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# Property rights *and the rural* land market in *Latin America*

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Land distribution in Latin America is characterized by striking inequality. Notwithstanding the emergence of modern structures in some regions, a few huge land holdings are found alongside a large number of small ones. This situation has long been considered undesirable for reasons of social equity as well as for reasons of efficiency. The topic remains high on the political agenda. The ultimately disappointing results of past redistributive reforms have caused contemporary policy-makers to search for alternatives. In recent years attention has focused on the institution of private property rights and land transactions through market mechanisms. This paper argues that it is extremely helpful to approach the issue from an institutional perspective. The objective here is not to prescribe concrete solutions, but rather to shed light on issues such as how transactions are actually being carried out in the rural setting; the role of transaction costs and of institutions such as property rights; and what influence externalities may have. The theme of this paper is that a meaningful analysis of how rural land markets work cannot be done in a conventional neoclassical framework. The rural economic environment is characterized by imperfect markets, asymmetric information and uncertainty. In addition, economic behaviour is often guided by the intrinsic logic of the peasant farm, which differs markedly from the way in which commercial agriculture operates. No single property rights regime is universally valid. Indeed, a whole array of agricultural institutions has emerged as a response to different and evolving economic parameters. The complexities of rural land markets have to be considered in order to design effective policies. This article hopes to contribute to a deeper understanding of the issues. Thus, after laying the theoretical groundwork, an overview of viable policy instruments is given and a number of case studies are presented.

# I

## Introduction: Land-market reform vs. land reform

In rural areas, land performs an economic function of paramount importance. It is the primary production factor, source of employment and repository of personal wealth. Thus social status and power relations in rural societies are often largely determined by the structure of landholdings. Although in many cases this is still an adequate description of the situation in contemporary Latin America, a modernization process has clearly begun. With the emergence of agroindustry and modern, well-managed, mostly medium-sized farms, the polarization in land distribution is no longer as stark as it has been in the past.

Nevertheless, the distribution of this vital resource within the region as a whole remains highly inequitable even when we take into account that "lumping all parcels of land together in an economic analysis, by counting acres, certainly violates every rule of aggregation" (Schultz, 1953, p. 141). On huge properties, wide tracts of land are underutilized or lie idle while significant portions of the rural population are struggling for access to land, a predicament which has led to civil unrest in the past and continues to do so at present.<sup>1</sup> Additionally, the environmental degradation that occurs as peasants penetrate the fragile frontier in search of land has become a cause for concern.

This has fuelled demands to change the skewed land tenure structure. Generally speaking, the argument rests on grounds of social equity, efficiency, or both. However, the first justification may be open to

subjective interpretations, while the second point does not provide a clear-cut tool for analysis.

From a use-efficiency point of view, the case for more equitable land distribution that is made in much of the existing literature on the subject assumes a systematic relationship between farm size and land productivity. The discussion of this "inverse relationship" can be complicated and sometimes confusing. Some authors even discount the existence of such a relationship altogether, while others argue that the postulated size-productivity correlation is actually incorrectly defined. According to this argument, the observed connection simply stems from the fact that population growth is fastest in areas of high soil fertility, thus leading to the subdivision of land into parcels of high productivity, or quality concentration, as it were (Jonakin and Carter, 1987).

Hypotheses which try to explain the inverse relationship usually look at wage differentials between small-scale and commercial agriculture, given the intrinsic economic logic of the peasant unit (Schejtman, 1980), or concentrate on the failings of contingent markets for labour and/or credit. Yet another interpretation emphasizes certain diseconomies of scale found in large commercial farms, such as higher labour supervision costs.

Other authors maintain that the inverse relationship observed in these investigations is probably much smaller in reality. Feder (1994) offers three criteria for empirical testing of the size-productivity relationship:

i) A distinction has to be made between owned holdings (where capital-constraint effects are dominant) and operated holdings (where the effects in terms of supervision costs are more important). The number of family members who could act as supervisors should also be taken into account;

ii) For census data on total factor productivity, farm profits net of family labour cost rather than yields should be used as the appropriate efficiency indicator; and

□ The author wishes to express his gratitude for the helpful suggestions made by his colleagues at ECLAC, by Alejandro Schejtman of FAO and by Carl Bauer of the University of California at Berkeley.

<sup>1</sup> Witness, for example, an incident on 9 August 1995 in a Brazilian state bordering on Bolivia, when 10 people died in a dispute over land. Around 500 landless farmers had occupied parts of a huge *hacienda*, and attempts by the police to evict them resulted in a shoot-out. Reportedly, 379 similar conflicts left at least 36 people dead during 1994, making land disputes the chief cause of violence in the interior of Brazil.

iii) Adjustments for land quality should be made.

The author suspects that under these conditions the magnitude of the inverse relationship detected in these empirical tests would be reduced, but not eliminated altogether.

It is not entirely clear whether the assumption of an inverse relationship is still valid in an environment of rapid technological change and progress in mechanization. Whatever the case, all the approaches described above contribute to a theoretical foundation for the inverse relationship which is strongly supported by a considerable number of empirical studies. It should therefore not be viewed as a strictly scientific hypothesis, awaiting refutation. Rather, the overall consensus in the literature is that it is a helpful working premise that is valid under a certain set of circumstances and parameters. It should be kept in mind, however, that the existence of an inverse relationship and the link between land ownership and rural poverty are methodological assumptions that have to be verified case by case.

Assuming the existence of such a size-productivity relationship, the conclusion to be drawn would be that: "... for given technology, factor prices, land quality and farming skills, there is an optimal operational holding size where the economies of scale from lumpy inputs and management skills start to be fully offset by the costs of adding more workers" (Feder, 1994, p. 136).

It follows from the assumption of an optimal, size-sensitive distribution of holdings over time and space that a highly skewed distribution of land which does not allow for optimization adjustments in size will almost certainly be undesirable from an efficiency standpoint as well.

It should be pointed out at this stage that whether an inverse relationship holds or not, from the perspective of a socially optimal resource allocation the existing tenure structure, in which agricultural land is underutilized or allowed to lie fallow, is not acceptable. But rather than trying to validate the justifications given for reforming the structure of land tenure in Latin America, the objective of this paper is, first

and foremost, to shed some light on two fundamental questions: first, why does a situation persist which *prima facie* is ineffective and, second, what are the perceivable outcomes of a market-led redistribution of rural land assets?

Over the last few decades attempts have been made to alter the existing tenure structure through redistributive land reforms. These initiatives have so far failed to bring about any decisive change, however. Apart from the fact that reform efforts in individual countries have differed in terms of both their initial political resolve and their scope (compare, for example, the extensive reforms in Mexico in the 1930s or Bolivia in the 1950s with the much weaker efforts in Brazil), the post-reform situation has been affected by factors such as the poor quality of the land redistributed, insecure land titles, a lack of farming know-how on the part of the beneficiaries, and a number of policy distortions. These experiences have led to the search for alternative solutions.

