

## **Module VII**

# **Valuation, Compensation, Investments in Resettlers' Development, and Benefit-Sharing**

Prof. Michael M. Cernea

# I. Main Themes/Issues in Valuation and Eminent Domain

- The need to change and innovate current practices for reconstruction after displacement
- Brief overview of main themes: economic, financial, and legal themes in this module
- Eminent Domain legal principle: justification and limitations
- Eminent Domain in public sector. Does it apply also to private sector projects?
- Valuation of losses: Valuation of tangible assets, of opportunities and intangible values
- Valuation procedures and measurements may falsify outcomes.  
New recommendations. (continued, see next slide)

(Continued)

## II. Main Themes and Issues in Compensation and Economic Recovery

(continued overview)

- Compensation as instrument for resettlers' re-capitalization: Does it live-up to its function?
- Typical ongoing distortions in compensation procedures
- Structural limits of compensation as main resource for improving livelihoods
- Distinction between “investment and compensation”. What are the investments in current resettlement components?
- The financial provisioning needed for reaching “Resettlement with Development” objectives
- Benefit-Sharing as financial source for sound resettlement

# The “Material” and the “Social” in Reconstruction

- Recurrent resettlement failures have prompted an intense search for more innovative solutions and new instruments
- Innovative approaches emerge here and there; they need identification-analysis-generalization
- What is our basic success criterion in resettlement projects?  
The policy objectives
- Perceived discrepancies between policy-mandated goals and policy-mandated means in resettlement. Are means commensurate with policy goals?
- How to overcome internal inconsistencies and overcome risks?

# Eminent Domain as Legal Dispossession: Justification and Limitations

- Eminent domain issues, and opposition to ED, are surfacing in all countries (developing and developed) concerning the extent of ED applicability and its effects on those affected
- Examples:
  - India: The revised Land Acquisition Act (1994) expands eminent domain use to private sector project
  - USA: Supreme Court 2005 Decision on New London Case and the new national controversy ignited across the USA
  - China: Interpretation of “public use”, revision of land by the state for private sector ventures
- Legal Justification of Eminent Domain; “highest good for the largest number”
- In built limitations in ED law, even in public sector: it imposes expropriation without resettlement, only compensation

# I. Risks and Financial Losses Resulting from Eminent Domain Extension

- Recent trend in some DMC (including India), to extend the ED law to support private sector land acquisition for new enterprise creation
- ED is supposed in its original definition to be invoked for “public use” state projects
- Private sector projects (some co-financed by IFIs, including ADB) also need land for footprint, but land acquisition for “for private profit” projects has historically developed well-tested market rules for free negotiation of prices

# The “Willing Buyer-Willing Seller”

- The norm of “willing buyer-willing seller” causes less risks and provides higher protection to small landowners than Eminent Domain law, with its attendant (a) expropriation, (b) one-sided valuation and (c) low compensation.
- India’s Land Acquisition Act (1994) replaces the “willing buying/seller” market principle by expanding the rationale for ED from “public use” to “public purpose” and to “public interest”. Critics of this expansion argue that “public interest” is a very loose and soft justification, conflicting with constitutional guarantees for security of property.
- By giving the private sector the ability to acquire land for “for profit projects” by using the ED (power of the state), resettlers are exposed to new and increased risks of de-capitalization. They lose the right to bargain directly with private sector companies.

# Eminent Domain and new financial losses

- Evidence is being collected by RETA country studies on:
  - (a) Physical extent of state ED land acquisition for transfer to private entrepreneurs
  - (b) The difference between the “price paid” (as compensation to those displaced) and the “transfer price” – (the price received by state from private companies for these lands).
- The difference between “paid prices” and “transfer prices” represents the amount of financial extraction from what is the due to land owners, a “measurement” of one of the modalities of impoverishing displaced people

