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REPORT FROM THE COMMISSION TO THE COUNCIL

Review of the transitional measures for the acquisition of agricultural real estate set out in the 2003 Accession Treaty

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The Commission is presenting this report to the Council in accordance with the Act concerning the conditions of accession of the Czech Republic, the Republic of Estonia, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Republic of Hungary, the Republic of Malta, the Republic of Poland, the Republic of Slovenia and the Slovak Republic and the adjustments to the Treaties on which the European Union is founded (the Act on Accession of 2003). In seven out of ten new Member States, the Act established transitional periods for the purchase of agricultural land by foreigners, but also stipulated that "a general review of these transitional measures shall be held in the third year following the date of accession. To this effect, the Commission shall submit a report to the Council."

The Commission report of these transitional measures and their impact has been preceded by a study of the situation in the agricultural sector in the countries concerned, carried out for the Commission by a consultant[1].

1. Legal basis for the Commission report

   On the basis of the Act on Accession of 2003 the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland and Slovakia (the seven new Member States, referred to hereafter as NMS7) were each granted a **transitional period** for maintaining existing legislation **restricting the acquisition of agricultural land and forest**[2], by derogation from the freedom of capital movements enshrined in Article 56 of the EC Treaty. By virtue of Article 24 of the Act, these transitional measures are listed in Annexes V, VI, VIII, IX, X, XII, and XIV respectively. The chapters on the free movement of capital in those Annexes stipulate that "a **general review** of these transitional measures shall be held in the third year following the date of accession. To this effect, the Commission shall submit a **report to the Council**. The Council may, acting unanimously on a proposal from the Commission, **decide to shorten or terminate the transitional period** […]."

2. The transitional arrangements

   Free movement of capital is one of the fundamental freedoms guaranteed by Community law. It includes investments in real estate[3], notwithstanding transitional periods that have been established for the purchase of agricultural land by foreigners in seven new Member States. The main reason underlying the request and subsequent granting of those measures appears to be **a need to safeguard the socio-economic**

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[1] Centre for European Policy Studies, "Review of the Transitional Restrictions Maintained by New Member States on the Acquisition of Agricultural Real estate" (http://ec.europa.eu/internal_market/capital/reports).

[2] The scope of the study is limited to the acquisition of agricultural land and forest. With respect to secondary residence the transitional measures of 5 years granted to Cyprus, Czech Republic, Hungary and Poland are not subject to review.

[3] See nomenclature of capital movements set out in Annex I to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty (OJ 1988 L 178, p. 5). Although this Directive was repealed by the Maastricht Treaty, the nomenclature is recognised by the European Court of Justice as having indicative value.

conditions for agricultural activities in the wake of the introduction of the single market and the transition to the Common Agricultural Policy in the NMS7. In particular the measures were to meet concerns raised about the possibility of the **transitional impact on the agricultural sector due to initial large differences in land prices and income compared with the rest of the EU**. The temporary derogations were also designed to ease the **process of privatisation** and restitution of agricultural land to farmers in some countries. The time limits for those restrictions were set with a view to limiting the negative impact on development of the agricultural sector in the NMS7 resulting from prolonged restrictions on foreign investment in the sector, which might, it was thought, hold back productivity and competitiveness for years to come. The transitional period is 12 years for Poland and seven for the Czech Republic, Estonia, Hungary, Latvia, Lithuania and Slovakia.

3. Objectives of the report

The Commission's objective was to review the transitional measures and their effects in order to report on the **potential for moving forward the end date of the transitional measures.** Given the reasons behind the temporary derogations, the Commission set out to investigate **whether the initial concerns had been mitigated by subsequent developments** in the NMS7 sufficiently to **allow the derogation to be terminated ahead of deadline**. This involved a survey and analysis of developments since the accession negotiations and a comparison with the situation and developments in the "old" Member States.

4. Methodological approach

To understand the current and future impact of the land ownership restrictions, the study focused on two questions: the continuing relevance of NMS7 concerns about a possible massive takeover of land by foreigners; and the extent to which the restrictions on foreign ownership have affected the efficiency of land exchanges and land allocations, and of productivity growth in NMS7. The survey focused on the following main issues: comparative analysis of the NMS7 transitional restrictions; other factors affecting the markets for agricultural land and land transactions; how agricultural land markets have developed over recent years, in particular in terms of land prices and rentals and their degree of convergence with EU15; and analysis of key indicators of agricultural performance in NMS7 compared to corresponding EU15 indicators.

