VITALIY KRUPIN¹, VASYL CHEMERYS²

FINANCIAL BACKING AS AN ELEMENT OF INFRASTRUCTURAL SUPPORT FOR AGRICULTURAL DEVELOPMENT: UKRAINIAN REALITIES

Abstract: This article sets out to investigate the current situation for financial backing of agricultural development in the Ukraine as an element of the complex infrastructural support for this type of economic activity. The research is based both on statistical data and its analysis, as well as on expert opinions of Ukrainian scientists, dealing with these particular issues. A number of components of the financial system were reviewed, including the activities of banks in financing of agricultural production, Ukrainian peculiarities and activities of credit unions, leasing and insurance companies, stock exchange markets, foreign and domestic investors, as well as the financial specificities in operation of local rural self-governance authorities and various inter-budgetary relations. The main conclusion is that Ukrainian financial backing of agricultural production remains inefficient, yet with proper measures, introduced in the future, it could become a proper tool for infrastructural support of producers and processors in agricultural sector of Ukrainian economy. It is a key requirement for being able to participate and be internationally competitive on agricultural and food markets.

Key words: financial backing, infrastructure, agriculture, development, the Ukraine

INTRODUCTION

Efficiency of agricultural development and the level of its innovativeness depend not only on the application of scientific research, the quality of modern technologies or the excellence of companies’ management, but also on availability and accessibility of adequate financial backing, being a crucial element of infrastructural support.

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In the Ukraine the lack of financing for most agricultural producers puts them in a difficult position and limits their development possibilities. There are various aspects to this problem and numerous reasons for poor financial backing being an obstacle for agricultural development. This article researches and reveals key points of these issues.

**MATERIALS AND RESEARCH METHOD**

Selected publications and monographs of Ukrainian economic researchers, as well as investigative reports and articles in newspapers have been used for the assessment of the various peculiarities of financial backing of agricultural development in the Ukraine. Analyzed statistical data has been taken from the National Bank of Ukraine and the Statistical Service of Ukraine and covers the period of the last 5–7 years.

The main sources of financial backing used as an element of infrastructural support for agricultural development researched in the article are: the banks and non-bank financial institutions (credit unions), leasing and insurance companies, stock exchange markets and direct foreign and domestic investors, as well as the operations of local rural self-governance authorities and their inter-budgetary relations. These have the capability of serving the development of agricultural producers and processors. The peculiarities of their activities in Ukraine have been reviewed and analyzed, as well as the problems and obstacles they present for the support of agricultural development.

**RESEARCH RESULTS**

Innovative development of agriculture, under contemporary socio-economic conditions is not possible without adequate financial backing. Engagement of investment resources into innovative development and their rational management is a key issue in order to ensure the sustainable development of agriculture. The current “investment hunger” in Ukraine in general and in agriculture in particular is caused by a decrease of state financial support for agricultural producers (due to a shrinking state budget), a lack of developed and resourced financial sector, changes of priorities in state agricultural policy (primarily due to admission of Ukraine into WTO), a permanent increase of price disparity between industrial and agricultural produce, a high level of depreciation of materials and technical assets in agriculture, as well as low investment attractiveness of various sectors of agricultural production. These aspects are creating major obstacles for a growth in agricultural producers’ demand for innovation [Zhydiak 2012].

One of the current key issues for the financial backing of agricultural development in Ukraine is an inefficient system of financial and credit support for agricultural producers. Experts have indicated [Baranovskiy 2008] that credit resources play an important role in agricultural processes, and that a seasonal gap exists between the need to invest and acquisition of income by producers. The banking system, however, does not provide adequate financial support for the agricultural sector, especially during the periods of most acute need (during sowing and harvest periods), as it stumbles over numerous obstacles. Popov [2012] listed these and these include:
the optimal (and in some cases minimal) term for credit, which would enable the producers to enhance their technological or operational state is, on average, three to five years, but the banks, on average, grant credits up to three years (sometimes only for one year), which is caused by a lack of stable long-term funds at their disposal;

that most agricultural producers lack negotiable security, which is worsened by the fact that agricultural land market is still under imposed moratorium, while the banks usually wish and tend to demand collateral a few times higher than the value of the loan;

the difficulty to forecast the agricultural output and therefore – possible financial losses (due to weather conditions, harvest failure, unfavorable price on the market), increases the risks for financial institutions (not only this leads to fewer loans given to agricultural producers, but also makes the loans more expensive for them);

the situation where agriculture lacks a proper insurance system against the risks of a natural character resulting in an underachievement of expected income or other possible unfavorable events;

contradictions in substantiation of loan sizes, which is due to lack of defined criteria for evaluation of lendee’s creditability and consideration of peculiarities of the national agricultural sector (this problem is aggravated by weaknesses of agricultural companies in management of current assets).

