

# Critical Analysis of Ethiopian Urban Land Lease Policy Reform Since Early 1990s

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**Key Words:** Urban, Land, Lease, Market Value, Modality of Transfer, Revenue, Speculation, Contract termination, Mortgage, Compensation

## Abstract

In the early 1990s, the Ethiopian government launched urban land reforms. While maintaining public ownership of land of the previous era, Ethiopia has moved towards a system in which market forces shape the process of land allocation and utilization through the establishment of an urban land leasehold system.

The aim of this paper is to critically review the limitations and implications of the Ethiopian urban land lease policy reform since early 1990s. Through reviews and analysis of international practices in an Ethiopian context, debates and challenges on land lease policies are assessed. The methodology employed here is a descriptive analysis where the source of the data is mainly secondary-

The study findings revealed that although the existing Ethiopian government considered urban land lease tenure as a tool to cure urban challenges, the lease policies have not been formulated in such a way to meet many of their objectives. The study also revealed that payments for the duration of the lease are not equal to what the market considered to be the value of the lease. The principles and practice of getting revenue from increasing land value is not addressed. The tools initiated to discourage speculators are controversial. Lessees' right of transferring and pledging use rights are restricted. The paper concluded that a more harmonized and legitimate urban land policy framework is needed. To this end, the government legislators should reconsider basic conceptual problems that have not yet been addressed and solved. So far no attempt has been made to link the urban development strategy of the government of Ethiopia with land lease policies in Ethiopia. The outcome of this paper therefore has important implications for legislators on how urban land lease policy reform is designed

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## 1. Background of the Research

### 1.1 Introduction

Property rights in land constitute one of the fundamental institutions that determine the social and economic framework of society. These rights are critical for economic growth and sustainable development as well as for good governance and stability (The Development Corporation Amsterdam, 2003). With respect to urban land, necessity of land is further accentuated by the rapid urban development that leads to swift and drastic changes in the physical, economic, social, political and administrative structures of the cities (Yusuf et al. 2009).

In developing countries, more than ever urban poverty requires the urgent attention of policymakers. Unless urban poverty is addressed, continued urbanization will augment urban poverty and inequality. Likewise, in Ethiopia, as elsewhere in the world, this enormous socio-economic significance stems from the fact that land is a source of wealth, economic growth, employment and a source of basic survival of the majority of the population. Evidences show that prevalent widespread urbanization required prudent and responsive urban land administration and management. Ethiopia's total population in 1983 was estimated at 33.5 million and in the past 25 years, the population has reached more than double (81.2 million). It is expected to be more than double by 2050 (170.2 million) which will make the country the 10<sup>th</sup> most populous nation of world (Ministry of Works and Urban Development Report, 2007).

Although there is wide recognition about the role of urban land in conveying sustainable urban development, there is no clear and universally applicable "blueprint" as to what an appropriate urban land policy should be in place. Urban land policy for each country is a complex undertaking and must involve a large number of policies and instruments, carefully orchestrated to be mutually supportive (Doebelej, 1987). Even if the principle of private ownership is considered to be largely valid, experience has shown negative consequences of unrestricted private ownership of land (Deininger and Chamorro, 2002). As a result, public land ownership, as opposed to private freeholds, became popular, for example, in many former socialist countries, especially in the 1960s and 1970s (Hong and Bourassa, 2003; Nega, 2005). Experience has repeatedly shown that in many countries state ownership land has conductive to mismanagement, underutilization of resources, and corruption (Deininger, 2003). The implication is that urban land epitomizes the classic conflict between equity and efficiency. The socialization

of key elements of ownership can produce equity, but at the price of inefficiency; and unlimited private control can be highly effective with respect to the exploitation of individual parcels, but grossly inequitable in their impact on the whole (Doebelej, 1987). This has been putting greater pressure on the prevalent land tenure systems.

The struggle of most socialist countries has been to find a system of tenure that would best optimize the contraries' pulls of productivity and social justice. Evidently, leasing public land has been advocated as a viable land tenure option for former socialist countries and other transitional economics (Belachew, 2010). In the last few years, in the process of market oriented land development, giving occupants of state land legal rights and regularizing their possession became important, along with ensuring that appropriate means are in place for resolving any conflicts that may arise in the process. It is suggested that provision of land certificate, legalizing long-term lease and free land right transfer arrangement can effectively assure the existence of tenure security (Deininger, 2003). It is also presumed that leasing public land may lessen tension between communists' (or socialists') desire to uphold public land ownership and reformists' demand for increasing private property rights (Nystrom, 2007). China, Vietnam, Poland, Ukraine, and Ethiopia are some of the typical transitional countries which had accepted and have implemented land lease policy as the alternative land tenure system (Chengri and Knaap, 2003; Christie, 2003; Nega, 2005) while leasehold as a form of land tenure is a well known system applied over one hundred years in Europe (The Development Corporation Amsterdam, 2003).

