

AGRICULTURE TRANSFORMATION IN GEORGIA: 20 YEARS OF INDEPENDENCE



SUMMARY
OF THE DISCUSSION PAPER



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CONTENS

SUMMARY	4
CHAPTER ONE CONCEPTIONS OF THE ECONOMIC ROLE OF THE AGRICULTURE SECTOR	4
CHAPTER TWO AGRICULTURE REFORMS IN THE 1990S.....	5
CHAPTER THREE AGRICULTURAL DEVELOPMENT 2003-2011.....	7

SUMMARY

This study analyses the role of agriculture in Georgia, the theoretical aspects of the strategy for its development and the trends prevailing in the Georgian agriculture sector during the post-Soviet transformation period.

CHAPTER ONE

CONCEPTIONS OF THE ECONOMIC ROLE OF THE AGRICULTURE SECTOR

This chapter provides an overview of three theories on the strategic role of agriculture – classical theory, global competition theory and the theory of the advantage of large-scale farms. It also states that the direction of an overall agricultural development strategy depends on whether the decision is made to support the commercialisation of this sector or to retain its social importance as a means of meeting households' subsistence needs.

Georgian academics and public figures have the same opinion with regard to the importance of agriculture in the economic development of the country. They are also unanimous when it comes to defining the appropriate level of agriculture sector development and the need for its commercialisation, since agriculture and food production comprise one of the most important engines of growth and poverty reduction.

Although the importance of agriculture is recognised the pace of agricultural development in today's Georgia is very slow, with the numerous small-scale farmers who are its backbone unable to ensure its high efficiency. Georgian farmers face a variety of problems, including the cheap imports flooding the country, the still underdeveloped agriculture infrastructure, insufficient knowledge and qualifications, non-availability of new technologies and other necessary resources and the inefficient work of both the private and public sectors. All these hinder the strategic development of agriculture in this country.

The major decline in agricultural production has aroused some scepticism concerning the potential agriculture has to fight poverty and increase household incomes. The result is that agricultural development in Georgia is proceeding in unfavourable conditions, as only small subsidies are available and these are invested primarily in physical, institutional and human resources.

At the beginning of the 19th century classical economic theorists observed that labour productivity was lower in agriculture than in industry, and hence the role of agriculture was primarily to produce goods to meet subsistence needs. Therefore agriculture was viewed, irrespective of other economic activities, as a decreasingly productive sphere. It is through this prism that the development of agriculture has been viewed.

Though it is of vital importance, it has been considered that the development of this sector is automatically constrained by certain intrinsic limits. However over the years it has become more and more evident that agriculture development depends to a great extent on the development of other sectors of the economy. The idea of the independent development of agriculture has been abandoned, and hence the passive view of agriculture's role has been swept aside gradually.

Many academics maintain that the development of agriculture depends on the success of small-scale farming. However, there is considerable speculation about the ability of small-scale farmers to become integral parts of trade liberalisation and globalisation processes in order to confront increasingly global competition and meet market demands. It is obvious that farmers in remote locations, who because of the unfavourable local infrastructure are unable to market their products, have no potential to succeed. On this basis it sounds reasonable to direct investment to large-scale farming activities and commerce-oriented farmers. Some academics maintain that instead of trying to "save small farms" a diametrically opposite approach should be taken, one calling for the "gradual disappearance of small farms".

However, criticism of this traditional theory of the advantages of large-scale farming began in the mid-20th century. By the late 90s many papers had been produced which viewed small-scale farming as more efficient than large-scale farming.

Supporters of small-scale farms point out that they require lower profit margins on their products and are more sensitive and flexible in terms of transaction costs than large-scale farms. In addition, when the low cost of labour and other external factors are taken into account, the efficiency of small-scale farmers is in no way inferior to that of large-scale farmers. Though large-scale farms can produce more commodities than cooperatives of small-scale farmers, the latter generate more profit than the large ones. Thus small-scale farming is evidently more efficient, but food safety and quality issues are of primary importance in the open markets. This considerably affects the development of small farmers.