# Eminent Domain and the “Holdout” cases

- Some justification for using (ED) state power may exist, in “holdout” situations, at the limit. This is when isolated individuals or small groups keep “hostage” projects, while the bulk of acquisition cases is resolved through “willing buyer-wiling seller” (WB-WS) arrangements
- WB-WS usually generate much higher prices for condemned land and immobile assets than ED forced acquisition
- WB-WS may come close, if done fairly, to changing forced resettlement into voluntary resettlement. Affected people may be interested in trading off their “location” for other significant livelihood advantages elsewhere

# Valuation of Losses: Correctable Deficiencies

- Asymmetric information (Stiglietz) between expropriators and displaced people works always to the latter's disadvantage
- People resist moving out because of asymmetric information and low price offers. This often ends up costlier in the long run to the developers than paying upfront a price acceptable to the "willing seller"
- Valuation is a dual process: technical and social. The technical measurements of assets must be outlined in detail in economic and technical project guidelines, subject to inspection by resettlers' organization.
- Third party: Social guarantees in valuation are assured best when a neutral party is involved in negotiations and in monitoring the to apply the agreed technical measures for valuation

# Innovations in Valuation Methodology

- Recent research in economics has compared two valuation modalities of environmental goods for conservation purposes: willingness to pay (WTP) and willingness to accept (WTA). Experiments concluded that WTP levels tend to be higher than WTA levels, but under fair criteria the gap becomes easier negotiable.
- Resettlement researchers are now exploring whether the same argument can be developed for the valuation of assets lost in population displacement situations. Economist David Pearce, founder of environmental economics, is *“advancing the argument that the correct measure of economic loss from dislocation is one based on WTA, not WTP. We surmise that the use of WTA will provide significantly larger values because of the lack of substitutionability of new locations for the existing ones. At the very least, we argue this is the case of older and more vulnerable people”* (2004).
- This is a new researchable hypothesis, of great promise for practice, if validated.

# Compensation: is it able to counter impoverishment risks?

- The response to this key question has several elements:
  - 1) Compensation is necessary and indispensable for all losses incurred
  - 2) Compensation even at the “replacement cost level” is vulnerable to several dysfunctionalities:
    - (a) Errors in valuation, discussed earlier
    - (b) Dysfunctions in the delivery of compensation payments, [well known: corruption, siphoning off, delays, etc.]
    - (c) Dysfunctions resulting from resettlers’ conditions (indebtedness, customary obligations, inexperience with cash, etc.)
    - (d) Unanticipated changes in market prices
- The result: compensation payments tend to regularly NOT return to resettlers the real and full values of their assets. They end up worse off, impoverished.
- **Conclusion:** Unless Governments and agencies do not reform the compensation system, impoverishment of resettlers will continue, despite policies to the contrary.

# The Empirical Evidence on Compensation

- Socio-anthropological research has generated overwhelming evidence proving that resettlement's key tool – compensation – is incapable to re-capitalize resettlers
- Displacements extract wealth, while reconstruction demands investments. If compensation doesn't provide enough even for restitution, the conclusion is that solely compensation can not achieve reconstruction
- Intangible losses can not be valuated properly and “grants” (e.g. solution grants) are a weak remedy.
- Let us examine how resettlers perceive compensation, how they describe the compensation (Cambodia, RETA findings) and further examine what are the most poignant forms of under-compensation reported by international social research (next 2-3 slides)

**“I was told that I should take what they give.”**

## **Compensation: Voices of the Displaced**

Chea Sarin, a RETA social researcher, convened in November 2004 a focus group in the Chi Pho commune, Cambodia, with women of families affected by displacement under the Highway Project Phnom Penh-Ho Chi Minh City.

The discussion was about compensation. The researcher reports that participating women “complained that the compensation practice was not fair at all, ...that it was not adequate, and it aggravated their poverty.”

