

# Privatization in Ukraine: Economics, Law, and Politics

Matthew S.R. Palmer<sup>†</sup>

I. INTRODUCTION	454
II. UKRAINE	456
A. <i>Politics and Nationalism</i>	457
B. <i>Economics</i>	461
C. <i>Law</i>	467
D. <i>Summary</i>	473
III. PRIVATIZATION	473
A. <i>Context: Moving to a Market Economy</i>	473
B. <i>Theory: Reasons for Privatization</i>	476
1. <i>Private Property</i>	476
2. <i>Privatization in a Market Economy</i>	477
3. <i>Privatization in Ukraine</i>	480
C. <i>International Experience</i>	481
1. <i>Overview</i>	481
2. <i>New Zealand</i>	483
3. <i>Great Britain</i>	485
4. <i>British Columbia, Canada</i>	486
5. <i>Chile</i>	488
6. <i>Poland</i>	490
IV. DEVELOPING A SUBSTANTIVE PROGRAM	492
A. <i>Objectives</i>	492
B. <i>Assumptions</i>	495
C. <i>Constraints</i>	498

---

<sup>†</sup> Doctoral Candidate, and Ford Foundation Fellow in Public International Law, Yale Law School; B.A., University of Canterbury, New Zealand; LL.B. (Hons), Victoria University of Wellington, New Zealand; LL.M. Yale Law School. An earlier version of this article was distributed in the Background Reading Material for the Conference on Economic Reform in Ukraine, Harvard University, November 13-15, 1990, and will be translated into Ukrainian and published in Kiev. For their assistance with my research in Ukraine, thanks are due to Anne Brailsford, Russell Palmer, Victor and Olga Perchuk, the Center for Studies in Law, Economics, and Public Policy at the Yale Law School, the John M. Olin Foundation, the Project on Economic Reform in Ukraine, and the Ukrainian organization SPURT. I also acknowledge, with thanks, the comments of Andrzej Blach, Zohar Goshen, Henry Hansmann, William Hogan, Lewis Holden, Stephen Ingersoll, Leon Lipson, Thomas Richardson, Pablo Ruiz-Tagle, Susan Rose-Ackerman, and all of the participants in a faculty seminar at the Yale Law School, as well as participants in the Conference on Economic Reform in Ukraine. I would also like to thank my editors at the *Yale Journal of International Law*: Jonathan J. Ross, Student Writing Editor, and Christine L. Herrell, Articles Editor, both of whom acted as Managing Editors and without whose help the publication of this article would not have been possible. The remaining inadequacies of the article are due to my own efforts.

D. Options .....	499
E. Analysis .....	500
1. Not by Distribution to Workers .....	500
2. Not by Sale Alone .....	502
3. Gift .....	503
4. Part Sale, Part Gift .....	507
F. Summary of an Illustrative Program .....	508
V. THE PROCESS OF IMPLEMENTATION .....	510
A. What? .....	510
B. Who? .....	511
C. How? .....	513
D. When? .....	514
VI. CONCLUSION .....	516

## I. INTRODUCTION

Many in the Ukrainian Soviet Socialist Republic (Ukrainian SSR or Ukraine),<sup>1</sup> as in other Soviet Republics and in Eastern Europe, no longer view the traditional Soviet economic system as an adequate basis for a modern, efficient, and prosperous economy.<sup>2</sup> They see the solution to wasteful resource allocation, shortages of commodities, and general economic stagnation as lying in the transformation of the basis of the Ukrainian economy from command and control to market principles. In Ukraine, market principles continue to gain official endorsement by various government bodies, despite increasingly apparent hesitation at the Soviet All-Union level.<sup>3</sup> The economic transformation of a socialist economic system is a massive and unprecedented task, carrying with it unforeseeable risks of social, economic, and political instability. The position of the USSR as a nuclear superpower in the current world order highlights the significance of such a transition.

This article examines one important aspect of economic transformation in Ukraine -- the process of privatization. It is the goal of this article to provide

---

1. Throughout this article, the Ukrainian Socialist Republic is referred to as "Ukraine," rather than the conventional English usage of "the Ukraine" in deference to the strongly held preference of the expatriate Ukrainian community in North America.

2. See, e.g., Conference Summary: Conference on Economic Reform in Ukraine (Ukrainian Research Institute, John F. Kennedy School of Government, Harvard University) (Nov. 13-15, 1990) (unpublished report) [hereinafter Conference Summary]; PERESTROIKA AND THE ECONOMY: NEW THINKING IN SOVIET ECONOMICS (A. Jones & W. Moskoﬀ eds. 1989) [hereinafter PERESTROIKA AND THE ECONOMY].

3. See, e.g., *Opposition Leader Assesses Situation in Ukraine and Soviet Union*, 1 UKRAINIAN BUS. DIG., Feb. 22, 1991, at 9 [hereinafter *Yukhnovskii Interview*].

information and advice about the process by which Ukrainians could, themselves, formulate and implement a program of privatization. It does not pretend to provide a substantive blueprint to guide Ukrainians in changing their economy and society. It is for Ukrainians to think through their own economic and social aims, and to formulate and implement their own policies. Ukrainians should feel able to exercise such a right of economic self-determination against the advice of western experts just as strongly as many Ukrainians now feel they can exercise rights against the Soviet center.<sup>4</sup>

Ukrainians are acutely aware of the severe lack of Soviet experience with and theories about market principles. As a result, they turn to the West for help.<sup>5</sup> Western expertise, information, and advice regarding economic reform can be very useful. Western economic principles provide a basic tool kit of concepts and a distinctive method of reasoning that can yield important insights into the nature of human economic behavior and contribute positive analyses of policy proposals. Yet that is not, by itself, sufficient to advance economic reform. Economists are not as good at examining issues of implementation, such as the speed and sequencing of reforms during a fundamental economic transformation.<sup>6</sup> More importantly, economics cannot provide the value judgments necessary to arrive at normative proposals.<sup>7</sup>

The analysis of privatization in this article demonstrates why Ukrainian economic self-determination is so important. Privatization would be inherently associated with massive and unpredictable economic and social consequences in Ukraine. Because of the continuing democratization of Ukrainian politics, such consequences would fundamentally constrain the shape of Ukrainian reform that could feasibly be implemented. "[T]he imperatives of political sustainability may dominate the analysis of the reform process."<sup>8</sup> The process of democratization in Ukraine, as in the USSR generally, is crucially interrelat-

---

4. See, e.g., *The Declaration of Sovereignty by Ukraine*, Pravda, July 17, 1990, English summary reprinted in CURRENT DIG. SOVIET PRESS, Aug. 29, 1990, at 8. See *infra* notes 31-32 and accompanying text.

5. One example is the Project on Economic Reform in Ukraine (PERU), based in Kiev, Ukraine, and at the Ukrainian Research Institute, John F. Kennedy School of Government, Harvard University. PERU is a cooperative effort to bring together western experts and Ukrainian policymakers to study, design, and implement economic change in Ukraine. See Project on Economic Reform in Ukraine, Reform Update (Feb. 1, 1991) (unpublished report).

6. Hewett, *Economic Reform in the USSR, Eastern Europe, and China: The Politics of Economics*, 79 AM. ECON. REV. 16, 18 (1989).

7. See Hovenkamp, *Positivism in Law & Economics*, 78 CALIF. L. REV. 815 (1990) (providing a thoughtful treatment of this subject). See also Posner, *Some Uses and Abuses of Economics in Law*, 46 U. CHI. L. REV. 281, 287 (1979) ("[I]n measuring economic costs and benefits, the economist *qua* economist is not engaged in the separate task of telling policymakers how much weight to assign to economic factors," although his own analysis often seems to conflict with this). Regarding the inherent existence of positive and normative qualities in two different schools of law and economics, see Rose-Ackerman, *Law and Economics: Paradigm, Politics or Philosophy*, in LAW AND ECONOMICS 233 (N. Mercuro ed. 1989).

8. S. FISCHER & A. GELB, ISSUES IN SOCIALIST ECONOMY REFORM 38 (Massachusetts Institute of Technology Department of Economics Working Paper No. 567, 1990).

ed with economic reform.<sup>9</sup> The ideals of individualism and freedom link the pursuit of each goal. Pursuit of one goal individually, however, complicates and could defeat the achievement of the other. Economic reform and democratization accelerate and decelerate in much the same way as two participants in a three-legged race. If both are to succeed, the design of a program of economic reform, including privatization, must be guided by the likely Ukrainian political consequences. In addition, large-scale privatization in Ukraine would involve the most fundamental legal restructuring of existing property relationships of any aspect of economic transformation. Since reform must be implemented primarily through law, this article examines the nature and characteristics of the existing Ukrainian legal system.

It is vital to understand the political, social, economic, and legal context of Ukraine to determine the optimal shape of a program of privatization. Informed Ukrainians should use western advice in pursuing the goals of Ukrainian society. The Ukrainians, who understand the Ukrainian context and who will have to deal with the consequences of their decisions, should ultimately determine the nature of economic transformation in Ukraine. This article is designed to facilitate the process of Ukrainian economic self-determination. Following Part II, which provides background information about Ukraine, Part III illustrates the theory of, and international experience with, privatization. Part IV identifies and analyzes options for a substantive program of privatization in Ukraine and, in so doing, demonstrates a process for formulating a program of privatization. Part V emphasizes the importance of careful attention to the process by which a privatization program is implemented.

## II. UKRAINE

In order to understand the political, economic, and legal issues of economic reform in Ukraine, one must be aware of the separate, national identity that is part of the Ukrainian consciousness. Ukraine has its own language,<sup>10</sup> reli-

---

9. See, e.g., Gomulka, *Gorbachev's Economic Reforms in the Context of the Soviet Political System*, in *ECONOMIC REFORMS IN THE SOCIALIST WORLD 67-74* (S. Gomulka, Y.-C. Ha & C.-O. Kim eds. 1989); Palterovich, *Competition and Democratization*, in *PERESTROIKA AND THE ECONOMY*, *supra* note 2, at 60. See generally A. Przeworski, *Political Dynamics of Economic Reforms* (Nov. 10, 1990) (unpublished manuscript) (drawing on South America and Eastern Europe); Shelley, *Democratization and Law*, in *THE IMPACT OF PERESTROIKA ON SOVIET LAW* (A. Schmidt ed. 1990) (drawing same conclusion from legal perspective); J. BATT, *ECONOMIC REFORM AND POLITICAL CHANGE IN EASTERN EUROPE: A COMPARISON OF THE CZECHOSLOVAK AND HUNGARIAN EXPERIENCES* 281 (1988). While a full analysis of the theoretical and empirical relationship between economic transformation and democratization is beyond the scope of this article, aspects of the relationship are important in the article's analysis of privatization.

10. Ukrainian is the second most widespread Slavic language after Russian and was declared the official state language of the Ukrainian SSR in 1989. Ukrainian Research Institute, *Ukraine and the Ukrainian People*, in *Background Reading Material: Conference on Economic Reform in Ukraine* (Ukrainian Research Institute, John F. Kennedy School of Government, Harvard University) (Nov. 13-15, 1990)

## Privatization in Ukraine

gion,<sup>11</sup> time zone,<sup>12</sup> and representation in the United Nations.<sup>13</sup> The Ukrainian SSR is the second largest of the fifteen republics of the USSR in terms of its land area, its population,<sup>14</sup> and its economic significance. Its people are urbanized, educated, and predominantly of Ukrainian nationality. The capital, Kiev, is a beautiful and historic city of 2.6 million people. Ukraine borders four Eastern European nations, three Soviet republics, and the Black Sea.<sup>15</sup> Ukrainian citizens are deeply conscious of their European-oriented history and of the richness of Ukraine's natural resources.<sup>16</sup>

### A. Politics and Nationalism

Although Ukraine has been a core, influential unit of the Russian Empire and the Soviet Union since the late eighteenth century, it has historically exhibited a vigorous sense of its own national identity.<sup>17</sup> Kiev was the center of the powerful Kievan-Rus' empire of Ukrainian Slavs from the ninth century until the Mongol invasions of the thirteenth century. Ukraine again formed an independent state in the mid-seventeenth century.<sup>18</sup> There was a resurgence of Ukrainian national self-assertiveness in the nineteenth century, which was again prominent during both the formative period of the Soviet Union and

---

(unpublished collection) [hereinafter Background Reading Material].

11. Ukrainians were converted to Christianity in 988 and split between the Ukrainian Autocephalous Orthodox Church and the Ukrainian Catholic Church (Greek-Catholic or Uniate) in 1596. Both were recently legalized again after attempts at forced assimilation into the Russian Orthodox Church, the Ukrainian branch of renamed itself the Ukrainian Orthodox Church in Ukraine. *Yukhnovskii Interview, supra* note 3, at 8; Bociurkiw, *The Ukrainian Catholic Church in Gorbachev's USSR*, PROBS. OF COMMUNISM, Nov.-Dec. 1990, at 1.

12. This became effective on July 1, 1990, seemingly as a gesture of independence by the Ukrainian Supreme Soviet. Aeroflot, a federally-managed airline, however, continued to run according to Moscow time even in Ukraine. *On Kiev Time*, *Izvestiya*, June 13, 1990, at 4, English summary reprinted in 42 CURRENT DIG. SOVIET PRESS, July 18, 1990, at 24.

13. This was agreed to by Stalin, Churchill and Roosevelt in 1944 and sanctioned at the Yalta Conference early in 1945 as the price of Soviet participation in the United Nations. T. KIS, NATIONHOOD, STATEHOOD AND THE INTERNATIONAL STATUS OF THE UKRAINIAN SSR/UKRAINE 1, 82 app. (1989).

14. Ukraine's population is 52 million. GOSUDAISTVENNII KOMITET SSSR PO STATISTIKYE, SSSR V TSIFRACH V 1989 GODU 36 (1990); it is comparable in size and population to France.

15. The bordering countries and republics are: the Polish Republic, the Czech and Slovak Federated Republic [hereinafter Czechoslovakia], the Hungarian Republic, Romania, the Russian Soviet Federative Socialist Republic (RSFSR), the Byelorussian Soviet Socialist Republic, and the Moldavian Soviet Socialist Republic.

16. Many Europeans, as well as Ukrainians, have historically regarded Ukraine as the bread basket of Eastern Europe. Several recent Ukrainian papers have attempted to show that Ukraine is a European country given its economic potential, making favorable comparisons with Germany, France, and Italy with respect to per capita production of key industrial and agricultural products. See 1 UKRAINIAN BUS. DIG., Mar. 28, 1991, at 5.

17. See N. FR.-CHIROVSKY, AN INTRODUCTION TO UKRAINIAN HISTORY (vol. 1, 1981) (vol. 2, 1984) (vol. 3, 1986); Pritsak, *Kiev and All of Rus': The Fate of a Sacral Idea*, 10 HARV. UKRAINIAN STUD. 279 (1986).

18. 1 N. FR.-CHIROVSKI, *supra* note 17, at 105-84; 2 N. FR.-CHIROVSKI, *supra* note 17, at 169-225; O. SUBTELNY, UKRAINE: A HISTORY 19-200 (1988).

World War II.<sup>19</sup> In the late 1950s and 1960s, Ukrainian nationalism gained momentum as a popular dissident movement until a crackdown by the Soviet authorities in the 1970s.<sup>20</sup>

Since the mid-1980s, Mikhail Gorbachev's All-Union Soviet government has pursued a policy of *perestroika*, or "restructuring," that has affected virtually every sphere of Soviet life: economic, social, political, legal, and cultural.<sup>21</sup> The amalgam of approaches under the general heading of *perestroika* includes: democratization and the development of pluralist politics; *glasnost*, or "openness," which has significantly liberalized state restrictions on information, discussion, and criticism in public and in the media; and *khozraschet*, which has involved decentralization of economic accountability within the state economic system and liberalization of private economic freedom.<sup>22</sup>

*Perestroika* has allowed Ukrainian nationalism to reemerge, fueled by such events as the 1986 Chernobyl nuclear catastrophe, the current economic decline, the collapse of socialist Eastern Europe, and the celebration of the Millennium of Ukrainian Christianity.<sup>23</sup> Nationalism has now become an intense driving force in the Ukrainian political debate, as it is in some other Soviet Republics.<sup>24</sup> It springs from a deeply felt, historically rooted desire that Ukrainians should govern Ukraine. It has serious implications for the future existence of the USSR because "[w]ithout Ukraine, something is torn from the heart of the Soviet Union."<sup>25</sup> The nature of the debates, and their potential effects both on Ukraine and the whole USSR, are similar, although larger in scale, to the constitutional debates in Canada over the status of Québec.<sup>26</sup>

19. Duncan, *Ukrainians*, in THE NATIONALITIES QUESTION IN THE SOVIET UNION 95, 96-97 (G. Smith ed. 1990); O. SUBTELNY, *supra* note 18, at 201-572.

20. Duncan, *supra* note 19, at 97-99; Solchanyk, *Ukraine, Byelorussian, and Moldavia: Imperial Integration, Russification, and the Struggle for National Survival*, in THE NATIONALITIES FACTOR IN SOVIET POLITICS AND SOCIETY 175, 176-79, 194-96 (L. Hajda & M. Beissinger eds. 1990).

21. See Campbell, *How to Think about Perestroika*, in SOCIALISM, PERESTROIKA, AND THE DILEMMAS OF SOVIET ECONOMIC REFORM 1, 1-2 (J. Tedstrom ed. 1990) [hereinafter DILEMMAS OF SOVIET ECONOMIC REFORM]. In Ukrainian, *perestroika* translates as *perebudova* and *glasnost* as *hlasnist*. See Bohayevsky, *Some Aspects of Perebudova and Hlasnist in the USSR and in Soviet Ukraine*, in ECHOES OF GLASNOST IN SOVIET UKRAINE 12 (R. Bahry ed. 1989). This article employs the more familiar Russian terms.

22. See, e.g., D. LANE, SOVIET SOCIETY UNDER PERESTROIKA 13-17, chs. 2-4, 9 (1990); Cohen, *Introduction: Gorbachev and the Soviet Reformation*, in VOICES OF GLASNOST: INTERVIEWS WITH GORBACHEV'S REFORMERS 15-16 (S. Cohen & K. Heuvel eds. 1989).

23. Duncan, *supra* note 19, at 100-07; Solchanyk, *supra* note 20, at 185-86, 197-98. The Chernobyl disaster, just north of Kiev, was a particularly important catalyst for popular mobilization. See also, Onyshkevych, *Echoes of Glasnost: Chernobyl in Soviet Ukrainian Literature*, in ECHOES OF GLASNOST IN SOVIET UKRAINE, *supra* note 21, at 151; Marples, *Nuclear Power, Ecology and the Patriotic Opposition in the Ukrainian SSR: An Analysis of a Post-Chernobyl Trend*, in *id.* at 18.

24. See generally, THE NATIONALITIES QUESTION IN THE SOVIET UNION, *supra* note 19; S. KUX, SOVIET FEDERALISM: A COMPARATIVE PERSPECTIVE ch. 3 (1990).

25. G. HOSKING, THE AWAKENING OF THE SOVIET UNION 93 (1990).

26. Constitutional Committee of the Québec Liberal Party, A Québec Free to Choose (Jan. 28, 1991).

The democratization of Soviet politics under *perestroika* has enabled and legitimated the public expression of radical Ukrainian views. A coalition of opposition democratic groups and parties called *Rukh*, the popular movement of Ukraine, won a significant presence in the nascently democratic Ukrainian Supreme Soviet in 1990.<sup>27</sup> The views of the people and groups within *Rukh* are varied, ranging from moderate to an extreme that might be considered treasonous in western societies. The major concern for most members centers on the promotion of democratization and *glasnost* and on support for the development of Ukrainian culture and language.<sup>28</sup> Economic concerns are significant but, at least in the initial stages of the movement, secondary.<sup>29</sup>

There is ample evidence of continuing Ukrainian popular support for *Rukh* and its objectives. The pressure by *Rukh* has, tellingly, yielded remarkable concessions from the communist government. *Rukh* members hold chairs in seven of the twenty-three Commissions of the Supreme Soviet, including the chair of Economic Reform and Economic Management.<sup>30</sup> On July 16, 1990, the Ukrainian Supreme Soviet voted 355 to 4 in support of a Declaration of Sovereignty.<sup>31</sup> The Declaration provides that Ukrainians have the exclusive right to possess, use, and dispose of Ukraine's national wealth. It also proclaims Ukraine's right to have its own internal troops, and its intention to become a nonnuclear state.<sup>32</sup> In October 1990, 300 student hunger-strikers camped outside the Ukrainian Supreme Soviet for fifteen days; their strike was supported by other strikes and demonstrations.<sup>33</sup> The conflict was resolved when the Ukrainian Supreme Soviet decided that the Prime Minister would resign, Ukrainians would perform regular military service outside the Ukraine

---

27. *Rukh* includes the two largest non-communist and anti-communist organizations — the People's Party and the Democratic Party — as well as the Ukrainian Republican Party, the Democratic Center, the "greens," and the Memorial Society. After the March 1990 election, the Communist Party held only 239 of the 450 seats in the Ukrainian Supreme Soviet. 1 UKRAINIAN BUS. DIG., Dec. 15, 1990, at 7, 12. See Kuzio, *Unofficial Groups and Semi-Official Groups and Samizdat Publications in Ukraine*, in ECHOES OF GLASNOST IN SOVIET UKRAINE, *supra* note 21, at 66 (providing an overview of dissident groups); see also Kuzio, *Inaugural Congress of the Ukrainian Popular Front (Rukh) in Kiev*, in *id.* at 102.

28. In a survey at the founding *Rukh* conference in September 1989, 75% and 73% of members chose these as their goals. See Paniotto, *The Ukrainian Movement for Perestroika - 'Rukh': A Sociological Survey*, 43 SOVIET STUD. 177, 178 (1991).

29. Forty-six percent of *Rukh* members at the founding conference chose as their goal the promotion of economic sovereignty within the framework of the USSR. The same percentage chose to work toward the solution of pressing economic problems. *Id.* at 178.

30. That chair is held by Volodymyr Pylypchuk, who participated in the Conference on Economic Reform in Ukraine. Conference Summary, *supra* note 2.

