The Potential Role of Market-based instruments in land use planning: lessons from UK regulatory experience

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Abstract

Land use planning policy in the United Kingdom in its present form can be traced back to the introduction of 1947 Town and Country Planning Acts. Although there have been numerous legislative changes since that time, in essence, the system has remained unchanged ever since. Under the terms of the Acts, anyone wishing to develop land must first obtain a llicence in the form of planning permission from the local planning authority. While leaving the ownership of land, in terms of its legal title, unchanged, the 1947 Acts profoundly changed the property rights governing land development. In effect, the Acts nationalised land development rights and gave the planning authorities the power to reprivatise those rights on a partial and discretionary basis. The principal element of flexibility in the system – originally known as 'planning gain' – was not introduced until 1971. This introduces some, rather limited, scope for negotiation between developer and planning authority on the terms under which planning permission will be granted. This paper explores the economic consequences of the United Kingdom's highly regulatory approach to land use planning. It also discusses the potential role that a more market-based system, based on private property rights and the use of economic instruments, might play in land use and the environment. And it analyses some of the problems that a decision to introduce such a market-based approach might encounter.

Introduction

1. The use of market-based instruments for environmental policy purposes in the United Kingdom was first advocated in an official publication as long ago as 1972 (Royal Commission on Environmental Pollution, 1972). However, it was not until the publication of the environment white paper of 1990 (HM Government, 1990) that it was explicitly adopted for policy purposes. Of course, the relevant theoretical principles had been developed long before (Pigou, 1920) and it is interesting to reflect on this as an example of just how long the delay between theoretical development and practical application can be. However, one should perhaps not overstate the time delay in this case; there are examples of market-based instruments in place before the 1990 white paper, the differential rates of duty on leaded and unleaded petrol being perhaps the best known example. On the other hand, progress since the 1990 white paper has not been especially rapid.
2. The white paper itself was followed up quickly by an official publication that provided a more detailed explanation of the case for market-based instruments (Department of the Environment, 1993). However, the proof of the pudding is really to be found in the policy applications actually in place, and here progress has been somewhat patchy and uneven. Part of the reason has to do with the amount and complexity of the research and analysis that often has to be carried out before policy implementation. An early example of this problem can be seen in the complex analysis preceding the application of tradable emission permits in the control of sulphur dioxide pollution (see, for example, London Economics, 1992). And the more recent case of the London congestion charge probably needs no introduction. Whatever the reasons, it can be said with some confidence that one area of policy

where virtually no progress has been made is in land use planning. This paper discusses why there has been so little progress in this field, what obstacles would need to be overcome before progress might be made, and what the potential role of market-based instruments in land use planning in the UK might be. First, however, we discuss some of the salient characteristics of the UK land use planning system.

The UK Land Use Planning System

3. The system of land use planning in currently in force in the UK has its origins in the 1947 Town and Country Planning Acts. Although there has been a substantial number of legislative changes governing land use planning since 1947, essentially it is the system introduced by the 1947 Acts that remains in place. The Acts adopted an approach in which decisions on planning applications for development submitted by prospective developers are determined by local planning authorities (LPAs) against the policy background of a generalised development plan. The key to understanding how the 1947 Acts work is the concept of planning permission. Generally, under the terms of the Acts, anyone wishing to develop land by carrying out a substantial physical operation or by making any significant change to the use of land or buildings must first obtain a licence in the form of planning permission from the LPA.
4. While leaving the ownership of land, in terms of its legal title, unchanged the 1947 Acts profoundly changed the property rights governing land development. The Acts effectively nationalised land development rights and gave the planning authorities the power to re-privatise those rights on a partial and discretionary basis. Thus, although under the terms of the Acts, the state does not own any physical asset, it does have a right to control development. This right is divested by the grant of planning permission, but this divesting relates only to a specific development proposal, and LPAs tend to maintain tight controls over its execution and subsequent use. The key point is that LPAs and the relevant government minister (in England currently the Secretary of State for Communities and Local Government) have a wide measure of discretion as to whether to grant planning permission and as to the conditions under which that planning permission is granted.
5. The 1947 Acts place certain limits on the discretionary powers of the planning authorities (Grant, 1988). It is important to realise, however, that although landowners and developers have certain rights under the terms of the 1947 Acts, in exercising those rights, they have only limited recourse to the courts. Thus, for example, although landowners have a right to make representations in relation to planning applications made by others that might impact upon their own property, there is no right of litigation for this purpose. Also, while it is true that prospective developers have the right to appeal to the courts about decisions on planning permission, the role of the courts in deliberating on such appeals is quite limited. Under the terms of the 1947 Acts, the role of the courts is largely confined to that of ensuring that the planning authorities have made their decisions about planning applications in accordance with the proper procedures. Generally, the courts have not seen it as their role under the 1947 Acts to try to determine the proper relationship between the conditions accompanying a grant of planning permission and the projected impact of the respective development (Grant, 1996).

