A commercial mall in my backyard: a royalty might be efficient

A recent vote from urban residents within a community in Santiago rejected the proposal to have a commercial mall in its backyard. It was a yes or no vote with no proposed compensations whatsoever. Considering the net benefits residents could receive - compensations over congestion costs-, it might be a mistaken decision from their point of view; from the point of view of the city, if other parts of it were to be relieved by this new mall and other marginal benefits were to be bigger than its marginal costs, the current decision would decrease the value of the city. The lack of an explicit price to account for externalities explains this inefficient scenario where the city ends with no mall and less aggregate value.

Ronald Coase said it before: economic decisions have to be taken under a general equilibrium concept and not a partial one. If property rights are well defined and transaction costs are low, the efficient decision under a competitive market is feasible and private and social decisions do not differ. It is via transactions over those property rights that externalities get corrected, because private decisions do effectively take into account not only their immediate private consequences but also those over others.

In our case, let us assume that the city needs another mall – the private estimate of the developer is socially right -and in so doing increases its value. For the immediate mall neighbors, there is a negative effect over their standard of living, mainly reflected in additional congestion costs relative to the no mall scenario. On the other hand, there is a benefit for the city as a whole when the existence of this mall decreases congestion levels in other secondary urban centers of it. If the decision is only taken by the immediate community, the mall will probably not come into existence; if the decision is taken by the city as a whole and benefits of less congestion in the rest of the city are bigger than costs attributed to the higher congestion in the particular community, it will probably be built. If the right to build the mall is within the grasp of our community members, they could sell their right to the rest of the city and everybody would be better off with the additional mall. Conversely, if the right to build the mall belonged to the rest of the city, the mall would also be built, but there would be no compensation for the specific community. In both cases the final decision with respect to the existence of the mall and city consolidated net benefits would be the same; what would differ is the wealth distribution between the community and the rest of the city depending on who has the initial right to build the mall. Needless to say, the allocation of this initial right to either party is not irrelevant when viewed under a long term equilibrium perspective – big distributive inequalities are certainly a source of instability -.

In a real and dynamic urban world, a possible solution trying to mirror the above could consider three parties - the mall developer, the community and the rest of the city – and be as follows:

1. In the case of an already existing city, establish the “right to perceive a compensation due to a major urban change such as a new commercial mall” in favor of the community directly involved. The mall developer – the main private beneficiary but not the only one: remember the city -, in the name of the rest of the city, would have to pay a compensation to the community if it wanted to have a new mall and would also need to contribute with an upgrade in the surrounding road network so as to smooth the impact on congestion levels in the area.

2. A royalty would be charged on the new mall. It would be based on sales (¿1%?) as a good approximation for the activity level and the value of time. As incomes went up, so would the cost of time and congestion levels due to more sale activities around the mall, increasing the corresponding royalty.

3. Part of the royalty would then go into paying for the network upgrade and part of it to the residents of the particular community open to have the new mall in its backyard, being more compensated those residents living closer to it than those living farther away and less disturbed.

4. A royalty paying mall would probably be reflected in higher products and services prices and a smaller private return, enabling the compensating payment to the city and the community. There has never been a free lunch in the intervention of an existing city; it was usually the case that others paid for it.

5. The dynamic city would then evolve under a majority rule: if more than 50% of the community residents approved of the proposed compensation, 100% of them would receive it under an impact graded scale – presumably distance based - and the mall would come into existence.

6. The movement of people within the city as time goes by would start changing relative new mall royalties perceived by its communities, precisely reinforcing those with higher congestion levels.

7. However, in the case of a new town in a growing city the royalty mechanism could be avoided, if the zoning approval by city authorities previously considered the existence of a commercial mall and its corresponding wider road infrastructure investments to connect to the city and within it. New incoming community residents would not receive mall related compensations for they would know before arriving into town that a mall would exist for their service at some location.

Under present discretionary practices, decisions over commercial malls and big office facilities in already consolidated areas that were not prepared for them risk being suboptimal from the city viewpoint and give rise to unfair wealth distribution consequences in favor of some few who are given those initial building rights and against the rest of the city, particularly the most immediate residents.

The above mentioned proposal could be similarly implemented with new buildings in the neighborhood. Nearby residents could be compensated and the city would vitally evolve under a neighborhood majority rule that would better reflect what people really want. Community authorities would lose their present discretionary allocation of building permits and it would be the community itself the final arbiter, with the restriction that new buildings would also contribute to the transport network upgrade.

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June 25th, 2010