

**THE COST OF SECOND BEST:  
THE PRICE OF LAND REGULATION IN ASIA**

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**Michael Lee  
DPU Associate  
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## **ABSTRACT**

This paper attempts to identify and quantify the costs of land regulation. By drawing on case studies from different parts of Asia, it quotes estimates made by researchers of the order of magnitude of the impact. The costs identified arise from: zoning practices which restrict the supply of developable land below the level of demand; from time-consuming administrative requirements, which tie up capital and require specialist skills to master, or demand the time of poor people who can ill afford to spare it; from the complexity of regulations which, together with other practices, inhibit small firms from becoming developers, and thus preserve monopolistic practices; and from bribery, whether to accelerate legal processes or to evade them. In some cases, the regulations and the way they are applied can double the cost of land, or more. There is a human rights issue in that land regulation forces a large part of the population into a "legal twilight". The issue is, How do we get from bad regulation, to good management?

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The paper would not have been started without considerable encouragement and valuable advice from Earl Kessler, then Director of USAID's Regional Housing and Urban Development Office for Asia, in Bangkok. Wittingly or not, most of my other colleagues in that office have also contributed to this paper. My thanks go to them, too.

Several people have commented on earlier drafts of the paper, four of the most particular commentators being Ray Archer, John Taylor, Earl Kessler and Joel Kolker. I greatly appreciated their critiques, and hope that the paper has benefited as a result.

The author, of course, remains responsible for selection and interpretation of the case studies, and for the overall content of the paper.

## 1. THE AVOIDABLE COSTS OF DEVELOPMENT

### **The Extravagance of Planning: A National Concern**

A study published by the institute that was prominent in shaping the economic policies of the West in the 1980s<sup>1</sup> came to the conclusion that the cost of land regulation in Britain may be as much as 10 percent of national income. The author, a professor of environmental economics at one of Britain's most respected universities, doubts whether "this is an acceptable price for the population as a whole to pay for the preservation of the physical environment..." (Evans, 1988).

It is an astounding finding. To the writer's knowledge, there has been no rebuttal either of the calculation or of the principle on which the estimate was based. It is baffling, too - if it is correct that land regulation is so wasteful - that the facts should have been reported only in a little-read academic paper, and that the "waste" caused by land regulation has not been taken up as a crusading cause by radical reformers in Britain.

The extravagance of public land management is not confined to Britain. Another economist has determined that the cost of land and housing regulation in Malaysia is equivalent to 3 percent of that country's GDP.

Malaysia and Britain are not unique. Although each country's bureaucratic systems, of course, differ, these figures may well illustrate the order of magnitude of the cost of planning and other regulatory land controls in many other countries.

This paper hazards a guess that avoidable costs of development typically increase land prices by 50 percent in Asian cities.

Perhaps the existence of bureaucratic hindrances to economic growth is seen not to matter very much in those south-east Asian economies that, anyway, are growing at rates that are the envy of the rest of the world; and where macroeconomists are often concerned more to control the rate of growth than to accelerate it further.<sup>2</sup> However, sustained and rapid growth is not (yet) a feature of all Asian countries, whereas immoderate planning practices are widespread, if not universal, and are a major factor impeding national economic development.

Of greater concern to Asian leadership may be that regulations which indirectly regulate access to land - the subject of this paper - worsen income inequalities by raising those barriers that prevent people from moving from the informal into the modern sector of the economy. In recent years, stability and prosperity, and increasing equality of incomes, have gone hand in hand in Asia. *The Economist* (1991b) points out that leaders of the more successful economies have "managed to keep the common good in hand while not succumbing to what Adam Smith called the 'clamorous importunity of partial interests'".

But land regulation strongly benefits those 'partial interests'. There are therefore powerful vested interests in retaining, even strengthening, present land administration practices. If entrenched malad-

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<sup>1</sup> The Institute for Economic Affairs -- see also footnote 17.

<sup>2</sup> East Asian economies grew at an average annual rate of 7.4 percent in the 1980s.

ministration of land threatens to worsen income inequality or to prevent millions from moving into the formal sector, then Asia's stability may also be endangered.

Be that as it may, the theme of waste caused by regulation is, little by little, being taken up by land policy analysts in developing countries.<sup>3</sup> Those of us who follow trends in urban development theory are now frequently told that the degree of public intervention in urban land markets is excessive; that "excessive" regulation tends to increase costs and reduce economic growth. But the arguments remain theoretical and therefore inaccessible for many practitioners. This is partially because there have been few attempts to quantify the effects of land regulation. How great are these costs? Are they really significant? Which type of regulation results in the greatest costs? It is important to be able to answer such questions. It is important to be able to inform policy-shapers in governments and donor agencies; it is important that officials in the Ministries of Finance, Land and the Home Affairs should be aware of the consequences of their regulations.

There is a variety of ways in which regulatory costs are manifested:

- There are, for instance, huge costs incurred by developers as a result of years of delay getting through the bureaucratic maze to obtain planning permissions: costs that are realized in terms of manpower and in the cost of capital tied up waiting for the permits to be granted.
- There are proportionately even greater time costs incurred by poor households in trying to obtain similar permissions so they can comply with the law.
- Excessive time taken to get permits can dampen the ability of the private sector to respond to changes in market conditions, so lessening the beneficial impact of market forces.
- Difficulties of penetrating the administrative system can discourage new firms from starting up business, and so preserve inefficient monopolies, thereby increasing prices.
- The bureaucracy is structured so as to connive at or even encourage bribery: by its complexity, dense administrative requirements encourage government officials to expect bribes either to circumvent the rules, or, simply, to demand "sweeteners" just to get the job done.
- There are also the better-documented costs of inappropriate planning regulations. Restrictive zoning regulations severely limit the availability of land for new development, and thereby contribute to raising its price.
- There are costs incurred as a result of inappropriate land use planning when, for instance, trunk infrastructure complies with zoning plans but development doesn't.
- Not least are the social, environmental and economic costs imposed on the poor for being unable to comply with the regulations, hence being obliged to live outside the law and unable to take advantage of government subsidies and other benefits.

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<sup>3</sup> Even though little may be published as yet, several of the best minds in urban research are currently being applied to the question of the cost of regulatory and institutional constraints, among other places, in the World Bank, UNCHS (Habitat) and UNDP - working together in the Urban Management Programme - and the United States Agency for International Development (USAID). This paper uses a number of their published and semi-published works, and would be considerably poorer without them.

Most of these costs - the indirect costs of land regulation - are generally passed straight on the consumer, if not borne directly, as significantly higher land prices. They are eventually translated into higher prices for all locally-produced consumer goods and services.

In ignorance, we suffer from systems of land administration that work expensively, and to the predominant benefit of the existing residents of Asia's cities. The present system is only the second best.

### **Regulation and the Market: the Alternative**

The argument of this paper is based on the belief that development of many Asian cities has been substantially influenced by a malign combination of ill-advised regulation and the invisible hand of the market, but with relatively little positive city management (the "first best") employed to mitigate the effects of these two robust forces.

The principle of regulation has been generally well-intentioned, often having been designed to counteract the effects of the market on the poorer and weaker sections of society. But it has generally not worked that way. As is shown in the following pages, market mechanisms and personal incentives have generally proved more powerful in pricing and therefore shaping the city than all the benign ordinances and controls put together. Many regulations have served to amplify the more damaging consequences of the market. City organisms have thereby become able to resist the best efforts of city managers to shape them into better places to live.

The physical consequences of the unfortunate alliance between regulation and the market are obvious. The logical conclusions of how to contend with these forces, less so.

On the one hand, it is not clearly true that the market, unfettered by the public sector, produces results that are unequivocally to the public good. The state of the environment and of the traffic in Bangkok are as good an illustration of this as any. Complete disengagement by the public sector is not the answer to the need for good city management.

On the other hand, forceful intervention by governments to counteract the power of the market by regulation has been little more successful in managing urban development for the public good. In Asia, few countries have been more active than India in regulating land development; but the results as experienced in, say, Calcutta, are as unsatisfactory to policy makers as they are to the city residents. More vigorous pursuit of regulation is not the answer to urban ills, either.

It is an unavoidable conclusion that positive urban management, by skilled and sensitive urban managers, is needed. Management should seek to harness market forces to the public good, not to ignore those forces, nor to attempt to deny them. It will not be an easy task involving, as it will, a multiplicity of new and revitalized skills and techniques. These include, for example, engaging the private sector in planning, financing and providing for public needs; utilizing pricing as a tool of environmental management; re-appraising appropriate vehicles for providing subsidies as part of a poverty alleviation strategy; involvement of non-governmental agencies and community organizations in interpreting popular needs; and integrating specialized urban and shelter financial circuits into national (and international) financial markets.

Sensitive urban management will also require regulations, whether to limit fire hazards, safeguard public health, or conserve our physical urban heritage. This paper does not argue that land regulation

is always unjustified; but that the consequences of each regulation should be weighed, not merely against an idealized outcome, but also against the reality of market forces and of opportunities for personal gain.

## **Framework of the Paper**

This essay started life as an attempt to assemble quantitative information, through case studies, on the cost of land regulation in Asia.<sup>4</sup> The land market is one that, in recent years, has been written about at considerable length. It seemed reasonable to assume that economists should have made efforts to identify and quantify various bureaucratic influences as they affect land prices. It emerged, however, that, although theory has advanced, there has been very little primary quantitative research on the real effects of regulation of urban land in Asia. Statistics are quoted in this paper, hopefully sufficient to make the point that unnecessary land regulation is stifling national development in almost every Asian country. But, although examples are quoted from many countries of the region, only in one instance has anyone attempted a comprehensive estimate of these costs.

The phenomena reported in the following sections are not unique to Asia. The findings of the investigation should be of interest to urban managers worldwide. And although the focus of the enquiry is land development for shelter, the findings are likely to have implications for the design and management of urban management programs in the broadest sense.

In order to preserve a clearer focus, this paper comments only on costs arising from land use and planning controls; not, for instance, on the implications of practice in recording land transactions or titling; not with barriers to access to ownership of land (controls over transfer of ownership, constraints of public land banking schemes; the complications of land adjudication schemes), nor with the land registration process. The scope of the paper also excludes discussion of the effect on land prices of rent controls, and of other public policy measures.

