

1 Background

1.1 Introduction

Land is more than an asset; it is related to various facets of life. Beyond its role as a key factor of production it also performs an essential role as an insurance device and a social safety net.¹ Although the role of land as a major source of income diminishes with socio-economic development and technological advancements, land still remains an important element of life. Land ownership can provide access to credit which enables households to make indivisible investments they would otherwise not have been able to undertake.² Ownership of land was reported to be important also as a major player in building democracy, settling civil unrest and in reducing urban criminality.³ Where labor markets are imperfect or absent, ownership of land can help households to make effective use of family labor.⁴

The way in which the property rights of land are defined and documented, the rights and obligations they convey and the extent to which they facilitate the exchange of land through rental or sales markets have important consequences not only in productivity but also for the social organization and the establishment and stability of democratic institutions. In this research, the author will argue that it was the failure of policy makers in ignoring the multi-faceted nature of land rights that may have resulted in politically unacceptable land policies.

Successful economic policy involves the development of and commitment to strategies that can reduce social gaps and establish economic, environmental and political sustainability. A central issue therefore is to investigate whether a strong concentration of wealth or a wealth-redistribution policy could -in the long term- either exacerbate or ameliorate inequalities. Unfortunately, upward redistribution (i.e. towards a greater wealth concentration) was a characteristic of many Latin American countries through the 1980's, especially where countries adopted "Washington-Consensus-style" stabilization and adjustment

¹ See Deininger, Jin, Adenw et al. (2003).

² See Galor and Zeira (1993), Banerjee and Newman (1993)

³ Alesina and Perotti (1996) argue that (asset-) inequality can lead to less political stability and increased violence. See also Bourguignon (1998); Fajnzylber, Lederman, and Loayza (1998) for studies on the growing national costs that society experiences through increasing violence, not only in terms of direct costs in lives and medical resources, but also in terms of (public and private) opportunity costs.

⁴ See Burgess (2001).

programs.⁵ Regrettably, because of past development and stabilization strategies in El Salvador, the income distribution has generally worsened and exacerbated poverty, fueling tensions, producing a civil war that raged throughout the 1980's.

This document argues that the case of El Salvador can be utilized to illustrate how short-term efficiency goals (related to land and income concentration) cannot attain sustainability. If equity (related to agrarian reform) had been considered earlier, serious reductions in efficiency (due to war) could have been avoided. Therefore, it can be argued that in El Salvador, a prolonged period of short sighted views in pursuing efficiency aims drove the country to civil war with extreme impacts on society and infrastructure. Furthermore, there is a broad consensus among Salvadorian politicians and academics that a significantly unequal access to land is the principal source of endemic poverty of 73 percent of the Salvadorian population living outside the San Salvador metropolitan area, widely defined as rural.⁶

The objective of this research work is to gauge at the empirical level the relationship between policies related to asset distribution, institutional change and economic development. In order to achieve this, the question of whether improved (land-) equity and increased efficiency can be compatible rather than conflicting is located as focus point of the research work.

In El Salvador, the role of land in economic development and political power during different periods has given rise to the existing forms of land use and tenure. The study of land tenure and power structure should therefore include an analysis of the ways in which the relationship between individuals and their environment (natural, economic and political) has altered in response to exogenous changes. This situation certainly fluxes as the economic and political conditions change within and outside the national boundaries.⁷ The following chapter provides a review of the conjectural situation that led to the last of the agrarian reforms in El Salvador. It tries to provide a descriptive, institutional economic analysis of the relevant agrarian issues and the immediate and subsequent economic and distributive consequences. This research does not concentrate on a historical analysis; instead, it uses the economic historical theory, as proposed by Douglas North,⁸ to enhance the understanding of the historical situation that led to the unfavorable distribution of land and its impact on insufficient democratic representation, isolation and impoverishment.

