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**LAND TRANSFERS AND THE ROLE
OF LAND BANKS IN RURAL DEVELOPMENT**

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Land ownership and property rights are the foundations of most societies. In rural Latin America and the Caribbean, land is the fundamental factor of production, the principal means of employment, and a primary source of wealth, income, and political power. Rapid population growth and technological advances are strongly influencing the demand for agricultural land, contributing to significant changes in land ownership and land use.

Changes in land ownership and tenure patterns mean changes in farm operations, land use, and production structures which directly affect the agricultural sector's overall performance. The nature and pattern of land ownership attract widespread interest because of the widely recognized relationship between property institutions and agricultural productivity, and because of the fundamental importance of agriculture to developing countries.

This interest is often expressed in new property laws, tenure reforms, and land-related development programs. Nineteen Latin and Caribbean countries passed agrarian reform laws after signing the Charter at Punta del Este which established the Alliance for Progress in 1961. Since then, governments and international agencies have spent hundreds of millions of dollars addressing persistently difficult land tenure issues. They concentrated their initial efforts on land reform, land settlement, and colonization programs, an interest which continues to be significant. U.S. foreign aid obligations for land reform and related programs worldwide totalled \$3.9 billion between 1978 and 1983 (Montgomery, 1984 p. 3).

Despite these efforts, many goals remain unrealized. Agricultural census figures demonstrate that most Latin and Caribbean countries are still characterized by growing unemployment in the rural labor force, food consumption which outpaces food production in some countries, and a high concentration of land holdings. Other research indicates that income distributions have worsened (Ahluwalia, et. al. 1979; Thiesenhusen, 1983).

The purpose of this paper is to review how land ownership patterns, land policies, and property institutions affect farmland transfers in Latin America and the Caribbean. Since many of the reform programs fell short of their goal of redistribution of land for more productive use, attention has increasingly focused on the distributive processes inherent in the land tenure structure and the nature of farmland transfers. (Land transfers include selling, renting, leasing, and bequeathing property and land use rights, fundamental characteristics of private property systems.) These land transfers are controlled and influenced through both informal customary arrangements and formal legal structures. An important aim of this study is to examine the ways these customs and their manifestations as rules, policies, and laws affect land transfers and land markets.

The paper also explores the potential for using farmland financing programs to promote rural development in Latin America and the Caribbean through interventions in the land transfer process. Farmland financing programs are important economic policy components of industrialized countries and mortgage financing has existed in several of them for over a century. This paper reviews the various reasons why governments of so many industrialized countries turn to these programs either to solve a land market problem or to treat the consequences of those problems. It extrapolates from those

experiences to explore the potential use of similar programs for the promotion of more efficient resource use and more equitable land distribution in Latin American and Caribbean countries.

OVERVIEW

In the 1960s and early 1970s, literature on land tenure focused on how inequitable land distribution created serious economic and social problems for developing countries. A number of researchers clearly and persuasively demonstrated the economic, political, and social rationale for agrarian reform (Barraclough and Domike, 1966; Penn, 1961; Raup, 1967; Long, 1961; Carroll, 1961; Dorner, 1972; Dorner and Kanel, 1971; Thiesenhusen and Brown, 1967). It is now generally accepted as axiomatic that highly concentrated land ownership limits economic growth by curtailing efficient labor use, by inhibiting effective land utilization and by promoting skewed income distribution. Furthermore, social and political instability results when governments ignore the rural landless and land-poor for too long a period (Nye, 1984).

At the same time, a body of thoughtful research warns that choosing one type of tenure pattern as optimal simply because it has worked well in some countries at some times is most likely a mistake (Dorner and Kanel, 1971; Hayami and Ruttan, 1971). One recent work argues that because social, economic and property institutions vary widely not only between countries, but also within countries, property systems should be adapted to the endowments and resource constraints facing particular rural communities (Runge, 1986). Effective interventions in tenure systems may depend on an understanding of the bundle of rights associated with land use and land transfers. The bundle of rights may be thought of as the right to sell, use, lease, mortgage, give away, or not to use land.

As in most North American and European property systems, in Latin American and Caribbean countries land ownership and land use rights may be transferred under certain circumstances. But these transfer rights are neither absolute nor unitary. They are regulated by social systems and legal structures--the bundle of rights. Private landowners normally have the right to sell their properties to other individuals or groups. But, since these rights vary from country to country, and internal to countries, it is prudent to carefully trace out to whom various strands in the bundle of rights belong. Such analyses reveal, for example, that in Ecuador, small parcel owners must obtain government authorization before selling their land, even when they have clear title. In St. Lucia, traditional inheritance practices provide each heir a share of the undivided farm, a custom which greatly complicates the land market mechanism since all heirs must agree before a land transaction can occur. Other examples include land reform laws which establish size limits on holdings, and tenancy reforms which provide sharecroppers and landless laborers with land rights through either direct ownership or long-term leases.

