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Privatization in Ukraine: Challenges of Assessment and Coverage in Fund Conditionality

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Abstract

The paper examines the recent privatization experience in Ukraine in the context of the streamlining of Fund structural conditionality. A particular focus is the shift from privatization-related conditionality based on quantitative targets to conditionality aimed at strengthening privatization procedures. The paper examines how this shift was managed in Ukraine and discusses the challenges of applying conditionality to privatization procedures and the implications for country ownership.

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I. INTRODUCTION

Privatization issues have been an important structural component of IMF program work and policy advice for more than a decade. For most of this period, the fiscal implications of privatization have been of prime concern for program design, notably privatization receipts as a source of budgetary financing, and the strengthening of fiscal balances by reducing net transfers to the public enterprise sector. Conditionality in Fund programs accordingly reflected these priorities with explicit targets for the level of privatization receipts and the privatization of specific enterprises.

More recently, the experience gained during the 1990s, including in Eastern Europe and the former Soviet Union, has demonstrated that privatization is a complex and time-consuming process, which may not fit a predefined schedule. In many cases, specific conditionality on enterprise sales and fiscal targets for privatization receipts have been associated with rushed and inadequately prepared sales, undermining successful implementation as well as public support for privatization and the reform effort in general. In the context of a broader review of Fund conditionality, it became evident that some shift in conditionality toward the procedural aspects of privatization would likely strengthen countries' privatization programs and the authorities' ownership thereof.

Upon independence, Ukraine inherited a huge public enterprise sector, with enterprises of all sizes spanning the full range of economic activities. Privatization in Ukraine began in earnest only in 1995 and picked up considerably in 2000. Results have been uneven, both in terms of the volume of successful privatizations and the scope of enterprise restructuring that it has engendered. Throughout this period, Ukraine has been an active user of Fund resources, with conditionality on privatization appearing as a component in most of its Fund programs. Conditionality related to privatization in Ukraine's programs has evolved over time from quantitative targets on the number of enterprises and amount of fiscal receipts to a more explicit effort to improve privatization procedures. This shift recognizes the importance of privatization not only in fiscal terms, but also its role in promoting output growth, the objective being efficiency gains for the economy by moving enterprise ownership and management into the private sector.

This paper examines the evolution of privatization in Ukraine and the application of conditionality in the context of the streamlining of Fund structural conditionality. A particular focus is the shift of conditionality from an emphasis on specific quantitative targets to improved procedures, which aims to strengthen the transparency of privatization in Ukraine, but has also entailed challenges for program design. Section II provides a background on privatization in Ukraine, focusing on more recent developments. Section III summarizes the evolution of structural and privatization-related conditionality in Fund programs, and Section IV examines this evolution in the context of Ukraine. On this basis, Section V provides an assessment of the shift in conditionality, and Section VI offers some conclusions.

II. The Privatization Experience in Ukraine

Background

Compared with other transition countries, Ukraine's privatization program picked up momentum rather late.[2] A number of countries moved rapidly on privatization in the early 1990s, with the Czech Republic and the Russian Federation in particular resorting to mass-privatization or voucher schemes. Other countries, such as Hungary and Estonia, avoided mass privatization programs but nonetheless moved steadily ahead with direct sales, often to foreign investors. Poland introduced privatization more slowly, first addressing broader economic reforms such as trade liberalization, tight fiscal and monetary policies, and the imposition of hard budget constraints on public enterprises, before embarking on large-scale privatization in 1995.

Ukraine's overall achievements in the area of privatization have been modest, resulting in cumulative privatization receipts of only 3 percent of GDP through 2000, compared to an average of 9 percent of GDP for all transition countries. As measured by EBRD's indices of structural reform, Ukraine's progress has likewise been slow, with the indices rising from

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[2] In relation to other countries most transition countries have privatized remarkably quickly.

1.0 to 3.3 for small-scale privatization and from 1.0 to 2.7 for large-scale privatization (on a scale of 1 to 4.3), respectively, over the 1991–2000 period. These improvements are less than those achieved by most other transition countries, particularly in Eastern Europe.[3]

The Ukrainian privatization record

Since the early 1990s, the privatization of Ukrainian enterprises has been marked by a wavering commitment of the authorities, and ambitious targets that were often not met. Following the 1992–94 divestiture of 1,240 medium and large-scale enterprises (MLE) through lease buyouts by managers and employees, the government embarked on the 1995–98 mass privatization program, under which a total of 9,240 MLE were privatized through auctions for privatization certificates.[4] The program aimed for rapid and equitable distribution to the public and the development of capital markets, while revenue generation was of a lower priority.

