

# **URBAN INFRASTRUCTURE, REAL ESTATE & HOUSING POLICY:**

Eliminating Slums and Generating Employment

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CHINTAN

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# **POLICY REFORM FOR HOUSING & REAL ESTATE:**

Eliminating Slums and Generating Employment

By

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May 1999<sup>\*</sup>

Any views expressed in this paper are those of the author and should not be attributed to the organization for which he works.

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<sup>\*</sup> Paper reissued in December 1999 with a new section on FDI added at the end.

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## **I. INTRODUCTION**

1. In many countries across the world the real estate sector has been a leading sector in promoting overall growth. This has been true of emerging markets such as those in E & S E Asia. A substantial part of China's FDI has been in this sector. The most visible sign that S E Asian countries were moving ahead of us in the eighties were the transformation of the skyline and roads of their capital cities. We have to remove the plethora of controls on our real estate and housing sector if we are to initiate a similar boom.
2. Rent control is perhaps the most important single policy (distortion) in creating slums. Other policy distortions, which have stifled the growth of private housing (rental & self occupied), include the Urban Land Ceiling act, monopoly of land with development agencies, controls on conversion of agricultural land to urban use and municipal laws. The greater the overall supply of housing and rental accommodation the more housing will be available for the poor.

## **II. RENT CONTROL**

3. Rent control was introduced in many countries during World War II as part of comprehensive but temporary price control and rationing in aid of the war effort. India, a British colony during the war, is probably one of the few countries, which still retains this colonial price control. Control on rental charges is a control on the price of rented residential and commercial space, and needs to be abolished. The 'Rent control act,' is even more pernicious than ordinary price controls, as it virtually amounts to expropriation of the rented asset. Rent control ensures that even those who have unutilised space prefer to keep it locked up rather than risk

loosing it permanently to a tenant. It discourages and inhibits construction of residential apartments solely for the purpose of rental.

4. The lower middle class and the poor are most dependent on rental housing (as seen across the world). It can therefore lay claim to being an anti-poor policy, which is substantially to blame for the creation of slums in Delhi, Bombay and other metros subject to rent control laws. The periodic collapse of Bombay's rented buildings is the direct result of rent control, as there is no incentive to maintain and keep rented property in habitable condition.
5. Rent control on commercial property is a major reason for the culture of tax evasion and black money that characterises the real estate sector. We must abolish this colonial law, if a housing and real estate boom is to be initiated which benefits not just income tax evaders & payers but also those who live in the slums of metropolitan and big cities.
6. The price control can be phased out gradually on properties that are currently under 'rent control' to ease transition. For such property 'rent control' on commercial property would expire in three years and on residential property in five years. During the transition period rent would be allowed to increase *annually* by the higher of 10% real (i.e. after adjusting for inflation) or Rs. 7500.<sup>1</sup> The latter is essential, as many properties with a market rent of lakhs are rent-controlled at a few hundred rupees.

### **III. URBAN LAND CEILING ACT**

7. The Urban Land ceiling Act, by freezing the land market acted as a constraint on private development of housing and real estate (commercial & industrial). The States needs to follow the lead of the centre and abolish the State Urban Land Ceiling Acts.

#### **IV. LAND MONOPOLY**

8. Many cities (e.g. Delhi) have created development agencies (Delhi Development Authorities) and handed over control over all urban land within the municipal jurisdiction to them. The belief that they would act in the interests of the public is mistaken because all such agencies tend to act like the monopoly that they are. It is in the interests of the monopolist to restrict the development and sale of new land & keep prices high, so as to maximise its own returns. Also like all monopolies, X-inefficiency flourishes and monopoly rents decline over time often because they are siphoned off into personal accounts. Introduction of a competitive construction boom requires abolishing the monopoly over urban land by such agencies, by completely separating control of land from its development. A time bound programme for auctioning of all vacant government land should be drawn up and implemented. Municipal development agencies can bid along with others for the land they want to develop.

#### **V. RURAL-URBAN CONVERSION**

9. The presence of so called villages in the middle of the capital city of Delhi is an anachronism & a monument to bad policy. It is difficult to find a worse policy for protecting farmers than preserving villages in the middle of a metropolitan city. Conversion of rural land at market prices should be completely de-controlled and left to the market. The assumption that farmers or owners of rural land on the outskirts of a city are ignorant & stupid enough to sell their land for a song is offensive. The problem has risen solely because the government gave the right to its development agencies to expropriate this land at below market prices. Once this power is taken away from development agencies and sellers are

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<sup>1</sup> Maximum [ Rs. 6000, 20% of rent]

fully aware of this change (government must provide the information) they can look after their own interests.

