CNC
COMISIÓN NACIONAL DE LA COMPETENCIA

COMPETITION PROBLEMS IN THE SPANISH LAND MARKET

Discussion Paper

CONTENTS

I. INTRODUCTION

(1) The purpose of this report is to analyse the impact of land use intervention on the land market. Land plays a fundamental role in the economy. Firstly, land is a limited, heterogeneous, irreproducible factor of production which is necessary in almost any economic activity. Secondly, it is a very important financial asset for households, businesses and the public sector. Thirdly, it is a key element for the production of housing, an asset which, in addition to its significant social dimension, accounts for a large percentage of household wealth, with major bearing on consumer spending and savings decisions and even employment decisions.

(2) Given its economic importance, it is essential that land regulation be efficient and fosters a competitive functioning of the land market and of all markets that depend on it.

(3) While public intervention in this area is fully justified by the existence of market failures, public intervention may also have unintended effects on competition and efficiency and give rise to a negative effect on overall social welfare. Therefore, the regulatory instruments that are implemented must be aimed at correcting market failures but without introducing unjustified distortions of competition.

(4) Spain's antitrust authority, the Comisión Nacional de Competencia (CNC), has on numerous occasions called attention to a deficient urban planning intervention as a subsequent source of competition problems in related markets. For example, in food retailing the CNC has pointed out that constraints on the freedom of establishment of retail outlets constitute one of the most important sources of inefficiencies in that sector, as they tend to protect local market power and other types of inefficient situations[1]. More recently, in relation to distribution of automotive fuels, zoning-related difficulties in finding suitable land for establishing service stations, together with obstacles for obtaining the required urban development licences, have been regarded as one of the main factors constraining competition in that sector[2].

(5) The land market itself has also been the object of analysis by Spain's competition authority on past occasions. The former Competition Tribunal (Tribunal de Defensa de la Competencia or TDC) studied competition in the land market in two different reports during the 1990s: *Policy Remedies*

[1] Comisión Nacional de la Competencia (2011) *Report on the Relations Between Manufacturers and Retailers in the Food Sector*.

[2] Comisión Nacional de la Competencia (2012) *Report on the Consultation Request Submitted by the State Secretariat for the Economy and Support for Business Regarding the Automotive Fuel Market in Spain.*

that May Favour Free Competition in Services and Curb the Damage Caused by Monopolies (1993) and *Competition in Spain: Current State and New Proposals* (1995).

(6) The former TDC and the CNC are not the sole institutions that have called attention to problems spawned by land use intervention in Spain. Both the Organisation for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF) have on several occasions examined how supply side rigidities in the land market generated by land use regulation impact the pricing of land and housing, driving prices higher and intensifying their volatility, exacerbating the real estate cycle in the Spanish economy, and, as a consequence, increasing macroeconomic instability.

(7) Land use intervention, which undoubtedly stems from legitimate objectives and may help to correct market inefficiencies, may nonetheless also have undesired effects on competition, efficiency and social welfare. This document seeks to identify and characterise those effects and their causes to make it easier for public authorities to take into account the costs and benefits of their intervention when formulating land use policies.

(8) This report uses as reference the *Recommendations to Public Authorities for More Efficient and Pro-competitive Market Regulation*, published by the CNC in 2009. The same as for other sectors, urban development regulation must conform to the principles of better regulation and, specifically, to the principles of necessity, proportionality, least distortion, effectiveness and transparency.

(9) The report is structured as described here. Section 2 gives a description of the regulatory framework and the main phases in the urban development process (urban planning, implementation and control), along with an economic characterisation of the land market. Section 3 studies a number of indicators of market operation, specifically, supply elasticity, price trends and the level of regulation in comparison with other countries in our environment. Section 4 analyses the main regulatory factors that are having a negative effect on competition in the land market. Section 5 sets out the principal conclusions of the report. Lastly, section 6 includes recommendations and encourages stakeholders to engage in the needed debate in the future.

(10) This report has been approved by the CNC Council at its meeting of 30 July 2013, pursuant to the consultative powers attributed to it under article 26 of the Spanish Competition Act 15/1 of 3 July 2007 (Ley de Defensa de la Competencia — LDC[3]. That article lays down the duty of the CNC to

[3] The CNC continues exercising the powers conferred upon it by article 26.1 of Act 15/2007 according to the third transitional provision of Act 3/2013 of 4 June 2013 creating the

promote effective competition in the marketplace through advocacy work and by conducting studies and research on competition issues, making proposals for liberalisation, deregulation or regulatory changes, and issuing reports on situations that hinder the maintenance of effective market competition as a result of the application of legal provisions.

Commission Nacional de los Mercados y la Competencia (National Markets and Competition Commission).

II. LEGAL AND ECONOMIC CONTEXT OF THE LAND MARKET

(11) Urbanism may be defined as the land use policy of a city that determines how, when and where "*human settlements may arise or develop and in the service of which there are placed the planning instruments and techniques required for achieving that objective*"[4].

(12) Urbanism is a process that develops in time and in which three clearly differentiated areas may be distinguished. First, planning; second, implementation; and third, control of development. Furthermore, an essential role is played in Spanish urbanism by the instruments of direct intervention in the land market that are attributed to public authorities[5].

II.1. Regulatory Framework

(13) Today's urban planning and development system is rooted in the 19th century legislation governing the internal expansion and reform of cities, which to a certain extent was a response to the growing concentration of the population in cities, and was based on the design of new neighbourhoods to provide for planned urban growth[6].

(14) Contemporary Spanish urbanism was born with the Law of 12 May 1956 on Land Regulation and Land Use Planning (LS 1956) and current urban development legislation remains heir to that law. That statute marked a considerable change from the previous model, providing for strong public intervention in urban development and, to a certain extent, for a different conception of property rights[7]. As from that time, those rights were to be limited by a social function, with landowners required to cede land to the community when some public use or social interest was held to exist. LS 1956 faced some difficulties in its practical application. First, it did not provide for sufficient regulatory development and implementation, which limited its application. Also, municipal governments did not approve urban plans, specifically general planning, which was at the heart of the urban development model ushered in by the Law.

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4 Spanish Constitutional Court (CC) judgment 61/1997.

5 Public authorities intervene in the land market through a series of instruments that are regulated in the national or regional laws and which aim to have a direct impact on the market, in particular, to directly affect price determination.

6 The description of the regulatory framework has drawn on laws as well as bibliographic references, mainly Alonso Timón (2012), Memento Práctico Urbanismo (2011), Peñaranda Ramos (2011), Muñoz Machado and López Benítez (2009) and Perales Maldueño (2006).

7 Alonso Timón (2012).

(15) The first reform of LS 1956 was enacted by Law 19/1975 of 2 May 1975 reforming the Law on Land Regulation and Land Use Planning, aimed at amending certain elements of the previous legal framework, though remaining true to the prevailing model. In fact, those two laws were recast in the Consolidated Text of the Law on Land Regulation and Land Use Planning, approved by Royal Decree 1346/1976 of 9 April 1976 (CT 1976). First, it introduced new planning concepts in order for some type of planning to exist in small municipalities. Second, the present-day urban development management systems began to be designed, and the land-use "net benefit" (*aprovechamiento*) technique was regulated. Third, the new framework provided for its regulatory development and implementation, leading to the approval of the Urban Planning, Implementation and Control Regulations in 1978.

(16) With the approval of the Spanish Constitution of 1978, the Autonomous Communities were given exclusive powers for land use planning and urban development matters. Nevertheless, despite that shift of authority, national lawmakers continued producing urban development laws. Thus, a reform was carried out of the general framework established in 1976 via the Law of 25 July 1990 on Reform of the Rules on Urban Planning and Land Appraisals. That reform was later incorporated into the Consolidated Text of the Law Regulating Urban Development and Land Use Planning, approved by Legislative Royal Decree 1/1992 of 26 June 1992 (CT 1992).

(17) The Consolidated Text of 1992 prompted regional governments to lodge challenges to the constitutionality of the 1990 and 1992 laws. Those suits were resolved by Constitutional Court (CC) judgment 61/1997 of 20 March 1997. That judgment declared unconstitutional the most important substantive part of CT 1992, with great impact in the Autonomous Communities that had not adopted their own urban planning laws[8]. Some of those regions opted for approving single-article laws or minimal regulations that were confined to establishing CT 1992 as their regional law. At the same time, the Constitutional Court's decision holding that the repealing provision of CT 1992 was unconstitutional meant that CT 1976 came back into force, which thenceforth became of subsidiary application to the regional laws.

(18) After the Constitutional Court's ruling, the national government maintained a series of powers recognised in the Spanish Constitution. On urban planning and development matters, the State's powers referred to the

[8] Some regional governments (known as Autonomous Communities) had their own urban development legislation, which took precedence over others. Many regions, however, had not yet approved their own legislation and came under the national rules. The cancellation of the national laws as a result of Constitutional Court judgment 61/1997 of 20 March to a certain extent dismantled the legal framework for land use planning in those regions.

regulation of the Basic Urban Property Statute[9], which covers the following aspects: rights and duties of the owners of each type of land; rules on appraisals; compulsory expropriation as a result of urban planning; and financial liability of authorities for urban development acts. In this context, the State approved Law 6/1998 of 13 April 1998 regulating land and appraisals (LS 1998)[10], which was substituted by the Land Act 8/2007 of 28 May 2007, complemented by Legislative Royal Decree 2/2008 of 20 June 2008 approving the Consolidated Text of the Land Act (CT 2008)[11].

(19) At present, all Autonomous Communities have their own urban planning and development legislation, except for the Balearic Islands. As a result, most regions apply CT 2008, the specific law of each Autonomous Community and relevant implementing regulations, where such exist; with subsidiary application of CT 1976 and its implementing regulations insofar as matters not regulated by the law of each Autonomous Community. In the Balearic Isles and Autonomous Cities of Ceuta and Melilla the CT 2008 and CT 1976 apply (subsidiarily in the Balearic Isles and directly in Ceuta and Melilla).

(20) As regards the applicable national rules, there should also be considered, albeit on a complementary basis, the Building Regulatory Act of 1999 and the Regulation on Urban Development Entries in the Land Registry of 1997. There must also be taken into account the urban development regulations contained in sectoral laws. For example, provisions on urban planning and development matters exist in laws on State property (Waters, Coasts, Ports, Roadways, etc.), environment (Laws on Conservation of Areas or on Noise) and cultural heritage (Spanish Historic Heritage Act).

(21) CC's judgment 61/1997 served to clarify the powers of the different territorial public administrations in the domain of urban planning and development. The State, on the one hand, exercises indirect competence under the authority attributed in article 149.1 of the Spanish Constitution to regulate what the CC terms the Basic Urban Property Statute, as mentioned above. And the regions, on the other hand, have direct power to legislate on the entire urban planning and development process, and

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[9] Primarily, under article 149.1.1 of the Spanish Constitution, which gives the State power to regulate the basic conditions that ensure equality of all Spaniards in the exercise of constitutional rights and duties, which in this case was used to determine the fundamental regime on urban property, always at the level of principle; and also under article 149.1.18, which was used to establish the principles that would govern urban planning expropriations.

[10] LS 1998 was challenged before the Constitutional Court, leading to the court's judgment 164/2001 of 11 July 2001, which, with the exception of certain articles, held that LS 1998 did conform to the constitution. Said judgment 164/2001 contributed to clarifying the distribution of land use and town planning powers, even though the fundamental ruling in this regard is CC judgment 61/1997 of 20 March 1997.

[11] This text integrates the 2007 Law and the articles of CT 1992 that remained in force.

specifically on the three phases that characterise it: planning, implementation and control of development.

(22) With respect to municipal governments, they exercise executive powers in all three areas on the terms provided in the relevant national and regional legislation. Specifically, executive powers to prepare and approve planning instruments (town plans), to choose the systems for urban development action, and to monitor and enforce land use laws.

II.1.1. Urban plans

(23) The core objective of urban plans is to design the land use transformations that will be carried out. Put more colloquially, the purpose of planning may be said to be to give a detailed rendering of the future city, determining the part of the territory that may be developed and the specific uses of the land. At the same time, planning plays a legitimating function for urban development transformations, as approval of the relevant plans is a necessary condition to be able to develop land.

(24) Urban planning is the product of the rulemaking authority[12] of the administration and, as a discretionary power, enjoys a very wide margin for its configuration. The discretionality of the planning power is legally limited by two techniques: the legal rules of direct application[13] and the minimum urban development standards[14].

(25) Planning consists of a series of instruments designed to delimit, in greater or lesser detail, how land must be used. Those instruments are organised by priorities based on hierarchy and specialisation. Prior to the approval of the Spanish Constitution, authority to define and articulate this system rested with the national government. After the Constitution's approval, however, it is the regional lawmaker who designs and configures the

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[12] Town plans are regulatory in nature: they are regulatory norms that must respect the provisions of the law.

[13] In the case of legal rules of direct application, the legal framework lays down a number of provisions on land use or building use that are directly applicable, whether or not there is a town plan. There are three main types of rules of direct application: the prohibition on building near roads and communication routes, the obligation that construction must adapt to the environment where it is located, and the legal rules on the protection of certain areas derived from different sectoral rules.

[14] In the case of urban development standards, the legal framework sets out minimum criteria that must be respected by the planning instruments. Those development standards are land use rules such as, for example, provisions that must be contained in the town plan on reserves of land in the different zoning categories for public purpose use (parks, gardens, sports zones, etc.) or on reserves of public facilities and services (public and private cultural and educational centres, health and medical centres, parking facilities, reserves of land for publicly developed or subsidised housing, etc.) or on maximum housing density.

planning system[15]. In any event, despite the introduction of certain changes, regional laws remain faithful to the traditional Spanish legislation on urban development initiated in 1956 and, specifically, to the framework set down in CT 1976 and CT 1992.

(26) The planning system is divided into two main categories. First, supra-local planning, of a fundamentally executive nature, and included in territorial planning. Second, local or municipal planning, which is primarily operative in nature and gives legitimacy to land development operations.

(27) Within the local planning a distinction should be made between general planning and development planning. General planning is normally embodied in the General Plan or similar instruments, such as what are known as Subsidiary Standards. Development planning, for its part, is primarily materialised in the Partial and Special Plans.

II.1.1.1 General planning

(28) The General Plan is an integral land use planning instrument and the cornerstone of urban planning. Although its scope is normally that of a specific municipality, it may on occasions span more than one municipality (supra-municipal plans), if deemed necessary. It is original, in the sense that its approval does not require the existence of any previous plan, and necessary in that it is indispensable both for the subsequent planning development and for the urbanisation and construction activity. Despite its fundamental nature, the General Plan must respect the terms of the Territorial Plans and Guidelines[16], as well as other provisions included in sectoral plans (for example, roadway and infrastructure plans). It is contained in all regional regulations, although with slightly different names. In some Autonomous Communities, the existence of the General Plan is

[15] The CC clearly took this position in its judgment 61/1997 when it ruled that *"It must be underscored that the State cannot impose the urban planning means or instruments for articulating the basic conditions for exercising the right and discharging the duty referred to by article 149.1.1 of the Spanish Constitution (…). Those means or instruments belong to the realm of the regional lawmakers' freedom of choice on urban planning matters, no matter how much, in certain cases, they may be considered an almost necessary consequence of the conception of property rights that underpins those basic conditions, such as the establishment of distribution zones or areas in which objectives of fair distribution and basic duties are to be realised. But the definition of the legal regulation of those techniques and instruments, which certainly admit diverse configurations, is thus part of the regional powers for urban development matters."*

[16] Territorial Plans establish strategic determinations, although urban development planning must be conducted in a manner consistent with those determinations, primarily in relation to communication and transport systems, facilities, infrastructure and supra-municipal services or basic natural resources. In this regard, there is a tie-in between urban planning and land use planning. Specifically, municipal plans must respect the limits on urban growth that are written into the territorial plans of some regions. For example, in Andalusia the Land Use Plan sets a limit on the growth of developable land (no more than 40% of the existing urban land) in eight years.

compulsory for all municipalities, whereas others only impose it for cities that surpass a specific population threshold.

(29) The General Plan includes general and specific provisions[17] on municipal land, in particular, using two essential techniques of the Spanish planning system: classification and zoning.

(30) Land classification consists in assigning each part of the municipal territory to one of the traditional categories of land in the Spanish planning system: urban land, developable or 'urbanisable' land (*suelo urbanizable*) and non-developable or 'non-urbanisable' land (*suelo no urbanizable*)[18]. Although regional laws tend to bring in their own specific nuances and peculiarities, a general definition may be given of each one of those categories:

- Urban land is that which meets certain criteria. The first is the transformation of the land which, starting from its initial state, is or becomes suitable for urban development. The second is the criterion of location, which endows urban status on land by reason of the consolidation of the surrounding area, irrespective of the services it may or may not have.

  According to the first criterion, urban land is: a) land which, at the time the general planning is approved, has already been transformed because it has, at minimum, access by roadway, water supply,

[17] In the General Plan, the specific determinations are primarily circumscribed to urban land.

[18] It should be pointed out that CT 2008 dispensed with the traditional land classification criterion that had been followed by all previous national legislation. Instead, it established two basic situations of land: a) developed land: that which is legally integrated in an urban mesh composed of a network of roads, community service allocations and parcels belonging to the population centre or settlement of which its form part, and which meets at least one of the conditions set out in article 12.3 of CT 2008; and land included in traditional rural population centres legally established in rural areas, provided that the applicable urban and land use legislation confers status as urban land or similar status upon it and that, in accordance with that legislation, it has the facilities, infrastructure and services required for that purpose (12.4 of CT 2008) and b) rural land: (i) land that territorial and urban planning preserve from being urbanised because it meets a series of criteria or (ii) land which territorial and urban planning instruments envisage or allow possible development until the specific urban development action is completed, and all other land that does not meet the requirements for being considered urban developed land. These two principal situations allow the basic duties of landowners to be defined and are salient for purposes of land appraisals. In any event, the national rules do not exclude the regulation enacted by regional lawmakers in its recourse to classification and zoning of land in order to define the rights of landowners according to the type of land. In this regard, it bears noting article 8.1 of CT 2008 which provides: *"property rights over land include the powers of its use, enjoyment and exploitation in accordance with the status, classification, objective characteristics and destination stipulated from time to time, under the applicable land use planning and urban development laws by reason of the characteristics and situation of the land"*. Therefore, the basic situations in CT 2008 must be construed integrally with the traditional classification and zoning techniques. CT 2008 takes the approach that those techniques fall within the ambit of regional lawmakers.

sanitation service and power supply; b) land which, though not having the aforesaid basic services when the general planning is approved, eventually acquires them through development pursuant to the general planning. According to the second criterion, urban land is that which, irrespective of its state of transformation, is located in consolidated built areas.

A distinction is normally drawn between consolidated urban land (located in an area where urban development has been completed) and unconsolidated urban land (located in an area where urban development is pending).

- Non-developable land is that to which any of the following circumstances apply. First, land subject to a special protection regime that is incompatible with its transformation according to land use plans or sectoral legislation by reason of: its landscape, historical, archaeological, scientific, environmental or cultural value; the natural risks evidenced in the sectoral planning; its subjection to limitations or easements for protection of the public domain. Second, land included in the general planning because it is considered necessary for preserving the aforementioned values or for its agricultural, forestry or livestock value, for its natural riches, or because it is not considered suitable for urban development (for reasons of rational use of resources or for territorial or town planning criteria).

  There are two types of non-developable land. One is non-developable land subject to special protection. In this type of land, the General Plan must lay down the measures and conditions required to conserve and protect its natural elements. And there is common or simple non-developable land, i.e., that for which no special protection is established, but it has been preserved from the urban development process.

- Developable land is land that does not fall into either of the two preceding categories and that may be the object of transformation according to urban planning legislation. In many regions a distinction is usually made between developable land integrated in sectors[19] for immediate development, and developable land not integrated in such sectors, which will foreseeably take longer to be developed.