⁵ For reviews of the distributional experience of Latin America over the 1980s period of adjustment, see Pastor and Dymski (1990) and Paus (1994). For information about the Washington Consensus please refer to Stiglitz (1998).

⁶ See Boyce (1996)

⁷ See North and Thomas (1971), Posner (1980)

⁸ See North (1981), North (1973)

The evolution of the social arrangements of land ownership and political representation are very important issues, especially if it is taken into consideration that the widespread consensus among historians and economists specifies that the extreme inequality of land distribution in El Salvador led to the civil war of 1980.⁹ The agrarian structure of the 1980's that preceded the civil war was established by a massive eviction of small landholders and existing producers because of the increased demand of land to grow coffee during the second half of the ninetieth century.¹⁰ This situation was later aggravated by the increased demand of land for extensive crops in the lowlands to produce sugar cane, cotton and for extensive cattle ranching.

It has been widely accepted by historians and academics alike that in the El-Salvadorean tenure struggle both, the large landholdings (*latifundio*) and the small landholdings (*minifundio*) were required factors for the agrarian structure.¹¹ In the following chapters it will be argued that due to the expansion of agricultural production towards large landholdings, *campesinos* did not have any choice but to cultivate marginal slopes¹² or to work as seasonal workers during the harvest period in order to increase their income.¹³

The various attempts to reverse the unequal land distribution culminated in the land reform of 1980.¹⁴ In its original form the decrees expected a radical change in the agrarian structures, however the reform had to be changed and adapted as an instrument to try and stop the emerging armed conflict. Despite these efforts, a civil war broke out because of the poor targeting of the beneficiaries, who mainly consisted of the already better off former permanent workers of the plantations.

The outbreak of civil war could not be stopped, nor the disastrous economic and social consequences that followed it. In the end the 1992 Peace Accords included, as a third agreement, a land distribution program.¹⁵ A review is

⁹ See Strasma (1989), Conning, Olinto, and Trigueros Arguello (2000), Dada-Hütt and Hernandez (1997), Dijkstra (1993) p. 53, Pelupessy (2000) p. 24

¹⁰ See White (1972), Browning (1975)

¹¹ See Diskin (1989), Pelupessy and Ruben (2000)

¹² See Salinas (1993) for the origins and implications of agriculture on slopes and marginal land in El Salvador.

¹³ Another option for this group of landless farmers was to emigrate, first to Honduras and later to the USA. The large landowners could use this land shortage to lock in landless individuals by offering them a piece of land in exchange for loyalty and a secure labor offer during the labor intensive seasons. This system of land use and tenure was maintained throughout the entire country and was stabilized with the help of the military since the 1932 repression until the first agrarian reform that developed following a military coup in 1979. See Dijkstra (1993)

¹⁴ The proclamation of the Decrees 143 and 144 in 1980 initiated the agrarian reform

¹⁵ Other elements were a judicial reform and a reform of the military and police.

presented of the land tenure development since colonial occupation using economic theory to study the main historical changes in land eviction that the rural poor experienced.

Given the previous violent conflicts evidenced under undemocratic experience and political instability in the country, maintaining peace does not only require an economic stability that an open economy offers, but it also requires an active income distribution and poverty alleviation.¹⁶ In other words, policies that promote both **growth and equity** are needed. Policies of this orientation are something new and it is only until recently that these policies have been researched and evaluated.

The decade of the nineties was full of discussions about macroeconomic reforms aiming precisely at **poverty reduction and growth** through the solving of chronically deficient fiscal, monetary, competition and trade policy problems. These reforms, widely known as **structural adjustment programs**, were mainly prescribed by international financial organizations, IMF and World Bank being the most prominent ones. They included an overhauling of the fiscal, monetary and judicial systems.

During these reforms, products, financial services and other factors markets, were liberalized. In the case of land market reforms in particular, the most commonly used policy instrument was a generalized program of land titling, which tried to clarify land rights of smallholders.¹⁷

It was anticipated that the resulting benefits of a functioning land market would be the appropriate instrument to transfer income and provide economic growth among the urban and rural dwellers.

