

INSTITUTIONAL BASIS FOR DEVELOPMENT OF INVESTMENT PROCESSES IN AGRARIAN ECONOMY OF UKRAINE

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Abstract. The state of investment processes in agriculture was studied; the structural shifts and priority trends of investments were analyzed. The influence of the institutions was substantiated on the development of the investment policy, formation of investment processes. The influence of formal institutions (legal regulations for the 'rules of play') was assessed on the investment efficiency. The role of the formal institutions was identified in the investment success of the big agricultural business of Ukraine. The main causes of the low investment attractiveness of small and medium-sized business in the agrarian sector of the Ukrainian economy were defined – a limited and inefficient use of budget funds, weak market and investment maturity of non-formal institutions. The state of the non-formal institutions (sociocultural, psychological type of the Ukrainian peasantry) was identified as the main reason of the small and medium-sized business lag compared to the investment achievements of the agricultural holdings. The ways of development for the non-formal institutions were substantiated from the experience and examples of Poland and other developed countries. It was accentuated that asset capitalization of the small and medium-sized companies would be important for development of the investment processes in Ukraine.

Key words: investment processes, investment policy, investment attractiveness, state investment support, investment trends, institutional theory

INTRODUCTION WITH JUSTIFICATION OF THE TAKEN RESEARCH

Successful development of the Ukrainian economy, its agro-industrial segment requires a large-scale and efficient investment provision and favourable investment climate. Domestic investment sources and credit possibilities in Ukraine are insufficient to satisfy the investment potential of agriculture and processing industry. At the same time foreign investments (even including the investments of the Ukrainian business from offshore zones) are attracted in limited volumes, and their share in total investments is for the time being insignificant.

Increase in investment volume and quality determines the course for broad integration in the world, and especially European economic space, which formulates a new vector in the development of the investment processes of Ukraine. The base for the new stage of the investment processes consists now in developing the national institutions and institutional environment up to the level of Europe, USA, Japan and other developed countries.

No doubt, the conditions which ensure investment attractiveness of the agro-industrial sector depend on the economic potential of the branch, its specific companies, infrastructure, market, taxation and other factors. However western investors are not less concerned also about sociocultural psychological types of the local population, level and trends of transaction costs and a number of other aspects which are studied and treated in terms of fundamentals of the institutional economic theory.

ANALYSIS OF THE LATEST STUDIES AND PUBLICATIONS

A significant contribution to investigation of the investment provision problems in the agrarian economy of Ukraine belongs to the scientists including V.H. Andriichuk, P.I. Haidutskyi, M.Ya. Demianenko, I.H. Kyrylenko, M.I. Kisil, Yu.O. Lupenko. Valuable for the domestic scientists are the studies of Polish colleagues – Wasilewski and other. However, influence of the structural changes in capital accumulation on the agricultural development needs further investigation. Not of lower importance is the study of the theoretical fundamentals underlying the investment process development in Ukraine in view of the western standards and changing trends of the domestic institutions.

GOAL OF THE STUDY

Goal of the study is assessment of the Ukrainian economy agro-food sector investment attractiveness and scientific identification of the institutional basis for further development of the investment processes under conditions of integration into Europe.



RESULTS

During the recent years the investment processes in the agrarian sphere of Ukraine are being noticeably updated. The volumes of the capital investments in agriculture in 2010–2013 increased by about 1.6 times compared to 2010 and in 2013 amounted to UAH 18.6 billion (nearly 2.3 billion US Dollars) – Table 1.

TABLE 1. Capital investments in economy and branches of agro-industrial production of Ukraine in 2010–2013(in actual prices)

Item	Year							
	2010		2011		2012		2013	
	UAH million	% from total volume						
Total in Ukraine*	189061,0	100,0	259932,3	100,0	293691,9	100,0	267728,0	100,0
Including: Agriculture, hunting and relevant services	11311,3	6,0	16702,7	6,4	19085,7	6,5	18639,7	7,0
Food industry	8297,0	4,4	12144,0	4,7	11366,3	3,9	12821,2	4,8

*Without VAT, Report on capital investments per types of economic activities (for relevant years).

Source: State Statistics Committee of Ukraine.

In addition the volumes of direct foreign investments nearly doubled in 2013 compared to 2011. In 2012 it appeared possible to stop the capital outflow due to the world financial crisis. About 60% of foreign investments in agriculture are used for development of export-oriented products such as grain, sunflower seeds, rape and soya. Nevertheless, the growth of foreign investments in the agro-food sector is still insignificant (Figure 1).

