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Privatization and Restructuring of State and Collective Farms: Policy Environment and Strategies

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Abstract

Issues, choices, and strategies in the transformation of collective and state farms in transition economies are explored. Analysis includes how other reforms have an impact on the transition in farming systems and farm structure. Economic forces to direct the changing structure of farming to the maximum extent possible should be allowed. The role of the government is to create an appropriate legal, economic, and institutional environment for the transition process to be carried out successfully.

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Baltic Report 94-BR 16
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Lithuanian Ministry Agriculture
Vilnius, Lithuania

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ABSTRACT

Issues, choices, and strategies in the transformation of collective and state farms in transition economies are explored. Analysis includes how other reforms have an impact on the transition in farming systems and farm structure. Economic forces to direct the changing structure of farming to the maximum extent possible should be allowed. The role of the government is to create an appropriate legal, economic, and institutional environment for the transition process to be carried out successfully.

PRIVATIZATION AND RESTRUCTURING OF STATE AND COLLECTIVE FARMS: POLICY ENVIRONMENT AND STRATEGIES

This paper explores issues, choices, and strategies associated with the transformation of collectivized and state-owned farming units into systems that will be viable in the emerging market-oriented economies of post-communist countries. Most of these countries have already designed the techniques for this transformation and some are well advanced in implementation, so we focus more on the policy environment than on the mechanics of the process. Regardless of the techniques employed,—and there are many variations,—the economic and policy environment can have significant impacts on the short- and long-term results. Since this transformation does not occur in a vacuum but is taking place in an environment of rapid political and economic reforms in other sectors of these economies, attention also needs to be given to how these other reforms affect the transition in farming systems and farm structure. The goal here is not to provide answers to these difficult questions but to frame the issues and choices in a way that will stimulate productive discussion. We first discuss the decision environment faced by state, local, and individual decision makers, then explore transition options and constraints, and discuss linkages to other reforms. Finally, we comment on strategies to support the transformation process.

The Decision Environment

The specific objectives of farm restructuring and privatization certainly vary across countries; but an overriding economic objective is to create a farm sector that can operate efficiently within an economy where economic incentives are, at various speeds and to different extents, replacing the centralized command system. Other social, economic, and political objectives also have varying degrees of importance in different countries. Restitution of land to former owners, increasing the efficiency of agricultural production, improving resource allocation in the economy, and maintaining employment opportunities for rural inhabitants are some of the related goals that have been shaping these reforms.

Initial conditions are also an important element of the decision environment. Although it has been observed that the former Soviet Union provides an excellent research laboratory because the 15 successor states are pursuing different approaches to reforms, it also needs to be recognized that there

are significant differences in the initial conditions in these countries and these differences are even greater when other Central and East European countries are considered. Therefore, it would be a mistake to ignore such differences in this discussion.

In some Central and East European countries, including the Baltic states, there was a political imperative from the beginning to give priority to the restitution of land to former owners. This was both a stimulus for rapid privatization and a factor that complicated the overall privatization and restructuring process. In other countries, mainly among successor states of the Soviet Union, there is a far smaller proportion of rural inhabitants who desire to own land or to manage their own farms. Related to these differences is the fact that in some countries there was significant pressure for reform from the rural population, while in other countries reform has been more of a top-down initiative by the government.

Large countries, such as Russia and Ukraine, have a more complex decision environment than small countries because there is a greater potential for differences in policy and implementation priorities among national, regional, and local governments, resulting in failure to implement programs announced by the national government. Finally, the progress and impacts of other political and economic reforms can have a profound influence on what decision makers at all levels are willing and able to do.

Transition Options and Constraints

No one really knows the optimal sequence of steps required to achieve restructuring and privatization goals, since there is little historical precedence upon which to evaluate options. Even if we were well enough informed and clever enough to devise such optimal strategies, they would surely differ among countries because of differing initial conditions and constraints. For example, Germany has far greater monetary resources to support restructuring in the former GDR states than other countries will ever have. Since conditions and constraints differ, it is more important to establish laws, institutions, and procedures that create incentives and options for restructuring than to direct it along a predetermined path.