## **1.2 Urban Land Leasehold Tenure System in Ethiopia**

The Ethiopian People's Revolutionary Democratic Front (EPRDF) that came to power following the fall of Derg in 1991 has made significant changes in policy measures. It has adopted a free market economic policy. Despite the government's position of free market philosophy, the then Transitional Government of Ethiopia decided to maintain all rural and urban land under public ownership. State and public ownership of land was reemphasized by the last Federal Constitution of 1995. The Constitution prescribes that:

*The right to ownership of rural and urban land, as well as of all natural resources, is exclusively vested in the State and in the peoples of Ethiopia. Land is a common property of the Nations, Nationalities and Peoples of Ethiopia and shall not be subject to sale or to other means of exchange (EPRDF Federal Constitution 1995 Art 40 (3) pp 13).*

At the beginning of the 1990s, prompted by consideration of a free market philosophy, a clear demarcation between public ownership of land and individual land-use right appeared and for the first time, an urban leasehold system was introduced in Ethiopia. In 1993, the Ethiopian

government enacted the first and new urban leasehold proclamation that may be cited as the *Urban Lands Lease Holding Proclamation* No. 80/1993. Ethiopia witnessed two other urban land leasehold proclamations that came one after the other: Proclamations, 271/2002, and 721/2011. In general, the current arrangements of land use rights are somewhat less restricted of public land ownership as compared to the previous communist regimes which prohibits the sale, mortgage, lease and donation of urban land.

In Ethiopia, one of the rationalities for adopting a leasehold tenure system, as stipulated in the Lease Proclamation No. 80/1993 and Proclamation No. 272/2002, was to provide market driven exchange value. This tenure system was also assumed to encourage investment, provide housing and infrastructure, control undesired expansion of cities, and combat speculation and non-transparent system of plot allocation. With this system, the government expected to collect enough money to run urban infrastructure and transfer all urban land holdings into the lease system. However, many of the claims stated in the urban lease laws of Ethiopia have been heavily questioned by studies that tried to evaluate performance of Ethiopian urban land lease policy functions. Available empirical studies show that many urban cities experienced ineffectiveness in land delivery. Corruption, non-transparency and unfairness have reigned in the system and, created a means of exploiting the system by a few urban speculators and brokers. Urban speculators profit by selling bare land without adding value to it, and the government has been unable to generate expected revenue (Nega, 2005; Aneleye, 2006; Belachew, 2010).

It was against this background that the House of Peoples Representatives has passed a new revised urban lease holding proclamation in 2011. Under this proclamation, the prevalence of good governance is assumed to be a fundamental requisite for the development of an efficient, effective, equitable and well functioning market. At this point, it should be admitted that the newly enacted proclamation has made some changes and improvements on its predecessors. However, it also introduced some unusual and contested provisions. The terms for leasehold arrangements remain somewhat restrictive and remain ambiguous about land tenure security. Thus, taking the broader debate on urban land lease polices into account, this paper posed a central discussion question: *Is the Ethiopian urban land policy designed as a form of land holding system to bring tenure security and sustained urban development and governance?*

### **1.3 Objective of the Research**

The main objective of this paper is to critically analyze the problems and prospects of urban land tenure system in Ethiopia with particular emphasis on urban land lease policies since 1990s. In doing so, the paper aims at identifying gaps, inconsistencies and ambiguities in the lease laws and regulations as well as the constraints and challenges that impede their effective implementations.

## 1.4 Organization of the Paper

Following this section, the rest of the paper is structured in the following manner: Part 2 examines land tenure system evolution and theoretical notion of public land lease; Part 3 looks at research methods including all techniques/ methods adopted for conducting this paper; Part 4 considers results and discussions, and finally part 5 deals with conclusion, policy implications and recommendations.

## 2. Conceptual Framework : Land Tenure System and Its Evolution

Researchers have developed an immense literature devoted to understanding and solving the problems associated with property rights (Demsetz 1967, Besley 1995). The neo-classical economic theory of property rights asserts that clearly defined individual property rights to land, secure and easily transferable land rights are necessary and sufficient conditions to boost economic agents' attempt in land-related investment (Deininger & Jin 2006). At the other end of the ideological spectrum, the social aspect warns that individual rights to land are not inherently beneficial endeavor in all societies. There might be adverse social consequences in creating unequal opportunities. This creates inequalities among the richer and the poorer societies when claiming their rights. This may result in a consequence of accumulation of land by less efficient operators, on non-equitable terms in the land market. It also may distort credit markets in favor of 'inefficient but wealthier' operators (Feder, 1999; Fitzpatrick, 2006).

State ownership to land has been introduced as a reaction to the negative consequences of unrestricted private ownership to land by only a few. The concept of state ownership to land has proven to have many limitations. The dichotomy between economic and social perspectives calls for multi- disciplinary rigorous analysis. The literature indicates that to minimize the economic and political conflicts arising from land reforms, public officials in many former socialist countries have been practicing within a public leasehold system. Supporters of a leasehold tenure argue that it allows state intervention if the tenant fails to utilize the land or damages it by mismanagement. They find that unrestricted ownership of land offered by a freehold tenure is undesirable because it may also result in speculation, fragmentation, underutilization or damage to the land by irresponsible farming practices.

Leasehold tenure has by in large become the dominant form of land tenure. It is believed that leasing public land may lessen the tension between the communist's desire to uphold public land ownership and the reformists' demand for increasing private property rights (David, 2000; Hong and Bourassa, 2003). If existing institutions can credibly commit to lease contracts, giving users secure, transferable, long-term lease rights will permit the realization of most, if not all, of the investment benefits associated with higher levels of tenure security. In these cases, the award of

long-term land leases with provisions for automatic renewal will be the most desirable option. If the leases awarded by state institutions are not credible, measures to increase tenure security or, alternatively, full privatization, will be required to give users sufficient security of tenure and the associated benefits. An indicator of limited credibility of leases is that even where there is strong, effective demand for credit, financial institutions will not accept long-term leases as collateral (Deininger, 2003)

Many scholars have suggested that public leasehold systems have advantages. In general, the reasons for adopting public land leasing is classified as financial, urban planning and financial instruments reasons that are presented below:

**Financial reason:** One of the advantages of retaining land in public ownership is the appropriation of future land price increases by the public and distributing it to society. When a municipality grants the use of land under a leasehold system, it reserves the right to claim a substantial proportion of future increments in the capital value of land at the end or in the middle of the contract. There are social benefits because the income generated by the leaseholds can be invested in urban projects that are beneficial for all citizens (The Development Corporation Amsterdam, 2003; Hong and Bourassa, 2003).

