The Role of Government, Urban Planners, and Markets

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We are going to discuss the relative role of government, of urban planners and of real estate markets in developing cities. We will look in particular at the way government action and the real estate market interact with each other in shaping cities.

In particular we are going to discuss in detail the role of government and the role of urban planners within the government in developing cities in the context of a market economy.

And, finally, we are going to concentrate on what urban planners should know about the real estate market to do their work efficiently.

Government and the real estate market. This is a rather difficult subject in China because the country is going through an economic transition. Markets are playing an increasingly important role, but sometimes the line between market and government action has not been very clear. This is not really specific to China. There are a lot of other countries where the boundaries between the role of government and markets are not very well defined. But I think that in China, during this period of transition, defining a little more clearly the role of market and the role of government is particularly important.

A very common mistake consists in thinking that in a market economy, the role of government is very reduced. In my opinion, this is completely wrong. In a market economy, the role of government is as important as in a planned economy, it is just very different. The role of government as a regulator is more important in a market economy than in a socialist economy.

In a socialist economy, the government is a planner, the government is a developer, the government is a builder. So its role as a regulator is secondary, because being at the same time a planner, a developer and a builder, it can change regulations relatively fast, depending on the circumstances.

In a market economy, the government is first a regulator. Its role as developer is much reduced, and as a builder it has no important role. So the focus is on regulations, but regulations are much more important in a market economy than in a socialist economy. I could compare a socialist economy to a ballet where everybody is acting according to a prearranged script; there
is really no regulations for the way a ballet should be executed, but there is only a script, and everybody follows the script, and the script is under the control of the director.

In a market economy, there is no script. It's more like a soccer match, rather than a ballet. You need rules and you need a referee, and the referee, in the case of market, is the government. The government is the referee, and the referee has to follow the rules. It's very important. In the absence of rules and referee there is no possible soccer match. Even if the players are very good, if there is no referee or if there are no rules, nobody can play.

Well, markets are exactly like that. If there are no rules or if the rules are imprecise or if there is nobody to enforce the rules, markets do not work. This is extremely important to bear in mind; that for markets to work efficiently, the government has to play an extremely important role. When the government does not play well its regulatory role the market will not work at all.

The government in China may not yet be playing the regulatory role that it should, and so we are going to develop that a little further in order to see in particular what should be the role of planners within government. Defining these roles is always a little controversial and at time difficult to grasp. In many countries, unfortunately, the proper role of government and planners is not always very clear, and as a consequence it creates a lot of confusion and inefficiency in a lot of cities.

First, let us look at the role of government. Government, first, should develop urban objectives and an urban policy. Developing an urban policy is a political task. It is not a technical one, although the government, of course, will have to use the input of planners. It will have to use technical documents, in order to set up priority objectives, but the choice of objective and their relative priority is not a technical task; it's a political one, and it's very important that planners understand that this task is political and is done by mayors and municipal councils.

The job of urban planners is technical; they have to translate political objectives into a strategy. The goal of the strategy is to implement the municipal objectives. Planners do not select objectives. It's the government, because it is mainly a government which is responsible in front of the people.

Urban planners are accountable to the government, and the government is accountable to the people for the success of its strategy.

What is then the specific role of urban planners? If the government set up the objective and, in a way, selects a strategy with the help of planners, then the most important role of planners is to set up the framework within which the market will work, and this framework is composed of three components.

The first component is constituted by land-use regulations; the second one is the primary infrastructure investments; and the third one is taxation. This is the role of the planners, to develop this framework within which the private sector will work.
It's very important to bear in mind this separation of responsibilities. A master plan should always start with a clear statement of Municipal objectives, and those objectives should be set up by the government. The objectives are political, and those objectives will change over time.

It is possible that a local government will want to put a priority on creating employment, for instance, or on new housing, and that within after 5 or 10 years, the same government will shift objectives or priorities.

