The Political Economy of Privatization in Ukraine

by

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Materials published in these series have a working papers character. They can be subject to further publication. The views and opinions expressed here reflect Authors' point of view and not necessary those of CASE.

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Abstract

Along with macroeconomic stabilization and liberalization of commercial activity, privatization is a central pillar of transition from post-socialism to a market economy. Privatization transfers inefficient state-owned enterprises to private owners, promoting "hard budget constraints" and economic incentives for managers in place of political incentives. Although privatization is only one step in the process of enterprise restructuring, it is a key element and certainly the one which has received the most attention.

Privatization in Ukraine started slowly. Serious discussion among Ukrainian policymakers about privatization began around 1990, and by 1992 Ukraine adopted its main privatization laws. However several years later, by December 1994, very few enterprises had actually been privatized, mostly on a case-by-case basis.

At the end of 1994, with the support and cajoling of western donors, Ukraine launched a revised mass privatization program. Although this revised program alleviated many of the problems that previously had blocked privatization, the speed of privatization nevertheless did not pick up as much as was expected and needed. By the end of June 1995, less than 200 medium and large enterprises had competed the mass privatization program, out of 8000 enterprises targeted for privatization in 1995.

This paper recounts and analyzes privatization in Ukraine from 1990 to 1995 in light of the lessons learned by East European countries and Russia. Part I of this paper recounts the experience of privatization in Ukraine from the beginning until late 1995. Part II of the paper presents an analysis of privatization in Ukraine, identifying problems and suggesting possible improvements.
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PART I: THE UKRAINIAN PRIVATIZATION EXPERIENCE


Discussions about the need for privatization in Ukraine began in 1990 among progressive Ukrainian policymakers, shortly after similar discussions began in neighboring Poland and Czechoslovakia. Through 1990 and 1991, Ukrainian policymakers acquired basic understanding of the defining characteristics of private property, the economic importance of privatization, and privatization methods being proposed in Eastern Europe. At first, most information came to Ukrainian policymakers from two western organizations established in Kiev in 1990 (Harvard's Project on Economic Reform in Ukraine and the Council of Advisors to the Parliament), from the visits and writing of economists Roman Frydman and Adrzej Rapaczynski, from Ukrainians' visits to the US and to Poland, and from the initial visits to Ukraine of the World Bank and the International Monetary Fund in late 1991. The concept of voucher privatization and the use of financial intermediaries in mass privatization was introduced to Ukrainian policymakers in 1990 by the Project on Economic Reform in Ukraine, who had contacts with advisors in Poland who were discussing similar proposals. A promise of voucher privatization was even written into the economic platform of the Ukrainian Republican Party in 1990.

Through 1991 and early 1992, these privatization discussions solidified into legal acts, first the Concept on De-statization and Privatization of State Enterprises, Land, and Housing, from December 1991, and then three laws on privatization in early 1992: the Law on Privatization of the Property of State Enterprises, the Law on Privatization of Small State Enterprises (Small Privatization Law), and the Law on Privatization Certificates.

Before the adoption of these laws and the first Privatization Program, in August 1992, only a thimbleful of ad hoc privatizations took place. The most well known of these was the privatization of Lviv's Electron Television Factory in which shares were given to workers after special permission was granted by the government in Kiev. This
privatization was done under the leadership of Viktor Pynzenyk, currently Vice Prime Minister and then Director of the Lviv Management Institute.

The privatization laws and programs have divided enterprises into six categories:

**Group A [1]** — small enterprises, with asset values under 33 billion karbovantsi. (Cutoff points for determining categories have frequently been re-indexed to account for high inflation. These cutoff points used here come from the 1996 draft Privatization Program from Fall 1995. In Fall 1995 the exchange rate was roughly 170,000 coupons to the US dollar.)

**Group B** — medium enterprises, with assets between 33 billion and 2150 billion karbovantsi, and with a level of assets per worker not higher than 1.5 times the value of a privatization certificate, and not belonging to Group D.

**Group C** — medium enterprises, with assets between 33 billion and 2150 billion karbovantsi, and with a level of assets per worker higher than 1.5 times the value of a privatization certificate, and not belonging to Group D.

**Group D** — Enterprises that have asset values greater than 2150 billion karbovantsi, or that have been declared monopolists, or that are in the military-industrial complex, or that will be privatized to foreign investors.

**Group E** — Objects of unfinished construction or of liquidated enterprises.

**Group F** — State-owned shares in enterprises that are of mixed ownership (eg, part state-owned and part privately held).

A number of allowable privatization methods were specified in the legislation: auction, tender, non-commercial tender (in which bidders compete on the basis of promised investment or adherence to certain conditions, rather than on the basis of price), leasing with buyout, buyout, public offerings of shares on stock markets, foreign investment, etc. Most of these methods could be employed using cash or privatization certificates.

Privatization certificates were to be given to each citizen "on account" in the bank rather than in a paper form. Although officials recognized that paper certificates would be easier for citizens to understand and use, they feared that the government did not have the
logistical ability to issue and distribute so many millions of pieces of paper, so they opted for certificates "on account" in special accounts in savings banks.

Citizens were not allowed to sell their certificates for cash, but they were allowed to trade them for shares in financial intermediaries. Policymakers recognized the need for financial intermediaries in the privatization process, but they feared that allowing full tradability of vouchers would eventually result in foreigners' acquiring all Ukraine's productive enterprises (especially foreigners from other CIS countries).

Early drafts of the privatization laws specified that the value of privatization certificates given to each citizen would depend on their age, the number of years they worked, their contribution to the society or other factors. The final laws gave all citizens an equal value of certificates, avoiding what otherwise would have been a logistical quagmire.

In the privatization process, workers were given certain privileges, including the priority right to buy shares in their own enterprises on advantageous terms using certificates and cash. Workers had the priority right using their privatization certificates to acquire shares in their own enterprises at book value. Additionally, workers could use their own cash, up to 50% of the nominal value of their privatization certificates, to acquire more shares at book value. Since book value was often quite low, this feature gave workers considerable privileges. This process of acquiring shares on privileged terms was called "closed subscription," in contrast with the subsequent "open" process of selling shares for cash or certificates to outside buyers. Note that Group B enterprises are those medium- and large-sized enterprises which theoretically could be totally acquired by workers if they use all the certificates and cash which they are eligible to use on advantageous terms. Group C enterprises are those medium- and large-sized enterprises which could not be totally acquired by workers even if they use all the certificates and cash which they are eligible to use on advantageous terms.

These privileges were one of many compromises between those who supported privatization mostly to workers and those who believed workers should be given no special privileges. The former either believed that justice required a transfer of property to the people who worked at that property, or they believed that any privatization that
minimized worker participation would not succeed politically. The latter believed that worker control of enterprises would lead to a Yugoslav-type floundering of the economy because workers would be ineffective, undisciplined owners.

The final versions of the privatization laws that were adopted by the Parliament were in many ways far more progressive and likely to be effective than earlier drafts and than programs being discussed in other countries. The final privatization laws, unlike earlier drafts, emphasized giving shares directly to workers as individuals rather than to collectives, and favored "open" stock companies (in which shares can be freely traded) to "closed" stock companies (in which shares cannot be sold without permission of other shareholders). Giving shares to collectives rather than to individuals and allowing closed rather than open stock companies would have greatly increased worker control and impeded the development of capital markets. Their exclusion from the laws was an important victory for market reform.

