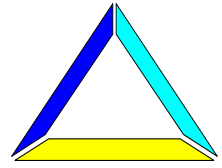




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**GERMAN – UKRAINIAN AGRICULTURAL POLICY  
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## **Policy Paper No. 8**

# **AGRICULTURAL LAND MARKET IN UKRAINE: ALLOW OR FORBID?**

### **Disclaimer:**

This paper was prepared by the author using publicly available information and data from various sources including papers from the Institute for Economic Research and Policy Consulting as well as the German Advisory Group. All conclusions and recommendations included in this paper in no circumstances should be taken as the reflection of policy and views of the German Federal Ministry of Food, Agriculture and Consumer Protection.

## Introduction

Since 1991, when independence was declared in Ukraine, i.e. more than during 15 years now, discussions have been underway in the country whether it makes sense to introduce a fully-fledged agricultural land market, in particular, the possibility of land trading. The moratorium on purchase and sale of agricultural land was introduced by current Land Code of Ukraine till January 1, 2005 and then extended till January 1, 2007.<sup>1</sup> Today the issue of introducing a fully-fledged agricultural land market is being debated again. Quite a lot has been said and written in this regard already<sup>2</sup>. The *objective* of this article is to destroy certain myths and inaccuracies concerning the functioning of agricultural land markets and to facilitate open public discussion about the necessity of introducing it in Ukraine. The *methodology* is based on independent experts assessments of opportunities created by a fully-fledged agricultural land market for sector development and improved well-being of rural residents, as well as potential threats that may emerge.

Economic, institutional and legal aspects of agricultural land market functioning, in particular, land lease, are considered in this paper. The first section reveals the essence of land reform as the key component of agrarian transformations from an international comparative perspective. The issues of agricultural land lease in Ukraine as an important element of land market formation are considered in section 2. Opportunities and threats that may emerge in the process of agricultural land market functioning are reviewed in section 3. Section 4 reveals institutional and legal aspects of agricultural land market formation and functioning, particularly the problems of separating the functions of land cadastre keeping and registration of land ownership, provision of information concerning land market transactions, role of the state in exercising monitoring of and control over agricultural land use. Ideas and proposals stated in previous sections are summarized in section 5.

### 1. Does Ukraine need a fully-fledged agricultural land market?

The role of the agricultural sector is decisive in the history of economic development of mankind. Increased productivity and efficiency of the agricultural sector creates opportunities for development of all other sectors of the economy, in the first place for the industry. The issues of land ownership and land use were always central in agrarian development. That is why the history of human civilization has always been inseparably linked with these issues, and it became apparent in course of social and economic structures' change and land reforms. Almost all countries went through phases of land transformation, starting from ancient Greece in the VI century B.C. up to modern land reforms in post-socialist countries at the end of the XX – beginning of the XXI century. Experience of land reform in different countries tells that usually its major goals were as follows: establishment of democracy in the society; mitigating conflicts between land owners and peasants; creation of small land owners class.<sup>3</sup>

In this view land reform may have two directions: the first one is to improve social conditions of peasants' life and their income, which is ensured through land fragmentation and distribution among peasants, and entails restrictions on land ownership (purchase and sale in particular) and state regulation of land transactions; the second one is to increase land productivity by improving its use, which is attained through concentration of land and creation of land use areas that are efficient from the point of view of land use.<sup>4</sup>

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<sup>1</sup> Land Code of Ukraine with amendments and alterations introduced by Laws of Ukraine, article 15, Interim Provisions.

<sup>2</sup> Agricultural land market in Ukraine. German Advisory Group on Economic Reforms with the Ukrainian Government . – Q 4, July 2000; S. Demianenko. Agricultural land market in Ukraine. William Meyers, Sergiy Demianenko, Thomas Johnson, Sergiy Zoria «Changed focus of agrarian policy and rural development in Ukraine: conclusions and progression outlooks”. – K.: KNEU, 2005, p. 53-81; N.V. Kalynchuk. One! Two! Three! Land sold... .. APK-Inform, 24.06.02, <http://www.apk-inform.com/>; Pavlo Kulynych. The trap of land moratorium. Legal Weekly, № 2, August 3, 2006.

<sup>3</sup> Elias H.Tuma (1965). Twenty-six centuries of agrarian reform. A comparative analysis. University of California Press, Berkeley and Los Angeles, Cambridge University Press, London, England, p.4.

