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GRADUATE SCHOOL OF ARTS AND SCIENCES  
DEPARTMENT OF ECONOMICS

IS MARKET- ASSISTED LAND REFORM AN APPROPRIATE  
CHOICE FOR CAMBODIA AT THE PRESENT TIME?

SUBJECT: MASTER THESIS

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NEW YORK CITY, NEW YORK

DECEMBER 19th, 2001

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## **ABSTRACT**

This paper seeks to explain that due to various market-distorting conditions currently present in Cambodia, the market-assisted land reform approach is likely not a practical choice for achieving a desirable outcome with regards to equity and efficiency in land distribution. There are three principle reasons that would reduce the effectiveness of the market-assisted land reform program as a means for achieving equitable and efficient allocations of land in Cambodia under current tenure and credit conditions. These are: (i) a general lack of supporting institutions, a fact that would hamper market efficiencies and limit the effectiveness of the market-based approach; (ii) high transaction costs of obtaining information in an environment characterized by imperfect/ asymmetric information, and similarly high costs of monitoring and enforcing transactions in the presence of an unclear and weakly enforced property rights regime; and (iii) the high cost of the program as a whole which makes it difficult for the poor to participate and also imposes a huge financial burden on the government. Therefore, it is in the public interest for government to have an active role in monitoring land distribution in a way that would achieve an appropriate balance between equity and efficiency.

## **ACRONYMS AND ABBREVIATIONS**

CDRI	Cambodia Development Resource Institute
MLMUPC	Ministry of Land Management, Urban Planning and Construction
NGO	Non-governmental organization
Oxfam GB	Oxford Famine Great Britain
RGC	Royal Government of Cambodia

## **I. INTRODUCTION:**

It is now a critical moment for Cambodia to determine an appropriate strategy for addressing the problem of land rights and distribution in order to achieve its economic development and poverty reduction objectives.

Land ownership rights in Cambodia have varied throughout history in accordance with changes in government. Before French colonization in 1863, all land theoretically belonged to the sovereign and people were freely allowed to till unoccupied land and could cultivate as much of it as they liked. During their colonial rule (1863-1953), the French introduced a Western-style property rights system in 1884.<sup>1</sup> After Cambodia gained independence from France in 1953, the property rights put in place by the French continued until 1975, when the Khmer Rouge seized power and eliminated all private property rights. The Khmer Rouge also systematically destroyed all property records. After the liberation from the Khmer Rouge regime in 1979, a collectivized system was introduced and all land was put under the ownership of the state. Land ownership rights were reintroduced in 1989, under which land was redistributed to individuals and families who had lived and worked on the land since 1979 and in accordance with family size (Sik 2000, p. i). Furthermore, the state recognizes only those land property rights that exist after 1979, declaring all prior ownership rights invalid. This was done to prevent the complications and confusion associated with land ownership, and to guard against possible disputes between former owners or their heirs (prior to 1979) and new owners (after 1979).

Since 1989, private ownership and control rights over land have been divided into two different types. The first type is the ownership rights, which give owners exclusive and alienable rights over land. This type of rights arrangement is given to

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<sup>1</sup> Although it did not come into effect until 1912 due to strong resistance from farmers.

individuals and families only over residential land, i.e. houses.<sup>2</sup> Such ownership rights apply mainly to urban residential buildings, especially in Phnom Penh. The second type of rights is the possession and use rights. These rights are given to individuals and families over agricultural and cultivation land. Like that for ownership rights, this type of rights arrangement gives individuals the rights to work on and have full entitlement to all the benefits from the land they occupy. They can also transfer (i.e. sell), lease, inherit and mortgage land for loans. However, the ultimate ownership of land belongs to the state. In addition, unlike the ownership rights arrangement, under certain circumstances the state can forfeit possession and use rights from individuals. For example, land granted under possession and use rights would be forfeited back to the state if land is left vacant for more than three years for purposes other than letting the land lie fallow.

The new land law, the *Immoveable Property Bill*, just approved by the National Assembly in 2001, recognizes private ownership over not just residential buildings but over agricultural and cultivation land as well.

Supporting institutions for the land market, such as land titling and registration systems, microfinance institutions and legal and judicial systems are not yet fully developed, however. The property rights system in Cambodia is not yet complete and is weakly enforced. There is a general lack of data on land inventories even for state land. The majority of the population still occupies land without legal documents. Following the enactment of the 1992 Land Law, the Department of Land Titling started a program that issues land tenure certificates to confirm the occupancy and use rights over rural land by calling for applications. About 4 million people applied, but due to the lack of both resources and capacity for processing and issuing land tenure certificates, only about 10 percent of the rural population have received these land-use certificates, while many

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<sup>2</sup> According to *Sub-Decree No. 25* (passed in April 1989) and *Political Instruction No. 3* (passed in June 1989).

gotten only receipts for their applications (World Bank 2000a).<sup>3</sup> Similarly, only about 25 percent of the land and property in Phnom Penh Municipality has been reported as properly registered (World Bank 2000b, p.3). In addition, Table 1 (p.56) shows a significant slow down in the registration process, with a 84.3 percent decrease in the number of certificates issued during the period 1995-2000 compared to 1989-1995.

Credit institutions are also undeveloped. In fact, the severe lack of effective financial services in rural areas is one of the major constraints on agricultural growth and rural development. Microfinance operations of the NGOs are virtually the sole financial service providers in rural areas, but despite the significance of their operations this access to credit is limited to an estimated 11 percent of rural households (RGC 2000, p.10). Finally, the legal and judicial systems essential for enforcing property rights and contacts and settling disputes are also in need of strengthening and reform.

With the re-introduction of private ownership, people have transferred their residential land among themselves even though only a small proportion of the population has official title to land. Moreover, many private and state properties have changed hands legally or illegally as a result of market and other forces. Although possession rights can be obtained only for agricultural and cultivation land, the market for this type of land has also been active. The official figure for number of land transactions since 1995 is over 10,000, excluding transactions in Phnom Penh. The actual figure is believed to be much higher, however (Sik 2000, p.17).

In the absence of a formal land market based on land titles, an informal market in rural and urban land based on customary tenure has developed. However, as Cambodia's market-based economy grows, there are worrying signs that this informal land market is struggling to cope with the country's growing population, changing technology and integration into the global economy. The demand for the labor market in the rural area is

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<sup>3</sup> Other studies have put the number of certificates issued since 1989 to be about 13 percent (Sovannarith et al. 2000, p.14).

flat and cannot absorb the surplus labor created by landlessness. As the land market becomes more and more distorted in response to these pressures, the consequent loss of productivity and increasing social tension becomes more evident (Williams 1999b, p.3).

In spite of claims by some experts that land distribution in Cambodia is relatively equitable compared to neighboring countries, various studies have shown worrying signs of increasing incidents of landlessness and land concentration. Different surveys have found an increase in the number of landless families from about 3 percent in 1984 to about 13 percent at the end of 2000 (Biddulph 2000). A recent survey conducted by Oxfam Great Britain, an international NGO working on land issues in Cambodia, concluded that the largest single cause of rural landlessness is the expanding rural population and the consequent growing demands for land. Of the landless families surveyed, 55.4 percent had never had land, usually because of movement between villages or former returnees from Thai-Cambodian border camps. The largest number of those who had never had land, however, were couples who had married after land was distributed by the government in the late 1980s, and whose parents did not have enough land to give them. Given the current rate of population growth <sup>4</sup>, there is need for an increase in the supply of land to meet these increasing demands. The survey also found that for those landless families who previously had land, the single biggest cause for becoming landless is distress sales mainly due to health problem (45 percent) (Oxfam 2000, cited in CDRI 2000, p.2).

In the same vein with such findings, various studies have shown that land distribution has become highly unequal during the last decade. The average size of an

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<sup>4</sup> The 1998 Population Census shows the number of people for the age group most likely to correspond to first marriage (20 to 24) is projected increase in its absolute size by 2006 (some 350,000 more persons) could mean, up to 150,000 new households in needs of land of their own – or alternative off-farm employment. This new demand is of course adding to the existing demands from the landless, be they former farmers, demobilized soldiers or returnees.



agricultural land holding is quite small – about 1 hectare per family <sup>5</sup>. The land ownership distribution data from the CDRI-study (1997) in terms of decile shares reveals that the top 10 percent of households account for 34 percent of the land, while the bottom 40 percent own only 9 percent of the land.<sup>6</sup> Other sources (Sik 2000, p.i) show that about 40 to 50 percent of the landless and marginal land holders possess only about 10 to 15 percent of all agricultural land in rural areas. The estimated Gini coefficients of land concentration range from 0.47 to 0.66 for the different surveys that target different groups. Current trends in land transactions confirm the situation of an increasingly skewed distribution of land. A survey conducted by the Cambodian Development Resource Institute (1998) found that in the villages surveyed, much of the purchases were by the rich and well-off, while sales were made by the poor and the extremely poor. If these trends continue, the existing inequalities in land ownership are going to be exacerbated even further (CDRI 1998, cited in Williams 1998, p. 11).

Thus, it is critical to frame answers to the question that rises from all of these findings: what land reform approach should Cambodia adopt in order to solve its land distribution problems in a way that would achieve both equitable and efficient objectives?