Original drafts of laws required that workers hold the shares they receive in privatization for a minimum of three years before re-selling. This was because of a fear that foreigners would quickly buy shares from Ukrainians, acquiring control over Ukraine's productive assets. Such a requirement would have destroyed all prospects for capital liquidity, making it virtually impossible for inefficient owners to sell to more efficient owners. Fortunately, a compromise was reached between advocates and opponents of this proposal, and a clause was added to the law making it possible for workers to sell their shares anytime after the introduction of a Ukrainian currency. Policymakers thought (incorrectly) that the existence of a Ukrainian currency would somehow create a barrier that would lessen the possibility of outsiders' coming into Ukraine to purchase privatized enterprises.

Initial interpretation of this clause was that trade could only start after introduction of the hryvna — the Ukrainian national currency whose introduction seemed imminent for several years. Subsequent interpretation, however, identified the kupon- karbovanets (the "temporary" currency already in circulation) as a national currency and permitted trade immediately. Pressure by those who were eager to begin buying and selling these enterprises forced this re-interpretation. Because of the relative simplicity of privatization by worker buyout followed by secondary sale to large investors (compared to other forms
of privatization), almost all privatization involving large investors has happened through worker buyout of the enterprise followed by purchase of shares by investors from the workers. This is true for participation of foreign investors as well as domestic investors. According to the law, almost any party could initiate privatization of an enterprise, including workers and managers, the central State Property Fund, local privatization authorities, Ukrainian citizens, and foreign citizens and organizations. For each enterprise, a privatization plan had to be developed and approved by a special privatization commission established for each privatizing enterprise. Developing a privatization plan was a cumbersome process, requiring an extensive inventorization and valuation of the enterprise. On the commissions were to sit representatives of the workers, the managers, the State Property Fund, the Antimonopoly Committee, the branch ministries, local authorities, and potential buyers.

A central role in the privatization process was played by the "buyers' association" — a poorly defined group of people taking primary responsibility for developing the privatization plan. The buyers' associations theoretically could include anyone but in practice were made up almost entirely of workers and managers. The convoluted rules for preparing a privatization plan for each enterprise, approved by a privatization committee that would represent so many different interests, made privatization of thousands of enterprises en masse practically impossible in spite of a legislative framework that theoretically called for rapid mass privatization. However, case-by-case privatization, usually in which workers and managers bought their own enterprises and sometimes sold them to outside investors, was possible and became the primary method of large-enterprise privatization.

Except for a few important events, described immediately below, the general privatization legislation did not change much between 1992 and the end of 1994. The Privatization Programs of 1992, 1993, and 1994, which filled in the details into the laws each year, were all fairly similar to each other.
2. Leasing

One of the most important issues over the 1992-1995 period is leasing. Leasing is a form of enterprise control dating to pre-independence Soviet law in which workers and managers would lease "their" enterprises from the state. The original Ukraine-specific legislation governing leasing was written in 1992. According to this legislation, workers had the priority right to lease their enterprises without having to seek approval from the state. Leased enterprises were controlled almost entirely by the workers, unlike regular state-owned enterprises, which were tightly controlled by ministries. Leasing enterprises also paid tiny rents to the government for their lease rights, which often were not adjusted for high inflation.

As a result, leasing was a very attractive form of enterprise control and was chosen at many small and large enterprises, particularly when the threat of privatization to outsiders arose. Given the advantageous conditions for leasing enterprises, such enterprises were in little hurry to privatize. Leasing soon became a major impediment to Ukraine's privatization process.

In May 1993, another decree was issued which sought to change the incentives for leasing. Leasing enterprises were still given priority rights, but measures were also taken to push them toward privatization. Leasing enterprises would either have to purchase their enterprises, or risk having the enterprise privatized to outsiders or the lease terminated.

Conditions for leasing changed several times over the 1992-1994 period as political power shifted back and forth, particularly in the Parliament, between proponents and opponents of leasing. Although a moratorium was eventually placed on further leasing, a significant portion of Ukrainian state-owned enterprises had converted to this type of enterprise control. As a consequence, leasing with buyout became a significant form of privatization both for large and for small enterprises.
3. Small-scale privatization

An important initial milestone in small-scale privatization occurred on February 20, 1993, in Lviv, when the State Property Fund and the Lviv municipal authorities, with the technical assistance of the International Finance Corporation, ran the first auction in Ukraine for small enterprises. Seventeen restaurants and shops were sold for cash to the highest bidders, nine of whom were worker collectives.

It was hoped that the so-called Lviv model would set a precedent for small-scale privatization, to be repeated across the country until almost all small enterprises were privatized. Although many auctions did follow the initial Lviv one, a number of problems impeded rapid progress. First was the question of leasing rights, discussed above. Because during most of the 1993 - 1994 time period workers had a priority right to lease and then buy-out their enterprises, workers frequently were able to block privatization of small enterprises, and they had an incentive to do so. Workers frequently feared the cash auctions because they did not want to lose control of "their" enterprises or risk losing their jobs at the hands of new owners. When enterprises were put on lists to be auctioned, workers frequently initiated the process of becoming leased enterprises followed by a slow buy-out procedure. Once leased, enterprises had little incentive to move quickly with buy-out. Such moves prevented local authorities from moving rapidly with privatization.

Partially, this problem was addressed over time by restricting possibilities for leasing, and partially this problem was addressed by encouraging leased enterprises to buy out quickly so that lease- with-buyout became a genuine method of privatization, along with cash auctions, in the small privatization process.

A second problem in the small privatization process arose because of distribution of revenues from small-scale privatization. Originally, local governments kept the revenues from cash auctions, giving them incentives to privatize rapidly. Then, the rules were changed so that the central government received fifty percent of revenues and local governments the other fifty percent. This greatly reduced the incentives for local governments to implement small-scale privatization, so they began to balk, and the pace of enterprise sales greatly decreased. Later, the division of revenues changed again, giving 80% to local governments and 20% to the central government. Predictably, the
privatization pace increased after this change. Also, in December 1994, a presidential decree instituted a number of measures to block further leasing of enterprises and to push those enterprises already under leasing toward privatization.

Although auctions had been a primary means of small-scale privatization in Russia, in Ukraine buyout (either after leasing or directly for state ownership) became the most common method. Even western advisors in Ukraine eventually shifted attention to buyout, recognizing that auctions were not working well. As an example of the prevalence of buyout over auction, note that, according to unofficial inside sources, roughly 1000 small enterprises under communal (local government) ownership in the second quarter of 1995 were privatized by buyout, while only around 100 enterprises were privatized by auction. Although not all periods were so skewed toward buyout, it is interesting to note the much greater prevalence of buyout in Ukraine than in other countries, such as Russia.

4. The 1994 Privatization Moratorium

In July 1994, the newly elected Parliament passed the resolution "On Perfection of the Privatization Mechanism in Ukraine and Intensifying the Control of Its Conduct" — popularly called the privatization moratorium. Specifically, the resolution forbade privatization by cash sales of medium and large enterprises. Technically, privatization of small enterprises (in communal property) and sale of shares for certificates were not affected. In reality however, partially because of ignorance about the resolution and partially because of attempts to use the resolution as an excuse for blocking privatization by opponents of privatization, even certificate and small privatization slowed during the period of the moratorium.

