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**Integrational Transfers of Farmers in Different
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Intergenerational Transfers of Farmers in Different Institutional Environments

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ABSTRACT

This research studies the issues of intergenerational transfers in general and farm succession in particular in two different institutional environments. One is the relatively unregulated farm sector in the United States, and the other is the heavily regulated family farms in Israeli moshavim. Most of the analysis is based on modern economic theory dealing with inheritance and other intergenerational issues. However, we start with two background studies. One is a review of the legal system affecting farm succession in the moshav, which, as we claim throughout the report, is of major importance to the question in hand. The second is an ethnographical study aimed at documenting various inheritance and succession practices in different moshavim. These two studies provide insight for most of the economic studies included here.

The theoretical studies mostly deal with various aspects of two major decisions faced by farmers: who will succeed them on the farm, and when will succession take place. The first decision clearly depends on the institutional structure: for instance, Israeli farmers are limited to one successor while American farmers are not. The second decision can be taken in three stages: sharing farm work with the successor, sharing farm management, and eventually transferring the ownership. The occurrence and length of each stage depend on the first decision as well as on the institutional structure directly.

The empirical studies are aimed at analyzing the practices and considerations of Israeli and American farmers regarding various intergenerational transfers-related issues. We found that American farmers' decisions are mainly driven by the desire to let the farm prosper in future generations and by a preference for equal treatment of heirs, and not at all by old-age support considerations. In contrast, we demonstrate the significant effect of old-age support on the value of the transferred farm in a sample of Israeli farms. Using Israeli census data, we find that the time of farm ownership transfer responds to economic incentives. A smaller Israeli panel data set shows that controlling for the occurrence of succession, farm size rises with operator's age and eventually falls, while intensity of production seems to decline steadily. This explains another finding, that farm transfer contributed significantly to farm growth when farming was attractive to successors. This finding supports our main conclusion, that the succession decisions are of major importance to the viability and profitability of family farms over the long run.

Objectives of the original research proposal, and deviations

Objectives

- (a) Developing a conceptual framework that describes the modes and timing of resource transfers between farmers and their children. This framework will explicitly reflect institutional constraints and policy measures.
- (b) Deriving testable empirical implications of the theory, regarding relations among observable variables, e.g. the timing of the farm transfer as a function of the ages of the farmer and his successor; estimating these relations using data from Israel and the U.S.; comparing the results for the two countries in order to identify the impact of the different institutional environments: the U.S. inheritance taxes and the Israeli Moshav regulations.
- (c) Simulating the transfer processes over several generations, using the current as well as alternative institutional setups; projecting the outcomes in terms of size distribution of farms, their product specialization and quality of farm population in the future; and deriving policy recommendations.

Deviations

- (b) A direct comparison of the results in the two countries was not performed due to the vast differences in the data sets including coverage and variable definitions.
- (c) We did not analyze policy by simulations since we could not identify in the data the direct effects of policy variables on inheritance and succession practices.

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CHAPTER 1: OVERVIEW

The importance of intergenerational transfer mechanisms to growth through their effects on savings and investments is well established in the economic literature, yet little has been done in order to understand their particular importance to the development of the agricultural sector. Considerations for future generations are an integral part of the decision making processes in the farm household. The family farm is more than another profit maximizing enterprise. It is an asset whose productive life expectancy is well beyond that of its operator, and whose future value depends crucially on its continuous functioning; it is a place of residence for the farmer at old age; and it is attached to land, whose symbolic importance is way above its economic value in many societies. Moreover, the market value of a farm is often well below its value as a 'going concern', and hence considerations for retirement and succession cannot be disentangled from day-to-day farm management decisions (Dunaway 1991).

Intrafamily succession enables the extended family to enjoy the benefits of intergenerational risk-sharing when annuity markets are imperfect (Kotlikoff and Spivak 1981). It also allows farmers to rely on the farm for old-age support, and thus enables them to partly overcome binding borrowing constraints. However, the risk of conflicts within the family cannot be insured against, and hence it is not guaranteed that succession practices are designed to maximize the value of the farm. Rather, they are designed to maximize family welfare as a whole, and these two objectives can lead to quite different decisions (Perkin and Rehman 1994). For example, although it might be optimal to give the farm to a child rather than sell it in the market (Rosenzweig and Wolpin 1985), it is not necessarily true that the most suitable child is chosen as a successor (Kimhi 1995). Also, there is likely to be an optimal time to transfer the farm to the designated successor, from the point of view of farm performance (Kimhi 1994), but some evidence suggests that a large proportion of farmers abstain from transferring the farm *inter vivos*. Therefore, we might expect succession patterns to vary considerably according to family attributes such as demographic composition.

Perhaps this is the reason for the surprisingly scarce literature on farm succession, and for the fact that the existing literature is dominated by social scientists other than economists (Blank and Perrier-Cornet 1993; Carroll and Salamon 1988; Coughenour and Kowalski 1977; Errington 1993/94; Friedberger 1983). American agricultural economists contemplated farm

succession mostly to the extent that it is affected by tax considerations (Boehlje and Eisgruber 1972; Harl 1989; Harlin 1992; Tauer 1985). Recently, economic historians' studies of Irish emigration have also examined farm succession practices (Guinnane 1992; Kennedy 1991). Tweeten and Zulauf (1994) view intra-family farm succession as allowing entering farmers to overcome borrowing constraints, at least in commercial farms.

