

# Unlocking Urban Land Values for Infrastructure Finance

## Keynote Address by Mr. Nandan Nilekani

Workshop in New Delhi, September 14, 2009

It is really a great pleasure to be in such distinguished company talking on the issue of unlocking land values for financing infrastructure. My own involvement with urban issues was really my first contact with the public sector in some sense, and it began when I was heading a group of people in Bangalore, something called the BATF (Bangalore Agenda Task Force) and subsequently a lot of those lessons we tried to incorporate in conceptualising the JNNURM (Jawaharlal Nehru National Urban Renewal Mission). One of the things I realized in India was that cities were really what I call fugitives in the Indian imagination. For a long time urban development was not really a big thing and I think a lot of that goes back to India's historical roots for two reasons. First, urban India before independence was essentially British India and for India's rulers, visiting urban India was essentially reminding them of the British, and therefore in some sense there a kind of an antipathy to India's cities. Second, that whole argument that India lives in its villages reinforced this sense that India's cities were not important. So, I think for a long time urban India was neglected and was set against rural India, rich versus the poor. Cities were seen as being rich, cities were seen as being wealth creators and therefore able to generate their own resources. When you today you look at the large number of government programmes, they are essentially rural focused and not so much urban focused.

I think the historical point in changing that world view was really in 2004 when the JNNURM was launched because this is the first time that public policy acknowledged that India's cities are now important, India's cities are engines of economic growth, India's cities are engines of innovation, India's cities are centres of excellence, and in a modern, liberalized, globalized economy, cities are very critical to the strategic direction of the country. So JNNURM became really the first programme in which urban India got a lot of attention, and for the first time billions of dollars of central funding were committed to improving cities. Mr. Ramachandran, the Secretary of Urban Development, is one of the prime architects of what has happened in the last five years and I think this has brought urban India to the forefront, it has brought for the first time major fund flows and grants from the Government and a recognition that our cities need to be dealt with in a much more strategic fashion. However, even as you look at these fund flows it is becoming increasingly clear that the money that we can mobilize just from Central Government and other governments is simply inadequate to the challenge that we face in our urban infrastructure. For example the work of the High Powered Expert Committee on Urban Infrastructure is making it very clear that the kind of monies involved in improving our cities, in really modernising them and bringing them to some level of quality and equitable access to key urban services is really much more than any kind of flow that we can have either from governments or from outside agencies.

This problem I think is compounded by the fact that our cities don't really have many possibilities for taxation. Because of the historical nature of our centre-state relations, cities and the third tier of government have essentially become much more marginalised and much more disempowered. Therefore, when you look at the taxation potential of cities it is really limited to things like property tax and couple of other things. This is unlike the city of New York which can levy income tax for people who work there, requiring every hedge fund manager who makes a bonus to pay a part of it to the city of New York. In India that is not happening. I believe there are many people working in Bangalore who are making a lot of money, they are not paying the taxes to the city of Bangalore. Therefore, part of the problem we have in India is that this connection between the economic activity and the income generation of a city and its well being is not made, and therefore there are necessarily few channels for improving infrastructure.

Apart from the financial disempowerment, I think the political disempowerment of Indian cities is also huge. Again, because the cities really don't have the kind of constitutional mandate that they should have, cities are very low on the pecking order in the political process. In fact the Constitution does not mention cities even once. Whatever sanction we have got for our urban and rural local bodies has essentially come from the 73rd and 74th amendment where again the responsibility of actually giving the power to

the cities and villages rests with the State Governments. When you entrust that power to the state governments, the state governments have their own reasons for not wanting strong cities. The result is weak cities which continue to be a problem. Therefore, structural problems of politics and finances strongly affect our cities.

So, given all these facts it is very clear that we have to look at other innovative ways of funding urban development and urban growth and clearly unlocking the value of land seems to be a very good idea. Land is something whose value can be unlocked and all of you have looked at the different options. You can do that by sale of public land, you can do that by charging betterment or development fees, you can do that by density authorisation, you can do that by joint development of public land and so forth. So, there are many techniques that we have for unlocking urban land value. I think the difference between urban land and other public resources is that to a large extent I feel that the value creation of urban land is much more localised. This is in contrast with let us say iron ore. Iron ore is really a function of global prices, if China's GDP growth drops from 8% to 5%, iron ore prices will drop 60% and therefore for those natural resources have a much more global linkage. Land as a national resource has a much more local linkage. In other words land value gets created locally by smart infrastructure or whatever. So, in that sense, we have much more control in creating land values. So, clearly this is an issue which we need to take forward.

