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Industrial Restructuring in Ukraine:

from socialism to a planned economy ?

by

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Abstract

Six years into post-socialist economic reform, a division has appeared between the Central and Eastern European reform countries (CEE) and the CIS-countries. Whereas the former are dedicated to introducing the institutions of a capitalist market economy, the European CIS-countries (Russia, Ukraine, Belarus, Kazakstan) still hang on to some type of state-planning and a high degree of political interference in economic life. We show this development in a country that is new to European economics and policy: kraine. Just like its fellow CIS-countries, Ukraine has quickly succeeded macroeconomic stability, but insufficient structural reform may prevent a sustained economic development process.

Our thesis is that Ukraine is at present embarking on a path from non-monetary socialism to a monetary planned-economy. An incredible amount of planning activity is observed in almost all spheres of economic life. We provide proof of that through empirical case studies, carried out personally in about 50 industrial enterprises all over the country. We conclude that the “window of opportunity“, during which substantial reforms can be pushed through based on a large social consensus, is over. Remaining reforms will be piecemeal only, and hence, can have only piecemeal results. The post-Soviet patterns of economic reforms that are emerging in the CIS-countries have a direct impact on the European and world integration of these countries.

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Zusammenfassung

Sechs Jahre nach Beginn der post-sozialistischen Wirtschaftsreformen ist eine zunehmende Kluft zwischen den mittel- und osteuropäischen Ländern (MOE) einerseits und den Ländern der GUS andererseits zu beobachten. Die mittel- und osteuropäischen Länder unternehmen ernsthafte Schritte zur Einführung der Institutionen einer kapitalistischen Marktwirtschaft. Im Gegensatz dazu wird in den großen GUS-Staaten (Rußland, Ukraine, Belarus, Kasakstan) in weiten Bereichen an staatlichen Planungsmethoden festgehalten und erhebliche politische Eingriffe in das Wirtschaftsleben bestimmen das Bild. Dies ist besonders deutlich im Fall der Ukraine, einem jungen Staat, dem eine zunehmende Rolle im europäischen Wirtschaftsleben zukommt. Zwar hat die Ukraine rasch makroökonomische Stabilität erreicht, jedoch gefährdet das Ausbleiben grundlegender Strukturreformen den Übergang zu einer nachhaltigen Wirtschaftsentwicklung.

In diesem Aufsatz vertreten wir die These, daß sich die Ukraine derzeit auf dem Weg vom nicht-monetären Sozialismus zu einer monetären Planwirtschaft befindet. Praktisch alle Bereiche des Wirtschaftslebens werden von zentralen staatlichen Planungsvorgaben überschattet. Dies wird anhand konkreter Fallstudien nachgewiesen, die in Industrieunternehmen des Landes durchgeführt wurden. Jene Periode, in der grundlegende Reformen möglich sind und von weiten Teilen der Bevölkerung getragen werden, ist vorbei. Zukünftige Reformschritte können nunmehr nur noch graduell erfolgen, und somit auch nur graduelle Änderungen hervorrufen. Die post-sowjetische Wirtschaftspolitik, so wie hier beispielshaft für die Ukraine beschrieben, wird nicht ohne Auswirkungen auf die Integration der GUS-Staaten in die europäische und die Weltwirtschaft bleiben.

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Industrial Restructuring in Ukraine: from socialism to a planned economy ?

The industrial policy of the government is aimed at maintaining, supporting, and developing domestic industrial producers in those branches that represent vital interests of the country, in particular its economic independence and the social and cultural standard of living of the population.

Preamble of the "State Concept for Industrial Policy in Ukraine",
decree No. 272 of the Ukrainian Cabinet of Ministers, February 29, 1996

Introduction

The success of economic reforms in the post-socialist countries of Eastern Europe depends upon their ability to move from macroeconomic stabilization to sustained economic growth. The key to attaining this goal is market-oriented structural reform on the enterprise level. Six years after the first radical reform program in Poland, most of the countries of Central and Eastern Europe (CEE-countries) have achieved sufficient structural reform to embark on a sustained growth path; examples are Poland, the Czech and Slovak Republics, Estonia, but also Hungary or Romania (EBRD, 1996). Instead, in the countries of the Commonwealth of Independent States (CIS-countries), economic reform does not yet show any long-term success; examples for this are Russia, Belarus, Ukraine or Kazakstan. Though macroeconomic stabilization is achieved in these countries, signs for sustained recovery are weak. Therefore, a division seems to appear between Central and Eastern Europe on one hand, and the CIS-countries on the other hand. This difference touches not only quantitative economic results, but also institutional and regulatory issues. CEE-countries are more or less dedicated to principles of a market economy. Instead, CIS-countries seem to be dominated by a post-Soviet component, hanging on to some type of state-planned economy and a high degree of political interference.

In this paper, we analyze the problems of post-Soviet industrial reforms in a country that is new to European and world economics and politics: Ukraine. In Ukraine, the conflict between market-orientation and state-intervention is wide open, and so are the prospects of a successful and sustainable reform process. Having started a serious reform effort in mid-1994 only, Ukraine had to cope with drastic output decline in 1994 and 1995, which will come only slowly to a halt in 1997. But whereas macroeconomic and monetary stability is achieved, signs for successful structural reforms are weak. Instead, state-planning activities seem to be back and alive: instead of fostering market-oriented enterprise restructuring, the successive governments did much to save the un-savable structures of value-subtracting factories, and to hamper the development of small and medium enterprises (SMEs).

Our hypothesis, then, is that Ukraine is at present embarking on a path from the non-monetary socialism to a monetary, planned economy. Socialism is definitely dead since 1992, in that the reign of the Communist Party was abandoned and a universal monetary unit of accounting introduced. But important elements of state planning - in the sense of prescribing quantitative economic plans - continue to dominate the process of industrial restructuring. The risk of this policy is that the country will not reap the benefits of macro-reform, but engage in a low-level equilibrium trap of GDP. This will not leave the foreign economic relations of Ukraine untouched: stumbling reforms will require Ukraine to reorient its economy towards Russia and the CIS, upon which it depends for a large part of its imports of energy and intermediary goods. The integration into the European and world economy, which slowly began over the last three years, would suffer.

The plan of this paper is straightforward: in section 1, we sketch out the two trajectories of post-socialist reform that are emerging in Eastern Europe. We distinguish between countries that are about to establish the institutions of a Western European-type capitalist market economy, and those who are not. CIS-countries belong to the latter: indications for structural change are weak, be it industrial production, unbundling of combines, efficient corporate governance structures, or competition policy. We argue that this is not due to the latecomer-position of CIS-countries, but the result of an economic policy that is insufficiently market-oriented. In section 2, we highlight the difficulties of reform in Ukraine, which until 1991 was an over-industrialized satellite of the Soviet Empire. From late 1991 onwards, Ukraine’s top priority was to consolidate its newborn nation, with no coherent economic policy for the first years. A shift occurred in late 1994, with the introduction of an economic reform program, that succeeded rapidly in reducing inflation. Yet, little was done to "unleash the forces of capitalism and private ownership".

Instead, it seems that Ukraine used its newly gained independence to "unleash the forces of state planning", now that the Moscow-dominated system was abolished. Indeed, an incredibly detailed and work-intensive planning activity can be observed in many spheres of economic life: instead of setting up markets for goods and services, the government continues to plan production targets and to fix prices. Examples are the 1-year and 5-year plans developed for each industrial branch, and which include large state subsidy programs; the state planned restructuring of 60 large combines from mechanical engineering and the military-sector; the plan to set up state-controlled transitional industrial-financial groups; the plan to decrease energy consumption through administrative measures; the state-controlled channeling of foreign direct investment to certain enterprises (section 3). The danger that we see is that these "reforms" may lead

Ukraine from the former socialist system directly towards a state-planned economy. We conclude with a discussion of the perspectives of post-Soviet type economies (section 4). Contrary to common belief, industrial restructuring in Russia, Ukraine, Belarus or Kazakstan is not at the end of a ”crisis” but just about to enter its critical phase. The process will take many years if not decades. The ”window of opportunity” in which radical reforms can be pushed though based on a large social consensus, is definitely over in all CIS-countries; if reforms are continued, they will be piecemeal only, and hence, the results, too, can be piecemeal only.

