

## MASS PRIVATIZATION

### WHAT WE ARE DOING:

The United States is the principal source of funding and technical assistance to implement Ukraine's mass privatization program. USAID has worked very closely with the World Bank and, to a lesser extent, the European Union's TACIS to negotiate with the Government of Ukraine a mass privatization program that would be rapid and transparent, and that would elicit popular participation and support.

Implementation of the program, and extensive USAID funding, began in late 1994 after President Kuchma's new government identified mass privatization as a priority. Now, USAID finances and provides technical assistance to a) operate a nationwide network of auction centers and bid collection centers, b) extend information about privatization and market reform to the public and encourage them to participate, c) prepare state enterprises for auction, d) calculate and disseminate auction results, and e) monitor and improve the mass privatization program as a whole.

### ACCOMPLISHMENTS:

- 48 million privatization certificates were designed, printed and delivered to Ukraine - 11 million citizens have collected one so far (8 million additional persons have collected one in an electronic form that is no longer available)
- 201 million savings certificates are being printed and distributed - they compensate citizens for savings lost to inflation and may be redeemed at privatization auctions
- 26 auction centers operate around Ukraine and over 1,000 bid collection centers are open in local neighborhoods for citizens to offer certificates for shares
- a national public education campaign is informing the population about privatization and market reform and encouraging all to participate in the process
- over 1,000 state enterprises have been offered at the six auctions conducted to date - approximately 300 of these have been fully sold

### OBJECTIVES FOR THE NEXT 6 MONTHS:

- significantly accelerate the program by assisting the Government of Ukraine to overcome technical and political impediments
- assuming impediments are addressed, fully privatize 2,500 medium and large scale enterprises by the end of 1995 and 8,000 by July, 1996

ISSUES: The program has encountered technical and political snags that are slowing it down dramatically. These will require high level attention in the government if they are to be successfully

addressed. USAID staff, EU/TACIS, and a World Bank team now in Ukraine have developed a joint approach to the government. The principal suggestions being jointly made to the Government of Ukraine are to:

- introduce greater incentives for management and workers of enterprises to accelerate rather than delay privatization - an ownership share up to 51% should be offered to them
- limit the role of line ministry representatives on enterprise privatization committees to assure that enterprise preparation is not delayed
- shorten the enterprise preparation time for agro-industrial enterprises -- from over one year to four months or less -- and prevent suppliers from gaining sole control of these firms
- allow the value of shares sold at certificate auctions to fall below their theoretical nominal value so that all shares offered can be sold at once, without repeat auctions
- retain no shares in government hands except for an absolute minimum number of cases
- allocate additional free air time for mass privatization advertising on state radio and television

(These issues have been addressed with the Government of Ukraine since 1992 in memoranda of understanding and conditionalities on World Bank loans. Further, World Bank intends to impose tough conditions relating to mass privatization before it will negotiate its next round of loans to Ukraine. Although final plans are not made yet, we understand the Bank will require that at least 2,000 enterprises be fully privatized through mass privatization before the Government is invited to Washington to negotiate the loan. At least 3,000 enterprises must be privatized before the Bank takes the loan to its Board. The value of loans subject to these conditions will be between \$300 million and \$700 million.)

FUNDING:

Planned FY96: Privatization: \$10 million  
Public Education: \$8 million

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PER/LMAILLOUX//WCOLES/AID/ENI/NCA/WN/SGROSSMAN/AID/DAA/  
ENI/BTURNER//DPRESSLEY/AID/AA/ENI/TDINE/

E.O. 12356: N/A  
SUBJECT: MASS PRIVATIZATION IN UKRAINE: PART TWO

REF: KIEV 8194

(1) SUMMARY: THIS MESSAGE SUPPLEMENTS THE REFTEL  
ANALYSIS OF PROBLEMS IN THE UKRAINIAN PRIVATIZATION  
PROGRAM. IN ADDITION TO OUTLINING THE MECHANICS OF  
MASS PRIVATIZATION, THE CABLE DISCUSSES THE ISSUE OF  
LOW PUBLIC PARTICIPATION IN THE CERTIFICATE AUCTION  
PROCESS AND THE INTERRELATED PROBLEMS OF ASSIGNING