In moving to case-by-case privatization of large-scale enterprises in 1998, the government shifted its emphasis to the maximization of revenue through cash privatization via stock exchange sales, commercial cash tenders, and mass cash auctions, but remained reluctant to offer significant shares of attractive enterprises. By end-1998, a total of only 24 large-scale enterprises had been offered for sale through non-commercial tenders. On the other hand, starting in 1999, considerable progress was made in privatizing agricultural and agro-industrial enterprises.

The pace of privatization picked up considerably in 2000, both in terms of the amount of privatization receipts (Table 1 and Figure 1) and stakes in large-scale enterprises sold, and was accompanied by some improvements in procedures; privatization receipts in 2000 equaled 1.3 percent of GDP. This pace was largely maintained in 2001; with almost all sales

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[3] EBRD Transition Report, 2001.

[4] Each Ukrainian citizen received one non-tradable and indivisible certificate free of charge. In addition to MLE, by 2001 close to 60,000 small-scale enterprises had been sold through cash auctions or tenders, largely completing the small-scale privatization program.

carried out through open tenders, receipts remained at 1.3 percent of GDP. Sectors that were fully state-owned only five years ago, such as chemicals, wood products, and construction are now dominated by privately-controlled firms (Figure 2).[5] In early 2001, the sale of six regional energy distribution companies (*oblenergos*) to foreign and foreign-controlled investors constituted the first large sale to non-CIS investors through an open tender. While privatization during 2001 was overall less successful than anticipated as a number of tenders failed to attract bidders, the transparency of the operations was generally satisfactory.[6] However, the privatization of several large utility companies has been hampered by seizure of physical assets by creditors ("asset-stripping").

In recent years, the institutional and technical capabilities of the State Property Fund (SPF)[7] with regard to enterprise management and valuation, conduct of tenders, and information dissemination have been strengthened considerably. The broader framework for privatization has also been improved through the passage of a three-year privatization program for 2000–02, which outlines more clearly the responsibilities of the SPF in managing privatization. The program identifies procedures to be followed, including limits on investment obligations required from buyers and the maintenance of a certain number of staff, as well as restrictions on the interference from other government agencies.

Despite these gains, a number of procedural weaknesses remain and new ones have appeared. Often, only minority shares have been sold, with the government maintaining at least a blocking minority stake in a large number of enterprises. Collusion among bidders is rumored to be widespread, and in many cases, managers of enterprises have taken ownership control of their firms through front companies initiating bids. Stock market sales became an important avenue for the privatization of stakes in larger enterprises, particularly in 2000.

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[5] To date, detailed aggregate information on the performance (including on productivity and profits) of privatized enterprises compared to state owned enterprises is not available.

[6] Advisory Project of the Federal Government of Germany on Privatization in Ukraine, 2001.

[7] In 1993, the Ministries of Destatization and Demonopolization were consolidated to form the State Property Fund. The SPF was strengthened in 1994, when regional property funds were placed under its authority. The responsibility for oversight of privatization is currently shared by parliament and the cabinet of ministers.

While in many countries, stock market sales demonstrate some depth of the capital market and suggest more transparent sales methods (Megginson and Netter, 2001), the Ukrainian stock market is very thin with enormous spreads and little transparency; moreover, stock market sales have provided a means for existing owners to expropriate minority shareholders.

Other factors, which have adversely affected the privatization program in Ukraine, include political interference, conflicting objectives of the SPF, and generally difficult business conditions. More specifically, political decisions and reversals have scuppered ongoing privatization operations or led to substantial delays, undercutting outside interest in privatization and leading to a further depreciation of assets.[8] The largest sales carried out in 2000 took place through arranged tenders driven by political decisions. In addition, the SPF has been entrusted with the potentially conflicting objectives of revenue maximization, the conduct of procedurally sound privatizations, and government insistence on specific social and industrial policy objectives. More broadly, despite the advances in the privatization program, the environment for private enterprises in Ukraine remains very difficult. A small number of interest groups still control vast areas of the economy, particularly in industry. Also, the Ukrainian government continues to place a heavy bureaucratic and regulatory burden on the private sector. The tax authorities maintain wide powers, which are not always used even-handedly, with enterprises allowed little right of appeal. Governance issues in economic and corporate management remain pressing. Accordingly, interest from non-CIS bidders in Ukrainian enterprises is still very limited.

