



Rural development and land market in Ukraine: (un)clear perspectives

by Max Fedorchenko and Alex Yanov¹

The current discussion on the development of rural communities focuses on social and economical conditions of the countryside. Opponents are trying to draw less and less attractive picture – social devastation, unemployment, overgrowth and degradation of lands etc. The left and the right are threatening each other with the forthcoming trade in agricultural lands. One side detects in it the final impoverishment of rural population and as a consequence a certain reinforcement of its electorate, at least in a quantitative sense. Another side perceives it as a definitive rejection of the Soviet inheritance in the agricultural sphere of Ukraine and the loss by certain political forces of their authority and influence in rural areas.

A lot has been already said and will be said about land and agrarian reforms which are most directly affecting the countryside. At the same time there are no authoritative modeling and forecasting of the consequences of the reforms as well as no clear understanding of the main goal of the reforms. Taking into account that 17 millions of Ukrainian citizens dwell in rural areas, our attitude towards reforming agrarian and land relations is irresponsible at the least. A goal like overcoming of unemployment and raising living standards as such is not a goal at all, because employment and living standards are more likely the outcomes of functioning of a certain model of the existence of a society, of its *modus vivendi*. A current model of existence and development of a rural community provides for a high unemployment rate and low living standards. Thus it is essential to define and set up another social and economical model which would ensure effective overcoming of unemployment and growth of living standards.

We believe that the process of globalization causes the copying of economical, social and political processes, and that means that almost everything that has happened and is happening in the leading countries will certainly take place with slight differences in all other countries. Therefore the most developed states of the world may be considered a projection of our modern situation on our own future. We in Ukraine do not yet realize it to the full; for instance China has already understood it and added to its arsenal: in 50 years Chinese are going to reach the modern level of the developed countries, and in 100 years – the modern level of the USA. The success of the global process of copying of models of existence on the ground of China will certainly speed up the global tendency of copying in light of the importance the Chinese economy has on the world scale.

So, a look at the countryside of the developed countries lets us glimpse into the future of Ukrainian countryside. And what we see there?

First of all, the future requires us to accept several axioms:

- 1) the agriculture of the developed countries is an unprofitable branch of economy and needs a state support;
- 2) the agriculture is a highly technological branch of production with low level of employment, and it cannot solve the problem of job placement of the unemployed;
- 3) rural area is a territory mostly inhabited by the people working in cities (commuters) or employed in human service in the countryside, that is they are not agricultural workers.

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All these axioms may be backed up by the EC statistics. As of May 1, 2004, before the enlargement, farmers accounted for only 3% of the EC population². To support its agricultural production, EC assigns EUR 43 billions annually (in the years to come this sum may grow within 1 % a year) or 38 % of the EC budget (in the previous years this sum amounted to 45 %). These billions are mostly used to pay subsidies to farmers. That means that 3 % of the EC-15 population consumes 38 % of the EC budget.

This policy has long ago gained among specialists a nickname "Communist Agricultural Policy"³. A European farmer has only one aim – to produce as much as possible in order to receive more substantial a subsidy from the EC. A real demand for agricultural production is not taken into account. And any attempts of reforms encounter the active resistance of highly organized farmers employing different forms of public protest. Raising public support is not very complicated an issue for the farmers: a fear of hunger is in genes of not only Ukrainians and reminders of it promptly open the wallets of the most intractable Europeans.

Historically, the establishment of the system of subsidies on the ground of EC was connected to the need to provide for a maximum availability of foodstuff for the population of European countries and at the same time to secure high living standards for the farmers. The EC budget accumulates funds and subsidizes the farmers, and in the outcome an average European does not become aware how much the food part of a customer's basket of goods costs in fact and a farmer enjoys high living standards.

