



ECONOMIC PROSPERITY INITIATIVE: AGRICULTURE SECTOR POLICY ENVIRONMENT ASSESSMENT

REPORT

FINAL

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REPORT

FINAL

USAID ECONOMIC PROSPERITY INITIATIVE (EPI)

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ABSTRACT

The purpose of this scope of work was to: 1) identify and analyze the major policy, regulatory, and institutional constraints limiting the growth and development of the agricultural sector in Georgia; and 2) recommend in detail how EPI can apply its resources to address these constraints and factors.

As per direction from the EPI team, we focused on issues that affect high value agriculture, given the value chains the EPI project has selected to focus on: fruits and vegetables (fresh and processed), hazelnuts, and wine. Through a combination of desk research and interviews, we determined that there is not a significant number of existing policy constraints in the agricultural sector that are value chain-specific. The constraints we identified and determined to be relevant to EPI's objectives and value chains were mostly cross-cutting. One major policy-related issue surfaced, which was land tenure and the related policy and regulatory measures and their implementation. In this paper, we suggest that addressing this is essential to future development and competitiveness of the sector. The other issues this report addresses are: taxation, food safety, and intellectual property rights. These, we note, are considerably narrower in focus than the issue of land ownership.

ABBREVIATIONS

APLR	Association for the Protection of Landowners' Rights
EPI	Economic Prosperity Initiative
GDP	Gross Domestic Product
ITC	Investment Tax Credit
KfW	Kreditanstalt für Wiederaufbau (German Government Development Bank)
LMDP	Georgia Land Market Development Project
MOA	Georgian Ministry of Agriculture
NAPR	National Agency of Public Registry
SDLM	State Department of Land Management
USAID	United States Agency for International Development
UNDP	United Nations Development Programme
VAT	Value Added Tax
EU	European Union
SIDA	Swedish International Development Cooperation Agency
IFAD	International Fund for Agricultural Development
DCFTA	Deep and Comprehensive Free Trade Agreement
WTO	World Trade Organization

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I. EXECUTIVE SUMMARY

The purpose of this scope of work was to:

- 1) Identify and analyze the major policy, regulatory, and institutional constraints limiting the growth and development of the agricultural sector in Georgia (as related to the EPI Project's value chain focus)
- 2) Recommend in detail how EPI can apply its resources to address these constraints and factors

Methodology: We employed the following methodology to complete the above:

1. Desk Research: review of reports and assessment documents completed by USAID, the EU, and other donors and organizations. We have referenced information from several of these documents; specific citations are noted in parenthetical citations or in footnotes.
2. Analysis of data and policy and regulatory material (laws, policies, decrees).
3. Interviews with stakeholders in the donor community, government, private sector, and the non-governmental organization (NGO) sector (see list of interview schedule in Annex A).
4. Identification, prioritization, and recommendation setting for specific issues that respond to EPI's objectives, will contribute to achievement of its set results and are within its manageable interests.

In order to ensure our focus was correct, from the early stages of the assignment we provided regular verbal and written report back to the EPI project team (particularly the BEE component management) on our progress and planned next steps.

Summary of Findings: We note that there are few policies currently in place in Georgia that are specific to the agricultural sector and which present an opportunity for EPI to offer recommended improvements. Limited budget allocations have been dedicated directly to the sector by the government, so there is generally a need for increased resources in most areas, such as research, extension, farm organization strengthening, and marketing promotion. A 10 year strategy for the sector has been expected since the first quarter of the year for comment by the donor community, but it has not yet been released by the MOA. Once the strategy is released, EPI will be able to provide detailed input, identify any gaps, and identify specific alignment of its activities with relevant components of the strategy. Within the existing donor coordination mechanism in country for the agricultural sector, we encourage EPI to take a leadership role in this feedback process.

Land ownership and registration was the single major policy and regulatory-based constraint to growth and development of the agricultural sector that arose repeatedly from our consultations and research. Public information about land ownership, through registration in the land cadastre, is extremely low in Georgia. The absence of land cadastral registration for the vast majority of rural citizens challenges the land transfer market and renders ownership increasingly tenuous over time. Currently, the documentation maintained by the majority of landholding citizens (and local registrars at the rayon and sakrebulo levels) is not sufficient for entry into the national cadastre without additional surveying to exact legal boundaries. This has far reaching and multiple consequences including limited development of the land market, low incentive for consolidation and investment in increased productivity, and limits maintenance of key infrastructure (irrigation, feeder roads). This issue is sensitive for several

reasons, including perceived conflict with the desire to attract larger scale investments on Georgia's agricultural land (for agricultural and nonagricultural purposes) as well as a recent increase of cases in which land is a subject of dispute. Past efforts by the Government of Georgia and donor community have laid a foundation for development of a formal land market in Georgia. Unfortunately, given the very complex environment of the last decade, the process has not been completed and significant additional effort will be needed to deliver a high quality solution to the land ownership and registration issue and create a viable land market. In any event, in our opinion, the current situation is the most significant policy constraint to the agricultural sector from a legal and regulatory standpoint and without attention, will continue to pose a major challenge for agricultural development. This report is meant to provide an empirically-based status report from the assessment process we undertook and to provide productive recommendations for where USAID/EPI could play an effective role based on its objective and anticipated results.

In addition to the land registration issue, we have identified other areas where EPI could support an improved enabling environment in the agricultural sector. These areas focus on improved incentives to stimulate investment and productivity in the sector, which are currently limited for reasons such as perceived risk and concentration of investment in other sectors and urban centers (Tbilisi, Batumi). Issues we identified include: allowing a more favorable amortization schedule for bio assets (live plants and animals) to reduce tax liability and increase income; adjustments to VAT reclamation practices to incentivize purchase of domestic primary produce; and improved protection of branding and licensing of plant material and input supply products. We have also included a suggested equipment leasing product that would target the agricultural sector and meet the considerable demand for farm and processing-related technologies and machinery in Georgia. Finally, we include in the background section below a broader discussion of the Government of Georgia's anticipated agricultural sector strategy and their budgeted funding for the sector.

There are other important areas that we have not focused on in this report for varying reasons. These include: trade agreements, livestock management, and irrigation. A brief discussion of these and our reasons for not selecting them for elaboration is included in the following section. Finally, we note that there are several cross-cutting areas that are being addressed by other consultant teams and subcomponents of the project that also could affect the enabling environment of the agricultural sector. These include: customs, agricultural insurance, financial services, and transportation. As such, we recommend these subcomponents specifically look into their relation to the agricultural sector and identify specific measures to improve the related enabling environment.

A table summarizing the findings within each of the target issues we focused on along with recommended interventions for EPI and associated results can be found below, beginning on page 10. Detail per issue then follows within the main body of the report. We have categorized the identified constraints and recommended interventions into three levels of priority to assist EPI to prioritize activity design and resource allocations:

1. **Priority Level 1: Cadastral Registration of Land Ownership:** We determined this to be the most significant policy and regulatory-related constraint to development of the agricultural sector. The issue both affects the EPI value chains and the agricultural sector at large. It directly responds to EPI's project objective of increasing competitiveness of the agricultural sector and resolving it would have broad based impact.
2. **Priority Level 2: Taxation/Accounting Standards and True Leasing:** The activities recommended under this level can be accomplished with a combination of EPI's in-

house resources and a reasonable level of consultants. We determine they are well within the project's manageable interests. There are specific and targeted interventions that can incentivize increases in investment into the agricultural sector and directly respond to EPI's objectives. Therefore, we recommend them for inclusion into EPI's work plan.

3. **Priority Level 3: Food Safety and Intellectual Property Rights:** While these issues are important, we have ranked them and related activities lower in priority for EPI intervention. The policy and regulatory frameworks are largely in place and what is needed is enforcement and monitoring, the capacity for which will depend largely on the Government of Georgia's allocation of resources. Further, for food safety, there are other (non-USAID) donor interventions already addressing a full spectrum of related issues. These are areas where EPI can play a facilitative and collaborative role by providing input via the existing donor coordination mechanism, particularly by articulating the feedback it receives from the project's value chain stakeholders.

A table summarizing the prioritized activities is attached in Appendix C.

II. APPENDICES

A. BACKGROUND

B. ISSUE BRIEFS

C. ADDITIONAL INFORMATION

A. BACKGROUND

The agricultural sector in Georgia is critical for achieving economic growth, poverty alleviation, and stability. It is estimated to contribute to approximately 55% of the country's employment – an increasingly significant figure. Yet in terms of performance, the current situation in agriculture is a reversal of that during Soviet times when the sector experienced strong annual growth rates, based on the production of high value products. These earlier levels are proof that Georgia has several important assets to realize a greater potential within the sector, including a high number of agroclimatic zones, good soil conditions, good water supply, and skill within the population. However, these results were realized under the Soviet system and a different set of circumstances. Recently¹, the agriculture and agroindustry sectors have been in decline in terms of productivity levels and an increasing trade imbalance. There has been a steady decline in production and productivity in the agriculture sector, which have caused it to contract by 20% in real terms since 2005 (up to 2010) alone.

Not only is there a decline since the Soviet era, but there has also been steady decline in recent years (see table below for figures of the contribution the agricultural sector has made to overall GDP since 1995). By the end of 2008, the real value of output by the agriculture sector had fallen to GEL 1.19 billion, representing less than 9% of GDP, and was nearly 20% less than in 2000 (Note: part of this recent decline may be attributed to the Department of Statistics' altered data collection methodology). Additionally, food and agricultural exports in 2008 were only 25% of imports vs. 70% in 2005 and 170% during Soviet times. Private investment to agriculture has also remained extremely low. For instance, foreign private investment to the sector in 2009 was only 1% of total foreign investment. The sector's performance also trails that of other countries in the region (see graph with gross agricultural outputs of other former Soviet countries below).

While the country is producing a lesser amount of agriculture-related products, and agriculture is contributing less to the GDP, the number of people engaged in the sector remains almost the same. Therefore, the per capita income of those engaged has declined. Yet, this does not need to be the case. By some estimates, the sector could be performing at five times its current levels there are domestic and international markets that would absorb an expanded output. Georgia now needs to establish the right conditions within its market-led economy to once again, promote growth and development of the sector.

¹ We found several limitations in data when attempting to compare production and marketing levels in Georgia across periods of time. Data from the Soviet era was difficult to find and there was a major shift in the data gathering method from 2004 to 2006 that resulted in a substantial drop in reported production and trade levels. This report is not designed to be comprehensive review of the sector's performance. Therefore, we have referred to multiple other sources for this information, including the National Statistics Department and reports from the EU, UNDP, and others.

Table 1: Georgian Agricultural Sector Performance

AGRICULTURAL SECTOR PERFORMANCE*					
<u>Year</u>	<u>Sown Area (ha)*</u>	<u>Livestock Numbers</u>	<u>Employment</u>	<u>GDP</u>	
				<u>Value Added</u>	<u>% of</u>
1990	701,900	4,287,000	25.2	N/A	29.7
1995	453,100	2,104,300	30.6	2,771	41.7

Figure 1: Percentage contribution of Georgian agriculture to overall GDP from 1990-2008

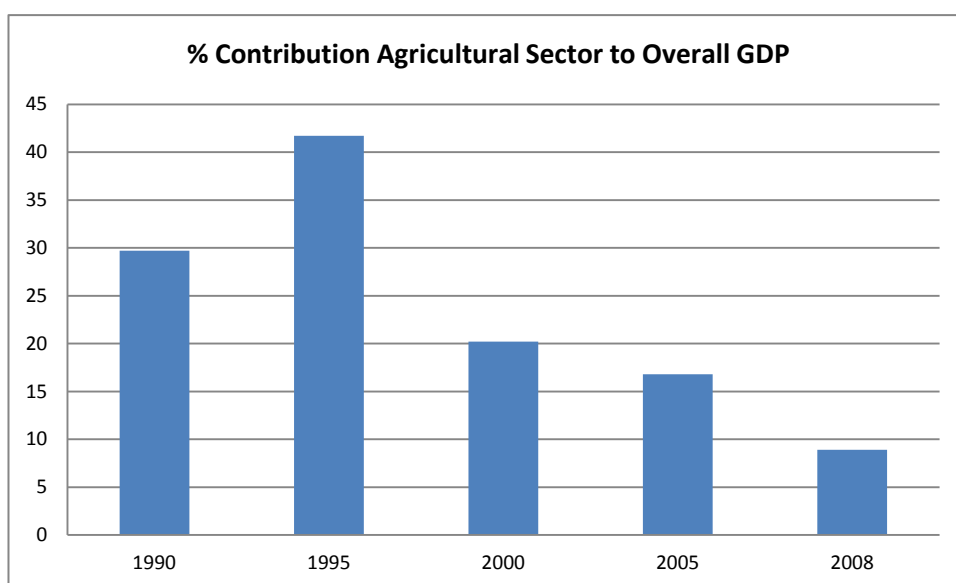
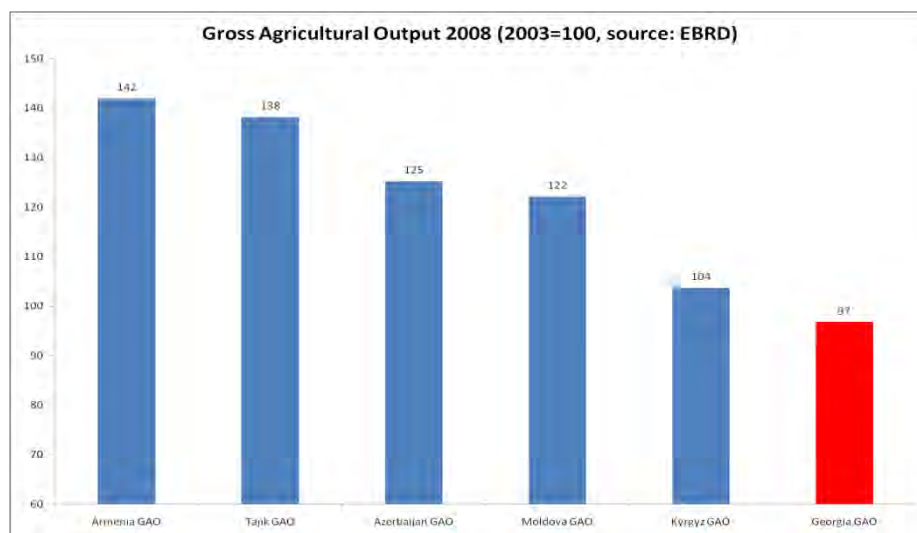


