Price of land: Shifting the burden from past to future

Circle rates have lost their relevance. It needs to be replaced with a scientific model to ensure that land is available for India's economic growth without causing social conflicts or compromising food security, write up By Prasanna Mohanty and Kaushik Dutta

In the clamour over procedural delays and high cost of acquisition that has trailed and now threatens to derail India's new land law– The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act of 2013 (LARR Act) –a fundamental question has been overlooked: How fair and equitable is India's land pricing mechanism?

There is no gain saying that a fair pricing will go a long way in resolving some of the vexing problems associated with land acquisition – social conflicts and litigations leading to a developmental logjam. India's growing population, which is projected to reach 1.45 billion in 2028 and surpass China's, will need more houses and office space, civic and social infrastructure, industrial and other hubs of economic activities. Urbanisation is on the rise and according to a 2014 UN report, the urban population will grow from 377 million in 2011 to 814 million by 2050, when half of India's population will be living in urban areas. All these will require land and the demand for land will keep mounting.It is, therefore, critical that when land is acquired it is valued appropriately to reflect its future use and earning capacity to avoid social conflicts and not compromise food security that an indiscriminate use of agriculture land for non-agriculture purpose may entail.

What is wrong with current model

The land price is based on what is commonly known as 'circle rates' in most Indian states. A circle rate is the minimum rate below which a land or a house can't be bought and sold. It is a benchmark for taxation and is primarily aimed at curtailing black money. The rate is fixed by district administration on the basis of historic data of registered sale deeds in the area. The outliers are discarded and the average is taken as the market value of land. So long as land transactions were confined to agricultural use it worked fine but rapid industrialisation and urbanisation in the past two decades have significant altered land use and local economy which the principles of determining circle

rates, based as it is, on historic data or past transactions, no longer reflect. Experience shows that a change in land use (for industrial or housing purposes), even if proposed, changes land value so dramatically that it is no longer measured in acres but in square yards.

In a study conducted by Thought Arbitrage Research Institute (TARI), in collaboration with the Ministry of Rural Development and German development agency GIZ, looked at land pricing and trends over three decades in four representative districts of two states in India.The findings, based 700,000 data points, are revealing. The circle rates grossly undervalue land. Though revised from time to time, the circle rates have not kept pace with inflation. The revisions have not followed any clear rationale nor are uniform across the states. That's not all. The rates don't take into account economic and locational factors that influence land prices, such as productivity of land, irrigation facility, level of industrialisation of the area and geographical indicators like proximity to airport, railway lines, highways, urban centres etc.The degree of influence of these factors may differ from place to place, depending on the level of economic development and time factors, but these are critical determinants of the value of land.

There are other issues too. As transactions move away from urban areas to the interiors, lack of developed land market and information asymmetry lead to land being sold at values significantly lower than what is fair and equitable. That probably explains why people in rural and tribal areas are up in arms against all development projects. A parliamentary standing committee examining the land law commented in 2012 that the circle rates "are much below the real running price of land across the country and there is a tendency to register the sale deeds at minimum value to avoid the stamp duty".

Clearly, the circle rates are uni-dimensional, unscientific and inappropriate for valuation of land for acquisition purposes. LARR Act recognises this and uses a multiplier to the circle rates –1 in urban areas to a number between 1 and 2 in rural areas – and adds a solatium of equal amount, on the assumption that it is a forced transaction, to work out the final compensation for land. The parliamentary committee that examined the issue lamented that there was "no explanation/justification or scientific basis" for the multiplier and solatium and that they make the final compensation 4 times the value of land as obtained through the circle rates in rural areas and 2 times in urban areas.A continued

reliance on such artifices speaks volumes about the arbitrariness of the system and the industry is right in objecting to it.

Designing a scientific model

These flaws can be easily corrected though. Many developed countries use scientific data and GIS mapping to determine individual or unique characteristics to value land, including proximity to infrastructure, purpose of acquisition, comparable prices in the area, loss of livelihood or opportunity costs etc. and feed them into a scientific model. Seemingly, it is working there and there is little to doubt why it shouldn't in India. Many states are digitising their land records, which captures key details such as location, crops, irrigation, soil type and land use etc. These details can be used, supplemented with other relevant information, such as loss of livelihood, future use of land, future development plans for the area and its neighbourhood that the master plans provide.

A scientific model reflecting the relative influence of all these factors can be designed to project the future earning capacity of land once the change in its use happens. This will shift the burden of pricing from the historic data-based circle rates to the one that uses current and future economic valuations. When that happens there will be less to protest against.

Land for smart cities

The bigger demand for land will be coming from the need for rapid urbanisation. Census reports say that India's urban population has increased from 285 million in 2001 to 377.1 million in 2011, forming 31.16% of the total population. This is expected to go up to 814 million by 2050, contributing the maximum to the world's urban population surpassing even China.

Most Indian cities have not had the structural changes to accommodate such large influx in decades, turning much of its urban space to slums. Census 2011 data presents a grim picture. Some of the top cities have a large part of their population living in the slums and leading a sub-human life – 41.3% in Mumbai, 29.6% in Kolkata, 28.5% in Chennai and 8.5% in Bangalore. The civic facilities have crumbled and power cuts, water shortages, flooding, traffic congestions etc. have become regular features of these cities.

