

Challenges in the Privatization of Ukrainian and Slovakian Large Enterprises: Special Focus on the Steel Industry

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Abstract

The challenges of privatization in the post communist world have not been an easy task to resolve and have caused a lot of controversy and debates. My thesis looks into the problems of privatization practices and settings throughout post-communist Ukraine and Slovakia. There is a special focus on the steel industry's large enterprise privatization in order to see the patterns even more clearly and allow in depth analysis. Using the comparative analysis in my study I have shown similarities as well as contrasted findings within the similar categories of the analysis. The major finding of my thesis is that in the statement "challenges of privatization", *challenges* played a specifically important role in the privatization process in post communist Ukraine and Slovakia. The two countries have both undergone similar processes, which at the end resulted in different outcomes, which does not support the arguments about path dependency and limit in the choices when it comes to privatization. The great evidence of this has been the Slovakia's breaking 1998, when it has finally stepped on the prosperity developmental path and made the privatization processes more transparent and legal. Nevertheless, privatization from above by large transnational firms proved to be the most efficient solution for the two countries. However, privatization by local business groups in Ukraine has also been surprisingly enough a good solution for the earlier state owned enterprises.

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To all the people I love and cannot imagine my life without... dedicated.

Table of Contents

Introduction.....	1
Chapter 1 - Historical approach to privatization in transitional economies after communism	7
Chapter 2 - Challenges of large enterprises' privatization in independent Ukraine and Slovakia	16
2.1 General trends in privatization of the large enterprises in Ukraine and Slovakia .	17
2.2 Methods of privatization at the early stages	19
2.3 The lack of transparency in privatization	22
2.4 Cronyism and favoritism as widely used tools in privatization processes.....	26
2.5 Threats and the real examples of re-privatization	27
2.6 The role of the State Property Fund of Ukraine (SPF) and National Property Fund of Slovakia (FNM)	31
2.7 Privatization in the strategic sectors of the economy	33
Chapter 3 – Steel industry after communism in Ukraine and Slovakia – transnationalization coming from below and above	40
3.1 The historical setting for privatization in steel industry in Ukraine and Slovakia and the need to restructure	45
3.2 Revenues and net income of the Ukrainian steel mills.....	50
3.3 Success of the Kryvorizhstal (ArcelorMittal Kryvyj Rih).....	54
3.4 Challenges of the domestically owned enterprises	57
3.5 Revenues and net income of the Slovak Steel mill: Success of the US Steel Kosice	62
Conclusion.....	66
Bibliography.....	70

‘For any assessment of the results of privatization, look hard, and evidence for
opposite conclusions can be found’

Frydman, Murphy and Rapaczynski (1989)

Introduction

Privatization has played one of the most important roles in the post communist countries’ move towards market economy. It has also brought about the issues that were never on the agenda before – democracy, prosperity and the rule of law. However, together with privatization, many serious and important negative issues came along. The lack of transparency, extensive corruption, tremendous political pressure on the business processes and economy in general resulted in some of the biggest scandals in the history of these countries.

This thesis will deal with the challenges in the privatization processes in the two chosen countries – Ukraine and Slovakia. In depth analysis of the large enterprise privatization in both countries will be provided, as well as the special focus on the steel industry will be made. This will enable to deepen and enrich our understanding of all the controversy in privatization in post-communist Ukraine and Slovakia. The recent focus on the re-privatization is of a special value in the research. It shows that privatization is not something that has passed by and there are only the results left to be assessed, but it is an on-going process with very important implications.

A lot has been already done in order to assess the first steps and outcomes of the privatization in the countries in transition, extensive amount of literature on privatization is out there. One of the main experts in the privatization matters in post-communist countries Anders Aslund argues that privatization has been the most important change for the countries in transition, since it has shifted the private sector from being non-existent to one of the most influential sectors that formed GDP. He further argues that it was fundamental in drawing the line between the socialist and capitalist society.¹ Other authors further argue that in the competitive sectors of the economy privatization has been fundamental in establishing the efficiency of the enterprises and welfare profitability.² In terms of large scale enterprises privatization, authors agree that privatization has been crucial in eliminating loss making, with huge public debts and incapable management state owned enterprises.³

Nevertheless, the established knowledge about the mostly positive impacts of privatization on the national economy needs to be reconsidered. My thesis will focus on the challenges which privatization brought about and the “dark side” of these processes. Privatization has been such a unique phenomenon in the post-communist countries that it took a long time before it could be managed properly. Before that, the people in power and the leaders of the biggest business and interest groups turned it in their own convenience which resulted into main frauds, anti-democratic issues, and huge financial and economic losses. This is the main area I will cover in my research.

¹ Aslund, A. (1992). *Post-Communist economic revolutions: how big a bang?* Washington, D.C.: Center for Strategic and International Studies (CSIS).

² Megginson and Netter (2001), Nash and Megginson (2000), Megginson, Nash and van Randeborg (1994) in Kikeri, S., & Nellis, J. (2004). An Assessment of Privatization. *World Bank Research Observer*, vol.19, No 1 , 87-118

³ Fries, S., & Lane, T. (March, 1994). Financial and Enterprise Restructuring. *IMF Working Papers* , 1-28.

My main arguments include but are not limited to the following. First of all, the outcomes of privatization in the Central Eastern Europe (CEE) and Former Soviet Union (FSU) countries resulted in a lack of transparency, big issues with corruption, cronyism and favoritism, which in many cases outweighed the positive results from the privatization. Besides, privatization of the strategic enterprises requires a very special attention and unique program for each of these enterprises. Otherwise, dependency from the foreign irresponsible owners can lead to the collapse of economic prosperity and severely harm the political image of the country. Finally, in the example of the strategically important sector in both Ukraine and Slovakia, I argue that although transnationalization from above proved to be a more efficient form of the takeover, transnationalization from below turned out to be quite efficient form of the buyout as well.

My selection of the countries was made on the basis of perfect comparability within the specific category of post communist countries; yet, the two countries are also perfect examples of the divergent paths which were undertaken regardless of the fact of the common communist legacies and the concept of path dependency. Since the steel industry is one of the most important sectors that form GDP in both countries, I have chosen it on the basis of the very good compatibility which makes my results even more valuable.

The main findings of the thesis on the one hand, are not surprising. First of all, my study has confirmed the stylized knowledge that privatization at the end contributes to better efficiency and separation of the economic sector from political interest. However, in the process of privatization some major issues as cronyism, lower selling

prices and conflict of interests largely contributed to the privatization processes that have been quite unsuccessful and therefore not efficient. Most of the positive outcomes brought by privatization could not be enjoyed by these countries due to the above stated reasons. What is further surprising is that Slovakia has managed to overcome the communist legacies and step on the legal and transparent privatization path after a certain time period (1998) and Ukraine has been stuck in the dependant position since the time privatization started. The other main and important findings are that, in the example of the steel industry, I have shown that privatization by local business groups can also be beneficial for the economy, no matter the political implications of this step.

To conduct the research in the most proper way, I have analyzed the data in a comparative manner, singling out the categories, which serve the best purpose for my studies and are most suitable for comparison. I have brought up the newest data in the form of analytical papers, Property Funds' official statements and briefings, privatization experts' opinions, modern books and articles on the privatization in the transitional economies, as well as journal articles and my own observations. For the research in the steel industry specifically I use the official data from the national Statistical Committees in both countries, year reports in the corresponding enterprises as well as the official data from the stock exchange market in Ukraine to obtain information about the legal property rights of the largest steel mills in Ukraine. For the purpose of deep analysis, I quantify my research, assessing the revenues and net income of the largest steel enterprises in Ukraine and Slovakia, observing the changes with time, and their connection to the particular events, but mostly concentrating on the differences between foreign and domestic ownership.

The structure of the thesis is as follows: the first chapter reviews the main literature in the field with constant emphasis on the categories to be analyzed in the examples of Ukraine and Slovakia. Its thematic structure includes the reasons for privatization in transitional economies, speed of privatization and its impact on the success of the process, challenges in privatization of the large enterprises, outside vs. inside privatization, the arguments against privatization and their weight compared to the positive outcomes of privatization. I identify my own position within the literature, arguing that no matter that the literature is highly concentrated on positive results, negative outcomes cannot be neglected and therefore are given the special attention in my own research.

The next chapter deals with the privatization of the large enterprises in Ukraine and Slovakia specifically, emphasizing the common as well as divergent patterns in the development of the process. Within the chapter I discuss such categories as methods of privatization which were used in both countries, not transparent privatization processes which resulted in lowering the selling price of the enterprises, cronyism and corruption schemes which were common for the two countries, with a correction of Slovakia after 1998, privatization and the reversed processes – re-nationalization with following re-privatization and its threats for the two countries, the role of the managing bodies of the privatization in both countries and how they affected the privatization process in general and finally, I will look at the strategic sectors' privatization and what the challenges and differences were in performance of privatization in the two countries.

Finally, the last chapter will deal with the steel industry's largest enterprises privatization, emphasizing the strategic purposes it served as well as the main outcomes. I will identify the patterns with which the given enterprises were privatized; concluding that privatization from above still is the best form for large buyouts. At the end, I emphasize all the main findings as well as possible broader implications of the research done with a specific focus on the larger context, in which my main findings can be placed.

Chapter 1 - Historical approach to privatization in transitional economies after communism

Since the fall of Soviet socialism and the need for restructuring of the economy from a planned to its market form, the question of privatization was placed on the agenda. Privatization processes in post-communist countries were unprecedented. In a matter of a decade more than 15,000 large and medium sized enterprises, hundreds of thousands of small firms and millions of houses were privatized.⁴ The study of Djankov and Murrell (2002) showed that restructuring was more likely to take place in the privately owned enterprises than state owned; the study was conducted on the Foreign Soviet Union (FSU) transitional economies. Although the special case was Russia, where there was hardly any difference between the two forms of the ownership.

The privatization effect in the Central Eastern Europe (CEE) has shown to be two times more effective than it was in the FSU block.⁵ The explanation of why privatization has mostly in FSU at the first stages was offered by Stiglitz and Godoy. They state that such reasons as the lack of incentives, ineffective law on corporate governance, absence of the financial institutions and macroeconomic policies largely contributed to the worse results in privatization in FSU than in CEE.⁶ Still, Aslund argues that privatization was the most prominent change brought by transition, since

⁴ (Djankov and Murrell (2002) in Kikeri and Nellis, 2004)

⁵ *ibid*

⁶ (Stiglitz, S. G. (2007). Growth, Initial Conditions, Law and Speed of Privatization in Transition Countries: 11 years later. In G. W. Saul Estrin, *Transition and Beyond* (pp. 89-118). New York: Palgrave Macmillan, p.106)

the private sector underwent a dramatic change from being almost non-existent to one of the most important providers that formed GDP. It became a fundamental line between a socialist and a capitalist society.⁷

Aslund in his later work argues, that since the state is incapable of providing marketization of the economy, because it is badly organized, distrusted, and is not able to respond flexibly to demand, privatization in the FSU and CEE was often viewed as a tool for covering the costs of transition. Therefore it was better to sell the property so that it's private, and then to get tax revenues from the booming and successful enterprises, than to keep it in the state hands.⁸ Aslund further explains that the state is not only incapable of being a good manager of the enterprises, but often even possesses an obstacle to the privatization processes. By doing so, the state wishes to still influence the labor conditions, profile of the enterprise, suppliers' choice and other aspects. Aslund further states that the main aim of privatization has become really to create a good management structure, and to create a welfare state in the long run.⁹

Aslund and Bornstein agree on the purposes of privatization processes. These included mostly political reasons (to separate enterprises from the state) which were supposed to ensure the path towards democracy and pluralism. The next goal for privatization was building of the market economy, which required independent

⁷(Roland. (1991). Political economy of sequencing tactics in the transition period. In L. Csaba, *Systemic change and stabilization in Eastern Europe*. Dartmouth., Aslund, 1992)

⁸ (Aslund, A. (2007). *How capitalism was built: The transformation of Central and Eastern Europe, Russia, and Central Asia*. Washington D.C.: Cambridge University Press. p.143-164)

⁹ *ibid*

enterprises, and as Aslund puts it “they could be nothing but private”.¹⁰ The third driving force was to re-establish justice towards the owners of the previously nationalized private property.¹¹ Achieving democracy has been one of the main goals and results of privatization. As Aslund argues, in order to achieve the full democracy, the pluralist ownership is needed. He further identifies that there is a positive correlation between predominant state ownership and the authoritarian regime has been proven on many countries.¹² That is why democratization through privatization became one of the main ideas in the post-Soviet countries.

Joseph Schumpeter in his turn argues that private ownership is necessary in order to also achieve innovation, and structural reforms are needed in order to boost development and encourage entrepreneurship.¹³ Other authors also support the idea that in infrastructure sectors, privatization seemed to improve the welfare profitability of the enterprise and, usually, efficiency as well.¹⁴ Morris Bornstein and others also express similar ideas.¹⁵ Welfens in his turn argues that privatization on a larger scale should be prioritized to, for example, the privatization of the separate individual firms which will not have a macroeconomic impact on the economy. This, in turn, will have a considerable impact on the separately privatized lonely firms.¹⁶

¹⁰ (Aslund, 2007), Bornstein, M. (1994). Privatization in central Europe: techniques, policy options and economic consequences. In L. Csaba, *Privatization, liberalization and restructuring. Recreating the market in Central and Eastern Europe*. Dartmouth.)

