

Regional Convergence or Just An Illusion?

Place-based Land Policy and Spatial Misallocation *

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Abstract

We study how place-based land allocation policy can create spatial misallocation. Such policy may seem to "help the region", but actually hurt people from the region. Combining micro-data and a spatial equilibrium model, we investigate a major policy change of distributing more land to under-developed non-eastern (inland) regions in China. First, using a method combining RD and DID, we show causal evidence that this inland-favoring policy increased land prices and decreased firm-level TFP in developed eastern regions relative to non-eastern regions. Second, we build a spatial equilibrium model featuring worker mobility and residential/production floor space constraints. Counterfactuals reveal that the national TFP and urban output would have been 7.3% and 2.4% higher in 2010 if the policy had not been implemented. Moreover, wage and income of workers from underdeveloped regions would have been increased by 1% to 2%. The result shows that the inland-favoring policy seems to reduce the regional output gap. However, it causes overall TFP and output losses, and unfavorably hurts workers from under-developed regions by hindering their migration to higher-paid developed cities. At last, we show that instead of the inland-favoring land policy, a direct regional transfer can increase the income of people from under-developed regions without causing efficiency losses.

Keywords: Place-based Policy; Land Policy; Spatial Misallocation; Regional Inequality; China;

JEL Classification Numbers: R58, E24, J61, R52;

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1 Introduction

Most countries regulate land allocation using place-based policies. Many of these regulations, such as land supply quotas, enterprise zones, and local infrastructure investment plans, are implemented to boost the economy in specific areas (Neumark and Simpson, 2015). They commonly target on underperforming regions, to ensure balanced development. However, such balanced development may be achieved at the cost of generating spatial misallocation. Moreover, the balance across regions does not necessarily mean equality among people, when the place-based policy may deter people from migrating to places with higher productivity. Some place-based policies may result in a paradox of helping the region but hurting people from the region. These issues are often missing in place-based policy discussions.

In this paper, we study the impact of place-based policy on economic development using China’s inland-favoring land supply policy in 2003. Similar to other place-based policies, this policy aims to mitigate the unbalanced development across regions due to the rapid economic growth in the eastern region near the coastline (Lin, 2011; Fleisher, Li, and Zhao, 2010).¹ The inland-favoring policy reversed the demand-driven land distributing rule, which favored fast-growing eastern cities before 2003, to the development-encouraging distributing rule, which favored under-developed non-eastern cities after 2003.²

We analyze the consequences of this policy change in three steps. First, we use a method combining Regression Discontinuity with Difference-in-Difference (RD-DID) and show that this policy change increased relative land prices and decreased relative firm-level TFP in eastern areas. Second, we develop a spatial equilibrium model to quantify the aggregate impact of the policy. We find that developed eastern cities have higher fundamental productivity and face more severe land supply constraints. Finally, by conducting a counterfactual exercise of eliminating this inland-favoring land supply policy, we find that total output and measured TFP would have been 7.3% and 2.4% higher in 2010. Although the output gap across geographic regions would have been increased, the income of workers from under-developed cities actually can also be increased. These results show that the inland-favoring policy does create spatial misallocation, which not only lowers overall productivity and output, but also harm people from poor areas.

¹China is currently the largest developing economy and experienced remarkable economic growth after the 1970s. However, the development in China is very unbalanced across regions. Most of the coastline lies in the eastern region, which gives them the keys to the global market. Consequently, eastern areas achieved massive growth, and the gap between eastern cities and non-eastern cities was enlarged over and over, which became a big concern of the Chinese government.

²Different from western countries, the state owns urban land in China. The central government plays a dominant role in land usage regulation and sets a strict cap on how much land can be used for construction in each city each year. Thus, construction land allocation is a powerful policy tool for the Chinese government.

The mechanism is as follows. Compared with the inland regions, the eastern regions are on average more productive and more constrained in land supply. After the implementation of the inland-favoring policy, the eastern regions become even more constrained in land and the land price increases, which leads to increases in floor space costs. It on the one hand increases housing costs of residence, on the other hand increases production floor space cost, which results in a reduction in labor demand. Both of them then deter the migration of workers from the inland to the eastern region with higher productivity and wages. The misallocation of land and labor leads to an reduction in the national output and productivity. The income of workers from under-developed regions is reduced since many migrants are locked in their hometowns and lose their chance to migrate to higher productive eastern cities with higher wage. Thus, the geographic output convergence is just an illusion when people are actually hurt.

In the first part of this study, we empirically investigate the effect of the inland-favoring land supply policy in 2003 on land prices and firm-level TFP in different regions. The land price data is collected from the China Land Market Website (<http://www.landchina.com/>) at the land parcel level. The firm-level TFP is calculated using data from the National Industrial Enterprise Database. A typical identification problem is that land parcels and firms in the eastern region are usually very different from those in the non-eastern region regarding both observed and unobserved characteristics. To solve this endogeneity issue, we employ a method combining Border Regression Discontinuity Design (Black, 1999) and Difference-in-Difference (RD-DID). The basic idea is that land parcels and firms within a minimal bandwidth just at the border are very similar, no matter whether they are located on the eastern side or the non-eastern side. Thus, their prices or TFP should have a similar time trend. Then we can implement DID strategy on these samples to identify the effect of the inland-favoring land supply policy. We find that the inland-favoring land supply policy in 2003 led to 3.3-9.4% increase in the land prices in the eastern developed region, compared with the non-eastern region. Furthermore, this policy also reduced the firm-level TFP in the eastern region by 0.34-0.55%, compared with the non-eastern region. Thus, the empirical analysis shows that the inland-favoring land supply policy shrank the productivity gap between the eastern and the non-eastern regions. However, it came with the cost of slower growth in the eastern region and possibly the overall economy in China.

In the second step of this study, we construct a spatial general equilibrium model (Eaton and Kortum, 2002; Ahlfeldt et al., 2015) to quantify the aggregate effects of China's land supply scheme. There are K cities in this model and each city has two sectors, urban and rural. Each worker is endowed with a skill level, either high or low, and a specific Hukou (home) city and Hukou sector. Their utility is determined by the location taste shock, goods consumption, amenities, and floor space consumption. They need to choose their working locations (city-sector pair) ac-

according to wages, housing prices, and migration costs. We assume that their location taste shock follows a Fréchet distribution, which gives us a closed-form migration flow equation across city-sector pairs. In urban areas, final goods production employs a Cobb-Douglas technology with factor augmenting productivities, using production floor space and a CES aggregator of high/low skill labors as inputs. Land supply in the urban areas in each city is exogenously given based on government's policy, and construction firms can convert land to floor space proportionally (with different ratios in different cities). There is also a tax-equivalent land use regulation to restrict the relative price of production floor space to residential floor space, which helps to clean the floor space market. In rural areas, the production function has a simple Cobb-Douglas form with total labor as the input. The residential cost in the rural area is also simplified, which equals a discounted fraction of the cost in the urban area of the same city. Using data from the Population Census, the City Statistic Yearbooks, and the Urban Statistic Yearbook in 2005 and 2010, we calibrate and quantify the model. We find that in developed eastern cities, the total land supply is not enough, and the per capita land supply is much smaller than that in under-developed cities.

Finally, using this model, we implement two counterfactual simulations. In the first one, we examine what will happen if the pre-2003 land supply policy is maintained. We assume that in the counterfactual world, each city's land supply growth rate is the same before and after 2003. That is, the central government does not implement the inland-favoring policy. We find that, we can increase the land supply in eastern cities with higher productivity and decrease the floor space prices. It then attracts more people to migrate to these cities and results in a 2.2% (2.4%) increase in the total national output in 2005 (2010). We also find that the productivity loss due to the inland-favoring policy is enormous. If we remove the policy, the national-level TFP will increase by 6.2% in 2005 and by 7.3% in 2010. Meanwhile, the removal of the policy can reduce the output and productivity in under-developed cities and cause a larger regional output gap. It seems that the inland-favoring policy achieves regional convergence by balancing regional development. However, this is in fact, just an illusion. We find that removing the inland-favoring policy can lead to increases in wage and total income for workers from almost all places. Specifically, there is about 1-2% increase in the average wage and total income of workers from under-developed areas. In the second counterfactual, we propose a direct regional transfer to replace the inland-favoring land policy. We show that the direct transfer can increase the income of people from under-developed region without creating misallocation and distortion.

In general, the inland-favoring land supply policy resulted in severe land misallocation. It not only caused overall output and TFP losses, but also hurt workers in under-developed regions whom it intended to help. The convergence of regional gap is just an illusion since people from almost all places were hurt, including those from poor areas. These analyses teach us an im-

portant lesson that even if place-based policies sometimes can help specific regions, they may actually harm people from those places.

Literature Review Our study extends the current literature in several dimensions. First, it draws on evidence for the effects of place-based policy. Many studies have investigated different kinds of place-based policies in developed countries from different perspectives (Neumark and Simpson, 2015), including enterprise zones (Neumark and Kolko, 2010; Freedman, 2013; Ham et al., 2011; Busso, Gregory, and Kline, 2013), discretionary grants (Crozet, Mayer, and Mucchielli, 2004; Devereux, Griffith, and Simpson, 2007), infrastructure investment (Kline and Moretti, 2014; Glaeser and Gottlieb, 2008; Becker, Egger, and Von Ehrlich, 2010), and community development (Eriksen and Rosenthal, 2010; Accetturo and De Blasio, 2012; Romero, 2009). This paper considers a large-scale place-based policy in a developing country. We are one of the first to discuss a paradox of the place-based policy when it can help the region but at the same time hurt the people from the region.

Second, our study is connected with the literature on spatial misallocation (Romero, 2009; Fajgelbaum et al., 2019; Hsieh and Klenow, 2009; Hsieh and Moretti, 2019; Fu, Xu, and Zhang, 2021). The most related studies are Yu (2019) and Fang and Huang (2020). Yu (2019) investigates the effect of the Farmland Red Line Policy on economic development in China. She finds that this restriction on converting rural farming land to urban construction land leads to severe land and labor misallocation, decreasing workers' welfare. Fang and Huang (2020) discuss land misallocation and its inequality implication in China. They find that as migration explodes, land supply in developed cities is far from enough, which causes the roaring housing costs. The increased housing costs benefit local housing owners and hurt migrants, which results in increased inequality. Our paper departs from the previous two studies in the sense that we are the first to investigate the important inland-favoring land supply policy and its effect on migration, productivity, and inequality in China.

Third, we are also connected with the literature on migration and regional development in China. Other scholars investigate the Hukou restriction and regional trade barrier (Tombe and Zhu, 2019; Hao et al., 2019; Pi and Chen, 2019), international trade and labor mobility (Ma and Tang, 2020; Tian, 2018; Fan, 2019; Zi, 2020), air quality (Khanna et al., 2021), and local public services for migrants (Sieg, Yoon, and Zhang, 2021; Huang, 2020). This study connects land misallocation and workers' domestic migration to examine the effect of an important place-based policy on the Chinese economy in terms of efficiency and equality.

2 Background and Data

2.1 Background

In China, agricultural land is owned collectively by the village, while urban land is state-owned. The ownership of agricultural land has to be transferred to the state through land expropriation before being used for urban construction. To ensure that there is enough agricultural land for domestic food supply, the central government places strict controls on expanding urban areas. Each city is assigned a quota of construction land usage in each year. However, rapid economic growth has led to a massive demand for urban land, especially in developed regions.

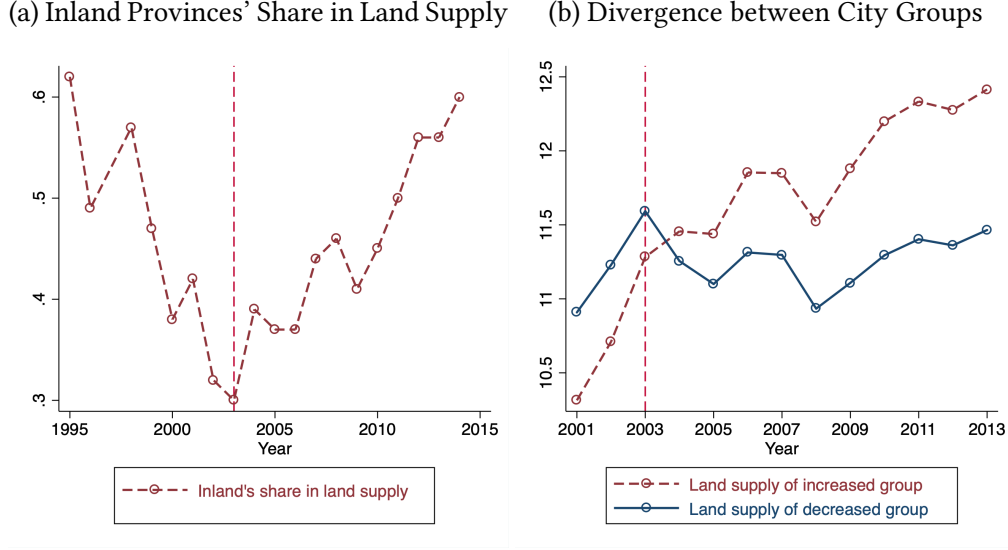
The allocation of construction land quotas has been used as a place-based policy since 2003. The National Master Land Use Plan (2006–2020) issued in 2008 states that the total construction land use in the coastal areas will be strictly controlled, and land-use quotas in the inland areas will be increased. Before 2003, developed areas with higher land demand were usually assigned more land quota. However, since 2003, the central government started to focus on balancing economic development by allocating more land quotas to under-developed inland provinces (Lu and Xiang, 2016; Han and Lu, 2017; Liang, Lu, and Zhang, 2016; Fu, Xu, and Zhang, 2021). In 2004, the Central Committee of the Chinese Communist Party made it clear that it is necessary to strengthen the role of land supply policy in macroeconomic management.³

Figure 1 panel (a) shows that the inland provinces' share of the total land supply increased from less than 30% in 2003 to 60% in 2015. The turning point in 2003 is clear. Another policy change related to land supply is that, during 2003–2004, about 70% of existing development zones were closed. The planned land supply of those closed development zones was also cut. Most of the closed development zones were in the coastal region, and many newly opened development zones have since been established in the inland areas to support their local economic development (Lu and Xiang, 2016; Chen et al., 2019).

The trend of using land-use quotas as an inland-favoring place-based policy became even more apparent at the city level. Figure 1 panel (b) divides Chinese cities into two groups: one with the cities whose land-supply shares increased after 2003; the other with the cities whose land-supply shares shrank after 2003. The land supply in the first group was lower before 2003. While it surpassed the second group after 2003 and the gap was enlarged across time. Han and Lu (2017) also show that a city's land-supply share was more likely to shrink after 2003 if the city had a larger share of land supply before 2003. Those were usually eastern developed cities.

³Decision of the State Council on deepening the reform of strict land management, issued on 12/21/2004. Source: http://www.gov.cn/ztc1/2006-06/30/content_323794.htm.

Figure 1: The Inland-favoring Land Allocation Policy since 2003



2.2 Data

2.2.1 Data for Empirical Analysis

The main dataset we use in the empirical part is the land transaction data from 1998 to 2014, collected from the China Land Market Website (<http://www.landchina.com/>). It includes unique land ID, parcel location, land usage (industrial land, commercial/service sector land, housing land, and other), land area, and leasing prices. The *Regulations on the Disposition of State-Owned Land Use Rights for Auctions and Biddings* requires that local land administration departments to publish the information on the transfer of state-owned land-use rights. The unit of the price is 10000 Yuan per hectare.

