



CENTRE FOR
DEVELOPMENT
AND ENTERPRISE

COMMISSIONED RESEARCH SERIES

EXPANDING OPPORTUNITY FOR THE URBAN POOR

Brandon Fuller¹

Paper prepared for the Centre for Development and Enterprise's Expanding Opportunities Project

August 2017

¹ Brandon Fuller is Deputy Director of Marron Institute of Urban Management, New York University



ABOUT CDE

The Centre for Development and Enterprise (CDE), an independent policy research and advocacy organisation, is South Africa's leading development think tank. Since its establishment in 1995, CDE has been consulting widely, gathering evidence and generating innovative policy recommendations on issues critical to economic growth and democratic consolidation. By examining South African and international experience, CDE formulates practical policy proposals outlining ways in which South Africa can tackle major social and economic challenges. CDE has a special focus on the role of business and markets in development.

CDE disseminates its research and proposals to a national audience of policy-makers, opinion formers and the wider public through printed and digital publications, which receive wide media coverage. Our track record of successful engagement enables CDE to bring together experts and stakeholders to debate the policy implications of research findings.

FUNDED BY

The logo for the Bill & Melinda Gates Foundation is a solid red square. Inside the square, the text 'BILL & MELINDA GATES foundation' is written in white, with 'GATES foundation' in a smaller, italicized font.

BILL & MELINDA
GATES *foundation*

TABLE OF CONTENTS

INTRODUCTION.....	4
URBAN GROWTH CONTAINMENT & URBAN AFFORDABILITY	5
MAKING ROOM FOR URBAN EXPANSION.....	7
PUTTING IDLE OR UNDERUTILIZED GOVERNMENT LAND TO USE.....	8
ALLOWING LAND USE TO ADAPT	10
LAND USE & HOUSING POLICIES SHOULD NOT EXCLUDE THE URBAN POOR	11
THE INADEQUACY OF GOVERNMENT SUBSIDIES AND THE GROWTH OF INFORMALITY	12
ACCOMMODATING THE URBAN POOR.....	13
COMPARING URBAN DEVELOPMENT IN CHINA AND VIETNAM.....	15
FLEXIBLE LAND USE AND COMMERCIAL REAL ESTATE	18
JOBS AND URBAN MOBILITY	19
URBAN JOB CREATION & LABOR MARKET FLEXIBILITY.....	20
CONCLUDING DISCUSSION	23

INTRODUCTION

The urban population of middle-income countries will swell in the coming decades—from 2.6 billion today to 4.3 billion by 2050. Over the same timeframe, the urban share of middle-income country residents will rise from just over 50 percent to nearly two-thirds. The urban population of South Africa is expected to grow by 14 million; Brazil by 35 million; Nigeria by more than 200 million; China by 270 million; and India by an astonishing 394 million—90 times the population of metropolitan Johannesburg.²

Under plausible assumptions about the ultimate share of the global population that will live in cities, it appears that what is left of global urbanization will mostly run its course during the 21st century. The UN estimates that the world's urban population will grow to 6.3 billion by 2050.³ This number could reach 9 billion one hundred years from now, at which point urban population growth will begin to level off. Our choices in the intervening period will permanently shape the world's cities, having lasting impacts on the lives of urban dwellers for many generations to come.

Whether driven by natural population increase or rural-to-urban migration, the collaborative potential of growing cities can offer billions of people opportunities to improve their lives. This essay will focus on the opportunities for low-income residents of growing cities in middle-income countries (MICs). MIC urbanization is important in part because the majority of the world's poor—79% of the people below the \$2 per day per capita poverty line—live in MICs.⁴

While this does not negate the issue of poverty in low-income countries (LICs), it is a reason for optimism. MICs have, by definition, greater domestic resources with which to address poverty. Increasingly, reducing poverty in MICs will mean facilitating opportunity in growing cities. There is much that governments can do to facilitate urban opportunity. This essay is not meant to be an exhaustive list. Instead, it focuses on obstacles to opportunity for the urban poor in land, housing, and labor markets.

What follows is a set of principles for reducing barriers to opportunity for the urban poor. Many of the principles below apply to cities around the world, whether they are located in high, middle, or low-income countries. Though fiscal resources vary dramatically across the globe, all governments face capacity constraints. Understanding where policy interventions are actually depriving the urban poor of opportunities is the first step toward better channelling public resources in pursuit of prosperity for all.

For many middle and low-income countries, a key urban policy challenge is that of population growth. Compared to high-income countries, both low and middle-income countries face much faster rates of urban population growth. Between 2015 and 2020, the urban populations of low-income and middle-income countries are expected to grow at rates of 3.6% per year and 2.1%, respectively. This compares to an expected growth rate of just 0.6% high-income countries over the same period.⁵ At these rates, urban populations in high-income countries will double every 120 years, compared to every 35 years for middle-income countries.

² United Nations, Population Division: 2014 Revision of World Urbanization Prospects, <https://esa.un.org/unpd/wup/>

³ B. Fuller and P. Romer, 'Urbanization as Opportunity,' in E. Glaeser and A. Joshi-Ghani, (eds.), *The Urban Imperative Towards Competitive Cities* (Washington, D.C: Oxford University Press, 2015)

⁴ A. Sumner, *Where Will the World's Poor Live? An Update on Global Poverty and the New Bottom Billion*, Working Paper 305 (Washington, D.C: Center for Global Development, 2012)

⁵ United Nations, Population Division: 2014 Revision of World Urbanization Prospects, <https://esa.un.org/unpd/wup/>

Because urbanization is occurring at a much faster rate in middle-income countries their policy priorities will be different from those of high-income countries. The urban policies en vogue in the cities of high-income countries will not necessarily translate to the urban challenges that middle-income countries face. That said, the historical correlation between urbanization and economic prosperity suggests reason for optimism: in the coming decades, middle-income countries can leverage urbanization as an opportunity for their lowest-income residents to substantially improve their standards of living.

URBAN GROWTH CONTAINMENT & URBAN AFFORDABILITY

For governments of urbanizing middle-income countries, the first step to facilitating urban opportunity is accepting the inevitability of urban population growth. Efforts to contain or wilfully ignore urban growth will effectively choke off the supply of developable urban land in growing cities. (Throughout this essay, I will use the terms city and metropolitan area interchangeably.) Constraints on the supply of developable land act as a limit on the supply of housing. Where the supply of housing units fails to keep up with demand, prices and rents will rise. Many of the lowest-income households will find themselves priced-out of formal sector housing markets, relegated to informal settlements where they are uncertain in tenure and isolated from municipal services and formal sector job opportunities.

Urban growth restrictions generate a scarcity of developable urban land, leading to higher rents and prices in the formal market for residential and commercial real estate. Such restrictions come in several forms, including: the green belts of London and Seoul, the urban growth boundary of Auckland, New Zealand, or the urban land quotas of China.