¹¹ (Bornstein in Csaba 1994)

¹² (Aslund, 1992)

¹³ (Schumpeter in Aslund, 1992)

¹⁴ (Megginson and Netter (2001), Nash and Megginson (2000), Megginson, Nash and van Randeborg (1994) in Sunita Kikeri, John Nellis, 2004)

¹⁵ (Bornstein in Csaba, 1994)

¹⁶ (J.J.Welfens, P. (1994). Privatization and FDI in the East European transformation: theory, options and strategies. In L. Csaba, *Privatization, liberalization and restructuring. Recreating the market in Central and Eastern Europe*. Dartmouth.)

The ongoing debate about gradual vs. swift (shock) privatization has raised many important issues. Aslund in his earlier book argues that prerequisite for the successful privatization is strong property rights. Therefore, if privatization is performed very quickly, it may raise doubts for the new owners about the stability of their property rights, and the possibility of them being taken away from the new owners.¹⁷ Opinions are changing with time, and in his later book, Aslund already argues against the popular view that privatization can be done either soon or later, arguing that the real choice was between fast privatization (in case of Slovakia) and little privatization (Ukraine).¹⁸ The other popular view that Aslund is opposing is that the timing and pace didn't matter, what mattered was the quality of privatization. However, Aslund illustrated that the above statement contradicts the evidence –the choice was between early privatization and no privatization.¹⁹

Negative effects of the speed privatization were also found by Stiglitz and Godoy who show in their study that the privatization speed negatively affect growth, reinforcing the anecdotal thing for gradualism, and against shock therapy²⁰. Their further finding in the cross section study reported that fast privatization contributed to the decadal slump in the medium run – up to 10 years. Another important point which was raised by the authors is that shock therapy resulted in major inequalities, undermined confidence in market, and caused the lack of legitimacy of the property rights.²¹

The other authors who supported delayed privatization argued that the states with transitional economies don't have an experience in doing these things, and if they

¹⁷ (Aslund, 1992)

¹⁸ (Aslund, 2007, p.178)

¹⁹ (Aslund, 2007, p.179)

²⁰ (Stiglitz, Godoy 2007, p.103)

²¹ (Stiglitz, Godoy 2007, p.105)

want privatization to be a smooth and a fair process, the very fact of privatization should be delayed.²² Other authors, for example, Tandon (1995) argues that privatization should have been postponed until the institutional framework is established.²³ However, as we already know from Aslund, - “the choice was between early privatization and no privatization” (see above).

Privatization of the large enterprises specifically is the most controversial and hotly debated issue. Aslund in his earlier publication argues that before privatization of large enterprises happens, other essential measures should be taken to achieve a positive result. First of all, de-monopolization and liberalization of trade should occur and old equipped and therefore inefficient enterprises should be eliminated at the earliest stage.²⁴ Fries and Lane strongly agree with this issue, and argue that it is crucial to eliminate chronic loss making state enterprises which often have bad and highly bureaucratic management. They further state that if these measures cannot be done because of the strategic importance of the particular enterprise, it should be at least reduced in scale and scope, and strengthened in terms of the financial control.²⁵ This should be done in order to facilitate the elimination of the debts burden, which considerably slows down the privatization process and further restructuring of the enterprise.

There is also a popular view, that rather than privatize, the government should opt for the new enterprises establishment and still “squeeze out the revenues from the dying

²² (Grosfeld (1990) in Roland, in Csaba 1991)

²³ (Tandon (1995) in Nellis, J. (2001). Time to rethink privatization in transition economies? In S. M. Oleh Havrylyshyn, *A decade of transition : achievements and challenges*. Washington, D.C.: International Monetary Fund, p. 179)

²⁴ (Aslund, 1992)

²⁵ (Fries, Lane 1994)

enterprise”.²⁶ In his later book Aslund states, that this was actually not a feasible option for many of the countries, since starting conditions – like initial claims on property, political power, legal and administrative capacity – mattered so much that they did not allow for the new enterprise establishment or choosing freely between all available effective methods of privatization.²⁷ Therefore the feasible options were much less than it was understood. An interesting point regarding the issue has been made by Mackenzie, who argues that for many of the transit countries’ economies privatization has been primarily the source of the revenue.²⁸ This was especially true for Ukraine, since the main economical goal of privatization was to fill in the budget and to cover the old debts. Therefore it was impossible for Ukraine to start new enterprises since there were no means to do so. Quite contrary, in Czechoslovakia, which aim was not to boost efficiency of the separate enterprises, but to create a strong market sector in general and encourage private businesses, it was possible to start the new enterprise establishment.²⁹

The debate about whether the state should prefer outside owner rather than national investor has also been ongoing. There are views, that privatization by foreign owners increase dependency of the country from the foreign capital and it might be dangerous for the country’s security.³⁰ However, much more common are the views which emphasize the positive impact of the foreign ownership, since it tends to be more effective, and by bringing the FDI, foreign owners involve management skills,

²⁶ (Aslund, 1992)

²⁷ (Aslund, 2007, p. 179-180)

²⁸ Mackenzie, G. A. (1997). *The macroeconomic impact of privatization*. IMF.

Mark Flanagan, L. M. (2008). *Ukraine: Selected Issues*. Washington D.C.: International Monetary Fund.

²⁹ (Aslund, 2007, p. 143-164)

³⁰ (Kornai (1990) in Roland in Csaba (1991)

capital and technical know-how.³¹ Nevertheless, Aslund himself states that privatization by the foreign owner created confusion in its meaning. Most of the times, it was not the act of foreign investment, the sale of the enterprise to the foreign owner meant only the form of revenue for the state budget, and not the foreign investment.³² Stiglitz and Godoy find yet another correlation, arguing that without access to finances the owners (mostly domestic) would be probably engaged in the asset stripping, therefore foreign ownership is preferred.³³

To sum up all the comparative aspects of privatization raised above, let me restate the following arguments. Private firms perform better than the state owned, startups perform the best, firms that are privatized by outsiders perform better than the ones privatized by insiders, foreign ownership is mostly beneficial, firms privatized to insiders perform almost as bad as the state owned, partially privatized firms do much better than completely state owned, the new outside managers perform much better than the original managers, the earlier the privatization took place – the better it became, the breakthrough was always large scale privatization, positive results of privatization were immediate in CEE, but took years to emerge in FSU.³⁴

The major criticism towards privatization is expressed in terms of shifted transparency and privatization's fairness. Authors point out, that firms were experiencing layoffs and worsening labor conditions on the firm level in the short run and in the economy as a whole in a long run. They further argue that privatization benefited the small amount of the citizens – managers, stock holders, domestic and

³¹ (Havrylyshyn, McGettigan, 2000) in Aslund, 2007, p. 145-50)

³² (Aslund, 2007, p.143-164)

³³ (Stiglitz, Godoy 2007, p.104)

³⁴ (Aslund, 2007, p. 172-181)

foreign investors, while the consequences of privatization would be borne by the major rest of people – tax payers, consumers and workers therefore the total welfare will reduce.³⁵

In addition, some of the biggest condemners of privatization Bogomolov (1996) and Stiglitz (1999) argued that even if more efficiency could be observed over time, it happened due to the increased competition and demonopolization, and not due to the change of ownership.³⁶ However, the empirical evidence does not support this claim, since the competitiveness did not exist with the state ownership and it has increased dramatically, when privatization processes first occurred.

Tandon's opposition to privatization indicates yet another important aspect of it. He argues that the enterprises that were already privatized need to be rethought in terms of increased state control and further re-nationalization, which will return the enterprises for the satisfaction of the public interest.³⁷ My own evaluation of this suggestion is purely negative, since what Tandon did not take into account, is that re-nationalization could threaten off the private, which are also often foreign investors who showed much better results in efficient enterprise management than the state. Furthermore, the assumption of the better results because of the increased state control presupposes the strong state which was not and still is not the possible option in most of the FSU countries. Finally, public interest does not necessarily require the state ownership; if enterprise is managed successfully, the type of ownership does not matter.

³⁵ (Kikeri and Nellis 2004)

³⁶ (Bogomolov 1996, Stiglitz 1999 in Aslund (2007))

³⁷ Tandon (1995) in Nellis in Havrylyshyn, Nsouli, p. 179)

To sum up, the biggest achievements of privatization, which all the supporters of privatization have agreed on, are the following. First of all, emergence and expansion of the private sector has been recognized as a big and major achievement of privatization, however major concentration efforts were necessary to get the dominance of the private sector. Democratization was next very important result, brought by privatization. Separation of the property from the state therefore depoliticizing the property was also a major consequence of privatization. As a natural result of it, there was an increased competition on the market, which positively affected the economy. Enterprise restructuring, including replacement of previous management, cutting the costs, decreasing in the scale and scope, elimination of the loss making enterprises, and finally, raising the capital through the stock market was next large step and result of privatization. It has all led to the formation of the market economy, replacing the old regime of the planned economy. Moreover, privatization has brought about justice, which was striven for by so many nationals of the post Soviet countries.

However, those who opposed privatization, also find legitimate arguments to do so, including corruption, lack of transparency and worsening of the labor conditions in the short run. Nevertheless, regardless of the fact that there are some precautions about the impact of privatization in the countries of transition, the general picture of privatization's results looks quite positively and inspiring.

Chapter 2 - Challenges of large enterprises' privatization in independent Ukraine and Slovakia

Privatization of the large enterprises in both countries has gone through hard and often controversial processes, which resulted into major issues with transparency and economic inefficiency. These processes has often been made through the trial – and – error method and some privatization projects have failed from the economic point of view did so mostly due to the private interests of large influential business groups. In Ukraine these processes are continuous and the State Property Fund of Ukraine (SPFU) is still incapable of successful privatization conduct. In Slovakia, although more transparent privatization was established after 1998, the major privatization scandals and corruption fights are still on the agenda of the National Property Fund of Slovakia (Fond Národného Majetku - FNM). I find this in contradiction with a general idea that privatization necessarily brings prosperity and speeds up the move towards a developed economy as well as immediately ensuring transition towards more democratic processes and better transparency.³⁸ In ideological terms there is much support for privatization; in political reality fight persists between groups.³⁹

Therefore, since most of the scholars focus on the positive effects of privatization, I want to show the controversiality and some negative effects of privatization being undertaken in Ukraine and Slovakia. The major focus will be on the privatization of

³⁸ See, for example, Aslund, 1992, 2007; Mackenzie, 1997; Nesh and Meggison, 2000 etc

³⁹ This wording has been suggested by Julius Horvath

large enterprises only, since it has had the biggest impact on the economy compared to the privatization of small and medium sized enterprises. In my research, I will mostly rely on the views of privatization experts in Ukraine and Slovakia, views of the media, known scholars as well as official Property Funds' management to illustrate my main argument.

The chapter is structured in the following way: I will review the processes of privatization in Ukraine and Slovakia, based on the concrete categories, as methods of privatization which were used in both countries, un-transparent privatization processes which resulted into lowering the price of the enterprises for which they were privatized, cronyism and corruption schemes which were common for the two countries, with a correction of Slovakia after 1998, privatization and the reversed processes – re-nationalization with following re-privatization and its threats in the two countries, the role of the managing bodies of the privatization processes in both countries and how they affected the privatization process in general and finally, I will look at the strategic sectors' privatization and what the challenges and differences were in performance of privatization in the two countries.

2.1 General trends in privatization of the large enterprises in Ukraine and Slovakia

During the first stages of privatization in Ukraine, there were some major issues with the transparency and legality, since right after the fall of communism and huge currency depreciations, the objects were privatized at the fire price. The state's

interests were to a large extent neglected; therefore during mid-to late 90s a young independent state received lower profit from privatization than otherwise could. During the next stage, which was in the early 2000s, the management of the State Property Fund at the time, and some of the leading economists including Riabchenko, Karmazin, Paskhaver turned against privatization, therefore stressing the need for effective management of the state owned enterprises rather than opting for a mass privatization of the strategic objects that are still left in the state ownership. The very current trends show that, even during the crisis period, a new government and a new SPF management are initiating and justifying the need of the privatization of the strategic objects. What stays behind these privatization ideas is never known for sure, but is almost always clear that the interests of the biggest business groups in Ukraine are to be preserved. Nevertheless, from the efficiency viewpoint, privatization stimulation in the crisis times goes against the logic.

Slovakia joined the rapid privatization processes at the rather early stages. Privatization there became one of the most urgent economic priorities and served as a part of successful reform implementation. Unlike Ukraine, Slovakia initially had a good plan for large enterprises privatization.⁴⁰ Slovakia has done so in order to prevent further asset stripping, to make the links between the state and the enterprises more regulated, and what is most importantly, to prevent the communism from returning. However, the speed did not ensure privatization processes in Slovakia to be a large success at the first stages and did not prevent it from doing same major mistakes as Ukraine also did.

⁴⁰ (Frydman, R. (1998). Capitalism with a Comrade's Face: Studies in the Postcommunist Transition. *Central European University Press* , 60)

Looking back, we see that privatization could have been performed in not such a harsh manner. Return of communism was not such a big threat, and if privatization would have been approached from the more deliberate viewpoint, the results could have been also different with less insider ownership and domination, less resistance and hostility to the external investors, more protection for the minor shareholders and so on. Therefore if the state is not yet ready to privatize, it is better to delay such processes as Poland and Hungary did.⁴¹ However, what Slovakia was able to do is overcoming the communist legacies and move to a new – more advanced stage in privatization of the large enterprises.

