

# Land Policies for Growth and Poverty Reduction\*

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## Introduction

Well-defined and secure land rights are critical to provide incentives for investment and sustainable resource management, to facilitate low cost transfers of land and credit access as the rural non-farm economy develops, and to allow provision of public services at minimum cost. At the same time, and despite their importance, the fact that land issues are politically highly charged and often controversial has often limited their inclusion in the policy dialogue. Based on a brief review of the historical evolution of property rights, the paper outlines channels through which such rights affect economic growth, poverty reduction, and governance. For each of these areas, policy actions that can help to improve the security of land rights, reduce the cost of exchanging them, and promote socially desirable land use are outlined.

## The historical context

Land and associated real property are key assets for the rural and urban poor that provide not only a foundation for economic and social development but can help to empower them to adjust to the challenges posed by urbanization and globalization in a number of ways. Focusing on the main forces shaping the evolution of land rights, possible sources of tenure insecurity, and ways in which action by the community and by the government can help to reduce such insecurity and provide a basis for more effective land utilization that will be critical for countries to utilize the resources at their disposal most effectively, thereby promoting growth and poverty reduction.

Historically, a key reason underlying the evolution of property rights to land was in response to increased payoffs from investment in more intensive use of land due to population growth or opportunities arising

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from greater market integration and technical advances. Land rights are of little importance in situations of shifting cultivation where land is plentiful. In the course of development by virtually all societies, the need to sustain larger populations will require investments in land that cultivators will be more likely to make if land rights are secure (Boserup 1965). There is abundant evidence suggesting that institutional innovations to gradually increase the security of property rights can lead to a virtuous cycle whereby higher population density leads to greater investment in land, economic growth, and increased welfare (Hayami and Ruttan 1985). At the same time, failure of the institutions administering land rights to respond to these demands can lead to social conflict which, in extreme cases may undermine societies' productive and economic potential.

This paper draws on a Policy Research Report that has recently been completed by the World Bank (Deininger 2003). Readers interested in amore detailed discussion of the issues are encouraged to consult this document for references and a more in-depth treatment of the issues raised here.

Over the course of history, property rights to land were often imposed by outside forces, with far-reaching implications for development (Binswanger et at. 1995). The goal of such intervention was to obtain surpluses from local smallholder populations or to force independent smallholder into wage labor by preventing them from acquiring independent land rights. To do so, a variety of mechanisms, often supported by distortions in other markets, were used. Not surprisingly, this often disrupted a more organic evolution of land rights and, by co-opting local institutions or changing the way in which local institutions functioned, implied vast changes that had implications beyond the land sector.

Given that the evolution of property rights has been strongly affected by political factors, the way in which such rights are assigned and the institutions involved in their administration are often highly sub-optimal from an economic and a social perspective. In the formerly communist countries of Eastern Europe, collective and state ownership of land have for a long time failed to provide incentives for investment and sustainable management by economic actors. In Latin America and parts of Asia, highly unequal patterns of land ownership imply that large parts of the

population do not have access to assets and economic opportunities. As recent studies demonstrate, this makes it more difficult to achieve economic growth (Birdsall and Londono 1997, Deininger and Squire 1998). The high levels of inequality observed in these countries are associated with social polarization that often leads to instability and violence (World Bank 2003) and makes it more difficult for the benefits of growth to be distributed equally among the population instead of widening pre-existing inequalities (De Ferranti et al. 2003)

While the above implies that inefficient assignment of property rights can reduce growth and negatively affect poverty, inefficiencies in the institutions managing land rights have equally far-reaching and negative consequences. In many parts of the developing world, it is very difficult and costly to formalize land ownership and thus transform land into an economically valuable asset, something that can trap the poor in informality and prevent them from enjoying the benefits opened up by participation in the formal economy (de Soto 2000). In Africa, the vast majority of the land area is operated under customary tenure arrangements that, until very recently, remained outside the formal law, creating high levels of ambiguity and insecurity. Even though, in many developing countries, large benefits could be had from more effective and efficient land administration institutions, establishing them requires strong political commitment to take on economically powerful vested interests who benefit from the status quo. This explains that, even though their shortcomings are obvious, socially undesirable and economically inefficient property rights structures have often remained in place for long periods of time and that far-reaching changes of land relations have generally been confined to major historic and political transitions.

The rest of the paper discusses the conceptual framework for land policy as well as applications with respect to three key functions of governments in this area, namely (i) to ensure that land rights are well defined and effectively administered; (ii) to provide the legal and institutional framework to allow for low-cost exchange of land in markets; and (iii) to establish regulations that would allow for effective land use. Implications for policy are drawn in each of these chapters and in a concluding section.