1. Diverging patterns of post-socialist reform: the CEE-model against the CIS-model?

1.1 Structural change as the key to economic reforms

Economic reform in Eastern Europe is an attempt to introduce the institutions and constraints of a capitalist market economy to countries dominated by socialism. Socialism was characterized by the dominance of the Communist Party in all spheres of production and distribution. Thus, the system was based on a purely materialistic rationality (Weber, 1921/1980); it was impossible to identify any economic rationality, i.e. a formal rationality based on monetary calculation (von Mises, 1920, Lazarus, 1995, von Hirschhausen, 1996 a). Therefore, abandoning socialism had to be a radical process, in that the incumbent socialist institutions had to be abolished at once (i.e. the Communist Party, the segregation between monetary spheres, the isolation from international markets). The fact that not a single country in Central and Eastern Europe or the CIS avoided a drastic slump in output shows that there was no way to conduct reforms gradually (von Hirschhausen, 1996 b). The debate between "shock-therapists" and "gradualists" turns out to have been quite irrelevant.

Instead, no consensus has emerged on the precise content of structural policies as a part of the "Holy Trinity" proclaimed in 1990, i.e. liberalization-stabilization-structural reform. The first two policy elements, liberalization and stabilization, could be easily designed with a pencil and a white piece of paper. But the restructuring of socialist industrial structures to market oriented enterprises turned out to be a problem that far exceeded the issues of ownership change and privatization. Stylized facts on restructuring on the enterprise level then contradicted the generally held wisdom that rapid privatization was central to the success of restructuring (Pinto, Belka and Krajewski, 1993). Adopting a political economy perspective, Roland (1994) argued for a gradual approach to industrial restructuring, to ensure an efficient hardening of budget constraints while developing a sound private banking and financial sector. Drawing upon a series of empirical case studies, Carlin et al. (1994) pretended on the contrary that deep restructuring requires the takeover of former state enterprises by strategic investors, preferably foreigners.

On the basis of over 150 case studies on enterprise restructuring, Bomsel (1995) and von Hirschhausen (1996 b) argued that the key to structural change is to facilitate the disintegration of socialist factories, and their re-combination to capitalist enterprises, under an external capital constraint; we called this the process of "enterprization". Horizontal industrial policies should be designed, specific for each country, in order to overcome these obstacles to enterprization. The success of structural reforms depends on the capacity of the new governments to design and implement horizontal industrial policies. Today, a wide consensus has emerged on the central role of structural change as a prerequisite for sustained economic development.

1.2 A new divide between CEE- and CIS-countries

Six years into post-socialism, a new divide is developing today between different trajectories of structural change: most CEE-countries have achieved a profound reorganization of industrial structures and enterprises; instead, the CIS-countries have not. This can be seen using different indicators for industrial branches or enterprises (e.g. size, scope, employment, ownership structures, markets, etc.). In CEE-countries, different privatization schemes lead to different corporate governance structures, in particular between insider and outside control. Yet, new enterprises were created in large numbers in all CEE-countries, and put under budget constraints that are becoming more and more severe. Financial markets and banks start to exercise capitalist constraints. Unemployment is accepted as a phenomenon resulting from the separation between enterprises and the state. State enterprises still abound, yet they, too, operate under market conditions and are subject to a more or less strict control from their owners (i.e. State Property Agencies, Branch Ministries, or the like). In brief, the basic institutions of a capitalist market economy are in place. Today, the only policy question is one of refining the regulation, to "grease" the economic system in order to make it work more smoothly.

In CIS-countries, none of these institutional developments have taken place sufficiently so far, and chances are that they will not over the next years. Socialism was abandoned in late 1991/early 1992, with the currency reform and the far-reaching price liberalization in Russia. The destruction of socialist industrial networks was more radical than in the CEE-countries, because the entire Soviet Union patterns of industrial cooperation blew up in 1992. Yet, four years later, the output decline has not been halted, neither in Russia - where prospects are the least bleak - nor in Belarus, Ukraine, or Kazakstan, the other important republics. As a rule of thumb, privatization has moved the control from outsiders to insiders. Factory closures are quasi-inexistent. Financial markets do not work, an efficient, competitive banking system does not exist. High real interest rates render credit-financed investments impossible, even for the medium-term. The legal framework is incomplete, and even where it exists, the implementation is rarely assured. The state has developed large industrial holding companies in almost each branch. The most lucrative companies were "privatized" to former managers, in particular in the energy sector (i.e. Gasprom, Lukoil). The concept of Financial-Industrial-Groups (FIGs), conceived in Russia, has become a buzz-word for successful, state-controlled restructuring; so far, it does not seem to have accelerated the restructuring process (Bomsel and Rouvez, 1995).

Probably the clearest signal that the CIS-countries adopted a fundamentally different approach to economic reform is their refusal to accept responsibility for the social results of the transformation process. Officially, unemployment rates are in the order of 2-4%, i.e. next to nothing. Everybody knows, though, that real unemployment is in the range of 20-30%, if not higher (Standing, 1994). In brief, the CIS-countries are quite far away from introducing a market-regulated capitalist system.

Table 1 summarizes some indicators of what we perceive as a difference in nature of the trajectories of post-socialist countries.

Table 1: Differences in economic institutions between CEE-countries and CIS-countries

	CEE-countries (e.g. Poland, Hungary, Czech and Slovak Republics, Romania)	CIS-countries (e.g. Russia, Ukraine, Belarus, Kazakstan)
Progress of enterprization	enterprization is largely achieved, creating a host of new enterprises; abandon of multifunctionality of industrial factories	enterprization is achieved in few former state combines only; multifuctionality (production intertwined with social sphere) remains strong
Ownership change	largely completed; an important stock of enterprises remain state-owned (e.g. Poland: 54% of all industrial enterprises), but they, too, are subject to budget discipline and capital constraints	formal privatization is advanced, but ownership is widely spread-out; state retains controlling stakes in many enterprises; mysterious “auto-privatization” of the few lucrative objects (e.g. Lukoil, Gasprom)
Budget constraints	hardening; (relatively) large number of factory closures (in particular: Hungary)	weak; no factory closures; serious rise in inter-enterprise arrears
Role of banking system, financial markets	increasing importance of financial markets (in particular: stock market, foreign exchange); competition within the banking sector is intensifying; remaining problem: outstanding credits	financial markets hardly work, competitive banking system does not exist; high degree of concentration of few banks; strong state impact remains
Investment financing	real interests rates are becoming “reasonable” (i.e. one-digit); investment financing of enterprises through banking system and financial markets is increasing	collapse of investment is continuing; small investments are auto-financed from retained earnings
Role of the state	more and more a “state-regulator”, with strong emulation of EU-model of economic regulation; active regional policies	active pursuit of vertical industrial policies and post-Soviet-type of state planning; selective protectionist trade policies
Unemployment	unemployment is accepted as a result of separation between economic sphere and the state; extensive unemployment schemes, unemployment benefits and social security are largely in place and working; level of unemployment similar to EU-countries (i.e. ca. 10-20%)	the state refuses to accept responsibility for the social results of economic reform; official unemployment figures are artificially kept low (2-4%); real underemployment is estimated in the range of 20-30% (Russia and Ukraine)

1.3 Towards a ”post-Soviet” mode of economic development?

The differences in development trajectories identified above can be interpreted in two ways:

a) as temporary phenomena, where one would assume that the CIS-countries only trail 2-3 years behind other CEE-countries. In that case, the CIS-countries should be able to inverse their economic decline in 1997/98, and embark on a dynamic growth path thereafter;

b) as long-term phenomena in that case, the very nature of the restructuring process in the CIS-countries differs from those in Central and Eastern Europe; this will keep the CIS-countries from following the trajectories prescribed by CEE-countries.

Arguments for case a), i.e. a temporary lag only, can be the later starting point of reform (1992 instead of 1990), the heavier legacy of the Soviet industrial system, the breaking-up of the ruble-zone, and the complex process of nation-building that may have interfered with the definition of consistent economic policies.

We contend, on the contrary, that the basic economic reform policies underlying CEE-recovery were not adopted in CIS-countries. Therefore, our argument clearly points in the direction of case b), i.e. a long-term deviation of the CIS-countries from CEE-countries' reform patterns. Reasons for this need not only be sought in the economic sphere, i.e. the breaking-up of an over-distorted Soviet industrial structure. It is evident that historic elements also account for a difference in nature between CEE-economies and the post-Soviet economies. The close integration of the main Republics (i.e. Russia, Ukraine, Belarus, Kazakstan) date back several centuries; geographical proximity will oblige the new Republics to maintain a certain economic interdependence. The main reasons for a similarity of modes of development is the dependence of all post-Soviet Republics upon Russia. Russia is and will remain the economic, political, and geostrategic core of the CIS. Therefore, it is logical that other CIS-countries, in particular Belarus, Ukraine and Kazakstan, try to emulate the Russian mode, at least partially.