People have used the term “land reform” to mean different things – redistributing land certainly is a common one, but equally valid are land reclamation, reforestation and many other forms of policy actions that affect land. In this paper, land reform is limited in its meaning to the process of making land more accessible to a broad number of the people and thus more equitably distributed among the population.

To address these issues, the Royal Government of Cambodia has adopted a Land Administration, Management, and Distribution Program (LAMDP) which aims to: (i) strengthen land tenure security and land markets, and prevent or resolve disputes; (ii)

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<sup>5</sup> The findings of a poverty mapping exercise undertaken by the World Food Program in 1993 in 73 rice-growing districts across Cambodia showed that 54 percent of families possess less than 1 hectare of land (World Food Program 1994 cited in van Acker 1999).

<sup>6</sup> Cited in van Acker 1999.

manage land and natural resources in an equitable, sustainable and efficient manner; and (iii) promote land distribution with equity (World Bank 2001a). Several countries and international institutions have helped Cambodia with its land reform effort through a wide range of programs including land titling (funded by the German and Finnish governments) , cadastral mapping (funded by the French government), the Land Management and Administration project (through the World Bank) and the new Land Law (with assistance of the Asian Development Bank) (World Bank 2001b).

With regards to land reform approaches, the World Bank has been actively promoting a new model of land reform – called “market-assisted land reform” or “negotiated land reform.” It has been adopted by a number of countries including Colombia, Brazil, South Africa and the Philippines. This new land reform model, “relies on voluntary transfers based on negotiation between buyers and sellers, where the government’s role is restricted to establishing the necessary framework and making available a land purchase grant to eligible beneficiaries” (Deininger 1998,p.2). This approach aims at removing various government interventions in land distribution that have been viewed as causing distortions in the market. Thus, under this approach the demand for and supply of land will determine the allocation or distribution of land.

Is this land reform model suitable for Cambodia? Under the current tenure and credit situation in Cambodia, this new approach in fact may prove not to be a practical solution for achieving a more equitable and efficient land distribution. There are three principal reasons why market-assisted land reform could face problems in Cambodia:

- 1) Supporting institutions such as land titling and registration systems, credit institutions and legal and judicial systems are still undeveloped. Such a lack of supporting institutions limits the efficiencies of a market mechanism as the tool for achieving a more sustainable and equitable distribution of land. Therefore, unless property rights and other

supporting institutions improve, market-assisted land reform will not provide a practical solution to land distribution problem in Cambodia;

2) imperfect/asymmetric information and the absence of a clear and enforceable property rights regime would increase the transaction cost under the process; and finally

3) the requirements for obtaining loans under the negotiated approach is fairly complex and costly for beneficiaries, thereby creating barriers to entry for the land-poor and the landless. This condition would lead to an even more skewed land distribution, which empirical evidence has shown to be less efficient in promoting long-term economic growth than a more equitable distribution. The program would also be very expensive, thus putting its long-term sustainability at risk.

This thesis is based on two separate hypotheses:

Hypothesis 1: *The current land ownership and credit situation in Cambodia is such that a market-assisted land reform approach is not likely to yield an efficient and equitable land distribution. People who have financial advantage such as wealthy farmers, business people, and some people with connections to the government are likely to accumulate large amounts of land while the poor and the disadvantaged face the risk of become landless.*

Hypothesis 2: *Therefore, it is in the public interest for government to have an active role in monitoring land distribution in a way that would achieve an appropriate balance between equity and efficiency.*<sup>7</sup>

This thesis seeks to explain that due to various market-distorting conditions currently present in Cambodia, the market-assisted land reform approach is likely not a

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<sup>7</sup> Efficiency in this case refers to the ability to increase the level of productivity on a given set of land resources mainly through increases in factor inputs such as capital, labor and raw materials.

practical choice for achieving a desirable outcome with regards to equity and efficiency in land distribution. There are some limitations to this paper, however. Although land distribution problems exist also in urban areas, this paper will focus on the rural area where a majority of the poor population live. Also, it will focus mainly on agricultural and cultivation land even though other resources such as water resource and forestry need immediate attention as well. Furthermore, although there exist many other related land problems such as land grabbing and land encroachment, I will devote this paper only to addressing land access and distribution issues. Finally, empirical evidence has shown a positive correlation between equality in land distribution and the rate of economic growth. Thus, this paper is based on the premise that a more equitable distribution of land is likely to result in a higher economic growth rate and a higher degree of efficiency as well.

The second section of the paper will take up the historical background behind the evolution of land property rights in Cambodia. The third section will supply a theoretical discussion which lays out the pros and cons of the market-assisted land reform approach to land distribution as experienced in various countries from Latin America to Asia. I will also discuss the nature of the land market and the impacts which land reform has had on economic growth and development. The fourth section, the analytical part, will explain three principal reasons for the unsuitability of market-assisted land reform as a method for bringing a balance between efficiency and equity in terms of land distribution to Cambodia under its current tenure and credit situations. The final section will provide conclusions and certain recommendations for possible approaches the government can adopt in the short-to-medium term in order to address short-term land distribution and poverty problems as well as to build a solid foundation for effective and sustainable land reform programs.

## II. HISTORICAL BACKGROUND OF LAND TENURE SECURITY IN CAMBODIA

Land ownership rights in Cambodia have varied throughout history in accordance with changes in regime. The notion of private ownership rights over land did not seem to exist in Cambodia before the arrival of the French in the late nineteenth century. Under the traditional system, property rights were recognized under the principle of user rights – meaning that individuals or families are given the right to use a piece of land and to reap the benefit from its outputs. Nevertheless, individuals or families theoretically did not acquire inalienable ownership rights over land. Theoretically, all land belonged to the sovereign. The King was the lord of all the land in the Kingdom, which meant that he could reward people with the right to use it. However, in practice, the people who cultivated the land were given ‘ownership’ recognition (Greve 1993, p.6). Such a practice is called ‘acquisition by the plough.’ With a small population and the absence of a land market, the cultivating proprietor could move from one area to another and assume ownership. Owners had exclusive rights to possess, use and inherit agricultural land, without having to fulfill any formal obligations except corvee or other feudal tributes (Sik 2000, p.3) In addition, the distribution of land was rather equitable, with landholdings tending to be small and even high officials holding only a few hectares (Chandler 2000, p.101).

Responding to the request of the Cambodian king, the French established their protectorate over Cambodia in 1863. During the colonial period, the French introduced the concept of private land ownership and protected it by law. The *Land Act of 1884* stated that, “the land of the Kingdom, up to that day the exclusive property of the Crown

will cease to be inalienable. The French and Cambodian authorities will proceed to establish private property in Cambodia.”<sup>8</sup>

The French established the first cadastral administration, the ‘Service du Cadastre’, in 1896 and introduced a cadastral mapping and registration system in 1912 in order to promote the registration of land in the country. As a result, about 90 percent of property had been registered by 1975<sup>9</sup>, when the Khmer Rouge took over and destroyed virtually all property records.

Initially, French attempts to use legal mechanisms to consolidate their expropriation of Cambodian property were met with wide resistance from Cambodian peasants. As a result, land reform was not fully implemented before 1912 (Greve 1993, p.6). In 1920, the French introduced the Civil Code which established the system of French land laws that recognized private property rights.

These French actions were motivated mainly by economic reasons. The establishment of private ownership over land provided the guarantee for the investments of French settlers (Thion 1992, p.2). French authorities also wanted to make all unoccupied land available for sale, which opened up the opportunity for establishing large-scale plantations. Further, the Civil Code theoretically would provide the means of achieving increasing land values and thus raising capitalized rents on land.<sup>10</sup> In practice, however, this objective was not met and low market values for land were maintained. The introduction of land registration and ownership gave rise to land transactions. By 1930, most of the rice-growing fields were registered as private property and people were also free to sell their land. In the meantime, most of the land was divided into plots of less than 5 hectares and large plantations had been established (Greve 1993). Nonetheless, the accumulation of land in private hands was not substantial and neither the problem of land

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<sup>8</sup> As cited by Thion 1992, p.29

<sup>9</sup> World Bank (2001d), p.1.

<sup>10</sup> According to Thion 1992, p.29

concentration nor of landlessness emerged, for the availability of unexploited land provided opportunities for those people who sold their land to move into a new area.

After independence in 1953 and until 1975, the Cambodian elites continued to embrace the private property rights system put in place by the French. However, as a result of two factors -- the combination of low farm productivity and the high interest rates <sup>11</sup> charged on loans which farmers borrowed to finance both their farm expenses and non-farm expenses -- many farmers became indebted. This eventually gave rise to the growing landlessness during this period as some farmers were forced to sell off their land in order to repay their debts.

During the Democratic Kampuchea (DK) period between 1975 and 1979, the Khmer Rouge abolished all private ownership of land and systematically destroyed all cadastral and land registration records. A massive resettlement of the population took place across the country, as people were forced out of the cities and moved towards rural areas. This apocalyptic experiment wiped out the administrative and institutional infrastructure, which had underpinned the entire post-colonial land market.

