The Cost of Land Use Decisions

Applying transaction cost economics to planning & development

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Preface

Doing a research project like the one that is presented in this book is often characterised by depths and heights. For me personally, from the very beginning, I have not experienced these strong fluctuations at all. Before joining the university in March 2002, I expected my academic career to be temporary and short. But I am afraid that this kind of work has grabbed me in a big way. The freedom that I have experienced, especially in the beginning, is something that can hardly be paralleled in any other working environment. This freedom needs to be accompanied by discipline and the will to explore on behalf of the researcher. But probably more importantly, it also needs to be matched by an academic environment that stimulates the exploration. This environment is made by people.

There is one person in particular that I want to thank for all his help during the process. Barrie Needham has proved to be a great teacher, source of inspiration, colleague and person. His honest curiosity for both theory and practice, his engagement with my project, and his constructive and stimulating attitude has made this research project a pleasant journey.

I also want to thank my colleagues in the department of Human Geography, Spatial Planning, and Political Sciences of the Environment. There are some who I would like to thank in particular, which are my colleagues from our thematic research group 'Land policy and location development': Esther Geuting, Peter Hendrixen, Wouter Jacobs, George de Kam, Erwin van der Krabben, Barrie Needham and Arno Segeren. This group is part of a larger team called Governance and Places (GaP), which is led both practically and substantively, in a very inspirational way, by Arnoud Lagendijk, who deserves to be thanked for creating such an environment. He has contributed to this book more than he is probably aware of. He and Esther Geuting are also gratefully acknowledged for reading, and making comments to, the manuscript as a whole.

This book includes comparative research, for which the willingness of many respondents and other people was needed. All these people – most of them mentioned and acknowledged in the Appendix – are thanked for sharing their knowledge and experiences. There is one person in particular that I want to thank in this respect, and that is Janet Askew from the University of the West of England. Her help has made

Chapter 5 much better than it would have been without, and made my stays in Bristol extremely interesting and entertaining.

Other people who had an important role at some stage in the research by making comments to a chapter or a paper, by pointing me to the right sources, or helping me in any other way are Ernest Alexander, Raffael Argiolu, Margo van den Brink, Dan Bromley, Andreas Faludi, Cecilia Giusti, Henri Goverde, Patsy Healey, Rob van der Heijden, Leonie Janssen-Jansen, Ton Kreukels, Michael Neuman, John Raggers and Roelof Verhage. Obviously, a good personal environment is the most important prerequisite for performing professionally. The people who are responsible for that are my parents, my brother and my friends. Thank you all!

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The Cost of Making Land Use Decisions

Introduction

The song that would become the Beatles' last number one hit in the US, (in 1970), *The Long and Winding Road*, was most certainly not written by Paul McCartney with the evolution of our cities in mind. It is, however, applicable to them. In every country the built environment is continuously under construction: one land use is turned into another. This includes both the development of undeveloped greenfield land and the redevelopment of the existing urban fabric, the brownfield locations. However, these conversions do not occur instantly and without costs. Aside from the fact that a structure needs to be built, decisions have to be made about how the land should and should not be used. Because of this decision-making process, many projects take up much more time and cost than first intended. An interesting – though not uncommon – example is that of Hofpoort, a case study (Buitelaar *et al.*, 2006) in the city of Arnhem (in the Netherlands), where it took 10 years to deliver around 80 houses. A cynic could say that this project had a production of 8 houses a year. In many cases government regulation and the role of the government in general is held responsible for delays in the development process.

In the Netherlands, for instance, a task force responsible for investigating the reasons behind the lagging building production, concluded that the primary source was delays in the building process, caused mainly by the extensive permit system (Taskforce Woningbouwproductie, 2002).

