

Urban Land Policy

Issues and Opportunities

Harold B. Dunkerley
Coordinating editor

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Harold B. Dunkerley

coordinating editor

with the assistance of

Christine M. E. Whitehead

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Preface

THE URBAN LAND ISSUES now facing developing countries are necessarily of concern to the World Bank. The availability and price of urban land affect project design and the relation of economic and social costs to benefits. Conversely, the projects supported by the Bank often have a significant influence on the supply of, and demand for, urban land—and hence affect land prices. Wider considerations of land utilization are involved in the quest for more efficient spatial patterns, more employment opportunities, and a less uneven distribution of income and wealth between the rich and the poor. As the U.N. Habitat Conference in Vancouver demonstrated, many of these urban land issues are of almost universal concern, not least the rapidity of the rise in urban land prices, the potential for capturing publicly created land values, and the developmental problems inherent in the rights of ownership and land use. For this reason, these chapters, initially designed for use by World Bank staff in urban project and program activities, are being made available here, in a rather different form, to a wider audience.

The origin of this book in the urban project work of the World Bank explains its format. The introductory chapter provides a context, or perspective, for more detailed consideration of the urban land issues that most clearly impinge on the preparation and implementation of urban projects and programs. This overview serves as a starting point for the following chapters on major problems of urban land by various authors with long experience in their respective fields. The second chapter deals with the economic valuation of land, based on the opportunity cost of using land for one purpose rather than another, and with the underlying relationships behind shifts in the provision of services. The third chapter provides perhaps the most thorough discussion available of different types of urban land tenure in relation to objectives of equity and efficiency. The following short chapter links these issues to the rationale for government intervention and to the forms that such intervention may

take. A fifth chapter discusses measures to influence the allocation of surplus values created in the development of urban land, including various forms of land taxation and government acquisition and development of land. Finally, two chapters deal with other forms of regulation of land use, the general limitations to which they are subject, and the characteristics of individual regulatory tools.

Urban land problems are inherently complex because of the many interactions between land uses, locational specificity, and the deep roots of land rights in legal and social systems. The subject is poor in accepted theory and rich in controversy. In developing countries conditions vary greatly, and the data base is generally extremely poor. In this context it was recognized that a comprehensive and fully consistent treatment of all the problem areas was not possible. Readers should not therefore be surprised to find some differences of opinion among authors, particularly on the relative merits of different solutions to the problems. Although generalized recommendations are of limited use in this field, the analyses presented should nevertheless refine and illuminate many of the urban problems that confront the authorities of developing countries and provide some practical guidance to suitable and adaptable approaches for dealing with them.

The program as a whole was directed by Harold B. Dunkerley, senior adviser of the Urban Projects Department, who also wrote the overview chapter. He was assisted by Douglas H. Keare, chief of the Urban and Regional Economics Division, Development Economics Department, and by Suzanne M. Snell, who surveyed actual experience with land problems in urban project work. Alan A. Walters, William A. Doebele, Donald C. Shoup, Malcolm D. Rivkin, and John M. Courtney contributed the original supporting papers. Acknowledgment is also due to many World Bank colleagues, particularly Orville F. Grimes, Johannes F. Linn, Callisto E. Madavo, Rakesh Mohan, Maurice Mould, Anthony J. Pellegrini, and Bertrand M. Renaud, who helped review earlier drafts and whose constructive suggestions have been largely incorporated in the present texts. Particular recognition is due to Christine Whitehead, who carried out the arduous task of editing the original Bank-focused papers and added a short connecting chapter to make the presentation more suitable for a wider audience.

ANTHONY A. CHURCHILL
Director, Urban Development Department
The World Bank

Contents

Preface	ANTHONY A. CHURCHILL	vii
1. Introduction and Overview		3
HAROLD B. DUNKERLEY		
The Rising Cost of Urban Land	6	
Tenure and Transfer of Urban Land	11	
Acquisition of Project Land	14	
Evaluation of Urban Land Costs and Benefits	16	
Allocation of Surplus Value of Urban Land	22	
Control of Urban Land Use	29	
Reconciliation of Multiple Objectives and Instruments	36	
2. The Value of Land		40
ALAN A. WALTERS		
The Rise in the Value of Land	40	
The Opportunity Cost of Land	44	
Capitalization of Surpluses and the Price of Land in a Market Economy	51	
Planning Restrictions in the Free Market	54	
The Effect of Servicing on the Value of Land	56	
Conclusions	59	
Appendix A. The Relation Between Current Yield and the Capital Value of an Asset: A Mathematical Note	60	
Appendix B. Portfolio and Savings Effects	62	
3. Concepts of Urban Land Tenure		63
WILLIAM A. DOEBELE		
Some Special Characteristics of Land and Its Tenure	64	
Policy Objectives and Types of Land Tenure	69	
Advantages and Disadvantages of the Main Forms of Tenure	75	
Policy Objectives Measured against Tenure Form	94	
Toward More Dynamic Concepts of Land Tenure	99	
More Specific Proposals	102	
Conclusions	106	

