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POLICY BRIEF SERIES

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Can Farmland Market Liberalization Help Ukraine in its Reconstruction and Recovery?

The Russian full-scale invasion of Ukraine has inflicted massive damages and losses on Ukraine, already amounting to more than 2.5 times Ukraine's 2023 GDP. Despite substantial and continuing international political and financial support to help Ukraine in its recovery and reconstruction, it is becoming increasingly clear that it will need to mobilize its own resources and private financing as well – not just for the country's reconstruction but also for its long-term development. From a government perspective, it is important for Ukraine to leverage scarce public and donor resources and to undertake necessary reforms to facilitate and crowd in private financing. Farmland market liberalization is one of the key reforms in this respect. Its scale, with farmland accounting for more than 70 percent of Ukraine's territory, and capacity for private financing generation for agriculture and rural areas, is, however, often underestimated.

An Unbearable War Toll and the Need for Private Financing

The raging Russian war on Ukraine enters its third year, imposing an immense toll in terms of human life, economic stability, and regional security. About 20 percent of Ukraine's territory has been occupied. More than 10 million Ukrainians have left their homes, including 6.45 million refugees that have resettled across Europe (UNHCR, 2024). Ukraine's military casualties are reported to be approaching 200,000 (The New York Times, 2023) and at least 10,000 civilians have been killed (United Nations, 2023). Ukraine's GDP plunged by 30 percent in 2022, and the documented total damages to Ukraine's economy have reached US$ 155 billion, as of January 2024 (KSE, 2024). Similarly, economic losses amount to around US$ 500 billion (as of December 2023). At the same time Ukraine's reconstruction and recovery needs are estimated at about US$ 486 billion (World Bank, 2024). This immense number make up more than 2.5 times Ukraine's 2023 GDP.

While there is a substantial and continuing international political and financial support for Ukraine's defense, recovery, and reconstruction, this will not be enough (World Bank, 2023). Ukraine needs to mobilize its own resources and private financing, not just for its reconstruction but also for its long-term development. The Ukrainian government must leverage scarce public and donor resources and undertake necessary reforms to facilitate and crowd in private investments. One of the crucial reforms in this regard is the ongoing liberalization of the farmland market. The scale of its impact and capacity to generate private financing for agriculture and rural areas is frequently undervalued.

Ukraine's Farmland Market and Reform

Almost 71 percent of Ukraine's territory (or 42.7 million ha, including occupied territories) is farmland and 33 million ha is arable. This is far more than in the largest countries in the EU. Ukraine also has one-third of the world's most fertile black soils. This resource has however been heavily underutilized for agricultural and overall economic development (KSE, 2021). Over the last two decades, Ukraine has turned into an increasingly important global supplier of staple foods (von Cramon-Taubadel and Nivievskyi, 2023), but this has largely happened without a full-fledged farmland market in Ukraine capable of facilitating even further agricultural productivity growth.

The farmland sales market was virtually non-existent for over three decades, instead rental transactions dominated. The farmland sales market began operating only in July 2021, and in a very limited format. Only individuals could purchase farmland plots and with a 100-ha cap per person. The minimum price was set at the normative monetary land value, and tenants had pre-emptive purchase rights while foreigners and legal entities were excluded; state and communal farmland remained under the 2001 sales ban. The farmland sales market opening was part of a large-scale land reform to support an efficient and transparent farmland market. This included a legislation package aimed at preventing land raiding, decentralizing land management, introducing electronic land auctions, establishing tools for land planning and use, creating a national infrastructure for geospatial data, establishing institutions for supporting small scale farmers, and empowering small scale farmers capacity to compete for land (KSE, 2021).

