



Munich Personal RePEc Archive

Property Rights and Corruption

Kemal, M Ali

Pakistan Institute of Development Economics

17 December 2007

Online at <https://mpra.ub.uni-muenchen.de/55709/>

MPRA Paper No. 55709, posted 10 May 2014 17:21 UTC

PROPERTY RIGHTS AND CORRUPTION: THE CASE OF PAKISTAN

M. Ali Kemal

“Property rights are vital to your freedom and inseparable from it. Without them, you are nothing more than a tenant paying taxes on property over which you have lost some, most, or all of your rights¹.”

I. INTRODUCTION

Property rights are the core of economic development. Capitalism in America and Japan is successful because they have a good system of property rights [Desoto (2000)]. Protection of property against expropriation is one important yardstick against which foreign investors assess the risk of investment. Thus we should have better system of property rights with lesser corruption to increase investment and achieve ten percent GDP growth rate².

Ibid argues that property rights are essential for the people to believe in the market system and capitalism cannot be successful without having proper property rights system in the country. Secured property rights reduce the insecurity of land. It also reduces the workload of the courts to settle disputes and credit availability to small farmers is easier due to property ownership. Moreover, it generates tax revenues and prevents cost and time overruns in development projects involving land acquisition. Thus property rights are inverse transaction cost [Khan (2006; Page 3)] and increase efficiency [Demsetz (1967)].

Pakistan’s property rights system has several anomalies such as *benami* transactions and general power of attorney. There are several loopholes in the system through which big landlords with the help of authority personals avoid/evade taxes and create a scenario where the third (any other) party remains deprived off using the land.

Corruption of authorities is an undeniable fact. Khan (2006) reported several cases of corruption in the Lahore Development Authority (LDA), which is the main registration authority in Lahore. Authority personals ask for bribe to issue allotment letter for an already purchased plot, accessing a file, giving NOC etc.

¹ <http://www.propertyrightsresearch.org/>

² This issue was discussed, among other issues, in the PIDE-LUMS seminar on “Law and Economics” in June 2006.

Designing property rights is the most concerned thing because we need to take care of customs and social norms in Pakistan in designing the formal rules otherwise enforcement would be very difficult. Enforcement is the most important element after the rules have been made. The enforcement should be done by third party who is neutral and acceptable to both the parties (buyers and sellers).

In this study we are examining different problems of property rights in Pakistan, the ways to overcome those problems and how would it affect corruption. Section II describes importance of property rights; Section III explains the problems of property rights in Pakistan; Section IV illustrates the possible design of property rights in Pakistan; Section V examines the impact on corruption and Section VI draw conclusions of the study.

II. IMPORTANCE OF PROPERTY RIGHTS

Theory distinguishes between legal and economic property rights (e.g., Barzel (1997)). *Ibid* interprets economic property rights are the end and legal property rights are means to achieve the end. According to Coase (1960) both are two sides of the same coin.

Secured property rights are the core of the market system to be functioned. Desoto (2000) argues that an important characteristic of capitalism is the functioning state protection of property rights in a formal property system where ownership and transactions are clearly recorded. He is very critical of the policies in the developing countries that farmers in most of the developing countries remain trapped in subsistence agriculture because developing countries have lack of such integrated system of property rights. Work of Desoto's organization "Institute of Liberty and Democracy (ILD)" in Peru and El Salvador shows that property rights are the essential reforms helping both countries to reduce unemployment and poverty.

Implementing law of registering titles will reduce the insecurity of land and enhances the marketability of land. In addition, it will reduce the workload of the courts to settle title disputes, enable implementation of land reforms, facilitate credit availability to small farmers, generate tax revenues by providing information that can be used to

check evasion of income tax, and prevent cost and time overruns in development projects involving land acquisition [PIDE Policy Viewpoint (2007)].

