

# Role of Land Rental Market in Agricultural Development in Sri Lanka

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Land is one of the most discussed subjects among different stake holders groups within the past few decades. A land policy which is conducive to the growth of the country's economy has been in urgent need for a long period of time. Land has been the major means of livelihood and the basic form of assets of the marginalized and vulnerable groups of rural Sri Lanka. Further ownership and user rights to land are likely to determine the land use efficiency, accessibility to capital market and thereby to the socio economic and social well being of the lower income groups. Even though there are arguments for and against the inverse relationship between land availability and poverty, getting access to land is considered one of the key pro-poor strategies in Sri Lanka. Besides within the current context eradication of rural poverty seems a far fetched objective without solving the problems related to land. Property rights, land market system, institutional and organizational set up within the regulatory framework and poverty seems to be largely influencing the efficient use and equitable distribution of the land resource. Land markets in developing countries are often criticized to be imperfect, malfunctioning and not necessarily leading the efficient allocation of land among uses and users. In Sri Lanka it was observed that the behaviour of two land markets - rental and sales is reasonably varying across different regions of the country as well as within themselves.

Poverty estimates for Sri Lanka vary from about 20 to 30 percent of the country's population. 90 percent of the poor reside in rural areas and 50 percent of them are employed directly or indirectly in agricultural sector. Alilima (1998), shows that the poor are largely found among the landless, near landless and agricultural laborers. Fifty percent of country's total extent of 65,610 sq. km land mass is arable and expanding population over the years has exerted increasing pressure on this limited land mass. At present per capita arable land of the country is 0.15 ha and this is expected to reduce rapidly due to the increasing population, urbanization and conversion of agricultural land into non agricultural uses. Limited arable land base and escalating land prices in rural areas is limiting the access to land by the poor and marginal farmers further concentrating land in the hands of a few rich and powerful. Further

more in rural areas off-farm employment opportunities for the poor who lack skills and managerial capabilities are scarce and poorly remunerative. Besides land transfers, particularly land sales, are more or less stagnant due to malfunctioning land sales market. General argument is such that land is not transferred to the most efficient producers and therefore land resource of the country is not in the optimal use. Distortions in the credit, insurance and input markets seem to have largely prevented marginal producers getting access to such markets as well as to land. Hence land rentals, which require less or no transaction cost and initial capital outlay seems to be the only option available for disadvantaged and vulnerable groups of farmers to gain access to land for cultivation. Literature suggests that the rental market is a more flexible and effective means of transferring land to more productive uses and users. Further it is considered to be the means of accumulating farming experience and capital for landless peasants to move up the agricultural ladder towards the land ownership. Hence active land rental market appears to be a promising avenue for accelerating development of the broader rural economy through better utilization of land resource.

The tenure status of agricultural land has changed with the policy environment of the country over the years. Tenure reforms implemented from time to time with the objective of guaranteeing tenure security to the tenants has generally failed in doing so and has been detrimental to the landlord-tenancy relationship. For example the two key tenure reforms, Paddy Lands Acts of 1953 and 1958 have led to eviction of thousands of poor tenants. However in Sri Lanka impact of the state regulations and restrictions on rental transfers are minimal and hardly any penalties imposed on the violators. It was well noticed that in spite of the restrictions on the rental transactions in the alienated state lands, all forms of transactions - leases, share tenure arrangements and mortgages are taking place. Besides the transaction costs involved in the rental transactions are relatively low with minimal deterrence on the participation of the agents.

It is difficult to comment on the rental markets in Sri Lanka in general due to the diverse nature of the rental contracts across different agro-ecological and geographical zones of the country. There are hardly any arguments against the suitability of land rental markets as a potential means of eradicating rural poverty in the broader sense.

Even though the social welfare effects of such contracts are obvious, the implications of rental involvements on economic wellbeing of the tenants have not been studied in Sri Lanka. Majority of the tenants in Sri Lanka seems to be cultivating mainly for consumption and have not been able to derive any savings or accumulate any wealth out of agriculture. Apparently only 20 percent of the tenants are involved in commercial production while others were producing for their subsistence.

Impact of the rental contracts on the productive efficiency is often debated but there are hardly any empirical evidences on this subject in Sri Lanka. In the case of rental transactions it is often argued whether lands are transferred to the most efficient users and whether those lands transferred are productive ones. It was noticed that farmers are not driven only by the economic efficiency in the use of land and other social, political, cultural issues also occupy important places. Low productivity in rented land can be partly explained by the inherent characteristic of low efficiency associated with the Sri Lankan agriculture. Moreover low resource endowment, poor technology, imperfections in other markets and lack of infrastructural facilities seem to be preventing the realization of full potential of the rental market. Hence to make the optimal use of land it is crucial to eliminate these obstacles tenants encounter at the grass root level and to facilitate access of tenants to other factor markets and provide them with the needed infrastructural facilities to improve their land use efficiency.

