

I N S T I T U T O D E E C O N O M I A

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AGRARIAN REFORM, LAND PURCHASE, AND INDUSTRIALIZATION IN PERU^{1/}

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1/ Preliminary; circulate for criticism and discussion. This paper is based largely upon interviews and material gathered in Lima during the week of April 20-24, 1964, while visiting the First National Training Course for Professional Personnel of the Institute of Agrarian Reform and Colonization. I am grateful to Lander Pacora C., Pablo Salmón J., Alberto Zumaesta, Pedro Alibert, and Luís Barandiaran, whose comments and suggestions were most useful. The responsibility for errors, however, is my own.

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I. Introduction

To some people, agrarian reform is basically a real estate transfer carried out on a wholesale basis. To others, agrarian reform is a profound process of social change, affecting political, social, economic and legal relationships among the people of a nation.

Those who prefer the second viewpoint see agrarian reform in terms of the present and future of the rural families who benefit. These families are usually considered to be exploited unfairly and inhumanely under present systems of land tenure and cultivation; they have few or no political rights, no social mobility, no incentive to save, produce more, or innovate, and little hope that things will be any better for their children. ^{3/}

For these campesinos, title to land is but the starting point. Agrarian reform must also help them obtain know-how, working capital, better seeds, livestock, tools and access on fair terms to markets for their harvests. In most cases, the reorganization of credit, supplies, and marketing requires far more talent, resources, and effort than does a mere change in the legal ownership of land. Extension workers are few, but lawyers abundant, in most Latin American nations.

Those who hold the "real estate transfer" view, on the other hand, see agrarian reform almost entirely in terms of the present and future of

^{3/} See, for example, "Lo que implica una Reforma Agraria," by Solon Barraclough, in La Reforma Agraria y el Desarrollo Economico y Social de los Paises Latinoamericanos (Santiago: Institute of Economic Research, University of Chile, 1963), pp. 323-358.

the large landowners, part of whose land is to be redistributed. Since these families will not voluntarily relinquish their land and perquisites (including their power over other human beings),^{4/} they must be ejected forcibly or they must be compensated. If we agree to reject the first alternative, what will the former landlords do with the compensation? Will they invest in urban construction, or in new factories, or in commerce, or will they buy foreign exchange and move to Europe? What can be done to influence this decision? In the light of their expected behavior, how should compensation be paid?

Among the writings of those who appear to take this "real estate transfer" view of agrarian reform, is a recent paper by Mann and Blase on the financing of agrarian reform in Peru.^{5/} The authors, members of an AID-sponsored university mission to the Institute of Agrarian Reform and Colonization in Peru, argue for the creation of a mutual investment fund which, they feel, would further both agrarian reform and industrial development in Peru.

This proposal is well-known in Lima, and it has influenced the agrarian reform legislation now before the Peruvian Senate. In addition, it has received some attention from international agencies. The authors suggest that the proposed institution may be applicable to other countries

^{4/} In some Haciendas, a social structure similar to the feudal period in European history is maintained through tradition and "debt slavery." For an objective description, see Seoane, Surcos de Paz (Lima: Industria Grafica, 1963).

^{5/} Fred Mann and Melvin Blase, "A Potential Institution and Procedure for Financing Agrarian Reform and Stimulating Industrialization in Peru," published by the Iowa Universities-AID Contract group in Lima.

as well.^{6/} However, the present paper will examine the proposal in the Peruvian situation, attempt to determine the usefulness of such a mutual fund in Peru's Agrarian reform and/or industrialization.

II. The Agrarian-Industrial Investment Trust

In their opening paragraph, Mann and Blase make clear their approach to agrarian reform. One of two characteristics observable in countries undergoing initial stages of development, they state, is ownership of the land by a relatively small proportion of the population. The other characteristic is the lack of industrial development. The authors then suggest that "it would be desirable to accomplish 1) the sale of agricultural land to smaller owner-operators, and 2) the investment of the land-sale proceeds in new industry." ^{7/}

To achieve this, the authors propose an institution which would achieve the following objectives:

1. Provide an institutional means for financing agrarian reform in Peru.
2. Stimulate non-agricultural industrial development of the country.
3. Make agrarian reform more acceptable by minimizing risk.
4. Utilize existing public institutions.
5. Minimizing the extent of public control in accomplishing these objectives."^{8/}

^{6/} Ibid., p.1, n., and pp. 13-15. The proposal will be discussed in a seminar on the financing of agrarian reform, schedules for May, 1964, in Panama.

^{7/} Ibid., p. 1.

^{8/} Ibid., p. 2.

The institution is to be called the "Agrarian-Industrial Investment Trust." The magnitude of the job to be done has been estimated, on the basis of a study by Erick Thorbecke as to the amount of land subject to expropriation and its compensable value.^{9/} For the first objective, "the total cost of the agrarian reform program in Peru" will be about 8.2 billion soles, or US\$308 million.^{10/}

Mann and Blase then state that such payments, without control of capital movements, may generate capital flight. The second objective thus is to channel these payments into domestic industrial investment. Agrarian reform will probably have to be spread over ten years, trained personnel being the chief bottleneck.^{11/} During this period, annual payments for expropriated land would be on the order of 10% of current annual net private investment, an increment which the authors consider easily absorbed in industry.^{12/}

^{9/} "Some notes on the macro-economic implications and the cost of financing agrarian reform in Peru," Nov. 30, 1963. Lima, Iowa Universities-AID Contract Group, ditto process.

^{10/} Mann and Blase, op. cit., p. 2, based on Thorbecke, op. cit.

^{11/} Most agrarian reform officials interviewed were inclined to accept the ten-year period as a target for completion of the land transfer. A draft budget proposal by the Institute of Agrarian Reform and Colonization contemplates the installation of 31,230 families in the first year. This is probably about 15% of the total program, but some preliminary work has already been done in most of these zones. (Lima: Ministry of Agriculture, Instituto de Reforma Agraria y Colonizacion. "Incremento de la Productividad de la Pequena Agricultura en Zonas de Reforma Agraria y Colonizacion," Tomo I. September, 1963).

^{12/} According to the Plan Nacional de Desarrollo Economico y Social del Peru, private sector net investment averaged 9 billion soles between 1950 and 1960 (table 20). Private sector savings averaged 8 billion soles. By 1965, the Plan called for private sector savings of almost 16 billion soles (at 1960 price levels), but no indication was given as to what measures need to be taken to bring this about. (Table 51).