4. The Rationale for Government Intervention	108
CHRISTINE M. E. WHITEHEAD	
The Prima Facie Case for Intervention	109
Choice of Techniques	115
Problems of Intervention	119
Conclusions	129
5. Intervention through Property Taxation and Public Ownership	132
DONALD C. SHOUP	
Betterment	132
Property Taxation	133
Public Ownership	146
Conclusions	151
6. Intervention through Land Use Regulation	153
JOHN M. COURTNEY	
The Objectives and Problems of Land Use Regulation	153
Review and Evaluation of Land Use Control Mechanisms	156
Conclusions	168
7. Intervention through Direct Participation	171
MALCOLM D. RIVKIN	
Rationale for Land Use Regulation and Control	172
Constraints on Land Use Regulation and Control	174
Some Examples of Interplay and Impact	176
The Array of Techniques	183
Toward a More Effective Policy of Land Use Control	196
Bibliography	199
Index	207

Urban Land Policy

Issues and Opportunities

1

Introduction and Overview

Harold B. Dunkerley

THE PHENOMENON OF THE RECENT extraordinary growth of cities and towns in the developing world is by now familiar. It is still difficult, however, to grasp the magnitudes involved. More than 400 million people were absorbed into the urban areas of developing countries other than China between 1950 and 1975, a number almost equal to the present urban population of the industrialized countries of the Western world. One billion more are expected to be added between 1975 and the end of the century. By then, probably as many as forty cities in developing countries will have populations exceeding 5 million inhabitants (in 1950 none had reached this size) and ten or eleven cities are likely to exceed 15 million. Well within the lifetime of most persons being born today, the majority of the population of the developing countries is likely to be urban.¹

When this explosive urban growth is set against the paucity of resources to provide housing, workplaces, schools, roads, water supplies, transport vehicles, and the many other requirements of urban life, the conflict between the pressures of urbanization and the means available becomes clear. Two-thirds of the population of the developing world live in countries where annual output per head still averages below US\$500; annual net saving for all types of investment, even at this level of income, is usually well below US\$75 per head. The scarcity of skilled administrators for policy direction and implementation is an equally critical constraint. The task of directing and coordinating the wide variety of activities that interact in the process of urban development is inherently

1. Urban areas are generally defined as population centers exceeding 20,000 habitants. In some countries, however, a population of 5,000 or more is considered urban.

difficult; the rapidity of change, social as well as economic, greatly enlarges the institutional problem.

Against this background, the absorption of such a vast increase in urban population in so short a time, without much higher unemployment and mortality than now exists, is as extraordinary as it was unanticipated. It should not be surprising that the unprecedented urban growth has also produced many seemingly intractable problems, in particular the proliferation of slums and squatter settlements in which living conditions are deplorable and incomes low and precarious. The great and growing interest of developing countries in the supply, price, and allocation of urban land reflects this unprecedented growth of their towns and cities and the severe social and economic problems they face. Unfortunately, there is no corresponding corpus of accepted theory, of analysis of experience, or usually even of minimally adequate statistical material, against which to test the possibilities for improving conditions.

The use of urban land poses serious problems in all countries simply because the supply of serviced land is limited and subject to many competing claims. Dissatisfaction with the emerging urban forms is almost universal. But in the developing countries, where towns and cities often double in area as well as population within a decade, these land problems are most critical. The quality of life in towns and cities, the environment and conditions under which the inhabitants live and work, and the possibilities for recreation are heavily dependent on the systems now being developed for servicing and allocating urban land and on the adaptability of these systems. The effective supply of urban services, such as roads and public utilities, in turn largely depends on the effective collection of revenue from beneficiaries, through general land taxes or special levies on land benefiting from public projects, or the collection of costs via public ownership of urban land.