The question today is how agrarian structures would evolve if agrarian property rights were marketable and land markets were active. To put it differently: Would competitive market forces break down and reform a bimodal tenure structure, shifting land to the landless and land-poor? Would small-scale producers end up selling their plots, thus either creating further land concentration, or possibly allowing the emergence of a new, efficient subsector made up of medium-sized operational holdings with the characteristics of commercial agriculture? Or would the outcome be altogether different?

As will subsequently be seen, these are rather complex questions. The outcome of the land market process depends on whether or not the inverse relationship holds, the nature of conditions in complementary markets (capital, labour, insurance), power structures, the initial land distribution, whether property rights are assigned and secure, the quality of the soil, the choice of crops cultivated, and not least on whether it has been a good year for agriculture or a bad one.

## II

### Understanding the logic behind transactions

*We often apply the simple "laws" of market supply and demand without being fully conscious of the complex of institutions on which contracts in actual markets crucially depend.*

Pranab Bardhan

#### 1. An institutional perspective

This chapter attempts to illustrate that it can be immensely helpful to analyse the issue of rural land markets within the framework of institutional economics.

To this end, it will suffice to describe institutionalism in terms of two central premises, both showing that its analytical focus differs from that of conventional neoclassics. The first point is the belief that social institutions matter in shaping economic behaviour and performance. Second, it is crucial to grasp the evolutionary aspect of the concept. Institutions change over time in response to changing economic circumstances.

A distinction is often made between old and new institutionalism. Briefly, followers of the old school reject the neoclassical assumption of rational behaviour, while new institutionalists are, at the most, willing to modify it. While, in much of what follows, the underlying premise is the abstraction that institutions are the result of optimizing decisions made by individuals and respond to changing sets of relative prices, it is not suggested that factors such as status, group identity, or power, which clearly may influence behaviour in a rural environment, should be completely disregarded.

The fundamental idea in this context is that markets are nothing other than transactions between economic agents, and that transaction costs<sup>2</sup> are of enormous importance in shaping the way these transactions take place. One of the reasons for the emergence of social and economic institutions such as

property rights is to reduce transaction costs. Lipton (1993, p. 642), who refers to this body of ideas as the "new paradigm", describes its fundamental premise –i.e., the existence of endogenous, rural institutions that reduce transaction costs– as being: "in four words, that transaction costs endogenize institutions".

This new understanding of institutions, including agrarian institutions, which constitutes a body of knowledge that was not available for the land reform efforts of the 1960s and 1970s, can help to understand past failures and provide guidelines for future intervention.

Typically, there are three ways in which economists have treated agrarian (or rural) institutions: i) in *standard neoclassical economics*, these institutions are a given. Knowledge, organization and technology remain constant. Within this framework, individuals maximize utility and the outcome will usually be Pareto-optimal; ii) for *structuralists*, rural institutions are the result of power relations between groups and classes, and emerge through "extra-economic coercion". Such institutions will persist as long as those who benefit perceive the situation to be to their advantage and as long as "the gainers can brainwash, bribe, compensate or coerce the losers into acceptance" (Lipton, 1993, p. 631); iii) *institutional economics* views agrarian institutions as the endogenous outcome of measures taken partly in order to reduce transaction costs.

While it is not my intention to discount the contributions of neoclassical and structuralist economics, I suggest that institutionalism attempts to bring parts of the three approaches together. Of central importance in the current context is the institution of property rights. To understand rural land markets it is helpful to shift the analytical focus from the physical ownership of land to the prevailing system of property rights. This means that control over an asset

<sup>2</sup> The term here is defined as all costs associated with transfers of property rights other than direct production costs. Examples include costs of information, of negotiation, of drawing up and enforcing contracts, or of defining and enforcing property rights.

such as land has to be seen as a web of entitlements between persons, rather than merely as the possession of something. "Property" is defined as the "bundle of rights" of one individual in relation to others. In the words of Hoff (1993, p. 231), "little economic activity would occur in the absence of rights, or powers, to consume, obtain income from, and transfer assets. The level of economic development of a region will therefore depend on its system of property rights".

## 2. Property rights and land

Land is a special commodity: it is completely immobile, it can be put to different uses and it can be used by several parties simultaneously. What governs the use of this resource is a system of property rights. Agrarian property rights have some peculiar features: they can be very complex and they vary over space and time. Feder and Feeny (1993, p. 242) illustrate this point: "uses of land may include hunting, passage, gathering, grazing, cultivation, the mining of minerals, the use of trees, and even the right to destroy the resource. For instance, in medieval England and contemporary South India, rights to the crop are private, while rights to the stubble after harvesting are communal. Similarly, in many parts of Sub-Saharan Africa land and tree tenure are separate".

Property rights are so important because they determine resource allocation in a world of conflicting user interests. It has been noted that only on Robinson Crusoe's island was there no need to define property rights—at least not until the arrival of Friday. This obviously means that the outcome of land (re-)distribution via market transactions will also depend on the prevailing system of property rights. Why, then, is so little attention paid to them? The answer is that economic analysis usually assumes Western-style systems of property rights which are exclusive, transferable, alienable and enforceable. In such an environment, it is acceptable not to include property rights issues in the analysis. But this is often not the case for developing countries, and the results of a study that does not consider the impact of the existing system of property rights are therefore misleading.

Any attempt to alter the inegalitarian pattern of landholdings found in Latin America necessarily implies shifting individual property rights in land, plus their associated rents, from the relatively rich to the

relatively poor. It is important to note that an analysis of these issues often "... fails to recognize the subtlety and complexity of property rights in land, so that the question of what, precisely, is being transferred is often obscured" (Bell, 1990, p. 148). One of the reasons for the unsatisfactory results achieved by redistributive land reforms is that they often ignored the hugely complex economic realities involved.

According to Feder and Feeny (1993), property rights should be thought of as a social institution. These authors distinguish three basic categories of institutions: i) *the constitutional order*, which is made up of the fundamental rules about how a society is organized—the rules for making the rules, so to speak; ii) *institutional arrangements* such as laws, regulations, associations, contracts and property rights, which are created within the framework of the constitutional order; and iii) *normative behavioural codes*, which are determined by the cultural values that legitimize the above arrangements and constrain behaviour. Categories i) and iii) evolve only slowly, whereas the second may be more readily modified.

It is important to note that all three categories are interlinked and may influence each other. Feder and Feeny give examples:

"Although the formal legal system may provide for alienability of land, the transfer of land to persons from another clan or ethnic group may represent a violation of cultural norms. Similarly, although the constitutional order may make provisions for private property rights and there may formally be laws establishing such rights, the corresponding registration and enforcement mechanisms may be largely absent" (Feder and Feeny, 1993, p. 241).

For analytical purposes, property rights in land may be classified into four theoretical types: i) no rights or open access, i.e., property rights are left unassigned; ii) communal property; iii) State property, and iv) private property, where exclusive rights are given to a group of people, the State, or some private entity, respectively. All four forms may be found in one society. Similarly, more than one category may apply to the same tract of land.

The concepts of State and private property are quite straightforward when compared with common-property and open-access regimes. The demarcation line between the latter two can become somewhat blurred, since the incentive structure in a common-property system may be such as to cause the economic behaviour of individuals to resemble the type of

behaviour observed under open-access regimes. In many countries of Latin America, it is often the case that up to 50% of the cultivated land is untitled, thus giving rise to a de facto open-access system. Therefore, a closer examination of the characteristics of non-private property rights systems—other than State property—seems justified.