In the following sections, we identify the peculiarities of the reform path of the second most important CIS-country: Ukraine. Section 2 sketches out the latecomer aspects of economic reforms in Ukraine, whereas section 3 indicates why we believe the Ukrainian reform path will fundamentally differ from what was expected in 1992.

2. Ukraine: latecomer of macroeconomic and structural reform

2.1 Point of departure: an independent Ukraine facing an economic disaster

Ukraine emerged as an independent nation when the population confirmed Parliament's (August 1991) declaration of independence in the December 1991 referendum. The new Ukraine was built on a fragile consensus between nationalists, turnaround bureaucrats, and the coal miners[2]. This peculiar coalition was sustainable only for one purpose, i.e. assure Ukrainian independence. Beyond that common goal, each of the parties pursued very diverging interests: for the nationalist movement, independence was a goal in itself and economic reform a necessity to stabilize the newly acquired independence. For the turnaround bureaucrats, independence was a way to hang on to new (Ukrainian) power, where old (Soviet) power inevitably vanished. For the coal miners, the country's largest industrial lobbying group, independence was the only way to assure a strong position for the coal mining industry in a weak Ukraine (instead of having to play a weak role in the

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[2] A thourough analysis of the nationbuilding process and economic policy is compiled by Wittkowsky (1996 and forthcoming).

strong Soviet coal industry). "Ukraine" thus emerged as a new concept both for politics and economics; it stands for the December 1991 compromise between elites that hardly talked to each other little time before.

The compromise on Ukraine’s independence was also built on the (false) belief that the Ukrainian economy belonged to the strongest of the Soviet Republics, and that it would benefit from economic independence. The strong raw material position it held at Soviet times gave Ukraine an ill-founded oververstimation of the economic potential at the moment of independence. This subjective impression of Ukrainians themselves was strengthened by an international reputation of the country as a strong raw material and agricultural base. Analyses carried out by international institutions and banks, still based on socialist criteria of evaluation, estimated that Ukraine was among the richest Soviet Republics and that it had the best potential for growth[3]. The only source that pointed in the right direction, i.e. warning against an overestimation of Ukraine’s economic potential, was the Goskomstat´s (the Soviet Planning Agency) internal calculation of "givers" and "receivers" among the Soviet Republics. Goskomstat had calculated that, if valued at world market prices, Ukraine would have been the third largest net receiver of external aid within the Union (and not, as it thought, the second largest net payer; cf. Selm, 1995, pp. 74-78). This is due to considerable imports of natural gas and oil from Russia and Turkmenistan. In fact, the only Republic that could receive a benefit from liberalizing trade with the others was Russia.

Ex-post, one has to contend that the Ukrainian economy faced the worst imaginable conditions to enter post-socialist economic reforms. Within the Soviet Union, the Ukrainian Socialist Soviet Republic had indeed been strongly industrialized and had become a major supplier of mining and heavy industrial goods (steel, chemical goods, metallurgy, heavy engineering, military and civil ships)[4]. This "wealth" fell apart when the Soviet Union broke down, and with it the "socialist sharing of work" between Republics. Instead of boasting a resource-based, rich economy, Ukrainian industry faced dilemmas it was incapable of coping with:

- Socialist production and distribution networks in which Ukrainian industry was heavily integrated, broke up rapidly. Transportation costs, lack of communication, juridical

[3] A study carried out by the Deutsche Bank Economic Research in 1990 placed Ukraine on top of the Soviet Republics, thanks to the export potential (i.e. ores, coal, oil and gas, agricultural products), cf. Corbet and Gummich, 1990.

[4] In the late 1980s, Ukraine produced approximately 54% of Soviet Union iron ore, 34% of steel, 20% of refined petroleum products and 50% of civilian shipbuidling of the entire Soviet Union. This is not to mention agriculture, where Ukraine had emerged as the main supplier of the Soviet Union, contributing 23% of grain, 54% of sugar beets, 42% of sunflower seeds, 26% of potatoes, 25% of vegatables, and 44% of flax. Statistical sources: USSR statistical yearbooks, UN-ECE statistical yearbooks, professional societies’ yearbooks (steel, shipbuilding, agriculture).

instability, monetary uncertainty and protectionist trade policies lead to major disruptions of former network relations, in particular with Russia;

- it turned out that Ukrainian industry had assured the low-tech end of production networks, whereas the high-tech activities had been reserved for Russian producers. In the military-industrial complex and in the electronics industry, Ukrainian producers had mainly carried out assembling tasks. Within the satellite program, Ukraine produced electric control devices, but never the strategic parts. For a lot of consumers goods, i.e. TV-sets and radio, main parts such as electric tubes and screens were imported, the same was the case in automobile and truck construction. Even in nuclear energy, where Ukraine had developed the highest per-capita capacity of the Soviet Union, technology and engineering had been entirely supplied by Russian firms;

- most Ukrainian natural resources turned out to be economically worthless, when compared with international market criteria. Metal ores (e.g. iron, copper, titanium) were of low metal content, located in remote areas, and little infrastructure to get them to consumers at reasonable prices;

- the energy resource base turned out to be uneconomic, too, so that Ukraine had to rely almost entirely on imported energy sources; only one third of coal production is economically viable, oil and gas reserves were depleted (World Bank: Ukraine - The Energy Sector, 1993). Ukraine was able to produce economically only 15% of the energy it needed; the energy import bill made up more than 50% of all imports (Vincentz and von Hirschhausen, 1996). The energy dependency of Ukraine made it vulnerable to economic and political pressure from the major CIS-suppliers: Russia, Turkmenistan and Tatarstan;

- the so-called agricultural "potential" of Ukraine turned out to be low in the post-socialist context, too. The famous black earth, considered to be the most fertile soil in the world, turned out to be of little real value as long as seaming and harvesting techniques were outdated, many soils eroded, and specific returns only about one sixth of international standards (World Bank: Agriculture Report Ukraine, 1994). Increases in the prices of fuel, fertilizers and other inputs, and an inefficient organizational production structure rendered the agro-industrial complex a cripple. For the first time in history, Ukraine had to import cereals. The share of agriculture in total exports fell from 18% in the 1980s to 11% in 1994; the absolute volume of exports declined by 50%, production by 33% on average;

- geostrategically, too, Ukraine's position as a gate between the Eastern and Western sphere of Comecon and the Warsaw pact was transformed into a disadvantage. Under socialism, Ukraine was developed as the strategic access of the Soviet Union to Central Europe; the post-World War II treaties had provided Ukraine with direct frontiers to four European Comecon countries, i.e. Poland, Czechoslovakia, Hungary, Romania. But whereas the Central and Eastern European countries turned westwards in the early 1990s, Russia and Belarus increasingly closed their borders to Ukrainian products. Though trade with southern ”neighbors” across the Black Sea, in particular Turkey, developed, Ukraine found itself politically and commercially isolated.

The failure to realize that the "wealth" of Ukraine depended entirely on the socialist sharing of work within the Soviet Union can be considered as the main reason of the current post-socialist disenchantment.

2.2 1992-1994: nation-building and absence of economic reform

Three years of inconsistent economic policies rendered the difficult situation disastrous. The reasons for this has to be sought in the priority given to a peaceful institutionalization of the new Ukrainian nation, i.e. the process of ”Ukrainization”. Ukrainization could only be achieved by discarding the conflicts of economic policies within the fragile national alliance of the December 1991 referendum on independence and the presidential election, i.e. the peculiar combination of Ukrainian nationalists, turnaround bureaucrats, and miners. Struggles of economic concepts and individual rent-seeking among these elites were permanent, making it impossible to carry out a consistent economic policy. Instead, the government bowed to all requests of each pressure group, be they miners, Branch Ministries, regions, etc.