Generalized organizational forms evolving in the process of transition in farm structure are presented in Figure 1. Nearly all countries began the transition with public farms (state, collective, or cooperative) and some individual production activities on subsidiary or household plots (both for private consumption and commercial purposes). Public farms usually were large-scale diverse

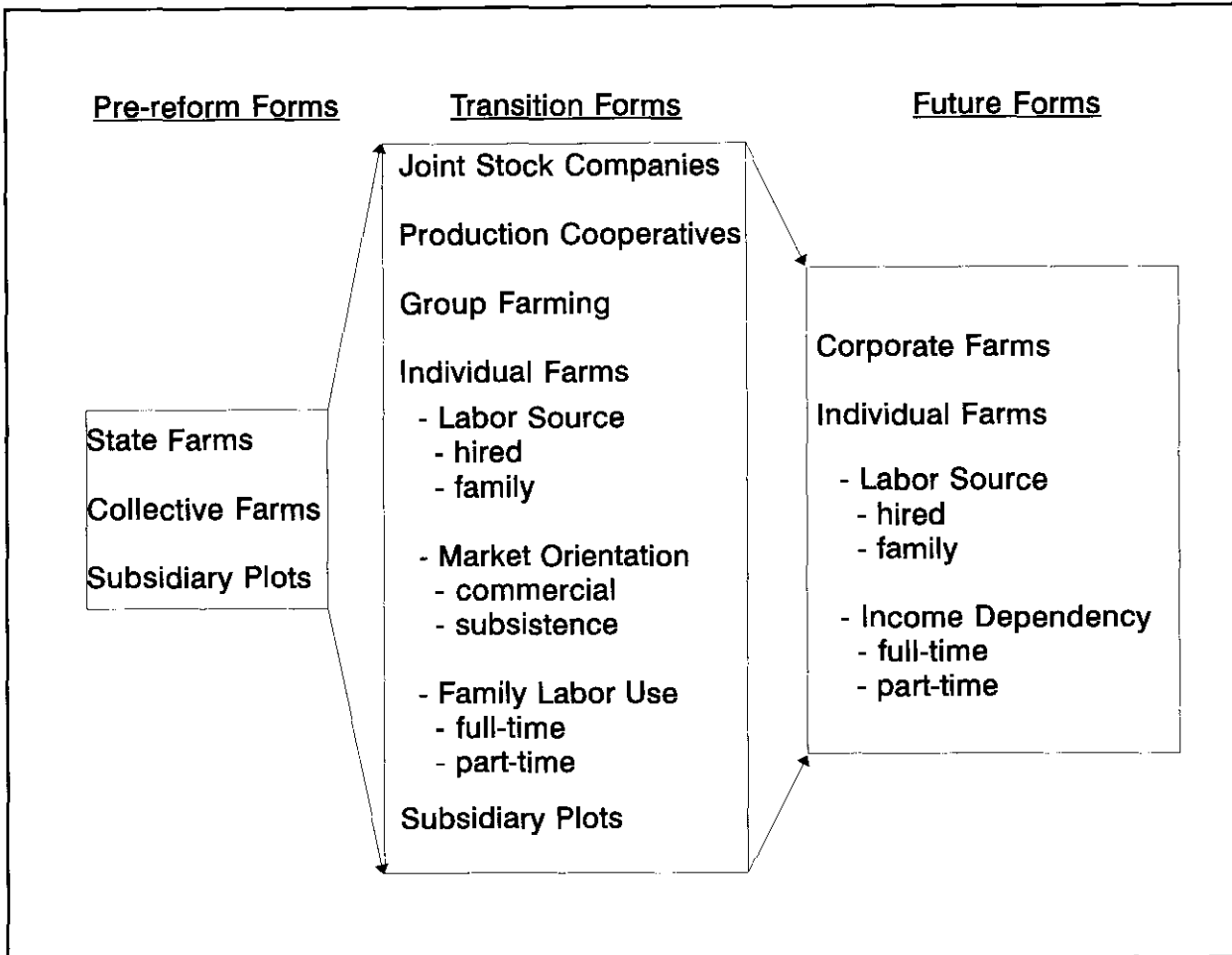


Figure 1. Enterprise forms at different stages of the transition

farms with several semi-independent agricultural industries operating within the farm. Subsidiary or household plots represented additional farming activity undertaken by current and retired employees of the public farm and other rural households. As a rule, their size was restricted, and they used major inputs provided at little or no cost by the public farm. Poland, of course, was a unique exception and had retained some of its traditional family farms; but these had not evolved and adjusted significantly over time as would have been natural in a market economy.