<sup>4</sup> *ibid*, p.240

A particular feature of land reform in Ukraine is that it has to go in both of these directions. The first direction, which is land fragmentation and distribution among peasants, has already been passed. Unfortunately, it was accompanied not by improvement but by worsening of peasants' social living conditions and income. However, it was not so much related to land reform as to transformation processes of market economy establishment in the country. Next step in implementation of land reform should be improving productivity of land through its better use facilitated by land markets. Obviously, the matter concerns the whole set of issues related to economic development on the whole, in particular, macroeconomic stability and judicial system that secures contract enforcement and market entry for new enterprises.<sup>5</sup>

On the whole, land reform in Ukraine was implemented for the purpose of improved land use. However, today we observe a paradoxical situation in Ukrainian agriculture concerning its productivity, which is almost three times lower than in Western Europe and Northern America. In Ukraine average yield of grain crops and productivity of cows is 2.5-3.0 tons per hectare and per cow respectively, while in developed countries these indicators are 7-8 tons. Academic studies accentuated many times on the problem of reducing fertility of Ukrainian black soils and annual losses of humus. In particular, it is noted "... in Ukraine annual losses of humus as a result of mineralization and soil erosion reach 32-33 million of tons, which is almost 2 billion US dollars of losses".<sup>6</sup> Today out of 30 million hectares of arable land one third is eroded, half of it is overconsolidated, almost 4 million hectares are acid, 2 million hectare are solonetzic, not less that 6 million hectares are overdamped, even more droughty land, over 50% of arable land have poor nutrient regime as a result of humus loss.<sup>7</sup> Besides, valuable meliorated land (about 6 million hectares) is being lost – both drained and irrigated, phosphoric soil regime is deteriorating because appropriate fertilizers are not introduced. Insufficient application of organic fertilizers as a result of livestock reduction adds to the problem. At the best times of socialist agriculture collective and soviet farms introduced not more than 10 tons of manure per hectare, while peasants introduced 40-50 tons per hectare at their subsidiary plots. This is the secret of their sustainable and successful farming. European farmers introduce approximately the same amount of organic fertilizers together with nutrient elements of mineral fertilizers, otherwise they would have not been able to increase land fertility continuously with such high productivity figures. Knowingly or unknowingly, but the key task of agrarian reform in Ukraine was to create a land owner who would take care of land like a peasant takes care of his subsidiary plot. That is how Ukrainian farmers appeared as an alternative to collective and soviet farms.

Agrarian transformations in Ukraine return to its natural evolutionary state. This is indeed the return, and the problems of dramatic decline in production, impoverishment of peasants, decay of rural areas are related to it because in Ukraine, like in Russia and unlike Europe and North America, the evolutionary process of agriculture development was interrupted. In Europe and North America evolution of agriculture, which was and is based on family farms, took the form of vertical integration and cooperation without ruining its base – private farms. In the former Soviet Union forced collectivization of peasants' farms was conducted, which was implemented by establishment of collective farms, i.e. through horizontal concentration of production.

Therefore, in Europe and North America agricultural production developed evolutionary during many centuries and was the base of economic development on the whole.<sup>8</sup> With some exceptions due to natural or political factors (for example, the Netherlands or Israel) agriculture in these countries is based on private land ownership, market economy and clear systems of securing economic agents' rights (laws, judicial system). Unfortunately, incorrect information regarding land ownership and use in other countries is often quoted in Ukraine. In

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<sup>5</sup> Rozelle, S., J.Swinen (2004): Success and failure of reform: Insights from the transition of agriculture. *Journal of Economic Literature*, Vol. XLII, pp. 404-456.

<sup>6</sup> P.T.Sabluk. Establishment of agrarian policy in Ukraine. *Economy of AIC*, № 1, 2006, p.5.

<sup>7</sup> V.Kysil, V.Medvedev. Land does not excuse miscalculations. *Agribusiness today*, № 1-2 (087), 2006, p.24-25.

<sup>8</sup> S.Demianenko. Agrarian reform in Ukraine: genesis, process and outlooks. *Theory and practice of AIC development. Materials of international scientific and practical forum. Volume 1. Lviv state agrarian university, Lviv, 2006, p. 223-233.*

particular, certain politicians and economists refer to Israel where land is in state ownership without taking into account that this country is permanently in the state of war related to specific territorial problems, and the absence of private ownership of land there is explained by political not economic factors. They refer to the US where 40% of land is in state ownership but do not specify that these are national parks, forests, mountains and testing fields but not agricultural land of which 99 % is in private ownership. The same references are made to examples of other countries, Norway or the Netherlands, without clarification that state ownership in certain parcels of agricultural land in these countries is related to natural factors. In particular, in the Netherlands the land is below the sea level and the state has to invest significant amounts in construction of dams and other protection constructions. Naturally, the land that was won back from the sea is rented out for at least partial compensation of capital investment costs.

