

Analysis

The Perpetual Impermanence of Enterprise Land Reforms in Russia

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Abstract

Despite fifteen years of federal-level efforts to unify ownership over their land and capital, most Russian enterprises still do not own the plots on which they are situated. Indeed, many continue to use their lands under an antiquated, Soviet-era form of tenure. The irresolution of enterprise land reform likely imposes a serious economic burden on the country that might be alleviated by giving firms a stronger financial incentive to convert their land rights – for example, by imposing a tax or rental payment on those continuing to operate under the old form of tenure.

Early Momentum Lost

A fifteenth anniversary in the history of Russian privatization passed largely un-noticed this past summer. Presidential Decree 1535, issued in July 1994, represented the first clear, official recognition that the land underneath non-agricultural enterprises would be an important part of the general privatization program. By spelling out specific procedures governing acquisitions, Decree 1535, in conjunction with a 1995 decree that reduced the purchase price of enterprise-occupied land, paved the way for a substantial number of privatized enterprises to take ownership of their land plots. Between 1994 and 1997, an estimated 34.5 thousand hectares, across roughly fifty Russian regions, were transferred to private enterprises.

This initial momentum, however, was not sustained. And despite legislative efforts over the past decade, enterprise ownership of the lands they occupy remains a rarity throughout much of the country. Most recently, the long-awaited Federal Law 212, the so-called “Major Amendments to Land Privatization Legislation” enacted in July 2007, seemed to hold out the promise of resolving, once and for all, ambiguities surrounding the ownership of enterprise land. Indeed, in its wake, we observe much less debate and discussion of enterprise land ownership issues.

Over the past two years, most federal legislative work addressing non-agricultural land has concentrated on residential properties: procedures for allocating state plots for multi-family housing and for registering titles for personal holdings, such as those used for gardens and vacation homes. Even the commentators and business community representatives who had been so involved in the heated debates surrounding Law 212, seem largely un-interested in the current state of affairs with respect to the ownership of enterprise land. It is difficult to find any new studies exploring trends in enterprise land transactions. And the relevant Russian pro-

fessional journals are largely devoid of articles reviewing the issues relevant to enterprise land ownership.

Some might interpret this lack of attention as confirmation of the recent legislation’s success. Others might see it as reflecting an inevitable and perhaps even a necessary lull, believing that a new set of discussions and debates can be comfortably postponed. Our perspective is different. Available evidence suggests, first, that ownership rights over enterprise land have not been successfully resolved (nor will they be any time soon) and, second, that postponing their resolution by delaying the realization of the vision laid out fifteen years ago may impose an unnecessary burden on the Russian economy.

The Evolution and Irresolution of Enterprise Land Rights

Transfer of non-agricultural commercial lands to users and occupants was an important first step in the property rights reform process in much of the transitioning world. Many of the Central and East European countries simultaneously privatized enterprise capital and land, often transferring the latter at a nominal fee. Russia followed a different path. The initial measures governing the corporatization and privatization of Russia’s state enterprises were applied only to equipment, buildings and other structures. The land plots beneath them remained state-owned. A fundamental principle of market economies – that the ownership of surface objects derives from ownership of the land underneath (*superficies solo cedit*) – was thus ignored and, in a sense, inverted. The reason seems not to have been the ignorance of Gaidar and the team who authored the 1991 Privatization Law, nor was it their concern about the special sensitivities of Russians to land tenure issues. Expediency seems to have been the main motive. The potential complexities of resolving property boundaries and the perceived need to develop parallel legislation on title registration and a land cadastre struck Russia’s

privatization architects as potentially too time consuming given the priority they placed, largely for political reasons, on speed. The value of temporary mechanisms, applied successfully elsewhere in the world, such as “conditional title” and “general land boundaries” were not appreciated then (nor are they now).

Privatized enterprises initially held the lands they occupied under the right of *permanent (perpetual) use*, a Soviet-era form of land tenure, which granted its holder a right to use and build on a parcel but not to dispose of it, for instance through its sale to another party. The right, re-enumerated in the Russian Civil Code of 1995, was characterized as permanent only because a termination date is not specified. If the state did dispossess a permanent use holder of its lands, it faces an obligation, according to law, to provide compensation at market value. Many Russian enterprises continue to this day to hold their land under permanent use rights; this requires them to pay a tax, determined by the land’s assigned cadastral value (meant to approximate something like a market value), at the same rate as land owners.

Presidential Decree 1535 marked the first noteworthy effort to unify ownership over enterprise land and capital. And with land prices held at a relatively low level by a complementary decree, the mid-1990s witnessed substantial progress with respect to enterprise land privatization. In May 1997, however, a new presidential decree granted regional administrations near full discretion in establishing land sale prices. Although some officials, looking back, refer to this apparent inconsistency as the result of an error in the drafting process, the measure was entirely consistent with Yeltsin’s strategy of winning over the support of regional leaders by inviting them to “take as much sovereignty as you can swallow!” Thereafter, land prices began to vary significantly across Russia’s territorial subjects. With prohibitively high prices in many regions, the pace of enterprise land privatization decreased dramatically.