Consider, for example, the greenbelt established in 1971 in Seoul, South Korea. At the time of its imposition, the greenbelt did not impose a binding constraint. In 1971, Seoul's built-up area was 206 km² and the greenbelt confined further urban development to an area of 554 km². Between 1971 and 1989, Seoul's population increased from nearly 6 million to over 10 million and the built-up area of the city expanded to fill just about the entirety of the area inside of the greenbelt.⁶ The extreme scarcity of developable land led to higher housing costs. By 1990, Seoul's rent-to-income ratio was second highest among a sample of 53 global cities and more than double the average.⁷

The legacy of greenbelts in Britain, which traces back to the London Greenbelt Act of 1938, continues to manifest itself in the island's ongoing housing crisis. The constraints on development help explain why the real price of developable land in Britain increased by 15-fold between 1955 and 2014, resulting in higher house prices and tighter household budgets. As Paul Cheshire points out, Britain's greenbelts cover one and a half times as much land as all of its towns and cities put together. Developing a small fraction of the total greenbelt land could provide housing affordability for generations to come.⁸

Cheshire also notes that greenbelts aren't all that green. The primary land use in the towns and cities that greenbelts surround is parks and gardens—areas that are that are surprisingly rich in

⁶ Demographia, *Seoul: City Population History*, <http://www.demographia.com/db-seoul-pop.htm>

⁷ S. Angel, *Making Room for a Planet of Cities* (Lincoln Institute of Land Policy, 2011)

⁸ P. Cheshire, *Turning houses into gold: the failure of British planning*, 2014, <http://cep.lse.ac.uk/pubs/download/cp421.pdf>

biodiversity.⁹ As much of the greenbelt land itself is devoted to intensive agriculture, it hosts relatively little biodiversity. What amenities greenbelts do provide are largely inaccessible for the vast majority of urban residents who don't live on the urban periphery. What's more, greenbelts displace development to satellite towns beyond their boundaries leading to longer commuting distances, higher energy costs, and greater vehicle emissions.

In the slow-growing cities of high-income countries, officials might be able to credibly claim that they can manage growth by moving the inner-limit of an urban growth boundary out over time, as development occurs. In the fast-growing cities of low and middle-income countries, officials won't be able to keep up. In the face of rapid urban population growth, a growth boundary is not unlike failing to plan for urban growth at all: in the absence of access to developable land in the formal sector, population growth will not stop, it will simply manifest itself in high formal sector housing prices, land invasions, and the growth of informal settlements.

Growing cities will serve low-income residents far better if they come to terms with their inevitable expansion and take the fairly simple and non-intrusive steps necessary to accommodate it. Even if one assumes that a city's population density will remain fixed, population growth will lead to the outward physical expansion of the city. Of course, in middle-income countries, this assumption is unrealistic given the strong likelihood of continued and substantial gains in per-capita income. Residential floor-space is a normal good: as real incomes rise; we can expect that households will consume more floor space per person.

Cities accommodate the increase in demand for residential floor space through two channels: adding floor space in the existing built-up area of the city— "building up"—or adding floor space on the urban periphery— "building out". I will come back to the prospects for building up later on but I will note here that building up alone cannot adequately address urban population growth, in part because extraordinarily high population densities are already the norm many urban areas in low and middle-income countries.

Consider, for example, that the average built-up area density of a city in the United States was 24 people per hectare in the year 2000. (Built-up area density is the ratio of the population within the city and its built-up area.) In Bangladesh, the figure was 191 people per hectare—8 times higher. In Dhaka, built-up area density was 555 people per hectare. In 2005, the built-up area of Dhaka's informal settlements, taken as a whole was 2,220 people per hectare.¹⁰ Comparing the relatively low-density cities of the United States to the relatively high-density cities of Bangladesh is admittedly an exercise in extremes. However, to the extent that dwellings in high density areas lack access to light and air or suffer from overcrowding and pollution, the decongestion that accompanies urban expansion in middle-income cities will provide welcome relief. In some cities in middle-income countries, such as Johannesburg, built-up area densities will be closer to those of the United States. In such cities, decongestion may be a concern in select neighborhoods but there may be significant scope for allowing developers to build more intensively within the cities' existing built-up areas.

Because of rising incomes, growing cities should anticipate that the growth of urban land cover will exceed the growth of population by a factor that is larger than one—leading to reductions in population density. For example, between 1909 and 2000, the population of Kolkata increased by a factor of 11 while its built-up area increased by a factor of 17. Between 1902 and 2000, the population of Shanghai increased by a factor of 22 while its built-up area increased by a factor of nearly 65. Mexico

⁹ J.M. Marzluff, *Welcome to Suburbia: Sharing Our Neighborhoods with Wrens, Robins, Woodpeckers, and Other Wildlife* (New Haven and London: Yale University Press, 2014)

¹⁰ S. Angel, *Making Room for a Planet of Cities* (Lincoln Institute of Land Policy, 2011)

City saw its population increase by a factor of 24 between 1910 and 2000 while its built-up area increased by a factor of nearly 100. In cities where populations and incomes are rising in tandem, expansion is inevitable. Fortunately, a modicum of foresight and a light touch of urban planning can go a long way toward improving urban opportunity in growing cities.

MAKING ROOM FOR URBAN EXPANSION

Shlomo Angel, an urban planner who has devoted the better part of two decades to advancing a global understanding of urban expansion, suggests four fairly simple and non-intrusive steps that cities can take to make room for inevitable urban expansion. Cities should first work to project scenarios for urban population growth and the corresponding growth in urban land cover. Regional and national authorities can then help by securing new municipal boundaries that encompass the feasible expansion areas of the growing cities. Cities should then work to acquire the rights of way for a grid of arterial roads in the expansion area. Arterial roads are those that will carry trunk infrastructure such as sewer and water as well as transportation services. Finally, cities should acquire land for public parks and open spaces in the expansion area now, prior to development.

The grid of arterial roads in the expansion area should connect to the city's existing network of arterial roads. With the rights of way for the arterials established, the city will be able to more easily and inexpensively add infrastructure on a just-in-time basis, as development expands the urban footprint. In addition to one day carrying public transit and private traffic, these arteries will also establish the routes for trunk infrastructure such as water mains, sewers, storm drains, and telecommunications networks—services that are vital to keeping communities healthy, safe, and connected.

Angel suggests that cities space arterial roads approximately 1 km apart. That spacing will ensure that a resident who lives in the middle of one of the arterial bounded superblocks is never more than a ten-minute walk from the private and public transportation services that will utilize the arterials. The arterial roads themselves should be about 30 meters wide so that they can support regular traffic but also designated bus lanes, bike paths, and medians.

Angel's approach is different from most top-down urban planning schemes. It does not rely on urban planners to make exhaustive prescriptions about land use, development, and population density—tasks that are routinely bungled by even well financed and high-capacity public agencies. Development of the superblocks between the arterials is market-driven—reflecting and adapting to the needs of individual users and therefore producing the unpredictable spatial and structural diversity that makes cities such wonderful places to explore. By setting aside the public space in advance, the grid that the government creates merely establishes the sensible platform upon which private initiative can drive future city growth.

Making room in this way should therefore be complemented by a fast approvals process for development of the superblocks between the rights-of-way for the arterial roads. Alain Bertaud cites an example of costly permissions from Ahmedabad:

“In Ahmedabad, which is not exceptional, being able to build legally on a lot in a greenfield development requires 14 steps involving the federal revenue department and multiple offices of the state and local government. The process would normally take several years, with no guarantee of success.”