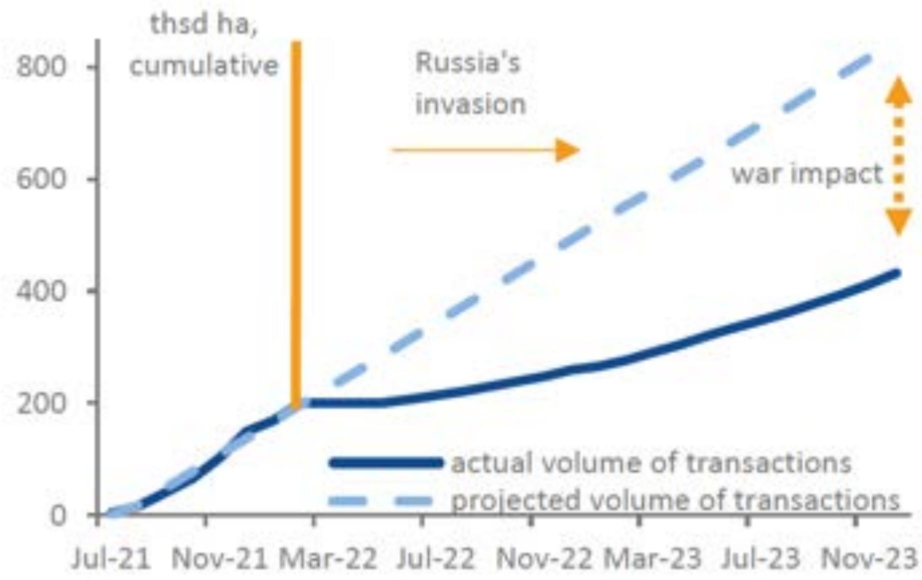
In general, there are two broad benefits of sales and lease transactions. First, the farmland market, via transactions, sorts out more efficient farms from less efficient ones, thus increasing the overall sector value added. Another important benefit, specifically linked to the farmland sales market, is that a functioning farmland sales market makes farmland a collateral which can generate productive investments in increased agricultural and non-agricultural productivity growth (Deininger and Nivievskyi, 2019).

Early Reform Outcomes

Almost two out of the first two and a half years of the reform phase unfolded amidst the profound shock from Russia's full-scale invasion of Ukraine. Following this, nearly 20 percent of Ukraine's farmland has been occupied (Mkrtchian and Mueller, 2024), almost a third of the agricultural sector has been ruined – the total damages and losses to the agricultural sector amount to US$ 80 billion (Neyter at al., 2024). As a result, a very restrictive first-phase format of the market, on top of the war challenges, effectively limited the expected benefits of the market liberalization.

The war has put a sizable drag on the farm-land sales market development, effectively slashing the transacted volume almost by half (see Figure 1).

Figure 1. Cumulative market transactions and the effect of the war.



Source: Nivievskyi and Neyter, 2024.

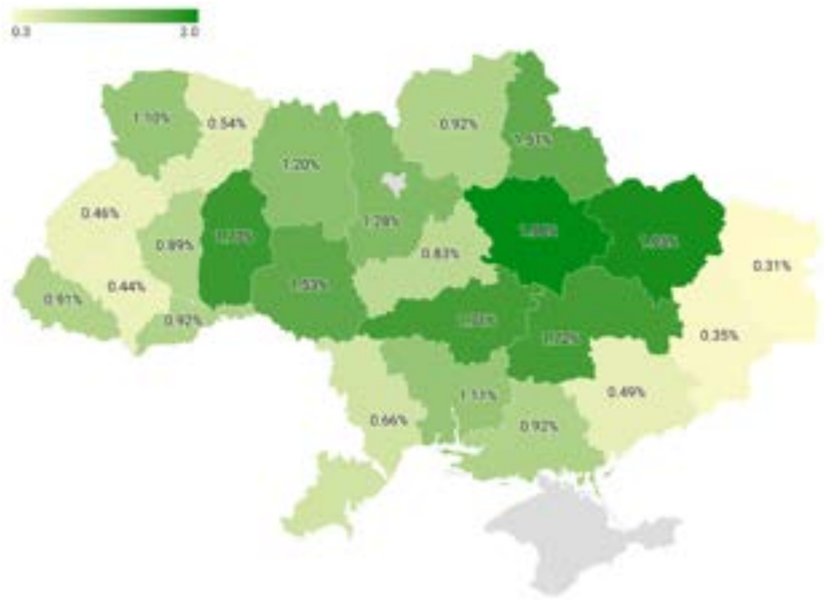
Overall, about 1.1 percent of total farmland area, or about 1.3 percent of Ukraine's total controlled farmland (equivalent of 200,000 sales transactions or 444,300 ha) has been traded since the opening of the market. Regionally, the outcome is quite diverse (see Figure 2).