5. Overview of the situation after three years of EU membership.

Legal restrictions in NMS7 on the acquisition of agricultural real estate by foreigners

There are **differences in the way the NMS7 formulate their restrictions** on the acquisition of agricultural real estate by foreigners. This applies mainly to the way 'foreigners' are defined and to the conditions that foreigners have to fulfil in order to (exceptionally) obtain ownership of agricultural real estate (Annex I).

As to the definition of foreigners, Hungary is the only country not accepting companies as owners of agricultural land (this is a non-discriminatory restriction). As to the conditions for (exceptional) acquisition rights, all NMS7 allow acquisition of agricultural land by foreigners who have been farming the land in question, as residents, for at least three years. The Czech Republic and Lithuania go even further, in permitting acquisition of agricultural land in general for such persons. Furthermore, Estonia, Lithuania and Slovakia permit acquisition by resident companies that are majority-owned by foreigners. In addition, Estonia has a general exemption from the restriction for plots smaller than 10 ha and Poland for less than 1 ha (unless in border regions). Finally, Hungary permits the acquisition of very small farmsteads (6000 m2 or less) and of real estate for farm buildings necessary for intensive livestock breeding. Most importantly, there are **no restrictions on foreigners renting agricultural land in any of the NMS7**. The differences illustrate that a complete and strict ban on foreign acquisitions is not in force and may therefore not be viewed as essential for achieving the transitional objectives.

In view of these differences between the NMS7, it is interesting to note to what extent foreigners have actually been able to buy agricultural land. The official statistics show quite a small share of foreigners in agricultural land ownership. For instance, in Hungary, agricultural land transactions involving foreigners represent less than 0.2% of total turnover in 2005 and 2006. Latvia has the highest percentage among NMS7, but it still does not exceed 2% for the same reference period. However, national land experts participating in the survey stressed that official statistics are likely to underestimate the actual foreign ownership of agricultural land because they do not take into account transactions by local intermediaries or the use of informal contracts that are not registered with the authorities.

Ownership restrictions and land markets

It is important to put the effect of foreign ownership restrictions within the broader perspective of the way land markets operate. In the NMS7 context, we have to remember that **the restrictions do not affect the renting of agricultural land.** Other, institutional, factors that affect land transactions include constraints and imperfections in capital markets. Transaction costs in land markets and imprecise property rights remain important and still have a significant impact on the allocation of land. Problems with uncertain property rights, and in particular **unfinished privatisation**, affect both sales and rental markets, albeit in different ways and to differing degrees, and are the main factor impinging on the development of land sales and rental prices.

Foreign investments

Foreign investment in agriculture would have important long-term impacts, on the provision of the necessary capital and know-how, on the functioning of land markets and on agricultural productivity. Of total FDI stock of some €170 billion (in 2004) in the NMS7, less than €1 billion has so far gone to the agricultural sector. Even so, this is still an appreciable inflow of capital, bearing in mind the temporary restrictions in force. It underlines that "informal" foreign ownership of agricultural land is already in excess of the official statistics, but also points to investments in company-held farms and farm rental. To the direct (horizontal) impacts of these – still limited – investments on the agricultural sector can be added the (possibly) much greater of indirect (vertical) spill-over impacts of investment in the food industry, currently totalling some €9 billion. All of this is helping to ease the transition process in the agricultural sector.

Influence of EU accession on NMS7 land markets

EU accession has also had an indirect effect on NMS7 rural markets. It stimulated direct investments from the former 15 Member States, enhancing the effects mentioned above. By stimulating financial sector reforms and encouraging the growing presence of financial institutions from EU15, it improved access to credit and insurance, alleviating major obstacles to more efficient land markets. Last but not least, it led to a strong increase in **subsidies** for NMS7 farmers through the Common Agricultural Policy (CAP). While NMS7 farms are eligible for only part of the subsidies available to EU15 farms, these subsidies still account for an important share of NMS7 farm income. They are improving social conditions among NMS7 farmers and, together with improved access to credit, are giving a timely push to the incentives and possibilities for domestic investors to acquire agricultural land, and have already led to a strong increase in farm incomes, in land transactions and land prices.

Changing land markets in NMS7

The amount of land being rented is considerably higher[4] than the amount being sold. In all NMS7 except Latvia and Poland more than half of agricultural lend is rented out, and this share is much higher than the average in the EU15. In contrast, Latvia and Poland range below the EU15 average.