He quotes verbatim several answers:

*...We are waiting and waiting for compensation, but every time they came, we never heard our names called. We wonder why some received and some didn't receive compensation...*

*...Some of our stalls were not compensated and some of our trees were cut off without any compensation. We lost our businesses and the benefits from the trees...*

*...If we were compensated for our lost assets, we could have afforded to buy land, but now land is much more expensive, and we would not be able to buy anything with the compensation...*

(Continued on Next Slide)

# **“I was told that I should take what they give.”**

## **Compensation: Voices of the Displaced Continued**

*...We are upset, and don't know what to do. We gave them our finger prints, they removed our houses and stalls, but we haven't received any compensation so far...*

*...Some people argued with them for more compensation and they succeeded. But we didn't and dared not complain, so we are waiting for what they agreed to give us. But why is it now that we haven't received even that little compensation?...*

*...We have no idea of what to do if we're not satisfied with the project or the compensation. We weren't told anything if we can complain...*

*...We heard that if we disagree with them we might risk not getting any compensation...*

*...Me too. I was told that I should take what they give.*

*...We just could not disagree with them. They asked us to remove our assets and we just did what they said and dared not disagree.*

Chea Sarin's conclusion was:

“Nobody in the group appeared to know about how to seek help when they were not satisfied with the compensation...and expressed fear of the project officials, fear that they may not get any compensation if they complained.”

# Findings on compensation from international academic research

The most frequent forms of under-compensation (and cost externalization) reported in international social research are:

- Market-defying subjectivity in the valuation of assets, with consequent partial – or non-replacement of lost assets (Nayak, 2000; Ota and Agnihotri, 1996);
- Physical undercounting of condemned assets for which compensation is due, but not paid (Parasuraman, 1999; Mahapatra, 1999)
- Non-physical losses, difficult to measure, are largely ignored; failure to recognize non-market income (Konig and Diarra, 2000; Pandey, 1998)
- Under-compensation results from late disbursement of compensation to shoe left assetless for a long time (Maahaptra, 1999; Guha, 2001)
- Subtraction by corrupt officials of part of the compensation money before it reaches those rightfully entitled (Maybury-Lewis, 2003; Parasuraman 1999)

(Ct-nued)

## Findings on compensation from international academic research

- Under-compensation because of lost consumer surplus from existing assets (Pearce, 1999)
- Preemptive exclusion of some common assets from consideration (Schmidt-Soltau, 2002; Kibreab, 2000; Konig and Diarra 2000);
- Asset-price upward changes occur after calculation of compensation, diminish the purchasing power of recipients (Downing and Garcia, 2002)
- Recipients unaccustomed to handling cash tend to misdirect comp. & are left both asset-less and cashless (Mahapatra, 1999; Nayak, 2000; Hakim, 2000).
- **Conclusion:** If a tool – compensation – that seems good as a principle in theory turns out in practice to be ineffective, prone to chronic flaws, policies cannot remain aloof, indifferent to feedback.
- Policies must not continue to stick ot theory that is falsified by practice.
- The inescapable conclusion: there is a policy and moral responsibility to reform flawed compensation legislation and practice.

# Structural Insufficiencies of Compensation

Assume that, by sudden miracle, valuation of losses would become perfect, and ideal compensation delivery will have no flaws. Two questions must be asked:

**(A) Will compensation be enough for *restoration* of livelihood?**

[Answer: Hardly. Compensation even at replacement cost still remains (by design) time-insensitive: it does not recover the “without the project” development]

**(B) Will compensation be able to ensure significant *improvement* over pre-displacement level?**

[Answer: No. This demands investments, while compensation is only restitution]

# (Ct-nued) Structural Insufficiencies of Compensation

- Conclusion: Therefore, even in ideal, miraculous conditions, relying solely on compensation will not achieve the goal prescribed in resettlement policies
- The gradual shift upward in policy objectives from “restoration” to “improvement” was not matched by an equal shift for increasing the “means” available to projects
- One key (compensation) cannot open two locks, the second lock being more complex than the first: restoration and improvement
- By “improvement” we must have in mind not a 1% “improvement” over pre-displacement (hard to even measure in project contexts), but a significant increase, surpassing the “without the project” rate of local growth.

# Investments are indispensable for improving resettlers' livelihood levels

Take the clear case of an irrigation dam. The state invests in the cost of the dam and of building the irrigation system for downstream farmers.