If the permissions for bringing the land into urban development create long lags, the supply of land will not be responsive to the rising demand from urban population growth, resulting in higher interim

prices for land and housing and, very likely, land invasions and informal development.

Setting aside public space for parks and arterial roads now, together with efficient approvals for greenfield development will help fast-growing cities to ensure that there is a supply of land sufficient to keep land and, by extension, house prices affordable to all. It also allows the city to direct urban development away from areas that are environmentally sensitive or prone to natural disaster. By staking out the rights of way in advance, the city gives developers—be they formal or informal—a strong incentive to build only in areas that will be proximate to the arterial grid. As the superblocks between the arterial roads are subdivided and developed, the city can extend the trunk infrastructure network in parallel, ensuring access to transportation and services for all urban residents. By leading, rather than following, developers into new areas, cities can also avoid the expensive and politically toxic task of retrofitting arterial roads or trunk infrastructure through already settled neighborhoods.

Angel's light-touch and inclusive approach to planning, grounded in the realistic understanding that urban expansion is inevitable, should be a top priority for fast-growing cities that aim to remain vibrant, accessible, and affordable for the urban poor. That said, cities can do more than simply look outward when considering obstacles to land and housing for the urban poor. Governments should look inward as well, starting with their own holdings of urban land.

PUTTING IDLE OR UNDERUTILIZED GOVERNMENT LAND TO USE

Though public agencies often manage substantial amounts of urban land, they often face weak incentives to put the land to its highest value use. The results are substantial swaths of idle or underutilized public land. A World Bank study found that, in Ahmedabad, India, the public sector owns 6,850 hectares or 32 percent of the developable land area (developable public land is public land excluding roads, waterways, and railways).

Of the 6,850 hectares of developable public land in Ahmedabad, the researchers found that nearly half was “marketable”. In the study, marketable public land included vacant lots (20% of all developable public land in Ahmedabad) as well as lots with at least some construction. Non-marketable land included land in dedicated use such as cemeteries, parkland, informal settlements, heritage sites, and the operational portions of the airport and military base.

If all of the idle or underutilized public land in Ahmedabad were to be sold, the authors estimate that the city could raise between \$3.6 billion and \$9.8 billion. For a city whose population is expected to grow from 7.3 million people today to 10.5 million by 2030, releasing this land for higher value residential and commercial uses would put downward pressure on rents and prices while raising useful revenues for the municipality.¹¹ For example, the high end of the estimate from selling idle and underutilized public land in Ahmedabad is more than double the cost of meeting the city's urban infrastructure needs for the next 20 years. The authors of the Ahmedabad study provide a replicable methodology for taking stock of marketable public land holdings that sit idle or underutilized in cities around the world—many of which are no doubt in a similar position.

Divestiture of idle or underutilized public land can improve the affordability of urban real estate and generate fiscal resources. Cities should pursue it. But to the extent that cities are sitting on large amounts of idle or underutilized public land, there is an important question of how governments should give public agencies incentives to free up the land or structures that they no longer need in the

¹¹ United Nations, *Population Division: 2014 Revision of World Urbanization Prospects*, <https://esa.un.org/unpd/wup/>

first place? George Peterson's work on unlocking land values for urban infrastructure finance highlights two interesting examples from Australia and South Africa.¹²

Australian policy is intended to routinely audit public land holdings and to dispose of property no longer necessary for the provision of public services.

"Australia's Commonwealth land policy starts with a clear statement of principle: Land held by government should be viewed as an input into the provision of the public service for which the landholding agency is responsible. All public landholdings therefore should regularly be reviewed, with the goal of divesting those properties not necessary or cost-effective for service provision. Commonwealth property having no efficient use is to be sold on the open market at full value."

To retain land, Australian government agencies have to make a convincing business case to the Ministry of Finance and Deregulation each year. Land deemed unnecessary by the Ministry can be transferred to local authorities or non-profits or sold on the open market. Any public land that is leased to private entities at below market rates is also reason for divestiture in Australia—a policy intended to reduce waste and prevent sweetheart deals.

Australia further encourages the efficient use of public structures by charging public agencies market rents for the buildings that they occupy. Public agencies can choose to occupy public or private buildings but either way they pay the full market rate. Because the market rents reflect the value of the location of the underlying land, public agencies face a strong incentive to economize on their use of public resources. By giving public agencies a strong incentive to consume land and floor space in accordance with their actual needs, use only the land and floor space that they require, such policies ensure that more land and floor space is available for private use, be it residential or non-residential.

Peterson also points to South Africa's taxation of government-owned land as a framework for economizing on the use of public resources.

"South Africa is one of the first countries in the world to pass a Property Tax Law that includes government-owned property in the taxable base. In principle, the need to pay property taxes on government-owned property should provide a pricing incentive to agencies to re-examine the importance of retaining real estate."

The local authorities in South Africa are responsible for the administration of the property tax administration. One potentially problematic aspect of the scheme is that, should they see fit, the local governments can exempt public land from the tax. Not surprisingly, public land used by local authorities is routinely exempt and the taxation falls primarily on national government property and land owned by parastatal utility providers. Peterson also points out that there is little evidence of significant taxation of vacant government land in South Africa, at least in so much as it would encourage divestiture. That said, in principle, treating public and private property owners the same in terms of property taxation should discourage some inefficiencies in the use of public sector land.

Though the systems in Australia and South Africa have their imperfections, they are suggestive of how to move incentives in the right direction. Public agencies, especially those consuming expensive land in urban areas, should feel pressure to use their space as efficiently as possible. Selling idle or underutilized public land can finance important infrastructure and free up land for residential and non-residential development, including additional housing for the urban poor.

¹² G. E. Peterson, *Unlocking Land Values for Urban Infrastructure Finance: International Experience*, Policy Research Working Paper 6683 (World Bank, 2013)

ALLOWING LAND USE TO ADAPT

In addition to its own land holdings, governments should be mindful of the urban land that it influences through land use and zoning regulations. In particular, zoning rules that restrict the development of parcels to obsolete uses can keep large swaths of otherwise valuable land from being put to more productive uses, including residential development.

Parcels zoned exclusively for manufacturing are typical culprits for obsolete land use. As urban economies advance, urban land tends to become more valuable and manufacturing activity tends to become more land and capital intensive. Land and capital intensive manufacturing naturally tends to locate beyond the periphery of densely populated urban areas, on less expensive land. However, some manufacturing firms can maintain a foothold in urban areas if cities provide an implicit subsidy for their land consumption by eliminating any competing uses.

Urban land zoned exclusively for manufacturing comes at a steep price since the land could otherwise be used for residential housing development or higher value commercial use. The story of Mumbai's cotton mills, as told by Alain Bertaud, illustrates this point.¹³

In the 1930s, Mumbai's cotton mills employed 350,000 workers and occupied 280 hectares of land. In the decades that followed, through a combination of intense global and domestic competition—along with prolonged labor disputes—the cotton mills went out of business. In the wake of the shut downs, workers' unions convinced the city to prevent the mill owners from selling the underlying land in hopes that the industry would one day return. Even when the government recognized that the mills were not coming back, it made the rules for redevelopment so complicated that the land became tied up in court cases for years.

