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Leasing of Agricultural Land Versus Agency Theory in the Light of Study Results

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**Leasing of Agricultural Land Versus Agency Theory in
the Light of Study Results**

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Leasing of Agricultural Land Versus Agency Theory in the Light of Study Results

JEL Classification: D82,L51, Q15

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Abstract

Research background: Agency theory examines relations between entities as contract relations. The agency relation is always present when the situation of one person depends on the activities of another person. The individual who performs such activities is the agent, and the other party dependant on the activities of the agent is called the principal. The agency relation occurring between the above-listed parties is one of the oldest and most extensively codified modes of social interactions. Relationship studies: andlord - tenant, belong to the earliest and classic examples of agency relationships, analyzed by economists.

Purpose of the article: the determination of the significance of the lease in Polish agriculture with the use of agency theory.

Methods: The theoretical basis is primarily provided by a review of the literature encompassing publications devoted to agency theory, legislative acts pertaining to leases, as well as domestic and foreign scientific studies. Statistical data deriving from the Agricultural Property Agency. The time range of the analysis encompassed the years 1992–2015. The empirical section was prepared on the basis of results of our own studies.

Findings & Value added: According to the analysis of the results of the author's own studies, the most important advantage of leasing for the lessees is the possibility of expanding the farm (76.1%). Very similar importance was also assigned to the possibility of the pre-emptive right (70.1%). Most frequently (42.4%) this answer was indicated by the respondents who held over 75% under lease in total used land. This may be justified by the fact that farms with a high share of lease function in the environment of a relatively higher level of risk than farms with the majority of ownership, whereas purchase of leased land contributes to its minimisation.

Introduction

The agency relation is considered a common fact of economic life. A lessee may be called an agent of a land owner, doctors may be called agents of patients, and MPs may be called agents of voters. It is commonly believed that with the use of this theory, it is possible to understand the actual nature of market transactions (Iwanek, Wilkin, 1998, p. 124). This trend currently offers extensive possibilities of using cognitive tools in numerous modern economic relations, whereas its application seems to be particularly promising in reference to the issue of agricultural leases. An agricultural lease represents a very important form of ownership and structural transformation in agriculture. In relation to the above, the objective of the article is the determination of the significance of the lease in Polish agriculture with the use of agency theory.

Methodology and Scope of Study

The article is of a theoretical and empirical nature. Statistical data deriving from the Agency of Agricultural Property of the State Treasury (Agencja Własności Rolnej Skarbu Państwa – AWRSP, later the Agricultural Property Agency – Agencja Nieruchomości Rolnych, ANR or Agency). The time range of the analysis encompassed the years 1992–2015. The empirical section was prepared on the basis of results of our own studies¹, performed in 2014 on a group of 68 agricultural lessees².

The studies primarily encompassed the area of Warmia and Mazury Province, which was considered representative for the issue in question due to the fact that the surface area of land leased from the Agency constituted approx. 12.5% of total cultivated land (above the average value for the country) in 2014 (*Rocznik statystyczny rolnictwa 2015 (Agriculture Statistical Yearbook)*, 2016, *Raport z działalności...2015 (Report on Operation...*, 2015); over 50% of cultivated land was, in the prior economic system, state property (extensive possibility of offering land for lease) and the basic economic activity in the region relies on agriculture – in 2014, the share of agriculture, forestry, hunting and fishing in the generation of gross added value amounted to 6.1% in comparison to the national average on the

¹ The study was conducted as part of the M.A. thesis of A. Zielińska *The Significance of Leases in Polish Agriculture in the Context of Agency Theory (Znaczenie dzierżawy w polskim rolnictwie w kontekście teorii agencji)*, prepared in the Institute of Economic and Regional Policy, thesis supervisor: Assoc. prof. R. Marks-Bielska. The defence took place at the Faculty of Economics, University of Warmia and Mazury in Olsztyn, 24.06.2015.

² Remaining in a lease relationship, both individual farmers and, operating upon the principle of a different legal form, managing farms, taking into account the members of the Federation of Employers-Lessors and Farm Owners Association.

level of 2.8% (*Produkt krajowybrutto (Gross Domestic Product...2016)*).The performed study was aimed at providing answers to the following questions: how are contract terms shaped in lease agreements, what are the stances of lessees, and which factors are conducive to the emergence of information asymmetry and building positive relations between the parties to the agreement?

