



TERRA INSTITUTE LTD.

1406 Hwy. 18-151 East • Mt. Horeb, WI 53572-2064

Phone: (608) 437 -8716 • **Toll Free:** (877) 437 -8716

Facsimile: (608) 437 -8801

E-mail: TerraInstituteUSA@att.net

www.terrainstitute.org

OPTIONS FOR STATE OWNED AGRICULTURAL LAND IN GEORGIA

By J. David Stanfield PhD

Terra Institute, Ltd., has provided technical assistance and training in Georgia since April 2001 under the Georgia Land Market Development Project. This document, among others has been archived as a report under this Cooperative Agreement and readers may make verbatim copies of this document for non-commercial purposes by any means, provided that this copyright notice appears in all such copies.

This document was originally submitted to Terra Institute, Ltd. in May, 2002.



This publication was made possible through support provided by the Economic Restructuring, Europe and Eurasia, U.S. Agency for International Development, under the terms of Grant No. 114-A-00-0-00111-00. All opinions, interpretations, recommendations, and conclusions expressed herein are those of the author (s) and do not necessarily reflect the views of the U.S. Agency for International Development or Terra Institute, Ltd.

Options for State Owned Agricultural Land in Georgia

There have been continuous discussions of the agricultural land that remains in State ownership after the privatization process which began in 1992. The objective of this paper is to present a summary of the available statistics and of the arguments for and against various options.

1. Privately Owned and State-Owned Agricultural Land

The total agricultural land in Georgia amounts to about 3 million hectares. Its distribution according to predominant use in 2001 is shown in Table 1. There are in 2001 793,000 hectares of arable land and nearly 270,000 hectares are under perennial crops. Meadows and pasture land amounts to almost 2 million hectares. About 19,000 hectares are held in house and garden parcels

In 1985, the distribution of land in these same categories is shown in Table 1, column 1

[Get these statistics and comment].

Soon after independence, the Government quickly prepared a land reform program, launched by Resolution 48 of January 1992 to rapidly provide land to a demanding rural population. The major aim of the reform was to increase the land available to farm households after a turbulent period which included civil war and the collapse of most of the collective and state farm enterprises. This land would ensure food security in difficult times for a large proportion of the population, including village residents but also including households with work or residences in cities, but with some connection to the ex-cooperatives and state farms.

The situation before land privatization was¹:

- 1,300 large collective and state farms cultivated about 3 million ha of agricultural land. About 1 million ha were arable or perennial land. The rest was mostly pasture and meadows.
- About 700,000 farm households cultivated about 200,000 ha of arable and perennial land.

Following the Government Resolution No. 48, a privatization "fund" of land, composed of about 850,000 ha of mainly arable and perennial plantation land, was set up for distribution including the above 200,000 ha of household farmed plots from before the reform.

Land was distributed free of charge to three types of recipients:

- a) The work force of the large-scale collective or state farms represented by the farm household (Komli, not individuals) received land up to a maximum of 1.25 ha.
- b) Other households in the villages should receive .75 ha.
- c) City households should receive .25 ha (if formerly farming in the village) or .15 ha (if not).

The distribution process based in most cases on Sakrebulo Land Commissions composed of villagers, but supported by district committees involving Sakrebulo mayors and local Government administration.

¹ From Strubenhoff, 2002.

To date, about 781,000 ha of land have been distributed to about 1 million households. The average size of these privatized agricultural land holdings varies from 0.3 ha in districts with a low land-man ratio to reach the ceiling of 1.25 ha in districts with sufficient available land. The differences among districts are significant.

Agricultural land ownership is based on the Law on Agricultural Land Ownership of 22 March 1996, amended by the Civil Code of 26 June 1997, and the Amendment to the Law on Agricultural Land Ownership of 9 June, 1999. Much of this legislation is to confirm ownership conferred previously through Government decisions, and to provide greater definition of the rights and responsibilities of private land owners.

It is important to note that households (Komli) – not individuals - received agricultural land. According to the law, the head of the household is obliged to obtain consent from other household members, verified by a notary, to change ownership of the land.

Table 1 shows that in 2001, 26% of the total agricultural land has been privatized into ownership and 31% has been leased. The land remaining in State ownership and not leased is predominantly pastures.

