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European guidelines for the institutional frameworks of agrarian development in Ukraine

Abstract: *Transformation of the economy in Ukraine since its independence took place fast enough. However, the former communist system had a powerful influence on market mechanisms. As a result, the effectiveness of their actions did not justify expectations, because the market mechanisms could not provide equal opportunities for the development of different economic units, especially for agricultural producers. As a consequence, nowadays Ukrainian agriculture has a dual structure with the high developed corporate and the low commercial individual sectors.*

The present paper is based on the rural development concept which explores agriculture and rural area regarding the requirement of economic, ecological and social balance. The paper investigates the development of agriculture and institutional environment in Ukraine. It has been established that Ukrainian agrarian policy contributed to the development of corporate agrarian holdings, which don't satisfy the social and the ecological purposes of agrarian and rural development while individual agricultural producers, which are provided the national food security, survive in unfavorable institutional environment and conditions of large capital market power.

The main conclusion of this study is that the rural development policy requires not only to create effective institutions but also to change Ukrainian society understanding of their nature.

Keywords: *agriculture, rural area, individual and corporate sectors, agroholdings, rural development policy, Common Agricultural Policy, institutions.*

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Introduction

Problem statement

Search for investments and actual owner in the process of agrarian transformations in Ukraine for more than twenty last years ended with advent of a "rural landlord", who established a new corporate-like agrarian organization with prevalence of large capital, of non-agricultural origin mostly. Individual sector, represented by peasant farms and households, functions in strongly unfavorable institutional environment and conditions of large capital market power. Investors of agricultural production act exceptionally as business entities, which main purpose is multiplying own capital by means of transferring agricultural production to the individual basis. However, generally accepted fact that agricultural production, save for industry, is connected to wildlife and human beings, is neglected. Economic activity in rural areas may be viewed beyond general system of its social connections and ecologic limitations. Agriculture is not only a sphere of production, but also a sphere of life. Economic behavior of economic entities in rural area is being shaped not so much by a market as by a complex of social relations and norms, composing institutional environment of rural development. Interaction of this environment with economic interests determines nature and targeting of economic decisions. This means that analysis of current trends in agricultural production development without analysis of their close relation with change trends and dynamics in other spheres of economic and social rural life shall not reflect a real situation.

Research objective is to analyze agricultural development of Ukraine compared to the common European principles of farming and rural area development in order to establish on this basis scientifically grounded directions for harmonizing further agricultural transformations in Ukraine according to the needs and interests of different producers and rural communities.

Results

Rural areas and agrarian economy occupy an important place in Ukrainian society. Rural population makes up almost one third of the population (31.6%, 2011). Share of employed in agriculture decreases, but it is still on a high level compared to the European one (15%). Notwithstanding that agriculture contribution to the GDP has decreased compared to the 2000-s, it remains significant – 9.5% (Fig. 1).

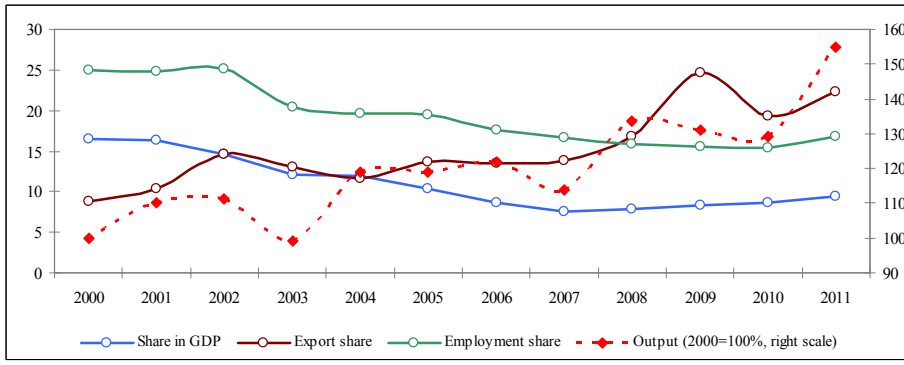

Figure 1. Ukrainian agriculture in the national economy (%)

Source: own calculations based on the Statistical Yearbook "Agriculture of Ukraine, 2011".

