



**SigmaBleyzer**

*Where Opportunities Emerge.*

# **Attracting Private Capital to Ukraine Through Good Governance**

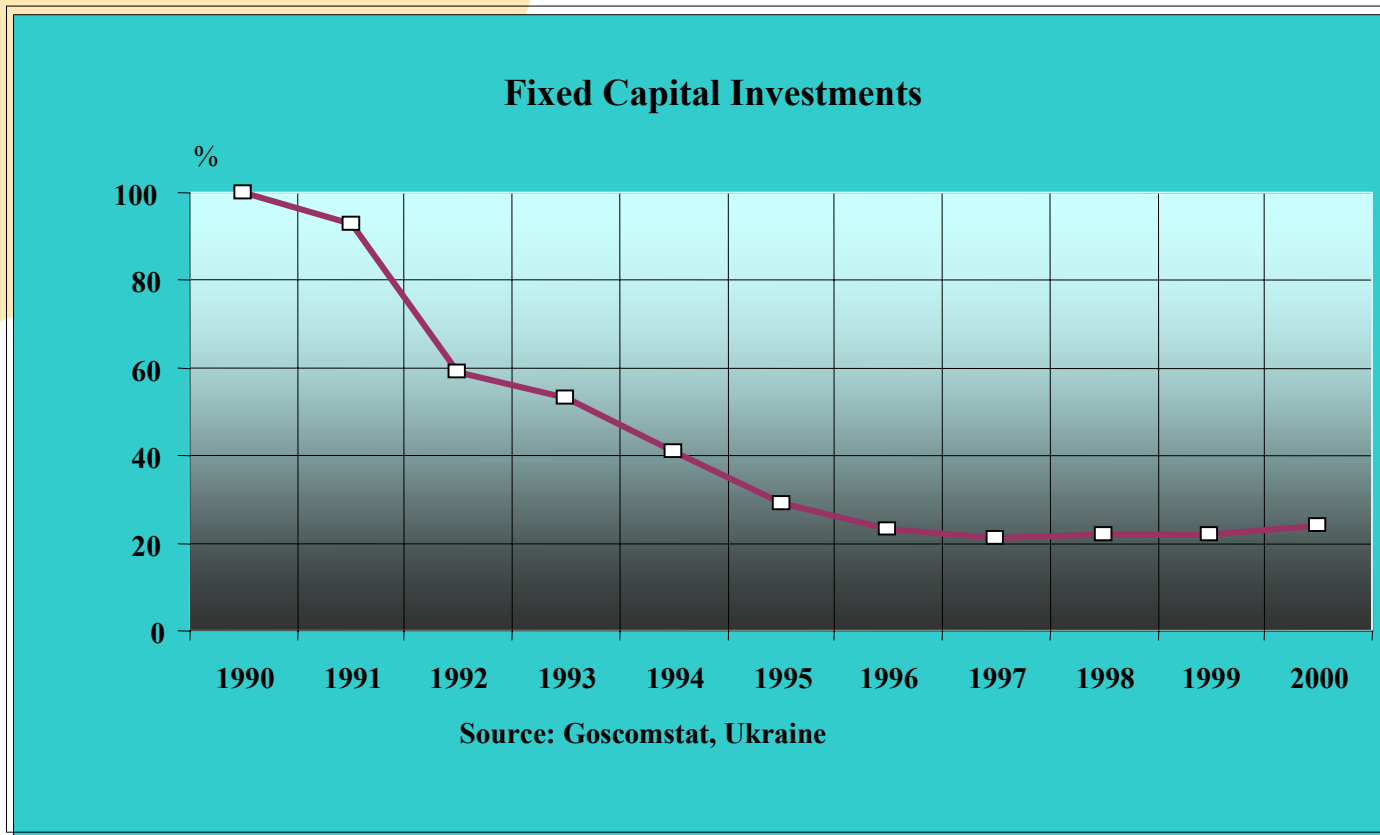
**FIAC Investment Forum  
And Fifth Plenary Session**

