent areas of these projects could be dilapidated residential areas, industrial areas or areas not designated for a specific usage. The uncertainty of the future developments may cause externalities problems for the development. Zoning laws, however, are too slack to remove uncertainty (see Yeh & Wu, 1999). This type of project also suffers from the problems of residual claims, but the developers may perceive that the potential externalities caused by the immediate neighbourhood are more pressing to them. Some institutional devices could be deployed by HK developers to overcome the potential problems. First, HK developers may select larger-scale developments such that the potential externalities could be internalised through careful spatial arrangements. Second, HK developers may reduce their shareholdings in this type of development. Third, they may join forces with a strong local partner who has comparative advantages on site acquisition and also on the enforcement of property rights through informal institutions. In terms of local rules, cultures and connections, local partners know much more than HK developers and hence have lower information costs to enforce property rights which are not clearly specified under the formal institutions. To safeguard HK

developers' interests in the joint-venture projects, some contractual terms can be devised. The most apparent one is to make the local partner contractually obligated for site clearance. A payment schedule can be made according to the granting of LUR certificates, preliminary land use approval, building and planning permits, demolition and removal permits, commencement of building work permits and the like. An exit clause can be entered into so as to allow the player to pull away from the project if needed. Equally useful is an option clause for buyout, which is, although made bilaterally, usually exercised by the HK developers only. There are a handful projects in which HK developers have increased their shareholdings over time. With the enforcement of the PRL, it is also anticipated that HK developers will increase their shareholdings in this type of urban development since the law, to a certain extent, has removed the uncertainty created by those residual claimants. Two propositions can thus be formulated for the second type of development: (1) HK developers tend to select larger-scale projects when the surrounding areas are not well organised, and (2) following *Hypothesis 7*, they tend to cede shareholdings to the local partners who bear lower transaction costs, to enforce the property rights through informal institutions. However, since these projects are usually located in the prime locations of cities, for long-term strategic investment considerations, FDI players pay less attention to exit strategies even with the existence of residual claimants. This means that they tend not to reduce their shareholdings in the medium to long runs.

3.5.2.1: Uncertainty of Property Rights

Type 2 and Type 1 are both in the town centre, and the most significant difference between the two is whether there are obvious problems in the development of their internal and external environments. Reducing the transaction costs of these problems

becomes the key to the smooth operation of Type 2 projects. In order to reduce transaction costs, HK developers tend to adopt cooperative development with local developers, especially with the original owner of the land. The Xindong'an Shopping Mall to be introduced in the next subsection is a project that takes such a cooperative route. In the cooperation with the local original owners, there will often be various potential risks in the cooperative relationship with the change of time, which will be described in detail below.

Very often, Type 2 projects encounter problems associated with uncertainty in the cooperative relationship. Owing to ambiguous property rights and other factors, this type of project often leads to the joint development in cooperation with local groups in the initial stage. In the early stage of cooperation, when everyone has similar ideas about development, the whole project can develop steadily according to the given strategy. However, with the change of time, there is a greater possibility that the two sides will have inconsistent understanding of the operation of the project, which will lead to the risk of problems in the direction of project operation, due to the influence of project concept, business considerations, personnel changes or policy changes. For the long-term holdings of investment property, it is more necessary for all shareholders to make different arrangements for the project at different stages of development because of the long operating cycle. Next, I will take two projects as examples to introduce the project of this type.

3.5.2.2: Beijing Xindong'an Plaza (Beijing APM)

Beijing Xindong'an Plaza (Beijing APM) is located in the Dongcheng district of Beijing. It is located on Wangfujing Street, an important street in the Wangfujing Commercial Circles. It is an important commercial real estate project developed and

operated by Sun Hung Kai Properties in Beijing. Beijing Xindong'an Plaza has a long history. Its predecessor can be traced back to the late Qing Dynasty (around 1903). Since it is near Donganmen, it is called Dongan Market. The book '*Jing Hua Bai Er Zhu Zhi Ci*'⁵¹ published in the first year of Xuantong (1909) said that 'The newly opened market is wide, and it is not difficult to buy what you want. When it comes to prosperity, it comes first, and you are sincerely invited to Donganmen when entering the capital'. A paragraph describes the bustling look of Dongan Plaza in history.

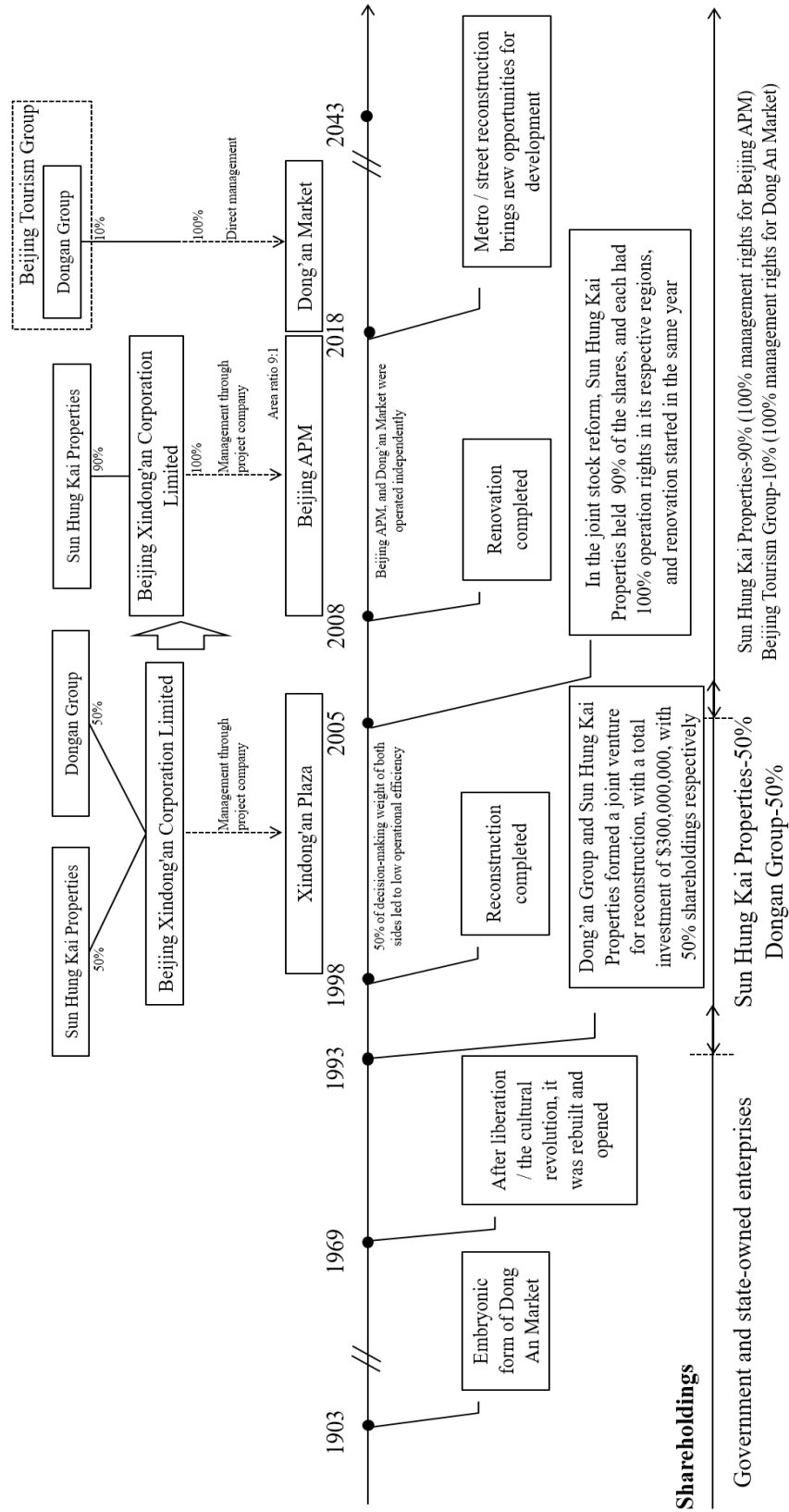
I will introduce Beijing Xindong'an Plaza in two periods, from 1993 to 1998 and from 2005 to 2008. Beijing Xindong'an Plaza can be classified as a Type 2 development during the reconstruction from 1993 to 1998, which is strongly related to the uncertainty of future development arising from the internal and external factors of the block and the problems of cooperation over property rights left over by history.

In terms of geographical position, as the first reconstruction project on Wangfujing Street, the reconstructed site in 1993 was adjacent to Wangfujing Street with an average number of 100,000 visitors per day (1993 data) on the west, Muslim Building and Beijing Department Store which were put into operation on the opposite, and the crowded Jinyu Hutong on the north, the Jiaowei Hutong with low residential buildings on the south, and Peking Union Medical College Hospital with a long history on the more southern side. The properties, people and traffic of continuous operation in the surrounding areas have led to higher requirements for the road traffic, lighting and other aspects of the construction site, as well as added some uncertainty about future reconstruction projects.

⁵¹ The book name '*Jing Hua Bai Er Zhu Zhi Ci*' in Chinese: '京华百二竹枝词'.

Figure 3.2: Development Process of Beijing Xindong'an Plaza (Beijing APM)

(source: author)



In addition to geographical location, the distribution of property rights in the project also determines that the block belongs to Type 2. In 1993, under the government's policy of attracting investment, Sun Hung Kai Properties entered Beijing, jointly invested with Dongan Group to rebuild the Xindong'an Market, and demolished all the original buildings to build the 'Xindong'an Market' Building. The project was entrusted to the Design Institute of the Ministry of Machinery, School of Architecture of Tsinghua University, the Wong Tung Group of Companies (WT), Associated Consulting Engineers (Asia) Ltd. and H. K. Cheng & Partners, Consulting Engineers to design the Xindong'an Market, and later authorised ARCADIS China (formerly Legacy Langdon & Seah) to provide material measurement services for it. Such a mode of joint development and operation with a local partner (Dongan Group) gradually shows its institutional cost in the later stage of operation. The institutional cost caused by property rights problems in the process of completion and operation is also more and more important in the later renovation process from 2005 to 2008 and is re-arranged, which will be explained in detail later.

In 1993, Sun Hung Kai Properties and Beijing Dong'an Group invested US\$300 million to establish and operate a joint venture with Beijing Sun Dong An Corporation Limited, responsible for the operations and management of Xindong'an Plaza. Both sides have 50% of the company's shareholdings, and have 50% weight in the decision making of the operations and daily business of the shopping mall. This institutional arrangement has a certain effect on the initial stage of the completion of Xindong'an Market, but with the continuous operation, when the two sides begin to show some disagreement on the concepts of market operation and development, more and more operation decisions need to be negotiated and solved by both sides according to the proportion of shareholdings. Such a mode of communication for decision making leads to low operational efficiency

of the later stage and the lower benefits from the market than expectations, and then increases the additional institutional costs arising from the way of cooperation.

The low efficiency caused by the cooperative arrangement was solved to a certain extent during the renovation of Xindong'an Plaza from 2005 to 2008. In August 2005, Xindong'an Plaza completed the shareholding system reform, and Sun Hung Kai Properties acquired 40% of the shares of Dongan Group by means of equity purchase and property replacement. After the reform, Sun Hung Kai Properties accounted for 90% of the shares, and Dongan Group accounted for 10% of the shares. It was divided in the south-north direction with the area ratio of 9:1 as the boundary, and each had 100% decision-making rights within its own operating range. The redefined way of property rights allocation reasonably reduces the additional decision-making costs caused by institutional arrangements. It has also made the renovation project of Xindong'an Plaza from 2005 to 2008 completed with high efficiency.

After the property rights were clarified, the investor was more willing to make additional investments, and the further renovation project was completed in 2008. After that, Beijing Xindong'an Plaza was formally renamed 'Beijing APM', which means am + pm, providing services to consumers all day, and the return on investment was increased accordingly. And the mode of property rights arrangement, in which Sun Hung Kai Properties divided the plaza with Dongan Group by area and the two operated their respective part, has enabled the management of Beijing APM Mall to maintain efficiency after its completion.

In 2018, with the opportunity of improving the image of Wangfujing Street and the underground connection of Wangfujing North Station, investors will make more positive decisions to prepare for the next round of increasing production and value for

Beijing APM Mall based on the efficient operation guaranteed by the clear property rights system, and the Mall will continue to radiate a new vitality.

3.5.2.3: Beijing Oversea Oriental Plaza

The Oriental Plaza in Beijing is the second example of Type 2 projects. It is a commercial complex with offices, hotels, shops and serviced apartments developed by the Cheung Kong Group in 1999. The developer only holds 51% in this project. Although the joint-venture partner is also a Hong Kong-based company (with core business in the shipping industry), the leader of the company has strong political roles in China,⁵² which means the company can also be seen as a ‘strong local connection company’. On the north-western and north-eastern boundaries of the site were some dilapidated residential areas where the future development planning arrangement was unable to be finalised. In between the core development and the residential areas, the developer has carefully put two rehousing buildings (so-called ‘compensation buildings’) and an open space so as to create a buffer zone to alleviate the potential externalities problems created by the unplanned districts.

3.5.3: Type 3 – New Town Centres Driven by Local Government

Type 3 projects refer to urban development in new developing areas. Due to the *de facto* rights assigned to sitting tenants in the town centres which make urban renewal

⁵² The partner is Orient Overseas (International) Ltd. The company owner, CH Tung, was the first Chief Executive of the HKSAR and was elected as the Vice Chairman of the Chinese People’s Political Consultative Conference of the People’s Republic of China after his resignation from the second term of HKSAR Chief Executive in 2005.

difficult, developing new areas in a city has become a sensible choice under the rapid urbanisation process. The most favourable settings to carry out urban development projects in the new areas are those well-planned regions with the provisions of infrastructure as well as tax incentives by the municipal governments. Lands are mainly disposed through public channels and business invitation. The Pudong New Area is a vivid example.

Type 3 projects tend to be located in the planned new areas, and are characterised by favourable policies due to the construction of new area, clear property rights due to the first development and complete supporting infrastructure facilities due to reasonable planning.

3.5.3.1: Special Policies and Changing Rules

However, even though the rights are better defined in these areas, there are occasions when the development rights can be trimmed down as a result of other superimposed policies. For instance, because of a newly imposed planning restriction in Shanghai, the total developable areas of a premium office development project conducted by SHKP had fallen short by 5.4% (to be discussed later). It is increasingly common to use a compensation clause in the agreements entered into between the municipal government and developers in order to alleviate the loss caused by the change of policy. Nevertheless, due to the clearer delineation of property rights and fewer residual claimants, I claim that HK developers tend to have higher shareholdings for Type 3 urban development projects. The next will also be followed by two typical projects to illustrate Type 3 project developments.

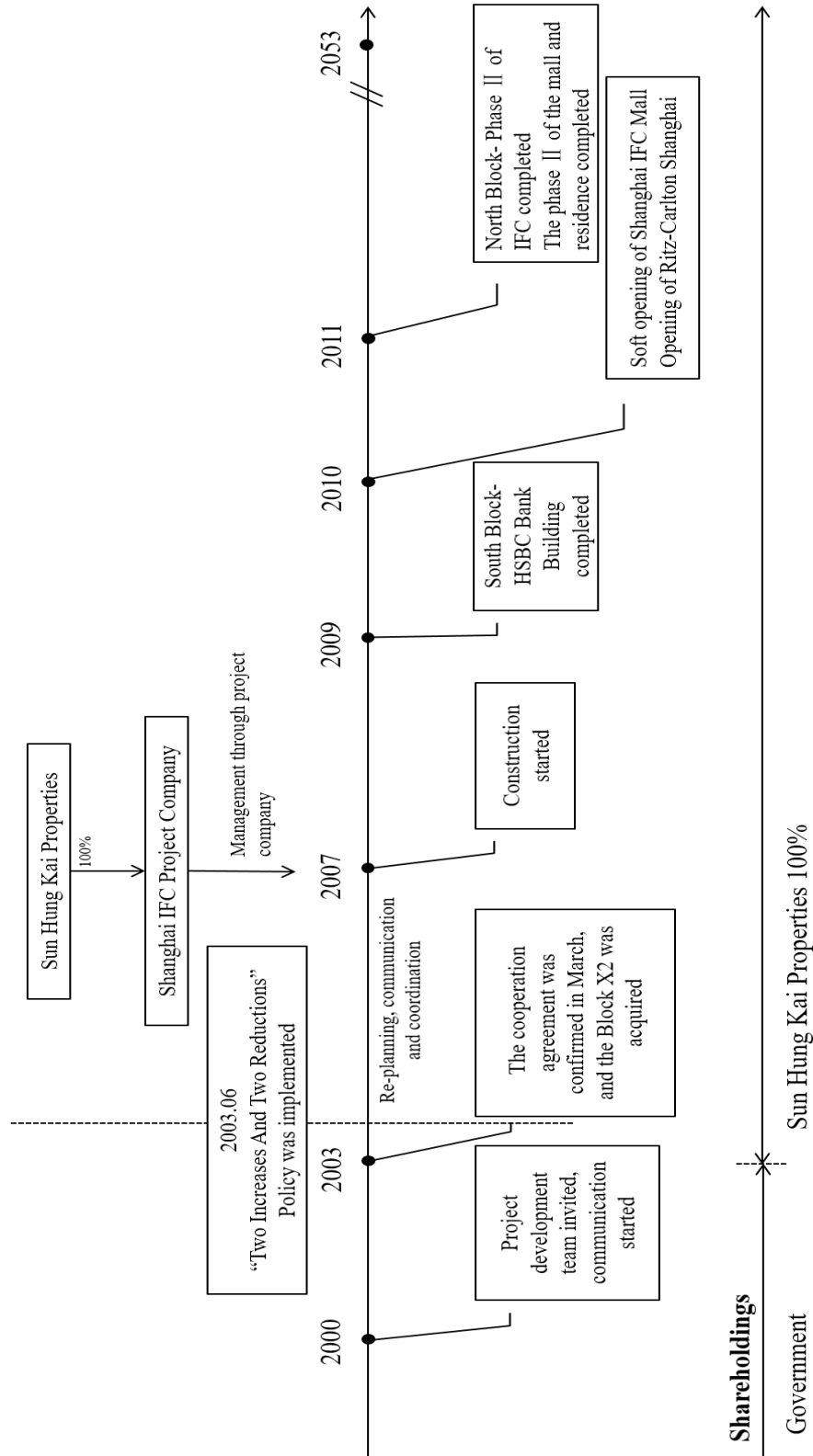
3.5.3.2: Shanghai Lujiazui X2 Project (Shanghai IFC)

Shanghai IFC is located at No. 8 Century Avenue, the core commercial section of Lujiazui in Pudong New Area, Shanghai. It is adjacent to Jinmao Tower on the east, and Super Brand Mall on the west, and Lujiazui Station of Shanghai Rail Transit Line 2 and the central green space of Lujiazui on the north. It covers a floor area of about 64,000 square metres. As a complex project which integrates office areas, residential buildings, hotels and retail businesses, it covers a total construction area of 355,000 square metres, of which grade-A office buildings cover an area of about 150,000 square metres, hotels cover an area of 50,000 square metres, shopping malls cover an area of 120,000 square metres and residential buildings cover an area of 40,000 square metres. The project, with a total investment of HK\$8 billion, will be developed in five phases: two high-rise office towers, a low-rise building and a podium building. The south block is 249.9 metres high (fifty-three stories), the north block is 259.9 metres high (fifty-six stories), and the low-rise building is eighty-five metres high. The first phase of office buildings and shopping malls with an area of 80,000 square metres was completed in 2009, and the rest of the buildings were gradually completed by 2011.