Land Transfers: The U.S. Experience

The political ideas of equality, democracy, and human rights which emerged during the 18th and 19th centuries, to which Mill, Jefferson, and Locke importantly contributed, form the conceptual foundation of the bundle of rights for our private property system. In a system where rights are equal, each member of society has the right to own land.

The economic concepts developed during this period theorized that with private property rights, social efficiency would be maximized by the free play of market forces. During the early development of the American frontier, this

political/economic philosophy proved to be quite practical. At the same time, many of the early classical economists, including Ricardo and Malthus, recognized that a free market system could lead to market distortions such as monopoly ownership of land (Platteau, 1983).

Today, the concept of a free market economy is still characterized by private asset ownership with a competitive enterprise system which depends on a market structure and price signals. This model minimizes the role of government and public intervention in economic affairs. Contemporary neoclassical economists treat land as simply another factor of production, like any other commodity. As Scitovsky notes in Competition and Welfare, "There is no logical reason for treating land as a separate factor because, from the economist's point of view, it is similar in all essentials to produced factors."

Although the competitive market paradigm offers key insights into efficient resource allocation mechanisms, the experience of most countries with market economies has led to diverse public policy and program interventions over the years to modify free market operations in property. In the United States, property rights are constitutionally constrained by four specific government powers: eminent domain; taxation; police powers; and, escheat. In addition, federal programs and public policies specifically aimed at guiding the pattern of land use have been common.

At first, the U.S. federal government made use of land-related policies to develop and settle large regions occupied by indigenous populations. Between 1781 and 1867, it either purchased or took possession of 1.3 billion acres, and over roughly the same period (until about 1890), granted or sold 1.1 billion. The policy debate concerning the disposition of these public lands focused on two issues: whether it was legal to give land away, and the value

of land sales as compared to land taxes as a revenue source. Prior to the Civil War, southern state legislators argued that it was unconstitutional to give away land because land grants to some were unfair to those who had already purchased land. It has been suggested that their real fear was that small family farms would undermine the plantation system which depended on slave labor (Strong, 1932). The Free Soil Democrats argued that the government, as trustee of all lands, had no right to sell those lands. Others noted that land sales were slow and cumbersome and land should be given away so that it could provide an annual tax source (Hibbard, 1924).

Around 1900, the concessional land transfers slowed and the government's role shifted to one of land management. Attention turned to preserving permanently the remaining government lands for national forests and parks. Later, public lands became important for private sector activities like grazing and logging. There are presently 112 land-related programs administered by 23 Federal departments and agencies (Boxley, 1979). The most recent developments in government land use policies affecting agricultural property rights are aimed at soil conservation, farmland preservation, water quality maintenance, and wetlands protection.

The Development of the U.S. Federal Land Banks

Government land-financing programs designed specifically to facilitate transfers have been an important intervention in the land markets of the U.S. and other industrialized countries. When the Federal Reserve Banking System was established in 1914, the farm states mounted political pressure to address the special banking needs of agriculture, especially the need for mortgage financing. With the land grants and government land sales ending, tenants, young farmers, and those who wished to add to their farms, needed relatively

large sums of money for land purchases. Most banks were organized to serve the rapidly growing industrial sectors and the banking "machinery" was not appropriate for farm real estate loans. Commercial banks could not afford to tie up their capital, raised mostly through short-term deposits, in the type of long-term loans required for buying farmland.

To address agriculture's special needs, the U.S. government found its example in Europe. Three Presidential commissions went to Europe to study farmland financing mechanisms between 1900 and 1914, and in 1916, a national farmland mortgage system, the Federal Land Banks, was established. Signing the bill into law, President Wilson noted (Hoag, 1976), "Farmers, it seems to me, have occupied, hitherto, a singular position of disadvantage. They have not had the same freedom to get credit on their real estate as others have had who are in manufacturing and commercial enterprises and, while they have sustained our life, they did not in the same degree with some others, share in the benefits of that life."

