

Chapter 7

Land and Private Sector Development

Constraint: *Uncertainty about what land is available for lease and what the requirements for securing a lease are once land is identified makes it difficult for investors to secure leases within a reasonable period of time.*

A. The Importance of Land for Growth

No country has become prosperous without well-protected property rights and a centralized, unambiguous record of who has the right to use a particular piece of land and what the exact boundaries of that land are. The private sector in Tonga is constrained by the existing land framework because it makes it very difficult for investors, especially small ones, to identify land available for leasing. And once it has been identified, it is difficult to get the rights to use it. Even Tongan farmers wanting to expand their farms have trouble negotiating leases that give them long-term security over the new area they would like to farm.

B. Quasi-Owning and Quasi-Leasing

In Tonga, all land is the property of the Crown and there is no formal concept of freehold ownership. However, by law male subjects are entitled to receive allotments of land with a permanent right of use that amounts to ownership. Although the Land Act (1988) prohibits the buying and selling of these rights of use, there is an active market in informal land transactions, because land rights can be “gifted”—the person with the right to use the land can give this right away. While there is not supposed to be a sale, in practice an exchange of rights is brought about through a “gift exchange,” in which the right to use a piece of land is exchanged for a “gift” equivalent to the value of the quasi-lease.

This is even taxed at a rate based on the imputed value of the land and the number of years of the right to use it.

There is also a leasehold market, in which leases are bought and sold. To some extent, the lease market overlaps with the “gift exchange” market. The potential for 99-year leases exists (in fact, a large international hotel chain announced recently that it had secured one on Vava’u and will be investing up to US\$100 million in a new resort), but there

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appears to be insufficient awareness among smaller investors of the possibility of obtaining longer leases. And many investors report that the process of securing long-term leases is arduous. Leases of 50 years or longer require the approval of the Privy Council. Shorter leases require cabinet approval.

C. Mortgages

The mortgage framework has a number of practical problems. First, it is time consuming. The Land Act requires the Minister of Lands to approve and register all mortgages, which

increases the amount of time needed to obtain land for leasing. Second, using land leases as collateral involves significant risk to those who are pledging the leases. Lawyers report that some banks repossess mortgages even when the debtor owes only a small amount. The bank then holds onto the lease rather than auctioning it off and using the proceeds to refund to the debtor the difference between the amount owed and the value of the lease.

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In addition, when a bank has a primary mortgage, it will not allow a second mortgage on leasehold assets to another creditor, even when the value of the lease exceeds outstanding liabilities to the bank by a large amount. Third, only banks are allowed to grant mortgages. This removes the possibility of using a credit union to finance a lease (Chapter 6).

D. Land Rights

In Tonga, rights in land need to be strengthened if the country's development potential is to be realized.²⁹ Although land transactions are taking place, there is an urgent need to centralize them in a formal way so investors can know what is available and what the terms and various costs are. Formalizing the process would greatly reduce search costs that arise from lack of information and uncertainty.³⁰

Women can and do enter into lease agreements. However, they have limited formal use rights. Only when a woman's husband dies is such a right created—the widow has the use right while she is alive, but she cannot pass it onto her heirs. As restrictions on the use of assets tend to lower their productivity, security of tenure for both sexes would probably make land use more productive.³¹

E. Summary of Recommendations

- Streamline and modernize the leasehold system and its administration.
- Make the land-leasing process less complex and more transparent by creating a register of landowners who would like to lease their land for cultivation or business.
- Have a national debate on how best to achieve these goals in a way that takes traditional inheritance structures into account.
- Consider extending women's land rights.

²⁹ The considerations presented in this chapter apply only to land. Under Tongan law, dwellings and other buildings are treated as personal property and so fall under movable property law.

³⁰ When people are uncertain of their rights to a piece of property, they are reluctant to make the investments necessary to protect and improve it, the expected returns being low." (Partha Dasgupta, *Human Well-Being and the Environment* (Oxford: Oxford University Press, 2001), p., 113.

³¹ For a more detailed discussion of land issues in Tonga, particularly those related to women, see International Finance Corporation. 2005. *Gender Equal Land Laws: Driving Businesses Forward Gender Entrepreneurship Markets Quick Notes*. Washington DC. Also see ADB. 2007a. Kingdom of Tonga 2007 Social Economic Report: Facing the Future.