(31) Zoning consists in assigning uses and intensities to land that has been previously classified. Basically, zoning establishes different zones in the territory by use, density, lot coverage, or volume, shape, height and class

[19] A sector of developable land is a portion of developable land which has not yet been developed but for which the General Plan envisages future urbanisation. The sector is properly the subject of the Partial Plan, an instrument that will be discussed further ahead.

of buildings. The are two main types of use: general use (*uso global*) and specific use (*uso pormenorizado*). General uses encompass residential, industrial, tertiary sector and public purpose uses (*dotacional*). Within each general use there are specific uses, which, in turn, consist of further subcategories. This generates a considerable number of highly detailed and different categories of use[20]. For example, municipality A may have (i) a *tertiary* general use, (ii) composed of specific uses such as *tertiary services*, *large commercial centres* or *service stations*, and (iii) the *tertiary services* general use may include *commerce*, *offices*, *hotels*, *public entertainment*, or *parking facilities*, and (iv) *commerce* may include different types of retail activity, such as *small commerce* and *medium commerce.* Taking into account that there are other general uses which are subdivided, the total final uses may be very large in number and heterogeneous in different towns, giving rise to very specific and detailed planning of each municipal territory.

(32) Through its general or basic determinations, the General Plan outlines the theoretical model of a city. First, the General Plan classifies and zones land. Second, the overall structure of the territory is established, identifying, inter alia, the general communication and transport systems and free zones set aside for parks or green areas. Third, the public or private nature of the public purpose allocations is determined. Fourth, the appropriate measures are set forth for protecting the landscape and environment. Fifth, there are delimited, on a case-by-case basis, the burden and benefit-sharing sectors or areas (distribution sectors or areas) and the average or standard net benefit[21] is established for each zone, and the norms are set out for programming the execution of the plan and its revision.

(33) In its specific determinations, the General Plan includes provisions that vary according to each type of land. On urban land, the General Plan provides a detailed land use plan. For developable land, the General Plan provides a more general and less intense regulation. The detailed planning is determined as part of the development planning process, primarily through the Partial Plan. In non-developable land, the Plan preserves land from urban development and sets forth, if applicable, measures to protect the territory and landscape.

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[20] Unlike types of land, the uses that may be assigned to land are not established in the regional legal framework, and are instead determined by the municipal planning authority. That is why the categories used by different municipalities, though similar, are not homogeneous: for example, town X may have an “industrial” general use and town Y a similar one that it terms “industrial activities”.

[21] In a given town planning action zone, land may differ as to the net benefit enjoyed, that is, as to how it can be used. The mean or standard net benefit is an average of the objective net benefits of a specific area.

(34) The General Plan must be accompanied by a series of documents of varied subject matter. One of the principal documents is the *Memorandum to the General Plan and Complementary Studies (Memoria y los estudios complementarios)*. The Memorandum describes the reasoning behind the General Plan, explaining the thinking behind its general contours. The Memorandum will also play an important role in controlling the discretionary use of planning powers[22]. For these reasons, regional laws tend to include a series of rules intended to have the Memorandum justify the solutions and determinations contained in the Plan. The Plan must incorporate other documents as well[23]. According to the case-law of Spain's Supreme Court[24], in the event of inconsistency between the textual documents and the graphic documents of the Plan, the former have clear pre-eminence.

(35) The other general planning instrument is the Sectorisation Plan (*Plan de Sectorización*[25] the main purpose of which is to include non-sectorised developable land in the development process, mapping out the sectors and, where applicable, the execution units[26] in which the planning will be

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[22] The Supreme Court case-law reflects the importance of the Memorandum and the binding nature of this document for the planning process. In its judgment of 16 June 1977 (which goes by the name of Plaza de la Memoria Vinculante) the Supreme Court held that the Memorandum includes, above all else, the rationale of the Plan, and the 9 July 1991 judgment provided that the Memorandum is not an *"accidental documental, which may or may not exist, but an indispensable requirement of law"*, and that *"the profound discretionality of planning, a regulatory product emanating from the Administrations (…) explains the essential necessity of the Memorandum as a fundamental element for avoiding arbitrariness".* And the Supreme Court judgment of 21 September 1993 states that the importance of the Memorandum is obvious *"from the public interest standpoint, because it ensures that the chosen and justified land use planning model will be realised"*.

[23] Including the *information drawings and land use planning drawings*. The information drawings map out the situation of the regulated territory at the time the Plan is drawn up. And the land use planning drawings give a graphic depiction of the determinations included in the Plan. There are also *the town planning norms*, the primary purpose of which is to regulate zoning and the different uses that can be assigned to the land subject to the Plan; *the programme of action*, primarily intended to schedule the Plan's implementation; *the economic and financial study*, which assesses the economic and financial possibilities of the Plan; *the environmental report*, which evaluates the Plan from the environmental standpoint.

[24] Supreme Court judgments of 14 December 1989 and 28 January 1999.

[25] Although differences exist between Autonomous Communities in relation to specifics, they have opted to include Sectorisation Plans in the general planning process because their purpose is to lay down the determinations that are to structure non-delimited developable land. In some cases, such as Andalusia and the Community of Madrid, they may even innovate the General Plan's determinations. Save for certain nuances, Sectorisation Plans have a similar legal nature and purpose to the Programmes of Town Planning Actions, a planning instrument recognised in traditional national urban planning legislation but which, generally speaking, is no longer referred to in regional laws.

[26] Not all of the plan is executed simultaneously; development is done by parts. On developable land, execution is done by means of execution units, which are normally portions of a sector and composed of parcels.

implemented, that is, urbanised. In this regard, the Sectorisation Plan, like the General Plan in sectorised developable land, establishes the general determinations for this type of land, and may also contain specific determinations, and is only limited by what the General Plan provides for that land. The division into sectors requires that they be adequately sized to allow realisation of all phases of town planning management, in particular, its essential element, the fair distribution amongst affected landowners of the burdens and benefits of development.

(36) Lastly, it should be noted that in many towns the general planning determinations are wholly or partly established in the planning Subsidiary and Complementary Standards, which stand in for the General Plan in a municipality or fill in any gaps that it may have. The Subsidiary Standards have an essentially supplemental purpose, although not as detailed, with respect to the general planning provisions in towns that have no General Plan. Specifically, they classify the land (urban, developable and non-developable) and provide the basic plan for the town. For their part, the Complementary Standards complement the General Plan, regulating aspects not provided for in the latter and developing points addressed there insufficiently.

II.1.1.2 Development planning

(37) The purpose of development planning is to develop the general planning provisions for each type of land targeted for development. The two main instruments in this case are the Partial Plan and the Special Plan.

(38) The Partial Plan is fundamental to development planning. It is derivative in nature as it presupposes and is hierarchically subordinate to the General Plan, and executive, as it legitimates the Plan's execution. The purpose of the Partial Plan has traditionally been the detailed development of developable land, thus culminating the planning process for that land and legitimating the execution of the development plans. In general terms, this continues to be the Partial Plan's essential function, even though in some cases it may also be used to establish detailed planning of unconsolidated urban land, modifying the structural regulation of the General Plan, or even establishing such regulation in non-sectorised developable land[27].

(39) Taking into account its main functions, the Partial Plan completes the land use planning for a sector defined in the Plan, and, in relation to its effective development, defines execution units within that sector through a detailed planning. The determinations of the Partial Plan are confined to: delimiting the sector into execution units; assigning specific uses; indicating reservations of land for public parks and gardens, public and recreational zones, and public-purpose uses according to the standards established by

[27] In cases where the regional laws do not provide for a Sectorisation Plan or a similar instrument.

law; designing the layout and characteristics of the road and communications network for the sector and its connection with the general system; designing the characteristics and layout of utility and service networks (water, sewage, electric energy, etc.); performing an economic assessment of the installation of services and of the execution of the urban development works; and establishing a plan of stages for executing the development works and, where applicable, the construction works.

(40) Another important instrument of development planning is the Special Plan, derivative in nature though not always necessary. Its purpose is to respond to a concrete and specific need, on occasion of a sectoral nature. For example, there may be an Special Plan for Interior Reform, a Special Plan for Historic-Artistic Protection or an Airport Special Plan. In essence, it provides detailed and specific regulation of a domain that cannot be addressed by the Partial Plan. Special Plans are by nature exceptional and not necessary.

II.1.1.3 Other instruments

(41) Both the regional regulatory and national supplemental frameworks regulate other instruments which are differentiated by purpose, scope, importance and regulatory or non-regulatory nature.

(42) First, the Urban Land Delimitation Project (*Proyecto de Delimitación de Suelo Urbano*), which mainly serves to define what part of the municipal land is urban and what part is non-developable in towns where Subsidiary Standards cannot be approved.

(43) Second, Detail Studies (*Estudios de Detalle*), intended to complete or adapt, when necessary, the determinations established in the development plans for urban land on a detailed scale. They are regulatory in nature, although their capacity to effect changes in the planning is very limited.

(44) Third, the Catalogues of Protected Domain (*Catálogos de Bienes Protegidos*), which are auxiliary documents that list monuments, gardens, nature parks or landscapes that are subject to special protection due to their specific values or characteristics.

(45) Fourth, the Urbanisation Project (*Proyecto de Urbanización*), detailing and scheduling the urban development works (for example, water supply, sewage system, electric energy) with the precision needed for them to be executed. Although this has traditionally not been considered a planning instrument, there are some regional provisions that introduce confusion in this regard. It is not regulatory in nature and requires the existence of a plan.

II.1.1.4 Preparation and approval of planning instruments

(46) The legal framework sets down a set of rules on the power of public authorities to prepare and approve planning instruments. Private initiative is also recognised in certain situations.

(47) The assumption underpinning the regulatory framework is that the formulation of planning instruments rests with public authorities, and specifically with the municipal governments. This holds for the General Plan, the preparation of which can only be initiated ex officio, even though on some occasions that ex officio initiation is allowed to come pursuant to the request of a private party.

(48) In any event, the legal framework allows private initiative in relation to development planning instruments, specifically in their drafting and in proposing them to the municipal governments, who have the final decision as to their initial approval or otherwise. Private initiative plans may be presented by any private person, although provisions may be introduced which tend to favour landowners. At the same time, they are generally subject to the same requirements as public plans and to the normal processing period, although the landowners affected by the planning instrument in question are personally summoned.

(49) The procedure to arrive at final approval of a plan begins with the initial approval phase[28]. After initial approval the plan is submitted to a public input procedure, which usually lasts at least one month. After the public input phase ends, the plan is given provisional approval[29]. Normally, initial and provisional approval of a General Plan rests with the plenary town council, as is also usually the case with Sectorisation Plans. There are variants with respect to development instruments, which in some cases require approval by the plenary council and in others by the mayor.

(50) The public input period and provisional approval is followed by the definitive approval phase[30]:

- In general terms, a general plan is given final approval by the Autonomous Community, although in some regions it may be approved

[28] The initial approval marks the start of the plan's processing. All prior acts are called preparatory acts, a phase during which, amongst other things, summaries and draft versions of the plan are presented, but in which the procedure for approving the plan is not yet initiated.

[29] In some cases there is no provisional approval; for example, with Special Plans and other planning instruments whose initial and definitive approval rests with the municipal government, although there are exceptions.

[30] The processing and approval phase of a planning instrument may stretch out over lengthy time periods. A General Plan can take nearly five years to be processed and approved. Section IV.3 of this report deals with this issue in greater depth.

by the municipal government, with a prior binding report from the regional government.

- In relation to development planning, there are instruments (Partial Plan, Special Plan) which may be definitively approved by the municipal government in some cases, but in others their final approval rests with the Autonomous Community. Instruments such as Detail Studies and the Urbanisation Project are approved by the municipal authorities.

II.1.1.5 Revisions and amendments

(51) Given their regulatory nature, the plans are valid indefinitely. In any event, this does not mean that a plan cannot schedule or impose a time limit for its review, or for amendments and revisions.

(52) Although both revisions and amendments imply planning changes, there is a difference between the two. A revision consists of adopting new criteria in relation to the general structure of the territory or regarding the classification of the land subsequent to the election of a different land use planning model stemming, for example, from the emergence of unforeseen factors related to demographic change or economic growth. An amendment, for its part, is confined to making isolated modifications which in principle do not change the overall land use model of the plan, but which may affect aspects such as land classification or zoning.

(53) In any event, although many regional regulations recognise both concepts, they include them within a broader array of innovations or alterations in the planning instruments. This means that the rule that any change in a planning instrument must be made by the same instrument and pursuant to the same procedures has been nuanced somewhat. Thus, there are cases in which specific determinations of a General Plan may be changed by a hierarchically inferior instrument, such as a Partial Plan.

II.1.1.6 Planning accords

(54) National and regional regulations recognise the validity of the so-called town planning accords, wherein the administration agrees with private parties to promote certain changes in planning instruments. Their essential purpose is to prepare a revision or amendment of the prevailing plan, giving guidance as to the content of the change, but without being the instrument that effectively modifies the plan, given that the power to do so rests with the administration and is not transferable[31].

[31] The Supreme Court judgment of 15 February 1994, taking as its starting point that planning power is non-transferable, upheld the validity of planning accords whereby the administration undertakes to make amendments or revisions to the planning (for example, a change of classification or zoning) in exchange for consideration offered by the private party (for example, assignments of land the private person is not legally required to make or cash

(55) The key features of planning accords are described below:

- They are agreements between the administration (usually the municipal government, but at times regional authorities as well) and any public or private persons who may but need not own land affected by the accord.
- The purpose is to prepare a planning change, and, specifically, through these agreements the administration undertakes to put in motion all necessary procedures for that change to be carried out.
- In the event the modifications referred to by the accord are approved, the private party is obliged to fulfil the commitments made in the accord. Those commitments can be varied in nature, including: cash payment; assignments of land; execution of land lots; construction of underground accessways to a shopping centre.
- The accords do not bind the administration in the exercise of its planning powers, given that said powers cannot be disposed of by contract[32]. In theory, there is nothing to prevent the administration from approving a decision contrary to the accord.
- They cannot act contrary to the law, so an accord containing an unlawful provision would be rendered absolutely null and void. Specifically, article 6.3 of CT 2008 prohibits town planning accords from requiring additional obligations or consideration of landowners that are more burdensome than those determined by law.
- According to the 9th Additional Provision of CT 2008, which amended Act 7/1985 of 2 April 1985 that regulated the Basic Terms of Local Government, authority to approve accords that modify the land use plans and other planning instruments provided for by urban planning legislation rests with the town council in plenum.
- The resolution approving the accord must identify the parties thereto and state the scope, subject matter and term of the accord, and must be made public after the accord is signed. In procedural terms, both regional law and case-law subject the processing, execution and performance of the accords to the principles of publicity and transparency, and, in fact, article 11.1 of CT 2008 requires the accords to be submitted to public input[33]. In some cases, such as

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payments) provided there is conformity with the legal system, the public interest and the principles of good administrative practice to achieve the best regulation possible.

[32] Supreme Court judgments of 13 February 1992, 27 October 1992 and 19 July 1994.

[33] According to article 11.1 of CT 2008: *"All territorial planning and urban planning and development instruments, including those meant to distribute benefits and burdens, and the accords that will be signed for that purpose by the administration, must be submitted to the public input procedure on the terms and with the duration laid down by law, which in no*

Andalusia, the regulations require the accords to be entered in administrative registries.

- Breach of a town planning accord may generate a right to compensation in certain cases[34].

II.1.2. Urban planning implementation

(56) Approval of the planning gives way to the management or implementation phase in which the land will be developed (urbanised) in accordance with the terms of the plan. Urbanisation is the development phase prior to building and consists in equipping land with the services and infrastructure needed to acquire status as developed lot on which construction can take place.

(57) In the Spanish land use planning system, exercise of development rights obliges landowners to fulfil a series of principal obligations. The first obligation is to carry out a fair distribution (*equidistribución*) of the benefits and burdens of the plan. This mechanism is intended to correct any "inequities" that may have been generated in the planning phase. This principle forms part of the Spanish urban planning tradition and today is set out both in regional laws and in CT 2008. In essence, fair distribution seeks to ensure that within each execution unit all landowners obtain the same net benefit, even though the plan assigns different net benefits (for example, a public park for one owner and an intensive residential zone for another) and generates inequities. The main tool used in Spanish urban planning to achieve that goal consists of redistribution techniques, which basically involve grouping together the properties existing in an execution unit[35] and generating new parcels that conform to the plan so that the

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event will be less than the minimum required in the legislation on common administrative procedure, and must be made public in the manner and with the content provided by the relevant laws".

[34] Indemnification may be sought through two avenues. First, on the basis of the administration's responsibility for modifying the planning other than as agreed in the accord. The aim here is to have the breach captured by one of the indemnification events regulated in CT 2008. Nevertheless, the restrictive nature of those events limits the possibilities of compensation being obtained with this approach considerably. In theory, according to urban planning law, indemnification would only be possible in those cases where the private party can demonstrate that he has certain vested building rights, and not just mere expectations. Second, a claim could be based on the administration's contractual liability for breach of the town planning accord. This approach is more likely to be successful. In this case, the indemnification would arise from the administration's contractual liability. The action allowable in this situation would be for rescission of the contract, with a claim demanding that the administration either perform the accord or, if that is not possible, that it pay damages.

[35] Not all of the plan is executed simultaneously; development is done by parts. On developable land, execution is done by means of execution units, which are normally portions of a sector and composed of parcels.

landowners are given an identical net benefit proportional to the size of their original parcels[36].

(58) Second, in addition to carrying out the fair distribution, urban development requires that the landowners comply with the duties that the laws and regulations impose on owners when their land undergoes development. Those obligations mainly involve compulsory assignments of land[37] to the administration, payment for the projected development works and delivery of the relevant infrastructure.

(59) In order for the planning to be implemented and, hence, for the determinations contained in the planning instruments to be carried out, a number of requirements have to be met:

- First, all of the necessary plans must be duly approved.
- Second, the action must have a delimited geographical scope. The planning is implemented in territorial units called "execution units", except where implementation involves general systems or asystematic actions on urban land. The benefits (land use net benefit) and burdens (development costs, compulsory assignments of land, etc.) of the planning are distributed in the execution unit, thus complying with the duties of fair distribution, assignment and urbanisation. The execution unit may be delimited in one of two ways: a) by the authority that approves the planning, with the delimitation set out in the land use planning instrument; b) by modifying the delimitation of the execution units envisaged in the planning by means of a specific procedure (delimitation procedure).

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[36] This principle can be illustrated by one very simple example. Suppose that an execution unit has three plots: X, Y, Z. All three have been zoned for residential use, but X will contain gardens, Y streets and Z will only have homes. Each plot will therefore have a different net benefit. The plots affected by the plan are reparcelled so that all of them will bear the burdens of development (streets, gardens, etc.) and ownership is redistributed through the allocation of new plots. With the new allocation, the landowners will have the same net benefit.

[37] According to article 16 of CT 2008, the compulsory assignment duties are to: a) hand over to the competent administration land reserved for roads, free zones, green areas and other public-purpose lots included within the action or assigned to it for acquisition, and, in certain events, the land which the planning instrument assigns to public-purpose housing under a protective scheme; b) hand over to the competent administration, in order for it to become public domain land, land that is free of urban development burdens with the same weighted average building rights percentage as the development action (or as such higher framework of reference as may include that action) provided in the legislation regulating territorial and urban planning. In general terms, the percentage cannot be less than 5%, nor higher than 15%. Territorial and urban planning legislation may by way of exception allow a proportionate and reasoned decrease or increase of this percentage, up to a maximum of 20% in certain circumstances. It is also provided that land use and urban planning legislation may determine the cases and conditions in which delivery of land may be replaced by other forms of performing this duty.

- Third, the type of action that will be used to implement the planning must be selected. The traditional systems provided by law are compensation, cooperation and expropriation. If the action consists of executing systems or public-purpose uses, the system used is expropriation or direct occupation. The choice between the different systems is made by the administration.

