

## WHITE PAPER

### PRIVATIZATION OF AGRICULTURAL LAND REMAINING IN STATE OWNERSHIP

Development of the agricultural sector is critical for Georgia. This sector, comprising 20% of GDP and 50% of employment, remains weak and in need of substantial reform. A functional agricultural land market is urgently needed. Secure title to property would encourage investment in land and agriculture, increase access to credit by enabling the use of land as collateral, and ultimately result in greater productivity. This White Paper briefly describes the current situation in Georgia's land market and offers recommendations for further privatization of agricultural land.

#### BACKGROUND

Privatization of agricultural land started in the early 1990s, with 4 million land parcels distributed, free of charge, to 1 million households. Free-of-charge distribution provided a basic safety net for the rural population, providing food security to poor households with limited sources of income, and enabled landowners to sell, mortgage and lease their titled properties. Agricultural land reform has been a popular, high profile program. USAID, the World Bank, KfW, UNDP and other donors have provided substantial support for titling and registration of privatized parcels.

Nevertheless, much of Georgia's most fertile land – 45% of agricultural land suitable for intensive farming (arable, perennial) – remains state-owned. Most state-owned agricultural land parcels are leased; the remainder are not used or are used informally. About 7% of lessees are legal persons (i.e. commercial farms) leasing 33% of these intensive farming lands. While most leases were obtained and administered in good faith, a significant number were obtained non-transparently and have had a poor record of lease payment and land administration.

State ownership of agricultural lands has the following negative effects:

- (a) Lack of private ownership limits landowners' ability to attract private credit resources to develop their farming enterprises. Leased land can not be used as collateral.
- (b) Lease agreements do not provide farmers and other investors the level of confidence necessary to make serious investments in agriculture. Unfair and unpredictable local government lease management practices undermine the security of land use rights, making long-term investment excessively risky.
- (c) State regulation of lease contracts has been badly managed and often corrupt. In many cases leases have not been registered or documented in any way, leased lands have not been correctly identified geographically, improper subcontracting has been overlooked, rental payments have not been properly administered, and land taxes have not been duly paid to local and central budgets. Of roughly 40,000 parcels of leased land, only 14,000 lease agreements are properly registered in the Public Registry. Private ownership would create a self-regulatory environment in which the principles of the free market would demand efficient property usage.
- (d) State ownership has kept fertile agricultural land in the hands of inefficient users. In free-market economies, the land market guarantees that after several transactions the most efficient cultivator obtains the land for optimal use.

Until (i) guaranteed ownership rights are established for agricultural lands currently under state ownership, (ii) corrupt and distorted land leasing is eliminated, and (iii) these lands become part of the land market, it is impossible to develop a functional land market in Georgia. Without such a land market, the development of the agricultural sector will be severely impeded.

## RECOMMENDATIONS

Privatization of agricultural land would eliminate the aforementioned problems and inefficiencies, but only if implemented in an equitable and economically efficient manner. The Association for Protection of Landowners' Rights and the former State Department of Land Management have prepared draft legislation proposing privatization of some 360,000 hectares<sup>1</sup> of arable and perennial land, taking into account several critical economic, social and legal considerations:

- (a) Ensuring transparency of the privatization process with the involvement of local residents and self-government bodies is necessary to gain public support for the privatization process. Privatization commissions should be set up for every Sakrebulo, and be staffed not only with the representatives of governmental agencies, but also with local residents, and representatives of local self-government bodies and community based organizations.
- (b) To ensure the fairness of the privatization process, existing lease agreements should be reviewed and cancellation of invalid and unregistered leases should be seriously considered. This review process should be dealt with carefully, and the issue of legality of these leases should be open for public discussion. Defined time periods should be set for lodging grievances on the legality of lease agreements with privatization commissions; courts should be involved as legitimate bodies to resolve any disputes. Meanwhile, new lease agreements and lease extensions on agricultural lands should be prohibited.
- (c) Newly privatized land should be sold through open auctions, encouraging wide participation and ensuring transparency. Special auctions could be used to provide local residents with certain privileges to advance the social fairness of the process.
- (d) As an exception to (c) above, in the case of properly registered leased parcels, lessees should have first right of refusal to directly purchase their land. The methodology for calculating the sale price should be defined by law to minimize opportunities for corruption.
- (e) Sales conditions should allow a flexible timeline for payment. The purchase price should be paid in installments in a rational timeline<sup>2</sup>, during which the new owner would be able to make payments using revenues from cultivation of the privatized land. After paying the first installment, the former lessee or the winner of the auction should become full-right owner of the land parcel<sup>3</sup>. With this approach, privatized lands, although encumbered by mortgage obligations, would quickly become a part of the land market.

An estimated 42 million GEL could be generated as a result of this stage of land reform, if the principles set forward in the aforementioned draft law are applied. Some 60% of revenues could go to local budgets, creating opportunities to finance rural infrastructure.

Earmarking 20% of revenues to the entity responsible for the privatization process (preparing privatization plans with maps and appropriate cadastre; conducting auctions) would ensure that it quickly becomes self-financing.

In summary, agricultural lands suitable for economically viable farming should be privatized to ensure their most effective use. Rights of owners would be registered and protected lawfully under State auspices. The newly privatized lands would become part of the land market, creating increased access to credit and improvement of the investment climate. In short, further agricultural land privatization is fundamental to achieving more stable and sustainable agriculture development in Georgia.

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<sup>1</sup> The proposed legislation does not include 1.65 million hectares of public land, comprising community pasture lands, scientific/research farms, and lands within strategic border areas adjacent to the national boundary.

<sup>2</sup> The proposed legislation recommends a 10 year period for payment.

<sup>3</sup> Land would be encumbered by a mortgage in favor of the State until the purchase amount is paid in full.

Table No.1 Agricultural Land Balance as of April 1, 2003

	<b>Total Area of Agricultural Lands</b>	<b>Privatized</b>		<b>Leased Lands (Excluding Samachablo and Abkhazia)</b>		<b>Remaining Lands (Excluding Samachablo and Abkhazia)</b>		<b>Agricultural Lands of Samachablo and Abkhazia</b>	
	Thousand hectares	Thousand hectares	%	Thousand hectares	%	Thousand hectares	%	Thousand hectares	%
<b>Total Agricultural Lands</b>	3023,5	763	25,2 %	905,1	29,9 %	1099,5	36,4 %	275,2	9,1 %
<u>Including:</u>									
<b>Arable</b>	798,7	436,3	54,6 %	222,7	27,9 %	101,3	12,7 %	47,7	6 %
<b>Perennial Plants</b>	264,9	181,4	68,5 %	30,3	11,4 %	18,7	7,1 %	44,2	16,7 %
<b>Mowing</b>	143,2	41,9	29,3 %	46,1	32,2 %	45,2	31,6 %	10	7 %
<b>Pasture</b>	1796,9	83,6	4,7 %	606	33,7 %	934,3	52 %	173,3	9,6 %
<b>Residential</b>	19,8	19,8	100 %	0	0	0	0	0	0

Source: State Department of Land Management, Report on "The Progress of Privatizing and Leasing Agricultural Land in Georgia