Regardless of insignificant decrease of agriculture role in economic development of the country, we may see a build-up of its production and export potential. Volume of agricultural production increased almost three times (Fig. 1), and volume of export of agricultural products – almost ten times (Fig. 2) over 2000-2011. Owing to this, Ukraine occupies a leading position on the global market: first place in terms of sunflower oil export, second place – rape and barley export, fifth place – corn export, sixth – sunflower seed export, seventh – wheat export, ninth – soy export (FAO, 2010). However, regarding livestock raising Ukraine is not even among twenty world leaders-exporters (save for hard cheese – 17 place). Along with that, general economic figures do not reflect trends in sharing benefits from ramping up agricultural production and export, and processes in rural society may be identified as systemic degradation:

- general employment level in agriculture has decreased over the period studied (by 20%);
- number of workers employed in corporate sector has decreased almost four times (form 2.75 Mio in 2000 to 0.73 Mio in 2011);
- salary level in agriculture remains low (⅔ of salary in economics);
- large share of unemployed (7%) and self-employed in farming households has emerged (70% of economically active rural population);
- service sector in rural area gradually diminishes.

At the beginning of the reforming period in 90s advisers in young independent countries of the former USSR propagated the ideas that success of agrarian transformations depends on speed of asset flow from inefficient collective farms and state owned farms (so-called kolkhozes and sovkhozes) to new effective owners (Csaki, Nash, 1998). As they hoped, family farms were to become those new owners. None could even imagine that creation of new owners may have resulted in land grabbing by large capital and excessive economic power concentration by agroholdings in agriculture.

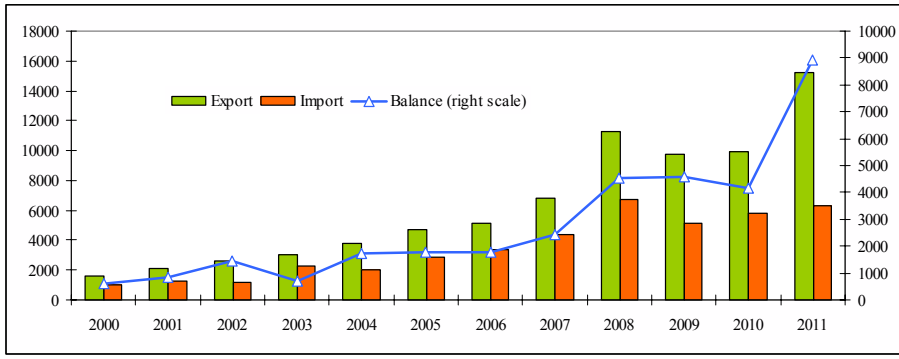

Figure. 2. Foreign trade in agricultural products, 2000-2011 (Mio dollar)

Source: calculated based on data: Commodity structure of foreign trade. State Statistic Service of Ukraine. – Access at: http//www.ukrstat.gov.ua.

There were preconditions for establishing corporate mechanism in agriculture of Ukraine (Rilko, 1999; Khramova, Serova, 2002):

1 Existence of transition markets, which leads to exaggerated development of vertical and horizontal integration as an instrument, which allows opposing excessive transaction costs and risks.
2. Huge constrains for entering into the "traditional" sectors of agriculture, stipulated by debts and many shortfalls of newly established economic entities on the bases of reformed kolkhozes and sovkhozes. External financing of agriculture under such conditions could be performed only through establishment of new business structures.
3. Influence of foreign investments on the national economics through close relations among new agricultural operators with foreign investors, chiefly employed in food industry and trade.
4. Dynamics of the global macroeconomic sectoral structure of variable (alternative) costs, which is defined by the fact that long-term outward investment in agriculture and agribusiness are viewed as one of the most attractive long-term directions for capital allocation.