  Most regions have based their system of action, to a greater or lesser extent, on the traditional national legislation. In some cases, regional governments have confined themselves to the traditional system without including others. In other cases, Autonomous Communities have added variations and innovations[38] to the traditional systems since 1956 or an alternative system —called urban development agent (*agente urbanizador*)— in which an agent, who need not be a landowner, carries out the development of one or more execution units[39]. And in some cases the development agent system is subsidiary, that is, it is used when landowner initiative fails to carry out the development works to urbanise the land.

  In any event, note that at present the Valencian Community and Castilla la Mancha diverge substantially from the general models seen in other regions, as they apply a model in which public management (be it direct or through a development agent) is the only means for implementing planning.

- Fourth, the timeframe for implementation must be set out and respected. That timeframe is indicated in the planning instruments themselves or in the urban planning legislation.

(60) There are two fundamental stages in the implementation phase: legal execution and material execution. The purpose of legal execution is to resolve the inequities generated in the planning phase. In the case of the development systems mentioned above, the main legal instrument used in the implementation phase would be the compensation project (compensation system), the reparcelling project (cooperation system) and the expropriation project (expropriation system)[40]. Material execution is when the parcels are transformed into buildable lots, whether immediately

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[38] Notable amongst the innovations present in some regions are compulsory execution systems and the "concerted" system (*sistema de concierto*). Arrangements similar to the urban development agent model in the Valencian Community and Castilla-La Mancha are the corporate execution system (*sistema de ejecución empresarial*) and the competitive system (*sistema de concurrencia*) in place, for example, in the Canary Islands and Castilla y León respectively.

[39] The characteristics of the main systems of development action are described in more detail in Annex.

[40] In the urban development agent system, there are reparcelling, compulsory reparcelling and, in certain cases, expropriation projects.

after the urban development ends or sometime thereafter, within the stipulated timeframe. Carrying out the material execution requires filing an urbanisation project or an ordinary works project.

(61) Once the legal and material execution phase have been completed satisfactorily, the landowner is entitled to build, as long as he does so in due time and in accordance with the conditions provided in the planning instruments and in the applicable laws and regulations.

II.1.3. Control of development

(62) The third phase of the urban development process focuses on the control of development. Once the planning phase has defined what the city should be like and those plans have been implemented in the development implementation phase, the public authorities, especially town councils, must make sure that the different forms of land use are consistent with the planning determinations.

(63) Administrative intervention in this phase addresses different areas:

- First, there is preventive control, which consists in making certain actions subject to prior mandatory municipal licensing. Urban development licences are regulated municipal authorisations that allow works to be executed or land to be used according to the provisions of the relevant planning instruments. The technique is based on monitoring construction and other land uses to ensure legal and planning compliance.
- Second, there is ex post control. Once the licensee has executed the works, he is subject to the planning duties established by law[41].
- The third type of control addresses situations referred to as 'legalisable' and enforcement of urban planning law, through a series of measures which, though not part of the sanctioning rules per se, are intended to restore urban planning legality. This technique is applied to different types of building activity[42]. The measures adopted have to conform to the principle of proportionality and may consist, for example, in the suspension of actions that quality as land use, licensed or unlicensed, or in demolition where the unlawful nature of the works is evident.

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[41] Inter alia: consistency between use of the land and urban planning instruments; adequate maintenance in safe and healthy conditions; or compliance with rules on environmental protection, heritage and urban rehabilitation.

[42] Inter alia: unlicensed building works in progress; completed building works that do not conform to the licence; construction under an unlawful licence; completed building works covered by an unlawful licence; illicit building works on land zoned as green area, free zones or protected non-developable.

- Fourth, there is control against the commission of urban planning irregularities that justify application of the sanctioning powers of public authorities, which are confined to levying fines on the persons liable for an illicit act that qualifies as an infringement of urban planning law.

II.1.4. Instruments of intervention in the land market

(64) Public authorities intervene directly in the land market using a series of instruments that are regulated in national and/or regional laws. The three main instruments are: Public Landholdings (*Patrimonios Públicos de Suelo* or PPS), surface rights (*derechos de superficie*) and rights of first refusal and redemption (*derechos de tanteo y retracto*).

(65) According to article 38.1 of CT de 2008, PPS are composed of properties, resources and rights acquired by the administration by virtue of compulsory assignments in urban development actions (article 16.1.b) of CT 2008), in addition to others that may be determined by land use and urban planning legislation.

(66) There are different categories of PPS. First, there are State public landholdings, the regulation of which rests with the national government. Second, there are supra-municipal public landholdings, title to which may be held by an Autonomous Community or by a supra-municipal entity and which are regulated in the regional laws. Third, there are municipal public landholdings, regulated both at the national and regional level.

(67) Municipal landholdings constitute a separate type of asset of local corporations, consisting mainly of land of whatever classification. According to CT 2008 their purpose is to: (i) regulate the land market, (ii) obtain reserves of land for public initiative actions and (iii) facilitate the implementation of territorial and urban planning. Supra-municipal landholdings have a similar rationale, although they normally go beyond town planning objectives and also pursue regional goals in the land use planning and environmental areas. One crucial point that bears emphasis again is that the objectives and final purpose of the PPS (housing subject to some sort of public protection rules or other uses of social interest) are specifically itemised and regulated in the applicable laws, which means their use is rule-based.

(68) Surface rights, for their part, entitle their holder (the 'superficiary') to build on the surface and above and below-ground of a property owned by another and maintain temporary ownership of the constructions or buildings. Such rights, in turn, may also be constituted over constructions or buildings that already exist or over homes, premises or privately owned elements of constructions or buildings, attributing temporary ownership over the same to the holder of the surface rights.

(69) Lastly, the rights of first refusal and redemption are preferential acquisition in rem rights that operate to limit property rights. They imply the possibility of acquiring a given property if the current owner decides to sell it (right of first refusal) or if the owner has already sold it (right of redemption). Both imply preference in acquisition; the first aims to block a sale before it is consummated, while the second is used to unwind a sale that has already been made. This instrument gives town planning authorities the capacity to define on any class of land zones in which transfers of land and buildings will be subject to said rights and hence to their intervention.

(70) Regional town planning laws regulate the possibility of these rights being exercised by the regional and municipal administration and require landowners included in an area of first refusal or redemption to notify the competent planning authority of all sales involving any of their properties in that area.

II.2. Economic characterisation

(71) The physical properties of any good are fundamental factors for its production and distribution, as well as for the nature of its consumption and for its end value. The economic characteristics of land are determined in part by its physical characteristics, those that make it immovable property by nature.

(72) Land is, first of all, a scarce and non-renewable resource. Second, land is locationally immobile, it cannot be relocated and can only be used where it is found. Third, land is heterogeneous, mainly because no parcel is located identically with respect to the others, in addition to their differentiation by surface, size, features and attributes of adjoining parcels. Thus, not all plots are substitutable from the standpoint of demand. Fourth, land is a durable good that is useful over time. Fifth, land is a repository of value, primarily as a financial asset both for households and for businesses. Sixth, land, as a factor of production, provides a derivative utility that depends on the end use for which it is destined. Lastly, land is at the same time a factor of production that is generally non-substitutable in other economic activities and a final consumer good, mainly for recreational-environmental uses.

(73) These characteristics make land highly unique as an economic good and have important implications for the functioning of the marketplace. Specifically, land's immobile and heterogeneous nature contribute to a spatial segmentation of the market, favour the persistence of market disequilibriums and can generate monopolistic positions in certain circumstances.

II.2.1. Importance of land in the economy: basic data

(74) Land is a fundamental factor of production in the economy; almost all sectors of the economy need land, from homebuilding to other manufacturing and service activities. It is also a very important financial asset for households, businesses and government administrations. Furthermore, land is a non-substitutable factor in housing construction. Apart from its notable social implications, it is crucial to the economy in that it is a key element in the wealth of households and thus has major bearing on consumer spending and savings habits and even on employment decisions.

(75) According to data from Spain's Ministry of Public Works and Infrastructure (Ministerio de Fomento), in 2012 the total value of land transactions amounted to approximately 2.6 billion euros, around 0.2% of GDP[43]. It should be noted that recent years have seen a historic drop in prices and volumes in the land market, so the total value of land transactions and their relative weight in GDP have decreased considerably in comparison with the upside of the cycle. In 2004 land transactions totalled 23.0 billion euros, or 2.7% of GDP for that year.

(76) Land is at the same time a major component in housing prices. In 2009, land values represented 45% of the total value of the nation's housing stock[44]. As in the previous case, that relative weight varies over the length of the cycle. In 2000, for example, it stood at 27% and then rose to 46% in 2007.

(77) Lastly, land has considerable importance in the financial sector. According to the Ministry of Economy and Competitiveness[45], in 2011 financial sector assets in respect of loans to developers for land or developments in progress amounted to 132 billion euros.

II.2.2. Market failures in the land sector

(78) From the standpoint of economic efficiency, public intervention may be justified inasmuch as the market is incapable of achieving an optimum allocation on its own. This may occur in the face of “market failures”, when government intervention capable of correcting these failures may enhance

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[43] The ratio of land transactions to GDP is calculated solely as a reference for their weight in the economy.

[44] The value of capital stock in housing is the sum of the value of residential capital stock (construction and overhang) and the value of land capital stock. The estimates of housing and land capital stock come from Uriel Jiménez and Albert Pérez (2012).

[45] *Reforma del Sector Financiero*, document published by the Ministry of Economy and Competitiveness, May 2012. www.lamoncloa.gob.es/nr/rdonlyres/00ca8858-b343-4c20-a7e0-5f543b429f33/203036/20120511presentacionreformafinancieramayo2.pdf

social welfare. The main market failures in the land market arise from the existence of externalities and of public goods[46], from problems of imperfect information, and from market power generated by certain economic characteristics of land (mainly its heterogeneity and immobility).

(79) Public intervention in the land market may also pursue other interests, perhaps legitimate, that do not involve correcting market failures. But since that intervention is capable of generating distortions in allocative efficiency and diminishing overall welfare, it is highly recommendable that public authorities carry out a strict analysis of the advisability of such measures[47] applying the threefold test of necessity (to what extent does the interest to be safeguarded justify imposing a constraint on efficiency), proportionality (do the benefits outweigh the harmful effects of the restriction and, if so, are there other means of achieving the same objectives that are less detrimental to efficiency) and non-discrimination. Public authorities should likewise act according to the principles of effectiveness, transparency and predictability.

(80) There follows a succinct description of the main market failures in relation to land.

II.2.2.1 Externalities

(81) The term externality refers to a situation in which the action of an agent has an uncompensated impact on the welfare of another. An externality may be positive (if the impact is beneficial) or negative (if it is detrimental). In such conditions, each agent acts without taking into account the impact of its actions on other agents, and market prices therefore do not reflect the genuine social benefit or cost. This generates inefficiencies and the social welfare is not maximised.

(82) One basic characteristic of land is that land lots have a fixed specific location, so their value is to a great extent determined by the characteristics and use of the surrounding zones. That is why the land market tends to generate externalities[48].

(83) Some concrete sources of externalities are:

- Generation of waste and pollution: Certain activities can generate external effects on others, in terms of environmental, noise, light or

[46] Public goods, the systematisation of which began with Samuelson (1954), are characterised by being non-rivalrous for consumers and non-excludable in prices. Subsection II.2.2.2 provides a more in depth analysis of their characteristics and importance in the land market.

[47] See Comisión Nacional de la Competencia (2008), *Recommendations to Public Authorities for More Efficient and Pro-Competitive Market Regulation*.

[48] See, for example, Brueckner (2011), Chesire and Vermoulen (2009), Mills and Hamilton (1994), OECD (1992), or World Bank (1983).

other types of pollution. A classic example is a factory that gives off noxious fumes and imposes an external cost on the surrounding area. If the factory does not internalise that cost, the ultimate situation reached will not be efficient (too much pollution will be generated). In these circumstances, government action may encourage a more efficient allocation by causing external costs to be internalised (in this example, by requiring the polluting company to bear the costs of the pollution).

- Increase in total infrastructure and service costs as a result of new urbanisation. The natural growth of cities generates certain externalities that can foster a tendency toward geographic overreach or disorderly expansion. The advance of urbanisation requires construction, for example, of new roadways and sewage systems, as well as schools, parks and other types of facilities. New urbanisation will increase spending on services such as policy, cleaning and trash collection. If the increased expenditure on services and infrastructure is not wholly borne by the developers, there will be incentive for over-expansion of the city.

  For example, the cost of much urban infrastructure depends to a great extent on the geographic size of the network (public lighting, roads, etc.) and much less on the density of the population that uses those services. So the more densely populated areas can achieve greater economies of scale in those services. In this situation, the development of new areas may increase the average cost of providing services to the entire city if the population density of the new zones is less than for the city as a whole. If the cost is not paid incrementally and is paid by reference to average expense, the new development will be less than optimally priced because the price will not reflect the total cost of infrastructure and services. Consequently, urban development would be artificially cheap (as it does not price in the cost of the "budgetary" externality of the new development), thereby favouring inefficient growth of the city.

- Reduction of open areas implicit in urbanisation. The existence of such areas is useful for society. As urbanisation advances, it consumes previously undeveloped land and generates a social cost in terms of loss of open spaces. Since the market will not on its own internalise that cost, a negative externality arises, and an inefficient situation prevails (too much open land areas are consumed) and the city acquires a geographical size in excess of what is socially optimal.

- Greater congestion in transport infrastructure and other public infrastructure. This gives rise to an externality because the presence of an additional user of transport infrastructure will slow traffic for the rest of the users and increase their commuting time. Although the

loss suffered by each user is minor, the aggregate cost borne by all users has a sizeable overall impact. Given that most of the cost falls to the rest of the users, no individual users have an incentive to take those costs into account in their decision-making process. The result is that private cost of transport does not reflect the overall cost, giving rise to an inefficient situation (too much traffic) and to a greater than optimally sized city[49]. Similar situations of congestion may occur in other public infrastructure and services, such as parks or the trash collection system, in which enjoyment by additional individuals leads to inefficient congestion of the service and thus harms all individuals, including the new users.

II.2.2.2 Public goods

(84) A second market failure in the land market is the existence of public goods. Although goods of this type provide society with a net benefit, the system of relative prices that characterises the natural operation of the market does not provide them optimally. Public goods have two main features. First, they are non-rivalrous for consumers: their consumption by one agent does not reduce their consumption by another, so consumers do not have an incentive to pay or to reveal their preferences for these goods. Second, public goods are non-excludable in price: the pricing system cannot be used to exclude certain agents from consuming them. The market will therefore not provide the public good in question or do so only insufficiently. Although in the real world there are not many cases of pure public goods (clean air, noise-free environment, etc.), there are many goods that exhibit some of their characteristics (impure public goods).

(85) There are several examples in the land market: many of the infrastructures, facilities and services needed for urban development, such as parks and gardens, water supply, sewage and drainage systems and roadways, to cite a few. At the same time, there are services which generate positive externalities and require a cooperative solution amongst landowners, such as maintaining or upgrading common infrastructures. The presence of strong externalities in land and in the activities that use land can lead to “coordination failures” that give rise to suboptimal

[49] In the basic model of urban spatial structure in urban economics, the city's limits mainly depend on four factors: income, population, transport cots and the opportunity cost of urban land in terms of non-urban uses. An increase in transport costs makes it relatively more expensive to live in areas further away from downtown, prompting individuals to move to relatively closer zones, with the consequent tendency for the city to “shrink”. A situation in which the congestion externality is not internalised implies lower transport costs than a situation in which the externality is internalised. Therefore, the geographic size of the city will be greater in the former case than in the latter. See, for example, Brueckner (2011) or Mills and Hamilton (1994).

equilibria. For example, a given urban area may be gradually degraded because all individuals that inhabit it expect that the zone will deteriorate in the future; or the opposite may occur, that expectations for a zone's future improvement encourages investment there and makes those expectations self-fulfilling. In this situation, public intervention can contribute to achieving the best of the possible equilibria by implementing policies to restore degraded buildings or investing in key infrastructure to contribute to luring further investment.

(86) In such situations public intervention can enhance market efficiency, directly correcting the allocation of public goods or establishing mechanisms that reveal individual preferences so that public goods can be properly allocated.

II.2.2.3 Information problems

(87) Thirdly, the land market is affected by information problems. Buyers, on the one hand, do not have complete information on the characteristics of the land or on its ownership, and this can generate inefficiencies in the decision-making process. For example, a company looking for a suitable site for a business may run into difficulties in obtaining a list of possible locations that meet its requirements.

(88) On the other hands, the permanent nature of land gives rise to a significant flow of income and costs that is highly dependent on the economic environment. That is why an incorrect decision can be much more costly in the land market than in other markets. Stable planning, for example, can have a positive effect by reducing the risk associated with uncertainty regarding future development (for example, the value of a home next to a wooded area will be greater the planning instruments credibly preserve the woods in the future).

(89) Lastly, in relation to financing development projects, the existence of information asymmetries and uncertainty may generate inefficiencies in the allocation of credit and prevent loans from being granted using properties in certain specific areas as collateral.

II.2.2.4 Market power

(90) The heterogeneity and locational immobility of land can in certain situations favour the existence of market power. The successful completion of many urban development and construction projects, such as railroad infrastructure or major private sector projects, require consolidating many plots owned by different parties. For example, an incomplete railway will have no value unless it is completed, so owners of land where the railway is planned will wield greater market power and be encouraged to withhold their plots.

II.2.3. Costs of intervention

(91) According to economic theory there are a number of factors that can also give rise to failures in the action of urban planners (a role which is in fact played by public authorities), so it is proper that said action be submitted to a rigorous cost-benefit examination. Some restrictions or difficulties faced by planners and which can contribute to rendering their intervention inefficient are described below:

- First, like the market, planners must confront information problems. One type consists of problems in identifying social preferences. Another involves difficulties assessing the costs and benefits generated by a specific planning policy. Public decisions are therefore not always efficient.
- Second, land use intervention can pursue several objectives that possibly conflict with each other. Spanish urban planning, thus, is characterised by pursuing, inter alia, objectives of efficiency, environmental conservation and social equity. The difficulty of determining the priority and relative weight of those objectives tends to complicate the valuation and acceptance of trade-offs between them and, in short, the right design of planning policy and its proper evaluation.
- Third, land use interventions may be inconsistent over time, generating uncertainty and unpredictability and thus making it harder for agents to make efficient decisions. As a result, even greater distortions may be introduced in the land market.
- Fourth, land use interventions can create or reinforce situations of market power. If the result of planning policy is to constrain the supply of land and curb competition in the market, landowners will wield greater market power than in an intervention-free scenario.
- Fifth, the effect that land use intervention usually has on land prices facilitates the appearance of regulatory capture and rent-seeking, which influence decision-making and can distort the instruments used and even prevent the public interest from being the criterion that guides the design of the town planning intervention.
- Sixth, administrative intervention is limited by regulatory restrictions that can slow the administration's response to changing market conditions and thus produce supply-side rigidities in the land market that drive prices upward.

(92) Economics literature has analysed both the theoretical and empirical aspects of the economic effects of land use interventions[50], and underscores that the land market is complex in nature and that planning intervention can generate negative effects not anticipated by planners.