Transition forms are those that, to varying degrees, have privatized land and/or production assets, completely or partially lost government production directives together with guaranteed marketing, prices and subsidies, gained management and financial independence, and improved individual decision and incentive structures. Some of the most common transition paths in reorganizing farming forms include those illustrated in Figure 2 (adapted from Csaki and Lerman).

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1. Private farming on small-scale farms is combined with reorganized parental public farm. Private farms in this case evolve as a result of land reform (land distribution among employees, enlargement of subsidiary household plots, purchase of land from the state, and restitution of land ownership rights) from the initial state or collective farm. The large-scale public farm itself undergoes substantial changes not only in its size, but also in its organizational form, management, specialization, and other areas.
2. Farm land of parental public farm is completely distributed to small scale private farms and agro-service cooperatives are organized to serve the needs of agricultural producers. This is common for reorganization of weak, inefficient public farms as well as specific cases with high demand for land to establish private farming activities. Nonland assets of the parental public farm are subject to privatization, and are used both by private farmers and by newly established service cooperatives (input supply, product marketing, small- to medium-scale processing, agro-services).

If in the process of reorganization the public farm survives, it also undergoes significant changes. There are two common scenarios for the reorganization of a public farm.

1. The parental farm is divided into independent technological operations, based on previously existing production facilities and assets, followed by privatization of them. Specialized agricultural operations usually include farming activities (both in livestock and crop sectors), storage or processing, and services and are based on private ownership of assets and corporate work. Later on, these specialized private operations either stay as separate independent activities, or form associations (with the possibility for private farmers to participate) following horizontal or vertical integration needs.
2. The public parental farm is reorganized into a joint-stock company, agricultural partnership, or production cooperative. In this case, a new unit is a multifunctional diverse enterprise, which usually includes such activities as agro-services, agricultural production, processing, and marketing.

There is a great variation across different forms and among countries in the extent to which real transformation has occurred. When a state or collective farm is converted into a joint stock company, there may be little or no apparent change in the operation of the farm; but it should, at least, lose access to government budget resources and provide a more flexible starting point for further restructuring. Production cooperatives and various other kinds of group farming represent a variety of enterprise forms that are owned and operated by farm workers and others. These, like the joint stock companies, are still relatively large-scale farms but, in many cases, are smaller than before as a result of splitting the collective and state farms into two or more new farming units and transferring land to private farms.