As a result, in the volume of loans given by banking sector of Ukraine provided to agriculture (together with forestry and fishery, according to the current state classification) at the end of year 2013 equaled 6.3% of the total. At the same time the share of agriculture in GDP accounted for 9.1%, and the share of people employed in agriculture (of all employed in the economy as of year 2012) totaled 17.2%. The share of agriculture, forestry and fishery in overdue loans equaled 5.6%, while the average index for Ukraine was at the level of 7.4% (Table 1).

<table>
<thead>
<tr>
<th>Indices</th>
<th>Agriculture, forestry and fishery</th>
<th>All economic activities in Ukraine</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>mln UAH</td>
<td>%</td>
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<tr>
<td>Total granted loans, including:</td>
<td>43 534</td>
<td>6.3</td>
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<tr>
<td>– for up to 1 year</td>
<td>23 829</td>
<td>54.7</td>
</tr>
<tr>
<td>– for 1–5 years</td>
<td>15 520</td>
<td>35.7</td>
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<tr>
<td>– for over 5 years</td>
<td>4 185</td>
<td>9.6</td>
</tr>
<tr>
<td>In national currency</td>
<td>31 559</td>
<td>72.5</td>
</tr>
<tr>
<td>In foreign currencies</td>
<td>11 975</td>
<td>27.5</td>
</tr>
<tr>
<td>Total overdue loans, including:</td>
<td>2 467</td>
<td>6.6</td>
</tr>
<tr>
<td>– for up to 1 year</td>
<td>944</td>
<td>38.3</td>
</tr>
<tr>
<td>– for 1–5 years</td>
<td>1 310</td>
<td>53.1</td>
</tr>
<tr>
<td>– for over 5 years</td>
<td>213</td>
<td>8.6</td>
</tr>
<tr>
<td>In national currency</td>
<td>1 868</td>
<td>75.7</td>
</tr>
<tr>
<td>In foreign currencies</td>
<td>598</td>
<td>24.2</td>
</tr>
</tbody>
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Source: compiled based on the data of the [National Bank of Ukraine 2014a].

Źródło: Zestawiono na podstawie danych [National Bank of Ukraine 2014a].
The majority of loans granted by the banks to agricultural producers didn’t exceed one year in length (54.7%), and loans for over 5 years were granted in less than in 10% of cases.

Financial support of agricultural sector was provided primarily in the Ukrainian national currency and only 27.5% of loans were granted in foreign currencies (of which 90% were U.S. dollars). This corresponds with the division of credit resources in banking system of Ukraine in general. It created an additional financial burden for the loanees, as the interest rates for loans in national currency were for a long time over twice as high (18.5% in national currency against 8.5% in U.S. dollars at the end of year 2013). Then the political events of late 2013 have led to economic instability. This has pushed the exchange rate of national currency down (the average exchange rate of U.S. dollar in the middle of 2013 was around 8 UAH/USD, while in the middle of 2014 – up to 35–40 UAH/USD on unofficial black markets). This made „hostages of the situation” out of those loanees, who received loans in foreign currencies, especially those of them, who were producing their goods for domestic market.

An understandable yet unfavorable fact is that large agricultural enterprises and agri-holdings dominate as recipients of credit. This is explained by their higher liquidity, as well as an ability to repay the loans along with fees and commissions at much higher rate, especially in national currency (many of large agricultural enterprises and agroholdings are export-oriented, which allows them to ignore the fluctuations of national currency, and even gain from these processes). Yet from a standpoint of the agricultural and rural development of the Ukraine such tendencies are unfavorable. Over 50% of Ukrainian agricultural output is being produced by small family farms (households), which in the current situation are unable to apply for and receive credit resources and introduce new technologies to the production processes, increase the quality of their produce, or comply with international standards of food safety. The situation is aggravated by the fact that the loan interest rates in national currency granted to small family farms are almost twice as high as those for non-financial corporations (which includes agroholdings) – 26.1% against 16.8% at the end of year 2013 [National Bank of Ukraine 2014b]. This farther complicates the access of agricultural producers to financial and investment resources, especially in Western Ukraine, where the share of small family farms is the highest.