About 55% of arable lands and about 67% of lands used for perennial plantations have been privatized, and are located mainly in and around villages (the English term “agricultural land” translates literally as “village farmed land” in Georgian). In some regions, however, the settlement pattern can be households grouped into physically contiguous housing arrangements, interspersed with household gardens, while in other villages houses and their gardens are scattered around the countryside.

[Discuss the 1985 statistics, and if shows much less pasture land in 1985, discuss possible explanations]

Certain features of the leased land are:

- Around 290,000 hectares (27.2%) of arable and perennial lands are leased to farmers by the State.
- Nearly half of the leased land is classified as pastures.

Most of arable and perennially cropped land that remains in state ownership and not leased nor privatized (156,500 hectares, or 14.7% of these combined categories), and some of the unallocated pastures is in border areas (Abkhasia, Adjara and Samachablo/South Ossetia) where conflicts have been problematic.

Most of the unallocated land (neither privatized nor leased) is pasture (1.1 million ha) and it is probably used by communities or groups of families and is composed of mountain summer pastures and some winter pastures.

Table 1: Privatized and Leased Agricultural Land in Georgia, 2001

| | Total 000 ha | Total 000 ha | Privatized 000 ha | | Leased, 000 ha. | | Remaining State Land, 000 ha | |
|-------------------|-----------------|-----------------|----------------------|-------|-----------------|------|---------------------------------|------|
| | 1985 | 2001 | 2001 | % | 2001 | % | 2001 | % |
| Agricultural land | | 3,038.7 | 781.1 | 25.7 | 939.6 | 30.9 | 1,318.0 | 43.4 |
| Arable | | 792.9 | 434.8 | 54.8 | 257.5 | 32.5 | 100.6 | 12.7 |
| Perennial | | 269.3 | 181.8 | 67.5 | 31.6 | 11.7 | 55.9 | 20.8 |
| Meadow | | 142.3 | 41.3 | 29.0 | 57.1 | 40.1 | 43.9 | 30.9 |
| Pasture | | 1,795.8 | 84.8 | 4.7 | 593.4 | 33.0 | 1,117.6 | 62.2 |
| House parcels | | 19.0 | 19.0 | 100.0 | 0 | 0 | 0 | 0 |

Source: State Department of Land Management, Land Balance for April 2001, as presented in the Strubenhoff et. al. report, 2002.

2. Farm Structures

Three main types of agricultural land tenure have emerged in Georgia since 1992.

Table 2: Agricultural Land Tenure Form

| Tenure type | Number entities | Total area in Ha | Average Area in ha |
|---|--------------------|---------------------|-----------------------|
| Families with privately owned land | 1,055,200 | 762,100 | 0,72 |
| Families and groups with leased land | 31,900 | 352,000 | 11,03 |
| Legal entities with leased land | 6,300 | 587,600 | 93,27 |

Source: State Department of Land Management, Land Balance for April 2001, cited in Strubenhoff, 2002.

The largest tenure type are the small-scale farmers (more than 1 million families) who own agricultural land. This group includes families living in villages but working in nearby cities, and families who live and work in cities, but who had recently lived in the ex-collective farms. The average farm size for this somewhat heterogeneous category is 0.72 ha, and this figure differs from region to region.

The second group is larger individual farms of 32,000 families or groups of families, mostly village residents who have received some land in private ownership, but also lease state owned agricultural land. These families and groups lease on average 11.03 ha of land from the state.

Since only some of the villagers who received land in ownership also lease state owned agricultural land, it is difficult to estimate the size of the holdings in this category, or what type of land they lease.

The third group comprises 6,300 agricultural enterprises or corporate structures (cooperatives, joint-stock societies, limited liability companies and other partnerships). These entities are successors of former state farms or they are legal entities created since 1992. They rely mainly on leased land. The average amount of state owned land which they lease is around 93 ha.

3. Leasing of State Owned Agricultural Land²

The legal situation for leasing state owned agricultural land has undergone several modifications. A Law on Agricultural Land Leasing was introduced in 1996. In the following year, this law was repealed by the Civil Code on 26 June, 1997. Finally, according to Presidential Order No. 446 on the Rules for Leasing State-Owned Agricultural Land from August 1998, in effect the Law on Agricultural Land Leasing has been put back into force.

Local lease commissions representing district and city/ village representatives conduct lease competitions. Competitions may be “commercial” or “non-commercial”. In a “commercial competition”, the applicant who offers the highest lease rate shall be awarded the land. A “non-commercial” competition may be organized if the commission decides to base the competition on “business plans”. In this case the land is awarded to the applicant submitting the most satisfactory business plan.