(93) Economic theory points out several costs that may arise from faulty intervention:

- First, the main forms of intervention tend to curb the supply of land or its use and thus raise the price of real estate (residential, commercial, industrial) in urban areas.
- Second, restriction of land uses can reduce competition in many sectors of the economy. By diminishing the available area, such restrictions may decrease entry by new operators or prevent them from competing with the necessary intensity.
- Third, government intervention may decrease business productivity directly: for one, if it causes real estate prices to go up (in the tertiary or industrial sectors) or limits the number and size of possible business sites so as to prevent the optimum production scale from being achieved; also, if it causes an excessive decrease in employment density, economies of agglomeration may be affected negatively, and productivity may suffer as a result.
- Fourth, insofar as it limits the available amount of land or slows down its transformation or adaptation, intervention reduces the supply-side elasticity of land and real estate, which means that in the long term increases in demand for land will drive prices up faster. Short term, where supply is more rigid, variations in the demand for land and housing are less responsive to price changes, so that a more restrictive regulation may accentuate price volatility in respect to demand-side shocks and is more likely to generate speculative bubbles in the land and housing market.
- Fifth, intervention may reduce the amount of available land, which facilitates the emergence of market power on the supply-side and encourages speculative behaviours by suppliers, driving prices higher.
- Sixth, by reducing elasticity of supply in numerous markets, land use regulation can also curb labour mobility by limiting the responsiveness of land supply in regions that are more attractive in

[50] The theoretical analysis has studied the principal forms of intervention which exist to a greater or lesser degree in different countries. The main ones include limits on the municipal territory that can be urbanised (urban growth boundaries), zoning, minimum lot sizes, and the regulations and administrative timeframe that govern the urbanisation process. See, for example, Brueckner (2011), Chesire (2009) or Brueckner (2009).

terms of employability, thereby hindering the entry of workers and creation of employment in those areas[51].

- Seventh, if supply is relatively more rigid in the more productive regions or cities of a country, this will also hinder entry and shift growth toward relatively less productive areas[52], thereby reducing the overall productivity of the economy.

(94) The economic literature provides evidence on the expected costs that can result according to theory[53]. Note that the costs generated by intervention may outweigh the benefits sought by intervention, resulting in a net welfare loss for society in comparison with a situation without the intervention. In relation to the net impact on welfare, that is, to the existence of an eventual net cost of the intervention, empirical analyses are not as abundant, although there is one that indicates an overall negative impact. A study conducted for the city of Reading in the United Kingdom[54] concluded that the urban boundary (the limit on where urbanisation may reach) was overly restrictive and generated a net welfare loss to citizens quantified at 3.9% of annual household income. According to the authors, shifting the urban boundary outwards would lead to an overall enhancement of total welfare.

II.2.4. Land supply and demand

(95) The real supply of land is the supply of developed land, that is, the supply of buildable lots. As predicted by economic theory, in the land market short-term supply is relatively unresponsive, whereas in the long term its elasticity, though low, is greater. The main reason is that production of

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51 OECD (2011).

52 Glaeser, Gyourko and Saks (2006).

53 Recent articles that provide evidence of the impact on land and housing prices are Ihlanfeldt (2007) and Glaeser, Gyourko and Saks (2005), both centred on the United States. For their part, Malpezzi, Green and Mayo (2005) for the United States, and Caldera Sánchez and Johansson (2011) for different OECD countries, concluded that land use regulation reduces the elasticity of housing supply. In addition, Andrews (2010) and Catte, Girouard, Price and André (2004) for different OECD countries or, for example, Huang and Tang (2010) and Glaeser (2006) for the United States, give evidence indicating that greater supplyside rigidity in the housing market tends to increase price volatility there. In relation to the impact on business productivity, Chesire, Hilber and Kaplanis (2011) estimate that since 1980 urban planning has reduced by 25% the total factor productivity of the British supermarket chain for which they made their estimates, mainly because the planning increased the cost of retail space, reduced the average size of outlets and sited outlets in areas that were not very attractive commercially. The authors argue that the results may be extrapolated to the supermarket sector as a whole.

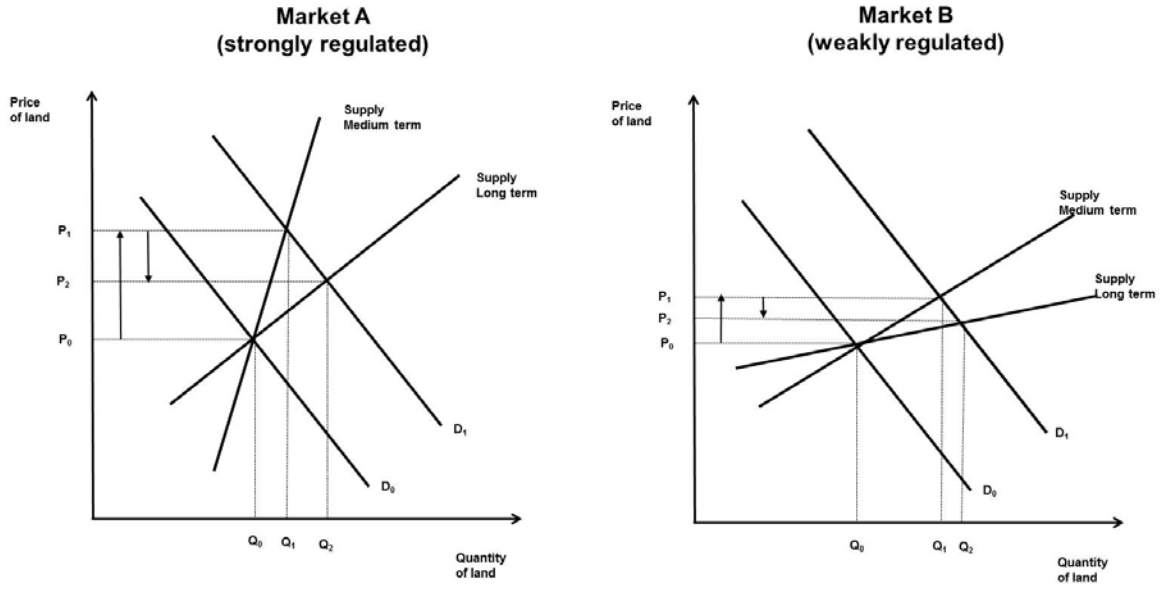
54 Chesire and Sheppard (2004).

land is very time consuming, even if there were no restrictions in the market's regulation that hinder urbanisation.

(96) Urban development of land takes in, amongst other elements, the acquisition of parcels, development of the area and construction of infrastructure. As a result, in the near to medium term, a rise in demand has to be met using buildable lots that are vacant or by means of improvements in parcels that are not completely suitable but which only require limited development actions to be converted into buildable lots. The supply-side response will therefore be more limited than in a long-term scenarios, and prices will rise. Over the long term, the market reacts progressively, adjusting the quantities offered to the sustained change in demand, which, in theory, should decrease prices from their short/medium-term levels and bring them into line with the cost of production of developed land.

(97) Supply responsiveness depends on a number of factors, including costs of negotiating and of searching for parcels, the level of uncertainty, access to lending and the actual availability of land. One additional factor that is crucial to supply-side behaviour is the intensity of land use regulation, as this affects both the quantity of land that can be developed and the time and monetary cost of developing it. Very restrictive regulation that limits the amount of land that can be developed or that hinders its development will increase the slope of the land supply curve, making supply more inelastic in comparison with an unregulated or less restrictively regulated scenario. Given its impact on elasticity, regulation can affect the evolution of prices and their volatility in the long term. A more intensely regulated market will respond to demand increases with higher prices and greater volatility. To illustrate these effects, Figure 1 depicts a simple comparative static analysis for two land markets differentiated by the intensity of their land use regulation.

Figure 1. Effects of regulation on land supply elasticity in two markets with different intensity of land use regulation



Source: Prepared in-house

(98) Market A is characterised by a restrictive regulation that limits the quantity of land and hinders its development, for example, by requiring a myriad of administrative formalities stretched out in time. The result is a relatively inelastic supply. In response to an upward demand shock (rising from D_0 to D_1), land supply rises little in the near to medium term, and the consequent adjustment is primarily through prices (from P_0 to P_1). In the long term, when supply is more elastic, the response will be more intense. The price falls from P_1 to P_2. Conversely, in market B, where regulation is not as restrictive and supply price elasticity is greater, increased demand will have a smaller impact on prices. Therefore, markets subject to regulations that introduce more supply rigidities exacerbate the fluctuations of the real estate cycle to generate bigger price shocks and greater volatility. And, as pointed out in the economic literature, they also increase the likelihood of speculative bubbles emerging, with effects that go beyond the microeconomic sphere, and the duration of such bubbles. In short, land supply rigidity contributes to greater macroeconomic instability.

(99) Demand for land is composed of two main segments: public administrations and real estate developers[55]. Government demands land for different reasons, including construction of infrastructure, public buildings, parks and schools. Public authorities often obtain land by means

[55] San Martín Varó (1996).

of non-market mechanisms, through compulsory assignments by landowners in connection with development projects or by means of expropriations (a clear case in which this avenue is used is infrastructure construction). Real estate development companies, on the other hand, obtain land in the market and their demand is tied to the demand for real estate, which consists of several different categories: housing, industrial land, offices and commercial premises. There is also a demand for investment properties, closely tied to possible tax incentives as well as to the prospects for future housing prices versus other property or financial assets.

(100) In quantitative terms, demand for housing is the most important. In the short term, it is affected by the prevailing conditions, such as ease of borrowing in the economy, tax treatment of housing and the jobless rate. Over the long run, the pace of formation of households and the real income trend are the key drivers. For its part, demand for office and industrial space and commercial outlets is mainly driven by current economic conditions and, to a lesser extent, by long-term changes in economic structure and by economic regulation itself.

(101) Demand for land is a derivative of the demand for housing and for other types of real estate. Therefore, like any other derivative factor of production, land prices are tied to real estate prices insofar as demand for land will offer, as maximum, the difference between what it costs to develop land and the expected market value of the real estate that can be built on it. In the near term, since supply is inelastic and hence relatively unresponsive, the price of land is mainly determined by the demand for goods that use land as a factor of production. Nevertheless, in the medium and long term, the way land supply reacts to demand is fundamental for determining the equilibrium price. As can be gathered from the preceding analysis, the effects of regulation on elasticity play a crucial role in determining the market equilibrium price.

III. INDICATORS OF THE LAND MARKET'S OPERATION IN SPAIN

(102) This section includes a description of certain indicators of the land sector in Spain. These indicators point to the existence of inefficiencies in the market, although it should be taken into account that these are aggregate indicators that the CNC has evaluated on a preliminary basis for this discussion paper.

III.1. Spain's housing supply is relatively unresponsive to long term prices in comparison with other OECD countries

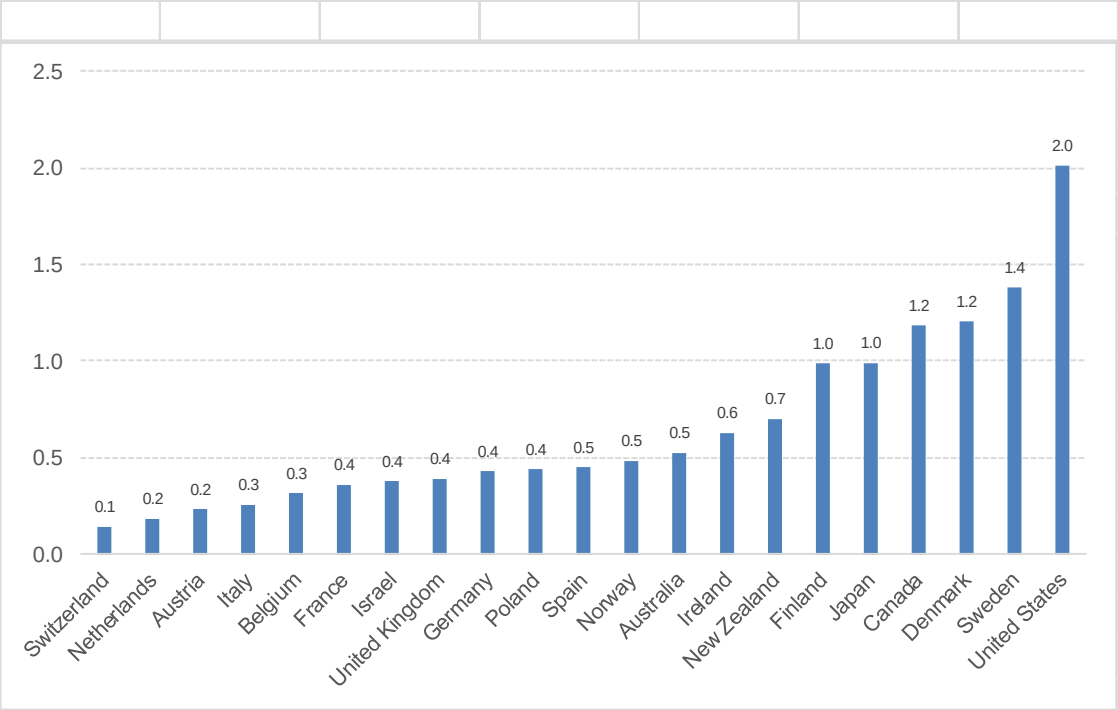
(103) Housing supply is determined by various factors, including land supply elasticity and the degree of substitutability between land and other factors of production used in homebuilding. The elasticity of land supply plays a key role, as has been underscored by the relevant economic literature. Accordingly, the long-term elasticity of housing supply is used as a 'proxy' for the long-term elasticity of land supply.

(104) Housing supply elasticity measures the extent to which increases in demand (which may be caused by improved economic prospects, easier borrowing conditions or population increases) translate into a rise in price or into greater quantities. In other words, it measures how supply responds to changes in demand. Where elasticity is relatively high, supply will respond to a greater extent to increases in demand, and prices will tend to rise less than if supply were inelastic. Elastic supply is vitally important for avoiding bottlenecks in the market, reducing volatility and achieving a more stable macroeconomic environment.

(105) Over the long term, a responsive supply is desirable, insofar as it allows better adaptation to changes in market conditions. According to the OECD, long-term housing supply elasticity is relatively high in North America and in some Nordic countries, whereas countries in continental Europe and the United Kingdom the elasticity is relatively lower (Graph 1). As can be seen in the graph, the elasticity of long-term supply in Spain is less than one[56] and is more inelastic than in many other countries.

[56] Long-term price elasticity equal to one means that a price increase of 10% will generate a 10% increase in the quantity of homes offered. In the case of Spain, which has elasticity of 0.5, a long-term increase in prices of 10% will only bring about a 5% expansion of the number of homes offered.

Graph 1. Long-run elasticity of housing supply in a selection of OECD countries



Note: estimates of the long-run price-elasticity of new housing supply

Source: OECD (2011).

III.2 Spain is one of the OECD countries in which real housing prices have risen the most in recent decades

(106) According to what economic theory predicts, lower elasticity tends to increase the medium to long-run growth rate of prices. According to data from the OECD, Spain is one of the OECD countries in which housing prices have risen the most since 1980 (Table 1). In addition, and likewise according to OECD data, Spain ranks amongst the five countries with the highest volatility in the housing price growth rate from 1997 and 2011.

(107) Prices in the land and housing market are affected by the play of supply and demand. The growth recorded in housing prices in the last three decades in Spain and in other countries was driven both by demand-side factors (such as rising real incomes, lower interest rates and expectations of continued increases) and by supply-side variables, which are affected by structural and regulatory conditions. What economic theory underscores and empirical evidence illustrates is that in the face of demand increases driven by different elements, the supply-side factors are

important to price behaviour and to the final equilibrium attained by the market[57].

(108) In this regard, the price behaviour observed in Spain may be due to a relatively larger and more changing demand than in other countries. But it appears that land supply has also played a key role in these trends, as has been underscored by some institutions. The OECD has called attention to the impact of supply rigidity in the evolution of prices in Spain on several occasions[58]. Other institutions have also analysed the trend in Spanish housing prices, underscoring the relative inelasticity of supply. The International Monetary Fund (IMF) has emphasised the importance of supply rigidity as a factor driving land and housing prices in Spain in the period from 1999 to 2007, in which housing prices doubled and urban land prices grew by more than 30% in one year during that time[59]. The Bank of Spain has also focused on supply-side rigidity and its impact on the growth in housing prices in Spain's last expansive real estate cycle[60].

Table 1. Growth in real housing prices (1980* – 2008)

90% or more	20%-90%	Less than 20%
Australia	Austria	Chile
Belgium	Canada	Germany
Finland	Denmark	Hungary
Ireland	France	Israel
Netherlands	Greece	Japan
New Zealand	Italy	Korea
Norway	Slovenia	Portugal
Spain	Sweden	Switzerland
United Kingdom	United States	

** Or year closest to 1980 available.*

Source: OECD (2011).

III.3. The low relative responsiveness of housing supply in Spain does not appear to be due to the physical scarcity of land in Spain

(109) Supply may be constrained by regulatory and non-regulatory factors. For one, demographic and geographic conditions, such as actual scarcity of land, will affect the elasticity of supply negatively (Graph 2). In fact, supply elasticity tends to decrease as population density rises (proxy for actual

[57] See, for example, OECD (2011) or ECB (2003).

[58] OECD (2005) and OECD (2007).

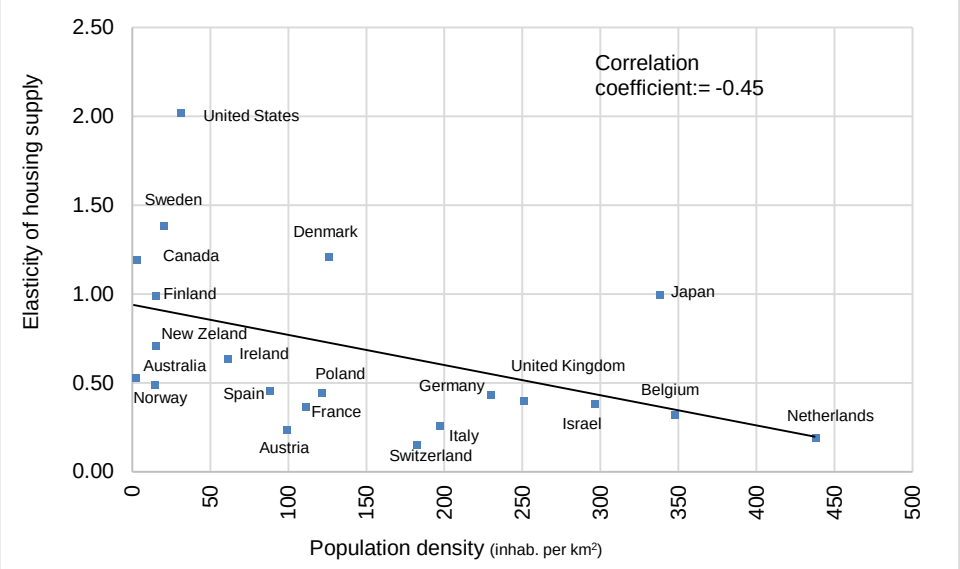
[59] IMF (2009).

[60] Bank of Spain (2002).

scarcity of land). But regulatory factors can be extremely important. Where regulation creates an artificial shortage of land or slows its urbanisation, elasticity will tend to be lower (Graph 3). Empirical studies of this issue are abundant and generally conclude that the more restrictive the urban planning intervention, the lower the elasticity of supply.

(110) In specific reference to Spain, Graph 3 shows that Spain is the country with the fifth most restrictive intervention of all the countries in the panel. For its part, and as shown in Graph 2, Spain's population density is relatively low compared to other countries in the panel, which would tend to indicate that physical land is relatively abundant in Spain. Consequently, it would appear that in the case of Spain the factor with the most influence in the low elasticity of land would be the regulatory factor. In this connection it should be noted that on several occasions, both the OECD and IMF have underscored the impact of excessive land use regulation on the supply-side rigidity observed in Spain[61].