After the liberation in 1979, both the economy and land distribution were put under a collectivized and centralized form of management. Large numbers of people all across the country moved about seeking refuge and food. Claims to ownership of residential land were based on occupancy. In the cities across the country people were free to settle in any unoccupied house or on any piece of land they wanted with only a few exceptions. Meanwhile, in the countryside the agricultural infrastructure had been decimated and food production was critically low. The government appealed to its displaced citizens to return to their pre-Khmer Rouge villages and try to reconstruct their lives (William 1999a).

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<sup>11</sup> Many farmers borrowed from informal lenders at a rate often as high as 30 percent, but sometimes as high as 100 to 200 percent per season (Meijers 1994).

In 1989, however, the government reintroduced private property rights in its efforts to restructure the economy from a centrally-planned to a market economy. Land was redistributed to households which had occupied or worked on the land since 1979 in accordance with their family sizes at the time. Further, the state declared invalid all property rights that existed before 1979. Private ownership was assigned to residential land, which then could be bought and sold. On the contrary, for production or cultivation land, households could receive only possession rights while ownership rights still belonged to the state.<sup>12</sup> Theoretically, peasant households would have to pay taxes for using land for production, but in practice such taxes were never collected. Production land left vacant for more than three years for purposes other than lying fallow would be forfeited back to the state. Furthermore, the possession of farmland was salable and farmland could be converted into residential land, both actions being subject to the approval of government offices (Summers 1997).

The reintroduction of private property rights and the adoption of the market economy have given rise to an increase in land transactions during the last decade, although only a small percentage of the population have some sort of legal documents proving their relationship to the land, such as titles or tenure certificates.<sup>13</sup> There has been a rapid increase in the demands for land due to various socioeconomic changes during the last decade, such as refugee repatriation, the advent of markets and urbanization, and increased population growth (Sovannarith et al. 2001, p. vi). According to the official figures given by the General Department of Cadastre and Geography, the number of land transactions since 1995 is over 10,000, excluding transactions in Phnom Penh. The actual figure is believed to be much higher, however.<sup>14</sup>

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<sup>12</sup> According to Sub-decree No. 25, Political Instruction No. 3 and 1992 Land Law.

<sup>13</sup> Only a little over 10 percents of the rural people, who applied for tenure certificates since 1989, have received these land use certificates, while many received only the receipts for their application (World Bank 2000a).

<sup>14</sup> Sik Boreak 2000, p.17



Land privatization and the adoption of a market economy in the late 1980s and early 1990s have produced mixed results with regards to both the welfare of the rural population and land distribution. On the one hand, the new system in some cases, has enabled the transfer of land for more productive uses. For example, different tracts of land were being bought by companies and converted into factory buildings, which in turn produces higher-value products while opening up off-farm employment opportunities for people, including those from the rural areas.

On the other hand, those people who have not been able to adapt to the new system – particularly, the most vulnerable segments of the population such as the disadvantaged and female-headed households -- have not benefited from such processes, and in many cases have actually been adversely affected by the changes. Similar to the period after the independence from France, landlessness has emerged and is possibly on the rise. Different surveys have found an increase in the number of landless families from about 3 percent in 1984 to about 13 percent at the end of 2000 (Biddulph 2000). Some of the causes for landlessness are similar to those that occurred during the post-colonial period such as loss of land due to distress sales resulting from the need for cash to pay for both farm and non-farm expenses (e.g. medical expenses, debts). Other causes include a high population growth rate, internal movements and refugee repatriation, all of which have contributed to a rapid rise in demands for land.

Adding to the problem of landlessness, land concentration has also occurred. This problem must be addressed immediately given the high rate of rural population growth which can only worsen the problem in the future. About 40 to 50 percent of the landless and marginal land holders possess only about 10 to 15 percent of all agricultural land in rural areas. The estimated Gini coefficients of land concentration range from 0.47 to 0.66 for the different surveys that target different groups (Sik 2000, p.i).

For these reasons, it is clearly now a critical time for Cambodia's adoption an appropriate and effective approach for dealing with these land-related issues, if it is to set a solid foundation for achieving its ultimate goals of poverty reduction and sustainable economic growth.

### **III. THEORETICAL DISCUSSION:**

#### ***1. The Nature of the Land Market:***

Before discussing the positive and negative aspects of market-assisted land reform as a method for solving the land distribution problem, we should first discuss the nature of the market for land itself.

Neoclassical economic theory assumes perfect and costless information and zero transaction costs as the main underpinnings for the complete and perfect markets found in general equilibrium model – the so-called Walrasian model. In this model, prices are a sufficient mechanism for addressing all the allocation problems by costlessly and quickly adjusting to changes in supply and demand to achieve equilibrium. (Byanmugisha 1999, p.2) Similarly, according to static price theory and welfare economics, resource allocation will inevitably be at an optimum level under market conditions of perfect competition. Due to the free interplay of supply and demand, prices of all productive factors and marginal productivities will have come to rest at a level corresponding to maximum economic efficiency (Strassmann 1956, p.425).

However, these assumptions for perfect competition usually do not hold in practice. Information is imperfect and there are costs associated with obtaining the information. With imperfect and costly information and incomplete risk markets, the information economics has established that, in general, markets are not Pareto efficient; that even when there are many participants in a market, competition may be highly imperfect; and that the distribution of income matters for economic efficiency, thus rendering the dichotomy between distribution and efficiency that characterized neoclassical economics generally invalid. In addition, the monitoring and enforcement of contractual relationships in such an environment is costly and can lead to distortions and market failures (Stiglitz 1993, pp.109-110).

Joseph Stiglitz (1985, pp.26-28) argued that markets are not perfectly competitive, though they may be monopolistically competitive. With perfect information and no non-convexities the postulates underlying perfect competition have a certain plausibility and are internally inconsistent. Nevertheless, as he pointed out, the competitive paradigm is an artificially constructed structure: when one central piece (the assumption of perfect information) is removed, the structure collapses. To construct a new paradigm several of the assumptions need to be replaced. In the presence of imperfect information, both the law of supply and demand and the law of single price in traditional market theory do not hold – meaning that equilibrium is characterized neither by demand equaling supply nor by the law of single price.

The same qualifications of theory also apply to the market for land. Market theories suggest that land must be treated the same way as other factors of production such as labor and capital. Neoclassical economics makes no fundamental distinction between the market for land and the markets for other factors of productions and for goods and services. According to this school of thought, the conditions for the existence of perfectly competitive markets for land are the same as for other markets, including those for labor and capital (Stringer 1989). There must be: (i) a substantial number of buyers and sellers (so that no single purchase can influence the price and an individual's demand or supply may increase or decrease without affecting prices); (ii) homogeneous units (to ensure that buyers and sellers are indifferent about who they buy from or to whom they sell); (iii) uniform access to information for both buyers and seller; (iv) complete freedom of entry and exit from the market; and (v) no influence of customary and institutional rules on distribution of resources among perspective buyers and land sold to the highest bidder ( Shearer, Lastarria-Cornhiel and Meshba 1991, p.7).

Experiences from different countries have also confirmed that land markets are imperfect. Individual buyers and sellers can in fact influence prices. Land is not a

homogeneous good since different qualities of land exist in different geographical areas. Information about land is usually asymmetrically distributed among participants -- for instance, availability of land is often announced through kinship or friendship networks. Transaction costs are often very high, creating barriers to entry by the poor and disincentives for large landholders to participate in the market. In many circumstances, the government restricts various forms of land transactions (Melmed-Sanjak and Lastarria-Cornhiel 1998). Therefore, due to the imperfect nature of the land market, the price-determining equilibrium model will not hold.

## ***2. A Case for Market-Assisted Land Reform:***

Land distribution has been a major issue for developing countries trying to promote economic growth and development. Many governments have adopted various land reform programs promoting the distribution or redistribution of land, even using force on some occasions in order to achieve a more equitable land distribution among the population.

Recently, a new approach to land reform, called ‘market-assisted land reform,’ which uses the market mechanism with limited government support to improve the efficiency of land use and equitability of land distribution has gained supports from both certain governments and international development agencies. Under this approach, qualified beneficiaries receive a combination of loans and grants from public or private institutions to purchase land at a market or negotiated price. The government role is limited to making supporting institutional frameworks for the market and providing the grant.

The World Bank has played a leading role in promoting this new approach. According to Robert Thompson, director of the World Bank’s rural development department, “the approach responds to the need to make land reform more demand-

driven and, in addition to giving access to land, provides avenues for beneficiaries to make productive use of the land” (Mutume 2001).

Static price theory and welfare economics hold that, due to the free interplay of the supply and demand, the prices of all productive factors and marginal productivities will have come to rest at a level corresponding to maximum economic efficiency. In the view of this model, government interference with pricing itself would mean dislocation and impaired efficiency (Strassmann 1956, p.425). The new welfare economics is also predicated on the assumption that the government does not have perfect information concerning different individuals; it cannot tell who is of high ability, low ability, disadvantaged by the innovation, who benefits from certain public programs. The absence of this information implies that government interventions in allocation of resources (e.g. through lump-sum re-distributive taxes) are in general not feasible and can cause distortions leading to inefficient outcome (Stiglitz 1985, p.31). In addition, the theory behind market liberalization holds that there is no need for action other than removing government-imposed constraints on the operation of markets because when markets are allowed to work freely, growth will occur and all will benefit (Melmed-Sanjak and Lasterria-Cornhiel 1998).

