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Kazakhstan

A Review of Farm Restructuring

John Gray

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A Review of Farm Restructuring

John Gray

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Foreword

Agriculture in Kazakhstan is in crisis: the majority of farms are insolvent and production has fallen to the lowest level in 30 years. Initial restructuring efforts yielded disappointing results and mostly failed to lead to new patterns of ownership or management. However, since 1998 the Government has pursued a more aggressive approach to farm restructuring based on increased reliance on farm bankruptcy. This report reviews the experience of the farm restructuring policies and programs pursued in 1998 and 1999 and draws conclusions for the continuing development of agricultural sector policies. This review forms one of a group of simultaneous agricultural sector studies undertaken by the World Bank at the request of the Government of Kazakhstan. The other studies cover grain marketing and exports to regional markets, and agricultural risk management and insurance.

The review is based on a mission to Kazakhstan undertaken by John Gray (Emerging Market Economics LTD), a consultant of the FAO/World Bank Cooperative Program in April-May 1999. During the course of this mission a substantial number of farms of all categories were visited in four oblasts – Almaty, Akmola, Uralsk and Kostanai. The detailed discussions with farm managers and employees held during these visits, coupled with meetings with government officials in the oblast administrations and in the Ministry of Agriculture in Astana form the basis for the conclusions drawn in this report. Roy Southworth and Valencia Copeland edited the document.

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Abstract

This report analyses the Kazakhstan's Government reform measures to overhaul the farm sector. The report focuses on farm restructuring measures that were implemented beginning in October 1998, and which used bankruptcy as a key tool to create forms of ownership and management intended to promote improved farm productivity. The report is based on a field mission undertaken in April-May 1999 that included interviews with government officials, farm owners, managers, and workers as well as a review of existing documentation. The focus of the field work was on former state and collective farms which were privatized but continue to function poorly. The report found that the initiative led to substantial changes in farm ownership and management that promise to lead to improved farm efficiency. However, the way in which the process was implemented raises serious concerns about equity, as ownership is increasingly being concentrated in the hands of a few dominant individuals, and the welfare of farm workers who have lost their ownership shares and possibly their jobs in the process.

Acronyms

APB	Kazagroprombank
ASF	Agricultural Support Fund
DOLP	Director-Owned Limited Partnerships
GDP	Gross Domestic Production
Ha	Hectare
JSC	Joint Stock Company
PC	Production Cooperative
PLL	Partnership with limited Liability
Mm	Millimeters
MMT	Million Metric Tons
MT	Metric Ton
NMP	Net Material Product
T	Tenge (the national currency)

EXECUTIVE SUMMARY

Background

The crisis in the farm sector in Kazakhstan, which has continued unabated since the break-up of the Soviet Union, has two essential features. First, the sector is heavily indebted as a result of losses incurred during the 1990s. These losses were caused primarily by low prices for outputs due to continued state controls on marketing while input prices were liberalized. The heavy indebtedness in the farm sector is hampering sector recovery as farms are illiquid and not creditworthy and as a consequence do not have money to purchase inputs which leads to the widespread use of barter. Second, in spite of several initiatives, progress in restructuring farms to create forms of ownership and control conducive to growth in a market context has been limited. Initial attempts at reform, which saw the state and collective farms converted first into collective farm entities and subsequently into producer cooperatives (PCs), involved little real change in patterns of ownership, management and control. The reason for this limited progress is plain: throughout the period up to 1998 the former state and collective farms were never subjected to a hard budget constraint. The system for delivery of credit to farms went through several stages involving successively the Agroprom Bank, the Agricultural Support Fund and, most recently the oblast administration budgets, but without the sanction of the threat of bankruptcy there was little incentive for farm managers either to reduce their indebtedness or to reform their internal governance.

Despite this initial lack of progress, the Government has progressively laid the framework for a more substantive approach to farm reform, notably through passage of the Bankruptcy Law (revised version January 1997), through approval of the Order of December 1998 which defined the practical application of bankruptcy to the farm sector, and through administrative instructions issued in October 1998 which instructed the oblast administrations to proceed with farm reform, including the liquidation of insolvent and unviable farms. Moreover, Government undertook to write-off much debt accumulated as a result of directed lending through, originally Kazagroprom bank and more recently through the Agricultural Support Fund.

This report reviews the progress to date in the implementation of the Government's reform measures which only begun to be implemented seriously in late 1998. The report is based on a field mission undertaken in April-May 1999, which concentrated primarily on the Northern oblasts and information provided by the staff of the Headquarters of the Ministry of Agriculture in Astana.

Main Findings

The New Policies are Having a Profound Effect on the Sector

The new approach to farm restructuring adopted since 1998, which includes the bankruptcy of the most insolvent farms, is already having a profound impact on the sector. A significant number of farms have been liquidated already and the knowledge that insolvent entities will be bankrupted has prompted a spate of negotiated changes in farm ownership, control and management. The bankruptcy process itself is now well-known to all stakeholders and liquidation sales have become commonplace in most oblasts. It appears that the formal process of declaration of bankruptcy and liquidation of farms is being conducted in a proper manner with few complaints of irregularities. However, the procedure is weak in its treatment of commercial creditors. Under the current legislation commercial creditors are fairly low on the priority list of creditors (fifth). For commercial creditors to view bankruptcy as a viable option in the future their claims must be given higher priority.

The Authorities are Leading a Standardized Process of Pre-Bankruptcy Restructuring

In many cases of bankruptcy initiated by the authorities, farms have been taken first through a pre-bankruptcy procedure. This procedure has been adopted for two reasons: (i) to protect moveable assets from being stripped from the farms and sold to buyers from outside the community; and (ii) to put in place a single owner-manager to improve management and accountability. Under this procedure, members of the Producer Cooperative (the commonest legal form prior to restructuring) are encouraged and assisted by the local administration to create one or more limited liability partnerships and to transfer remaining quality assets (principally non-land productive assets) into the name of the Partnership Director. This procedure protects cooperative assets from seizure through liquidation under the subsidiary liability for debts of individual cooperative members. In this way the non-land assets can be kept on the farm and the cooperative members are freed from their debt burden, although they no longer own the assets. After the assets have been moved to the new entity, the old producer cooperative is then taken through bankruptcy procedures.

Athough pre-bankruptcy restructuring relieves cooperative members of their debt liability, it raises several concerns.

- It concentrates non-land asset ownership in the hands of a few individuals and reduces the status of the farm workers from shareholders to wage laborers. This is a direct and immediate negative distributional consequence of asset concentration. Often workers are also encouraged to transfer their land entitlements to the new owners rendering them little more than landless laborers facing a very uncertain job market.

- The concentration of farm assets at the time of formation of the partnerships tends to reduce the options for subsequent farm restructuring into smaller production groups or into family farms.

- The form of farm organization favored by the authorities, the Partnership with limited liability, typically of significant size (3-5 partnerships created from a single producer cooperative) is currently untested in Kazakhstan. There are no strong grounds for believing that the partnership will form an enduring and effective form of farm organization.

- Several aspects of the pre-bankruptcy restructuring involve non-transparency, both in the frequent decisions to give ownership to the current farm director or in other cases in the selection of outside investors (usually with involvement of the local authority). In essence the authorities are trying to pick "winners" in a situation where their judgement can be easily swayed by other stakeholders.

- Commercial creditors will have little confidence in bankruptcy proceedings as long as pre-bankruptcy restructuring to avoid asset liquidation is possible.

The Outcome of the Bankruptcy-Led Restructuring Varies Between Agro-Climatic Zones

The outcome of the bankruptcy-led restructuring process depends critically on the viability of the farm and the agro-climatic zone. Within the northern oblasts a rapid process is underway of acquisition of ownership and control of complete entities by large grain and food industry companies, which are buying up groups of complete former state and collective farms. This pattern of acquisition is, however, limited to the most favorable zones for wheat growing. In other less favored areas within the same oblasts, farms are unable to attract investors and the prospects for start-up, whether in the form of the partnerships favored by the administration or as smaller individual/household farms, appear poor. In the most unfavorable areas bankruptcy is essentially leaving complete farms bereft of the equipment for production, which is sold in liquidation auctions and typically removed from the area. In other parts of the country more suitable for mixed farming rapid changes are also occurring, but with a wider range of alternative outcomes in terms of farm type and size.

A Number of Farm Types are Viable

Several viable farming structures seem to be emerging including producer cooperatives, various forms of partnership, Joint Stock Companies (JSC) established by outside investors individual farms, and small group cooperatives. Contract farming involving contracts between farms and input supply companies for delivery of crops in exchange for inputs, which has been an important form of farming in the north in recent years, has diminished substantially following poor experiences in the 1998 drought. The input supply companies which formerly engaged in contract farming are now buying in as owners and managing the farms directly. The multiplicity of potentially viable farm types suggests that government policy should concentrate on facilitating the emergence of whatever farm types and structures are favored by the market, rather than trying to impose a blueprint of a specific form after restructuring. Many authorities are still trying to engineer their favored model.

The Position of Workers

The effect of restructuring on former (and present) farm workers also varies greatly. In the less heavily indebted parts of the sector, former workers are now increasingly opting to form individual or small groups-based farms on the basis of their property and land shares. The greatest concern arises with respect to two other groups of workers. The first group involves those workers on farms which have emerged from bankruptcy (or out of court settlements) with a dominant investor who has acquired property, and in some cases land shares as a condition of investment. In general, workers in this situation have relinquished property (and often land) to escape from debt liabilities. The terms of transfer of these shares often provide little substance in return. Such workers have lost the right to work enshrined in the soviet system and many are in fact promptly made unemployed. It is important to bear in mind that these workers have been placed in this position primarily due to the adverse Government policies on crop and input pricing and directed credit which led to the build up in farm indebtedness. The second group of workers facing difficult circumstances are those in less favored areas where the farm faces limited prospects for start-up after bankruptcy and where there is no investor interest. This group is generally in a worse position than the former group because of the dearth of economic opportunities in their communities as the farming base collapses.

Social Services

There has been a marked decline in the provision of social services which were formerly maintained by the state and collective farms. However, this decline largely preceded the present farm restructuring. The present level of social service provision depends primarily on the level of success of the farm under whatever system of organization. Where the farm is successful the resources are available to maintain essential levels of support for the mandatory services now required to be provided by the local authorities. Farms that have been restructured with the help of outside investors are characterized by better services arising from direct support for the services by the investor from farm proceeds, pressure applied by the investors on the local authorities to meet their obligations, the ability to pay heating and power bills and hence to avoid cut-offs, and, in some cases, major investment in service improvement, for example through gasification of residential and social heating systems (which dramatically lowers running costs).

Policy Issues

The success achieved in stimulating real change in farm ownership, control and management in some areas, combined with the extremity of the difficulties faced by farms in less-favored areas, point to the need for an active process of policy reformulation to address the problems which are now emerging from the restructuring process. These policy issues fall into four main groups.

Policies to Address Possible "Overshooting" of Liquidations

Can the market correctly identify viable and potentially viable farms. The main function of the bankruptcy process is to separate viable, or potentially viable farms, for which a creditor-led solution should be possible given the right procedural framework for negotiation, from non-viable farms which need to be liquidated. Clearly the present policies are leading to accelerated negotiated solutions for manifestly viable farms. It is less clear, however, whether the present processes are avoiding the liquidation of potentially viable farms. While all farms facing liquidation under the program are deeply insolvent, it is more difficult to establish clear benchmarks for viability, and especially for potential viability. While it is recognized that there is a need for a retreat from the extent of crop cultivation established under the Soviet period, there is danger that market-led restructuring will lead to a level of farm closure which is inappropriate in relation to longer term potential, and may prove difficult to reverse. There are currently two factors which may lead to a failure of market-led solutions to sustain borderline or potentially viable farms. First, the deficiencies in marketing, which lead to abnormally high costs of input acquisition and output marketing, render farms non-viable under present conditions, which have the potential to be viable in a more settled economic environment. Second, the gross imperfections in the capital market greatly limit investor capability to buy into otherwise viable operations

It is beyond the scope of this review to establish definitively whether overshooting is occurring. To do this it would be necessary to estimate farm financial margins under a hypothetical improved marketing environment and with current constraints on capital inflow to the sector reduced. What is apparent, however, is that under bankruptcy-led liquidations, large tracts of currently farmed land can be stripped of all moveable assets in a very short period and those assets are either transferred to other areas or exported. This process is occurring in many less favored areas in the north of Kazakhstan.

Implications of "Overshooting." The problem associated with overshooting farm closures stems from the fact that a bankruptcy-led solution is being applied in an economic context characterized by major market failures. The appropriate policy response is, of course, to move as rapidly as possible to remove the sources of constraints and excess costs in the production and marketing chain. Chapter III of this report summarizes the main elements of such a program to improve the economic environment for the farm sector.

Policies to Address the Specific Problems of Non-viable Areas

The on-going restructuring has thrown into high relief the contrast in outcomes for farms in viable and non-viable areas. In the absence of substantial subsidies, farming as currently practiced is not viable in the drier parts of the land area opened up under the Virgin Lands Campaign. Farms in these drier areas are unable to attract investors, are unable to start-up after bankruptcy because they lack working capital, and increasingly, are unable to provide for the survival of their populations. The issue of non-viable areas has been hidden in the past by the policies of universal subsidization (through input loan guarantees). However, many local oblast authorities are now unwilling or unable to maintain the former guarantees and many of these farms will not be able to plant the 1999 spring crop, leading to possible social and humanitarian problems as winter approaches. The exact magnitude of the emerging non-viable areas is not yet well-documented. It is, however, likely to include a substantial tract of land in the drier southern half of the northern oblasts of Kazakhstan, stretching from Western Kazakhstan through Kostanai and Akmola oblasts.

At present the Government has no defined policy for coping with mass farm closures in non-viable areas. It is recommended that the development of such a policy should be treated as a priority, since the alternative in the absence of policy, will involve mass suffering as households struggle to migrate to more favorable environments. Possible policy instruments which should be considered include: a support package for internal migration from areas facing mass closures; and efforts to assure that existing social safety net programs (pensions, unemployment benefits, and other transfers) are delivered to these vulnerable groups.

Policies in Support of Smaller Farm Types in Potentially Viable Areas

The concept of viable areas and viable farm types is dependent on the constraints facing farmers. At present a wide range of legal, marketing and institutional constraints greatly reduce the profitability and hence viability of farms emerging from the bankruptcy process. There is an acute need for the authorities to pursue a set of reforms aimed at improving the economic environment (and especially the trading environment) for smaller independent and partnership farms. Easing of these constraints could go a long way to permitting restarts after bankruptcy for those farms which have not attracted outside investors and who currently lack the working capital to farm the land. Particular areas of policy where a more supportive environment could be created relate to: (a) inputs market for fuel, seed, land and credit; and (b) constraints to output marketing arising from monopolies at the elevator, bureaucratic interference and corruption, problems with policing and tax inspection, and the lack of an appropriate legal framework for marketing and other non-production cooperatives. Proposed policy developments are detailed in the main text of this report.

Policies for the Continuing Farm Restructuring Process

The new restructuring policies are having an important positive effect in stimulating real changes in farm ownership, management and control, and this program should certainly continue. There are, however, a number of respects in which the program can be improved on the basis of the experience gained to date.

- The Current Pre-Bankruptcy Restructuring Efforts Should Be Amended. While the pre-bankruptcy measures to create new partnerships and transfer assets to the selected owners of these partnerships keeps the assets on the farm, it is not equitable and imposes unacceptable risks to the former shareholders. This process should be stopped. In many instances, given the high priority that wage arrears receive in bankruptcy proceedings, farm workers can often use these arrears to bid on and acquire farm assets. In such circumstances, outright bankruptcy without prior restructuring serves the purpose of retaining the assets in the community, and alleviating the debt burden without requiring the workers to give up their ownership of the assets. They are then in a position to make their own decisions on the ownership and management structure of farms. The main text also highlights a promising approach to restructuring in Moldova, which through a combination of debt write-offs and tax credits, allows farm assets to be retained in the community, the debt burden to be relieved, and new organizational and management structures to be encouraged.

- Restructuring should facilitate emergence of market-led solutions, not imposed blueprint farm types and pre-selected owners. It is evident that in many areas the oblast authorities, who have been given a leading role in management of farm restructuring, continue to favor the formation of particular farm types and the selection of existing managers. Whereas formerly the emphasis was on producer cooperatives, currently efforts are devoted to encouragement of limited liability partnerships of an intermediate scale (between the former large state and collective farms and atomistic individual or family farms). While these partnerships have been an effective device for asset protection during bankruptcy proceedings it remains to be seen whether the partnerships will provide a durable and viable solution for farm ownership and management. In other areas, notably in the north, the oblast authorities are making substantial efforts to keep the former farm entities intact through the introduction of major investing companies into the farm sector. In some oblasts this is proving to be an effective method for creating new large-scale efficient farm businesses. While government policy has embraced the concept of multiplicity of farm type in principle (individuals are free to break away to create family farms; various forms of partnership and joint stock company are being created) the full logic of permitting the emergence of farm structures and management suited to the widely varying farm and market conditions has not yet been fully taken on board.

