

## FINANCIAL SUPPORT TO THE AGRARIAN SECTOR OF UKRAINE

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### ABSTRACT

*The paper studies the current state of agricultural production in Ukraine, it analyzes the agricultural financial system and the tools of the financial mechanism of agricultural development activation, and determines the main factors restricting the flow of investments into the agricultural sector.*

*The terms of agricultural producers lending are analyzed, modern instruments of financial support of agricultural activity, including bill financing and agrarian receipts, factoring, forfeiting and using venture capital are substantiated. The paper also focuses on market participants lending through credit unions and on the need to modernize state agricultural policy in small and medium-sized businesses support.*

*It is proved that in order to minimize the negative effects of agribusiness development in Ukraine, it is necessary to develop effective measures preventing the investment downturn and*



*creating an attractive investment climate in the industry, aimed at further development of the national stock market, leasing and establishment of specialized credit institutions..*

**Keywords:** Investments, Financial Support, Crediting, Agro-Insurance, Agrarian Sector, Government Support, Agricultural Products, Prices.

## INTRODUCTION

Ukraine's agriculture is among the life support systems of the society since it forms the society's food resource and the condition of the resource determines the national and economic security of the country. In addition, agriculture is a basic area for rural development, providing employment to the rural population, their standard of living, the vector of demographic processes and, ultimately, the reproduction of the rural society.

At the same time, there are some problems in modern agriculture predetermined by its specificity: seasonality of production, high dependence on natural and climatic factors, volatility of prices for agricultural products, insufficient investment attractiveness of the industry, the complexity of credit resources attraction. Above all, the absence of a system of rational use, accumulation and formation of financial resources in the process of economic activity are specific to the agricultural sector.

In this regard, the development of prudent agrarian policy of the state and the formation of a financial mechanism for agricultural development activation, which involves the use of budgetary, investment, tax, credit, price and customs policy instruments have become especially relevant recently.

The aim of the paper is to present the agricultural financial system of Ukraine and determine the tools of financial mechanism of agricultural development activation in Ukraine.

## MATERIALS AND METHODS

following sources: Ministry of Economic Development, Trade and Agriculture of Ukraine; The State Statistics Service of Ukraine; Office of Financial and Economic Analysis in the Verkhovna Rada of Ukraine; National Bank of Ukraine; scientific papers. Analysis and synthesis method, abstract-logical and statistical comparisons as well as survey research methods were used in the paper.

Results and discussion. Over the last five years, the agrarian sector of Ukraine has shown an upward trend and is currently the main source of foreign currency inflows into the country and a key factor in maintaining the trade balance. Agricultural land accounts-70.8% of the territory of Ukraine; 44 of them are black soils. The share of agriculture in Gross Domestic Products accounts for almost 11.9% and the agricultural sector occupies the leading roles in the export commodity structure equal to 39.8% of the total export of our country (Table 1) (State Statistics Service of Ukraine, 2019).

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Output in Agriculture (actual prices, UAH million)	189405	253569	258270	307054	371189	544206	637791	707792	847587
Export of agricultural production, USD billion	9.9	12.8	17.8	17	16.7	14.5	15.3	17.8	18.6
% in GDP	8.4	9.5	9.1	10	11.7	14.2	13.8	12.1	11,9
% in employment	15.3	16.8	17.2	17.5	17.1	17.5	17.6	17.7	18.0

\* State Statistics Service of Ukraine, 2019

18 % population of Ukraine is employed in agriculture. Land is one of the main factors in the development of the agricultural sector. Ukraine has a huge natural resource potential for the agricultural sector development and a variety of favorable climatic conditions creating opportunities for high-quality agricultural production, which positions the country in the global food market through ensuring the food security. The agricultural sector exports grew by almost 2 times in 2010-2018, having reached \$18.6 billion. At the same time, we have an unbalanced - 90/10 - ratio of raw materials and processing in the export structure. The industry has been suffering a very difficult financial and economic conditions recently, and it has faced a number of significant challenges like extremely limited opportunities in drawing investments and loans; ineffective system of registration of leasing rights of agricultural land; the lack of legislation aimed to the facilities economic activity in agriculture; distorted state support for agricultural producers; underdeveloped infrastructure and mechanisms for regulating the agrarian markets; insufficient investment management of agricultural companies; imperfection of the credit mechanisms of the industry; military actions in the east, etc. In addition, excessive regulation in economic activity creates opportunities for corruption.

A thorough analysis of current trends in the agricultural sector showed that Ukrainian agribusiness (except for large agricultural entities) operates in conditions of constant and severe shortage of funds.

