



title: Cities Without Land Markets : Lessons of the Failed Socialist Experiment World Bank Discussion Papers, 0259-210X ; 227

author: Bertaud, Alain.; Renaud, Bertrand

publisher: World Bank

isbn10 | asin: 0821327402

print isbn13: 9780821327401

ebook isbn13: 9780585253176

language: English

subject: Land use, Urban--Russia (Federation)--Congresses, Land use, Urban--Government policy--Russia (Federation)--Congresses, Real property--Valuation--Russia (Federation)--Congresses, Land tenure--Russia (Federation)--Congresses.

publication date: 1994

lcc: HD720.2.Z7B47 1994eb

ddc: 333.77/0947

subject: Land use, Urban--Russia (Federation)--Congresses, Land use, Urban--Government policy--Russia (Federation)--Congresses, Real property--Valuation--Russia (Federation)--Congresses, Land tenure--Russia (Federation)--Congresses.

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Cities without Land Markets
Lessons of the Failed Socialist Experiment

Alain Bertaud
Bertrand Renaud

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1818 H Street, N.W.
Washington, D.C. 20433, U.S.A.

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First printing March 1994

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full ordering information) and indexes of subjects, authors, and countries and regions. The latest edition is available free of charge from the Distribution Unit, Office of the Publisher, The World Bank, 1818 H Street, N.W., Washington, D.C. 20433, U.S.A., or from Publications, The World Bank, 66, avenue d'Iéna, 75116 Paris, France.

ISSN: 0259-210X

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Library of Congress Cataloging-in-Publication Data

Bertaud, Alain.

Cities without land markets : lessons of the failed socialist experiment / Alain Bertaud, Bertrand Renaud.

p. cm. (World Bank discussion papers, ISSN 0259-210X ; 227)

ISBN 0-8213-2740-2

1. Land use, UrbanRussia (Federation)Congresses. 2. Land use, UrbanGovernment policyRussia (Federation)Congresses. 3. Real propertyValuationRussia (Federation)Congresses. 4. Land tenureRussia (Federation)Congresses. I. Renaud, Bertrand, 1939- . II. Title. III. Series.

HD720.2.Z7B47 1993

333.77'0947dc20

93-42813

CIP

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Foreword

About a third of the world's population lives in former centrally planned economies. The transition of these countries to market-based, competitive mechanisms for resource allocation is one of the dominant issues of the 1990's. However, such reforms raise analytical and operational problems which are considerably more difficult to address than those of liberalization or privatization in market economies.

The possibility to observe closely the outcomes of a state-run, administrative-command system which has been in operation for a long time can also throw a powerful light on critical elements of a well-functioning market economy which we often take for granted. One such outcome is the pattern of land use and resource allocation in socialist cities. There the well-intentioned goal of socializing the collection of the land rent through total public ownership and allocation of real estate property has yielded unexpected and undesirable outcomes. The resulting structure of socialist cities renders the transition to markets economically much more difficult and socially painful. This evidence also holds major implications for developing countries which are grappling with this same issue of land rent recovery and may be tempted by various forms of land nationalization and public allocation.

The present paper relies primarily on data from Russian cities but consolidates results from field work in several socialist economies in transition. It provides important systemic insights into the transition problems of socialist cities and points at the critical need to develop efficient urban land markets. The findings also strongly underline the need to identify suitable urban regulatory systems for the transition cities. What are the most desirable urban planning regulations, institutions and professions for land development, commercial and real estate investment, and property transactions? How do they affect the provision of infrastructure? What are their pricing effects? Finding an answer for transition cities will also be of great value to the rapidly growing market cities of developing economies.

Implementing a sound and adaptable urban regulatory system is not a narrow technical issue when one considers that the international competitiveness of countries rest on the efficiency of their cities where most of the GDP now originates. Land use management and the urban regulatory framework are not

critical only to a city's internal organization, but also to its economic viability, its adaptability to change as well as its livability. Looking beyond this paper, we therefore hope that these important regulatory issues can soon be successfully addressed by the international community working on the urban problems of transition economies, and beyond.

