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FACTORS IN CARRYING OUT LAND REFORM

FINANCE

by

Lyle P. Schertz
Foreign Economic Development Service
United States Department of Agriculture

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FACTORS IN CARRYING OUT LAND REFORM: FINANCE

Lyle P. Schertz*

INTRODUCTION

Of all the problems of agricultural development, land reform surely falls under the heading of what the English economists called political economy. Politics and economics are part and parcel of practically every aspect of land reform. But perhaps their interaction is no greater in any area than in the financial one.

Land values reflect not only economic benefit from its productivity and from its usefulness as a hedge against inflation, but also political leverage and influence which the land gives its owner.

There is great political appeal for individual peasants to own their land; but the economic obligations to pay for it can be exploitation in a new form.

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* Deputy Administrator, Foreign Economic Development Service, U.S. Department of Agriculture, Washington, D.C.

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The difference between the compensation paid to landowners for land and the payments by peasants for that land is measurable in terms of economics. But bridging this gap requires a political commitment to carry through an effective land reform program.

Too, the threat of the masses is a constant warning to the large landowners that neither the political nor the economic structure to which they are accustomed is assured.

Land reform can have many different meanings. Therefore, it is well that the scope of this paper be stated. It is limited to the financial aspects of the acquisition and distribution of land under programs designed to bring about a significant change in the structure of landownership. In turn, financial aspects of cadastral surveying, titling, assistance to low-income farmers and colonization--all legitimately considered to be part of agrarian reform and of great importance--are not discussed.

Also, it is recognized that programs to acquire and distribute large amounts of land often involve substantial efforts to improve the availability of services and supplies such as production credit, cooperatives, fertilizers and seeds. But financing of these activities is appropriately included in the paper prepared for this Review by Dale Adams. On the other hand, I will take the opportunity to discuss some of the financial aspects of investments in social infrastructure such as roads and schools

which are sometimes associated with land reform programs. These have important implications for bridging the financial gap between compensation to landlords and payment by beneficiaries.

There are three major sections to this paper. The first focuses on compensation paid to landowners. It reviews the different approaches used in determining compensation, the level of compensation paid and the methods of making the payments such as in cash and bonds. The second section focuses on similar questions with respect to payment by beneficiaries of land reform. And the third examines the possible gap between compensation to the landowners and the payments by beneficiaries and approaches to covering the gap.

COMPENSATION TO LANDOWNERS

Approaches in Determining Compensation

The 1970 AID Spring Review papers reveal three primary approaches to determining compensation to landowners: (1) crop yields--the Asian Model, (2) land taxes--the Mid East/Latin American Model and (3) zero compensation.1/

Crop yields--the Asian Model. The dominance of individual crops and the search for a device to blunt the effects of inflation have given prominence in Asia to the use of crop yields as the basis for compensation to landowners.

The March 26, 1970, "Land to the Tiller" law of the Republic of Vietnam provides that "the rate of compensation shall be equivalent to 2-1/2 times the annual income in paddy for the land" (28. p. 16).2/ Taiwan, considered to have had one of the most successful land reform programs, paid compensation to landowners on the basis of 2-1/2 times the annual yield of the major crop--rice for irrigated areas and sweet potatoes for dry lands. South Korea used a factor of 1-1/2 times

1/ In some cases rents have been utilized as the basis for compensation. However, in many of these instances the rents were in turn directly related to crop yields or taxes. Thus, a fourth category was not included.

2/ While the legislation specifies that annual income means "the average income for the past 5 years," there is ambiguity as to if this is to represent average yields times average price or average yields times a price for a more recent period. This ambiguity could be significant. For example, South Vietnam paddy rice was VN$2,605 per quintal in March 1970 at the time the legislation was approved, but the 1965-69 five-year average price was only VN$1,122 per quintal.

annual production.3/ The Philippines' legislation stands out as an exception in Asia in basing its compensation on rental income capitalized on the basis of a 6 percent return.

Land taxes--the Mid East/Latin American Model. In many countries, land taxes and related information are the only set of data for individual parcels of land that are readily available to government officials. Thus, their use is extremely attractive from an administrative point of view. Ostensibly, the compensation in the United Arab Republic was to be 10 times the annual land rent. However, the 1952 land reform legislation linked rents directly to land taxes. These were to be limited to 7 times the basic land tax. Thus, the compensation to landowners was to be 70 times the basic land tax (18, pp. 40-42). Many variations have been utilized. In Iran, compensation was based on taxes paid; in Iraq and Chile, on assessed land value; and in Brazil, Bolivia and Guatemala, on owner-declared value for tax purposes.