2.2 Methods of privatization at the early stages

The methods of large enterprises' privatization were quite similar in both countries, but they still differed in terms of successfulness and the results after privatization has been performed. In Slovakia they were clearly defined and prescribed and unlike in Ukraine, already at the first stages included advanced methods of privatization such as auctions and public competition.⁴² For nationalist reasons Ukraine did not want to follow the Russian example of voucher and insider privatization, but the debate over the privatization methods preferred was going on for such a long time, that it finally led to the implementation of the Russian scheme anyways.⁴³

Unexpectedly enough, the management employee privatization was a very popular privatization method in both countries.⁴⁴ Nevertheless, through this method, most of

⁴¹ (Nellis, J. (2001). Time to rethink privatization in transition economies? In S. M. Oleh Havrylyshyn, *A decade of transition : achievements and challenges*. Washington, D.C.: International Monetary Fund, p. 188)

⁴² Mikloš, I. (1996). *PRIVATIZATION IN SLOVAKIA DURING 1991-1995*. Retrieved 05 20, 2010, from <http://www.internet.sk>

⁴³ Yekhanurov 2000 in Aslund 2007, p.180

⁴⁴ (Aslund, 2007, p.157)

the property in Ukraine was sold for “next to nothing” to the employees and managers.⁴⁵ In 1998, the ratio of managers and employees share of the stock of privatized industrial enterprises was 17.5% to 47%.⁴⁶ This is very surprising, since the share of employees in Ukraine owning the enterprises was much more than in many other countries. However, in reality, the managers controlled the biggest part of the employee’s stock. As a result, there was no big difference between the state and privately owned enterprises even in 1999.⁴⁷

In Slovakia employee privatization included both employees and managers and did not read as a distinct category. The amalgamation of these two categories was lobbied by the certain business groups. The term “employee privatization” was often used by politicians to gain political loyalty or to make the privatization by managers possible. Therefore, just as in Ukraine, regardless the fact that it first looked like a real possibility for the employees to acquire their property share, it turned out to be just a scam.⁴⁸

The insider privatization, which was very popular in both countries, had some major advantages: it was fast, created legitimate property rights and was easy to administrate. Nevertheless, it created problems with efficiency of the enterprise and very slow restructuring process, since insiders had little incentive to restructure.⁴⁹

⁴⁵ Aslund, A. (2009). *How Ukraine became a market economy and democracy*. Washington D.C: Peterson Institute for International Economics, p.81

⁴⁶ *ibid*

⁴⁷ Estrin and Rosevear (1999) in Aslund 2009, p.81

⁴⁸ Brzica, D. (2000). *Privatization in Slovakia: The role of employee and management participation*. ILO

⁴⁹ (Aslund, 2007, p.162)

Voucher privatization was an idea of liberal economists with the good intentions of whole population benefitting from such form of privatization. Initially, it became the major privatization method in Slovakia, but soon it lost its attractiveness. Voucher privatization was much less costly, than many other forms of privatization, such as auction, tenders, or Initial Public Offerings (IPO). Nevertheless, this form of privatization was accused of the ineffective corporate governance.⁵⁰ In Ukraine voucher privatization officially ended in the mid 1997, never gaining popularity among Ukrainian people.⁵¹ Voucher funds emerged as a support tool for regulation of voucher privatization, but they just faded away, offering no benefit to their many small investors⁵². Generally, voucher privatization in both countries as well as other CEE countries was blamed for the unrelated problems like insider privatization or management theft.⁵³ Nevertheless, looking back, voucher privatization was recognized as the tool for fastest, more transparent and biggest privatization method plus for the minimum administrative costs. What was also important in particular Slovakia, that it facilitated big industrial restructuring.⁵⁴

What was unique about privatization methods in Ukraine, that it employed such method as bankruptcy privatization. It became a very popular one, but the whole idea of it was understood and used wrongly. Bankruptcy and liquidation were supposed to be legitimate methods of privatization, which would allow fast and effective restructuring, relieving the enterprise from its past debts and ineffective

⁵⁰ (Aslund, 2007, p.160)

⁵¹ (Aslund, 2009, p.81)

⁵² Pistor and Spicer (1996) in Aslund 2007, p.161

⁵³ Stiglitz (1999) in Aslund 2007, p.161

⁵⁴ (Aslund, 2007, p.161)

management.⁵⁵ This nevertheless has turned into very un-transparent privatization schemes with insider and business groups taking advantage of such imperfection.

2.3 The lack of transparency in privatization

Un-transparency in Ukraine and Slovakia has resulted into the similar problem – lowering the selling price of the enterprise, which caused significant losses and led to biggest scandals in the history of privatization in Ukraine and Slovakia. As evidence suggests, un-transparency schemes can be developed quite differently. For example, in 2004 Ukrainian President proposed a moratorium on the privatization in Ukraine. This step would have almost surely developed illegal machinations and stimulation of shade privatization. If legal privatization would have really stopped, the bankruptcy schemes would have been performed on those enterprises which were getting ready for the privatization through competition, and would be privatized for the next to nothing.⁵⁶

The example of un-transparent and ineffective privatization in Ukraine can be the privatization program for the biggest ore mining enterprise, Ukrrudprom, which was viewed by economists as premature and not ready for changing ownership. It was advised that if a state-owned enterprise is actually managed by a certain big business group, it is a specific sale. “You should not think that it would be possible to conduct this sale in a classic way through a tender and that there would be five companies competing honestly with one another without taking any preventative measures...” (O. Riabchenko, a leading economist, Head of the State Property Fund

⁵⁵ (Aslund, 2007, p.163)

⁵⁶ Chechetov, M. (2004). *Privatization of the state property on the sum of 2.7 bln UAH is real*. SPFU

since March 2010).⁵⁷ Nevertheless, in 2004 privatization of this enterprise took place and it was suspected that money out of the deal was to be spent on the upcoming presidential elections to finance the candidate Yanukovych.

The bigger impacts of the above described deal, this time on the international arena were to follow soon. Kryvorizhzhya, an ore enrichment plant, which was supposed to be a part of Ukrrudprom when privatized, is another example of government irresponsibility. This plant was built with the involvement of other countries, such as Germany, Slovakia, Romania and Bulgaria. Therefore, before negotiating the question of privatization of this plant through the diplomatic channels with these countries are made, one cannot start privatization process of this plant. Otherwise, as deputy Karmazin argues, transferring this enterprise into private ownership without agreement and compensation to these countries may lead to the international scandal.⁵⁸

The current events suggest that these problems have not been overcome in Ukraine until now. The predictions which Mykhaylo Chechetov made as a head of Property Fund in 2004 about illegal schemes that bankrupt the state enterprise first and later get sold at a low price to the interested business groups, seem to come true. This was also noticed by the former Prime Minister Tymoshenko, who stated that procedures with illegal bankruptcy of the enterprise should be stopped by a new law, since this is the way “shadow privatization” takes place. Her other claim was that with a new law, privatization will take place only through auctions to make it transparent,

⁵⁷ Yatsenko, N. (2003, January 21-31). Oleksandr Riabchenko: One can only set up a privatization agency at the state Property Fund. *Zerkalo Nedeli*

⁵⁸ RBC-Ukraine. (2008). Reprivatization will not be allowed. Yuriy Karmazin . *Informational agency* , <http://www.rbc.ua/ukr/newsline>

only the majority holding will be put up for auctions (to make sure that “integral property complexes of enterprises” are sold, and not just some parts of it – this is to exclude the possibility of a hundred owners which will fight among themselves). The final claim was that privatization will be performed under individual schemes; therefore the package of bankrupted enterprises sold together will be avoided.⁵⁹ These good intentions do not hold true, taking into consideration that privatization processes are performed with a violation of all these rules. For example, as a deputy, Serhiy Teriohin, the vice head of the Ministry of Agriculture and Property land argues, privatization by some interested business groups in the very important export sector for Ukraine, such as agricultural grain, was undertaken when the state enterprises were seemingly announced to go bankrupt.⁶⁰ Another example of this is the coal mines. A lot of the state owned mines are announced to go bankrupt and now there have been formed packages of 10-15 mines as a single privatization object, besides they will be sold by other than auction, methods.⁶¹ Such processes clearly indicate non-transparent processes, which are being adjusted to the private interests, excluding the best interest of the state and its people.

In Slovakia the biggest examples of fraud and unlawful privatization include such big scandals as privatization of Bučina Zvolen – enterprise of the renewable energy, PSIS – First Slovak Investment Company, Slovenské liečebné kúpele – Slovak Healing Spas, NCHZ - Nováky Chemical Company, Slovnaft - the oil company and

⁵⁹ Pravda, U. (2008). The procedure of the mock bankruptcy will be prohibited. *Express*, <http://www.expres.ua/articles/2008/01/23/23206>

⁶⁰ Kovalenko, I. (2010, Apr 16). Ukrainian bread was about to get privatized. *Express*

⁶¹ Lopukh, I. (2010). Such mines cannot be sold? . *Express*

others. Nevertheless, these precedents did not find response in the public because of the lack of truthful information and public awareness.⁶²

Nevertheless, while in Ukraine these processes seem to be continuous, there was a radical change in the transparency issues during the second period of privatization in Slovakia. After the changing of the government under the rule of Mikuláš Dzurinda (1998), the privatization processes became much more regulated and lawful. They became adjusted to the legislation, with the goal of attracting more investment, using lawful tenders as a method of privatization, prevention of the conflicts of interests as well as taxation regulations to prevent money laundering.⁶³ This is not an easy task to fulfill, although during the recent times of privatization processes in Slovakia, National Property Fund has developed schemes in which it regulates privatization forms and methods, the pace of privatization, and preservation of the equal opportunities, giving an equal right for the foreign companies to participate in bidding.⁶⁴ These measures help to prevent corruption schemes and illegal privatization. The close control on the privatization procedure, which is separate from the political control, was established. The other important aspect is monitoring restructuring state-owned assets to prevent mismanagement and misuse of the enterprise. Privatizing the objects at a very high pace, Property Fund still keeps the procedures; speed privatization stopped being the self-aim and transformed into efficient form of changing ownership.⁶⁵

⁶² Mikloš, 1996

⁶³ Autner, R. (2006). *The National Property Fund and Privatization in Slovakia: lessons learned*. Jefferson Institute

⁶⁴ Ibid

⁶⁵ Ibid

2.4 Cronyism and favoritism as widely used tools in privatization processes

Cronyism was a common disease in both countries. When it came to privatization, especially during the first stages when it was performed, political favoritism was the number one criteria for the potential owner. This obviously has caused a big harm on the both countries' political reputation and their economic health. Nevertheless, Ukraine even in the current times finds itself in a position, when enterprises are dependent on the certain business groups, because they are monopolists in terms of the material supply, while Slovakia has moved forward with the issue.⁶⁶

In Slovakia, the biggest example of the favoritism in privatization during the years of Mečiar was the story with the largest steel mill in Slovakia – VSŽ, a big stake of which was sold for less than a market price to the political allies.⁶⁷ This can be perfectly compared to the first time privatization of the largest steel plant in Ukraine – Kryvorizhstal with the same outcome. In the next chapter the challenges and patterns of these enterprises' privatization will be examined in depth.

Since the National Property Fund of Slovakia was the only body responsible for the privatization processes, and its management consisted of the loyal to the Mečiar's regime people, the control over the privatization processes was completely the ruling and other major parties' priority.⁶⁸ Some privatization schemes which were developed by the previous government were revoked.⁶⁹ This situation which Slovakia experienced at the end of 2004, Ukraine went through at the beginning of 2008,

⁶⁶ Yatsenko, 2003

⁶⁷ (Mikloš, 1996)

⁶⁸ Mikloš, I. (1995). Corruption Risks in the Privatization Process. *Windsor klub*

⁶⁹ (Mikloš, 1996)

when Tymoshenko government took exactly the same measures.⁷⁰ Therefore privatization on the competitive basis was becoming more and more formal rather than executed, and the cronyism measures prevailed.

As for allowing the foreign capital enter the privatization market in Slovakia, that was also in the competence of the government to decide whether foreign capital in this particular object is purposeful or not. This was another sign of political favoritism which favored the domestic investor rather than foreign. Similar processes were and still are going on in Ukraine, where domestic business groups control most of the large scale objects and it is very rare in Ukrainian history that the object becomes foreign owned.⁷¹

2.5 Threats and the real examples of re-privatization

Re-privatization, which intends to redeem justice and make a legal privatization of the enterprises which were earlier wrongfully privatized, usually has inversely proportional impacts on the country's economy and reputation. As much as the Property Fund can boost the profits from the re-nationalization with further re-privatization, just as much it can cause harm on the country's reputation from the side of potential investors.

During the recent times, talks about re-privatization in Ukraine become more and more popular. In 2008, V. Semenyuk – former Head of the Property Fund initiated talks about possible re-privatization of many other enterprises which were privatized

⁷⁰ (U. Pravda, 2008)

⁷¹ Hajko, J. (1996). Privatization in 1995 Dominated by Direct Sales to Domestic Buyers. *Trend*

seemingly with great violations of the law. She backed up her decision by the fact that in some cases re-privatization was demanded by the workers themselves at the enterprise. The example that is worth mentioning is Sambir Furniture Plant, where workers indeed were not satisfied with their investor – Cuman.⁷² Nevertheless, this is not a precedent, and the idea of re-privatization is not new. In 2005 former Prime Minister Tymoshenko was threatening to a mass re-privatization, later similar ideas were expressed by former President Yushchenko, and his minister Kinakh. At that time, ideas of mass re-privatization were the result of the voucher privatization before 1997 which is now considered as “a crime against the population”.⁷³

The claims about necessity of re-privatization are made mostly due to bankruptcy reasons, since by the end of 2008 every second privatized enterprise in Ukraine was announced bankrupt. Nevertheless, there are many enterprises that are in temporary financial troubles, and under the condition of restructuring or reorganization, they can pay the debts and successfully function further. However, due to the legal system’s imperfections, bad financial management, the absence of restructuring reforms experience and other subjective reasons, these enterprises are wrongfully announced as being potentially bankrupt and placed under the same condition as the really bankrupt enterprises.⁷⁴

The other important reasons for re-privatization include legal aspects, such as if privatization was made with violations of the law, or, the enterprise stopped production and it belongs to the strategic branches of the economy, or if

⁷² 2.5 thousand of the stockholders demand the re-privatization of the Sambir Furniture Plant. (2005). *ZIK*, <http://zik.com.ua/ua/news/2005/05/25/10735>

⁷³ Deev, O. (2008). Reprivatization-2008:cure for the economy or a soap bubble for the SPF? *Today*

⁷⁴ *Refine*. (n.d.). Retrieved 05 18, 2010, from Restructuring and reorganization of the bankrupt enterprises

management of the privatized enterprise does not fulfill the contract conditions.⁷⁵ Practically, it means that almost any enterprise that is in the Property Fund's interest to be re-privatized can be re-privatized. Nevertheless, the enterprise Kryvorizhstal remains the only example of its scale which went through the process of re-privatization. Another example which approaches Kryvorizhstal is Nikopol ferroalloy plant, which was privatized in 2004, but for a lower than market price.⁷⁶ It was intended to be returned into state ownership, although only a 50% share ended up back in the state ownership. However, the state turned out to be ineffective in dealing with other stakeholders, which are two large business groups, and in a constant fight for the plant.⁷⁷ At the end, re-privatization never took place, since the state turned out to be a very incapable owner of the control share and never able to sell the share back to the private owner. Therefore it cannot be considered a "finished" case of re-privatization.