Besides the U.S., Canada, Australia, New Zealand, Spain, India, Sri Lanka, Japan, Taiwan, Ireland, France, Germany, Switzerland, Denmark, Sweden, England, and many other countries have farmland mortgage systems. In Europe, land banks date back to 1763. Unlike commercial banks, which depend on savings deposits for their funds, these institutions issue longer-term mortgage bonds and other securities, or they receive capital resources from the government. The securities are backed by the first lien on the properties purchased by the borrowers.

In their detail, these land financing institutions differ greatly from one country to another. Individual organizational structures have evolved over time in response to changing circumstances. They have developed a variety of specialized functions and organizational forms. Some are privately owned,

while some are joint-stock operations, others are cooperatives, and still others are state-owned public corporations. All receive special privileges from their governments such as tax exemptions or guarantees for the bonds they issue. Financing is often arranged through share capital and deposits as well as long-term securities. Many have established specialized departments for examining titles and appraising the land which becomes the ultimate security for bondholders.

This broad approach to land financing has never been attempted in Latin America. Small, local efforts are underway in some Latin and Caribbean countries, but the idea has never materialized as a public policy issue. In the past few years, however, Guatemala, Honduras, St. Lucia, Brazil and Ecuador have considered experimenting with land financing programs on a pilot basis. The variety and complexity of the institutional arrangements affecting land transfers in these countries should provide useful insights into the possibility of implementing such programs for development purposes. First, a discussion of the theoretical concepts underlying these programs provides a context for comparing these examples.

LAND MARKETS AND LAND TRANSFERS

Economic theory suggests that several general conditions are necessary before a perfectly competitive market can allocate land resources to their optimal use. First, a substantial number of buyers and sellers is needed so that no single land purchase influences the price of land. With a large number of buyers and sellers in the market, each recognizes that he/she has no influence on price. That is, an individual's demand for or supply of land may increase or decrease without affecting land prices.

Second, homogeneous land units are needed to insure that buyers and sellers are indifferent as to whom they buy from or sell to. Further, customary and institutional rules should not effect the distribution of land resources among prospective buyers. Land should be sold to the highest bidder.

Third, both buyers and sellers require easy and equal access to information about current land transactions including prices and bids. This condition insures that there are no uninformed buyers and sellers are unable to obtain a bid above the prevailing market price.

Finally, complete freedom of entry and exit from the land market for both buyers and sellers is another requirement for perfect competition. No potential buyer is excluded from the land market because of cost or effort. Land resources can move easily and freely into uses which are in great demand. This unimpeded flow of resources allows alternative uses of land so that inefficient land users are replaced by efficient ones.

These conditions do not actually exist for a land market in any country. Land is clearly heterogeneous; individual buyers and sellers can influence price; institutional and customary factors do affect land transfers; perfect information for all market participants is unattainable; and barriers to entry do exist. Clearly, therefore, land markets are imperfect everywhere and they are more distorted in less developed countries than in industrialized ones.

In fact, agricultural land may be categorized according to location, fertility, and ownership structure--each classification representing a submarket with special features facing individual buyers and sellers. For example, an obvious submarket is defined by the traditional latifundio-minifundio system, with various competitive market features existing within the minifundio sector and within the latifundio sector. Another may be

found within colonization projects where land distributions provide for similarly sized family farm units. Other types of market imperfections result from nonpecuniary preferences such as social and cultural factors. A major problem for policymakers in any one country is the need to understand what imperfections exist before designing programs and policies to improve access to land.

Land Market Imperfections

At present, several problems appear to be constraining efficient farmland market operations in Latin American and the Caribbean. The most obvious is the highly concentrated land ownership pattern found in many countries which results in land price distortions; inhibits the formation of new, more efficient farms; and causes the inefficient use of capital and labor resources. Several Asian countries including Japan, Taiwan and South Korea, have successfully addressed this problem with land reforms. Despite many efforts and some good intentions, this approach to breaking up traditional landownership patterns has not succeeded in Latin and Caribbean countries.

A second problem is that the majority of landless and land-poor do not have access to the financial resources required to convert an economic desire into effective demand. This lack of resources severely restricts land market entry and limits their bargaining power, eliminating the poor majority of the rural population from participation in the land market. The most common and effective intervention for this problem in industrialized countries has been the provision of long-term financing for farmland purchases to improve the access of young and landless farmers to establish themselves or to obtain enough land to become full-time commercial farmers.

Tenure insecurity also impedes land transactions. Some estimates suggest that overall about half of the rural properties in Ecuador have no registered titles. The proportion is higher in much of Central America. Without title, sellers must undervalue their properties to sell them because new owners will also lack title and hence be unable to obtain production credit from most institutional lenders (Feder, 1986). In other cases, owners will underutilize their land, but not sell it because without negotiable title, they can not expect to get much for it. Titling projects are aimed at correcting this problem.