**Planning tool reasons:** In principle, public leasehold systems allow the government to manage urban growth by incorporating land use regulations into land leases. If lessees do not develop their land according to the lease provisions, the government has the right to take back the land, a contractual right not available to the government when land is privately owned. Public leasehold systems indirectly permit the government to control the undesired expansion of the city. The leasehold system also does away with speculation and the non-transparent system (corruption) of plot allocation. This is accomplished by charging the extra profit made in the case of an undeveloped land transaction, designing a proper institutional set up for the disposal of land (using mainly an auction system) and discourages those land speculators and government officials of the past who benefited from public sector land allocation (Needham, 2003; Hong and Bourassa, 2003).

**Financial instrument:** In other cases, public ground leases may be used as a financial instrument to ease the way into home ownership. The urban problems related to water supply, sewerage, housing and other social and economic infrastructures are priorities to be addressed through the leasing of land in the city. Today, ground leases serve mainly as a financial instrument for building projects which are assumed to provide principal importance to society with low or free rent (Virtanen, 2003; Lincoln Institute of Land Policy, 2003).

It has to be stressed, however, that the reasons for offering a ground lease are not limited to the above reasons. In other cases, public ground leases may be used for political and social purposes. For instance, in Stockholm (Sweden) and London Haringey (Great Britain) ground lease are mainly used for political and social reasons. In Stuttgart (Germany), one of the major reasons for offering a land lease is social (The Development Corporation Amsterdam, 2003).

Although the above mentioned reasons for leasing are persuasive in principle and at a policy level, empirical studies have shown that governments fail to achieve these policy goals in practice. This does not mean countries which have leasehold systems cannot achieve all the objectives mentioned above. For instance, study by Chengri and Knaap (2003) demonstrated that China's urban land policy reforms promoted the development of land markets, enhanced the fiscal capacity of local governments, and accelerated the advancement of market socialism. However, the same study has shown that the government lacks the ability to capture its share of rents as they increase over time. There are still non-transparent systems of plot allocation through administrative channels. This causes price distortions and large losses of local government revenues.

A study conducted by the Lincoln Institute of Land Policy (2003) discusses and compares land leasing experiences from six countries around the world (Canberra, the Netherlands, Sweden, Finland, Israel and Hong Kong). The study reported that among all of the systems, Hong Kong was the most financially successful: the proceeds were more than enough to cover the cost of public works and land development. The revenue generated helped finance public infrastructure and improve many social services. More importantly, the money collected from leasing is not a substitute for property taxes in Hong Kong (Hong, 1999). The public leasehold systems in the Netherlands, Sweden, and Finland also generated public funds, but the lease revenue played a much smaller role in those countries while the Canberra leasehold system has not generated significant public funds.

In Ethiopia, the urban lease policy has been considered an important change in the evolution of the urban land tenure system. In spite of the wide range of legal and institutional reforms undertaken by the government, the fundamental elements and principles in the process of enacting policies have not been the same as achieving what the policy intended. In addition, it is argued that in the absence of a willingness from the majority to promote reform, there are important issues that are not covered in a revised land lease proclamation. It has been more than two decade since Ethiopia has experienced an urban leasehold tenure system by passing three urban lands lease holding laws. Thus, documentation of the urban land lease policies' limitations and implications is possible. This paper discusses the background of Ethiopian urban land lease policies and examines the limitations and implications based on a genesis of the land policies in the country and through international experiences.

### **3. Methodology**

Policy based documentary analysis research method to assess urban land lease policy implementation and implication in Ethiopia has had little attention as compared to other methods because of the dominance of positivism and empiricism and of the popularity of statistics and quantification in data collection and analysis. Although surveys, in-depth interviews and participant observation have been tried and tested, they are not the only ones available nor are they always useful. Understanding the legal basis of urban land lease formulation and implementation and providing the description of success and failure based on practices and international experiences is also relevant to improve the prevalent urban leasehold tenure. Experience has shown that policy based documentary research method provides the most effective way of gaining the necessary understanding of complex and dynamic policy outcomes. Therefore, this paper used documentary research method that is often marginalized or when used, it is only as a supplement to the conventional social surveys (Mogalakwe, 2006).

This paper methodology mainly combined collection and synthesis of existing national and regional level urban land policies which have been put in to effect at different time as source materials. Besides, research reports that focus on land lease policies, land laws and other related documents (published and unpublished materials from national and regional urban land authority, newspapers, magazines, government and NGO statistics) is used.

### **4. Results and Discussion**

The major elements considered in this discussion are: assessing scope of legislative application, techniques used to transfer urban land, modalities of the lease fee payment, and lessee rights related to transferring, mortgaging, and getting compensation. The presentation and analysis of the findings are categorized into six thematic sub-sections. The first section addresses the assessment of the application of the lease policy and scope. The second section discusses the modality of land allocation. The third section focuses on the institutional characteristics of the urban land lease policy as a source of government revenue. The fourth section discusses the mechanisms of controlling land speculation. The fifth section treats lessee and lessor rights related to transferring and pledging leasehold rights. The final section deals with patterns of the lessor and lessee interacting during termination of lease and payment of compensation.