Unfortunately, in Ukraine agrarian reform during the last 15 years did not lead to return land relations to their regular state. That happened not because the reform is not correct but on the contrary, implementation of this idea was very much delayed due to passivity and indecision of authorities responsible for its implementation, as well as unawareness of landowners of their rights and opportunities. Interesting results have been obtained in course of the review of land relations' transformation in post-socialist countries of Eastern and Central Europe conducted by the World Bank. According to these data, Ukraine's ranking is far from the best. Evaluation of agricultural land market efficiency should be based on fundamental principles of market economy that can be summarized as private land ownership and possibility to buy and sell land freely. The World Bank study was based on these particular principles.<sup>9</sup> Program and strategy of land privatization, strategy of land allocation and legislative framework regulating exchange of ownership rights in land were evaluated as well. In particular, the evaluation was conducted in the following areas: a) transfer of agricultural land into private ownership of citizens by means of restitution of land or its allocation to those people who work on it; b) possibility to buy and sell or only to lease land; c) current legislative framework for exchange of ownership rights in land; d) land privatization by means of issuance of land certificates or land titles. Respective coefficients and cumulative comprehensive index of land policy were determined for the purpose of evaluation. The aggregate of countries under review included: Azerbaijan, Albania, Belarus, Bulgaria, Armenia, Georgia, Estonia, Latvia, Lithuania, Kazakhstan, Moldova, Kirgizstan, Russia, Romania, Poland, Tadzhikistan, Turkmenistan, Check Republic, Slovakia, Ukraine, Hungary and Uzbekistan. The highest index value (10) was assigned to Hungary and Romania and the lowest – to Uzbekistan and Belarus (0.6 and 1.3 accordingly). Ukraine got 15<sup>th</sup> rating among 22 countries under review with aggregate index of 6.7. This may contribute to low investments in land. Foreign direct investments in Ukrainian agriculture as of 01.01.2004 came to only USD 4.3 per hectare, compared to USD 35.4 in Slovenia, USD 42.7 in the Czech Republic, USD 53.3 in Latvia and USD 69.8 in Estonia per hectare. Agricultural land market exists in all of these countries and in Latvia and Estonia foreigners have free access to land purchase.<sup>10</sup>

Comparing land reform and land market development in a quite significant aggregate of countries with Ukraine, unfortunately, this comparison will be not to the benefit of Ukraine. The conclusion that can be made from it is that Ukraine has to speed up the movement towards competitive agricultural land market. On the whole, delayed land reform in Ukraine impedes agrarian reform in general, does not allow full involvement of market mechanisms for stimulation of agricultural development and attraction of investments as the key factor of its renewal and development.

Today the reasons for agriculture reform containment are political rather than economic, in particular, the moratorium on agricultural land sales. Everyone would agree that a house without a roof cannot be considered full value house. Land market that is based exclusively on

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<sup>9</sup> Zvi Lerman, Csaba Csaki and Gersbon Feder. Land Policy and Evolving Farm Structures in Transition Countries. Policy Research Working Paper 2794. The World Bank Development Research Group, Rural Development, February 2002, pp. 79-84.

<sup>10</sup> A.P. Haidutsky, Investment attractiveness of land market in Ukraine. Economy of AIC, № 8, 2005, p.125-131.

its leasing without procuring into private ownership cannot create an adequate landowner, which was one of the major goals of agrarian reform. It is not possible to stop halfway if we want market mechanisms to start working in agriculture. Moreover, we believe that in the future foreigners should also have the right to buy land.<sup>11</sup> This would contribute to development of land relations and European integration of Ukraine. Of course, certain legislative restriction must exist, in particular, priority rights of Ukrainian citizens, first of all, those who reside in rural areas and work in agriculture. For instance, Ukraine could use the Polish approach to legislative regulation of agricultural land purchase and sales by foreigners as an example.<sup>12</sup>

## **2. Agricultural land lease**

The agricultural land market consists of two parts – purchase and sales market and lease market. The general purpose and principle of its functioning is transfer of land from inefficient producers to efficient ones. Therefore, land market does not necessarily mean direct transfer of land ownership, it also includes the possibility of using it by other agricultural producers by way of lease.

Today, agricultural production in Ukraine is based on land lease mostly. However, the owners and the state do not control its use. There are no agrochemical laboratories necessary for evaluation of soil state and fertility before and after the lease period, so these indicators are not fixed in lease contracts. As a result, no sanctions are applied to careless tenants who deteriorate land as a result of their activities. Table 1 contains information about agricultural land lease in Ukraine as of 01.01.06. Out of 22.9 million hectares of agricultural land operated by agricultural farms 19.9 million hectares, or 88.1%, were rented. Experience of other countries tells that purchase and sale of land is not the main element of land market. According to Lermon, Csaki and Feder<sup>13</sup>, transparency and security of land lease transactions are even more important for ensuring productivity and efficiency of agrarian production than legal ownership rights in land. Experience of developed countries demonstrates that in these countries significant parts of agricultural producers are not owners of land but lessees. In particular, in Belgium, France and Germany over 60% of agricultural land is leased, and in 15 EU countries on the whole – 40%, in Canada – 30%, in the US only one third of cultivated land is owned by the farmers, 55% of land is in mixed form of use and 10% of land is used by the farmers who do not own it.

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<sup>11</sup>S.I.Demianenko. Mortgage lending on the collateral of agricultural land: German experience and possibility of applying in Ukraine. *Economy of AIC*, №10, 2002; S. Demianenko. Agricultural land market in Ukraine. William Meyers, Sergiy Demianenko, Thomas Johnson, Sergiy Zoria «Changed focus of agrarian policy and rural development in Ukraine: conclusions and progression outlooks”. – K.: KNEU, 2005, p.61.