As a logical result of such a paradigm change, the development of sale and rental markets was hence to solve the remaining „land question“.¹⁸ The expected benefits were twofold:

- Large landholders would supply additional land through sale and rental market, land which otherwise would not have entered the market because

¹⁶ See Binswanger, Deininger, and Feder (1995), Deininger, Olinto, and Maertens (2001)

¹⁷ These reform measures were and remain common for many Latin American countries which have established large-scale collective or cooperative enterprises as part of earlier land distribution programs. See Deininger and Squire (1998); and Deininger and Binswanger (1999)

¹⁸ The argument is that the market will operate in such a way that it will allow the more efficient to gain access to land. Eswaran and Kotwal (1986) provided the theory of hyper-competitiveness of small landholders due to the non-contractibility effort and reduced supervision costs. Thus, family managed farms should be the winners of policies of liberalization of restrictions in the land market.

of the risk of land dispossession in case of ownership disputes. Thus, an increased and better access to farmland would follow.¹⁹

- Credit supply would increase as small holders would be able to present collateral to satisfy credit requirements. Due to lower risk in lending to land owning households, the supply of credit would increase. New banks and other private lending institutions would enter the market and the flow of capital to the rural sector would increase as a result.²⁰

As a principle, any policy that reduces poverty in rural areas can be regarded as good. The effect of the presented programs on the rural poor is widely unknown, as they have not yet been researched. The goals presented by these reforms, which in theory could lead to a higher tenure security for small landholdings through an increased ownership of land by the agrarian reform beneficiaries, are manifold. These, among others, are:

- An increase in agricultural productivity leading to higher individual and national income.²¹
- Poverty reduction through the redistribution of wealth and assets.²²
- Environmental protection through the use of sustainable production systems on private lands.
- A greater political and economic stability and therefore social peace at least in the long run as a result of the reduction of poverty and increased equity.²³

The reforms in El Salvador have concentrated on the reform and reduction of laws regulating rural land use and ownership rights and with it a free market is considered as the proper and unique arbiter of social efficiency.²⁴ However, these expected results have not occurred. Many of the expected benefits of the titling programs have not occurred either. It has been widely assumed that the institutional change associated with change in tenure form could improve the welfare of the rural poor.

¹⁹ Deininger (2001) argues that the market-led land reform includes above all the securing of property rights and conflict resolution mechanisms, which enhance the supply side of the land market. See also Deininger and Jin (2002)

²⁰ See Carter and Olinto (2003), Feder and Chalamwong (1988)

²¹ See Binswanger, Deininger, and Feder (1995), Deininger and Kirk (2002), Feder, Onchan, Chalamwong et al. (1988)

²² See Deininger, Olinto, and Maertens (2001)

²³ See Alesina and Perotti (1996)

²⁴ Because of this, the solving of the classical “agrarian question” (i.e. how the less well off will gain access to land) is left to the market.

This latter point of view was a more controversial one. Thus, whether liberalized rural land markets will work in favor or at least in a neutral way towards the poor (in a way that they enhance income), remains a question.²⁵ This research aims to use the case of El Salvador for a **“real-world” assessment of the impact of land policy changes** that is likely to be superior to what can be obtained from hypothetical studies that have, up to now, largely formed the basis for policy recommendations in this area. A “real world” assessment of the impact of the policy change in various dimensions will address the complexity of the issue and is more likely to respond to the need of policy makers as it will focus on both: land-redistributive and land-tenure changes.

Since the nineties, a series of reforms prescribed by international organizations have been implemented with the objective of stabilizing the economy. For the agricultural sector, this meant a reduction of taxes on agricultural imports, the liberalization of financial services and produce price in the agricultural market and the reinforcement of land markets as an alternative to land accessibility for poor *campesinos*.