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NOMINAL VALUE TO ENTERPRISES AND OF ENTERPRISES REMAINING UNSOLD AFTER THE AUCTIONS. ALSO DISCUSSED IS THE DECLINING NUMBER OF ENTERPRISES IN THE PRIVATIZATION PIPELINE, THE SLOW ENTERPRISE PREPARATION PROCESS, THE SPECIAL ISSUE OF AGRO-INDUSTRIAL ENTERPRISES, AND THE POSSIBLE DISINCENTIVES TO PRIVATIZATION SURROUNDING THE SHARE ALLOCATION PROCESS. THE MESSAGE REVIEWS POSSIBLE GOVERNMENT RETENTION OF SHARES FOLLOWING PRIVATIZATION, POLITICAL CONSTRAINTS IN THE PRIVATIZATION PROCESS AND THE WEAKNESSES OF THE STATE PROPERTY FUND. FINALLY, A LIST OF POSSIBLE STEPS TO STREAMLINE PRIVATIZATION AND ADD INCENTIVES TO THE PROCESS IS PROVIDED. END SUMMARY.  
TARGETS, INFRASTRUCTURE AND PUBLIC PARTICIPATION:  
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(2) PRIVATIZATION IS A CENTRAL COMPONENT OF THE KUCHMA REFORM PROGRAM. RECOGNIZING THAT OLD SOVIET SYSTEMS DID NOT WORK, THE KUCHMA ADMINISTRATION DETERMINED THAT MARKETS AND A SIZABLE PRIVATE SECTOR HAVE TO BE CREATED IF UKRAINE IS TO SUCCEED AS A NATION. ACCORDINGLY, A TARGET WAS SET AT THE END OF 1994 TO PRIVATIZE, BY THE END OF 1995, 8,000 STATE ENTERPRISES THROUGH A MASS PRIVATIZATION PROGRAM.

(3) THE INFRASTRUCTURE TO IMPLEMENT THE TARGET OF 8,000 ENTERPRISES IS NOW IN PLACE. FINANCED LARGELY WITH USAID FUNDS, IT WAS PULLED TOGETHER AT RECORD SPEED DURING THE SPRING OF THIS YEAR. AUCTION CENTERS ARE ESTABLISHED IN EACH OF THE 25 OBLASTS, WITH TWO IN CRIMEA. APPROXIMATELY 800 UKRAINIANS OPERATE THE  
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CENTERS. HARDWARE AND SOFTWARE AT AUCTION CENTERS AND AT A NATIONAL DATA CENTER ALLOW EACH AUCTION TO BE PROCESSED ON A NATIONAL BASIS (UNLIKE MASS PRIVATIZATION IN RUSSIA THAT  
THAT  
CONDUCTED MOSTLY LOCAL AUCTIONS,  
ANY CITIZEN IN UKRAINE CAN BID ON ANY ENTERPRISE OFFERED ANYWHERE  
IN THE  
COUNTRY). OVER 1,000 BID COLLECTION CENTERS ARE NOW OPERATING AT  
BUSINESS  
CENTERS, PRIVATE BANKS AND INSURANCE COMPANIES, AND AT SAVINGS BANK  
BRANCHES TO RECEIVE THE CERTIFICATES OF CITIZENS.

(4) ONE PRIVATIZATION CERTIFICATE IS ISSUED TO EACH CITIZEN, AND ARE AVAILABLE AT SAVINGS BANK BRANCHES. ABOUT 11 MILLION CITIZENS HAVE PICKED UP CERTIFICATES

SINCE FEBRUARY. BUT THE NUMBER TAKING PART IN THE PROGRAM IS GREATER. THE GOU PERMITTED "PRIVATIZATION ACCOUNTS" TO BE OPENED AT LOCAL BANKS UNTIL JUNE 30 OF THIS YEAR (THE ACCOUNT SYSTEM PRECEDED TNE INTRODUCTION OF PAPER CERTIFICATES AND ALLOWED CITIZENS TO DRAW ON NON-MONETARY "CREDITS" TO BID IN PRIVATIZATION AUCTIONS). UP TO JUNE 3

1995 8.1 MILLION PEOPLE HAD OPENED ACCOUNTS OF WNICH 2.5 MILLION WERE OPENED THIS YEAR. THUS 19.1 MILLION CITIZENS, ABOUT A THIRD OF THE POPULATION, HAVE THE RIGHT TO PARTICIPATE IN MASS PRIVATIZATION SO FAR. PARTICIPATION IS HIGHEST IN THE EAST. AS OF AUGUST 1, FOR EXAMPLE, 34% OF CITIZENS IN ZAPORIZHIA HAD OBTAINED THEIR PAPER CERTIFICATES. TERNOPIL, BY CONTRAST, WAS THE LOWEST IN THE COUNTRY AT SLIGHTLY LESS THAN 10%. ONLY TERNOPIL STOOD AT LESS THAN 10% AND THE AVERAGE NATIONALLY WAS 18%. BUT 34 MILLION UKRAINIANS HAVE NOT YET OBTAINED A CERTIFICATE. A GOAL OF THE USAID-FINANCED PUBLIC EDUCATION PROGRAM IN SUPPORT OF PRIVATIZATION IS TO ENCOURAGE THE MAJORITY

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OF THESE PEOPLE TO DO SO BY THE END OF THE YEAR. IT WILL BE NECESSARY TO OBTAIN ADDITIONAL FREE AIR TIME ON STATE TELEVISION AND RADIO TO ACHIEVE THIS GOAL. MOST ADVISORS BELIEVE THAT A CUTOFF DATE BY WHICH ALL CERTIFICATES MUST BE PICKED UP WOULD ALSO STIMULATE PARTICIPATION IN THE PROGRAM. THE SPF IS CONSIDERING THIS STEP.