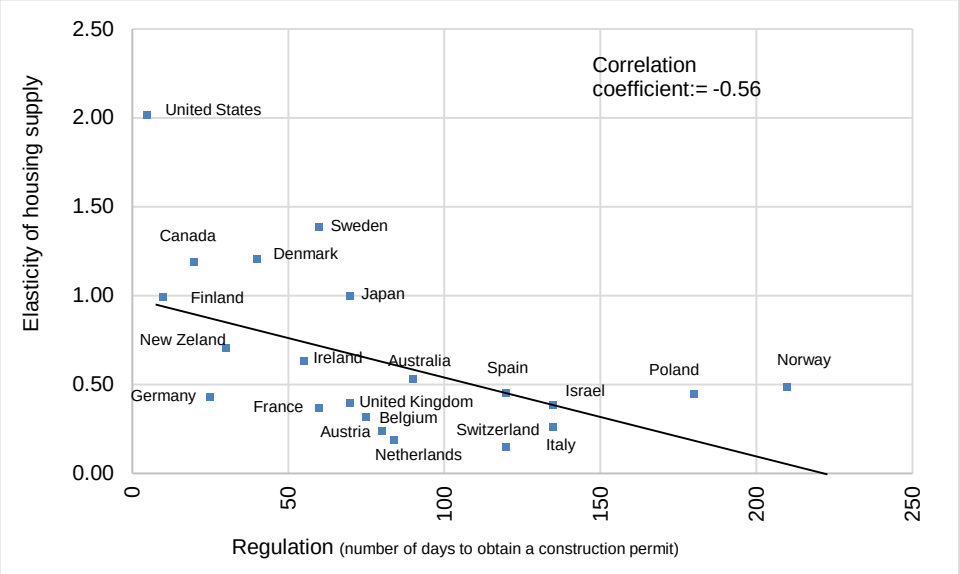
Graph 2. Responsiveness of housing supply and relative scarcity of land



Source: prepared in-house from OECD (2011).

[61] IMF (2009), OECD (2007) and OECD (2005).

Graph 3. Responsiveness of housing supply and intensity of land use regulation



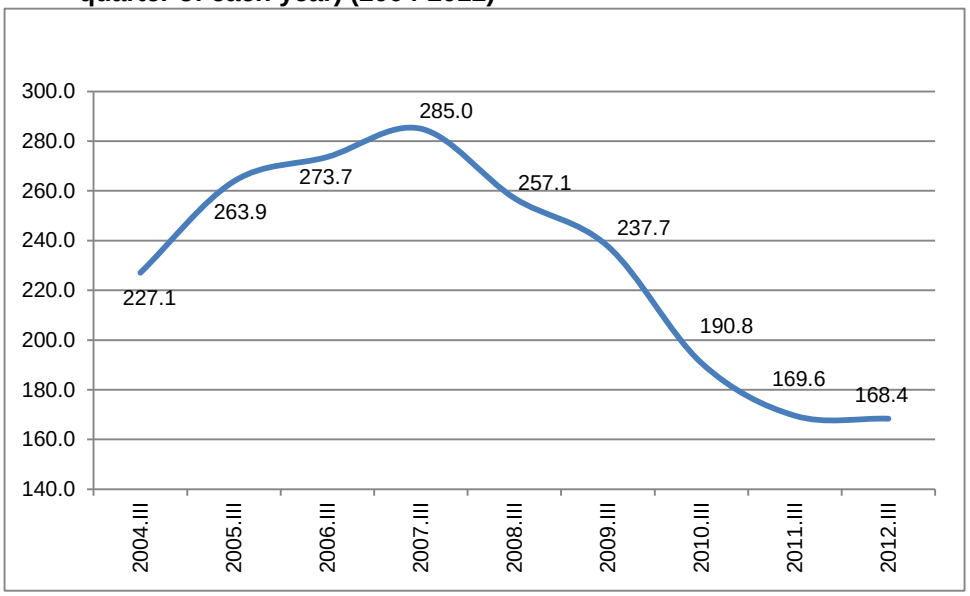
Source: prepared in-house from OECD (2011).

III.4. The land sector in Spain has recently undergone a historic downturn in which different regional dynamics can be observed

(111) According to data from the Ministry of Public Works and Infrastructure, in 2012 the total number of land transactions in Spain was 14,908 for a total value of approximately 2.6 billion euros. The average price of land was 182 euros per m^2. By region, 51% of the total number of transactions in 2012 were concentrated in Andalusia (25%), Castilla-La Mancha (14%) and Catalonia (12%). By value, the three top Autonomous Communities were: Andalusia, with 19% of the total value, Madrid (17%) and Catalonia (16%). There were significant price differences between regions. The average price per m^2 of land varies considerably, from 418 euros in Madrid or nearly 300 in the Basque Country, to 114 in Extremadura or 67 in Castilla y León.

(112) In the last few years, after the expansion recorded in the 1990s, the land market went into a historic tailspin. By reference to the maximum average price per m^2 of 285 euros reached in third quarter of 2007, the average price per m^2 of land had dropped 41% by the third quarter of 2012. In value terms, the total value of land transactions plummeted 89% from 2004, going from approximately 23.0 billion euros in that year to 2.6 billion euros in 2012. Lastly, the total value of land transactions relative to Spanish GDP narrowed from 2.3% in 2004 to 0.2% in 2012.

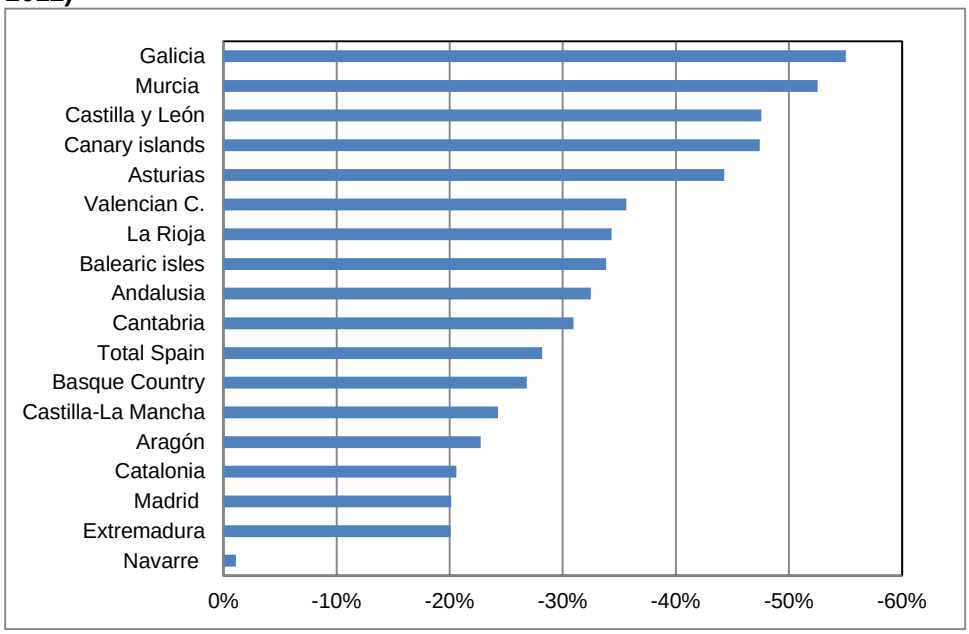
Graph 4. Average price of urban land in Spain (in € per m^2, price reading of 3rd quarter of each year) (2004-2012)



Source: prepared in-house using data from the Ministry of Public Works and Infrastructure.

(113) In this sector, recent years have seen different dynamics from one region to another in terms of activity and prices. From 2008 to 2012 the number of transactions fell more than 60% in Asturias, Cantabria, La Rioja and the Basque Country, whereas in other Autonomous Communities, like Madrid and Murcia, the drop was limited to less than 40%. And the inter-regional variability is even greater in terms of average prices (Graph 5). Between 2008 and 2012, average land prices fell more than 40% in many regions, whereas others saw declines of less than 30%.

Graph 5. Changes in average price per m^2 of urban land by Autonomous Community (2008-2012)



Source: prepared in-house using data from the Ministry of Public Works and Infrastructure.

IV. REGULATORY FACTORS THAT CONSTRAIN COMPETITION

(114) Our analysis has underscored the theoretical and empirical importance of regulatory intensity in the functioning of the land market and shows that, in Spain, the relative rigidity of supply stems from a comparatively restrictive regulation.

(115) This section analyses certain characteristic instruments of land use intervention in Spain in order to pinpoint possible factors that may be contributing to generating the observed supply-side rigidity. This exercise first examines the administrative delimitation of the land that can be urbanised and of how it must be urbanised. Attention is then focused on the complexity, discretionary nature and lack of consistency of planning intervention. The third area of attention is transaction costs and rigidity in the urban planning and development process. Lastly, this analysis takes up direct intervention by public authorities in the land market, in particular, through what are known as Public Landholdings (*Patrimonios Públicos de Suelo* or PPS).

(116) In line with the *Recommendations to Public Authorities for More Efficient and Pro-Competitive Market Regulation* approved by the CNC in 2009, for each of the elements analysed the following aspects are examined: the main characteristics of the intervention, justification of the instrument used in terms of the market failures it seeks or has the potential to resolve, competition problems that may be generated by the current application of the instrument and, if applicable, possible alternatives that cause less distortion to market competition are discussed. The same as regulation of other sectors, land use regulation must conform to the principles of better regulation and, specifically, to the principles of necessity, proportionality, least distortion, effectiveness and transparency.

IV.1. Administrative delimitation of the land that can be urbanised and of how it must be urbanised

(117) Spanish town planning is characterised by detailed planning of the land that is developable, of how it is to be developed and of when it should be developed.

IV.1.1. Delimitation of the land that can be developed: urban boundary

(118) Through the classification technique, Spanish urban planning establishes a “system of urban boundaries” aimed at defining the land which can be urbanised and excluding part of the territory from the urban development process. Three boundaries may be considered. First, there is a boundary

between non-developable land (non-urbanisable) and developable land (urbanisable); this is the fundamental urban boundary. Second there is the boundary between delimited developable land and non-delimited developable land. The third boundary is between urban (developed) land and urbanisable (developable land).

(119) When deciding what land to urbanise, the fundamental factors are the classification established in the General Plan and the conduct of the planner in relation to approval of Sectorisation Plans (or similar instruments) and approval of the Partial Plan. In theory, these instruments are used by land use planners to decide the general course of the urban development process in the long run.

(120) It should be recalled that when setting out the fundamental boundary, the one between developable and non-developable land, planners are not limiting urban development solely for the purpose of protecting zones which have objective characteristics (natural, ecological and landscape values and risk zones) which require their exclusion from urbanisation for public interest reasons; rather, an important amount of land is prevented from being urbanised for reasons of timing. In essence, planners leave a part of the territory out of the development process that can in theory be urbanised in the future, when they deem necessary or convenient, at their discretion.

(121) Table 2 provides data on land classification in the largest Spanish cities. In some of them, non-developable land accounts for more than 60%, with much lower percentages in others. Furthermore, in most of them the percentage of delimited developable land is less than 10%, with percentages of less than 8% in many cases and below 2% in some. The percentage of vacant developed land or land in the process of being urbanised compared to the total municipal area is less than 2.5% in most cases.

Table 2. Distribution of municipal land by land class in largest Spanish cities (2011)

	Madrid	Barcelona	Valencia	Sevilla	Zaragoza	Málaga	Las Palmas	Bilbao	Alicante	Córdoba	Valladolid
Consolidated urban land	27.1%	78.5%	24.1%	39.2%	4.0%	13.7%	27.8%	26.6%	19.4%	2.5%	19.9%
Unconsolidated urban land	2.2%	3.0%	0.8%	5.2%	0.9%	2.7%	2.1%	2.3%	1.1%	0.3%	2.3%
Delimited developable land	12.4%	0.0%	4.3%	14.0%	0.3%	5.8%	7.9%	1.5%	3.3%	1.2%	8.7%
Non-delimited developable land	3.0%	0.3%	1.3%	5.2%	2.3%	1.4%	1.3%	1.2%	0.4%	1.6%	17.1%
Non-developable land	37.8%	16.9%	60.3%	21.1%	85.5%	70.8%	59.0%	39.8%	74.5%	94.2%	52.0%
General Systems not allocated	17.6%	1.3%	9.3%	15.2%	6.9%	5.6%	1.8%	28.6%	1.2%	0.2%	0.0%
TOTAL	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Urbanised or in the process of urbanisation	*3.7%*	*0.5%*	*1.7%*	*3.1%*	*0.4%*	*1.0%*	*3.0%*	*0.1%*	*1.5%*	*0.3%*	*2.3%*

Note: data are given for 11 Spanish cities with populations of more than 300,000 for which there is available homogeneous information such as that compiled in the table; land that has been urbanised or is in the process of being urbanised is included under land being developed in the so-called development areas, composed of unconsolidated urban land and/or delimited developable land.

Source: prepared in-house from data of the Ministry of Public Works and Infrastructure (2011).

(122) In theory, the urban boundary[62] is an instrument used to avoid urban sprawl. In an intervention-free scenario, a city's geographic size is governed by a series of factors, primarily income, population, transport costs, and the opportunity cost of land in terms of non-urban uses. These are the factors, specifically, competition for land for urban and non-urban uses, which in an intervention-free scenario would determine the natural confines of the city. Nevertheless, as discussed in section II of this report, certain market failures can give rise to excessive and economically inefficient growth[63], and may produce overconsumption of open areas, too much congestion and excessive spending on infrastructure and services (that is, an overly costly city). In addition, the urban boundary is intended to help maintain a sufficient level of occupation of residential areas so as to avoid degradation of certain urban areas.

(123) Market failures exist and have to be corrected. Establishing an urban boundary, for the prime purpose of preventing urbanisation beyond a certain limit, is the chosen mechanism of Spanish land use planning for correcting those failures and for ensuring cities are adequately sized.

(124) But urban boundaries have certain costs that should not be ignored by planners.

(125) First, an urban growth boundary is a quantitative mechanism, which does not serve to efficiently correct the market failures tied to urban sprawl. It is primarily aimed at avoiding the main symptom (sprawl) but not at correcting or internalising the cause of that result (the market failures)[64]. For example, an urban boundary does not necessarily take congestion to the optimal level, given that it does not act on the external cost. Its effect is to increase population density in the entire urban area, instead of achieving exploitation of economies of agglomeration there where they may be found. In particular, the growth boundary does not alter the relative cost of residing downtown with respect to outlying urban areas, so that living away from the city centre continues to be artificially cheap.

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[62] In the rest of the section, urban boundary means the establishment of a limit on the land that may be urbanised within the municipal territory; that limit does not just exclude land protected for public interest purposes, but other types of land as well which may in the future be urbanised if planning authorities so decide.

[63] The first market failure is the non-internalisation of the social cost brought about by the reduction of open areas that is implicit in urban development. The second is the failure to internalise the social cost generated by greater congestion of transport infrastructure. And the third market failure originates from the non-internalisation of the total additional cost of infrastructure and services associated with new urbanisation.

[64] Brueckner (2011), Brueckner (2000) and O'Sullivan (2011) assert that urban growth boundaries are a rather blunt mechanism for correcting the identified market failures and that it would be more efficient to use instruments based on price mechanisms, such as taxes and tolls specifically targeted at correcting market failures, that is, at attacking the root problem instead of addressing the symptoms.

(126) Second, the essence of the urban boundary is to prevent the market and competition from determining what land should be urban (in terms of both quantity and location). It is the administration at its discretion, and not the market corrected from its failures, that establishes a "non-market" allocation. Compared to a situation without intervention in which it is the market that allocates land amongst the alternative uses according to their marginal productivity, the growth boundary modifies the relative prices between urban land and non-urban land[65], raising the price of urban land and housing (and other types of real estate), in addition to reducing average home sizes and increasing the city's population density[66].

(127) Although public data on price differentials between land with different classifications are scarce, there are studies that point out the major differences that can exist (see Box 1).

Box 1. Real example of price differentials between land with different planning classification

In a study conducted for San Cugat del Vallès in the mid-1990s (Riera, 1997), the quantification indicates that based on a price per m^2 of 'rustic' land of 1, the value of the land after being reclassified as developable for residential use would be 8 times more (that is, some 665% higher), and 31 times larger than the rustic value after being urbanised (that is, some 3,028% higher) and 4 times greater than when classified as developable (that is, 309% higher).

(128) At the same time, by curbing competition in land supply, urban boundaries further reduce the responsiveness of land supply and give market power to owners of developable land. This makes speculative withholding of land more likely, although according to Spanish law (specifically, article 47 of the Spanish Constitution of 1978), Spanish land use planning must combat speculation[67].

(129) Third, given the price impact, achieving a change of land classification (for example, from non-developable to developable) can become a highly

[65] Evans (1985).

[66] Brueckner (2000) and Mills and Hamilton (1994).

[67] In fact, the preamble to CT 2008 asserts that *"land classification has historically contributed to inflating land prices, giving rise to expectations of further increases long before the necessary operations are carried out to implement the planning determinations of public authorities and, accordingly, has also fostered speculative practices, which we have a constitutional imperative to combat"*.

valuable economic good with no inherent production costs beyond the resources used to convince the regulator. This prompts landowners and developers to try to persuade public authorities, primarily at the municipal level, to include their landholdings inside the boundary, which gives rise to the rent-seeking[68] activities that are typical of town planning in Spain and in other planning systems with similar traits.

(130) The main problem behind this situation is that, even if the quantity of land included inside the urban growth boundary were socially optimal at a specific point in time, the concrete delimitation of the plots included inside the boundary may be arbitrary and unpredictable. For parcels initially left outside the boundary, the expectation as to the possible timing of future inclusion is highly uncertain. In fact, the market displays absolutely inefficient behaviours such as sudden changes in land values due to a mere change in the classification. If the boundary functioned more predictably, such changes would not be as sharp, as economic operators could at all times assess the future value of each tract of land with a relatively low risk.

(131) Furthermore, Spanish land use planning is absolutely conditioned by municipal dependence on revenues from land and housing, which increases the risk that town planners will use planning, at least in part, to maximise fiscal revenue[69]. Thus, the regulator's role as agent with direct interests in the process makes it very likely that the layout of the urban boundary will be economically distorted.

(132) Economic theory offers more efficient intervention alternatives than the urban growth boundary as instruments for correcting the market failures detected. One widely used alternative for correcting externalities is the *pigovian tax*[70], instead of the urban boundary[71]. This 'tax' which involves

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[68] Since this is a restriction of quantity that does not entail internalising externalities, urban growth boundaries generate scarcity rents which potential landowners seek to appropriate through rent-seeking processes.

[69] In municipal budgets, the most important revenue items are as follows. First, there are the main taxes in this arena: the Real Estate Tax (Impuesto sobre Bienes Inmuebles or IBI), the Tax on Value Increase of Urban Land (Impuesto sobre el Incremento del Valor de los Terrenos de Naturaleza Urbana or IIVTNU), and the Tax on Construction, Installations and Works (Impuesto sobre Construcciones, Instalaciones y Obras or ICIO). According to data from the Ministry of Finance for 2010, these items carry considerable weight in municipal revenues. With respect to total revenues, the IBI accounts for 19.2%, IIVTNU for 2.5% and ICIO 1.8%; in aggregate, 23.5%. Second, the revenue from land obtained through the compulsory assignments landowners must make to the municipal government when their land is urbanised. Third, the town planning compensations obtained by means of modifying planning via town planning accords. OECD (2003, 2005 and 2007) and TDC (1993, 1995) have pointed out the perverse incentives that this fiscal dependence, specifically the compulsory assignments of land, can generate for the planning behaviour of town planners.

[70] These instruments allow private incentives to be aligned with social efficiency. In the case of negative externalities, these instruments usually consist of taxes or corrective charges

classifying as suitable for development all land that does not have to be protected for duly evidenced public interest reasons (primarily natural, ecological and landscape riches, and hazardous zones). From a theoretical standpoint, price mechanisms are just as effective as the urban boundary in taming urban sprawl, but clearly superior in terms of efficiency, as they attack the market failures head-on, allow externalities to be internalised and minimise economic distortions. One concrete benefit of such mechanisms (for example, a tax) is that by internalising the externality it hinders the appearance of rent-seeking[72]. As for the specific mechanisms, taxes and tolls can also be used to confront the loss of open areas and congestion. The cost of infrastructure and related services can be addressed by impact taxes that oblige the developers to pay for the incremental infrastructure and service costs[73] associated with new developments.