Theoretically, this new method of market-assisted land reform would remove policy distortions created by excessive government interventions and thus reduce the cost and improve efficiency of the land reform program. This new approach is based on the premise that government interventions in the agricultural sector have imposed heavy costs and uncertainties on farmers as well as distortions in agricultural production and markets (Cainglet, p.101). Unlike government directed land reform in which the government dispossess the land from a large landholder and gives it free of charge to the poor, market-assisted land reform programs allow beneficiaries to receive a combination of grants and loans from the public and private sectors which they use to negotiate the

purchase of land from willing sellers. This practice is called the *willing seller-willing buyer* framework of market-assisted land reform. By taking away the unnecessary administrative process involved, this method lowers the cost of land reform programs and increases the incentives for beneficiaries to make productive use of their lands. Market-assisted land reform thus can avoid the problems of bloated bureaucracies and non-working farms seen in some earlier land reform programs.

Furthermore, the new market approach would remove unnecessary subsidies that would prevent efficient functioning of the market. Large farmers tend to benefit more than small farmers from agricultural subsidies, such as reduced tariffs on imports of capital equipment and tax breaks. Eliminating these subsidies will improve the bargaining position of small farmers in the land market because the subsidies tend to offset the inherent advantages of small versus large farmers (Shearer, Lastarria-Cornhiel and Meshba 1991, p.vii).

Land tenancies are most efficiently allocated when their values/costs are determined by the market. The emphasis here falls on the negotiated market transaction. That is, when all parties to the transaction of temporal or partial interests are able to negotiate the terms, we find the lowest transaction and contract maintenance cost (Riddell 2000, p.2).

In addition, strengthened and enforced land taxation policies could be used to increase the supply of land available for purchase by pushing large farmers to sell land that is underutilized (Riddell 2000, p.vii). The World Bank claims that this new approach in Brazil succeeded in bringing down the cost of land transfer to less than half of its anticipated cost.

Another advantage of market-assisted land reform is that by lowering transaction costs, this approach encourages productive transfers of land between individuals. Market theory has that high transaction costs can reduce the efficiency of resource allocation.

Transaction costs in the land market are the aggregation of a number of costs: legal paperwork, searching costs, valuation of the asset, management costs, bargaining, etc. The higher the transaction costs in land market, the lower the incentives to do land transactions. This disincentive to do land transactions has two important effects: it does not allow land allocation to its best economic use, and it reduces demand for land as an asset because it becomes too costly to obtain the benefits derived from owning the asset. This last situation is highly relevant for the use of land as collateral for credit (Trivelli 1997, p.6). Therefore, market-assisted land reform which allows low-cost transactions can help solve this incentive problem and increase the efficiency of resource allocation.

Unlike under government-directed land reform programs in which the government can expropriate land from owners against their will, market-assisted land reform supports voluntary transfers of land between people. A landowner may hold on to his land if that is what he wants. A landowner can only be parted from his land and be included in the program if he is willing to sell at the price that agrarian reform beneficiaries are offering.

Market theory states that a functional land market is vital to the national economy because it is the best mechanism by which this important productive resource gets to be controlled by those best equipped to use it most productively (Williams 1999: 13). Market-assisted land reform helps activate the market which promotes the transfer of land between large landowners and small landowners. By activating the market, the new reform programs and policies encourage and facilitate transfers of land from the extensive large-farm section to the intensive small-farm section of society. This goal is premised on the hypothesis that making large farm sector more accessible will, over the long term, promote a more efficient allocation of resources between small and large holdings and transform the pattern of ownership by shifting land to more efficient users of resources( Shearer, Lastarria-Cornhiel and Meshba 1991, p.vii).



Furthermore, this new approach to land reform entails measures which dynamize the rural land market- both from the supply side and the demand side. On the supply side: this approach removes any policies that provide incentives for people to hang on to their farm land for reasons other than farming (e.g. speculative gain) and introduces an incentive regime (a set of taxes and subsidies) that is efficiency-enhancing. On the demand side, this approach provides subsidies to the poor to buy land (favoring those with previous farming experience), provides the training that is essential if sound farm projects are to be designed, and invests in the economics of the social infrastructure (on-farm and off-farm) that makes farms more viable (World Bank 2001c).

The key elements of this new model of market-assisted land reform are:

1. A land purchase grant to support freely negotiated land transfers or transfers resulting from a willing buyer-willing seller bilateral land price negotiation, where the government's role is restricted to establishing the necessary framework for negotiation and making available a land purchase grant to eligible beneficiaries;

2. beneficiaries are obliged to come up with a productive project before approval of the purchase grant, a plan for how to develop the land after acquisition based on crop choices, identification of marketing channels and sources of working capital to determine if the whole process is economically viable and merits support from financial intermediaries like banks, and to facilitate land price negotiation on the basis of the productive capacity of the project -- thus ensuring integration of land transfer with productivity increases and clarifying the potentials and limits of land transfers to ensure sustainable poverty reduction goals;

3. the program is demand- rather than supply-driven which means that areas and production systems are to be matched with the capacity and plans of beneficiaries, and that beneficiaries must show the ability to make good use of public funds which are the purchase grants;

4. decentralized implementation, which brings down transaction costs and achieves better integration of land reform with local government development priorities and investments; and

5. maximization of private sector involvement is sought, particularly in credit access and investments (Deininger 1997, pp.28-30).

### ***3. A Case Against Market-Assisted Land Reform:***

The main opposition to the market-assisted land reform is the argument that this new approach would lead to increasing land inequality, which would exacerbate poverty among the poor and reduce their agricultural productivity. Therefore, the state should play a more active role in providing supports to the people who might be hurt by the market process.

In theory, competition favors those producers with comparative advantages and penalizes non-competitive sectors. In the case of agriculture, however, the rural poor and small farmers are often the least competitive due to their lack of skill and other resources. They are often compelled to continue agricultural practices that are uncompetitive in order to survive. Therefore, the market approach in agriculture and land reform is not likely to benefit the poor sector of the population.

Small farmers in the land market are further disadvantaged because transaction costs are high for them and if there is no insurance system and without access to capital, they are often forced to sell their land to cover unexpected expense or misfortune ( Shearer, Lastarria-Cornhiel and Meshba 1991, p.vii). In Cambodia, as in many other developing countries, such distress sales are a very common reason for people to sell their land and become landless.

The requirements surrounding access to credit that usually follow economic liberalization frequently exacerbate the plight of the rural poor. The establishment of

formal market mechanisms within a rural economy often removes, or reduces, the level of traditional credit mechanism and imposes formalized banking conditions on credit procedure. As a result, small and poor farmers, especially female-headed households, are not in a position to compete for available credit (FAO 2000a). Experiences from countries such as the Philippines and Brazil show that the requirement for participating in the market-based land reform program is putting more and more of the cost burden of land transfers on the shoulders of farmer beneficiaries (Pilipinas 2000).

This poor access to capital makes it difficult for small farmers to purchase land. Recent work like that of Zimmerman and Carter (2001) suggests that in the absence of insurance markets, these portfolio considerations may further diminish the competitiveness of small farms in the market. Unfavorable price swings (land price collapse due to natural disasters reduce farm income) make it especially difficult for poorer individuals who lack adequate capital access to defend and maintain their land holdings (Carter 2001, p.8). In this case, only economically larger and financially more secured interests are able to participate in the market for larger and better endowed properties. Therefore, attempts to introduce land markets have led to land concentration. This often leads to inefficiently sized units, idle land and speculation (FAO, 2000a).

As explained previously, the imperfect nature of the land market would cause inefficient land distribution if left to function by itself. It is nevertheless important to note that, even if land markets were perfectly competitive, it is unlikely that land would shift to the landless or the land-poor. Binswanger (cited in Carter and Mesbah, 1993) identifies the “fundamental financing problem of the poor” as the culprit. The basic argument is that, in order to finance land purchases in competitive capital markets, the poor would have to dig into current consumption, which they cannot afford to do. Such a cut in current consumption would deplete their resources, which could be used for other purposes such as investing in land and thus reducing their productivity. This environment

increases the chance that some poor farmers will be in debt and eventually forced to sell off their land leading to an increase in landlessness and growing land concentration in the hands of the a few landlords.

Neo-classical economics has shown that land markets are in fact imperfect and do not guarantee inclusion of all economic and social agents mainly because information is asymmetric. Due to informational asymmetry, one group of participants involved in the exchange of a particular commodity will have better access to information and hence greater bargaining power than other groups, and so will contrive to use it to their own advantage. When information is costly and asymmetrically distributed, incentive problems arise. When information is imperfect, it is more important and convenient for the state to strengthen the bargaining power of the less favored than to try to regulate private contracts (de Anda 1997, p.4).

Empirical evidence shows that the market-assisted land reform policies are unable to address the problem of unfair land distribution. There is no evidence that land market reforms have fundamentally altered the patterns of land ownership. Further, the supposed cost reduction will thus turn out to be an illusion: If the land price increases, the state and so-called beneficiaries will be unable to pay for the land reform process (Weissman, 2000). Therefore, government intervention would be a better option for promoting conditions for fair interactions between buyers and sellers.