Land registration and titling is the heated issue across developing countries to reduce poverty and better growth and development. Ali (2007) emphasize on those countries who have included land reforms as the major strategy to reduce poverty under PRSP (e.g., Sri Lanka) and criticized government of Pakistan for not doing the same. World Bank and neo – liberal school of thought ask for formalized registration and titling to ensure safe transferable land rights which can lead to economic growth and poverty reduction [Khan (2006); Page 3].

Following Desoto (2000) many economists have argued that protection of property rights brings several benefits which includes, higher level of investment, better matching through higher level of trading, more labor supply and better access to credit [Tell, Galiani, and Schargrotsky (2004); Page 23]. Galiani and Schargrotsky (2005; Page 30) found that entitled families increased housing investment, reduced household size and improved the education of their children but effects of credit are modest and no effects on labor income. Field and Torero (2006) also found no evidence, for Peru, that titles increase the likelihood of receiving credit from private sector banks although the interest rates are significantly lower for titled applicants regardless of whether collateral was requested. Contrary to Galiani and Schargrotsky (2005), Field (2002) found substantial increase in labor hours and substitution of adult for child labor due to titling in Peru.

Libecap, Calvert and Egertsson (1989; Page 1) defines property rights as social institutions, which functions to define the range of privileges granted to the owner to a specific assets(s) including, selling of an asset, excluding non-owner from access to use, giving it on rent etc. According to *Ibid* property rights institutions can be in the form of formal and informal arrangements. Formal arrangements include constitutional provisions, statues, and judicial rulings, while informal arrangements include conventions and customs regarding the allocation and use of property.

However, above disused arguments and findings are possible if the mindset of the people is changed. Mindset includes beliefs, habits and individual behavior. Tell, Galiani, and Schargrotsky (2004; Page 23) argues that property rights may change the beliefs of the people to pro–market direction. Once people start believing in the market system their

habits would be changed towards working for themselves and country. This will lead to change in individual behavior and overall mindset will change but how long that transition period will be is difficult to tell. For market system to work, the other policies should also be consistent with securing property rights.

III. PROBLEMS IN PAKISTAN

The main problem in Pakistan is that the registration act of property rights envisages the registration of documents but not the registration of the titles. The documents of title provided by the seller to buyer are private documents relating to transactions between two private parties but do not certify the title. These documents confirm only one transaction, i.e., current transaction, in the whole chain of transactions [PIDE Policy Viewpoint (2007)].

The registrar, who registers the documents, records a transaction but cannot guarantee that the transaction is valid. He cannot refuse to register the document irrespective whether it is a fraudulent document. He is neither empowered nor required to question the transaction [*Ibid*]. In addition, state/government do not guarantee that the person mentioned in a land record is a true owner and if he/she is proved to be wrong later then the state/government could not be taken to the court. This system asks buyer to investigate the authenticity of seller's property. Khan (2006; Page 14) argues that the main emphasis of the registration process is on the identification of parties instead of identification of property.

Names of legal successors are not recorded in the record of rights, hence, many legal owners do not have possessions and their names are not written in the relevant registers of the rights in land. This leads to never ending litigation and the overburdening of judiciary system.

Oral declarations of gifts, under Islamic law, and inherited land do not have to be registered [PIDE Policy Viewpoint (2007)]. Agriculture transactions, rural mutations, agriculture mortgages, wills and verbal transfers and gifts do not need to be registered [Khan (2006); Page 18]. This law has a big loophole for the tax evaders.

Patwari is the main person in villages who records ownership and tenancy in register of record of rights under the land act of 1967. He also records mutation, inheritance and change in rights [Khan (2006); Page5]. These records are apparently evidence of ownership but not the conclusive proof of ownership [*Ibid*; Page 5]³. This is why, in case of disputes, courts are over stretched to decide land record cases because patwaris' records are taken as one of the evidence of ownership but not the proof [Khan (2006); Page5].