<sup>12</sup> A.M.Tretiak. Ways of land market regulation. *Herald of agrarian science*, № 10, 2003, p.62-65.

<sup>13</sup> *Zvi Lermon, Csaba Csaki and Gersbon Feder*. Land Policy and Evolving Farm Structures in Transition Countries. Policy Research Working Paper 2794. The World Bank Development Research Group, Rural Development, February 2002, p. 64–66.

**Table 2**

Agricultural land lease by farms in Ukraine (as of 1.01.06)\*

№	Indicator	Total	including:		
			Agricultural enterprises	Private family farms	Private farms*
1.	Total area of land, thou hectares	22588,3	10877,2	3861	7634
2.	Including leased, thou hectares	19908,3	10362,4	3779	3241
3.	Leased land, %	88,1	95,3	97,9	42,5
	Leased land owned by pensioners, %	52,0			
4.	Number of lease contracts, thou	4560,1	2371,7	885,7	615,6
5.	Breakdown by lease term, %:				
	1-3 years	10,0			
	4-5 years	62,2			
	5-10 years	14,7			
	Over 10 years	3,6			
5.	Number of founders, people	269028	141215	6822	44312
6.	Number of founders per one farm, people	12,7	18,0	1,9	1,0
7.	Area of land belonging to founders of farms, thou hectares	5071	406	29,5	4393
8.	Average land share of a farm founder, hectares	5,2	2,9	4,3	10,0
9.	Number of farms	57877	7849	3643	44312
10.	Number of individuals entitled to get land shares, people	6913495	X	X	X
11.	Number of individuals who got land shares, people	6794999	X	X	X
	Registered transfers of land share title, total number	1052639			
	Including by way of (%):				
	inheritance	89,5			
	gift	9,0			
	sale	1,3			
	exchange	0,2			
12.	Number of issued land titles	5673168	X	X	X
13.	Issued land titles to land certificates, %	83,5	X	X	X
14.	Accrued according to lease contracts, thou UAH	2275514	X	X	X
15.	Actual rent per one hectare, UAH	114,30	X	X	X
16.	Cash portion of rent, %	14	X	X	X
17.	In-kind portion of rent, %	80	X	X	X
18.	Services portion of rent, %	6	x	x	X

\*Statistic handbook "Agricultural sector of Ukraine 2005", State Statistics Committee of Ukraine – Kyiv, 2006.; Structure of 50 farms for 2005; Current information of the Ministry of Agrarian Policy and State Committee of Ukraine for Land Resources, own calculations.

\*\* Category "private farms" includes also registered farms established on the basis of former collective agricultural enterprises.

Agriculture productivity and efficiency also depend on the area of land cultivated by one agricultural producer. Of course, countries with efficient land markets, clear and transparent rules of land use and, in particular, land lease, provided that all other conditions are in place, have an opportunity to increase farm areas. In European Union farmers who rent more than 30% of land that they cultivate have average farm area of 40 hectares, while farmers who rent less than 30% of land have 18 hectares on average. Similar trends are observed in other countries as well<sup>14</sup>. In Ukraine a paradoxical situation is observed when tenant companies emerge that rent dozens and hundreds thousands hectares of land. This is abnormal and not to the benefit of agricultural land market development for it strengthens existing monopsony in agricultural land lease market in Ukraine.<sup>15</sup> It also impedes the development of farming in Ukraine because farmers cannot compete with large tenant companies. At the same time it is the farmers who are interested in development of rural territories where they live together with their families. Large tenant companies may quit agrarian business if conditions (e.g. taxation) are unfavorable to them and leave peasants-landowners alone with their problems.

Today in Ukraine only the level of rent paid by the tenants to landowners can serve as an indicator of land market value. If in 2005 average rent per one hectare of agricultural land was about UAH 114 and average bank credit interest rate was 16.2% (in the absence of mortgage and long-term lending), annual inflation rate was 10.3%, then the present value of one hectare of land according to the simplest calculation will be about UAH 2000 ( $114 / (0,162 - 0,103)$ ).<sup>16</sup> These are average figures of course. Actual values depend on the economic situation of a specific location. For example, in Odessa, where farmers specialize in vegetable growing and land is quite productive, rent reaches UAH 1000 per one hectare of arable land, so the price of land here is about UAH 17,000.

The level of competition is an important element of the agricultural land leasing market. Studies on the influence of competition on the level of rent payments demonstrate that with development of competition in the lease market the level of rent payments increases significantly (about 50% in all oblasts of Ukraine). The maximum level of rent payments is 2.5 times higher than its minimum level<sup>17</sup>.

Another important factor that influences the level of rent and land price accordingly are transaction costs of the formalization of leasing relations. They are related to search for land to be rented, reaching agreements about the term, rent and other elements of lease contract, making lease contracts and notary fees. The amount of these transaction costs depends on state and functioning conditions of land lease markets, infrastructure development, in particular, available information about land areas for rent, network of notary offices and cost of notary services. The lower the development of lease markets the higher are transaction costs for execution of lease contracts and the lower is the rent for land accordingly. If we take into account further aspects such as unstable Ukrainian legislation, lack of other elements of market infrastructure such as long-term lending and high interest rates for short-term credits, crop insurance, market infrastructure, it will be clear why in Ukraine the level of rent for agricultural land is so low, 18-20 times lower than in the European Union. Risks that emerge in the course of rent relations contribute to this and reduce lessee's income.