## **Property Rights to Land**

Land rights are social conventions that regulate the distribution of the benefits that accrue from specific uses of a certain piece of land. A number of arguments support public provision of secure land tenure to support such rights. First, unless property rights are defined and enforced by society, households and entrepreneurs will be forced to spend resources to defend their claims to property, for example through guards, fences, etc. This is not only socially wasteful but also disadvantages the poor, who will be the least able to afford such expenditures and, in the extreme, leads to state of anarchy. Second, the high fixed cost of the institutional infrastructure needed to establish and maintain land rights favors public provision, or at least regulation. Finally, the benefits of being able to exchange land rights at low cost which are, for example, the basis for the use of land as collateral in credit markets, will be realized only in cases where such rights are standardized and can be easily and independently verified, e.g. through a publicly accredited registry of deeds or title that is guaranteed by the state.

## **Desirable Characteristics of Property Rights to Land**

Property rights to land need to have a horizon long enough to provide investment incentives and be defined in a way that make them easy to observe, enforce, and exchange. They need to be administered and enforced by institutions that have both legal backing and social legitimacy and are accessible by and accountable to the holders of property rights. Even if property rights to land are assigned to a group, the rights and duties of individuals within this group, and the way in which they can be modified and will be enforced has to be clear. Finally, as the precision with which property rights will be defined will generally increase in line with rising resource values, the institutions administering property rights need to be flexible enough to evolve over time in response to changing requirements.

As one of the main purposes of property rights is to facilitate investment, the duration for which such rights are awarded needs to at least match the time frame during which returns from possible investments may accrue. Clearly this depends on the potential for investment, which is higher in urban than in rural areas. While indefinite property rights are the best option, giving long-term rights that are renewed automatically is an

alternative especially if, as in China, the duration and security of such rights is gradually increased over time. Given the long time spans involved, attention to the way in which such rights can be inherited is particularly warranted and has in fact often proven to be critical to enhance women's ability to control land on their own.

Property rights to land should be defined in a way that makes them easy to identify and exchange at a cost that is low but commensurate to the value of the underlying land. With limited land values, low-cost mechanisms of identifying boundaries, such as physical marks (hedges, rivers, and trees) that are recognized by the community, will generally suffice while higher resource values will require more precise and costly means of demarcation. Similarly, where land is relatively plentiful and transactions are infrequent, low-cost mechanisms to record transactions, such as witnessing by community elders will be appropriate. More formal mechanisms will normally be adopted once transactions become more frequent and start to go across traditional boundaries of community and kinship.

The key advantage of formal, as compared to informal, property rights is that those holding formal rights can call on the power of the state to enforce their rights. For this to be feasible, the institutions involved need to enjoy legal backing as well as social legitimacy, including accountability to and accessibility by the local populations. Yet in many countries, especially in Africa, the gap between legality and legitimacy has been a major source of friction, something that is illustrated by the fact that in Africa overall more than 90% of land remain outside the existing legal system. Failure to give legal backing to land administration institutions that enjoy social legitimacy can undermine their ability to draw on anything more than informal mechanisms for enforcement. By contrast, institutions that are legal but do not enjoy social recognition may make little difference to the lives of ordinary people and have therefore often proven to be highly ineffective. Bringing legality and legitimacy together is a major challenge for policy that can not be solved in the abstract.

Whether it is more appropriate to give property rights to individuals or to a group will depend on the nature of the resource and on existing social arrangements. Group rights will be useful in situations characterized by economies of scale in resource management or if

externalities exist that can be managed at the level of the group but not the individual. Where agro-ecological conditions and economic factors permit intensification of land use, a number of factors tend to diminish the relative advantage of group over individual land rights over time. Technical progress reduces the risk of crop failure while at the same time increasing the potential payoff from investments; development of the non-farm economy provides access to more predictable income streams and greater access to physical infrastructure reduces not only the risk, but also the cost, of publicly providing property rights. One would therefore expect to see a move toward more individualized forms of property rights with economic development. Studies demonstrating the importance of women's asset ownership for outcomes such as spending on health and girls' education suggest that attention to property rights by women is particularly important.

Even though many societies have made the transition towards more individualized property rights to land with economic development, this is by no means automatic. To the contrary, failure to develop the institutions to define and exchange property rights will imply that, instead of leading to a virtuous cycle of greater investment and economic development, resources are dissipated in downward spiral of strife over property rights that can have significant impact on productivity and tends to affect vulnerable groups disproportionately (Deininger and Castagnini 2002).