Several authors focused on the time-pattern of succession. Weston (1977) claims that succession should involve gradual transference of control from father to son. Such gradual shift of responsibilities has been found by Coughenour and Kowalski (1977) in a sample of father-son partnerships in the U.S., and by Errington (1993/94) in a sample of English farmers. Hutson (1987) quotes an English farmer saying "I started working for my father, then with my father, now he works for me." Blanc and Perrier-Cornet (1993) survey patterns of succession in the European Community. In the United Kingdom and the Netherlands, it is common that parents form an equal-rights partnership with the successor. German successors often work as laborers for their parents for ten years or more before receiving ownership. Longer apprenticeship periods are observed in Mediterranean areas of Europe. In Denmark, the successor buys himself some land (sometimes a part of his parents' farm) after a short apprenticeship period, and develops an enterprise of his own. He later purchases his parents' farm when they decide to retire.

The situation in Israel is mostly governed by institutional regulations. The vast majority of Israeli family farms belong to moshavim. A moshav (moshavim in plural) is an agricultural cooperative that consists of all the residents of a single village. In each moshav, production is individual as well as consumption, and only matters of mutual concern are handled collectively. However, members are constrained by an external set of regulations imposed by the settlement institutions, by internal village constitution and by decisions of the elected governing bodies.¹

Moshav members do not own their land, but rent it from the National Land Authority on a long-term basis. The Authority does not allow trading parts of the holdings (Berck and Levy 1986). Thus, members can only sell the right to use the land, including farm buildings and family residence, and move out of the village. The only exception with respect to land transactions is the institution of "succeeding child." This is one child, chosen by the parents, who is expected to take over the farm after the parents' retirement. The succeeding child, once

declared so by his parents, is allowed to build his residence next to his parents', and is accepted as a member in the cooperative. Nevertheless, he has no property rights, and the parents may change their mind and declare another child as a succeeding child any time. The succeeding child may get property rights in two situations: (a) after the parents' death unless their will specifies a different successor;² or (b) if the parents give away their rights in favor of the child, in which case they keep no property rights to themselves except for their right to remain in their residence till their death.

Some of the succession patterns observed in other countries are not possible in Israel because of the institutional regulations. For example, no formal partnership between parents and children is possible. The succeeding child cannot develop a farm of his own and later succeed his parents, since no person can hold the lease for more than one farm unit. Although we would like to think that institutions are affected by economic considerations, they are certainly not flexible enough to adjust for changes in the economic situation, at least in the case of succession regulations in moshavim. These regulations were initiated decades ago in order to guarantee that farms are not subdivided, and to support the functioning of the cooperative by preventing large families from gaining control of the governing bodies. Neither reason is very relevant these days. Subdivision of farms is not such a disaster since land is not a scarce resource as it used to be (many farms are not active at all, many farmers work only part-time on the farm, and many of the active farms engage in capital-intensive enterprises such as covered vegetables or flowers and do not use all their land). Membership in the cooperative is not perceived as valuable as it used to, because the level of cooperation has decreased substantially and in some cases vanished. Nevertheless, the succession regulations have not changed a bit.

As a consequence of this legal framework, intergenerational succession in moshavim generally follows one pattern: a succeeding child joins the parents' farm at a certain point in time with no property rights, and gets all the property rights much later in his life cycle, often only after the parents' death. The successor depends on the farm for his living expenses before the transfer of rights, mostly without any formal agreement. The parents depend on the farm for their living expenses after the transfer of rights, sometimes with a written agreement and sometimes without it. Thus, two major decisions have to be taken by the parents: (a) choice of succeeding child; and (b) when to transfer the property rights. The first decision is reversible,

as long as other potential successors are still available. The second decision is irreversible. Other decisions, such as the sharing of income, responsibility, and specific tasks, depend on the two major decisions, and are often made implicitly or by default.

The purpose of this research was to study the issue of farm succession, both in the relatively unregulated farm sector in the United States and the heavily regulated family farms in Israeli moshavim, from the point of view of modern economic theory dealing with inheritance and other intergenerational issues. Naturally, we focused on succession practices in the moshav since they are much more complicated, and used our knowledge of American succession practices as a reference for comparison. However, a significant part of this research is theoretical and applies to both economies equally.

This report is divided into three parts: background studies, theory, and empirical and econometric studies. Some of the chapters were designed to stand on their own, and others were fully incorporated into the framework of the report. The majority of the chapters were written by Yoav Kislev and Ayal Kimhi. Whenever other researchers contributed (solely or jointly), this was indicated in the title of the chapter. The background part includes two studies. Chapter two examines the legal framework of the Israeli moshav with an emphasis on laws and regulations affecting intergenerational succession. It is very important to understand this complicated framework before trying to explain observed succession practices. Chapter three reports the findings of an ethnographical study of inheritance and succession practices of farm families in several different moshavim. This study describes the behavioral patterns without trying to explain them, but provides very important insight for the rest of the research.

The theoretical part includes several chapters which link the existing theory in the field of family economics to the current problem. Chapter 4 starts with a review of the different aspects of the succession process from the point of view of the family. Chapter 5 uses the single utility function approach suggested by Gary Becker (1991) to explain inheritance considerations of altruistic farmers. Chapter 6 demonstrates how the number and spacing of children affect the choice of successor in farm families. Chapter 7 focuses on the stage in the life cycle in which a successor has already been chosen, but works on the farm alongside his parents, and discusses several possible contractual arrangements between the generations. Chapter 8 discusses the problem of the legal transfer of ownership to the successor in case of uncertainty, including

numerical examples. Chapter 9 provides a clarification of several notational issues related to the analysis of intergenerational insurance within families, which will be dealt with in the empirical part. Chapter 10 uses a dynastic utility model to show how differential abilities of children can affect the choice of successors through differential investments in specific human capital. Chapter 11 presents a model of the optimal timing of transferring a family business in general to a succeeding heir, using a single utility approach, and chapter 12 extends this analysis to the case of uncertainty and conflicts within the family.