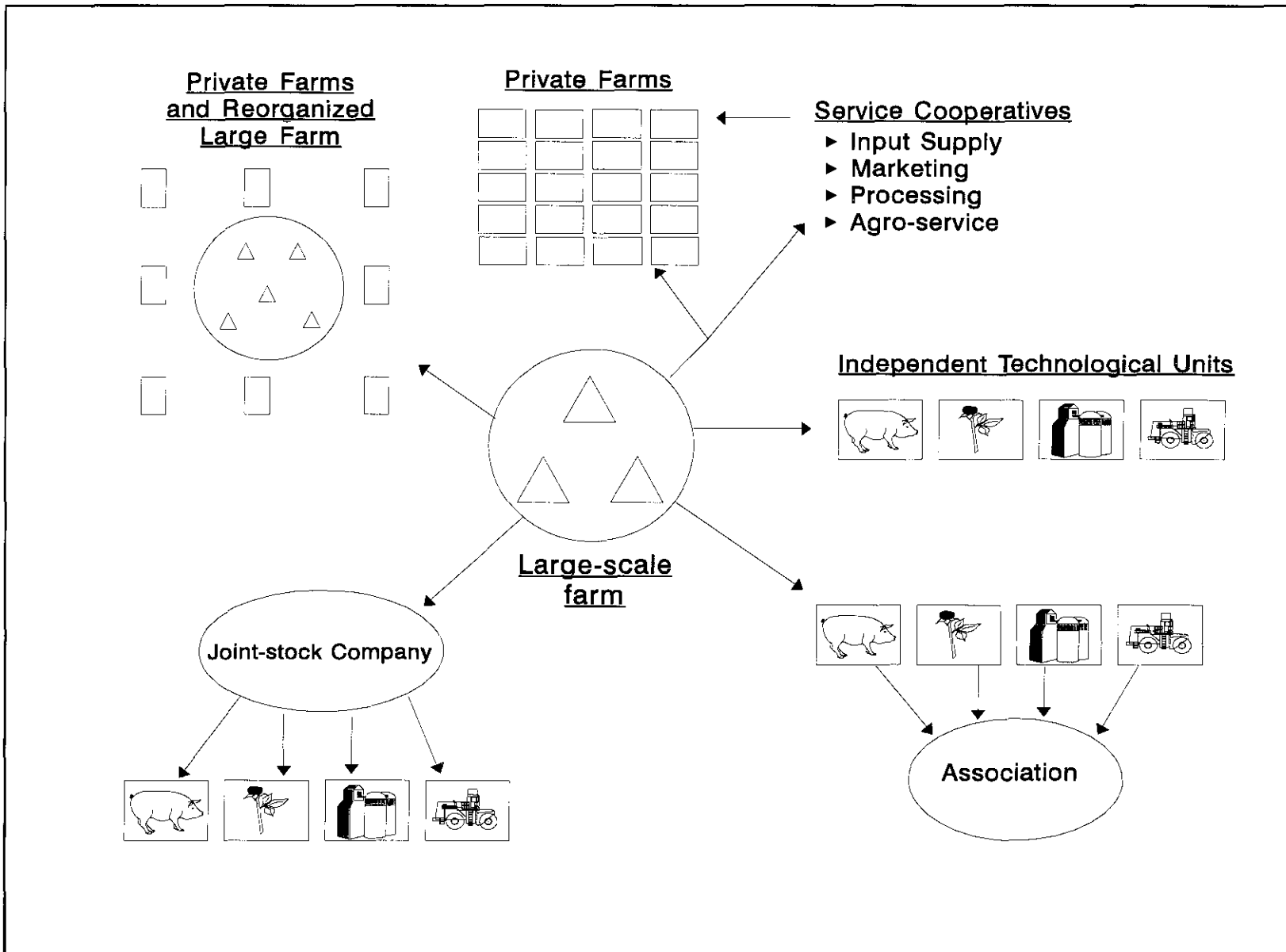


Figure 2. Examples of transition forms for state and collective farms

Private farms, by which we mean those owned and/or operated by private individuals, also appear in various forms. We have categorized these in Figure 1 according to whether labor is primarily hired or family, whether they have a commercial or subsistence orientation, and whether family labor is used full time (and derives most of its income on the farm) or part time (and has significant other income sources). Many combinations of these categories exist in transition economies.

A few commercial farms have been established by entrepreneurs who own or lease large areas of land and use hired labor and custom services as needed. Full-time family farms operated primarily by family labor exist in many countries but are not very numerous. Part-time farms and subsistence farms are more common, especially in countries that have implemented land restitution programs. Subsidiary plots still exist in many rural areas; but they are unlikely to last long, since they were a child of the collectivized system. Individuals operating such plots may choose private farming in another form but will no longer enjoy the benefits of support, often including free inputs, they received from the parent collective or state farms.

The current patterns of transition forms vary greatly among countries. At one extreme is Albania, which liquidated all large-scale farms and divided the land into small, private subsistence farms. In the Baltic states, many private farms of various sizes have been created, but numerous, relatively large farms operated by various types of partnerships also have emerged. Other countries that have implemented restructuring and privatization also have varying mixtures of different forms.

All of the transition forms must be viewed as temporary unless and until they have established their viability and competitiveness in the new economic systems that emerge from the transition process. The process of transformation may take years or decades, but eventually a few forms will dominate the rest. The final, post-transitional forms illustrated in Figure 1 may include corporate farms, production cooperatives or some other form of group farming, and private commercial farms. It is not yet clear if group farming in any form can remain viable in the long term. The fact that it has never been significant in other market economies does not necessarily mean that it is doomed, but its future is certainly questionable. The number and size distribution of farms in each category will depend on farming traditions, government policies, and economic conditions as well as decisions made by entrepreneurial groups and individuals.