Stiglitz (1985, pp.27-31) pointed out that, with imperfect information, there is a *fundamental non-decentralisability theorem*: efficient resources allocation cannot be efficiently decentralized without a whole set of subsidies and taxes from the state. He also pointed out that, the findings from recent literature have established that the proposition is not correct: whenever there are information problems, there are government interventions – taxes and subsidies levied on observable variables – which could make everyone better off. Therefore, a market-assisted land reform method, which

promotes decentralized implementation while limiting the government's role in providing various forms of subsidies to farmers (except for loan or grant) would not in fact yield an efficient and equitable allocation of land. A more active role of the government is thus desirable.

Furthermore, state involvement as well as that of financial intermediaries in providing the information on land prices to reduce informational imperfections and help the negotiation to be more transparent and fluid, may improve the negotiating positions of beneficiaries.

In addition, lack of supporting institutions hampers the development of market efficiencies in achieving a more sustainable and equitable distribution of resources. This is the existing condition in Cambodia. Thus, market mechanisms will not work efficiently at this early stage of development. The movement towards a market system must proceed carefully to allow time for appropriate institutions to develop. In a changing world, the required institutional changes in markets do not always take place automatically. The state can play an important role in promoting and supporting the right kind of market institutions. Where market signals alone are not effective guides to desirable action, appropriate non-market institutions must be created (Datta-Chaudhuri 1990, p.38).

#### ***4. The Relationship Between Land Reform and Economic Growth:***

Land management is described as the process by which the resources of the land are used to the best possible effect. Fundamental to the process of land management are the management of land resources, of the information about land use policies and of other land-related information to ensure the best possible use of land (Dixon-Gough 1999, p.2). The main objectives of land reform are the improvement of distributive equity, political

stability and the reduction of the concentration of economic and political power in the hands of large owners.

It is now recognized that with the existence of imperfect markets and informational asymmetry it is even more difficult to separate efficiency issues from equity issues. Under certain circumstances, changing property rights or asset distribution can make possible transactions that increase the overall productive potential of the economy, and hence achieve Pareto improvement (Bardhan 1989). Land reform programs aim at changing the asset distribution in a way that would result in an efficient allocation of resource. Land reform, either through market or government distribution or both, allows the transfer of land from a less productive to a more productive sector and thus moves the system towards a more efficient use of this productive asset.

Empirical studies have confirmed the positive impacts of land reform on agriculture. Examining the results of land reform in Mexico between 1950-1960, Doving (1974) and Mueller (1970) found that the land-reform sector performed at least as well as the private sector in terms of the growth rate of crop output and better than the private sector in terms of the growth rate of output per unit of total measured inputs (i.e. land, labor and capital investment of all kinds). Further studies by Saldivar and Nguyen (1979, pp.624-35) between the period 1959-69 have produced similar results. These studies thus strengthen the case for land reform in other developing countries.

Thiesenhusen (1989) argued that, in general, the reforms broke the political hegemony of the landed elite and/or emancipated a substantial portion of an oppressed population (Mexico, Bolivia, Cuba, Ecuador, Peru, Nicaragua); temporarily resolved acute regional or local problems of landless unemployment and/or unrest (Panama, Honduras, Dominican republic, Venezuela, El Salvador); and everywhere improved the low level of living standards for vast numbers of rural families.

Land structure has also contributed to urban poverty. Unless conditions for stable self-employment on the land are assured for the rural poor, already-high migration rates into urban areas will increase. This will lead to increasing pressure on the resources of the urban sector and thus cause increases in urban poverty, pollution, over crowding, etc. For these reasons, land reform which aims at elevating rural income and the rural standard of living will be beneficial overall, for it would reduce rural-urban migration and would also encourage migrant workers to move back to the rural area. Such movement would result in higher wages and thus higher standards of living for the urban population.

A fundamental tool in the land reform process is the establishment of secured private property rights through land registration and titling. Various benefits from secured property rights include: a higher incentive to invest in the land and raise the efficiency of land use, better information about land, decreases transaction costs, improved valuations of land, better information in general, and improved access to capital. All of these are very important for promoting fast economic growth and sustainable development.

In addition, various studies have found that the agricultural rate of growth in an economy where land is more evenly distributed among the population tends to be higher than in those economies with more unevenly distributed land. Roland Benabou (1997) has speculated that inequality slows growth because it generates political and macroeconomic instability, and, given weak capital markets and resulting liquidity constraints for the poor, reduces savings and investments, especially in human capital. Nancy Birdsall and Juan Luis Londono, through their analysis of various data, have proved that, higher initial income inequality is negatively associated with long-term growth and as noted elsewhere, that differences in the rate of capital accumulation account for an important part of the differences among growth rates across countries (Birdsall and Londono 1997, p.34). Their results also show that an unequal distribution of

assets, especially of human capital, affects overall growth, and that it affects income growth among the poor disproportionately, presumably because an unequal asset distribution penalizes the poor.

Another possible cost of inequality is the prevalent tension between the haves and the have-nots, which contributes to political instability, a condition detrimental to long-term investments that would lead to sustained economic growth and development. According to Mancur Olson, “no society can work satisfactorily if it does not have peaceful order... Obviously, anarchic violence cannot be rational for a society: the victims of violence and theft lose not only what is taken from them but also the incentive to produce any goods that would be taken by others” (Olson 1993, p.567). Thus, there would be little or no economic growth in the absence of peaceful order. Unequal land distribution causes various problems such as declining per capita farm production, increasing numbers and shrinking landholding sizes of small farmers, growing numbers of the landless, and environmental degradation. Such increasing poverty and inequality among the weakest portion of society in the long term will lead to discontent and possibly violent conflicts, bringing a country into chaos and insecurity, an unfavorable environment for economic growth.

For these reasons, a more equitable distribution of assets increases the income of the poor, reducing poverty directly. It would also contribute to an increase in poor farmers’ capital accumulation and investment resulting in higher productivity. Such productivity increases in turns lead to a higher aggregate economic growth over the long term. Furthermore, new welfare economics holds that whether the economy is or is not at Pareto efficiency may depend on the initial distribution of wealth (Shapiro and Stiglitz 1984): the separation between equity and efficiency considerations is no longer generally valid.



#### **IV. MARKET-ASSISTED LAND REFORM IN THE CURRENT CAMBODIAN CONTEXT**

There are three principle reasons that would reduce the effectiveness of the market-assisted land reform program as a means for achieving equitable and efficient allocations of land in Cambodia under current tenure and credit conditions. These are: (i) a general lack of supporting institutions, a fact that would hamper market efficiencies and limit the effectiveness of the market-based approach.; (ii) high transaction costs of obtaining information in an environment characterized by imperfect/ asymmetric information, and similarly high costs of monitoring and enforcing transactions in the presence of an unclear and weakly enforced property rights regime; and (iii) the high cost of the program as a whole which makes it difficult for the poor to participate and also imposes a huge financial burden on the government.

##### ***1. Insufficient Supporting Institutions for a Well-Functioning Land Market:***

Supporting institutions for a well-functioning land market such as land titling systems, rural credit institutions and legal and judicial systems are still undeveloped in Cambodia. Such a lack of supporting institutions hampers the development of market efficiencies in achieving an efficient and equitable distribution of land. Therefore, unless property rights and other supporting institutions improve, market-assisted land reform will not provide a practical solution to Cambodia's land distribution problem.

Land titling and registration systems are incomplete. Only a small portion of the population has legal documents to the land that they own or occupy. There is a general lack of data on land inventories and even the state does not have full information on all the land it currently owns. This has sometimes led to overlapping claims on land by different individuals or different government bodies. The land survey and cadastral

mapping process is not yet complete. In 1995, digital cartography was carried out in France using the aerial photography, covering approximately 60 percent of the surface area of the city. However, the staff of the Municipal Cadastral Office have not mapped any additional land parcels since the French technical assistance left and the office does not have enough funds to continue any operations (World Bank 2001b).

The legal procedures for land registration and titling involve many steps and can be very complex (see Figure 1(p.60) for the steps required for obtaining a title to agricultural land). Further, the cost of obtaining a land title can be expensive,<sup>15</sup> making it difficult for people to obtain this legal document. As a result, only a very small portion of land has been registered and recorded. Only about 25 percent of land and real estate in Phnom Penh Municipality is reported to be properly registered (World Bank 2000b). This number is about 10 percent in the rural areas. In such an incomplete property environment, the market is not likely to function as an effective and efficient distributor of land because there is no way to clearly determine who has the rights to use how much of it, and for what purposes.

Rural credit institutions are also insufficient to accommodate a well-functioning land market. Access to banking services in the rural areas is scant, and NGOs are the main source of financial services for rural communities. The National Bank of Cambodia monitors their operations. The general lack of funds due mainly to the inability to attract savings and deposits severely limits the ability of these NGO microfinance institutions in providing credits to the rural population. The formal banking system does not have funds available to meet the needs for loans of up to a few hundred US dollars, and its existing infrastructure limits its ability to achieve the outreach needed to extend such credit. As a result, there is market failure in terms of the availability of credit services, with NGOs reaching only a small portion of rural households while formal institutions have no

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<sup>15</sup> Largely due to unofficial costs.

significant outreach (ADB 2000). In addition to their lack of funds, many of these rural financial institutions have neither sufficient management capacity nor enough able staff to ensure the long-term sustainability of their programs.