Many objectives will always be there, but priorities may shift. The Municipal government will say, “our priority is the environment”, or “our priority will be culture”. Every time the planners will have to adjust the framework within which the market is working so that the government's objectives will be implemented.

Do not forget that, at the end, it is mostly the market or independent players who are going to build the city, but they are going to build it within the framework which is established by government and which follows overall objectives set up by government.

So let us now concentrate a bit more on the role of urban planners. The market framework: regulations, infrastructure investments and urban taxation would have to be developed by urban planners, and it should reflect government objectives. And this is not easy to do, frankly.

Ensuring that the set of regulations which are regulating markets are in conformity with government objectives requires an audit of existing land use regulations. That means that planners will have to review existing regulations which were set-up in previous administrations to see if those regulations are consistent with government objectives.

Very often, regulations have a tendency to accumulate in layers, and sometimes they even contradict each other. And in many countries, you will find that there are many contradictory regulations, which end up creating a lot of inefficiency.

Land use regulation should be submitted to the six steps of urban planning that we discussed in the previous session: objective, strategy, input, output, outcome and impact.

Therefore, when a planner drafts a regulation, it is absolutely necessary to also include in the regulations its objective but also the projection of what will be its impact on the city structure. Unfortunately, this is not often done.

Many land use regulations have what I will call “side effects”. It is a bit like medicine. You may take some medicine for a headache, and it has the side effect of giving you a pain in the shoulders, and many regulations have side effects like that. They are intended for one purpose, but they do something else.

For instance, let us say that you have a set of regulations which establish very high standards for housing. The objective are clear, it aims at improving the housing conditions of the
city. For instance, the homes have to be a certain size, rather large, and there should be a rooms and bathrooms of a minimum size, et cetera.

This is all good and well, but it could be that a side-effect of this well intentioned regulation will make housing much more expensive, and that therefore a large number of people will have no access to housing at all, and therefore they will tend to overcrowd existing housing, therefore reducing the standards of the city, rather than improving them. This will be rather typical of a side effect of regulations. That's why a planner should be very careful about calculating side effect by taking into account the reaction of the market to the regulation.

Planners should always look at the effect of a regulation on the market. For instance, a regulation which aims at increasing or decreasing density would have a direct effect on the price of land, and planners should be aware of that. Regulations are not like a design. Imposing a regulated low density will reduce the price of land, but at the same time planning a city at low density will require much more land to be developed because the same number of people will require more land at low density than at high density.

On the opposite side, a regulation which increases overall density will normally increase land prices, but it will contribute to decrease the land which is required for the development of the city. As a consequence higher density normally results in cheaper housing, although it increases the price of land. But, higher density means requiring less land for housing. Therefore, it tends to lower the price of housing.

Land use regulations therefore have a direct effect on the land markets, and planners should be aware of it. They should be aware of the effects of land use regulation on the cost of land, on the price of housing, and of course they should check if the anticipated changes in price are consistent with the objectives of the government.

Planners also should have a role in the development of primary infrastructure. Primary infrastructure is very important not only to provide water supply and roads, in general, to the inhabitants of a city, but also because the development of primary infrastructure will have an impact on the supply of land which can be developed, and the density at which this land can be developed. Therefore infrastructure will have an impact on housing prices, land and even transport costs and time spent commuting.

Therefore it's very important that planners understand that developing infrastructure has a double impact. It allows the development of a certain area of land, but it also influences the supply of housing and offices and commercial buildings. Planners should always try to measure the impact that the supply of infrastructure has on prices. The prices and rents are sending signals to the urban planner and he/she should be able to interpret these signals. We will discuss that more in detail a little later.

Let us summarize: urban planners should have an action in three areas: land use regulations, which is normally their traditional area of action; infrastructure, which is a little further than what they do traditionally, but they should study the impact of infrastructure on the land and housing market; and, finally, taxation. Taxation normally is an area where urban
planners have no action or even no interest because, in general, local taxation on land and rent is imposed mostly to raise revenues for the municipality, and most people think that it has nothing to do with planning. In fact, land taxation has a lot of impact on land use because it gives an incentive or disincentive to keep or sell land.

