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Reforming India's Land Policy

*Maitreesh Ghatak
Parikshit Ghosh
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...the most significant failure of many current policy initiatives on land is the inability to combine idealism with pragmatism, to balance distributive concerns and aggregate goals like industrialization or conservation of forest cover. Distributing our land endowments more equally is important for social justice, but this has no real conflict with allowing land markets to function smoothly and promoting the best use of land

AS INDIA struggles to reverse the economic slowdown that has followed a decade of high growth rates, it is increasingly becoming clear that a critical determinant of our economic future will be the handling of problems surrounding the land. There are two major reasons why this is so.

The reallocation of resources from agriculture to manufacturing and services is the *sine qua non* of development. This structural transformation cannot be achieved without rapid improvements in the agricultural productivity and release of enough surplus labour to run the factories. Low yields in Indian agriculture have a lot to do with the imperfections in land markets – inequality, fragmentation, lack of good land records, ill-defined and often insecure property rights, the disincentives of tenancy, and the inability to use land titles as collateral that lead to credit constraints. Unless measures are taken to increase productivity significantly, food supply could become a serious bottleneck.

The second reason that land is so important is, our high population relative to land available, and its concentration in fertile areas. In India, the space required for non-agricultural production must come largely at the expense of farmland. Stiff resistance to land acquisition has sprung up all across the country in the last decade or so from the *Narmada Bachao Andolan* to Singur. It is the sign of a maturing democracy that it is no longer easy to evict poor people in the name of progress.

This is not to say that the problems have gone unrecognized or that legislative efforts have been absent. Two of the signature laws passed by the government have to do with food security and land acquisition; a new bill on land reforms is also in the pipeline. However all these initiatives, despite being well-intentioned, have not paid sufficient attention to the operation of market forces – both its limitations and possibly benign uses to which they can be put. There is insufficient recognition of informational constraints facing decision-makers and the often unintended consequences of policies through how they shape incentives

Maitreesh Ghatak is Professor of Economics at the London School of Economics where he also serves as the Director of the research programme Economic Organization and Public Policy (EOPP) at STICERD. He is the Editor-in-Chief of the Journal of Development Economics, an Adjunct Professor at the Indian Statistical Institute, a Lead Academic of the India-Bihar Programme of the International Growth Centre, and a member of the Editorial Board of the Ideas for India blog.

Parikshit Ghosh is Associate Professor at the Delhi School of Economics. He received his Ph.D. in economics from Boston University, and has taught at Texas A&M University, University of British Columbia and the Indian Statistical Institute. He is a member of the council of the Centre for Development Economics at the Delhi School of Economics and a member of the Editorial Board of the Ideas for India blog.

Dilip Mookherjee is Professor of Economics at Boston University, where he has been serving as Director of the Institute for Economic Development since 1998. He is the Lead Academic of the India Central Programme of the International Growth Centre, an Adjunct Professor of the Indian Statistical Institute and a member of the Editorial Board of the Ideas for India blog.

of various affected parties. Both are likely to be serious hurdles in the way of implementation.

The Land Acquisition Act

The Land Acquisition Act of 1894 has defined the framework for eminent domain in India until now. This law required that compensation has to be equal to the local market price for land based on circle rates and recently recorded sale deeds. The new law brings about three significant changes. First, compensation has to be much higher – two times the market price in urban areas and up to four times in rural regions. Second, landowners as well as ‘livelihood losers’ (individuals like sharecroppers and labourers who made a living off the land) are now entitled to an R&R package. Third, the procedural hurdles have been raised – acquisition now needs more clearances from more committees and further in the case of private companies, consent of at least 70 per cent of the affected population is required.

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To evaluate the new law, it is first necessary to understand what was wrong with the old one. Simply put, compensation at market price is a deeply flawed principle. The market price of land should not be confused with its value to the owner. The latter derives from many factors including crop output, employment for family labour, food security, use as collateral, protection against inflation and social status. The value of land (and the price at which owners would be voluntarily willing to give up) is individual specific and varies considerably across owners. Even with a well functioning land market, many owners will end up putting a value on land that is higher

than its market price. That is precisely why they have not already sold it!