Despite the fact that the implementation of a set of measures provided by the Single Integrated Strategy for the Development of Agriculture and Rural Territories for 2015-2020 (Verkhovna Rada of Ukraine, 2016), contributed to some positive changes in the area, the level of capital investment in the agricultural sector does not allow to fully exhibit the existing resource potential of the industry. That is why the effective functioning of the Strategy requires the formation and development of specific mechanisms for financial support.

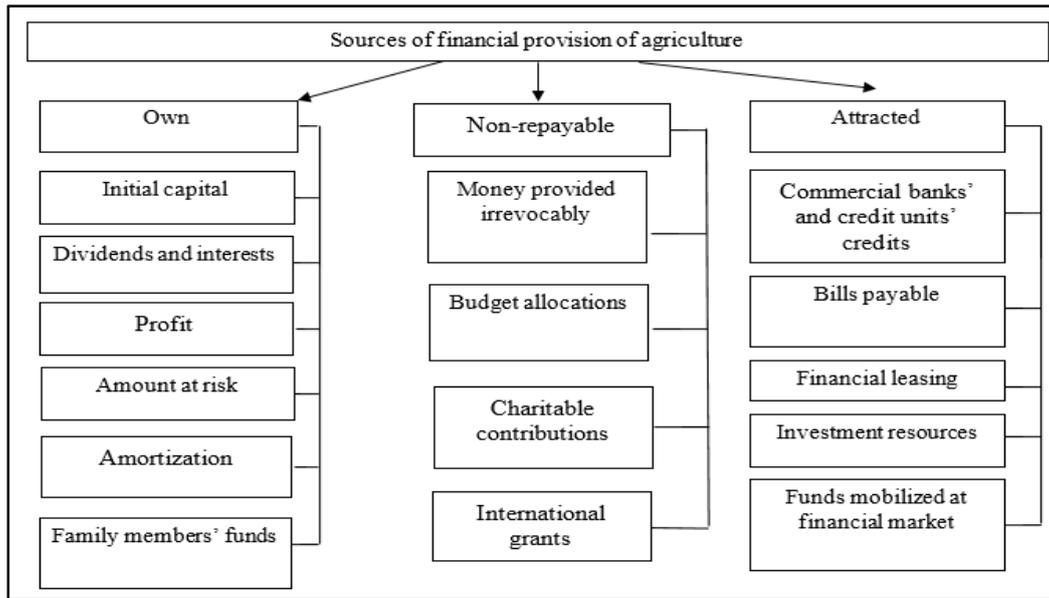
Financial support for agro-food production differs in its specificity due to low rates of capital turnover, the influence of different natural and climatic factors, which create different opportunities for managing seasonality of production and uneven income generation during the production cycle, limited ability to diversify the production; the complexity of attracting investment; imperfection of agricultural infrastructure.

The specificity of agriculture financing is also conditioned by the diversity of management forms and the active participation of the state in the distribution and redistribution of monetary income in agriculture. Due to this specificity, the market mechanisms of agricultural management cannot be implemented with the same completeness and efficiency as in other sectors of the economy.

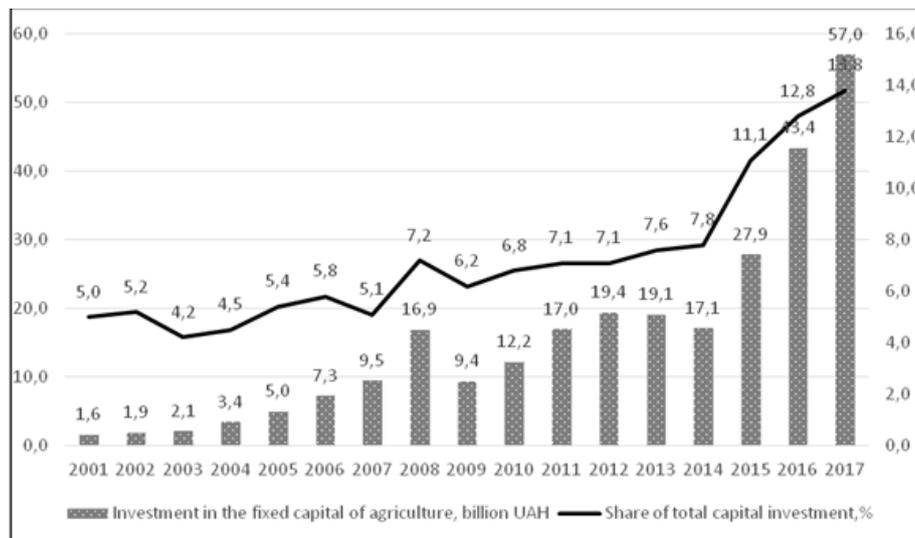
The sources of economic entities financial resources formation include their own, involved and irreversible ones (Figure 1).

