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**INEFFICIENCY AND ABUSE OF COMPULSORY  
LAND ACQUISITION:  
AN ENQUIRY INTO THE WAY FORWARD**

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# **Inefficiency and Abuse of Compulsory Land Acquisition: *An enquiry into the way forward***

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## ABSTRACT

This paper focuses on two issues: the problems with the compulsory acquisition of land, and the regulatory and institutional impediments that obstruct voluntary land transactions. We argue that any compulsory acquisition based process is intrinsically inefficient and unfair, even if it is accompanied by presumably benevolent schemes such as land-for-land and the R&R packages. Moreover, it is inherently prone to litigation. We demonstrate how what we call the ‘regulatory hold-up’ precludes a large number of potential transactions in agriculture land, and puts a downward pressure on land prices. The paper offers suggestions for reforming the legal and regulatory framework governing the land and its use. Finally, we discuss the Land Acquisition and Rehabilitation & Resettlement (LARR) Bill 2011. We show that the bill leaves open several backdoors for the states to favour companies. Moreover, it fails to address the fundamental causes behind rampant disputes and litigation over compensation.

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## 1. Introduction

The Land Acquisition and Rehabilitation & Resettlement (LARR) Bill 2011 has been introduced in the Lok Sabha. The stated aim of the bill is to rectify the failings of the archaic Land Acquisition Act 1894, which is the existing law on compulsory acquisition of land and private properties. Besides, the bill aims to facilitate transfer of land from agriculture to other developmental activities while safeguarding the interests of the affected people. The bill has several laudable provisions. The most important is the restriction of the scope of the *emergency clause* made notorious by its frequent misuse by the states. Moreover, the bill recognizes that acquisition of agriculture land affects not only the owners but also many others dependent on it for their livelihood. So, it seeks to protect the welfare of all affected parties by creating legal entitlement to compensation and rehabilitation & resettlement (R&R) for the owners as well as other livelihood losers.

At the same time, by diluting the crucial public-private distinction, the bill allows compulsory acquisition of land for all sorts of activities of private companies. Indeed, the proposed law significantly expands the scope of *eminent domain* – that is, the power of the *state* and its agencies to compulsorily acquire private property for ‘public purpose’ activities. This paper argues that any eminent domain based process is intrinsically inefficient and unfair, even if it involves compulsory acquisition of only a fraction of the required land. Moreover, by discussing several forms of eminent domain proposed in some recent works on the subject, it is argued these problems cannot be avoided even if the compulsory acquisition is accompanied by presumably benevolent schemes, such as compensation in the form of land-for-land and/or the R&R packages.

We also argue that the use of the compulsory acquisition power is inherently prone to litigation over compensation. Furthermore, the litigation over compensation is socially inefficient and regressive in its effects; it is relatively much more profitable for the owners of the high-value properties. These claims are corroborated by using a data-set compiled from 525 judgments of the Additional District Judge (ADJ) courts in Delhi.

Nonetheless, the LARR bill seeks to rationalize the compulsory acquisition of land by appealing to a growing national need for industrialization, urbanization and development in general. The bill seems to be guided by the perception that in the absence of compulsory acquisition, many developmental projects will get held-up. This view is also shared by several works on the subject.

This paper, in contrast, argues that it is the regulatory hold-up and not the hold-out by the owners that is the biggest impediment for voluntary transactions in land. At present, the use of agricultural land for other purposes is subject to many obstructive regulations. We demonstrate that these regulations preclude a large number of potential transactions. Moreover, they put a

heavy downward pressure on the transaction prices. Rather than increasing the scope of compulsory acquisition, there is a need to facilitate transfer of land from agriculture to other purposes through voluntary transactions. This calls for immediate reforms in the legal and regulatory framework governing the land and its use. The paper offers some helpful suggestions.

Finally, we discuss the LARR bill. We argue that the bill in its present form fails to address some of the ongoing abuses of the power of eminent domain. The bill leaves open several backdoors for the states to favour the powerful and private companies at the expense of the rights of the farmer and the forest dweller. Moreover, it fails to address the fundamental causes behind rampant disputes and litigation over compensation. If anything, its provisions are likely to further intensify the litigation over compensation.

The paper is organized as follows. Section 2 discusses some of the prominent abuses of the eminent domain powers by the states in India. It also analyses the causes behind the widespread disputes and litigation over compensation. Section 3 examines the merits and de-merits of compulsory land acquisition. By discussing various forms of eminent domain as suggested in various works on the subject, this section shows that there are inherent problems with compulsory land acquisition even in its most benign forms. Section 4 argues why the voluntary transactions are superior to the compulsory acquisition. This section also demonstrates how the regulatory hold-up is the principal factor behind the lack of voluntary land transactions. Section 5 discusses the relevant legal and regulatory frameworks, and offers some suggestions for facilitating voluntary land transactions. Section 6 discusses the LARR bill and provides further suggestions for improving the land acquisition laws.

## **2. Eminent Domain in India**

**2.1 Misused Public Purpose** The history of eminent domain in India is a saga of unmitigated abuse of the land acquisition laws by the state governments. The states have been repeatedly misusing the power of eminent domain to acquire land for companies. Moreover, they have been using emergency powers for the purpose, in strict violation of not only the spirit but also the letter of the law. Some of the other notable abuses of the extant law are: acquisition of land citing some public-purpose but covertly diverting it to private ends; adoption of pick-and-choose method for selecting project site; and the use of the de-notification clause to exempt land belonging to the powerful but simultaneously acquiring all neighboring properties.

The Land Acquisition Act, 1894, (LAA) is archaic and has several ambiguities. The states have repeatedly exploited the ambiguities to compulsorily acquire land for the benefit of companies and the powerful. Part VII of the Act allows acquisition for the private companies. However, sections 38-44 of this part impose several restrictions on private purpose acquisition. For

instance, there is no provision for emergency acquisition. Besides, the company and the state government are required to sign an agreement stating the purpose of acquisition. The agreement must specify the terms on which general public will be entitled to use the services provided by the company. The objective behind these riders is to restrict the compulsory acquisition to those activities of companies from which public can benefit directly; such as, housing for workers, setting up of schools and hospitals, etc.

These conditions on private purpose acquisitions notwithstanding, the states have acquired land for all sorts of activities of companies, including the ones that cannot even remotely serve any public purpose; for example, for setting up of shoe manufacturing factories, air conditioner compressor plants, hotels and swimming pools!<sup>1</sup> Moreover, acquisition has largely been done using the emergency clause that allows the acquiring authority to dispense with several procedures - such as, hearing of objections against the acquisition of the targeted land - meant to guard against potential misuses of the law. Large tracks of forest land and other common property resources have been acquired in violation of not only the LAA but also the Forest Rights Act and other laws governing common property resources. How have these blatant violations of the law been possible?

In order to bypass the restraining provisions of Part VII, the states have frequently acquired land for companies under Part II of the LAA. This part concerns acquisitions by government departments for public purpose. Understandably, it does not impose the above restrictions on acquisition for companies. However, the act is ambiguous as to when acquisition for companies can be undertaken under Part II. Exploiting this ambiguity, the states have used this part for private purpose acquisition. Unfortunately, judicial interpretations of the law have only facilitated its misuse. As to the issue of whether acquisition or transfer of land to a company serves public purpose or not, for the most part the judiciary has left it to the discretion of the executive - it is true that courts have annulled some acquisitions, but largely on procedural grounds.<sup>2</sup> Since 1960s, the judiciary has allowed acquisition for companies to qualify as public purpose acquisition, as long as a part of the compensation cost is paid out of the state exchequer.<sup>3</sup> So much so that in *Indrajit C Parekh Vs State of Gujarat AIR 1975 SC 1182* the SC upheld an incredibly bizarre contention of the Gujarat government who claimed that a contribution of even one rupee from the exchequer is sufficient to validate the acquisition for a private company

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<sup>1</sup> Kaur (2010) provides many examples of land acquisition for essential private activities of companies.