Farmers downstream are the beneficiaries of a large financial investment of the state in improving their welfare (state pays full cost of irrigation system, also of the dams). However, NO investment is made by the same project in support of the upstream displaced reservoir residents: they only get a partial restitution for what was extracted away from them. This is not an increment over their prior wealth, not an additional investment.

What is the rationale of treating differently the farmers upstream than the farmers downstream?

# The Lack of Economic Analysis for Resettlement Project Components

- When resettlement is structured as a “project component”, the “project within a project” is not subjected either to full-scale project economic and financial analysis, or to a specially adjusted “component-economic analysis”
- Project CBA (Cost-Benefit Analysis) is, by definition, insensitive to cost and benefit *distribution* among the project stakeholders.
- Economic sensitivity analysis is not applied to resettlement
- Conclusion: Under current international guidelines, resettlement operations do not receive the scrutiny of a full battery of analytical economic techniques

# China's Innovations in Resettlement Economics:

## Continuous refinement of valuation criteria and increasing compensation standards

- Deficiencies of valuation procedures and of low compensation levels have been identified early in China (particularly, regarding land compensation in the water conservancy projects)
- Because low compensation is contrary to China's policy objectives in resettlement, China's Government took the course of adopting several, stage by stage, increases in the formal (state enacted) norms for land compensation
- Historical chronology of these increases over land 15 years old, (to be added, from forthcoming RETA country materials, see next).

# (Ct-nued) China's Innovations in Resettlement Economics

- In essence, e.g., compensation was increased, amazingly, from equivalent of 3 times annual output, to 30 times annual output!!
- (The criterion of output may be disputable, and may be soon replaced by different criteria. But the political will and the “policy message” of increasing (ten-fold) the compensation level are unmistakably clear.)
- Some interpret China's increases in compensation as a form of channeling to resettlers a combination of “compensation for losses” with “investments” for development
- (Consider also the Chinese way of channeling compensation resources partly to the community, not only to individuals)
- **Conclusions:**
  - (1) Political will is present for avoiding impoverishment by displacement
  - (2) Financial inputs for lifting up the end-results of resettlement are necessary, and have been made available in China as an upward spiral
- World Bank comparative analyses have concluded that, in similar classes of projects, livelihood results in China are on average significantly higher than in India, or in other borrowing countries

# Japan's Innovation: Eminent Domain Expropriation, and Compensation Use of "land lease" and rent payments

- Japan has experimented with ways to avoid expropriation and one-time compensation only
- The Innovative approach at Japan's three Jintsu-gawa dams (W1, W2, W2), small and medium scale, consisted in a land-lease approach, without applying the Eminent Domain law even in these public sector projects

(Ct-nued)

## Japan's Innovation:

### Replacement of Compensation and Eminent Domain-based Expropriation with Land Lease and Rent Payments

- Farm land “contributors” to the Jintsu-gawa dam-projects were paid an upfront fee, plus annual “rent” for land (paid out from the benefits of the power plants, as annuities. This did reduce resistance to dams, provided options for investing in alternative livelihood, plus security payments (continuous rent). Rents continue to be paid by the power companies for 50 years now!
- The same Jintsu-gawa land-lease/rent approach was applied in Numata dam planning, the biggest planned dam in Japan, (The Government decision for building that dam was ultimately changed)
- Japanese resettlement researchers consider that the precedent embodied in Jintsu-gawa and Numata planning “still appear to be innovative” today.

# Discuss the new argument for financially enabling resettlement to become development

- A new argument is taking shape from the analysis of impoverishment risks and actual impacts of DIDR, developed in a few emerging publications on the economics of resettlement.

(see for details Cernea in bibliography at end, and other studies)

- Discuss in class the “pros and cons” of what, in essence, this argument states (see next slide:)

# Summary Rationale for a New Argument

To promote “resettlement with development” it is necessary both to reform compensation processes and to supplement compensation (which at best is only restitution of what existed in the past) with investments in resettlers’ accelerated re-development apt to improve their livelihood above prior levels.