Khewat based system is a complicated system in rural areas of Pakistan [*Ibid*; Page 7]. Each *khewat* contains several parcels and each parcel has some *marlas* or *kanals* of land⁴. Suppose a family owns a land and they were allotted *Khewat* number 1. They have 10 parcels in *khewat* and each parcel contains 8 *kanals* of land. If they sell 2 *kanals* of land to someone else then the buyer will be in the same *khewat* and he has his share of land in any part of that *khewat*. If the buyer sells his portion of land to someone else then that person is also in the same *khewat* and the system gets more complicated. This complicated process is consolidated during the settlement survey but settlement surveys are not done since years⁵ [*Ibid*; Page 10]. System of *Khewat* is very flexible and can be done verbally which has several problems. The most immense problem among those is that if someone verbally lease or transfer the land and buyer do not register in time then that land can be transferred again to some third party⁶ [*Ibid*; Page 12].

According to the 1967 Act, mutations need to be presented in the village common assembly. These assemblies are needed to inform about land transaction to the third party and serves the role to inform public and increase public supervision. But this procedure is not followed continuously and only 50 percent of the mutations are done through common assemblies [Burns (2005)].

Year to year lease of property is under stamp duty Act of 1899 which gives an incentive to parties not to register for first year. Thus parties often enter into an 11 month contract to avoid registration and duty and then renew it after 11 months [Khan (2006); Page 18]. Similarly, power of attorney does not need to be registered. In this case owner

³ These records only serve for the purpose of revenue.

⁴ Marlas and Kanals are the language used to measure the area of land. Each kanal contains 20 marlas and one acre is equal to 8 kanals.

⁵ According to rules, settlement surveys needs to take place after every 25 years [Khan (2006); Page 10].

⁶ This problem can be resolved through third party enforcement.

can appoint more than one attorney against a same property. Both the attorneys are equally capable of selling the property.

Benami transactions are where a property is transferred to surrogate owner to gain undue advantage. It is generally done by feudals and large landholders to avoid redistribution of land by putting it in the name of servant, trustee or any other family member. These types of transfers increase the complexities in the record of rights [*Ibid*; Page 22]

The records of rights are of fiscal variety [PIDE Policy Viewpoint (2007)]. The present land records system dates back to 1850s and was essentially designed to collect tax on land rather than to document and hold land titles [*Ibid* and Khan (2006); Page 4 and 5]. The person shown on records is presumed to be the owner and responsible for paying land revenue/property tax [PIDE Policy Viewpoint (2007)].

Agriculture land record is maintained by board of revenue in provincial governments but in urban areas there is no single agency keeping the records of land [PIDE Policy Viewpoint (2007)]. Khan (2006; Page 6) elaborates that Excise and Taxation department (ETD) deals with urban areas of land in Punjab excluding some of the areas, such as housing authorities⁷. Certain housing authorities also keep land records of their own housing area and property records are also available at *Tehsil* sub-registry level. Hence, there is a multiplication of records – one can get it from ETD and other authorities.

Lahore Development Authority (LDA) is the enforcement agency in the province of Punjab. *Ibid* (Page 25) argues that LDA seems to have very sophisticated procedure but her key informant interviews reveal that LDA is very corrupt and massive cases of fraud were found in the allocation/transfers of plots in Johar Town, which was the last scheme opened by LDA in 1980s. Another person reveals that often allottees needed to go to LDA office for five years to get the letter of allotment. Moreover, allottees/owners cannot access their file in LDA without paying bribe. Even a clerk of LDA had to pay bribe to his fellow colleague in the other department of LDA to get NOC for his small plot. However, if allottee is not influential and cannot bribe then he does not get his

⁷ After the introduction of devolution plan of power in 2001 ETD was reorganized and put under the jurisdiction of district governments [Khan (2006)].

allotment letter and another allotment letter for the same plot is issued to other person and if he is also not influential and cannot bribe the officials then this process keep on going.

Qabzah groups are one of the major problems. They illegally occupied the property of others and exhaust the original allottee to the point of despair and get the plot transferred to their names at a very low market price. Lack of transparency, poor governance, corrupt officials, political interference, ad hoc policies and influence of *qabzah* group are the main factors which contribute to the fragile property rights in LDA [Ibid; Page 27]. I believe that it is true for all the enforcement authorities working in Pakistan.

