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# Conditions of resuming and completing privatization in Ukraine

Analytical report and recommendations  
for the State Privatization Program

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Kyiv-Warsaw, 2007



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The views and opinions expressed here reflect the authors' and not necessarily those of the CASE or the Ministry of Foreign Affairs of the Republic of Poland

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## Introduction

Privatization that used to be a “locomotive of the Ukrainian reforms” (Paskhaver and Verkhovodova, 2006) is now in a holdup. The last State Program for Privatization for the years 2000-2002 was adopted as late as in May, 2000, and this was probably the end point in the privatization as a conscious reform. Since then the process has derailed. The new Program developed in 2003 was not accepted by the Parliament, instead during the last two years of Kuchma regime a sort of uncontrolled deetatization took place. A number of the most lucrative assets went to private owners, connected with the authorities, either at a price well below the market one (due to restrictions on competition at the privatization tenders and auctions), or bypassing the privatization procedures all together.

The Orange Revolution resulted in an attempt of revision of this entire wave of privatization – which, however, would inevitably affect the remaining results of the privatization as such. Only a single but notable case of Kryvorizhstal’ has been eventually finalized, but the overexposure of this attempt resulted in a massive weakening of property rights, which may be detrimental for the revival of privatization and attracting new investors. Even giving up the idea to “revise privatization” did not allow the last three governments in power to resume the process. The idea of privatization is still in a deep crisis and its perception by the population became as negative as never before.

The new government has to cope with these difficulties, in order to continue the institutional reforms which include further development of the private sector and strengthening of property rights but also, to be able to use the privatization revenues for important social and economic goals. Under these circumstances, transparency and clearness of the privatization policy, and of the property rights acquired as a result of it, become crucial.

In this paper we try to discuss in a systematic way the main factors and barriers that may influence the future privatization policy in Ukraine and we recommend the directions of the privatization program of the country on the base of a reconstruction of the draft Privatization Program of 2003.

In the first section of the report we present shortly the outcomes of the entire privatization process from 1992 until now, its achievements and delays, we also characterize the ownership structure of the economy that has been achieved through privatization and we show the actual share and role of the remaining state sector. We shortly present the former state privatization programs and we show the amount of revenues from privatization to the state budget in previous years. Finally, we discuss the privatization prospects under the new political circumstances.

In the second section, we analyze the political-economic issues of the current privatization holdup along with the most plausible ways of its resolution.

The third section is devoted to the problem of better legitimization of the privatization process and its results.

Section four is devoted to the difficult technical problem that currently affects the consistency of property rights already acquired or subject to future transfer through privatization (and, therefore, indirectly affects the market value of enterprises too) – the status of land plots under the objects of privatization.

Finally, in section five we consider the problem of clear and formal regulation of the investment regime for foreign buyers.

All issues presented in sections 2 – 5 were not addressed or insufficiently addressed in the draft Program of Privatization of 2003, merely because they were not so topical those times, and have become important mostly after the Orange Revolution.

In the recent political situation, when the political forces in Ukraine are searching for a new equilibrium, the process of privatization needs certain legislative and regulatory framework that would address the above mentioned problems and the Program of Privatization providing a time schedule and methodological recommendations for the process. In our opinion, the new, long-term, and comprehensive State Program of Privatization, along with some supplementing legislation, should become an important part of the global compromise between the main political players. Among other things, it should provide the answers and solutions for the problems, as described below.

# 1. Privatization outcomes after 15 years<sup>1</sup>

## 1.1. Major stages of privatization in short

1992 – start of privatization

1996 – end of small privatization

1998 – end of mass privatization

2000-2002 – adoption of the State Privatization Program aimed at the facilitation of privatization in the strategic industries, monopolies, infrastructure sectors, large technological complexes.

2003-2004 – last years of the Kuchma regime, period of rush sales of state property to business groups, connected with the authorities, as well as to government officials (“on request” privatization), start of the crisis in the privatization process.

2005-2007 – permanent strengthening of the crisis in the privatization process, which was characterized by following facts:

- Orange revolution has destroyed the mechanism of “on request” privatization, but has not offered a new mechanism instead;
- Strengthening of the negative perception of the privatization in the society augmented with increasing political influence of the public consciousness;
- Lack of trust between different political forces to each other has led to the blocking of the whole privatization process (except sales of small objects) since all groups were afraid of re-establishing the selective approach/preferences in privatization that may favor their competitors.

## 1.2. Property structure at the beginning of privatization

As we can see in Table 1, before transition the dominating ownership form of enterprises was the state property, while a small number was in the former collective property and mixed property forms. The official data on the property structure in 1992 covers only the industrial sector.

Table 1.

**Industrial enterprises and their output by types of ownership in 1992**

	<b>Number of enterprises</b>	<b>%</b>	<b>Output, bln krb.</b>	<b>%</b>
Total	9114	100	5801.1	100
Collective property (of workers, corporate company, co-operative)	803	8.8	133.8	2.3
State property	6394	70.2	4746.9	81.8
Mixed property (rented state enterprises, unions of citizens)	1906	20.9	919.5	15.9

Source: Own calculations of L. Verkhovodova, numbers from the State Property Found

<sup>1</sup> This section has been compiled on the base of different unpublished papers and notes prepared for this report by L. Verkhovodova and A. Paskhaver

### 1.3 Scope of privatization

In 1992 – 2004 (pre-orange period) 96.5 thousand companies were privatized, including those of state property – 26.1 thousands and of communal property – 71.4 thousands.

Their characteristics by sectors were as follows:

- industry – 8.8 thousand companies (mining industry - 154, processing industry – 8410, production and distribution of electricity, gas and water – 263)
- construction - 3750,
- wholesale and retail trade, motor vehicle repair and sales outlets - 38371,
- hotels and restaurants – 7085,
- transport and communications – 1997,
- financial sector – 363.

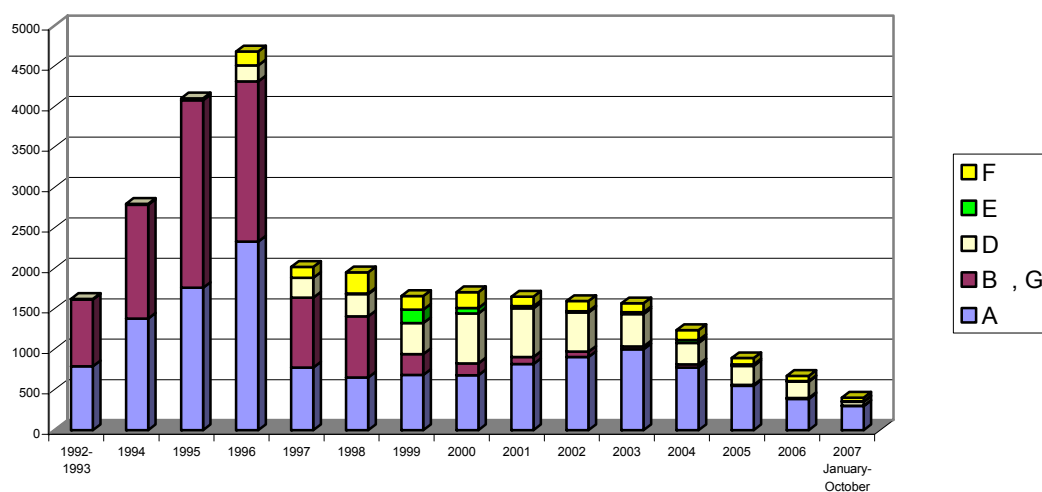
In 2005 – 10 months of 2007 (post-orange period) 14.9 thousands objects were privatized, including: state-owned – about 2000, and of communal property – 12.9 thousands objects. The structure of privatized enterprises, belonging to different groups of size and importance for the economy is shown in Table 2 and Graph 1. The numbers of privatized companies in each year show clearly the crisis in the privatization process after 2004 (especially referring to large and strategic enterprises – Group B and G). The first major privatization decision in respect to six regional energy distributing companies was taken by the Cabinet of Ministers only in April 2007 (Dabrowski 2007).

**Table 2.**

**Number of privatized state enterprises, by groups**

	Total	By groups				
		A	B ,G	D	E	F
1992-1993	1623	789	826	8		
1994	2795	1377	1408	10		
1995	4099	1759	2319	21		
1996	4680	2330	1980	197		173
1997	2018	772	867	246		133
1998	1952	651	754	278	6	263
1999	1659	682	256	386	166	169
2000	1705	678	147	616	66	198
2001	1650	816	89	599	26	120
2002	1594	903	66	483	17	125
2003	1569	998	37	397	25	112
2004	1236	774	38	264	37	123
2005	890	549	11	234	19	77
2006	672	387	11	201	9	64
2007 January-October	403	297	6	47	10	43

**Graph 1. Number of privatized entities by groups and years**



A – small companies; B,G – Large and strategic companies, D- unfinished constructions, E- shares and parts of companies, F- Companies in the social sectors (education, health , research) Source: Own calculations of L. Verkhovodova, numbers from the State Property Found

Different methods of privatization have been adopted during the process. Table 3 shows the structure of all privatized enterprises by the adopted method and Table 4 the same, only for former state enterprises. There is to note, that the largest part of enterprises has been privatized by the redemption method and only a very small number by the sale of shares of open joint stock companies. This illustrates the difference in privatization methods between Ukraine and most Central East European countries, where the sale of shares through public offer is one of the most popular methods of privatization of large enterprises.

Table 3.

**Number of enterprises that have changed the form of property, by methods of privatization**

Method of privatization	Total	1992-2004	2005	2006	10 months 2007
Total	107389	96549	5664	5176	4167
Redemption	54043	46390	3703	3950	3019
Redemption of rented assets	19241	17734	1119	388	476
Auction	16643	15263	683	697	534
Sale at non-commercial contest	2417	2286	29	102	34
Sale at commercial contest	4569	4416	123	30	100
Sale of shares of open joint stock companies	10476	10460	7	9	4

Source: Own calculations of L. Verkhovodova, numbers from the State Property Found



Table 4.

**Number of state enterprises that have changed the form of property by methods of privatization**

<b>Method of privatization</b>	<b>Total</b>	<b>2005</b>	<b>2006</b>	<b>10 months 2007</b>
Total	1965	890	672	403
Redemption	817	395	241	181
Redemption of rented assets		59	28	25
Auction		421	386	192
Sale at non-commercial contest		4	8	-
Sale at commercial contest		4	1	1
Sale of shares of open joint stock companies		7	8	4

Source: Own calculations of L. Verkhovodova, numbers from the State Property Found

The revenues from privatization to the state budget and the percentage of plan execution corresponding to this issue are shown in Table 5. As we can see, the receipts from privatization were very uneven in different years and have been diminished sharply after 2005. The very high revenues in 2005 are due to the resale of only one company - Kryvorizhstal' JV.

Table 5.

**Total annual privatization receipts by years**

<b>Years</b>	<b>amount. millions UAH</b>	<b>completion of the plan. %</b>
1992	0.01	-
1993	0.88	-
1994	14.78	-
1995	17.95	-
1996	35.52	-
1997	78.1	15.6
1998	360.8	34.7
1999	694.6	86.85
2000	2075.5	80.6
2001	2132.0	37.4
2002	576.11	10.3
2003	2175.1	n/a
2004	9501.5	184.05
2005	20686.0*	241.27
2006	552.92	26.33
10 months 2007	2001.99	18.91

\*sale of the Kryvorizhstal' JV.

Source: Own calculations of L. Verkhovodova, numbers from the State Property Found

## 1.4. The scope of private and state sectors in the economy and their role

### The private sector in the Ukrainian economy

The role of private sector has become strategic upon the completion of the small and mass privatization (1998). Private sector was the major factor facilitating the overcome of the deep economic crisis during 1991-1998, and from 2001 – the transition to the sustained high economic growth.

**Table 6.**

**Role of private sector\* in important economic indicators (in %)**

<b>Indicators</b>	<b>2005</b>
Number of entities	88.2
Value of fixed assets	45.2**
Profits from the major activity	90.2
Average annual number of employees	73.8
Capital investments	74.8
Sold industrial output	84.6
Sold construction output	89.6
Domestic wholesale turnover	96.3
Exports of goods	91.9

\*including companies with the private property share accounting for more than 50% of the statutory capital

\*\*last official data as of 2004

Source: Own calculations of L. Verkhovodova, numbers from the State Property Found

### The sector of state and communal property<sup>2</sup>

Historically, the scope and current configuration of the state and communal sectors in the Ukrainian economy have been settled step by step. Their parameters results from the privatization process itself, i.e. from the speed and directions of the transformation of state and communal enterprises into the private ones. There have not been yet developed conceptual approaches for defining limits and content of the state and communal sectors.