The 'large versus small' issue is generating more and more public discussion. It should be resolved in the light of other issues of global and state importance, since agriculture is of primary importance for countries like Georgia, where small-scale farming is characterised by a low capacity for diversification and export orientation and high levels of unemployment.

Presently, there is no single piece of academic research (though there are some expert opinions available) which demonstrates the strategic significance of large-scale farming for the Georgian market or explains to the politicians the necessity of stemming the workforce flow to the cities. However, research is unlikely to prove that the development of small-scale farming can be a panacea for rural and agricultural development ills unless integrated farming and value chain development are introduced. The development of agriculture is only possible through the integrated development of all related sectors of the economy. It is clear that any profit generation through agriculture development, if occurring as a result of poverty alleviation projects implemented in pursuit of social change, is also a backhanded recognition of the passive role of agriculture. Along with its social role, agriculture gains its commercial significance through government support initiatives, strengthened by private investment, and infrastructure rehabilitation which in the long run results in a drastic increase in agricultural competitiveness and the development of a favourable business environment for the sector.

CHAPTER TWO

AGRICULTURE REFORMS IN THE 1990S

This chapter reviews the agricultural development tendencies of the 1990s, including land reform, agricultural infrastructure reform, investments and issues of agricultural finance.

It is now evident that the reforms of the first phase of the economic transformation period, which were aimed at destroying the large-scale socialist land-use system and creating small-scale farming units, were implemented in order to help farm households meet their subsistence requirements through the privatisation of their land plots. Having been divided into a number of small farms, agricultural production units suffered an efficiency loss and hence the sector saw a gradual decrease in production. Insufficient investment in the sector also contributed to its de-capitalisation.

Nevertheless, agriculture remained an economically viable sector during this period. In 1995, as the result of a significant economic decline in industrial production, agriculture's share of the Gross Domestic Product increased to 42%, but agricultural productivity and efficiency were still declining annually. Inadequate supplies of equipment, chemicals, seeds, fertiliser and relevant technological resources further impeded the development of this sector of the economy.

The implementation of agricultural reforms, with land privatisation one of its major components, began in the first half of the 1990s, but setting up a system of efficient farming remained one of the major problems facing the industry. During this period the transition to market agriculture based on private ownership occurred spontaneously, and the major obstacles to this process were the macroeconomic instability and hyperinflation caused by the military conflicts in Abkhazia and South Ossetia, the inadequacy of state fiscal policy, corruption and lack of access to finance due to the underdeveloped banking system. All these factors, along with an energy deficit and the destruction of the transportation system, created unfavourable conditions for the development of agriculture. Though retaining control over the prices of some agricultural products, the state was still unable to design and implement an efficient privatisation strategy.

In 1992 Georgia began its land reform programme. Land distribution took place prior to elaborating the legal basis of land ownership. The land remained in *de jure* state ownership and private farmers still did not have their rights duly defined. In order to create a land market and ensure the rational use of the land owners needed to hold unrestricted and unlimited rights to the land distributed to them under the land reform.

It should be mentioned that the land distribution started during the period of the Civil War, when ethno-political conflicts were taking place all over Georgia, which explains why the pace of land distribution differed according to region. Managed by local village committees and collective farms, it failed to include the qualitative differentiation of lands.

Overall, the land reform led to a cumulative increase in the number of privately owned land parcels and the share of all agricultural commodities produced on privately owned farms. The private sector has progressively become the driving force of agricultural development. In 1994 the private sector already accounted for almost the entire Georgian production of livestock, potatoes, vegetables, fruit, citrus fruit and grapes, and more than half the production of crops. However dilapidated and split up farms did not have the capacity to replicate the production levels of large-scale Soviet farms, and agricultural production capacity progressively decreased. It eventually became impossible to promote agriculture development by focusing all effort on land redistribution.

As a result of the economic liberalisation of 1995 consumer prices for all basic products except milk and bread were technically set by the market forces of supply and demand. In 1996 the state stopped regulating prices on these products. These reforms stimulated the recovery of agricultural production. However the lower prices then set by the processing industry (wineries, for example) and the decline of the canning industry and food production became significant factors impeding agricultural development.