Many developers also regard this as the main factor. It is said about planning in Britain that:

> 'The reality of land-use planning in Britain has often been one of institutional sclerosis and special-interest capture. Benefits have been concentrated on interest groups and bureaucrats with costs dispersed across an invisible mass of tax payers and consumers.'
>
> (Pennington, 2002, p. 71)

Recently, there have been many initiatives and intentions in many countries to cut rules and bureaucracy and to streamline procedures for land use planning. In France, for instance, a law (Loi SRU; urban solidarity and renewal law) was adopted in 2000, which intended, among other things, to break with the past desire to create detailed rules in the local land use plan. In England, the proposals to reform the planning system in the Planning Green Paper (from 2001) were mainly focused on reducing the complexity of the system and streamlining procedures. The Treasury was worried about economic competitiveness and, at the national level, a view prevailed that the planning system delayed development so much that England's competitiveness was suffering. However, at the same time, one of the (possibly contradictory) goals was to increase citizen participation during the development process. The Planning and Compulsory Purchase Act that was adopted in 2004 took over the main goals that were posed in the Planning Green Paper. In the Netherlands also, the cabinet is preparing a new planning act (that will probably be operational in 2008) that is driven partly by a desire to cut rules and to speed up the planning process. The maximum duration of the procedure for adopting a land use plan (the *bestemmingsplan*), which is the core planning document on the basis of which building permissions are granted or rejected, is halved in the new act. It remains to be seen in each of the above examples whether the goals of cutting rules, reducing complexity and streamlining procedures will really work out as intended. Looking at the first experiences in England, this seems most questionable.

More privatisation, more market, less bureaucracy and fewer rules are phrases that can be heard on a regular basis in almost every democratic country. In the US and the UK, this discourse took off significantly in the late 1970s and early 1980s when both Reagan and Thatcher came to power. In continental Europe it generally emerged a few years later. In the Netherlands, for instance, generally regarded as a highly regulated country, the mission statement of the Dutch cabinet (Balkenende 2), after its inauguration in 2003, was 'participation, more work and fewer rules'. It was argued that there were too many rules in every policy sector. In essence, this cabinet's strategy was a continuation of a neo-liberal discourse that had emerged in the mid-eighties when prime-minister Lubbers came to power. Recently, China and former members of the Warsaw Pact have also started following this line. This observed pressure on public intervention also applies to spatial planning or, as Sorensen (1994) puts it:

> 'Our era is reconsidering the ends and means of governments in general in view of limited public finance; concerns over national economic efficiency; and a growing community preference for individual responsibility, self help, and small government. Planning is not immune to these trends.' (Sorensen, 1994, p. 198)

This book is about the formal rules that are made and used to steer land use decisions. These are primarily public rules, but they can also be privately made, as in the case of covenants. Whatever the origin of the rules, all of them are applied at a site-specific level, and this application is not without costs. The relationship between the way land use institutions are made and used at the site-level, and the costs associated with this, form the core of this book. One of the key debates that always seems to be behind discussions on regulation and deregulation, is that of 'the market versus government' debate.

Beyond the 'market versus the government' debates

The starting point of this book is the recurring and fascinating 'market versus government' debate, an argument that is also ongoing in academic fora (see, for an extensive account on the starting point, Buitelaar, 2003). For over two decades in the UK and the US (with the coming of Thatcher and Reagan), and for more than a decade in many continental European countries, there has been renewed interest in the idea of more private involvement in traditional government activities. Some academics claim that the 'market' is more efficient in coordinating land use decision-making (Ellickson, 1973; Pennington, 1999). The counter-argument from welfare economics is to say that the 'market' often fails to operate efficiently; as a result, correction by government intervention is justified (Pigou, 1920). In economics, the discussion is often held around the concepts of market and public failures.

In neo-classical economics, it is assumed that in perfectly competing markets, demand and supply will become equal at an equilibrium that leads to an optimal allocation of resources. But, in practice, markets are rarely (and might never be) fully competitive. If the competitive equilibrium cannot be achieved, there will be a sub-optimal allocation of resources[1]. Pigou (1920), who can be seen as the founding father of welfare economics, addresses these situations as market failures, and these market failures are the justifications for government interventions. To welfare economists, the task of land use planning is to take care of the goods, which the market will not provide, undersupplies (Webster, 1998) (e.g. public transport in remote rural areas) or oversupplies (e.g. office buildings).