The constitutional documents of the EC, first of all article 33 of the Rome Treaty, explain the European agricultural policy as follows: provision of the foodstuff to the population of Europe at a reasonable price and securing the fair income for farmers. The EC acknowledges that this policy ensured a sufficient supply of foodstuffs in a short period of time, but high living standards of farmers made European prices much higher than the world prices which were formed by the subsidized export of the developed countries and the distress price export of the third world countries. To reach both goals simultaneously – reasonable prices and fair income – turned out to be impossible. The fairness of farmers' earnings made prices too high for Europeans. The EC faced a classical question: what to do? How to strike a balance between a fair income and reasonable prices in real life? Unprofitable production would have rendered unattainable a goal of securing a fair income for farmers. Profitable production on account of consumers would have ensured fairness of earnings against a background of unreasonable prices. Under such conditions there would have appeared a necessity to raise the standards of living of the consumers of agricultural production. In turn, the rise of the standards of living of the consumers of agricultural production would have caused unfairness of farmers' earning. This way of achieving a goal of the CAP (reasonable prices and fair income) obviously was a vicious circle. Therefore the EC decided to reimburse a share of the agricultural production cost and introduced a system of subsidies for farmers. As a result, retail prices are reasonable, and the farmers' income is fair, exactly on account of subsidies. In the USA the same process is going, and at the level of the WTO there is a constant discussion between the USA and the EC as whose protectionist agricultural policy inflicts more damage upon the world trade. It is pertinent to mention that in 1992 a gradual reforming of the agricultural policy of the EC finally started, and the CAP share in the expenditures of the EC budget shrank from 45 % to 38 %. The reform is also aiming at overcoming the overproduction of agricultural output which is becoming more and more heavy a burden on the EC budget (oddly enough, the overproduction was subsidized too).

Thus, those Ukrainian politicians who employ a term "profitable agricultural production" are omitting the fact that its profitability is ensured by a very low living standards for persons engaged in farming. A paradox: a profitable production entails poverty. Even the most developed nations of the world have so far succeeded in breaking this paradoxical connection only directly subsidizing farmers.

Another factor calling for financial interventions of a state on the agricultural market is the coexistence of three worlds: developed countries, countries in transition and developing countries. Living standards of these "three worlds" are that different that the agriculture of developed countries is fairly unable to compete with the developing countries farming due to ultra low prices for the latter's output. A global market provides for the global competition. The WTO setting aside all its drawbacks allows the developing countries to block effectively decisions they are not in favor of, and to affect the global agricultural market.

² To compare: in Ukraine, up to 20% of population is engaged in farming, or 9.6 million persons.

³ It is a sort of a pun. The policy has an official short name CAP which stands for "Common Agricultural Policy". Ironically, the same abbreviation may stand for "Communist Agricultural Policy".

A support for a high rate of employment is also not an advantage of agriculture. A modern American or European farmer is using that complex machinery, so many computers, software, elite seeds, highly effective fertilizers, fodder, herbicides, insecticides and pesticides, his labor productivity and income are that high that at creation and maintenance of every working place is extremely costly and, in fact, unnecessary. The agricultural market does not suffer a lack of supply. Accordingly, it is more economically feasible to pay a decent support to the unemployed or to invest into the development of private initiative in less capital-intensive branches of public production, first of all, in the sphere of non-manufacturing business (i.e. human services).

So, the future of Ukrainian countryside looks like the present of the countryside of Europe. It is inhabited mostly by commuters and workers of the social sphere of villages, self-employed persons. The state spends up to 20% of the budget to subsidize farmers. In Ukrainian agriculture about 1.5 million people are engaged. The living standards of the countryside are the same as in urban areas. This future is inevitable. Whatever measures we resorted to, everything should happen exactly in this way. The only question is when it will happen.

One of the main factors of transformation of the miserable present of Ukrainian rural area into the prosperous future is the establishment of a civilized agricultural land market.⁴ In Ukraine, a land market – we are knowingly leaving out the adjective “civilized” – should have begun functioning on January 1, 2005, but due to the Parliamentarians efforts the event has now been rescheduled on January 1, 2008.⁵

This is a topic to discuss as well. How long one may hesitate? – We believe that one must not hesitate at all, but ready to admit that at the moment Ukraine is not yet prepared for the opening of the agricultural land market. There is no a legislative and organizational mechanism to secure the rights of small landowners in the inevitable process of large-scale latifundias (estates) formation.

The massive sale of agricultural lands will certainly follow due to the next reasons:

- 1) 53-56% of land parcels owners are pensioners;
- 2) 30% of those pensioners do not have heirs, or their heir are residing abroad;
- 3) the standards of living of rural landowners are extremely low.

These factors ensure the readiness of landowners to expose of their parcels. The lease is not a choice for them because the land not being marketed has no real value, and the ground rent is scanty. The opening of the market will entail the price rise, and the lease might as well become unprofitable for lessees.