Panel A in Table 1 shows the descriptive statistics of the data. The enterprise information is from the National Industrial Enterprise Database, published by the National Bureau of Statistics. It covers all state-owned industrial enterprises and non-state-owned enterprises that are “above scale” (main business revenue greater than 5 million RMB). This dataset accounts for more than 90% of the industrial production. Since one of our major concerns is TFP, and there is a problem of missing data after 2007, we only use samples from 1998 to 2007. The database contains rich enterprise-level information, such as firm name, legal person code, four-digit industry category,

starting year of business, employee number, salary, and total fixed assets.⁴ Panel B in Table 1 shows the descriptive statistics of the data. TFP calculation is based on LP (Levinsohn and Petrin, 2003) estimation methods.⁵

Table 1: Summary Statistics

Variable	Description	Observations	Mean	Std.dev.	Min	Max
Panel A: Land Parcel						
Ln (land price)	Ln (10000 Yuan per hectare)	445,689	5.09	2.36	-14.96	19.91
Area	Hectare	445,689	3.09	16.53	0.00005	6486
East	Dummy	445,689	0.607	0.49	0	1
Land Distance	Km	445,689	29.39	110.64	-199.99	199.99
Panel B: Industrial Enterprises						
Ln (tfp_op)	TFP (OP)	1,057,775	3.15	1.05	-0.038	5.63
Ln (tfp_lp)	TFP (LP)	1,058,102	6.30	1.12	3.08	9.02
Ln (output)	Ln (1000 yuan)	1,058,102	8.58	1.34	4.77	12.29
Ln (wage)	Ln (1000 yuan)	1,056,023	2.32	0.72	-7.82	11.23
Age	Year	1,058,102	10.26	9.86	1	48
Employee	Person	1,058,102	208.93	329.54	12	2300
East	Dummy	1,058,102	0.79	0.41	0	1
Firm Distance	Km	1,058,102	72.99	103.60	-199.99	199.99

Notes: Ln (land price) is the logarithmic land price, and land price is the leasing price per hectare. East is a dummy variable, set to 1 if the land parcel is in the eastern area. Land distance is the distance from the parcel to the east-inland provincial boundary, which is positive for the eastern land and negative for the western land. Firm distance is the distance from the firm's location to the east-inland provincial boundary, which is positive for the eastern land and negative for the western land. All chosen samples are within 200 km of the boundary.

2.2.2 Data for Spatial Equilibrium Model

For the model part of this study, the main dataset we use is the Chinese Population Census. It is the most comprehensive household survey in China. Every ten years, Chinese government will have a thorough investigation of all the households in the country, which is called the Census. All the families have to take a short survey, which requires them to provide basic demographic information such as name, age, gender, education, and living address. Among all the families, 10% of them will take a long survey. The questionnaire of the long survey includes additional information such as jobs and birth history. Between each decennial-Census, there is a mini-Census. The National Bureau of Statistics randomly choose 10% of the population to take a survey

⁴For unknown reasons, some companies provide missing or erroneous information. Therefore, we conducted a clean-up and a 1% censoring process to avoid abnormal observations.

⁵We also calculate the TFP using OP (Olley and Pakes, 1992) method. The results are similar, which are available in Appendix A.

which is similar to the long survey in the decennial-Census. For simplicity, we call both decennial-Census and mini-Census, the Census. In this study, we use the Census data from 2005 and 2010. They give us city-sector-level migration flows and housing rents for individuals with different education levels. In total, we have 2,585,481 individuals in the year 2005, which covers 0.2% of the Chinese population. And we have 4,803,589 observations in the year 2010, which covers 0.36% of the population.

Besides the Census, we also utilize the City Statistic Yearbooks and the Urban Statistic Yearbook. The City Statistic Yearbooks are edited by local branches of the National Bureau of Statistics. Each city collects its data on city-level information and publish it in every year. We use the city-industry level wage information in these books to impute city-skill level wages. The basic idea is as follows. We know each individual’s industry and skill from the Census data. We also get the average wages for each industry in each city from the City Statistic Yearbooks. Then we assign this average wage to each individual in the Census data based on their city and industry information, as the imputed individual wages. Then, we calculate the average wages in each city for each skill using these imputed wages. The detailed imputation method is identical to the one used in [Fang and Huang \(2020\)](#). We also derive city-level GDP growth and constructed land area data from the Urban Statistic Yearbook, which is a book with a summary of key characteristics in all Chinese cities.

3 Empirical Evidence

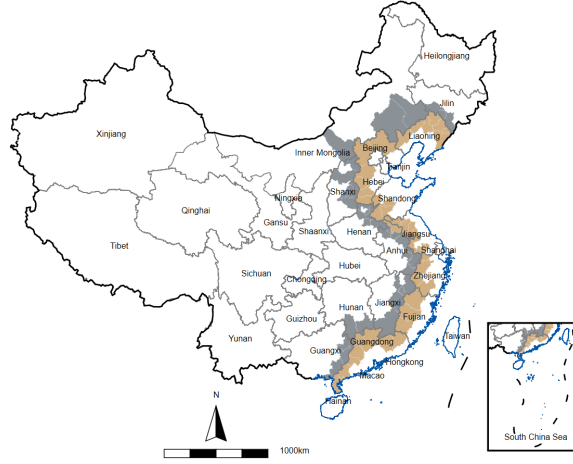
As we have mentioned in the previous section, urban land is totally owned by the state in China and government has the power to distribute the construction land quota to different places. In 2003, Chinese central government started its plan to allocate more land quota to under-developed non-eastern inland provinces ([Lu and Xiang, 2016](#); [Han and Lu, 2017](#); [Liang, Lu, and Zhang, 2016](#)). In this section, we show empirical facts that this place-based land allocation policy resulted in a relative increase in the land prices and a relative decrease in the TFP for firms in the eastern region.

3.1 RD-DID Specification

The empirical strategy we use is a combination of Border Regression Discontinuity Design ([Black, 1999](#)) and Difference-in-Difference (RD-DID). The basic idea is to first compare land parcels’ prices on the eastern and the non-eastern side just at the border. Then we compare this price

difference at border, before and after the year when the central government implemented the inland-favoring land supply policy. Figure 2 shows the location of the boundary (at prefecture level) between eastern and non-eastern region in China. We use the definition of eastern and non-eastern region published by the National Bureau of Statistics of China.

Figure 2: Boundary between Eastern and Non-Eastern Region in China



Notes: Data sources are the National Bureau of Statistics of China.

For land parcel i at border segment b in city c , year t , we have the following regression:

$$\begin{aligned} \ln(y_{ibct}) = & \alpha + \beta_1 East_{ibc} + \beta_2 f(Dist_{ibc}) + \beta_3 East_{ibc} \times f(Dist_{ibc}) \\ & + Post2003 \times [\delta_1 East_{ibc} + \delta_2 f(Dist_{ibc}) + \delta_3 East_{ibc} \times f(Dist_{ibc})] + \beta_4 X_{ct-1} + \phi_b + \gamma_t + \epsilon_{ibt} \end{aligned} \quad (1)$$

where y_{ibt} is the land price of parcel i , $East_{ib}$ is a dummy which equals 1 if the land parcel is located on the eastern side of the border, $f(Dist_{ib})$ is a smooth function of the distance between the land parcel and the border, and $Post2003$ is a dummy which equals 1 if t is after 2003 (including 2003 itself)⁶. X_{ct-1} is a set of lagged city-level control variables, including the log of GDP, the log of population, the log of city area, and the scale of the service sector. ϕ_b is the border segment fixed effect. Here, we divide the border into five segments of equal length and designate each land parcel to the nearest segment.⁷ γ_t is the year fixed effect.

⁶We also run all regressions in a specification when 2003 is excluded from the treatment group. The results are not changed qualitatively.

⁷We also try specifications when we also control for city and province level fixed effects. The policy effect δ_1 does not change. The results are available upon request. The reason we do not use these two specifications in the main context is because city or province level fixed effects will absorb all variations at city or province level, which leads β_1 to be unidentified.

This is a regression combining RD and DID method. First, we can consider the first three terms (except the intercept), that is, $\beta_1 East_{ibc} + \beta_2 f(Dist_{ibc}) + \beta_3 East_{ibc} \times f(Dist_{ibc})$. They consist of a border regression discontinuity design regression with the running variable to be the distance to border. Using the observations within a small bandwidth, we can assume that land parcels just on the eastern side of border b are very similar to land parcels just on the non-eastern side. By fitting a smooth function $f(Dist)$, we have β_1 to be the effect of being in the eastern region on outcome variable y . We use three fitting functions in this study, local linear regression, linear regression, and quadratic regression. The optimal bandwidth we use for local linear fit is based on [Imbens and Kalyanaraman \(2012\)](#). The bandwidth we use for linear and quadratic fit is 80 km.⁸

Second, we add in the interaction between the post 2003 dummy and all previous RD terms. Parameter δ_1 then denotes the policy effect. It can be interpreted as the difference between eastern region effects before and after the 2003 inland-favoring land allocation policy. Thus, this is a difference-in-difference estimation. The first difference is between the eastern and the non-eastern region (at the border, within the bandwidth). The second difference is between the before policy (2003) period and the after policy period. In general, this specification combines border regression discontinuity design with difference-in-difference method. In the main context, we investigate two outcome variables. Except for land prices at land parcel-level, we also consider TFP at firm-level.⁹

3.2 Regression Assumptions Validation

One of the most important assumptions of any estimation involving DID method is the parallel trend. Figure 3 shows the time trends of two main outcome variables, including land prices, and firm-level TFP calculated using LP method.¹⁰ The blue solid line is the average outcome value in the developed eastern region and the red dashed line is the value in the inland region, both of which are calculated within the bandwidth around the border. The dashed vertical line is put in the year of 2002, just before the implementation of the inland-favoring land policy. It is clear that both of the outcome variables have very similar trends before the policy.¹¹

Furthermore, we implement a traditional event study regression to investigate the evolution of the eastern region effect across time. We take the year of 2002 as the baseline and then have

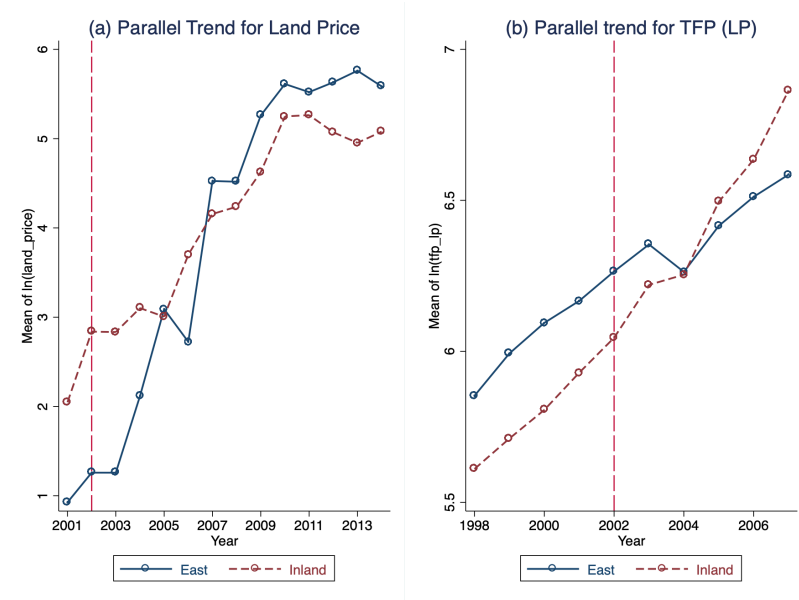
⁸We also try some other bandwidths, the results are similar. Please refer to Appendix A for details.

⁹For regression of firm-level TFP, the meaning of subscript i then becomes each firm.

¹⁰The parallel trend test on TFP calculated using OP method is available in Appendix A.

¹¹We do not have enough samples for land parcels at the border before 2001. Thus, for the parallel trend test of land price, we only show results after 2001.

Figure 3: Parallel Trend of Outcome Variables



Notes: This figure shows the time trends of two main outcome variables, land prices, and firm-level TFP calculated using LP method. The blue solid line is the average outcome value in the developed eastern region and the red dashed line is the value in the inland region. The dashed vertical line is put in the year of 2002, just before the implementation of the inland-favoring land policy. It is clear that all the outcome variables have very similar trends before the policy.

the following regression:

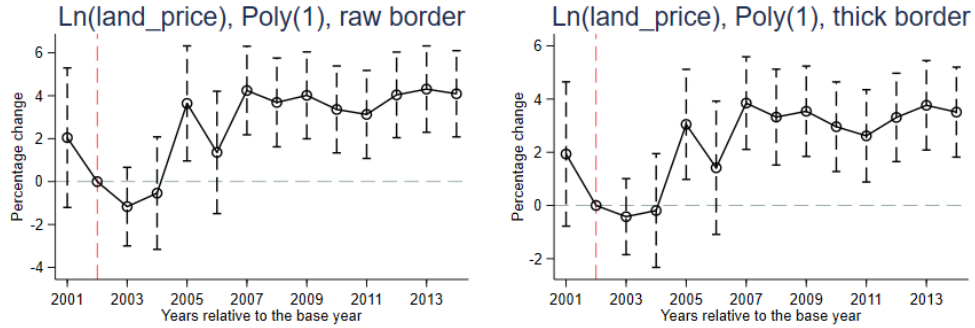
$$\begin{aligned}
 \ln(y_{ibct}) = & \alpha + \beta_1 East_{ibc} + \beta_2 f(Dist_{ibc}) + \beta_3 East_{ibc} \times f(Dist_{ibc}) \\
 & + \sum_{s \neq 2002} \mathbf{1}(s = t) \times [\delta_{1s} East_{ibc} + \delta_{2s} f(Dist_{ibc}) + \delta_{3s} East_{ibc} \times f(Dist_{ibc})] \\
 & + \beta_4 X_{ct-1} + \phi_b + \gamma_t + \epsilon_{ibt}
 \end{aligned} \tag{2}$$

We plot the evolution of the coefficient δ_{1s} across time s in Figure 4, and 5. These figures show the changes of the eastern region effect across time, with 90% confidence intervals. We choose linear smoothing function and use either the raw border or the thick border recommended in (Michalopoulos and Papaioannou, 2014) in the regression.¹² It shows that all the coefficients are very close to zero before 2002. They become statistically and economically significant from zero

¹²Considering that provincial borders are generally mountains or rivers with special geographic characteristics, in this setting, we follow Michalopoulos and Papaioannou (2014) and remove land parcels within 10 km of both sides of the original provincial boundaries, thereby obtaining a “thick provincial border” and alleviating the effect of special landforms on land prices. We also try regressions using local linear and quadratic smoothing functions. The test results are not changed. They are available upon request.

only after the policy was implemented. The results from this event study confirm the fact that there is no pre-trend in our data. These figures also give us a first look of the main results. We can see that, after the central government imposed the inland-favoring land policy in 2003, there was a relative increase in the land price in eastern region. Meanwhile, the policy also relatively decreased the firm productivity in eastern region. We will have more detailed discussions in the next section. We also implement more tests and the results are available in Appendix B.

Figure 4: Event Study - Land Price



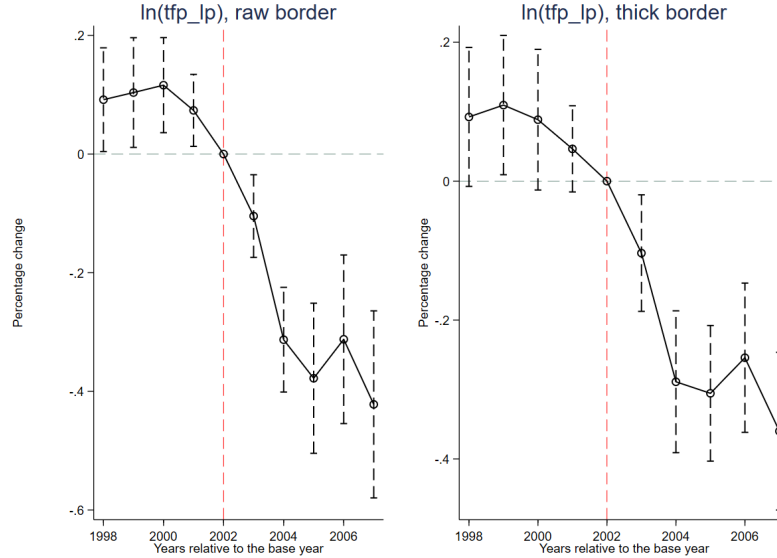
Notes: The dependent variable is the land parcel-level price. We only show the results for the linear fitting function since we do not have enough observations before 2003 for quadratic fitting function. As we add in high order polynomials, the behavior of the fitting becomes weird, which indicates a typical overfitting and boundary problem. The bandwidth is 80km. The confidence interval is 90%.

