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NEWSLETTER

German Economic Team

UKRAINE

Land market: how much light do we see at the end?

In March 2020, the Ukrainian Parliament made a revolutionary step and brought to the end the 20-year long moratorium on agricultural land sales. The Law on Amendments to Legislative Acts on Turnover of Agricultural Land (552-IX) was finally adopted. Ukraine effectively completes the land reform, which transformed the Soviet-era state land into truly private property with all corresponding rights. Despite the importance of this step, we keep hearing voices from both sides of the land reform camp that the adopted law will make no good to Ukraine. To assess if such statements have any justice, we highlight the key features of the law, the benefits and losses to the key stakeholders and steps that remain to be taken to realize the full potential of the agricultural land as a driver of sustainable growth in Ukraine.

Who is affected by the land reform?

In Newsletter No. 108 we have outlined that the moratorium has affected about 40m ha (93%) of agricultural land, currently in ownership of 7m private individuals (16% of Ukrainian population) and of the state. The reform affects also renters of agricultural land (primarily medium and large-scale producers), users of state land, local governments, financial sector, speculative investors, land surveyors and related service providers, and several others including political parties supporting these groups. Often, we hear analysis of the law reflecting the position of only few of the above stakeholders. This note is an attempt to bridge this gap.

What does the law offer?

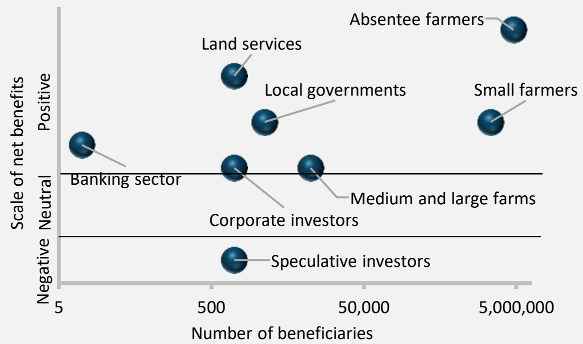
The key points are that the law lifts the restrictions on land sales starting July 2021, and defines that the owners of agricultural land in Ukraine could be individuals, legal entities, local communities and the state. From the legal perspective, the law restores the constitutional rights of private land owners to dispose of their property and responds to corresponding decisions by the European Court of Human Rights. However, the law also defines several important restrictions to the land turnover. The key restrictions are:

- Only Ukrainian citizens and legal entities owned exclusively by Ukrainian citizens can keep land in ownership. This restriction on foreign ownership can be lifted only by a national referendum;
- Banks can acquire land in the process of foreclosure but have to dispose of it within two years;
- The maximum size owned by one person, including via legal entities, cannot be more than 10,000 ha;
- State and communal land cannot be sold;
- Minimum prices are established at the level of normative valuation until 2030;
- The transition period until January 2024 forbids legal entities to participate in the market and caps the size of landownership at 100 ha per person.

Who benefits and who loses from the law?

About 2.5m ***individual owners*** ("odnoosibnyky") and about 25,000 ***small farmers*** (under 100 ha) who jointly ***cultivate*** close to 10m ha of their own private land would be the net beneficiaries of the reform as it may improve access to finance, increase their land holdings, and increase the value of their assets (both land and non-land), investments and productivity. They will also have to increase transparency, as they need to improve their accounting practices to access bank credits and to participate in land transactions. The above restrictions provide this group with a breathing space to improve their practices before the competition with larger farmers starts in 2024.

Short-run effect of land market in Ukraine



Source: Author's estimations

About 4.6m ***individual owners (absentee farmers),*** who jointly possess 16-18m ha and rent their land out or keep it idle will also benefit. The majority of this group are elderly former members of collective farms or their heirs. This group is the largest net beneficiary as they will face a gradual increase in rental revenue driven by higher competition and productivity growth in the sector as well as an increase in the value of assets. They will also be able to dispose of land and cash the value of rental revenue stream. The restrictions, imposed by the law, would slow down an appreciation of land prices, and introduce the risk that the circulation of pre-emptive rights (introduced by law) would shift the market benefits from owners to renters after 2024.

About 10,000 ***medium and large agricultural producers,*** who cultivate about 18m ha of rented land will face an increase in production cost. Moreover, less productive farmers will have to leave the sector leading to an increase in allocative efficiency in the sector.

At the same time, the reform will increase transparency, decrease institutional risk, increase the value of assets and, thus, increase investment attractiveness, which, in turn, would further increase the productivity in the sector. The legal restrictions will have a negative effect on this group as they will not be able to participate in the market while the initial prices are low. Instead, they will have to wait with their investment decisions and are likely to get involved with land transactions via proxies before 2024.

The **banking sector** is likely to be a net beneficiary. Land market opens up a large segment of potential clients, who possess land assets worth at least USD 59bn with an expected increase in the value during the next 3-5 years to about 100bn USD. This is a considerable amount, compared to the total value of productive assets in Ukraine at ca. USD 300bn in 2018. This makes land an attractive collateral. It also creates opportunity for new mortgage products and land-based finance for small farmers. These restrictions, however, slow down this development as the most attractive clients – legal entities – will be banned from the market until 2024. On the other hand, this delay may stimulate development of innovative products for small farmers, although normative land prices may establish a barrier for disposal of collateral.

Speculative investors are likely to find the current design less attractive for large-scale operations as the temporary ban for legal entities, the low cap on land ownership and minimum prices will decrease the margins. This lack of speculative demand would slow down the price growth and liquidity of land assets, but will make the agricultural sector less vulnerable to price bubbles and overpaying for land assets.

Corporate investors (domestic and international) are likely to respond positively to the reduction in institutional uncertainty, which would open opportunity for investments in capital-intensive high value-added production and processing. However, the constraints on foreign ownership would limit this opportunity and lead to some creative corporate structures to overcome this limitation.

Local governments are also among the net beneficiaries as the development of small farming and investments in other sectors would create new jobs in rural areas. Higher land prices would also increase budget revenue, subject to changes in normative valuation and taxation of land and agricultural sector. However, the ban on sales of state and communal land effectively preserves corruption and inefficiency in land privatization schemes and in the use of about 10m ha of state and communal land.

Land developers, land surveyors, notaries, valuators and other support services will clearly see a significant increase in demand both for securing the existing rights of landowners and users, and supporting new transactions (around 1m transactions p.a.). There will also be a demand for land consolidation and other spatial planning projects, particularly in light of recent deregulation and upgrading of land governance.

Outlook: key steps to increase the benefits

Despite the broad range of beneficiaries of the adopted land market law, its effect can be augmented by restricting concentration of land ownership at the level of amalgamated communities to prevent local land monopolies, adopting the law on partial credit guarantee and establishing the guarantee agency, which would absorb the risks of loans to small producers at the stage of establishment of land-based finance. Moreover, by providing for registration and publication of land prices, the development of a mortgage market and the upgrading the normative valuation can be supported. To sum up, the largest beneficiaries of land market in Ukraine in the short-run are 7m owners, who were previously discriminated against. In turn, a transparent market of agricultural land will affect economic growth in the long-run, from establishing marketable land assets as well as improving allocative efficiency and access to finance. Current restrictions slow down this process, but only marginally. Instead, it provides time to establish market infrastructure and price discovery and equalize access to credits for small producers.

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