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Changing ownership and the system of property rights in Latvia: restitution and privatization - legal, economical and political issues

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Introduction

Problems and approaches in legislation of changes ownership and property rights in Latvia has been caused by political, legal and economical reasons, which were rather different from other Central and Eastern Europe countries (renovation of state *de jure*, the lowest ratio of native nation in the population of country among CEE countries). That is the reason, why, before analyses of current changes in ownership and property rights in Latvia, is necessary short return in history.

Main facts of historical changes in ownership and property rights on natural resources are following:

- after first independence of the Republic of Latvia in 1918, reforms on land ownership had been based on nationalization of parts of the large scale landlord property and its distribution and selling to new farmers (the old farms were usually larger in size, for their history reaches as far back as the end of the 19th century)¹;
- from 1920 to 1937 was implemented the land reform during that decision-makers also got suggestions to make a changes in property rights which have been finalized in accepted Civil Law;
- after occupation of Latvia in 1940 all land was nationalized, property rights determined by Soviet legislation;
- 1949-1950 total collectivization (after it even land use rights under private farming was not allowed)²;
- till 1990 have been made lot of natural transformation of land (including new building on it), forest, water, which created additional difficulties for carrying out of the restitution;
- from 1990 Latvia started ownership and property rights reforms.

1. Main principles of ownership and property rights reforms.

1) Renovation of the first Republic of Latvia *de jure* created necessity of legitimization of ownership and property rights on the date of occupation and nationalization (according the Hague Convenience and other international treaties).

It cause restitution of former owners as a main stream in the process of changes ownership is characterized by high degree of restitution in previous physical borders of real properties.

2) Some exception in restitution from economical and political reason.

Process of changes in ownership is add with newly created legal base on privatization. In implementing private ownership of land, restitution to former owners is a key principle.

¹ The average size of the farms on end of reforms was 22 ha.

² Soviet rules did not provide even restricted rights on land to farmers as it was in some other post-socialist countries in Eastern Europe.

Consideration of the interests of other rural people is also being taken into account. This is why much of the legislation has been based upon political compromise (more detail about implementation of this principle in chapter 2).

3) Big influence of the state in the process of solution of disagreement between previous and present ownership.

Mixing two processes: restitution and privatization created high social costs of the reforms, slow development of land market and decrease in value of real properties (examples of most common disagreement situations are given in chapter 3).

4) Return from very primitive Soviet type property rights to property rights defined by renewed Civil Law of Latvian Republic (1937).

Most substantial change in renewed Civil Law concerning property rights is rules which provide compulsory, but temporary splitting rights on real property (land and building);

5) Graduality of the ownership and property rights reform process

2. Changing ownership on agricultural land.

Latvian land reform in rural areas is divided into two overlapping phases: the first takes place between 1990 and 1996, and the second covers a period of 10 - 15 years, starting on January, 1993.

In the first phase all land petitioners, including former owners who possessed the land before Latvia was occupied in 1940, the present users, and the new land petitioners, submitted their requests for land allocations before June 20, 1991. All the district use land projects had to be developed and ratified in 1992.

In the second phase, which started after passage of the law "On Land Privatization in Rural Areas" (1 01 93), land users can obtain or renew (former owners) their land ownership rights. Both the most important and the most disputed item was listed as point 1 of 12 in the Law "On Land Reform in Rural Areas", where the priorities for satisfying land petitions were determined:

Priority number 1 is assignment of land to the former owner or his heir, *except* when on the former holding or part there are:

- Developed individual farms or subsidiary plots;
- Obtained or built residential homes;
- Situated environmentally protected objects, or historical, cultural, and archaeological monuments appointed by the Republic;
- Autonomously requested land;
- Land needed for test plots; or
- Situated construction, buildings, or orchards with production of social significance belonging to other owners (collective and state farms inclusive) with acreage defined by the regulations. Those who benefit from this priority must compensate the owner for his real estate value through mutual agreement.

Priority number 2 has been established in the following sequence:

- To expand existing individual farms and subsidiary plots if the petitioner has a residential home;

- To construct individual homes;
- To meet the needs of inhabitants;
- To legal entities (legal person); or
- The present users of land (usually former collective or state farm)

In the second stage, which started on January 1, 1993, ownership to land is established, based on the land survey documents; and a land market should begin. The guideline for the land reform was to create a framework of land ownership where, in most cases, the land user is the same person as the landowner.

On July 9, 1992 the Law "On Land Privatization in Rural Areas" was passed. It was a logical sequence to the Law "On Land Reform", adopted on November 21, 1990. The latter contained regulations for a gradual restructuring of legal, social and economic relations in the countryside regarding land use and ownership. It established the procedure for carrying out the land reform, defining the provisions for submission of land claims and complying with them, as well as regulations for restitution of landowners' rights.

