

## **Memorandum**

From: Alain Bertaud  
 Date : April 11 2002  
 Subject: India – Urban Land Reform 2488

### **The economic impact of land and urban planning regulations in India**

Government intervention – in the form of regulations, infrastructure investments and taxation – has a direct impact on urban land supply and on the demand for land, and therefore on the price of land and housing. De facto, some regulations have the effect of allocating land administratively, ignoring demand and costs and bypassing market mechanism in allocating resources. Land regulations are necessary to the well functioning of markets but when poorly designed they can constitute a serious drag on economic development.

In India, the combined effect of multiple layers of poorly conceived central, state and municipal regulations contribute to an artificial urban land shortage. As a result urban land prices are abnormally high in relation to India's household income, and households consume less floor space than they could afford if the regulatory environment had been reformed. In addition, some regulations have a negative impact on the spatial structure of cities. By unreasonably reducing the amount of floor space that can be built in centrally located areas, and by making land recycling difficult, some regulations tend to “push” urban development toward the periphery. As a result, commuting trips become longer, public transport become difficult to operate and urban infrastructure has to be extended further than what would have been the case if land supply had been unconstrained.

Some regulations are responsible for an increase in corruption. By making urban development financially unfeasible in areas where there is high demand for commercial or residential space, some regulations encourage corruption. The corruption is compounded by the fact that nobody sees any social benefit in enforcing the regulation (contrary to environmental regulations where the social benefits are usually obvious to all). For this reason, many people consider that flaunting regulations is a victimless crime. It has been said that the regulatory environment in India has contributed to a “criminalization” of real estate.

Many regulations have the effect of rendering construction unaffordable for a large part of the population. As a result, many households and firms build illegally and therefore have weak property rights, which cannot be used to obtain formal financing.

### **Regulations should be regularly audited and submitted to a cost benefits analysis**

Land use regulations have costs and benefits. When regulatory costs outweigh benefits, regulations should be amended or repealed. In India, there is already a consensus that the social and economic costs of rent control regulations and of the Urban Land Ceiling Act far outweighs whatever benefits these regulations were supposed to

provide. However, there are a number of regulations which impact – positive or negative – are less obvious. Some regulations should not be repealed but simply amended. The decision to repeal or amend regulation should be based on a “regulatory audit” that would evaluate the costs and benefit of a specific regulation.

In addition, some land use regulations – such as the regulation of FSI (or FAR in some states) – are not objectionable per se, but the general principles that justify specific value for the FSI at specific locations should be revised. In this case the State governments may provide guidelines to urban planners to help them regulate FSI in a manner that is consistent with an efficient and market driven urban spatial structure. The same applies to land subdivision regulations. Land subdivision regulations might be necessary, but the quantitative parameters contained in these regulations – minimum plot size, streets right of ways, etc – should be carefully audited, taking into account their impact on development costs, on the land affordability for various socio economic groups and their negative impact on the environment when they result in an over-consumption of land to meet the minimum standards.

### **Impact of regulations and planning practices on supply and demand for urban land**

In reviewing or auditing land regulations it is convenient to divide them according to their impact on markets. Some regulations contribute to a decrease in land supply, other artificially increase land consumption and therefore demand for land. The double effect of restricting supply and mandating high land consumption has an evident impact on price.

a) Government regulations or practices contributing to a decrease in land supply:

1. *Urban Land ceiling act*

The major effect of the urban land ceiling act has been to freeze large areas of land in legal disputes. These areas are not available for development or redevelopment. An additional negative impact of the act was to prevent private developers to assemble land for subsequent development. The act gave a de facto monopoly on land development to government developers such as housing boards or Development Authorities.

2. *Rent control*

The effect of rent control on the supply of new rental stock is obvious and well documented. However rent control laws have also an effect on land supply and city shape. Rent control contributes to a decrease in land supply because buildings which are under rent control cannot be redeveloped or even renovated. Many rent controlled buildings are very old and by necessity badly maintained, even in some cases, in Mumbai for instance, structurally unsound. But no redevelopment can occur until the tenants move voluntarily out the building. Rent control creates the perverse incentive for landlords to see their property deteriorate or even collapse. Until this happen, development has to bypass the areas under rent control which constitute a form of “frozen” land as far as development is concerned.

*3. Regulations preventing or slowing down the conversion of land from one use to another.*

Any change of use, even when approved by Master plans, requires lengthy approval to become effective. This is particularly serious at the periphery of cities where land has to be converted from agricultural to urban use. Change of land use within cities is also long and cumbersome resulting in pockets of “dead land”. For instance, obsolete cotton mills in Mumbai and Ahmedabad are still occupying large areas of land in central location, although there is a consensus that it is neither environmentally desirable nor economically feasible to put back these mills into operation.

*4. Master plans ignoring real estate demand*

Master plans allocate land between various uses and limit the amount of floor space which can be built on specific parcels, either directly through maximum FSI or indirectly through set backs, plot coverage ratio, and maximum number of floors. While these types of control are not objectionable per se, the parameter used are often arbitrary and have been set without taking into account the efficiency of city structure or the affordability of different social groups. Indian urban planners have a tendency to prefer low intensity of development through low FSI values and to ban commercial development in central area to “avoid congestion”. This is the urban version of the regional development philosophy which had been banning new industries around successful metropolises like Bombay and Surat and had been subsidizing industrial infrastructure in remote areas like Western Gujarat (next to the desert of Kutch) and in the mountains of Arunachal Pradesh. A wide debate should take place in India to discuss “demand, location, congestion, economy of scale and uniform geographic development”. There is still a widespread conceit among policy makers that the absence of development in some remote location (whether urban or regional) is a sign of market failure which should be corrected by Government investment and tax subsidies; and reciprocally, that fast growth in high demand locations should be discouraged by government regulations.