The role of the non-state sector in the Ukrainian economy is quite high. In 2005, the state objects made up only 4.2% of the total number of enterprises, communal objects – 7.5%. The remaining enterprises were mainly private companies – 88.2%. But these numbers do not reflect the real scope of the state sector in Ukraine. The absolutely different picture appears when we compare different forms of property by the value of fixed assets. According to the last official data<sup>3</sup>, at the beginning of 2004 state property accounted for 31.5% of fixed assets, communal – 23.3%. This means that the state and local communities have still controlled more than half of fixed assets of the country – 54.8%.

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<sup>2</sup> Including companies with 50% and higher state and communal property share in statutory capital

<sup>3</sup> They are still representative since the volumes of privatisation contracted during 2005-2007 were very low, only small objects were sold.

The state sector is mainly comprised of large enterprises. The average value of fixed assets per one entity in the state sector – is UAH 8.3 million, communal – UAH 3.4 million, private – as little as UAH 0.57 million.

Since the privatization of enterprises of high national importance has been prohibited for a long period of time, in some economic sectors the state property dominates, such as:

- military-industrial complex
- fuels and energy complex
- defense industry
- objects of natural monopolies and adjacent markets
- infrastructure industries
- mills and cereal factories

In addition, from the very beginning the privatization of enterprises of the social sector (medicine, education, culture) as well, as objects of science has been prohibited.

As a result, the state sector still possesses huge assets and consists of strategic objects having strong influence on the country's economy as a whole. On the other hand, we can say that further privatization of the public sector is one of the opportunities or important reserves for further economic growth, which has not been utilized yet.

#### **The structure of state companies**

As of 01.07.2007, the Register of state-owned property was almost completed and made workable by the State Property Fund. It included 36.1 thousand companies. Types and the number of state companies in the production sphere<sup>4</sup> are as follows:

- State enterprises (SE) – 2674. These are “relicts” of the socialism system. They mainly include large enterprises. The most substantial assets are (expert market estimation): Energoatom, - USD 5.9 billion, South-Western Railway - USD 2.05 billion, Donetsk Railway – USD 1.42 billion, Pridneprovskaya Railway - USD 1.7 billion, Ukrenergo - USD 0.7 billion.
- State “kazenni” enterprises – 50. New category of enterprises in Ukraine. They are established entirely in those spheres in which operations are allowed to be performed only by state enterprises, provided the state is a main consumer of their output (more than 50%) or they mainly produce socially necessary goods (more than 50% of total output). They largely include scientific and construction centers, producers of military products, enterprises producing prosthetic and orthopedic devices;
- Joint-stock ventures, in which the state owns corporate rights – 1012, including 30 national joint stock companies and state holding companies established by the President and the Government; 895 open and closed joint stock companies; 87 limited liability companies established by various ministries and the State Property Fund. The nominal value of the state corporate rights in all these companies amounts UAH 34.48 billion (USD 6.83 billion). The structure of state shares by size: 100% of statutory capital – 178 (17.5%) companies, from 50% to 100% – 187 (18.5%), from 25% to 50% - 319 (31%), less than 25% - 328 (33%). The portfolio of state corporate rights is overwhelmed by small parcels of shares, the most of which are not attractive for investors. Companies with the 50% and higher state property share in statutory capital have the status of the state companies (365). In accordance with the expert market estimations, the assets of the largest state companies are estimated: NAK Naftogas Ukrainy - USD 8.6 billion, OAO Ukrtelecom - USD 2.43 billion, OAO Odessa portside plant - USD 0.3 billion, etc.

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<sup>4</sup> According to the classification inherited from Soviet times, it included the firms operating in the industrial, energy, transportation, communication, construction agricultural, and some other sectors – in distinct to finance, education, health care, and so on.

The monitoring of the economy done by the Ministry of Economy proves that the state sector is less efficient in comparison with the economy on average. In 2006, the average level of profitability in the economy equaled 6.6% while in the state sector it was only 0.7%. State and “kazenni” enterprises, and state corporate companies overall turned to be unprofitable in 2006. The other problem of the state sector is a large number of companies which are bankrupt. Only natural monopolies in the state sector operate with profit (12.5%).

The level of profitability of state corporate rights remains low. The pick in the receipts of dividends observed in 2005 can be explained by the shock actions of the post-revolutionary government of Yulia Tymoshenko, directed on de-shadowing of operations of the state companies and mobilization of their profits. The revenues from the state companies contracted after the government had weakened its pressure on them.

Table 7.

**Value of state corporate rights and receipts of dividends in the State Budget**

(exchange rate USD 1=UAH 5.05)

	2004	2005	2006	1 half 2007
Value of corporate rights, billion UAH	26.62	28.51	34.7	34.21
Dividends, million UAH	319.208	1795.105	538.5	252.897
Dividends per 1 UAH of the value of corporate rights, UAH	0.012	0.063	0.016	0.007

Source: Own calculations of L. Verkhovodova, numbers from the State Property Found

## **1.5. The government privatization programs**

### **State privatization program 2000-2002**

State privatization program (Program) is the basic legislation, which designs scale and scope of privatization process and its specific tasks for a given period of time. Until 2000 the parliament or president approved the Program every year. The documents regulated the terms of small and mass privatization, which was implemented with standard instruments.

The State privatization program 2000-2002 for the first time designed the mid-term privatization goals (for three years). It introduced enterprise-specific conditions for privatization of strategic enterprises, natural monopolies, and sophisticated technological complexes.

According to this program, the provision of enterprise-specific conditions of privatization should have provided: declining national and mass-consumers risks when moving to private ownership; selecting the new efficient owner and preserving state control over post-privatization activity of national significant objects.

The enterprise-specific sale conditions included the following elements:

- the preparation of the object prior to privatization,
- market analysis, selection of the date for privatization, advertising for attracting investors
- sale of the control stock to strategic investors,
- assessment of qualifications for the potential purchasers,
- assessment of terms for post-privatization activities,
- investor selection based on the results of investment project competition.

Particular attention was expected to be paid to the transparency of the privatization process. In addition, within the Program privatization mechanisms for complex enterprises that first became subject to privatization were proposed.

However, limitations of the approach were identified promptly. The enterprise-specific methods:

- did not eliminate the national and mass-consumers risks since did not consider general sector conditions, for instance, availability or absence of efficient state management;
- frequently led to breaking up of cooperation and technological relations, established among enterprises;
- under widespread corruption, the qualifications mechanism were used to pre-define the future owner by restricting possible competitors (Dabrowski M., 2007).

### **State privatization program draft 2003-2008**

By the end of 2002 the State Property Fund of Ukraine (SPFU) has commissioned a new privatization program. At that time the SPFU was defining methodology of privatization policy. The Center for Economic Development (Kyiv) and a German government consulting project supported analytical work of the SPFU. For considering peculiarities of new privatization stage working groups of sector experts were created which included specialists from ministries and other state institutions.

For the first time the program was developed publicly. A concept was provided for consideration of the society, the government and the president. After public discussions, the State privatization program for 2003-2008 based on this concept has been developed. The Program project was also discussed publicly. State institutions studied the document thoroughly.

The working groups put forward an original concept: the Program should be a document regulating final stage of privatization in Ukraine. The clear goal allowed consolidating efforts of society on attaining the target. Also this aim was perceived to be a strong driving force of privatization process.

At the Program project the privatization tasks were combined with the goals of effective state management formation. Preparation of an inventory and creation of Unified State Ownership Register was planned for the first year. The work should have defined borders of the state sector.

The project changed the organizational approach to privatization. The document proposed cluster method of moving from an enterprise level to sector in total.

A specific legislation tool for privatization regulation and state sector development has been introduced. The instrument was named *Sector program of market transformation and privatization*. The document harmonized market transformation process within the sector thus aiming at reducing risks. The sectoral programs defined the borders of state property within a sector and developed lists of enterprises for privatization (distributed through the upcoming years). The sector programs were supposed to play an important political role of implementing reform policy at the sector level that could be recognized by the society.

Given a new goal for finalizing privatization in Ukraine, the Program included new ways of 100% depth privatization i.e. price reduction, auctions without predefined prices, free transfer of property etc.

The working group put aside the privatization with predefined qualifications for buyers due to its vast corruption vulnerabilities.

Long and complex process of new privatization stage stipulated for monitoring procedures which should be used for correction of the Program.

The Program project was supported by the SPFU, approved by the government and submitted to the parliament. However, the document was not considered due to political confrontation. Moreover, before the presidential elections the ruling parties started fast distribution of state property between close business groups and government officials. Under such circumstances there was no possibility for implementation of new privatization strategy.

## **1.6. The “on request” privatization period and the response of the Orange Revolution**

During the second presidential term of L. Kuchma (1999-2004), especially in the last three years of this period, privatization became the factor that deformed the progress of post-socialist transformation and led to exacerbation of political controversies inside the country. The in-born clientist relationship between high-level Ukrainian officials and big business revealed in the so-called ‘on request’ privatization.<sup>5</sup> The metallurgical giant Kryvorizhstal’ became the most spectacular example of non-transparent and unfair privatization. It was sold in 2004 to the consortium of two conglomerates System Capital Management and Interpipe for USD 800 million (Dabrowski 2007; Paskhaver&Verkhvodova 2006). Renationalized a year later it was sold again in an open international tender to the Mittal Steel Germany GmbH for USD 4.8 billion (six times more).

The privatization format developed in the country became a source of growing hostility among considerable social strata of the Ukrainian business community in respect of the small group representing winners in the process of state property distribution. Despite the privatization being not the only way of new capital accumulation by far, the vast variety of non-equivalent exchange and budget exploitation sources employed by businesspersons provided the public with blatantly clear proof of inequality in the form of numerous strategic objects that had changed hands to become the property of ‘oligarchs’, which has been further undermining the legitimacy of property rights. The ‘on request’ privatization together with its outcomes became one of the key imputations against the President Kuchma’s regime when Orange Revolution participants opposed it.

Hence, the privatization in Ukraine was brought to a full stop in January - February 2005. A moratorium on privatization of strategic enterprises further remained in effect until June 2005.

Restoration of justice in the privatization area started assuming radical forms that, to a certain extent, appealed to expectations of the public incited by the Revolution (according to the public opinion poll held in February 2005, the idea of restitution of ‘on request’ privatization assets in state ownership was favored by some 71.4% respondents.<sup>6</sup>)

That prompted the Tymoshenko’s cabinet to launch its intentionally shock-style “re-privatization” policies accompanied by public allegations to the address of ‘oligarchs’. Assets were selected for restitution in state ownership solely based on political considerations. The government itself initiated re-privatization of a dozen and a half assets thus goading a property redistribution process of scale across the country at large.

The SPFU did its bit into the review of privatization outcomes, too. It was in the form of an insistent intention to restore big and strategic enterprises back in state ownership under the pretence of their new owners breaching terms and conditions of acquisition. Some 95 formerly governmental enterprises were restored their state-owned status by court procedures in 2005 – first semester of 2007 (245 of them by progressive total since the start of the privatization). Although formally it was just a part of continuous routine process of the oversight of conditions stipulated by privatization contracts that the SPFU has been routinely carrying on in previous years too, after the Orange Revolution it was redirected from enforcement of the contracts to re-nationalization.

Secondly, a growing distrust in private capital as such is that politicians and experts note as related to the Orange Revolution. It was the establishment of an efficient public sector that was officially proclaimed as the mission of the property ownership reform. After V. Semeniuk, a Socialist Party of Ukraine (SPU) activist, took charge of the SPFU in April 2005, the nation’s main privatization office started evolving into a state property managing authority only. From that moment on, privatization as a massive process was only allowed as a measure of state sector rehabilitation.

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<sup>5</sup> That was how the country’s biggest industrial enterprises – Kryvorizhstal’, Nikopol Ferroalloy Works, UkrRudProm State Holding Company etc. have been privatized.

<sup>6</sup> O. Razumkov Centre’s Public Opinion Surveys. March 2005, p.8.

The Orange Revolution not only put an end to the political regime of President L. Kuchma but also liquidated the system of informal arrangements providing the rules for privatization. As no either new stable informal system to replace it or a new formal (legal) system to fill in place of destroyed old informal mechanisms were developed, that led to an abrupt slope in efficiency of regulation of the real privatization process.

Still, the restoration of the full-scale privatization process proved futile in Ukraine even after the lift of the moratorium (see Table 2.) In spite of all the efforts by three post-Revolution prime ministers,<sup>7</sup> the privatization eroded into a decaying process; the annual average slope in the number of sold assets made 22.8% and for B and G group properties, almost 30%, throughout 2005-2006. Recently, the President, the Prime Minister and the SPFU Chair tried to manually manipulate the privatization process but without visible outcomes<sup>8</sup>.

For that time, none of the multitude of projects within the State Privatization Program ever made it to be considered by the Parliament.