Researchers note [Vlasenko n.d.] that a seriously restraining condition on the way to intensify bank loan granting for agricultural producers are the procedures of loan application itself. This especially targets small farmers. The need to collect numerous documents and fill complicated forms creates additional obstacles for such loan applicants.

These issues, as described, for crediting of the agricultural sector by banking system intensifies the need for additional sources of financial support for agricultural producers, especially small family farms.
As foreign experience shows, one of the ways to aid entrepreneurs with financial resources is to develop credit cooperation institutions, in particular the credit unions. According to theory [Dadashev et al. 2011], such unions are financial institutions, which are performing their activities on the market of financial services, where similar services are not being offered by other financial institutions, or are offered on unacceptable terms. Accordingly, in the past banks have been working with small clients, yet with the time lost their interest for such cooperation on mutually-acceptable conditions and have basically exited the market (cut down on financing offered to small farming).

According to data source [Mokrytskiy 2011], there are from 650 to 850 credit unions in Ukraine, yet not all of them remain active. The National Association of Credit Unions of Ukraine lists 139 member unions, but not all of them are granting loans to agricultural producers. Expert research [National Rating… 2013] suggested that the aggregated volume of credit unions’ capital in Ukraine as of July 2013 equaled 1187.2 million UAH, with most of credit unions (60.1%) having less than 1000 members. Due to the financial-economic crisis, since 2010 there has been a gradual tendency towards a decrease in the number of members of credit unions with deposits on their accounts. Additionally, the share of loans granted to family farms or rural households accounted to only 5.1% of total loans granted. This gives grounds to conclude that there is inefficient utilization of the ability of credit unions to finance agricultural development in Ukraine.

The development of credit cooperation in Ukraine is currently slowing down. This is the result of a list of objective and subjective causes:
- the complexity of regulatory mechanism, which is leading to an increase of the share of illegal businesses in the agricultural sector of economy (especially in intermediary services), as well as a growth in corruptive activities of local authorities;
- insufficient development of civil society institutions and a limitation of administrative and financial powers of self-governance at a local level;
- a poor adaptation level of agrarian higher educational facilities to the current needs of agricultural development, in particular in terms of training and educating specialists in credit cooperation;
- a lack of efficient agricultural consulting and extension services at a local level, which limits the small agricultural producers’ ability to learn good practices in the utilization of financial resources, including those offered by credit cooperatives;
- the spread of labour migration of rural inhabitants, which causes the outflow of entrepreneurial population of working age, further draining the human capital resources from the Ukrainian rural areas.

These problems are obstacles to the diversifying of financing sources for agricultural producers. They limit the investment possibilities for innovative projects and decreases the innovative potential of Ukrainian agriculture. They also lead to the
inefficient functioning of other elements of the financial support infrastructure of agriculture. This affects, primarily, leasing and insurance services, as well as the attractiveness of investments, including foreign investment in the sector.

Leasing should be a progressive and competitive (compared to banking services) tool for enhancement of production processes, opening opportunities to implement modern technologies in agricultural production and processing. On the global scale it has become one of the main financing instruments for various sectors of economy [Ghnatkovych 2009]. Ukrainian researchers [Ivanchenko et al. 2012] indicate that leasing is not just an investment activity in the form of loan granting or temporary use of equipment, but something in between, utilizing the advantages of both these approaches. It defines an interest of equipment producers in ensuring constant supervision over the agricultural production processes, constantly increasing the technological level of equipment used in these processes. Leasing, however, still hasn’t found enough support in Ukraine, especially in those regions, which are dominated by small farmers. It is developing, with the volumes of leasing services in agriculture being the second only to transport leasing. In the years 2007/2008/2009 the share of leasing in agriculture grew from 7.5%, to 9.5% and 11.6% [Gholovchuk et al. 2010], in years 2012–2013 it has increased to 16.3% and 24.0% accordingly [Analitychnyi... 2013]. This suggests that the financial infrastructure of Ukrainian agriculture is slowly, but certainly, transforming into one which resembles the systems of economically developed countries. It may be presumed that in the near future leasing services in agriculture shall play a more important role in support of the innovative development of Ukrainian agriculture.

The current obstacles in development of leasing services for agriculture have been pointed out [Kolomiyets 2012]. These obstacles include: an imperfect national legal framework that regulates leasing operations, a high degree of monopolization on the lease market and the high costs of such services, a weak financial and economic situation of small agricultural producers and their inability to be the users of leasing services without the need for additional external financing.