The "risk" to be minimized (objective 3) refers to an argument by present hacienda owners, that they will be "vulnerable" to inflation while they hold the long-term bonds in which they are compensated.^{13/} Mann and Blase originally proposed that the mutual fund buy expropriated land, issuing securities less vulnerable to inflation. Subsequently, when the Congress approved payment in bonds, the proposal was amended to have the mutual fund offer to exchange its shares for land reform bonds. The ex-landowner will thus be able to choose between holding a fixed-interest obligation of the government, and shares in the fund.

The only new institution to be created (objective 4) is the fund itself, to be known as the "Agrarian-Industrial Investment Trust," hereinafter referred to as the AIIT. An impressive list of existing institutions, from AID to the Industrial Development Bank and the Agricultural Development Bank and even a Graduate School of Business Administration, is paraded to show how many would be involved to some degree. Public control of the whole agrarian reform would be minimized (objective 5) by giving the AIIT considerable autonomy;^{14/} its Board would consist of trustees named by the President of the Republic from nominations submitted by various public and private sector organizations.

The assets of the AIIT would be whatever funds might be assigned

^{13/} Although Peru is noted for the stability of its price level and foreign exchange, relatively large fiscal deficits are expected this year and next unless tax revenues are increased. There is a widespread, but unproved, belief that land values will rise with prices, should inflation occur.

^{14/} The agrarian reform law before the Senate rejects this objective; public control of agrarian reform is asserted throughout, and the social objectives clearly overshadow the formal land transfer aspects.

it from the annual government budget, the land reform bonds which former landowners exchanged for AIIT shares, and whatever grants or loans the AIIT could get from international agencies. Liquid assets would be invested in shares or debt of new industrial firms, or of firms that want to expand, subject to prior approval of the project by the National Planning Institute. In very special cases, the AIIT could even pay out cash to a former landowner up to 75% of the face value of the bonds deposited, to enable the ex-owner to start or expand an industrial firm. AIIT investments would not be restricted to activities launched or directed by ex-landowners, though the purchase of AIIT shares is implicitly limited to ex-landowners or to others who acquire land reform bonds and then exchange them for shares.

Through its preference for equity investments, AIIT would increase the supply of "Peruvian" risk capital. This should make Peruvian and foreign commercial banks and other financial interests more willing to lend or to associate themselves with Peruvian firms. Some would-be foreign investors are believed to have been discouraged by the lack of Peruvian capital and partners for joint investments; the AIIT would improve the supply of such capital.^{15/}

The authors recognize that a free-market value of the land reform bonds is likely to be well below nominal value, especially if inflation is anticipated. To protect the bond quotations, AIIT should not be forced to liquidate its bondholdings in order to obtain liquid assets

^{15/} To be sure, it will be largely foreign capital, borrowed by AIIT against the security of its other assets, including the land reform bonds, but it would look like Peruvian money.

to invest in industry. AID is therefore "expected to provide a long-term loan, below private interest rates..."^{16/} The objective is to enable the AIIT to exhibit liquid assets (cash and industrial shares) equal to the face value of the securities it has given out in exchange for land reform bonds at par.^{17/} It will hold non-liquid assets (bonds) equal to its borrowing from AID and other international agencies.

The AIIT is also to use its influence and financial weight to bring about "company reform" in favor of minority shareholders and profit-sharing plans for workers, as well as some as-yet-undefined worker participation in management. The investments of the AIIT would be limited to those firms which incorporated themselves, and agreed to these fundamental reforms.^{18/}

As the land reform bonds are redeemed by the government (about 5% a year) shareholders will be able to turn in a like proportion of their AIIT shares for redemption in kind; that is, in industrial shares held by AIIT. When the last bond matures, the AIIT should have repaid its borrowings, and paid out its assets to its shareholders, in a final liquidation.^{19/}

Finally, looking at the possibility of forming similar trust funds in other Latin American countries, the authors are enthusiastic

^{16/} Mann and Blase, op. cit., p. 8.

^{17/} Ibid., p. 8.

^{18/} Ibid., p. 11.

^{19/} At this point, it becomes interesting to ask whether shares have been given AID and the Peruvian Government in exchange for budget contributions and loans at below-market interest rates. If not, these donations will almost be distributed to the ex-bondholders in the final liquidation.

about the "Common Market Effect" which this would permit. Once such trusts have been formed in several nations, the authors would create an Agency for Interamerican Investments. This new organization would take over from AID the responsibility for loans secured by land reform bonds, made to national trusts which would reinvest the loans in industrial enterprise. The amount loaned to each country would depend upon 1) the extent to which the country had lowered tariffs for LAFTA partners, and 2) the merits of the investment proposals as such. It is assumed that the availability of credit on such terms would lead to more rapid tariff liberalization, making industrial investment in LAFTA countries more profitable as wider markets are opened. The authors conclude, "...the type of recent economic gains made in Western Europe due to the Common Market can be enjoyed in Latin America, through the proper structuring of an international agency."^{20/}

III. General Comments on the Proposal

The investment trust proposal aims to achieve a great deal in the industrial sector. Besides promoting new firms and the expansion of existing enterprises, it aims to reform relations of firms with their workers and with minority stockholders, to improve the local capital market, to hasten the Latin American integration movement, etc. Curiously, Mann and Blase seem to have at best a casual interest in agrarian

^{20/} Mann and Blase, op. cit., p. 13. It probably isn't as easy as all that. See, for instance, Carlos Massad and John Strasma, La Zona de Libre Comercio: Algunos Problemas por Resolver (Santiago: Institute of Economic Research, 1961).

reform as such. Everything that does not concern the legal transfer of title to land or the payment of compensation to the former land-owner, is lumped off into "public welfare considerations" outside the scope of their paper.^{21/} It is not stated why an agrarian reform advisory mission omits consideration of social, economic and human relations within agriculture, while recommending similar reforms needed within industry.^{22/}

This bias appears in the analysis of the very first objective: financing agrarian reform, which Mann and Blase measure strictly in terms of the amount to be paid to some 250 to 300 families and firms

^{21/} Ibid., p. 17.