#### **4.1 Urban Lands Lease Policy - Scope of application**

Review of the first Ethiopian lease laws, Proclamation No. 80/1993, indicates that the regulation is being applied only to urban land permitted to be held by lease. This proclamation was not applicable to an urban land held by other means prior thereto. However, if an old possessor, with the exception of inheritance, wishes to transfer their use rights, the person to whom the stipulated

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land use rights is transferred shall hold the land in accordance with the lease holding system. As a result, in Ethiopia, permit (informal) and leasehold (formal) systems co-existed. This resulted in tensions between *de jure* and *de facto* rights of urban land. Discrepancies between these versions of the urban land tenure holding system often created ambiguities. This in turn complicated the legal status of the land since it gave rise to competing claims. Therefore, it is expected that standardization of urban land tenure will make for a fair and reasonable allocation of land to citizens.

Proclamation No. 272/2002 repealed the first law and declared that any urban land held by the permit system, the lease-hold system, or by any other means prior thereto should be under lease system. The proclamation is intended to meet the ever increasing demand for land, reduce unfair allocation of land and control illegal settlements. However regional governments did not have the expertise nor the long term management skills required to carry out the policy. It is only small part of cities that have cadastral map, so the functions of local government regarding urban land proved to be slow in identifying type of land use. In practical terms, no systematic tool was used to convert all urban lands to leasehold system.

The newly enacted proclamation No. 721/2011 has emphasised that any urban land which has not been under leasehold system shall be permitted to be held only by lease system (Art.3).The mechanisms and the time framework about modality of converting old possessions into leaseholds have not been clearly specified. The proclamation states that it will be determined by the Council of Ministers on the basis of a detailed study to be submitted by the Ministry; provided, however, that the process of such study may not preclude a revision of the existing rental rate applicable to old possessions. In Ethiopia, the national Ministry of Works and Urban Development (MWUD) in collaboration with regional and cities land administrations is vested with the power of conducting a study in order to make a determination on how old possessions shall be converted to lease by the Ministry.

The newly enacted Proclamation No. 721/2011 has addressed important issues that are not covered in previous lease policies such as: failure to push permit holders to make annual rent payments for use rights, the absence of formalizing informal tenure, and consolidation of the permit and leasehold tenure systems. The intent is to create uniformity of the informal settlement of the old possessions with the new, consolidated leasehold system. The new proclamation clearly states that lease payments are provided when informal land settlements are unified with old possessions and are merged with newly leased lands. The effect of transfer of land right or the status of a landholding, in the event of the above two situations, is a “lease benchmark price”

(minimum lease price)<sup>1</sup>. The lease rates are applicable to possessions converted into leasehold tenures and serve as the lease bench mark price of the local area.

Concerns of the general public are why old possessors should pay for their holdings while the permit system is converted into the leasehold system. What is the rationality behind limiting the duration of urban land use rights of those who have no time limit on use is also another debatable issue (Daniel, 2011).

Theoretically, uniform land policies and administration can contribute significantly for building transparent and accountable land administration system. In this sense, emphasis given by the government on regularity of urban-land holding system should be appreciated. The course of regularizing and converting old and other possessions into leaseholds may result in a reduction or increase of the size of household plots. In such cases, compensation shall be paid to landholders whose land is reduced. The payment will be made to those landholders for additional land obtained. This is treated so it conforms to the relevant lease principles established (Art 6). Therefore, the implementation of the new lease policy is expected to achieve equitable allocation of urban lands.

#### 4.2 Modality of Urban Land Transfer or Allocation

In Ethiopia there are different ways that land use transferring system has been practiced since 1990s. There are several problems associated with land transfers. The following table summarizes the major modalities of urban land transfer as stipulated in the Urban Lands Lease Holding Proclamation.

Table 1: Modality of Urban Land Transfer Under the Lease Holding System since 1993

	Proclamation No. 80/1993	Proclamation No. 272/2002	Proclamation No. 721/2011
Modality Land Transfer	1. Tender	1. Tender 2. Negotiation 3. Allotment	1. Tender 2. Allotment

Source: Federal Lands Lease Holding Proclamation No. 80/1993, Proclamation No.272/2002 and Proclamation No. 721/2011

The first lease Proclamation 80/1993 stipulates that urban land shall be permitted to be held by leasehold; and only through tender or auction (Art 5). There may be exceptional circumstances

<sup>1</sup> The threshold price shall be determined by taking into account the cost of infrastructural development, demolition cost, sand compensation provided to displaced persons in the case of built up areas, and other relevant factors.

whereby the government shall guarantee urban land for investment, social services establishments, or other purposes with direct benefits for the public (Are 13). The transfer of land-use rights through tendering or auction has similar characteristics to international regulations. However, in facilitating land transfer, the institutions concerned are caught in bureaucratic bottlenecks that negatively influence the transfer. Speedy facilitation and transparency is demanded in the market. Evidence is available that suggests that the allocation of land through public tendering has failed to address the demand for urban land and development priorities, requiring revisions (Yusuf et.al, 2009).

