

Challenges of Governing Urban Commons: Evidence from Privatized Housing in China

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Abstract:

The emergence and spread of common-interest housing is widely rationalized as club economics. However, such conceptualization is subject to flaws due to two essential features of common-interest housing which hinder the efficient function of these housing clubs. First, homeownership involves much higher mobility costs than rental housing. Second, common-interest housing necessitates further investment after recruiting members. This paper re-conceptualizes common-interest housing after being sold to individual owners as common-pool resources in urban settings. Privatized housing in China can especially reflect the characteristics of urban commons. The community solution to the problems of urban commons in China is constrained by external factors like legal and political system.

Keywords: *club theory, common-pool resources, urban commons, self-governance, housing privatization*

Introduction:

Since James Buchanan produced his seminal work of “An Economic Theory of Clubs” in 1965, a keen academic interest has been devoted to club theory. Before James Buchanan, Charles Tiebout (1956) offered the well-known “vote-with-the-feet” model to hypothesize a spontaneous process under which the whole population given free mobility was distributed into various jurisdictions with their services-tax package respectively. Then Buchanan (1965, p.1) spelled out “a theory of clubs” to name such way of organizing consumption and cost burden for a finite number of people. He added ‘club goods’ into the ownership-consumption spectrum which had been only composed of private goods on the one polar and pure public goods on the other. A club is defined as “a voluntary group deriving mutual benefit from sharing one or more of the following: production costs, the members’ characteristics, or a good characterized by excludable benefits”(Sandler and Tschirhart, 1980, p.1482). The club theory suggests a possible solution to the provision of certain kinds of public goods featuring excludability. However, a group of people who tend to consume a public good with possibility of exclusion does not necessarily form a club, because costs exist in reality for presenting an exclusion mechanism. Only when the exclusion costs are “reasonable” the exclusion mechanism works (Sandler and Tschirhart, 1997,

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p.338; Webster, 2002, p.399). These “reasonable” costs should be “less than the benefits gained from allocating the shared good within a club arrangement” (Sandler and Tschirhart, 1997, p.338).

Club theory has been applied to many fields including housing. The second half of 20th century witnessed an expansion of common-interest housing developments (CID) in many countries and regions across the world, especially in America, Latin America, Africa and Asia. The development of common-interest housing is regarded as a form of privatization of local government functions with respect to providing public goods and services (McKenzie, 2003, p.203). Club theory is widely employed to account for the rationale of the emergence and spread of common-interest housing with a high percentage being physically gated (Foldvary, 1994; Manzi and Smith-Bowers, p.2005; Wu,2005; Webster and Glasze, 2006). Foldvary (1994, p.55) ascertained the incentive for market to provide housing and common facilities by virtue of the concept of rent “either periodically or in the purchase price or as an admission charge” (Foldvary, 2006, p.36). Chris Webster (2002) took the occurrence of gated communities as an analogy to the emergence of firm as stated by the economist Coase, namely a market solution to the high transaction cost of producing collective-consumed goods. The production process is a natural result of club economics “with or without the help of planning policies” (Webster, 2002, p.409). Manzi and Smith-Bowers (2005) applauded gated communities for their contribution to urban renewal through distinguishing members from non-members in terms of enjoying the benefits, which constitutes the essential merit of clubs.

The conceptualization of common-interest housing as clubs really reflects the truth of housing provision in a certain time period, albeit it is not without flaws. Club economy explains the course of transaction between the developer and individuals during which the former obtains its profit through selling divided parts combining a proportion of common parts while the latter obtain them in lower cost. The mentioned researchers treat the provision of common-interest housing as one-shot game. The fact is that housing and facilities after being constructed are also resources which have a life span. Man’s usage and maintenance negatively or positively influence their function, value and life span. The investment on housing and facilities does not conclude when they are built or owned by individual owners. After individual owners enter the housing club, they face another situation which is internal to the club members. Two common tasks they face is how to manage usage behaviors which may damage or depreciate their housing and, maintain the physical structures, common road, sewer and drainages etc. for the sake of a safe and comfortable living environment. Will the club economy still work to accomplish the tasks?