**Michael Bleyzer**

**Kiev, Ukraine**

**June 18 – 19, 2001**

# How long can this continue?



# Transition to Market Economy

	Centrally Planned Economy	Transition Economy	Market Economy
Decision Making	Centralized	Chaotically Decentralized	Mainly Decentralized
Sources of Savings for Investments	The State	Initially, without domestic savings, source is principally foreign capital, and primarily debt.	Savings of Individuals and Corporations (Retained Earnings)
Coordination	Compulsory Plans, Overly Restricted	Weak State and Inefficient Markets	Primarily Market, but with some State Regulation
Ownership	The State	State, Legally Private, Semi-Private, and Shadow	Primarily Private
Incentives:	None, Collective Success	Money	Individual Success

**Every Transition Economy has to start being a capital importer. With successful reforms it hopes to become a capital exporter.**

# How to Finance Transition?

- Debt (foreign, public, private, domestic)
- From Debt to Equity
  - Successful Transition Economies attract private equity capital
- Effects of Private Equity Investment
  - Fundamental change in the structure of economy
  - Reduction of government's role and responsibility
  - Promotion of healthy sustainable businesses
  - Increased tax revenue base
  - Happy and prosperous taxpayers

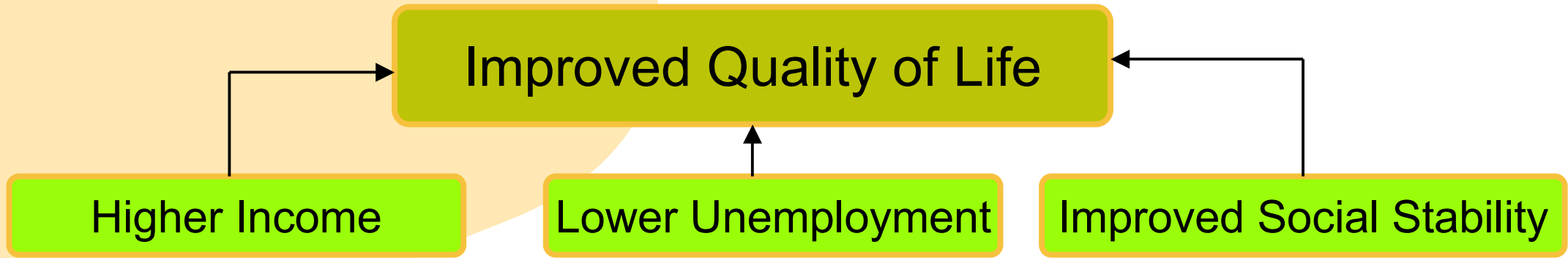
# Capital Market Lessons

- **What other countries have done:**
  - Simplified investment process
  - Created legal framework and protection that is fair and uniform
  - Reduced taxes to increase tax base!
  - Created climate of transparency
  - Rules of the game made clear and stable
  - Protected and clarified shareholder rights
  - Reduced administrative barriers
- **These countries have attracted hundreds of billions of dollars in investment!**