“As a consequence, over the course of more than 40 years, an increasing number of mills stood empty in the middle of Mumbai, obliging the city to expand its infrastructure further north while by-passing the 280 hectares of already well serviced area occupied by the empty mills. When, in 2009, some of the land formerly occupied by the mills was finally auctioned, the price reached more than US \$2,200 per square meter!”

External market forces drove the decline of Mumbai's cotton mills—wishful thinking and local land use restrictions weren't going to bring them back. The efforts to pause the city's industrial activities in time only served to prevent the introduction of new firms, jobs, and residences on the vacant land that the shuttered mills left behind.

Mumbai is not alone in its efforts to tilt at the windmills of the global economy. The problem of obsolete zoning is one that affects cities in countries of all income levels. In 2005, for example, about 9,100 hectares of New York City were zoned exclusively for manufacturing. The benefits of this massive implicit subsidy to manufacturing firms are highly dubious. But the costs are largely hidden from the course of normal civic debate because the value of the land in an alternative use is not factored into the city's public budget. Developed at densities near the average for the city's borough of Brooklyn, this land has the potential to generate hundreds of thousands of housing units, putting downward pressure on the city's notoriously high rents.¹⁴

¹³ A. Bertaud, *The formation of urban spatial structures: Markets vs Design* (Marron Institute of Urban Management, NYU, 2014)

¹⁴ R.M. Hills and D. Schleicher, *The Steep Costs of Using Noncumulative Zoning to Preserve Land for Urban Manufacturing*, George Mason Law & Economics Research Paper No. 10-02, 2009, Retrieved from: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1527276

LAND USE & HOUSING POLICIES SHOULD NOT EXCLUDE THE URBAN POOR

In growing cities, constraints on the supply of developable land drive up land prices and make housing unaffordable to the poor. Relaxing such constraints will make cities more accessible to low and middle income households. But threats to housing affordability can come from other sources as well. This section will focus on the other ways in which land use and housing policy can end up limiting opportunities for the urban poor.

Governments often impose minimum housing standards with the laudable goal of ensuring that everyone lives in adequate housing. But laudable aspirations don't house the urban poor. When minimum housing standards are set too high relative to the local level of income, formal sector housing will be the preserve of only those who can afford it and largely out of reach for the urban poor. With no other option, the urban poor will live in precisely the sorts of informal settlements that the minimum standards sought to avoid.

Paul Collier sees this dynamic playing out in Sub-Saharan Africa where governments either adopted or inherited housing standards from higher-income countries:

"...Africa has bifurcated urban housing. Elite homes are constructed by foreign construction companies using capital-intensive techniques and imported materials. The structures are individually designed, and adhere to OECD building standards, usually inherited from the British 1947 Town and Country Planning Act which was imposed indiscriminately in the colonies. They are financed by savings or by banks. Ordinary people live in informal housing. Their homes have usually been self-built without adherence to building standards (which are unenforceable because they would impose excessive costs), and their design is idiosyncratic. The owners have de facto rights but lack legal title. Similarly, tenancy arrangements are likely to be informally enforced."¹⁵

Examples of minimum housing standards include rules that set the minimum permissible size of housing units or residential plots, rules that dictate the minimum number of parking spaces per unit of housing, or rules that define the minimum permissible width of local surface streets. When these sorts of minimum standards are set too high relative to local incomes, they create a wedge between the cost of developing a unit of housing and the price that a low-income household can afford.

A related set of land use policies effectively constrain the supply of housing units in high-demand urban locations by forcing households to consume a minimum amount of land per unit of housing. Floor-area-ratio (FAR) is the ratio of a building's total floor area to the area of the plot of land on which it is built. FAR restrictions set a limit on the amount of floor area that can be built on a given piece of land. In residential areas, FAR restrictions effectively limit the heights of buildings as well as the number of housing units that they can contain. A related set of restrictions on population density simply limit the number of housing units permitted on each hectare of land.

As Alain Bertaud points out, FAR and density restrictions effectively act as regulatory minimums:

"For instance, a maximum density of eight housing units per hectare, as imposed in many neighborhoods of Mexico City, is equivalent to imposing a consumption of 1,250 square meters of land per housing unit. A maximum floor area ratio of 1.33, as imposed in most Mumbai municipalities, is equivalent to imposing a minimum land consumption of 75 square meters for every 100 square meters of floor space built."

¹⁵ P. Collier, (11 April 2012), 'Housing In Low-Income Cities: Learning From 19th Century European Urbanization,' *Social Europe*, Retrieved from: <https://www.socialeurope.eu/housing-in-low-income-cities-learning-from-19th-century-european-urbanization>

Bertaud's research on Bangalore, joint with urban economist Jan Brueckner, highlights the consequences of excessive FAR restrictions. Using data from the year 2000, their research suggests that the city's FAR restrictions impose significant welfare costs on Bangalore's residents. As the city continues to grow over time it would be denser, more compact, and more affordable without the restrictions than with them.¹⁶

Bertaud and Brueckner suggest that FAR restrictions in Bangalore may have reflected a conscious decision by city officials. Higher FARs would presumably allow for higher densities in high-demand areas of the city's centre, which would require improved public services and infrastructure investments. City officials may have felt ill-prepared and ill-equipped to provide the services. But as the authors point out, the FAR restrictions remained the same even as the technical capacity of local government improved. Furthermore, in a growing city like Bangalore, FAR restrictions simply encourage new development on the urban periphery. Whether the city grows up or out, the challenge of improving and expanding municipal services will remain.

By constraining the supply of housing, FAR restrictions raise its price. By limiting densities in high-demand areas near the centre of the city, the restrictions encourage spatial expansion of the city, which can increase the average commute distance. To get an estimate of the welfare costs of the FAR restrictions, Bertaud and Brueckner focused on the increase in costs associated with longer commutes. They estimate that FAR restrictions in Bangalore impose additional commuting costs equivalent to 3 to 6 percent of the typical household's consumption—a substantial amount for low-income households that are already struggling to make ends meet.

Lifting the FAR restrictions in Bangalore would increase consumer welfare. Relaxing the restrictions would require additional infrastructure spending in the city's central area to maintain consistent service but the city would also expand at a slower rate without the restrictions than with them. The reduced need to expand the infrastructure network would therefore offset the costs of improving infrastructure in the city centre.

As discussed above, rising populations and the falling densities associated with higher incomes make outward urban expansion inevitable in growing cities. While cities should absolutely make room for this expansion, they should also allow for market-driven development of additional floor space in their existing built-up areas. A failure to do so is equivalent to forcing urban households to consume a minimum amount of land; it represents a costly barrier to the development of more affordable housing citywide.

THE INADEQUACY OF GOVERNMENT SUBSIDIES AND THE GROWTH OF INFORMALITY

In principle, governments could apply minimum housing standards and then subsidize low-income households enough that their housing consumption meets the minimum standards. In practice, most governments lack the fiscal resources or the political support to raise the housing consumption of all or even most of the poor households to meet the minimum standards. Targeted housing vouchers would be the most efficient means by which to improve the housing consumption of the poor. However, as Bertaud points out, housing vouchers are a transparent subsidy and as such there usually limited public support for the size and number of vouchers that would be necessary bring low-income households up to the regulatory minimums.¹⁷

¹⁶ A. Bertaud and J. Brueckner, *Analysing Building-Height Restrictions: Predicted Impacts, Welfare Costs, and a Case Study of Bangalore, India*, 2003

¹⁷ A. Bertaud, *The formation of urban spatial structures: Markets vs Design* (Marron Institute of Urban Management, NYU, 2014)

Public housing represents another common approach. Meeting the regulatory minimums is relatively straightforward when the government directly supplies housing. But because public housing expenses are a relatively transparent subsidy as well, public support extends only so far. And unlike housing vouchers programs—which give recipients the freedom to choose their own housing—public housing does not necessarily reflect the tastes and preferences of its residents.