Pudong New Area, where the project of Type 3 is located, is the first pilot area of comprehensive supporting facilities reform in the People's Republic of China, a sub-provincial area and a national new area. Its growth and development are strongly promoted by policies and concerns all walks of life. The Bund, Shanghai IFC project and Oriental Pearl TV Tower, Jinmao Tower and Shanghai World Trade Centre constitute the super-modern urban landmark group of Lujiazui, which also symbolises the revival of Shanghai, known as the Pearl of the Orient, which has accumulated for decades.

Figure 3.3: Development Process of Shanghai Lujiazui X2 Project (Shanghai IFC)

(source: author)



In the early stage of the project, the United Front Work Department of the Central Committee of the Communist Party played a key role in facilitating the cooperation. At the beginning of 2000, Shanghai Lujiazui Finance & Trade Zone Development Co., Ltd. (a state-owned enterprise specialising in the development of the Pudong New Area) issued an invitation to foreign investors to cooperate in this area, which attracted the attention of many companies from Britain, Hong Kong, Singapore and other regions. From the point of view of the United Front Department, Sun Hung Kai Properties is one of the most suitable candidates, which is not only because the company has the ability to build the highest buildings and operate large-scale complexes in Hong Kong, but also because it can bring a large amount of foreign capital into the mainland market and make contributions to the government's investment attractions, as well as play a promoting role from the senior management of the company at the political level that cannot be ignored. After many rounds of follow-up by front-line colleagues on project details and planning arrangements, the senior management of the company communicated with the government on many occasions. Finally, one day in a golf class, the executives of Sun Hung Kai Properties received a phone call from the Shanghai government, in which they finally confirmed some details of the cooperation after more than a year of discussion, and determined the right of Sun Hung Kai Properties to develop the project. As far as the client recalled, 'it is more exciting than a hole in one'.

Then, on 15 August 2003, Sun Hung Kai Properties and Shanghai Lujiazui Finance & Trade Zone Development Co., Ltd. signed a land assignment agreement on the development of the project of block X2 in Lujiazui, which required 415,000 square metres for the largest gross floor area of the above-ground space. But only three months later, Shanghai issued new regulations of 'Two Increases and Two Reductions' on urban planning. The new plan requires that buildings should increase the greening area and

open space, reduce the density and height of buildings. Although the regulation was promulgated after the signing of the project cooperation agreement, it also affected the IFC project because the project had not yet reached the stage of applying for building planning permission, and the maximum gross floor area in the original plan could no longer meet the policy requirements.

After the implementation of the 'Two Increases and Two Reductions' regulations, the gross floor area of Shanghai IFC project was reduced by 355,000 square metres, with a decrease of 14.5%, which undoubtedly had a negative impact on the later development and operation of the project. Finally, after the long-term coordination with the government planning departments several times, the impact of the regulations had been minimised. The final agreement was to reduce the floor area above ground by 5.4% compared with the previous one. With the underground area excluding the block ratio, the gross floor area of the project was eventually confirmed as 572,000 square metres. At the end of 2005, other details of the supplementary clauses concerning the change were confirmed, and the total land price to be paid by Sun Hung Kai Properties was also reduced by 5.8% compared with the previous one.

There are frequent changes in the policies of new areas. At the same time, not all policy changes will have a negative impact on project development. For example, the Shanghai World Financial Centre built by Mori Building Corporation gained additional benefits from changes in the policies. In 1997, when Mori Building Corporation communicated with the government, the two sides confirmed the resolutions and requirements to build the project into the world's tallest building at that time. But then the construction had to be suspended because of the financial crisis in 1998. When the construction project was restored in 2003, Taipei 101 Tower, located in Taiwan, had a higher planning height than the project and was under construction steadily. In this

regard, Mori Building Corporation communicated with the government planning department on the original agreement, and finally decided to adjust the height of the building to 492 metres, which would make the project forty-four metres higher than the computable height of Taipei 101 Tower. If the foundation construction had not been started before, the bearing capacity of the upper parts would have been confined. The building will be sixteen metres higher, and higher than the planned height of the top of Taipei 101 Tower. In this case, apparently, the tower's height is mingled with political factors, and some of the corresponding policies emerged. No matter how the building height issue was handled, it is obvious that Mori Building Corporation has won the skyscraper competition. Attributed to the policy change, the raised building height and plot ratio benefitted the projects in many ways, which is quite different from the policy factors encountered in the Shanghai IFC project.

SHKP is not inclined to participate in the height competition of skyscrapers, but will give a comprehensive consideration of the function, constructability, area and space of the building to work out the most appropriate height. Just as Shanghai IFC was initially planned to be 320 metres, and was then reduced to between 250 metres and 260 metres, the company did not strive for the highest height. However, the Shanghai centre, which was not planned at that time, reached a height of 632 metres when it was completed in 2016, becoming the tallest building in China. This obviously contradicts the 'Two Increases and Two Reductions' policy, although there are political factors involved, it is undeniable that policy uncertainty is one of the most important considerations for FDI flows into China market.

To sum up, the project on the Type 3 block is less affected in internal and external aspects because of the particularity of the new area where it is located, but the project has been more affected by the changes in policy planning under the unstable policy

arrangements compared to those in its earlier stage and planning stage. It is a key issue which is necessary for HK developers to pay attention to in the development of Type 3 projects to find proper ways to analyse the gain and loss in the process of these policy changes, have effective communications with government decision-makers, and achieve a balance in coordination, and minimise the losses caused by the changes.

3.5.3.3: Guangzhou Chow Tai Fook Financial Centre

Guangzhou Chow Tai Fook Financial Centre, also known as Canton East Tower, is a real estate project located in the core of the central business area of Zhujiang New Town in Guangzhou. Its block number is J2-1 and J2-3, and its planned use is commercial offices. It covers a land area of 26,500 square metres, a planned floor area of 350,000 square metres above the ground and 18,000 square metres of underground commercial buildings, with a block ratio of 13. And it is definite to build super high-rise buildings. It is also the last piece of commercial land assigned in the core business area of Zhujiang New Town. The block was won by New World China Land Limited in 2008 and was initially planned to build a 430-metre high-rise office building. As Type 3 projects are often located in the areas where planning policies are active, the project has been intervened by the government many times in the process of development, while the government has been committed to developing it into the highest building in Guangzhou, and hopes to eventually build it to a height of 530 metres. Since the land was acquired in 2008, the project has undergone a lot of changes in planning and design in the process, among which there were many delays due to supporting fire and other matters. It took ten years for the office and commercial parts of the project to finally open in 2018, while the hotel on the top floor is still under construction.

3.5.4: Type 4 – New Areas in City Fringe with Basic Infrastructure Due to Rapid Urbanisation

Type 4 projects are tract developments located at the urban fringes. In general the scale of the development is much larger than the projects mentioned previously. Levelling works, provisions of utilities, roads and infrastructure are usually the responsibility of the municipal governments. The developers, however, will be required to prepare the master plan of the whole development by themselves. The development rights at the fringe areas of major cities in China are usually assigned to SOE development companies which are designated to take part in the urbanisation process. The land conversion process may also involve the transfer of collective land in rural areas to state-owned urban land. Because of the presence of residual claimants, as stated in *Hypothesis 7*, I postulate that HK developers tend to have a fewer shareholdings in this type of development projects.

3.5.4.1: Internalities and Externalities

Most Type 4 projects are located in villages and towns adjacent to the urban areas, the transformation of which are usually through urban renewal. However, because of the need to undergo the process of demolition (first-level land development and maturation), it is more vulnerable to internal factors, such as the hold-up problem and ambiguity of property rights, and external factors, such as peripheral lighting and protection of riverine wetland. Therefore, for this type of project, HK developers often choose to cooperate with local developers who are familiar with the local environment and can reduce the institutional costs. At the same time, this type of project does not have perfect supporting infrastructure facilities and needs the strong participation of the government, and thus it is common to cooperate with local developers, especially state-owned enterprises that

can carry out infrastructure construction. The Oriental Bund project in Lanshi Street, Foshan and the Forest Hills project of SHKP in Liede Village, Guangzhou are all such projects.

A common feature of Type 4 projects is that the initial property rights are assigned to the *in situ* LURs users, who are also the residual claimants of the projects. They are usually bear lower transaction costs than FDI players in dealing with property rights and governmental policy issues. So a sensible exit strategy for FDI players is to reduce their shareholdings upon completion of the projects. I therefore propose the following hypothesis:

Hypothesis 8

H8: FDI players tend to reduce shareholdings upon project completion with the existence of residual claimants.

It is noteworthy that although the residual claimants also play prominent roles in Type 2 projects (prime locations surrounded by areas that are not well developed), the testability of *Hypothesis 6* should be distinguished because of the long-term strategic investment considerations of FDI players.

Next, I will elaborate on Type 4 projects based on the two projects in which SHKP participated.

3.5.4.2: Foshan Lanshi Urban Village Redevelopment

The Oriental Bund project in Foshan is located at the core of Foshan New Town, in the south of Zumiao Business Circle. It is on the north bank of Dongping River and adjacent to the planned Lanshi Station on the Guangzhou-Foshan Rail Line. At the same time, Foshan New Town is the focus of Foshan Municipal People's Government to

develop in the next ten years. It will be upgraded to a new CBD in Foshan, enjoying the supporting urban facilities built by the government at a cost of billions of Yuan. The project covers an area of 754,000 square metres, with a construction area of 28.0 million square metres, of which 400,000 square metres are used for commercial use and 2.4 million square metres are used for residential use, with a block ratio of 3.71. The project is jointly developed by Sun Hung Kai Properties and KWG Property Holding Limited.

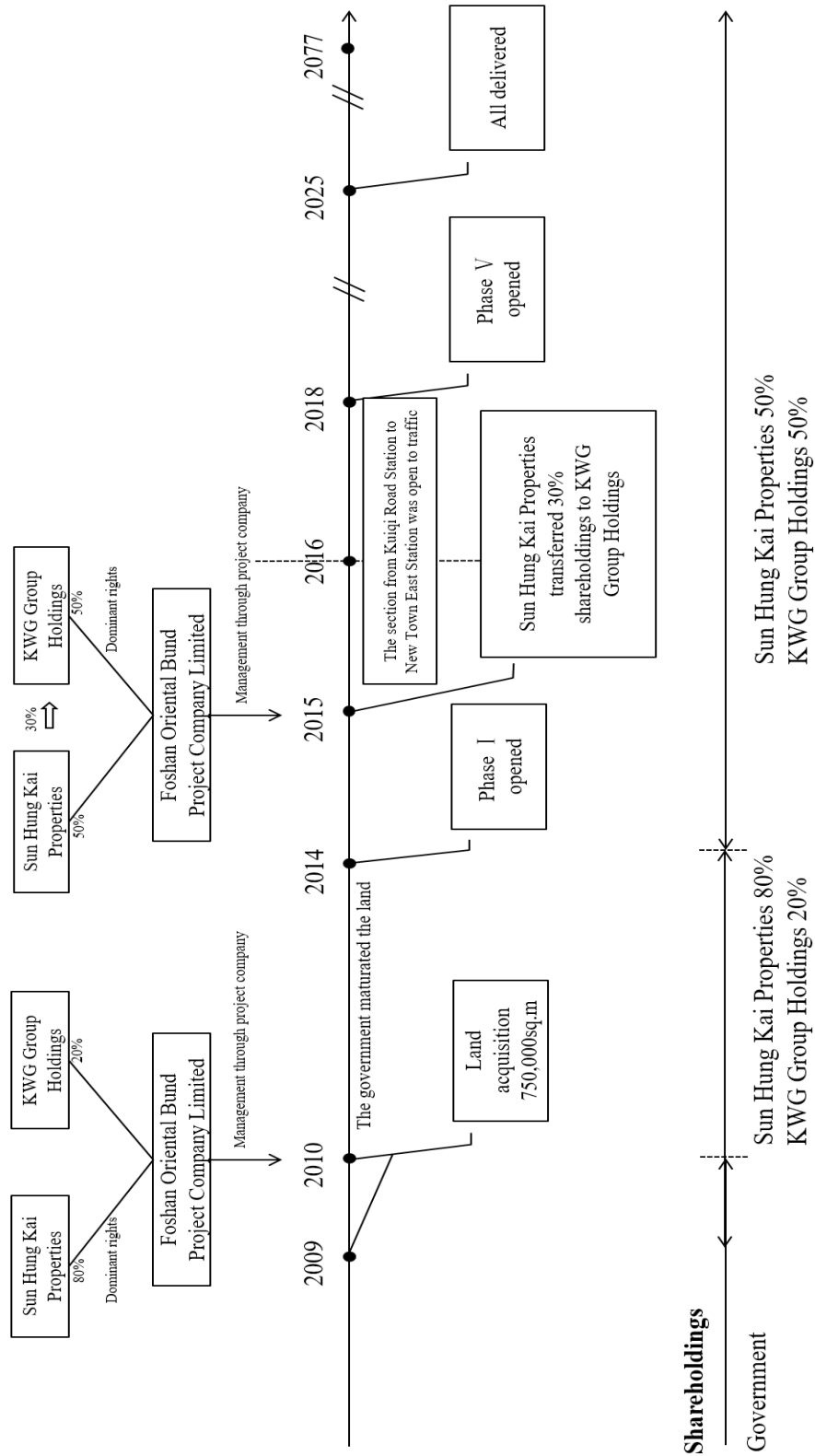
At the end of 2009 and the beginning of 2010, Sun Hung Kai Properties acquired seven blocks of the old city renewal project in Lanshi Town, Chancheng District, and Foshan at the cost of US\$511.83 million⁵³ and US\$696 million,⁵⁴ respectively. That is, the whole area of the Block A in the renovation area in Lanshi Town was solely acquired by Sun Hung Kai Properties, covering a gross floor area of more than 750,000 square metres. The whole old city renewal project in Lanshi Town was developed by means of delivery in batches, and is expected to be completely delivered by 2025. In March 2010, KWG Property Holding Limited and its subsidiary Fulai signed an agreement with Sun Hung Kai Properties and subscribed for 20% of the ownership of its project company to jointly develop the old city renewal project of Sun Hung Kai Properties in Lanshi Town.

⁵³ 3.46 billion RMB, 1 USD = 6.76 RMB according to *China Statistical Yearbook*, 2010.

⁵⁴ 4.705 billion RMB, 1 USD = 6.76 RMB according to *China Statistical Yearbook*, 2010.

Figure 3.4: Development Process of Foshan Lanshi Urban Village Redevelopment

(source: author)



In the South China market, KWG Property Holding Limited is a local developer with considerable operational capacity. It has several benchmarking projects in Guangzhou, covering high-end residential buildings, five-star hotels and grade-A office buildings. Before that, KWG Property Holding Limited and Sun Hung Kai Properties cooperated with R&F Properties to develop the old city renewal project in Liede Village in the core of Zhujiang New Town in Guangzhou (I will discuss it in chapter 6), while the Oriental Bund project in Foshan is the second project developed by KWG Property Holding Limited and Sun Hung Kai Properties.

In the analysis of the Oriental Bund project in Foshan, I define this project as Type 4 development, which is mainly because of its land location, block size, as well as the public and municipal supporting facilities and the hold-up problem and externalities involved in the process of land development. The Oriental Bund project in Foshan conducts public tendering, auction and quotation by means of maturation and assignment of raw land, which refers to the process in which the government leads the development of first-class land and assigns the development of the second-class land. This means that after the developers acquire the land, the development progress of the project will be directly affected by the efficiency of the first-level land development, and the premium space of its pricing and profit potential will also be directly affected by the expansion speed of the city fringe. This project is affected by factors such as the opening of the Guangzhou-Foshan Rail Line.

Typical problems associated with Type 4 development kick in at this moment. Because of the hold-up problem and externalities, the government-led land development at the first level makes slow progress, which leads to the lagging of the overall progress of project construction. It is a fatal impact on many real estate enterprises in light-assets operations which pursue high turnover and quick efficiency.

In addition to the progress problem, the lack of surrounding supporting facilities in the city fringe also has a negative impact on the premium space. Unlike high turnover enterprises, HK developers tend to cover overhead costs when entering the mainland market. Taking into account human resources and corporate strategies, they are more inclined to refine their products and then make profits by increasing premiums (Alchian-Allen Theorem). However, local real estate enterprises which choose high turnover strategies usually make profits by offering more competitive unit prices, lower costs and shorter development cycles, while tending to ignore the product itself. As a result, HK developers lay much stress on the strategies that can meet the strategy of fine product design and have the potential of high premiums.