Currently, project investments are channeled only to non-displaced project beneficiaries, but not to those displaced as well.

There is no developmental or moral justification for this financial de-linking of displacement from development investments.

The resulting argument is, conversely, that the resettlers are among the primary stakeholders of the project. They make the project possible by ceding their lands and houses for the project’s “right of way”. Therefore, projects must be structured and financed so as to contain explicit development programs and development-focused investments for resettlers, incremental to compensation.

This would fulfill the “*to improve*” objective of the resettlement policy, and will help reduce poverty, instead of creating new impoverishment:

# (Continued) Summary Rationale for a New Argument

## Suggestions for discussion:

First, think of counter-factual arguments contending that resettlers should be left impoverished. Why? Are these arguments convincing?

Second, ask: (surely, this is the first question likely to come up): How can investment resources be provided? Where from would the money come?

# Where from would the money come?

## Two main sources for investing in “resettlement with development”

- Earlier in the training course it was concluded that the most effective way (or the only real way) for “resettlement risk management” and for preventing impoverishment was “resettlement with development”, through the recommended strategies (IRR model).
- The concept of “capacity building” for risk management (RETA 6091’s theme) should include:



## (Ct-nued) **Where from would the money come?**

- The best resettlement manager would not be able to manage the severe economic and financial risks without financial means.
- (Absence of financial resources, (expressed in (a) insufficient compensation and (b) lack of investments), has chronically undercut the work of countless resettlement project-component managers.
- Thus, two main sources:
  1. Initial, the usual upfront budget allocation for displacement and resettlement
  2. Subsequently, some small fraction of project-generated benefits (some of which start accruing already during the project's construction)

# Benefits-Sharing: Policy support

- International policies explicitly include the principle of “enabling resettlers to share in project benefits”
  - World Bank Resettlement Policy of 1990 (OD 4.30) and of 2001 (OP/BP 4.12)
  - ADB Involuntary Resettlement Policy of 1995 and OMF2 of 2003
- The ADB involuntary resettlement policy “treats involuntary resettlement as a development opportunity and allows planners to manage impoverishment risks and turn the people dispossessed or displaced into project beneficiaries,” (OM 2003, Para. 3).
- In practice however, explicit measures for sharing and channeling back to resettlers a fraction of the projects’ financial share of benefits, are seldom included (positive examples come from China, in some large projects in Brazil), but it is still far from being “general” project practice.

# Rationale for Benefit Sharing: Hydropower Projects

- Justification for benefit sharing
  - Goes far in preventing impoverishment, helps poverty reduction
  - It is economically rational for the project itself
  - Equitability/moral rationale
  - Political rationale
- Dam projects are the sector most advanced in evolving mechanisms for benefit sharing.
- Sharing of rents arising from hydropower projects is major new source for financial support beyond compensation, to be used as investment for local area development. The potential for benefit sharing exists in other sectors as well (with some modified mechanisms)

# Options for Benefit Sharing and Equity-Sharing in Mining Sector Projects

- Consider Mining Sector Projects: Develop and discuss rationale for benefit sharing or equity sharing
- Shareholders in private power companies share in benefits (a stream of dividends) because they invest money in purchasing stock-shares on the market. People displaced by “right of way” see their land “invested”, but are being bought out before construction, at prices that do not include the future development potential of land acquired at replacement costs. Their land is by far more indispensable to those companies than the stock-share equivalent of purchasers on the market. Is it reasonable to regard them too as “shareholders” and reform arrangements for land purchase and benefit sharing?

# Options & Mechanisms for Benefit Sharing for Resettlers' Development

1. Enhance compensation levels with a pre-defined % above replacement costs (this, however, is risky, rarely desirable)
2. Direct Revenue Transfers
3. Establish of Development Funds
4. Equity sharing in new project products, or various forms of co-ownership
5. Taxes paid to regional and local government (this is not only a “resettlement-specific” form of benefit sharing)
6. Regular allocation (enacted by law) of a fraction of power benefits for local area development (or directly to resettlers' groups, enterprises, etc.)
7. Preferential electricity rates or other water-related fees

Participation of resettles in the negotiations for benefit sharing and in managing redistributed benefits.