31. 1 UKRAINIAN BUS. DIG., Dec. 15, 1990, at 7, 12.

32. *Declaration of Sovereignty*, Pravda, July 17, 1990, at 8, English summary reprinted in 42 CURRENT DIG. SOVIET PRESS, Aug. 29, 1990, at 8.

33. Tsikora, *Students End Hunger Strike. Studies Are Resumed*, Izvestiya, Oct. 18, 1990, at 2, English translation reprinted in 42 CURRENT DIG. SOVIET PRESS, Nov. 14, 1990, at 17.

only on a voluntary basis, and that the Ukrainian SSR Constitution would be brought into conformity with the Declaration of Sovereignty.<sup>34</sup>

In a referendum of March 17, 1991, a large majority of Ukrainians voted in support of only qualified membership in a Union of Soviet sovereign states. A large majority in the three regions in Western Ukraine where the question was asked, supported full independence.<sup>35</sup> On the same occasion, however, a majority of Ukrainians approved the All-Union alternative put forth by Gorbachev in his efforts to retain some central federal power.<sup>36</sup> These votes illustrate the complicated contradictions and conflicts within Ukraine and the USSR over *perestroika* in general. While an unforeseen momentum for change has been strongly built up over the last six years, its aims and attitudes are often vague, contradictory, and heavily influenced by the communist rhetoric and ideology of the past. For instance, private economic activity is now formally sanctioned but still ideologically alien.<sup>37</sup> Some Soviet surveys indicate that those people who believe that the country needs private ownership of land and enterprises outnumber those who have a positive attitude toward private property.<sup>38</sup> Other research suggests that popular attitudes toward free markets in the USSR and the United States are surprisingly similar in their ignorance and acceptance of the concepts, characteristics, and results of market activity.<sup>39</sup>

Communist Party officials and the bureaucracy at all levels strongly resist moves that threaten their personal or ideological interests. This impacts particularly on economic matters where party *apparatchiki* and *nomenklatura*

---

34. *Id.* In January 1991, some of these student activists were prosecuted for their occupation of a university building. Tsikora, *Prosecutor's Office Prosecutes Students*, *Izvestiya*, Jan. 15, 1991, at 3, English translation reprinted in 43 *CURRENT DIG. SOVIET PRESS*, Feb. 13, 1991, at 27.

35. Of those eligible, 80.2% of Ukrainians voted, and of that percent 80.2% of the voters (and 44% of those in Kiev) supported Ukrainian membership of this Union of Soviet Sovereign States, rather than "Socialist States," on the basis of the Declaration of Sovereignty. Over 85% of the population in three strongly nationalistic regions of Western Ukraine voted for Ukraine to be an independent state. 1 *UKRAINIAN BUS. DIG.*, Mar. 28, 1991, at 4.

36. Gorbachev's question of support for the USSR as a renewed federation of sovereign republics with equal rights, guaranteeing the rights and freedoms of individuals, received support from 70.5% of Ukrainians. *Id.*

37. Rousek, *Private Enterprise in Soviet Political Debates*, 40 *SOVIET STUD.* 46, 47 (1988).

38. Aage, *Popular Attitudes and Perestroika*, 43 *SOVIET STUD.* 3, 16 (1991). See also A. ASLUND, *GORBACHEV'S STRUGGLE FOR ECONOMIC REFORM: THE SOVIET REFORM PROCESS, 1985-88*, at 172 (1989) (other surveys revealing significant generational differences in attitudes toward private enterprise and cooperatives, with those under 45 and those over 75 being most in favor of cooperatives).

39. R. SHILLER, M. BOYCKO & V. KOROBV, *POPULAR ATTITUDES TOWARDS FREE MARKETS: THE SOVIET UNION AND THE UNITED STATES COMPARED* (1990) [hereinafter R. SHILLER]. This research found little difference between Moscow and New York regarding: attitudes toward income inequality; willingness to impose policies of rationing rather than market clearing; belief in the importance of providing material incentives for hard work; willingness to provide venture capital; reasons for saving; and fears of potential government interference with their savings. Soviets were found to be less likely to accept exchange of money as a solution to personal problems and to have less warm attitudes toward business success. But Americans were found to be more of the opinion that speculators may cause economic problems and more unwilling to support an economic reform that would create income inequalities.



## Privatization in Ukraine

have wielded power for years and have developed sophisticated habits of pursuing their self-interest.<sup>40</sup> Gorbachev has identified bureaucrats as the most obdurate opponents of economic restructuring.<sup>41</sup> Political and bureaucratic factors "between them suffice to explain the main contours of the [economic] reform cycle, from the recognition of the problem, on through the design and implementation of the reforms to the retrenchment."<sup>42</sup>

Nationalism and the political rhetoric and strategies that concern economic transformation often influence each other.<sup>43</sup> The nationality problem has become "entwined with, and indeed has become a metaphor for, all the major issues of reform."<sup>44</sup> For example, in September 1990, a union-wide working group on the formulation of a new union treaty found, after preliminary consultations, that all Republics unanimously agreed that preparation of a new union treaty should proceed simultaneously with the transition to a market economy.<sup>45</sup> Nationalism also has direct implications for the nature of economic reform, as demonstrated by the heightened fear in the Ukraine of exploitative foreign economic activity, regardless of country or region of origin. This typifies the fundamental interrelationships between economic transformation and politics in Ukraine. Ukrainian nationalism, sovereign capacity, public confusion and prejudices, and party and bureaucratic entrenchment all affect the nature of economic reform in Ukraine.

### B. Economics

The principle of command and control forms the fundamental basis for the traditional economic system in the Soviet Union.<sup>46</sup> Following Marxist ideology, almost all economic production, distribution, and exchange has been under both federal and republic ownership and control. A network of government planning agencies such as *Gosplan* (the State Planning Committee), government industrial ministries, and government productive enterprises developed, resulting in a complicated system of plans and directives to organize almost all

---

40. The *nomenklatura* are people occupying key bureaucratic positions that must be formally appointed by the Communist Party. See P. GREGORY, *RESTRUCTURING THE SOVIET ECONOMIC BUREAUCRACY* 3 (1990). *Apparatchiki* occupy responsible positions in the bureaucracy but bear little responsibility for final results. *Id.* at 71. An *apparatchik* may be part of the *nomenklatura*.

41. Colton, *Approaches to the Politics of Systemic Economic Reform in the Soviet Union*, 3 *SOVIET ECON.* 145, 158-59 (1987).

42. Hewett, *supra* note 6, at 18.

43. See generally Conference Summary, *supra* note 2 (comments by participants in conference on economic reform in Ukraine).

44. Lapidus, *Gorbachev and the "National Question": Restructuring the Soviet Federation*, 5 *SOVIET ECON.* 201, 247 (1989).

45. Stepovoi, *Searching for a Formula for a Union Treaty*, *Izvestiya*, Sept. 6, 1990, at 2, English excerpts reprinted in 42 *CURRENT DIG. SOVIET PRESS*, Oct. 10, 1990, at 1.

46. See generally P. GREGORY & R. STUART, *SOVIET ECONOMIC STRUCTURE AND PERFORMANCE* (4th ed. 1990).

economic activity.<sup>47</sup> Intermediate and final prices, and quantities of all products were set by this government apparatus. Industries were often deliberately structured as monopolies<sup>48</sup> or in groups of scientific-production associations.<sup>49</sup> Only at the consumer level have enterprises been able to choose what to buy without state direction. Market prices have had no role in facilitating efficiency; the resulting resource allocation has not reflected the forces of supply and demand. Consequently shortages, waste, and technological obsolescence have often resulted in, and encouraged the development of, an informal, illegal, second economy with interconnecting networks throughout the bureaucratic and political hierarchies.<sup>50</sup> According to western economic theory, the Soviet economic system can be expected to be inefficient in production, allocation, and dynamic adjustment.<sup>51</sup> However, the Soviet government was, for a time, able to shield its citizens from economic vicissitudes by manipulating prices and employment.

Presently, the traditional planned Soviet economy based on command and control has broken down, whether as a result of the intolerable demands that a complex economy inherently places on Soviet planners, or as a result of the erosion of centralized, hierarchical authority that has accompanied the policies of *glasnost* and *perestroika*. The system of authority once used by All-Union ministries to control economic activity throughout the republics is ceasing to function as the Soviet economy becomes regionalized and paralyzed.<sup>52</sup> Ukrainian citizens have been facing shortages of consumer goods at official prices, notably food,<sup>53</sup> and have experienced rising real prices, wasteful and pointless resource allocation, environmental hazards, growing underemployment and unemployment, and growing inequalities of wealth and income. Not surprisingly, these problems are accompanied by increasing social tension, manifested especially in the emergence of crime and violence.<sup>54</sup> Such trends stand in sharp relief against the rhetoric of Marxist communism in which all Ukrainians have been socialized, thus exacerbating their political impact and the Ukrainian

---

47. *Id.* at 18-23; see also D. LANE, *supra* note 22, at 27-37.

48. In 1990, the All-Union State Committee on Statistics examined 600 categories of manufactured goods and found that half of the output came from a single factory in 219 cases, and all of the output from a single factory in 215 other cases. Five examples of products produced by monopolies located in the Ukraine are agricultural sowers, bicycles, color film, hoisting machines for mines, and steam driven piston pumps. BUS. USSR, Jan. 1991, at 64-65.

49. Schroeder, *Organizations and Hierarchies: The Perennial Search for Solutions*, 29 COMP. ECON. STUD. 7, 16 (1987).

50. Grossman, *The Second Economy: Boon or Bane for the Reform of the First Economy?*, in ECONOMIC REFORMS IN THE SOCIALIST WORLD, *supra* note 9, at 79, 81.

51. See, e.g., Moore, *Agency Costs, Technological Change, and Soviet Central Planning*, 24 J.L. & ECON. 189, 191 (1981).

52. S. KUX, *supra* note 24, at 51-52.

53. See Noren, *The Soviet Economic Crisis: Another Perspective*, 6 SOVIET ECON. 3, 20 (1990) (regular food availability in Ukraine and Moldavia declined from 40% in 1987 to 23.6% in 1989).

54. See, e.g., Chirovsky, *The Soviet Economy and Perestroika*, 45 UKRAINIAN Q. 388, 397 (1989).

## Privatization in Ukraine

desire to acquire control over the economic resources directed from Moscow.<sup>55</sup>

At the same time, it is clear that *perestroika's* introduction of market principles represents significant economic, social, ideological, and legal change. After limited initial measures, momentum toward market principles at the All-Union level received an important boost in mid-1987, with the Union's adoption of the Law on the State Enterprise and the joint adoption of ten decrees by the Central Committee of the Communist Party of the Soviet Union (CPSU) and the USSR Council of Ministers.<sup>56</sup> Several significant reforms were formulated and announced over the following three years, constituting important shifts toward the decentralization of economic power, increases in individual enterprise autonomy, and liberalization of the rules governing private enterprise and private property.<sup>57</sup> However, this progress was incremental because each element of these economic reforms was usually considered as a self-contained package. In the larger All-Union economy, these reforms were accompanied by an increasingly alarming federal budget deficit, and a significant ruble "overhang" of money held involuntarily because of lack of goods.<sup>58</sup>

The breakdown of the traditional economic system is not complete. Nor has *perestroika* led to economic freedom. Rather, the transition period has resulted in a crisis of confidence and a crisis of economic authority. One western commentator has described a schizophrenic attitude in government policies. Economic freedom has been legislated, but the bureaucratic apparatus of a controlled economy has been left in place, and retains a variety of ways of affecting economic behavior.<sup>59</sup> Another commentator described the resulting confusion as "centrally planned chaos."<sup>60</sup> Ministries remain able to use broad control indicators, norms, and state orders to interfere in state enterprises' operations.<sup>61</sup> There is significant political, bureaucratic, and popular

---

55. S. KUX, *supra* note 24, at 62 ("The argument between the USSR government and the radical reformers is not so much a dispute over the specific steps of transition towards a market economy, but a struggle over the power of the central apparatus and the distribution of resources").

56. W. BUTLER, *SOVIET LAW* 255 (2d ed. 1988).

57. See generally A. ASLUND, *supra* note 38; For a comprehensive account of legislative reforms, see Hanson, *Property Rights in the New Phase of Reforms*, 6 *SOVIET ECON.* 95 (1990).

58. Ofer, *Budget Deficit, Market Disequilibrium and Soviet Economic Reforms*, 5 *SOVIET ECON.* 107, 124, 143 (1989) (citing estimates that the overhang, or "hot money," at that time was around 80-100 billion rubles). Though it is not at all clear, the size of the ruble overhang may have been reduced by Gorbachev's drastic decree in January 1991 withdrawing all 50 and 100 ruble notes from circulation and limiting citizens' and, apparently, cooperatives' withdrawals from banks to 500 rubles a month. See Fein, *Soviets Withdrawing 33% of Currency*, N.Y. Times, Jan 23, 1991, at A3, col. 4; English excerpts of various articles from *Izvestiya* and *Pravda* reprinted in 43 *CURRENT DIG. SOVIET PRESS*, Feb. 27, 1991, at 4-9.

59. Campbell, *supra* note 21, at 5; Grossman, *supra* note 50, at 93. See also Lipson, *Piety and Revision: How Will the Mandarins Survive Under the Rule of Law?*, 23 *CORNELL INT'L L.J.* 191, 201-03 (1990) (Soviet bureaucracy can cope with change in a number of ways).

60. C. OSAKWE, *SOVIET BUSINESS LAW: INSTITUTIONS, PRINCIPLES AND PROCESSES* xxii (1991).

61. M. LINDSAY, *INTERNATIONAL BUSINESS IN GORBACHEV'S SOVIET UNION* 14-15 (1989).

suspicion and resentment of private business activities, which restrict the activities of cooperatives.<sup>62</sup> This feeds on the combination of shortages, inefficiencies, and monopoly profits that are currently resulting from the steep learning curve of business in a semi-market environment, the deliberately monopolistic structure of much existing industry, and the often arbitrary mix of controlled and uncontrolled activities. Also, there is evidence that a substantial proportion of the consumer "crisis" is due, not to a drop in production, but to distribution through closed networks, speculation, and widespread hoarding provoked by a loss of confidence in government policies.<sup>63</sup> Perhaps such economic chaos during the transformation is to be expected, especially when the politics of economic reform and the laws of economic activity are of uncertain effect and duration.

The economic debate is integrally associated with political unrest at the All-Union level. Discussion centered on the radical Abalkin and Shatalin plans of October 1989 and September 1990, and the more conservative plans of Prime Minister Ryzhkov of December 1989 and May 1990 and, most recently, Prime Minister Pavlov's plan of April 1991. Little progress has been made, however, toward the practical implementation of these plans.<sup>64</sup> Schroeder's characterization of previous Soviet economic reforms as a "treadmill" potentially remains apt.<sup>65</sup> The period after the twenty-eighth CPSU Congress in July 1990 was one of vacillation preceding the reassertion of the conservative forces' influence against economic reform, nationalism, and democratization. This reassertion was demonstrated by the resignation of Foreign Minister Eduard Shevardnadze.<sup>66</sup> Gorbachev's adopted plan still involves a substantial transformation toward market principles, but it appears there is neither substantial privatization,<sup>67</sup> nor a sense that the leadership is committed to economic transformation.<sup>68</sup> It seems that many All-Union and other Soviet policymakers are still

---

62. Tedstrom, *The Reemergence of Soviet Cooperatives*, in DILEMMAS OF SOVIET ECONOMIC REFORM, *supra* note 21, at 131-34; Aage, *supra* note 38, at 13-15.

63. Schroeder, "Crisis" in the Consumer Sector: A Comment, 6 SOVIET ECON. 56, 62-63 (1989).

64. McKinney, *Confusion in Soviet Economic Reform*, CURRENT HIST. 317, 319 (1990); Richardson, *Still Running in Place: Soviet Economic Reform Plans*, 1 Brown University World Business Advisory, Nov. 1, 1990, at 1.

65. Schroeder, *The Soviet Economy on a Treadmill of "Reforms"*, in 1 SOVIET ECONOMY IN A TIME OF CHANGE 312 (Joint Economic Committee of the U.S. Congress, 1979).

66. *The Fourth Congress of USSR People's Deputies*, Izvestiya, Dec. 21, 1990, at 2-10, English excerpts reprinted in 42 CURRENT DIG. SOVIET PRESS, Jan. 30, 1991, at 7-8 (excerpts of Shevardnadze's resignation speech); Charodetev, *The Minister's Decision is Final*, Izvestiya, Dec. 21, 1990, at 10, English summary reprinted in 42 CURRENT DIG. SOVIET PRESS, Jan. 30, 1991, at 14-16.

67. Richardson, *supra* note 64, at 7; ECONOMIST, Apr. 6, 1991, at 18 (Pavlov pushed aside decisive privatization in favor of worker management).

68. For Shatalin's own views on the recent history of economic reform, see S. Shatalin, *You Can't Use Evil to Fight Evil*, Komsomolskaya Pravda, Jan. 22, 1991, at 2, English translation reprinted in 43 CURRENT DIG. SOVIET PRESS, Mar. 6, 1991, at 1-4.

trying to become "a little pregnant."<sup>69</sup> While privatization has been an important issue,<sup>70</sup> the political process of economic reform reflected, and continues to reflect, a complicated interplay among personalities, self-interest, ideology, and perceptions of public opinion that have acted to prevent its implementation.

The dissolution of the old regime has opened new vistas for Ukrainians interested in profitable, private economic activity. For the first time, managers of state firms have to make many, and sometimes most, decisions about production, distribution, and marketing.<sup>71</sup> Forcibly freed from the frustrating security of administrative fiat, many state-owned businesses now make direct contacts with private parties to undertake these tasks. The newly legalized private cooperatives are gaining an increasing economic presence in Ukraine, numbering 13,895 in 1989.<sup>72</sup> Many cooperatives are contributing to the creation of a business lobby and to aspects of a business-enterprise culture. The activities of black marketeers also serve as a living example of an alternative economic system and dispel the view that private enterprise and initiative have been crushed from *homo Sovieticus*.<sup>73</sup> There are many examples of spontaneous private Ukrainian business initiatives inventively exploiting market opportunities. In Kiev, for instance, regulated taxis have been effectively supplanted by an informal private market in transportation services.<sup>74</sup>

Additionally, in Ukraine, economic reforms and *perestroika* have maintained their own momentum, drawing on the forces of Ukrainian nationalism. Historically, the Ukrainian economy has consistently represented about twenty percent of the Soviet economy, with a significantly higher contribution in agriculture, ferrous metals, and solid fuels, though a lower contribution in construction and transportation.<sup>75</sup> The Council of Ministers (Ukraine's executive branch of government) controls eleven planning and control ministries and

---

69. Popkova, *Where are the Pirogi Meatier?*, in PERESTROIKA AND THE ECONOMY: NEW THINKING IN SOVIET ECONOMICS, *supra* note 2, at 99, 100 (this became a catchphrase for the controversial position that there is no third way between socialism and capitalism).

70. Aslund, *The Making of Economic Policy in 1989 and 1990*, 6 SOVIET ECON. 65, 90-91 (1990). See also S. KUX, *supra* note 24, at 63 (political sensitivity of ownership issues and their relation to nationalism).

71. See, e.g., Gassanov, *Local Markets and Their Interaction with Big State-Run Enterprises*, in Conference Papers: Conference on Economic Reform in Ukraine (Ukrainian Research Institute, John F. Kennedy School of Government, Harvard University) (Nov. 13-15, 1990) (unpublished collection).

72. Tedstrom, *The Reemergence of Soviet Cooperatives*, in DILEMMAS OF SOVIET ECONOMIC REFORM, *supra* note 21, at 104, 122-28.

73. Grossman, *supra* note 50, at 83-85.

74. Despite cheap, frequent, and regular public metro, bus, and tram services, many Kievites now openly hitch car rides with strangers on the mutual and implicit understanding of a schedule of one to five rubles, depending on the length of the ride.

75. Cohn, *Economic Growth*, in THE UKRAINE WITHIN THE USSR: AN ECONOMIC BALANCE SHEET 67, 78 (I. Koropeckyj ed. 1977) (Ukraine's economic analogue in the United States is the Great Lakes region — Ohio, Michigan, Indiana, Illinois and Wisconsin). *Id.* at 67-69 (significance of Ukraine for the Soviet economy).

committees,<sup>76</sup> twenty-five regional executive committees,<sup>77</sup> as well as the five main economic departments at the republic level: Heavy Industry and Machine-Construction, Agro-Industrial, Construction, Transport and Communication, and Service Industries.<sup>78</sup> Each department contains a number of ministries, forty-five in total, and oversees a total of 116,647 enterprises, farms, municipal organs, and groups thereof.<sup>79</sup> The extent of the Ukrainian government's economic oversight is matched only by the extent of its economic problems.

The Ukrainian government's economic policy response is predominantly cautious, but occasionally daring. Progress to date is limited but, overall, moves have been in the general direction of a market-based economy. A recent proposal to streamline the administrative structure of the economy involves cutting the number of units in some levels of administration by over one-third, but this still leaves a large administrative apparatus intact.<sup>80</sup> There are reports that a stock exchange was set up in Kharkiv, that a Commodities Exchange is currently being established in Kiev, and that the Kiev City Executive Committee has sold eighty-eight new apartments after having had received 400 applications.<sup>81</sup> The most remarkable economic measure actually implemented so far was in November 1990, when Ukraine took the startling step of issuing a crude form of its own currency.<sup>82</sup> Designed mainly to limit non-Ukrainians' access to scarce goods and to curtail speculation, "coupons" were issued with Ukrainian wages and were required to be redeemed to purchase most consumer goods in short supply. The measure seems to have succeeded in stopping the panic-buying and hoarding that was rife in October 1990.<sup>83</sup>

---

76. The ministries and committees are: the State Committee on the Economy, State Committee on Prices, State Committee on Statistics, State Committee for Material and Technical Supplies, Ministry of Finance, State Arbitration Committee, Ministry of Justice, Public Prosecutor's Office, Ministry of Foreign Affairs, Ministry of Internal Affairs, and the Committee for State Security (KGB). 1 UKRAINIAN BUS. DIG., Jan. 22, 1991, at 6.