### **Evidence on the Impact of Tenure Security**

In many countries of the developing world, insecure land tenure prevents large parts of the population from realizing the economic and non-economic benefits such as greater investment incentives, transferability of land, and improved credit market access, more sustainable management of resources, and independence from discretionary interference by bureaucrats, that are associated with secure property rights to land. More than 50 percent of the peri-urban population in Africa and more than 40 percent in Asia live under informal tenure, implying that they have highly insecure land rights that can not be marketed. While no such figures are available for rural areas, any rural land users are reported to make considerable investments in land as a way to establish ownership and increase tenure security (Plateau 2000, Otsuka 2001), illustrating that tenure security is highly valued.

A first benefit from increased tenure security that can easily be measured is the increase in land users' investment incentives. Some studies have reported a doubling of investment, and values for land with more secure tenure are reported to be between 30 and 80 percent above those for land where there is a higher probability of losing land (Feder 2002). Transferability of land will increase this effect and is important in situations where the scope for transacting land between less and more productive producers has increased, for example, because of increased development of the nonagricultural economy and rural-urban migration (Deininger et. al. 2003). Higher tenure security will also reduce the time and resources individuals need to spend on securing their land rights, allowing them to invest these resources elsewhere.

Finally, where effective demand for credit exists, giving formal title to land can help producers gain access to credit and at the same time improve the functioning of financial markets. Because it is immobile and nearly non-destructible in the short term, land is ideal collateral. The ability to draw on a formal registry to verify land ownership can thus dramatically reduce the cost of providing credit as compared to, say, micro-lending schemes. This should not obviate, however, that the impact of credit access may be differentiated by size of landholdings and that the likely equity impact will have to be taken into account (Carter and Olinto 2003). In situations where the credit effect associated with title is unlikely to materialize in the near future, a more gradual and lower-cost approach to securing land rights and improving tenure security, with the possibility of upgrading once the need arises, will allow provision of most, if not all, benefits from increased tenure security at lower cost.

### **Ways to Increase Tenure Security**

The findings described in the previous section imply that governments have a role to play in providing secure tenure to owners and users of land. While there are many situations where formal title will increase tenure security, title is not a sufficient condition for optimum use of land resources and is in some cases not necessary either. The goal of providing tenure security for the long term, administered in a cost-effective way through institutions that combine legality with social legitimacy can be achieved in a variety of ways that may co-exist within the same country, depending on the type of land.

In customary systems, legal recognition of existing rights and institutions, subject to minimum conditions, is often more effective than premature attempts at establishing formalized structures. Legally recognizing customary land rights subject to a determination of membership and the codification or establishment of internal rules and mechanisms for conflict resolution while drawing to well-defined procedures within the community to assign rights within the group. Conflicts historically often erupt first in conjunction with land transfers, especially with outsiders. Where such transfers occur and are socially accepted, the terms should be recorded in writing to avoid ambiguity that could subsequently lead to land-related conflict (Lavigne Delville et al. 2002).

Occupants on state land have often made considerable efforts to increase their level of security, in some cases through significant investments, but often remain vulnerable to eviction threats. Due to their limited land rights they often cannot make full use of the land they occupy. Giving them legal rights and regularizing their possession is therefore important, along with ensuring that appropriate means are in place for resolving any conflicts that may arise in the process. In many situations, political or other considerations may preclude the award of full private property rights. If existing institutions can credibly commit to lease contracts, giving users secure, transferable, long-term lease rights will permit realization of most, if not all, investment benefits associated with tenure security. In these cases, recognition of long-term peaceful occupation in good faith (adverse possession) and award of long-term land leases with provisions for automatic renewal will be the most desirable option. If the leases awarded by state institutions are not credible, full privatization may be required to give users sufficient security of tenure and the associated benefits. An indicator for limited credibility of leases is that, even where there is strong effective demand for credit, financial institutions will not accept long-term leases as collateral.

Where individual title will be the option of choice, inefficiencies in the land administration institutions responsible for demarcation of boundaries, registration and record keeping, adjudication of rights, and resolution of conflict can still preclude the realization of many of the benefits of secure tenure. If these institutions are not working well, are poorly coordinated, inefficient, or corrupt, transaction costs will increase



thus reducing the level of transactions below what would be socially optimal and in many cases excluding the poorer completely. In the extreme, lack of clarity about who is responsible for specific areas or infighting between institutions has evolved into a major source of insecurity that undermined the value and authority of titles or certificates of land ownership that were distributed. In such situations, institutional reform, including improved coordination within the government and with the private sector, will be a precondition for the state's ability to effectively deliver property rights. Efficient institutions that are responsive to client demand are particularly important to ensure sustainability of the significant investments that many countries have made in establishing land administration systems. In addition, it is important that the processes used by such institutions do not inadvertently discriminate against women (e.g. by giving title only to the "head of household" - who in most cases will be male), thereby preventing that legal provisions for gender equality in land access are put in practice.