These policy instruments contrast sharply with previous policies that focused on a high degree of government involvement in the provision of credit and setting of produce prices. The idea behind this market liberalization was that if the “*pro-indiviso*” (collective land tenure form) was to be partitioned, the beneficiaries could have access to credit by themselves and the government could rely on private institutions to provide the households with credit. At the theoretical level, **individual land titles should enhance productivity as a result of increased tenure security**, while at the same time changes in economic policy towards less governmental involvement would allow the commercial banks to allocate their resources free of political interference.

Notwithstanding changes in land tenure rights towards **individual land titles** the agricultural sector presents **below average performance** especially vis-à-vis the development of the other sectors of the economy. In a report from the World Bank²⁶ the growth of the agricultural sector had not only stagnated in comparison to other sectors of the economy, but was the only sector that showed negative growth rates, an indication that the agricultural sector had not benefited as much from the economic reforms as other sectors had. As agriculture is the

²⁵ Note that it is not only the case of El Salvador but also the case of many other Latin-American countries where there is a need to analyse the conditions and impediments that have restricted the compliance of results of the land titling programs that followed the distribution of land after the peace agreements. This phenomenon of land titling and privatization is not particular to El Salvador but has also occurred in several Latin American countries with different grades. See Deininger (1999) for the cases of Brazil and Colombia. See also Carter and Chamorro (2000)

²⁶ See World Bank (1998)

main economic activity in rural areas, it appears that the process of economic reform towards more liberalization is less beneficial to rural areas than to urban areas.

This might be due to the high level of poverty in rural areas. According to the World Bank, 45 percent of rural dwellers live in poverty and 20 percent in absolute poverty. This balance shows that the current economic policy has a bias against agriculture and therefore against rural areas. Thus, the economic policy in its actual form will not accomplish the goal of reducing poverty in rural areas, which was the primary objective of the agrarian chapter of the peace agreements.

This situation of increasing poverty among beneficiaries of former agrarian reforms in rural areas can be considered worrisome, especially if the devastating consequences of the civil war that lasted many years are considered from both social and economic standpoints. The outcome of the peace agreements should therefore be monitored in order to enhance economic and social development.

Considering the lack of democratic roots, former experiences with civil unrest due to inequity and poverty and increasing crime rates in urban areas, it is necessary to study those aspects of the situation that inhibit the economic development of the population involved. The economic reforms of liberalization and openness that aimed at agricultural productivity through liberalization of the economy and enforcement of land markets²⁷ have resulted in the separation from stated economic benefits and that they have further impoverished the rural population in general and the agrarian reform beneficiaries in particular.

It is unclear whether the benefits of a liberal agrarian policy enhance or diminish the **benefits of land ownership** and institutional change gained by the beneficiaries of the agrarian reform. If the benefits are diminishing, then a search for the **countervailing market failures** will provide valuable information in order to solve the problems of poverty among rural dwellers in general and agrarian reform beneficiaries in particular.²⁸

Questions about the outcome of a process of **institutional change**²⁹ must be considered. Recent studies show that in the presence of countervailing market failures which strongly bias against low-wealth individuals (i.e., do not provide the same opportunities to all market participants), the possibilities of the land market to convert itself into an instrument of development and poverty reduction depends on its capacity to efficiently distribute the productive resources.

²⁷ The liberalization of the land market according to the policy statement will transfer land to the most productive farmers on the policy statement

²⁸ This is important because the land distribution program and the subsequent partition of the “pro-indiviso” could result in an instrument to expropriate the land of the LTP beneficiaries.

²⁹ Here I refer to the transfer of individual property rights with full transfer rights.