77. These regional economic committees supervise 141 City Executive Committees and 430 (rural) District Executive Committees. *Id.*

78. "[O]il, gas, chemical, and machine-building enterprises, however, are under All-Union -- i.e., the Kremlin's -- direct control." *Id.*

79. These consist of: Social Development, 82,441 (24 ministries and state committees), Agro-Industrial, 24,724 (four ministries and state committees), Heavy Industry, 3,680 (seven ministries and state committee), Transport and Communication, 3,039 (six ministries and state committees), and Construction 2,763 (four ministries and state committees). *Id.* at 7-8.

80. 1 UKRAINIAN BUS. DIG., Jan. 22, 1991, at 6-8.

81. Romanova, *Stake Your Claims Now*, BUS. USSR, Jan. 1991, at 42; Project on Economic Reform in Ukraine, Reform Update (Mar. 1, 1991); Trehub, *Perestroika and Social Entitlement*, in DILEMMAS OF SOVIET ECONOMIC REFORM, *supra* note 21, at 207, 225.

82. Keller, *Ukraine Introduces a Form of Currency*, N.Y. Times, Nov. 2, 1990, at 3, col. 4; 1 UKRAINIAN BUS. DIG., Dec. 15, 1990, at D3.

83. Gross sales receipts apparently fell by 1.8 billion rubles in the month following the introduction of coupons. Tsikova, *Ukraine Eliminates Panic Buying*, *Izvestiya*, Dec. 26, 1990, at 7, English summary, reprinted in 42 CURRENT DIG. SOVIET PRESS, Jan. 30, 1991, at 30.

## Privatization in Ukraine

The Supreme Soviet, pressured by *Rukh*, is currently discussing several more far-reaching aspects of a radical economic reform strategy. These discussions have spawned position papers prepared in October 1990 by the Committee of the Supreme Soviet on Economic Reform on the creation of a market economy, the denationalization of state property, and draft laws on privatization of state-owned property, banks, investment policy, and the financial system.<sup>84</sup> The position paper on denationalization and the draft law on privatization seem to suggest privatization of enterprises (except monopolies) by way of sale at market prices (30% to 40% of the shares of medium and large-sized enterprises) and at nominal cost to citizens (60% to 70% of the shares of medium and large-sized enterprises), with special privileges reserved for workers of the enterprise and their families.<sup>85</sup>

The problems inherent in the economic transformation that Ukraine is currently contemplating are, of course, enormous. The historical structure of the economy means that important skills and institutions of a market economy are lacking in Ukraine. Few concentrations of capital are available for commercial investment.<sup>86</sup> Capital markets in debt and equity as well as the popular understanding of the role of capital are very underdeveloped. Few people have the necessary skills for assessing a business, monitoring management in a competitive market environment, or making a financial valuation. The domestic private sector is dwarfed by the state sector, which is often deliberately structured in a monopolistic manner. Additionally, there are pervasive conflicts of interest among state bureaucrats who are often mainly interested in their own personal futures.

### C. Law

The issue of Soviet nationalism is manifested in the fundamental constitutional and legal conflict between the Constitutions of the USSR and Ukrainian SSR and the July 1990 Ukrainian Declaration of Sovereignty. The 1977 Constitution of the USSR, though allowing for the possibility of secession from the Union,<sup>87</sup> provides that union law has supremacy over republic law.<sup>88</sup> The

---

84. These draft laws can be found in Background Reading Material, *supra* note 10.

85. *Id.* See also Savchenko, *Privatization in Ukraine*, 1 UKRAINIAN BUS. DIG., Mar. 28, 1991, at 1, 10.

86. Despite the ruble overhang, most private accumulations of money have been very concentrated. See Feige, *Perestroika and Socialist Privatization: What is To Be Done? And How?*, 32 COMP. ECON. STUD. 1, 31 & n.33 (1990) (seven out of eight people have no savings).

87. KONST. SSSR art. 72, English translation reprinted in CONSTITUTIONS OF THE COUNTRIES OF THE WORLD, THE UNION OF SOVIET SOCIALIST REPUBLICS 31 (A. Blaustein & G. Flanz eds. 1990). In April 1990, the USSR Supreme Soviet passed legislation providing for complicated procedures (in 13 steps) for secession. See Hazard, *Gorbachev's Impact on the USSR Constitution*, in CONSTITUTIONS OF THE COUNTRIES OF THE WORLD, THE UNION OF SOVIET SOCIALIST REPUBLICS xv, xvii (A. Blaustein & G. Flanz eds. 1990).

1978 Constitution of the Ukrainian SSR acknowledges this supremacy.<sup>89</sup> This acknowledgment supports a conclusion that, domestically and internationally, Ukraine is not itself a state,<sup>90</sup> although that could conceivably change.<sup>91</sup> In practice, there was little controversy about such federalist arrangements while central government and party institutions controlled and resolved political issues. With the emergence of nationalism and pluralism under *glasnost* and *perestroika*, the question of the location of power has become a subject ripe for legal and political conflict and has led to a "war of laws."<sup>92</sup> In December 1988, a new Committee of Constitutional Supervision was established to deal with the legal implications of such problems.<sup>93</sup>

The declarations of sovereignty by a variety of Soviet Republics, including Ukraine, pose a direct challenge to the Union government's historical centralized control. The severity of the challenge is recognized by the April 1990 All-Union Laws that provide for a transition to substantial economic autonomy by 1991.<sup>94</sup> Several Republics are dissatisfied by this level of autonomy and want full ownership of economic resources, control of production facilities, independent budgets, control over banking, credit and money supply, and the recognition of inter-republic agreements.<sup>95</sup> Direct inter-republic cooperation adds to the pressure on the center. Ukraine has already signed protocols of intent with twelve other republics and has concluded intergovernmental agreements with five Republics, including the Russian SFSR.<sup>96</sup> These agreements, along with negotiations over a new union treaty, indicate the direction in which power is moving. However, the January 1991 crackdown in Lithuania and increased powers of the KGB to investigate economic activity<sup>97</sup> represent an important

---

88. KONST. SSSR art. 76, English translation *reprinted in* CONSTITUTIONS OF THE COUNTRIES OF THE WORLD, THE UNION OF SOVIET SOCIALIST REPUBLICS 32 (A. Blaustein & G. Flanz eds. 1990).

89. KONST. UK. SSR art. 71. *See also* KONST. UK. SSR art. 68 (voluntary nature of union by this "sovereign" republic with the republics). *See also supra* note 34 and accompanying text (agreement to make the Ukrainian Constitution consistent with the Declaration of Sovereignty).

90. T. Kis, *supra* note 13, at 28-34.

91. *Id.* at 72-74 (Ukraine has potential to become a state and that establishment of international diplomatic and consular relations would imply *de jure* recognition of international personality). In this regard, note that Germany and the United States have opened consulates in Kiev. 1 UKRAINIAN BUS. DIG., Feb. 22, 1991, at 1; 1 UKRAINIAN BUS. DIG., Jan. 22, 1991, at 11; 1 UKRAINIAN BUS. DIG., Mar. 28, 1991, at 2. One commentator has reported that Ukraine intends to become more active in the United Nations. S. KUX, *supra* note 24, at 71.

92. N.Y. Times, Apr. 10, 1991, at A9, col. 1 (characterization in Gorbachev's latest program of recovery).

93. Hausmaninger, *The Committee of Constitutional Supervision of the USSR*, 23 CORNELL INT'L L.J. 287, 289 (1990).

94. *Law on the USSR, Republic Economic Ties*, Izvestiya, Apr. 16, 1990, at 1-2, English translation *reprinted in* 42 CURRENT DIG. SOVIET PRESS, July 18, 1990, at 17-19; *Law on the Demarcation of the Powers of the USSR and the Members of the Federation*, Izvestiya, May 3, 1990, at 1-2, English translation *reprinted in* 42 CURRENT DIG. SOVIET PRESS, Jun. 13, 1990, at 23.

95. S. KUX, *supra* note 24, at 57-58.

96. 1 UKRAINIAN BUS. DIG., Dec. 15, 1990, at 8.

97. This occurred via the so-called "Yazov" Decree. *See* N.Y. Times, Mar. 5, 1991, at A4, col. 1.



setback to the apparent trend of economic decentralization. The conflict is essentially political. It reflects the new challenges of pluralism to the power of the central institutions of government and the Communist Party, which are no longer able to resolve such issues internally. Negotiations between Republics and the center continue on the formulation of a new union treaty.<sup>98</sup> Eventually, the issues of republic nationalism will be resolved either politically, through negotiation, or militarily, through a return to central repression or civil war.<sup>99</sup>

While the new constitutional order continues to emerge in response to politics, it also engenders uncertainty about the future of economic reform. The future location of power will determine the interpretation and validity of laws passed today. The effect of this uncertainty on economic reform is itself uncertain. Realism suggests that legal measures that are within the effective power of the Ukrainian government will have *de facto* effect, even if constitutionally dubious. It is on the margins of such effective power, where political conflict is most apparent, that economic reform will be most affected. A particularly significant area is the allocation of ownership of property between the USSR and the Republics.<sup>100</sup>

The traditional role of law in the Soviet economy has been to reinforce and facilitate the centralized administration of economic activity.<sup>101</sup> Indeed, there was a Soviet legal debate as to whether the aspects of law governing economic activity deserve status and codification as a separate body of law.<sup>102</sup> Law governed the nature and characteristics of property, which were fundamental to the Soviet economic system.<sup>103</sup> Law provided the formal mechanism by which planners micro-managed the activities of an enterprise and the relationships between enterprises. From 1965 to 1986, this direction became less focused as enterprise autonomy was enhanced with respect to planning,

---

98. A draft union treaty was released in late November 1990. *Draft: Union Treaty*, Pravda, Nov. 24, 1990, at 3, English translation reprinted in 42 CURRENT DIG. SOVIET PRESS, Dec. 26, 1990, at 14. Another was published in March 1991, but was immediately attacked by Boris Yeltsin, President of the RSFSR, and by four Republics, which declared they would not sign it. See Schmenann, *Moscow Publishes New Plan of Union*, N.Y. Times, Mar. 10, 1991, at A3, col. 1. In April 1991, a significant agreement was reached between Gorbachev and the leaders of nine Republics, including Ukraine, that recognized the necessity of negotiation among sovereign republics. N.Y. Times, Apr. 28, 1991, § 4, at 1, 3.

99. See, e.g., Brovkin, *The Politics of Constitutional Reform: The New Power Structure and the Role of the Party*, 23 CORNELL INT'L L.J. 323, 338-39 (1990); ECONOMIST, Apr. 6, 1991, at 17.

100. Maggs, *Constitutional Implications of Changes in Property Rights in the USSR*, 23 CORNELL INT'L L.J. 363 (1990).

101. Ioffe, *Law and Economy in the USSR*, 95 HARV. L. REV. 1591 (1982); see generally O. IOFFE & P. MAGGS, *THE SOVIET ECONOMIC SYSTEM: A LEGAL ANALYSIS* (1987).

102. See generally W. BUTLER, *supra* note 56, at 252-54; V. LAPTEV, *ECONOMIC LAW* (1987).

103. See generally G. ARMSTRONG, *THE SOVIET LAW OF PROPERTY: THE RIGHT TO CONTROL PROPERTY AND THE CONSTRUCTION OF COMMUNISM* (Law in Eastern Europe No. 26, 1983); see also Kulikov, *The Structure and Forms of Socialist Property*, in PERESTROIKA AND THE ECONOMY: NEW THINKING IN SOVIET ECONOMICS, *supra* note 2, at 217.

contracts, and legal personality; hierarchical control was exercised more through target-setting and plan-approval.<sup>104</sup>

The union-wide policy of *perestroika* has involved constitutional and legal changes.<sup>105</sup> The progressive relaxation of government involvement in private business is reflected in the laws from 1986 to 1990.<sup>106</sup> The 1986 law on individual labor activity allows, for example, the establishment of part-time, small-scale private family businesses.<sup>107</sup> The August 1988 guidelines for leasing enterprises limit the involvement of state authorities in the operation of a leased business.<sup>108</sup> The July 1988 All-Union Law on Cooperatives provides a remarkable vehicle for the organization of private businesses independent of the government, even though more recent decrees restrict some areas of activity and institute some price controls.<sup>109</sup>

Since November 1989, significant new All-Union laws and resolutions have been passed regarding leasing, ownership in general, land, business units in general, joint-stock companies, securities, a currency market, small business, an All-Union holding company, foreign investment, and banking.<sup>110</sup> In December 1989, the Congress of People's Deputies announced plans to create the structure for privatization by the summer of 1990,<sup>111</sup> a timetable which proved hopelessly optimistic. In February 1991, the State Commission on Economic Reform released to the media a draft Principles of USSR and Republic Legislation on the Destatization of Property and the Privatization of Enterprises.<sup>112</sup> It reportedly suggests the sale of enterprises to Soviet and foreign citizens and organizations at auction, with special privileges reserved for workers, credit extended to citizens, and a certain proportion given to the new owners free of charge.<sup>113</sup> However, the relationship between these draft principles and any future enacted All-Union legislation is nebulous and their relationship to Ukrainian policy even more so.<sup>114</sup>

104. W. BUTLER, *supra* note 56, at 245-52.

105. See generally Symposium, *Perspectives on the Legal Perestroika: Soviet Constitutional and Legislative Changes*, 23 CORNELL INT'L L.J. 187 (1990); THE IMPACT OF PERESTROIKA ON SOVIET LAW (A. Schmidt ed. 1990).

106. For a recent, comprehensive review of laws affecting businesses, see generally C. OSAKWE, *supra* note 60.

107. Tedstrom, *The Reemergence of Soviet Cooperatives*, in DILEMMAS OF SOVIET ECONOMIC REFORM, *supra* note 21, at 83-84.

108. *Id.* at 86-90.

109. *Id.* at 114-21.

110. Hanson, *supra* note 57, at 100-09; Maggs, *supra* note 100, at 368-73; 2 PARKER SCH. BULL. SOVIET & EAST EUR. L., Feb. 1991, at 5.

111. Maggs, *supra* note 100, at 369.

112. Zhagel, *Parting Words from L. Abalkin*, *Izvestiya*, Feb. 5, 1991, at 2, English summary reprinted in 43 CURRENT DIG. SOVIET PRESS, Mar. 6, 1991, at 26.

113. *Id.* (draft principles apparently released in conjunction with draft Law on Entrepreneurial Activity and draft Law on Demonopolizing the Economy).

114. These relationships are dependent on future political developments. It is worth noting that Mr. Abalkin, the then Deputy Prime Minister and Chairman of the State Commission on Economic Reform, stated at the release of the draft principles that he did not see a place for himself in the new cabinet. He

The vast majority of enterprises remain in state ownership, though the particular identities of the state bodies that own any particular enterprise is often difficult to establish.<sup>115</sup> Most productive property is still under the operative management and influence of a variety of union, republic, and city ministries and departments, executive committees of local soviets, planning agencies, committees, and various production associations.<sup>116</sup> The June 1987 Law on the State Enterprise (Association) conferred more operational freedom on enterprises, while rationalizing the planning apparatus.<sup>117</sup> Enterprise planning is now much less integrated with long-term state economic planning, but state organs still have significant legal and administrative power over several sorts of enterprise activities.<sup>118</sup> Contract law is supposed to be evolving from an administrative system of penalties for breach toward a system based on the recovery of damages for breach of contract.<sup>119</sup>

Many aspects of law are inadequate for the process of transformation and for the economic system it will create. Some aspects of western commercial exchange are simply not covered by any legal provisions, as the scope of individuals' economic activities outpace the tortured process of legal reform. Some aspects of the new laws oriented toward market behavior are ironically frustrated by the imposing legacy of the socialist economic system. For instance, assessing damages for breach of contract in a semi-reformed economic system may well induce more economic uncertainty than the previous system of administrative penalties.<sup>120</sup> New laws are often vaguely drafted, either to cover political compromise or disagreement,<sup>121</sup> or simply due to the evolution of new legislative drafting procedures.<sup>122</sup> In such cases, it is difficult to determine legality in particular circumstances.<sup>123</sup> New laws may also be inconsistent with other laws, new or old, and may not be publicly available. Laws frequently lack the necessary provision for implementation and administration.

---

cited missed opportunities for economic reform and called for the preservation of the State Commission under the new cabinet. *Id.*

115. A working group of republic representatives on the division of property was reported as being established by the USSR Council of Ministers. Zhagel, *On the Topic of the Day: Own, Possess and Use*, *Izvestiya*, July 2, 1990, at 1, English summary reprinted in 42 CURRENT DIG. SOVIET PRESS, Aug. 1, 1990, at 20. The problem is essentially political.

116. W. BUTLER, *supra* note 56, at 180-88. Ioffe, *Soviet Law and the New Economic Experiment*, in SOVIET LAW AND ECONOMY 3, at 22-28 (O. Ioffe & M. Janis eds. 1987).

117. Hazard, *Gorbachev's Vision for the State Enterprise*, in THE IMPACT OF PERESTROIKA ON SOVIET LAW, *supra* note 105, at 192.

118. W. BUTLER, *supra* note 56, at 255-60; D. LANE, *supra* note 22, ch. 2.

119. Kroll, *Reform and Damages for Breach of Contract in the Soviet Economy*, 5 SOVIET ECON. 276 (1989).

120. *Id.* at 294.

121. Kurashvili, *Restructuring and the Enterprise*, in PERESTROIKA AND THE ECONOMY: NEW THINKING IN SOVIET ECONOMICS, *supra* note 2, at 21, 27-28.

122. Belousovitch, *The New Soviet Parliament: Process, Procedures, and Legislative Priority*, 23 CORNELL INT'L L.J. 275, 280-81 (1990).

123. Roucek, *supra* note 37, at 47-48.

Drafters seemingly envisage that exhortatory statements of policy will ensure compliance with laws that in fact require government establishment of administrative institutions or procedures. The Ukrainian currency issuance in November 1990 provides one example. In addition to the economic problems of this measure, the issuance revealed inadequate attention to necessary administrative institutions and procedures and the potential for corruption. These inadequacies are characteristic of the new Soviet law, but there are some reports that the quality and availability of economic legislation are improving.<sup>124</sup>

Perhaps surprisingly to a western lawyer, law is largely irrelevant to much of the current economic activity in Ukraine. The concept of the rule of law that underlies all western economic behavior is still missing, despite an official embrace of the concept.<sup>125</sup> Business people and bureaucrats are accustomed to most economic activity being directed by administrative discretion and fiat. Officials at different levels continue to use their legal powers to direct economic activity.<sup>126</sup> For example, there are reports that officials have ignored, opposed, and sabotaged the operation of leased enterprises and cooperatives.<sup>127</sup> Yet, other laws are simply disregarded and unenforced. An official who does not like a particular law may not enforce it. One Soviet commentator has referred to this bureaucratic attitude as "legalized lawlessness."<sup>128</sup> *Gosarbitrazh*, the state commercial arbitration agency, reportedly refused to handle disputes involving the rights of state enterprises to reject state orders.<sup>129</sup> The traditional, centralized, bureaucratic levers for controlling economic behavior (i.e., criminal law, directives, material incentives, and moral incentives), are not suited to government activities in a market economy.<sup>130</sup> Corruption, patronage, and the networks of the second economy induce further arbitrariness in official behavior.<sup>131</sup> Indeed, one commentator characterizes the operation of the second economy as developing a system of informal private property

---

124. Papachristov, *An Evolving Legal Culture*, BUS. USSR, Jan. 1991, at 58 (laws have become more consistent and comprehensive over time); Butler, *Modern Patterns of Law Reform in the Soviet Union*, in THE IMPACT OF PERESTROIKA ON SOVIET LAW, *supra* note 105, at 47 (regarding improvements in codification processes and substance).

125. Quigley, *The Soviet Union as a State Under the Rule of Law: An Overview*, 23 CORNELL INT'L L. J. 205 (1990).

126. *But see* Quigley, *The New Soviet Law on Appeals: Glasnost in the Soviet Courts*, 37 INT'L COMP. L. Q. 172 (1988); and Quigley, *supra* note 125, at 216 (regarding the Law on Appeals, allowing citizens to seek judicial review of illegal bureaucratic decisions).

127. *Leasing and Cooperatives Play Important Role in Denationalization of Property in USSR*, 1 PARKER SCH. BULL. SOVIET & EAST EUR. L., Nov. 1990, at 8.

128. Yakovlev, *Perestroika or the "Death of Socialism"*, in VOICES OF GLASNOST: INTERVIEWS WITH GORBACHEV'S REFORMERS, *supra* note 22, at 33.

129. Kroll, *Property Rights and the Soviet Enterprise: Evidence from the Law of Contract*, 13 J. COMP. ECON. 115, 130 (1989).

130. Orland, *Perspectives on Soviet Economic Crime*, in SOVIET LAW AND ECONOMY, *supra* note 116, at 169, 206-11 (criminal sanctions for economic activity may have involved little enforcement and were mainly important as mechanisms for political control). P. JOHNSON, REDESIGNING THE COMMUNIST ECONOMY: THE POLITICS OF ECONOMIC REFORM IN EASTERN EUROPE 142-43 (1989).

131. *See* Grossman, *supra* note 50.

## Privatization in Ukraine

rights supported by customary norms of the Soviet underground networks and corrupt patronage throughout officialdom.<sup>132</sup> While such influences may work in the direction of economic freedom, they have also encouraged a widespread disrespect and disregard for the rule of law.<sup>133</sup> Many Ukrainian business people believe that any law could go unenforced, depending on the inclination and political judgments of a relevant official at any level. This leads to tremendous uncertainty for business decisions and to corruption and arbitrariness in government. The substantive content of Ukrainian law today does not yet accord with western understandings of the role of law in a market economy.

### D. Summary

The above three sections provide background information about the politics, economy, and law in Ukraine. They provide the context in which any program for privatization must operate and the factors that must be taken into account in the formulation of a program. There are clearly large political, economic, and legal impediments to formulating and implementing a program of privatization in Ukraine. That is true of all the reforms necessary for the transformation of the Ukrainian economic system. At the same time, a substantial political, economic, and legal momentum has gathered force in the direction of some such transformation. To undertake such a transformation requires a coherent integrated strategy and as much information and advice as are available.<sup>134</sup> The intertwining political, social, cultural, economic, and legal aspects of reform in Ukraine mean that the occurrence and nature of the transformation must be determined by Ukrainians.