As regards structural policies, too, no serious effort was made to constrain the factories and combines to restructure or close. Between the referendum of December 1991 and summer of 1994, three years passed in which the government tried to preserve an industrial structure that was unpreservable. The misunderstanding of the nature of the "crisis" added to the deterioration of the situation. Industrial policies were designed as if the post 1991 reforms were just another ”crisis”, like the ones witnessed and (more or less) mastered all along the 1960s to 80s. The irreversibility of the break between the Soviet socialist system and the monetary post-socialist world was not understood. Instead, the new Ukrainian administration tried to emulate the institutions of the Soviet Union on the national level, including all facets of state planning.

In purely economic terms, the results of this “absence of economic policy” were disastrous. Macroeconomic policies were loose in 1992 and 1993. The money printing press was substituted for a monetary policy, leading to inflation rates of 2,100% in 1992, 10,255% in 1993 and 801% in 1993. The introduction of an intermediate currency, the karbovanetz (Krb) or ”Coupon”, did not contribute to stability vis-à-vis the Ruble zone.

Instead, the Ukrainian currency continued to devalue against the Russian ruble[5]. Even massive interventions on the exchange market, culminating in the closure of the foreign exchange market on the 4th of November 1993, could not halt the slide of the currency.

Administrative controls ceased somewhat between early 1992 and mid-1993, just to go up again sharply by early 1994 (Kaufmann, 1994). Export and domestic trade restrictions remained permanently high, retail and wholesale price controls zic-zagged between 80% and almost 0. The exchange rate was kept artificially low, leading to an increasing black market and to dollarization.

Table 2 summarizes key economic indicators for Ukraine between 1992 and 1996. One detects clearly the deterioration of main aggregates between 1992 and 1994, in particular the output slump in 1994, as well as hyperinflation in 1992 and 1993. In fact, Ukraine featured the highest inflation ever witnessed in a non-war country.

Table 2: Key macroeconomic indicators for Ukraine, 1992-96

	1992	**1993**	**1994**	**1995**	**1996***
GDP (market prices, % change year on year, yoy)	-16.6	-14.2	-23.0	-11,8%	-8,0%
Gross Industrial Output (%change, yoy)	-6.4	-7.6	-27.7	-17,4%	-2,7%
Capital Investment (% change, yoy)	-36.9	-10.3	-25.0	-35,0%	N/A.
Inflation rate (CPI, Dec./Dec.)	2,100%	10,255%	801%	182%	50%
Balance of Payments (Mill. USD)	-2,700	-1,100	-1,679	-1,152	N/A.
Energy Imports (share of total imports)	N/A.	49%	44 %	45%	46%*.

*: estimates

Sources: Ministry of Economy, Ministry of Statistics, Ukrainian Economic Trends, World Bank

The economic apathy of the first years of independence only becomes understandable in the context of the peculiar process of nation-building, that we called "Ukrainization". Indeed, from a historical point of view, avoiding hardship for any particular social group may have been the only way to save a national consensus that was not based on a common economic program. Given the heterodox coalition between reformers (nationalists), pseudo-reformers (turnaround bureaucrats) and anti-reformers (coal

[5] Introduced at par in spring 1992, the karbovanetz fell to 4.12 Krb/Rbl in the first quarter 1993, and to 20.48 Krb/Rbl in the second quarter of 1994 (in April 1996, it stood at 37.69 Krb/Rbl) (Ukrainian Economic Trends).

industry), it was impossible to strike a coherent reform path. Ex-post, the non-policies pursued in 1992-94 may have not been as irrational as they are usually judged from outside: Ukraine is the only European Republic of the CIS that has managed a peaceful passage from a Soviet Republic to a democratic nation. In the Russian Federation, the President had to assault Parliament and burn it down in order to keep the situation under control; in Belarus, elementary human rights, such as the freedom of demonstration, were suppressed. None of that type happened in Ukraine, which is, instead, considered to be the CIS-country with the best human rights record[6].

2.3 1994-1996: macroeconomic stabilization

The situation changed with the general realization that continued inflation and economic isolation would lead to the complete loss of the country's industrial and technological base. The idea according to which national independence would have led per se to economic recovery, was profoundly disqualified. The election to President of the industrialist Leonid Kuchma against the former apparatchik turned nationalist Leonid Kravchuk, in July 1994, was a sign that the population now preferred an industrial strategy over a national project, that it sought wealth rather than national symbols. As the former general director of the Soviet Union's most important producer of military rockets (Jushmash), Kuchma understood that without a minimum of macro-stability, the industrial sector would not be able to maintain its power; this was particularly true for the industrial-military complex, Kuchma's origin. The so-called "reform" program of 1994 was in fact not a shift towards a Western-type market economy, but instead an attempt to create conditions under which state control on industry could be made more efficient.

The results of the October 1994 reform program are impressive, though from a macroeconomic point of view only. Domestic prices were almost fully, and foreign trade largely liberalized. Administrative control of the exchange rate was abandoned, the budget deficit reduced (from 20% of GDP in the first quarter of 1994 to 9.6% in December 1994) and Central Bank financed credits to industry reduced (Conrad and Gummich, 1995). Mass privatization, in the pipeline for a long time, started in January 1995 and the process of direct privatization was strengthened through a centralization of power in the State Property Fund.

Consequently, inflation stabilized rapidly, after the November 1994 peak. In 1995, inflation was down to "only" 180% (December/December), and continued to fall to about 50% in 1996; for 1997, it is expected to be around 25%. The real exchange rate stabilized somewhat during 1995, and even appreciated in 1996. The slump in industrial

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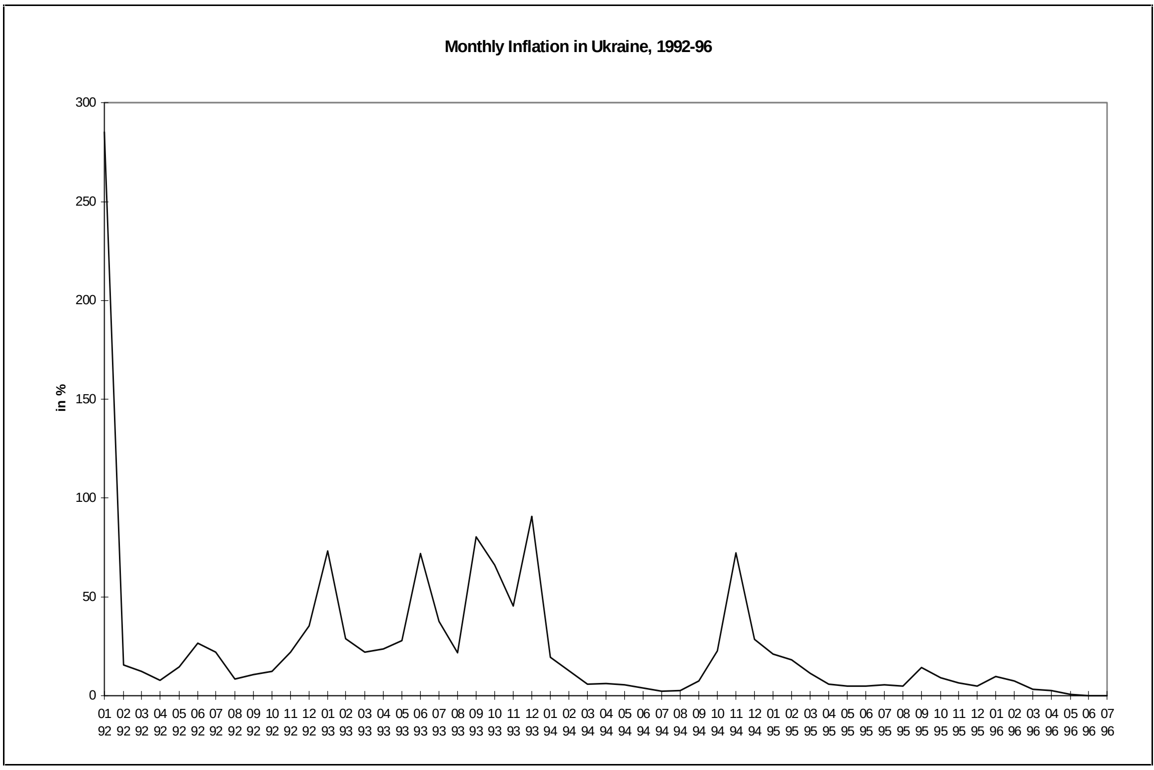
[6] According to the speaker of the U.S. House of Representatives Committee for Foreign Affairs, Robert Torricelli (cf. Intelnews, August 22, 1996, p. 2).

output was limited to 11% in 1995 and about 3% in 1996. Monetary policy remained tight, leading to high real interest rates. International financial institutions started to support the reform program. The IMF offered credits in order to assure the country's liquidity, and mainly to pay the Russian energy supplies. Between 1994 and 1996, about 1.3 bn. USD were channeled to Ukraine in the form of Systematic Transformation Facility, and two Stand-By-Agreements. Other international organization followed.[7]

By mid-1996, the Ukrainian economy has achieved stabilization. Figure 1 shows the development of monthly inflation rates since 1993, which has fallen to a record 0.1% in June and July 1996. The two administrative price hikes planned for 1997 will only have a limited impact. Even a sharp appreciation of the currency, which is required to succeed the September 1996 introduction of the new currency (Hryivna), is unlikely to put macrostabilization in danger. Within two years after the beginning of the reform program, Ukraine has joined Russia and other CEE-countries featuring "moderate inflation".