The Law "On Land Privatization in Rural Areas" stated the former landowners' rights to their landed estate provided they had submitted their applications before June 20, 1991. However, there were some exceptions if the land had been allocated for a permanent use during the first stage of land reform.

The reason privatization in rural areas is being carried out in two parallel and closely linked, yet independent, directions is rooted in the establishment of collective farms in 1940 and 1949-1950. All land became state-owned with nationalization (without any compensation) in 1940. Collectivization happened in 1949-1950 when farmers were compelled to collect all non-land assets (machinery, livestock, buildings) into collective ownership. Formally each farmer was a part owner of all collective property. This is a background to the political decisions to reconstitute rights of landowners and to give rights to privatized non-land assets according to shares in the value in these collective farms.

The Law "On Land Privatization in Rural Areas" regulated the second stage of the land reform. Subsequently the law "On Privatization of the Agricultural Enterprises and Collective Fisheries" was passed, this law regulated the privatization of non-land assets. These two laws dealing with privatization are often in conflict. There were instances when Land Commissions had allocated land to the former owners or to new users (mainly for establishment of new individual farms), and the production units envisaged to emerge from former collective farms under privatization (most often livestock-farms) were left with no land. This means the operation of these units in future is impossible.

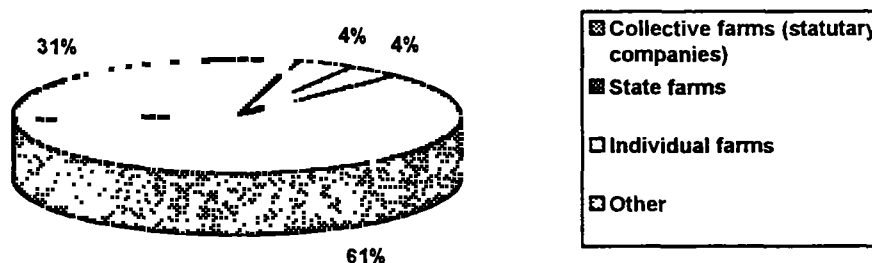
The Supreme Council has adopted several amendments to the laws with the goal of rectifying the errors. However, there have been several occasions when the aprinkis or pagasts authorities have disobeyed the court decision, thus violating the law, with no legal consequences.

The Law "On Land Privatization" stipulates that the joint-stock or limited liability companies (the former collective farms) have the right to use the state-owned land on which they farm for 5 years. However, when a shareholder of a company wants to buy an asset such as a cattle-shed, he may lose the land on which it stands immediately, because in most cases former landowners' rights are restituted for this land immediately

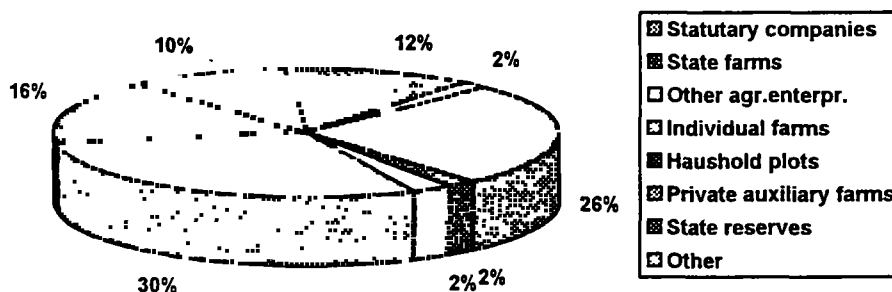
Due to objective and subjective reasons (symbolic land and property taxes etc.) there is not yet an effective land and rental market in Latvia . So it may often happen that a farmer full of entrepreneurial spirit, who buys, for example, a cow shed with 200 cows, has no real possibility for raising feed.

The structure of land users during last 4 years has changed substantially:

Graph 1: Agricultural land by users, 01.11.1990



Graph 2: Agricultural land by users, 01.01.1994



There is also a technical problem that hampers the establishment of ownership rights in the proper sense of the word. Though formally the Law "On Land Privatization" provides for the formalities connected with land ownership, only in December of 1992, a law on the establishment of the State Land Service was passed (it is under the command of Government and will have to deal with confirmation of ownership rights for people who are already given the land use rights according to the rule). At the same time the Law "On Land Title Register" was revived - it is under the

command of the Supreme Court, and its task is to register changes in ownership. In fact the offices of the Land Title Register were set up only after April 1, 1993, and the first land title was registered on May 31, 1993. It is envisaged that this registration process might take a lengthy time.