It is obvious that each of these factors af fected establishment of corporate structure to a certain extent. However, in our opinion, this problem lies much deeper. Heavy role here belongs to informal institutions of the soviet times, which, as is known, changetoo slowly. On the political level it is seen in terms of active state supporting for development of a large commodity agricultural production and neglecting of a role and significance of family farms (peasant farms and farming households). The latter, existing under such institutional conditions, have to adjust gradually to their "needlessness" in social production. That is the reason why they lease out their land to corporations or just sell it, without a second thought about after-effects of such actions.

The Government of Ukraine over the entire period of agrarian transformations favored establishment and development of large business in agriculture.

The same old way they intrude opinion uponsociety that it is large enterprises that can ensure food safety , "pull back" agriculture out of recession, ensure high quality of products manufactured, build up export potential etc. Instead, family farms are assigned a role of "part-time" farms, which they were during pre-reform times. Thus was established a dual structure of producers in agriculture of Ukraine: corporate (agroholdings, VISs) and individual (peasant farms and households) sectors.

Regardless of privileged position of the corporate structures, over a half of agricultural GDP in Ukraine is ensured by the individual sector. They remain major producers of essential types of agricultural products, which ensure food security of the state, in particular. Instead, corporate structures are involved in production of mostly export-oriented products, oil and grain crops (Fig. 3).

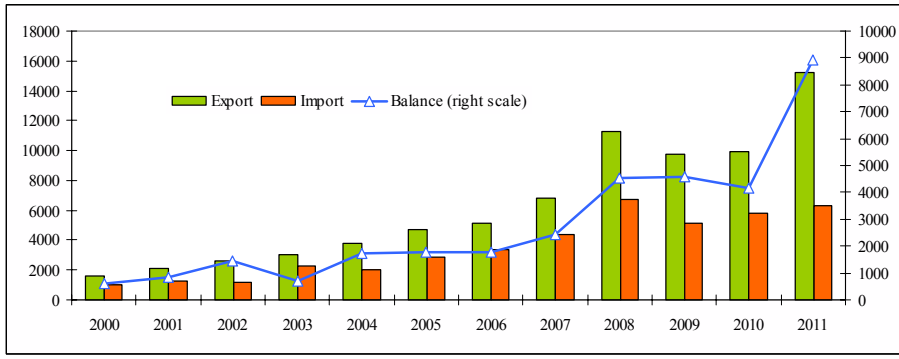

Figure. 3. Shares of individual and corporate sectors in production of main agricultural products (%)

Source: Statistical Yearbook "Agriculture of Ukraine 2011"

At present corporate sector sizably strengthens its influence on structural dynamics of agrarian sector. Agro-industrial corporations of a holding-like type are being gradually enlarged, acquiring agricultural enterprises and land. As a result, as of the end of 2012, 10 the largest agroholdings control 22% of arable land in Ukraine (Fig. 4).

From the institutional point of view, this can be identified as misbalanced institutional development, which leads to certain motives in behavior of economic entities, aiming it at seeking natural resources and disregarding tasks of socio-economic society development. Production and land concentration process continuous regardless of existing limitations. The main problem lies in whether agroholdings are able to increase effectiveness of the sector and how their emergence can affect domestic producers, economic welfare of small agro-producers and rural population (Rilko, 1999), considering that during the period of agrarian transformations limitation of pre-reform socioeconomic rights of rural population took place. The State does not guarantee any more:

steady prices on agricultural products and food; incomes amounting to minimum subsistence level; full-time work and absence of unemployment. Rights to free medical care and education have been limited as well. These changes in institutional and legal sphere have officially introduced new "rules of game" for corporate structures in rural area, which stimulates them to apply certain managerial models of functioning.