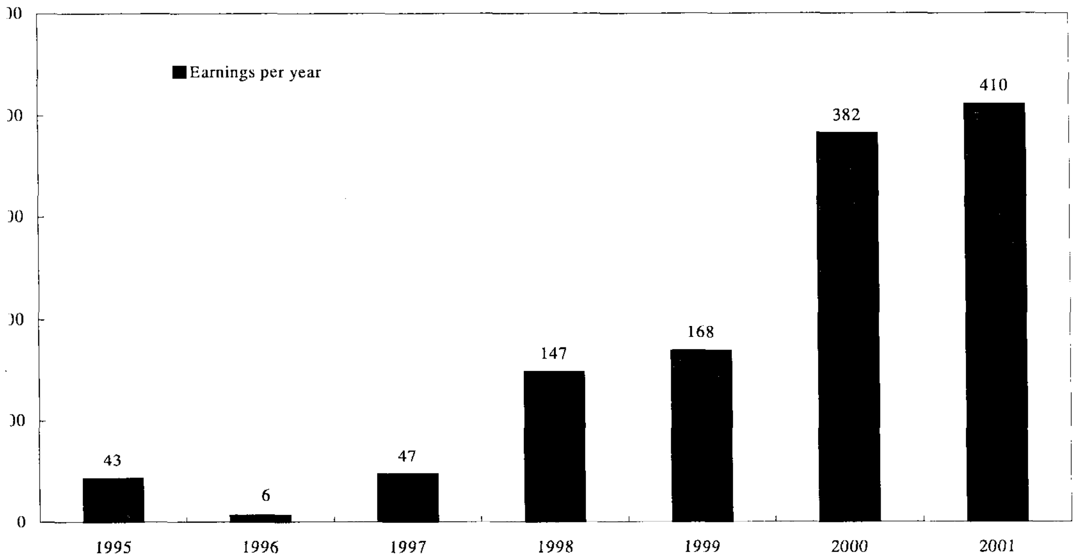
[8] For example, a tender for a majority stake in the enterprise Krimsoda—a large producer of soda ash located in the Crimea region—was undertaken in the context of initial disputes over whether the SPF should be the public agency responsible for privatizing the firm. Subsequently, mixed messages from the government as to whether the sale of a majority stake would be permitted, explicit opposition from the Crimean regional authorities, and ill-timed leaks of information on the conduct of the tender tempered investor interest. One American enterprise submitted a bid, but—under regulations requiring more than one bidder—the tender failed and, since then, has not been taken up again.

Table 1. Ukraine: Privatization Receipts by Type of Sale, 1998–2001

	1998		1999		2000		2001		Total	
	In thousands of Hrv	In percent of total	In thousands of Hrv	In percent of total	In thousands of Hrv	In percent of total	In thousands of Hrv	In percent of total	In thousands of Hrv	In percent of total
SPF sales										
Tenders (central office)	147,772	31.3	386,538	47.0	1,219,290	53.2	1,868,003	72.9	3,621,604	58.9
of which: 6 Oblenergos							865,716		865,716	
Stock Exchange and OTC	162,962	34.6	330,716	40.2	760,300	33.2	156,824	6.1	1,410,802	23.0
Special cash auctions	1,252	0.3	11,424	1.4	7,702	0.3	4,379	0.2	24,757	0.4
Preferential sale of shares	43,963	9.3	13,981	1.7	9,934	0.4	53,001	2.1	120,880	2.0
of which: Ukrtelecom							51,354		51,354	
Other sources	75,612	16.0	33,037	4.0	146,435	6.4	136,817	5.3	391,901	6.4
Subtotal	**431,562**	91.5	**775,696**	94.4	**2,143,662**	93.6	**2,219,025**	86.6	**5,569,944**	90.6
Other sales	39,863	8.5	46,089	5.6	147,433	6.4	342,849	13.4	576,235	9.4
Total	**471,425**		**821,785**		**2,291,095**		**2,561,874**		**6,146,179**	
Total (*in percent of GDP*)	**0.46**		**0.63**		**1.35**		**1.23**		**…**	
Total (*in millions of U.S. dollars*)	**192.2**		**198.9**		**421.1**		**477.0**		**1,289.2**	