Agency Theory and Leasing in the Light of Reference Literature on the Subject

Agency theory examines relations between entities as contract relations. The agency relation is always present when the situation of one person depends on the activities of another person. The individual who performs such activities is the agent, and the other party dependant on the activities of the agent is called the principal (Prett, Zeckhauser, 1985, p. 2). The agency relation occurring between the above-listed parties, as determined by S. A. Ross (1973, p. 134),is one of the oldest and most extensively codified modes of social interactions.

In the course of the formation of the principal/agent relation, at least two problems appear. The first occurs when the objectives of the principal and the agent are in conflict, and the principal is not able to verify whether the agent is behaving properly (from the point of view of the contract that they concluded). The second problem is the issue of risk distribution. This derives from the fact that the ordering party and the contractor, on account of natural differences in their positions, may represent various stances towards risk and, therefore, prefer various manners of applied technologies, plant farming, etc.

The first problem is the consequence of information asymmetry between the principal and the agent. Its occurrence is most often related to two issues: furtive activities of the agent which refer to the situation when the principal does not observe the activities, but only sees their result, or hidden information, when the principal notices the agent's activities, but does not observe the external factors that determine them (Czarny, Miroński, 2005, p. 157). A specific example of furtive activities of the agent is the so-called temptation of abuse, which causes a transfer of the risk of potential losses onto the principal in a situation when the agent makes decisions aimed at accomplishing its own profits, and at the same time exposing the principal to excessive losses. The temptation of abuse may occur when the following premises have been met: the utility of both sides of the contract depends on the activities of the agent; the principal may only monitor the results of the agent's activities (but does not see the

agent's activities); the agent's decisions are not optimum in the Pareto sense, i.e. it is impossible to improve the situation of one entity without aggravating the situation of another entity (Piotrowski, 2014, pp. 99-113). As noted by Kata (2011 p. 130), the occurrence of moral risk is related to the period after conclusion of the contract.

On the other hand, the example of hidden information before conclusion of a contract may cause negative selection. Negative selection takes place when better informed entities, yet of lesser credibility, displace other market participants, preventing the conclusion of optimum contracts. However, it may turn out that in certain situations it may be profitable for the agent to disclose specific information, hardly available for the principal. This phenomenon, known as signalling, allows the agent who has a product or a service of above-average properties to avoid a "detrimental" market mechanism (Wilkin, 2016, p. 183). The mode of preventing information asymmetry on the side of the principal may be, on the other hand, so-called sorting (also known as discrimination), which is aimed at differentiating two types of agents in the market and admitting to cooperation only those groups that fulfil specific criteria (Maskin, Tirole, 1990, pp. 379-409, Kivistö, 2007, p. 20). In reference to leasing, the example of sorting is provided by the criteria of participation in a limited tender addressed to individual farmers. The definition of this group of entities was specified in the amended act on the management of agricultural property of the State Treasury of 19 October 1991³; this solution has greatly limited the number of entities admitted to procedures. This allows for guaranteeing, to a greater degree, that the land from the Agricultural Property Stock of the State Treasury is entrusted to entities which are intent on performing actual agricultural tasks.

The conflict of interest between the principal and the agent is also reflected in different preferences with respect to the risk influencing the premises of the concluded contract. It is believed that the standard situation for the problem of the agency is when the principal's attitude to risk is neutral, whereas the agent is characterised by aversion to risk. This justifies the fact that the principal may frequently diversify his risk to a greater degree than the agent, e.g. a land owner may lease land to several farmers, yet a farmer – due to economic reasons – will be interested in the lease of land located in closest vicinity. In the case of the agent's minimum impact on the results and great aversion to risk, his remuneration will be of fixed value.

³As a result of the act on suspension of sale from the Agricultural Property Stock of the State Treasury and amendments of other acts of 14 April 2016.

Study Results

Two dominant groups of lessees can be indicated in Poland, depending on the origin of the land leased by them: i.e. land from the Agricultural Property Agency – in this case, we are talking about lessees of state land and lessees of private land, when the owner of the land is another farmer, most often a neighbour, a friend, or a family member. Land subject to lease may also be the property of a forest inspectorate, a parish, a municipality, a school, etc. (Marks-Bielska, 2013, p. 795, Marks-Bielska, Babuchowska 2013, p. 83, Marks-Bielska, Zielińska, 2014, pp. 57 – 71). In the case of a lease between neighbours, no detailed data are available as in the case of leases from the Agricultural Property Agency; however, it is estimated that among individual farms in general, approx. 20% of farmers work on their own or leased land, which is the most frequent phenomenon on farms with relatively large surface areas.