ANIL SOOD, DIRECTOR
TECHNICAL DEPARTMENT
EUROPE AND CENTRAL ASIA OFFICE
MIDDLE EAST AND NORTH AFRICA OFFICE

Abstract

What has happened to the socialist city where all investment decisions have been made without land markets? What are the consequences for the national economy? This paper presents an empirical analysis and a theoretical interpretation of the spatial dynamics and urban efficiency of socialist cities. The empirical work is based on Russian cities which have been operating without land markets for seven decades, precisely at the time when the Soviet economy became fully urbanized. Soviet planners have made urban investment decisions under three greatly distorted prices: land had no site value, interest on capital was not recognized, and energy prices were only a small fraction of world prices. Lacking price signals and economic incentives to recycle land sites over time, the administrative-command process has led to a startling pattern of land use with a perverse population density gradient which rises as one moves away from the center of the city, in total contrast with the market city. Population density in Moscow at 17 kilometers from the center is equal to that in the center of Paris which is known as one of the densest market cities. Equally remarkable, the location of jobs has remained highly centralized like in 19th-century cities, in contrast with modern market metropolitan areas with their multiple suburban employment centers. Today, the Soviet city is characterized by rusting factories in prime locations, a monocentric pattern of job location together with distant residential areas located in the suburbs. Such an internal structure tends to maximize the internal inefficiency of the socialist city in terms of energy use, infrastructure and commuting requirements. The share of land allocated to industrial use in the socialist city is often two to three times higher than that found in market cities of comparable size and economic function. These major inefficiencies diminish the international competitiveness of the socialist city. Moreover, the environmental impact of a ring of older or decaying industries in the urban core surrounded by high density residential areas is likely to be very significant.

These land use distortions are causing problems for the transition to markets. With price liberalization and the opening of the economy, relative prices are shifting very rapidly; especially energy prices. In Russia, a good part of the residential stock of high-rise suburban mass housing may have a negative asset value for a significant period of time as rents compared to housing

operating costs are out of balance. Meanwhile, opportunities for capital gains at the center are very significant. The analytical framework presented shows why and how these distortions are generic to the "socialist city". However, the intensity of distortions may vary according to the length of time a specific city has been operating without land markets. In Moscow, the trading of housing is now allowed and a clear negative price gradient has emerged in 1992. This gradient is rotating very rapidly. Yet, legal, institutional, and administrative impediments to clear property rights remain large and center-periphery price differentials are still too weak compared to those found in the market city to stimulate much land recycling yet.

The evidence presented points at two key issues: what are the critical decisions required to start-up a viable land market? What are the appropriate institutions needed to sustain sound urban land markets? The final section outlines key components of the program of urban land reforms needed to support the emergence of land market. Yet considerable technical work is needed beyond this paper to provide operational answers to these two key questions in Russia and other semi-reformed transition economies.

Acknowledgements

This paper reflects extensive discussions with and contributions from colleagues working in China, Russia, Poland and quite a few other semi-reformed transition economies. While our concerns were first raised in China in 1988, much of the work reported here was part of the Technical Cooperation Project on Housing Reform and Privatization carried out with the Government of Russia in 1992. We are particularly grateful to the urban planners and economists of Russia who assisted us in the collection of data without which the evidence presented in this paper would not exist. Our special thanks go in alphabetical order to Mikhail P. Berezin, Olga Z. Kaganova, Nataliya V. Kalinina, and Oleg Matiukhin. We thank Joseph K. Eckert for his permission to reproduce the price gradient analyses which he generated as part of our technical cooperation work. During the development of our analyses we have benefitted from discussions with our World Bank colleagues, in particular Gian Carlo Guarda who currently works in Poland and Albania and Andrew Hamer who works in China. A more limited version of this paper was presented at the 1992 *Seminar on Urban Land and Housing Reform in Socialist and Formerly Socialist Economies* held to commemorate the centennial of the foundation of the University of Chicago.