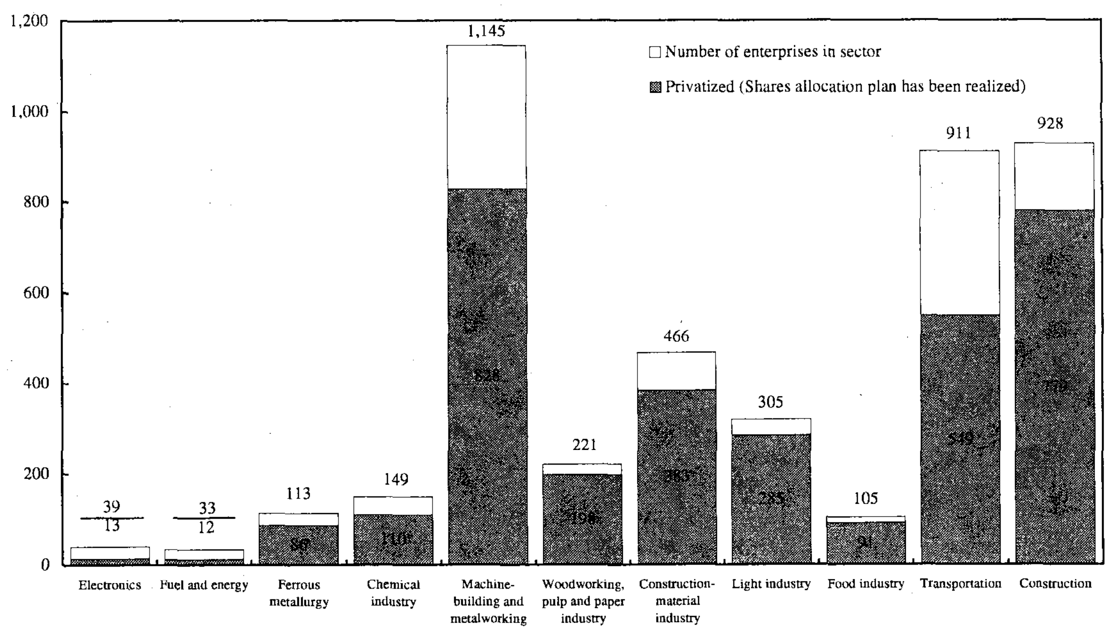
Sources: State Property Fund of Ukraine and Fund staff estimates.

Figure 1. Ukraine: Receipts for Tender Sales, 1995–2001
(In millions of U.S. Dollars)



Source: State Property Fund of Ukraine.

Figure 2. Ukraine: Extent of Privatization by Sector, November 2001



Source: State Property Fund of Ukraine.

III. Fund Conditionality

Structural conditionality in Fund programs

In the late 1980s and early 1990s, structural conditionality gained significance in Fund programs (Polak, 1991). This development reflected a new emphasis on growth and supply side economics, as well as the Fund's involvement in new member countries with substantial structural distortions. While the average number of structural conditions per program year had been two in 1987, it increased to seven in 1994, and further to 14 during 1997–99. While the number of performance criteria rose only moderately, there was a sharp increase in structural benchmarks and prior actions (IMF, 2001a).

Although the majority of structural conditions remained in Fund core areas, the increase in the breadth of conditionality posed some challenges (Goldstein, 2000). Highly detailed conditionality placed additional stress on the monitoring capacity of the authorities and the staff, resulting in often superficial program implementation. Moreover, excessive conditionality, in some cases designed to compensate for weaknesses in ownership or to support reform-minded factions of government, occasionally diverted attention from the central elements of the program and overstrained the authorities' implementation capacity, which was already limited by strong vested interests opposed to enhanced transparency and reforms. Thus, wide-ranging conditionality sometimes undermined national ownership of programs without any apparent positive impact on program implementation.[9]

Initiatives to streamline conditionality in the Fund began in the mid-1990s and gained pace in 2000.[10] The streamlining exercise aimed to enhance national ownership of programs by achieving essential program objectives through a more targeted conditionality, covering only measures essential for the attainment of macroeconomic objectives within the Fund's core

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[9] The notion of ownership is difficult to pin down, but, as outlined in Khan and Sharma (2001), can be defined as the policy stance of the authorities in the absence of IMF involvement, whereby they share both the objectives of the program and an understanding of the link between those objectives and economic policies.

[10] The principles of streamlined Fund conditionality are articulated in "Streamlining Structural Conditionality in Fund-Supported Programs—Interim Guidance Note," September 2000 (Köhler, 2000).

mandate (IMF, 2001b). Critical measures outside the Fund's core responsibilities would be subject to conditionality by other institutions; in areas that were relevant to the success of the macro program but not critical, judgment on the degree of importance would be exercised, depending in part on how active other institutions were in the given area. Measures that were neither critical nor within the Fund's core responsibilities would not be covered by conditionality. It was realized that a Fund program was not always the most adequate instrument for promoting structural reforms because of the necessarily long-time horizons for some structural measures. The new policy therefore implied a more limited formal conditionality in structural areas, consisting of specific, well-designed, and monitorable measures, with program reviews becoming increasingly forward-looking.