<sup>2</sup> Very recently though the higher judiciary seems to have woken up to the abuse of the acquisition laws by the states, especially after the prolonged and violent protests by Bhatta-Parsaul farmers. While reprimanding the UP government for unnecessary use of the emergency clause, on June 28 the Supreme Courts expressed serious dismay at the wide-spread misuse of the land acquisition laws. (Hindu accessed at <http://www.thehindu.com/news/national/article2139144.ece> on September 13, 2011). Since April 2011, courts have struck down acquisition of more than 1000 hectares of land acquired for development projects in the Greater Noida area alone.

<sup>3</sup> See *Smt Somawati & Others Vs. State of Gujrat* AIR 1963 SC 151, and *Devinder Singh & Others Vs. State of Punjab & Others* 2008(1) SCC728, among others.

under Part II! Unsurprisingly, in order to justify acquisition for companies under Part II, the states have been contributing nominal amounts toward the cost of acquisition. Some governments have gone to the extent of contributing just Rs 100!<sup>4</sup>

In such a scenario, the states have been able to violate the law with impunity. In fact, they have competed to ‘outperform’ one another in acquiring land for private companies who clearly find it profitable to use the state machinery to acquire land at subsidized rates. There are many instances in which the states acquired land ostensibly for the use of a government department but eventually transferred it to companies. For instance, in 2002 the Haryana government acquired land to construct a Metro rail line, evidently a public purpose. However, after acquisition as much as 90 percent of the land was transferred to private developers. In another illustrative instance, about 1500 acres of high-value agriculture land in close vicinity of Gurgaon city was acquired quoting public-purpose, namely for development of an industrial complex. However, later the land was transferred to the Reliance SEZ, a project whose future is uncertain even after a lapse of 5 years. In the state of UP also there are several instances in which the government acquired land in the Greater Noida area citing some public purpose but ultimately diverted it to the builders. Besides, the states have been routinely misusing the de-notification clause to grant mid-way exemption to the properties of the powerful from acquisition. Indeed, the recent controversies over land acquisitions in the UP, Haryana and Karnataka are due to such misuses.

**2.2 Disputes and Litigation over Compensation** In addition to the problems discussed above, the use of the eminent domain in India is invariably followed by disputes and litigation over compensation. To put the relevant issues in perspective, the LAA entitles the affected owners to the ‘market value’ of their property. In practice, for the purpose of compensation the market value of a property is determined on the basis of what are called ‘circle rates’ (popularly known as registry rates)<sup>5</sup> and/or the sale-deed of a similar property. In several judgments, the higher judiciary has held that the market value should be determined on the basis of the circle-rate or the registered sale-deed of a similar property, whichever is higher.<sup>6</sup> The problem, however, is that the circle-rates are perpetually outdated and well below the market rates. Sale-deeds are also under-valued since, in order to save on stamp-duty charges, the price reported in a sale-deed is generally less than the actual transaction price. Moreover, for agricultural land the market price

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<sup>4</sup> For more on misuse of the law by the state to favour private companies see Gonsalves (2010), Mihir (2011) and Nielsen (2011). For misuse of acquisition laws in general see Morris and Pandey (2007) and in West Bengal see Sarkar (2007). For weakening of property rights in India see Singh (2006).

<sup>5</sup> These rates are determined by the state government, and differ across the categories of land. A circle rate is the minimum rate for the official valuation of a property. So, the registered transaction price quoted in sale-deeds cannot be lower than the circle rate.

<sup>6</sup> See for instance, *The Special Land Acquisition Officer, Bangalore v. T. Adinarayan Setty* (AIR 1959 SC 429), *K.S. Paripoornan vs. State of Kerala*, (AIR 1995 SC 1012). *Panna Lal Ghosh & others vs Land Acquisition Collector & Others* decided on 12 December, 2003 vize Appeal (civil) 9734 of 2003; *Rameshwar Solanki & others vs. UOI & Others*, AIR 1995 Delhi 358; and *Tindey and Others vs. UOI & others*, 2000(54) DRJ(DB) 384; and *Jasrath Vs. Union of India* 130 (2006) DLT700, among others.

itself is acutely suppressed. This is due to a set of unreasonable restrictions imposed by the change-in-land-use (CLU) regulations. Therefore, the sale-deeds as well as the circle rates under-represent the true market-value of land. Moreover, the circle-rates are lower than the sale-deed rates. Nonetheless, the land acquisition collectors (LACs) – the officer responsible for awarding compensation to the affected parties – routinely award compensation on the basis of the circle-rates. This is the primary reason behind the inadequacy of the government provided compensation and associated disputes.

The excessive litigation under the existing law is due to the fact that the LACs and courts use a different basis for determining compensation, though the LAA provides the same set of rules to be followed by both the entities. While the LACs use the circle-rates, courts tend to use relatively high-value sale-deeds as the basis for determining compensation. Consequently, the court awarded compensation is consistently higher. An analysis of judgments of the ADJ courts in Delhi confirms this claim. The analysis is based on the available 525 judgments delivered over three years; 2008, 2009 and 2010.<sup>7</sup> Summary statistics are presented in Table 1. As the table shows, for every single adjudicated case, the court awards are at least equal to the LAC award. For as much as 86 percent of the cases, the court awards are strictly greater than the LAC awards.

**Table 1: Summary Statistics of ADJ Courts (Delhi) awards**

Land Type	Number	% of Cases with Court awards > LAC award	% Increase in Compensation by court				% Increase in Compensation by court, conditional on positive increase			
			Mean	Std. Dev.	Min	Max	Mean	Std. Dev.	Min	Max
Agriculture	470	90.21	18.36	49.53	0	427.63	20.35	51.76	1.0	427.63
Residential	12	83.33	29.47	38.72	0	109.09	35.36	40.01	9.1	109.09
Commercial	13	46.17	33.09	45.66	0	109.09	71.69	41.04	30	109.09
Others	30	73.33	49.21	131.91	0	514.28	67.11	150.9	1.41	514.28
Total	525	86.09	20.57	56.68	0	514.28	23.44	59.95	0.20	514.28

Source: The ADJ Courts (Delhi) awards made in 2008, 2009 and 2010.

Preliminary research suggests that this is an all India phenomenon. In some cases, the difference between the LAC award, on the one hand, and the judiciary awarded compensation, on the other hand, is really startling. Here are a few examples:

<sup>7</sup> As available at <http://delhicourts.nic.in/> and downloaded during January-April 2011.

In *C.E.S.C. Limited vs Sandhya Rani Barik and Ors*, 2008,<sup>8</sup> the judiciary increased compensation rate substantially. The LAC had awarded compensation at the rate of Rs 50,000 per-cottah. In contrast, the judiciary awarded compensation at the rates of 2,25,000 per-cottah. In *Kanta Devi & Ors vs State Of Haryana & Anr*<sup>9</sup> the compensation rate was increased from Rs 40,000 per-acre (by the LAC) to Rs 3,84,000 per-acre. In *Revenue Divisional Officer-Cum-L.A.O. Vs. Shaik Azam Sahem*<sup>10</sup> the Supreme Court increased compensation rate from Rs. 16,000 to Rs. 1,41,666.66 per-acre!

Understandably, the acquisition affected people have strong incentives to go for litigation. In fact, those who can afford, approach the higher judiciary and demand further enhancement in compensation. In many cases, the owners succeed in getting even higher compensation. For example, in 96 percent of the judgments delivered by the Punjab and Haryana High Court during 2009-10, the court awarded compensation is higher than the LAC award. Moreover, the average judicial awards are 342 percent higher than the LAC awards!

However, regardless of its appeal to the affected owners, litigation involves unnecessary spending of social resources. That is, from a social perspective it is an inefficient means of enhancing compensation. Indeed, as is demonstrated in the next section, litigation is intrinsically pro-rich and against the poor. The poor farmers and the forest dwellers as such cannot afford the legal expenses. Moreover, many a times, there are no or very little transactions in the agricultural land in rural areas and in the forest lands. Consequently, there is very little scope for these people to use litigation to get higher compensation.<sup>11</sup> These people have no option but to take to the street to resist acquisition as such, at times leading to dreadful consequences as have been experienced in Nandigram, Singur and some other parts of the country.