At the same time, one of the main sources of the replenishment of agricultural producers working capital is the manufactured production, but the prices for most cereals and oilseeds fluctuate significantly in the domestic market. Also, the investment support is an important prerequisite for agribusiness effective functioning and development.

According to the State Statistics Committee, capital investment in agriculture, forestry and fisheries amounted to UAH 57.8 billion, or 13.8% of their total economy in 2018, Figure 2



**FIGURE 1**  
**SOURCES OF FINANCIAL PROVISION OF AGRICULTURE**



**FIGURE 2**  
**SHARE OF TOTAL CAPITAL INVESTMENT, % INVESTMENTS IN FIXED CAPITAL OF AGRICULTURE AND THEIR SHARE IN TOTAL CAPITAL INVESTMENT AS A WHOLE ACROSS UKRAINE**

According to the National Scientific Center "Institute of Agrarian Economics" in 2019, there is a significant slowdown in investment activity of agricultural producers, the absolute share of capital investments is made at the expense of their own sources of financing.

The principal barriers for investing in the agricultural sector are as follows: low efficiency of agricultural production, unadjusted legislation, lack of warranties to protect the legislation against changes; price disparity for industrial and agricultural products, a moratorium on agricultural land market sale; the loss of trust for most national trust companies in the stock markets, etc.

We applied correlation and regression analysis to study correlation of gross agricultural production growth and the volume of internal investments in fixed capital. We have found out

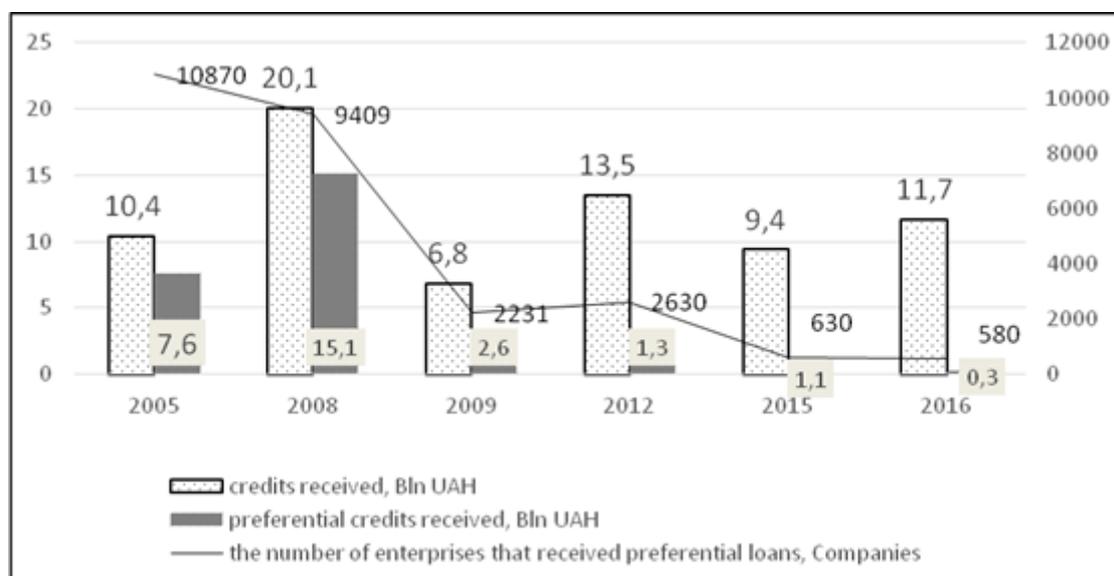
that the overall growth in gross agricultural production closely correlates with the investment volume. In particular,  $R^2=0.839$  for 2000-2017.

Currently, the relative volume of investments into the economy of Ukraine is 2-2.5 times lower than the regulatory need (Yarmolenko, 2017).

An average investment of up to 30% of GDP is estimated to be required for GDP growth of 6.0 %.

The study found that, about 70% of the working capital for the agricultural sector development is generated by bank lending in developed countries, while in Ukraine, only 7% of the bank loans are issued to agriculture producers. And only 5-6% of capital investments in the agroindustrial complex are formed at the expense of bank loans and similar borrowed funds (Polyarush, 2018).