*5. High stamp duty*

High stamp duties discourage land transactions, and as a consequence reduce the supply of land on the market. A high stamp duty incites to under-declare the real value of land. This in turn adversely affects the possibility of using land as collateral for construction financing. In the future, Indian cities will have to move to an ad valorem property tax system. However, setting an ad valorem tax requires a reasonable transparency in land transactions. It could therefore be said that an unreasonably high stamp duty prevents the modernization of the property tax system in India.

*6. Large institutional land holdings*

Government entities or parastatals such as Railways often own large tracts of land in cities. Because this land cannot be sold on the market to the benefit of the owning institution, it is often underused, or used in a way incompatible with its real market value. Many of the land holdings have been inherited from colonial time and are located in downtown areas. Government entities and parastatals should be required to make a full inventory of their land holdings and to evaluate

them at market value. Government entities and parastatals should be allowed to sell their land holdings, and retain the proceeds, whenever they feel that the cash value of land would be more valuable to them than the use of land. A complete inventory of urban Institutional land holdings has never been done in India, but an informal survey made in Chennai some 20 years ago indicated that more than 30% of the urban land was owned by government institutions (not including housing boards or development authorities).

*7. Very low property taxes*

Very low property taxes and property taxes based on actual rents rather than on land values create an incentive to hold vacant or underused land, thus decreasing the amount of land on the market. Introducing an ad valorem property tax would require more open and transparent land transactions. Of course ad valorem land taxation is incompatible with rent control.

*8. Inadequate primary infrastructure*

The failure to provide primary infrastructure with a capacity consistent with demand is often cited as a justification for constraining development intensity, in particular low FSI. It is important to realize that an adjustment of land use regulation to actual market demand will also require the provision of primary infrastructure of sufficient capacity. The means to finance primary infrastructure could come for a better design of the property tax or from the imposition of impact fees when redeveloping high density areas.

b) Government regulations or practices contributing to an artificial increase in land consumption:

*9. Land subdivision regulations*

Land subdivision regulations tend to “over-design” roads right of ways, open space and other land reserves. This practice results in an increase in the consumption of land compared to what would be necessary. Many of the right of ways reserved are never used for circulation.

*10. Minimum plot size*

Minimum plot sizes are often set at different value for state development agencies and for the private sector. This practice results in excluding the private sector from the supply of plots and housing for a large segment of the population.

Minimum plot sizes should be adjusted to reflect land values and the affordability of various socio economic groups and the same standards should be available for both the private and public sector.

*11. Low FSI*

Low value for FSI (typically, FSI in India are seldom above 1.6, even in centrally located areas, compared to values ranging from 5 to 15 in the CBD of other cities of Asia) tend to increase the consumption of land because with low FSI more land is required to built a given area of floor space. In the case where the supply of land is severely constrained by the laws and practices described above, low FSI values result in a reduction in the consumption of floor space. This affects low and middle income households more than others and in the non residential sector contribute to a loss of productivity.

## **Expected impact of land regulatory reforms**

The careful review and reforms of the regulations mentioned above would result in a lower cost for urban development and for housing. An additional benefit will be a more efficient spatial organization for cities. Specifically, the expected outcome of regulatory reform can be summarized as follows:

1. More compact cities, more efficient land use. No enclaves of under use or unused land; more efficient use of existing primary infrastructure.
2. Increase share of the housing stock supplied by unsubsidized formal private sector developers, decrease in illegal subdivisions and slum areas.
3. Generally lower land prices but higher prices in some prime commercial and business areas
4. Decrease in trip length due to more compact cities and because of more intense use of land in the CBD (less dispersion of employment). A more intensely used CBD allows a better efficiency of transit and therefore should increase urban air quality in the long run.
5. Increase in the consumption of floor space per person for both residential and business use. This should result in an increase of welfare for households and an increase in productivity for firms.
6. Average urban population densities are likely to stay constant as more efficient land use and higher FSI are likely to be balanced by a higher floor consumption.
7. Because of an increase in the number and transparency of transactions, In the long run possibility to convert progressively property tax from an area base to an ad valorem base. The ad valorem property tax constitutes an incentive for the local government to keep land at its best and higher use.
8. Finally, by reducing the difference between what is allowed and what is financially feasible, land use reform should reduce significantly the opportunity for corruption.

## **Implementation**

Some regulatory reforms require prior legislative action by the States. The center should then create incentives to stimulate action, this include full documentation of the benefits of reform and some financial incentive to reverse the status quo. Other reforms – master plans fixing FSI and land use, minimum plot sizes – will require setting up example in selected 2 or 3 cities to illustrate the methodology to be used. No standards value for FSI or minimum plot size should be legislated at the state level. The best vehicle for reform of this type would be an investment project in urban infrastructure including a “master plan and regulatory reform component”. The example and methodology could then be transferred to other cities and states.

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The following recently published article may be relevant to our work in India:

**Measuring the Costs and Benefits of Urban Land Use Regulation: A Simple Model with an Application to Malaysia ).**

*Journal of Housing Economics*, 10 (3), September 2001

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pp. 393-418 (doi:10.1006/jhec.2001.0293)

Land use regulation *per se* is neither good nor bad. What matters is the cost and benefit of *specific* regulations in *specific* market conditions. This paper presents a straightforward cost-benefit framework for analyzing land use and related regulations in such a context, and presents an application of the method to Malaysia. We use these results to illuminate several important issues, namely the effects of such land use regulations on housing markets, how to use such analyses to suggest revisions to common land use regulations, and what changes in higher-order incentives facing regulatory authorities might be required to encourage an appropriate regulatory environment for urban land.