- The procedures for liquidation should be amended to provide greater security for commercial creditors. The law and regulations on bankruptcy have proven to be workable instruments, as evidenced by the rapidly growing number of cases taken through the courts. The specific regulations, however, may require amendment as the circumstances of the sector change. Specifically, the creditor prioritization rules established in the law itself give unqualified precedence to the wage arrears and to the government as creditors over the claims of commercial creditors. This prioritization has, perhaps, suited the initial reform period, when the vast bulk of farm debt was to Government (including the extra-budgetary funds and the Agroprom Bank and Agricultural Support Fund) and when Government wished to provide a measure of asset-protection to the producer cooperative members. For the future, however, there is a need to establish a more equitable system of prioritization with respect to commercial creditors, which recognizes the seniority of lending, prioritizes collateralized debt and which does not tend to undermine the otherwise sound credit allocation rules followed by the commercial banks.

- Need to close loopholes currently used for asset protection. The pre-bankruptcy restructuring procedures have been effective in preventing farm assets to be stripped away from the farm though as noted above, other less opaque measures can achieve the same results. They have also made it possible for the Government, as the chief creditor to the farm sector, to absorb a large measure of the losses which have arisen as a direct result of its own polices. For the future, however, with a presumed reduced relative role of government financing for the sector, it is important to close such loopholes, which can be exploited either for asset-stripping by unscrupulous farm directors, or as an asset-protection device to prevent liquidation by the commercial banks. The commercial banks will not increase their lending to the sector significantly if liquidation, as the mechanism of last resort, is effectively closed off to them. Such loopholes could be effectively closed by empowering the manager of the bankruptcy process through amendment to the Bankruptcy Law to examine and countermand transactions effected prior to bankruptcy whose sole purpose is to protect assets from valid creditors.

1. BACKGROUND

The agricultural sector in Kazakhstan is in a prolonged crisis which has persisted since the break-up of the Soviet Union. Production fell by 55 percent overall between 1991 and 1998 and grain production declined from a peak of 30 million MT to around 12 million MT over the same period. Above all, the vast majority of farming entities are insolvent and face a doubtful future. Government farm policy has passed through several stages, by which the original state and collective farms were transformed initially into collective entities and later into production cooperatives (PCs) with, until recently, little change in the actual operations and management at the farm level. Partial liberalization of the input markets, which led to rapidly increasing input prices beginning in 1993 combined with unchanged official procurement prices for the monopoly state trading channels to drive most farming entities into insolvency. The sector came to rely increasingly on barter with government guarantees against input supplies which led to accumulated indebtedness. Major creditors to the farm sector included the Agricultural Support Fund, Agroprom Bank, the state budget (including the extra-budgetary social funds) and the commercial banks.

In 1998 the Government drew up a new approach to farm restructuring which relied more heavily on the use of bankruptcy and on creditors to become the driving force in restructuring the ownership and management of farm entities. This new approach was the subject of a Decree in April 1998 and detailed instructions issued in October 1998.

This report reviews briefly the experience gained in the first six months of the operation of the Government's new approach using bankruptcy and creditor-led restructuring. The report is based mainly on the findings of field visits to farms in Almaty, Uralsk, Kostanai and Akmola oblasts in the course of which some 15 farms were visited and discussions were held with oblast and Department of Agriculture officials. The concentration of the field visits on the Northern oblasts corresponded to the initial perception that the most serious problems in farm restructuring would be encountered in the wheat-growing regions of the Northern oblasts. The report is, accordingly, more hesitant in drawing specific conclusions with respect to the Eastern and Southern oblasts.

Conditions of the Agricultural Sector

Kazakhstan has an area of 2.7 million square km. It is predominantly low plateau with a continental climate. The average length of the growing season is only 125 days in the north, rising to 175 in the south. Annual rainfall varies from 50mm to 500mm, increasing from north to south. The main agro-ecological zones are: the dominant steppe land of northern Kazakhstan, a natural grassland which is location for most wheat production; and the east and south-east have a higher and more reliable rainfall and, mostly, good soils. These former woodlands support the most diverse and intensive farming systems in the country. Access to irrigation extends the cropping options in most regions, but especially in the south-east with its longer growing season.

Agriculture used to be the second largest sector in the economy, contributing 30 percent of NMP in 1992. The subsequent decline saw its share fall to 11 percent of GDP in 1997, though this statistic may be understated as a result of under reporting of household farm activities. Most domestic food supply is met from domestic production. In 1997 the country exported 5.5 million MT of grain, mostly to Russia, down from 12 million MT in 1991.

Expansion of Agriculture Under the Soviet Virgin Lands Policy

The structure of farming in Kazakhstan is of relatively recent origin, especially in the northern wheat belt. Under the Virgin Land policies of the 1960s huge tracts of land were opened up to wheat farming centered on large state farms (and a few collective farms). This policy, which was aimed at maximizing the output of wheat for export within the Soviet Union, extended the production of wheat into extremely marginal areas with thin soils and low and unpredictable rainfall (down to 200mm). Much of the current farm debate centers on the question of the viability of economic farming in these extreme conditions.

Farm Restructuring (1992 to 1997)

The current restructuring exercise commenced in 1998. Between 1992 and 1997, the farm sector, which in 1991 comprised 2,120 state farms and 430 collective farms, was taken through several evolutionary stages. These can be summarized as follows.

- The former state and collective farms were dissolved as legal entities and collective farm entities were created. This formal change had little or no effect on the practical ownership and management of the former state and collective farms.

- The majority of the collective farm entities were converted into Producer Cooperatives (PCs), with the land and property shares retained under the common ownership of the cooperative.

- Following a presidential decree in April 1997, the PCs were encouraged to reallocate shares held in common to create a more clearly defined structure of ownership. The explicit objective of this change was to foster the formation of groups of shareholders or to concentrate ownership with certain individuals so that such individuals or groups could take a controlling shareholding and "ownership of farm enterprises, together with the associated financial responsibilities and obligations. In many cases the formal distribution of land and property shares was accomplished by direct gifts of shares, either by the President or from the local administration (oblast or raion Akim). The most common method for share concentration was the creation of one or more Partnerships with Limited Liability (PLL) by leading members of the PC, with an accompanying transfer of some or all property and land shares into the name of the Director of the PLL. In these cares, such property ceased to be legal property of the PC, either as a legal entity in its own right or through the property shares of the producer cooperative members. This approach is now a key element of the most recent Government farm restructuring initiative and is being adopted usually with active support from the local authorities as a mechanism for protecting the productive assets of the producer cooperatives facing bankruptcy.

Farm Types

The categories of legally recognized farm entity are established in terms of the various forms of enterprise structure permissible under the Civil Code of Kazakhstan. These comprise four main categories: PCs, Joint Stock Companies (JSCs), Partnerships of various types, and Individual (Peasant) farms. Table 1, Appendix I summarizes the ownership structure of the farm sector in terms of the permissible farm types as of April 1999. Of the total legally recognized farm entities of 89,996, peasant farms form a large numerical majority (84,766, or 94.2 percent). In fact these figures tend to understate the numbers of peasant farms as the registration process is time-consuming and not all newly former peasant farms are legally registered. Informed opinion suggests that the peasant farms may now number some 200,000 to 250,000.

The remaining farm entities fall into three significant groups: PCs (2,380), Partnerships with limited liability (PLLs) (2,290) and Joint Stock Companies (373). The trend over time is for a steady decrease in the numbers of PCs and a more than off-setting increase in the number of PLLs (since PCs are often divided into several PLLs). There also remain a total of 60 state enterprise farms mostly undertaking specialized functions such as seed multiplication. There is a marked geographical pattern in the form of farm ownership, with the majority of legally registered peasant farms located in the southern and eastern oblasts, while the majority of the JSCs and PLLs are situated in the wheat-growing northern oblasts.

Land Ownership

Important land reforms were introduced with the passage of the Land Code in 1995. This law, which remains the basis for current law in spite of important amendments currently under discussion, makes provision for long term (99 year) lease-holdings of land by individuals while ownership of land remains vested in the government. While leases can be legally transferred between individuals and between legal entities there are restrictions on such transfers. Furthermore, agricultural land which is uncultivated for three years is liable to expropriation by the state. While actual cases of land expropriation on these grounds may be very rare, the legal provision for expropriation acts as a significant deterrent to, for example, foreign investors considering investments and local banker seeking appropriate collateral. In support of a process of moving toward land privatization the Government issued instructions in 1997 for the farm population to be issued with land titles, or "acts" which established the long term leaseholder title to land within the farming entity to which the individual belonged. However, land was in general not demarcated at the time the acts were issued, so that individuals acquired a share in land property of the larger entity instead of becoming true owners of a defined physical piece of land. Specific pieces of land initially were only identified when an individual indicated his or her desire to leave the larger farm and operate independently. Not surprisingly the land they ultimately received was often on the fringes of the larger entity. Later in 1997, a decree instructed farms to demarcate plots and to issue each individual with titles, but this process is progressing slowly and in most areas land remains undemarcated. In practice, land is still only demarcated when individuals leave the larger entity to farm independently. In a few cases, the former state farm had already been acquired by an investor and no land titles were ever issued.

Non-Land Property Shares

Ownership of the productive assets of the former state and collective farm was also vested in the farm population at the time of the formation of Production Cooperatives. Such property included the machinery and other movable assets of the farm and the buildings used for both production and social purposes. Property shares and land shares were treated separately so that it has become possible for an individual to hold property but not land in a farm entity or vice versa. The property shares of Production Cooperative members also carried a liability to the debts of the cooperative, as under this form of organization individual cooperators, are liable for their share of the debts of the cooperative.

Box 1: The Land Allocation process in Kazakhstan and Azerbaijan

The procedures followed with respect to ownership of farm land in Kazakhstan can be interestingly compared and contrasted with those followed in Azerbaijan, a country where most land is irrigated with fertile soils and has substantial market value.

In Azerbaijan, land owned and cultivated by the former state and collective farms has been comprehensively privatized in a major reform over the past two years. Responsibility for the privatization of farm land is vested in the State Land Committee. A detailed regulatory base for the allocation of land parcels to individuals (and hence households) was prepared in the form of a Presidential Decree which has formed the blueprint to the actual subdivision and allocation of land titles. The basic Land Law provides for full ownership of land by individuals including essential unfettered rights for land sale and transfer.

The allocation of land was undertaken in several stages in Azerbaijan. These included:

- the physical demarcation of land parcels and the mapping of these parcels, initially by the state and collective farms, later in computerized form by the State Land Committee;
- the taking of soil tests to establish soil quality for every demarcated parcel;
- the definition of the value of each parcel expressed in land quality units;
- the distribution of land parcels to eligible individuals and households by means of a publicly conducted lottery; and
- the issue of titles (one for each household) which contained full details of the location, size, quality and owner's name for each plot.

A total of nearly 800,000 land titles have been created and distributed over the past two years, details of which are maintained on a central computer register. As a result of these measures very clear and transparent ownership rights to cultivable land have successfully been created, and these are already forming the basis for a developing land market.

In Kazakhstan, by contrast, the initial allocation of agricultural land rights was not accompanied by demarcation of individual or household plots or parcels though this is now progressively being implemented. The lack of demarcation of plots has hampered the ability of individuals or family to break-off into smaller units and has facilitated the take-over of complete former state farms by large scale investors.

The Evolution of the Farm Crisis

The farm sector in Kazakhstan is in a deep financial crisis, which has finally led to the restructuring exercise in which the authorities are currently engaged. However, it is important to emphasize that the origins of the financial crisis do not stem primarily or directly from deficiencies in the legal or organizational status of farms, though such deficiencies may have exacerbated a deteriorating situation. The financial crisis is rather the direct result of successive government policies, notably: (a) the price squeeze to which the sector was subjected in 1992-95 as input prices were decontrolled while output prices were kept below the cost of production; (b) the widespread practice whereby local authorities continued to require farms, even after they became producer cooperatives, to engage in production activities which were well-know to be loss-making, especially livestock production; (b) the continued policies of extending loans (or guarantees) for inputs to farms which were already insolvent; and (c) the imposition of heavy penalties for arrears of tax and social payments owed to the government (budgetary and extra-budgetary funds). Given these policies, it was virtually impossible for most farms to avoid indebtedness, whatever their legal structure or organization.

An important corollary of this observation is that the level of indebtedness or degree of insolvency is only a poor indicator of the underlying profitability of farms: farms in the more climatically favored areas tended to receive larger loans to provide the inputs necessary to achieve their high potential levels of output. Where the loss incurred is proportionate to the level of output (as occurred under the price squeeze) the farms with the greatest potential are also those bearing the greatest debts.

The question of the causes of the present crisis also has a strong bearing on analysis of equity aspects of the current restructuring. Relative to other sectors (such as urban housing) the agricultural sector was subjected to savagely adverse government policies, which have essentially bankrupted the sector. The overall situation for the farm sector has certainly improved since the 1992-95 period, but there is still a bias in policies, particularly those implemented at the local level that serve to tax the sector (e.g., restrictions on commodity movement for "food security reasons" and locally imposed directives on what farms are to produce). The heavy taxation of the sector was offset somewhat but not completely by the lack of hard budget constraint implicit in the accumulation of debt that has necessitated the current bankruptcy proceedings.

The Effects of Drought in the 1998 Season

Most parts of the country have experienced drought in the past three seasons (1996 to 1998). In particular the 1998 season was exceptionally dry in almost all areas, leading to widespread crop failure. In the north, which was most affected, many farms decided not to harvest, as with wheat yields often below 0.4 MT/ha the costs of combining exceeded the value of the marketed crop. The drought of 1998 led to a deterioration in the financial status of most farms, including many which had shown a measure of improvement during 1997.

2. THE 1998-99 FARM RESTRUCTURING PROCESS

The Emergence of Restructuring Policy Using Bankruptcy

The process of farm reform undertaken up to 1997 led to formal rather than substantive changes. The majority of former state farms and collectives, although now legally registered as production cooperatives, continued to function much as before, though under ever more difficult financial constraints and in an ever-deepening crisis of indebtedness. Partial attempts at writing off debts to the public sector led to little lasting improvement and threatened to generate complacency at the farm level with respect to debts. The virtually complete reversion to barter as the principle form of trade on both domestic and external markets greatly reduced the efficiency of transactions, adding a further burden to the farms.

Faced with these mounting problems, the Government initiated a fresh approach to farm restructuring during 1998. The new approach was based on recognition of the need for extensive application of bankruptcy law both to remove the burden of farm debts which rendered the sector non-creditworthy and in the hope that bankruptcies would lead to changes in the ownership and management of farms conducive to post-bankruptcy recovery.

Classification of Farms

In preparation for the new policies the Ministry of Agriculture undertook a classification exercise for all remaining state or cooperatively-owned farm enterprises. In the course of this review, farming entities were placed into three categories:

- Group I - Farms which were in sound condition and required no special restructuring efforts;
- Group II - Farms which although facing financial problems, had reasonable prospects of recovery given appropriate support; and
- Group III - Farm entities which could not be salvaged as viable entities and which should be prepared for and submitted to bankruptcy.

Table 2, Appendix I shows the classification of the farms for December 1997 and again for April 1999. Of the total of 5,230 farms classified in April 1999, 18 percent were judged financially sound, 46 percent fell in Group II and 33 percent fell in Group III. Since December 1997 there was a substantial further deterioration, with the number of entities falling into the bankrupt category rising sharply from 17 to 33 percent, while the proportion in Group I fell from 21 to 18 percent. This deterioration is due to the extreme drought conditions experienced in the 1998 season. A large proportion (71 percent) of the Group III entities are located in the six northern oblasts, giving a strong regional character to the problem.

The Legal Base for Bankruptcy Proceedings

The legal basis for bankruptcy proceedings for farm entities is contained in two key documents. The Law on Bankruptcy of 21 January 1997 provides the economy-wide legal framework for bankruptcy proceedings. The law defines the conditions under which bankruptcy proceedings may be initiated, the definition and functions of the bankruptcy courts, the provision for the appointment of a Tender Manager following the finding of bankruptcy and the framework for creditor recovery of the assets of bankrupt enterprises through auctions. The second key document for bankruptcy of farm enterprises is the Order of 22 December 1997 on the Peculiarities in the Application of the Bankruptcy Law to Agricultural Production Enterprises. The Order provides (inter alia) specifically for:

- the requirement that seasonal aspects of farming operations be taken into account in determining the solvency of enterprises;
- definition of insolvency in the case of agricultural producing entities;
- declaration of bankruptcy for farms even if their assets exceed their liabilities;
- the provision of documentation to the court on national and local climatic information for the previous season;
- the inclusion of land value in the assessed tender value of the entity;
- the lack of specific regulations for the function of the Tender Manager;
- details of the tender procedures to be adopted in agricultural bankruptcies which included presentation for sale by tender of entities as a single lot using a Dutch auction, with division into multiple lots in the event of failure of the tender, and the estimation of a starting price and a minimum price for bids; and
- the right of creditors to off-set their claims against the purchase price where a creditor agrees to purchase an entity in a single tender lot.