(133) In theory, there are other *a priori* regulation alternatives that could be suggested which are more efficient than laying down an urban boundary (although less efficient than the *pigovian* mechanisms mentioned above, they can be easier to implement). One is the competitive allocation of urban development rights that can be traded by the holders of the rights on an organised secondary market. This would allow town planners to control the quantity of land that can be urbanised at any one point in time, without specifying the parcels that can be built on.

IV.1.2 Delimitation of urbanised land: zoning

(134) The other fundamental administrative delimitation of land use is zoning. The planning instruments lay down certain uses for each part of the territory. The plan basically draws up a list of uses and a map. Then, zones are assigned to different uses on the list. It is the planner who determines how each zone is to be used. As pointed out at the beginning of this discussion paper, the uses may be general or specific, with additional subcategories within the latter. Furthermore, apart from defining

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designed to make private players take into account the social cost of the negative externality. One example is petrol taxes.

[71] There are many cities in the United States that do not have an urban growth boundary, and in which, in theory, all municipal land is developable. See, for example O'Sullivan (2003) and Riera (1997).

[72] With a well-designed charge, the scarcity rent that landowners and developers try to appropriate disappear and become tax revenues.

[73] The United States has many examples of such development charges. In the city of Los Angeles, developers pay taxes in respect of items such as the increase in traffic that will be generated by new office building construction. The revenues are used to improve and conserve the infrastructure associated with those new developments. In the Chicago metropolitan area, different types of impact fees are used, such as for building schools.

uses, the planner determines other characteristics relating to the intensity of the use, mainly in terms of construction, lot coverage and density.

(135) In theory, the main purpose of zoning is to separate incompatible uses in order to correct externalities. For example, industry generates externalities such as noise, odours, smoke, dust and vibrations; commercial zones generate externalities such as traffic, parking conflicts, noise and pollution; high-density residential zones generate externalities such as congestion, parking conflicts, noise and loss of sunlight and scenic views. By separating some uses from others, zoning seeks to stave off the negative external effects between incompatible uses, which no doubt exist and can give rise to a loss of welfare.

(136) Another rationale for zoning is to reserve land to ensure the provision of public goods (such as parks) that an intervention-free land market might not provide sufficiently. That is why planning instruments set aside land for parks, gardens, sewage systems and public facilities such as sports complexes that must be relinquished by landowners when their land is urbanised.

(137) Now, certain problems and drawbacks of zoning should be kept in mind.

(138) First, although externalities between incompatible uses exist and can generate welfare losses, it should be noted that zoning does not correct the externality efficiently (for example, the one associated with pollution), because what it does is simply to relocate and group it into a specific location, but without bringing the pollution in line with the economically optimal level. Thus, the solution brought about by zoning is only partially effective and is improvable from the standpoint of overall welfare.

(139) Second, the provision of public goods by zoning and compulsory assignment of land does not ensure that their provision will be efficient[74]. The land set aside for those uses has an opportunity cost vis-à-vis alternative uses. Planning provisions and compulsory assignment can require landowners to give up land without compensation. This means the administration has incentives to zone land for these uses whenever the marginal benefit to society is positive, even if that benefit may be less than the opportunity cost in terms of alternative uses, which would be inefficient.

(140) Third, its impact on competition bears similarities to the effects that were studied for land classification. Zoning segments land by uses, reducing land supply *caeteris paribus*, and prevents the free play of competition from allocating land amongst alternative uses, both in quantities and in location. Thus, zoning has an impact on prices similar to that of the urban boundary. It can distort pricing and cause, for example, land for offices to

[74] O'Sullivan (2011) and Riera (1997).

be priced higher than what the market would dictate and land for industrial premises lower. At the same time, by disproportionately restraining competition in land supply, it reduces the elasticity of supply and gives market power to owners of land that can be urbanised, increases vulnerability to rent-seeking and the dependence of municipal budgets on revenue from land and homebuilding.

(141) Nevertheless, in this case, and specifically due to its highly detailed segmentation of land, the implications of zoning for competition are much more intense. The possible uses are not laid down in the regional legislation and mainly depend on the municipal planning authority, where a great variety of possibilities exist, although the planning instruments are always overly detailed. For example, in the city of Vitoria, the town plan employs 10 general uses and 40 specific uses[75]. The combination of such detailed uses with differences in building rights (floor area ratio) and density generates a very large number of uses that greatly segments municipal land. As a result of this highly detailed approach, zoning may reduce the space available for premises in many economic sectors characterised by a local geographical market, such as retailing, hospitals and petrol stations. Planning is an essential factor for the administrative configuration of supply in those sectors. In the case of retailing, there are many cases where town plans directly prohibit the establishment of certain retail formats in parts of the territory (see Box 2).

[75] According to the Planning Rules of the General Urban Land Use Plan of Vitoria-Gasteiz – Revision – Consolidated Text (09-04-2010), www.vitoria-gasteiz.org/wb021/http/contenidosEstaticos/adjuntos/es/06/62/40662.pdf. The CNC does not rule out the possibility that this document may have undergone changes since its approval.

Box 2. Real examples of prohibition of certain retail formats in town plans

- The ordinances of the Partial Plan of Jerez provide that: *"The Ordinances of this Partial Plan prohibit the establishment of large retail complexes"*.

- In Alcalá de Guadaíra, the Partial Plan ordinances include an even more detailed provision. In relation to tertiary use of the blocks in a sector, the ordinances stipulate that commercial use will be permitted *"except for large food retailers"*.

Source: Partial Plan of the Sector "Dehesa de Siles II" of the Town Council of Jerez, May 2013, given final approval by Plenary Resolution of 28 June 2013 www.jerez.es/fileadmin/Documentos/urbanismo/Anuncios/Planeamiento/PLAN_PARCIAL/SECTORS_DEHESA_DE_SILES_II/00PP_SILES2_DEF_1de7.pdf; Partial Land Use Plan of the Sector "Palmetillo", of Alcalá de Guadaíra www.ciudadalcala.org/contenidos/normativas/182-1.pdf. The CNC does not ignore the possibility that the documents cited may have been changed since their approval.

(142) Also, and more indirectly, town plans may result in land that is envisaged for a certain use not being large enough or not being attractively located, thereby limiting entry and competition. This can sometimes give rise to land not being used for long stretches of time until the town plan is changed. It can thus constrain competition in several markets, leading to inefficient prices for consumers, slower innovation and less variety.

(143) In any event, planning instruments normally go beyond setting forth uses and intensities, and tend to include additional restrictions on siting and opening establishments in a variety of activities, further restricting entry and competition (see Box 3).

Box 3. Real examples of additional restrictions on competition in land use plans

- The town planning norms of the General Plan of Sevilla, in addition to restricting the type of land on which fuel distribution outlets may be established, also lay down the rules for access (administrative concession, if the land is public) and other constraints: minimum parcel size, minimum distance between outlets, characteristics of the parcel, etc.

- In relation to large commercial complexes, the town planning norms of the General Plan of Santa Cruz de Tenerife refer to a licensing scheme and provide that the grant of the licence *"may be made subject to demonstration of the acceptability of the impacts those outlets may have on traffic and the existing commercial structure"*, which implies the type of economic criterion (existing commercial structure) that is outright prohibited by the Services Directive and by the provisions transposing that EU Directive into Spanish law.

Source: Town Planning Norms of the General Urban Land Use Plan of Sevilla, www.sevilla.org/plandesevilla/adef/doc/AD_NORMAS.pdf; Town Planning Norms of the General Urban Land Use Plan of Santa Cruz de Tenerife, www.bopsantacruzdetenerife.org/2006/03/030/Bop030-06.pdf. The CNC does not ignore the possibility that the documents cited may have been changed since their approval.

(144) Fourth, the zoning system tends to create zones with one predominant use which, taken together with the incompatibility of uses established in the town plan (prohibited uses)[76] and the highly detailed segmentation of the categories used, hinders the development of zones with sufficiently diverse types of uses. This contributes to forcing residents in those zones to increase their mobility, to lengthening their commuting distances and times and to generating more pollution in cities. All these effects are contrary to the planning objectives (compact development and less pollution).

(145) In summary, the zoning system is not a sufficiently effective mechanism for correcting certain externalities, may lead (in combination with compulsory assignment) to inefficient provision of public goods and limits competition in the land market considerably, with different effects on competition in a variety of economic sectors in which the geographical scope of the market is local. At the same time, the same as the urban

[76] For each specific use, town planning norms establish compatible uses (the ones with which the use can in theory coexist) and prohibited uses (those with which it cannot coexist).

boundary, its capacity to correct market failures is influenced and distorted by rent-seeking behaviours and by the dependence of municipal finances on revenue from land and housing developments. Lastly, it tends to somewhat hinder the development of mixed-use zones, which can generate greater forced mobility, longer commutes and more pollution, effects which run contrary to what is pursued by urban planning.

(146) There are certain alternatives for correcting the detected market failures which may be less distortionary.

(147) One alternative for avoiding externalities between incompatible uses that might be more appropriate could be to use, on a general and fundamental basis, rules or standards which allow the externalities associated with incompatible uses to be corrected but that at the same time allow the land use to be determined in large part via the market, and not through the planning instruments designed, modified or covenanted by each planning authority[77]. In theory, this technique would not separate uses from one another, but instead ensure compatibility between uses by means of the fulfilment of certain previously established and stable rules that are the same for all agents.

(148) For example, whereas current zoning tends to separate large department stores from residential areas, zoning by standards lays down certain requirements so that a shopping mall located near a residential zone does not generate externalities for the latter. This may entail requiring shopping centres to have adequate parking facilities, to install the necessary infrastructure to organise the extra traffic they generate or to be built in such way as limits their acoustic and environmental impact. In short, standards-based zoning[78] can assure that the externalities associated with certain uses will be corrected but without ex ante determination of the location or quantity of land allocated to different uses. This fosters more competition in alternative land uses, greater flexibility in land use and better supplyside responsiveness to the market's needs. This zoning approach is compatible with the use of structural instruments, which basically map out protected nature reserves, the layout of infrastructure

[77] O'Sullivan (2011).

[78] Standards are present in Spanish town planning to some extent. Examples include the planning standards described in II.1 and other types of provisions written into town planning norms, such as the rules that the walls of an industrial building must have insulation of a certain type. Nevertheless, the point is that Spanish planning is not grounded in a standards-based approach and instead is segmentation-based. This approach separates uses spatially, on an a priori and excessively detailed basis, instead of **allowing the market** —subject to compliance with a set of necessary, proportionate, non-discriminatory standards or rules, clearly and objectively predefined, that allow correction of externalities between incompatible uses— **to decide more flexibly and efficiently the location and amount of land to allocate to the different possible uses**.

networks and location of certain facilities (such as an airport or train station).

(149) The use of rules may also solve the problem of providing parks and other types of public goods, by setting standards which must be met by developers in relation to those goods when land is urbanised or developed.

(150) In any event, it is obvious that the Spanish land use planning system spawned by the clearly interventionist legislation of 1956 is too detailed. Therefore, even if an ex ante planning approach similar to the present one is maintained, it would be desirable for the uses not to be so specifically detailed in order to avoid over-segmentation of the market and to foster competition in the allocation of land.

IV.2. Complexity, discretionality and inconsistency of land use planning intervention

(151) The Spanish planning system is characterised by its complexity, discretionality and inconsistency. These factors limit competition in the land market.

(152) There are several factors which affect the system's **complexity**:

- The number of planning instruments used is clearly very large (General Plan, Sectorisation Plan, Partial Plan, Special Plan, etc.), each with its processing and approval phases and associated formalities that are different even between comparable Spanish administrations. There is one Autonomous Community that has 10 different planning instruments.
- The inherent complexity of Spain's land use planning system is aggravated by regulatory heterogeneity at the regional and municipal level. There are a multitude of different regional laws which, despite their shared common characteristics inherited from the traditional Spanish planning model, are also marked by differences of importance for the functioning of the land market. Examples include the laws on the different categories of land, determinations for each type of land (for example, in terms of buildable area), the predominant implementation systems, or the formalities for approving and modifying general plans.

  And this heterogeneity is even more pronounced at the municipal level. Planning differences between the more than 8,000 municipalities that exist imply different rules and regulations. One highly illustrative example involves uses, which may be different between municipalities, even between those located in the same Autonomous Community. This hinders the activity of operators in

many different sectors. For example, a hotel company must confront an indeterminate number of different ways of zoning “hotel” use.

- Lastly, there is a notable lack of transparency and intensifies the complexity. Many times, there is no clear and readily accessible information on what is permitted on certain land, as the town plans undergo constant modifications and no consolidated texts are available to all agents in the market. The lack of transparency also has a negative effect on competition in relation to the process of drawing up the town planning accords that are negotiated bilaterally between municipal authorities and public or private persons.

(153) Second, town councils have a disproportionate degree of **discretion in all stages of the town planning process**. In general terms, the planning decisions of municipal governments do not have to conform to any set of clear and objective criteria: in Spanish urban planning, subjectivity tends to be the norm. The examples are countless. In the planning phase, there is discretion for deciding whether or not to approve the planning instruments, for establishing the model of the city and associated determinations, and for specifying the contributions that must be made by landowners in planning accords. In the implementation phase, there is discretion when deciding on which system of implementation will be used. Although development control is perhaps the most rule-based of these phases, it still leaves broad discretion as a result inter alia of the subjective nature and lack of specification of the requirements and criteria applied for licensing approvals or rejections.

(154) Third, land use intervention, especially planning, displays a notable degree of **temporal inconsistency**. For example, in the 1990s the General Plan of Barcelona underwent an average of one modification per week[79]. This inconsistency is the natural result of two characteristic factors in the Spanish urban planning system. For one, planning is overly detailed. Nevertheless, given the planner's lack of information on the future evolution of the market, the result is normally a lack of adaptation to the needs of market demand, citizens and businesses. As a result, in order for the system not to collapse and to be of some utility for society, it must be submitted to constant discretionary modification. Secondly, the fiscal dependence of municipal budgets on land-related revenue, specifically on the development compensations they obtain in exchange for modifying plans via town planning accords, also heightens the lack of planning consistency over time[80].

(155) On many occasions, town councils approve planning accords in which they reach an agreement with public or private agents, whether or not they

[79] Riera (1997).

[80] Riera (2000, 1997).

own the land involved, to carry out modifications in land use plans in exchange for compensation. For example, a developer proposes a change in the general plan (for example, a change of use or increase in building rights) in exchange for a monetary payment to the municipal government or for building a school, a gymnasium or parking deck. Rent-seeking by the town council through such "contract planning" encourages municipal authorities to adopt planning design strategies that allow them to obtain such compensation over time. Specifically, the optimal economic strategy for a town hall may be to draw up an initial plan that is very restrictive, or not in keeping with the actual market demand, but at the same time convey an image of flexibility and openness for negotiating modifications as a means of ensuring a steady stream of development compensation via planning accords[81].

(156) The environment of complexity, lack of transparency, discretionality and temporal inconsistency that characterises Spanish urban planning increases the level of unpredictability, rent-seeking, uncertainty and legal insecurity in land markets. Not only is this contrary to the purpose of land use planning —to give guidance and provide a predictable environment— but it also hinders entry into land markets and thus curbs competition.

(157) Furthermore, the town planning accords generate their own specific competition problems:

- They allow private agents, who need not be landowners, to covenant with the administration changes in town plans in a context of bilateral negotiations and information asymmetries, which facilitates the attainment of competitive advantages that cannot be matched by competitors. The accord gives agency power to the proponent. What is more, it can even allow an operator to obtain the introduction of anti-competitive restrictions in the town plans in exchange for delivering compensations to the administration. For example, a major leisure park or hospital complex to be installed in one part of the territory could covenant with the municipal government to build certain infrastructure in exchange for land use planning modifications that tend to limit entry of competitors.

[81] For example, the Partial Plan of Jerez cited above provides as follows: *"The Ordinances of this Partial Plan set forth the prohibition on establishing large retail complexes… Nevertheless, by processing a specific occasional modification of this Partial Plan, the compatibility or complementary fit of the installation of large retail complexes could be allowed…"*. This paragraph is an example of how a town council signals the market that it is willing to negotiate future modifications of planning instruments in order to allow the establishment of department stores that are currently prohibited. At the same time, it underscores how inconsistency is an inherent characteristic of Spanish planning: strict determinations are approved at one point in time, accompanied by an announcement that they can be changed in the future.

- Also, the consideration stipulated in the accords often entails the construction of infrastructure for the municipal government, which will later be executed or subcontracted on conditions not wholly in keeping with the principles of government procurement and originate maintenance costs.
- Lastly, construction of infrastructure for the town council can on many occasions convert that public administration into an economic agent in markets in which private initiatives was already operating or was capable of operating, with the consequent unnecessary distortion of competition.

(158) Although planning accords are the means by which a rigid and excessively detailed system manages to introduce some flexibility, they somewhat exemplify the problems inherent in Spanish land use planning. In effect, a system whose overriding objective is to defend the public interest ends up producing a system of covenanted or concerted planning in which what prevails on occasions is not the general interest, but the private interests of certain market agents, both public and private, with the connections and capacity to have town plans tailored to their wishes.

(159) Reducing the complexity, discretionality and inconsistency that are the hallmarks of Spanish urban planning may entail the need to advance toward a more stable, objective and impartial rule-based approach to land use planning.

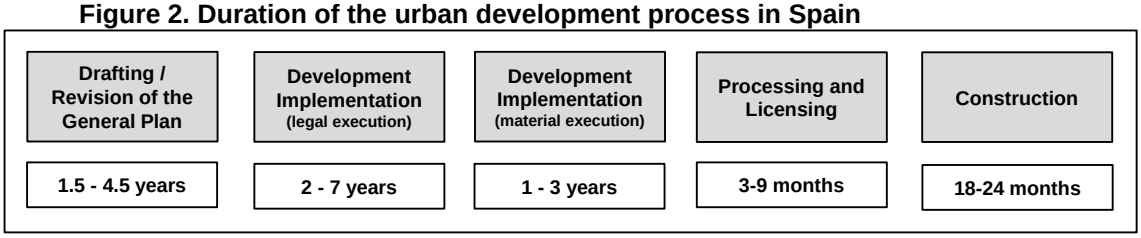
(160) In principle, establishing a system based on market-type mechanisms, rules and structural instruments that are binding on planning authorities would diminish the problems analysed here to a great extent. For one, there would not exist the present myriad of planning instruments, making the system less complex and less opaque. And having a land use planning system based on market mechanisms and governed by a set of necessary and proportionate rules that are the same for everyone would notably reduce discretionality and inconsistency. In short, we would have land use regulation that is effective in correcting market failures but that conforms to the principles of stability, predictability and consistency, and, therefore, that is conducive to greater freedom of entry and greater competition in land markets and in other sectors of the economy.

IV.3. Transaction costs and rigidity in the urban development process

(161) Urban transformation of land, that is, the production of urbanised land consists in fitting the land with the services and infrastructure needed for land to qualify as buildable lots. This process should be streamlined because the actual supply of land is the supply of urbanised land.

(162) Nevertheless, the urbanisation process in Spain is, generally speaking, very slow (Figure 2). Where land development requires a change in the general plan[82], the land's urbanisation can take between 4.5 and 14.5 years. In those cases where urbanisation does not require modifications in the general plan, the pertinent development plan must be approved, followed by the legal and material execution of the plan, as a result of which the urban transformation can take from 3 to 10 years.

Figure 2. Duration of the urban development process in Spain



Note: the development implementation phase (legal execution) includes the time employed in processing the development planning.

Source: prepared in-house using data from Círculo de Empresarios (2001), citing as primary source the Madrid association of developers, Asociación de Promotores Inmobiliarios de Madrid (ASPRIMA).

(163) Several regulatory factors increase the transactions costs and rigidity of the land market and delay urban development.

