
SOCIAL IMPACT OF LARGE SCALE AGRO- INVESTMENTS IN THE FSU: LESSONS FROM UKRAINE'S EXPERIENCE

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Summary

The author shows that large-scale agro-investments in Ukraine have net positive social outcomes for the local communities. Particularly, welfare gains for pensioners, the largest and one of the most socially vulnerable groups of the land owners, are observed. Yet investment project outcomes for the local communities could be further maximized. Land owners have weak negotiating power which leads to suboptimal social outcomes. Inadequate negotiation procedures and outcomes harm both investors and owners when conflicts over land use arise. Recommendations on strategies to improve the investment outcomes are provided for different stakeholders.

Key words: Social impact, agriculture investments, conflicts, pensioners, Central Europe, Ukraine

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Introduction

Ukraine and a number of other former Soviet Union countries, especially Russia and Kazakhstan, are recognized as countries that have a significant potential of increasing agricultural output. Since the collapse of the Soviet Union in 1991 the farm sector in these countries has seen a downward trend and much of the land was left not cultivated. Yet this potential was not utilized as investing into land was viewed very risky in these countries given a slow pace of the land reform.

From 2000 companies started to invest in agriculture driven by favorable changes in the land legislation (See **Charts 1 and 2**). Later on investments were driven by growing world agricultural commodity prices and demand. Since economic growth in Ukraine also resumed in 2000 (after a decade of decline and impoverishment) growing domestic market and food sector have played a role in attracting investments into agribusiness as well.

After the Orange Revolution in 2005, another stage began: investors improved their expectations and Ukraine was treated more seriously and more strategically. Foreign direct investments in Ukraine's agriculture increased substantially. Finally, Ukraine's entry into World Trade Organization in 2008 further improved the country's investment image.

Chart 1. FDI in Ukraine's agriculture, mn USD

Chart 2. Fixed capital investments in Ukraine's agriculture, mn UAH

Despite a significant interest in Ukraine from investors, the general public does not know much about large companies leasing land. In part this is because prior to 2005 there were not many large agribusinesses as there are now and many of the investors that lease land are not public. Only recently the press started to disclose the names of these companies and their owners and publish rankings on the amount of land leased.

The social aspect of doing business in agriculture is researched relatively well – there is an extensive body of literature that covers issues such as the social impact of the land reform and the effectiveness of the state social policy in Ukraine. Examples of such literature are Lerman et al (2007) and CASE (2009). Other papers that focus on other fSU countries and consider impacts of leasing land on the local communities are CISR (2003), looking at Moldova, and Almaganbetov (2006), Kazakhstan. Yet, the social impact of large scale investments has not been particularly in the focus in the empirical research on Ukraine.

Methodology

The paper is based on the results of the field visits to three investment sites in Ukraineⁱ. Interviews took place in Western and Central Ukraine over 2009–2010. Three types of investors were chosen: a foreign company (10 000 ha of leased land), a local, family owned business (150 000 ha) and a foreign non-strategic investor (300 000 ha). Two of the investors focus on crops and one operates pig farms.

Three hypotheses were tested through the interviews with the stakeholders: 1) land owners get suboptimal price from the investor, 2) investors break their commitments made to the local communities, and 3) all groups in the community become better off economically as a result of the

investment made. The findings on the social impact of the considered investment projects are presented below.

Social impacts of the investment projects

Channels of investment impact

The social impact of investments is mostly positive for the local communities. The key channels of such an impact are the following:

1. **Lease payments.** Land owners start to receive a return on the asset they own. An increased competition for land between investors gradually drives prices for leasing land up. Land owners can receive payments both in cash and in-kind (such in option is foreseen nearly in all contracts)ⁱⁱ.
2. **Cultivation of land.** The very fact that investors start cultivating the leased land is positive. It is often the case that after the collapse of the Soviet farm in the area the land was left not cultivated for years and therefore had been degradingⁱⁱⁱ.
3. **Maintenance of the social infrastructure.** Investors often donate money to the local communities to be distributed as presents to the elderly, children or to be spent on local infrastructure (natural gas distribution networks, roads, schools and healthcare). Such assistance is an important social contribution in the rural area where unemployment is high and local governments do not have sufficient financial capacity to take care of the socially vulnerable groups.
4. **Creation of jobs.** Outcomes are mixed: when investors come, labor shedding often occurs because of higher labor productivity. However, those jobs that are being created are high paid jobs; workers often receive training to use modern machinery.