It did not appear possible to fully overcome the consequences of the financial crisis. One of the reasons was that the investors had an 'internal' feeling of uncertainty due to coming institutional changes. Through inertia, nearly three fourths of the capital investments are developed in crop production where the main directions are the investments in development of the export-oriented directions. Growth of the investments in the branch is mainly ensured at the expense of own sources of the big producers whose share makes about 70% yearly. The main share of the borrowed funds comes from credit resources and makes about 20% of the aggregate incomings, state budget funds make 3% and other sources – 5%.

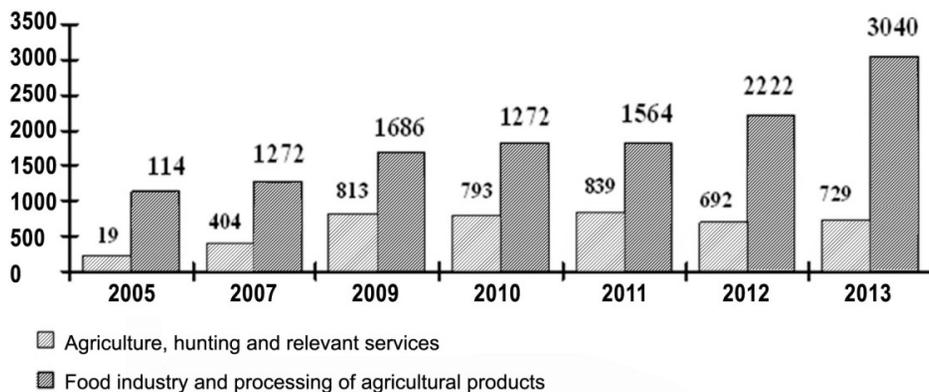


FIGURE 1. Dynamics of direct foreign investments in agro-industrial production of Ukraine (as at the beginning of the year), million US Dollars

Source: State Statistics Committee of Ukraine.

The dynamics of big business investments which is in many aspects positive was formed in early 2000s based on formation of the formal institutions ('rules of play'). According to our estimates, the legislation and organizing economic, financial measures taken earlier are still providing a comparatively high level of the Ukrainian agrarian branch investment attractiveness. Impact of special tax regimes alone allows the owners (investors) to save about two billion US Dollars yearly (Table 2).

TABLE 2. Volumes of indirect state support of agricultural producers due to special tax regimes (UAH billion)

Description	Year				
	2009	2010	2011	2012	2013
Special regime of VAT collection (accumulation regime)	7,7	11,1	12,9	14,3	15,0
VAT – subsidies to processing companies	1,5	2,4	X	1,1	1,0
Concession at the expense of the fixed agricultural tax	2,8	2,9	3,1	3,3	3,5
Total	12,0	16,4	16,0	18,7	19,5

Source: State Statistics Committee of Ukraine.

As a result, in the period of 2005–2013 investment volume indexes on an average were 115% in economy, and 191% in agriculture (Table 3).

The structure of investments in the agrarian sector features the trend towards innovations. Use of the fertile land as a main resource, cheap compared to Europe, predetermined the priority capital investment in crop growing. Each year

TABLE 3. Indexes of investment volumes in the fixed capital (in% to previous year)

Item	Year						2013 in% to 2005
	2005	2009	2010	2011	2012	2013	
Economy of Ukraine	101,8	58,5	99,4	122,4	108,3	91,2	115
Agriculture	126,8	49,8	116,4	132,1	111,0	98,2	191

Source document: Agriculture of Ukraine in 2011: collection of statistical documents – Kyiv: State Statistics Committee of Ukraine – p. 384.

the agricultural companies spend more than 70% of investments for purchase of technologies, state-of-the-art machines and equipment whereas expenses for construction and installation amount only to 22–24%. At the same time in Ukraine on the whole 42–44% of the aggregate investments are spent for purchase of machines and equipment and 50–52% for construction (Table 4).

TABLE 4. Share of investments in the fixed capital of Ukrainian agriculture and their technological structure (%)*

Item	Year				
	2005	2008	2009	2010	2011
Share of agriculture in the total volume of investments in the economy	5,2	7,2	6,1	6,0	6,4
Structure of investments: Construction and installation	18,6	23,1	27,0	24,0	22,7
Purchase of machines and equipment	76,2	72,6	66,4	70,2	71,2
Other	5,2	4,3	6,6	5,8	6,1

*Beginning from 2012 no statistical observation is provided concerning technological structure of investments in the fixed capital of agriculture.