(164) First, in general terms, transforming developable land into developed land requires approval of planning instruments in addition to the General Plan, and their processing slows the pace of production of urbanised land. According to the available data, processing a Partial Plan can take up to two years.

(165) Second, even where the necessary planning (both the general and the development plans) has already been approved, there are further transactions costs in the legal execution of the plans. Those costs mainly arise from the objective of fair distribution of development burdens and benefits amongst landowners.

(166) The fair distribution of benefits and burdens is a unique element of Spanish urban planning. As already indicated in previous sections, the general idea behind the fair distribution concept is to resolve the "inequities" that land use planning generates, ensuring that the return obtained by landowners on their land is in line with the amount of land they own and not with what the town plans allow them to do with that land. The

[82] This would be the case, for example, if one wishes to develop land that is classified as non-developable. Generally speaking, this requires changing the classification of non-developable land to developable in the general plan.

goal is to guarantee that each landowner obtains the same or similar benefits for each unit of land area[83].

(167) The mechanisms for achieving this goal are to identify an average or standard net benefit per distribution area, and the various redistributive techniques, which have effects at the execution unit level.

(168) The average benefit enjoyed is an average of the objective benefits for a distribution area[84]. The basic aim is to ensure a certain fairness in the final benefit enjoyed in developable land and unconsolidated urban land. The overall benefit enjoyed is determined by a process that involves homogenising the uses and intensities in each area, mainly by means of weighting coefficients established in the land use plans, so as to allow the net benefit of land area to be expressed in the same unit for the different zones in the distribution area. Once all of the net benefits are available in the same measurement unit, they are summed up and divided by the total quantity of land to obtain the average net benefit[85].

(169) In any event, if the average net benefit is used at the general planning level, then redistribution techniques constitute the mechanism for effectively achieving fair distribution of benefits and burdens at the execution unit level. Redistribution techniques require prior approval of the development plan and is therefore compatible with the average net benefit levelling technique, which operates at the general level and for general uses. The redistribution techniques are carried out by means of the action systems explained in earlier sections of this document and in Annex I.

(170) Although those systems seek to ensure a certain level of fairness at the execution unit level, in practice their application is hindered by numerous transactions costs.

(171) Specifically, the compensation system requires that a considerable percentage of landowners agree to form a Compensation Board (CB), a process that involves many formalities and steps[86], and to draw up the

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[83] The benefit per unit of land area will thus be equal regardless of whether the land use plans have determined that the land must be used for housing, parks or sidewalks.

[84] On developable land, the distribution area can be a sector or a set of sectors; on urban land, an execution unit.

[85] For example, take a simple and completely hypothetical case in which there is a distribution area composed of two zones: (a) residential and (b) industrial. Each zone has a land area of 1,000 m^2 and (a) has buildable floor area ratio of 3 m^2/m^2 and (b) $2m^2/m^2$. The weighting coefficient set in the town plan is 0.6 for (a) 0.2 for (b). The objective net benefit of (a) is 1,000 x 0.6 x 3=1,800 m^2/m^2 and of (b) 1,000 x 0.2 x 2=400m^2/m^2. The total net benefit of the sectors is equal to 1,800+400=2,200m^2/m^2. The average net benefit would be 2,200m^2/m^2/2,000m^2=1.1 m^2/m^2.

[86] To set up the CB, landowners must draw up draft bylaws and basic terms of action. Once this condition has been fulfilled, the process of constituting the CB begins and must go through a series of formal steps: initial approval; publicity of the initial approval resolution;

compensation project proposal. The negotiations in this system are further hampered by two additional factors:

- First, it is the planning authority who decides (for example, when approving a Partial Plan) which parcels will be included in an execution unit. The delimitation is done not according to economic criteria, but having regard to town planning considerations and fairness[87]. The result may be that the final combination of landowners spawned by the plan is not the most conducive for them to reach an agreement. At the same time, restricting the landowners' freedom of action and choice increases the likelihood of opportunistic behaviour in the negotiations of the compensation project, which can delay execution even more.
- Second, the weighting coefficients, calculated in the initial phase of the plan, might not bear close relation to the market value of the different landholdings in later periods, given that the market value of each use changes over time. If the planning coefficients diverge from the market value of the different types of land, the fair sharing of burdens and benefits runs the risk of not being truly fair and the negotiations may be stymied.

(172) The compensation system, in turn, incorporates further transactions costs. For one, it requires expropriation of landowners who choose not to join the Board, which normally delays execution even longer[88]. Also, there are costs in the form of professional fees and public deeds that delay the CB's activity.

(173) In short, transactions costs are numerous and mainly arise from the goal of achieving fair distribution of the benefits and burdens of the land use plan. Designing town planning systems to, on the one hand, ensure the production of urbanised land and, on the other, to implement a policy of equity, necessarily leads to a highly complex system that delays the production of land.

(174) The system's rigidity and impediments on occasion lead to use of more or less interventionist formulas, such as cooperation or expropriation, or the

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public input and allegations; final approval; publication of the final approval resolution; effective incorporation; approval of the incorporation; registry; notification of registration. The approval of the bylaws and basic terms of action, and the actual incorporation of the CB, require administrative sanction, and the CB does not acquire its legal personality until the incorporation has been approved in the registry.

87 There are a series of requirements for delimiting execution units which depend on the type of land on which the action is to be carried out. On developable land, this delimitation is conditional on: that the land assignments envisaged in the plans are possible; that the benefits and burdens of the urban development can shared equitably; and that it has sufficient size to technically and economically justify the action's autonomy.

88 García-Montalvo (2000).

urban development agent “contract planning” system that predominates in some Autonomous Communities. Although these systems may cut transactions costs down somewhat, they are not clearly based on landowners or on free agreements between landowners and developers, and are therefore not fully compatible with land development based on market mechanisms.

(175) Specifically, the urban development agent system originates in a contract between the administration and an urban development agent, who is not necessarily an owner of any of the land involved, but who nevertheless proposes a programme for a specific area and urbanises it, without necessarily having to reach an agreement with the landowners, who will in any event have to negotiate with the development agent in a context in which they may eventually be expropriated, and who will have to pay the development agent for developing the land. In addition to its markedly interventionist nature, this system generates an incentives structure that may have undesired effects. For one, as part of the typical functioning of contract-based land use planning, the administration may accept a proposal from the development agent that is less than optimal from the standpoint of social welfare but which allows the administration to obtain some sort of benefit in return. Also, the fact that the urban development agent's goal is to maximise its profit by means of the development activity may vitiate and compromise the fair distribution of benefits and burdens[89]. Lastly, if the administration does not adequately supervise the project presented by the development agent and, specifically, the proposed execution costs, the development agent may inflate the development costs to increase its profits[90].

(176) The slowness of the land development process, caused by the system's transactions costs and rigidity, reduces competition in the market considerably. When demand increases, the difficulty of transforming land protects incumbent landowners and prevents the entry of new ones from curbing the resulting upward price pressure. Obviously, this slowness in transforming land entails per se a reduction in the elasticity of land supply, which, as discussed in earlier sections, is relatively rigid in Spain. Taking how long planning implementation takes, it is not surprising that a rise in demand brought about by population growth or better borrowing terms translates into very large price increases in the short and medium term. Also, the overly long duration of the process saddles operators with

[89] For example, to save costs and speed up development redistributive formulas might be adopted that do not ensure fairness in the sharing of development burdens and benefits.

[90] The development agent has incentives to inflate costs regardless of whether it is paid in cash or in land. If the remuneration is monetary, the profit may reach up to X% (normally 10%) of the total cost of execution. If compensation comes in the form of land, taking into account how the compensation coefficient is determined, the agent will have incentives to inflate costs and underprice the land.

significant financing costs and entails risks in terms of economic opportunity. In fact, the transformation phase sometimes takes so long that by the time the development is fully in place, the market conditions have changed and the operators involved must bear economic losses.

(177) There are various alternatives that could streamline land development in Spain.

(178) First, if land use planning is made more flexible in line with what has been discussed in the preceding sections, there would not be as many ex ante "inequities", and there would therefore be no need for their ex post solution in the implementation phase. In other words, simplified planning would lead to simplified implementation and thus expedite land development.

(179) Second, if the current planning approach is maintained, there would still be room for reducing transactions costs. One possibility would be to study in more detail the option of disassociating land development from the achievement of the equity objective, using other mechanisms for solving the inequalities generated by town plans. Another, while maintaining the equity principle, would be to consider at least making the design of the execution units more flexible, allowing landowners to decide which lots should be included in the execution unit, and agreeing, if they consider appropriate, modifications to the weighting coefficients to facilitate the negotiations. Lastly, administrative simplification of the current systems would notably reduce rigidity and make supply more responsive.

IV.4. Direct Government Intervention in the Land Market

(180) The current legal framework gives public authorities, and municipal governments in particular, a series of instruments for direct intervention in the land market. The purpose of those instruments is to regulate the market, but also to assure certain land use planning objectives.

(181) In particular, the regulatory framework requires the administration, specifically at the municipal level, to have Public Landholdings (*Patrimonios Públicos de Suelo* or PPS), mainly composed of land turned over by landowners in connection with urban development actions. It also allows the administration to intervene in land transactions by means of rights of first refusal and redemption. This means that the administration may use the PPS to offer land in the market if the authorities deem prices are high or to exercise their rights of first refusal and redemption to affect the formation of prices.

(182) The fact of the administration having capacity to directly influence the determination of the amount of market exchanges and in the pricing process can severely crimp competition, with negative effects in terms of efficiency. This restriction should always be properly justified.

(183) In principle, the objective of regulating the land market by means of PPS ties in with the need to *"prevent speculation"*, that is, to prevent practices of land-withholding, as provided in article 47 of the Spanish Constitution. PPS-type landholdings, however, are not the most appropriate means for achieving that objective. If the land market were a competitive market — something which is not the case— the best way to ensure its efficient functioning would be the free play of supply and demand. In this case, speculation is not bad *per se*, in as much as it allows arbitrage in the market, a more responsive supply and greater price stability over time. Conversely, if the market is not competitive and there are numerous entry barriers such as those analysed thus far, practices of withholding land during the upside of the cycle will be more likely. Nevertheless, the optimal solution in the latter case is not to give the administration a direct intervention role, but rather to attack the root of the problem by eliminating constraints on entry and fostering free competition in the land market. It is actually the intervention itself, in its introduction of entry barriers and protection of incumbent landowners, what can fuel land-withholding, thereby generating the opposite effect to the constitutional mandate.

(184) In any event, there are additional arguments that may be cited. The aforesaid scenario does not consider that the interventionist role of planning authorities is distorted by two factors; first, the administration is also the regulator in this market; and second, the PPS may be used as a municipal funding source. These two features create a structure of perverse incentives for municipal authorities, who will design land use regulations taking into account their fiscal revenues and not just the overall social welfare. This generates incentives to curb the supply of land and boost revenues through direct transactions with PPS or to obtain more cash, instead of land, in the compulsory land assignment chapter. There is also an incentive to make strategic use of the considerable land supply they control. As shown in Table 3, the administration is the largest owner of unbuilt urban land in many of Spain's biggest urban areas, with an important position in the overall supply.

Table 3. Ownership structure of unbuilt urban land, by type of owner, in the 15 biggest urban areas of Spain (2011)

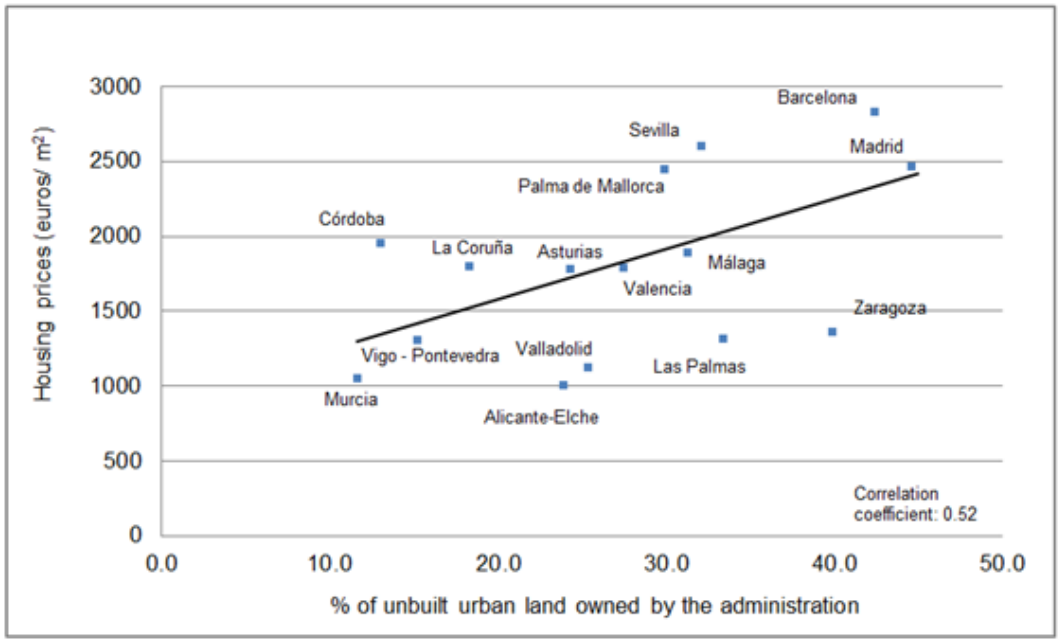
	Administration (%)	Legal persons (%)	Natural persons (%)
Madrid	44.6%	35.6%	19.8%
Barcelona	42.4%	28.3%	29.3%
Zaragoza	39.9%	46.6%	13.4%
Las Palmas	33.4%	29.2%	37.4%
Sevilla	32.1%	46.3%	21.6%
Málaga	31.3%	51.7%	17.0%
Palma de Mallorca	30.0%	41.6%	28.5%
Valencia	27.5%	34.9%	37.6%
Valladolid	25.4%	44.2%	30.3%
Asturias	24.3%	32.5%	43.2%
Alicante-Elche	23.9%	38.5%	37.7%
La Coruña	18.3%	26.2%	55.5%
Vigo	15.2%	21.3%	63.4%
Córdoba	13.0%	33.1%	53.9%
Murcia	11.7%	45.0%	43.3%

Note: the table includes the 15 top urban areas by population of the anchor city for which data exist on the ownership structure of unbuilt urban land; an urban area may comprise several municipalities.

Source: Ministry of Public Works and Infrastructure.

(185) The foreseeable effects of public sector action in the context of the incentives structure described above will be (i) that the PPS are not used to regulate the market, but to finance the municipal government, as indeed appears to have been the case and (ii) the PPS will introduce distortions into the planning decisions, with a negative effect on competition and impact on the formation of prices in the market. In fact, a simple analysis of the relation between the administration's relative weight in the supply of unbuilt urban land and the price of housing in Spain's 15 principal urban areas (Graph 6) signals the second effect and indicates that PPS may be having the contrary effect to the fundamental objective they pursue, and are actually making land and housing more expensive and constraining access to housing.

Graph 6. Housing prices and % of unbuilt urban land owned by administration in Spain's 15 largest urban areas



Note: data on ownership structure, 2011; data on housing prices, 2012.III.

Source: Prepared in-house using data from the Ministry of Public Works and Infrastructure.

(186) Ultimately, taking into account that PPS are used to obtain revenues, one may wonder if there is at least some linkage between the PPS and the social policy goals (primarily, social housing) to which PPS must be destined according to the current legal framework. In this regard, analysing the oral information provided to the CNC by Ministry of Public Works and Infrastructure, it appears that in many cases it is very difficult to assure that there is compliance with the specific uses and purposes that the law imposes on PPS: construction of social housing and other interests of social use. Therefore, it does not seem that their use systematically conforms to the applicable legal provisions.

(187) In summary, the function of regulating the market directly via PPS or restrictions in market transactions appears to have no justification. Moreover, given the perverse incentives that are in place, municipal governments are using PPS as a funding source, which injects distortions in the design of planning instruments. And lastly, it does not seem that PPS are being used solely for the specific purposes mandated by law. For these reasons, there appears to be no justification for their existence, nor therefore for the compulsory assignment of land to the administration be held as PPS in urban development actions. Other funding instruments need to be chosen for municipal budgets that are more efficient and less distortionary.

(188) In any event, it bears noting that PPS are not being used to achieve the objectives provided for by law, many of them related or tied to social policy goals. For this reason, for so long as PPS exist, measures should be established to ensure that they are actually used for their legally stipulated purposes.

V. CONCLUSIONS

One. Land plays a fundamental role in the economy.

Land is a necessary factor of production in almost any economic activity, a very important financial asset for households, businesses and the public sector, and a key element in housing production, an asset which, in addition to its significant social dimension, accounts for a large percentage of household wealth, with major bearing on consumer spending, savings decisions and employment decisions, with decisive influence on the economic cycle.

Therefore, **properly functioning land markets are essential for ensuring the efficient and competitive functioning of many other sectors of the economy**.

Two. The presence of market failures justifies public intervention in the land sector. However, that intervention can also have negative effects that need to be taken into account when designing land use policy.

Market failures refer to situations in which the market is not capable on its own of achieving efficient allocation of resources and in which public intervention could, in theory, enhance social welfare. In the land market the main market failures have to do with the existence of **externalities** due to incompatible uses of land, urban sprawl, loss of open spaces and congestion, amongst others; insufficient supply of **public goods**, such as parks and garden zones, sewage systems or roadways; **problems of asymmetric information** and uncertainty; and situations of local **market power**.

Although there are reasons that can justify intervention, it may generate costs that have to be taken into account when designing the intervention. Given that land is an essential and irreplaceable production input in a multitude of economic activities, these effects spill over beyond the land sector and can have adverse impact on a great many industries.

- Poorly designed intervention can **constrain land supply** and thereby limit competition and increase the price of land and real estate.
- By reducing the space available for siting different economic activities, **it can restrain competition in many economic sectors** whose geographical market is local.
- By making real estate more expensive or reducing the size of the sites where businesses may be established, intervention has a **negative effect on business productivity**.
- Inadequate intervention contributes to greater rigidity in the supply of land and real estate, which lessens the capacity to adapt to changing market conditions, generates **greater price growth and volatility**, and increases

both the likelihood and duration of speculative bubbles in the housing market.

- Intervention's effects on supply elasticity can **hinder labour mobility or divert economic growth** toward relatively less productive zones of an economy.

Three. The indicators analysed point out that land use intervention in Spain gives rise to a relatively more rigid land supply than in other countries, which may have contributed to intensifying the faster growth of prices recorded in Spain in recent decades.

Spain's long-term housing supply is inelastic and relatively unresponsive compared with other countries. This rigidity, apparently caused by rigidity in land supply, exacerbates the Spanish economy's real estate cycle and spurs stronger price growth, which aggravates macroeconomic instability and increases systemic risk in the financial sector.

Four. The CNC's preliminary analysis of land use intervention mechanisms in Spain detected numerous sources of inefficiencies

A) Administrative delimitation via town planning instruments of what land can be urbanised and how it must be urbanised.

A1. The urban growth boundary

The administrative uses land use planning to lay down an **urban boundary** to determine which land can be developed and which must be spared from the urban development process, with the aim of avoiding excessive and disorderly growth. The underlying idea is that without interventions cities tend toward urban sprawl, which raises the cost of services for all citizens as a result of the discontinuity of the urban sector and low density, while also jeopardising nature areas. The boundary is meant to keep the city within certain predefined limits.

Nevertheless, laying down a boundary is not the most economically efficient mechanism for pursuing those aims, as it does not address the origin of the external effect, but only deals with its symptoms. Thus, the boundary does not make citizens who live away from the downtown area internalise the external effect they generate, and this leads to the emergence of urban areas with non-optimal population density.

Furthermore, an urban boundary implies discretionary distribution of urban development rights amongst tracts of land in the municipality, which can contribute to rent-seeking conducts given the great value of “being included inside the boundary”. One criticism of the way urban boundaries are established in many Spanish cities is the excessive discretion with which their layout is

determined, as town plans do not include a detailed rationale for the solutions adopted or a projection of the future growth of the urban sector.