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<sup>14</sup> Zvi Lerman, Csaba Csaki and Gersbon Feder. Land Policy and Evolving Farm Structures in Transition Countries. Policy Research Working Paper 2794. The World Bank Development Research Group, Rural Development, February 2002, p. 66.

<sup>15</sup> S. Demianenko. Agricultural land market in Ukraine. William Meyers, Sergiy Demianenko, Thomas Johnson, Sergiy Zoria «Changed focus of agrarian policy and rural development in Ukraine: conclusions and progression outlooks». – K.: KNEU, 2005, p. 67.

<sup>16</sup> Calculations were made based on Present Value estimation of future rent payments flows. Assuming endless period

and constant each period rent payments we end up with simple formula for present value of perpetuity:  $PV = \frac{C}{r}$

(see Ross-Westferfield-Jaffe, 2002, page 82). Normative pecuniary evaluation of land in Ukraine as of 1.01.06 is UAH 9526.

<sup>17</sup> Arnim Kuhn, Sergiy Demianenko. Ensuring competition in land lease market. Ukrainian agriculture: crisis and rehabilitation/ Edited by Stephan von Cramon-Taubadel, Sergiy Demianenko and Arnim Kuhn. – K.: KNEU, 2004. – p. 84–92.

### **3. Opportunities and challenges arising from a fully functional agricultural land market**

Experience of developed countries tells that a fully-fledged agricultural land market is a necessary condition of agrarian sector development, improving its productivity and efficiency. At that increasing land fertility and investments in the land are the major issues of agrarian sector development to improve its productivity and efficiency. The experience of the previous century brought out clearly that only the capitalist economy based on private land ownership and market economy can ensure increased land fertility. Public use of land, which in the former Soviet Union took the form of collective and soviet farms, in planned economy appeared to be incapable of ensuring increased land fertility and necessary level of its productivity (despite of significant capital investments in agriculture its productivity in the Soviet Union was permanently lower than in developed capitalist countries and starting from 1963 grain and food products were imported regularly). The purpose of agrarian reform was to resume the capitalist way of farming and ensure increase of land fertility and productivity. Agricultural land is part and parcel of the market mechanism and its value is determined by a number of economic factors such as inflation rate, credit interest rates charged by banks, prices of agricultural products and industrial inputs of agrarian production, profit generated by agricultural producers per hectare, conditions of land market functioning and possibility of unhindered land transactions (purchase/ sale and lease). On the other hand, the listed economic factors also depend on the land value. The value of land functioning as economic resource has a direct impact on the possibility of lending to farms and on allocation of primary manufacturing resources – labor and capital, and also on capitalization in agriculture. Therefore, the development of productive and competitive agriculture requires a fully functional agricultural land market.<sup>18</sup>

Taking into account that the current moratorium on purchase and sale of land is the major impediment to the introduction of a fully-fledged agricultural land market, an attempt was made in table 2 to summarize potential consequences of its cancellation or prolongation. Cancellation of the moratorium and introduction of a fully-fledged agricultural land market will facilitate prompt passage of required legislation and ensuring stable and legitimate land use, while prolongation of the moratorium would preserve the current situation with illegal alienation of land under shadow schemes and delayed creation of legislative framework, which was not passed by the Supreme Rada of Ukraine during five years after passing of the current Land Code of Ukraine. When agricultural land market functioning begins land value will start growing due to establishment of transparent schemes in this market. Of course, improved efficiency of agriculture will contribute to increased value of land as well. On the other hand, if the moratorium is continued, the growth of land value will be contained artificially, and peasants who decided to sell land under current shadow schemes will lose their income. Today several schemes are applied in Ukraine for alienation of agricultural land: by making lease contracts with buyout after moratorium cancellation; issuance of proxies authorizing other persons to alienate land; making preliminary contracts according to article 635 of Civil Code of Ukraine for transfer of right for land alienation for the future.<sup>19</sup> Also a scheme is becoming widespread of transferring commodity agricultural land to the category of land for individual farming. This is done because it is easier to transfer land for individual farming into other land categories, in particular, to take it out of agricultural land category and to use it for a different purpose, particularly for community development. This scheme became most widespread in Kyiv oblast, where cottages are actively constructed around Kyiv.<sup>20</sup>

The possibility of getting mortgage loans on the security of land parcels is also an element of agricultural land markets. It is unlikely that at the initial stage of agricultural land market

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<sup>18</sup> Agricultural land market in Ukraine. German Advisory Group on Economic Reform with the Ukrainian Government. – Q 4, July 2001.