### **1.7. Recommendations on methodological approaches for development of next stage privatization program**

After the Orange revolution all three governments – Yulia Tymoshenko, Yuriy Yekhanurov, Victor Yanukovytsch – demanded from the SPFU preparing State privatization program 2005-2007. Through 2005-2006 the SPFU proposed to the government several versions of the Program; however, none of them was approved.

The Program project was based on the following principles:

- firstly, the key goal of privatization 2005-2007 was declared as removing loss-making, small and unattractive objects out of the state property;
- secondly, it was expected that large attractive enterprises (especially strategic companies) could be sold only in exceptional cases for improving budget revenues and under case-specific government decisions.

Such approach reflected the situation in the country since stern political confrontation increased risks for strategic enterprises' privatization.

There is no possibility to overcome the crisis of privatization process unless new fundamental policy is approved. This strategy has to be accepted by the main political forces in the country. We recommend for the reconstruction of this strategy to use the methodological approaches suggested within the project of State privatization program 2003-2008. The next step should be proclaimed as the final stage of privatization as an extraordinary social and economic process in Ukraine.

Chosen mechanisms stipulated by the project have been already applied in practice. The SPFU made an inventory and created Unified State Property Register. The SPFU is now able to select privatization projects considering efficiency of state sector. Sector ministries already started preparing the *Sector programs of market transformation and privatization*.

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<sup>7</sup> Yulia Tymoshenko did try to use privatization as a source of extra funds for implementation of social agendas of scale promoted by V. Yushchenko; Yu. Yekhanurov employed his previous experience of managing the SPFU to restore the privatization process. V. Yanukovych, the top man in the Party of Regions that united big business representatives attempted to renew the 'on request' privatization in the interest of big companies affiliated with the power.

<sup>8</sup> This can be actually witnessed by the fate of the two nation's biggest strategic assets, Ukrtelecom and the Odessa Portside Plant.

However, the former project needs some key amendments. It should contain the following three new elements:

- firstly, overcoming the gaps which emerged due to irregular privatization process. One of the main tasks is privatization of enterprises in conjuncture with land plots they are located on. From the very beginning the state enterprises were sold separately from the plots and now the ownership of the land remains unregulated;
- secondly, the legitimization of privatization results should improve negative perception of privatization and reduce the related political risks for large investors. It is essential to recognize property rights on objects privatized during the pre-orange period. The legitimization of privatization results will favor transition to transparent sales of state property in future;
- thirdly, adaptation of privatization to new challenges of Ukrainian integration to globalization processes. It is important to introduce an official regulatory system for admission of foreign investors to privatization process. The current Ukrainian legislation does not give real techniques for this. The foreign investors' admission is regulated by unofficial methods. In addition large Ukrainian capital in the foreseeable future will maintain its access to authorities and that is why the risk of protectionism remains.

In the following sections of our report the three areas mentioned above will be discussed in a more detailed way. Additionally, the scope of the future state sector shall be reconsidered more deeply.

There are no universal criteria defining the spheres of activities to be performed by the state or private economic agents for an economy. Each country sets up limits between the state and private sector in accordance with its strategy of economic development, comparative efficiency of companies of different forms of ownership, the quality of state governance, etc., as well as non-economic factors such as social considerations, political objectives, mentality of the population and even national traditions.

It may be argued that in Ukraine, the scope of the state sector will be greater, compared to the most developed countries, at least in the short term perspective. Factors that will recently restrict the privatization process comprise:

- Economic factors
  - the state sector consists of a number of assets, which privatization is risky because of the weak regulatory system
  - lack of sufficient investment resources of national capital, which being in power is likely to block the flows of foreign investments into the Ukrainian economy
- Social factor – the population, which, on the one hand, has preserved the socialist mentality, on the other hand, has materially lost in the historical process of distribution of the state property – has negative attitude towards privatization per se (Denisova et al. (2007)).
- Political factor – sharp political confrontation during last years has led to the disappearing of the strategic component in the state administration system. Inability of the leading political forces to reach a compromise has been relevant also in the privatization issues. The privatization process has been paralyzed – during the last two years the State Property Fund has failed to complete the privatization of any strategic or big enterprise. Unfortunately, this situation of political confrontation is expected, in our views, to persist in 2008, at least.

In a longer term perspective one can however expect that the regulatory system would be developed similarly to the levels of other European countries what could allow for a significant broadening of the privatization perspective. The second negative economic factor listed above – the lack of national investment resources could be also alleviated through enhancing of access of the Ukrainian private corporations to inexpensive bank and capital financing, primarily through their globalization (IPOs of the most powerful business groups are expected soon), development of



domestic stock market, first of all improvement of corporate governance and protection of domestic minority shareholders, and liberalization of domestic banking sector. An important factor is also lowering the most cumbersome impediments in the regulatory environment of business that now prevent capital accumulation and discourage investors (both foreign and domestic). As we know, the Ukrainian business climate needs a lot of improvements<sup>9</sup> (Doing Business 2008, World Bank).

As many authors claim (Dabrowski 2007, Balcerowicz and Ustenko 2006)<sup>10</sup>, the poor business and investment climate in Ukraine results from various institutional and systemic deficiencies, such as numerous barriers to market entry (for example, registration and licensing regimes), an excessive number of administrative permissions and inspections, non-transparent tax and custom systems and their poor administration, an unstable and intransparent legal system and its poor enforcement (especially weak and corrupted public administration and judiciary), weak contract enforcement and insufficient property rights protection and the underdevelopment and monopolization of infrastructure.

The most needed areas of improvements for Ukraine are, in the opinion of EBRD<sup>11</sup>: the enforcement of property and contract laws, higher standards of competition, better minority shareholder protection and generally improved corporate governance, better quality of insolvency law and the introduction of joint-stock company law.

Similarly, the Blue Ribbon Analytical and Advisory Centre<sup>12</sup> in Ukraine is calling for a number of reforms in the regulatory area combined with reforms enabling directly further privatization. Besides a strong commitment for a broad, transparent and competitive privatization program<sup>13</sup> the key policy recommendations of the Blue Ribbon Commission include among others a deep judicial reform, creation of administrative courts, decentralization of local administration, creation of transparent land and real estate markets, enacting of a joint-stock company law to improve the business climate and pave the way for stock market development, abolishment of the outdated and peculiar system of the Commercial Code, adoption and implementation of a legal framework in the field of public procurement that is compatible with international standards, establishing of “one-stop shops” for business registration and licensing, and reducing the paperwork and permits required.

It has to be kept in mind that an ambitious privatization program will not work efficiently without all the urgently needed reforms in the regulatory area.

Also the negative attitudes of the citizens to privatization could be changed if the government would be able to develop a public campaign that would explain to the people the reasons for privatization, its’ new transparent rules and the important tasks for spending the privatization revenues. The political barriers for privatization can be resolved by political means, what will be discussed in the next section.

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<sup>9</sup> In WB Doing Business Report 2008 Ukraine is scored 139 (among 178 countries), below all EU and CIS countries (excluding Tajikistan)

<sup>10</sup> Dabrowski, M. (2007): ‘Ukraine at a Crossroads’, CASE – Center for Social and Economic Research, Warsaw, Studies and Analyses, No.350 ; Balcerowicz, E. and Ustenko, O.(2006), ‘Regulatory Policy in Ukraine: Current State and What Should be Done to Improve the Business Environment’, CASE – Center for Social and Economic Research, Warsaw, Studies and Analyses, No. 324

<sup>11</sup> EBRD Transition Report 2007. People in transition, pp.202-203

<sup>12</sup> BRAAC is a project funded by the EC, co funded and implemented by UNDP

<sup>13</sup> Such program would require: setting clear and fair policy requirements for bidders’ selection, avoiding abusive practices of artificial limitation of number of bidders through “specific” requirements, use reputable international advisors to prepare large-scale privatization tenders that secures competitiveness, ensuring transparent procedures for all privatization tenders etc. See: *Policy Recommendations on Economic and Institutional Reforms*, Blue Ribbon Analytical and Advisory Centre, Kyiv, 22 November 2007, pp.3 and 7-9

## 2. Political - economic factors of privatization in Ukraine, and the most acute current problems in its continuation

In the beginning of privatization Ukraine had neither influential social strata nor political forces keenly interested in its promotion. Nevertheless, the privatization did move ahead, even behind numerous bits and stops and resulted in the formation of a new property rights constellation.

The “vague” property rights characterized the entire Soviet system, including Ukraine (Boyko, Shleifer, and Vishny, 1995). Since then, the control and cash-flow rights of the most of state owned enterprises (SOE) were in effect seized by their directors or some other private persons, most often either affiliated with the management, or, later on, belonging to the business administrative groups (BAGs), it turn affiliated with state or local authorities. Such kind of de-facto “owners of the cash flows” received a rent from the assets that they did not ever paid for, and without investing anything in their development. This made the rent-seeking interest of such incumbents remarkably strong and vested and made them the strongest fighters against privatization. Such kind of interest (often underestimated both in the scholar works, public opinion, and policy decisions) is an underlying pattern of the whole process of privatization. Given the limited government’s capacity, and its arguable benevolence in the post-soviet countries, for the privatization to occur the incumbent’s interest should be outweighed by some equally strong interest, unless the assets go for free to those who have actually seized control over them. The latter has been happening during the initial privatization in Ukraine, however its scale was limited by the share of really entrepreneurial “red directors” that were willing to own their enterprises in full, including the responsibilities that the owners have to bear.

This process partly continued during the “mass” phase of privatization (1995-97). Vast privileges made the insiders partly interested in privatization, although in the most of cases it was just a sort of sweetening of the pill for them. As measures of attracting the public, it involved such tools as ‘worker’ and certificate privatization. ‘Worker’ privatization methods were used in the small privatization to transfer up to 75% smaller assets; certificates contributed to buy off of up to 47% state property at value. However, the realm of the Ukrainian privatization (transition of ownership title from staff employees to enterprise management or third party investors, absence of earnings per shares exchanged for certificates and impossibility to sell those) became a setback for residents. Rank-and-file Ukrainians felt losers in that historical process.

Then, in the years of 1997-2004 a significant part of low-price cash privatization occurred by “request” of BAGs that were already de-facto controlling the assets. The major cases of such kind were “ZaporizhStal”, and several mining plants that were parts of the state-owned holding of UkrRudProm. All of these cases were fairly considered as unjust and rent-seeking activities.

Still, at least in the case of mass privatization the political interest of President Kuchma has played a decisive role. The BAGs (as potential buyers) those times were much weaker than the directors (the incumbents), so their support was insufficient, although still helpful for pursuing of such a wide-scale reform. But Kuchma badly needed the mass privatization in order to stop economic recession caused, among all, by the inefficient management of the SOE; the massive asset tunneling; exhausting (“over appropriation”) of the SOE’s assets that became a sort of common source of rents for numerous rent seekers, neither of which being responsible for their maintenance; and the soft budget constrains distorting the incentives structure for management. At the macro level, the fiscal stabilization was unachievable without elimination of the soft budget constrains<sup>14</sup> – which, in turn,

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<sup>14</sup> Unlike the most of “usual” cases of macroeconomic destabilization (including the CEE countries at the 1990<sup>th</sup>) extremely high inflation in Ukraine in 1992-94 was caused mostly by the direct and indirect subsidies to enterprises (mainly in the form of “soft” crediting), rather than excessive social expenditures (Kravchuk, 1998, 2003). Privatization was a necessary (although still not sufficient) condition for elimination of those subsidies, and the general reducing in the paternalism towards the enterprises.

required privatization as a precondition<sup>15</sup>. Last but not least, privatization was strongly and insistently advised by the International Financial Organizations, and became a crucial precondition to their lending.

But as soon as the most of entities were privatized, the soft budget constraints eliminated, the fiscal stabilization achieved, and eventually the economic decline reversed, there was no further need in privatization as an urgent reform. The fiscal role of privatization revenues was never significant enough (with the only exception of the years of 2004-2005) to generate the political interest for continuing privatization for the sake of raising the budget revenues. So, the cash privatization has become driven predominantly by well-arranged rent seeking interests of the potential buyers that were successfully overcoming the ones of incumbents.

The sense of lobbying is normally an extra profit, above the competitive return to assets. In the case under consideration, the buyer's interest in lobbying for privatization depends on the perceived difference between the net present value of anticipated return on assets in question (which mostly defines their "market" value), and the one of an alternative investment opportunity, which is proportional to the price paid in the process of privatization. Therefore, the power of lobbying for the privatization of an enterprise is roughly proportional to the difference between its "true" market value and the price that a buyer is required to pay.

Giving that a potential buyer can usually provide better quality of management than the incumbents do, thus get more as a return, his or her interest can still outweigh the one of incumbents, provided that the price charged for an asset is well enough below the market one. But an open and transparent privatization requires them to pay a competitive price, and therefore receive a competitive return on this investment, with only a marginal possible premium. It creates only a weak interest in lobbying, which is insufficient to overcome the one of incumbents. So, this political-economic engine for privatization requires a credible commitment that the competition on auction or tender will be effectively restricted to a single participant. It would not work for a fully transparent and competitive privatization.