The ownership of housing in most of societies enjoys more freedom and also involves much higher cost than rental. The management and maintenance of common-interest housing has inherent problem for club solution due to difficulties in revealing consumption preference. A housing unit is excludable and separable while the common facilities are not separable physically. Therefore, a tie-in arrangement has been employed during selling housing unit. A total rent is charged for unit occupation periodically in hotels, apartments. The rent represents recruitment

mechanism of club members with the same price and taste. A fine exclusion regime is adopted based on visit time. The management service provider continues to be the sole owner of the hotel or apartment. In competitive market, hotels and apartments can be provided and managed efficiently consistent with the principles of firm-provided club goods. However, cooperatives and condominiums invoke much higher transaction costs. From the side of consumers, ownership decision is more difficult to make than rental selection because ownership involves higher price and exit cost. Therefore, the membership mobility of ownership is not as freely as that of rental tenure.

The exclusion of free-riders is also difficult to be enforced physically and legally. After the ownership of unit and proportionate common facilities is sold to individuals, the housing club becomes a member-ownership club. Although the property management services for multi-owner housing basically benefit the owners in the certain geographical area and can be excluded from non-owners. But they are not excludable for the owners within the boundary. For example, once the green land is grown and well-maintained, every resident in the community can enjoy it. Therefore, the original local public goods which are tied into the housing unit during sale now becomes local public goods again. If a firm wishes to provide the property management services voluntarily and goes to every unit to invite contract, the function of such club will doom to fail or function in inefficiency due to free-riders. Eviction of free-riders also involves high social costs in legal practice.

By virtue of the high costs of exclusion and externality among owners, the management and maintenance of cooperatives and condominiums are more like common-pool resources than club economics. The sustainability of the common-interest housing hinges more on collective action of all owners. The privatized housing in China serves as an evidence to this point. The housing privatization policy as well as legal, political and social structures stuck the privatized housing in the dilemma of common-pool resource. The subsequent sectors of this paper will go into both the theory of common-pool resources and the reality of the privatized housing in China.

Common-pool Resources

An overwhelming part of the academic endeavors have been dedicated to the research of commons, especially the natural resources, such as fisheries, range, ocean, wildlife, forests, etc. "A common-pool resource is a valued natural or human-made resource or facility that is available to more than one person and subject to degradation as a result of overuse. Common-pool resources are ones for which exclusion from the resource is costly and one person's use subtracts from what is available to others" (Dietz, Dolsak, Ostrom and Stern, 2002, p.18; Dolsak and Ostrom, 2003, p.7). Costly exclusion and subtractability are the two defining attributes of common-pool resource.

Hardin is widely acknowledged as the most influential researcher who initiated to pay attention to the problem of use without limit "in a world that is limited" (1968, p.1244). He reminded people of the ruin consequence of overpopulation through the

analogy of an open-accessed range in which herdsmen made self-interested decision rationally and independently. Hardin's assertion not only invoked long-lasting academic interest into the theoretical and empirical inquiries into the commons, but also received critics. Some researchers pointed out that what Hardin indicated as the commons were per se the open-access resources (Stevenson, 1991, p.3). Dietz, Dolsak, Ostrom and Stern defined open access as, "when no property rights define who can use a common-pool resource and how its uses are regulated, a common-pool resource is under an open-access regime" (2002, p.18). What Dietz, Dolsak, Ostrom and Stern referred to is actually the ideal version of open-access. In the real world, physical or, social factors lead to other versions of open-access. In some cases, usage of a resource is constrained by geographical distance which causes costs for transporting to the place where the resource is located. In other cases, there are many "limited user open access" situations (Stevenson, 1991, p.52), in which "property rights have been established for a limited number of users, but the property rights among these users remain ill-defined". Common-interest housing fits into the type of limited user open access. Although the extent of open access varies, common-pool resources often result in overuse or deterioration.

Solutions of privatization and nationalization to common-pool resources were strongly promoted before 1970s. A large number of case studies since 1980s proposed an alternative solution: common property with community self-governance. The relevant pros and cons of three broad types of solution to common-pool resource problem are out of the scope of discussion in this paper. For policy researchers, understanding the real problems related to a particular common-pool resource embedded in certain context is the prerequisite of searching for a solution.

