

# Governance Capabilities and the Property Rights Transition in Developing Countries

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**Executive Summary:** The ‘good governance’ property rights reform agenda and the interpretations of colonial history on which it is based, are deeply flawed. A different analytical and policy approach is needed for promoting growth-enhancing governance capabilities for managing the property rights transitions in developing countries.

To sustain growth property rights have to address three problems: i) how to create security for investors so that they have *extended time horizons*, ii) how to make *asset transfers* efficient; and iii) how to create incentives and compulsions for *productivity growth*. There are likely to be conflicts between different goals. As countries grow, rights that were appropriate in the past may require significant changes. Strengthening existing property rights may often be the *wrong* response. Growth may require changes in existing rights as well as the creation of new ones.

Interventions to modify property rights trigger conflicts because they involve potential winners and losers, *even if losers are compensated* because there is no ‘right’ way of splitting future gains between affected parties. The new structures of property rights that emerge and the compensation for those who lose out depend on the bargaining power of the contestants often established through costly conflicts. Two important results follow. First, enhancing growth can involve not just the strengthening of some rights but also the weakening of others. Thus, growth requires the reduction of *growth-constraining transaction costs*. Second, property rights changes also trigger *transition costs*. The political settlements and the types of growth strategies that are attempted define the trade-off between reductions in growth-constraining transaction costs and increases in transition costs. The less favourable this trade-off, the more difficult it is to trigger or sustain growth.

This ‘growth-stability trade-off’ defines the challenges for property right reforms in particular countries. Our examination of Thailand, the states of West Bengal and Maharashtra in India, Bangladesh and Tanzania shows the historical roots of differences in trade-offs across countries, and explains why different strategies and problems are observed in these countries today.

Colonial history has often been damaging not because it destabilized property rights with extractive policies but because many conflicting rights were created to maintain political stability. These initial conditions shaped how states and businesses interacted to address serious land market failures. A number of partially successful strategies are identified with implications for how growth-enhancing governance can be improved in developing countries. One variant was of agencies aligning political, bureaucratic and economic interests to reduce transition costs to enable growth-enhancing restructurings of rights. Examples include the MIDC in Maharashtra which was very successful in setting up industrial zones (despite being very corrupt). Another variant involves significant financial compensations to reduce contestation costs but requires strong alignments of political interests with projects and the exclusion of outside political organizers.

Donor and partner governments therefore need a different approach for promoting growth-enhancing governance capabilities for managing the property rights transitions in developing countries.

# CONTENTS

1. Introduction.....	4
2. Property Rights: Some Historical Perspectives .....	9
Thailand: The Autonomous Evolution of Property Rights .....	11
West Bengal and Bangladesh: The Legacy of Colonial ‘Zamindari’ Rights.....	16
Maharashtra: Did ‘Ryotwari’ Rights Make any Difference?.....	24
Tanzania: The Legacy of Customary Authority and Collective Rights.....	28
3. Property Rights and Growth .....	34
Extending Time Horizons .....	38
Opportunities for Trade.....	41
Compulsions for Productivity Growth.....	46
Growth-Constraining Transaction Costs.....	49
Transition Costs .....	52
The Growth-Stability Trade-off .....	56
Colonial History and its Misleading Narratives.....	59
4. Contemporary Strategies and Governance Implications.....	65
Thailand: Land Rights Supporting Capitalist Development.....	66
Features of South Asian Transitions .....	70
Bangladesh: The Limits of Capitalism from Below .....	72
The Garments Industry: Growth despite Inefficient Land Markets.....	72
Public Land Acquisition: The Jamuna Bridge and RAJUK .....	75
Political Lessons from the Reversal of Karnaphuli EPZ .....	77
West Bengal: Political Mismanagement and Changing Trade-offs.....	78
Successful Land Acquisitions: Rajarhat, Haldia, Salboni .....	81
Debacles at Nandigram and Singur.....	82
Maharashtra: Facing Growing Land Market Failures.....	86
The MIDC.....	86
Tanzania: The Challenge of Multiple Transitions .....	89
Multiple Agents Can Determine Land Use Rights .....	90
Protection Strategies Are Vulnerable and Can Break Down.....	91
The Advantages of Collective Rights: The Case of Mining.....	93
5. Policy issues.....	95
6. References.....	97

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## FIGURES

Figure 1 The Simple Theory of Property Rights .....	35
Figure 2 An Extended Theory of Property Rights .....	36
Figure 3 Aggregate versus Growth-Constraining Transaction Costs .....	51
Figure 4 Growth Effects and Transition Costs of Changes in Property Rights .....	55
Figure 5 The Growth-Stability Trade-off .....	57
Figure 6 Most Favourable Trade-Off Paths Can Vary Across Societies .....	58
Figure 7 The Acemoglu et al. Version of Colonial History.....	60
Figure 8 Colonial History's Inconvenient Truths .....	62
Figure 9 Transitions in Settler and Non-Settler Colonies.....	63
Figure 10 Colonial Compromises Worsen Trade-offs.....	64
Figure 11 Thailand: Emergence of Tradable Land Rights Mid-19 <sup>th</sup> to Mid-20 <sup>th</sup> Century.....	66
Figure 12 Contemporary Thailand: Resistance to Extending Capitalist Rights over Land .....	68
Figure 13 Initial Conditions in Indian Subcontinent Regions c. 1980.....	70
Figure 14 The Singur Transition Cost Trade-off after External Organizers Enter .....	85
Figure 15 Possible High Transition Costs in Reforming Village Rights.....	92
Figure 16 Low Transition Costs for Allocating Mining Rights in Tanzania.....	93

## TABLES

Table 1 Land Fragmentation in Bangladesh 1984-1997.....	21
Table 2 Land Fragmentation in West Bengal 1971-1996.....	23
Table 3 Land Fragmentation in Maharashtra 1977-2001 .....	27

## 1. Introduction

The high growth of a number of developing countries in the 1980s raises important questions for our evaluation of the economic and governance strategies required to sustain and accelerate growth. This series of papers examines areas of governance reform that are most likely to sustain and accelerate growth in these countries and to develop a methodology that can be applied for policy analysis in these and other countries. The series of papers looks at the post-1980 growth experience of Thailand, the states of Maharashtra and West Bengal in India, Bangladesh and Tanzania. Our methodological approach is to examine the nature of significant market failures in land, labour, capital and technology markets in these countries (Khan 2008b) and the methods through which some of these were actually addressed during the growth takeoffs of the 1980s.

This paper looks at the market failures affecting land markets. Policy responses to these market failures have focused on ‘good governance’ reforms informed by a narrow understanding of market failures and a particular reading and re-interpretation of evidence. We have argued in earlier papers (Khan 2007, 2008b) that good governance theory has important limitations in explaining the historical experience of developing countries and in particular for suggesting feasible policy responses.

There are significant implications of inadequate theory in this area because failures in land markets seriously constrain growth in developing countries. Sustained growth requires significant changes in land use. Productivity growth in agriculture, the transition from agriculture to industry and services or the development of mineral and oil resources are all likely to require significant changes in land use. These can in turn face high economic, political and social “transition” costs, particularly in densely populated developing countries. Land use changes raise fundamental questions about the property right regimes in developing countries. The emerging consensus in institutional economics is that land market failures are symptoms of weakly protected property rights and/or predatory or extractive states. These problems have in turn been traced to deeper roots in the colonial past, to the relative newness of some states, to historical factor endowments that created path dependence in the development of property rights or to poor investments in human capital (Sokoloff and Engerman 2000; Acemoglu, et al. 2001, 2002; 2004: 11; Rodrik, et al. 2004; Bardhan 2005; Austin 2008).

Weak property right regimes are generally expected to be inhospitable for investors (North 1995). In fact the underlying arguments are complex, and the structures of rights that are appropriate for addressing one type of problem may be inappropriate for addressing other problems. We will discuss three different types of problems that property rights need to address in a context of growth. First, property rights have to prevent the theft of investor returns to enable investors to take a longer view of investment and conservation of assets. Secondly, in a context where changes in land use are required, rights have to be structured to enable efficient transfers. And thirdly, there are more complex incentives and compulsions that property rights can create to induce or compel productivity growth in the context of a capitalist economy. Each of these functions requires complex specifications and conditions for property rights. Unfortunately much of the theoretical discussion that informs policy is excessively

simplistic and assumes that property rights in developing countries are in some general sense weak or suffer from expropriation risk.

Our alternative reading of the historical evidence and of property rights theory suggests a very different set of reform constraints and problems. We then use these insights to construct an alternative framework for looking at the property rights challenges facing developing countries. Finally, we use this framework to look at some contemporary responses to market failures in land and the implications these have for policy. We argue that the simple theory of property rights and the inappropriate reading of historical and contemporary evidence that is used to support it have hindered rather than helped the development of feasible growth-enhancing governance reforms in developing countries. The reform suggestions coming from current canonical theory does not provide an adequate account of the reasons which prevent property rights being ‘properly’ defined in developing countries. In reality, these failures are embedded in political constraints and are not always just errors of policy or the outcomes of venal intentions of states that only seek to achieve high levels of short term resource extraction from citizens.

The evolution of the property rights appropriate for a modern capitalist economy has historically been a heavily contested process. An alternative reading of history suggests that countries that have moved faster on the property rights transition have done so because they have been able to absorb the ‘transition costs’ of these changes better, or as in the case of settler colonies, have had these costs imposed on them with intolerable levels of force. This provides a very different ‘transition-cost based’ reading of colonial history that challenges the version provided by Acemoglu et al. (2001; 2002). Settler colonies were not really benign states that created nice property rights while non-settler colonial rulers focused on extraction. Rather, settler colonies completed the transition to capitalism very quickly by imposing huge costs on indigenous populations, in many cases almost wiping indigenous populations out of existence. In contrast, weakly rooted non-settler colonial regimes created complex structures of rights to ensure political stability at the expense of rights that would accelerate an economic transition. In developing countries the difficult task of capitalist transition is still continuing, and the problem of how to manage the transition costs during this process explains the persistence of and responses to different types of market failures. If we want to devise reasonable responses to market failures, we need to understand this context, the types of transition costs that affect particular countries, and devise solutions that are implementable in specific political settlements.

We begin in Section 2 by looking at critical aspects of the history of our case study countries going back to the colonial period. Thailand, which was not colonized, provides a very interesting counterpoint to the other countries which were. This excursion into history from the perspective of our property rights analysis is important because it provides us with the ‘stylized facts’ for our theory and to engage with some contemporary re-interpretations of colonial history that have now acquired currency in the debate on property rights.

In Section 3 we develop an alternative theoretical framework for evaluating the property rights transformations in developing countries. Sustaining growth in developing countries requires solutions to at least three separate but closely related

problems affecting land markets. First property rights have to protect investors sufficiently to enable them to take the long view in making investment and resource conservation decisions. Achieving this solely through the protection of formal individual rights may not be efficient in *any* context and particularly not in developing countries where the fiscal base of governments is insufficient to provide high levels of formal protection of rights. Successful growth stories show that unorthodox structures of rights have often been the most appropriate response for reducing expropriation risk (Haber, et al. 2003; Qian 2003).

Second and no less important, growth requires a solution to the problem of resource re-allocation in a way that satisfies the twin requirements of economic efficiency and political acceptance. The property rights structures that solve the problem of expropriation risk may not be appropriate for the efficient trading of assets. Indeed, making valuable assets like land highly tradable has historically been strongly resisted by peasants and other agrarian interests. As a result, there are serious market failures in most developing countries in these areas and many types of non-market asset transfers have evolved to respond to this. High levels of resistance to land transfers continue to determine the extent of this 'market failure'. The operation of *eminent domain* type interventions is politically contested to a much greater degree in developing countries because the underlying rights are not well defined and market prices are often not meaningful indicators of socially acceptable transfer prices. The 'governance capabilities' of developing countries in responding to these market failures have often been vital in sustaining growth during transitions.

And finally, the structures of property rights that are appropriate for compelling productivity growth may be different again. The productivity growth that characterized early capitalism was based on very specific configurations of property rights. In late developers the adoption of new technologies becomes an important issue and more demanding conditions are required for achieving productivity growth. Given the fiscal constraints facing developing country governments and the global bias against formal or explicit industrial policy, states are increasingly trying to attract investors with advanced technologies by using land market transactions to provide hidden subsidies. The types of rights that would ensure efficiency and compulsions for productivity in these contexts are an important issue for growth-enhancing governance strategies.

We will discuss the market failures affecting technology acquisition in our next paper. Clearly some of the problems of market failures in land markets cannot be effectively addressed if we do not make the market failures in learning and technology acquisition explicit so that comprehensive solutions to multiple market failures can be found. The problem with some of the informal and *ad hoc* solutions that have emerged is that while they may work for accidental reasons, they often fail in sustaining growth. For instance, non-transparent ways of providing industrial policy subsidies may often provide excessive incentives to investors that are socially wasteful. These incentives can also be socially unjust for those losing their land at low levels of compensation so as to provide subsidies to investors. The presence of multiple objectives makes it important to identify priorities in an integrated analysis. Simple property rights fixes are unlikely to work.

Our alternative theoretical framework makes explicit the complex objectives that property rights have to address to sustain growth. This explains why property rights have to be continuously evolving (even in advanced countries) if growth constraints are to be addressed. This process of evolution is clearly at a different stage in developing countries but much of the property rights literature is not geared to identifying the conflicts and choices that developing countries face. Conflicts between different property right objectives allow us to explain some inconvenient truths about the capitalist transition. Capitalist development requires stable property rights and expectations of non-appropriation for capitalist investors. This is indisputable. But while the capitalist transition is taking place, most assets are still in the hands of low-productivity asset holders who have rights that are inappropriate for efficient asset transfers, or rights that are unclear and conflicting. In this context, strengthening all the pre-capitalist rights that defined agricultural systems where asset transfers were not a priority can hinder rather than help growth and poverty reduction. In these contexts, many existing rights are inappropriate for efficient asset transfers and are actually the source of high transaction costs. The growth of the productive capitalist sector therefore often requires non-market interventions to enable asset transfers to sustain growth.

These non-market asset transfers do not necessarily mean that existing holders of land are 'expropriated'. The acquisition and transfer of assets may be achieved through many different mechanisms including fully or partially compensated acquisition. While the historical experience has been dominated by uncompensated or at best partially compensated transfers, compensated transfers are preferable on grounds of justice as well as the requirement of minimizing political conflicts. Nevertheless, any intervention in processes of resource re-allocation is likely to be strongly resisted or held up by many groups, including but not restricted to the immediate occupants of the land required for alternative uses.

The main point is that sustaining growth may well require the weakening or even the destruction of some pre-existing rights and not just strengthening the protection of all rights. The simple theory of property rights, using an unrealistic benchmark of a zero transaction cost world as a feasible policy goal suggests that strengthening all property rights will lower transaction costs and is the path towards greater efficiency. This proposition is rejected when we look at the details of property rights issues even in advanced countries. In reality choices always have to be made between several high transaction cost situations to select the 'best' one. The efficient solution even in theory is not to strengthen all property rights all the time.

We argue that once we understand the complexity of functions played by property rights and the impossibility of achieving zero transaction costs, the conceptual task is to identify the specific property right changes that at each stage will do the most to reduce *growth-constraining transaction costs*. In addition, it is important to understand that any process of creating and destroying property rights is conflictual because there are winners and losers who will fight to an extent that depends on the specific organization of power (the political settlement) in that society. Thus, we argue that strategies of reducing growth-constraining transaction costs face political contestation and '*transition costs*'. Our main objective is to show that the persistence of market failures is not just a function of the stupidity or venality of states, but can be better understood in terms of particular 'growth-stability' trade-offs. These trade-offs

describe how rapidly transition costs increase when property rights reforms of a particular type are being pursued to achieve growth.

The real cost of colonialism in non-settler colonies was in our view not the extraction of surplus or the creation of property right uncertainty, but rather the creation of very unfavourable growth-stability trade-offs. These were the result of long periods of social engineering that created many conflicting rights to achieve political stability. This interpretation of history appears radical in the context of contemporary institutional and governance debates, but is in fact strongly supported by a reading of colonial history.

There is little dispute that land market failures are serious constraints on growth in developing countries. The problem is the policy consensus that the achievement of stable property rights and a non-expropriating state (based on institutions of political democracy) are preconditions for well-working markets in land (Khan 2007, 2008b). The policy consensus suggests that developing countries should focus on defining property rights better through measures such as improving and completing the registration of land, computerization of land records, improving the court system for dispute resolution and improving the general rule of law, including strengthening anti-corruption capabilities. These theoretical insights, supported by a particular interpretation of the empirical and historical evidence have determined the bulk of governance policy on how to address land market failures in developing countries.

In contrast our reading of theory and history does not support the view that successful transitions were primarily based on these types of reforms. Capitalist property rights *evolve*, they do not emerge with a big bang as a precondition of development. In countries where they appear to have suddenly emerged (in particular the settler colonies) this is only because a re-writing of history has missed out the much more violent transition in these societies that simply shortened the ‘evolutionary period’ at very high transition cost. The real governance challenge for developing countries is to manage the transition better and to minimize these transition costs. In that sense, the settler colonies should be a model of what *not* to do. It does not help contemporary developing countries to be told that they are still some way away from the property rights advocated by the simple theory. This simply presents developing countries with implausible ‘policy choices’ that are not feasible given the economic capacities of these countries, and in particular given the transition costs that such policies would actually face if anyone tried to implement them.

Instead of pushing ahead with technocratic property rights reforms which have little chance of implementation or success, our approach suggests that the growth-enhancing governance challenge is to understand the determinants of the growth-stability trade-off in each country, identify the priorities for property rights reform to reduce growth-constraining transaction costs, and work with and through existing political constraints to make incremental improvements that can help to sustain growth. We argue that this is a considerably different governance reform project and a more challenging one. But it is also more likely to make a real difference to the growth prospects of developing countries.

Finally, in section 4 we use this framework to make sense of some of the actual responses to market failures in our case study countries. The post-1980 growth

experience in our countries (and we believe more generally) shows a variety of formal and informal responses to market failures in the context of different types of growth-stability trade-offs. Relationships between businesses, political organizations and government institutions created a range of arrangements, some of which effectively addressed market failures while others did not. We are more likely to evolve effective growth-promoting strategies if we understand the ways in which critical market failures were addressed in the past and the political or institutional reasons for their relative success or failure. This may allow future policy to work with the flow of evolving economic and political arrangements in particular countries rather than unrealistically seeking to impose entirely new arrangements from outside. And if we identify serious political constraints that prevent the solution of significant market failures in some countries, we will at least be able to identify the nature of the political problem so that a more informed debate can take place to promote growth. At the very least this may help development partners to be less negative about processes that may be both necessary and useful, and help them to focus on processes that are genuinely damaging and dysfunctional.

## **2. Property Rights: Some Historical Perspectives**

The historical development of property rights in our case study countries provides the background for our discussion of contemporary responses to land market failures. In addition the variation in historical trajectories in the development of property rights provides interesting stylized facts which we will draw on in the next section to develop our analytical framework for the property rights transition. Thailand was one of a few countries not to be colonized by European powers. It has made steady progress in defining rights for productive capitalists, often at the cost of significant injustices inflicted on the peasants who worked hard to extend its land frontier into forest and swamp over the last century. Thailand is not only the most developed of our group of countries; it is furthest down the road in terms of clearly defining the property rights of critical high valued investors. The economic and political challenge facing Thailand is a somewhat different one: how to address the rights of the peasantry, particularly the poor, who have been left occupying lands and forests over which property rights are not clearly defined.

India as the jewel in the crown of the British Empire is an excellent case study for testing the hypotheses of Acemoglu et al. (2001), Sokoloff and Engerman (2000) and others as colonial history has justifiably become an important area of study for understanding contemporary property rights issues. Bangladesh and West Bengal were the original acquisitions of the East India Company and as such provide useful case studies for looking at the long-term effects of a variant of non-settler colonialism. Contrary to many simplistic assumptions about the goals of extractive colonial powers, the historical evidence is that the British in Bengal attempted through the Permanent Settlement of 1793, however unsuccessfully, to create property rights that it hoped would create tax paying productive gentry farmers. The experiment failed not because it was a cynical attempt to maximize extraction but because the colonial power did not want to risk the political costs of forcing adjustments in the direction of greater efficiency. Over time, the creation of a huge variety of rights of different types in response to multiple pressures of revenue, productivity and in particular politics left India in general, and Bengal in particular, with a complex and unproductive set of rights that successor governments are grappling with.

Maharashtra in the west was colonized much later and the land settlement there was different from that in Bengal. The *ryotwari* system of revenue collection in Maharashtra and other later acquisitions where revenue-collecting rights and responsibilities were allocated to individual *ryots* or petty peasant landlords has been favourably compared to the *zamindari* system of land rights that characterized Bengal where revenue rights were allocated to substantial revenue collectors or *zamindars* in terms of the implications for growth (Banerjee and Iyer 2005). While Maharashtra's contemporary land markets may be somewhat better placed than those of Bengal, the differences should not be exaggerated. Maharashtra's agriculture is still far away from a capitalist agriculture, with the state suffering one of the highest levels of small farmer suicides. And in common with the rest of India, Maharashtra faces serious constraints and contestation in its development of industrial zones. The historical evidence suggests that property right evolution in the *ryotwari* areas was also constrained by political constraints that were very similar to those affecting the *zamindari* areas.

Tanzania's colonial history was different again, demonstrating important differences between Asian and African colonies. Not only did African countries have a much shorter colonial history, in addition their pre-colonial histories of state building were also different and in some respects shorter compared to Asian ones (Bardhan 2005). But there are also interesting similarities between the African and Asian colonial experiences that are often underestimated (Bayly 2008). Colonial attempts to create land rights in non-settler Africa were not very successful, and again it is tempting to attribute this to the *intentions* of extractive colonial states. But in fact with the exception of a number of egregious and widely quoted cases like the Belgian Congo, the historical evidence is more complex. In Africa as in Asia, attempts by non-settler colonial states to create productive property rights systems were constrained by their political concerns of creating and maintaining allies who may have been threatened by the capitalist transformations of these societies (Mamdani 1997). These insights allow us to radically recast the analysis of Acemoglu et al. (2001; 2002) in the next section. The difference between settler and non-settler colonies may have less to do with the productive and extractive intentions of the respective colonial states and more with the ability of settler colonies to push through social transformations without regard to the potentially massive internal social resistance to property rights transformations.

Within Africa, Tanzania represents a somewhat unique example because of its political history under Nyerere. Strategies of villagization under Nyerere attempted to create a settled peasantry but with limited success. Nyerere's political organization was able to absorb significant social resistance to change, but for political and ideological reasons, the change forced through was in the direction of a collectivist rural economy that did not in the end succeed. More recently, the successor state in Tanzania has been able to use the relatively centralized organization of the Tanzanian state (compared to most other African countries) to move towards the creation of de facto land rights for mining companies, particularly foreign ones. The valuation of mining rights has implicitly offered many investors significant subsidies to attract them to Tanzania. The much more vital task of creating an indigenous productive class of entrepreneurs in Tanzania remains to be addressed.

### ***Thailand: The Autonomous Evolution of Property Rights***

Thailand is significantly different from most other developing countries in that it was never colonized by a European power even though it came under the sway of the British in India. For instance, it had to sign the Bowring Treaty of 1855 opening the country up to trade. But the absence of a colonial presence allows us to look at more complex and autonomous processes of developing property rights than in colonies. Although Thailand was clearly not a settler colony of the type identified in the new literature on the colonial roots of property rights (Acemoglu, et al. 2001, 2002), this did not preclude Thailand from making its own internal progress towards the evolution of capitalist property rights. This transition began gradually and then accelerated as its economy made a transition that was increasingly rapid in the 1980s and beyond. Nor did the absence of an extractive (non-settler) colonial presence mean that the emerging state in Thailand was not interested in resource extraction. As a general proposition, all states are interested in revenue extraction. But the absence of a colonial state did mean that the evolution of social classes (and therefore of property rights) was driven by internal conflicts of subaltern groups with an indigenous ruling class and not with a foreign ruling class with weak roots in society. The contrast with the Indian case along this dimension is important because an important factor in the development of property rights in India was the increasingly complex political calculations of the imperial power about the social balances that would best preserve its rule. These calculations (and not the desire to maximize revenue extraction) had significant implications for the complex and problematic rights that emerged in the Indian subcontinent.

A second significant feature of Thailand was that possibly till as late as the 1980s Thailand had an internal land frontier which allowed extensive peasant settlement. The land frontier had important implications for the strategies that king and aristocracy could use to extract a surplus as peasants could always move away if surplus extraction became too onerous. This was different from India where the land frontier was largely exhausted in most parts of the country by the early twentieth century. The rice-growing ecology and the availability of unlimited supplies of imported labour from China also made Thailand different from Tanzania. Tanzania's land frontier prior to and during the colonial period was perhaps too extensive relative to population so that settled peasant agriculture did not evolve in the same way.

In Thailand, waves of immigration and settlement were managed by shrewd monarchs who were able to prevent either the aristocrats or the peasants from becoming too powerful. From a country with a population of only around one million in the early nineteenth century, settled mostly in the Chaophraya delta around Bangkok, Thailand emerged in the early twenty-first century as an extensively settled country of sixty five million (Phongpaichit and Baker 1997: 9). The interesting aspect of this transformation is that the peasants who did the hard work of clearing and settling the land did not in most cases have any clear title to the land. On the other hand, aristocrats and emerging merchants did manage to define their rights over the lands they controlled or acquired, and this greatly assisted the land consolidation and land use changes that were required during Thailand's transformation into an industrialized country in the 1980s and beyond.

Nevertheless, even as late as 1985 only 9.5% of occupied land had full ownership titles. A further 33.2% of land had certificates of utilization, which give less than full

title rights. The remaining 57.3% of land was illegally occupied forest land, land occupied with no title or land occupied with certificates of occupation (Phongpaichit and Baker 1997: Table 2.5). Significant land titling issues therefore clearly remain in Thailand, particularly affecting the poor who often find that they are ‘occupying’ land designated as public or forest lands. In the early 1990s when Thailand was already a middling middle income country, a quarter of the entire population was estimated to be illegal squatters on untitled land (Phongpaichit and Baker 1997: 63). Most of these were poor people.

But the absence of titling for significant numbers of people and the weakly defined rights of most others hides a significant real change in social power that had left Thailand’s emerging capitalists with effective control over the most valuable lands and resources by the 1980s. That is why when in 1984 Thailand sought loans from the World Bank and Ausaid to rationalize its land titling system, the subsequent process of titling was a relatively smooth and to a large extent technical process. By 2004 the titling process of private lands, approximately 40 per cent of total land, was in its final stages (Nabangchang-Srisawalak and Srisawalak 2008). The relatively smooth progress in titling significant and valuable private holdings indicates that the effective informal control of valuable assets by private occupants had already become well developed, based on the less than perfect documents and titles that had evolved. This leaves a mass of small plots with less than full title, illegal squatters and those with occupancy titles whose claims will take time and effort to resolve. But in the Thai case the transition in terms of the emergence of a significant capitalist sector with access to reasonably well-working land markets is far ahead compared to any of our other countries.

To understand how Thailand achieved this transformation we need to place the evolution of types of land rights in Thailand in the context of its specific political settlement. Also relevant was the extensive land frontier and access to significant immigrant labour from China with limited capabilities of political organization. A stylized summary of the phases of settlement and evolution of land rights based on the work of Phongpaichit and Baker (1997), Turton (1989a; 1989b) and Hirsch (1990) shows how by the 1980s effective control over significant chunks of valuable land had been acquired by a relatively small commercialized class who could then participate in the emerging capitalist land market. In many respects, this is a story of capitalist emergence from below which has some similarities with the emergence of capitalist land markets in European countries.

Thailand is therefore a useful contrast to set against the more typical developing country story where the emergence of capitalist land markets faces significant political constraints today partly as a result of the rights created by colonial powers to manage political stability. Thailand is particularly interesting as a comparator because an effective capitalist land market emerged here *without* a prior set of clearly defined land rights and without the institutionalization of good governance. Rather, it became possible to institutionalize land rights over valuable and critical assets because the difficult political task of establishing effective control over valuable assets had already happened through a process involving the use of political power, weakly defined or missing rights for significant numbers of people and plenty of corruption, conflict and deception. The point is not to excuse these injustices or to learn how to replicate them elsewhere. Rather, the experience of Thailand, like that of the English

Enclosures shows that the creation of new property rights appropriate for a commercial economy is based primarily on finding economic, political, legal, or military solutions to what are essentially *distributive conflicts* (Khan 2005a). If conflicts over property rights were resolved in unjust ways in some countries, the response should be to find fairer resolutions elsewhere, not to deny the problem.

The transition from a hunter-gatherer economy to settled peasant agriculture began in earnest in Thailand only in the nineteenth century. This period saw the transition from systems of forced labour to the emergence of a tax-paying peasantry, the *phrai*. The king formally owned all land, but the *phrai* had occupancy rights that were eventually recorded in a registry and were heritable. The royal land tax amounted to ten per cent of the rice yield and in addition the *phrai* had to contribute labour and crops to the local aristocracy, the *nai*. The ranks of the aristocracy were described in terms of units of *sakdina* which Phongpaichit and Baker (1997: 11) point out referred to their notional entitlement to command numbers of people rather than areas of land. This reflected the vast land frontier within Thailand and the scarcity of people. From the 1830s the Crown encouraged Chinese immigration to enable the expansion of rice farming, and began to use Chinese wage labour for canal building rather than corvée labour.

The tussle between the monarch, the aristocracy and the growing army of peasants defined the evolution of land rights in Thailand. The political weakness of the peasantry, and in particular the sustained inflow of Chinese immigrants meant that the king could use the immigrants to keep the aristocracy in check, but had no need to create credible land rights for the peasants. Near the capital large areas of new lands were opened up through the construction of canals from the mid-nineteenth century onwards. Initially the king's family and the nobles held large tracts of these lands, leasing them out to peasant tenants. But in the 1870s in the face of conflicts between nobles and tenants, the king supported colonization by individual peasant households. While this excluded the wider body of the nobility from canal development near the capital, it did not in the long-run provide the peasants with well-defined rights. In 1896 the government revoked the decision of 1866 that gave peasant occupiers legal ownership on the basis of tax payments. The peasantry on its own proved unable to resist. When land registration and certificates of ownership began to be developed in the early twentieth century, the main winners were the families close to the king. The incredible concentration of ownership over some of the most valuable land in the country proved to be a lasting legacy. As late as the 1970s three families accounted for one-third of the total tenanted land in the four provinces around Bangkok (Phongpaichit and Baker 1997: 26).

Further away from the capital peasant smallholders continued to dominate as the frontier kept extending. The plentiful supply of land and almost non-existent formal rights for the peasants meant that the peasantry played a very useful function in extending the frontier but had little incentive to settle down or invest much in the land. The cost was the use of very inefficient labour-saving technologies, and the very slow penetration of credit and merchant capital given the absence of effective property rights that could serve as collateral. This situation only began to change significantly after the Second World War, with the government for the first time using the instruments of the state to penetrate the rural economy in an attempt to raise productivity. Village elites became absorbed into the administrative structure of the

state and they assisted merchants and outside capital to enter the village economy through credit and marketing chains. The marketization of the village economy and the pressures of tax and debt led to a differentiated peasantry emerging in the 1970s and beyond. A significant village working class also emerged, amounting to around a third of the rural population, with more substantial peasants acting as employers.

The commercialization of the economy changed the way in which the frontier was being extended. One variant was the development of agribusinesses in the 1970s. Companies like Charoen Popkhand and Dole went into large scale agribusinesses like poultry, pineapple farming and fish farming particularly in frontier upcountry areas with government assistance. A more colourful 'Wild East' variant took the form of entirely private initiatives where new merchant money together with military officers took the initiative in clearing land, often forest land, settling new settlers and then providing protection without any form of government documentation. Local power brokers or *kamnan* often with their power base in local administrative offices collaborated in this nexus. As they were charged with collecting taxes, keeping records and settling disputes, they were potentially important from the perspective of outside investors for securing effective possession and eventually titles over valuable chunks of forest or newly cleared land. It was a gamble for the outside investors, but many fortunes were made when these gambles paid off (Turton 1989a, 1989b; Hirsch 1990, 1993; Phongpaichit and Baker 1997).

These historical developments in land clearance and the evolution of land rights were a critical part of the background against which the rapid industrial transformation of Thailand was organized in the 1980s. By the mid 1980s manufacturing overtook agriculture in its contribution to GDP and to exports. The rapid growth of manufacturing required a significant change in land use as new factories, infrastructure, roads and warehouses had to be constructed. Although formal and clear land rights did not exist even then, a significant part of the most valuable land in the country was by then firmly in the possession of a commercialized class. In addition, a significant chunk of the most valuable land around Bangkok was not only available in huge contiguous plots; much of this land already had clear titles given the history of the canal developments. Directly as a result of these developments, the market failures in the land market facing potential investors in new sectors were relatively minor. It is not surprising that some of the earliest industrial developments were in and around the Rangsit belt near Bangkok. Much more land was available further from the capital and in these cases though land titles were sometimes not complete the most valuable land was already in the hands of a commercial class who would be willing to sell effective possession at a market price. The missing titles raised transaction costs as informal methods of verification and protection had to be used for a time, but other aspects of transaction costs were low. Valuable land near the infrastructure of the capital and other towns was available in contiguous plots in the hands of individuals who would want to sell at a market price. Not surprisingly, market failures in land markets were not serious enough to make the market collapse. In this respect Thailand was significantly different from many other developing countries.