PRIVATIZATION AUCTIONS -- THE PROBLEM OF UNSOLD SHARES:  
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(5) SIX AUCTIONS HAVE BEEN HELD SO FAR. 1,127 ENTERPRISES HAVE BEEN OFFERED FOR SALE. BECAUSE AUCTIONS ARE NATIONAL AND RESULTS MUST BE RATIFIED BY SEVERAL LAYERS OF THE BUREAUCRACY, RESULTS ARE CALCULATED SLOWLY. OFFICIAL FIGURES ARE ONLY AVAILABLE FOR THE FIRST FOUR AUCTIONS (THROUGH MAY). AS OF MAY, ONLY 27% OF THE 496 ENTERPRISES OFFERED HAD BEEN FULLY SOLD. THIS PERCENTAGE WILL RISE AS THE NUMBER OF CERTIFICATES

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\*\*\*\*\* KIEV 7500 - XXSECTION 02 OF 06 \*\*\*\*\*

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IN CIRCULATION INCREASES AND AS MORE AND MORE BID COLLECTION SITES MAKE IT MORE CONVENIENT FOR CITIZENS TO PLACE A BID. A PROJECTION OF THE 27T "FULLY SOLD" RATE THROUGH THE AUGUST AUCTION SUGGESTS ABOUT 300 ENTERPRISES HAVE BEEN FULLY SOLD SO FAR.

(6) UNSOLD SHARES ARE A MAJOR IMPEDIMENT. IN UKRAINE THEY EMERGE WHEN THERE IS LOW DEMAND FOR SHARES AT OR UNCLASSIFIED

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ABOVE THE SHARES' NOMINAL PRICE (THIS PRICE IS SET ACCORDING TO A COMPLICATED FORMULA AND NORMALLY BEARS NO RELATION TO THE ACTUAL MARKET VALUE OF THE SHARE). ELIMINATING THE NOMINAL PRICE RESTRICTION AND/OR INCREASING THE DEMAND FOR SHARES WOULD, IN THE VIEW OF MOST EXPERTS, ADDRESS THE PROBLEM. BUT THE NOMINAL PRICE RESTRICTION IS SET FOR LARGELY POLITICAL REASONS. SPF OFFICIALS REMEMBER THAT THEIR PREDECESSORS RESIGNED LAST YEAR UNDER HEAVY CRITICISM FROM PARLIAMENT THAT STATE ASSETS WERE BEING SOLD TOO CHEAPLY (THESE PRIVATIZATIONS PRECEDED THE MASS PRIVATIZATION PROGRAM). SINCE PARLIAMENT IS ON RECORD AND VIGILANT, THE SPF INTERPRETS THE 1991 LAW ON SECURITIES TO MEAN THAT SHARES MAY NOT BE SOLD BELOW NOMINAL VALUE EVEN WHEN BEING "SOLD" FOR CERTIFICATES. IT IS USAID'S UNDERSTANDING THAT THE LAW IS UNCLEAR TO BEGIN WITH, PARTICULARLY IN A CASE WHERE NO MONEY IS CHANGING HANDS.

(7) THE RULES ESTABLISHED TO CALCULATE AUCTION RESULTS, AND TO APPLY THE

NOMINAL VALUE RESTRICTION, FURTHER DELAY PRIVATIZATION. IF 70% OF THE SHARES OF A COMPANY OFFERED AT AUCTION ARE SOLD AT OR ABOVE NOMINAL VALUE, THE COMPANY IS CONSIDERED FULLY SOLD AND THE

REMAINING SHARES ARE DISTRIBUTED FREE OF CHARGE ON A PRO RATA BASIS TO ALL BIDDERS (INCLUDING EVERYONE WHO PARTICIPATED IN THE CLOSED SUBSCRIPTION - SEE PARA 14. BELOW). IF, ON THE OTHER HAND, LESS THAN 70% OF THE SHARES ARE SOLD AT THIS VALUE, THE UNSOLD SHARES ARE OFFERED AGAIN LATER. IRONICALLY, THE NOMINAL VALUE REMAINS UNCHANGED. THE RULES FOR DETERMINING NOMINAL VALUE ARE INTENDED TO PREVENT IT MANIPULATION BY

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MANAGERS AND WORKERS. IN PRACTICE, SOME MANIPULATION OCCURS.

(8) SEVERAL SOLUTIONS TO THE NOMINAL VALUE PROBLEM ARE BEING CONSIDERED. FIRST, BUT LEAST LIKELY, THE SPF COULD SIMPLY RE-INTERPRET THE LAW ON SECURITIES AND ALLOW SALE OF SHARES FOR CERTIFICATES AT BELOW NOMINAL VALUE. THERE IS GROWING SUPPORT AT THE SPF FOR A SECOND APPROACH IN WHICH THE PERCENTAGE IN THE 70% RULE WOULD BE REDUCED OR ELIMINATED SO THAT MORE OR ALL UNSOLD SHARES CAN BE DISTRIBUTED ON A PRO RATA BASIS, AT NOMINAL VALUE, IMMEDIATELY FOLLOWING AN AUCTION. THIS WOULD ELIMINATE UNSOLD SHARES, AND ELIMINATE THE IMPACT OF ANY MANAGEMENT/WORKER MANIPULATION OF NOMINAL VALUE.