Figure 1: Stabilization of inflation in Ukraine, 1992-1996



[7] Among them a 500 mill. USD World Bank Rehabilitation credit, a 200 mill. ECU stabilization credit by the European Union, and increased engagements by multilateral or bilateral banks and donors (EBRD, EU-Tacis, OECD). Technical aid was mainly provided through US-AID, the British Know-How fund, and the German KfW.

Source: Ukrainian Economic Trends, IMF

2.4 The velvet privatization: procedures and results

During the time in which macroeconomic decline persisted, a unique phenomenon gained ground on the enterprise level, unobserved by many, including a part of the government: privatization. Public debate on the usefulness of and justification for privatization remained vivid, culminating in the interruption of privatization by Parliament in June 1994. But on-site, in the enterprises, ownership changes proceeded nonetheless[8]. Two driving forces were behind this process: workers' collectives, and private investment funds. For workers' collectives, the redemption of "their" state enterprises, mostly leased formerly, was a cheap way of becoming real owners of the entity they already managed for quiet some time. Over 3,000 "lease enterprises" were privatized this way between 1992 and 1995. For the newly created private investment funds, the privatization of medium and large enterprises through auctions was an efficient way to accumulate capital quickly. For this, the funds used mainly external resources, i.e. privatization vouchers entrusted to them by individuals[9]. Though privatization had a difficult start in 1992, it came into full swing in 1993 already, i.e. in the midst of macroeconomic decline. There is no particular acceleration to be observed after the enacting of a coherent macroeconomic strategy in Q3 1993. It thus seems as if privatization and macroeconomic reform were entirely disconnected

Mass privatization through the free distribution of vouchers was initially confined to the control of investment funds, who had rapidly understood how to work the system. But since January 1995, after the reorganization of privatization and revaluation of vouchers, it started to attract increasing interest of the population, too, as documented in the rise of the domestic demand for vouchers by individuals. Thus, only one privatization method remained without success: the strategic investor privatization, i.e. the takeover by an individual investor of a strategic majority of an enterprise. Until late 1996, neither domestic nor foreign industrial enterprises showed a great interest to take over Ukrainian post-socialist enterprises.

Contrary to common belief, ownership reform and privatization did go a long way in Ukraine; they did significantly alter the composition of industry ownership. Table 3 provides evidence on this: due to unbundling, the number of medium and large

[8] The most important privatization techniques were: redeem of small-scale enterprises by buyers partnerships; redeem of state property that was leased earlier; auction; commercial or non-commercial competition; selling of shares of joint stock companies.

[9] The branches in which investment funds were most active are food processing, cement and construction materials, metal trading, furniture, infrastructure (mainly ports).

enterprises increased from 6,850 (Q4 1992) to 8,972 (Q1 1996). The number of private enterprises, be they collectively owned or leased with a private majority of ownership, increased to 5,401 in Q1 1996, i.e. 60% of the total number of large and medium scale enterprises[10]. The part of private enterprises in industrial production grew significantly, too, from 17% (Q4 1992) to 48% (Q1 1996). Among the 16,000-20,000 small enterprises, about 90% are today owned by private agents, either directly or in the form of collectives. Taking into account the important share of non-official production (shadow economy) which is almost exclusively generated in private enterprises, it is certain that more than 50% of industrial production comes from private enterprises.

Table 3: Results of large scale privatization in Ukrainian industry, 1992-1996

	Number of large and medium scale industrial enterprises	of which: * state ownership	* private ownership	of which: # collective	# mixed	Share of industrial enterprises in private property: number of enterprises	volume of production
1992	6850	5159	1686	151	1535	24,6%	17,0%
1994	7963	5421	2525	472	2053	31,9%	29,0%
1994	8826	4763	4045	2412	1631	46,0%	38,0%
1995	8931	3882	5030	n.a.	n.a.	56,5%	48,0%
Q1 1996	8972	3552	5401	n.a.	n.a.	60,4%	48,4%

Source: Ukrainian Economic Trends[11]

What we are not saying is that the new ownership forms are efficient for the restructuring of enterprises and the imposition of capital constraints. Today, insider control clearly dominates in Ukrainian industry. The dispersion of ownership to employees and the defensive attitude that the latter may adopt can result in priority given to job preservation in the short run, rather than to medium-run profit orientation. Also, access to new capital may be more difficult for collectively owned enterprises that have few guarantees to offer[12].

One should not underestimate the fact that privatization of non-strategic enterprises is far advanced. That the corporate governance structures resulting from Ukrainian ownership reform may be less efficient than initially hoped in 1992 is one thing. But that privatization has worked smoothly in a chaotic macro-environment is another fact, now established, that one has to integrate in the analysis of Ukrainian post-socialist industrial

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[10] Three important areas excluded from privatization are the energy complex, the agro-industrial complex, and some enterprises in the "strategic" military-industrial complex; i.e. a total of about 6,000 enterprises.

[11] Totals may not round up due to double counting.

[12] Experience shows, though, that investment financing can be obtained by insider controlled enterprises, too, if a worth while industrial project can be identified in cooperation with a bank or an investment fund.

restructuring. In particular, it means that the impact stemming from future privatization can only be limited.

Yet, macroeconomic stabilization and formal privatization remain ineffective unless they are accompanied by substantial structural reform. This is exactly what has not happened, as we indicate in the next section.

3. The state-planned restructuring process

The patterns of restructuring socialist industrial units were somewhat similar in the ”advanced” post-socialist countries. Among them were rapid separation of productive functions and social services, unbundling of productive functions to new enterprises conducive to competitiveness and investment; a growing role of financial intermediaries and more or less rapid imposition of budget constraint; enterprise closures; a net reduction of the energy intensity of production. The results of enterprization have come quickly to the fore: growth rates of industrial production have skyrocketed, and the integration of CEE-enterprises in European markets is accelerating (World Bank, 1996).

In Ukraine, one observes markedly different patterns of restructuring of large and medium scale industrial enterprises. For small enterprises, differences with other post-socialist countries are quantitatively only, i.e. in speed and numbers of enterprises concerned. But among the 9,000 large and medium enterprises registered in 1996, that account for 98% of official production, one finds recurring peculiarities of restructuring. In particular, there has been no clear commitment by the government that market economy principles should guide the restructuring process. Instead, state planning is present almost everywhere. In this section, we stylize some peculiarities that make the Ukrainian restructuring process a unique case. For each aspect mentioned, we provide evidence from concrete case studies.

3.1 Absence of liquidation and enterprise closures

Even after four years of post-socialist reform, enterprise liquidation or closures are not happening in Ukraine. The legal framework is only formally set up, including a bankruptcy law from 1992. But so far, there is neither a political will nor a determination by the creditors to enact that law (Mirskey and Coates, 1996). Factories usually have three ways to continue operation even after entering into illiquidity: direct state subsidies, delayed tax payments and - most important - inter-enterprise arrears. The number of factories that were in the state to be liquidated increased during 1993 and 94. In early 1995, the government finally agreed to carry out 20 ”pilot-closures” of state enterprises which were resenting to restructuring. As of today, none of the closures was carried out (ibid).