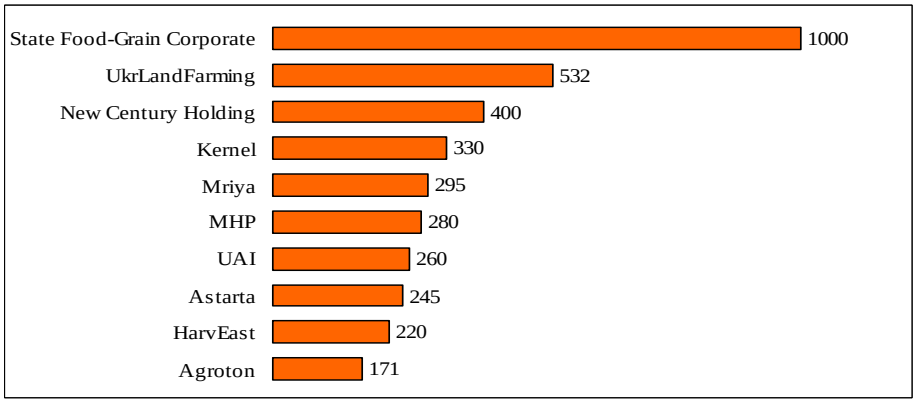

Figure 4. Land banks of the largest agroholdings in Ukraine (1000 ha)
Source: BAKERTILLY; FINANCE

Literature analysis (Borodina et. al., 2012; Gutorov, 2011) and empirical studies show that accretion of economic power of agro-industrial holdings bears a heavy danger, relating to significant distortions in the national economy, as well as in the sphere of socioeconomic, demographic and ecologic development of rural territories. Small and medium agro-producers under pressure on their land rights and under conditions of monopoly power on agrarian markets and in policy of agroholdings can hardly survive. Absence of real state support for small and medium producers in agricultural sector implicitly contributes to intensification of agro-industrial holdings positions in agriculture. Threat to food self-production is growing, as far as it is small and medium business that is able to support economics and population under conditions of financial instability or new crisis phenomena in economics. Export-orientated large agrarian capital destabilizes internal supply, thus leading to deficit of certain types of food and raw materials. As for Ukraine, membership in WTO prohibits quantitative limitations of export that is why the best way of filling-up domestic food market was to push prices up. Such situation triggers food inflation, decrease of purchasing power of the population, which worsens structure and quality of its consumption and may increase frequency of "supply shocks", which became almost ordinary situation in Ukraine.

However, the most severe danger resides in agricultural development sphere, as agriculture represents not only mere production of agro-food. This is

a sphere of public goods production, which is as important for the country as food and agricultural raw materials. Along with that, providing public goods and undistorted prices on inputs are key macroeconomic conditions for controlling unregulated concentration in agriculture of the countries in transition (World Bank, 2011).

Rural economy in European countries is based on family management patterns. They have proved to be effective and able capable of adjusting to changeable internal and external institutional environments within several decades. That is why current European institutional environment of agricultural and rural area development is mostly aimed at achieving long-lasting, economically efficient development of family farming while saving natural grounds of life activity and providing all strata of rural population with economic and social protection. The environment is created on the basis of major mechanisms of sustainable development (DEFRA, 2011).

Methodology of sustainable development through understanding of social role of agriculture and defining its multifunctionality forms the basis of Common Agricultural Policy (CAP) of the European Union for the period of 2006-2013 (EUROPA, 2009). For practical implementation of sustainability principles there were extracted two separated directions of the CAP: support for agro-production and sustainable development policy. The latter is viewed as an integrated (multidisciplinary) process, which includes not only economic figures of growth and development of agro-production, but also ecologic safety and adjustment of rural communities to changeable business environment. Important role is given to the processes of political partnership, which is an integral part of the integrated approach. Recently a ranking place is dedicated to the extended influence of knowledge-based economy on rural development and possibilities of extending its potential owing to new technologies, such as telecommunications, biotechnologies, and Internet.

On the level of practical implementation EU funds are spent on realization of sustainability principles, embodied in four directions of rural development: support for farms compatibility; safe environment and land use; economic diversification within and beyond agriculture to increase standard of living of rural population. These three directions are grounded on one methodological basis (fourth direction) – establishing and functioning of local action groups (community leaders), that mobilize local population for developing and implementing complex local development strategies on democratic principles. Fourth direction is titled «LEADER» and characterized with realization of human potential and social capital of rural communities , and also point at providing with priority conditions for women and youth. Major purpose of the «LEADER» program is to involve rural population into designing and implementing original strategies of integrated rural territory development in general context of priority European tasks: improving standard of living in rural area; involving high technologies to rural areas; optimization of using natural and cultural resources of local level. Strategic directivity of the EU

CAP on rural development has been justified and this approach is reserved for the future period of 2014-2020. Stipulated changes are related to main priorities of the EU rural development: promoting knowledge sharing and innovations in agriculture and forestry and rural area; competitive growth and viability of all types of activity; promoting organization of food supply chain and risk management in agriculture; recovery, preservation and strengthening of ecosystems, depending on agriculture and forestry; stimulating of effective use of natural resources and transition to a low carbon, resistant to climate changes economics of agriculture, food and forestry sectors; promoting social integration, poverty reduction and economic development in rural areas.