However, even the talks and threats of re-privatization can scare off the foreign as well as national investor, and will negatively influence the investment climate in Ukraine, which is not high in any case. As the most pragmatic case – it will lower, even without bad reputation unfavorable prices on the privatization market, and in the crisis time will bring zero profit to the budget. And since filling the budget seems to be the main goal of the government, it is not interested in the re-privatization schemes being talked about. On the other hand, Ukrainian investors – big business groups, might be interested in the budget deficit, since it will force the government to sell

⁷⁵ Semeyuk, V. (2002). *The Law of Ukraine about Pe-privatization of the property in Ukraine*

⁷⁶ UNIAN. (2005). Yushchenko decided to re-privatize Pinchuk only? *Express*

⁷⁷ Umanskyy, S. (2006). Re-privatization must come to the legal end. *Dzerkalo Tyzhnya*

more bankrupt enterprises to them.⁷⁸ Nevertheless, neither party is interested in re-privatization.

In Slovakia there are also precedents in re-privatization, especially in strategic sectors. Two cases in the oil and gas sector, as well as energy sector confirm this. At a certain point, the Slovak government indicated that it wants to re-nationalize 66% of the stake in the dominant energy utility Slovenske Elektarne(SE) from the major power station in Italy Enel.⁷⁹ The deal of selling 66% of the SE was made in 2006 as a transparent privatization process. "Tlacova Agentura Slovenskej Republiky" news agency reported that the Slovak Economy Minister Lubomir Jahnatek ambiguously defended the deal, explaining that "while the privatization deal was performed legally correct, from the point of view of their contents, however, the sale of the shares was the biggest 'roguery' that the state could possibly have made in the sale of its property."⁸⁰

Taking from there, the next year the Slovak government initiated the process of buying-back of the shares. It is suspected that the idea of the deal to be renegotiated came up due to the prediction of the energy prices rising by around 20% that year. Observers noticed that if the government would have been able to re-nationalize SE, it would have set the price controls for electricity. It was important for the government in order to meet Maastricht criteria to join the euro zone. Nevertheless, the deal could not be reached, since Enel stated that they were already in the process of implementation of their investment program which was negotiated under the privatization contract.⁸¹ Nevertheless, in order to endure fiscal transparency, the

⁷⁸ I am thankful to Julius Horvath for this idea

⁷⁹ EIU. (2006). *Energy & electricity: Slovakia*. The economist.

⁸⁰ International, U. P. (2009). Slovakia defends energy privatization. *UPI.com*

⁸¹ EIU. (2006). *Energy & electricity: Slovakia*. The economist.

contract of privatization included that both stakeholders (Enel and the Property Fund) have the right to audit the SE.⁸²

In the gas sector, the Slovak government managed to re-nationalize 49% of the share in the Slovak oil transit company Transpetrol from the Russian oil company Yukos.⁸³ There is no official confirmation on the agreed price, but sources say that the buying back price exceeded the sale price by 51 mln USD. Yukos announced the sale of its stake in order to prevent the Russian court from declaring the company bankrupt.⁸⁴

2.6 The role of the State Property Fund of Ukraine (SPF) and National Property Fund of Slovakia (FNM)

In both countries specialized institutions for the property management and privatization – State Property Fund in Ukraine and National Property Fund in Slovakia– were created at the early stage. Unlike in Ukraine though, all the responsibilities considering these issues were prescribed and strictly defined. In Slovakia, this was probably one of the stabilization steps that played an important role in the history of privatization in Slovakia, since in Ukraine privatization of the state property was a largely uncontrolled process. Starting with the point, that only in 2008 the law, which stated that only State Property Fund is in charge of the property management was initiated.⁸⁵ Before that there were numerous centers of management that often had conflicting interests in the privatization matters which did not lead to the successful privatization processes.

⁸² International, U. P. (2009). Slovakia defends energy privatization. *UPI.com*

⁸³ EIU. (2006). Petroleum and Gas: Slovakia. *The Economist*

⁸⁴ *ibid*

⁸⁵ (U. Pravda, 2008)

The institutional changes, which underwent in Slovakia rather soon, and were attempted to be negotiated in Ukraine rather late became a part of the reason of the increased un-transparency in the management sphere during the first stages of privatization. Having two national bodies to regulate the property relation in Slovakia – National Property Fund and the Ministry of Privatization, Slovak government decided to undermine the importance of the Ministry of Privatization to be able to influence the National Property Fund.⁸⁶ In Ukraine the opposite law was planned. It was initiated to reform the State Property Fund into the Ministry of Privatization for the same purpose of being able to have more control over its activities, since it would have been directly subordinated to the Cabinet of Ministry – the executive branch of the Ukrainian government. Nevertheless, the implementation of this plan never occurred. In order to do that, many laws would have to be changed and that would have taken a long time. In the meanwhile, there was a strong need to fill in the budget. And after all the strategic objects which will bring a lot of profit to the budget will be sold, the idea of the Ministry will automatically lose its initial purpose in serving the governmental personal needs.⁸⁷

However, as of 2008 the share of the state property in Ukraine was already quite small, and amounted in only 21%. The management of the SPU at a time was opposing privatization for this matter, backing up its decisions by claims that the remaining share of the property cannot be sold for a trifle. “If the state is an effective owner for now, what is the purpose then to sell?”⁸⁸ Valentyna Semenyuk also

⁸⁶ (Mikloš, 1995)

⁸⁷ Skoryk, A. (2008). Privatization 2008. *Glavred*

⁸⁸ SPFU. (2008). Valentyna Semenyuk. “Firing of the Head of the SPF – this is the next crime, done by the Prime – Minister of Ukraine. SPFU

expressed the opinion that the emphasis should be given on leveling up state control, rather than privatization.⁸⁹

We have been obsessed with the idea that everything must be sold off and the sales volumes must be reported. This was the political objective of the mid 1990s; the goal was to close the door upon any return to a state monopoly of the means of production. Now, we do not have this goal any longer. The State Property Fund can conclude a very rigid and specific agreement for the management [of state-owned enterprises]. It can set up joint ventures with foreign investors, thus the money can go directly to the enterprise. Oleksandr Riabchenko, the current Head of the SPF, advisor in the privatization processes at the time⁹⁰

2.7 Privatization in the strategic sectors of the economy

Strategic sectors were always of a special matter for privatization and large debates whether and how much of these enterprises are to be privatized have been ongoing. One very important aspect in this strategic privatization was raised by the head of Socioeconomic Development Committee in the President Secretariat of Ukraine.

Privatization of the enterprises in the strategic branches of Ukrainian economy has to take place on the basis of the development plans of these branches. However, these plans are still not approved by the government, the work in this direction is moving very slowly. Before initiating any privatization processes of the certain object, the clear vision for the economic branch development as well as the situation on the market should be taken into consideration.... In any other case, privatization would turn to be a disaster for the Ukrainian nation. Roman Zhukovsky – the Head of Socioeconomic Development Committee in the President Secretariat.⁹¹

The current Head of SPFU, Riabchenko, agrees that due to the crisis, the value of the strategically important enterprises that are offered to be privatized has fallen (UKRTELEKOM, Odessa seaport yard, atomic enterprise Turboatom, regional power

⁸⁹ SPFU. (25.01.2007). Valentyna Semenyuk. *"I am glad that Ministry is now talking about the effective management of the state property and not only about privatization"*. SPFU

⁹⁰ Yatsenko, 2003

⁹¹ President, P. C. (2009). Against the privatizational "sale" . *Express*

enterprises). But it does not mean that the privatization processes should stop. There are enterprises that need considerable capital inflows, and in time of economic crisis they need these investments even more. Therefore these enterprises are to be considered for privatization. Since the state does not have money to support them anyway, how then the state can be considered an effective owner?⁹² At the same time, the government admits that if the economic crisis develops as it does now, the prices for the objects will drop even more. And the fact that the crisis will develop in this manner nobody doubts.

Nevertheless, no schemes for the sector's development were developed either in Ukraine or in Slovakia. A very pronounced example of this can be named privatization of the banking sector in Slovakia, which was initiated very rapidly and without any research of the strategic importance of the sector for the Slovak economy.⁹³ The banking sector was treated by Mečiar's government as a strategically important sector, therefore not a subject to a full privatization. In the meanwhile, the banking sector lacked capital inflows. On this basis, when the foreign capital was not freely allowed in Slovakia, it has faced the potential of the financial crisis. This has forced Moody's financial service to lower of the Slovak credit ranking in the late 1998. The irregularity of loans in Slovakia was labeled as "among the highest among Central European countries, with the trend showing little improvement"⁹⁴

⁹²Naboka, M., & Sherstyuk, N. (2008). The hope for privatization: Selling of the state enterprises. *Radiosvoboda.org*

⁹³ (Mikloš, 1995)

⁹⁴ (*Financial Times*, 29 April 1999 in Kopanic, M. J. (2000). Corruption: Stealing the Eastern Slovak Steelworks. *Central Europe Review*)

The idea of creating some sort of a waterline in the strategically important sectors in Ukraine was first placed on the agenda in the energy sector. When Russian companies came in order to privatize the energy branch of the Ukrainian economy, the President at the time refused since he said that privatization of these enterprises at a time, when they are highly indebted was very inefficient for Ukrainian interests. Shortly after the expressed Russian interest in the Ukrainian energy sector, the President created the national electricity company where all the regional companies merged into one national without a right to be further sold to foreign investors. In this case, the President fixed the waterline.⁹⁵ Nevertheless, before that, in 2001, through open international tenders four out of six regional electricity distributional companies were sold to the Slovak state utility company – Slovenske Elektarne (SE).⁹⁶ This however turned out to be performed on the Russian order – Aleksander Babakov, a Russian businessman, who had very close ties with Prime Minister Putin and was the business partner of Surkis and Medvedchuk – two Ukrainian oligarchs.⁹⁷

The great debates rose around the privatization of Odessa port. There was not a slight consensus on its privatization even among the power branches. As much as Tymoshenko argued in the favor of privatization, the Yushchenko was as much opposing it ⁹⁸, and most likely, due to political reasons and personal controversy with the Prime Minister, and not to preserve the Ukrainian strategic branch. But since as a Head of the government, Tymoshenko's prerogative was filling in the budget, she was even initiating the new law, under which only the Property Fund (where she was hoping to appoint a person from her political party) could initiate and decide on the

⁹⁵ (Chechetov, 2004)

⁹⁶ (Aslund 2009, p.141)

⁹⁷ Ibid

⁹⁸ Interfax. (2009). Constitutional Court decided to not help Yushchenko stop the privatization of Odessa port. *Express*

matters of privatization so that she could bypass President's prohibitions.⁹⁹ Others, namely two former Heads of SPFU – Bondar and Chechetov are in support of the privatization, since they see it as a budget fill and fulfillment of the privatization plan.¹⁰⁰ Deputy Yuriy Karmazin shows the other aspect of this privatization, and a very important one, and argues that Odessa port cannot be sold by any means. In support he states, that if the enterprise will not be handled in respect of all the rules and without proper preventive measures, it may lead to the anthropogenic catastrophe.¹⁰¹

Turboatom is yet another enterprise which is strategically important for the country's security, and it is strongly recommended by analysts to leave it in state ownership. The others are rightly pointing out that since the biggest share of Turboatom is already in private ownership, there is no sense in keeping the small share of state ownership. If the process of privatization started, this process should now come to its logical finish. It is nonsensical to keep state ownership, when the state is not controlling the enterprise in any case, then it is better, if it completely belongs to private owners.¹⁰²

In other Ukrainian strategic sectors, such as oil and gas, for example, foreign capital is already deeply embedded, and has a 25% share of such enterprises as "Halychyna" and "Naftohimik Prykarpattya" and in one of the main oil processing enterprises – Kremenchuh - the foreign capital exceeds 40%.¹⁰³ The waterline of this sector is already under the water, as Chechetov states. But in the situation when

⁹⁹ (U. Pravda, 2008)

¹⁰⁰ (Skoryk, 2008)

¹⁰¹ (RBC-Ukraine, 2008)

¹⁰² (Skoryk, 2008)

¹⁰³ (Chechetov, 2004)

Ukrainian oil processing business is totally dependent on Russian companies, which possess oil resources, this waterline security sinking was quite inevitable for Ukraine.