The moratorium forbade most cash privatization until a list of enterprises to be excluded from privatization would be adopted. The moratorium had broad support in the Parliament. Conservatives supported it because they don't favor any kind of privatization. Interestingly, reformers supported it too mostly because they wanted to buy some time to study the privatization process and influence it before it went too far. Having mostly just
been elected to the Parliament, reformers did not feel comfortable with allowing rapid progress of a process they did not yet understand.

In early 1995, the Parliament adopted a list of enterprises not to be subject to privatization, and the moratorium was lifted. After this act, the pace of privatization once again quickened.

5. Corporatization

Corporatization was originally viewed as a part of the privatization process, to be undertaken once an enterprise began privatizing. In June 1993 this changed with the issuance of a new corporatization decree. Through the decree, enterprises were to be transformed into joint-stock companies in which all shares held by the government were transferred to the State Property Fund. The decree and subsequent Cabinet of Ministers procedures specified instructions for choosing boards of directors and drafting charters and by-laws.

Corporatization continued to be a part of the privatization process for medium and large enterprises. Additionally, many enterprises not intended soon for privatization also began a process of corporatization. Unfortunately, enterprises targeted for corporatization generally did not do so as quickly and as widely as was envisioned by the law and regulation. From June 1993, corporatization proceeded in an ad hoc, disorganized manner. in November 1994, a streamlined scheme for corporatization was written into the presidential decree that launched the mass privatization effort.

6. Privatization Organs and Individuals

Primary responsibility for privatization was originally given to two bodies — the State Property Fund and the Ministry for Destatization. These two bodies, along with the Committee for the Support of Entrepreneurship, came under the jurisdiction of State Minister Volodymyr Lanovoi. (The position of State Minister was eventually abolished in a later reform of government structures.) Because of political opposition to the first
Minister of Destatization, Victor Salnikov, a conservative, the Ministry was given almost no power and was eventually eliminated even though Salnikov was later replaced by Roman Shpek, a reformer.

The State Property Fund took the lead role in preparing privatization normative acts and in managing the privatization process, in collaboration with many other organs. De jure the State Property Fund worked as an independent agency, reporting directly to the Parliament. De facto, the Fund worked like most ministries, reporting up the chain of command to the Cabinet of Ministers. (The most recent Chairman of the Fund was made a member of the Cabinet of Ministers, increasing the Government's control over the Fund.) Some normative acts were written and issued by the Fund after consulting with the Cabinet of Ministers, other ministries, and outside advisors. Other more important documents were written by the Fund and sent to the Cabinet of Ministers for revision and formal introduction as Cabinet decrees. The most important documents, such as laws, presidential decrees, and the annual privatization programs, were written by the Fund with broad input from other organs, sent to the Cabinet of Ministers for revision and approval, and then sent to the President's administration or to the Parliament for revision and final approval.

The State Property Fund oversaw almost all aspects of privatization implementation. However many other cooks worked in the privatization kitchen. The Antimonopoly Committee participated in the privatization of enterprises occupying a monopoly position in their markets. The Ministry of Finance participated in the licensing and regulation of financial intermediaries, and oversight of circulation of privatization certificates. The State Savings Bank distributed the privatization certificates. Independent auditors appraised property. Non-governmental privatization certificate auction centers, established with USAID support, collected bids from citizens and financial intermediaries during 1995's mass privatization attempts, determined clearing prices and distributed shares. All these organs collaborated with the Fund in writing relevant law and regulation.

The State Property Fund was first headed by Volodymyr Pryadko. According to many western observers, Pryadko played a very passive role, reluctant to push privatization aggressively or to take public stands. His tenure lasted throughout the presidency of Leonid Kravchuk, a leader who similarly preferred politics over policy and
who did not see privatization implementation as a top priority. The second Ukrainian President, Leonid Kuchma, took seriously the tasks of economic reform, among them privatization. Because of the new presidency and the new Parliament's dissatisfaction with privatization in 1994, Pryadko was fired (eventually along with senior State Property Fund staff) and replaced with Yuri Yekhanurov, an experienced economic policymaker. Compared to Pryadko, Yekhanurov was far more dedicated to pushing the privatization process faster. With new leadership in the Presidency and the Fund, a recognition in the Parliament and other political circles that fundamental change in the privatization program was needed, and increased western support, the government adopted a new mass privatization program by Presidential Decree in November 1994. Without the rise of Kuchma and Yekhanurov, it is possible that the new mass privatization program (quite ambitious at least on paper) would never have been adopted under the previous leaders.

Compared to its counterpart in Russia (the State Committee for Property), the State Property Fund has been quite weak, politically. The Fund has primary responsibility for crafting the details of privatization policy, but any major decisions could only be made with the input of at least the Cabinet of Ministers. Neither Pryadko nor Yekhanurov were given the power and authority that Chubais achieved in Russia. Although many key senior leaders in the Cabinet of Ministers during these years strongly supported privatization (Volodymyr Lanovoi, Victor Pynzenyk, Roman Shpek, etc.), the dispersion of decision making responsibility to so many people and agencies greatly hurt the process. Since the head of the Fund did not have sufficient power and since senior Cabinet of Ministers officials had a host of other economic issues to address in addition to privatization, Ukraine's privatization program seemed frequently to be drifting like a captainless ship.

The State Property Fund had several problems internally that greatly impeded its work. Among the most important problems during the first several years of privatization was that the local privatization funds, with jurisdiction over privatization of municipal property (mostly small enterprises), were autonomous from the central State Property Fund in Kiev. Rather than reporting to the central Fund, municipal funds reported to their local governments, making it impossible for the central Fund to implement its mandate of privatizing the nation's enterprises. Much political effort was expended to solve this
problem by creating a unified system of privatization bodies, with local funds directly subordinated to the central Fund.

Another important problem that plagued the Fund was that it had few financial resources to attract sufficient numbers of competent, motivated people to its staff, both at the central and municipal levels, and that it received almost zero direct western assistance. In Russia, large sums of western assistance were devoted to assisting the State Committee for Property (GKI) and for creating a non-governmental policymaking counterpart to the GKI, the Russian Privatization Center (RPC). This assistance allowed the GKI and RPC to attract top-level western advisors and to offer competitive salaries to competent Russian experts in order to draft and implement sound privatization policy.

In Ukraine, tens of millions of dollars of western assistance were spent on advisors in the field to help implement privatization and in the direct costs of privatization (such as printing paper privatization certificates), but no money was spent on long-term inside advisors to help the Fund draft and implement privatization policy. The unwillingness or inability to provide long-term inside western advisors to the Fund or to support the work of Ukrainians at the Fund is one of the great failures of western assistance to Ukraine and partially explains why Ukraine's privatization has lagged so far behind Russia's.

7. Ukraine's Revised Mass Privatization Program

In November 1994 in order to address many problems in the Ukrainian privatization program, President Kuchma signed a Decree "On Measures for Ensuring the Rights of Citizens to Use Their Privatization Certificates." The Program had the strong support of the World Bank, USAID and EC TACIS, whose consultants advised on the drafting and implementation of the program. This Decree outlined a revised mass privatization program. The program applied to enterprises in Groups B, C and D, specifically to 8000 that were to have been put on a list by the Cabinet of Ministers.

