

September 2016

Assessment of the Consequences of Lifting the Land Moratorium in Ukraine

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The Land of Ukraine

Agricultural land is the greatest asset of Ukraine, currently contributing 45% to Ukrainian exports and 12% of GDP (as much as manufacturing). The country has more than 60 million hectares of land, of which some 42 million (or 70%) is agricultural land. About 11 million hectares of the agricultural land (about 26%) are owned by the government. Of Ukraine's 42 million hectares of agricultural land, about 34 million hectares are arable land, 5 million hectares are pastures, 2 million hectares are mowing meadows, and about 1 million hectares are perennials. Ukraine also has one-third of the world's richest black soil (chernozem), making Ukraine the leader on high-quality fertile soil. Black soil covers about 65% of agricultural land. By way of comparison, France, the largest agricultural country in the EU, has 29 million hectares of agricultural land.

Who Owns the Land

In the 1990s, about 28 million hectares of agricultural land were owned by agricultural collective farms. At the end of the decade, in 1999, these agricultural collective farms were "privatized", with their agricultural land transferred to seven million farmers that were working at the collective farms at the time. Each farmer obtained the equivalent to around four hectares of land. Today, about half of these new land owners, possessing about 14 million hectares, are pensioners who lease their land to private agro-firms. Of this amount, about 6 million hectares are leased by large agro-holdings with an average area of about 75,000 ha.

The Introduction of the Land Moratorium

In 2001, the Ukrainian Rada extended the moratorium (ban) on the sale of agricultural land to the new private lands, a moratorium that had been in place since 1992 for cooperatives. The moratorium was considered necessary to permit the development of the legislative framework for the proper functioning of a land market for the smooth sale of land, including a proper cadastral system. The moratorium was periodically extended and currently it will expire on January 1, 2017.

Consequences of Lifting the Land Moratorium

Over the short/Medium Term

There is broad agreement that lifting of the moratorium would be highly disruptive for the agricultural sector over the short/medium term (3 to 5 years), with major losses in investments and in exports. About 14 million hectares are currently under cultivation by private firms that are leasing their land. These firms have invested an average of about \$200/ha to \$500/ha to acquire the leasing rights. In addition, they have spent about \$500/ha to \$1,000/ha for capital investments (improvements and farm

equipment) and \$300/ha to \$600/ha for working capital. Therefore, on their total rented land, agro-firms have already invested from \$14 billion to \$33 billion into their total rented land. In addition, the agro-firms pay about \$700 million to \$1.6 billion of rental payments per year to land owners (at an average rent of \$50/ha to \$120/ha).

The maturity term of these leases varies from leases that are currently expiring to leases that are about 10 years long; but under the moratorium, there was the expectation that these leases would be renewed. If the moratorium is lifted, the possibility of litigations with land owners that may wish to sell their land would create great uncertainties for those firms that are not envisaging buying land. Furthermore, the current inadequacies in the land registration and cadastral systems would encourage fraudulent transactions and disputes. These uncertainties will affect investments by current agro-firms and international investors. This would lead to an immediate decline in production and exports. The impact on the economy would be substantial as agriculture today accounts for 45% of Ukrainian exports. Therefore over the short/medium term, lifting of the moratorium would have highly negative economic effects.

Over the short term, there may also be negative political effects. Given the current military situation with Russia and declined living standards, a good portion of the population may become over-excited by the possibility that Ukraine's land may fall into the wrong hands, particularly of Russia's cronies. In fact, recent surveys suggest that a majority of Ukrainians are against lifting the moratorium at this stage. Populists may take advantage of these feelings. This may lead to another round of street protests and civil disorder, events that the country cannot afford to have at this time. The European orientation of Ukraine towards democratic and free market values will be questioned. The country will be divided. As a result, an even more weakened state might be converted into an easy “trophy” for Russia.

Over the Longer term

Over the longer term (over five years), the short/medium term disruptions may ameliorate and lifting of the moratorium is expected to have beneficial effects. In particular, the possibility of acquiring ownership may attract international investors. They would bring larger investments to improve the land and improve farm efficiency, which today few agro-firms undertake. This should increase production and exports.