3.3 RD-DID Results

Table 2 shows the RD-DID regression results when we use the log of land prices as the outcome variable. The first two columns illustrate the results when we use local linear smooth function. The third and fourth columns illustrate the results when we use first order (linear) polynomial smooth function. The last two columns illustrate the results when we use second order (quadratic) polynomial smooth function. In general, we can see that before the inland-favoring land supply policy was imposed, eastern region had about 3.0-9.2% lower land prices. However, the policy totally eliminated the price gap. The reduction in the construction land quota after 2003 led to approximately 3.3-9.4% increase in the land prices in eastern developed region.

Table 3 shows the regression results when we use the log of firm-level TFP as the outcome variable. We find that before the policy, eastern firms generally had 0.27-0.42% higher TFP than non-eastern firms. However, the reduction in the construction land supply after 2003, reduced the relative TFP of eastern firms by 0.34-0.55%. In addition to TFP, we also run the same regressions

Figure 5: Event Study - TFP (LP)



Notes: The dependent variable is the firm-level TFP calculated by LP method. The bandwidth is 80 km from the border of eastern and non-eastern classification. The confidence interval is 90%.

Table 2: RD-DID Results on Land Prices

	Local Linear		Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	Raw Border (1)	Thick Border (2)	Raw Border (3)	Thick Border (4)	Raw Border (5)	Thick Border (6)
East	-5.128*** (1.442)	-9.189** (3.538)	-3.371*** (1.167)	-2.964*** (0.957)	-4.540 (2.748)	-5.341*** (1.761)
Post2003×East	5.270*** (1.434)	9.446** (3.538)	3.660*** (1.161)	3.279*** (0.951)	4.658* (2.733)	5.557*** (1.775)
City Lagged Controls	Y	Y	Y	Y	Y	Y
Border FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Observations	128294	55654	169339	154990	169339	154990
Adjusted R-squared	0.060	0.070	0.055	0.054	0.056	0.055

Notes: The dependent variable is the land parcel-level price. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. Sample in Local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Polynomial RD is restricted to be within a bandwidth of 80 km around the raw boundary. *** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

Table 3: RD-DID Results on TFP (LP)

	Local Linear		Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	Raw Border (1)	Thick Border (2)	Raw Border (3)	Thick Border (4)	Raw Border (5)	Thick Border (6)
East	0.359*** (0.077)	0.272*** (0.083)	0.420*** (0.051)	0.379*** (0.051)	0.392*** (0.064)	0.366*** (0.074)
Post2003×East	-0.551*** (0.095)	-0.353*** (0.087)	-0.405*** (0.066)	-0.344*** (0.050)	-0.498*** (0.084)	-0.380*** (0.079)
City Lagged Controls	Y	Y	Y	Y	Y	Y
Border FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Observations	71168	52299	281718	253850	281718	253850
Adjusted R-squared	0.100	0.107	0.092	0.093	0.093	0.093

Notes: The dependent variable is the firm-level TFP measured by LP method. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. Sample in Local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Polynomial RD is restricted to be within a bandwidth of 80 km around the raw boundary.

*** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

for firm-level output, average wages, and return on asset. They all show the same pattern that the inland-favoring land policy decreased the relative output, wages and return on asset in the eastern region. The detailed results are available upon request.

3.4 Remarks on Empirical Results

Generally speaking, in the empirical part, we have two main findings. First, the inland-favoring land supply policy reduced the land supply and increased the land prices in the developed eastern region relative to the non-eastern region. Second, the inland-favoring land supply policy also decreased the relative firm productivity in the eastern region. In Appendix A, we implement more robustness checks to validate our empirical findings. The results show that the conclusions are maintained in different specifications.

We claim that although government achieved the goal to shrink the productivity gap between eastern and non-eastern regions, we have to pay a huge cost. In the eastern region, when land prices are increased, residential cost will be increased for workers and production land cost will also be increased for firms. Then firms and workers may relocate themselves to other places with lower cost and leave the developed region with higher productivity. This can lead to a loss in

terms of the national TFP and output. The inequality may also increase rather than decrease since the policy prevent many workers from under-developed areas from migrating to developed cities with higher wages. Thus, the policy may hurt the people it intended to help. We will explain this mechanism in more details in the next few sections.

So far, we have discussed the local effect of the inland-favoring policy on land misallocation. However, these results are local average treatment effect at the border. There are still more questions to ask. What is the national-wide effect? What is the effect on not only land misallocation but also labor misallocation? How is the wage and income gap between regions affected? We need a model to give the answers.

4 The Model

The economy consists of a set of discrete locations, more specifically in this paper, **cities**, which are indexed by $i = 1, \dots, K$. Each city j consists of two sectors: urban u and rural r . The economy is populated by an exogenous measure of H workers, who are imperfectly mobile within the economy subject to migration costs. Each worker is either low skill $s = l$ or high skill $s = h$. Each location i has an effective supply of urban floor space S_i^u which is produced by a fixed amount of land supply L_i^u of the urban region. In urban areas, floor space can be used for both production and residence, and we denote the endogenous fractions of floor space allocated to production and residential use by θ_i and $(1 - \theta_i)$, respectively. The housing market in rural areas is simple such that the rent is proportional to the average rent in urban areas in the same city.¹³

Workers decide whether or not to move after observing idiosyncratic utility shocks between each possible pair of destination location and their original location. Firms produce a single final good, which is costlessly traded within the country, and is chosen as the numeraire. Locations differ in terms of their urban final goods productivity (A_i^u), rural final goods productivity (A_i^r), and supply of floor space in urban region (S_i^u).

4.1 Worker Preferences

Utility of worker o with skill s , originated from region i sector n , migrating to region j sector k is a combination of final good consumption ($c_{in,jk}^o$), residential floor space consumption ($s_{in,jk}^o$),

¹³This model setting reflects a special land distribution system in rural China. All lands in rural China are owned by the village collectively, but not by individual. There is no housing market in the rural area. The village council first distributes land to farmers (housing land, or in Chinese, *Zhaijidi*), then farmers build their houses by themselves. They cannot sell or buy any houses. Thus, the housing cost for them is basically building cost.

migration costs ($\tau_{in,jk}^s$), and an idiosyncratic shock ($z_{in,jk}^o$) in a Cobb-Douglas form:

$$U_{in,jk}^o = \frac{z_{in,jk}^o}{\tau_{in,jk}^s} \left(\frac{c_{in,jk}^o}{\beta} \right)^\beta \left(\frac{s_{in,jk}^o}{1-\beta} \right)^{1-\beta} \quad (3)$$

We model the heterogeneity in the utility that workers derive from working in different parts of the economy following [Eaton and Kortum \(2002\)](#). We also do not distinguish the utility function forms of urban residence and rural residence, but allow rural workers to construct their own residential floor space with construction costs. For each worker o originated from region i sector n , migrating to region j sector k , the idiosyncratic component of utility ($z_{in,jk}^o$) is drawn from an independent Fréchet distribution:

$$F(z_{in,jk}^o) = e^{-z_{in,jk}^o{}^{-\epsilon}}, \quad \epsilon > 1$$

where the shape parameter $\epsilon > 1$ controls the dispersion of idiosyncratic utility. We assume that the migration costs can be separated into two parts:

$$\tau_{in,jk}^s = \bar{\tau}_{in}^s d_{in,jk}$$

where $d_{in,jk}$ captures the physical distance and institutional cost, due to the Hukou system and other potential frictions, in migrating from city i sector n to city j sector k ; and $\bar{\tau}_{in}^s$ captures the difference of the cost across individuals with different skills which may include skill-biased migration policies, and differences in their preferences for specific types of amenities such as education for children, entertainments, and transportation.

After observing the realizations of idiosyncratic utility for each pair between their origination and potential employment location, each worker chooses his/her location and sector of employment to maximize his/her utility, taking as given residential amenities, goods prices, factor prices, and decisions of other workers and firms. Each worker is endowed with one unit of labor that is supplied inelastically with zero disutility. Combining our choice of the final good as numeraire with the first-order conditions for consumer equilibrium, we obtain the following demands for the final good and residential floor space for worker o with skill s from location i sector n and migrate to location j sector k :

$$c_{in,jk}^o = \beta v_{in,jk}^s \quad (4)$$

$$s_{in,jk}^o = (1-\beta) \frac{v_{in,jk}^s}{Q_{jk}} \quad (5)$$

where $v_{in,jk}^s$ is the total income for a worker with skill s who stays in sector k , including wage

income and return from owning floor space in worker's Hukou place (city-sector) in . Q_{jk} is the rent of the residential floor space in sector k in city j .

Floor space is not tradable and is owned in common by local residents. This assumption is broadly consistent with the institutional features of China, and implies that migrant workers have no claim to this fixed factor income. Therefore, the income $v_{in,jk}^s$ is a combination of wage income of skill s and equally-divided residential floor space rent income among local Hukou registers in location i sector n :

$$v_{in,jk}^s = w_{jk}^s + \frac{Q_{in} S_{in}^R}{H_{in}^R} \quad (6)$$

where H_{in}^R denotes all local Hukou registers including those who migrated out for working.

Substituting equilibrium consumption of the final good and residential land use into utility, we obtain the following expression for the indirect utility function:

$$U_{in,jk}^o = \frac{z_{in,jk}^o v_{in,jk}^s Q_{jk}^{\beta-1}}{\tau_{in,jk}^s} \quad (7)$$

4.2 Distribution of Utility and Migration Flow

Using the monotonic relationship between utility and the idiosyncratic shock, the distribution of utility for a worker from city i sector n and move to city j sector k is also Fréchet distributed:

$$G_{in,jk}^s(u) = Pr[U \leq u] = F\left(\frac{u \tau_{in,jk}^s Q_{jk}^{1-\beta}}{v_{in,jk}^s}\right) \quad (8)$$

$$G_{in,jk}^s(u) = e^{-\Phi_{in,jk}^s u^{-\epsilon}}, \quad \Phi_{in,jk}^s = (\tau_{in,jk}^s Q_{jk}^{1-\beta})^{-\epsilon} (v_{in,jk}^s)^\epsilon \quad (9)$$

Since the maximum of a sequence of Fréchet distributed random variables is itself Fréchet distributed, the distribution of utility across all possible destinations is

$$1 - G_{in}^s(u) = 1 - \prod_{jk=11}^{JK} e^{-\Phi_{in,jk}^s u^{-\epsilon}} \quad (10)$$

Therefore we have

$$G_{in}^s(u) = e^{-\Phi_{in}^s u^{-\epsilon}}, \quad \Phi_{in}^s = \sum_{jk=11}^{JK} \Phi_{in,jk}^s \quad (11)$$

Let $\pi_{in,jk}^s$ denote the share of workers with skill s registered in in who migrated to jk . The law

of large numbers implies that the proportion of workers who migrate to region jk is

$$\pi_{in,jk}^s = \frac{(\tau_{in,jk}^s Q_{jk}^{1-\beta})^{-\epsilon} (v_{in,jk}^s)^\epsilon}{\sum_{j'k'=11}^{JK} ((\tau_{in,j'k'}^s Q_{j'k'}^{1-\beta})^{-\epsilon} (v_{in,j'k'}^s)^\epsilon)} = \frac{\Phi_{in,jk}^s}{\Phi_{in}^s} \quad (12)$$

This is a typical gravity equation in spatial equilibrium models.

4.3 Production

We assume that there is a single final good y that is costlessly traded within the economy. In urban regions, it is produced with constant returns to scale in a Cobb-Douglas form, using efficient labor combination X_j , and production floor space S_j^M :

$$Y_{ju} = (X_{ju})^\alpha (S_{ju}^M)^{1-\alpha}, \text{ where } X_{ju} = [(A_{ju}^h H_{ju}^h)^{\frac{\sigma-1}{\sigma}} + (A_{ju}^l H_{ju}^l)^{\frac{\sigma-1}{\sigma}}]^{\frac{\sigma}{\sigma-1}} \quad (13)$$

where X_{ju} is a CES combination of efficient high skill labor H_{ju}^h and low skill labor H_{ju}^l multiplied by their corresponding city-level efficiency A_{ju}^h and A_{ju}^l respectively. In rural regions, the production is simply $Y_{jr} = A_{jr} H_{jr}$. Since we are not focusing on trade and substitutions between agricultural goods and other goods, we simply assume that Y_r and Y_u are perfect substitutes. In the equilibrium, A_{jr} equals the wage return of agricultural sector w_{jr} in city j rural sector r .¹⁴

Firm Optimization: We assume that the goods market is perfectly competitive. Urban firms choose their inputs of workers and production floor space to maximize profits, taking as given final goods productivity ($\{A_{ju}^h, A_{ju}^l\}$), the distribution of idiosyncratic utility, factor prices, and decisions of other firms and workers. From the first-order conditions, we obtain:

$$w_{ju}^l = \alpha X_{ju}^{\alpha-1} S_{ju}^{M1-\alpha} A_{ju}^l^{\frac{\sigma-1}{\sigma}} X_{ju}^{\frac{1}{\sigma}} H_{ju}^l^{-\frac{1}{\sigma}} \quad (14)$$

$$w_{ju}^h = \alpha X_{ju}^{\alpha-1} S_{ju}^{M1-\alpha} A_{ju}^h^{\frac{\sigma-1}{\sigma}} X_{ju}^{\frac{1}{\sigma}} H_{ju}^h^{-\frac{1}{\sigma}} \quad (15)$$

$$S_{ju}^M = \left(\frac{1-\alpha}{q_{ju}} \right)^{\frac{1}{\alpha}} X_{ju} \quad (16)$$

This also given us a measure of skill premium ω of city j :

$$\omega_{ju} = \frac{w_{ju}^h}{w_{ju}^l} = \left(\frac{A_{ju}^h}{A_{ju}^l} \right)^{\frac{\sigma-1}{\sigma}} \left(\frac{H_{ju}^h}{H_{ju}^l} \right)^{-\frac{1}{\sigma}} \quad (17)$$

¹⁴We make a simplification such that $w_{jr}^h = w_{jr}^l = w_{jr}$.

To determine the equilibrium production floor price, q_j , we use the requirement that profits are zero:

$$(X_{ju})^\alpha (S_{ju}^M)^{1-\alpha} - W_{ju} X_{ju} - q_{ju} S_{ju}^M = 0$$

where $W_{ju} X_{ju} = w_{ju}^l H_{ju}^l + w_{ju}^h H_{ju}^h$. This together with profit maximization (16) yields the following expression for the equilibrium production floor price:

$$q_{ju} = (1 - \alpha) \left(\frac{\alpha}{W_{ju}} \right)^{\frac{\alpha}{1-\alpha}} \quad (18)$$

4.4 Land Market Clearing

4.4.1 Land Market Clearing in Urban Areas

Urban land market equilibrium requires a no-arbitrage condition between production and residential land use after taking into account the tax equivalent of land use regulations:

$$q_{ju} = \eta_j Q_{ju} \quad (19)$$

where η_j captures the land use regulations that restrict production land price relative to residential land price. Let θ_i be the proportion of floor spaces allocated to production use over residential use. We assume that $\theta_i \in (0, 1)$. Because production requires both production land and labor, and there is no commuting to work across cities, a city cannot have 100% production or 100% residential land.