## III. PRIVATIZATION

### A. Context: Moving to a Market Economy

Privatization only makes sense in an economy based on market principles which is fundamentally different from the traditional Soviet economic system.<sup>135</sup> In essence, the general preconditions for the existence and proper

---

132. *Id.* at 81-82. *See also id.* at 85 (vested interests in the second economy opposed legalization of freer economic activity to protect their own positions).

133. *Id.* at 86.

134. *See, e.g.*, Memorandum from Graham Allison of Harvard University, Joseph C. Bell of Hogan & Hartson, Henry Hansmann of Yale Law School, and William Hogan of Harvard University, to City Council of Kiev (June 22, 1990) (discussing strategy for the transition to a market economy), in Background Reading Material, *supra* note 10; W. Hogan, J. Bell, J. Hewko, & C. Kedzie, Conceptual Framework for the Creation of a Market Economy in Ukraine (Oct. 10, 1990) (unpublished manuscript), in *id.*

135. *See* K. SCHENK, *NEW INSTITUTIONAL DIMENSIONS OF ECONOMICS: COMPARATIVE ELABORATION AND APPLICATION* (1988) (examining behavioral and economic consequences of different directory, regulatory, and commercial economic systems).

functioning of a market economy can be seen not as rules dictating behavior, but rather as the absence of such rules. These preconditions include: the freedom for anyone to own property, to buy and sell goods and services at freely negotiated prices, and to establish a business organization. They also include: the freedom for any firm to enter any market, to decide what to produce, how much to produce, whom to employ, what prices to ask, and whether to spend or keep the business profits earned.<sup>136</sup>

Market prices function as signals to producers about what production and marketing decisions to make. Individual producers are motivated by their own positive and negative incentives. It is not necessary that producers or consumers understand the conceptual basis of a market economy.<sup>137</sup> Instead, they merely have to respond to the incentives created. In theory, these incentives, and the operation of prices that are formed by free markets, induce people and firms to act efficiently. A market economy is made up of the interactions of many such individuals, groups, firms, and other organizations. They freely transact with each other to produce and distribute the goods and services used by society as a whole. Overall, through freely and individually negotiated prices, such production and distribution should efficiently respond to consumers' demands and to producers' constraints.

It is impossible to understand a market economy without first understanding its legal framework. Through creating and enforcing property rights, law provides the basic building blocks of an economy. Laws regarding securities, business organizations, labor relations, and commercial transactions facilitate the establishment and operation of different kinds of businesses. Law may also limit anticompetitive behavior to protect free market competition; it may also serve as the vehicle for government impositions on business (e.g., in the form of taxes). Most importantly, however, law in a market economy should guarantee and define market freedoms while protecting the public from market manipulation. It should not attempt to enforce economic efficiency by prescribing or enforcing efficient behavior for people or firms. In this respect, the importance of freedom in western economies means that the role of economic law is very different than it has been in the USSR. Laws should be clear in their meaning and in the procedures by which they are interpreted and applied. Laws guarantee market freedom by assuming that any activity is allowed unless there is a law forbidding it.

The importance of freedom to the economics of market behavior means that both law and politics are important influences on a market economy. The ability of a government to interfere with any private market transactions of its

---

136. For the list of freedoms upon which this list was based, see J. KORNAI, *THE ROAD TO A FREE ECONOMY: SHIFTING FROM A SOCIALIST SYSTEM: THE EXAMPLE OF HUNGARY* 39-40 (1990).

137. For factual support of this assertion in the form of a comparative survey of popular attitudes toward free markets, see R. SHILLER, *supra* note 39.

citizens is second-nature to Ukrainians, but inimical to market activity. If a government is willing to use its power to interfere, the incentives of individual market participants become distorted, as they try to predict the nature and extent of government interference. In the extreme, individual incentives become vitally bound up with government preferences and actions. Economic activity comes to be effected by administrative fiat, and the ordinary provisions of law become irrelevant -- a mindset with which Ukrainians have become familiar.

It is thus clear that the political, social, and cultural climate is important to the efficient functioning of a market economy. Factors that affect the likelihood of arbitrary government interference in individual market transactions affect the functioning of a market economy. These include the nature and stability of constitutional arrangements, democratic principles, and of the ideologies of those in government and in the public at large. Even stable, democratic western governments with long-established free enterprise cultures are often tempted to intervene in economic activities by providing special subsidies, or by imposing special taxes or tariffs on certain industries (e.g., agriculture). These may be politically popular, but most economists generally regard them as distorting the price signals generated by the free market, thereby reducing economic efficiency in the long run.

On the other hand, a government in a market economy does not abdicate its power to address social concerns,<sup>138</sup> though such a perspective has been implied by a Soviet economist, presumably for rhetorical purposes.<sup>139</sup> Economists themselves recognize justifications for the existence of government actions. These include addressing market failure through production of public goods and the correction of externalities.<sup>140</sup> Social equity considerations provide a redistributive justification for government activity.<sup>141</sup> Social policies may be advanced through the personal income tax system, the government purchase or provision of social services, and through a social welfare system charged with allocating resources to those people the government identifies as most in need. Western nations differ in the extent to which their governments provide such services and the methods by which they are provided. Ukrainians

---

138. See Priest, *Introduction: The Aims of Privatization*, 6 YALE L. & POL'Y REV. 1 (1988).

139. Schmelyov, *The Rebirth of Common Sense*, in VOICES OF GLASNOST: INTERVIEWS WITH GORBACHEV'S REFORMERS, *supra* note 22, at 140, 151-52 (stating, then qualifying "Shmelyov's Law" as "[e]verything that is economically inefficient is immoral and everything that is economically efficient is moral").

140. See, e.g., D. MUELLER, PUBLIC CHOICE II: A REVISED EDITION OF PUBLIC CHOICE 9-12 (1989). Public goods are goods that can be provided to an additional consumer at no cost (i.e., with a marginal cost of zero). Examples include a society's legal system of property rights and enforcement procedures, as well as such services as national defense, and police and fire protection services. Externalities include environmental or other effects of economic activity that are not reflected in market pricing.

141. *Id.* at 37-39.

must choose their own preferred degree of emphasis on social welfare. But the means selected should not disrupt productive efficiency.

### B. *Theory: Reasons for Privatization*

It is obvious from the above description of a market economy that many related reforms have to be formulated and implemented if market principles are to be constituted as the basis of the Ukrainian economy. Privatization, in the sense of "de-governmentalization,"<sup>142</sup> is one aspect of this overall program. This article focuses on the privatization of productive property that is currently owned by the state and not on the broader meaning of privatization, defined as: "the act of reducing the role of government, or increasing the role of the private sector, in an activity or the ownership of assets."<sup>143</sup> This article is concerned only with property or resources that are used for commercial production rather than, for example, residential property. It is important to distinguish between three related concepts: the existence of private property, the existence of private ownership of enterprise, and the transfer of state ownership of enterprise to private hands. Only the last of these concepts constitutes privatization in the sense used in this article, though it is predicated on the other two concepts.

#### 1. *Private Property*

Private ownership of property is a vital element of market economies, and it illustrates the importance of market freedom.<sup>144</sup> "Property rights in fact measure the degree of the holder's liberty; the amount of property together with the rights, the degree of his power."<sup>145</sup> Using a western conception of private property rights implies a different relationship between the collective and individuals<sup>146</sup> than does a Soviet legal conception of property.<sup>147</sup> Two main elements of private property can be distinguished: the right to receive

---

142. This translates as *razgosudarstvleniye*, a horrible term that elucidates the meaning of privatization for Ukrainians.

143. E. SAVAS, *PRIVATIZATION: THE KEY TO BETTER GOVERNMENT* 3 (1987). In addition to transfer of government property, this broader definition includes: the contracting out by government to the private sector for any specific good or service that it wants produced; the distribution of vouchers as entitlement for needy citizens to buy certain goods and services; the charging of user fees for government services; and the deregulation of industry. See D. LINOWES, *PRIVATIZATION: TOWARD MORE EFFECTIVE GOVERNMENT - REPORT OF THE PRESIDENT'S COMMISSION ON PRIVATIZATION* 1-2 (1988).

144. C. VELJANOVSKI, *SELLING THE STATE: PRIVATISATION IN BRITAIN* 77-92 (1987).

145. Nutter, *Markets Without Property: A Grand Illusion*, in *THE ECONOMICS OF PROPERTY RIGHTS* 217, 221 (E. Furubotn & S. Pejovich eds. 1974).

146. On the importance of property in encapsulating the inherent tension between the individual and the collective, see Underkuffler, *On Property: An Essay*, 100 *YALE L.J.* 127 (1990).

147. See, e.g., Pejovich, *Towards a General Theory of Property Rights*, in *THE ECONOMICS OF PROPERTY RIGHTS*, *supra* note 145, at 341.



the profits made from the use of the property, and the right to control the use and transfer of the property.<sup>148</sup> These rights of ownership allow and encourage individuals to respond efficiently to market incentives. The informal system of property rights developed in the second Soviet economy mirrors many aspects of western conceptions of property, but is based on more arbitrary enforcement mechanisms with less social legitimacy.<sup>149</sup>

Private property rights are also important with respect to productive organizations. In western economies, the primary form of business organization is the limited liability, investor-owned company. The two main differences between privately and publicly-owned enterprises are the existence in private enterprises of freely transferable property rights in the residual claim and differences in institutional goals.<sup>150</sup> Sometimes, governments in market economies own productive enterprises in order to control the behavior of a monopoly, provide a good or service that the free market does not provide (because of market failure), or to achieve redistributive aims. Recently, however, there has been an international trend toward privatization in which governments sell their ownership of productive enterprises. "[Privatization] involves the transfer and redefinition of a complex bundle of property rights which creates a whole new penalty/reward system which alters a firm's incentives as well as its performance."<sup>151</sup>

### 2. Privatization in a Market Economy

Western economic literature contains several arguments for and against the privatization of government-owned enterprises in a predominantly market economy. The efficiency arguments for privatization are most convincing when they focus on the incentives of private owners and managers compared with the incentives of government departments and politicians.<sup>152</sup> The motive of private shareholders of a private business is usually profit maximization, which provides incentives for the business to be managed more efficiently than when the government is owner. The political motives of politicians and the ease with which they can interfere with the management of a government-owned enter-

---

148. See Hansmann, *Ownership of the Firm*, 4 J. L. ECON. & ORG. 267 (1988). Cf. Schroeder, *Property Rights Issues in Economic Reforms in Socialist Countries*, 21 STUD. COMP. COMMUNISM 175, 176 (1988) (accepting ownership and control as fundamental aspects of property rights).

149. See Grossman, *supra* note 50, at 81-82.

150. Cass, *Privatization: Politics, Law, and Theory*, 71 MARQ. L. REV. 449, 481-85 (1988).

151. Veljanovski, *Privatization in Britain -- the Institutional and Constitutional Issues*, 71 MARQ. L. REV. 558, 570 (1988).

152. See, e.g., Sappington & Stiglitz, *Privatization, Information and Incentives*, 6 J. POL'Y ANALYSIS MGMT. 567 (1987); De Alessi, *On the Nature and Consequences of Private and Public Enterprises*, 67 MINN. L. REV. 191 (1982) (incentive structures of public and private enterprises); McPetridge, *The Efficiency Consequences of Privatization*, in PAPERS ON PRIVATIZATION 109 (W. Stanbury & T. Kierans eds. 1985).

prise do not often provide such efficiency-promoting incentives.<sup>153</sup> Consequently, many government organizations tend to be inhibited by inflexible and commercially inappropriate bureaucratic rules concerning the payment of workers and the acquisition of equipment. They also tend to face "soft" budget constraints in that if government-owned businesses lose money, they can usually get more from the government. This contrasts with the commercial discipline of financial markets for a privately-owned enterprise. There are several established market practices and institutions for reducing the agency costs between principal-owners and agent-managers in a privately-owned firm.<sup>154</sup> Commercial discipline comes from the monitoring of an enterprise by those who lend money to the firm, by the firm's owners, and from the threat of takeover by another enterprise if efficiency, and therefore share price, falls significantly. Privatization could thus theoretically yield efficiency gains.<sup>155</sup>

Supporters of government ownership argue that the government can try to duplicate private sector incentives.<sup>156</sup> It seems theoretically possible to substantially improve the efficiency of state-owned enterprises by structuring them in a commercial manner, providing them with clear and consistent goals, allowing management to have substantial operational autonomy, access to private financial markets, and establishing a monitoring regime over their operations.<sup>157</sup> Indeed, the New Zealand government followed this course during the late 1980s,<sup>158</sup> and has apparently succeeded in improving the efficiency of government-owned enterprises. However, the question then arises as to why the government wants to own such commercially-oriented enterprises. More importantly, the efficiency of these enterprises is still directly dependent on the political environment at any given moment. The political value of efficiency in government-owned enterprises, the amount of information that is publicly available about these enterprises, and the competitiveness of the

153. Sappington & Stiglitz, *supra* note 152; Zeckhauser & Horn, *Control and Performance of State-Owned Enterprises*, in *PRIVATIZATION AND STATE-OWNED ENTERPRISES: LESSONS FROM THE UNITED STATES, GREAT BRITAIN AND CANADA* 7-57 (P. MacAvoy, W. Stanbury, G. Yarrow & R. Zeckhauser eds. 1989); Eckel & Vermaelen, *Internal Regulation: The Effects of Government Ownership on the Value of the Firm*, 29 J. L. & ECON. 381 (1986).

154. See generally Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); *Corporations and Private Property: A Conference Sponsored by the Hoover Institution*, 26 J. L. & ECON. 235 (1983).

155. Caves, *Lessons from Privatization in Britain: State Enterprise Behavior, Public Choice, and Corporate Governance*, 13 J. ECON. BEHAV. & ORG. 145 (1990).

156. See, e.g., Lange, *On the Economic Theory of Socialism* (pts. 1 & 2), 4 REV. ECON. STUD. 53, 123 (1936-37) (classical efficiency justification for socialist ownership).

157. See, e.g., M. HARIRIAN, *STATE-OWNED ENTERPRISES IN A MIXED ECONOMY: MICRO VERSUS MACRO ECONOMIC OBJECTIVES* (1989); Deane, *Public Sector Reform: A Review of the Issues*, in *PURPOSE PERFORMANCE AND PROFIT: REDEFINING THE PUBLIC SECTOR* 12 (Studies in Public Administration No. 32, M. Clark & E. Sinclair eds. 1986); Palmer, *Directions for State Enterprise*, in *id.* at 25.

158. THE TREASURY, *BRIEFING TO THE INCOMING GOVERNMENT* 89-90 (1990); Palmer, *The State-Owned Enterprises Act 1986: Accountability?*, 18 VICTORIA U. WELLINGTON. L. REV. 169 (1988).

political environment all influence whether a government will continue to refrain from interfering in the operations of an enterprise.

This article suggests that if there are no social goals for which a government needs to own enterprises, and most social goals are better achieved through other means, then it is better to privatize enterprises that operate in competitive markets. Competition is the important caveat. Most western analysts consider the competitive structure of an industry to have more of an impact on efficiency than on the question of ownership.<sup>159</sup> Where an industry is monopolistic, the advantages of private ownership are much more disputable. The question of the best methods to regulate monopolies is much debated in western economic theory, but government-ownership is one of the options.

Another argument for privatization, often used by governments in predominantly market economies, concerns the government's own financial position. Privatization by sale produces money that governments can use to reduce a budget deficit. Although superficially attractive, such a sale contains an economic problem that: the price a government gets for an enterprise should be equivalent to the discounted net present value of the expected future net earnings from the enterprise were the enterprise to remain under government control.<sup>160</sup> Making money on a sale requires the enterprise to be worth more in private than in government hands. In summary, if privatization of an enterprise by sale is to positively affect the government's financial position, then the government should try to ensure that: the proceeds from privatization are used to repay debt rather than finance current spending; the rate of interest of the debt that is able to be repaid is more than the rate of future income from the enterprise; and finally that the enterprise is more profitable in private ownership than government ownership, and the government captures some of this extra profitability in the sale's price.<sup>161</sup> Privatization can also be justified on the grounds of reducing debt if a government's total debt position is unsustainable, or if the macroeconomic effects of high government debt are considered undesirable.

In market economies debt reduction is, in general, an unconvincing argument for privatization of government enterprises, and the efficiency justification is primarily driven by the effects of political interference on commercial business operations. The most difficult conceptual task is in determining which

---

159. See generally PRIVATISATION AND COMPETITION: A MARKET PROSPECTUS (C. Veljanovski ed. 1989); Yarrow, *Privatization in Theory and Practice*, 1 *ECON. POL'Y* 324-25, 373-75 (1986); Hemming & Mansoor, *Privatization and Public Enterprises*, INTERNATIONAL MONETARY FUND OCCASIONAL PAPER No. 56, 12 (1988).

160. See, e.g., Heller & Schiller, *The Fiscal Impact of Privatization, With Some Examples from Arab Countries*, 17 *WORLD DEV.* 757, 758-59 (1989).

161. See Mansoor, *The Fiscal Impact of Privatisation*, in *PRIVATISATION IN LESS DEVELOPED COUNTRIES* 180 (P. Cook & C. Kirkpatrick eds. 1988).

activities should lie within the government's purview, and which of those should be undertaken through ownership of an enterprise.<sup>162</sup>

### 3. *Privatization in Ukraine*

In some ways the conceptual justification for privatization is easier in Ukraine, where the government owns most of the productive property. The most important engines of growth in a newly-marketized economy may be new firms set up and developed under market conditions.<sup>163</sup> However, in moving to a market economy in Ukraine, it will not be sufficient to simply allow new private organizations to emerge and dominate price-setting and hence resource allocation in the Ukrainian economy. While the growth of cooperatives has been rapid, the time necessary for such a transformation to occur on its own would be substantial. Continuing economic difficulties over such a period, and the social and political consequences, could well stifle the whole program of reform.

Furthermore, for the political reasons presented in Part II, it is inconceivable that the Ukrainian economic apparatus of government could be reformed so as to provide effective efficiency incentives for state-owned enterprises. In Ukraine, the temptation for politicians, steeped in government interference, to interfere with productive enterprises would prove too great. It also would be too difficult to isolate state-owned enterprises from political pressures.<sup>164</sup> Because of the dominance of these enterprises and property, this would negatively affect the functioning of the entire Ukrainian economy. Furthermore, the current breakdown in hierarchical government authority in Ukraine means that it would probably be difficult to prevent privatization from occurring in one form or another.

At the level of general principle, it seems clear that, in order for market principles to have their greatest beneficial effect on the production and distribution of goods and services, control of most productive property should be exercised by individuals rather than by the government.<sup>165</sup> This is best guaranteed by transferring ownership of state property in the western sense to non-governmental organizations, groups and individuals, and by privatizing existing productive state property. By allowing individual firms and people to control most Ukrainian productive property in order to produce and distribute goods and services in free markets, privatization would set the basis for a market

---

162. See Chamberlin & Jackson, *Privatization as Institutional Choice*, 6 J. POL'Y ANALYSIS MGMT. 586 (1987).

163. See, e.g., Wash. Post, Mar. 29, 1991, at F3, col. 1 (western economists' doubts on Eastern European policymakers' emphasis on privatization of existing enterprises).

164. See, e.g., Campbell, *supra* note 21, at 9.

165. *Id.* at 18.

economy. Privatization is the logical extension of relying on the beneficial incentives of market forces. "[T]here is a strong logic that leads from market-socialist reforms to reforms of ownership."<sup>166</sup> Privatization should not be the first element of the transformation to a market economy, nor should it be the most important. But it should involve the most major restructuring of existing property relationships of any of the elements of reform. The issue of privatization must be addressed, and it is fundamental to the shape of the overall strategy of transformation.

### C. *International Experience*

#### 1. *Overview*

By 1988, privatization of state-owned enterprises had been, or was in the process of being, implemented by a variety of methods in a large and diverse range of countries. Methods of full privatization have included the following: public offerings, private sales, sales of assets, fragmentation, and employee or management buy-outs.<sup>167</sup> The nations that use these methods include: twenty-three nations in Sub-Saharan Africa, eleven nations in Asia, five Pacific countries, two nations in North America, eleven nations in Latin America and the Caribbean, and seventeen nations in Western Europe, the Middle East and North Africa. Enterprises have been privatized in the following sectors: agriculture/agri-business, oil/mining, manufacturing, transportation, tourism, infrastructure/construction services, public services and utilities, finance, and retail/trading.<sup>168</sup>

There is also a range of rationales for privatization.<sup>169</sup> Several nations have wished to improve efficiency through private ownership, while others have wanted to reduce budget deficits or the amount of government resources flowing to enterprises. Other states have pursued macroeconomic objectives, such as instilling confidence in the economy or creating competitive financial markets. Political ideology and popularity have dominated privatizations in some countries. The assessment of these privatization programs continues. Present thinking, however, indicates that there are attractive arguments for

---

166. Hanson, *Ownership Issues in Perestroika*, in *DILEMMAS OF SOVIET ECONOMIC REFORM*, *supra* note 21, at 65, 71-73. Cf. Bajt, *Property in Capital and in the Means of Production in Socialist Economies*, 11 *J. L. & ECON.* 1, 4 (1968) (reversing this logic to the effect that taking enterprise independence seriously implies private ownership rights in firms).

167. C. VUYLSTEKE, 1 *TECHNIQUES OF PRIVATIZATION OF STATE-OWNED ENTERPRISES: METHODS AND IMPLEMENTATION* annex E (World Bank Technical Paper No. 88, 1988); R. CANDY-SEKSE, 3 *TECHNIQUES OF PRIVATIZATION OF STATE-OWNED ENTERPRISES: INVENTORY OF COUNTRY EXPERIENCE AND REFERENCE MATERIALS* (World Bank Technical Paper No. 90, 1988).

