

TO: Clients and Friends of the Firm  
FR: Frishberg & Partners  
RE: Evaluation of Ukrainian Privatization Efforts (by Alexander Paskhaver)

Most of Ukrainian privatization is now behind us, with comparatively few quality enterprises remaining in state ownership. This allows us to look back on the cornerstone of President Kuchma's "economic reforms," the privatization of state-owned enterprises. Even back then, during the exciting 1990s, privatization received very little public support. Mirroring the public opinion, prominent privatization analysts see the privatization process and its results in a harsh, negative light, pointing to such factors as:

- (a) the lack of a positive effect on economic efficiency and production output increase;
- (b) dilution of ownership as a result of a certificate-driven privatization; and
- (c) the formation of inefficient insider ownership and fictitious corporate ownership as a basis of a shadow market economy, which is utterly corrupted and uncivilized.

Among the main causes of unsuccessful privatization are the following:

- (a) the selection of a poor privatization model (the certificate-driven component of privatization is especially criticized) that did not allow global experience to assist Ukrainian enterprises;
- (b) the start of privatization during a period in which the necessary privatization environment had not yet been created; and
- (c) infrastructural causes (the lack of a securities market, as well as of the lack of a sufficient legal framework protecting property rights and mechanisms for the transparent redistribution of property, etc.) and macroeconomic deficiencies (liberalization and stabilization of the economy have not been implemented in full, which is a pre-condition for successful privatization).

Nevertheless, the results of the conducted analysis revealed that despite the subjective mistakes of the policy-makers, the selected initial privatization model (including a certificate-driven approach) was objectively and rationally substantiated.

At the time, the key factors for the selection of the initial model included:

- (a) implementing high rates of privatization in order to achieve the political goal of assuring that the transformation to the market economy will be irreversible, based on the predominant position of the private sector;
- (b) acknowledging the impossibility to directly apply the methods that are typical for developed countries, (i.e., selling on the securities and real estate markets because those markets were not formed);
- (c) lack of sufficient national private capital accompanied by the public's lack of preparation with respect to the dominance of foreign capital in the process of privatization; and
- (d) the necessity to apply a compromise model that would ensure broad public support for privatization.

Much worse than in the other European post-Soviet countries (with the exception of neighboring Belarus), the results of privatization could be explained not by the drawbacks of the selected model, but rather by the unique conditions in which privatization in Ukraine has been implemented.

Objectively, Ukraine had the worst starting conditions for market reforms in general, and for privatization in particular. Below we list the main reasons for this conclusion:

- (a) Ukraine's economy was structurally based on the highest level of centralization and industrial production concentration in the world (even in comparison to Russia);
- (b) Ukraine has a critically low share of the light industry and the service sector in comparison to its excessively developed raw materials and primary processing industries, as well as the military-industrial complex, which did not have any prospects for development after the collapse of the Soviet Union; and
- (c) the insignificant size and role of the Ukrainian small enterprise sector.

Despite the State's key role in slowly furthering the process of reforms, in the early 1990s there were no formed state institutions in Ukraine. Ukraine did not have the historical experience in building up the state (in contrast to the Baltic states) and it also did not inherit the developed state machinery from the USSR (as was the case with Russia).

Ukraine also suffered from unfavorable sociopolitical conditions: the predominance of socialist and collectivist stereotypes in the minds of the majority of the population prevailed. Long term domination of overt opponents to privatization in the governmental bodies, including the Parliament, was routine.

Due to a number of objective causes, other Central European countries were able to commence the process of radical market reforms not from privatization, but from so-called "marketization", which included liberalization and stabilization of the economy. Unfortunately, this was not so with Ukraine.

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