Zero compensation. Several land reforms have provided no compensation to landowners considered enemies of the state. For example, the Hungarian land reform law of 1945 called for complete confiscation of land which belonged to "enemies of the people"

3/ However, land income taxes were an integral part of calculating annual production of individual land parcels. Production of representative fields in each township were determined and then related to their respective land income tax. This relationship was applied to land income tax for individual parcels (24, p. 189). Specific payments were based on the determined amount of rice and the current government rice purchase price.

including members of designated political organizations (5, p. 22). Estates of the Hapsburg dynasty were to be taken without compensation in connection with the Yugoslav land reform begun in 1919. In the same country, the 1945 land reform legislation provided that Germans should not receive compensation for expropriated lands and also included a prohibition of compensation for lands of public and religious bodies (4, pp. 17-18). In Taiwan and Korea, Japanese-held lands were taken over by the new governments without compensation but then sold later to farmers. Confiscation was also the rule in Cuba for lands owned by foreigners and land companies.

Zero compensation for lands of public bodies has been the rule throughout the world.

In a few cases, legislation provided for compensation but the implementation was such that the land was confiscated. Mexico, Bolivia and North Vietnam are examples (6, p. 2) (3, p. 41) (30, p. 39).

Discussion. Basing compensation on yields of major crops is an attractive approach. It awards owners in line with their effectiveness in having increased the productivity of their land. It also offers a unique device as an inflation hedge. The compensation can simply be designated in quantities of major commodity or commodities as done in Taiwan. Individual monetary payments can then be based on current prices of the commodities. And, in addition, its basic concept is understandable by all.

Yield data, on the other hand, may be difficult to establish. Therefore, it may be advantageous to utilize land taxes. I recognize that there is considerable distrust of most tax systems and, therefore, the dependence on tax data may be open to skepticism and distrust. But in many cases where the tax data is available, this is the easiest way to calculate payments for land.

The Concept of Market Value

Regardless of the approach to determining compensation, the question of level of compensation remains. For example, if crop yields are utilized, should they be multiplied by two or six or some other number to calculate the total compensation? Should this total compensation equal the tax assessed value, the price the landowner thinks his land is worth, or some other value? In such discussions the concept of market value or transfer price is prominent. To some, it is an objective. To others, it is a benchmark for measuring the degree of confiscation.

But market value of land in most land reform settings is extremely difficult to quantify in specific cases. In many areas, land is not transferred often. Therefore, prices for actual transfers of representative pieces of land are often scarce or simply nonexistent.

Market value of land is influenced by such factors as soil productivity, proximity to transportation facilities and markets, prices of products, level of taxation and cost of non-labor inputs and technology. The market value of haciendas is influenced by the possibilities of exploiting colono labor and the effectiveness of

landownership as a hedge against inflation. The market value of land is also affected, as Lodge suggests, by "the political power, prestige, and security which it entails" (13, p. 41).

Should owners be paid the full market value as appears to have been the case in Venezuela and in the Philippines? Landed interests and strong proponents of the rights of private property answer "yes." With a much more sophisticated rationale, Prosterman concludes that "full compensation" is essential, in fact, to accomplish land reform (19).

Market value (full compensation) is, of course, one standard that might be used. But to depend solely on it overlooks the many factors discussed above that influence that value. It also ignores the more fundamental question, "What level of compensation is required in order to tilt the balance of political power in support of the land reform that is needed?"4/ In some cases the answer may be the market value; in many cases it will be less.

Obviously, this "price" will vary among countries and over time. A Castro-type revolution within the hemisphere will decrease the amount necessary, as will a riot between landlords and tenants within

4/ Experiences in both Guatemala and Tunisia remind us of the balance of political forces which are involved in land reform. In Guatemala, the implementation of the program was so severe that political reaction completely reversed the land reform (8). In Tunisia in 1969, the land of 5,000 landowners was nationalized. Their dissatisfaction combined with that of small owners tipped the political scales against land reform. In turn, the program was completely reversed and all landowners were permitted to withdraw their land from the cooperatives which had been a central feature of the land reform program (21).

the state. Strong peasant political power would also. But on the other hand, the price will likely be higher if the program must win approval of legislators with strong land interests.

