



## Market-Assisted Land Reform: A New Solution to Old Problems

Studies worldwide show that large estates and collective farms, which are still widespread in southern Africa, Latin America and eastern Europe, are less efficient than small, family-operated farms. Land reform, which reallocates land from large holdings to family farms, can improve equity, productivity, employment and rural growth.

Historically, land reform has been implemented by government agencies expropriating land, with or without compensation, and then distributing it to the landless. Such reform is typically undermined by disputes, delays and inefficiencies. A new approach, *market-assisted land reform* (MALR), is being explored jointly by the World Bank and South Africa, and also independently by Colombia. MALR aims to encourage willing buyers to negotiate deals with willing sellers, with the government facilitating the process through grants and other supportive measures.

Several conditions are needed for successful reform; it should be preceded by the end of special privileges and tax breaks for agriculture; it should be accompanied by macroeconomic adjustment; it should include grants to poor farmers, and measures to increase the supply of land; it should include, in countries with thinly populated mechanized farms, a program for bringing in settlers from outside the area; and it must be supplemented by substantial public investment in developing regions targeted for reform.

### What Should Land Reform Avoid?

#### Excessive Subsidies, Tax Breaks and Other Privileges

Most of these benefits are captured by the

landed elite, because they own most of the land and because they have the political influence to manipulate the bureaucracy. These privileges are a fiscal drain. Besides, they get capitalized in the price of land, and the subsequent rise in land price means that land becomes too costly for the poor to buy, even if they can get credit at reasonable rates.

#### Blanket Debt Relief

Macroeconomic adjustment in countries can lead to high interest rates for some years, and the abolition of subsidies and other farm privileges can mean that farmers who borrowed on the expectation of substantial profits suddenly face losses. When a farm debt crisis occurs, banks are reluctant to foreclose on mortgages, since they will find few buyers of land, except at give-away prices. Farmers and bankers often form coalitions to demand generalized debt relief, and governments have sometimes succumbed to the pressure, e.g. in Brazil, Colombia, Mexico. However, such generalized relief confers windfall gains on viable farmers who have no need of rescue; subsidizes inefficient farms that would otherwise have failed, releasing land for other more efficient farmers to purchase; and imposes a substantial fiscal burden on the government. An alternative is to provide limited subsidies to banks to encourage foreclosures, as well as grants to poor, landless people who want to buy land—thus, increasing the demand for land. This can solve a farm debt crisis more efficiently and at far lower fiscal cost than generalized debt relief. The lower fiscal burden will also aid macroeconomic adjustment.

#### Confiscation or Expropriation at Below Market Prices

Expropriation may succeed after a violent

revolution—as in China in 1949, but in less radical circumstances, expropriation will be resisted. Large landowners and others who fear expropriation may form a powerful political alliance that can seriously undermine or even reverse land reform—as in Chile after Pinochet came to power. Disputes over expropriated land and legal delays can run into decades—Mexico’s land reform was contested for more than 50 years. This penalizes potential beneficiaries disproportionately. Such people typically have high discount rates, meaning they greatly prize immediate benefits but attach virtually no current value to benefits that come after seven or eight years.

#### **Land Acquisition by Governments or State Agencies**

The administrative costs of official agencies are large, and can exceed the cost of land in cases where legal disputes delay land transfer. Bureaucracies generally do not know how to take into account fully differences in land quality and agroclimatic conditions. They are less likely to make good decisions than beneficiaries themselves in identifying the most appropriate land for transfer. In some Latin American countries, bureaucracies decided to acquire land that had been tenanted for more than three years, or was lying unused. The landed elite promptly evicted all tenants with less than three years’ tenure, and started ranching unused land.

#### **Excessive Limits On Renting and Selling Land**

Countries like Mexico have attempted to restrict land sale or leasing to try and ensure that only “genuine” farmers can operate. But even the most genuine farmers may need to mortgage their land to get credit, and mortgages are not possible without an active market for land. Renting is an efficient strategy for widows or those handicapped in operating land themselves; in such cases, renting can increase productivity. The institutional structure of settlements should be determined by local communities, not central rules.

#### **Administrative Selection of Beneficiaries**

Bureaucrats are not well equipped to identify farmers with the most skills or enterprise, or to screen out land speculators trying to get cheap land. Administrative selection can degenerate into patronage, and much land may be allotted to undeserving candidates, including nominees of the landed elite. Administrators may demand bribes even from deserving beneficiaries.

#### **Settling Beneficiaries on Low Quality Land**

The land most easily available is often of low quality, including that owned by the government. Low quality land may be suitable only for ranching, not for settled agriculture, and distributing this to beneficiaries is a recipe for failure and environmental degradation. Such land should not be included in the land reform program. If the government itself has surplus low quality land, this should be sold to ranches, and the sale proceeds used to buy better quality land suitable for settlement.

#### **What Should Land Reform Include?**

##### **Amended Laws and Regulations Must Be Consistent with the Aims and Processes of Land Reform**

Unless legal clarity is ensured, the scope for disputes and delays will be enormous, and coalitions of interests that oppose reform will be able to subvert the process.