6. Even when the courts do quash a planning decision because an LPA has, in the court's view, behaved unreasonably, the matter is simply returned to the LPA for further consideration. The courts have seldom severed a condition they have considered unlawful from a grant of planning permission. The LPA's right to make a planning decision, therefore, is not abrogated. Where their decision to grant planning permission subject to conditions is quashed by the courts, the LPA might simply decide to refuse planning permission altogether. The reality is that the consent of the LPA has to be obtained before development takes place, and, whatever decisions are made in the courts, the element of discretion on the part of the LPA is retained.
7. This position was confirmed recently by the House of Lords, the highest court in the UK, in overturning a decision of the High Court. On 13 December 2000, in response to four separate applications, the High Court considered the English planning system and found it wanting in terms of Article 6 of the European Convention on Human Rights. The High Court found that the role of the minister as ultimate decision-maker in current planning legislation was incompatible with the procedural right to a fair hearing set out in Article 6. One consequence of this finding would have been that the minister would no longer have been allowed to determine planning appeals, as his doing so would have contravened the UK's Human Rights Act. The ruling would have removed the conflict of interest whereby the minister both sets the rules of the planning system and also decides the outcome of individual cases brought under those rules (Armstrong, 2000). In the event, the House of Lords quickly overturned the High Court's decision and it appears that legislation will now be necessary before the minister can be divested of his powers in this area.

Administrative Discretion

8. Differing views have been expressed about the desirability or otherwise of the exercise of administrative discretion in land use planning. In his comparison of land use planning in the UK with that in the USA, Wakeford (1990) expressed support for the discretionary content of British planning. On the hand, in his comparison of land use planning in the UK with that in the Province of Ontario, Canada, Stephen (1987) was critical of the discretionary content in the British system on the grounds that it was not conducive to clarity in the ultimate objectives of public policy. As it happens, such criticism of a lack of clarity in the objectives of British land use planning has been quite frequently voiced over the years (see, for example Hall et al., 1973; Department of Land Economy, University of Cambridge, 1995). Even a recent government consultation paper expressed the view that the outcome of planning applications is frequently uncertain precisely because there is insufficient clarity about the criteria against which an application will be judged (Department for Transport, Local Government and the Regions, 2001).
9. One of the consequences of such lack of clarity in land use planning objectives is that, over the years, it has proved very difficult to carry out any sensible evaluation of land use planning in the UK. Official guidance on policy evaluation generally indicates that the first step in policy evaluation is to define the objectives of the policy in question. Yet it is precisely this first step the few serious attempts to conduct an

economic evaluation of British land use planning have found it difficult to take or to go beyond. An obvious example is that of planning gain.