Since local administrations were given greater control to set lease rates on state-owned land than tax rates on enterprise-owned land, they have had an incentive to make land privatization procedures complex, expensive and time consuming. And in 32 regions, land privatization was banned either by laws that contradicted federal legislation, by popular referenda, or by provisions added to the region’s constitution. In Moscow, for instance, the city Duma passed a resolution that land plots occupied by privatized enterprises could be leased but not sold.

A breakthrough in the enterprise land privatization process appeared to have been achieved when the new Putin administration successfully pushed through

a package of laws including, most notably, the Russian Federation Land Code, which was adopted in 2001 and came to supersede Presidential Decree 1535. Seeking to reinvigorate the process begun in the mid-1990s, it laid out mechanisms to force divestiture of state lands under privately owned structures and to unify titles to land and buildings. For instance, it called for the ownership of real estate objects to henceforth follow ownership of the attached land plot; it granted exclusive right to purchase or lease state-owned land to the owner of the attached real estate object; it gave to private owners of buildings on land plots owned by other private parties the pre-emptive right to purchase the land; and it prohibited the future privatization of real estate objects without the concurrent privatization of the attached plot.

Perhaps most notably, the Land Code sought to bring an end to the rights of permanent (perpetual) land use by requiring private enterprises and building owners to convert from the Soviet-era form of land tenure to rights of ownership or lease by January 1, 2004. Further, the upper bound limiting the price that regional administrations could charge for enterprise land was reduced and their land sale legislation was to be brought into line with federal law.

Although this legislative push did lead to an increase in the re-registration of enterprise land rights in many regions, its impact was not as great as anticipated. In an effective capitulation to the resistance the new provisions were encountering, the original deadline for converting rights of permanent use was first pushed back two years to 2006, and then again later to 2008. In Law 212, the latest attempt to revive the process, the deadline was delayed once more until January 1, 2010. Since the financial penalty for non-compliance is negligible, many enterprises will no doubt ignore it. Indeed, in a July pilot survey of large industrial enterprises across six Russian cities, we found that two of fifteen reported holding their primary production plots under permanent use rights; neither, moreover, intended to convert them before the end of the year. It is perhaps no surprise that proposals are already being floated to push the deadline back another two years.

Local administrations continue to be a primary source of resistance. Indeed, in our pilot survey, six of fourteen enterprises responded that authorities in their region have actively tried to slow down the process of privatization; only one of fourteen responded that regional authorities have encouraged the process. Of the eight firms that responded to a similar question about the actions of municipal officials, none reported that that their city’s government had encouraged the pro-

cess and four reported that it had actually been working to slow it down. Although Law 212 laid out a new mechanism for establishing the purchase price, requiring that it not exceed 2.5% of the plot's cadastral value (20% in Moscow and St. Petersburg), evidence now suggests that some regions responded by rather capriciously increasing cadastral values so as to discourage land purchases. Since cadastral values are also the basis for rental payments and land taxes, this strategy has had the perhaps unintended consequence of putting additional financial pressures on enterprises already in the throes of a recessionary downturn. In Vladimir, Samara and Smolensk *oblasts*, large groups of companies have filed appeals to regional arbitration courts, arguing that recent hikes in cadastral values, by as much as a factor of seventy, well above what might reasonably be construed as market rates, had pushed them to the edge of bankruptcy.

Potential Economic Consequences

According to the most recent government data, of the country's 1.6 million hectares of industrial land located outside of settlements, nearly 96% is owned by various levels of government, while only 4% is owned by firms. And of 3.5 million hectares of non-agricultural, commercial land in urban settlements, roughly 89% is owned by government, just over 3% is owned by firms, with the remainder held by households. The dominance of state land ownership captured by these numbers arguably imposes a non-trivial burden on the Russian economy.

The absence of private ownership, for one, may slow the distribution of land according to best-use criteria. But perhaps of greater importance, continued state ownership of land may diminish enterprises' willingness and/or ability to invest in their development. State ownership of land gives public officials an additional mechanism through which to interfere with private enterprise, making for a business environment in which property rights are less secure and the future is more uncertain. In the pilot survey, we found that eight of fifteen enterprises currently lease their primary production plot. But five of these hoped to privatize their lands, and, when asked to select among six possible motives for declaring that intention, the potential to create more secure property rights for their firm emerged as the most popular response.

Not owning land, moreover, limits the assets that can be used as collateral, potentially making it more difficult for firms to access external loans. Data from the 2005 EBRD-World Bank Business Environment and Economic Performance Survey, which targeted small

and medium-sized enterprises, reveals that only 8.9% of Russian firms that posted collateral on their most recent loan used land; the corresponding rate in the other surveyed countries in the FSU (excluding the Baltic states) was 16.3%, while it was 31.9% in the ten former socialist countries now in the EU. Initial results from our pilot survey suggest that the connection between not owning land and difficulties in accessing credit holds for large enterprises.