What’s more, to limit the costs of public housing, governments often choose to build it on relatively inexpensive land that is not urban amenities and job opportunities. Alain Bertaud cites an example from South Africa:

“In Gauteng, a massive state-subsidized housing program had spacious individual houses with well-designed infrastructure and social services but—to save money on land—they were built in distant locations that would have been considered outside the land supply area defined by the transport mode that the beneficiaries could afford. The result has been costly and lengthy commutes, chronic unemployment, or both.”¹⁸

Public housing often meets minimum regulatory standards but to the extent that it is effectively cut off from large portions of the urban labor market it will not offer much assistance along the path out of poverty.

Inevitably, governments that set high minimum housing standards can only provide limited support for an often-small subset of the urban poor that need financial assistance to consume at the minimum standard. High housing standards and limited support are a recipe for the growth of informal settlements in urbanizing areas. For low-income households with few if any options in formal housing markets, the informal market will be the only place to find housing that fits their budgets and locational preferences.

Informal housing rarely meets a society’s definition of decent housing. Though no doubt meager in many circumstance, the trouble with informal housing is less its quality or size than the fact that it is informal. Because the government does not legally recognize informal housing, households in informal dwellings have weak tenure. This leaves them vulnerable to government takings and extrajudicial settlements of tenure disputes. Informal settlements are routinely isolated from networks for public services such as storm drainage, electricity, water, and sewerage. The uncertainty of weak tenure and the exclusion from municipal services represent substantial obstacles for the urban poor.

ACCOMMODATING THE URBAN POOR

A more realistic and sustainable approach to housing in fast-growing cities will involve relaxing regulatory minimums to reflect the local level of income. To the extent that housing subsidies can be provided, governments should provide targeted demand-side subsidies to low-income households so that they have a greater say in the quantity, quality, and location of the housing that they consume. By lowering the cost of providing housing units, relaxing regulatory minimums can put more formal sector housing within reach for the poor. As their incomes rise, low-income households who feel secure in tenure will then upgrade their housing over time.

Relaxing regulatory minimums will allow for more formal sector housing at more affordable prices. A few examples:

¹⁸ A. Bertaud, *Converting Land into Affordable Housing Floor Space*, 2014

Eliminate mandatory parking minimums: Requiring developers to devote a certain amount of off-street parking per housing unit raises the cost of development and reduces the supply of units. There is no reason for the government to dictate parking minimums—the market will send developers strong signals about the appropriate amount of parking (if any) to provide for each unit of housing. Parking minimums are particularly wasteful in areas with access to plentiful public and private transportation services. What’s more, as only middle and high-income people are likely to make use of a private vehicle, parking minimums serve as an implicit subsidy for the relatively well-off.

Reduce or eliminate minimum unit size requirements: Households are capable of making trade-offs between the size of housing unit and its location. Governments shouldn’t limit their options by insisting on minimum unit sizes that, in high-value urban locations, are financially out of reach for low-income households. The best way for lower-income households to compete with the rich for premium urban locations is by consuming less space.

Reduce or eliminate minimum plot size requirements: Minimum lot size requirements are a notorious tactic for excluding the urban poor. Like minimum unit size restrictions, the insistence on a minimum level of land consumption puts housing in certain locations out of reach for low-income households. When property owners have greater latitude to develop their parcels as intensively as they see fit— adding floor space or subdividing their plots—the urban poor can compete more effectively for high-value urban locations by consuming smaller amounts of land.

Relax street-width requirements within the superblocks bounded by arterial roads: Doing so can free up land for housing without compromising access to public services. Narrower roads may be inaccessible for vehicular traffic but to the extent that low-income households rely on other modes of transportation they may be willing to make the trade-off.

In parallel, cities can help the poor by legitimizing heretofore-informal settlements in which many poor households live. Legal recognition of residences in informal settlements can at least protect inhabitants from uncompensated expropriation or the loss of tenure outside of the formal legal system.

Formalizing informal settlements would mean recognizing the tenure of residents and exempting the housing markets therein from costly standards applied elsewhere in the city’s formal real estate markets. By formalizing informal settlements, the city needn’t embrace the housing conditions therein. Formalization simply recognizes that, however imperfectly or inadequately, such settlements fulfil a need for poor households that cannot be immediately filled by other means. Legitimization paves the way for the city to gradually and constructively work with these communities to upgrade infrastructure, services, and the housing stock.

If municipalities legitimize informal settlements early enough in their development, the settlements can be integrated into the city’s larger network of social and physical infrastructure. If cities wait too long or ignore them altogether, the informal settlements will grow too large for the people within them to take full advantage of public services, urban amenities, and the urban labor market.

Alain Bertaud documents experiences in China, Vietnam, and Indonesia that hold important lessons for cities struggling to incorporate and formalize informal settlements. In each of these countries, rapid urbanization involves urban expansion into a countryside populated with a relatively dense

network of compact villages. In each case, the housing standards in the subsumed villages are different from those in the formal sector housing developments elsewhere in the growing cities.¹⁹

For example, in the kampongs (“kampong” is Indonesian for village) of Surabaya, the structures and streets are not subject to the same standards as the formal sector, middle-income settlements nearby. But the state nevertheless sanctions the development of the kampongs. This gives the communities in these areas a much stronger sense of tenure, allowing them to make upgrades and legally connect internal services to the formal infrastructure networks that surround them. Because households can make non-regulation constrained decisions about the trade-off between land consumption and location within a city, the kampongs help with affordability and accessibility.

Bertaud points out that the housing stock in the kampongs has steadily improved with time, in part because the incomes of the residents are rising and in part because the local authorities have taken an accommodating approach—working with the communities to gradually upgrade infrastructure. Though poor households may occupy units that are small and simple, the official recognition of their community means that they benefit from connections to safe water, sanitation, sewerage, arterial roads and social services.

Bertaud also notes that the many of the kampongs are centrally located near commercial districts and job clusters. Due to narrow street widths, the portions of the kampongs situated further from the city’s street grid are inaccessible by car. But given their desirable location, the kampongs remain a vital source of affordable market-rate housing for low and middle-income households who either can’t afford a vehicles or are happy to use bicycles, motorcycles, or mass transit as a primary means of transportation instead.

As Indonesian incomes rise, the kampongs will undergo a demand-driven transformation. As household demand for floor space increases, developers will purchase small, contiguous parcels and consolidate them into bigger lots—setting structures back to widen roads and improve vehicular access. Indeed, Bertaud points out that such market-driven redevelopment is already underway and that kampongs are quite socio-economically diverse as a result. The kampongs undergo steady redevelopment—but rather than an urban renewal scheme led by government planners, the process is driven by the individual decisions of the residents.