The streamlining exercise resulted in complex policy choices, including the distinction between critical and non-critical measures and the need for cooperation with other institutions (IMF, 2001c). Close cooperation with the World Bank gained importance in order to ensure that country authorities continued to receive adequate advice in all policy areas and that complementary conditionality by other institutions would be in place (IMF, 2001d). Measures critical for program success would continue to be covered by Fund conditionality even if designed and monitored by another institution. Moreover, Fund structural conditionality outside the core mandate could still be appropriate, as not all areas are sufficiently covered by the World Bank or other institutions.

Conditionality on privatization

Fund conditionality in the area of privatization has targeted the elimination of fiscal subsidies, the financing of fiscal deficits with privatization proceeds, and efficiency gains.[11] Between 1997 and 1999, about one sixth of structural conditionality measures in Fund programs were related to privatization. While programs with transition countries initially had focused on macroeconomic stabilization and issues of liberalization, in later programs the

[11] The evidence indicates that the fiscal impact of privatization programs through improved fiscal performance and declining domestic borrowing requirements can be quite substantial, notably when privatization substitutes for debt-creating financing rather than being used for additional expenditure (Davis and others, 2000).

disengagement of the public sector from commercial activities moved to center stage. In a number of transition economies, mass privatization was considered the best solution as the magnitude of the task often excluded the possibility of a case-by-case approach, and a market-based reallocation to more efficient owners was hampered by the absence of a developed capital market.

As privatization got under way, a number of problems became apparent. Efficiency gains were at risk if privatization did not lead to enterprise restructuring, quite likely in the absence of an adequate regulatory framework and standards of governance. Also, conditionality would sometimes limit the government's flexibility, and occasionally its bargaining power vis-à-vis a potential buyer. To deal with these problems, privatization conditionality partly shifted from specific targets to procedural improvements, with the focus on numbers of enterprises and amounts of receipts increasingly giving way to an emphasis on processes, in particular on enhancing the transparency of privatization. This approach recognizes that privatization involves complex processes and potentially long time horizons, which are not necessarily consistent with a focus on budgetary receipts within the fairly short planning horizon of Fund programs.

IV. Conditionality in Ukraine's Fund Programs

Throughout the 1990s, structural conditionality—including on privatization—expanded significantly in Ukraine's programs with the Fund. Despite often weak ownership, the Fund continued its support for Ukraine's structural reforms with the aim of ensuring the maximum possible progress with the reform agenda, expecting that successful efforts would strengthen ownership. Under the 1995/96 Stand-By Arrangement, conditionality in the area of privatization had been strictly quantitative, stressing the number of enterprises to be privatized or to be removed from the "negative list" of enterprises excluded from privatization. With the program under the Extended Fund Facility (EFF), approved in 1998, overall structural conditionality expanded considerably (Table 2). The focus of privatization conditionality remained quantitative, with five structural benchmarks and two prior actions in this area; this emphasis on quantitative targets reflected in part the pressing fiscal situation and fragile external reserve position at the time. Only one structural benchmark, on the establishment of transparent and clear tender procedures, was of a more qualitative character. While privatization-related prior actions and benchmarks were implemented, albeit sometimes with a delay, tracking these conditions and their implementation proved difficult due to the large number of details; on the other hand, monitoring was helped by the quantitative character of the majority of measures.

Table 2. Ukraine: Structural Conditionality in Fund Programs with Ukraine

	Structural conditions	**Total**	**Implementation record**			
			Implemented	Partly implemented	Delayed	Not implemented
Stand-By-Arrangement 1995/96	Exchange system	1	1			
	Trade systems	9	8			1
	Pricing and marketing policies	9	8			1
	Public enterprises	2	1	1		
	Tax/expenditure reform	15	11	1	1	2
	Financial sector	13	9	3		1
	Systemic and ownership reform 1/	19	11	4	2	2
	Other	5	3	1	1	
	Total	**73**	**52**	**10**	**4**	**7**
Extended Fund Facility 1998	Exchange system	4	4			
	Trade systems	4	4			
	Pricing and market policies	13	7		2	4
	Tax/expenditure reform	31	29		2	
	Financial sector	18	16		1	1
	Systemic and ownership reform 2/	19	17		1	1
	Other	21	21			
	Total	**110**	**98**		**6**	**6**
Extended Fund Facility (rev.) 2000	Trade systems	2	1	1		
	Tax/expenditure reform	7	6	1		
	Financial Sector	4	3	1		
	Systemic and ownership reform 3/	2	2			
	Other	3	3			
	Total	**18**	**15**	**3**		

Source: Fund MONA database.