Although state ownership of commercial lands remains the rule, we do observe, as indicated above, a fair amount of variation in the extent of private ownership across regions. These differences can easily be seen in the most recent state cadastral data. For instance, in Tatarstan, the majority of industrial land located outside of urban settlements is held by firms. But in nearly a third of regions (25 of the 78 for which there is data), all such land is government-owned. Of non-agricultural, commercial land in urban settlements (much of which, necessarily, is given over to public infrastructure and un-developed territories), the ratio of land held by firms to that held by government is 0.035, with the specific figures ranging from zero in eight (of the recorded eighty) regions to 0.250 in Belgorod *oblast*. In the city of Moscow, where the Luzhkov administration prefers signing long-term leases, this ratio is only 0.002. In addition to Tatarstan and Belgorod, regions that might be characterized as more progressive on the basis of these, admittedly imperfect, indicators include Vologoda, Sverdlovsk, Kemerovo, Lipetsk, Perm, Rostov and St. Petersburg.

With available evidence, it is difficult to establish a causal link between these indicators and various measures of development across regions. But simple regression models do indicate that both are strongly and positively correlated with both bank-financed and total capital investment from 2005 to 2007. These relationships hold even after controlling for the value of these variables in 2000, as well as the beginning-of-decade gross regional product, regional branch structure, population, urbanization rate and various political-institutional variables. Whether because of weaker property rights security or a diminished capacity to use land to secure external loans, these findings are at least suggestive that continued high rates of state land ownership may be suppressing investment activity.

Russia's Eternal "Land Question"

The history of property relations in Russia is full of paradoxes. The country may be the largest in the world and possess vast swaths of underutilized land, even in and

near urban settlements, but strict controls on land access and usage have consistently served as a foundation of state power and as a regulator of social relations. During the late-imperial period, the “Land Question” was central to the build-up of social pressures that climaxed in the October Revolution. And though the Bolsheviks came to power championing “All land to peasants,” the promised rights to land were never realized. Indeed, it is possible to speak of an “unbroken line” – from the tsars, through the Soviet period, and into the present day – tracing a history of the Russian state suppressing the land rights of private properties.

Indeed, the resilience of perpetual use rights can be considered a part of this history. But while history’s weight may be, in part, responsible for the slow pace of unifying ownership over enterprise land and capital, pragmatic considerations of how land privatization affects local budgets are also at work. Further, state land rights confer upon bureaucrats powers that, regardless of century-old norms, might only be expected to be given up with great reluctance. In Moscow, the absence of private property rights gives the city government an ability to rather capriciously expropriate land for unspecified future public uses and to move enterprises, often with little compensation, according to the dictates of the City Master Plan. More generally, local governments’ ability to manipulate rental rates leaves enterprises vulnerable to government predation. Many surveyed companies report having been threatened by state officials that their lease rights could be unilaterally and abruptly terminated. For enterprises that cannot afford, in these times, to buy their land, it is thus not terribly difficult to understand why they might not regard leasing as a more attractive option than perpetual use.

Thus, despite the potential cost that it imposes upon the Russian economy, it is not clear that there are forces

in play in Russia that will either bring an end to the perpetual use form of land tenure or promote further privatization of enterprise lands. Although evidence suggests that most enterprises would prefer to hold their lands privately, it is not clear that they have the political will or economic wherewithal to change the *status quo*. Nor is it clear that at the federal level, there exists a desire for a renewed push on land rights reform. The lessons of the last fifteen years suggest that enterprise land reforms are doomed, at least in the medium run, to a state of perpetual impermanence.

A Policy Suggestion

If we are incorrect in suspecting that policy makers have lost either interest in or the willingness to confront anew the problems of permanent use rights, we would hope that they might still be receptive to a suggestion. Enterprises with permanent use rights, we believe, should be better incentivized to convert them. If the tax payments that they were required to make were to be raised above those required of land owners, financial considerations alone would create pressure to bring an end, once and for all, to the Soviet era land rights regime. Varying tax rates according to land tenure rights would not contradict any current Russian legal provisions. The change itself would only require a minor amendment to the Tax Code. Alternatively, a land rental payment could be added to the land tax already being paid by permanent users. Whichever approach is chosen, careful analysis and financial modeling would of course be needed to ensure the optimal additional payment for permanent users. Under current conditions, such approaches may represent the best hope for eliminating enterprises’ rights of permanent use.

About the authors

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Further Reading

- Andre V. Khakhalin and Stephen B. Butler, “Privatization of Enterprise Land in the Russian Federation: 1992–2003”. See at the website of the Russian American Rule of Law Consortium, Events Section, 2–3 March, 2007 (<http://www.rarolc.net/events/detail.php?cid=222>).
- Stephen B. Butler and Andre V. Khakhalin, “Final Report on Business Access to Land. Prepared for the Ministry of Economic Development and Trade of the Russian Federation. October 2005”, FIAS Project: Land Reform Privatization Procedures and Monitoring System. See: *Ibid*.
- William Pyle, “Ownership and allocation of industrial land in Russia”, *Focus/Opinion*, Bank of Finland Institute for Economics in Transition, no. 4, 2009.
- R. Jerome Anderson, Igor A. Romyantsev, Larisa G. Sudas, “Path Dependence in Russian Land Relations: An Analysis of Recent Legislation Through an Historical Perspective”, *Journal of Eurasian Law* (forthcoming).