

Olga Kaganova

Question 1.

Hernando de Soto's book *The Mystery of Capital* might be summarized as follows: "Most of the poor already possess the assets they need to make a success of capitalism. ... But they hold these resources in defective forms. ... They lack the process to represent their property and create capital. ... They have houses, but not titles. ... It is that gives them the power to create surplus value." To get our discussion started, could you provide a general comment on de Soto's main theme and, from your experience, an illustration of the importance of the relationship between improved tenure and development?

My comments are based on experience in urban areas in countries in transition (Eastern and Central Europe and the former Soviet Union). Most de Soto's ideas are applicable in cities in many of these countries, especially in the former Soviet Union, but there are some specifics, some of them discussed below.

One of several points that I want to make is that de Soto's main theme - absence of the representation of assets in legal property documents, which is typical for POOR in poor countries, - has a wider applicability in countries in transition. His statement is correct not for individuals only but for POOR ENTERPRISES and POOR CITIES as well. A typical problem in such countries as Russia, Ukraine, Armenia, and Kyrgyzstan¹ is that buildings and structures above land have undergone a mass transfer from state ownership into either private or municipal ownership, but without land. Most land in urban areas continues to be either state-owned or in limbo. Legislation of all these countries stipulates one or another way of conveying some land use rights for land underneath privately or municipally owned buildings when buildings are sold; however, such property sales, as a rule, do not improve land rights that continue to be either less than ownership or not documented at all. Also, authorities continue to "allocate" vacant land for construction without granting ownership; in the best case, land is given with "perpetual use right". These flawed land rights make most of de Soto's reasoning applicable to the situation.

First of all, banks don't take vacant land as collateral for lending when a borrower doesn't have ownership for land. As a result, land-secured construction and business lending doesn't exist. Further, in the situation when potential borrowers own buildings but have only use rights for land, bankers do not include a potential land value in property's mortgagable value. As a result, mortgagable value of most such properties is diminished down — and often close to zero because a big part of socialist-time constructions is obsolete and in the best case has the value of second-hand construction materials that can be extracted from demolished buildings, while land underneath might be quite valuable if it could be vacated from obsolete structures and sold as vacant.

Second, inability to recycle land for new use, which results from absence of land ownership, postpones redevelopment and involvement of urban land in economic turnover, which is very important, given well documented inefficiencies of land use patterns in ex-socialist countries.²

Illustrative example:

During 1995–1998, 11 cities in Kyrgyzstan³ were granted the status of self-governing cities and obtained a number of properties into "communal" (municipal) ownership. Properties given to cities were listed by their then functional use (such as schools, kindergartens, movie theaters, culture centers, stadiums, administrative buildings, etc.), without any reference to land attached to buildings. From the accounting standpoint, this transfer was accomplished by placing buildings and structures as capital assets on cities' balance sheets, and valuing these assets at depreciated balance value of buildings and structures, without land. Currently, Kyrgyzstan begins the process of systematic property registration (using a World Bank loan), and there is a hope among international consultants and local lawyers that as the result, land sites underneath "communal" buildings will be linked with the buildings, and these unified real properties (land plus building) will be registered in communal ownership. The analogous hope is related to registration of real estate owned by enterprises.⁴ However, whether this will really happen still should be seen. In practice, new property registration offices are not functioning yet in most places, and the old registration system rejects to confirm "communal" ownership for land. Meanwhile, self-government cities faces situations as follows:

City N. (population of about 40,000 people) owns, among other properties, a former kindergarten located on a site of about 3,000 square meters, in a residential area in the central part on the city. The building is in a very bad shape and mainly abundant, though about 1/5 is still used as an office of the city Education Department. A professional real estate appraiser hired for a feasibility study demonstrated that the "highest and best use" of this property would be to sell the building for de-construction on second-hand construction materials, and then to subdivide the site on 5 lots and sell them for single-family homes⁵. Under this scenario, city's net income could be at least 480,000 som, with at least 150,000 – 200,000 som out of this total resulting from the sale of 5 land lots for single-family homes (to give the scale: 200,000 som is the amount desperately needed for a roof repair in one of city's school, where the temperature in winter falls below zero). However, when the city government began preparing this disposition, it found that it can not obtain any document certifying its ownership for land, and therefore it can not sell vacant land after demolishing the building.

The same kind of freezing land from useful recycling is typical for enterprise land: privatized enterprises can not convert land into capital because they do not own it, but the State also does not have any benefits from this land, and can not take this land away, because law guarantees "use rights" to owners of buildings.

Question 2. In your experience, what are the practical challenges to achieving the "representation of assets in legal property documents"?

In countries of the former Soviet Union, there are two biggest problems: Reluctance of local authorities of various levels to privatize land despite the fact that the national legislation allows privatization; Mass legal illiteracy of both local authorities and private sector participants regarding land and property rights established by national laws and regulations. This is especially true for the most pure countries such as Kyrgyzstan or Armenia.

Question 3. Can you describe your experience with "extralegal property systems", and how can they be incorporated into a larger and legal property system?

Question 4. In the absence of an effective legal system to manage property rights, microlending programs can be effective in drawing on other abstract assets that people might have such as social connections and a good payback history. This is already

happening in what the deSoto refers to as the extralegal sector. Microcredit is a way to extend credit opportunity for investment until a better legal framework for identifying physical capital is developed. A microlending system can work hand in hand with the property rights system adjustments the author is calling for. Any comments on this?

In the former Soviet Union, the most common form of off-financial institutions micro-lending is lending from family and friends, though I have not seen any statistics about this. Also, one might expect that private local lenders, backed up by an informal brutal enforcement system for securing repayment, should exist, but I have not heard about it.