As Type 4 developments are located at the city fringe, apart from the product itself, the premium also depends greatly on the expansion speed of the city boundaries. However, because of the unsettled issue of the Guangzhou-Foshan Rail Line and the less satisfactory infrastructure construction in the surroundings, the project did not have good performance in the selling prices of the first and second phases, changing from the price of 2,900 USD⁵⁵ per square metre in the first phase to US\$1,600⁵⁶ per square metre and even lower due to the pricing competition of its competitors. Such premium capacity, which is difficult to enhance and the Guangzhou-Foshan Rail Line, which has not been opened to traffic, have forced Sun Hung Kai Properties to have to consider another solution: selling part of its equity, and to deliver the dominant right to operate the project to KWG Property Holding Limited, so that it may choose different development and operation modes.

⁵⁵ 18,000 RMB, 1 USD = 6.22 RMB according to *China Statistical Yearbook*, 2015.

⁵⁶ 10,000 billion RMB, 1 USD = 6.22 RMB according to *China Statistical Yearbook*, 2015.

Hence, in 2015, Sun Hung Kai Properties transferred 30% of its equity to KWG Property Holding Limited, and also delivered the dominant right to operate the project to KWG Property Holding Limited. At this point, the two companies held 50% of shares, respectively, and KWG Property Holding Limited adjusted its strategy with high turnover and low costs on the project after gaining the dominance.

Finally, in 2016, the section from Kuiqi Road Station to New Town East Station on the Guangzhou-Foshan Rail Line was officially opened to traffic, and then the premium capacity of the land gradually emerged. Guangzhou-Foshan Rail Line passes through the bustling downtown area of Chancheng District, Foshan in the northeast direction, and connects to Guangzhou Metro Line 2, while it can reach Guangzhou Centre without great pains. The Guangzhou-Foshan Rail Line extends southeast to Guangzhounan Railway Station, providing convenience for residents to travel throughout the country. The planning and opening of the rail line is the key to increasing the incremental income of the project.

At this point, the project has gradually stabilised and the cash flow has shown better performance under the government's intensification of land maturation and the high turnover operation mode by KWG Property Holding Limited. In exploring the development mode of the land, Sun Hung Kai Properties has chosen to cooperate with local developers who have their own strengths and complement each other to develop the large-scale project. KWG Property Holding Limited cooperates with Sun Hung Kai Properties in landscape design, fine interior decoration and other aspects, and provides strategic support in the development cycle and the profit-making mode in the later period. Other HK developers often have similar changes in cooperative mode when launching such projects.

3.5.4.3: Dalian Rui'an Software Park

The Dalian Software Park in Liaoning Province is an example of Type 4 projects. It is a joint development between Shui On Group and the Dalian Software Park Company. The latter company is an SOE which was set up for the development of IT industry in Dalian. Development rights for the Dalian Software Park has been assigned to the SOE and the first phase of development has been completed by the company already. In 2007, Shui On Group entered into a joint-venture agreement with the SOE to develop the second phase of the park. It holds 61.54% of this 6.5 million square metres project. Due to the longer cooperation relationship and development period, the development concept and financial situation of the developers are no longer able to continue to support the continued holding and development of the project. Shui On Group eventually sold 61.54% of its equity and loans of the project to Yida China Holdings Limited at a price of US\$478 million⁵⁷ in 2018, thus completing the sale and withdrawal of the Dalian Tiandi Project.

3.5.5: Type 5 – Virgin Land that Entails Initial Assignment of Property Rights

Type 5 projects are tract developments over raw lands that are usually located in remote areas. To carry out this type of project, typically the developers are responsible for the master planning, levelling works and the provisions of utilities, infrastructures and roads by themselves. Since the majority of the land involved in this type of development is virgin land, such as uncultivated land and marsh, rights are better defined during the initial assignment of property rights exercise. Generally, this type of

⁵⁷ 3.16 billion RMB, 1 USD = 6.61 RMB according to *China Statistical Yearbook*, 2018.

development is less affected by the problems of residual claims and externalities. Hence following *Hypothesis 7*, a higher shareholding by HK developers is postulated.

3.5.5.1: Initial Assignment of Property Rights

In Type 5 developers must acquire property rights for the first time, and there are often no problems of internal and external factors. But because this type of land involves the arrangement of property rights for the first time, it is likely to have the risk of land change or recovery in the process of communication with the government. Moreover, this type of land tends to have a weak supporting infrastructure in the surroundings, and there is a lack of a lively and commercial atmosphere. The developers are usually optimistic about the future development of the region, and they are willing to invest resources in advance in the development of some infrastructure and the maturation of the surroundings to further develop the project. This mode was common in the early period of opening in the mainland, and HK developers could do a lot because of their advantages in technology and capital at that time. However, in recent years, because of clear ownership status, freedom given to the imagination, low entry threshold and huge development volume, this type of land is increasingly sought after by mainland developers who pursue fast turnover and strong cash flow, which HK developers are often not keen on. Moreover, the technological and capital advantages of Hong Kong businessmen had been shrinking with the passing of time, which eventually led to this type of project gradually becoming the main battlefield for mainland developers over the past ten years.

3.5.5.2: Chengdu Shuangliu Project (Chengdu Jovo Town)

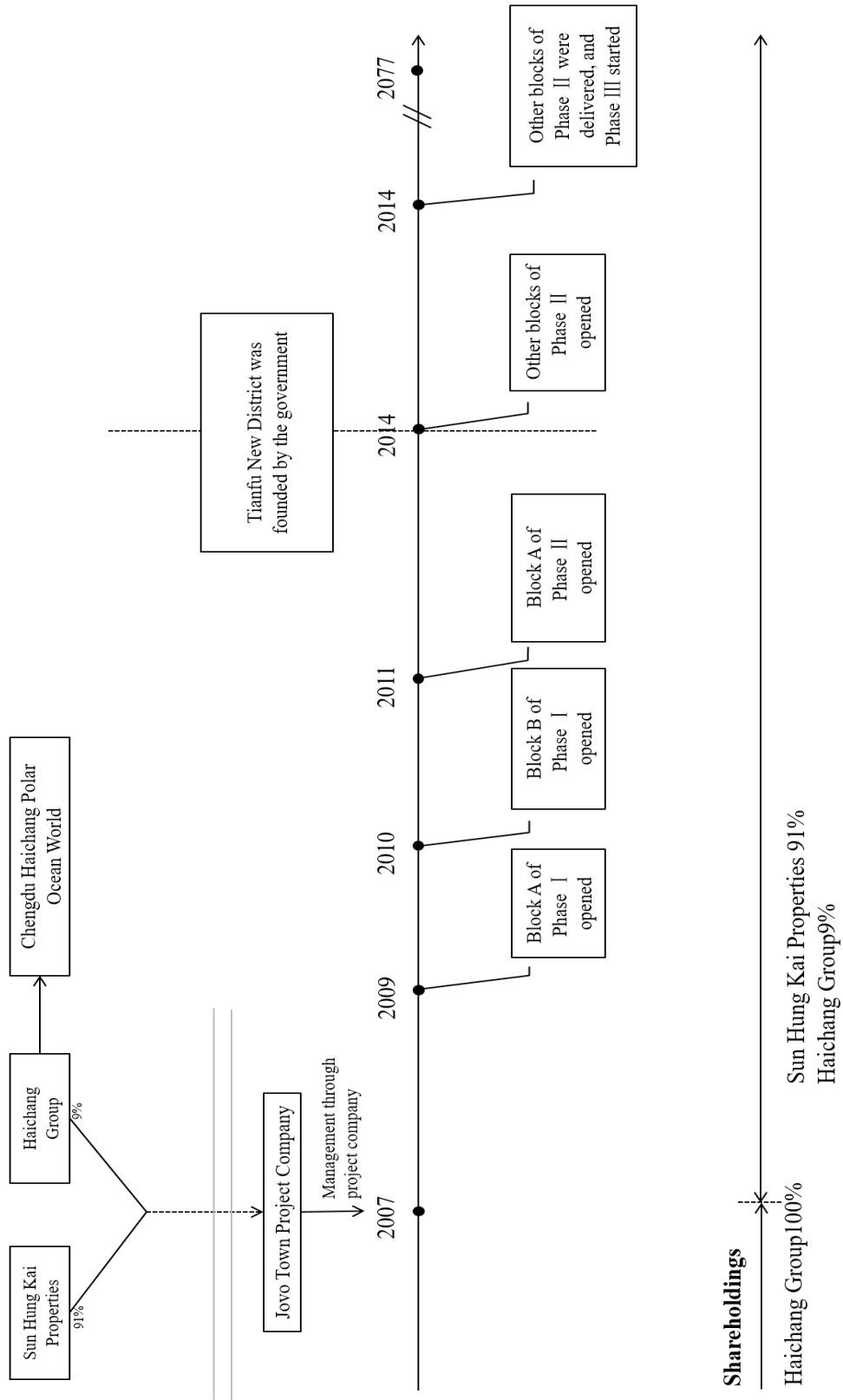
The Jovo Town project developed by Sun Hung Kai Properties is located in the core area of Shuangliu County in the south Chengdu New Centre International City, adjacent to Haichang Polar Ocean Park in Chengdu. The project covers an area of 160,000 square metres. The residence project covers a gross floor area of about 640,000 square metres with a block ratio of 3.99. It is being developed in three phases, providing a total of 4,320 houses and more than 4,800 parking spaces. It is another classic residential project presented to Chengdu by Sun Hung Kai Properties.

Sun Hung Kai Properties acquired 91% of the equity of the land owned by Dalian Haichang Group at a price nearly ten times the original land price through the form of shareholding of BVI Offshore Company, and eventually built it into the Jovo Town, thus smoothly developing its businesses in Chengdu.

In terms of geographical location and scale, the development belongs to Type 5. The block has clean and clear property rights, low unit prices and great freedom of planning, but there are also some problems, such as the less-than-perfect municipal supporting facilities in the surrounding area and the lack of scarcity, which results in the difficulty in raising the selling price. In the course of the development of this project, the special mode of cooperation with Haichang Group has resulted in a higher tax burden, which has led to excessive costs in the earlier stage of the project. Moreover, the location of the block has resulted in relatively weak premium capacity. The situation of high costs and low selling prices has caused the project to be difficult to move forward as a whole in the early operation. It was not until then that the new policy of ‘state-level new area’ was launched and that the project had a turning point.

Figure 3.5: Development Process of Chengdu Shuangliu Project (Chengdu Jovo Town)

(source: author)



As mentioned above, although Type 5 developments usually have higher degrees of freedom in design, lower unit land cost and larger volume, they are disadvantageous in terms of lower premium for selling prices and rentals, which is also the problem that Sun Hung Kai Properties and Haichang Group want to solve. At the beginning of the twenty-first century, the tourism industry in the mainland was booming, and one of the key needs of the population in the suburban housing is the establishment of supporting tourism and entertainment facilities. Haichang Group had a strong ability to develop the aquatic amusement park, and the Haichang Polar Ocean Park that it developed around this project is its key achievement. It provides targeted products for some customers with the demand in tourism and residence in the form of an amusement park and residence. It is also the strategy that the two companies formulated in relation to the increasing selling prices in the initial stage.

However, in spite of the low unit price of the land, the construction cost of the project accounts for a higher proportion, and the unit price in sale is not high, and the corresponding after-tax profits are so low that it is difficult to meet the requirements of return on investment. At the same time, compared with local developers, HK developers do not have the advantage in carrying out mega-scale Type 5 development because of capacity constraints. So some HK developers choose to encash the properties and withdraw their cooperation, which is a risk-adverse but also negative kind of exit strategy. On this basis, it is one of the solutions to the difficulty for the block to slow down the development cycle, wait for the opportunity to increase the land value and then raise the premium rate.

A turning point came for the problem. In 2014, the region where the project was located was planned by the government as Chengdu Tianfu New Area, the eleventh state-level new area in China, and the support and impact arising from the policy began to

show. Driven by the favourable policies of the state-level new area, the infrastructure around the block has developed rapidly, and more and more projects have sprung up, and thus the area has become the focus of residence and investment among the citizens. The housing price was naturally increased to more than US\$300⁵⁸ per square metre in a short time along with the expansion of urban boundaries and favourable policies, and thus the profit-making problems caused by excessive costs were alleviated.

To sum up, Type 5 development is generally the main battlefield for local developers because of their large development volume and better conformity with the strategy of high turnover, while out of consideration for the transaction costs, HK developers tend not to invest too much in projects with large scale and low unit prices on the premise of limited technology output and human resources. However, Type 5 developments are usually located in the outskirts of cities, which gives them favourable policies, and thus foreign companies have cautiously entered this type of market in recent years. For existing projects, on the one hand, they may choose to adjust their own strategies and use them for fast turnover. On the other hand, they may choose to complement each other with local developers and use their respective advantages to develop jointly, or even transfer the projects to local developers who have more advantages for such projects.

3.5.5.3: Changchun Jingyuetan Project

Another example of Type 5 development is the Changchun Jingyuetan Project, which is located in Jilin Province and run by the Cheung Kong Group. The site is about 400,000 square metres in size and is a 45-minute drive away from the town centre. The

⁵⁸ 2,000 RMB, 1 USD = 6.14 RMB according to *China Statistical Yearbook*, 2014.

project is designated a high-end residential development. The Group obtained the land through a public land auction held on 22 March 2005, with total land price at 34.7 million USD.⁵⁹ The project opened for to sale in 2008 and the whole development was completed in 2011. According to historical news, there have been incidents of owners' rights protection during the housing handover process in terms of the poor construction quality and design. The Group develops and operates the project with a goal of fast turnover, which is also in line with my propositions about Type 5 developments.

In Type 5 development, since the land cost in remote countryside areas is relatively low, the main cost is usually for construction. In this project, sacrificing quality to reduce costs in order to maximise profits is the major cause of quality disqualification and events which safeguard owners' rights. At the same time, high turnover projects often require rapid completion, which may further aggravate the defects on quality because of the 'more haste less speed' principle. As a wholly owned project, the Cheung Kong Group develops and operates the project in view of fast turnover. In general, this project is in line with my propositions about Type 5 developments.

To sum up, for these five types of projects, enclosed please find the Figure 3.6 and Table 3.1. The above types of projects are presented in two cases of each type: one with a detailed description of the project that the author participated in by SHKP, and the other with a brief supplement of other projects with similar attributes by other HK developers.

⁵⁹ 281 million RMB, 1 USD = 8.10 RMB according to *China Statistical Yearbook*, 2005.

Figure 3.6: Five Types of Sites (Source: author)

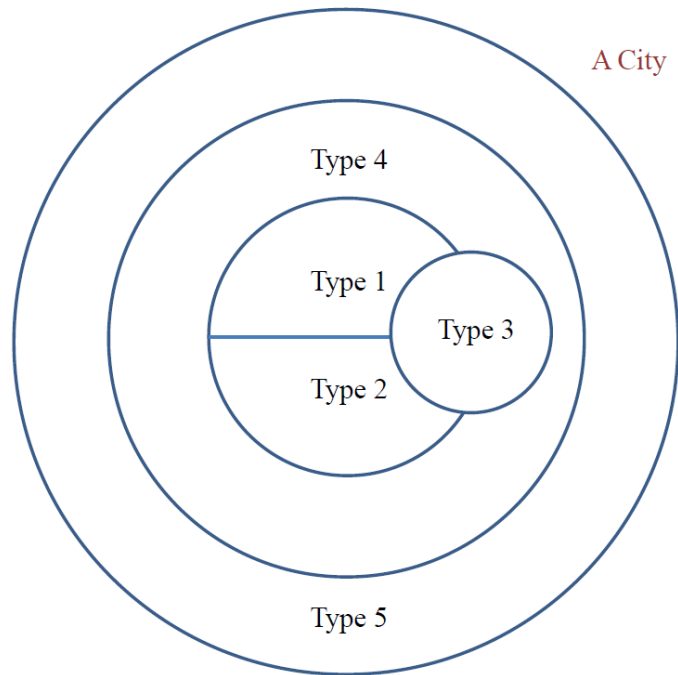


Table 3.1: Five Types of Sites (Source: author)

	Type 1	Type 2	Type 3	Type 4	Type 5
Location	Downtown	Downtown	New city centre	New area in city fringe	Virgin land
Property Right (Protection)	Government defined	Difficult to fully defined	Well defined	Difficult to fully defined	Initial assignment
Property Right Clarity	Well-defined	Uncertain e.g. presence of hold-up issue /externalities	Certain but Changing, affected by gov's changing rule	Uncertain e.g. presence of hold-up issue /externalities	Easier to defined
Share Holding (Perceived)	Higher	Lower	Middle or Higher	Lower	Higher

CHAPTER 4: EMPIRICAL TESTS

Two multiple regression analyses will be conducted in this chapter to test the hypotheses formulated in the previous chapter. The first regression analysis tests the effects on FDI players' shareholdings with respect to the development parameters, institutional factors, types of projects and city tiers. The second modifies the first by putting changes in shareholdings by FDI players as the dependent variable.

4.1: A Survey of 354 Urban Development Projects Conducted by Eleven Key Hong Kong Developers

For this thesis I collected data from more than 350 projects developed by eleven HK developers in mainland China, which I focus on in order to retrieve the companies' annual reports, the query of public information and the accumulation of work information. I hope to identify the law of business development and the investment trends of the HK developers, who play the role of FDI when they carry out real estate projects in mainland China, under the certain factors, such as time, policy, interiority and externality, through the descriptive analysis, correlation analysis and the building of the regression model. Prior to the analysis, I first conduct basic display and induction of the information on the data from the 350 projects.