In discussions with businessmen in Thailand it is clear that the difficulty of acquiring land is rarely perceived today to be an important constraint for business expansion plans. For specific reasons to do with political nationalism foreign investors have faced a number of legal barriers to land ownership in Thailand but these barriers are

not part of the structural transaction costs of the land market. The stylized history sketched above suggests that the *relatively* low transaction costs facing productive investors in Thailand in the 1980s and beyond can only be properly understood by looking at the historical evolution of rights. The reasons lie in the gradual acquisition of *effective control* over significant tracts of valuable land by a class of commercially minded landholders and their ability to transact these rights with the assistance and connivance of state officials at all levels even in the absence of full and clear titles. It is clear from this history that the relatively low transaction costs for productive investors are not directly the consequence of a favourable land-person ratio. Tanzania has more land per capita than Thailand but a different evolution of land rights in Tanzania has meant that investors requiring new land face more significant transaction costs.

Nor can this outcome be attributed to the prior achievement of well-protected property rights across the board. Indeed it could be argued that the ease with which land was acquired by proto-capitalist classes from the late nineteenth to the mid-twentieth century had much to do with the systematic exclusion of the bulk of the population from effective land rights. Many of Thailand's poor who still have little or no formal rights over the land they occupy often face very high transaction costs in protecting their tiny plots of land from the encroachment of well connected land grabbers. The land problems that remain in Thailand have to do with resolving the access to land for these poorer sections of the population who find themselves in occupation of 'illegal' lands within forests or with no title over land that they have long farmed. These are vitally important problems for ensuring justice today. The failure to address these problems is also likely to have political consequences particularly in areas like the increasingly disaffected north-east where Taksin's populism found deep social support. But at the same time, Thailand did not confront to a significant degree the growth reducing problem of very high transaction costs facing investors attempting to acquire relatively large chunks of land for new productive uses.

Underlying the Thai experience has been a very specific political and ecological history. A fortuitous balance of greed and power between competing classes allowed primitive accumulation to continue over a period of a century as the frontier expanded. Land steadily accumulated in the hand of a class of merchants and ex-aristocrats whose interests in their holdings were increasingly commercial. Intermediate groups were either incorporated into these classes at lower levels (like the village-based *kamnan*) if they were useful for the processes of accumulation, or they were entirely excluded. But the distribution of power and rights was not such that these early primitive accumulators could impose high levels of labour discipline. Thai agriculture remained land-using and suffered from very low yields. Nevertheless, the relatively concentrated group of people with the political and later financial power to acquire effective control over substantial tracts of valuable land did not have to share their formal or de facto rights with any other significant political groups. Here, Thailand emerges as significantly different from the countries of the Indian subcontinent and many other developing countries.

Contemporary Thailand therefore represents a success story in terms of an advanced stage of transition to well-defined property rights in land in urban and industrial usage, though a long path of travel remains for clarifying and granting rights to the majority of the population that remains in agriculture, informal activities and in small

urban settlements far from the capital. As far as the demand for land for high value-adding activities in industry and services based near urban centres is concerned, land registration and titling is reasonably efficient. Speed money is sometimes reported as useful for speeding up the bureaucratic process, but the titling and registration are now sufficiently clear that in some cases transfers of ownership can be done in a single day. In rural areas, the spread of commercial farming and other land-using activities into areas where titling is weak or where forest and other public lands are involved often involves far more significant ‘partnerships’ with public officials and occasionally conflicts with environmental groups, local residents and others. But as Thailand has shifted to a manufacturing driven growth strategy in the 1980s and beyond, conflicts over lands far from transport networks have temporarily receded in political significance. If more land-using growth strategies emerge in the future, the political conflicts over titling in the more remote areas may become significant.

### ***West Bengal and Bangladesh: The Legacy of Colonial ‘Zamindari’ Rights***

The history of the evolution of land rights in the Indian subcontinent sharply contrasts with that of Thailand. The first major British conquest in the Indian subcontinent was the Mughal province of Bengal in 1757 which by then was already a settled peasant economy. The province included the modern states of West Bengal in India and independent Bangladesh, which are two of our case study areas. Parts of Bengal had settled agriculture from the second millennium BC and most of Bengal had been settled for at least four centuries before the British arrival (Eaton 1993: 3-21). Contrary to the simple story of a non-settler colonialism setting up an extractive system that was disruptive of stable property rights, the history of British imperial rule in India was one of a continuous but ultimately futile series of interventions to create rights appropriate for a more productive revenue-paying agriculture while attempting to maintain political stability. These two objectives proved to be conflicting and led to the creation of conflicting sets of rights that in the end significantly raised transaction costs for productive investors. The colonial state failed even to sustain the levels of revenue collection it had begun with. The history of British property rights interventions in the Indian subcontinent shows powerfully that it is not the presence or absence of rights that matters but rather the *types* of rights that are created or destroyed and how that affects the productive transformation of that society.

From the Indian perspective, the impact of British imperialism came at a most unfortunate moment when the Mughal system of land rights and revenue collection was facing severe internal tensions. The growth of long-distance trade in the eighteenth century led to growing conflicts between merchants, financiers and the nobility who comprised the Mughal ruling classes over what to tax and by how much. These conflicts were in turn increasingly expressed in political intrigues within the state apparatus of the last independent ruler of Bengal, Nawab Siraj-ud-Daula. They led directly to a calamitous dénouement with the military disaster of 1757 at the Battle of Polashi (Plessey), where intrigue, deception and betrayal on the part of the nawab’s main financiers and generals led to a pre-arranged victory for the English against nominally much superior Bengal forces (Pavlov 1979: 83-107 and 215-56). The new balance of military power enabled the East India Company to install and remove subservient nawabs at the provincial capital Murshidabad, till in 1772, Warren Hastings brought the unnecessary facade of dual government to an end. An English council under a governor took over the administration and shifted the capital to Calcutta, which eventually became the capital of British India.

Before the colonial impact, Bengal was ironically a relatively prosperous and food surplus province of the disintegrating Mughal Empire. The agricultural technology used in India just prior to the colonial period was significantly inferior to that used in Europe but yields per acre were comparable or even higher than European levels (Raychaudhuri 1983: 17-18). Bengal in particular also appeared to be an especially promising region for the indigenous development of manufactures from the late seventeenth century onwards. The artisan sector, particularly textiles, was well-established and was the basis of a thriving long-distance trade organized by Indian merchant capital. The agricultural surplus was large enough to maintain substantial urban populations, particularly at Dhaka and Murshidabad, even when the Mughal capital at Delhi could enforce the full payment of taxes to the central authority (N. Ahmad 1968: 98-104). Prior to the English, civil and military administration was in the hands of a tax-collecting nobility, the Indian equivalent of a 'feudal elite'. It was not in the interest of this landed nobility to either accumulate inordinately or kill the peasants and artisans who produced their surplus, both of which would attract the unwelcome attention of higher-level administrators. This allowed the growth of a substantial artisan sector, which despite technical backwardness produced commodities which were in high demand throughout the world. Many artisans were directly settled in cities supplying the demands of the administrative and military elite. According to one estimate, the home market for luxury handicrafts alone amounted to about five per cent of Mughal national income, with the export market accounting for another one and a half per cent before the English takeover (Maddison 1971: 54).

In the aftermath of the victory of the East India Company, some of its immediate actions came close to the expropriation model of a non-settler colony. While the company used the language of free trade, its strategy of unequal taxation and underpaying the Bengali artisans ensured the destruction of the artisan economy. The company and its servants acquired the right to move goods in the interior duty-free, depriving the nawab's treasury of revenue and destroying local merchants who were forced to pay domestic tolls and duties. In 1763, Nawab Mir Kasim made a final attempt to save the local economy by declaring that since the English enjoyed free trade, his treasury would also absolve Indian merchants from paying any duty. The English reaction was swift and unequivocal. The head of the company's factory at Patna attacked the city, and in the ensuing two and a half month war, the nawab's depleted army was defeated in six successive battles. The company's privileges were restored by restoring duties for indigenous merchants. This symbolic effort was in effect the last 'nationalist' stand of the fractious indigenous ruling elite (Mukherjee 1974: 304-12; Islam 1984: 47-53).

The company's servants and *gomastahs* (local agents) now had unbridled power to underpay the artisan, and the company appeared to prefer vast short term profits to the survival of the artisan economy. William Bolts, a contemporary English merchant has left a graphic account of the system of fines, floggings, imprisonments and forced bonds which enabled them to do this (Bolts 1772: 73, 83, 191-4; Mukherjee 1974: 302-4). Furthermore, the destruction of the Mughal elite destroyed a substantial part of the domestic demand for luxury handicrafts. As much as three quarters of domestic demand disappeared according to one estimate (Maddison 1971: 54). In less than a century, the thriving artisan manufacturing sector was virtually destroyed, with

serious implications for indigenous skills, technology and entrepreneurship. The vast urban settlements which visitors from Europe had once marvelled at also disappeared. Sir Charles Trevelyan reported in 1840 a decline in the population of Dhaka from 150 to 30 or 40 thousand (Dutt 1950: 114).

However, on the issue of land revenue and land rights, the early colonial discourse was much more constructive from the outset even if the actual outcomes appeared to conform to the extractive model. The declared aim was to create a productive landlord class by creating rights over land revenues that were formal and marketable. The fact that this was not just a cynical discourse is shown by the fact that when the results in Bengal proved disappointing, the colonial authorities experimented with different allocations of land revenue rights in other parts of India. As a result of these different experiments as well as important differences in initial conditions, there were differences in the character of the new middle classes which emerged across British India, and in the pace and extent of industrial development. Class evolution depended not only on pre-existing structures of land rights and the organization of merchant and usury capital, but also on the types of land rights that the British experimented with. Much depended on when a province was annexed and changes in prevailing fashions in the contemporary 'institutional economics' debates going on in England. Regional variations in the availability of raw materials and in the fertility of the soil were also of importance. But while some Indian regional results were indeed better than the Bengal experiment, nowhere did the British succeed in creating the productive agrarian capitalist class that they wanted to create to increase land revenue collection.

The conflicting objectives and strategies of the evolving colonial state in India can be analysed in terms of the analytical distinction David Washbrook makes between the motivations of the 'mercantilist' colonial state of the mid-eighteenth to mid-nineteenth century and those of the 'High Colonial state' that coexisted from the beginning but emerged in its full form after the 1857 Mutiny/War of Independence. In its initial phase, the colonial power was primarily interested in maximizing revenue from the land, and this was achieved by making the pre-existing Mughal and Nawabi land-tax collection system more efficient (Washbrook 1981). The Mughal state collected land-tax by appointing a chain of intermediaries, who though they had no rights to the land they collected from, had formal and often inheritable and transferrable rights to collect revenue (Sinha 1962; Habib 1963; Hasan 1969). While the disintegration of the Mughal Empire from the late seventeenth century onwards made some difference to the relative power of different levels of this hierarchy, the structure itself remained more or less intact. The Mughal *subahdar* (governor) of Bengal, Murshid Quli Khan, virtually declared independence in 1707 by stopping revenue payments to the centre, but within Bengal he rationalized the revenue collection system and attempted to exert greater pressure on the higher level revenue collectors, the *zamindars*, to increase revenue collection (Ray 1979: 1-51).

The 'mercantilist' colonial state's ambitious property rights experiment was in intention not just a mercantilist surplus extraction project but an attempt to create institutional incentives for agricultural 'improvement' along the English model (Arnold 2005). The Permanent Settlement of 1793 boldly declared that *zamindars* were 'proprietors of the soil' and granted them formal tradable rights to collect revenue (Chaudhuri 1983: 88). In fact, the Act only gave *zamindars* the formal right to buy and sell their revenue collecting authority, in exchange for a perpetually fixed

money rental paid to the state. Though the money rent was fixed at a high level, it was fixed in perpetuity in nominal terms, so the intention was clearly to create incentives for *zamindars* to improve the land. At the same time, failure to pay the revenue to the state would lead to the *zamindari* being auctioned. Historical consensus has now shifted away from the opinion that the Permanent Settlement created ‘capitalist’ property rights in land (Mukherjee 1974; Alavi 1975), to the more tenable position that it attempted to make the pre-existing revenue structure more efficient by ensuring that *zamindars* had strong incentives to make the revenue payment on time and to improve the land (Ray and Ray 1973; Ray 1974; Ray and Ray 1975; Ray 1979). But whether any of this could be done depended on whether the *zamindar* had adequate rights to compel the settled peasant producers to put in more effort or otherwise do things differently. And here lay one of the fatal flaws in its institutional design. The Permanent Settlement did not give *zamindars* any such rights, and the subsequent evolution of colonial law successively increased the rights of lower level intermediaries at the village level (though rarely the rights of the poorest peasants).

The design failure could initially have been the result of thoughtlessly transporting bits of an institutional model from one context to another. The Mughal *zamindari* system worked through the *zamindar* using lower level tax collectors who included village-level petty landlords and professional tax collectors. In the original version, the *zamindar* had a strong hold over these lower level collectors and over peasants because the *zamindar* was not just a revenue collector but also at the apex of a local *political* unit providing policing and conflict resolution functions (Rahman 1986). These formal powers gave the Mughal *zamindar* a network of informal powers through which revenue collection could be enforced. But under the permanent settlement, while the British created formal rights for *zamindars* they also removed policing and judicial functions to new classes of professional functionaries. This undermined the informal powers of *zamindars* without giving them new rights that may have established a market-based discipline. For instance, peasant *ryots* could pledge land against arrears, but they could in theory also claim their land back by paying off the arrears even after generations, significantly weakening the possibility of *zamindars* permanently changing land use (Chaudhuri 1983: 151-2).

Lacking market power, rural creditors and agents of *zamindars* often used crude forms of coercion that created hatred rather than efficient responses by the producers. The outcome was therefore not surprising. The increase in revenue could not be delivered in many cases without very crude and obvious coercion and large numbers of *zamindaris* went up for auction without many new takers appearing. As inflation reduced the real burden of the revenue settlement, *zamindaris* eventually did become viable investment propositions for merchants and traders, but the creation of *zamindari* rights never had the desired effect of creating incentives for improvement. The persistence of this experiment and others like it in other parts of India cannot simply be explained by a technical design error. *Zamindars* and merchants continued to demand that their rights vis-à-vis lower level surplus claimants and peasants should be strengthened but these demands were systematically rejected. Subsequent reforms made the situation even worse by further strengthening the rights of village-level petty landlords and revenue collectors.

Why this happened can be understood in terms of the evolving motivations of the ‘High Colonial State’ (Washbrook 1981). The colonial power clearly lacked

traditional sources of power and authority and its existence could not but undermine the authority of indigenous dominant classes. This made the maintenance of social order a matter of great concern from the outset but particularly after the 1857 Mutiny/War of Independence. It is not surprising that the state's policies demonstrated a growing concern to construct new allies and balances of power. The innovation was a new concern with the 'peasant' or *ryot* meaning not the impoverished tillers of the soil but the petty village landlords and intermediaries who were most likely to emerge as the organizers and representatives of mass discontent. Prior to 1857 this concern manifested itself in the refusal to extend *zamindar* rights too far against lower level intermediaries and peasants. After 1857 the state's concern with the possibility of further disturbances took the form of positive legislation to protect *ryots* and strengthen their rights.

This was clearly a political agenda of delivering to groups whose support the colonial power thought it needed. The strategy cannot be explained either by a desire to extract a greater surplus (indeed this was a period of falling land revenues) or to enhance growth (as these rights made it more difficult for *zamindars*, merchants and usurers to achieve effective control of the land to change production relations and technologies). Important legislation of this period includes the Rent Act of 1859 and the Tenancy Act of 1885. Both Acts, and particularly the latter, strengthened the rights of the so-called 'occupancy *ryots*' who were the petty village level landlords often called *jotedars* in Bengal. As the *jotedars* were surplus farmers and sometimes also village-level rentiers, they had structural conflicts of interest with the higher-level revenue collecting *zamindars* (Chatterjee 1982: 123-4). The Tenancy Act formally recognized the rights of *ryots* as formal tenants of *zamindars* but again without granting the latter any formal powers to compel their 'tenants' to do anything.

The creation of these new rights meant that these 'intermediate classes' could keep a bigger share of the surplus for themselves. But the *jotedars* too did not have any effective capacity to change production relations at the village level because their powers to accumulate land, evict their own tenants on any significant scale or to settle new tenants were very limited. It was only through an amendment of the Tenancy Act in 1928 that *ryots* acquired the right to buy and sell their occupancy rights, but that too by paying 25 per cent of the sale price to the *zamindar* and with the *zamindar* having the right of pre-emption (Chaudhuri 1983: 152-3; Barkat and Roy 2004: 25-7). These complex checks and balances were intended to preserve the status quo in precisely the way in which a properly working land market would threaten to disrupt. The result was that by the 1870s it was clear that the surpluses of the village petty proprietor group were not being invested in agriculture but rather to finance the migration of their sons to the city. This migration was greatly assisted by another 'stabilization' strategy of the raj: the rapid growth in the largely unproductive employment opportunities created by the burgeoning state that 'managed' empire (Gordon 1974: 28; A. M. Ahmad 1975; Chatterjee 1982: 121).

Thus the rights the raj created for different categories of landed peasants and revenue collectors may have reduced some specific transaction costs but did not reduce the critical transaction costs facing potential investors who may have wanted to achieve effective control over land in the way Thai investors were able to do in the second half of the twentieth century. And certainly the new property rights did not help to change the organization of production in peasant farms. Paradoxically, the flow of

people from the intermediate classes to urban professions resulted in a further increase in the organizational power of the intermediate classes and the creation of further rights and protections for them. The increasingly assertive intermediate classes were behind the formation of the Indian Association in 1876, which split from the old British Indian Association dominated by the big zamindars. They were also to provide the organizational backbone of the Indian National Congress, the Muslim League, and in Bengal set up their own party, the Krishok-Proja (or Peasant) Party. Ironically, in the end the empire was brought down by the very classes the British nurtured to check the pretensions of the *zamindars* and merchant capitalists above and the poor below. It can then be argued that the damaging effects of British colonialism on the productive economy were not primarily due to its extraction of surplus but to its social engineering. This created competing rights that blocked a productive transformation of agriculture or even the acquisition of effective rights over contiguous territories of land, which could have reduced the transaction costs of a subsequent productive transformation into manufacturing.

After independence in 1947 Pakistan abolished *zamindari* in 1950 and India in 1951. By then the real value of the rents the *zamindars* appropriated had in any case dwindled to insignificance. The *ryots* who had effective occupancy rights now became legal owners of land and directly responsible for the land tax which had become trivial in real terms. But land markets did not work to create any consolidation of land in Bengal. The very small scale of most farms meant that for many of them, the agrarian surplus was simply not there for expansion through buying up neighbouring lands. And the transaction costs for investors outside the village to attempt to take over significant quantities of land and then change the organization of peasant production were too prohibitive (Mahbub Ullah 1996; Khan 2004). As a result, demographic forces were the main determinants of the declining average size of farms in Bangladesh. Table 1 shows the worrying and continuing fragmentation of land in Bangladesh's agriculture.

**Table 1 Land Fragmentation in Bangladesh 1984-1997**

Size of holdings (acres)	1983-4 Census		1996-7 Census	
	Frequency (%)	Owned Area (%)	Frequency (%)	Owned Area (%)
Small (0.05-2.5)	75.4	18.2	83.1	26.2
Medium (2.5-7.5)	19.9	56.2	14.3	56.3
Large (7.5- )	4.7	25.6	2.6	17.5

Source: World Bank (2000: Tables 1.5 and 1.6).

The land market continued to have high transaction costs because the land rights the *ryots* inherited had not been designed to facilitate purchases and sales of land. The process of reconciling registered records of ownership of landholdings with the land records and maps that had served the colonial revenue system threw up millions of disputes that continue till today all across the Indian subcontinent. In Bangladesh, according to one estimate, of the roughly 1.8 million cases pending in the courts in December 2000, 1.4 million were land related cases, and the average time in court for a land-related case was 7.6 years (Barkat and Roy 2004: Tables 9 and 16). Major initiatives are under way to computerize land records and to resolve inconsistencies in

the dual system of registering records in the deeds registration offices and the cadastral records and mutations therein held in the land records offices (Uniconsult Ltd. 2009). However, the reason that court cases take so long to resolve is only partly because of shortcomings in procedures and management capabilities in record keeping.

A successful land transfer involves not only a registered transfer between the legal holder of the title and the buyer, but also a record or 'mutation' in the maps of the surveyed lands. As the plots in the two systems of record do not necessarily overlap and as border disputes between neighbours or partition disputes between heirs can be significant, the resolution of claims can be a lengthy process of attrition. The system of land rights where different records do not have a clear legal primacy is a reflection of the colonial tradition of land management established by the British whose aim in its later phases was primarily to avoid conflict by preserving the status quo. Attempts at resolving conflicting allocations of rights were conflictual and avoided as far as possible. The resolution of inconsistencies will almost inevitably produce one or more losers and conflicting records and claims reflect the fact that this resolution has not been done in the past. As land values have risen the courts have become an arena for lengthy wars of attrition as a method of resolving disputes, at great cost to society. Once these conflicts are resolved for a particular plot of land, the system of land titling and transfers works reasonably well and transfers do not take long to make effective. The issue therefore appears to be not the system of record-keeping and the process of changing the records that land transfers involve but the cost of resolving disputes.

In the meantime, the costs of resolving these disputes have grown exponentially because of the rapid fragmentation of land due to demographic processes. The absence of significant manufacturing employment opportunities makes poor peasants hold out in long disputes out of desperation (and also makes them easy recruits for political opportunists taking advantage of land disputes). At the same time, the high transaction costs of acquiring land contribute to the slow progress of manufacturing, creating a vicious cycle. Even in the absence of disputes over land ownership and boundaries, extreme poverty can be expected to raise transaction costs because poor peasants will hold out for very long for slightly higher prices, particularly given the low opportunity cost of waiting. Land fragmentation and poverty have therefore not only made it difficult to resolve the conflicts that could create property rights appropriate for a well-working land market, the likelihood is that with poverty and fragmentation transaction costs will be high even with well-defined property rights (Sarkar 2007).

In West Bengal land reform to benefit the poor and middle peasantry was a central plank of the political strategy of the Communist Party Marxist (CPM) which came to power in 1977 as the dominant party in a Left Front government. The strategy of strengthening the rights of small and medium peasants was the cornerstone of the electoral strategy of the left front. The reforms had two major objectives. The first was to improve the bargaining power of *bargadars* or sharecroppers by registering them and making it legally more difficult to evict registered tenants. Between 1977 and 2003 1.2 million additional *bargadars* were registered (the registration process had begun under the previous government), accounting for 9 per cent of all cultivators (Dasgupta 2005: Table 2 and Appendix Table 2). The second objective was to carry

out a redistribution of land to landless and land poor peasants making them minor landholders or *pattadars*. The land was acquired from landholdings greater than the land ceilings set by many Indian states including West Bengal in their land reform acts which had not been fully enforced. Over the same period, an additional 3.5 per cent of sown area was redistributed benefiting another 14 per cent of the agricultural population (Dasgupta 2005: 4).

**Table 2 Land Fragmentation in West Bengal 1971-1996**

Size of holdings (hectares)	1970-71		1995-96	
	Frequency (%)	Owned Area (%)	Frequency (%)	Owned Area (%)
Less than 1	60.0	21.5	76.4	42.9
1-4	35.6	54.6	22.6	47.8
4-10	4.4	19.2	0.9	5.7
More than 10	0.1	4.6	0.02	3.6

Source: From Dasgupta (2005: Table 11)

These policies benefiting small and medium peasants together with the expansion of high yielding varieties of seeds in the 1980s drove very high growth rates in West Bengal agriculture. In the 1980s foodgrain output increased at 5.5 per cent a year. Nevertheless, rural poverty remained higher than the Indian average and in the 1990s agricultural growth slowed to just over 2 per cent per annum (Sarkar 2007). The constraint to agricultural growth was the smallholder model which cannot sustain endless growth given that after a point scale economies in land use and mechanization become important. Table 2 shows that growing land fragmentation is as severe in West Bengal as in Bangladesh (note that Indian figures are in hectares, with 1 hectare = 2.47 acres). If anything, pro-poor land redistribution in West Bengal has kept the amount of land held in uneconomic tiny holdings at excessively high levels (43 per cent of agricultural land is less than 1 hectare each). The problem for the government was that when it realized the need for attracting industry to the state in the 2000s, it found that its land policies, while they were clearly pro-poor and had many desirable features, had actually further raised the transaction costs of organizing a significant change in land use.

As West Bengal has a longer industrial history than East Bengal (Khan 2008b), West Bengal has more land near urban centres and transport networks with titling and land record issues sorted out. As in Bangladesh, where registered ownership and the land records based on cadastral surveys (maintained by the Land and Land Reforms Department in West Bengal) are consistent, land transactions are relatively efficient. The issue in both West Bengal and Bangladesh has been that the land already available in the industrial land market is insufficient and extending land use has proved to be very difficult given the types of land rights that were inherited. The types of conflicts that could emerge were brought to the fore by the conflict in Singur over the failed attempt to set up Tata's Nano factory, which we will examine as a case study later.

### ***Maharashtra: Did 'Ryotwari' Rights Make any Difference?***

Western India came under British rule fifty or so years after the fall of Bengal. Gujarat fell to the British in 1803 and most of the Bombay Presidency in 1818. As the poor results of the *zamindari* Permanent Settlement in Bengal were apparent, other experiments were tried in the newly conquered parts of India. Two major variants were the *mahalwari* system introduced in northern and central India in areas which now include western Uttar Pradesh, and the *ryotwari* system introduced in western India and parts of southern India. The areas that are now the state of Maharashtra came under the *ryotwari* system. In the *mahalwari* system the revenue collecting rights were settled on a lineage or clan of smaller village level *zamindars* who collectively controlled a group of villages. While the *mahalwari* system was effectively quite similar to the *zamindari* system (as a dominant coordinating landlord often emerged), the *ryotwari* system was different. In the *ryotwari* system the revenue was settled on individual landholders. In the *zamindari* and *mahalwari* systems the proprietary right to collect revenue could be bought or sold with no effect on the peasant or *ryot* who farmed a piece of land. In the *ryotwari* system the landholding peasant was also the 'revenue collector' so a failure to pay the rent could result in the dispossession of the peasant from the land. Partly because of this, the survey and assessment of revenue claims was done much more carefully. The Bombay Survey System was framed in 1835 and took sixty-six years to complete. Unlike the *zamindari* system the assessment was based on a judgement of ability to pay, and the assessment was to be revised every thirty years (Fukazawa 1983).

Later observers have argued that *zamindari* areas consistently underperformed the *ryotwari* areas. In an influential econometric exercise Banerjee and Iyer (2005) argue that *zamindari* districts in India have ended up in the 1980s with lower agricultural yields compared to *ryotwari* and *mahalwari* areas. As *zamindari* was abolished in the 1950s, these findings appear to show a significant lasting effect of institutions. But a careful reading of their article shows that the mechanisms that could explain the persistence of the effect are not very convincing. They point out that the differences in contemporary yields are largely due to differences in contemporary levels of investment. So we need to know if historic land revenue systems can plausibly explain differences in contemporary investment behaviour. They consider three mechanisms which could relate colonial land settlement to contemporary investment.

The first possibility is that *ryotwari* and *mahalwari* areas were the main beneficiaries of colonial investment in infrastructure that in turn had a lasting effect on difference in profitability between regions. The colonial government may have preferred to invest in infrastructure in *ryotwari* areas because of the possibility of raising *ryotwari* revenue assessments. But the most significant colonial investments happened in the *mahalwari* areas of north-west India, including modern Pakistan. We know that these investments had little to do with revenue and were motivated by the need to pacify the areas from which the British Indian army recruited. Banerjee and Iyer themselves discount this mechanism as significant for contemporary differences in yields because the gap between *zamindari* and other areas only begins to emerge after 1965 and includes the southern Indian *ryotwari* states that did not benefit from colonial infrastructure to the same extent. A second possible explanatory mechanism could be that *zamindari* areas had a greater area of very small 'marginal' farms (64% of holdings were less than 1 ha in 1990 compared to 56% in non-*zamindari* areas). This could explain lower investment and growth, but Banerjee and Iyer discount this

mechanism on the grounds that the differences are not great enough, and in any case this feature of *zamindari* areas may have nothing to do with the revenue structure introduced by the British.

The third possible mechanism is that the political environment that developed in the perhaps more unequal *zamindari* areas was not conducive to cooperation between the 'masses' and the 'elites' resulting in lower development spending (13 rupees per capita in *zamindari* areas compared to 19 rupees in non-*zamindari* areas between 1960-65, with the gap increasing even further subsequently). Interestingly, this mechanism has little to do with the structures of property rights established by revenue systems. It refers to rather broad differences in elite-mass political relationships that may have developed as a result, but these are not well established or explained. The link between structures of revenue settlement rights established in the eighteenth and nineteenth centuries to the politics of Indian states in the late twentieth century fifty years after these revenue arrangements were abolished would need to be much more carefully established to be convincing. At best, we can agree that there are statistical differences in government development spending between regions and that the most likely explanation is a difference in political organization between regions. To attribute these differences in political organization to historic land revenue systems requires more convincing causal explanations.

In particular, Banerjee and Iyer need to argue that the British choice of revenue system had nothing to do with pre-existing social structures in these areas, and was an accident of when the province was absorbed into empire. In fact, there was a great deal of continuity in the land revenue structures the British introduced and pre-existing Mughal systems. Much of the British effort was to formalize rights that described how they thought the existing economy worked. This was certainly the case in Bengal, the northern and central states where *mahalwari* was introduced (Stokes 1983), and in the west including Maharashtra, where *ryotwari* was introduced (Fukazawa 1983). Only in the south was there a significant randomness in the type of revenue rights introduced. To argue on the basis of the experience of the southern states that the entire revenue structure across India should be seen as an exogenously determined institutional experiment could clearly be misleading. The revenue structures introduced by the British could in many if not most cases be correlated to earlier differences in ecology, social organization and class structure, which could in turn be the real determinants of some of the contemporary differences in political organization across Indian states.

Returning to Maharashtra and the *ryotwari* system introduced in the west, we know that this too was built on earlier Mughal and Maratha land revenue systems. The Maratha land revenue system was itself based closely on the Mughal system and the British built on this base. Unlike Bengal where the *zamindar* under the Mughals was in charge of a political administrative unit, in the Konkan, Deccan and North Kanara regions which include much of modern Maharashtra, land administration was in the hands of hereditary district level officials, the *deshmukh* and the *deshpande*. The Marathas introduced their own paid officials who fixed the land tax for each village with the village headman. Village landholders or *mirasdars* were then responsible for the share of the revenue allocated to them by the village, though they did not lose their land in case of a temporary inability to pay. When the British adopted the *ryotwari* system they were clearly working with the grain of the revenue system that

already existed. Indeed their intention of settling the revenue for each *ryot* or *mirasdar* was mainly to prevent the stronger peasants passing on an excessive share to weaker peasants within the village (Fukazawa 1983).

Despite the obvious differences in the structure of rights created in the *ryotwari* system, the common outcome across India was that the different systems of rights had little effect on the ease with which land could be accumulated or its use changed. In Bengal there was an active market in *zamindari* rights but no significant change in the effective occupation and use of land. The really interesting feature of the market in *ryotwari* rights in the Bombay Presidency is that it too did *not* lead to any *significant* change in the overall distribution and use of land. Effective control of significant amounts of land did not pass to merchants or financial capitalists as one may have expected once the occupancy rights of the *ryots* became alienable. To understand why not, we need to go back to the political imperatives of the colonial state, which rapidly created countervailing rights precisely to prevent an outcome that may have had destabilizing political consequences for a state with weak roots in society.

Following the introduction of the *ryotwari* system, revenue pressures on poorer peasants did lead to land acquisitions by Gujarati moneylenders and also by the more prosperous cultivating castes like the Kunbis. But riots broke out in 1875 in the poorer parts of the Deccan and turned to violence in Poona and Ahmadnagar districts (Natarajan 1979). The British response was swift. Nearly a thousand peasants were arrested within a fortnight but after quelling the uprising the government went to work on the law, redefining rights to ensure that this did not happen again. The Deccan Agriculturalists' Relief Act of 1879 put limits on the alienation of land and on usury. Courts were enjoined to go into the history of each transaction and try to find a solution that did not require dispossession, including if necessary reducing the interest rate already agreed upon or increasing the repayment period. The result was that moneylenders reduced their lending. Far from any land concentration or even consolidation being achieved as a result of the *ryotwari* land market, in Maharashtra as in other parts of India, peasant landholdings actually became more fragmented throughout the colonial period, primarily as a result of the natural effect of demographic forces (Fukazawa 1983: 199-202).