### **3. Inefficiency and Abuses of the Eminent Domain: There are no easy ways out**

Section 2.1 shows that the self-interested uses of the compulsory acquisition laws have played a major role in making the outcome as bad as it has become. However, there are inherent problems with the use of eminent domain. This section shows that the eminent domain can guarantee neither efficiency nor fairness of the outcome, even if the decision makers are honest and want to use it to further social welfare. Moreover, there are no easy ways out of the abuses and inefficiency of the eminent domain.

**3.1 The Inherent Problem** In principle, the process of transfer of land from agriculture to non-agricultural ends can take several forms. For instance, it could be based on pure voluntary

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<sup>8</sup> *C.E.S.C. Limited vs Sandhya Rani Barik and Ors*, 2008, INSC 1036 decided on 7 July 2008.

<sup>9</sup> Decided by Supreme Court on 8 July, 2008.

<sup>10</sup> Decided on 13 January, 2009.

<sup>11</sup> However, the market transactions in the agricultural land adjacent to or near the urban areas do exist. That is why, the owners of agricultural land in Delhi have been able to produce sale-deeds and get higher compensation through litigation.

transactions whereby the people desirous of buying agricultural land directly negotiate the sale price with the owners of the land. Or, the process could allow for compulsory acquisition of land, as is the case with the standard use of eminent domain. Or, it could be a complex mix of these two processes. For any given process of land transfer to be 'just', it should compensate the adversely affected parties so that they are left no worse off. This in particular requires that the owners should get compensation at least equal to their individual valuation of their respective properties. For the process to be efficient, the process should allow a land transfer if and only if the total benefits from doing so are greater than the sum total of the resulting costs. The benefits can be private as well as public. The same is the case with the costs, which can be divided into three broad categories: First, the costs to the owners of the land in question due to loss of asset ownership. These costs can be taken as the sum of valuation of the land by the owners *plus* the cost of dispute and litigation borne by the owners. Second, costs to the non-owners who lose livelihood due to the transfer in question. Third, the remaining third-party/external cost; such as, the environmental damage caused by the alternative use of the land, the social cost of the disputes and litigation instigated by the transfer process, etc. As is demonstrated below, the litigation and disputes over land transfer impose huge social costs on the society, apart from the costs directly borne by the litigant owners. However, these costs crucially depend on the transfer process used. Therefore, the choice of the process is critical for the efficiency as well as the fairness of the outcome.

The primary advantage of the eminent domain or any process involving its use is that the problem of hold-up does not arise. Since, the properties are compulsorily acquired, regardless of the intensity of unwillingness of the owners to part with their property. In principle, the process can ensure efficiency also, by making the buyer internalize all of the above discussed costs. For instance, the state can make the buyer compensate all of the livelihood losers on account of land acquisition. However, for an eminent domain based process to be efficient and fair the state must be able to get information about the benefits as well as all of the costs of the land transfer. The problem is that the state lacks the relevant information on the costs as well as the benefits.

The first and foremost is the lack of information about individual valuation of the owners, i.e., the price at which they are willing to sell their property - by definition, a compulsory acquisition implies lack of an actual voluntary transaction which could reveal the value of the property to its owner. So, in practice, most eminent domain laws require the compensation to be equal to the 'market' value of the property, plus a solatium. The market value is taken as the price that the property will fetch in the market under existing conditions, if it were put up for sale. In reality, this value is determined by taking the average of the sale deeds of 'similar' properties. Due to several reasons, the awarded compensation is invariably different from the value of the property to its owner. First of all, many attributes of a property affect its market value and no two properties are exactly identical. Identification of similar properties and, therefore, the market price of the acquired property is a genuinely difficult task vulnerable to errors. Several empirical

studies confirm that the actual compensation received by the owners of acquired properties is generally different from their market value. (See, e.g., Burger and Rohan (1967), Munch (1976), Bell and Parchomovsky (2007), Aycock and Black (2008)). Moreover, even if it were possible to determine the market value correctly, it will not help much to fix compensation at the so called market value. Since, a property of given market value is valued differently by different owners.<sup>12</sup> In this scenario, there is inescapable variance between the awarded compensation, on the one hand, and the actual valuation of affected owners, on the other hand. This divergence, however, leads to two adverse implications. One, the fairness of the compensation cannot be guaranteed.<sup>13</sup> Two, the land transfers may take place though it is not efficient to do so even from a pure cost-benefit standpoint. It is also possible that land transfer does not take place, though it would be efficient. Between the two scenarios, however, for the reasons discussed below the first one is more likely.

Indeed, there are even more serious problems with eminent domain which have been ignored by the literature on the subject. Compulsory acquisition is inherently prone to litigation which, in turn, has serious implications in terms of efficiency and fairness. As discussed above, identification of similar properties that have been transacted is a genuinely difficult task, even if the state agents are competent and honest. Many a times, several properties can be claimed to be identical to the property in question. So, the owner can always find a property with price higher than the compensation received, and claim the higher price property to be identical to his own. So, there is always a scope to litigate for higher compensation; unless the officer-in-charge identifies all of even vaguely similar properties and uses the one with the highest rate to award compensation. In practice, the government officials responsible for making the initial compensation awards do not have incentives to assiduously search for adequate market value of acquired properties. They play it safe and award compensation based on circle-rates or a relatively low-value sale deed. This means that the owners stand very good chance of winning during litigation, as they can use the high-value sale deeds as evidence in support of their claim.

However, litigation entails unnecessary spending of a great deal of money and other human resources by the acquisition affected parties as well as by the state. Therefore, it is an inefficient means of providing compensation. Moreover, litigation is socially regressive; it is much more profitable for the owners of the relatively high-value properties than for those owning low-value properties. The relatively high-value property owners can gain more by putting in a lot of effort during litigation – in terms of choice of the quality of lawyers, search for high-value sale-deeds and other evidence needed to prevail in the court, etc. In contrast, the gains from litigation efforts are relatively low for the low-value property owners. So, the court compensation is expected to

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<sup>12</sup> In any case, the value of a property to its owner is greater than its market value; otherwise he would have already sold it.

<sup>13</sup> From the perspective individual sovereignty no compensation is adequate to justify involuntary acquisition. (See Sarkar 2011).

be relatively large for the high value properties.<sup>14</sup> The results reported in Table 1 provide empirical, though only a preliminary, support to this conjecture; the gains from litigation are higher for the commercial and residential (plausibly higher value) properties than for the agricultural land.<sup>15</sup>

Things are even worse for farmers and the forest dwellers. As was remarked earlier, there is very little scope for these people to use litigation to get higher compensation. Since for large tracts of agricultural and forest lands there are no or very little market transactions which could be used to claim higher compensation. The poor as such cannot afford litigation. In the Indian context, what makes things particularly bad is the fact that the burden to prove the market value is on the owner, notwithstanding the fact that all of the relevant information - records of the sale-deeds, land-type, etc. – is solely possessed by the government.

**3.2 *There are no easy ways out*** The above discussion shows that there are serious problems with the compulsory acquisition of land. However, before a downright condemnation of the eminent domain, the following question needs to be addressed. Can there be an eminent domain based process or mechanism that is free from the above discussed problems? Several works have advocated the state intervention in the transfer of land from agricultural to non-agricultural purpose. The state intervention is sought to protect the rights of the farmers (Banerji, at el 2007, Bhardhan 2011), or to provide compensation in the form of land for land (Gangopadhyay, 2011). Recently, Ghatak and Ghosh (2011) have proposed an auction mechanism based use of eminent domain. The process is claimed to be free from the above discussed problems with compulsory acquisition of land. In particular, the claim is that the proposed scheme: induces true reporting of valuation of land by the owners, i.e., the price at which the owners are truly willing to sell their property; is fair as the project affected owners get to choose the form of compensation either as cash or as land-for-land, and the cash compensation is at least equal to the value of the property to its owner; is least coercive in that the state force is used to relocate only those owners who refuse to accept land-for-land. Obviously, the claimed qualities are quite appealing. In view of these virtues, the authors argue that the suggested form of the state intervention is desirable, regardless of whether land acquisition is for a public or private purpose. (See G&G first para, page 66, and third para page 69).