Dovring in appraising the Mexican experience points up the political dimensions of land reform when he states that, "Part-way expropriation was resorted to because only then could landowners be persuaded to accept the reform and ever abstain from filing claims for compensation" (6, p. 53).

In many countries included in the Spring Review, the compensation has not been sufficient to tilt the political balance in favor of effective land reform.. While such a conclusion suggests a need for higher payments it does not mean that they need to be increased all the way up to market values.

Political opportunities have been exploited by many in the past. I see no reason why we should expect it to be otherwise in connection with land reform. Thus, if the political setting is such that reform can be accomplished at less than market values, why should more be paid? The important point is that it be accomplished.

Methods of Paying Compensation

It is inevitable that landowners will carry a substantial portion of the financing of land reform. Peasants do not possess sufficient capital; governments do not; and international agencies have been unwilling to finance acquisition of land.

Most land reform programs call for the payment of cash for only a portion of the total compensation. The remainder is in the form of bonds. There are numerous examples. In Venezuela, if total compensation is less than 100,000 bolivars, the total amount is paid in cash. Larger amounts involve a combination of cash and bonds. Kenya, with substantial financial backing from England, settled for relatively high prices to landowners and paid one-half in cash. The remainder was in 3-year bonds. Vietnam contemplates paying 20 percent in cash and issuing 8-year bonds for the remainder of the compensation.

Discussions of land reform give a great deal of attention to the effect of inflation on the value of bonds. However, there are only a few cases in which the bond values have been protected in some way from inflation. South Korea, Taiwan, Chile and Brazil have included some type of protection. In the two Asian countries, bonds were denominated in terms of major commodities. Current commodity prices were utilized to calculate the annual payments. In Chile, two types of bonds are issued. Installments on one type are adjusted in line with the cost of living; the other is not (14). Vietnam chose not to include an inflation clause even though inflation has been on the order of 30 percent per annum. The draft legislation submitted to the Vietnam National Assembly provided for 8-year bonds paying 5 percent interest and maintained in value. However, the National Assembly increased the interest to 10 percent, dropped the maintenance of value clause and substituted a 20 percent downpayment.

Thus, while there is much talk about the effect of inflation on land bonds, only a few countries have done anything about it.

Interest rates on land bonds are sharply below market rates of interest. And nobody seems to write about it. Kenyan bonds had the highest percentage--6.5--among the country papers in the Review. Most of the rates were 3 to 4 percent. Yet the interest rates within these countries are substantially higher. Chile, for example, has a land bond rate of 3 percent and a discount rate of 20 percent. In Brazil, the comparable rates are 6 and 20 percent.

Success in directing capital and entrepreneurial abilities of expropriated landowners into industrial enterprises has varied. Land reform legislation of Iran, Korea, Taiwan and Chile included provisions to facilitate this type of transfer. Not all were successful.

In Iran, compensation bonds could be used for purchase of shares in government industrial enterprises. However, this alternative was not attractive to most landowners. This was partially because of the diverse and widely scattered enterprises held by the government corporation which the government was unwilling to break up. Also, many of the enterprises were overvalued (17, pp. 79-80).

In Korea, efforts to attract exlandlord capital to former Japanese-owned plants were also unsuccessful (16, p. 31). However, the transfer was much more successful in Taiwan. This was because the landowners automatically received 30 percent of their total compensation in government enterprise stock. In contrast to the

large government corporation of Iran covering several enterprises, the Taiwanese firms were divided into separate enterprises. The landowners received a bundle of stocks in four different companies (12, p. 39). Today, some of the largest stock owners of these corporations are former landowners.

PAYMENTS BY BENEFICIARIES

Now let us turn to the other side of the "financial coin" of land reform, payments by beneficiaries.

Relationship to Compensation.

In most cases, these payments have been roughly equal to the compensation extended to landowners. For example, in Taiwan, landowners were paid at a rate 2-1/2 times the annual yield of their major crop. In turn, the beneficiaries assumed an obligation to make payments over 10 years, totaling 2-1/2 times the annual yield, plus 4 percent interest on the unpaid balance.