For instance, a high land tax will force some obsolete industries, like old factories or old warehouses, to leave the city or at least to leave the center of the city and go to the suburbs.

In this case it is not the action of the planner that is changing land use; it is the price of land and the taxation on land. So the taxation can be used to reform land use in a city, and it might be a much more useful and efficient tool to bring about a more efficient land use than just drawing a plan with color and saying “this is industry” and “this is residential”. Very often it is really the tax and the land prices which will change land use, not the colors on the master plans.

In Western European cities and in American cities, the prime movers of land use are not land use plans. They are taxes. It is the land taxes and the land market which create order and efficiency in a city. Land prices and taxation are responsible for removing obsolete industries automatically from the centers of cities. It is not so much the action of urban planners, but planners should be aware of the effect of markets and tax on land use and should use taxation as a tool to reform land use.

There are very few planners in the West which are using these tools and, in fact, sometimes the land tax acts at counter purpose of the desired land use. Often the objective of land taxes is just to raise money, not necessarily to achieve efficient land use, and I think that it is a lost opportunity.

Land taxation is an area where planners should intervene, not necessarily by designing the tax, this would be a bit outside their competence, but at least to be aware of the effect of existing taxes on land use. Eventually planners should try to get the Mayor or the City Council to modify taxation so that it's consistent with the urban development objectives of the government.

It is important that planners concentrate on three topics: regulations, primary infrastructure and taxation. Planners should look at how those three topics affect the shaping of the spatial development of cities, how they impact the price of land and floor space, and whether they allow economic growth or not. At time, a poor land use plan or the lack of infrastructure is responsible for economic stagnation. Some cities do not generate much employment; sometimes, this is could be due to very poor land use or faulty infrastructure or infrastructure which is developed in the wrong place.

I would like now to discuss what planners should know about markets, land prices, and the role of markets. In many countries urban planners tend to ignore the signals which are sent by markets. Economists are using the word "signal" or "messages" when talking about prices variations; the market is sending messages and planners need to understand these messages. For instance, if land prices are going up or going down, the real estate market is sending a signal, and
this signal has a meaning that planners should know how to interpret. Market signals should never be ignored.

The meaning of market signals is not always self-evident. Planners have to understand the way markets work in order to understand the meaning of market signals. Variations in real estate prices are important. Every time there is a change in price, urban planners should be aware of this change and, if necessary, take action. Because every time there is a change in price, it indicates a change in supply or demand.

For instance, if housing prices are going up, in general that may mean that there is more demand than supply. That means there is a shortage of either housing or land. If prices are falling, it normally indicates that supply is catching up with demand, or that demand is falling.

So the planners will have to interpret those messages because the rising prices or falling prices by themselves are not necessarily good or bad. It all depends on what they mean.

Lower housing price and land price, in general, could be considered good because it makes housing more affordable, but falling prices are not always a positive sign. For instance, if land prices and rent are falling in a neighborhood, it may have two possible opposite meanings. Either it means that housing supply is catching up with demand, so that's very positive. That means that there are more housing being built than there is demand for it, therefore, the prices are going down. Or, it could well mean that conditions in the neighborhood are deteriorating and that, therefore, prices are falling because people don't want to live there anymore, and that's not a very positive sign.

It is important to note that price change up or down need to be interpreted by planners, and they should investigate to find what is the real reason for it and whether it is a sign that objectives are being achieved or on the contrary that their strategy is failing.

Let us look at a concrete example of price signal. Let us suppose that there is an increase in rent along a road which has been recently built. The road existed but was not paved, and now it's paved, and immediately after it has been paved, rents in adjacent lands and in buildings are going up.