Under the standard procedure for industrial bankruptcies, the Agency for Liquidation is the authorized manager of the bankruptcy process. However, for farm bankruptcies the order lacks specific regulations describing the functions of the manager. The Oblast Department of Agriculture has typically been appointed as the authorized body for managing bankruptcies and for representing creditor interests. Specifically, the oblast Department of Agriculture is empowered to participate in meetings of creditor committees held under bankruptcy proceedings to represent the interest of the state (which is the principal creditor in most cases).

Creditor Prioritization

The bankruptcy process provides for a specific prioritization for distribution of assets from the bankrupt entity as follows:

1. Costs of the Tender Manager;
2. Payment of wages arrears to injured and disabled members;
3. Other wages arrears;
4. Debts to the fiscal and other government authorities; and
5. Commercial creditors.

An important additional rule affecting creditor prioritization is that creditors submitting bids in the tender process may offset amounts they are owed from the bankrupt entity against their cost of purchase through the tender. In other words some creditors, can take precedence over competing creditors if they choose to participate as buyers in the tender. This provision is particularly important for farm workers who in many farms are owed significant amounts of wage arrears. They can use these arrears to bid for assets in the bankruptcy auctions.

Pre-bankruptcy Restructuring (from Producer Cooperative to Limited Liability Partnership)

Given the overwhelming magnitude of the debts due from farms, primarily to the Government, simple application of the bankruptcy law, in the absence of any prior restructuring, would often leave the existing PCs wholly bereft of assets and would greatly undermine the ability of the former members, under whatever form of ownership, to recommence farming. This is because under the Civil Code, the individual members of a Production Cooperative face subsidiary liability for any debts incurred by the PC. The Government has, accordingly, widely applied a standard pre-bankruptcy restructuring package to enterprises slated for bankruptcy aimed at protecting the interests of workers and to prevent the wholesale diffusion of farming production assets.

Typically, local (oblast or raion) authorities have directly encouraged the farm members to register one or more Partnerships with Limited Liabilities (PLLs) and to transfer the ownership of assets with significant value and high liquidity into the hands of a single individual in each PLL, frequently but not invariably the PC Director, as a pre-emptive move for asset retention within the community. The authorities also see this approach as a means to move away from cooperative forms of management and to place all control and responsibility in the hands of owner managers ("the true owners) who are capable of making the farms productive and profitable.

Given that the ownership of property in the PC lies in the hands of many holders of undistributed and undivided non-land property shares the consolidation of property ownership in a single individual has required a very substantial body of documentation consisting of the deeds of transfer of the property shares of each individual, since many entities have 600 or more property shareholders. Specialized consultancy firms have rapidly developed the capacity to provide a service in the preparation of all the necessary documents for the property transfer to be legally in order as a preliminary to re-registration of PCs and PLLs. In the cases encountered during the review this service is provided for a fee of 80,000 to 150,000 Tenge ($700-$1300).

Patterns of Restructuring During and After Bankruptcy

The application of the new restructuring policies is still only at an early stage in most oblasts. While the shift in policy was announced in April 1998, the detailed administrative instructions date only from October 1998 and, in most oblasts, only a limited number of bankruptcies have actually been completed as of late April 1999. However, in the areas visited by the mission the authorities are proceeding actively to prepare Group III entities for bankruptcy and the number reaching the courts are likely to rise sharply during the coming months. The limited extent of completed processes is reflected in the outstanding farm indebtedness which, although falling slightly, remains at approximately the level of a year earlier, (i.e., at a total of approximately $1 billion (See Table 3, Appendix I)).

Emerging Patterns of Ownership

Important changes currently are taking place in the legal and organizational structure of farms which are closely linked to the greater emphasis placed on use of bankruptcy. It should, however, be emphasized that changes are not uniform across oblasts and climatic zones, but rather are differentiated by farming system. The following current trends can be identified.

- A number of Partnerships with Limited Liability (PLLs) have been created within PCs. This process involves the establishment of one or more successor farms as PLLs and transferring assets from the producer cooperative to these farms prior to taking the PC through bankruptcy. In some cases there is no real change in farm management and operations from the former PC. In other cases it involves the real division of the entity into smaller legal and operational farming units.

- There has been a marked decline in the prevalence of contract farming by large grain companies faced with poor experiences of debt recovery in the 1998 season; this trend is most clear in the northern wheat belt.

- A number of complete farms have been acquired by investors either through purchase or long term lease agreements, especially in the north of the country, but confined to the most favorable growing areas.

- There has been a consolidation (legally and operationally) of entities acquired by large companies where these had been previously split into several segments.

- A rather rapid process of fragmentation into smaller units (PLLs or independent farms) is occurring in the more favorable southern oblasts and in irrigated areas in the north.

- There is a complete collapse of farming entities in the least favorable farming areas (e.g., the southern raions of Kostanai oblast).

Box 2: Case Study: Application of Farm Restructuring Measures in Kostanai Oblast

The activities of the Kostanai oblast Department of Agriculture provides a clear example of the pro-active role being taken by local authorities (at both oblast and raion level) in managing the farm restructuring process both in terms of pre-bankruptcy restructuring and in the management of the bankruptcy and liquidation process.

Objectives: The explicit aim of the oblast authorities is to maintain the existing large farm basis of grain cultivation established under the state farm system but with a successful transition to privatized ownership and control. The oblast has set itself a target for 1999 season of maintaining 2.8 million hectares under grain production and is actively linking farms to prospective investors to maintain planting and production levels.

Pre-bankruptcy Restructuring: The oblast authorities are actively supporting struggling Groups II and Group III farms to convert to Partnerships (usually several PLLs per PC.) The oblast officials advise the farms on how to go about this process and may organize consultancy support for the completion of the necessary legal documentation (at the expense of the farm).

Preparation of farm "passports:" The oblast authorities have prepared prospectuses (referred to as "passports") for all farms in the oblast as an aid to attracting investors. The oblast is actively playing a role of marriage bureau for investors. Investors fall into two main groups: (i) large companies building portfolios of groups of farms, often combined with backward or forward linkages into input supply or marketing and processing; and (ii) individual investors, mostly individuals of local origin who have made a name for themselves in the local business /manager community, who are actively encouraged to discover a new role as owner-manager of former state farms.

Residual provider of loan guarantees for farm inputs for wheat: the oblast expects to continue to provide guarantees for approved farms to receive inputs supplied either by the state seed farms (usually outside the oblast) or by the state diesel suppliers.

Creation of Machinery-Technical Stations: the oblast authorities helped to establish six machinery pools.

Management and the New Directors

From the farms visited during the study, it is clear that the present restructuring process is leading to widespread changes in the management of farms, linked to the fundamental underlying changes in the ownership and control of land and productive assets. While many production cooperatives still in the pre-bankruptcy phase have retained their former directors, changes in farm control are in most cases reflected in the imposition of new management. Several cases can be distinguished. First, where large investing companies are acquiring ownership the almost universal practice is to replace the former director (and other farm managers) immediately, usually by younger managers who have been trained during the 1990s, but often with no prior direct experience of farm management. The large companies interviewed all stated it is policy to put in their own new management, who have stronger marketing skills and a different outlook. In cases where individual investors are taking control of farms (or parts of former entities) typically the investor manages the farm directly. These are often individuals who have acquired their wealth in trade or manufacturing and who, again, do not have continuity with the past. In cases of the creation of independent farms from within the former entity, the new farmers also are usually not the former director. However, an unfortunate and all too common exception is where a PLL is created as part of the pre-bankruptcy restructuring process, in which case the former director often becomes the director and manager of the PLL, often with the active support of the local authorities. In this situation, there is no injection of new managerial talent into the farm and the farm members have little, if any, input into the decision on who is going to manage and own the new entity.

Viable Start-Up Models

The on-going restructuring process is already providing an indication of viable forms of farms legal and organizational structure. Several viable models were visited during the field visits of the mission, though these models differ in their likely replicability. Appendix II provides case studies of these models based on the mission's field visits. The following discussion briefly describes the key features of each model.

Well-Managed PC. While the PC is likely to experience several well-know organizational disadvantages in a difficult economic environment (including difficulty in controlling costs and high internal costs of achieving consensus between members with varying interests), the existence of examples of successful production cooperatives implies that this form should not be ruled out as impossible. Case Study No. 1 (Karl Marx) provides an example of a PC (legally it is a PLL, but in all other respects it operates as a PC) which has out-performed neighboring farms. However, the high level of managerial skills required to successfully operate a production cooperative make this an unlikely form to be replicated successfully and the overwhelming lesson of the past two years has been the difficulty experienced by PC in surviving.

Director-Owned Limited Partnerships (DOLP): This is the dominant form emerging immediately after bankruptcy. The DOLP has the advantage that ownership and control have been concentrated in the hands of a single individual (usually the manager). Two sub-types can be distinguished: where an outside individual has been brought in (usually with a measure of personal capital injection) and where the former director has taken control. In the former case, the new management and the capital injection may indeed help the new enterprise to survive. However, it is too early to predict whether the second type will survive. In many cases the former director lacks the managerial skills to operate the farm under market conditions. The risk is that badly managed production cooperatives are turned into badly managed DOLPs and the former shareholders will have given-up their shares with little to show for it.

Investing Grain Company. One of the emerging dominant types of farming in the north of the country, are entities which have been acquired by specialized grain production and trading companies with substantial financial resources, usually accompanied by vertical interests in the grain marketing process. Successful examples of this organization mode are shown in Case Studies 9 Bisco-Trade and 10 Zhambul farm). The main advantages of this form are:

- access to working capital in a severely credit-constrained environment;
- the ability to spread climatic risk by investing in several raions within the same oblast (experience points to significant climatic variations within the oblast with a given year);
- economies of scale arising from reduction in the cost of specialist staff, which can be used across several farm entities and lower marketing costs because larger (usually export) consignments can be organized;
- economies in the provision of central services (e.g. finance and accounting);
- economies and efficiencies in the use of their own elevator and other marketing facilities; and
- exploitation of backward linkages to the input supply industries and distribution (especially fuel and seed).

Investing Food Chain Conglomerates. This group is distinguished from the preceding group only in that the parent company is less concentrated in grain-related activities and derives its strength from efficiencies arising from a fully developed food chain group of activities (production, primary processing, industrial processing, marketing and use of industrial side-products back into the production process). Case Study No. 2 (Arai JSC) is an example of this category. Advantages additional to those enjoyed by the above category include the ease of diversification into a wider range on on-farm processing and production activities in support of the processing and marketing units of the conglomerate.

Individual or Family Farms. While there are examples of viable and profitable private farms the majority of these are farms established early in the reform process, in 1991 and 1992. These early farms had the advantage that they were privatized "spontaneously" shortly after independence and before the introduction of formal privatization procedures. In essence, they were able to acquire crucial farm equipment through a variety of informal means that are now no longer available. More recently created farms face many constraints to operation. Nevertheless, many such farms now exist and more are created every day. The tendency to fragmentation in the better climatically endowed areas and worldwide experience with the effectiveness of private farming as a basis for organization suggest that private family farms will occupy a large place in future agriculture in Kazakhstan. A major policy priority is to create a legal marketing and institutional environment in which private farms are able to function in economically viable areas.

Contract Farming. Contract farming was the main organization form during the past three years, with grain companies entering into annual contracts to provide inputs against delivery of an agreed level or proportion of output. The potential viability of this form is attested by the fact that some companies are continuing with this mode of production in spite of most receiving poor results during the 1998 drought, with many contracted farms unable to honor their delivery liabilities. These difficulties have led to a large proportion of companies shifting to a more direct ownership relationship with a longer time horizon with effect from 1999. Thus, while contracting is a potential form its prevalence is declining at least for the time being.

The Impact of Restructuring on Farm Size

It is evident from the case studies in Appendix II that the wide range of ownership and management changes resulting from the present restructuring are having a variable effect on farm size. In areas where investment by larger companies is taking place the new investors are typically maintaining the origin state or collective farms as their units of management, or they are gathering groups of entities within a common management framework. In a larger number of cases, and certainly in most areas outside the northern wheat belt, there is a process of fragmentation occurring. This is occurring in several ways: (a) the formal decision to split PCs into several PLL in the pre-bankruptcy restructuring operations; and (b) the autonomous splitting off by individuals of households or groups of households to form independent farms. However, there are also opposing forces at work leading to off-setting consolidation.

In many cases individual investors are busy aggregating land and property shares, rebuilding larger individual farms within an entity the size of which is determined by the number of land-holders prepared to relinquish or transfer their leases. It would appear that the processes of fragmentation and consolidation vary systematically between areas with differing conditions, with a stronger tendency to fragmentation in the higher rainfall, more fertile and irrigated areas, while the difficulties of operating small farms in the semi-arid areas act as a brake on fragmentation into individual farms.

Impact of Restructuring on Farm Workers

The current restructuring has had a marked impact on the pattern of ownership of farm property by individuals. This arises through the mechanisms which have operated on the ownership of property shares and of land respectively. It is important to emphasize that ownership of farm "property" shares and of land stem from different legal bases and are treated separately in the farm restructuring process. The treatment of property shares stems from the provisions of the Civil Code and varies between the different legal forms of association. By contrast the rights, obligations and conditions of transfer of land are set out in the Land Act. The key characteristics of property and land shares are spelled out below.

Property Shares

The reforms of 1995/96 which saw the creation of PCs out of the former Collective Farm entities as the normal farm type were accompanied by the creation of PC share capital and the issuance of PC property shares to all farm members. These "property" shares covered the fixed and movable assets of the farm, with the important exception of land. As noted earlier, under the pre-bankruptcy restructuring engineered by the authorities during the current restructuring exercise, ownership of property shares is being extensively concentrated in the hands of a limited number of individuals. The conditions under which this transfer of shares has taken place vary from farm to farm with considerable variation in the formality of the arrangements adopted. Some mechanisms observed during the course of the field visits included the following:

- The development of a formal contract for the transfer of property shares, specifying the number and nominal value of the shares, the treatment of shares of debt of the PC (which are concomitant to property shares), and the formal specification of the rights and obligations of the PLL Director both during and after the anticipated bankruptcy of the PC. In many cases these contracts include conditional clauses specifying, for example, the post-bankruptcy rights of the share transferor in areas such as right to fodder, share of profits in the event of profitable operations are achieved, and the right to work or limitations on the right to work on the reconstituted farm.

- The purchase of property shares by the PC from members retiring from the PC (for example those who wish to start individual farms or to form alternative PLLs). Such purchases are usually paid for with livestock, priority in payment of arrears of wages, or, most commonly, simply relief from the individual's share of the PC's indebtedness.

- The creation of tailored contracts issued by an incoming investor. In one case this involved two types of contracts: (i) a generic contract with the farm as a whole (the PC) spelling out the investors general commitments and rights on taking over the farm covering such items as the investor's right to employ only the labor required by the farm business and to terminate other workers; and (ii) contracts with each individual tailored to the specific situation of the individual, varied accordingly to the prospective status of the individual as employee, rights to animal fodder, etc.

- In many cases the rights and obligations of the incoming director are not reflected in formal exchange of contracts with property share transferees.

The common feature of these contractual forms is that they relinquish the obligations of the PC member for their share of the debt. Given the insolvent status of the farms undergoing restructuring and bankruptcy the property shares held by the former farm workers typically are of small or negative value at the time of restructuring, when allowance is made for the debt obligations which accompany PC property shares. Farm workers have been persuaded to relinquish their property shares in many if not most farms under the threat of loss of all farm property under liquidation, and share transfer had been presented as an option for retaining some prospect of at least wage employment in the post-bankruptcy situation, by keeping some assets of the former cooperative in the hands of the director.

In practice the fate of the former workforce after restructuring has depended closely on the success of the resulting privately controlled farm. Almost all farms visited during this mission had shed substantial labor, usually immediately after concluding the agreement between the director and the workforce. Some farms had managed to retain all the workforce and these covered several farm types (including both a PC which converted to partnership in legal form only, but was able to maintain employment by diversification, and an investing company which had expanded the workforce on the basis of farming land leased from adjacent farms).

Labor shaken out from the base farms has met with a variety of fates:

- establishment of individual family farms;
- early retirement;
- migration to more favorable rural areas (e.g. from the southern raions of Kostanai oblast to the more favorable northern raions);
- migration to urban areas in search of non-farm employment;
- household-based agricultural activities (livestock and poultry keeping); and
- substantial on-farm unemployment in the less successful farms.

It is not within the scope of this study to make quantitative assessments of the relative importance of these labor market outcomes. What is evident, however, is that for those shaken out in the less well-endowed areas productive alternative employment opportunities have been limited and as a result many families face a rather difficult situation.