This legal situation has led to corrupt practices and widespread abuse (see below).

The Presidential Order states that no lease agreement may have a lease term longer than 49 years.

The agreement must be registered at the local SDLM office.

The minimum lease price equals the land tax rate. This tax rate is set locally by the Sakrebulo administration, and can range (according to the tax code of June 13, 1997) from 8 to 51 GEL per hectare of crop land per year. (By way of comparison, in the outer districts of the city of Tbilisi, the tax rate is .06 GEL per square meter, or 600 GEL per hectare.) Pasture land is taxed at the rate of 3 GEL per hectare.

Since the lease fee is close to the tax rate, which is around 1% of the “value” of the land, the lease fee is well below the productive potential of the land. That potential on a yearly basis should be at least 10% of the “value” of the land under conditions of approximately 7% interest rates on deposits. People will want to recover their investment in buying land in 10 years, or else they can make more money by leaving money in savings accounts. So, the lease fee being about equal to the tax rate is a substantial subsidy to the lessees. One result is the sub-leasing of land to other farmers allowing the lessee to profit substantially from the lease arrangement with the state without any investment in time or money in the farming operation. Such sub-leases are illegal without the consent of the SDLM, which has not been given.

Another feature of the lease agreement is that the leased land must be cultivated and used for agricultural purposes, otherwise the SDLM could declare the lease agreement void in order to lease the land to another lessee.

The lease term varies from 1 to 49 years. Table 3 shows the distribution of the leases and leased land according to the time period of the leases.

² From Strubenhoff, 2002

Table 3: Lease Terms in the Year 2000

| | Duration | | | |
|----------------|-----------------|------------|-------------|--------------|
| | 1 | 2-5 | 6-10 | 11-49 |
| Proportion (%) | 4.8% | 4.4% | 67.5% | 23.3% |
| Area (ha) | 45,101 | 41,342 | 634,230 | 218,927 |

Source: SDLM and Draft Law on Land Privatization

Most of the leases and most of the land leased are in the 6-10 year term category, and most of these are for 10 years exactly. The land leased in the 11-49 year category are mostly for 49 year terms. While ambiguous, the Civil Code's article 570³ seems to say that any lease for a term in excess of 10 years may be terminated after 10 years unilaterally by either party upon three months notice to the other party.

Lessee's can transfer their leased land to third parties, but only with the consent of the lessor (see Civil Code, Article 549)⁴. There appears to be no legal authorization for the sale of leased land, that is, the transfer of the entire lease agreement, with or without the consent of the lessor. A market in leased land is blocked.

One of the arguments in favour of long-term agricultural land lease contracts is that by exempting the farmers wanting more land to farm from having to finance the purchase of land, more capital is available for investment in the farming operations. The leasing arrangement allows the lessee to use capital for investments in fertilisation, irrigation, establishment of plantations etc. However, the GFA report argues that with the low lease prices and favouritism in the granting of lease agreements, the lease policy frequently leads to: a) uneven income distribution in the villages because of sub leasing practices, b) welfare losses for the Georgian economy because of sub-optimal allocation of resources (less money for inputs available for sub-lessees who actually work on the land), and c) significant losses for the state budget because of un-registered sub leasing arrangements⁵.

In summary, the leasehold policy for state owned agricultural land has, in practice, negative consequences of blocking land markets, allowing a favored few lessees to profit without investment, discouraging investments by sub-tenants, and loss of revenue to the State.

³ **Article 570. Procedure for Revocation of a Contract Concluded for More than Ten Years**

If a contract of tenancy has been concluded for a term exceeding ten years, each party shall be entitled to revoke the contract after ten years by the date fixed in accordance with Article 561.

⁴ (Article 549. Lessor's Consent to a Subtenancy

The tenant has no right to transfer the tenanted thing to a third person (subtenancy) without the lessor's consent thereto. Members of the tenant's family shall not be regarded as a third person.

⁵ From Strubenhoff, 2002.

4. Further Privatization of State land:

Comparing draft laws on privatization of state land from SDLM and APLR, both proposals aim to transfer the ownership of much of the remaining state owned land to the private sector.

SDLM proposes to transfer ownership of unused state land to households which have not yet received their complete share of 1.25 ha.