After India's independence there was less to do in *ryotwari* areas as significant classes of intermediary rent-owning classes did not exist and no serious land reform to change actual farm sizes was considered anywhere in the Indian subcontinent. But here too, some landholders had become *de facto* intermediaries through the accumulation of significant landholdings that were then sub-let to tenants. Tenants on these lands were now further protected with legislation making eviction difficult and setting land ceilings on holding (though as elsewhere these land ceilings were not strictly enforced). Contemporary land fragmentation in Maharashtra is less serious than in Bengal, but the trends of growing fragmentation over time are just as strong as can be seen in Table 3. If we adjust the slightly higher average landholding sizes in Maharashtra for the significantly lower land productivity, the issues of rural poverty and peasant desperation are even more severe. A comparison of agricultural yields for 2006 demonstrates the relative poverty of Maharashtrian agriculture. The yield for rice was 1768 kg/ha compared to an Indian average of 2102, and West Bengal's 2509 kg/ha. For wheat, Maharashtrian yields were 1393 kg/ha compared to an Indian average of 2619 and West Bengal's 2109 kg/ha. And for cotton, Maharashtra

achieved only 187 kg/ha compared to an Indian average of 362 and West Bengal's 510 kg/ha (Government of Maharashtra 2008). Clearly, Maharashtra does not fit Banerjee and Iyer's (2005) general statistical claim that *ryotwari* areas ended up with higher yields than *zamindari* areas.

**Table 3 Land Fragmentation in Maharashtra 1977-2001**

Size of holdings (hectares)	1976-77		2000-01	
	Frequency (%)	Owned Area (%)	Frequency (%)	Owned Area (%)
Less than 1	26.1	3.3	43.7	13.2
1-4	43.1	26.1	48.5	55.9
4-10	23.5	39.5	7.1	24.2
More than 10	7.4	31.0	0.7	6.8

Source: Government of India Agricultural Census 1976-7 and (Government of Maharashtra 2005: Table 3.10).

A most disturbing illustration of Maharashtra's poor agriculture is provided by the staggering figures for peasant suicides in the state. The state has one of the highest rates of suicides of indebted peasants in India, with some estimates putting the figure at 29,000 deaths between 1997 to 2005 (Sainath 2007). Paradoxically, the poverty of Maharashtrian agriculture has meant that land acquisition for industry has been significantly easier compared to West Bengal. In West Bengal not only was the population density higher, in addition land reforms and agrarian growth benefiting primarily middle and rich peasants made them less willing to sell out even though their absolute standards of living were still very low. Land acquisition in Maharashtra for industry was in general easier but not because property rights on land were more appropriate for efficient land market transactions. Rather, the operation of the Maharashtra Industrial Development Corporation (MIDC) which we will look at later suggests that state institutions were able to exercise political power more effectively to acquire large tracts of land from relatively weaker and more impoverished peasants.

Maharashtra is also one of several Indian states that made significant progress in computerizing parts of their land registry and land record systems (Uniconsult Ltd. 2009). As land registration and land records are a state matter in India, there are important variations across states. The Maharashtrian experience is that the effect of computerization has been to speed up registration in straightforward cases but computerization by itself obviously does not resolve either the conflicts created by inconsistencies in records or the overall problem of high transaction costs when purchasing land from multiple small and/or very poor peasants.

The differences between the *zamindari*, *ryotwari* and *mahalwari* systems from the perspective of how they affected the distribution of effective land use are therefore exaggerated. The *zamindari* system had a design fault from the perspective of developing a market in agricultural land because the revenue collecting right was delinked from the occupancy right. However, even after the implications of this were well understood, the raj made no attempt to correct this. On the contrary, the rights of

lower level intermediaries were strengthened over time, not only making it difficult for merchants to accumulate land, but even making it difficult for *zamindars* to collect their share of the agrarian surplus. The real failure of the land market in Bengal therefore had political roots which lay in the unwillingness of the colonial state to confront the potential instability that may have followed attempts to define rights in ways that would be consistent with accumulation and growth.

The underlying political constraints that influenced colonial land policy can also explain why the *ryotwari* structure of revenue rights in western India that united revenue with occupation rights had little effect on land accumulation strategies. When trade in *ryotwari* rights led to some limited signs of peasant resistance to agrarian accumulation, the British felt compelled to create offsetting rights for the poorer *ryots* that made it very difficult for merchant capital to penetrate into and accumulate effective rights over the land using the land market that would allow them to determine land use. The legacy of this continues in Maharashtra's agriculture where land fragmentation is continuing as fast as in other parts of India. The difference in Maharashtra is that at the margins of the impoverished agrarian economy aggressive state-led land accumulation strategies have worked in making significant amounts of land available for industrial development. Clearly, the creation of and evolution of property rights on land in Bengal and Maharashtra did not create compulsions for productivity growth. Nor did the formal rights over revenue and land set up during the colonial period assist the accumulation of land by commercial accumulators. In this at least, the colonial legacy made India significantly different from Thailand.

#### ***Tanzania: The Legacy of Customary Authority and Collective Rights***

Pre-colonial political organization over large swathes of the African continent was in general less 'state-like' than in Asia, with a few notable exceptions. Low population densities and an ecology that produced a lower agricultural surplus meant that in general African societies could not sustain dense structures of surplus-consuming administrative classes. There were sparsely populated parts of Asia too, but as we saw in Thailand, state formation followed periods of rapid expansions of population. Tanzania like Thailand had a vast land frontier but the land was of poorer quality and Tanganyika was one of the poorer countries in Africa, certainly during colonial times. But it has to be remembered that Thai agriculture too had very low yields and extending land use required significant investments in drainage, canal building and the clearing of forests. The more important difference was possibly that unlike Tanzania, from the early nineteenth century the Thai king and nobles could access virtually unlimited supplies of immigrant labour desperate to build new lives and willing to work in harsh frontier conditions with almost no guarantees of rights. African societies had a variety of land-use arrangements and class structures but in general as long as labour scarcity was severe they were necessarily less hierarchical with fewer surplus consuming classes compared to the Asian norm. While these differences were real, the subsequent impact of colonialism on African societies had important elements of similarity with the Asian experience which are relevant for our understanding of property rights transitions.

As in Asia, non-settler colonial rule had a variety of impacts in different parts of Africa and in different sectors that are difficult to summarize in a simple way. What we do know is that only between 2 and 10 per cent of land in contemporary sub-Saharan Africa is held under freehold title while much of the rest is held in various

forms of communal or customary tenures (Deininger 2003: 62). Purchases and sales by individuals of land held in the latter types of tenure are not supported or not fully supported by the formal enforcement structures of the state. This suggests obvious problems for achieving changes in land use and changes in the organization of farming as land under communal or customary tenures accounts for the vast bulk of the available land. We would expect these structures of rights to further deepen the market failures that are anyway widespread in poor economies. It is not therefore surprising that the liberalization of fertilizer and other product markets in African agriculture has typically had weak and sometimes negative effects on agricultural productivity in countries like Tanzania (Skarstein 2005). These negative effects are not surprising in the absence of the full framework of property rights or other institutions to mitigate widespread market failures.

Why did African countries inherit such structures of rights after a century or more of colonial rule? Explanations can be placed along a simplified spectrum. At one end are theories that say non-settler colonial states *introduced 'extractive' structures of rights that were systematically inimical to development*. To be so systematically damaging they had to be the product of deliberate colonial policies that sought to extract resources using institutions and politics that undermined productive rights. The now influential arguments of Acemoglu et al. (2001; 2002) are modern variants of this position. At the other end of the spectrum are arguments that claim that the *colonial impact introduced capitalism* in Africa which is now growing apace. These arguments look at other indicators of capitalist development, such as the growth of markets, particularly labour markets and infrastructure, and underplay the slow evolution of property rights (Warren 1980; Sender 1999). In between are a range of theories that point out that non-settler colonial states did not have a singular objective and that *outcomes depended on the interplay between colonial objectives and the interests of indigenous social forces* (Mamdani 1997; Daley 2005a, 2005b; Chimhowu and Woodhouse 2006; Austin 2008; Bayly 2008). Given the diverse transition experiences and outcomes across Africa, the last approach clearly ought to be carefully considered. Some of these 'interplay' approaches also offer potentially important insights that overlap with the Asian experience and allow us to generalize further about the impact of non-settler colonialism on the long-term evolution of property rights.

The lack of fit between Acemoglu et al.'s (2001; 2002) arguments and African history in particular has been extensively discussed by economic historians (Austin 2008; Bayly 2008). Austin provides examples showing why British property right interventions in Africa are not in general consistent with the extractive state hypothesis. For instance, in Ghana the colonial state supported productive African property rights and intervened to moderate monopsonistic behaviour by European commodity purchasers (2008: 1011). However, Austin's examples of support for productive African property rights can also be interpreted as a demonstration of the willingness of the colonial power to support conflicting sets of rights out of political expediency. Thus, Austin provides an example where the British colonial power supported the rights of cocoa planters to the trees they had planted under indigenous Akan land law even when the land did not belong to the chief of the planters. At the same time, the traditional rights of the chiefs were left intact.

The political constraints driving colonial land property policy is even more obvious in the example of the British West Africa Lands Policy when British policy suddenly changed from supporting individual ownership of land in Lagos in 1861 to a newly discovered preference for 'traditional' land tenure in the Nigerian territories acquired between 1892 to 1903 (2008: 1009). The shift to a form of property right that was theoretically inferior for a capitalist transition cannot be explained by the presence of an extractive state of the Acemoglu et al. type since the non-settler colonial power had supported individual property rights in the immediate past and it is not at all clear how traditional land rights would allow more expropriation. A more plausible explanation is that the thinning out of British military power as its territories expanded led colonial administrators to prioritize the avoidance of social conflict and to seek to retain the support of the broadest possible definition of 'traditional elites'. There are parallels here with the mass of conflicting rights that the raj eventually supported in India in response to conflicting economic and political pressures. Efficient economic rights were supported as long as this did not require the creation, destruction or modification of any rights that threatened to destabilize important social balances on which the colonial power was based.

A growing body of literature has corroborated critical aspects of Mamdani's (1997) analysis of the 'bifurcated state'. This argued that *traditional* or *customary* forms of tenure in Africa are largely colonial creations that had tenuous roots in pre-colonial history. The colonial power artificially created 'customary authorities' as a method of exercising social, political and administrative control in a context where direct rule was difficult given the military and demographic disadvantage faced by colonial administrators in non-settler colonies. In these cases, far from just 'recognizing' pre-existing rights, colonial powers created new rights for the constituencies they needed. This perspective is supported by a considerable body of corroborating evidence (Chimhowu and Woodhouse 2006). Clearly the recognition of traditional rights aimed to draw in different layers of traditional elites located in pre-colonial power structures. But as the motivation for granting these groups formal and semi-formal rights was political, it is not surprising that they very often created conflicting and incoherent rights that could impede economic transformations. Adjusting for obvious differences in the details of the types of rights created, this analysis suggests very remarkable parallels with the Indian experience of raj strategies of preserving stability by creating new rights for politically important constituencies.

What is important is that while there were often negative economic consequences of supporting 'growth-reducing' rights, this was not necessarily based on the non-settler colony's desire to extract the maximum surplus from these societies. Economic and social transformation in traditional societies would have been difficult whether or not external colonial powers arrived. Ethiopia, which was not colonized, did not thereby achieve a faster rate of transformation than its colonized neighbours. However, this does not mean that the formal recognition of an arbitrary mix of *traditional* rights was without consequence. In many cases the recognition of conflicting rights and the definition of 'traditional' rights that created collective ownership of land made the subsequent reorganization of land use even more difficult in post-colonial African societies.

In most African societies, colonial strategies of indirect rule politically strengthened a broad range of groups who were the beneficiaries of the traditional authority system.

The political entrenchment of the ‘traditional elites’ through these processes ensured that post-colonial states had to maintain ambivalent positions towards customary tenure to the detriment of attempts to rationalize land use. The move towards an individual rights-based market in land has therefore been a slow process in Africa, though clearly there is growing evidence of individuals working through structures of traditional authority to buy and sell land and to establish individual rights over land (Chimhowu and Woodhouse 2006).

Contemporary Tanzania clearly does not suffer from an absolute scarcity of land but almost all land has multiple ownership claims and land market failures are a major constraint on investment. These problems are intense in areas with a long history of commercial agriculture such as the Arusha region where there are competing land claims and users, village residents, nomadic people and others. In the part of Tanzania surveyed by Daley (2005a) the traditional structure of the village from the late nineteenth century was of initial groups of ‘first occupants’ or *wenyeji* laying claim to unused land by clearing it. The *wenyeji* had the traditional right to determine which newcomers could settle on nearby lands and the lands newcomers could get. Somewhat higher in the social structure were the *wajumbe* or sub-chiefs the Germans and later the British installed as subordinate rulers, part of the ‘traditional authority’ structure of Tanzania. The *wajumbe* would oversee land matters but would typically not operate without consulting the *wenyeji*. The Germans tried to encourage agricultural productivity through various measures, including taxing the peasants, which required them to sell agricultural products. The British continued these policies with strategies of directing resources to productive farmers but attempts to make peasants more productive have nowhere been very successful in the presence of widespread market failures in land and other markets.

In Tanzania these customary authority structures were formally replaced by elected village councils after independence in 1961. The relevance of the *wajumbe* disappeared rather rapidly, though individual *wajumbe* were absorbed as executive officers at the sub-divisional and later the village level. The *wenyeji* remained socially relevant for a time as they were the more established families in the village and many often joined the ruling party. At one level though there was no significant change. The new Tanzanian village government, though it was increasingly dominated by younger and better-educated people, had appropriated for itself the collectivist decision-making rights of traditional village authorities. The de facto restrictions on individual transactions remained in operation (Daley 2005a).

A further transformation took place with Nyerere’s grand experiment of villagization where large numbers of people were expected to relocate into more densely populated *Ujamaa* or collective farming village communities where the provision of public infrastructure could be more efficiently organized. Villagization began to be seriously enforced between 1973 and 1975 often with the use of considerable violence by village governments and all land was formally nationalized in 1976. Daley reports how village government officials would sometimes burn down peasant houses and deploy army trucks to move reluctant individuals. Villagization was a failure in terms of creating a viable form of collectivist agriculture. But the experiment did result in a further weakening of the informal traditional power structures and strengthened village government in a relative sense. It also introduced new elements in the

conditions of tenure as village land allocation was now based on usage, to discourage large fallow landholdings.

Under current laws, seventy per cent of Tanzania's land is classified as 'village land' supporting eighty per cent of the population (farmers and pastoralists). Another 28 per cent of land is 'reserved land' (forests, national parks, game reserves) and the last two per cent is 'general' (mainly urban) land supporting twenty per cent of the population. An informal land market gradually developed in Tanzania in the 1980s as surplus land began to disappear due to population growth (Daley 2005b). Village governments could no longer provide new land to newcomers and young people and so it effectively became a registry of land transactions, with individuals buying, selling and renting their occupancy rights to each other and recording these transactions with village officials. These transactions often had a quasi-formal aspect as individuals would contribute 'fees' to the village government for recording transactions.

In 1999 a new Land Act and Village Land Act was passed giving village governments the authority to manage community-based land tenure systems in a decentralized way. The most significant change was to recognize customary land rights as legal and secure. The aim was to demarcate village boundaries, with villages getting certificates of village land if they could settle their 'border disputes' with neighbouring villages, to title individual landholdings (now called customary rights of occupancy) that are allocated by the village and to maintain formal records of these titles. These would be titles of occupancy rights, not formal ownership titles.

However, little progress appears to have been made. The reasons are somewhat similar to those we have already come across in Asia. Even if only titles to use are being delivered, the demarcation of lands has important consequences, and conflicting titles have been issued in the past by different authorities. There are three registers of land rights, the Village Land Registry, the Local Land Registry and the Registry of Titles and the three do not provide coordinated or consistent information. The resolution of conflicting allocations and records of rights entails not just a bureaucratic cost but more importantly involves winners and losers who will engage in significant conflicts for a valuable resource. It is not surprising that very little progress has been made in clarifying unequivocal titles for land users (Lange 2008). In 2009 it was estimated that only about two per cent of rural land and 20 per cent of urban land carries titles (Kironde 2009).

Effectively though, political authorities at the village and higher levels intervene to determine the allocation of land plots through village councils. Emerging Tanzanian 'capitalists' who want to acquire land have to acquire political influence to operate through these formal structures of the community based tenure system. There are frequent disputes between villagers and investors over land use and these are usually resolved with the intervention of higher authorities. In most cases the interventions do not benefit the village as a whole but only the village elite whose help is required to get the required authorizations at the village level. Overlapping institutional jurisdictions make these problems worse, but they reflect the fundamental problem of overlapping rights and the political contestation they result in, rather than being simply administrative mistakes. The Ministry of Lands and the Regional Administration and Local Government section of the Prime Minister's Office (PMO-RALG) have overlapping jurisdictions and different criteria for recognising

settlements (Kironde 2009). Both authorities have the power to allocate land and control development.

Only about 165,000 land parcels have been registered nationwide out of an estimated 8 million land parcels in the country that need registering. The registry is not yet computerised, but as the Asian experience suggests, computerization can only make explicit but cannot on its own resolve underlying inconsistencies in competing land records and claims. But given that in Tanzania the conflicts are between villages, and since occupancy is the only right at issue, in theory there should be fewer dimensions of contestation, and it is likely that some more progress can be made in titling under the Village Land Act. There are a number of different programmes that are pushing land titling issues in Tanzania, for example the Strategic Plan for the Implementation of Land Laws (SPILL), which is trying to accelerate the granting of certificates of village land titles to villages and occupancy right titles to villagers. The longer term question for Tanzania is whether titles of occupancy are sufficient for enabling a land market to develop that would be appropriate for the acquisition of land by long-term investors.

The process for buying land in urban areas or close to urban areas free of disputes and with titles already registered at the Ministry of Lands appears to be straightforward. Starting with the seller conducting an official search at the Land Registry and clearing all taxes, a valuation report is obtained from a government valuer who inspects the property to determine its value. The Commissioner for Lands has to approve the disposition of the property and this requires full documentation of ownership and official valuation of the land. At the end of the process the transfer deed must be provided to the Land Officer who records the change of ownership in the Land Registry. The official fees for completion of this kind of transaction are very low and the whole procedure is meant to take a number of weeks. The issue is that the seller only has occupancy title and not full title and in theory the transaction can be blocked by other parties with rights over the land operating through the Land Office.

This problem is most apparent in the case of the Land Bank established in 1998 to identify large tracts of land that would be made available for foreign and local investors. The Land Bank is officially managed by the Tanzania Investment Centre. Officially the Land Bank has 743 land parcels covering 3.14 million hectares of land of which 2.5 million hectares are suitable for investment purposes. In reality the Land Bank is scarcely operational due to local level conflicts over land that have not been resolved over this supposedly available land (Global Exchange 2009). The Tanzanian state remains publicly very ambivalent about the private ownership of land, clearly concerned by the possible political fallout, including strong political fears that private ownership could give foreigners the ability to directly own large tracts of land or effectively control land through the back door. Piecemeal land grabbing is tolerated but there is no concerted policy to transfer land ownership in order to stimulate productive investment. At the same time, illegal and semi-legal expropriations are increasingly resisted by peasants, villages and NGOs (Kironde 2009).

The most significant change in land use in Tanzania over the last decade has been driven by the growth of gold mining. However, the growth of mining has involved the intervention of the highest levels of the state. Paradoxically, the absence of individual land ownership facilitated the central state's allocation of mining rights because it

could legally override the rights of local occupants relatively easily. The 1979 and 1998 Mining Acts build on earlier British policy and vest ownership of mineral resources in the state. As village plots are theoretically allocated for use and are not owned by the individuals using them, the government can legally ask people to move and pay compensation for the investment they have made on the land, not for the land itself. The Commissioner of Mines who has the power to issue prospecting rights has considerable powers to adjudicate and settle disputes (Lange 2008). Rangelands can also be allocated by the state for mining, dispossessing pastoralists who have depended on these ranges as commons.

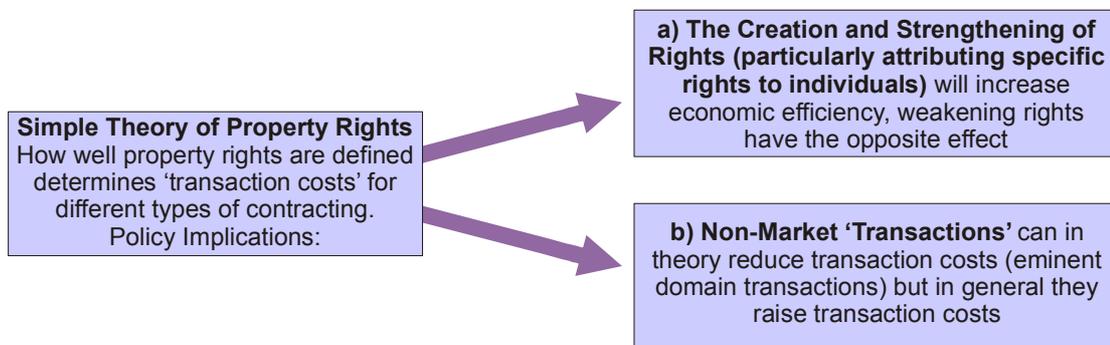
Ranged against the power of the state, smallholders in Tanzania have proved unable to resist the land use changes that mining has brought about. The alignment of the interests of high public officials with those of mining companies has not been difficult to achieve, and interests of village level users have been regularly suppressed, occasionally through violent confrontations (Lange 2006, 2008). The mining sector shows very clearly that property rights issues can be ‘solved’ when the stakes are high enough for significant political power to be deployed to settle conflicts. In this case ‘settling’ conflicts involves the imposition of solutions taking advantage of the absence of freehold ownership in Tanzania and the political ability of the central state to overcome village level resistance, often with the assistance of village power brokers in the village government structure. The approaches used in the mining sector are difficult to replicate in the more ‘normal’ contexts of land disputes between peers or in attempts by relatively small-scale Tanzanian entrepreneurs to resolve land disputes so that the land they require can be acquired at low transaction cost.

### **3. Property Rights and Growth**

This section develops a theoretical framework for looking at the property rights challenges that developing countries face. Property rights are rules that (if effectively enforced) give individuals the right to make specified types of decisions or carry out specified activities, usually but not necessarily concerning the use of an asset. Coase (1960) pointed out that individuals who possess property rights possess nothing more than the right to carry out a circumscribed set of actions. For an asset, this may include the right to use, sell, lease out, employ others to work on, and so on, and usually there are also detailed social and legal rules that limit these rights in particular ways. For instance, an owner of a car is allowed to drive the car but not in contravention of traffic, taxation, insurance and other rules. Some limits to the exercise of rights may be formal legal limits as in the case of traffic laws. But rights are only meaningful to the extent that they can be made effective and actually exercised. Effective property rights require a mix of formal and informal enforcement capabilities and the formal enforcement capabilities of the state are particularly important. As a result, particularly in developing countries, *de facto* limits to the exercise of rights could be set by the limitations of the enforcement frameworks underpinning particular rights.

The simple theory of property rights summarized in Figure 1 often informs policy. Based on the work of Coase, Barzel, North and others in the new institutional economics tradition, the simple theory says that property rights make contracting easy and thereby reduce market failures (Coase 1960; Barzel 1989; North 1990, 1995). The expectation is that if the right to make specific decisions are clearly defined, a greater

number of potentially beneficial contracts will become possible. The general expectation therefore is that creating property rights defining rules of decision-making will in general be socially beneficial as will the protection of existing decision-making rights. As decision-making rights are clearest when they are attributed to individuals, individual property rights are always preferred. One way of describing this is to say that clearer definitions of property rights reduce *transaction costs* which are the costs of acquiring information, reaching agreements about how to organize collective activity, observing that these agreements are upheld, and subsequently enforcing these agreements. If the individuals who have the right to make specific decisions are clearly identified transaction costs will be lower. Note that transaction costs are not part of the price that has to be paid for assets or resources in transactions, but rather the cost of *organizing* the transaction. In standard economics transaction costs are typically assumed to be zero, but the new institutional economics has rightly pointed out that if rights are not clearly defined the transaction costs of determining whether a transaction can be carried out at all may preclude the transaction even if the buyer was willing to pay the price asked by the seller.



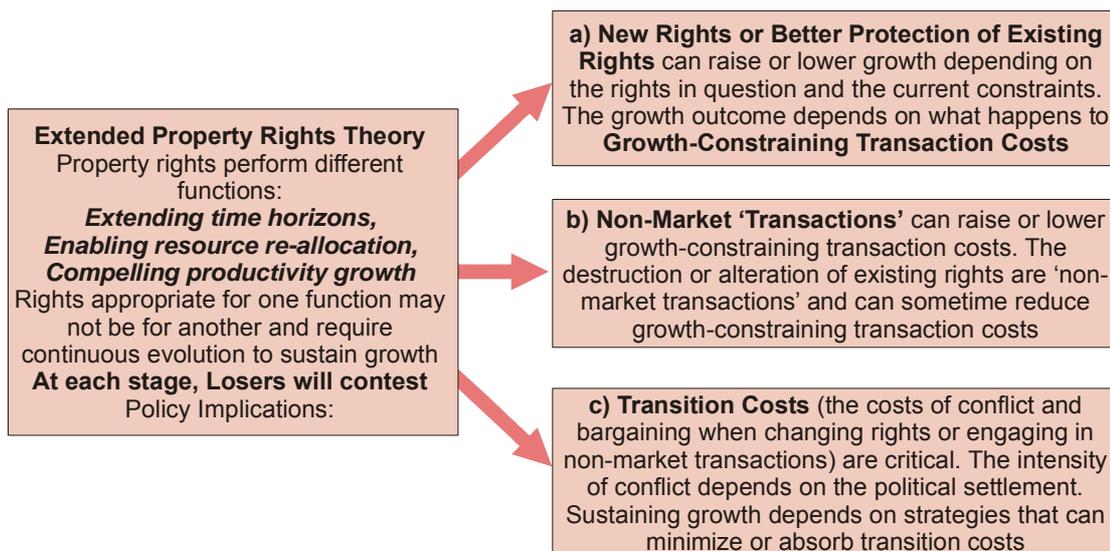
**Figure 1 The Simple Theory of Property Rights**

However, the creation and enforcement of property rights is not costless. Even the simple property right theory recognizes that it is not feasible to remove all transaction costs by creating property rights over all dimensions of decision-making (Barzel 1989). The costs of creating and enforcing property rights means that the definition of property rights is never complete and significant transaction costs will remain. There may therefore be a role for administrative allocations of valuable resources, in particular land, using powers of *eminent domain* or other interventions. This may be justified if the transaction costs of administrative discovery and implementation of improved allocation are lower than the costs of market discovery and implementation. But in general the standard property rights theorists argue that non-market interventions are likely to fail in terms of discovering true costs and benefits and are likely to result in a loss of confidence in the ownership of assets with negative consequences for investment.

The simple theory suggests that the property right problem in developing countries is essentially one of incomplete or weak implementation of property rights. This is an excessively limited view of the property right problem. The problem is not just that a full definition of property rights is infeasible. Given the many different decision-making rights that can be defined over an asset, it is theoretically possible that some specifications of rights may block rather than facilitate optimal resource use from the perspective of economic efficiency, growth, social justice or any of a number of other

criteria. It may therefore not be very useful to argue that ‘stable’ or ‘well-defined’ property rights are *in general* important for economic growth. In advanced countries where modern capitalist property rights have been evolving in some cases for centuries, property rights in an everyday sense appear to be ‘well-defined’. In fact, the allocation and definition of decision-making rights are continuously evolving. Take for instance the ‘property rights’ of company shareholders which not only differ from country to country but are continuously evolving within countries. Apart from changes brought about by the politics of taxation and equity, many changes are driven by the realization that strengthening the rights of some categories of owners can be efficiency and growth-enhancing, while strengthening or protecting other rights may have the reverse effect.

An example of the types of unexpected outcomes that can follow from strengthening property rights comes from the analysis of shareholder rights initiated by Grossman and Hart (1980). They pointed out that if small shareholders in a company have very weak rights they can be exploited by bigger shareholders and eventually small shareholders will stop investing. But if the rights of small shareholders are too well-defined such that they can extract the full benefit of say takeover activity, this may dissuade raiders from investing in takeovers. As the threat of takeovers is a potential source of pressure on managers, it is at least theoretically possible that the rights of small shareholders could be protected to a point that is detrimental to their own interest. In addition, there are profound questions about whether shareholder rights defined primarily by claims on dividends are really in their own long-term interest given the short-termism this can induce in managers (Stiglitz 1996: 92-6). The financial crisis of 2008 raised further questions about the economic implications of complex rights over financial instruments, and many of these rights are likely to evolve further in consequence. Clearly, structures of rights are continuously evolving in advanced countries in response to new facts and to changes in economic and political conditions. Unfortunately, this insight has not in general been transferred to the analysis of the evolution of rights in developing countries.



**Figure 2 An Extended Theory of Property Rights**

Our analysis develops an extended theory of property rights by drawing on a number of strands of property right analysis in the literature to develop a framework for analysing the evolution of property rights in developing countries. The building blocks of our framework are summarized in Figure 2. First we draw on what property right theories say about the *types and allocations* of rights that are required for economic efficiency and growth. Note that specifications of property rights that are appropriate for addressing specific problems of growth and efficiency are distinct from specifications that may be recommended by concerns for social justice or equity. We begin by looking at the relationships between property right specifications and efficiency and growth, but as all specifications of property rights have distributive implications we will come back to the issue of distribution in our discussion of transition costs. In terms of efficiency and growth, the general focus on transaction costs is misleading. We argue that the conflicts between different types of rights can be better summarized by looking at *growth-constraining transaction costs* (GTC).

Secondly, we ask what theory tells us about the *costs of creating* different types of rights and the implications of these costs for institutional transitions. The inclusion of the costs of creating or changing property rights as part of overall transaction costs is misleading because the determinants of these costs are largely political. To give these costs separate analytical attention we describe them as *transition costs* (TSC). Transition costs depend on how intensely the distributive implications of changes in property rights are resisted. The resistance to changes in property rights depends on the distribution of organizational and political power in society, but also on how specific changes are perceived in terms of prevailing concepts of distributive justice.

The existing literature on property rights allows us to make useful distinctions between at least three ways in which property rights can reduce social losses or increase social gains. First, there is the very basic argument that *property rights extend time horizons*. The well-known free-access model in economics shows that property rights are necessary to create incentives to conserve assets from dissipation and overuse. Missing property rights lead to tragedies of the commons. A corollary is that if there is significant ‘expropriation risk’, investors will not invest, and may indeed deplete resources and export, consume or even destroy capital if they fear they may be expropriated. Second, there is the related Coasean argument that *property rights create opportunities for trade*. Without property rights defining claims and liabilities, all social costs or benefits may not be accounted for in decision-making, leading to lower aggregate social welfare. A corollary is the more obvious argument that resource allocation cannot be efficient if property rights are missing over vital assets (like land). Thirdly, there are arguments coming from Marxist economics and agency theory developed by Alchian and Demsetz (1972) that show that *specific structures of property rights can create compulsions for efficiency and productivity growth*. Efficient production and growth require not just decision-making rights within the firm, but also the absence of these rights for others. Too many people with decision-making rights within a firm can render these rights ineffective. There is no reason why a property right system that is adapted to address one type of problem will necessarily be effective in addressing other problems.

Changes in property rights that improve one dimension of economic performance may have contrary effects on others. One way to look at these potentially conflicting goals is to describe the net effect of a change in property rights on the transaction costs that

happen to be constraining growth in that context. This net effect on *growth-constraining transaction costs* is what will matter for growth. The relevant difference with the simple theory of property rights is that strengthening the protection of any existing property rights will not always enhance growth, and may indeed impact negatively on growth. In the same way, the *destruction* of some pre-existing rights may be a potentially growth-enhancing change. This extends the role of non-market transactions beyond the traditional importance given to *eminent domain* interventions. As changes in property rights and certainly the destruction of some rights always appear to be non-market interventions, this is another dimension along which non-market transactions can be growth-enhancing. Of course, it remains true that the destruction of property rights and in particular predatory expropriation can often have significantly negative effects on growth. Finally, the simple theory of property rights does not make explicit the ‘political’ nature of the most significant costs of creating, altering or destroying rights. The concept of *transition costs* focuses on the political determinants of the potentially intense costs that can determine whether changes in property rights along a particular dimension are feasible or not.

We use these building blocks to argue that many of the historical and contemporary difference between countries in their property right evolution can be described by differences in the *trade-offs they face between growth-enhancing changes in property rights and political stability*. The shape of this trade-off depends in theory on the type of growth-promoting property right transition being attempted and the political settlement in that society that determines the transition costs that the potential losers can inflict on the potential beneficiaries. The political settlement describes the relative power of relevant groups and classes in a society. The political settlement is relevant for an analysis of property right transitions because the relative power of gainers and losers and the ability of the state to absorb the resistance of losers are important determinants of the likelihood of particular rights being created or destroyed.

If important features of the historical experiences outlined in our last section can be summarized in this framework, the nature of the growth-stability trade-offs will provide insights into the constraints these countries face today. While political settlements must change over time, our understanding of contemporary political settlements has to be built on an understanding of history. We look first at the three different mechanisms through which property rights impact on economic performance, then develop the concepts of growth-constraining transaction costs, transition costs and the trade-offs between the two.