Housing Privatization in China

After the Chinese Communist Party (CCP) came into power in 1949, a socialist public housing system was gradually set up in urban areas. Since 1966 housing investment, construction, distribution, ownership and management in urban China had been totally dominated by the public sector. Public ownership housing accounted for 82.2% of all tenures in the 225 officially defined cities at the end of 1981 (Wang and Murie, 1999, p. 106). The neighbourhood design of multi-storey flats was introduced from Russia in the 1950s (Wang and Murie, 1999, p. 64), which became the dominant building structure in urban China. This collective living style also conformed to the communist ideology (Zhang, 1997). Housing ownership, allocation and management were in fact controlled by municipal governments and various work units (*danwei*) separately. Housing units were allocated to individuals according to their political and employment positions instead of real housing needs. Municipal governments, institutions and enterprises set up their own housing management offices to play the dual roles of landlord and management service provider. Low rent was regarded as one of the socialist advantages. Rent at the end of 1956 only amounted to 1.7 percent of a worker's income (Ministry of City Services, 1957). Political movements before 1978 even caused the rent to be adjusted lower and lower until just a symbolic charge. The low rent policy led to inadequate funding for housing management and maintenance

every year. Therefore, public housing experienced rapid and serious deterioration in these problematic financial and bureaucratic management systems. Many housing units were 'new only in the first year, turning old in the second, worn in the third and messed-up in the fourth year' (Shanghai Housing Committee Research Group, 1996, p. 283). The housing provision and management clubs which recruited members according to employment and charged costs according to political ideology led to their collapse of whole system.

Chinese policymakers began to put the reform of the housing system on their agenda in late 1970s. Housing privatization is one of the most important programs. The sale of public housing progressed in three phases:

First, *pilot sale period* (1979-1987). In 1979 the Chinese government chose four cities (Xi'an, Nanning, Liuzhou and Wuzhou) to implement the pilot sale of newly-built public housing at cost price. However, the price of a typical dwelling was far out of the affordability of average workers. The cost price sale was abandoned in 1982 due to low demand (Wang and Murie, 1999). In 1983 a cheap price sale program was carried out in four test cities (Zhengzhou, Changzhou, Siping and Shashi) with only one-third of the total price of a flat. The sale scope was also extended to existing public housing, but this heavily-subsidized housing was not attractive to individuals in the low rent system, therefore it was stopped in 1985. In 1986 raising rents with subsidy was introduced into housing reform to promote selling public housing at standard price and first experimented in Yantai, Shandong Province.

Second, *Low price sale inconsistent with overall reform objectives* (1988-1993). Housing reform was fully kicked-off in 1988. All cities and towns were suggested to gradually implement housing reform programs similar to those in the Yantai experiment (Wang and Murie, 1999). A standard price and minimum price were set for new housing and existing housing respectively. An essential policy, '*Resolutions on Encouraging Employees to Buy Existing Public Sector Housing*' (State Council, 1988), was issued to guide the practice of housing sale. However, public housing was still sold at low prices in various places. Considering the big loss of national assets, the State Council ordered a stop to the sale of public dwellings on 31 December 1993 (Lau, 1999).

Third, *Differentiated sale* (from 1994). Chinese housing reform came into a new stage in 1994, marked by the release of '*The Decision on Deepening the Urban Housing Reform*' (State Council, 1994). The most comprehensive policies were proposed to change the total housing system including investment, provision, distribution and management, etc. The sale of public housing was required to take a gradual approach in different pricing methods according to three income groups respectively (high, middle and low income) (Lau, 1999).

Over 80% of the sellable public housing in China had been sold to individuals by the end of 2002 (Liu, 2003), involving millions units of housing. For example, in Shanghai, 1,638,100 units of public housing had been sold to tenants by the end of 2004 (Shanghai Housing, Land and Resources Bureau, 2006).