The real issue is how to do these transactions in a way that makes sense. I know that many of you have great examples of what is happening in the rest of the world. But the reality is that unlocking land value in India has been hugely controversial and it has actually got immobilized more often than not. I think the reason for this really comes down to two or three things. The first is the question of private capture of the value created. As long as there is the perception that the value created from land is captured by narrow private interests, then you will not have public acceptability for anything like this. Oftentimes, value is actually captured either by rent seeking or by asymmetric knowledge between the State and developers. So, as long as the public perception is that this kind of value capture is diverted from public good to private good, you are not going to have a great amount of public support for unlocking the land value. Just to give you an example in Bangalore I remember 10 years back they wanted to build a vegetable market at Madivala. The idea was that the vegetable sellers would move from the pavements to this building, but since the building was not really designed for selling vegetables they never moved. Now, it has become a very upscale mall and vegetable vendors are still selling on the road. So as long as we don't have complete transparency and complete confidence that the land value capture is captured for public good, we will always have resistance such deals. So, whatever be the technique that we use—and there are any number of techniques that can be used—unless we are able to get to the bottom of ensuring that there is a high level of confidence and trust that there is no private capture, I think we will not really get the public support for doing that.

One aspect of it is how we make sure that the public value is fully captured. Let us say that we tackled the first issue which is to make sure that the public value is fully captured, I think the second part of the question is how we make sure that the public value which is fairly captured is fairly distributed. Therefore, it is a separate issue from the first issue because the first issue is just making sure that there is no diversion or leakage of the value captured. The second one is having captured everything, how do we make sure that the distribution is reasonable. Here I think that it is a very complex issue because first of all we have multiple levels of government to worry about. Let us say a hundred rupees of value is captured from a particular transaction, what part of that goes to the federal government, what part of that goes to the state government, what part of that goes to the municipal government, that itself is a contentious issue. It is not just a government, it is actually layers of government. This is compounded by the fact that, with the rise of parastatal authorities in India, the municipal authority frequently has absolutely no control over the land value that is created. In Bangalore the land value is created by the BDA, in Delhi by DDA, in Hyderabad the HUDA, and therefore if the land value captured is appropriated by a level of agency of government which is not directly affecting or improving the area then again, you will perhaps not have great public acceptance for such projects. Therefore, another critical question becomes: how do we equitably distribute the value captured between different levels of government and how we make sure that the local governments have a credible role in deciding what happens—which today is rarely the case. Often the public land belongs to some other agency, most of the urban public

land in India belongs to the military or railway authorities or Bombay port trust or whatever. Therefore there is a whole issue of how the proceeds are distributed between different parts of the government.

The second part of this is how to deal with existing stakeholders on that land. In other words that is the whole question of compensation and rehabilitation. There again there are many dimensions here. Because of the complete anarchy in our land records, nobody actually knows who owns many urban properties and nobody actually knows who the tenants are. So, if you don't know who is the owner and if you don't know who is the tenant, how are you going to have an equitable way of compensating them for that? So clearly, the second part of the fairness issue is how do we make sure that the people, the owner and so on are able to actually participate equitably in that. This is compounded by the fact that the owner often has no other means of earning his livelihood. Such owners have a disproportionate attachment to the land as we have seen in the recent events in West Bengal situation. This is because they simply don't have the skills or the capabilities to actually function in a different kind of economy and therefore there is an additional need to hang on to it. Therefore I think the whole issue of what is the fairness for existing incumbents, I said incumbents because it could be owners, it could be tenants, or whatever.

Then there is a whole question of how do we look at the equity from the point of view of the community where this is happening. I think again if one can technically capture the full value of public land one can make sure that the distribution is fair between governments and the incumbent owners but then what about the impact on the area, theoretically if you have this piece of land let us say that we sell it for the best possible price and build a mall and then we give the money to the State Government, Central Government, local Government and to people so the first issue of full value capture and the second issue of fairness but that in turn completely stresses the public infrastructure around that location, then again we have lost out. In other words, if the people around that place where you do development are hurt because public services are compromised, then there is a fairness issue with respect to that.

Finally there is an issue regarding environment and what does that development mean in terms of environmental costs. Given the current model of environment, we don't now have a vehicle for capturing environmental costs in the models, and environmental impact again is an issue of fairness.