IV. DESIGNING THE PROPERTY RIGHTS

Designing property rights is the most important step. One need to see at the increase in transaction cost initially because the failure of formal land titling in Kenya is the result of the transaction costs of the registration process [Ensminger (1997; Page 180)]. PIDE Policy Viewpoint (2007) argues that it can be financed through increase in revenues and setting up some funds for it.

North (1990: Page 53) argues that to get better outcomes we need to build formal laws based on cultural and social norms (informal constraints) and enforcement characteristics. One of the other reasons for the failure of land titling in Kenya is incompatibility with the all important social norms and organization without which people cannot produce or enforce anything [Ensminger (1997; Page 180)].

However, if people need to learn a totally different system then this might be the major informal constraint. Thus, it should be designed in such a way that the system would be formal, procedure remains the same and there should have third party enforcement which is neutral and acceptable to both parties. Third party enforcement in informal way will definitely reduce the transaction cost in the short run but in the long run in case of disputes the transaction cost will rise. On the other hand, doing it informally will reduce the potential revenues which a government can get otherwise. Thus formal third party enforcement is better as an enforcement agency.

Section III outlines main problems in the system of property rights system in Pakistan. However, the system can be cured by removing the anomalies such as *Benami* transactions and general power of attorney and introducing new techniques such as GIS system. Let's look at some of the recommendations;

1. Completely scrap the obsolete and dysfunctional systems managed by Patwaris, Tehsildars, Tapedars, and Mukhtiarkars and set up system of guaranteeing title to land rather than a system that merely serves the purpose of registration of documents [PIDE Policy Viewpoint (2007)].
2. GIS is a good way of enabling quick and efficient recording of title transfers. Though it will be expensive initially but it can be financed through increased tax revenues and setting up special fund for this purpose [PIDE Policy Viewpoint (2007)].
3. There is a need to establish a centralized land registry system in the form of a central registration of title of the most expensive and commercially attractive land [PIDE Policy Viewpoint (2007)].
4. The provincial governments should give the responsibility of determining the title of land to the Excise and Taxation Department (ETD). This Department has the most complete and accurate record of urban properties in the province, and hence best suited to shoulder this burden [PIDE Policy Viewpoint (2007)].
5. The Registration Department should be bifurcated and the section dealing with urban properties should be placed under the ETD department. Alternatively, the institutional arrangement proposed above can be placed under the Board of Revenue by establishing a Revenue Authority [PIDE Policy Viewpoint (2007)].
6. As a first step in the long-term strategy to design and implement a system of title and registration. There should be a requirement for compulsory registration of all documents relating to property including sale agreements, declaration of gifts, awards, transfers, and powers of attorney. Any party claiming title through adverse possession should be required, within six months of acquiring such title, to register their claim. A system of registering deeds can provide the platform on which a system of registering titles can eventually be built [PIDE Policy Viewpoint (2007)].
7. General Powers of Attorney should be abolished altogether [PIDE Policy Viewpoint (2007)].
8. *Benami* transactions should be declared unlawful [PIDE Policy Viewpoint (2007)].
9. Any suit with respect to any immovable property should be compulsorily registered with the Registrar of the High Court. The Registration Act and the Stamp Duty Act should be amended to reflect this. Moreover, by linking court records to the computer database of the Registrar, prospective buyers would be informed that the property is under litigation [PIDE Policy Viewpoint (2007)].