1/ These included the sale of 70 percent of shares of at least 3,000 medium and large enterprises (MLE) and the removal of 1,250 MLE from the negative list.
2/ Measures related to privatization included the privatization of 70 percent of shares in 9,500 enterprises by end-1998; the privatization of 70 percent of 443 grain silos by June 1999; the preparation for sale and beginning of sale of Ukrtelecom; and the establishment of transparent and clear tender procedures for cash sale of large enterprises. Program reviews specified additional measures such as the approval of share allocation plans of specific enterprises and the adoption of government decisions to unblock shares in grain procurement and storage facilities.
3/ These included the submission to parliament of a privatization list for 2001 consistent with the 2001 budget, the provision of information to parliament on privatizations in 2000, and placing this information on the SPF website.

Ukraine's revised EFF program of December 2000 was accompanied by a shift in strategy and a considerable degree of streamlining of conditionality in the area of privatization. Despite the increased scope of Ukraine's privatization efforts since 2000, the weaknesses cited above prompted donors and the Fund to encourage the authorities to focus more explicitly on the quality of privatization procedures rather than on quantitative targets. A key feature of improved procedures has been an emphasis on the transparency of privatizations, which can serve to draw a wider pool of potential investors through minimizing information asymmetries, attracting more serious bids by deterring collusion among bidders, and discouraging side agreements among enterprise management, public officials, and potential buyers. Policy measures as outlined in the program included the implementation of the privatization program for 2001 using open tenders and, for larger sales, financial advisors; tenders for financial advisors for privatization of the remaining 12 regional energy distribution companies (oblenergos); [12] the appointment of a financial advisor for the privatization of the telecommunications firm Ukrtelecom and tenders for financial advisors for the sale of other large companies; the reduction in the number of enterprises blocked from privatization; submission to parliament of a list of enterprises for sale in 2002; and ex-post reviews of privatization. The design of conditionality in the revised EFF also reflected the view that the Fund is often insufficiently equipped to design and monitor specific conditionality in a sector characterized by complex regulatory and institutional issues that may be difficult to split into discrete intermediate steps. Staff was also cautious not to jeopardize ownership through a too broadly-defined conditionality where the same result could be achieved through reviews, which would be more appropriate to the nature of the reforms.

In this framework, the focus on privatization has shifted from a short-term focus on fiscal receipts, the reduction of transfers, and the sale of specific enterprises, to broader objectives of enhancing efficiency in the economy, and ultimately boosting the country's long-term growth potential. The key aim in the effort to strengthen privatization procedures has been to draw on a set of best practices, which promote transparent privatizations, in particular:

[12] World Bank conditionality under its ongoing adjustment operation includes the transparent privatization of *oblenergos* to strategic investors.

- **The use of transparent tenders**, open to foreign investors and with minimal prequalification criteria for bidders, widens the scope of potential bids and minimizes possibilities for manipulating privatization procedures;

- **Open publication of tender information and results**—including widely disseminated tender announcements, independent tender commissions, and published tender results—minimizes information asymmetries among bidders and bolsters public confidence in the process;

- **Up-front cash sales** are an important tool to limit criteria for the selection of the winner of a bid to a single and simple parameter: the cash price offered. The objective of cash sales is to minimize any discretion that might enter into the selection process, and limit the insertion in the process of social or industrial objectives that could be addressed through other means;[13]

- **Financial advisors** can prove instrumental in preparing bid documentation, contacting and cultivating potential bidders that may have little knowledge of Ukraine, and serving as an independent source of advice for the authorities.

On the basis of these best practices, the Ukrainian authorities in conjunction with donors and the Fund have taken steps to bolster privatization procedures. As an initial step, the authorities established the Privatization Advisory Group (PAG) as a forum to examine pressing issues related to the design and execution of the privatization program. This group comprises representatives from the government, the SPF, the donor community, and the private sector and has focused on articulating guidelines for transparent privatization, introducing more precise prequalification criteria for investors, identifying problems of specific ongoing privatization operations, and considering means of sheltering the SPF from

[13] The emphasis on cash sales renders more transparent the selection of a winning bidder in individual sales. This emphasis, however, is not always consistent with revenue maximization, which might, for example, allow for the introduction of distortions such as the granting of monopoly rights to increase sales prices.

various political influences. The inclusive nature of the group has enhanced the quality of the discussion, but has not always resulted in a consensus on its strategy. An important achievement of the PAG has been the development of a set of transparency criteria (Box 1), which serves as an ex-ante guidepost as well as an ex-post benchmark for the quality of specific privatizations.[14]

