

The effects of the nonmarket urban land use system in Eastern Europe: the case of Belgrade

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1. Introduction

The political changes which took place in the late 1980s in Eastern Europe cleared the way for the radical reforms of the economies of these countries, taking them from a command (planned) to the market system. Although the general strategy of such a transition is clear, there are many distinctive ways to apply the general strategy. The choice varies from country to country and from one segment of the economy to another. A crucial prerequisite for making the correct choice of a particular strategy is knowledge of the current (previous) nonmarket system, its features and how it worked. An appropriate diagnosis of the current (previous) system and its effects can be solid ground for the formulation of a sound transition strategy. Therefore, considerable effort has been put into an analysis of the nonmarket economic system and its various segments.

Nonetheless, one of the segments of the economic system which has not been widely studied until now is urban land use system in Eastern Europe. Hence, the intention of this paper is to examine the crucial features of the nonmarket urban land use system and to analyze its effects on urban development. This will be done using the case of Belgrade as a representative Eastern European city. Accordingly, the institutional framework and the crucial features of the current (nonmarket) urban land use system will be analyzed. Its economic and financial effects as well as its impact on urban development will be surveyed and evaluated. Such a procedure will hopefully provide a solid basis from which to consider the reform of the nonmarket urban land use system in Eastern European cities.

2. The institutional framework of the nonmarket urban land use system

The economic system which existed in Yugoslavia before the 1991 civil war was similar to the Soviet economic system. The crucial features of such a socialist system were:

- a) the monopoly of public ownership of virtually all assets and wealth;
- b) a nonexistent market; i.e. no market allocation of either production factors or goods;
- c) administrative (command) allocation of both production factors and goods.

At the core of Yugoslav economic system was public ownership, called «social ownership» according to Yugoslav legal terminology. Social (public) ownership dominated the major industries (the manufacturing industry, transportation, commerce, banking, insurance, etc.) as well as national wealth (urban land, etc.). There were just a few cases where this monopoly did not apply, so private ownership was allowed only in agriculture (agricultural land up to 10 ha) and in the small trade and technical services sector (firms with up to five employees).

Nonetheless, the Yugoslav economic system (also known as socialist selfmanagement) had several distinctive features setting it apart from the Soviet system.¹ The first feature was the social ownership system which, contrary to the Soviet state ownership system, was characterized by the absence of a recognized property owner and well defined property rights. Hence, socially owned assets or wealth did not belong to anyone specific (either to the State or to the employees), but belong to society. This rather nebulous concept has eliminated a recognized owner (with related property rights) of the vast majority of assets and wealth. The concept of social ownership was developed in compliance with the idea that property rights are not important for economic performance (efficiency), but only for the distribution of returns (earnings). The basic idea of the architects of the system (Kardelj (1971)) was to abolish every type of proper ownership, thereby abolishing all revenues based on ownership (non-labor revenues).²

The second distinction was that the market was not replaced by a central plan body but, in the last twenty years at least, by the concept of «social bargaining», whereby allocation resulted from a system, in which the numerous parties concerned would negotiate and settle all important economic issues (supply, prices, wages, etc.) through relevant institutional mechanisms.

The architects of the system considered that social bargaining would lead to the settlement of all conflicts based on partial interests.

Since there was no production factor market allocation, there was no labor or capital market (stock exchange), no securities (capital was immobile), employed labor could not be fired (lose their jobs), wages were determined exogenously, and interest rates (which were fixed by the state) were the same at all banks and always lower than inflation (hence there were no earnings from capital).

Contrary to the Soviet system, there was a goods market in ex-Yugoslavia, although it was not quite similar to the goods markets in Western countries. It was cartelized and protected from foreign competition and market information was not crucial for decision making in firms.