The U.N. Habitat Conference of 1976 identified sharply rising urban land prices as the most serious of the many problems facing developing countries in this urbanization process. But rising prices are only symptoms, and attempts to forbid price increases, without dealing with underlying causes or weighing the economic consequences of removing price signals, can do more harm than good—as evidenced by the experience with rent controls in many countries. Securing for the community the rise in urban land values caused by community action, such as the provision of infrastructure, or by general urban growth is also fraught with problems, however logical and equitable such a move may appear. And the widely advocated solution of public ownership of urban land or detailed control of its allocation cannot of itself ensure efficient, equitable, or harmonious patterns of urban land development.

This is indeed a field in which simple solutions are suspect. Land

problems are inherently complex both in theory and in practice, particularly because of the interdependencies of land use, the specificity of locational advantages, transfer costs, social taboos and inhibitions, and many other market imperfections, not least the opportunities land transactions provide for corruption. Empirical information on land markets, prices, and total transaction costs is grossly inadequate. Local geography, history, social and legal systems, and general economic policies are too diverse in their effect on land to permit easy generalizations even when evidence is available. Land rights, moreover, are deeply embedded in the social and legal structure and are often the source of family and community cohesion. In consequence, they can be developed and transformed only with difficulty, and major changes are likely to be impractical within a short time.

The situation is made still more complex by the variety of objectives that land policies are supposed to further and by the limitations, interactions, and side effects of the instruments that can be used. The objectives generally put forward for urban land policies, each of which must be considered within the dynamic setting of rapid urban expansion, can be summarized as:

- An appropriate supply of urbanized land for dwellings, for community and recreational activities, and for productive activities, including the provision of basic urban services
- Harmonious urban spatial patterns that minimize the use of resources relative to economic and social benefits
- Greater equity in wealth and income, including access by low-income families to adequate shelter
- A spatial distribution of population and activities at regional and national levels consistent with general national priorities.

The trouble with such objectives is not only that they overlap and raise familiar conflicts between efficiency and equity, particularly in the short term; they are also too vague to be useful. They do not define the concepts needed to determine operational priorities and to adjust these priorities to rapidly changing conditions. Desirable urban patterns are particularly difficult to define with precision; many value judgments are involved and must be made in ignorance of long-term effects and of changes that will occur over the long lifetime of what is now being built.

In such a setting, this initial outline of the field attempts no more than an overview of the issues involved. After a brief look at some salient characteristics of urban land, subsequent sections deal with groups of issues related to the implementation of large-scale urban projects, including tenure, valuation, the allocation of surplus land values, and the control of land use. Some general conclusions are drawn in the final

section to reconcile the multiple objectives of urban land policy and the instruments that appear to offer the greatest opportunities for meeting these objectives in developing countries.

The Rising Cost of Urban Land

The unprecedented expansion of urban population in most of the developing world is causing an exceptionally rapid increase in the demand for urban land. Land location is specific, and existing urban plots cannot be reproduced. Thus the rising demand for urban land tends to be met primarily by converting rural land at the periphery of the existing built-up area. The subdivision of agricultural holdings and the provision of access roads is followed by the extension of other services. This expansion of total urban area—many cities are more than doubling in area in a decade—is accompanied by higher economic values for the more central sites; their locational advantage is continually increased by their enlarged access to a growing number of people and by a corresponding growth in expenditures. Higher values in turn increase the pressures for economy in land use, so that part of the expanded demand for urban land is met by increasing the density of activities on the more highly valued land in the central areas.

The basic pressures toward higher urban land values are derived from the increasing demands of a rapidly growing urban population and are accentuated by factors constraining the supply of urbanized land. Some constraints are physical—mountains, swamps, or the sea, for example. Others relate to the lengthy and costly processes of the transfer of land and the establishment of title; these may bear particularly heavily on the supply of small plots for low-income groups.

At present more important constraints in developing countries are probably the shortage of financial resources and the lack of capacity to provide urban services on a scale that matches the growth in the number requiring services. These shortages are typically amplified by design standards that are unrealistically high in relation to the ability of most of the population to pay for them, and often by charges below the costs of supply to those actually receiving the services. Unclear or contested ownership of land may also hold up the provision of services. The net result is an aggravated shortage of serviced land, in the sense that people would be prepared to pay the full cost of considerably more services than are made available. Such serviced land as is available can hence command a premium; the user pays a higher rent and the benefits go largely to the landowner.

The total supply of urban land, or the supply for particular purposes, may also be constrained by excessive “holdouts” and other monopolistic

practices, particularly if a small group of landlords is in collusion or there is no effective power of expropriation. It is, however, difficult to ascertain how far practices of this nature exceed the legitimate economic function of holding land ready for a more valuable economic use that will be feasible only later. (Neutze, 1973, pp. 14–15, discusses some of the issues involved.)