Compensation at market price would be the right thing to do if what is being seized is a transferable physical asset traded on a perfect market, which can be repurchased at the going price. Consider two hypothetical scenarios: (a) the government needs to seize some cars from specific citizens (b) the government needs the forced labour of these citizens to meet some emergency. Setting aside the issue of liberty or property rights, compensation at market price is correct in the first case but not in the second. Those who have lost their cars can always buy back a similar vehicle with the compensation money. Those who were forced into several hours of work will not be able to buy back their time.

In the latter case, therefore, to pay just compensation, the true value of the workers’ time must somehow be elicited. Imagine that a group consisting of self-employed doctors, lawyers and businessmen were forced to work on some public works project and compensated at the “market rate”, i.e., the going wage rate of comparable salaried workers. If this remuneration was enough, we should expect to see doctors and lawyers quit their private practice and take up salaried jobs. The price accepted by those who have self selected to be land sellers or employed workers cannot be projected onto those who have been forced into that role.

Land acquisition is, in principle, closer to the car example but given the realities of rural land markets in India, it is much closer to the example of forced labour. The thinness of land markets is a well-known phenomenon in developing countries (see, for example, Deininger and Feder, 2001 and Deininger, Jin, and Nagarajan, 2009). The market price of land is irrelevant if it is difficult to actually buy land at that price, just as it is difficult to find work at the going wage rate in a labour market riddled with frictions and high unemployment.

There are two additional reasons not to treat the market price based on

past transaction prices as a benchmark for compensation. Acquisition of a significant quantity of farmland is a supply shock to the local agricultural economy that will raise land prices and rents by the usual laws of demand and supply. Historical prices are not adequate if land prices are rising fast enough that the displaced owners are unable to buy back equal areas from the remaining pool of agricultural land. The project can itself create land price inflation through its economic spillovers, especially if it attracts ancillary industries to the region. An additional reason not to rely on recorded prices of recent transactions is that actual transaction prices are often under reported in India to evade stamp duty.

In light of this discussion, it should be obvious that compensation at market price is always under- compensation. How much it should be increased depends on the particulars of the case and should vary locally. The degree of land market imperfection, the fraction of land being taken, the nature of the project that will come up on the acquired land, the characteristics of farmers who lose land will all determine what mark-

A recent survey of households whose lands were acquired in Singur provides evidence of the heterogeneity of land valuations to owners and the important role this played in opposition to the land acquisition (Ghatak et al 2012). The compensation offered by the West Bengal government was on average equal to the market values reported by the owners. Yet one third of these owners refused the compensation and opposed the land acquisition.

up is acceptable. There is evidence of considerable heterogeneity in this regard. A recent survey of households whose lands were acquired in Singur provides evidence of the heterogeneity of land valuations to owners and the important role this played in opposition to the land acquisition (Ghatak et al 2012). The compensation offered by

the West Bengal government was on average equal to the market values reported by the owners. Yet one third of these owners refused the compensation and opposed the land acquisition. This is partly explained by the inability of compensation offers to include information relevant to market values of individual plots, such as irrigation or multi-cropped status, or proximity to public transport facilities. Households for whom agriculture played a larger role in income, or those with a larger fraction of adult members who were workers, were less likely to accept the offer. This points to the role of income security as an important consideration, and the role of complementarity of land with farming skills that are non-transferable. Those who had a stronger financial interest (such as those who had purchased rather than inherited the plot or absentee landlords) were also less likely to accept.

The fixed mark-up introduced in the new law (with only a rural-urban distinction) is simply too rigid to serve its purpose all over the country. The problem is that getting this ratio correct is crucial. If it is set too high, the cost of acquiring land will become prohibitively large and industrialisation will slow down too much. It may also compromise farmers' interests by depriving them of windfall gains from profitable land conversion. If it is set too low, the problems seen in Singur will re-emerge.

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multiplication factor was chosen to be two or four. Even as an averaged adjustment, it remains inscrutable.