4.2: Data Sources and General Information

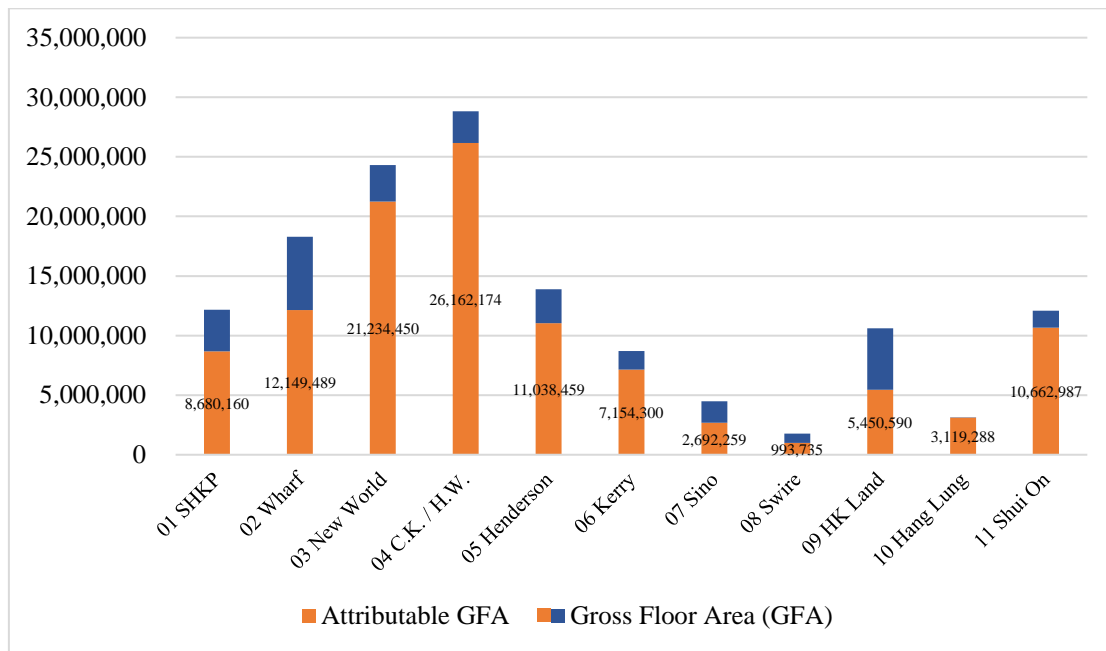
As shown in Table 4.1 and Fig 4.1, by the beginning of 2018, the eleven HK developers that were operating in mainland China have developed a total of nearly sixty-four million square metres of land, with a total construction area of more than 138 million square metres. In terms of gross floor area, Hutchison Whampoa Limited, New World China Land and Wharf Holdings Limited cover the largest scale of property development in mainland China, and it goes in the same way after the allocation of shareholdings. In terms of number of projects, the top three are still Wharf Holdings Limited, New World China Land and Hutchison Whampoa Limited.

From the perspective of the plot ratio of the project, there are greater differences between these companies because of the differences in the development strategies of their own projects, and the highest one is Hang Lung Properties with a plot ratio of 6.27, which is closely related to its product type of Hang Lung Plaza, the super-high-rise commercial office complex project. At the same time, the average shareholding ratio of Hang Lung Properties is the highest among all the developers, accounting for 99%.

Table 4.1: Basic Information of the 354 Projects by HK Developers

Company	Project Numbers	Total Construction_Area	Total Site_Area	Average Plot Ratio	Total Attributable_Area	Average Shareholding
	(No.)	(s.q.m)	(s.q.m)		(s.q.m)	
01 Sun Hung Kai Properties	32	12,155,038	4,397,471	2.76	8,680,160	71%
02 Wharf Holdings Limited	67	18,294,920	6,779,465	2.70	12,149,489	66%
03 New World China Land	62	24,312,299	13,698,041	1.77	21,234,450	87%
04 Cheung Kong and Hutchison Whampoa Ltd	57	28,824,151	17,511,328	1.65	26,162,174	91%
05 Henderson Land	30	13,880,035	5,843,264	2.38	11,038,459	80%
06 Kerry Properties Limited	32	8,705,202	1,892,889	4.60	7,154,300	82%
07 Sino Group	13	4,492,507	2,188,696	2.05	2,692,259	60%
08 Swire Properties	8	1,771,230	415,431	4.26	993,735	56%
09 Hong Kong Land	14	10,618,000	6,980,817	1.52	5,450,590	51%
10 Hang Lung Properties	10	3,148,088	501,864	6.27	3,119,288	99%
11 Shui On Land	29	12,099,872	2,989,745	4.05	10,662,987	88%
Total	354	138,301,343	63,199,010	2.19	109,337,890	79%

Figure 4.1: GFA and Attributable Area of 354 Projects by HK Developers



4.3: City Tiers

As far as city division is concerned, at present, the experts and scholars usually divide cities into first-tier, second-tier, third-tier and fourth-tier cities in the analysis of the real estate market, while there is no strict and unified official definition. By referring to the latest data of the National Bureau of Statistics,⁶⁰ the National Development and Reform Commission and the relevant research institutes⁶¹ and the New First-Tier Cities Lab,⁶² this thesis divides the cities involved in the projects into four categories from the perspective of the size of GDP, the per capita income of residents, the degree of

⁶⁰ http://www.stats.gov.cn/tjsj/zxfb/201509/t20150918_1246629.html

⁶¹ <http://www.hq100.com/article/185646-zhongguo-chengshi-zonghe-fazhan-2017-paiming>

⁶² <https://www.yicai.com/news/5418765.html>

concentration of commercial resources and the urban hub and other factors, and the corresponding relations are as follows:

Table 4.2: Names of Chinese Cities by Tiers (sources: National Bureau of Statistics)

Tier 1	Shanghai, Beijing, Shenzhen, Guangzhou
Tier 2	Chengdu, Hangzhou, Chongqing, Wuhan, Suzhou, Xi'an, Tianjin, Nanjing, Zhengzhou, Changsha, Shenyang, Qingdao, Ningbo, Dongguan, Wuxi, Kunming, Dalian, Xiamen
Tier 3	Foshan, Fuzhou, Jinan, Changchun, Changzhou, Guiyang, Nanchang, Xuzhou, Huizhou, Zhongshan, Zhuhai, Haikou, Yangzhou, Tangshan, Langfang, Zhangzhou, Putian, Anshan, Zhaoqing, Qinhuangdao
Tier 4	Yingkou, Tieling

Figure 4.2: Numbers of Projects Conducted by 11 Developers by City Tiers

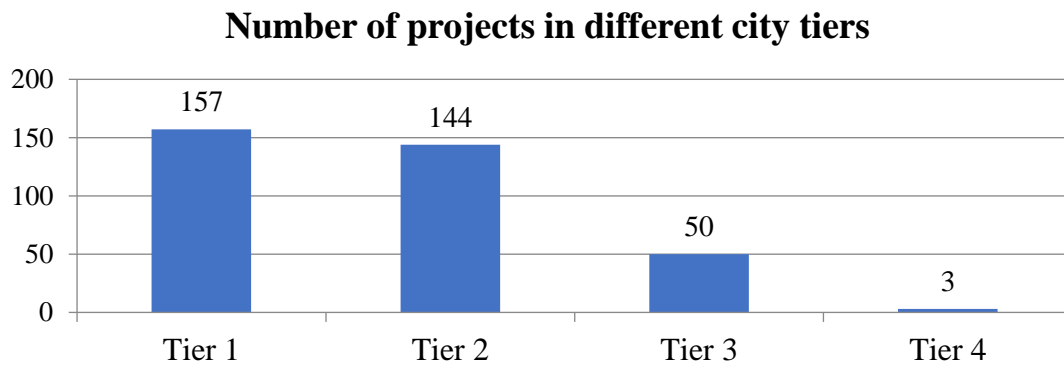


Table 4.3: Number of Projects Conducted by 11 Developers in Major Cities

(source: author)

Major City - No. of projects (more than 10) in cities	
01 Shanghai	90
02 Beijing	28
04 Guangzhou	24
05 Chengdu	20
07 Chongqing	19
06 Hangzhou	17
08 Wuhan	17
03 Shenzhen	15
09 Suzhou	15
23 Foshan	14
11 Tianjin	10

Figure 4.3: Number of Projects Conducted by 11 Developers in Major Cities

(source: author)

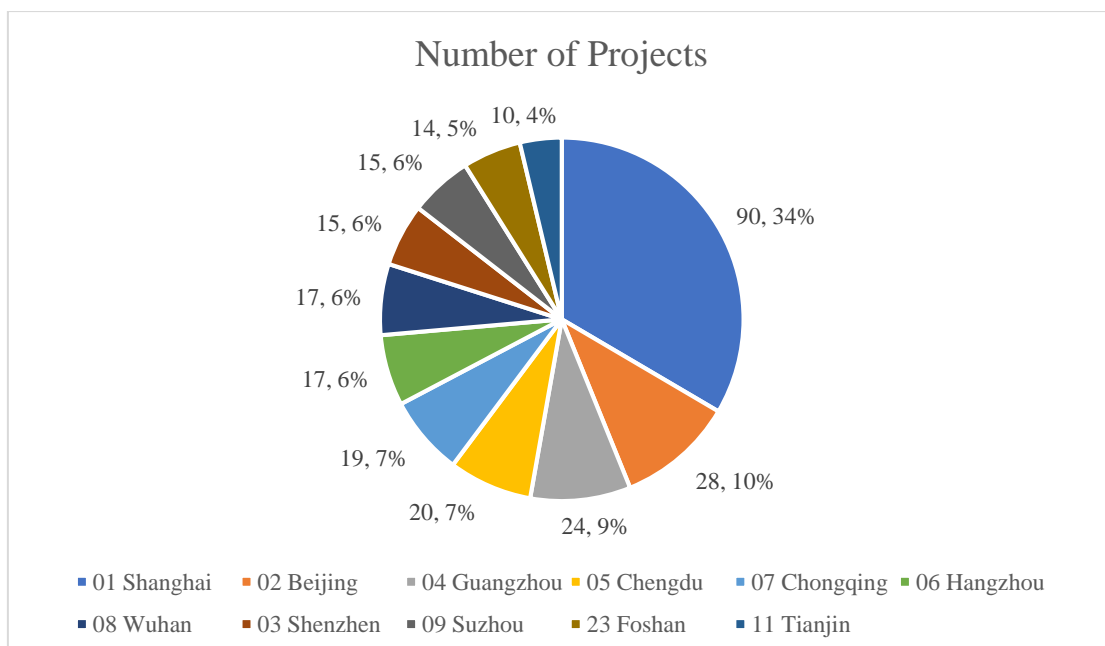


Figure 4.3.1: Proportion of Areas by 11 Developers in Tier 1 Cities – Beijing

(source: author)

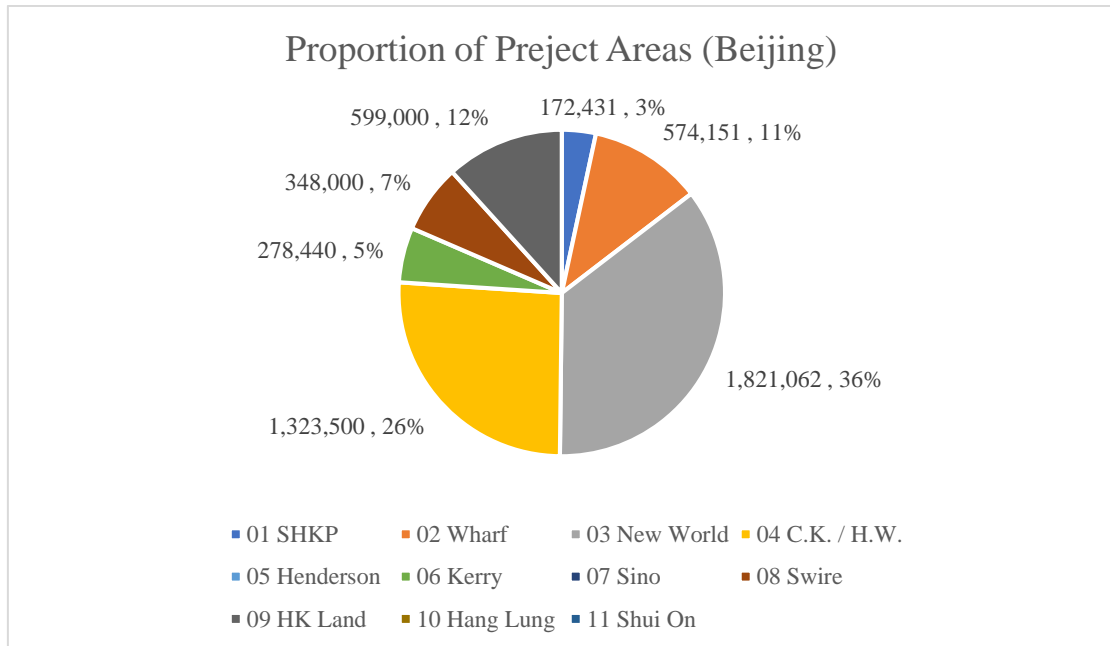


Figure 4.3.2: Proportion of Areas by 11 Developers in Tier 1 Cities – Shanghai

(source: author)

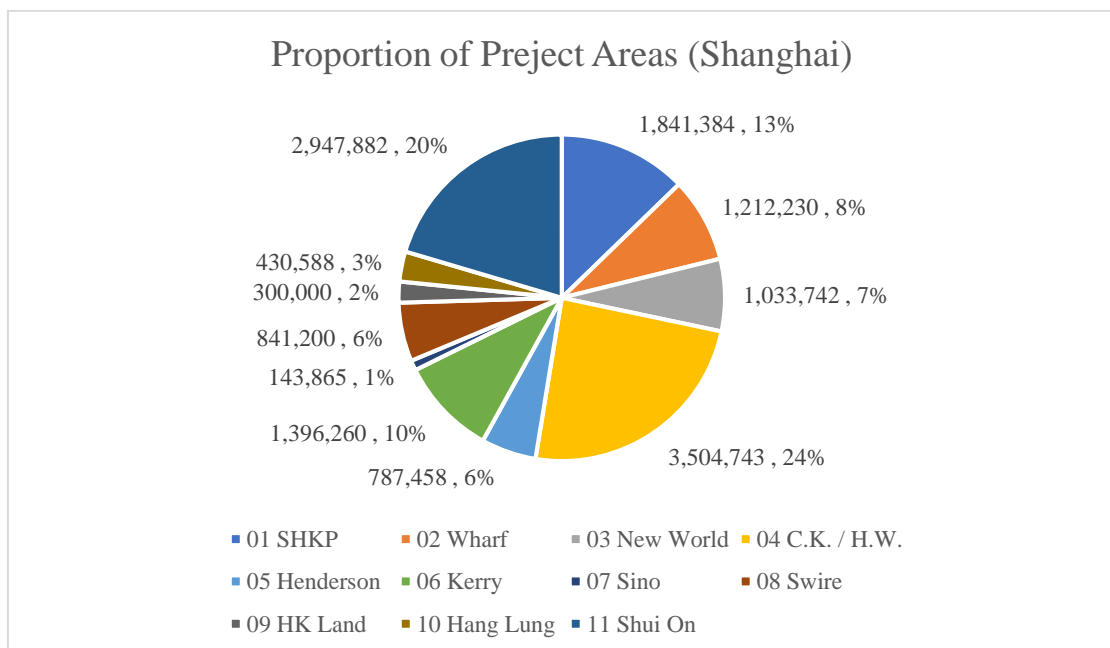


Figure 4.3.3: Proportion of Areas by 11 Developers in Tier 1 Cities – Guangzhou

(source: author)

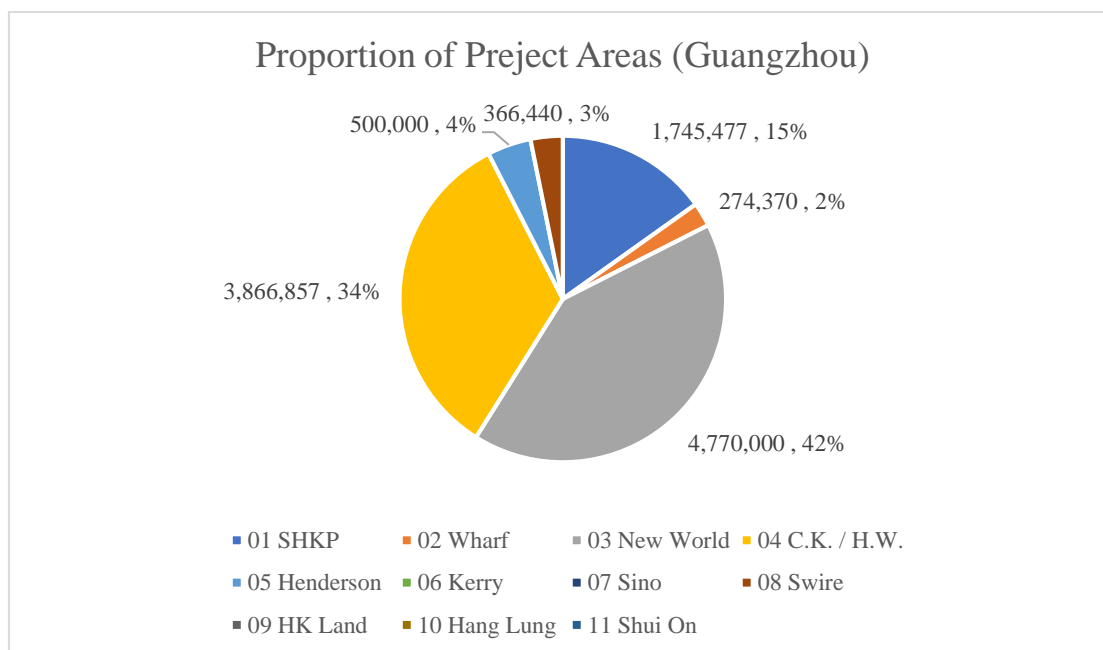
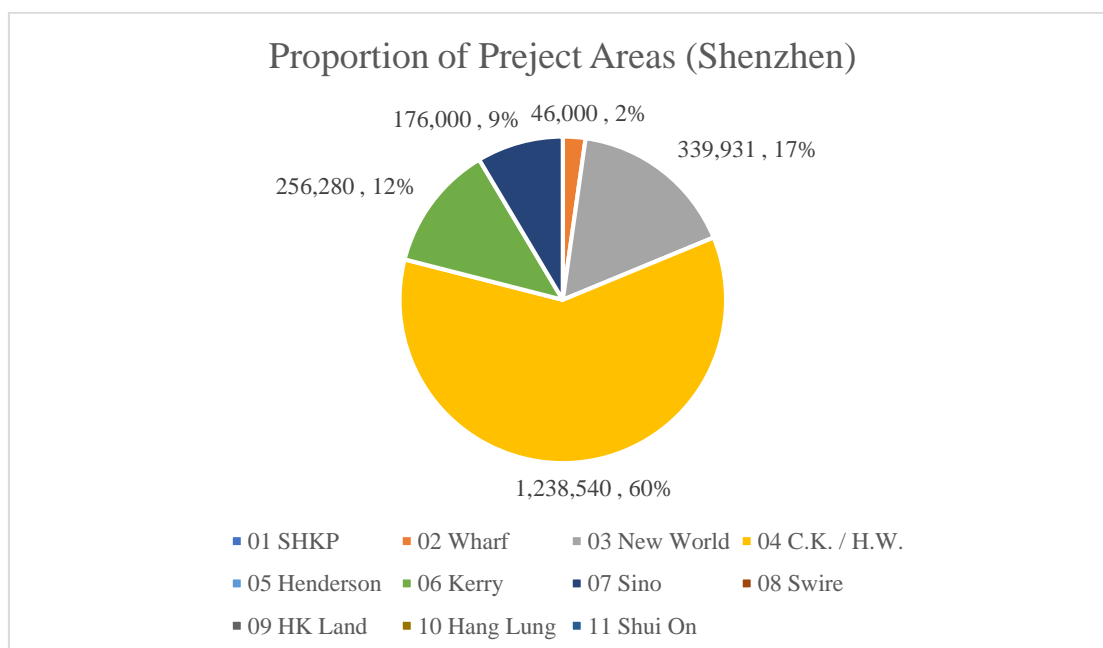


Figure 4.3.4: Proportion of Areas by 11 Developers in Tier 1 Cities – Shenzhen

(source: author)



According to the above data, most of the projects are concentrated in the Tier 1 and 2 cities from the perspective of the tendency for HK developers to enter the cities. For single cities, the largest number of projects has been developed in Shanghai, up to ninety, which is significantly more than the number of projects in other cities. As the capital, Beijing is the first city for HK developers to enter mainland China, and the project is the Beijing Great Wall Sheraton Hotel, which was built in 1981 by Hutchison Whampoa Limited. After that, in Shanghai, Guangzhou and Shenzhen, among the cities of the type Tier 1, projects were developed by HK developers. Among the cities that HK developers prioritise, they have tended to locate within Southern China Great Bay Area (Shenzhen, Foshan, Zhaoqing, Dongguan, and Guangzhou) and the cities at the level of provincial capital (Wuhan, Chongqing, Fuzhou, and Tianjin).