### ***Extending Time Horizons***

Free access and expropriation risk are variants of a general problem: conserving or investing for the future requires looking at *future* costs and benefits and not just current ones. Since conservation or investment involves immediate costs to achieve future benefits, these costs will not be incurred if the individuals facing them are not sure that some at least of the additional returns will accrue to them. The most obvious solution is to establish a rule that gives a defined individual or group the rights to future income flows from the asset, and provided this is credible and effective, the rule (or property right) will create the appropriate incentives for investment in or management of the resource (Khan 2000b). The absence of the property right here creates a market failure by definition because the loss of potential net benefit can be attributed to the difficulty of contracting the allocation of costs and benefits over time.

The creation of effective and enforceable property rights can solve this particular market failure provided these rights can be enforced.

The function of property rights in this case is to prevent free riders from appropriating the benefits of someone else's conservation or investment efforts. However, the rules allocating future benefits have to be enforced and enforcement is never perfect even with strong state enforcement capabilities. Part of the responsibility of enforcement is therefore always shared by the property right owner, and their responsibility is likely to be greater in countries where external enforcement is weak. As enforcing the exclusion of free riders is critical in this case, the optimal allocation of the right should be based on the likelihood that the potential owner has the most credible capability of enforcing the right in question. In addition, and possibly in contradiction with the previous requirement, if investment is to be maximized, property rights should be allocated to individuals with the greatest capability of making investments in the resource over time (Barzel 1989).

Thus, even from an efficiency perspective, we can get different answers about how best to allocate rights to an asset that is subject to free riding or underinvestment because of time horizon problems. But this is not all. There is a further set of problems that emerge because the allocation of exclusive rights over a resource to an individual or a collective of individuals excludes others by definition. If A gets the right and not B, A will benefit much more than B, even if in the end the general improvement in resource usage benefits B indirectly. It follows that there may be distributive conflicts between A and B about the allocation of these rights, and these conflicts have social costs. We will come back to these costs later in our discussion of transition costs, but one way of minimizing transition costs is to allocate rights to the groups who are most likely to create serious social disruptions if they are denied. We already have three competing criteria of allocation: to the individuals most capable of controlling free riding at the local level, to the individuals most capable of investing for the long run or to the individuals who would most strongly resist being excluded. It would be very good luck if the same individual would be selected on every criteria.

Looking first at the prevention of free access depletion, consider for instance the problem of managing forestry resources in a remote area in a developing country. Property rights for *any* individual or group may reduce the problem, but not all individuals or groups may be equally good at enforcing the exclusion of outsiders and limiting overuse by insiders. In some circumstances, collective ownership of the forest by a local community may be more successful. This would be the case if state capabilities for enforcing contracts in the remote area were weak and the group could deploy collective monitoring and enforcement to achieve a better result (Ostrom 1990). On the other hand, if state enforcement capabilities were moderately good, individual ownership may be more effective because this would avoid the possibility of free riding behaviour within the group of collective owners who may fail to put in high levels of collective effort in monitoring and enforcement. Thus, the theory suggests that the allocation of rights over a resource subject to free riding does not matter too much provided the ability to exclude free riders is maximized. Individual property rights may not always be the most efficient solution from the perspective of solving free rider problems. In general, while the theory tells us that free riding will be reduced by the creation of property rights, the success of the strategy will depend on the identification of an owner or owners who are most likely to enforce the right.

In contrast, significant investments in an asset are likely to require clearer allocations of rights to prevent free-riding behaviour. Investment involves more significant losses of current consumption for uncertain future returns and investors typically need stronger protection of these returns to justify investment. If individual ownership of the asset is not possible, clearer specifications of differential rights to the future returns between investors and others within the group are required to protect investing parties. This level of detail may be implausible in the context of agriculture in developing countries and may explain why significant investments in collectively owned assets are not widely observed in poor country agriculture. One of the problems in early peasant settlements is that while different types of collective control to address free access problems make sense at an early stage, if transitions to ownership structures that allow long-term investment are not eventually achieved, productivity can stagnate. In addition, we have seen how colonial interventions froze forms of collective control for political reasons, because the transition to other forms of control threatened to induce 'transition costs' in the form of peasant opposition. Thus, even in terms of the most basic property right requirement of providing extended time horizons, all we can say is that the complex combinations of landlord and peasant rights that evolved in different countries addressed some of these issues, but not necessarily in the most efficient way in every case.

However, in contexts of high transition costs where the exclusion of powerful groups can result in significant conflicts, it is not unusual to find complex property rights protecting assets. Haber et al. (2003) and Qian (2003) describe variants of such rights in Mexico and China. If the 'price' of effective protection of the asset is some sharing of future returns between investors and protectors, this can work in preserving time horizons as long as the direct investors have a credible expectation of significant and predictable returns. These rights are clearly not the individual rights over future returns that simple theory says are necessary for maximizing investor time horizons. Nevertheless these unconventional structures of rights can sometimes achieve a combination of effective protection and predictable future returns that maximizes investor horizons in a context where individual rights over the asset may have resulted in rapid expropriation by excluded social forces.

If the structure of property rights cannot even address the very basic problem of preventing free access and expropriation of investments, it is unlikely to address any other type of market failure. Conversely, if an economy is not in freefall, it is very likely that the basic problems of free access have been addressed through formal or informal property rights. This is one reason why the focus on expropriation risk in much of the contemporary literature on property rights is somewhat misleading. With a few exceptions, all traditional societies evolved some forms of formal or informal property rights to conserve assets, even in the presence of multiple users and non-settled agriculture. In all the cases we considered, settled agricultural societies had evolved well before the impact with the west, with the partial exception of Tanzania, but even there we have no evidence of a collapsing ecology that could be attributed to a classic free access overuse. The *de facto* occupancy rights of peasants in pre-colonial India or in nineteenth century Thailand were forms of property rights that effectively addressed the time horizon problem of the actual occupants of land. Of course, there may be questions about the extent to which a particular structure of rights was *effective*, and more importantly, the extent to which the structure of rights

addressed the time horizon requirements of investors with the capability of making long-term investments. More seriously, these structures of rights may have been even less appropriate for a number of other problems that property rights have to address.

### ***Opportunities for Trade***

If the current allocation of rights is not appropriate for some reason, the simplest way of solving this problem would be to re-allocate rights through the market mechanism. Those who can use an asset better should be able to buy it off those who use it less well. However, efficient market transactions themselves require very specific types of rights over assets, particularly in the vitally important markets in land. Coase pointed out a long time ago that trading opportunities may be thwarted if property rights were missing or even if they were difficult to assign and transfer (Coase 1960). Efficient resource re-allocation may therefore require as a precondition some specific types and allocations of property rights. If these do not exist, the re-allocation may not take place and we may be stuck with a persistent market failure that cannot be solved by making the market a little more efficient. For instance, peasant occupancy rights or collective rights of villages or clan lineages over land may have preserved assets from free riders but the way they were defined may not allow the easy transfer of assets. As a result, land re-allocation may not happen in ways that allow significant gains to be captured. If the rights that exist are not appropriate for efficient asset re-allocation, then any inefficiency in the initial allocation of rights is not likely to be resolved through the market mechanism.

In some circumstances the weakness of formal state protection structures may mean that the optimal structure of rights to protect expropriation or free-riding behaviour may initially have been the creation of multiple claims over an asset. For instance, occupancy tenants sharing revenue with local administrators who provide protection could maximize protection from free riders and expropriators in some contexts. But with multiple agents having rights that can block changes in land use, transfers would subsequently be very costly if not impossible. To achieve efficient land markets to re-allocate land to more efficient uses requires further and different specifications of rights. Some of these conditions are recognized in the new institutional literature and the political economy analysis of heterodox analysts, but the conflicts between these conditions and the ones required simply for achieving extended time horizons are typically not recognized.

First, rights to each plot of land have to be specified to individuals or small groups who need to be able to decide on purchase or sale decisions without veto rights by others. Collective ownership or ownership that is not clearly attributable to individuals would not satisfy this condition, even if the ownership structure was adequate for preventing free riding behaviour. Achieving agreement between multiple owners about price and the distribution of benefits from sales may raise transaction costs to levels that preclude sales. This is entirely consistent with the analysis of new institutional economics that the simple property rights theory draws on.

Secondly, if the initial distribution of holdings is too fragmented, the transaction costs of negotiating with a large number of micro-owners can raise transaction costs even if each plot is owned cleanly by single owners. Apart from the simple problem of multiple transactions, in fact transaction costs with multiple owners can go up exponentially and not just arithmetically because of holdup problems coming from

later sellers. The value of subsequent pieces of land goes up hugely for the buyer once the buyer pre-commits to buy tracts in a particular direction by actually buying a few. Subsequent sellers can hold out for a higher and higher price, increasing not just the overall price paid for the land, but more significantly, the transaction costs of reaching agreement about the price. This is well recognized in the literature and is the justification for *eminent domain* interventions by the state. Even in advanced countries with well established individual property rights, the purchase of a large number of plots say for road construction typically does not take place through sequential market transactions (Posner 1986).

But in advanced countries, *eminent domain* transactions are relatively simple because the purchase price can be established with reference to the current market price. The administrative decision is only about the identity of the plots to be purchased and this can be organized in an open and transparent process, leading to the issuance of compulsory purchase orders. In developing countries *eminent domain* transactions have significantly higher implementation/transaction costs because the market price itself may not be known. In addition, the gap between the current economic value of the land and the economic value in the subsequent use may be vast, leaving potentially massive ‘gains from trade’ to negotiate over and this can significantly increase the transaction costs of reaching an agreement about a fair price even for a compulsory purchase order process (Sarkar 2007). And if each parcel of land has multiple and conflicting ownership rights, the process of compensation can implicitly recognize some rights and destroy others, further differentiating the process of *eminent domain* in developing countries from that in advanced ones.

A final condition that is required to enable market transactions in assets comes from the heterodox political economy analysis of Marxist historians. Standard economics assumes that transactions take place because individuals are ‘rational’. This is assumed to mean that if someone is offered a price for an asset marginally higher than the return that person can achieve, the asset will be sold. In fact, uncertainty about the future, insurance against uncertainty or simply an emotional attachment to the asset may prevent a sale. The ‘rational’ behaviour that is observed to a greater extent in modern societies may have a lot more to do with the compulsions that a capitalist economy creates to compel sales of assets when better uses emerge. The *compulsion* in capitalist economies emerges because producers who fail to match social productivity cannot continue to hold on to land on a subsistence basis. With a significant commoditization of agricultural production when a particular piece of land is not being used productively, the owner rapidly becomes bankrupt and creditors can use bankruptcy proceedings to change land use. This is why clean individual title is not sufficient to achieve asset re-allocation through normal market processes. If peasant producers can opt out of the market and engage in self-exploitation then low productivity may not result in land sales. Of course, if in addition title is not clear or if debt cannot be recovered through bankruptcy proceedings it is even less likely that land re-allocation will take place.

As Wood’s Marxist analysis of the transition to capitalism in English agriculture shows, the resistance of smallholders in agriculture to sell economically unviable landholdings is only overcome when their production is sufficiently commoditized and individual producers can no longer produce without buying most of their inputs from the market and selling to pay for these inputs (Wood 2002). Economic survival

under these circumstances requires each landowner to achieve the (rising) social productivity that is setting the prices of inputs and outputs. Aspects of Wood's analysis were in fact anticipated much earlier in the 1920s by the Soviet economist and sociologist Chayanov in his argument that markets in peasant agriculture would not necessarily lead to a systematic transfer of land from less efficient to more efficient land users (Chayanov 1966).

Peasant resistance to land sales is neither irrational nor unjustified. In particular, the absence of rapid industrialization in many developing countries means that significant employment opportunities do not exist outside agriculture. But land is first required to enable investment opportunities to emerge. In this vicious cycle, the political response of states, and in particular the colonial states, was to protect peasant rights. As we have seen in the last section, the British in India often reacted rapidly to the incursion of merchant capital into agriculture whenever land alienation became serious. A long history of protection of peasant rights created an expectation that these rights are important to protect and that the commercialization of agriculture was an anti-poor strategy. The fact that peasants losing land may actually become even poorer in the short run before industrialization can absorb labour does not help the achievement of transition in poor societies.

If a commercialized agriculture is required for efficient land markets, we can see why the extreme fragmentation of agricultural landholdings can become an indirect obstacle to market efficiency. Small peasant holdings are likely to be the least commoditized in terms of reliance on hired labour and to rely heavily on the over-exploitation of family labour to achieve subsistence needs. Large capitalist farms will use more hired labour and depend to a greater extent on purchased inputs. They are less likely to survive if they cannot produce marketed outputs whose sales cover their market costs of production, and therefore more likely to sell out if they fail to achieve minimal productivity. Thus the emergence of larger farms may indicate the possibility of a more effective land market emerging. However, the trend in most developing countries is the reverse: small and medium peasant farms appear to be fragmenting as we saw in the data in Table 1, Table 2 and Table 3 for our three regions in the Indian subcontinent, and this trend is replicated all across the subcontinent. These observations have spawned a debate about the relative 'productivity' of small versus large peasant farms that has further confused analysis in this area.

The commoditization argument for large farms would obviously only apply to significantly large farms organized on a capitalist basis. In the Indian subcontinent comparisons of 'large' and 'small' farms in the literature on the relationship between size and productivity have been misleading because most 'large' farms are actually slightly bigger peasant farms in reality. They simply cannot achieve the level of mechanization or scale economies to make them significantly commoditized and so they too depend to a great extent on family labour to supervise labour-intensive production processes. A comparison of these 'large' farms with very small farms often shows that the very small farms are not only more productive in terms of yields, they also use more hired labour per unit of land, giving the misleading impression that small farms are more commoditized. This is essentially because the 'large' farms in question are actually not large enough to deploy mechanization or otherwise change the technology of production away from the labour-intensive production methods that require a large amount of supervision. Very small farms have more family labour to

deploy on each unit of land, therefore they can use hired labour more intensively. This obfuscating debate on the relative productivity and labour market exposure of 'large' and small farms has unfortunately dominated a large part of the discussion of land policy in poor countries, including in South Asia (Boyce 1987; Faruqee and Carey 1997; World Bank 2000; Griffin, et al. 2002; Deininger 2003; Khan 2004).

The evidence of slightly greater yields in very small farms is often misleadingly used to justify redistributive land reform that seeks to achieve even greater land fragmentation than already exists. The greater yields of micro-farms have clearly not produced prosperity for them, indeed the reverse. Moreover, the difference in yields between the micro-farms and their slightly bigger neighbours is typically very small. The land fragmentation that we saw earlier in South Asia is not coming about because more productive or efficient small farms are buying land from less efficient large ones, but rather because of demographic forces. The challenge for agrarian transformation in poor densely populated countries is to reverse these demographic trends and create not just slightly larger farms but significantly larger farms that can benefit from scale economies, thereby generating the productivity growth that is essential for poverty reduction. Such a transition would also, as a result of significant commoditization, arguably create the compulsions to sustain an efficient land market.

These transitions are not costless particularly in densely populated countries, so even marginal movements in these directions are not likely to be achieved without conflict. But the international evidence on farm productivity provides no example of a prosperous agriculture based on the type of land fragmentation that we find in South Asia and other developing countries with peasant-based agriculture. Only by understanding the alternatives can policy be devised to achieve growth transitions at the lowest social cost. Clarifying and strengthening the property rights of micro-sized peasant farms will not address the market failures in re-allocating land because non-viable small peasant farmers have no compulsion to sell land and poverty gives unviable micro-plots an emotional insurance value that further precludes land markets from working. The creation or clarification of titles for marginal farmers or the better protection of existing titles will certainly reduce the transaction costs that small peasants face in protecting their land. But it is unlikely to result in active land markets for re-allocating assets to the most optimal uses, and may actually *raise* the transaction costs of land acquisition by providing significant legal holdout powers to non-viable subsistence farmers who have no compulsion to come to sale agreements. In comparison, if the initial allocation of rights had favoured much larger and more commoditized farms, a clarification or better protection of their titles may have strengthened compulsions for market-driven land re-allocations.

The conflicting functions of property rights means that to achieve land rights appropriate for a capitalist transition, pre-existing land rights that played a function in pre-capitalist agriculture may have to be attenuated or even destroyed. This is one reason why many agrarian transitions to capitalism, including the English one, required significant non-market transfers of land that amounted to the destruction of the complex structures of rights on which English peasant agriculture was based. The English Enclosures were not directly transfers of peasant property to emerging capitalist farmers but they created private property for large landholders out of the commons. Large plots could then be leased out to emerging 'capitalist' tenant farmers who were under strong compulsions to raise productivity in an increasingly

commoditized agriculture (Wood 2002). Nevertheless, Wood's argument suggests that if the commons had first been transferred to small peasants in individual plots, then even with well-defined and transferable property rights, emerging English sheep farmers may not have been able to get access to land if they had to buy this land from self-sufficient subsistence peasants.

While all our agrarian societies had evolved clear structures of rights that prevented free riding and land overuse, only Thailand had an initial allocation of rights that gave a relatively small group of primitive accumulators the ownership of large tracts of valuable land. The agglomeration and land concentration in valuable areas close to Bangkok resulted in the emergence of an effective land market in Thailand in a way that did not happen in the other countries in our sample. The concentration of valuable land rights in the hands of individuals who had a commercial interest in marketing the land if the price was right later allowed commercial investors to acquire land from these accumulators through land market transactions. The initial creation of rights for these politically powerful primitive accumulators in Thailand was, as we saw, often based on overriding the emergent claims and interests of the smallholders who made the initial investments in clearing the land.

In contrast, the history of South Asia and Tanzania showed that for different reasons at a critical phase of emerging land rights, land rights were consolidated for initial settlers who were typically smaller, together with multiple local power brokers whose collective incentives and compulsions for trading in land were very different. This is not because property rights over land were absent, but because they were not structured to make *transfers* cheap or to compel non-viable users of assets to sell. The colonial state consolidated these complex rights because of the political constraints it faced. This is particularly obvious in India, where the High Colonial State took an increasingly pro-cultivator position in the late nineteenth century, which amounted to a complex series of interventions to protect the status quo on the land. In Tanzania, land settlement was still continuing during the colonial period, and collective 'traditional' ownership was invented and strengthened by colonial powers to create incentives for investment in clearing and consolidation. Land markets aimed at efficient land transfers are least developed here, as we have seen.

Thus, market failures in asset transfers cannot be solved by simply enforcing and protecting whatever pre-existing structure of rights happens to exist on the land. If the pre-existing structure happens to be appropriate for a commercialized land market, as in Thailand, titling can be a success and strengthening the legal protection of pre-existing land rights can improve the efficiency of the commercial land market. But this is because in Thailand the conflicts between the rights of the land-clearing peasants and commercial investors in the land were resolved long ago to the detriment of the peasantry. In some of our other cases, our analysis suggests a paradox for land rights reform. Strengthening and protecting the mass of micro-claims on land may have a paradoxical effect of further increasing the transaction costs of efficient asset re-allocation to more productive uses. Achieving efficient asset allocation may paradoxically require overriding some of the rights and interests of the pre-existing structure, which does not preclude generous compensation arrangements. Otherwise the task of organizing a productive transformation may become progressively more difficult, a conclusion that is in stark contrast to the property rights reform agenda outlined by De Soto (2000). Our analysis therefore suggests a role for non-market

transactions and transfers in developing countries that is much more significant than the role of the *eminent domain* transactions recognized in the context of advanced country land markets.

### ***Compulsions for Productivity Growth***

Effective markets for transferring assets are necessary but not sufficient to achieve the productivity growth that characterizes the capitalist system. Paradoxically, some of the most convincing analysis of the institutional features that made capitalism so dynamic came from the Marxist analytical tradition even though it was in general critical of capitalism's social injustice and proneness to crisis. Here we focus on the Marxist analysis of capitalist dynamism and some developments in modern institutional economics that come close to that analysis. The analysis overlaps with the analysis of compulsion already referred to but is developed further here. Capitalist dynamism depends not just on the presence of clear rights over assets, but also on a range of decision-making rights which are *exclusive* in that not all individuals in a capitalist society can have these rights.

One of the powerful insights in Marx's analysis of capitalism was that its dynamism did not in the main derive from efficient markets for exchange (though markets are necessary for capitalism). Markets after all had existed for centuries before capitalism emerged. Rather the distinctiveness of capitalism was the emergence of a structure of rights that ensured discipline in the production process and compelled both capitalists and workers to achieve productivity growth (Wood 2002). As we have seen, commoditization ensured that individual capitalists would have to rapidly match the productivity of the most efficient producer to survive. But to do this they would also need the capacity to enforce discipline on their own workforce. This discipline required not just that capitalists owned capital; it also required that workers owned none, so self-sufficient artisan production was not possible. These *mutually exclusive* rights made capitalists dependent on hired labour and made labour subject to capitalist discipline. This allowed and compelled capitalists to continuously change the organization of production in the direction of greater productivity.

Aspects of this insight reappear in the 'agency theory' of new institutional economics (Alchian and Demsetz 1972). Agency theory argues that the organization of the capitalist firm which gives the capitalist exclusive decision-making rights needs to be explained. It cannot be explained simply in terms of property rights, because the rules that give the owner of capital these decision-making rights in turn need to be explained. The agency theory explanation is that team production using modern technology is subject to free riding because a small decrease in the effort put in by a single individual cannot be traced back to that individual, and may not even have an observable effect on output. But if too many individuals engaged in such free riding, output could precipitously collapse. Some system of 'monitoring' needs to be devised and the monitor has to have strong incentives to monitor effectively. The structure of rights in a modern capitalist firm then begins to make sense: the capitalist is the owner of the residual or surplus and this gives the capitalist strong incentives to monitor workers. According to agency theory, this explains why property rights over capital are defined not just in terms of the right to buy and sell assets, but also provide their owners rights over the residual income of team production (profits) and to act as 'monitors' who can hire and fire members of the team.

The agency analysis is significantly different from that of Marx in some respects. It argues that because the capitalist firm makes sense in terms of efficiency, the team will voluntarily contract to create a monitor and cede monitoring, hiring, firing and residual return rights to that monitor for mutual benefit. In reality capitalist firms do not emerge through this type of voluntary contracting because workers are unlikely to voluntarily cede claims over the surplus to achieve greater monitoring efficiency as they would rightly suspect that they will not be able to capture most of the increase in productivity. In reality capitalist rights are typically defined through contestation and conflict as the Marxist analysis stresses. Nevertheless, the area of overlap is that both traditions point out that the capitalist firm can transform social productivity because of its very specific rights structure. This is based not just on the rights of the capitalist to own capital, but also to make production decisions and on the *absence* of equivalent decision-making rights for workers, including in particular their right to decide whether they should continue to work with the team.

The capture of decision-making rights by small groups of people has been a long and contested process in capitalist countries. The assumption that simple property rights reform will achieve conditions for productivity growth is deeply misleading. A necessary but not sufficient condition for the imposition of capitalist discipline over the workforce is the presence of a large class of people without access to land and other means of organizing their subsistence. In England, the Enclosures accelerated the creation of a working class by depriving poorer peasant households of the common lands on which their livestock production depended. The undermining of the peasant economy for poorer peasants together with the consolidation of large farms through the Enclosures which could employ them as workers began to see the early emergence of the English working class. This created the conditions for the imposition of discipline in the transition to agrarian capitalism in agriculture and subsequently in industry. In contrast, the persistence of the peasantry in France helped to explain its much slower transition to capitalism (Brenner 1976, 1977, 1985).

But a proletariat is not a sufficient condition for the imposition of capitalist control over production. Many contemporary developing countries, particularly densely populated Asian ones, have long had large populations of landless workers. But even the landless may find alternative ways of eking out a living and the 'rationality' of accepting capitalist discipline for a higher wage may not strike them as obvious. The creation of a disciplined working class involves further conflict and contestation to impose a social discipline that rules out other ways of making a living and indeed the choice of living in poverty as vagrants. Historically, European countries went through long periods of 'socialization' through the establishment of legal and social rules that made idleness or a life of poverty difficult if not impossible (Thompson 1991). The Marxian analysis shows why the emergence of private land ownership, an effective land market and even the presence of a class of landless workers are not sufficient for the imposition of capitalist control over the production process, without which production efficiency and the introduction of new processes are unlikely to emerge. The link between property rights and growth is therefore much more complex than may appear at first.

The balance of rights that may have compelled productivity growth in agriculture was not achieved in any of our case study countries. Even in Thailand where the landed classes were closely allied to the monarch and powerful merchants and were already

effective owners of the land, effective control rights over the labour process could not be successfully implemented. Thai agriculture remained land-using with limited investments. Labour scarcity and the extensive land frontier made it difficult for Thai capital or the state to impose the discipline of capital over labour in agriculture. Nevertheless, while Thai agriculture did not become capitalist, the effective control that commercial interests achieved over sizable chunks of valuable land proved to be very efficient *later* when land was required on a significant scale for an industrial transformation. Imposing discipline over a smaller emerging industrial workforce proved to be somewhat easier in all developing countries.

In the Indian subcontinent as well as in Tanzania, capital could not even achieve sufficient land agglomeration for proper capitalist farming to begin. In these countries the fragmentation of land was also to constrain the later emergence of effective land markets that could allocate land for industrial development. In the Indian subcontinent, the rights granted by the colonial power to peasant occupiers prevented both the agglomeration of land and the acquisition of effective control rights over land in the hands of financial interests. The structure of colonial land rights only allowed the agglomeration of *rent receiving rights* in the hands of the more business-minded of the *zamindars* but these rights declined in value over time and became entirely valueless with the abolition of *zamindari* after independence. In Tanzania, the colonial period did not even see the creation of clear peasant land rights that would indicate a settled peasantry.

In late developers there is a further problem in attracting investments in high productivity industries where skills and experience are missing. The existence of significant market failures constraining the adoption of new technologies means that the structure of rights that compelled productivity growth in early capitalism are no longer sufficient in catching up countries (Khan 2005a). In particular, new investors often require risk sharing arrangements or subsidies to induce them to invest, and this has significant implications for the structures of rights that are necessary to compel productivity growth. One way in which many developing countries have attempted to attract investments is to attenuate the rights of small groups of existing landholders so that their land can be acquired by or for new high value investors at a low price.

However, we know that industrial policy subsidies of any sort are only likely to have the desired effect if there are clear procedures for comparing alternative investment opportunities and defining performance conditions for investors getting assistance. Most importantly, the efficient allocation of these rights now requires the presence of institutional capabilities to reverse allocations or otherwise withdraw subsidies if subsequent performance is weak. Without these conditions, the compulsions for *ex post* productivity growth in the newly attracted industries may be too weak. As subsidies given through land market transactions are by their nature opaque, this is a problematic way of transferring subsidies to attract high-value investors. Yet the absence of formal industrial policy mechanisms in most developing countries means that we often find examples of land markets being manipulated to attract investors, but without any compelling conditions attached. We will describe examples of such transactions in India and Tanzania in our case studies, but in neither case were the institutional conditions adequate to ensure that productivity growth would in fact be maximized. This aspect of the problem will be further discussed as part of the problem of technology acquisition in a later paper.

### ***Growth-Constraining Transaction Costs***

If property rights have multiple ‘tasks’, the structures of rights that are appropriate for addressing one type of problem may not be appropriate for another. The broad concept of transaction costs blurs the distinction between the specific transaction costs that are relevant for each of the problems that we have been discussing. Implicit in our discussion so far is the possibility that the creation or improvement of a specific type of property right can reduce one set of transaction costs but increase another. However, if we are aware of these trade-offs, a transaction cost framework can still be useful for *describing* possible conflicts in a simple way. We can do this by distinguishing between transaction costs (TC) in general and growth-constraining transaction costs (GTC). The latter focuses on the transaction costs of achieving growth-enhancing changes in the allocation of assets, effort and investment. *A reduction in growth-constraining transaction costs by definition improves the chances of growth.* But a general reduction in transaction costs does not in general have that effect in a world where transaction costs are high along many dimensions. It is even possible that reducing a transaction cost that is irrelevant for growth may have an adverse effect if it inadvertently raises a critical growth-constraining transaction cost.

We have already seen that strengthening some property rights can actually make the organization of a growth-enhancing change *more* difficult. Strengthening the definition and protection of the property rights of small peasants in a context where growth is constrained by land fragmentation would be an example. In this case, the transaction costs of small peasants in protecting their asset would be reduced, and this is desirable in itself. But small peasants are not often drivers of growth, and the improvement in investments that this may bring forth may be relatively small. On the other hand, their stronger rights may increase the complexity of the bargaining that a bigger investor may have to go through to buy many individual parcels of land. So growth-constraining transaction costs may have been *increased*. The paradox from the perspective of the simple theory of property rights is that sometimes *weakening* or even *destroying* some property rights can *decrease* growth-constraining transaction costs and thereby promote growth. For instance, this may happen if a weakening of the rights of collective landholdings made it easier for individual investors to take over land and thereby achieve efficient land use re-allocation.

The generalizations coming from simple property right theory about the unequivocally good effects of strengthening property rights are misleading. These conclusions are based on a misleading comparison of reality with an imaginary benchmark of a world free of transaction costs. Since a perfect world has no transaction costs, the argument goes, any reduction of transaction costs must be a good thing. This conclusion need not hold in a world where we are comparing scenarios to identify the second-best. Ironically, the work of new institutional economics has itself established that zero transaction costs are unattainable (North and Wallis 1987). The work of Stiglitz has also shown that using the benchmark of a first-best world with zero transaction costs can be deeply misleading for policy (Stiglitz 1996). Any real world policy intervention is never going to achieve zero transaction costs and can only change *specific* transaction costs. The same intervention may raise some transaction costs and reduce others, and the net reduction is less relevant than the incidence. A reduction in the transaction costs of groups who

are not engaged in driving growth at the expense of even a small increase in the transaction costs of groups that are may have paradoxical effects on growth.

It is important to keep in mind that weakening any rights has immediate impacts on the time horizons of those who possess these rights, and can lead to asset consumption or even destruction. If transfers to better uses have to be achieved through weakening some rights, the new owners have to rapidly achieve security of rights in the sense of protection and non-expropriation. Otherwise the re-allocation is likely to fail in its objectives. Successful non-market transfers of rights such as in the English Enclosures or the transfer of public land in China over the 1980s and 1990s first to TVEs and then to private hands succeeded because they protected new users at the same pace as the asset transfers were being achieved. If they had not, the result could have been disastrous. But equally, the English Enclosures or the Chinese transformation did not protect *all* rights to the land. Rights were *destroyed* and *created* in short succession. It is very misleading to forget about the destruction and focus only on the protection.

Non-market asset grabbing in many countries fails to achieve any improvement in growth outcomes because the expropriators are themselves not certain of their future protection and so do not have the incentive to take a long view to conserve their investment. Without this, any further progress towards a productive ‘capitalism’ is not likely. In these cases, the destruction of the property rights of the initial users does *not* reduce growth-constraining transaction costs because the damaging effects of the initial destruction are not balanced by any improvement in subsequent asset use. It is therefore important to repeat the obvious, namely that undermining the basic rights that give asset users an extended time horizon are damaging and only justified for relatively short periods if there is no other way of achieving other objectives like asset re-allocation or the introduction of some of the conditions necessary for compelling productivity growth.

Figure 3 summarizes the implications of our analysis for the types of property right interventions that are typically of concern in developing countries. It compares the expectations of the simple or standard theory of property rights with the expectations that follow from our extended theory that distinguishes growth-constraining transaction costs from aggregate transaction costs. The simple theory supports across the board improvements in property right protection and definition. Our argument suggests that every policy needs to be specifically looked at to identify the types of rights affected and the identity of the beneficiaries and those adversely affected. The first row in the figure looks at policies that strengthen some existing rights or create new rights. The expectation of standard theory is that these reforms will always reduce some relevant transaction costs and thereby improve economic efficiency. Our analysis shows that strengthening or creating particular rights can have indeterminate effects on growth-constraining transaction costs. In some circumstances, strengthening existing rights can *increase* growth-constraining transaction costs with adverse effects on potential growth.

The second row in Figure 3 describes policies that destroy or weaken specific rights. The standard theory predicts that these policies will raise transaction costs and indeed they will for specific right-holders. Our analysis suggests that the net effect of weakening or destroying some rights can occasionally be to *reduce* growth-constraining transaction costs and thereby assist growth prospects.

POLICY/ INTERVENTION	Effect on Transaction Costs (TC) in Standard Analysis	Effect on Growth-Constraining Transaction Costs (GTC)	Effect on Transition Costs (TSC)
Creation of New or Strengthening of Existing Rights	↓ TC expected to decline	↓ or ↑ (Depends on net effects on investor time horizons, asset re-allocations to investors and compulsions for productivity)	Usually ↑
Destruction or Weakening of Some Existing Rights	↑ TC expected to rise	↑ or ↓ (Depends on net effects on investor time horizons, asset re-allocations to investors and compulsions for productivity)	Usually ↑
Increase in surplus extraction by the state	↑ TC expected to rise	↑ or ↓ (If state's surplus extraction creates political incentives for supporting growth GTC can decline)	Usually ↑
State withdrawal from the economy	↓ TC expected to decline	↑ or ↓ (If state's capacity for assisting growth declines GTC can rise)	Usually ↑
Non-market allocation of resources, eg through exercise of <i>eminent domain</i>	↑ or ↓ (TC could be lower than in market)	↑ or ↓ (GTC could decline if non-market allocation makes assets available to growth-promoting investors constrained by high market transaction costs)	Usually ↑

**Figure 3 Aggregate versus Growth-Constraining Transaction Costs**

The third row in Figure 3 looks at the impact of policies that represent attempts by political coalitions in control of the state to increase surplus extraction, typically through taxation. In the standard theory this will unequivocally raise transaction costs. This is because it is typically assumed that taxation raises uncertainty about future returns and owners of assets may also face difficulties in contracting for the future. However, in the context of the transformations that we have described this is a very limited analysis. If the political coalitions controlling the state face significant transition costs in pushing through growth-promoting changes they may be more likely to accept these costs if they have incentives. Surplus extraction provides that incentive. Historically, the need to raise revenue, particularly in the face of external threats has often moved states to take risks to define property rights in growth-enhancing ways (Tilly 1975). Surplus appropriation by the state can of course be growth reducing if the state has a short time horizon and simply extracts for consumption by politicians. This can reduce the time horizons of investors who may also begin to destroy and consume assets. In this case the prediction of the simple theory would be borne out.

