



Fixed-rent contracts and investment incentives. A comparative analysis of English tenant right

Samuel Garrido

Departament d'Economia, Universitat Jaume I, 12071 Castellón Spain

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ABSTRACT

This article stresses that tenants are more motivated to improve the holding when they have formal property rights over their improvements. In this case, however, their rights over the improvements usually come into conflict with the landlords' rights over the land. Through a comparison with what happened elsewhere in Europe, the article analyses the attempts to delineate and ensure both rights in nineteenth-century England. No wholly satisfactory solution was found to the problem and the article concludes that this is one of the reasons explaining the poor performance of English agriculture in the early twentieth century.

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1. Introduction

On starting up a line of reasoning that has received little attention from the theoretical literature on agrarian contracts, Pigou (1946 [1920], p. 174) resorted to English fixed-rent agreements in order to analyse the dysfunctions produced by the fact that 'some part of the investment designed to improve durable instruments of production is often made by persons other than their owners'. Even when the landlord is responsible for improvements, on quitting the farm the tenant may leave growing crops, tilled fallows or fertilisers 'stuck' in the land. Who do they belong to? Moreover, good cultivation may give rise to something that is very similar to the permanent improvements produced by landlords' long-term investments, as is the case of 'the accumulated fertility which is the result of high farming carried on for a long period' (BPP [British Parliamentary Papers], 1897, C.8540, p. 96) Can a tenant have his rent increased for having 'accumulated fertility'? Who does 'fertility' belong to?

Obviously, tenants are always the 'economic owners' (Barzel, 1997) of their improvements while the tenancy contract is in force.¹ Whether or not they are also their 'formal owners' will depend on the existence of a law (or a contract or a custom) that acknowledges that right. If that is the case, outgoing tenants must be compensated for the improvements they leave on the holding. Are investments in land positively associated with the possession of formal property rights over improvements?

The literature on agrarian contracts has frequently referred to property rights in its analyses of the influence exerted by the distribution of wealth on the choice of contract (Shetty, 1988; Ray, 1998; Hoffman, 1996, pp. 66–69, 2003). Economists and economic historians have also often discussed the impact of formal land titling on farmers' investments (Alston et al., 1996; Braselle et al., 2002; O'Rourke, 2007; Do and Iver, 2008). Yet the problems arising from the property of improvements and their repercussions on capital formation in agriculture is a topic that has received less attention (Mokyr, 1985; Besley, 1995; Barzel, 1997).

Landlords who allow tenants to enjoy their investments are not only favouring the growth of the tenants' income but also the growth in value of the farm (Solow, 1971, p. 36). As a starting point from which to address the issue, however, it is convenient to bear in mind that when tenants are the legal owners of the improvements a portion of the growth in value of the farm does not

E-mail address: samuel.garrido@eco.uji.es.

¹ If the contract expires and the tenant enters into another one in which he accepts to be rented on his improvements, some of the 'attributes' of the improvements will become the economic property of the landlord.

belong to the landowner, but to the farmer. In consequence, the costlier it is for the purchaser of an estate to settle the compensation for improvements, the lower the sale price obtained by the landowner will be.² Must the purchaser of land be obliged by law to inherit the commitments the previous owner had with his or her tenants? Does there have to be a law to prevent tenants from losing their investments as a result of a change of landlord?

In Pigou's opinion, the legal code should recognise tenants' property rights over their improvements. Any intervention in this area, however, entails the appearance of legal restraints affecting the landlords' capacity to dispose of their land like any other commodity. When those restraints are introduced by means of low-intensity interventionism, the expected upshot is that landlords will take advantage of loopholes in the law to avoid having to abide by it.³ And the threat of a stronger interventionism will act as an incentive for them to get rid of their tenants before the procedure becomes too expensive⁴ or as an inducement to sell the land.⁵ The Irish Land Reform seems to match this sequence quite closely. It began in 1870 when an Act legalised the Ulster Custom of tenant right, guaranteed all outgoing tenants the right to be paid compensation for improvements, and granted ejected tenants the right to be compensated for disturbance. In the early twentieth century land was bought on a massive scale by tenants (Guinnane and Miller, 1997).

