

Land and Real Estate Transactions for Businesses in Russia

Businesses complain about little land privatization, non-transparency and favoritism in the process

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Land privatization in the Russian Federation has a checkered history, with a clear favorable policy not firmly established until the enactment of the 2001 Land Code. Even after the enactment, many vital parameters of land privatization, including pricing parameters, have still not been settled.

The new Land Code explicitly calls for land to be privatized as follows:

- Land under buildings that were privatized earlier is supposed to be sold (or leased) to the owner of the building at an administered price within parameters set by federal legislation (this category accounts for the great majority of land transactions involving businesses).

- Vacant land intended for new construction is supposed to be privatized by transparent auction or tender procedures (there have so far been relatively few transactions of this type).

The privatization procedure for land under privatized buildings (the most common procedure for acquisition of land) involves an average of 11 stages, eight different agencies, 17 different documents, 220 days, and about 70,000 Rubles (about US\$2,400) in official fees. The range, however, is quite large, from low figures of about 50 days in Rostov region and 10,000 Rubles in Novgorod region to high figures of over 400 days in Novosibirsk and 360,000 Rubles in Moscow region.

To date, most land of interest to businesses is still owned or controlled by municipal governments, which gives them strong "market power" as near-monopolist landlords, while greater legal flexibility over land rents (as opposed to buy-out prices and land taxes) provides a strong fiscal incentive to municipalities to try to maintain their ownership rights, and encourage businesses to apply for lease rights instead of ownership rights. In ten out of 15 regions in our survey, more than three-quarters of land is owned or is in the possession of the state or municipalities. Only in one region — Rostov — the share of state and municipal lands is

much lower at 35%. The city of Moscow stands out with 100% of land still publicly owned. The remainder of the land is owned by legal entities and individuals, with individuals owning significantly more land parcels than businesses do.

In addition, there is still considerable evidence of municipalities abusing their market power through administrative barriers, not necessarily to keep rents high, but more often to favor some firms over others and/or exercise undue influence over local business development.

Limited Access to Land as an Obstacle to Business

Businesses continuously complain that there has been very little land privatization to date, and that the limited amount of privatization that has taken place has suffered from severe inconsistencies, non-transparency, and outright favoritism. While this problem is not unique to Russia, cross country comparisons suggest that businesses in Russia are even more likely to perceive "access to land" as an obstacle, relative to many other emerging markets.

In our study we investigate the problems faced by businesses in carrying out land and real estate transactions in Russia. The analysis is based on a survey carried out by the Foreign Investment Advisory Service, which covered 15 Russian regions and included information from 517 business intermediaries that helped clients with land and real estate transactions in 2004, as well as 1,188 legal entities and sole proprietors that attempted, underwent or completed land and real estate transactions in that year.

Our analysis demonstrates that the principal factor influencing the level of land privatization in a region (dominated by privatization of land under buildings) is the pricing policy pursued by local authorities. In those surveyed regions where the local government pricing policy is at the low end of the range stipulated by federal law, the rate of land privatization transactions is higher. A reduc-

tion of the official price from the higher to the lower end of the federally mandated range is associated with a significant increase in the rates of land privatization (more than doubling for some regions).

Excluding the pricing policy from consideration, the length of time required to complete the relevant procedures becomes the main factor influencing the level of land privatization; the longer the duration of the procedure, the lower the rate of land privatization in a region. A decrease in the average procedure duration by one month increases the overall number of land privatization transactions per 100,000 residents by about 11%.

If businesses are deterred from applying for ownership rights, their only other choice is to apply for lease rights. Delays associated with land privatization procedures lead to an increase in the proportion of transactions for long-term land leases as opposed to land ownership. If the delays are reduced by 25% from their mean length, the rate of land lease transactions would decrease by about 15 percentage points in favor of land privatizations.

A second factor influencing land privatization is the frequency of refusals by government agencies in the course of a procedure. The analysis demonstrates that while processing land privatization applications, government agencies tend to refuse the completion of such transactions twice as much, on average, as land lease procedures, even though the procedures and criteria are supposed to be the same.