Figure 2: Georgian Gross Agricultural Output as Compared to Other Countries in Region



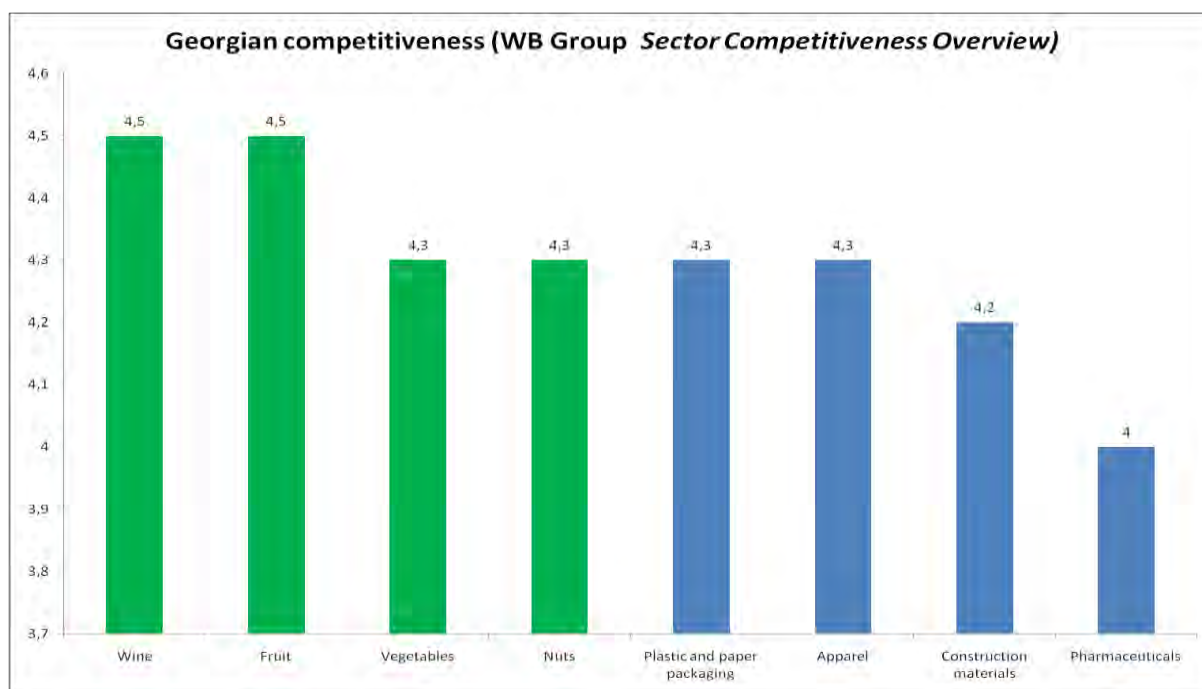
From our consultations and desk research, there appear to be several constraints that have contributed to this performance (NOTE: these are simply meant to provide context. This is not meant to be a comprehensive competitiveness study):

- Policy, Legal and Regulatory (**focus of this assessment**)
- Production Techniques and Input Use
- Infrastructure and Logistical
- Quality, Standards, and Hygiene
- Access to Technology
- Access to Financial Services
- Market Access, Information, and Knowledge

Yet, there are also performance indicators that are cause for optimism, including:

- Agriculture remains a large component of Georgian trade:
 - Total Georgian exports in 2009: 1,135 million USD
 - Total agro-food exports in 2009: 316 million USD, 28% of total exports
- Agricultural products remain highly ranked in terms of their competitiveness relative to other subsectors in Georgia. See the below graphic, which is from the World Bank Group's *Georgia Sector Competitiveness Overview, Identification of Most Promising Manufacturing Sectors and Priority Actions to Accelerate Investment and Growth: Preliminary Recommendations to Government of Georgia*.

Figure 3: Competitiveness Ranking for Agriculture Subsectors in Georgia



Policy and Enabling Environment:

From this assessment, we have noted that while there are disincentives to growth and development of the agricultural sector related to enabling environment, the reasons for the sector's lack of performance in Georgia is the result of a complex set of macro and micro economic issues, some of which are directly related to the enabling environment. Current enabling environment-related constraints to the sector's competitiveness include:

- Land fragmentation and poor quality of land ownership
- Poor state and management of key infrastructure (irrigation, market feeder roads, processing facilities)
- Limited access to financial services
- Limited introduction of up-to-date varieties in demand by the market
- Limited resources committed by the government for key support functions such as extension and research

The agricultural sector in Georgia is in need of several measures to increase competitiveness and be better positioned in domestic (through import substitution) and export markets. These include: improvements to quality of land ownership, financing, infrastructure upgrades, new technologies, and improvements in product quality. The government can put in place resources, measures, and the right incentives to promote development of the sector and attract private sector investment (domestic and foreign and of all scales). This requires a comprehensive strategy.

The MOA does not currently have a strategy in place for the sector. It has been making progress toward developing the draft 10-year strategy for 2012-2021. Its release for comment and input has been delayed; it was originally expected in the first quarter of the year. Based on our consultation with the MOA, it is scheduled to be released in the month of May 2011 for feedback by technical experts in the donor community and private sector. This is expected to be followed by a multiple-month action-planning process that will assign specific resource levels and sources to individual activity areas. This is much needed at this point for the development of the sector and to help external support from international donors to be focused, complementary and strategic.

As the sector reaches a basic level of performance and competitiveness, the government of Georgia, with input and advocacy by the private sector, should continually assess whether to consider more advanced policy measures. Advanced policy measures might be considered necessary in light of Georgia's very diverse topographic and climatic conditions, which provide excellent opportunities for niche product specialization but also complicate conduct of more or less uniform agricultural policies Georgia-wide. At the very least, this will set targets and benchmarks that Georgia will need to achieve to be competitive. We also note that the approach to development of the agricultural sector needs to focus on both large scale as well as small and mid-sized enterprises. While promoting investment in large scale operations (farms and agribusinesses) is important for attracting foreign investment, the commercial development of small and mid-sized operations provide important sources of income and rural wealth creation and ultimately, economic growth.

Input into Sector Strategy and Donor Coordination: Given the current lack of strategy and highly limited budget allocations to the sector, we did not assess or make recommendations regarding key functions of the MOA, such as:

- Extension
- Research and development
- Support to farmer organizations

We should continue to track the strategy release and play a leadership role in providing thoughtful and concrete inputs. To do this, EPI should work through the existing Donor Coordination mechanism. The Donor Coordination group has structured its five subcommittees according to the anticipated focus areas of Government of Georgia's strategy. We note that the Donor Coordination mechanism consists of the below subcommittees with designated roles for EPI highlighted below.

Composition of Donor Coordination Subcommittees

1. "Competitiveness improvement through private sector development"

Chair: EC

Members: **USAID/EPI**, Mercy Corps, FAO, IOCC, ACH, CARE, CNFA, ABCO, Czech Embassy, WB, German Business Association, Polish Embassy, Embassy of the Netherlands, Italian Embassy, SIDA, USDA, French Embassy

2. "Capacity improvement of the institutions and stakeholders involved in agriculture"

Chair: UNDP

Members: WFP, FAO, IOCC, EC, ABCO, Lithuanian Embassy, WB, GRM, USDA, French Embassy, Estonian Embassy

3. "Development of food production chains"

Chair: USAID/EPI

Members: SDC, Mercy Corps, FAO, IOCC, CARE, CNFA, ABCO, Czech Embassy, WB, Polish Embassy, Italian Embassy, SIDA, GRM, USDA

4. "Development of rural infrastructure"

Chair: WB

Members: ACH, Lithuanian Embassy, Polish Embassy, USDA

5. Food security

Chair: FAO

Members: WFP, EC, Mercy Corps, IOCC, CNFA, WB, Estonian Embassy, USDA

We also note the need for improved organization within the private sector to provide an effective voice and advocacy platform to lobby for improvements in the enabling environment in the future (in addition to the market-based incentives for forming such a group). This is important for sustainability, so that increasingly, farmers and agribusinesses can provide sector-level input outside of donor support. Certain subsectors and value chains are better organized than others. For example, an Association of Wine Growers' was established approximately one year ago. This Association represents 25 large scale vineyards. We anticipate that the EU's future programming will be focused on strengthening the organization of farmers. In response to demand, there may be a role for EPI to play in this regard – for example, to help a particular segment of the agricultural sector to create an apex association equivalent to what exists for wine. As such, we recommend that EPI's agricultural value chain component coordinate with the EU on this, by communicating the interests of the value chain stakeholders EPI is targeting directly.

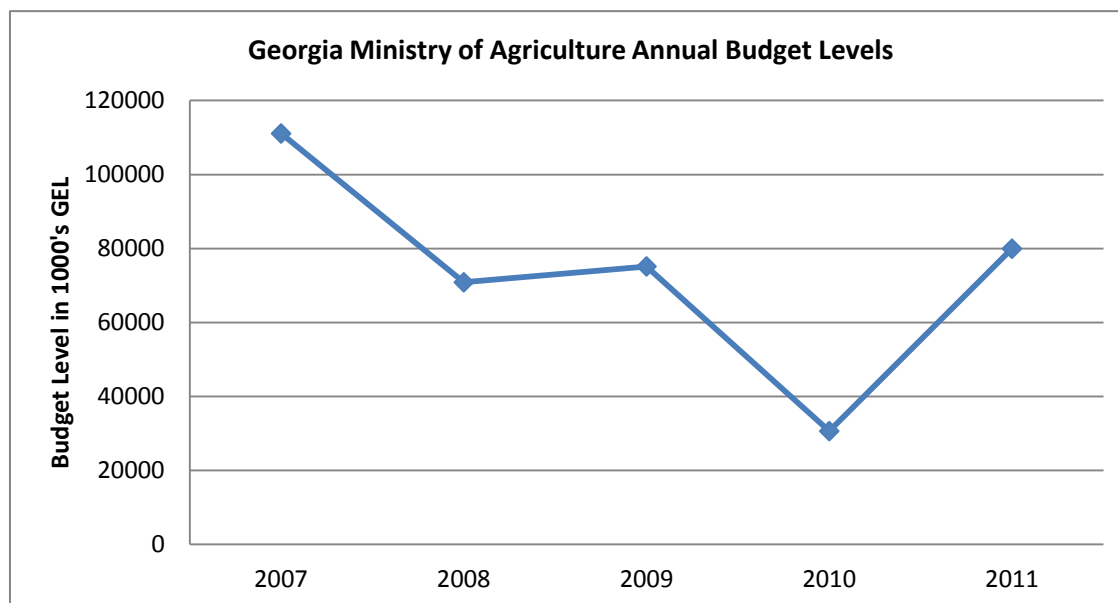
New Provisions and the 2011 Budget: despite the above noted challenges regarding a lack of strategy, agriculture has taken a higher profile within the Georgian political agenda in the past couple of years. Government officials, including the President, are discussing the issues and means to address them. This has resulted in several recent announcements of expected measures related to the sector, such as:

- The hiring of agronomists to be placed in the regions.
- The declaration by the President of the importance of Vocational and Educational Schools in the development of agriculture skills and training.
- The announcement in April 2011 of 150 million GEL budget to support the agricultural sector. It remains unclear exactly where these funds will come from or when they will be appropriated.