Section 2 first discusses the rationale for the investigation. Subsequent sections draw on case studies in the following areas:

Section 3: INAPPROPRIATE CONTROLS: THE COST OF PLANNING

Section 4: COMPLEX PROCEDURES: THE COST OF INEFFICIENCY

Section 5: INFORMAL PAYMENTS: THE COST OF BRIBERY

Section 6: THE COSTS OF INFORMALITY.

A final section summarizes the main findings from the case studies concerning how much our present land regulation systems, the second best, cost. It refrains from drawing many morals: greater awareness of the problem and its magnitude should provide an incentive for policy-makers to move away from bad regulation towards adoption of a more optimal system of land management which works with, not against, market forces.

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<sup>4</sup> It is also an outgrowth of a short article in *Asia Perspective* (USAID, 1992).

## 2. THE COST OF BUREAUCRACY

### **The Source: Government Monopoly**

All of the costs considered in this paper derive from one source: control, by government, over entry to the land market. Government has a monopoly on granting rights to develop land, which it exercises by the use of zoning controls, subdivision regulations and building regulations. These are not newly-acquired rights: the Chinese have been using building regulations for some three thousand years, and the ancient Romans had building and sanitary codes.<sup>5</sup>

Use of this monopoly power itself has almost always introduced distortions in the efficient and equitable allocation of land rights. The most obvious distortions arise because the government restricts the supply of land below the level of demand; economic forces thus increase the price of land. Government's use of its powers also artificially raises the cost of development and the cost of entering the modern sector, by insistence on (unduly high) standards for legal development, by requiring the payment of fees, by the de facto imposition of time delays on individuals and developers alike; or by a combination of all these methods.

The government's rights to control land use and development have a financial value. Scarce resources are used trying to break down or evade the monopoly. This introduces further distortions into the system, including the institutionalization of graft. In the end, the corrupted system becomes self-sustaining. In economic terms, the use of these resources is pure waste, a deadweight loss.

Use of resources to circumvent government powers represents, however, a rational response by developers and individuals to a public sector failure positively to manage urban growth - it is a second-best solution. It is widely assumed that, because the developers' responses are rational (responding to the "hidden hand"), they are therefore also economically sensible. This is often untrue. The second-best solution is generally totally uneconomic.

### **Why Don't We Know the Cost?**

All of these effects are the subject of innumerable anecdotes from everyday life. Many of the stories are undoubtedly true. However, there appear to be several reasons why researchers and practitioners have hesitated to investigate many of these subjects systematically, to measure just how much all of these bureaucratic controls actually cost.

The cost of land bureaucracy is made up of many, relatively small, often intangible components. In some of the examples quoted in this paper, bribes - for example - are said to amount to the equivalent of a few hundreds of dollars for building permits for some very large houses: not a very significant amount in comparison with the overall cost of construction. But add together the various hidden costs: the higher costs resulting from monopolistic practice, the cost of capital tied up in land while waiting for permissions to be granted, the excess costs of complying with arbitrary planning regulations - and the total cost of bureaucracy can be seen to be massive.

The subject of the price of land has, until recently, largely been ignored by Asian development practitioners, government ministers and officials, journalists even (with a few, laudable, exceptions) -

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<sup>5</sup> Quoted by Guarda (1989).

virtually everyone with a public voice - except to blame "exorbitant" prices on "unscrupulous" land speculators (perhaps a way of saying that the market is failing). It may simply be that we didn't know the magnitude of the costs resulting from public administrative extravagance, that they were assumed either to be a fact of life, or a relatively minor inconvenience. "What the mind doesn't know, the heart doesn't grieve over."

Firmer reasons for this lack of knowledge are that land economists lack a coherent and empirically-based theory of urban land markets to explain the relationship of the various factors contributing to price changes, let alone to justify intervention or deregulation of markets. Maybe because of weaknesses in the theoretical base, relatively little rigorous analysis has been undertaken of land markets in industrializing countries in Asia. (Research into urban phenomena is still considered academically downmarket in many countries of Asia, and few of the best university-trained minds in the economic and social sciences are applied to this field.) Carole Rakodi (1992) recommends that "a more sophisticated analytical approach to urban land markets is needed, spanning political and social theory as well as traditional neoclassical economic analysis."<sup>6</sup>

But above all, there is a straightforward lack of hard data on which to base any analyses. This is discussed a little more below.

### **Inadequacy of the Data Base**

Hard data are absent for several reasons, rational and less so. One good reason for the poverty of data on urban land is that statistics are difficult to collect: land prices, for example, are rarely published or openly available, and it is necessary to use a variety of little-known and/or relatively expensive techniques to collect good data<sup>7</sup>.

Not least, there is often a web of humiliation involved in disclosing facts about corruption in one's own country to a foreign researcher. There is embarrassment occasioned by a foreigner's desire to undertake research in a poor country, into matters that might lead to a conclusion that people of that country are "somehow inferior or in part to be blamed for their underdeveloped circumstances".<sup>8</sup> There is a widely respected need for diplomacy in research. Gunnar Myrdal (1977) noted the phenomenon that corruption is rarely mentioned in scholarly discussions of the problems of government and planning. Since Myrdal wrote, there has been a spate of literature dealing with bureaucratic corruption, a few works of which are referenced in this paper; but it remains true that a

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<sup>6</sup> She points out that there is a need to resolve a number of theoretical problems in understanding the issues before normative solutions can be proposed. Not least of the issues, she finds, is that although economists can agree in the abstract that we need "efficient" land markets, there is no agreement on what is meant by "efficiency". Furthermore, if a goal of land planning is also to promote "equity", then, too, there must be some trade-offs with the goal of efficiency.

<sup>7</sup> David Dowall has been in the forefront of a small field in developing rapid techniques for the collection of good land price data. He has publicized the techniques in several places, including *Dowall (1991)*. However, the methodology is low cost for a land management authority (such as a city council), not for a poorly-endowed research institute. And the recommended techniques are often unavailable to researchers, insofar as the inquiries will often only be answered to questioners with authority and not, for instance, to university students.

<sup>8</sup> Klitgaard (1988).

high proportion of these papers still prefer to pontificate in the abstract. Few quote actual cases of corruption in land administration; fewer still cite statistics.

The deputy prime minister of Singapore is quoted as saying that "corruption, as well as ineffective organs of public administration, can have an immediate impact on the economic growth of Third World countries. It escapes my understanding why their importance has been ignored not only in the academic literature but also in the conduct of affairs."<sup>9</sup> Maybe we have grown to expect this sort of statement from Singapore. But is it naive? Questions of who gets what, and in what ways, always cause unease. Unease grows when there are also questions of illegality, or even of wrong-doing.<sup>10</sup>

There is, then, also the fear of dealing with illegal matters and dangerous subjects. There are a number of countries in Asia where it is believed that powerful businessmen and politicians have interests in land. It is unwise to cross their paths, even by asking innocent-seeming questions, for instance, about under-the-table payments for building permits or land ownership certificates. Even if researchers are unwise enough to ask, others may be sufficiently cautious to prefer not to answer.

### **In the Last Resort, Does it Matter?**

In the last resort, does it matter that we don't know these costs or, as William Doebele put it, "is this subject simply an ivory tower inquiry at the level of an academic wanting to know more, say, about the sex life of sea urchins"?<sup>11</sup>

For instance, it is not totally clear on whom the burden of land regulation falls most heavily; nor even if it matters significantly in comparison with the overall costs of urban development. Many of the costs impact on the cost of formal development, by putting up the price of land acquired legally and of the construction of authorized housing. These bureaucratic practices impact readers of this paper, certainly; but, directly, they do not affect the majority of the inhabitants of most Asian countries: these people do not - cannot - buy land legally, and cannot put up houses in accordance with regulations.<sup>12</sup>

This is the severest cost of bureaucratic regulation of land development: the alienation of the greater part of urban society from legality<sup>13</sup>. This is not a rhetorical statement about human rights, important

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<sup>9</sup> Dr. Goh Keh Swee, talking in 1983, quoted by Klitgaard (1988).

<sup>10</sup> Schaffer (1986) quotes a certain R. J. Williams as saying, "Corruption, like beauty, is in the eye of the beholder. Like beauty, it is widely believed to be more than skin deep...".

<sup>11</sup> In an unpublished paper for the World Bank.

<sup>12</sup> Insofar as people living in informal settlements spend at least a part of their income on formal sector goods and services, and since the price of these latter is affected by inefficient land regulation, so the cost of living in informal settlements is impacted by formal sector bureaucratic practices. Some of the other costs are discussed in Section 6.

<sup>13</sup> Hardoy and Satterthwaite (1989) quote estimates of illegal settlement in certain Asian cities: in Bangkok, in 1978, 26 percent of the population "lived in slums and squatter settlements, while many more lived in factory houses and dormitories and in servants quarters"; in Delhi, in 1982, 1.3 million of the city population of 5 million "lived in what are officially defined as slum areas, while 600,000 or more lived in squatter settlements"; in Manila, in 1978, close to 40 percent of the population were squatters.

though they are. The true costs of living in this "legal twilight" are significant and real, and will be explored later in this paper.

### **Who Benefits?**

It would be impractical to evaluate the effects of land bureaucracy without understanding who gains from present practice.

To interpret the findings, ask, "How can the benefits of land administration practice be withdrawn from this group of people?"

Farvacque and McAuslan (1991) note that "winners are politicians, senior public servants, traditional rulers, existing landowners.... Armies of lower and middle civil servants and thousands of persons who make a living by guiding both the poor and the middle class through the mazes,... all have a substantial stake in the confused, multilayered and irrational systems that now prevail." All of these groups will dislike the idea of change, which would threaten their well-being and their way of life. Change would upset powerful vested interests.<sup>14</sup>

So, who are the beneficiaries? Considerable profits are to be made from land development. Whoever makes these profits often has a direct channel of communication to those decision-makers and bureaucrats who might be in a position to end inefficiencies and distortions which act to benefit the profiteers. As Michael Kitay (1985) notes, "the most active speculators in land markets invariably would be those holding high government positions or their family members. These 'establishment' figures would not take kindly to any concept that threatened their investment opportunities." Kitay was referring to threats of public intervention in land markets; he could equally well have been talking about threats to withdraw government controls over land markets.