A major constraint in the transformation of state and collective farms is the fact that they usually provided a wide range of economic and social services that need to be transferred to local or

national governments or independent private enterprises. For example: safety net functions need to be provided at the national level; schools, roads, and medical services may be the purview of local and/or national governments; construction and transport services are best undertaken by the private sector. However, without parallel reforms in national and municipal governments and economic incentives to the private sector, they will not provide the financial or management resources to undertake these services.

There is an ongoing conflict between equity and efficiency goals, which is nearly always present in policy choices. The decision in some countries to implement land restitution has created many private land holdings; but their viability as farms is threatened by small size, lack of production assets or credit to obtain them, unavailability of small-scale machinery, lack of management and technical skills, poorly developed marketing channels and information systems, and, occasionally, even lack of interest in farming. At the same time, production assets of many former state and collective farms are underutilized, and adequate land resources are sometimes difficult to obtain. Private farms that want to obtain more land to improve their efficiency and viability are often unable to do so. Hungary has reduced the disruptiveness of restitution by relying totally on vouchers rather than on land transfers. Compensated individuals can buy land or other assets with the vouchers, but there is no implied obligation of the government to match claimants with specific, previously owned property. Lithuania expanded compensation options and made other changes in the restitution procedures in 1993 to reduce the fragmentation of land holdings and the number of land claims that have to be processed.

There is often a tendency on the part of governments (and even researchers and foreign advisors) to overly plan or direct the process of restructuring. This could be dangerous, especially since it is difficult to know what is the optimal path or even the optimal final outcome. One evidence of this is the frequent discussion of the optimal farm size and the preoccupation with full-time farming. Part-time farming is not inherently bad. It may be the best choice for a person located close to alternative employment. Moreover, efficiency for a particular product line does not increase continuously with size, and it often depends as much on the skills of the manager as the size of the farm. The most important task of the government is to establish the rules of the game and be sure they are well-disseminated and understood. To the extent possible, decisions should be made by local governments and rural inhabitants who are private farmers, managers, workers, or members of state and collective farms.

Linkages to Other Reforms

If reform measures in agriculture and other sectors of the economy are designed independently, there may be rather little attention given to the effects of one on the others. However, these interdependencies soon become apparent and can be very important. Many countries have reduced or eliminated subsidies to producers and consumers and initiated price liberalization measures that give market forces a greater role in the determination of prices. In many countries this has led to a substantial deterioration in the terms of trade for farmers. As illustrated in Figure 3, price liberalization and subsidy removal tends to cause input prices to rise much earlier and faster than producer prices. As consumer subsidies are removed, retail prices also tend to rise faster than producer prices in order to cover the intermediate costs of processing and distribution. The market power and inefficiency of the enterprises in the intermediate sector lead to wide margins between farm and retail prices, and political pressure from consumers and the desire of governments to soften the