10. Simultaneously, the government could start a process of converting presumptive titles into exclusive titles after preparing draft lists that would be open to public inspection for a period of 6 months, during which objections and disputes would be settled [PIDE Policy Viewpoint (2007)].
11. One of the main reasons for the long delays in settling title disputes in the courts of law is the system of multiple appeals and revisions even in the case of a small property dispute. This system must be replaced by one in which a party in a civil claim does not have a right of more than one appeal. The final court of appeal should be the High Court, and not the Supreme Court, since property is a provincial subject [PIDE Policy Viewpoint (2007)].
12. Torrens system of land titling is a parcel based system, which is followed in the rural areas and is very successful in Australia [Khan (2006); Page 29]. Following this system people may not need to know entirely new system, which helps in reducing the transaction cost initially.
13. One of the main problems identified in Section III was that main emphasis of the registration process is on the identification of parties instead of identification of property. Thus an authority needs to check the existence of property before getting sign the contract between the parties and should not put ask the party to check the authenticity of the existence of property. This evolves the issue of enforcement which should be formal system and done by the registration authority who are registering the titles.
14. The enforcement authority should endure the legality of transaction, actual price of the property and buyer should pay the total amount to the seller as well as revenues to the revenue authority.

V. IMPACT ON CORRUPTION

Third party enforcement is a better idea for having good property rights law but pertaining to current system of development authorities or revenue boards it is extremely unlikely that it is going to happen on fair basis. Verdier and Thierry (1998) argue that contract enforcement requires that a fraction of the agents work in the public sector and do not accept bribes. However, authors find that (1) it may be optimal to allow some corruption and not enforce property rights fully; (2) less developed economies may choose lower levels of property right enforcement and more corruption; and (3) there may exist a 'free-lunch' such that over a certain range it is possible simultaneously to reduce corruption, increase investment, and achieve a better allocation of talent.

North (1990; Page 58) says that third party enforcement would involve a neutral party with the ability, costlessly, to be able to measure the attributes of a contract. However, it is generally believed that people in the business of land transactions have very good public relationing in the registration departments and can manipulate the things in their favor. They can easily do it by bribing authority personals hence corruption will definitely increase.

If formal rules are made in line with the social and cultural norms then registration authorities conduct the initial exercise easily and transaction cost would be lower⁸. This implies that parcel based system (similar to Torrens system) is generally known to the people involved in the land transactions, it is easy to adaptable under the formal system and regularly conducts the settlement survey helps in formalizing property rights with lower transaction cost. However, because the patwaris who have the registers of records have contacts with the revenue authorities and very good relations, in general, with the big (feudal) landlords, thus it is expected that corruption will increase under this system.

Cancio (2007) argues that citizens demand corruption when legal institutions do not sufficiently protect private property rights. A general observation shows higher level of corruption associated with worse property rights condition (*Ibid*). However, *Ibid*'s analysis is based on cross country data and we cannot apply it on a single country that is in a transition phase of making property rights law. *Ibid* also suggest that if reformers wish to decrease corruption, they should focus on reducing citizen demand for it by ensuring that legal institutions provide genuine protection against asset predation.

I would suggest here is the fair role of enforcement authority, i.e., they should treat everyone equally and in a justified way. Moreover, we need to change our habits and role of individual behavior is very important for it. Unless enforcement authority does not do their work with honesty and sincerity, people will not believe in the system and the mindset of the people will not be changed. On the other hand if the individual behavior (mindset) and habits are changed that each individual do not bribe the authorities to have their work done, then the corruption will definitely decrease.

⁸ Ensminger (1997; Page 192) argues that complementarity between formal and informal institutions is crucial to successful property rights change.

Most important, if the punishment and enforcement of punishment for taking and giving bribe is very strong then people and authorities would fear of punishment and corruption will be reduced. This would change the habits and behavior of the people.

VI. SUMMARY AND CONCLUSIONS

Property rights are the core of economic development. The paper discusses importance of property rights, problems in the property rights in Pakistan, possibility of designing property rights in Pakistan and its impact on corruption.

The study concludes that there are lots of anomalies in the current property rights law which needs to be abolished such as *benami* transaction and general power of attorney. Moreover, single authority should be set up, which ensures the titles of the land rather than registers the documents only. The process should be under the Excise and Taxation Department of each province because provinces deal in the property. In designing property rights law we need to make formal laws which compliments informal norms, otherwise it would be difficult to implement. However, this system will increase corruption because people in the business of land transactions have very good public relationing in the registration departments and in that case corruption will not decrease because they can sue their contacts and power to maneuver things.