Land use controls may also limit supply both in general and for specific purposes—though the latter may have the effect of increasing the supply available for other purposes. Communities almost always exercise some control on urban land use, if only to reserve land for public purposes such as roadways or to reduce hazards such as fire. Often these controls bring added costs and delays because of the need to prepare and submit applications for specific approval of uses of new urban land or new uses of existing urban land. Moreover, land controls can be readily diverted from their stated purpose, for instance to reinforce the exclusive nature of some neighborhoods by effectively denying residence to certain groups, particularly low-income groups.

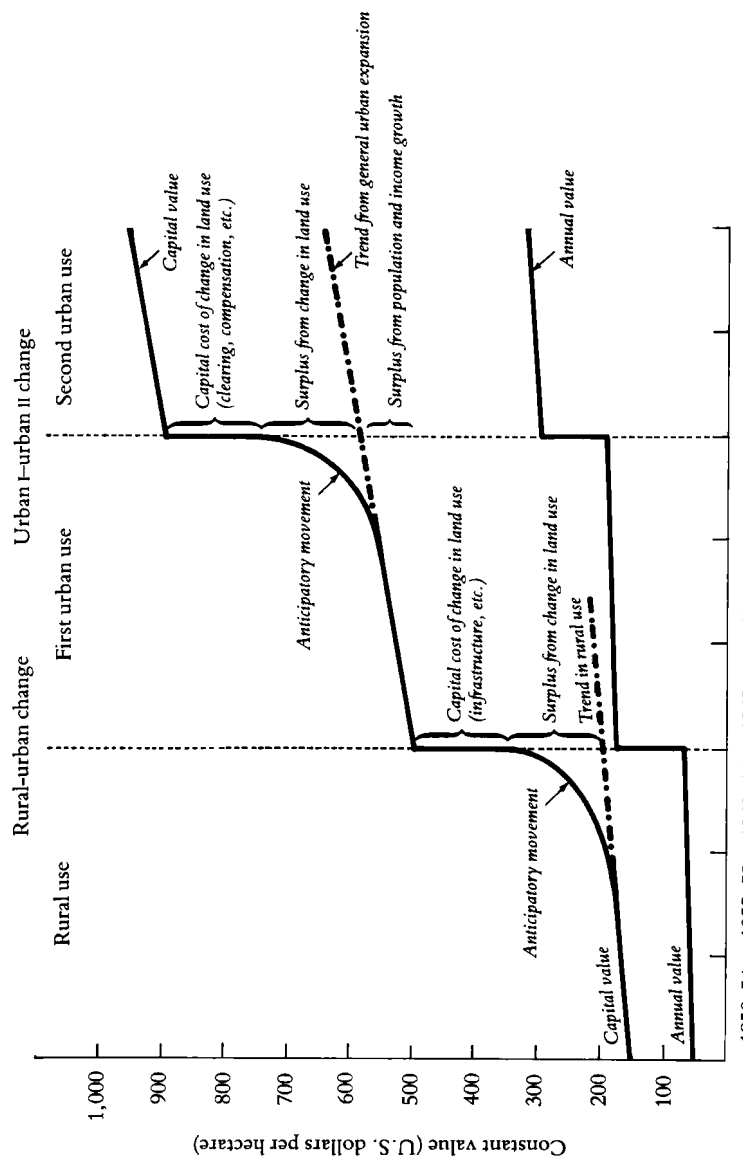
The increase in the economic value of land in and near urban areas that results from these various forces is unlikely to follow a smooth path. For any site, jumps in value are likely to occur at certain transitional points, often associated with the provision of infrastructure and other urban services. Of these, the most important transition for the rapidly expanding cities in developing countries is usually the initial transfer from rural to urban use.

In anticipation of the increase in rent and capital values, prices of rural land near urban areas will start to rise several years before the change in use. The length of time in which this rise will occur and the rate of increase will depend on the size of the expected “unearned increment”—that is, the rise in annual value from the change in use, net of any costs falling on the owner—and on the alternative rate of return on investment of comparable risk. The higher the level of real interest rates and the greater the risks associated with the land transaction, the shorter will be the time and the faster the rate of increase in the value of the land during the adjustment period preceding the change in use.