One of the implicit assumptions of this welfare economic approach is the idea that when the market fails and the government intervenes, the latter will do so perfectly and without costs. In addition, it assumes that the government acts always and only in the public interest. These assumptions have led to an important counter reaction, where it is argued that there are not only market failures, but also public or government failures (Levacic, 1991; Lai, 1997; Webster, 1998; Pennington, 1999), or non-market failures (Wolf, 1979). These authors challenge the welfare economists' implicit assumption of an imperfect market allocation versus a perfect administrative process of allocation. This assumption would suggest that planning is without costs, which it is obviously not, and also that a public body is always able to find and apply the best correction (see, for an extensive enumeration of planning costs, Sorensen, 1994, p. 198).

So, although markets often do not succeed in achieving economically efficient results, government intervention is not necessarily a guarantee for achieving these either (Levacic, 1991, p. 45). Welfare economics and the idea of a costless, selfless and perfectly operating government, *in casu* a planning agency, have their shortcomings[2], and one

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[1] By optimal allocation, I mean 'economic' or 'allocative' efficiency. Allocation is more efficient if more goods and services are produced, or if goods and services are produced which people value more highly.

[2] This is often argued by public choice theorists, who start from the assumption made in many economic theories that rational actors are characterised by self-interested behaviour. In line with this, public choice theory argues that government serves itself rather than the public interest.

can conclude that both the market and the government have their failures (Wolf, 1988; CPB, 1999). However, this discussion over the failure of the market and the failure of the government does not take us any further. In welfare economics, every situation that is not optimal is qualified as inefficient or as a 'failure'. But as these optima are hardly ever reached, there is only failure, and this significantly devalues failure as a concept for judging the allocation of resources.

In addition, the reality is often too complex to fit within the neat dichotomy of 'the government' versus 'the market' (Dixit, 1996; Buitelaar, 2003) and 'planning' versus 'the market' (Lai, 1997; Alexander, 1992, 2001a,b). It is not helpful to regard the government and planning on one side and the market on the other as opposing forces (Alexander, 2004), since they are not mutually exclusive. The market is structured by the government that makes the rules that facilitate exchange. In addition, the government can be, and often is, a market actor. Comparing the market to the government, therefore, is like comparing apples and pears.

For these reasons, I start from a different perspective. Many land use decisions are made by many agents and agencies, and these have to be coordinated. 'Without co-ordination these agents and agencies might all have different and potentially conflicting objectives resulting in chaos and inefficiency' (Thompson *et al.*, 1991, p. 3)[3]. Coordination can be seen as '…the bringing together of otherwise disparate activities or events. Tasks and efforts can be made compatible by co-ordinating them' (Thompson *et al.*, 1991, p. 3). This coordination can be fulfilled in different ways. There are various *governance structures* (Williamson, 1975, 1985), or *models of coordination* (Thompson *et al.*, 1991), that can be distinguished, and these will be set out in more detail in Chapter 2.

Transaction cost economics[4] assumes that the choice of one structure above another depends – when all other variables are equal – on

[3] Some (e.g. Scharpf, 1993, p. 125) argue that the need for coordinating the choices of actors, is increasing through an increased interdependence and differentiation of interests.

[4] Although transaction cost economics is a more specialised strand than the broader new institutional economics (Williamson, 1993), both are used interchangeably. In my view, the difference is more in the label and the message it is supposed to send; the label 'transaction cost economics' is used to emphasise the importance of transaction costs, whereas new institutional economics illuminates the importance of institutions. Since this research focuses on both transaction costs and institutions, both labels will be used, depending on what I want to stress.

the nature of the transaction and the costs that result from it. This theory describes and prescribes which institutional design (more specifically, which governance structure) is currently and should in the future be aligned to which type of transaction. Transaction costs are the independent variables and the governance structures the dependent variables. This version of transaction cost theory has also been endorsed in planning theory (Alexander, 2001a). What these accounts somehow neglect to show, is that setting up and using institutions also involves costs, which I also classify under the heading transaction costs. The focus in this book is on the relationship between transaction costs and institutions, and especially the effect of institutions on transaction costs. There is very little empirical knowledge in land use planning and land economics covering this. In the development process, one land use is converted into another; but the same occurs for the institutional arrangements with regard to land use as these are also converted (Healey, 1992). How does this work? The goal of this book is to gain more insight into the nature of the institutions and related transaction costs in the production process of the built environment (i.e. the development process). What makes this particularly complicated is the multiple character of the concept 'institution'. Institutions occur at different levels and in different ways. In addition, institutions are dependent and independent variables at the same time. Gualini illustrates this nicely for planning, by saying that planning is at the same time 'an institutionalised practice' and 'a factor of institutionalisation' (Gualini, 2001, p. 55). This study tries to handle this multiplicity, its complexity and dynamics, by looking at the relationship between different institutional levels and how this in turn affects transaction costs. The central question that emerges from this is: how are the different institutional levels and transaction costs interrelated under different circumstances, and how does this affect the existence, size and incidence of transaction costs in the development process?