^{22/} According to Thorbecke, op. cit., agrarian reform will be unable to give land to more than 13-20% of the rural population. Under that assumption, perhaps the advisers feel that industrial development should be their principal concern. However, there are doubtless many research needs in agrarian reform as such, starting with careful studies of economic units that will determine how many families can be helped, and the most desirable forms of organization in each area. Single-family owner-operator farming is not the only possibility, nor always the best, as Mann and Blase themselves recognize at one point (p. 17). Numerous research needs are mentioned in "Inventario de la Informacion Basica... Peru," part of the CIDA project, just published by the Pan American Union.

who will lose a part of the land they are now farming.^{23/} Other researchers, studying the cost of agrarian reform, start with the credit, technical, and related assistance programs aimed at the new farm families.^{24/} Some even dismiss the question of compensation for ex-owners entirely, or set it aside as a transfer problem in the realm of fiscal

^{23/} This estimate is my own; Mann and Blase do not mention how few families are really going to be involved in the proposed trust fund. The thirty largest hacendados control 28.7% of the cultivated land in the rich coastal area, which is the most valuable. To include all coastal property over 500 ha., and thus almost certain to have some land taken, one must include 190 families and firms. With 36 more, 66% of the land concessions in the Eastern jungle region can be included; there may be some overlapping with the families and firms owning coastal property. Data on the ownership of grazing lands in the highlands (Sierras) is poor, but only 99 properties are larger than 1000 ha. There may be overlapping ownership of these properties, and further overlapping with properties on the Coast and in the jungle; in any case, only grazing property over 1,500 ha. will be subject to expropriation of part of the excess. Making allowances for the probable exemption of a few Coastal sugar plantations, it appears that agrarian reform as currently under debate in the Senate will take some land from -- and pay compensation to -- between 250 and 300 families and companies that actually operate farms. Obviously, this is an insignificant number alongside the 130,000 to 200,000 families who will receive lands in the process. An additional group of rentistas, absentee owners who rent out units smaller than three "family units," will also be expropriated, as will the Catholic Church and other institutions whose basic activity is non-agricultural.

This information was taken from various sources, but principally from La Reforma Agraria en el Peru, Documentos --I, of the Commission for Agrarian Reform (Lima, 1963), pp. 12-15, and Malpica,

Carlos, Guerra a Muerte al Latifundio (Lima: Ediciones "Voz Rebelde," 1963), pp. 156-225.

^{24/} For example, "Programa de Trabajo del Instituto de Reforma Agraria y Colonizacion para el año 1965," a budget study.

policy.^{25/}

Even in the estimates of the amount to be paid out for lands, there is probably a bias. For his calculations, Thorbecke used average values for cultivated and pasture land, by provinces, as shown in a tax assessor's handbook. These figures are probably well under future compensation awards, given the well-known underassessment of the tax.^{26/} The draft Work Program of the Institute of Agrarian Reform and Colonization for 1965 contemplates a purchase price of 200 soles/ha. of natural pasture, about the same as Thorbecke's figure. However, for cultivated lands Thorbecke assumed an average of 4,000 soles/ha. and IRAC expects to have to spend an average of 8,000/ha. On the other hand, though around 1 billion soles per year would have to be paid out to landowners, the actual net government outlay would be less because after an initial grace period, the new landowners begin to pay for their lands. Thorbecke estimated net budgetary contributions for land expropriation only, at 108 million

^{25/} Edmundo Flores, for example, rejects compensation as wrong, on grounds that agrarian reform is a redistribution of wealth and compensation nullifies the redistribution. Tratado de Economía Agraria (Mexico: Fondo de Cultura Economica, 1961), p. 324.

^{26/} Existing taxes affecting land are as follows: Owners of urban and rural real estate must declare their gross income from realty. One sixth is deducted for presumed costs. The balance is subject to an income tax at 7%. There is no property tax as such. Informants considered evasion or understatement to be general. There is also a transfer tax of 4 to 5.5% on declared prices of realty transactions, and a capital gains tax at rates from 1 to 15%, varying progressively with the ratio of gain to the original purchase price. Again, informants considered declared transaction prices to be grossly understated.

soles in the first year (US \$4 million), rising to a peak of 451 million soles (US \$16.9 million) in the ninth year, from which they would steadily decline.^{27/}

Compensation, as the bill was reported out by the Senate Committee (following House approval), will be based upon actual net earnings of the land during the last 5 years prior to expropriation. Years of drought or disaster may be excluded from the calculation. This average yield is to be capitalized at 9%, with a margin of up to 30% increase in the resulting price if the property is judged unusually well located, or if higher recent sale prices in the zone seem to warrant a better price. Idle land will be paid for at estimated potential yield, capitalized at 9% less the estimated cost of putting it into production.^{28/}

Payment for land taken will include up to 200,000 soles (US \$7,400), and the balance in bonds paying 4 to 6% interest on unpaid balances, with amortization coupons for repayment of principal over 18 to 22 years. Interest rate and payment terms depend upon how well the land was farmed. The lowest down payments (US \$1,850), lowest interest, and longest amortization go to owners who left the land idle.

^{27/} Thorbecke, op. cit., Table III.

^{28/} Apparently, it is better to leave the land completely idle than to exploit it badly. It is difficult to reconcile this apparent generosity to owners of uncultivated land with the stated intention of punishing owners who have not cultivated their lands. Payment for such land, however, is made with the lowest down payment and interest, and longest term bonds.

The law is silent as to whether the owner's declaration of earnings will be checked against his past income tax declarations, and as to what will be done when these do not match.^{29/} Some authorities argue that compensation on the basis of (lower) false declarations from the past would constitute an unconstitutional retroactive increasing of the penalty for false declaration under the income tax, after the crime. Under this view, tax evasion is not really "wrong," but just a game, and the penalty for getting caught at it should not be increased without warning. One reply might well be that a landowner should not be permitted to report his own past tax fraud when such a report will lead to advantage for himself; most countries will not grant a divorce to a man who asks it on grounds that he has been an adulterer.^{30/}

If the estimates of the amount of money to be paid for land takings are low (and the exact amount will depend upon the final version of the law, and even more upon the quality of field administration), at least Thorbecke does not assume that this is the only cost of agrarian reform. He estimates an immediate need of about US \$1,000 per family in short and medium-term credits. Upon plausible assumptions as to the number of families to receive land each year, the annual outlays for the credit

^{29/} According to one publication (CIDA: Inventario de la Informacion Basica... Peru), income declared for tax purposes will, under existing law, be the basis for compensation. I was unable to find any basis for this statement. See note 26, p. 11, for description of the income tax.