Production land market clearing requires that the demand of production floor space equals the supply of floor space allocated to production use in each location: $\theta_j S_{ju}$. Using the first-order conditions for profit maximization, this production land market clearing condition can be written as:

$$S_{ju}^M = \left(\frac{(1 - \alpha)}{q_{ju}} \right)^{\frac{1}{\alpha}} X_{ju} = \theta_j S_{ju} \quad (20)$$

Residential land market clearing implies that the demand of residential floor space equals the supply of floor space allocated to residential use in each location: $(1 - \theta_j) S_j$. Using utility maximization for each worker and taking expectations over the distribution for idiosyncratic utility, this residential land market clearing condition can be expressed as:

$$S_{ju}^R = E[s_{ju}] H_{ju} = (1 - \beta) \frac{E[v_{ju}] H_j}{Q_{ju}} = (1 - \theta_j) S_{ju} \quad (21)$$

We assume that floor space S is supplied by a highly-regulated construction sector that uses geographic land L and regulated plot ratio ϕ_j as guidance to produce:

$$S_{ju} = \phi_j L_j \quad (22)$$

where ϕ_j determines the density of development (the ratio of floor space to land).

4.4.2 Land Market Clearing in Rural Areas

The housing market in rural area is simpler where there is no production land. We assume that the rural housing cost is a discounted cost relative to the urban cost:

$$Q_{jr} = \tau Q_{ju} \quad (23)$$

The price Q_{jr} is the cost of building a unit of floor space on farmers' housing land. Given the cost, rural residence choose the optimal floor space to build.

4.5 Definition of Spatial General Equilibrium

We now define and characterize the properties of a spatial general equilibrium given the model's fixed parameters $\{\beta, \epsilon, \alpha, \sigma, \mu\}$.

A **Spatial General Equilibrium** for this economy is defined by a set of exogenous economic conditions $\{\tau_{in,jk}^s, A_j^s, \eta_j, \phi_j, L_j, H_{in}^s\}$, a list of endogenous prices $\{Q_{ju}, q_{ju}, w_{jk}^s\}$, quantities $\{v_{in,jk}^s, Y_{jk}, H_{jk}^s, S_{ju}\}$, and proportions $\{\pi_{in,jk}^s, \theta_j\}$ that solve firms' problem, workers' problem, floor space producers' problem, and market clearing such that:

(i).[**Worker Optimization**] Taking the exogenous economic conditions $\{\tau_{in,jk}^s, A_{jk}^s\}$ and the aggregate prices $\{Q_{ju}, w_{jk}^s\}$ as given, workers' optimal choices of migration pins down the equilibrium labor supply in each city H_{jk}^s and the migration flow between each city pairs $\pi_{in,jk}^s$.

(ii).[**Firm Optimization**] Taking the exogenous economic conditions $\{A_{jk}^s\}$ and the aggregate prices $\{q_{ju}, w_{jk}^s\}$ as given, firms' optimal choices of production pins down the equilibrium labor demand H_j^s , equilibrium production floor space demand $\theta_j S_{ju}$ in each city.

(iv).[**Market Clearing**] For all cities, labor supply equals labor demand and floor space supply equals floor space demand. This pins down the equilibrium aggregate prices $\{Q_{ju}, q_{ju}, w_{jk}^s\}$, the equilibrium floor space S_{ju} , and the equilibrium output Y_{ju} .

5 Quantitative Analysis

In this section, we solve the model, and quantify the unobserved fundamentals of the economy, using the Census data we have in 2005 and 2010.

5.1 Calibration

We fix a set of parameters. We first use some moments from various data sets to pin down share parameters in preference of workers (β), final good production (α), and floor space regulation (η). We then use the estimations of the elasticities from Fang and Huang (2020) for the city pair migration elasticity (ϵ).

We match $(1 - \beta)$ to the share of residential floor space cost in consumer expenditure, $(1 - \alpha)$ to the share of production floor space in firm costs, and $(\eta - 1)$ to the relative production land use costs compared with residential land. First, to match $(1 - \beta)$, we use average accommodation expenditure share of total consumption from the Urban Household Survey of China (UHS). The survey is conducted by the National Bureau of Statistics of China with a change in statistics standard in 2012. We believe the new standard is more realistic which gives us an average around 23% from 2013 to 2017¹⁵. Hence, we choose (β) to be 0.77. Second, to match $(1 - \alpha)$, we use the average land cost per unit of output. Unfortunately, there is no direct measure of land usage and costs available, therefore, we rely on the *Enterprise Surveys* of Chinese manufacturing firms conducted by world bank in 2005. Firms report their tax payments of land usage through which we could infer the costs. The mean across all the firms and cities are 12% per unit of output. Therefore, we choose the labor share of production (α) to be 0.88. Finally, to match $(\eta - 1)$, we need to compare the land use costs of production compared with residential. The government of each city may have different incentive to promote residential construction or production construction due to tax or development motivations. Therefore, we use the land price differences to match η_j for each city j . The land price differences in each city come from land transaction data in the China Land Market Website, which is also used in our empirical part. We define land used for both industrial and service sectors as production land.

The elasticity of substitution between H/L-skills (σ) is calibrated to be 1.4 (Katz and Murphy, 1992), which is widely used in the previous literature. The city pair migration elasticity (ϵ) is

¹⁵According to the old statistical standard, the average housing expenditure share ranges from 11.7% in 2012 to 14.3% in 2002 which is very low because they did not include the converted rent costs of self-owned houses and apartments. From 2013, the converted rent costs of self-owned houses and apartments was added to housing costs which resulted in a range of 22.7% in 2017 to 23.3% in 2013. Within each of these two periods, we find that the average expenditure share is very stable across time.

calibrated to be 1.9. [Tombe and Zhu \(2019\)](#) estimates at province-sector pair and ends with a number of 1.5. [Fang and Huang \(2020\)](#) show that the city pair migration elasticity is around 1.9. We choose the latter one since it is estimated in an almost identical model context of this study. Finally, the relative cost of rural housing (τ) is calculated using the relative rent paid by observed rural sector workers over corresponding rent paid by observed urban sector workers in each city in both Census 2005 and Census 2010. This gives us a number of 0.34.

Summary of Parameters: Below in Table 4 is a short summary table of our parameters of estimation.

Table 4: **Parameters**

Parameter	Description	Value
β	share of consumption in utility	0.77
α	share of labor in production	0.88
η_j	relative cost of production to residential land	city-specific
σ	elasticity of substitution between H/L-skills	1.4
ϵ	migration elasticity	1.9
τ	relative cost of rural housing	0.34

5.2 Solving the Model

Based on the data we have on the observed equilibrium allocation and prices $\{H_{jk}^s, \pi_{in,jk}^s, w_{jk}^s, Q_{jk}, q_{jk}\}$, we could calculate all the unobserved variables: productivity $\{A_{jk}^l, A_{jk}^h\}$, migration cost ($\tau_{in,jk}^s$), floor spaces $\{S_{ju}^M, S_{ju}^R, S_{jr}^R\}$, and construction density (ϕ_i) in both 2005 and 2010.

A. Productivity

From profit maximization and zero profits, we could infer productivity from the data of employment and wage. First, we solve productivity A_{ju}^h as a function of A_{ju}^l using first order conditions.

$$A_{ju}^h = A_{ju}^l \left(\frac{H_{ju}^h}{H_{ju}^l} \right)^{\frac{1}{\sigma-1}} \left(\frac{w_{ju}^h}{w_{ju}^l} \right)^{\frac{\sigma}{\sigma-1}} \quad (24)$$

Plug A_{ju}^h into the definition of X_{ju} , we have

$$X_{ju} = A_{ju}^l H_{ju}^l \left[\frac{w_{ju}^h H_{ju}^h + w_{ju}^l H_{ju}^l}{w_{ju}^l H_{ju}^l} \right]^{\frac{\sigma}{\sigma-1}} \equiv A_{ju}^l H_{ju}^l (\Xi_{ju}^l)^{-\frac{\sigma}{\sigma-1}} \quad (25)$$

where $\Xi_{ju}^l = \frac{w_{ju}^l H_{ju}^l}{w_{ju}^h H_{ju}^h + w_{ju}^l H_{ju}^l}$ is the share of labor income distributed to low skill workers. Also agri-

cultural productivity equals to agricultural wage by assumption,

$$A_{jr}^s = w_{jr}, \quad \text{for both } s = \{h, l\} \quad (26)$$

Combining the previous equation to the definition of W_{ju} , we have

$$W_{ju} = \frac{w_{ju}^h H_{ju}^h + w_{ju}^l H_{ju}^l}{X_{ju}} = \frac{w_{ju}^l (\Xi_{ju}^l)^{\frac{1}{\sigma-1}}}{A_{ju}^l} \quad (27)$$

Plug W_j into the price function of q_j , we solve

$$A_{ju}^l = \frac{q_{ju}^{\frac{1-\alpha}{\alpha}} w_{ju}^l (\Xi_{ju}^l)^{\frac{1}{\sigma-1}}}{\alpha(1-\alpha)^{\frac{1-\alpha}{\alpha}}} \quad (28)$$

We then have

$$A_{ju}^h = \frac{q_{ju}^{\frac{1-\alpha}{\alpha}} w_{ju}^h (\Xi_{ju}^h)^{\frac{1}{\sigma-1}}}{\alpha(1-\alpha)^{\frac{1-\alpha}{\alpha}}} \quad (29)$$

where $\Xi_{ju}^h = 1 - \Xi_{ju}^l$. Intuitively, higher production floor prices, higher wages, and higher share of total payroll of skill s require higher productivity of skill s at the equilibrium.

B. Land Market Clearing

From workers' first order conditions for residential floor space and the summation over all workers residing in each city j (residential demand) and the firms' first order conditions for production floor space, we could calculate both urban and rural floor space:

$$\begin{aligned} S_{ju}^R &= E[s_{ju}]H_{ju} = (1-\beta) \frac{E[v_{ju}]H_{ju}}{Q_{ju}} \\ &= \frac{1-\beta}{Q_{ju}} [w_{ju}^l H_{ju}^l + w_{ju}^h H_{ju}^h] + (1-\beta)S_{ju}^R \\ &= \frac{1-\beta}{\beta Q_{ju}} [w_{ju}^l H_{ju}^l + w_{ju}^h H_{ju}^h] \\ S_{ju}^M &= \left(\frac{(1-\alpha)}{q_{ju}} \right)^{\frac{1}{\alpha}} X_{ju} \\ S_{jr}^R &= \frac{1-\beta}{\beta Q_{jr}} [w_{jr} H_{jr}] \end{aligned} \quad (30)$$

we are then able to calculate the total amount of floor space S_j :

$$S_{ju} = S_{ju}^R + S_{ju}^M \quad (31)$$

and finally back out the construction intensity ϕ_j :

$$\phi_j = S_{ju}/L_j \quad (32)$$

C. Migration Costs

To compute migration costs, we need first to compute the city-level equally-divided rent income for local residents $\frac{Q_i S_i^R}{H_i}$ from the residential floor space S_i^R we calculated above. So we have the value of workers with skill s and sector n to move from i to j :

$$v_{in,jk}^s = w_{jk}^s + \frac{Q_{jn} S_{jn}^R}{H_{in}^R} \quad (33)$$

From gravity equations, we could calculate all the migration costs between all city pairs. We assume that the iceberg migration cost for staying in the original city is one, that is $\tau_{in,in}^s = 1$. With data Q_{in} , $v_{in,jk}^s$ and $\pi_{in,jk}^s$, and the gravity equation, we have:

$$\Phi_{in}^s = \sum_{jk=11}^{JK} (\tau_{in,jk}^s Q_{jk}^{1-\beta})^{-\epsilon} (v_{in,jk}^s)^\epsilon = \frac{(Q_{jk}^{1-\beta})^{-\epsilon} (v_{in,in}^s)^\epsilon}{\pi_{in,in}^s} \quad (34)$$

then by inserting Φ_{in}^s into the original gravity equation, we have:

$$\tau_{in,jk}^s = \frac{v_{in,jk}^s}{Q_{jk}^{1-\beta} (\pi_{in,jk}^s \Phi_{in}^s)^{1/\epsilon}}, \text{ for } i \neq j \quad (35)$$

for city-sector pairs with zero migration flows, we assign a migration probability $\pi_{in,jk}^s \sim 0$, resulting in a huge migration cost approaching infinite.

5.3 Measured TFP in the Model

Based on the model solution, we could calculate the measured total factor of productivity in the model. Different from the fundamental skill-augmented labor productivities A_{ju}^h and A_{ju}^l , measured TFP in neither [Olley and Pakes \(1992\)](#) nor [Levinsohn and Petrin \(2003\)](#) can take into consideration the land factor as one of the production inputs. Also, data for the costs of land input

at firm-level is not available. In addition, the fundamental skill-augmented labor productivities A_{ju}^h and A_{ju}^l are not distinguishable in the data as well. Given all these limits, the measured urban TFP in the model which matches the empirical part the best is

$$\begin{aligned}
\ln(\widetilde{TFP}_{ju}) &= \ln \left(\frac{Y_{ju}}{(H_{ju}^h + H_{ju}^l)^\alpha} \right) \\
&= \alpha \ln \left(\frac{[(A_{ju}^h H_{ju}^h)^{\frac{\sigma-1}{\sigma}} + (A_{ju}^l H_{ju}^l)^{\frac{\sigma-1}{\sigma}}]^{\frac{\sigma}{\sigma-1}}}{H_{ju}^h + H_{ju}^l} \right) + (1 - \alpha) \ln(S_{ju}^M) \\
&= \underbrace{\frac{\sigma}{\sigma-1} \ln(A_{ju}^l)}_{\text{fundamental}} + \underbrace{\frac{\sigma}{\sigma-1} \ln \left(\left(\frac{A_{ju}^h}{A_{ju}^l} \Gamma_{ju}^h \right)^{\frac{\sigma-1}{\sigma}} + (\Gamma_{ju}^l)^{\frac{\sigma-1}{\sigma}} \right)}_{\text{skill premium}} + \underbrace{(1 - \alpha) \ln(S_{ju}^M)}_{\text{land scale premium}}
\end{aligned} \tag{36}$$

where $\Gamma_{ju}^h = \frac{H_{ju}^h}{H_{ju}^h + H_{ju}^l}$ and $\Gamma_{ju}^l = 1 - \Gamma_{ju}^h = \frac{H_{ju}^l}{H_{ju}^h + H_{ju}^l}$ are the corresponding high-skill and low-skill labor shares. The decomposition shows that $\ln(\widetilde{TFP}_{ju})$, the measured urban TFP in city j , could be decomposed into four components: fundamental low-skill labor productivity, skill premium of having higher share of high-skill workers (relative high-skill productivity), labor scale premium of having more working population, and land scale premium of having larger urban land.

Table 5 shows a summary of the model results of measured TFP and its decomposition following equation 36 by groups. There are four observations. First, the major difference in measured TFP across regions is in the fundamentals. Eastern and more developed cities have much higher fundamental productivity than non-eastern and less developed cities. Second, growth in measured TFP is mainly from the growth in fundamental productivity rather than other premiums. Third, eastern and more developed cities have higher land scale premium due to relatively larger city size in both population and land. Fourth, however, eastern and more developed cities do not necessarily have higher skill premiums.

We calculate the national-level TFP as the weighted average of city-level TFP, with the number of workers as the weights. Using this decomposition result, we can investigate the changes in the national-level TFP by moving a low-skill worker from a small city to a big city. First, the fundamental term will increase since this worker goes to a big city with higher low-skill productivity. Second, the change in land scale premium is negative. This term is concave functions of S , which means the marginal increment in big cities would be smaller to the marginal deduction in small cities when one worker migrates to a big city. However, the fundamental term dominates the other parts in terms of magnitude, making it clear that having more workers in big cities can increase the national weighted TFP.