Before compensation for improvements became compulsory in England, English landlords were the legal owners of their tenants' improvements. Yet they could renounce part of their legal privileges by means of private agreements and the enforceability of the contracts depended not only on the legal framework but also on custom and social control (Eggertsson, 1990, p. 46). Indeed, in nineteenth century England there was a customary 'tenant right', which has been granted a great deal of economic importance by many historians. The argument they usually employ can be summed up as follows. Since the 'high farming' of the middle decades of the nineteenth century was based on the purchase of huge amounts of feeding stuffs and fertilisers, tenants had to make considerable sunk investments. The landlords' tendency to replace long leases by short leases and year-to-year agreements, which meant that farmers had fewer guarantees of stability than in the past, did not favour this kind of expenditure. Tenant right, however, made it possible to successfully combine short contracts and tenants' willingness to invest.⁶

In England, regulation of the tenant right by law began in 1875, but the abundant legislation that was passed for this purpose was often accused of being less effective than the customary methods it was meant to replace. If the relations between landlords and tenants are regulated by an effective custom, is it a good idea for the State to turn it into a law? Had English tenant right really been effective? When the State interferes in the contract choice, does this always have the negative repercussions pointed out by Hayami and Otsuka (1993)?

In an attempt to answer these questions, in this article I will compare the English tenant right with similar customs developed elsewhere in Europe, and I will reconsider how compensation (or no-compensation) for improvements affected the way English farming worked. First of all, I will analyse the advantages and drawbacks that the existence of tenant right had for landlords. Then I will show that, before 1875, tenants received compensation for improvements in just a small part of England. The way the law attempted to correct the situation will be examined in the fourth section, and in the fifth I will show that whether farmers received compensation or not did have an effect on their investments in the early 1880s. Lastly, I conclude that there are sound reasons to believe that the imperfect definition of landlords' and tenants' property rights over the improvements was one of the causes of the poor performance of British agriculture following the Great Depression.

2. Compensation for improvements

Whereas Guinnane and Miller (1996) maintain that when some custom that established that outgoing tenants had to be compensated existed it was because its presence was beneficial to landlords, compensation for improvements has frequently been regarded as a right that tenants claimed and landlords were reluctant to grant (McQuiston, 1973; Mutch, 1983). However, the two approaches are in fact compatible.

Compensation for improvements can be a source of great advantages for landowners, but landlords are often unwilling to compensate their tenants because to do so involves having to cope with a series of risks. An explanation of what happened in the vast area of market-gardens surrounding the city of Valencia will help the reader to understand why this is the case. In the rest of the article I will refer back to that case on a number of occasions for two reasons. On the one hand, I am interested in comparing the so-called Lincolnshire Custom with a 'stronger' custom of compensation for improvements, and one such custom existed in Valencia. On the other hand, as far as I know, the Valencian Custom of tenant right is the only one in Continental Europe of which we have an accurate idea of how it worked.

2.1. The Valencian Custom

We should expect hired labour and sharecropping to predominate over fixed-rent contracts on the most valuable land (Alston and Higgs, 1982; Allen and Lueck, 2002). We should also expect landlords not to offer fixed-rent contracts to the poorest tenants (Shetty, 1988; Hoffman, 1996, pp. 66–69; Ray, 1998, p. 440). In Valencia, however, in the nineteenth century most of the high-value irrigated land was tilled by fixed-rent tenants (the rest was nearly always owner-operated by family farmers) and the

² One of the main aims of Section 2.1, which is devoted to Valencia, is to illustrate this point.

³ Similarly to what happened in Asia after the enactment of land-to-the-tiller legislation (Hayami and Otsuka, 1993, pp. 101–3).

⁴ As in Latin America (Ray, 1998, p. 418).

⁵ As occurred in Spain in the 1940s (Pan-Montojo, 2008).

⁶ Grigg (1966, p. 132), Thompson (1968, pp. 72–73), Perkins (1975, p. 8), Beastall (1981, p. 432), Turner et al. (1997, p. 11), Beckett (2000, pp. 741–4), Mingay (2000, pp. 794–802).

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