Privatized Housing Becoming Urban Commons

A mode of firm-service was designed to carry out the management and maintenance works. The traditional property management organizations were all subsidiaries of housing authorities or work units. The property management companies had first appeared in luxury developer-built housing estates in Shenzhen in 1980s. Then Chinese government adopted a series of policies to strongly promote the development of property management industry. A strategy of corporatization was introduced to transform former public housing management offices to firms. For instance, in Shanghai, the former municipal 167 housing management offices were corporatized into 123 property management companies by the end of 2003(Shanghai Real Estate and Land Bureau, 2003). Henceforth, property management company dramatically increased partly due to the reform of public housing management offices and partly to its grow in private sector. 'State Ordinance of Property Management' (State Council, 2003) only admits the service provision by property management company as legal. Forms of self services by owners and several contractors hired by owners are ruled out.

Meanwhile, competition did not follow the development of property management industry. Government has taken a price-capping policy, which was originally aimed at reducing the nominal cost of housing services after individuals bought public housing units so as to promote the sale of public housing. But it then turned privatized housing estates to be stuck in poor services. In Shanghai, the service price was set as follows: 4.5-7.5 yuan RMB (about 0.45-0.75 euro) per unit per month for low rise buildings (below 7 storeys); for high rise buildings (no less than 7 storeys) the price was 5-10 yuan RMB (about 0.5-1 euro) per unit per month (Shanghai Price Bureau and Shanghai Housing and Land Bureau, 1996). Cleaning and security fees were charged separately with 6-12 yuan RMB (about 0.6-1.2 euro) per unit per month (Shanghai Housing and Land Bureau & Shanghai Price Bureau, 1995). In other words, a unit owner is charged 10.5-22 yuan RMB (about 1.05-2.2 euro) per month for all management services. The low-price policy discourages the upgrade of service quality and receives many critics, albeit the government has no strong motive to ban it due to its increased attention on employment and social stability. During the process of reforming the public housing management offices, staff, technology and organization management remain the same. These companies turning from public housing management offices have low competitive strength in the open market. Few have accessed the service market for commercial housing. Therefore, the low price strategy for privatized housing can ensure these companies remain employed because no other company is willing to take over the job for the privatized housing. Thus the staff who used to work in public housing management can continue to be employed even with low salaries. At the same time, as far as the population remaining in privatised housing is concerned, most of the unemployed and low income families who are victims of Chinese economic restructuring are strongly against any rise of living expenses. The government does not want to open the property management market at the expense of arousing resentment from this part of the population.

In addition to low competition of service market and poor quality of services, the

owners' decision mechanism has many problems. Owners' organizations do not exist in many privatized housing estates. Even among those with owners' organization, the function is problematic. During the housing reform in China, many work units sold their housing units to the tenants as if they were throwing out their burden and were reluctant to provide maintenance anymore. Moreover, the drastic economic restructuring in China has led to a large number of work units going bankrupt especially in the textile industry. So the government has been enthusiastic in promoting the initiation of owners' organizations in order to compel the owners to take up the responsibility of maintenance and management. However, the process of setting up owners' assemblies and owners' committees usually did not follow democratic rules. In a large part of privatized estates, the property management companies even appointed their own staff directly to the owners' committees to act as the representative for the public housing owner of unsold units. Although owners' organizations occurred in privatized estates, most of them exist only in name but not in reality, not to mention the absence of owners' organization in most of privatized estates all over the country.

Under the circumstances of low service quality and weak governance, most of privatized housing estates are subject to overuse and deterioration problems which are typical in common-pool resources. Most of the housing stock had deteriorated before privatization due to reasons mentioned above. The housing privatization policy never urged public housing owners to have an overall examination of the condition of housing stock and do necessary repairs before sale. During the decades of housing privatization, even less was invested to maintain and upgrade physical structures and facilities under the misguidance of the sale-prioritized policies. Now most of the privatized estates are facing the problems of worn-out roads and walls, rusted drainages and ruined facilities etc due to low investment from owners and poor services from property management companies. Fee arrears are taken as effective way to express dissatisfaction of property management services. Moreover, wide-spread unauthorized works make privatized estates even shabbier. Misusage of housing facilities happens ubiquitously. Many owners occupy public corridors with their bicycles and tools or damage housing structure by changing internal unit design according to personal preference. It can be seen that privatized housing is lack of investment both in terms of time and money on maintenance and management and becoming a common-poor resource in urban setting.