These imperfections in Cambodia's capital markets produce problems in the land markets. When lending institutions begin to function, lending is restricted to short-term, high-yielding projects for a few borrowers. On the capital demand side, the lack of functioning capital markets means that only people with accumulated capital participate in the land market. Thus, a potential danger is that the emergence of the market would set the stage for polarization of the society into a few landlords and a mass of people without property (Stanfield 1999, p.6).

In addition, the domestic savings rate in Cambodia is very low making the cost of administering such a few small savings high. If the cost of providing credit to the rural poor remain high, improving the collateral quality of land by titling it may benefit only those with access to other assets. Indiscriminately improving access to credit can therefore lead to further transfers of land from small to large land owners (Williams 1999b, p.5).

Legal and Judicial systems are also in need of strengthening and reform. Results of a recent survey of households and enterprises conducted with the assistance of the World Bank, a study that is also high-lighted in the Governance Action Plan (RGC 2000a, p.3), found the general view of the quality of several public services to be relatively poor, especially courts, custom and tax authorities and police. The ability of the courts to settle disputes transparently is low, and the enforcement of contracts, rules and regulations by relevant authorities is still weak in many respects.

Relevant land law is complex and not entirely clear. At present, there are several different sources of land law <sup>16</sup> and they sometimes contradict one another, causing confusion.<sup>17</sup> Such complex legal framework and poor enforcement mechanisms are likely to give rise to disputes and other market distortions, which will prevent the land market from functioning efficiently.

For these reasons, the market mechanisms promoted under the market-based land reform approach will not work efficiently at this early stage of development. The movement towards a market system must proceed carefully to allow time for appropriate supporting institutions to develop and strengthen.

Evidence shows that reform must not refer simply to a shift from state to market. The successful transmission of the full benefits of economic and political reform to all sectors of rural society requires an integrated strategy of multi-sectoral adjustments and compensatory actions. Changes need to be effective in credit and land markets, supporting land information systems and legislation, and in overall agricultural sector policies and perspectives. Therefore, an immediate adoption of market-assisted approach to land reform in Cambodia, when other supporting institutions are yet developed, is impractical. It is also critical for the government to take an active role, at least in this early stage, in monitoring credit and land transactions and also in providing supports for the poor section of the population that is likely to be negatively affected by market forces.

## ***2. High Transaction Costs and the Financial Burden on Beneficiaries:***

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<sup>16</sup> There are no less than five main sources of land law in Cambodia including the National Constitution (1993), Sub-Decree No. 25 (1989), Political Instruction No. 3 (1989), the 1992 Land Law and the Law for Management of Urbanization and Construction (1994) (Van Acker 1999, p.16).

<sup>17</sup> Interviews with judiciary and senior government officials conducted in Cambodia in 1995 (Russell 1996) revealed significant different in opinions as to which legislation holds precedence. In general, the judiciary favor the 1992 Land Law, while the officials from the Land Titles Office regarded the 1989 Instruction as the governing principles for land administration.

The implementation of a market-based land reform approach in an environment characterized by imperfect/ asymmetric information, and in the absence of a clear and strongly enforced property rights regime would increase transaction costs.

Transaction costs in the land market are the aggregation of a number of factors: legal paperwork, searching costs, valuations of the assets, management costs, bargaining, etc. The higher the transaction costs in the land market, the lower the incentives to do land transactions. Faced with the complexities and high costs involved in making a transaction, people would be less likely to participate in the process because doing so would mean higher costs for them and thus reduce benefits from the transaction. This disincentive to engage in land transactions has two important effects: it does not allow land allocation to its best economic use and it reduces demand for land as an asset because it becomes too costly to obtain the benefits derived from owning the asset. This last situation is highly relevant for the use of land as collateral for credit (Trivelli 1997, p.6). Another disadvantage of a high transaction costs is that they encourage poor farmers to continue to engage in informal land transactions – i.e. land transactions outside of the legal or formal framework – that bring about a loss of efficiency and reduce effectiveness of any land reform program as a distribution mechanism.

This by no means, however, implies that market mechanisms used in the market-assisted land reform would always result in higher transaction costs. In fact, theoretically the market-assisted land reform approach would help lower the transaction cost of land transfers because it takes away unnecessary and costly administrative processes involved in traditional land reform approaches. The decentralized implementation of the program would also bring down transaction costs of land transfers. As the World Bank has claimed, the experience in Brazil proves that the new approach succeeded in bringing down the cost of land transfers to less than half of its anticipated cost (Esguerra 1999). Land tenancies are most efficiently allocated when their values/cost are determined by

the market. The emphasis here falls on the negotiated market transaction. That is, when all parties to the transaction of temporal or partial interests are able to negotiate the terms, we find the lowest transaction and contract maintenance cost (Riddell 2000, p.2).

However, for a market to fully function in an environment like Cambodia's, which is characterized by poor or asymmetric information, lack of clearly defined property rights, clear legal documents, accurate valuation and weak enforcement mechanisms, the need to develop an effective monitoring and enforcing mechanism and proper institutions is essential. Therefore, for a market to function efficiently in such an environment implies that more money must be put into making effective land transactions, such as the valuation and dissemination of information to both buyers and sellers, so that such mechanisms can make the negotiation process work fairly and efficiently. This condition thus implies a very high cost of obtaining the information and a high cost for transactions. This cost might well be borne by both buyers and sellers, which in turn increases the transaction cost for land transfers.

In addition, due to informational asymmetry, one group involved in the exchange of a particular commodity will have better access to information and hence greater bargaining power than the other, and will contrive to use it to their own advantage. When information is costly and asymmetrically distributed, incentive problems arise. When information is imperfect, it is more important and convenient for the state to intervene in order to strengthen the bargaining power of the less favored party than to try to regulate private contracts (de Anda 1997, p.4).

The functioning of land markets depends on formal mechanisms for defining and enforcing rights, including the court system, police, the legal profession, land surveys, record-keeping systems, and titling agencies (Feder and Feeny 1991, p. 137). In an environment where monitoring and enforcement mechanisms are weak, such as that in Cambodia at the present time, parties to the transaction must pay a higher cost for the

proper enforcement of a contract. Otherwise, they would have to face both the uncertainty over the long-term validity of the contract and the insecurity over the assets. Private property claimants are also faced with high costs of providing their own enforcement in the form of massive fences and armed guards, and with any costs involved in disputes. This, thus there is bound to be an increase the transaction cost for land transfers. These market-distorting conditions are likely to discourage people from participating in land market, which reduces the effectiveness of market-assisted land reform if it is implemented.

The market-assisted land reform approach attempts to deal with this problem by making the government responsible for providing information on land, and setting up proper mechanisms to facilitate the transfer and ensure the security of the transaction, thereby reducing the transaction costs incurred to the beneficiaries of the program (i.e. both parties of the transaction). While this idea is good, its practicality in the Cambodian situation seems to be doomed in the short run, because developing the human and institutional capacities, especially at the local levels, <sup>18</sup> to support such market transactions would require times and cost money.

The process of assigning and transferring private property rights is not cost-free. The cost of maintaining records, negotiating, contracting, and policing property rights can be high and may even exceed the value of the land, especially in rural areas with low population density and little market access (Binswanger and Deininger 1997, p.1966). For a large part of the rural area in Cambodia, poor access to the market is still dominant mainly due to the lack of roads and other means of transportation to markets. Thus the land value in these areas seems to be very low relative to the transaction cost required to make such land marketable in the formal system. Such a high transaction cost would thus offset any benefit that a market-assisted land reform approach would bring.

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<sup>18</sup> As part of its decentralized approach to implementation.

As discussed earlier, land prices are needed to determine the optimal allocation of land resources among different uses, as well as to determine the value of land as collateral for credit or to define land taxes. Therefore wrong or misperceived land prices could lead to inadequate allocation and use of land resources. However, in the current environment in Cambodia, where asymmetric information and unclear and weak enforcement of property rights prevail, incentive problems arise leading to a possible reduction in efficiency of land distribution. For example, the possessor of land tends to know more about the extent to which the rights to land are (or are likely to become) contested than other persons. This may discourage some individuals who might want to acquire the land (for a higher-value use than the current one) and who may be reluctant to risk purchase or may offer a lower price (reflecting the perceived risk of challenging the claims). Both outcomes tend to reduce the extent of land trading, with a consequent loss of efficiency, since land trading generally facilitates the allocation of land to higher-productivity users (Frischtak 1995).

In a well-functioning land market, land prices will reflect land quality and differentiated prices can be used, but in imperfect markets (with asymmetric information, for instance) taxes do not perform as they should, having perverse effects on certain types of land owners (Hoff and Stiglitz 1993). In Cambodia at the moment, the lack of adequate information about land and the lack of adequate institutional capacity for valuing land and disseminating information to both parties of the deal make it very difficult to determine proper land values. As the theory suggests, these facts would lead to inadequate allocation of resources.