The Decree specified that enterprises would be valued based on their 1 January 1995 book value, rather than the previous cumbersome process. Privatization commissions were simplified, to include a representative of privatization authorities, the top manager,
the head accountant, and in some cases a representative from the Anti-Monopoly Committee. The privatization plan, the articles of incorporation as an open stock company, the plan for share distribution, and other legally required documents were standardized and mandated to be completed in a short time.

Top managers were given a right to purchase up to five percent of the shares in the enterprise at nominal value, paying for the shares over the course of a year.

Paper privatization certificates were to be distributed to the population in place of the old system of certificates on account.

The Decree mandated that 100% of shares of Group B enterprises, no less than 70% of shares of Group C, and up to 70% of shares of Group D enterprises would either be given to workers at privileged terms or would go through certificate privatization auctions. Additional shares would be used to compensate citizens for the losses that have been incurred in their savings accounts due to inflation, in exchange for compensation certificates that would be printed at a later time. Remaining shares would be privatized after 1 January 1996 for cash.

The revised mass privatization program, at least initially, was not successful. In the first five months of implementation of the Program, less than 200 enterprises were privatized, out of 8000 targeted for 1995. Partially, this sluggishness was caused by a rule requiring that shares offered in nationwide certificate auctions from an enterprise must be sold above a minimum price, which was based on book value. In most cases, insufficient numbers of shares were bid to cover the nominal prices of offered shares, so enterprises were considered undersubscribed and no shares were sold. An even deeper problem, however, lay in the fact that far too few enterprises were being supplied to the mass privatization program. Auction bid centers were established throughout the country with USAID assistance, but they had few enterprises to sell. As a result, so-called mass privatization was proceeding even more slowly than the case-by-case privatization.
8. Privatization in Ukraine Quantified

It is very difficult to get a quantitative sense of the state of privatization in Ukraine. Statistics have not been collected in a thorough, organized, centralized manner. The Ministry of Statistics has not conducted or released an inventorization of Ukraine's medium and large enterprises, so State Property Fund officials and western advisors do not even know how many medium and large enterprises there are in Ukraine. There is a list of over 6000 medium and large enterprises that are subject to mandatory privatization, and there is a list of over 6000 enterprises for which privatization is forbidden. It is not clear how many thousands of enterprises may exist that are not on either list. It also seems that some enterprises are on both lists, some enterprises on the lists are not really enterprises, and some on the lists may even not exist. Similar problems exist in counting small enterprises, with estimates of the total number of small enterprises varying by tens of thousands.

Much information regarding the details of privatization of medium and large enterprises is collected by local property funds and perhaps not fully reported to the central State Property Fund in Kiev. As a result, for instance, it is not known what portion of shares in enterprises, on average, is acquired by workers and managers on privileged terms. Also, according to some accounts, the Ministry of Statistics may report many enterprises as privatized when in fact they have only been corporatized and remain in state control.

The following numbers, reported by Taisia Voronkova at the Center for Economic Development in Kiev, based on materials from the Ministry of Statistics and the European Centre for Macroeconomic Analysis, provide a general picture of the state of privatization in Ukraine, even though the numbers may contain significant inaccuracies.
### Table 1: Privatization of Enterprises by Group

<table>
<thead>
<tr>
<th></th>
<th>All SOEs</th>
<th>SOEs owned at national level</th>
<th>SOEs owned at municipal level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Privatized in all groups</td>
<td>14856</td>
<td>5735</td>
<td>9121</td>
</tr>
<tr>
<td>(1992 – 1 July 1995)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Of which, by %:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group A</td>
<td>74.6</td>
<td>44.3</td>
<td>93.5</td>
</tr>
<tr>
<td>Groups B, C, D</td>
<td>25.0</td>
<td>55.4</td>
<td>5.9</td>
</tr>
<tr>
<td>Group E</td>
<td>0.4</td>
<td>0.3</td>
<td>0.6</td>
</tr>
<tr>
<td>Planned priv. in 1995</td>
<td>30450</td>
<td>10120</td>
<td>20330</td>
</tr>
<tr>
<td><strong>Of which actually priv. in 1st half 1995, %</strong></td>
<td>10.7</td>
<td>13.3</td>
<td>9.4</td>
</tr>
<tr>
<td><strong>Of which:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Group A planned</td>
<td>22450</td>
<td>3720</td>
<td>18730</td>
</tr>
<tr>
<td>Group A actual, %</td>
<td>9.6</td>
<td>10.8</td>
<td>6.8</td>
</tr>
<tr>
<td>Groups BCD planned</td>
<td>8000</td>
<td>6400</td>
<td>1600</td>
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<tr>
<td>Groups BCD actual, %</td>
<td>13.4</td>
<td>14.7</td>
<td>8.1</td>
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<tr>
<td>Group E planned</td>
<td>1200</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Group E actual, %</td>
<td>-</td>
<td>-</td>
<td>-</td>
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</tbody>
</table>
### Table 2: Privatization of Enterprises by Means of Privatization

<table>
<thead>
<tr>
<th></th>
<th>All SOEs</th>
<th>SOEs owned at national level</th>
<th>SOEs owned at municipal level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Privatized by all means (1992 - 1 July 1995)</td>
<td>14856</td>
<td>5735</td>
<td>9121</td>
</tr>
<tr>
<td>Of which, by %:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>buyout &amp; lease/buyout</td>
<td>73.4</td>
<td>60.0</td>
<td>81.8</td>
</tr>
<tr>
<td>auction, tender</td>
<td>10.9</td>
<td>3.3</td>
<td>15.7</td>
</tr>
<tr>
<td>sale of shares</td>
<td>15.7</td>
<td>36.7</td>
<td>2.5</td>
</tr>
<tr>
<td>Privatized by all means (1st half 1995)</td>
<td>3253</td>
<td>1342</td>
<td>1911</td>
</tr>
<tr>
<td>Of which, by %:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>buyout &amp; lease/buyout</td>
<td>58.1</td>
<td>24.9</td>
<td>82.2</td>
</tr>
<tr>
<td>auction, tender</td>
<td>9.4</td>
<td>3.3</td>
<td>13.9</td>
</tr>
<tr>
<td>sale of shares</td>
<td>32.5</td>
<td>71.8</td>
<td>4.9</td>
</tr>
</tbody>
</table>

### Table 3: Numbers of Privatized Enterprises by Method (1993, 1994)

<table>
<thead>
<tr>
<th></th>
<th>1993</th>
<th>1994</th>
</tr>
</thead>
<tbody>
<tr>
<td>Buyers’ assoc. buyout</td>
<td>1403</td>
<td>3157</td>
</tr>
<tr>
<td>Buyout by alternative plan</td>
<td>64</td>
<td>87</td>
</tr>
<tr>
<td>Buyout from leasing</td>
<td>1319</td>
<td>2886</td>
</tr>
<tr>
<td>Sale at auction</td>
<td>260</td>
<td>396</td>
</tr>
<tr>
<td>Non-commercial tender</td>
<td>141</td>
<td>173</td>
</tr>
<tr>
<td>Commercial tender</td>
<td>133</td>
<td>196</td>
</tr>
<tr>
<td>Commercial tender with delayed payment</td>
<td>7</td>
<td>-</td>
</tr>
<tr>
<td>Free transfer</td>
<td>-</td>
<td>67</td>
</tr>
<tr>
<td>Sale of shares of open join-stock co.</td>
<td>219</td>
<td>986</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3555</strong></td>
<td><strong>7947</strong></td>
</tr>
</tbody>
</table>
Table 4: Privatization by Form of Property (1993, 1994)