10. Planning gain was first introduced through section 52 of the 1971 Town and Country Planning Act (now superseded by Section 106 of the 1991 Planning and Compensation Act which, however, did not result in any change to the general approach). This legislation introduced the concept of 'planning by agreement' whereby a developer obtains planning permission by providing, at his own expense, an asset or service to the community that would not have been provided but for the need to obtain planning permission (Bowers, 1992).
11. There seem to be two rather different ways of looking at the function of planning gain. First, it might be regarded as a means by which developers might compensate third parties for the damage arising from development or for the public infrastructure costs contingent upon it. Secondly, it might be regarded as an informal way of taxing land betterment. The consultation paper on planning gain published by the government in 2002 specifically denied the latter interpretation (Office of the Deputy Prime Minister, 2002). On the other hand, the reference in the same paper to using the proceeds of planning gain to provide 'social, economic and environmental benefits to the community as a whole' implies the opposite conclusion. Whatever the truth of the matter, the reality is that because negotiations about planning gain are generally conducted behind closed doors the developer's liability is open-ended and is therefore likely to amount to informal betterment taxation.
12. The point of this example is not to argue against betterment taxation. On the contrary, one does not have to go along with the Georgists' position on land value taxation (George, 1879) to advocate betterment taxes on development land, made artificially scarce by the planning system, as a means of siphoning off economic rent. No, the point of the example is to illustrate just how little clarity there is in the objectives of land use planning in the UK. It should be emphasised that, ultimately, this lack of clarity can be attributed to the fact that development rights are vested in the state. Landowners and developers, and indeed other private parties, have no right of access to the courts to challenge the content of planning decisions as distinct from the questions of whether those decisions have been arrived at in the procedurally correct manner.
13. One critique of this kind of situation derived from public choice theory points to the inherent tendency towards 'government failure' if the allocation of property rights is left to politicians and bureaucrats. When interest groups and bureaucrats capture the political process, voters have insufficient incentives to discipline mismanagement because costs are so widely spread among taxpayers, none of whom can have a decisive influence on the result of an election (see, for example, Pennington, 1998). If development rights were vested in landowners and other private parties, government would continue to have a legitimate interest in how they were exercised but the regulatory framework would necessarily be more transparent and private parties would be able properly to defend their interests in the courts. Planning gain, for example, would probably have to be negotiated according to a published tariff along the lines pertaining, for example, in the case of Ontario (Stephen, *op cit*). Thus, for example, developers wanting to develop land in the flood plain of the Thames or the Humber estuaries would be expected to contribute towards the costs of flood risk

management in accordance with the beneficiary pays principle. However, the extent of such contributions would be known beforehand and, in the event of disputes, the matter could be referred to the courts. Equally, third parties or prospective developers wishing to challenge decisions about planning permission would have access to the courts in defence of their interests.

Free Market Environmentalism

14. If the inadequate definition of property rights in land development is one of the principal criticisms levelled against the UK land use planning system, a second relates to the difficulties of calculation and 'knowledge problems' associated with central planning. It is argued that the preferences of individual consumers are subjective and not capable of being measured by an outside observer. Only in situations of actual choice are preferences revealed and only when people decide to exchange one thing for another (an amount of money for a scenic view, for example) are relative weights assigned to these preferences. In the absence of a genuine market where property rights are assigned, there is no way (so it is argued) for government planners to know how much environmental protection is actually desired (Pennington, *op cit*)
15. It is these problems that have led free market environmentalists to argue that the ultimate solution to the problems of land use planning is to have the allocation of property rights and hence the level of environmental protection itself determined by the market. The role of the state would be confined to the enforcement of contractual agreements made between private parties. A favourite example of such property rights entrepreneurship is the use of restrictive covenants enforced under the common law (*ibid*.).
16. Whilst there is little doubt such an approach can have a useful role to play in some circumstances, it is highly questionable whether it can be regarded as any kind of panacea. To understand why, it is necessary to refer to the normative Coase theory (after Coase, 1960). Put simply, this provides that the law should be structured so as to minimise he impediments to private agreements (Cooter and Ulen, 1988). For example, voluntary exchange is more likely to be successful when property rights are clear rather than when they are ambiguous. Property law therefore favours criteria for determining ownership and property rights that are clear and simple. So far so good for the free market environmentalists.
17. Unfortunately, there is more to it than this; Coase's analysis also emphasises the importance of transactions costs – defined as the costs of information and bargaining, and of policing and enforcing property rights and contracts. Transaction costs can block mutually beneficial exchange and co-operation. Voluntary bargaining is often costly because discovering an agreed solution might require extensive negotiation, whilst enforcing it might require equally extensive monitoring and policing. Negotiation, in particular, involves communication, and the costs of negotiation depend, in large part, upon the number of parties to a dispute and their geographical dispersion (*ibid*.).