168. C. VUYLSTEKE, *supra* note 167; R. CANDY-SEKSE, *supra* note 167.

169. Vernon-Wortzel & Wortzel, *Privatization: Not the Only Answer*, 17 *WORLD DEV.* 633, 635 (1989); Holle, *Privatization - A Global Perspective*, 4 *PRIVATIZATION REV.* 6 (1988).

privatization of businesses facing competition, while the arguments for privatization of monopolies are more tenuous.

There are no completed precedents for privatization as an element of fundamental transformation to a market economy. Ukrainians should closely watch the developing experience of other Soviet Republics and Eastern European countries.<sup>170</sup> The example of Poland is discussed below. Many former large, East German enterprises are being rapidly privatized in Germany, though the program faces significant economic and political obstacles.<sup>171</sup> Czechoslovakia has already made some progress in privatizing small businesses and, though with less consensus, is turning its attention to developing a strategy for privatization of large-scale enterprises using vouchers.<sup>172</sup> Hungary has established a framework for privatization by competitive bidding. In September 1990, the Hungarian government announced an initial list of twenty enterprises for privatization and, in December 1990, invited more volunteers.<sup>173</sup>

The World Bank has assisted many developing countries in the consideration of privatization and actively promotes it as a useful policy option.<sup>174</sup> Some of the constraints and complications are similar to those faced by Ukraine -- especially the fragile nature of democracy, the political importance of the identity of those who acquire property, and the lack of developed economic, legal, and institutional infrastructures for a market economy.<sup>175</sup> Some of these aspects are outlined below, using the experience in Chile.

This article examines five case studies of privatization from around the world. Each is chosen for its illustration of a particular strategy of privatization that is potentially available to Ukraine. The case studies are treated in reverse order of importance with those most relevant to the circumstances of Ukraine appearing last. The following order is used: New Zealand, Great Britain, British Columbia (Canada), Chile, and Poland. Together they provide a good

170. It is important that the Ukrainian government establish reliable channels of information about government measures. Unfortunately, communication tends to be fragmentary and *ad hoc*. My experience suggests that western advisers often seem to know more about ideas and proposals in other Eastern European nations, and even in other Soviet Republics, than do Ukrainian policymakers.

171. N.Y. Times, Mar. 12, 1991, at A1, col. 5; N.Y. Times, Mar. 19, 1991, at D5, col. 4 (1,000 of 8,000 businesses already have been sold).

172. *Czechoslovakia: The Scenario for Privatization*, 1 PARKER SCH. BULL. SOVIET & EAST EUR. L., Oct. 1990, at 5; N.Y. Times, Jan. 27, 1991, at A10, col. 1; N.Y. Times, Feb. 27, 1991, at A17, col. 1; *Czechoslovak Privatization: An Intermezzo*, 1 PARKER SCH. BULL. SOVIET & EAST EUR. L., Jan. 1991, at 5.

173. 1 PARKER SCH. BULL. SOVIET & EAST EUR. L., Nov. 1990, at 4; Blata, *Hungary Invites Privatization Bids*, 2 PARKER SCH. BULL. SOVIET & EAST EUR. L., Feb. 1991, at 3.

174. Mosley, *Privatisation, Policy-Based Lending and World Bank Behavior*, in PRIVATISATION IN LESS DEVELOPED COUNTRIES, *supra* note 161, at 125 (analyzing and disputing popular stereotype of World Bank as engaged in privatization crusade); Nellis & Kikeri, *Public Enterprise Reform: Privatization and the World Bank*, 17 WORLD DEV. 659, 664-71 (1989).

175. See generally Berg, *The Role of Divestiture in Economic Growth*, in PRIVATIZATION AND DEVELOPMENT 23 (S. Hanke ed. 1987).

## Privatization in Ukraine

range of examples of privatization options. It must be remembered that these programs were developed in the context of the particular political, economic, and legal circumstances of each nation. Of particular relevance to Ukraine are the objectives pursued through privatization and the potential characteristics of a privatization program.

### 2. New Zealand

New Zealand's privatization program was developed in 1988 and has been substantially implemented since then.<sup>176</sup> The following assets have been sold by the government to the private sector: forty-two exotic forests for commercial use, the dominant telecommunications company, an insurance company, the largest domestic savings bank, the largest domestic lender of farm mortgages, one of the largest domestic merchant banks, an international and domestic airline, an oil and gas company, a tourism and hotel company, a partial interest in the largest domestic steel company, a printing company, a computing company, irrigation schemes, and a shipping company. Almost US\$6 billion have been raised so far.<sup>177</sup>

In 1986, the New Zealand government embarked on a policy of "corporatization" -- turning state trading departments into commercially-structured enterprises with as many incentives for commercial efficiency as are consistent with preserving government ownership.<sup>178</sup> This policy proved to be important for privatization. The difficult restructuring separated state-owned enterprises from government labor and procurement procedures and laws, and made later sales to the private sector much easier.

New Zealand's privatization program is notable for its relatively strict concentration on one objective -- the maximization of revenue from the sale of assets to repay government debt.<sup>179</sup> New Zealand's ratio of public debt to gross domestic product was one of the highest in the Organization for Eco-

---

176. Much of the personal perspective in this section is influenced by my experience in implementing privatization, as an Investigating Officer in the New Zealand Treasury. Nothing herein is to be taken to represent the views of the New Zealand Treasury. See also Williams, *The Political Economy of Privatization*, in *THE FOURTH LABOUR GOVERNMENT: POLITICS AND POLICY IN NEW ZEALAND* 140 (M. Holland & J. Boston eds. 1990) (economic and political critique of privatization in New Zealand). For a legal perspective, see M. TAGGART, *CORPORATISATION, PRIVATISATION AND PUBLIC LAW* (Legal Research Foundation Publication No. 31, 1990).

177. The New Zealand Treasury forecasts that over NZ\$9.5 billion will be raised by June 30, 1991. *THE TREASURY*, *supra* note 158, at 67.

178. Palmer, *supra* note 158, at 171.

179. The government has also cited other complementary reasons why privatization is important: 1) for government management reasons -- ministers are not good owners of businesses; 2) to avoid the potential for future calls from the businesses for government cash; 3) to minimize the government's risk exposure in the business sector of the economy; and 4) to enable ministers to concentrate on matters of economic and social policy. HON. R.O. DOUGLAS, *BUDGET 1988*, PT. II, annex 4, at 35 (1988).

conomic Cooperation and Development (OECD).<sup>180</sup> The nature of New Zealand's privatization program has reflected its objectives. Each enterprise was analyzed separately, and most sales involved the issuance and transfer of shares in a corporatized enterprise.<sup>181</sup> In general, the sales process has consisted of the following elements:

- 1) A governmental regulatory review of the market in which the business operates with the objective of ensuring that the market is competitive before any privatization is implemented, even if this results in reduced revenue from the sale;
- 2) A governmental scoping study (often assisted by a competitively chosen private investment bank consultant) of the nature, structure, prospects, and value of the business feasibility of sale, and of the optimal sales process for each business. This study included an analysis of legal impediments to sale and those areas where new legislation is needed; and
- 3) Management of the competitive sales process itself, usually by way of a competitively negotiated tender process. This process usually involves the following steps. First, a sale is announced and commercial advisors to the government are appointed. Second, expressions of interest are invited and potential buyers are given information about the business in an information memorandum and through a due diligence process. Lastly, would-be buyers competitively offer secret bids to the government consistent with the government's terms and conditions of sale.<sup>182</sup> There have generally been few, if any, restrictions on foreign bids, other than the minimal legal restrictions that ordinarily apply to the sale and purchase of businesses or assets in New Zealand.

The process of implementing New Zealand's privatization program involved more technical, legal, and political difficulties than were originally expected. It generated domestic political controversy, culminating in a July 1990 announcement by the government that no more assets would be considered for privatization.<sup>183</sup> Much of the controversy seemed to be inherent in the process of selling assets of a democratic government in which every citizen had an indirect interest.<sup>184</sup> However, much of the controversy focused on

---

180. In 1986-87, gross public debt peaked at 79% of gross domestic product. By 1990-91, it is forecast to be reduced to 53%. One of the criteria for deciding whether to privatize a business was that the government must receive more from sale than it would from continued ownership of the business.

181. An exception to this was the treatment of commercial forests that were sold in separate blocks of Crown Forestry Licenses, a specially created form of property right.

182. Sometimes it has been required that the successful bidder later sell some fraction of the shares to the public (e.g., the sale of Telecom Corporation).

183. The Minister for State-Owned Enterprises in the new government, elected in October 1990, has since indicated by press statement that further sales are expected to proceed.

184. Langford, *Privatization: A Political Analysis*, in PAPERS ON PRIVATIZATION, *supra* note 152, at 55-74.



## Privatization in Ukraine

the way in which the privatization process was conducted, and on the political desirability of the new buyer of an enterprise. Many vested interest groups, especially existing management, can potentially lose from any single privatization. Such groups can be expected to try to frustrate privatization or steer it toward their own ends. The position of management reflects the ironic "paradox of privatization" in which efficiency benefits of privatization are expected to come from improved management incentives, yet the consent or acquiescence of management is virtually essential for a successful sale.<sup>185</sup>

This tendency emphasizes the importance of carefully formulating the process of privatization before implementing it to ensure that it serves the interests of society as a whole. Of the lessons that the New Zealand Treasury has learned from New Zealand's privatization program to date, most pertain to process and include: clearly stating the objectives of sale, and then sticking to them; preparing thoroughly, and then proceeding swiftly; and making the roles of participants in the sale process clear and distinct.<sup>186</sup>

### 3. Great Britain

During the last ten years, under the Thatcher government, Great Britain carried out the world's most comprehensive privatization program. A variety of enterprises were sold, including the following: an airline, an aerospace company, a bank, oil companies, a gas company, airports, telecommunications companies, car manufacturing companies, a coal company, a radioactive materials development company, a port operating company, and a freight company. Between 1979 and 1988, the British government received at least UK£25 billion from privatization.<sup>187</sup> Ukrainians should note that despite the comprehensive range of businesses and the enormous size of some of the individual businesses privatized in Britain during this ten year period, these privatized businesses accounted for only 9.2% of Britain's total output and employed only 6.7% of Britain's total workforce.<sup>188</sup>

One academic commentator identified the following explicit and implicit aims of privatization as the program evolved in Great Britain:

- 1) Improving efficiency by increasing competition and allowing firms to borrow from the capital market;
- 2) Reducing the public sector borrowing requirement;
- 3) Easing problems of public sector pay determination;

---

185. See Kay & Thompson, *Privatisation: A Policy in Search of a Rationale*, 96 *ECON. J.* 18, 18 (1986) (situation explains why potentially efficiency-improving liberalization and deconcentration policies are used for concessions to management).

186. THE TREASURY, *supra* note 158, at 92.

187. Hemming & Mansoor, *supra* note 159, at 7.

188. D. SWAN, *THE RETREAT OF THE STATE: DEREGULATION AND PRIVATIZATION IN THE UK AND US* 320, app. (1988).

- 4) Reducing government involvement in enterprise decision making;
- 5) Widening the ownership of economic assets;
- 6) Encouraging employee ownership of shares in their companies; and
- 7) Redistributing income and wealth.<sup>189</sup>

These objectives have given Great Britain's privatization program a different character from New Zealand's. The combination of the two main objectives -- the reduction of debt and the widening share ownership -- has meant that most privatizations in Britain have been in the form of sales, but at rates less than true market value.<sup>190</sup> In most sales, the government invited the public to apply for shares at a set price,<sup>191</sup> with some rationing system to deal with oversubscription. In general, the undervaluations of most sales created windfall profits for buyers, thus increasing the popularity of this activity at a financial cost to the government. However, the initially high number of shareholders who bought shares in a privatized business usually fell quickly as people sold their shares on the market to obtain the resulting windfall.<sup>192</sup>

Other methods of privatization were also used, depending on the circumstances of the particular business. Some sales of shares were made to the highest bidder in a process of competitive tenders, while in other sales a proportion of shares was reserved for employees. In fact, one commentator identified twenty-two different methods of privatization in Great Britain, depending on the likely political opposition that had to be dealt with in each case.<sup>193</sup> This again emphasizes the importance of taking political circumstances into account when formulating plans for privatization, and of adopting a case-by-case approach toward each privatization.

#### 4. *British Columbia, Canada*

In 1975, a new government was elected in the Canadian Province of British Columbia. It promised to return assets, which the previous government had

189. Yarrow, *supra* note 159, at 327. See also J. VICKERS & G. YARROW, *PRIVATIZATION: AN ECONOMIC ANALYSIS* 157 (1988) (changed last objective to "gaining political advantage"). It seems that the primary objective evolved through several phases from *ad hoc* debt reduction, to improving efficiency, to a political emphasis on widely dispersed shareholding. See Graham & Prosser, *Privatising Nationalised Industries: Constitutional Issues and New Legal Techniques*, 50 MOD. L. REV. 16 (1987); see also Buckland, *The Costs and Returns of the Privatization of Nationalized Industries*, 65 PUB. ADMIN. 241, 243 (1987) (focusing primarily on issue of share sales).

190. J. VICKERS & G. YARROW, *supra* note 189, at 173-83.

191. The set price was lower than the market price by 18% on average. J. VICKERS & G. YARROW, *supra* note 189, at 178.

192. For example, the number of different shareholders in British Aerospace dropped from 158,000 to 27,000 in a 10 month period. Buckland, *supra* note 189, at 254. However, it seems that government measures to encourage continued shareholding can reduce such decreases. See Mayer & Meadowcroft, *Selling Public Assets: Techniques and Financial Implications*, 6 FISCAL STUD. 42 (1985).

193. M. PIRIE, *DISMANTLING THE STATE: THE THEORY AND PRACTICE OF PRIVATISATION* (1985).

nationalized, to individual ownership.<sup>194</sup> The government encountered technical difficulties in valuing and capitalizing the enterprises, as well as political opposition in trying to develop a sales program. It decided that the way out of these problems was to implement the following measures. First, the government would form a single holding company, the British Columbia Resources Investment Corporation (BCRIC) that would own a variety of other, resource-based companies previously owned by the government (forestry, oil, and natural gas companies calculated to be worth Can\$150 million). Second, the government would give away five shares in BCRIC to each citizen of British Columbia over the age of sixteen who had applied for them over a three month period. Concurrently, the government would allow each citizen to buy more shares, up to 5,000 shares at six Canadian dollars per share, in BCRIC to raise new capital for the company.

British Columbians were enthusiastic about the stock share issue and the option to buy. For five free shares, 1.7 million applications were received, representing eighty-seven percent of eligible citizens.<sup>195</sup> Nearly 170,000 people bought eighty-one million new shares, which raised Can\$487.5 million for BCRIC -- the third largest common stock issue in North American financial history at the time.<sup>196</sup> Interest in buying shares continued after the issue closed, when the shares became tradeable on the stock exchange. After three weeks of fluctuating around the price of U.S.\$6, the share price rose to over U.S.\$9 per share, until it eventually followed a general downward trend in the stock market.<sup>197</sup> Share ownership in BCRIC has subsequently spread across Canada and across institutional investors;<sup>198</sup> it appears that the success of the privatization of BCRIC provided an important impetus to the privatization program of the Thatcher government in Britain.<sup>199</sup>

One commentator has identified important lessons about administering a giveaway.<sup>200</sup> Primarily, they are the need to educate citizens about the program as well as to plan efficient administrative procedures that are flexible enough to accommodate change. This analysis also suggests that it would be

---

194. Ohashi, *Privatization in Practice: The Story of the British Columbia Resources Investment Corporation*, in *PRIVATIZATION: THEORY & PRACTICE -- DISTRIBUTING SHARES IN PRIVATE AND PUBLIC ENTERPRISES* 3-73 (T. Ohashi & T. Roth eds. 1980) [hereinafter *PRIVATIZATION: THEORY AND PRACTICE*] (providing the basis for this section of the article). See also Ohashi, *Privatization: The Case of British Columbia*, in *PRIVATIZATION AND DEVELOPMENT*, *supra* note 175, at 101.

195. Almost 5,000 people applied for the maximum number of shares. Ohashi, *Privatization in Practice: The Story of the British Columbia Resources Investment Corporation*, in *PRIVATIZATION: THEORY AND PRACTICE* *supra* note 94, at 40.

196. *Id.*

197. Ohashi, *Privatization: The Case of British Columbia*, in *PRIVATIZATION AND DEVELOPMENT* *supra* note 175, at 192 (by 1986 the shares were worth US\$2 each).

198. *Id.* at 193.

199. Walker, *Preface*, in *PRIVATIZATION: TACTICS AND TECHNIQUES* ix (M. Walker ed. 1988).

200. Ohashi, *Privatization in Practice: The Story of the British Columbia Resources Investment Corporation*, in *PRIVATIZATION: THEORY AND PRACTICE* *supra* note 194, at 41-42.

easier to separate the giveaway from the sale. Ukrainians should note that this privatization occurred in a market economy where active capital markets and a stock exchange were already established, as was true in New Zealand and Great Britain.

### 5. Chile

Since 1973, Chile has implemented the most extensive program of privatization of any developing country, reducing the number of publicly-owned enterprises from 507 to 35 by the end of 1986.<sup>201</sup> The conditions under which privatization took place are similar to those currently found in Ukraine. By the mid-1970s, Chile's economy was overwhelmingly dominated by the government.<sup>202</sup> It suffered from a lack of capital and a lack of confidence.<sup>203</sup> It was severely shaken by political turmoil and faced tremendous structural changes due to the pursuit of stabilization and liberalization policies by the newly-installed military dictatorship. Capital markets, already underdeveloped, were deregulated. Four phases of privatization can be identified<sup>204</sup> in which a variety of enterprises were privatized throughout the Chilean economy.<sup>205</sup> Each phase had different characteristics, but it is important to note that they were undertaken during a period of military dictatorship, when the government could suppress political tensions to some extent.

The first phase, from 1974-75, involved the privatization of 259 enterprises, usually free of charge, to the original owners from whom they had been expropriated.<sup>206</sup> In the second phase, from 1975-79, 110 enterprises that had previously been purchased by the government were privatized by sale, raising US\$802 million, allegedly less than their true market value.<sup>207</sup> The sales process first involved the public auction of shares and assets, then direct negotiation over attractive offers between the bidder and the Corporación de

---

201. Marshall & Montt, *Privatisation in Chile*, in PRIVATISATION IN LESS DEVELOPED COUNTRIES, *supra* note 161, at 281.

202. Yotopoulos, *The (Rip)Tide of Privatization: Lessons from Chile*, 17 WORLD DEV. 683, 684-85 (1989).

203. Marshall & Montt, *Privatisation in Chile*, in PRIVATISATION IN LESS DEVELOPED COUNTRIES, *supra* note 161, at 285.

204. *Id.* See also H. NANKANI, 2 TECHNIQUES OF PRIVATIZATION OF STATE-OWNED ENTERPRISES: SELECTED COUNTRY CASE STUDIES 17-45 (World Bank Technical Paper No. 89, 1988).

205. These included enterprises in the following sectors: agriculture and agro-industry, forestry, fisheries, mining, textiles, chemicals, electronics, metallurgy, automobile, construction, energy and gas, services, and others. Marshall & Montt, *Privatisation in Chile*, in PRIVATISATION IN LESS DEVELOPED COUNTRIES, *supra* note 161, at 286.

206. *Id.* at 285-87.

207. *Id.* at 287-94. See also Yotopoulos, *supra* note 202, at 693-95 (showing that the sale price is, on average 60% of the book value of the enterprise, and noting several circumstances that may imply the market value of enterprises was not captured by the government). Book value does not necessarily bear much relation to the maximized sales value of an enterprise.

Fomento de la Producción de Chile (CORFO).<sup>208</sup> Most of these enterprises were sold to domestic companies that often financed the purchase through debt, borrowing from CORFO itself. However, seventy percent of the privatized companies (especially the banks) found it difficult to cope with the newly liberalized market environment. By 1983, many had gone bankrupt, had been liquidated, or had to be taken over by the government.<sup>209</sup>

The third phase, from 1985-86, was one of reprivatization. Its two primary aims were to diffuse ownership and to assure adequate capitalization of the enterprises, thereby distinguishing it from the second phase.<sup>210</sup> Most privatizations during this phase were conducted through sales to private investors,<sup>211</sup> but shares in two large banks and in portions of two pension funds were sold in small packages to 50,000 small investors. This goal was also that of the fourth phase of privatization from 1986-88,<sup>212</sup> and was similar to that in Britain. In addition, CORFO extended loans to investors and, during the fourth phase, sold shares to pension funds and workers. There were restrictions imposed during the fourth phase on the concentrations of ownership and on the incentives for diffusion of ownership.<sup>213</sup> It is difficult to assess public perceptions of the legitimacy of these distribution schemes. Although diffused ownership seems to be a fair objective, acquisition of control by managers and workers who are associated with the military regime has raised questions about the legitimacy of its achievements. There are now indications that the newly-democratized government of Chile is planning to maintain, and perhaps even to extend, privatization.

The example of Chile, especially during the second phase of privatization, illustrates two lessons.<sup>214</sup> First, there are severe dangers in proceeding simultaneously with liberalization and privatization, particularly where there is heavy reliance on uncontrolled debt financing and little scrutiny of concentration of ownership. Second, large-scale privatization by sale can place heavy pressures on underdeveloped capital markets.

---

208. CORFO is the Chilean state development and holding company, the council of which is dominated by government ministers. See C. VUYLSTEKE, *supra* note 167, at 83-84.

209. Marshall & Montt, *Privatisation in Chile*, in PRIVATISATION IN LESS DEVELOPED COUNTRIES, *supra* note 161, at 291-92.

210. The third and fourth phases were undertaken in the context of a new regulatory regime governing financial institutions and concentrations of ownership. *Id.* at 294-98.

211. In the sales to private investors, CORFO scrutinized the bidders more closely than they had in the second phase and provided little debt financing for the acquisitions. *Id.*

212. Marshall & Montt, *Privatisation in Chile*, in PRIVATISATION IN LESS DEVELOPED COUNTRIES, *supra* note 161, at 298-302.