Proclamation No.721/2002 that repealed the first lease law provided three alternatives land allocation: auction, negotiation and allotment. In principle, this proclamation has potential to improve the urban land delivery system, ensure rapid urban development, and provide equitable benefits to citizens, thereby ensuring the sustainability of the country's development. Unfortunately, this practice offered inadequate results leading to failure rather than success. In practice, negotiation became the dominant form of land transfer. This method of land transfer failed to provide municipalities and cities the ability to collect adequate and proper fees because of personal interests and corruption. Such experiences led to the newly enacted proclamation that clearly declares that all urban land areas shall henceforth be transferred either by auction or allotment, suspending negotiation as means of modality. As per the objective of the lease policy, it is believed that by prohibiting allocation of land through negotiation, it is possible to discourage corrupt public officials seeking to personally benefit from illicit transactions at the expense of the people.

Allotment of urban land may, upon decisions of the government authorities of region or the city administration, be permitted for development activities that benefit the public since 1993. However, a number of significant issues are currently arising in practice regarding what constitute development activities that request for urban land lease holding through allotment. The previous lease proclamations declared that the rate of rent payable for urban lands granted through allotment shall be low. However, there is no direction or regulation directly stating what a “low payment” means. The preceding laws did not provide regulation to describe activities in which lease payments would be low. In this regard, the new proclamation seems to have taken the previous challenges into consideration.

Proclamation No. 721/2011 provides detail lists that can request for urban land lease holding through allotment. Under this law, except urban land holdings granted by allotment for two entities, the budgetary government and religious institutions, all other users of the land allotment were assigned administratively to public agencies or state-owned enterprises. These institutions are required to pay land use rent as those granted use rights through auction. It is noted that a budgetary government entity or religious institution provided with an urban land allotment will

pay an amount equivalent to the compensation paid in the course of clearing the land. From the state's perspective, the reasons for this rationale include avoiding some of the significant risks inherent in the modality of urban lands transferred and enhancing government land basis for revenue. There is an improvement with regard to the basis of a fair allocation of urban land and collection of adequate revenue from leasing. In addition, the newly enacted lease policy has the potential to remove the shroud of secrecy surrounding many land allocation decisions.

### **4.3 Urban Land Lease – As Sources of Revenue**

One of the basic rationalities for the Ethiopian government to adopt land lease tenure system is to give land market value, which in turn enables the government to collect adequate revenue. However, the principles and practices of setting up ground rent and payment arrangement create controversies that require further solutions.

In a number of countries, ground rental rates are determined by a variety of processes, mainly administrative, legislative prescription, executive decision, precedent or customary valuation practice and negotiation. In some other countries the setting of ground rental rates seems to be partly politically or administratively determined. This is particularly so where negotiations are not really open to market forces or effective challenge and independent determination (Jefferies, 2005). International experiences indicate the prevalence of an increasing pressure world-wide to deregulate government institutions and to let market forces set price for the use of capital. This means, pressure will be exerted to remove ground rentals from administrative or prescribed formulae to market based determinations. It is clear from the literature to contemplate that the rental stream should be a 'mark-to-market rental stream.

In Ethiopia, it is impossible to set lease price by reference to the market condition of the land since land sale has been prohibited by law. The practice shows that allocating urban land through auction is used as a mechanism to give land market value. The experience reveals that the practice of offering lease tender and land delivery system does not reflect the prevailing transaction value of land. One of the problems is associated with basis of selecting the winner. The highest bidder is selected based on various parameters such as bid price, amount of down payment and duration of payment. This implies that even if the bidder has not provided highest bid price, he or she has a possibility to be a winner based on other criteria (if weight given to other basis as selection criterion is high). This implies Ethiopia follow traditional approaches which seek to replicate the "market" in a normative and hypothetical approach since the process assumes a willing but not over anxious leaseholder. In general, mechanism to give land market value through the process of auction is not worked out.

Consideration of competitive parameters (duration and amount of down payment) as a criterion to select winner also creates additional problem. First, giving priority to those who can pay the total amount of the lease price at the signing of the lease contract has created contradiction with the objective of the lease policy. It is made clear that once the full payment is done, no other payment is expected from the lessee until the contract expires. Although a huge amount of money is required for initial investment, the problem of encouraging full payment of the lease price contradicts with the objective of the retention of land in public ownership. A one-time payment creates a very uneven revenue stream for the government and is not sustainable in long-run because land for lease is limited. And after most of it is allocated for long-term leases, this source of revenue will dry up.

The principle of up-front payment and of compound interest rate for the unpaid portion is equally disadvantageous for the investors, especially in the initial phase of their investment. In fact, such modality of payment is found to discourage the initiatives of any investment (Gerhard Stepper, 2000). Therefore, in Ethiopia, the prevalent simplistic assumptions have created serious negative consequences. It is necessary to recognize that the method of selecting a winner of urban-land-lease use should be evaluated in light of achieving the policy objectives. The legislature should further think about the mechanism of achieving all of the lease policies simultaneously.

One of the advantages of retaining land in public ownership is to have the increase in land values accrue to the community at large. Calculation of the ground rent, therefore, has a critical bearing on the success or failure of this endeavor (Mattson, 1995). In many countries, the experience is that the norm of periodic lease payment is to be indexation provisions or rent reviews to come to know the open market rental level. This is not the principle and practice in Ethiopia. The highest bidder is required to make the remaining payment every year, and the yearly payment shall amount to the average price of the remaining lease payment divided over the period payment. The practice is that a ground rent is fixed for the whole lease, which in periods of zero inflation maintained their value. The changes in the land value are not reflected in the lease rent or annual rental payment. The annual payment is calculated as:

$$\text{Annual Payment} = \frac{\text{Total Lease Amount} - \text{Amount of Down payment}}{\text{Lease Period}}$$

One can argue that the socialist concept of urban land management permitted the acquisition of land with nominal payments and annual land rent that does not reflect the market value of land. This is reckoned to have resulted in the sub-optimal use of urban land and competition for the mere grabbing of urban land by public agencies, individuals, and businessmen. I hope that this concern will call attention to the possibilities of improving the prevalent problems and therefore will be a source of inspiration for those who are involved in urban land development and

governance. The issue of improving simplifying structure of lease payments in Ethiopia should be considered seriously. There should be a mechanism that reserves municipalities' right to benefit from increase in land values and claim substantial proportion of future increments in the capital value of land at the end of the contract.