The rediscovery of an article published almost 30 years ago (Demsetz, 1967) appears to be particularly helpful in this context. Demsetz's approach is at times broad, and it can be difficult to see the practical applicability of his contentions. Nevertheless, the basic premises of his paper help to shed light on many of the questions which are of interest to us.

For Demsetz, property rights "derive their significance from the fact that they help a man form those expectations which he can reasonably hold in his dealings with others" (Demsetz, 1967, p. 347). He sees a very close relationship between property rights and externalities. "Externality" here means any harmful or beneficial effect that someone suffers or enjoys through the activities of someone else. The classic example is smoke from a factory chimney; another might be the shadow a tall building casts on the swimming pool of a neighbouring hotel. These effects are "external" in that no prices are attached to them and they thus have little or no impact on the decisions of economic agents, since no information is transmitted through the price mechanism. "Internalizing" external effects accordingly refers to a process or mechanism whereby such effects are brought to bear on the behaviour of those affected.

Demsetz maintains that "a primary function of property rights is that of guiding incentives to achieve a greater internalization of externalities" (Demsetz, 1967, p. 348). His article analyses the different patterns in the emergence of property rights among North American Indians belonging to two groups. One of these groups inhabits the northern Labrador Peninsula and engages in a profitable fur trade. The hunting of forest animals under a common-property regime eventually makes it necessary to define and establish clear private property rights as the cost of coordination of user entry—unavoidable in (de facto) open-access systems—becomes excessive and the resource runs the risk of over-utilization.

The second group is made up of the Indians of the south-western plains, where the indigenous grazing animals are of no commercial value—unlike the fur animals of the north—and, in addition, tend to

wander over wide tracts of land. These two conditions make the establishment of enforceable private property rights neither highly desirable nor feasible. As a result, a long tradition of private property rights in land could be observed in the case of the Labrador Indians, whereas no similar arrangement could be found among the Indians of the south-west.

The analysis then turns to the issue of communal ownership. The distinction between "communal" and "common" ownership is not made clear, but the observations are instructive nevertheless. Demsetz was apparently thinking of open-access regimes when he referred to communal ownership. Because of the difficulty of making a clear distinction between the two in certain cases, however, his conclusion—that such a property-rights arrangement results in significant externalities which are not internalized—may none the less be valid. External effects may be less obvious in the case of communal ownership when the community is sufficiently small and exhibits a certain degree of coordination among members, to the exclusion of outsiders. In this case, externalities may be internalized through negotiations whose costs rise in direct proportion to the size of the community concerned. This points up the second advantage of private property rights: negotiation costs tend to be considerably less than under communal ownership. Thus, Demsetz (1967, p. 358) plainly states that "ownership tends to be an individual affair".

The main lessons to be learned from this proposition may be that: i) property rights internalize externalities; ii) property rights emerge when the benefits of internalization become greater than the associated costs; iii) this is precisely what usually happens in the course of economic development; iv) private property rights provide the best mechanism for internalizing external effects; v) such rights therefore appear to be—generally speaking—a necessary, though not sufficient, condition for development; and vi) consequently, it seems crucial that the State should allow property rights adjustments, because over time new technologies and markets appear on the scene and old property rights regimes are ill-equipped to deal with new realities.

This is not to say that private property rights constitute the first-best solution in all instances at all times. The most suitable property rights regime will depend on the particular circumstances of a given society, including its stage of economic development. Demsetz takes this into account when he writes that



account must be taken of "... a community's preferences for private ownership. Some communities will have less well-developed private ownership systems. But, given a community's tastes in this regard, the emergence of new private or state-owned property rights will be in response to changes in technology and relative prices" (Demsetz, 1967, p. 350).

Lastly, property rights also play an important role in providing incentives for efficient land use and investments by making the flow of information less asymmetric and thus reducing the associated inefficiencies and uncertainties, all of which facilitates transactions in financial markets. Asymmetric information in land markets can emerge in the course of the (agrarian) development of a society. In the early stages, land transactions will largely be carried out among members of the same community, where information is still mostly symmetrical. The individuals know who they are dealing with and which tract of land belongs to whom. As the mobility of individuals and capital increases in the more advanced stages, more and more transactions take place with outsiders and, consequently, problems of imperfect information and therefore of land disputes arise. This can lead to efficiency losses since in such a scenario the market price of land will move away from its shadow price and the level of land transactions will be sub-optimal.

This, of course, assumes that land transactions generally increase efficiency because they allocate resources according to their potential marginal productivity.

It is important to note "that changes in economic relations and in power structures that characterize the development process generate changing needs for property rights and the institutions to regulate or enforce them" (Feder and Feeny, 1993, p. 242). Factors such as population pressure or technological change that make investments in land quality more attractive create a need for property rights to be more precisely defined. There is a strong demand for institutional arrangements to do just that in many of today's developing countries, where these factors are at work.

It can now be argued that, even though the "optimal" property rights system in any given situation is not necessarily equivalent with the institution of private property, in the course of the "modernization" of a society, private property becomes ever more important. The economic history of European countries, for example, indicates that, as the development process progresses and the division of labour increases, economic interaction between agents becomes more complex and factor markets slowly emerge; accordingly, the institution of common land ownership has to give way to private property arrangements (Barlowe, 1958).

### III

## Land transactions in the rural setting

*"The world operates, at best, in a second best framework"*

Erik Thorbecke

#### 1. The economic environment

According to De Janvry, Sadoulet and Thorbecke, rural economies in developing countries are "... characterized by highly imperfect markets, with low transaction costs within the community but high with the outside, asymmetrical information, fragmented oligopolies, lack of formal collateral, and highly covariant risks" (De Janvry, Sadoulet and Thorbecke, 1993, p. 569).

In these circumstances, rural transactions can be highly complex. Market as well as non-market configurations may emerge, transactions may take place

within the household or among members of an organization and may not have a visible price. Or they may set up links between labour and land and between credit and labour. Furthermore, the way in which these transactions are carried out depends, among other things, on the relative power position of an individual in society or on such institutions as cultural norms and the legal system. Therefore it can be grossly misleading to view transactions in the rural community as taking place within perfect markets and to disregard the whole array of agrarian institutions that may exist (Bardhan (ed.), 1989).

The basic conclusion here is that the emergence of an organized, formal market or a non-market configuration to carry out transactions for a certain good will depend—in a world of imperfect and asymmetric information and multiple imperfections in associated markets—on the transaction costs involved. Similarly, it is important to see that the different market and non-market configurations that exist in an economy do not operate independently from one another, but instead interact.

It has to be made clear in this context that non-market operations should not be perceived as taking place in some sort of vacuum, outside the economic sphere. The very existence of a certain economic rationale (minimizing transaction costs) explains this type of configuration.

The crucial question is whether relatively free transactions between economic agents will allow all the necessary information to be processed and thus accomplish more than past redistributive reforms.