Land Ownership

At a formal level the restructuring process has no direct impact on land ownership, as land as an asset is not included in the liquidation sale process (though it is included as an asset in the valuation of farms as going concerns). Strictly speaking, therefore, the changes in land ownership which have accompanied the reforms should be treated as a separate issue. In practice, however, changes in land ownership have closely matched changes in the ownership in property shares. In particular, incoming investors have invariably sought to acquire or at least to control the land shares for the farm properties into which they invest. Investors have used several methods to acquire land leases as summarized below.

- Larger scale incoming investors have usually received all land titles with respect to the area coming under their control (this may or may not be coterminous with the former state/collective farm – some land may have been separated off already to form individual farms). In most cases legally binding transfer of land leases has been completed (or is planned). However, such transfers are not necessarily for the full 99 year period of the original lease. In one case a large company had acquired subsidiary lease-holdings of between 5 and 15 years from the varicus farms over which the company had taken control.

- Individual investors may acquire land by grant from the local administration from land held by the state (in many cases raion authorities have access to land funds established early in the privatization process from which grants of land can be made). These gifts form part of a package of incentives to attract investors with no previous involvement. The problem, however, is that the decision making process around the granting of land from the land funds is rarely transparent.

- Smaller scale farmers wishing to farm individually or as partnership may build up a land-holding by persuading those with no interest in direct farming (pensioners, professional and technical employees) to relinquish their shares (and to legally transfer the titles) on the basis of either settlement of part or all of the wage arrears due to the individuals or on the basis of an agreement, often conditional, for share in profits in the event of profitability. In some areas they may also obtain land from the local land fund.

- In some of the earliest cases of farm acquisition by investing companies land titles had not been issued, and agreement has been reached with the raion authorities and the farm workers that the titles will now be issued to the company, not to the individuals.

As is clear from the above discussion of property and land share transfers, a very wide range of types of trade in assets, land use rights and debt is taking place. In general, however, the terms of these trades reflect the relative bargaining positions of the parties. The farm workers are aware both that their property shares carry debt obligations and that their property is of limited or no value in the absence of a viable farming entity which can muster the resources to cultivate the land. Given the acute shortage of investors able to restart farm operations workers in most farms have been prepared to relinquish both their property and land rights in exchange for the removal of personal liability for group debts and for some small promise of support in meeting immediate survival needs. The critical factor behind these transactions is the indebtedness of the base farm itself, primarily the result of government policies relating to incentives. Moreover, previous rural studies revealed that many rural households were ignorant of their legal rights in respect of land in the early days of the privatization process. Such ignorance may still be contributing to the perceived willingness of shareholders to hand over land and property shares.

Impact of Restructuring on Social Service Provision

Prior to the farm restructuring reforms, the farms typically financed and managed all social services in the collective, including schools, health facilities, leisure and cultural facilities and kindergartens. Government policy is that social services should be progressively transferred from the management and budget of the privatized farms to the account of the local (usually raion level) authority. At a formal level this process has proceeded for several years. Table 12, Appendix I provides a summary of the number of institutions transferred during the past 16 months (roughly one third of those still attached to farms as of the beginning of 1998 have been transferred).

The transfer of services to the nominal responsibility of the local authority does not constitute a solution if the local authority lacks the funds to maintain the services adequately. In general, the acquisition of new responsibilities by the raion authorities has not been matched by any equivalent increase in financing grants from the Government budget. The position observed in the course of the mission is that the level of provision depends primarily on the degree of success of the farm entity. Farms which have managed to attract investment enjoy higher levels of service provision than less successful farms. This is not necessarily because responsibility for services are retained on such farms, rather the reverse, the new investors are more insistent on the local authorities meeting their legal obligations with respect to social service provision, and as significant local tax payers they have the clout to pressure the raion to meet its obligations. The more successful farms also have much greater financial capacity to provide for services under-supplied by the local authorities such as school and heath center heating, assistance with school fees for children of poorer families, etc.

Maintenance of power and supply of fuel for both residential and school heating are among the greatest problems facing the less successful farms as utility providers are increasingly resorting to cutting off supplies when payments are in arrears. Again, the more successful farms are reducing the magnitude of this problem through investment in gasification, which dramatically reduces the cost of winter heating. However, it is only the most successful farms which are able to afford such investment under present conditions.

In most farms there has been a steady process of the sale of social facilities not deemed essential, such as cultural facilities and miscellaneous out-buildings. In all areas visited, the kindergartens had been closed early in the farm crisis.

3. ANALYSIS OF ON-GOING RESTRUCTURING

The previous chapter described the application of restructuring measures adopted since October 1998 and assessed the actual changes which are occurring in farm ownership, size, management and behavior. This Chapter draws some broader conclusions regarding the restructuring process which have a bearing on the development of policy, both for restructuring itself and in the wider context for the agricultural sector.

Is Pre-Bankruptcy Restructuring Helpful and/or Necessary

The previous chapters have indicated some of the effects and implications of the on-going farm restructuring processes. What is striking is that in many cases the final result of the process has been the loss of property rights for a significant proportion of the rural labor force and the associated concentration of rural assets in the hands of a relatively small number of new owners. It is necessary to ask whether alternative procedures could be defined which would have less adverse consequences for the distribution of assets and incomes.

Government pre-bankruptcy support has been based on twin objectives: achieving a measure of assets protection to ensure that rural communities are not completely stripped of the productive assets essential for maintaining cultivation; and achieving a concentration of ownership of shares and control of farms in a new class of farm directors/owners. It must, however, be questioned whether this process of concentration is really an essential part of the farm restructuring process.

The method of pre-bankruptcy restructuring adopted, based on creation of a limited number of Partnerships with concentrated asset ownership raises a number of concerns as outlined below:

- The concentration of asset ownership in the hand of a few individuals inevitably carries with it a concentration of income, since the new owners of farm assets will effectively appropriate the rental income from those assets. This is a direct and immediate negative distributional consequence of asset concentration.

- The concentration of farm assets at the time of formation of the partnerships tends to reduce the options for subsequent farm restructuring into smaller production groups or into family farms. Essentially the concentration of assets is a process which is difficult to reverse (except in the small minority of partnerships where the new director has permitted the members to retain the legal right to assets initially assigned to him). In other words, asset concentration is tending to limit the scope for further rounds of farm break-up.

- The form of farm organization favored by the authorities, the PLL, typically of significant size (three-five partnerships created from a single PC) is currently untested in Kazakhstan (or indeed, elsewhere). There are no strong grounds for believing that the partnership will form an enduring and effective form of farm organization. Rather, this would appear to be a perpetuation of the former practice of attempting to guide the process of farm restructuring, which clearly failed in respect of the Collective Farm Entities and the PCs.

- Several aspects of the pre-bankruptcy restructuring involve non-transparency and the potential for corruption, notably the deals cut with investors (usually with involvement of the local authority).

The principal alternative to pre-bankruptcy restructuring based on partnership would be to pursue the bankruptcy route without any attempt to guide the process through pre-bankruptcy restructuring. A second alternative would be to use a combination of tax credits, and the write-off of government debt (as an alternative to bankruptcy proceedings) as an enticement to induce changes in the structure or management of farms, a route that has been followed in Moldova (see box below).

Box 3: Privatization and Farm Restructuring in Moldova

After a slow initial phase of land privatization and farm restructuring, agricultural reforms in Moldova has accelerated since 1996 when individuals' rights to exit from large-scale farms were restored, and the **National Program for Farm Restructuring** (NPFR) was initiated. Under this program, land is being fully privatized free of debt, i.e. physically identified land plots are given to each beneficiary (farm employee or pensioner) with individual titles on an equal basis. This first step of farm privatization leaves the 'remaining enterprises' with social and other non-land assets, namely buildings, agro-processing facilities and any shares in other agro-enterprises, as well as with an often considerable amount of accumulated debts.

In a second step, NPFR will now begin to settle these debts and complete farm restructuring by liquidating the old farms as legal entities. The **Law on Restructuring of Farms Undergoing Privatization** of May 1999 provides the comprehensive legal framework. It defines a set of 'critical assets', including irrigation facilities, tree crops, and agricultural machinery that are distributed along with the land to each beneficiary, thereby protecting these assets from the bankruptcy procedures. The Law also gives farm creditors the option of expedited liquidation as opposed to the regular court procedure in conformity with the existing Bankruptcy Law. In the out-of court procedure, after agricultural land and the 'critical assets' have been distributed to the eligible beneficiaries, the remaining assets are then used to cover any secured debts and wage arrears. Then all remaining farm debts, both to private and to public creditors, are transferred to the state. In turn, the state receives the book value of any remaining farm assets, including both social assets and any remaining commercial assets. The latter is sold where possible. Debts to the public are written off against these assets and private creditors, whose credits have been transferred to the state, are compensated by tax credits which they can use over a five year period against any kind of payments due to the state and local budgets. The final steps of the privatization procedure are, first, either to write off any debts exceeding the book value of the farm assets or–in most cases–to transfer the remaining assets to the shareholders of the farm; and, second, the final legal liquidation of the old enterprise.

This expedited debt settlement will rapidly complete farm privatization in Moldova and provide its rural population with broad ownership of land and non-land farm assets. The new owners can freely decide to rent or sell their assets or to farm individually, cooperatively, or in any other manner they choose. The various forms of newly emerging farming organizations provide opportunities for further restructuring and modifications in the use of agricultural resources according to market principles.

In the absence of pre-bankruptcy restructuring the outcome of bankruptcies would differ in some significant respects.

- Without the asset protection provisions of pre-bankruptcy actions, bankruptcies could lead more frequently to the dispersion of productive farm assets to buyers outside the farming community in question. This is certainly happening in some areas where bankruptcies have proceeded without previous restructuring measures. Given the shortage of purchasers in bankruptcy auctions this probably implies a concentration of assets on an equal scale to the concentration which has resulted from pre-bankruptcy restructuring, with the important difference that the new owners are more likely to remove assets physically from the farm (Such removals will often, of course, be in the interests of improved allocation efficiency).

- In terms of the position of farm workers, given the high prioritization of workers' wage debts in the bankruptcy auction procedures in many cases workers would be better off. Asset sale realizations from bankruptcy auctions would be used in the first instance to meet wage arrears. Workers also would have the option of acquiring the farm's assets in lieu of wages and this would underwrite their ability to continue farming. In some cases bankruptcies have, in fact, been precipitated by the workforce to secure payment of wage arrears.

- Use of bankruptcy without prior restructuring would also avoid the need for the authorities to "pick winners" as is currently required as the local authorities attempt to identify appropriate investors to become farm directors. This would also help to avoid accusations of cronyism at the local authority level and the danger that inappropriate new managers/directors will be selected on the basis of their links to the local administration.

On the basis of these considerations it is recommended that the government stop its involvement in the type of pre-bankruptcy restructuring of farms currently being pursued in many areas. Bankruptcy proceedings without restructuring where the farm workers can use their wage arrears to retain the farm assets is a preferable option. Also if pre-bankruptcy restructuring is still deemed necessary, the approach adopted by Moldova as described above accomplishes the same objectives of asset protection, and encouraging new farm entities to develop without the negative consequences associated with the farm workers having to give up their claims to the assets.

Explanation for the Growth of Large Scale Commercial Farming in the North

Present trends suggest strongly that a dominant form of large scale commercial farming is emerging in the more favorable parts of the northern wheat belt. The reasons for this dominance are worth studying as they point also to the limits of this form as a general model for the evolution of the farm sector in Kazakhstan. While the view is often expressed that smaller private farms have failed to develop in the north mainly as a result of inadequacies in the policy and institutional regime, there are very powerful economic reasons why the large investors are taking over. The principal advantages which farms of this type have over their rivals are:

- in a very tight capital market these companies control a large part of the liquid financial resources in the regions concerned making it possible for them to farm when many other farm types are not assured access to inputs;
- they have access to bank lending, apart from their own liquid resources, on the basis of non-agricultural assets with high collateral value;
- they enjoy economies of scale in a farming situation where these are important, arising notably from specialist staff economies, bulk purchase of inputs economies;
- they wield political influence with the local akimat, which still intervenes in many ways in commodity markets;
- their vertical ownership in the grain market allows them to purchase inputs at the source (e. g. the refinery for fuel), to avoid barter terms, and to ensure their produce reaches export markets;
- they are able to attract and install the best professional management;
- they are able to dispense with non-required labor costs and can pick the best workers;

- because they are able to extend off-field employment through investment in processing, they are able to maintain employment at higher levels than smaller outfits;

- they are able to spread or pool risks by careful selection of entities in multi-entity enterprises and by crop and activity diversification;

- they have reduced contracting costs compared to annual contract farming operations and have no risks of default from tenants since they control the production process directly;

- they can command the large mechanized fleets essential to complete sowing within the prescribed 15 day period and to effect the harvest on time which significantly reduces risk of low yield; and

- the former state farms comprise ready-made units that are already large enough to yield some of the economies of scale described above and it is a simple process to consolidate groups of adjacent entities.

The Limitations of the Dominant Large Commercial Farm Model

While the large industrial farm complex is proving the most effective model in favorable parts of the wheat growing belt, it cannot provide either a general solution for the many different farm situations in Kazakhstan, nor can it provide a general solution to the problem posed by existing entities in areas which are uneconomic for farming. The investment currently taking place is confined to specific areas with the best growing conditions. Even within the same oblast the drier areas are attracting no such investment and the situation of the existing entities can only be described as desperate. For example, in Kostanai oblast no large investor has acquired any entity in the drier southern raions. In effect the operations of market forces is leading to the survival of only the best and most profitable areas. The remaining areas, which constitute a numerical majority of farms, entities lack the working capital to operate and continue to be dependent on the local authorities to provide guarantees for delivery of fuel and seed inputs.

The Appropriate Role of Bankruptcy in the Farm Restructuring Process

It will be clear from the preceding discussion that the introduction of bankruptcy as a real and implemented policy during the recent past has radically accelerated the process of farm restructuring, which for several years had proceeded without real changes in farm ownership and control. This has occurred both through the direct effect of the many farm bankruptcies which have already been taken to court and through the indirect impact of bankruptcies on the process of negotiation between former owners of farm property and land, on the one hand, and creditors and potential investors on the other hand.

However, it is also clear that there is a danger that wholesale bankruptcies will lead to the permanent closure of many farms, some of which may in fact have potential as viable entities. It is accordingly necessary to examine existing safeguards and those that may be required. The principal function of the bankruptcy law, as opposed to the alternative existing legal mechanisms for creditors to foreclose on debts through the courts, is that the Bankruptcy Law imposes a process, with explicit prioritization of creditors and a legally recognized framework through which incentives can be created for the negotiation of solutions which maintain the on-going concern value of the bankrupted entities. In this context, the key issues are whether in the present circumstances in agriculture in Kazakhstan, bankruptcy proceedings can assist in the selection for survival of viable or potentially viable farms. Answering this question requires that the procedural aspects of bankruptcy be reviewed simultaneously with the economic and incentive environment facing farms.

The desired outcome of the farm restructuring process is that viable farms should survive and be taken over by competent owners and managers, while non-viable farms should be liquidated and their assets transferred to augment the capital stock of viable farms or transformed for alternative economic uses. In a complete and orderly set of markets the bankruptcy process can lead to a rapid restructuring of ownership and management as failing but potentially viable farms are acquired by investors with the capacity and competence to farm more efficiently. For this benign process to work effectively, however, there are two essential requirements: (i) the incentive structure in the economic environment facing farms must reflect underlying real economic costs; and (ii) capital markets must be present and functioning to enable competent investors to acquire and operate viable but failing farms.

Unfortunately in Kazakhstan at present neither of these two conditions is fully met. There are a large number of structural and economic constraints facing farmers stemming from transitional imperfections in input and output markets. Also, the market for credit for the agricultural sector is underdeveloped and regarded as unacceptably high risk by the formal financial intermediaries. Of course financial intermediaries will always face commercial risks in lending to agriculture. But these risks are compounded by the high perceived risk that the sector is particularly vulnerable to changing Government policies that impact on its profitability and sustainability. As a result of the underdeveloped credit market, it is generally impossible for a competent investor to supplement his own savings with debt capital to purchase farms facing liquidation through the bankruptcy courts. As a result there is a marked shortage of investors, most of whom are wholly or largely reliant on personal savings for farm acquisition. With these two conditions not being met in practice, there is an obvious danger that a policy which relies heavily on bankruptcy may overshoot in the sense of accelerating the liquidation of potentially viable farms for which either the potential viability is obscured by the deficiencies in the current economic environment or, although the potentiality is evident, investors may not be forthcoming to exploit the opportunity due to capital market imperfections.

The assessment of farm viability in Kazakhstan, and especially in the northern oblasts, is complicated by the widely acknowledged excesses of the Virgin Land policy, in the sense that it pushed cultivation well beyond any likely economic boundary of viable grain production. Policy-makers are accordingly faced with two conflicting tendencies: on the one hand it is recognized that the present historically defined boundary of cultivation includes large tracts of land which should be taken out of cultivation; on the other hand the inadequacies of the existing incentive structure may lead to market forces underestimating the true viable extent of economically viable production. The use of market forces to draw the boundary of viable agriculture must be accompanied by measures to remove artificial and institutional constraints which lower the profitability of farming and tend to reduce the viable scope for cultivable agriculture.