The main changes in legislation regarding ownership and property rights during land reform are reflected in annex Figure 1.

3. Some common problems in property rights during land reform

It seems that the major problem with property rights during agrarian reform will be the creation in the relatively short-run of a system of land titles conferring full property rights on all immovable property on land. During the 50 years when land was state owned, many nationalized buildings were destroyed. Over the same period many new buildings were constructed by the state, collective farms and individuals on land that was previously privately owned.³

These developments have contributed to many problems of an efficiency and equity nature in restituting of land to its previous owners. The classes of problems which are common in Latvia are outlined below, together with some approaches to their solution and short analyses of each.

The first common situation.

A village has been built on the former owner's land. This situation is illustrated in annex (Figure 2. A) In the illustration the village occupies 80 % of the former title. The buildings may include: 1) apartment buildings; 2) privately owned houses; 3) collective farm owned family houses which are leased to members of a collective farm; 4) collective farm owned public needs buildings (for example, cultural clubs, movie theaters etc.)

There are at least three approaches to solving this problem.

1.1. Restitution to the former owner of the full area of his former land title and a restricted long term compulsory lease agreement between the owner of the land and of the buildings.

Such an agreement should include compulsory terms of the lease; minimum and maximum rent, first rights to buy any building sold by its owner or first rights to buy land sold by its owner.

The advantages and disadvantages of this approach are summarized as follows:

³The Soviet-time Constitution allowed three type of ownership: state, collective and individual. But individuals were allowed to own only personal consumption items - the family house was the biggest legal individual property unit.

advantages	disadvantages
<ul style="list-style-type: none"> - restitution is automatic, with no exceptions; - subdividing of former land titles is unnecessary (i.e. a subdivision is privately organized); - the process is judicially clear and relatively inexpensive 	<ul style="list-style-type: none"> - the owners of buildings would not have an incentive to invest in property; a usual consequence is a reduction in the value of the whole landtitle; - evaluation problems for determination of minimum and maximum rent; - no restriction on what will occur after the termination of the compulsory lease period (partly also a positive influence).

1.2. Creation of compulsory titles in the form of "tenancy in common".

This approach is a way of assigning to owners of buildings property rights in the land associated with buildings, perhaps best thought of as supplementary approach 1.1. beyond the term of the compulsory lease.

advantages	disadvantages
<ul style="list-style-type: none"> - the approach enables ownership rights, to be resolved in any situation, although with compulsory methods; - these would be more rapid creation of a market for land, including shares on landtitle. 	<ul style="list-style-type: none"> - the approach would be against the current Constitution, which allows land to be owned only by Latvian citizens; - an expensive property valuation system would be needed to resolve disagreements between owners of the land and the buildings.

1.3. Creation of new land titles for the owners of buildings, including partial restitution of former owners in case of existing nationalized buildings or free parcels of land and (this approach follows from current legislation).

All land under buildings and around them (like a parcel) will not be able to be restituted and the former owner will be able to get back the free part of the land on former title (annex Figure 2.A), free neighboring land, but all the rest of the lost land (in the example 30 ha.) should be compensated by the state with vouchers, which can be exchanged for land, buildings, stocks etc. Parcel land in villages will be privatized to the owners of the building, if a person has rights to be the land owner or will be leased 'long term' from the state to a private person (if he or she is not a citizen) or legal entity.

An apartment building, which is owned by a former collective farm, mainly are privatized as "strata title", except the parcel, which will be owned by the state and leased on a long term to owners of the strata title. This is provided for in the law "On Privatization of the Agricultural Enterprises and Collective Fisheries".

Former collective farm owned public buildings (including parcel of land) will be given to the pagasts, with compensation to their current owners.

advantages	disadvantages
- fewer compulsory lease agreements between private persons; ⁴ - more equity among different interest groups.	- expensive and complicated State Land Service work, including creation of many new titles; - opportunities for corruption, because of a possibility of clearly defining rules covering every case.

Variations to approach 1.3. in cases if:

- residential buildings outside villages, and
- nationalized residential buildings are fully or partly preserved.

If a privately owned family house has been built outside a village, the former landowner is restituted in his rights except on the parcel attached to the family house. At the same time, it is not clearly defined how long the family house owner will be able to keep the parcel use rights. There is an opinion that the private owner of a house should be compensated via the state by the owner of the land. In the case of new apartment buildings owned by a former collective farm or by a shareholder of this farm outside a village, the solution of problems will be similar to that for apartment buildings in the village.