For this possibility to be realized, the investment climate of Ukraine will need to be significantly improved. Without these improvements, no serious international investor would be able to justify making investment in Ukraine. In particular the level of corruption will need to be brought to the levels observed in Eastern Europe. Furthermore, the judiciary will need to work effectively to deliver unbiased judgment and enforce the validity of contracts. Moreover, the risks associated with a military confrontation with Russia should have been reduced significantly. But all these changes will require several years. In the meantime, investors will take a wait-and-see attitude.

Over the long term, there are also significant negative effects from early lifting of the land moratorium. Considering today's conditions, the country cannot expect to attract serious international investors. On the other hand, according to several estimates, today, the country has about \$50 bln to \$80 bln that are placed within Ukraine but outside the banking sector. Possibly as much as \$10 bln to \$30 bln out of that is held by working class Ukrainians who lost confidence in the banking sector and who maintain these savings for day-to-day expenses and emergencies. But about \$40 bln to \$50 bln of these extra-bank funds are likely to be held by people who obtained these resources illegally (including members of the former Yanukovich administration). These people may not have been able to legalize their illegal funds and transfer them abroad. The sale of land would provide a unique opportunity to these people to

"launder" this money. Lifting the moratorium could potentially lead to an enormous money laundering operation in Ukraine, allowing criminal elements to convert their ill-gotten wealth into Ukrainian land.

Even more damaging for the country, the new owners of these lands would have little inclination to make further investments and increase agricultural output, as happened in the 1990's post privatization of collective farms. Without agricultural knowledge and inclination, a large portion of the land will lose efficiency or be idle. With absence of a strong law enforcement and widespread corruption in Ukraine, it is not difficult to assume that crop rotation patterns will not be respected. Land erosion might increase dramatically. At the end, portions of the previously high quality land will be taken out from use. Agricultural output and exports would decline over the long term.

With Lifting of the Moratorium, the Small Land Owners will Lose

The likelihood that criminal elements may indeed take advantage to launder money under the liberalization of the land market is quite high. In fact, they may become the main beneficiaries of lifting of the moratorium. The current land owners may be the real losers over the medium/long term.

From surveys, it seems that a large number of small land owners may be inclined to sell their land for minimum prices that may amount to \$300/ha to \$1,000/ha. The expectation to receive from \$1,200 to \$4,000 for their four-hectare plots may be too high to resist. This temptation would be even stronger given the major decline in living standards during the last two years, the increase in unemployment and the degree of economic uncertainties. But this money would be used quickly and these people will have no assets for their future. If they were to wait a few years until the business environment is improved, they will be able to sell their land at prices several times higher, comparable to Poland at \$11,000/ha, or \$6,000/ha as in Romania, or \$4,000/ha as in Hungary. In its own estimates, the government is assuming that land prices will indeed be very low. With the announcement of the intention to sell about 11 million ha of state land, the average price assumed by the government is \$270/ha. Furthermore, according to agricultural experts, illegal land sales are already taking place at prices ranging from \$500/ha to \$700/ha. The organizations of agricultural producers estimate that 10-15% of the land owners are ready to sell their land at any moment.

Conclusions

It is clear from the above that the country should wait until the investment climate and the anti-corruption fight has advanced to the level required to attract serious international investors. An appropriate legal framework for land sale should be in place as well as a well-functioning cadastral service. The overall business environment should be more attractive. This will avoid the likelihood that the wrong class of owners may merge in the short term if the moratorium is lifted prematurely.

Furthermore, there should be a thorough analysis of the possibility of maintaining the land moratorium on an indefinite basis while improving the legal framework for land leasing. Land leasing has important advantages. It facilitates the formation of agricultural enterprises since investors will not need to invest in the purchase of agricultural land. It also makes it easier for firms to leave the market if conditions were to deteriorate. These advantages would lead to increases in investments and growth in production and exports. A number of countries do not permit the sale of agricultural land, such as France and the Western USA, and only lease the land for long terms of up to 50 years. This is an option that Ukraine must consider.