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PRIVATIZATION OF FARM LAND IN THE RUSSIAN FEDERATION UNDER THE NEW CONSTITUTION AND NEW PARLIAMENT

REPORT

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INTRODUCTION

Despite the provisions of the new Constitution allowing private land ownership, no significant portion of Russian farm land is likely to move into the hands of family farms during the next few years. The former state and collective farms have been transforming themselves rapidly into agro-business companies, rather than into family farms. They are successfully resisting the implementation of existing legislation designed to privatize their land for family farming. The new, apparently conservative Parliament is unlikely to enact new legislation to force or even facilitate privatization. The virtual absence of family farming does not mean that Russian agriculture is doomed to the low productivity it suffered under Communism. Rather, the new agro-businesses could prosper in the next few years as remaining government controls are lifted.

ENTRENCHMENT OF EXISTING MANAGEMENT BY FARM REREGISTRATION

During 1992 and 1993 the state and collective farms rushed to reregister themselves. Legislation required each farm to reregister. Each farm had the choice of reregistering in its old form, as a state or collective farm or in a new form, as some kind of business enterprise. The vast majority of farms chose forms that left control in the hands of former management. (Theoretically state farm employees or collective farm members made the choice; in practice, existing management generally was successful in guiding the choice.) By mid-1993, 78% of farms had reregistered. Of these, 23% remained collective farms, 12% remained state farms, 32% became limited liability companies, 6.2% became cooperatives, 1.2% became joint stock companies, and the rest took on a variety of other forms. The land reform legislation had envisioned reregistration as a first step toward privatization. However, farm managements used reregistration as a means of keeping themselves in power, by choosing legal forms in which ownership interests were not readily transferrable. To understand the legal barriers that will hinder further privatization, it is necessary to consider each of the major forms in which farming is now conducted.
The most popular form for reregistration is that of the "limited liability company." This form is popular because it provides the greatest potential for management to retain power. The Russian legislation outlining the structure of limited liability companies is only 31 words long! Because of the laconic nature of this legal provision, nearly all aspects of the governance of such a company are determined by the charter drafted by its founders. Such freedom is quite appropriate for a business form intended for use by private investors. Individuals investing their own money should be able to choose how they want to organize their business. However, state and collective farm management have abused this freedom to protect their own jobs and prevent privatization of the farm land they manage. They have done this by drafting charter provisions making it difficult to remove management and impossible for farmers to sell their ownership shares.

The next most popular form was that of remaining as a collective farm. Collective farms have always, in theory, had the freedom to draft their own charters. In fact, under Communist rule, they were forced by the Party to conform their charters to a "Model Charter." With the disappearance of this compulsion, collective farm management has the possibility of arbitrary redrafting of charters upon reregistration. Again it has been using this power to entrench its own position and to make it impossible for members to transfer their shares.

Third in popularity is that of remaining a state farm. Under legislation governing state farms, employees have no power to choose management and no ownership shares. Management thus has nothing to fear from employees. If the local government is dominated by farm managers (as is the case in many rural areas), there is nothing to fear from it either.

The least popular form was the joint stock company. The reasons for this unpopularity are obvious. Legislation on joint stock companies is rather detailed, protecting the rights of shareholders to choose management and allowing sale of shares. The joint stock company form could be a threat to entrenched management. Disgruntled farmers could vote their shares to oust management. Alternatively, they could sell their shares to outsiders, who could take over the farm and put in their own management.
STRENGTHENING MANAGEMENT CONTROL OVER FARM LAND

Developments in land reform have also played into the hands of management. When a farm applies for reregistration, it also applies to the district commission on land privatization, requesting transfer of the land historically allotted to the farm under the Soviet system without charge to the reorganized enterprise. This land is assigned free of charge, unless the resulting assignment would result in the farm ending up with more land per capita than the average for the region. The farm was supposed to pay for excess land. However, local authorities, dominated by farm managements, are using assessments several years old. Because of inflation, these assessments are a tiny fraction of current land values. Thus the farms get the land free or for only a token payment. Initially the land was merely to be assigned to the farms. However, President Yeltsin issued an edict on land ownership on October 27, 1993, which converted this assignment into outright ownership. Thus farms are obtaining full ownership of their land without making any significant payment for it.