<table>
<thead>
<tr>
<th>Level of Ownership</th>
<th>1993</th>
<th>1994</th>
</tr>
</thead>
<tbody>
<tr>
<td>National</td>
<td>1596</td>
<td>7947</td>
</tr>
<tr>
<td>Municipal</td>
<td>1959</td>
<td>5251</td>
</tr>
<tr>
<td>Total</td>
<td>3555</td>
<td>7947</td>
</tr>
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</table>

Table 5: Pace of Privatization

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Cumulative Number of Privatized Enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992 Q4</td>
<td>30</td>
</tr>
<tr>
<td>1993 Q1</td>
<td>430</td>
</tr>
<tr>
<td>1993 Q2</td>
<td>830</td>
</tr>
<tr>
<td>1993 Q3</td>
<td>1,685</td>
</tr>
<tr>
<td>1993 Q4</td>
<td>3,585</td>
</tr>
<tr>
<td>1994 Q1</td>
<td>5,442</td>
</tr>
<tr>
<td>1994 Q2</td>
<td>8,402</td>
</tr>
<tr>
<td>1994 Q3</td>
<td>10,214</td>
</tr>
<tr>
<td>1994 Q4</td>
<td>11,552</td>
</tr>
<tr>
<td>1995 Q1</td>
<td>12,802</td>
</tr>
<tr>
<td>1995 Q2</td>
<td>14,957</td>
</tr>
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</table>
PART II: AN ANALYSIS OF UKRAINIAN PRIVATIZATION

In the 1980s, governments all around the world began privatizing utilities, companies that extract natural resources and other so-called "natural monopolies" and "strategic" enterprises. This privatization trend spread through much of the Third World and the developed economies.

If the 1980s can be characterized as the Era of Privatization, then the first half of the 1990s must be named the Era of Mass Privatization, during which most countries of the formerly socialist bloc attempted ambitious privatization programs for whole economies. At first, policymakers and scholars working in East European countries assumed they faced issues similar to those confronted by their counterparts in the 1980s. Over a short time, however, this belief proved false, as mass privatization of the 1990s turned out to be an entirely different animal from the 1980s breed. Post-socialist privatization required ownership transformations on an unprecedented scale — thousands of large enterprises to be privatized within several years, compared to the handfuls of enterprises involved in First and Third World privatization programs. Furthermore, post-socialist economies lacked many kinds of market institutions, such as capital markets, which made market valuation of enterprises impossible. They also lacked an appropriate legal infrastructure, banking systems, western-style accounting standards, wealthy investors, and skilled policymakers, business managers, and accountants [2].

Successful mass privatization in any post-socialist country requires compromise between economic goals and political constraints. Economically, mass privatization must transfer state- owned enterprises to private ownership is a way that maximally encourages restructuring and efficient operation. Politically, mass privatization must provide enough incentives to key groups in the society so that sufficient support is raised for mass privatization to be implemented.
1. The Economics of Mass Privatization

The following points on the economics of mass privatization are important:

- The purpose of privatization is to separate enterprises from the state, depoliticizing them so that managers pursue profit-maximizing strategies under hard budget constraints rather than seeking subsidies and special privileges (i.e., rents) from the government. [3]

- Privatization must establish private property rights and institutions. Chief among these rights must be the right of owners to use the enterprise as they see fit within certain legal limits. This of course includes the right to make basic production decisions, to make enforceable contracts with suppliers and customers, and to set prices.

- Capital markets must be created that give owners the right and ability to sell their property freely. Through such markets, owners who run their enterprises poorly will frequently sell to new owners who are better able to manage them. Also through capital markets, prices of stocks will provide signals about the health of companies.

- Privatization should encourage core investors to the extent possible (i.e., investors who own relatively large blocks of shares). Core investors are better able to manage and restructure enterprises than are small shareholders. Core investors are also more likely to inject capital into the enterprise or to attract new capital from outside sources, and they will be strong enough to safeguard shareholders' rights.

- Privatization should encourage investment into enterprises to the extent possible. Restructuring enterprises requires money. Old equipment needs to be sold (rarely) or junked (more likely), new equipment must be purchased, and employees need to be trained or retrained.

- To succeed, privatization must be accompanied by other key economic reform measures—stabilization and convertibility of the money, liberalization of prices and domestic and foreign trade, reduction of the budget deficit, reform of the tax system...
so that revenues are collected without overly burdening enterprises, etc. Tight monetary policy is particularly important for reducing the incentives to enterprises to stay in the state sector by reducing overall subsidies.

The current privatization process in Ukraine only partially has achieved these objectives. Formally, privatized enterprises are separated from the state budget, and the state does not interfere in basic production decisions. However it is still too early to tell the extent to which privatized enterprises are becoming depoliticized, turning their attention to markets and to internal restructuring rather than focusing on government relations. Development of capital markets and laws and institutions to protect private property has occurred quite slowly, which is to be expected given the low portion of the economy that has already crossed into the private sector. Only after a larger constituency of private enterprises in the formal sector has developed can there be substantial progress towards these economic goals.

Privatization has somewhat been encouraged by macroeconomic stabilization and liberalization of the economy. The scarcity of credits from the government due to stabilization has greatly reduced the incentives for managers to stay in the state sector. Much greater financial discipline will be needed however to push greater numbers of enterprises into private ownership. This is especially true for the agricultural industrial complex, which continues to draw inflationary credits from the state budget.

A number of economic problems in Ukraine's privatization process are caused by the fact that it is very difficult for large investors to participate in Ukrainian mass privatization. Large active investors cannot directly buy shares in enterprises that participate in mass privatization, nor can they buy privatization certificates directly from citizens. The only ways they can acquire controlling packets of shares are to form financial intermediaries or to buy shares on the secondary market after privatization. Buying shares on the secondary market would be slow and costly since shares likely will be widely dispersed, and the markets will not soon function efficiently. Two kinds of financial intermediaries considerably could play the role of core investors - - investment funds and trust companies. Investment funds, however, are limited in the portion of shares
they can acquire in any one enterprise. They therefore are likely to be passive investors —
speculators. And trust companies, which are not limited in the portions of shares they can
acquire, also are unlikely to become active investors. Since they were entirely
unregulated, they too tend to be passive speculators, engaging in everything from
certificate privatization to pyramid scams. (A new privatization security, called
compensation certificates, to be introduced in late 1995 or early 1996, would be tradable,
allowing better access by large investors to privatization through the possibility of trading
blocks of certificates for blocks of shares.)

The barriers to participation by core investors are bad for several reasons. Because
few outsiders have controlling packets of shares, there may be nobody who has the
interest and ability to restructure enterprises and to run them efficiently. Small individual
investors would not be able to organize themselves. As a result, control would be left in
the hands of existing managers, as it is before privatization, without any efficiency gains.
Without core investors, enterprises will find it harder to raise capital. Usually, capital is
most likely to come either directly from core investors or from other outside investors
who decide to invest in the company because they see a core investor whom they can trust
to manage the investment wisely. Privatization without core investors may lead to control
structures similar to Yugoslavia, where ineffective worker councils control enterprises,
even if the majority of shares are in the hands of small outsider shareholders.