Within several decades CAP has been major financial strategy of the EU expenditures. Till the last reform almost 70% of the budgetary costs were spent on agrarian policy, according to the current budget – approximately 35%. Costs, spent on support for agrarian sector of Ukraine, are significantly lower, however "at ineffective institutions even huge state investments in support for economics are in vain; they will result in mere "application of funds" and will not result in a real effect. Moreover, increase of state subsidies in agrarian sector (preserving a status-quo – author's note) shall result in widespread and intensification of leading-strings mentality, rooting of thoughtless and irrational spending of budgetary funds, bribery expansion. By improving institutional system it is possible to reach much better results, then by simple filling in of economics with additional resources» (Barlibaev, 2011), as effective institutions allow involving not only finances, but also organized collective efforts for solving common problems and reaching common purposes.

Imperfection of rural and agricultural development institutions in Ukraine may be characterized by the following:

A. Lack of institutional coordination. An issue of development of agriculture and rural areas is within cognizance of various state bodies – ministries of agriculture, economics, social development, finances, ecology etc. Nevertheless, their policy is aimed at own interests and does not serve commonpurpose of rural development. This results in institutional chaos on the rural territory level. Maladjustment requires institutional integration for reaching final targets and coordination between various organizations and law authorities at all levels of decision making and protection of rural community interests from uncontrolled grabbling of their resources.

B. Institutional inability to act collectively – means lack of effective social institutions, able to resist pressure of big business: agricultural advisory services, farmer organizations, rural community organizations, institution of trust and cooperation between the parties regarding protection of rural people rights etc.

There has been established a lot of social institutions in Ukraine within the period of agrarian transformations: associations, unions, agrarian chambers etc. They have been mainly established on the initiative of public authorities of donor organizations and support of technical assistance projects. Upon support reduction, these structures undergo influence of local authorities. Another part of them continue function only for the purpose of receiving costs for self-financing of administrative staff. Similar transition forms of institutional authorities may be observed on the level of sectoral management bodies. They influence financial disposition on the local level, using own status, image and power to solve the issues not included into the range of their direct duties.

C. Pseudodemocratization of governance. During the period of agrarian transformations a certain progress in decentralization of governance structures of rural development and villages was reached. A role of governmental institutions was changed and new structures of decentralized governance were established. Notwithstanding this, local communities do not participate in making decisions regarding local development, or their participation is insignificant. Thus, decentralization process, relating only to structural changes, but not ensuring qualitative changes (such as actual participation, transparency, competency and reliability) has a little impact on establishing governance system with active participation in policy making of rural population. Save structural and qualitative changes, decentralized structures (state, as well as social) should possess sufficient rights and financial resources to protect social interests.

D. Underdevelopment of private ownership institutions. With introduction of private ownership on land and property , rights and obligations regarding use of natural resources in agriculture were not defined clearly. This resulted in uncontrolled resource concentration, land in particular. Also a question remained who should a right to receive lease payments from their use (land firstly) and who shall bear expenses on their renewal. Right of ownership in land relations system reflects all complexity of allocation, governance problems and adjusting various expenditures and gains flows for resource, technologies and agricultural equipment use.

Compared to establishing of euro-institutional space of the EU CAP , these difficulties are greatly intensified by the fact that Ukraine does not have experience in evolution of market economy institutions in agrarian sector and established new institutions on the heritage of the administrative command system. Notwithstanding that collapse of the Soviet economic system serves as an obvious proof of its inviability, still, even Western European economics, which was mainly shaped and developed by market mechanisms, was not aimed at sustainability at once. Such conclusion is well supported by external displays, peculiar to the European agricultural practice of the previous century. This includes, in particular, agro-food processing, significant ecologic expenses, problems of rural population migration and rural communities decline etc. These are the problems that Ukraine faces in the twenty first century.