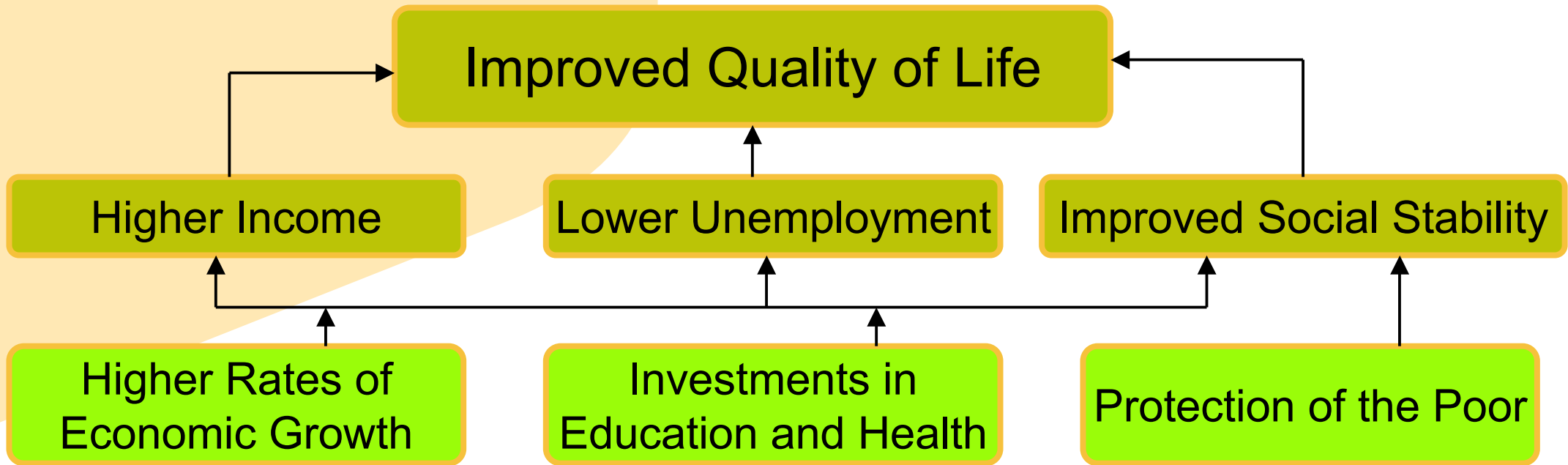
# Why Transition?

Improved Quality of Life

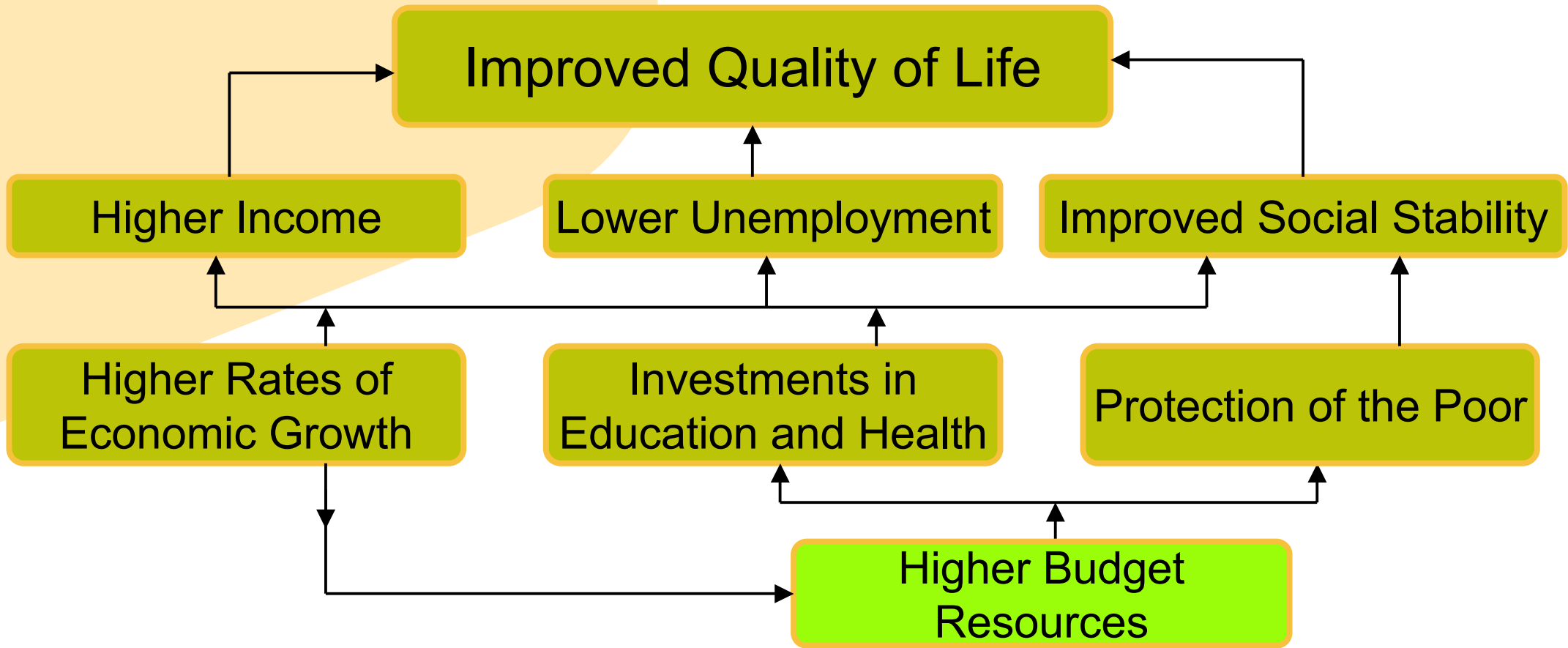
# Why Transition?