^{30/} I am grateful to a participant in the Training Course for this example; unfortunately, I failed to note his name at the time. If he will identify himself, I shall thank him by name in the future.

program alone would be between US \$13 and \$20 million per year.^{31/}

In addition, there are all the expenses of administration, extension, preliminary improvements and studies prior to parceling, and so forth. For example, in one project (Lurin), involving the expropriation of 1,500 hectares of cultivated land along the Coast, the total cost of the agrarian reform program is expected to be (just in 1965):

Expropriation (10% of total price)	Soles	4.5 million
Infrastructure improvements		6.8 "
Technical assistance		1.5 "
General Administration		1.4 "
Credit (net) to be extended		11.3 "
<hr/>		
Total Cost	Soles	25.5 million ^{32/}

In addition, 40.5 million soles will be paid (plus interest) on the land reform bonds given the ex-landowners, over the next 20 years. A substantial part of this will be covered by payments by the new landowners, starting at the end of a grace period yet to be determined. The price to the new landowner is "not more than" the purchase price plus the cost of infrastructure improvements.^{33/}

Finally, in any discussion of the future activities of landlords in Peru, we should note that only certain types of landholdings will be expropriated in their entirety:

^{31/} Thorbecke, op. cit., pp. 5-6.

^{32/} "Programa de Trabajo del Instituto de Reforma Agraria y Colonizacion para el ano 1965," Ditto, Table 5. The 10% for expropriation includes an average 5% cash down payment, plus an average six month's accrual of interest and amortization (5% per year apiece).

^{33/} Article 99 of the Agrarian Reform bill as reported by Senate Committee.

- 1) State and autonomous agency lands not used directly in the work of the agency (e.g., agricultural experiment stations).^{34/}
- 2) Church and other institution-owned lands, not used directly and efficiently in teaching, social welfare, higher education and research in agriculture.^{35/}
- 3) Land which is unexploited.^{36/}
- 4) Land rented, not larger than three "family units." (Larger properties may continue in rental, subject to reforms in lease conditions, and to expropriation to the extent that they exceed the limits applied to owner-operated land).^{37/}

In general, all land farmed directly by the owning family or company will be subject to progressive expropriation, as follows:^{38/}

the first 150 ha.	exempt
the next 350 ha. (to 500)	30% will be expropriated
the next 500 ha. (to 1,000)	50% " " "
the next 500 ha. (to 1,500)	70% " " "
the next 500 ha. (to 2,000)	90% " " "
all over 2,000 ha.	100% " " "

^{34/} Article 9, of the same.

^{35/} Articles 11 and 15.

^{36/} Article 14.

^{37/} Article 16.

^{38/} Article 33.

All landholdings anywhere in the country are lumped together to determine the amount to be taken.^{39/} So far as possible, buildings will be left in the owner's portion, but the land must be divided in such a way that the owner and the Institute of Agrarian Reform take equally of the good and the bad.^{40/}

The exemption and expropriation table above is based upon land with dependable irrigation. Other lands are converted to equivalents in irrigated land, as follows:

irrigation irregular, unreliable	2:1
cultivated lands, no irrigation	3:1
natural pasture	10:1

In any case, if the entire property is efficiently exploited and capitalized by its owners, pays its taxes, provides good wages, schools, etc., and is a model farm in the region, the Institute has discretionary power to expropriate up to 25% less land than is indicated by the tables above.^{41/}

^{39/} Article 24.

^{40/} Article 61, g.

^{41/} Article 34.

IV. Evaluation of Possible Advantages of the Scheme

The Mann-Blase proposal claims to offer four principal advantages arising from the creation of the AIIT. It might bring about "industrial reform," it might nail down the principle of payment by beneficiaries for the land they receive, it might overcome political opposition to agrarian reform, and it might increase the real resources available for Peruvian industrial development. This last in turn would be achieved in four ways: capital flight would be stopped, the domestic capital market widened, more foreign investment would be attracted, and international agencies might increase their lending and grant donations to Peru.

1. Social reform in industry

The operations of the trust fund could conceivably lead to worker participation in profits, capital and management, to the protection of minority stockholders, and to other measures favoring workers and small investors. These are stated aims of the Peruvian Government, as is agrarian reform.^{42/} However, the business community in Lima cherishes "free enterprise" of the pre-1914 sort, and it seems probable that entrepreneurs, including ex-landowners, would refuse AIIT money rather than accept these unwelcome reforms. The large sugar plantations along the Coast seem already to have escaped similar reforms which they were

^{42/} Seoane, op. cit.

originally supposed to accept in exchange for exemption from expropriation.^{43/}

Until the Congress is ready to legislate and the Executive able to enforce reform in industry in general, insistence by AIIT might fail to achieve either social change or industrial investment. The failure would also discredit the reform movement itself.

2. The principle of payment by new landowners

In the original scheme, the AIIT was to acquire expropriated land by issuing its certificates to former landowners, and to resell that land in small parcels. Since the trust was independent, and charged with business-like operations, it would be expected to insist upon payment by new landowners.

Unfortunately, collection by a semi-autonomous agency will not automatically guarantee an absence of political interference, nor of an attempt to give the land away instead of selling it.^{44/}

^{43/} Articles 41 and 42 of the Agrarian Reform bill exempt land used to supply industrial plants. Article 43 says merely that these plants may be included in a future law for "industrial reform."

^{44/} For example, the Chilean Housing Corporation (CORVI) has a sorry record of collections in its otherwise laudable low-cost housing projects, where interest rates are low and terms long, but the debt is reajustable to maintain the real purchasing power of repayment in favor of future house construction. This bad collection record seems to be partly inefficiency, but largely the work of politicians who urge new owners not to pay, promising to get the reajustment factor reduced in favor of the voters. (The voters who will thus not receive houses in the future are presumably unaware of this, while present householders are acutely conscious of the monthly payments). The Chilean Congress also has a well-entrenched habit of voting a moratorium or forgiveness of penalties and interest for debtors who put themselves up-to-date with the State and its agencies, including the autonomous ones.