If a building which was nationalized or confiscated is fully or partly preserved, according to legislation (mainly according to the law "On Denationalization of Living Buildings"), all former owners of land and buildings must be restituted on full previous title. However, for 7 years the restituted owner will not be able to break a hire agreement with the present lessee of the apartment. This restriction in restituted property rights creates distortions in the market value of apartments and residential buildings.

The second common situation.

Close to big cities, particularly to Riga, during the Soviet time, there have been built "family garden cooperatives" which consist of plots of land with a size of 0.1 - 0.5 ha. with invested capital in this state owned land including some capital buildings. The number of such gardens is about 36 000 in the Riga district alone.

The actual situation in that problem is as follows:

⁴Public opinion is that psychologically, in the postsocialism age it is easier to make a lease agreement with the state than with a private person.

- the former landowner is restituted on part of his land, which is free (see Figure 2, B.),
- all land after 1996 will be restituted except parcels of land on which there are capital buildings;
- the former landowner is still under pressure to choose compensation.

The solution to this problem is very unclear and there are many efficiency and equity issues not yet answered:

- 1) is land more efficiently used by a large number of handworkers, which produce mainly fruits and vegetables for self - consumption , than compared to land used by one farmer ?;
- 2) in the near future it may be uneconomic to grow fruits and vegetables in these gardens, rather it may be cheaper to buy them?;
- 3) do the interests of many people outweigh the interests of the former owner?;
- 4) is gardening more a hobby and relaxing, or is it a rebate in the "consumption basket" of gardeners?

Perhaps, the main argument in the solution of this problem might be the following: if a former landowner will not be restituted on all current garden land, then creating ownership amalgamation on these gardens, will create the same situation of ownership as in the case of immediate restitution. It seems that the problem of garden cooperatives is mainly a political problem, as in the Soviet-time to get a garden was some kind of privilege, and additionally for the government, compensation to one former owner landowner is easier and cheaper than compensation for hundreds of improved gardens.

The third common situation .

If on land, which is requested by a former owner in the first stage of land reform, there has been built a non-apartment building (for example, a 200 capacity cowshed, see Figure 2. C. in annex), then, according to the law "On Land Reform in Rural Areas", the Local Land Commission allocated land for this cowshed with acreage defined by the regulation (see above Priority). The next law - "On Land Privatization in Rural Areas" - has been more a turn to restitution, because of political changes. It includes, for example, such rules as former collective farms (companies) have no rights to use the land after 5 years, if this land is requested by the former landowner, who not later than after 5 years will get full restitution. It also creates a paradox situation, where the collective owner has more rights than the physical owner:

- when a shareholder of a company wants to buy an asset such as a cattle-shed (according to the other law - "On Privatization of the Agricultural Enterprises and Collective Fisheries"), he might lose the land on which it stands immediately, because in most cases the former landowners' rights are restituted on this land immediately.

There are several approaches to solve this problem during these 5 years and also later.

3.1. State-guaranteed rights for the former collective farm to use land around the cowshed for 5 years, with restitution of this land to the former landowner after this period.

This approach followed from current legislation. The problem arises when the cowshed is privatized by a shareholder of a former collective farm who is not the former landowner. There are possible ways of dealing with this problem:

3.1.1. The new owner of the cowshed immediately loses the land around the shed, because it will be restituted to the former landowner (the same land would not be restituted before 5 years if the shed was still owned by the former collective farm - this approach follows from current legislation).

advantages	disadvantages
- there is a high possibility that upon liquidation of the collective farm the cowshed will be sold to the landowner. In that case the land title including the rights to the building will be fully owned by one person. ⁵	- reduces the attractiveness of the shed to the owner and to potential owners; - reduction of livestock production.

3.1.2. The new owner (former collective farms shareholder) has the same 5 years use rights to the land around the cowshed as the former collective farm.

advantages	disadvantages
- if the shareholder wants to buy the cowshed, but the former landowner does not, that usually means that the shareholder as cowshed owner has a more efficient business plan for managing the shed; - would stimulate the process of non-land assets privatization; - enables existing cowsheds to be preserved for the future. when these sheds will be more efficient than small ones currently used by farmers.	- sometimes the main reason a shareholder buys a cowshed would be to get "some" rights in the future to the land around the cowshed - short-term lease of land does not encourage maintenance and improvement of the cowshed and of the land around the shed. This could lead to a decrease in the value of the whole land title over 5 years.

3.2. Approaches to restrictions in property rights between former landowner and cowshed owner after 5 years:

3.2.1. compensate the cowshed owner and give the shed to the landowner.