Although there is controversy as to whether such a system provided dynamic growth in its early phase,³ there is consensus that the system as such did not provide economic efficiency: there was no way for the efficient allocation of resources. Maximizing wages was the goal of the self-management firms, so such firms characterized a distortional reaction to the changing conditions on the market. Furthermore, the benevolent socialist government made the budget constraint of self-managed firms very soft by means of a generous credit and subsidy policy. The result was apathy, mismanagement, inefficiency, inflation, unemployment, zero growth and big structural debalances.

The features of the general economic system determined the institutions and mechanisms of the urban land use system: the monopoly of public ownership and the lack of a market allocation of resources.

3. The features and mechanisms of the nonmarket urban land use system

There is a monopoly of public urban landownership, known in Belgrade as «social landownership». The actual landowner is the municipal (city) authority. This monopoly was established by the nationalization of urban land which was completed in 1958.⁴ As there is a monopoly of public urban landownership there can be no trading and other related transactions concerning urban land.

Since the urban land trade is not feasible, the necessary condition for the existence of an urban land market is missing. Hence, there are no market transactions, no market land price, or market rent. The nonexistence of an urban land market implies there is no market allocation of urban land, but only administrative allocation.

Since there is a monopoly of public urban landownership, privately owned agricultural land on the urban fringe is transformed into publicly owned urban land by compulsory purchase. This compulsory purchase is applied in all cases, regardless of future (planned) land use. A compensation is paid to the previous owner and the level of this compensation is arbitrarily (unilaterally) determined by the municipal authority. It has nothing to do with the market value (price) of a given plot of land (the compensation for a sq.met. of purchased land equals 0,5% of the average price of a sq.met. social housing floor space). As the city grows, all plots of land on the urban fringe are transferred to public landownership.

The essence of the administrative allocation is to donate urban land to developers and/or users. The plot of urban land is still publicly owned, but the developer and/or user is given the right to develop this plot and to retain the building in his ownership. This regulation is somewhat similar to the institution of land leasehold in market economies, with the exception of two points: a) unlike a leasehold arrangement the urban land donation is not restricted in time, i.e. no expiration date is specified up to which time the plot of land can be used; b) no market rent is paid by the developer/user. Furthermore, the right to develop a plot of donated urban land is nontransferable. Hence development has to be carried out by the selected developer/user.

Urban land donation is based on the discriminatory right of the local authorities to select potential users according to arbitrarily established criteria. All potential users (private

housing as well as socially owned companies) apply to the municipal authorities for the urban land donation. The procedure to select a user is not strictly defined, so applications are evaluated according to arbitrarily established (even *ad hoc*) criteria. The municipal authorities can refuse any application without giving reasons for doing so.

Three fees are paid by the developers/users of the urban land. An urban land donation fee is paid as a premium to the municipal authority by the developer/user before development begins. This fee is calculated according to the blueprint floor space. The amount of the fee is determined by decision of the municipal authority and this amount is differentiated according to the location and planned land use. The level of the urban land donation fee can be changed unilaterally by the municipal authority at any time and by any amount, but nowadays it is usually changed once a year. The amount of this fee usually comprises 8-10% of the total property investment (development costs).

An urban land servicing fee is also paid as a premium to the municipal authority by the developer/user before development begins. Urban land servicing includes site clearing (only in the case of redevelopment) and providing the on-site infrastructure, which includes connections to the water supply, sewage, power supply and gas supply networks, heating system and telecommunications. This fee equals the actual land servicing costs of a given location, so the average fee (amount of fee per ground sq. met.) varies considerably from location to location. The amount of this fee usually comprises 35-45% of the total investment.

An urban land use fee is paid regularly (monthly) by the user of a given plot of urban land (location). This fee is calculated according to the floor space. The amount of the fee is determined by the municipal authority and is differentiated according to the location and the actual or planned land use. The amount of the urban land use fee can also be changed unilaterally by the municipal authority's decision at any time and by any amount, but nowadays it is usually changed quarterly. For many years the level of the urban land use fee has been virtually negligible.⁵

All the financial resources obtained through the payment of such fees are used to finance infrastructure investments related to urban development, i.e. urban utilities supply (water supply and sewage, power and gas supply, the heating system, public transportation and telecommunications) and to finance the supply of urban public utilities (roads, streets, pavements, pathways, parks, etc.). The investments related to urban utilities cannot be financed from market revenues since the prices of these utilities have been distorted downwards as the result of a policy prescribing that prices should cover operating costs only. Therefore these investments must be financed externally. On the other hand, the character of public urban utilities is such that their supply and development must be financed externally.