The empirical part starts with an examination of retirement and succession patterns in Maryland, using a farm-household survey that was conducted especially for this project (chapter 13). The next two chapters discuss two econometric procedures used for analyzing farmers' time allocation between farm work and off-farm work. Several empirical studies were conducted on this topic using data from the Israeli Census of Agriculture. One of them, which emphasizes family structure and hence related to the succession issue, is presented in chapter 16. In chapter 17 we use actual farm income data to conduct calculations of the value of the farm as an asset which is transferred to a succeeding child, taking into account many of the aspects of the inheritance issue. Chapter 18 presents the results of an empirical investigation of the timing of farm transferal to children, using the Israeli Census of Agriculture. Chapter 19 presents empirical evidence on the succession process based on a new panel data set of moshav farms.

We certainly did not cover all aspects of the retirement, inheritance and succession issues in family farms. Neither have we reached strong conclusions regarding farmers' motivations, considerations, and practices. However, we strongly believe that our research adds a lot to the literature, especially by combining modern economic theory and econometric techniques, and creating a basis from which further studies can start. There certainly is a lot more interesting and important research to do in this field.

Notes

1. For more details about the institutional structure see Kimhi (1991) and Zusman (1988).
2. Sometimes the succeeding child will get the farm even despite such a will, since the parents' rights to bequeath their farm are also questionable from a legal viewpoint.

CHAPTER 2: FARM SUCCESSION IN THE MOSHAV--A LEGAL EXAMINATION¹

Original version: Shuky Regev

I. Introduction

The process of farm succession is both complex and complicated, involving social, economic and legal problems. Not all the children can stay on their parents' farm and in most cases only one son or daughter establishes residence on the parents' homestead, continues operating the farm with them, and succeeds the parents as the legal owner of the farm. The other children are forced to leave and to seek residence and employment elsewhere.

The determination of the succeeding child often raises conflicts within the family--the issues involved are the choice of the successor, the alternative solutions for the other children, the division of ownership and responsibility on the farm between the parents and the succeeding couple during the overlapping period, and the security of the parents in their old age.

Despite the importance of farm succession in the life of the family in the moshav, the legal framework is not simple and clear at all. At the root of the problems lies the dualism of the rights relating to the farm in the moshav; namely, the property right to the farm on the one hand, and the membership right in the cooperative association of the moshav--on the other. Unlike a common stock company, the structure of the cooperative is based on personal association of the members. The difference between membership (owning shares) in a cooperative association and ownership of stocks in a corporation is illustrated clearly in respect to the transfer of the rights of a deceased member in the moshav. While the owner of common stocks can bequeath them at will, a member in a cooperative association is not free to dispose of his share in the coop, either in his lifetime or at death.

The dualism of rights may cause a separation between the membership in the association,

¹ This is an abridged translation of a Hebrew paper commissioned especially for BARD's study (Regev 1994). The laws, regulations, and court decisions were translated by us and the quotations in the paper should not be regarded as the official English version of these documents. References, all to Hebrew sources, were omitted in the translation. It is appropriate however to note that the paper draws heavily on Ottolenghi's (1983) original critical summary of the issues discussed here.

which is not transferable even after death, and the property rights to the farm--as the coop may refuse, in principle at least, to accept the membership of a designated successor who rightfully inherited the property of the farm. Such conflicts may hinder the orderly transfer of the farm, reduce its productivity, and even result in its sale to outsiders, in contrast to the wishes of the original owner-member.

The legal difficulties and confusion surrounding the issues of farm transfer, may explain why parents often postpone indefinitely the nomination of a succeeding child--while the parents are left to grow old and infirm as the farm deteriorates.

II. The Classification of the Legal Rights in the Farm

The possibility of farm transfer, in one's lifetime or as a deceased estate, are derived from the farm operator's property rights.

The farmers actually purchased their land in only a few moshavim--and mostly in moshavim that were founded before the establishment of the State of Israel. In these moshavim, land is privately owned with legal titles to the cooperative association of the moshav or to the farmers themselves.

The majority of the moshavim cultivate national land. Whatever rights the farmers have are derived from a set of contracts between the State and its institutions on one hand, and the cooperative associations and the member-farmers on the other.

In a small number of veteran moshavim, the farm land, or part of it, was leased directly to the operator. In such cases the lease "for generations" (formally 49 years) is officially registered.

In the majority of the moshavim the leasing contract is indirect. The prevalent form is that the Jewish Agency² leased the land from The Administration of the Lands of Israel; the Agency then contracted with the cooperative association of the moshav, for the land to be

² For a long time most of the work of the Jewish Agency was in agriculture and, by agreement with the State, it was assigned the responsibility for the funding of newly established farms. It is one of the "settlement institutions" mentioned in various regulations. Other such institutions are the Ministry of Agriculture and farmers' organizations that participated actively in the establishment of new moshavim or kibbutzim.

parcelled to member-farmers for residence and cultivation. In these cases, the association and its members are secondary lessees of the land.

Moreover, in many of the moshavim, even the secondary leases have not been properly registered. The farm operators can only rely on a commitment of the Land Administration to register the lease in the future. In the meantime the farmers are just permittees, and in places where the association itself does not have the full legal rights to the lease, the members are permittees of a permittee.