In order to hasten the prosperous future, the state should have provided for a free sale of land parcel on a decent price. Taking into account the achievements of our growing economy, it may be possible to provide buyers of agricultural lands with long term loans at low interest rate, or introduce a mechanism of installment payments on a security of the state. These simple mechanisms would ensure for present-day landowners a decent living in a village or city or a possibility to start own business. At the same time there emerges a significant and prosperous middle class of persons not engaged in agricultural production. Their quite substantial funds may be invested into social development of rural communities, i.e. into the development of social infrastructure. If an average land share consists of 4 ha per person, than being sold at USD 10.000 per ha,⁶ it would raise up to USD 40.000. The first sale of land shares must be exempt from taxation, and all consequent sales must be taxed at an increased rate.

Degraded and low-yield lands must be bought back by the state or institutional investors through the mediation and under control of the state. These areas shall become a territorial basis for the realization of complex investment projects for the development of territories according to certain profiles: ecotourism (hotels, parking facilities, recreational establishments), infrastructure (communications, roads, water and waste water

⁴ Under a civilized market we understand a market where sellers and buyers are transacting under economic considerations only, the prices are just and fair for the parties, and any possibility for fraud is excluded.

⁵ When the Ukrainian version of this article was published, the President vetoed the said law, and the date again became January 1, 2005. Then the Parliament overcame the veto for the second time (on November 18, 2004).

⁶ Current normative value of agricultural lands in Ukraine. It may be higher or lower under conditions of free market.

management, huge trade centers, entertainment complexes), industrial production (placing of units of EU companies looking for the cheaper parcels and workforce).⁷ It is complicated to attract investments, but it is possible. Canada, for instance, in order to facilitate prompt development of a territory or an activity allows a 3-year depreciation period for fixed assets. The results of that simple mechanism's application are astonishing. We must make an effort, give up all political, emotional and egoistic considerations and to copy an example (remember – there is a globalization ongoing), pick someone's brain.

The farmers already today operating profitably (they exist in Ukraine) will certainly be unable to compete with a large-scale production equipped with all modern techniques. These farmers must be assisted by the state. Their output may be placed in the government reserve or used for supplying social establishments.

Bigger producers also may count on subsidies. The state will use subsidies to regulate prices of foodstuff on retail market.

Another argument in favor of the system of subsidies is the process of Ukraine's integration into European and Atlantic structures. When Ukraine's Euro-integration aspirations are embodied in full EU membership – and this future is inevitable as well – the system of direct subsidies in any case will be applied in Ukraine.

Therefore the land market will have to be open anyway, and we must prepare for the opening. It is clear today that inevitable and prosperous future of Ukrainian countryside requires the designing of an effective model for the management of land parcels of small landowners. This model shall ensure that the land works for its possessors or is alienated in a way which will not become a new means of impoverishment. The Center for Land Reform Policy in Ukraine has already started working upon the design of the model. This process should unite most prominent experts of Ukraine and other countries. In our opinion, the model must include, among others, the following components:

- 1) a finalization of the process of land titles issuance;
- 2) introduction of a mechanism of buying of the agricultural lands out of present-day owners at a decent price. A decent price shall be close to European prices (around USD 10-20 thousand per ha);
- 3) introduction of a system of state crediting of land buyers under privileged conditions (if needed) or installments purchase of agricultural lands on a state security;
- 4) implementation of a system of direct subsidies for farmers;
- 5) a wide popularization of the idea of private entrepreneurship in the countryside;
- 6) support for the migration of urban population to neighboring rural areas.

We understand that this paper will entail debates. This is what we actually want – to start a constructive discussion, to facilitate a realization by the society of the perspectives, to make the state and society to step towards the future. Up till now there is only a moratorium in our arsenal of progress. Without a system of measures that we suggest this weapon is having an effect only upon us.

⁷ Degraded lands sold for industrial and commercial purposes may bring much more money than high-quality agricultural lands sold for agrarian purposes. For instance, in Germany the rotation of crops is going like this: "potato-potato-highway". This is how German farmers maximize their utility (agriculture for them is just way of living). Thus the sale of degraded lands for industrial and commercial purposes could fill in the local budgets and miraculously change the countryside.