PIPELINE ISSUES - SPEEDING UP ENTERPRISE PREPARATION:  
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(9) IN ADDITION TO THE PROBLEM OF UNSOLD SHARES, THE NUMBER OF COMPANIES BEING PREPARED FOR AUCTION IS DECLINING. THE AUGUST AUCTION OFFERED A RECORD 344 ENTERPRISES. BUT THE NUMBER OF COMPANIES THAT ARE NOW ENTERING THE AUCTION PREPARATION PROCESS APPEARS TO BE FAR LESS. DESPITE THE ACCELERATION IN AUGUST, THERE WILL BE AT BEST A FEW HUNDRED PRIVATIZATIONS THIS FALL UNLESS CHANGES ARE MADE.

(10) 5,300 ENTERPRISES HAVE BEEN DEEMED SUBJECT TO MASS PRIVATIZATION SO FAR BY THE CABINET OF MINISTERS (COM). AN ADDITIONAL LIST OF 2,700 IS BEING COMPLETED

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BY THE COM NOW. FINALLY, THE GOU AND THE WORLD BANK HAVE AGREED, IN PRINCIPLE, THAT AN ADDITIONAL 2,000

ENTERPRISES WILL BE ADDED TO THESE LISTS BY THE END OF THE YEAR. THE COMPOSITION OF THE FINAL 2,000 IS UNKNOWN. BUT THREE TYPES OF COMPANIES DOMINATE THE FIRST 8,000 FIRMS. FIRST, ARE APPROXIMATELY 1,000 FIRMS THAT PREPARED FOR MASS PRIVATIZATION THROUGH AN OLD (AND LENGTHY) "CORPORATIZATION" PROCESS CONTROLLED BY THE MINISTRY OF ECONOMY. THIS GROUP ACCOUNTS FOR ALMOST ALL OF THE ENTERPRISES THAT HAVE BEEN OFFERED AT AUCTION SO FAR. THERE ARE NO MORE ENTERPRISES IN THIS GROUP. THE SECOND GROUP CONSISTS OF ABOUT 1,250 ENTERPRISES SUBJECT TO THE NOVEMBER, 1994 PRESIDENTIAL DECREE INTENDED TO STREAMLINE THE ENTERPRISE PREPARATION PROCESS. THE FIRST GROUP INCLUDES AGRO-INDUSTRIAL ENTERPRISES.

(11) FOUR MEASURES, IF TAKEN, COULD ACCELERATE THE PREPARATION OF THE 1,250 ENTERPRISES SUBJECT TO NOVEMBER'S PRESIDENTIAL

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SUBJECT: MASS PRIVATIZATION IN UKRAINE: PART TWO

DECREE. THE FIRST IS UNDERWAY. IT CONSISTS OF GIVING EACH ELIGIBLE FIRM A STANDARD, CLEARLY-PRESENTED PACKAGE OF DOCUMENTS TO INITIATE PRIVATIZATION. IT PRESENTS A LIMITED NUMBER OF CHOICES TO THE FIRM FOR COMPLETING THE PREPARATION AND PRIVATIZATION PROCESS.

THE DOCUMENT PACKAGES ARE READY FOR DISTRIBUTION WITH THE EXCEPTION OF SHARE ALLOCATION PLANS WHICH STILL AWAIT SPF APPROVAL. THE SECOND

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*(See corrected copy)*



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C O R R E C T E D C O P Y (TEXT)

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FOR:  
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MORNINGSTAR/S/NIS/DSPECKARD/COMMERCE/JKALICKY/AID/ENI/  
PER/LMAILLOUX//WCOLES/AID/ENI/NCA/WN/SGROSSMAN/AID/DAA/  
ENI/BTURNER//DPRESSLEY/AID/AA/ENI/TDINE/

E.O. 12356: N/A  
SUBJECT: MASS PRIVATIZATION IN UKRAINE: PART TWO

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DISTRIBUTION WITH THE EXCEPTION OF SHARE ALLOCATION  
PLANS WHICH STILL AWAIT SPF APPROVAL. THE SECOND  
MEASURE NEEDED IS FOR THE SPF TO SET AND RIGOROUSLY  
ENFORCE DATES BY WHICH ALL ENTERPRISES MUST COMPLETE  
EACH STEP OF THE PREPARATION PROCESS. WE BELIEVE THIS