COMPARING URBAN DEVELOPMENT IN CHINA AND VIETNAM

The challenge of incorporating Indonesian kampongs in the face of rapid urban growth would seem familiar to officials in China and Vietnam. In both countries, rapid urbanization raises questions about how to deal with traditional urban neighborhoods and the rural villages being subsumed at the urban periphery. Alain Bertaud’s work contrasting the approaches to the redevelopment of urban village land in China and Vietnam is instructive for growing cities with substantial numbers of people living in informal settlements.

Though the market plays an increasingly important role in the development of both China and Vietnam, the market for land continues to be dominated by the state. In principle, land ownership gives the governments of China and Vietnam complete control over land use within their jurisdictions. In practice, the Chinese and Vietnamese governments exercise this power in very different ways.

¹⁹ A. Bertaud and Marie-Agnes Bertaud, *Note on Surabaya mobility and housing issues*, 2012, Retrieved from: http://alainbertaud.com/wp-content/uploads/2013/10/AB_Note-on-Surabaya-land-use-and-transport_Aug_23_back_up.pdf

Vietnam embraces a model that is quite similar to the one in Indonesian kampongs, notably in the sense that community norms—rather than city imposed standards—guide urban redevelopment in Vietnam’s urban villages. Self-evolving urban villages exist in China as well: the “handshake” buildings in the urban villages of Shenzhen are one prominent example. But compared to Vietnam, China’s urban villages are much more likely to become the focus of state-led redevelopment efforts—projects that relocate residents, demolish traditional structures, and rebuild at very large scales.

Bertaud points to the redevelopment of the ancient walled city of Tianjin as an example of the more dirigiste approach in China:

“The old walled city of Tianjin covered an area of 200 hectares with a population of 106,000 people according to the 2000 census...In 2000 the area was still occupied by a dense maze of courtyard houses with a few shopping streets with petty commerce and restaurants.

In January 2004, the area had already been entirely cleared of its population, relocated in the flats in the periphery.

In August 2011, the area had been entirely rebuilt with large high rise apartment buildings on the periphery of the site, community facilities and low rise residential buildings in the more central locations.”

China’s grain self-sufficiency goal—and the urban land quotas it uses to meet it—is part of the reason why its urban villages in China are more liable to see state-led redevelopment. By creating an artificial scarcity of greenfield sites on the periphery of growing Chinese cities, the urban land quotas have given cities an incentive to redevelop the traditional and urban village land that is not subject to the quota.

In China, the central government delegates the management of rural land use to farmer collectives. The management of urban land use falls to local governments. Along with agricultural production, farmer collectives can allocate rural land to their members for the purposes of housing or non-farm activities (such as town and village enterprises). The members of the collective can, in turn, rent land and structures to outsiders. The collectives do not, however, have the right to sell rural land in an open market.

To prepare for urban expansion, the local governments that manage urban land have limited authority to expropriate the rural land immediately beyond the urban edge. The rural land near the urban edge typically falls into one of two categories: agricultural land devoted to crops or village land devoted to housing and businesses. As Bertaud points out, the compensation formula used by local governments allows them to pay a price well-below the market value for eligible plots of rural land adjacent to cities.

Worried that urban expansion into agricultural land will compromise China’s grain self-sufficiency, the central government imposes quotas on the amount of land that local governments can convert from agricultural to urban use. The quotas apply only to cultivated land, not to the built-up village land on which many members of the farmer collectives own structures in which they live and lease out space to urban migrants.

Many of the low-income people who migrate to cities in search of work cannot afford to live in the relatively new apartment towers that characterize much of China’s urban landscape. One affordable alternative is to rent a room in the urban villages within or near the city that are nonetheless technically located on rural land under the control of farmers’ collectives.

As in the kampongs of Surabaya or the urban villages of Hanoi, the farmers who own structures in these urban villages are not subject to the building and land use regulations that local governments enforce on urban land. They are free to adjust housing consumption standards to meet the demand coming from low-income migrants. For many new arrivals to China's cities, urban villages have become an important source of affordable rental housing.

However, by limiting the conversion of the arable land just beyond the periphery of growing cities, the land-conversion quotas encourage local governments to expropriate and redevelop the urban village land instead. Chinese planners often respond to the land scarcity by redeveloping the villages on the urban fringe, absorbing the costs of demolition and villager relocation through apartment sales targeted at middle and high-income households. The process of expropriation and state-led redevelopment ensures relocation for members of the village collective but not necessarily for the low-income migrants who relied on rental units in the villages traditional structures. All of which makes it more difficult for new arrivals to find affordable housing in or near the city. As Bertaud puts it:

“The land-conversion quotas, originally conceived to reduce the footprint of cities, instead exacerbate the progressive destruction of the only type of privately built low-income rental housing that has consistently responded to demand from low-income migrants.”

China's experience is instructive for other countries struggling with the question of balance between urban and arable land uses. Because local governments can acquire the rural land on the urban edge at below market prices in China, it is not unreasonable to worry about the misallocation of land between urban and agricultural uses. However, as Bertaud suggests, there are better ways than quotas to address this concern.

For example, the central government could compel local governments to acquire arable land at prices that are closer to true market values. This, combined with relaxing FAR restrictions for apartment buildings would encourage cities to use land more efficiently before moving to acquire additional land for expansion. Other options include bringing additional cultivatable land into production or increasing the productivity of existing agricultural land. Both of these options would help to enhance grain output without imposing artificial constraints on urban expansion.

It should be noted that China is already grappling with how to provide cities with some relief from the constraints imposed by the urban land quotas. Cities such as Chongqing and Chengdu are experimenting with tradable land quotas. By opening up additional land for cultivation beyond the city's borders, a municipality can generate a land quota that it can then sell to a developer. The developer can then use the quota to convert arable land on the city's periphery into urban land.

In contrast to China, the Vietnamese government actively avoids redeveloping existing villages, preferring to integrate them into the expanding city by upgrading village infrastructure and linking it to the city's trunk infrastructure network. Much like those who own structures in the kampongs of Surabaya, the villagers are free to build additions to existing dwellings. Like the undisturbed urban villages of China, Vietnam's urban villages are an important source of market-rate affordable housing for low-income urban households, particularly migrants.

Though China's mega projects have some adverse consequences, Bertaud points out that they are, for the most part, efficient and well-coordinated. What's more, one has to respect “the incredible logistical effort that has allowed the orderly urbanization of 437 million people in less than 20 years.” But in addition to the concerns about the impact of state-led redevelopment on housing affordability, Bertaud also makes it clear that the project scale in China often comes at the expense of “the

individualism and idiosyncrasy” characteristic of the kampongs of Surabaya or the urban villages of Hanoi. Both China and Vietnam hold important lessons for the rest of the urbanizing world but Vietnam’s approach to incorporating the informal settlements in urban villages will be far more practical in the many parts of the world where large-scale redevelopment and relocation is either a political non-starter or beyond the capacity of the state.

Bertaud’s work does suggest that cities move quickly to legitimize informal settlements before they spread over so much land that they become very difficult to service. He points to the Al Mounira neighbourhood in Cairo as an example of a city ignoring informality for too long. Cairo’s land use regulations attempt to prevent the formal extension of the city to agricultural land nearby, but to little effect:

“Because of its proximity to the rest of the city, the market price of land for housing construction became a multiple of the price of agricultural land. As a result, farmers sold their fields illegally to informal developers who built apartments for the low-income population of Cairo.”