Source: Report on capital investments per types of economic activities' for relevant years. State Statistics Committee of Ukraine, form 2-in.

In recent years gradually increased in volumes and share the investments in the development of animal-raising which in 2000–2010 suffered a significant drop in production and reduction in livestock number.

A strong aviculture branch has been built up in Ukraine which does not only meet the internal demand for eggs and chicken meat but also steps up the export potential (140 thousand tons poultry meat in 2013) including to EU. More than 45% of the investments in animal-raising go to aviculture.

The 'Cattle Breeding Revival' program adopted in 2012, for the time being has not produced any results which were expected. The investment segment share in dairy and beef stock farming does not exceed 12%. The situation in pig-breeding is but slightly better.

Now due to (but not limited to) the investments and growth of prices for food, the agriculture of Ukraine is ranking among the leaders in the world exports of sunflower, corn, wheat and other products of plant-raising. In 2012 the share of exports of agrarian products had occupied the leading positions driving back the exports of ferrous metals, traditional for Ukraine (Table 5).

TABLE 5. Change in share of the Ukrainian exports of ferrous metals and agrarian products (%)

Products	Year			
	2004	2006	2009	2012
Ferrous metals	33	34	26	22
Agrarian products	11	12	24	26

Source: State Statistics Committee of Ukraine, form 2-in.

Due to increase in the production and exports volume, recently the financial result of the branch exceeds UAH 25 billion yearly which makes about 20% on the whole in Ukraine (Table 6).

TABLE 6. Foreign trade balance of the agro-industrial complex of Ukraine (million US Dollars)

Detail	Year		in% to 2011	January to April 2013		
	2011	2012		2012	2013	in% to 2012
Foreign trade turnover	19836	26069	131,4	7831	8662	110,6
Including exports	13147	18194	138,4	5278	5583	105,8
Imports	6689	7875	117,7	2554	3077	120,5
Favourable balance	6458	10319	159,8	2726	2508	92,0

Source: State Statistics Committee of Ukraine, form 2-in.

In the period 2008–2012 on an average the rate of return in the agriculture of Ukraine increased to 4.2% whereas in economy – to 1.3%, industry – to 3.4% while construction and trade suffered losses.

Not the least of the factors in the branch economy growth stimulation is attracting of big foreign credits to Ukraine. Among such the notable was the credit of the Chinese Eximbank at whose expense already in 2012 1.5 billion US Dollars were attracted for export deliveries of corn and other grains. During the next 5 years it is supposed to attract from China another 1.5 billion US Dollars. However the scientists are not unanimous about the consequences of such Projects for the investment climate of Ukraine.

But the basic factor of the investment processes shaped in the domestic agrarian economy is today's land relations. As on 01.01.2014, 6.9 million peasants of

Ukraine acquired as private property 27.2 million hectares of agricultural land. Out of these 17.5 million hectares were given in rent. In 2013 the total paid for the rent of these lands amounted to UAH 9.8 billion. Here it is important that the share of the rental charge in the total costs of the agricultural companies does not exceed 5–10%. The land tax is included in the fixed agricultural tax, and the latter does not exceed 1 US Dollar/year per 1 hectare land. In addition, practically there is no competition for the land rent in the countryside.

Therefore the land relations as well as taxation to a large extent make up the attractiveness of today's investment processes of the Ukrainian agrarian economy including for foreign investors. But not all the businesses gain profit from this.

The determinative entities in the investment processes of today's agriculture of Ukraine are domestic and foreign agro-holdings which obtain maximal profit from the tax, land and other factors of the investment attractiveness.

The big agro-industrial companies of Ukraine learnt to attract investment resources on the world stock markets. It is characteristic that during the period of the financial crisis it was mainly the agro-industrial companies that made public offering and attracting of capital to Ukraine. During 2005–2012 their share in the structure of offerings on the stock markets is more than 50%. According to the forecasts of Fitch Rating analysts, during the next 5 years the Ukrainian agro-industrial companies would be able to attract additionally another 20–30 billion US Dollars.

To a large extent the accumulated investment potential contributes to formation of a huge land bank by these businesses (Figure 2) which gives rise to the objective concern among the economists.