The Concept of the Farming Viability Frontier

It has long been recognized that the Virgin Lands policies had the effect of pushing the frontier of cultivated agriculture beyond the economically sustainable limits. In the Soviet period this problem was ignored and the state farms in drier areas simply used more inputs and delivered less outputs than those in more favored areas. Many entities regularly planned for a financial loss in their annual budgets. In the years following independence, Government policies continued to shield non-viable farms from the effect of market forces as local authorities continued to subsidize the supply of inputs, either through direct provision, or through provision of guarantees on the barter debts incurred by PCs and meeting the subsequent calls on those guarantees when the cooperatives failed to deliver. The poorer performance of marginal areas was reflected in a more pronounced tendency to indebtedness. The new reliance on bankruptcy is now making these entities' future dependent on their ability to re-start after bankruptcy, either through their own ability to gather together the resources to continue farming or through the attraction of an outside investor. Farms which are outside the farm viability frontier are unlikely to be able to achieve this (by definition).

Two Aspects of the Farm Viability Frontier

The farm viability frontier defines the geographical limits beyond which cultivated agriculture cannot be sustained without subsidies. It is primarily a geographical concept, the limits of which are defined on the basis of economics. However, since it is evident that farm types differ, under present conditions, in their ability to farm profitably in a given environment, the farm viability frontier will be located differently for the various farm types. As an example, it is evident that the large investor farms in the most favored areas in the northern wheat belt are well within the farm viability frontier and they are regularly profitable operations. However, at the same time, and in the same areas, most other forms of farms are not currently viable as their costs are higher and their operations less efficient. A pure market-oriented policy would accept that the actually farmed area will be determined by the extent and willingness of investor companies to enter the market and restart farms which are potentially viable, but are not under their current ownership/organization. However, this approach is flawed as the pool of potential investors is currently limited and the application of such a pure market-based policy is likely to lead to extensive farm closures, even in areas where, if adequate investors were forthcoming, farming would be viable. In terms of the language of market failure, there is a capital market imperfection with an inadequate presence of investment capital to exploit the full range of profitable opportunities at current market prices.

Three Types of Policies

The choice of policies for coping with the farm situation can be illustrated in relation to the farm viability frontier. Policies can be grouped into:

- policies aimed at extending the farm viability frontier, for example, by improving land markets and the marketing system for inputs and outputs, thereby reducing farm costs and improving crop profitability for all types of farms;

- policies aimed at coping with the social consequences of farm failure in areas beyond the current and potential farm viability frontier, including policies aimed at **accelerating migration** from non-viable areas or alternatively at **subsidizing uneconomic production** in areas beyond the farm viable frontier; and

- modifications to the Regulatory Framework for Bankruptcy and Farm Restructuring.

The challenge facing Kazakhstan is to set the right balance between these types of policies. The remainder of this Chapter reviews the principle policy issues falling under each of these headings.

Policies Aimed at Extending the Farm Viability Frontier

The purpose of this class of policies is to improve the profitably of all farm types of and in this way both to increase the attractiveness of farming and to extend the farm viability frontier. Since the major current constraints to farm profitability lie off-farm, these policies are naturally discussed under the individual factor or input and output markets affected.

Land Markets. The legal basis for agricultural land ownership in Kazakhstan remains flawed and the defects continue to inhibit the development of land markets based on transfer of ownership. The current Land Code provides only for 99 year leases for land-holders with the state retaining legal ownership. Furthermore, until recently there was no requirement for land shares to be physically demarcated and in most areas this process is even now only at an early stage.

It is frequently argued that these defects, which are partially addressed in the draft amendments to the Land Code currently before Parliament, are having a serious negative effect on the development of Kazakh agriculture in the following ways.

- Even individual farmers who have demarcated plots with full lease-title have less than full security of tenure – the state can in principle reclaim and at any time. In addition, there is legal provision for the state to reclaim land unused for 3 seasons. In some cases, however, extended fallow and application to permanent pasture is the optimal economic use of land; farmers should be encouraged to make these adjustments, not threatened with expropriation.

- Land remains unacceptable as collateral for banks as the lack of full ownership titles is unattractive and the absence of a developed legally recognized land market means that land valuation for collateralization is not possible.

For these reasons land legislation needs to be changed to allow for: (i) the universal issuance of full ownership titles in accordance with a comprehensively revised Land Code; (ii) the demarcation of all individual plots to increase the ability of individuals to form independent farms; and (iii) the removal of all restrictions to legally valid land transfers and sales.

While these measures are certainly much needed in many areas of the country, and especially in the higher rainfall areas in the east and south of the country, it is important not to expect the adoption of such land measures to have a radical effect in the drier areas of the country. Some observers have questioned the apparent readiness of farm workers to transfer their land shares to investing individuals or companies and have attributed this phenomenon to ignorance on behalf of the workers and exploitative misleading practice on behalf of investors. Doubtless, this has been the reality in many places. However, it is also true that in the drier areas land, even cultivable land in medium quality areas, has practically no marketable value, and where it has a value that value is dependent on the presence of a farm entity with the capacity to farm the land. In most farm entities in the north there are still reserves of uncultivated land (often held by the raion authorities), and with the sharp fall in cultivated area in recent years it is not difficult to acquire access to land at near zero lease-fee. Indeed, the land lease market for rain fed land is operating at the very low minimum price set by current legislation.

In these circumstances land is not the most critical input to the farming process. Alternative areas may easily be found elsewhere by a prospective investor. It is not surprising that the organization of farming in the north is evolving in a way in which land ownership is almost irrelevant. The new successful farms comprise a set of property and contractual relations in which land ownership is a peripheral issue. The companies have taken control of the land in their areas primarily to preempt disruptive parcelization by individuals living in the entity and because the law links closely to land tenure with the ownership of fixed properties such as buildings.

The situation is, of course, quite different in areas where higher rainfall, irrigation or proximity to urban markets or processors place a higher value on land. In these areas, again mostly in the south and east of the country, the clarification of legal land rights and the unfettering of land markets will have a significant affect on small farm capitalization and the ability to collateralize loans.

A specific policy issue relates to the demarcation of land. On the basis of the above arguments concerning land value, it is clear that the value of the demarcation process varies widely between different farm situations. This difference is also reflected in the costs of physical land demarcation, which rise with the average size of individual holding. (It is more expensive to demarcate a farm of 300,000 hectares and 500 members than a farm of 15,000 hectares and the same number of members). These simple facts explain the reluctance to engage in a potentially expensive exercise which is of little practical benefit in those areas where land values are negligible. The implication is that policy towards demarcation should differentiate between areas with varying needs, emphasizing and obligating demarcation only in areas of comparatively high land values. In other areas strict enforcement of the requirement for individuals who wish to farm independently to be provided with land of not less than average quality and accessibility should be sufficient, with demarcation occurring as and when required to meet the requirements of specific individuals. In practice this is close to what is happening in the field.

Input Markets – Fuel and seed. The two key purchased inputs for grain production are certified seed and fuel for land preparation and harvesting operations. Unfortunately the continued retention of state control over supplies of seed and, to a lesser extent, fuel, coupled with and lack of liquidity on most farms has created the conditions for perpetuation of barter trade for these key inputs. Barter is not a neutral alternative to money-based exchange but is imposing real costs on farms, especially smaller and weaker farms. These costs include: (i) a pervasive non-transparency of transactions creating problems in the valuations of inputs and outputs (especially where both are purchased and sold into barter chains); (ii) additional transactions costs of marketing as farm managers must match their outputs to barter requirements; and (iii) a strengthening of the already powerful monopoly elements in the input and output marketing chains, which further reduces competitive pressures as investors exploit monopolies through increased vertical integration from both output and input supply industries into farm production.

The continuing dominance of the seed industry based on state farm production is tending to perpetuate the single channel system and places farms under the control of the local authorities which continue to determine the physical flows of seed grain (especially when it crosses oblast boundaries).

Most farms are entering the 1999 planting season with a continued dependence on the local authorities to supply key inputs and for finance for these inputs through the issue of local authority guarantees for the provision of seed and fuel by supplies on a barter basis against the season's farm production. However, this system is now reaching its limits: the progressive application of budgetary controls and penalties for over-spending on both the oblast and raion authorities are reducing the scope for open-ended guarantees by the raion authorities, and this tendency is strengthened by the evident fact that only very limited realizations are achieved at farm liquidation sales. So the system must be regarded as unsustainable, and this is likely to be reflected in sharply reduced plantings in the 1999 season as farms are unable to access the usual guaranteed supplies of seed and fuel and are forced to cut back their planted area (See Box 4 below).

Box 4: To Sow or Not to Sow: A Dilemma Faces Western Kazakhstan

(Article from The Times of Central Asia, April 29, 1999)

"In the course of one week, deputies of the Western Kazakhstan regional parliament were twice compelled to hold sessions on the same issue: sowing campaign financing. For three years in a row, the oblast was attacked by severe droughts and farmers had run out of resources to pay for the sowing campaign. The agrarian sector of the oblast is already indebted for the previous year in the amount of $6.5 million and 128,000 tons of seed. To sow this year's crop 66,000 MT of seed is required. The oblast's own seed fund constitutes only about 3,600MT.

The question is to sow or not to sow? For the oblast where two thirds of the population lives in rural areas, this question could be more aptly phrased as "to live or not to live ?" Thus, the deputies had no choice but to respond positively to the akimat's request to make a decision on extending a seed loan from the Agricultural Support Fund in the form of borrowings from the oblast budget. However, when at the extraordinary session the terms of the new loan became known, the decision of whether the agrarian sector will exist or not was complicated by the possibility of bankrupting the oblast budget if good weather eluded the farmer yet again.

In accordance with the agreement with the Agricultural Support Fund, the oblast budget will acquire an 870mn Tenge debt in the form of a seed loan. At the same time, wage arrears to oblast budget-financed organizations constitute 850mn Tenge. If the season ends in failure again and the oblast cannot manage to repay to the ASF in time, then the budget will suffer a similar fate to that in 1997, when the oblast's accounts were frozen and for more than two months all entities dependent on the oblast budget did not have access to a single tenge."

The Government should take all possible steps to normalize the markets for purchased farm inputs. Two steps are required in this respect: (i) reform of the seed industry to reduce the role of the government's direct role in the multiplication and sale of quality seed, concentrating rather on the more limited but essential functions of framework regulation and certification, leaving the production and supply to certified private producers; (ii) discontinuing the current practice of guaranteeing input loans to favored farms during a potentially long and painful process of exit from farming. Discontinuation of government guarantees on inputs would have several beneficial effects including unification of the input markets on a more transparent cash basis and the reduction of future bad loans from the Government to the farms which tend to have priority over private sector creditors to the farm sector.

Input Markets: - Credit. The agricultural sector is not currently accessing commercial credit sources on a significant scale. There are good reasons for this, notably the poor financial performance of almost all farms in recent years relative to other sectors, the specific difficulties related to use of land as collateral, and the high level of climatic and other risks, for which no adequate insurance instruments are currently available. Lending to the sector has mostly been through concessional channels such as the Agriculture Support Fund and most loans have proved bad. One growing area of lending, however, is to the new larger-scale entrants to the farm sector, namely the grain companies, several of which originated as lending arms of commercial banks, and the food sector conglomerates. Such lending is possible because the borrowers have non-agricultural collateral in the form of urban assets and industrial assets.

However, for most farms commercial borrowing remains impossible. Given the strength of the continuing financial constraints on farm operations, it is important that all possible steps be taken to improve the prospects for commercial lending to the sector. The main requirements are: (i) to address the continuing legal issues on land ownership and the associated creation of a land registry and pledge registration facilities to allow agricultural land to become a normal form of collateral; (ii) to encourage the use of moveable property as collateral through assuring that the legislative framework is fully developed and required registries of liens on moveable property are functioning, and developing the fledgling system of warehouse receipts; and (iii) to improve the prospects for commercial banks to recover funds from liquidation sales, especially where they hold collateral or where they have temporal seniority. In practice this is blocked at present by the priority of government as a creditor given that almost all insolvent farms have debts to the government. This situation will need to change over time. Change can occur both by the Government withdrawing from its current heavy role as residual financier for large parts of the sector (mostly through default on input guarantees and tax arrears) and through a formal change in the rules of priority in bankruptcy cases (discussed below).

Output Markets. The greatest difference between the large investor-led farms and smaller individual and partnership farms lies in the difficulties experienced by the smaller farms in marketing their output. A large number of constraints fall differentially on the smaller operators which policymakers need to address if these farms are to stand a chance of survival.

Policy should address several issues.

- Monopoly at the elevator. While this was a major area of concern in the north of the country in the early 1990s following a flawed privatization process, indications are that in most areas there is now a more diversified pattern of ownership, with a wider range of storage and processing outlets available, especially for the domestic market. However, elevator pricing should be kept under review and in principle the state should act against collusive oligopoly pricing where small groups of operators dominate a geographical area.

- Role of oblast authorities. The oblast authorities continue to play a highly interventionist role in agricultural commodity markets, in spite of the greatly reduced role of the state in procurement. Often this is defended as necessary in support of the oblast Akim's statutory role to ensure food security in his oblast. The issue is painfully familiar from many countries in Africa and elsewhere as a problem associated with recently decontrolled markets and will only be resolved by very clear decrees from the center which strictly limit the types of intervention which the Akim may make (for example to the physical distribution of humanitarian food aid to poverty struck communities) and which specifically exclude the right to intervene in the marketing system for food security reasons. In practice such interventions are open to widespread abuse, with favored (large) operators allowed to export grain to neighboring oblasts or to Russia while smaller producers are prohibited, often until all outstanding debts for inputs are paid.

- Bureaucratic constraints. Despite the Presidential Decree of July 1997 concerning simplification of the bureaucratic requirements for trading and exporting commodities, the old practices persist in all the areas visited by this mission, requiring up to 11 separate permits and certificates to trade a given consignment. This burden falls quite unequally on the smaller producers, since the costs per unit volume of trade are much higher for such producers (See Case Study No. 5).

- Police corruption on the road. Harassment by uniformed officers appears to be universal, with established normal bribes required to pass each of a large number of police checks, even if all papers are in order. The solution to this problem successfully adopted elsewhere is to limit legally the range of activities of the police on the road, specifically eliminating any role in relation to the checking of trade documentation, and through the issue of decrees limiting the number of police checkpoints to minimal levels for any purposes except security controls and traffic management. This usually requires off-setting increases in police pay.

- Taxes. The tax situation has greatly improved both with the reduction of the burden of taxation as a three year holiday on most tax instruments for agricultural producers has taken effect, and especially through the introduction of the "patent" system whereby farmers with sufficient liquidity can pay their tax in advance. The patent is a receipt of tax paid in advance on an imputed basis. The patent holder is free to market his/her output without further certification of tax payments and is much less likely to have unexpected tax inspections. The patent is a popular device, but only a minority of farms have a robust enough cash flow to be able to make the necessary up-front payment of tax to acquire the patent. The statistics indicate that 18 percent of peasant farms were under the patent system by April 1999. At the oblast level the proportion of peasant farms acquiring the patent is highest in the less stressed areas of the south and east of the country. (see Table 13, Appendix I). In spite of this, unacceptably frequent tax inspections are the norm and should be legally curbed. This could be done by limiting the absolute frequency of inspections on a given enterprise within the tax year, or by requiring the Tax Inspectorate to show grounds for suspicion of fraud to a court and to obtain a court warrant before descending on business premises. While this would obviously weaken the tax collection abilities of the Inspectorate, the actual loss of revenue would only be modest, given the tax holidays already declared.

- Legal Constraints to the Formation of Marketing Cooperatives. The marketing constraints faced by independent farms and small partnerships could be partially addressed through the formation of producer associations aimed at input procurement, output markets and, perhaps, credit activities; and this approach is being adopted in many countries, including developed economies in Europe and America. However, in Kazakhstan there continue to be basic legal constraints to the types of association which can legally be established. Specifically the Civil Code, which defines the categories of legal business entities makes provision only for producer cooperatives, in which producers pool production resources for a common production purpose. At present it is not possible to register an association formed, for example, for marketing or input procurement as a cooperative. Without registering, an association may not open a bank account or become the legal owner of property. This gap in the law severely limits the scope for farmers to use the strengths of association to reduce moral hazard risks encountered by suppliers of inputs and credit and to pool their resources for common output marketing. Drafts of a proposed cooperative law prepared by the National Farmer's Association have been under discussion for several months but have met with political obstacles from entrenched large-scale producer and trading interests. This is an area where the Government needs to act to ensure that appropriate legislation is passed which opens the door to a much wider range of producer cooperative activity in the marketing field.