Investments in agriculture have had evident positive economic impact at the national level. Large companies have high yields and greater efficiency as they apply new technology (e.g. no-till) and exercise economies of scale. Moreover, large companies are able to produce homogeneous products (according to international standards) which should eventually benefit the food sector and drive exports of finished goods. At the same time, large companies also start to drive less competitive individual producers and small and mid-size firms (peasant farms) out of the market^{iv}.

Pensioners: the largest beneficiary

Pensioners are arguably the greatest beneficiary of large agro-investments. First, the elderly are the largest group owning and leasing land in the country (see **Table 1**). The former members of the Soviet collective farms received land plots as a result of the land reform in the early 1990s. Since it is not allowed to sell land, there was little change in ownership.

Table 1. Share of pensioners in contracts concluded and in land area leased out in four visited raions (districts) of Ukraine, %

Raion (district)	Number of contracts	Land area
Kalush	53	44
Husiatyn	55	57
Talne	55	52
Kremenchuk	61	57

Source: State Committee for Land Resources

The demographic pyramid in rural area is skewed towards the elderly as well. As work-age people massively leave rural area looking for jobs elsewhere, the share of the elderly and children in the local communities increased (see **Table 2**). Women outnumber men among the elderly in villages since men have much lower life expectancy in Ukraine.

Table 2. Distribution of households by presence of those in employment, %

	Total	Urban area	Rural area
Households with employed members	69.3	74.3	58.2
Households without employed members	30.7	25.7	41.8

Source: State Statistics Committee

Pensioners benefit from the first three channels of impact described above. Aside from the lease payment, the elderly land owners benefit from the investor's social policy and better services of the social infrastructure (health care, utilities). Finally, pensioners are often not capable to cultivate the land they own so they are most interested in leasing out land.

Though pensioners are the largest socially vulnerable group that benefits the most from the investment project, they may not be the most socially vulnerable group. Interviewed leaders of the local communities underline the fact that the pensioners, though being socially vulnerable, do receive pensions from the state. Young people often cannot find a job and while unemployment benefits are low they find themselves in a very difficult financial state. Therefore, pensioners often provide financial assistance to their children.

It may be the case that large families headed by a single parent (usually, a female) are the least protected socially since they are not properly covered by the safety net. For example, a woman in her 40's was interviewed: she has seven children and earns UAH 500 (USD 60) per month working as a janitor in the village school. However, the lady is not eligible for the state aid, as she owns 1.95 ha of land, and the threshold for aid eligibility is 0.6 ha.

The social impact of investments is suboptimal

The lease payment that land owners receive is low and their contribution in the total household incomes quite modest. The average income from leasing land of the interviewed land owners was UAH 400–800 (USD 50–100) per year for an average of 2 ha of leased land. Even for pensioners that have lower incomes lease payments are by far not the most important source of income (the average annual pension in Ukraine was UAH 10 700 or USD 1 347 in 2009). For example, the incomes from selling crops and livestock products for rural households are several times more than what pensioners get from leasing land to the companies (see **Table 3**).

Table 3. Structure of gross resources of households consisting of members above working age in rural area, 2008 average, %*

Pensions	61.0
Value of consumed products obtained from own farming	12.4
Income from selling agricultural products	8.7
Use of savings and loans	3.9
Value of non-cash privileges; value of consumed products obtained as presents	3.3
Monetary assistance from relatives and acquaintances	2.8
Labor compensation	2.4
Income from leasing out a land plot	2.3
Other kinds of social assistance	0.9
Other incomes	2.2

Source: State Statistics Committee. Calculations: ICPS

* Women (55+) and men (60+).

It seems that the amount of social aid that investors provide for the local communities is also relatively low. For example, one of the interviewed investors benchmarked aid to be provided to equal UAH 10–15 (USD 2) per leased hectare a year. (Yet it is an important contribution as often this money is spent on local infrastructure and thus public good is created).

There are two groups of reasons why social outcomes of investment projects are not optimal. The first set of reasons is country-specific. The leasing price is low since the competition for land is only starting to develop. The price investors are willing to pay for leasing land also reflects a high risk of doing business in Ukraine. The land reform has been frozen and the country performs poorly in major international rankings, for instance, assessing corruption.

The second group of issues has to do with the low bargaining power of land owners. The number of land owners is significant: an average size of the land plot owned and leased by one household is a mere 2–4 ha^v. This means that the negotiation process over land lease contracts could be very costly for individual land owners. At the same time, land owners cannot afford to obtain legal advice given the expected payoff from leasing land. This seems to be true both for the small villages (a few hundred inhabitants) and large ones (a few thousand inhabitants).