<sup>19</sup> P.F.Kulynych. Regulation of agricultural land market: ideas and draft laws. Land law of Ukraine, № 3, 2006, p.41-42.

<sup>20</sup> Natalia Boguta, Svetlana Slesarchuk. Black soil in the black market Expert-Ukraina, № 10, October 16-22, 2006, p.58-64.



functioning this type of lending will become widespread, because only founders of agricultural enterprises and farmers as landowners will be able to pledge commodity agricultural land. There is approximately 5 million hectares of such land in Ukraine (table 1). However, mortgage lending on the security of agricultural land will develop rapidly and contribute to facilitate access to long-term credit resource in Ukrainian agriculture.

The agricultural land market will create conditions for concentration of land and creation of rational areas of land use, it will also facilitate rent growth in contrast to current small land properties and low land rent.<sup>21</sup> On the other hand, in a functioning land market people who wish to sell their land, in particular pensioners who are not able to cultivate it and have no heirs, will have an opportunity to get significant amounts to their family budgets. According to information of the State Committee of Ukraine for Land Resources, at the beginning of 2006 24 thousand people from this category have already died and their land was transferred to state ownership<sup>22</sup>. This can be hardly considered fair. Such unfairness will grow with each day of the moratorium. According to certain studies, 15% of landowners are single pensioners without heirs and 30% of landowners live in cities (usually they are legal successors (children) of peasants-landowners). On the whole, 52% of leased out land belong to pensioners (table 1). In addition, there is an increasing number of cases when people return their land shares to the state because they do not see the prospects of its further use. They claim that as landowners they do not get state subsidies for compensation of utility costs, they do not have money to receive land titles and nobody wants to lease their land. It should be noted that not all citizens who were entitled to get land certificates really got them, and the number of people who will get land titles is even smaller (table 1). Concentration of land in the hands of efficient landowners will ensure its higher productivity, efficiency and fertility. Increased levels of land value and rent will lead to creation of rational areas of landholdings including proprietary and leased land.

As a result, labor productivity in agriculture will increase, the total number of people working in the sector will be reduced and income levels of those who will continue working there will increase (farmers, wage earners, owners, managers and specialists working at large farms). Therefore, conditions will be created for increased revenues of those who remain working in the sector, emerging of middle class in rural areas and increased revenues of local budgets. On the other hand, it will be necessary to retrain work force that will be redundant in agriculture to work in other sectors, migration processes will be accelerated. However, it is not a negative phenomenon because in view of low level of economic activity of rural population and low level of rural economic development it is necessary to develop non-agricultural activities in rural areas. It has to be accompanied by appropriate institutional changes from village council to national level. If the moratorium on purchase and sale of agricultural land is prolonged it will preserve farming on rented land mostly, hidden unemployment in rural areas, small-scale commodity agricultural production, lack of institutional and structural changes in the sector, impeded development of non-agricultural activities, rural areas and local self-government. Another negative aspect of the moratorium is that the state does not control transactions with agricultural land, which leads to illegal seizure of land.

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<sup>21</sup> Agricultural land market in Ukraine. German Advisory Group on Economic Reform with the Ukrainian Government. – Q 4, July 2001.

<sup>22</sup> Pavlo Kulynych. The trap of land moratorium. Legal Weekly, № 2, August 3, 2006.

**Table 2**

Potential consequences of cancellation or prolongation of moratorium on purchase and sale of agricultural land

<b>Cancellation of moratorium and implementation of a fully-fledged agricultural land market</b>	<b>Prolongation of moratorium</b>
Accelerated enactment of necessary legislative acts and ensured stable and legitimate land use	Delayed enactment of necessary legislative acts, preservation of agricultural land black market and speculative land trading
Increased value of land and its capitalization	Low value of land and losses of peasants related to existing shadow schemes of land sales and low land price
Mortgage lending on the security of land is possible	Mortgage lending on the security of land is impossible
Concentration of land and creation of rational areas of land use, increased rent	Small agrarian property and large-scale land lease under low level of rent
Elderly people who have no heirs will have an opportunity to sell their land and get significant funds	Elderly people who have no heirs will not have an opportunity to sell their land and get significant funds
Increased productivity and efficiency of land use by efficient landowners	Farming will take place mostly on leased land, reduced soil fertility and humus loss
Reduced number of people working in agriculture due to increased labor productivity, creation of middle class in rural areas	Preserved hidden unemployment in rural areas and hindered transfer of peasants to other fields
Institutional and structural changes in agrarian sector	Conservation of existing agrarian structure
Stimulated development of non-agricultural activities in rural areas, rural economy on the whole and rural communities	Small-scale farming and stagnated development of rural economy and local self-government

At the same time it is necessary to take into account also potential threats that may emerge with the introduction of a fully-fledged agricultural land market and to apply appropriate measures to prevent these threats. The possibility of significant concentration of land with individuals or land holdings is one of such threats. Formally there is a provision in the Land Code of Ukraine, which is intended to prevent this threat and says that maximum area of agricultural land owned by individuals or legal entities may not exceed 100 hectares till January 1, 2010 (paragraph 13, section X of Interim Provisions). However, in our view it is necessary to have a permanent provision restricting the area of agricultural land in private ownership. The exact level of this restriction – 100, 500 or 1000 hectares or as percentage of land that can be owned by one person within a particular territory – has to be established for each region taking into account the area of land available in a particular region, because the level of land supply and the farming conditions are significantly different in, say, Transcarpathian and Kherson oblasts.

