

Urban Land Misallocation and Markets in Russian Cities

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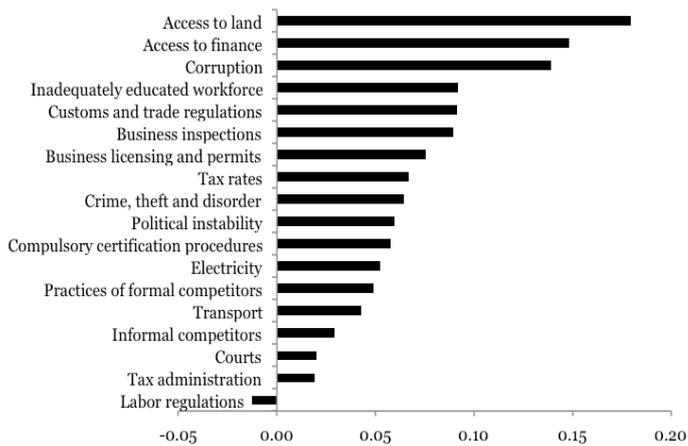
Former socialist countries inherited factory-dominated cityscapes since planners made industrial location decisions in relative ignorance of land's opportunity costs. Drawing on unique survey evidence and policy variation across territorial units within Russia, this brief discusses the relationship between land tenure reforms and land reallocation. The evidence points to land privatization as an important factor in the reallocation of land in Russian cities.

Urban areas in post-socialist countries inherited inefficiently organized, factory-dominated cityscapes (Bertaud, 2004 and 2010; Bertaud and Malpezzi, 2003; Bertaud and Renaud, 1997). Socialist planners made industrial location decisions in relative ignorance of land's opportunity costs. By the 1990s, over one-third of the built-up area in Russia's largest cities consisted of industrial land, compared to the norm of around five percent in cities as diverse as Seoul, Atlanta, Hong Kong, London and Paris (Bertaud, 2004). Instead of experiencing an out-migration of land-intensive industries for cheaper land in the suburbs, socialist cities in the twentieth century became progressively more industrialized. In this brief, we discuss our recent research on the correlation between the pace of land reallocation and the transition from state to privately owned land.

To give an idea of the potential for inefficiency, Bertaud (2004) provides the example of one forty-hectare plot near the historic center of St. Petersburg still being used for the storage of coal. Evidence from the 2009 round of the Business Environment and Economic Performance Survey (BEEPS)

demonstrates the continuing significance of land-access problems. Comparing Russian enterprises with the Central and Eastern European countries now in the European Union, Figure 1 shows that the greatest difference in the frequency of reporting a factor as a "very severe obstacle to current operations" is land access. Roughly a quarter (24.7%) of the Russian firms characterize access to land as a "very severe obstacle," whereas only 6.7% of CEE firms do. In general, the misallocation of resources depresses aggregate productivity (Hsieh and Klenow, 2009). In the case of land misallocation in urban areas, these efficiency losses can be severely magnified due to the many externalities associated with the urban environment. Therefore, an important issue on the urban development policy agenda for cities in transition countries is supporting mechanisms that reallocate land.

Figure 1. BEEPS 2009, Russia and Central Eastern Europe – Difference between percentage of Russian and CEE firms with respect to factors managers describe as a “very severe obstacle to current operations”



Note: Average number of responses per “obstacle” question, 1127 in Russia and 1285 in Central and Eastern Europe. All enterprises in cities with a population of at least 50,000. The CEE firms represent eight countries: Poland, Czech Republic, Slovak Republic, Hungary, Slovenia, Estonia, Latvia and Lithuania.

One such policy reform that has been employed to promote reallocation is the privatization of land. The privatization of firms’ land assets, in stark contrast to the privatization of firms and their structures, has proceeded slowly and unevenly across Russian regions. Some territorial subjects have pushed to liberalize land rights and encourage other re-allocation mechanisms. In other subjects, however, land privatization has faced difficulties. For example, in the 1990s, 32 regions specifically banned land privatization, some through laws that directly contradicted federal legislation. Sub-federal administrations had financial incentives to slow the pace of privatization due to their relatively greater control over setting lease rates on state-owned land than tax rates on enterprise-owned land. In addition, there was a ready-made tool to discourage privatization following a presidential decree in May 1997, which

granted regional administrations near full discretion in establishing land sale prices.