## 2. Market transactions in land

While there are different ways to acquire land (for example, inheritance, granting of ownership by the State or squatting, all of which may be important factors in determining the structure of landholdings), this section deals exclusively with formalized market transactions.

In analyses of rural land markets, the focus is usually on land sales markets. How do they work? What determines the outcome of the process? Consequently, we, too, will start by looking at these questions. However, as will be suggested in point b) below, land rental markets probably deserve considerably more attention than they commonly receive.

### a) Sales markets and their limitations

In general it can be said that land sales markets in Latin America have been inactive in the past. Recent adjustment policies have initiated a change, but the problem persists in many cases. Thus, there must be factors at work which hinder these markets from functioning more vigorously. Shearer, Lastarria-Cornhiel and Mesbah (1991) distinguish between demand and supply constraints.

Supply constraints are considered more crucial. The authors mention three: i) supply constraints due to land concentration: it is assumed that a skewed distribution of land is somewhat self-perpetuating be-

cause large landowners are seldom willing to sell. Explanations for this include the preference for land as a repository of wealth, an effective hedge against inflation, and also as a source of power; ii) constraints due to a lack of private land titles: untitled land is either kept off the market or sold at a price below its real value to compensate for uncertainty (for reverse effects of land titling, see section IV below); iii) legal, administrative, and fiscal constraints: these include lengthy as well as costly transfer and registration procedures, restrictions placed on beneficiaries of land reform programmes (who are often not allowed to sell or rent their land for many years) and fiscal requirements such as transfer and capital gains taxes.

The main constraints on demand are the lack of resources to purchase land and high land transfer costs. The rural poor have neither sufficient assets to buy land nor the ability to obtain financing through commercial channels due to their lack of collateral, to imperfections in financial markets or to the absence of such markets. High transaction costs, which mainly stem from bureaucratic inefficiencies, taxes, or the search for information, exacerbate the situation by causing effective land prices to rise.

The authors place greater importance on demand constraints and maintain that land markets alone, given the environment in which they operate, will not be able to bring about a decisive change in the existing structure of holdings. The basic argument is that this failure is caused by numerous imperfections and inefficiencies in such areas as land-credit links and policy distortions. The point here is that, even though increases in efficiency through land transactions are likely, markets are nevertheless unable to achieve a first-best solution.

As concerns price distortions, a present-value consideration is at the heart of the matter. For a variety of reasons, the equilibrium price of (unmortgaged) land will, at given credit costs, always exceed the discounted present value of the income stream generated by it. However, in an idealized case of perfect markets, the value of land for agricultural use would equal the present value of agricultural profits, capitalized at the opportunity costs of capital.

This observation holds because: i) land has a collateral value (i.e., it provides access to credit); ii) it helps to spread risk (e.g., it serves as a hedge against inflation), and since the “services” of this type which land provides enhance its utility for its owners, buyers need to offer compensation for this attribute;

iii) the transaction costs incurred when acquiring land or accessing credit are usually fixed and are thus subject to regression (i.e., the bigger the holding or the larger the amount of credit, the lower these costs are in proportional terms); iv) the future real appreciation of land prices (as well as credit subsidies or tax breaks on agricultural income) as population and urban demand for agricultural land grows is—at least partly—capitalized into the current market price. Thus, the market price of land is not determined solely by its productive use.

All this contributes to the financing problems faced by poor groups, in addition to the general difficulty they face in accessing capital markets due to a lack of collateral and insufficient income flows. The argument presented in the preceding paragraph implies that those buyers who need credit (but have no access to it) have to finance the purchase out of savings; this situation favours wealthy players and thus tends to make the distribution of holdings even more unequal. To summarize:

“Land is often a preferred store of wealth, so with imperfect inter-temporal markets the utility derived from landownership will exceed the utility derived from farm profits. Its immobility makes land a preferred form of collateral in credit markets, which confers additional utility from landownership, especially in an environment where production risk cannot be insured” (Binswanger, Deininger and Feder, 1993, p. 50).

There are additional factors that obstruct the process and reduce its efficiency. As a rule of thumb, it could be said that in good crop years, the supply of land will be limited while in particularly bad years, distress sales will go up, again hurting the poor first.

The main point here is that price distortions, stemming from a variety of sources, will make it hard or impossible for the rural poor to acquire land. Thus, Lipton (1993, p. 651) concludes that: “price distortions favouring large farms mean that inverse relationships, strong at shadow prices, are suppressed at market prices, and even at effective prices including transaction costs. *Correcting such distortions therefore helps to get land into smaller holdings*” (emphasis added).

#### b) *Tenancy markets*

It is important to note from the start that, contrary to a widely-held belief in policy-making circles, there is strong evidence in the literature on rural land markets to suggest that rental (or tenancy) arrange-

ments are a rational response on the part of economic agents to a certain set of variables which overcomes or softens some of the above-mentioned impediments to a more equal distribution of land.

Fixed-rent tenancy can be seen as the alternative to wage labour. In a perfect market environment, either contractual choice would have the same outcome; in other words, it would not matter whether land hired labour (wage employment) or labour hired land (fixed-rent tenancy). Given the existence of the inverse relationship discussed earlier, however, it will often be more profitable for large landowners to rent out part of their holdings.

An even more important factor than this gain to the landlord, however, is that the evidence suggests that rental arrangements can also be beneficial to the rural poor. Besides being a natural response to thin sales markets, tenancy markets emerge in a world of multiple imperfections and uncertainty. They may solve supply constraints such as landowners' reluctance to sell (because, for example, they prefer to keep their property as a hedge against inflation) or demand constraints such as a lack of equity to purchase land.

Smallholders may prefer to rent out all or part of their plots. In an interesting case in Peru (Figueroa, 1995), agroindustry firms rent land from peasants in the region and often hire the owners to work the fields as paid labourers.

Depending on the environment, different kinds of rental arrangements may make sense. In imperfect inter-temporal risk insurance markets, for instance, sharecropping contracts may work well to insure against stochastic fluctuations in output (due, say, to weather factors).

However, concerns have been raised which have caused policy-makers to place restrictions on tenancy arrangements, particularly share contracts. The doubts of some hinge on considerations of social equity, since the weight of relative bargaining power usually lies with the wealthy landowners. Many economists also view sharecropping as being problematic from an efficiency point of view (Marshallian inefficiency), since under share contracts the tenant receives only a fraction of the marginal product of the inputs used. Available empirical evidence suggests, however, that these inefficiencies are not large at the farm level (Binswanger, Deininger and Feder, 1993). These studies have not found significant differences between yields or input intensities in owner-

cultivation and land tenancy systems. In any case, Bell (1990, p. 161) points out that, "whether there is constrained efficiency or not, however, the role of share tenancy in a static system of incomplete markets appears to be useful, because it provides an inducement to risk-averse individuals to supply family resources and skills to cultivation, as opposed to unskilled wage employment, in which some skills and resources are of no account, and which is usually less remunerative".