The 2011 State Budget Law includes (Chapter 37, MOA budget framework) a provision of 79,954 million GEL (representing a 160% increase above 2010 factual levels) for the (agriculture development programme in the regions), a provision for financing agriculture strategy-related projects². This is a positive indicator and reverses the trend of declines in this budget that started in 2007 (see below graphic). Although agriculture brought a lot of political attention in 2010, in practical and financial terms, the support of the government to the sector remains very low, not only in gross terms (i.e., as a percentage of total public spending) but also vis-à-vis the sector's contribution to the GDP and to employment. The factual share for the MOA in the national budget in 2010 was only 0.44%, which is substantially less than half of its share in 2009 and one of the lowest in the world, despite the fact that more than half of the Georgian working population is engaged in agriculture and that the sector still constitutes 9% of the GDP (not including agroindustry's contribution). As noted by a recent EU review of the 2011 sector budget: *“due to these extremely limited resources, the MOA of Georgia is unable to deliver services to the farmers and/or to streamline policies and, in general, to make any significant contribution to the sector to improve production and productivity.”*

Example: 2011 Food Safety Budget

It was reported to us that the total budget for laboratory research of food products amounts to 200,000 GEL. Given the scope of the Government's role in promoting food safety as per its own strategy, this is inadequate. We also noted from interviews with multiple stakeholders that the MOA should play more of a centralized leadership role in the planning, budgeting and decision-making related to the agricultural sector. Currently, this responsibility appears to lie, in large part, with other

Figure 4: Agricultural Sector Annual Budget Levels

Source: www.maf.ge

Additional Detail Regarding Assessment Methodology:

The assessment team's interview schedule was designed to be issue-specific (e.g., the Food Safety Agency of the MOA; NAPR to discuss land) as well as sector wide (MOA, Agrarian Committee to the Parliament). We held meetings with Tbilisi-based stakeholders as well as traveled outside to key production zones to speak with value chain stakeholders (farmers, processors, farmer and machine service centers) directly about enabling environment issues affecting their businesses. As per our scope of work and agreement with the EPI team, we targeted issues that affect the value chains selected for EPI focus. We undertook the following process to identify and prioritize issues:

- Review of overall sector performance and competitiveness
- Review of Government of Georgia strategy, planning, and resource allocations for the agricultural sector
- Identification and understanding of current status of major legal, policy, regulatory and institutional constraints
- Prioritization of target issues based on the following criteria:
 - Relates to value chains targeted by EPI project
 - Addressing the issue in whole or part is within the objectives, manageable interests, and expected results of the EPI project
 - Addressing the issue would improve competitiveness at the firm, subsector, and/or economy-wide level
- Analysis and identification of specific corrective and reform measures to be undertaken to improve the enabling environment
- Consultation with EPI and USAID to develop consensus of issues for EPI to address
- Intervention planning to allow for execution by the EPI project

Additional Issues – not prioritized by this assessment: There are a number of other enabling environment issues that affect the agricultural sector for which we have not provided detailed analysis and recommendations to EPI, because we have determined they do not fall within the manageable interests of EPI or because they have been covered by another scope of work under the project. These include the following:

- **Irrigation:** Lack of functional irrigation is a major limitation to the agricultural sector – this is arguably the major production-related infrastructure item that inhibits development of the sector and is in need of upgrading. Control and operation of the irrigation system has passed to four state-owned limited companies. There have been recent attempts to address this issue that have not been conclusive. Most notably, an investment from World Bank credit lines to rehabilitate canal systems has been suspended due to a lack of any regional level resources to maintain the systems.
- Until there is a coherent strategy on the part of the Georgian government to rehabilitate irrigation on a broad-based scale, we do not recommend EPI's involvement at the policy level. Successful and comprehensive addressing of irrigation problem, in our view, cannot be accomplished in isolation from land ownership quality issue. Until definitive boundaries are demarcated that clearly define ownership and indicate where irrigated lands are, instituting a system to manage irrigation infrastructure (i.e., secondary and tertiary canals), through either a public or private sector-led model, it will not be possible. Once the government releases the agricultural sector strategy, EPI will be able to comment on the specific inclusions related to irrigation.
- **Access to Finance:** access to credit is a constraint to the agricultural sector. The limited willingness of financial institutions to lend to small and mid-sized farmers at competitive rates inhibits their investment in upgrades and increases in productivity and production. Again, we note that land ownership is directly tied to credit access, as proof of ownership (with surveyed plot and registration in the national cadastre) is generally a loan collateral requirement (from our consultations with banks in Tbilisi). While we note access to finance is an enabling environment consideration, it is being addressed by a separate team under EPI and therefore, we refer to their report, findings, and recommendations.
- **Trade:** One of the areas that the Government of Georgia can influence is in promoting favorable trade terms for exporters through bilateral and multilateral agreements. The major consideration here is the ability for Georgia to regain access to the Russian market, following Russia's imposed embargo. Addressing this is outside of EPI's manageable interests, but we do note the strain this puts on developing export-oriented sectors in Georgia. One of the other major target markets is the EU, which Georgia has prioritized. There are substantial efforts underway to approximate policies, regulations, and standards to those of the EU (also as part of accession ambitions). The EU is providing direct support to these efforts and we, therefore, do not view this as a favorable use of EPI's BEE budget. We recommend that EPI's focus in this regard be through its value chain component by supporting firms and subsectors to improve production quality, meet food safety and quality requirements, and forge market linkages.
- **Livestock/Herd Management:** The current status of animal health and herd management in Georgia is in dire condition. The sector is significantly underperforming. There is a need for broad-based animal identification, registration, and health/vaccination campaigns plus ongoing animal husbandry services. Given

that livestock and related products falls outside of EPI's selected value chains (to which the BEE component is supposed to relate), we have not included this as a focus issue. We note that there are other donor efforts focused on this, including USDA and SIDA.

Additionally, transportation, customs procedure and agricultural insurance are issues that are being addressed by separate teams and expert consultants. Therefore, we have not addressed these directly in this report. These interventions should be considered part of EPI's overall support to an improved enabling environment for the agricultural sector. One of the recommended roles for the Ag/BEE program manager, Lasha Dolidze, is to serve as a central repository for these multiple efforts to ensure that EPI's effort are coordinated.

B. ISSUE BRIEFS

KEY ISSUES IDENTIFIED AND RECOMMENDATIONS

ISSUE BRIEF #1 LAND OWNERSHIP AND LEASING ISSUE BRIEF

Introduction

As noted in the introductory section, the agricultural sector in Georgia has seen significant decline in production levels as well as exports since the Soviet era. In 2008, the sector represented 9% of GDP as compared to over 40% in 1995. Import levels of fresh and processed food, meanwhile, have increased dramatically. Food and agricultural exports in 2008 were only 25% of imports vs. 70% in 2005 and 170% during Soviet times³. We believe that one of, if not the major areas influencing this decline, is the status of land ownership in the country.

The land privatization and reform process in Georgia began in 1992. It has had several iterations; been governed by multiple laws; instituted by multiple agencies and systems; and received extensive support from multiple donor agencies. As per the scope of work of this assignment and given that this issue was raised as one of, if not the primary constraint to growth and development of the agricultural sector by public, private, donor, and non-governmental actors in Georgia, we have chronicled the relevant events over time in order to understand what has occurred to date. This is especially important to do, given how complex the history of this issue is and to provide the readers of this report a uniform understanding of it. In addition to multiple interviews with government, private sector, NGOs (APLR, GYLA, Transparency International), and donors, we conducted an extensive document review.

One important document we reviewed was **USAID's LMDP Final Report** dated October 2005. This was the document we identified that provided the most comprehensive and clear chronology of events related to land ownership and therefore, we have taken the time to summarize its findings. The following section is a summary of the key activities and results that are primarily taken from this report, which also serves as a timeline of major events in the land ownership system in Georgia since 1992. We have bolded words or phrases that we determined to be particularly important and relevant.

Brief Summary of Events

In 1992, Georgia began a “small parcel” land reform process via the distribution of land parcels and leasing of land. The land reform program was intended to create a self-maintaining sector of “**subsistence-oriented small farmer and a market-oriented sector controlled by larger leaseholders**”. The process began with a privatization fund that included an estimated 763,000 hectares⁴ of agricultural land, which were technically “transferred” into private hands. Land was transferred by means of certificates, which in and

³ UNDP Green Fields Report, David Land.

⁴ Figures on hectareage transferred during this process are taken directly from the UNDP, Green Fields Report and the Third Draft of a 2006 contribution to The Georgian National Food and Agriculture Strategy: 2006-2015.

of themselves gave the individual holder the right to own a predetermined amount of land but did not provide actual title to a specific unit of land (location with defined boundaries)⁵. The average size of these privatized agricultural landholdings varied from 0.3 hectare in districts with a low land-man ratio to 1.25 hectare in districts with more available land. In many cases, individuals received 3-4 separate parcels, constituting their total allocation. Through this process, individuals were to receive “Land Receive and Delivery Acts” from village-based land commissions to document this acquisition of land. Another 464,000 hectares were retained by government, although the majority of this land was made available for lease to farmers. (this is discussed in more detail below).

- While this formal 1992 transfer was instituted, the process remained incomplete, leading to chaotic land management systems and low quality of land ownership. As noted, due to inadequate surveying and mapping, most farmers could still not demonstrate the legal boundaries of the land they owned without paying expensive surveying fees. Without such documentation, the land could not be easily sold or used as collateral to secure production or investment credit.
- **1997:** USAID support to the privatization process began in 1997. At the time, no unified legislative framework was in place to govern the process. The primary government agency in charge was the SDLM.
- In 1997, APLR, under a Eurasia foundation grant, completed a comprehensive inventory of land-related laws and normative acts.
- Under this project, APLR conducted further analysis of the legal framework as a necessary precursor to starting land management reform interventions.
- **1999:** As a result, the following was passed: Order of the President of Georgia No. 327 “On Urgent Measures for the Initial Registration of Agricultural Land Ownership Rights and Issuance of Registration Certificates to Citizens of Georgia” (later abolished by Law of Georgia on Registration of Property Rights on Immovable Property. 05/11/2007/#4741). This reduced paperwork required to register land and created a certificate confirming right to ownership. This effort was clearly meant to remedy the results of the original 1992 process.
- Based on this decree, initial registration was declared free of charge and at the same time, parcel mapping began to be carried out using simplified methods for the purpose of accelerating the “initial registration” process.
- **1998:** Under the USAID project, APLR began the surveying and issuance of certificates in two rayons through support to local registration offices.
- With the field work completed in the Zestaponi Rayon, a ceremony was held in Zestaponi on May 26, 1999, where the President of Georgia personally presented ownership certificates to the new landowners with U.S. Ambassador in attendance.
- World Bank also began a pilot activity for land cadastral work in two rayons. UNDP and KfW also initiated projects related to land reform.

⁵ It was noted to us that a relatively small percentage of the landholders from the original 1992 privatization process did manage to have their land parcels surveyed and have been able to use the resulting documentation for contemporary registration. This process was expensive and so; few managed to have it done.

- USAID pilot then expanded to additional 40 rayons and completed public awareness and education campaign and played a role as a catalyst in this land market activation process (helped formed brokerage companies that provided services free of charge).
- **2001:** The USAID-funded Georgia LMDP commenced working with APLR to register an additional 1,400,000 parcels, issue registered certificates, and thereby, provide “secured title”. Between the 1997 project and LMDP in total, 2.4 million plots were reported to have been registered initially. Also included in LMDP’s objectives were to conduct public awareness and contribute to land market development.
- LMDP methodology for registration: APLR worked through subcontractors to hire “surveyors” and other experts to complete initial registration. “Cadastral maps” were developed to replace the initial “Land Receive and Delivery Acts” from the 1992 process.
 - Using geodesic tools, subcontractors completed the following, as cited by the final report:

“surveying and mapping of privatized agricultural land parcels, the preparation of parcel index maps, the preparation of registration cards for each parcel indicating the owners, and the preparation of registration Journals and base maps.” These materials were provided to local Registrars.
- **2003:** LMDP received a two year extension. This extension had the following objectives:
 - Complete a “quality assurance” program for the initial registration of agricultural reform land.
 - Develop, test, and revise regulations for implementing the law for the privatization of remaining state-owned agricultural land.
 - Develop the real estate market institutions.
 - The project also included an objective to work with KfW to carry out initial registration in Adjara.
- LMDP worked closely with SDLM and provided them institutional support to reorganize.
- Subsequent Quality Assurance program began under LMDP and was designed to correct mistakes made in the registration and cadastral process.
- Harmonization across donor-funded efforts: Several donor-supported projects carried out land survey and registration activities in Georgia using different technologies and procedures. USAID LMDP and KfW Land Cadastre and Registration Project were two of the largest efforts. We do not know what the exact scope of the KfW programs were, but it appears that both USAID and KfW worked in the same sakrebulo. Problems existed that “prevented the practical use of the data” across the two programs, including the lack of a unified cadastral mapping and the lack of a uniform database.
- To correct this, KfW contracted APLR to integrate the cadastral information of the two processes.
- **2004:** With close cooperation of LMDP and new management of SDLM, and as a result of consultations with the Georgian government, on June 1, 2004, the Law on Public Registry was adopted. Several important achievements resulted from adoption

of this law as it provided basis for reorganization of SDLM into the NAPR. In accordance with the same law, Bureaus of Technical Inventories were abolished and their archive of information was handed to NAPR.

- **2004-2008:** NAPR issued additional “titles” based on local maps, but no electronic national cadastre yet existed (see following bullet points).
- **2007:** Another push was in made in 2007 by the government to improve the laws related to land and property ownership and secure titles for rural citizens. The Law of Georgia on Declaration of Private Ownership of Land Used by Natural and Legal Persons of Private Law was adopted along with the cancellation of the 1999 Presidential Decree that had led to the disbursement of 2.5 million registered certificates under LMDP. Subsequently, Property Rights Declaration Commissions were established in municipalities. Thus, from this time onwards, ownership was recognized officially only with entry into the NAPR centralized cadastre (this system is not linked to the preexisting cadastral maps at the rayon level, according to our understanding and research).
- **2008:** KfW supported the development and instituting of a national cadastral system housed within NAPR. NAPR worked to audit the rayon-based information that existed from these past efforts to make the information as usable as possible with any new requests to register land.