Both the proposed AIIT and the Financial Corporation created in the agrarian reform law (Art. 210-217) would rely upon the Agrarian Development Bank to handle the actual collection, so creation of a trust fund offers little advantage here. While we are on the subject, however, the principle of payment by new landowners might be worth discussion.

Historically, the purpose of agrarian reform seems always to include the increase of savings and their transfer (together with entrepreneurs) to industry. More recently, agrarian reform is also seen as a spur to industry on the demand side: a more even distribution of wealth and income provides a market for domestic manufactures. Before reform, the rural worker bought nothing in the market, and the rural landowner bought chiefly imported goods.

In Peru, agrarian reform clearly intends to increase the income of new landowners.^{45/} Ambiguity enters, however, when one asks whether a redistribution of wealth is also intended. To the extent that new landowners pay more for their land, than old landowners were prone to save, national savings increase. But when these savings are channeled to the old landowners instead of (via taxes) to the capital or investment budget, redistribution is foiled. Worse, the ex-landowners may still cherish luxury consumer goods (largely imported), or may buy foreign exchange. Either way, the savings of the new landowners are lost in the

^{45/} In determining the size of a "family unit," the Peruvian Commission for Housing and Agrarian Reform assumed that campesino families should have a parcel on which they could double the present average wages for working members of the family. La Reforma Agraria en el Peru, Documentos, Vol. I, p. 54 (Lima, 1963).

absorption of resources by the continuing high consumption of the ex-landowners. We shall return to this topic in the next section.

When recipients pay the government for their land, it is obviously possible to finance more agrarian reform and economic development than if the land is given gratis, taxation and other government spending being constant. Payment for the land or a stiff land tax are of course substitutes; either requires saving and can divert part of the new income of the campesino to public purposes. However, it may be possible to get the new landowner to save and transfer more of his income through land payment plus taxes than through taxes alone. To feel more secure in the possession of the land, he pays for it; having more security, he will also invest more in the land through greater effort and ingenuity and postponed consumption.^{46/}

The exemption of new landowners from taxation would be equally unwise, since a peasantry spoiled by exemption will not later accept taxation, even when relatively prosperous. (Witness the French experience in recent years). Indirect taxes would be the only practical way to collect taxes from this segment of the population -- and this would favor continued subsistence farming, lower production, and lower trade with the urban population.

^{46/} In Bolivia in 1961, agrarian reform officials told of campesinos who still did not believe the government could give them land titles. They wanted to pay something, and they wanted a receipt signed by the ex-owner. They also wanted to pay taxes, as a further act which they understood to prove ownership. (Strasma, J.D., Tax Reform in Bolivia, 1961. I. C. A., multilith).

The trust fund scheme as originally presented by Mann and Blase did require a down payment by the new landowners, but the agrarian reform bill does not.^{47/} There is an interesting research opportunity here for social scientists willing to get out of the city. Some scholars are convinced that peasants in the Andean highlands have substantial liquid savings in their mattresses. Others are equally certain these people are so poor that down payments for land are out of the question. (All agree that any payment from current income will be difficult during the first few years, until the new landowner gets settled and has his new farm unit well under way.)

To be sure, the hiding of domestic currency in mattresses is as good as an interest-free internal loan from the viewpoint of the Finance Minister. As fast as money disappears from circulation, other money can be printed and spent without inflationary pressures. However, the latent threat of sudden spending of such hoards suggests asking for a down payment for land, geared to these liquid savings, followed by a grace period of several years before land payments are resumed from current income. It is assumed that supervised credit is available to the new landowners for working capital; it is also assumed

^{47/} As the bill stands, approved by the House and reported by Senate Committee, land is to be paid for in 20 equal installments, with no down payment and a grace period as determined by the Institute of Agrarian Reform, up to five years. Interest rates are also to be set by the Institute. Land will be repossessed if two yearly payments are defaulted; land recipients must also cultivate the land themselves, must join cooperatives, and in case of death the land must be taken over by just one son. If the heirs can't agree, a court will choose one or the land reverts to the Institute.

that such credit will be used more productively than would the "mattress savings." To the extent that the latter would be spent for ostentatious weddings, funerals, or other non-productive consumption instead of used as working capital, the down payment approach will reduce consumption and favor savings. If the desire for such conspicuous consumption is strong in the community, a down payment plan may give the new landowner even more incentive to produce and to save, in order to replace the "mattress savings" he had to give up in order to buy the land.

Naturally, a down payment could be required in agrarian reform whether or not a trust fund is set up in favor of ex-landowners.

3. Removal of "political opposition" to agrarian reform

Those who recommend schemes to make compensation to ex-landowners more nearly cash on the barrelhead, to remove political opposition to agrarian reform, must assume that a landed aristocracy is firmly in control of the political situation. They assume that agrarian reform can only be achieved with the consent and on the terms of the landowners. Is such a reform likely to be worth the trouble?

While there are in Latin America various countries where a small landed oligarchy is firmly in control of what it claims is "constitutional, Christian, Western democracy," none has had a genuine agrarian reform. True reform becomes possible only when the pressure for it becomes overwhelming. Such pressure may be expressed in invasions by peasants and Indian communities, and more recently it also appears in arm-twisting by Uncle Sam and by international organizations.

Since reform will undermine their present absolute power, land-owners will hardly agree to it willingly, even with cash compensation for the income lost through land takings. Land has a psychic income, as a base of power, that would require much higher compensation than any democrat would be willing to pay. While inflation-proof securities might make them less angry about it all, persons who consider themselves the nobility of the country can hardly be happy about a reduction in their social, political, and economic predominance -- a leveling which is a basic aim of agrarian reform movements in Latin America.^{48/}

For Peru, the investment trust scheme is a thinly-disguised request for foreign loans to pay off the present landowners in cash or the equivalent, supporting the value of negotiable bonds. Now that the political balance in Peru appears to have shifted in favor of the urban middle classes and the rural and urban masses, there is a danger of a reaction against the trust fund shortly after it could be set up and operating.

