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THE INFLUENCE WIELDED BY LAND DEVELOPER LOBBIES DURING THE HOUSING BOOM: RECENT EVIDENCE FROM SPAIN

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Introduction

Housing construction grew at an extraordinary pace during the last economic boom. In the period 2003–07 over 18 million housing units were built in the US, roughly 15 percent of its historical record (American Housing Survey 2009). In Spain, growth was of a similar magnitude, with 4.3 million new housing units built during the same period, representing 17 percent of the housing stock. At the peak of the boom, Spain built more housing units (around 800,000 per year in 2006) than Germany, France and the UK together.

This big expansion in housing supply was not able to contain housing prices, which since the mid-1990s have also experienced growth of an unprecedented magnitude. In the US, housing prices rose by around 86 percent (in real terms) between 1997 and 2006 (and by around 50 percent in the six-year-period ending in 2006). In Spain the boom was even more spectacular, with a real price increase of about 150 percent for the whole period, and of 90 percent in 2000–06.³ In Spain, this generated a serious housing affordability problem, only mitigated by the ease of access to credit.

The consequences of these developments for the Spanish economy are already well-known: the housing bubble burst, activity in the construction industry stopped abruptly, unemployment skyrocketed, foreclosures multiplied, many savings banks (with businesses

overly concentrated on the mortgage industry) had to be bailed out, and the public deficit plummeted due to the sudden disappearance of the huge construction-related revenues available during the boom. The main causes of the situation were external to the country: the increasing flow of credit as a result of the introduction of the Euro, huge demand for second-home residences from foreign nationals, and the massive immigration inflow experienced during those years.

Besides these economic drivers of growth, however, a more critical assessment needs to consider the possibility that bad governance has exacerbated the problem. Did the influence wielded by the economic sectors profiting from the construction-intensive boom (i.e., developers and the real-estate industry, public works, the tourist industry and savings banks) block appropriate policy responses to the growing bubble? Some authors have already suggested that governance in Spain deteriorated severely as a result of the introduction of the Euro (Villaverde, Garicano and Santos 2013), and that this contributed to the “prolongation of the credit boom, delaying the response to the bubble when the speculative nature of the cycle was already evident”. Here we follow this line of reasoning by also suggesting that bad governance in itself was responsible for the intensity of the boom and for its consequences. Our point is that due to the poor quality of institutions (for example, low transparency of government, lack of regulation of lobbying activities and of campaign finance, as well as the inefficiency of the courts and the partisanship of the media, etc),⁴ rent-seeking activities by development-related interest groups in Spain were unconstrained during the boom years. We contend that this state of affairs was partly responsible for the bad outcomes generated by the housing bubble, from excessive development to corruption scandals.

Development-related interest groups probably had too much influence over government at all levels. At the central level, pressure from real-estate firms and the banks lending to them had probably some influence over



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³ Ministerio de Fomento, www.fomento.es.

⁴ See Transparency International (2012) for a report identifying the institutional failures in fighting corruption and money influence in Europe; the report identifies the aforementioned problems for the case of Spain and other southern European countries.

several policies, including the favourable tax treatment of housing ownership, the bad oversight of exposure to the housing bubble by financial institutions (Villaverde et al. 2013), the basic legislation on land-use matters⁵ and on protection of forests and the shoreline, or the decision to build certain development-promoting infrastructures such as highways and water pipelines. The influence wielded by land-related interest might be felt with more intensity at the regional level, with impact on the basic framework under which local land-use regulations operate and/or on the intensity of oversight of these local policies.⁶ However, perhaps the strongest impact occurred at the local level, where powerful land-related interests found it very easy to bribe local politicians in exchange for amendments to local land-use plans (Transparency International 2007; Fundación Alternativas 2007).

The rest of the contribution is organised as follows: In the next section we briefly explain how land-use policies work (in Spain and elsewhere) and discuss the possible role of several political players in their design. In the section that follows we present some indirect empirical evidence on the influence wielded by developers (and/or land-related interest groups in general) over local land-use policies, relying on our own work for Spain. Some descriptive evidence is subsequently presented that documents the involvement of land-re-

⁵ When the Partido Popular was elected to lead the central government (1996–2004) it made several attempts at liberalising the regional regulatory framework. The main acts were the ‘Law of Land’ (Ley 7/1997), and the ‘Law of liberalisation of the building sector’ (Ley 10/2003).