Moreover, the negotiation procedures and contracts are not well developed in the country and it follows that many issues are left at the investor's discretion. The investor presents the investment project to the local community at the village council convened by the village head and deputies. If members of the village agree with the suggested terms, then the investors starts signing the contracts with the land owners individually. Village inhabitants usually have very little information about the substance of the contract and sign without studying it carefully.

The contract usually is prepared by the investor and follows a template recommended by the government. It is very brief and specifies only the value of the money and term of lease. Some of the issues are mentioned very briefly (quality of the land) and some (social assistance to be provided by the investor) are left out. The contract is usually the only legal document that is concluded between the investor and the land owners. There is no investment memorandum or any other similar type of the document. Finally, contracts between investors and land owners are not flexible and it is difficult to change them unilaterally.

The state attempts to address negative outcomes of the absent land market. For example, the President issued a decree recommending investors to increase the lease payment norms.

Most of the investors do follow such regulations. However, since these are often only recommendations (and not laws) they are not legally binding and cannot be easily enforced when disputed between the parties end up in court over).

Conflicts are costly for both investors and local communities

Inadequate negotiation procedures and outcomes harm both investors and owners when conflicts over land use arise. Two of the reviewed investors faced conflicts with the local communities. Conflicts emerged over such three matters:

1. **Improper use of land.** First, land owners sometimes oppose the way investors use the land. For example, land owners objected to the use of fertilizers (and the way they are used). Second, some investors stooped cultivating the leased land as they faced liquidity problems because of the financial crisis. Land owners were worried that the land quality would deteriorate as a result and the local governments were concerned over the relative performance of their region in terms of agricultural output.
2. **Inadequate lease terms.** Some investors made people sign contracts with the long term of lease (20–25 years) while land owners often prefer 5 year contracts. The same happened with the price of leasing land: some investors chose not to follow government's recommendations (i.e. the President's decree) to increase the prices for leasing land (which is not a legal obligation but something that the majority of investors nevertheless observe).
3. **Negative externalities.** Companies sometimes produce externalities that negatively impact local communities:
 - *Environmental pollution.* For example, people living near investor's pig farm were convinced that the company pollutes water in the wells. People disliked the smell the farm produces as well. Similar conflicts are known to happen when companies growing crops use certain chemicals and bees or birds die as a result. These problems sometimes occur not because investors violate environmental legislation, but rather because people are not used to some types of chemicals or certain activities (large-scale pig farms) in their area.
 - *Damage of roads.* Investors damaged local roads by using very large trucks to transport crops or livestock. People were concerned that the trucks damage the road and their homes when passing by. At the same time, investors claim that maintaining roads is the responsibility of the government (which it is) and would not invest in roads.

To resolve these conflicts is difficult both informally and formally. Media is often a sole way for the local communities to advocate their case. Local governments usually do not intervene and do not help much either investor or local communities. NGOs are often absent. When a conflict comes to a dead end, land owners (usually from one village) may set up a group consisting of 6–12 people with one leader to settle the issue with the investor.

Land owners often end up being involved in various types of public protest. Investors often incur additional costs as a result. For example, the investor had to postpone building the pig farm at the site and using local road since the village dwellers blocked the road. The company had to spend on building a bypass road and look for a farm site in a neighboring area.

Sometimes conflicts are brought into court, for example, when land owners intend to terminate the contract. Local courts are usually sympathetic to land owners (even when from a legal point of view

investors are right) but eventually investors win in courts at the higher level. This is because a lease contract, the only written agreement between the sides, is designed by the investor.

Conclusion

Key lessons

A key lesson that can be learned is that it is the local communities that are least prepared for the new reality when investors come and pay the cost of slow reforms in the market and the country. In their turn, investors seem to be ready to take high risks of the largely unreformed land market and poor institutional environment.

It seems that a major problem is that Ukraine lacks progress in areas that are crucial for agricultural development - judicial reform, administrative reform, fiscal decentralization, social policy, rural development policy. Establishing the land market (and lifting the ban on land sale in the country) does not appear as the only and most important predicament to fostering investments and better social outcomes in rural area.