##### **Reforms Should Facilitate Voluntary Deals Between Willing Sellers and Buyers**

A voluntary process is the best way of avoiding disputes and delays that have plagued past reforms. Voluntary deals make it more likely that the most inefficient large farmers will cease operating, and that the most enterprising and skilled poor farmers will be major beneficiaries. The task of choosing what land is most suitable and at what price is best done in a decentralized manner by buyers and sellers.

### **Governments May Give Partial Grants to Poor Buyers and Provide Incentives for Appropriate Self-Selection**

Without grants, it is not possible to target the poor, who lack money for outright purchases. Besides, since the land price may contain an inflation premium even after structural adjustment, a grant is needed to reduce the net purchase price to levels that make farming affordable and profitable. Better-off beneficiaries can raise some equity for land purchase from relatives, friends and their own savings, but need some assistance too. Since public works will be needed to develop infrastructure in land reform areas, small farmers can contribute free labor as "sweat equity." Grants can be up to 100 percent for small subsistence plots, and then decrease on a sliding scale for additional land up to a specified maximum, adjusted for land quality. Such cost-sharing will reduce the fiscal burden on the government. It will also act as a self-selecting device that discourages land speculators and encourages the most enterprising families to acquire the maximum-sized plots.

### **Steps Must Be Taken To Improve the Supply of Land**

MALR implies a significant increase in the demand for land that will drive up prices to prohibitive levels unless prior steps are taken to increase the supply of land. The best ways of doing so are:

- Abolishing subsidies, tax breaks and other farm privileges. The resultant decline in farm profitability will translate into falling land prices, and inefficient large farmers with substantial debt burdens will cease operating.
- Implementing structural adjustment, which typically results in less protection against imports and high interest rates, both of which will tend to drive out inefficient large farmers. In high-inflation countries people buy land as a hedge against inflation, e.g., one study has estimated that 28 percent of the rise in land prices in Brazil is due to an inflation premium. Macroeconomic stability

will reduce the inflation premium on land, and encourages land speculators to sell their land.

- Encouraging unviable farmers to cease operating through exit bonuses, government retraining schemes and subsidized loans for starting new businesses. These approaches have been used successfully in Australia.
- The government should increase the supply of land by selling its own holdings.
- If land supply needs to be increased further, the government can subsidize or guarantee pension schemes for farmers who want to retire. The income stream from such pensions should be close to that from farming, while being free from the risks and fluctuations inherent in agriculture.
- Lending agencies should place a cap on the price (adjusted for quality) at which they will finance purchases. This will limit any possible price war between beneficiaries. If the land price reaches the credit cap, this will be a signal to the government to take additional steps to improve the supply of land.
- As several tools are available to promote market-assisted reform, it will be prudent to use only some to begin with, keeping the others in reserve for use if problems arise.

### **Substantial Public Investment In Land Reform Areas Is Essential**

The reforms will fail unless they are supplemented by public investment in roads, water, social services, extension, credit and marketing facilities. These are essential for helping family farms reach their full potential. In densely populated Asian countries, the large estates of old were usually tenanted, and land reform was relatively simple since the tenants already had the requisite skills and knowledge of local conditions. However, thinly populated mechanized farms are common in other parts of the world, and the local population is not sufficiently large to settle the entire area as family farms. People from outside must be brought in to settle the land. However, settlers often lack the necessary skills and local knowledge, so farm ex-

tension and infrastructure development are particularly important. The government should create appropriate conditions for settlers to set up new settlements through access to infrastructure. Fixed blueprints for the location and size of new settlements are unlikely to be appropriate.

#### **Local Communities Should Participate In Selecting Beneficiaries and Distributing Benefits**

Beneficiaries are better at selecting participants and distributing benefits than government agencies, which are sometimes inefficient or corrupt. The reforms will necessarily be spread over several years, and communities will be better than bureaucracies in prioritizing beneficiaries, supervising grants, and setting rules for the functioning of settlement areas. Criteria should be evolved for choosing beneficiaries, like farm experience, gender and poverty level, and these can be consolidated into a points system. Individuals and groups with the highest points can be prioritized for receiving grants. Local communities are best placed to screen out false claims and supervise beneficiary selection.

#### **Local Communities Should Get Powers to Raise Taxes and Plan and Implement Local Projects**

The development of infrastructure and social services is essential, and local governments are likely to do the job better than centralized agencies. They are better suited to raising local taxes, but will also need revenue transfers and matching grants from the national government for the formidable task of developing new settlements. Global experience suggests that the enthusiasm and creativeness of elected mayors is more important than technical expertise in creating local capabilities, and that technical assistance should be driven by local demands, instead of being imposed by central agencies.

#### **Emphasize Supervision Through Monitoring, With Penalties for Those Breaking Rules and Awards for Those Who Do Well**

A properly monitored system of penalties

and awards is better than supervision through detailed step-by-step clearance, which leads to delay, waste and corruption.

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#### **Suggested Reading:**

Van Zyl, J., Kirsten, J. and Binswanger, H. 1995. *Policies, Markets and Mechanisms for Agricultural Land Reform in South Africa* (Cape Town: Oxford University Press).

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