This is nonetheless an encouraging outcome as it is quite comparable to developed countries benchmarks where, on average, roughly 1 percent (and up to 5 percent) of the total agricultural land area is transacted annually (Nivievskyi et al., 2016). Another important outcome is that the transacted farmland has remained in agricultural production.

Farmland price development is also positive, especially for commercial farmland (see Figure 3). Since the commencement of the farmland sales market in Ukraine, the capitalization has increased by US$ 5.5 billion (KSE Agrocenter, 2024).

In fact, farmland market capitalization might be even greater. There are indications that the actual market price should be much higher, on average, than the officially registered one, as transacting parties may try and evade fees and taxes (Nivievskyi and Neyter, 2024).

Figure 2. Transacted area as share of total oblast (administrative region) area.



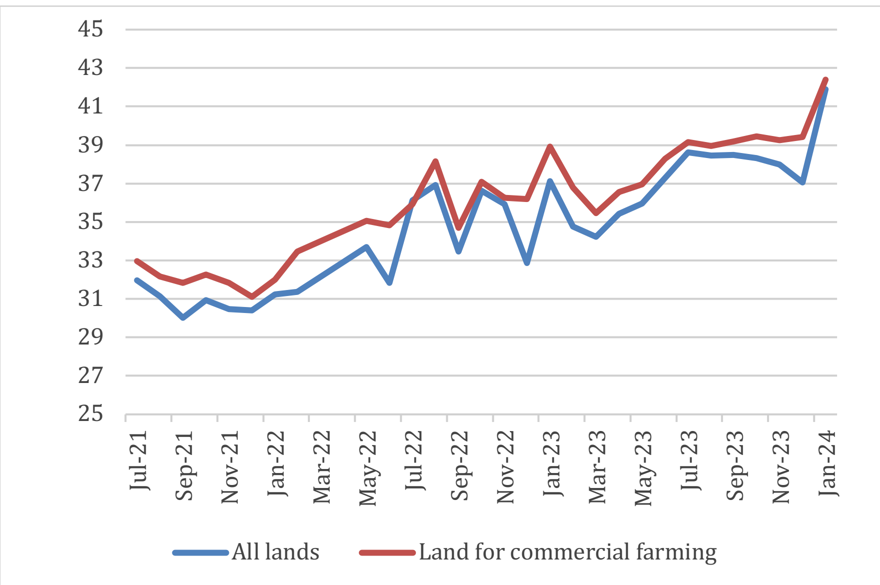
Source: The Center for Food and Land Use Research at Kyiv School of Economics (KSE Agrocenter), 2024.

Continued Farmland Market Liberalization and Associated Expectations

As of January 1, 2024, legal entities gained the right to acquire farmland that had, from 2001, been under sales ban. Also, in this second stage, the farmland accumulation cap per beneficiary increased to 10,000 hectares. Other restrictions remain, including that legal entities with a foreign beneficiary still cannot purchase farmland.

The first results of the second stage are premature, and firm conclusions cannot be drawn, yet the preliminary results are quite encouraging. The new market participants have already increased the volume of transactions and corresponding price by 13 percent, on average (see Figure 3).

Figure 3. Average farmland prices, in thousands UAH.



Source: KSE Agrocenter (2024). Note: Demonstration and estimations are based on the State GeoCadaster Data.

Another encouraging result highlights that legal entities bring further transparency into the market. For half of the transactions involving individuals, the sales price did not exceed the minimum price by more than 1.5 percent, while in half of the farmland transactions with legal entities, the price exceeded the minimum one by more than 44 percent.