Assessment Team Conclusions

Based on the above information from the LMDP 2005 Final Report, it appears that, as of 2005, principal donors and Government of Georgia had concluded that they comprehensively addressed the agrarian land ownership issues. The opinion was that individuals holding registered certificates, recognized by the local government, constituted having constitutional ownership under Georgian Law. However, by 2007, it seems that the Government of Georgia, through its 2007 legislation, determined that the issue of clear, transparent, and constitutional ownership of land was not fully resolved.

With a great majority of land not appearing in the national cadastre now in place, this raises a significant concern about the transparency of land ownership and land markets in Georgia. This has a broad-based impact on the agricultural sector in Georgia and impedes achievement of EPI’s objective to promote increased competitiveness of the agricultural sector in Georgia⁶. Conversely, addressing the issue could substantially contribute to the project’s expected results (see below). Finally, as we note in more detail below, larger scale investments in agricultural land in Georgia may be complicated given the fact that within the framework of current system, it is rather difficult to establish clear boundaries between land belonging to the state and private sector, as well as boundaries between land plots belonging to private sector representatives. As such, we believe the land ownership transparency issue will also tend to impact foreign direct investment.

⁶ We acknowledge that several other factors will also need to be addressed to achieve growth and competitiveness of the agricultural sector in Georgia. These include, for example: technologies, infrastructure, access to finance, and increased access to markets.

Our in-person consultations identified that the transfer of true land ownership to Georgian citizens based on the system and legislation in place in Georgia today has been inconclusive in the majority of cases. Initial certificates issued in 1992 and later, registered certificates issued after 1999 (under LMDP and other efforts), were reported to us as lacking coordinates and legal descriptions (again, certain individuals did attain the required documents from the 1992 process that are recognized today). Currently, based on our interviews, the estimated volume of officially registered agricultural land entered into the national cadastre varies within the range of 9%-30%⁷ of the total. All other land, by default, could potentially be interpreted as owned by the state under Georgia's Civil Code. NAPR and the local registrars we met with in Akhagori and Mtskheta⁸ (see meeting notes in Annex C) reported that the data held at rayon-level registrars (from earlier efforts such as LMDP) could not be reconciled with the national system, because they do not contain clear legal boundaries (e.g., Global Positioning System (GPS) coordinates). Private sector actors confirmed this, as did APLR. In these cases, larger land areas are demarcated by yellow boundary lines, within which individual parcels are indicated. However, the individual parcels do not appear to have descriptions of legal boundaries. The parcels in the national cadastre, by contrast, have borders defined by GPS coordinates and are demarcated by red lines. NAPR and the local registrar offices do not appear to be able to reconcile the land areas outlined in yellow with the national cadastral system. Therefore, they remain two separate sets of data until an individual has a plot surveyed and registered with NAPR.

We studied several registered certificates issued under LMDP and other previous initiatives and also confirmed that they do not provide clear definition of legal parcel boundaries. Based on present day legislation, this effectively means that the land is not owned in the legal sense by these occupants. Further, ownership is only recognized if individuals have their plots surveyed (through an additional, subsequent process to the one implemented under LMDP, described above) and registered with NAPR. However, survey and registration costs currently average approximately 300 GEL per 1

On Topic of State-Owned Land:

“It is not necessary for the Government of Georgia lands to be registered, because, by default, anything not registered on the map reverts to the ownership of the state”.

Defining Quality of Ownership

For purposes of this discussion, the term “quality” of ownership describes the possession of land and the compliance of that possession to all laws, rules, and regulations. Therefore, the highest quality of land ownership would be that, that conforms and is directly protected by the Georgian Constitution with respect to ownership rights.

The government can distribute agricultural land and it can be sold, but the quality of ownership to the farmer is limited if adequate documentation does not exist to show proof of that ownership and the legal boundaries of the plot. Without such documentation, land cannot be securely sold, transferred as inheritance, or used as collateral to access credit from a bank, and is de facto owned by the state in accordance with 2007 legislative.

⁷ This figure is an average figure we estimated based on discussions with stakeholders including APLR, NAPR. This % is of the total land originally transferred to private ownership in 1992.

⁸ EPI Agricultural Policy Manager, Lasha Dolidze, met with Mtskheta Akhagori and Mtskheta Registrars on May 13, 2011.

hectare plot, which is very expensive, if not prohibitive, given current income levels of rural households. In addition, our understanding is that many citizens are unaware that such limitations exist to the current status of their land ownership.

Specific risks to land ownership in Georgia based on this present day system include:

- Occupation and claims to land by private citizenships of questionable legalities. Currently, the system provides ownership on a first-served basis, according to whichever individual surveys and registers a plot first. This has led to a number of boundary disputes among individuals and with larger enterprises.
- Difficulties of distinguishing between state-owned and privately-held land: There have been a number of recent cases of the Government auctioning land to private investors to develop, in substantial number of cases, tourism-related infrastructure, such as hotels and ski resorts. Because few land boundaries are clearly demarcated in the national cadastre, the government may be unintentionally selling land belonging to private citizens. Given the current situation, cases of auctioning land plots not belonging to the state might substantially increase in number given the government policy to attract investment in key locations.

Given the information we received from the multiple sources noted above, we determined they have raised the following questions regarding land ownership in Georgia. We raise these questions, because having answers to them would help advance effective solutions. First, we think that it is necessary to thoroughly analyze the affect of the 2007 reform legislation to the processes occurring before 2005. Second, the obstacles to incorporation of rayon-level cadastral systems with NAPR national cadastral system should be established and analyzed to determine whether the obstacles are technological institutional. Third, the cases associated with problems related to purchase and sale of land, as well as boundaries enforcement problems, should be studied to determine potential legal/regulatory deficiencies thereof. In light of an apparent increasing number of disputes, it should be determined whether the current legal/regulatory framework should be upgraded and government officials in charge of protecting and enforcing property rights be trained. Finally, it is crucial to build a transparent and secure land market, with incentives for land consolidation into economically viable sizes.

The current situation serves as a substantial burden on market-driven consolidation of agricultural plots into larger, more efficient blocks⁹. The most attractive option for consolidating land appears to be with the use of state-owned land. We would suggest that addressing this issue will require a commitment and effort on the part of the public sector. Addressing the shortcomings of the land tenure system in Georgia is an essential precursor to realizing any real investment, growth, or development of the agrarian sector for small to medium-sized farmers. Further, sustainable wealth creation for Georgia's rural citizens depends on the reparation of this issue.

Negative economic impacts include:

- limits development of land markets
- limits capital investment

⁹ We note that other issues affect consolidation levels, such as tax policy that incentivizes cultivation and disincentivizes holding for speculative purposes.

- prevents market-based consolidation from taking place
- makes it difficult to accurately account for tax revenues
- lowers productivity by creating disincentives to invest in productive assets (e.g., new orchard material)
- is detrimental to public infrastructure
- limits the ability to transfer water user rights

Affecting Access to Finance, Productivity, Income:

Increases to the production capacity and income levels of Georgia's farmers will come from an improved land tenure system through the security and ownership structure, consolidation, and development of capital markets. Having a title to land can be associated with increased farm output for two specific reasons. On the one hand, access to credit may require the use of land, to which there is secure title, as collateral. The second way through which title affects output is by increasing (or decreasing) the landholders' tenure security and, thus, the incentive to make investments tied to the land, whether credit-financed or not.

The Moldovan Experience

Since the privatization of Moldova's state and collective farmers, the sector has experienced significant foreign and domestic investment. The exact amounts are difficult to attribute entirely to improved land tenure, but they total in the hundreds of millions of USD. Highlights include wine (Russian, Italian, German and Austrian investors); dairy products (US and Dutch investors; and HVA US, Italian, and Turkish investors).

Assuming the Georgian economy begins to create jobs to which some farmers can move into (as the agriculture sector becomes more commercialized), the system of land ownership in Georgia needs to be prepared to facilitate the sale or lease of land, so that remaining farms can become more efficient and productive.

Generating Capital Investment in Rural Land Markets: There is tremendous wealth and investment currently untapped and locked-up in Georgian's rural agricultural land. At present, there are roughly 700,000-800,000 hectare of agricultural land under private holdings in Georgia (Geostat). Again, as reported to us potentially up to 90% of these holdings or a total of 630,000-720,000 hectare are not registered in the central cadastral system¹⁰. Only by extension can the actual economic value of this land be considered private investment in the agricultural sector unless and until it is registered. The government appears to be selling its land at values between, approximately, \$500-\$2,000 per hectare (based on our consultations with officials and posted auction prices). The world price of class 1 and class 2 agricultural lands is multiple times this value on average. Therefore, the registration (and therefore, legalization of ownership) of this land represents the addition of equity capital/investment to the agricultural sector. For example, 560,000ha X \$500 = \$280,000,000.

In our estimation, responding to this challenge will require the buy-in of the Government of Georgia significant resource commitments, and the use of local implementing partners. A comprehensive response to this issue would require achievement of the following results:

¹⁰ All figures included here are based on Geostat data sets and our interviews with stakeholders. We have requested more precise figures from NAPR and as of the time of this report's submission, had not yet received the data

- Laws, policies, and codes that ensure transparency of land ownership will unlock the unutilized economic value inherent in rural land.
- Competent public sector capacity will enforce land ownership quality compliant laws, policies, and codes.
- Cadastral maps will be in place at national and local levels documenting surveyed and registered land and land ownership, including land plot boundaries, easements, natural demarcations (rivers and streams), and public demarcations (public lands, roads, and other right-of-ways).

Additional Background

To understand this issue in Georgia, one must first understand the basic distinctions between categories of agricultural land in the country (also see tables and graphs below). The first type are those lands that belong to the state, some of which had been leased to private citizens (beginning with the initial '92 privatization process, which is described in more detail below) and others were retained by the state. All leases were scheduled to have ended by May 1, 2011. Lessees have the option to buy out their leases and maintain ownership of the land. In cases where they opt out of this, the state is auctioning the land, through which Georgian citizens and foreign investors are eligible to bid. The second category consists of those lands that were originally transferred as private holdings during the 1992 process. Without both of these areas fully mapped and entered into the national cadastral system, it is impossible to verify:

- Where, specifically, the government-owned lands are located. As it stands, all land not entered into the map is by default, vested in the state.
- It is also impossible to verify where the boundaries of individual plots are, and therefore, to determine which of the above two categories a particular parcel of land falls into. Then, within the second category, it is impossible to determine where the boundaries of one citizen's plots are versus another's.
- Land appears to be extremely fragmented. Approximately 800,000 hectare are divided into more than 2.5 million parcels.
- Finally, this situation hinders the ability to know how much land is being farmed.

Land Fragmentation, Consolidation, and Functional Market: When allocations of land were originally made in 1992, there was a high level of fragmentation as farmers often received noncontiguous parcels of differing quality land. Not only was average farm size generally small to start with, it's functionally was much smaller due to this approach. This was due to a lack of formality and criteria of land allocations to shareholders. This has led to multiple problems. First, it is estimated that as much as 10% of land is not cultivated because of lack of access roads between these small parcels. Further, this discourages consolidation within the private system¹¹. The easiest way for a farmer or investor to accumulate land is to purchase from the government. To attempt the same within the private system is time consuming, tedious, and uncertain, given the small sizes of individual plots and lack of defined boundaries within a cadastral system. In the absence of available land from the government, purchasing within the market place is likely to remain very limited. It should be

¹¹ While ongoing land consolidation is hampered, we also note that an estimated 40% of farmed land is held by 16,000 farmers on plots of 4HA or more. This constitutes only 2.5% of farm plots in Georgia.

understood that land titling as such is a public function and cannot be supplemented by market forces only. The overwhelming majority of land plots remain unregistered today clearly supports this principle.

The census in 2005 reported 726,021 farm holdings with an average size of 1.37 hectares. Included in this were nearly 140,000 holdings with less than 0.2 hectares, which were essentially residential garden plots. When these smallest holdings are excluded, average farm size is approximately 1.6 hectares but with over 360,000 holdings still having less than 1 hectare. At the other end of the spectrum, 16,000 farms of 4 hectares or more controlled nearly 40% of all farmed land in Georgia. The LMDP final report indicates a 10-fold increase in sale transactions of agricultural land parcels between 1999 and 2004. The 5,518 agricultural land transactions registered in 2003 constitute 0.3% of the total land parcels initially registered in that year. While this data offers some optimism regarding the consolidation of land in Georgia to date, there is clearly a need for a more active and functional land market, something that the LMDP final report itself notes (see page 46).

This also raises several questions regarding the system and how these transactions have been handled (again, if EPI decided to include interventions related to this issue in its work plan, answering these questions would be highly beneficial):

1. Are the plots related to these transactions entered into the national cadastre? From looking at the cadastral map on line, it is hard to identify this quantity of plots of 4HA or more in the system.
2. If they are not in the system, sales are taking place without full ownership title. Does this create uncertainties around land value and the legitimacy of these transactions?
3. Is this having an impact on the land market?

We also note that we made a formal request to NAPR for basic information regarding the number of plots currently registered per rayon and their average size (mean and median) to correlate these plot size figures with what is currently entered into the national cadastre. As of the time of this report's completion, we had not received these figures.