The need for developing more urban space has led Indian government to announce a plan to build 100 'smart cities' as satellites of the existing urban

centres. The plans are at a formative stage now but when the actual work starts the first challenge will be to acquire land. The situation is pretty grim even now and many states are locked in bitter fights. Jharkhand is unable to secure acquired land or acquire land afresh to set up institutes like IIT and IIM on the outskirts of Ranchi. Chhattisgarh is battling for nearly one-and-half decades to build its new capital, Naya Raipur.

Pricing urban land or land meant for urbanisation means taking additional variables (to the ones already mentioned) into consideration, like urban land regulations, taxation and infrastructure investment etc., which impact the supply and demand of land and so, the valuation. Particularly those relating to urban ceiling, rent control, land conversion and recycling, stamp duty, property tax, master plan and floor space (FSI or FAR) etc. When designed well and tuned in to the market, they make more space available and unlock the value of land but when not, do the opposite.

Some cities have, seemingly, managed their affairs better. Ahmedabad, for example, has no problem in acquiring land and developing a highly successful BRT corridor and other infrastructures, while Pune is stuck for decades to implement its plans for BRT, ring roads and other social infrastructure. All land acquisitions are help up in litigation and there is a growing voice for a separate law to deal with the problems of urbanisation.

What, therefore, needed is a complete rethink on the valuation of land in urban areas. Its unique characteristics, multiplicity of land use and an opportunity to generate far better returns on investments make urban land or land meant for urbanisation very distinct. Not only do we need a scientific and data-driven methodology too replace the circle rates, we need to factor in all these aspects in the valuation so that the fair price of the land to be acquired is be discovered and the expectations of the land owners are be met.

The LARR Act has a special provision which says, “In case the land is acquired for urbanisation purposes, 20% of the developed land will be reserved and offered to land owning project affected families, in proportion to the area of their land acquired…” But, again, this is a poor substitute for a scientific valuation method.

Food security

Industrialisation, infrastructure and urbanisation will, undoubtedly, make great demands on India's land resources but it will have to make sure its food security is not compromised. That is because its cultivable land is shrinking and the economic returns from its agricultural use are diminishing as against its non-agricultural use. The situation may not be alarming now but if the trend persists that could very well be so.

The threat to India's food security comes from two developments. One, India may already have run out of non-cultivable land to meet its needs for economic development and secondly, the current land pricing mechanism has developed in a way that it makes more economic sense for the farmers to sell it than use it for farming.

That India may have run out of spare land for developmental purposes is acknowledged in in its National Land Utilisation Policy of 2013 (NLUP), which says, "Between 1950-51 and 2007-08, land utilisation in India underwent significant changes. While the lands under net sown area, forests and non-agricultural uses have increased, the lands under 'other areas' uses have almost halved from 40.7% to 22.6%, meaning that for future land demands, the forest lands and agricultural lands may have to be used".

NLUPduly recognises the threat to country's food security and seeks "reasonable restrictions on acquisition and conversion (of) at least certain types of agricultural land". The LARR Act has gone even further by making acquisition of "irrigated, multi-cropped land" has to be only "as a demonstrable last resort" and prescribes certain safeguards. But many states, including Bihar and Madhya Pradesh, are strongly opposed to such restrictions.

On the other hand, farming is becoming less lucrative. According to the Economic Survey of 2013-14, more than 36 millionworkforces have moved out of agriculture and allied activities between 2004-5 and 2011-12. Steadily improving food productivity may have ensured adequate supply of food grains now but that may not be the case always, especially when the cultivable land shrinks further. Official data shows the cultivable land has shrunk from 183 million ha in 2000-01 to 181 million ha in 20011-12 – a steep fall of nearly 2 million ha in a decade or so.

To compound the problem, TARI's study found that factors such as location, level of industrialisation and change in land use have become more important determinants of the price of land than its productivity. In fact, productivity is progressively declining as a price determinant. What it means is that the farmers stand to gain much more by selling their fertile land than by farming.

So long as the circle rate remains, the incentive to swap farm land for non-farm use will continue. And so will the potential threat to India's food security that the loss of farm land would bring about. Increasing productivity may have compensated for the loss of farm land and migration of the agricultural workforce for now, but beyond a point the productivity alone wouldn't be sufficient. The debate over modified seeds would continue for years and no short term solutions to increase productivity is likely to emerge, given the low outlay of agricultural research in India. India would need to protect its farm lands but that would create a discomforting choice between the apparent profits available to famers by way of selling their productive land or plying a trade that has lower economic returns and significant risks of failure.

Farm subsidies across the globe, be it in the form of crop insurance or minimum support price, are meant to ensure that agricultural activities flourish and remain economically viable so that there is adequate supply of food grains. In the present context, India would need to find a mechanism to compensate farmers for not exercising their right to sell productive land but continue to grow food grains; a mechanism that is equitable and transfers the entitlements from the consumers to the producer. Call it a subsidy or by any other name, this would only be an innovative addition in order to protect the farm land and the farmers and would be worth the effort given the bigger threat looming ahead.

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