The analysis of credit security in 2005-2016 shows that crediting of the agro-industrial complex enterprises was cyclical (Figure 3) (Materials of the official website of the National Bank of Ukraine)



\* The National Bank of Ukraine.

**FIGURE 3**  
**THE VOLUME OF CREDITS RECEIVED BY AGRICULTURAL ENTERPRISES**

During 2005-2008, the loans volume extended by 1.93 times (from UAH 10.4 to UAH 20.1 billion). During 2009-2011 the lending was reduced though it had a positive dynamics (increased from 6.8 to 13.5 UAH billion), and from 2012 to 2016 the volume of agricultural producers lending decreased (from 13.5 to 11.7 UAH billion) and measured the levels of 2005 and 2010.

We interviewed 250 private households owners and found out that only 53 of them used the loans. For all this, the sources of crediting are quite different: in particular, only 5 private individuals received a loan from a commercial bank, 1 – from a credit union, 10 – from an agribusiness company, 37 people received a commercial loan. The loans were used mainly for the purchasing agricultural machinery and the attachments equipment (40 private owners), the others used the loans for the purchasing farm animals and for farm facilities construction. This situation can be explained by the distrust of agrarians to the state support for lending, bureaucratic and non-transparent procedure for obtaining preferential loans, and most importantly, there are cases when agricultural producers are forced to seek financial resources for banks since the state can not provide the preferential loans payment when the time is due.

Also, the land is not the capital and the farmers have no mortgage property, so the banks are not willing to lend to small and medium-sized agribusinesses.

Most banks provide financing only to farms owning more than 100 hectares of land as they consider smaller economies to be too risky. Commercial banks offer medium- and long-term financing, which is difficult to access because banks have limited information about the agricultural sector and are unwilling to provide it. As a result, most loans are provided for a period of 1-3 years (Dumanska, 2018).

The specific risks of lending to agribusiness, especially small and medium-sized ones, include climatic conditions, seasonality of production, and low liquidity of the collateral (fixed assets, including operating assets that are illiquid due to their high depreciation, make up over 70% of total property value).

Therefore, since loan procedure is complicated and cost-based, as well as due to high interest rates and low creditworthiness of agricultural producers, the vast majority of them do not have access to bank loans today. Only the future crop can be used as a pledge since the land the producers use as their basic production means is leased.

We believe that is credit unions are the most promising and convenient form of financing for small and medium-sized businesses. Therefore, credit unions are becoming widespread and they provide additional financial, material, intellectual and other resources to the commodity producers.

Also worthy of attention is the financing of Ukrainian farms through bill financing (availing bills for the purchase of seeds, herbicides and pesticides from world-renowned importing suppliers). As foreign experience shows, bill financing provides some freedom to farmers, banks, distributors. Besides, and commodity producers can be provided with resources (machinery, seeds, plant protection products, etc.). Such cooperation has already proved to be effective with the following suppliers: Bayer, Singenta, BASF, DuPont, which operate under the following scheme: the enterprise buys resources from a distributor, pays by a bill (the willingness of the distributor to accept a bill is discussed at the stage of negotiating the contract). The bill is to be availed by a bank which guarantees a future payment on the bill's due date. The distributor, in turn, uses the bill to settle accounts with the manufacturer and thus it avoids credit risks. The funding period is as long as 12 months, but short-term promissory notes issued for the period from spring to December 1 of the respective year still prevail. Within the framework of programs on cooperation with large suppliers, this scheme is beneficial for all participants of the process, especially for farmers: the bill is cheaper to use as compared to a bank loan (average rate in the current period ranges from 2.7 to 4.5% for a six-year instrument), the buyer can expect additional discounts for purchasing the products by means of bills of exchange, no currency peg since all currency risks are borne by the manufacturer. However, such risks are incorporated into the price and thus the buyer receives non-monetary benefits (staff training, timely supply of resources, etc.).

Agrarian receipts, regulated by the Law of Ukraine *"On Agrarian Receipts"* (Pavlenko & Duchenko, 2019), are becoming of considerable spread among modern instruments of financial support of agricultural activity. They enable commodity producers, especially small and medium-sized ones, to obtain loans to finance their current operations as collateral for future harvest under the simplified procedure.