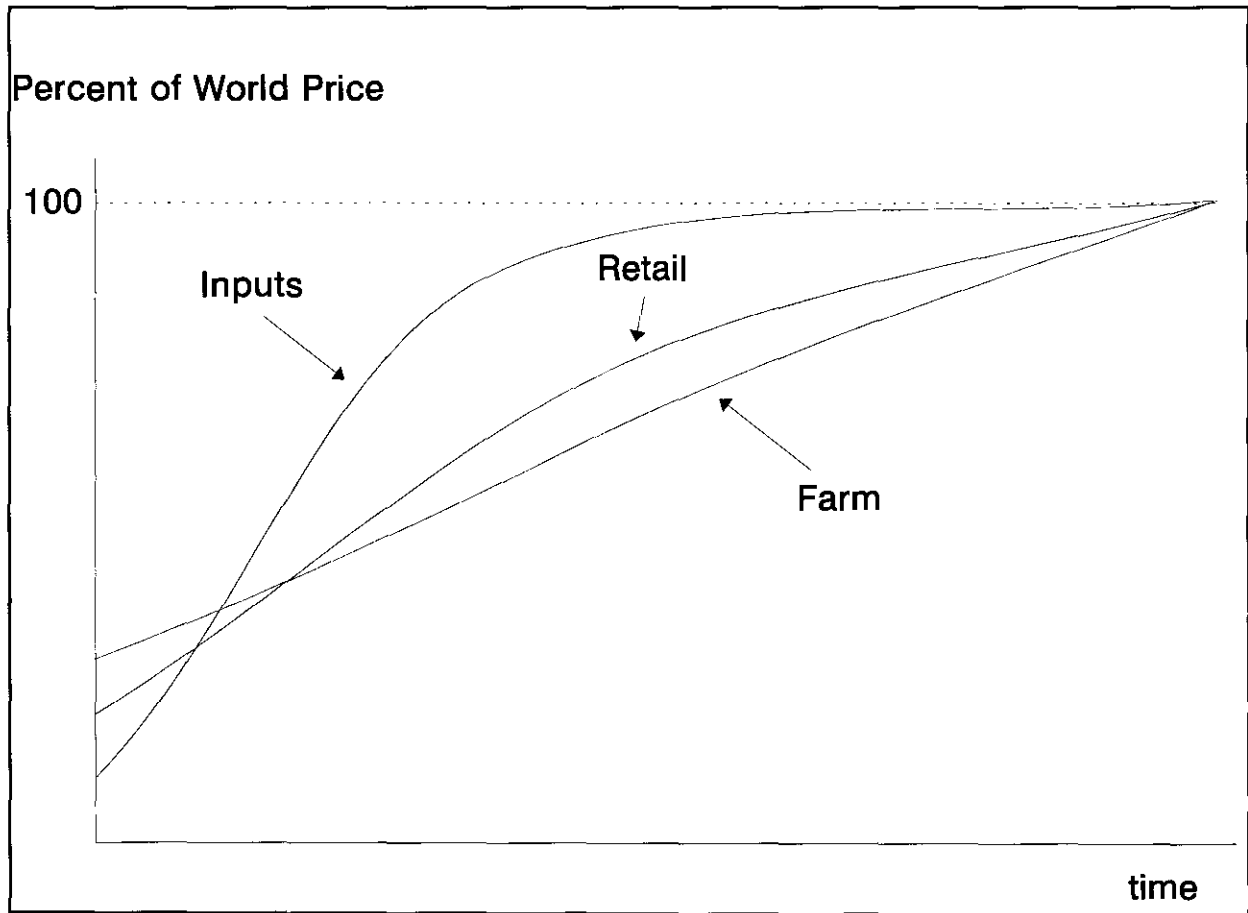


Figure 3. Generalized dynamics of prices during transition

economic impacts of the transition often slows the adjustment of these prices toward market equilibrium. The cost-price squeeze brought about by the disequilibrium in price adjustments puts farms and farmers under severe financial stress. Farms that are undergoing restructuring, and especially new private farms that are attempting to establish themselves, have to deal with the additional uncertainties and difficulties associated with market reforms.

Macroeconomic and financial policies and institutional reforms are another source of uncertainty for farm enterprises during the transition. Government decisions in this area can have as much or more of an impact on agriculture than do direct agricultural sector policies. Effective stabilization policies can reduce the costs imposed by rapid inflation rates, especially when farmers are subjected to substantial payment arrears by processors purchasing their products. Similarly, failure of credit institutions to provide credit services to privatizing farm enterprises, imposes a severe constraint on their ability to purchase production inputs or acquire production assets. How well or poorly the government implements macroeconomic and financial policies will have a significant effect on the ability of newly formed enterprises, large or small, to succeed.

The privatization of upstream and downstream enterprises in the marketing chain often has proceeded more slowly than the restructuring and privatization of farms. This imposes additional constraints on farms and farmers, since a healthy private farm sector cannot develop when it is surrounded by upstream and downstream enterprises that are exercising excessive market power over input and output prices. If the newly constituted farms are to operate in and provide the benefits of a market-oriented food chain, the other enterprises in the industry must also be market oriented and have sufficient competitive behavior to prevent private monopsonistic and monopolistic pricing from replacing state pricing.