Landowners in the UAR, under the 1952 legislation, received 30-year, 3 percent bonds; beneficiaries assumed 30-year, 3 percent obligations for the same prices paid to the landowners--namely 10 times the annual rent. Later, in 1961, the terms of the landowner bonds and the beneficiaries' payments were increased from 30 to 40 years and the interest rate was dropped from 3 to 1.5 percent. However, the unpaid balance owed by the beneficiaries was reduced by one-half.

On the other hand, there are a few cases in which the land was given free to beneficiaries. In South Vietnam under the new legislation, peasants are to receive the land free even though landowners are to receive compensation at the rate of 2-1/2 times the annual income. Bolivian peasants receiving land were not officially obligated to cover even part of the costs of compensating

the landowners. However, in some cases, peasants did compensate the landlords and incurred substantial costs in connection with topographic work and expropriation procedures (3, pp. 41-42).

In some cases free distribution was not planned but occurred anyway. In Mexico, it had been anticipated that beneficiaries would pay for the ejido land. "But this was soon abrogated and apparently never applied" (6, p. 25).

In most cases, government-held lands have been distributed free. This is not always the case, however. For example, the price paid by Koreans receiving former Japanese lands was 3 times annual production.

Thus, while there are exceptions, the vast majority of land reform programs have called for payments roughly equal to the compensation paid to landowners.

Should Payments Equal Compensation?

The principal basis for the close linkage of payments to compensation is the limitation of resources.5/ The willingness of the British Government to make a grant for partial payment of land in the Kenyan situation is not likely to find many parallels. This fact has important implications for the individual farmers and for the strategy of land reform.

5/ Administrative costs have in most cases been handled by the governments. In some situations, however, beneficiaries have been assessed a percentage on their basic payment to cover administrative expenses. The highest indicated in the country papers was 20 percent in Iraq. The UAR had a 15 percent fee initially but later reduced it to 10 percent. Others included Iran, 10 percent; Philippines, 6 percent; and Chile, 2 percent.

As argued earlier, the compensation paid to landowners is influenced by politics. It may be above or below the value of the land in terms of agricultural productivity, even though this productivity would seem to be the more appropriate criteria for determining the payments by beneficiaries.6/ Payments above this level merely substitute another form of exploitation in place of the former landowner and lead to widespread defaults. A possible example is Kenya even though the Africans receiving land were to pay but 2/3 of the price paid to Europeans. The British Government made a grant to cover the difference. But even this reduced price was too high for many of the farmers to carry and, at the end of 1968, over 40 percent of the settlers were in arrears with 24 percent in arrears for one year or longer (9, pp. 19-20).

To argue that the payment by beneficiaries should not necessarily equal that paid as compensation does not constitute endorsement of giving land free to beneficiaries under typical conditions. Raup forcefully reminds us that "security of expectation is crucial" to capital formation in agriculture, because such formation involved "numerous incremental additions made successively over many production cycles" (20, p. 273). Payments by beneficiaries tend to reinforce their expectation that their ownership of the land is stable and that land distribution is not an interim step to an arrangement depriving them of management and control of the land.

6/ See Karst (11) for a discussion of how compensation, even though confiscation in disguise, can contribute to stability.

THE FINANCIAL GAP

In the previous sections it is suggested that (1) the major criteria for compensation should be that level necessary to obtain a political commitment to land reform and (2) the major criteria for payments by beneficiaries should be the agricultural productivity of the land. The possible difference between the compensation and payments based on these suggested criteria can give rise to an important financial gap. This section focuses on approaches to covering that gap.

Inflation

Consciously planned or otherwise, inflation has also been a factor influencing the distribution of benefits and costs of land reform. The post-World War II land reform programs in Japan, Hungary and Yugoslavia provided for payments by beneficiaries roughly equal to the compensation paid to the landowners. This compensation was not protected from inflation and, as a result, the real cost of payments by beneficiaries declined sharply with the rapid inflation that occurred in each of the countries.