Successful developers can well afford to spend a portion of their gains to safeguard, defend and increase them; as can those who dispense the favours. Over time, the mechanisms by which successful rent-seekers obtain their gains become extremely well entrenched and defended. One observer, reporting to the World Resources Institute, found that

"those who control the allocation of rents, whether administratively or politically, are in a position of power relative to rent-seekers because they are dispensing rights to resources for which excess demand is chronic. ... Politicians gain votes and contributions, and public agencies gain expanded budgets, staffs and authority. ... In extreme cases, allocators adopt an exploitative attitude towards users.

"All who share in the rent - politicians, administrators and users - have a shared interest in preserving and expanding the arrangements that benefit them. They combine to do this, finding ways to shift the costs of the system to other parties while keeping as much of the benefits as possible themselves. Since parties to this coalition can then prosper whether or not total benefits exceed total costs, they typically press to

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<sup>14</sup> Cynthia Ozick (1983) notes, tellingly, about Bangladesh, *"The civil servants were grass. Nothing destroyed them, they were stronger than the pavement, they were stronger than time. The Administration might turn on its binge, turning out one lot of patronage-eaters and gathering in the new lot: the work went on as before. The organism breathed, it comprehended itself."*

expand the system beyond its economic limits. If the coalition is sufficiently diffuse and ill informed, the economic losses rent-seeking coalitions can inflict, and their duration, can be staggering."<sup>15</sup>

Farvacque and McAuslan conclude that "Too many laws, particularly in the area of land management, are procured and passed by the economic and social elite to help them benefit from state activities rather than to meet any perceived need of society at large".

The adverse effects of land administration translate into higher land prices. Gainers include existing landowners in zoned urban areas. Which property owner, acting in self-interest, would choose to change laws so as to reduce the value of his property? Who makes the choice: purchasers of land, or sellers of land?

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<sup>15</sup> Repetto (1986).

### 3. INAPPROPRIATE CONTROLS: THE COST OF PLANNING

#### The Cost of Urban Land Policies in Developing Countries

Individual land use regulations were designed to meet limited objectives: social, aesthetic or environmental. Alain Bertaud (1992) comments, however, that "after some time, the objective is often forgotten; but the regulation remains. More regulations are added in response to more problems and newer objectives which interact and exacerbate the effects of the existing regulations on land markets.... The combined effects of the regulations succeed only in simultaneously contradicting all the objectives which were their original *raison d'être*." The following paragraphs give some examples.

25 experts and researchers in land markets and land price behaviour met in Cambridge, England, in 1991 to determine the impact of urban land policy in developing countries upon land prices.<sup>16</sup> The participants found it difficult to reach a consensus. They did agree, however, that there are major methodological difficulties in analyzing land price changes over time, and that past descriptions of upward land price trends in third world cities have been exaggerated and defective. They found agreement that, in most cities, informal land sales continue to be an essential factor in providing accessibility to land for the poor. They recognized that state intervention has often led to regressive effects, particularly for low income populations: increased state control has often had the effect of restricting the supply of land and worsening the regressive effects of monopoly elements in land ownership.

The conference concluded that:

"perhaps planning intervenes in too many areas, but we are uncertain whether reducing controls on the land market will necessarily improve matters... We are uncertain whether land-use planning produces a more efficient and equitable market or one that is less efficient and less equitable."

This ambivalent finding is not, however, shared by many other observers, in Britain - as noted in the introduction to this paper<sup>17</sup> - in the United States, and in individual countries of Asia, as the following paragraphs show. The first section looks at the effect of controls in the United States, and finds that there are some strong parallels to be drawn with Asia.

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<sup>16</sup> Fitzwilliam College (1991).

<sup>17</sup> Evans' observations were based on research at Reading University (Cheshire et al, 1985). This tested the hypothesis that "via its control of development, the planning system effectively constrains the supply of land for different uses and thus raises the price of land. These 'scarcity rents'.. would be expected to influence industrial and commercial costs and hence prices of goods and services, output and employment and, in the residential sector, .. they would have direct welfare costs." At the risk of oversimplifying, the analysis compared land values in two cities: one with a restrictive planning regime, and one with a relatively unrestrictive planning regime. The values were then adjusted to isolate the pure effects of development control. Changes in land prices were then estimated on the assumption that the green belt envelopes were removed, and that other development constraints were eased. Finally, actual land prices were compared with derived prices, and welfare gains from the 'new' policies were calculated according to estimates of transport costs paid by households located at different distances from the city center.

## The United States and Asia: Zoning Out the Poor

Recent years have seen a widespread scholarly debate in the United States on the economic effects of imposing growth controls: techniques such as tightening traditional zoning laws, moratoriums on the extension of water and sewer lines, non-price rationing of building permits, and tying development permits to the provision of new public facilities. Growth controls were widely introduced in the U.S. at a time when the baby boomers of 1946-64 were beginning to demand suburban homes and to put unusual pressure on the roads of suburban areas. The controls were used as tools to restrict urban growth in local communities, by representatives of those communities, largely as a response to the traffic that was seen to be overwhelming the suburbs of metropolitan areas.

William Fischel (1990) is the author of a critical examination of studies of American local government growth controls in the 1980s. He reports that a group of econometric studies, mainly from California, find that growth controls have indeed raised house prices - by 9 percent in two particular communities studied, and by 17 to 38 percent in a group of 64 communities studied in the San Francisco Bay area. The original authors of these research studies note that rising house prices imply negative effects on affordability, and, since they are not associated with concurrent economic benefits, are therefore undesirable.<sup>18</sup> (Fischel suggests that the growth controls very likely do achieve just what they had set out to do - namely, prevent the growth of what he calls disamenities - zoning out the poor.) Other studies quoted by Fischel provide "moderate support" for the thesis that the more monopolistic the structure of government, the higher are housing prices, via delays and the general lack of availability of zoned lots.

In summary, empirical evidence assembled by Fischel concludes that U.S. "growth controls and other aggressive extensions of land use regulations probably impose costs on society that are larger than the benefits they provide. The higher housing prices associated with communities that impose growth controls are more likely the result of wasteful supply constraints than benign amenity production."

The American situation is not, of course, directly comparable to circumstances in Asia. There are a number of reasons why comparisons are dangerous, and most of these are obvious. Among other things, there are few zoning plans for Asian cities that take as an objective the control of growth, in the sense of discouraging development within the city area - as distinct from discouraging development within particular areas of the city.<sup>19</sup>

Land is kept out of the formal market in Asian cities by zoning (such as 'green belt' restrictions, often designed to protect agricultural lands), or by subdivision regulations (which typically require that the amount of 'non-sellable land' in a residential development is as much as 70 percent of the total, or

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<sup>18</sup> High land prices lower the incomes of land purchasers; they raise the incomes of sellers of land.

<sup>19</sup> But there do exist plans which assume an optimum city population, and design for the realization of that size regardless of the realities of city dynamism. An eminent Indian city planner likes to quote a city plan for Bombay where "the planners had apparently adopted a very low projection for population growth on the grounds that the city could not accommodate a large growth - despite the fact that the population had already almost reached the projected figure before the plan was submitted". Source: Devas (1989).

which prescribe the minimum size of a plot).<sup>20</sup> It is evident that the practical effect of most Asian city plans is to restrict legal growth by imposing requirements that cannot be afforded by a large part of the population, thereby legally prohibiting them from residence in the city. Asian land planning practices therefore have effects similar to those of American growth controls: by restricting land availability, formal sector prices have been increased.

In the context of Asian cities, if growth controls were completely effective, 'green belt' land would be left unoccupied, and - given current and foreseeable levels of subsidy - there would be no affordable place in the cities for new low income residents. However, this is not true: much 'unzoned land' is occupied by informal settlements, with varying degrees of legality, and at more affordable prices than if the land use ordinances were obeyed and enforced.<sup>21</sup>

It is also true in certain instances that zoning is largely ignored or subverted by formal sector developers as much as by the informal sector. The Philippines is the most notable case, although in most other Asian countries larger developers, with better connections, are able to obtain development permits where less influential people would be advised that their proposals run contrary to official plans. That zoning may be ineffective does not, however, mean that it does not carry heavy, disguised, costs. They, too, are noted in the following sections of this report.

It is time to turn to some actual experiences from Asia which illustrate the cost of planning.

### **India: Land Ceiling Act**

One of the more notorious pieces of land legislation is India's Urban Land (Ceiling and Regulation) Act of 1976 - sometimes abbreviated, maybe unkindly, as ULCER. The primary purpose of the Act was to impose a ceiling on private ownership of land in urban areas, and for public acquisition of land in excess of the ceiling, to be used for the benefit of poorer families. The Act's objectives were to prevent the concentration of urban land in the hands of a few persons, to reduce "speculation and profiteering", and to bring about an equitable distribution of land in urban areas. Implicitly, it was also intended to control land prices.

There is no question but that the authors of the Land Ceiling Act were well-intentioned. There were, however, many problems with implementation of the Act, to the extent that very little 'excess' land has actually been expropriated by the government. By the late 1980s, the government had taken possession of only 3,852 hectares in the whole country; of this amount, only 621 ha. had been used for the construction of housing (0.37 percent of total 'excess' land), and the greater part of this was

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<sup>20</sup> Bertaud (1992) says that planners feel that "market forces are considered disturbances which have to be quelled through even more detailed planning regulations. A number of land use regulations have often been imposed with no other aim than to cancel the effect of market forces."

<sup>21</sup> A myth prevails that informal settlements are caused by squatting, a process in which no payment is made for use of the land; hence the price of land would be irrelevant to the squatters. Although some informal settlements are, indeed, created by squatting, it is increasingly true that informal settlements in Asian cities come into being as a result of an overt (but unregistered) financial transaction between the land owner and a representative of the informal community or, more frequently now, an informal developer. Thus residents of informal settlements in unzoned land probably do benefit from the lower prices.

not used to benefit low income households. It was also clear that the government of the time did not understand the role of private developers in providing housing.<sup>22</sup>

The Act has thus not made any significant impact in acquiring vacant land, and even less in having land developed. It did, however, have the effect of freezing the urban land market and, as a result, of pushing up urban land prices in general.