The absence of factory closures does not mean that the internal structure of these factories remained identical. Instead, internal reorganization of production has radically changed in almost all enterprises: the product mix, production techniques (usually from mass production to individual production), upstream and downstream relations with suppliers and clients, the number of personnel. Empirical studies show that the destruction of socialist industrial structures on the enterprises level is much more advanced in Ukraine than can be deduced from pure statistics (Brainerd, 1995, Standing, 1994). The reduction of personnel employed and paid by the enterprise was reduced between 20-30%. Entire departments are already closed, or transformed to serve totally different purposes than before. But the publicly announced closure of a factory is yet something unheard of. Two reasons may explain the resistance to closing down productive capacities. One is the perception by many directors that the current period is ”just another crisis”. Once over, business would continue as usual, demand would pick up and the capacities recover their former raison d’être. The second reason is that in Ukraine, capitalist criteria of judging an enterprises’ performance have not yet become a reference, neither economically nor politically. In socialism, the closure of a factory was unimaginable, as the output of that factory was justified by the Party through the official planning process. In conditions of permanent shortage, reducing capacity would have been irrational indeed. Today, a similar reasoning still prevails in the justification to keep capacities alive: it is the idea that a good renders a service beyond the price it can obtain on a market. Thus, a major reason for the maintenance of uneconomic factories in Ukraine is that politicans have not made it clear to the population that socialism is definitely over.

A concrete example may illustrate this point. At socialist times, the Ukrainian oil refining industry boasted a capacity of 62 mn. t in six large refineries, supplying all of Ukraine’s consumption needs, and also consumers in other Soviet Republics. The raw oil was supplied by Russia, at practically no cost. In post-socialism, energy prices rapidly increased to international levels (approx. 100 USD/t), domestic demand for petroleum products decreased considerably, overcapacities abounded in the neighboring countries. Foreign refineries, mainly Russian, Belarussian and Lithuanian, then started to supply petroleum products below the prices of Ukrainian producers. Thus, domestic refineries found themselves deprived of natural resources, but also without clients. In 1994, only 13 mill. t of capacity were used to process petroleum products for the Ukrainian market, i.e. 21% of total capacity; the 1995 results were still worse[13]. In fact, two large refineries only would suffice to supply all of Ukraine’s demand, whereas the other four will hardly

[13] Economic Review, May 22, 1995.

face enough demand to survive. An improvement of the situation is unlikely. Yet none of the state-owned refineries is constrained to close any of its capacities, let alone close down. Instead, the State Committee for Oil and Gas developed another four-year plan, in which detailed development and investment schemes for all six refineries are compiled: the Plan includes state investments of over 4 bn. USD (!) for the modernization of all six refineries[14]. Thus, the inevitable restructuring process of the Ukrainian oil refineries is postponed, and substituted by formal state-planning.

3.2 State-planned restructuring of large-scale enterprises

As we have shown above, the formal privatization process proceeded quickly; yet the state continues to play an important planning role in the restructuring of state enterprises. I 1994, 6,110 state enterprises were excluded from privatization, upon a decision by the Parliament. This is justified by the ”strategic character” of these enterprises, in accordance with Art. 4(1) of the privatization law. But in many of the enterprises to be privatized, too, the state continues to act as the dominant organizer of the restructuring process. This is particularly the case for the factories of the former military-industrial complex, but also for other factories from metalworking, mechanical engineering, vehicle construction and electronics.

That state enterprises prevail in post-socialist countries is neither a new phenomenon nor contestable as such. Empirical evidence on industrial restructuring in CEE countries indicates that privatization does matter, but that incentives to restructuring may exist in public just like in private enterprises (Pinto, 1993, v. Hirschhausen, 1996a)[15]. But the peculiarity of the Ukrainian case is that no corporate control structures were defined for the factories concerned, nor were any incentives provided for restructuring. After having been declared as ”strategic” and formally subjected to “restructuring plans“, the state-owned factories found themselves without a real owner, uncontrolled by Parliament and without any guidance from their respective branch ministries. Practically, many of the 6,110 were stuck in a stringent legal frame of budget organizations without any financial freedom. Corporatization, i.e. the transformation into state share companies with independent bookkeeping and profit&loss statements, did often not take place in these factories. As a result, the reduction of personnel, through voluntary or unpaid leave, and the loss of network relations hit the ”strategic” factories harder than others[16].

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[14] This plan is in fact a follow-up of the governments ”State program for Oil and Gas”, signed 1993 by then-Prime Minister L. Kuchma: Resolution No. 774/93 of the Council of Ministers, dated 21 September 1993.

[15] Indeed, it is a little-known fact of post-socialist restructuring that a majority of medium- and large-scale enterprises in these countries continue to be state enterprises (e.g. in Poland: 54%, World Bank, (1996): From Plan to Market. Annual Report 1996. Washington, D.C., p 53).

[16] What the rationale was behind the selection of the 6,110 factories as ”strategic” is yet another question. Just like in any other branch, the structure of the military-industrial sector completely fell apart with the end of socialism. The hyperintegration, prevalent in the socialist model of the ”town-factory

The example of a large military-industrial factory in the Kiev area shows the dilemma of state-planned restructuring. Under socialism, the factory, employing 20,000, was a large producer of satellite control equipment. It was part of the Soviet ”Sputnik”-military program, and as such classified “highly strategic”. Integrated in the Soviet industrial network, it received 90% of the electronic parts from Russia, and gave away 80% of its products for further processing in other Soviet Union Republics. After the collapse of this network, the old military factory was dead, and sought to develop new civilian products: wooden furniture, metal foundry, gas pistols, printers, cash registers, plastics, NC-machines, sawing machines, electric devices, TV-sets and radios, etc. Payed employment fell from 20,000 to 13,000 in 1995.

The Cabinet of Ministers then decided to carry out a state-planned ”pilot-restructuring”[17]. An inter-ministerial Committee was set up, composed of the owner of the factory, i.e. the Ministry for Machine Building and Conversion, and the Ministry of Economy, the State Property Fund, the Antimonopoly Committee, and the management of the factory. This inter-ministerial Committee then planned each step of the restructuring, i.e. the unbundling of the former combine, the setting-up of a new, state-owned holding company, the reorientation of the product range, and the distribution of investment. The Committee also replaced the former General Director. But none of the departments was given freedom to pursue its own strategy. Nor was the large industrial site (80 hectares) opened for new small and medium enterprises, seeking well-equipped industrial space. One year after the start of the ”pilot restructuring” (August 1996), the factory has not undergone any substantial change, no jobs were created on site. Employment may fall further to 3,000-4,000 by the end of the decade.

Yet, instead of giving the other non-privatized factories freedom and responsibility to restructure themselves, the government intends to make state-planned restructuring the dominant mechanism for large-scale factories. In a speech before Parliament on June 17, 1996, the Minister for Machinebuilding declared that a further 60-70 large-scale factories were identified for ”government-lead restructuring” through new inter-ministerial

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(zavodgorod)”, lost its justification. In post-socialism, there is no need for a military combine that produces anything from a nail to a tank. Downscaling, unbundling and outsourcing become inevitable. Rather than to facilitate this restructuring process, the anti-privatization scheme blocked it. Military factories were declared indivisible; not even the football field controlled by the complex could be given away to a new owner, let alone any of the workshops. Private investment and capital participation in any inidividual asset was impossible. All this did not stop the internal structures of the ”strategic” factories to fall apart. The so-called ”strategic military-industrial” factories are no longer strategic, nor are they military factories any longer. According the Ministry for Military-Industrial Complex and Reconversion, the turnover of the 1,430 former military-industrial factories consisted to 96% of civilian goods in 1994; i.e. only 4% of their production was for military purposes, and thus „strategic“.

[17] Cf. Economic Review, May 27, 1996.

Committees; this number has increased since to 208[18]. There is little reason to expect that these Committees will provide a new impetus to the dragging restructuring process. Instead of letting factories unbundle and create small and medium enterprises according to their core activities and competencies, the state continues to prescribe restructuring patterns and bureaucratic reporting procedures.

3.3 State planning of industrial policies in so-called ”strategic” branches

The state also continues to play a crucial role in the definition and the execution of plans for entire so-called ”strategic” industrial branches. Until today, the main concept of industrial policy was that of vertical intervention, consisting mainly in subsidies to ailing industries and agriculture, price controls, and import and export restrictions. State investment programs continued to be defined for many sectors on a yearly and a 5-year basis. Examples are the automobile industry, packaging, copper and nickel mining, steel, non-ferrous metallurgy, airplane and shipbuilding, and the agro-industrial complex[19]. The amounts allocated for vertical industrial policies are not explicitly earmarked in the budget. Estimates for 1995 point to 3-5% of GDP for direct state subsidies in industrial branches[20]. Export licenses were required for many goods, including agricultural goods, textiles, steel and energy. According to the ”State Concept for Industrial Policy”, the government’s task is it to maintain, develop and support these branches, to define investment plans and provide this money to the branch, and also to watch over the correspondent employment effects of the programs. The execution of the plans has to be reported regularly to the Branch Ministries.