213. Legislation provided that no investor could own more than 20% of an enterprise, 50% of the capital had to be spread among shareholders who owned no more than 10% of the shares, and at least 15% of the equity had to be owned by 100 or more independent investors. *Id.* at 302.

214. *Id.* at 293-94, 303-05; Yotopoulos, *supra* note 202, at 698-99; H. NANKANI, *supra* note 204, at 40-41.

## 6. Poland

Poland is undertaking a task of transformation to a market economy similar to that contemplated in Ukraine. Poland has adopted a "big bang" or "shock therapy" approach, one of the most radical approaches in Eastern Europe to achieve the desired transformation.<sup>215</sup> Preliminary results indicate success in improving the efficiency of production and distribution in some sectors. In the small-scale sector, especially in the area of retail consumer goods, market incentives have become more important and have induced new efficiencies. The same has not occurred in the giant monopolistic businesses. Inflation and unemployment have risen sharply and growth has fallen.<sup>216</sup> Three notable features of the Polish stabilization and price-liberalization to date are large increases in prices over wages, a demand-induced contraction, and a larger decrease in sales than employment.<sup>217</sup> As can be expected, social tension and political volatility have accompanied this fundamental change in economic arrangements.

Privatization is a key part of Poland's economic transformation as over 90% of Poland's industrial assets are in the state sector,<sup>218</sup> and there are at least 7,800 candidates for privatization.<sup>219</sup> On July 13, 1990, Poland adopted the State Enterprise Privatization Act<sup>220</sup> and the Office of the Minister for Ownership Transformation Act. This legislation provides the framework and machinery for undertaking a variety of potential privatization strategies with respect to the shares or assets of state enterprises, by gift or sale, as well as the formation of a stock market. The main strategies of privatization are approved by the lower house of Parliament (*Sejm*) each year. Apparently, this legislation envisages two main methods of privatization. One method involves the liquidation of a state enterprise, which can be undertaken by the "parent body" of a state enterprise in order to sell its assets, transfer its assets to a corporation, or lease its assets to a new company formed by the employees.

---

215. Beksiak & Winięcki, *A Comparative Analysis of Our Programme and the Polish Government's Programme*, in THE POLISH TRANSFORMATION: PROGRAMME AND PROGRESS 9 (1990).

216. Prices rose 79% between December 1989 and January 1990, and at 5% per month in February and March 1990. Blanchard & Layard, *Economic Change in Poland*, in THE POLISH TRANSFORMATION: PROGRAMME AND PROGRESS, *supra* note 215, at 67. Unemployment increased five-fold between January and March 1990. Lipton & Sachs, *Creating a Market Economy in Eastern Europe: The Case of Poland*, in 1 BROOKINGS PAPERS ON ECON. ACTIVITY 75, 119-25 (1990) [hereinafter Lipton & Sachs, *Creating a Market Economy*]. Gross domestic product has declined by 30% since January 1990. Ordober, *Poland: Economy in Transition*, 26 BUS. ECON., Jan. 1991, at 25, 27.

217. Blanchard, Dornbusch, Krugman, Layard & Summers, *Reform in Eastern Europe and the Soviet Union (1990)* [hereinafter Blanchard & Dornbusch] (forthcoming 1991 as REFORM IN EASTERN EUROPE (M.I.T. Press)).

218. Beksiak & Winięcki, *A Comparative Analysis of Our Programme and the Polish Government's Programme*, in THE POLISH TRANSFORMATION: PROGRAMME AND PROGRESS, *supra* note 215, at 13.

219. Lipton & Sachs, *Creating a Market Economy*, *supra* note 216, at 127.

220. State Enterprise Privatization Act, July 13, 1990, 29 I.L.M. 1226.

The second method involves the transformation of state enterprises into state-owned corporations and the sale or gift of shares in these corporations. The Minister for Ownership Transformation is advised by the Ownership Transformation Board, which is appointed by the Prime Minister. The Minister for Ownership Transformation has the authority to transform an enterprise into a state-owned corporation at the request of the employees or at the request of the parent body. All the shares in these newly-formed corporations must be offered to individuals within two years of their formation. The Minister of Ownership Transformation has the authority to offer shares to the public, but must have the approval of the Council of Ministers if they are to be offered free of charge. Before offering shares, the Minister must order economic and financial analysis of the business and its ownership structure to establish whether changes are required.

The process of offering shares will be either through auctions conducted on the basis of a publicly-announced offer, following negotiations initiated by public invitation, or by some other method chosen at the discretion of the Council of Ministers. In the first year of any offering, employees of the enterprise have the right to acquire up to twenty percent of the shares at half price.<sup>221</sup> Flexibility in this process is ensured since the Council of Ministers may permit shares to be sold in a manner different than that specified in the Act. Furthermore, foreigners may not buy more than ten percent of a company's shares without obtaining the approval of the Foreign Investment Agency.<sup>222</sup> Additionally, privatization coupons are to be distributed free of charge to all resident citizens of Poland. These coupons may be used to buy an interest in privatized enterprises in one of two ways. First, the coupons could be used to buy shares in privatized corporations directly from the government, or the coupons could be used as shares in mutual investment funds that may be created to hold and sell shares in privatized corporations.<sup>223</sup>

A pilot project involving the sale of some five to seven carefully selected businesses on the basis of a publicly-announced offer apparently proved unattractive to the Polish public. One explanation centers on the lack of public confidence in Polish businesses and managers. In November 1990, the Polish government announced a more comprehensive program of privatization, drawing largely on Frydman's and Rapaczynski's proposals.<sup>224</sup> Following

---

221. The half-price requirement is not reflected in the Polish government's privatization strategy announced in November 1990. See *infra* note 224.

222. Concern about foreign ownership is of particular concern to the Polish public. Fay, *Polonia Firms: Reaction to Foreign Investment in the Polish Press*, in YEARBOOK ON SOCIALIST LEGAL SYSTEMS 245, 249-56 (W. Butler ed. 1989).

223. Later in this article, the potential details of such a scheme are explained further. See *infra* text accompanying notes 261-74.

224. For a description of the program, see Frydman & Rapaczynski, *The Polish Government's Large Scale Privatization Plan: A Preliminary Analysis*, in 2 PARKER SCH. BULL. SOVIET & EAST EUR. L., Feb. 1991, at 1 [hereinafter Frydman & Rapaczynski, *The Polish Government's Plan*]; R. Frydman & A.

corporatization, 10% of the shares in the 500 largest companies will be given to the workers, 30% will be retained by the state, 20% will be given to the Social Security Office to capitalize the state pension fund, 10% will be given to a number of state banks, and 30% will be transferred to citizens at large through vouchers. The vouchers, issued in several phases, can be exchanged for shares in any intermediary institution, which anyone can create. The intermediaries will use the vouchers in an auction process to acquire the shares in the underlying enterprise. They then will be given the state's thirty percent of the shares according to some unspecified formula, which they will be required to sell to other investors. The new owners of the underlying enterprises and of the intermediaries will be able to exercise the usual rights of ownership that exist in a capitalist economy.

Despite the frustration with economic reform exhibited during the December 1990 presidential elections, the Minister of Finance, Mr. Balcerowicz, has retained his position in the new government. This may indicate that the Polish government will go ahead with the above scheme, the first stage of which is planned to be completed by the end of 1991.

#### IV. DEVELOPING A SUBSTANTIVE PROGRAM

As has been emphasized throughout this article, it is for the Ukrainians themselves to assess their particular conditions and to formulate their own privatization policy. Part IV of the article provides an illustrative example of the formulation of a program of privatization for Ukraine, working from my own perceptions of Ukrainian conditions. It then considers the objectives, assumptions, and constraints on -- and options for -- a program of privatization in Ukraine. By drawing on my understanding of the Ukrainian context and the theory and international experience of privatization, Part IV develops the general shape of a program of privatization that also represents a contribution to substantive Ukrainian debate. My development of this illustrative program demonstrates a process by which Ukrainians could develop their own program, reflecting their own objectives, assumptions, and constraints.

##### A. *Objectives*

Each government has its own special reasons for privatization, as illustrated by the above case studies. A government's objectives will be primarily determined by the current political atmosphere and informed by economic and legal analyses of the effects and feasibility of the options proposed. The nature of

---

Rapaczynski, *Markets and Institutions in Large Scale Privatizations: An Approach to Economic and Social Transformations in Eastern Europe* app. 3 [hereinafter Frydman & Rapaczynski, *Markets and Institutions*] (unpublished manuscript given to Yale Law School Legal Theory Workshop, Feb. 21, 1991).



## Privatization in Ukraine

a government's objectives have a determinative effect on the shape of its program. It is only possible to design a program, and assess its success, if its objectives are clearly formulated and expressed. In designing a program of privatization for Ukraine, it is therefore crucial to explicitly identify the objectives sought.

The underlying objective of privatization in Ukraine must be to facilitate the transformation of the Ukrainian economy to a market-based economy so as to improve the economic and social welfare of the Ukrainian people. Part II of this article outlined both the political, economic, and legal momentum necessary to transform the Ukrainian economy and the existing impediments to that process. Such a transformation is desirable for a variety of reasons, including: the conceptual attraction of market principles, the enormous conceptual and practical problems of trying comprehensively to plan economic activity in a modern economy, the exigencies of the collapse of the existing economic system, the pernicious nature of much of the established Soviet bureaucracy, and the apparent desire of Ukrainians to enjoy the greater economic freedoms inherent in a market economy.

Part III argued that privatization is an important element in the transformation to a market economy and provided an account of the theory of, and international experience with, privatization.<sup>225</sup> Yet it is important not to lose sight of the ultimate objective of both the transformation and privatization -- to improve the economic and social welfare of the people of Ukraine. This implies that any privatization program must focus on improving the economic and social welfare of Ukrainians, and that any program of privatization must be tailored to the legal, economic, social, and political conditions of Ukraine.

There are five requirements that should shape a Ukrainian privatization program. These are derived on the basis of my personal understanding of Ukrainian social attitudes, politics, economics, and law, and on my observation of the causes of social and political concern during privatization in other countries. The requirements are that:

- 1) Government property must be distributed to people on a basis that is, and is seen to be, fair and legitimate;
- 2) The government must have the means to address social problems that arise during the economic transformation;
- 3) Privatization must encourage the establishment of market-oriented behavior, institutions, and laws, and favorable popular attitudes toward them;
- 4) Privatization must apply to most existing Ukrainian productive property; and

---

225. The focus here, as before, is on the privatization of existing state-owned property.

- 5) Privatization must proceed as quickly as is politically and technically feasible.

The first requirement is a function of two concerns.<sup>226</sup> The first concern is the inherent moral undesirability of an unfair and illegitimate distribution of property. The second concern is the likelihood that such a distribution would, at some future stage, cause serious social and political tension in Ukraine that could jeopardize the entire process of economic transformation.<sup>227</sup> The concept of social justice was heavily cited by both Gorbachev and Andropov throughout their campaigns against official corruption and privileges. It has proved to have powerful, though a double-edged, political force since then with respect to wealth and privilege, non-labor income, concern for the poor, and class conflict.<sup>228</sup> The second requirement also has as its goal the avoidance of social and political turmoil.<sup>229</sup> The ideals of socialism may affect Ukrainian perceptions of fairness and legitimacy. Ukrainians may well view significant distributions of property to *nomenklatura*, *apparatchiki*, black-marketeers, and non-Ukrainians, as unfair and socially illegitimate. The third requirement reflects the objective of privatization -- the facilitation of the economic transformation. The efficient management of privatized enterprises, an important feature of a market economy, relies on all the elements listed in item three. Managers should respond with initiative and entrepreneurship to the institutionally and legally-based incentives for efficiency.<sup>230</sup>

Privatization should apply to a large number of Ukrainian businesses, ranging from large-scale industrial enterprises to small state-owned cafes, in order to have the greatest beneficial effect. The existing situation in Ukraine, as well as in other Eastern European nations, illustrates the difficulties of exposing only a few elements of an economy to market forces while protecting others through command and control mechanisms. However, it is also important that the economic transformation should not be unduly delayed or prolonged. Ukrainian public patience with vacillation by the center over economic reform has already worn thin, and the social and political impacts of adjustment to the transformation are likely to increase. This sets up a complicated political calculation over the speed of reform. An extended process could stall

---

226. Cf. Frydman & Rapaczynski, *Markets and Institutions*, *supra* note 224, at 7 ("Privatization must be socially acceptable").

227. See, e.g., Aven, *The Distribution Mechanism and Social Justice*, in *PERESTROIKA AND THE ECONOMY: NEW THINKING IN SOVIET ECONOMICS*, *supra* note 2, at 233.

228. Mason & Sydorenko, *Perestroika, Social Justice, and Soviet Public Opinion*, 39 *PROB. COMMUNISM* 34, 35-41 (1990) (popular concern for social justice is instrumental toward higher personal standards of living).

229. Hanson, *Ownership Issues in Perestroika*, in *DILEMMAS OF SOVIET ECONOMIC REFORM*, *supra* note 21, at 96.

230. Cf. Frydman & Rapaczynski, *Markets and Institutions*, *supra* note 224, at 8 ("Privatization must assure effective control over management of the privatized enterprises").

## Privatization in Ukraine

through political and bureaucratic inertia, resulting in prolonged economic and social disruption that could well engender a shortsighted popular conservative reaction.<sup>231</sup> On the other hand, the shock of quick, drastic measures could also cause a political or even military reaction from the conservative establishment.

### B. Assumptions

This article's two most important assumptions regarding privatization in Ukraine, which are explored further below, concern the need for a program of privatization and the limits of its application. It is also necessary to make some explicit assumptions about the context of privatization. Although privatization in the context of transforming the Ukrainian economy to a market basis is of main concern, it is beyond the scope of this article to analyze the necessary stabilization and liberalization policies that must accompany privatization.<sup>232</sup> However, it is assumed that the institutional and legal elements of a market economy, as outlined in Part III.A, will be introduced prior to privatization. These elements will probably be conceptually similar to those of western economies, but in practice the details of such laws could differ. For instance, it is assumed in this article that organizational law will provide for company-like organizations that issue shares. Nevertheless, a modified version of the existing All-Union Law on Enterprises or the union regulations on joint-stock companies and limited liability companies may be adequate for this purpose.<sup>233</sup>

Part III.B.3 set forth reasons why a program of privatization is essential to the establishment of a market economy in Ukraine, including: 1) the extraordinary difficulty of reforming the current economic apparatus so as to embody incentives for efficiency sufficient to support the operation of a market economy; 2) the delay that waiting for the evolution of a significant private enterprise sector would involve; and 3) the probability that privatization would occur anyway. These factors support the formulation of a government policy of privatization despite the political and social tension that privatization univer-

---

231. Blanchard & Layard, *Making it Safe for Capitalism*, Financial Times, July 11, 1990, at 15, col. 5.

232. See, e.g., Blanchard & Dornbusch, *supra* note 217; Lipton & Sachs, *Creating a Market Economy*, *supra* note 216.

233. See Dolganov & Stepovoi, *Law of Enterprises Adopted*, Izvestiya, June 5, 1990, at 1-2, English excerpts reprinted in 42 CURRENT DIG. OF THE SOVIET PRESS, July 11, 1990, at 11 (proposed enterprise regulations). For instance, the requirement that enterprises are to perform work and deliveries for the state's needs on a contractual basis and according to procedures defined by legislative acts, violates the freedom of such enterprises. The union regulations on joint-stock companies and limited liability companies are reportedly designed to facilitate transition to these forms of organization. Hanson, *supra* note 17; Zhagel, *Important Action by USSR Council of Ministers*, Izvestiya, June 21, 1990, at 2, English translation reprinted in 42 CURRENT DIG. SOVIET PRESS, Aug. 1, 1990, at 21.

sally seems to cause. As noted earlier, privatization of productive enterprises does not necessarily imply abandoning the pursuit of social justice and a welfare state as governmental aims through other means. It also does not mean that a process of corporatization of state enterprises, as proposed in Poland and in a draft Ukrainian law,<sup>234</sup> should not occur as a transitional measure prior to privatization; such a process would probably be very useful. However, a further question must be addressed before designing a program for privatization: is a program of privatization necessary or not?

The concept of "spontaneous privatization" or "*nomenklatura* capitalism"<sup>235</sup> does offer certain advantages. If privatization is necessary to economic transformation and will occur anyway, there is a temptation to let it proceed on an *ad hoc* basis. Presently, there is a tendency by both the Ukrainian government and the city government in Kiev to allow *ad hoc* privatization at the initiative of *apparatchiki*, current managers of businesses, and apparently even a few private takeover specialists. This *ad hoc* privatization is consistent with the privatization experiences of Poland, Chile, and Hungary. It effectively involves buying off existing managers and *apparatchiks* who would otherwise have had an interest in opposing privatization. Those existing managers with initiative and with confidence in their ability to run a business without government controls will make the effort to advance such proposals. Consequently, privatization will occur on a case-by-case basis, depending on the economic and managerial circumstances of each business, and the political atmosphere at any given moment. Because spontaneous privatization is not a program, it does not attract the sustained glare of publicity that privatization programs usually attract while they are being implemented.

There are, however, disadvantages to spontaneous privatization, which are dispositive. In most cases severe conflicts of interest and potential areas for corruption will emerge. This is already a pervasive problem throughout state institutions in Ukraine and does not need to be encouraged. Some enterprises could be quickly privatized, but others may have managers who do not want privatization at all, especially given the current decrease in government control over managers. There also is likely to be significant doubt about the competence of existing managers to operate in a market environment.<sup>236</sup> Furthermore, those managers who do propose privatization will have incentives to offer the minimum benefits to the government necessary to obtain agreement

---

234. Draft Law on Privatization of State-Owned Property, in Background Reading Material, *supra* note 10. See *supra* text accompanying notes 215-24. See *supra* text accompanying notes 176-86 (utility of corporatization before privatization in New Zealand).

235. Savas, *The Rocky Road from Socialism: Privatization and Economic Reform in Socialist Countries*, *THE PRIVATIZATION REV.* 14, 17 (1990).

236. See P. JOHNSON, *supra* note 130, at 147.

for privatization.<sup>237</sup> These terms may not be in the best economic interests of Ukraine. The incentive problems of management attempts to frustrate the process of privatization or to use it for their own benefit illustrates the "paradox of privatization" revealed in international experience.<sup>238</sup>

The most important objection to spontaneous privatization is that it offends a basic sense of fairness. It does not satisfy the requirement for actual and apparent social and political legitimacy that is critically important in the context of Ukraine. In both Poland and Hungary, the realization by the public that spontaneous privatization had occurred is already provoking social tension and a political backlash that involves demands for government confiscation.<sup>239</sup> This dynamic could also occur in Ukraine and, if it does, could jeopardize popular support for a regime that will probably be identified with the transformation to a market economy.<sup>240</sup>

A well thought out program of privatization will deal with all government-owned businesses on the government's terms and on a consistent basis. Depending on what sort of program is adopted, it may still be possible to retain sufficient flexibility to take account of the peculiar circumstances of particular businesses. The main political risk of the government initiating a program of privatization, rather than allowing spontaneous privatization, is that positive action inherently stirs up public controversy while the process is occurring. Perhaps this could be turned to the advantage of the government by actively encouraging debate, discussion, and therefore education about the mechanisms of a market economy. Overall, the disadvantages of simply allowing spontaneous privatization appear to outweigh the advantages.

Part IV.E outlines a program of privatization of large and medium-scale enterprises that involves gift and sale of shares to the public generally. Although different principles are appropriate with respect to different kinds of property, this article deals only with productive property. It does not deal with agricultural property, such as *kolkhoz* or collective farms, which have historically enjoyed a *sui generis* status, or with small-scale, retail enterprises. Dispersed public shareholding is not necessarily an appropriate form of ownership for very small-scale businesses, collective farms, or residential property, which require careful consideration of their own special characteristics.

---

237. Managers in Ukraine have explained to me some ingenious plans they are pursuing to acquire control of a large enterprise. The process of management-government bargaining over sale of an enterprise is a bilateral monopoly bargaining situation with information asymmetries favoring the management.

238. See *supra* note 185 and accompanying text.

239. For example, a Hungarian privatization, that occurred at what many believe was a gross undervaluation, was stopped by the Supreme Court of Hungary. See 1 PARKER SCH. BULL. SOVIET & EAST EUR. L., Apr. 1990, at 3.

240. Cf. Lipton & Sachs, *Privatization in Eastern Europe: The Case of Poland*, in 2 BROOKINGS PAPERS ON ECON. ACTIVITY 239, 327-32 (1990) [hereinafter Lipton & Sachs, *Privatization in Poland*].

Many small, retail businesses (e.g., family-run cafes), are currently "owned" by a state body in Ukraine. It would substantially increase the efficiency incentives of such owner-operators if they could own these enterprises themselves and keep the profits generated. There seem to be few economic or legal reasons to insist that these enterprises be sold rather than given to their operators, given the administrative costs and delays associated with sale transactions.<sup>241</sup> Furthermore, there need be few legally or organizationally inspired delays to interfere with disposal of such small-scale businesses. One useful policy prescription offered to Ukrainian policymakers with respect to this is "do what you can do *now* to promote change."<sup>242</sup> The highest priority in Ukraine with respect to small-scale enterprises should be the quick transfer of ownership into private hands.

However, there are equity arguments that mitigate against a straight give-away. Windfall wealth gains by those who happen to be operating a particular small business at a particular time are likely to cause social resentment. Additionally, the government might believe that it would need a return for whatever establishment costs it had incurred with respect to these businesses. If so, the government would need to devise a simple scheme through which small businesses could quickly be transferred to private ownership without delay in return for some financial obligations. Czechoslovakia, for instance, has started a process of auctioning all of its several hundred thousand state-owned stores.<sup>243</sup> A draft policy paper circulating in Kiev has suggested that a similar process be used with respect to collective and Soviet farms.<sup>244</sup> Alternatively, the government could first offer to sign a standard agreement for sale of the business in return for payment to the government of a small percentage of the business' profits over the next five years in addition to normal taxation. Existing operators could be given a right of first refusal of this offer, to be exercised within a set time period. If an operator refused, the business or assets could be sold to the highest bidder in a simple, standardized auction process.