I

Introduction^{1/}

1. The rejection of private ownership of capital and of the means of production, and of the market as a mechanism for resources allocation has been a central tenet of Marxist ideology. The total commitment to public ownership of land under the administrative- command system used to manage the economy has led to a dramatically different structure of socialist cities. Now that controls over information have been lifted, access to actual local urban data can be obtained. It is therefore possible to carry out empirical analyses of the urban land use which has resulted from the absence of markets to allocate land among competing uses. The combination of marxist ideology, national institutions and domestic economic system has produced somewhat different results in each socialist economy. Yet, the systemic impact of the administrative-command system as a substitute to the market is quite clear. The empirical evidence provided in this paper is based on the Soviet Union and Russian cities, because these are urban centers with the longest history of development in the absence of land markets. Russia is also the country where we have worked most recently. The conceptual framework we use, however, is applicable to other socialist cities with a strong legacy left by the administrative command-system. We observe similar outcomes in the cities of Poland and China which we have analyzed.

2. Except for the old historical centers, almost all of Russian urban growth has taken place during the socialist era 1917-1992. The fact that urban development took place in a period when land was nationalized and administratively allocated rather than sold on an open market for a price has had a very profound impact on the internal organization of Russian cities. It is therefore

^{1/} This paper has been prepared by Bertrand Renaud. It is based on joint work done with Alain Bertaud in Russia, China, and Poland. The land use analyses of St Petersburg (formerly Leningrad) and Moscow presented here were carried out by Alain Bertaud with the cooperation of the state planning organizations of these two cities, and the assistance of independent Russian urban planners. Joseph K. Eckert contributed the analysis of prices for Moscow, Russia and Krakow, Poland. This analysis of urban land use in Russia originates in a larger technical cooperation project directed by Bertrand Renaud for the World Bank

whose results appear in the report *Russia: Housing Reform and Privatization, Strategy and Transition Issues* to be published.

empirically quite relevant to speak of a distinct "socialist city".^{2/} The inability of the administrative-command system to evaluate even approximately the value of a land site and its opportunity cost in alternative uses (under such concepts such as site value according to highest and best use) has generated striking spatial anomalies and urban inefficiencies. The transition to markets and the opening of the national economy requires a shift from administered prices and bureaucratic allocation to market prices. This is resulting in major and rapid shifts in relative prices which are bringing into sharp relief the pattern of past resource misallocation in the urban economy. For instance, Russian domestic energy prices until 1992 were less than 5 percent of world prices. Even an imperfect adjustment to 50 percent of world prices will have a massive impact on urban transport costs and the energy intensive construction sector as well as on the maintenance of the inordinately energy intensive housing stock.

3. In order to identify generic features of the socialist city using Russian cities, this inquiry treats four questions:

- (1) How do Russian urban land use patterns differ from those in market economies; do those differences generate major inefficiencies?
- (2) What issues may arise once market land pricing is applied to Russian cities previously developed under a command model?
- (3) Will long run market forces correct existing inefficiencies or should Russia adopt specific transition strategies?
- (4) What changes in existing laws, institutions, and professions will be needed to operate sound urban land markets?

4. These questions are central to the urban economy with the end of the socialist administrative-command system. During the transition toward a market economy, urban infrastructure and housing investments may help restart the construction sector. Depending on the geographic pattern of future real estate market values, transition investments might have a negative economic rate of return and might perpetuate land use distortions. Failure to carry out land use reforms could lead to even worse land use distortions as partial market forces collide with distorted existing uses. By contrast, recognizing and understanding land market values will help direct investments to high return areas and could reduce relatively quickly some of the worst land use inefficiencies. In short, the spatial distribution of

investment in the urban areas is a matter of substantial policy relevance during the transition. Far from being an ideological or doctrinaire prescription, the development of urban land markets is the only way to remedy past urban distortions and inefficiencies in a decentralized, incremental and organic way in all transition socialist

2/ A seminal influence when we started our joint field work in China in 1988 has been the series of papers in R.A. French and F.E. Ian Hamilton eds., *The Socialist City, Spatial Structure and Urban Policy*, Chichester, U.K.: John Wiley, 1979. Our early findings were presented in B. Renaud and A. Bertaud, "Urban Housing Reforms in China: The Main Points", paper presented to the China Leading Group on Urban Housing Reforms, Joint China-World Bank Seminar, Beijing, October, 1989.