Another threat could be alienation of land by creditors in case when mortgage loans issued on the security of land parcels are not returned. However, international experience tells that in practice such cases are very few. Actually a bank does not need land, it just needs back the moneys that have been spent for lending on the security of land. This is possible only in case of efficient land use, i.e. by applying modern production and management technologies. Therefore banks will take lending decisions based on these particular factors of land use. Alienation of a land parcel and reselling it to a different legal or natural person is considered as an extreme case.

The list of threats may also include the loss of opportunity to receive income from land property in the future by people who will sell it and also potential losses related to increased value of land in the long run. Therefore peasants who own land have to be informed of these opportunities so that they take decisions on the basis of full information and in view of possible alternatives.

#### **4. Institutional and legal aspects of agricultural land market formation and functioning**

In order to complete the privatization process and to ensure normal functioning of land market in the future institutional framework of land market functioning needs to be developed in Ukraine which would determine institutional grounds of land trading and ownership. Essential aspects of this institutional program must be as follows: a) cadastral monitoring; b) planned use of land resources within the framework of respective legislation; c) registration of property rights in land; d) registration of pledges and other obligations related to land ownership; e) resolution of conflicts; and f) land mortgage.

Therefore, passing the laws of Ukraine "On State Land Cadastre" and "On Land Market" is urgent. Legislative framework that regulates land market in Ukraine consists of the Civil Code of Ukraine and the Land Code of Ukraine. This legislative framework is sufficient for functioning of non-agricultural land market. However, the issues of agricultural land market requires a separate legislative framework. This gap in the legislation must be filled by the laws of Ukraine "On State Land Cadastre" and "On Land Market". The purpose of the latter is to ensure, in the first place, the legal basis for initial alienation of agricultural land parcels, i.e. primary land market, and, accordingly, protection of peasant landowners' rights, and also to prevent high concentration and monopoly regarding agricultural land.

With regard to agreements in the land market it is necessary to distinguish between two important aspects – cadastre and registry of land parcels. The purpose of the cadastre is to provide description of physical characteristics of land parcels. It consists of map and registry of land parcels where these characteristics are recorded. Today methods of Geographic Information System (GIS) are used for cadastre keeping. A registry of land parcels is created for description of legal status of a land parcel. It means that former and current owners of a land parcel are recorded. Other rights are recorded as well, for example, the right to use a road passing through the land parcel. Pledges are also registered in the registry.

Information contained in one system may be reflected in the other. For instance, the owner of a land parcel may be mentioned in the cadastre but the registry remains the document that describes the legal status of a land parcel. The registry, in turn, may contain copies of maps and descriptive parts of the cadastre. However, it is the registry not the cadastre of land parcels that confirms property and other rights in land of a particular person.

The institutional framework of these two elements may have different forms depending on traditions and importance of certain constitutional and legal principles. However, the form of the land market institutional framework is not purely a legal issue, it has important economic consequences for rural development.

First of all, it is necessary to ensure efficient and transparent exchanges of ownership rights. In many countries with badly functioning institutional arrangements capital owners suffer from excessive bureaucracy. Opening new businesses, filing applications for credit or property sales always require involvement of large numbers of civil servants, paying bribes, which can sometimes reach annual wages and take a lot of time. Procedures and contracts in the land market and have to be as simple as possible to ensure land market functioning.

Guarantee and reliability of land ownership rights are other important aspects. If a landowner cannot prove (confirm) his right in a land parcel in a quick and reliable way it will be difficult for him to sell, to lease out or to use it as collateral. Lack of ownership rights' guarantee will lead to increased transaction costs in form of risk premium in course of contract making, which, in turn, will lead to reduced value of land. One of the reasons of imposing the moratorium on land sales was that Ukrainian politicians were concerned about low prices of land. Insufficient level of checks and balances between constitutional branches of power in the area of land relations will lead to lack of guarantees, especially in a country like Ukraine where executive branch of power was traditionally quite strong. If the state is a broker and a landowner at the same time as a result of conflict of interest property rights will be unreliable in the absence of control from judicial structures.