The fourth row summarizes a similar qualification by looking at the reverse policy. A withdrawal of the state from the economy does not necessarily reduce transaction costs in a way that is beneficial for efficiency and growth. In the standard theory, state withdrawal assures property owners that their expropriation risk is reduced. In reality, the withdrawal of the state can have the opposite effect and *raise* growth-constraining transaction costs if it diminishes the political ability of investors to push through

growth-promoting changes. If these changes are likely to be strongly resisted, the chances of making progress are much reduced without active state support.

The final row shows some areas of overlap between the simple theory of property rights and our own. The simple theory accepts that in conditions of significant market transaction costs, administrative interventions can lower transaction costs and thereby improve resource allocation. This is the basis of support for *eminent domain* interventions. However, administrative interventions can also get valuations and allocations wrong, generating resistance and implicitly raising transaction costs. Similar conclusions follow from our analysis, except that ‘administrative interventions’ or non-market resource allocations now cover a very significant part of the allocative process in developing countries. Straightforward *eminent domain* interventions are difficult in developing countries because initial rights are often overlapping and unclear and meaningful market prices do not exist for many assets. Here, administrative allocations implicitly end up destroying, attenuating or amending pre-existing rights. As we have seen, these interventions can be growth-promoting or the reverse, depending on the net effect on time horizons, resource allocation and productivity growth.

It is important to keep political and moral judgements separate from the institutional analysis. We may judge on moral or political grounds *not* to promote growth (if, for instance, the distributive implications are dire) and that may be a perfectly valid judgement. Indeed we will argue that political judgements continue to constrain growth in the countries we are looking at. But in making such judgements we should be compelled to be transparent about the trade-offs we are making. If we reject any interference in the rights of some people and as a result they or others continue to remain in sustained poverty, we should at least make that decision explicitly. It is also important to point out that growth in developing countries is typically constrained not by political concerns for the very poor but rather by political conflicts between the moderately rich. To investigate the political constraints that states have operated under we now move to a discussion of transition costs.

### ***Transition Costs***

We define *transition costs* as the collective social costs of *creating new rights or altering or destroying existing rights*. These costs can be of two broad types. First, the costs could refer to the costs of *organizing* negotiated transitions, perhaps using compensations. The compensation itself is not part of the transition cost because it is paid effectively to acquire control over an asset and is therefore equivalent to its price. But the cost of *organizing* these ‘transactions’ are transition costs and includes the cost of possibly complex negotiations with multiple claimants to agree on the price and terms of the transaction. It is because transitions can in theory be carried out through negotiation and compensation that the simple property right theory often incorporates transition costs as part of normal transaction costs.

However, secondly, in many if not most transitions, including those in which some compensation is offered, a significant part of the costs of the transition are ‘political’ *contestation costs* between different parties. Contestants typically impose costs on each other, on the state and often on broader society to signal that they will not give up their claim to the rights in question or to demand a different level of compensation. Often there is no substantive difference between a transition that is achieved with

contested and enforced compensation and one that is enforced without any compensation at all. In both cases, these political transition costs or costs of contestation may be the biggest part of the transition cost. Transition costs can be transmitted in a variety of forms, including electoral mobilizations, political mobilizations to bring down governments, strikes and lockouts that inflict direct costs on specific targets but also on broader society, riots, targeted political violence and even civil war.

When property rights stand to be transformed, intense conflicts can break out for many reasons. Traditional ways of life are threatened, and at the same time new opportunities for dramatic enrichment open up. The possession of control rights over assets that promise to have significant economic value in the future can transform the class status of individuals and their heirs for generations forward. Equally, those who lose out may find their relative status in the new society has dramatically worsened. In addition, the negotiation over compensations is likely to verge on violence and frequently descend into it because dramatic changes in resource use increase the potential value of assets by orders of magnitude. Paradoxically, the greater the gain from asset re-allocation, the more intense is the conflict likely to be between current and future users in determining the 'price' of the right.

The intensity of the conflicts depends on the relative organizational and political power of the contestants, their links with the state and how successfully they can mobilize themselves and broader social coalitions. Differences in the social and political organization of societies can therefore explain differences in the opposition that similar transformations face. Differences in social organization can therefore explain different trajectories of property right evolutions. A detailed analysis of social organization will be the subject of a later paper in this series.

Some simple insights from game theory can help to identify the types of factors that can determine the costs of conflict but also to show the limits of trying to explain these costs in terms of a strictly economic logic. A transfer or alteration of rights over an asset can be seen as generating a potential gain from asset re-allocation. The bargaining game is over how to split this potential gain between those who are giving up (or losing) their old rights and those establishing new rights. In the case where new rights are being created conflicts are also likely to emerge between the many aspirants for the new right, since all of them typically cannot be satisfied. In all these cases we have variants of the conflict-with-cooperation bargaining game (sometimes called a chicken game in game theory literature) with each party benefiting if they can capture all or a bigger share of the potential gains. Game theory shows that these games have no determinate outcome. The way aggregate gains are split depends on the relative bargaining power of the parties which in turn depends on how long each can credibly hold out in costly conflicts. The social costs of the institutional change are therefore not determinate and depend on how long conflicts go on. The length and intensity of the conflicts depends on the 'holding power' of the contestants and this determines whether the institutional change will happen at all, and if it does, how the benefits are split (Knight 1992).

Holding power is a measure of how long each side can credibly engage in a conflict, given that conflicts have costs. Holding power measures the relative ability to absorb the costs that follow from engaging in, for instance, strikes, mobilizations and

ultimately violence. The theory is that the side that can credibly hold out the longest is most likely to win. If one side has transparently greater holding power the conflict may not begin at all because if there is no chance of winning, the weaker side may feel compelled to accept whatever is offered. The interesting implication of this analysis is that conflicts are likely to be more prolonged and intense when the contestants are evenly matched in terms of their initial economic conditions.

But Knight's holding power is difficult to pin down in purely economic terms. As a first approximation holding power appears to be related to economic power because we might expect that richer contestants should be able to last longer in conflicts and inflict more costs on the other side by investing in the 'technology' of fighting battles. However, economic power is only a first approximation for holding power, and may not even be a good approximation. After all the poor do engage in contests and they occasionally win as well. This is because holding power is more indeterminate than economics would suggest. The poor can have significant holding power if they are able to absorb more pain than the rich. They could also mobilize themselves and other social forces to inflict costs on their opponents using their organizational ability to compensate for a weaker financial capability. Taking these political, organizational and motivational differences into account means that the outcome of conflicts cannot be predicted by the initial economic (or even military) differences between the participants.

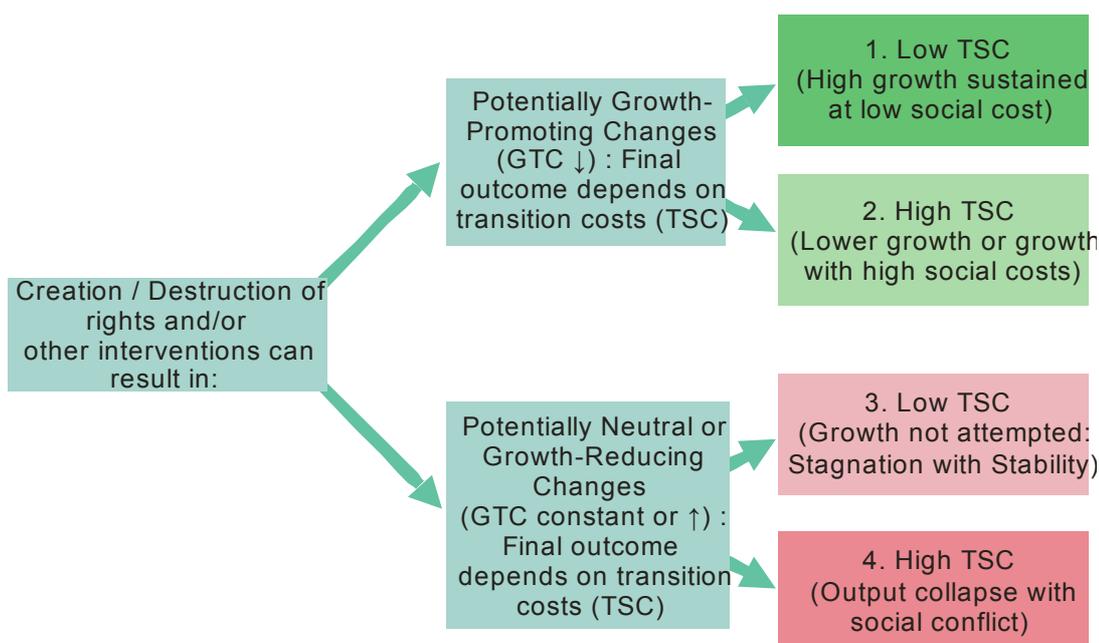
We need a summary description of social organization to say anything useful about the likelihood and intensity of conflicts and therefore the transition costs facing any strategy of property right transformation. We will use the concept of a *political settlement* to summarize the *distribution of political and organizational power in society between the groups and classes that are significant for analysing a specific strategy of social transformation* (Khan 1995). The political settlement is therefore relevant for understanding the costs that different groups and classes are likely to impose on their opponents in the course of conflicts. The capabilities of different groups to *absorb* these costs are also relevant for understanding the likely outcomes of conflicts.

The insights from game theory only help us to a limited extent in outlining broadly defined hypotheses that can indicate the magnitude of transition costs. It tells us that if the groups potentially losing out from a change are evenly matched with the groups that stand to benefit, the contest may be prolonged and intense. Under these circumstances, neither side may give up too quickly. The ability of groups to impose costs on their competitors is particularly indeterminate in reality because it depends not just on the economic base of the group but also on their political and organizational ability to form alliances with other social groups. In developing countries this is particularly important because of the factional organization of politics which means that all sides are able to find allies at a price (Khan 2000a, 2002, 2005b).

The critical role of the 'intermediate classes' in developing countries can be understood in this context. Individuals from within these classes have the ability to mobilize patron-client factions that are potentially large social coalitions. These can inflict significant social costs through political conflict. These political realities have a significant effect on strategies of property right transformation. The contending parties in an actual conflict in developing countries do not have to rely only on their

own abilities to engage in conflicts. They can significantly increase their holding power and capacity to inflict costs on the other side in exchange for a share of the ‘rents’ coming from increased bargaining power. Thus transition costs can depend on how patron-client factions are structured and how they network with different economic and social forces within their societies and the outside world. We will examine patron-client politics in our case study countries in detail in a later paper.

The likelihood of any particular growth-enhancing property right transformation being implemented depends on the transition costs they unleash. A few broadly defined scenarios are described in Figure 4. Note that transition costs are only partly economic costs. It is possible to sustain growth with high transition costs measured in terms of non-economic conflict costs. Even if some of the costs of conflict are economic, if they are largely inflicted on groups that are not driving growth, high economic transition costs can also be consistent with economic growth. However, in both cases, high transition costs may indirectly impact on growth if the political system is unable to absorb these costs and growth is abandoned as a result. Finally, transition costs can of course directly impact on growth by affecting the growth economy directly, and in this case high transition costs directly raise growth-constraining transaction costs.



**Figure 4 Growth Effects and Transition Costs of Changes in Property Rights**

The most fortunate combination is shown in box 1 at the top right hand of Figure 4. This is a fortunate conjuncture of growth-promoting changes in rights that face low transition costs. In this optimistic scenario growth-enhancing changes are not strongly resisted because the losers are politically weak and do not contest strongly. Few countries are likely to be in this fortunate position for very long. Sequential changes in property rights are likely to be required to sustain growth over time, and as new groups are affected by change, the combination outlined in box 1 is unlikely to be a permanent position for a country.

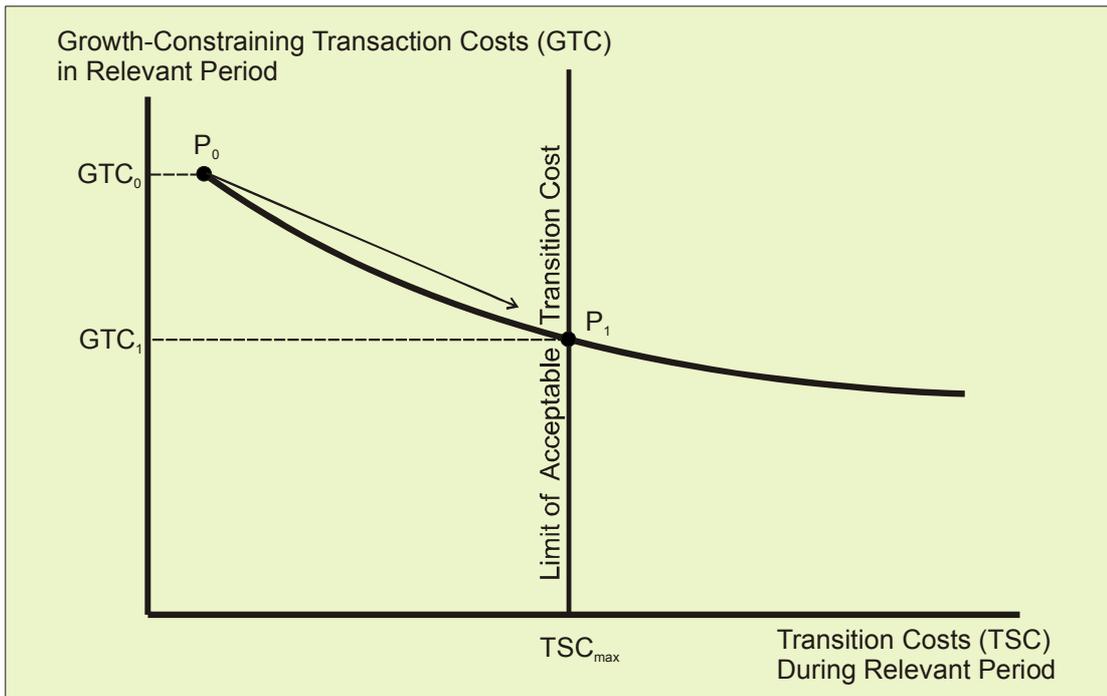
Box 2 summarizes the cases where growth-enhancing transformations face high transition costs. This describes a range of scenarios that are very important for most developing countries. There are a number of important variants within this broad category. In some cases growth-promoting changes may be forced through at high transition cost because the ruling coalitions can absorb or tolerate significant social costs from the sources that are affected. In these contexts growth can be sustained despite social conflict. However, if the social conflict begins to affect the growth sector directly, growth-constraining transaction costs may increase and growth will suffer. A more common variant is one where continued resistance forces some changes to be abandoned. Growth in many contemporary developing countries is often of this type: driven by gradual, *ad hoc*, interventions in rights that are often blocked or reversed. The sustainability of these processes can vary from case to case and the challenge for policy-makers is to intervene in rights to sustain growth. In extreme cases, the transition costs may be so high that growth strategies are almost entirely abandoned and we then collapse into the third scenario.

The scenario shown in box 3 is one where attempts to change property rights to support growth are largely abandoned or even reversed because of potential transition costs. The actual transition costs may be low because few if any growth transitions are attempted. The political compromises on which non-settler colonial powers were based in Asia and Africa were often of this type. High growth developing countries can also revert to stagnation for these reasons if the transition costs of sustaining growth become too high. This could happen if ‘populist’ political parties based on the power of redistributive patron-client factions protect the rights of inefficient clients in industry and agriculture.

Finally, the worst case is represented in box 4 where growth-enhancing rights are actually destroyed through conflicts that in turn have significant contestation costs. This is a scenario of destructive civil war or the outbreak of warlordism. Distinguishing between these scenarios is obviously extremely important. Some of the destruction of property rights in the first or second box could be *driving* growth but the destruction of rights in these scenarios is very different from the destruction of rights in the fourth which may be responsible not just for a growth collapse but eventually a collapse of the social order. This again shows why the simple theory of property rights can be misleading.

### ***The Growth-Stability Trade-off***

We can now bring together these conceptual building blocks to show that there are conceptually different paths along which we can proceed to change structures of rights to support higher growth. Each of these paths is defined by how much additional improvement in growth is achieved for an additional ‘price’ in terms of social contestation. In Figure 5, the height of the starting point  $P_0$  tells us the initial level of growth-constraining transaction costs. The higher we are, the lower the growth achievable with the existing structure of rights. From this starting point, we can consider different types of changes in rights that may reduce growth-constraining transaction costs. Any particular type of change is likely to have detrimental effects for specific groups and we can expect transition costs that are likely to increase the further we go along that direction of reform.

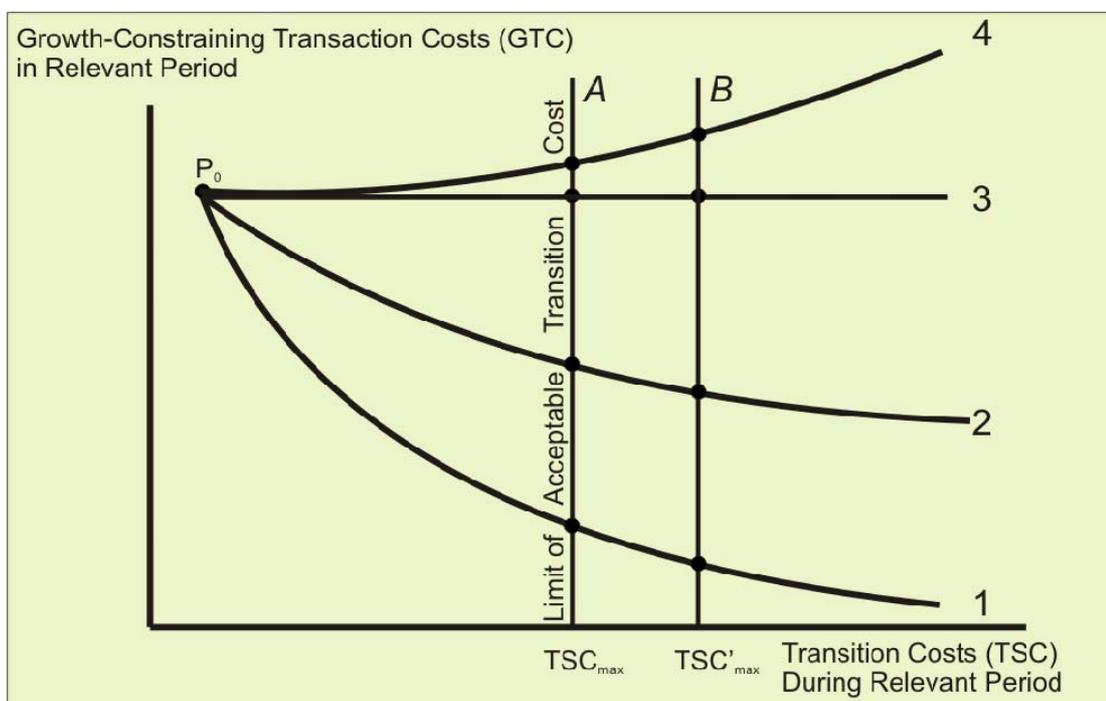


**Figure 5 The Growth-Stability Trade-off**

The slope of this ‘trade-off’ curve tells us how steeply transition costs increase for this strategy of improving growth. The more vertical the curve is, the bigger the improvement in growth that is likely to be achieved for any given increase in transition costs. The flatter it is, the higher the price in terms of transition costs that has to be ‘paid’ for any given improvement in growth. We should obviously look for the strategy that achieves the greatest growth effect at the lowest social cost, in other words, the trade-off curve that is the steepest in each period of reform. The steepest available reform path is not however equally steep in all societies. The shape of the trade-off and the maximum acceptable transition cost are not only likely to be different across societies and over time, but also across strategies targeting different changes within a society.

How far the participants are likely to proceed even along the most promising path of change depends on the maximum ‘acceptable’ transition cost,  $TSC_{max}$ . This is defined by the absorption capacity of the coalitions in state and society driving the changes to absorb the costs inflicted on or by the groups adversely affected by these changes. Both the shape of the trade-off and the maximum acceptable transition cost describe features of the political settlement which determine the likely constraints that will be faced by that strategy of transition. The slope of the trade-off curve and the maximum acceptable transition cost defines the *limits* to the implementation of any specific strategy over the period in question. In this case the limit is a transition to  $P_1$ . This does not mean that change will actually be pushed all the way to  $P_1$ , as the transition costs may deter the groups pushing for these changes even if they could theoretically have been absorbed. For the sake of simplicity we are ignoring the organization of agency in these diagrams but will return to this in a later paper. Finally, the growth-stability trade-off is not a summary of all the institutional changes and political conflicts that may be going on in a society, but a way of focusing on specific growth-promoting changes in property rights structures.

Figure 6 shows how differences in the slopes of the most favourable trade-off curves available to a society at any time and in the maximum acceptable transition cost can define the limits of growth-enhancing property right changes. The four curves in the figure correspond to the four scenarios described in Figure 4. The trade-off curve marked 1 in the figure corresponds to a scenario where growth-enhancing changes in property rights beginning at  $P_0$  face very limited opposition and rapid reductions in growth-constraining transaction costs can be achieved. Implicitly in this political settlement the groups adversely affected by these changes are weak. The tolerance limits of the ruling coalition for the transition costs depend on the political settlement and the identity of the groups affected. If the change adversely affects groups whose support is necessary for the coalitions in control of the state, the tolerance for transition costs could be at a low level shown by the line A. If on the other hand, the adversely affected groups are not politically important for ruling coalitions their tolerance for transition costs could be much higher, for instance up to line B. Movements in the direction of growth-enhancing changes in rights could then go even further, though at a higher social cost in terms of conflicts.



**Figure 6 Most Favourable Trade-Off Paths Can Vary Across Societies**

The other three lines in Figure 6 show how growth outcomes can change with different combinations of the best available trade-offs and tolerance levels. The trade-off curve marked 2 shows the case where resistance to change is much higher. With the same levels of tolerance to transition costs more limited improvements in growth prospects are likely. Most developing countries experiences are variants of this case as discussed earlier. The limiting case when even trivial attempts to change rights in the direction of greater growth are very strongly resisted is shown by case 3. Here a growth improvement is hardly discernible even for significant increases in transition costs and therefore there is no incentive to move from  $P_0$ . This could represent the extreme case of stability with no growth.

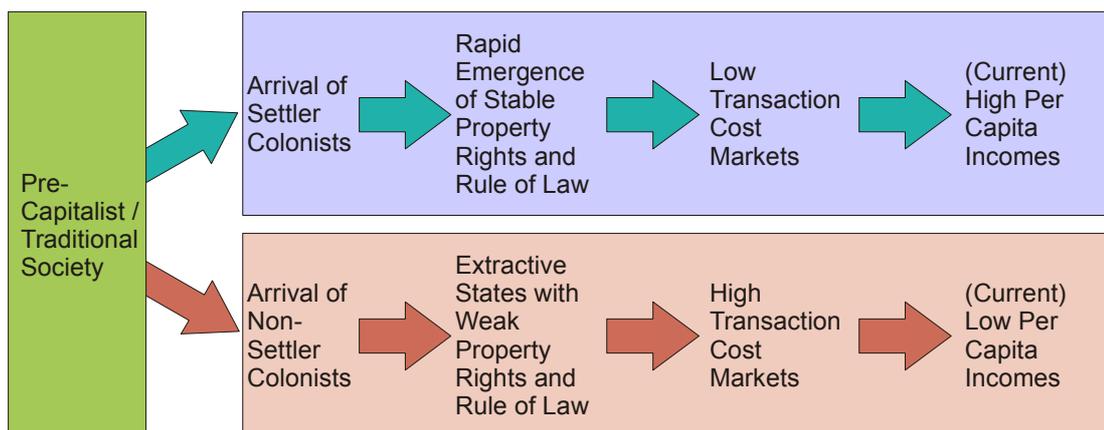
As the trade-off curve becomes flatter, case 2 becomes more like case 3. Reform in the direction of growth becomes increasingly costly which means that sustaining reform requires a change in the underlying political settlement. The only viable strategy for societies where growth-enhancing changes in rights are seriously blocked is for alternative coalitions to emerge or be organized that can take on the blocking coalitions. This will also involve conflicts and perhaps a period of conflict without growth, but there may be no alternative but to restructure political coalitions if growth-enhancing changes are seriously blocked. If successful, these political mobilizations could change the underlying political settlement and enable a more favourable growth-stability trade-off to emerge. But equally, political mobilizations can also be in the direction of strengthening patron-client factions that block change, so that the trade-off curve becomes flatter.

Case 4 represents a pathological case where growth-reducing changes in rights may be taking place in a context of intense conflict. This could happen if some groups drive growth-reducing changes in rights for their own benefit *and* unleash increased social conflicts in the process. There are some sectors in every developing country that might fit this picture but when these activities become widespread we have a descent into a warlord society. Fortunately, none of our case study countries were in this category.

### ***Colonial History and its Misleading Narratives***

One of the most influential arguments frequently referred to in support of the good governance agenda comes from Acemoglu, Johnson and Robinson (Acemoglu, et al. 2001, 2002) henceforth AJR. Our analytical framework demonstrates why their analysis and the underlying re-interpretation of history they offer are deeply misleading. The comforting narrative they offer suggests that bad colonialism created the problem of unstable property rights in some countries. Instead, we need to learn the lesson of the good colonialism in settler colonies that created stable property rights and prosperity. This comforting but deeply misleading narrative diverts our attention from the economics and politics of growth-enhancing property rights reform and the governance capabilities required by developing countries to sustain growth during their contemporary transitions.

AJR's innovation was to use exogenous proxy variables (the incidence of malaria as well as low initial population density) as instruments for locating where white settlers settled and set up settler colonies. It turns out that settler colonies did significantly better in achieving development than non-settler colonies. The bias that their instruments arguably correct for is that they ensure that the analysis does not pick up the possibility that white settlers settled in areas that had an advantage for some other reason. But in the end, their econometric sophistication says little more than something that is quite uncontroversial: white settler colonies did a lot better than other developing regions. The question is why? Here they make an assertion that has nothing to do with their econometrics. They assert that the reason was that settler colonies set up stable property rights while non-settler colonies set up extractive systems that disrupted property rights, apparently with lasting and persistent consequences. This reassuring version of colonial history, summarized in Figure 7, has become widely accepted as having been *proved* by the econometric exercise carried out by AJR.



**Figure 7 The Acemoglu et al. Version of Colonial History**

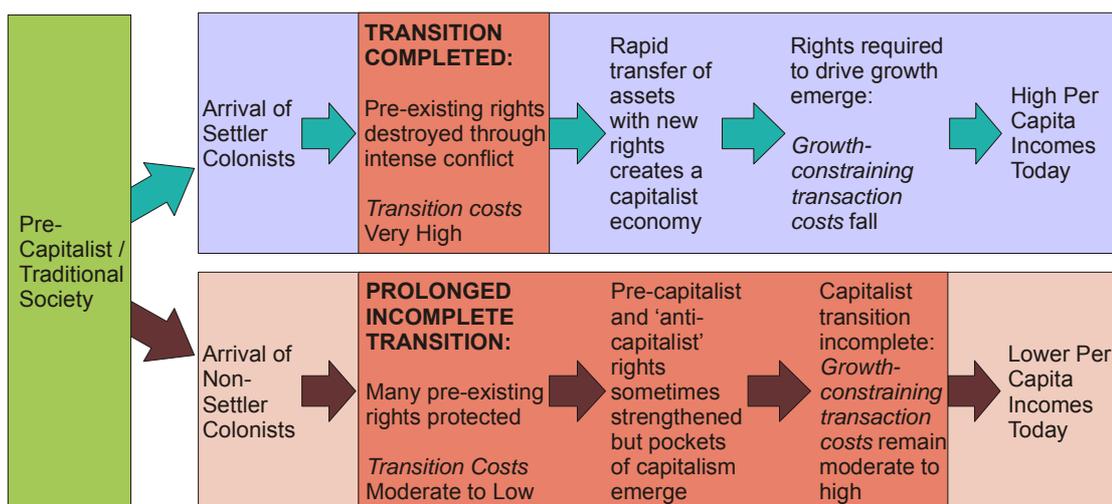
In fact, nothing of the sort is actually demonstrated in their work. All that the work demonstrates is that settler colonies ended up with significantly higher per capita incomes and high scores in property right stability a century or so later. AJR present no conclusive argument that the eventual outcomes were achieved *because* these states *first* established stable property rights and set up limited government. In reality, as Glaeser et al. point out, the same evidence could be used to argue that what the settlers brought with them was primarily their human capital (that is themselves) rather than their institutions, which arguably developed much later (Glaeser, et al. 2004). What is worse, since the acquisition of human capital is in the long run a policy choice, a sophisticated racist could use the AJR evidence to argue that the superior performance of white settler colonies demonstrates the genetic advantage of whites in acquiring human capital (or indeed in setting up good institutions). AJR's regressions only establish that white settler colonies did better (which no-one questioned anyway), and that where white settlers settled probably had little to do with the pre-settler productivity of the region. However, AJR's own work shows that settler colonies were more likely to be set up in areas where indigenous populations were not dense (Acemoglu, et al. 2002). The significance of this for transition strategies has not been picked up.

From the perspective of our discussion of transitions, the re-telling of history summarized in Figure 7 is not just misleading but very damaging for improving our understanding of how to intervene in contemporary transition processes. Not only have significant historical facts been misrepresented, more significantly, critical but inconvenient aspects of the *processes of transition* have been airbrushed out. While historians have pointed out that AJR have missed or misrepresented some historical facts, they have not focused on the implications of misrepresenting the history of the transition. For instance, Austin (2008) points out that AJR's assertion of how extractive colonialism worked in non-settler colonies is overly simplistic and perhaps only applicable to the Belgian Congo. Bayly (2008) points out that AJR ignore the way in which some colonial subjects, particularly in India, used non-settler colonial institutions to develop productive capabilities. But the most obvious and striking fact about settler colonialism is the *qualitatively more violent process* that was unleashed on indigenous populations, verging on and in some cases amounting to genocide. The Belgian Congo was a possible exception to the rule that non-settler colonies faced lower levels of violence compared to settler colonies.

If anything, AJR's story of expropriation can be turned on its head for the early period of colonialism in settler and non-settler colonies. In the non-settler colonies the colonial power faced dense populations that were relatively well organized and they immediately made complex political compromises with pre-existing and new elites to sustain colonial rule. In contrast, in settler colonies pre-existing populations were thinly spread out and the consequences of this turned out to be devastating for them. It meant that settlers were not threatened to quite the same extent by densely organized indigenous populations and could follow much more aggressive military strategies of land grabbing and destruction of pre-existing collective rights. Here indigenous populations faced dramatic and rapid expropriation of their lands, were pushed into smaller and smaller pockets of territories and in many cases suffered precipitous collapses in numbers that in some cases amounted to genocide.

In North America the size of the 'pre-contact' American Indian population has been the subject of debate but the fact of its precipitous decline into near disappearance and the rapid and largely uncompensated loss of American Indian communal land rights is not (Snipp 1989; Sale 1990; Stiffarm and Lane Jr. 1992; Stannard 1993). In South Africa, the militarism and unwillingness to compromise that is evident for instance in the writings of Lord Garnet Wolseley during the Zulu Wars is in stark contrast to the strategies the British followed in India (Gump 1996; Lieven 1999). Indeed, Lieven's description of the uncompromising 'total war' the British waged against the Zulus and their economy has elements of similarity with the German genocide of the Herrero people in neighbouring south-west Africa (Lieven 1999: 631) In Australia there is an explicit discourse of genocide to describe what happened to the aboriginal population (Tatz 1999; Moses 2000). Violence against aboriginal peoples in Australia was directly related to settler demand for land and the need to clear the land of the hunter-gatherer aborigines. The simple expedient was to deny any recognition of prior rights. The forceful exclusion of aboriginal peoples from their livelihoods led to precipitous population declines, in some areas by as much as 80 per cent (Moses 2000). To describe these processes in terms of the settler states establishing a rule of law and stable property rights clearly does huge injustice to our understanding of history and is at least manifestly economical with the truth.