International financing of the trust fund could actually slow industrial development and weaken the capital market if it inspires such attacks from the left. Constant demagogic threats in a Congress to dissolve the fund, limit its profits, tax it to death, etc., plus oft-expressed concern over the increased external debt, could wipe out the

^{48/} Solon Barraclough, "Lo que implica una reforma agraria," in La Reforma Agraria y el Desarrollo Economico y Social de los Países Latinoamericanos (Santiago: Institute of Economic Research, University of Chile, 1963), pp. 323-358.

usefulness of the trust fund.^{49/} Many Peruvian professionals working in agrarian reform have already jumped to the conclusion that the AIIT scheme will merely convert the overwhelming concentration of land among a few families and foreign-owned companies, into a similar concentration of industry in the very same hands. They are not willing to assume foreign debt for that:

At this point, we may fairly ask whether land taken in agrarian reform should be compensated at all. (In an academic discussion, no topic is forbidden.)

Perhaps the strongest argument against compensation is the re-distributive aim of most agrarian reforms. Most developed countries have a progressive income tax, taking a larger share of income from those who have more, and no one dreams of compensating the rich for this loss. Why, then, should the rich in land be compensated because a progressive "land tax" has been enacted?^{50/} The agrarian reform law about to be enacted in Peru is just that; the land taken depends on the size and type of total holdings.

In underdeveloped nations, including Peru, income taxes tend to be weak, poorly administered, and full of tax exemptions favoring the rich. Only the wage and salary earners are said to pay their full share

^{49/} Exactly such criticism has damaged the usefulness of the dollar-dominated internal debt bonds issued by the present Chilean Administration starting about 1960. The constant threats to tax, confiscate, etc., these bonds, in spite of many advantages given bondholders, led to uncertainty and a yield on the bonds that sometimes approached 48% a year, when the bonds were loaned for import deposit purposes.

^{50/} Edmundo Flores, Tratado de Economia Agraria (Mexico: Fondo de Cultura Economica, 1961), p. 324.

of income taxes; from them, it is withheld by the employer.^{51/} Since landholdings and total income are presumed to be highly correlated, a progressive expropriation without compensation, provided all landowners in like circumstances are treated alike, might be an acceptable substitute for a more effective progressive income tax.^{52/}

One former agrarian reform bill in Peru included a steep land tax, graduated from 6 to 45 per mil on realistic land values.^{53/} This tax is nowhere to be found in the present bill, though perhaps it will reappear in the forthcoming tax reform proposals.

Tax reform, indeed, is closely related to the agrarian reform bonds. If the Congress votes tax reform sufficient to finance the government program, there is no reason to expect an inflation, and the bonds will be as good financial investments as the external debt. Under such circumstances, their 5% average yield would be quite satisfactory.^{54/} If tax reform is frustrated, it will be largely the work of the same people who will be receiving bonds for land, and it is hard to see why AID or anyone else should protect them against the consequent loss in value of their bonds through inflation.

^{51/} See papers presented at the Conference on Fiscal Policy in Santiago, Chile, in 1962 (sponsored by ECLA, IDB, OAS).

^{52/} Naturally, one would prefer a tax on all types of property. Colombia has enacted and is trying to apply such a tax in the form of a progressive, annual tax on patrimony. Rates rise to a top of 15 per mil.

^{53/} CIDA, "Inventario de las Informaciones Basicas...Peru," p. 77.

^{54/} Peruvian external debt bonds paying 6% interest are traded in London at 121. La Prensa, April 21, 1964.

In recognition of one type of distributive justice in agrarian reform, the current bill provides that once the compensation payable for land takings has been established, the Institute of Agrarian Reform shall also determine whether in its opinion the workers on that land were paid legal salaries, social benefits, etc. If not, the Institute may assign up to 30% of the total compensation to the workers affected, reducing the landowner's share accordingly. This will be applied on the purchase price of the land each worker receives.^{55/}

Returning to the arguments against compensation, it has been argued that former landowners, forced to turn to the cities, have education, contacts, other investments, and advantages such that they do very well for themselves in industrialization, even if their lands are confiscated. The Mexican agrarian reform is cited to prove the point.^{56/} It will here be recalled that agrarian reform, through income redistribution, also increases the domestic market for manufactured goods -- more so if the new landowners do not pay for the land received.

One group of ex-landowners may be judged worthy of compensation: churches and similar non-profit institutions. While they are reputedly very inefficient farm operators, agriculture is admittedly "out of their line". Their lands are usually turned over to intermediaries, who sublet the land, keep most of the profit, and turn over a little to the institutional owner.^{57/}

^{55/} Article 234.

^{56/} Flores, *op. cit.*, p. 328.

^{57/} Malpica, *op. cit.*

These institutions, like the proverbial widow and orphan, will fare better holding the bonds, receiving a sure interest without intermediaries. They are the rentiers who need riskless investments; an investment trust is for them inappropriate except as a hedge against inflation. If their social usefulness is recognized, perhaps government and private benefactors can be expected to maintain them even in inflation; if they are not useful, euthanasia via inflation may be a "good thing."

To conclude the discussion of compensation, we note that the payment of compensation requires resources, which must be obtained from the new landowners, from taxation, or from international grants and loans. Any resources the government can get its hands on, however, have various alternative uses. If industrial development is the top priority objective, perhaps all available resources should be channeled into it. If the best available entrepreneurs to carry out such projects are in the private sector, and if they turn out to be ex-landowners, fine-- give them the loans. But not just because they happen to hold land bonds.

This policy would be consistent with "democracy in credit," another goal of the Peruvian Government.^{58/} The best projects and the best men should get the resources with which to develop the country, regardless of their present wealth -- and especially regardless of whether that wealth has up until now been invested in land.^{59/}

^{58/} Seoane, op. cit., pp. 50-69.

^{59/} The present agrarian reform bill provides that loans are to be made to anyone who presents land bonds in guarantee. This merely forces non-ex-landowners to buy bonds, bidding up their prices, in order to obtain a loan which they should obtain on the merits of the project and on their personal merit.

4. The provision of additional resources for industrial development

It might be argued that the trust fund scheme would lead to the provision of additional resources for industrial development through the prevention of capital flight,^{60/} the attraction of foreign capital and loans, and through additional international agency lending.

Capital flight can be stopped in at least three ways. Exchange control, or especially for ex-landowners, an annual accounting as to the whereabouts of the land compensation proceeds (with penalties for non-acceptable uses), is one possibility. Another is to make financial investment opportunities in Peru so attractive no one would dream of taking his capital out of the country. This is the essence of the AIIT scheme. The third, and by far the simplest, would be simply to make the land bonds non-marketable.