Recent developments in the sector are that Ukrainian gas and oil refineries will be merged by 100% with the Russian oil and gas system. Shortly after the initiation of such cooperation, the law that removed the ban to privatize oil and gas system was processed.¹⁰⁴ The Head of Gazprom in Russia Olexiy Miller argues that this step was inevitable.

*This idea (offered by Russian Prime Minister V.Putin -author) was determined by the mutual development of the gas systems of our countries, including the common gas transporting complex, which was created back in the USSR times. Therefore it is natural that modernization of the system in Ukraine should be closely tightened to the development of the common system of gas delivery from Russia. Ukrainian gas transporting system is created for the transporting of the Russian gas to Europe. And we all know, that any pipeline is a very valuable asset only if it is filled by gas. Olexiy Miller – the Head of Gazprom.*¹⁰⁵

Miller further states, that there are also plans to build new transition lines and diversify the paths of the Russian gas supply to Europe. “I am sure that merger of the two companies will become a very important part of the energy security in Europe”¹⁰⁶. What will really happen in Ukraine is 100% subordination to its Russian headquarter.

Privatization in the gas sector in Slovakia came with different types of challenges. In 1998 Property Fund has sold through the direct sales the 46% of non-privatized share of Nafta Gbely - a very profitable natural gas storage company to the mysteriously created concern Druha Obchodna. Despite the interest of such major players as Ruhrgas, Nafta Gbely was sold for 500 mln Slovak Koruna (SK) at the

¹⁰⁴ News, U. (2010). The new law about privatization of the gas transportation system is being processed. *Express*

¹⁰⁵ Interfax-Ukraine. (2010). Russian Gazprom's take over of the Naftogaz Ukraine - is pure pragmatic decision . *Express*

¹⁰⁶ Ibid

time when it was worth more than 3.2 bln SK. Consequently, it was pointed out that the owner of the unknown company was Vladimir Poor, chairman of the regional board of the Movement for Democratic Slovakia – HZDS (lead by Mečiar) in Trnava. The other co-owners were also people from the HZDS – Ivan Gasparovic (who is not the Slovak President) and Marian Huska.¹⁰⁷

In this chapter I have shown that the privatization process in Ukraine and Slovakia was not as smooth and as efficient as was projected by many scholars, predicting greater efficiency and transparency with the changing ownership into private hands. Political favoritism, business groups' influence and other diseases were closely following the privatization processes in both Ukraine and Slovakia, with the correction of Slovakia after 1998.

Privatization processes in Ukraine made in order to improve the macroeconomic situation and fill in the budget rather than boost enterprises' efficiency, is not the way to go. The short term vision of selling all the potentially attractive objects to the private owners is definitely not the way to economic prosperity. This is even more true if we take into consideration the fact that objects to be privatized are not countless and the profits made from privatization are not unlimited. That is why a common vision of the privatization process should be developed while there is still something left to be privatized, so that it can be performed with inclusion of the best interests of the state as a whole, and not the separate business group only.

In Slovakia we can see the two very different periods in privatization processes. During the first period, the most important characteristic was political favoritism,

¹⁰⁷ Haughton, T. (Burlington). *Constraints and opportunities of Leadership in Post-Communist Europe*. 2005: Ashgate p. 33

control of the privatization processes by the leading parties, tremendous underpricing of the enterprises fit for privatization. Non-transparent and uncontrolled privatization favored the people who were close to government. There was no equality of chances, which resulted in the lack of foreign capital flowing into the Slovak economy for better restructuring. During the second period, after the change of the government, considerable change and improvement appeared on the privatization agenda. Slovakia has managed to finally employ lawful means in the privatization processes. Nevertheless, the control mechanism must work constantly in order to fight the challenges and prevent the processes from irreversibility.

Chapter 3 – Steel industry after communism in Ukraine and Slovakia – transnationalization coming from below and above

Out of all privatization projects in the strategic sectors, the steel industry has been among the most urgent and most controversial projects in both Ukraine and Slovakia. The sector itself is very important in the post socialist countries in general, and in Ukraine and Slovakia specifically since it has contained the bigger part of the export structure. For the Eastern European countries with small and usually open economies, export structure is the best pathway to growth, prosperity and catching up with the western world.¹⁰⁸ Even if Ukrainian economy is not small by the definition, it remains small regardless of the big territory. Therefore, the steel industry, which makes the biggest share in the economies of the two countries, is so important for the economic growth in general.

The steel industry has always been a strategic sector in Ukraine, since it is one of the few heavy sector productions there, 80% of the output goes for export.¹⁰⁹ Due to the fact that economic growth of Ukraine merely depends on the export performance, the whole economy is dependent on the steel sector. To measure directly, the steel industry provides about 12 percent of Ukraine's national income, and more than one-third of total exports of goods. Steel is even more important, since many other

¹⁰⁸ Munkacsi, Z. (2009). *Export structure and export specialisation in Central and Eastern European countries*. Budapest: Magyar Nemzeti Bank

¹⁰⁹ EIU. (2008, Nov 6). *Economic performance: Steel output plunges*. Country Report - Main Report

economic activities and industries depend on the steel sector performance.¹¹⁰ In the territorial system, metallurgical enterprises fulfill the function of the city-creating centers. They are the main source of employment, and are also financially supporting housing and social structure of the occupied territories.¹¹¹ Therefore it can be concluded that patterns in the steel prices are closely linked to the performance of other economic activities.

In Slovakia steel industry makes a bigger share of the export structure, it is on the third place after machinery, electrical equipment and vehicles to compose the Slovakian export.¹¹² Steel sector has been traditional in the Slovak economy, and it keeps growing due to the big amount of FDI flows. The most important player of the whole metal industry in Slovakia is US Steel, which accounts for more than 10% of the total sector earnings.¹¹³ Therefore steel industry comprises the leading sector in both countries. Since it has such an immense influence on the economic development and performance of the two countries, it is important to look at the paths they underwent to restructure, and what difficulties were posed in terms of economic restructuring. I adopt Greskovits and Shafer's framework, and argue that "the heavier a leading sector, the less flexible its business and labor are, and the more difficult will be its restructuring agenda"¹¹⁴. Since the steel industry possesses its specific equipment, largely defined infrastructure and non-transferable labor skills, restructuring might not happen at once.

¹¹⁰ Hofman, D. (March 2009, Volume 46, Number1). Metal Fatigue. *IMF working paper*

¹¹¹ Pashaver, O. (2004). *Development of the metallurgical sector in Ukraine*. Kyiv: International bank for the Reconstruction and Development

¹¹² CIA Factbook 2009

¹¹³ Sami Humala, P. H. (2008). *Manufacturing in Slovak Republic*. Finpro Czech Republic

¹¹⁴ Greskovits, B. (2003). Beyond Transition: The Variety of Post-Socialist Development. *Budapest. Central European University Press*, 1-24, p. 5

Applying Greskovits's model, the steel industry in Slovakia can be characterized as being foreign-led large-scale capitalism.¹¹⁵ It became possible by means of capital intensive complex manufacturing, which proves to be an efficient form to the capitalist development. In Ukraine we can see the mix of foreign and national large-scale capitalism. Both employ capital-intensive basic manufacturing, as well as capital intensive complex manufacturing, as is in the case of the transnationalized from above ArcelorMittal Steel Kryvyi Rih. At the beginning, although Ukraine has inherited "the "heavy-metal" legacy of state-socialism"¹¹⁶, with a large share of steel and iron export, it now makes a considerable move in the direction of the transnational takeovers. It is possible in the form of either domestic business groups or the true transnational actor. Slovakia has opted for the steel industry development, which heavily uses the foreign capital and technology, but also adds its domestic skilled labor, which resulted into a larger success story.

Throughout the analysis I show that in both cases the states' capacity to restructure the heavy sector industry was limited and not successful. The reason for that could be that they both could not count on the flows of foreign capital and technology, as well as intangible resources such as advanced marketing and management practices.¹¹⁷ In cases of transnational takeovers, TNCs were in the most favorable positions. Since transnational corporations had partners in domestic business in the form of national based enterprises established before, it allowed them to secure local natural resources, labor and entrepreneurship for the purposes of the enterprises' restructuring and expansion¹¹⁸. Although, as mentioned by Greskovits and what can

¹¹⁵ I follow Greskovits (2003) in the definitions of the leading sectors

¹¹⁶ Greskovits, 2003, p.3

¹¹⁷ Ibid, p.4

¹¹⁸ Ibid

be observed as the empirical evidence in the Ukrainian case, such coalitions of stakeholders in national development did not occur automatically, but it was rather a time consuming and painful process, highly dependent on the specific circumstances¹¹⁹.

Nevertheless, I further show that once transnationalization happened, the performance of the industry boosts immensely. To illustrate the success, I will analyze the process of restructuring of this industry in both countries and observe the transnationalization pattern. Looking at how the industry historically developed in the two countries, the stage when it got privatized, the type of private owners, and the current performance I will draw conclusions on which transnationalization pattern – from above (takeover by the TNC) or below (privatized by the local business groups which often have foreign origins) turned out to perform better.

The chapter is structured in the following way: first, I will make a brief overview of the steel industry in the two countries; stressing the extent to which these countries' steel industry influences the world's market. In order to assess the productivity of the Ukrainian steel industry, I will look at the five enterprises, one foreign and four domestically owned that are ranked among the 80 largest steel makers of the world, as assessed by the World Steel Association¹²⁰. The choice of the company to evaluate Slovakian steel industry came naturally, since US Steel Kosice is the largest steel mill in Slovakia with the biggest share in the market. It is a good representative case, since the other two, Slovakia Steel Mills, and Intersteel Slovakia have smaller

¹¹⁹ Ibid

¹²⁰ World Steel represents approximately 180 steel producers (including 19 of the world's 20 largest steel companies), national and regional steel industry associations, and steel research institutes. World Steel members produce around 85% of the world's steel

shares in the market, and while also foreign owned, will not add significantly different information to my case studies.

Then, for the purposes of in-depth analysis of the steel industry in the two countries, I will look at the performance of the largest steel enterprises in Ukraine, assessing the revenues¹²¹ and net income¹²² of them, observing for the changes in particular years and relevant events, but mostly concentrating on the differentiation between the results that are shown by foreign owned enterprise and the domestic ones. I will compare my findings to the Slovakian case, where I take one largest steel enterprise, owned by the US Steel.

Finally, I will apply the theoretical model of Greskovits and assess the state and foreign companies' capacity to restructure the fixed asset enterprises on the particular example of the steel industry. Based on this, I argue that steel enterprises both in Ukraine and Slovakia perform better under the foreign ownership. Nevertheless, I further state that domestically owned enterprises although lagging behind in the incomes, still perform rather well economically, showing similar trends in the revenues. The reasons behind such trends I attribute to the transparency issues in the ownership as well as an interest of Ukrainian enterprises to hide their incomes of tax evasion.

¹²¹ Revenue - Amount generated from sale of goods or services, or any other use of capital or assets, associated with the main operations of firm before any costs or expenses are deducted (BusinessDictionary.com)

¹²² Net income - Total revenue in an accounting period less all expenses during the same period (BusinessDictionary.com)

3.1 The historical setting for privatization in steel industry in Ukraine and Slovakia and the need to restructure

Having a wide range of natural resources, including, but not limited to, iron ore, as well as high concentration ores, manganese, metallurgical limestone, kaolin, dolomite, coking coal in the Donbass region, anthracite and a range of other mining products, Ukraine had a solid base to become a metallurgical hub.¹²³ In its turn, steel production in Slovakia is one of the oldest industries. Its development, especially in the east, depended upon the extraction of ironstone. During the 18-19 centuries, the technique of iron and steel production underwent major improvements until finally in 1959 the foundation of the modern metallurgic factory Východoslovenské železiarne (VSŽ) was signed.¹²⁴

Twenty years ago, Ukraine was one of the world's top four producers of pig iron and crude steel, producing up to 57Mt of crude steel, before the country was preparing to undergo its post-communist transition.¹²⁵ Despite the steep decline in production volumes from the mid-1980s onwards, the industry started showing some signs of recovery in the mid-90s.¹²⁶ Reorganizing the industry in Ukraine was a very difficult and slow process, and the shadows from this period still echo in the present times. Finally now the transition times are behind and the industry has finally emerged and presented a fully integrated iron and steel cluster, having the complete production cycle from raw material extraction to semi-finished and finished metal products. Now, according to the World Steel Association, one of the largest and most dynamic

¹²³ (Couronne 2004, Oct 1)

¹²⁴ U.S. Steel Košice is Aware of Its Position - Slovak Steel Giant. (2009, Apr 12). *SK magazine*

¹²⁵ (Couronne 2004, Oct 1)

¹²⁶ *ibid*

industry associations in the world, Ukraine in 2009 earned the 8th position among the world's largest producers of crude steel.