### C. Constraints

Law and politics vitally constrain the future of economic reform in Ukraine. Politics, as well as morality, is behind my formulation of the fairness

---

241. Furthermore, little revenue is likely to be gained from such sales.

242. Allison, Conference Summary, *supra* note 2, at 23 (Moscow and Leningrad are taking such steps). The Project on Economic Reform in Ukraine is sponsoring an Initiative for Privatization of small local businesses.

243. The stores are sold without their real estate and occupancy is guaranteed for two years, after which time there will be new land owners. *N.Y. Times*, Jan. 27, 1991, at A10, col. 2.

244. Committee on Economic Reform, Ukrainian Supreme Soviet, *Conceptual Framework for the Creation of a Market Economy in Ukraine*, in Background Reading Material, *supra* note 10.

## Privatization in Ukraine

and legitimacy requirement of privatization in Ukraine. As appears from the outline in Part II, a fundamental issue is the political and legal capacity of Ukraine to implement its own economic measures, such as privatization. This is a problem that does not affect independent Eastern European nations and which affects each Soviet Republic in different ways. Of particular relevance to privatization is the question of security of title to property. As noted, the existing structure of ownership of productive property vis-à-vis union, republic, and city and local authorities, is not at all clear. This goes to the very essence of the function of property in a market economy -- the relationship between individual and collective rights. This constraint is dealt with in true economists' fashion, by assuming it away and by relying on my previously expressed belief that inter-republic relations will be resolved either politically or militarily. In the interim, formulation of republic economic policy should not simply be put on hold. It should, however, be noted that an essential precondition for implementing privatization is that the legal status of the affected property be clarified for the purposes of Ukrainian law.<sup>245</sup>

Particular features of the current Ukrainian economic system will cause difficulties in the transformation to a market economy and must be taken into account by policymakers trying to design a program of privatization. These include: the lack of concentrated private capital, the deliberately monopolistic existing structure of industries, the interrelationship between civilian and military industrial production, the lack of popular understanding of shares, the lack of competitive markets for capital, the lack of market-oriented accounting practices, the lack of skills or experience in financial analysis or valuation in a market environment, the lack of skills in assessing a business or monitoring the performance of its management in a market environment, the lack of skills or experience in organizing or managing businesses in a market environment, and the prevalence of conflicts of interest for most existing government bureaucrats.<sup>246</sup> All of these factors affect and constrain the method of privatization, though many of them may be positively addressed by privatization.

### D. Options

International experience illustrates that there are many different options available for developing a program of privatization in Ukraine. It also illustrates the importance of taking into account the local economic, social, and political circumstances when adopting one or more of the options, thinking of new options, and developing a program of privatization unique to Ukraine. The

---

245. Blanchard & Dornbusch, *supra* note 217, at II-3.

246. Some of these draw on Frydman & Rapaczynski, *Privatization in Poland: A New Proposal* (undated draft manuscript, on file with author). A revised version of this paper, translated into Polish, appeared in *RES PUBLICA*, Sept. 1990.

most fundamental decision to make in developing a program of privatization is the choice between sale and gift. For each individual choice, there are two basic options for implementation:

- 1) Sale at the highest price (e.g., New Zealand);
- 2) Sale at a government-determined set price (e.g., Great Britain);
- 3) Gift of shares directly (e.g., British Columbia); and
- 4) Gift through holding company intermediaries (e.g., Poland).

Variations of each option are illustrated in the examples of international experience from New Zealand, Great Britain, British Columbia, Chile, and Poland.

There are further choices available within each of these four basic options. For instance, with respect to each option, a sale or gift could be made of all the shares of an enterprise, or only a proportion of the shares, or of all or some of the physical assets. With respect to options 2, 3, and 4, there are a number of categories of people to whom the sale or gift can be made -- workers, managers, or all citizens. The variety of options raises the possibility of adopting a mixture of approaches in an overall program of privatization. The first three basic options are reasonably easy to understand. In the course of the analysis below, I further explain the last option, gift through intermediaries.

### E. Analysis

In summary, the basic choice in designing a program of privatization for Ukraine, that between sale and gift, is best resolved by a mixture of approaches. The hybrid approach advocated here combines a gift of a proportion of shares in all enterprises to every citizen through intermediary mutual funds, and the sale of a proportion of shares in all enterprises at a set price.<sup>247</sup>

#### 1. *Not by Distribution to Workers*

One must first address a frequent, instinctive Soviet tendency to advocate privatization of state enterprises to their workers. The tendency is primarily politically and ideologically motivated, and is implicit in the Soviet leadership's criticisms of existing state enterprises for alienating workers.<sup>248</sup> Indeed, some degree of worker ownership may well ease Ukrainian labor relations during a traumatic period for workers. It is logical that an ownership interest can improve both managers' and workers' economic incentives to work, and may

---

247. This is a mixture of options 2 and 4.

248. See Hanson, *Ownership Issues in Perestroika*, in DILEMMAS OF SOVIET ECONOMIC REFORM *supra* note 21, at 74. See also Lipton & Sachs, *Privatization in Poland*, *supra* note 240, at 308-13 (politics and economics of privatization to workers in Poland).



reduce agency costs by internalizing the effects of opportunistic behavior at the firm's expense.<sup>249</sup> This is most likely to occur with small businesses in which an individual's effort determines the performance of the business. For this reason, this article advocates the privatization of small businesses to existing operators. In western economies, however, worker ownership has only proved efficient in certain types of businesses, such as lawyers' partnerships.<sup>250</sup> Internationally, privatization through worker ownership is usually pursued on a case-by-case basis, and often occurs where an enterprise is in substantial financial difficulty and liquidation is the main alternative.<sup>251</sup>

Some commentators argue that workers have short time horizons with respect to business decisions. They will pursue their own interests in terms of, for example, wages and job security at the expense of the longer term financial health of the business.<sup>252</sup> This may not necessarily be true. A worker may expect to work in a business for a long period of time. However, the age profile of employees will affect the coincidence of worker and firm incentives, especially regarding labor hiring policies. A better argument from the workers' perspective is that ownership of the firm in which the worker is employed involves a high concentration of risk in that firm.<sup>253</sup> Another argument against distribution to workers is that in larger firms that employ workers with diverse interests, such as administrative clerks, factory workers, and managers, there are high costs associated with collective decision-making by workers.<sup>254</sup> Where collective action problems exist, they inhibit the efficiency of worker ownership. It is unlikely that the Ukrainian government will be able to identify the potential for such problems on its own. These factors, therefore, militate against wholesale policies of noncompetitive disposal of medium and large-scale enterprises to workers alone.

The most important argument against an overall program of privatization only to workers is the unequal income distribution that would result. Across society, individuals would receive shares of very unequal worth, depending on the enterprise in which they worked or whether they worked in an enterprise at all. The results of such a pattern of distribution in Ukraine would be seen, at least eventually, as socially illegitimate by society at large. However, Ukrainians might decide that the special relationship between workers and their enterprises deserves some recognition in a Ukrainian privatization program.

---

249. Hansmann, *When Does Worker Ownership Work? ESOP, Law Firms, Codetermination, and Economic Democracy*, 99 *YALE L.J.* 1749, 1770 (1990); see also Wright, Thompson, & Robbie, *Privatization Via Management and Employee Buyouts: Analysis and UK Experience*, 60 *ANNALS PUB. COOPERATIVE ECON.* No. 4 at 399 (1989) (especially where there is debt financing of the buy-out).

250. Hansmann, *supra* note 249, at 1770.

251. C. VUYLSTEKE, *supra* note 167, at 29-34.

252. See, e.g., Frydman & Rapaczynski, *Markets and Institutions*, *supra* note 224, at 19-20.

253. See, e.g., Lipton & Sachs, *Privatization in Poland*, *supra* note 240, at 311.

254. Hansmann, *supra* note 249, at 1779-96.

It may also be useful to ease labor relations and to provide a new incentive for worker productivity.<sup>255</sup> It is not difficult to provide for a small proportion of shares in enterprises to be available to workers, either through sale or distribution. Similarly, once shares are tradeable after initial privatization, workers of a financially-troubled firm would be free to make a buy-out offer to the new owners.

## 2. *Not by Sale Alone*

Disposal of Ukrainian businesses by sale alone also involves important problems. First, the lack of concentrated private Ukrainian capital severely limits the domestic market for such businesses, and it seems politically unlikely that either foreign capital or identifiable black marketeers would be allowed to act as the primary purchasers. A paucity of demand in a thin market would be likely to produce "low" prices relative to an efficient market valuation. This in turn would create accusations of government incompetence and corruption and exploitation by buyers, charges that have recently been politically unwelcome in Eastern European countries. As shown in Chile, it is also likely to put undue pressure on the availability of capital for the potentially more important objective of establishing new businesses.

Second, the time and resources necessary for ordinary individual Ukrainians to inform themselves adequately of the relative merits of buying shares in any of the thousands of individual businesses are prohibitive. This also would mean that initial purchases of shares from the state would be seen as unequal and probably unfair. Third, in any case, the lack of an established free commercial environment makes valuation of businesses on a market basis very difficult, both for the government and for all potential purchasers.<sup>256</sup> Fourth, even given time and full information, there is little Ukrainian expertise in assessing the value of a business in order to buy shares. The existing managers of businesses, the *apparatchiki* in government, and the wealthy black marketeers would have a competitive advantage in buying shares at rates that most likely would be seen as unfair and illegitimate.<sup>257</sup>

A New Zealand-style privatization program based on case-by-case competitive sales at market value could only be feasible with respect to the few largest enterprises. Even then, it would probably face major problems with respect to the lack of available concentrated domestic capital, a lack of investor

---

255. See Grout, *Employee Share Ownership and Privatisation: Some Theoretical Issues*, 98 *ECON. J.* 97 (Supp. 1987).

256. For an excellent discussion of these problems, see Frydman & Rapaczynski, *Markets and Institutions*, *supra* note 224, at 10-14, 38 app. 1.

257. See Blanchard & Dornbusch, *supra* note 217, at II-6 to II-7.

interest, and a possible political backlash, as in Poland.<sup>258</sup> The approaches to sale in Great Britain, which were more oriented toward the individual citizen, would deal better with the first problem. However, the general lack of markets for valuation purposes, of financial information and of skills in the evaluation of investments, would probably still inhibit the participation of most citizens, depress share prices, and encourage inequalities in initial capital acquisition that would be perceived as unfair and illegitimate. Unless a strong market environment has already been created, initial share prices are unlikely to reflect true free market conditions.

One distinguished commentator on Hungary favors the sale of businesses with credit financing based on the belief that those who value the businesses most highly would pay the most for them.<sup>259</sup> The example of the second phase of privatization in Chile shows that debt-financed privatization with simultaneous liberalization carries with it severe risks. Also, the assumption that those who would pay the most for an enterprise in an initial round of privatization value them most ignores the probability that subsequent share trading would better achieve this, as investors begin to understand the emerging market conditions. The frequent assertion that people do not value what they do not pay for,<sup>260</sup> implies that Ukrainians who have lived all their lives with artificial prices cannot distinguish between the price they pay for something and the price they can receive for it. However, this article argues that windfall endowments of any sort of asset are unlikely to be ignored in Ukraine, where people have become adept at making the most of what they have.

### 3. Gift

Given the above analysis, this article favors the initial privatization of the shares in all medium and large enterprises by gift to all citizens equally. A gift scheme imposes fewer valuation problems on the initial distribution, but leaves them to be worked out by those who choose to transact on the established stock market. Given the number of enterprises that would be given away, it would be impractical to give a share in each enterprise directly to each citizen, as occurred in British Columbia. Too much time and effort would be required of each citizen in their decision as to whether and when to sell their shares or

---

258. There are reports that the USSR Council of Ministers envisages case-by-case privatization of large enterprises, such as the Kama Automotive Plant Production Association. See Zhagel, *Important Action by USSR Council of Ministers*, *Izvestiya*, June 29, 1990, at 4, English summary reprinted in 42 CURRENT DIG. SOVIET PRESS, Aug. 1, 1990, at 21. However, it is not clear that true independence is envisaged for each enterprise. See 1 PARKER SCH. BULL. SOVIET & EAST EUR. L., Nov. 1990, at 12.

259. J. KORNAI, *supra* note 136, at 80-86. See also Feige, *supra* note 86 (proposed privatization that uses cheap credit in some of its elements).

260. See, e.g., State Property Denationalization, in Background Reading Material, *supra* note 10, at 9 (last document in material).

to buy more.<sup>261</sup> Furthermore, the dispersed nature of shareholding would inhibit the monitoring of management by shareholders.<sup>262</sup>

Gift through intermediaries as a mechanism for privatization in Eastern Europe has been discussed in many variations by several sources, including the Polish government.<sup>263</sup> This mechanism responds to some of the particular circumstances faced by privatization programs in Eastern Europe: the existence of thousands of government businesses, the lack of any widespread experience at trading shares or monitoring management, and the political and moral requirements of fairness in the distribution of shares. This method of privatization is a prime candidate for use in some form in the Soviet Union and Eastern Europe.<sup>264</sup>

In essence, the concept is to give shares in all underlying productive companies equally to each citizen. This is done through the formation of several intermediaries, such as mutual funds, each of which holds shares in the underlying companies to be privatized. The shares in the mutual funds are then given equally to each citizen.<sup>265</sup> For example, each citizen of Ukraine would receive an equal number of shares in each mutual fund.<sup>266</sup> Because the mutual funds would own the shares in the underlying companies, all citizens would receive equal interests in the privatized companies. They would be able keep their shares in mutual funds and receive dividends from the profits of the funds or sell their shares on the stock market.

As demonstrated in British Columbia, and as understood by *Rukh*,<sup>267</sup> an educational campaign would be necessary to ensure general understanding of these options. In Ukraine, the educational campaign would have to be very comprehensive because of the lack of popular understanding of basic institutions of capitalism. The campaign would have to confront popular prejudices against capital and profit, reinforced by seventy years of communist rhetoric. Yet the consideration of popular attitudes to such concepts in Part II.A illustrates some basis for hope that such a campaign would be successful, especially

261. Blanchard & Dornbusch, *supra* note 217, at II-9 to II-10.

262. Frydman & Rapaczynski, *Markets and Institutions*, *supra* note 224, at 22.

263. For the three best academic discussions of privatization through intermediaries, see Blanchard & Dornbusch, *supra* note 217; Frydman & Rapaczynski, *Markets and Institutions*, *supra* note 224; and Lipton & Sachs, *Privatization in Poland*, *supra* note 240. The ideas discussed in each of these studies differ in major respects, but all advocate the use of holding companies, investment trusts, or investment funds in some form. The concepts presented in this section represent my amalgam of such ideas. See also Memorandum from Joseph C. Bell to V. Pylypchuk, Chief, Commission for Economic Reform, Presidium Supreme Soviet, Uk. SSR (Oct. 10, 1990), *reprinted in Background Reading Material*, *supra* note 10; Blanchard & Layard, *supra* note 231; MENDELSON, *PRIVATIZING EASTERN EUROPE* (University of Pennsylvania Institute for Law and Economics Discussion Paper No. 97, 1990).

264. See S. FISCHER & A. GELB, *supra* note 8, at 26; Hanson, *supra* note 57, at 106 (USSR State Property Fund envisaged to be body in charge of privatization rather than vehicle for it).

265. Cf. Feige, *supra* note 86, at 26 (analogous idea of a "citizen share").

266. *Rukh* believes that the identification of Ukrainian citizens should not be a problem, once a draft law on citizenship is passed.

267. Savchenko, *supra* note 85, at 10.

if it were expressed in terms of returning the people's property to the people in a socially legitimate manner. The gift of shares in mutual funds would provide an important educational experience to the Ukrainian public in generating interest and disseminating information. Everyone would have a stake in the success of the economic transformation, as well as in the increase in wealth.<sup>268</sup> People would probably debate the concepts and mechanics of the distribution and the subsequent operation of a stock exchange and become more familiar with these institutions of a market economy.

The mutual funds would act as institutional investors.<sup>269</sup> They would trade shares in the underlying companies and monitor the managers of the companies. They would thus form the engine of a stock market in which individual citizens and presumably foreigners could buy and sell shares. More importantly, they would begin to exert the commercial monitoring pressure on management that is necessary for business efficiency.<sup>270</sup> This avoids the problems of lack of monitoring that would occur with direct gifts to all citizens and the social illegitimacy that would occur from sale to the highest bidder. The profits of a mutual fund would come from the dividends of all the underlying companies in which it owns shares and the profits it makes from buying and selling shares. The performance of a mutual fund would be reflected in the performance of its own share price, which should rise if the mutual fund does well.

Mutual funds provide an effective way of giving an equal interest in all enterprises to each citizen without overwhelming them with shares in thousands of individual companies or forcing them to guess the value of businesses. It seems to satisfy the requirement of fairness and legitimate distribution,<sup>271</sup> and could be politically attractive in Ukraine not only for its equality but also for its positive conferral of wealth on all citizens. This could aid the political reputation of a government's economic reform efforts. Such a scheme could also enhance the efficiency of the stock market by establishing professional investment institutions. It would address the need for the quick development of markets for equity financing, while providing the opportunity for a relatively unhurried and considered restructuring of individual businesses and organizations.<sup>272</sup>

---

268. Feige, *supra* note 86, at 32.

269. Institutional investors – such as mutual funds, pension funds, banking and insurance companies – constitute a highly and increasingly significant proportion of shareholders in western economies. Jensen, *Eclipse of the Public Corporation*, HARV. BUS. REV., Sept.-Oct. 1989, at 61 (institutional ownership is more efficient than ownership by individuals and will become predominant in western economies).

270. Frydman & Rapaczynski, *Markets and Institutions*, *supra* note 224, at 6 (“[E]fficient control over management performance . . . is, in turn, the essence of the genuine restructuring process”); Lipton & Sachs, *Privatization in Poland*, *supra* note 240, at 313 (importance of effective corporate governance).

271. Privatization by lottery may also satisfy such aims. See Savchenko, *supra* note 85, at 11.

272. Blanchard & Dornbusch, *supra* note 217, at II-2, II-11 to II-21 (achievement of this dual objective is important and a convincing reason for proceeding with privatization by gift through intermediaries). Lipton & Sachs, *Privatization in Poland*, *supra* note 240, at 315. *But see* Beksiak, Gruszecki, Jedraszczyk, & Winiecki, *Outline of a Programme for Stabilisation and Systemic Changes*, in *THE POLISH TRANSFORMA-*

The above considerations warrant founding a program of privatization on the gift of shares to all citizens through intermediaries. The major problem with such a program lies in the institutional structure of the mutual funds. There is a danger that a mutual fund will act like, and be staffed by the personnel of, the various organs of the state that used to control these enterprises. However, to the extent that an efficient stock market emerges, there will exist an independent, objective commercial assessment of the performance of mutual funds. Related to this, the performance contracts of the managers of mutual funds will require careful structuring to ensure that they face appropriate incentives for efficient behavior. There must also be a conscious effort to insulate the operational management of funds as much as possible from political interference. Lastly, the corporatization experience in New Zealand demonstrates that a change of organizational form and corporate culture does matter. This could be encouraged through careful and professional establishment of mutual funds, with special provisions for foreign advisers, along with simultaneous restructuring of the organizational form of businesses.

The proposals of Frydman and Rapaczynski and the Polish government's plan both address the problem of incentives for intermediary managers by, ingeniously, turning the creation of the intermediaries over to the market.<sup>273</sup> Certainly, the ability of anyone who so wishes to form a mutual fund and to use citizen vouchers to bid for assets has conceptual attraction. Those who want to run a business based on monitoring the management of a variety of other companies can do so. Those who do not want to be involved in monitoring the management need not be; they can pay a management fee to someone who does.

On the other hand, competition between intermediaries creates informational problems for citizens in choosing between intermediaries of different skills and competence. Furthermore, there is no necessary relationship between the competitively determined level of the management fee and its political acceptability. If the competitively determined equilibrium management fee effectively involves a twenty percent profit share going to the financial institution, there may well be a popular feeling of exploitation. This will be exacerbated if, as is likely, those best able to form competitive intermediaries are the *apparatchiki*, black marketeers, and foreigners. Once the principle is accepted that intermediaries are to compete for the initial distribution of shares, it becomes very difficult to maintain equality of distribution across the citizenry.

The above considerations illustrate the nature of the tradeoff in deciding how mutual funds or other intermediaries are to be created and operated. If the government decides, then there are incentive and efficiency problems. If

---

TION: PROGRAMME AND PROGRESS, *supra* note 215, at 19, 47 (rejected "fiction" of speed of institutional ownership).

273. Frydman & Rapaczynski, *The Polish Government's Plan*, *supra* note 224, at 1-2.

## Privatization in Ukraine

the market decides, there are political problems regarding perceived fairness. These problems are at the core of privatization. The problems illustrate the nature of the use of intermediaries for privatization. Intermediaries do not change the fundamental nature of the issues or options, but they do ameliorate some of the problems.

Finally, it appears from the above that it would be especially important to facilitate the emergence of a Ukrainian stock market if privatization through intermediaries were to be pursued. Yet the formation of several intermediaries that hold all the shares of all the underlying businesses might only lead to a thin market. Mutual funds could be subjected to legal requirements to sell a proportion of their holdings over a period of several years -- thus achieving wider share ownership and a thicker, more efficient market. However, the aims of trading, monitoring, and selling down could create conflicting incentives that lead to neither being satisfactorily achieved.<sup>274</sup> As a result, it could be difficult to design an organizational structure and laws that adequately reconcile the two.

### 4. Part Sale, Part Gift

There are two other significant problems with privatization by gift alone. First, although using intermediaries makes large scale privatization of ownership possible, it does little to encourage individual ownership of shares in the underlying companies.<sup>275</sup> Poland has responded to this problem with ideas to combine such a program with distribution of proportions of shares in enterprises to workers, banks, other financial institutions, and local authorities. Second, privatization by gift alone does not contribute substantially to one of the requirements identified above, that the government has the means to deal with social problems of transition to a market economy. This can be taken into account to some extent by altering the terms of distribution of mutual fund shares. They could be distributed, for example, on the basis of some measure of need. Alternatively, a proportion could be reserved for future distributions to specific target groups.