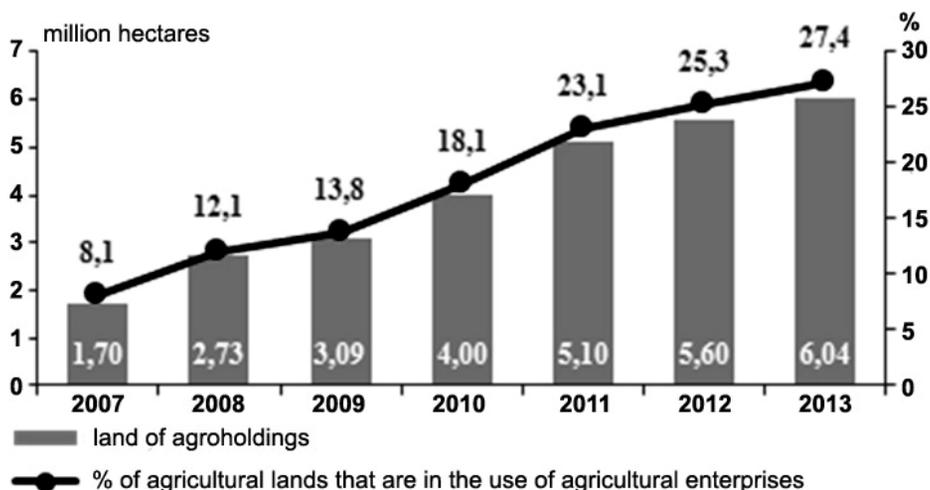


FIGURE 2. Structural indicators of agriculture: agricultural holdings

Source: Study "The largest agricultural companies in Ukraine".

Concentration and intensification rate in the agro-holdings causes serious social and ecological problems. Further, obvious are also the problems of big business management and even efficiency of their production. There are examples when due to bankruptcy of the agro-holdings the entire agrarian regions become depressive because new organization approaches, technologies wash out material and technical facilities, personnel potential, current assets etc. from the villages. It often happens that the land is concentrated for the purpose of future speculation during business resale.

In addition, the present-day investment processes feature inconsistent and imperfect investment policy of the state. As little as 3% of the total investment volume in the branch come from the state budget funds whereas it is just in this branch that around 10% of the Ukrainian gross domestic product are produced. The state support has no investment strategy because the majority of the budget funds are spent for financing of the current expenses of agriculture. These funds are spent primarily for financing the state programs of selection in plant- and animal-raising, measures against epizooties, partial compensation of credit interest rates and other spheres which are more beneficial for agro-holdings. Such policy resulted in degradation of the material and technical facilities, and personnel potential of the majority of the Ukrainian villages, and does not create basis of investment process development for other businesses.

High transaction costs and monopolies of intermediaries on the markets of agricultural products and investment resources do not allow the medium-sized and small companies to create sufficient sources for development of their own material and technical facilities, to ensure their expended reproduction.

Reduction of jobs in the countryside and costs for creation of human capital strengthens the decline processes on rural territories. In 2013 in Ukraine 4.2 million individual farms were functioning. But only about 1 million peasants decided on independent commercial farming and added 4 million hectares of the land acquired free of charge to the household plots.

Therefore the problem of the investment provision for development of the branch is the sharpest one in the small and medium-sized agricultural companies and in the individual farms which, taken together, produce today around 72% of all the agricultural products and use more than 70% of agricultural lands of Ukraine.

Nevertheless, the state does not eliminate the unfavourable conditions for development of cooperation, medium-sized and small business in the countryside. Pending are the problems of mortgage, financing of measures to develop the social sphere, road network and other factors which would predetermine the future pro-European investment attractiveness of the economy agrarian sector.

Positive moves in this direction mostly depend on the local possibilities of investment provision. However such possibilities are limited in most of the regions and territories. Therefore the investment provision problem for development of agriculture and rural territories is a large-scale problem, its solution is of both national and local importance and requires effort consolidation of all the links and spheres of production, society, state and government authorities.

It is obvious that the prospects of the investment potential of Ukraine are concentrated in the small (about 42 thousand farms each cultivating from 10 to 1 thousand hectares of land) and medium-sized (about 12 thousand companies each cultivating from 1 thousand to 10 thousand hectares of land). Not less important are also the individual farms (4.3 million) about 1 million of which are already oriented towards marketability of the products. However these prospects will be implemented when the relevant institutional basis for the new investment conditions is created.

Unlike Poland, where priority of the family type of agriculture is determined on the legislation level, Ukraine practices a multi-structure development of the agrarian economy. But social and economic distortions in development of the agro-holdings and degradation of other businesses require revision of such position. It is noted in the Economy Agrarian Sector of Ukraine Development Strategy till 2020 that although the underlying principle of such development is still multi-structure the priority is given to the so-called village-forming companies (business entities whose owners live in a village and combine the right for land (including rent) with the work on it, economic interests with social responsibility).

