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No way out of this plot

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Now that the fate of a certain small-car factory is signed and sealed, high-flying politicians pay daily visits no more, and the media circus has gone off to more newsworthy locations, we visited a rather deserted-looking Singur last month as part of a group of economists. We wanted to talk to various farmers, try to understand their reluctance to give up land, and get their reactions to alternative compensation policies. Even though the prospects for industrialisation in the area, or for that matter in the state, do not look very bright at the moment, we felt there are lessons to be learnt here that might be useful in other times and places.

In retrospect, the key and somewhat surprising issue in the context of industrialisation has become transferring land from agriculture to industry. Theorists of industrialisation, such as Arthur Lewis, focused on capital and labour as the key resources, and concentrated on the movement of 'surplus' labour from agriculture to industry as key to capital accumulation and the process of industrialisation. As industry offers a much higher expected return than agriculture, the transfer of land to the former from the latter is expected to be smooth.

Given the high expected returns from industry, it should have been easy to compensate those who had to part with their land. It is true that political forces vitiated the atmosphere and interfered with the buying and selling of land that is normally expected to be mediated through the market. But even then, what was the basis of the reluctance (resistance) to sell the land that necessitated coercive acquisition?

Textbook economics suggests that, given his level of wealth, human capital and prevailing market prices, an individual has a reservation price for an asset that he currently owns. If a landowner gets an offer above that price from the seller, the transaction will go through. Otherwise, the owner will leave it in its existing use. Since the expected profit from industry is high relative to the return from agriculture, the offer price for land should be high enough to induce the owners of the land to accept the deal.

In general, one would think that poorer people will have the least resistance to sale (meaning, a lower reservation price) of their land if offered a reasonable price. Because they have less of it, the poor will have a higher value for cash. For example, this would relax borrowing constraints and provide working capital that can be used in some other activity. In contrast, the rich would be expected to have a higher reservation price.

One of the most striking things that we found out from our interviews in Singur is that it is the poorer farmers who are most reluctant to sell their land and the opposite holds for the richer farmers. When we asked the poorer farmers what they would do if offered a price considerably above the market price for their land, they told us that they still would not be willing to sell. When asked why, they offered several reasons. First, they said that a large chunk of cash was not very useful to them because they do not have the skills and temperament to invest it profitably in non-agricultural uses. Agriculture is the only thing they know well. Second, even if theoretically the money can earn a higher return in the bank compared to agriculture, they are worried that inflation would eat into their savings, and interest rates could go down. Third, agriculture has the big advantage of offering them the guarantee of subsistence. Fourth, they are worried that a lump sum received from selling land might be frittered away by themselves or family members (the "son buying a motorcycle" was a phrase often heard).

We asked them if they would prefer a monthly payment system but they felt that they could not trust the government, private buyers, or banks to keep the commitment and continue payments over time.

It seems that to this group of people with minimal exposure to the world outside agriculture, land is not merely an income-generating asset but an insurance policy-cum-pension plan as well. Moreover, their own skills are completely specialised in agriculture, and as a result, if they sell their land, they feel they will not have any other option but to work as an unskilled labourer, which is not an attractive option in a labour-surplus economy. It seems that to this group of farmers, cash from the sale of land resembles a currency that they do not have the ability to convert to a form that is of much use to them.

We also spoke to some middle-level farmers who were more senior in age. They claimed that agriculture is profitable and the prospect in industry is more uncertain because companies may go out of business. They have less aversion to selling land that is not fertile.

The group that was most outspoken in favour of selling land were younger, wealthier, landed people who were more educated and had greater exposure to the outside world. Some of them had their land acquired for the project but did not seem very upset by it. They were the most devastated due to the scrapping of the car project because as suppliers they were doing very well when the construction work was going on. They felt that agriculture was not profitable and industry was the way of the future.

Our conversations with the farmers suggest some interesting hypotheses. First of all, the true price of land is much higher than what would be dictated by a simple calculation of availability and current market prices. This has nothing to do with the relative profitability of industry or agriculture or the physical scarcity of land. Rather, it is driven by the absence of good insurance mechanisms and financial instruments, and low levels of human capital, all of which make switching to alternative occupations costly.

Second, the distribution of land is important in determining the average reservation price of land. If there is a substantial group of small and poor farmers who for reasons outlined before are reluctant to sell, then the price that would be needed to acquire land for industry would be much higher. Similarly, the reservation price will also be very high for richer landed gentry who are older for two reasons.

Possession of larger tracts of land confers personal benefits in the form of local prestige; more importantly, their expected benefit from switching to non-agricultural occupations is low given their age. In contrast, the reservation price is lower for richer farmers, who tend to be more educated and exposed to the world outside agriculture, especially the younger generation, who has a long time horizon. Therefore, in the context of West Bengal, the success in implementing limited land reform may have, ironically enough, created a distribution of land that makes industrialisation more difficult.

As a result of these forces, the economy appears to be stuck in a vicious circle. Because of poverty and low levels of human capital, farmers have a high reservation price for land as their alternative earning options are limited. The resulting scarcity of land is a major constraint on industrialisation, thereby keeping productivity in alternative occupations low, and keeping the economy at a low level equilibrium.

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