WILL BE DONE (SPF CHAIRMAN, YEKHANUROV, INFORMED USAID STAFF ON JULY 27, FOR EXAMPLE, THAT HE WAS PREPARING TO FIRE THREE ENTERPRISE DIRECTORS WHO HAVE NOT FOLLOWED FUND INSTRUCTIONS). THE THIRD WOULD REQUIRE A PRESIDENTIAL DECREE TO REVERSE PRESIDENTIAL DECREE 468 OR LIMIT ITS IMPACT. DECREE 468 PLACED LINE MINISTRIES BACK ON THE PRIVATIZATION COMMITTEES THAT OVERSEE THE PROCESS OF EACH ENTERPRISE'S PREPARATION FOR AUCTION. NOVEMBER'S DECREE HAD ELIMINATED THE LINE MINISTRIES AND REPRESENTED A HARD-FOUGHT VICTORY FOR STREAMLINING. WITH LINE MINISTRIES BACK ON THE COMMISSIONS, THEIR INTEREST IN RETAINING OWNERSHIP CONTROL WILL ALMOST CERTAINLY SLOW DOWN ENTERPRISE PREPARATION. FINALLY, THE ISSUE OF INCREASED INCENTIVES FOR MANAGEMENT AND WORKER PARTICIPATION MUST BE RESOLVED IF THEY ARE TO ACCELERATE RATHER THAN BLOCK THE ENTERPRISE PREPARATION PROCESS (SEE PARA 15 BELOW).

AGRO-INDUSTRIES -- A SPECIAL PIPELINE PROBLEM:  
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(12) THE STEPS NEEDED TO ACCELERATE PREPARATION OF THE MORE THAN 3,500 AGRO-INDUSTRIAL ENTERPRISES SUBJECT TO MASS PRIVATIZATION ARE NOT YET CLEAR. THESE FIRMS WERE INITIALLY UNDERSTOOD TO BE SUBJECT TO THE NOVEMBER STREAMLINING DECREE, BUT IT BECAME APPARENT ONLY A FEW

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MONTHS AGO THAT THIS MAY NOT BE THE CASE. IN FACT, SOME TRADITIONAL AGRARIAN INTEREST GROUPS AND THEIR SUPPORTERS IN PARLIAMENT HAVE DEVELOPED LEGISLATION THAT COULD MAKE ENTERPRISE PREPARATION FOR THESE FIRMS TAKE UP TO ONE AND ONE-HALF YEARS AND WOULD THEN GIVE FULL CONTROL OVER AGRO-INDUSTRY TO FARM PRODUCERS. IN THE VIEW OF MANY OBSERVERS, THIS WOULD EXCLUDE ALL OTHER OUTSIDE OWNERSHIP AND INSTITUTIONALIZE VERTICAL MONOPOLIES. THE SPF IS RELUCTANT TO MAKE SUCH LEGISLATION DEBATED OPENLY IN PARLIAMENT (FOR FEAR IT MIGHT BE APPROVED). THEY ARE ATTEMPTING TO PREVENT IT FROM REACHING THE PARLIAMENTARY FLOOR IN THE FIRST PLACE, THEN WILL ATTEMPT TO STREAMLINE PROCEDURES WITHIN THE EXISTING LAW TO CUT PREPARATION TIME TO SIX MONTHS. (IF PARLIAMENT PASSES THE LAW, THE SPF INTENDS TO REQUEST A PRESIDENTIAL VETO.) AT THIS POINT, THOSE GROUPS WORKING IN UKRAINE FOR PRIVATIZATION ARE URGING THE GOU TO APPLY THE NOVEMBER DECREE, OR SOMETHING SIMILAR TO IT, TO AGRO-INDUSTRIAL ENTERPRISES. USAID AND OTHER CONSULTANTS ARE REVIEWING THE LAW TO DETERMINE HOW THIS

MIGHT BE DONE. SUCCESS WILL DEPEND ON THE ABILITY OF THE EXECUTIVE BRANCH TO COME TO AGREEMENT WITH AGRICULTURAL PRODUCER INTERESTS. IT WILL ALSO DEPEND ON THE NUMBER OF AGRO-INDUSTRIAL ENTERPRISES THAT APPEAR IN THE FINAL LIST OF 2,000 FIRMS THE GOU HAS PROMISED THE WORLD BANK WILL BE ADDED TO THE MASS PRIVATIZATION PROGRAM.

SHARE ALLOCATION AND DISINCENTIVES TO PRIVATIZE:  
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(13) THE FINAL CONSTRAINT ON UKRAINE'S MASS PRIVATIZATION PROGRAM IS THE ALLOCATION OF SHARES BETWEEN MANAGEMENT AND WORKERS, THE PUBLIC, OTHER INVESTORS, AND GOVERNMENT. A CLEAR, EASY-TO-UNDERSTAND PLAN HAS YET TO BE MADE PUBLIC. THIS LACK OF TRANSPARENCY DOES NOT IN ITSELF NECESSARILY DELAY PRIVATIZATION, BUT AT BEST IT MEANS CITIZENS DON'T ALWAYS KNOW THE OWNERSHIP PLAN FOR A COMPANY THEY BID ON (WHICH COULD ULTIMATELY DISCREDIT THE PROGRAM). AT WORST, IT COULD DISGUISE GOVERNMENT EFFORTS TO RETAIN COMPANY CONTROL.