III. Transferring the right to the Farm, the Legal Aspects

1. A Land owner

As indicated, in a small number of moshavim the operators purchased their land and have complete property rights enabling them to dispose of their property at will. The only constraints they face are those emanating from the Law of Inheritance which will be surveyed in the next section.

2. A Lessee, a Secondary Lessee

A lessee is constrained by the specifications of the leasing contract. Indeed, where a farmer leases the land directly from The Administration of the Lands of Israel, the contract usually specifies that land disposition--whether during life or by inheritance--must be with the consent of the cooperative association of the moshav and the Jewish Agency. The association will generally grant permission to transfer the land after the new owners become members in the moshav's coop. In this way the possible conflicting situation of a non-member owning property in the moshav is avoided.

In practice, associations seldom reject chosen succeeding sons. Outside buyers are more carefully scrutinized, particularly where the transferring farmer is indebted to the association, or a guarantor of its debts. But the requirement for formal approval of the association means that it can veto a transfer and intervene in family disputes. The farm family on the moshav is therefore legally constrained from free disposition of its property even if it is the sole direct lessee to its land.

3. A Permittee

The question of the ability of the permittee to dispose of his³ right to the farm, whether during the lifetime or after his death, has been discussed in the courts several times and it seems that the judicial decisions do not point to a single unified approach but rather two different views emerge.

a. The first approach

In several decisions, particularly in the civil and circuit courts, we find that wherever the member is just a permittee, it is impossible to consider inheritance--either by bequest or by the Law of Inheritance.

Thus in deciding in a dispute between brothers

"The farm operator is a permittee in his plot of land and he is obliged to vacate it as the permission is withdrawn. The permission is personal and therefore it is terminated at his death and the plot returns to its owner--The Administration of the Lands of Israel."

The right to the land and the farm is personal and only the Jewish Agency (or the Land Administration) can determine who will eventually own the farm.

This approach stresses the personal characteristic of the right (permission) the member was granted. The right returns to the grantor (the association, the Jewish Agency, the Land Administration) and only the grantor has the right to determine who will receive the farm.

b. The second approach

The second approach is found in several of the decisions of the Supreme Court. For example,

"Can a permittee dispose of his right during his lifetime or after death? The answer is in the affirmative--a permittee may transfer his right, subject to the agreement between the parties."

The conclusion is, therefore, that despite the permission being personal, land can, in principle, be transferred by a permittee, and if the question arises, it should be examined in light of the

³ Israeli law is written in the masculine gender; it applies equally to females.

particular agreement between the permittee in question and the grantor of the permission to use the land. Indeed in a recent Supreme Court decision it was stated that

"In principle, the right to the farm may be bequeathed unless it was negated prior to the agreement."

c. In conclusion

The courts did not provide a unanimous answer to the question of the right of a permittee to bequeath his farm. We have to go by the higher court, and conclude that, in principle, the right to the farm can be bequeathed, subject to the agreement between the farm operator and the grantors of the permission: the cooperative association, the Jewish Agency and the Land Administration.

IV. Farm Inheritance

1. General

Where the farm operator has the right to bequeath his farm-- relying on ownership, direct leasing on a permittee agreement--the inheritance is subject to the appropriate laws. Particularly relevant are The Law of Inheritance, Land Laws, laws pertaining to financial relations between husband and wife, and The Ordinance of the Cooperative Associations and the regulations that follow it.

2. Principles of Inheritance Included in the Right Creating Agreements

In most of the agreements with the farm operators in the moshav and by which the operators have the right to direct leasing, secondary leasing, or the status of a permittee--one finds specific direction as to the inheritance of these rights. The directions determine, in most cases, the constraints limiting the possibilities of transferring the farm by bequest.

One meta-principle appears in all these agreement; it relates to the maintenance of the homestead as one single unit. By this principle the homestead cannot be divided between several heirs and has to be maintained intact. The leasing agreement of The Administration of the Lands of Israel stipulate, for example, that the right granted to the operator cannot be subdivided upon

his death. The contract further specifies that where the bequest requires division of the homestead--the Administration has the right to revoke the leasing contract. The principle of no-subdivision also appears on the majority of the regulations of the cooperative associations in the moshavim.

3. Inheritance by Bequest

As seen earlier, inheritance by bequest is possible in the majority of the farms in the moshavim--subject to constraints pertaining to the specific local agreements which may differ between the moshavim. A private owner, in a moshav or elsewhere, is unrestricted in bequeathing the farm; he is virtually unlimited except where the operator was a member of a cooperative association and accepted its regulations in which no-division principles appear.

Inheritance of farm land--whether the property rights are restricted or not--is subject to several laws. An example is Article 100 in the Real Estate Law which stipulates that, if a farm was transferred to more than one person--whether by inheritance or by bequest--the heir cannot transfer his share in the land unless he first offers it to another heir who has the right of first refusal.

It was also seen earlier, that an inheritor who is a lessee or a permittee and has the right to bequeath cannot subdivide his farm between heirs.

4. Inheritance by Law in the Absence of a Will

Wherever the right of inheritance exist but a will was either not prepared, is invalid, or cannot be executed--the general laws of inheritance apply.

a. Article 100 to Real Estate Law: Was already referred to earlier.

b. Article 114 to the Law of Inheritance: This article stipulates that if the division of the farm may damage its viability, the farm will be transferred undivided to a single heir; and the others will be compensated.