Taxation: The new tax code adopted in 2004 incorporated agricultural and nonagricultural land into the property tax system. However, there are ways the current tax code (developed by September 17, 2010, and enacted on January 1, 2011) could further promote increased productivity of agricultural lands, such as increasing land tax on uncultivated plots in order to pressure owners (e.g., holding plots for speculative purposes) to cultivate their plots, lease/sell their land, or contribute additional revenue to the state. However, the ability to effectively instate such measures is severely hampered by the lack of ability to verify ownership.

Cases of Losses of Land by Private Individuals: Recently, there appear to have been cases where the government appears to have acquired privately owned land without giving proper compensation to those involved. These cases have occurred with both registered and nonregistered land. There are numerous challenges pending in the courts regarding these cases. Some cases like this may be judged as unconstitutional. Others may be justified as constitutional, based on the flaws in the original decrees and deficiencies governing land certificates. As discussed earlier, this paper aims at suggesting creative solution to the problem by bringing together the key players in the field with substantial policy, institutional, and technical expertise. A number of local organizations are already in the process of addressing several of these cases, such as Transparency International and The Georgian Young Lawyers Association, supported in part by the Open Society of Georgia. We note

this as important context and argument for rapidly addressing the large, outstanding balance of land possessed but not officially held by private citizens.

Stakeholder Identification:

Stakeholder Name	Specific Divisions/Role in the process
1) Legal and Executive Authorities of Georgia	<ul style="list-style-type: none"> • Parliament, Agrarian Committee • Prime Minister's Office • Ministry of Justice, National Agency of Public Registry • MOA • Ministry of Economy • National Public Registry • Office of Public Defender
2) Potential donors	<ul style="list-style-type: none"> • USAID • European Union • Open Society of Georgia • Other Potential
3) Implementers and subject experts	<ul style="list-style-type: none"> • Association for the Protection of Landowners Rights • Georgian Young Lawyer's Association (GYLA) • Transparency International • Georgian Regional Media Association • Association Green Alternative

Constraints

We have identified a number of constraints within the system that need to be addressed:

Costs: The full cost of land registration varies depending on the size of the plot. For each plot, despite its size, a 50 GEL registration fee and a 1 GEL transaction fee is charged. An additional survey cost is charged by a private surveyor of approximately 250 GEL per hectare (prorated for smaller plots). This gives a total per hectare cost of approximately 300 GEL. This is as much as 35% of the per hectare plot price at which the government appears to be selling land. For current farmer incomes – from a 2004 IFAD study, income of agricultural workers in Georgia could have been as low as 600 GEL per annum this is exorbitant and even prohibitive. In order to mobilize and accelerate a major transformation of agricultural land registration, the cost per unit would have to first be adjusted down. One method that would undoubtedly assist in reducing cost would be for communities and multiple landowners to apply for registration of larger areas simultaneously. This would work more efficiently for surveyors.

Lack of Accurate Information: There is clearly a lack of understanding on the part of rural households as well as local government officials and land commission members as to what the laws and protocol are related to land titling and ownership. Citizens need to have an increased awareness of the importance of having land registered; how the process works; their rights; and the resource they have available to them in case of encroachment on these rights.

Institutional Capacity: It was reported to us that the local land commissions and local government authorities in Georgia have had minimal to no training in their roles, level of authority provided by relevant laws, or the regulations and processes for managing land registration – for which they are responsible. This has led to inconsistent application of rules and regulations and disorganization of the system.

Legal and Regulatory Implementation: From the standpoint of the individuals we met, there are limitations in the provisions of laws and regulations, but also in their implementation and enforcement. For example, the land commissions operating at local level apparently lack technical expertise and manuals that could provide clear and precise guidance in their operations.

Rationale for Inclusion in EPI Policy Component Work Plan:

Broad-Based Impact: while firm and farmer-level interventions are important, establishing a secure and organized land market has the potential to have a broad-based impact: both in terms of scale (number of households and rural businesses positively affected) and depth (potential to unleash revenue and open capital markets throughout the country). Addressing the issue of land ownership in its current state would have transformational impact socially and economically, in terms of transfer of wealth, increases in growth, and investment promotion. Important econometric studies conclude there is a clear positive link between formal land titling and investment to agriculture, as well as efficiency of production and increase in number of farm jobs in such diverse places as Vietnam and Brazil.

Mitigating Risk: There has been an apparent surge in publically reported cases of land disputes in Georgia – particularly around foreign investments that involve use of those land areas. We note that EPI should make sure that any facilitation of foreign investment that it provides should include due diligence around this issue to make sure there are no potential conflicts involving local landholders.

Catalyst and Precursor for Other Issues: We view an organized and sound land tenure system and a high quality of ownership protected by law (in principle and practice) as a necessary precursor to achieving other economic priorities, including EPI's high level results:

- stimulating domestic and foreign investment
- mobilizing access to credit
- increasing productivity through consolidation and incentivizing farmers to invest in their lands
- developing infrastructure in the agricultural sector
- having accurate census data and statistics for purposes of planning and decision-making

Existing Expertise in Country: There are a number of organizations in Georgia that are already focused on property and land ownership rights, including those noted in the stakeholder Identification table above. They have developed thorough expertise on this issue and offer a base of implementing partners through which to tackle it.

Resources/Cost-Benefit Analysis: Other donors, such as the EU and **OSI** and other international donors, have the potential to contribute complementary resources as part of a joint, concerted effort. Working through the local NGO partners offers a cost effective vehicle

for implementation. These factors, combined with the potential to achieve tangible and broad-based results, offer an attractive cost-benefit ratio.

On the part of farmers, when registration is complete, Georgian rural citizens numbering in the 100,000's will be able to impute real market value for their land holdings.

Conclusion: Broad-based progress within the Georgian agrarian sector will not be accomplished, except on a case-by-case basis, until this issue has been addressed.

Recommendations

We recognize that fully addressing the above situation on a national level is outside of EPI's manageable interests and resource capabilities. This being said, we also see this issue as directly responding to EPI's stated goal (see text box), given its ability to affect firm, industry, and country-level competitiveness. Formalization of agricultural land ownership is necessary to lay the foundation for sound agricultural policies and induce market driven consolidation. As noted already, it will be important to first begin with a detailed assessment at the rayon level of the systems that are currently in place and to fully understand the gaps reported to this assessment team and understand all possible solutions that are available.

Goal of the EPI Project

The goal of USAID's Georgia EPI is to improve enterprise, industry, and country-level competitiveness by targeting key external and internal factors to enhance the growth rates and productivity of enterprises, thereby enhancing the economic well-being of Georgians. EPI will improve the competitiveness of agricultural and nonagricultural value chains, and support this work with targeted policy and business enabling environment reforms.

Strategy #1: Thought Leader: This would include the following intervention areas:

Strategic Working Group: Organize and chair a working group composed of donors, relevant Government of Georgia entities, and private sector and NGO representatives. The primary responsibility of this group, led by EPI, will be to establish a working strategy/project design, which is acceptable to all parties (particularly to the Government of Georgia) and to launch such a strategy, so as to reconcile land ownership issues and consolidation, to the extent possible. This action plan will contain specific roles and responsibilities of government agencies, donors, and NGOs and specific timelines for the accomplishment of all tasks associated with resolution of the issues. Specific responsibilities and activities would include the following:

- *Development of an econometric model* quantifying the economic value of achieving quality land ownership in EPI target areas and nationwide.
- *Comprehensive review of land ownership*¹² including the history, legal and regulatory environment, and specific constraints to land quality ownership in the following areas:
 - Laws, decrees, and codes related to land ownership and leasing.
 - Reports and analysis to date related to land and property rights.
 - Work to date related to land tenure in Georgia as well as of regional and international precedent for land ownership systems and reform.

¹² This review has been substantially addressed under this scope of work. If this activity were selected, we would need to undertake gap-filling and augment our information.

- Value chain stakeholders (farmers, agribusinesses, investors, banks) to understand practical application and implications of rules and regulations.
- *Analysis of enabling environment* including an analysis of each legal, policy, and regulatory framework and environment; identification of adjustments to these items required to affect quality land ownership; recommendation of specific courses of action and resources required to make adjustments; and as needed, specific input into any drafting of revised laws required.
- *Assessment of institutional capacity* required in land commissions and other relevant institutions (i.e., NAPR) to affect quality land ownership; specification of capacity enhancements required to effect quality land ownership; and recommendation of specific capacity strengthening plans for addressing weaknesses.
- Work with government and private sector to develop cost-effective models for land registration.
- Develop a communication and community awareness campaign that could be easily rolled out by the government and/or other stakeholders.
- Develop operating manual for local land commissions and the training materials required for training commission staff on the operating manual.
- As appropriate, provide training of trainers for implementing organizations.
- Support the Ministry of Sustainable Economic Development efforts on state property management system implementation. This includes organizing and managing state-owned land.

Strategy #2: Targeting EPI's value chain-specific farmer and agribusiness beneficiaries. This would entail the following:

- Assessment of beneficiaries' land ownership, including leasing for land use purposes.
- Development of a standard information brief re: the issues related to land ownership and the importance of having land officially registered.
- Incorporate these topics into technical service delivery package and provide assistance with registration in response to demand.
- As needed, link individuals and firms to NGOs to resolve issues (APLR, GYLA) related to boundary dispute

Strategy #3: Targeting a Specific Region: This strategy includes ensuring the full registration of land holdings for a designated region. This would serve as a model that could be replicated in additional locations, based on available resources on the part of the government and donor community. Specific steps would include:

- Working with local land commissions, other local authorities, former arrangers, and other key stakeholders conduct an assessment of the status of land ownership in the particular region. This will identify the land owned by the state vs. the private individuals (entered into the central cadastre vs. not) and any areas currently under dispute.
- Working with NAPR and other national bodies; train and work with local authorities to ensure that their systems are in place to properly handle the influx of additional registrations.

- Work with government and private sector to facilitate cost-effective means of registration (group registration, possible one-time subsidy on part of government).
- Conduct an awareness campaign with landholders within the region.

IMPORTANT NOTES:

- The above strategies #s 2 and 3 emanate from the effective completion of the first strategy, which sets up the conditions and environment around which registration can be facilitated.
- It is expected that increases in officially recognized registration that results from strategies 2 and 3 above would generate demand among neighboring farmers and agribusiness and would begin to create a ripple effect.
- These three options are not mutually exclusive and could be done in concert with one another.

ISSUE BRIEF #2: TAX CODE AND ACCOUNTING STANDARDS

Introduction

There are multiple areas related to taxation that impact the agricultural sector in any country. These include property tax, income tax, input VAT, customs and duty related taxes, and accounting standards. From a review of each of these areas with value chain stakeholders and subject matter experts, we have identified the following constraints, where modifications could improve performance and incentivize development and investment within Georgia's agricultural sector.

1. VAT application: The inability of companies in Georgia to file and reclaim VAT (at 18%) from certain purchases of primary production (primary producers are exempt from VAT) materials serve as a disincentive for processors and retailers to purchase inputs domestically. For example, for a milk processor purchasing fresh milk from Georgian cows, this effectively forces them into taking a loss of the 18% upon sale to a retailer or passing this burden on to the farmer. Adjusting the VAT policy of the country would better incentivize purchasing of domestically produced materials across several sectors.
2. Amortization schedule for bio assets: According to the accounting standards of Georgia, bio assets are defined as living animals or plants (from adopted International Accounting Standards clause 41.5). According to the tax code in Georgia, bio assets must be fully expensed in their first year of ownership. This prevents a farmer from exercising the option to depreciate the asset over a schedule that favors their revenue generation in latter years and allows them to offset their tax liability. This is particularly unfavorable for small and medium-sized farmers planting new perennial crops. This does not apply to machinery and equipment for which the individual or legal entity has the option to fully expense in the first year or to depreciate at a rate of 20% (starting from the calculated "salvage" or first year residual value).
3. As we have been informed from our field interviewees, tax payments at the processor level are not based on sale levels, but rather units of production. Further, taxes are valued based on the maximum or ideal capacity of a processing facility. Average losses are not factored in. So, for example, if the plant purchases 1 million bottles for a juicing business, but experiences losses during production, they will still pay taxes based on the 1mn bottle capacity. This can result in a tax burden that is incongruent with output levels.

Recommended EPI Interventions: The below interventions can be managed by EPI's BEE/Ag Sub-Component Manager with technical assistance from a tax expert (we have already identified Naira Kharkheli, as an appropriate individual) to review the specific sections of the tax code and developed the detailed recommended adjustments. This should be coordinated with EPI's overall activities related to taxation.

- Identify specific impediments to filing for VAT returns on purchases of primary produce in order to allow for reclamation of VAT refunds on such purchases.
- Assemble and propose specific revisions to the appropriate clauses of the tax code (*Book V, Income and Profit Taxes, Article 111, "Depreciation expenses and deductions according to fixed assets"*) and accounting standards to permit more favorable depreciation of bio assets by farmers.

- With these adjustments made, incorporate these concepts into BDS-related technical assistance provided to farmers under EPI's Value Chain Component and provide this feedback to the donor coordination committee.