The most striking effects of central planning on the branch level can be observed in the Ukrainian coal industry. Coal is the only energy resource of which Ukraine has some reserves; yet two thirds of current coal production is unprofitable (see above). Therefore, the coal industry has been hit particularly hard by the end of socialism: domestic production declined sharply, from 131 mn. t of primary coal (1990) to about 50 mn. t (1996), i.e. by 62%; it may level out at about 30 mn. t. The average production cost for coaking coal is 50 USD/t, imported coal (from Poland or Russia) of the same quality

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[18] Cf. Official Journal of Parliment, Session of June 17, 1996; the 208 state enterprises are listed in the Decree of the Cabinet of Ministers Nr. 684, 27 July 1996 “On carrying out the privatization according to individual plans”.

[19] See, for example, the decision of the Cabinet of Ministers No. 774/93, the development program "Packaging 2000", the Energy program drawn up by the Ministry of Economy. In agriculture, too, the state guaranteed prices and quantities to buy from the state farms. Prices continued to be fixed on a ”cost-plus” basis, bearing no relation to efficient prices under competition. Import and export regulations were handled on a case-to-case basis.

[20] It is impossible to obtain precise figures, as state subsidies are scattered in a variety of titles in the budget, hidden under the title "expenses for the economy", or put in one of the 3,000 (!) mysterious "extra-budgetary funds". When looking at real practice, one realizes that these "plans" are hardly ever carried out fully. As the plans usually exceeded the financial capacities of the budget, most investment programs had to be abandoned half way through, leading to yet higher misallocations of capital.

costs about 40 USD/t. Among the 256 coal mines, between 50-70 are considered viable in the medium run. Imports play an increasing role; in 1995 alone, coal imports more than doubled.

Yet, instead of fostering reforms in the sector and providing competitive coal mines with new business opportunities, the government, under the pressure of the Coal Ministry, institutionalized centralized planning for coal production, trade, and prices. Cross-subsidies between efficient and inefficient mines are maintained; this prevents efficient coal mines from reaping the benefits of productivity gains, and prevents them from investing. Domestic trading is entirely dominated by the Coal Ministry, that prescribes quantitative indicators for each mine, and fixes the prices. Mines can freely sell only the coal produced beyond these ”plans”. Coal imports, too, were controlled by the state coal trading agency, Ukrglavugol, until 1995; in 1996, an average 2 USD/t import duty was imposed[21]. Though three mines have been slated for closure[22], and 20 more identified to be closed over the next three years, not much has really happened locally to accelerate the conversion. This, in turn, provides the conservative coal lobby with arguments to halt restructuring.

Instead of trying to cope with the inevitable decline in output, the ”plan” requires the coal-industry to increase production back to 130 mn. t in the year 2010, i.e. double current production! This is not only unrealistic, but it endangers the state’s capacity to anticipate future energy needs of the country realistically. Also, state planning of the coal industry remains expensive: the financing of the coal industry, directly and indirectly, is the single most important subsidy in the country’s budget. Direct financing amounted to 3,3% of GDP in 1994, i.e. more than half of the envisaged budget deficit alone!

3.4 No clear and economic criteria for the creation of so-called ”industrial-financial groups”

Another area where state activity is intense are the so-called ”industrial-financial-groups” (IFG, promyshlennye-finansovo-gruppy). In that case, a Branch Ministry defines a series of enterprises whose vertical integration it considers to be viable. A (state) bank is then attached to these industrial enterprises, and the Branch Ministry is given a controlling stake in the group. The economic rationale of these groups sometimes looks doubtful. Right from the start of the fall-1994 economic reform program, the intensification of economic links with Russia received priority on the agenda. The government put together a list of 32 Ukrainian-Russian transnational industrial-financial groups, that it wanted to create. These groups are mainly situated in the military and heavy industrial sectors, in which the Soviet Union industrial networks were particularly intense: aviation,

[21] IEA, 1996.
[22] World Bank (1996): Coal Industry Restructuring Sector Report; Washington, D.C.

electronics, chemistry, metallurgy, mechanical construction, vehicle production[23]. The re-establishment of some of these contacts is seen as a necessary condition to revive and develop trade relations, resume input supplies, and stimulate domestic production.

The problems with the Ukrainian industrial-financial groups is that they are based on a logic of state-planning, instead of letting enterprises co-operate according to market mechanisms. Nothing indicates that the participation of state-owned banks and Ministries in the IFGs is a necessary condition for the establishment of such corporations, neither do they guarantee their efficiency. Enterprises are glued together under political pressure, whose cooperation does not correspond to a strategy of medium-term sales and profits. In that case, profitable enterprises would be forced to finance unprofitable ones, or the state would have to bear a heavy financial burden.

A case from the Ukrainian energy sector shows the risk of a hasty creation of a financial-industrial group whose economic rationale stumbles once prices are completely liberalized. A large Ukrainian petroleum refinery and a Russian oil producer, both state enterprises, were joined in 1994 to form a financial-industrial group, with equal 50%-shares held by the two countries. The Russian oil producer has a long-term contract to supply crude oil to the Ukrainian refinery, which - in turn - delivers 79% of the processed petroleum products to Russia, keeping 21% of crude oil as the tolling fee. One Ukrainian and one Russian import-export bank finance the start-up capital of 250.000 USD and provide some investment in new infrastructure[24].

At the time of the contract (early 1995), the market for petroleum products was still protected in Ukraine, so that domestic demand, though small, was geared mainly towards Ukrainian refineries. The situation changed drastically with the liberalization of the Ukrainian market in 1995, the surge of imports and the implosion of domestic prices. Imports soared from 6.5 mn t (1994) to 9.5 mn t (1995), at prices about 15-25 USD/t below the costs of Ukrainian producers. Thus, the barter deal within the industrial-financial group, that was designed as a long-term project, has lost its economic justification.

3.5 State-planned energy conservation

Dependence on imported energy resources is Ukraine’s most critical weakness on its way to economic and political independence, representing over 50% of all import expenditures. Yet, while all politicians are formally dedicated to reducing the energy bill, little is done in practice to attack the issue of energy consumption up-front. Domestic

[23] The first six industrial-financial-groups to be implemented are the following: titanium and titanium products; gas pipes; chemical fibres; combines; alumina and aluminium. See Interfax Ukraine, May 7, 1996; Window on Ukraine, November 21, 1995 and April 19, 1996.

[24] See Intelnews, July 6, 1995.

energy prices are still subsidized[25]; even where full cost recovery was introduced, the non-payment crisis hit the energy sector particularly hard. Over 50% of payment arrears are for non-payments of energy. Thus, energy largely continues to be a ”free lunch” in Ukraine.

However, the policy response did not consist in the hardening of budget constraints on energy consuming enterprises and households, and the freeing of prices. Instead, the government launched several administrative procedures to reduce energy consumption through state planning. On 1 July 1994, then-President Leonid Kravchuk signed the ”Law on energy conservation”, which proposed a host of administrative measures to cut energy consumption. Among them were tax breaks for enterprises using less energy, subsidies to producer of energy-saving equipment, and fines for enterprises exceeding their consumption target[26]. In order to enforce that law, another bureaucracy was created in July 1995, the ”State Energy Conservation Committee”. According to socialist tradition, an odd three-step ”plan” was drawn up: in the first planning period (1995-96), the institution was to be set up formally; in the second planning period (1997-2000), small improvements in energy conservation were to be enforced; but it was only for the third planning period (2001-2005), that industrial restructuring and technological modernization were to occur[27].

By late 1996, none of the hopes placed initially with the State Energy Conservation Committee have realized. Energy intensity not only did not decline, but increased. A few enterprises were fined for high energy consumption, but these fines were not enforced. The Committee itself is not really installed, its active staff being largely limited to the one chairman. In August 1996, yet another body was created, supposed to control electricity consumption, the “State Inspection for Control over the Electricity and Thermal Consumption“[28]. In the meantime, Ukraine’s estimated medium-term energy conservation potential of about 60% remains untapped...