⁵If a collective farm sells a cowshed in a public Dutch auction to another person, it creates the same situation as when cowshed cowshed is bought by a shareholder, but with more uncertainty in the future towards land use rights.

advantages	disadvantages
<ul style="list-style-type: none"> - would solve all land restitution problems without subdividing landtitles; - excludes motivation for a third person to buy the cowshed only to get "some" rights on land around the shed. - enables preservation of these sheds for the future, when they will be more efficient than small ones, which have been actually used by many farmers. 	<ul style="list-style-type: none"> - cowshed would lose its value, because landowners will often destroy the shed (this will occur, because he has no interest to carry out his first hand rights and buy this shed before, but is just waiting for his postponed rights) ⁶; - would create more complicated estimation comparison with land compensation. - encourages land owner to retain his "fully owned" land in order to get full rights to the shed land around the shed.

3.2.2. Compensation to landowner and subdividing of former land title.

advantages	disadvantages
<ul style="list-style-type: none"> - would increase value of cowshed and create more efficient milk production; - no need to estimate the value of buildings for compensation purposes. 	<ul style="list-style-type: none"> - would increase the number of exceptions in restitution and make the privatization process more complicated, partly by requiring subdivision of landtitles; - would create motivation for strategic behavior - that is buying cowsheds only for the purpose of obtaining property rights on the land.

3.2.3. Determination of compulsory lease agreement rules between owners of land and of shed.

This approach seems like a compromise, but at the same time looks like a postponing of a solution in property rights and the advantages and disadvantages are similar to approach 1.1..

4. Property rights development and problems .

General public opinion during Soviet occupation concerning property rights was considerable distorted. Politically and also psychologically in 1988-1990 approach to solve property rights problems, which was based on the theory of Marx - that land has no value itself, because it not a product of human labor. It created preconditions for the Latvian Soviet Parliament at the start of agrarian reform to pass rules which have established a preference for compensating those losing ownership rights to land over those losing ownership rights to buildings. These rules, partly embodied in legislation, created much uncertainty and made land reform a very complicated process. That is why the latest approaches in legislation, which are based on restitution of

⁶For the landowner there is no real opportunity to actually lease the shed for reasonable rent - livestock products, particularly dairy products, have difficult marketing problems and their production is unprofitable.

landtitle, are meeting with such equity problems. These equity problems may have been avoided, if agrarian reform had started on other principles

Restitution should be the main equity instrument in continuation of the agrarian reform, because it is the only way to end in Latvia the results of occupation, socialism and colonization. Creation of new private property rights on the basis of present user rights for state owned property would mean legitimization of the crimes of the period of occupation (nationalization and confiscation of property, deportation of former owners etc.). This means also that restitution is an equity as well as a political decision.

Property rights of restituted and new owners have been determined mostly by renewed Civil Law (which firstly passed in 1937, and with little change was fully renewed in the summer of 1993) and by new reform legislation. One of the major tasks in property rights reform is to clearly define the rights of owners in cases, where Civil Law does not provide clear guidance due to circumstances arising after occupation. On the other hand, given the great uncertainties in Latvian agriculture at present, it may be wise for the government to remain detached, lest regulations be imposed which restrict response to later market changes.

Development of property rights in Latvia in last 5 years is useful to analyze through the six characteristics of interest in property rights that qualify their usefulness in economic exchanges. Those characteristics can be based on following descriptors:

Duration: length of time for which an arrangement holds, a period in which a right-holder can profitably invest in harvesting;

Flexibility: discretion to change use; ability to adapt to change; what can and cannot be done without consulting others;

Exclusivity: the strength of a right, the inverse of the number of persons who must be contacted to internalize enterprises such as fishing; freedom from disturbance; strength of acceptance by the community;