Discussion of Community Solution in Privatized Housing

Ostrom (1990, p.90) illustrated eight institutional design principles for achieving sustainability of institution in common-pool resources. They are:

1. Clearly defined boundaries;
2. Congruence between appropriation and provision rules and local conditions;
3. Collective-choice arrangements;
4. Monitoring;
5. Graduated sanctions;
6. Conflict-resolution mechanisms;

7. Minimal recognition of rights to organize;
8. Nested enterprises.

Ostrom did not mean that all these eight principles were necessary conditions, but they impose great influences on the effectiveness of the institution. The privatized housing in China is encountered severe negative influences from external legal and political regime, which causes much higher costs for successful collective actions and shapes the behaviors of individuals, if not fatal for them. The vital dimensions of the impacts reside in property right and self-governance organization in housing estates.

Literature on housing privatization in China mentioned unit ownership of individuals. For example, Wang and Murie (1999, p. 251) characterize the practice of privatization in China as 'piecemeal approach', which was conducted on a building by building (or flat by flat) basis. Wang and Murie (1999) had depicted the approach of 'piecemeal' privatization would create a very cumbersome property ownership system and raise issues about management. However, they didn't further describe and analyze the consequence of housing privatization in China in management aspect. The key policies during housing system reform only recognized the property right of units leaving ownership of common parts and facilities in ambiguity. 'The Decision on Deepening the Urban Housing Reform' by State Council in 1994 stipulated different property right bundles for housing units sold in market price, cost price and standard price. Market price units sold to high income people could be freely transacted in open market. Cost price units and standard price units sold to middle and low income groups were subject to some limitations with respect to resale and revenue distribution. No proposition in it mentioned whether the common parts and facilities were still owned by the former public owner or all the unit owners. It is not until 2007 when the 'Real Right Act of People's Republic of China' was made effective (Chairman of People's Republic of China, 2007) that the common ownership of common parts and facilities was recognized. However, in reality some roads and facilities are still under contradiction or actually occupied or controlled by other parties than the housing owners. The obscurity of property right obstructs the distribution of sense of common interest among individual owners. Consequently, owners have little consciousness of their legal relationship with other others in the same estate.

As far as self-governance organization is concerned, it encounters more and more challenges and interferences from government since its inception. The tight control weakens the initiatives of owners to management their communities. Collective actions by the owners are loaded with extra risks and costs from external organizations.

In 1994, when the first local regulation concerning homeowners' organization was released in Shenzhen, 'Regulation of Property Management in Residential Estates in Shenzhen Special Economic Zone' (The Standing Committee of Shenzhen People's Congress, 1994) defined "owners' management committee" as the executive body of owners' assembly (like homeowners' association in other countries) and could be registered into juridical person after approval from the government. In 1995, the name of "owners' management committee" was changed into "owners' committee" (Shenzhen Housing Bureau, 1996). Owners' organization was also

introduced into other provinces and cities. However, the organization name, structure, rights and liabilities are subject to discretionary treatment in various places. What's surprising to the government is that the owners' committee developed gradually to be a symbol of right protection organization who organized mass struggles (*weiquan zuzhi*). The burgeoning commercial housing market in 1990s was lack of regulation. Problems of housing structural quality defects, lack of property right certificate, violation of housing transaction contraction were reported a lot. Chinese people are likely to resort to the government to solve problems for them due to high cost and uncertainty of court trials. Tens of, Hundreds of homeowners sit down in front of government offices or went to housing authority from time to time. For example, Mr. Wu Haining, Director of the Owners' Committee of Kaili Garden in Shenzhen organized owners to sit down in front of district and municipal government for several times until their land right problem was solved (Soho Housing Net, 2007). Government regards these mass struggles for interests and rights as threat for social stability. Then government takes tighter and tighter control of owners' organizations in all communities including privatized housing.