The group of examined lessees was represented by 68 people who included individual farmers (77%), representatives of companies involved in agricultural activities and cooperatives. In the structure of farmed land, the respondents had land leased from the Agricultural Property Agency, land leased between neighbours, and land from both sources. The examined lessees were primarily users of farms with a surface area from 100.1 to 1,000 hectares (33.8%). The least numerous was the group of lessees managing the smallest farms – below 10 hectares (2.9%) and the largest ones – 1,000.1 hectares (5.9%). The surface area within a range between 10.1 and 100 hectares was managed by 29.4% of respondents, and 27.9% managed a surface area between 50.1 and 1,000 hectares.

The lessor, entering into relations with the lessee, delegates tasks, which is the cause for the emergence of the agency relation. In line with agency theory, it is necessary to assume the occurrence of information asymmetry and various perception and distribution of risk between the parties to the contract. The shape of the relations and the level of information exchange between the lease parties is influenced by the perception of drawbacks and advantages of the lease by the lessee. Table No. 1 presents the results of studies pertaining to the perception of advantages of this form of land management by the respondents.

Table No.1. Advantages* of leasing in the opinion of lessees

No.	Advantages	Percentage of indications
1.	Possibility of exercising the pre-emptive right	70.1

2.	Possibility of extending the surface of a farm	76.1
3.	Possibility of setting up a farm	34.3
4.	Opportunity to farm land which is cheaper than purchase	53.7
5.	Possibility of procuring exemption from rent	10.4
6.	Possibility of exemption from agricultural tax	19.4

N – 67 (number of respondents)

* The respondents could choose more than one answer.

Source: author's own study on the basis of research

According to the analysis of the results of the author's own studies, the most important advantage of leasing for the lessees is the possibility of expanding the farm (76.1%). Very similar importance was also assigned to the possibility of the pre-emptive right (70.1%). Most frequently (42.4%) this answer was indicated by the respondents who held over 75% under lease in total used land. This may be justified by the fact that farms with a high share of lease function in the environment of a relatively higher level of risk than farms with the majority of ownership, whereas purchase of leased land contributes to its minimisation. Therefore, reinforcement of this element in the above-mentioned amendment of 14 April of 2016 is to be evaluated positively. In line with the new provisions, the lessee is vested with the pre-emptive right to purchase property from the Agricultural Property Stock of the State Treasury if the lease lasts at least 3 years (Suchoń, 2016, pp. 53 – 75). The interviewed group of respondents often treat leasing as a temporary form of land management which is going to be transformed into property in the future. This is evidenced by the fact that as many as 53.7% of the respondents also perceive the beneficial financial aspect of leasing, i.e. no necessity of incurring significant costs as in the case of land purchase. This may be interpreted in a manner that they see the opportunity for alternative assignment of financial assets to other investments on the farm.

Reinforcement and maintenance of positive factors pertaining to leasing on the part of lessors – the Agricultural Property Agency or private land owners – should also be accompanied by a reflection and reaction to the perception of drawbacks of this form of land management. Drawbacks pertaining to leasing in the opinion of agents are presented in Table No. 2. The interviewed group of lessees deemed uncertainty of farming (77.3%) as the greatest drawback of leasing. In the next place, the possibility of exclusion of land (53.0%) was listed. The uncertainty of farming may result from a conviction about the instability of the institutional framework regulating the lease.

Table No. 2. Drawbacks* of leasing in the opinion of lessees

No.	Drawbacks	Percentage of indications
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1	Farming insecurity	77.3
2	Possibility of excluding a part of land	53.0
3	Difficult investments/renovations	53.0
4	No return of incurred outlays in the case of resignation from purchase due to unforeseen events	51.5
5	Necessity of paying the lease fee	25.8
6	Manner of charging the lease fee	22.7
7	No possibility of inheritance	43.9
8	Possibility of conflicts with the land owner	30.3
9	Unwillingness with respect to the control rights of the land owner**	9.1
10	No act pertaining to lease	22.7

N – 66 (number of respondents)

* The respondents could choose more than one answer.

Source: author's own study on the basis of research.

Conclusions

Leasing, irrespective of the source of origin, exerts a positive impact on the land structure. Farms which have leases as part of their resources are characterised by a greater surface area, which is confirmed by the results of the author's own studies. This testifies to the significant role of the institution of leasing in the disposal of land, enabling the conduct of the commodity economy.

Therefore, it has to be noted that agricultural leasing should be a supported solution for the disposal of land from the Agricultural Property Stock of the State Treasury, as well as neighbourhood leases. It does not require the involvement of any significant capital (such as purchase of land), allowing for alternative assignment of funds to other investments, but it is also a fixed source of income for the state budget.

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