⁶ Among the most criticised regional laws was the Valencian law on urbanism (Ley 16/2005), which enhanced the role of private developers in land use policies.

Box 1

Land use regulations in Spain

Land-use regulations in Spain adhere to a very detailed and rigid system, although they do not greatly differ from the zoning regulations operating in some parts of the US or in other European countries. A key characteristic of the Spanish system is that, although an individual might own the land, the government is empowered to control and implement all the processes of urban development. Landowners are not permitted to develop their land without the prior agreement of the local administration. It is not that they need a building license (which is granted automatically in most cases): before reaching this step, the government must have declared the land ‘developable’ and must define precisely the conditions for such development. The main tool that the government uses to do this is the urban plan. So town planning in Spain is essentially a municipal responsibility, but as there are over 8,000 municipalities, the system is highly fragmented.

Municipalities draw up a ‘General Plan’, which provides a three-way classification: built-up land, developable land (the areas of the community where future development is allowed), and non-developable land (the rest of the territory – agrarian or other uses, where the development process is strictly prohibited, at least until a new plan is approved). The ‘General Plan’ includes very detailed regulations regarding many other aspects: land zoning (residential, commercial, industrial), minimum floor-to-area ratio for each plot, the reservation of land for streets, green spaces for public facilities, etc. In theory, the ‘General Plan’ has a length of eight years, but the land classification can be quite easily modified by a majority vote in the municipal council. The amendment plan, known as a ‘Partial Plan’, is also a legally-binding document.

The local institution responsible for passing these regulations is the city council. The city council is elected every four years. The candidates are included in party lists (usually using the brands of national or regional parties) and voters are allowed to select one of these lists, without the possibility of marking any specific name. Besides urbanism, municipalities have many other responsibilities, so residents must take into account many different aspects when casting their vote (including ideological attachment to the party). The council elects the mayor (usually from the most voted list) and the mayor chooses the executive and acts as the agenda setter. To facilitate scrutiny by the residents, a number of participatory or transparency requirements apply to the land-regulation process. These requirements are stricter in the case of the initial introduction of the ‘General Plan’, but the transparency of the system is heavily dependent on the will of local politicians. To implement the plan, politicians can resort to a variety of means to introduce the desired amendments, without these changes being exposed to much scrutiny from residents or the media. A good example of this are the contractual arrangements made between local governments and developers (the so-called ‘*Convenios urbanísticos*’, which are permitted under the Spanish law. Such contracts might modify the status of a plot, its floor-to-area ratio, involve the renegotiation of developers’ fees or swaps between land plots located in different areas.

Source: The authors.

lated interest groups in many of the corruption scandals that have broken out in Spain in the recent past. The then following sections discuss the influence of land-related interest over the land-use policies implemented by parties with differing ideologies, again using evidence from Spain. The last section provides some conclusions and suggests potentially interesting topics to study in the future.

Politics of land use regulations

In many countries, local housing and land markets are heavily regulated. In the US, urban growth boundaries restrict the amount of land available for development, zoning ordinances limit the amount of land for specific uses, and obtaining a building permit often entails a lengthy process subject to many other regulations (Gyourko, Sáiz and Summers 2008). In Europe, urban planning encompasses many of these instruments, generating a very detailed and sometimes rigid regulatory system, which specifies what can and cannot be done with a specific plot of land (Cheshire and Sheppard 2004). In particular, the Spanish system of land-use regulations is extremely rigid and interventionist. In Spain, local urban plans determine whether it is allowed to build on a given land plot or not, specifying in a very detailed way how this development should proceed (see Box 1 for a description of the workings of local land use regulations in Spain). A growing body of empirical research shows that these land-use regulations account for a sizeable proportion of housing prices (Glaeser, Gyourko and Saks 2005a; Cheshire and Sheppard 2004). Some authors even suggest that stringent regulations helped amplify the size of the recent housing bubble (Glaeser, Gyourko and Saiz 2008).

There is very little empirical evidence on how these regulations are enacted, and most of it focuses on the US case. Traditionally, the urban economics literature has assumed that land-use regulations are designed in the interest of the homeowners (Fischel 1985 and 2001). Homeowners would oppose growth because it reduces the quality of life in the community and/or reduces the value of housing (Brueckner and Lai 1996; Ortalo-Magne and Prat 2011). The fact that in many areas of the US the median voter is a homeowner would account for the observed restrictions placed in the US. Yet, the empirical evidence in favour of this hypothesis is scarce and restricted to specific types of communities, like the suburbs (Dehring, Depken and Ward 2008; Hilber and Robert-Nicoud 2012).