A fourth constraint is the complex, expensive, and excessively bureaucratic nature of the land transfer process in most countries. To obtain and register a legal title or deed both buyer and seller are subjected to a series of time-consuming and expensive hurdles. In Ecuador, all agricultural land transactions must be authorized by the Director of Instituto Ecuatoriano de Reforma Agraria y Colonizacion (IERAC), the agrarian reform institute. In Honduras, this type of authorization is necessary for all land parcels of less than 17 hectares--and properties of less than 5 contiguous hectares cannot be titled at all unless coffee is present.

Fiscal policies such as land transfer taxes and capital gains taxes also inhibit transactions. In Ecuador, the capital gains tax on land sales has never been adjusted for inflation, so that even very small transactions can mean a tax of 25 to 30% of the declared sales price. Taxes on land sales in Ecuador also include a straight transfer tax, a national defense tax, a potable water tax, a provincial tax, and various stamp taxes, as well as lawyers which buyers and sellers must. As a result most purchasers agree to one "real" price for the transaction and another "declared price" for the taxes, although in some cases the transactions are simply not reported.

In many Caribbean countries, all heirs traditionally receive a share of the undivided farm, which continues to operate as a single unit. About one-third of the titles currently being issued by the new land titling project in St. Lucia are for family lands with an average of six owners per property. While this custom avoids the subdivision small parcels, it limits the negotiability of the land because the signatures of all co-owners are required for a transaction to occur.

Finally, the land market is imperfect because people hold land for reasons other than its productive commercial value. For example, people hold land for capital gains, as an inflation hedge, as an asset, or savings, or simply for home consumption purposes. In some cases, owners find it difficult to part with land which has been in their family for generations. Many cultures place special emphasis on land.

This variety of market imperfections highlights the need to understand how land markets operate on a local level before attempting to intervene. The following section reviews the ways land financing programs are addressing some of these imperfections.

THE ROLE OF LAND-FINANCING PROGRAMS

While no substitute for land reform, establishing a land financing system may represent a viable institutional mechanism to assist some landless in overcoming difficulties caused by land market deficiencies. However, it is obvious that credit policies and institutional problems in capital and financial markets (as well as labor markets), which inhibit borrowing and savings, will greatly complicate the process.

Providing agricultural production credit to small farmers is one of the more common methods used by developing countries for promoting agricultural development. Supported by large loans from foreign-aid donors, many Latin American and Caribbean countries design their agricultural sector policies around the belief that agricultural production credit is an effective way of increasing food production, improving employment opportunities, easing rural poverty, and integrating poor farm households into the mainstream of economic activity (Colyer and Jimenez, 1971; Donald, 1976). The problems associated with these credit programs are well documented. A recent paper summarizing the implications of these problems outlines the changing emphasis in policies which affect rural financial markets (Gonzalez-Vega, 1986).

While the purpose of a land financing program is different from that of agricultural credit, research on production credit systems provides valuable insights. Empirical studies of credit delivery mechanisms in Africa and Asia, as well as Latin America, demonstrate a variety of institutional problems which help explain why poor, small farmers have either avoided or been unable to participate in government-sponsored credit programs. One of these reasons is that rural financial barriers exist in the form of an inadequate rural infrastructure and public policies which emphasize the growth of the industrial sector, i.e., the urban-bias argument (Lipton, 1976). Gonzalez-Vega (1976) points to a second problem, suggesting that supply allocation bottlenecks are caused by concessionary interest rates. Formal lenders are forced to grant a small number of large loans rather than numerous small loans because of high lender transaction costs. Differences in borrowing costs among various lenders also affect credit choice and can limit the demand for formal credit programs with high transactions costs. Thus, high borrowing costs discourage the rural poor from using formal credit programs (Adams and Nehman, 1979). Finally, poor

farmers may not participate because they do not have any potential investment opportunities which merit credit use (Schultz, 1964). Together, these issues suggest that understanding why small farmers are unable to participate more fully in credit markets is crucial to the success of a land financing program.

The kind of land purchase program to be established depends on local institutions, resource constraints, and agricultural policies, as well as the primary goals of the program. The programs currently being considered or implemented in Latin America are attempting to address the following situations:

1. Small property owners who wish to consolidate their existing holding by purchasing a contiguous parcel, or one located in the same vicinity.
2. Landless farm workers or tenant farmers who wish to obtain land to begin farming under secure tenure status on a full-time basis.
3. Family members who wish to buy out other members when they have received a parcel through inheritance. Financing could help owner-operators avoid unnecessary subdivision, reduce conflict and increase their tenure security.
4. Groups and cooperatives who wish to purchase a hacienda, plantation, or estate either to work as a group or to subdivide the property into family-sized, commercially viable farm units.