Otherwise, the effect of the newly emerged land market would be detrimental to the welfare and the socioeconomic development of the agrarian reform beneficiaries.³⁰

Partly as a result of an unequal distribution of assets, several Latin American countries have implemented a series of policy reforms since the 1980's which concentrate on openness, competition and deregulation with a clear policy statement manifesting that the market should be responsible for the allocation of resources.³¹ These policies of economic openness used in the research region, contrast sharply with the economic isolation of the two previous decades which were characterized by protectionist policies. The market mechanisms of the new policy for efficient resource allocation and growth should therefore provide the key for positive implications for poverty reduction.³² It is also relevant to point out that these reforms took place under democratic rules, while former changes in economic policy were accompanied by civil unrest. It is possible to argue that the policy mix (redistribution, openness and deregulation of factor markets) does not have a bad intention, but as the policy makers have to embrace the same information difficulties faced by other market participants, the policies need to be refined for current and local market conditions.³³

Today, this double objective is being tackled with a package of reforms that includes almost every sector of the economy and that was spearheaded by donor organizations.³⁴ The reforms include improvements in different parts of the economy ranging from financial services to the land market and even telecommunications. These market reforms expect that the liberalized markets will improve the productivity of the economy in general and in particular the agricultural sector and secure as well as enhance the land accessibility of the less well off. As previously presented in the agrarian sector, they include the partition of *pro-indiviso*. This partition does not face any difficulties because of the poor popularity of the mentioned tenure form.

It is of key interest to this research to therefore examine how the liberalized rural property rights and the factor markets work for the poor while increasing their income, land accessibility and wealth accumulation potential as well as promoting more efficient resource allocation. As similar reforms have taken place in other Latin-American countries and as land issues are increasingly

³⁰ In doing so, the need for understanding policies goes beyond the limits of neo classical theory. Institutional aspects will be used for this study in order to help explain the market failures reducing the opportunities of the LTP-beneficiaries to improve their welfare.

³¹ See Deininger and Binswanger (1999)

³² See Carter (2000)

³³ See Deininger, Jin, Adenw et al. (2003), Deininger and Kirk (2002)

³⁴ In the particular case of El Salvador, these reforms took form notably after the prescription done by Lopez (1998)

debated in peace-making processes, the importance of studying the case of El Salvador clearly overpasses theoretical interests as consolidation of peace is of great national relevance. If the net effect of more secure land rights (transferability, mortgage-ability and full security of expropriation) on household abilities to reduce poverty and engage in a more sustainable land use, were clearly demonstrated, the application of such a research approach to further regions would allow

a broader applicability of the results.

Moreover, researching the relationship of growth enhancing effects of “redistribution” policies will facilitate the design of policies in other factor markets to help benefit the rural poor. This research is also needed to contribute to the growing concern of the implementation of market oriented reforms to promote agricultural sector growth and poverty alleviation under conditions of **market failures**. Under these circumstances access to credit and output markets, technology and information, is biased towards wealthier individuals and the set of reforms might lead towards **land re-concentration**.³⁵ This resulting situation is neither economically nor socially optimal in either efficiency or equity terms, as land provides other functions besides agricultural production, such as, among others, a place to live.³⁶ A process of land re-concentration can lead to difficulties in housing policy with social non-optimal results. Therefore, the relaying of the market as an instrument of development requires more than the establishment of secure and marketable individual property rights.³⁷ Hoff, Braverman, and Stiglitz (1993) state:

“... [T]he orthodox view that privatizing land transfer rights should precede the extension on a wide scale of the formal credit markets in rural sectors of developing countries may not be justifiable in either efficiency or equity terms”. Hoff, Braverman, and Stiglitz (1993)

In other words, the **full benefits of liberalization** require paying attention to the proper mix and sequencing of reforms in which the assignment of transfer rights is an instrument but not a final objective.

The key-problems can be summarised as follows:

- It is not known whether the change in property rights in El Salvador has had a beneficial effect on rural households
- The effects and relationships between increased income, enhanced access to credit and increased investment, are unclear

³⁵ See Deininger and Kirk (2002)

³⁶ See Binswanger, Deininger, and Feder (1995)

³⁷ See Salazar Brandao and Feder (2001)