Perhaps most importantly, outside core investors may be less likely to focus as many
resources on seeking subsidies from the central government than current enterprise
directors, who developed professionally in an environment where the central government
was the only source of inputs and credits. Compared to current managers, outside core
investors may be more interested in maximizing profits rather than breaking hard budget
constraints.

Core investors have both the profit motive and the power of concentrated ownership
to overcome resistance to reform. Core investors in Russia and more so in Czechia have,
on some occasions, successfully thrown out old management in order to launch
restructuring [4].
In Czechia, there were two means through which core investors could participate. Large investors could simply buy a portion of shares directly from the state without touching those shares that go for voucher privatization. Or intermediary funds could trade blocks of vouchers for controlling packets of shares in enterprises. Intermediary funds are the most common large investors. Intermediary funds own more than 20% of shares in 787 companies and more than 50% in 334 companies. Although small individual shareholders own many of the shares in enterprises, it can be argued that core investors own enough shares in most enterprises to control them. Individual investors are too dispersed to have a voice; among those investors who own sufficient numbers of shares to have voice, ownership is sufficiently concentrated for certain owners to be able to exert control. According to one analysis of Czech privatization, “97% of all companies can be controlled by the coalition of the five largest shareholders” [5].

In Russia, a different approach to encouraging large investors was taken. There would have been too much opposition to direct participation by outside investors initially in privatization because of the comparatively powerful industrial lobby. However, since certificates were freely tradable, it was possible for large investors to simply buy up certificates and then to acquire blocks of shares. In Russia, roughly one-fourth of the roughly 150 million vouchers were sold by citizens on the secondary market, and a third of vouchers were invested through Russia’s 640 investment funds [6]. This allowed large investors to accumulate large blocks of vouchers, sometimes numbering into the millions, which they traded for large packets of shares in enterprises. Large investors also were able to participate in Russian privatization at later stages by buying shares in cash auctions, in which a portion of the cash was directed into the enterprise for the purpose of restructuring.

The government of Ukraine could directly increase participation by large investors in the privatization process by allowing the free tradability of privatization certificates. Free tradability would allow large investors to accumulate blocks of certificates which they could trade for shares in enterprises, as was allowed in the Russian scheme. Although economically desirable, such a change is extremely unlikely because of continued political opposition to the idea of tradability. A more feasible way of encouraging participation by large investors would be to implement sales of packets of
shares, in exchange for cash, certificates, or investment promises. Such a scheme is described in a later section.

Strengthening fiscal discipline, increasing liberalization of the economy, and drafting and enforcing better legislation to protect private property and promote capital markets are all additional measures that would promote the economic objectives of privatization.

2. The Politics of Mass Privatization

Turning to the political aspects, the following points are worthy of mention:

- The key to successful implementation of any mass privatization program is creation of incentives for important stakeholding groups in the society to support the program. Key stakeholders will include: workers and managers, powerful groups seeking to acquire enterprises, local governments, the national government (top government structures, branch ministries, the parliament), privatization authorities, and the people as a whole. Incentives can be created by granting cash or enterprise control rights. Most stakeholders must be given incentives; only a few stakeholder groups can be simply defeated politically.

- Mass privatization is war, not microsurgery. Mass privatization is a process of revolutionary transformation implemented by weak, overburdened governments in conditions of social chaos. Policies must bluntly stretch toward as many political and economic goals as possible in a very short time. Tweaking and refining policies until they approach perfection will usually end in delay and failure as the brief window of opportunity in each post-socialist economy quickly slams shut.

- Although the eventual goal of privatization is enterprise restructuring and not privatization merely for the sake of privatization, restructuring of enterprises during privatization almost never should be undertaken. If socialist governments could not manage state-owned enterprises efficiently for 50-70 years, then there is no reason to think that they could possibly restructure them now. The immediate goal of privatization should be to move enterprises through the privatization process as fast
as possible, recognizing that restructuring will best be done by new private owners.

One exception to this rule might be in the case of monopolies and conglomerates, when the government may wish to split up enterprises into smaller units during privatization.

- Privatization processes should be kept as simple as possible, delegating as much privatization work as is possible from the central government to other capable governmental and non-governmental organizations.

Of the above points on the politics of privatization, the current Ukrainian privatization procedures achieve several. The program is blunt, aimed at privatizing quickly rather than focusing on restructuring first. And, although the procedures are still quite complex, simplicity is at least recognized by Ukrainian policymakers and their western advisors as important, and much effort is devoted to devising simpler methods.

Unfortunately, however, the most important political point, regarding the need for creating incentives for stakeholders, has been largely ignored by designers of the privatization programs. Primarily for this reason, privatization in Ukraine currently is failing.

Although privatization in the long run should create many winners, it will also create a number of losers — groups in the society who benefit from the current system and who enjoy considerable controls and incomes that they stand to lose. These potential losers are likely to block privatization efforts. The success of a mass privatization program depends on its ability to pay off or co-opt a sufficient number of potential losers so that they at least do not block privatization and so that coalitions of potential winners are sufficiently stronger than remaining losers for the privatization program to prevail.

A basic problem with Ukrainian privatization is that the program simply creates too few incentives for stakeholders to support it. Many key stakeholder groups receive little control and little cash in exchange for supporting privatization. Most importantly, workers and managers generally are unable to buy out their enterprises on privileged terms. Either they are not allowed to buy a sufficient portion of shares in their enterprises at privileged terms because of the nominal value of the enterprise assets relative to the number of
workers and the nominal value of privatization certificates, or they do not have sufficient cash even to buy shares at nominal value.

Furthermore, almost no revenues are generated, so there are few financial incentives for stakeholders to participate. In Russia, portions of shares were sold for cash. This revenue was then used as a financial incentive for local governments and privatization authorities. Much of the cash earned in privatization went straight to the enterprises themselves to help with restructuring, giving a financial incentive to managers. The fact that privatization certificates could be sold for cash gave the public an incentive to participate in it. Without any of these financial incentives in Ukrainian mass privatization, many key stakeholders will be reluctant to support it, which may threaten its success.

The barriers to participation by core investors further reduce incentives to support privatization. Mass privatization without core investors will be slower. Core investors frequently could push the privatization process so it proceeds quickly. They could hire consultants to help if necessary and confront the managers if the managers try to delay.

Because Ukrainian mass privatization discourages participation of core investors, those core investors who want to invest in enterprises and the managers who want to work with them will try to keep their enterprises out of the mass privatization program. The difficulty the Cabinet of Ministers had in completing the list of enterprises to be privatized and the Parliament's opposition to finalizing the list both stem partially from a desire among certain groups to not lose good enterprises into the mass privatization process. As a result, mass privatization without core investors may lead to a program that includes only Ukraine's worst enterprises, with the best enterprises' going entirely to core investors completely separately from the certificate program.