This is a positive sign because it means that the people who are living there are recognizing the value of the paved road, more people are competing to live there rather than in other parts of the city. The difference in rent before and after building the road measures the benefit of the paved road as perceived by the market.

Planners can also measure the benefits of a new school, by measuring its effect on land price. For instance, imagine that you have a very good school, a very prestigious school, well equipped, with good teachers. It will have an effect on the land price around it. Very quickly the households with children will see the advantage of living close to this school, and this will be reflected in the higher rents which would be paid. So, in this sense, a rising price is really a positive sign.
On the other hand, if, in the entire city, housing prices are rising much faster than income, this may mean that there is a shortage of something. It might be a shortage of land, it might be a shortage of construction, it might be a shortage of building materials, it might be a shortage of infrastructure. The planners should try to interpret and find the real reason for it.

This is why it is so important for planners to monitor the land market, the real estate market, and interpret it. Although interpreting the signals sent by the market is not always very easy.

In order to be able to understand market signals sent by changing prices, planners should, of course, constantly monitor the market. I've been talking mostly about prices affected by changes in supply and change in infrastructure, but in fact land use regulations may also change the price of land. Planners should be aware of the effect of regulations on land price. And taxation of course also may change land prices. Planners should therefore carefully monitor land prices and decide whether the increase in land price is a good sign or is a bad sign for the implementation of their strategy.

Planners should also be aware that changes in land prices may trigger desirable land use changes. As a city economy evolves, some land use becomes obsolete. For instance, the amount of industrial land has decreased in most cities of the world during the second part of the 20th century because it is much more efficient to locate industries either away from large cities or at least in the far suburbs of large cities, rather than in the center. This decrease in industrial land in large cities has been due to increased land prices rather than to changes in land use plans and regulations.

It is important that when a city’s economy changes, the land use also changes. How do you planners contribute to changing obsolete land use into more efficient land use? One way, of course, is to draw a master plan, and to decide that some areas which were industrial should become residential, and planners would just paint some part of their land use map in a different color to reflect the desired change.

However the only efficient way for changing land use is through the pressure of land prices and taxes. When land prices are going up, industries which are consuming a lot of land should feel a lot of pressure to move in order to cash in on the value of the land they occupy.

Planners should allow factories to cash in on the value of the land they occupy if they are not occupying the land efficiently. And one way of doing that is to recognize that those factories should have an interest in the value of the land, whatever the status of the land. If they are just renting or if they have a land use right which is more permanent, they should be able to trade this land use right because it will be the best way to get real land use change. It is the most efficient way to promote land use changes because the changes are in the self-interest of the factory. However, if taxes and land use regulations make it too expensive for factories to move, they will continue to occupy central city land even if they have very little use for it.
Using economics to promote land use changes is much more efficient than just painting a map a different color or changing the land use on the map. Planners have to use more land economics and less “design” in order to promote more efficient land use.

It doesn't mean that planners have to try to maximize land value all the time, but they have to be aware of the changes in land value brought by their land use decisions. For instance, when planners decide that an area should stay at low density or becomes a park, they are decreasing the land value of this land. Planners should always evaluate the consequences of their decisions on the land market.

Let us conclude by saying, first, that the regulatory role of the government is extremely important to allow a real estate market to work.

Second, that government should set up clear objectives and strategies; that urban planners should develop new regulations, infrastructure investment and a land tax system which are internally consistent, are supporting the objectives of the government.

And, finally, that in order to do all of that, urban planners should be aware of the changes in the land market. They should monitor land prices and rents very carefully, and when there are some changes that they do not quite understand, try to find the real reason for it, and sometimes it will require a complex investigation. Planners should not dismiss land prices going up and down by always blaming some external event or speculators. Although some external events at times have effect on prices, very often the reasons for prices variations are internal.

Understanding and using the land market to plan cities does not guarantee success, but I think that it will greatly improve the possibility of successful implementation of a plan. The success for planners should be measured by the degree of success in the implementation of municipal objectives.