Risk Management. In spite of the legal requirement for all legal farm entities to take risk insurance on all operations, the market for insurance remains under-developed and few farms take out insurance. Those that buy insurance usually do so only to meet formal requirements for other purposes (such as loans from international donor funds). Farms cite their lack of trust in existing insurers (especially state-owned operations) and the high premiums charged as reasons for not insuring. The Government established Kazagropolis in 1998 with a view to developing a public-sector supplier of crop insurance, but its operations remain only very limited to date. The issue of risk management is covered in a companion study to this one.

Policies Aimed at Coping with the Consequences of Farm Failure in Non-Viable Areas

The policies discussed above are appropriate for the context where farming is viable or can efficiently be made viable through identifiable policy interventions. For many areas, however, these conditions will not be met and the authorities face a stark choice between ignoring the plight of farms, providing high levels of subsidy which are unlikely to be forthcoming or sustained in the longer term or devising policies aimed at assisting the adjustment of the communities concerned out of farming or to migrate to more favorable areas. The need for policies to address this situation is only now becoming evident as market-led restructuring is discriminating sharply between what the market perceives as viable and non-viable areas.

Farm Restructuring Policy and Regulatory Framework

The basic finding of this review is that the present restructuring process is contributing in an important way towards the resolution of long-standing structural problems at the farm level. After several years in which government initiatives brought about a series of modifications in the legal status of farms without really affecting the former systems of management and control, the present efforts, with the use of bankruptcy as an instrument of policy, is now forcing the pace of change and profound shifts in ownership, control and management are occurring. In view of this finding, it is recommended that the present policies should, broadly, be continued and deepened and the modifications proposed relate to specifics of implementation rather than the overall approach. Nevertheless several shortcomings in the current procedures and processes should be addressed as indicated in the following paragraphs.

The Pre-bankruptcy procedures need to be modified. The pre-bankruptcy procedures involving the establishment of a PLL and the transfer of property shares to new owners in many instances raises serious equity concerns. While it alleviates the debt burden as individuals, it strips away ownership of the assets and transforms the former shareholders into little more than assetless laborers in a very uncertain job market. As the study demonstrates, other approaches to pre-bankruptcy restructuring meet the same objectives of resolving the indebtness arising from past Government policy but without concentrating the assets in the hands of individuals through a non-transparent process.

The Priority System for Creditor Claims currently in use gives least weight to commercial creditors. While perhaps appropriate for the initial stages of the implementation of bankruptcy-led restructuring, where the Government's objective for the exercise is to remove debt from the restructured farms without stripping the farming communities completely of their productive assets, and where by far the major creditor is the Government (including both the budget and extra-budgetary funds). The typical effect has been to relieve farms of debt while requiring a legal redefinition (typically from PC to PLL) which has allowed the emergence of new owners and managers of both land and property. Commercial creditors, including the state agricultural bank Kazagroprom, have usually not received any of the proceeds from liquidation auctions.

Given the importance of attracting commercial funds into the sector to finance both working capital and investment, it is recommended that the system of prioritization should be amended to give greater weight to commercial creditors, thereby increasing the value placed on collateral and the willingness to lend to the sector. At present the commercial creditors are not only placed at a low fifth in the prioritization ranking, but can also be by-passed by Government as a creditor in relation to the timing of the incurring of debt.

The position of commercial creditors could be improved through any or all of several mechanisms.

- Change in the prescribed order of prioritization, introducing a change in the order of prioritization in particular removing the priority of government over commercial creditors, would be a simple and effective means of improving the usefulness of bankruptcy for commercial credits.

- Explicit recognition of the temporal prioritization of debts. In other words debt claims should be paid in the sequence of their being incurred by the bankrupt entity. This would be particularly appropriate in relation to the relative ranking of commercial and government creditors in view of the fact that there is a statutory requirement for recipients of bank loans to produce a certificate from the tax authorities showing that the borrower is current on tax obligations. Providing a bank can demonstrate that this condition was met prior to loan disbursement there should be no case where the tax authorities should tax priority over bank lenders.

- Differentiation between collateralized claims and those without collateral. Collateralized claims should be epic preference over unsecured claims.

- Spread liquidation sales over time. *This step may contribute to improved auction prices as it* avoids saturating the available market for farm assets.

The need for protection of creditors from fraudulent pre-bankruptcy moves by owners to protect assets from creditors. Under the pre-bankruptcy procedures followed during the past year the Government has encouraged PCs to use a legal manipulation to protect their assets from forfeiture during liquidation - the simple device of transferring production property assets into the name of the director of a newly created Partnership. This step is legally permissible as one of the powers of the director in his role as manager of the PC, and protects the assets from the subsidiary liability for PC debts shared by all property share holders in the PC. As with the prioritization issue, given that the Government is by far the largest creditor , this mechanism has effectively provided for debt write-off without forfeiture of all assets by the PC members (including the Director). However, it has also evidently diminished the ability of commercial creditors to realize any gains from liquidation and has blunted the force of creditors as debt monitors.

With a view to increasing the willingness of the banks to lend to the sector it is important that such legal loopholes for asset protection be removed so that creditors have the confidence that all assets of the bankrupt entity will in the future enter the liquidation process. It is recommended that this topic be reviewed by an appropriate specialist to check what other legal loopholes exist which would potentially be utilized by the emerging important category of Partnerships (PLLs) in the event that they too succumb to bankruptcy, as seems likely in many cases.

The involvement of the raion and oblast administrations in the restructuring process. The authorities have been heavily involved in the farm restructuring program. Apart from setting the regulatory framework of the Bankruptcy Law and regulations for the agricultural sector, the local authorities have been given a more direct mandate to manage the process. At a meeting of the oblast akims addressed by the President in December 1998, the akimat was given the authority to manage and direct the process of bankruptcy and farm restructuring within their respective areas. This instruction was consolidated in many areas through the appointment of the oblast Department of Agriculture as the legally mandated Manager of the bankruptcy process for agricultural entities.

The oblasts have typically taken a pro-active role in determining the classification of farms, which in turn decides which farms are subjected to government –initiated bankruptcy proceedings, and have also taken a leading role in initiating out-of court negotiations for creditor or investor-led buy outs. Often this process has involved the oblast in identifying and negotiating directly with well-known local businessmen. In the farms visited in the course of this study, this process of official intervention had clearly been effective in introducing competent businessmen to farming and was assisting to resolve the severe problems of post-bankruptcy start-up. However, it must be recognized that the process is potentially open to abuse and cronyism, with favored investors being given strong incentives to enter the sector and with the local authorities forcing selected investors onto unwitting farm workers. As the process continues and the most prominent businessmen have already been approached it will be difficult to continue without a dilution of the quality of investor approached.

A second issue concerns the active promotion in most areas of a particular form of farm restructuring – namely the splitting of original farm entities into a small number of rather large partnerships. This form is being actively promoted. However, there is at present no strong evidence to indicate that the intermediate sized farms resulting from the formation of these partnerships will provide an enduring and viable farm type. While the device of concentrating property shares (and often land shares) in the hands of the PLL director has attempted to address the most prominent governance problems associated with the former PCs, the partnerships continue to reveal weaknesses. In particular:

- most partnerships emerging from bankruptcy proceedings are under-capitalized in relation to their requirements for working capital for farm operations which forces them to transact on unfavorable barter terms; and

- the partnerships are likely to experience labor incentive problems relative to individual/household farms, which will be reflected in high internal contracting and organization costs.

In other words the partnerships with limited liability are yet to be tested, and it would be unwise to base policy on the assumption that they will provide a durable solution. In view of these problems it is recommended that the authorities adopt a neutral attitude to questions relating to the optimal farm size and organizational/legal structure. Local authorities should rather concentrate on empowering farm directors and workers to make their own decisions on organization on the basis of full information and sound understanding of the options available.

4. CONCLUSIONS

This report has reviewed briefly the on-going program of farm restructuring which the Government launched in 1998. The principal finding is that the new approach to restructuring, which places greater emphasis on the threat of bankruptcy and creditor or investor-led buy-outs, is having a profound impact on the ownership, structure and management of farms. The new policies have effectively broken the stalemate in farm reform which has persisted for the previous 5 years and opened the way for a market-led process of restructuring which will eventually change the face of the sector. The process is young, however, and it is not possible at this stage to predict the final outcome and the full implications of the changes which have been unleashed. Conclusions drawn at this juncture are, therefore, necessarily tentative.

The review has drawn attention to the different processes which are unfolding in the widely different agro-climatic zones of the country. In the northern wheat belt the strong logic of the existing infrastructure base centered on large commercially managed farms is leading to a rapid process of inward investment by both individuals and grain companies. However, this investment is only occurring in the most agriculturally favored raions, while in other areas the prospects for post-bankruptcy re-starts are very poor. In these latter areas there is an acute need for government policies to support the adjustments by households on closing farms, possibly through assisted migration to more favorable areas.

In other areas a more variegated outcome is evident with a stronger tendency towards the breakup of large farm entities into smaller or individual households.

A central concern about the on-going reforms relates to the question whether bankruptcy and liquidation will prove effective instruments in generating market-led recovery of currently weak but potentially viable farms. This concern arises because of the prevalence of important constraints to the profitability of farm operations, notably from the virtual absence of a credit market, and from the marketing constraints enumerated in previous chapters of this report. If the Government is to continue to apply bankruptcy/liquidation driven policies it is essential that these important constraints to farm profitability be removed as soon as possible. Failure to do so will lead to a much greater problem of farm closure than should ideally be necessary with all the attendant problems for poor households and public sector budgets.

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APPENDIX I

STATISTICAL APPENDIX

This Annex provides an overview of the status of the Government's restructuring program as of April 1999. The source for all material is the World Bank. The following points are noted:

Table 1: Summary of Legal/Organizational Farm Types (April 1999)

The total farm population, which stood at 5,000 in 1992 has increased substantially, largely due to expansion in the number of peasant farms. The statistics provided on peasant farms (almost 85,000 peasant farms in April 1999) are believed to be a substantial under-estimate as they include only those farms which have registered. Informal estimates point to around 200,000 peasant farms altogether as of April 1999. The rise in Partnerships with limited liability is associated with the on-going pre-bankruptcy restructuring, whereby production cooperatives are actively encouraged to break into several partnerships.

Table 2: Classification of Farms by Financial Status (Dec 1997 and April 1999)

Summarizes the breakdown of entities according to the classification into Groups by financial status for December 1997 and April 1999.

Table 3: Classification of Farms by Solvency Status (April 1999)

Indicates the magnitude of indebtedness of all the farms classified. Total debts stood at Tenge 1.04 billion ($US929 million) as of April 1999, down marginally from 3 months earlier. In absolute terms the debts are strongly regionally concentrated, with the 3 northern oblasts of Akmola, Kostanai and North Kazakhstan accounting for 70 percent of the total indebtedness.

Table 4: Group I Farms (April 1999)

The majority of Group I Farms have adequate liquidity to meet their operational requirements.

Table 5: Group II Farms (April 1999)

This table shows that in most areas the process of rehabilitation is only at an early stage, as only 380 out of a population of 2005 farms are actively undergoing restructuring. However a larger number are being reformed through segmentation (i.e. typically through the break-up of the former entity into several partnerships, usually without an outside investor). In Kostanai and North Kazakhstan a significant proportion of the Group II farms have been sold as complete entities to investors.

Table 6: Group III Farms (April 1999)

These groups of farms are facing liquidation. Interestingly two thirds of liquidations have occurred out of court. Sales of complete farm entities to investors predominate in the northern oblasts of Kostanai and Pavlodar, whereas in other areas sales to workers collectives or individuals are more important.

Table 7: Implementation of Pre-Bankruptcy Measures

The majority of Group III farms are being taken through pre-bankruptcy measures, consisting of the creation of new smaller legal farm units, usually on the basis of Partnerships with limited liability. (A small number of Group II farms had already passed into bankruptcy before the start-up of the government's pre-bankruptcy reform efforts). Of the new legal farming entities formed (i.e. JSCs and PLLs) 247 out of 1,272, or 19 percent, have been formed on the basis of creditor buy-ins, while the remaining 81 percent involve the reallocation of property rights within the stakeholders in the former production cooperatives. The breakup of farms in pre-bankruptcy measures is also a fertile source for the creation of peasant farms, with 6,675 farms (registered) resulting from this process to date.

Table 8: Results of Economic Reforms

Table 9: Investor Activity (April 1999)

A total of 434 farms, roughly 8 percent of the original total of state farms had been, or were in the process of being transferred to the control of investors, who had injected a record total of Tenge 13 billion into these farms ($115 MN). The total investment to date is of the order of 10 percent of the outstanding net farm indebtedness.

Table 10: Transfer of Social Services of Agricultural Organizations to Local Authorities

Records the transfer for social services (typically educational and health facilities) from the budgets of former state and collective farms to the accounts of their respective local (raion level) authorities. Roughly one third of the entities still under farm budgets as of the beginning of 1998 had been transferred to local authority control by April 1999.

Table 11: Availability of Tender Managers (Official Receivers)

Indicates the progress made in the training of Tender Managers (Receivers) for the bankruptcy process. As of April 816 had been trained. Leaving a national balance of 102 to be completed.

Table 12: Adoption of the "Patent" System for Taxation

Shows the extent of adoption of the new streamlined system for farm taxation based on the purchase of a "patent."

Table 1: Summary of Legal/Organizational Farm Types (20 April 1999)

Oblast	Total Farms		Peasant Farms		Production Cooperatives		Legal Associations										State Farms	
							Joint Stock Company (JSC)		Partnership (LL)		Collective Partnership		Director Owned Limited Partnerships		Other			
	1.01.99	20.4.99	1.01.99	20.4.99	1.01.99	20.4.99	1.01.99	20.4.99	1.01.99	20.4.99	1.01.99	20.4.99	1.01.99	20.4.99	1.01.99	20.4.99	1.01.99	20.4.99
Akmola	3956	3954	3600	3575	112	112	33	34	180	203	26	25	-	-	-	-	5	5
Aktybinsk	2277	2474	1879	1958	284	329	18	18	95	168	-	-	-	-	-	-	1	1
Almaty	18593	19482	18084	19024	355	312	39	35	83	83	10	10	1	1	1	-	20	17
Atirau	1146	1143	1100	1097	25	24	9	9	12	13	-	-	-	-	-	-	-	-
E-Kazakhstan	7080	6989	6841	6761	60	55	19	19	153	149	2	-	1	1	-	-	4	4
Zhambul	5441	6252	5153	5963	103	100	16	15	165	170	-	-	-	-	-	-	4	4
W-Kazakhstan	3073	3417	2820	3018	188	186	15	15	50	198	-	-	-	-	-	-	-	-
Karaganda	4489	4522	4281	4309	73	73	84	82	45	52	-	-	5	5	-	-	1	1
Kyzl-orda	1693	1623	1538	1473	43	29	45	45	53	63	2	2	10	9	-	-	2	2
Kostanai	6164	6307	5578	5647	85	69	35	35	462	552	-	-	-	-	-	-	4	4
Mangistai	393	435	376	418	8	6	6	6	3	5	-	-	-	-	-	-	-	-
Pavlodar	3322	3347	3179	3197	34	18	5	4	102	126	-	-	-	-	-	-	2	2
N-Kazakhstan	5821	5801	5148	5128	220	220	45	45	395	395	6	6	1	1	-	-	6	6
S-Kazakhstan	20477	24250	19570	23198	712	847	11	11	137	113	-	-	33	67	-	-	14	14
Total	**83925**	**89996**	**79147**	**84766**	**2302**	**2380**	**380**	**373**	**1935**	**2290**	**46**	**43**	**51**	**84**	**1**	**-**	**63**	**60**

Table 2: Classification of Farms by Financial Status (December 1997 and April 1998)

Oblast	Total Farms		Group 1				Group 2				Group 3			
	No.	No.	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
	Dec-97	Apr-99	Dec-97		Apr-99		Dec-97		Apr-99		Dec-97		Apr-99	
Akmola	230	379	33	14	9	2	115	50	196	52	82	36	174	46
Aktybinsk	372	516	41	11	2	0	285	77	326	63	34	9	223	43
Almaty	614	458	87	14	53	12	521	85	375	82	6	1	29	6
Alturau	43	46	14	33	10	22	18	42	18	39	11	26	22	48
E.Kazakhstan	256	228	78	30	81	36	91	36	72	32	87	34	75	33
Zhambul	249	289	26	10	12	4	175	70	244	84	48	19	77	27
W-Kazakhstan	235	399	35	15	151	38	186	79	52	13	14	6	196	49
Karaganda	181	213	8	4	2	1	144	80	107	50	29	16	83	39
Kyzyl-Orda	117	150	11	9	0	0	86	74	121	81	20	17	24	16
Kostanai	488	660	90	18	26	4	337	69	248	38	61	13	214	32
Mangistai	55	17	44	80	3	18	11	20	14	82	0	0	0	0
Pavlodar	147	150	27	18	30	20	45	31	5	3	67	46	113	75
N-Kazakhstan	490	673	111	23	199	30	174	36	181	27	205	42	293	44
S-Kazakhstan	1085	1052	356	33	388	37	623	57	484	46	106	10	180	17
Total	4562	5230	961	21	966	18	2811	62	2443	47	770	17	1703	33