- The aim of this draft law is to privatize the remaining state land.
- The leased state land is to be sold to the lessees at a price amounting to ten times the land tax.
- The remaining non-leased state land was to be given free of charge to those land owners who had not received their full share during the first privatization round.
- Pastureland that is commonly used is excluded from privatization.

APLR proposes to sell the state land (unused and leased) to the private sector. Leased land should be sold to the current lessees. The one-time payment equals the amount of the land tax multiplied by two for the first 20 ha, and the amount of the land tax multiplied by ten for amounts above 20 ha. Land that the lessees do not agree to purchase under these terms would be auctioned. Pastureland should be handed over to communes and should not be privatized to individuals.

The APLR proposal is based on the following principles:

- Much of the agricultural land is not used up to its potential.
 - For most households their holdings are very small and their access to capital and markets is very limited.,
 - for much of the leased land the lessees are more interested in speculation or sub-leasing based on limited investments of the sub-tenants.
- Under equal conditions of credit and market access, smaller operations are more efficient users of land and capital than are larger farms⁶
- Leased state owned land is blocked from market transactions
- Private ownership is preferable to leaseholds, under present Georgian conditions
- Extreme fragmentation of the land presently leased should be avoided.
- The privatization of leased state owned land should be through sale, not gift, so that the privatized land holders will be motivated to use the land well.
- The lessees holding large leased parcels should pay close to the market value of the land to acquire ownership of the land,
- The lessees holding small leased parcels should pay less than the market value, in order to avoid de-capitalization of the already poorly capitalized small farm operations.
- Entrepreneurial small scale farm operations have the ability and willingness to buy land under favorable conditions.⁷
- Pasture land should be privatized under group tenure arrangements in most cases, and not to individuals.

⁶ See Koechlin, Jean and Jegat Mariannick, 1999, and Thiesenhusen, William, 2002

⁷ See Thiesenhusen, 2002

The GFA report⁸ proposes to continue the leasehold policy, but make the procedures more transparent and fair. Their argument is composed of the following points:

- Privatizing the leased land will either produce further fragmentation of the land presently used in larger blocks or will benefit the lessees who have acquired the lease agreements through corrupt practices and will thereby contribute to social tensions at the local level.
- There is a limited amount of state owned productive land available (arable and perennial plantation land)
- Small scale farm operations are mostly for subsistence purposes, and are not as productive as the larger operations due to lack of access to financing, markets, and management expertise.
- The land market based on private land ownership is only very slowly developing. The land market is not yet efficiently performing. Banks are not lending for mortgaged properties. The most important factor in this respect is competition. A land market will only function if many farmers competitively bid for the right to use or purchase a plot of land. If competition is lacking, then a less efficient user but with access to capital may have preferential access to the land preventing more efficient users to bid for the land. For the economy as a whole, when the land market is not active, a given amount of output will be produced at higher costs than necessary, or that with a given amount of money less output will be produced than would otherwise be possible.

Thus, with imperfect land markets, a few gain but the majority loses:

- a) Farmers with limited access to land;
 - b) The state budget (including local level);
 - c) The whole national economy (including consumers).
- Under present leasing procedures, the leased land is under-utilized and held for speculative purposes. This may be due to the very favorable lease conditions and the public procedure of the leasing. The procedure favors well connected local powers and leads to corrupt practices. The emergence of non-registered sub leasing arrangements and share cropping practices clearly indicates this.
 - The State may easily double or even triple its income from agricultural land by applying proper land leasing procedures. As this income remains at Sakrebulo level it may significantly contribute to communal development.
 - Under either the SDLM or APLR proposals for privatization through sale of the land, even if the farmer was willing to pay a certain price and announced this price at an auction, he would have to finance the purchase of land. This is extremely difficult during the first years of farming because of many necessary complementary investments, e.g. in seeds, fertilizers, machinery and livestock. The financial sector is also very reluctant to finance land purchases based on mortgage loans for small farmers.

⁸ See Strubenhoff, 2002.

-
- The implementation of either the SDLM or the APLR land privatization proposals would benefit buyers with preferred access to capital probably outside the village or even outside agriculture and would lead to a concentration of land ownership with likely detrimental effects on community development. Wealthy and well connected businessmen may buy the land at low prices (even in small parcels of less than 20 ha) speculating on rising real protection rates for agriculture or rising purchasing power and higher food demand and hence rising farm land profitability in future. This may be observed in some regions in Russia or Moldova where companies from the energy sector currently buy arable land in large blocks.