In Slovakia, the big transformation and positive shift in the industry happened in 2000, when the US Steel took over VSŽ Kosice. It was once successful steel mill in Slovakia, run by a Slovak family and it has represented the crony capitalism of a Slovak-run business. This has been a great success story since it was the first time a big enterprise, namely VSŽ Kosice, which was a strategic plant in the Slovak economy, was owned by Slovak nationals. Before that, all the companies were foreign led, therefore VSŽ Kosice presented a special pride to the nation.¹²⁷

Alexander Rezeš, who purchased the controlling share of the VSŽ has soon became one of the richest men in Slovakia.¹²⁸ He acquired the share for the minuscule price, much less than it has been worth, due to the fact that Rezeš has been among the favorites during the Mečiar's times and was preparing to become a candidate for elections in Mečiar's party, the Movement for a Democratic Slovakia (HZDS). At that time, VSŽ alone accounted for almost 8% of GNP of all of Slovakia. It was the 14th largest Central European Company and the second largest employer and the biggest Slovak exporter (14%).¹²⁹ According to the other source, at some point, VSŽ brought 16% of total Slovak production and 26% of its export.¹³⁰ During the first years after it has been privatized it has become of the greatest success stories in Slovak privatization history. In 1995, VSŽ had annual sales of 49.8 billion Slovak Koruna

¹²⁷ This has been suggested by Julius Horvath

¹²⁸ (Kopanic 2000)

¹²⁹ *ibid*

¹³⁰ Frydman, R. (1998). Capitalism with a Comrade's Face: Studies in the Postcommunist Transition. *Central European University Press*, 60

(SK) (USD 1.66 billion) and the Slovak business newspaper Trend ranked it as number one among Slovakia's top 100 companies.¹³¹

VSŽ has backed up its success and secured easy credit by buying controlling interest in a number of leading Slovak banks such as Priemyslná banka Košice, Dopravná banka and Postová banka. VSŽ's financial acquisitions continued later as well, and in 1996 it bought a 40% share of Investičná rozvojová banka (IRB), which was among Slovakia's top three banks. VSŽ acquired a huge financial empire in a very short period of time. It has also acquired a large share of Slovenská poisťovňa (Slovak Insurance), which was a monopolist insurance company on the Slovak market.¹³²

By 1998, VSŽ under Rezeš had become a huge holding company with controlling interests in companies and banks across Slovakia and in foreign countries such as the Czech Republic, Hungary, and the Netherlands. Rezeš maintained control of most decision-making process by establishing personal ties with leading managers, whom he constantly rewarded with all kinds of luxury goods. He had soon become one of the most powerful men in Slovakia.¹³³

By 2000, when VSŽ finally got privatized, the plant was on the edge of bankruptcy and very low efficiency. VSŽ has faced huge financial troubles in 1998 when the banks called for 35 million USD loan which VSŽ was not able to repay and therefore defaulted. This situation was caused by falling steel prices, bad management and occurred right after the non-transparent privatization process under the Premier at

¹³¹ (Kopanic 2000)

¹³² Ibid

¹³³ Ibid

the time, Vladimir Mečiar.¹³⁴ Another reason for the VSŽ failure was that the management was investing into a series of unrelated activities, such as football, banking and insurance before the company ran out of money.¹³⁵ Its ownership structure has also been very opaque exactly due to the fact that stakeholders of VSŽ were involved in the above mentioned unrelated businesses, getting away from its core business – making steel. Nevertheless, VSŽ could not afford to fail, since before 2000, the plant alone accounted for 14 percent of Slovak export and turnover approaching 8 percent of the Slovak GDP.¹³⁶ Therefore some urgent measures had to be taken in order to save the enterprise from going out of business.

First of all, under a new management by Eichler, unrelated to the steel making businesses were sold, such as national daily newspaper Narodna Obroda and dominant Czech football club Sparta Prague. Talks have also been started with the banks to which VSŽ was indebted about possibility of the debt restructuring.¹³⁷ The final step which had to be made was to find a reliable foreign investor. Such opportunity arose and in 2000 VSŽ became part of the large US Steel group. As was assessed by some analysts, VSŽ Kosice, being “a symbol of post-communist corporate trouble, became a test for western companies which joined forces with Central Eastern Europe, seeking to marry Western business skills with regional resources in the new era of globalization”.¹³⁸ The grounds for optimism lay in the company’s position in the Central European steel market, and the sign that the enterprise has not failed the test, comes from the fact that right after privatization in

¹³⁴ *Official web site Slovensko*. (n.d.). Retrieved 05 14, 2010, from <http://www.slovensko.com/investor/us.htm>

¹³⁵ Done, K. (1999). Slovak Steel Group seeks fresh Mould. In P. A. Wickham, *Financial Corporate Strategy Casebook* (pp. 398-399). Financial Times, Prentice Hall

¹³⁶ *ibid*

¹³⁷ *ibid*

¹³⁸ Forging a new Europe: US Steel saves Slovakia steel factory from bankruptcy. (2001, jan 2). *Starbanner*

November 2000 took place, in the first quarter of 2001, U.S. Steel Kosice s.r.o (USSK) reported income of 41 million USD, or 55 USD profit per ton at the time, when its headquarter, U.S. Steel Group, during the same time reported a loss from operations of 151 million USD, or 62 USD a ton.¹³⁹ US Steel's main contribution to the Kosice enterprise was to introduce a modern way of doing business. Transparency has become a new and dominant idea in the Slovak plant.¹⁴⁰

In Ukraine, a strong need to restructure enterprises came from different initial conditions, but the main goal was always to increase efficiency. As one of the official sources informs, the general need in financing of metallurgical assets modernization makes 25-28 bln USD, and only two out of more than 15 metallurgical plants – Kryvorizhstal and Zaporizhstal will need more than half of this sum.¹⁴¹ In terms of the owners, enterprises belonged to the private Ukrainian business groups as well as foreign-led companies which was not a usual scenario in Ukraine. Therefore we can say that transnationalization in Ukraine came mainly from below (with the exception of Kryvorizhstal, taken over by ArcelorMittal, the Netherlands), by large business groups and other private owners. Following the Soviet legacies, the main driving force behind the privatization was imperialist ambitions. Unlike in Ukraine, Slovakian steel industry transformed from above, large world steel companies took over the Slovakian largest and other smaller steel mills. In Slovakia transnationalization happened mostly because of strategic purposes, since selling to the rich foreign investor meant getting out of the bankruptcy as well as cornering bigger share in the world's steel production for the bigger supply volumes to the Europe's car makers and other manufacturers.

¹³⁹ Official web site Slovensko.com

¹⁴⁰ Hundley, T. (2001). East Europe Steelworks enjoys Americal revival. *Chicago Tribune* , 1-3

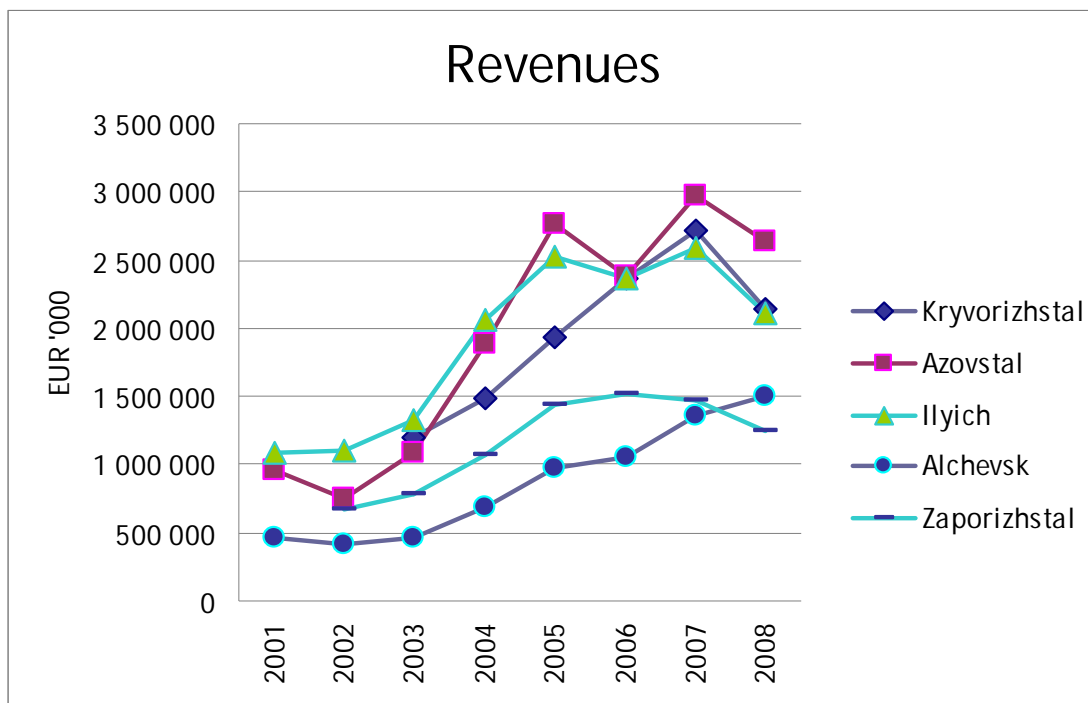
¹⁴¹ Ukraine, I. (2010). Akhmetov lacks money for Zaporizhstal buy out? *Economic truth*

3.2 Revenues and net income of the Ukrainian steel mills

In order to assess the performance of the transformation, brought about by transnationalization, I analyze and compare the revenues and net income of the companies using the available data for the examined period. Based on the performance of one large foreign owned enterprise, and four domestically owned steel mills in Ukraine, as well as the foreign owned Slovakian steel mill, the main findings are that the foreign owned Kryvorizhstal in Ukraine and US Steel Kosice in Slovakia tend to be more transparent, and therefore perform much better economically than the others. Out of all Ukrainian steel companies, Kryvorizhstal is the only example of the foreign owned company with 95% share belonging to ArcelorMittal Duisburg GmbH, Germany, and now owns a new name – ArcelorMittal Kryvyi Rih. This has been the biggest takeover in the history of Ukraine, and turns out to be the most successful one. Others can be grouped in the following way – three other companies are totally domestically owned - Alchevsk Metallurgical plant, Azovstal, Ilyich Metallurgy Plant. The remaining Zaporizhstal is mostly domestically owned, with a small share of British investments; nevertheless, for the purposes of my study I consider it domestically owned.

Based on the country's yearly data, showing their revenues and net income, as well as transforming the data to EURO currency in order to make it compatible with Slovakian data set, the following trends can be observed:

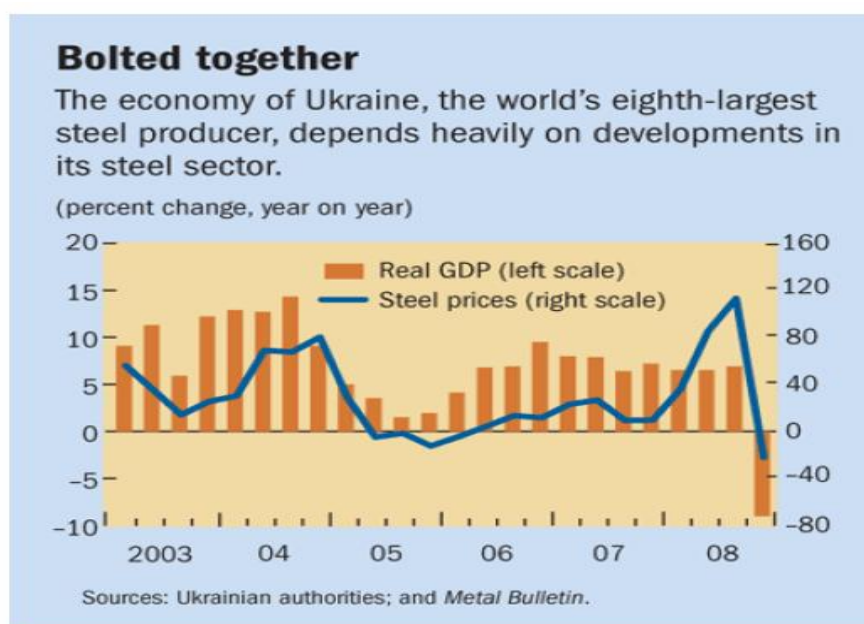
Figure 1 Revenue rated of the 5 largest Ukrainian Steel Companies 2001-2008



Source: Author's own calculations, based on the different year's reports at Ukrainian stock exchange. <http://www.pfts.com/en/>, and correspondent exchange rate UAH-EUR, generated from currency converter OANDA <http://www.oanda.com/currency/converter/>

From the figure 1 we can observe rising revenues over time for all the companies almost without exceptions. There is a common positive trend for the revenue development during the given time period until 2007, when revenues started falling. What happened to the steel industry in and after 2007? Let us look at the global trends as this may have an answer to the question.

Figure 2 World Steel Prices 2003-2008, real GDP rate in Ukraine



Generally, Ukraine's strong link to metals' prices previously helped to boost the economy. The time period of 2000–08, when the steel prices were almost constantly rising, greatly added to Ukraine's favorable export conditions and performance as well as impressive GDP growth: between 2001 and 2007, the Ukrainian economy grew by an average of 7 percent a year.¹⁴² At the beginning of the global economic crisis, positive pattern of recent years in the commodity prices unexpectedly ended. The processes that followed - decreasing car sales all around the globe as well as limited opportunities in construction activity, added to steel being particularly badly affected. To the end of 2008, steel prices had fallen more than 80 percent from their peaking levels in August same year.¹⁴³ Most of Ukraine's steel plants were reported

¹⁴² Mark Flanagan, L. M. (2008). *Ukraine: Selected Issues*. Washington D.C.: International Monetary Fund

¹⁴³ (Hofman March 2009, Volume 46, Number1)

to work at only 70-80% of their capacity, and some of them have even notified of a possible close down in production because of a lack of orders.¹⁴⁴

The fall down of steel prices has affected Ukraine hard. The metals sector's current problems were largely caused by a sharp decline in external demand and unfavorable price conditions. Global demand that consisted of the large construction and investment projects dropped. Also, Ukrainian steel makers seemed to start losing their comparative advantage – low production costs, which reflects dull picture for the Ukrainian steel industry.¹⁴⁵ These trends got immediately reflected on the economic performance in general, and in the last quarter of 2009, GDP has tightened by 9%.¹⁴⁶ If exports don't recover in the close future, domestic demand will be unable to support the industry. The reason for this is that only 20% of the output goes to the domestic market, and the main consumers of the steel in Ukraine – construction plants, are down by 50% each year. Yet another industry analyst at Astrum Company, which specializes in the design and manufacture of steel components, predicted in 2009 that it will take 2 to 3 years for Ukraine's mills to return to their pre-crisis capacity utilization rate of 90-95%. This is an optimistic figure, now it is only left to see how Ukrainian steel industry will be sustained by the end of the crisis period.¹⁴⁷

The above drawn trends in the steel industry and steel prices in the recent times are very pessimistic, but they are the same for everybody on the market. However, the

¹⁴⁴ (2008, Oct 2). *Economic performance: Industrial output contracts year on year in August*. EIU Country Report - Main report.