Other Noteworthy Points:

- Up to January 1, 2010 income received from initial supply of agricultural products, is not taxed if such income does not exceed GEL 200,000 during a calendar year.
- We also note that several stakeholders raised concern over potential for double taxation with respect to the establishment of cooperatives. The concern is that income tax will be applied to earned revenues at the firm and individual levels. Given the importance of increased organization on the part of farmers to achieve economies of scale and increased competitiveness (through activities such as collective purchasing of inputs, bulking of product for marketing purposes, storage of crops, and transportation), this needs to be reviewed in light of the pending, revised cooperative law, so that the tax code provides appropriate incentive measures to help facilitate this increased organization. We note that other donors are expected to be focused on strengthening farmer organizations and will be focused on the content of the cooperative law. Therefore, EPI should work in coordination with them to develop appropriate recommendations and support any needed reforms to the tax policy.
- Finally, we note that the Government of Georgia raised property tax levels in 2011 from 50 GEL to 100 GEL per hectare on a per annum basis. The exact rate depends on the administrative unit as well as the quality of the land. Local government can increase these rates by up to 150% based on a series of criteria. Note that a different set of rates are applied to pasture land (1.5 GEL to 20 GEL). We note that such increases can provide positive incentives to land holders to maintain productive lands. This is particularly important in the face of the (estimated) large areas of lands that are being held for speculative purposes, hedging against anticipated increases in land prices. However, before such measures can be applied as part of a comprehensive strategy, the more substantial issue of land ownership needs to be addressed.

ISSUE BRIEF #3: TRUE LEASE PRODUCT

Introduction

The purpose of this briefing is to present a leasing product that could target the agricultural sector in Georgia, which is currently underserved by leasing companies operating in the country. The EPI project has an effort underway to reform the leasing law in Georgia. This input will be comprehensive and conclusive and is presented in a separate report. This paper does not duplicate or overlap with that input. Rather, it is meant to recommend an innovative product that would facilitate greater access to machinery and equipment in the agricultural sector and present leasing companies and a secondary market with an attractive business opportunity. The product, as described below, includes two incentives that the Government of Georgia could consider to stimulate the development of the leasing market in the agricultural sector. These include an investment tax credit and accelerated depreciation. As appropriate, the discussion of these could be incorporated into EPI's overall input into the leasing system in Georgia.

In Georgia, farmers and agribusinesses need to make extensive upgrades to equipment and machinery in order to become competitive. Despite significant increases in mechanization services available through the machine service centers in the country, the demand for access to these equipment items far outstrips supply. These needs include farm machinery, irrigation, and food processing and storage equipment. Many in the agricultural sector struggle with inadequate access to the commercial credit, particularly medium or long-term financing to invest in newer, better technologies and improved equipment. This demand could be met at reasonable costs below commercial financing rates through leases.

Leasing these equipment items not only meets this demand in the agricultural sector, but also provides a profitable business model for leasing companies and an attractive product for a secondary market. There is a perceived risk of the agricultural sector and a lack of understanding of opportunities within it. In Georgia, leasing companies focus on industrial sectors in Tbilisi and other major urban centers. As such, there is a significant capital base that does not reach Georgia's rural sector. There are methods the government can use to stimulate companies to engage in leasing in the agricultural sector in Georgia through the tax and leasing law and the country's accounting standards (an investment tax credit and accelerated depreciation); these are described below. A leasing product subject to these favorable terms and the promotion thereof would attract investment to the sector that would not otherwise be realized under current market conditions.

We note that the government has to balance the joint priorities of promoting economic growth through the private sector as well as strengthening revenues to finance goods and services. The effect these incentives would have on the state's revenue stream is that there would be the initial reduction in year one of the lease's life as a result of the investment tax credit. The accelerated depreciation provides more favorable tax terms in the initial years, but presents no net loss to the state over time. These relatively minor adjustments need to be weighed against anticipated increases in productivity. The first step to promoting this product is making sure that the leasing and tax laws would permit these incentives to be put in place. Should this product generate interest on the part of stakeholders in Georgia, EPI could conduct a full cost benefit analysis to demonstrate in detail the potential financial returns these incentive measures would have.

Definition of terms:

(1) Leasing vs. Traditional Installment Finance: The principal distinguishing characteristic between leasing and conventional installment financing of machinery and equipment is primarily in the ownership terms. In traditional installment financing, someone borrows money to buy a tractor and becomes the titled owner to the tractor after purchase. The lender of the funds may take the tractor as collateral for the loan. In the event of default by the borrower, the lender has to go through a court-supervised repossession process to be able to take possession of the tractor from the borrower in order to liquidate it against the remaining balance of the loan. In leasing, by contrast, the lessee may only become the titled owner at the end of the period of the lease once certain conditions are fulfilled by the lessee.

(2) Financial Leasing vs. True Lease: For both of these categories of lease, the lessor purchases the asset and leases it to the lessee for a fee. For the duration of the contract the lessor owns the equipment, thus providing an immediate alternative to collateral if the lessee defaults. In the case of a **financial lease**, it is intended that the lessee will become the owner at the end of lease term. Finance leasing is, in effect, no different than installment financing in that the lessor pays for the original value of the equipment during the life of the lease and it is recognized through the contract that the lessee will become the owner at the end of the lease. Usually the terms of the lease are for the entire economically productive life of the asset and lease payments are set so that their total value over the lease term covers the cost of the asset plus interest. Financial leases are much more advantageous for banks and financial institutions (management of financial leases for traditional financial institutions is much more consistent with their accounting and regulatory environments).

A **true lease**, by contrast, can be managed by nonfinancial institutions that specialize in leasing. The two, however, are not mutually exclusive. Often, the banks and other financial institutions are owners of the true leases. The terms of true leasing are usually, but not always, less than the economically productive life of the asset. Therefore, the lessee, upon termination of the lease, has the option to return the equipment, which the leasing company then sells in the used market. Also, the lessee is usually given the option at the end of the lease period to purchase the equipment at fair market value or any value agreed upon between the lessor and the lessee. Note: under a true lease, the ultimate value to the lessor is the total yield on the lessor's investment in the equipment subject to the lease. The yield is the sum total of:

- Lease payments made by the lessee during the life of the lease
- Lessor's actual cash tax benefit from utilization of depreciation and investment tax credit.
- The residual value of the equipment subject to the lease when it is sold either to the lessee or the market

The major reason to promote the utilization of this tool in Georgia for development purposes is to open up otherwise unavailable investment capital that is currently deployed in activities other than agriculture. True lease contracts, once executed by the lessor, may be sold to a second entity – individual or company – who may use it for offsetting tax liabilities, and be able to maximize their financial benefit from the ownership of the lease contract. The lessor, for a fee, will continue to manage the lease contract on behalf of the secondary owner, maintaining certain responsibilities described in the lease covenants.

Benefits to the lessee:

- Use of the equipment item for a stipulated period of time at a lower per annum cost than installment finance
- The ability to exercise purchase of the equipment at the end of the lease term, if so desired
- The ability to utilize new equipment less subject to maintenance costs
- Record the use of the new assets off the balance sheet (“off balance sheet” financing – reducing the recorded debt burden of the lessee)

The leasing company will make its decision to lease the asset item to the lessee based more on the lessee’s cash flow abilities and not his net worth, thus differentiating this decision-making from that related to traditional bank installment finance credit.

True leasing used in the multiple sectors in the United States including automobile, construction equipment, and farming equipment.

Incentives: We are proposing to stimulate the creation and utilization of true leasing in the Georgian market and increasing access to capital not otherwise available to agriculture. Based on their effectiveness in other environments where agricultural sectors were in initial stages of development, we have identified the below described incentives that could be put in place in Georgia to attract entrants into both a primary and secondary lease market and thus, accelerate access to key equipment and machinery assets for Georgian farmers and agribusinesses. The effectiveness of such incentive provisions are measured by the extent to which they stimulate additional productive investment. Their impact is measured by the broader effects on revenue, tax administration, economic efficiency, social equity, and, ultimately, prospects for economic growth.

We are proposing that the Georgian government establish within its tax code, the provision for ITC to agriculture and agro-industry. Investment tax credits have been used very successfully in the United States and other industrialized economies to promote investment in specific sectors of the economy¹³. A tax credit for the lessor would be based on the original purchase price of the leased equipment. The amount of investment tax credit provided by the government authority through its tax codes is subject to a future impact study. For purposes of the example model provided below, the ITC has been set at 10% of the new cost of the equipment to be leased.

Accelerated depreciation: refers to any one of several methods by which a company or individual, for “financial accounting” and/or tax purposes, depreciates a fixed asset in such a way that the amount of depreciation taken each year is higher during the earlier years of an asset’s life. In this case, this refers to leasing companies or individuals interested in providing leasing to the agricultural sector. For tax purposes, accelerated depreciation provides a way of deferring income taxes by reducing taxable income. This is a valuable tax

¹³ Today in Russia, the policy, legal and regulatory framework for leasing is relatively developed and leasing companies rarely cite legal and regulatory issues as a major hindrance to operations. When the 2002 Federal Law “On Amendments and Addenda to the Federal Law on Leasing,” passed, it substantially reduced the investment risks created from legal and tax uncertainties and established a stronger legislative base for the leasing industry to develop. In Russia, the main tax advantages to leasing are the flexibility to record an asset on either the balance sheet of the lessor or lessee, accelerated depreciation of the asset up to a factor of three, lowering profit and property taxes, and the ability of lessees to fully expense leasing payments, lowering the taxable profit.

incentive to the lessor or the secondary owner of the lease. Although, the lessee does not have access to the ITC or depreciation, he may, write-off the total amount of the lease payment – offsetting his tax liability as well.

Sample Product Model: the below provides a simple, illustrative sample model, using a tractor as the illustrative equipment item¹⁴.

For purposes of this report, the detail is oversimplified so that the reader can understand the basic principles involved with a true lease with tax incentives, as it would apply to a development technique for agriculture. The model illustrates the following elements of the lease:

1. Sample lease terms for a tractor with a purchase value of \$20,000.
2. Yield calculations (annually and over the lease term) based on five-year accelerated depreciation schedule and a first-year investment tax credit
3. Costs to the lessee (e.g., the farmer leasing the equipment)

Yield Calculations		
#	Cost Element	Amount (USD)
1)	One time tax deduction (ITC)	\$2,000.00
2)	Security Deposit, deductible from the last payment	\$1,250.00
3)	Write off from accelerated depreciation at 40% income	\$8,000.00
4)	Total Lessee Annual Payments (\$2.5k per year)	\$11,250.00
5)	Residual Value	\$5,000.00
	Less Tax Captured on Residual Value at 40%	\$2,000.00
	Net Residual Value	\$3,000.00

¹⁴ A tractor was used as the example above. However, the terms and conditions may vary for different categories of equipment. Yields levels would remain relatively the same and percentage costs to lessee would also remain approximately the same. Example: if we were using a compressor for a cold storage facility as an example, the term and depreciation may be for a longer period and residual value may be lower to encourage buy out at the end.

Annual Yield Calculation to Lessor		
	USD	%
Year 1	\$ 7,350.00	37%
Year 2	\$4,100.00	32%
Year 3	\$4,100.00	48%
Year 4	\$4,100.00	92%
Year 5	\$5,850.00	N/A

In this illustrative model: farmer gets use of new tractor for \$208 monthly/\$2,500 annually, which is 13% of the tractor’s new value annually¹⁵. The leasing company receives an average annual return of 52% in years 1-4 and an additional \$5,850 as profit in year five, where there is no capital investment. Without the investment tax credit, the leasing instrument’s annual yield for years 1-4 (with all other terms equal) would be approximately, 39%. This incentivizes nontraditional players to take equity stakes in the agricultural sector.

Recommendations for EPI Interventions:

1. EPI BEE team decides whether this is a product of potential interest and whether to seek input and follow-up with the project’s leasing and tax experts. If EPI BEE management determines to pursue this, proceed with the below recommendations.
2. EPI leasing experts are informed of this potential product and identify whether it would be possible within the input/recommendations that EPI is already making into the establishment of a leasing law for Georgia.
3. If not, EPI leasing experts determine what those adjustments would need to be and incorporates them into the project’s overall input into the leasing law.
4. EPI tax experts are informed of this idea and provide feedback on the feasibility of promoting an investment tax credit and accelerated depreciation within the country’s tax code and accounting standards. They can advise on the appropriate meetings that would need to be conducted with government agencies to determine their interest in these measures.

¹⁵ The three most sensitive figures in the model are the annual payment the farmer makes; the residual value of the equipment item; and income tax level, where we have used 40% as an estimated figure. Adjustments to these will result in the most significant fluctuations in the yield calculations.

5. Once the leasing law has been finalized and passed, potential EPI interventions related to this product would include:
 - Market study on the leasing sector as it specifically relates to agriculture and agribusiness. This would identify the specific characteristics of demand within the market.
 - Conduct a detailed cost/benefit analysis for tax incentives to demonstrate the benefits for generating economic activity against the impact on tax revenue generation.
 - Presentation to government of the above noted incentives in order to facilitate adoption.
 - Develop a fully functional leasing product including comprehensive covenants that allow for management and mobilization of a secondary market in Georgia.
 - Promote the use of leasing on both the consumer and supplier sides. Develop business models for leasing that companies in the market can take advantage of and use to promote a secondary market.
 - Once tax policy is reformed, engage local governments especially tax authorities to explain how leasing operates and the benefits it can have on the local economy to lessen the scrutiny regarding leasing activities and create a more transparent environment.