Table 3: Classification of Farms by Solvency Status (20 April 1999)

Oblast	Total Agric. Entities	Total Agric. Entities	Financial Results			Total Debts Outstanding (Million Tenge)		No. of Farms in Current Year			
			Profit (+) Loss(-)	No. of Farms				Total	Of which:		
				Profitable	Unprofitable				Group I	Group II	Group III
	1.1.99	20.04.99				1.01.99	20.04.99				
Akmola	356	379	-35770	21	335	18451	18590	379	9	196	174
Aktybinsk	398	516	-15157	-	196	3967	3359	551	2	326	223
Almaty	509	458	-	-	-	4339	3595	459	53	375	29
Atirau	46	46	+13,7	26	2	548	493	50	10	18	22
E-Kazakhstan	239	228	-593,7	71	168	2875	2765	228	81	72	75
Zhambul	288	289	-515,1	38	250	3120	3073	333	12	244	77
W-Kazakhstan	253	399	-1353,0	-	253	6535	3557	399	151	52	196
Karaganda	208	213	-1953,4	2	139	6010	4940	192	2	107	83
Kyzl-orda	155	150	-299,5	16	125	1856	1908	145	-	121	24
Kostanai	586	660	-	-	-	30448	33257	488	26	248	214
Mangistai	17	17	+13,3	10	7	611	573	17	3	14	-
Pavlodar	143	150	-2053,7	11	88	3852	1765	148	30	5	113
N-Kazakhstan	673	673	-3217,7	17	656	20763	21587	673	199	181	293
S-Kazakhstan	907	1052	-	-	-	2940	2124	1052	388	484	180
Total	4778	5230	15051,8	212	2219	106315	101586	5114	966	2443	1703

Table 4: Group I Farms (20 April 1999)

Oblast	Total No. of Farms	No. of Farms With Their Own Working Capital	No. of Farms with Liquidity Coefficient > 2
Akmola	9	8	5
Aktybinsk	2	2	2
Almaty	53	50	24
Atirau	10	10	4
E-Kazakhstan	81	34	30
Zhambul	12	11	12
W-Kazakhstan	151	151	3
Karaganda	2	2	2
Kyzl-orda	-	-	-
Kostanai	26	26	11
Mangistai	3	1	-
Pavlodar	30	30	18
N-Kazakhstan	199	199	23
S-Kazakhstan	388	274	46
Total	**966**	**798**	**180**

Table 5: Group II Farms (20 April 1999)

Oblast	Total	No. of farms s.t. Rehab. Prog	No. of farms Rehabed	Debts (Million tenge)		No. of farms sold to Investors	Investment (TMn)	Reformed without Segment-ation	Reorganized through Segment-ation	Formed on this basis	
				At start of Rehab.	Currently					Legal farm entities	Peasant Farms
Akmola	196	196	42	7523	6313	73	2592,7	58	29	29	28
Aktybinsk	326	156	4	1194	1033	58	39,0	3	122	132	213
Almaty	375	375	27	5757	2870	5	592,6	5	52	9	450
Atirau	18	18	18	218	211	1	5,9	1	4	-	-
E-Kazakhstan	72	50	-	1588	2058	13	700,0	-	13	-	23
Zhambul	244	244	19	2098	2192	9	108,8	12	215	-	690
W-Kazakhstan	52	52	-	561	701	-	-	-	4	3	1
Karaganda	107	59	34	2513	2008	10	68,1	9	15	4	18
Kyzl-orda	121	79	1	1157	1391	2	-	1	3	4	-
Kostanai	248	234	66	15472	11080	36	1053,5	26	70	80	339
Mangistai	14	14	-	577	548	2	-	2	-	-	-
Pavlodar	5	5	5	293	318	-	-	-	-	-	-
N-Kazakhstan	181	181	75	4317	3983	34	583,6	37	13	-	-
S-Kazakhstan	484	342	89	2892	1357	6	16,5	12	18	-	40
Total	**2443**	**2005**	**380**	**46160**	**36063**	**249**	**5760,7**	**166**	**558**	**261**	**1802**

Table 6: Group III Farms (20 April 1999)

Oblast	No. liable to bankrupt. as of start 1998	Of which Liquidat-ed	Including		Of which			Documents being prepared for Court	Materials		Of which		Number of farms at current date	Including: Newly-Formed Farms
			In Court	Out of Court	Sold in 1 lot to single legal entity	Sold to Workers Collective	Sold to Individ-uals		Submitted to Court	Under Court Consider-ation	In Court	Out of Court		
Akmola	186	12	-	12	-	-	12	56	16	102	101	1	174	122
Aktybinsk	223	35	18	17	1	10	24	-	182	169	163	6	188	7
Almaty	32	3	-	3	3	-	-	8	6	20	13	7	29	-
Atirau	22	4	-	4	-	-	4	-	3	18	3	15	18	-
E-Kazakhstan	150	75	70	5	1	73	1	12	5	58	55	3	75	-
Zhambul	77	44	33	11	-	1	43	-	12	21	21	-	33	-
W-Kazakhstan	201	5	-	5	-	5	-	-	174	196	174	22	196	-
Karaganda	83	1	1	-	1	-	-	-	82	49	45	4	82	-
Kyzl-orda	43	19	-	19	-	-	19	-	4	20	-	20	24	2
Kostanai	214	48	3	45	45	-	3	4	162	142	137	5	166	6
Mangistai	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Pavlodar	113	104	3	101	69	28	7	-	8	9	8	1	9	-
N-Kazakhstan	293	17	4	13	13	-	-	-	280	270	270	-	276	1
S-Kazakhstan	191	11	-	11	-	6	5	58	100	89	67	22	180	-
Total	**1828**	**378**	**132**	**246**	**133**	**123**	**118**	**138**	**1034**	**1163**	**1057**	**106**	**1450**	**138**

Table 7: Implementation of Pre-Bankruptcy Measures (20 April 1999)

Oblast	Farms Liable to Bankruptcy at start of 1998	Of which, Expected to go Through Pre-Bankruptcy Measures	Newly Formed as a Result of Implementation of the Pre-Bankruptcy Measures for Agricultural Sector Bankrupt Entities				
			Juridical Agricultural Entities	Of which, Established on a Creditor Base	Present Debts (TM)	Peasant Farms	Present Debts
Akmola	186	174	122	54	2253	522	
Aktybinsk	223	210	153	76	785	378	7
Almaty	32	32	5	2	133	263	
Alturau	22	22	6		3.2	4	
E.Kazakhstan	150	150	23	5	3218	542	3333
Zhambul	77	77	118		59	993	
W-Kazakhstan	201	201	151		155	398	
Karaganda	83	77	69	4	395	150	
Kyzyl-Orda	43	43	28			13	
Kostanai	214	204	178	31	8047	446	
Mangistai							
Pavlodar	113	113	114	28	1167	935	60
N-Kazakhstan	293	276	253	45	2498	195	41
S-Kazakhstan	191	153	54	2	121	1836	
Total	1828	1732	1274	247	18843.2	6675	3441

Table 8: Results of Economic Reforms

Oblast	Agricultural Entities 1.01.99	Agricultural Entities 20.04.99	Financial Results (Tm) Profit (+) Loss (-)	Farms Profitable	Farms Loss-making	Total Indebtedness (TM) 01.01.99	(TM) 20.04.99
Akmola	356	379	-3577	21	335	18451	18590
Aktybinsk	398	516	-1515		196	3968	3360
Almaty	509	458				4339	3595
Alturau	46	46	13.7	26	2	549	494
E.Kazakhstan	239	228	-593.7	71	168	2875	2766
Zhambul	288	289	-515.1	38	250	3120	3073
W-Kazakhstan	253	399	-1353		253	6535	6557
Karaganda	208	213	-1953.4	2	139	6010	4940
Kyzyl-Orda	155	150	-299.5	16	125	1856	1908
Kostanai	586	660				30449	33258
Mangistai	17	17	13.3	10	7	611	574
Pavlodar	143	150	-2053.7	11	88	3852	1765
N-Kazakhstan	673	673	-3217.7	17	656	20763	21587
S-Kazakhstan	907	1052				2940	2124
Total	4778	5230	-15051.1	212	2219	106318	104591

Table 9: Investors Activity (20 April 1999)

Oblast	Investors		Farms Sold Or Under Sale To Investor Control		Investor's Investment In Farms (Tm)	
	01.01.99	20.04.99	01.01.99	20.04.99	01.01.99	20.04.99
Akmola	13	18	50	73	2592	2592
Aktybinsk	31	43	48	58	852	1229
Almaty	9	7	15	13	1777	1746
Atirau	2	2	2	-	8	8
E-Kazakhstan	15	15	20	18	580	820
Zhambul	7	6	9	7	161	108
W-Kazakhstan	4	-	4	-	385	-
Karaganda	10	10	10	10	226	226
Kyzl-orda	5	2	5	2	792	792
Kostanai	37	42	47	56	1550	1812
Mangistai	2	2	2	2	-	-
Pavlodar	35	45	31	47	182	197
N-Kazakhstan	45	45	141	141	3197	3197
S-Kazakhstan	9	9	4	7	187	204
Total	**224**	**246**	**388**	**434**	**12489**	**12931**

Table 10: Transfer of Social Services of Agricultural Organizations to the Account of the Local Authorities

(No. and Million Tenge)

Oblast	Social Service Entities on the Books of Agricultural Organizations	Social Service Entities Transferred to Local Authorities (20 April 1999)	Expenditure on Social Service Entities not Transferred (million Tenge)
Akmola	289	57	5.9
Aktybinsk	147	115	31.7
Almaty	65	-	100.0
Atirau	67	62	0.7
E-Kazakhstan	-	-	-
Zhambul	9	-	0.2
W-Kazakhstan	-	-	-
Karaganda	-	-	-
Kyzl-orda	-	-	-
Kostanai	-	-	-
Mangistai	42	28	3.6
Pavlodar	7	-	0.1
N-Kazakhstan	184	65	-
S-Kazakhstan	31	-	1.2
Total	**841**	**327**	**143.4**

Table 11: Information on Tender Managers (20 April 1999)

Oblast	Number of Trained Tender Managers	Number of additional Tender Managers Required
Akmola	77	15
Almaty	14	32
Atirau	16	4
E-Kazakhstan	12	4
Zhambul	36	5
W-Kazakhstan	80	-
Karaganda	45	28
Kyzl-orda	27	11
Kostanai	180	-
Mangistai	-	-
Pavlodar	65	-
N-Kazakhstan	60	-
S-Kazakhstan	144	-
Total	**756**	**99**

Table 12: Adoption of the Patent System of Taxation

Oblast	Total Farm Entities	of which: Using Patent	%	Legal Entities	Of which: Using Patent	%	Peasant Farms	Of which: Using Patent
Akmola	3954	306	8	379	27	7	3575	279
Aktybinsk	2474	403	16	516	59	11	1958	344
Almaty	19482	3535	18	458	12	3	19024	3523
Atirau	1143	337	29	46	22	48	1097	315
E-Kazakhstan	6989	1337	19	228	45	20	6761	1292
Zhambul	6252	416	7	289	77	27	5963	339
W-Kazakhstan	3417	249	7	399	13	3	3018	236
Karaganda	4522	907	20	213	9	4	4309	898
Kyzl-orda	1623	403	24	150	-	-	1473	403
Kostanai	6307	733	12	660	7	1	5647	726
Mangistai	435	221	51	17	-	-	418	221
Pavlodar	3347	949	28	150	26	17	3197	923
N-Kazakhstan	5801	435	7	673	28	4	5128	407
S-Kazakhstan	24250	5393	22	1052	35	3	23198	5358
Total	89996	15624	17	5230	360	7	84766	15264

APPENDIX II

FARM CASE STUDIES

Case Study No. 1 Karl Marx – A Surviving Production Cooperative

Situated in favorable wheat-growing area of Kostanai oblast, the Karl Marx PLL is surviving without significant change. A former collective farm, the entity converted into a Producer Cooperative in 1996. In 1998 it further converted into a PLL as a precautionary measure to avoid possible bankruptcy proceedings in the future, although it has a healthy balance sheet. (Specifically, it converted in view of the clause in the 1997 bankruptcy law which provides for entities to be declared bankrupt if arrears are outstanding for more than 12 months). The present director, who has been in post since 1984, received formal ownership of all property shares during the conversion to PLL status, but has also signed contracts permitting the property owners to reclaim their shares without payment at any time.

The entity was dominated by ethnic Germans, and 95 percent of the original owners have emigrated. However, the population has remained stable with incoming migrants from the southern raions of Kostanai oblast who have deserted their land and property shares in financial distress in recent years. Some of the migration is circulatory with individuals returning to the south when conditions improve for a season. Immigrants are attracted by wage labor on the farm and by the possibility of renting houses in the entity. Wage arrears are never more than 2-3 months.

The farm looks set to survive and managed to break even in the drought year of 1998. Success has been based on two principal factors: **diversification** into milk production through retention of the milk cow herd at a time when surrounding farms sold their livestock, leading to a local monopoly in milk products. This has produced a strong cash flow during a period when most neighboring entities accumulated debts for inputs obtained on barter which eventually have led to bankruptcy; second, **the Director has strong managerial abilities** and has followed a risk averse strategy through diversification and minimal exposure to borrowing (including minimization of receipt of inputs on credit from the local authorities).

The emigration of the former owners of property shares in the entity has created an environment where almost all workers on the farm are pure employees with neither land nor property rights in the entity. The entity must, however, be regarded as a peculiarity rather than a replicable model and it is unlikely to survive a change in the incumbent director without external investment and provision of managerial skills.

Case Study No. 2. Perelyevsky – a Bankrupt Production Cooperative Converted into a Successful Branch of a Vertically Integrated Food Industry Conglomerate

An entity founded in 1963 as a Virgin Land settlement which operated successfully under the Soviet period, though with a general decline from the early 1980s in common with the wider economy. Incurred significant debts since 1992 totaling Tenge 80mn of which half was to the budget, tax, tax arrears penalties and pension contributions, the balance commercial debt to the Arai JSC food complex which had contracted the entity to supply wheat. The livestock population had been reduced from 7,800 in 1986 to 1,700 in 1996. Arai JSC applied for bankruptcy in May 1997 (under the former legislation) and the production cooperative was judged bankrupt in August 1997 (one of the first bankruptcies of agricultural entities in the region and before any land distribution had been made to the cooperative members).

The entity was auctioned in September 1997 and Arai JSC, as the major creditor, acquired all fixed and production assets. The local population initiated the transfer of the production cooperative to Arai JSC following a general meeting by a unanimous decision. The production cooperative was legally disbanded and no longer exists legally.

The entity now forms a branch of Arai JSC, an integrated complex of food companies comprising grain, meat and milk production and production of alcohol, soft drinks and beer. Conditions improved radically after the take-over with an influx of working capital and investment. A new young manager was appointed. The cattle herd has been rebuilt to 4,200, combining a milk and meat herd.

Land, shares of which were only issued in 1997, has been formally transferred to Arai JSC by all former owners in return for a commitment for regular wage income for all employees. A single land title has been issued in the name of Arai JSC. One family which subsequently wanted to leave the company and farm independently has been allocated land from undistributed land reserves (belonging to the raion) on the edge of the farm.

The full former labor force has been retained and employed on the farm and some additional workers have moved into the entity. Increased labor absorption has been possible through: (i) the expanding diary production and processing operations on farm; and (ii) expanded production of wheat on land leased from adjacent entities (obtained on the basis of a 5-year lease, signed as a single contact with the lessor entity. The company has leased 4,000 ha and their own tractor operators cultivate this land. This is seen as an important source for future expansion of output.

The company has discontinued financing of basic social services which are legally the responsibility of the raion authorities (notably teachers salaries). However, it uses its leverage as a major tax-payer to the raion to obtain assurance that raion obligations are in fact met (unlike most neighboring entities). The company has undertaken a major investment in gasification of the entity, including housing heating and heating for the school and other facilities. This has led to a massive reduction in current heating costs (which previously depended on coal and fuel oil both in irregular supply).

Attractions for the Cooperators: The takeover offered many attractions to the cooperative members, notably a guaranteed market for their wheat (previously a major problem), assured working capital, retention in the branch of a proportion of the unit's profits for reinvestment.

Attractions for the Company: For Arai JSC the main attraction of owning Perelyevsky is control over the supply and quality of inputs for the company's food processing plants. The former contract farming relationship had not worked, and debts arising from that relationship had precipitated the bankruptcy. Arai JSC also has elevator interests which would normally permit exportation of wheat surplus to processing requirements at profit, or at least without loss.

Perelyevsky is a good illustration of the relative advantages in ownership of primary production capacity through vertical integration for processing companies such as Arai over contact farming procedures, where contracts are largely unenforceable, vulnerable producers are uninsured against major risks, inputs must be supplied in kind on credit and pre-bankruptcy management is poor. Ownership reduced risks, contracting costs and supervision costs observed under contract farming.