The criteria of the village-forming companies are met by the most of the medium-sized and small businesses in Ukraine. It is for them that it is reasonable to improve the concessional taxation system and the main programs of the budget allocations (it is worth noting that the effective concessional taxation system is valid only till 2018).

The project of the Law of Ukraine 'On turnover of the lands for agricultural purpose' envisages in particular the restriction on land-use by the agro-holdings which would also contribute to strengthening of the investment potential for small and medium-sized business in the countryside.

The legislation initiatives stated above are aimed at creation of a new institutional basis for the investment processes in the agrarian economy of Ukraine.

However, if in the legal regulatory provision (the formal institutions) the trends of the institutional changes are clear and obvious, the situation in the non-formal segment of the institutional changes is worse. E.g. in accordance with the World Bank studies, only around 5% of the agricultural land owners of Ukraine understand the significance of the land capitalization and are ready to actively use it in the economic turnover. The investment attractiveness and success of the



agro-holdings is known to be based to a great extent on the attractive presentation of their assets and cash flows in the financial reporting certified by recognized audit companies.

It is not a year that the big business spent on the way to the established investment attractiveness through capitalization. This is not the case with the medium-sized and small companies of Ukraine. According to our estimates, if the small and medium-sized companies do nothing but enter the rights for the rent of the land in the company books, their aggregate capitalization would increase at least by 10 billion US Dollars. We would like to note that in all the agro-holdings of Ukraine the rights for the rent of the agricultural lands are entered in the company books. Other assets are also successfully capitalized.

The objective prerequisites of asset capitalization for the small and medium-sized business are shown in the Table 7.

TABLE 7. Dynamics of rent contract validity for the lands of agricultural purpose in Ukraine (%)

Rent period	Year			
	2001	2008	2010	2013
For 1–3 years	45,7	18,8	10,0	5,1
For 4–5 years	41,2	57,2	49,0	40,3
For 6–10 years	11,3	19,9	30,6	41,1
Over 10 years	1,8	7,1	10,4	13,5

Source: Study "The largest agricultural companies in Ukraine".

Entering the rights for long-term and medium-term land rent in the company books is the first step to the increase of the investment basis. But most of the medium-sized and small business managers are not ready for the mission of creation of the new basis for the investment processes, new investment sites. The state obviously needs to concentrate efforts not only on changing the legal regulatory field (the formal institutions), but also, first of all, to initiate propaganda, training of the small and medium-sized company owners, managers and accountants. In other words, it is important in parallel to create the investment potential by changing the non-formal institutions too.

On this way the experience of Poland is of importance for Ukraine. In 2007 at the Warsaw stock exchange the site was set up for the small and medium-sized companies – NewConnect. It functions outside the regulated market as an alternative trade system. For six years of existence this market surpassed the main platform of the Warsaw stock exchange (Main List) in the number of the listing companies (444 companies including 9 from abroad). The total offer of securities amounts to 150 million PLN, out of which the primary public offering – 123 million zloty, secondary – 27 million PLN.



Not the least role in the surpassing dynamics of NewConnect development was played by comparatively less severe formal obligations and requirements for disclosure of information by the issuers of securities.

The NewConnect advantage lies in possibility of private offering following the shortened access procedure which saves time and costs to begin listing. Preparation for the issue at NewConnect (time from decision-taking to the first quotation) takes only 1–3 months whereas on the regulated market the same may take 6–9 months.

The projects of EU, USA, world organizations could contribute to such practice in Ukraine. The importance and viability of the efforts aimed at changing the social and psychological platform of the investment processes is demonstrated by the regional profile. The western regions of Ukraine, due to geographical proximity and better awareness about the features of the investment policy in the developed EU countries, show better performance.

While in agricultural companies of Ivano-Frankivsk region in 2011–2013 UAH 2,632 per 1 hectare of lands respectively were invested in the fixed capital, in Luhansk region it was only UAH 451. The volumes of investment in animal-raising development represent a certain criterion for institutional maturity of the investment processes. On an average in Ukraine 22% of aggregate investments are made in this branch. In the companies of Odesa and Mykolaiv regions this share does not exceed 5% whereas in Ivano-Frankivsk region it is nearly 80%, in Kyiv region – 50%.