Country Examples

At present there are at least two successful examples of small private development foundations which are providing funds for land purchases by groups of campesinos. One is the Penny Foundation in Guatemala and the other is the Fondo Ecuatoriano Populorum Progressio (FEPP) in Ecuador. The basic aim of these two projects is to provide land to landless campesinos.

Ecuador

The project managed by FEPP is the only organized land purchase program in that country. In the mid-1970s, FEPP established a rotating credit fund for land purchases. Since 1977, FEPP has made 19 loans to campesino groups to finance the purchase of haciendas. In most cases, the groups consist of from 20 to 40 former workers from the hacienda. Loan installments are programmed to coincide with the type of economic activity practiced on the new farm and, thus far, FEPP has had no problems with late payments. They require a minimum down payment of 10%, but most groups have paid more. One group made a down payment of 40% of the total purchase price. FEPP allows up to 12 years for repayment but some groups have repaid in less time. The interest rates on these loans have risen from 9% in 1977, to 12% in 1982 and more recently to 16%, about 5% lower than interest rates on commercial loans. The foundation also requires that the group maintain responsibility for repayment by individual members.

FEPP officials have learned that assisting the groups in their purchase price negotiations is very important. In their excitement about obtaining land, the campesinos are too willing to agree to the seller's first price, or as one FEPP official suggested, they lack experience in the process and are hesitant to counter an offer for fear of losing the land. Presently, FEPP's biggest problem is that more groups want land than their fund allows. While the foundation averages about four farm loan applications per month, they have only been able to finance about two sales each year because of their limited funds.

Guatemala

The Penny Foundation established a land-financing program in Guatemala with funds from the Agency for International Development. In 1984-85, the first year of operation, the Penny Foundation financed eight purchases of

haciendas throughout the country. Over 450 families are now farming 1,000 hectares as a result of that program. The Foundation's staff finds large farms offered for sale, subdivides these farms into family units, and then resales these smaller units to eligible families from the community. Farm operations on the properties financed by the Penny Foundation range from traditional subsistence crops to export crops for the U.S. market.

One of the interesting features of the Penny Foundation program is the nature of the loan arrangements. The Foundation acts as broker for both the negotiations and the financial aspects of the land sale. Sellers handle the transaction with the foundation directly, and not with the group of buyers, i.e., the Penny Foundation is the real purchaser of the property. It will pay a potential seller up to 50% of the total agreed price as down payment and pay the balance over a five-year period. The buyers in turn pay the Penny Foundation a minimum down payment of between 1 to 10% and then, depending on the type of farm operations and enterprises, pay the remaining balance over several years. The advantage of this approach is that sellers apparently have more confidence in the transaction when the Penny Foundation acts as guarantor of the loan balance. The disadvantage is that the funds available for farmland purchases are quickly drained when large down payments are made.

Another important feature of both the Penny Foundation and the FEPP programs is that the groups buying the land also receive production credit and technical assistance from the foundations, a service which may be necessary to the successful operation of the new farm and, consequently, the ability of that farm to repay the land loan. This assistance would be harder to provide if loans are channeled through large banks or cooperatives which lack experience with agricultural loans.

Brazil

Another approach to land financing is under design with World Bank assistance in the State of Piaui, in northeast Brazil. The World Bank's strategy is to establish a regional land agency which purchases farms on the market, and redistributes them to landless farmers and the land poor. In addition to providing access to land, this project attempts to help consolidate small land units into commercially-sized farms.

The land agency's role is to coordinate the financial mechanism with local rural banks to purchase land, restructure it and then resell it to the landless. This role is significantly different from that of the foundations described above. The Piaui Land Agency is responsible for land acquisitions, capital improvements, redistribution and social and economic infrastructure (such as feeder roads, water supply, health and education facilities). This approach is much broader than that of the most industrialized countries.

The designers of this project, recognizing that land reform on a national scale is probably politically unacceptable in Brazil, sought an alternative program for correcting the skewed land distribution. The experiences of this approach toward land tenure problems should provide valuable lessons for future programs in other parts of Latin America. Unfortunately no evaluation or research has been published to date on the Piaui Land Agency.