This has led other authors to suggest that the owners of undeveloped land might also be interested in influencing the political process, in order to increase the price commanded by these assets. These actors might be individuals or families owning huge tracts of rural land, firms in the real-estate industry that have acquired these lands and have plans to develop them (i.e., developers). This group might also include other sectors that have their scale of activity and profit levels conditioned by the supply of land (for example, the building industry, the tourist and recreation industry), or sectors whose activities are closely interlinked with those mentioned above (for example, banks lending to developers or the building industry). These groups represent a coalition advocating development, or the so-called 'growth machine' in the classical study by Molotch (1976) on urban development politics.

These interest groups will use all of the instruments at their disposal to influence policy decisions that might either push for growth or deter it. These instruments may include: (i) advocating the virtues of growth (for example, job creation) through the media, (ii) lobbying bureaucrats and politicians, (iii) promoting development-based parties and/or running as candidates in elections, (iv) making campaign donations to political parties, or (v) bribing politicians. In many countries in Europe, and certainly in Spain, in which the lobbying business is not well regulated and legal campaign donations are either prohibited or opaque, options (ii) and (iv) are fairly limited. Especially at the local level (which is where regulations are mostly enacted), the main ways to exert influence are by directly bribing politicians or running for election. Advocating through the media and informational lobbying may be more important activities at the regional and national level (or even at the EU level in Spain). These are the levels of government responsible for basic legislation regarding land development and for other policies that might limit local autonomy in the design of development strategies (for example, national parks and protected areas, the location of major infrastructures, availability of water supply, forest fires, etc.). In the remainder of this section we discuss some empirical evidence from Spain regarding the use by land interests of these different channels to influence local land-use regulations and other development-related policies designed by higher layers of government.

Lobbying and land development: empirical evidence

Some authors have already suggested that these special interests do influence land-use regulations in the US at the local level (Glaeser, Gyourko and Saks 2005b and Hilber and Robert-Nicoud 2012), although the evidence they present is rather anecdotic. Obviously, the hypothesis is difficult to test, since the influence activities of these groups are really difficult to measure. In a recent paper (Solé-Ollé and Viladecans 2012) we overcome this difficulty by employing an indirect approach. The intuition of our approach is as follows: in a system of representative democracy (like the one used in Spain to elect local politicians, who will afterwards be responsible for passing these regulations), the incumbent party will tend to cater for the preferences of the median voter when it expects the next local election to be highly competitive. If voters are mainly homeowners (as 92 percent of families in Spain are), this means that when electoral competition is stiff, development incentives are low. On the contrary, when the incumbent expects to be re-elected without much opposition, it might be tempted to accept the payments from the lobby of land developers in order to boost the rents received while in office. In theory, these payments could be legal, but in Spain – as already explained – there is no legal way to channel monies from interest groups to the parties, so these payments end up being opaque and illegal and can therefore be qualified as bribes.

In the paper, we focus on the main regulatory decision Spanish local governments are empowered to take: the delimitation of land between the developable and non-developable categories. Our prediction is that stiff election will limit the amount of land newly declared as developable during a given term-of-office. This simple intuition is developed with the help of a simple theoretical model in which we assume that the local incumbent maximises a weighted sum of the political rents it will obtain in the present term-of-office and the effect of his decision regarding land use regulations on the probability of re-election. Rents are higher if more land is allowed to be developed, since the developer's profits increase the greater the amount of land they are allowed to build on, and so do their contributions to the politicians. Some of these rents might be non-monetary and others monetary, and some of the monetary rents might entail politicians pocketing some money personally, while others may actually be directed towards financing politicians at the regional or national level. The probability of re-election is reduced when more land is allowed to be developed because we assume that development entails

costs for the representative voter. The incumbent chooses the amount of new land to develop so as to equate the value of additional rents and the loss of utility derived from not being elected. The weight put on the voter's welfare rises (and the weight put on rents obtained when satisfying lobby's interests decreases) with the degree of political competition (measured in the model as the proportion of swing voters, i.e., voters that are indifferent between the incumbent and the challenger). This means that an increase in political competition decreases the amount of new land that is allowed to be developed. A finding like this would thus provide indirect evidence that developers do have influence on the land use policies enacted by local governments.