In the second half of 1990s the share of GDP accounted for by agricultural production and food production gradually decreased, while other sectors experienced growth and economic recovery. In post-Soviet countries free markets generally increased competition, a challenge which agricultural production in Georgia failed to meet due to the low quality of its products (for example, the tea distributed and sold in the former Soviet Union) and logistical issues, namely inadequate storage, processing and transportation facilities (for example, for the variety of citrus fruits supplied through Abkhazia).

The rapid transition from socialist collective farming to commercial agriculture laid bare a number of the factors impeding agricultural development: the shortage of technical and technological resources, lack of infrastructure, a lack of skills and knowledge, an inadequate market infrastructure, a destroyed transportation system and worn out agricultural machinery and equipment. Reorganisation of the supply of fertiliser and chemicals failed to have a positive impact on land cultivation efficiency due to the low quality or counterfeit products used.

Agricultural infrastructure, like the whole agricultural sector, suffered from de-capitalisation, which was only addressed by some insignificant reinvesting from the public and private sectors. At the beginning of the 2000s the state began the rehabilitation of infrastructure and irrigation/melioration systems with the support of the World Bank. All these interventions proved insufficient, and the government continued to largely disregard the sector while de-capitalisation damaged the farms.

The major obstacle to infrastructure development was the shortage of financial resources, though this was accompanied by a significant reduction in the supply of irrigation water, weak management and administration of water resources and the absence of a water market, which caused irrational water waste. The infrastructure system was still not privatised and market principles had not yet been introduced.

On the whole, the agricultural reforms failed to ensure the development of the agricultural infrastructure. After the collapse of the Soviet supply chain system peasant farmers were left vulnerable, with no access to seeds, fertiliser, chemicals and other means of production. The majority of households experienced problems accessing good quality seeds, fertiliser, chemicals and veterinary services. In these years a number of vineyards were damaged by the distribution of fake fertiliser. There was a major need for agricultural consultancy services which would help farmers introduce new agricultural techniques and practices aimed at increasing crop yields and the productivity of cattle breeds and facilitate the production and sale of agricultural produce.

One more problem facing the industry was the lack of agricultural machinery and equipment. Distributed through the highly centralised Soviet-style system of supply, the agricultural machinery in use had not been renewed since the 1990s and very little of it was operational. The sector experienced a disastrous drop in mechanisation levels.

CHAPTER THREE

AGRICULTURAL DEVELOPMENT 2003-2011

This chapter reviews the agricultural reforms and agricultural development tendencies of this period.

The new government which came to power after the Rose Revolution targeted state property privatisation and building a favourable business environment in the country. This privatisation process included handing state-owned lands over to the private sector through sale or letting. The privatisation of forests and other natural resources would also take place on the basis of issuing long-term trade licences.

Since 2003, despite the new transfers of land into private ownership, the condition of agriculture has become even more aggravated and real production has again diminished. The structure of agriculture has also changed, and the production of specific products (hazelnuts, cattle, grain, milk and dairy products) has acquired priority significance. Nevertheless, Georgia is still dependent on imports of agricultural products, as a result of which the index of food self-sufficiency in the country remains very low.

A steady decline of the share of foreign trade accounted for by agricultural products has manifested the low competitiveness of agriculture and, despite the significance and role of this branch in the development of the country, no market diversification has occurred and the least attention has been paid to it when developing economic policy.

Since 2003 no serious changes have occurred in agriculture infrastructure development, due to the fact that the new government has not devoted proper attention to agriculture development. Infrastructure development has again been beset by inertia, and the process of de-capitalisation, which began in the 1990's, has continued. Household production has proved practically incapable of altering this state of recession.