Figure 4.4: Relationship between Project Area, Area of Shareholdings and the Year
(sources: author)

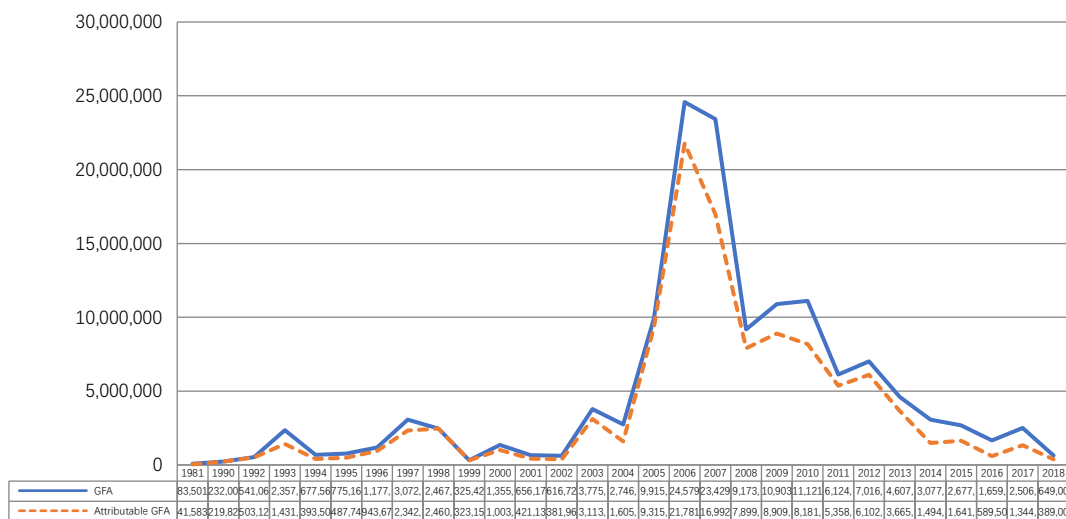
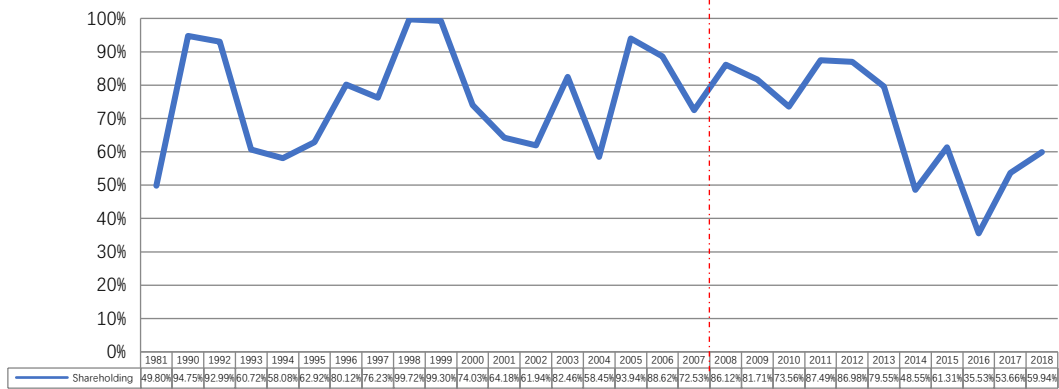


Figure 4.5: Average Shareholding by Year (sources: author)



From the point of view of the increment of project acquisition, the newly acquired area of the project and the area of shareholdings both showed a steady and positive growth with fluctuations before 2007. However, since 2007, the situation of land acquisition by HK developers has shown a trend of rapid decline in fluctuations. In this thesis I argue that the formation of that trend is affected by a large number of internal and external factors, such as the internal factor of enterprise operating strategy, and the external economic market environment and so on. However, the chart of the proportion of shareholdings cannot clearly show the development trend of the factors similar to the development area and the area of shareholdings. In this chapter, I will focus on the proportion of shareholdings as a dependent variable in testing, and carry out correlation analysis between the various data obtained and the proportion of shareholdings. I try to take each project as a research unit to discover the correlation and regression between the proportion of shareholdings and other development factors in the trend, which is not visually obvious as the years change.

4.4: Building the Empirical Model

For the empirical model, the table below shows the factors and controlled variables to be built in the analysis.

Table 4.4: Key Variables in Regression Analyses (sources: author)

α_0	An intercept term to be estimated
β_i	The marginal value and the coefficient corresponding to the explained variable to be estimated
ε	A random error term
<i>S_{holding}</i>	Represent the development rights and interests
<i>S_{change}</i>	The change of development rights and interests
<i>inter</i>	Interiorities
<i>exter</i>	Externalities
<i>policy</i>	Policy factor, the change of policy
<i>dev</i>	Represent development issues, which refers to the sum of the internalities, externalities, and policy factor
<i>C_{variables}</i>	The controlled variables
<i>city_type</i>	Type of Cities
<i>sp</i>	Special policy factors
<i>project_type</i>	Type of projects (the residential use type is represented as 1, and the other natures are represented as 0)
<i>lnarea_i</i>	The natural logarithm of the land area
<i>plot_ratio</i>	Plot ratio
<i>lncaarea</i>	The natural logarithm of the gross floor area
<i>lnaarea</i>	The natural logarithm of attributable gross floor area
<i>const_duration</i>	The construction duration (from the commencing year to the finishing year)
<i>rhyear</i>	The right holding year
<i>lnprice</i>	The natural logarithm of 2018 average price of city housing prices
<i>lnlandcost</i>	The natural logarithm of City Average Land Cost on Project Commencing Year
<i>lnunit</i>	The natural logarithm of City Average Unit Selling Price on Project Commencing Year

Inter, exter and policy are all dummy variables. Their occurrence is given the value of 1, while the absence of such factors is represented as 0.

Some of the projects which were started before 2000, and some small cities' statistics, are not well recorded. This creates a data deficient of about fifty land cost and selling price data. Given that this deficiency is relatively limited, GDP and CPI can be used in some ways, on behalf of the city's economic development level and consumption level, to help forecast the cities' land costs and selling prices (Guan, 2013). In this study, the missing data were supplemented by finding all projects' corresponding city GDP and domestic CPI data. With GDP and CPI as an explained variable, and land cost and selling price also as explained variables, respectively, a regression equation is obtained, and the missing data is thereby forecasted. But the missing data eventually lead to a result of inexactness on the regression to a certain extent, which will be explained in the following sections.

4.5: Descriptive Statistics (Continuous Variables and Binary Variables)

Specifically, in order to understand the distribution characteristics of data, I conduct descriptive statistics and analysis of the data to obtain Table 4.5, which shows the basic information of each variable (including the sample size, the mean value, standard deviation, the minimum value, and the maximum value).

Table 4.5 is the basic information from the data. The average value of the development rights and interest is 77.96%. Relatively speaking, the average value is biased towards the maximum value, indicating that there are relatively large development rights and interests. The minimum value is 11.35% and the maximum value is 100.00%. 50.28% of the projects are residential use, the average value of the

construction duration is 7.62 years. The occurrence of internal factors accounts for 55.08%, the occurrence of external factors accounts for 66.67%, and the occurrence of policy factors accounts for a relatively low proportion, 31.36%.

From the above I can see that the average construction duration of project development is as long as seven years, which is slower than the development pace of fast turnover developers in mainland China (usually two to four years for a residential project). Such a speed can provide better protection in terms of product quality through intensive and meticulous cultivation, and obtain greater advantages when the project is launched in the market.

Table 4.5: Descriptive Statistics of Regression Analysis

Variable	Obs	Mean	Std. Dev.	Min	Max
<i>Sholding</i>	354	77.9635	24.7049	11.3500	100.0000
<i>Schange</i>	354	-4.1180	22.2598	-100.0000	62.0000
<i>spec_policy</i>	354	0.3757	0.4850	0.0000	1.0000
<i>function</i>	354	0.5028	0.5007	0.0000	1.0000
<i>lnarea</i>	354	11.0785	1.4820	6.9078	17.0927
<i>plot_ratio</i>	354	4.2591	3.1128	0.1359	18.4778
<i>lncarea</i>	354	12.2212	1.1736	9.0407	15.1505
<i>lnaarea</i>	354	11.9084	1.2457	8.8297	15.1505
<i>const_duration</i>	354	7.6215	4.7508	0.0000	28.0000
<i>rhyear</i>	354	58.8983	12.4903	40.0000	70.0000
<i>inter</i>	354	0.5508	0.4981	0.0000	1.0000
<i>exter</i>	354	0.6667	0.4721	0.0000	1.0000
<i>policy</i>	354	0.3136	0.4646	0.0000	1.0000
<i>lncprice</i>	354	10.0111	0.6745	8.2436	10.9001
<i>lnlandcost</i>	354	8.2912	0.7630	6.5058	10.5629
<i>lnunit</i>	354	8.4508	0.9391	6.3026	10.7177

However, the risk of encountering a variety of policies in a single project development cycle is also greater than that of a short-term project. On the other hand, the proportion of internal factors is slightly smaller than that of external factors in terms of the proportion of various issues on the projects developed by the developers in Hong Kong. Through analysis, I also find that it is also greatly related to the order of knowledge about internal and external conditions when they get the project.

Table 4.6: *S_{holding}* and *S_{change}* before and after 2007

	Group	Obs	Mean	Std. Err.	Std. Dev.	T	p
<i>S_{holding}</i>	Before 2007*	165	80.4275	1.7614	22.6259	1.7585	0.0795
	After 2007	189	75.8124	1.9099	26.2572		
<i>S_{change}</i>	Before 2007*	165	-3.9683	1.7581	22.5831	0.1181	0.9061
	After 2007	189	-4.2487	1.6027	22.0330		

* Before and on 2007

Recall *Hypothesis 1*, which postulates that the average shareholdings held by FDI players decrease after the enactment of the PRL because of investment diversification. Table 4.6 shows that the *S_{holding}* before and after 2007 is significantly different as the significance level of 0.1 of *S_{holding}* after 2007 is less than what it was before 2007, although *S_{change}* does not show significant differences before and after 2007. The null hypothesis of *H1* cannot be rejected by the empirical test. On average, HK developers hold 4.6% fewer shareholdings in FDI real estate projects after the enactment of the PRL.

I believe that the way in which there are significant differences in the development rights and interests (*S_{holding}*) before and after 2007 is closely related to the promulgation and implementation of the PRL. Prior to this, there was no direct legal protection for the concept of property rights in China. The implementation of the PRL

was a process that started from scratch. At this time, only the existence of property rights was defined, and the clarity of each property right was not defined (it is also the result expected by the registration of property rights which is being carried out in full swing in China in recent years). Therefore, in a context where the existence of property rights is defined but not clear, HK developers still have doubts about the protection of property rights of new projects in mainland China based on the impact of other possible factors. Moreover, due to the PRL, it becomes more difficult to dispose of some other internal and external factors, while the enthusiasm to obtain the right to use land is reduced. The direct embodiment of data is that the proportion of equity ownership in the new project is reduced as a whole. After the implementation of the PRL, the main reason for the change in shareholding is that the accountable time period is longer and projects are getting 'older', which may increase the possibilities of shareholding change.

4.6: Frequency Analysis (Multiple Classified Variables)

In order to study the proportion of multiple classified variables, frequency analysis is carried out on the variables, and the results are shown in Table 4.7. It can be seen that the Tier 1 cities account for the largest proportion, 44.35%, the Tier 2 cities account for 40.68%, and the Tier 4 cities account for the least proportion, 0.85%. In terms of project types, Type 2 cities account for the largest proportion, 35.88%, Type 5 accounts for the least proportion, 2.54%, and the type without the impact of development rights and interests accounts for 18.36%. The type with the effect of two block factors accounts for the largest proportion, 34.75%.

Table 4.7: Frequency Analysis

variables		Freq.	Percent	Cum.
<i>city_type</i>	1	157	44.35	44.35
	2	144	40.68	85.03
	3	50	14.12	99.15
	4	3	0.85	100
<i>project_type</i>	1	78	22.03	22.03
	2	127	35.88	57.91
	3	67	18.93	76.84
	4	73	20.62	97.46
	5	9	2.54	100
<i>dev*</i>	0	65	18.36	18.36
	1	101	28.53	46.89
	2	123	34.75	81.64
	3	65	18.36	100

* *dev* represent development issues, which refers to the sum of the internalities, externalities, and policy factors

As can be seen from the above, HK developers mainly develop projects in the first and second-tier cities of mainland China, with the priority to the projects of Type 1, 2 and synchronous development of Types 3 and 4. I find that the project is vulnerable to various factors, and affected by multiple factors (two or more) accounts for the largest proportion.

4.7: Univariate Test

In order to verify whether the development rights and interests and the changes of development rights and interests vary among different cities and different developers, variance analysis is carried out on the variables:

Table 4.8 Variance Analysis

group	Variable	F	Prob > F
city	<i>Sholding</i>	1.6200	0.0113
developer	<i>Sholding</i>	7.6400	0.0000
city	<i>Schange</i>	3.4800	0.0000
developer	<i>Schange</i>	4.6000	0.0000

It can be seen that at the significance level of 0.05, there are significant differences in *Sholding* and types of cities, and at the significance level of 0.01, there are significant differences between *Sholding* with different developers, and *Schange* with different cities and developers. This indicates that, in the macro-context of the project development by Hong Kong developers in mainland China, the eleven different companies have different development tendencies towards different cities and the interests and interest changes of their respective projects.

4.8: Correlation Analysis

After the descriptive statistics is carried out on the samples, correlation analysis is conducted on the data, and the degree of correlation between variables is measured based on the Pearson correlation coefficient. The formula of Pearson correlation coefficient is as follows:

$$r_{ij} = \frac{\sum_{k=1}^n (x_{ki} - \bar{x}_i)(x_{kj} - \bar{x}_j)}{\sqrt{\sum_{k=1}^n (x_{ki} - \bar{x}_i)^2} \sqrt{\sum_{k=1}^n (x_{kj} - \bar{x}_j)^2}}$$

In order to study the influence between the variables, correlation analysis is conducted on such variables, and correlation analysis can analyse the degree of correlation between each two variables. The closer the absolute value of the correlation coefficient is to 1, the stronger the correlation will be. The positive and negative nature of the correlation coefficient represents whether the correlation of two variables is in the same or negative direction. Then the correlation between the variables is analysed. This thesis mainly analyses the correlation between the explanatory variables.

From the correlation analysis in Table 4.9, I can see that the correlation coefficients of the explained variable *S_{holding}* with the explanatory variables *dev*, *inter*, *exter*, *policy* and *Inlandcost* are significant at the significance level of 0.01. The negative correlation of *internal factors* with *S_{holding}* is the strongest, which is -.41***; the correlation coefficient with external factors is -0.38***; the correlation coefficient with policy is -0.27***, and the correlation coefficient with land cost on land acquisition year is -0.20***. The correlation coefficients of the explained variable *S_{change}* with the explanatory variables *dev* and *inter* are significant at the significance level of 0.05, and are significant at the level of 0.1 with *policy*.

The correlation coefficient *dev* with share change is the largest, which is -.13**, the correlation coefficient *inter* is -0.13**, the correlation coefficient *policy* is -0.09*, and the correlation coefficient *Inlandcost* is -0.10*. All the correlation coefficients with shareholding change except externality are significant.

Meanwhile, I found that the correlation coefficients of the explained variable *lnunit* with the explanatory variables *inter*, *exter*, *policy* and *Inlandcost* are significant at the significance level of 0.01. The correlation coefficient *Inlandcost* with unit selling price is the largest, which is 0.60***, the correlation coefficient *policy* is 0.20***, the correlation coefficient *inter* is -0.18***, and the correlation coefficient *exter* is -0.14***. This result is consistent with the understanding of front part of *Hypothesis 6*: when there is a higher land cost, there should be a higher selling price of the year.