In addition to this static argument, the case for rental markets can also be made by reference to their dynamic role as a vehicle for the accumulation of assets and skills. This is what is known as the *agricultural ladder* hypothesis, according to which "Young, relatively poor individuals begin as laborers and acquire sufficient skills and capital through experience, work, and saving to progress through the succeeding stages of share tenancy, fixed rent tenancy, and, with good fortune, outright ownership." (Bell, 1990, p. 162). Although this scheme will de-

pend on a whole array of favourable conditions, it is surely feasible in many cases where rural farmers start out with few assets or limited skills, or both. For them, tenant farming might be the best, if not the only, way to grow out of poverty. Some research suggests that the agricultural ladder performed an important role in rural development in the southern United States after the abolition of slavery (Binswanger, Deininger and Feder, 1993).

In conclusion it can be said that, in a world of multiple imperfections and uncertainties, tenancy arrangements are often a very useful tool for arriving, if not at an optimum, at least at a second-best solution. Some of the apprehensions mentioned above are attributable to a failure to understand the fact that sharecropping arrangements, widely used all over the world, emerge as a response to an imperfect environment and thus should not be blamed for inefficiencies caused by this environment. However, if as a result of these reservations rental markets are heavily regulated, even greater efficiency losses may result.

## IV

### Policies for successful land-market reform. An overview

#### 1. Government action in an imperfect environment

When analysing policy measures related to rural land markets, attention should be given to the fact that the foregoing observations on agrarian institutions are highly significant for the decision-making process. In a rural setting where economic transactions take place under complex property rights systems, imperfect interrelated markets and non-market configurations, it is difficult to foresee the consequences of government action. Instruments designed to affect a particular configuration may have spillover effects that influence other configurations. So, for example, it is conceivable that liberalizing the official financial market could raise interest rates in the informal market because savings would be diverted from the latter to the former.

Generally speaking, the question as to whether there is a strong case for government intervention in

agricultural markets should always be asked. Stiglitz (1987) provides a helpful framework for answering this question. He mentions five points that describe forms of market failure and therefore constitute reasons for government action: i) incomplete markets in insurance futures and credit; ii) increasing returns in the provision of public goods (for example, publicly financed water projects); iii) imperfect information; iv) externalities; and v) income distribution.

What matters most in our context is a special type of market failure: the non-emergence of a market. A market also fails: "(...) when the cost of the transaction through market exchange creates disutility greater than the utility gain that it produces, with the result that the market is not used for the transaction. Either surrogate institutions will emerge to allow the transaction to take place or the transaction simply does not occur. Non-existence of the market is thus the extreme case of market failure. In a more general sense, the market exists, but the gains

for a particular household may be below or above costs, with the result that some households will use the market while others will not." (De Janvry, Fafchamps and Sadoulet, quoted in Thorbecke, 1993, p. 598).

It is these "surrogate institutions", which Thorbecke calls "*non-market configurations*" and Bardhan calls "*agrarian institutions*", that make the outcome of government intervention somewhat unpredictable.

Caution in this area therefore seems in order. As one researcher points out: "if, in our reformist zeal, we do not pay enough attention to the underlying economic rationale of pre-existing institutions and their interconnections, and hack away parts of them, we may not always improve (and may even worsen) the lot of the poor tenant-labourer-borrower, the intended beneficiaries of our programme" (Bardhan, quoted in Thorbecke, 1993, p. 594).

In addition, Carter and Mesbah (1993, p. 1088) observe that land-market reform policies rely "... on the presumption that the resource-poor do not suffer a fundamental competitive disadvantage in the sphere of production which spills over into the land market." Therefore, such policies ultimately require a framework which explicitly links both aspects.

Having said this, there nevertheless seems to be ample room for public policies to invigorate or create rural land markets. However, it is often not so much a question of what new policies should be designed. Rather, attention should be given to regulations that are already in place and that often have undesirable efficiency as well as equity effects.

Lawmakers should be cautioned not to prefer one form of economic organization over another. For example, the existence of a wide variety of tenure arrangements can also be explained in part by the fact that decisions are taken by individuals who differ in capacities and preferences: some may be more inclined towards wage labour or share tenancy, while other more entrepreneurial, risk-taking individuals may prefer cash renting and aspire to owner-operatorship (Schweigert, 1989).

## 2. Land-market policies

Land-market reform through programmes such as land banks or the financing of land purchases with the help of government subsidies has played an important role in the United States and Europe during

much of this century. In contrast, there have been few similar experiences in the Latin American region, and the literature on rural land markets is very limited.

Policy instruments should focus on improving the supply of land (for example, through titling programmes) and the demand for land (for example, by eliminating certain subsidies in order to lower land prices).

Shearer, Lastarria-Cornhiel and Mesbah (1991) mention five areas in which they see a need for government action to give the poor greater access to land:

i) *Eliminating subsidies to scale*: Subsidies such as credit at negative real rates of interest tend to favour large landowners. They have better access to the relevant information and legal counsel, and financial institutions prefer them to small farmers because they can offer better security. In addition, such subsidies are often capitalized into the land price, which makes it even harder for the rural poor to purchase land. Eliminating subsidies to scale should therefore improve the relative bargaining position of the poor.

ii) *Land taxation*: The main point in this context is the assumption that a progressive tax on land will induce large landowners to break up their holdings and sell portions of their land. However, implementation of such tax programmes has been very difficult, mainly because of existing power relations and ample opportunity for evasion ("paper subdivision"). Another point raised in favour of improved land taxation is that the revenue thus obtained could be used to finance land or mortgage banks that could provide loans at preferential rates to the rural poor.

The numerous problems involved in taxation issues will only be touched upon here. Hoff (1991, p. 93) compares the effects of land taxes and output taxes, and comes to the conclusion that the preference for land taxes rests on the "... assumption that institutions for pooling and spreading production risks are perfect. When account is taken of the imperfections in those institutions, some use of output taxes will be Pareto-superior to a pure land tax regime and may induce higher output, as well".

Skinner (1991) points out that introducing a land tax in lieu of an export/output tax may, under certain circumstances, even increase land prices and thus thwart its redistributive purpose. This could happen when the capitalization effects of the export tax (depressing land prices) are larger in magnitude than

those of land taxation. In his view, the main obstacle to effective use of a land tax consists of administrative factors:

"Unlike the commodity or export tax, which is based on readily observable measures of output, the land tax is based on site value, market value, or net income, measures which in rural areas with sparse land markets are often difficult to observe" (Skinner, 1991, p. 114).

iii) *Land registration*: Of importance here is the fact that highly bureaucratic and cumbersome registration procedures carry significant transaction costs which work against an active land market. Moreover, this affects both the demand and the supply side, since transaction costs are incurred by sellers and buyers, and may thus be part of the reason why large landowners are reluctant to break up their holdings and sell to numerous buyers, since they would incur hefty costs for each operation.

iv) *Land titling*: Several arguments can be made in support of land titling programmes. Registered title will most likely increase a holder's security in terms of future expectations. This may improve productivity since the incentive to invest in machinery or fertilizers will be higher if you know that you will be able "to reap what you have sown". In addition, only secure title will allow the smallholder to use his land as collateral to raise additional capital.