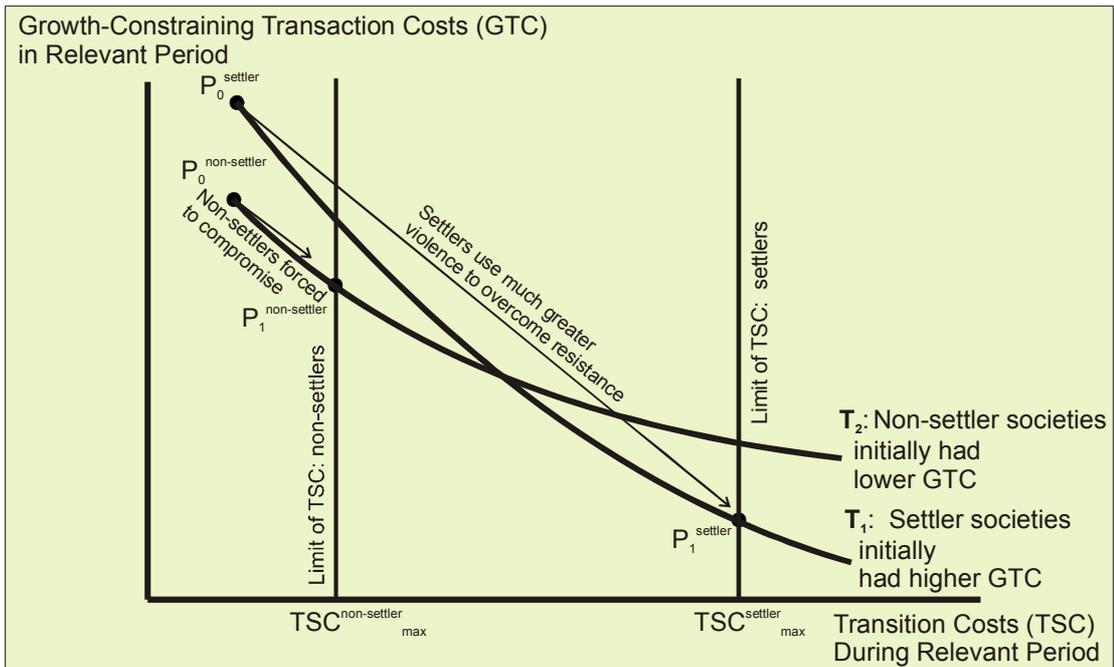
Figure 8 draws on the colonial histories summarized in our case studies and what we know about the violent transitions in the settler colonies. Settler colonies did indeed make a transition to 'stable property rights' but only after the rights inappropriate for the new capitalist economies were thoroughly destroyed. Settlers from already capitalist countries came with ideas of how to organize production but they did not try to work with pre-existing rights, defining them better, creating markets and then trying to re-allocate assets through markets. For reasons that we have extensively discussed, such a process may well have been blocked. Instead, the transitions here were *not* periods of stable property rights but the absolute reverse. They were periods of systematic and widespread destruction of almost all pre-existing rights because these rights did not serve the interests of settlers who were setting up capitalist economies in their own interest.



**Figure 8 Colonial History's Inconvenient Truths**

The reason why settler colonies could push these painful changes through so rapidly and with so little concern for the human costs is precisely because settler states were based on significant settler presence and did not require the support of indigenous peoples at all. Nor did the resistance of indigenous people register in the political concerns of these colonial states to any great extent. The transformation of rights over assets in the direction of protection, accumulation and the creation of incentives for productivity growth was achieved completely and rapidly *only because the indigenous society 'paid' massive transition costs*. Moreover, these transition costs could be absorbed by the state and its supporting coalitions because the support of indigenous society mattered little if at all in settler colonies.

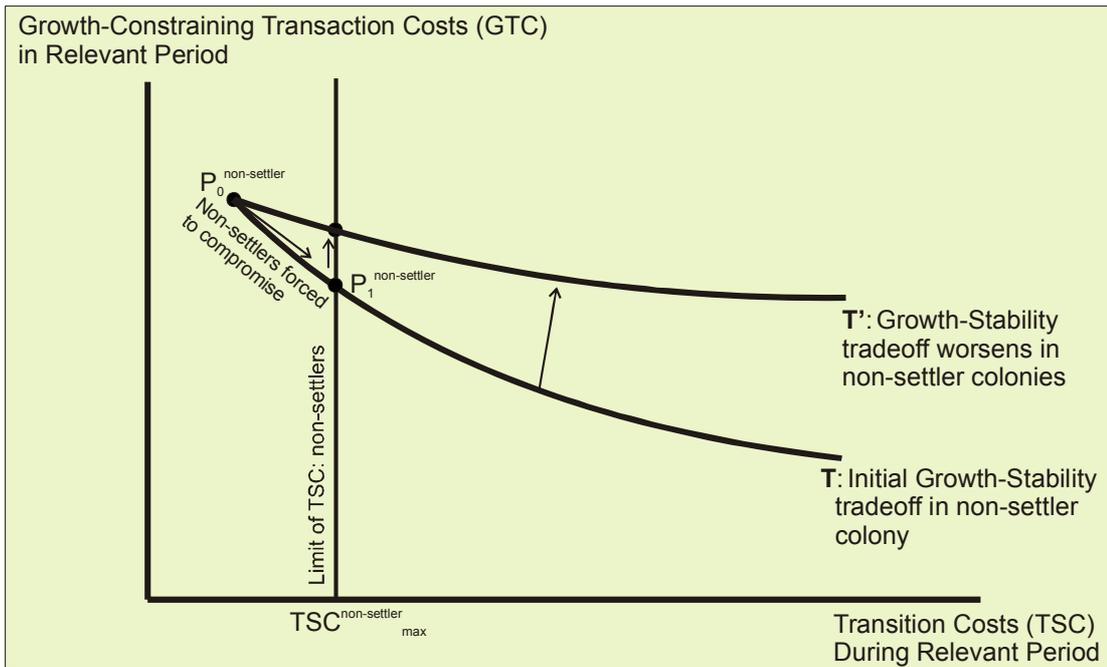
Pre-existing property rights were much better protected in the non-settler colonies. Ironically, many pre-capitalist rights were coming under pressure for renegotiation in the more advanced pre-colonial societies like India as commoditization increased. But with colonialism pre-capitalist rights came to be better defined and became more permanent as a result of colonial political strategies. In addition, the colonial power was often compelled to create further 'non-capitalist' rights to protect the new intermediate classes that were emerging as mediators of imperial rule. The effect was that the transition was protracted and incomplete, and is indeed still continuing. On the positive side, the transition costs in non-settler colonies were significantly lower. On the negative, the colonial power institutionalized many pre-existing pre-capitalist rights and made them even more difficult to change. Where the settler colonies paid the price of very high transition costs (in some cases verging on genocide), non-settler colonies paid the price of many pre-capitalist rights being created, strengthened or even formally institutionalized. The really negative legacy of empire in places like India was probably not the extraction of surplus that AJR are concerned about, or the disruption of property rights stability, but rather the strengthening of many non-capitalist rights and the creation of many new and stable non-capitalist rights that are still proving difficult to change.



**Figure 9 Transitions in Settler and Non-Settler Colonies**

Figure 9 summarizes these arguments. Settler colonies probably started off in a less advantageous position because their economies were even less developed, and initial growth prospects were low, shown by the point  $P_0^{\text{settler}}$  initially being higher than  $P_0^{\text{non-settler}}$ . But there were two significant differences in the political settlements underpinning these colonial states. Compared to non-settler states, settler states probably had steeper trade-off curves because the thinly populated indigenous populations in the settler societies could not inflict the same level of transition costs for similar changes in their structures of rights. Secondly, and more importantly, the maximum transition cost that the state could absorb was much higher, significantly higher, in settler states compared to non-settler states. While critical elites from within the indigenous populations had to be incorporated in the power structures in non-settler states for the colonial enterprise to be politically viable, there was no such necessity in non-settler states. Here the political viability of the state was based almost entirely, and in some cases solely, on the settler community.

Not surprisingly, growth-enhancing changes could be pushed much further in settler colonies during the colonial period to  $P_1^{\text{settler}}$ . In contrast, changes in rights in non-settler societies were driven by complex motives, including in particular the need to maintain political stability. Growth prospects improved marginally if at all, from  $P_0^{\text{non-settler}}$  to  $P_1^{\text{non-settler}}$ . Thus, settler states achieved a significant decline in growth-constraining transaction costs but also a very significant increase in transition costs over this period. The human suffering this entailed has already been referred to. In contrast, non-settler states achieved minimal or no reductions in GTC, but transition costs did not increase much either.



**Figure 10 Colonial Compromises Worsen Trade-offs**

The problem in some non-settler colonies was compounded because the greater protection and formalization of some pre-capitalist rights and the invention of new ‘traditional’ rights increased the political resistance over time to asset re-allocations or the creation of conditions that could compel productivity growth. This is shown in Figure 10 as a movement *upward* of the trade-off curve, making growth-enhancing transitions *more difficult*. In Bengal, for instance, we saw how the colonial creation of new rights on the land rolled back the incipient growth of merchant capital and its penetration into agriculture as well as reversing the rapid growth of the artisan manufacturing industry. Over time these rights evolved in progressively more complex ways, blocking asset re-allocations and the accumulation of land, and creating strong incentives for intermediate class entry into politics as the most promising avenue for accumulation. In less dramatic ways, the creation of ‘traditional’ land rights in Africa is also likely to have had similar effects.

The analysis of colonialism is important for contemporary policy for several reasons. First, the challenge facing contemporary developing countries has to be understood properly. The challenge is not to create through good governance the stable property rights that settler colonies apparently created. A rapid creation of such rights is precluded once we understand what that would entail in terms of transition costs. Once these are taken into account, the settler colonies should serve as models of what *not* to do, because such high transition costs cannot be recommended today and were not justified in the past. If developing countries today are not following the example of settler colonies and moving rapidly in the direction of capitalist property rights it is not because they necessarily lack the political will, but more likely because they implicitly understand the issue of transition costs. Secondly, the long history of non-settler colonial rule has also left serious problems in the form of social engineering that created a multitude of rights and social entitlements that were inappropriate for asset re-allocations and for creating the productivity compulsions necessary for driving growth. A comparison of the property right evolution in non-colonized

Thailand with the problems in different areas in the Indian subcontinent illustrates the nature of this legacy.

The third point takes us to our next section. Contemporary developing countries that are growing rapidly are doing so through *ad hoc*, sector-wise changes in property rights that allow some reductions in their growth-constraining transaction costs at acceptable levels of transition cost. These moves are haphazard; they often involve hidden business-government relationships and the use of political influence and sometimes corruption. They are vulnerable to reversal because social forces threatened by these changes can often easily mobilize patron-client factions which can inflict serious transition costs on growth strategies. At the same time some changes or interventions in property rights are of course predatory and damaging. Policy-makers need to be able to assess different processes that are simultaneously going on. A simplistic adherence to the good governance strategy derived from a misreading of history can do more harm than good. The challenge is to work with developing countries in areas where property rights are being transformed in productive ways, understanding the political difficulties of doing these things and the strong social resistance that can be evoked by all kinds of interests who are not acting in the interests of growth or poverty reduction. At the same time, predatory interventions and destructions of property rights that damage investment horizons also need to be identified and targeted. These are not simple challenges and the complexity of our framework unfortunately reflects the complexity of the world.

#### **4. Contemporary Strategies and Governance Implications**

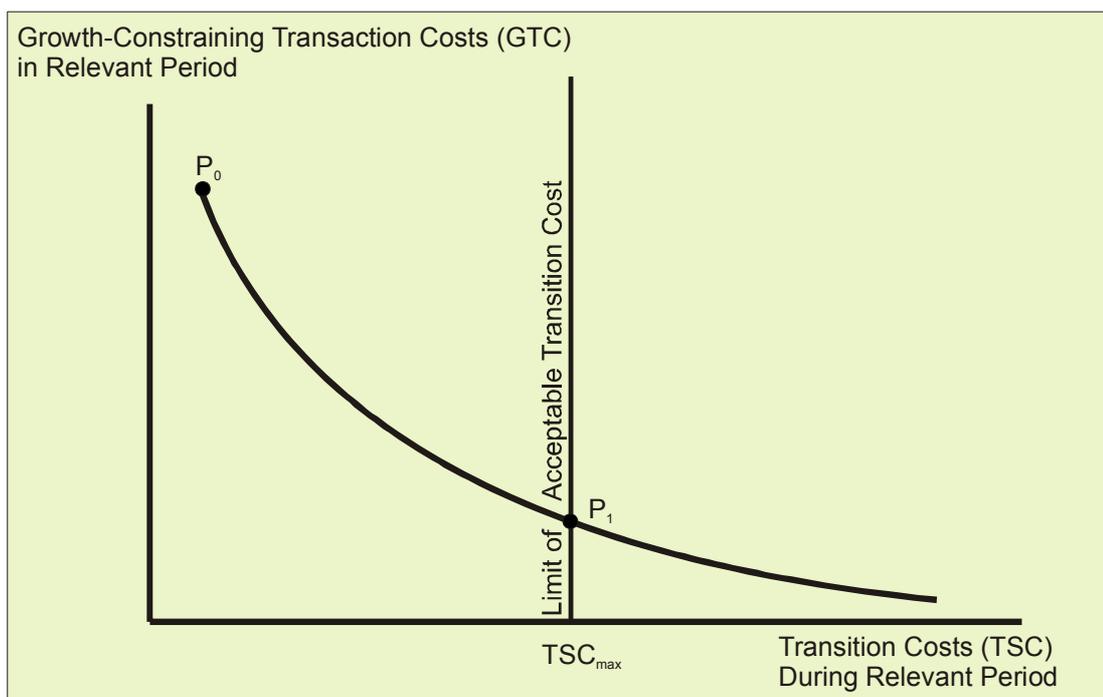
Many of the initial conditions of the economies of our case study countries were quite different in the 1980s (Khan 2008b). The preceding discussion has identified further significant differences in the evolution of property rights in our countries and the degree to which property rights were appropriate for growth transitions in the 1980s. They also differed significantly in their political organization and the relevant distributions of power (their political settlements) that could plausibly affect the evolutionary paths of changing property rights. As a result, the processes that we observe in our case studies in the 1980s and beyond through which market failures were being addressed through ‘interventions’ in property rights are also very different as we would expect. This section draws on a series of case studies of property right interventions that we conducted in our countries, using a combination of interviews, observations and a reading of the secondary literature.

The object of this section is not to provide a comprehensive picture of the property right transition that is going on in each country or region. This would be a very extensive task to conduct even for a single country. This is because countries are themselves very diverse across sectors and regions and are developing using very different processes in different sectors and for addressing different problems. The property rights challenges in say the residential sector, small and large industries, the informal sector, different types of agriculture, homesteads and land requirements of the poor and the marginal and so on raise very different issues. Our aim is rather to focus on a few examples that pick on specific growth constraining market failures to examine the processes through which different players respond to these market failures and the degree of success with which these challenges are being addressed.

Our contention is that the generic developing country problem is that existing property right structures are far removed from the structure that would be necessary to sustain growth in an efficient capitalist market economy. Big changes in property rights are not possible because of significant transition cost constraints. So we would expect to see many different types of informal and often *ad hoc* processes that are different across sectors, types of technologies, and countries. Their success or failure depends on the details of the strategies, the context but also on the kind of involvement that political factions or governments have in these processes. This is consistent with our framework because we would expect the involvement of particular political forces in favour or against a strategy to determine the transition costs and tolerance limits for these transition costs in the way discussed in the last section. The exercise is therefore one of a series of investigations to identify specific problems, opportunities or missed opportunities. At the end we identify some patterns that may help to identify areas where growth-enhancing governance reforms could focus.

***Thailand: Land Rights Supporting Capitalist Development***

We saw earlier that within our set of countries, Thailand made the most significant progress in transforming its property rights structures in the direction of rights appropriate for an industrial capitalist economy. Much of these changes happened during the late nineteenth to mid-twentieth century as the land frontier was being extended and the labour supply was rapidly expanding. The absence of complex political alliances made by a weak colonial power was a critical part of this story. So were the land frontier and the availability of virtually limitless labour supplies. Together these factors implied that peasant resistance to the gradual incursion of the king, the nobles and eventually merchants in establishing superior rights over the most valuable tracts of land was relatively weak. Figure 11 shows that the trade-off curve during this critical period for changes in property rights in the direction of tradable rights over significant tracts of valuable land was relatively steep.

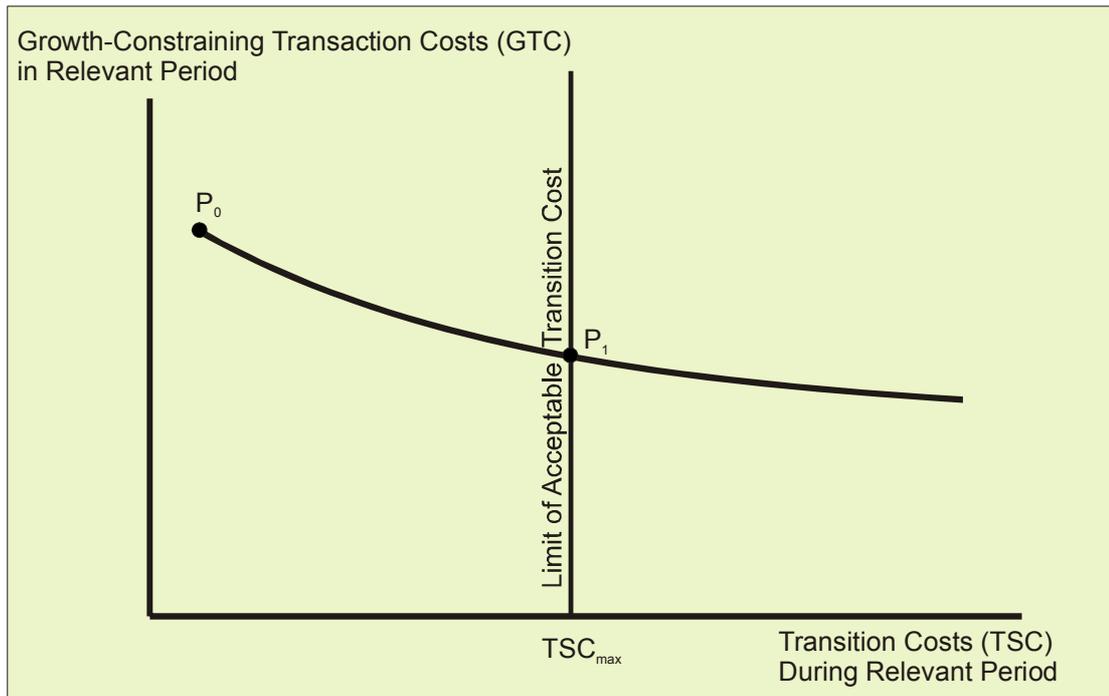


**Figure 11 Thailand: Emergence of Tradable Land Rights Mid-19<sup>th</sup> to Mid-20<sup>th</sup> Century**

While much of Thailand's land remains agricultural and much of this is not yet properly titled, the transformation of significant amounts of valuable land close to infrastructure and ports that became available for industrial and high-value commercial and residential development is critical for understanding contemporary land issues. Discussions with businessmen, lawyers and academics in Thailand suggest that as far as growth is concerned, the contemporary structure of easily tradable land rights around Bangkok and extending to a number of emerging industrial zones including in particular the extensive Eastern Seaboard area means that land availability for industrial development is not a significant constraint. Indeed, in contrast to most other developing countries, industrial land development is supply-led, with large industrial development companies like Amata and Hemaraj taking up available land, developing large industrial zones, building infrastructure on the land, then selling factory space and ready-made factories once they are built. The relative ease with which these industrial zone developments have happened in Thailand over the last two to three decades cannot be understood outside the context of the evolution of land rights over these tracts in the nineteenth and twentieth centuries.

Much of the industrial zone developments are in the Eastern Seaboard zone that the government had begun developing as early as the late 1970s as part of its import substituting industrialization drive. Located to the south-east of Bangkok and served by two deep sea ports at Laem Chabang and Map Ta Phut in Rayong, the Eastern Seaboard zone covers sixteen separate industrial estates and more are being developed. Occupancy rates in 2009 were around 70 per cent despite rapid take-up, showing the supply driven nature of these developments. Much of Thailand's chemical, automobile, automobile component and electronics industries are located in these estates. Apart from the Eastern Seaboard, discussions with real estate lawyers in the Bangkok area suggest that businesses do not find it difficult to rapidly identify and acquire land for commercial purposes. Thai law does not allow companies with more than 49 per cent foreign ownership to buy land in Thailand, but foreign owned companies investing in a promoted activity can readily get Board of Investment (BOI) authorization to acquire land for industrial or other commercial activities. The only constraint is that if the authorized business ceases activity, the foreign owner has to sell the land within a year of the business being suspended. These laws are aimed at preventing foreign ownership of land for speculative or store of value purposes.

The situation is somewhat different in agriculture where much land is still not properly titled. Around 60 per cent of land in Thailand is public and forest land and many poorer people find they are living on lands that turn out to be public or forest lands. The full titling of the occupancy rights of the agricultural population and poorer people in particular will take more time and is likely to be a conflictual process if the government were eventually to take a hard line of evicting significant numbers of people from forest and public lands. As a land surplus country, an easy option would be to recognize occupancy rights as legal rights in most cases, and there is some evidence that this is happening in the land titling that is going on (Nabangchang-Srisawalak and Srisawalak 2008). But clearly there are problems of announcing that this is the strategy in advance.



**Figure 12 Contemporary Thailand: Resistance to Extending Capitalist Rights over Land**

The recognition of the rights of poor landholders is a relatively new development in Thailand. The dominant process in Thai agriculture has been the occupation of public lands by commercial interests acting in concert with local power brokers who then gradually changed local land records over time. Now titling is gradually happening for some of the poorer squatters and occupants of public and forest lands. Greater awareness by the poor of their rights, the activities of NGOs and the deepening political mobilization of the poor in rural areas has probably ruled out a continuation of land agglomeration by commercial interests at least at the old pace. Taksin's populist politics rose on the tide of a more assertive rural society in the 1990s and perhaps strengthened it further. It is likely that attempts to extend commercial interests over new lands in contemporary Thailand will face a flatter trade-off curve as in Figure 12. If trade-off curves become sufficiently flat small extensions in these rights can generate significant transition costs. Extensions of these policies will either be much slower or abandoned entirely because the transition costs may not be worth the relatively small benefits (even if the beneficiaries could theoretically have absorbed these costs).

Extending the land titling programme into the agrarian hinterland would primarily benefit Thailand's peasant farmers and the poor. It would be a policy with lower transition costs but with much lower reductions in growth-constraining transaction costs as well: the trade-off curve for this programme of property rights reform is likely to be flat and truncated. Property rights for smallholders may marginally improve their time horizons, may enable them to borrow more easily using their title documents as collateral. But these property rights would be unlikely on their own to set up a capitalist land market or compulsions for capitalist productivity growth. We would not therefore expect to see the rapid emergence of a capitalist agriculture in Thailand as a result of an extension of land titling. But land titling can be justified on other grounds. Thailand faces serious political challenges if it fails to rapidly improve

the social protection of the poor. Extending the land titling programme to cover the poor and marginal in an inclusive manner would contribute to this. Moreover, there is no immediate conflict with growth sectors. Sufficient land with appropriate tradable rights is available for industrialization strategies for some time to come.

Apart from land titling, there are other governance issues affecting land but they do not appear to be binding constraints for growth sectors. Administrative corruption and delays in land registration and land transfers are occasionally reported but corruption rarely allows the changing of land records or titles. There is no evidence that corruption can be used to amend clear ownership titles over valuable land. Its role is limited to speeding up some transactions which are not too slow in any case. For the commercial sector, much of the business is conducted by professional lawyers and agents. The close alliances between finance, politics and local administration that allow encroachments of public lands in remote areas and can change land use classifications are not reported in urban areas or in industrial zones. However, there are exceptions. In discussions with the National Anti-Corruption Commission (NACC) of Thailand a number of cases were cited involving land acquisition that the Commission had identified and prosecuted. A high profile example was the ADB-financed Klong Dan Wastewater Treatment Plant project where a scandal in 2003 eventually led to the sentencing of a senior minister to ten years in prison. The minister, Mr. Vatana used his influence to acquire land cheaply that was then bought by the state for the project at a much higher price. In the process some public land was also declared as private land with the connivance of Land Department officials. An interesting aspect of this case was that the acquisition of land for public works in Thailand clearly appears to be at very favourable prices.

The relatively efficient operation of the land market in Thailand makes it difficult for the state to try and provide industrial policy support to specific industries through land acquisition and transfer strategies. Industrial policy in Thailand increasingly takes horizontal forms, through the provision of high quality infrastructure and tax breaks in industrial zones. Board of Investment tax privileges for investing in the Eastern Seaboard zone, for instance, include up to eight years corporate income tax holidays (capped at the level of the initial investment), a 50 per cent reduction for a further five years, import tax exemptions for machinery, and up to 75 per cent cuts in duty on essential raw materials. Industrial policy regimes in Thailand and elsewhere will be the subject of a later paper on technology adoption strategies. But in Thailand land policy is not used as a surrogate for industrial policy so the issue of the effectiveness of land allocation procedures for inducing productivity growth does not arise.

Although it is tempting to see Thailand as a model for developing countries in areas like the successful construction of industrial zones and its rapid progress in land titling, there is a longer history that enabled Thailand to make progress in these directions in the 1980s and beyond. The political settlement in Thailand in the nineteenth and twentieth centuries was significantly different from that of most contemporary developing countries and explains the rapid emergence of tradable land holdings and land rights over these holdings. This history also helps us to understand the political importance of extending land titling to the poor and to remote areas in Thailand today.

### Features of South Asian Transitions

The next three sections deal with different regions in the Indian subcontinent. The interventions of the non-settler colonial state had common features across the subcontinent. As part of the very earliest colonial conquests in India, West Bengal and Bangladesh acquired a different set of land and revenue rights compared to Maharashtra. But in general, the underlying trade-off for the colonial state was unfavourable for significant changes in the direction of effective tradable rights over land. In terms of the trade-off graph, the experience of the Indian subcontinent is described by the non-settler colonial strategy described in Figure 9.

The colonial state did try to improve land rights to enhance their revenue collection but also intervened to restrain the penetration of merchant capital into agriculture at every sign of peasant discontent. These countervailing interventions created new rights and entitlements for a variety of agrarian interests that blocked significant agrarian transition. These interventions were more damaging in Bengal because political stabilization in the *zamindari* system empowered layers of intermediary landed and political interests. Not surprisingly, intermediate class political mobilization was stronger in Bengal compared to Maharashtra at the end of Empire. A peasant party (the *Krishok Proja Party*) led by intermediate class politicians played a dominant role in Bengal politics in the 1930s while the regions that became Maharashtra were dominated by Congress with its close associations with Indian capitalists in the region.

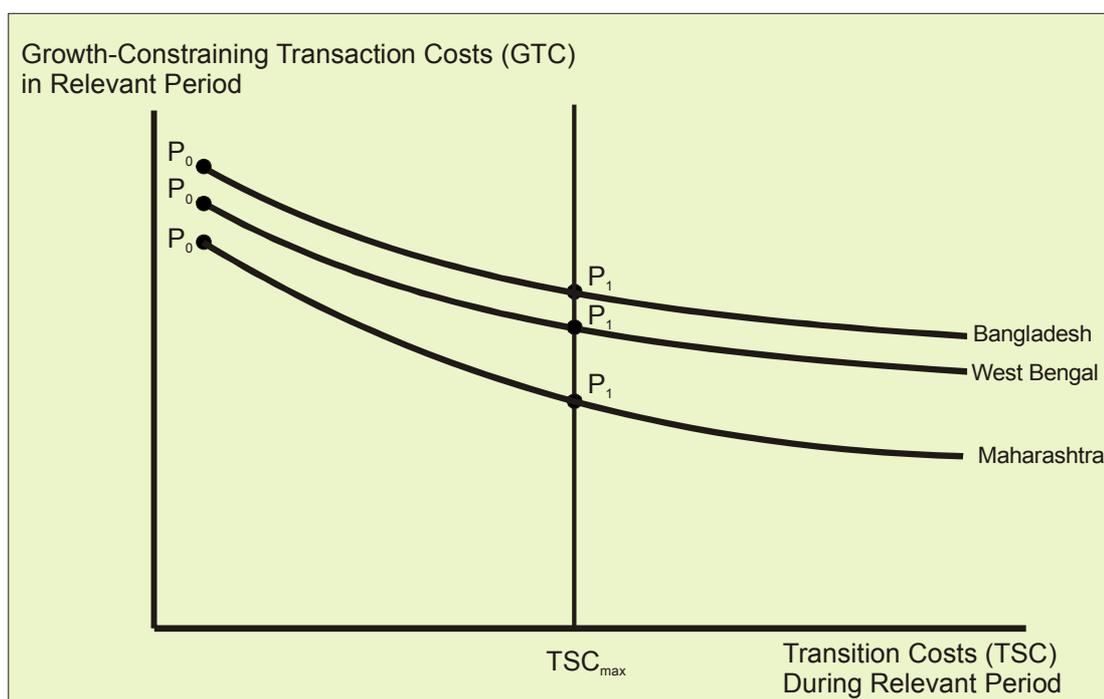


Figure 13 Initial Conditions in Indian Subcontinent Regions c. 1980

In addition, eastern Bengal was less developed in terms of industry and per capita income in 1947 compared to West Bengal which had a significant industrial base around Calcutta. These initial advantages led to somewhat different post-independence economic development strategies. For a comparison of the initial economic conditions and a summary of early development experiences in our case

study countries see Khan (2008b). These initial differences in the relative size of the capitalist sectors and the relative strength of intermediate class-led factions in politics persisted into the 1980s despite the growth of the capitalist sector in all these regions. These differences in initial conditions are likely to have given Maharashtra an advantage over Bengal as a whole and a slight advantage to West Bengal over Bangladesh in terms of the growth-stability trade-off available for many types of growth-enhancing property right interventions. This is summarized in Figure 13. However, we would expect important differences in the trade-offs *within* each of these regions for different types of changes in property rights, and for the trade-offs to change over time as political conditions and economic development progressed.

A number of case studies from across the Indian subcontinent are discussed in the next three subsections, which demonstrate a number of common themes. First, with unfavourable trade-offs to begin with, successful interventions necessary for sustaining growth have often been informal, and often required the direct involvement of political allies to push through particular changes in the allocation or definition of property rights. The specific and sometimes accidental alliances between particular factions and contestants in conflicts over rights have often had significant effects on outcomes. Some groups of the poor are well-organized and could be mobilized by political factions who wanted to cash in on land transactions and in these cases even projects with reasonable compensation packages could be blocked. The experience of the Nano project in Singur in West Bengal is an example. The other side of the coin is the unfortunate observation that weakly organized constituencies like minorities, tribals or *dalits* have a higher chance of losing their rights in processes of transformation (Fernandes 2007). For property right transformations, states and corporations often find that trade-offs are more favourable for them when dealing with isolated groups, less well-connected to political factions that can enhance the bargaining power of these groups significantly. Clearly, this solution has severe implications for distributive justice, but in many cases in the Indian subcontinent, it is only a matter of time before isolated groups become much better organized.

Secondly, resistance to property right changes is easier to overcome if there are good financial packages of compensation that can be called upon. This is more likely in aid-funded projects or mineral extraction projects driven by companies with deep pockets. If some of the transition costs are monetized, the politics of handling the transition becomes easier. However, the monetization is not simple and can often also require significant political intervention because there are typically wide discrepancies between current market valuations and the valuation at which affected holders of rights are likely to want to 'transact'. Monetization can also attract the attention of political players who want to cash in on these bargaining games. The politicization of land transfer issues in India suggests that monetization of some transition costs also requires new institutional arrangements if these strategies are to be effective. There is also an important paradox that compensated transitions are likely to assist big corporates and foreign investors, particularly those involved in minerals and oil, but they may disadvantage smaller local manufacturing sector investors with more limited financial abilities.

Thirdly, where trade-offs are unfavourable because of features of the political settlement, a successful response appears to be the construction of decentralized coalitions between investors, local government bureaucrats and politicians that can

result in *ad hoc* and unplanned acquisition of relatively small pieces of land in a piecemeal way. Because each ‘transition’ is a small one, transition costs never become too high. But here there is a serious consequential set of costs due to path dependency in the spatial evolution and scale of productive sectors. A classic example of this is the unplanned spatial growth of small garment factories in Bangladesh and the problems they now face in achieving scale economies.

### ***Bangladesh: The Limits of Capitalism from Below***

The land issue is intense in densely populated Bangladesh and West Bengal. Small peasant farms have a ceiling of productivity and profitability set by their limited ability to achieve scale economies in mechanization and marketing. Nevertheless, the growth of triple cropping using HYVs in many parts of the country means that much of the land is farmed well above a subsistence level. The absence of significant pre-existing industrial employment opportunities means that land market transactions with smallholders face high transaction costs. In addition, for reasons we have discussed, land titles and land survey records remain inconsistent. The legal system has come to be used as an arena for settling these conflicts through prolonged wars of attrition rather than a place for deciding ownership based on documents. The law cannot deal with genuine inconsistencies in documents and records. Formal attempts to make conflicting records consistent through computerization may simply transfer conflicts from the courts to other arenas. These conditions undoubtedly provide a promising environment for criminals to use political power and corruption to forge documents and deeds. Yet in the midst of this otherwise unpromising environment significant growth has happened including the growth of new manufacturing sectors and rapid urbanization. It has been driven by a version of capitalism from below, with emerging entrepreneurs negotiating *ad hoc* arrangements that give them access to land. However, the experience is different from Thailand because this works only if the land required is relatively small. And even then, a high price had to be paid in the sense that many entrepreneurs have been unable to achieve scale economies. Nevertheless, it is important to understand the ‘governance’ capabilities that allowed *capitalism from below* to continue to grow rapidly for two decades.