### **Land Transactions**

Even though land can be accessed through a wide variety of mechanisms (de Janvry et al. 2001), land transactions can play an important role by allowing those who are productive but are either landless or own little land to access land. Land markets also facilitate the exchange of land as the off-farm economy develops and, where there is a supply of credit, provide a basis for the use of land as collateral in credit markets. Capital market imperfections and policy distortions have, in many instances, led to speculative land accumulation rather than better access to land by the productive poor. This has led some observers to take a negative stance on any type of land market activity and to support government intervention in land markets and requires a more careful review of the factors affecting different types of land market transactions before proceeding to policy recommendations. To understand why in some cases land transactions may fail to contribute to improving productivity and equity, it is necessary to review the conceptual foundations that underlie the operation of land markets and how some of the market imperfections frequently encountered in rural areas of the developing world will have a differential impact on land rental and sales.

## **Conceptual Foundations**

Imperfections in labor and credit markets, and the scope of economies of scale in production, will affect the way in which land markets function. A large literature has demonstrated that unmechanized agriculture generally does not exhibit economies of scale in production (Carter 1984, Benjamin 1995, Deininger and Feder 2001), even though economies of scale from marketing may in some cases be transferred back to the production stage. At the same time, the need to closely supervise hired laborers [implies that owner-operated farms]. Policy distortions that encourage speculative land acquisition can exacerbate this tendency. Generally, these factors will have different implications for rental and sales markets.

Rental markets are characterized by low transaction costs and in most cases where rent is paid on an annual basis, require only a limited initial capital outlay. This, together with participants' ability to adjust contract terms so as to overcome market failures in capital and other markets, implies that rental is a more flexible and versatile means of transferring land from less to more productive producers than sales markets (Sadoulet et. al. 2001). Renting is thus more likely to improve overall productivity and, in addition, can provide a stepping stone for tenants to accumulate experience and possibly make the transition to land ownership at a later stage. Where land tenure is perceived to be insecure, long-term contracts that will provide the investment incentives needed to help transform the structure of production are unlikely to be adopted.

## **Sales markets**

Although transfer of land use rights through rental markets can go a long way towards improving productivity and welfare in rural economies, the ability to transfer ownership of land will be required to use land as collateral in credit markets, and thus to provide the basis for low-cost operation of financial markets. At the same time, sales markets will be more affected than rental markets will depend on participants' expectations regarding future price movements, creating a potential for asset price bubbles and speculative land acquisition by the wealthy in participation of capital gains. Historical evidence also demonstrate that in risky environments where small producers lack credit market access, distress sales of land by the poor can occur, with negative equity and efficiency

impacts. The impact of such distress sales is magnified by the fact that, where, as in most rural areas, land sales markets are thin, land prices can fluctuate considerably over time. High transaction costs associated with land sales, which are often further increased by government intervention, can result in the segmentation of such markets whereby certain strata only deal with each other or sales remain informal. All these factors imply that land acquisition by the poor through the land sales market will be difficult, and that as a consequence, the potential for productivity-enhancing land redistribution through sales markets is likely to be very limited.

### **Empirical Evidence**

In many developed countries, rental market activity is high, in some cases covering more than 70 percent of cultivated land (Swinnen et. al. 2001). This illustrates that land rental is far from archaic; to the contrary, because of lower capital requirements, many producers prefer to rent rather than to buy land. The fact that well-functioning, and regulated rental markets in most developed countries allow households to enter into long-term contracts that do not appear to be associated with a visible reduction of investment incentives, demonstrates the flexibility and possible advantages of land rental. It also highlights that long-term tenure security is critical to achieve the full potential from land rental.

In countries of Eastern Europe and the Commonwealth of Independent States (CIS), land rental was particularly important in the initial phases of the transition to a market economy, and continues to be relevant for facilitating access to land by younger producers and for consolidating operational holdings in situations where the ownership structure is highly fragmented. This potential is particularly high where land plots were restituted to original owners who have neither the skills nor the desire to make productive use of them but where the development of land sales markets is slowed down by macro-economic uncertainty and shallow financial markets. Land rentals are also important to achieve market-based consolidation in countries that distributed extremely small plots of land.

While high levels of insecurity in ECA and CIS prevent long-term leases, short-term leases of public land are widely applied to "privatize" enterprise and other local government land. These leases are likely to be highly inefficient because the need to renew contracts periodically

encourages rent-seeking and causes insecurity about contract terms that is likely to undermine the scope for long-term investment. Sales or other means of transferring ownership would be preferable to rental. Developing true lease markets is also difficult where land was privatized only in share form and where a combination of high risk, scant market development, and limited knowledge about their property rights, prevent owners from making the most effective use of their endowments or establishing operations different from the former collectives.