Kiran Wadhva (1987) comments that the Act

"did not make any difference to the housing situation of the very poor. The poor were squatting illegally on urban lands prior to the enactment of [the Act] and they continued to do so. The only difference is that earlier they were squatting on lands (say) worth Rs.200 per square meter and now they squat on the same lands which have increased in value to say Rs.2,000 per square meter. The groups which have really been affected are the low middle income groups - who either had to drop out of the legal formal market altogether or had to reduce their demand for housing space substantially."

The World Bank has been quoted as saying that, as a result of the Act, a thousand square kilometers of land has been taken off the market, in 73 Indian cities. "Partly as a result, land prices have risen between 10 and 100 percent annually in major Indian cities such as Bombay and Madras." But there are reasons for scepticism about these findings, not least because of a questionable use of land price statistics: there has been no systematic study of the price effects of the Act.<sup>23</sup> It is noteworthy that in Ahmedabad, a city in the state of Gujarat also in thrall to the Urban Land Ceiling Act, land prices probably fell in real terms during the first ten years of the Act, starkly contrasting with the critical statements of observers from other cities.<sup>24</sup>

The effect of the Act in encouraging bribery is described in Section 5 below.

### **Serpong New Town: Zoning Distorts Land Markets**

If national legislation, as in India, can have an effect on land supply and hence prices, so, too, can local zoning restrictions. So much is claimed by a study of the development plan for a private sector new town, Bumi Serpong Damai, south-west of Jakarta. In order to test whether zoning does

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<sup>22</sup> Lee (1989). Readers who want a fuller, critical, description of the Urban Land Ceiling Act and its operation could refer to Wadhva (1989) for a first class description of its implementation in Ahmedabad. Pugh (1992) also reports that the Government of India is actively considering reform of the Act.

<sup>23</sup> But Dowall (1989) does quote a number of respectable studies purporting to show dramatic increases in Indian urban land prices in the 1970s and 1980s.

<sup>24</sup> There were, though, two special circumstances in Ahmedabad: as a textile city, it was seriously affected during that period by a significant reduction in world demand for its products, so that disposable income fell, and with it, the demand for new land; and the city fathers were as anxious to stimulate growth (and to work with developers) as anywhere in India, and made liberal use of legal exceptions to the Act in order to release land to the housing market.

effectively provide for "orderly development", Alain Bertaud (1989) analyzed the implications of the plan as drafted by the private consortium.

Proposed zoning restrictions would make the plots affordable only to the richest 5 percent of the population; the other 95 percent would inevitably have to live elsewhere. The plan gave no indication where that was likely to be, nor where they "should" reside. "The pattern of development in the year 2005 will be very different from the pattern shown on the master plan", says Bertaud. "The low and lower middle income population will be concentrated in villages densified at about 10 times the maximum density envisaged in the master plan. Formal housing will be scattered in areas around the existing road infrastructure network. The overall area occupied by housing will be much smaller - because of the higher density - than the area shown on the plan."

Bertaud thus concludes that the zoning plan increased the cost of land, by using it restrictively and wastefully. Worse, he says, is that the plan was biased against the poor, in the sense that the vast majority of the population would both literally suffer from the downstream effects of the new town development<sup>25</sup>, and would be required to live outside the law. (Since Bertaud wrote his critique, however, practices have been modified, and a significant proportion of the units in the new town are now being built at a price affordable to households at about the 50th percentile.)

Bertaud's conclusions about the effects of the plan are disputed by Ferguson and Hoffman (1993), who quote a Jakarta developer as saying that "zoning has little connection with actual land use". To support that contention, the authors report that only 8 percent of 'housing land' in greater Jakarta is in compliance with the official spatial plan. Bertaud, too, found that much of the zoning was anyway irrelevant, since developers could not risk buying much of the land zoned residential, for it has no road access, nor would it for the foreseeable future.

In its therefore more pertinent to blame the masterplan for a failure to predict what infrastructure would be needed, where and when. "Masterplans, by confusing the unavoidable reality with the regulatory fiction, are misleading the line agencies into planning and providing infrastructure and services for a population whose future geographical distribution will be directed by regulations rather than by predictable economic constraints." The real constraints lie in the limited amount of land with public road connections and with an adequate supply of water.

### **Seoul: Land Supply Constraints**

The phenomenon of reduced supply leading to increased prices has also have been noted at city scale, in Seoul, South Korea, although there it is not possible to point to a single regulatory "villain" as responsible. There, a range of government policies constrained the supply of developable land in and around the city: strong zoning policies designed to restrict the conversion of agricultural land; a greenbelt policy which constrained the outward growth of the city; and monopolistic practices which jointly forced up land prices. As a probable result, land prices in Seoul increased at an annual rate exceeding 25 percent in the mid-1980s.<sup>26</sup>

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<sup>25</sup> The higher density of low income housing will most likely result in ground water pollution and unsanitary liquid waste disposal, because the sanitary network planned for much lower densities, will be unable to handle the increased stream of waste.

<sup>26</sup> Renaud (1989), quoted by Dowall (1990).

If overall land use and zoning policies conspire to restrict the availability of land in several countries, thus raising prices, inappropriate subdivision regulations and building standards have an effect that is at least as marked. Many regulations have been introduced in an attempt to help the underprivileged. For instance, most cities have regulations that impose minimum residential plot sizes, supposedly to protect the poor against unscrupulous developers who would impose inhumanely small plots upon the economically weaker sections of society. However, standard minimum sizes translate directly into minimum costs, and minimum costs into a minimum income for affordable legal occupation of land, as the following examples, from Malaysia and India, show. The examples also resonate with the previously quoted case studies of Serpong and San Francisco.

### **Malaysia: Land Development Standards**

A World Bank analysis (1989) of land development standards in urban Malaysia reported that, in low-cost residential projects, standards require "road areas per household which are up to four times larger than those used in Asia, Europe and the United States for similar ranges of plot sizes. ... The effect of these and similar practices is that about 170 square meters of raw land are required to develop the minimum plot size of 68 square meters, although at least a third less land would be sufficient if land use standards were in line with those used elsewhere. ... Due to such wastage, only 25% to 50% of the land area developed may be saleable (in contrast to the 65% typically achieved in other countries). The cost of the land which cannot be sold is passed on to the home buyer, so that housing costs are higher than necessary."

### **India: Planning Standards**

The World Bank commissioned a similar study, in 1984, to calculate the financial implications of planning regulations in the Indian state of Uttar Pradesh (World Bank, 1984). The study found that the minimum standards implied a plot cost unaffordable to the poorest 95 percent of the urban population. Wadhva (1989) reached similar conclusions in her study of Ahmedabad. (She does, however, note that pressures have reduced the minimum permissible plot size to 200 square meters today, down from 1 acre - about 4,000 square meters - in 1920! The Ahmedabad Municipal Corporation feels that a more realistic contemporary minimum would be 20 square meters.)

The Uttar Pradesh study concludes that

"many development regulations are working against their original intentions. By making legal development too expensive for most urban households and by effectively excluding private sector developers from legal development, large areas of cities are left to develop outside the scope of urban regulations where even the most minimal services and environmental protection are not provided. ... The impact of this situation is felt most heavily by the lowest income groups whom government regulations should strive to protect but who can least afford legal development."

#### 4. COMPLEX PROCEDURES: THE COST OF INEFFICIENCY

The argument advanced by the authors of the case studies quoted in this section is that the complexity of administrative procedures necessarily causes considerable delays in getting development permissions (and, in one case, actively encourages delay). These delays have costs, in terms of capital and human resources: the great bulk of these costs are found to be passed on to the consumer. The existence of these costs, however, also helps to maintain an oligopolistic structure of the development industry in many localities and this, too, is presumed to raise prices further.

##### **The Costs of Entry**

The complexity of the permitting processes in most Asian cities means that land developers need full time file pushers. Small entrepreneurs lack the resources and know-how to do the same thing. And individuals often do not have, or can ill afford the time, to find their way through the administrative entanglement of land regulations if they are trying to build their own home or small business legally. "The additional time and cost involved in getting the legal permits is so costly that they often prefer to relinquish the benefits attached to the formal process, particularly access to housing finance.... The major cost associated with the formal sector is not the costs of minimum physical development standards per se, but the costs incurred on account of the complexity of the administrative land subdivision system" (Bertaud, 1989).<sup>27</sup>

Even the official language used, for example, in expressing building regulations, or the sheer volume of the legislation, can be sufficient to deter many would-be small builders. McAuslan (1985) cites a requirement of the Madras City Corporation Building Rules:

"The level of foundation shall be such that the minimum depth for the foundation to prevent the soil moving laterally under pressure shall be according to Rankine's theory",

which is then set out in mathematical symbols. It would be a matter of chance if small building contractors were able to comply with Rankine's theory or, indeed, with many other of the regulations in order to fulfil the requirements of the law.

Know-how - knowledge and expertise - though important, is, however, probably not the most significant barrier to small developers participating in the formal sector. That is the need for capital: not only for the initial investment in land purchase, but for the cost of holding land during the interminable periods of procedural negotiations, for the payment of black money to accelerate procedures, and to compensate for the considerable risks involved in land development due to the uncertainty of dealing with capricious officials and ambiguous regulations. Given the risks, and the poorly developed state of many capital markets, it is little wonder that the formal sector land markets

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<sup>27</sup> The passage could have referred to practices in most Asian countries, but was written of Indonesia. In response to extensive public criticism of his bureaucracy, the head of the Jakarta City Development Control Agency announced in early 1992 that the Agency would henceforth issue building licenses within 24 hours of receipt of a complete application. The author has no evidence, however, that this standard has actually been achieved.

in many cities are dominated by a small handful of developers, able to act in concert to manipulate property prices.<sup>28</sup>

This is not universally true, though. Some observers have noted that high profits available from land development do seem to motivate small entrepreneurs in some markets to find ways to overcome these apparently high barriers to entry - see, for instance, Wadhva (1989).