Some authors doubt the validity of these arguments. They point to the possibility that land secured by legal title may command higher prices, thus making it more difficult for the resource-poor to become buyers. It is also argued that future expectations are only one input in the decision to invest in land improvement and that other factors such as alternative off-farm investment opportunities or the availability of capital play an important role. While this is undoubtedly true, it is probably safe to assume that secure title will not harm investment decisions.

Similarly, some maintain that titling will actually increase insecurity. They contend that if titled land functions as collateral, then foreclosure and land loss

become a real possibility. It is hard to see, however, how this kind of risk is any worse than the risk associated with having no title or no access to credit whatsoever.

There is a critical point, however. In an environment of imperfect or missing capital and risk markets, communal tenure systems can act as important substitutes for those markets. In such a situation, it is conceivable that awarding private title to individuals takes away the "protective shell" of the community and can thus lead to distress sales (that is, sales made to meet basic needs such as food) in many cases.

These difficulties make it clear that full ownership security involves much more than the mere possession of legal title. The surrounding infrastructure in terms of adequate credit, existing contingent markets and access to them, as well as other public assistance, has to be in place too.

Last but not least, it must be remembered that titling programmes are not without cost. In each case, the benefits to be derived from such a programme and the resources needed to carry it out should be weighed against each other.

v) *Mortgage banks and land banks*: As has been mentioned before, the lack of external financing for the rural poor constitutes a major obstacle in the effort to improve their access to land. Part of the problem is that financial institutions are unable to supply credit because of the conflict between the short-term capital they raise in the market and the long-term capital required for land purchases. The huge transaction costs involved when lending to large numbers of small farmers is another point.

In this scenario, the establishment of mortgage banks, which make preferential loans to individuals, and/or land banks, which acquire large holdings and then resell smaller plots, may bring substantial benefits. However, obtaining funding for these institutions in developing countries, where financial markets are usually not well developed and capital is thus difficult to raise, is a daunting task and thus often falls to international donors.

# V

## Selected country experiences

An analysis of the countries in this sample reflects regional policy-makers' recent preoccupation with market solutions. It is clear that attempts have been made to correct misconceived policies of the past. In some countries, rural land markets have been operating during the last few decades at a modest level of activity, and some observations on the outcomes are possible. In others, the mechanisms for transferring property rights still lie dormant.

A look at individual cases also highlights the complexity of the issue: the degree to which land distribution is still monopolistic, the wide variety of existing property rights regimes, the sorry state of cadastral systems, frequently counterproductive and inconsistent policies, the multiple factors that influence the behaviour of rural agents, and the extent of untitled land. It also gives a sense of the diversity of conditions within a given country. The need for institutional innovation becomes evident. Rural institutions and/or configurations may differ from region to region, thus calling for diversified instruments to foster land markets.

### 1. Chile

Under the two governments that preceded military rule, Chile experienced two waves of comprehensive expropriations which eventually encompassed 40% of the national territory. Economic policy after the *coup d'état* in 1973 prioritized private property, and a process of returning land to the previous owners began. Although in many cases there was a return to the situation as it had been before agrarian reform, by the end of the redistributive procedure, around 48 000 peasant families, known as *parceleros*, had received tracts of land fit for agricultural production.

Around 45% of the land distributed to the *parceleros* was subsequently resold by the new owners. An analysis of the background for this process affords valuable insights into the workings of a considerably liberalized rural land market.

In an interesting publication, two Chilean researchers provide a case study of the Metropolitan Region in Chile's Central Valley (the agricultural

heartland) and Region VIII in the southern part of the country, where traditional agriculture plays an important role (Echeñique and Rolando, 1991). They found that by 1991 around 70% of the previously-assigned parcels in the Metropolitan Region and roughly 45% in Region VIII had been sold. The level of market activity was highest in the areas with the most fertile land and the best surrounding infrastructure. This is accounted for mainly by the substantial demand for quality agricultural land generated by the rise of Chilean fruit and horticultural export crops, primarily in the Central Valley. While the *parceleros* slowly began to sell their land one or two years after it had been given to them, the bulk of the sales took place in the years between 1979 and 1982. These four years marked a deep crisis in the country's agriculture, but this was also around the time that fruit exports began to boom and thus began fuelling a strong demand for land, with the result that 58% of all sales of *parcelero* holdings took place within this period.

To explore the motivations of the sellers, Echeñique and Rolando carried out a survey among former *parceleros* and rural agricultural leaders which produced some remarkable results. The major reasons mentioned for selling were excessive debts and a lack of working capital. A total of about 40% of the peasants surveyed in the Metropolitan Region claimed that these two factors induced them to give up their land (the breakdown of these two factors was 23% and 19%, respectively). This was far from being the whole explanation, however. Some 19% of the peasants who sold their land said they did so because they had no interest in agriculture and preferred to engage in other activities, which means that this motivational factor was as important in the peasants' decision as the lack of working capital and almost as important as debt. In addition, in some 10% of the cases, the reasons cited were old age and the fact that the sellers had no children willing to continue with their farming activities, while 8% admitted to family problems such as alcoholism or plain laziness. In some cases the families were so large (10 or more children) that, upon the death of the father, the heirs

decided that the only practical way to divide the inheritance among them was to sell the land. In addition, legal regulations put the *parceleros* at a disadvantage in some instances. For example, until 1980 the sale of land that had been distributed to peasants was illegal under the country's military government. To circumvent this rule, many *campesinos* entered into long-term lease arrangements that gave leaseholders the option to buy later. The peasants often did not understand these contracts well, however, and in a number of cases they thus became victims of fraudulent practices.

The majority of the buyers of these parcels were farmers or agricultural entrepreneurs, but there were also urban professionals and business people in this group. However, the predominant motivation for the acquisition of agricultural land was to put it to productive use.

These characteristics of the Chilean case suggest that care is needed when evaluating some of the prevailing ideas about rural land markets. One such contention is that the economic situation typical of the peasant population makes it impossible for market mechanisms to shift land to this group. However, 19% of smallholders covered by the above survey said they sold their parcels out of a lack of interest in agriculture, and another 18% mentioned family problems, old age or a lack of children to carry on the tradition. While it cannot be claimed that this is a representative sample, this is nevertheless surprising. A large number of the sales were not motivated by a lack of capital or excessive debt, but were instead attributable to extra-economic factors. These land-market transactions in Chile by and large allocated the resource according to production potential, thus promoting the emergence of modern, successful agriculture.

## 2. Colombia

An analysis done by the Food and Agriculture Organization of land markets in several municipalities in Colombia (FAO, 1994) illustrates the difficulties involved in changing ownership patterns through market transactions.

In Colombia, too, land distribution is highly skewed. In 1992, 78% of the holdings were of a size of 10 hectares or less and accounted for only 8.8% of the total agricultural land area. In contrast, 1.3% of

the holdings comprised 200 hectares or more and accounted for over 48% of the total area.

In 1994, with this situation in mind, the Colombian Government passed the "New Agrarian Reform Act" (Law 160 of 1994) (Colombia, Ministry of Agriculture/INCORA, 1994) establishing a national system of agrarian reform and rural peasant development, introducing a subsidy scheme for land purchases by the rural poor, and reforming the Colombian Institute of Agricultural Reform (INCORA).