In 1999, 'Regulation of Property Management in Residential Estates in Shenzhen Special Economic Zone' was revised (The Standing Committee of Shenzhen People's Congress, 1999). The revised version regulated in its 16th article that "Owners' committee as well as its list of members should be reported to district housing authority for records within fifteen days after its establishment". In 2003 the State Council issued "State Ordinance of Property Management"(State Council, 2003). This top regulation for owners' committees in China stated that the owners' assembly should be convened under the guidance of district housing authority. Another national regulation followed it to make the initiation and function of the owners' assembly and owners' committee more detailed (Ministry of Construction, 2003). This Regulation prescribes that the owners' representatives and developer should be leagued into a preparation group under the guidance of the housing authority and street government to carry out the convention of owners' assembly.

In 2005 Shenzhen government took the leading place in concretizing the control of the owners' organizations. "Rules for the owners' assemblies and owners' committees in Shenzhen" was taken into effect (Shenzhen Municipal People's Government, 2005). The residents' committee was introduced into the control of the owners' organizations by virtue of guiding and monitoring the initiation and function of the owners' assembly and owners' committee.

In 2007 "Real Right Act of People's Republic of China" was released by the Chinese central government (Chairman of People's Republic of China, 2007). This Act is the first law in China which mentions condominium. However, it only states that "The owners may set up an owners' assembly and vote for an owners' committee. For the establishment of the owners' assembly and the vote of the owners' committee, the related departments under the local people's governments shall provide guidance and assistance." This Act leaves local government to decide which government department/s to provide guidance and assistance. The State Ordinance of Property Management was then revised (State Council, 2007), which stipulates the owners'

committees should report to two government departments after their establishment: the district or county housing authority and street government or township government. When the owners of the same condominium convene their owners' assembly and vote for the owners' committee, they should be guided by district/county housing authority or street/township government. During daily work, the owners' assembly and owners' committee should accept the guidance and monitor of the residents' committee.

In June 2007 Shanghai government brought into effect 'Three-year Program (2007-2009) for Enhancing Comprehensive Management of Residential Estates in Shanghai'(Shanghai Municipal Government General Office, 2007), in which Chinese Communist Party was added officially to increase political and organizational leadership among the owners' committee. Hereon, the CCP, residents' committee, street government and housing authority have formed a concrete control framework for the owners' assemblies and owners' committees.

In practice, the residents' committees are assessed every year by street government in terms of a wide variety of issues with "the community comprehensive governance" included. One deputy-director of the residents' committee must be in charge of the work of comprehensive governance. The collective movements in their constituency affecting social stability degrade his or her and the whole residents' committee's scores. The collective actions affecting social stability imply those excluded by the state and local ordinances of visits of and letters to government. Generally speaking, three types of visits of government are especially inhibited: the collective visits of more than five persons, visiting the government higher than the directly responsible level, visits causing social turbulence. To avoid potential negative impacts on their performance assessments, the residents' committees are enthusiastic with intervening the nomination and voting procedures during the initiation and re-election of owners' committees.

Conclusion

The re-conceptualization of common-interest housing is of much theoretical and policy significance. The efficiency of common-interest housing has been taken for granted for many years. It's time to take a more micro perspective to reconsider the issue. Theories of common-pool resources can help to understand the problems in the communities and search for solutions. Privatized housing in China reflects serious problems of overuse and lack of maintenance like many limited user open access resources. The effectiveness of condominium solution arranged by Chinese government depends on the collective action of individual owners. The distinction of collective action problems of Chinese homeowners lies in the strong shaping and impediment from legal and political structures. Property right of many common parts and facilities are in ambiguity. The initiation and daily function of homeowners' assemblies and owners' committees receive much interference and even control from residents' committee and housing authority. These external factors impose high costs of collective action on homeowners, which negatively affects the use and maintenance of privatized housing. It's interesting to carry out empirical research in

the future to find out whether there are successfully managed and maintained estates in China. If there's, their experiences would contribute to the governance of common-pool resources in other regions with similar legal and political conditions.

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