Table 4.9 Correlation Analysis

	share	sharechange	dev	inter	exter	policy	Inlandcost	lnunit
share	1.0000							
sharechange	-0.1375***	1.0000						
	0.0096							
dev	-0.5115***	-0.1320**	1.0000					
	0.0000	0.0129						
inter	-0.4095***	-0.1293**	0.7699***	1.0000				
	0.0000	0.0149	0.0000					
exter	-0.3763***	-0.0509	0.6868***	0.3494***	1.0000			
	0.0000	0.3393	0.0000	0.0000				
policy	-0.2721***	-0.0918*	0.6143***	0.2186***	0.0775	1.0000		
	0.0000	0.0846	0.0000	0.0000	0.1456			
Inlandcost	-0.2011***	0.0988*	0.0831	-0.0368	-0.0197	0.2372***	1.0000	
	0.0001	0.0632	0.1185	0.4899	0.7114	0.0000		
lnunit	-0.0168	0.0170	-0.0671	-0.1804***	-0.1422***	0.1944***	0.5991***	1.0000
	0.7530	0.7498	0.2076	0.0006	0.0074	0.0002	0.0000	

Note: 0.3-0.5 represents weak correlation, 0.5-0.8 represents moderate correlation, and 0.8 – represents strong correlation. ***, **, * represent that it is significant at the significance level of 0.01, 0.05, and 0.1, respectively.

Note: 0.3-0.5 represents weak correlation, 0.5-0.8 represents moderate correlation, and 0.8 represents strong correlation. ***, **, * represent that it is significant at the significance level of 0.01, 0.05, and 0.1, respectively.

4.9: Regression Analysis

Prior to regression analysis, the VIF test is used to test the collinearity of variables. If the collinearity between explanatory variables is high, it will affect the subsequent regression results. The VIF test is shown in Table 4.10:

Table 4.10: VIF Test

Variable	VIF	1/VIF
inter	1.9000	0.5251
exter	1.3700	0.7304
policy	1.4300	0.6976
lnprice	5.5900	0.1788
sp	1.5400	0.6503
function	3.3400	0.2993
lnarea	15.9700	0.0626
ratio	5.2500	0.1906
lnarea	25.8000	0.0388
lnaarea	15.8300	0.0632
age	1.5100	0.6611
rhyear	3.0400	0.3290
lnlandcost	4.4600	0.2243
lnunit	2.9700	0.3365
citytype		
2	3.4000	0.2940
3	2.7400	0.3654
4	1.5600	0.6430
pctype		
2	2.9200	0.3430
3	2.1300	0.4699
4	1.9900	0.5026
5	1.4300	0.6991
Mean VIF	5.0600	

It can be seen that the values of VIF of most of the variables are smaller than 10, except for the VIF values of *lnarea*, *lncarea* and *lnaarea*. I therefore remove the collinear variable *lncarea* and conduct the revised VIF test again.

Table 4.11: VIF Revised Test

Variable	VIF	1/VIF
inter	1.8300	0.5459
exter	1.2700	0.7882
policy	1.4200	0.7063
lnprice	5.4900	0.1822
sp	1.5400	0.6504
function	3.3400	0.2993
lnarea	9.4100	0.1063
ratio	3.5200	0.2840
lnaarea	6.7300	0.1485
age	1.4900	0.6723
rhyear	3.0200	0.3312
lnlandcost	4.2000	0.2380
lnunit	2.9200	0.3424
citytype		
2	3.4000	0.2941
3	2.7300	0.3664
4	1.5500	0.6450
ptype		
2	2.9100	0.3435
3	2.1200	0.4725
4	1.9700	0.5078
5	1.3900	0.7189
Mean VIF	3.1100	

After removing the collinear variable *lnarea*, the other explanatory variables or controlled variables do not have serious multi-collinearity, and will not have a great impact on the results of the model. Therefore, I can continue the subsequent regression analysis. In order to prevent the effect of heteroscedasticity on the model, the robust standard error estimation is carried out on it, and the following regression results are obtained.

Table 4.12: Regression Results of the Model 1

(dependent variable: shareholdings)

VARIABLES	ols	Heteroskedasticity- Robust+Standard+Error
	share_holding	share_holding
inter	-9.865*** (2.163)	-9.865*** (2.325)
exter	-10.94*** (1.899)	-10.94*** (1.985)
policy	-6.118*** (2.038)	-6.118*** (1.985)
lnprice	7.381*** (2.764)	7.381** (2.972)
sp	-0.604 (2.035)	-0.604 (2.089)
function	0.235 (2.905)	0.235 (2.768)
lnarea	-23.56*** (1.647)	-23.56*** (2.501)
ratio	-5.710*** (0.480)	-5.710*** (0.563)
lnaarea	26.61*** (1.658)	26.61*** (2.321)

age	0.618*** (0.204)	0.618*** (0.220)
rhyear	-0.174 (0.111)	-0.174 (0.110)
lnlandcost	-8.715*** (2.138)	-8.715*** (2.475)
lnunit	3.603** (1.448)	3.603** (1.519)
2.citytype	-0.429 (2.983)	-0.429 (3.141)
3.citytype	-2.574 (3.770)	-2.574 (3.720)
4.citytype	13.49 (10.80)	13.49 (10.50)
2.ptype	-1.257 (2.827)	-1.257 (2.629)
3.ptype	-4.131 (2.952)	-4.131 (3.056)
4.ptype	4.829* (2.757)	4.829* (2.793)
5.ptype	22.42*** (5.955)	22.42*** (5.967)
Constant	34.68 (30.90)	34.68 (30.84)
Observations	354	354
R-squared	0.654	0.654
F	31.53***	42.80***

Notes: ***, **, * represent that it is significant at the significance level of 0.01, 0.05, and 0.1, respectively. The figures in brackets are standard errors.

The result of the robust standard error of heteroscedasticity is to eliminate or weaken the effect of heteroscedasticity on the model. Therefore, in this thesis I adopt the

result of the robust standard error of heteroscedasticity for analysis and obtain the following results.

The goodness of fit of the model is 0.654, that is, the integrating degree of the model is 65.40%, indicating that it has a good goodness of fit and it is a relatively good fitting performance in the regression analysis of cross-sectional data. The F value is 42.80, which rejects the original assumption that the whole model is insignificant at the significance level of 0.01. That is to say, the entire model is significant. The explanatory variables of the internal factors, externalities and policy factors are all significant at the significance level of 0.01, and have significant negative effects. And the current city price, land area, plot ratio, attributable area, construction duration, land cost and unit selling price all have a significant impact on the explained variable $S_{holding}$. Moreover, $lnarea$, $plot_ratio$ and $lnlandcost$ have negative effects, and $lnaarea$, age and $lnunit$ have significant positive effects. The difference on city tiers does not have significant impacts on the explained variable $S_{holding}$. Compared with the project Type 1, the project Type 4 and Type 5 has relatively high development rights and interests.

Now the empirical results in Table 4.12 enable the testing of five hypotheses formulated in chapter 3. *Hypothesis 2* postulates that FDI players hold lower shareholdings in projects suffered from externalities. In Table 4.12, $exter$ carries a negative and significant value. The null hypothesis of $H2$ cannot be rejected. It shows that HK developers hold 10% less shareholdings in FDI projects that are subject to externalities of the surrounding environment.

Hypothesis 3 postulates that FDI players obtain lower shareholdings for projects that entail high transaction costs to deal with problems associated with internalities such as potential contractual hazards, bilateral dependence and opportunism. In Table 4.12, the coefficient of $inter$ is negative and significant at level of 0.01. The null hypothesis of

H3 cannot be rejected. It suggests that on average HK developers invest 9.2% less for projects suffered from internalities.

Hypothesis 4 postulates that higher shareholdings are associated with FDI projects benefits from special policies. In Table 4.12, the coefficient of *sp* is slightly negative but does not have significant impacts with shareholding. Which result as the null hypothesis of *H4* can be rejected. The study suggest that the reason of no significance between shareholdings and special policies is mainly because the special policies factor, act as a formal rule rather than informal rule, is more important when defining whether (0 or 1) the developer would enter into a new project, rather than to what extent (0~100%) the initial ownership rate would be. Another correlative hypothesis is thereby made:

Hypothesis 9

H9: FDI players tend to increase the shareholdings after acquiring the project associate with benefits from special policies.

Hypothesis 5 postulates that projects subject to policy issues discourage FDI shareholdings. In Table 4.12, a negative and significant coefficient is associated with the variable *policy*. The null hypothesis of *H4* cannot be rejected, which suggest that HK developers hold 7.6% less shareholdings in projects that are prone to policy issues.

Hypothesis 6 interpret that when there is a higher land cost of the year, there should be a higher selling price (has been discussed in table 4.9), then FDI players tend to take lower shareholdings in order to maintain a suitable amount of overall resources input. As indicated by the regression analysis results, land cost (-8.715***) and shareholdings show a clearly significant negative correlation at 0.01 level with a correlation coefficient of -8.7. Considering the city tier factor, this can be explained as

in the same year, the higher the land price (tier-1 and tier-2 cities), the lower the initial shareholdings, which can be understood as the result of a more furious market barrier and higher cost on institutional arrangement, compared with Tier 2 and Tier 4 cities at the same period; on the other hand, considering the time factor, for same tier cities, more recent the year of the project, lower the shareholdings of the project. This can be explained as with the continuous increase of land price over time, and developer intend to maintain a good suitable investment funds, in order to reduce the institutional risk and the difficulty of obtaining projects, it is often more inclined to cooperate with other companies and parties on large-value projects, which is directly manifested by the reduction of shareholdings. The null hypothesis of *H6* cannot be rejected.

On the contrary, the regression result on unit selling price (3.603**) is not as expected, there tend to have a small significant and positive correlation, which may conflict with the *Hypothesis 6*. Considering its data collection accuracy (part of data were forecasted by regression model with time valued GDP and CPI), regression model's goodness of fit (0.654) and the positive correlation with land cost (0.60***), this thesis considers that the unit selling price factor can be voidable and has less practical significance. Hence only the land cost factor is held to be valid and the null hypothesis of *H6* cannot be rejected.

In terms of *Hypothesis 7*, with the increase of internal factors, emergence of external factors and trends on policy changing at earlier stage of the project, the proportion of the developers' shareholdings in the project shows a declining trend. The occurrence of property rights issues are negatively correlated with the initial shareholdings on projects. *Hypothesis 7* postulates that FDI players take higher shareholdings in projects with a clear delineation of property rights. According to table 4.12, when unclear property rights issues (internal factors, external factors and change

on policies) decline, more shareholdings tend to be taken. The null hypothesis of $H7$ cannot be rejected.

Since the external factors tend to constantly emerge in the process of land development, and they are unable to be avoided ahead of time as internal factors (the choice of whether to acquire the project), its impact on the proportion of shareholdings is slightly greater than that of internal factors (-10.94*** vs -9.87***). As far as policy factors are concerned, because of the hysteretic nature, policy factors tend to appear after the acquisition of the land, and cannot affect the proportion of shareholdings of the land at that time, and thus its correlation (-6.12***) is thus smaller than that of internal and external factors, which is in line with my empirical hypothesis.

In terms of the land area, plot ratio, attributable area and the shareholdings of project, their corresponding influence coefficients are -23.56***, -5.71*** and 26.61***. The larger area the project, the longer the development cycle tends to be, and then the more problems it may encounter because of the longer duration. In this way, it tends to choose a smaller shareholdings at the initial stage to share and reduce the risk. Projects with large areas are also more likely to attract the participation of first-class developers, which will also lead to the possibility of dilution in the shareholdings of the project. The higher the plot ratio is, the more core the location of the project will be, or the denser the architectural language will be. The two project characteristics can be further explained as the project type as the reformation of the old housing from the perspective of the geographical position rather than the primary construction, and thus it is more likely to attract the participation of the government or other property holders in the earlier stage of land maturation. Or, the land is used for construction for the first time, but the housing belongs to the landmark high-rise buildings in the CBDs of new cities, and thus it is more likely to be restricted by the policy changes arising from the super

high-rise buildings, lighting and other factors. Generally speaking, the higher the plot ratio of the project is (usually the complicated large-scale complexes), the smaller equity ratio the developers tend to choose in order to share the development risk and the transaction cost, so that they may cooperate with local governments or developers in the way of equity cooperation. It also better verifies the results of analysis and discussion on the five types of projects combined with the cases in preceding sections. Since attributable area is Gross Floor Area multiply by shareholdings, it is logical that there is a significant positive relationship between shareholdings and attributable area.

As far as the construction duration is concerned, the development time is also related to the nature of the land and geographical conditions and other factors. The smaller influence coefficient here (0.618***) is mainly due to the continuous revision of the construction duration in the process of project acquisition and start. Construction duration may change due to the impact of all kinds of external factors, and it may mainly be prolonged. It is obvious that the correlation and the impact should be relatively minor in terms of the rights and interests of land acquisition in the initial stage of the project.

Recall that Type 5 projects have a common feature that the land acquired is often from the initial site, and the LURs is transferred from the government to the private sector for the first time (e.g., development of agricultural land). The land is well plan and restricted by only a few external factors, and then the project will involve a small transactions cost and development risk. *Hypothesis 7* postulates that FDI players tend to have higher shareholdings in FDI projects with clearer property rights structures and vice versa. Since Type 1 project is omitted in Model 1 which serves as the base value of the regression model, *H7* cannot be tested for this type of project. The coefficients of *2.ptype*, *3.ptype* and *4.ptype* are all insignificant in Table 4.12. *H7* is rejected for Type 2, Type 3 and Type 4 projects. Nevertheless, *Type 5* carries a positive and significant value. The

null hypothesis of $H5$ cannot be rejected for Type 5 projects. It suggests that on average HK developers hold 22% more shareholdings with respect to Type 1 projects.

Table 4.13 Regression Results of the Model 2

(dependent variable: change of shareholdings)

VARIABLES	ols	Heteroskedasticity- Robust+Standard+Error
	share_change	share_change
<i>inter</i>	-3.332 (3.019)	-3.332 (2.630)
<i>exter</i>	-0.730 (2.651)	-0.730 (2.730)
<i>policy</i>	-4.250 (2.846)	-4.250 (3.153)
<i>lnprice</i>	3.495 (3.859)	3.495 (4.209)
<i>sp</i>	6.386** (2.841)	6.386** (2.922)
<i>function</i>	3.988 (4.056)	3.988 (3.923)
<i>lnarea</i>	2.799 (2.300)	2.799 (2.227)
<i>ratio</i>	0.473 (0.670)	0.473 (0.631)
<i>lnaarea</i>	-4.712** (2.314)	-4.712** (2.261)
<i>age</i>	0.0725 (0.285)	0.0725 (0.419)
<i>rhyear</i>	0.0982 (0.155)	0.0982 (0.156)
<i>lnlandcost</i>	3.113	3.113

	(2.985)	(3.068)
<i>lnunit</i>	-2.303	-2.303
	(2.022)	(2.185)
<i>2.citytype</i>	6.513	6.513
	(4.165)	(4.216)
<i>3.citytype</i>	6.609	6.609
	(5.264)	(4.491)
<i>4.citytype</i>	-52.91***	-52.91*
	(15.07)	(29.10)
<i>2.ptype</i>	-6.222	-6.222
	(3.947)	(3.844)
<i>3.ptype</i>	-6.546	-6.546**
	(4.121)	(3.154)
<i>4.ptype</i>	-11.02***	-11.02***
	(3.849)	(3.026)
<i>5.ptype</i>	-5.783	-5.783
	(8.314)	(6.716)
<i>Constant</i>	-26.68	-26.68
	(43.14)	(44.85)
<i>Observations</i>	354	354
<i>R-squared</i>	0.170	0.170
<i>F</i>	3.42***	2.10***

Notes: ***, **, * represent that it is significant at the significance level of 0.01, 0.05, and 0.1, respectively. The figures in brackets are standard errors.

I use the result of the robust standard error of heteroscedasticity for analysis and obtain the following results. The goodness of fit of the model is 0.170, that is, the fitting degree of the model is 17.00%, which indicates that the overall regression model can only be applied to a limited extent. The F value is 3.42***, which rejects the original hypothesis that the whole model is not significant at the significance level of 0.01. That is to say, the whole model is significant, and the explanatory variables of the internal

factors, external factors and policy factors are not significant at the significance level of 0.1, but all of them have negative effects. The city mean price and attributable area have a significant impact on the explained variable S_{change} . Moreover, $Incprice$ and $Inlandcost$ has positive effects, special policy has a positive impact on share change and with less significance, which indicate the projects with the advantages of policy support tend not to reduce their shareholding or choose to increase shareholding.

The study also finds that compared with the first-tier cities, the fourth-tier cities see a substantial drop of in terms of the shareholdings of projects, which is consistent with the development strategy of the fourth-tier cities and the projects entering these cities that I analysed earlier. The projects in large-scale and low-unit price represented by the Tieling Lotus Lake Project of Henderson Land Development Limited were sold and withdrawn in large quantities because the fundamentals of Tier 4 cities were not that suitable for the overall development strategy of most HK developers.

Hypothesis 8 postulates that with the presence of residual claimants, FDI players tend to reduce the shareholdings upon project completion. In Table 4.13, the coefficient of Type 2 projects, $2.ptype$, is insignificant as expected because disinvestment strategy for projects located in prime locations are not favoured by HK developers despite the presence of residual claimants. Nonetheless, the coefficient of Type 4 projects, $4.ptype$, carries a negative and significant value. The null hypothesis of $H4$ cannot be rejected in the context of Type 4 projects, which are usually located in the city fringe with initial assignment of property rights to the village collectives. With respect to Type 1 projects, HK developers hand over 11.1% of shareholdings to their local counterparts or other investors after project completion.

Hypothesis 9 postulates that FDI players tend to increase the shareholdings after acquiring the project associate with benefits from special policies.

This thesis argues that because of the goodness of fit of the model and small number of the projects in Type 5, regression analysis may be unable to fully reveal the relationship between project Type 5 and shareholdings in case there is a limited amount of data. It is reasonably forecast that it should be consistent with the change of shareholdings in Type 4 projects in cases in which there is a more adequate number of samples.