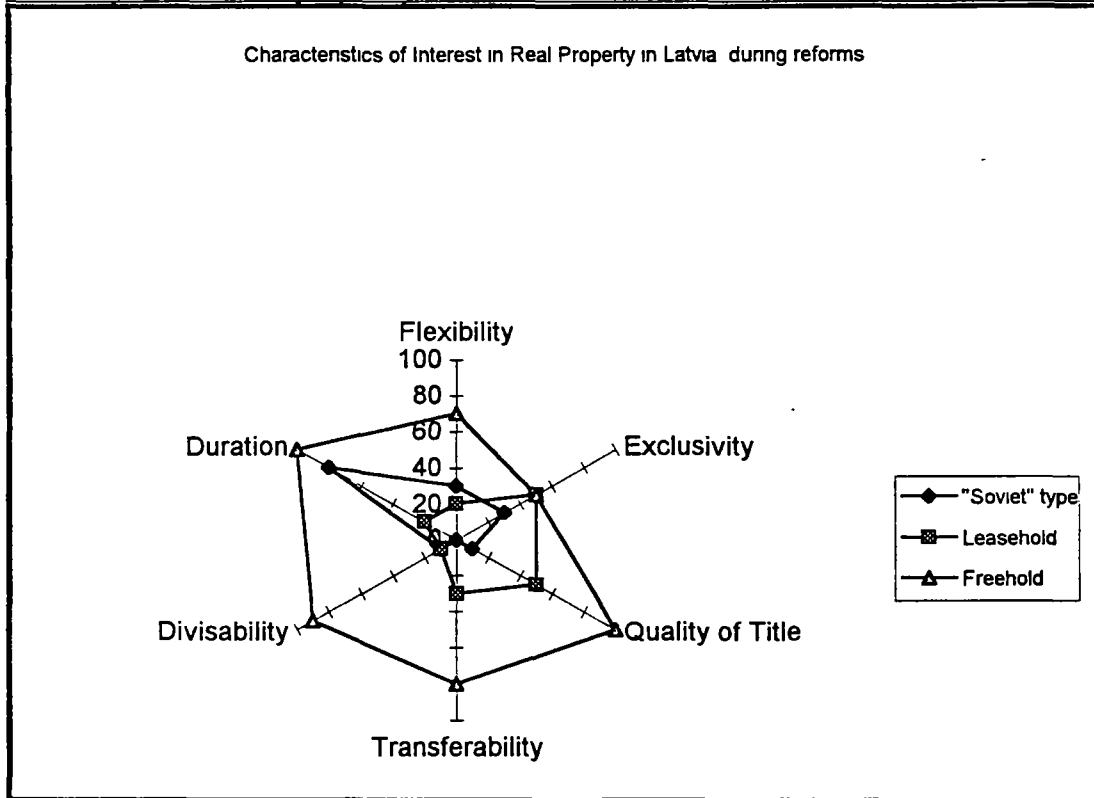
Quality of Title: legal protection and security provided by common law and registration systems; acceptance of title by others;

Transferability: ability to transfer to others: number of parties to whom a transfer can be made; and

Divisibility/Assemblability: ability to sub-divide; ability to aggregate; ability to share; ability to have joint holders; ability to assist transferability.

Each of these characteristics have been scored from 0-100. There are compared three systems of property rights on land in Latvia:

- Soviet time land tenure system (formally rights to use land);
- early reform time - leasehold land tenure system (1989-1990, first individual farms);
- freehold land tenure system (present situation after renovation of the Civil Law)



Transferability of property rights is still legally restrict by subject of ownership on land - even after legal changes concerning that in spring 1995 (the owner of land can be: Latvian citizens and legal entities, where owners of at least 50 % of the fixed capitals are Latvian citizens, or where owners are foreigners from countries, which have bilateral foreign investment protection agreements with Latvia) and limited by technical obstacles (capacities of Land Title register and Land Survey services). Long term credit shortages, slow and weak development of mortgages, some rules in the process of alienation of real properties and unprofitability of property possession and managing are still breaking real property market (particularly in rural areas).