Table 5: **Summary of Measured TFP in the Model**

Regions (location, development)	No. of Cities	2005				2010			
		Total	Fund	SP	LSP	Total	Fund	SP	LSP
National	225	38.17	35.31	0.66	2.19	40.43	37.52	0.70	2.22
(eastern, high)	8	40.15	37.28	0.62	2.26	42.08	39.29	0.50	2.29
(eastern, mid)	28	39.08	36.07	0.73	2.28	40.80	37.61	0.91	2.28
(eastern, low)	61	37.36	34.68	0.53	2.15	40.02	37.28	0.55	2.19
(non-eastern, mid)	9	37.74	34.83	0.83	2.08	40.05	37.04	0.88	2.13
(non-eastern low)	119	36.85	34.06	0.69	2.10	39.72	36.87	0.70	2.16

Notes: This table displays a summary of measured TFP $\ln(\widetilde{TFP}_{ju})$ in the model by group (weighted by population) in 2005 and 2010 as well as its decomposition: Fund stands for fundamental, SP stands for skill premium, and LSP stands for land scale premium. Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for overtime comparison consistency.

5.4 Spatial Distribution of Land Tightness

As discussed in the empirical section, the inland-favoring land allocation policy potentially constrains the land supply in eastern and more developed cities. Now, we show how the spatial distribution of land tightness is in our model. We measure the across-city difference in land tightness using land per thousand workers and the within-city difference in land tightness using the relative price of production floor space over residential floor space.

The distribution is presented in Table 6. The across-city difference in land tightness measure shows that eastern and more developed cities have much higher and increasing land tightness in the land-worker ratio, which matches the trend we show in Figure 1. Comparing to non-eastern and less developed cities, eastern and more developed cities have on average 30% to 50% lower land-worker ratios. The within-city difference in land tightness measure shows that eastern and more developed cities have much higher and increasing land tightness in the price of production land relative to residential land. Comparing to non-eastern cities with low development levels, eastern and more developed cities have on average 15% to 80% higher price of production land relative to residential land.

Table 6: **Spatial Distribution of Land Tightness**

Regions (location, development)	No. of Cities	Land/Worker (km^2/k)		Prod./Resid. (q_{ju}/Q_{ju})	
		2005	2010	2005	2010
National	225	0.093	0.083	0.99	0.96
(eastern, high)	8	0.072	0.062	1.53	1.42
(eastern, mid)	28	0.082	0.084	0.98	0.98
(eastern, low)	61	0.083	0.076	0.79	0.79
(non-eastern, mid)	9	0.127	0.117	1.02	1.04
(non-eastern, low)	119	0.121	0.092	0.85	0.85

Notes: This table displays a summary of total urban land supply data by group (weighted by urban population) in 2005 and 2010, as well as the counterfactual migration-based land supply in 2005 and 2010 (unit: km^2/k). Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for overtime comparison consistency.

5.5 Remarks on Quantitative Analysis

These patterns in measured TFP and spatial distribution of land tightness indicate that there are potential productivity and equality gains if we reallocate land from non-eastern and less developed cities to eastern and more developed cities. Since eastern and more developed cities are much higher in fundamental productivity, such land reallocation would attract more workers to migrate to developed cities with higher wages and generate much higher national average fundamental productivity.

6 Eliminating the Inland-favoring Land Policy

In this section, we simulate a counterfactual land allocation policies to alleviate land supply distortions. In this counterfactual world, we assume that the inland-favoring land supply policy was not implemented and the pre-2003 land allocation rule was maintained. Then, we investigate the effect of removing inland-favoring policy on workers' migration, land markets in different regions, TFP measures, and workers' income. We develop an iteration algorithm based on Fang and Huang (2020) to compute the counterfactuals. The details of the algorithm are shown in appendix C.

6.1 Constructing the Counterfactual Policy

Land Supply: We investigate what would have happened if the inland-favoring land supply policy after 2003 was not implemented. To do so, we keep the total land quota increments from 2003 to 2005 and 2010 unchanged, but redistributing the total land supply increment based on the land supply growth rate from 2000 to 2003.¹⁶

$$\widehat{L}_j(t) = L_j(2003) + \underbrace{\sum_j [L_j(t) - L_j(2003)]}_{\text{actual total increment of land}} \times \underbrace{\frac{L_j(2003)(1 + g_{L_j})^{t-2003}}{\sum_j L_j(2003)(1 + g_{L_j})^{t-2003}}}_{\text{city } j\text{'s share if no inland-favoring}} \quad (37)$$

where the first component $L_j(2003)$ is city j 's urban land stock in 2003 just before the structural change happened. The second component is a multiplication of the actual total increment of land $\sum_j [L_j(t) - L_j(2003)]$ in the whole nation and city j 's share of land supply if the total land supply follows the growth rate before 2003. We consider this constrained counterfactual policy because this policy still fulfills the central government's strict goal of controlling total urban land supply expansion. This policy counterfactual can simulate a path without the land allocation rule change in 2003, reflecting the empirical findings in Section 3.

Table 7: **Removing Inland-favoring Policy: Total Land Supply (km^2)**

Regions (location, development)	No. of Cities	Land Supply (Data)			Counterfactual	
		2003	2005	2010	$\widehat{2005}$	$\widehat{2010}$
National	225	19,498	22,268	28,336	22,268	28,336
(eastern, high)	8	2,000	2,190	2,938	2,582	4,377
(eastern, mid)	28	5,836	6,641	8,512	6,925	9,946
(eastern, low)	61	3,890	4,300	5,335	4,295	4,781
(non-eastern, mid)	9	795	873	1,266	836	864
(non-eastern low)	119	6,977	8,264	10,285	7,629	8,367

Notes: This table displays a summary of total urban land supply data by group (summations within group) in 2005 and 2010, as well as the counterfactual migration-based land supply in 2010 (unit: km^2). Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for overtime comparison consistency.

Policy Summary: The counterfactual land allocation policy is summarised in Table 7 for total quantities of land supply and in Table 8 for relative measures of land supply. In Table 7 (8), column

¹⁶We cannot easily date back to pre-1999 because land supply data at the city level is mostly unavailable.

Table 8: **Removing Inland-favoring Policy:
Land Supply Per Thousand Workers (km^2/k)**

Regions (location, development)	No. of Cities	Land Supply (Data)		Counterfactual	
		2005	2010	2005	2010
National	225	0.093	0.083	0.092	0.083
(eastern, high)	8	0.072	0.062	0.075	0.079
(eastern, mid)	28	0.082	0.084	0.085	0.094
(eastern, low)	61	0.083	0.076	0.083	0.070
(non-eastern, mid)	9	0.127	0.117	0.122	0.087
(non-eastern low)	119	0.121	0.092	0.113	0.079

Notes: This table displays a summary of total urban land supply data by group (weighted by urban population) in 2005 and 2010, as well as the counterfactual migration-based land supply in 2005 and 2010 (unit: km^2/k). Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for overtime comparison consistency.

3-5 (3-4) shows the land supply from the data in the real world, and column 6-7 (5-6) shows the land supply in the counterfactual world when we redistribute the land quota according to equation (37). In general, we find in Table 7 and 8 that if we keep the land allocation rule before 2003 (rather than implementing the inland-favoring policy), we redistribute more urban land to more developed cities and increase land per worker in those places, compared with the real world. For instance, land supply per thousand workers in eastern cities with high productivity increases from 0.062 to 0.079 in 2010. Meanwhile, it decreases from 0.092 to 0.079 in non-eastern cities with low productivity in the same year.

6.2 Effects on Economic Development

We show the effects of this counterfactual policy on economic development in migration, output, and measured TFP in this subsection.

Migration and Output: Table 9 illustrates some significant counterfactual outcome changes compared with the real world. First, column 3-4 shows that more workers migrate to urban areas in developed cities when more land quotas are allocated to developed regions. Specifically, the urban low-skill (high-skill) population in eastern cities with high productivity can increase by 14.3% (4.2%) in 2005 and by 17.2% (11.2%) in 2010. On the contrary, under-developed cities lose population. The urban low-skill (high-skill) population in non-eastern cities with low produc-

Table 9: **Removing Inland-favoring Policy: Population, Land Prices and Output**

Regions (location, development)	No. of Cities	Urban Population		Floor Space Price		Total Output		Urban Output
		High	Low	Resid.	Prod.	Urban	Rural	Population
Panel A: Percentage Changes in 2005								
National	225	0.1%	1.5%	-3.2%	-3.6%	2.2%	-0.9%	2.2%
(eastern, high)	8	4.2%	14.3%	-22.7%	-22.7%	13.5%	0.6%	0.5%
(eastern, mid)	28	0.6%	1.2%	-6.1%	-6.1%	1.0%	0.4%	-0.1%
(eastern, low)	61	-0.7%	-0.7%	0.1%	0.1%	-0.8%	-1.0%	-0.1%
(non-eastern, mid)	9	-0.6%	-0.3%	6.3%	6.3%	-1.4%	0.0%	-1.0%
(non-eastern low)	119	-1.5%	-1.6%	-1.4%	-1.4%	-1.9%	-1.7%	-0.3%
Panel B: Percentage Changes in 2010								
National	225	0.1%	1.4%	-7.8%	-5.8%	2.4%	-1.1%	2.4%
(eastern, high)	8	11.2%	17.2%	-23.5%	-23.5%	19.1%	5.6%	2.0%
(eastern, mid)	28	3.6%	5.3%	-22.9%	-22.9%	5.5%	1.8%	0.4%
(eastern, low)	61	-2.9%	-2.7%	7.9%	7.9%	-4.1%	-1.4%	-1.4%
(non-eastern, mid)	9	-7.3%	-8.3%	26.2%	26.2%	-13.2%	0.9%	-4.7%
(non-eastern low)	119	-4.2%	-5.6%	3.5%	3.5%	-7.7%	-3.6%	-2.1%

Notes: This table displays a summary of changes in urban population, floor space price, and total output by group (weighted by population) in 2005 and 2010 as well as its decomposition: Fund stands for fundamental, SP stands for skill premium, PSP stands for population scale premium, and LSP stands for land scale premium. Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for overtime comparison consistency.

tivity declines by 1.6% (1.5%) in 2005 and by 5.6% (4.2%) in 2010. Second, column 5-6 displays the changes in the floor space prices. The national average residential floor and production floor space prices are reduced by 3.2% and 3.6%. As more land is supplied in developed cities, they experience a massive decrease of 20% in the floor space price.¹⁷ Third, column 7-8 shows the changes in the total output in different regions. We find an increase of about 2% in the total output in the urban area in China. The national-level output per capital can also increase by the level (column 9). Like previous outcomes, output in developed cities is increased a lot, at the cost of a relative decrease in regions with lower productivity. We find a 19.1% increase in the total output in eastern cities with high development, but 7.7% decrease in non-eastern cities with low productivity in 2010. However, according to column 9, the output per capita does not change as much as the total output within regions, which means that the loss in the output in under-developed areas is

¹⁷ Lu, Zhang, and Liang (2015) uses regression-based method and finds similar results that the 2003 policy resulted in a relative increase in housing costs in the eastern area.

due to the loss in the population.

Table 10: **Removing Inland-favoring Policy: Measured TFP**

Regions (location, development)	No. of Cities	2005				2010			
		Total	Fund	SP	LSP	Total	Fund	SP	LSP
National	225	6.2%	5.1%	0.0%	1.0%	7.3%	6.2%	-1.0%	0.0%
(eastern, high)	8	8.3%	8.3%	-3.9%	4.1%	16.2%	8.3%	-3.0%	5.1%
(eastern, mid)	28	-2.0%	-2.0%	0.0%	1.0%	2.0%	0.0%	0.0%	1.0%
(eastern, low)	61	0.0%	0.0%	0.0%	0.0%	-1.0%	0.0%	0.0%	-1.0%
(non-eastern, mid)	9	-1.0%	1.0%	0.0%	-1.0%	-10.4%	-4.9%	0.0%	-4.9%
(non-eastern low)	119	0.0%	0.0%	0.0%	0.0%	-4.9%	0.0%	-2.0%	-3.0%

Notes: This table displays a summary of changes in measured TFP $\ln(\widetilde{TFP}_{ju})$ by group (weighted by population) in 2005 and 2010 as well as its decomposition: Fund stands for fundamental, SP stands for skill premium, and LSP stands for land scale premium. Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for overtime comparison consistency.

Measured TFP: Table 10 shows the effects of changing the land supply policy on national-level measured TFP. We can see that by keeping the pre-2003 land allocation rule and distributing more land to developed regions, we can increase the national-level TFP substantially by 6.2% in 2005 and by 7.3% in 2010. The decomposition also shows that most of the national TFP gains are driven by the increase in the fundamental term. We attract more workers to migrate to developed regions with a higher level of TFP, which raises the weighted national TFP. The TFP changes are not even across regions. In 2005, TFP in eastern cities with high productivity increases by 8.3%, and at the same time, there is almost no change in TFP in other cities. In 2010, although we find a larger increase of 16.2% in TFP in developed cities, there is also a significant decrease in under-developed cities due to the land losses. For instance, TFP in non-eastern cities with medium and low productivity decline by 10.4% and 4.9%, respectively. This result shows that although national TFP and output can be increased if we keep up with the pre-2003 land allocation policy, the regional productivity gap will also be increased.

6.3 Effects on Workers' Income

In the previous subsection, we find that regional inequality in productivity and output will widen if we remove the inland-favoring land supply policy. It seems that the inland-favoring land policy

did help to reduce regional gap. However, this is just an illusion. In this subsection, we show the effects on incomes of workers from different places.

Table 11: **Removing Inland-favoring Policy: Workers' Incomes**

Regions (location, development)	No. of Cities	Hukou-based Income					
		2005	$\widehat{2005}$	Changes	2010	$\widehat{2010}$	Changes
(A) Hukou-based Average Wage Income							
National	225	14.6	14.7	0.6%	28.5	28.7	0.7%
(eastern, high)	8	26.1	26.2	0.4%	40.6	40.2	-1.2%
(eastern, mid)	28	20.8	20.8	0.0%	36.3	36.3	0.0%
(eastern, low)	61	12.9	13.0	0.8%	26.3	26.7	1.5%
(non-eastern, mid)	9	15.9	16.0	0.6%	30.4	30.1	-1.0%
(non-eastern low)	119	12.6	12.9	2.4%	26.5	26.9	1.5%
(B) Hukou-based Average Total Income							
National	225	19.0	19.2	1.10%	36.9	37.3	1.04%
(eastern, high)	8	44.5	46.9	5.22%	84.9	92.7	9.14%
(eastern, mid)	28	28.7	28.7	0.20%	52.7	53.4	1.42%
(eastern, low)	61	16.1	16.2	0.59%	32.8	32.9	0.50%
(non-eastern, mid)	9	20.6	20.6	-0.05%	40.9	39.5	-3.58%
(non-eastern low)	119	15.4	15.6	1.34%	31.8	32.0	0.37%

Notes: This table displays a summary of Hukou-based average wage income and total income by group (weighted by Hukou population) in 2005 and 2010 (unit: k RMB). Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for comparison consistency.

Panel (A) and (B) in Table 11 show the changes of wage and total income for workers from different hometowns (Hukou registered locations). We find that in the counterfactual world, the wages for workers from all places are larger than in the real world in 2005. Specifically, workers from non-eastern cities with low productivity gain the most, with a 2.4% increase in their wages. In terms of the total income, it also increases for workers from almost all regions. The only difference is that the total income increases more for citizens from developed cities since we allocate more land to those places which increases their housing income. Similarly, in 2010, workers from cities with low productivity are better off in their incomes if there is no inland-favoring policy. Thus, the inland-favoring land policy in 2003 did not help workers from under-developed areas at all. It actually hurt them by reducing their wages and total incomes.

