

Land Market Issues in Development: Evidence from South Asia

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Introduction

- Land is different from capital and labor.
- 90% of Assets in rural India was held in the form of Land, Building and Livestock in 2002.
- Usual sense of Depreciation is not assigned to land unlike other Factors of Prod. and assets.
- Under the Common Law, ownership of underground resources depends on the ownership of land on the surface.
- Land Price is regarded as the Discounted Price of Rent: proportionate relationship between Rent (flow) and Land (stock) was theoretically assumed by the Classical Rent Theory.

Formation of Private Ownership of Land in the Former Punjab

- The former Punjab was annexed by the British Colonial Government in March 29, 1849 after the 2nd Anglo-Sikh War.
- Massive scale of Canal Colonies were constructed by the development of Canal Irrigation System in the Former Punjab.
- Private ownership was established as against the assertion of James Mill, the father of J. S. Mill.
- Profitability of land holding was ensured by the revenue rate at one half of rent, or 'half of the net produce,' which was called 'private rent property.' (Punjab Land Revenue Act, 1887)
- The revenue rate was revised after 20 years, but extended to 30 years in 1893.

Land Market and Money Lender

- Land Price per acre was cheap (Rs.63 in 1891) as against gross agricultural Product (Rs.31).
- Hindu Money Lenders found it attractive to invest in land, due to the higher profitability compared to their traditional occupations.
- Indebtedness of Muslim Peasants increased with high pace. (Malcolm L. Darling, *Punjab Peasant in prosperity and Debt*, 1928)
- By learning the lesson from the Decca Riot of 1875, the Punjab Land Alienation Act (PLAA) was passed in 1900 to disqualify the Hindu Money Lenders to participate in the land market.

From Money Lenders to Progressive Farmers and Landlords

- The Profitability (rate of return of investment in land) started declining well before the enactment of PLAA in 1900.
- Yet, around 2 lakhs of acres had been transacted in the market during 1900-47.
- Concentration of land by the progressive farmers (Yeoman) and landlords (Capitalist) and the land under tenancy started increasing after 1900.
- Limited extensive margin of land (scarcity value) price inelastic demand for land and the excess liquidity were the major driving forces.

Declining Trend of Rent-Land Price Ratio (R/Lp Ratio) Over Time

- Land price (L_p) has been increasing much faster than Rent (R) over time.
- As a consequence, the R/L_p ratio started declining sharply towards 1900 below the two yardstick the Hindu Money Lenders had.
- The R/L_p ratio declined from around 15% in 1900 to 4-5% towards 1947.
- Price inelastic demand for land is explained by two factors; Land has been the basis of power in rural society, and land has to be acquired to respect the Muslim Inheritance Law (equitable inheritance system) .
- Excess liquidity at the micro level in the form of accumulated rent has had not many assured alternative investment outlets.

Land Purchase as an Alternative Form of Savings, not Investment

- Assuming that all the land transactions were made by the loan from financial institutions, R/L_p should have been higher than the on going interest rate charged for the loan. This condition had not been met since 1900.
- Only probable explanation is to interpret that the land purchase financed by the accumulated excess liquidity was regarded as an alternative form of savings, not as an investment for profit maximization.
- Considering the fact that the opportunity cost of the excess liquidity was zero or close to zero, land market behavior is understandable.
- However, the purchase of land as another form of savings has proved to be a profitable 'investment' due to the faster growth of land value than its utility value in real terms.

Formation of Land Bubble and the Capital Gain from land holdings.

- $R/L_p = r(1 - e/L_p)$, where (R) is a rent, (L_p) is a land price, (r) is a rate of return, and (e) is a residual deviating from the theoretical value.
- Historically, (e) has been positive and increasing, which implies the increasing 'capital gain' and thus the formation of land bubble.
- Land bubble in South Asia has less chance to burst, because land purchase has been financed in most cases from own savings.
- However, is it socially justifiable to admit 'capital gain' to accrue in land transaction? Land is not a man-made resource as James Mill pointed out, not a capital.

Land Bubble as an Issue of Development in South Asia

- The declining R/L_p ratio should not be interpreted as a false of Rent Theory. The false lies with the fact that the windfall gain accrues to the holding of land (capital gain) has not been taxed away by any government, which was the precondition of the classical rent theory.
- To be realistic, poverty and vulnerability question cannot be effectively analyzed by the measurement of consumption and income, ignoring the asset aspect.
- If the capital gain issue is left attended, it would crowd out the majority of people from the land market. Moreover, it would crowd out future public investments, since the substantial portion of investible fund has to be spent on purchasing required land.

Land Reform: A Magic Pill ?