These early results provide insight into the market's direction and the associated benefits. The expected economic benefits from liberalizing the farmland market for legal entities could amount to an annual increase of 1-2.7 percent of GDP over the next three years. The scale depends on many factors, including the availability of financing and financial support for small farmers (KSE Agrocenter, 2023).

Rural and agricultural financing is of particular interest as land is generally considered a high-quality collateral which could be utilized to attract loans and investments. This is particularly important during the current wartime period, as agricultural producers are facing significant collateral damage and severe financial difficulties for the third consecutive year. Currently, despite its potential, only a meager share of all farming loans is secured by farmland – far below global benchmarks.

Under current registered farmland prices, the total farmland market capitalization is equivalent to roughly US$ 35.5 billion. This could potentially generate an additional US$ 12.4 billion of loans (under the current low liquidity risk ratio of 0.35), already much greater than the current agricultural debt of about US$ 3.5 billion. Adding legal entities to the pool of farmland buyers (as of January 2024), is expected to increase farmland prices by an additional 40 percent. Thus, the farmland market will grow to almost US$ 50 billion, and the volume of land-secured financing could amount to US$ 17.5 billion. Further liberalization of the farmland market, such as a strengthening of its transparency, boosting the market liquidity, and accumulating necessary market statistics, may allow the National Bank of Ukraine to reconsider the liquidity risk ratio for farmland – potentially considering it as collateral similar to other types of real-estate (see the National Bank of Ukraine Resolution #351, June 30, 2016). A liquidity risk ratio at the level of developed countries (0.6-0.8) could further increase the volume of potential land-secured financing available to agriculture and rural areas/landowners to at least US$ 35 billion. This would, in turn, close the more than US$ 20 billion current financing gap for agricultural reconstruction, recovery and development. It would also contribute to Ukraine's nearly US$ 500 billion reconstruction and recovery needs.

Further significant strides toward liberalizing Ukraine's farmland sales market are anticipated as part of the country's journey towards EU membership (European Commission, 2024), aligning with Chapter 4 'Free Movement of Capital'. Specifically, this pertains to allowing foreigners (EU citizens and legal entities) the right to purchase Ukrainian farmland (Nivievskyi and Neyter, 2024).

Conclusion

Russia's full-scale invasion of Ukraine have inflicted massive damages and losses to Ukraine, already amounting to more than 2.5 times Ukraine's 2023 GDP. The recently estimated reconstruction and recovery needs measure at nearly US$ 500 billion. This is an unbearable burden for Ukraine alone. Despite substantial and continuing support from international partners and donors, Ukraine will need to heavily draw on its own resources and capacity to generate private financing, not just for the country's reconstruction, but also for its long-term development. It is therefore essential, from the Ukrainians government's perspective, to focus on necessary reforms and optimize policy decisions to leverage the scarce public and donor resources and facilitate and crowd in private investments. Continued farmland market liberalization is one such critical reform, providing hope to generate substantial private investment in the agricultural sector and rural areas.

The size of the farmland market is immense (with farmland accounting for more than 70 percent of Ukraine's territory). The first two years following the opening of the farmland sales market demonstrate a substantial potential for private financing generation for agriculture and rural areas. The results from regular market monitoring and the early findings, as discussed above, suggest that further farmland market liberalization and increased transparency could generate about US$ 35 billion of financing for agricultural producers and rural areas/landowners. That could, in turn, close the current agricultural financing gap of more than US$ 20 billion for rebuilding and recovery, as well as partially close the nearly US$ 500 billion financing gap for Ukraine's overall reconstruction and recovery. The expected economic benefits from liberalizing the farmland market for legal entities are estimated at 1-2.7 percent of GDP annually, over the next three years. A further liberalization of the farmland market, and a step towards EU membership, would include granting foreigners (EU citizens and legal entities) the right to buy Ukrainian farmland – expected to bring even further benefits.

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