Taxation

Taxation has important implications for the financing of land reform. As pointed out above, several countries have utilized tax assessments as a basis for compensation paid to landowners and in

turn for payments by beneficiaries. In India, tax values were the basis for payments to the tax intermediaries--the Zamindars (26, p. 103). Tax assessments have also been an important ingredient in determining financial arrangements in Italy, Iran, Venezuela and Peru--in some cases being the principal basis upon which compensation is calculated, but in other countries merely one of the ingredients. Tax files, if adequate and complete, can greatly facilitate the implementation of land reform programs. Even if they are inadequate, they are often the only source of records of landownership (22, p. 57).

In addition, taxes clearly have an important effect on land values and influence the resources available to the government for land reform and other programs. In India, for example, agricultural income is not subject to the central income tax. This has disturbed "the natural flow of resources between sectors" (7, p. 30) and has inflated land prices. In addition, large areas of India have land taxes fixed for perpetuity thus providing incentives for investments in land. An increase of taxes may not only result in lower land market values and lower financial requirements for compensation, but also they could stimulate voluntary sales and perhaps mitigate political opposition to land reform once the higher taxes were in effect.

Landowners, however, can be expected to resist tax reform as they do land reform. As Kaldor has pointed out, "In countries where a powerful landowning class exists the prospects for effective land taxation do not appear more promising than the prospects for land reform" (10, p.414). For example, in 1963, provisions to adjust land taxes were deleted from the land reform legislation of the Philippines at the insistence of those opposing land reform (29, p.46).

Thus, it is little wonder that tax reform has seldom been linked to land reform. In the UAR, however, the 1952 land reform legislation specified that taxes 5 times the basic rate would be assessed on landlords in excess of the maximum holding of 200 feddans (18, p. 42). Perhaps tax changes have been utilized in a similar manner in other countries, but this is not evident from the country papers prepared for this Review.

In spite of the political dimensions of tax reform it would be well for leaders of land reform to carefully consider the potential of using tax reform as an integral adjunct to land reform even if political trade-offs in terms of the extent of land reform were required. 7/

7/ See Raup (20, pp. 278-9) for discussion of the advantages of coordinating tax reform with land reform in order to facilitate capital formation in the public sector. Another fiscal question is the tax treatment of the compensation paid to landowners. This matter was not discussed in the country papers. It should be given substantial consideration when devising a land reform program since it has implications for inflation, capital flight and exchange rates.

International Resources

In spite of the policies of international assistance agencies which preclude assistance in directly financing land acquisition, economic assistance can be used in several ways to indirectly support land reform. One of the obvious arrangements is to finance a non-land reform program in order to release funds of the recipient government to support land reform. Another is to finance commodity imports, as is being contemplated in Vietnam, in order to dampen inflation pressure from compensation payments. For example, investments in infrastructure might be made with two different objectives.

One objective would be to increase the productivity of lands retained by large owners. Such projects might be important means of modifying their political opposition to land reform and facilitating satisfactory pricing arrangements for the land that is acquired and redistributed. In Mexico, for example, the expansion of irrigation has been of particular benefit to the private farms as opposed to the ejidos. From 1940 to 1960, the irrigated area in private farms increased from .6 million to 2.0 million hectares while the ejidos' irrigated land increased from 1.0 million to 1.4 million hectares (6, p. 32). Admittedly the private farms were of the nature and located so that they could take advantage of irrigation.

and this type of investment pattern was probably not part of the arrangement for land reform. However, it is illustrative of how investments can influence the various parties affected by land reform.

On the other hand, investments in infrastructure can be primarily designed to increase the productivity and standard of living of the beneficiaries of land reform. In turn, the productivity of these investments can lighten the burden of the payment schedules assumed at the time of land reform. In Cuba substantial investments have been made in schools, housing, clinics and health centers concurrent with the implementation of land reform. International assistance can, of course, provide substantial capital on a grant or loan basis for these projects.

None of the country papers identified the use of food assistance to support land reform. This possibility should not be overlooked.8/

Revision of the present policies, however, would be required if food assistance were to play a large role in supporting aggressive land reform programs.9/ But relatively few

8/ See (27) for a discussion of how WFP can support land reform under present policies.

9/ It is interesting to note that a 1961 New York Times article reported on serious considerations at the time to utilize P. L. 480 commodities to support Latin American land reform (1).

adjustments in policies of food assistance, if any, would be necessary to provide food as an offset to decreases in food production and increased food requirements associated with land reform. Also, local currencies derived from the sale of food commodities can support investments in infrastructures. A limiting factor to such activities is that the terms of P.L. 480 Title I agreements are becoming increasingly harder; also there are many other demands for the currencies which are generated.