18. The choice of remedy for resolving disputes about incompatible property uses in circumstances where one person is illegitimately interfering with another person's property has been analysed by Calabresi and Melamed (1972). Where an externality has arisen, the courts have to choose between compensatory damages and an injunction. Where there are few obstacles to co-operation, the preferred remedy usually involves the award of an injunction against the defendant's interference with the plaintiff's property. However, where there are obstacles to co-operation, the preferred remedy usually involves the award of compensatory money damages.
19. When this standard is actually applied, the preferred legal remedy depends in large part upon just how many parties must participate in a settlement. Where a dispute involves a small number of contiguous property owners, the costs of bargaining are likely to be low, bargaining is likely to be successful, and, therefore, the most efficient remedy for resolving property disputes is injunctive relief. In contrast, where disputes involve a large number of geographically dispersed individuals, the costs of bargaining will be high, bargaining will therefore not work, and the efficient legal remedy is for the courts to determine compensatory damages.
20. The relevance of Calabresi and Melamed's findings for the free market environmentalists' view of land use planning should be obvious. If there is a large number of parties involved a dispute about land development and/or land use, the kind of remedy preferred by the courts will be likely to be compensatory damages. How are the courts to determine such compensatory damages other by reference to the methods of environmental valuation? It is no use free market environmentalists (or, for that matter, others not of that particular persuasion) to wring their hands about how difficult it is for politicians and bureaucrats to assess how much value to place on environmental protection. If the courts have to arrive at such assessments anyway, the argument falls away. There is no reason to believe that the courts will find the task any easier than bureaucrats, but this does not alter the fact that it will have to be done. As already explained above, in reality, the principal advantage of getting the courts to take on the role is to get greater transparency in decision making. This is evidently the view taken in the North America; witness the aftermath of the Exxon Valdez disaster! (see, for example, Willis, 1995) And this is the view we would urge should be taken in the UK too.

Market-Based Instruments for Land Use Planning

21. If free market environmentalism seems unlikely to provide more than a small part of the solution to land use planning in densely populated countries like the UK, might there be more scope for the kind of market-based instruments advocated in the 1990 environment white paper? The starting point for addressing this question is to define the market-based instruments we are talking about. The Department of the Environment (*op cit*) listed a number of different types of market-based instrument. However, most market-based instruments fall into one of two principal categories: environmental taxes and charges and tradable permit regimes. It is not our purpose here to advocate precisely which combination of such instruments might be

appropriate for land use planning purposes in the UK. Rather, we confine ourselves to making a series of observations on their potential application in this context.