The main problem that could potentially hinder such kind of "on request" privatization, however, is competition between the potential buyers. As described above, the price competition at an auction would discourage all of them from lobbying for privatization at all. But if the privatization itself is a sort of "gift" to the pre-specified buyer, a political rivalry for the selection of the latter can be equally detrimental. Competing BAGs are rationally jealous to each other, thus try to prevent from strengthening of any of their rivals. At the same time, all the remaining BAGs are (at least in Ukraine) always stronger than each of them alone, furthermore they often have a sort of a veto right allowing them to block any kind of privatization deal. Therefore, the privatization may become stalemated unless their efforts aimed at obstructing to the "gifting" of the competitors by non-transparent privatization will be coordinated in some way.

Before the Orange Revolution President Kuchma played a role of an "arbiter"<sup>16</sup> of BAGs arranging their rent seeking efforts in various areas, including privatization. The latter has become especially important as one of the few residual major sources of rents in Ukraine after elimination of the "soft budget constraints"<sup>17</sup> and so called "virtual economy"<sup>18</sup> by the Yushchenko's Cabinet in the year of 2000. Since the end of mass privatization, President Kuchma has been unilaterally distributing

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<sup>15</sup> In the most of CEE countries the soft budget constraints were eliminated prior to privatization, primarily because the state power in those countries was politically responsible from the very beginning, so the directors could never be so influential as they used to be in Ukraine.

<sup>16</sup> For more detail see [http://www.gdnet.org/pdf/global\\_research\\_projects/understanding\\_reform/country\\_studies/draft\\_studies/Ukraine\\_Draft.pdf](http://www.gdnet.org/pdf/global_research_projects/understanding_reform/country_studies/draft_studies/Ukraine_Draft.pdf)

<sup>17</sup> see Kornai (1986)

<sup>18</sup> see Gaddy and Ickes (1998)

the privatization “gifts” between the BAGs<sup>19</sup> supporting him. While doing this he has preserved a sort of “oligarchic justice” by satisfying the requests of his supporters one by one – so each of them used to be sure that it will receive some “piece of a pie” sooner or later, provided that the BAG will keep the loyalty to the arbiter, and do not obstruct to the others. In such a way the process of “on request” privatization was driven by mutually contradicting but coordinated rent-seeking interests of the BAGs.

On the one hand, such an “on request” privatization has largely contributed to the formation of large domestic business that is currently dominating in the Ukrainian economy. It well may have happened that otherwise the foreign, primarily Russian one, would take its place. On the other hand, this part of domestic business appeared selected and self-selected as a predominantly rent-seeking one. Among all, this makes it inherently disadvantaged in competitiveness (thus, rationally afraid of liberalization), and interested in the weak property rights and the weak rule of law<sup>20</sup>. Furthermore, the property rights acquired in such a way appear insufficiently legitimate due to the openly rent-seeking character of such kind of privatization. Even worse for the legitimacy of property rights, the most of elites felt losers too, because gains for the BAGs were highly uneven, with the vast part of rents concentrated by just a handful of them.

The rent-seeking aspirations of the main BAGs close to Kuchma became especially impudent in the last years preceding to the Orange Revolution, probably due to the “end game” that the main actors played in anticipation of inevitable end of the Kuchma’s era, and a major uncertainty about the succeeding regime. The last valid State Program of Privatization, which has been at least formally systematizing the process of privatization and ensuring some public control over it, has ended up in 2002<sup>21</sup>. But since the “end game” players did not like systematization and control of any kind, the new Program was not adopted. Impertinent behavior of the buyers, as well as vast support that they had to provide to the massive election fraud in favor of Yanukovytsch has further undermined the legitimacy of big Ukrainian businesses and of the privatization of large enterprises in particular. Moreover, the losing BAGs have later played a decisive role in the arranging of the Orange Revolution.

The general public’s interests have never been a driving force for the privatization. Moreover, the public opinion was always negative towards privatization of the large-scale enterprises. This is a complex phenomenon that deserves a special study (see more detailed discussion at the beginning of Section 3). One of the plausible reasons that could contribute to such an opinion may be tiny returns that the “ordinary people” received on their privatization certificates. If this is true, then there is a chance that channeling of the revenues from a transparent and competitive cash privatization to the social needs and urgent infrastructure projects could partly alter the very dangerous trend of further deterioration of public’s attitude towards privatization that is observed within the last few years. Yet, the pseudo-democratic regime of Kuchma did not care much about the public opinion, otherwise the privatization of large enterprises would most probably never occur at all.

But the times have changed after the Orange Revolution. The combination of rent-seeking aspirations of the large business groups that are particularly dissatisfied with the current results of “on request” privatization of 2000-2004, and the people’s general negative attitude to privatization and its results, has begotten an attempt of revision of the results of privatization – the so called “re-privatization”<sup>22</sup>. Its goal was not just re-nationalization of those assets, but instead their further privatization to other owners, mostly known as being affiliated with the “Orange” political forces, or just selling at the highest price. Although in some cases the interests associated with the former state

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<sup>19</sup> Although with exhausting of the major sources of rents after elimination of the soft budget constrains in the years of 2000-2001 the most of these business groups started evolving into the financial-industrial groups, in respect to privatization they still behave as the BAGs use to. For this reason we refer to them as BAGs unless they demonstrate some different economic and political behavior.

<sup>20</sup> See Sonin (2002), Polishchuk and Savvateev (2000), Hoff and Stiglitz (2004)

<sup>21</sup> Formally, it continues until a new one would be adopted. But it regards mostly the methods. The Program in terms of the schedule for privatization ended up in 2002.

<sup>22</sup> For more details see Paskhaver and Verkhovodova, 2006

ownership still remained quite strong, and tried to freeze this process at the phase of re-nationalization, they were in minority and had very low chance to win.

“Re-privatization” has brought a limited success in terms of real re-distribution: just a single but notable privatization case of Kryvorizhstal” was annulled by a doubtful court decision, an under the reason that could be equally applied to many other cases as well. Then, this steelmaker was privatized at an open auction, and eventually went to the Mittall Steel Germany GMBH for USD 4.8 bln, while the revenues were used mostly to financing of extensive social liabilities. At the meantime, thousands of other less important enterprises across the whole country were attacked by the raiders and corrupted law enforcement officers on the ground of questioning of the validity of their initial privatization. The extreme uncertainty has prevented even the Ukrainian businessmen (known by their very high resistance to risks) from investing and eventually contributed to a sharp decrease in a GDP growth in 2005.<sup>23</sup> At the meantime, within the same campaign a number of impudent transfers of state property that occurred outside of a regular privatization process were investigated and reversed with just a negligible resistance of their new owners.

Nowadays, three years after the Orange Revolution, we see the major holdup in privatization. In the light of above-described historical facts it can be explained with three most important reasons.

First and foremost, the Orange Revolution has removed a supreme “arbiter”, and mostly destroyed the whole arbiter-client hierarchy in the ruling elites. In the absence of such an arbiter, the main potential buyers has got stalemated, as described above, so they prevent each other from privatizing of any major assets. The only successful large privatization deals of these years were either arranged by an open auction (as Kryvorizhstal”), or lobbied by the politically powerful foreign players that nobody was dare to obstruct (as LuganskTeplovoz). It seems very much unlikely that a new arbiter will appear to resolve this conflict; or that the players would be able to reach and enforce a new agreement on the non-transparent privatization “by turns”. This means that the privatization can hardly go ahead with its previously used methods. Most plausibly, the potential buyers would have to agree on a sort of “null solution”, that is, privatization through open auctions or other transparent and competitive methods of sale, which would make impossible “gifting” of any of them.

Secondly, even if they reach such an implicit or explicit agreement, the driving force for privatization able to overcome the vested interests of incumbents would be still lacking, as described above, because of absence of above-competitive returns for the buyers. Moreover, neither the legislation, nor the bureaucracy, is ready to meet the new challenges brought about by the transparent cash privatization. In particular, this refers to the defending of public interests other than privatization revenues – such as national security, regulation of the natural monopolies, and so on. The corresponding problems used to be resolved by the arbiter’s discretionary decisions (for instance, concerning individual “permissions” for the foreign owners to buy certain assets), but now should become regulated in a formal way. Hence, the recommendations for the new legal framework and the formal privatization procedures ought to be developed within the new Program of Privatization.

Finally, the voters are against privatization, and unlike previous times, their opinion cannot be ignored anymore. This factor, although less important than the previous two ones, can steadily become acute with time. Although it has rather indirect impact (until now there were no protests against the privatization as such), the politicians had to become much more cautious in their decisions concerning privatization. Any kind of “unjust” or otherwise dubious decision of such kind can be now easily used against them in the political rivalry. The new wave of politicians that came to power after the Orange Revolution vary from the adheres of “exclusively transparent” privatization that would bring maximum revenues to the state budget, to the outspoken opponents of the privatization as such (the latter represented by the Socialist Party).

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<sup>23</sup> The negative growth effects of the renationalization campaign could not surprise. The annual growth rate reached its highest level in Q3 2004 (14.2%), then rapidly decelerated: to 9.1% in Q4 2004, 4.9% in Q1 2005, 3.4% in Q2 2005, 1.4% in Q3 2005 and 1.7% in Q4 2005. Recovery came in 2006: from 4.1% in Q1 2006 to 9.5% in Q4 2006 and 8.0% in Q1 2007. See: Dabrowski M. (2007)

The political will based on people's preferences was never a driving force for privatization in the past, and will hardly become the one in any foreseeable future. At best, the public opinion on this issue can be mitigated or neutralized. A special sort of supplementary policy is required in order to make the privatization going on, despite this negative sentiment. Most probably, the politicians will not only try to mitigate the negative attitudes by the respective spending of privatization revenues, but also will pursue the privatization for the sake of increase in budget revenues that they need in order to fulfill their social liabilities. It would be desirable if these revenues could be spent on financing of the urgent institutional reforms, such as the one of the pension system, health and education sectors, communal utilities, etc.; or on the infrastructure projects such as the motorway construction or the urban infrastructure. If this scenario will eventually come true, the Ukrainian privatization may start resembling cash privatization in some of CEE countries, with important exception for presence of the powerful domestic business. Such a turn would largely change the agenda for SPFU as a government body in charge with privatization, and constitute a real challenge to it.

On the one hand, collecting the privatization receipts as budget revenues would be put as its main task. Accordingly, now the increase in sales value of assets will become the goal indeed, both formally and informally. The main problems that currently tend to depreciate this value are, in our opinion:

- unclear status of the land plots behind the enterprises – both those under privatization, and those already privatized; and
- insufficient legitimacy of the property rights acquired through privatization

On the other hand, excessive focusing on the privatization receipts may result in neglecting of some other important issues related to privatization, such as regulation of the natural monopolies and other sensitive sectors, securing the national interests while attracting the foreign investors to privatization, and so on. Ideally, these issues should be legally resolved before privatization; and then the open sale within this regulatory framework would become indeed a socially optimal procedure. But in fact, the most of such kind of legislation is currently missing, outdated, or would create problems if applied in practice.

Formerly, while privatization was held “on request”, such a legislation received insufficient attention. In particular, the State Program of Privatization for the years of 2003-2008 that required the development of such kind of legislation, and also contained some important clues for its drafting, was not adopted by the Parliament. Basing on the above described considerations we may suggest that the main players of those times were not interested in setting up of a clear and stable regulatory framework for above-described kinds of issues. Neither the BAGs, nor president Kuchma were interested in binding themselves with any kind of rules or schedules for privatization.

But since the privatization receipts may probably soon become an important source of budget revenues, such kind of a legal framework becomes vitally needed, especially giving the foreseeable political instability, which is inherent to the young democracies. Otherwise, each of the frequently changing short-living Cabinets will face a temptation to privatize the most lucrative assets and spend the revenues for the financing of extended social liabilities in order to increase its political support. First of all, while doing this it may ignore the necessary preparation, the logic of privatization within the sectors and between the complementary industries; as well as the possible public interests other than maximization of receipts. Then, such kind of ad hoc privatization will result in high volatility of revenues. Last but not least, the stock of assets available for privatization will end sooner or later. If the budget planners would use to account for privatization receipts, the end of privatization may end up in a fiscal crisis. Alternatively, the Cabinet that will face this problem will be tempted to continue privatization “at any costs”, just in order to fulfill its social pledges.

Due to all of these reasons, the process of privatization needs certain legislative and regulatory framework that would address the above mentioned problems and the Program of Privatization providing a time schedule and methodological recommendations for the process. Nowadays, the main political forces seem to approach an agreement about the way in which they could co-exist in the future, and exchange each other in power without destroying the country. In our opinion, the new, long-term, and comprehensive State Program of Privatization, along with some supplementing

legislation, should become an important part of this global compromise. Among other things, it should provide the answers and solutions for the problems, as described below.