Case Study No. 3. ASAN Farm: Buy-Out by an Individual Investor

This farm provides an example of a successful buy-out by a former state farm director, who has managed to diversify his investments well beyond agriculture and has established a successful and diversified core farm.

The state farm became a Collective Entity in 1994, but the members subsequently sold their property shares to the Director, and he paid in full within 1 year. (There had been no demarcation of individual land plots) Subsequently the state farm was purchased at auction by the Seris JSC which acquired 78 percent of the shareholding in the property shares. The Director is the trust-holder of all individual land leases. He pays a lease fee in kind, the magnitude of which varies with the output achieved by the farm.

Some individuals wanted to sell out, but the law was perceived as requiring that land transfers were confined to the community (this is not correct, - though the community have right of first refusal in many areas). In practice land is not a constraint. There are currently 1,500 hectares within the farm area which are not cultivated, so it is not difficult to accommodate individuals who wish to farm independently.

Under the director's ownership the farm has diversified. Recent developments include purchase of a modern milk processing plant, modernization of milling equipment, production of dried and smoked fish for export to cities in Russia, etc. The diversification was an important element in the farm's survival of the serious drought of 1998.

The Director had expanded his machine fleet through purchase at very low prices on the many bankruptcy auctions taking place. Typically there are very few buyers and prices are very low. Almost all producers in the area are going through bankruptcy.

The farm finances all the social services in the village, with the exception of teachers salaries.

Immediately after purchasing the entity the Director sacked most of the workforce. He subsequently re-employed on a selective basis using annual employment contracts.

Case Study No. 4 NIVA: A Partnership (PLL) Carved Out of a Production Cooperative Expected to Emerge after Bankruptcy as a Viable Entity

The former state farm, Niva, situated in prime wheat growing area of Kostanai oblast provides an example of an entity which is breaking into a number of limited liability partnerships (PLL), some of which may be able to restart after the completion of the on-going bankruptcy.

The former state farm, of 24,000 hectares, became a Collective Entity in 1995 and converted to a producer Cooperative in 1996/97. Classified in Group 2 by the authorities it is not subject to forced bankruptcy, but nevertheless has a large burden of arrears. In 1997 the PC split into 3 PLLs as the entity was regarded as unmanageably large. Land was divided between the 3 PLLs on an equal basis. 24 individuals opted to split off to form family farms and these are currently farming 4,000 hectares.

The PC, which remains as the base entity, is seeking bankruptcy to cope with large arrears. These amount to T120 million ($1.1mn) and include T30mn to the Agricultural Support Fund and T52mn to the state budget in the form of outstanding VAT, pension contributions and tax penalties (T8mn). The entity had successfully paid off T24mn in tax arrears following the good harvest in 1997.

The first PLL was created by a group of 4 farmers who opted to relinquish their property shares in the base cooperative, as they did not wish to take on the accompanying debt liabilities attached to the property shares. They have purchased the property they need and operate independently of the base cooperative.

The base cooperative has arrears of wages owing to members, including those who opted to farm independently. These arrears are being paid off progressively in the form of provision of seed and machinery services.

Preparations for Bankruptcy: the remaining base unit (the PC) is being split into 2 more PLLs, each of 9,000 hectares and with a single founder. The decision to use bankruptcy was taken by the farm at a meeting of all PC members. All liquid property of any value is being transferred into the name of the PLL directors by a legally valid transfer procedure. The PC will continue to retain buildings and other realizable assets to meet wage arrears as a part of the bankruptcy process. All land attached to the PLLs is being transferred to the Directors of the PLLs in return for acceptance of liability for wage arrears. This is reflected in a formal contract, and the land and property transferred to the Directors will pass to their unencumbered ownership once wage arrears are fully paid off. The members have each signed Powers of Attorney for the Directors to receive their wage arrears under the bankruptcy procedure. A major effort has gone into the preparation of all the necessary legal documents (mainly Powers of Attorney and Agreements between the Director of each PLL and each member. The entity has hired the assistance of the Center for Anti-Crisis Management and Bankruptcy Management from Almaty to supervise the preparation of all necessary documents to ensure a successful outcome of the bankruptcy procedure.

The PLLs are greatly reducing their employment compared to the operations of the PC. Of the original labor force of 600 only 260 will continue to work in the PC, with 150 employed in the PLLs. Others are either working on the breakaway family farms or have sought other work (e.g. in nearby grain terminals). All workers no longer employed in the PC or the PLLs have had their employment formally terminated and have been paid wages arrears. There remains a significant problem of unemployment in the community, however. Much of the wage arrears payment took the form of distribution of livestock, which is not profitable for the PC or the PLLs.

The main problems faced by the emerging PLLs relate to input supply (given the lack of financial working capital) with all goods purchased on adverse barter terms) and difficulty in marketing the crop. Grain is usually profitable, but livestock production is not.

Case Study No. 5 Uralsk Oblast – Bilokurova (1) : A Viable Independent Farm

This is an independent farm, established in 1991, before the restructuring process commenced, which has survived and is managing to build up its capital base. As a wholly independent ("peasant") farm it is not included in the oblast classification of enterprises. The farm provides a wealth of insights into the difficulties for independent farms stemming from the inadequacies in the marketing system, the prevalence of barter and the heavy weight of the bureaucracy.

The farm was established in 1991 from an allocation of formerly unutilized land by the raion, following the passing of the soviet Law on Peasant Farms in 1990. The farm grows wheat, mustard seed (under contract to a Russian processor) and barley. There are 36 workers, up from 22 last year. With bankruptcy at a nearby Producer Cooperatives the farm has increased its land area and equipment fleet. There were only two bidders at the auction . The farmer has also acquired land from the bankrupt PC while accepting a liability to pay wages arrears. Formal transfer of land leases will take place shortly.

The main problems faced relate to output marketing. Major obstacles are quotas and bureaucratic restrictions and requirements. The oblast Akim has placed a ban on export of grain by private operators from the oblast (even to adjoining oblasts) until all entities in the oblast have paid all arrears on inputs. This occurs frequently and is perceived as unfair to those who have no arrears. Meanwhile larger entities and companies are favored with access to the export market. Even when the export market is open the bureaucracy is burdensome. Requirements include:

- Permit to sell from oblast Department of Agriculture
- Permit from oblast Department of External Relations
- Phytosanitary certificate
- Gostandard quality certificate
- Clearance from the Commodity Exchange
- License from the Chamber of Trade
- Customs Committee clearance
- Tax Inspectorate (certificate of no outstanding tax)
- Certificate from Russian Committee for Standards and Metrology

The last consignment took 22 days full time effort to obtain the clearances and permits. There had been no improvement since last year's Presidential Decree on the simplification of grain marketing.

Corruption on the road is a major problem, requiring 15-20 Russian rubles per policeman, with many checks. There is no local market for the private traders as larger players have cornered the market for processors. Farmers from Kazakhstan are not able to deliver directly to Russian processors but must sell to Russian intermediary traders. Previously he delivered to local millers but their fees for processing and storage over 7 months have risen to 30 percent of the consignment. There are many elevators in the region and the smaller ones price competitively.

The farmer had acquired a tax "patent" in respect of all the farm production and this had greatly simplified coping with the Tax Inspectorate. In spite of this tax inspections are not unusual and tax officials need to be induced to leave the premises.

Livestock is not profitable and the farm's animals have been sold to households.

Case Study No. 6 Bilokurova (2) : An Non-Viable Independent Farm Unable to Start-Up

This is an attempt by a group of three individuals to establish a small farm (842 hectares of which 680 are arable) out of disused land following the bankruptcy of the Producer Cooperative (as under Case Study No. 5). The groups approached individuals thought to have no interest in farming (the elderly, professional, teachers etc.) and were provided with their land lease shares. No formal contract was signed but the groups accepted an obligation to share some benefits with the providers of land shares. Although land shares had been issued by the Producer Cooperative, the land had not been physically demarcated, and this fact made it easy to establish a consolidated farm area.

The farm was created and farmed in 1998 using seed and fuel entirely supplied on credit by the local authorities. Given the bad harvest there was an outstanding debt of T 600,000 ($5,400), but the enterprise does not feel pressured to repay and is currently illiquid.

The enterprise now faces difficulty for the 1999 season, as it unlikely to receive inputs on the same basis as in 1998. Furthermore it has been able to purchase a tax "patent".

The enterprise cannot, at present, survive without the support of the administration, but observe a tendency for the latter to support larger enterprises at the expense of smaller farms.

Many start-up farms in the area are said to be in this condition.

Case Study No. 7 Agrocenter: A Major Company Withdrawing from Contract Farming

One of the major investment companies which has been active in contract farming in the wheat-growing belt, Agrocenter, provides one model for the organization of extensive wheat farming. However, the difficulties experienced with contract and debt management cast doubts on whether this will provide a durable solution and the company is withdrawing from contract farming in 1999.

In 1998 the company contracted 11 former state farms totaling about 400,000 hectares. Under the typical contract the company provided spare parts, chemicals, seeds and met the wage bill for an agreed employment level. Various contractual forms were adopted including both a fixed physical delivery requirement and a delivery related to the output achieved. It was one of 20-30 companies operating in this way, which together contracted for roughly one half of the cultivated wheat-growing area.

The main problem with the contracting approach is the levels of risk experienced. These include: (i) natural risks, (ii) personnel/ management risks, and (iii) default risk on input credit in kind. The contracts require a high level of monitoring/control activities and a significant presence on farm of the company's employees, monitoring equipment and fuel use, seed application use etc. In practice the mechanisms led to large outstanding debts, where entities had accepted inputs on a barter basis but were hit by the drought and unable to deliver to pay off the input loans. Most assets of the entities have very low realizable value, e.g. 20-30 year old fully depreciated equipment and buildings in remote locations.

The high contracting cost is exacerbated by the fact that the contracts are only for a single season.

While Agrocenter has pulled out of contract farming some other companies are expected to continue in 1999.

Case Study No. 8 Uralsk: Mr. DP's Farm: A Successful Individual Investor in Irrigated Agriculture

DP's farm provides an example of the introduction of a local businessman as an investor at the request of the local administration as a mechanism for accelerating farm recovery. DP accumulated capital (T30-40 m) through trade in the period from 1992 when trading conditions were abnormal and margins were high. He was invited to invest in a struggling producing cooperative by the oblast authorities. The farm is in a prime location on the banks of a river and has a substantial strip of irrigated land, with functioning equipment.

Under the terms of his investment DP received land shares for 500 hectares of irrigated land. He has taken on the liability for wage arrears in proportion to his share of the entity and has subsequently selected his workforce.

A part of his land is now leased back to the PC members, using a system of lease contract closely based on the leases issued formerly by the PC to vegetable growing brigades. Under these leases the lease rental is specified in physical quantities of specified products which DP guarantees to purchase. Having met their "quota" in this wage the leaseholders are free to plant crops of their choice on the remaining land. The leaseholders are drawn from the former PC. DP also provides inputs including seeds, fuel and water for a share of the physical output. There is a strong demand for leases.

DP has applied for an investment loan from the Asian Development Bank loan scheme for a major expansion and development of the irrigation system (1,000 hectares).

Comment: It is clear that the introduction of Mr. DP to this entity has been a strong impact on the entity because of his drive and managerial skills.

Case Study No. 9 Bisco-Trade: A Rapidly Expanding Grain Sector Investment Company

Bisco-Trade provides a further example of an investment grain sector company which is achieving a diversified portfolio within the grain sector and is achieving economies of scale.

B-C's involvement in production is based on the maintenance of large entities and establishment of long-term contracts. The company believes that the current pattern of break-up of former entities into smaller units forms an appropriate basis for its investment. It has accordingly concluded agreements with complete entities, and has reconstituted the entities where they have already been split. It currently "owns" 11 entities covering 220,000 hectares all within the oblast of Kostenai. In 1999 the company is cultivating 120,000 hectares of wheat and barley, with the remainder left fallow as part of the rotation.

The company has taken transfer of all land leases for the entities concerned, on leases which vary from 5 to 15 years. Lease contracts have been signed with each individual prime lease-holder in each of the entities. These leases, which cover the whole period of the agreement, provide for:

- the company pays a lease fee in kind (wheat, forage, milk); and
- variable provisions depending on the involvement of the household in the farm, e.g. the leases differ between household with employment on the farm and those not also employed. These terms of the leasehold are specific to each case within the context of a wider standard agreement.

The company is currently employing 20-30 percent of the shareholders in each entity.
At the time of acquisition some of the entities were already bankrupt, others approaching bankruptcy. There was a large number of entities which the company could choose from as most are in desperate conditions.

The company's selection of entities is based on several factors, including:

- climatic and soils conditions, concentrating on the northern parts of the oblast with higher and more reliable rainfall;
- location in relation to the company's own elevator interests;
- geographic dispersion of groups of entities to reduce their covariance of drought. This is believed to provide an effective mechanism for countering drought risk as there is substantial farm-to-farm variation in rainfall and yields within the same year across raions even within one oblast; and
- the quality of the remaining infrastructure in the entities.

The company has also experimented with contract farming with mixed results: several cases have significant outstanding accounts receivable. The company brought some cases to court but realized very little because of the nature of the assets seized. However, the company will continue with some contract farming but limiting itself to known and trusted partners who have met their obligations in the past.

The company has diversified into fuel distribution following its poor experience with fuel supply problems in previous seasons. This allows purchase at ex-refinery prices. The trend is for the refineries to refuse to supply customers directly because of poor repayment on barter credit arrangements, leaving a gap in the market for fuel distribution. The company believes that it will benefit greatly from having entered the market for entities first and has been able to select the prime entities on terms which will prove favorable in the medium term as the market recovers.

Case Study No. 10 Kostenai, Zhambul Farm: Acquisition and Investment by a Grain Company

The farm was acquired in 1996 as a result of bankruptcy with a large grain company, Ivolga JSC acquiring a 90 percent stake in the property shares of the former PC. The entity's land, which was undistributed at the time of the auction, was included in the purchase price and acquired by the investing company. The investor also took over all liabilities of the entity, totaling T200mn ($1.8mn) which are now partially repaid. Legally the farm is now a Partnership with Limited Liability (PLL) with a single (corporate) owner.

The farm produces grain, vegetables and potatoes.

The company can produce grain profitably. This is assisted by vertical integration (the company owns12 grain terminals and elevators) and by economies of scale in management and specialist expertise across the 23 such farms owned by the parent company.

Comment: this is clearly a viable form of ownership and management

Case Study No. 11 Plodoovoshchnoi (1): A Failing Producer Cooperative (Uralsk)

A former state farm on the perimeter of the city of Uralsk with 1,200 employees, 1,000 milk cows, 500 irrigated hectares, 300 hectares of vegetables and 8 hectares under greenhouses. The entity became a Collective in 1994 with no effective change in operations and in 1997 was converted to a Producers Cooperative. The entity accumulated large debts and was disconnected by the state energy company, which led to discontinuation of greenhouse production. In 1998 the several groups split off from the PC which was performing poorly, creating 6 larger farms and 3 smaller ones with a total area of 4,000 hectares. The base PC continued to farm the remaining 2,000 hectares directly. Land and property shares were distributed but land was not demarcated.

The immediate prospects for the PC are poor. It will have difficulty farming the remaining area in the 1999 season unless the local authorities provide all inputs, as its sources of credit have been exhausted. Bankruptcy is only a matter of time, as the entity is categorized in Group 4, but the PC has not been undertaking any restructuring to maximize the usefulness of debt write-off through bankruptcy.

Case Study No. 12 Plodoovoshchnoi (2): A Private Investor within a Failing Cooperative

One of the larger private farms created out of Plodoovoshchnoi PC, this farm was created by a local businessman with no previous experience in farming, but who had acquired some capital through his construction company. He is entering farming because of lack of contract opportunities in construction. The investor applied to the local authority and was given the go-ahead to attempt to negotiate the creation of a farm out of the Plodovooshchnoi PC.

The land for the farm was acquired from PC members who have no interest or ability to cultivate. The investor negotiated directly with land title holders, mostly old people, many of whom fear they will receive shares for land located 60 km out of town and in this way built up a holding of 1800 hectares in a consolidated plot . The terms of the transfer provide for the previous title holders to receive a dividend if the farm is profitable. A new lease title has been issued in the name of the investor by the oblast Land Committee. The Land Committee is expected to demarcate land this year, but this is not perceived as solving any of the key problems.

Property shares and debt: The investor invested T6mn ($55,000) and acquired the property shares from the owners in respect of T1.5mn of assets. The balance (T4.5mn) was used as working capital and in recognition of this investment his shares are not liable to existing debts.

The farm has adequate working capital to undertake planting for the complete area this season and the investor is confident that the farm will be successful. This is in contrast to the base farm which faces very poor prospects of start-up after bankruptcy unless this induces a change of management and an inflow of working capital.

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