

People Power

Real Estate, Black Economy and Equity

In the midst of robust growth indicators, one issue which is causing concern is the black economy and the role of real estate in that. Some estimates put this parallel economy between 25 and 50% of the accounted GDP.

The negative consequences of such a large parallel economy are all-too-evident. Corruption is both a cause and consequence of unaccounted money. Competition is eroded with tax evasion, and genuine tax-payers find it difficult to survive in the market. Tax, GDP ratio is depressed as a large part of the economy is unaccounted. The consequent failure of public services and decline in infrastructure are all evident in India. With poor quality public goods, the poor suffer disproportionately. The consequent decline in productivity affects the whole economy. Parallel economy encourages wasteful expenditure, and resources are misallocated at the cost of pressing national needs. Unaccounted and untaxed money breeds envy and discontent in society.

All these causes and consequences of parallel economy are well-known. In India, real estate is the sector which feels the impact of black money most. Our land prices are shooting up irrationally. True, land is a scarce commodity, and cannot be created. This supply constraint is further aggravated by our cultural obsession with land. Far too many people are in search of land as a safe investment outlet.

While land is a scarce commodity by definition, the demand-supply gap is aggravated by bad policies and misgovernance. Despite our small land mass (2.5% of the world's land surface), India accounts for almost 12% of the global agricultural land. There is also huge potential for developing residential and industrial areas. Mere building of roads and creation of infrastructure will open up vast areas for utilization. Instead, development is limited to small pockets, and real estate prices are reaching the stratosphere. The new development of townships and special economic zones is hampered because land holders typically want to hold on to their property for speculative purposes. Experience teaches us that land prices shoot up a hundred times or more with even modest development, and therefore no farmer or land-holder is content with the measly 'compensation' offered under the Land Acquisition Act. Even if above market prices are offered to owners, there is severe resentment as farmers do not share in the anticipated prosperity.

High stamp duties have traditionally fueled black economy, as sellers declare sub-market prices to reduce tax liability. In a market dominated by unaccounted money, those who wish to disclose real prices are at a great disadvantage. The seller has to pay high capital gains taxes with full disclosure. If he wishes to buy a property, in turn he has to pay a large part of the sale consideration – typically 50 to 70% - in cash, which in turn needs black money! Most people are therefore forced to evade taxes and further enlarge the parallel economy.

Land registration has always been a source of corruption. Rent seeking for placement of officials dealing with land records and transfer of property is ubiquitous. In turn, the officials extort

payments from citizens for all land-related documentation and sale registrations. Absence of periodic land surveys and poor record-keeping have added to the woes of citizens and corporates. Land ownership is difficult to establish, and many innocent buyers have been cheated by unscrupulous real estate agents. This further shrinks supply of reliable land with assured titles, and leads to escalation of land prices.

Corrupt state politicians and bureaucrats are increasingly using their control of government land and land records as a source of patronage and extortion. With the decline of license-permit raj, control of land has become one of the key sources of corruption. The state politicians can dramatically alter the fortunes of favoured individuals and corporates by allotment of land. There is no rational policy for land allocation, nor is there a proper assessment of realistic needs. In alienation of government land, market does not operate, as there is no competition and all decisions are discretionary. On the few occasions when land is auctioned, the prices are inflated unrealistically as realtors indulge in strategic high bidding to enhance the market value of their other assets, or some buyers pay unreasonably high sums in a state of irrational exuberance. Rent control laws have further inhibited development of land, and created scarcity by diminishing supply.

Clearly, unrealistic real estate prices, huge black economy and phenomenal corruption are a drag on the economy. This will eventually inhibit growth and enhance the risks to individuals and businesses. The government can act in a few simple ways to disentangle the complicated mess we have created over the decades.

First, supply can be enhanced by opening up more land for development by building roads and infrastructure. Second, stamp duties need to be rationalized, and land records updated by periodic surveys and computerization with full public access to all information. Third, in all developmental projects like special economic zones, land losers can be given equity in the form of ownership of a portion of the developed land. This will give farmers a share in the prosperity and make available more land for development. Finally all alienation of land for profitable activities should be non-discretionary and by public auction.

Simultaneously, a few concomitant steps need to be taken to curb black-money in land related transactions. Giving right to charities to acquire land at 50% above the declared purchasing price within 6 months, high vacant land tax to inhibit speculation without development, and a reasonable estate duty on inheritance of non-agricultural land are measures which promote transparency and equity.

The governments need to act with clarity and good sense before our growth is hampered by irrational land prices and the growing black economy.

Jayaprakash Narayan

The author is the Coordinator of VOTEINDIA – a national campaign for political reforms;
Email: loksatta@satyam.net.in; info@voteindia.org; Url: www.loksatta.org; Url: www.voteindia.org