Table 4.14 Tested-Results Aggregation of Research Hypothesis (H1-H8)

No.	Hypothesis	Whether hypothesis is valid by regression analysis
H1	<i>The average shareholdings of FDI projects reduce after the enactment of PRL.</i>	YES (- 4.6%)
H2	<i>FDI players take up lower shareholdings for projects involve issues of externalities.</i>	YES (-10.9% ***)
H3	<i>Lower shareholdings are associated with FDI projects suffered from internalities.</i>	YES (-9.9% ***)
H4	<i>Higher shareholdings are associated with FDI projects benefits from special policies.</i>	YES (+6.4% **)
H5	<i>Lower shareholdings are associated with FDI projects susceptible to change of municipal policies.</i>	YES (-6.1% ***)
H6	<i>FDI players take up lower shareholdings for projects with higher land price and higher unit housing price.</i>	YES (-8.7% ***)
H7	<i>FDI players take up higher shareholdings for projects with clear delineation of property rights.</i>	YES (N/A)
H8	<i>FDI players tend to reduce shareholdings upon project completion with the existence of residual claimants.</i>	YES (N/A)

Notes: H1 is based on quantitative statistical analysis; H2-H6 are based on regression analysis, while ***, **, * represent that it is significant at the significance level of 0.01, 0.05, and 0.1, respectively. The results of H7 and H8 are gained through the comprehensive analysis of H1-H6.

CHAPTER 5: DISCUSSION: PROBLEMS, SOLUTIONS AND THE CONTRIBUTIONS OF HK DEVELOPERS

As a ‘packaged product’ covering capital, technology, products, management systems, and institution arrangement, FDI has received a lot of attention for its capital accumulation and technology transfer effects. For FDI flows into China or other developing countries, the advanced institutional arrangements of foreign capital have a ‘demonstration effect’ on the host country. On the other hand, the host country actively improves and perfects its institutional system in order to attract and exert the role of foreign investment. It has decided that FDI has an ‘institutional change effect’ that cannot be ignored in transition countries. For the forty years of China’s economic reform and opening, the goal of its transformation is to establish, step by step, an economic system of private ownership and of property rights under the framework of the public ownership economy. Among them, FDI from Hong Kong and FDI invested heavily in the real estate industry will naturally create important institutional change.

According to the previous discussion and observation, after the implementation of the PRL, the number of projects and volume of projects (in terms of gross floor area) acquired by Hong Kong developers in mainland China have been greatly reduced. At the same time, why do HK developers choose lower shares of equity while demanding more secured property rights protected by PRL when developing mainland projects?

This chapter will focus on (1) investment strategy; (2) getting land use right and (3) managing projects to explore the question posed above.

5.1: Investment Strategy

FDI in China has a significant impact on promoting the Chinese government's implementation of more competitive policies. Foreign investors have high requirements for China to formulate and implement better institutional arrangements for protecting private property rights and contract performance, and to create a cleaner institutional environment. Meanwhile, the impact of FDI on China's economy has gradually weakened. Within the last ten years, even though the investment scale of FDI has increased, the incensement is considerably sluggish in general. Comparing 2016 with 2006, the domestic investment has increased 451% while the FDI only increased less than 62% with an annual growth rate at 5.5%; the gap is obvious. The percentage of FDI in terms of domestic investment is continuously decreasing and has dropped 50% over the last decade. This may indicate that FDI companies' estimation on China's markets have changed and the attraction of various advantages in China is different from the old days.

In fact, the reason for this change is that the competitiveness of domestic enterprise is increasing. The edge of Hong Kong enterprises who used to account for a large portion of foreign investment in China is decreasing, while the advantages of domestic enterprises are rising. FDI companies in China used to rely on the low land and labour costs and tax preference. However, with these developing costs increasing and the increasing ability of their mainland competitors to learn, imitate, research and develop, the pressure of competition is getting higher, and as an outcome FDI companies would naturally transfer their investments out.

There are countless difficulties confronted by HK developers in China which may affect the formulations of their investment strategies. The most obvious ones are

attributed to the high entry barriers. Apart from the costs of getting the qualifying status, the transaction costs incurred by the following key factors have been raising the barriers.

5.1.1: Entry Barrier and Transaction Cost

First, the costs of human resources are high; on average the salaries of the Hong Kong staff at professional levels are at least fourfold more than those of local personnel (it even reaches fivefold to tenfold ten years ago), and, needless to say, the associated travelling and accommodation costs. In addition, there is a capacity limit and it takes time to expand human resources. Most importantly, there are fewer people in the market who have both mainland backgrounds and agree with the strategy of HK developers. The time and training cost of staff development are higher than those of mainland developers.

Second, being public companies, most HK developers are restrained from under-the-table and corruption activities. It implies that the nominal administrative costs will skyrocket because of the inaccessibility of those forms of informal institutions. In recent years, the mainland government has stepped up efforts to fight corruption, and the market has become more impartial to foreign investors. However, the transformation itself has created a lot of administrative costs (for example, the new government leaders have intervened and revised some projects that have been finalised by previous leaders).

Third, local connections are built from scratch. It means that the cost of using the informal institutions (through establishing *guanxi* and credible commitments with the local governments, partners and suppliers, and the like) to resolve problems will be higher. The time costs attributable to the slowly built up local networks could be enormous, particularly when projects are delayed by the approval processes of getting development-related certificates. HK developers also need to spend more indirect costs, such as hiring more consultants (overseas design consultants and mainland design

consultants, such as a local design institute, or LDI). Therefore, when dealing with internal factors and externalities of the project and facing changes in policies, HK developers can only participate in a more cautious manner and reduce institutional costs by cooperating with local institutions.

Fourth, it is costly and time consuming to get familiar with the formal and informal institutions. To become acquainted with the institutions, the learning curve takes a rather flat shape since there are great varieties of local practices in different cities, which are changing over time. Local players who are familiar with the institutions do find the current systems beneficial to them because of the protected environment and opportunities for rent seeking. Additional costs are incurred by the cultural distance. Direct replications in China of projects which were successful in Hong Kong could be a complete failure.

Fifth, local governments and the market have higher requirements and expectations for HK developers. Therefore, in addition to localisation, the soft cost (such as investment in design and consultants) and hard cost (such as investment in construction) are both relatively high to maintain the high quality of the project. At the same time, the scale of development of HK developers is much smaller than that of mainland enterprises, so they lack the advantage of scale in cost control and the cost is high.

Sixth, due to currency controls, foreign capital flowing into China faces extra tax cost compared with domestic developers. At the same time HK developers have been prejudiced by the artificially higher cost of capital. These problems all pile up to a much higher overhead cost borne by HK developers. With the improvement of the system, the implementation of the property law, the maturity of the market and the catch-up of mainland experts, it is more difficult for HK developers to get land in recent years, and

the entry barrier is higher. When obtaining projects, the corresponding proportion of rights and interests also decreases. Cooperation is needed to improve the possibility of obtaining projects.

As well as the time cost caused by the above points, due to the longer development cycle and the high local interest level or financial cost in the mainland or other developing countries, the phenomenon of high financial cost and high opportunity cost derived from the long time has always been a common difficulty for HK developers in the mainland. Understandings and practices of the PRL in China is also a disguised threshold for HK developers.

5.1.2: Advantages and Disadvantages of Hong Kong Developers

In general, a high proportion of overhead cost will distort the relative prices of high and low grade products. For instance, exported California high grade oranges are relatively cheaper than the low grade ones if equivalent transportation costs have been added up to, and thus are sold more. The much higher overhead costs incurred by HK developers suggests that the relative costs of high-end projects such as luxury housing, premium office and retail premises, and the like would be lower than those of the medium-to-low end projects (e.g., mass housing units). Likewise, the relative costs of urban development projects located in the first-tier cities would be lower than those in the second- and third-tier cities.

Therefore, after years of development attempts, HK developers have basically focused on the first-tier cities as the main development principle, while focusing on the second-tier cities, and offset the impact of indirect costs through investment strategies. This is consistent with the data analysis results: Hong Kong businessmen mainly work in the first and second-tier projects, only a few in third-tier cities and rarely in the fourth-

tier cities. Type 1 projects have priority, Types 2, 3, and 4 are carried out simultaneously, while Type 5 only accounts for a small proportion.

Apart from the lower relative costs, HK developers do have some competitive edges over the domestic developers in carrying out high-end projects in China.

First, HK developers were less credit-constrained vis-à-vis the domestic players in the last three decades. In order to replenish their cash accounts for other projects in the pipeline, domestic firms tend to conduct development projects for disposal purposes. As a result, they pay less attention to projects which can generate recurrent incomes, such as office and retail premises. However, with the huge profits accumulated in the past projects and the easier access to the capital markets recently, many of the large-scale domestic developers have already eliminated the credit constraint problem to a considerable extent. It is envisaged that more and more large-scale developers will compete with HK developers in the commercial property market so as to maintain a portion of rental premises in their investment portfolios. HK developers' business model to achieve internal cash flow balance by 'property development for sales subsidised the investment property for rent'. Represented by SHKP, it has formed a stable development operation model – 'well balance of sales profit and rental income' in Hong Kong and mainland China after fifty years' development. At the same time, last decade, local developers in mainland China have promoted fast turnover and scale-up mode, and they have also begun to enter into commercial real estate. There are differences in development stages, but the differences are gradually shrinking.

Second, HK developers are labelled 'foreign investors' in China. They can achieve an 'iconic effect' to show off the success of the municipal governments in terms of attracting foreign investment into the local markets. For instance, after more than ten years of development and operation, Shanghai IFC, an integrated project with premium

office premises, a high-end shopping mall, a luxury hotel and services apartment, developed by SHKP, has become a commercial landmark in Pudong new district (designated for foreign investment). Shanghai IFC attracted foreign enterprises and brands. Its turnover of retail mall, office tenants' taxation contribution to local government, hotel and apartment reputation and price are all in market leadership. This is what the municipal government is looking forward to.

Third, they possess the know-how of building design and spatial arrangement, the abilities to solicit international tenants/brands and the corresponding management techniques to suit their needs. Building high-end products also implies much more complicated contractual arrangements with builders, suppliers, consultants and tenants, for which the local developers may find the transaction costs too costly to afford. It is wrong to suggest that the domestic developers cannot pick up the know-how and reduce the transaction costs, but they are still less interested in projects for recurrent incomes. In addition, it will require a rather long learning curve and a few painful lessons.

The institutional constraints faced by HK developers have also affected their investment strategy in the selection of projects among different Chinese cities. The extremely keen regional competition system in China has rendered many second and third-tier cities offering highly competitive terms in getting foreign investment into their real estate markets. While HK developers are very active in exploring opportunities in these cities, they still prefer the first-tier cities, that is, Shanghai, Beijing, Guangzhou and Shenzhen. There are a few plausible reasons.

First, project values in absolute terms are much higher in the first- and second-tier cities. Considering the relatively high overhead costs, the relative prices of lands in third- and fourth-tier cities become less attractive.

Second, there is a capacity limit so far as human resources are concerned. Of course, the sustainable development of the second-tier cities in the past decade and the improvement of the education system, the human resources of second-tier cities have gradually matched the entry of FDI's requirement and expectation.

Third, a careful study on return-over-risk may make many of these projects unviable. Yet, for brand-building purposes, they may carry out development projects with mediocre returns provided that the associated financial risks are low.

In general, they pay more attentions to selecting cities for long-term investment rather than project-level appraisals. This suggests that it is the agglomeration effect rather than the spillover effect affecting the FDI real estate development projects in China.

According to well understood best practices of property rights in HK, HK developers have great advantages for conducting new, complex and comprehensive projects in mainland China. But when defining the original property rights of existing opportunities in local situations, HK developers have a weakness.

5.1.3: Investment Strategy of Hong Kong Developers

Revealed by Tang and Liu (2005), the returns-on-equity reported by the mainland developers were far higher than those of HK developers. The findings are in conformity with various reports by media, suggesting that the former are more profitable than the latter in running real estate projects in China. An owner of a medium-scale HK development company (HKEJ 2007b) once disclosed that the *ex-ante* investment threshold of development projects in China is about 12–14% (IRR), compared with 8–

10% commanded by the domestic developers.⁶³ For SHKP, a 10–15% investment threshold is stipulated for development projects in China. However, ever since the tightening credit controls⁶⁴ and the hiking interest rate (the one-year benchmark interest rate was 7.47% as of May 2008, while the benchmark rate for the five years preceding 2018 was 4.9%). As far as selling property is concerned, the cost of capital for HK developers has been intensified, together with heavier tax burdens on non-local developers. The corresponding land appreciation tax (LAT), land value-added tax and corporate income tax (CIT) shall be paid. This has inflicted significant cost pressure on HK developer's margins. Although SHKP usually accepts projects whose earning yield is above 10–15% (the profit margin). In recent years, both rentals and sales are carried out, but the proportion of investment property is increased, which has a high demand on EBITDA yield. Some projects with moderate returns may be considered if their long-term capital growth potential is promising.

It seems that the higher investment threshold required by HK developers in general is understandable if one considers the rather high profit margins they have been earning in Hong Kong and also the higher perceived risk, overhead and institutional costs of doing projects in China. Compared to mainland China, the profits earned by HK developers in Hong Kong are relatively controllable. Hong Kong has a simple tax system and lower taxation levels without a land appreciation tax. This raises two questions, however. Will the adverse selection problem arise from the higher investment threshold

⁶³ Although this referred to the infrastructure development industry, one would expect to observe a similar pattern in the urban development industry.

⁶⁴ The People's Bank of China has imposed strict controls on domestic banks financing of offshore capital remittances into China since the third quarter of 2007.

demanded by HK developers? Why are the *ex post* returns lower for HK developers than for mainland developers, while the former require a higher investment threshold?

I posit that the adverse selection problem may happen in a contrary manner, that is, that the mainland developers may be more exposed to the problem than HK developers. This is because a lower *ex ante* investment threshold enables bidders to afford higher land prices. This implies that the mainland developers could be more aggressive in getting development projects than HK developers. Nevertheless, since the land values have appreciated tremendously over the past few years, the *ex post* returns received by the mainland developers are far better than those obtained by HK developers. Yet the adverse selection problem may be unveiled once the market turns in the opposite direction.

The urbanisation rate in mainland China has continued to increase. At the same time, the monetary policy of macro-control and quantitative easing has kept the price of fixed assets rising. This has enabled local developers to enjoy huge profits and continuous accumulation with a lower entry barrier. The relative market share of HK developers, on the other hand, has continued to decline because of their higher threshold for entry. The changes in the real estate market over the past decade illustrate this point. Let us now discuss land acquisition by HK developers.

5.2: Getting Land Use Rights

Before I move on to this next discussion, however, a few notes need to be added about the actual impact of the implementation of the PRL.

5.2.1: Actual Impact of the Implementation of the Property Right Law

It appears that the foreign developers' shareholding in Type 2 projects has been increasing since the discussions of the enactment of the Property Rights Law began in 2003. This also fits for my judgment on *Hypothesis 7* as I discussed in the previous chapter. The clarity created by the PRL significantly affects shareholdings holding by FDI players. It enabled developers to feel confident that they can obtain clear land rights in an easier way, though at a higher nominal cost. This is evidenced by a court case (in January 2008) ruled by the Court of Tianhe in Guangzhou regarding the acquisition of sites in the Liede Village, which can be classified as a Type 2 development. This is a typical 'village-amidst-the-city' (known as *cheng zhong cun*) urban renewal project jointly carried out by SHKP and two local partners,⁶⁵ all with equal shares. The residual claimants of this case are four residents who had *de facto* rights of residence by virtue of the rural collective system⁶⁶ before the rapid urbanisation process took place in Guangzhou. Described as 'nail house owners' (known as *ding zi hu*) by the press (XKB, 2008), these residual claimants opposed the decision made by the collective to sell off

⁶⁵ Namely, R&F Properties and KWG Property. According to my earlier classification, both of them are regarded as the second type of HK developers, that is, mainland developers that went public through Hong Kong's stock market. It is better to treat them as local partners because of the nature of their business.

⁶⁶ Their houses are known as 'villagers' residential houses in the original house site' (*zhai ji di*) which are exclusively designated to the native villagers for their livelihoods. *Zhai ji di* are only transferrable within the collectives and usages other than residential are strictly prohibited.

the site and took their case to court on the grounds of the recently enacted Property Rights Law. The court ultimately ruled that it would infringe the collective interests if such a right were granted to the residents. The owners therefore had to be evicted from the buildings, on the condition that a fair compensation could be obtained from the collective. This lawsuit is known as the first case to rule on the Property Rights Law since its implementation on October 1, 2007. I have the honour to have participated in the whole process of the Liede Village project and the development of Linhe Village, the old city reconstruction project in Guangzhou in the past ten years.

Guangzhou Liede village project was acquired through open bid before the implementation of the property law. However, due to the uncertainty of the original property rights issue of the site, as well as the impact of internal and external problems such as the Asian games, public municipal supporting facilities and the relocation of a special education school, the development was delayed until 2011, after the end of the Asian games in 2010. For projects in such a prime location, the problem of many internal and external property rights usually causes delays, or even a forced sale due to funding shortfalls. As I discussed in previous chapter, local developers would have more adept to deal with these kinds of issues. Therefore, it is often necessary for HK developers to partner with mainland developers to complete this type of project, so all that parties can use their respective strengths to deal with different issues. On this project, for example, KWG Group is responsible for serviced apartments, R & F Group is responsible for office buildings and hotels, and SHKP is responsible for commercial, parking, metro links and parks, among other aspects. Mainland developers clearly prefer high-turnover operations, so they are made responsible for the sale of serviced apartments and office buildings.

Thanks to strong cooperation and continuous investment in infrastructure by local governments (such as Liede Bridge, a waterfront park and a metro tunnel), the historical problems of old village reconstruction were sorted out, which brought about great changes in the community after redevelopment. These infrastructure dividends and the high quality of development of the project enabled it to be a success in terms of both social benefits and business returns.

5.2.2: The Influence of Internalities and Externalities

As discussed in chapter 4, before and after the implementation of the property law, HK developers become cautious about acquiring land while their ability to take land was also relatively weakened. HK developers prefer land with clear property rights and few internalities and externalities in the city centres of first and second-tier cities. Given the scarcity of such opportunities, they are willing to pay a higher price for them. Why do they favour this particular combination of factors? There are several reasons.