Another element of the financial infrastructure for agricultural development is the need for insurance services. The underdevelopment of insurance tools in the Ukraine highly limits the options for utilisation of development opportunities, as it places agricultural producers at risk from various kinds of unpredictable circumstances: natural, climatic, political, economic, social, psychological, global, etc.

Insurance under the current conditions is one of the most efficient tools for agricultural producers in economically developed countries. A variety of approaches are being implemented there [Chernyshov et al. 2005], for example, the insurance of future harvest from a number of risks, insurance of forecasted profit level, insurance of future product quality and other. In the Ukraine, however, most of such approaches are not being used mainly due to a lack of their legal regulation therefore insurance companies tend to concentrate on more typical kinds of risks, which are easier to calculate and manage, at the same time with more clients willing or
obligated to participate. The latter gives the insurance companies enough financial resources to give adequate backup in case of need.

Tomashevskiy Y. [2011] in his paper on the problems of Ukrainian insurance market servicing the agricultural sector stresses that the risks in agriculture are of a systemic kind, which in many cases means losses for numerous entrepreneurs in the agricultural sector in the case of an occurrence of an unwanted event. If a region is dominated by small producers (like in Western Ukraine), this issue just aggravates the risks, since in a case of an insurable event the payouts would be much higher than previously collected insurance premiums. The insurance premiums currently collected by insurance companies would not be able to guarantee full coverage of losses for agricultural producers, at the same time the latter are not ready for higher risk coefficients and therefore – higher insurance premiums. As a result, the market of insurance services for agricultural producers is still very limited and unattainable for most.

Stock market instruments could play an important role in providing financial support for agricultural production with the creation of wider possibilities for attracting investment. Additionally, the stock exchange market could perform an important indicative function of innovative development of agricultural market agents, since it is the stock exchange that portrays the prospects for development of different businesses and economic sectors, stimulating the financial inflow to those companies, which represent future success, innovative management and technologies. Unfortunately Ukrainian domestic experience shows a low level of participation of businesses on stock exchange markets, as well as their underdevelopment as institutions. The high level of monopolization and centralization of the agricultural market by large agroholdings and corporations in reality blocks such instruments, which under different circumstances should be more available to a wider range of companies.

Except from the problems of monopolization and centralization, Prokhorovova [2013] states that the development of stock exchange markets in Ukraine also suffers from:

- an insufficient range of stock exchange instruments with acceptable levels of profitability, risk, liquidity and security for investors, as well as lack of various offered sizes of investments (small and medium investment opportunities are not usually represented);
- a low level of transparency on the stock exchange markets – information available to investors is not always sufficient, up-to-date and objective, at the same time there are cases of insider trading and this is a typical issue;
- low capitalization level of stock exchange market;
- inefficient development of basic instruments and a faulty legal framework regulating these issues;
- absence of derivative financial instruments on currency and commodity markets (due to previously stated reasons), even though the formation of justified prices for strategically important commodities (such as energy resources, grain, metals, etc.) is not possible without the use of futures and options market.
It is understandable that these flaws of aforementioned instruments are having negative influence upon investment activity, in particular in the agricultural sector. In the Lviv oblast (one of 25 major regions of Ukraine according to current administrative-territorial division, located at western part of country, bordering with Poland), during the years 2010–2012 the capital investments into agriculture amounted to 1084.0 million UAH (approximately 127.5 million USD), which equaled 3.4% of all capital investments in the region. At the same time the total volume of accumulated foreign investments in agriculture up to the end of year 2012 accounted to 1634.8 million USD, and the share of these investments equaled 7.4% of all foreign investments in the Lviv region (Main Administration of Statistics in Lviv Oblast 2013).

Along with this it is important to point out that these shares are much smaller than the share of agricultural input into the economy of the region. This again supports the statement that agriculture is underfinanced and needs improvement of its regulatory measures, as well as of the investment climate.