Mass privatization without core investors will be bad for Ukrainian citizens who have invested privatization certificates as well. Only core investors are strong enough to fight for the right of all shareholders against insiders, who will try to weaken ownership control. Small investors benefit if there are also large core investors who manage the enterprise effectively, defend shareholder rights, and raise capital. Small investors may lose if they are the only outside investors.
For political reasons, as well as economic reasons, it would be advisable to increase the opportunities for participation by large investors in Ukrainian mass privatization. This would improve corporate governance, increase prospects for investment into restructuring, and improve political support for privatization among those investors wanting to acquire shares in enterprises and those enterprises seeking core investors.

Both Czechia and Russia developed their own approaches to privatization that provided adequate incentives to key stakeholders. In Czechia, mass privatization succeeded because Czech leaders were able to build unified popular support around the principle that each Czech citizen was entitled to an equal share of property without anyone's receiving any special privileges. Mass support for this idea was built by a very active campaign in the mass media by Vaclav Klaus and other Czech leaders. Each citizen would have a choice of where to invest his or her privatization voucher; the government would not make investment decisions for the people.

Furthermore, the government would not determine the exact course of privatization for enterprises. Rather, any organization or individual had a right to submit a privatization project, proposing how shares would be sold and distributed. This feature created flexibility and choice, most importantly for enterprise insiders, so that they could propose plans for privatization that most suited them. Because of the choice and flexibility they were given, opposition to mass privatization from managers and workers was far less than what it otherwise might have been.

Although a pure voucher scheme was originally envisioned, the model that eventually developed was mixed, using both voucher sales through auction centers and direct sales to core investors for cash and/or investment promises. The former created incentives for the people as a whole to support privatization, and the latter created incentives for those seeking to acquire enterprises and for managers to support privatization. Because the Czech privatization program was able to build popular support through the voucher program and to minimize opposition from workers and managers through allowing these groups to submit privatization projects, it succeeded politically.

Russian mass privatization also achieved political (as well as economic) success, though the Russian program was far more complicated politically than the Czech version,
reflecting the far greater number of political obstacles that were found in Russia than in Czechia.

In Russia, there were more stakeholders than in Czechia. "The main stakeholders were the enterprise managers, who got substantial control over investment, employment, product development and many other decisions that were previously controlled by central ministries. The second key stockholders were the workers, who (unlike in Poland) did not have much control over decisions in the firm but did have, through their allies in the Parliament, effective veto power over any change in the legal ownership structure of the enterprise. The third key stakeholders were the local governments, which wanted enterprises to maintain employment and provide social services for the local residents, and controlled the supply of water, electricity, and other services to firms. Finally, the central ministries retained some control over firms in part because they could coordinate supply and distribution much better than enterprise managers." [7]

All of the stakeholders gained something through privatization. Workers gained shares in their own enterprises on advantageous terms in several different ways depending on which privatization variant was chosen. Workers also received a share of the proceeds when their enterprise was sold [8].

Many of the control rights to all workers really end up in the hands of managers because of the power managers have within the enterprise. Additionally, managers have the right to choose the privatization variant for their enterprise, which gives them considerable control over the privatization process.

Local governments were given a share in the proceeds from the sale of certain enterprises. Local governments were not given shares in privatizing enterprises, for to do so would have compromised too much from an economic perspective. Branch ministries were given some authority to review privatization programs for certain large strategic enterprises, but they were not given much else. Finally, the public was given the right to participate in privatization through the voucher program. This created broad popular support for the program and gave it its initial momentum, especially since the vouchers were tradable so citizens had the choice of becoming shareholders or receiving cash.
More recently, Russia has moved towards cash privatization, in which shares are sold to investors for cash rather than certificates. The shares being sold are mostly large minority packets of shares in enterprises that were held by the government while the rest of the shares went to insiders or to voucher privatization. The unique feature of Russian cash privatization is that most of the proceeds go into the enterprises being privatized. A smaller portion of the proceeds goes to privatization authorities and to local governments. Cash privatization makes sense economically because it provides enterprises with capital needed for restructuring and it brings in core investors who have a vested interest in the efficient operation of the enterprises.

Politically, cash privatization provides financial incentives for many of the key stakeholders to support the process: managers receive infusions of capital for their enterprises, and local government and privatization agency officials receive a cut of the income. Central government officials receive political benefits from satisfying the capital needs of newly privatized enterprises [9].

The Ukrainian program fails because it does not create the many incentives found in the Czech and Russian programs. Workers and managers receive little control or cash; large investors are mostly excluded from mass privatization; and there are no cash sales to generate revenues, which could be spread around to various stakeholder groups.

The only significant incentive created by the Ukrainian program is through the certificate auction program, which stimulates some support among the general population for privatization in the abstract but does not create pressure to privatize any specific enterprises. Even this incentive is probably weaker than was the case in Czechia and Russia. First, the additional possibility of selling one's certificate to earn cash, which existed in Russia, is absent in Ukraine.

Second, the Ukrainian certificate program suffered because it started after the post-independence euphoria had dissipated and after programs in other countries had been implemented. This delayed start gave Ukrainian policymakers an opportunity to learn from the experiences of its neighbors. It also gave the Ukrainian people an opportunity to preview what they could expect from the process, and what they saw they did not like. It certainly is true that citizens of Russia, Czechia, and other countries received a small
benefit in return for their privatization vouchers and a large benefit from the opportunity to live in a privatized economy. However, this is not what Ukrainians saw and heard. What they saw and heard through their mass media is that their neighbors were being plagued with scandal after scandal: the St. Petersburg voucher thefts, the scams of MMM Invest and other financial intermediaries, bribery cases of even senior Czech privatization officials, etc. As a result, the attitude of Ukrainian citizens toward certificate privatization has generally been one of cynicism and apathy, as few Ukrainians bothered to acquire or invest their certificates. An emphasis by western donor public relations campaigns on family and security rather than on speculation sought to address this cynicism but did little to assuage it. The inability of citizens to sell their certificates for cash (as was possible in Russia) also did little to raise public interest in certificate privatization.

Without substantial changes in the Ukrainian privatization program to dramatically increase incentives to key stakeholders, there would be little chance of ever meeting the ambitious targets of the program.

3. Recommended Improvements to Ukraine's Privatization Program

The privatization program of Ukraine needs to be changed to provide more incentives to key stakeholder groups in the society so that they will support privatization. Many of the possible changes that would address these issues would also improve economic aspects of privatization. (For instance, creating opportunities for core investors would improve corporate governance and increase the likelihood of investment, in addition to addressing political concerns.) Adopting the following suggested changes in the privatization program could substantially improve the prospects for successful privatization.

− Managers and workers could be given outright the right to acquire 51% of the shares in their enterprises. This measure perhaps more than any other would go furthest toward creating an effective incentive for one of the most influential stakeholder...
groups in society to support privatization. However, this measure would have little likelihood of being adopted since it would be too great a departure from the current methods.

- Subtler ways could be found to increase the portion of shares in enterprises that are acquired by managers and workers. Managers and workers could be given the right to acquire more shares on privileged terms in exchange for cash or certificates. The purchasing power of their cash and certificates could be increased by multiplying by a special coefficient to be used only during "closed subscription." Certificates could be re-indexed upward so that manager and worker purchasing power increases (or nominal enterprise value could be indexed downward). (Re-indexation would also increase citizens' purchasing power.) Or, special privatization certificates could be distributed for the exclusive purpose of allowing workers and managers to acquire shares in their own enterprises. All these suggestions would require no or only minor changes in current privatization methodology.