The report finds that in the municipalities examined, 4% of all holdings, equivalent to around 9% of these municipalities' total area, changed hands in 1991. The structure of these transactions reflects the segmentation of rural land markets. The vast majority of transactions took place between smallholders and accounted for a smaller total transfer in terms of land area than the relatively few large holdings that were sold. Thus, the study concludes that buyers and sellers usually belong to the same socioeconomic level.

Another important observation is what the authors call the "social segmentation" of the market. The social norms of groups such as extended families or closely-knit rural communities often result in the exclusion of outsiders. Cases are reported of individuals who did acquire land in such communities but who eventually had to give it up because they were denied certain services or could not find people who were willing to work for them.

Usually transactions are carried out only among members of the same group, and this (in addition to hereditary customs) has led to worrisome degrees of fragmentation. The report found that, in 1991, in areas dominated by peasant farming, over 50% of total land sales were carried out among family members. In this environment, efforts by State agencies to redistribute land may be frustrated. In one case, INCORA had purchased land with the intention of reselling it to small producers of a certain municipality. The offer was rejected because the peasants refused to give up the holdings they owned and did not want to relocate to other regions.

Another form of denying market access to unwanted parties is the authoritarian rule of guerilla or paramilitary groups over an area. Coercion and the application of sheer physical force make sure that only sales that are welcomed by those in power take place.



The study also found that land prices were closely linked to the revenue-generating capacity of the land in question. The location of the property, surrounding infrastructure and the prices which the produce can command in the marketplace thus become determining factors. In one predominantly coffee-producing region, the extent of land sales was about three times less than normal during a period of depressed coffee prices.

These researchers also observed another interesting phenomenon: owners of large holdings frequently sell portions of their property to investors coming from outside the rural community, mostly urban buyers. Before the sale, improvements are made (e.g., the construction of new fences or—often luxurious—homes) and, as a result, the parcel commands a price of up to twice the original value of the land. Apparently, some *latifundistas* had at one time contemplated breaking up their holdings to sell them to a number of peasant farmers. Eventually, though, they discarded the idea because they feared that insufficient profit margins would result from such an arrangement. One of the conclusions that can be drawn from this experience is that organizational hurdles and bureaucratic delays, plus the associated transaction costs, may prove to be prohibitive.

In the light of the above observations, the FAO report concludes that, in the regions studied, land markets were relatively active. However, transactions primarily took place in the form of “intra-strata” sales. Transfers of property rights through the existing market mechanisms have thus failed to shift land from one economic group to another.

### 3. Ecuador

An analysis of rural land markets in Ecuador, undertaken by FAO in 1992-1993 (FAO, 1995a), concludes that the country's agriculture has experienced drastic changes over the past three decades.

Until new legislation was passed in 1994 (Agrarian Development Act, 14 June, 1994), legal and bureaucratic hurdles were such that the vast majority of land transfers between private individuals took place outside the framework established by governmental regulations.

A study of the situation in Ecuador before the new law came into effect (Stringer, 1989) illustrates the effects land policies can have. It suggests that the administrative and legal structure of the country,

together with the accompanying policy regulations, worked against more active land markets in several ways.

First, there were very specific rules governing land transactions, and the public Institute for Agrarian Reform and Colonization (IERAC, now INDA, the National Institute for Agricultural Development) played a crucial role in this respect. For example, the approval of the Institute had to be obtained for transfers of *minifundios* (note that the relevant law did not define the term “*minifundio*”, either by area or by soil type), subdivisions of farmland, or sales with the intention of changing the category of land use from traditional farming to, say, cultivation of flowers or beekeeping.

Another stumbling block was the tax system: due to a combination of capital gains taxes, which were especially high because the rate set in the early 1970s had never been adjusted for inflation, plus a transfer tax, national defence tax, drinking-water tax, provincial tax and other fees, each land sale incurred a tax load of between 25% and 30% of the sale price. This led to illegal transfers, false price declarations and other problems.

Even if two contracting parties agreed to carry out a transaction, the process was immensely cumbersome. For example, for each sale an application had to be sent to IERAC requesting authorization. This application had to be accompanied by a map of the property, a copy of the title, a certificate from the land registry verifying that the property was clear of liens, a declaration by the contiguous property owners stating that they did not want the parcel, and the personal identification numbers of the buyer and seller. Then, the application had to go through various departments within IERAC, after which it was sent to the directorate in the capital. Finally, the parties to the transaction could begin drafting and notarizing the contract. It was not uncommon for the whole process to take up to six months. Furthermore, IERAC was never able to process more than 5% of the requested transactions. The new legislation did away with this process, and private land transactions do not now require authorization of any kind.

Today, through a combination of past agrarian reform, the settlement of new lands, and the stimulation of formal land markets the agrarian structure has been altered in such a way that the traditional *latifundio* no longer predominates. This is all the more remarkable if one considers how the situation stood in

1954 and 1974, when the last agricultural censuses were taken. In 1954, 2.2% of all holdings were over 100 hectares in size and covered 64% of the total land area. Smallholders operating on less than 5 hectares made up 73% of all holdings, but occupied only around 7% of the total area. In 1974, the ratios still stood at 2.1%/48% and 67%/6.8%, respectively. Today, by contrast, small and medium-sized producers which, together with agroindustry, use modern production techniques and are often geared towards export markets, have come into their own.

However, a different problem of polarization now exists. The modernization process has been accompanied by a substantial increase in *minifundios* and landless rural households. The 1991 survey of rural households shows that 39% are landless, while around 20% are smallholders operating on less than one hectare. At the same time the composition of the rural labour force has been altered. About 40% of the economically active rural population has entered the urban labour market or found other off-farm employment.

While, in the past, beneficiaries of agrarian reform often lost their land due to the overwhelming debt they had accumulated, today transactions in formal markets play a much more prominent role. The FAO study identifies market transfers as the predominant mechanism for the re-allocation of agricultural land over the last few years. On the supply side, peasant producers are the principal sellers, whereas demand largely stems from medium-sized and large agricultural enterprises that are further expanding their holdings. However, although this development often means that peasants—many of whom are former beneficiaries of agrarian reforms or of the distribution of colonized land—cease to be producers with their own holdings, the report highlights another very important aspect: the *campesinos* who have to give up their farms are usually the most “traditional” farmers who have failed to integrate into the modernization process. Thus the peasant sector splits into two parts:

“Sectors of the peasant population that have benefited from agrarian reforms and land settlement programmes, and that, over the years, have achieved a degree of accumulation, have adopted entrepreneurial forms of behaviour, have become a source of demand for land and are successfully expanding their land/production-unit base. However, those peasants who have maintained their position as on-farm landowners without changing their traditional behaviour

have fallen into decline, since their production base has been reduced” (FAO, 1995a, p. 73, original emphasis).

The FAO study on Ecuador concludes that the country is undergoing a sustained transformation. Market arrangements have become the main mechanism for land transactions. While this has led to the modernization of agriculture in many cases, on the other hand a considerable number of the rural poor find themselves in a crisis situation. Many have been forced to give up their land or have become part of the process of agrarian fragmentation. While this process may in general be interpreted as a positive aspect of economic development, it also creates new problems in respect of those parts of the rural population that remain outside the modernization process.