4. The economic and financial effects of the nonmarket urban land use system

The most significant effect of the nonmarket urban land use system is that there are no market land prices, or market rents. As the existence of competitive market prices is a

necessary condition for the efficient allocation of urban land as a resource (changing the pattern of land use from lower to higher value use), the global use of urban land in Belgrade is inefficient. There are two basic inefficiencies: the physical inefficiency of urban land use and its economic inefficiency. There are also two cases where both types of inefficiency occur: inefficiency in new development and/or redevelopment and inefficiency in the use of urban land by the actual occupants (users). An examination of all cases of inefficiency follows.

Physical inefficiency in the case of new development results from the urban fact that the land donation fee is an extremely downward distorted surrogate of the urban land price. It is reasonable to estimate that the market price would be much higher, particularly in the city center. A relatively low urban land donation fee is not an incentive for the physical efficiency of land use, so a relatively low floor-to-ground index and low densities result from this distortion. Furthermore, the urban land donation fee is calculated according to the blueprint floor space, not the ground (land) space. Such a method of fee calculation means that there is no incentive whatsoever for the efficient physical use of urban land (ground). Hence, the average cost (amount of the fee per floor sq. met.) is constant and financially it is all the same to the developer/user whether a single floor or a hundred floor building is constructed on a given location.

Economic inefficiency in the case of new development is a direct consequence of the absence of a urban land market. If there were a market there would be competition for a plot of land at a given location, so that the location would be used by the prospective user who offered the highest bid, i.e. the user to whom a given plot of land is the most valuable. Since efficient allocation requires that resources (urban land in this case) be channeled to their highest value use, a given plot of land would be used efficiently. However, the actual nonmarket, noncompetitive manner of selecting the users by the local authorities offers no guarantee of economic efficiency in the case of development and or/redevelopment.

Physical inefficiency by the actual occupants is encouraged by the negligible level of the urban land use fee which they have to pay. The actual location users do not pay a market rent which, it is reasonable to expect, would be far higher than the urban land use fee. Hence this fee is a negligible expenditure for the occupants. That is why the inefficient users of space characterized by low densities, such as manufacturing industry plants, etc., are not encouraged to leave the best and otherwise the most expensive locations, so they have retained them. Furthermore, the urban land use fee is also calculated according to floor space, not ground (land) space. Such a method of fee calculation implies that there is no incentive for the physically efficient use of urban land (ground) because the average cost (the amount of the fee per sq. met.) is constant regardless of the floor to ground index. This arrangement is the reason why there are still worthless ground floor buildings in the very center of Belgrade.

Economic inefficiency by the actual occupants is the consequence of physical inefficiency. The reason lies in the fact that physically inefficient users of space, such as the manufacturing industries, the building industry, etc., that have retained their locations are economically inefficient urban land users. It has been demonstrated that these industries when located in big cities are relatively inefficient compared to the same industries located in small

cities. On the other hand, service industries located in big cities are more efficient compared to those located in small cities.⁶ Hence, the restructuring process that leads to increasing the economic efficiency of a city is impeded by the nonmarket urban land use system.

Since the regulations governing the allocation of a site do not include any time limit for land use, there is no solid basis for the land user's financial calculation, especially the calculation of net present values. Furthermore, since urban land use fee can be changed unilaterally at any time by the municipal authority's decision the developer/investor cannot control the costs which comprise the amount of the urban land servicing fee. This implies that an investment project which is profitable according to the current fee level, can become unprofitable according to some future fee level. Evidently such an arrangement discourages property investment.⁷

Moreover, such arrangements for urban land allocation imply that municipal authorities are empowered to withdraw the right to use a location at any time, meaning that the actual user can be evicted from the location at any time. This increases the uncertainty for potential users/investors which discourages property investment. On the other hand, a lower level of investment diminishes the potential for economic restructuring which leads to perpetuating the inefficient economic structure of cities.