BARRIERS TO CREATION OF FAMILY FARMS

Legal developments have erected serious barriers to the creation of family farms. The original idea of land reform legislation was that farmers or groups of farmers would be free to withdraw from farms and take their share of land with them. Other rural residents could demand a share of land from excess farm land holdings. As mentioned above, in fact these excess holdings were sold to farms for nominal prices, thus making this land unavailable to rural residents not connected with farms. Farm members and employees wishing to leave the farm and take land with them face the entrenched power of farm management. In practice, management is able to sabotage the scheme. It simply refuses to processes applications for land, or gives out the worst or most isolated land. If farmers accept such isolated land, there is no way they could combine it to make larger contiguous areas for efficient mechanized farming.

The system of land allocation will not work in areas with a high ratio of population to land. This system provides that farmers withdrawing farms receive a land allocation determined by dividing the total quantity of farm land in the region by the number of
inhabitants of the region. In densely-populated areas, no individual or family’s allocation is large enough for efficient farming.

A further problem is the lack of reliable financing for farm operations. Farming is, of course, a seasonal business. Farmers spend money in the spring for seed, fertilizer, ploughing, and sowing. They spend more money in the early fall for harvesting. Only in late fall, when they sell their crops, do they receive money to cover their expenses and provide them with funds to survive the winter. While there have been some government programs of subsidized financing for private farmers, there is no working system of commercial lending to private farmers. There is still no mortgage law that could provide banks with security. Bank regulators set discouragingly high reserve requirements for unsecured loans by commercial banks. Substantial changes will be needed in mortgage legislation and banking regulations before working credit becomes available to farmers.

To make matters worse, even if a private farm could survive until a first fall harvest, current inflation rates will make it impossible to save money to pay for seed and fertilizer for spring planting. The only banks in most rural areas are part of the state savings bank system. Their interest rates are far below the rate of inflation. Commercial banks also pay interest rates below the rate of inflation. Many commercial banks are in an unsound financial condition.

"NOMENKLATURA" LAND PRIVATIZATION

Some privatization of land has taken place. At least three percent of farm land is now in the hands of private farmers. Some of this tiny percentage represents further management influence. In some regions of Russia, farm management and local government have colluded to provide large grants of the best land to friends and relatives. Sometimes this has been done in formal compliance with the land privatization scheme. In other cases, there have been violations of the privatization scheme, for instance by granting larger amounts of land than the official allotment.

BARRIERS TO TRANSFERABILITY OF LAND

The recent lifting of restrictions on land transferability are unlikely to create a significant market for farm land. Full private land ownership exists only when the owner
has the right to transfer land. Under the Russian Constitution in effect until the fall of 1993, neither family farmers nor farming enterprises had the right to transfer land ownership. On October 27, 1993, President Yeltsin issued an edict which, for the first time, gave owners of farm land the right to sell it freely. The new Constitution confirms the transferability of land ownership. However, there are a several factors that are likely to discourage transfers. These are the lack of desire to sell, the impossibility of buying up large contiguous area of land, imperfect land title records, lack of mortgage financing and taxes on land sales.

The small number of people who overcame various obstacles to obtain their own private farm land probably did so with the intent of farming the land, not selling it. If they had wanted to sell it, they would have used the quasi-legal mechanisms available before the fall of 1993. The small isolated plots that were issued in the privatization process are not attractive to prospective commercial buyers, who presumably would want farms large enough for efficient mechanized farming. Managers of farm enterprises are unlikely to want to sell their farm's land and thereby abolish their jobs.