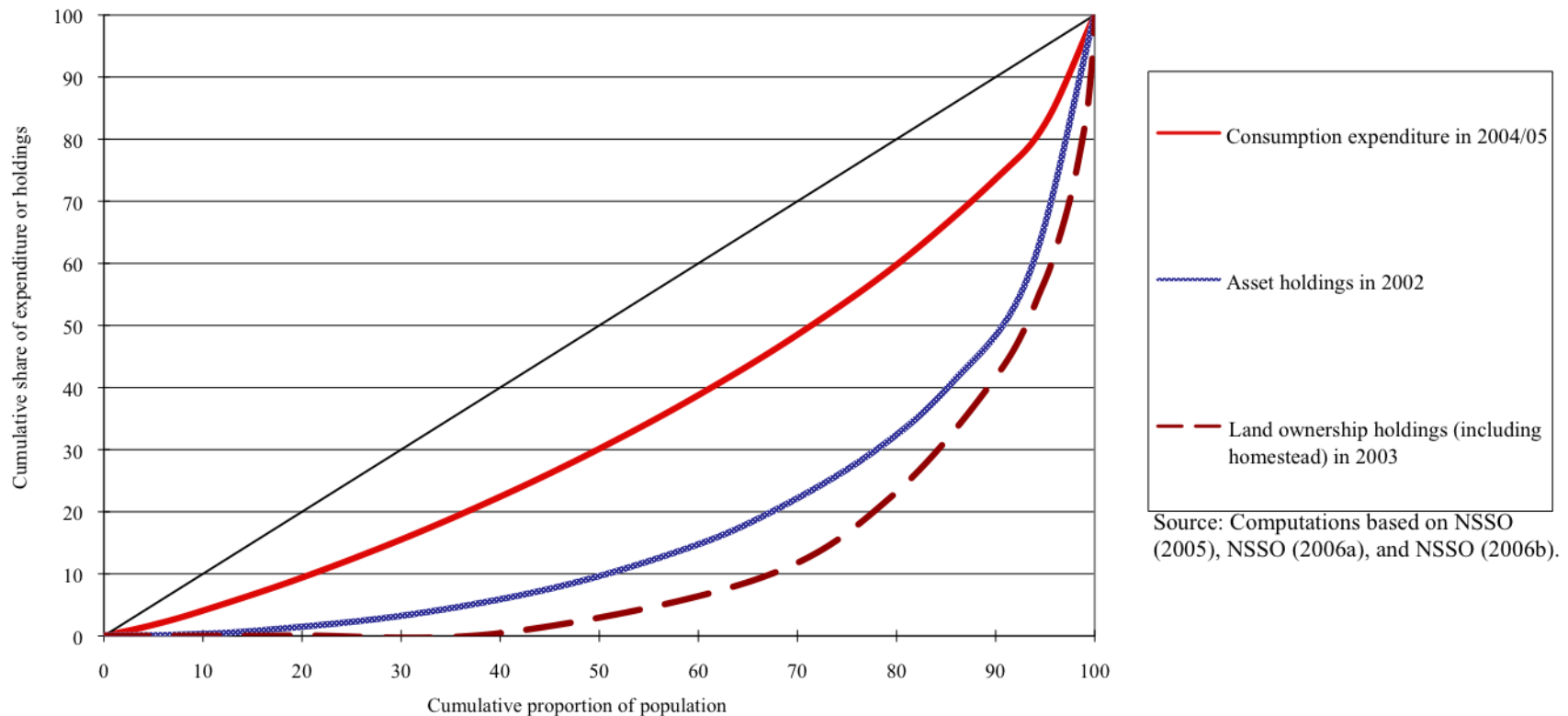
- Confused definition of land reform.
- Land reform is a political process.
- Preconditions for successful land reform.
- Market friendly land reform is inconsistent with the logic of market economy.
- If is there any possibility to change the structure of society, scrutiny of land market behavior is essential.
- Half-hearted land reform simply creates additional beneficiaries of land bubble.
- Importance of land and water tax policy reform as a second best substitute for land reform.

Land and Water under the Common Law Regime

- Distribution of water is much more skewed than that of land. (M.L. Dantwala)
- Under the Common Law, ownership of underground resources, water for example, is subject to the ownership of land above.
- Water pump-up from private TW set up on private land becomes a private property.
- Cost of it does not include the cost of water as a raw material.
- Water running through public canal is a public property. Likewise, water in the village tank is a community good.
- How to control salinity, water-logging, contamination of underground water?
- Water market arguments ignore the land-water linkages.

Gini Coefficient: Consumption, Total Asset and Land, India

Figure 1 Lorenz curves for consumption expenditure and asset holdings



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