After the initial change from rural to urban use, the value of the now urban land will continue to rise, but more slowly, as the city expands and the locational advantages of the plot increase. At some later stage, however, there may be another sharp jump in annual value and consequent capital value, brought about, for instance, by the addition of urban infrastructure, such as a nearby bus terminal, or a change in restrictions that permits a more valuable use of the land. A similar sharp rise in value will then occur in advance of the change in use, becoming more rapid as the time of change approaches (see figure 1-1).

Three elements of the rise in land values can be distinguished. One

Figure 1-1. Changes in Annual and Capital Values of Land with Changes in Land Use



Note: In this illustrative example, capital value is three times annual value under stable conditions. Value changes owing to general inflationary trends are excluded.

derives from investments made at the time of the change in land use, including those for preparatory work, various costs of subdivision, the provision of urban services (whether public or private), and other activities such as clearing the land and relocating the original occupiers. The second element derives from changes in permitted uses, and the third from changing locational advantages as towns and cities expand. These last two elements are not the result of capital investment specific to the plot, but are generally classified as “socially created.”

Market values, though fundamentally based on economic rents, also depend on the extent to which an acquirer or user of the land is entitled to the full economic rent. Some part of the economic rent may go to others as a result of rights to multiple uses of the land, or taxation. More precisely, the amount an acquirer will be ready to pay is determined by the expected return from the land, net of any expenses, compared with the return expected from other investments. Thus, the existing restrictions on use and the taxes on output or rent lower the present and prospective rents received and are automatically taken into account in lower market values. Expectations of higher future taxes (including, in extreme cases, expropriation) will be discounted to produce lower present market values. Expectations of changes in restrictions may work to raise or lower anticipated future returns.

Market values are also affected on the demand side by the availability and cost of finance for the acquisition of land and buildings and the availability of other forms of readily marketable securities for the alternative investment of savings. Most developing countries lack a capital market that provides an easy and reliable avenue for the domestic investment of savings. Financial instruments are scarce and provisions for safeguarding holders' interests are weak. Interest on bank deposits, regulated by the authorities, is often below the rate of inflation. By contrast, loans on the security of land may be obtained at low or negative real rates of interest by persons with the requisite standing and collateral. Accordingly, the institutional framework may tend to increase demand, thereby creating an upward pressure on market values of land.

The pressures on land prices just described are superimposed on the general rise in prices. Thus the overall rise in land prices may be very sharp in the cities of developing countries, and the rate of increase will normally exceed that of the general price level. However, if savers and asset holders had adequate knowledge and rational expectations, one would expect the yield on holding land for conversion into urban land use, or from one urban use to another, to approximate closely the yield on comparable forms of investment. But the generally accepted view and some evidence, spotty though it is, suggest that real land values in or near most urban centers have in fact continued to rise at a rate providing net

yields substantially in excess of market rates for comparable investments. Among the possible explanations for continuing high returns are:

- The future growth of city populations, areas, and incomes and hence of the benefits accruing to landholders from public expenditure and enhanced locational advantage may be underestimated. The “urban explosion” is relatively recent and still far from being fully understood.
- Similarly, for individual holders of land awaiting future development, the perceived risks of confiscation, changing master plans, building code restrictions, delays in obtaining permits, and the like may be greater than for the community as a whole.
- The skills of developers may be in short supply.
- The anticipation of high yields may itself induce holdouts and higher prices and thus become self-fulfilling at least in the short run.
- Market imperfections may increase the spread between the price of undeveloped and developed land. In particular, insiders with a privileged position can extract a larger yield and reduce risks as a result of their personal connections with the decisionmakers who administer the provision of services or land use controls.

In contrast, the real costs of development by private developers may well be underestimated—and the “unearned” increase in values consequently overestimated. Part of the growth in land values and apparent yields may reflect the high transaction costs of changes in land use, including determination of title, taxes, and payoffs to officials. The yield on alternative investments may also be greater than generally recognized. Finally, it is possible that the news media play up exceptional increases in market value, particularly in cases of a change of use, so that the perceived upward movement is exaggerated. Averages of prices of actual transactions in land are also heavily influenced by such cases. (See chapter 2 for a fuller analysis of these factors.)

When the price of land rises much more rapidly than other prices, and the high profits cannot be justified by private improvements to the land, there is an obvious case, on grounds of equity, for capturing part or all of these profits for the public purse—particularly if this can be accomplished without adversely affecting efficiency.

More fundamental in the long term, however, is the reduction of the underlying causes of excessive land prices, particularly the political and institutional constraints that contribute to the shortage of serviced urban land. The high land prices and rents that derive from this scarcity effectively exclude large and often growing segments of the poorer