#### **4.4 Urban Land Leasehold and Land Speculation**

One of the objectives of adopting leasehold system in Ethiopia as stipulated in the urban lease Proclamation is to discourage land speculators. Concerning this, the regulations clearly state:

*Any person who has been granted the right to hold any urban land on lease shall start to use the land for the prescribed purpose within the period of time stated in the lease contract provided that, the period of commencement of construction may be extended depending on the complexity of the construction and in accordance with regulations to be issued by the concerned region or city administration (Article 9 of proclamation No 80/1993; Article 12 of Proclamation no. 272/2002 and Article 21/22 of Proclamation No. 721/2011)*

Despite the legislations' aim to discourage land speculators, there is no means that has been placed as a law to achieve this goal. In the event of transfer of leasehold right, the proclamation did not indicate any difference in operation whether a lessee transferring his leasehold right prior or post to commencement of construction. Experience has shown that most of the lessees who take the land through paying higher prices and down payment have failed to undertake development activities but to sell with higher prices for other land demanders. This makes the land price over and above the market value, which in turn affects lenders' or bankers' confidence to take undeveloped land as collateral unless the lessee develops the land (Belachew, 2010).

In more recent year, there was a directive adopted by Addis Ababa City Administration that directly discourages land speculation. Addis Ababa City Administration Government Urban Land Lease Holding Regulation No 29/2010 has established a timetable for investors to start construction and listed out the consequences if a lessee fails to commence construction within the period specified in the contract. The regulation clearly states that those investors who cannot honor this will have their legal document discarded by the city administration and the land will be returned back to the government. Over 74 investors have recently been forced to give back plots that covered a total of 52-53,000 square meters to the government.

Whereas there are broader implications on the directive adopted by Addis Ababa City Administration, the newly enacted Urban Lands Lease Holding Proclamation No. 721/2011 gives details of punishments. To encourage timely land development and prevent land speculation, the newly proclamation sets out the consequences of what would be happening if a lessee fails to commence construction according to the contract. From the legislator and

politicians points of view, it is assumed that this approach will discourage land speculators. For example, if a lessee fails to commence construction on permitted urban land leasehold through *auction* according to the contract, the lessee shall be liable to pay a penalty fee amounting to 7% of the total lease price. In addition the lessee shall pay a lease amount that covers the period from the date he/she took possession of the land, and the appropriate body shall take back the land. On the other hand, if a lessee fails to commence construction on permitted urban land leasehold as *compensation*, he/she shall be liable to pay a penalty fee equivalent to 3% of the deposit in his/her blocked bank account; and the appropriate body shall take back the land. Whereas, if a lessee fails to commence construction on permitted urban land leasehold through *allotment*, the leasehold contract shall be terminated, and the appropriate body shall take back the land.

The newly enacted proclamation is now at the centre of an intense debate. The tools adopted to combat speculators have reflected the difficulties in creating simple but nonetheless acceptable principle. It is argued that imposing penalty on lessee would not have any rationality, unless the government supplies full serviced land, basic infrastructure and social services. Monetary measure may not be realistic to address the real problem of delaying construction. The majority of lessees delay construction perhaps not because of their speculation mentality; it may rather be due to their financial capability that could be accelerated due to the existence of underserviced land. The regularizing of such punishment on a large scale may have serious negative consequences which have so far not been fully acknowledged (Daniel, 2011)

As the experience of some countries show, although governments intend to discourage speculators, the tools used to do so are far from the types of penalty introduced in Ethiopian lease proclamation. The very idea is without providing the required precondition for implementation of the policy, imposing a sort of monetary penalty and taking back the land if construction does not start in a prescribed time is one of the commonly cited factors that make land lease less attractive. There is an experience where land speculation is dysfunctional, but the cause of economic trouble may not really be the speculation itself, but the tax system in which it takes place, particularly in a country where the tax system is based mainly on tax on income and profits. Good as it sound some of the tax money goes to build public infrastructure and services. However, this pushes up land values. So leaseholders get a government subsidy in the form of increased rent due to infrastructure that workers and businesses, not the leaseholders, are paying for. Subsequently, land speculators profit from this forced transfer of wealth from workers to landowners, if they guess right on where new development will go (Oberly, 1990)

The idea behind mentioning property taxation is to describe how the existing rate of land and building tax has attracted land speculation. In Ethiopia, it is found that property taxes across cities are very low and the collecting mechanism is extremely weak. This has highly contributed

for the increase of land speculation. It has to be stressed, however, that the proposed property taxation system requires a lot of things to be done from government side. Hence, to apply such system, it requires clear and unambiguous legal frame works for rights to hold and to transfer in various ways. To mention some of them, cadastral map and uniform land information systems are mandatory. Institutions which will be responsible for such system should be empowered in respect to legal, financial, logistical, and personnel departments. Besides, there should be programs that create public awareness about leasehold policy and land taxation.