As there is a monopoly of public urban landownership, it is not possible for potential urban land investors to invest vast financial resources. This is why significant potential investors such as pension funds, insurance companies and other financial institutions cannot invest in land and real property, thus inducing a decline in property investment. Furthermore, the nonexistence of an urban land market accounts for the nonexistence of numerous financial mechanisms that are common in free market systems (mortgage loans, property bonds, property companies' shares, etc). Accordingly, the concentration of financial capital for funding real property investments has been slow and inefficient, i.e. capital is not mobile. This has resulted in a constant shortage of financial resources which in turn reduces property investment activities.

The current urban land use system (as well as the legal system) is rather vague and is inconsistent with the urban land use system in market economies. Hence, potential foreign property investors are amply discouraged to invest. This accounts for a further reduction in property investment and a further delay in the internationalization of the economy.

Thus, it is evident that the current urban land use system in Belgrade shows a very poor performance in the domain of economic efficiency.

Furthermore, the nonmarket urban land use system has resulted in the poor performance of the municipal and local authorities' financing. As the system is nonmarket there are no urban land market prices or market rents. It is reasonable to expect that market prices and rents would be much higher than the current urban land donation and urban land use fees. Hence, if there were an urban land market prices, municipal and local authority revenues from urban land sales and rents would be much higher.

As there is monopoly of public urban landownership there is no solid basis for urban land taxation. One could reasonably assume that municipal and local authority revenues

from the taxation of privately owned urban land would be considerable. Hence, the monopoly of public urban landownership and the nonexistence of an urban land market and market prices leads to a poor performance in the realm of the municipal and local authorities' financing, as revenues are considerably smaller than what they could be potentially.

In addition, the municipal authorities' financing policy has induced a further reduction in local revenues. Firstly, fees have not been properly indexed to the high inflation rates. For example, during 1987 the average monthly fee indexation was 3%, while the average monthly inflation rate was 10%, in real terms, revenues were significantly reduced. Moreover, as there were no constraints, urban land users/occupants were encouraged to postpone payment of the urban land use fee. This was a component of the policy aimed at decreasing the tax burden of the enterprises and to help them in the troublesome times of economic crisis.

An «informal» practice existed of writing off the debts of socially owned firms where the urban land fees were concerned. This actually meant that these firms evaded fee payments. Such a policy was applied very frequently in the case of big lossmakers which usually employ a huge labor force.⁸ All these elements have led to a further reduction in municipal and local revenues. Very frequently this reduction is so vast that the revenues are not sufficient to finance land servicing and provide public urban utilities. These deficits are dealt with by borrowing money from clearing (commercial) banks.

5. The effects of the nonmarket urban land use system on urban development

Urban development in Belgrade is affected in some cases directly, but in many more, indirectly as the result of the nonmarket urban land use system. One of the most important effects is that there is no conventional central business district in Belgrade. This is due to the negligible urban land use fee. It has already been pointed out that such a fee level has persistently encouraged the physically and economically inefficient use of urban land. Thus low density housing still exists in the very center of Belgrade. As there is no incentive for tenants to relocate (due to negligible housing costs) it is not possible for business (office space, retail, etc.) to be highly concentrated in the very center of Belgrade. Hence, the process of urban redevelopment is strongly discouraged.

As it has been pointed out, the urban land donation fee and the urban land use fee are virtually identical for all locations. However, the urban land servicing fee equals the actual land servicing costs at a given location. Hence in the case of redevelopment all the costs of clearing the location should be paid by the investor/developer. These costs are high because appropriate accommodation (new houses or flats) must be provided for all the tenants located in the building due for demolition. Furthermore, the whole operation of demolition, clearing the site and finding appropriate accommodation for tenants is exclusively carried out by the municipal authority, so there can be no cost control by the investor. Therefore, potential investors are discouraged to invest in redevelopment.