Foreign observers have worried that the relatively primitive state of land title registration in Russia might be a barrier to private land ownership. President Yeltsin's edict of October 27, 1993, contained provisions on issuing land title certificates. A vigorous market has emerged in urban housing in Russia, despite the less than perfect state of urban title records. The same could happen with rural land, if the other conditions for a land market were present. Land title problems may appear, however, if a system of bank mortgage financing emerges. Banks may be more aware of title risks than farmers, and may be less willing to take them. Efforts are underway in Russia to improve land title records. These non-controversial efforts are likely to succeed more quickly than the difficult task of bank mortgage reform.

Mortgage financing is not available to land buyers in Russia. There are two problems, one easily solved, one much more difficult. The easy problem, which is likely to be solved at some time during 1994, is the lack of legislation providing a framework for mortgage financing of land purchases. The hard problem is curbing inflation and reforming the banking system to enable and encourage it to engage in long-term mortgage financing. The present legal scheme of bank risk classification ranks long term loans in general as
extremely risky, generating extremely high capital requirements under bank regulation rules. Given the highly volatile rate of inflation, long term loans are indeed exceedingly risky. Thus, reclassification of these loans as "low-risk" could only make matters worse, leading to a crisis of the type that hit the United States savings and loans in the 1980s. Only when these loans become truly low risk, will it be safe to restructure banking regulations to classify them as low risk.

A Presidential edict of December 1993 imposed an income tax on profits from land sales. Since initial farm land distribution to private farmers was free of charge, 100% of any resale proceeds would be profit. Because the value of a farm would be quite large, sellers would find themselves in the highest income tax bracket. Undoubtedly sellers will attempt to evade the tax by reporting fictitiously low prices to the tax agencies. If they get away with this tax evasion, the tax will present no burden to land sales. However, if the tax enforcement authorities do their job, the tax could prove to be a very significant burden on land transfers. The experience in cities with land transfer taxes, where tax authorities (perhaps for bribes) have accepted fictitiously low prices, suggests that probably this land sale tax will not be enforced.

CONCLUSIONS

Further farm privatization in Russia will be a slow process. While Russia moved quickly to turn state and collective farms into business enterprises, it has moved very slowly toward private family farming. The interests of management of the new agro-businesses are strongly against privatization of farm land. In many ways the situation is similar to that in industry, where privatization often has kept former management in place. As in industry, subsidies are keeping inefficient farms operating. The present situation is likely to remain stable for some time. Small percentages of land will continue to be converted to family farms each year, but corporate farming will dominate. Further movement to family farming will only occur with law reform in the area of land title, mortgages, and banking regulation, and macroeconomic reform in terms of curbing inflation and reducing subsidies to corporate farms.
PRIVATIZATION OF FORESTS IN THE RUSSIAN FEDERATION UNDER THE NEW CONSTITUTION AND NEW PARLIAMENT

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INTRODUCTION

The next few years should see extensive privatization of timber-cutting enterprises and of growing trees in Russia, but little or no privatization of forest land, despite provisions of the new Constitution allowing private land ownership. The pace of privatization of timber-cutting enterprises will depend upon their legal status. Most forest land is assigned to state forest enterprises. Privatization of these has only begun, but should move forward steadily during the mid- and late-1990s. A much smaller portion of forest land is assigned to farms and is exploited by the farms themselves or by interfarm enterprises formed by groups of farms. Most of these farms and interfarm enterprises have already privatized on paper at least, though often they remain under their old management. The remaining unprivatized farms and interfarm enterprises are likely to be privatized over the next few years.

NON-PRIVATIZATION OF FOREST LAND

While a Presidential edict of October 27, 1993, and the new constitution would allow forest land to be privately owned, legislation remains in effect that forbids transfer of most forest land to private ownership. There are two reasons, economic and political, why there is no pressure to change this legislation. The economic reason has to do with the high value of cutting rights and the low value of forest land. Cutting rights can be exercised immediately to turn growing trees into timber, timber into lumber and lumber into cash. In contrast, land ownership carries with it only the right to grow another generation of trees, which will not be ready for cutting for decades. Given the instability of the Russian economy and property rights, a right that requires investment now and provides benefits only thirty or forty years from now has no real value. The political reason has to do with the perception that popular sentiment opposes privatization of forest land but is indifferent to the privatization of timber-cutting and cutting rights. Those making money from lumbering operations are too smart to want to risk public scrutiny by seeking land privatization. Current law reflects apparent public sentiment. It forbids privatization of most forest land, but allows the privatization of lumbering enterprises and the sale, or even giveaway of
cutting rights. The new, relatively conservative, more nationalistic Parliament, is unlikely to rush to privatize Russia’s forests.