(14) THE ALLOCATION OF SHARES IS SAID BY THE SPF TO BE, ROUGHLY, A 30/70 SPLIT BETWEEN MANAGEMENT AND WORKERS ON ONE HAND AND THE CERTIFICATE-HOLDING PUBLIC ON THE OTHER. MANAGEMENT AND WORKERS' INTERESTS ARE HANDLED THROUGH A "CLOSED SUBSCRIPTION" PROCESS THAT PRECEDES CERTIFICATE AUCTIONS. IN THE CLOSED SUBSCRIPTION, MANAGEMENT AND WORKERS CAN OBTAIN AS MANY SHARES AS THEY ARE WILLING TO PURCHASE WITH THEIR OWN CERTIFICATES (THROUGHOUT THE CLOSED SUBSCRIPTION, SHARES ARE

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PURCHASED AT NOMINAL VALUE). MANAGEMENT AND WORKERS MAY ALSO PURCHASE, WITH CASH, UP TO 50% OF THE VALUE OF THE CERTIFICATES THEY HAVE OFFERED FOR THE FIRM. FINALLY, MANAGERS (BUT NOT WORKERS) MAY PURCHASE AN ADDITIONAL 5% OF THE COMPANY'S SHARES FOR CASH. THE TOTAL HOLDING OF MANAGEMENT AND WORKERS WILL VARY WIDELY, DEPENDING ON THEIR BUYING POWER AND THE SIZE OF THE FIRM. AS A RULE OF THUMB, THE SPF ASSUMES THAT

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CLOSED SUBSCRIPTION WILL YIELD 30% OWNERSHIP TO THIS GROUP. USAID CONTRACTORS AND OTHER OBSERVERS BELIEVE THE AVERAGE WILL BE CLOSER TO 15%.

(15) THERE IS GROWING CONSENSUS AMONG THE CONSULTANT AND DONOR COMMUNITY THAT THE AVERAGE 15% OWNERSHIP SHARE THAT MANAGEMENT AND WORKERS MAY ACTUALLY GET IS TOO SMALL AND ASSURES THAT MANAGEMENT AND LABOR WILL OPPOSE AND DELAY THE PRIVATIZATION PROCESS. IN RUSSIA, BY CONTRAST, MANAGERS AND WORKERS WERE GENERALLY ASSURED ACCESS TO CONTROLLING INTEREST AND THE PROCESS MOVED VERY QUICKLY. RIGID AND UNREALISTIC RULES THAT CAN FORCE ENTERPRISES TO PAY EXTREMELY HIGH BILLS FOR AUDITS PRIOR TO PRIVATIZATION ARE AN ADDITIONAL DISINCENTIVE FOR MANAGEMENT AND LABOR IN UKRAINE. USAID AND EU/TACIS ARE POLLING ENTERPRISE DIRECTORS NOW TO DETERMINE THEIR PERCEPTION OF THE COSTS AND BENEFITS OF THE PRIVATIZATION PROCESS. IF, AS WE SUSPECT, ISSUES OF CONTROL AND AUDIT ARE CRITICAL, WE WILL WORK WITH THE GOVERNMENT TO ADDRESS BOTH DIRECTLY.

TRANSPARENCY AND RETENTION OF GOVERNMENT SHARES:  
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(16) WHAT ALSO REMAINS UNCLEAR IS THE DISPOSITION OF THE 70% OR SO OF TOTAL SHARES THAT REMAIN AFTER CLOSED SUBSCRIPTION. THE STANDARD MODEL IS SAID TO BE THAT

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(19) EFFORTS TO CORRECT THE PROBLEMS OF MASS PRIVATIZATION MUST TAKE ACCOUNT OF THE POSITION OF PARLIAMENT. WHILE THE PARLIAMENT AS A WHOLE NO LONGER OPPOSES THE CONCEPT OF A PRIVATE SECTOR, THE ISSUE FOR MANY MEMBERS IS HOW LARGE A PRIVATE SECTOR UKRAINE SHOULD HAVE. SUCH CONCERNS MEAN PARLIAMENT WILL RESIST EFFORTS TO MOVE MORE QUICKLY, ESPECIALLY WITH THE LARGEST INDUSTRIES AND ON ANY LAND MATTERS. PRIVATIZATION OF COMMUNICATIONS AND STRATEGIC MILITARY INDUSTRIES WILL ALMOST CERTAINLY REMAIN OFF LIMITS. WITHIN THE PARLIAMENT, FACTIONS WILL CONTINUE TO LOBBY. COMMUNISTS AND ELEMENTS OF THE SOCIALIST PARTY WILL OPPOSE ACCELERATION ESPECIALLY IF LAND IS INVOLVED, ON THE BASIS OF

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IDEOLOGY. WHILE REFORMIST AGRARIANS WILL NOT STAND IN THE WAY OF ACCELERATING THE PROGRAM, THE CONSERVATIVE BRANCH INCLUDES BOTH IDEALOGUES AND FARM DIRECTORS WHO, FOR DIFFERENT REASONS, MAY OPPOSE PRIVATIZATION (TO THE PUBLIC) OF AGRO-INDUSTRIAL ENTERPRISES AS WELL AS PRIVATIZATION OF LAND. THE KUCHMA GOVERNMENT MUST DEAL WITH THESE GROUPS AND WILL HAVE TO COMPROMISE WITH THEM.