In general, these results imply that even though it seems that the inland-favoring land supply policy achieved its original goal to shrink the regional output gap, it actually hurt workers

from under-developed areas. Income of people from almost all places were decreased and the convergence of the income is because people from developed regions were hurt more.

6.4 Remarks on Eliminating the Inland-favoring Land Policy

Generally speaking, our counterfactual results show that the inland-favoring land supply policy resulted in a severe misallocation of both land and labor. It increased the price of residential and production floor space and discouraged workers from under-developed cities to migrate to developed cities. It then led to a loss in national-level output and TFP.

The regional convergence is just an illusion. It seems that the regional output and productivity gap was reduced, which was precisely the government's original goal. However, it actually hurt people from both developed and under-developed regions. The income gap was reduced not because the income of people from poor areas increased, but because everyone's income decreased and people from rich areas were reduced more. This placed-based land policy finally resulted in a paradox of helping the region but harming people in the region. We will show in the next section that we can achieve a real convergence by a direct regional transfer policy without efficiency losses, which can help people from poor areas.¹⁸

7 Direct Transfer Instead of Land Policy

In this section, we simulate a regional direct transfer policy without land quota changes. In this counterfactual world, we assume that the inland-favoring land supply policy was not implemented and the pre-2003 land allocation rule was maintained as in Section 6. The central government, instead, chose to transfer the additional land income generated from developed cities to under-developed cities to satisfy its redistribution motive.

7.1 Constructing the Counterfactual Policy

First, we keep the total land quota increments from 2003 to 2005 and 2010 unchanged, but redistributing the total land supply increment based on the land supply growth rate pre-2003 as in Section 6. Then, the central government subtracts partially land income and wage income from land-gaining developed cities and subsidizes land-losing under-developed cities according

¹⁸Another interesting point is to consider the welfare changes in terms of expected utility. We briefly discuss this issue in Appendix F.

to their changes in land allocation.¹⁹ All Hukou registered people in land-losing under-developed cities can get the corresponding subsidy. The amount of subsidy is higher in cities with more land losses, higher floor space prices, and higher wage incomes. They are proportionally but not fully compensated and the transfer proportion is a tuning parameter for policy makers. We have infinite choices of the tuning parameter and only show the results from one set of them. We also choose some other set of parameters and the results are similar. Please refer to Appendix D for detailed discussion about the transfer rule and tuning parameters.²⁰

7.2 Effects on Workers' Incomes

The effects of this counterfactual policy on economic development in migration, output, and measured TFP are very similar to the first counterfactual. Thus, we will not discuss them in details. The main idea is that comparing with the inland-favoring policy, a pre-2003 land supply scheme with direct transfer can increase regional migration, national output and TFP, and reduce average housing cost. The policy does not lead to any spatial distortion or misallocation of resources. Please refer to Appendix E. Now we discuss the effects on worker's incomes.

Table 12 shows the results on incomes of workers from different home cities. Comparing with the real world, when we replace the inland-favoring land policy with a direct transfer, we can increase the total income of workers from the least developed regions by 6.8% in 2005 and 5.9% in 2010. On the contrary, the total income of workers from highly developed cities are reduced by 12.2% in 2005 and 22.0% in 2010. The wage income of workers from under-developed areas is also increased in both years because more of them now can move out to big cities with higher wages. Therefore, this direct transfer policy achieves a real convergence by increasing both the wage income and the total income of workers from cities with lower development level.

Generally speaking, using a direct regional transfer instead of inland-favoring land policy can not only sustain efficient resource allocation, but also achieve real convergence by increasing

¹⁹For instance, in a two city example, subtracting land supply in the under-developed city i and reallocating to the developed city j affects income of workers Hukou-registered in city i (opposite for city j) in both income components: less residential floor space income and lower Hukou city's wage income due to less production floor space. Therefore, we could partially subtract the additional income from the additional land allocated to land-gaining cities and compensate land-losing cities for their losses to achieve the redistribution motive.

²⁰We do not discuss the optimal redistribution rule for two reasons. First, finding the optimal redistribution rule is computationally impossible because of the infinite dimensions of the redistribution problem caused by the number of cities, continuous choice of transfer in each city, and the nonlinear interactions among agents. Second, the intention of our paper is not about designing the optimal rule but to show the current land policy is neither efficient nor equal. Therefore, we show just a simple rule which performs better in both efficiency and equality. For discussion about optimal spatial policy, please refer to Hsieh and Klenow (2009); Fajgelbaum and Gaubert (2020).

Table 12: **Direct Transfer Instead of Land Policy: Workers' Incomes**

Regions (location, development)	No. of Cities	Hukou-based Income					
		2005	$\widehat{2005}$	Changes	2010	$\widehat{2010}$	Changes
(A) Hukou-based Average Wage Income							
National	225	14.6	14.8	0.97%	28.5	28.6	0.49%
(eastern, high)	8	26.1	26.2	0.36%	40.6	40.3	-0.60%
(eastern, mid)	28	20.8	20.8	-0.01%	36.3	36.2	-0.40%
(eastern, low)	61	12.9	13.0	1.08%	26.3	26.6	0.83%
(non-eastern, mid)	9	16.0	16.0	0.09%	30.4	29.7	-2.38%
(non-eastern, low)	119	12.6	12.8	1.63%	26.5	26.7	0.93%
(B) Hukou-based Average Total Income							
National	225	19.0	19.1	0.50%	36.9	37.3	1.09%
(eastern, high)	8	44.5	39.1	-12.21%	84.9	66.2	-22.01%
(eastern, mid)	28	28.7	27.5	-4.00%	52.7	49.6	-5.77%
(eastern, low)	61	16.1	15.9	-1.10%	32.8	33.7	2.88%
(non-eastern, mid)	9	20.6	20.4	-0.73%	40.9	45.1	10.21%
(non-eastern, low)	119	15.4	16.5	6.80%	31.8	33.7	5.93%

Notes: This table displays a summary of Hukou-based average wage income and total income by group (weighted by Hukou population) in 2005 and 2010 (unit: k RMB). Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for comparison consistency.

incomes of workers from under-developed cities.²¹

8 Conclusion

This paper studies how regulated land allocation policy creates spatial misallocation. We focus on a major policy change favoring under-developed non-eastern regions in China, also known as the Inland-favoring Policy, which is intended to balance the regional growth between the developed eastern regions and the under-developed non-eastern regions. Causal evidence shows that this policy change increased land prices and decreased firm-level TFP in the developed eastern region. A spatial equilibrium model shows that spatial misallocation was created because developed eastern regions have higher productivity and are more constrained in land supply. Counterfactuals of eliminating this inland-favoring policy can ease this spatial misallocation and improve national-level productivity and output.

²¹We also consider the welfare changes in terms of expected utility. We briefly discuss this issue in Appendix F.

Moreover, at the cost of sacrificing national-level productivity and output, the inland-favoring policy actually hurt workers from under-developed regions. By eliminating this policy change, the income of workers from poor areas would have increased thanks to more migration to developed cities. This shows that even though the inland-favoring policy reduced the regional output gap, it in fact caused TFP and output losses, and unfavorably hurt workers from under-developed regions by hindering their access to higher-paid developed cities.

Finally, we suggest a direct regional transfer to replace the inland-favoring land supply policy. By keeping pre-2003 land allocation and transferring additional income from developed cities to under-developed cities, we can achieve a real convergence by increasing incomes for workers from under-developed regions and in the same time there is no efficiency loss or spatial misallocation.

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Appendix

A Additional Robustness Checks

In this section, we implement more robustness checks for our empirical analysis.

First, we implement the empirical analysis using firm-level TFP calculated by OP method. Figure A1 and A2 show the parallel trend test. Table A1 shows the results of the main regression. All the results are very similar to the results when we calculate TFP using LP method.

Second, we drop Liaoning, Hebei, and their neighbor provinces. Since northeastern China also enjoyed favorable policies for regional development, Liaoning was not restricted by the land supply policy after 2003. Hebei, usually regarded as a coastal province, is actually more like a middle province in terms of its per capita GDP. Therefore, we drop the samples in Liaoning, Hebei, and their neighboring cities in the inland areas. Table A2, A3, and A4 show that the results are robust.

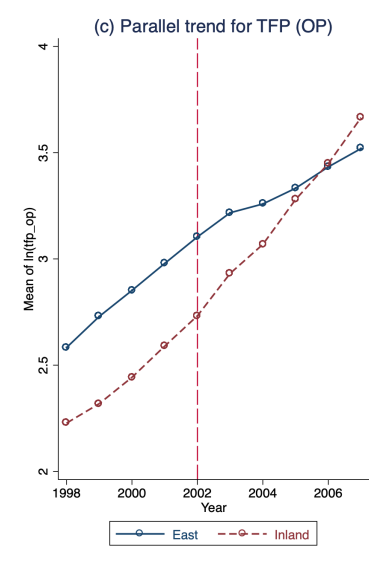
Third, we change the bandwidth for linear and quadratic fit.²² We show two other bandwidth choices, 70 km and 90 km. Table A5 to A7 show the results on land prices, firm-level TFP measured by LP and OP method respectively. The results are very robust compared with the main regressions.

Fourth, Chinese central government did not restrictively require local governments to upload their land transaction information to China Land Market Website until 2006. Thus, there was a drastic increase in the number of land parcels in our data after 2006. Then, there is a concern that the samples after 2006 could be very different from the samples before 2006. Thus, we check the robustness by dropping all samples after 2006 in the land price regression. The results are shown in Table A8. It illustrates no quantitative change.

Fifth, China entered into WTO at the end of 2001, which changed entirely China's economic structure. Although it is about two years before the inland-favoring land supply policy, we are still concerned about the possible confusion from a reducing trade barrier, which may affect firms in eastern and non-eastern regions differently. To address this issue, we run the TFP regression by keeping only firms with zero goods export. These firms should be the ones that are affected the least by the WTO entrance. The regression results are shown in Table A9 and A10. The main conclusions are still sustained.

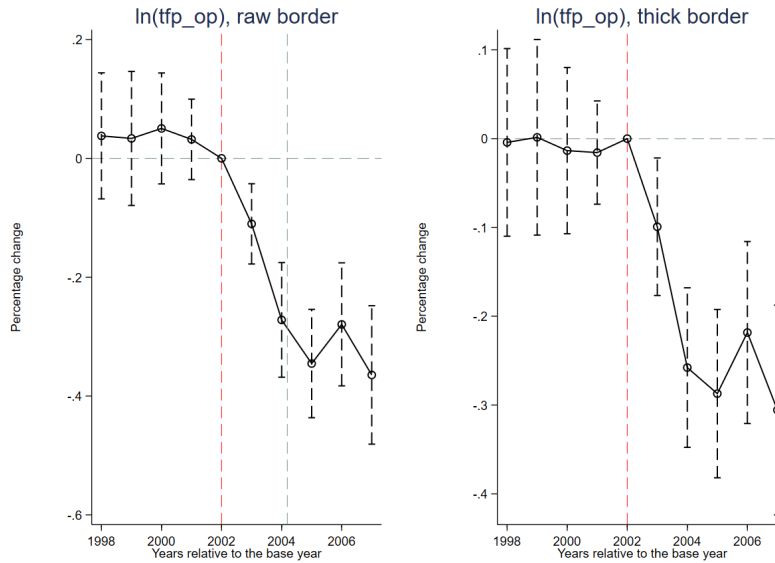
²²We do not change bandwidth of the local linear regression since it already uses the optimal bandwidth.

Figure A1: Parallel Trend of Outcome Variables



Notes: This figure shows the time trends of the firm-level TFP calculated using OP method. The blue solid line is the average outcome value in the developed eastern region and the red dashed line is the value in the inland region. The dashed vertical line is put in the year of 2002, just before the implementation of the inland-favoring land policy. It is clear that all the outcome variables have very similar trends before the policy.

Figure A2: Event Study - TFP (OP)



Notes: The dependent variable is the firm-level TFP calculated by OP method. The bandwidth is 80 km from the border of eastern and non-eastern classification. The confidence interval is 90%.

Table A1: RD-DID Results on TFP (OP)

	Local Linear		Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	Raw Border (1)	Thick Border (2)	Raw Border (3)	Thick Border (4)	Raw Border (5)	Thick Border (6)
East	0.512*** (0.086)	0.391*** (0.072)	0.411*** (0.045)	0.351*** (0.050)	0.473*** (0.054)	0.338*** (0.073)
Post2003×East	-0.492*** (0.071)	-0.262** (0.100)	-0.324*** (0.054)	-0.240*** (0.050)	-0.428*** (0.061)	-0.244*** (0.081)
City Lagged Controls	Y	Y	Y	Y	Y	Y
Border FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Observations	46688	48991	281718	253850	281718	253850
Adjusted R-squared	0.174	0.165	0.151	0.151	0.152	0.151

Notes: The dependent variable is the firm-level TFP measured by OP method. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. Sample in Local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Polynomial RD is restricted to be within a bandwidth of 80 km around the raw boundary.

*** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

Table A2: Robustness: Land Prices Regressions without Liaoning and Hebei

	Local Linear		Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	Raw Border (1)	Thick Border (2)	Raw Border (3)	Thick Border (4)	Raw Border (5)	Thick Border (6)
East	-12.575*** (1.985)	-12.009*** (1.659)	-7.940*** (1.617)	-6.172*** (1.319)	-20.142*** (4.720)	-15.375*** (2.618)
Post2003×east	12.931*** (1.988)	12.394*** (1.685)	8.340*** (1.602)	6.591*** (1.297)	20.446*** (4.743)	15.799*** (2.631)
City Lagged Controls	Y	Y	Y	Y	Y	Y
Border FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Observations	91427	41206	123071	113349	123071	113349
Adjusted R-squared	0.047	0.068	0.043	0.041	0.044	0.042

Notes: The dependent variable is the land parcel-level price. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. Sample in Local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Polynomial RD is restricted to be within a bandwidth of 80 km around the raw boundary. *** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

Table A3: Robustness: TFP Regressions without Liaoning and Hebei (LP)

	Local Linear		Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	Raw Border (1)	Thick Border (2)	Raw Border (3)	Thick Border (4)	Raw Border (5)	Thick Border (6)
East	0.281*** (0.100)	0.194** (0.093)	0.317*** (0.059)	0.267*** (0.050)	0.281*** (0.083)	0.184** (0.077)
Post2003×East	-0.423*** (0.073)	-0.305*** (0.088)	-0.279*** (0.064)	-0.249*** (0.056)	-0.325*** (0.078)	-0.204** (0.085)
City Lagged Controls	Y	Y	Y	Y	Y	Y
Border FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Observations	59198	43604	235932	212859	235932	212859
Adjusted R-squared	0.089	0.104	0.086	0.089	0.087	0.089

Notes: The dependent variable is the firm-level TFP measured by LP method. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. Sample in Local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Polynomial RD is restricted to be within a bandwidth of 80 km around the raw boundary.

*** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

Table A4: Robustness: TFP Regressions without Liaoning and Hebei (OP)

	Local Linear		Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	Raw Border (1)	Thick Border (2)	Raw Border (3)	Thick Border (4)	Raw Border (5)	Thick Border (6)
East	0.546*** (0.106)	0.368*** (0.079)	0.391*** (0.050)	0.300*** (0.053)	0.458*** (0.068)	0.242*** (0.076)
Post2003×East	-0.448*** (0.059)	-0.220** (0.099)	-0.272*** (0.057)	-0.196*** (0.060)	-0.340*** (0.062)	-0.132 (0.090)
City Lagged Controls	Y	Y	Y	Y	Y	Y
Border FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Observations	38550	40744	235932	212859	235932	212859
Adjusted R-squared	0.150	0.148	0.136	0.137	0.136	0.137

Notes: The dependent variable is the firm-level TFP measured by OP method. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. Sample in Local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Polynomial RD is restricted to be within a bandwidth of 80 km around the raw boundary.

*** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

Table A5: Robustness: Land Prices Regressions with Different Bandwidth Choices

	Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	bandwidth=70km (1)	bandwidth=90km (2)	bandwidth=70km (3)	bandwidth=90km (4)
East	-3.279** (1.269)	-2.389** (1.068)	-1.564 (3.131)	-5.720** (2.220)
Post2003×east	3.492*** (1.261)	2.780*** (1.055)	1.742 (3.118)	5.824*** (2.203)
City Lagged Controls	Y	Y	Y	Y
Border FE	Y	Y	Y	Y
Year FE	Y	Y	Y	Y
Observations	147108	190990	147108	190990
Adjusted R-squared	0.057	0.049	0.058	0.051

Notes: The dependent variable is the land parcel-level price. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. *** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

Table A6: Robustness: TFP Regressions with Different Bandwidth Choices (LP)

	Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	bandwidth=70km (1)	bandwidth=90km (2)	bandwidth=70km (3)	bandwidth=90km (4)
East	0.410*** (0.054)	0.434*** (0.047)	0.319*** (0.065)	0.389*** (0.062)
Post2003×east	-0.436*** (0.071)	-0.412*** (0.060)	-0.485*** (0.084)	-0.469*** (0.086)
City Lagged Controls	Y	Y	Y	Y
Border FE	Y	Y	Y	Y
Year FE	Y	Y	Y	Y
Observations	228271	340561	228271	340561
Adjusted R-squared	0.097	0.088	0.098	0.089

Notes: The dependent variable is the firm-level TFP measured by LP method. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. *** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

Table A7: Robustness: TFP Regressions with Different Bandwidth Choices (OP)

	Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	bandwidth=70km (1)	bandwidth=90km (2)	bandwidth=70km (3)	bandwidth=90km (4)
East	0.412*** (0.049)	0.423*** (0.041)	0.449*** (0.054)	0.451*** (0.053)
Post2003×east	-0.348*** (0.059)	-0.325*** (0.049)	-0.433*** (0.060)	-0.404*** (0.065)
City Lagged Controls	Y	Y	Y	Y
Border FE	Y	Y	Y	Y
Year FE	Y	Y	Y	Y
Observations	228271	340561	228271	340561
Adjusted R-squared	0.157	0.148	0.157	0.148

Notes: The dependent variable is the firm-level TFP measured by OP method. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. *** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

Table A8: Robustness: Land Prices Regressions Before 2006

	Local Linear		Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	Raw Border (1)	Thick Border (2)	Raw Border (3)	Thick Border (4)	Raw Border (5)	Thick Border (6)
East	-5.767*** (1.314)	-9.208** (3.443)	-3.818*** (1.042)	-3.311*** (0.811)	-5.906** (2.935)	-6.338*** (1.639)
Post2003×east	5.771*** (1.339)	9.017** (3.428)	4.032*** (1.013)	3.567*** (0.779)	5.552* (2.815)	6.266*** (1.744)
City Lagged Controls	Y	Y	Y	Y	Y	Y
Border FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Observations	11683	4967	14848	13671	14848	13671
Adjusted R-squared	0.146	0.170	0.132	0.139	0.136	0.145

Notes: The dependent variable is the land parcel-level price. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. Sample in Local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Polynomial RD is restricted to be within a bandwidth of 80 km around the raw boundary. We drop all samples after 2006. *** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

Table A9: Robustness: TFP Regressions without Exporting Firms (LP)

	Local Linear		Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	Raw Border (1)	Thick Border (2)	Raw Border (3)	Thick Border (4)	Raw Border (5)	Thick Border (6)
East	0.355*** (0.098)	0.232*** (0.081)	0.425*** (0.053)	0.374*** (0.051)	0.383*** (0.071)	0.337*** (0.073)
Post2003×East	-0.550*** (0.135)	-0.269** (0.102)	-0.408*** (0.078)	-0.331*** (0.054)	-0.516*** (0.116)	-0.343*** (0.087)
City Lagged Controls	Y	Y	Y	Y	Y	Y
Border FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Observations	49617	37511	195068	176822	195068	176822
Adjusted R-squared	0.122	0.124	0.113	0.112	0.113	0.112

Notes: The dependent variable is the firm-level TFP measured by LP method. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. Sample in Local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Polynomial RD is restricted to be within a bandwidth of 80 km around the raw boundary. We drop all firms with export. *** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

Table A10: Robustness: TFP Regressions without Exporting Firms (OP)

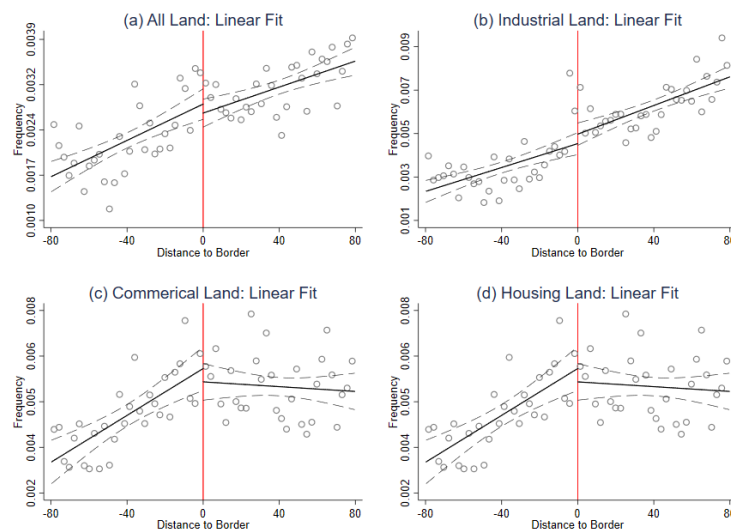
	Local Linear		Polynomial RD (Poly=1)		Polynomial RD (Poly=2)	
	Raw Border (1)	Thick Border (2)	Raw Border (3)	Thick Border (4)	Raw Border (5)	Thick Border (6)
East	0.477*** (0.099)	0.324*** (0.076)	0.401*** (0.043)	0.344*** (0.046)	0.459*** (0.058)	0.333*** (0.068)
Post2003×East	-0.495*** (0.086)	-0.190 (0.114)	-0.316*** (0.055)	-0.240*** (0.052)	-0.432*** (0.073)	-0.261*** (0.087)
City Lagged Controls	Y	Y	Y	Y	Y	Y
Border FE	Y	Y	Y	Y	Y	Y
Year FE	Y	Y	Y	Y	Y	Y
Observations	32013	35184	195068	176822	195068	176822
Adjusted R-squared	0.206	0.186	0.176	0.175	0.177	0.175

Notes: The dependent variable is the firm-level TFP measured by OP method. The set of lagged city level control variables includes the log of GDP, the log of population, the log of city area, and the scale of the service sector. Sample in Local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Polynomial RD is restricted to be within a bandwidth of 80 km around the raw boundary. We drop all firms with export. *** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

B More Regression Assumption Validations

Apart from the parallel trend assumption, there is another RD-related assumption we need to impose in our RD-DID specification. We assume that there is no manipulation of land selling and the land parcels around the border are comparable. Although the land quota is set by the central government, local governments are responsible for choosing which piece of land to develop and sell. Thus, they may deliberately develop land with specific characteristics, either observed or unobserved by econometricians. For example, non-eastern government may choose to develop all of their land at the border for some reason while eastern government may not. If this manipulation is true, we may not be able to assume that the land parcels just on the eastern side of the border are similar to the ones just on the non-eastern side. Figure B1 shows the distribution of the sold land parcels. We also separate the figures by their usage. It illustrates that for all kinds of land parcels, there is no evidence of discontinuity in their distribution at the border. Similarly, Table B1 shows the balance of some pre-determined land parcel characteristics, including elevation, slope and ruggedness. We test whether there is any jump of these covariates at the border by running different RD regressions. The results do not show any evidence of jumps of these pre-determined covariates. Thus, the land parcels at the border are comparable.

Figure B1: Distribution of Land Parcels



Notes: The dependent variable is the land parcel frequency. The bandwidth is 80 km from the border of eastern and non-eastern areas.

Table B1: Balance Check

	(1) Elevation	(2) Slope	(3) Terrain Ruggedness
Panel A: Local Linear Regression			
East	8.762 (30.015)	-0.165 (0.217)	-5.413 (7.130)
Border FE	Yes	Yes	Yes
Observations	2766	3088	3684
Panel B: Polynomial RD (Poly=1)			
East	-18.943 (17.796)	0.140 (0.152)	4.852 (5.015)
Border FE	Yes	Yes	Yes
Observations	8498	8506	8498
Panel C: Polynomial RD (Poly=2)			
East	5.553 (25.162)	-0.191 (0.210)	-4.719 (7.008)
Border FE	Yes	Yes	Yes
Observations	8498	8506	8498

Notes: Unit of observation: 10 km × 10 km grid. Sample in local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Local linear regression specification is restricted to be within an optimal bandwidth using a constant kernel. Sample in Polynomial RD is restricted to be within a bandwidth of 80 km around the raw boundary. Standard errors in parentheses are clustered at the 1 km interval level in regressions with polynomials in distance. Data source: elevation comes from the US Geological Survey Center (<http://www.webgis.com/srtm30.html>). Slope and terrain ruggedness index come from Nunn and Puga (2012), <https://diegopuga.org/data/rugged/#grid>

*** $p < 0.01$, ** $p < 0.05$, and * $p < 0.1$.

C Algorithm for Counterfactual Analysis

Given the exogenous variables and parameters, we need to calculate the response of endogenous variables resulting from some policy changes. As we have mentioned, we will select the equilibrium that is the closest to the one in the real world. Thus, the initial values of the variables will be set to be equal to the model result in 2005 and 2010. Since we have a within-city land market between residential and production usages, we adopt a double-loop variation of the method in Fang and Huang (2020).

We first specify the exogenous variables and the model equation system. The exogenous variables would be $\{H_i^s, \epsilon_j^s, \tau_{ij}^s, L_j, \phi_j, \eta_j\}$ where i index Hukou city, j index destination city, and s index skill. The equation system consists of three blocks: 1). Migration Block: worker income equations, and gravity equations; 2). Production Block: production equations, wage equations, and production floor space price equations; 3). Housing Block: construction equations and market clearing equations.

To calculate the counterfactuals after some policy changes, we start with the block which changes happens, and then iterate block by block to update the endogenous variables until all endogenous variables converge to certain small thresholds. We present the process of calculating a counterfactual which is direct increase land supply as an example below.

Suppose a land reallocation policy is $\hat{L}_j = \Delta_j \times L_j$ for every city j . We have a following process of updating variables $\{x_{jk}^t\}^{OI}$ which indicates t 's iteration of variable x . Let's start with the housing block just for initiating (there is no need to update $\{\hat{S}_j\}^*$ again):

Outer Loop: In the outer loop we update the floor space distribution between residential and production usages according to the inner loop equilibrium unit prices of residential and production floor space. The outer loop converges when the prices satisfies the equilibrium price equation between both markets.

Step 1: Initiating (make sure of non-zero floor space supply)

$$\{\hat{S}_{ju}^*\} = \phi_j \hat{L}_j \quad (38)$$

$$\{\hat{S}_{ju}^R\}^1 = S_{ju}^R \times (\{\hat{S}_{ju}^*\} / S_{ju}) \quad (39)$$

$$\{\hat{S}_{ju}^M\}^1 = S_{ju}^M \times (\{\hat{S}_{ju}^*\} / S_{ju}) \quad (40)$$

Step 2: **Inner Loop** (feedback prices to Outer Loop, x^{1*} means Inner Loop for x converges)

$$\{\hat{Q}_{ju}\}^{1*} = \frac{1 - \beta}{\beta} \frac{w_{ju}^l H_{ju}^l + w_{ju}^h H_{ju}^h}{\{\hat{S}_{ju}^R\}^1} \quad (41)$$

$$\{\hat{q}_{ju}\}^{1*} = (1 - \alpha) \left(\frac{\alpha}{\{\hat{W}_{ju}\}^{1*}} \right)^{\frac{\alpha}{1-\alpha}} \quad (42)$$

Step 3: Compare floor space prices, generate excess demand for residential. The core idea is that if $\{\hat{Q}_{ju}\}^{1*} > \frac{\{\hat{q}_{ju}\}^{1*}}{\eta_j}$, residential floor space is smaller than equilibrium and production floor space is larger than equilibrium, so we need to redistribute more residential floor space to production floor space, until $\{\hat{Q}_{ju}\}^{1*} = \frac{\{\hat{q}_{ju}\}^{1*}}{\eta_j}$. We update partially with step size γ .

$$\{ED_j^R\}^1 = \gamma \left(\frac{\{\hat{Q}_{ju}\}^{1*} - \frac{\{\hat{q}_{ju}\}^{1*}}{\eta_j}}{\{\hat{Q}_{ju}\}^{1*} + \frac{\{\hat{q}_{ju}\}^{1*}}{\eta_j}} \right) \times \{\hat{S}_{ju}^R\}^1 \quad (43)$$

Step 4: Update floor space

$$\{\hat{S}_{ju}^R\}^2 = \{\hat{S}_{ju}^R\}^1 + \{ED_j^R\}^1 \quad (44)$$

$$\{\hat{S}_{ju}^M\}^2 = \{\hat{S}_{ju}^M\}^1 - \{ED_j^R\}^1 \quad (45)$$

Finally, we repeat Step 2 to Step 4 until market clearing condition holds: $\{\hat{Q}_{ju}\}^{**} = \frac{\{\hat{q}_{ju}\}^{**}}{\eta_j}$.

Inner Loop: In the Inner Loop we update the migration and production decisions given the residential and production floor space. This Inner Loop is almost identical to [Fang and Huang \(2020\)](#)'s method. Notation: we denote by x^{OI} where O denotes the step in the Outer Loop and I denotes the step in the Inner Loop. Here we demonstrate with $O = 1$.

Step 2-1: Update housing block

$$\{\hat{Q}_{ju}\}^{11} = \frac{1 - \beta}{\beta} \frac{w_{ju}^l H_{ju}^l + w_{ju}^h H_{ju}^h}{\{\hat{S}_{ju}^R\}^1} \quad (46)$$

$$\{\hat{Q}_{jr}\}^{11} = \tau \{\hat{Q}_{ju}\}^{11} \quad (47)$$

$$\{S_{jr}^R\}^{11} = \frac{1 - \beta}{\beta} \frac{w_{jr} H_{jr}}{\{\hat{Q}_{jr}\}^{11}} \quad (48)$$

Step 2-2: Update migration block

$$\{v_{in,jk}^{\hat{s}}\}^{11} = w_{jk}^s + \frac{\{\hat{Q}_{in}\}^{11}\{\hat{S}_{in}^R\}^{11}}{H_{in}^R} \quad \text{from eq.(6)} \quad (49)$$

$$\{\pi_{in,jk}^{\hat{s}}\}^{11} = \frac{(\tau_{in,jk}^s \{\hat{Q}_{jk}\}^{11^{1-\beta}})^{-\epsilon} (\{v_{in,jk}^{\hat{s}}\}^{11})^\epsilon}{\sum_{j'k'=11}^{JK} (\tau_{in,jk}^s \{\hat{Q}_{j'k'}\}^{11^{1-\beta}})^{-\epsilon} (\{v_{in,j'k'}^{\hat{s}}\}^{11})^\epsilon} \quad \text{from eq.(12)} \quad (50)$$

Then, combining $\{\pi_{in,jk}^{\hat{s}}\}^{11}$ with $\{H_{in}^s\}$, we are able to calculate $\{\hat{H}_{jk}^s\}^{11}$.