Secure tenure rights are considered important in increasing overall output of the land since it provides incentives for investment, assures the tenants' access to formal credit and enables the transfer of lands to efficient producers. In the case of Sri Lanka user rights seem to be more important than the ownership rights, in determining the effort an operator puts on the land. It is commonly observed that rental transactions are taking place even in the settlement areas where such transactions are prohibited. Tenants are operating encroached lands and also lands for which they had only claims but no formal titles. Hence full ownership rights to land are not seen as a necessary precondition for the operation of rental markets.

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Tenants are more concerned about their user rights and the share they get in return for their effort. Apparently there are different social mechanisms at the village level through which the rental markets are operated and the tenure rights are protected. All the terms and conditions related to tenure are determined by such local institutions and empirical evidence is scarce on the exploitation of tenants by the land lords, contrary to the popular belief.

Non-farm employment opportunities available at the village level are significantly affecting the rental market participation and the choice on the rental contract by both agents; landlords and tenants. This provides the opportunity for the less efficient producers to exit agriculture transferring their lands to more efficient producers. It was clear that without a concomitant increase in non-agricultural opportunities effective land rental transactions are unlikely to happen. However in Sri Lankan villages non farm employment opportunities are not very abundant and not sufficiently remunerative to attract the inefficient producers out of agriculture. Hence it could be beneficial to take necessary measures at the village level to speed up the process of structural transformation parallel to promoting rental markets in order to make land allocation more efficient.

Apparently the welfare impacts of the rental contracts depend on the terms of contracts. Theory suggests that fixed rental contracts are more likely to maximize economic gains and share contracts as the second best solution. It was estimated that nearly 70 percent of the tenants were involved in share tenancy

contracts, which is the most traditional form of tenure in the rural Sri Lanka. Substantial involvement of tenants in the fixed rental contracts could also be observed and such contracts were mainly confined to more resource endowed tenants. Even though fixed rental contracts are assumed to be more secure and advantageous to tenants, share tenancy contracts seem to be the only option available for the poor tenants who lack investment capacity and managerial skills needed. Hence in the current context facilitating share tenancy contracts relative to more resource demanding fixed rental contracts is likely to bring about more benefits to the poor.

There is not enough evidence to come to a firm conclusion whether the rental market of Sri Lanka is in favour of the agricultural ladder hypothesis or not. Majority of the rural households are involved in diverse income generating activities and it is quite difficult to separate out the absolute effect of the rental involvement. Rental transactions have not shown positive contributions to the wealth accumulation or access to land or to houses by the tenants as expected. This may be true in the current economic, social and political context and with hitherto available information but one cannot simply ignore the importance of this possibility for a developing country like Sri Lanka. It was observed in a recently conducted survey<sup>3</sup> that nearly 40 percent of the villagers are involved in the rental transactions. It was interesting to notice that nearly 78 percent of the tenants had their own land with full ownership rights implying that the majority of tenants are not landless. Even in the landless group more than 90 percent of the households had encroached lands or land to which they had claims. However 67 percent of the tenants were earning below the average level of monthly income from agriculture<sup>4</sup>. Hence it is clear that the

problems relating to land market are not mainly attributable to failure in the property rights system, ill functioning land rental markets or failure in the land regulatory and administrative system. The major problem lies in their lack of capacity to get involved in commercial production and inability to make a substantial saving out of the income. Getting access to land even via sales market would not solve the problem with the poor tenants since they are unable to make productive use of land with the low resource endowment and other limitations. Hence full potential of the rental markets can only be realized by removing these obstacles at the ground level. It is essential to promote commercial production in the rented lands by facilitating investment through improved access to credit and other markets. Promotion of local credit institutions could be helpful to the poor tenants who lack collaterals and hence access to formal credit. Removal of restrictions on the rental transactions in the state lands will in a way facilitate smooth functioning of rental markets in the agriculturally progressive areas. Provided the basic infrastructure and a conducive economic environment, land rental market can be used as an effective tool in the rural development process of the country.

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<sup>3</sup> The study is based on a survey conducted in 07 districts covering all the three agro climatic zones, Dry, Wet and Intermediate zones in October 2004. Sample size is 700 households.

<sup>4</sup> Average monthly income of households (per family) from agriculture was taken as Rs. 5200/-. This was calculated by taking the average value of the studied districts using the data of Household Income and Expenditure Survey (HIES) 2002. Average size of the family was considered as four. ■