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CHAPTER 9

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Abstract

The challenges of the modern world, such as urbanization, and the urgent need to increase access to infrastructure are forcing many countries to look for new solutions to support economic growth and a sustainable development agenda. Meanwhile, there is the problem of the infrastructure investment gap, when state development institutions are in dire need of money to implement the long-term infrastructure projects. According to the *Global Infrastructure Outlook*, the demand across 50 countries and seven sectors to 2040 for investment resources could reach $97 trillion (Oxford Economics 2017). To solve this problem, the active participation of private companies is proposed through the framework of public–private partnerships. In July 2016, the Group of 20 (G20)/Organisation for Economic Co-operation and Development Task Force on Institutional Investors and Long-term Financing provided a supporting note to the Guidance Note on Diversification of Financial Instruments for Infrastructure and SMEs to the G20 Finance Ministers and Central Bank Governors and the G20 leaders. Land-based financing was indicated among innovative financial approaches; its mechanism uses land jointly with financial and/or tax instruments (such as tax increment financing), so that infrastructure investment spurs growth in the economic sector as a whole. At the same time, there are a number of challenges when applying this tool that should be resolved for practical successful implementation.

Challenge

Land-based financing (LBF) is an investment tool used by governments to generate income from private land and then redistribute it through private actions with stakeholders. We can see a promising side of the land-based approach in developing countries, since land can become a profitable asset with proper management and tax measures, and the national currency will be used to protect against risks. Let us draw attention to the complex aspects that require collective decisions.

Investors may experience complex difficulties

Some of these difficulties are associated with raising capital and investor confidence, while others are dictated by unformed money circulation tools. Key concerns include a possible land asset bubble, misunderstanding of how “unlocking” land value may work, risks, lack of interaction policies, among others (UN-Habitat 2016).

Governments do not know what to do and how

The policy of government participation and coordination with private capital should be formed with the consideration of account tax, managerial, and sociocultural factors. The key task is also to explain how public authorities can exchange land assets for infrastructure assets. This understanding should inspire governments to provide the necessary institutional, legislative, taxation, and other measures (OECD and World Bank 2018).

Tax instruments may still be unpopular

Tax policy has been and remains a sensitive issue, especially as developed-country models cannot be replicated in the context of developing countries. At least six land-based financing taxation tools exist, each with its own pros and cons. Tax uncertainty, thus, forces governments to choose between excessively high or insufficient rates, opportunities, and risks (UN-Habitat 2016).

Decentralization is considered an inappropriate step leading to loss of control

Decentralization is an important decision, as it allows cities to grow, therefore infrastructure should not be too centralized either. However, this step is difficult for governments that must transfer the management of vital assets to cities. On the other hand, cities cannot use effective tax, management, or other measures, because they simply have no rights to do so (OECD 2017).

Working to solve this complexity of problems (which can include dozens of different objections and controversial points) can help stakeholders start land-based financing and earn revenues.

Proposal

Various solutions can be proposed for more effective implementation of the LBF tool.

The first step is a systematic approach and long-term participation

Designed solutions from time to time return us to the basic concepts related to investment, taxation, and institutional approaches. The first solution can be a systematic approach, acting across disciplines in all areas, to obtain the most effective results. A systematic approach involves investing in cities as a whole, but not in individual projects, which is why land-based financing involves such complex (i.e., “core”) measures as legislation, municipal management, taxes, and even reforms. Analyzing the highlighted difficulties, we suggest the following measures.

What needs to be done:

- creation of unified tax, legislative, enforcing policies
- sharing opportunities between the public and private sectors
- focus on long-term expectations and stable land management

Long-term participation implies that the processes last long, are complex, and require certain changes or upgrades. The creation of infrastructure and the respective economy that appears around it and generates income takes a long time. Ultimately, such a large-scale problem as the provision of clean water in developing countries requires the largest amount of investment, as well as needing effective measures.

This is, therefore, not a project that investors and governments can start merely gathering enough capital. While using a long-term (systemic) approach, countries can also solve the missing-middle problem by introducing private capital to public funds (UN-Habitat 2016).

Launching decentralization and transferring rights to municipalities

Institutional reform is a must for the implementation of land-based financing. Whether there is a meaningful intermediary government between the national government and the local government, it is often the case that the central authority must adopt enabling legislation, creating the legal framework for the land-based financing instrument. The local government must then adopt a local ordinance implementing the instrument and setting out the details for its administration within the local context. Municipalities will be able to gain the institutional capacity to manage debt or a portfolio of built assets. This will open the way to balanced capital management. Central and local authorities can be involved in a dialogue to build win-win frameworks, when decentralization becomes an effective measure, not a risk, from a financial point of view, among others (OECD 2017).

From this perspective, we can see reform as an opportunity to exchange municipal provision of services for public–private partnerships, which improve the quality of services delivered. Grant financing of municipal infrastructure can be replaced by debt financing. Finally, cities will be able to get quality services, operating with capital and developing infrastructure, which is the basis of economic development. However, before giving municipalities elevated rights, it is necessary to understand that they can come to a certain financial stability. Municipal revenue streams can be improved by rational fiscal policy; in other words the stability of own-source revenues.

In developing countries, the government can be far from the people, and grant projects do not provide effective results, especially systemic ones. But decentralization makes the government closer to society. Decentralization as a set of policies and frameworks delays revenues where it works, elected officials become more responsible, and the development of local government capacity increases.