The mental conservatism of traditional banking permeates the proposal. For instance, Mann and Blase say:

"...the quality of the bonds will determine the extent to which they are discounted in the financing market. Consequently, the bond issuing agency must hold ample assets if the bonds are to be of sufficiently high quality to carry a small discount."^{61/}

Since the bonds are issued and fully guaranteed by the Peruvian government, it is not clear just what assets would satisfy the authors. Considering the present insignificance of the domestic financial market,

^{60/} Short-term liabilities of U.S. banks to Peruvians averaged US \$79 million in 1958-61, rising to \$105 million on December 31, 1962, and climbing steadily to reach \$158 million on December 31, 1963. Federal Reserve Bulletin, Feb., 1964, p. 257.

^{61/} Op. cit., Appendix, p. 3.

it is equally absurd to expect the bond price to depend on the "quality" of the bonds in the way in which bond prices in New York or London do. The only reasonably sure way to avoid quotation of the bonds way below par, is to prohibit their sale, except perhaps in very small quantities -- to get that market started. Perhaps sale could be permitted when necessary to settle an estate, for instance.

Marketable or not, the bonds represent a financial asset whose payment when due is beyond question, as an obligation of the Peruvian Government. They can serve as a guarantee for industrial development credits, although one might hope that at least state bank credits can get away from traditional guarantees and be assigned more on the merits of the project.

We must remember that not just capital flight, but consumption, too, is to be avoided so far as possible. This would argue in favor not only of non-marketability, but also that no amortization should be paid on the bonds. In other words, land takings should be compensated with "Consol" type perpetual bonds, at a market rate of interest but with marketability limited sharply, at least until the country achieves satisfactory growth rates. As noted in the last section, there is no reason for Peru to have inflation if the rich -- the bondholders, in large measure -- accept tax reform.

If the land were to be paid for in long-term bonds yielding an average of 5%, this would be almost identical with the present yield of Peru's external debt. There is no obvious injustice so far as yield is concerned. While the yield may be less than energetic, efficient land-owners might have had their land (the agrarian reform bill assumes

9% to be a fair capitalization rate), it must be noted that no effort, no administrators, and no intermediaries are required to collect the interest.^{62/} It may also be recalled that agrarian reform is expected to improve the market for industrial products -- and the landowners are already very substantial owners of Peru's industry. Of the 47 Directors of the National Agricultural Society (who are chosen by an election in which voting is weighted by size of land holdings), all but 8 already have very substantial interests in industrial firms and urban real estate.^{63/}

Given the fact that Peru seems determined to have marketable bonds, the tentative conclusions at this point seem to be that 1) if the landowners try to sell the bonds, the price should be allowed to fall enough to discourage most of them from doing so. 2) Those who exchange bonds for shares in an investment trust should keep the money in; the trust should not be liquidated steadily, but should pay out at most current earnings (mostly interest on the bonds). Otherwise, the cash flow to ex-landowners, and hence their consumption, is about the same as with the bonds. As the bonds are paid off, the trust would repay foreign loans and invest in industrial shares, but it would not liquidate in favor of

^{62/} Interest on land bonds is taxfree, though no one is quite sure why. At a top rate of 30% in the personal income tax, 5% is thus equal to about 7% taxable yield.

^{63/} Malpica, Carlos, Guerra a Muerte al Latifundio (Lima: Ediciones "Voz Rebelde," 1963), pp. 156-225, lists the holdings in detail. They account for more than 23% of the agricultural land along the Coast alone.

ex-landowners. Likewise, the government should be permitted to amortize by buying up bonds in the market if their price is below par.

At one point, the transferability of bonds was limited to the purchase of shares in the proposed trust fund. This has been replaced in the current bill by a provision permitting the pledging of these bonds as collateral, up to 85% of their face value, for loans for any purpose obtained at any state bank, and at full nominal value for projects financed by the Fondo Especial de Inversiones Industriales, the legislative result of the Mann-Blase proposal.^{64/} This fund, administered by the Industrial Development Bank, will finance only projects presented by holders of land reform bonds: i.e., ex-landlords, or others who buy land bonds.

The ex-landowner with good friends may obtain an 85% cash loan from one of the state banks, with no strings attached about industrial development. At least a few landowners or speculative purchasers of the bonds at prices below par may thus succeed in discounting the bonds almost at once, at that figure. Those able to do so would scarcely swap the bonds for shares in a new project yet to be organized^{65/} unless their industrial plans were so well advanced that they were going to start an industrial project anyhow. In that case, they wait for the Fund to open for business in hopes that its credit will be more generous even than

^{64/} Articles 218-223 of the Senate Committee bill.

^{65/} In this sense the project differs from the Taiwan agrarian reform, in which landowners were allowed to swap up to 30% of their bonds for shares in existing government-owned industry. Tang and Hsieh, "Land Reform and Agricultural Development in Taiwan," The Malayan Economic Review, April, 1961, pp. 49-54.

other lenders offer.^{66/} Meanwhile, foreign lending for projects requiring investment largely in domestic currency (other loans for equipment financing are readily available from suppliers), will make foreign exchange relatively more abundant as the Fund gets started, making it easier for ex-landlords to send their capital abroad.

Throughout the project, one misses discussion of the future role of the landowners (or of their administrators) in agriculture. Hacendados will be permitted to keep 150 ha. of irrigated land or 1500 ha. of pasture, plus part of the excess. Mann and Blase expect the presence of the landlord in the area to put social pressure on the new owners to make their land payments.^{67/} This is a recipe for social conflict. Why not rather stress the role of the experienced farm manager, demonstrating and teaching his former tenants? If assigned this role, however, landlords may prefer to invest compensation on the part of their land which they retain. Mann and Blase do not consider this possibility.

As to the attraction of more foreign investment, it is true that the availability of "Peruvian" equity capital might attract some foreign investors looking for a partnership. It is not clear that the existing Industrial Development Bank could not provide such equity capital without creating a separate trust fund, and without getting ex-landowners as such mixed up in it. If the Bank's statutes or the ideas of its managers are

^{66/} The bill before the Senate provides that tax incentives for Fund projects shall be greater than for other investments. Other privileges are so generous that the Finance Minister may have trouble fulfilling this norm.