The impact of policy interventions and historical circumstances on land markets in Africa is evident from differences in the performance of such markets across countries and regions. Rental markets, including long-term transactions that are in many respects equivalent to sales, are extremely active in West Africa although they mostly remain informal. Land transfers are more limited in East and Southern Africa where colonial policy had outlawed them for a long time. Recent studies suggest that activity in rental markets can nevertheless increase relatively quickly once opportunities to do so emerge and that rental markets help to improve efficiency and equity (Deininger and Mpuga 2002). In Ethiopia, restrictions on operation of rental markets tend to undermine the emergence of nonfarm enterprises, suggesting that elimination of remaining restrictions against the operation of rental markets could make a critical contribution not only to better land utilization but also to accelerated development of the broader rural economy (Deininger et. al. 2003).

While the variation in terms of market activity in land sales is even wider than in the case of rental markets, evidence points towards rising importance of informal land sales in peri-urban locations and in areas with potential for high-value crops. Although such transactions may be recognized locally, lack of formalization can create opportunities for opportunistic behavior and conflict in the future, especially if buyers are from different groups or regions. Low-cost means to formalize land transactions at the local level can therefore have a very beneficial impact.

Most South Asian countries combine land ceiling legislation imposed in the context of land reform with restrictions on land rentals (either rent ceilings or prohibition of certain contracts) to avoid exploitation of tenants. While such laws may provide advantages to sitting tenants, they will reduce the ability of the landless to obtain land

through the market and undermine landowners' incentives to undertake land-related investment. The case for gradual abolition of such restrictions is strengthened by the example of China and Vietnam, where rental markets transfer land to more productive and land-poor producers in a way that is more effective than what was achieved by administrative reallocation.

In most of East Asia, land remains state owned and markets for long-term use rights have developed only recently. From a very low basis, active rental markets in use rights have developed rapidly in situations such as China and Vietnam. In China, decentralized transactions have been shown to be more conducive to efficiency and equity while offering less scope for corruption and other undesirable side effects than administrative intervention, especially as the number of exchanges increases and the contractual details become more complex. (Deininger and Jin 2002). Evidence on sales of land use rights from Vietnam illustrates that except in situations where credit markets do not work well and shocks may force households into distress sales, such markets contribute to higher levels of productivity and do not disadvantage the poor.

Latin America has one of the most unequal distributions of land in the world. However, a history of weak land property rights and land rental market restrictions implies that rental markets are less effective than one might expect in transferring use rights to this land to small or landless producers, leading to major inefficiencies and widespread underutilization of very productive land. The high costs of transferring land from large to small producers imply that markets remain segmented and thin, and transactions limited to close relatives where enforcement is easy.

Although macroeconomic liberalization led to a significant drop in land prices in the 1990s, the expected greater land market activity has only partly materialized. High inequality, together with barriers to entry into financial markets, imply that sales markets are often highly segmented, i.e. large and small owners trade with each other, but traders rarely occur across size classes of producers. This supports the hypotheses that land markets alone will not be able to sustainably equalize the land ownership distribution and thus help to overcome the structural difficulties plaguing rural areas in the region.

## **Policy Implications**

A key constraint on land rental markets has been the imposition of rent ceilings or the award of implicit ownership rights to tenants. While effectively implemented tenancy regulation can benefit sitting tenants, it is costly and may thus not be an efficient way of transferring resources to the poor, even in the short term. In the longer term, such restrictions will reduce the supply of land available to the rental market and undermine investment, directly hurting the poor. Evidence from countries that have eliminated such restrictions suggests that doing so can not only improve access to land via rental markets, but can also increase households' participation in the nonfarm labor market and, by reducing the discretionary power of bureaucrats, improve governance. A key policy issue is therefore how to sequence the elimination of such restrictions in way that does not undermine equity and, in particular, protects sitting tenants. Also, since short-term rental contracts will provide only limited incentives for users to undertaken land-related investment, high levels of tenure security and long enough duration of land rights are critical.

It is well known that, because they provide higher incentives, rental arrangements based on a fixed payment rather than a share of output are more likely to maximize productivity. This has led a number of countries to outlaw sharecropping as a "feudal" production relationship. Poor producers may, however, not be offered fixed rent contracts because of the risk of default, e.g. in case of a crop failure. Sharecropping is a second-best solution for such circumstances and a large literature shows not only that the efficiency losses associated with sharecropping contracts are relatively small but also that improving on them through government intervention is difficult, if not impossible (Otsuka et al 1992). While landlords may impose contractual terms on tenants that leave the latter with little option to improve their welfare, the ability to do so is independent of the form of the contract and linked more to the alternatives open to the latter. Efforts to improve potential tenants' economic opportunities, e.g. via access to infrastructure and non-agricultural labor markets, are likely to have a more beneficial impact on rental market outcomes and rural productivity than prohibition of certain contractual options.