Food for work programs have been focused on the development of basic infrastructure. Their scope, however, has been seriously limited by funding and by the policy which requires laborers to receive the food as part of their wages. This barter type requirement constitutes a significant logistic and management restraint. One major program has benefited from a relaxation of this barter type requirement. It was the East Pakistan Rural Public Works Program. After strenuous representation by Richard V. Gilbert, arrangements were made whereby work programs were to be financed from the proceeds of the sale of P.L. 480 commodities. Wheat was to be sold in the market. Proceeds were to pay for labor on public works projects. Opponents of this approach argued that East Pakistanis would not eat the wheat and that the increased buying power would not be absorbed by the increased availability of wheat thereby contributing to inflation. However, these fears were proved to be unfounded (23).

Technology

The potential role of technology in land reform is an interesting issue. For research, which makes yield increases possible, can play an important role in "financing" a land reform program--if the increases come after redistribution. Increased yields can go far in dissipating the onus of payments set high in order to meet compensation requirements so long as they are fixed.10/ They will also enhance the value of the peasant's land provided that government policies and programs effectively protect them from price declines.

On the other hand, the introduction of new technology before a land reform can seriously hamper the realization of an effective program. For example, the introduction of high-yielding varieties has caused prices of land on which these varieties can be grown to increase dramatically. Thus, the potential costs of future land reform programs in these areas have increased dramatically and almost certainly the political opposition by landowners to such reforms has strengthened.

The relation of technology to land reform raises fundamental questions with respect to development strategies and priorities

10/ In Korea, payments by beneficiaries were composed of two elements: price and a quantity of rice. The price varied from year to year but the quantity of rice was not changed even though yields increased (15, p. 17). Thus, the beneficiary did not have to share any increases in yields by making higher payments.

on such matters as agricultural research. For the question arises, if the green revolution comes first in countries with skewed ownership patterns, can a peaceful social revolution follow? Or must there be social revolution first, then a green revolution?

SUMMARY

Land reform presents an almost classic problem in political economy. So, also, does its subphase--financing. Politics and economics are interwoven throughout.

The level of compensation to the landowner is one of the crucial questions in land reform programs. Some argue that the compensation should equal the land market value. Others suggest using much lower prices. This paper suggests that the criteria should be, "What level of compensation is required in order to tilt the balance of political power in support of land reform?" Although the evidence is far from complete, it seems to me that much of the political opposition from landlords stems not from a marginal shortfall in compensation, but from the fact that other landlords have often not been paid at all or--due to low initial price, inflation or default--have received only a small fraction of the value of their land.

But even when the question of compensation can be answered, the more fundamental question is: from where will the funds eventually come? Peasants do not possess sufficient capital to pay cash; governments do not; and international agencies have been unwilling to finance the acquisition of land. Inevitably landowners must carry the costs by accepting bonds in exchange for a major portion of their land. These might or might not be

protected against inflation, or convertible into industrial stock. The chances are high that their interest rates will be substantially below market rates.

In the context of paying landowners the full market value of land it has been suggested that the new owners pay the full price. But, it may simply be too much to expect beneficiaries to pay a full market value which is based on the productivity of the land as well as other factors which influence the value of the land such as inflation hedge, political power and prestige.

Breaking the linkage between compensation and payments by beneficiaries can give rise to financial gaps which might be covered in different ways. Inflation is one. Taxation is another. Even though international assistance agencies do not help in directly financing the acquisition of land, economic assistance can be used in several ways to indirectly support land reform. One of the obvious arrangements is to finance a non-land reform program in order to release funds of the recipient government to support land reform. Another is to finance commodity imports, as is being contemplated in Vietnam, in order to dampen inflation pressures from compensation payments. Support for investment in infrastructure and food assistance are other ways.

One of the more interesting issues is the role of technology in land reform. High-yielding varieties can lead to increased land values and in turn increased cost and political opposition

to land reform. Thus, important questions arise with respect to assistance strategy. If the "green revolution" comes first in countries with skewed ownership patterns, will it be possible for a peaceful social revolution to follow? Or must there be social revolution first, then "green revolution?" This problem may indeed be political economy.

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