Thus while market-assisted land reform helps lower transaction costs by taking away unnecessary administrative procedures, it also involves other transaction costs associated with valuation, monitoring, enforcing and other related activities in order to ensure that the process works properly and effectively. This may offset the reduction in



cost from adopting the program under the current tenure environment. Therefore, we must carefully weigh the costs and benefits of adopting the program before we decide which approach to land reform is suitable for Cambodia in supporting the effort to achieve a balance between efficiency and equity.

For these reasons, if we go too fast in the process of adopting the market-based reform program as a tool for solving land problems in Cambodia, we must ask ourselves, first of all who has the information about the price, who sets the prices and who can afford it. We need to determine also whether there are enough human and institutional capacities to handle the new land market process to make it fully functional. Generally, the people who we are trying to assist are the ones at a disadvantage because they do not have the necessary assets (credit, knowledge, information, etc.) to gain access to land, and that writes a recipe for a disaster. Then, as de Anda (1997, p.4) points out, it is imperative that, before the market process goes fully into force, the necessary regulatory and normative conditions are already in place, i.e., all other micro-reforms should precede land-market reform.

### ***3. Barriers to Entry Leading to Further Land Concentration and Increased Program Costs:***

Market-assisted land reform, if implemented under current tenure and credit conditions in Cambodia, would lead towards further land concentration and thus an even more skewed land distribution, which empirical evidence has shown to be less efficient in promoting long-term economic growth than a more equitable distribution. The program would also be very expensive, thereby placing its sustainability at risk.

As we have discussed in section II of this paper, societies in which a relatively equal distribution of assets allows large number of individuals to make investments that enhance productivity may reach permanently higher rates of growth than those in which highly unequal distribution of assets prevents such investment. An unequal distribution of

initial endowments in environments where the financial market is imperfect and credit is rationed can prevent a large proportion of the population from making productive investments.<sup>19</sup> Unequal distribution of land slows economic growth also because of potential disputes and political instability between the have and the have-not portions of society.

There are already some worrying signs of an increase in land concentration in Cambodia although the land distribution tends to be more equal at the moment compared with neighboring countries. As discussed earlier, several studies have indicated a growing inequality in land holdings among the population within the last decade. Since landholding is the main source of income for a large portion of population, this finding might also suggest a widening income gap among the population as well.

The case for a market-assisted land reform rests on the assumption that, left to themselves, markets fail to transfer enough land to meet the needs of poor people with the desire and ability to farm. Proponents of market-assisted land reform have argued that the approach aims at dynamizing the market for land in rural areas and thus promoting land transfers between large landowners and small landowners. By activating the market, the new reform programs and policies would encourage and facilitate the movement of land from the extensive large-farm sector to the intensive small-farm sector of society. This goal is premised on the hypothesis that making the large farm sector more accessible will, over the long term, promote a more efficient allocation of resources between small and large holdings and thereby transform the pattern of ownership by shifting land to more efficient users of resources.

Yet one must still ask: will market-assisted land reform provide a solution to inequality of land holding and thereby provide an efficient allocation of land in Cambodia? This paper establishes grounds for considerable doubts. Regardless of its

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<sup>19</sup> Binswanger and Deininger 1997, pp.1971-85.

good intentions, market-assisted land reform, if implemented under the current tenure and credit situation in Cambodia, would further exacerbate inequality in the distribution of land and thus result in a less efficient allocation of this productive asset among the population.

The main reason for this negative outcome is that a market-assisted land reform approach involves a high cost for the beneficiaries, which is likely to constitute barriers to entry and prevent a broad participation of the Cambodian rural poor.

The requirements surrounding access to credit following economic liberalization frequently exacerbate the plight of the rural poor. The establishment of formal market mechanisms within a rural economy often removes, or reduces, the level of traditional credit mechanisms and imposes formalized banking conditions on credit procedures. As a result, small and poor farmers, especially female-headed households, are not in a position to compete for available credit (Dixon-Gough 1999).

The requirements for participating in a market-assisted land reform program make it more difficult and costly for poor Cambodian farmers to participate in the program. For example, under the program, beneficiaries are obliged to come up with a productive project before approval of the purchase grant, a plan on how to develop the land after acquisition based on crop choices, identification of marketing channels and sources of working capital to determine if the whole process is economically viable and merits support from financial intermediaries like banks, and to facilitate land price negotiation on the basis of the productive capacity of the project--thus ensuring integration of land transfer with productivity increases and clarifying the potentials and limits of land transfers to ensure sustainable poverty reduction goals (Deininger 1997).

While this requirement is good for ensuring the viability and sustainability of the farm enterprise once beneficiaries take over the land which may enhance their participation and welfare, it is not practical for achieving its ultimate objective of

reaching a wide range of the poor and the landless population in Cambodia. One reason for this weakness, as we have discussed earlier, is that for the poor and the disadvantaged, poverty or sickness is a major reason for the need for capital. This fact implies that these farmers would not be able to satisfy the first condition for obtaining the credit. Those who would benefit are only those farmers and others who are already in a better position to satisfy these loan requirements. Furthermore, in Cambodia where markets are not well-integrated, prices can vary considerably in response to shocks such as droughts, leading to distress sales of assets at very low prices. Such sales leave the seller with insufficient resources to purchase the assets back later when prices return to normal. These circumstances all tend to concentrate land holdings in the hands of a few rural elites.

Low levels of education of the rural population <sup>20</sup> also make the requirement for a business proposal for a productive project turn out to be costly and complex for them. For example, in order to come up with a good business proposal for the project to meet the requirements of the program, farmers would need to get technical assistance from the public or non-public agencies at a cost. This cost comes on top of their other daily costs, making their farming submit to unfavorable market conditions and making it more difficult for them to become beneficiaries of agrarian reform. In addition, the whole process of obtaining the loan approval in this way might take considerable amounts of time and involve numerous steps. Thus, poor Cambodian farmers might be unable to take part or discouraged from participating in the program since they might find it more convenient, faster and sometimes even cheaper to borrow from informal lenders. For these reasons, many poor Cambodian farmers are likely to remain outside the formal land and credit market system promoted under the market-based approach. This, in turn, reduces the effectiveness of this land reform approach as a land distribution mechanism.

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<sup>20</sup> Literacy rate in Cambodia is still one of the lowest in Asia with the adult literacy rate of about 67 percent in rural areas based on 1996 estimates (RGC 2000b, p.4). The UNDP Human Development report calculated an human development Index (HDI) value of 0.427 for Cambodia in 1997 putting Cambodia's rank at 140 out of a total of 175 countries for which HDIs are reported (UNDP 1997).

Furthermore, it is likely that only economically larger and financially more secured interests are able to participate in the market for larger and better endowed properties. In these cases, attempts to introduce land markets have led to the emergence of multiple and polarized land markets, with few inter-market transaction. This often leads to inefficiently-sized units, idle land and speculation.<sup>21</sup>

Another factor that limits the success of the market-assisted land reform program is the potential rise in land value that would negatively affect the ability of the poor to acquire land. Liberalization and the introduction of private land markets would increase the market price of the land, making it more expensive for poor farmers than a government-subsidized rate. The knowledge of a credit support program for land purchases might also lead to an increase in land prices. This increase in land prices would result in a greater cost burden on the land poor and the landless for repayment of expensive loans, often from their meager harvests from poor soils (Mutume 2001). For this reason, a market-assisted reform program – which involves granting loans and credits to small farmers and the landless to buy land at market rates and to acquire fertilizers and technical assistance for new marketable crops – may be viewed as instrument for rewarding landlords rather than for improving the livelihoods of the landless and the land-poor.

Adding to the increase in land price, high interest rates on loans and limited amounts of loan available from both formal and informal institutions create a heavier burden on poor families.<sup>22</sup> In the long run, this might contribute to a higher incidence of landlessness and land concentration as poor farmers are forced to sell off their land at a lower value to repay their debts while the rich would buy up land at a low price and

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<sup>21</sup> This is a condition affecting many economies in transition (FAO, 2000).

<sup>22</sup> Because of the limited amount of loan offered by microfinance institutions or government agencies at relatively low interest rates, many people would need to borrow money from informal lenders at a high interest rates (some as high as 200 percent per annum) in order to purchase land.

sometimes hold it for speculative purposes. In either case, the productivity of and the return on land both decrease.

In addition, many Cambodian farming communities have exhibited relative stability over long periods of time through the myriad of diversification, income-smoothing and other self-reliance devices for which some communities are known. However, as Carter (2001) points out, in the context of market-assisted land reform, where beneficiaries are challenged to purchase commercial properties at market prices, it is not clear that such conservative (and expected income reducing) strategies will be enough.

Another potential factor leading to land concentration is the drive for decentralization of land management under the market-assisted framework, while the human and institutional capacity at the local levels is still weak. This market-based approach relies strongly on support from the local governments and NGOs for the implementation of its decentralized and demand-driven model of land reform (World Bank 2001e, pp.73-76).