Credit market imperfections will affect the functioning of sales markets and may lead to situations where government intervention could,

in a hypothetical world of perfect implementation, lead to outcomes that would improve efficiency and equity. Implementing such interventions has, however, proved to be exceedingly difficult in practice. In vast majority of cases restrictions on land sales markets have undermined tenure security and ended up making things worse than they were at the outset. Restrictions on the transferability of land imposed by a central authority have generally limited credit access and often only pushed such transactions into informality. Except in situations of rapid economic transition, they are unlikely to be justified. Local communities are more likely to be able to appreciate the costs of limiting the transferability of land to outsiders or the benefits of eliminating such restrictions than central government bureaucrats. As long as such decisions are reached in a transparent way and can be enforced, allowing communities to decide on whether to maintain or drop the restrictions on land transactions with outsiders that generally characterize customary systems of land tenure may be more effective than imposing central restrictions that can not be enforced. Land ownership ceilings have generally been ineffective as a means to facilitate the breakup of large farms, and instead have led to red tape, spurious subdivisions, and corruption (Appu 1997). Where they were low, they have apparently had a negative impact on investment and land owners' ability to access credit, as in the Philippines. The only situation where they can be justified is where high enough land ceilings may help to limit the speculative acquisition of land, something that may be relevant in some CIS countries.

High levels of fragmentation, caused either by successive subdivision in the course of inheritance or by the desire to award at least one plot of a specific quality or use type to each producer in the process of land distribution, are often thought to lead to inefficiencies in agricultural production. The magnitude and importance of such inefficiencies increases as agricultural production becomes more mechanized. Dealing with fragmentation case by case based on individual initiative may incur high costs of negotiation, something that has provided the justification for governments to adopt programs to complement market mechanisms in an effort to facilitate more rapid consolidation of holdings at lower costs. Although high benefits from such programs are reported from Western Europe, the programs have been slow. Evidence from China highlights that, in environments where administrative capacity is limited, programs aiming at consolidation can run into great difficulties and fail to yield the expected benefits. Rigorous evaluation of the costs and benefits of

different approaches to consolidation in Eastern Europe would be very desirable and will be required before wider adoption of such measures can be recommended.

### **Promoting Socially Desirable Land Use**

The above implies that, in addition to providing tenure security and establishing conditions for markets to function, governments have a key role to play in helping to ensure that land as a key factor of production will be used in a way that is in line with broader goals of social equity and economic efficiency. Two areas that are of relevance are promotion of land reform in situations where the land ownership structure is economically inefficient or socially inappropriate and the regulation of land use so as to establish the framework within which individual landowners make their decisions.

### **Land Reform and Farm Restructuring**

The fact that, in many countries, the land ownership distribution has its origins in discriminatory policies rather than in market forces has long provided a justification for adopting policies aimed at land reform. The record of such policies is mixed. Land reforms have been very successful in Asia (Japan, Korea, Taiwan [China]) and positive impacts have been reported from some African countries such as Kenya and Zimbabwe in the early phases of their postindependence land reforms (Gunning and et. al. 2000, King 1977, Jeon and Kim 2000). At the same time, land reforms in Latin America failed to live up to their objectives and remain incomplete in many respects (de Janvry and Sadoulet 1989). A key reason for such limited impact was that reforms were often guided by short-term political objectives, and that limited participation by local governments and the private sector made it difficult to combine the transfer of land with the necessary improvements that would have allowed the productive utilization of such lands.

Where extreme inequality in the land distribution and underutilization of vast tracts of productive land co-exist with deep rural poverty and lack of opportunity, a case for redistributive measures to increase access to land by the poor can be made, both politically and from an economic perspective. Even in such cases, a number of different instruments (ranging from expropriation with compensation to activation



of rental markets) to affect the government's disposal; access to nonland assets, working capital and conducive policy environment have proven to be essential in this respect (Deininger 1999). Those benefiting from land reform need to be able to access output markets as well as credit, the selection of beneficiaries needs to be transparent and participatory, the form of land tenure they receive in line with their aspirations (i.e. in many cases individual rather than collective), and attention needs to be paid to the economic viability of the farms established as well as the fiscal sustainability of government's efforts.