Land shows advantages by generating revenue

Public and private participation in land-based financing changes the outlook on what land can give. By selling or leasing publicly-owned land, economies receive income for infrastructure investments. Economies, guided by the opinion of specialists, should provide that the expectations from land financing should not be overstated, but rather rational. The obtained revenue cannot be used in the operational budget, but must work to developing the complex infrastructure.

The other related question is: How does the value of private and public wealth compare? Is it possible that public action and/or investment can lead to increased private wealth? Public actions can increase the well-being of all who are connected with the land. There are many tools, such as partnerships and joint participation of the public and private sectors, but another side is adherence to the policy by users of services.

Parties receive income that can be further invested and capitalized. Common goals bind the parties and lead to a common result, such as infrastructure development.

Land financing can be used to:

- cover the cost of providing public goods
- cover the cost of providing public infrastructure investments
- stimulate the efficient use of land
- receive state compensation for the private use of land owned by the party-state
- cover the costs of managing private construction
- increase tax revenues
- create a land registration system

The parties must also understand that land is a unique asset. That is why sociocultural norms highly value land and can be perceived as a difficulty if we are not sensitive to them. People must know in advance what kind of land can be used, how it relates to the people, and what are the possibilities to develop it.

Taxes are becoming a living tool for infrastructure development

Properly selected tax measures, in combination with an understanding of the land-based tax regulation at all levels, can play a key role in the infrastructure financing process. Recurring taxes on land and buildings can serve as follows:

- finance local infrastructure costs
- provide benefits in public finances
- lead to land value sharing

It is also important to consider the following factors:

- Compatibility of tax policy with the traditions of property management and/or taxation in the country.
- Creation of a fiscal cadastre linking real estate with taxpayers. This allows parties to track all existing communications with a certain land.
- Tax policy should be formed taking into account modern realities. If markets are ready to introduce certain rates, then it can be set.
- Administrations should participate in the creation of tax policy and propose their measures, literally influencing the process of infrastructure development in real time.

Tax policy should be the subject of active discussion in every country. Many tools can be reviewed and applied regardless of how they worked in developed countries since the market specifics vary greatly from region to region. Annual property taxes may be revised and other tools reinstated. Betterment levies, especially when collected as special annual assessments, can increase attractiveness for private investors.

Developer exactions can mitigate the expected negative effects of development

The objectives with which this tool may be used are region specific. The infrastructure of each country may have its own characteristics. But, for example, developer exaction (one-time fee paid up-front by developer as a precondition for public approval to develop land) may offset the municipal costs associated with larger water and wastewater lines building, demand for vehicle access, public spaces, among others.

Parties should contribute to establishing developer exactions at many levels, such as legal, planning, engineering, and administration levels.

This tool has its negative sides, such as high prices, which are returned to users of services. Therefore, fees should be considered with caution, in a system of comprehensive measures to ensure infrastructure projects and systemic reforms.

Investors should not be afraid “to enter this plot of land”

Private capital still assesses the risks of investing in developing countries. There are several systemic measures that can be taken by states and implemented at a broad level:

- supporting the institutional capacity of municipalities
- creating a monitoring and reporting system to control decentralization
- implementing measures related to debt financing
- regulating the introduction of infrastructure
- the public sector still has to provide important parts of the projects
- governments should focus on dialogue with the private sector

Finally, the debt must be expressed in the local currency, since foreign income is limited in this sector. The use of the local currency also prevents the risks associated with fluctuations in exchange rates and solves many issues of private investors.

It is also worth making it clear to investors that land is an excellent source of income, besides the fact that it may be a traditional little-used state asset.

Land has many advantages:

- the management of land is more transparent; land is in a fixed place
- land financing may allow subnational governments to gain independence
- taxes related to land ownership are generally less risky for the tax system as a whole, compared to other types of property

Many studies highlight the link between the level of urban infrastructure and economic growth, poverty reduction, and the quality of life. According to Mathur, 9% to 10% of economic growth depends on how a city's infrastructure is developed (Mathur 2018). Transport is one of the most important areas for working in this space. Although the mechanism for obtaining benefits from transport infrastructure is more like cost recovery, it is a necessary step to build an effective economic chain at all times, and taken at a higher level.

Creation of consistent policies

Consistent policies imply a holistic work of the land-based financing mechanism. Parties should also receive information on the detailed plans and projects directly, taking into account the systemic approach. Data on land, parties, partnerships, and legislation should be communicated to the parties and publicly disclosed.

Important points to note are:

- registration of land, identification of connections—land cadastre
- systemic legislation—each norm of which is in agreement with another norm
- support for processes involving state participation

It is also possible that social policy is a lost moment, and specialists ought to pay attention to other negative effects associated with the growth of economies in developing countries. The infrastructure will serve as a basis for solving the set tasks, but social analysis may also play an important role.

However, there is still an extremely important condition to be mentioned. All these solutions to reduce the infrastructure gap will only work in developing countries with growing economies. It cannot be done in crisis situations or in total poverty. In conditions of severe poverty, starvation, or unemployment, infrastructure development will most likely not be considered a priority field. That is why the first thing a government should do is stabilize the national economy, and most preferably create conditions to support constant growth. Thus, countries are the stakeholders, on which the development of infrastructure also depends. Governments representing the will of the whole country can find an opportunity for dialogue with the private sector, municipalities, developers, and civil society to provide quality services, without which further growth and investor profits will not be possible.

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