Step 2-3: Update production block

$$\{\hat{X}_{ju}\}^{11} = [(\{A_{ju}^h\}^{11}\{\hat{H}_{ju}^h\}^{11})^{\frac{\sigma-1}{\sigma}} + (\{A_{ju}^l\}^{11}\{\hat{H}_{ju}^l\}^{11})^{\frac{\sigma-1}{\sigma}}]^{\frac{\sigma}{\sigma-1}} \quad \text{from eq.(13)} \quad (51)$$

$$\{\hat{w}_{ju}^l\}^{11} = \alpha(\{\hat{X}_{ju}\}^{11})^{\alpha-1}(\{\hat{S}_{ju}^M\}^{11})^{1-\alpha}(\{A_{ju}^l\}^{11})^{\frac{\sigma-1}{\sigma}}(\{\hat{X}_{ju}\}^{11})^{\frac{1}{\sigma}}(\{\hat{H}_{ju}^l\}^{11})^{-\frac{1}{\sigma}} \quad \text{from eq.(14)} \quad (52)$$

$$\{\hat{w}_{ju}^h\}^{11} = \alpha(\{\hat{X}_{ju}\}^{11})^{\alpha-1}(\{\hat{S}_{ju}^M\}^{11})^{1-\alpha}(\{A_{ju}^h\}^{11})^{\frac{\sigma-1}{\sigma}}(\{\hat{X}_{ju}\}^{11})^{\frac{1}{\sigma}}(\{\hat{H}_{ju}^h\}^{11})^{-\frac{1}{\sigma}} \quad \text{from eq.(15)} \quad (53)$$

Step 2-4: Update prices

$$\{\hat{Q}_{ju}\}^{12} = \frac{1-\beta}{\beta} \frac{\{w_{ju}^l H_{ju}^l + w_{ju}^h H_{ju}^h\}^{11}}{\{\hat{S}_{ju}^R\}^{11}} \quad (54)$$

We repeat Step 2-1 to Step 2-4 until residential floor space prices $\{\hat{Q}_{ju}\}^{1t}$ converge to $\{\hat{Q}_{ju}\}^{1*}$. We then output $\{\hat{Q}_{ju}\}^{1*}$ and $\{\hat{q}_{ju}\}^{1*}$ for the use in the outer loop.

$$\{\hat{Q}_{ju}\}^{1*} = \frac{1-\beta}{\beta} \frac{\{w_{ju}^l H_{ju}^l + w_{ju}^h H_{ju}^h\}^{1*}}{\{\hat{S}_{ju}^R\}^{11}} \quad (55)$$

$$\{\hat{W}_{ju}\}^{11} = \frac{\{\hat{w}_{ju}^h\}^{11}\{\hat{H}_{ju}^h\}^{11} + \{\hat{w}_{ju}^l\}^{11}\{\hat{H}_{ju}^l\}^{11}}{\{\hat{X}_{ju}\}^{11}} \quad (56)$$

$$\{\hat{q}_{ju}\}^{1*} = (1-\alpha) \left(\frac{\alpha}{\{\hat{W}_{ju}\}^{1*}} \right)^{\frac{\alpha}{1-\alpha}} \quad (57)$$

D Details of Transfer Rules

Without loss of generality, we design a direct transfer rule as follows for each city i :

$$\begin{aligned} \hat{D}T_{iu} &= \underbrace{\hat{Q}_{iu}\hat{S}_{iu}^R \times \gamma_u^l \times \frac{-\Delta L_i}{L_i}}_{\text{urban land income transfer}} + \underbrace{(\hat{w}_{iu}^l H_{iu}^l + \hat{w}_{iu}^h H_{iu}^h) \times \gamma_u^w \times \frac{-\Delta L_j}{L_j}}_{\text{urban wage income transfer}} \\ \hat{D}T_{ir} &= \underbrace{(\hat{w}_{ir} H_{ir}) \times \gamma_r \times \frac{-\Delta L_j}{L_j}}_{\text{rural wage income transfer}} \end{aligned}$$

where $\hat{D}T_{iu}$ stands for direct transfer to urban workers and $\hat{D}T_{ir}$ stands for direct transfer to rural workers. For a city losing $\frac{\Delta L_i}{L_i} (<0)$ of its land, urban workers will be compensated with their floor space income $\hat{Q}_{iu}\hat{S}_{iu}^R$ partially to a share of γ_u^l , and opportunity wage income $(\hat{w}_{iu}^l H_{iu}^l + \hat{w}_{iu}^h H_{iu}^h)$ partially to a share of γ_u^w . Since rural workers also face losses in their opportunity wage income for losing accesses to their closest urban sector (the urban sector in their own city), they will be compensated with indirect opportunity wage income $\hat{w}_{ir} H_{ir}$ to a share of γ_r . These direct transfers are possible to implement because land-gaining cities ($\frac{\Delta L_i}{L_i} > 0$) have much higher floor space prices and wages. The scale of transfer depends on the tuning parameters $\{\gamma_u^l, \gamma_u^w, \gamma_r\}$. As we mentioned, we are not planning or able to discuss the optimal redistribution policy design in this paper, therefore, we show just one set of the tuning parameters $\{\gamma_u^l, \gamma_u^w, \gamma_r\} = \{0.5, 0.1, 0.5\}$ for 2010 and $\{\gamma_u^l, \gamma_u^w, \gamma_r\} = \{0.75, 0.1, 0.5\}$ for 2005 which are sufficient to generate substantial redistribution. We also choose some other set of parameters and the results are similar.

This counterfactual is feasible to implement and still fulfills the central government's goal of balancing regional development. This mechanism mimics a policy called the "land quota market", which has been recommended by previous literature (Lu and Xiang, 2016). The basic idea is that central government can balance the development of different regions by transferring revenues from developed cities to under-developed cities, rather than allocating the land supply directly. Since the land income and wage income in land-gaining cities is higher than the land income in land-losing cities and the total amount of land supply is unchanged, this redistribution is feasible and central government can even generate additional profit.

E More Counterfactual Results with Transfer

Table E1: Direct Transfer Instead of Land Policy: Population, Land Prices and Output

Regions (location, development)	No. of Cities	Urban Population		Floor Space Price		Total Output		Urban Output
		High	Low	Resid.	Prod.	Urban	Rural	Population
Panel A: Percentage Changes in 2005								
National	225	0.0%	1.0%	-3.9%	-3.9%	2.0%	-0.9%	1.1%
(eastern, high)	8	5.3%	13.9%	-22.8%	-22.8%	12.4%	0.4%	-0.2%
(eastern, mid)	28	0.6%	0.5%	-6.5%	-6.5%	0.5%	-0.4%	0.0%
(eastern, low)	61	-1.1%	-0.9%	-0.2%	-0.2%	-1.1%	-1.0%	-0.1%
(non-eastern, mid)	9	-0.9%	-0.8%	5.9%	5.9%	-1.4%	0.0%	-0.6%
(non-eastern, low)	119	-2.2%	-1.6%	-1.5%	-1.5%	-1.9%	-0.9%	-0.1%
Panel B: Percentage Changes in 2010								
National	225	0.0%	0.0%	-8.3%	-8.3%	0.8%	0.0%	0.8%
(eastern, high)	8	11.3%	13.1%	-25.5%	-25.5%	15.8%	-0.9%	2.6%
(eastern, mid)	28	4.1%	3.1%	-23.8%	-23.8%	4.2%	2.4%	0.9%
(eastern, low)	61	-3.4%	-3.4%	7.4%	7.4%	-4.6%	0.1%	-1.2%
(non-eastern, mid)	9	-7.8%	-9.6%	24.9%	24.9%	-14.2%	0.0%	-5.6%
(non-eastern, low)	119	-4.7%	-6.2%	2.8%	2.8%	-8.3%	-0.5%	-2.5%

Notes: This table displays a summary of changes in urban population, floor space price, and total output by group (weighted by population) in 2005 and 2010 as well as its decomposition: Fund stands for fundamental, SP stands for skill premium, PSP stands for population scale premium, and LSP stands for land scale premium. Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for overtime comparison consistency.

Table E2: **Direct Transfer Instead of Land Policy: Measured TFP**

Regions (location, development)	No. of Cities	2005				2010			
		Total	Fund	SP	LSP	Total	Fund	SP	LSP
National	225	5.4%	4.5%	-0.3%	1.2%	5.3%	5.6%	-0.4%	0.1%
(eastern, high)	8	7.3%	8.1%	-4.9%	4.3%	10.9%	8.2%	-2.8%	5.5%
(eastern, mid)	28	-1.3%	-2.0%	0.0%	0.7%	0.7%	-0.3%	0.0%	1.1%
(eastern, low)	61	0.2%	-0.1%	0.1%	0.3%	-1.7%	0.0%	-0.2%	-1.5%
(non-eastern, mid)	9	-0.3%	0.5%	-0.2%	-0.5%	-9.9%	-5.2%	-0.2%	-4.8%
(non-eastern, low)	119	0.4%	0.4%	0.2%	-0.2%	-5.2%	-0.4%	-2.2%	-2.7%

Notes: This table displays a summary of changes in measured TFP $\ln(\widetilde{TFP}_{ju})$ by group (weighted by population) in 2005 and 2010 as well as its decomposition: Fund stands for fundamental, SP stands for skill premium, and LSP stands for land scale premium. Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for overtime comparison consistency.

F Discussion on Utility Implications

F.1 Calculation of the Utility

In this section, we briefly discuss the utility changes. We do not put this section in our main context since we believe the results can only be suggestive. First, utility is fundamentally ordinal. Thus, the aggregation of utilities across people with different characteristics from different regions is not innocuous. We do not know how to assign weights on different people. Second, the aggregation results depend heavily on the utility's functional form. As a result, we focus on income changes in our main context. This section can only give some suggestive implication for the policy effect on workers.

We could calculate the ex-ante expected utility of worker based on the property of Fréchet distribution. The cumulative distribution function of utility of workers originated from city i sector n with skill s is

$$G_{in}^s(u) = e^{-\Phi_{in}^s u^{-\epsilon}}, \quad \Phi_{in}^s = \sum_{j'k'=11}^{JK} (\tau_{in,j'k'}^s Q_{j'k'}^{1-\beta})^{-\epsilon} (v_{in,j'k'}^s)^{\epsilon}$$

with the expected utility as

$$\mathbf{E}_{in}^s[u] = \Gamma\left(1 - \frac{1}{\epsilon}\right) \times \Phi_{in}^{s \frac{1}{\epsilon}}$$

where the Gamma function $\Gamma\left(1 - \frac{1}{\epsilon}\right)$ is a constant number and Φ_{in}^s reflects the expected utility from accesses to all alternative cities and sectors. This choice set value is positively correlated with the potential income $v_{in,j'k'}^s$ and is negatively correlated with the migration cost and housing cost. We could then calculate the changes in utility as

$$\Delta \mathbf{E}_{in}^s[u] = \frac{\hat{\mathbf{E}}_{in}^s[u]}{\mathbf{E}_{in}^s[u]} - 1 \quad (58)$$

F.2 Utility Changes in the First Counterfactual

Table F1 shows the utility changes in our first counterfactual. Each row refers to a group of Hukou registered home location with some development level. Each column refers to a group of Hukou type (rural or urban) and skill type. We can see that when we remove the inland-favoring land policy, the total utility of the nation can be increased by 3.44% in 2005 and 10.87% in 2010. The utility of workers from developed areas is increased a lot in both years. Meanwhile, the utility of workers from under-developed areas is increased in 2005 but decreased in 2010 with

smaller magnitudes. In 2010, the changes in the utility of workers from poor areas is opposite to the changes in total income (shown in Table 11). One possible reason is that developed cities are usually far away from under-developed areas. The removal of the inland-favoring policy allocates more land to developed regions and makes the urban sector of less developed regions less accessible. Then some short-distance migrants have to migrate to big cities far away and pay more migration cost. If this migration cost increment dominates the income increment, then we may see a decrease in the utility.

Thus, in conclusion, the inland-favoring land supply policy reduces the total utility of the whole country in both 2005 and 2010. It decreases utility for almost everyone in 2005, but increases utility for workers from under-developed areas in 2010.

Table F1: Removing Inland-favoring Policy: Regional Utility

Regions (location, development)	No. of Cities	Hukou-based Utility Changes (R/U, skill)				
		All	(Rural, Low)	(Rural, Hi)	(Urban, Low)	(Urban, High)
Utility Changes in 2005						
National	225	3.44%	1.12%	4.39%	1.34%	1.94%
(eastern, high)	8	13.70%	2.91%	21.80%	13.98%	13.40%
(eastern, mid)	28	-1.63%	0.09%	-2.28%	0.15%	0.69%
(eastern, low)	61	0.31%	0.24%	0.36%	0.06%	-0.08%
(non-eastern, mid)	9	0.74%	-1.03%	1.98%	-1.73%	-1.16%
(non-eastern low)	119	1.24%	-0.58%	1.82%	-0.46%	-1.26%
Utility Changes in 2010						
National	225	10.87%	12.65%	9.15%	-0.49%	2.39%
(eastern, high)	8	18.97%	18.64%	19.87%	21.37%	28.76%
(eastern, mid)	28	-1.14%	-3.62%	-0.78%	0.74%	2.39%
(eastern, low)	61	-2.28%	-2.16%	0.57%	-3.84%	-3.56%
(non-eastern, mid)	9	-9.43%	-7.48%	-10.72%	-11.95%	-12.33%
(non-eastern, low)	119	-3.99%	-1.56%	-8.57%	-5.64%	-7.10%

Notes: This table displays a summary of Hukou-based utility changes by group (weighted by Hukou population) in 2005 and 2010. Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for comparison consistency.

F.3 Utility Changes in the Second Counterfactual

Table F2 shows the utility changes in our second counterfactual. When we remove the inland-favoring land supply policy and replace it with a direct transfer, the total utility of the country

can be increased by 2.47% in 2005 and by 4.31% in 2010. Meanwhile, with direct transfer from developed regions to under-developed regions, we can increase the average utility for people from both developed cities and under-developed cities. Comparing with the first counterfactual, the advantage in this policy is that now the utility of workers from under-developed cities will not be decreased when the inland-favoring policy is eliminated. They are better off by the compensation from the direct transfer.

Table F2: Direct Transfer Instead of Land Policy: Regional Utility

Regions (location, development)	No. of Cities	Hukou-based Utility Changes (R/U, skill)				
		All	(Rural, Low)	(Rural, Hi)	(Urban, Low)	(Urban, High)
Utility Changes in 2005						
National	225	2.47%	0.94%	4.12%	-8.89%	-8.68%
(eastern, high)	8	5.41%	-3.67%	13.78%	-17.79%	-18.12%
(eastern, mid)	28	-0.22%	3.51%	0.60%	-9.19%	-8.08%
(eastern, low)	61	1.13%	1.33%	1.96%	-8.02%	-6.93%
(non-eastern, mid)	9	1.81%	1.78%	3.62%	-7.91%	-7.24%
(non-eastern, low)	119	2.81%	6.89%	2.53%	-6.13%	-5.33%
Utility Changes in 2010						
National	225	4.31%	6.84%	9.58%	-20.57%	-20.70%
(eastern, high)	8	4.67%	5.19%	9.07%	-39.98%	-40.05%
(eastern, mid)	28	-2.51%	11.11%	7.11%	-21.60%	-19.08%
(eastern, low)	61	2.26%	9.24%	3.42%	-18.38%	-17.15%
(non-eastern, mid)	9	9.82%	23.03%	29.41%	-15.53%	-13.79%
(non-eastern, low)	119	6.56%	11.23%	11.89%	-15.22%	-14.80%

Notes: This table displays a summary of Hukou-based utility changes by group (weighted by Hukou population) in 2005 and 2010. Regions are classified by the location of the city (east or non-east) and the level of development (GDP per capita) in 2005 as in the data. For the level of development, we equally divide all cities into three categories (high, mid, and low), based on their GDP per capita. Since there is no "high" development city in non-eastern region, we only have 5 groups in total. Each region consists of the same cities in both 2005 and 2010 for comparison consistency.