Notably, the land sales market has been strongly affected in recent years by public sales under ongoing land privatisation programmes. This is particularly the case in the Czech Republic, but also in Poland and Lithuania. Privatisation is largely finished in Estonia and Latvia, and while public land may still be privatised in the future in Hungary and Slovakia, it is currently not significantly affecting the land sales market.

The study used national sources to obtain price statistics for land sales and rentals. The Commission has also made use of EUROSTAT figures wherever available. Both the coverage and quality of the statistics are still under development, and results are subject to delays. As far as could be assessed, for the period 2000-2006, there was a significant increase in **land sales prices** (Annex II), measured in national currency and adjusted for inflation, in all countries but the Czech Republic and Slovakia. Average increases ranged from around 10% per year in Poland to almost 60% per year in Latvia. Importantly, a major part of the price rise occurred around the year of accession. In the Czech Republic and Slovakia, prices actually declined after 2001. During that time there was, in the Czech Republic, a substantial increase in public sales due to the privatisation of remaining state land.

Prices for rentals did not appear to rise more strongly overall than land prices, although diverging trends were noted in individual countries (Annex II). In Poland, rises early on in the period 2000-2006 were reversed towards the end. Nonetheless, rental prices rose by about 4% per year on average over the period. In other countries price increases proved more stable, ranging from about 6% per year in Hungary to more than 20% per year in Lithuania. Still, in view of the fact that the rental market was open to foreigners, whereas the land sales market was largely closed, it is notable that rental price increases remained relatively moderate overall.

At the end of the period, price levels still differed markedly between the NMS7 (Annex III). **Land sales prices**, measured in common currency, were in 2005/2006 lowest in Estonia and Lithuania, not exceeding €800/hectare. This was greatly

4 Renting of land is particularly important in Slovakia, Hungary, the Czech Republic, Estonia and Lithuania, where the share of total agricultural land rented by farms is more than 50%. In Latvia it is 24% and in Poland 22%. Between 2003 and 2005, the share of rented land in total land use declined slightly (1%-4%) in all countries except in Hungary, where it grew by 3%.

surpassed by Poland (€1927/ha[5]) and by the Czech and Slovak Republics (with, respectively, €1625/ha and €1017/ha). Latvia showed the highest price level, at €3591/ha. However, part of the difference in price levels may be attributable to statistical bias, since the basis for price calculations may still differ between countries. Again, **rental prices** show a different pattern. Among the countries that reported figures, Slovakia had the lowest level, with €18/hectare (in 2005) and Hungary the highest (€67/ha[6]). The Czech Republic, Lithuania and Poland held the middle ground with, respectively, €32, €33 and €41 per hectare[7].

The patterns in price increases and price levels appear to underline that institutional factors other than openness to foreign presence still have a major influence on the development of agricultural markets, such as constraints and imperfections in capital markets, transaction costs in land markets and uncertain property rights, as well as unfinished privatisation,. In addition, the relatively subdued rental price increases appear to indicate that the risk of price hikes due to foreign presence may after all be manageable.

As a result of price increases, the gap in **land sales prices** between new and old Member States is gradually diminishing over time (Annex III), although the process is still far from being completed. A comparison with East Germany may be fruitful, since this region was subject to a transition phase much like that in the NMS7, but has, in contrast, experienced fully open borders with the EU since the early 90s. Compared to that region, Poland has reached about half its price level, whereas the Czech Republic, Hungary and the Slovak Republic lie somewhat lower. Only Latvia approaches East German price levels, which are also close to the prices in neighbouring Sweden (however, see earlier remark on differences in calculations). Again, considering that rental markets are open to foreigners, it is surprising that convergence in **rental prices** is not generally more pronounced than that in land sales prices.

Socio-economic structure of agricultural sector

The on-going transformation of the agricultural sectors in the NMS7, leading to increasingly efficient land use and production, is already showing remarkable results over the years, above all measured in yields, but also increasingly in labour productivity. For instance, in production of grains (wheat), the Central European NMS7 have reached about 60% (Poland) to 90% (Czech Republic) of EU15 yields. The Baltics are still lagging behind. In milk production, all NMS7 are already close to the average yield in the EU15.

The situation is not quite as favourable as concerns productivity. For instance, although the gap in labour productivity (gross value added per employee) is decreasing over the years, large differences, between the NMS7 as well as vis-à-vis the EU15, still prevail.