Leasing is the most affordable source of financial support for agricultural producers, with its affordability being the most important advantage as compared to lending. With a low down payment of 20%, leasing can minimize the use of working capital to obtain equipment by distributing monthly payments from the proceeds from the sale of products released on leased equipment, in accordance with the basic cash proceeds from the sale. In this case, the lessee has the opportunity to use the equipment until its full payment without any restriction and to protect itself from inflation during the leasing payments. Currently, every third machine

is acquired by farmers through leasing, as it is financed by foreign companies in most cases. However, the bankruptcy of Mriya agricultural holding company resulted in significant changes in the leasing market. These changes alerted foreign investors with further decrease in foreign capital inflow into the Ukrainian economy. Leasing companies working in the agricultural sector and using fully the state budget are ineffective.

The powerful monopoly position of these companies, in particular the one of Ukragrolizyng NJSC operating in the leasing services market prevents from the development of private leasing companies, introduces distortions in leasing schemes and discredits leasing as such. State support of agricultural enterprises through the financing of Ukragrolizyng NJSC results in the increase in the cost of domestic equipment, production of the equipment which is not in high demand, abuse and corruption in this area and thus it significantly reduces the efficiency of using the State Budget of Ukraine" (Pavlenko & Duchenko, 2019).

It is also worth noting that due to the imperfectness of regulatory mechanisms, distrust of insurance companies, lack of understanding of benefits, the risks insurance system related to price fluctuations, climate change and animal diseases is hardly ever applied in Ukraine. We believe that in order to stabilize the incomes of agricultural producers, the agrarian business needs a qualitatively new system of agricultural insurance. Given that no country in the world develops its agri-insurance without the government support, and in some cases it may amount to up to 90% of insurance premiums, such support does not contradict the WTO requirements, this system should be a priority of domestic agricultural policy, but at the same time it should be transparent and predictable with a balance of interests for all participants.

The agricultural sector of Ukraine needs the immediate establishing a specialized cooperative system of agrarian lending and a nationwide network of financial institutions (financial, mortgage, leasing and insurance) which provide specialized financial services to agricultural producers.

Analysis of the foreign experience in financial support for agricultural producers proved that non-traditional sources of financial resources, including factoring, forging and use of venture capital, deserve attention.

About 20 banks offer factoring services in the Ukrainian market, but their provision has declined somewhat in recent years (Dubyna et al., 2017).

With regard to the state support for agribusiness in Ukraine, the research has found that almost all its activities are too bureaucratic and they are focused on the revival of large-scale production, and therefore is not accessible to small and medium-sized producers. This situation has led to an excessive concentration of land tenure, monopolization of the agrarian market, reduced efficiency of land use, lower environmental standards of management, deformation of the traditional way of rural life.

The government support focuses insufficient attention on funding the programs capable of sustainable agriculture, such as research, infrastructure development, food security, sanitation and veterinary measures.

In our opinion, the issue of improving the mechanism of state support for agriculture is rather topical. The support focuses on farms and small private households, which are most fully fulfilling the social functions of the industry, in particular, in food security, employment, formation of solvency interest and maintaining the industrial and social infrastructure of the village.

Achieving economic growth of the agricultural sector is impossible without the introduction of effective diversified procedures for lending, the formation of a mortgage lending system, establishment of specialized banking and alternative non-bank credit institutions, mechanisms of financial guarantees for the loan return to agricultural producers, the insurance of financial risks, applying the mechanisms of the national agrarian market permitted by the WTO standards.

## CONCLUSIONS

Therefore, the current level of financial support to the agricultural sector does not meet the modern requirements for the positive dynamics of expanded reproduction and the industry competitiveness increase. The peculiarities of agricultural production and agricultural enterprises economies necessitate the formation of a multi-source system of the industry financial support with the income from the products sale as the main source of financial resources. However, in conditions of stiff competition, the formation of an effective financial mechanism for the Ukrainian agricultural sector development requires a comprehensive application of the tools, techniques and methods necessary to attract sufficient financial resources from all possible sources of financing. These tools include the introduction of free circulation of agricultural land, the use of innovative methods of agricultural producers crediting, the improvement of the system of institutions engaged in securing leasing relations and agricultural insurance in agribusiness, the realization of state support for farmers and united rural communities, introduction of the system of incentive taxation, price regulation, etc.

Modernization of the national agrarian policy is of great importance in this process. In order to minimize the negative effects of agribusiness development in Ukraine, it is necessary to take effective measures to suspend the investment downturn and create an attractive investment climate in the industry, as well as to improve the conditions for small and medium-sized businesses financing.

In our opinion, it is advisable to reduce the value of financial resources by 5-10% in the national currency, to extend the lending periods up to 20-30 years, to restore the level of confidence in most Ukrainian agro companies in foreign stock markets, to further develop the national stock market, leasing and creation of specialized credit institutions.

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