### 3. Legitimization

Privatization is a policy of creation of the private property rights. Respectively, its legitimacy in Ukraine is a sort of nexus between the one of the Ukrainian state institutions conducting this policy, and the private property rights as such. Both of them are questionable, however, which puts essential limits to the overall legitimacy of privatization.

Certain sort of people has a negative attitude to private ownership in general. Such an attitude was purposely augmented and nursed by the Communist regime. Little can be done about the category of people endowed with such an attitude, just enlightening – which, however, will most probably have moderate effect because of senior age of the most of proponents of these views. It is important, however, to teach the young people in such a way that would make them resistant to this kind of attitudes.

At the meantime, the government and other state institutions deserve quite a low trust in the Ukrainian society. This situation has changed dramatically soon after the Orange Revolution, but this positive trend was reversed just in a few months (Institute of Sociology, 2006). This windfall increase signals that the government can potentially alter the people's attitude, if only it could be able to change its policies, and get rid of at least outrage corruption. Arguably, this may take place to certain extent in the foreseeable future.

The above-discussed issues, although necessary to take in mind, go beyond the task of this report. But there are several reasons for the observed particular unpopularity of privatization as itself. In fact, the most of people do not deny the private property as such, and could even tolerate the present quality of the state governance in Ukraine. At the same time, they strongly dislike either a way in which the former state-owned assets were privatized, or the way they are currently operated (and the current owners respectively), or both (Panina, 2005; UCEPS, 2004). This kind of attitude is much more rational and therefore can be – and should be – addressed by the respective changes in the privatization policies, with addition of certain complementary measures. The suggested rationales behind these negative attitudes can be described as follows:

Small privatization was predominantly insider-driven, so brought nothing to the most of population. At the meantime it failed to meet the expectations of the most of insiders too, because in the most cases their shares were soon bought out by the management, and then many of such insiders lost in the process of restructuring<sup>24</sup>. From the customer's point of view, privatization and restructuring has made some of the former Soviet shops modern and attractive; but some others were replaced with unaffordable expensive boutiques, the latter not taken well by the less wealthy people. But in comparison with privatization of the large-scale enterprises, the small privatization remains relatively more popular.

The voucher privatization that has covered about a half of the whole assets of the large and medium-size SOEs brought even more disappointment. The people used to believe that the assets of these enterprises are precious, and respectively supposed that their own shares that they can receive in exchange for vouchers would be equally valuable. However, they have gravely underestimated both their tiny real rights of control (which, in fact, could be only formalized, but not really protected in the process of privatization), and the degree of obsolescence and depreciation of the physical capital. Furthermore, in the absence of an open and competitive secondary market there were no buyers that could pay a real market price even for the valuable shares; and due to weak corporate governance, the

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<sup>24</sup> Note that small objects mostly belonged to the retail and service sector that has inherited from Soviet times a gravely non-competitive corporate culture, with not only managers but the most of employees too being incapable to fulfill their routine duties in a market environment.

dispersed owners created by the voucher privatization had little chance either to replace inefficient incumbent management with a capable one, or prevent it from the asset shedding. As a result, the street unofficial (free trading was prohibited) price of a voucher has never exceeded USD 10, and soon has dropped to USD 2. Moreover, the intermediaries have massively reneged with their obligations. Insiders that have benefited from certain privileges during the voucher privatization (they have acquired about 34% of assets, among them 15% - for free) eventually suffered from the same kind of problems that the employees of small ventures.

Starting from the end of 1990<sup>th</sup> the cash privatization became dominating. However, the kinds of assets that remained state-owned – and thus, subject to privatization – by this time constituted of some more specific enterprises than those subject to mass privatization. They required a special treatment, which has provided the state officials with much broader discretionary opportunities. But in a corrupted environment this meant also much more lucrative corruption vulnerabilities. Besides, in the previous Section, we have already described the political-economic reasons that have led to the “on request” privatization. Moreover, even the modest budget revenues generated by the cash privatization have been dissolved within the state budget, which, in turn, became subject to embezzlement. So, the people did not feel any tangible direct benefits from this stage of privatization too.

Finally, some, although rather innumerable, assets were privatized under the “investment liabilities” of the new owners (perhaps, the most notorious case was a 50% share in Avto ZAZ car factory that went to Daewoo Motors). Furthermore, during all of this time uncounted assets went to private owners outside of the normal privatization procedures – through bail-out<sup>25</sup>, emission of assets<sup>26</sup>, non-competitive buy-out<sup>27</sup>, making contributions to the statutory funds of the joint ventures<sup>28</sup>, and the like mechanisms. In all of such cases, neither insiders, nor outsiders, have received any benefits. Although most of them should not be qualified as privatization at all, they have further contributed to the unpopularity of privatization.

Yet, the problem is not only that privatization brings little or nothing to the people. At the end, “broad population” has never effectively owned the public property, so in fact the people should feel no actual loss. But the new owners started being harsher towards their employees, especially in terms of tightening the working discipline, fighting against petty theft and shirking, and so on. Some of them (mostly but not only insiders) appeared inefficient, so the enterprises went bankrupt soon after privatization, or especially after the elimination of soft budget constrains in 2000-2001. Last but not least, the private owners have often treated their employees depreciatingly, particularly by generating the wage arrears. At least prior to the Orange Revolution they almost did not care about their image in the eyes of the employees. Very few of them cared about their political image too.

As a cumulative result of these adverse factors, the share of respondents considering the results of privatization as worth of revision reached 63.9% already by the end of 2003, and peaked 71.4% in March, 2005<sup>29</sup>. This made easier for the second-tier BAGs that have rightly felt losers of

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<sup>25</sup> The most vivid examples are Donbass Energo (5 power stations of the residual value of more than UAH 1 bln sold for UAH 207 millions) and a parcel of shares of Rosava tire plant sold for 4,29 millions while its nominal value constituted above 100 millions. Both took place in the year of 2001, then such a method was prohibited by the special law adopted in November, 2001.

<sup>26</sup> For example, in the mid-2004 the Oranta insurance company (former GosStrakh) that was 50%+1 state-owned those times has issued additional 45% shares that were distributed at low price between the private companies affiliated with InterPipe group of Viktor Pinchuk. In 2003 the Privat Group has in the similar way diluted the state’s share in the Ingulets mining and enriching plant from 50%+1 to 37.5%. Note that such kind of emission requires the permission of the Cabinet of Ministries, which were issued in both cases.

<sup>27</sup> In particular, several leading Kyiv hotels, and a few resorts at the Crimea beach were sold to the private companies by the State Directorate for Affairs (Ukraine Presidential Property-Management Department)

<sup>28</sup> For instance, the Makyiyv Steel mill, the Nikopol’ South Tube Plant, Severodonetsk Azot chemical plant.

<sup>29</sup> UCEPS, see also Denisova at all (2007)



privatization to question its results (at least, the most recent ones) by proclaiming of the “re-privatization” campaign. Notably, the reason for this campaign was rather not a flagrant violation of the law, but rather a general dissatisfaction of some societal groups in the “unjust” privatization. Respectively, this process has essentially political character, and could not be conducted within the regular legal framework – unlike the routine procedure of voiding the privatization contracts that were violated by the buyers (most often, through the non-fulfillment of the investment liabilities).

The Ukrainian re-privatization was the nationalization with a purpose of subsequent “honest” privatization. Its genuine sense was of a political nature: it has been primarily aimed at punishing of those enriched by allegedly dishonest privatization. Respectively, the actions were aimed predominantly against the business groups close to the former President Kuchma, but not against the government bodies and particular officials that were carrying on the process of “on request” privatization. The formal rationale behind such an approach was that the officials have been just obeying to the unlawful orders of the President. Kuchma himself, in his turn, has allegedly got an informal immunity in exchange for abstaining from violence during the Orange Revolution. The true rationale for the “counter-intuitive” punishing of the buyers rather than sellers, however, has plausibly included the (fair) jealousy of the competing business groups and their aspiration to restore the “even initial conditions”.

The course of this campaign, its causes and consequences were described in details in the work of Paskhaver and Verkhovodova (2006). In general, voiding of the property transfers that occurred outside of the normal privatization process appeared mostly successful, and were not resisted. At the meantime, despite the post-revolutionary euphoria and abundant political support, just a single but the most important case of “on request” privatization – the one of Kryvorizhstal” – has been eventually voided. Among the plausible reasons for such a limited success we would mention the general weakness of administrative control after the destruction of “arbiter-client” hierarchy that followed the Orange Revolution. Furthermore, the most of enterprises that were potentially subject to re-privatization are located in the Eastern Ukraine, where the positions of the Orange parties were much weaker.

Notably, the “re-privatization” was opposed by the whole community of economic experts, regardless to their political and scholar preferences. But the political pressure was so strong that there was no way to stop it completely. As the “second best” kind of compromise solution, there were a few rather spontaneous attempts to put this process into certain order, or better replace the property transfers with less harmful methods of the “restoration of a justice” – which should eventually legitimize the privatization’s results. As a “milder” alternative to the re-privatization, the voluntary settlements were put forward. Several laws were drafted with a purpose to define a reasonable way of levying certain compensations on the new owners of the assets that were privatized below their market prices, but none of them was eventually adopted. The main common problems with all of these attempts were as follows:

1. They did not satisfy the business groups that have actually initiated the re-privatization. Since their interest is mostly punishing the winners of “on request” privatization, they would like to see this procedure as painful as possible. Meanwhile, from a viewpoint of minimization of the inevitable social and economic losses, the procedure should be exactly of the opposite kind – the milder, the better.
2. The owners could agree on any kind of additional payments only under the credible threat of expropriation or prosecution. In the absence of such a threat the owners do not care about legitimization at all – otherwise it is hard to explain why they missed an opportunity to confirm their property rights by paying some rather symbolic extras (for instance, stipulated by the voluntary settlements) to the government under Yanukovytych. But such a threat, whenever it appears, is in itself a source of a destructive uncertainty for any kind of business and investments.
3. Rational criteria for selection of the cases are missing. There is a consensus that only privatization of sufficiently large enterprises that was carried out relatively

recently, and with an open violation of “justice”, could be potentially subject to revision. However, these characteristics are rather vague. Moreover, because the “on request” privatization was done “by turn”, levying of some buyers without involving their predecessors in this process would just further magnify the injustice.

4. By signing the privatization contracts the government has accepted the price, among other conditions. Demanding of additional levies above this price without voiding the contracts as whole (by the court) would create a dangerous precedent. Even if the new owners would eventually agree to pay the levies, they lack a guarantee against further extortion under the same or similar reasons.
5. There is an unresolved problem of a bona fide purchaser of the assets under question. It is further complicated by non-transparency of the most actual or fictitious capital transactions that are often paid through money transfers between off-shore companies.

Therefore, the main lessons that should be learned out of the previous experience of Ukraine, and the means to tackle the problems, are as follows.

The problem of legitimization is a part of a broader historical challenge of emergence of the large “oligarchic” capital in some of the post-Soviet countries. Although this problem has become especially vivid and acute during the Orange Revolution and took the form of extreme political actions, its roots are much deeper and should not be boiled down to the political fighting.

Generally unsuccessful experience of “re-privatization” in Ukraine corroborates with the commonsense view that any kind of revision of the privatization’s results is a bad idea that better should not be tried any more. Moreover, even its milder versions bring about serious problems, so their negative outcomes most probably prevail over the positive ones. True legitimization should address primarily the public consciousness, rather than legal issues, so the society would accept the results of privatization, and become honoring the private property (whatever large!) as such. Respectively, it may occur only as a result of certain sociopolitical explicit or implicit “agreement” between the authorities, business, and the public. In this regard, the best feasible solution should include the following components:

- Firstly, there is a necessity of confirmation of legitimacy of major Ukrainian capital that was formed in the process of privatization from the side of the state. Secondly, official confirmation of the privatization results legitimacy is also needed as a counteraction to raiders’ attacks. In this regard, the government should secure unambiguous acceptance of the existing property rights, hence abstain from any further attempts of “re-privatization” or nationalization, and amnesty of the possible violations in the previous privatization purchases
- Quick development of the stock market and general leveling of the playing field, which should facilitate secondary market-driven re-allocation of assets towards the most efficient owners, and in such a way fix the problem of initially inefficient allocation of assets in the process of privatization.
- Change of the public attitude towards newly emerged capital may be achieved on the one hand by higher legitimacy of the future privatization and enforcement of its social orientation; and on the other hand by adoption of social responsibility by businesses. Hence,
- The further privatization should be transparent and socially-oriented.
- The owners should start to care about legitimacy of their rights, which can increase the market capitalization of their businesses. In particular, they can make voluntary contributions to the public needs, most desirably in the form of charity, sponsorship, and arguably the private-public partnership in some sound and socially important projects.