### ***The Garments Industry: Growth despite Inefficient Land Markets***

The dramatic growth of the garment industry from the 1980s onwards was initially able to deal with the absence of a well-working land market by flouting zoning and residential regulations. Many very small units were set up in the middle of residential areas, sometimes using upper storeys or rented property that their owners were willing to let out at a higher rent. As scale economies became more important with bigger machines and multiple processes within a single plant, garments industries began to move out in search of non-residential locations. Areas to the north of Dhaka like Mirpur saw a rapid expansion in manufacturing, and soon factories began to go further afield to Savar and Gazipur which had previously been solely agricultural and forest land, in most cases without authorization. The demarcation and ownership titles of much of these agricultural lands, including forest lands was confused, with contradictory records, leaving ample opportunity for litigation and contestation. Despite these problems, the unplanned growth of the sector was meteoric. By 2005, the number of garment sector firms was estimated to be around 3500, employing at least around 2 million people and accounting for well over half of the country’s export earnings (Rashid 2006; Khan 2008a, 2008b).

The experiences of a few entrepreneurs may shed light on the complexity of local level processes through which land was acquired and protected. 'A' is an entrepreneur of a moderately sized garment factory currently employing around 500 workers, located in Gazipur, north of Dhaka. The factory was set up in the late 1980s with the entrepreneur buying several tiny plots which were initially not contiguous and then buying other small plots as they became available. The help of local power brokers was employed to negotiate prices with smallholders and to confirm that the people claiming to sell the land were indeed genuine local people who had been on the land in the past. Despite this, many conflicting documents and claims emerged. In the past land records kept at the land survey office were not updated (or mutated) as land was subdivided through inheritance or sale and over time sale deeds (which are legally recognized) and the land records (which were the basis of land tax in British times) had often become divergent. As land was not a traded commodity in the past, what mattered was possession by the occupant and title deeds to show how the land was initially acquired. The consistency of these documents with other records was not an issue. Fortunately for entrepreneur A land in Gazipur had not sky-rocketed in price in the 1980s. Today, the number of forged and conflicting claims emerging on every piece of land in that area has significantly increased.

Having acquired enough land to set up the factory, A had to retain a manager to deal with ongoing land disputes with other individuals who claimed that some of the land sold had not rightly belonged to the people who had sold it initially. Many of these disputes were between relatives disputing the shares in which land had been inherited in the past. Going back in history, registered documents could often be discovered where a father had gifted land to a wife or to a relative, which could not then be enforced because the land was occupied. But years later when a valuable land sale happened, descendants would emerge claiming their share. Sometimes claims were false, based on forged documents, at other times additional compensation had to be paid to those with 'genuine' conflicting claims. The same plot sometimes had to be 'purchased' more than once so that all paper claims could be extinguished, at prices determined by the ability of each claimant to make trouble. Court cases frequently emerged but because the entrepreneur was able to sit out prolonged cases, the war of attrition worked in his favour.

Matters became more complicated five years ago when some locals sold a piece of land which split the growing factory complex into two to a powerful Dhaka-based land speculator. The entrepreneur had tried to locate title for this land and purchase it but had not been able to locate the owners. The sale was potentially serious because the speculator could extort a high price from the entrepreneur or even buy out the entire factory by making it unworkable. A desperate search through complex land records ensued as well as a court case. The entrepreneur's manager discovered a potentially very significant anomaly in the historic records when he searched back to the early 1960s. Apparently when the last major land survey was conducted in 1966 some locals had paid government surveyors to record a part of forest land as private property. The land speculator had 'bought' forged documents based on this faulty land survey record. The entrepreneur informed the forest department of this and is assisting the forest department with the documents that the entrepreneur discovered proving the fraud. As the forest department lost a very large amount of land (and was apparently 'unaware' of this), the entrepreneur is currently hoping that when the forest department wins its court case and reclaims the land from the speculator, it will

treat the entrepreneur kindly. This could mean either a side ‘deal’ so that the Forest Department turned a blind eye on this tiny piece of land on which there were no constructions but which was inside the perimeter of the factory, or even better, exchanging that land with some other land when the records are finally corrected. None of this is likely to be resolved in the near future. In the meantime, the factory is doing well with rapidly rising export orders.

Even in this highly simplified presentation, the complexity of the case shows why transition costs would be very high if a big bang solution to land titling were attempted. Even for a plot of land of less than an acre dozens of claims are involved and most of the claimants believe their claim is justifiable. Even the land speculator and those who sold him the land may not have been fully aware of its dubious provenance. All titles are shaky to some extent, and our entrepreneur was lucky in this case because there was a glaring gap in the amount of forest land in that block in a survey done in the mid-1960s compared to the previous survey completed in the British period, given that forest land could not have been sold or transferred in the interim legally. More often, the fragmented nature of forest lands adds to the complexity faced by entrepreneurs. Although originally they were contiguous blocks, they were recorded in surveys as parts of big blocks (cadastrals) that included privately owned lands. As the private owners staked claims to different parts of a cadastral block, by the time detailed surveys were done, the forest lands often emerged as tiny plots scattered all over the block. This means that entrepreneurs often find (as did A) that there may be a tiny piece of forest land in the middle of and totally surrounded by their property and there is nothing they or the forest department can do about it. The solution is often a regular payment to overlook the inconvenient problem.

The garment industry experience suggests that when entrepreneurs get involved in decentralized conflict resolution over records using local land administrations, they can just about solve their land use requirements at a price. The price is not just the time and effort spent in managing these transitions at the local level. These types of solutions also result in some serious path-dependent consequences for the garment industry and other emerging manufacturing sectors. Surveys of garment industry entrepreneurs show that scale economies are often impossible because of the difficulty of finding contiguous plots of land (Khan 2008a). When entrepreneurs have the opportunity to expand production, they often find that the only option is to set up additional production units miles away from the main production site. This obviously leads to higher overhead costs than necessary and can preclude the development of integrated production processes.

Our case study also suggests that many of these problems of conflicting land records are not likely to be resolved by technical solutions like computerization, a process that is being widely supported as part of the current governance reform efforts in Bangladesh. Computerization will reveal significant inconsistencies in land records without creating any mechanism for resolving them. As all inconsistencies are not due to fraud but rather due to conflicts in records never having been addressed, a precondition for a successful land titling process is to set up the mechanisms which may address these conflicts somewhat more efficiently than the courts. The problem is that any solution that does not rely on attrition (the weaker side giving up voluntarily after several years of contesting in the courts) is likely to involve upfront transition costs for the state. Those who champion these strategies appear not to be

aware of the underlying conflicts that need to be resolved or they assume that these will be smoothly resolved once transparent records begin to be established.

It is not clear that the huge expenditure in computerizing titling will achieve such a smooth conflict resolution outcome. It will certainly centralize the conflict resolution process and this may increase the transition costs by making explicit all the inconsistencies in the records affecting each piece of land, and perhaps it will do this simultaneously for many pieces of land. In the worst case scenario a badly designed attempt at titling may clog the land market while the titling process is going on because investors will not want to buy titles which may be unequivocally rejected soon. Investors may hold on to see who ends up having clean titles, and if the process goes on for a while as it must, they are likely to engage in 'investing' in the titling process. This will simply transfer what goes on in the courts today into the titling process. In short, there is no reason to believe that the titling problem can be resolved quickly or at low transition cost. In the meantime other solutions have to be found to sustain the growth process. The most likely solution, though one which has had a bad track record in Bangladesh, is to focus on setting up industrial zones with adequate infrastructure, using compulsory purchase powers that exist in law. While the reversal in the Karnaphuli export processing zone (EPZ) in 2009 (discussed below) shows an ambivalent attitude to industrialization at the heart of government, experience with public land acquisition as such has not been entirely negative.

*Public Land Acquisition: The Jamuna Bridge and RAJUK*

One of the biggest infrastructure projects in the country was the construction of the Jamuna Bridge which required the acquisition of 2860 ha of land. The availability of concessionary foreign credit from the ADB and other sources and the strong political commitment of successive governments to push the project through changed the nature of the transition costs. The land acquisition happened over a relatively long period, from 1988 to 1997. Compensation was very generous, based on current market prices (rather than the much lower prices typically used for land registrations to reduce tax liabilities) *plus* a 50 per cent premium. A total of around 16,000 landowners were recognized for compensation. There was compensation for houses and constructions (which led to occasional rent seeking as new structures were sometimes constructed to claim the compensation). There were additional payments for resettlement, relocation, stamp duty refunds for new land purchases, skills training and so on. An entirely new category of affected people were recognized who were 'erosion and flood affected people' who could submit claims on that account. Around 15,000 people did and most of these claims were also recognized. Finally, there was a one-time cash compensation for landless workers and others who would also be displaced. Many NGOs were involved in assessments of compensations.

Given the context, the degree of success in implementation was quite good. Instead of civil strife, the effort of many local people went into maximizing their compensation. There were the inevitable cases of bureaucratic corruption, and one estimate put a figure of around 10 per cent of the compensation that had to be paid as 'speed money' to the local administration (Rahman and PPRC Team 2001: 278). While pointing out areas of weakness such as some people not being compensated and some misappropriations, these and other evaluators generally concluded that the compensation and resettlement schemes were satisfactory. The critical evidence is that a significant amount of land was acquired without civil war breaking out. The

critical determinants here were first the clear signals that had been sent by the political leadership over a long period of time that the project would go through. The project was also broadly supported in the region and the country and the compensations were very generous. Indeed, by compensating virtually everyone conflicts were hugely reduced. But the bill was also big, and could not have been paid without significant soft loans. There is a lesson in this for industrial land development. If haphazard and fragmented land acquisition is to be avoided, given that land availability is a serious constraint for industrial transformation, the setting up of industrial parks through public land acquisition, assisted if necessary by generous loans from international banks may be a viable strategy in the future.

A very different model of the use of political power to acquire land, more or less effectively, is provided by Dhaka city's *Rajdhani Unnoyon Kortripokkho* (RAJUK) which roughly stands for Capital City Development Authority operating under the Ministry of Housing and Public Works. This body is in charge of developing the master plan for the capital city and to acquire land for its extension, on its own and by authorizing private sector developers. It is widely known that RAJUK is more than a little corrupt and that it operates closely with political power in the capital (Masum 2009). Indeed, RAJUK's operations are often cited as examples of violations of transparency and accountability and there are many examples of land use laws being flouted. However, what we want to focus on here is that RAJUK is also reasonably effective in acquiring land from rural smallholders near the capital where land values are already reaching first world levels. Land is acquired at market prices in the rural areas, without any negotiation of sharing the difference in land valuation between these prices and what the land will soon be worth as a result of incorporation into the capital's master plan. Here the full weight of administrative and political persuasion is critical for achieving the transfer of land rights at low transaction and transition cost. The significant fact here is that by incorporating a large chunk of dominant political interests as potential beneficiaries, RAJUK ensures that counter-mobilizations which could raise transition costs become very unlikely.

The interests of the political elite are aligned with this process because the developed land is allocated for sale by 'lottery' but with explicit categories for ministers, members of parliament, judges, journalists, civil servants, professionals and so on. After all these categories are satisfied, the general public is unlikely to win anything in the lottery. Winning the lottery gives the right to buy a plot at a very steep discount to the market. This 'governance model' is effective because it concentrates most of the dominant political factions and important segments of the bureaucracy behind these land transactions because many of them stand to benefit. In addition, powerful politicians can get other types of RAJUK approvals for their own property development plans that are of considerable commercial value. If we treat land re-allocation to significantly higher valued uses as being consistent with the interests of sustaining growth in the capital city, RAJUK's political strategy effectively keeps the trade-off curve for this particular set of property right transformation efficiently steep. Relatively rapid property right transformations are achieved through a mix of market incentives and non-market pressures but with low transition costs (though there is a considerable cost in terms of social justice and transparent urban planning).

Property developers in and around Dhaka are typically very critical of the methods RAJUK uses and the bribes they have to pay, but they also say privately that RAJUK

gets the work done. Given its political backing, when RAJUK gives approvals to developers they are in most cases enforceable decisions. There are typically well established rates that developers have to pay for different types of approvals, but as these are mutually beneficial transactions, they are sustainable. These are of course relative judgements. But in the context of a developing country if land acquisition and development had to happen without an institutional structure like RAJUK that allowed the buy-in of political support, transaction and transition costs may have been much higher. While the RAJUK model works after a fashion in sustaining Dhaka's (fairly anarchic) growth, it is unlikely to work for industrial land acquisition. It is difficult to imagine how the interests of a large number of political leaders and others can be aligned so well behind the acquisition of industrial land which is unlikely to benefit them unlike the chance of getting a valuable plot of land in Dhaka city.

*Political Lessons from the Reversal of Karnaphuli EPZ*

A striking demonstration of the difficulty of aligning the interests of politicians to industrialization and industrial land development is shown by the dramatic decision in March 2009 to suddenly halt investment in a newly set up export processing zone (EPZ) at Karnaphuli. The reversal happened after the project had been approved a year earlier and despite at least fourteen foreign investors paying rent on the plots leased to them since July 2008. Some of them already had machinery on ships to Bangladesh. The decision was ostensibly taken because the land belonged to the Ministry of Food who suddenly decided it needed more storage for stocking foodgrains. Behind the story is a tussle within the ruling Awami League over control over scarce land. It is unlikely that this valuable land 6 kilometres from Chittagong port will in the end be used as a storage depot for foodgrains. The likely story is that politicians did not want to be tied down to a land use allocation decision made by the immediately preceding caretaker government without considering other more lucrative allocations. But it shows how difficult it is to align political interests with the interests of labour-intensive industry where wages are low and profits are good but not astronomical. The payoffs to politicians making industrial land allocations will only be over a longer period of time compared to land allocations in Dhaka.

There is thus a reverse danger of relying on political interests to deliver growth-enhancing land use changes or even to stick to apparently efficient decisions that have already been made. Unless politicians get significant payoffs, as they appear to do with RAJUK, they can readily reverse efficient land use decisions or contest allocations that may make economic sense. It is important to remember that politicians are themselves major contestants over the rights to land in a land-scarce country. They have constituents who may range from small peasants to land-grabbing speculators, and all of them may have interests that may be different from industrial investors. It is difficult to align the interests of a collection of leading politicians with the land use requirements of labour-intensive export oriented industries where the rents are not very high, but potential growth contributions to society may be significant.

It is not surprising that progress in extending EPZs and setting up industrial parks and zones has been rather slow in Bangladesh. The contrast with Thailand is striking in this respect, not just for Bangladesh, but across South Asia generally. The trap is that ready supplies of land that industry needs cannot simply be purchased through existing land markets. There are two possible routes to achieving a steeper trade-off

curve in land use re-allocation, thereby achieving land use re-allocation at acceptable transition costs. One is the possibility of buying out resistance by using generous compensations, if necessary at rates above prevailing market prices. But domestic land acquisition for setting up industrial parks does not have access to the levels of compensation that the Jamuna Bridge project had. The second route is to use concentrated political power to overcome resistance in the way that RAJUK achieves to some extent for acquiring very valuable land near Dhaka. Although RAJUK offers market levels of compensation, it is very likely that without political backing there would be very high transaction and transition costs in achieving these transfers so near the highly-valued land of the capital. But it is difficult to achieve this level of political interest for small industrial zone projects as the Karnaphuli case demonstrates. Indeed, political interest in and support for setting up industrial zones has not been very high in Bangladesh (World Bank 2007).

Given these political and institutional realities, a viable strategy would be to draw on features of different strategies that have worked in the past and to develop new institutional capabilities to experiment with other models for land acquisition for industrial parks. International development partners could assist by investing in capacity-building in the requisite 'governance' capabilities. Training for the agencies tasked with these projects is vital, together with achieving a broader understanding within the group of major stakeholders of the constraints that have to be overcome. Learning from a country's own experiences and bringing in the knowledge of bureaucrats and politicians who were involved in successful land acquisition projects in the past would be very useful if the wheel is not to be reinvented. Many of the methods that were used may be far removed from good governance. But a better understanding of why some methods were used in the past is the only way to construct more transparent methods and achieve better social justice in the future. However, an agency with high quality leadership could also try new experiments on a trial basis. For instance, land could be leased from small landowners instead of being purchased, giving owners a stake in future land values. The viability of these experiments cannot be decided in advance because they would face specific transaction and transition costs. In particular a resolution of local land titling disputes and compensation to the landless and to those who sharecrop land belonging to others would be necessary to make a leasing approach viable.

One of the lessons of the past is that an industrial land project cannot always rely on the weak incentives of political leaders in countries like Bangladesh. Some basis of political support is however required and this perhaps needs the construction of new alliances between business, reform-minded politicians and bureaucrats. International partners could assist with stakeholder dialogues to help the emergence of a broader understanding and new alliances. Countries like Bangladesh also need long-term credit lines from international financial institutions for these types of land acquisition projects, but the capability to run the acquisition in contexts of high transition costs has to be simultaneously developed. The next phase of industrialization in land scarce countries like Bangladesh is otherwise likely to face very hard constraints.

### ***West Bengal: Political Mismanagement and Changing Trade-offs***

Economic growth in West Bengal was driven to a significant extent in the 1980s by very successful land reforms and incentives for the agricultural sector. However, these reforms were not aimed at creating a capitalist agriculture. Apart from the ideological

preferences of the Communist Party, such an attempt would have faced very high transition costs given the pre-existing structures of rights and the population density in the state. The Left Front strategy strengthened peasant rights and helped consolidate the creation of a middle and rich peasant economy. Aspects of this transformation were discussed in our earlier paper (Khan 2008b). The emerging challenge in West Bengal in the 1990s was to respond to the limits of peasant agricultural growth. In the 1990s growth of foodgrains output dropped to just over 2 per cent per annum from around 5.5 per cent in the 1980s. Many of the poorer peasants who had benefited from tenancy reform could no longer sustain themselves in agriculture. According to one estimate, 13 per cent of the beneficiaries of land reform gave up their tenancy rights or sold their land. The real paradox was West Bengal's performance in rural poverty. The percentage of the rural population in poverty was 31.85 per cent in West Bengal compared to an Indian average of 27.09 per cent (Sarkar 2007). This was a stark demonstration of the limits of the peasant based agrarian strategy.

In this context, the Left Front government that had ruled the state since the late 1970s took a series of momentous decisions to shift the emphasis of development towards industrialization. A new industrial policy was announced in 1994, making it easier to get permissions for industrial development and offering assurances that unions would be curbed. But the major challenge to the new industrial policy eventually came from a land crisis. The land crisis took on grave political dimensions in the course of attempts by the Left Front government to intervene in land acquisition in favour of big industrial investors. Only two per cent of West Bengal's land is not cultivable. But to accelerate industrialization, the state government included in its priority areas land intensive sectors like petrochemicals and iron and steel (Purohit 2009; SIDBI 2009). These strategies required government support to reduce or overcome land market failures as the difficulty of land acquisition was likely to impede these plans significantly.

The formal power of compulsory acquisition was established in India by the Land Acquisition Act of 1894 which was an application of the concept of *eminent domain*. In its original manifestation, the Act only enabled the acquisition of land for strictly public purposes with compensation limited to market prices. An amendment of 1984 improved the terms of compensation to enable compensation at rates higher than the market to take account of additional losses suffered by the original landowners. But it also allowed the acquisition of land by the state for private development purposes. State governments now had the power to amend the act to determine the details of how compensation was to be decided, the agencies empowered to determine the public purpose and so on (Guha 2007). The significant change was that the legal framework was being used for a purpose somewhat different from its initial intention, which was solely to acquire land for public purposes. However, what is a public purpose is debatable, and implicitly Indian states were saying that solving land market failures for the private sector served a public purpose.

In addition, as a lagging industrial state within India, the West Bengal government also felt compelled to provide substantial implicit subsidies to attract investors, particularly in the case of the Tata Group's Nano project. The outcomes of some of these interventions were politically disastrous for the Left Front government. While some significant land acquisitions quietly took place, two high profile failures in Nandigram and Singur proved to be very damaging for industrialization strategies in

the state and for the political fortunes of the Left Front government. A successful mobilization of peasants opposed to land transfers in these areas by the populist Trinamool Congress led by Mamata Banerjee led not only to the withdrawal of the Tata investment but to a collapse in the broader political support for the Left Front government. In the 2009 general elections the Left Front's seats dropped from 35 (in the 2004 elections) to 15 out of a total of 42 seats in the state.

The reasons behind these catastrophic setbacks for the Left Front are complex. On the one hand, the property rights reforms of the 1980s had strengthened peasant rights and made some peasants more able to hold out for longer in contests over land transfers. This implied a structural worsening of the growth-stability trade-off for some strategies of land acquisition. On the other hand, the slowdown in agrarian growth was already leading some of the poorest peasants to abandon their land and many were willing to accept the relatively generous compensations that were on offer in some land acquisitions. The middle and rich peasants who were the political backbone of the Left Front alliance were themselves dissatisfied with their limited agrarian prospects. In general they supported the drive to industrialize. They just did not want to be affected themselves, and if they were, they wanted to extract a high price for their land. This suggests a more complex set of trade-offs, differentiated by region and ecology within the state. In areas where agriculture was doing particularly poorly, and poorer peasants dominated, the political management of land transfers was easier. However, in areas where agricultural reforms had worked and peasants were somewhat better off, strong resistance to land transfers was mounted. This suggests that the Left Front's problems came from a combination of less favourable growth-stability trade-offs in areas where strengthening peasant rights had resulted in growth. But there was also its own political mismanagement in selecting the wrong areas, and using inappropriate strategies of land acquisition.

The land issue has recently dominated economic development across India, but particularly in eastern India. The experiences in West Bengal are part of a series of costly stalemates that have affected the region. In neighbouring Orissa, South Korean steel producer Posco signed a 12 billion dollar memorandum of agreement in June 2005 but has been waiting since then because the land in Jagatsinghpura could not be acquired. The government has not even been able to put up the notification of acquisition under the Land Acquisition Act in the district revenue inspector's office as protestors blockaded the office. Four years later the impasse continues. Another large Tata Steel project in Kalinganagar in Orissa has also been on hold for four years. Protests against land acquisition have also taken place in Haryana, Uttar Pradesh, Delhi, Madhya Pradesh and Maharashtra.

These conflicts, particularly the ones in West Bengal resulted in the central government revising India's Special Economic Zones (SEZ) Act in 2007 to limit their maximum size to 5000 acres. It was also decreed that states could only acquire land if they or their State Industrial Development Corporations were the developers. Land could no longer be acquired by states to be transferred to an SEZ developed by private developers. Till 2009, 568 SEZs were approved but only 87 were operational and the smaller ones are only 5 to 6 hectares in extent.

*Successful Land Acquisitions: Rajarhat, Haldia, Salboni*

To understand what was different about the debacle at Singur it is useful to look at the background of a number of successful land acquisitions that the state government was involved in over this period. There were some significant successes in land acquisitions and these may have lulled the political leadership to be excessively sanguine in extending this approach to other areas. In fact, the areas where land acquisition was successful were significantly poorer in terms of their ecology and cropping, and peasants there were correspondingly weaker and less well-connected to state-level political parties.

The involvement of the ruling Left Front and in particular its dominant member, the Communist Party of India Marxist (CPI-M) in land acquisition processes began in the early 1990s when the state government decided to extend Greater Calcutta into an area called Rajarhat. In a process that had echoes with the activities of RAJUK in Dhaka, but which was even less institutionalized, the party used its disciplined organization together with informal mechanisms of persuasion and power to acquire a large amount of land at compensation rates that were very low. Around 12,500 acres were acquired and rates of compensation offered were around 100 dollars per acre. This land now sells for close to two million dollars per acre. The land was initially of little agricultural value and the owners were poor peasants who were eking out a living. In addition, many were poor Muslims as Rajarhat had a roughly 40 per cent Muslim population, about twice the state average. Moreover, they were not well-connected to opposition political factions. Finally, land acquisition was still an infrequent event and many people did not yet know their rights. This fortunate combination of factors (from the perspective of transition costs) was to change dramatically at Nandigram which was a Muslim majority area but with peasant farmers who also had significant bargaining power because they were clients of Mamata Banerjee's Trinamool Congress. The very low transition costs in acquiring potentially valuable land cheaply in Rajarhat may have lulled the CPI-M into assuming that transition costs were in general low whereas they were actually low in Rajarhat for very accidental reasons. Even there, when the locals began to realize the immense increase in the value of their land immediately after the transfer, the CPI-M lost support rapidly to the Trinamool Congress. This too should have registered a warning but apparently it did not.

There was a similar success story at Haldia where the state government acquired 6072 hectares beginning in the late 1980s. As Calcutta port got silted up, Haldia emerged as West Bengal's main port. It was an early beneficiary of the state government's turn to industry and the state government began to buy up land to promote Haldia as an industrial area and petrochemical hub. Here too, the disciplined organization of the CPI-M was deployed to keep transition costs low. In Haldia land acquisition did generate conflicts and the sitting Left Front Member of Parliament lost his seat. But the gradual emergence of the region as an industrial hub and the growth of jobs had a positive effect on the Left Front's popularity and the same MP managed to regain his seat. This experience too may have lulled the CPI-M into believing that it could ride out local storms as the long-run benefits of industrialization would pay off in the end. But in Haldia too, opposition parties had not fully mobilized and the transition costs were still low.

Finally, the example of Salboni is interesting as an example of a land acquisition deal involving a major corporate player that faced little local resistance. Salboni is an impoverished part of the state close to Jharkhand. The project in question is a 7 billion dollar integrated steel plant to be set up by JSW Steel, India's third largest steel producer. The agreement was signed in January 2007. In short order the company was able to acquire 4300 acres of land with relatively little local protest. The project is currently stalled because of the global slowdown, the collapse of steel prices and ongoing Maoist violence in the area (in 2008 the Chief Minister's motorcade was bombed when he was going to inaugurate the project). Nevertheless, as an example of a low transition cost land transfer, it is interesting to look at the features that allowed this to be negotiated.

Again, a combination of factors was at play here. Of the 4300 acres, 3800 acres were already owned by the government so in fact the company 'only' had to acquire another 500 acres of privately owned land, which the company acquired on its own initiative. However, this is a big chunk of land in the West Bengal context and some specific factors were important here. First, the company offered a very generous compensation package. In private, officers of the company indicated they had paid around 7000 dollars per acre to owners when the going market price was around 4000 dollars. In addition, the company offered a job to every affected family depending on skills and capabilities once the project was underway. Half of the compensation paid to each family would be used to buy an insurance annuity which would give a monthly income for life, and this alone would be significantly higher than the agricultural income. Finally, the company also offered warrants to its shares to 'local stakeholders' when the company would be floated, but specific details would not be made public. The floatation in any case is currently in abeyance and only the cash compensation part of the scheme has been implemented. But this is an example of a very detailed set of proposals that very significantly contributed to reducing opposition to the scheme.

Secondly, it greatly helped that this was an area with poor soil conditions. It supported fewer people than other areas and so a relatively small number of families were affected: 741 families in 4000 acres, or roughly about 4000 individuals. In contrast in the more fertile Singur area where the Tata plant was to be located, 24,048 individuals were affected in an area of about 1000 acres. Third, the organization of local peasants and their bargaining processes were insulated from major factional organizations in the state. Trinamool tried to make the steel plant a political issue but failed in this area, largely because few people felt that a harder bargain may bring them much more. Finally, the company did its homework. Before it started compensating it spent around a year in the locality sorting out legal documents and titles so that there would be no dispute about who was entitled to compensation. The relatively small number of people in an agriculturally poor region where land was not very valuable clearly helped here too. Thus, in each of these cases, specific factors explained why transition costs were low and the land transfers could be negotiated.

#### *Debacles at Nandigram and Singur*

The turning point in the Left Front's economic strategies came with botched attempts at land transfers in Nandigram and Singur that left the reputation of the Left Front in tatters. In Nandigram, near Haldia, the conflict began with a proposal in 2007 from Indonesia's Salim Group to construct a petrochemical SEZ. Around 18,000 acres

were to be acquired under the compulsory purchase provisions of the Land Acquisition Act. The local CPI-M political boss Lakshman Seth jumped the gun at this development opportunity and was probably behind the issuing of a notice from the Haldia Development Authority to authorize acquisition, though legally only a notification under the Land Acquisition Act was legal.

Taking advantage of local anger and government irregularities, Trinamool mounted an effective campaign of resistance with locals preventing outsiders from entering the area. It was a great opening for Trinamool because Nandigram was a Muslim-majority area and Trinamool (which had in the past been part of the BJP-led coalition, the NDA) now emerged as a champion of minorities. In contrast, the CPI-M had traditionally been supported by Muslims but now began to lose some of this support base across the state. From March 2007, CPI-M cadres began an offensive to take the area by force. Battles continued over several months involving thugs from both sides and the police. Several people died. In December 2007 the Chief Minister announced that the petrochemical complex would not be constructed at Nandigram after all but in a river island across from the region. But since no formal acquisition order had been given, there was nothing to withdraw as far as Nandigram was concerned. Festering conflict continued between the parties. The CPI-M was a significant loser in political terms, which soon became evident in election results. An even more significant effect of Nandigram was to enable the Trinamool Congress to carry out an effective campaign in Singur where a real investment was at stake.

Singur was to be the CPI-M's showpiece success story for industrialization. In May 2006 the Chief Minister announced the Tata Nano project was coming to West Bengal. Tata planned to build a 2000-dollar car for the Indian mass market. As it promised to be a successful project with export opportunities as well, it was an opportunity for West Bengal to shed once and for all its anti-business and anti-industry image. The problem was that Tata insisted on the site at Singur although it was a rich farming area with relatively prosperous middle and rich peasant farming. Tata insisted on this site because it was on a national highway on the Delhi-Calcutta route and close to the rail station at Dankuni, also on the Delhi-Calcutta rail link. Dankuni could potentially have been a site for a township housing Tata's managerial staff.

This time Trinamool organized rapidly. By July 2006 the highway bordering the earmarked site was blocked by protestors. By September there was police violence and by November Special Forces had to be sent in to protect the site. When it became clear later on that additional land needed to be acquired for the ancillary industries, the already significant resistance became impossible to overcome. The conflict continued till October 2008 when Tata withdrew from West Bengal and relocated its production to Gujarat where the government made an appropriate plot of government-owned land available for immediate use.

The West Bengal government used the West Bengal Industrial Development Corporation (WBIDC) to identify and acquire the land. It identified 997 acres affecting the land rights of 12,000 owners. Compensation would be based on the number of crops on the land per year, but the average price of the land was determined at approximately 20,000 dollars per acre. Registered sharecroppers would be compensated at 25 per cent of the value of the land even though they were not

owners. The average compensation put in a bank account earning interest at 10 per cent could earn an income significantly more than the income from the land. But once inflation of 6 per cent is taken into account, the real return the compensation achieves was just about fair compared to expected real returns from agriculture (Sarkar 2007). The initial package also ignored unregistered sharecroppers whose number was variously estimated to be 170 to 1200. They and the landless would lose their livelihoods but were not promised anything. The compensation was therefore not very generous. But the growth-stability trade-off was becoming significantly worse (flatter) for land acquisitions after Nandigram because of the huge mobilizations that Trinamool was engaging in. With hindsight, it was clearly very foolish of the Left Front not to have significantly improved the offer immediately.

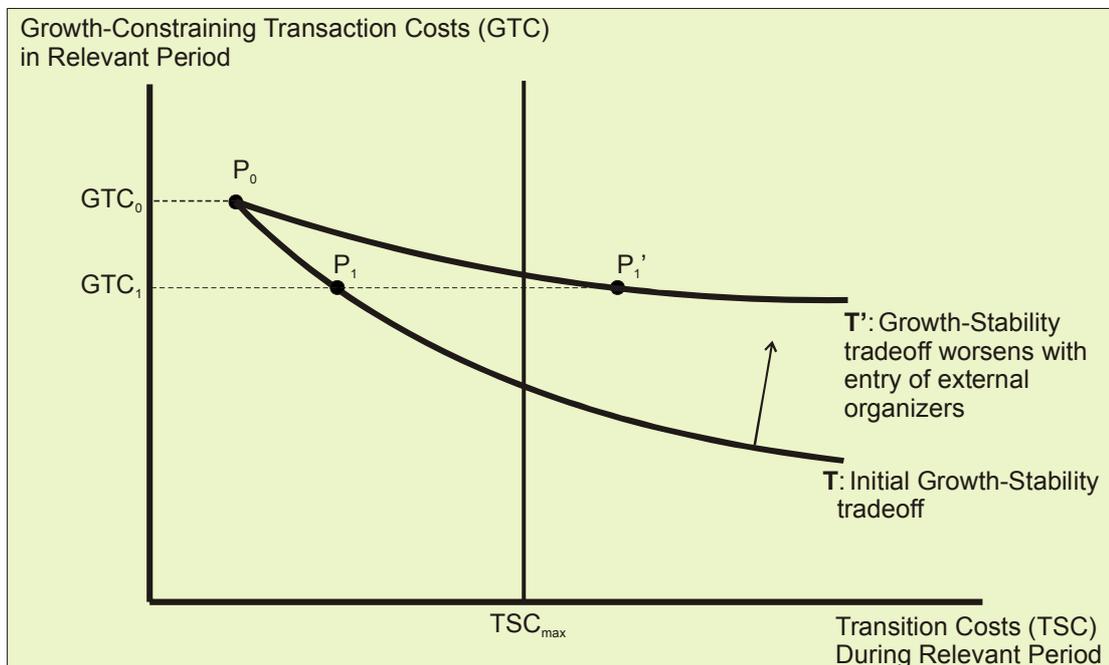
They were constrained by another aspect of the problem that became much clearer later. The West Bengal government was aggressively competing to attract Tata to the state and was implicitly offering very significant hidden subsidies to them in the land leasing agreements and in other ways. The land acquisition was clearly not a market transaction for the landholders. But it was not a market transaction for the West Bengal government either. Tata was saving on significant transaction costs and transition costs *and* getting a substantial hidden subsidy on the market rental value of the land. One way to see this is as an industrial policy subsidy. But a proper industrial policy subsidy should be explicitly allocated to maximize some technology acquisition objectives of a state, and should come with performance expectations and a capacity to re-allocate or withdraw the subsidy over time. In hidden land subsidies this is very difficult to do and we will return to the efficiency aspects of this method of offering subsidies in a later paper.