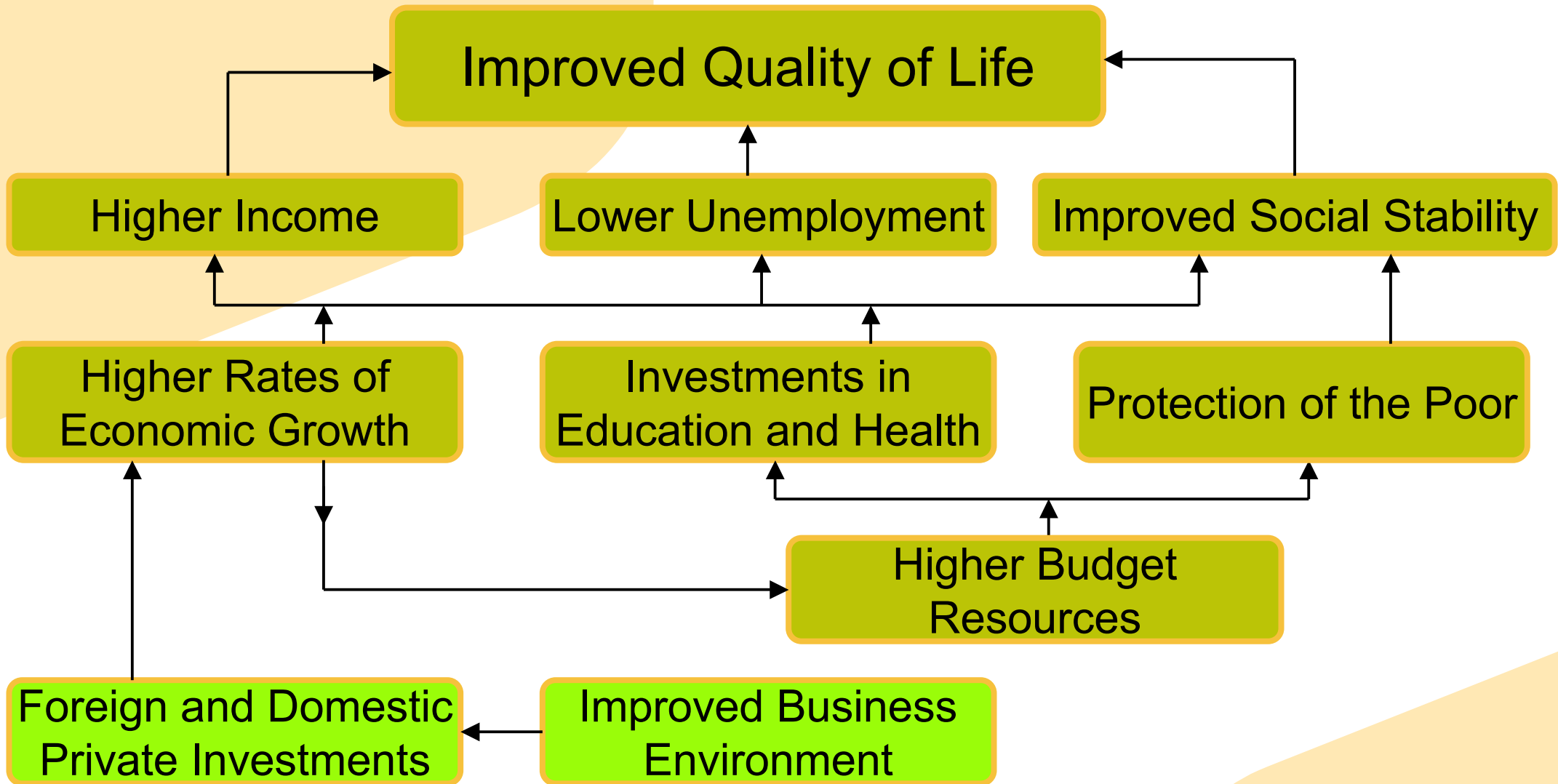
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