Indeed, Ghatak and Ghosh (2011) (G&G, hereafter) is a noteworthy contribution. The proposed mechanism is an innovative way of combining a market device (the auction mechanism) and of the eminent domain. The proposed combination possesses several desirable features, and is an important step towards solving the vexing problems associated with the standards use of compulsory acquisition. Under certain conditions, the mechanism produced outcome does hold

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<sup>14</sup> A formal model of litigation under eminent domain is developed in Singh (2011).

<sup>15</sup> Note, however, that the residential and commercial properties constitute only a small fraction of the total population. Therefore, the results should be taken as only an indicative support to the claim.

the above mentioned highly desirable properties. However, there several other contexts too which pose serious challenges to the intended functioning of the mechanism. Therefore, it is important to carefully analyse the mechanism and its implications before using it. Some of the relevant issues are pointed out by G&G themselves. In the following, I examine the properties of the outcome under the G&G mechanism for several land acquisition contexts. The underling motivation is to contribute to a better understanding of the consequences that will follow from the use of the mechanism. I argue that in several contexts of land acquisition that are of significant practical interest the mechanism in its present form does not deliver the intended benefits. Moreover, it is vulnerable to some of the problems associated with the standard compulsory acquisition. It is important to address these issues before using the mechanism.

***The G&G mechanism: An assessment*** The G&G mechanism requires state intervention in an area double the size of the project site. To illustrate, consider a project that requires  $n$  contiguous acres of land. Under the mechanism, the intervention area will consist of these  $n$  acres and another  $n$  acres surrounding them. The project site is to be called the *core* and the surrounding  $n$  acres, the *periphery*. Assuming that a farmer owns only one acre, implementation of the mechanism requires the following steps: First, each farmer is asked to submit a (sealed) bid, that is, the price at which he is willing to sell his acre. Second, these bids are opened and arranged in an ascending order. Third, the  $n$  acres with the lowest bids are procured at a uniform price. The purchase price is called the *auction price*, and is to be equal to the lowest bid price among the acres that remain un-purchased. That is, the auction price is equal to the  $(n+1)$ th bid when bids are arranged in an ascending order. If only  $c$  of the sold  $n$  acres are from the core, this means that  $(n-c)$  of the core acres had higher bids than the  $n$  lowest bids. At the same time,  $(n-c)$  of the periphery acres had bids among the  $n$  lowest bids. The final step requires the government to make a reallocation of the land as follows: The  $(n-c)$  farmers in the core, i.e., the ones with the higher bids, are relocated to the  $(n-c)$  periphery acres that were among the lowest  $n$  bids and have been purchased. A reserve price is fixed such that if the auction price turns out to be greater than the reserve price, the entire acquisition exercise is abandoned.

It will help to discuss the mechanism with the help of a simple example.

**Example.** Suppose setting up of an industrial project requires 5 contiguous acres of land, at a specific location. Following the description in G&G, let the demarcated area contain a total of 10 acres; the 5-acres core as the project site and another 5 acres surrounding it. Let 10 different farmers own these acres. Different farmers value their land differently. In principle, individual valuations can and will differ in numerous ways. For the ease of illustration, however, suppose individual valuations take the following values: 1 lakh, 2 lakhs, ..., and 10 lakhs. Let us call the farmer with valuation of land equal to 1 lakh as farmer 1, the one with valuation equal to 2 lakhs as farmer 2, and so on. Let us describe this profile as (1, 2, 3, 4, 5, 6, 7, 8, 9, 10). Suppose the 1<sup>st</sup>, 2<sup>nd</sup>, 5<sup>th</sup>, 7<sup>th</sup> and the 10<sup>th</sup> farmers are located in the core; the remaining ones are in the periphery. Let, the government announced reserve price be 6.5 lakhs.

This hypothetical example captures the essential attributes of the contexts discussed in G&G; namely, the land required for developmental projects needs to be contiguous, and individual valuation of land differs substantially across the owners.<sup>16</sup> Moreover, the numbers used here can be changed in numerous ways, without diluting the force of the arguments produced below.

Before proceeding further, it is pertinent to add that G&G assume that owners are heterogeneous in terms of their valuation of the land. But, all land plots of the same size are assumed to be perfect substitutes of one another. That is, owners are assumed to be completely indifferent between (have the same valuation for) any two of the same-size parcels. So, in the context of our example, farmer 1 finds each of the 10 acres worth 1 lakh. Similarly, in view of farmer 2, each acre is worth 2 lakhs, and so on.

According to G&G, their mechanism “gives the farmer a strong incentive to bid *truthfully*, i.e., ask for a compensation amount for which he is truly willing to part with his plot, instead of strategically inflating his asking price.” (See G&G, second para page 68). Moreover, the mechanism is claimed to be efficient in that it reallocates the land in a most efficient manner. To quote, “Our proposed method is designed to kill two birds with one stone. First, it determines a fair price not through government fiat but through a participatory process of competitive bidding where farmers are free to name their own price and choose their form of compensation (cash or land). Second, *it fills in for missing or imperfect land markets* in the region by reallocating the remaining farmland to those who place the *highest economic value* on such an asset.”<sup>17</sup> (emphasis added here).

In the context of our example, these claims imply the following: There is no collusion among the farmers; each farmer bids his true valuation of his land, i.e., the first farmer reports it to be 1 lakh, the second reports 2 lakhs and so on; land belonging to farmers numbered 1, 2, ..., 4 and 5 is purchased at a uniform price of 6 lakhs each; farmer numbered 7 and 10 are relocated from the core to the acres sold by farmers 3 and 4 in the periphery – farmer 7 gets land sold by 3 and farmer 10 gets land sold by 4, or the other way around; farmers numbered 6, 8 and 9 keep holding on to their respective acres. The reallocation of land in the periphery is efficient in that it is reallocated among farmers who place highest value on it, i.e., farmers 6, ..., 10.

First of all, the possibility of collusion among farmers cannot be ruled out altogether, especially when in a typical land acquisition context the affected owners are located next to one another, and have a collective and interactive social life.

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<sup>16</sup> Indeed, absent the contiguity requirement, there will be no need for the state intervention at all. On the other hand, if individual valuations of land are roughly equal, then the problem boils down to determining the average valuation, may be from the voluntary market transaction of a similar property. In that case, fair compensation can be provided by setting it little above the average valuation. The compensation so determined will allow the affected owner to buy similar property from the market.

<sup>17</sup> See page 69, first paragraph.

Even if the issue of collusions is set aside and a private value environment is assumed, the mechanism can fail to induce true valuations when individual valuations differ across land parcels. Moreover, it can fail to be efficient in the sense of the claim cited above. In the real world, individual valuations differ on account of a host of factors, such as, location, quality of soil and underground water, availability of irrigation, connectivity to market, among many others. Even if one were to assume that land parcels are identical in these aspects, people may still value them very differently. Many a time individual valuations differ across land parcels due to personal or non-replaceable factors. For instance, people tend to have sentimental attachment with their property, especially when it is an ancestral property. So, *ceteris paribus*, an ancestral property is valued more than the other properties. Moreover, individual valuations can differ across land parcels due to non-personal reasons as well. For example, controlling for all other relevant factors, strategically located parcels are valued more than the others.

Suppose, in our example the land owned by farmer 7 is an ancestral property, and his valuation, 7 lakhs, is partly attributable to this aspect of his land. His maximum valuation of any another acre which is not an ancestral property is 4 lakhs, even if it happens to be identical to his land in all other respects. Alternatively, if you are not persuaded by the ancestral property argument, think of a scenario in which there are several developers eyeing the land of farmer 7. It has become crucial for several small projects. Some of the potential buyers have even offered him close to 7 lakhs for his land. Realizing the strategic advantage of his land, he would not voluntarily sell it for less than 7 lakhs. His valuation of a non-strategically located acre in the periphery is just 4 lakhs, even though it is identical in all other relevant respects. In either of these scenarios, how much will farmer 7 bid under the G&G mechanism?