"a. If a farm operated as a single unit and its division would hamper its viability as a farm able to support a family--it would be given to a heir, willing and able

to maintain it, and he will compensate the other heirs to the extent that the value of the farm exceeds his share in the estate.

b. Where the heirs cannot agree on the willing and able heir to receive the farm and on which assets comprise the farm or on the compensations due to the heirs who do not receive the farm--the court will decide according to the circumstances.

c. In case of several heirs who are willing and able to operate the farm, and one of them is the spouse of the inheritor--the spouse of the inheritor is preferred.

d. Where an heir was working on the farm during the inheritor's lifetime and did not receive as much compensation as another person would have received--this will be taken into consideration when determining the above mentioned compensations."

c. Article 113 to The Law of Inheritance:

"a. In case the joint ownership of a farm causes a significant reduction in its value--even if it does not reduce its viability as defined in Article 114--the farm will be given to the heir who offers the highest price, provided the offer is not lower than the market value. The purchase of the farm will be charged against the share of the purchasing heir in the inheritance, and if the value exceeds his share, he will pay the excess amount.

b. Where a heir willing and able to purchase the farm under the stipulated conditions is not found--the farm will be sold and the money received divided between the heirs."

d. Article 110 to The Law of Inheritance: stipulates that if the heirs reached an agreement on the division of the rights to the farm--this agreement prevails and Articles 113, 114 will not be applied. Thus, the above articles will be applied only in cases in which the disposition and allocation of the inheritance are in dispute.

5. Compensating the Other Heirs in the Absence of a Will

The issue of compensation is crucial for the parents. Since if the succeeding son has to compensate the other heirs upon receiving the farm, he may encounter cash discrepancy and may even be forced to sell the farm--invalidating his parents' vision of the farm's future.

Articles 113 and 114 to the Law of Inheritance stipulate that the heir receiving the farm compensates the others, should the value of the farm exceed his rightful share in the estate. Compensation is given to eliminate discrimination between the heirs in the absence of a will specifying such discrimination.

The compensation principle may be applied even where the Law of Inheritance does not apply. Thus the court decided in one case that the association was allowed to lease the farm to one of the heirs only after he had duly compensated the other heirs.

It may be superfluous to add that the question of compensation arises only where the property rights of the farm are transferred to heirs without a will. Also, an important exception is that no compensation need be paid where parents nominated a succeeding son to their farm in moshav.

V. THE LEGAL PROCEDURES FOR THE DETERMINATION OF THE SUCCEEDING GENERATION

1. General

The determination of the succeeding generation to continue the parents' farm requires the examination of the interests of the parties--the parents, the child to continue, the other children, and the cooperative association in the moshav.

The parents are interested in the continuation of the development of the farm and that it stays in the hands of one of their children who will make it his home. However, the parents prefer to keep for themselves the right to choose the succeeding child to ensure that the one most suitable will be the successor. Also, the parents may prefer to keep the rights to the farm to themselves until "the last moment," fearing that once the rights have been turned over to the succeeding son, conflicts may arise and they will lose their authority as to the operation of the farm and may even have to leave.

In addition to the psychological difficulty of choosing the succeeding child, there exists

a family difficulty--in that only one child can succeed. The other children must, when the time comes, leave the farm and seek alternative employment and places of residence. Parents try to postpone the decision on the succeeding child in order to avoid or postpone the ensuing potential conflicts.

On the other hand--the son who sees himself as able and willing to continue in his parents' footsteps, is interested in an early decision. He may then build his home alongside his parents' house and direct his labor and energy into the development of the farm. It is also in his interest that the choice be irreversible since, should his parents change their mind and choose another son to succeed them, the first may lose much of his investment in the farm.

Another interest, common to all the parties concerned, is to avoid a separation between the property right of the operator to his farm and the membership in the moshav's cooperative association.

Below, we detail the possible legal ways open to parents in deciding on the succeeding child; their advantages and shortcomings. The specific regulation to the Law of Cooperative Associations dealing with farm succession will also be presented and discussed.

2. An Agreement for an Immediate Transfer of Rights

The best solution for the son, is an agreement between him and his parents transferring the right to the farm immediately. Once the right has been transferred, the parents lose their right to the farm and cannot take it back from the son (not even in a will).

It must be remembered that the ability of the parents to transfer their right to the farm is derived from rights they have. If they are the owner of the land of the farm, they can transfer the ownership to the son without constraints. Wherever the parents are lessees or secondary lessees or permittees--the limitations specified in the leasing agreements will determine the constraints on their ability to transfer the farm. As we have seen, most of the leasing agreements specify that no transaction in the farm can be completed without the consent of the cooperative association, the Jewish Agency and the Land Administration. These limitations prevent the separation of the property rights to the farm and membership in the association. Thus parents can transfer the farm to a son only with the consent of the association; such consent is usually granted once the son has himself been accepted to membership in the association.

In practice, only in a limited number of cases are parents willing to transfer their rights to one of their children during their lifetime. Usually they fear that conflicts which may arise with their child (or with the spouse) and that they will find themselves powerless once the rights have been transferred. However, these difficulties can be overcome--an agreement can be signed between the parents and the son specifying, in detail, the remaining rights of the parents; such as residence on the farm, participation in its running, assistance to the other children, and the division of the farm income.

An agreement to transfer the parents' rights to the farm is usually regarded as a gift agreement. Accordingly, we have to consider the possibility that the parents may change their mind and retract their gift.

(1) Can the parents retract the gift of rights to the farm in case of a breach of the agreement on part of the succeeding son (who did not give them the agreed share in the farm income, for example)?