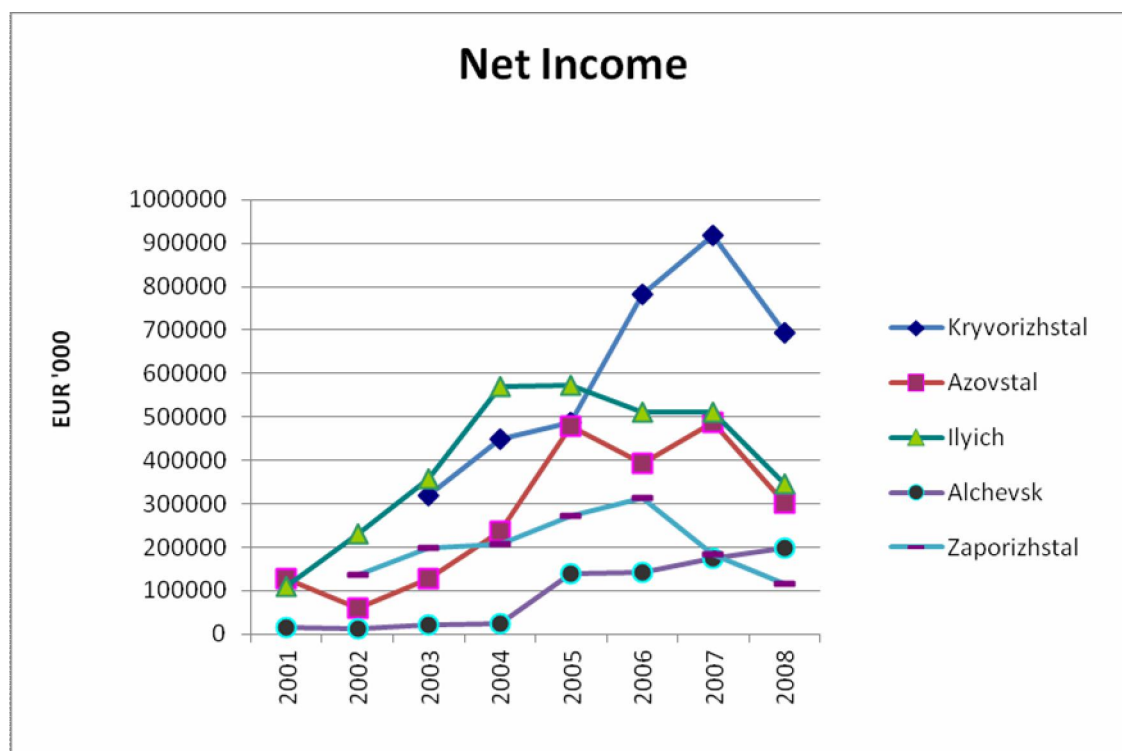
¹⁴⁵ (2008, Nov 6). *Economic performance: Steel output plunges*. EIU Country Report -Main Report.

¹⁴⁶ (Hofman March 2009, Volume 46, Number1)

¹⁴⁷ (2009, Aug 24). *CIS: Steel salvation? The big CIS steel producers are starting to recover—but is it sustainable?* EIU publication

net income trends are not the same for the Ukrainian largest steel mills and the difference in performance therefore are between the foreign owned Kryvorizhstal and four other domestically owned enterprises (see figure 3).

Figure 3 Net income of the 5 largest Ukrainian Steel Companies



Source: Author's own calculations, based on the different year's reports at Ukrainian stock exchange. <http://www.pfts.com/en/>, and correspondent exchange rate UAH-EUR, generated from currency converter OANDA <http://www.oanda.com/currency/converter/>

3.3 Success of the Kryvorizhstal (ArcelorMittal Kryvyj Rih)

Being a significant outlier, Kryvorizhstal's income after transnational take over boosted considerably. Building on this only case, I argue that the takeover by the ArcelorMittal underwent a very transparent process, and because Kryvorizhstal is a foreign owned company, it is interested in showing its profits for the statistical and

accounting purposes, in order to be transparent for the stockholders. There are obviously other reasons that contributed to its success. Among others, the easier access to the international markets was secured by ArcelorMittals' position on the world's steel market, further technological innovations that were invested in Kryvorizhstal to boost its productivity, as well as better managerial expertise. The reasons for the enterprises' success originate from the same reasons of why VSŽ Kosice got successful. Nevertheless, all these reasons go back to the fact that the companies are foreign owned which accounts for better transparency and therefore more efficient production process. Kryvorizhstal, peaking in 2007 showed an immense growth in terms of income. It is definitely an unquestioned leader on the Ukrainian market by profits and production volumes. According to the 2007 numbers, the production at the ArcelorMittal Kryviy Rih was 7.2 million tonnes of cast iron, 8.1 million tonnes of steel and 7.1 million tonnes of commercial stock. Net effective income in 2007 has made 18.8 billion UAH which is 70.2 percent more than in 2005 and 30.6 percent more than in 2006.¹⁴⁸

Privatization of Kryvorizhstal was a story with many layers. First attempt of privatization did not come as a success story. Only one year after it has been privatized, the State Property Fund of Ukraine (SPFU) has expressed the intentions for nationalization and further re-privatization of the enterprise. It was claimed that the new owners - local business alliances – Donetsk based System Capital Management (SCM), run by the wealthiest man in Ukraine Renat Akhmetov, and Kyiv based Intepipe, controlled by Pinchuk – Kuchma's son-in-law - won the competition unfairly and used shadow mechanism to compete against other foreign

¹⁴⁸ Koretskaya, Y. (2008, July 2, Issue 791). State property fund to denationalize Krivorostal. *Newseurope*, <http://www.neurope.eu/articles/88991.php>

based firms that also showed an interest in taking over the enterprise. The new owners ended up paying for the acquisition 4.5 times less than the real market price of Kryvorizhstal.¹⁴⁹ Regardless the fact, that four other foreign companies were present at the auction, it was concluded that “only these two of the six companies, both Ukrainian, which submitted tenders could meet the requirement of having produced at least one million tons of coke and two million tons of rolled steel for the last three years, two of them, profitably, in Ukraine”.¹⁵⁰

In October 2005 re-privatization of Kryvorizhstal took place, which was announced to be the most successful and transparent case in the history of Ukraine. SPFU announced Mittal Steel Germany GmbH (Germany)¹⁵¹ a winner of the tender for sale of 93.02% stake in Kryvorizhstal.¹⁵² It was a transparent operation, since privatization occurred through the fair auction, where other major bidders were present as well, and also, Kryvorizhstal was sold for a very high price. The winner company offered 24.2 billion UAH (4.81 billion USD), which exceeded the predicted price by 2.5 times¹⁵³, and this became the largest sum in the history of privatization in Ukraine. If we return back to the figure 1 and 3, we can see that 2005 is the date when, and after which we can see the dramatic increase of the revenues and profits of this enterprise. As I have argued before, this might have occurred so impressively due to two reasons. First, that foreign owners are more likely to invest into restructuring to boost productivity, and second explanation that is more likely to be shown in the short run, is that enterprise simply stopped hiding its profits. The realistic story is that

¹⁴⁹ Couronne, Caroline, Oct 1, 2004

¹⁵⁰ (Aslund 2009, p. 163)

¹⁵¹ Mittal Steel Germany GmbH is part of the Mittal Steel international holding (the Netherlands), which is the world's largest steel producer

¹⁵² Ukraine, S. P. (2005, Oct 28). SPFU and "Mittal Steel Germany GMBH" have signed the sale and purchase agreement as to the shares of "Kryvorizhstal"

¹⁵³ *ibid*

it was a mix of the two. On the one hand, the mechanism of the transfer prices which TNCs often use in their business activities do not favor revealing all their revenues for the purposes of tax evasion, on the other hand, TNCs are usually concerned about increasing efficiency and productivity. Nevertheless, it is known that the main goal of the TNCs is to increase their income and profitability, and from the figure 3 we can see dramatic increase in profitability since the year the enterprise was privatized. From that I make conclusions that boosts in the income is really due to the foreign ownership which helped the enterprise to boost the productivity rates.

3.4 Challenges of the domestically owned enterprises

Quite the contrary to the privately foreign owned Kryvorizhstal, all domestically owned firms show other common tendencies (figure 3), not reflecting the results one could expect, based on the data from the revenues figure. It shows that their net income is decreasing while their revenues increasing. This can be attributed to the two possible causes, not connected to the production capacity or other capacities to restructure. Domestically owned companies may be hiding their incomes in the off shores for the purposes of tax evasion. Another reason might be that there are problems with transparency with the enterprises owned by domestic business groups. The complicated and often muddled process of privatization and governance might be the case why the group of four kept the tendencies it did, no matter the same external climate in the development. TNCs can obviously be accused in the similar sins, for using their internal mechanisms of transfer prices, internal loan system; still, we see the dramatic difference in the income tendencies between the two groups.

Regarding the domestic companies, they can be grouped based on the different criteria of why being non-transparent. For example, the two out of four companies had a very complicated governance structure, which contributed to un-transparent processes within this structure. It is often hard to clarify the ownership and the shares of different business groups in the steel enterprises. Among these enterprises I single out Azovstal and Zaporizhstal.

Azovstal, which used to be country's largest steel producer, was producing 5.340Mt of steel annually. In 2003 Azovstal faced the urgent need restructure and reshape the old production workshops into modern and more efficient steel making facilities. After not finding the domestic sources of financing the restructuring, Azovstal management at the end turned to the foreign investor - Germany's SMS Demag, with the help of which the new technology was going to boost management performance, improve integrated IT systems and redeploy the sales and marketing activities.¹⁵⁴ This is when we see the dramatic increase of revenues in Azovstal, which, probably not surprisingly, was not reflected in the income indicators.

Azovstal is owned by the two companies – Metinvest B.V, based in the Netherlands, which has 74% share, and Metinvest Intl SA, based in Switzerland, with a share of 21%¹⁵⁵. Although at first sight it looks like the companies are foreign owned, going through complicated integrated schemes one can trace the ownership back to the Ukrainian business group – System Capital Management (SCM), based in Donetsk. This is made through complicated, cross privatized ownership, where Azovstal Trading House owns 44.84% of its shares, System Capital Management (Donetsk)

¹⁵⁴ Couronne, Caroline, Oct 1, 2004

¹⁵⁵ Financial times. (n.d.). *Company profile - Metalurhiinyi kombinat Azovstal' VAT*. Retrieved May 31, 2010, from <http://markets.ft.com/tearsheets/businessProfile.asp?s=DZ8:GER>

owns 29.38%, Leman Commodities S.A. (Switzerland) owns 13.71%, SCM Limited (Cyprus) 11.01%, and the Metinvest Holding 4.34%. At the same time, System Capital Management own 95.9% of the shares in the Azovstal Trading House.¹⁵⁶ Leman Commodities SA is a Swiss trading company separate from SCM, but they are generally accepted to be owned by the same person, Renat Akhmetov.¹⁵⁷ Metinvest Holding in its turn performs the strategic management of assets of SCM Group (System Capital Management) in coal and ore mining, coke, steelmaking and welded pipes industries. Therefore, Metinvest is a Ukrainian based group of companies that are in the domestic private ownership, 75% of it is in the control of the large Ukrainian business group SCM. Renat Akhmetov, who is the president of System Capital Management, owns 90% of the shares in the company.¹⁵⁸

In the struggle for ownership one loses the main reason for privatization – increased enterprise's efficiency by means of increased productivity and human capital investment. Through this complicated structure, it becomes clear, that the interests of business groups need to be preserved, therefore although the revenues are boosting, one cannot see the reflected income statistics, since it is in the interest of the owners to diminish them.

As for the second company in a cluster, Zaporizhstal, it has many investors which are mostly represented by the business groups with often conflicting interests. The current investors are: Ukrainian stock deposit with a share of 26%, Kyiv Securities Group – 22%, Gals-Invest – 17%, Zaporizhstal, Zaporizhzhya – 17%, Midland Capital

¹⁵⁶ Kuzmin, D. (2006, May, 29). UPDATE: Azovstal Decides To Increase Its Statutory Capital By UAH 491 Million To UAH 1,405.5 Million For Takeover Of Azovstal Trading House. *Ukrainian News*

¹⁵⁷ Iron & Steel - Owners emerge in Ukraine. (2003 Nov, 20). *Metal Bulletin plc*.

¹⁵⁸ (Kuzmin 2006, May, 29)

Management, Kyiv – 11%, and has 12% of foreign ownership of Global Steel Investments Ltd, Great Britain. Midland, with only 11% share has exclusive allocation of Zaporizhstal's export sales and enormous influence over its production.¹⁵⁹ The steep growth starting with 2003 can be explained by the major investments made by the company. Zaporizhstal is investing for increased performance: it is for instance investing 66.5 Million USD to renovate its blast furnace and improve the energy efficiency of every unit. The company is also starting a number of other urgent investments for the better performance. This is made to attract the leading carmakers to source high quality automobile sheet in Ukraine.¹⁶⁰ Nevertheless, the same picture as in other domestic owned enterprises can be observed in terms of inconsistency between the revenues and net income of the plant, which goes back to the complicated structure and unwillingness of different business groups to reveal the profits, since they already have to share among themselves.