Alternative Mechanism: Land Auctions

Ghatak and Ghosh (2011) argue that an auction based pricing mechanism should work much better than the arbitrary and rigid mark-up prescribed by the Land Acquisition Act of 2013. Here we will present the gist of the idea. As a first step towards acquiring land for any project, the government should buy land in the general neighbourhood through an auction, procuring an aggregate area roughly equal to the size of the project site. Next, owners of unsold plots that lie within the intended project site can be compensated with land-for-land awards, that is, by giving them cultivable land of equal area outside the location. This will consolidate the acquired land into contiguous territory where the project can be located.

This mechanism has two major advantages. First, it incorporates a transparent way of determining price that takes discretion out of the hands of corruptible officials and bases it on the farmers' own valuation of land, elicited through competitive bidding. This will substantially reduce the coercive element of eminent domain and defuse the political resistance against development. It will also base compensation on the true current value of land to the owners instead of the artificial benchmark of a pre-existing market price. Second, it will reallocate the remaining farmland to those farmers who place the highest value on land. These farmers can be expected to bid the highest asking price and will end up being compensated in land instead of cash. Essentially, the auction will simulate the missing land market.

The auction-based approach can be extended in various directions. The choice of location of a factory can also be decided by extending the auction to a multi-stage process. At the first stage, the industry in question or government could set a reserve price and minimum

quantity of land needed. Next, different communities can be asked to bid for the factory to be located in their respective regions. These bids are set equal to the minimum price at which they can in turn, procure the necessary amount of land from landowners within their areas (as elicited by a local auction).

Decentralising responsibility to local panchayat bodies in conducting these auctions within their jurisdictions will help minimise the sense of land acquisition being foisted on local communities by state or national governments in a top-down manner. In that case, panchayat leaders would have to be trained (or assisted) by bureaucrats to conduct such auctions. But this would be to help them acquire skills necessary for panchayats to take a more active role in business development within their respective areas.

In an op-ed piece in *The Hindu*, Minister of Rural Development, Jairam Ramesh and his aide Muhammad Khan justified eminent domain along these lines: "The State must have a role in acquisition given that land markets are highly imperfect in India and given that there are huge power and information asymmetries between

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the buyers and sellers of land." If the market is missing, what is needed is a mechanism that allows (a) discovery of the price that would prevail if a well functioning market was there and information about the project and its economic impact absorbed by all (b) the physical trades farmers would have carried out through the market post-

acquisition. Note that our proposed auction does precisely this. The new law, on the other hand, is in effect a *non sequitur*. It does not close the gap left by market imperfections. Rather, it tries to rectify matters through pure guesswork.

Reviving Rural Land Markets

As we have outlined in the previous sections, the problems encountered in the course of land acquisition arise from imperfections in the land market.

Many factors contribute to the dysfunctional state of rural land markets – poor land records that make it difficult to officially transfer ownership, the presence of tenancy and land ceiling laws lead to concealment of ownership status and roadblocks on the way to sales, limited mobility of potential buyers, lack of brokerage services and limited flow of information about buying and selling opportunities. Given the limited reach of the formal banking sector, another factor is the difficulty of financing land purchases.

Many factors contribute to the dysfunctional state of rural land markets – poor land records that make it difficult to officially transfer ownership, the presence of tenancy and land ceiling laws lead to concealment of ownership status and roadblocks on the way to sales, limited mobility of potential buyers, lack of brokerage services and limited flow of information about buying and selling opportunities.

On the flip side, in a world where there is very little access to formal sources of insurance, credit, and savings opportunities, land is not merely an income-generating asset but an insurance policy-cum-collateral-cum-pension plan as well. Therefore, even if land markets operated relatively smoothly, poor farmers may be more reluctant to sell than what some simple cost-benefit calculations of returns from agriculture will suggest.

Because land is not an easily tradable asset, owners are often unable to use it as collateral to obtain loans, contributing

to credit market imperfections. The difficulty of obtaining financing, on the other hand, introduces considerable frictions into the land market and prevents ownership from being transferred from less productive to more productive farmers. Furthermore, imperfections in the credit market also lead to suboptimal investment in land even by owner cultivators, and pose an obstacle for the adoption of new agricultural technologies that often need expensive complementary inputs like HYV seeds, fertilizers and water. All this underscores the importance of land reforms, not only from the point of view of social justice and equality, but also for the purpose of raising yields and enabling the shift of resources into manufacturing and services. Better defined property rights over land would not only allow operational holdings to reach closer to optimal size, but also increase productivity indirectly by strengthening credit markets and leading to multiplier effects.