Even if we assume that all other farmers will bid truthfully, farmer 7 can be better-off unilaterally mis-reporting his valuation. To see how, recall the reserve price is 6.5 lakhs. Now, consider a choice between true reporting by farmer 7, on one hand, and under-bidding of 4 lakhs or slightly above this amount, on the other. If the project goes through and he had reported truthfully, he is sure to be relocated to an acre which to him is worth no more than 4 lakhs. In contrast, had he under-reported slightly above 4 lakhs and got his land acquired, his payoff would have been higher – equal to the auction price.

It is important to note that depending on the profile of individual valuations, (and assuming that the other farmers will bid truthfully) a unilateral under-reporting by farmer 7 can affect the project outcome, i.e., whether the project goes through or not, which, in turn, depends on whether the auction price turns out to be less than the reserve price or not. For instance, suppose the profile of individual valuations were (1, 2, 3, 4, 5, 6.9, 7, 8, 9, 10). Since the reserve price is 6.5 lakhs, the project will not go through if farmer 7 reports truthfully, as in that case the auction price (6.9 lakhs) will be greater than the reserve price. In contrast, a unilateral under reporting (say 4 lakhs) by farmer 7 will lower the auction price to 5 and the project will go through. In contrast, for many possible profiles of individual valuations a unilateral under-reporting by

farmer 7 does not affect the project outcome. The profile of valuations considered in our example, i.e., (1, 2, 3, 4, 5, 6, 7, 8, 9, 10) is one of the many possibilities. For this profile, a unilateral under-reporting (say 4 lakhs) by farmer 7 does not affect the project outcome. But this under-reporting at 4 lakhs is a more profitable choice for him than true reporting, as it enables him to sell his land at the auction price of 5 lakhs which is greater than his valuation of land in the periphery. However, note that for farmer 7 the payoff is highest (at 7 lakhs) if the project does not go through – if project goes through his payoff can be at most 6.5 lakhs. In particular, note that for profile (1, 2, 3, 4, 5, 6.9, 7, 8, 9, 10) farmer 7 is worse off under-reporting at 4 lakhs compared to true reporting.<sup>18</sup> In such a scenario, in a typical private value environment that allows various possible profiles of individual valuations including the two mentioned here, for farmer 7, bidding 4 lakhs or 7 lakhs cannot be a dominant strategy. The optimum bidding response for him will depend on his beliefs about the (probability) distribution over individual valuations. For many possible beliefs of farmer 7, the effect in terms of the increased probability can be of second order compared to the gains from avoiding relocation by mis-reporting. So, farmer 7 can be better off under-reporting. An under-reporting by farmer 7 clearly goes against the claim of truthful revelation.

The mechanism induced reallocation of land in the periphery can be inefficient, for those beliefs of farmer 7 about probability distribution of individual valuations in which he reports truthfully and the project goes through. To illustrate, if the individual valuations are as mentioned above, by reporting truthfully, farmer 7 gets relocated to the periphery where his valuation of land is just 4 lakhs. But then the redistribution of land is not efficient, since the reallocated land goes to a farmer (i.e., farmer 7) who is not among the relatively high-value farmers any more, in contrast a farmer with higher valuation of land (farmer 5) does not get it.

Expectedly, some other farmers may also have idiosyncratic component to their valuation of land. In general, if farmers in the core put different value on their own acres than those in the periphery, the claim regarding truthful bidding can get violated in several possible ways. As the auction/compensation price depends on the submitted bids, untruthful reporting of valuations has immediate consequences for the fairness of compensation and the efficiency of the outcome under the mechanism.

From a related perspective, it is easy to see that the mechanism's outcome is not superior to the initial allocation in terms of the weak *Pareto* criterion as well, regardless of whether farmer 7 reports truthfully or not. Since, the use of the mechanism to acquire land makes farmer 7 strictly worse-off– if he reports truthfully he gets relocated to a less valuable plot, and if he under-reports, the compensation received by him is less than his true valuation. In contrast, if he is not

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<sup>18</sup> In these examples, the probability distributions of other farmers' valuations are degenerate at particular values. However, it is easy to show that point is more general.

forced to participate in the mechanism his pay-off would be at least 7 lakhs; he will sell his land only if he is paid at least this amount.

The use of the mechanism is all the more challenging once it is recognized that the land parcels as such are heterogeneous. That is, even if the idiosyncratic issue and preferences are set aside, in real world no two parcels are exactly identical. This means that invariably there will be differences between the land from which reluctant owners are uprooted and the one where they are relocated; in terms of locations of the lands, access to water resources, fixed investments, etc. Unsurprisingly, due to such differences, individual valuations will differ across parcels.

Of course, G&G recognize the issues arising from the above sources of heterogeneity in land type. The authors propose ad hoc monetary compensation to make up for such differences, along with the land for land for those who submit relatively high bids. Besides, to account for differences in the quality of lands, adoption of a conversion scale is suggested. (See G&G page 68, 2<sup>nd</sup> para).

To illustrate the implications of the suggested measures, let us describe the individual valuation of a typical farmer for his own acre as  $v+s$ ; where  $v$  is his valuation of the land, and  $s$  is the sentimental value he attaches to it. (For example, for farmer 7,  $v = 4$  and  $s = 3$ .) If the farmer is in the core, let  $v'$  be his valuation of an acre in the periphery – there are not sentiments attached to it. So,  $v - v'$  captures the worth of (non-sentimental) differences between the two acres. Let,  $\hat{s}$  and  $\hat{v}$  denote the expected values of the officially provided compensation on accounts of  $s$  and  $v - v'$ , respectively. In view of the discussion in Section 3.1,  $s$  varies across individuals and its determination by a third party is impossible. Also,  $v - v'$  will vary across acres and its assessment is extremely difficult even if the state agents are sincere in their endeavor. This means that for farmers in the core, invariably  $\hat{s} \neq s$  and  $\hat{v} \neq v - v'$ , therefore,  $v + s \neq v' + \hat{s} + \hat{v}$  will hold, i.e., valuation of their own acre will be different from their valuation of the land in the periphery, even after factoring in the expected compensation. As demonstrated above, this difference has consequences for the reporting decisions. In generally, neither  $v+s$  nor  $v$  is necessarily a dominant bidding strategy, so these values cannot be inferred from the submitted bids. As a result, there are efficiency implications as well. To demonstrate, a callous approach towards determination of compensation will have adverse consequences not only for those who have to be relocated, but also for those whose land gets sold through the auction. If people apprehend that they will be shortchanged during the relocation process, there will be a tendency to under-report valuations; just like farmer 7 above, owners may prefer lower cash compensation, rather than facing the prospect of a painful relocation. If this happens, the land may get transferred to projects that are inefficient even on a utilitarian ground. Moreover, as discussed earlier, officially determined compensation invariably lead to litigation.

## 4. Voluntary Transactions versus Compulsory Acquisition

**4.1 *Is one superior to the other?*** The previous section shows that the compulsory acquisition of land is seriously deficient on the grounds of efficiency as well as fairness. Moreover, many of the seemingly less coercive schemes involving the use of eminent domain are not as innocuous as they sound. Such processes inevitably require the state to determine the form and the magnitude of compensation - on account of quality, location and other differences between the type of land surrendered by the owners and the one given to them as a part of land-for-land, and for the execution of R&R packages. Therefore, even if the state agents are honest and capable, these schemes are as vulnerable to disputes and litigation and prone to failures on efficiency as well as fairness fronts, as is the case with the extant law. The abuses of the eminent domain reported in the previous section show that the assumption of a benevolent state is completely misplaced to say the least, especially when it comes to acquiring land for companies. Indeed, the use of the compulsory acquisition laws by the state governments has come to be dictated by the political and private interests, in total disregard to the legitimate interests of small farmers, poor workers and other people dependent on the land.

Most of the problems associated with compulsory acquisition get precluded if the land is transferred through voluntary transactions. By its very nature, a voluntary transaction ensures that the land transfer takes place only if the buyer can put it to a more profitable use than the existing owner. Besides, the owner receives a price which is at least equal to his valuation of the land. This means, controlling for the third-party effects, a voluntary transaction is strictly more efficient and fair than compulsory acquisition; the latter can guarantee neither efficiency nor fairness of land transfer, even when the external effects are ignored. Moreover, a truly voluntary transaction takes place at a price that is agreeable to the parties involved. So, there is no scope for ex-post disputes and litigation over the price received by the owner. In contrast, under compulsory acquisition the price received by the owners is not of their choice; it is determined by use of arbitrary references, such as the circle-rates or the sale deeds.