A2. Excessive delimitation of land uses

Second, in the planning process, and specifically when **zoning**, **town planners determine the use of each plot, as well as its buildable floor area ratio and other conditions for use**. Zoning seeks to avoid externalities between incompatible uses (for example, when a factory that generates waste is located next to a residential building) and reserves land tracts for public interest uses, with compulsory assignment of that land by the owners when the zone is developed.

Nor does zoning appear to be the most efficient intervention for correcting market failures, because instead of establishing conditions for the siting of activities that may generate externalities, in order to avoid them, what zoning does is to define the possible uses parcel by parcel. This mean that the more detailed the zoning, the more the municipal authorities replace the market in determining the quantity and location of economic activities. Excess zoning therefore configures, without justification, a planned municipal economy instead of a market economy.

Examples of disproportionate use of zoning in Spain have been found by the CNC in the past, with unjustified limits on supply in economic activities such as fuel distribution in service stations and the installation of large retail establishments.

Furthermore, and more indirectly, planning may result in land contemplated for a given use not being large enough or being located in an unattractive site, thereby limiting entry and competition. In the last instance, town plans usually go beyond determining uses and intensities and lay down specific restrictions of importance for setting up operations in different activities, curbing entry of competitors even more and further restricting competition.

As with the urban boundary, the capacity of zoning to correct market failures is influenced and distorted by rent-seeking activities and by the municipal government's fiscal dependence on revenue from land development and housing.

Zoning also tends to somewhat hinder the creation of mixed-use zones, thereby generating greater forced mobility, longer commutes and more pollution, just the opposite of the purposes pursued by the town planning process.

Lastly, zoning, in combination with compulsory assignments, can lead to inefficient provision of urban public goods. Indeed, given that it procures land supply at zero cost, the administration has incentives to zone land for public interest uses provided the marginal benefit to society is positive, even if that benefit is less than the opportunity cost in relation to alternative uses of the land assigned to those uses.

B) Complexity, discretionality and inconsistency of land use planning intervention

Land use planning employs a **large number of instruments**, each with its processing and approval phases and associated formalities. There is a considerable **lack of transparency** in the town planning process and in the determinations made for each type of land. At the same time, the inherent complexity of the Spanish land use planning system is aggravated by **regulatory heterogeneity at the regional and municipal level**. All this makes it harder for agents to make efficient locational decisions (such as finding the best spot to set up a business in a town), given that the costs of compiling the relevant information are quite high.

Furthermore, **town councils have very broad discretion** in all phases of the land use planning process. In general terms, the planning decisions of municipal governments do not have to conform to any set of clear and objective criteria: in Spanish urban planning, subjectivity appears to be the norm. And this implies a possible source of regulatory risk for agents, inasmuch as the value of the same piece of land can change dramatically due to unexpected governmental decisions.

Lastly, land use intervention, and planning in particular, display a **notable degree of temporal inconsistency**. This inconsistency is the natural result of two characteristic factors of Spanish urban planning. Firstly, planning is overly detailed and bears little actual relation to the real needs of the market. Secondly, municipal budgets are highly dependent on land-related revenue, specifically on the development compensation obtained in exchange for modifying land use plans via town planning accords. Rent-seeking by town councils through this type of "contract" urban planning favours a restrictive approach in the initial planning, in anticipation of subsequent modifications over time as a means of obtaining development compensation.

This complex, opaque, discretionary and inconsistent environment in Spanish urban planning augments the level of unpredictability, uncertainty and legal uncertainty in land market. Not only is this contrary to urban planning's core purpose of giving guidance and providing a predictable environment, it also acts as an obstacle to competition in the land market. Furthermore, town planning accords generate their own specific competition problems. For one, they allow private agents, who need not be landowners, to covenant with the administration changes in town plans through bilateral negotiations, generating information asymmetries that facilitate the attainment of competitive advantages. And the consideration stipulated in the accords often entails the construction of infrastructure for the municipal government, which may later be subcontracted on conditions not wholly in keeping with the principles of government procurement.

C) The transactions costs and rigidity of the urban planning process, especially in the implementation phase

Urban transformation of land, that is, the production of urbanised land, consists in fitting the land with the services and infrastructure needed for land to qualify as buildable lots. This process should be streamlined because the actual supply of land is the supply of urbanised land. Nevertheless, **the urbanisation process in Spain is, generally speaking, very drawn out: it can take as long as 15 years to transform non-developable land into developed urban land**.

There are several factors that increase transactions costs and rigidity in the land market. First, in general terms, urbanising land may require changes in the general plan and, in all events, additional planning instruments to the general plan will have to be approved that will slow down the pace of production of urbanised land.

Second, even where the requisite plans have been approved, there are additional transactions costs, especially in the legal execution of the plans. The system requires that inequities generated in the plans be addressed in this phase by means of fair distribution amongst landowners of the planning benefits and burdens. The final result is an extremely complex system that delays the production of land considerably, both for homebuilding and for other types of economic activity.

The slow pace of the land development process that is caused by the system's transactions costs and rigidity **limits competition in the land market and in other sectors considerably, reduces elasticity of supply and favours sharp price rises in response to increases in demand**. Finally, this lengthy duration imposes significant financing costs on operators, with a notable economic-opportunity risk in urban development projects.

D) Direct intervention by public authorities in the land market, especially in the form of Public Landholdings

The current legal framework gives the administration, and town councils in particular, a series of direct intervention instruments in the land market. The purpose of these tools, namely Public Landholdings (PPS) and rights of first refusal and redemption, is to regulate the market directly and assure certain planning objectives.

The fact that the administration has the capacity to directly participate in determining quantities and prices in this market is a very severe restriction of competition that does not appear to be justified. In theory, the prime objective it pursues is to *"prevent speculation"*, understood as withholding land from the market, as provided in article 47 of the Spanish Constitution. But the optimal solution for achieving this aim is not to assign a direct intervention role to the administration, but rather to eliminate entry restrictions and ensure there is competition in the land market so that it can be regulated by the free play of supply and demand. **As currently framed, land use intervention only**

aggravates the problem it is intended to solve, because it fosters supply-side rigidity and fuels "speculative" practices on the upside side of the cycle, generating an effect which is opposite to the constitutional mandate.

In addition, the actions of the administration, most specifically at the municipal level, are distorted by two elements which in any event prevent the aforesaid instruments from actually being used for the purpose for which they were designed. First, the **administration is also the regulator in this market**. Second, **PPS can be used as a source of municipal funding**. **These two elements create a perverse incentives scheme for town councils**, who will design their land use regulations taking into account their fiscal revenues, and not just the overall social welfare. Indeed, in practice, municipal governments do not use PPS to regulate the market so much as to finance their budgets. Moreover, in many cases the PPS are not allocated to the type of social uses — such as social housing— mandated by the current legal framework.

VI. RECOMMENDATIONS

Achiving an efficient regulation of the land market is crucial for promoting competition in the Spanish economy, boosting productivity and contributing to macroeconomic stability.

To attain this end, the CNC believes that an alternative model has to be articulated that is effective in correcting market failures and complies with certain public policy objectives but at the same time generates less distortions and fosters a competitive functioning of the land market.

The CNC is aware that changing the model demands changes to certain core elements of Spanish urban planning which have been shown to be inefficient through the empirical analysis. This must be carried out through a sweeping and well thought out reform of the current regulatory framework at all levels of government.

In any event, the analysis performed in this discussion paper has underscored areas in which there is clear room for improvement within the urban planning system as currently modelled, and which should be acted on near term in order to foster competition and productivity in the Spanish economy, boost its competitiveness and promote economic growth and employment.

The CNC believes the restrictions discussed in this analysis bear out the need to foster in-depth debate on the role played by current land use intervention tools, examining their necessity and appropriateness for the objective pursued and the costs they generate in terms of market efficiency. In this regard, the CNC initially proposes two alternatives to the current public intervention mechanisms which would entail a thorough revision of the latter, and which should become the object of immediate debate and detailed analysis:

- **Use tax (price) or development-right mechanisms instead of delimiting urban development borders, classifying as developable all land that does not necessarily require protection for duly justified public interest purposes.** Price mechanisms, based on fees and tolls, are as effective as the urban boundary, but clearly superior in terms of efficiency, as they attack market failures directly, allow externalities to be internalised and minimise distortions. There are other solutions as well, such as competitive allocation of development rights based on objective standards, which, though less efficient than price mechanisms, can be more effective than an urban boundary.
- **Replace the zoning that is characteristic of Spanish urban planning —highly detailed, interventionist and determined ex ante— with the use, on a general and fundamental basis, of rules or standards that serve to correct the externalities associated with incompatible uses**, but which at the same time allow the use of land not excluded from urban

development for public interest reasons to be determined, in large part, through the market and not via the town planning process.

In principle, this technique does not consist in identifying uses ex ante, but in assuring compatibility between uses by means of compliance with certain previously established rules that are the same for all players, allowing the externalities associated with certain uses to be corrected, but without deciding beforehand the location or quantity of land assigned to the different uses. This encourages a higher degree of competition in alternative land uses and swifter and more flexible supply-side response. This zoning approach is compatible with the use of structural instruments, which basically indicate where infrastructure networks will go and were certain public facilities will be located.

Without prejudice to the need for the debate proposed here, the CNC believes that even with the current model of planning instruments there are certain measures which can and must be applied, in both the planning and the implementation phases, to achieve a less inefficient functioning of the land market. Those measures, which could be adopted immediately, can foster greater supply-side flexibility in the land market, with the consequent reduction of costs for individuals and businesses:

One. **Zoning should be based on land use categories which are not unnecessary detailed and itemized**, with the goal of enhancing flexibility, reducing segmentation and encouraging competition and efficiency in the allocation of land.

Two. **Urban development plans should be required to include a *Competition Assessment Report*** that assesses the competition implications of land use and development plans, so that no unjustified restrictions on competition are introduced on the establishment of certain economic activities.

Three. **It must be ensured that the preparation and approval of planning instruments and town planning accords (*convenios urbanísticos*) comply with the principles of** publicity, transparency, competition and non-discrimination

Four. **Measures need to be introduced to reduce transactions costs in the development implementation phase in order to streamline land development**. In this regard, it is recommended that:

- **The design of the execution units should be made more flexible**, allowing landowners to decide which parcels should be included in the

execution unit and agree, where they consider appropriate, modifications to the weighting coefficients in order to facilitate negotiations.

- **The current administrative systems of action should be streamlined**, with the goal of reducing rigidity and facilitating quicker and more agile supply-side response.

Five. **It must be ensured that Public Landholdings (PPS) are actually used for the purposes established in the relevant laws and regulations.**

Six. Elimination of the rights of first refusal and redemption held by public authorities on land should be promoted.

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ANNEX I. Main Systems of Urban Planning Action

There follows a more detailed description of the features of the main systems of urban planning action in Spain.

Compensation System

The compensation system is the private execution instrument par excellence. The administration adopts a passive and vigilant role and private citizens take on the task and cost of executing the development plans. The goal of the system is for landowners to manage and execute the urbanisation of an execution unit with a sharing of benefits and burdens. Sharing benefits and burdens means that all of the landowners involved bear all of the development costs, even those that do not affect their respective parcels, and share in the common net benefit in proportion to their participation.

The choice of compensation system is set out in the relevant planning instrument and, in default thereof, when the execution unit involved is delimited[91].

The core element of the system is the Compensation Board (CB), an associative entity of an administrative nature that has its own legal personality and is necessarily created by the landowners to manage the execution unit and the execution of the development works. Its composition includes a member of the acting administration and representatives of the owners of the land lots included in the execution unit who have decided to be part of the board, the owners of land destined for generally systems, the public sector entities that own the assets included in the execution unit and such urban development companies as may join to collaborate with the landowners in managing the development.

A CB can only be formed if there is more than one landowner. To set up the CB, landowners must draw up draft bylaws and[92] basic terms of action[93]. Once this

[91] In the former case, the planning instruments establishes the system, and landowners accounting for at least 60% (or a similar percentage; percentages vary between Autonomous Communities) of the land area in the execution unit must submit draft bylaws and basic terms of action. Generally speaking, there is an initial time limit of three months and a second one of three months, after which failure to present the proposal entitles the administration to replace the compensation system with the cooperation or expropriation system. Some Autonomous Communities provide for variations in these time limits. In the latter case, the system is established at the request of the landowners in the execution unit delimitation procedure. The percentage of landowners who may request this is determined in the regional legislation, and ranges between 50% and 60% (or a similar percentage; percentages vary between Autonomous Communities).

[92] The bylaws are the organisational and operating rules of the CB.

[93] The basic terms of action (*bases de actuación*) regulate the CB's activity, the criteria for its actions, both as regards material execution and legal issues, and include the rules for distributing the development benefits and burdens. As with the bylaws, responsibility for

condition has been fulfilled, the process of constituting the CB begins and must go through a series of formal steps[94]. The approval of the bylaws and basic terms of action, and the actual incorporation of the CB, require administrative sanction, and the CB does not acquire its legal personality until the incorporation has been approved in the registry.

Once the CB has been formed, the land included in the execution unit is subject to fulfilment of the obligations that characterise the compensation system. The land held by landowners who have not joined the CB is expropriated by the administration, but transferred to the CB. The CB assumes responsibility for implementing the development, carrying out the full urbanisation of the execution unit and, if applicable, construction on the resulting buildable lots.

In this system, the principle of fair distribution of benefits and burdens is applied by means of the compensation project. The purpose of the project, in essence, is to draw up a concrete proposal for allocation of new plots that satisfies that principle. The content of the project varies depending on whether there is one or more landowners[95].

The compensation project is approved in a procedure that consists of several phases[96] and will in any event require final approval from the administration. In order for the project to be approved the landowners that do not form part of the CB have to be expropriated. Once the project is approved, execution of the development works can begin. Executing those works is the direct responsibility of the CB vis-à-vis the acting administration and constitutes, along with the distribution of benefits and burdens, the fundamental reason for setting up the CB. The works require approval of an urbanisation project (the cost of which is borne by the CB) and contracting of the works (part of the CB's duties).

Cooperation System

The cooperation system is considered a mixed system because the development is carried out by government but paid for by the landowners.

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drawing up the basic terms of action rests with the landowners included in the execution unit who undertake the initiative.

94 Initial approval; publicity of the initial approval resolution; public input and allegations; final approval; publication of the final approval resolution; effective incorporation; approval of the incorporation; registry; notification of registration.

95 Where there are several landowners, the project must include: description of the old properties; description of the resulting properties; location of the parcels subject to mandatory assignment and of the land reserves established in the plan; land area of the parcels which the CB reserves for sale to defray the development costs; cash compensation for differences in allocations, if necessary. Where there is only one landowner: location of the parcels subject to mandatory assignment and of the land reserves established in the plan; location of the buildable lots, indicating the ones where the administration's percentage of net benefit will be sited.

96 Drawing up of the project; hearing of all persons affected; initial approval by the CB; final approval by the acting administration; public deed; entry in the Land Registry.

Implementation of the land use plans by the administration implies that the latter takes the initiative for distributing benefits and burdens and for executing the development works.

In theory, this system is used when the number of landowners who state their wish to execute the development directly do not reach the required percentage, and in the absence of the reasons of urgency or necessity that justify applying the expropriation system.

The instrument for sharing benefits and burdens is the reparcelling project, which is required whenever there are several landowners and the planning has generated inequities between them. If reparcelling is not necessary (for example, where there is only one landowner), the transfer of compulsory-assignment land will be done by administrative resolution, the same as the placing of liens on the properties for discharge of the burdens and payment of expenses.

Once decided that the execution unit will be implemented under the cooperation system, the acting administration must follow the process of drawing up and approving the reparcelling project, or declare that it is not necessary.

The land development costs are distributed amongst landowners in proportion to the value of the reparcelled properties, or in proportion to the original properties if there is no reparcelling. The works are contracted by the acting administration, preferentially via a competitive auction. The affected landowners may form an association to work with the administration on the development works. Such associations may arise at the initiative of the landowners or of the acting administration.

Expropriation System

In this system the acting administration uses expropriation for all the properties and rights included within the scope of the action, and directly executes and pays for the development works and, if applicable, for the construction. The landowners receive a 'fair price' (*justiprecio*) as compensation from the administration. The prime difference with the cooperation system is that in the latter the administration directly drives the development process, although at the cost of the landowners, who continue to own their properties, receive the relevant development net benefit and bear the cost of the development. The expropriation system can be applied directly by the acting administration or through a concessionaire that it selects.

Compulsory Execution System

The laws in some regions include systems with this name (*sistema de ejecución forzosa*). The aim is to put an end to situations in which private action systems are stymied or fail to comply with the stipulated timetables. In some cases, the powers of the CB are transferred to a management commission on which the administration and landowners are represented in equal parts. The town council

occupies the land in favour of the management commission, which executes the development and proceeds to distribute the benefits and burdens. In other cases the municipal authorities undertake on a subsidiary basis the execution under any of the systems of private action instead of, and for the account and expense, of the landowners. The municipal government implements the system by commissioning a government owned commercial corporation or a commercial company set up for that specific purpose and which may have public-private capital.

Urban Development Agent System

Lastly, in the urban development agent system, which is predominant in regions such as Castilla la Mancha and the Valencian Community but also present in others, the development activity is pursued by the public authorities and not by the landowners. Despite its public nature, it requires a large economic investment and management capacity, so it is also conceived of as a business function.

In theory, in the Autonomous Communities where this system exists, the planning instruments do not programme the development of urbanisable land. The urbanisable land, is not yet programmed by mere fact of having been classified and zoned, that is, it is not included in the urban development process by mere fact of the approval of a general plan and a partial plan. Inclusion in the development process is determined by another specific type of instrument: the programme[97].

The agent that executes the plan is always a public agent. The system involves direct management if the development agent is the administration, and indirect management if it is a private urban development agent selected by the administration when the programme is approved[98]. In neither case is the developer required to own the land to be developed.

The developer is a public agent responsible for executing the development action, drawing up the development and reparcelling projects, carrying out the material execution of the works and passing the development charges onto the landowners.

The relation between the development agent and the owner is articulated, preferably, via the agreements they freely reach. If such agreements are not reached, the stipulated technique for ensuring that the plans are implemented is compulsory reparcelling, which is approved by the administration at the proposal of the development agent. This technique allocates new parcels to the landowners, parcels to the development agent (if the remuneration for its

[97] Programme of Integrated Action (*Programa de Actuación Integrada* — Valencian Community), Programme of Development Action (*Programa de Actuación Urbanizadora* — Castilla la Mancha).

[98] The systems for selecting the urban development agent vary from one Autonomous Community to another.

activity is land), and tracts are ceded to the administration. In direct execution programmes, expropriation is envisaged as one possible but not indispensable method.

The landowners obtain developed and buildable lots as a result of the programme's implementation. The developer bears the development costs and may demand to be compensated by the landowners by means of payment of development 'quotas' or the assignment of buildable lots[99] of those to be urbanised in the execution of the action. As a general rule, the developer is compensated in buildable lots and only exceptionally in cash[100]. Landowners who decline to cooperate because they do not approve of the urban development of their land, may waive participation and request to be expropriated at the price of developable land (that is, in theory, without taking into account the increase in the land's value that will take place after it has been urbanised). To improve the landowner's situation, the law allows landowners to organise (the requisite percentage of landowners is normally 30%) and propose an alternative to the developer's proposal.

[99] The development agent's land compensation is fixed using a remuneration coefficient obtained by dividing the development costs by the value of the land.

[100] When the landowners pay for the development work in cash, the development quotas and their imposition have to be approved by the acting administration, and the amount per parcel is calculated by pro rata distribution of the costs, having regard to the objective development net benefit. At the same time, non-payment of the quotas will give rise to compulsory execution through the acting administration for the benefit of the development agent.