Governments are more likely to meet these challenges if they use the mechanisms at their disposal in concert and with the objective of maximizing synergies between them. This also implies a need to integrate land reform into the broader context of economic and social policies aimed at development and poverty reduction, and to implement programs in a decentralized way with maximum participation by potential beneficiaries and at least some grant element. Given the continuing relevance of the issue, the often-heated political debate surrounding it, and the lack of quantitative evidence on some more recent approaches, rigorous, open, and participatory evaluation of ongoing experiences is particularly important.

Collective production structures were established in most of Eastern Europe and in other countries following land reform. The performance of production collectives, as opposed to service cooperatives for marketing, has been dismal worldwide (Deininger 1995). In CIS and CEE countries, many were unviable long before the political changes of the 1990s. The process of reform was affected by a number of factors. First, many of the production units performed important social functions and local governments to take over these functions have emerged only slowly. Second, establishing the infrastructure and supporting institutions needed to facilitate the smooth operation of other markets is a process that requires time. Finally, the mere magnitude of the transition and the large number of interests affected makes a smooth and direct procession towards a stable post-transition equilibrium more unlikely.

As a consequence, the specific modalities of farm restructuring were determined by political as much as by economic considerations that led most CEE to adopt restitution whereas most CIS countries and Albania opted for equal distribution of land to farm members. The distribution of

physically demarcated plots, as adopted in Albania, the Kyrgyz Republic, and Moldova, was slower and caused considerable fragmentation, whereas the distribution of land shares that could be taken out of the collective under specified procedures allowed quick privatization, but led to limited change in the structure of production. The malfunctioning of rural output and factor markets in a risky environment has in many cases prevented households from leaving former collectives. Improvements of the legal and institutional environment will therefore be critical for the development of rural markets, including those for land. To ensure that a gradual improvement in their functioning will take place, establishing a correspondence between land shares and physical property and eliminating implicit and explicit restrictions on land rental will be important.

### **Regulation of land use**

Governments have fiscal and regulatory instruments at their disposal to provide for land use that maximizes social welfare, for example by helping to internalize effects that are external to individual land user. Their lack of administrative capacity notwithstanding, many developing countries rely disproportionately on a regulatory approach, often with the result of encouraging discretionary bureaucratic behavior. Awareness of the rationale for specific intervention, the different mechanisms and the most appropriate level for doing so can help to promote an approach that could produce more satisfactory outcomes, both in terms of compliance, and in terms of reducing the red tape private entrepreneurs have to deal with.

In many developing countries, state ownership and management have failed to ensure protection of fragile lands or otherwise bringing land to its best use. Nonetheless, surprisingly large tracts of land continue to be under state ownership or management, with far-reaching consequences. In peri-urban areas, unoccupied land of high potential often lacks investments and is subject to bureaucratic red tape, nontransparent processes of allocation, and corruption. Experience demonstrates that privatization of such land could not only yield significant amounts of resources for local governments, but also increase investment and the effectiveness of land use. If public land has been occupied by poor people in good faith for a long time and significant improvements have been made, such rights should be recognized and formalized at a nominal cost to avoid negative equity outcomes. In cases where state land of high

potential, especially in urban areas, is unoccupied, offering it to the highest bidder will be the option of choice, especially if the proceeds can be used to compensate original land owners or to provide land and services to the poor at the urban fringes at much lower cost.

The disappointing experience with state management of land has led to a general preference for regulation in order to reduce undesirable externalities, to help maintain availability of public goods such as landscapes, historical values, or to facilitate more effective provision of services by the government. Where externalities from land use arise, limits on landowners' discretion with respect to land use are justified. The questions that need to be answered in trying to deal with these are whether such measures should be imposed by central or local authorities and how specific interventions should be designed.

In general, zoning and other land use regulations should be established based on a clear assessment of the capacity needed to implement them, the costs of doing so, and the way in which both costs and benefits will be distributed. Failure to do so has often implied that centrally imposed regulations could either not be implemented with existing capacity, that doing so was associated with very high cost that were predominantly borne by the poor, or that they degenerated into a source of rent seeking. At the same time, devolution authority without appropriate sources of funding and the necessary technical capacity is equally undesirable. Too little thought has often been given to providing mechanisms that would allow communities to deal with such externalities in a more decentralized and therefore less costly way. Gradual devolution of responsibility for land use to local governments, if coupled with capacity building, could make a significant contribution to efforts towards more effective decentralization.

Governments should have the right of compulsory land acquisition, with compensation, for broader public benefit. At the same time, the way in which many developing country governments exercise this right, especially for urban expansion, undermines tenure security and, as often little or no compensation is paid, also has negative impacts on equity. In a number of cases anticipation of expropriation without compensation has led landowners to sell their land in informal markets at low prices, thereby not only forcing them to part with a key assets at a fraction of its real value but also encouraging unplanned development and urban sprawl that will

make subsequent provision of services by the government harder and more costly.