Foreign direct investment in Georgian agriculture remains extremely small. Agriculture is also less attractive to the banking sector. Agriculture accounts for only between 1 and 2% of bank loans, a situation mainly predetermined by various factors, such as:

- The agricultural land market is still unformed and the fragmentation of agricultural land plots is high, due to which small entrepreneurship has become risky, while commercial credit organisations usually focus on large farmers.
- The agricultural infrastructure, such as storage and refrigeration facilities, processing plants, irrigation and drainage systems, agricultural equipment and machinery, etc. remains underdeveloped. An unstable fodder base for the cattle, incorrect pasture management, a shortage of agricultural equipment for land cultivation, high prices for fertilisers and seeds, etc. also present significant problems. At the same time, farmers' equipment and technologies need modernising. The fragmentation of land into small plots has made effective use of equipment and machinery difficult, especially in the production of grain and other single-year crops; weak sales methods (farmers do not have permanent providers and clients) and the non-existence of a storage infrastructure has increased their expenses. Due to the scarcity of investment funds, farmers buy cheap, low-quality seeds and other inputs, which naturally affect the quality and quantity of their final products. Underdeveloped infrastructure increases production risks, while unstable logistics, lack of infrastructure and insufficient support for trade create sales risks. High risks, in turn, produce a worsening of loan terms. Weak investments and high interest rates on bank loans have significantly diminished the capacity of farmers to use technology and expand production capacity.
- The low productivity of farmers is predetermined by their short value chain, which hinders their possibilities of receiving investment. Small farmers are not well enough vertically integrated,

connections between farmers and clients have not been solidly formed; they do not have permanent clients, and procurement of any clients is also comparatively expensive.

The abovementioned and other factors have hindered development of this branch, and this has made altering the political priorities of the country increasingly necessary.

In 2011 the Government of Georgia began to recognise agriculture as one of the strategic directions of the country. In March 2012 the Government presented the Strategy of Development of Georgian Agriculture (2012-2022), a document which envisaged the priority development of agriculture over the course of ten years and the formation of an efficient, competitive and stable agro-foodstuffs sector, which would rely upon a unified complex of enterprise value chain development.

This strategy did not define the milestones to be achieved, nor did it include an analysis of the available resources, and the proposed methods of implementation of the set objectives were mentioned only superficially. It was based neither upon current trends nor a detailed analysis of the various branches of agriculture, nor an assessment of human, material and financial resources and risks. The strategy failed to present a detailed analysis of the needs of farms of various sizes in different sectors and regions, etc.

One positive was that, for the purpose of its implementation, the authorities envisaged the mobilisation of additional funds from the state budget and the formation of an “Agriculture Development Foundation” which would be responsible for attracting private investment and project implementation.

The development of agriculture is now recognised as a priority by every political party, as are the identification of a specific strategy, the elaboration of a complex vision for the development of this sector and support for its role in general economic and regional development.

In Conclusion it can be noted that in the 1990s the Georgian economy was damaged by the collapse of the degraded Soviet economic system. Agrarian policy implemented during the subsequent period proved unsuccessful in both economic and social respects, since it did not consider the socio-economic interests of the half of the Georgian population whose livelihoods directly related to the agriculture sector. Due to the collapse of this sector the potential of agriculture-related industries in the regions, including the processing and food industries, remained untapped. As a result of the underdevelopment of both agrarian and industrial production, trade expanded but more and more products were imported.

The fragmentation of large farms into small land plots reduced their effectiveness, and consequently the majority of household production became oriented towards self-sufficiency. Small farms could have been quite efficient had there been an operational infrastructure. The higher effectiveness of small farms compared to large farms is predetermined by the operational status of their infrastructure.

Finally, in conditions of global competition, increasing the competitiveness of this branch and the effectiveness of numerous small household economies is possible through the implementation of agricultural processing, food industry and tourism-oriented initiatives alongside transportation logistics and infrastructure development. Agriculture sector development must be viewed globally. It should embrace the following: primary production of agricultural produce, services related to agriculture, including equipment supply, infrastructure operations, delivery of inputs, storage–packaging–processing, food industry, marketing, financial and other services, and the transformation of incomes generated rurally and in small towns into a source for small and medium-sized business expansion.