However, voluntary transactions as a means of land transfer have two limitations. First, the buyers and sellers will typically ignore the third-party effects resulting from their transactions. This can be a source of serious concern. When agriculture land is put to non-agriculture ends, generally it affects a large number of non-owners – share croppers, agriculture workers, artisans, etc. In some cases, they end up losing their primary source of livelihood altogether. Nonetheless, the voluntary transaction between the buyers of land and the owner farmers will ignore these effects. Similarly, the voluntary transactions will generally not factor in the other third-party costs, such as damage to environment, etc.

However, as far as the third party effects are concerned, whatever measures are available under eminent domain to assess and mitigate these costs, the same can be adopted to regulate a voluntary transaction. For example, the buyer can be made to compensate the land dependent

non-owners by the same amount as would be the case under the eminent domain –the LARR bill has adopted some such measures. Similarly, whatever clauses are used to regulate the activity of the project developer buyer, the same can be used if he buys land through a voluntary transaction. So, as far as the third party effects are concerned, a voluntary transaction is as efficient and fair as eminent domain, when the same rules are applied under both processes. Here it is pertinent to discuss one more argument used to argue for the state intervention in land transfers. It is argued that there is a potential case for the state intervention from the seller's viewpoint as well. Absent the state protection, the sellers may end up getting a raw deal from the buyer (See, e.g., Banerji, at el 2007). For instances, when the buyer is a big corporation with strong bargaining power and/or better information about prospective use of land, but the sellers in contrast are small, dispersed and inadequately informed. In such circumstances, the state can intervene to protect the legitimate interest of the land owners. However, a similar protection can be provided to regulate voluntary transactions.

In view of the above, when the direct and indirect effects of land transfer are considered together, regulated voluntary transactions are more efficient and fair than the compulsory acquisition under eminent domain. Indeed, if there were well-functioning land markets, there will be no justification for the use of eminent domain. It is here that the second limitation of voluntary transactions becomes relevant. Voluntary transactions are vulnerable to various market frictions. The inertness of the market in agriculture land is attributed to high transaction costs on account of poor land records, and most importantly to the hold-up by the sellers/owners. It is the fear of strategic hold-up by the self-interested sellers - who want to extract an undue share of the surplus from the buyer - that is used to justify the state intervention and the compulsory acquisition of land.

**4.2 A Few Transactions in Agriculture Land: Is it all hold-out?** While the property market in and near urban areas is very active, transactions in agriculture land in rural areas are rather infrequent. Certainly, high transaction costs owing to the poor land records and other market frictions limit the frequency of transactions in the agriculture land. However, there are other more crucial factors that severely restrict the scope of voluntary transactions in agriculture land. First of all, there is limited scope for a profitable transaction, as long as the land is to be used for agricultural purpose. While a potential buyer's valuation generally depends on the economic gains from the land, for the seller its worth depends on the economic as well as personal considerations discussed above. To use an earlier description of the individual valuations, while the seller cares for  $v+s$ , the buyer is primarily interested in the first component of valuation. A transaction over a land parcel is likely to come about only if its economic value to the buyer is much more than to the seller. However, there is limit to which the economic worth of agricultural land can vary across individuals. Since, the profitability of agricultural land does not vary considerably with the size of the holding; if anything, the data indicate existence of an inverse

relationship between the productivity and the size of land holding.<sup>19</sup> That is, the buyer's valuation, say  $v'$ , does not vary substantially across buyers. This means, generally, the buyer's valuation,  $v'$ , does not exceed the seller's valuation  $v+s$ . So, it is not surprising that very few transactions are observed wherein the seller and the buyer use the land for agricultural purpose. To the extent productivity differences arise - on account of differences in the access to banking system, labour-land ratio and technical/mechanical endowments of the parties - there is empirical evidence suggesting that these factors do play significant role in explaining whatever little transactions are observed in agricultural land.<sup>20</sup>

Presumably, major productivity differences arise when an agricultural land is used for non-agricultural purposes, say to set up an industry or develop a housing complex, etc. However, the use of agriculture land for non-agricultural purposes is subject to several regulations. The decision makers use these regulations to extract rent from the project sponsors. As is demonstrated in the following section, it is these obstructive regulations that are responsible for the absence of frequent transactions involving transfer of agricultural land to other developmental activities. When granted exemption from them, the project developers have been able to buy large tracts of land through voluntary transactions. Here are some illustrative examples.

The developers of Gurgaon SEZ have been able to buy several pockets of hundreds of acres of contiguous agricultural land directly from the owners.<sup>21</sup> Similarly, the promoters of the Kakinada Special Economic Zone in Andhra Pradesh have bought as much as 4800 acre by directly negotiating with the farmers.<sup>22</sup> In Maharashtra, the Navi Mumbai SEZ developers have been able to buy several thousand acres through voluntary transactions.<sup>23</sup> The GMR group for its Chhattisgarh project has purchased the 428 acres that it needed directly from the villagers. Indeed, there are several other examples also where the project developers have successfully purchased hundreds of acres directly from the owners.<sup>24</sup>

These examples show that the seller hold-out is not inevitable even for large projects, provided a facilitating environment is created; arguably voluntary transactions are much more likely to succeed for small projects and those that have flexibility about the location. Therefore, it is not

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<sup>19</sup> For discussion on this issue and survey of relevant literature see Gaurav and Mishra (2011).

<sup>20</sup> See Deininger, Jin, and Nagarajan (2007).

<sup>21</sup> This is not to say that any amount of land can be purchased through voluntary transactions. The SEZ project has got stuck since the developer has failed to get the needed 10,000 acres of land, all contiguous.

<sup>22</sup> See 'ONGC preparing ground for Kakinada refinery, SEZ', available at '<http://hindu.com/2006/12/15/stories/2006121508510300.htm>, accessed on January 6, 2012.

<sup>23</sup> 'RIL deals directly with farmers for SEZ land in state' at [http://articles.economicstimes.indiatimes.com/2007-01-15/news/28483538\\_1\\_maha-mumbai-sez-purchase-land-stamp-duty](http://articles.economicstimes.indiatimes.com/2007-01-15/news/28483538_1_maha-mumbai-sez-purchase-land-stamp-duty). Accessed on November 28, 2011. Also, Status of MSEZ on <http://www.docstoc.com/docs/26228984/MAHARASHTRA-SEZs> accessed on January 6, 2012.

<sup>24</sup> For more examples see "Who tilled my land and ate my pie?" at <http://www.rediff.com/business/slide-show/slide-show-1-special-who-tilled-my-land-and-ate-my-pie/20110629.htm>, accessed on October 20, 2011.

plausible to attribute the lack of transactions in agriculture land only to the seller hold-out or other market-frictions. Such a misbelief can only serve to justify an excessive use of the compulsory acquisition laws.

It must be granted that there is risk of hold-up for really large and the location specific projects. However, even for this set of projects the choice of compulsory acquisition is not immediate. There is a trade-off between the inefficiency on account of hold up, on one hand, and the earlier discussed inefficiency associated with the use of eminent domain, on the other hand. Moreover, the hold-up risk for large projects can be reduced substantially by lowering the transaction and the regulatory costs currently associated with land deals. The next section is devoted to these issues.

Also, the threat of hold-up has been overplayed in the traditional economic literature. The literature has posited the land assembly as a sequential purchase game. That is, the buyer approaches one owner at a time, buys his land, and then goes to the next owner. This means that by the time buyer negotiates for the last set of parcels, she has already invested large stakes, thereby falling hostage to exorbitant demands from the owners of the remaining plots. However, sequential purchase is not the only option available to the buyer. Some of the possible alternatives are discussed below.

## **5. The Way Forward**

As demonstrated in previous sections, the use of the eminent domain even for partial acquisition and in its most benign forms providing land-for-land and R&R packages - is vulnerable to failure on the efficiency as well as fairness fronts. Moreover, it is inherently litigious. Therefore, instead of expanding the scope of the compulsory acquisition, as is the case with the LARR Bill, there is a need to reduce it. At the same time, voluntary land transactions need to be facilitated by removing institutional and regulatory hurdles that thwart a large number of voluntary transactions. This section offers some remedial measures.