What the informal market in Al Mounira has not provided is much in the way of arterial roads. The government, hoping to discourage development, never developed a network of access roads to the neighbourhood; nor does it provide services to the residents. Had the government recognized the inevitability of expansion and either planned for orderly expansion in the first place or worked to provide access once the informal settlement took root, the households in the neighbourhood would have easier access to jobs and amenities in the rest of the city as well as better services.

FLEXIBLE LAND USE AND COMMERCIAL REAL ESTATE

While the discussion thus far has focused primarily on relaxing land use restrictions to promote the addition of market-rate affordable housing, it should be noted that flexible land use will also make commercial real estate more accessible to new urban firms. In *The Death and Life of Great American Cities*, Jane Jacobs argued that cities need old buildings because “New ideas must use old buildings.”

Jacobs was suggesting that old, somewhat rundown buildings are typically inexpensive. While it needn’t be the case that inexpensive real estate is old, her larger point is an important one: that new for-profit or not-for-profit firms need affordable real estate in which to get their foothold. Many such firms will fail but a subset will succeed, some dramatically so, creating jobs and wealth. Restricting commercial and residential development will effectively prevent some potentially great ideas from getting off of the ground.

To the extent that city governments want to promote specific organizations, firms, or industries, in-kind real estate subsidies—giving away city-owned land or zoning private land for exclusive uses—will be less efficient and less transparent than simply providing the favoured groups with vouchers that defray the costs of renting or buying real estate within the city. In general, when it comes to for-profit economic activity, city governments should stick to the role of facilitating economic activity by providing key public services rather than attempting the very difficult task of predicting which firms and industries will be successful job creators. As was the case with Mumbai’s cotton mills, failing firms and industries tend to stick around for prolonged periods of time when they enjoy subsidized leases or access to exclusively zoned land. They end up occupying valuable urban space that could otherwise be put to use by firms with much stronger job-generating potential.

JOBS AND URBAN MOBILITY

Cities are labor markets. One reason that big cities generate inordinate prosperity is that there are many potential matches between firms and workers, allowing for greater specialization and more productive couplings in the labor market. Thick urban labor markets are attractive for firms and workers alike: they represent a deeper pool of labor for firms and they represent more job opportunities for workers. One way to view the role of government in facilitating the economic productivity of cities is as the keeper of the connective tissue in the urban labor market. This is one reason that it is imperative for growing cities to establish the rights of way for arterial infrastructure corridors—the arterial grid is the platform upon which markets, driven by private initiative, can generate housing and jobs.

To help residents to access urban amenities, services, and jobs, cities should focus on mobility in the sense of spatial mobility—the speed with which people can move between two points in the city—but also in the sense of residential and commercial mobility—the ease with which households and firms can relocate themselves within (and between cities) to take advantage of new opportunities.

Much of this essay has dealt with the need for regulatory flexibility in land and housing markets—a key component of maintaining residential mobility. Housing markets should be able to adjust to location-specific changes in demand, providing additional units in response to the emergence of spatially concentrated opportunities. The call to formalize informal settlements works to this end as well. People that are secure in tenure will find it easier to change residence in the face of new opportunities. Flexible and well-functioning real estate markets will allow firms and households to adapt in ways that generate more job opportunities.

Making room for urban expansion—acquiring the rights of way for the arterial grid of roads prior to development—is critical if growing cities are to maintain spatial mobility. Arterial roads will carry collective transport services such as minibuses, buses, bus rapid transit, or collective taxis, as well as individual transport such as bicycles, scooters, motorcycles, private automobiles, and ride-hailing taxi services. Arterial roads spaced roughly 1 kilometre apart will allow easy access to transportation because people living within the superblocks between arterials will be within a 10-minute walk of services.

The failure to establish and appropriately space arterial roads in the expansion area of cities will greatly impair spatial mobility. This will in turn fragment the city's labor market by reducing commutable distances. A more fragmented urban labor market means a reduction the number of job opportunities that can be reached from a given point in the city. This lowers the potential for job matching between firms and residents, restricting the productive potential of the city as a whole.

Shlomo Angel points to Bangkok as a city in which the relative absence of planning for arterial roads leads to epic traffic congestion on the few arterials do exist. The lack of arterial roads not only reduces the city's productive potential, it also leads to heightened air pollution from idling vehicles and makes it much more difficult for the city to deliver infrastructure services such as water, sewerage, and storm drainage. Because the rights of way for arterial roads have not acquired in advance of Bangkok's expansion, the fiscal and social cost of retrofitting key infrastructure are enormous—requiring as it would the takings of large amounts of already built-up private property.²⁰

As rapidly growing cities expand and densities in the metropolitan area decline, trip patterns in cities tend to become more dispersed. Rather than commuting to one dominant job centre, residents make

²⁰ S. Angel, *Making Room for a Planet of Cities* (Lincoln Institute of Land Policy, 2011)

many more disparate trips between points throughout the city. Some trips will continue to take commuters from outlying areas to the city centre but many more trips will take commuters from one outlying neighbourhood to another—suburb to suburb. To keep door-to-door trip times within reason, many commuters will rely on individualized transport or a combination of individualized and collective transport. Individualized trips, particularly in private vehicles, raise legitimate concerns about social costs—primarily because the individuals making them do not internalize the social costs, including vehicle emissions and contributions to traffic congestion, of such trips.

In addressing social and environmental concerns about transport modes, authorities will do better to use price signals in encouraging less socially costly behaviour. Efforts to force commuters onto an official's preferred mode of transport, such as zoning schemes that allow development near transit hubs but suppress it elsewhere, are too blunt and typically ineffective. For example, a resident who resides in a transit-oriented development will not necessarily make use of transit—she may still use her private vehicle for errands and commuting.

If authorities are concerned about emissions from private vehicles, they are better off setting a carbon or vehicle emissions tax that makes people internalize the social costs of private vehicle use. Similarly, concerns about traffic congestion can be addressed with dynamic congestion pricing on the city's most heavily used roads. Charging market rates for on-street parking is another way to indirectly reduce congestion in the parts of the city where many people spend time cruising for on-street parking that is either free or priced below the market-rate.

Appropriately designed, such charges and taxes will give people the appropriate incentives to make more use of cleaner individualized and collective modes of transport. They will also help to improve door-to-door commuting speeds for low-income residents who are unlikely to make use of a private vehicle in the first-place. What's more, by pricing congestion, government can encourage the entry of new private transport providers to offer residents more options, more routes, and competitive pricing.

URBAN JOB CREATION & LABOR MARKET FLEXIBILITY

The discussion about urban mobility took as its starting point the idea that cities should focus on ensuring that people and firms have access to one another through flexible real estate markets (commercial and residential mobility) as well as efficient transport systems (spatial mobility). Of course, the value of urban mobility depends in part on the ease with which the urban economy can generate job opportunities. This section focuses on some of the barriers to opportunity that confront low-income residents in urban labor markets.

Unnecessary barriers to job creation limit the formal sector opportunities available to low-income residents. Formal sector firms tend to be run by well-educated managers and tend to be much more productive than their informal counterparts.²¹ As such, they provide a more promising path toward skill enhancement and earnings potential for relatively low-skill workers.