My point is that when we start looking at these models for unlocking land value unless we make it very clear that the entire value that is created is publicly captured, there is no private diversion, and that we have fairness to all these multiple stakeholders, we don't have a confluence, and we don't really have a gain in actually solving the problems. This problem becomes compounded because the ability of multi-stakeholders to negotiate equitable solutions is very poor. Therefore most of these things get into a gridlock of allegations and accusations and nothing happens. So, I think we really have to think about these things as the base meta conditions for using these instruments effectively and sustainably.

Notwithstanding this point, we have to pursue this whole issue very seriously because when we look at the scale of the problem, the scale of investment needs, at what we have to build in our cities—both for hard infrastructure as well as soft infrastructure, then I don't see any other choice but to tackle these difficult questions head on. If we keep avoiding this problem of how do we create an equitable, fair and transparent way of unlocking land value then the public is going to continue to lose out. Those people who want to unlock value will do it in their own way and the city at large or the state at large will be at a loss. So, we have no choice but to take on these issues. Given the kind of urban migration that we expect to see in the coming years, given the fact that smart planning, smart rules, smart densification can actually create dramatic value, then if that value is captured and distributed fairly then we have a great potential. Using these instruments, we could tackle a substantial part of the financing challenges that our cities face. Therefore it is too important a piece of the puzzle, too important source of revenue and infrastructure improvements to ignore and to put under the carpet. If we are really going to meet the challenges of urban infrastructure, we will need to find solutions to these difficult questions. It is very clear that as we go along, the claims on public financing would be more and more. Given the challenges in the rural areas, given the nature of social security and other benefit systems that we are evolving, the claims on our public finance will continue to grow. Even though we may accept that local taxation and decentralization is supported, I think it will simply not generate the kind of funding that we expect or the kind of funding that is required for what needs to be accomplished. Therefore there is no choice but to

take on unlocking land values very frontally, to understand why things are not working, discovering what the underlying issues are, and then tackling them in a very straightforward fashion.

So, I am very happy that this workshop is happening because I think it is addressing the issues very frontally. There are problems of public policy, there are problems of making sure that we have a way of doing it, there are different techniques of capturing value, I think all that is being discussed. But it is very important that we relate those models of discussion to the ground realities of our politics and economics. In our experience, as my friend Arun Maira<sup>1</sup> was just saying, he and I are two private sector refugees walking in the corridors of Planning Commission, and we believe that in the whole area of public solutions, unless we create public acceptability of the solutions we don't have a gain. You have to develop things which people buy into and I am certainly looking at this whole UID (Unique Identification Project<sup>2</sup>) from that point of view. The crux of the matter is how do we ensure that it really delivers value, because once it delivers value for people then it has a self-fulfilling sort of momentum, it creates positive energy, whereas if you don't, then it can never really take off. When you think of all the solutions that you are coming out with and discussing, please do think about how we are going to make it fair, equitable, and credible to the people. In that way, we have a best antidote, the best defence against the scams that you have around the world. So, I think this is a wonderful thing. This workshop is very well structured. We are very fortunate to have very senior people from Egypt, Manila, Santiago and Bogota, and those global experiences and best practices will be very useful as we deal with the Indian challenges. We are also particularly fortunate to have George Peterson here to bring his vast global experience to this event.

The other point I would like to emphasize is scale. At least certainly I have seen that in the work that I am trying to do, there is no shortage of pilots that are going on. Everyday I meet someone saying we did a pilot in Muzaffarnagar, and somebody has done something in Karimnagar—but you have to think scale. You cannot think of these things as sub-scale and therefore we have to see how to create scalable solutions which can be spread out without necessarily regimenting everything. Scalable solutions is not really about saying there is only one way of doing it. It is about figuring out the right balance between creating a scalable solution and at the same time giving ample room to factor that solution or to change that solution to local conditions. In this regard, we have to get to the bottom of these land markets, the land issues, how land can be best used. It would be a great pity if, as we take on this journey of urbanization, we don't unlock this key because that is really going to be a very important.

I am glad that this workshop is happening and I am delighted to have been invited. Because this is a closed door session for two days, I hope it is a session which is very interactive, very open, and people will have very honest and frank conversations. The format is great because we do these two days of internal discussion in a closed door manner and taking it up in Delhi to have a more public event where at least some of the consensus and some of the thoughts and insights which emerge today will be put up. So, I really like to congratulate the Brookings Institute, India Urban Space and all the other sponsors for this event and I wish you all success. Thank you very much.

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<sup>1</sup> Arun Maira, who was most recently head of Boston Consulting Group in India, was appointed Member, Planning Commission in charge of Urbanization and Industrialization in August of 2009.

<sup>2</sup> Nandan Nilekani assumed the position of Chairman of the UID authority in the Government of India in July, 2009.