At present, the use of agriculture land for other purposes requires what is called the CLU clearance from the state government, among many other regulatory clearances from the local authorities. Some of these regulations make the large scale purchases of land say for setting up of a big industry, totally impossible. To illustrate, the land ceiling regulation limits the size beyond which agricultural land cannot be owned. So, a project developer cannot buy and own agriculture land in its current use beyond this limit, which varies from state to state. Moreover, it is not possible to buy the required land by appealing to an alternative use (so as to avoid the ceiling regulation), since to get a CLU clearance the project developer should possess the land beforehand. Therefore, the developers of big projects have no other option but to 'persuade' the state government concerned to acquire the land.

Even when the land required for the project is within the permissible limits of the land ceiling rules, the regulatory hold-up is an equally serious issue. The other regulatory clearances are one of the primary sources of the rent seeking by the state politicians and bureaucrats. The formal and informal (kickback) costs of these clearances, especially the CLUs, are said to be a significant component of the project costs. For the real-estate projects and also for small and medium sized industrial projects these costs are comparable to the cost of land itself.<sup>25</sup>. Unsurprisingly, these ‘regulatory’ costs preclude a large number of potentially profitable transactions. Moreover, they put heavy downward pressure on the price of transactions that still remain feasible, and thereby affect the distribution of surplus against the farmers.

To see how, suppose there are two entrepreneurs. Each needs to buy one acre of land for her project. There are two farmers willing to sell their land. Each farmer values his (infra-marginal) acre at 80 lakhs. However, while the first entrepreneur finds each of the above acres of land worth 100 lakhs, the second one considers it worth 110 lakhs. In the absence of any regulatory costs, there is scope for two mutually beneficial transactions; each involving one of the farmers and one of the entrepreneurs. But, if the ‘rent-seeking’ costs of land use clearances are 25 lakhs per-acre, then the first entrepreneur’s net gains from the land are reduced to 75 lakhs, which is less than the farmers’ valuation. Consequently, a profitable transaction between the first entrepreneur and any of the farmers becomes impossible. In contrast, a gainful transaction between the second entrepreneur and any one of the farmers is still possible. However, now the entrepreneur would not pay more than 85 lakhs, i.e., his valuation of the land after factoring in the total regulatory costs; otherwise, he would have ended up paying any price up to 110 lakhs, depending on the bargaining skills of the farmer.<sup>26</sup>

Indeed, a large set of otherwise feasible transactions gets ruled out not due to the hold-out by the sellers but by the regulatory hold-up. This regulatory hold-up has greatly added to the tendency among project developers to bribe the state government concerned to use the eminent domain. When land is compulsorily acquired and given to a private company in the name of a public purpose, the CLU clearances are not needed or are provided along with the land. Therefore, the project developers are better off bribing the powers that be and get it to acquire the needed land. In fact, this route has had added advantage for the project developers. As the land price under eminent domain has been much lower than the market price, the developers have been getting land at a rate much cheaper than they would have ended up paying under voluntary transactions.

Things can be much better if the institutional and regulatory infirmities are set right. The large scale purchases of land by the developers, as discussed in section 4.2, became possible only due

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<sup>25</sup> See The Economic Times, ‘What's wrong with the real estate sector in India’, accessed on November 28, 2011 at <http://economictimes.indiatimes.com/markets/real-estate/realty-trends/whats-wrong-with-the-real-estate-sector-in-india/articleshow/8786642.cms>.

<sup>26</sup> Also note that the official rent seeking reduces the competition among buyers.

to the fact that the project developers were granted exemptions from the CLU and other regulations. There is need to replace the discretionary and devious CLU regulations with transparent, objective and ex-ante zoning regulations setting different zone for different activities. As long as the land is used for the purposes permitted by these regulations, the state should have no role in further governing transactions.

The transactions cost of direct purchases can be reduced greatly if the ownerships are well defined and land records are clear and verifiable. The poor land records and the resulting litigation have held back not only development of an efficient land market, but the overall development of the economy. There is urgent need to update and digitalized land records related to the ownership as well as the type of land. These records should be tamper-proof and made available publically, so that they can be used by the owners, the potential buyers and the courts for verification of titles. There should be a real-time coordination between the agencies responsible for registration of land deals and those responsible for maintenance of land records. These measures as such will go long way in facilitating voluntary transactions by clearing uncertainty of over the ownership.<sup>27</sup> As for large projects, it is also conceivable to not to let any legal dispute over ownership obstruct the project, if the ownership at the time of purchase was not in dispute.

Collective bargaining with the owners or their representatives seems to offer another important channel for reducing the transaction cost. There are instances wherein the owners themselves have taken initiatives to pool and provide contiguous land. For example, more than 1,000 farmers from Avasari-Khurd villages along the Pune-Nashik pooled together about over 2,665 acres to form a special purpose vehicle to set up a multi-product SEZ.<sup>28</sup> Indeed, there is a need to encourage collective bargaining. Besides, rather than focusing on transfers of land ownership itself, it will help to create a facilitating environment for lease agreements over the land.<sup>29</sup> In addition to increasing availability of land for developmental purposes, such agreements have advantage of permitting sharing of ownership benefits over time thereby making farmers stakeholders in the project rather land losers. Magarpatta City, a 400 acres complex developed by a co-cooperative of farmers is an illustrative case in point. Other possibilities also exist.<sup>30</sup> It will also help to legalize the contingent contracts for land deals. Under these contracts, the project developer can negotiate a 'future sale contract' with each owner. If the developer actually buys the land, the agreed price is paid to the owner; otherwise, the developer pays a small compensatory amount to the owner to cover the time and negotiation costs incurred by the latter.

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<sup>27</sup> Moreover, the will help small farmers by easing the credit-market frictions for them, and will enable better targeting of government welfare programmes.

<sup>28</sup> See 'Farmers to set up own SEZ near Pune' at [http://articles.timesofindia.indiatimes.com/2008-01-19/india/27773144\\_1\\_sez-avasari-khurd-village-barren-land](http://articles.timesofindia.indiatimes.com/2008-01-19/india/27773144_1_sez-avasari-khurd-village-barren-land). Accessed on November 28, 2011.

<sup>29</sup> For some possibilities in this regard see Arun (2011).

<sup>30</sup> On the merits of participatory development see Bhaduri and Patkar (2009).

These contracts will not eliminate the problem of hold-up altogether, but they can surely reduce its intensity.

The problem is that these initiatives can be undertaken only by the state government concerned; since the land, its usage, and the contracts over land are all in the *state-list*. But, as discussed above, the decision makers in the state governments do not have incentive to reduce the scope of eminent domain. Serious thinking is required to incentivize the states to undertake the above reforms. Fortunately, the land acquisition is in the *concurrent-list*. This means that there is room for a centrally enacted land acquisition law to help in the process and thereby reduce the potential for misuse of eminent domain. In particular, the central law can determine the scope and dictate the terms for compulsory land acquisition. Some helpful measures are proposed in the next section.

In the recent past, states have exhibited a strong tendency to use assembled land to attract big projects. Several states have competed with one another in offering lucrative land deals to the developers, leading to a race to the bottom. The LARR in its present form does not address this serious issue, though it is imperative to do so. International experience shows that neither the sellers hold-out nor is land scarcity the leading cause for this race to the bottom.

It is instructive to note that the use of the eminent domain for private projects is more frequent and controversial in the land abundant US than in the relatively land scarce and population dense England! How so? The local bodies in the US as well as in England have incentives to compete with one another to attract projects. However, in England there are several effective constraints on the use of land for the purpose. While the land acquiring authority is a local body, the power to grant permission for the use of eminent domain is a central authority. This authority, which is the office of the Deputy PM of the UK, makes sure that the local authorities do not engage in a race to the bottom. Moreover, before initiating the land acquisition process, the local authority has to publish, discuss and get the development plan approved by the local legislation. This means that for a local authority to be able to use the eminent domain powers, it has to prove preponderance of benefits over the costs resulting from the project at hand. A great advantage of this process is that the crucial issues, like desirability of acquisition, alternative locations, etc., get resolved beforehand. In contrast, in the US similar constraints on the use of eminent domain are amiss.<sup>31</sup> As a result, while the compulsory acquisition for private projects has become highly contentious in the US, by comparison, the authorities in England have rarely encountered resistance to compulsory acquisition.