We test this hypothesis with data on a sample of over 2,000 Spanish local governments during the period 2003–07, which coincides with one municipal term-of-office and with the peak of the last housing boom. This is the kind of situation where we expect these influences to be more important, since developers are more willing to bribe politicians when they expect a huge demand for building in the community. The variable analysed is the amount of new land allowed to be developed during the term and political competition is measured as the incumbent's margin of victory at the 2007 local elections. To deal with endogeneity problems, this variable is instrumented using vote results for the incumbent parties measured either at a higher geographical level of aggregation or in a distant past. With this method, we find that more political competition means less development: an increase in one standard deviation in the vote margin generates an increase in the amount of developable land or around 17 percent of the standard deviation in the growth of developable land during the period analysed. We also find that the effect is stronger in the suburbs and in places where there are a lot of commuters, homeowners and left-wing voters. These are the places where it is most probable that the representative voters really dislike growth, which is the main assumption behind our prediction. Overall, the results seem to confirm our hypothesis.

Corruption in land-use regulations

During the housing boom there was an upsurge of corruption scandals related to land-use regulations. So it is not only that we are able to infer the possibility of undue firm influence by observing specific regulatory decisions that benefit land-related interest groups. In fact, many of the deals between developers and local

politicians have been brought to light by newspapers and/or judicial investigations. A recent paper compiles all of these corruption scandals and studies their impact on the vote for local incumbents (Costas, Solé-Ollé and Sorribas 2012). The database used in that paper builds on a previous effort made by Fundación Alternativas (2007), a Spanish think tank. In 2007, and shortly after the surge in corruption scandals that occurred in 2006, this organisation commissioned a survey of local corruption in order to gauge quantitatively the magnitude of the phenomenon. They hired a journalist in each Spanish province with the task of compiling all corruption related stories involving municipalities in the province between 1 January and 1 February 2007. The authors of the above mentioned paper completed the database for corruption stories published before (since beginning of 1996) and after that date (until late 2009). Between January 1996 and November 2009 politicians in 814 municipalities were engaged in allegedly corrupt acts. This number was very small before 1999, with just 46 municipalities affected, and started to grow as the boom intensified: 288 municipalities were affected during the term 1999–2003 and 408 during the term 2003–07. Just 72 cases were found for the 2007–09, perhaps due to arrival of the crisis. In any case, new scandals have broken out during the crisis, so an update of the database would find plenty of new cases.

The vast majority of these corruption scandals refer to politicians accepting bribes from landowners or developers (usually individuals or small local or regional firms) in exchange for amendments in land use regulations. In this respect, the most problematic aspect of Spanish land use regulations seems to be the existence of a ‘development border’, a line between plots of land on which developers are allowed to build and plots where developed is banned. In periods of high demand this border creates a rent differential, which might fuel rent-seeking by developers who try to convince local politicians. A large number of corruption scandals involve local officials amending the land plans to allow huge tracts of land to be developed. Permitting higher densities than the ones specified in the plan or allowing building in places where it has been previously prohibited (Fundación Alternativas 2007). Many of the cases are also related to questionable contracts between developers and the city council, as a recent report identified (Transparency International 2007). Finally, in some cases corruption arose because land owned by the municipality was sold at below market prices or because payments made by developers for basic infrastructure were lower than those provided under the law.

These corruption scandals were concentrated along the coast and in booming urban areas. This is natural, since the rent differential between rural and urban uses of land that fuels the bribes paid by developers to politicians arises as a consequence of a shortage of vacant land (land already classified as developable) relative to boom in housing demand experienced by the municipality, which was much stronger in these places. Obviously, the existence of these rents is a necessary, but not sufficient condition for corruption to happen. Some of the areas experiencing this problem with a higher intensity had experienced a boom in the demand for land, but also had weaker governance. For example, some of the most prominent scandals affected entrenched incumbents. The two scandals also followed more closely in the press during the boom years (i.e., Marbella, in Andalucía, and Andratx, in the Balearic Islands) the incumbent accumulated several landslide electoral victories before corruption was detected.⁷

Political parties and local land-use regulations

Are some political parties more prone to cater to the interest of land-related interest groups? The results obtained in Solé-Ollé and Viladecans (2012a) suggest that the effect of electoral competition on land conversion is much stronger when the incumbent belongs to a left-wing party (in our sample, this means in most cases belonging to the socialist party, PSOE). This means that socialist incumbents are more sensitive to electoral competitiveness: when elections are really competitive they do cater to the interest of the median voter, but when vote margins grow they change their mind regarding the appropriateness of development. In contrast, right-wing incumbents (mainly the Partido Popular, PP) are not that sensitive to the electoral conditions. In a recent paper (Solé-Ollé and Viladecans 2012b) we study what happens in close elections. Using a Regression Discontinuity Design, we are able to document that in close elections right-wing local governments allow much more land to be developed than the left-wing ones. The difference is striking: a left-wing local government would allow approximately 65 percent less land to be developed than a right-wing local government facing a similarly competitive election.