The latter component is critically important, but subject to the problem of collective action (Olson, 1964). Such kinds of actions require certain degree of development of the kind of “social capital” (Putnam et al., 1993) among the business community of Ukraine, especially the big business. But its development was suppressed and de-motivated under an authoritarian rule (Putnam et al., 1993), while the restoration of such a rule seems to be unlikely. Thus, the extent to which the owners of privatized assets would invest in the legitimization of their property rights will, most probably, remain limited and insufficient. Under these circumstances, the “second best” is, in our opinion, implementation of the remaining above mentioned points while taking no special action on legitimization.

But we have to admit that passive awaiting for adaptation of the public consciousness to such a reality bears the risk of many years of permanent uncertainty, weakness in the property rights due to their low legitimacy, and even further attempts of revision of the privatization’s results. It is too early to eliminate the risk of possible demands for privatization results’ revision. Similar slogans were sounded once again during the extraordinary parliamentary elections in September 2007.

The need for additional budget incomes required for social programs implementation may push the new government to this idea. From this point of view the resale of the major metallurgical works “Kryvorizhstal” in 2005 may appear to be an attractive example as it helped to solve some budget problems. Respectively, the society should be prepared for the new politically motivated attempts on the property rights over privatized assets. Some kind of “third best” solution is needed for such a case. There should be a plan for legitimization that ensures the security of property rights, whereas does not involve any kind of involuntary re-distribution of property.

There are few international examples of resolving of such kind of a problem<sup>30</sup>. Perhaps, the most relevant and successful is the one of the Great Britain. However, despite its doubtless advantages, primarily clearness and understandability of the procedure, it is still far from being either fully relevant or completely successful one.

The Cabinet of Margaret Thatcher has privatized the infrastructure sector in the GB mostly for the sake of improving in its efficiency, and in order to decrease the burden it posed on the state budget. The prices paid by the buyers were rather low, as they were not the main criteria. However, soon after privatization the natural monopolies have sharply raised their rates, and became profitable. Respectively, their capitalization has increased dramatically, so in a way their owners have benefited at the expense of the rest of population. The Laborites have won the elections of 1997 with a program of revision of this privatization. According to the special law, the new owners had to pay a “windfall tax” at the rate of 23% levied at the difference between purchase price they have paid in the course of privatization, and estimated actual value of the assets they have acquired. Each company was appraised as its average profit for the first four years after privatization multiplied by average ratio of the share’s value and return to a share (normally, about 9). Such a measure generally corresponds to the normal practice of taxation in the GB. The extra revenues of 5.2 billions British pounds collected in such a way were directed to the programs of fighting the youth unemployment.

In Russia the similar measures are now under debates too. In particular, some authors offer that the new owners should pay compensation to the budget if the fact of purchase of assets below the market price was proven in the court. However, giving to the general weakness, corruption, and dependency of the courts in Ukraine (as well as in Russia) this, most probably, will result in the chaos and the arbitrary rule.

The British experience is directly inapplicable in the post-Soviet countries also because of the “conventional” character of declared profits: usually they are manipulated, and those finally reported appear as a compromise reached at the negotiations with tax authorities<sup>31</sup>. Instead, some Russian

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<sup>30</sup> The problem of legitimization should not be confused with nationalization. The purpose of legitimization is to strengthen the actual property rights of the private owners, while nationalization is aimed at the opposite.

<sup>31</sup> See Кульчинський, Роман, В’ячеслав Дарпінянц. Без комплексів – інтерв’ю Голови Державної податкової адміністрації України Анатолія Брезвіна. Діловий тижневик „Контракти”, №42, 16.10.2006

authors suggest using the price of the last sale of the company (or its share) net from the tax liabilities. This proposal is evidently weak, since it does not account neither for investments and improvements, nor for changes in the business cycle – not to mention the above described difficulties with transparency of capital transactions. Finally, what if the company did not change its owners at all? Even the least doubtful among the Russian experience – cutting of the statute of limitations for privatization affairs from ten to three years – is a right but just half measure, since it just legalizes the results of privatization, but does not legitimize them.

Therefore, we did not find any ready-to-use model that could be put forward as an alternative for possible attempts of “re-privatization”. Instead we can state that whatever kind of policy of legitimization should be well-articulated, transparent, pragmatic, and legally supported. It should necessarily come out as a result of the broad public discussion, which would ensure its feasibility and sufficient public support for its goals and methods. The discussion should be desirably focused on providing of the owners with a confirmation of their rights in exchange for certain extra contribution to the public needs.

Here we offer for discussion some ways of handling the above mentioned problems with such kinds of policies.

1. Validity of confirmation remains generally problematic. The amnesty of privatization deals in combination with other measures listed below could be a partial remedy, and serve as a signal that the compensation is really a one-shot action.
2. Criteria of applicability (e.g. in terms of time of the deals, and size of an enterprise) still lack clarity. The possible period covered by the legitimization could start at 2003 (expiration of the last valid Program of Privatization), or at earliest 2000 (start of economic growth, and the “on request” privatization). Questioning of the prices that were paid under the economic decline makes no sense at all. The size limit should be defined in the above mentioned public discussion. The remaining privatization should be subject to automatic amnesty. Those owners that would voluntarily agree on this procedure should deserve special privileges.
3. The way for calculating of the amount of compensation deserves a special attention. It should be as transparent as possible, and based on the suggested price of an object at the time of its privatization, not on its current price. More or less transparent appraisal of such a kind can be accomplished, for example, by a consortium of a well-recognized international consulting company, and its domestic partner – both selected jointly by the government and the owner (possible disagreements should be settled by arbitration). The documents of appraisal should be published and become subject to further contest (probably, limited in some way). Then, the compensation can be calculated in a way akin to above-described windfall tax of the GB. The Ukrainian tax legislation allows for taxing the extra profits that resulted from a purchase at the price below the market one. The compensations calculated in such a manner may be then corrected for inflation.
4. The revenues should go to the well-defined and socially important purposes, and under the public’s tight scrutiny.

At the same time, under any circumstances such an agreement should avoid the things like:

- using the legitimization as a tool for “punishment” or “prosecution” of the owners of assets in question. Offensive treatment of the latter would make this already excessively sensitive issue irresolvable, and unavoidably make it a subject to political fighting. As a result, such a policy can beget or further aggravate the economic distortions.
- providing the new reasons for retroactive denouncing the previously settled privatization contracts – for the obvious contradiction to the basic juridical principles

- involuntary changing of ownership (outside of prosecution of the flagrant criminal violations) – because it further weakens the property rights, creates a turmoil in the whole economy, and in addition provokes the rent-seeking aspirations
- proliferation across the economy – because the large-scale process of such kind may be highly inefficient (cost of settling of each case higher than possible social benefits), and also its destabilization effect may well exceed the social benefits.

Nationalization should normally be not a part of this process. Those exclusive cases (motivated by the national security or the like kinds of arguments) should be regulated by a special law that would, among all, stipulate the way for compensating the owners at the current market prices.

It is necessary to reiterate that we do not call for implementation of these measures, even if they would be developed in a very good way, unless the threat of re-privatization would again become urgent on the agenda for political reasons. What is most important, privatization results legitimization currently needs to be taken out of the field of political struggle for justice restoration in distribution of the state property. It needs to be viewed as one of the urgent issues of rationalization of the existing property rights system.

Change of the public attitude towards newly emerged capital may be achieved on the one hand by adoption of social responsibility by businesses and on the other hand by higher legitimacy of the future privatization and enforcement of its social orientation. Social commitments of the new owners and a good choice of directions to spend money received from the sold property may change the public attitude towards privatization.

## **4. Privatization of State Properties Together with Land Plots**

The scope of privatisation of developed areas, where state and public properties are located, is relatively insubstantial: e.g., the total area of agricultural lands makes for around 43 million ha, or 71.2% total land area in Ukraine. The depth of privatisation of such lands currently stands at 78% (in many respects formally, though.) The total development area makes 2.5 million ha, or 4.1% all land nation-wide. The maximum area available for involvement in the privatisation process, properties included, less residential development parcels, public and recreational land plots will make around 1 million ha, or 1.7% total land nation-wide; herewith, the major portion of available land will still be used on long term lease conditions.

Nevertheless, privatization of land is one of the most cumbersome problems among the entire issue of property transformations in Ukraine. While the land ownership is politically sensitive in every country, in Ukraine this problem was further augmented by a number of additional complications.

Sociopolitical. Historically, in Ukraine the private ownership of land by the large owners was associated with serfdom and injustice. At the meantime, about a half of the population is either employed in agriculture, or have migrated into the urban areas just one generation ago, so preserved their “agrarian” roots and have strong sentiments about land and its ownership. This part of the population constitutes the most important share of electoral basis for the left-wing parties. The latter have been strongly opposing the land privatization. Note that they were in majority before the elections of 2002, hence during the whole period of mass privatization.

Administrative. In the USSR the land was under control of the local or special central state authorities, while the most of enterprises belonged to the respective branch ministries. The trace of this conflict persists now, because the local authorities still hold the land, while the enterprises are already privatized. New privatization is carried on by the SPFU, which at the meantime has no legal right to sell the land.

Technical. In the absence of private ownership there was lack of demand for the necessary technical arrangements needed for clear identification of the borders. Delimitation is often unclear and inaccurate, the one between state-owned and communal land is not finished, the land cadastre is missing, and in many cases even the titles on the land property are contradicting.

For all of these reasons the land appeared much less ready for privatization than the enterprises did. Under the urgent need of privatization the only feasible “second best” decision have been made: enterprises’ assets were privatized with exception for the land plots<sup>32</sup>. Instead, the owners were allowed to get this land in a long-term rent. As soon as the privatization of land was allowed, they could also voluntary buy out their land plots at the nominal prices. However, this procedure is lengthily and costly, while de-facto the rights of control over a land plot belong to an enterprise anyway (and were even accounted as its immaterial assets), and it used to be hardly imaginable that anybody would question them. So, the owners possessed rather weak incentive to receive the formal titles, especially while the actual market price of land remained low.

The problem became especially difficult in the case of partly privatized entities, since the entities that have a State’s share are not eligible to buy the land at all. Indeed, procedure of “state (as enterprise’s co- owner) buying the land plot from state” is not legally defined, and barely could be consistent with common sense. Besides, the local authorities are poorly motivated to issue the titles, since the revenues are quite low (the plots go to the owners at their nominal prices), thus often hinder this process.

The times have changed with appreciation of the land prices, and after the Orange Revolution that have put the issue of increase in privatization receipts on the agenda, as described above. The problem has become especially acute when the Cabinet of Tymoshenko has tried to use the privatization of land plots as a source of additional budget revenues that it has been lacking so badly in order to fulfill the social obligations. Unclear legal status of the land plots behind the privatized enterprises has created a temptation of squeezing some extra payments from the owners (compare to re-privatization campaign described above) by auctioning of this land. Just like the “re-privatization”, such a proposition has created a panic among the owners, and strong resistance in the expert community. Fortunately, no actions were taken those times, mostly thanks to the abundant revenues from re-privatization of the Kryvorizhstal”. However, the threat of the further attempt of retroactive revisions persists, and nothing was done to mitigate it.

Nowadays the private ownership of land is already allowed, and the non-agricultural one can circulate at the market with relatively mild restrictions. So, there are no more principal legal impediments for privatizing the enterprises along with the land plots they occupy. Moreover, in our view, the transition towards state property privatization together with their land plots is one of the principal tasks of the closing privatization phase in order to clarify and to strengthen the property rights of the new owners. It is necessary to overcome that critical lag in privatization of the mentioned type of state properties. The issue of state properties sale with their land plots should not be regarded as a narrow fiscal problem; it rather concerns a strategic change in the content of the privatization process requiring some fundamental modifications in privatization mechanisms.

Further privatization should definitely go this way, especially giving that the government’s interest in maximization of the privatization receipts becomes much stronger than it was ever before. However, previous attempts of such kind that were persistently made by Tymoshenko’s Cabinet, followed by the Yekhanurov’s Cabinet, and somewhat less persistently by their successors have failed: up to the moment no enterprises were privatized according to the new principles.

We consider the main reasons for such a limited success as follows:

- lack of strategic vision, both in terms of time and goals: all of the regulations that stipulated necessary changes to privatization procedures were adopted just for a short term (e.g. by the Law on the State Budget), and with purely fiscal purposes. By

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<sup>32</sup> This was an important part of the broader political-economic compromise that have shaped the legal framework for mass privatization in Ukraine

the end of 2007 all of these temporary regulations will lose their validity, so a new and desirably comprehensive law or by-law is needed to substitute them. Ideally, the respective provisions should be included in the new Program for Privatization.