There are clear benefits to the decentralization process as we have discussed before such as cost reduction, more flexibility in implementation, and achieving better integration of land reform with local government development priorities and investments. Nevertheless, there is currently insufficient human and institutional capacity at the local levels necessary for an effective implementation of the program. The local governments have neither sufficient budget nor enough capable staff for effective implementation of the program. The situation is not better among the NGOs. Recent reports have revealed that many NGO microfinance providers are operating in an unsustainable way by offering investments in potentially non-viable enterprises, undermining their own financial sustainability and creating unrealistic expectations among borrowers about the future price of money. Many lack the management capacity to exercise the financial discipline necessary for sustainable credit. The NGO staff generally have limited knowledge about

savings, a factor which puts savings at risk. The savings and operations policies are not always made fully clear to clients. Generally, rural credit and savings schemes are not viable due to lack of savings and good savings services, excessive reliance upon external financing in the form of grants or project financing, lack of professional management needed to handle savings and credit, lack of appropriate legal structure and lack of external supervision.<sup>23</sup> Such a lack of human and institutional capacity at the local level would lead to ineffective implementation of the programs under the market-based approach. It could also cause problems such as collusion, corruption, poor coordination or even conflicts between different local interests, which indirectly lead to land disputes and possibly contribute to land concentration.<sup>24</sup>

Another problem that may result from using market mechanisms to determine the allocation of land in an environment of unclear and weakly enforced property rights in Cambodia is the potential for land speculation. Market theory states that a functional land market is vital to the national economy because it is the best mechanism by which this important productive resource gets to be controlled by those best equipped to use it most productively. When markets are competitive and information is evenly distributed, speculation provides liquidity to the markets and transfers the risk to those with a comparative advantage in risk management (Frischtak 1995, p.198). However, as we have discussed, such a competitive situation does not exist in the land market in Cambodia or in any other place. In an environment where property rights are not well-defined and/or are weakly enforced, speculation thrives, which may reduce agricultural productivity on land because landholders are likely to seek a short-term capital gain from land, rather than to invest in it for a long-term benefit. In such an environment land speculation can easily

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<sup>23</sup> Final Report: Rural Credit and Savings Project. Uniconsult International Limited. February 1999.

<sup>24</sup> It is important to recognize that the spread of corruption and other illegal activities which partly contribute to land disputes in the past has been exacerbated by a rapid decentralization of the government structure in the early 1990s without sufficient human and institutional capacities to handle the new changes, such as a transparent and effective monitoring and enforcing mechanism.

develop because speculators can easily hold on to land for speculative purposes rather than making productive use of the land without much fear of punishment, such as paying high taxes. As Williams (1999a, p.13) suggested, the unregulated market for land in Cambodia and the absence of tax disincentives to holding unproductive land has allowed large and important tracts to come under the control of speculators. Therefore, attempts to use market mechanisms to determine land distribution under current property conditions in Cambodia are not likely to have much effect on this speculation problem. On the contrary, making market mechanisms dictate land transactions and thus land distribution under such conditions would only exacerbate speculative activities and thus give further rise to unproductive use of land and slower growth.

A common method for dealing with the speculation problem is imposing a progressive tax on land size or a higher tax for unused land. However, attempts to impose such taxes, in some cases, has resulted in less efficient use of land by landowners. For example, to avoid being penalized for not using land, some landowners have planted some trees (such as palm trees, etc.) just to keep land occupied while minimizing the input being invested in the land. Therefore it is necessary to develop methods and strengthen the mechanisms to deal with the issue of land speculation and make sure that they are in place before the market approach can be fully adopted to promote an efficient land distribution and land use. For these reasons, immediate adoption of the market-based approach as an effective solution to the land distribution problem in Cambodia is not practical under present conditions.

Another drawback of the market-assisted land reform approach is the fact that it is expensive. Under the program, the government is required to provide the land purchase grant to beneficiaries. A limited survey conducted by GTZ (1996) <sup>25</sup> found that households on average borrow between US\$200 and US\$300 per year and that the total current

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<sup>25</sup> The project is currently updating this data.



demand is thus between about US\$ 143 million and US \$ 215 million for the 716,000 rural households in the country. These findings show that the demand for loans is huge. With loans from other channels such as NGOs and informal lenders being limited <sup>26</sup>, there is a large financial gap for the government to fill, placing a heavy financial burden on the government. Recent surveys show that although only a small percentage of rural households are able to borrow from formal services, there is already a severe shortage of supplies of rural credit. Adding to this, a possible increase in land prices resulted from adopting the market-based approach would imply an even greater demand for loans and thus make the program more expensive. Under Cambodia's current situation where there is a limited amount of funds to satisfy many needs, the program entails a huge opportunity cost for the society and the economy as a whole. Such budgetary constraints may also imply that not all beneficiaries, including those who qualify, could get loans. <sup>27</sup> This outcome would go against the cost-reduction objective that the market-assisted land reform approach intends to bring about. Also, the lack of funds would put the long-term sustainability of the program at risk. As Achieng (2001) suggests, studies conducted by various human rights groups have indicated that market-based land reform programs are disappearing in several countries ranging from Guatemala to the Philippines due to lack of resources.

Finally, the ability to obtain credit can have some negative effects on borrowers, especially where there are no proper mechanisms for providing proper technical supports to farmers and for continuously monitoring loans or projects. A recent survey of limited data <sup>28</sup> (see Table 2, p.57), found that among the sample families, a large proportion of

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<sup>26</sup> It is estimated that at the end of 2000, NGO microfinance operators supplied about US\$29 million in loans with an additional US\$ 10 million dollars came from other channels such as through friends, relatives and moneylenders (Agence Francaise de Developpement/ Rural Development Bank. *Rural Credit in Cambodia*, March 2001)

<sup>27</sup> As the case of the Philippine has shown (Esguerra 1999).

<sup>28</sup> The research was based on surveys of 39 families in two sample districts who had sold or pawned land and who used the proceeds to repay loans from credit organizations (Kassie 2000, p.2).

the interviewees, about 44 percent, believe that the loan from the credit organization had been a crucial factor leading them to sell their land. According to Table 3 (p.58), the survey also reveals that about 44 percent of the families surveyed sold their land in order to repay debts (Kassie 2000, p.13). In even more extreme cases, there have been reports that many farmers have been arrested and put in jails for failures to repay debt to microfinance institutions (The Phnom Penh Daily 2001).

## V. CONCLUSION:

Current credit and land conditions in Cambodia create an environment which limits the effectiveness of the market-assisted assisted land reform approach as a tool for solving the land distribution problem. Imperfect or asymmetric information, low levels of education, distress sales, undeveloped supporting institutions, and unclear and weakly enforced property rights have all contributed to possible and even likely negative impacts of any market-based approach on the equality and efficiency of land distribution in Cambodia at the present time.

Given low participation in the land market, and dysfunctional complementary markets for agricultural inputs, produce and services, an unregulated market will never achieve optimum efficiency in agriculture or equitable access for secure livelihoods. However, in an environment of weak governance in Cambodia, ensuring that the poor get to realize their productive potential and that the agricultural foundation of Cambodia is sustained will not be achieved by regulation alone either.

Therefore, an appropriate combination of market forces and government intervention, with the participation of local communities and with support from both domestic and international organizations, is needed to ensure that land distribution programs will achieve a desirable combination of equity and efficiency. Also, the market-based approach must be slowly and cautiously adopted to provide sufficient time for other supporting institutions to develop their capacities for handling the new system. Over the short term, the central government<sup>29</sup> should play an active role in monitoring land and credit transactions and providing supports to people who are at a disadvantage. The central government should therefore, in the short run, do the following:

- 1) Encourage and support the establishment of some form of local cooperatives

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<sup>29</sup> Because it is in a better position in terms of both the financial and human resources to do so compared to its local counterpart.

within farming villages so that they can consolidate and help strengthen the welfare of community members in the short run and help improve their ability to compete in the long run. These cooperatives, however, should be based on voluntary membership, and members should be given freedom of entry and exit from the cooperatives whenever they want, especially when they are capable of functioning competitively on their own.

2) Continue to provide basic subsidies for inputs such as water, gasoline, and other agricultural inputs to farmers, at least in the immediate future, to help combat poverty and sustain productivity. The distribution of these resources should be through close cooperation with village communities to ensure that they will reach the intended beneficiaries within the communities. When and where possible, allow the private sector to play a role in distributing these inputs.

3) Step up its effort to develop institutional and human capacities for supporting the development and functioning of the market in the future. Some of the measures that can be taken include adoption of a new land law, public education of farmers about their rights and different rules and regulation as applied to land rights, strengthening of the capacity of those government agencies responsible for land management, and strengthening enforcement and legal mechanisms. At the same time, the government should move slowly towards allowing a broader role for markets in land transfers. All these steps, however, are much easier said than done.

4) Help promote local governments' capacities to handle the various responsibilities, and develop effective monitoring mechanisms to ensure the transparency and accountability of local governments. The national government slowly and systematically transfer more policy responsibility to its local counterparts.

5) Increase the supply of land to meet rising demand, step up efforts to make accurate inventories of land, create a system for distribution of land that has been properly recorded – including the land cleared of land mines – and, where appropriate,

distribute these lands to the landless and the land poor. The government can then either sell the land to them at subsidized rates or provide it free of charge to the landless and the poor according to their income situations.

6) Develop and strengthen the interactions and co-operations between government agencies, local communities and other organizations such as NGOs in order to increase the effectiveness of the implementation of land reform programs.

# **ANNEX**

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