While on one hand the system will be the most efficient if monitoring of land relations is performed by one organization, on the other hand guarantee and reliability of ownership right are assured better if several constitutional bodies are involved. However, compromise can be found if we take into account that checks and balances require not direct interference of all constitutional bodies but require just mutual control. And, finally, guaranteed right of individuals to challenge administrative decisions in the court on equitable basis is an efficient way of exercising control over misuse of authority.<sup>23</sup>

After enactment of the new Land Code of Ukraine at the end of 2001 disputes occurred between the Ministry of Justice and the State Committee of Ukraine for Land Resources as to which entity will do registration of property rights in land. These discussions never ended during the last several years.<sup>24</sup> On the one hand, advantages of having a single body doing cadastre and registration were demonstrated, on the other hand this approach was criticized and proposals were made to share these functions between two organizations. In 2006 the Cabinet of Ministers of Ukraine issued two resolutions: "On separation of land cadastre keeping functions from functions of state registry of rights in land and non-land property" dated 16.05.06 and "On transfer of integral property complex of state enterprise "State land cadastre center" under the State Committee of Ukraine for Land Resources to the Ministry of Justice" dated 26.05.06 # 295-p. However, implementation of these resolutions requires amendments to the Law of Ukraine "On State Registry of Property Rights in Real Estate and their Restrictions" in part of assigning functions of the state registry to the Ministry of Justice.

## Conclusions

1. Agricultural land market is a necessary attribute of market relations and a mean for improving efficiency of agriculture. This is proven by many years of agrarian development in many countries. Agrarian and land reform implemented in Ukraine at the end of the XX century, which became a logical phase of agrarian development, was conducted specifically for the purpose of improved land use, increasing its fertility and productivity. That is why emergence of a fully functional agricultural land market has to be a logical conclusion of land reform
2. Moratorium on agricultural land sales in Ukraine is based on political rather than economic reasons. From an economic standpoint the moratorium is harmful. It does not prevent agricultural land trading but creates shadow markets. As a result losses are incurred by: peasants-landowners who get much lower price for their land compared to open market conditions; state in person of local authorities and local budgets from non-paid taxes on agricultural land transactions; agricultural producers and agrarian production on the whole because it is not possible to include land into economic turnover and get mortgage loans; and peasants-landowners who rent it out and receive below market land leasing prices.
3. In the absence of transparent agricultural land market several schemes exist in Ukraine for shadow alienation of agricultural land: by making lease contracts with buyout after moratorium cancellation; issuance of proxies authorizing other persons to alienate land; making preliminary contracts according to article 635 of Civil Code of Ukraine for transfer of right for land alienation for the future. Also a scheme is becoming widespread of transferring commodity agricultural land to the category of land

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<sup>23</sup> Institutional aspects of land market development in Ukraine. Institute for Economic Research and Policy Consulting, German Advisory Group on Economic Reform with the Ukrainian Government. — T. December 17, 2003.

<sup>24</sup> Institutional aspects of land market development in Ukraine. Institute for Economic Research and Policy Consulting, German Advisory Group on Economic Reform with the Ukrainian Government. — T. December 17, 2003; S. Demianenko. Agricultural land market in Ukraine. William Meyers, Sergiy Demianenko, Thomas Johnson, Sergiy Zoria «Changed focus of agrarian policy and rural development in Ukraine: conclusions and progression outlooks". — K.: KNEU, 2005, p.70.

for individual farming. This is done because it is easier to transfer land for individual farming into other land categories, in particular, to take it out of agricultural land category and to use for a different purpose, particularly for community development and construction.

4. The moratorium on purchase and sale of agricultural land is in violation of constitutional rights of peasants-landowners to dispose of their land freely. There is an increasing number of pensioners who had no heirs and died and their land was transferred to state ownership. The share of this category of peasants-landowners is 15%. There are increasing number of cases when people return their land shares to the state because they do not see the prospects of its further use. They explain in particular that as landowners they do not get state subsidies for compensation of utility costs, they have no money to receive land titles and nobody wants to lease their land.
5. Agricultural land leasing is an important market element. Farms rent over 88% of land that they cultivate. However, in the absence of a fully functional agricultural land market the level of rent is low reaching about UAH 114 per hectare. Only 14% of this amount is paid in cash and other 86% is paid in kind and services. The low level of rent leads to understated land prices. Besides, certain parts of agricultural land are not used at all because there is no lessee demand. Another extreme is lessees that rent dozens of thousands hectares of land all over Ukraine. It hampers the development of farming as farmers cannot compete with large corporate lessees.
6. In parallel with the cancellation of the moratorium on purchase and sale of agricultural land the development of the institutional and legal framework for land market regulation needs to be continued. Passing the laws of Ukraine "On State Land Cadastre" and "On Land Market" is urgent. The purpose of the latter is to ensure, in the first place, the legal basis for initial alienation of agricultural land parcels, i.e. primary land market, and, accordingly, protection of peasant landowners' rights, and also to prevent high concentration and monopolies.
7. The state must ensure: establishment of a unified system for registration of ownership rights in land and legal unity of land parcel and buildings, constructions and plantations located on it; monitoring of land cadastre; access to electronic information about land available for rent and sale for all who wish to get this information. Besides, the state must facilitate the creation of a system for monitoring and control of land use, particularly soil composition and fertility before and after the term of lease, exercised by state and private laboratories. Efforts of the state, judicial system, politicians and NGOs need to be focused on compliance with current land legislation, namely Constitution of Ukraine, Land Code, law of Ukraine and other regulatory documents.

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