Apart from the above measures, it is crucial that the entire cost of compensation is paid by the entity benefitting from the acquisition. Moreover, the compensation amount should be increased

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<sup>31</sup> For more on the comparison of the use of eminent domain in the US and England see Allen (2008) and Malloy (2008).

substantially. While it is almost impossible to determine and provide compensation equal to the valuation of land to its owners, it seems better to err on the higher rather the lower side. As discussed earlier, when compensation is different from the individual valuations, acquisition are very likely to be inefficient. However, this risk is much higher if the compensation is generally less than the individual valuations. Since, if the compensation rate appears to be too high, the developers can always choose to go for direct purchase from the owners. The LARR bill provides for an increase in the compensation. However, the proposed approach is rather faulty, a point discussed in the next section.

## **6. The LARR: Additional Critique and Suggestions**

The LARR Bill has several laudable provisions. The most important is the creation of a legal entitlement to compensation and R&R not only for the owners but also for all other livelihood losers. All the same, the bill fails to address the above discussed fundamental causes behind the disputes and litigation over compulsory acquisition. Moreover, it opens up several backdoors for the state to favour companies at the expense of farmers' rights and livelihood of forest dwellers.<sup>32</sup>

True, the Bill has drastically reduced the scope of the notorious emergency clause. However, as is demonstrated in the Section 2, the excessive use of the emergency clause is but one of the several abuses of the extant law. As mentioned earlier, others abuses involve covertly diverting of the acquired land to companies, adoption of pick-and-choose method during acquisition, and the misuse of the de-notification clause to exempt land belonging to the powerful.

Under the proposed law the states can continue with these practices unabated. Doubtful? Consider the following provisions in the bill. Section 69 allows the states to change the purpose for which the acquired land is finally used, that is, the public purpose can be changed after acquisition. Furthermore, Section 70 gives them unbridled power to transfer an already acquired land to private companies and individuals in the name of public purpose, as long as 20 percent of the resulting profit, if any, is shared with the original owners. As if this was not enough, Section 61 allows for mid-way de-notification as well! These provisions together give the states untamed powers to acquire land in the name of some public purpose and transfer it to companies. As to the sharing of 20 percent of the profit with the owners, the ministry seems to have learnt nothing from the insidious manipulation of accounts by companies.

As demonstrated in the above sections, the incentives to misuse the state force for land acquisition are especially pronounced for the private projects. Therefore, the public-versus-private distinction is important. The scope of compulsory acquisition for private projects needs to be reduced drastically. The use of the eminent domain for private projects should be restricted to large projects, by providing a lower limit for government intervention. As the examples

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<sup>32</sup> For some other criticisms of the bill see Chakravorty (2011), Ramanathan (2011), and Sarma (2011).

produced in Section 5 show, the seller hold up is not a serious concern for small and medium size projects. On top of it, these projects have flexibility as to where they can be located. Unfortunately, the all-encompassing lists of public purpose activities in Sections 2(n) and 2(y) of the Bill dilute the crucial public-versus-private distinction. Thereby, the bill allows the states to intervene in acquisition and transfer of land to companies for all sorts of essentially private activities.

For large projects there is a need to control the race to the bottom among the states. Given the federal structure of Indian politics, it is neither feasible nor advisable to have a central authority empowered to approve compulsory acquisition. However, it will help if the new land acquisition law provides an independent state level institution to discuss all relevant project details pertaining to its size, location, costs, benefits, form of compensation, R&R package, etc. Such a discussion should be a prerequisite to the start of the acquisition process. The LARR bill provides for a 'Land Acquisition Rehabilitation and Resettlement Authority,' (LARRA) as a supervisory authority. But, LARRA's role comes into play only ex-post. Moreover, most of the crucial decisions pertaining to Social Impact Assessment, R&R, etc. have been delegated to committees comprising of state level bureaucrats whose past performance leaves much to be desired. It is important that the final reviewing authority for crucial matters like SIA and R&R is an independent and representative body.

As Section 3 shows, litigation is a wasteful and socially regressive way of granting compensation. There is nothing substantial in the Bill to change the vicious cycle of litigation and the resulting wastage of private and public resources. The Bill unleashes conflicting forces in terms of incentives for the affected parties to litigate, and thereby further complicates matters. To put things in perspective, Section 25 of the existing LAA mandates that the court awarded compensation cannot be less than the LAC awarded compensation. The Bill, in contrast, provides no such safeguards to the litigant owners. So, under the proposed law, in principle, the court awards can be less than the LAC awarded compensation. Therefore, it makes the choice of litigation a riskier proposition for the affected parties. However, this aspect of the new law per-se is not going to make it any less litigious, since there is nothing in the Bill to make the LAC determine compensation carefully. The LACs will continue to play it safe by awarding compensation on the basis of the low valued sale-deeds or the circle-rates. This means that the tendency of the affected parties to litigate the LAC awards will remain undiluted. Moreover, during litigation only the owners can dispute the compensation awards - the government cannot question its own decision. Therefore, guided by the legal principle of the *prohibition of reformatio in peius*,<sup>33</sup> a court has to decide whether compensation can be increased or not. In this scenario, the court awards can be higher or at worst equal to the LAC awards, even in absence of

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<sup>33</sup> The legal principle of the *prohibition of reformatio in peius* does not allow a decision at appeal to put an appellant in a worse position than it was in under the impugned decision. The principle is generally applicable to the appeals against executive decisions.

an explicit provision in the law. So, the acquisition affected people will continue to litigate. All that the bill does is replacement of the ADJ court with a ‘Land Acquisition Rehabilitation and Resettlement Authority,’ (LARRA) to adjudicate compensation related disputes. Substitution of one adjudication authority with another cannot reduce litigation.

If anything, litigation is likely to intensify further. The Bill requires the compensation, including solatium, to be *four* times the market value of the land for the rural areas; and two times the market value for urban areas. That is, for purpose of compensation the multiplier has been raised from 1.3 under the current law<sup>34</sup> to 2 and 4 for the urban and rural areas, respectively. To see why the increased multiplier will further intensify the litigation, consider an agriculture land measuring just 100 sq-meters. Under the extant law, since the multiplier is 1.3, if compensation is determined using a sale-deed rate of say Rs 1300, instead of circle-rate of say Rs 1000 per-sq-meter, the total compensation will be higher by Rs 39,000. In comparison, under the proposed law since the multiplier is four, the compensation amount will go up by Rs. 1,20,000! So, under the proposed law the gains from litigation will be much more than is the case under the existing law, given the proclivity of the LACs and the courts to use a different basis for determining compensation. The basis of determining compensation – circle-rate versus sale-deeds, one sale-deed versus the other – becomes increasingly crucial and worth litigating, as the land size and/or the difference among sale-deeds and circle rates increases. In fact, people privy to the official decisions can profit by ‘engineering’ the high value sale-deeds ahead the acquisition, as these sale-deeds can be used to get higher compensation.

In order to avoid litigation, it is important that the initial compensation itself is determined in view of all of the relevant information, such as records of the sale-deeds, land-type, its future value, etc. All this information should be required to be shared with the affected parties before compensation awards are made. Here, it will help if the compensation is determined by an independent agency. This agency should be required to use all of the above mentioned data relevant for determining compensation. Moreover, the agency can be made responsible for fixing and updating the circle-rates, in keeping with the increasing value of the land. If not updated regularly, the circle-rates can remain low relative to the value of the property and become even lower with the passage of time. Therefore, the compensation can remain less than market value, even if it is set at a level several times the circle-rate.

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<sup>34</sup> Under the LA Act 1894, the compensation is fixed at the market value –determined on the basis of circle rate or the sale deeds- *plus* a solatium of 30 percent, that is, the total compensation is 1.3 times the market value.

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