Institutional problems of agricultural development of Ukraine are in the interface of economics, natural environment and society. Agricultural system is a specific form of institutional changes, which should base on understanding that achievements in economics are connected with losses in other sectors, as for example, destruction of social relations or dysfunction of ecosystem. That is why it is important to balance institutions for ensuring sustainable development and mitigating consequences of fast economic growth. Institutions, ensuring sustainable development, may be defined as a set of rules, which effectively help and contribute to reaching ecologic, economic and social targets. In European community, an assembly of institutions, contributing to sustainable development, is characterized by the following:

- system orientation: institutions of sustainable development in agriculture are developing at the interface of economic, ecologic and social systems, empowered in more scaled systems;
- dynamic orientation: systems of decision making and policy designing are adaptive to changes and include training process;
- participants orientation: participants unification, their interaction, motivation and resources, preconditioning behavior patterns;
- resource orientation: consideration of the natural resources peculiarities and consequences of their use, such as exceptionality, competitiveness, specificity, complexity and uncertainty (FAO, 2003).

«Europeization» of agricultural and rural area policy, as well as administrative governance of rural development is based on making and implementing range of various laws and legal procedures, widespread in the EU. They represent distant prospects, which shall be implemented in case of Ukraine's accession to the EU.

However, it is now required to harmonize institutional systems towards implementation of European principles of sustainable development, as one right and safe direction of increasing agrarian production and its export potential.

The process of the «institutional Europeization» emphasizes importance of potential development on the local level. Structures of the lower level should have respective rights, obligations, possibilities and resources for creating political course regarding limitation of corporations' power and preservation and reproduction of bases of sustainable rural development. Possibilities of local authorities and state structures of local levels are very limited due to limitation of resources and powers. Significant capital investments in development of local potential of institutional changes are required, which shall cover:

- creation of local, regional and state institutions, which are involved in problems of rural development;
- availability of well prepared and rightly organized system of public governance on the local level;
- intensification of institutions of society as an active partner in solving socio-economic and ecologic development tasks for agriculture and rural areas.

In the context of shaping European institutional development these tasks may be solved successfully via creation of direct relations between the EU states and Ukraine within the framework of Institutional partnership programs to share knowledge between the politicians, scientists and practitioners on the local level for the purpose of learning common and different problems. Such sharing with scientific approaches and experience shall serve as an initiator of euro-oriented institutional transformations.

Conclusions

Notwithstanding incompleteness of institutional transformations in agrarian sector of Ukraine, current institutional environment is dif fers significantly from pre-reform owing to those steps, which were done towards creation of new institutions. Along with that degree of moving towards European-like institutional environment is not that one, which may be seen in the context of assessing in terms of formal characteristics of those or other institutions.

Methodological aspects of institutional transformation of agriculture and rural areas in EU are incorporated in the CAP and are intensified in the European integration project. For the entire period of the existence, CAP has undergone many changes and for the period of 2014-2020 transformed into multifunctional policy of sustainable development, which supports innovative rural development and market oriented agricultural production in Europe along with securing life-sustaining activity of rural communities, territories and ecosystems. Primary tar gets of the CAP remained the same. However, their essence has changed significantly; in particular sustainable development (combination of economic, social and ecologic tar gets) became major purpose of the EU CAP.

Trends of contemporary agrarian development in Ukraine prove that market possibilities to solve socio-economic and ecologic problems in rural area are limited. In the given context it is required to study which institutional structure and motivations should be created in order agricultural practice became socially and ecologically safe. Current system of agriculture and mechanisms, regulating agrarian sector, do not promote using methods of agriculture that shall preserve communities and ecosystems.This problem is very topical taking into consideration that major priority of agrarian system restructuring was and remains increase of economic efficiency of agrarian sector. Thus, it is required to review the role of the market in governing agrarian sector, which stimulates development of socially and ecologically unacceptable agricultural policy.

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