4.1 Comparison of the APLR and GFA Proposals

There are areas of agreement between the APLR and GFA analyses:

- ◆ Extreme fragmentation should be avoided
- ◆ Much of the presently leased land is not used up to its potential
- ◆ The lease hold policy as implemented has negative social and economic effects
- ◆ Leased land is presently blocked from market transactions (sales, mortgages)
- ◆ Whether sale or lease, the price should be closer to market rates than at present.
- ◆ Pasture land should be managed under group or communal arrangements and not held by individuals, either through leasehold or ownership.

Areas of disagreement seem to be:

- ◆ Larger scale farms are preferred by the GFA analysis as economically more efficient because of their access to capital and markets, while the APLR analysis argues that entrepreneurial small farms can be economically more efficient than large farms because of their access to unpaid family labor, and because of their more detailed knowledge of the land. Thiesenhusen (2002) argues that the potential viability of small- scale farms, even though there are land and fragmentation constraints, should not be underestimated. The GFA study admits that productivity per hectare is lower on the commercial farms than on the smaller farms despite the fact that the commercial farms use higher quality inputs.
- ◆ GFA analysis assumes that small scale farmers do not have the capital to buy land and are not interested in buying land since they are basically subsistence farmers. The APLR analysis shows that some small scale farmers are entrepreneurial and have the capital and willingness to buy land if made available to them. The APLR does argue for more favorable prices and buying conditions for the smaller scale buyer of land than for the buyer of large parcels.
- ◆ Making land marketable under private ownership is not of priority for the GFA analysis, since land markets are not working presently. For the APLR privatizing the ownership of the land is necessary for land markets to emerge.
- ◆ GFA proposes to correct the deficiencies of past leasing procedures, while the APLR analysis argues that there is no practical way to eliminate corruption from leasehold administration, and moreover, leaseholds expose the farmers to undue political interference.
- ◆ The GFA analysis objects to the privatization proposals because of the arbitrariness of the sale price. They ask, what criteria justifies setting the price at 2 or 10 times the tax rate?

The GFA analysis argues that this arbitrariness will inevitably lead to endless controversial discussions because of conflicts of interests of different groups. It would be better to determine the sales price only by the market. The APLR proposal is for the sale price to be close to the market value of the land for the holders of large parcels, and with an admittedly arbitrary lowering of the price for the holders of small parcels. Controversy will be minimized because more people are small scale farmers.

- ◆ The GFA proposal to continue the leasehold policy eliminates the problem of how to void the existing lease agreements, while the APLR proposal will have difficulties with voiding existing leases, if the lessees are not interested in buying the land.

- ◆ The GFA analysis recommends that only those who farm the land should have the right to lease it. But it is very difficult to carry out this policy in practice. How can this be monitored, particularly since leases have been given out and presumably monitored for some years already. What objective criteria might be developed to define "farmed" land. Does that term mean that running a few head of cattle on the land constitutes "farming" it? Does it mean growing corn and wheat? Does it mean growing high value crops? As the GFA observes for arriving at prices for land sales, there may not be a clean way to avoid arbitrary decisions, but at least in the case of sales, the discussions will end after the sale. Discussions of the term "farmed" will be continuous for leased land, and almost certainly lessees will find a loophole.

References

Koechlin, Jean and Jegat Mariannick, Survey on Land Privatisation in Georgia, Typescript, European Commission for the EU, financed by the FSP and SDLM in Georgia, April-August 1999.

Strubenhoff, Heinz (team leader), **“THE STRUCTURE OF AGRICULTURE IN GEORGIA”**, A Report prepared by a team headed by Heinz Strubenhoff, composed of Wolfram Kneib, Bernd Schemschat, Jasper Lauert, Christiane Ortenburg, Jasper Lauert, Bernhard Voss, in collaboration with the Institute for Soil Science, Prof Charkseliani and Prof. Uruchadze, and Georghe Chumburidze, Sophie Kemkladze, and Jeko Mchedlishvili, 15 February, 2002, GFA Terra Systems GmbH, Hamburg, Germany

Thiesenhusen, William, “Discussion of the Draft Law Prepared for the Second Phase of Land Reform and Privatization in Georgia”, Terra Institute, 2002.