### **Indonesia: Heavy Carrying Costs**

A case study from Indonesia describes the phenomenon of heavy costs resulting from labyrinthine procedures required for development approvals; and puts a value on these costs.<sup>29</sup>

The study was initiated at a time when it was commonly believed that urban land and property prices were rising out of control. Land prices were, indeed, increasing at a rate well above the rate of inflation: the price of land in Jakarta appreciated at rates averaging 20-33 per cent a year over the period 1985 to 1988, and have subsequently continued to appreciate at a rate exceeding the rate of inflation. These price increases have been above the average for Asian cities, although not exceptional.

Demand for land in the city was high, thus explaining a part of the price increases. Demand was sharpened by expectations (justified, in retrospect) of continuing strong economic growth in the future. However, this was not the sole cause of land price inflation: various government practices also encourage holding urban land out of development. These, in turn, decrease supply and thereby simultaneously raise land prices. The study investigated these practices further.

The land titling and development approval system in Jakarta is reported to be complex and lengthy. The first stage involves developers in obtaining a "location permit" for the block of land in which they are interested; this reserves the land to the specified developer, in effect allowing no-one else the right to develop it, but not requiring the developer actually to buy it. The location permit takes about 6 months to obtain. However, because of the difficulties in assembling land, it typically takes 10 to 25 years to assemble enough land for a residential development of 100 to 2,000 hectares. During this period, the location permits freeze development on the land being held for eventual development. This process allows developers to control large tracts of land while only gradually purchasing them. It both legally allows developers to stretch out the development process over extraordinary lengths of time and makes it economically feasible to do so. The system also makes it difficult for land owners to sell their land to a third party; reduces incentives to put land to the most economic use; and is potentially environmentally-damaging, since environmental issues take second place to pecuniary considerations.

Figures quoted by Ferguson and Hoffman support their contention that there is a large and growing amount of land held out of the development process, facilitated by the location permit system.

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<sup>28</sup> For instance, Gilbert and Larkin (1989) report that ten large firms dominate the Indonesian real estate market. Ferguson and Hoffman (1993) comment that "economic theory and studies of areas with oligopolistic development areas suggest that this concentration limits competition and raises the price of the product."

<sup>29</sup> Struyk and others (1990), and Ferguson and Hoffman (1993). These are first class studies: an example of the type of in-depth research really needed, in contrast to more usual reports of two week in-and-out consultants' visits.

The location permit is only the first stage in the process of approving developments. The researchers report that average processing times for development approval and titling averaged 32 months in the early 1980s, but subsequently lengthened.<sup>30</sup> These delays result in carrying costs to developers, including interest charges on funds invested and property taxes. Informal and formal fees add further costs to the development process.

An Urban Institute report for USAID states that the complex regulatory procedures force developers to compete for government approvals and information - particularly location permits - rather than focus on efficiently building a better product (Hoffman and Ferguson, 1991). In this environment, small developers are at a considerable disadvantage.

The same report estimates that the total regulatory cost of formal development in Jakarta is about one third of the total project cost. This is made up of:

- interest carrying costs over the 2.7 years it takes to get development approvals: 9.3% of project costs;
- informal and formal fees at varying stages of the process: 6.8% of project costs; and
- the cost of restricting the supply of land, including the location permit process: about 18% of project costs - calculated as the real increase in land prices over the period of development.

The developers, so the consultants say, have been able to pass on the great bulk of these regulatory costs to small landowners and consumers.

### **Malaysia: Time Delays Double Land Costs**

In the mid-1980s, the Malaysian Housing Developers Association chronicled the housing project approval procedures they are required to follow. The procedures, involving 55 separate steps, are summarized in a diagram which is so complex as to be virtually incomprehensible without intense scrutiny. In real life, so a World Bank study reported in 1986, procedures for conversion of rural to urban land, and receiving land subdivision and building approval, take anything from five to seven years. In most states, from 15 to 20 separate government departments are involved in the approval of plans and specifications, adding two to five years to project completion. The report of the study states that "the impact of this time delay alone is sufficient to double the effective cost of land on which a developer intends to build."<sup>31</sup>

What are the implications of this? For one thing, it produces a housing supply system that cannot be responsive to demand because of the time lag between changes in market demand and the time of construction and sale of units intended to meet that demand. As in Indonesia, it requires developers to bear very heavy interest costs on capital that is tied up unproductively during the period of

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<sup>30</sup> The Ministry of Housing, once the attention of senior officials had been drawn to the fact that the procedures for obtaining development permits could be described only a sheet of paper four meters long, convened a series of meetings and working groups to determine whether all these procedures were needed, and how best to simplify them. These deliberations took place over a period of years, but did result in a shortening of the average time for granting permits from three years, to a matter of months.

<sup>31</sup> World Bank (1988) and Mayo (1990b).

acquiring the permits. And, as in Indonesia, too, it severely inhibits small developers wishing to enter the land development market.

As a result of these practices, housing prices rose dramatically in relation to incomes during the 1970s, and '80s. In 1972, an average single-story terrace house cost 3.71 times annual household income; by 1986, an equivalent house needed 6.05 years of income to purchase it. Even by 1982, so economist Stephen Mayo tells us, only households in the top ten percent of the income distribution could afford to buy new housing. When the economy began to falter in 1982, so there was a sharp fall in housing production.

It is estimated by the World Bank that "the additional cost paid each year for housing by Malaysian families is equal to about 3 percent of GNP - an amount that could be saved if it were not for the undue regulatory complexity of the Malaysian planning system" (Mayo, 1990b).

Mayo (1990a) points out that this sort of phenomenon can be observed even in high income Asian countries. In Japan, for instance, "policies that have had to do with rural urban land conversion have made it virtually impossible to convert farm land to urban uses, and have made it very difficult to redevelop and change the density of land in urban areas, resulting in a very long-term increase in the relationship between housing prices and income."

### **India: A New Class of Developers**

As in South-East Asia, getting permits in South Asia is a specialist, time consuming, and therefore expensive business. The Times of India commented on the class of real estate developer that has emerged since the mid-1970s:

"As for the values, behaviour and world view of the new class, its most striking characteristic is its drive. These people are making things happen. That they go about it in an uninhibited, pragmatic and amoral fashion is also true. They have had to fight to rise up from the bottom and they have learned to manoeuvre the system of licenses and permits and negotiate through the shoals of our labyrinthine bureaucracy. It is easy to despair over the vulgarity, the new rich mentality and the lack of education of the new class, but we must remember that India's future depends on the energy of this new class."<sup>32</sup>

Kiran Wadhva, an observer of India's housing scene, comments, in a memorable passage about these developers,

"The time consumed for getting No Objection Certificates, according to the developers we interviewed, can range from 2 to 5 years and for getting the final sanction, from 10 to 12 months. During the initial periods of submission of plan, the developer has to go to the office of the Competent Authority almost every day. **The main business is to get the permission; construction is secondary!**"

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<sup>32</sup> Quoted by Wadhva (1986).

## 5. INFORMAL PAYMENTS: THE COST OF BRIBERY

### Rent-Seeking

"Rent-seeking" is a term that was coined in 1974 to describe the monopoly profits created when governments use quotas to restrict economic activity. Since then, the use of the expression has become more widespread, to characterize other activities that are undertaken to exploit opportunities to defraud public institutions, without the creation of any useful economic output. It includes all costs incurred to avoid government regulation or to avoid the consequences of government regulation.

Rent-seeking, then, is an activity that does not add to the sum total of goods and services available to society, but is used solely to gain a monopoly profit, for instance by virtue of government having monopolistic control over land development rights. It is an activity that adds to the price of a product to the ultimate beneficiary, with no corresponding benefit. In the present context, it includes activities taken by developers both to obtain planning permission and to gain exemptions from land development permits. On the other side of the coin, it also includes the actions of public officials to benefit from their positions to charge ordinary citizens for permits to build - permits which might or might not be sanctioned by the law. Development permits, in this case, become not a service, but a cost to society.<sup>33</sup>

Lobbying to get a bigger share of the government's cake is also a form of rent-seeking. This does not happen so overtly, and is not so well documented, in the Asian LDCs as in western countries -- but it exists, for land development rights, as it does for many other forms of economic activity controlled by the government. Lobbies compete to win a bigger share of all government budgets, and to keep (or change) the regulatory system. Similarly, where subsidies and grants are a part of the system, governments are inundated with pleas from special interest groups, requesting changes to the distribution and taxation system favourable to themselves. "Some of this costly effort serves the useful purpose of making the [government] better informed about the economy; most of it is Directly Unproductive Profit-Seeking." (Ashoff, 1989)

Robert Repetto (1986) explains that

"potential recipients of economic rents compete for them, not by outbidding rivals in the marketplace through superior economic efficiency and foresight, but by trying to control the people who allocate them. Political manipulation, intimidation and corruption replace economic efficiency as ways to get ahead. Inevitably, most of the available rents are captured by those with power, influence and wealth, and rent-seekers think that using the resource efficiently is much less important than gaining control of the allocation mechanism."

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<sup>33</sup> Bertaud (1992) points out that informal payments to governments to expedite the permitting process mean that households and businesses substitute their own resources to finance part of the government's operating costs. This is inefficient and discriminates against the poor. It is an inequitable and inefficient way of paying the equivalent of a user fee.

Why, then, is land development particularly conducive to rent-seeking? Rent-seeking, according to Ashoff, is only possible under two conditions:

- there must be artificial restrictions on market access; and
- there must be the possibility of obtaining a government-fixed monopoly right.