Land taxes can not only provide incentives for effective land use that is easier to enforce than government intervention in markets but also have a number of other advantages such as (i) minimal distortions and less regressive than taxes levied on consumption which normally hurt the poor; (ii) discourage speculative accumulation of land and because they encourage more intensive land use, can help activate productivity – and equity-enhancing land markets; (iii) strengthen the link of accountability that links local government to the population it is supposed to serve, in addition to enhancing fiscal discipline at the local level and make land owners pay for at least part of the benefits they receive from local investments, e.g. infrastructure. For all of these reasons, land taxes can promote more effective land use.

Even though the extent to which land taxes are used varies widely across countries, actual revenues are generally well below their potential (Bird and Slack 2002). The high visibility of land taxes implies that establishing them may be difficult politically, especially in settings where landlords still wield considerable political power. In addition to democratic election of local governments and administrative support to the different aspects of tax collection, schemes to encourage fiscal responsibility and tax collection at the local level, for example a matching of taxes collected with central funds, can help to appropriately design and subsequently collect land taxes. This can have a significant impact on incentives for effective land use, local government revenues, the type and level of public services provided, and governance.

## **Conclusion**

The importance of property rights to land affects behavior of households and governments in a number of ways that go far beyond using land as a factor of production. We conclude by highlighting the importance of land tenure for economic growth, poverty reduction, and good governance and draw a number of conclusions for land policy reform.

*Economic growth:* Property rights to land affect economic growth in a number of ways. Secure property rights will increase the incentives of

households and individuals to invest, and often provide them with better credit access, something that will not only help them make such investments, but also provide an insurance substitute in the event of shocks. Also, broad and egalitarian asset ownership increases the voice of the poor, who are often excluded from political processes, allowing greater participation that can eventually shift public goods provision in their favor. Recent investment climate surveys demonstrate that poorly designed land market interventions and regulations of such markets by large, inefficient, or corrupt bureaucracies to hamper small enterprise startups in many parts of the world. Such interventions not only limit access to land by the landless and poor in rural and urban

*Poverty reduction:* For most of the poor in developing countries, land is the primary means for generating a livelihood and a main vehicle for investing, accumulating wealth, and transferring it between generations. Land and real estate are a key element of household wealth, often accounting for about 50 to 60 percent of the asset endowment of the poorest. Giving secure property rights to land they already use can thus greatly increase the net wealth of poor people. By allowing them to make productive use of their labor and possibly to access credit, land ownership reduces reliance on wage labor and the vulnerability to shocks. Control of land is particularly important for women, whose asset ownership has been shown to affect spending, for instance, on girls' education.

*Governance:* The ability of local leaders and authorities to control land has traditionally been a major source of political and economic power. Over and above the economic benefits that may be derived from giving households greater tenure security, measures to increase the households' and individuals' ability to control land will therefore have a clear impact on empowering them, giving them greater voice, and creating the basis for more democratic participatory local development. Fiscal decentralization is often hampered by the lack of own revenue and accountability on the part of local governments. Both of these could be increased by taxation of land. In countries where land continues to be a key productive asset, governments could use land taxation more effectively to motivate fiscal discipline and to strengthen the voice of the population by enhancing the accountability of local officials.

Land policy addresses structural issues which, in the longer term, will be needed to ensure that the economic opportunities opened by broad

policy changes will indeed benefit the broad majority of the poor. Measures to increase land tenure security, reduce the transaction costs of exchanging land rights and establish a regulatory framework to prevent undesirable externalities do, however, cut across traditional boundaries. Institutional responsibility for the measures required is often dispersed among ministries such as environment, land reform, urban planning, many of which do not have strong capacity. To overcome compartmentalization that may result from such arrangements, it will be essential to have a long-term vision and to include land issues in the framework of a development strategy that has broad backing. The extent to which goals are achieved should be monitored independently, and in conjunction with other government programs aimed at poverty reduction and economic development.

In addition to cutting across institutional boundaries, issues of land policy are normally complex, country-specific, aimed towards the long term, and often politically controversial. Even if they will make society better off, such measures are likely to be challenged by vested interests that derive considerable benefits from the status quo. Attention to the political economy of policy reforms will thus be critical. This will include an open and broadly based policy dialogue, carefully chosen and evaluated pilots, and sharing of experience across countries, something that will also help build local capacity for policy formulation and implementation.

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1 This paper draws on a Policy Research Report that has recently been completed by the World Bank (Deininger 2003). Readers interested in a more detailed discussion of the issues are encouraged to consult this document for references and a more in-depth treatment of the issues raised here.