Strategies to Support Implementation

Each country must choose its own path to restructuring and privatization, but lessons have already been learned by those countries that have made significant progress in these reforms. Albania's radical approach may have been a necessity, since the old system had essentially collapsed; but in many other countries such an approach would cause large production losses. Among countries where transition reforms have progressed rapidly, Hungary has chosen a gradual approach to farm restructuring in order to minimize efficiency and employment losses. The Baltic states implemented land restitution first; and while that is still in progress, privatization of production assets and

restructuring of state and collective farms is taking place, although the implementing mechanisms are not the same in each country. The restitution process tends to increase the adjustment costs and create land fragmentation, but it could also provide the basis for a more rapid development of family farms. It is too early to say which among these methods will prove to be the most successful in the long run, but there are some measures that are important in any of these approaches:

1. Full private ownership rights and the mechanisms for buying, selling, and leasing of land must be established as early as possible. If technical constraints slow the issuing of formal land titles, a legal framework should be developed to simplify the process and permit property transactions. Limitations to ownership rights, such as land use restrictions, should also be minimized. Corporate ownership, which is often prohibited, should also be permitted in order to eliminate the bias against this form of enterprise.
2. In order to support the development and healthy functioning of private farming, a network of commercial, technical and financial institutions needs to be developed. Such a network includes agricultural research centers, advisory services, market information systems, grades and standards systems, and competing financial intermediaries. Agricultural policies, credit programs, advisory services, and other government programs should be designed and implemented so they do not discriminate among different enterprise forms and farm sizes. This allows farms of whatever type or size to compete on a level playing field.
3. Privatization and restructuring of upstream and downstream sectors is a necessary part of developing a well functioning marketing chain to link farms to input and output markets. New private enterprises should also be free to enter the input supply and output processing and distribution industries. The best way to avoid the exercise of monopolistic and monopsonistic power by the large, existing enterprises is to allow free entry and exit and to minimize the protection of these enterprises from foreign and domestic competition.
4. Sooner or later there will be significant reductions in farm employment. Transformed state and collective farms are not obliged to employ members or shareholders and have to shed labor in order to survive. Social safety net programs as well as retraining and job placement programs will be needed to help ease this adjustment. Policies that support the development of small-scale, rural enterprises would also help to absorb these displaced workers.
5. It is important to establish a consistent domestic market and foreign trade policy framework that can guide private and government decision makers in the food and agricultural sector. As long as the policy directions for the future remain uncertain, it is difficult for decision makers to make consistent and well-informed short- and long-run operational and investment choices. As farm and processing enterprises are in the process of restructuring, the current and prospective policy environment will have an effect on decisions that are made. For example, if a highly protective policy were adopted now and firms adjusted their organization and behavior to this policy, there would be another difficult adjustment if the protection measures were removed later.

6. Regardless of the price and trade policies selected for food and agricultural products, it is important to develop a stable macroeconomic environment and well-functioning financial institutions. Adjustments in the food and agricultural sector will be less difficult and the policy constraints less severe if the general economic environment is more benign. As has often been the case in other countries, policies in other sectors of the economy can be of equal or greater importance than policies in the sector itself.

If policies neither preclude nor provide special incentives for the development of particular types of farms, various farming forms could evolve over time from the large-scale farms, the smaller groups that split from cooperatives, or from individuals that accumulate land and production assets through lease and/or purchase. There is no reason why large-scale farms, small part-time farms, and full-time family farms cannot coexist. If group farming does not prove to be viable in the long term, it is at least an important stage in the transition for most countries. These large group farming units could evolve toward corporate farms or toward one or more private farms. In any case, many of the countries in transition are likely to have a wide range of farming forms in terms of size, ownership, and management for the foreseeable future. It is important that the government allow economic forces to direct the changing structure of farming to the maximum extent possible so that the strongest and most competitive forms develop.

In a market economy, the transition never comes to an end. One can readily observe in Western Europe and North America that farm size and structure continue to evolve in response to market, policy, and technological factors. While these changes are far less pervasive and traumatic than those currently underway in the transition economies, they demonstrate that adjustment and transition are a continuing process.

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