Despite my rejection of privatization by public sale alone, partial use of the sale option does have its advantages. It offers the possibility of creating the means to address social concerns, encourages direct individual ownership of shares in the underlying companies, and does something to address the ruble

---

274. See Blanchard & Dornbusch, *supra* note 217, at II-12; Frydman & Rapaczynski, *The Polish Government's Plan*, *supra* note 224, at 1-2 (problem in the Polish Government plan).

275. Beksiak & Winiecki, *A Comparative Analysis of Our Programme and the Polish Government's Programme*, in *THE POLISH TRANSFORMATION: PROGRAMME AND PROGRESS*, *supra* note 215, at 9 (recommending against using intermediaries for this reason).

overhang problem to the extent that it still exists.<sup>276</sup> Privatization could be done in several stages. The first stage could involve privatization by gift through mutual fund intermediaries, as discussed above. But the mutual funds need hold only a specified majority of the shares in the underlying companies (e.g., sixty-five percent).<sup>277</sup> After the stock market has existed for an appropriate period of time (e.g., one year), with the attendant publicity and public education campaign, the government could sell the remaining shares in the underlying companies by using a British-style sale of shares to the public at set prices.

Hopefully, the existence of a stock market price for these shares for a one year period, and people's experience with owning mutual fund shares, would reduce the general information problems of assessing share values that make total reliance on sales difficult. This would also reduce, to some extent, the negative perceptions of social illegitimacy of those people who profited from their better access to knowledge.

Selling shares at a set price also may be advantageous if the stock market's stability is sufficient to generate confidence in pricing. Such shares could, as in Britain, be priced at a uniform discount from the expected market price to attract buyers' interest. The sales would encourage people and institutions other than mutual funds to directly own shares, while raising money for the government. The government could devise share allocation rules to increase the perceived fairness of the sales. Rules could include setting a maximum number of shares an individual may buy in an enterprise or, as discussed above, reserving a small proportion of the shares in a company for purchase by the employees of that company. Other groups might also make political cases for being deserving recipients.<sup>278</sup> As long as shares are tradeable, and if the demands of political constituencies are carefully managed, political arguments should not cause too much concern.

#### F. *Summary of an Illustrative Program*

As the above analysis indicates, there are many different economic and political arguments bearing upon the privatization options facing Ukraine. The appropriate conclusions rest heavily on assessments of Ukrainian social and

---

276. J. KORNAL, *supra* note 136, at 88-89 (reducing ruble overhang is important objective of macroeconomic policy). See Ofer, *supra* note 58, at 143.

277. The figure of 65% was chosen on the basis of a very loose and impressionistic view of the degree to which it would be necessary to demonstrate social legitimacy in privatization in Ukraine. This proportion is the inverse of that suggested by Rukh. See Savchenko, *supra* note 85 and accompanying text.

278. In several 1989 Hungarian opinion surveys about preferred identities of recipients of state enterprises to be privatized, of those polled: 9% favored a return to original owners, 29% favored selling to the highest bidders, 26% favored turning it over to the workers, 33% favored retaining it as state property, and 4% offered no opinion. See Hankiss, *In Search of a Paradigm*, DAEDALUS, Winter 1990, at 183, 204.



political attitudes. Based on my own assessments, this article has outlined a possible program of privatization in Ukraine to illustrate how such issues might be approached and conclusions formulated. I emphasize that it is ultimately for Ukrainians, not western advisers, to make such political and social assessments and to draw their own conclusions.

In summary, small-scale businesses and other types of productive assets should be treated differently from large and medium-scale enterprises. Current operators should quickly be given an option to buy small-scale retail businesses on terms that satisfy society's sense of equity. If operators do not accept these offers, the government should operate a simple auction of businesses and/or assets to the highest bidder, as Czechoslovakia is currently doing.

With respect to its large and medium-scale enterprises, the Ukrainian government should formulate and implement a positive program of privatization, rather than allowing spontaneous privatization, as follows (figures appear for the sake of illustration):

- 1) The government should give sixty-five percent of the shares in these businesses to each citizen equally, through:
  - a) the transfer of sixty-five percent of the shares in the businesses to eight mutual funds; and
  - b) the transfer of all the shares in the mutual funds to each individual citizen equally.
- 2) After one year, if the state of the stock market allows, the government should sell the remaining thirty-five percent of the shares in the businesses at a fixed price, with special reservations available for groups the government decides deserve special treatment (e.g., workers).

The above outline leaves the details of this illustrative program of privatization still to be worked out, especially for the operation of the mutual funds.<sup>279</sup> Consideration of the legal mechanisms necessary to implement the program highlight the important policy issues, including: how to encourage share trading on a stock exchange, how to encourage individuals and enterprises other than mutual funds to own shares, what the objectives of the mutual funds are with respect to their portfolios over time, how to encourage professional monitoring of the management of the underlying companies, how to structure the incentives of the managers of mutual funds so that they maximize profits, how best to structure the organizational form and capital structure of the mutual funds, and how best to structure the relationship between the government and the mutual funds.

---

279. For a more detailed consideration of these issues, see Frydman & Rapaczynski, *Markets and Institutions*, *supra* note 224, at 24-36; Memorandum from Joseph C. Bell of Hogan & Hartson, to V. Pylypchuk, Chief, Commission for Economic Reform, Presidium Supreme Soviet, Uk. SSR (Oct. 10, 1990), *reprinted in* Background Reading Material, *supra* note 10; Blanchard & Dornbusch, *supra* note 217, at II-17 to II-21.

Further analysis of such legal and policy issues is essential to the formulation of a program of privatization. It will reveal the complexity of, and the interrelationships between, the concepts broadly discussed above.

## V. THE PROCESS OF IMPLEMENTATION

Resolution of the substantive issues of privatization is necessary, but not sufficient, for embarking on a program. Academics intent on the elegance of substantive ideas often ignore issues of process,<sup>280</sup> yet inadequate attention to the process of implementation can destroy these processes.<sup>281</sup> The international experience of privatization suggests that it is just as important to think carefully about issues of process.<sup>282</sup> Privatization is an inherently controversial issue that will generate considerable public and political debate. This will be particularly true in Ukraine. Current changes and uncertainty in the structures and roles of government in Ukraine and the pervasive conflicts of interest that many people in power face require a clear and early formulation of the process of privatization. My suggestions here are more specific than in the last section, as process is less dependent on the local circumstances of Ukraine than is substance.

### A. What?

International experience indicates that the program selected must have clearly specified objectives,<sup>283</sup> and must not underestimate the enormity of the task of implementation. After formulation of the broad outline of the program, a myriad of tasks still remains. For example, the following tasks would be included in the initial implementation of a privatization program of medium and large-scale businesses in Ukraine such as that developed above:<sup>284</sup>

---

280. While the details of actual processes used in the past are often described, there is little analysis in the academic literature of the normative considerations relevant in formulating privatization processes or assessments of such processes. *But see* Wiltshire, *The British Privatisation Process: A Question of Accountability*, 45 AUST. L.J. PUB. ADMIN. 344 (1986). Process issues are much more important to analysts in, and consultants to, governments and to organizations such as the World Bank. *See, e.g.*, Marston, *Preparing for Privatization: A Decision-Maker's Checklist*, in PRIVATIZATION AND DEVELOPMENT, *supra* note 175, at 67.

281. *See Comments and Discussion*, in 1 BROOKINGS PAPERS ON ECON. ACTIVITY 309, 312 (1990) (comments of Edward Hewett on who is going to manage privatization in Soviet Union).

282. In this section, I draw heavily on my study, observation, and experience in implementing corporatization and privatization in New Zealand. My views should not be attributed to the New Zealand Treasury.

283. *See supra* text accompanying note 186 (lessons of process in New Zealand).

284. *See also* C. VUYLSTEKE, *supra* note 167, at 23-47 (surveying general issues arising in implementation of privatization under following headings: planning and management, valuation and pricing, determining future ownership; employment issues and employee participation, costs of privatization, resource mobilization, and financing); Wiltshire, *supra* note 280, at 347-48 (four stages in British

## Privatization in Ukraine

- 1) The investigation, drafting, introduction, debate, and passage of necessary legislation regarding the administration of the program and the substantive laws regarding corporations, securities, the stock exchange, and antitrust, and of associated legal instruments such as charters of mutual funds and performance contracts;
- 2) The initiation and organization of an intensive public relations campaign to explain and justify the program, the operation of a stock exchange, and the rights of individual citizens;
- 3) The establishment of the mutual funds, including physical offices and equipment, initial capital structure, appointment of managers and personnel, and the appointment of foreign advisers;
- 4) The distribution of shares in each mutual fund to every eligible citizen, with explanation of operation;
- 5) The organizational restructuring of underlying enterprises into corporate form, with shares held by the mutual funds in light of anti-monopoly considerations;
- 6) The establishment of a stock exchange, including physical offices and equipment, rules of membership and trading, and appointment of personnel;
- 7) The commencement of stock exchange operations;
- 8) The initial and continuing analyses of the mutual fund of businesses in their portfolio, the monitoring and sanctioning of the management of each underlying business, and the commencement of trading operations;
- 9) The constant scrutiny of monopolistic practices by underlying firms in dominant positions;
- 10) The constant evaluation of the program of privatization and development of ideas for improvement; and
- 11) The constant communication between the administrators of the program, Parliament, and the rest of the bureaucracy.

This list ignores the context of market reforms that should precede and accompany such a program of privatization as well as the later arrangements for the sale-phase of the program.

### B. *Who?*

The most important factor in whether such tasks are competently and efficiently undertaken is the identity and organizational structure of the group that administers the program. This would be an important temporary task of government requiring new skills and attitudes. Efficient management of the

---

privatization process); Marston, *Preparing for Privatization: A Decision-Maker's Checklist*, in PRIVATIZATION AND DEVELOPMENT, *supra* note 175.

privatization process requires centralization, simplicity, flexibility, speed, and transparency.<sup>285</sup> Managers must have access to competent analytical and informational resources. It is important to maximize the publicly perceived political legitimacy of those who administer the privatization program. Ideally, they should be free from any future accusations of conflicts of interests, and they should be free from the intellectual baggage that most people carry from the traditional system of government. This generally implies different personnel from those who have traditionally occupied government positions and a change in the organizational culture of the administration.<sup>286</sup> Those with vested interests, such as most current government administrators and managers of businesses, should not be able to subvert the process of privatization to serve their own ends. The task of privatization in Ukraine requires the establishment of a new body specially created for the task.<sup>287</sup> It could be called the Commission for Privatization (or Ownership Transformation, as in Poland), and should be accountable to the most politically legitimate existing public body (e.g., the Ukrainian Supreme Soviet).

The appropriate lines of accountability will depend on the way in which the relationships among the Supreme Soviet, the Commissions of the Supreme Soviet, and the Council of Ministers develop.<sup>288</sup> In the absence of specific knowledge of such institutions, it is suggested that the Chief Commissioner and two Associate Commissioners should be members of the Supreme Soviet, and should be elected as a unit by the Supreme Soviet. They should bear the ultimate legal and political responsibility to the Supreme Soviet for ensuring that the program of privatization is carried out. The allocation of responsibility for administering the privatization program should be clear. Those people should have legal powers sufficient to carry out the necessary functions. They should be subject to strict rules regarding conflicts of interest and prohibited

---

285. C. VUYLSTEKE, *supra* note 167, at 80.

286. Campbell, *supra* note 21, at 5 (necessity of destroying current apparatus).

287. This is, implicitly, the view of *Rukh* in its policy and legislative proposals for establishing a Fund of State Property of the Ukrainian SSR. See *supra* notes 84-85 and accompanying text. See also C. VUYLSTEKE, *supra* note 167, at 80-90 (international examples of organization of privatization, including: a specialized government ministry, a permanent privatization committee, a sectoral Ministry, *ad hoc* privatization units, and other options); Beksiak & Winiecki, *A Comparative Analysis of Our Programme and the Polish Government Programme*, in *THE POLISH TRANSFORMATION: PROGRAMME AND PROGRESS*, *supra* note 215, at 51-52; Shirley, *The Experience with Privatization*, 25 *FIN. & DEV.*, Sept. 1988, at 34-35.

288. For a schematic diagram of the relationship between these bodies, see 1 *UKRAINIAN BUS. DIG.*, Dec. 15, 1990, at 6-7; 1 *UKRAINIAN BUS. DIG.*, Jan. 22, 1991, at 6-8. The question of how to structure a program of privatization to encompass the property managed by local *oblasts* and soviets is difficult. A currently circulating draft law on privatization in Ukraine suggests the establishment of state-owned property management committees with similar structures and powers with respect to property at each level of centralization. Draft Law on the Privatization of State-Owned Property, in Background Reading Material, *supra* note 10.

from holding or acquiring shares or options during the privatization process.<sup>289</sup> The Commission should be abolished when it has finished its task.

The commissioners should appoint a professional Chief Executive to manage the privatization program. The Chief Executive should manage the day-to-day activities of the program and should report regularly to the commissioners. The Commission as a whole need not be large, but its employees should be carefully and competitively selected for full-time positions on the basis of their skills and ability. Existing ministries must be legally, administratively, and politically required to cooperate with the Commission in providing access to information about businesses. The Commission could also appoint foreign or domestic financial or policy consultants on a competitive basis.

### C. How?

The need to establish a Commission for Privatization in law raises the general question of what legal instruments should be used to implement the program of privatization. The level of generality of most Soviet law seems to allow the general principles, processes, and timetable of a program of privatization to be embodied in Ukrainian law without unduly restricting the flexibility of its administration. These enactments must include legal clarification of exactly what the government owns and can thus privatize, and establishment of the legal mechanisms by which to effect privatization. The process of debate in the Ukrainian Soviet would enhance the legitimacy of the program, as would freedom of information rules with respect to decision-making by the Commission.<sup>290</sup> Such legal authority would also make it more difficult to interfere with or change the direction of the program arbitrarily or without public debate.

As the above list of sample tasks makes clear, it will be necessary to delegate legally most decision-making autonomy to the Commission. The legal powers, duties and functions, as well as the other activities of the Commission, should be undertaken on the basis of the commissioners' authority to exercise their legally delegated powers and to direct the activities of the Commission. They should be circumscribed only by their responsibility to the Supreme Soviet for the Commission's actions.

---

289. Draft Law on the Privatization of State-Owned Property, in Background Reading Material, *supra* note 10.

290. Shirley, *supra* note 287, at 35. Such rules should contain carefully drawn and judicially reviewable justifications for withholding information on the grounds of commercial confidentiality.

D. *When?*

A program of privatization is itself only part of a broader program of reform. "The transition process is a seamless web" of stabilization, liberalization, and privatization policies.<sup>291</sup> Privatization is integral to a transformation to a market economy and should not be delayed. However, as noted above, it is important that certain preconditions be in place before Ukraine begins to implement a privatization program. Questions of speed and sequencing are among the most difficult issues, especially with regards to the relationship between privatization and anti-monopoly policies.<sup>292</sup>

First, it makes little sense to privatize businesses that are not free to engage in true market activity. Ending this lack of freedom is not only a matter of removing total administrative direction by the government, but also of encouraging new attitudes toward market activity. To encourage such attitudes, it is important to guarantee and define market freedoms, as mentioned in Part III.A. Privatized businesses must be free to buy their inputs and sell their outputs without administrative restrictions on quantities or prices. If a government needs to buy something, it must do so at market prices, on a willing buyer-willing seller basis. This involves removing the formal laws and informal norms of general bureaucratic government administration of business. It also involves establishing a legal basis for market operations based on the laws of contract and commercial transactions. Perhaps the most difficult task necessary to make these laws effective is a behavioral change in the attitudes of government bureaucrats in the direction of a western conception of the rule of law.

Second, laws regarding ownership, organization, and activities of businesses must be in place before privatization can occur. These were discussed in Part III.A: laws of property, laws of contract and commercial transactions, organizational law, bankruptcy law and banking law, securities law, laws establishing the stock exchange, taxation laws, and labor laws. It will require a serious and sustained effort to investigate what changes are necessary and to formulate the new laws.

Third, and perhaps most difficult to devise and implement in Ukraine, are the antitrust laws that protect market competition. Western economies use a variety of legal approaches to do this: laws against anticompetitive behavior, laws against the creation of monopolies through companies merging or being taken over, laws that provide for government regulation of natural monopolies such as utilities, and government ownership of natural monopolies. The difficulty in Ukraine is that many businesses have been deliberately designed as monopolies. Industrial associations of firms have developed that also seem

---

291. Lipton & Sachs, *Creating a Market Economy*, *supra* note 216, at 99.

292. See Hanson, *supra* note 57, at 121.

to have anticompetitive aspects, raising the possibility that freeing prices would not necessarily lead to competition, due to monopolistic decisions on pricing and production.

While rules concerning anticompetitive mergers and takeovers of firms will be necessary,<sup>293</sup> they will not address the problem of existing monopolies. To facilitate efficient market behavior, it would be logical to break up monopolistic enterprises into separate units. For example, all privatizations in New Zealand were preceded by analysis of the competitive structure of the relevant industry. In Ukraine, though, the problem with breakup as a solution is that some monopolies are single factories. Where controlling monopolies by breakup is not possible, it will be necessary either to continue government supervision of these enterprises through a regulatory regime of privatized companies, to continue government ownership, or to privatize them and ignore allocative inefficiency, monopoly profits, and social resentment in favor of the cost efficiencies that can be expected to result from private ownership.

This is not a comprehensive solution to the problem of monopolistic enterprises. However, it is important to have a plan for dealing with monopolies before a program of privatization is implemented. The problem of monopoly highlights the important question about the speed and sequencing of the reforms that are necessary to create a market economy. Most analysis of the transformation from a controlled economy to a market economy suggest that two distinct stages of reform are necessary.<sup>294</sup> The first stage involves stabilization of the macro-economy (including reform of currency, monetary policy and government spending), liberalization of the micro-economy (including freeing prices and guaranteeing market freedoms), and the establishment of a legal basis for the market economy. The first stage is perceived to be a necessary precondition for the second stage, which is privatization. Some analysts suggest, however, that monopoly problems could affect this sequencing.<sup>295</sup> They suggest that the immediate breakup and privatization of the monopolies must be undertaken at the same time as the first stage to encourage the development of efficient market conditions. A second, more practical reason for starting liberalization and privatization at the same time is that privatization will take substantial time to organize both technically and politically.<sup>296</sup> This supports the argument that issues of the timing of implementa-

---

293. The USSR is apparently considering draft legislation along these lines. Kroll, *Introducing Competition into the Soviet Economy: Anti-Monopoly Policy Under Perestroika*, PERSPECTIVE (1990). It is also considering retaining price controls on monopolistically produced products, in accordance with the draft Law on Enterprises. Dolganov & Stepovoi, *The Law on Enterprises: New Approaches*, *Izvestiya*, June 2, 1990, at 1, English excerpts reprinted in 42 CURRENT DIG. SOVIET PRESS, July 11, 1990, at 10-11.

294. See generally J. KORNAI, *supra* note 136; Beksiak & Winiecki, *A Comparative Analysis of Our Programme and the Polish Government Programme*, in *THE POLISH TRANSFORMATION: PROGRAMME AND PROGRESS*, *supra* note 215.

295. See Kroll, *supra* note 293; Frydman & Rapaczynski, *Markets and Institutions*, *supra* note 224.

296. Blanchard & Dornbusch, *supra* note 217, at II-1.

tion should be regarded as "packaging" issues rather than "sequencing" issues.<sup>297</sup>

For the whole program of privatization, speed and sequencing may be the most difficult and important issues to resolve, as shown by the example of the second phase of privatization in Chile. They depend on the resolution of legal, economic, and political questions.

## VI. CONCLUSION

This article contemplates the fundamental transformation of the Ukrainian economy to a market-based system. It contemplates the implications of the Ukrainian economy and Ukrainian law for economic transformation and vice-versa. The political momentum toward economic transformation generated by *perestroika* and *glasnost* is substantial, and is integrally interwoven with Ukrainian nationalism. The impediments to economic transformation are similarly substantial: the nationalistic conflict between Ukraine and the USSR, the political value placed on social policies, suspicion of private business activity, the absence of capitalist economic institutions of capitalism or an understanding of market concepts, and the absence of experience with a western conception of the rule of law. The problems of systemic transformation from command and control to markets are enormous in terms of law, economics, and politics. The direction of the future evolution or revolution in the Ukrainian economy is unclear, but Ukrainians have already made far more progress toward economic transformation than seemed possible two years ago.

Privatization is an essential element of transformation to a market economy. While the task is unprecedented, western economic theories can help elucidate the theoretical concepts behind privatization, while international experience can illuminate the practical problems of implementation. Five case studies of privatization throughout the world have been used to characterize options for formulating a substantive program of privatization in Ukraine. On the basis of my own perceptions of the Ukrainian political, economic, and legal contexts, this article has presented an illustrative program of privatization of medium and large-scale enterprises. It involves a combination of gift, to be distributed equally to all Ukrainian citizens, and of later sale at a set price. While the substantive analysis here may be useful of itself, it is more important to acknowledge and analyze the economic, legal, and political reasoning that might be involved in Ukrainians formulating a program themselves. Managing the process of implementation, a topic too often ignored in academic literature, deserves equally careful attention.

---

297. S. FISCHER & A. GELB, *supra* note 8, at 29 (suggested terminological change from traditional economic language emphasizes inherent interrelationships between policies rather than implying that linear time relationships are appropriate).



## Privatization in Ukraine

Political, social, and legal factors are too often ignored in the theoretical development of economic reform proposals. It is only with a thorough understanding of the Ukrainian context that a suitable program of privatization can be developed and implemented. This is particularly important with respect to economic transformation when democratization is occurring simultaneously. These two participants in a three-legged race are inextricably linked, but motivated and impelled by different forces. Surely the participants in the race have better knowledge of their constraints and the necessity for synchronization than western bystanders. Ukrainians understand their context. Although western information, experience, and advice will be useful, Ukrainians should exercise their right of "economic self-determination" to pick and choose those aspects they wish to use. The task is immense, but Ukrainians have the concern and determination that are necessary to succeed.