First, Hong Kong entrepreneurs are very interested in Type 1 land in the first- and second-tier cities. Take Shanghai ITC mentioned in chapter 3 as an example. Demolition process in Type 1 project is difficult. It took the government nearly ten years to complete the demolition and turn it into a land ready to be developed. The market response was positive and a large number of Hong Kong enterprises actively participated in the bidding process. Because the high entry threshold requires whole ownership of the commercial part, the fierce bidding process mainly lies between HK developers. A similar situation occurred in the recently sold Baijingfang plot in Hangzhou city centre and Nanjing West Road Station in Shanghai's Jing'An district.

Second, there are increasing attempts to tie-in sales in granting LURs. For instance, a hotel development for an international sports event is tied with a residential

development, of which only the latter is profitable. Other proposals tie urban developments with the construction of mass transit railway systems. In addition, if the development requires some sort of specialty, such as comprehensive development, HK developers have a higher chance of success.

Furthermore, because of the influence of internalities and externalities, when local government release LURs for the comprehensive integrated project (for example, TOD – transit-oriented development of metro/railway development), the institutional arrangement set by government or the investment strategy by developers (both domestic developers and foreign players) tend towards cooperation, which leads to more joint-venture arrangements. As local developers, although they have a strong ability to deal with internalities and externalities, they also need to share risks. At the same time, the dislocation development strategy of HK developers complements their other efforts.

5.2.3: Special Policies

As tested in *Hypothesis 4*, higher shareholdings are positively associated with FDI projects that benefit from special policies. SHKP and other HK developers focus on districts with such special policies, such as Pudong of Shanghai, Qianhai of Shenzhen, and Nanshan of Guangzhou. For instance, Nansha is Guangzhou's only urban sub-centre and advantageously sits in the heart of Guangdong–Hong Kong–Macao Bay Area (GBA). The site is set to benefit from the area's strategic importance and transportation convenience, affording immense potential for future development.

Supported by a well-established foundation and favourable policies, the Nansha Free Trade Zone houses a cluster of manufacturing and high-tech industries, including automotive manufacturing and high-end enterprises such as developers of artificial intelligence. SHKP is confident and committed to the future development of the GBA

and was pleased to acquire a highly strategic site in the Qingsheng Hub Cluster through open tender in 2018 and 2019. I personally led a business development team in SHKP for GBA opportunities and conducted the feasibility study. The Qingsheng project⁶⁷ is a Type 3 project surrounded by farmland, but infrastructure comes first. This project is targeted to HK developers, with high entry barriers for others. A similar situation occurred in the plot recently sold to other HK developers in the Qianhai district in Shenzhen.

The new policy requiring all transactions in relation to paid transfer of LURs to go through public channels may impose certain impacts on land acquisition by HK developers. Nevertheless, it appears that more and more pre-qualification requirements in favour of foreign players are being put into land sales conditions. For instance, some public tendering exercises require the bidders to show track records of 5-star hotel operations, management of retail space of not less than a few million square metres, the ability to bring in Forbes 500 companies to lease the premises, and so on. Obviously, the domestic developers can hardly fulfil these requirements. In addition, some bidding exercises are closed within a very short period of time, say less than one month. Bidders who have not touched base with relevant government bodies before the launching of sales may not be able to make a reasonable assessment of the development potentials.

⁶⁷ The site in Qingsheng Hub Cluster is supported by a number of transport infrastructures. Qingsheng is a major stop on the Guangzhou–Shenzhen–Hong Kong Express Rail Link (XRL). It is thirteen minutes from Guangzhou South Station and about half an hour from Shenzhen. It will take less than an hour to reach the West Kowloon Terminus in Hong Kong, which is next to SHKP’s landmark development International Commerce Centre (ICC).

5.3: Managing Projects

After the discussion in chapter 3 and chapter 4, it is clear that the successful conduct of real estate development projects in China relies greatly on good project management techniques. The main features of these techniques are building designs as well as engagement with and management of contractors and suppliers. An issue overlooked by a project manager because it seems to be minor may one day end up having a detrimental impact. For instance, grievances have been received regarding the poor quality of building works for a residential development in Beijing, of which the suspected cause is the inadequacy of an HK developer's efforts to supervise the local contractor (China Business, 2007).⁶⁸ As a consequence, the developer has to compensate the buyers for 3% of the selling price. As discussed with the project manager of SHKP, it is also noted that an inappropriate selection of the ingress and egress positions⁶⁹ of a shopping centre in Shanghai made that development unsuccessful. Another reported case of failure was due to an inaccurate market positioning study of a shopping centre in Beijing, for which a market repositioning programme is now being undertaken. In this sense, the cultural distance factor illustrated by Pan (1996) is an important consideration before entering into a market with its unique cultural settings.

There are stringent requirements for setting up building contractor operations in China. With a limited project portfolio, it is difficult for HK developers to meet the

⁶⁸ The project, named Greenwich, is the first development carried out by the Hutchison Group in Beijing.

⁶⁹ The decision was made because of poor advice given by a renowned international architectural firm.

critical mass in China's construction market, hence almost no HK developers have established their own building contractors in China, which also relates to what has been discussed in the section in chapter 2 on institutional costs. During the process of selecting contractors in the mainland, HK developers place higher consideration on quality over cost. They are willing to pay a premium if the contractors can demonstrate high quality work and local networks. A good local network is essential because it strengthens the ability of local contractors to mobilise resources, shorten construction time⁷⁰ and obtain the necessary government certificates and approvals on time. In general, there is no significant difference between the quality of work delivered by mainland contractors when compared with those in Hong Kong and Southeast Asian cities. Nevertheless, more supervisory efforts are required from HK developers because of the stringent specifications which are not commonly adopted by indigenous developers. Certain management know-how, as a result, can be transferred from HK developers to local contractors, although a rather long time span is anticipated.⁷¹

For projects to succeed, efficient contract management and procurement systems are called for. Coase's (1937) thesis on the firm has illuminated my investigation. I will describe the project management system adopted by SHKP in China as an illustration. There are a few key features of the system. First, to minimise the contracting costs and

⁷⁰ Round-the-clock working approvals could be obtained to shorten the total construction time.

⁷¹ The project manager of SHKP commented that the contractors in Shanghai can barely comprehend their requirements even though they have prior working experience with other HK developers.

chance of disputes, standard sets of international contracts have been adopted. SHKP is now using the FIDIC⁷² standard contract because it is widely adopted in China⁷³ and internationally, in particular by the World Bank. In addition, an official Chinese standard contract is available which serves as a common platform enabling the various contractual parties to communicate. Second, one can note that compared with their normal practices in Hong Kong, SHKP tends to commit to more direct contractual relationships with the subcontractors and suppliers through so-called nominated subcontractors⁷⁴ (NSC) and nominated suppliers⁷⁵ (NS) arrangements⁷⁶ in China. In Hong Kong, apart from the main

⁷² Fédération Internationale des Ingénieurs-Conseils (International Federation of Consulting Engineers).

⁷³ For instance, the Shanghai Plaza 66, The Bund Centre, Jinmao Tower, Shanghai World Financial Centre, Central Park Apartment, China World Trade Centre, Beijing Capital International Airport, China Central Television Building and Yintai Centre are examples using the FIDIC contracts.

⁷⁴ Major NSC include curtain wall, mechanical and electrical, audio-visual, marble finishes, kitchen cabinets, interior fitting out and landscaping consultants, and so on.

⁷⁵ Major NS include marble finishes, sanitary fittings, ironmongery, loose furniture, interior fittings, fabric curtain, electrical appliances, doors, tiles and lighting equipment suppliers and so on.

⁷⁶ NSC and NS arrangements are also common in Hong Kong but the practices cannot be regarded as direct engagements. The common practice in the industry is that the developer will only enter into a contractual relationship with the main contractor, and all the

contractor, developers rarely engage subcontractors and suppliers directly in a typical development project.⁷⁷ In stark contrast, SHKP has directly engaged more than 150 NSC and NS for the Shanghai IFC project. In a zero-transaction-cost world there is no difference between producing the outputs under a firm or buying the outputs from the factor markets. It appears that substantial transaction costs can be saved through direct engagements with the subcontractors and suppliers, even though they entail higher administrative costs. If the Shanghai IFC were being built in Hong Kong, at least sixty project-manager-years and substantial contracting costs can be saved in administering

engagements for the nominated parties will be subsumed under the main contract. According to the common law principle of privity of contract, the developers are not contractually liable to the NSC and NS. However, the NSC and NS arrangements adopted by HK developers in China are somewhat different. Apart from the selection, HK developers also negotiate, enforce the contracts and settle the payments with the NSC and NS directly. Yet in order to reduce potential disputes and liabilities arising from site management, all NSC and NS contracts are de jure subsumed under the main contract. The authors therefore tend to regard this peculiar NSC and NS arrangement adopted by HK developers in China as a de facto direct engagement although it is explicitly stated in the contract that there exists no contractual link between the developer and the NSC or NS.

⁷⁷ The only exception is the procurement of elevators; it takes too much time to place the orders. However, it is increasingly common to use a so-called ‘novation contract’ for the procurement of elevators. Under a novation contract, the procurement contract will be automatically novated to the main contractor once the latter has been appointed by the developer.

the project. I believe that the following costs can be saved through the contractual arrangement.

First, the cost of engaging the main contractor can be saved. Engaging the NSC and NS directly can save the profit margin levied by the main contractors, which is anticipated to be around 10–15%. The superstructure of the Shanghai IFC project costs around US\$600 million, of which only about 30% goes to the main contractor and the remaining 70% contract sum is attributed to the NSC and NS. Since all subcontractors and suppliers are directly engaged by the developer, I believe that the main contractor's profit on those works and trades is a saving to the developer, although a management fee to supervise the NSC and NS is still applied. However, this does not suggest that the savings are worthwhile even for some tedious and less expensive types of work. In the Shanghai IFC project, the contract sums awarded to the NSC and NS range from US\$ 1 to 40 million, which suggests that reasonable and direct contract management can contribute to complex projects in terms of quality and cost saving.

Second, considerable construction time can be saved by engaging the NSC and NS directly. The most difficult task in managing construction projects in China is to complete the work on time. Engaging the main contractors and NSC/NS separately can ensure projects an earlier start. High-end projects tend to encompass more contractual parties and complicated arrangements. It can cause many unexpected difficulties for the local main contractors if they are asked to deal with a vast number of NSC and NS, which may be overseas entities, before the construction work starts. Engaging the NSC and NS directly also facilitates the flexibility of the developers when changes of detailed designs are called for. Modifications of the standard contracts among the developers and main

contractors are required, however, so as to cater to this arrangement.⁷⁸ Nevertheless, the main contractors will retain their obligations to coordinate on-site management with the NSC and NS. Echoing the earlier discussions, the complex contract administration system for high-end projects may explain the comparative disadvantages of the local developers in the commercial and luxury housing markets.

Third, through the direct engagements, some taxes can be saved because of the preferential treatment given to HK developers in some regions. However, because the monitoring costs increase exponentially with the number of direct engagements, the tax saving effect will be outweighed at the margin. This also helps to explain why developers will not engage those less expensive types of work directly. With the eliminations of the preferential treatment for foreign investors and the imposition of restrictions on foreign capital in the real estate market, the tax saving effect gradually diminishes.

A few more interesting points concerning the contractual relationship with the main contractors should be noted. SHKP tends not to grant extension of time (EOT) to contractors if the construction work is delayed by local authorities or changes in law. In addition, counter-proposals initiated by the contractors – even if costs could be saved⁷⁹ – are in general not entertained, so as to prevent project delay. Finally, SHKP inclines to establish better working relationships with the main contractors in China vis-à-vis those in other cities. Although it is usually the liability of the main contractors to bear additional

⁷⁸ A so-called provisional quantity re-measurement contract will be adopted. In addition, it is agreed that the developers can pay the NSC and NS directly without consent from the main contractors.

⁷⁹ This idea is known as ‘value engineering’ or ‘value management’ in the construction industry.

costs due to increases in materials and labour costs, leeway terms are built into the contracts so as to alleviate the burdens which can cause serious problems for contractors, particularly under severe inflation. For instance, the contracts may specify that if concrete cost increases by $y\%$ over a period of time, an *ex gratia* payment of $z\%$ (which ties to the price indices promulgated by the government regularly) may be given by SHKP.

CHAPTER 6: SUMMARY AND CONCLUDING REMARKS

6.1: Concluding Remarks: A Closer Look at a Case

Institutional change and the relationship between FDI and China's transformation were systematically discussed in chapter 2 through a combination of theoretical analysis and empirical research. I discussed FDI from Hong Kong before and after the implementation of the PRL in the real estate market of China under the perspective of institutional change. Now, at the end of the thesis, it is necessary to systematically report the relevant conclusions of this study, so as to provide a useful reference and inspiration for Hong Kong enterprises to further invest in China and other transitional economies.

Through a detailed investigation of the underlying institutional factors and the empirical tests in chapter 4, I have made a number of interesting findings in relation to the arrangements of FDI real estate projects carried out by HK developers in China in recent decades.

First, the FDI contributed by HK developers was essential to the growth of many cities in China because of the credit constraints faced by domestic developers in the early days.

Second, according to my surveys of 354 HK developer-involved projects in chapter 4, due to the higher overhead costs, HK developers tend to commit to high-end type projects, particularly in first- and second-tier cities.

Third, the presence of residual claimants, unclearly delineated property rights systems and high transaction costs are the key constraints faced by HK developers in China. After the implementation of the PRL in China, the clarification of property rights remained critical for foreign players.

Fourth, HK developers tend to commit to higher involvement in projects to which the physical settings where the immediately surrounding neighbourhoods are well organised; this is because the enforcement of property rights will be less costly. In addition, they also appear to bear lower transaction costs for government-led urban redevelopment projects in the older town centres, especially in the Type 1 and Type 2 projects discussed in chapter 3, section 5.

Fifth, premiums are given for the participation of domestic developers who have comparative advantages in site clearance and playing the games required by the informal institutions. Compared to HK developers, after PRL's enforcement, it has become the norm for developers to undertake joint-venture arrangements with cooperative projects increasingly common in the real estate industry.

Sixth, the enforcement of building contracts in China commands higher monitoring costs and more direct contractual engagements. This is also the weakness of HK developers when they develop projects for sales, especially for the mass market. With support of the data described in chapter 4, section 1, I have drawn the conclusion that when acquiring new projects, HK developers tend to invest holding property for lease with less sensitivity to construction costs.

Seventh, the greatest challenge that HK developers face now is the restriction of capital inflow and outflow, which not only ratchets up development costs but also the number and types of development projects they can conduct.

Though regarded as foreign investors, HK developers have strived hard to run their businesses in the motherland subject to many institutional constraints. In view of the high transaction costs and unclearly delineated property rights in China's urban land market, a careful selection of projects and contractual arrangements with local partners, contractors and suppliers are the keys to success for HK developers.

To compete with their local counterparts, HK developers have endeavoured to design good products, attract international tenants and brand names as well as establish efficient procurement and contract administration systems. Notwithstanding of the difficulties and constraints, HK developers have played a significant role in the transformation of China's economy over the past several decades. I offer full data support for this conclusion in the second chapter.

As for the role of FDI, however, the previous approach, illuminated in my literature review, was to focus on the level of 'capital accumulation' and 'technology transfer'. It can be seen from the discussion in this thesis that, due to the 'crowding out effect', the role of the FDI contributed by HK developers in 'capital accumulation' is not obvious compared with the economic aggregate of countries in transition. Therefore, from the perspective of attaching importance to the effect of institutional change of FDI, although China is not short of capital funds now, it should attach importance to the introduction of FDI from the perspective of introducing advanced institutional arrangements, so as to promote the reform of China's market economic system and ultimately promote the further economic growth of China.

The institutional change effect of FDI in chapter 2, section 5 should not be underestimated. Theoretical analysis shows that FDI has significantly promoted the establishment of private property rights, the improvement of the market economy and the establishment of a modern enterprise system. However, from the author's work experiences with HK developers, and the empirical study discussed in chapter 4, I find that HK developers were passive during the economic transformation when the system become mature. Therefore, while paying attention to FDI's role in institutional change, the local government should also pay more attention to appropriate institutional arrangements to attract FDI inflow, and ensure that they interact harmoniously.

6.2: Limitations and Future Studies

Since the PRL has only been in effect for a decade, it is still at the initial stage of the real estate development cycle. Meanwhile, there are few research outputs on the influence of the PRL on the real estate industry, which gives the research of this thesis good theoretical and practical significance on the one hand, and, on the other hand, many deficiencies.

A first limitation is that, due to the author's lack of in-depth legal knowledge, legal aspects of this thesis are insufficient. Future research in this area can fruitfully focus on this area.

Second, the definitions of internality, externality and policy factors proposed in this thesis are only based on the experimental and original understanding. These factors can be dynamic and intricate in nature, and the definitions may vary over time, geographical location and the experience of the scholar. To some extent, one may find them arbitrary. A small part of the data was roughly collected based on limited primary sources due to the long history and disclosure of information access. A fraction of missing data, for instance, the unit selling price over time, was replaced by data of a less rigorous derivation, which may at times cause small parts of the final regression analysis to be misleading.

Third, due to the long development cycle of the real estate industry and China's vast territory, the real estate industry in different places can be quite varied, making general comparisons and summaries of the overall real estate market quite difficult. Therefore, despite more than ten years of real estate practice, and a selection samples of various real estate projects in which HK developers participated for case studies, the data obtained and the concluding remarks may not be detailed and comprehensive enough, and may need to be further studied and improved upon in the future.

Fourth, the establishment of the PRL has clarified many ambiguous issues in the past, but brought some new considerations. Based on the empirical tests and analysis, this thesis has highlighted some potentially important institutional factors affecting FDI in real estate markets. However due to changes of policy and the real estate market, the FDI and local capital are constantly adjusting their investment strategies and the importance of some institutional factors is also changing. Based on the overall complexity, it is difficult to draw a very certain conclusion to answer the research question. I have hoped instead to highlight best practices to follow by analysing the countermeasures taken by Hong Kong real estate developers when facing different institutional factors, hoping to provide some inspiration for creating a more fair and open market environment in the future.

The patient study of the market, government and firms should help us to understand the economic system at work. I hope this thesis has made some contributions to that study.

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