- resistance of the local authorities that lost the most of their revenues (both formal and alleged informal ones) that they use to receive as the land rent, or sales receipts for land plots<sup>33</sup>
- resistance of the State Committee on Land resources of Ukraine that had to seize a part of their authority to the SPFU
- an interest of the current owners that have not yet managed to get their land titles. They rightly feared that if the government will start raising the revenues from selling the land plots behind the newly privatized enterprises, it may at any moment again become subject to temptation of compulsory selling (or even auctioning) the land plots to the current owners of enterprises, with a threat of re-privatization in case of non-compliance.
- and last but not least, the decisions were adopted in a non-transparent manner, without a broad public discussion and independent expertise.

The legislative and institutional framework in this area is rather controversial and does not provide for transition towards a new privatisation method. While the budget law effectively introduces the principle of property mandatory privatisation with relevant land plot, the privatisation law gives the privatised property owner the option of either buying the land off or arranging for its long term lease.

Both privatization and the operations with land are regulated with the respective specific legislations, which are in many instances inconsistent to each other and the rights and competencies of different institutions taking part in the process are defined in a conflicting way. In particular, the privatization is carried on by the SPFU, while the local authorities and State Committee on Land resources of Ukraine are in charge with communal and State-owned land respectively. Furthermore, delimitation between the later kinds of land is unfinished, which in some cases (particularly, the Kyiv Bicycle Plant – KMZ) becomes an additional impediment. Privatization of enterprises along with their land plots currently involves the whole procedure of delimitation and recognizing the rights on land. Pursuant to the acting regulations the SPFU is entrusted with these responsibilities, although they are not inherent to a government body in charge with privatization. Due to these complications the process of privatization becomes at best almost twice as lengthily. Moreover, the Fund has to pay the respective preparatory fees, which can sometimes exceed the expected revenues.

The acting Land Code stipulates only two ways of privatization of a land plot: (1) auctioning, and (2) buy-out by a private owner of the real estate object built on it. Both are hardly applicable to the task of privatization of enterprises along with the land plots, since in the former case the land plot can be (and actually should be, if the law is applied literally) sold at a separate auction, especially giving to the above-described splitting of ownership of land and other assets. Applicability of the latter case, which is the main basis for current practice, is restricted to the fully privatized enterprises. According to the traditional privatization scheme, a new owner could start any procedures involving the land plot only after completion of the formalization of its property rights over the entity.

The new procedure adjusted to the privatization with land plots is badly needed, along with accompanying legislative changes that we suggest as follows:

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<sup>33</sup> The proportion of land sale revenue distribution between the central and local budgets breaches the balance of interests. According to the Law of the National Budget of Ukraine for 2006, the privatization yield was distributed, as follows: 95% went to the national budget, and 5% were distributed to local budgets; for the fiscal year 2007 the central budget was entitled to 90% while the local budgets were allowed 10%.

- i. Privatization of the land plots belonging to the newly privatized entities should be conducted through including their value to the entire statutory fund of a corporation, created in the process of corporatization. However, inclusion of the land plot into the composition of fixed assets can largely increase their nominal (assessed) value, which is used as a starting price at the auction. In some cases it may lead to the failure of the latter<sup>34</sup>.
  - ii. In such a case the seller should be obliged to arrange a Dutch auction (price-dropping) until the object would be sold.
2. For the partly privatized entities the above procedure should be modified in such a way that the (nominal) price of the land plot being accounted as a co-owner's (State's) contribution converted into the consequently privatized parcel of shares. The State as a co-owner can adopt a decision on inclusion of the land plot into the statutory fund unilaterally only if it holds more than 75% of shares, otherwise such a decision is subject to the shareholders' voting. Any kind of compulsion in this kind of issues is highly undesirable due to their special sensitivity for the owners. Instead, they can be stimulated indirectly by some positive incentives – such as the overall higher valuation of their property, especially the opportunity of using the land as collateral for loans.
  3. The articles 134 and 137 of the Land Code that stipulate that the land plots can be sold exclusively at the land auctions, and only by a certified seller, need modification that would allow for applying of the usual privatization procedures. For instance, they (arguably) may be augmented with a stipulation like “except for those belonging to the enterprises”.
  4. Introduce a special simplified procedure for preparation of the land plots to privatization along with enterprises, and start the advanced preparatory work on the delimitation of land.
  5. New policies should envision effective incentives for the stakeholders and contribute to the agreement of their interests (e.g., reallocation of obtained proceeds between various budgets, land repurchasing price valuation etc.)

When the object is located at a land plot that is more valuable (sometimes – far more valuable) than the rest of its assets, a private owner may be tempted to simply neglect with the rest of assets but land, and close down an enterprise in order to freeing the latter. In some rare but important cases (socially important enterprises (e.g. infrastructure), one-factory towns, enterprises important for national security) the society has a stake in keeping such kinds of enterprises active. In such cases (that should be identified by the law) some additional conditions, like movement of the fixed assets at some other place, are needed in order to prevent the undesirable consequences of privatization. Besides, for such a land plot with changed function, the usual rules for town planning should apply in order to alleviate the possible externalities.

## 5. Participation of foreign investors in privatization

This problem is at the nexus of two broader ones: of setting up the clear, consistent, and comprehensive legislative frameworks, firstly, for the foreign investments of any kind; and secondly – on the minimal necessary sector-specific regulations whenever they are needed. The latter is relevant

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<sup>34</sup> The problem may be further magnified by double-accounting of the right of control over this land – first time as a immaterial asset (right for renting the land plot, see ref. 14), and then as a value of the land plot itself. Should the new procedure of privatization along with land take force, the respective regulation needs to be adjusted accordingly.



because the foreign investors are usually more law-abeyant, but at the same time less sensitive to the informal controls. Although both tasks are not specific to the privatization, the political-economic interplay of interest has a number of essential features in the case of privatization.

Private domestic owners are generally interested in the liberalization of foreign investment because their assets would appreciate in the presence of potential buyers. However, the same business groups are interested in protectionism in favor of domestic capital in the process of privatization, because the lower the competition, the lower the price they pay. In some cases they are merely unable to raise enough capital to pay a truly competitive price for the assets like Kryvorizhstal". Meanwhile, the domestic business has limited, indirect, and highly dispersed benefits (mostly in the form of tax cuts, or rather abstaining from their increase) from a transparent privatization to a foreign investor. For this reason we foresee that some, most probably informal, restrictions for the participation of the foreign investors in privatization can appear quite persistent even despite the general trend towards its openness and transparency. In such circumstances it should be recommended to make the needed regulations explicit and formal, otherwise they will emerge anyway, but as the non-transparent informal impediments that are much more harmful, more persistent and lasting.

Historically, the unprecedented formal privileges to the foreign investors (like 10-years tax holidays, waiving from import and export tariffs, etc.) granted by the law at the beginning of 1990<sup>th</sup> were used almost exclusively by the off-shore companies established by the Ukrainian BAGs, while the genuine FDI remained very low. In 2000 these privileges were removed, and the national regime for the foreign investors formally established. However, in reality their participation was allowed only at the discretion of authorities. For example, while the Law "On the regime of foreign investments" stipulates that such investments do not require any permission, just registration, the Law "On the privatization of the state property" requires that the list of "enterprises of a strategic importance" for privatization with possible involvement of a foreign investor should be approved by the Parliament at the submission of the Cabinet.

At the meantime, the justified legal restrictions for the foreign ownership that are allowed by the international rules, and common for the most of developed countries, are almost missing. The main formal restrictions are bans for:

- land ownership: the Law on Privatization explicitly bans buying out the land by the foreigners, while the Land Code stipulates a very special procedure requiring a contest of the Cabinet and the Parliament
- establishment of the TV and radio channels in 100% foreign ownership. However, the share ownership is allowed (or rather the prohibition is missed), so many TV channels are co-owned by the foreign investors (1+1, Noviy, STB).
- existence of the 100% foreign companies in the "strategic sectors" (G group)

The latter is stipulated by the Commercial Code of Ukraine, which also allows for some sector and territorial restrictions for the FDI (the firms that have more than 10% of foreign ownership) that "can be stipulated by the law" on the ground of "national security" reasons, without further specification. The Law "On the Fundamentals of National Security of Ukraine", in turn, defines the economic threats to national security quite loosely, as "critical dependence on the business cycles of international markets", and "such an increase in the share of foreign capital at the strategic sectors of Ukrainian economy that jeopardizes to its economic independence". These formulations are too general for their practical application: an official cannot make decisions based on them without a threat of further accusations. There is no legal definition of a "strategic sector". Moreover, even if the terms like "critical" would be eventually specified, a great deal of economic analysis is required in order to make them practicable. But the corresponding procedure is not currently stipulated by the law. Thus, in general the existing sector-specific formal restrictions to foreign investment in Ukraine do not work.

Instead, participation of the foreign investors in the privatization of so called G-group of enterprises ("strategic" enterprises and monopolies) requires a special permit of the Parliament and the Cabinet. In addition, the procedure for such permission is not specified, which makes that process

completely non-transparent. It also makes little sense in the absence of any restrictions for the further selling of shares to the foreigners<sup>35</sup>.

The Government's policy towards participation of the foreign investors in privatization was never clearly articulated, not to mention its legislative implication. Before the end of 1990<sup>th</sup> the demand for such a policy and respective regulations was mostly missing, mainly because the sectors and enterprises that were involved in the process of privatization those times did not require any regulations of the foreign investments. Besides, neither insider-oriented initial privatization, nor the voucher mass privatization has been suitable for the foreigner's participation; while on the other hand the Ukrainian enterprises were in a negligible demand of the foreign investors. Regulating of the foreign investments was further complicated by the pervasive presence of the off-shore companies that actually represent the Ukrainian capital. During the consequent period of the "on request" cash privatization the necessary regulations were substituted by discretion of an "arbiter", the President Kuchma. Some of his discretionary decisions seem to be at least controversial, although in the absence of any practicable legislative framework the criteria for their assessment are vague.

The situation may further worsen with an anticipated dramatic increase in transparency, and especially while the government would be focusing on the rising of revenues rather than the more fundamental issues of privatization.

On the one hand, the foreign ownership of some kinds of assets may indeed threaten the national interests, especially if the corresponding sectors are poorly regulated. On the other hand, giving to the overall suspicion towards the foreign ownership that currently dominates in the public consciousness, a few real failures associated with foreign ownership can magnify this negative attitude, and thus make further privatization to the foreign investors politically complicated. Last but not least, while the regulation of this sphere remains "soft", it diminishes the actual scope of property rights<sup>36</sup> purchased in the privatization auctions, and hence the prices paid by their winners.

It should be added that in Ukraine there are justified reasons for a sensitive attitude to the presence of foreign capital. The lack of efficient regulation has led to a critically high proportion of foreign capital (mostly of Russian origin) in certain important areas of activity (the Russian capital controlling five of the six oil refineries, 81.3% mobile communications market, and the total gas imports). In addition, Ukrainian economy demonstrates an enhanced dependence on the competition on external markets: the country exports almost 80% its total steel production (which accounts for 40% Ukrainian commodity exports.) Furthermore, the nation is critically dependent on fuel imports (totally controlled by Russia.) There is some palpable threat of powerful state companies penetrating the Ukrainian economy to usher in non-economic influence of other nations; e.g., the Russian GazProm and RAO Unified Energy Systems have been rather insistent in eyeing possibilities of participation in the privatization of Ukrainian energy assets and gas transportation networks.

This problem goes beyond the purely privatization-related issues, because the assets in "sensible" sectors can be purchased at the secondary market as well. Thus, Ukraine primarily needs to develop the clear and well-thought legislative framework for the foreign ownership in general. Regulations concerning the privatization should become its essential part. Both should to the possible extent follow the best international practice and should be consistent with the international obligations that Ukraine already has, the EU practices and regulations – as well as Ukraine's aspiration to the EU membership in the future.

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<sup>35</sup> In effect, this otherwise senseless procedure just protects the interests of domestic capital in the process of privatization.

<sup>36</sup> The right of control means the one of operating with the object "within the pales of law". While these pales are unclear, ambiguous, contradictory, non-obeyed, or otherwise impracticable or simply missing and instead substituted by certain informal rules, the property rights become vague by definition. Besides, an investor has a high uncertainty about the way in which this legislative lacuna will be filled in the future.

Along with the factors that are common for all the post-Soviet, and mostly other post-communist countries, Ukraine has certain specific features that should be accounted while developing the policy in this area.

- Just like in Russia, and unlike the most of other post-communist countries, there is a large domestic business in Ukraine. But unlike in Russia, there is a plurality of business groups with a fierce competition between them, and they are not (any more) manipulated by the government. Although nowadays they are not the only influential political-economic force anymore, the big business remains politically influential. No government policy can be successful if it directly contradicts the interest of large domestic business. Any kinds of policy recommendations should account for this factor.
- The Ukrainian economy is critically dependent on the world markets, in particular the energy imports, and metallurgical exports
- There is in Ukraine a high level of monopolization (cartelization), within some important domestic markets – like the car fuel or mobile telecommunications – controlled by the allegedly cartelized foreign investors.
- Still, there is a weakness of the state governance that makes the government ineffective in protecting the public interests.
- Economic policy is closely related to politics. On the one hand, Ukraine is subject to non-economic interests of some foreign states that try to use economic tools (including the FDI of the dependent firms) in order to fulfill their political goals. On the other hand, the political consensus is absent, and situation generally unstable, so the government cannot ignore the public sentiments, and the interests of potential losers from liberalization.