It is also critical to getting compensations right for land acquired by the government. The Singur experience showed that a key problem underlying resistance of one third of all owners to the acquisition stemmed from the outdated land records (Ghatak et al 2012). The last cadastral land survey in Bengal was carried out by the colonial British administration in the 1940s. Subsequent updating of these records are based on efforts of landowners to navigate the complex and corruption-ridden land registration offices. The disincentives were compounded by the likelihood that the revision of the records would likely raise the property taxes assessed. Thus, the irrigation status of many plots had changed since the last date for which records were available, resulting in mis-classification and payment of compensation according to the recorded status. Owners that had invested in irrigation facilities were compensated at rates assessed for unirrigated lands, which were too low. Owners whose plots had been correctly recorded were considerably more likely to accept the offered compensation. The compensation rates *per se* were not the problem. Rather, it was the assessment

of the type of plot. Calculation of the correct market price therefore, requires up-to-date accurate land records.

The new land reforms bill, therefore, assumes particular importance, as is the administrative drive to complete land records and create computerized databases for quick access. One way to create improved land records is to provide incentives to owners to volunteer information and seek formalization of their status in official records. The key problem is that redistributive measures like ceiling laws encourage concealment and the widespread practice of holding *benami* property. On the other hand, the possibility of facing acquisition for public purpose is one reason owners may want to get their title deeds in order. This suggests a possible complementarity between the land reforms and the land acquisition process, where improvement in the former will facilitate the latter. And likewise, the prospect of land acquisition will render implementation of the land ceilings easier. Other rewards for disclosure can also be considered, such as tying it with various government services and benefits such as loans from public sector banks, increased work and food entitlements through NREGA or the PDS, subsidized inputs, etc.

Also, in the light of our failure to implement the land reform laws in most states for more than half a

The Singur experience showed that a key problem underlying resistance of one third of all owners to the acquisition stemmed from the outdated land records (Ghatak et al 2012).

century, perhaps ceilings should be relaxed to give officials a better shot at implementation. This is especially true in the light of evidence that suggests that overall for all states, land-reform legislation had a negative and significant effect on agricultural productivity, and decomposing by type of land reform, the main driver for this negative effect seems to be land-ceiling legislation (see Ghatak and Roy, 2007). Even incentive measures similar to tax amnesties could be considered to encourage disclosure and complete land records. The regulations and

restrictions on sale of agricultural or tribal land serve no real purpose and often hurt the groups they are supposed to help. They greatly impede efficient land use and also take away an important tool of social mobility from the SC/ST population. They make it difficult for members of the tribal population to move out of agriculture and also discourage investment and industrialization in tribal areas for the ostensible purpose of preventing “exploitation”. They place the Forest Rights Act directly in conflict with conservation efforts. The idea of formalizing property rights over forest land should not be to make these open to cultivation and deforestation, but to entitle the rights holders to compensation if they have to be displaced from their traditional foraging and hunting grounds. More generally speaking, the most significant failure of many current policy initiatives on land is the inability to combine idealism with pragmatism, to balance distributive concerns and aggregate goals like industrialization or conservation of forest cover. Distributing our land endowments more equally is important for social justice, but this has no real conflict with allowing land markets to function smoothly and promoting the best use of land.

Readings

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(E-mail : M.Ghatak@lse.ac.uk
pghosh@econ.dse.org
dilipm@bu.edu)

Meghalaya A ‘Jumbo’ Haven

Meghalaya has the highest density of elephants per square area in the country. According to the General Elephant Census and Project Elephant Census conducted by the Meghalaya Government in collaboration with Assam there were 18100 pachyderms in the Garo Hills and West Khasi Hills, in 2011. The Chief conservator of forest(Wildlife), Y S Shullai has appealed for more areas and more corridors for the giants of the jungle to move freely without feeling threatened. Project Elephant was introduced in 1992 by the Centre for the conservation of elephant habitats and to address the man-elephant conflict besides augmenting the livelihoods of the local people in the affected areas.. □

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