More Corruption in Complex Procedures With Sunk Costs

Procedures in which applicants have significant sunk costs (e.g., they have already purchased their land and are now trying to register their ownership rights) take about 34% more time than "reversible" procedures. Procedures in which sunk costs are involved are also more prone to corruption: the share of

stages involving unofficial payments is higher by 11% as compared to the "reversible" ones.

More complex land procedures are more prone to corruption. Each extra stage added to the procedure increases the percentage share of stages in which unofficial payments were reported by about 4 percentage points.

The procedure duration does not significantly affect the level of unofficial payments. However, the official cost of the procedures, along with the complexities associated with them, has a significant effect on the level of unofficial payments — the higher the official cost, the higher the level of unofficial payments.

Established relationships with government officials may help to reduce the duration of the process somewhat, although the effect is not significant. However, such connections cost money to maintain — intermediaries who have connections that they think can help in the facilitation of their work charge more for the completion of procedures.

The use of auctions or tenders is still not very common in many regions, and

while use of such mechanisms is associated with higher rates of land privatization, there is not yet clear evidence that they are associated with other positive outcomes such as fewer delays or unofficial payments.

Policy Recommendations

- Unnecessary complexity should be reduced in administrative procedures for businesses' access to land. Regions with the simplest procedures should serve as a positive example for regions with more complex procedures.

- For privatization of land under privatized buildings, keeping administered land prices low helps to encourage land privatization transactions and helps to develop a competitive secondary market in land. At the same time, if municipalities cannot obtain revenues from land rents, they may need some compensating source of revenue (e.g. enhanced land taxes) to maintain their fiscal balances and to encourage their cooperation with land privatization.

- For many administrative procedures, a policy of "silent consent" with

time limits should be introduced. Officials should be required to provide a written explanation, against established legal or administrative criteria, for any refusal of applications for land privatization, within a stipulated time limit. If no decision has been rendered by the time limit, it should be deemed approved, with enforcement available through the courts if necessary.

- Auctions and tenders for land privatization should be further encouraged, but need to be monitored closely for transparency and fairness.

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Land Issues: Barriers for Small Businesses

Questions, connected with the acquisition and renting of land and premises, play an important role in the decision to create and expand small businesses. This is proved by the sixth round of monitoring the administrative barriers to small business development. The monitoring is carried out by CEFIR and comes in the form of yearly repeated surveys of 2,000 firms in 20 regions of Russia. CEFIR has been conducting the survey since 2002 in order to evaluate the results of the deregulation reform, started by the federal government in 2001.

The monitoring results show that about half the firms face problems with land, while the problem of acquisition and renting of land and premises was singled out as the most serious problem connected with the federal regulations.

- *The procedure duration.* Purchase of land and premises looks like a lottery: in some cases the procedure is relatively fast (one to three months), while in others it drags on and takes more than six months. In 2003, more than a third of the firms, trying to acquire premises, had to spend over six months on the procedure; around 90% of the firms,

purchasing the land, could not finish the purchasing procedure within the six months. In 2006, the duration of such procedures did not change significantly.

- *Purchasing federal property.* The procedure for purchasing federal property was in 2003 — and still remains — the most expensive, time-consuming and the least transparent. In 2006, the procedure duration for an average firm was three months.

- *Costs connected with purchasing and renting land and premises.* The survey results from 2004 show that this was not influenced by who the partner is in the transactions: whether it be a private party or the federal authorities. However, there was more pressure to give bribes while conducting the transaction with government agencies.

Thus, the survey results show that small businesses face serious problems when trying to acquire premises and/or land plots. A significant number of entrepreneurs abandon plans to start or expand their business due to these difficulties. In order to decrease the arbitrariness of the local authorities, the appropriate procedures must be simplified; this will be a strong incentive for the development of small business in Russia's regions.

Source: Centre for Economic and Financial Research, Moscow, www.cefir.ru. Questions, related to the purchasing and renting land and premises, have been added to the monitoring survey on the initiative and with the financial help of the Foreign Investment Advisory Service (FIAS). BT

Duration (Days) for the Procedure of Acquiring Premises, Median Values

	Purchase of the Federal Property	Purchase of Private Property	Rent of the Federal Property	Rent of the Private Property
2004	22	60	30	7
2006	30	30	30	7