Both of these conditions hold for urban land markets. Governments everywhere have monopolized land development rights and created restrictions on access to these rights. Although it is not a necessary consequence of this monopoly power, Asian governments have almost universally restricted supply below the level of demand - see Section 3. Planning permissions and the like therefore have a value and can be traded. If buyers of these rights can increase their administrative allocations, they can increase their personal wealth. Public officials are put in a position of "being able to function as discriminating monopolists and fix market clearing rates for the services being offered." (Jagannathan, 1986)

So long as the now-conventional systems of restricting the supply of developable land are in place, there will always remain shortages of (a) land authorized for development and (b) permission to develop that land. So long as there are these government-generated shortages, rent-seeking in land development rights will persist.<sup>34</sup>

### **The Value of Planning Permits**

To illustrate how planning permissions have a value, Alan Evans (1988) cites a hypothetical case in which a developer owns four sites (in England), each of which has a one-in-four chance of planning permission being granted. The planning permission, he suggests, would be worth, say, £1 million -- a figure chosen for illustrative purposes, but not unrealistic.<sup>35</sup> In order to maximize the gain from these sites, it would be logical for the developer to be willing to spend up to a quarter of a million pounds for each site, in order to secure permission to develop. It may be that the developer would prove lucky and get permission for more than one site; or he may be unlucky and get no permissions. On average, however, he would expect to spend something less than £1 million, and to receive one planning permission worth £1 million. Add in the legal, architectural and other administrative costs to the local planning authorities and central government and, Evans concludes, probably more than £1 million will have been spent in total to secure and allocate that one permit. "From the standpoint of the national economy, the expenditure is wasteful; the same result could have been obtained if dice had been rolled."

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<sup>34</sup> It is easy, but ingenuous, simply to attribute corruption to that fact that land development is beset with regulations. Some people see rules and regulations as encouraging graft. Others, like India's Santhanam Committee on Corruption, suggest that *more* rules would help reduce corruption. Rules may be used to reduce discretion, or to make accountability easier. "Rules may create or reduce rents; they may delimit or increase effective discretion; they may help or hamper accountability. Rules are not inherently good or bad for corruption." (Klitgaard, 1988.) Rent-seeking is to do with supply and demand, not the volume of regulation.

<sup>35</sup> According to Mather (1983), a developer offered £2 million (around \$3 million) to the Camden Council for permission to build on Hampstead Heath, a large, near-sacrosanct, area of public heathland close to the center of London. The author of this paper must declare an interest in preserving Hampstead Heath in its entirety.

Evans also points out that in an open market, the price of new houses would be determined by the free play of forces of supply and demand. Developers will find out what the public wants, and then supply it. He goes on to note, though, that this sequence of events does not occur when land development is controlled by the allocation of scarce permits. In this case, the developer first obtains a site, then applies for detailed planning permission, and only then can buildings be constructed and sold. "The major part of the profits from a development is likely to accrue to a developer when permission for the development is obtained, rather than from the construction and sale of houses, offices or shops. If most of the profits can be made in this way, then for many developers gaining planning permission will become a relatively more profitable activity than building or selling offices, shops or factories." *Shades of Asia?*

Rent-seeking is also provoked in the many Asian countries where spatial planning policy is formulated vaguely, and is subject to often-arbitrary interpretation. However, says Bertaud (1989), "[in those countries where] detailed land use plans exist but the limits between zones and the maximum densities imposed are themselves arbitrary and their ultimate purpose unclear ... the final decision concerning what can be built in which location is left to the discretion of the civil servant who is charged to enforce the law. In fact, the legislation acts as a form of partial transfer of property rights from the land owner to the government employee in charge of enforcing land laws. It is not surprising to see the employee selling back this partial right to the original owner under the form of a permit."

What specific forms, then, does rent-seeking in land administration take; and how much does it cost whom?

The literature of corruption in public administration in Asia is extensive, but few cited examples relate to land management. The instances quoted below come from India and Thailand; but most extensively, from Indonesia which, despite having a reputation as a country where informal practices flourish, also does not hesitate to encourage publication of (some of the) examples of malpractice.

Case studies are of Asia, since that is the geographical focus of this paper. The point should be emphasized, however, that it is not only Asian countries that have to endure bribery and its consequences. The purpose of this section is not to show that the rapidly urbanizing countries of Asia are worse or better than the United States, Europe, Japan or anywhere else.<sup>36</sup> The point of quoting these case studies is merely to demonstrate that even well-intentioned misuse of monopoly powers over the right to grant land development permissions can have considerable repercussions on property prices.

### "Inside People"

Many people in Jakarta just do not understand the permitting procedures, or cannot afford the time to comply with the regulatory requirements, to the extent that only 70 percent of new, **formal** housing is fully legal in the sense of having complied with all laws and regulations. (Much of the housing, of course, is **informal**.) The Jakarta Post of September 16, 1992, provides some examples of the cost of satisfying the law.

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<sup>36</sup> It may be diplomatic to quote one of many examples cited by Klitgaard (1988): "In Massachusetts, a recent inquiry revealed that 76 percent of a sample of public buildings manifested at least one 'structural defect' that could not have occurred without corrupt deals by building inspectors."

The newspaper tells the story of a certain Mr. Rachman, wanting to build a house, legally, in South Jakarta. Before applying for his building permit, Rachman obtained preliminary documents. According to the city regulations, he should have waited `only' 84 days to acquire his land ownership certificate, another 40 days to have his land measured and yet another 44 days to acquire the city plans. The process took almost a whole year. Finally, when the official 19 day waiting period for a building permit turned into a year, it was more than Rachman was willing to bear, and he decided he had no choice but to accept an offer of help from an intermediary.

The first stage, of obtaining a land ownership certificate involves three consecutive steps: the mapping of the site, the processing of the land ownership application and the registration of the acquired certificate. There is a total of at least 18 documentary requirements, including obtaining the city master plan and proof of payment of land and building taxes. "You must pretend you know how to handle things at the city officials' offices", the unfortunate Rachman said. "You must not look ignorant or you will fall prey to the officials or the middlemen."

According to the newspaper, obtaining the certificate for a 700 square meter lot would typically take 6 months and cost more than Rp.1 million - about \$500. However, "one million rupiahs is only for the people handling administrative procedures", said Rasmani, a woman intermediary, "only 20 percent of the fee goes to the city treasury".

"Efforts to hasten procedures are hampered by the complexity of each step required by these agencies, public ignorance of the agencies' fees, the belief among agency officials that fees are too low, the attitude among the public and officials that under the table payments makes the difference and the inability of the government to control the agencies...."

The Jakarta Post goes on to quote Rasmani, the middleman, as saying

"that with the help of `inside people', a building permit can be processed in one and a half months. She estimated that if the service bureau obtained a building permit for a 70 square-meter wooden house on a 400 square-meter lot in East Jakarta, the cost would be between Rp.600,000 to Rp.1 million (\$300 - 500). In comparison, a brochure published by the Municipal Development Supervision Agency lists the building permit fee for a 100 square-meter house at Rp.40,000 (\$20)."

The Jakarta Post reporter comments that

"extra fees are not only required for every step, but also to progress from one step to another. `You pay a minimum of Rp.5,000 to 10,000 (\$2.50 - 5.00) or even more just to ensure your file is removed from the bottom to the top of the pile on the official's desk', said Suyono, an employee of a notary office in Central Jakarta.... `My friend was handling the processing of a land certificate for a client', said Suyono. `She gave the official Rp.50,000 and the official was very angry. He threw down her files and said, Are you insulting me?' Suyono added that such proceedings are not that difficult once one masters the feeling of the proper price to be paid. `This depends on where the land is situated, and also the particular official you have to deal with', he said. `A patient official can be paid less than a hungry looking person', she explained."

The Indonesian press is rich with other examples. The Indonesian language *Tempo*, of June 19, 1976, for instance is quoted as reporting: "One form of extortion is expressed by the English expression 'give and take'. A building contractor's employee took a request for a letter of approval to the Jakarta municipal offices. After waiting several hours, he asked what had happened. The municipal official replied, 'How is this, Sir? You want to take and do not seem to want to give.' In other words, the letter of approval would be given only when the payment had been made in accordance with a tariff."<sup>37</sup>

Various issues of *Tempo* and the *Indonesian Times* quote that a mayor of North Jakarta had received bribes from a contractor to whom he had issued building permits, of between Rp.100,000 and Rp.200,000 (\$240- \$480, at then-current exchange rates), as well as Rp.1.5 million for house repairs, Rp.500,000 for household furniture, Rp.4 million for refurbishing a second home, Rp.30 million for travel abroad, two motor cars worth Rp.7 million and a house worth Rp.200 million. The same company had provided an official of a Jakarta development board with a monthly payment of between Rp.25,000 and Rp.50,000 (\$60 - \$120) since 1970, as well as Jaguar and Honda Civic cars, and a house. An official of the City Planning Bureau admitted receiving a bribe of Rp.100,000 (\$240) for each construction permit he issued to the same construction company.<sup>38</sup>

The press, then, gives us a wealth of information. However, to our knowledge, no-one has published or quoted an estimate of the total cost of informal payments for building permits in Indonesia, although the Urban Institute has estimated that total payments of informal and formal fees amount to 6.8 percent of project costs (see Section 4 above).

To present a more complete picture of land administration in Indonesia, it is necessary to acknowledge squarely that the Government is well aware of the problems described above, and, from time to time, is taking action both to rid the country of the most chafing of the restrictions and to streamline permitting practices. For instance, the various land development permits for industrial development can now be obtained either from a single office in the Investment Coordinating Board or from the individual agencies, whichever proves the more expeditious. In other cases, where the climate for corruption is aggravated by simple lack of understanding by members of the public of bureaucratic processes, the administration is actively using publicity to inform people of their rights, thereby automatically reducing the opportunities for the 'inside people' to profit from outsiders' ignorance.

It is also worth commenting that the volume of documentary material available about informal payments in Indonesia is a considerable tribute to the openness of both the press and the government machinery which supervises research and publication. If this paper has quoted Indonesian practices at some length (here and in other sections), this is more a recognition of the quality of formal and media research on the subject than a reflection on Indonesian land administration practices.

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<sup>37</sup> Quoted by Palmer (1985).

<sup>38</sup> Issues of the *Indonesian Times* of November 29, 1978 and December 13 and 22, 1978, and of *Tempo* of September 30, 1978, as quoted by Palmer (1985).

## India: Black Money

The administration of land development regulations in India is legendary, although, to the writer's knowledge, there has been no systematic attempt to put an economic cost to the pervasive system of land controls there.

In 1983, the government itself commissioned a study of 'black money', and its findings about the cost of urban property regulations are singular for an official report. Transfers of land, for instance, require permission from various agencies, and the law says that 50 percent of any capital gains have to be surrendered. According to the report, "this affords substantial opportunities for unscrupulous elements in the staff of these agencies to extort bribes". A commentary in *The Economist* (1991) adds that "bribes are also paid in return for the authorities turning a blind eye to unauthorised building work". Other observers, Meera and Dinesh Mehta (1989b), suggest that "given the nature of land market operations, up to 40 percent of the [residential] land price is often paid over in 'black money'".