From the decisions of the Supreme Court a distinction emerges between a gift with an obligation attached and a conditional gift. If a promise or an obligation tied to a gift was breached--the gift cannot be retracted. However, a gift can be conditioned on the fulfilment of an agreement. Should the agreement be breached the gift can be rescinded and retracted. Should a dispute reach the court, the gift will be examined on its own merit and according to its specific characteristics. Hence, in order for the parents to maintain the right of rescindment, it has to be specified explicitly in the agreement.

(2) Can the parents rescind the agreement to transfer their rights to the son before the transfer is fully completed; that is, before the appropriate approval is acquired and before the son's rights were duly registered? Here one has to examine the question of a promise of a future gift to be awarded during one's lifetime, and which was not carried out. Can the grantor of the gift retract and annul his promise before the gift transfer is completed?

Article 5 to the Law of Gifts states that

"so long as the receiver of the gift did not change his situation, based on the promised gift, the grantor of the gift may retract unless he surrendered this permission in writing."

In one case parents promised their farm to a succeeding couple and even commenced the

necessary steps to accomplish the transfer. In the meantime, the father died and the young couple separated. Under these circumstances the mother decided not to transfer the farm to the son and her daughter in law. The young woman sued demanding half the farm, as was promised. The court decided that the mother could not rescind the present since the daughter in law had changed her position based on the promised gift--together with her (former) husband she invested in building an additional house on the farm. By Article 5 of the Law of Gifts a grantor cannot renege under these circumstance.

3. An Agreement of Common Possession and Use

A different kind of agreement can grant one of the children the right to common possession, use, and operation of the farm together with the parents. Such an agreement, assuming that it is limited to the life span of the parents, does not grant the child any independent rights. The child may then find, after the parents' death, that they willed the farm to another. It is therefore appropriate that, in addition to the agreement of joint possession and use, the parents prepare a will specifying, in such a case, the bequest to the chosen son. The determination of the heir should not be left to the general procedures of inheritance which apply in the absence of a will.

It goes without saying that an agreement for joint possession and use is subject to the limitations on the transfer of the parents rights which appear in the contracts that created these rights in the first place. Such agreements of joint possession will not be valid wherever they contradict the leasing contract.

4. Leasing or Permission

An agreement can be reached between the parents, the son, the association, the Jewish Agency, and the Land Administration according to which the son becomes a possessor of rights in the farm in addition to the parents. Such an agreement assigns to the son immediate rights to the farm and may delete the farm from the estate's assets. The agreement stipulates that the son will then receive whatever rights his parents had on the farm once their rights have been annulled--whether through death or for other reasons. For example, in a case where the parents are permittees, and a succeeding son was explicitly declared and approved of by the association--he will receive the farm upon his parents' death.

This agreement can be best for both sides, since it gives the son a clear and immediate right to the farm, while leaving it in the hands of the parents, as long as they decide not to transfer the farm formally and completely to the son.

5. Bequest by Will

Parents may specify which child to succeed them by naming him or her in their will. The greatest advantage of the will from the parent's point of view, and disadvantage for the heir's, is that it can be modified at any time until death.

One of the shortcomings of the will from the testator's point of view is the lack of assurance that after his death the cooperative association will agree to accept the nominated heir as a member in the moshav. If this is the case then, if the will itself states preference of a bequest over a lifetime's gift, the testator undermines the continuation of the farm. It is important to remember that if the case is of private land, then so long as the heir does not sell the farm, the cooperative association will not be able to require him to leave the farm or exit the moshav. If the heir insists, he may stay on his farm without getting the services of the village cooperative; although this, in many cases, may substantially reduce the value of the farm. In the case of leasing, secondary leasing, and particularly in the case of a permittee--refusal of the association to accept the designated son to membership may require him to leave the moshav and may even mean that the rights in the farm revert to the cooperative association, as the representative of the moshav at large.

To avoid difficulties, the parents may choose one of the following modes of action:

a. The bye-laws of the association permitting, request the moshav to accept the son for membership immediately, on the basis of him being designated as the successor in the parents will. In case of opposition to the particular son, the testator may suggest another child for membership and name him as successor.

b. The parents may request, as a pre-ruling, that the association decides that upon their death, the succeeding child becomes a member. Such a commitment by the association does not prevent the parents from changing the will at a later date. Should this happen, the association may face a dilemma in the future: Is its commitment to the first designated child binding and is he to become a member in the moshav despite the fact that he lost the right to the farm? Or,

alternatively, does the parents' change of mind free the association from its commitment and allow it to examine the membership of the alternate child? Because of these potential complications, some associations do not make future commitments of the kind considered here.

c. The parents may specify a heir in their will on condition the he or she is accepted to membership. If not, another heir is designated, or another, down the line.

d. In a Moshav Ovdim the parents may designate a chosen child as a succeeding son and request immediate acceptance to membership.

6. An Agreement to Transfer Rights Upon Death

It is often found that parents sign an agreement with one of their children to the effect that this child will receive the farm after the parents' death. Such agreements are in most cases termed "A Declaration and an Irrevocable Commitment." Based on this declaration, the nominated child is usually willing to build his home next to the parents' and invest time, energy and capital in the development of the farm.

However, such an agreement by which the parents' rights will be transferred to the child after their death lacks legal status. Article 8 to the Law of Inheritance specifies:

"(a) An agreement regarding the estate of a person and giving up of inheritance--that was done in the person's lifetime--is void.

(b) A gift a person grants to be given to the receiver only after the death of the grantor is not enforceable unless it was done in the form of a will according to the directions of this law."

A person cannot make an agreement according to which he grants part of his wealth to another person--if this agreement will be enforced only after his death.