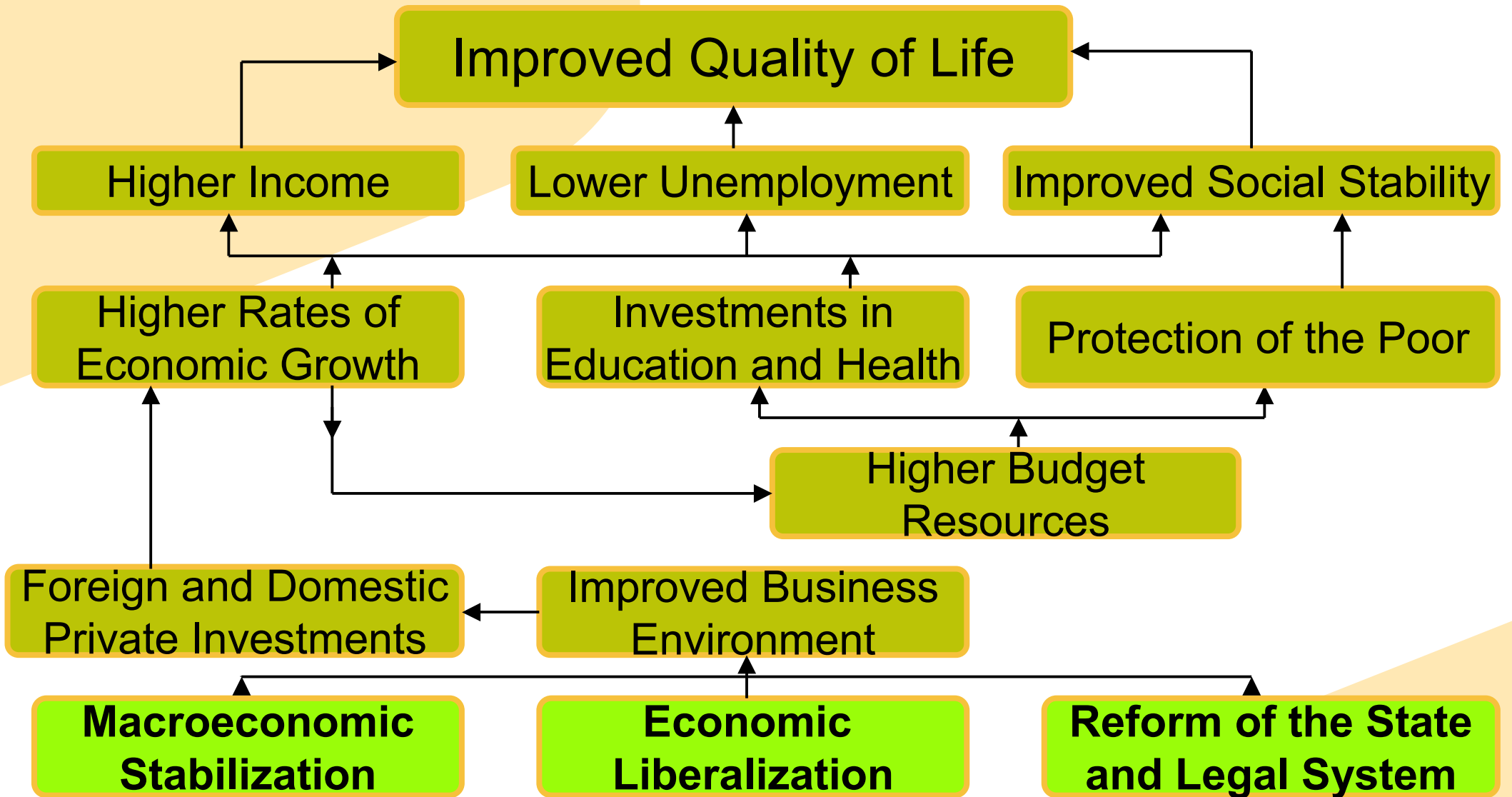
# Why Transition?