St. Lucia

The St. Lucian government has proposed a land-financing program to address the problems of multiple owners or, family lands, in that island-nation. To date, the government has been unable to find funding for the project. About 30% of the agricultural lands in St. Lucia have multiple

owners. The primary purpose of the St. Lucian land financing program is to allow one co-owner to become sole owner by "buying out" the other co-owners.

The reason for this effort is that most research on the relationship between family land and agricultural production suggests negative consequences. Bruce (1983) summarizes the main points:

1. The holding of family land is rendered insecure by the extra-legal nature of the arrangements among co-owners. There is no fear of major dispossessions, but rather a battle of attrition over house sites, uncertainty as to boundaries, and disputes over the rights of co-owners not in possession to share the crops. This last problem is primarily confined to tree crops.
2. Family landholdings are largely unmarketable. While family land tenure does not contribute to the creation of subdivision, it may help to perpetuate it. The unmarketability of family land reduces the possibilities for consolidation via the land market.
3. Because family land is unmarketable, it generally cannot be used to secure loans. It is one among several obstacles to lending to small farmers for major investments.

The land-financing mechanism proposed by the St. Lucian government is similar in some ways to the Penny Foundation Program in Guatemala. The lending agency would be the St. Lucian Development Bank (SLDB), a public institution. The SLDB would handle two separate transactions: one with the buyer and the other with the seller. The SLDB would pay the seller up to 30% in cash and then provide the seller with a one to three-year "frozen" certificate of deposit. The buyer would be required to pay the SLDB a minimum down payment of 10%; the balance would be paid over several years, depending on the type of farm operation. The government would also encourage co-owners to sell family lands, by offering them first option to purchase public lands (known as crown lands).

SPECIAL ISSUES

The Availability of Funds

The conception, design and implementation of land-financing programs have led to three special concerns: the availability of funds for the project, the appraisal procedures, and the land policies which affect land transfers. In the U.S., a well-developed capital market allows the Federal Land Banks to raise the cash necessary to finance farmland transactions. The Federal Land Banks issue large denomination bonds which are purchased by institutional investors such as commercial banks and insurance companies. The U.S. government does not guarantee the bonds but it does allow commercial banks to lower their reserve requirements by the dollar amount they are holding in Federal Land Bank bonds. These bonds are competitive, offering an interest rate one-half percent higher than Treasury bonds.

This option for obtaining funds for land financing is usually not available in less-developed countries. Lending institutions which must depend on depositors and international donors quickly deplete their funds with the first few land purchases and then are forced to wait until those funds are replaced by the borrowers. This problem will require a great deal of attention over the next several years.

Land Appraisals

A second issue in the development of land financing projects is the appraisal process. Assessing the value of a farm property and its repayment capacity is a critical step and one of the major responsibilities of the lender in determining whether a loan should be approved. The interest rate, length of the loan, the down payment and scheduling of repayments all affect the amount

of income required to service a given debt. Two appraisal methods are commonly used to value a property: comparable sales and income capitalization.

Finding the market price of recent farmland purchases constitutes the comparable sales approach to land appraisals. The comparable sales method has limited utility in Latin America because it may often lead to price distortions relative to the land's repayment capacity. For instance, the proximity to an urban center may cause land prices to be inflated for reasons having nothing to do with agriculture. Also, in much of this region, sales prices generally are under-reported to evade taxes. Consequently, it will be necessary to use income capitalization method to appraise the land values and determine whether a loan can be approved.

In the income capitalization approach, an estimate of operational and input costs is subtracted from the estimated gross income generated by the parcel to yield the net return for that piece of property. The return to land is then capitalized. Estimating the annual net return of a farm property is a difficult procedure. Product markets and prices, rainfall and plant diseases are all only partly predictable. Food prices do not necessarily move at the same rate as other price indexes. Production expenses should include the opportunity cost of the farm household's labor that will be employed in the land to be bought.

While the overall farm operation may be profitable enough to provide an adequate household income, if the land purchase price is high the borrower may not be able to service the land debt as well. In this case, the lending bank may choose to rely on other income, including profits from other land holdings. To guard against the use of land-financing funds by speculators, the lender should never approve purchases where the land's repayment capacity is insufficient even after payment to household labor is excluded.

THE EFFECTS OF LAND POLICIES: THE CASE OF ECUADOR

An overview of the land transfer process in Ecuador helps demonstrate how a country's land policies can complicate development of a land-financing program. Ecuador provides a good example since the transfer of rural properties there can be complex, cumbersome, and expensive in terms of both money and time. A simple land transaction requires the buyer and seller to deal with a number of public and private institutions and to pay a minimum of about 8% of the sales price in transfer taxes in addition to a capital gains tax. If the seller is subdividing a parcel, or if the seller does not have a title to the property, the process is even more complicated and expensive.