3.6 State-planned co-ordination of foreign direct investment (FDI)

As the last example in the list of state-planning activities, we shall cite one that directly impacts the participation of foreign enterprises in Ukraine. At a per capita rate of 21 USD per capita of foreign direct investment (FDI), Ukraine trails - by and large - most other post-socialist countries (Russia: 33 USD/capita, Hungary: 1,200 USD/capita). Only 800 mn. USD were directly invested in Ukraine between 1992-96, and an

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[25] In 1996, residential natural gas prices were at 77% of international prices, residential coal prices at 85% and industrial coal prices at 93%; World Bank (1996): Ukraine - The Real Economy and its Sectors; Kiev.
[26] Cf. Economic Review, 4 September 1995.
[27] According to Mykhailo Kovalko, Chairman of the State Energy Conservation Committee, in Economic Review, 4 September 1995.
[28] Cf. Interfax-Ukraine, 12 August 1996.

acceleration is not in sight. Thus the high hopes placed in Ukraine in the early post-socialist days were deceived. The main reason for the little interests that foreigners have shown in Ukraine are the bureaucratic procedures in which potential investors have to engage; also, the obscure legal environment is not conducive to foreign investment, where laws can change every other month, their implementation is stochastic, and treaties concluded with one legal body (e.g. an oblast-administration) are not respected by other bodies (e.g. a Branch Ministry).

Another reason for the limited investment is the maintained multifunctionality in the post-socialist factories. The decomposition of former socialist factories, including the separation of production and social functions, is not yet advanced far enough. In that case, the identification of investment opportunities is difficult. Which private investor would be willing to provide capital to a factory where he can not control whether it is spent on the modernization of production facilities or the construction of a new kindergarten? The few successful cases of large foreign investments in Ukraine show that a compromise on social functions is a necessary conditions for establishing cooperations[29].

In order to increase the attractiveness of Ukraine internationally, the government once again decided to proceed with state-planning. Three (!) different foreign investment agencies existed parallely in 1996, the goal of each being to attract further investment. The first in date was the ”State Investment Agency” (Derzhinvest), the head of which had the status of a Minister, subordinated to the Cabinet of Ministers. This agency was toppled by the creation, in July 1996, of the ”National Agency for Reconstruction and Development”, whose main objective is to facilitate the access of foreign investors to Ukrainian enterprises[30]. On top of these two agencies, the Ministry of Industry also decided to create its own investment agency, the ”Commission for the participation of foreign investors”[31]. The objective of the Commission is - once again - to channel foreign investment to state enterprises in the process of privatization; in a first instance, four state enterprises were advertised to foreign investors[32].

Whether three parallel state committees in the FDI-process will yield positive results is doubtful. In no case can any of the above institutions claim to be a ”one-stop shop” where a foreign investor would address itself to solve its administrative questions in a

[29] When Kraft-Jakobs-Suchard took over the Karl-Marx Chocolate factory and invested 26 mn. USD, the largest foreign direct investment to date in Ukraine, it was obliged to keep the multifunctional factory as such, including flats, holiday resorts, spas, kindergartens, and other social services; the number of employees was fixed for five years.

[30] Cf Intelnews of 6 July 1996, and Ukaz of the President Nr. 493/96 of 2 July 1996.

[31] Cf. Economic Review of 10 June 1996.

[32] Automotive works SAS Zaporozhe, steel producer Dneprodserzhinsk, electronic and TV-producer Elektron Lvov, alumina producer Nikolaev.

single step. Indeed, in no post-socialist country exist as many potential ”one-stop shops” as in Ukraine, and it may well be that their number still increases...

4. Outlook: unavoidable, long term restructuring process with an open end

The case of Ukraine stands for the difficulties and the reluctance of the major CIS-countries to switch from socialism to a capitalist market economy. Just like in Ukraine, the Russian, Belarus and Kazak governments are far from having identified a clear path of economic reform policies. Instead, the reform path will remain dominated by attempts to define a specific post-Soviet mode of development.

Ukraine has succeeded one step of post-socialist economic reform, which is macroeconomic stabilization, after a drastic slide in output that lasted until 1996. There are no indications, though, that this stabilization is accompanied by sufficient structural change and enterprise reform to aassure sustained economic growth. Instead, Ukraine is still in search of a social consensus on the path of economic reform, the lack of which has so far prevented the implementation of any coherent reform strategy. It is unlikely, therefore, that Ukraine emulates the growth path prescribed by truly reforming countries, such as Poland or Estonia.

A reorientation of structural reform is a condition for sustained development. On the enterprise level, this process is more advanced than it seems, but for the time being in the negative sense rather: socialist industrial structures and networks collapsed, as a result of the introduction of post-socialist economic reform. The task now is to create conditions conducive to establishing new enterprises within new industrial networks, based on monetary criteria such as prices, costs and profit.

All through 1996, a tendency towards increased state planning could be observed in Ukraine, that left no economic sphere untouched. We have shown that there is a substantial lack of confidence in the mechanisms of a capitalist market economy. Recourse to increased state intervention is seen as a means to better control the economy. The concrete results of state activity are little impressive, though: just like in the old, socialist days, none of the ”plans” is really being enforced, and few sanctions can be imposed on state enterprises today. Medvedev (1995) recently proposed that continued state planning today, just like state planning under socialism, is not meant to be an instrument of economic policy; instead, he characterizes the planning activity as a means of attaining a social consensus among the population, to move toward communism, or, today, towards Ukrainization[33]. In any event, there is a danger that increased state planning further curtails economic development.

The political ”window of opportunity”, which is the period immediately following the breakdown of socialism, was used in Ukraine to consolidate the new, fragile nation. Economic aspects mattered little during the 1992-94, and they are still largely ignored by the public policy debate today. Thus, the initial impetus, in which fundamental reforms are possible and can be pushed through based on a wide social consensus, is over. Any reform that is still to come can only be piecemeal, and therefore can have piecemeal effects only. Industrial restructuring in Ukraine is only at its beginning, and it will be a long-term process, the end of which is wide open. The heritage from the Soviet Union, that we have called the “industrial ruins from socialism”, are today easily identifiable, and the irreversible nature of structural change is beginning to be understood. But the implementation of the next steps of structural reform will take several years, be it the implementation of hard budget constraints and factory closures, the separation of productive functions and social services, the identification of economically viable patterns of industrial cooperation, foreign investment and ownership reform. The underestimation of the nature and the time frame of industrial restructuring was already striking in advanced post-socialist countries, be it East Germany, Poland or Hungary; in the case of Ukraine, this is even more the case.

The case of Ukraine hints at a difference in nature between Central and Eastern Europe post-socialist economies on one hand, and post-Soviet economies on the other. This does not necessarily imply a homogeneity between reforms within the CIS-countries. But it may well be that - by virtue of its size and geostrategic location - Ukraine become a test case for other post-Soviet countries. It remains to be seen whether Ukraine will

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[33] Whether state planning was ever meant as a means of economic policy, and thus potentially inefficient, has recently been radically doubted by Sergei Medvedev (1995), who characterizes the planning activity rather as means of attaining a social consensus among the population to move towards communism:

„The notions of five-year plan and state orders belong not to the sphere of economics but rather to an heroic epos, to the trials and tribulations of a mythical hero. It is always necessary to ‘struggle’ for the completion of tasks (e.g. ‘battling’ for the harvest). The notion of the ‘production drama’ from a local artistic genre becomes an overall description of Soviet economy, i.e. production turns into a real drama, into a play that develops according to the laws of esthetics. Hiding under the slogan of the norm, Soviet economy was in fact oriented not at average statistic growth, but at super-normative, dramatic, heroic development.
... the Soviet economy (if it ever existed at all) could be described in terms of developed simulation as a popular post-structuralist model of a *potlatch* - a feast of North American Indians and some other tribes marked by the symbolic giving and receiving of lavish gifts. Like members of the tribe who try to excel each other in the lavishness of their gifts in order to demonstrate their wealth, Soviet workers and the state kept giving to each other: pseudo-labour was exchanged for social pseudo-guarantees. Wages, remuneration of equivalent exchange became unimportant. ... Quotas of personnel, ratios of the number of workers and engineers were determined by social (status) reasons and not by economic ones. ... Economic forms of activity became side effects of the semiotic activity.“ (pp. 98 s.q.)

According to Medvedev, then, the continuation of state-planning in post-Sovietism is only the attempt to hang on to former types of socialization, without a real impact on economic activity.

gradually adopt a capitalist market economy-oriented reform path, or instead, chooses post-Soviet state planning to face the next steps of restructuring.

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