Alchevsk Metallurgical Plant can be also put in the same grouping as the previous two companies with one correction. It has similar problems that the previously described enterprises have; difference is only that it is owned by the single business group. Therefore, there are no conflicts of interest there; nevertheless, the enterprise is also interested in hiding its income. Alchevsk Metallurgical Plant, which is owned by Ukrainian Business Group Industrial Soyuz (Union) of Donbass (ISD) – 56% share, as well as Ukrainian stocks deposit with 44% share. 2001 was a year when ISD acquired ownership of Alchevsk Metallurgical Plant¹⁶¹, and since that time we can see continuous growth. This is the only enterprise that showed growth even after 2007, which is a major success among others. Even income increased after 2007,

¹⁵⁹ (Iron & Steel - Owners emerge in Ukraine 2003 Nov, 20)

¹⁶⁰ Couronne, Caroline, Oct 1, 2004

¹⁶¹ (Iron & Steel - Owners emerge in Ukraine 2003 Nov, 20)

nevertheless, the company started with very low numbers, and even showing the growth, the numbers are hardly significant. The seemingly lowered numbers may be due to the fulfillment of the private interests of the owners.

Ilyichstal creates the group of its own, being privatized by its own employees, and remaining the company, that maintained the Soviet production style. Nevertheless, the company is still able to keep the market position among the world's largest 80 steel makers¹⁶² by showing large production volumes as well as employing an immense amount of workers (around 70 thousands). Inheriting Soviet organizational structure, it is still able to survive, and even keeps its solid market share. In order to stay competitive and get access to the raw materials in a competition with other large scale private groups, company had to be privatized.¹⁶³ But as predicted by Frieden, in the heavy sectors, large firms are more dependent on the capability of collective pressure of the organized and concentrated labor, therefore aiming at maintaining status quo even in hard times.¹⁶⁴ The state in this situation was unable to play a strong role in the process of privatization, which supports Shafer's idea of the incapability of the state to restructure in these times.¹⁶⁵ It all resulted in Ilyich's employees receiving all the shares in the company in 2000.¹⁶⁶

¹⁶² Top steel producers 2008. (n.d.). *The World Steel Association*

¹⁶³ Couronne, Caroline, Oct 1, 2004

¹⁶⁴ Frieden, J. (October 1988). Classes, Sectors, and Foreign Dept in Latin America. *Comparative Politics* , 1-20, p.4

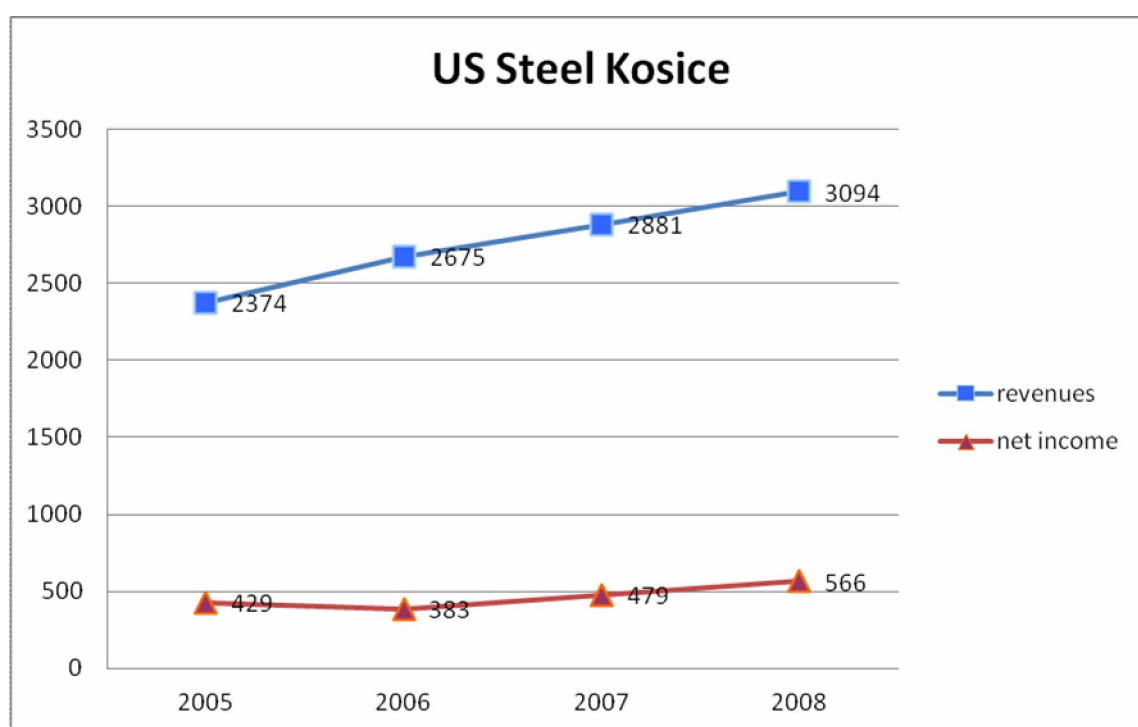
¹⁶⁵ Shafer, M. (1994). Winners and Losers. How sectors shape the developmental Prospects of States. *Cornell University Press*, p. 13

¹⁶⁶ (Iron & Steel - Owners emerge in Ukraine 2003 Nov, 20)

3.5 Revenues and net income of the Slovak Steel mill: Success of the US Steel Kosice

Analyzing the Slovakian US Steel Kosice data (figure 4), we can see that its performance has been extremely consistent and growing.

Figure 4 US Steel Kosice revenue and net income, 2005-2008



Source: own calculations, based on US Steel Kosice Financial Statements from different years, <http://www.usske.sk/corpinfo/fin-e.htm>

Large volumes of production at the US Steel Kosice reached 4.5 million tons of pig iron in 2008,¹⁶⁷ which are considerable numbers, especially taking into consideration that these numbers even increased compared to previous years, which was a hard task to accomplish. The steady growth rates can be observed, which can also

¹⁶⁷ (US Steel Kosice Financial Statements from different years n.d.)

partially be attributed to a strong currency and incentives from the EU side, but to a large extent to the fact that it has been acquired by the TNC which has a major experience on the steel world market.

The Slovakian case seems to perfectly support the argument that transnational takeover of a heavy leading sector requires domination by MNC¹⁶⁸, especially in a small country, which may choose transnational over national precisely because the state proved unable to restructure. In Slovakia we do see that MNC has a bigger capacity and the opportunities than the local companies, unlike in the most Ukrainian cases where local business groups have a lot of power. Exactly due to the reason of being so transnational, Slovak US Steel is able to put in line the revenues and net income growth and make it more transparent. Slovakia seems also to be successful in its steel industry, since it allows, as has been mentioned above, the supply of the steel to the complementary industry, namely, car industry, which is the other major leading sector in Slovakian economy. The interaction between the two leading sectors is very interesting to look at.¹⁶⁹ The car companies already were there to a degree, and US Steel had a strategic vision of the further car investors' presence, which definitely inspired the investment. US Steel has counted on it, although could not predict a clear timetable for when it will happen. The government also played an important role in building an infrastructure, and providing incentives, doing whatever had to be done in order to attract more investments.¹⁷⁰

To conclude, I have shown the way of development in which transnationalization happened in Ukraine and Slovakia in their major industry – steel. The Slovak case

¹⁶⁸ Shafer, 1994, p. 12

¹⁶⁹ Greskovits, 2003, p.14

¹⁷⁰ Interview with David Lohr, president of U. S. Steel Košice. (29 Aug 2005). *The Slovak Spectator*

turned out to be much easier in terms of clear ownership and comprehensive way of the industry restructuring. In Ukraine privatization of large steel enterprises underwent complicated restructuring schemes involving different types of ownership under complicated, and often not transparent mechanisms.

In the case of Ukraine, it is not so clear that the finding for the national led large capitalism came true precisely, since we observed two different forms of transnationalization there, and although the transnationalization from above turned out to be a more successful story for Ukraine in general too, it is too early to say that transnationalization from below has failed in terms of being trapped by “conservative coalition between inflexible and powerful business and labor”¹⁷¹, which aim to retain their status quo as well as squeeze the more successful rivals out of the market arena. It is hard to see this yet since the companies are showing good results and still keep a good share on the world steel market. The current trends on the world steel market are not so optimistic, but it is important to wait and see the path development of the industry after the crisis is over and then the clearer assessment of the enterprises future can be made.

Conversely, the findings for the Slovak foreign-led large-scale capitalist political economy supported the idea of transforming the least effective and inflexible elements of the industry, utilizing the local skilled labor, creating new workplaces and contributing to the decreasing unemployment, as well as boosting productivity.¹⁷² This supports my initial argument that yes, transnational foreign owner does show a better performance in terms of its revenues and especially, incomes. Nevertheless,

¹⁷¹ Greskovits, 2003, p.14

¹⁷² Greskovits, 2003, p.7

as I have further argued, domestically led national owners also have the capacities and means for the successful economic expansion, although they find themselves in very specific conditions in order to be more transparent. That is why they are developing their own mechanisms to stay competitive on the market, but most of all, to boost immensely their own profits, creating the cheating mechanisms and further avoiding the transparent and fair competition.

Conclusion

After the in depth analysis of the large enterprise privatization, as well as specifically looking into the steel industry, the conclusion is as follows. First of all, the evidence suggests that large scale privatization has gone through a lot of controversy, and therefore contributed to the large non-transparent sales of the strategic enterprises, cronyism and other deceases of the post-communist legacies. In the steel industry the two main examples in Ukraine and Slovakia – ArcelorMittal Kryvyj Rih and US Steel Kosice have enhanced our understanding of the transnationalization from above as well as re-stated the positive effects from the foreign privatization.

Surprisingly enough the results of other companies being privatized by local business groups turned out to be not bad either. Their profitability also largely increased, since no matter that it is the domestic owner, private ownership makes the enterprise better off in any case. There was still a lack in transparency, since after analyzing the revenues and profits of the enterprise, although the profits were increasing, the revenues stayed low. It means that the owners of the enterprises privatized by domestic business groups were interested in the lowering their official revenue statistics to avoid larger tax deductions. However, the change of the ownership brought about certain level of innovation to these enterprises as well as managerial expertise. Therefore there is no black and white privatization pattern with pre-defined winners and losers in the process.

Comparing to the findings of scholars in International political economy my results are similar in one fields and differ in others. For example, (Barberis et al., 1996, Earle 1998, Aslund (2002) who argued that regardless the fact that privatization occurred with the law violations, the positive results of it comparing to the state owned enterprises are still present and visible. This is also what I have found in terms of assessing the privatization of large enterprises in Ukraine and Slovakia. Findings made by scholars, that in some countries privatization has been used for covering the costs of transition turned out to be a very relevant issue for Ukraine especially, and it keeps its fiscal role in filling the budget and covering the debts until now. Other interesting findings by scholars that correspond with the ones I found is that the state was not only incapable in managing the enterprises, it has often possessed obstacles in privatizing them. the major difference which is of interest in my case studies is that in Ukraine the processes of controversy and not unite strategy on privatization of large enterprises still exists, while Slovakia has managed to overcome such conflict of interest by strictly establishing the level of authority of FNM and the governmental bodies.

However, arguments of Bogomolov (1996) and Stiglitz (1999) about competitiveness and demonopolization that mattered and not privatization do not hold true, since competitiveness increased proportionally with the privatization schemes, therefore these processes are complementary and not mutually exclusive. Tandon's arguments about increasing state control over the enterprises and possible re-thinking in terms of re-nationalization of earlier privatized enterprises did not find support in my research. The very idea about this negatively affects the country's

image and moreover, investors, since they feel that doing business in the country with such policies is simply highly unsafe.

To sum up, my main arguments can be expressed as follows. The lack of transparency and other negative issues in privatization can override many positive results from privatization as more efficiency, increased profitability, better management, which have been argued by many scholars. Privatization in the strategic enterprises should be approached with extensive care and special attention and a clear strategy in the privatization of the strategically important enterprises should be developed. The main argument in the steel privatization is that the US Steel Kosice and ArcelorMittal Kryvyj Rih show the undisputable advantages of the privatization from above by foreign giants in the form of increased profitability and better management, better political environment as well as placing the enterprises on the top of the largest steel producers' list. However, the enterprises which are managed and taken over by large business groups also show quite satisfactory results, and with some clearance in ownership shares, might also take the leading positions in the future.

However, I recognize the limitations of my research with regards to the countries' scope as well as the specific sphere – steel. This has been done in order to facilitate deeper understanding of the processes, and identify and analyze within the case studies the main challenges posed by privatization.

There are also broader implications of my research. Since many of the post communist countries in transition followed either “the Ukrainian” or “the Slovak” path,

i.e. that their privatization schemes looked almost surely like the one of the two cases, these cases are so typical, it means that the results almost without exceptions can be generalized on the other post-communist countries which underwent transition or still are in the process of transition. Having this in mind, my main findings can be placed back into the larger context in the following way. Taking into consideration the privatization paths in Ukraine and Slovakia, and the dramatic change in the efficiency and profitability after political change in 1998 in Slovakia, there are a lot of lessons to be learned by other countries that still are in the process of transition. Since the main driving force behind the radical change in Slovakia was the aim of the EU accession, the country has put a lot of efforts in fulfilling the legal obligations and conditions to be able to become a full member of the EU in 2004. Upon the greater time availability the in depth analysis of the legal aspects of the matter would be very useful to conduct, since it would have enhanced the understanding of the change in a more detailed manner. Therefore possible implications for the countries, still in the process of accession, including but not limited to Macedonia, Albania, Montenegro, Serbia and Bosnia and Herzegovina can be considerably huge.

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