"The legislator did not wish to allow a testator to tie himself with regard to his bequest by any arrangement or agreement--but to let him make his bequest in a will which he may rescind and change until the day of death."

This principle was upheld in several cases in the court of law.

7. An agreement on Future Transfer

Another possibility is the preparation of an agreement about the future transfer of the parents'

rights to the farm. In such a case, it is possible that the agreement will specify a test period in which the designated child will work with the parents on the farm, build a home next to the parents', and prove his or her ability to run the farm. The agreement can be nullified by any of the parties within the test period (with compensation). By the agreement, if it is not nullified, the parents' rights revert to the child at the termination of the test period.

An agreement of future transfer is not "an agreement about the inheritance of a person" and is therefore legally accepted. However, it does not completely secure the right of the child in case the parents die before the farm is transferred. In such a case, a will contradicting the agreement--if such exists--prevails.

There is a way to overcome this difficulty, however. The agreement has to demonstrate that it is "a commitment to strike a deal" between the parents and the child, and that the deal obligates the parents estate, and is not revocable. One possibility is for the parents to leave--with a lawyer or the cooperative association--an authorization to transfer the right to the child at the termination of the test period. In this way, the child's rights may be secured.

IV. A "Continuing Son"--Regulation 3a to the Cooperative Law, 1973

1. General

The term "continuing son" is well known in Israel to the extent that many think that it can solve all the inheritance problems in agriculture. However, as will be seen below, the regulation applies only to "moshav ovdim" and not to other forms of cooperatives in agriculture;⁴ and is irrelevant for non-cooperative agriculture. Moreover, the regulation on "continuing son" has next to nothing to say on inheritance, it deals mostly with membership in the cooperative association.

Regulation 3 to The Law of Cooperatives indicates:

"(a) In this Regulation, "a continuing son"--only one son, or one adopted son, or one grandson of the farm operator, including the spouse of the continuing son,

⁴ Most of the moshavim are classified by the Registrar of Cooperatives as a Moshav Ovdim, others are officially classified as Kfar Shitufi. The classification reflects historical political differences.

who operates the farm on his own or with his parents on the strength of an agreement with the parents, or on the strength of an inheritance, in an agricultural farm, as a lessee, a secondary lessee, or a permittee of a settlement institution or the association, or on the strength of an irrevocable commitment in writing from his parents, granting him partnership in the right to possess the farm together with both parents. In this context--"parents" including one of them in case the other ceased having rights to the farm or has died.

(b) A continuing son qualified to be a member in the association will submit to the executive committee of the association a written petition to become a member, according to the standard version of the association, together with documents confirming his being a continuing son.

(c) If the executive committee objects to membership of the continuing son, the executive committee will commence arbitration procedures against this continuing son, in accordance with the constitution of the association, within 45 days from the day he submitted the said petition, and his membership will be nullified according to the decision of the arbitration.

(d) In the case where the executive committee did not commence arbitration procedures as indicated in sub-regulation (c), the continuing son will become a member of the association within 45 days of the day the petition was submitted.

(e) This regulation is not intended to prevent another son of a member of the association of becoming a member.

(f) The directives of this regulation apply, with appropriate modification, to the spouse of the farm owner who has rights to the farm.

(g) Wherever the transfer of a farm is subject to the association's approval, it will be considered that approval was granted to a "continuing son"--unless he was not accepted to membership following arbitration procedures as indicated in sub-regulation (c).

(h) This ordinance applies to an association that was classified as a Moshav Ovdim."

The above regulation deals with the possible but undesired separation between the membership in the association and the ownership of a farm. Ordinance (a) determines that a necessary condition for the recognition of the rights of a "continuing son" is his possession of the farm. The legal right of possession may stem from several alternative sources--an agreement with the parents, inheritance, irrevocable commitment of the parents, or permission from the association or a settlement institution. At the same time, the regulation determines that in case restrictions exist on the transferability of the parents rights to the farm, that is expressed by the need to receive the acquiescence of the association to the transfer of rights, then, whoever acquired the status of a continuing son, has automatically also acquired this permission. In this way a connection was created between the de-facto status of a son who resides on the farm and maintains it with his parents, and between his status after their death. The son who lived on the farm and operated it together with his parents, and in the meantime became a member of the association, becomes, upon the death of the parents, the owner of the rights the parents had to the farm.

2. The Nomination of a "Continuing Son" in an Association that is not a Moshav Ovdim
Regulation 3 is specified explicitly to apply only to cooperative associations that were classified by the Registrar of the Cooperatives in Israel as a Moshav Ovdim. It has already happened that the courts ruled that the regulation does not apply to moshavim which were not so classified.

3. The Conditions for the Qualification of the "continuing son"

Regulation 3A specifies that only one son can be a continuing son; but along with the constraint, the regulation defines a son in broad terms: it includes, an adopted son, a grandson, and the spouse of each.

The Regulation specifies that the "continuing son" has to qualify for membership in accordance with the constitution of the moshav. The executive committee of the moshav can oppose the membership of a new candidate, including a son of a member designated as continuing, and if his application is rejected in the arbitration that follows the opposition of the association's executive committee, the son cannot be a member of the moshav and his rights to the farm his parents operated is denied him.

4. The Source (Origin) of the Status of a "Continuing Son"

Regulation 3A specifies several legal sources for the possession of the "continuing son" in the farm, which empower the son to apply for membership in the association: an agreement with his parents, inheritance, being a permittee of a settlement institution or the association, and an irrevocable commitment on part of his parents. Based on these four legal sources, all the possible arrangements for the transfer of the farm to the succeeding generation can be included:

(a) **An agreement with his parents**--such an agreement may be for transfer of the rights immediately, for joint cultivation of the farm together with the parents, an agreement for joint ownership of the rights to the farm (such an agreement may empower joint leasing or permission to cultivate), or an agreement to transfer the farm in the future, after a test period.