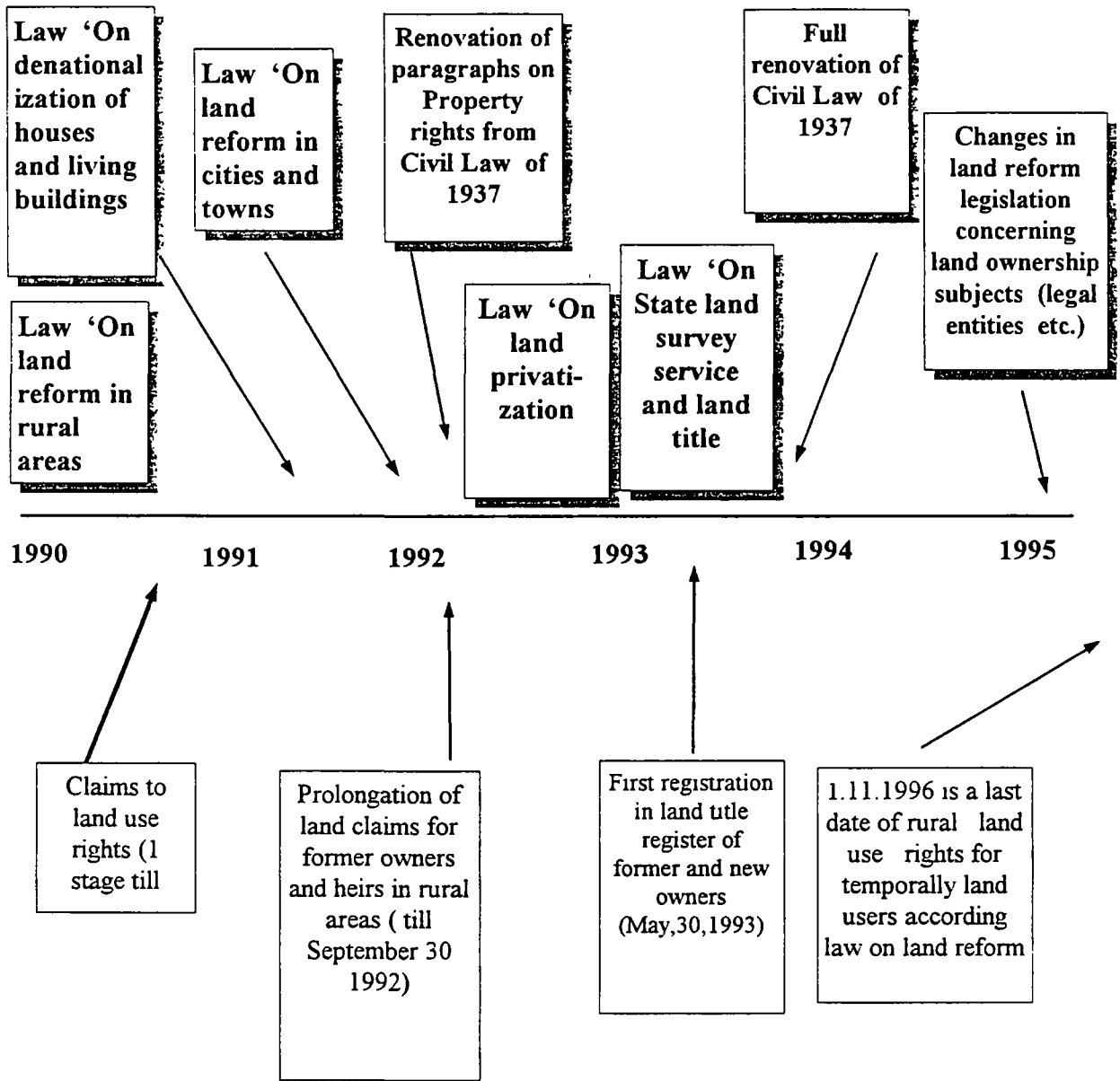


Figure 1
Dynamics of main legal reforms regarding ownership and property rights in Latvia

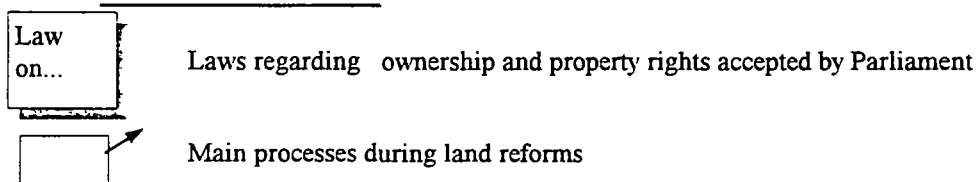
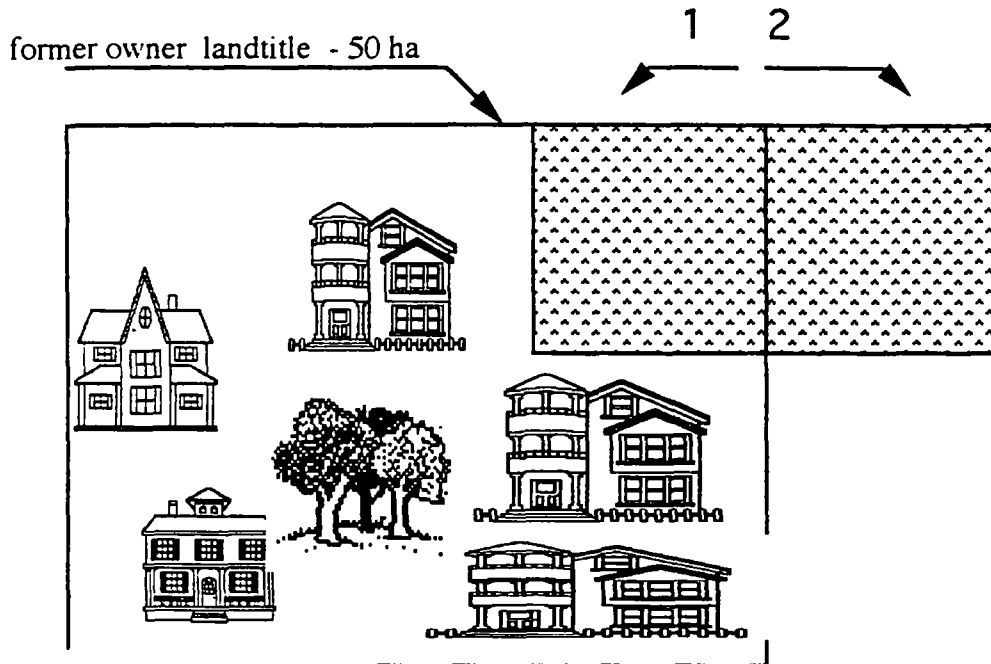