# Why Transition?



# Why Transition?



# International Private Capital Task Force (IPCTF)

- **Objective: Benchmark transition economies to identify best practices in government policies, which improve investment climate and attract private capital**
- The study was conducted by SigmaBleyzer and the Thunderbird Corporate Consulting Group, the consulting arm of one of the best international business schools in the United States
- IPCTF Steering Committee members provided valuable input
- ***The views expressed in this study are those of the authors and do not necessarily coincide with those of individual members of the IPCTF Steering Committee or the organizations they represent***

# IPCTF Steering Committee

*World Bank, EBRD, IMF, IFC, USAID, European Commission, US Embassy, American Chamber of Commerce, International Center for Strategic Studies, Harvard Institute for International Development, AGCO, SigmaBleyzer, Coca Cola, Citibank, Commerzbank, Credit Lyonnais, FMI, PricewaterhouseCoopers, Leo Burnett, DuPont*

# Benchmarked Countries

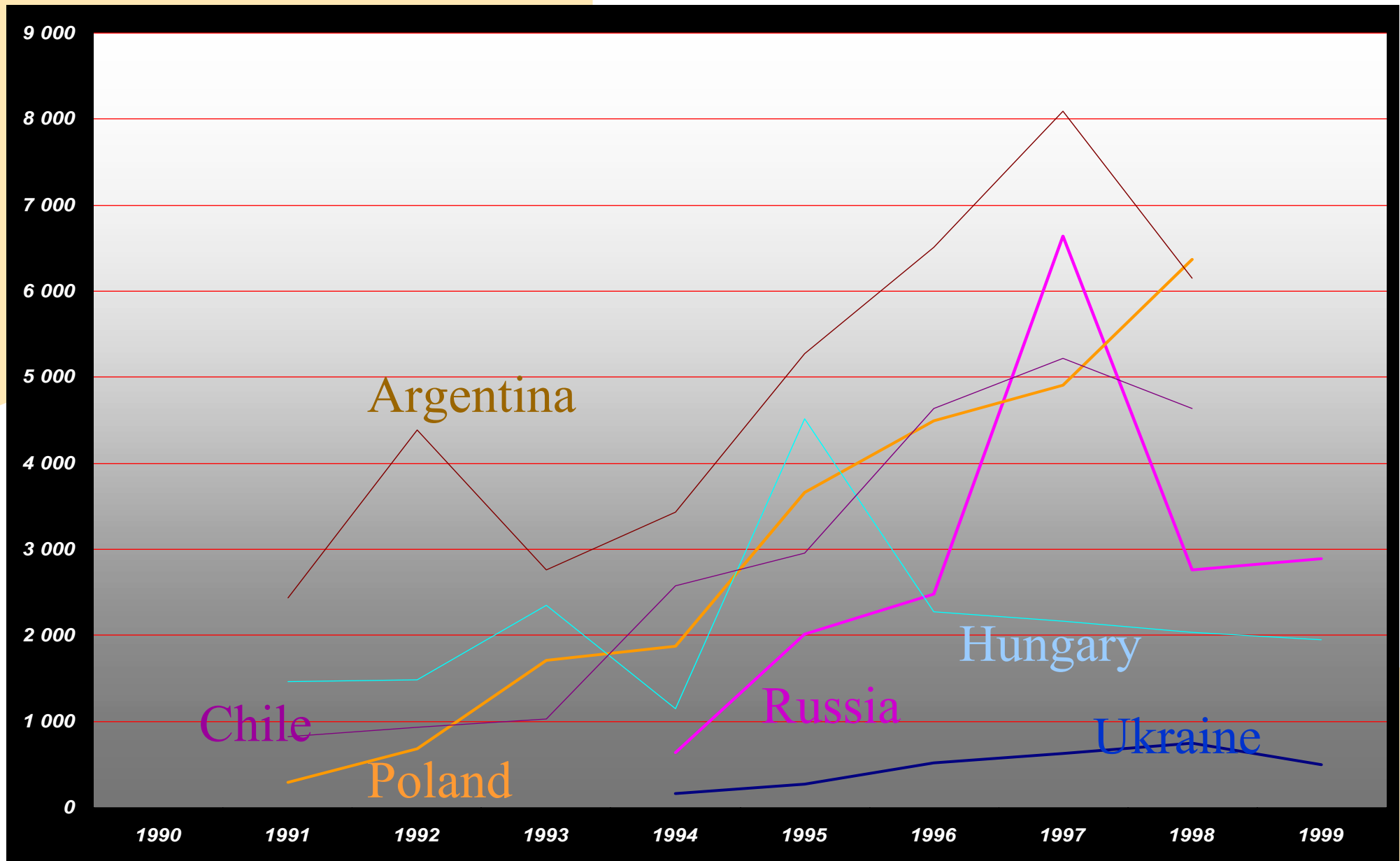
- Argentina
- Chile
- Hungary
- Poland
- Russia