**PRIVATIZATION OF TIMBER-CUTTING ENTERPRISES**

Even though forests are not being privatized, enterprises that engage in timber-cutting operations are being privatized. The most important types of organizations engaged in timber cutting are: enterprises of the Federal Service of Forestry Operations; collective farms, state farms, interfarm associations, and labor camp enterprises.

Enterprises of the Federal Service of Forestry Operations constitute the majority of the timber industry. In the past, they have had two roles -- regulation and production. With the opening of the Russian economy, this dual role creates severe conflicts of interest for the management of these enterprises. To the extent they remain as state organizations, they can regulate the cutting of the very timber that they harvest -- the "fox guarding the chicken coop." This self regulation can allow major abuses. A typical scheme works as follows. A timber cutting enterprise allocates the highest quality trees and most accessible trees to itself, cuts them, perhaps converts them to lumber, grades them below their real quality, and sells them for export for a low price based upon the fictitious low quality grade. The foreign buyer resells the timber or lumber at world market prices. The difference between the price received by the Russian exporter and the foreign buyer goes partly to the foreign buyer. The other part of the difference, in the best case, goes to a foreign bank account used by the Russian exporting organization in violation of Russian currency controls. In the worst case it goes to foreign bank accounts of the executives of the state forestry enterprise. Obviously, executives that have this good a scheme going are not going to be in a hurry to attract public attention by trying to get ownership of nearly-worthless, cut-over land. Nor are they likely to want to privatize their enterprises and thereby lose the benefits of self regulation.

The next largest type of timber-cutting organization is that connected with farms. Farms with large stands of trees may cut their own timber. But the more common form of operation is the interfarm timber-cutting organization. Each such entity in the past has belonged to a group of farms. Since the farms that own the interfarm organizations have generally been converted into private business organizations, the interfarm organizations have...
been privatized indirectly, with the privatized farms remaining as owners. In some cases interfarm organizations have been totally privatized with ownership typically going to their employees. In either case the interfarm organizations cut timber located on farm land. Under the original privatization organization, farms obtained only the right of use, not ownership of forest lands under their jurisdiction. However, President’s Yeltsin’s edict of October 27, 1993, on private land ownership, appears to have converted this right of use into a right of ownership. Thus, privatization of forests located on farm land is complete. The only exception is that of a relatively small percentage of farms that have elected to remain as state farms.

Enterprises attached to labor camps do about 8% of all timber cutting. These enterprises use inmate labor. Obviously it will be difficult or impossible to privatize these enterprises. Certainly neither the labor camp forests nor the labor camp lumber mills will be made available for worker buyouts!

Enterprises belonging to "small ethnic groups" -- for instance nomadic herding groups of the Far North, are eligible under special legislation for privatization and ownership of forest land. Because of the huge expanse of northern forests inhabited by these groups, this category of enterprises may take on some importance in the future. It is quite possible that wealthy investors will use these small ethnic groups as "fronts" for major commercial timber-cutting operations.

**PRIVATIZATION OF CUTTING RIGHTS**

Because of self-regulation, state forestry enterprises can assign cutting rights to themselves. While, in theory, the state should get the profits from state enterprises, through the export scheme mentioned above and a variety of other evasions, a high proportion of the profit remains with enterprise management.