(b) **Inheritance**--to qualify under Regulation 3A the inheritance must have been willed, and a written will should be exhibited to the executive committee of the association.

(c) **A Permittee of a Settlement Institution or of the Association**--wherever the parents, together with the son, reach an agreement with the Land Administration, the Jewish Agency, and the association to add the son's name to the leasing contract, he becomes a continuing son fully approved by them.

(d) **An Irrevocable Commitment on Part of the Parents**--Regulation 3A is not clear on this point, but such a commitment cannot be made as a gift after death. Therefore it must be understood as a commitment to transfer the farm in the future, but while the parents are still alive, and after a test period in which the son demonstrates that he can fulfil his part of the contract between the parties. Despite the qualification regarding gifts after death, a commitment for future transfer does not become void if the parents die unexpectedly and do not leave a will to the contrary. In such a case the commitment made in the parents' lifetime binds their estate, and the son may get the farm as his share in the estate.

5. An Example of a Nomination of a Continuing Son

The Supreme Court considered the case of Lukov vs Migdal in which a conflict erupted between the heirs of a couple that operated a farm as secondary lessees in a moshav. The parents nominated their daughter as the "continuing son," and she was accepted for membership in the association, built her house adjacent to her parents', and maintained the farm. The other two

children of the couple objected to the transfer of the farm after their parents' death. They argued that after the death of the father, the mother divided the rights to the farm between her children in the form of gifts; consequently each of them was entitled to a share in the farm.

The following are excerpts from the decision determining that by accepting the daughter as the "continuing son" the association approved the transfer of all the rights to her, any other transfer of the parents' rights was not possible because of the absence of the needed approval:

"It arises from the evidence that the daughter qualifies for the conditions of Regulation 3A and has the status of a "continuing son" in the farm of the deceased parents: she lived with her husband together with her parents on that piece of land, they operated the farm together with the parents and had their consent, she was accepted to membership of the association while the father was still alive... her possession of the farm is based both upon her being a potential heir and upon her being a permittee of the settlement institution,It emerges from the above that the daughter has the right to continue keeping the farm and operating it, subject--of course--to her obligation to compensate the other heirs in accordance with the constitution of the association and to the relevant expression in the leasing contract."

Description of cooperation

Cooperation was facilitated mainly by Dr. Kimhi spending the first year of the project in Maryland, and taking two additional shorter trips, in the summer of 1993 and in the beginning of 1995. Parts of the theoretical work were conducted in Israel, and other parts in Maryland. Lopez and Kimhi worked jointly on the American empirical part and Kislev and Kimhi - on the Israeli Empirical part.

Evaluation of research achievements

This research adds to the literature on intergenerational transfers in agriculture, especially by combining modern economic theory and econometric techniques. The theoretical basis developed can be used as a basis from which empirical studies can start. Our empirical applications serve as examples. We have focused on the institutional structure, and our results support the hypothesis that it is an important determinant of inheritance and succession practices among farmers. We have also concluded that intergenerational succession is an issue with major importance to the functioning and profitability of the family farm over time. Hence, farm policy design should take into account the impact of policy on the succession process, especially in periods of steadily declining farm profitability.

List of publications

- Kimhi, Ayal.** "Differential Human Capital Investments and the Choice of Successor in Family Farms." *American Journal of Agricultural Economics* 77 (forthcoming 1995).
- _____. *Off-Farm Work of Farmers: The Effect of Household Composition*. Presented at the Annual Meeting of the European Society for Population Economics, Tilburg, The Netherlands, June 1994.
- _____. "Optimal Timing of Farm Transferral from Parent to Child." *American Journal of Agricultural Economics* 76 (May 1994): 228-36.
- _____. *Intergenerational Succession in Family Businesses*. Paper presented at the Annual Meeting of the American Economic Association, Boston, Massachusetts, January 1994.
- _____. *Investment in Children, Selective Off-Farm Migration, and Human Capital of Future Farmers: a Dynastic Utility Model*. Working paper No. 9303, The Center for Agricultural Economics Research, The Hebrew University, Rehovot, Israel, March 1993.
- _____. *Optimal Timing of Transferring the Farm Operation from Father to Son*. Working Paper No. 92-12, Department of Agricultural and Resource Economics, University of Maryland, August 1992.
- _____, and **Ramon Lopez**. *Retirement and succession considerations of Maryland farmers: Preliminary Evidence from a Household Survey*. Working Paper, Maryland Agricultural Experiment Station (forthcoming).
- Kislev, Yoav, Claudio Pesquin and Ayal Kimhi.** "Intergenerational Insurance in Agriculture." *Hasadeh* 75 (4, January 1995): 17-19 (Hebrew).
- Nevo, Naomi.** *Inter-generational transfer of farms in Moshvei-Ovdim: an ethnographical enquiry*. Working paper No. 9503, The Center for Agricultural Economics Research, The Hebrew University, Rehovot, Israel, March 1995.
- Pesquin, Claudio.** *Intergenerational Farm Transfers in a Moshav*. A Master Thesis, The Hebrew University, Rehovot, Israel, forthcoming (Hebrew).
- Regev, Shuki.** *Farm Succession - the Legal Aspect*. Working Paper No. 9406, The Center for Agricultural Economic Research, Rehovot, Israel, March 1994 (Hebrew).