Facilitating the creation of formal sector firms is key to economic growth and development. Encouraging foreign direct investment (FDI) is one way for domestic workers to interact with foreign technologies, processes, and managers in the formal sector. Reducing the barriers to formality for domestic entrepreneurs should be a top priority as well. Reducing the time and expense that one must incur to register a formal business is one way to make things easier for entrepreneurs. Corporate incomes taxes may be an obstacle to domestic formality and FDI in many countries as well.

²¹ M. La Corte, (10 September 2015), 'An Alternative Way to Resettle the Refugees,' *Wall Street Journal*, Retrieved from: <https://www.wsj.com/articles/an-alternative-way-to-resettle-the-refugees-1441928091>

Additionally, improving the reliability of electricity and access to finance will encourage more formal sector start-ups.

This is not to suggest that governments should actively *discourage* the informal economic activity upon which many low-income residents rely to get by. Here are La Porta and Shleifer on informal firms:

“They provide livelihood to billions of poor people. Because these firms are so inefficient, taxing them or forcing them to comply with government regulations would likely put most of them out of business, with dire consequences for their employees and proprietors. If anything, strategies that keep these firms afloat and allow them to become more productive, such as microfinance, are probably desirable from the viewpoint of poverty alleviation. But these are not growth strategies in that turning unofficial firms into official ones is unlikely to generate substantial improvements in productivity.”

In other words, the tolerance and support of informal firms may not offer a path to significant, economy-wide productivity growth but it will help to alleviate poverty. If the government can create conditions favourable to the establishment of more formal sector firms, the growth of more productive firms in the formal sector will eventually phase out the importance of the informal sector.

Another obstacle to formal sector employment often comes in the form of occupational licensing requirements. Governments routinely require that practitioners of certain trades or professions be licensed in order to legally work for pay in their field. Occupational licenses are typically justified on the basis that they protect quality, health, and safety for consumers. For roles such as nurses or physicians, the rationale passes muster—though it is often debatable, for example, which job functions should be restricted to physicians versus nurses. For other professions, such as interior decorators in the United States or “web advertising brokers” in China, licensure is highly dubious and very often the result of a concerted effort by an interest group to create entry barriers to the markets in which they proffer services.

Occupational licensing should only cover essential professions and essential functions within those professions. Licensure requirements should be frequently audited and unnecessary standards should be removed. As of summer 2015, China’s State Council appeared to be taking just such steps. Economist Andrew Batson translated selections of a recent Council declaration:

“All localities and departments should further strengthen their efforts and continue to focus on cancelling occupational licensing and certification requirements.”

“Professional qualifications that lack a legal basis, whether established by government departments, national industrial associations or academic societies, must all be abolished.”²²

The declaration came with an announcement that the central government will abolish 62 of the 618 occupational licenses that it currently recognizes. This comes on the heels of the Council’s elimination of 256 types of licenses in 2012 and another 149 in 2013. There is more for Chinese authorities to consider—including an additional 1,875 occupations that require licensing at the local level—but the trend toward scaling back occupational licensure is a welcome development for Chinese entrepreneurs and job creation in urban China.

Governments intervene in labor markets for a variety of reasons including the prevention of discrimination and abuse as well as concerns about low pay. But like minimum housing standards in

²² A. Batson, (6 August 2015), ‘China goes after occupational licensing,’ *Andrew Batson’s Blog*, Retrieved from: <https://andrewbatson.com/2015/08/06/china-goes-after-occupational-licensing/>

the housing market, it is worth considering labor market regulations with an eye toward rules that may do more harm than good from the stand-point of low-income residents. Minimum wage policies, for example, are meant to boost the incomes of low-wage workers but can easily end up preventing the creation of entry-level jobs in which the urban poor could otherwise get a foothold in the formal economy.

In their survey of minimum wages in Sub-Saharan Africa, for example, Haroon Borat, Ravi Kanbur, and Benjamin Stanwix find that minimum wages are relatively high by international standards.²³ They also observe that non-compliance with minimum wage laws is relatively high in Sub-Saharan Africa—consistent with the notion that relatively high minimum wages are yet another deterrent to formal sector firm creation. In countries where minimum wages are high relative to the median wage *and* minimum wage enforcement is strong, the impact will show up in lower employment rates and / or weaker job creation for less-skilled workers.

Minimum wage laws should therefore be reviewed with an eye toward reducing negative impacts to formal sector employment. For minimum wages, it is also important to keep in mind regional variation in median incomes and cost of living. A minimum wage that is not binding in a large, productive city may have disastrous consequences for employment in smaller cities where the cost of living is lower. Economist Arindrijat Dube, a strong proponent of minimum wage policies, suggests that states and cities in the United States should limit minimum wages to close to half their median full-time wage.²⁴ But Dube also acknowledges that his recommendation “pushes the minimum wage beyond the experience over the recent period” in the United States. Other evidence from the United States suggests that higher minimum wages lead to slower job growth, even if the hikes don’t cause an immediate shock to employment.²⁵ In other words, minimum wage laws carry with them dis-employment risks—risks that should be taken very seriously, particularly in places where formal sector job creation is critical for the advancement of the urban poor.

If the goal of governments is to boost the earnings of lower-skill workers, minimum wages are a poor way to achieve it. Wage subsidies or earned-income tax credits offer a much more effective and transparent way to boost the earnings of low-wage workers—without any of the dis-employment risks of the minimum wage.

Just as minimum wages are intended to raise the incomes of low-wage workers, employment protection measures are intended to provide them job security. But like minimum wage policies, employment protection measures risk unintended consequences that actually harm the employment prospects of the urban poor, particularly youth. By raising the costs of dismissal, employment protection measures discourage firms from taking a chance on hiring inexperienced workers in the first place. This may rob urban youth of an opportunity to gain skill-enhancing experience in entry-level jobs with formal sector firms. Relaxing strict employment protection measures to allow for a trial period in employment contracts would encourage employers to take more chances on people who might be applying for a formal sector job for the first time.

²³ H. Borat, R. Kanbur and B. Stanwix, (06 October 2015), ‘Minimum wages in sub-Saharan Africa: A primer,’ *Vox*, Retrieved from: <http://voxeu.org/article/minimum-wages-sub-saharan-africa-primer>

²⁴ A. Dube, *Designing Thoughtful Minimum Wage Policy at the State and Local Levels*, The Hamilton Project, 2014, Retrieved from: http://www.hamiltonproject.org/assets/legacy/files/downloads_and_links/state_local_minimum_wage_policy_dube.pdf

²⁵ J. Meer and J. West, (10 September 2013), ‘The minimum wage and employment dynamics,’ *Vox*, Retrieved from: <http://voxeu.org/article/minimum-wage-and-employment-dynamics>

CONCLUDING DISCUSSION

The urban poor have tremendous agency. If the regulatory framework governing land, housing, and labor markets excludes them from formal participation, they will find ways, however precarious, to make a living and establish a home. Everyone would be better off if government policy complemented the efforts of the urban poor rather than inadvertently working against their interests. This essay argued that there are several principles that governments in urbanizing countries can adhere to in order to lower the obstacles to opportunity to the urban poor.