⁷ In Marbella, the GIL populist party won 80 percent, 76 percent, 70 percent and 64 percent of the seats at the local elections of 1991, 1995, 1999 and 2003, just before all the mayors serving during this period were sent to jail after the MALAYA crackdown in 2006. In Andratx, the governing coalition won the local elections in the same years by 75 percent, 80 percent, 70 percent and 64 percent, respectively, before the 2007 crackdown which sent the mayor to jail. In both cases, accusations were related to accepting bribes and to other charges related to land use regulations.

In that paper we explain that right-wing parties in Spain are very much in favour of deregulation of the land market and do not consider that the urban growth is bad per se. By contrast, left-wing parties are in favour of controlling urban growth in order to limit its negative effects. Left-wing parties also do not buy the idea that expanding the amount of developable land will have an effect on housing prices. Their preferred solution to the problem of housing affordability was the reservation of land for the provision of social housing. What this paper does not discuss is the possibility that these seemingly different ideological preferences in favour or against growth of the two main political parties in Spain are due to differences in the degree of influences that land-based interests have in the two parties. There is anecdotal evidence suggesting that people with economic interests in development tend to enrol in the Partido Popular, both at the local and regional levels and also at the national level. Firstly, although the PP is now the main party in most of Spain, some of its strongholds (for example, Valencia, Murcia, Madrid) are located in regions where the housing boom was particularly intense and/or where tourism and construction are the main industries. Secondly, some of the local politicians affiliated to this party are themselves developers or the owners of real-estate firms⁸ – or have family or friends with these occupations – or have a direct interest in the tourist industry,⁹ and some of the individuals involved in corruption scandals also have this trait. Thirdly, one might generally expect rich people and, in particular, landowners to choose a right-wing party in order to defend its interests. Clearly, one of the reasons for getting involved in politics at the local level is to advance personal interests; in Spain, it is quite common, for instance, to find contractors, or real-estate agents running for the local council and eventually having executive responsibilities related to urban planning. Our guess is that although this selection mechanism might affect all parties, it is much more natural for the right-wing parties to accept this type of person, given its ideology which is more favourable to development.

⁸ One notable example is the former mayor of Santiago de Compostela, Gerardo Conde Roa, popularly known as the ‘mayor-developer’, who had to resign in 2012 after a corruption scandal broke out. The mayors of the two most prominent corruption scandals (Marbella and Andratx) also were owners of real estate agencies. Even some very prominent politicians of the PP (for example, former regional president of Madrid, Esperanza Aguirre, and some ministries of the actual government) are known because they or their family have direct interest in the sector.

⁹ There are examples of politicians who are family of owners of hotel and tourism firms in the Balearic Islands. This is the case of Stella Matutes, daughter of Abel Matutes – former PP minister with the Aznar government and owner of an important hotel chain – who has been prosecuted because of voting for a change in the urban plan of Ibiza benefiting her family.

Conclusion

In this contribution we have discussed the role of developer lobbies in the design of local land-use regulations. We have documented that these interest groups had a considerable influence over land-use regulations enacted by Spanish local governments during the last housing boom. A substantial share of urban expansion over this period can be attributed to the effect of these lobbies, and worked either through bribes to local politicians (which, in many cases, have resulted in real corruption scandals) or through the control of local councils by political parties representing these interests. This evidence complements the results of recent papers on the influence of special-interests on housing policies by higher layers of government (for example, Mian, Sufi and Trebbi 2010 and 2013, for the politics of mortgage regulation in the US).

This evidence also suggests that a satisfactory explanation for the intensity of the housing boom in Spain (and other countries) and for its consequences should consider the role of the bad quality of political institutions that these countries had prior to the boom. Some authors have already suggested that the boom has its roots in governance problems (Villaverde, Garicano and Santos 2013), but this topic requires further empirical research.

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