6. Conclusions

[5] 2005 agricultural land prices data from the study “Review of the Transitional Restrictions Maintained by New Member States on the Acquisition of Agricultural Real estate”. 2005 EUROSTAT available data are only related to arable land € 2049/ha

[6] Data for 2006. In 2005: €63/ha.

[7] Data for 2006. In 2005: €32, €22 and €35 respectively.

a) The concerns raised during the NMS7 accession negotiations, in particular concerns regarding the possible impact on the agricultural sector of large differences in land prices and income with the rest of the EU, are important, but should not overshadow fundamental issues which are still holding back to some degree the agricultural structural reform needed to increase productivity and income in the NMS7. The markets for agricultural land within the NMS7 are subject to institutional factors, such as unfinished privatisation, uncertain ownership and co-ownership conditions, and cumbersome and costly routines for land transfers.

b) A considerable foreign presence in the form of rented agricultural land in the NMS7 has been accommodated without any visible shock to the system, and could even be seen as helping to resolve the above institutional restraints. It may have a positive influence on agricultural reform, through introducing new technologies and providing much-needed capital for production. In addition, it may assist in loosening, in some NMS7, the grip of dominant incumbent owners of large farms on small dispersed landholders with uncertain property titles, which tends to hold back land prices and prevents the easing-in of land ownership redistribution with a view to creating larger contiguous properties.

c) The Commission study has shown that the gap between NMS7 and the EU15 in terms of income and land prices has declined over recent years. Still, prices are well off from complete convergence, though this would not be neither expected nor seen as a necessary condition for terminating the derogations. There is also a marked, but smaller, price divergence within the EU15, albeit at a higher average price level. Transaction costs, particularly affecting foreign acquisitions, may also play an important, but smaller, role in the EU15. The development of rental prices hitherto in the NMS7 seems to indicate that, far from great price shocks, the gradual movement of land sales prices to the EU15 degree of convergence could continue once land sales markets within NMS7 were opened up to the same degree as within the EU15.

d) Socio-economic conditions for agricultural production have improved, and this positive trend is expected to continue. However, a large gap in productivity remains between NMS7 and the EU15. This underlines a need for the NMS7 authorities to continue addressing the lingering institutional factors delaying the process of rationalising land use and agricultural production. Foreign presence in the agricultural sector, at present through rentals and eventually also through land ownership is, and can be expected to be, conducive to this process.

e) Given the deadlines established in the Act on Accession of 2003 for the preparation of this report the period studied is necessarily too short[8] to have more extensive empirical evidence on the impact of accession on the acquisition of agricultural land by foreigners. Still, the Commission study has shown that the NMS7 would be well advised to put the remainder of the derogation period to good use in fostering the development of the sector, so as to prepare for the inevitable end of the derogation periods. In that context, NMS7 authorities might consider a smaller, intermediate loosening of the restrictions on foreign ownership, in a way which would be beneficial for the agricultural reforms. For instance, consideration

[8] The statistics available at the date of the adoption of the report refer only to 2006 with relation to some Member States. The most comprehensive data on land prices for comparison purposes between “new” and “old” Member States are only available for 2004 and 2005.

might be given to introducing the following small reforms, already partly in force in some NMS7:

– increase the minimum area of land that foreigners could buy without restrictions. For instance, a limit of 10 hectares could be considered, as in Estonia; and

– permit foreigners who are renting agricultural properties, to acquire farm buildings and the land on which they are built without restrictions.

Commission's response:

Based on the situation in NMS7 in the mid-term review of transitional measures for the acquisition of agricultural land, the Commission does not conclude that the time limits for these measures be shortened.

ANNEX I: Legal restrictions regarding the acquisition of agricultural land in the NMS7