Here we can look at various estimates of the extent of the subsidy. The implicit subsidy can be broken down into a number of components using data provided by Sarkar (2007). First the purchase price of the land for the West Bengal government was 1300 million rupees. For the 90 year lease, Tata would initially pay 10 million rupees a year, increasing at 5-yearly intervals at substantially less than the inflation rate, so in effect declining in real terms over time. As the interest cost of the outlay for the West Bengal government (at 10%) would be 130 million rupees, there was an annual subsidy of 120 million rupees on the rent alone. In addition Tata was to get a 2000 million rupee loan at a nominal interest of 1 per cent. Again, at a minimal market rate of interest of 10 per cent, this was a subsidy of 180 million rupees. Ignoring other incentives like rebates of VAT collections also offered to Tata, the subsidy on the land and the loan was in the region of 300 million rupees (6.4 million dollars) a year, growing in real terms over the lifetime of the project. Tata's own estimate of its investment in West Bengal was 15 billion rupees. Compared to that, the West Bengal government was effectively putting 3 billion rupees in the bank (at a notional 10 per cent interest rate) to provide the annual subsidy. Using a slightly different methodology India's Comptroller and Auditor General estimated that the net present value cost of the subsidy to the West Bengal government was 760 million rupees looking only at the subsidy on the land lease (Express India 2008). There was therefore not much leeway to make a more generous offer to the peasant occupants of the land.

One implication that follows from this experience is that industrial policy subsidies should be explicit and the allocation should be based on an evaluation of costs and

benefits for the state. The bargaining power of corporate giants like Tata in India or multinationals approaching smaller developing countries is that implicit industrial policy subsidies are now demanded by corporates playing one state off against another. Even if land market subsidies are one way of responding to technology market failures, developing country states still need clear evaluation frameworks to make effective decisions. An ‘industrial policy subsidy’ extracted in this way may have nothing to do with solving a technology market failure but may simply be a way of corporate giants extracting revenue from taxpayers. Tata’s investment may well have brought in new technology with significant backward and forward linkages for the West Bengal economy. If so, the subsidy offered should have been the subject of an explicit calculation by the state government. Selling the integrated package of policy interventions to its core supporters would also have been easier for the CPI-M if the payback to the state was clearer in a cost-benefit analysis.

A number of features of this conflict corroborate our argument that land market failures have to be looked at in an explicitly political economy framework. The first problem for the CPI-M was that Singur had a much greater number of middle and rich peasants who had the capacity to mobilize and demand a higher price for transferring their rights. A study of the peasants in Singur who first sold out shows that they were the small and marginal ones, while the more substantial peasants held out till the end (Mohanty 2007). This is consistent with our expectation. Secondly, Singur demonstrates how external political organizers can rapidly make the growth-stability trade-off curve flatter, making transition costs far too high for solving particular land market failures. This happened in Singur with the increasingly successful political organization and mobilization by the Trinamool Congress.



**Figure 14 The Singur Transition Cost Trade-off after External Organizers Enter**

In Figure 14 the worsening of the growth-stability trade-off is so severe that the achievement of the improvement in growth prospects by setting up the project (represented as a move from  $GTC_0$  to  $GTC_1$ ) is no longer possible given the maximum

tolerable transition cost. The options open to the government were not good but it should have responded more rapidly. Assuming that an appropriate industrial policy assessment showed the project was very desirable for West Bengal, the government could have tried harder to persuade Tata to locate somewhere else in the state, if necessary adding a little to their already substantial subsidy. Alternatively, it could have offered significantly better terms to the holdout peasants to monetize some of the transition costs. Or if the sums did not add up, it should have decided that the deal was not worth it and withdrawn to save itself and the state a long and unnecessary conflict.

In the longer run, the Singur experience tells us that it will be very difficult to institutionalize solutions to land market failures in these types of contexts. As transition costs are essentially political, there may not be a single optimal institutional way of addressing them, even within the same state or region. The conditions under which land market failures are being addressed (described by the growth-stability trade-off) are politically determined and changing over time and different in different parts of the same country. Our analysis suggests the need for flexibility and quick responses in states going through transitions, as well as the importance of knowing when to change tack. It is unlikely that institutional solutions alone will do the trick, but there are clearly more or less promising institutional approaches.

### ***Maharashtra: Facing Growing Land Market Failures***

At the time of independence in 1947 West Bengal and Maharashtra had comparable levels of industrialization. However, as we described in Khan (2008b) they diverged significantly after that. An important factor that contributed to this was the more favourable relationship between business and government in Maharashtra compared to West Bengal and the ability of Maharashtrian business interests to establish links with Congress politicians both at the state level and at Delhi. The post-colonial political settlement in Maharashtra was, as we have seen, different from that in Bengal because the power of middle peasants and the intermediate classes was less developed in Maharashtra. This allowed emerging capitalists and their allies to play a more dominant role in the politics of the state, at least for a while. These differences were not accidental and were related to colonial land policies and political strategies. These had their own autonomous effect but there were also differences in the productivity of the land which resulted in much lower densities of human settlements in Maharashtra. As we have described earlier, Maharashtrian agriculture remained rather poor and productivity was much lower than the Indian average. The greater poverty of Maharashtrian peasants paradoxically allowed Maharashtra to follow for a time land transformation policies with significantly lower transition costs compared to West Bengal.

### ***The MIDC***

A key player in Maharashtra was the Maharashtra Industrial Development Corporation (MIDC). As long ago as 1961, the Maharashtra Industrial Development Act provided for the acquisition of private land anywhere in the state by serving notice to landowners for compulsory acquisition under the Land Acquisition Act. The MIDC was given the task of identifying and carrying out these land acquisitions to assist industrial development. The core function of MIDC was to acquire land cheaply from private owners, typically poor peasants, develop infrastructure around the land, and sell it on to industry at a higher price. While MIDC made large profits, high

quality land with infrastructure was made available to small and medium industries at a price that was affordable. Land of this quality and price was not likely to have emerged through any other process. As a result, MIDC land was in high demand, particularly from small and medium industries that wanted to locate around large private industries as ancillary industries or component suppliers.

The MIDC strategy was so successful because the agency was closely associated with political power in the state. Political power was in turn rooted not in its impoverished agriculture, but in the close association between industrial and political interests as outlined in a previous paper in this series (Khan 2008b). The Chairman of the MIDC was always the Minister of Industries and used the MIDC to distribute patronage by allotting plots, fixing lease rates, granting various types of tax exemptions and so on. Any opposition to MIDC policies was therefore more than balanced by powerful constituencies who were benefiting directly from it. By 1997 the MIDC had acquired 35,000 hectares of land in over 200 locations. It has also planned the acquisition of another 30,000 hectares for 120 large industrial estates, and nine industrial townships ranging from 2000 to 7000 hectares each (Brahme 1997). By 2008 the MIDC had built 229 industrial complexes on 60,000 hectares of land, together with 2423 kilometres of railways. This was one of the most exceptional achievements of industrial land acquisition for an Indian state.

Once in operation, the MIDC was largely self-financing because it bought land cheap and sold it at a much higher price. The MIDC could do this because not only did it manage to acquire the land very cheaply in price and transition costs, it also constructed very high quality infrastructure on the land. The MIDC developed considerable expertise in infrastructure development, particularly in electricity and water supply, with a significant engineering base. It also has a civil engineering base involved in road construction. The availability of a dedicated cadre of engineers and technicians who focused on developing infrastructure for industry from the 1960s put Maharashtra at a huge advantage compared to most other Indian states. The plots that the MIDC developed were not necessarily cheap, so there was no significant 'industrial policy' subsidy, unlike the proposed Nano deal in West Bengal, but they were high-quality plots in good locations with good infrastructure.

The policy was simply to solve the land market failures and provide efficient infrastructural public goods. A typical breakdown of costs would be as follows. If the land was purchased for an initial price of one rupee, the infrastructure development cost would be four rupees, and the land would be sold at ten rupees. Even at a 100 per cent mark-up on development costs, the plots would represent very good value for those getting it because of their excellent infrastructure, the significant transaction and transition cost savings, and the locational advantages of clustering with other firms. They were also close to big industry near Pune or Nasik, so that SMEs could be near their potential customers and suppliers. Plots even at these 'market' prices were therefore highly desirable. The MIDC then had several types of patronage to dispense. Some plots were allocated by key people within the political system, though the vast majority were marketed. For the politicians the ability to get an estate in their constituency was also a payoff. And finally, the profits from the land sales were divided between the key 'stakeholders'.

The politics behind the MIDC explains why the transition cost trade-offs it faced in addressing land market failures remained so favourable for so long. First, the MIDC was explicitly a tool in the hands of ministers and bureaucrats, who used it to dispense various types of patronage. This aligned the interests of politicians with the programme because the operations of MIDC provided electoral advantage to the ruling politicians. Secondly, patronage could be widely distributed because of a *de facto* operational rule that the MIDC did not help large industrial players to acquire significant amounts of land. Rather, its policy was to support medium and small enterprises that would have had difficulty in acquiring land on their own. As a senior bureaucrat told us, referring to the West Bengal debacle, the MIDC would never have been involved with a Nano-type mega-project. Indirectly, the support for small and medium industries was very important for big business in Maharashtra because these firms became ancillary and component suppliers, allowing sophisticated value chains to be developed in Maharashtrian industry. The MIDC's industrial estates played an important role in the development of the ancillary industries serving Maharashtra's automobile and chemical industries.

Thirdly, the MIDC's board had political representatives from each of the main regions of the state and they pushed hard to get industrial estates in their own regions. This was very useful to align the interests of local politicians with the activity of the MIDC. Politicians could use the MIDC to dispense patronage to their constituents given the high demand for allocations of industrial plots. More importantly, it meant that these local politicians would in turn help with land acquisition by putting pressure on local land owners not to resist land acquisition. This was very significant in reducing transition costs and ensuring that long local disputes did not happen. Maharashtra also developed a pro-business statute which enabled the MIDC to take over land even if the owners were engaged in litigation. The MIDC would give advance compensation, leaving the final compensation to be decided after the litigation. In many cases the final settlement could be decided ten or even twenty years after the takeover, but industry would not be blocked by these moves.

This alignment of political, bureaucratic and industrial interests meant that the MIDC was a very effective industrial development agency despite also being very corrupt. Indeed, after the police and tax bureaucracy, it was probably the most corrupt public body in the state. The MIDC chairman dispensed patronage while the political representatives, described as 'non-official members', collected regular unofficial fees ('hafta') from industrial associations in their respective jurisdictions. And yet the MIDC's success and efficiency is shown by the results. The agency demonstrates the importance of aligning political and bureaucratic interests with economic ones. A comparison with RAJUK in Bangladesh shows a similar alignment except that the MIDC achieved interest alignment for industrial land acquisition, while RAJUK's alignment of interests was limited to achieving land acquisition for urban development. The MIDC is a particularly interesting model for developing countries because it demonstrates that transition costs in solving land market failures can be effectively lowered. It is an excellent example of growth-enhancing governance, though it would fail the test of good governance very easily.

However, several specific features of Maharashtra need to be kept in mind. The viability of the MIDC strategy focusing only on small and medium industries required that Maharashtra's big business was big enough to solve its land acquisition problems

by itself. Maharashtra had plenty of land that was under very low productivity agriculture and therefore available for purchase, even though land markets were not very efficient. The big players in Maharashtra had sufficiently deep pockets to address the relevant transition and transaction costs to acquire land for themselves. In states like West Bengal this is not the case, and some solutions would have to be found to assist the occasional large land purchase as well.

Secondly, Maharashtra's political structure was pro-industry from a very early stage. Even though most people were in agriculture, the intermediate class leadership even in peripheral areas was keen to dispense industrial patronage in the form that the MIDC provided. Indeed, agriculture was systematically neglected in Maharashtra for the benefit of industry. For instance, in a state where only 16 per cent of farm land is irrigated, industry still gets priority in getting water supplies. The fact that there is very little good land in the state helps to focus the minds of politicians that the landless have to be provided with other employment opportunities. This explains why Maharashtra has not attempted serious land reforms. It also explains why if land records are tampered with to facilitate land acquisitions, there is little risk of being taken to task by politicians with powerful rural constituencies. In these respects Maharashtra is very different from say West Bengal. But the general proposition holds that if the interests of politicians and the agencies engaged in correcting land market failures are aligned, market failures can be corrected at relatively low transition costs.

The relative quiescence of Maharashtra's agrarian sector is however cracking up over time. The significant numbers of agrarian suicides that we referred to earlier have politicized agricultural issues. And directly in response to the land movements elsewhere in India including West Bengal, peasant mobilization has increased in Maharashtra. For instance, following the mobilizations in West Bengal's Nandigram and Singur, district administrators in Maharashtra held a referendum in 2008 to determine whether they should proceed with a land acquisition programme for an SEZ proposed by Reliance Industries. The outcome was that 90 per cent of farmers rejected the proposal and it remains in abeyance. The ease with which the MIDC addressed land market failures in the past may not be sustained in the future.

Moreover, resistance from the poor has also resulted in compensation and rehabilitation packages evolving, so that levels of compensation in land acquisition strategies have been improving. Indeed, unlike other Indian states where the rehabilitation of displaced people has been legislated for typically under World Bank pressure, the Maharashtra Rehabilitation Act 1976 was passed by the state government on its own in response to the indigenous mobilization of thousands of displaced persons who lost their lands in the 1960s and 1970s due to dam construction in the state (Fernandes 2007).

### ***Tanzania: The Challenge of Multiple Transitions***

Tanzania faces challenges in property rights evolution that are somewhat different from our other cases. In addition to the types of problems that we have already discussed in our other case studies, Tanzania is also grappling with refining the operation of a property right system that is still distant from formally recognizing individual rights of land ownership. Thus, in addition to the problems of efficient markets for re-allocating land use, and devising rights that are appropriate for

maximizing productivity growth, Tanzania also has to address problems emerging as a result of collective decision-making about land use and the boundaries of lands. A lack of clarity in these decision-making procedures can create uncertainties that can in turn truncate time horizons of investors holding valuable assets. In our Tanzanian case studies we see that collective aspects of ownership rights can deter investors. In addition there are other problems similar to those we have come across in South Asia to do with land acquisition and productivity growth. But paradoxically, the absence of private land ownership helped Tanzania to reduce the transition costs of changing land use in the case of high-value mining.

#### *Multiple Agents Can Determine Land Use Rights*

In 1989 urban resident X bought two acres of unused farmland on the outskirts of a village about 10 kilometres from Dar es Salaam. The land was bought from the owner who was a village resident who owned around 20 acres of land. The sale was approved by the Village Council and the witnesses to the agreement of sale were the local village leaders of the ruling party, the CCM. The Village Council kept a record of this transaction and there was no involvement of the Ministry of Lands with the sale. The sale was recorded in an 'official record' which was a book kept in the village office. Later the Ministry of Lands started surveying the land and used the village records to undertake the ownership mapping of the area.

However, 'ownership' of occupancy rights in village land does not enable the owner to prevent access to and use of the land in the owner's absence. In subsequent years half of X's land was occupied by some villagers who started building on the land. They did this with the approval of the Village Council who gave them the right to use the land on the basis that X had not sufficiently developed the land since its purchase. The occupiers got official papers from the village stating that they were official owners so now duplicate 'official' papers of ownership of the land existed.

X reinforced the boundary markings of the land but villagers moved the physical boundaries and sold off some of the land to two people with senior positions within the political system. These people used the land to build personal residences. As the properties were built very quickly and were owned by influential people X decided not to challenge their land grab as he risked losing the whole area and being allocated a new plot by the courts that would be much further away from the city in an undesirable area. In 2006 X decided to build on the land. The area had now become a suburb of Dar es Salaam and was under the direct responsibility of the Ministry of Lands. In order to start building and to ensure that his investment would be safe X had to make sure that his ownership was recognised by the Ministry of Lands.

He showed the Ministry of Lands his ownership papers that had been produced by the Village. Officials at the Ministry of Lands claimed that they had to verify these papers with the Village. The plot numbers recorded at the Village level were different from the plot numbers used by the Ministry of Lands. The process of getting the Ministry of Lands to recognise his claim involved various 'side payments', otherwise he was told that it would take many years for the recognition process to be finalised. His ownership of the land was eventually recognised and official records are now kept by the Ministry of Lands.

The interesting feature of the village rights system is that ownership does not preclude the collective village leadership from deciding a change in land use without reference to the nominal owner of the lease. The ownership system was devised for a society where everyone lived in the village, not for non-resident investors like X. He held off from investing in the property for many years as a result. The system also allows political power to be used at the village level to influence land use allocation as this case also demonstrates.

*Foreign Investors Need Political Connections to Protect Assets*

Very similar problems are demonstrated in the case of a foreign business investor Y engaged in agricultural production in the agricultural region of Arusha. Y is well connected to people within the CCM at the highest level and is able to use his influence to get the Regional Commissioner (RC) and District Commissioner (DC) to support him in his struggle with local villagers to exercise effective control over his land. While he is currently producing on some of the land there are constant land invasions. Making his ownership effective requires constant vigilance and political negotiation. The DC's support tends to vary quite a lot. When higher level political pressure is called upon, he supports Y. Maintaining sufficient security in order to use the land has been very difficult and has led to a decline in output as Y is unable to use all the land that he owns for production. This in turn has affected local support for Y as he had promised to bring benefits to the area in terms of jobs.

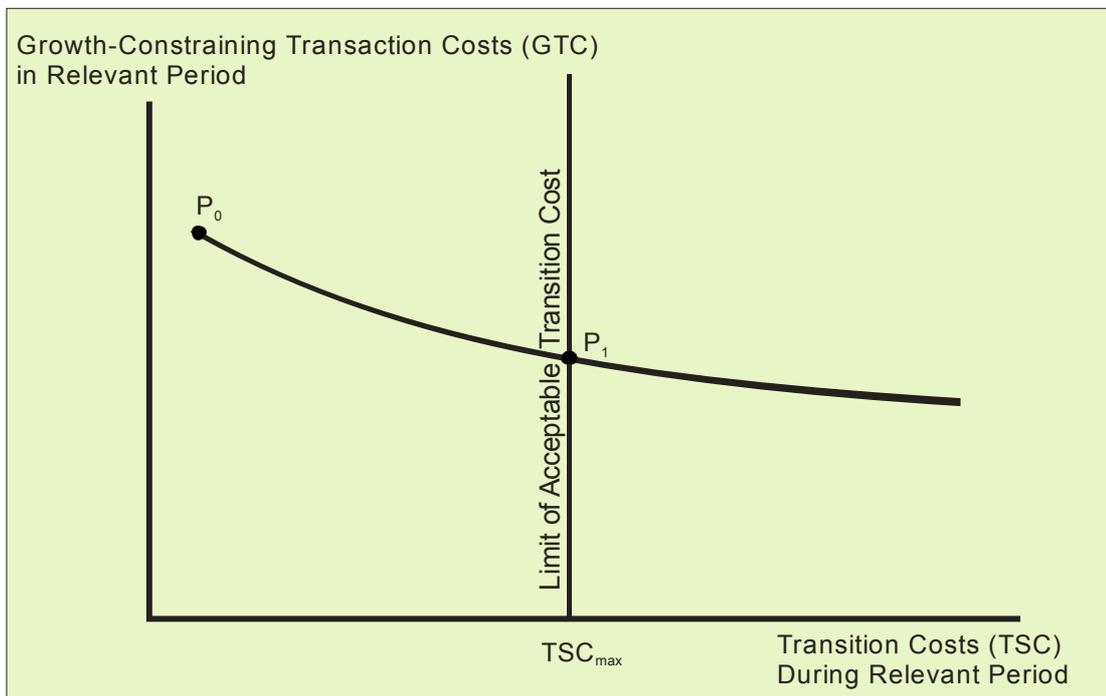
Y had bought the land in Arusha from a foreign owned company that had gone bust. This company had in turn bought the land from a privatized parastatal. There had been a struggle to acquire the lease which was finally granted to Y. The land was already being used and was occupied in some areas by people, some of whom had been given rights of occupancy by the previous owners. Despite the legality of Y's lease, enforcing his rights proved very difficult. It was not until he had used his high level political contacts to get the RC on his side that things started improving. The RC pushed the DC to hold village meetings to ensure that the villagers started to recognize Y's property. This was successful and for a while the business went well but when the business faced a downturn he stopped using as much of the land and local support collapsed. In order to retain local support and the support of the police he has to continue to use his high level contacts.

*Protection Strategies Are Vulnerable and Can Break Down*

In this case foreign investors ended up losing control over land they had bought in the Moshi region. In 2004 the investor (F) leased land from the owner (G) who was related to a very senior figure in Tanzania. The payment for the lease involved G and F both holding shares in the company holding the title to the land. The land was to be used for trials of genetically modified crops. A US company started carrying out trials but eventually pulled out. It was claimed by G that the company had gone bust and that gave him the right to reclaim the land for re-sale. The investor F claimed that the company had not gone bust and that there were no legitimate grounds for revoking his leasehold on the land. In 2005 G attempted to re-sell the lease to a neighbouring farmer (who was also an expatriate). Court cases were started by both sides to claim legitimate rights over the land. The conflict between F and G intensified and F and the managers and workers at the farm started to be intimidated by local police and thugs brought in by G.

There were high level interventions by the British Government in support of F and senior Tanzanian politicians voiced their support for the investors. However on the ground intimidation continued – F was arrested as well as his Tanzanian management team. Despite official pledges of support the local police arrested the investor twice based on the claims of G that F had not paid the full price despite official documents showing that the sale of the lease had been agreed by both sides. The local police and judiciary were firmly on G’s side and the intimidation continued over a three year period. At the national level, statements of support were given when there were interventions by the representatives of the British Government but these were not followed through on the ground. There are a number of legal cases still in the courts surrounding the lease of this land and claims and counter-claims of illegality and intimidation. In the end F fled the country in 2008 but due to the interventions of the British government in support of the investors the Chief Justice of Tanzania offered to mediate between the two parties.

The multiple points at which decisions about land use and allocation can be taken means that very concerted political pressure is required from above to override local coalitions if they decide to re-interpret the terms of land lease agreements. This type of property right structure obviously has some basic problems in protecting the investment of investors. In terms of our property rights analysis, this property right system is not well suited for maintaining long time horizons for investors. Paradoxically, the absence of very well-defined rights for individuals means that land use can be changed relatively easily compared to say the South Asian case.



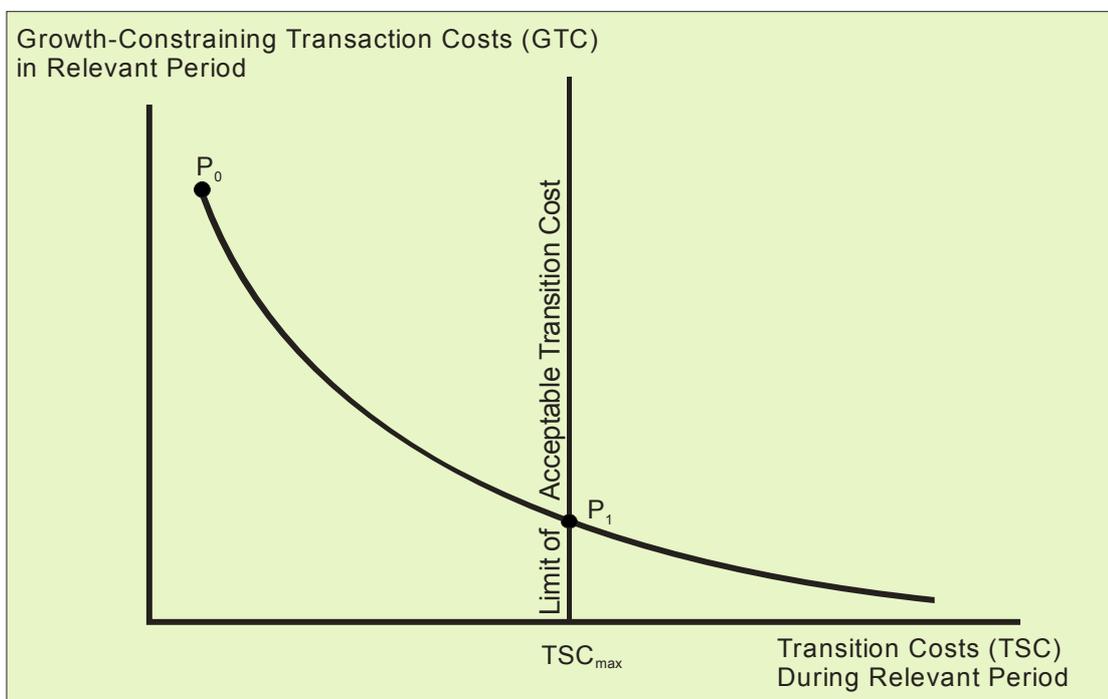
**Figure 15 Possible High Transition Costs in Reforming Village Rights**

In theory, if local political interests are using village land leasing systems to allocate land to investors, it would be in their interest to re-allocate the land if it was being inefficiently used. In our case studies, foreign investors ran into trouble when their business was not doing well. A serious problem with this system is obviously that

local power groups have no interest in sticking with an investor if the business is going through a bad patch. A bad patch is not a good indicator of a failed investment, so this type of land use re-allocation rights may be too flexible in the short term to allow efficient long-term decisions. Growth-enhancing property right transformations in the Tanzanian case may require reducing or weakening the rights of village authorities and local power brokers to re-allocate land use while strengthening the rights of leaseholders to greater long-term security, perhaps specified for precise periods of time. These property right transitions can be expected to have moderate to high transition costs (Figure 15) as village authorities and powerful groups in villages are likely to resist any reduction in their ability to override and change land use decisions.

*The Advantages of Collective Rights: The Case of Mining*

One area where the absence of private property rights has been very efficient for land use decisions in Tanzania is the development of mining, particularly for gold. Compared to other African countries, conflicts over mining rights have been relatively muted in Tanzania and this is not accidental. The state owns the rights to the minerals under the ground and in theory it does not need the consent of those using the land surface when making decisions about the allocation of mining rights. It only has to compensate lease-holders for crops and structures that may be damaged on the surface by mining activities. The absence of full rights for users means that it is difficult to organize resistance to land use decisions associated with mining. As long as the interests of power at the centre are aligned with local power groups, it is very difficult if not impossible for other social groups to mobilize against these allocative decisions. This is another way of saying that transition costs for mining right allocations are minimal in Tanzania, a scenario shown in Figure 16.



**Figure 16 Low Transition Costs for Allocating Mining Rights in Tanzania**

In an extensive set of case studies on conflicts in the mining sector in Tanzania, Lange finds that the most common conflicts are between the rights of large, often foreign mining companies and small illegal miners who often resist them with small acts of local confrontation (Lange 2006, 2008). These appear most often to be demonstrations of anger rather than serious attempts to block central decisions. There are no examples where a big chunk of a local community backed by local politicians has mobilized to block mining activities, in the way that we see in many parts of India or Bangladesh. Local authorities and MPs representing their constituents or the opposition party will often make political statements against mining companies and in favour of local residents of mining areas but at the cabinet level there is much more support for the mining companies. And even if they may have wanted to, there is little evidence that opposition politicians or others can organize significant mobilizations.

Compared to other parts of the continent, conflict over land and mining in Tanzania is relatively less significant. There certainly seem to be more disputes since the sector was opened up to large scale foreign investment but the conflicts are not really more ferocious. Importantly, most conflicts are not about the rights over the land but about the right to mine. Local landowners often receive rents from the companies or miners for the use of the land. Small-scale miners are usually immigrants to the area and are often in dispute with local landholders. Local landowners are therefore more likely to be interested in the rent-paying big companies than to side with the illegal small miners. Only very occasionally is there a conflict between a local community as a whole and a major mining company. Lange provides an example where Masai tribes people were able to protect a water source from a mining investment (Lange 2008: 17-18).

The coordination of political power within the ruling CCM combined with a structure of property rights that makes it difficult for legitimate resistance to be organized allows Tanzania to allocate mining rights with very limited transition costs. Thus, while improving the rights of investors in a growth-enhancing direction may in general face a potentially unfavourable trade-off curve, in mining the Tanzanian rights structure allows rights to be allocated or re-allocated at relatively low transition cost, implying a steep (favourable) trade-off in terms of our diagram.

The question is whether the political leadership's interests are sufficiently aligned with the long-term national interest to ensure that the allocation of mining rights will maximize national development goals. Given the stability of the political system in Tanzania, it is less likely that the political leaders in Tanzania will be making allocative decisions with very short term interests or concerns at heart, though we have no reason to doubt the veracity of at least some rumours of corruption and misallocation in the granting of mining rights. The more serious problem in Tanzania may be a different one, and related to the industrial policy issue that we came across in West Bengal. Global mining companies can exert significant market power to extract conditions from developing countries in exchange for their offer to invest. In the case of mining this can take the form of demanding very low royalties on leases, low income tax, carry forward of losses, and so on (Khan and Gray 2006). These are often presented as legitimate demands to cover the risks of investing in developing countries, the absence of skilled labour and so on. In other words, big corporates have become quite adept at making the case for industrial policy in all kinds of sectors, including mining.

An important area where growth-enhancing governance capabilities need to be developed is in building capacity within developing countries so that the allocation of rights to mining companies, and to corporate investors in general, does not give away too many rents that are not necessary from an industrial policy perspective. Without developing local governance capabilities to determine 'fair' levels of royalties and taxes for mineral companies, and the development of bargaining capabilities on the part of the state, states like Tanzania cannot be expected to allocate mining rights in ways that sustain growing benefits for the country and high levels of productivity growth, including efficiency in protecting the environment.

## **5. Policy issues**

Policy-makers need to be aware that property rights can be used to help achieve different objectives. These include protecting investors to take a long view in investment and conservation decisions, enabling efficient resource re-allocations, and creating conditions for sustained productivity growth. The property right adjustments that will further these conditions may in reality be conflicting. It is therefore important to have an assessment of immediate priorities, based on an analysis of the factors that are most seriously constraining growth.

We need to get away from the simplification that the creation of any new property rights or the strengthening of any existing property rights is growth enhancing. In some cases, the strengthening of existing rights in a context where transaction costs are high overall can increase the transaction costs for growth sectors and accumulators.

In addition, the property right transformations that are the priority for any society are not likely to be implementable by purely bureaucratic measures. This is because any development, amendment or change in property rights produces winners and losers, and losers will contest the change. The likely magnitude of transition costs, the determinants of transition costs and political and institutional measures to reduce transition costs have to play a significant role in any analysis informing policy in this area.

Growth-enhancing governance capabilities for addressing market failures in land markets refers to the political economy capabilities that enable states to address one or more market failures associated with inappropriate property rights. Since managing transition costs are a critical determinant of success, growth-enhancing governance requires a sufficient alignment of political and institutional interests to achieve interventions that correct these market failures at an acceptable transition cost.

We have seen there are examples from within developing countries where agencies have achieved limited success in addressing these market failures because they had by accident or design aligned the interests of some political forces and bureaucratic capabilities to pursue property rights changes that turned out to be moderately growth promoting. There were elements of these aligned interests in the MIDC in Maharashtra, the allocation of mining rights in Tanzania, and to some extent in the land acquisition strategies of RAJUK in Bangladesh. None of these cases are close to good governance and all of them have been identified with moderate to serious

corruption and patronage. Nor are they in their existing form models of growth-enhancing governance that could be supported as replicable models. Nevertheless, they provide examples in embryonic form of the types of conditions that need to be satisfied for effective growth promoting governance capabilities to be developed in poor countries. These capabilities would have to be appropriate for achieving the necessary growth-enhancing changes in rights given the political settlement and the transition cost trade-offs in that sector and society. By understanding these issues better we are more likely to devise improvements in growth-enhancing governance capabilities to sustain growth with social justice.

The other alternative is to monetize some of the transition costs by offering significant compensations to affected parties who can hold out in conflicts. Successful land acquisitions in the Jamuna Bridge case in Bangladesh or in the Salboni acquisition in West Bengal illustrate this possibility. Here too, an alignment of political and economic interests is required and implicitly also the exclusion of outside political organizers taking advantage of potential disputes. In addition, this strategy requires a significant upfront economic investment, and for many developing countries this implies that access to long-term soft loans may be required to finance the setting up of industrial zones. This could be a potentially important area for development partners to focus on, together with the development of growth-enhancing governance capabilities to manage these transactions effectively.

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