^{67/} Ibid., p. 16.

in the way, it might be easier to change them than to go through the creation of yet another agency.

It should be noted in passing that Peruvian opinion is by no means unanimously in favor of more direct private foreign investment, with the consequent perpetual drain on foreign exchange as profits are returned. Some prefer that the Industrial Development Bank (or the proposed Trust Fund) limit investment to participation in genuinely Peruvian projects, which seek only technical aid, process and product licensing, and loans, but not equity financing, abroad. The present writer is sympathetic to this viewpoint. Over time, it should improve the balance of payments and do a great deal to develop a genuine national business community, free of many of the sources of present international irritations.

Finally, it is suggested that added international loans might come to Peru through the creation of the proposed investment trust. Professional "gossip" has it that some agencies are weakening in their previous determination to avoid lending for compensation of landlords, in agrarian reform programs.^{68/} These agencies have been willing to lend for agricultural development, for supervised credit programs, for training courses, for the introduction of better seeds, livestock, fertilizers, pesticides, and for the improvement of marketing, but they have been unwilling to lend foreign exchange with which to pay off present landowners.

^{68/} While the idea seems far-fetched, the Senate bill authorizes the President to accept any offer to help landlords that may come along. Article 226 permits him to sign agreements with international agencies for the guarantee of the bonds or to exchange the bonds for others bearing such a guarantee.

It is obvious that the present proposal is a face-saving way to do much the same thing indirectly. The landowners receive bonds. They deposit the bonds with the trust fund, which borrows abroad on the security of the bonds. The fund will probably get a higher percentage of face value of the bonds than the landowners could by selling the bonds on the local market; furthermore, if many of the bonds are immobilized in the trust fund, fewer will be thrown into the local market, and the price will fall less. The fund lends cash or gives marketable securities to the ex-landowners, who are thus paid off through international lending, close to the nominal value of their compensation, in cash -- and given Peru's free exchange market, in hard currency.

If international agencies want to help develop Peruvian industry this can be done through existing agencies, and there is no need to do so in a roundabout way in order to favor ex-landowners. To the extent that the landowners aided are not the best candidates for industrial entrepreneurs, this procedure is a deadweight loss. Peru increases her foreign indebtedness, but gets less development than if more direct methods had been used.

If international agencies mysteriously prefer to lend money to something called an Agrarian-Industrial Investment Trust instead of lending it directly to an Industrial Development Bank, additional loan resources might come to Peru through the creation of the AIIT. However, most agencies have general quotas or limits for loans to a given country, according to their estimates of debt servicing capacity. Such loans to the AIIT therefore compete with other uses of external loans. Peru

must consider whether available loans should be assigned to the AIIT, in order to favor ex-landowners, in preference to assigning them to agrarian reform -- to technical assistance, to credit and marketing improvement, etc.

In fact, loans to the AIIT would go for industrial development. Yet because "agrarian" got into the name, lenders might even be deluded into thinking this project has something to do with agrarian reform.

V. Conclusions

On the whole, the proposal to finance agrarian reform from abroad via the formation of Agrarian-Industrial Investment Trusts seems wonderfully irrelevant. It concentrates on the compensation of former landlords, when the essence of agrarian reform concerns the new farm families.

The proposed trust is not "agrarian" at all, since all investments will be made in industry. Increased industrial investment, through international lending and through channeling of land payments into industry, could be achieved through existing banks, including the state industrial development bank. If need be, the statutes (or managers) of the bank could be changed so that the bank could make equity or risk investments; this might or might not be easier than setting up a brand new organization. At any rate, if a trust is needed it could be created and supported by international lending and budget appropriations without

bothering with the land reform bonds at all. Such a fund would aim to stimulate industrial growth, whereas most of the features of the proposed AIIT are irrelevant, confusing embellishment. Particularly unclear is why shares in the AIIT, if good investments, should be limited to bond holders.

Capital flight could be discouraged most effectively through non-marketability of the land bonds. The proposed interest rate is in line with the market rate on Peru's external debt, so non-marketability would not wreak grave injustice. The families and firms who are prominent landowners in Peru already are heavily involved in industry and urban real estate. The land bonds will be useful assets in their balance sheets, against which existing banks will doubtless lend for sound industrial expansion projects. The proposed new fund would not, therefore, necessarily increase industrial investment at all.

The social welfare aspects of industrialization, such as the rights of workers and minority stockholders, are worthy but seem irrelevant to agrarian reform. Further, the proposed trust might well fall flat on its face in attempting to achieve these reforms with no stronger arm than the withholding of its investments.

No real increase in domestic resources for industrial development would be achieved by the trust fund unless consumption were reduced; this would require that the fund not liquidate at the rate by which the bonds are paid off, but reinvest its earnings.

If industrial investment in Peru is unsatisfactory, the real reasons may lie in the lack of suitable projects, or in the wide availability of

attractive financial investments and of tax-privileged investments in housing and other non-industrial activities. Other tax exemptions should be withdrawn, and priorities set, between industrial, agricultural, and services investment.

Finally, the only reason government bonds should sell at a discount in Peru as elsewhere, is fear of repudiation, or of inflation, or an interest rate below the market. The interest rate is correct. A government that would repudiate the bonds would likely be a revolutionary government of the left, arising because the very same families that will lose land and receive bonds, block the aspiration for reform. And if Peru falls into inflation, the cause may well be the same families, blocking tax increases that would balance the budget.

It is obvious that the Belaunde Government has a mandate to carry out its reform program, whether or not it is able to finance that program through taxation. Substantially the same families are affected either way -- they will help pay for that program through tax reform or through inflation that decreases the real value of the land bonds they receive for excess landholdings. Unlike tax reform, however, inflation will also harm many innocent bystanders. It would therefore behoove international agencies and advisers to assist and insist upon tax reform, rather than concern themselves with gimmicks to support the price of the land bonds.

Further loans and grants, to any Latin American nation and for any purpose, including industrial development, should be contingent upon "satisfactory progress" toward agrarian and tax reform as promised at

Punta del Este. As for further research, it would be interesting to see the effort thus far expended on schemes to help out the landlords, instead of in research on costs, methods, and financing of the real agrarian reform.

Santiago, May 3, 1964

JDS/jlc