The study of transaction costs in planning and property research

There is a field of study that can be called economics and planning. Economic analyses of planning have been carried out for some decades now, and many textbooks have appeared in the past (see e.g. Harrison, 1977; Evans, 1985), and recently a new wave of textbooks has emerged (Heikkila, 2000; Webster & Lai, 2003; Evans, 2004; Oxley, 2004; Needham, 2006b). Some of these (Heikkila 2000; Evans 2004) follow the mainstream economic tradition and analyse the (welfare) economic effects of planning (although Heikkila briefly pays attention to new institutional economics in the last chapter of his book). Others follow new pathways that are closer to this book. Webster & Lai (2003) combine insights from Hayekian economics, with public choice and new institutional economics, in order to explain how organisations, institutions and cities emerge and change. By applying ideas from Barzel (1998), a very close link and overlap with law and economics can be seen. The first comprehensive book about this branch of literature in combination with planning has been written by Needham (2006b). Although law and economics could be seen as a part of (or closely related to) new institutional economics, it differs in the way that it is a combination of two disciplines (not surprisingly: law and economics). It finds its roots in both disciplines, whereas new institutional economics, originates mainly from one discipline, as a group of economists were dissatisfied with the a-institutional nature of neo-classical and welfare economics. A more elaborate treatment of the differences between new institutional economics and law and economics can be found in Chapter 2. This book builds upon the aforementioned disciplines, by exploring 'new' theories from economics and applying them empirically.

With the focus set out above, this study lies not only on the interface between economics and planning, but also between planning and property research. This study could be regarded as being part of the institutional turn that has emerged in both fields. With respect to planning theory, Gualini (2001) speaks of an institutional turn, which follows the earlier identified argumentative turn (Fischer & Forester, 1993) or communicative turn (Healey, 1996; Innes, 1995). In property research, neo-classical and, to a lesser extent, Marxist approaches have for a long time dominated research on the development process. Due to a lack of appreciation for the interaction between structure and agency (see e.g. Ball, 1998; Healey, 1992), an institutional turn in property research emerged in the early nineties (see Guy & Henneberry, 2000). Although the number of contributions with an institutional perspective has risen (see e.g. Healey, 1992; Van der Krabben, 1995; Ball, 1998; Keogh & D'Arcy, 1999), it is still a very small stream compared to the vast majority of scholars that take a mainstream economic stance.

In planning theory, two streams within the institutional turn have been identified (Gonzalez & Healey, 2005): the sociological (e.g. Innes, 1995; Healey, 1997; Gualini, 2001) and the economic institutional (or transaction cost) strand (Alexander, 1992, 2001a; Lai, 1994, 1997; Webster & Lai, 2003; Webster, 1998; Buitelaar, 2004; for a comprehensive overview of contributions to transaction cost economics and planning see, Lai, 2005). Although they are set out as two separate and almost incompatible strands, both approaches are combined here. As the cases will show, transaction costs are not made by agents that act independently of others and solely pursue economic self-interest; in fact the actions of these agents are embedded in social structures (Granovetter, 1985). Transaction costs, in other words, are the result of continuous structure–agent relations. By making this amendment, transaction cost economics becomes a very useful analytical framework, which should not be rejected, (as some do), on the grounds of its objectivist ontology and oversimplified psychology of rationally acting individuals.