#### **4.5 Transferring and Pledging Right of Leasehold**

Urban land leasing has been seen by many Ethiopian politicians as “tantamount to private ownership”. Because in principle the lease laws stipulate that leasehold right is subject to any form of transaction including sale, lease/rent, donation, mortgage, and as a capital contribution to a company. Under leasehold system, it is assumed that the payment of the market-determined rent for use of land allows the lessee to undertake any form of transaction with another party. However, serious problems have been observed in the regulation which could make lease holding tenure not different from absolute state ownership.

Ethiopian urban lease proclamations have shown that there are provisions that limit or restrict free transferability of lease rights. Any person who acquires the right to hold urban land on lease may transfer such right to contribute in the form of a share to the extent of the rent paid. In implementation, a lessee may not transfer his right of lease but may collect income which is higher than the rent of land he paid. When the lessee collects an income higher than the rent he paid, he has the duty to pay the difference to the city administration or municipally.

Analysis of the trend indicated that although the federal and regional lease laws limit the transferability of lease right, there were no any specific bodies that have been responsible to follow up and ensure that the seller hands over the difference of rent to town administrations. Instead, city administration has adopted directives here and there which may prohibit the transfer of bare land or foundation to discourage land speculation. Well-focused efforts directed at evolving, explicit and comprehensive financial market development policies have not been made so far. And those directed at evaluating the impacts of the various policies and strategies of urban land lease development are reckoned to be inadequate. This has given Banks an opportunity to estimate the amount of mortgage loan based on their own market analysis. Land use rights have been used as a commodity to be bought and sold and used as collateral, and restrictions on the leaseholder have not been considered by lenders. In other words, restriction on transferability of lease right is only found in the laws.



It should be noted that the application of land user right to transfer and mortgage urban land use rights is limited to urban land granted by lease system. According to the urban leasehold laws, the right to the use of land possessed through permit system shall not be subject to collateral or transfer where a building on leasehold and its accessories are used as collateral or transfer. The government should consider the opportunities that can enhance the emergence and growth of land and credit market by striking a balance in the harmonization of competing interests over all types of urban land tenure.

In Ethiopia, previously there was no clear indication that states what the maximum or minimum amount leaseholders may get if a leaseholder wishes to transfer or collateral their leasehold right prior to commencement of construction. Lessees were free to get the full market value resulted from transferring leasehold right prior to commencement or half-completion of construction. However, the current enacted proclamation has introduced two new provisions that directly minimize the interest of speculator.

First, it gives detail of lessee benefits in situation where a lessee wishes to transfer his/her leasehold right prior to commencement or half-completion of construction. Under the newly enacted proclamation, if a lessee, with the exception of inheritance, wishes to transfer his leasehold right prior to commencement or half-completion of construction, he or she shall be required to follow transparent procedures of sale to be supervised by the appropriate body. This implies that a lessee is not free to negotiate and get the full market value of transferring his/her leasehold right prior to commencement or half-completion without the participation of agents from city or municipality. For example, in the event of transferring leasehold right prior to commencement or half-construction, the value retained by the lessee equals the effected lease payment including interest thereon calculated at bank deposit rate plus value of the already executed construction plus 5% of the transfer lease value. And the remaining balance shall be paid to the appropriate body. Similarly, where a lessee uses his/her leasehold right as collateral prior to commencement of construction, the collateral value may not exceed the balance of the lease down payment after considering possible deductions to be made.<sup>2</sup> That is, if a lessee defaults and a claim, supported by a court execution order, on the collateral is presented, the appropriate body shall, upon terminating the lease contract, take back the land and settle the claim to the extent of the balance of the lease down payment after retaining the deductions to be made.

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<sup>2</sup> Article 22 (3) of Proclamation No. 721/2011 states that the lessee is liable to pay a penalty fee amounting to seven percent of the total lease price in addition to a lease amount that covers the period from the date he took possession of the land

Second, under the new lease proclamation, if any person repeatedly transfers leasehold right, without completion of construction, in anticipation of speculative market benefits, the appropriate body may bar him from participation in future bids.

It has been found necessary to develop a proper regulation which facilitates the development of land and discourage lessees who are waiting for land prices to increase and sell their leasehold at a profit. But a great deal of care is needed to ensure that considering monetary punishment action to achieve what it is intended to achieve. In many leasehold tenure systems, unless the lessees have secured a way of transferring land use rights at any time and entitled to receive full market value of transferred rights, they may hesitate to invest in land development. Without secure land rights there can be no credit market and sustainable development.

#### **4.6 Termination of Lease-hold Vs Payment of Compensation**

Theoretically, providing reasonable guarantee for the condition of leasehold right in terms of termination of leasehold has a vital importance for the people to accept lease agreement. Lease holding right may be terminated for good reasons; the state has no right to revoke this right whenever it wishes. Like any contractual agreement the expiry of the lease contract may be a reason for termination of the lease hold right. However, unlike lease of housing, the lessee has a better position. The municipality may not take back the land without giving compensation for lessee even in case of the lease period is not renewed. This approach is well known in different countries (Netherland, Finland, South Africa).