## **VI. PRIVATE INITIATIVE**

10. The expansion of urban infrastructure has not kept pace with increasing urbanisation and expanding urban population. In many cases the quality of urban infrastructure has deteriorated considerably. The Urban infrastructure in cities & towns across the nation has deteriorated because of lack of interest & concern among those responsible for running our municipalities. There is need for local governments to refocus their attention from provision of Urban Infrastructure services, to proper planning, monitoring and quality control.
11. Till such time as the municipalities can be forced by their citizens to get their act together, the private sector can play an important role in setting higher standards of planning, organisation and efficiency. They can also provide a demonstration effect. For this to happen, the uncertainty & risk must be reduced, through a comprehensive law on private townships and industrial estates. This law must specify both the rights and obligations of developers with respect to urban services and utilities. These include inter-connection with existing systems (e.g. sewers, water mains, telecom, electricity lines), the processing of liquid & solid waste, treatment & disposal of industrial pollutants and maintenance of public goods & areas.

## **VII. MUNICIPAL LAWS**

12. Our urban & municipal rules and regulations date back half a century if not more. There is a need to thoroughly review and modernise them in the light of the latest developments in urban infrastructure, transport, pollution control and zoning. A committee of eminent persons form

concerned fields should be set up to draw up a model municipal law. Such a law must make provision for private investment in and supply of all public utilities and services. It must ensure that the municipal authority focuses its attention on data gathering, analysis, planning, organisation and monitoring. The proof that these aspects are sadly neglected is seen everyday in the city as roads are dug up within weeks of fresh asphalt being laid. The new law should also incorporate provisions for residents' right to information about the activities of the municipality. The new law could be introduced immediately in Delhi to gain experience and iron out its kinks.

## **VIII. GOVERNMENT PROCUREMENT RULES**

13. The government is the largest user of construction services in the country. Its procurement & construction rules therefore have an overwhelming effect on the development of the construction industry. The government's procurement rules and standards have barely changed since independence. It is no wonder therefore that our construction industry is one of the most primitive among the emerging markets. This leads to shoddy construction and interminable delays, which impose large negative costs on the rest of the economy. We must urgently modernise CPWD, PWD, DGC&S and other construction & procurement rules to promote use of new efficient, effective, non-polluting technologies.

## **IX. FDI**

14. Private including foreign business can play a role in creation of urban infrastructure and in providing infrastructure services. Competitive supply will help in improving the efficiency and quality of urban services. The real estate sector is also a sector that attracts FDI from non-resident nationals (or former nationals) & small companies relatively easily and



therefore helps build momentum for an overall increase in FDI.<sup>2</sup> This factor is particularly important at this time given that FDI fell by around 40% in 1998-99 and is down 20% in April 1999 compared to the corresponding period of 1998. The target of annual inflow of \$10 billion FDI can only be achieved if FDI is liberalised across the board and the automatic route expanded.

#### A. Foreign Equity Proportion

15. Automatic 100% foreign equity approval should be given for,
  - a) Urban infrastructure.
  - b) The development of integrated township projects including urban infrastructure.
  - c) Manufacture of building materials/components and construction of building with newer technology.
16. Automatic 51% foreign equity approval should be given for Housing, Commercial and Industrial (Real Estate) complexes. Case by case approval could be given up to 49% foreign equity for stand alone housing and commercial projects.

#### B. Risks & Safeguards

17. The main speculative pressure arises from leveraging and excessive debt. A conservative regulatory policy for the financial sector, particularly banking, must ensure against excessive lending to or borrowing for real estate.
18. One of the potential risks that may need to be guarded against is “speculation in land.” The conditions for ensuring that FDI is not used as a route for speculating in land need to be strengthened. The main

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<sup>2</sup> This is what happened in China where a large proportion of FDI in the early years went into Real estate &

method for ensuring against speculative purchases is to contain the possibility of “leveraging”. One common method of doing so is by putting capitalisation norms and conditions (for automatic approval). Any capitalisation below these norms would have to be approved on a case by case basis.

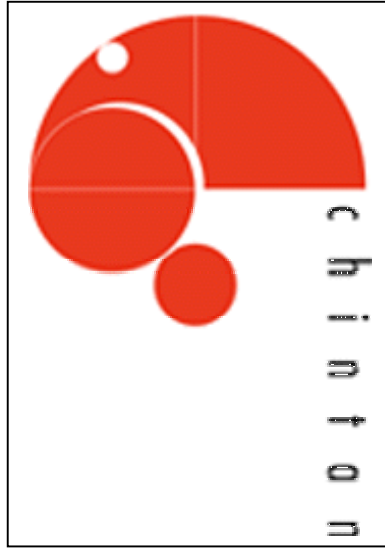
19. Some conditions would also have to be specified regarding reversion of land to the Government in case the project for which land is purchased is modified so that part of the land become redundant to the project. Other conditions, which could be considered, are to distinguish between Metro and non-Metro cities and between Corporate and Individual Foreign Investors.

## CHINTAN POLICY PAPER SEREIS\*\*

Policy Paper No.	<u>TITLE</u>	<u>DATE</u>
1.	Policy Measures for Meeting Capital Inflow Surge,	March 1997
2.	An Agenda For Tax Reform,	May 1997
3.	A New Foreign Exchange Act,	June 1997
4.	Development of Government Debt Markets,	July 1997
5.	Exchange Rate Management,	December 1997
6.	A Communication Policy For the 21 <sup>st</sup> Century,	November 1998
7.	From Poverty to Middle Income: Reforms for Accelerating Growth in the 21 <sup>st</sup> Century,	April 1999

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