The above-mentioned is also characteristic for the development of the domestic investment processes. The desirable movement would be towards the practice of the developed economies. In Ukraine the vector of such movement is already discernible. New views propagate from the west to the east and south of the country.

CONCLUSIONS

Not the least of the factors of the investment process new quality growth lies in changes not only in the formal (legal regulatory) institutions but also in the non-formal institutions. The latter, in terms of the institutional theory postulates, make the basis, ground for development of economy including its investment component.

1. In the domestic studies of the investment policy (processes) the theoretical substantiations are paid insufficient attention.
2. The problems of condition, development and, in the main, influence of socio-cultural psychological types of owners and managers of the Ukrainian agrarian sector business entities on the investment processes should not be secondary in the investigations. In many aspects success of their solution would allow to



improve the investment climate, to strengthen the positions of Ukraine on the world food market. To make forming of the new investment processes more active, strategically it would be reasonable to implement the following measures:

- to form the investment priority of development of the formal institutions (legal regulations concerning land relations, taxation, crediting, attracting foreign partners and other),
- Regarding the formation of the investment basis of the non-formal institution maturity – to launch the program training of the owners and managers of business entities, adopt and implement the Program of the Ukrainian small and medium-sized agro-business capitalization,
- Regarding the development of various businesses in the countryside – to re-orient the state support towards the village-forming businesses (medium-sized companies, farms and other small agricultural companies, servicing cooperative societies, individual commercial farms),
- Regarding the regional development – to provide special investment regime on the depressive rural territories,
- Regarding the branch development – priority grant for state support of animal-raising development, production of organic, export-oriented and import-substituting products,
- Regarding the priority for implementation of the investment projects providing fast increase of the Gross Domestic Product – to implement projects for introduction of innovation technologies, development of infrastructure for storage and processing of vegetables and fruits, build-up of facilities for processing of hop and substitution of imports of raw materials for brewing industry, construction of facilities for production of concentrated mashed potatoes, formation of network of dairies, pig-breeding farms, expansion of export possibilities of confectionary industry, modernization of sugar plants for production of bioethanol, formation of clusters for production and processing of flax, introduction of quality management system for agrarian products, construction and reconstruction of bakeries, production of important veterinary immunological and other drugs, development of aquaculture of fishing plants,
- Regarding the road network – to allocate at least one third of incomings of the road funds to the needs of road network development in rural areas,
- Regarding the social problems – to provide housing construction for employees of the state-financed organizations who work, live in the countryside and made long-term contracts, to provide organization support of the investment projects for development of the countryside.

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INSTYTUCJONALNE PODSTAWY ROZWOJU PROCESÓW INWESTYCYJNYCH ROLNICTWA W GOSPODARCE UKRAINY

Abstrakt. W artykule poddano badaniu stan procesów inwestycyjnych, ich zmian strukturalnych oraz trend priorytetowych inwestycji w rolnictwie. Potwierdzono wpływ instytucji na rozwój polityki inwestycyjnej oraz na zmiany procesów inwestycyjnych. Ocenie poddano wpływ instytucji (przepisy prawne dotyczące „reguł gry”) na efektywność realizowanych inwestycji. Zidentyfikowano działania podejmowane przez formalne instytucje celem przedstawienia inwestycyjnego sukcesu dużych podmiotów agrobiznesu na Ukrainie. Za główną przyczynę małej atrakcyjności inwestycyjnej małych i średnich przedsiębiorstw w sektorze agrarnym ukraińskiej gospodarki uznano ograniczone i nieefektywne wykorzystanie środków budżetowych, słaby rynek oraz stopień dojrzałości inwestycyjnej instytucji nieformalnych. Stan nieformalnych instytucji (społeczno-kulturowe i psychologiczne instytucji – typu ukraińskiego chłopstwa) został zidentyfikowany jako główny powód opóźnienia małych i średnich podmiotów gospodarczych w porównaniu do osiągnięć inwestycyjnych gospodarstw rolnych. Ocenie poddano drogi rozwoju nieformalnych instytucji, na przykładzie doświadczeń Polski i innych krajów rozwiniętych. Zaakcentowano, że atutem małych i średnich przedsiębiorstw była kapitalizacja, która jest istotna dla dalszego rozwoju procesów inwestycyjnych na Ukrainie.

Słowa kluczowe: procesy inwestycyjne, polityka inwestycyjna, atrakcyjność inwestycyjna, wsparcie inwestycyjne, trendy inwestycyjne, teoria instytucjonalna