	Czech Republic	**Estonia**	**Hungary**	**Latvia**	**Lithuania**	**Poland**	**Slovakia**
Can EU citizens buy agricultural land despite the restriction?	Yes, • if married with Czech partner • if s/he has been staying and farming in the country for at least 3 years, then s/he can buy any parcel in the country.	<u>Plots < 10 ha:</u> Yes. No additional conditions have to be fulfilled. <u>Plots>10 ha:</u> Yes • if married with Estonian partner • if s/he has been staying and farming in the country for at least 3 years, the particular plot that s/he has been ren-ting can be bought.	Yes, • if married with Hungarian partner • if s/he has been staying and farming in the country for at least 3 years, the particular plot that s/he has been ren-ting can be bought.	Yes, • if s/he has been staying and farming in the country for at least 3 years, the particular plot that s/he has been ren-ting can be bought; • if married with Latvian partner, but only as co-owner	Yes, • if married with Lithuanian partner • if s/he has been staying and farming in the country for at least 3 years, then s/he can buy any parcel in the country.	<u>Plot <1 ha not located in border zones:</u> Yes, • if residing in Poland for at least five years • if married to a Polish citizen • <u>Other plots:</u> • if married to a Polish citizen • if s/he has been staying and farming in the country for at least 3 years, the particular plot that s/he has been ren-ting can be bought.	Yes • if married with Slovakian partner • if s/he has been staying and farming in the country for at least 3 years, the particular plot that s/he has been renting can be bought.
Can a legal entity buy agricultural land?	Yes	Yes	No	Yes	Yes	Yes	Yes
Can a legal entity that is registered in the county but owned by foreigners, buy agricultural land?	Yes, if minority of shares is owned by foreigners	Yes	No	Yes, if minority of shares is owned by foreigners	Yes	Yes, if minority of shares is owned by foreigners	Yes

ANNEX II: Prices for agricultural land in the NMS7, 2000–2006
Measured in national currency per hectare, in 2005 prices

SALES		**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
	Czech Republic (CZK)	61134		48976	50501	50601	48279	45118
	Estonia (EEK) *)		3850		4985		7255	
	Latvia (Lats)			370	383	733	1602	2346
	Lithuania (LTL)	1139	1185	1663	1398	1439	1851	2441
	Hungary (**1000**HUF) *)					174	196	[373] **)
	Poland (PLN) ***)	5476	5649	5375	6088	6776	8244	9171
	Slovak Republic (SKK)	50672	47113	45438	41781	38908	37850	36303
Rentals		**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
	Czech Republic (CZK) *)	599	716	762	788	867	960	940
	Estonia (EEK)							
	Latvia (Lats)							
	Lithuania (LTL)	35	44	47	49	60	77	110
	Hungary (HUF)		12837	12780	14851	14871	15720	17101
	Poland (PLN)*)	132	104	101	122	200	141	164
	Slovak Republic (SKK) *)		368	462	479	562	684	

Sources: EUROSTAT, unless indicated otherwise. EUROSTAT data calculated in 2005 prices on the basis of EUROSTAT current prices.

*) Collected from national sources, as used in "Review of the Transitional Restrictions Maintained by New Member States on the Acquisition of Agricultural Real estate".

**) 2006 figures from FADN, referring to arable land.

***) Figures from EUROSTAT referring to arable land.

ANNEX III: Prices for agricultural land in the NMS7 and selected EU15, 2000-2006 Measured in current euro per hectare

SALES		2000	2001	2002	2003	2004	2005	2006
	Czech Republic	1556	1403	1528	1522	1561	1621	1625
	Estonia*)		218		297		464	
	Latvia			546	526	1031	2301	3591
	Lithuania	294	321	468	390	406	536	734
	Hungary*)					676	742	[1550] **)
	Poland***)	1194	1415	1307	1308	1465	2049	2385
	Slovak Republic	895	878	888	912	946	981	1017
	Denmark	10330	12211	12920	14669	15995	18787	22791
	Germany	9081	9427	9465	9184	9233	8692	8909
	West Germany*)	16830	17246	16966	16489	16035		
	East Germany*)	3631	3811	4014	3831	3944		
	France*)	4913	5384	5778	6079	6567		
	Netherlands	35713	37150	40150	34160	31432	30235	31290
	Sweden	1989	1988	2019	2126	2455	3351	3706
Rentals		**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
	Czech Republic*)	15	20	24	24	27	32	32
	Estonia							
	Latvia							
	Lithuania	9	12	13	14	17	22	33
	Hungary		41	45	53	57	63	67
	Poland*)	29	26	25	26	43	35	41
	Slovak Republic*)		7	9	10	14	18	
	Denmark	328	346	368	391	399	397	456
	Germany		164		174		176	
	West Germany*)		225		261			
	East Germany*)		104		116			
	France*)	124	123	124	123	122		
	Netherlands	405	443	445	445	447	462	466
	Sweden	107	104	108	110	110	108	110

Sources: EUROSTAT, unless indicated otherwise

*) Collected from national sources, as used in the study "Review of the Transitional Restrictions Maintained by New Member States on the Acquisition of Agricultural Real estate"

**) 2006 figures from FADN, referring to arable land.

***) Figures from EUROSTAT referring to arable land.