These obstacles to redevelopment have resulted in the concentration of development on the urban fringes and so Belgrade's urban development tends towards an urban sprawl.

Such a pattern of urban development has brought on a reduction in global urban densities, which in turn require investment in long urban infrastructure lines (roads, pipelines, etc). Furthermore, the reduction in global densities gives rise to the need for various urban utilities (public transportation, etc). Such a pattern of investment has reduced the economic efficiency in providing all urban utilities.

An additional factor in such a tendency towards urban sprawl is a persistent excess demand for housing and office space. This excess demand is also one of the results of the actual nonmarket urban land use system. Namely, one may say it is reasonable to expect that market land rent would be much higher than the urban land use fee.

This means that the cost of living has been significantly reduced. According to the results of a theoretical consideration of internal migrations,⁹ these costs are a significant generator of migrations. The lower the cost of living in a given city, the larger the population migration will be towards that city. Hence the low cost of living in Belgrade induced by the nonmarket system have significantly influenced a large migrational flow toward Belgrade. Such a flow has created a high growth rate of Belgrade's urban population, hence the excess demand for housing and office space.

6. Conclusion

The nonmarket urban land use system in Belgrade derives from the socialist nonmarket economic system. The essence of such a system is the monopoly of public ownership over assets and resources, and the administrative (nonmarket) allocation of these resources.

The institutions and mechanisms of the nonmarket urban land use system are very distinctive from the institutions of a market system. They correspond to administrative allocation and are based on the discriminatory rights of the municipal and local authorities. There are no market prices or rents, rather unilaterally determined urban land fees.

The economic effects of such a system are very poor. The crucial effect is the physically and economically inefficient use of urban land. Such inefficiency has a significant impact on the general economic inefficiency of a socialist economy. Additionally, the nonmarket system has caused a significant reduction in real property investment as well as in global investment activity. This leads to a deterioration of the prospects for economic restructuring, particularly with respect to industries located in cities. The financial performance of this system is also poor, as there is a perpetual deficit in the municipal budget.

The nonmarket urban land use system has had adverse consequences on urban development in Belgrade: urban development has a strong tendency towards urban sprawl and urban redevelopment is neglected, which implies a further reduction in the urban land use efficiency. A proper central business district has not been established. Due to the relatively low cost of living, a huge immigration has taken place, which has in turn activated a high population growth rate, which led to the deterioration of the quality of life.

The overall performance of the nonmarket urban land use system in Belgrade has therefore been evaluated as very poor. This is the result of the essence of the current urban

land use system: the monopoly of the public urban landownership and administrative (non-market) allocation of the land. That is why such a system cannot be successfully modified. It should be replaced by a market urban land use system.

Notes

- ¹ A fruitful analysis of the Yugoslav economic system, its origin and its distinctions compared to the Soviet system has been given by Prout (1985).
- ² This is consistent with the premises of communist ideology (based on Marx's value theory) that only revenues based on the employment of labor are socially justified.
- ³ See Madzar (1990) and Milanović (1991) for the discussion.
- ⁴ According to the Urban Land Nationalization Act, although nationalization of the vast majority of property rights was done by a Federal decree in 1945.
- ⁵ It can be argued that fee is essentially rent. However, it should be taken into account that no free will of users has been revealed, no contract has been established, no rent revision procedure has been agreed upon. Accordingly, this fee cannot be labeled rent.
- ⁶ For the empirical evidence which support this thesis in the case of Yugoslavia see Begović (1991a).
- ⁷ It can be argued that cyclical tendencies on the real property markets in Western countries have the same effects. However, it should be pointed out that market price fluctuations can be predicted, at least in principal, while the behavior of the state is rather unpredictable.
- ⁸ This is consistent with the job preservation policy, very popular in all communist countries.
- ⁹ For a good review of these considerations see Greenwood (1985).

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