Kiran Wadhva (1989) recalls that the need to pay 'speed money', as people called it in Ahmedabad, dates from the mid-1970s, the time of introduction of the notorious Urban Land Ceiling Act (discussed earlier). The Act introduced discretionary powers in land allocation to builders which, together with increased and more complex regulations, led to the emergence of black money as a much more significant component in land transactions. Wadhva reports that speed money now accounts for up to 10 percent of the total cost of production. With land comprising between 10 and 20 percent of total costs (probably a lower proportion in Ahmedabad than in most other Indian cities), 'speed money' would thus be equivalent to 50 to 100 percent of the cost of the land alone.

In Solomon Benjamin's 1991 study of the development of an informal manufacturing area in Delhi, he finds that, in the nearby formal industrial area, 'black costs', to reduce the period between approval of a proposal and allotment of the land, from a normal six to eight years, are substantial. Permits are required from the Fire Officer, the Chief Inspector of Factories, the Pollution Board, the Labor Board, the Planning Authority; plan approval by the Delhi Development Authority; connections of electricity (costs start at \$1,000 upwards) and water; and permits from the Pollution Board, the Electricity Inspector, police and others. Each of these authorities may use the opportunity to expedite the process for a substantial fee.

## Avoidance of New Restrictions

The amount paid in bribes by Thai developers to avoid proposed new floor space restrictions in Bangkok can be taken as a proxy for the cost to developers of the new controls. There are currently few effective controls on land development in Bangkok. In the middle of 1991, however, the Ministry of the Interior published draft regulations that would impose much tighter control over the development of high rise buildings: the effect of the new legislation would be to reduce the permissible floor space ratio from 12:1 or 15:1, down to 10:1. In order to beat the imposition of these regulations, according to a spokesman for the Ministry, investors were paying officials involved as much as five million baht (\$200,000) to have their projects approved.<sup>39</sup> If a typical building cost, say, \$4 million or more, the bribes would have increased the development cost by up to 5 percent (but of course would have reduced the developers' margins by a much higher percentage). (*Land*

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<sup>39</sup> *Bangkok Post*, June 27, 1991.

*subdivision* regulations are said to have be re-written several times in response to pressure from the development industry.)

Avoidance of building regulations in Thailand also made international headlines in 1993, with the collapse of the multi-storey hotel in the city of Korat, and the numerous deaths which resulted from the collapse. The structural failure was reportedly due to circumvention of the regulations by the building contractors; observers have assumed that building inspectors are 'encouraged' to turn a blind eye to such lapses. As a result of the catastrophe and the ensuing publicity, Thai building contractors and inspectors have been warned to adhere to the regulations in the future; threats of dismissal are reportedly proving to be a greater incentive to respect the law than the monetary rewards previously offered.

### **Zoning Agency Accused of Profiteering**

In a major Asian city that should remain nameless, a local newspaper reports that

"employees at the zoning agency keep the city's detailed spatial plan a secret in order to make a profit. 'The officials of the city development supervision office, who supervise building construction, do not even know about the plan, let alone the public', said an official. ... The lack of a detailed map makes it difficult for the officers to detect other than building permit violations. He said the zoning agency officials intentionally prevented access to the plan so that they could use it as a 'trap for money', which they could spring on an unsuspecting and uninformed public..."<sup>40</sup>

This story may or may not be apocryphal. And we have no indication of how much money may have been trapped by preventing people from seeing the zoning plan. However, the report was (indirectly) acknowledged as having at least a grain of truth when, a decent interval after the above report appeared, the same newspaper carried a statement from the chief of the planning office to the effect that there were official "counters" where members of the public could obtain information on the city's development plans. If they were not much utilized at present, the official explained, it was only because no-one knew of their existence.

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<sup>40</sup> Reported on July 6, 1992.

## 6. THE COSTS OF INFORMALITY

### The Costs of Compliance

Given the laws on land regulation, and the way that they are implemented, people wanting to develop have three choices: to obey the law, and to incur the financial costs that this implies; to pay bribes, so that laws are suspended or ignored; or to break the law and, as a consequence, often to be obliged to live outside it, permanently. In the event, current land regulation practices effectively require a large proportion of the population to take the third option, and live illegally.<sup>41</sup>

Informality certainly permits families to enjoy some of the benefits of urban living (in particular, relatively easy access to economic opportunities, if not always to the jobs themselves), without having to incur all of the costs that formal sector living involves. It was pointed out earlier that zoning practices may result in lowering the price of land for informal settlements. And it has been argued that a lack of tenure can be advantageous to the poor, since it protects them from the market pressure of the well-to-do who would otherwise take over well-located illegal settlements.<sup>42</sup>

In Indonesia, Alain Bertaud (1989) points out, informal households run few risks by their continued occupation of land illegally. This is also true of a number of other Asian countries where informal settlement is de facto recognized as a way of life - except, of course, where it threatens large formal

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<sup>41</sup> In many ways, Ahmedabad is a typical Asian city. In the last two decades, Mehta (1989a) found, about 50 percent of net additions to that city's housing stock was informal. "Almost 11 percent of the supply by the formal private sector was also unauthorized in the sense that the necessary permissions were not taken." See also footnote 13.

<sup>42</sup> Solomon Benjamin (1991) has done a ground-breaking piece of work to document the growth and development of an informal manufacturing area on the fringes of Delhi, demonstrating the economic advantages to enterprise of informal land management.

His study compares the land costs of an informally-developed manufacturing area (Viswas Nagar) with a nearby formal industrial estate (the Jhilmil Industrial Area). The latter has high land costs because the supply of land in the estate is restricted by the Delhi Development Authority (DDA). "Strict building regulations are in place; for example, structures may occupy only half of the property. Even at a low unit price, the size of the first plots auctioned makes them unaffordable to most small entrepreneurs... The trend continues to the present, with the DDA leasing plots in the industrial area a few at a time to sustain high land values. Demand increases because these are the only sites on which industrial development is legal. Although approximately 30 percent of the plots in the Jhilmil Industrial Area have been auctioned, many of the leased plots are not in use, most likely being held on speculation."

If prices in the informal area of Viswas Nagar are relatively high for an unauthorized colony, this is because of its high level of industrialization; but "few manufacturers think the prices are excessive. To the contrary, demand for industrial space continues to increase; in addition to affordable entry costs, entrepreneurs gain an indispensable level of flexibility by operating in Viswas Nagar". In summary, Viswas Nagar is successful because of the absence of development regulation:

- \*plots are available that could be upgraded over time;
- \*there is a tolerant system of public regulation
- \*it is possible to improve security of tenure incrementally.

sector interests. However, they do forego benefits reserved to the formal sector. "Poor households are made to pay either a direct cost if they decide to meet minimum standards and therefore pay more for shelter, or an indirect cost if they cannot afford the minimum standards and as a consequence lose the benefits of belonging to the formal sector."

Be that as it may, the cost of government controls over land, to those people - now often the majority of new residents of Asian cities - who are excluded from access to legal occupation of land, is immense. As shown in preceding sections of this paper, the costs to comply with the law are often unaffordable to poor households, and to many small entrepreneurs. They include:

- not just the direct costs needed to meet the minimum legal standards, by ownership of large plots, serviced inefficiently by costly roads and utilities;
- the costs of time and money to obtain legal permits; time is something that poor people can ill afford;<sup>43</sup> and
- informal permits to accelerate the legal processes, and informal payments made in an attempt to get a favourable interpretation of imprecise laws.

### **The Costs of Non-Compliance**

Costs to households and businesses of remaining in the informal sector, include the following:

- the social and economic segregation of the population and their businesses from the formal sector of the city, with all the inefficiencies and hardships this implies;
- the pervasiveness of land development (and other) controls leaves people living in illegal settlements in many countries open to exploitation: no laws or codes can be used in their defence since they are living in illegal settlements;
- public non-commercial infrastructure services are often not extended to informal settlements. When they are installed by the public sector, the infrastructure costs are generally much higher than they would otherwise be, since the pattern and density of housing makes servicing these areas expensive. Public sector installation of services tends to be politically-motivated (e.g. shortly before election time) and, at best, spotty. When services are provided by informal action, they tend to be under-designed or ill-maintained;<sup>44</sup>
- households are ineligible for (often-subsidized) loans to improve housing or to start a business. Land cannot be used as collateral, so mortgage financing cannot be obtained. (Bertaud, 1989, believes that 80 percent of all households in Jakarta are de facto unable to benefit from housing finance facilities simply on account of land regulation law and practice);
- people living in informal settlements are unable to participate in many aspects of urban living that the rest of us take for granted: "The inhabitants of Allahabad (India) could not obtain subsidized food from the government's 'fairprice' shops since the authorities would not provide the necessary card because they lived in an illegal settlement.

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<sup>43</sup> Consider the real costs to a poor labourer, working in a job without any security, needing to absent himself from his employment, time after time, to go to a government office to plead for land development and building permits.

<sup>44</sup> But there are honourable exceptions, of which development of Orangi, Karachi, is the best-known example: see Hasan (1990).

In Seoul, South Korea, households have to live in a legal, authorized address in order to register their children in the local school."<sup>45</sup> Ray Archer reports that this problem of participation surfaced as an issue in Bangkok in the mid-1980s, when children living in unregistered houses in slum settlements could not attend public schools. "It was resolved by giving the unapproved houses 'temporary' registrations."<sup>46</sup>

This existence of a "legal twilight" is a major, and real, problem in many cities in Asia, and should properly be regarded as of much of a human rights issue as many of the concerns currently exercising liberal minds. It is, however, not recognized as such internationally. Many millions of the urban poor would benefit from additional research and publicity on the subject.