ISSUE BRIEF #4: INTELLECTUAL PROPERTY RIGHTS

Introduction

Maximizing productivity and producing varieties demanded by the market are both crucial to Georgian agriculture. Further, intellectual property rights enforcement was set as one of the preconditions to the EC's assessment of Georgia's preparedness for DCFTA negotiations. As such, Georgia has made progress with legislative approximation to the EU and membership in the International Union for the Protection of New Plant Varieties. However, there is currently a lack of protection of plant genetics in Georgia, which disincentivizes foreign companies from introducing their most up-to-date varieties (i.e., seeds and cultivars under license). This is an issue that cuts across subsectors, including: fruits and vegetables, grains and live animals. There are laws and regulations in place to protect plant material. The issue appears to be with monitoring and enforcement, the responsibility for which seems to reside mostly with the customs authority currently. To be effective, there needs to be wider responsibilities within state structures (i.e., police that are empowered to assist in controlling the issue). Individuals and companies that are importing vegetative material, especially under license from producers, should be aware of how they can protect themselves from theft, counterfeiting, or misuse of biological materials.

Counterfeiting and repackaging of inputs also remain a problem. Significant amount of chemicals come in, other than the manufacturer's source, and are either repackaged in Georgia using false labels or enter the country with false labels. These products are generally attenuated and do not perform well. Every effort should be made by the customs department to curtail this activity. In addition, powers should be given to other agencies such as the police and the food safety agency – to provide monitoring and enforcement. Further, training to input suppliers and farmers should promote the benefits of using high quality and authentic materials and techniques for recognizing them. Understanding on the part of suppliers and consumers of the performance issues related to using products with diluted active ingredients is a market-based means to correct the problem.

Recommendations for the EPI Interventions

EPI's in house experts on intellectual property rights are aware of this issues and planning to build it into their overall work plan. We met jointly to confirm this. There is additional background research that needs to be done to identify the specific challenges in order to make concrete recommendations to the Government of Georgia to improve the protection and enforcement of quality, licensed goods.

- Meet with MOA's Research and Development department and the Central Agriculture. Research Institute to discuss laws, procedures, and resources in place related to this issue.
- Meet with sampling from private sector to discuss practical implications and implementation of laws. We met with end users. The additional meetings that should take place now are with the license holders or certified dealers. These could include Bayer and Dupont/Pioneer.
- Prepare and provide formal recommendations to the relevant Government of Georgia stakeholders to improve monitoring and enforcement functions related to protection of plant genetics and preventing sale of counterfeit materials.

- Incorporate into training of input, suppliers and farmers, and related associations on the importance of using high quality and authentic materials and techniques for recognizing them.

ISSUE BRIEF #5: FOOD SAFETY

Introduction

As part of its WTO accession process, Georgia's policies had to make certain provisions related to sanitary (food safety bacterial contaminants, pesticides, inspection, and labeling) and phytosanitary (pests and diseases) standards (SPS). Georgia has made more substantial efforts to fully enact its food safety policy and meet other related EU preconditions to be considered for DCFTA negotiations. Certain articles of the law to enforce requirements to meet food safety standards have been enacted and others have been delayed. The Government of Georgia has also recently finalized the Comprehensive Food Safety Strategy. However, due to very limited resources (financial, human etc.) it is questionable whether the Food Agency within the MOA will be capable to enforce the law.

The following is a summary of progress made by the Georgian government in 2010 with regards to food safety measures. This is taken directly from an EU Progress Report: *"The key articles of the Food Safety Law (i.e. traceability and inspections), which were supposed to be enacted in Dec 2009 (so food safety inspections could start in all food-processing sectors) were once again postponed by the government in the last minute. Thus, contrary to what was initially planned, in 2010 Georgia did not start yet implementing in full its own food safety legislation. Despite this negative signals, 2010 shown some important improvements in the food safety field. In February 2010, the Government began the registration of food business companies. In July 2010, and after the strong complains made by the EU in relation to the postponement of the application in full of the Food Safety Law, implementation of food safety legislation related to inspections of food business operators oriented towards export to the EU started. Thus, for the first time since 2004, food safety official controls were conducted in Georgia, at least in some companies. Although this measure was well behind to what the EU was asking for (inspections to start in all food processing establishments), at least it gave the opportunity to the Georgian government to test the inspection procedures (i.e., learning by doing). The procedures under which these inspections where conducted presented a number of shortcuts."*

2010 Progress with EU Support (taken directly from EU Progress Report)

Border controls

The Revenue Service of the Ministry of Finance continued in 2010 implementing official Phytosanitary and veterinary border-quarantine controls, including documentary, identity and physical check as well as laboratory sampling.

EU Rapid Alert System for Food and Feed (RASFF)

Georgia has become a member of the EU RASFF system since 2008. In 2010, as in previous years, the Food Safety Agency was able to take prompt and adequate response to the threats, which were detected and communicated via RASFF.

Laboratories

With the aim to achieve the goal of developing a unified system of laboratories, including food safety-related laboratories, a special intra-agency working group on laboratories was created by the government in June 2010.

This issue has three main dimensions:

- **Import SPS controls:** testing, monitoring, and enforcement of controls on imported food products to ensure requirements are met for bacterial contaminants, pesticide residue, etc. In Georgia, this is primarily the responsibility of the Customs Authority (with basic lab facilities at borders) with training from the Food Safety Agency. Our understanding is that the Customs Authority is under resourced currently to fully assume this responsibility and that additional training and technical and human resources are needed to put in place adequate controls.
- **Domestic food safety controls:** this includes testing, monitoring, and enforcement of food safety controls on domestic produce as well as the hospitality industry (restaurants, hotels). Adequate controls require a combination of lab testing (by the private sector and government) and monitoring and enforcement. Our assessment is that there is currently a lack of resources to adequately enforce these measures. Additional budget support is needed.
- **Exports:** ensuring food safety, plant and animal protection and quality standards are all important for Georgian exporters, especially those targeting markets in the EU, U.S. and Canada. Rejected shipments of Georgian products (see Annex D for a list of alerts or rejected shipments in 2011) can have a broader impact with buyers in these markets requiring tighter controls on Georgian products, reducing purchase prices, and/or seeking alternative sources altogether. There are labs in country, but many require facility upgrades to be able to conduct the full range of tests (pesticide residue testing, for example). The labs are not internationally certified, generally, or accredited to certify the products they test. Though their testing results are still useful, this can limit their ultimate value to the user. From the consumer side, low demand (or utilization of lab services) for tests was reported to us to be driving up the costs for these services. The onerous is really on the exporter to have this testing done and ensure their products meet the requirements of the markets they are targeting. We note that there is a relatively small set of major high value agriculture exporters in Georgia who are generally aware and capable of meeting these requirements. These firms can seek alternative measures such as having testing conducted in the target market or having their facilities and products certified according to an internationally-recognized standard (ISO, HACCP) to further promote entry of their products in target markets (particularly those requiring such certifications).

There are multiple donors supporting the Georgian government and firms to improve these areas and ensure food safety and market access for Georgian products. These include the EU, Food and Agriculture Organization (FAO), and IFC. Given relatedness to the potential DCFTA negotiations, the EU has worked closely and extensively with the Government of Georgia in the development of the Food Safety Strategy and putting in place the Food Safety Agency to serve as the institutional back bone for implementation of the law and strategy. Given this support already in place and the fact that EPI does not provide direct budget support to the Government of Georgia, we have made the below recommendations for potential roles EPI can play in supporting upgrades in this area.

Recommendations for EPI Interventions

- Provide input into the MOA Sector Strategy regarding resources required to support and monitor food safety and plant and animal protection related to imports, exports, and domestic food industry
- Provide technical assistance to the MOA in the implementation of the Food Safety Strategy.
- Provide training and potential grant access to labs to reach international certification and accreditation
- Provide training package to agribusinesses on food safety requirements (HAACP, ISO)
- On a demand basis and in response to forecasted market opportunities, incorporate Global GAP into technical assistance provided to farmers
- Work through local partner to conduct an awareness raising campaign on importance of food safety targeted at consumers in Georgia

C. ADDITIONAL INFORMATION

INTERVENTION AREA OVERVIEW

USAID/EPI Business Enabling Environment/Agricultural Sector Subcomponent:			
Intervention Area Overview			
Issue Name	Constraints to the Agricultural Sector Identified	Potential EPI Interventions	Anticipated EPI Results
PRIORITY LEVEL 1			
1) Land Ownership	<ul style="list-style-type: none"> Limited registration of land and entry into central cadastre and corresponding lack of protection of ownership rights create tenuous land ownership for private citizens. This significantly increases information costs to investors, as well as cost associated with land purchases. It limits the sector's competitiveness and results in several economic constraints, including: Constrains production and productivity by impeding consolidation and investment in technology upgrades Limits development of a land market; realization of wealth tied up in value of land; and attraction of foreign and domestic investment in the sector Limits repair and maintenance of key infrastructure, including irrigation and market feeder roads Reduces rural wealth creation by hindering transfer of land value and indirect reductions in income and employment opportunities. 	<ul style="list-style-type: none"> Serve as thought leader and chair of the working group to coordinate the development and implementation of a detailed plan of action to respond to this challenge. Conduct key analyses to form recommendations, including: review of enabling environment; strengths and weaknesses of institutions and systems; and econometric modeling to quantify returns of improved land ownership in the country Conduct a pilot initiative in a target region. Work with local authorities, land commissions, and former arrangers to: <ul style="list-style-type: none"> Implement cost effective means of broad-based registration Train local authorities Launch awareness raising campaign with rural landholders/farmers, focusing on consolidation and cadastral registration of larger landholdings Incorporate land registration concepts and support into training of EPI's target farmers under the value chain component. 	<ul style="list-style-type: none"> The results will vary by the response that EPI adopts. They could include the following: Comprehensive action plan in place to respond to status of land ownership in Georgia Increased transparency of land holdings in Georgia Increase in credit accessed by farmers as a result of registered land Increased recognized value of rural landholdings in Georgia. By transferring the value of land currently not registered in absolute terms would mean a realized investment value in the hundreds of millions of USD. Increases in productivity, consolidated land, and income levels (measured through proxy indicators, interviews, a sampling methodology, and key

		documentation)	
• PRIORITY LEVEL 2			
2) Tax Code and Accounting Standards	<ul style="list-style-type: none"> • Tax code and accounting standards require that a farmer fully expense a bio asset in the first year of ownership. This prevents a farmer from depreciating the asset over a schedule that favors their revenue generation in latter years and allows them to offset their tax liability. • VAT application: the limitations on companies in Georgia to file and reclaim VAT (at 18%) from purchases of primary production materials serve as a disincentive for processors and retailers to purchase inputs domestically. 	<ul style="list-style-type: none"> • Assemble and propose specific revisions to the appropriate clauses of the tax code and accounting standards to permit more favorable depreciation of bio assets by farmers. • Identify specific impediments to filing for VAT returns on purchases of primary produce and propose specific measures thereof • Assuming these adjustments are made, incorporate these concepts into BDS-related technical assistance provided to farmers under EPI's value chain component. 	<ul style="list-style-type: none"> • Reduced tax burden for farmers with newly purchased bio assets • Tax code and accounting standards reformed • Increased understanding of value chain actors on how to handle VAT related to purchase of relevant domestically-produced products • Increased purchase of domestically produced material (measured through proxy indicators, interviews, a sampling methodology, and key documentation)
3) Equipment Leasing	<ul style="list-style-type: none"> • Challenges with accessing traditional financing • Lack of affordable access to on-farm storage and processing equipment and machinery. • Farmers and agribusinesses need upgrades in technologies to achieve competitive position • Lack of leasing companies currently engaged in the agricultural sector • Limited investment in rural Georgia and the agricultural sector, in particular, due to perceived risk and cost and lack of opportunity • While mechanization services exist for land preparation and cultivation, there remains an overwhelming need overall for these technologies and equipment items. 	<ul style="list-style-type: none"> • Design a leasing product that could be used by a leasing company • Through EPI experts, provide input into the leasing law and related tax code to make appropriate provisions to incentivize use of the product and entrants to the market. These include: <ul style="list-style-type: none"> ○ Investment tax credit ○ Accelerated depreciation • Conduct a market assessment of the leasing sector (supply and demand) • Provide government a cost/benefit analysis for the Investment Tax Credit and promote adoption • Develop a detailed modeling for the product and provide interested leasing companies with training on product and how to promote a secondary market. • Incorporate leasing into Business Development Services training provided to farmers and agribusinesses 	<ul style="list-style-type: none"> • Leasing law and tax code revised to include provisions that promote true leasing to the agricultural sector • Leasing product model is developed • Leasing companies are trained in use of the product • Farmers and agribusinesses are trained in use of the product • Increased access to and use of on-farm machinery, storage, and processing equipment • Increased profitability and competitiveness of farms and agribusinesses using leasing to upgrade their operations