5) In October 1999, the UN and the International Federation of Surveyors held a Workshop on Land Tenure and Cadastral Infrastructures for Sustainable Development in Bathurst, Australia. The "Bathurst Declaration" stated "land administration systems need to be re-engineered, using modern technology for recording and describing tenure arrangements." Please comment on the effort to "re-engineer land administration systems" based on your own experience.

A very interesting question is how technology-based registration systems will handle the mass mess existing at the level of initial paper documents. For example, in Kyrgyzstan, a large portion of paper property documents has flaws (such as absence of dates on paper documents; usage of terms, which do not exist under current legislation, etc.). Is the new registration system, which is being developed under the World Bank loan, supposed to be a Big Interpreter and convert these flawed documents in non-flawed?

6) The Bathurst Declaration also stated: "An integrated perspective of the interface between markets, land registration, spatial planning and valuation indicates that society, through processes of good governance enabled by access to appropriate and reliable information, sets minimum requirements in terms of environmental standards and expectations and social tolerances." One of our roundtable participants, Edesio Fernandes, has written that "a new, socially-oriented and environmentally friendly approach to property rights is needed ... A wide range of legal-political options should be considered ..." Any comments or observations, based on your experience?

I am not sure that I understand what "socially-oriented and environmentally friendly approach to property rights" means. What is clear in the former Soviet countries, is that the old Soviet "Construction Norms and Rules", which formally still regulate land use in urban areas in most countries, are neither rational nor affordable within current economic conditions, which require liberalization of land use regulations in order to boost economic development and small entrepreneurship. Violation of these Rules is daily practice but their formal existence is a good ground for corruption at Architecture Departments at local governments, which are in charge for issuing approvals for land development and construction projects. Liberalization and decentralization of land use rules in former Soviet cities is among most pressing reform issues.

7) Richard May makes the case (in another article that will appear in this issue of Interplan) that de Soto's research and findings help relate the two current campaigns of the UN Center for Human Settlements ("security of land tenure" and "good governance") to the broader topic of "finance for development". In June, there will be a special session of the UN General Assembly to discuss progress in implementing the Habitat Agenda

("Istanbul plus 5"). There will be a lot of discussion about the two campaigns, and "finance for development" (FfD) will be the subject of a global UN conference in 2002. What can organizations such as Habitat learn from de Soto's research?

8) What do you imagine will be the impact of these ideas and findings on donor approaches to property reform and good governance?

First of all, donor organizations, in particular, USAID, should recognize that property reform and good governance are closely interrelated, and technical assistance in these subject areas also should be coordinated and interrelated. Sometimes, USAID internal structure creates artificial divisions, when property reform and governance reform (in particular, government decentralization) are managed by different departments, which not always coordinate their programs.

Secondly, a liquidation of "legal illiteracy" in the area of property reform AND its implementation, where local governments are key players, should be recognized by donors as a high and immediate priority. Some countries, such as Armenia and Kyrgyzstan, are entering the critical stage when property rights in urban areas are subject to systematic registration, and if and when this process would go wrong (in particular, land would not be registered together with buildings in full ownership), these countries would miss a unique opportunity to switch rapidly onto a development tract, which made Western countries rich.

Third, donors and their contractors should be extremely careful when they intend to transfer their previous, even successful, experience from one country to another. For example, in early 90s, Russia and Ukraine adapted the idea to sell land underneath privatized enterprises to these enterprises. USAID provided assistance to this process, and while the results of the assistance itself are considered as the success, the overall results of treating land and building separately, and in particular, of enterprise land sales, are very questionable from economic and political points of view. In particular, this idea:

- froze big land areas from economic turnover because many enterprises rejected to buy,
- undermined trust of the private sector to government because enterprises felt cheated by the idea itself and its implementation, and
- re-allocated remarkable private resources from productive use into payments to public budgets for land purchase; in Russia, purchase prices have changed many times, and quite arbitrary.

It would be a disaster to try to import the experience of enterprise land sales to countries (such as Kyrgyzstan, for example) where there still is the hope to join land and building without repeating political and economic mistakes made in Russia and Ukraine.

9) What specifically can planners — and planning — contribute to the process of changing "dead assets" into capital?

Urban planning and land use reform did not happen yet in most ex-socialist countries, and this is one of key current obstacles for economic and urban development in these counties (not in the former Soviet Union alone but in Eastern and Central Europe as well). In particular, over-regulated property use has two negative impacts on the conversion of assets into capital. First,

even when conversion is possible, the over-regulated environment makes the costs of this conversion higher. For example, in Russia, even if an investor has documented ownership on property, to get approval for re-development takes a lot of time and money, and without these approvals, banks would not lend for re-development. Also, over-regulated property use reduces potential market values of practically all urban properties. Therefore, current over-regulated land use systems are responsible for diminishing substantially the wealth accumulated in urban real estate.

Notes

1. These are countries about which I have first-hand knowledge on the issue; however, there are indications that the same is true for all countries of the former Soviet Union except the three Baltic countries (i.e. for 12 countries).
2. Alain Bertaud and Bertrand Renaud, (1997). “Socialist Cities without Land Markets.” *Journal of Urban Economics*. 41(1):137-151.
3. Kyrgyzstan belongs to the group of low income countries, therefore all issues of poverty alleviation are very relevant to it.
4. Registering land into ownership of physical persons — at least for single family homes — is a lesser problem in many countries of the former Soviet Union.
5. There is a high unmet demand for plots for housing construction in the city — the city government has about 800 applications for allocating land for homes.

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