So, having enumerated these factors, what is the net financial cost of staying in the informal sector? Meera and Dinesh Mehta, who have extensively studied the land market in the city of Ahmedabad, are able to provide the sole clue. Much of the housing in that city is built on "problematic lands" and schemes are rarely advertized. The land price here is about 25 to 35 percent lower than the price of 'officially buildable land'. "As the entire building activity is without the necessary permissions from the appropriate authority, the speed of execution is crucial to the project and the builders attempt to hand over the possession of the unit to the client as early as possible. Since such units are 20 to 25 percent cheaper than formal units, many clients purchase such units despite their knowledge of their unauthorized nature. The benign neglect (and probably petty corruption) of the authorities towards such schemes have helped keep this market buoyant."<sup>47</sup>

Let Hardoy and Satterthwaite have the last word: "There must be something wrong with a law or code", they say, "if it is broken daily by so many people as they go about their daily lives."

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<sup>45</sup> For more detail see Hardoy and Satterthwaite, (1989) and Bertaud (1992).

<sup>46</sup> Personal communication.

<sup>47</sup> Mehta and Mehta (1989a) and (1989b).

## 7. THE COST OF THE SECOND BEST

### The Evidence: A Summary

The first assertion examined was that every act of zoning reduces the supply of land in a city, and therefore - since the demand is given - increases the land price. This is, in part, a reflection of the absence of reality in the planning process.<sup>48</sup>

This thesis was examined for the case of the **United States**. A review of the literature was quoted at some length, because there are close parallels with Asia, and because academics have examined the theory more rigorously than anywhere else. They found, on balance, that growth controls have achieved higher prices, with costs exceeding gains. In some cases, at least, the poor "have been zoned out". A case was quoted in which growth controls - maybe not entirely dissimilar from restrictions imposed in Asian cities - raised house prices by 38 percent.

The cost of planning controls in **Britain** was quantified as up to 10 percent of national income.

One of the two pieces of national planning legislation in Asia whose price effects have been quantified was the **Indian** Urban Land Ceiling and Regulation Act. This is believed to have caused land prices to rise at an annual rate of between 10 and 100 percent, although this paper expressed some scepticism of the validity of these particular statistics.

The other piece of national legislation examined is specific to **Indonesia**, although other countries do have equivalent laws. This gives the option for developers to obtain 'location permits'. By restricting the supply of land, land regulation in Jakarta has been estimated to increase prices by 18 percent.

As for city-specific cases, prices in **Seoul** were said to have been rising at an annual rate of 25 percent on account of restrictive planning practices, notably the preservation of a green belt around the city.

A similar effect was asserted to be true for **Bumi Serpong Damai**, a new town in Indonesia, where a town plan was examined and found likely to lead to land price inflation by its inefficiencies and by excluding the majority of the population from its benefits.

Next, the complexity, unpredictability and number of the land control regulations is asserted to have increased the time taken to undertake a development. This has hence raised the interest carrying costs borne (in the first instance) by developers; and thereby deterred small entrepreneurs from entering the industry. Land purchasers have to bear these capital costs; the existence of oligopolistic land development cartels, too, is assumed to act to raise prices to consumers. Evidence was quoted from the following sources:

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<sup>48</sup> Bertaud (1992) quotes von Hayeck, "Order generated without design can far outstrip plans men consciously conceive".

In **Malaysia**, it could take seven years or more to obtain all the necessary permits. This, and other restrictive practices, are estimated to cost the country the equivalent of 3 percent of national income.

The price impact of time delays was estimated differently for **Indonesia** where, in contrast to neighbouring Malaysia, and before recent streamlining, it took 'only' 2.7 years, on average, to get development approvals. This raised total project costs by 9.3 percent.

Similar circumstances have been reported in **India**, where obtaining No Objection Certificates alone can take up to five years, and where building regulations are close to incomprehensible to small builders. Nevertheless, at least one observer in India has found that the potential for good profits appears at least partially to offset the high costs of entry into the business of land development.

Thirdly, on account of the volume of stories of the bribery needed to facilitate and accelerate land development, it is often assumed that this must account for the highest part of the costs associated with bureaucracy. But evidence is largely anecdotal, and relatively little firm evidence was uncovered. Those examples quoted were:

Numerous cases of intermediary and other informal payments were reported from **Indonesia**: a tribute to the courage and the colourful reporting of the local press. But it is difficult to disentangle the magnitude of total sums paid, or sums received for the overall permitting process. An Urban Institute study finds that developers pay 6.8 percent of project costs in informal and formal fees, probably less than most observers would guess (although the reported bribe to a city official of a house valued at almost \$500,000 is hardly insignificant).

**Bangkok** developers were reported to be offering the equivalent to perhaps 5 percent of the total cost of a single development, in order to have one specific, threatened, building permit waived.

The greatest sums involved are reported from **India**, where two observers find that 'black money', or 'speed money' paid by developers for permits is at least 40 percent of the cost of the undeveloped land, and maybe as much as 100 percent.

No evidence was found of the cost of lobbying. This is presumably because this is a very elusive subject, not because lobbying does not exist in Asia.

Nor is there any readily accessible information on the staff and other direct costs to governments of attempting to maintain zoning and other regulatory controls.

Finally, the paper looked at the influence that land regulations have on the growth of informal settlements, and what this implies in terms of cost to their inhabitants:

The impact of land subdivision regulations was examined in **Uttar Pradesh (India) and Malaysia**, and in each case, legal plots of land were found to be unaffordable to all but 5 to 10 percent of the population. In other words, 90 to 95 percent of the population has no choice, if they want to occupy a plot of their own, but to live illegally: "informally", as we prefer to describe it.

·There is a very considerable literature describing the very heavy, but incalculable costs of informality; Section 6 of this paper summarized some of them (although noting that there is another side of the coin, too, in that informal tenure gives some protection against the predations of the formal market). Researchers in India have calculated that purchasers value informal residential plots at 25 to 35 percent below the cost of otherwise-equivalent plots in the formal sector. This may be a rough valuation of the cost of informality.

·The difficulty of complying with all the regulations has a strong tendency to prevent people from moving from the informal to the formal sector.

## In Conclusion

There is no single estimate possible of the total cost of land regulation, but regulation in its various guises clearly accounts for huge increments in raw land costs. The table below summarizes the findings of the case studies quoted in this paper.

	Zoning, Subdivision	Delays	Bribery	Informality
India	land prices +10-100% p.a.	up to 6 years	up to 100% of raw land cost	UP State plots unaffordable to 95% of population;  formal sector land has premium of 20-35%
Indonesia	location permits: 18% of project costs	9% of project costs	formal +informal fees: 7% of project costs; but huge bribes reported	new town plots unaffordable to 95%
Malaysia	c.50% of usual area saleable	3% of GDP		plots affordable to top 10%
Others	UK: 10% of GNP  Seoul: land prices +25%p.a.  California: house prices raised by up to 38%		Bangkok: ≤5% of project cost  Massachusetts: practised, but not quantified	

So, one asks, what should be done? Any answer should address the two parts to the problem:

·That **the most important effect of many regulatory interventions in the land market has been to restrict supply.** This has served to raise prices, both directly and indirectly (especially by opening the door to corrupt practices).

·And that **the number and intricacy of the land regulations** have a variety of indirect cost (and social) implications.

The answer should, simultaneously, acknowledge that there *is* a need and justification for some degree of land regulation, mainly to protect public health and safety. But, as Albert Einstein is reported to have said, "everything should be made as simple as possible; but not simpler".

The second part of the problem can - in theory - be the more easily managed. A reduction in the number of regulations, and simplification of procedures (and of the language describing the procedures) will result in significant improvements - for buyers - in the price of land. Footnote 30 of this paper referred to a determined and successful effort by the Indonesian Ministry of Housing to simplify the permitting process, thus giving a practical demonstration of major benefits that can be achieved relatively painlessly.

As for the first, and more significant part of the problem, the conceptual solution is obvious: for government to re-examine the absolute need for each individual regulation: to ask what is its effect on land supply, and how it contributes to urban developmental objectives. The inquiry would focus on the extent to which the regulations attempt to circumvent or neutralize market forces (which, as has been seen, is usually counterproductive, to the extent of resulting in consequences worse than the original cause), or whether they work *with* the market to produce the desired result. Regulations which result in a reduction in the supply of land, prevent mobility between sectors, or challenge the market, should be scrapped or significantly modified.<sup>49</sup>

Before this can be done, however, it is of course necessary to know what regulations there are in existence. In many countries, that is just not known. In one, for instance, a recent study uncovered a total of some 1,500 national land laws and regulations: the first time they have been inventoried. It is encouraging to see the Indonesian authorities taking the initiative, within the USAID-funded Municipal Finance Project, to compile an inventory of urban management guidelines, prior to reviewing them for consistency and impact and, ultimately, to re-issuing a new set of management directives.

In order to assist such processes of re-examination, there is, too, a need for additional research, above all to determine which type of regulation should be changed to make land supply more responsive to a city's (presumed) objectives of environmental protection, economic efficiency, and promotion of equity.<sup>50</sup> The result of these research enquiries will make it easier to analyze the economic impact of existing regulations.

Above all, there is a need for greater transparency - honesty in acknowledging the problems associated with land management as currently practised. The author (still) believes in the power of knowledge. The more that is widely known and understood about the issues - not just by academics and professionals employed by donor agencies - the less easy will it be for the people who presently benefit, to continue doing so.

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<sup>49</sup> There are, of course, many specific recommendations on reform of land administration that are consistent with this advice. Among others, see Dowall (1990a) and (1990b), Holstein (1989), Durand-Lasserre (1989), Dowall and Clark (1991) and Farvacque and McAuslan (1991).

<sup>50</sup> This is one of several research questions put forward by Bertaud (1992) as part of a good research agenda -- although questioned by Rakodi (1992). Bertaud recommends a study "to link an analysis of the physical aspects of planning with an economic analysis of the costs implied by these physical aspects... The research output will be considered successful only if the linkage between urban planning practice and economic theory is strongly established and convincing...".

This paper, then, has had the limited objective of highlighting the costs of bad practice in land planning and regulation. If it has not succeeded in framing the complete picture, it may have demonstrated that the costs are real and large; that they raise land prices, sometimes enormously; that they impact on residents of both formal housing and informal settlements, and on purchasers of all urban goods and services; and that they reduce economic growth and national welfare. If the land development system works at present, it is only as the second best.

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