PRIORITY LEVEL 3			
<p>4) Intellectual Property Rights and Counterfeit Materials</p>	<ul style="list-style-type: none"> • Lack of protection of plant genetics • Reduced introduction of up-to-date varieties (i.e., seeds and cultivars under license) • Counterfeiting and illegal repackaging of materials such as fertilizers and pesticides undermines long-term performance of input supply businesses and inhibits on farm performance 	<ul style="list-style-type: none"> • Incorporate into training of input suppliers and farmers and related associations the importance of using high quality and authentic materials and techniques for recognizing them. • Through donor coordination mechanism, provide assistance in preparation and provision of formal recommendations to the relevant Government of Georgia stakeholders to improve monitoring and enforcement functions related to protection of plant genetics and preventing sale of counterfeit materials 	<ul style="list-style-type: none"> • Increased awareness of EPI target agribusinesses and farmers • Increased purchase, sale and use of certified, quality input products • Increased awareness on part of Government authorities of these issues
<p>5) Food Safety</p>	<ul style="list-style-type: none"> • Despite a strategy and law being in place with the necessary provisions, the government has limited budget to support firms in Georgia to upgrade and meet food safety requirements for domestic market and for export. • Government has limited budget to monitor and enforce food safety on imports. • Exporting firms in Georgia have had rejected shipments in Europe. In addition to loss of sales, this can affect the Georgian brand name over time. • Labs in Georgia are not certified and there is a limited supply of technologies required to support testing that meets international certification requirements. 	<ul style="list-style-type: none"> • Provide training and access to grants or other affordable sources of capital for labs to reach international certification and accreditation • Provide training package to agribusinesses on food safety requirements (HAACP, ISO) • On a demand basis and in response to forecasted market opportunities, incorporate GlobalGAP into technical assistance provided to farmers • Provide input into the MOA Sector Strategy regarding resources required to support and monitor food safety and plant and animal protection related to imports, exports, and the domestic food industry • Work through local partner to conduct an awareness raising campaign on importance of food safety targeted at consumers in Georgia 	<ul style="list-style-type: none"> • Labs are officially certified and possibly, accredited • Agribusinesses and farmers are trained in upgrades required to meet key food safety requirements • Strengthened systems within government to support, monitor and enforce food safety requirements (indirect result)
<p>6) Cross-Cutting:</p>	<p>Note: when finalizing the work plan for the Ag/BEE component, the final version should reference those cutting areas that will positively influence the enabling environment as it relates to agriculture. Further, input should be made into each one of these areas to ensure it covers key issues related to the agricultural sector.</p> <ul style="list-style-type: none"> • Agricultural insurance • Financial services • Transportation • Customs 		

LIST OF INTERVIEWS CONDUCTED

March 28 - May 6, 2011

#	Individual Names	Position	Name of Organization
1	Konstantin Kobakhidze	Head of Agriculture Development Department	Ministry of Food and Agriculture
2	Tornike Mgaloblishvili	Head of Food Safety and Risk Analysis Service	Ministry of Food and Agriculture
3	Iveri Akhalbedashvili	Head of the Office of Agrarian Issues Committee	Parliamentary Agrarian Committee
4	Donara Surmanidze	Minister	MOA of Autonomous Republic of Ajara
5	Sergo Tsikarishvili	Chairman	National Agency of Public Registry
6	Shota Chachkhunashvili	Chief Information Officer	National Agency of Public Registry
7	Tamar Dvali	Head of Office	National Agency of Public Registry, Mtskheta Office
8	Gela Shermadini	Head of Office	National Agency of Public Registry, Akhgori Office
9	Matti Lampi	Food Safety Expert/Deputy Team Leader	GRM International
10	Ilia Kvitaishvili	Rural Development Specialist	World Bank
11	Juan Echanove	Attaché, Agriculture, Rural Development and Food Safety	EU Delegation
12	Rati Shavgulidze	Country Coordinator for Georgia	FAO
13	Hans Gutbord	CRRC Regional Director	Caucasus Research Resource Centers
14	Irakli Kordzakhia	Partner	Law Firm Kordzakhia Jgenti
15	Irina Lashkhi	Human Rights and Good Governance Program Coordinator	Open Society Georgia Foundation
16	Ekaterine Bokuchava	Project Coordinator	Transparency International Georgia
17	Mariam Gabedava	Project Manager	Transparency International Georgia
18	Gia Gvilava	Senior Lawyer	Transparency International Georgia
19	Kakha Kozhoridze	Head of Legal Aid Center	Georgian Young Lawyers Association

20	Irakli Songulia	Director	Association for Protection of Landowners Rights
21	Giga Bakradze	Appraiser	JSC BTA Bank
22	Ekaterine Malazonia	Head of Credit Risk Department	ProCredit Bank
23	Giorgi Gavashelishvili	Credit Risk Manager	ProCredit Bank
24	Tina Kezeli	Head	Georgian Wine Association
25	Levan Kalandadze	Director	Multitest (Laboratory) Ltd
26	Ivane Goglidze	Director	Geoconcentrate (Kula Factory) Ltd
27	Tamaz Niparishvili	Director	I/E Tamaz Niparishvili
28	Goga Simonishvili	Founder, Director	Agrokartli Ltd
29	Giorgi Mchedlishvili	Director	I/E Giorgi Mchedlishvili
30	Soso Dzmanashvili	Director	Agrospero Gurjaani Ltd
31	Nugzar Junjikhadze	Project Coordinator	Georgian Institute of Public Affairs
32	Mamuka Alpaidze	Founder, Director	Farkoni
33	Mamuka Tsikoridze	Director	Geguti Ltd
34	Davit Chaprava	Director	I/E Davit Chaprava
35	Konstantine Vekua	Director	Nergeta Ltd
36	Jeneri Belkania	Director	Agro Plus Ltd

MEETING NOTES FROM LASHA DOLIDZE VISIT TO WITH AKHALGORI AND MTSKHETA REGISTRARS (MAY 12, 2011)

Meetings in Mtskheta with Akhagori (part of nowadays occupied rayon of South Ossetia) and Mtskheta Registrars.

Conducted by: Lasha Dolidze, BEE Agricultural Sector Program Manager

Date: May 12, 2011

Questions:

1. Is there a cadastral system for the area, into which plots of private landholdings are entered? When was it established?

There is a cadastral system in place at these offices, which is connected to the national cadastre (the NAPR system). The registrars' offices have two types of records related to land. There are plots within yellow boundaries (without coordinates) along with plots within red boundaries (which are properly surveyed and registered). Yellow-outlined plots were mostly completed by the LMDP project. Interestingly, by scrolling over the boundaries of the yellow plots with the mouse one can see coordinates in some locations, but there are no numbers within such yellow boundaries indicating individual plots.

It is possible for plots within the yellow boundaries to be registered – if a proper survey is conducted – and this process is underway with some of the plots.

2. Within the system (and in order to receive legally recognized title), what designates legal boundaries of individual plots? Have all plots that are entered into the system been surveyed? What is the method that has been used to survey plots?

Legal boundaries of plots are established by provision of a surveyed cadastral map. One has to survey, present the map to the registrar, pays the registration fee to get the plot fully registered and be able to see it on the map within red boundaries and assigned to a unique code.

The yellow-outlined plots described above are maintained in a separate system – they do not appear in the web-based system and do not have coordinates. There are also yellow plots that do not appear on the web page and that do not have coordinates defining individual plots. For these yellow plots, some measurement was done, but, in current, modern, and proper terms, the plots within these yellow boundaries were never truly surveyed.

3. When did this process of registering individual plots begin? Has your office received any support from APLR, for example, or other donor-funded projects in setting up the system?

The Mtskheta and Akhagori Registrars (registrars themselves and people currently running the system) did not and have not received support from APLR or donors. The registration of plots started prior to NAPRreg and NAPRweb. Of course, this pertains only to individuals, who by their own effort, created surveyed maps and established legal documentation that could be recognized.

4. Is the system compatible with the NAPR system developed in 2008? Has there been an attempt to harmonize the system from your office with the NAPR system? What is the status of this process?

As a note: the overall, national cadastral system composed of two parts: NAPRreg and NAPRweb. NAPRWeb was established in 2007, NAPRreg in 2008

NAPRreg is a unified system of registration operating at the national and local levels, compatible and harmonized with each other. Through NAPRweb, one can obtain detailed information on a given plot. The head NAPR office can only view plots registered into the centralized system and cannot view anything maintained through local records.

In terms of harmonization: the local office reported that in some rayons, the original electronic system supported by LMDP and other projects were Access-based, others Page Maker-based, and others were completed manually. In Mtskheta, they relied on Page Maker previously, but now use NAPRreg. NAPR head office had experienced compatibility problems with these different systems, because the data prepared under the different programs (and especially when they are maintained manually) cannot be fully incorporated and unified. The problem is complicated further by the existence of numerous Sakrebulo with their own registration databases.

5. What is the estimated percentage of private parcels in the area that are entered into the system (i.e., how complete is the registration process?) Do individuals continue to submit requests for land titles?

The Mtskheta Registrar was hesitant to refer to concrete numbers. She says that it is possible that some 30-40% of plots are fully registered (based on the current legal framework). She suspects this relatively high level (relative to the national average of 9-30%) is because of proximity to Tbilisi, existence of a more affluent community, and a better organized registration process. Landholders are still approaching them for registration. The Akhagory Registrar could not refer to concrete numbers, but he said that in more remote rayons from Tbilisi, such as Akhagori, Dusheti, and Kazbegi, the percentage is probably very low.

6. What is the title (proof of ownership) that you recognize? Could you show me a copy, please? When did you begin issuing these?

The Ownership Certificates (issued by the Decree of the President #327 in 1999) have no power and are not recognized according to current registration requirements. The process is governed and driven by the Law of Georgia on Recognition of Property Rights on Land Plots under Possession (Use) of Legal and Physical Persons, Law on Legalization of Property, and the Decree of the President (#525) on Georgia on Rules for Recognition and Approval of Form of Ownership Certificate Rights on Land Plots under Possession (Use) of Legal and Physical Persons. All these were issued in 2007 and we are familiar with all of these. Decree #525 outlines the documentation based on which lawful possession (use) is established:

- 1. Acts of delivery and acceptance (you see this in the LMDP report)*
- 2. Lists of local branches of the Ministry of Finance, in which taxpayers names appear. One has to be on this list. (NOTE: I was told that currently and on an interim basis only, these lists are not required for opening a registration case, due to the fact that the Ministry is undergoing a reorganization process.*

3. *List of initial allocation of land by 1992 reform*
4. *The presidential decree of 2007 also added to this list: a statement from the court.*
5. *Inheritance documentation*

In overwhelming majority of cases, registration cases are opened by means of presenting documentation based on the original 1992 Receive and Delivery Acts. With proof of the right to own based on the above, the individual must then have the plot surveyed and then registered.

8. Has this process undergone several iterations over the past two decades? Could you take me through the major stages in the process?

The key milestones are the reform of 1992, then the 1999 framework and donor activity, then 2007 legislation, and then 2008 NAPR system.

LIST OF ALERTS OR REJECTED GEORGIAN EXPORT SHIPMENTS

	Classification ▼ ▲	Date of case ▼ ▲	Last change ▼ ▲	Reference ▼ ▲	Country ▼ ▲	Subject	Product Category ▼ ▲	Type ▼ ▲
1.	information for attention	24/03/2011	02/05/2011	2011.0396	CZ	aflatoxins (B1 = 638; Tot. = 713 µg/kg - ppb) in hazelnut kernels from Georgia	nuts, nut products and seeds	food
2.	border rejection	28/02/2011	20/04/2011	2011.ALX	GR	unauthorised color Sudan 1 (4.4 mg/kg - ppm) in dry adjika from Georgia	herbs and spices	food
3.	border rejection	28/02/2011	20/04/2011	2011.ALY	GR	unauthorised color toluidine red (246 mg/kg - ppm) in saffron from Georgia	herbs and spices	food
4.	information for follow-up	18/03/2011	21/03/2011	2011.0370	CZ	dead insects in hazelnut kernels from Georgia, via the United Kingdom	nuts, nut products and seeds	food
5.	alert	08/02/2011	15/02/2011	2011.0148	DE	aflatoxins (B1 = 38.9; Tot. = 59.8 µg/kg - ppb) in ground hazelnuts from the Czech Republic, with raw material from Georgia	nuts, nut products and seeds	food
6.	border rejection	13/01/2011	14/02/2011	2011.ABL	GR	too high content of E 210 - benzoic acid (1166 mg/kg - ppm) in tkemali green sauce from Georgia	soups, broths, sauces and condiments	food
7.	border rejection	13/01/2011	13/01/2011	2011.ABM	GR	too high content of E 210 - benzoic acid (1085 mg/kg - ppm) in tomato sauce from Georgia	soups, broths, sauces and condiments	food
8.	border rejection	13/01/2011	13/01/2011	2011.ABK	GR	unauthorised color Sudan 1 (2.2 mg/kg - ppm) in tomato sauce	soups, broths, sauces and	food

	Classification ▼ ▲	Date of case ▼ ▲	Last change ▼ ▲	Reference ▼ ▲	Country ▼ ▲	Subject	Product Category ▼ ▲	Type ▼ ▲
						from Georgia	condiments	
9.	border rejection	13/01/2011	13/01/2011	2011.ABJ	GR	too high content of E 210 - benzoic acid (1200 mg/kg - ppm) and unauthorised colors Sudan 1 (0.7 mg/kg - ppm) and Sudan Red G (0.2 mg/kg - ppm) in fresh tomato sauce from Georgia	soups, broths, sauces and condiments	food

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