Conclusions for Ukraine:

Transparency is vital. Taking into account the foreseeable tendency of preserving of certain level of protectionism of the domestic capital in the process of privatization, we suggest that it should be, to the possible extent, formalized in the sector-specific programs of transformation. In any case, the government's policy in respect to foreign investors and their participation in the privatization should be articulated, made subject to the open public discussion, and eventually formulated legislatively. Arguably, it may eventually result in a form of some "lists" or entities that are subject to different regimes of foreign investments – from a complete ban, to some minor restrictions. This form is perfectly transparent, largely simplifies the decision-making, and corresponds to the well-established practices of qualification of entities by the groups with different regimes of privatization. However, just as in this case, the criteria for qualification as well as the procedure of qualification should be transparent and clear. The formalized legislative restrictions are "second best" comparing to the informal practices, because they are at least transparent to an investor. Therefore, the new Program of Privatization should stipulate the clear procedures of decision-making that would allow for minimal possible discretion of the officials. The latter, in turn, should be made responsible for violations of the procedures. The whole process should be made as transparent as possible, with vast opportunities for civil control.

In particular,

- a. The definition of "threats to the national security" should be made operational through the special procedure of identification of the "critical dependence on the business cycle of international markets", and "increase of the share of foreign capital in the strategic sectors of Ukrainian economy that jeopardizes to its economic independence". For example, the exact criteria should be defined by the Ministry of Economy and adopted by the decision of the Cabinet.

- b. The notion of an “industrial investor” that was used in the Program of Privatization for 2000-2002 should be abolished, since in practice it was widely misused as a ground for discretion and arbitrary decisions. For the similar reasons we suggest abolishing of the permissions for participation of the foreign investors in the privatization of entities belonging to the group G.
2. Liberalization is needed. As of now, the role of private investors is excessively restricted regardless to its national origin. There is a vast list of activities that are restricted to the state-owned organizations, and in addition the privatization of a huge number of particular enterprises (1969) is banned. Moreover, by the decision of the Cabinet the state can keep 50%+1 shares in any of so called “strategic” enterprises for three years, with a possibility of prolongation. Fortunately, the status of a “strategic enterprise” is relatively well defined by the law. But this definition currently covers 443 entities, which seems to be too much – compare to France in which the “golden share” was used only in four cases.

The new Program of Privatization should make these norms much milder. The list of entities not subject to privatization needs a revision under certain clear criteria, which should result in its substantial cut. The legal definition of a “strategic sector” is needed, and (arguably) it can substitute the one of the “strategic enterprise”.

3. At the same time, no special incentives are needed. As the previous experience of Ukraine as well as other countries has demonstrated, special incentives were largely abused, and at the same time ineffective for a genuine foreign investor. Moreover, even while attracting the genuine foreign investors, the privileges led to a sort of negative selection of the latter, while attracting the rent seekers.
4. Arguably, the “golden share” should not be recommended for the case of Ukraine, since it will further enhance the possibilities for government’s control over the privatized companies. In the case of Ukraine this may lead rather to inefficiency, and create (or preserve) the corruption vulnerabilities, than help in prevention of any undesirable potential effects of privatization. Instead, the priority should be given to the development of sector-specific regulations, and the competition policy. Some specific provisions could be included in the privatization contracts too.
5. Giving to the persistent slackness of the Ukrainian stock market, a final buyer is unlikely interested in purchasing of the minor parcels of shares, thus setting the limitation at the level of less than 25%+1 share makes little sense. Most probably, such kinds of limitations would be hardly effective in Ukraine at all.
6. A special treatment of the state-owned foreign companies, the ones that can be used as tools for political purposes (especially, in the energy, gas, and oil sectors) and the like cases can be justified, and has good precedents among the EU countries. In particular, the companies with a State’s share exceeding 25% can be claimed ineligible for investing in the “sensitive” sectors, just as they were treated in by the privatization legislation.

# Appendix A.

## Ukraine’s practices at the background of international experience in foreign investment regulation

In general, the policies towards FDI in the most countries are compromise between the desires to receive the benefits of globalization, on the one hand; and both the national security considerations, and interests of domestic business that is usually too weak to be exposed to fully open international competition, and thus requires some temporary protection – on the other hand. However, few countries have managed to provide such a protection on a really temporary basis, and eventually nurse the really competitive firms. In the most cases the governments failed to withstand the pressure for continued protectionism of the non-competitive domestic industries and business groups. In the case of Ukraine, we would suggest that a significant increase of the share of foreign capital is rather desirable. This could bring the new technologies and managerial know-how along with competition that would provide incentives for their implementation – as it has happened in the food industry. At the same time, it would diversify the politico-economic interests, thus increase the room for maneuver for the Ukrainian government.

As we mentioned earlier, still, there is a necessity to protect the national interests, as the most of countries do. But giving to the high level of corruption and other informal practices, we suggest that in Ukraine this should be accomplished in as clear and transparent way, as possible. We suggest that some clear and precise sector-specific restrictions may be introduced by the law, if they would be supported by the sound arguments in a public discussion. At the same time, to the possible extent the government should avoid any kinds of impediments outside of these regulated sectors, and especially the possibilities for discretionary decisions<sup>37</sup>. This approach corresponds to the requirements of the OECD, and recommendations of the World Bank. The new Program of Privatization should include the respective principles, and the development of their legislative implications should be commissioned.

The main conceptual problem is that the notion of “national security”, not to mention the “national interest” is much too broad, so the interest groups can relatively easily adjust both for their purposes. Which kinds of restrictions could be acceptable from the perspective of international best practice? Below we provide a brief survey of the latter.

Country or a group of countries	Applicability		Methods of regulation	Procedures of decision-making
	economy’s sectors	origin and share of foreign ownership		
Germany	defense industries,	25%	restriction	Cabinet’s permission concerning each particular case

<sup>37</sup> Among other problems, the non-transparent and informal protectionism makes certain (and growing!) part of non-competitive business, both domestic and foreign, interested in persistence of such practices. Furthermore, the non-transparency and “informal” protectionism creates the vast corruption vulnerabilities, and pre-selects those foreign investors that benefit from non-transparency and informal practices, thus further magnifying their persistence. At the meantime it remains the sensitive sectors potentially vulnerable to invasion of such kind of investors, while some of them may have even political motivations.

<b>Spain</b>	energy sector, oil processing, , game industry, aircraft, telecommunications, TV, defense and explosives' production, some mining	Investors owned by residents of non-EU countries	permissions 5% limit for a share of each individual investor may not take part in management	Cabinet's permission concerning each particular case
		all investment in telecommunications, TV, and defense	permissions	
<b>USA</b>	key infrastructure (nuclear power plants, water supply, some transports, etc.) businesses related to national security	any significant share	permissions	the Ministry of Trade, and some government agencies according to a special procedure
<b>Japan (generally attracting the FDI)</b>	agriculture, fishery and forestry; oil processing; leather processing; aircraft and sea transport		preliminary permission required, may be refused if considered as "having a serious negative impact on the development of the national economy"	
	defense and explosives' production; aircraft and space production; biochemical production; nuclear power plants; water, energy and heat supply; railways; telecommunications; passenger transport; broadcasting; signaling and security equipment	all sectors in case of investors originating from a country that "does not meet the reciprocity requirements", hence does not create equally favorable conditions for the Japanese investors	various kinds of restrictions	

The recent years have seen several cases of selective impediments to international merges introduced by the EU countries using various means. Along with the announced intentions of the EU to restrict the access to its energy, gas, and oil sector for the companies from supplying countries, and especially the state-owned investment funds, these cases may manifest the general trend towards some

increase in protectionism in the EU. Similar trends are observed in the USA after the terrorist attack of 9/11.

Great Britain, France and Italy introduced certain specific restrictions in the course of privatization. Just as Ukraine nowadays, they privatized the firms operating in “sensitive” sectors (e.g. natural monopolies), while lacking the regulatory framework for the business activity in them; their population treated private investors, especially the foreign ones, cautiously; and their national capital was too weak to withstand the competition of multinationals. Under these conditions they restricted the investments from outside the EU, and tried to preserve some temporary government’s influence on the company’s operations, even after its full privatization through the “golden share”. In Great Britain, it was used in order to prevent from closing down, change of the CEO, concentration (no more than 15% of shares), asset’s shading (no more than 25% of assets could be alienated), and foreign ownership (no more than 15% totally). Only a British citizen could be appointed as a CEO of such a company. However, the priority was given to the development of sector-specific regulations.

In Italy and France the government selected so called GSS (group of stable shareholders) that received privileges in exchange to restriction for selling of their shares during certain time. A French law has limited the parcel of shares that could be sold to a non-EU investor at 20%, which could be further decreased to 5% for the national security reasons. In Italy, the government has preserved a tree-years veto right for transactions that lead to concentration of 10% and more shares at the companies operating in the defense, transport, energy, and telecommunication sectors. In the defense industry, production of telecommunication equipment, banking, insurance and energy sector the maximum parcels of shares that an investor was allowed to buy in the process of privatization was limited. Then, the government used a “golden share” in order to control the company’s operations.

Notably, **all of these restrictions were either introduced as temporary ones, or removed soon after the accomplishment of privatization.** They were applied to the firms operating in the “sensitive” sectors (actually, this factor used to be the main justification for their state-owned status before privatization).

The experience of CEE countries significantly varies. Probably, the Czech Republic and Hungary represent two polar cases. In the former, the voucher scheme was used, partly in order to ensure the domination of domestic owners in the economy. However, the investment funds that have accumulated the most of privatization vouchers are partly foreign-owned. Some enterprises, like Skoda motor works, were privatized to the “strategic” foreign investors directly. In Hungary the privatization was remarkably open for the foreign investors, which were strongly encouraged to buy the former state-owned assets. Moreover, later on the law on privatization of “strategic” enterprises has made involvement of such kind of investors obligatory. As a result, 76 out of 100 largest multinationals are currently present in Hungary, and their capital dominates in the country’s economy.

Russia has an informal system of “regulation” of the foreign investments, just as Ukraine used to. It is partly institutionalized through the special list of “strategic” enterprises that is formed according to unclear criteria (there is no legal definition of a “strategic enterprise”) and constitutes of 500-600 entities, mostly operating in the defense industry. President of the RF unilaterally determines the order and mechanism of their privatization. Investments in the large firms are subject to special permits, along with banking, insurance, and investments that may lead to increase in activities potentially damaging to the environment, or related to extraction of the natural resources. Finally, the foreign investments are completely banned in the defense industry, pharmaceuticals, production of alcohol beverages and jewelry. In the oil drilling and processing industries the limit on foreign ownership is 15%.

Poland, along with its preparations to the EU accession has adjusted the rules for foreign investors to the EU practices, what means equal treatment of foreign and domestic investors in privatization and in establishment of new companies (with the exception of additional procedures for land acquisition for foreigners). However, in June 2005, a new law on so called “golden veto” has been accepted by the parliament, which gives special rights to the government to participate in chosen strategic decisions of companies (partly privatized, even with minority state shares, both with domestic and foreign capital) when these companies belong to the group “of substantial significance

for the public order and the public security". The first list of such companies included 15 largest companies. But in December 2005, after the new government came to power, the list has been broadened by 76 other companies and prospects for further broadening were signaled. The European Commission is rather sceptic toward this regulation and is currently considering its' compliance with the European law.



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## Center for Social and Economic Research CASE Ukraine

Analysis of the privatization course in Ukraine and causes of its current holdup concludes that a new Program of Privatization is likely to become an essential part of new political-economic compromise between main political and business players. For political-economic reasons it should provide a framework for competitive and transparent cash privatization aimed at maximization of revenues. The draft Program developed by the State Property Fund in 2002-2003 with support of the group of domestic and foreign experts may become a good basis containing mechanisms for ensuring important social interests – such as integrity of industrial organization, consumer rights protection, etc. – which could be otherwise sacrificed to the price paid through an auction. This Report suggests three necessary amendments to this Program based on extensive analysis of the Ukrainian and relevant foreign experience.

First concerns a special policy of legitimization of the private property rights acquired through privatization. The authors emphasize the necessity to counteract increasingly dominating negative attitude towards privatization and its results. Legitimization is deemed as essential for sustainable privatization under the democratic conditions. Second consists of technical issues of privatization of land plots occupied by the objects of privatization, both past and future. And third is devoted to the problems of national security tied to participation of foreign investors in the privatization.

# CASE