- Privatization certificates could be made freely tradable, allowing large investors to buy blocks of certificates which then could be traded for blocks of shares. Tradability of certificates, like the 51% giveaway, would probably be too radical to be accepted. At a minimum, the government could follow through on plans to make compensation certificates fully tradable when they are introduced in late 1995 or early 1996. (Compensation certificates are an additional type of privatization security that have been planned for several years.)

- Packets of shares could be offered to core investors in sales for cash, certificates, or investment promises. So-called "investment tenders"—bidding in which participants compete partially based on investment pledges—would be particularly desirable because the incentive of cash for enterprises would raise manager and worker support for privatization. Investment tenders were written into the draft 1996 Privatization Program that the State Property Fund submitted to the Cabinet of Ministers in October 1995.

- Workers could be given the option of "cashing in" their certificates during closed subscription, through which shares acquired by workers on privileged terms would
be collected from participants into packets and sold for cash in an immediate secondary sale, allowing better access to privatization by core investors and creating a cash incentive for workers, who would receive the proceeds of the sales. Such a scheme was written into the draft 1996 Privatization Program that the State Property Fund submitted to the Cabinet of Ministers in October 1995.

− The quota that 70% of shares in enterprises be sold for certificates could be greatly reduced. Only a small portion of shares in enterprises needs to be directed through certificate privatization auctions. These auctions only stimulate support among the general population but not among other key groups in the society. Setting quotas for certificate auctions too high does not leave sufficient shares left over to create incentives for other important groups.

− Cash earned by the government during privatization could be distributed to enterprises, local governments, privatization authorities, the state budget, etc., to stimulate broad support for privatization.

− A number of other measures could be undertaken, not directly related to increasing incentives. The rule preventing certificate sales of shares for lower than nominal value could be scrapped or circumvented; the procedures for privatization, especially in the agricultural-industrial complex, could be simplified and time periods shortened; etc.

Many of the above recommendations would not require substantial changes in existing privatization law and regulation. However, they could radically alter the underlying incentives provided by the privatization program, greatly increasing prospects for success.
4. Conclusion: The Importance of a Conceptual Paradigm for Privatization

How one thinks about privatization directly shapes the policies one promotes. Successes and failures in mass privatization experiences of Eastern Europe and the former Soviet Union can partially be traced to how architects of privatization schemes conceptualized the general privatization problem.

Andrei Shleifer, a key architect of the successful Russian model, has characterized mass privatization as the redistribution of property rights (control rights and cash rights) from a system where property rights are ambiguous and conflicting to a system in which they are clear and privately held. His understanding is grounded in the stakeholder paradigm that also is the basis of this paper. "Companies in Eastern Europe in general, and Russia in particular, do not have an unambiguous de facto ownership structure, in which the government owns the shares. On the contrary, many 'stakeholders' have existing ownership rights, in the sense of being able to exercise control rights over assets effectively. Moreover, these stakeholders take both economic and political action to defend their rights. Unless these stakeholders are appeased, bribed, or disenfranchised, privatization can not proceed"(10).

This application of property-rights concepts to the socialist pre-privatization context seems inappropriate at first glance. Most observers of socialist economies at the beginning of the decade would have said either that they had no system of property rights whatsoever, or that property rights rested in the hands of the state or the people as a whole. Such an observation, however, while perhaps true de jure, is quite far from the truth de facto. Shleifer's property-rights analogy, though not consistent with socialist property concepts, allows one to understand the confusing socialist SOE sector in terms familiar to western economists and legal experts.

The property-rights analogy also provides a framework for understanding what privatization is and what is necessary for its success. Privatization is the re-allocation and clarification of property rights in order to create more efficient control structures. And, in order for privatization to succeed, it is necessary either to compensate existing property-
right holders (stakeholders) or to build sufficient political power to "confiscate" "property rights" from these holders.

Other analogies used to describe mass privatization often miss these points. For instance, a surprising number of western advisors working on mass privatization have equated mass privatization with paper privatization certificates and certificate auctions. This has been the case in Czechia, Russia, and Ukraine. Although paper certificates and certificate auctions have been integral parts of mass privatization, they do not alone constitute mass privatization. They are a means, not an end. Specifically, they are, economically, a means of transferring property from the state to private individual and institutional investors and, politically, a means of building popular support for privatization. Also, although certificates are a piece of mass privatization, they are not the whole of mass privatization. In Czechia and in Russia, the blocks of shares that were sold for cash have been as important a piece of mass privatization as have the voucher programs, both for the economic goals of creating private (and, especially, large) owners and raising capital, and for the political goals of satisfying stakeholder demands.

Another problematic analogy frequently applied to mass privatization is of supply and demand, where the government supplies the enterprises to the privatization process, and the citizens demand them by buying shares through voucher auctions. This analogy is simplistic on several counts. It wrongly assumes that the government is the whole owner/stakeholder of enterprises and that it can simply toss them on to the sales block without having to build support among many other stakeholders as a principal task of privatization. The analogy also exaggerates the power of the citizens participating in voucher programs. Although it is true voucher programs build general popular support for privatization, participating citizens are passive demanders. They have no way to cajole or coerce any one enterprise into entering the privatization process. Citizens are only one source of demand and, arguably, not the most influential. Finally, the supply-demand analogy implies that supply and demand must be distinct. In fact, a defining trait of mass privatization has been that, frequently, the enterprise is acquired by its own managers and workers; those who supply it to the privatization program are the very same people who demand it.
The property-rights analogy proposed by Shleifer provides much better insight and practical guide for mass privatization than these other paradigms.

Not only does Shleifer's property-rights analogy provide better insight than the other paradigms into why the Russian and Czech programs succeeded, it also helps to explain why other countries' large-enterprise mass privatization programs failed. The failure of Poland's program during 1990-1995, in particular, can best be explained by the fact that enterprise managers and workers and various groups in the Parliament, as well as other stakeholders, were not given sufficient incentives to support mass privatization. The main group who would gain from mass privatization is the general public, who would get intermediary fund shares. But the general public is poorly organized. They represent passive demand. They are unlikely to force specific enterprises to enter the privatization process or to force the Parliament and government to adopt needed laws and regulations.

In Ukraine, western advisors exaggerated the importance of certificate auction sales in privatization, and they relied too heavily on a supply-demand paradigm and on a metaphor of an "enterprise supply pipeline," which somehow would carry all the state-owned enterprises to the certificate auctions. Because of this conceptualization of the privatization problem, too much focus was placed on certificate auctions, too high a portion of shares was directed toward these auctions, and too little attention and assistance money was devoted to the vast sea of problems related to all aspects of privatization other than the certificate auctions. The idea of paper certificate auctions was superficially copied from Russia, but the whole purpose of the auctions as one instrument among many others for building stakeholder support was lost because the stakeholder paradigm was missing.

In order to design practical improvements in Ukraine's privatization program, it would be necessary to start with a fundamental understanding of the power and interests of key stakeholders, and a recognition of how certificate auctions and other policy tools can create incentives to stimulate support for privatization among these stakeholders. On this foundation, with these tools, could be built a successful privatization program for Ukraine.
Notes:

[1] From Ukrainian, these categories are transliterated as A, B, V, G, D, and E.