In Ethiopia, urban land leasehold agreement does not automatically expire at a given point of time. The lease proclamation also highlighted that, the agreement may not, however, be cancelled by lessee, only by government. The lease policy stipulates that the period of lease may, upon the termination thereof, be renewed for the lease-hold possessor as per the agreement to be reached, unless the urban land is wanted for public interest. The assumption is that unless the ground is needed for public interest, the municipality shall renew the agreement. The terms of agreement especially the rent and manner of payment as well as other conditions shall be based on current conditions. One can clearly see that renewal is the rule. The lease holder must apply as early as possible to secure his/her rights. The municipality is given a maximum of one year to notify its decision to the lessee. As regards this, the Ethiopian urban land lease proclamation provides three basic reasons for the termination of the contract:

- 1) Where the lease-hold possessor has failed to use the land in accordance with the contract;
- 2) Where it is decided to use the land for a public interest; and

### 3) Where the period of lease is not renewed

In the first and second case, termination of lease contract is subject to payment of compensation. If termination is made because the leaseholder fails to use the land in accordance with the contract, it is subject to payment of compensation. Accordingly, as compensation, the lease payment shall be returned subject to the deduction of costs incurred and of penalty fee. When an urban land lease holding is expropriated prior to its expiry date for public purpose, the urban landholder shall be provided with commensurate compensation<sup>3</sup> in accordance with the relevant law<sup>4</sup>. In the third case, however, there is no any compensation to be paid. Where the lease period is not renewed upon termination, compensation shall not be paid to the leasehold possessor.

In most countries, the municipality is obliged to pay lessee the residual value on land, if the termination of the contract is not renewed. The reason behind protecting the leasehold possessor is the investments already made on the ground. People may build residential houses, commercial, agricultural, industrial and so on buildings on the ground, and it would be unjust and unfair if the government is going to take back the land just to sale it to another person. This would create insecurity upon leaseholders which would again discourage them from making additional investments on the ground land they leased. It is also categorically against the interest of the state, for the demolition and reconstruction of structures is expensive. Secondly, people will not build good buildings for fear of losing them. In this aspect, the prevalent Ethiopian lease regulation only emphasizes the rights of the state and undermines those of the leaseholders. In Ethiopia, although termination of leasehold has not appeared at large so far, considering these facts and putting clearly the suspicions in advance will protect both parties in the future.

## 5 Conclusion and Policy Implications

### 5.1 Conclusion

The Ethiopian urban land lease policy looks to have been adjusted in direct line with the contemporary orientation towards a free market philosophy. It was also within this reform framework that the first urban land leasing policy and legislation was promulgated and put in to effect in 1993 and then revised in 2002 and 2011. However, the urban lease policy has been built to address the urban poverty while it ultimately helps the government to satisfy only a few objectives of such tenure system. This paper considered the need for assessing and analyzing urban land lease policies from the perspective of principles, theories and international practices

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<sup>3 3</sup> Federal Democratic Republic of Ethiopia Urban Land Lease Holding Proclamation, No. 80/1993; 272/2002 and 721/2011

<sup>4</sup> Expropriation of Land holdings for Public Purposes and Payment of Compensation Proclamation No. 455/2005: the lessee shall be paid compensation for buildings and improvements. In addition to such compensation, the lessee shall be provided with a similar plot of land to use it for the remaining lease period.

as an important factor to fill the existing literature gap. It attempted to review policies and to analyze problems and lost opportunities resulted from the urban land lease policy.

The result reveals that different forms of urban tenure system allowed to co-existing in the country (permit and leasehold system). Standardized and liberalized urban land market is getting attention in a newly enacted proclamation, yet the mechanisms and the time framework about the modality of converting old possessions into lease hold has not be clearly specified. Modalities of urban transfer are highly characterized by non- market and non- transparent transfers. Currently, an attempt to improve the leasehold tenure system has been made on modality of land transfer through adopting auction and modified allotment, which required lease payment as the only means of transfer.

While one of the main objectives of introducing lease system is to enhance government revenue, there are simplistic assumptions and formulation on the laws which limit the government to give land market value and collect adequate revenue. The penalties introduced in the newly enacted proclamation No. 721/2011, concerning land speculators is simple but not acceptable principle.

Previously, limitations on leasehold transfer and pledging were normative merely written in proclamations and were known by neither leaseholders nor other stakeholders, as a result were not practiced on the ground. However, the newly enacted lease law gives high emphasis on restrictions of leasehold right to transfer prior to commencement of construction and collateral which is expected to result in negative consequence that have not yet been recognized. The lease law stipulates that the lessee is not granted compensation in case of non-renewal of lease contract. This is unfair and unjust; and will create tenure insecurity.

## **5.2 Policy implications and recommendations**

Sustainable development of urban areas is critical to the alleviation of urban poverty. Therefore, based on experiences from other countries and on the foregoing discussions in this paper, the following specific recommendations are forwarded:

- All statutes relating to old land possessions which require immediate revision to lease system should be identified and necessary actions should be implemented
- New normative improvements should not only be written in proclamations, they should be understood and accepted by all stakeholders.
- “Urban land without value” concept should be abolished and replaced by a free land market value. So, the lease policy should turn land from a timeless and costless resource into formally exchangeable commodity with both cost and time limit.

- Measures, which ensure the legal security of title registration over the period for which the land is leased, are urgently needed (or the concept of “unrestricted transfer of leasehold right” should be appreciated).
- Lessees’ right of getting compensation for the residual value in case of unrenewed contract is inevitable.
- An economic differential tax on leaseholds should be developed to encourage more efficient land use and to discourage speculation.
- A simplified land registry system, which can be managed regionally, should be established. This will make it possible to compile a comprehensive land register, which would greatly enhance government revenue and national resource planning process.

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