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MANAGEMENT CONSTRAINTS AT THE STATE PROPERTY FUND:  
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(20) EFFORTS TO IMPROVE PRIVATIZATION WILL ALSO HAVE TO TAKE ACCOUNT OF WEAKNESSES IN THE STATE PROPERTY FUND ITSELF. BY ONE SENIOR SPF OFFICIAL'S ESTIMATE,

ONLY TEN PERCENT OF SPF STAFF DO "USEFUL" WORK. CHAIRMAN YEKHANUR  
OV BR  
GHT ENERGY AND COMMITMENT WHEN HE  
WAS APPOINTED TO THE SPF LAST FALL. THE PROGRESS OVER  
THE LAST NINE MONTHS CAN BE ATTRIBUTED TO HIS LEADERSHIP OF A PROG  
RAM T  
T HAD BEEN STALLED FOR THE TWO  
PRECEDING YEARS. BUT MR. YEKHANUROV IS NOT A STRONG  
MANAGER AND HAS FACED SIGNIFICANT OPPOSITION, EVEN  
SABOTAGE, FROM ELEMENTS OF HIS OWN ORGANIZATION (VIRUSES, FOR EXAM  
PLE,  
RE PLANTED IN THE PRIVATIZATION DATA  
BASE BY ONE EMPLOYEE). HIS VISION OF LARGER PRIVATIZATION ISSUES  
(THE  
LATIONSHIP BETWEEN PRIVATIZATION  
AND CAPITAL MARKETS, THE DISPOSITION OF SOCIAL ASSETS,  
ETC.) SOMETIMES APPEARS NOT FULLY FORMED. HE MAY  
THEREFORE NOT ALWAYS GIVE CONSISTENT SIGNALS TO HIS  
STAFF.

RE-INVIGORATING THE PROCESS:  
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(21) OUR OPTIMISM THAT THE PROBLEMS OF MASS PRIVATIZATION WILL BE  
ADDR  
SED DESPITE THESE OBSTACLES IS BASED  
ON THE BELIEF THAT THE KUCHMA GOVERNMENT GENUINELY  
WANTS TO SEE THE PROGRAM WORK. DOMESTIC CRITICISM IS  
GROWING THAT THE PROGRAM IS GOING TOO SLOWLY. THIS

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CRITICISM HAS COME FROM BOTH THE EXECUTIVE BRANCH AND  
PARTS OF THE PARLIAMENT. THE SPF IS BEING FORCED TO  
RESPOND. THERE ARE OTHER POSITIVE SIGNS. THE RECENT  
NOMINATION OF YEVGENY GRIGORENKO AS A DEPUTY CHAIRMAN  
OF THE FUND WOULD GIVE THE SPF A VERY CAPABLE ADMINISTRATOR, COMMI  
TTED  
RAPID AND TRANSPARENT PRIVATIZATION. HIS MANAGEMENT AND POLICY L  
EADER  
IP IS ALREADY  
FELT IN WHAT HAS HITHERTO BEEN A POORLY MANAGED ORGANIZATION. FIN  
ALLY,  
HERE IS NOW A MORE P  
OSITIVE ATTITUDE  
ON THE PART OF THE SPF TOWARD WORKING WITH EXTERNAL  
CONSULTANTS. FOR EXAMPLE, USAID'S PRINCIPAL MASS  
PRIVATIZATION CONTRACTOR IN UKRAINE, PRICE WATERHOUSE,  
WAS VIEWED VERY NEGATIVELY BY THE SPF EARLY THIS YEAR.

THAT VIEW HAS TOTALLY CHANGED.

(22) BUT THE CHANGES REQUIRED TO KEEP MASS PRIVATIZATION ON TRACK  
WILL  
T OCCUR QUICKLY UNLESS DONORS AND  
DOMESTIC SUPPORTERS OF PRIVATIZATION CONTINUE TO PUSH  
VERY HARD FOR ACCELERATION AND TRANSPARENCY. CONDITIONS ALLOWING  
DISBU  
EMENT OF THE NEXT ROUND OF WORLD  
BANK LOANS TO UKRAINE ARE BASED ON PRIVATIZATION PERFORMANCE. SUC  
CESS

THE PRIVATIZATION PROGRAM WILL  
REQUIRE THAT DONORS, INCLUDING THE BANK, PRESS THE CASE  
TO THE GOVERNMENT VERY STRONGLY AND WITH ONE VOICE AND  
SPEAK TO GOVERNMENT AT THE APPROPRIATE LEVEL. PROPOSALS THAT THE  
UNITE  
STATES MISSION, IN COLLABORATION  
WITH OTHER DONORS, PLANS TO PUT IMMEDIATELY TO THE  
STATE PROPERTY FUND ARE:

A. IMMEDIATELY FINALIZE AND DISTRIBUTE STANDARD SHARE  
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ALLOCATION PLANS AND STANDARD ENTERPRISE PREPARATION  
PACKAGES TO THE 1,250 COMPANIES SUBJECT TO PRESIDENTIAL  
DECREE 699

B. SET AND ENFORCE FIRM DATES BY WHICH THESE SAME FIRMS  
MUST REACH EACH STEP OF THE ENTERPRISE PREPARATION  
PROCESS

C. WITHIN EXISTING LAW, SHORTEN ENTERPRISE PREPARATION  
TIME FOR AGRO-INDUSTRIAL ENTERPRISES TO 6 MONTHS

D. DIVERT UNDERUTILIZED AUCTION CENTER STAFF TO ASSIST  
REGIONAL STATE PROPERTY FUNDS ACCELERATE THE FLOW OF  
ENTERPRISE PREPARATION DATA

E. MAKE ALL SHARE ALLOCATION PLANS PUBLICLY AVAILABLE  
TO A WIDE AUDIENCE

F. EITHER IGNORE THE PERCEIVED NOMINAL PRICE RESTRICTION OR DISTRI  
BUTE  
L SHARES UNSOLD AT AUCTION PRO

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\*\*\*\*\* KIEV 7500 - XXSECTION 06 OF 06 \*\*\*\*\*

SUBJECT: MASS PRIVATIZATION IN UKRAINE: PART TWO

RATA TO ALL BIDDERS

G. ESTABLISH A CUTOFF DATE FOR CITIZENS TO PICK UP  
PRIVATIZATION CERTIFICATES

(23) ISSUES THAT THE U.S. MISSION, AGAIN IN COLLABORATION WITH OT  
HER D

ORS, EXPECTS TO ADDRESS SOON AT THE  
LEVEL OF VICE PRIME MINISTER SHPEK, PRIME MINISTER  
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MARCHUK, AND THE PRESIDENT'S ADMINISTRATION INCLUDE:

A. REVERSE THE PORTION OF PRESIDENTIAL DECREE 468 THAT  
REINSTATES LINE MINISTRIES ON PRIVATIZATION COMMITTEES,  
OR TAKE OTHER ACTION THAT LIMITS ITS IMPACT

B. APPLY PRESIDENTIAL DECREE 699 TO AGRO-INDUSTRIAL  
FIRMS OR SIMILARLY STREAMLINE ENTERPRISE PREPARATION TO  
FOUR MONTHS FOR FIRMS IN THIS SECTOR

C. RETAIN NO SHARES IN STATE HANDS EXCEPT FOR AN  
ABSOLUTE MINIMUM NUMBER OF SPECIAL CASES

D. ALLOCATE ADDITIONAL FREE AIR TIME FOR MASS PRIVATIZATION MESSAG  
ES ON  
TATE TV AND RADIO

(24) IF ALL OR MOST OF THE STEPS ABOVE ARE TAKEN, IT  
WILL STILL BE POSSIBLE TO PRIVATIZE 2,500 COMPANIES BY  
THE END OF 1995 AND THE ENTIRE 10,000 BY THIS TIME NEXT  
YEAR. BUT THE CHANGES NEEDED ARE SIGNIFICANT AND THERE  
IS NOT MUCH TIME TO MAKE THEM. FURTHER CHANGES RELATING TO INCREA  
SING  
CENTIVES FOR WORKERS AND MANAGEMENT, AND REDUCING AUDIT COSTS, WIL  
L BE



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SHORTLY WHEN THE SURVEY OF ENTERPRISE MANAGERS' ATTITUDES IS COMPLETED.

INCENTIVES MAY PROVE, IN THE END, TO HAVE THE GREATEST IMPACT OF ALL.) THAT WILL ALSO BE AN APPROPRIATE TIME TO DETERMINE THE SHARE OF GDP AND THE LABOR FORCE THAT ARE REPRESENTED BY THE GOV'S PRIVATIZATION TARGETS, TO INSTITUTE MECHANISMS TO TRACK PROGRESS OF THE PROGRAM IN THESE TERMS, AND TO BEGIN TO DISCUSS EXPANDING THE TARGETS AS NEEDED.

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CONCLUSION:

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(25) ALTHOUGH THE KUCHMA GOVERNMENT IS COMMITTED TO MAKING MASS PRIVATIZATION WORK, THERE ARE MAJOR TECHNICAL AND POLITICAL OBSTACLES. THE U.S.G. SHOULD STRONGLY EMPHASIZE THE IMPORTANCE OF TAKING THE ACTIONS IDENTIFIED IN PARAGRAPHS 22, 23 AND 24 ABOVE IN ANY BILATERAL DISCUSSIONS CONCERNING ECONOMIC REFORM IN UKRAINE. OUR ENCOURAGEMENT AND PRESSURE CAN HELP ASSURE THAT THE REQUIRED CHANGES ARE MADE DESPITE POLITICAL OPPOSITION. OUR CONTINUED SUPPORT WILL BE NECESSARY TO IMPLEMENT CHANGE AS IT OCCURS.

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