Box 1. Transparency Criteria

- Public announcement of a tender, containing clear and full information on conditions
- Equal opportunity for all interested parties to participate in a bid
- For tenders, a controlling block to be sold
- The price offered by the buyer as the only criterion; no investment requirements prior to sale
- Clear qualification requirements for advisers
- Following the announcement, no changes to the conditions for the tender and privatization
- Independent tender commission; any interference in the commission's activity is inadmissible
- Free access to an enterprise being privatized, including site visits in cooperation with management, and open financial and operational information

Under the auspices of the PAG, the SPF has initiated a system of semi-annual ex-post reviews. These reviews are carried out by an external agency and cover both results and procedures with the aim of assessing the conduct of the privatization program related to its objectives. This somewhat formalistic exercise has been useful in identifying areas for strengthening privatization procedures, but has not fully captured certain distortions in the privatization process, such as political influence and collusion among bidders. Also, such reviews cannot address problems of the broader privatization environment, as reflected for example in the absence of bidders for certain tenders.

V. Assessment

It is still premature to draw firm conclusions regarding the impact of the greater focus on procedures—and the use of conditionality that targets these procedures—on Ukraine's

[14] Satisfaction of a certain number of transparent privatizations is also a benchmark under the World Bank's ongoing adjustment operation.

privatization program. Nonetheless, the limitations in applying conditionality in the area of privatization raise several issues for incorporating such measures in Fund-supported programs. An initial observation is that, as demonstrated by the limited progress in 2001, a privatization strategy focusing on the "quality" of privatization may proceed more slowly despite an overt commitment to speed on the part of the authorities. As noted above, the difficulties in adapting a privatization program to a specified time frame have long been evident, and this has proved to be even more the case in the context of ensuring that the procedural elements of enterprise sales progress smoothly and in a transparent manner. Many components of transparent sales can be time-consuming, particularly in cases where advisors are involved, or when interruptions require the repetition of key steps.

Similarly, conditionality that targets privatization procedures does not guarantee that outcomes will significantly improve, as interest groups may find new loopholes for taking control of enterprises. In Ukraine, influential interest groups have increasingly circumvented transparent sales procedures by resorting to such asset-stripping schemes as the bankrupting of previously attractive enterprises, with the aim of taking control of collateralized assets at minimum values. On the side of the authorities, some misgivings remain about the use of financial advisors in preparing privatization operations, in part related to the costs involved; accordingly, financial advisors were used more sparingly in 2001 than in 2000.

The Ukrainian experience raises a note of caution whether conditionality on privatization procedures rather than quantitative targets necessarily deepens ownership on the part of the authorities. National authorities may view such conditionality as intrusive and micromanaging in an area where Fund staff have limited expertise. However, a greater focus on procedures can provide some assurances that a privatization program is more resistant to political and insider influences than otherwise would be the case. This in turn could help to deepen support for privatization among civil society. For Ukraine, it is uncertain whether this focus has generated any broader popular support for privatization, particularly given the still-prevailing suspicion with which the public regards asset sales by the authorities. Certainly, the greater openness of the privatization process and the management of public enterprises have helped expose previous operations marked by collusion and potentially corrupt practices. This greater transparency has also highlighted the cost of leaving enterprises in the state sector, which include further financial losses by public enterprises, or the diversion of company resources to personal or political ends.

Moreover, the monitoring of conditionality on privatization procedures can become very subjective, and thus difficult to incorporate in program design. In this respect, conditionality related to privatization procedures needs to be very tightly defined. Regarding Ukraine, certain measures have been formally implemented (e.g., carrying out ex-post reviews), although the substantive contribution may have been minor.

The justification for including conditionality on privatization as a component in Fund programs has in the past relied on the fiscal impact of privatization, both to reduce other forms of financing and to lower transfers to public enterprises. As the focus in privatization programs shifts toward procedural concerns, however, the notion of macro relevance has to be considered more broadly because the fiscal urgency of the measures and their relevance to the macroeconomic program recedes. Instead, the contribution of the privatization program is tied more explicitly to future improvements in the economy's efficiency and output growth, and to a better climate for private sector activity, including foreign direct investment. On this score, the evidence both for transition economies and a wider group of countries is that privatization is indeed strongly correlated with a boost in output growth:[15] economies with a successful privatization record show faster growth.[16] This link, however, is very difficult to demonstrate for individual countries and in the case of Ukraine, it is too early to determine whether the deepening of the privatization program has contributed to recent output growth.

Fund conditionality in the area of privatization rests in part on the view that privatization leads to improved enterprise performance, reflecting evidence for the microeconomic impact

[15] Havrylyshyn and McGettigan (1999) summarize the evidence for transition countries; Megginson and Netter (2001) also analyze other countries.