Out of the three hypotheses the first and third one were not verified. The low prices that land owners receive are better explained by the fact that there is low competition for land between investors rather than by non-transparent procedures regulating the land transfer and extensive bureaucracy. The investors do break their commitments made to the local communities with respect to the prices (e.g. when paying in kind) and spending on social infrastructure. This happens because the commitments made are often oral and are not legally binding. Finally, all groups in the community do not become better off economically as a result of the investment made. A very large number of people are neither worse off nor better off. The inhabitants that do not have land plots and do not lease land to the investor are worse off in case of externalities resulting from investor activities.

Recommended strategies

Below are some of the strategies that the stakeholders – both communities and investors could consider following to improve the investment outcomes.

Strategies for local communities:

1. **Insist on preparing a legally binding document with the investor (investment memorandum).** Investors and land owners should come up with the document that should reflect mutual expectations about the social obligations, investment plans. This should help resolve misunderstandings that often result from oral agreements. The parties can refer to the best practice from other industries in the country.
2. **Establish effective communication channels.** The local communities should create a committee consisting of the elected land owners from the very beginning of the investment project (and not when the conflict emerges). The committee should ensure a smooth feedback between the investor – both local managers and top managers/owners.
3. **Establish contacts with the relevant NGOs and media in the area.** Building coalitions with NGOs and mass media can be helpful when advice or advocacy is needed. Press is likely to be most helpful and available to assist. Political parties might become a point of reference as well – even though this is not a very reliable partner.

Strategies for investors:

1. **Formalize a social policy.** Most large companies do have criteria of being a socially responsible company. Yet, as large investors deal with dozens (sometimes hundreds) of villages, it is not just a matter of dedicating a certain percentage of revenues to social aid. Companies should know well the specific needs of the local communities and their members and ensure that the funds are spent efficiently in each case. Companies might consider creating a special department within a company to focus on social policy, develop a social passport of each village and monitor its social assistance.
2. **Take into account prevailing expectations.** People from the rural communities expect investor to share certain benefits with them. Investors should realize that the taxes they pay often do not return back to the local communities in a way of better roads, medical care etc. (This is because the way the fiscal system in the country works.) In addition, historically, the soviet collective farms have also been an important channel of the state meeting the needs of the local communities. So, it is often expected that investors would somehow continue this practice. The companies should decide how exactly they will respond to these expectations and communicate clearly their policy.
3. **Communicate about company activities regularly.** This is especially relevant when the company does something unusual or that might have negative impacts (e.g., applying a new chemical or transporting dead pigs through the village). The local community should be informed in advance of an event.
4. **When possible, pay taxes locally.** Many companies have headquarters and pay taxes not at the place of operations. This is often financially expedient but also leads to conflicts with the local administrations.
5. **Assist local farmers.** When possible companies are advised help the small farmers in the area by lending equipment and machinery or seeds. This practice is not costly but is important for improving the image of the company in the local community.

Strategies for national and local governments:

1. **Promote alternative employment opportunities in the rural area.** It is very likely that as more investment comes labor productivity will continue to grow and the problem of excessive labor force in the rural area will remain acute. The experience of other countries with promoting green tourism might work in Ukraine as well.
2. **Increase spending on rural infrastructure.** The social (education, healthcare) and transport infrastructure is severely underfinanced in Ukraine. Business will not be able to bear all the burden. To fully follow this recommendation fiscal decentralization is needed so that the local governments have the resources to invest in the infrastructure. It may require the administrative reform as well – the local governments might be able to spend money more efficiently within larger administrative units.

Strategies for donors:

1. Target reforms or transformations in areas that are important for the rural development: fiscal decentralization, administrative reform, social policy.

2. Continue helping the government with the land reform: increase the capacity of the relevant institutions, particularly, the State Committee for Land Resources, to define land rights (in kind) and process the land deals efficiently.
3. Reconsider approaches in supporting NGO activity. Many NGOs and technical assistance projects aimed at helping the land owners in Ukraine have proved to be not sustainable.

Notes

ⁱ Three case studies have been prepared: this paper draws from the key findings.

ⁱⁱ Land owners (rural households) often prefer to receive grain to feed their cattle and poultry. Sometimes investors inflate the price of grain to pay the land owners or give grain of poor quality.

ⁱⁱⁱ Companies leasing land usually also help the land owners to cultivate their small land plots located next to the village by providing machinery and equipment.

^{iv} This trend was mentioned only by the experts and by the representative of the Association of the small farmers and land owners. The general impression is however that competition on the product markets only starts to emerge. For example, the competition for land does increase between both large and small investors, yet in many regions there is still land that is not leased.

^v Two hectares is an average size of the land plot in Western and Central Ukraine. In Eastern Ukraine an average size of the plot is reaching ten hectares.

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