There is scepticism towards the integration of transaction cost economics and planning (Poulton, 1997; Moulaert, 2005), which I share when it comes to transaction cost theory as an explanatory theory for institutional change (Buitelaar *et al.*, 2006). The quest for reducing transaction costs as a determinant for institutional change, or even more broadly, as determinants of the emergence and evolution of cities (Webster & Lai, 2003), as often assumed, remains unproven and seems to be only part of the explanation of the emergence, continuity and change of socially constructed institutions. Nevertheless, transaction cost economics provides interesting analytical tools to investigate and compare institutional arrangements in theory and practice. In addition, 'the comparative institutional analysis of the world of positive transaction costs is a worthy challenge'. (Williamson, 1993)

Although the attention on transaction cost economics has increased, empirical applications of transaction cost theory in general, but in planning and property research in particular, are rare (see, for one of the very few examples, Needham & De Kam, 2004). This study seeks to identify transaction costs empirically and to understand their existence, size and distribution. It will not provide exact figures of transaction costs, nor calculate a total amount. This is almost impossible as transaction costs are often hidden, indirect and are not all quantified (in terms of money, man hours etc.) by the people involved in the development process. Where possible, an indication of the size of the transaction costs will be given.

The relevance for planning practice

This study should be relevant to planning in two ways. The first is the 'market versus government' debate in planning, which has remained topical throughout the years. This has often been held in the same way, namely seeing the two forces as opposing one another (see e.g. Dahrendorf, 1966; Klosterman, 1985), and the economic approaches applied usually employ the same (neo-classical and welfare economic) language. I argue (see also, Buitelaar, 2003) that this is a fruitless and counterproductive discussion that should be approached differently. Approaching an old debate by a different language could shed a refreshing light that might serve planning theory well, and planning practice too, when thinking about institutional design. Transaction cost economics is a more pragmatic approach that can be used to compare realistic alternative institutional arrangements.

There is a second potential benefit that this book could have for planning and development practice. If we know how to identify transaction costs, and why they are made and distributed as they are, we might be able to reduce them, or redistribute them better. There are some transaction costs that contribute to better land use decisions, by whatever criterion (e.g. spatial quality or legitimacy) that is measured. What is also interesting is which transaction costs can be seen as dead-weight losses, in other words, a waste of money and time. Identifying particularly those dead-weight costs might help to improve the efficiency of planning practice and the development process. This could be done in policy and institutional evaluations.

The structure of this book

In Chapter 2, I explore the literature on institutions and transaction costs, and illuminate the relationship between them. The main source of inspiration here is the institutional economic literature, but supplemented with insights from sociological institutionalism. This leads to a broad conceptual framework that indicates different institutional levels and how they impact on transaction costs. A distinction is made between macro-, meso- and micro-level institutions. In Chapter 3, both institutions and transaction costs are operationalised for the empirical research, focusing in particular on the micro-level institutions, since this is the level at which transaction costs are directly produced.

Applying land use law at the local level involves costs: transaction costs. However, a development process does not start and develop in an institutional void. There are rules of the game – the meso-level institutions – that set the stage within which the site-specific regime (i.e. the user rights regime as I call it in Chapter 3) is created and used. Therefore, Chapter 3 also pays attention to the meso level, which includes the formal land use institutions that can be used and applied at the site level. In addition the research strategy for the empirical part is set out in more detail.

Chapters 4, 5 and 6, deal with one case study each, showing which transaction costs are made during the development process of a small housing site as the result of the creation and use of the micro-level institutions. Each chapter starts with an exploration of the most important meso-level institutions in each country (like the planning act) that each stakeholder has to take into consideration. The three case studies are from Nijmegen (the Netherlands), Bristol (England) and Houston (Texas, United States). After analysis of each case study, they are compared to each other (Chapter 7). What follows from this chapter are some of the most discriminating dimensions with regard to transaction costs, which do not stand on their own but are related to deeper social and cultural norms and values (i.e. the macro institutions). Contextualising the transaction costs – which is done in Chapter 8 – provides an important part of the explanation of their existence, size and distribution. Chapter 9 contains the conclusions, in which the findings of the empirical section are confronted with the transaction cost theories of planning. In addition, some key issues in planning practice are fundamentally discussed from a transaction cost perspective.

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