[16] The direction of causality is difficult to ascertain as privatization is often associated with a broader regime change, which itself is associated with higher levels of output growth.

of privatization (Djankov and Murrell, 2000),[17] which in turn contributes to better macroeconomic performance. These effects, however, are strongly associated with concentrated ownership, transparent ownership structures, and as noted by Sachs, Zinnes, and Eilat (2000), a legal and regulatory environment conducive to private sector activity. Privatization in the absence of such reforms will likely yield more limited benefits.[18] Given that progress with respect to privatization in Ukraine is only very recent and that there is little evidence of resulting enterprise restructuring, the efficiency gains from privatization appear thus far to have been minor. Some evidence suggests that concentrated ownership has had a positive impact on enterprise performance in Ukraine (Pivovarsky, 2001). In this respect, the use of tender sales rather than mass privatization and buyouts by management and employees is more likely to result in concentrated ownership structures in privatized firms, which might be more conducive to improved efficiency.

Other potential effects of privatization are more diffuse and difficult to identify. In many countries, privatization programs have successfully attracted foreign direct investment (FDI), contributing to a stronger balance of payments position. In this regard, the sale of the *oblenergos* in early 2001 was an encouraging sign. However, the privatization program and, more broadly, the Ukrainian economy, have not been successful in attracting significant FDI flows, with the exception of investment from Russia. As a result, the strong improvement in Ukraine's balance of payments since 1999 has only minor links to the privatization program.

On a separate note, there is some evidence that privatization initially has a negative impact on lower income groups, but that this effect is reversed over the medium term (Gupta and others, 2001). In Ukraine, there is little evidence regarding the impact of privatization on

[17] The evidence in Djankov and Murrell (2000), however, is ambiguous for countries of the Commonwealth of Independent States (CIS).

[18] Ukraine's progress in these areas remains modest. For example, Ukraine's score on the Heritage Foundation's Index of Economic Freedom has been largely unchanged over the last five years, and indicates a low level of economic freedom relative to other countries (Heritage Foundation, Index of Economic Freedoms, various years).

household incomes, also because of the limited substantive enterprise restructuring that has taken place.

VI. Conclusions

Privatization in Ukraine has evolved considerably over the decade since independence, and the recent shift in privatization-related conditionality has likely helped to promote the adoption of more transparent privatization procedures. However, this does not guarantee a successful privatization program, and raises a number of policy challenges for program design and ownership on the part of the authorities.

First, in the context of the streamlining of Fund conditionality, the macro relevance of privatization will be more difficult to demonstrate when the aim of privatization is not the generation of resources for the budget. A more concerted effort is required to link privatization with boosting the productive potential of the economy, although this link can be difficult to demonstrate. Recent economic developments in Ukraine have been encouraging, with high output growth, low inflation, and a less vulnerable external position, but establishing a short-term relationship between these developments and any policy reforms remains elusive.[19]

Second, the post-privatization performance of privatized enterprises may be determined to a large degree by the general climate for the private sector. Thus the potential macroeconomic benefits of privatization may be realized only in part in the absence of improvements to the legal and regulatory environment governing enterprises. Yet, it would prove difficult to apply conditionality to these areas, which are well outside the Fund's core mandate. In this vein, some assessment of whether the legal and regulatory environment is conducive to private sector activity may be warranted to ascertain the potential contribution of privatization.

[19] Ukraine's recent output performance is being analyzed in Berengaut and others (forthcoming).

Third, process-related conditionality might be viewed as subjective and potentially intrusive, and thus would not necessarily be any closer to encouraging ownership on the part of the authorities than more outcomes-oriented conditionality. Still, the potential added credibility of privatization programs that are conducted in a more transparent manner can be considerable and may generate broader support in civil society if the process is seen as less corroded by political and insider influences.

Fourth, designing conditionality and evaluating privatization procedures is sometimes beyond the expertise of Fund staff and requires close coordination with other institutions. In deferring decisions to other institutions, however, some difficult judgments also have to be made about whether these institutions themselves have the appropriate capacity.

On a final note, despite the evidence from many countries, the potential gains from privatization and even privatization procedures may receive an unduly heavy emphasis. Analytical work suggests that the establishment of new enterprises in transition countries could be more important than existing enterprises in generating growth in output and employment (Havrylyshyn and McGettigan, 1999). From this point of view, more efforts are needed to promote new enterprises, including easier entry and exit, competitive markets, property rights, and improved corporate governance. Although many of these policy areas are unlikely candidates for Fund conditionality, further progress will be crucial to establish a dynamic and growing enterprise sector.

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