22. First, as regards environmental taxes and charges, there is an important distinction between resource use taxes and *in situ* resource rent or site-value taxes (see, for example, Young, 1992). Thus, on the one hand, there are taxes and charges designed to siphon off economic rent arising from the artificial scarcity of land for development actually generated by the land use planning system. On the other hand, there are taxes and charges designed to modify the pattern of land development activity. As we have seen, in the UK land use planning system, these economic functions are hopelessly confused in section 106 agreements on planning gain.
23. Second, as between environmental taxes and charges designed to modify behaviour and tradable emission permit regimes, there is an important difference of emphasis. Environmental taxes and charges generate revenue but do not guarantee certainty of outcome. Emission trading regimes should guarantee certainty of outcome but do not generally generate much revenue (Tietenberg, 1990).
24. Third, in land use planning, the generic equivalent of the emissions trading regime is the tradable development rights (TDR) regime. Unlike emissions trading regimes, TDRs do not guarantee certainty of outcome. However, a variant of TDRs known as the habitat transaction method (HTM) does do this. (Clark and Downes, 1995).
25. Fourth, experience to date with TDRs has been almost exclusively in North America. Consideration of their use in the UK has been advocated in the academic literature (see, for example, Corkindale, 1999; Chiung-Ting Chang, 2005). However, introducing TDRs into UK land use planning would be unthinkable in the absence of a thorough review of precisely how they work in North America, how successful they have been, and how far they might be applicable in UK conditions.
26. Fifth, experience with betterment taxation designed to siphon off economic rent generated by the artificial scarcity of development land in the UK has not been very successful. This is, in part, because it has historically been something of a political football. Incoming Labour administrations have introduced betterment taxation in various different forms in 1947, 1967 and 1976, whilst Conservative administrations have abolished it in 1953, 1971 and 1985. One consequence seems to have been that, while Labour has been in office, land has been held back from development by landowners and developers in the expectation of (to them) more favourable tax treatment from any incoming Conservative administration.
27. Sixth, as we have seen, the introduction of planning gain in 1971 has resulted in a good deal of confusion as to its true purpose. Paradoxically however, to the extent that its underlying purpose has been to tax betterment less formally, this very confusion about the purposes of planning gain might have helped take the political heat out of the betterment debate (Corkindale, 2004).
28. Seventh, there has been a good deal of discussion recently in UK government circles about the possibility of introducing a ‘planning gain supplement’ (PGS). These discussions do not so far seem to have been brought to a conclusion, although H M Treasury’s purpose seems to be the taxation of land betterment. If this is so, we would argue that a taxation model more likely to serve the purposes of siphoning off economic rent would be the highly lucrative (for the public finances) sale of third generation mobile telephone licences. The arguments of the Georgists about land

valuation taxation notwithstanding, the taxation of economic rent is unlikely ever to be regarded as wholly fair taxation (see, for example, Lipsey, 1989). A pragmatic approach, and one in keeping with the traditional principles of public finance, would be to design taxes that, whilst not being exactly unfair, are at least likely to be lucrative in terms of their impact on the public finances. The auctioning of planning permission, for example for out-of-town shopping centres or casinos that are deliberately restricted in number on planning grounds, might be one way forward.

29. Eighth, taxes and charges levied to discourage development, for example in areas of outstanding natural beauty (AONBs) and subsidies to encourage development, for example on brown-field sites, would require careful assessment of their likely impact before they could be introduced.

Conclusions

30. In January 2006, the Barker Review of Land Use Planning issued a call for evidence. (The Chancellor of the Exchequer and the Deputy Prime Minister had earlier invited Kate Barker, a member of the Bank of England's Monetary Policy Committee to conduct an independent review of land use planning in England.) At the time of writing it is not clear precisely what will emerge from this review, although it is perhaps unlikely to include recommendations in favour of the more radical measures such as tradable development rights. Although it is interesting to speculate about what *will* come out of Barker review, perhaps the more interesting question is what *should* come out of it?
31. In our view there are two essential elements. First, it is very hard to defend a land use planning system that denies interested parties access to the courts in defence of their own interests. The implication is that appeals to the courts from third parties and prospective developers should be concerned with the content of decisions about planning permission just as much as with the procedures by which those decisions are arrived at. In effect, this means that land development rights should be re-privatised. (Given that financial compensation for the nationalisation of land development rights was paid to landowners following the introduction of the 1947 Town and Country Planning Acts, this recommendation carries with it the assumption that financial compensation would have to paid to the government for their re-privatisation.) A further implication is that informal arrangements for resolving disputes about land use and land development would need to be available to avoid some of the costs of expensive litigation. One possibility might be to transform official planning enquiries into informal environmental dispute resolution procedures on the American model (see, for example, Susskind and Cruikshank, 1987)
32. Secondly, and a necessary consequence of the first recommendation, would be to adopt a more open and transparent approach to the question of what developers should pay towards the costs of public infrastructure investment contingent upon the land development they promote. If, for example, the beneficiary pays principle and the user pays principle advocated by OECD were to be adopted in this area, this would imply the need for published guidance, if not published tariffs. These would show in advance of any decision about planning permission clearly how these costs are to be determined and allocated.

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