#### 4. Mexico

The Mexican case differs from others in many important respects because of the considerable influence which the revolution that took place at the beginning of this century has had on the country's institutions.

The agrarian land structure of Mexico is still marked by the provisions of the post-revolutionary Political Constitution of 1917. Article 27 of the Constitution established the *ejido* system. *Ejidors* are areas of communal ownership (primarily made up of previously expropriated land) which are farmed collectively. In other words, the *ejido* came into existence by decree and the way in which it operated was regulated by specific laws.

Currently, more than 54% of the nation's total land area falls under this system of “social ownership” (FAO, 1995b). *Ejido* farmers and members of other communal ownership schemes represent 67% of the total agricultural population. The fact that this structure was, in many cases, designed to be sub-optimal is demonstrated by the widespread practice of ignoring many legal restrictions.

Until the laws were changed in 1992, economic activity in agriculture had been extraordinarily restricted. Under article 27, the Federal Government was entitled to expropriate private landholdings in order to convert them into communal property. *Ejido* land could not be sold, rented out or otherwise transferred, nor could its use be obstructed (“*embargo*”). Therefore it was beyond the reach—at least legally—of market transactions. Furthermore, it was

illegal for *ejido* farmers to hire paid labour, and corporate legal entities were not allowed to own real estate.

In 1992, realizing that these conditions entailed a high degree of uncertainty and obstructed development, the Administration passed a new agrarian law to provide legal security for economic transactions in rural Mexico. The main pillar of the new law is the reform of article 27, which makes significant changes in the governance of property rights and in the way transactions may be carried out.

The most important features of this reform are the abolition of the practice of granting land to peasant groups upon request; members of an *ejido* or a community (other land under common ownership, which was not established by, but was recognized under, the old law) may decide in their respective assemblies to dissolve their association and give individual property rights to their members, or to associate themselves with private corporations; such corporations are now allowed to own rural real estate. The aim of these measures is to generalize the institution of private property and thus to create an active rural land market.

According to the FAO study, the results so far have been more than disappointing. The report does little to shed any light on the reasons for this. A mechanism to carry out the privatization of former social property was set up through the establishment of the Programme for the Certification of *ejido* Rights and the Titling of Urban Plots, known by its Spanish acronym, PROCEDE (Programa de Certificación de Derechos Ejidales y Titulación de Solares Urbanos). The programme aims to control and legalize the process of titling land under communal ownership.

As of October 1993, PROCEDE had carried out negotiations with 17,731 peasant agencies representing *ejido* and other communal ownership interests. Of those, almost 9,700 (i.e., somewhat under

55%) had responded favourably to the privatization plan. The next step was the surveying of the land by the National Institute of Statistics, Geography and Informatics (INEGI). Then, the respective community assemblies were to convene to negotiate the final demarcation. Apparently, only around 200 *ejidos* (out of a total of almost 30 000), representing just over 1% of the total area under the social-ownership regime, had completed the procedure by the end of 1993.

This obviously falls short of the expectations of the policy-makers who drafted the new legislation. The FAO study concludes that this outcome demonstrates that "land for the peasant has a meaning other than simply that of a commodity" (FAO, 1995b, p. 207), and that the basic flaw of PROCEDE was to assume that "rural society yearned to bedeck itself with the trappings of private property in the 'modern' fashion" (FAO, 1995b, p. 207). The reasoning behind this conclusion is not easy to follow, considering that more than half of the communities under communal ownership agreed to privatize. Curiously, on the same page, the report states that during discussions on the merits of privatization, the peasants often cited the need to be clear about who owns what so that conflicts with neighbours and family can be avoided.

Keeping in mind that privatizing formerly socialized property is always a daunting task, the time that has elapsed since the reform of article 27 in 1992 seems too short to make a final judgement on how much legal security it provides. It is also not clear how formidable the bureaucratic hurdles and their associated transaction costs are. Another probably relevant consideration is the tendency of some social institutions that have been in existence as long as the Mexican *ejido* system to linger on even though they may be inefficient. It is therefore difficult to determine why land markets in Mexico are by and large still inactive.

## VI

### Conclusion

Solving the problem of the highly skewed structure of land tenure in Latin America is an inherently complicated task. Past reform efforts have been weighed down by a great deal of ideological baggage, misconceptions about the economic realities of the rural setting, and a lack of supporting measures. After un-

satisfactory experiences with the institution of redistributive land reforms by decree, Governments are now looking to land-market reform as a solution.

Whether the analysis concentrates on sales or rental markets, one point should be clear. Markets, as mechanisms for transactions in property rights, cannot

exist without the prior establishment of these rights. It is not suggested here that the institution of private property rights in the form of freehold ownership –the “right to use and abuse” (*jus utendi et abutendi*)–, is the first-best solution at all times and in all places. This will depend on the particular circumstances of a society or community and the stage of development they have reached. However, in a region where it is not unusual to find 50% of rural households operating on untitled land, and considering the external effects and associated inefficiencies of this state of affairs, the potential benefits of clearly defined property rights are obviously substantial. What seems crucial is that Governments provide the framework within which institutions may emerge and adapt according to the conditions of a changing economic environment.

It should be borne in mind, however, that the transaction-cost/institutional-economics approach presented here suggests that, depending on the circumstances, agricultural institutions of a non-market type may also make economic sense. In one particular environment, formalized markets for land may help shift resources to the peasant producer, while in others, non-market configurations will be the most suitable poverty-reduction mechanism.

The development of landownership patterns leading to a more efficient distribution of holdings thus depends on existing social institutions. These differ between countries, regional societies and rural communities. They result from and at the same time determine a society’s history, culture and religious beliefs. In addition, climatic and geographical conditions play their role.

It should be obvious that the evolution of these institutions is a long-drawn-out process. They cannot be altered overnight by conscious endeavour. There is no such thing as “institutional engineering”.

A slow, evolutionary transformation of land-tenure patterns does seem to have begun in Latin America, however. Not everywhere does the old *latifundio-minifundio* dichotomy still characterize rural relations. Thiesenhusen observes that: “... the most noteworthy change that has occurred in the land tenure system of the region in the last several decades is not redistributive land reform but the emergence of a growing (but still quite small when compared to farmland in *latifundio*) commercial and entrepreneurial sector made up primarily of well-managed and highly productive middle-sized and large farms” (quoted in Dorner, 1991, p. 62).

It has been pointed out that the State may frequently protect property-rights institutions which are socially inefficient in order to maintain its own support structures (Bardhan (ed.), 1989) but an enlightened administration can undoubtedly help in creating the conditions that (agrarian) institutions need in order to evolve and adapt.

Development is an evolutionary process. Public policies may stand in the way by, for example, prohibiting useful institutional devices such as sharecropping. An operational market system also depends on the surrounding social and legal infrastructure. It is here that an active role for the State can be found in helping societies to proceed through the stages of development up to a point where markets, including those for land, can perform their allocative and distributive functions.

(Original: English)

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