Data and Results

To better understand whether the progress of land privatization is related to land reallocation, one of us collaborated with Moscow’s Levada Centre to design and administer a survey of 359 large, urban industrial enterprises in the fall of 2009, covering general questions regarding the firm as well as those specifically addressing land-related issues. The survey restricted attention to former state-owned enterprises that had been founded prior to 1986 but became privately owned prior to 2004. Overall, the respondents represented 53 territorial subjects, with roughly one-fifth of the firms located in either Moscow or St. Petersburg, Russia’s two largest cities, and the rest were distributed relatively equally across the capital cities of varying sizes in the remaining territorial subjects.

These large firms with origins in the Soviet Union were likely to operate on large plots of land on some of the choicest real estate in Russian cities. As mentioned above, the privatization of the firm did not imply that the firm’s land assets had been privatized as well. By design, the survey targeted regions with a progressive urban land policy, resulting in roughly half of the firms coming from regions in the upper third of the distribution of private to state enterprise land ratio and ensuring policy variation across territorial units within Russia. As a result, these roughly similar firms likely differed in one important characteristic, their land tenure status, which determines the rules that govern the land under their control. And, while these differences may reflect individual characteristics, in a large part, they are driven by regional responses to federal land tenure reforms. Thus, this unique survey allows us to investigate how land tenure

reforms mitigate the legacy of socialist spatial misallocation of land.

Respondents answered general questions regarding their firm as well as those specifically addressing land-related issues. Of survey respondents, less than half own their primary production plot. The remaining respondents either lease their land or have access to the land through the Soviet-era “right of perpetual use.” All respondents were asked whether they leased (or sub-leased) out a portion of their primary production plot, which was legally possible for each of the three types of land tenure. The market mechanism of leasing or sub-leasing can be efficiency improving by either reallocating the land to a higher valued use or by bringing the unused land into use. (To properly assess whether the lease or sub-lease is efficiency enhancing, we would need to have information about who is leasing or subleasing and how the land is being used. Unfortunately, the survey does not provide such information. However, as a market mechanism, the presumption is that the transaction directs the land to a higher valued use, whether at the intensive or extensive margin.)

We find that firms that own their primary production plot rent out land at a higher frequency. Fully 20.5% of respondents that own their primary production plot report renting out a portion of it, whereas only 10.7% and 5.5% of leaseholders and those with perpetual use rights, respectively, do so. Even though all of these firms could legally transfer their misallocated land assets, those firms with private land titles transfer this land at least twice as often. Although only an unconditional correlation, given the theoretical importance placed on property rights for well-functioning land markets, these data are certainly suggestive of a causal link between land privatization and land reallocation. For a full discussion and analysis of these and other results, please see Karas et al (2015) and Castañeda Dower and Pyle (2015).

Conclusion

Both regulation and markets could solve the inherited land misallocation issue. The slow development of the urban land markets and concerns about overall bureaucratic corruption both justify a serious look at the functioning of land markets as an important policy tool for land reallocation. The evidence suggests that the privatization of land underneath Russia’s industrial enterprises has promoted land reallocation. Property right reforms can help deindustrialize the country’s hyper-industrialized cities by giving incentives to reallocate the land to more valuable uses. Yet, in some Russian regions, bureaucratic obstacles to land privatization have inhibited the mechanism of reallocation through urban land markets. If regulators have an incentive to limit the spread of land privatization, then these same incentives could decrease the likelihood of regulatory action to encourage reallocation.

In work with Egor Malkov and Leonid Polishchuk, we have found that indeed the positive effects of possessing a private land title on firm performance have been limited by regional institutional quality as measured by the corrupt practices of a region’s bureaucrats (Castañeda Dower et al 2015). Therefore, these two usually juxtaposed solutions to land misallocation may be intertwined. The apparent failure of land markets to correct for land misallocation over the past two decades does not imply that regulation would have been a more effective instrument of land reallocation. Similarly, any policy reform designed to improve land markets must consider the incentives of local bureaucrats when implementing these reforms.

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