In Ecuador, property titles are contracts prepared either by the Agrarian Reform Institute (IERAC) or by private lawyers and formalized by notaries. Since all notaries are lawyers, the contract is often drafted and formalized by the same person. The contracts become titles when they are registered at the canton land registry office, which operates under the supervision of the court system. The two fundamental problems in the transfer process are the need to obtain IERAC's authorization and the capital gains tax.

The Agrarian Reform Law and subsequent revisions and amendments stipulate the conditions under which rural property may change owners. There are specific rules for most land transactions, and IERAC has a department dedicated solely to scrutinizing and authorizing rural land sales.

In general, a title transfer cannot proceed without IERAC's approval in the following cases:

1. The transfer of a small parcel, or minifundio as described in Article 66 of the Agrarian Reform Law (which unfortunately does not define this term uniformly--for example by area, by soil type, or by location).
2. A subdivision (i.e., sale of part) of an agricultural property (Article 107 of the law and Article 69 of the reglamento);

3. The sale of any parcel which the seller previously obtained from IERAC (Article 111 of the law).
4. A sale to change the land use from traditional farming or grazing to, for instance, a subdivision for housing, or specialized agricultural uses such as the cultivation of flowers, truck farming (vegetable), or beekeeping.

On the other hand, IERAC's authorization is not required when the owner of a contiguous farm purchases a minifundio or when a co-property owner buys out the other owners, as in the case of inheritance (Decreto 3783, Article 1). As a result of these laws, IERAC reviews a large number of proposed title transfers each month, from all over the country. This poses a number of problems. For example, the definition of minifundio is vague. (Since it is not defined by size, many lawyers use an eight hectare limit as a guide in advising clients. In another context, the Agrarian Reform Law mentions eight hectares as a base for certain actions; see Articles 49 and 60 of the Law and Article 89 of the Reglamento.) Most of the farms fall within this limit. The 1974 Agricultural Census indicated that as many as two-thirds of the farms (347,000) had less than five hectares. In any case, regardless of size, buyers who want to be sure their titles are legal obtain IERAC'S authorization.

In addition, the seller of a minifundio must offer all holders of contiguous farms the right to purchase the property. IERAC is supposed to intervene to determine whether that has been done and whether the offer was fair. Since IERAC may cause delays of 6 months or more even after the buyer and seller have obtained all the necessary documentation, and may still reject the transfer, many informal transactions occur.

The other issue, the capital gains tax, is still more problematic. Even when buyer and seller decide to go through the legal steps to transfer land, they usually do not declare the real sales price. In this way, they evade part

of the capital gains and transfer taxes, and considerably undervalue the land tax assessment. As discussed earlier, the capital gains tax on land sales is particularly high because the rate set in the early 1970s has never been adjusted for inflation. Any modification of this rate would require a major effort at tax reform.

Table 1

Ecuador Capital Gains Tax for Land Transactions

<u>Capital Gains</u> (sucres ^a)		<u>Tax</u> (sucres)	
<u>From</u>	<u>To</u>		
0	10,000		10%
10,000	20,000	1,000 + 14% over	10,000
20,000	50,000	2,400 + 18% over	20,000
50,000	100,000	7,800 + 22% over	50,000
100,000	150,000	18,800 + 26% over	100,000
150,000	200,000	31,800 + 30% over	150,000
200,000	500,000	46,800 + 34% over	200,000
500,000	1,000,000	148,000 + 38% over	500,000
1,000,000		338,000 + 42% over	1,000,000

Source: DINAC

^a In November 1986 one U.S. dollar equalled 180 sucres, in November 1987, one U.S. dollar equalled 265 sucres.

The following example of the title transfer process for a 3 ha. parcel helps to illustrate the types of problems encountered by buyers and sellers of farmland in Ecuador.