# Brazil: Good Practices of Benefit Sharing

- Brazil is one of the world's 3 highest-investing countries in major hydropower dams, with large reservoirs but also severe problems of post-relocation area-development and resettlers' integration
- One-time compensation payments proved disastrously insufficient (examples: Tucuruí dam; Balbina dam; impoverishment)
- Brazil government adopted several successive policy and legal measures to compel power generation companies and dam owners to ensure continuity of financial support (next slides)
- Laws providing for sharing into local municipalities: 1989, 1990, 1997, 2000.

# Brazil: Adopted Legal Acts for Benefit-Sharing

## First Steps: Law 7990 (1989) & Law 8001 (1990)

{plus related legal rules}

- The laws have introduced financial compensation (6% of the generation “tarif of reference”) to be paid by power-producing companies (>10MW) to States and Municipalities affected by reservoirs (including local and upstream regularization reservoirs)
- Legal norms for distribution of proceeds – Applicable also to Itaipu’s royalties: 45% for States, 45% for Municipalities, 10% for the electricity regulatory agency\*

\* 40% for electricity services supervisory activities, 35% for water resources management and data gathering, and 25% for environmental protection. (F.L.S. Gomide)

## **New (Improved) Laws in Brazil for sharing/using dam proceeds:**

- Law 9433 (1997):
  - Outlines the national water resources policies and guidelines, and introduces the concept of payment for water use.
- Law 9984 (2000)
  - Creates the national water regulatory agency and increases from 6% to 6.75% the amount to be paid by power generation companies. The additional 0.75% is the back-payment for water use.

# Brazil: Benefits Actually Shared in 2004

## Royalties Channeled to Local Communities

- 137 hydroelectric power plants with 145 reservoirs, were scheduled to pay in 2004 over US\$ 400 million in financial compensation, or as continuous royalties to 22 of Brazil states and 593 municipalities:

| Communities Receiving Royalties (roy) and Financial Compensation (fc) |   |                                 |
|---|---|---------------------------------|
| 16 municipalities<br>(roy only)                                       | 325 municipalities<br>(both roy and fc) | 252 municipalities<br>(fc only) |

# Annual Payments for Inundated Reservoirs

- Generation companies pay 0.75% of R\$ 44.20 per MWh for water use
  - How the proceeds are used is the responsibility of the national water regulatory agency, required to assess and rank local needs
- Compensation for inundated areas: Power generation companies pay 6% of R\$ 44.20 per MWh (US\$ 0.93/MWh) and Itaipu pays more: US\$ 1.99/MWh
  - Distribution of the proceeds is 45% for States, 45% for Municipalities, 10% for the Federal Government\*
  - Continuity of revenues over time supports faster growth of resettlement areas

\*30% for electricity services supervisory activities, 30% for national water resources secretary, and 40% for the national fund for Science and Technology. (F.L.S. Gomide)

# Conclusions

- This Module concludes the presentation of the IRR model. It included the identification of main impoverishment risks and of basic strategies and new options for managing risks and fostering resettlement with development.
- Displacement and resettlement, because of their risks, will remain one of the thorniest, most complex activities.
- Recognition of the risk of impoverishment and recurrent failures brought crucial issues into current discussions. Better policy and operational solutions are incessantly researched, sought, implemented and tested.

# Conclusions

- Among new practices and methods, much emphasis is placed upon upstream and explicit risk analysis for all resettlement operations and planning directly targeted counter-risks development strategies.
- Further, the economic and financial analytical methods, and the reform measures discussed in these modules have high potential for bringing better standards and substantial success in resettlement performance. They need experimentation, open discussion, and compelling legal enactment.
- If displacement and resettlement operations are transformed into “resettlement with development”, not only the resettlers themselves but the entirety of the induced development process will benefit.