The study prefers Parcel (Torrens) based system because it is generally known to the people and the rules will be formed by taking informal constraints into consideration. Thus it is easy to adapt and helps in formalizing property rights with lower transaction cost. However, because the patwaris who have the registers of records has contacts with the revenue authorities and very good relations, in general, with the big (feudal) landlords, thus it is expected that corruption will increase in this process.

Informal system of third party enforcement would reduce the transaction cost in the short run, if the two parties are agreed to that neutral third party. However, in the long run the transaction cost might increase in case of severe disputes between the parties and government would definitely be losing potential revenues.

Titling and registration of property rights in a formal way, coherent with informal constraints, would definitely increase corruption in the short, i.e., in the period of

transition. But in the long run when the system is setup we can hope that the extent of corruption will decrease. However, fair role of enforcement authority will change the belief of people in the system. On the other hand if the individual behavior (mindset) and habits are changed that each individual do not bribe the authorities to have their work done, then the corruption will definitely decrease. Most important, if punishment and enforcement of punishment for taking and giving bribe is very strong then people and authorities would fear of punishment and corruption will be reduced. This would change the habits and behavior of the people.

References

- Ali, S. M. (2007), “View: Land Rights in Poverty Reduction, *The Daily Times*
- Barzel, Y. (1997), “*Economic Analysis of Property Rights*”, Second Edition, Cambridge University Press
- Cancio, G. A. (2007), “The Demand for Graft: How Property Rights Influence Political Corruption”, <http://Dscholarship.Lib.Fsu.Edu/Undergrad/275>
- Coase, R. H. (1960), “The Problem of Social Cost”, *Journal of Law & Economics*, Vol. 3: 1 – 44
- Demestz, H. (1967), “Towards a theory of property rights”, *The American Economic Review*, Vol. 57 (2): 347 – 59
- Desoto, H. (1989), “*The Other Path: The Invisible Revolution in the Third World*”, Harper and Row Publishers
- Desoto, H. (2000), “*The Mystery of Capital*”, Basic Books
- Ensminger, J. (1997), “Changing Property Rights: Reconciling Formal and Informal Rights to Land in Africa”, in a book *The Frontiers of New Institutional Economics*, Academic Press
- Field, E. (2002), “Entitled to Work: Urban Property Rights and Labor Supply in Peru”, *Research Program in Development Studies*, Working Paper # 220, Princeton University.
- Field, E. and M. Torero (2006), “Do Property Titles Increase Credit Access Among the Urban Poor? Evidence from Nationwide Titling Program”, <http://www.economics.harvard.edu/faculty/field/files/FieldToreroocs.pdf>
- Galiani, S. and E. Schargrodsy (2005), “Property Rights for the Poor: Effects of Land Titling”, http://economics.uchicago.edu/pdf/Galiani_022706.pdf
- Khan, F. S. (2006), “Taxonomy and Political Economy of Immovable Property Records: A Case of Lahore”, *Paper presented at PIDE Nurturing Minds Seminar*, Pakistan Institute of Development Economics
- North, D. C. (1990), “*Institutions, Institutional Change and Economics Performance*”, Cambridge University Press
- PIDE Policy Viewpoint (2007), “Establishing Property Rights through a Secure System of Land Title Management”, *Number 3*, Pakistan Institute of Development Economics

Tella, R., S. Galiani and E. Schargrodsy (2004), "Property Rights and Beliefs: Evidence from the Allocation of Land Titles to Squatters", *Working Paper Number 5*, Ronald Coase Institute

Verdier, T. and A. Daron, (1998), "Property Rights, Corruption and the Allocation of Talent: A General Equilibrium Approach," *Economic Journal, Royal Economic Society*, Vol. 108 (450): 1381-1403.