1. The buyer and seller agree upon a price and the payment terms.
2. A petition, signed by both buyer and seller, is presented to IERAC, describing the location of the property and requesting IERAC's authorization for the land transfer. The petition must be accompanied by:
 - a. A map of the property;
 - b. A copy of the title (i.e., the contract by which the seller acquired the property), as recorded at the canton registry;
 - c. A certificate from the land registry in the canton verifying that the property is clear of liens;
 - d. A declaration of the contiguous property owners that they do not want the parcel;
 - e. Personal identification numbers of the buyer and seller.
3. The petition first goes to the Records Department in IERAC, and then to a review by the IERAC Department of Land Sales Authorizations. If all the papers are in order, the petition is sent to the Director in Quito for a decision and signature. If not, the documents are returned to the petitioner for modifications and the process begins again. If the Director approves the sale, the petition goes back to the Records Department and then to the petitioners, who include this approval with the documents presented to the cantonal property registry.
4. The buyer and seller hire a lawyer, usually an authorized notary, to write a contract. If the contract is drafted by a lawyer who is not a notary, the contract must be formalized before a notary. In either case, the notary advises the parties of taxes due at this point. The estimated taxes for the transfer of a 3 ha. plot of land with total declared sales price of 60,000 sucres would be 11,012 sucres, or 18.4% of the declared sales price. These taxes include:

Taxes	Sucres
Transfer tax	2,250
National defense tax	360
Potable water tax	660
Provincial tax	660
Stamps	602
Capital gains tax (based on \$40,000)	4,200
First year's land tax	780
Estimated legal and registry fees	<u>1,500</u>
Total Direct Costs	11,012

The net charges might be somewhat lower if the seller can deduct the capital gains taxes on his/her personal income tax return. Also, a person buying a contiguous property to enlarge a minifundio is exempt from the transfer taxes.

5. The contract becomes a title, valid against other claimants, when it is taken to and legally entered into the canton property register.
6. In addition to the taxes, the buyer must also pay the notary and the land registry a fee for their services.

When a subdivision of a property is involved, the petition to IERAC must also include the following additional documents (Article 69 of the Reglamento):

1. Proof that the subdivision will not create a minifundio as defined in Article 66 of the Law.
2. Proof that the productivity of the parcel will not drop as a result of the subdivision.
3. A farm plan demonstrating that the parcel will be profitable when cultivating the traditional crops from that zone.

Tables 2 shows the land transfer tax schedule and Table 3 the Land Tax on rural properties.

Table 2

Ecuador Land Transfer Tax

<u>Sales Price (sucres^a)</u>		<u>Transfer Tax</u> ^b
<u>From</u>	<u>To</u>	<u>sucres</u>
0	5,000	2%
5,001	10,000	100 + 3% over 5,000
over 10,000		250 for the first 10,000 plus 4% of price over 10,000.

^aIn November 1986 one U.S. dollar equaled 180 sucres; in November 1987 one U.S. dollar equaled 265 sucres.

^bThere is a separate transfer tax of 1 sucre per thousand at a later stage in the legal process.

Source: DINAC

Table 3

Annual Land Tax on Rural Properties in Ecuador

<u>Land Value</u> (sucres)		<u>Tax</u> (sucres)
<u>From</u>	<u>To</u>	
0	10,000	6 per thousand
10,001	30,000	60 - 7 per thousand
30,001	60,000	300 - 8 per thousand
60,001	100,000	440 - 9 per thousand
100,001	200,000	800 - 10 per thousand
200,001	300,000	1,300 - 11 per thousand
300,001	400,000	2,900 - 12 per thousand
400,001	600,000	4,100 - 13 per thousand
600,001	1,000,000	6,700 - 14 per thousand
1,000,001	3,000,000	12,300 - 15 per thousand
3,000,001	-	42,300 - 16 per thousand

Source: DINAC

Conclusions

The importance of land ownership to rural development efforts is well established as are the problems associated with the highly skewed land distribution in Latin America and the Caribbean. Major agrarian reforms are needed to address these problems, but it is unlikely that they will take place given the experiences of the past 25 years. Although limited in scope, farmland financing systems may provide a viable mechanism for providing access to land for the landless and for encouraging more efficient resource use in the agricultural sector.

Most economic activities in the rural sector are affected by land tenure and property rights issues, including land markets. Yet little information is available on how land markets operate and on how policy and institutional constraints shape them. To understand the potential for policy and program interventions, we need a better understanding of the nature and scope of land markets, especially at the local level. We need to understand who is buying land and why; how are they financing those transactions; who is selling land and why; how these transfers are affecting land use, subdivisions, and consolidations; how land laws and regulations are affecting transfers; and many other related questions.

An immediate concern is the practicality of land financing systems. A few programs are currently underway. Each of these programs is designed for a special purpose and is working on only a pilot basis at present. None have been evaluated to determine whether similar programs may be useful in another country and another context. An important aim of the land transfer research over the next several years will be to assess the potential for land financing and land policy reforms to improve access to land and increase agricultural productivity.

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