Figure 2

Examples of the common Situations and Problems in
Property Rights during Land Reform

Fig. A. The case of
Village



- apartments and other village buildings



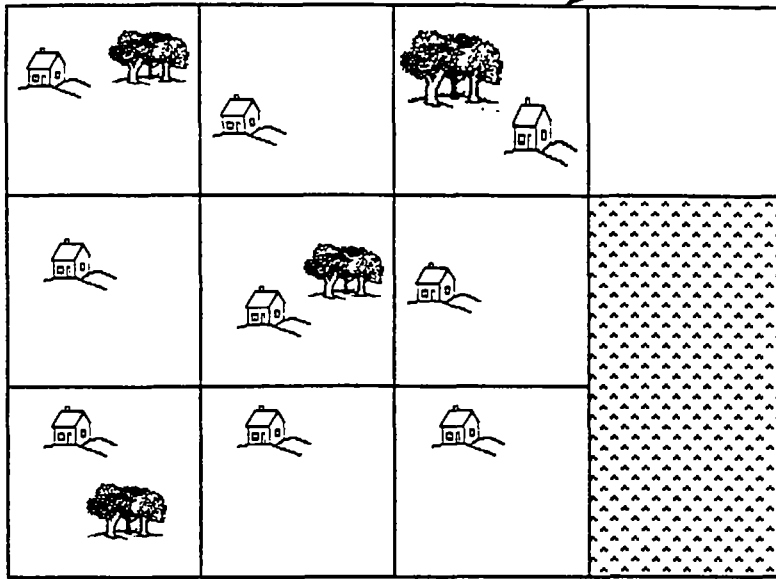
- allocated land for former owner from which:

1- part on former title, 10 ha;

2 - part on free neighbour land, 10 ha;

Fig. B. The Case of Family Gardens

former owner landtitle



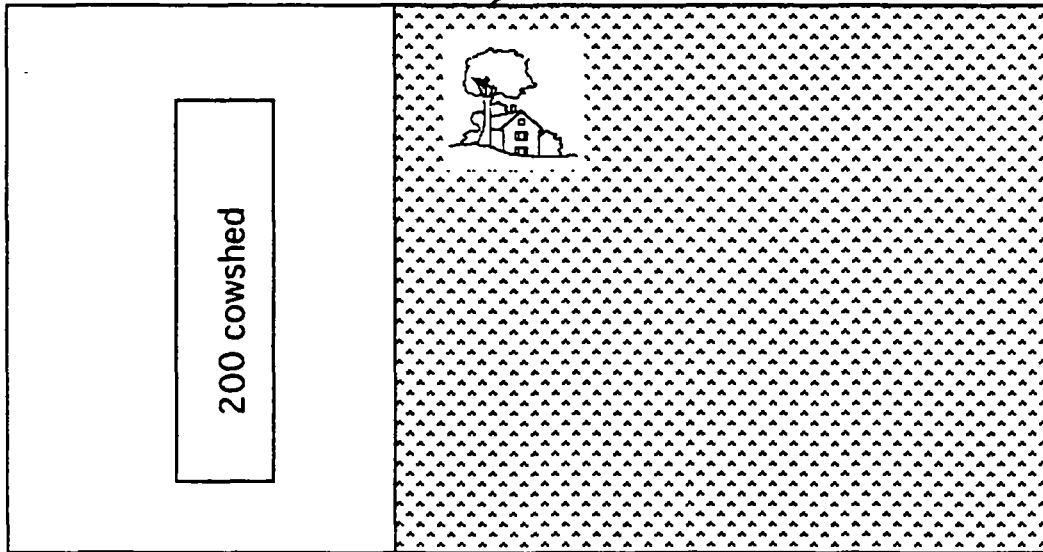
- hobby gardens, 0.2 ha



- part of land which is free and might be restituted without exceptions

Fig. C. The Case of Cowshed

former owner landtitle



- restituted owner residential house;



- part of land which has been restituted immediately;



- part of land which has been leased by state for former collective farm on 5 years