Contracts for the lease of timber rights are a method for rapid quasi-privatization of forests. Leasing is subject to much weaker legal control than land privatization. Yet the lessee gets the cutting rights, which are far more valuable than the right to ownership of the underlying land. Leases are supposed to limit cutting volumes, cutting times, and forest uses. However, in the relatively corrupt atmosphere of Russian forest exploitation, many
lessees can negotiate terms that do not seriously restrict their operations. An appropriate bribe to the official governmental administrators of the forests may be enough. Except as restricted in the lease, lessees have broad discretion in cutting, constructing roads, and erecting temporary structures and buildings. Lessees are required to pay for usage rights. But they can negotiate (or bribe to get) relatively low payment terms. Fixed multiyear payments can be beneficial because inflation will turn the payments into nominal sums very quickly. Because leasing is so favorable to the exploiting organizations, it is likely to take on great importance over the next few years.

TRANSFER OF CUTTING RIGHTS

Even though most forest land is state owned and cutting rights are not assignable, there are ways to transfer the right to cut trees. One straightforward and perfectly legal method is the purchase of shares of stock of a privatizing or privatized enterprise that has forest use rights. Another legal method would be the granting of shares in the charter capital of a newly formed joint stock company in exchange for forest use rights. A more common but more devious method of transfer of cutting rights involves reallocation of forest land from one user to another. An existing user finds a "buyer" who pays it under the table. A bribe is paid to the forest management authorities. The existing user then surrenders its cutting right and the authorities grant them to the "buyer." These mechanisms are imperfect, but nevertheless are likely to lead to the creation of a real market for cutting rights.

FINANCING THE PURCHASE OF CUTTING RIGHTS

There are at least three barriers to the provisions of financing for the purchase of cutting rights. These barriers will retard the development of markets in cutting rights. The least important barrier, which is likely to be solved at some time during 1994, is the lack of legislation providing for a system of registry of security interests in property rights. Until there is legal protection for security interests, commercial financing of purchase of cutting rights will be impossible. Another barrier, of much greater importance, is that many, if not most, sales of cutting rights are in fact illegal transactions, involving under-the-table payments to officials or deposits in foreign bank accounts. Banks will naturally be hesitant to finance clearly illegal transactions. A continuing barrier is the combination of high
inflation and a primitive commercial banking system. Major changes will have to take place before banks can engage in long term financing of the purchase of cutting rights. The present legal scheme of bank risk classification ranks multi-year loans as extremely risky, generating extremely high capital requirements under bank regulation rules. Given the highly volatile rate of inflation, long term loans are indeed exceedingly risky. Only when inflation is curbed will these loans become truly low risk, making it safe for banking regulators to reclassify them.

**RESTRICTION OF USE OF FORESTS**

The system of forest use regulation is left over from the old state planning system. Both public and private forest users are required to obtain cutting permits or similar permission from forest regulatory agencies before harvesting timber even on land assigned to or owned by them. A likely development over the next few years is the disappearance of this requirement, at least so far as privately-owned land is concerned. Even before these restrictions officially disappear, many users may find that a gratuity to local officials will cause them to disappear in practice.

**EXPORT CONTROLS AND EXPORT LICENSES**

Russia has attempted to substitute a system of export controls and export licenses for the old system of state trading in exports. The object is the same -- to ensure that the state receives a high percentage of the hard currency to be earned by exports of forest products. The wide open, Wild West nature of the Soviet economy, particularly in Siberia and the Far East, makes enforcement of these controls difficult. Furthermore, the controls cause friction with the local governments, which would like to get there share of the profits. All that is certain is that there will be a continual three way tug of war, among: (1) the forest producing entities, whether nominally still state enterprises or officially privatized; (2) the local governments; and (3) the central government of the Russian Federation. It is quite possible that, as was the case with oil, the central government will seek to reintroduce monopolistic state foreign trade companies as a way of securing control of revenue.
CONCLUSIONS

Russia's forest industry will continue to be productive in cutting trees, even assuming that land remains unprivatized. This is because there is an emerging market in timber cutting rights, which are much more valuable than land ownership rights. Management capture of state forestry enterprise and privatization of farm enterprises mean that the main producing entities act as if they were private businesses. All is not well, however. The present legal structure encourages massive corruption, since a license to cut is essentially a license to convert state property in private wealth. Lack of land will have long term negative effects, since non-owners have no incentive to engage in conservation or replanting measures.