Since investment activity in rural areas depends to large extent on the tax system, it is important to optimize the taxes, tax incentives and preferences for agricultural producers (fixed agricultural tax, special approaches to calculation and payment of VAT, etc.), in particular to allow agricultural cooperatives to utilize the existing tax benefits, which they currently are not allowed to do. Experts [Ternivskiy 2013] comment that experts comment that after the new Tax Code came into force two years ago, the small agricultural producers, while selling their goods through agricultural cooperatives, have an obligation to pay 15% or 17% tax of the value of the sold goods. Nobody, however, appears to take into account that these producers, even before the beginning of production process, are already incurring costs, and these costs should be taken into account. VAT is another problem. The problem focuses on the fact that those small producers, who want to sell their goods through agricultural cooperative, are obligated to pay VAT at the level of 20% to the state budget. Yet those farmers, who are legal entities and official payers of VAT (unlike small family farms or rural households), in reality do not pay this tax, since it is being accumulated on their special banking accounts, which they can use for the development of their economic activity. This way agricultural cooperatives have found themselves in a very unfavorable situation, which forces them to continue their activities illegally, or forces the rural population to stop cooperating and look for sales opportunities elsewhere.

Another aspect, which needs to be explained in the context of fiscal system, and as an element of financial infrastructure of agricultural development, is that most of the tax benefits implemented in rural areas apply only to agricultural producers, and not to those entrepreneurs or companies, which are not involved in agriculture, who play, however, an important part in local economic development. These other economic actors are an integral part of local economy and in fact are providing many supporting services, without which agriculture would be much more complicated to perform (these are non-agricultural type of activities, such as various services, transport, communication, repairs, IT-industry, as well as those complimentary to the
agriculture – food processing services). As a result the innovative potential for regional (local) development decreases.

A major barrier on the way to increase the volumes of investments into infrastructure of agriculture are also the inter-budget relations and flaws in financial support for local rural communities. As an example, in the structure of incomes of regional budget of Lviv oblast in year 2013 out of 5.6 billion UAH over 82% (or 4.6 billion UAH) were the official transfers from state budget [Department of Finances of Lviv Regional State Administration 2014], making the local development dependent on state authorities and resources. The budget directed towards development of agriculture, forestry and fishery equaled 0.04% of the yearly total budget. This was three times less than the support of construction sector, four times less than mass-media sector and 12 times lower than support for transport, roads, communication and IT.

Therefore, one of the necessary measures in order to enhance the efficiency of financial support for agricultural development is the decentralization of budgetary system and transformation towards an increase of self-government in local rural communities.

CONCLUSIONS

Even though the analysis showed many flaws and problems, Ukrainian agriculture is still developing and showing resilience and ability to overcome many obstacles. The question is how much better the result would be, as well as how much better the quality of life of the Ukrainian rural population would get, if these issues could be resolved and the financial element of infrastructural support for agricultural development would work more efficiently. This is something that needs the attention of the Ukrainian authorities and thorough and complex practical measures for the improvement of regulatory system, which would allow Ukrainian rural population to face European and global competition with adequate support of their industrial, financial and social infrastructure.

REFERENCES

WSPARCIE FINANSOWE JAKO ELEMENT INFRASTRUKTURY ROZWOJU Rolnictwa: REALIA UKRAiNSKie

Streszczenie: Celem artykułu jest zbadanie aktualnej sytuacji wsparcia finansowego rozwoju rolnictwa na Ukrainie jako elementu kompleksowego wsparcia infrastrukturalnego tego typu działalności gospodarczej. Badanie opiera się zarówno na danych statystycznych i ich analizie, a także opinii ekspертnych ukraińskich naukowców, zajmujących się poszczególnymi kwestiami z tego zakresu. Jako elementy rozległego systemu finansowego przeanalizowano działalność banków w zakresie finansowania produkcji rolnej, ukraińskie cechy charakterystyczne i aktywność unii kredytowych, firm ubezpieczeniowych, giełd papierów wartościowych, inwestorów zagranicznych i krajowych, specyfiki finansowej działalności banków w zakresie finansowania produkcji rolnej, ukraińskie cechy charakterystyczne i aktywność unii kredytowych, firm ubezpieczeniowych, giełd papierów wartościowych, inwestorów zagranicznych i krajowych, specyfiki finansowej działalności.
lokalnych władz samorządowych oraz stosunków międzybudżetowych. Główny wniosek jest taki, że ukraińskie wsparcie finansowe produkcji rolnej jest nadal nieefektywne, lecz po wprowadzeniu odpowiednich rozwiązań może stać się w przyszłości właściwym narzędziem wsparcia infrastrukturalnego producentów i przetwórców w sektorze rolnym ukraińskiej gospodarki, co jest jednym z kluczowych wymogów uczestniczenia ukraińskiego rolnictwa w warunkach międzynarodowej konkurencji na rynkach produktów rolnych i żywności.

Słowa kluczowe: wsparcie finansowe, infrastruktura, rolnictwo, rozwój, Ukraina