# Countries Included in Statistical Analysis

*Angola, Argentina, Armenia, Azerbaijan, Belarus, Bolivia, Botswana, Bulgaria, Burkina Faso, Cameroon, Chile, Colombia, Costa Rica, Croatia, the Czech Republic, Ecuador, Egypt, El Salvador, Estonia, Ethiopia, Ghana, Hungary, India, Indonesia, Jordan, Kazakhstan, Kenya, Lithuania, Malawi, Moldova, Morocco, Mozambique, Nigeria, Peru, Philippines, Poland, Romania, Russia, Senegal, Slovak Republic, South Africa, Tanzania, Tunisia, Turkey, Uganda, Ukraine, Venezuela, Vietnam, Zambia, and Zimbabwe.*

# Foreign Direct Investments – Selected Countries

(in millions of US Dollars)



# Key Drivers / Policy Action Groups

- *The study pre-condition is macroeconomic stabilization, resulting from sound fiscal and monetary policies.*
- Study identified the following key government policy actions, which stimulated foreign direct investments in successful transition economies:
  - 1. Liberalize and De-Regulate Business Activities**
  - 2. Provide a Stable and Predictable Legal Environment**
  - 3. Enhance Governance & Reform Public Administration**
  - 4. Remove International Capital & Trade Restrictions**
  - 5. Facilitate Financing of Businesses**
  - 6. Eliminate Corruption**
  - 7. Reduce Political Risks (non-economic country risks)**
  - 8. Expand Country Promotion**
  - 9. Rationalize Investment Incentives**

# Benchmarking Results

**UKRAINE**

**RUSSIA**

**POLAND**

**HUNGARY**

**CHILE**

**ARGENTINA**

## Business Liberalization Score

**18**

**49**

**87**

**80**

**89**

**62**

# Benchmarking Results

UKRAINE

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## Legal Environment Score

17

62

99

93

89

65

# Benchmarking Results

UKRAINE	RUSSIA	POLAND	HUNGARY	CHILE	ARGENTINA
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## Business Liberalization Score

18	49	87	80	89	62
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## Legal Environment Score

17	62	99	93	89	65
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## Financial Sector Score

10	39	62	68	74	39
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## Financial Sector Score

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## Governance and Privatization Score

29

30

89

82

80

65

# Benchmarking Results

UKRAINE	RUSSIA	POLAND	HUNGARY	CHILE	ARGENTINA
65	49	83	82	71	75

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## International Capital Controls & Foreign Trade Score

63	45	78	79	84	69
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15	21	41	52	74	35
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## Governmental Promotional Effort Score

20	30	80	100	90	75
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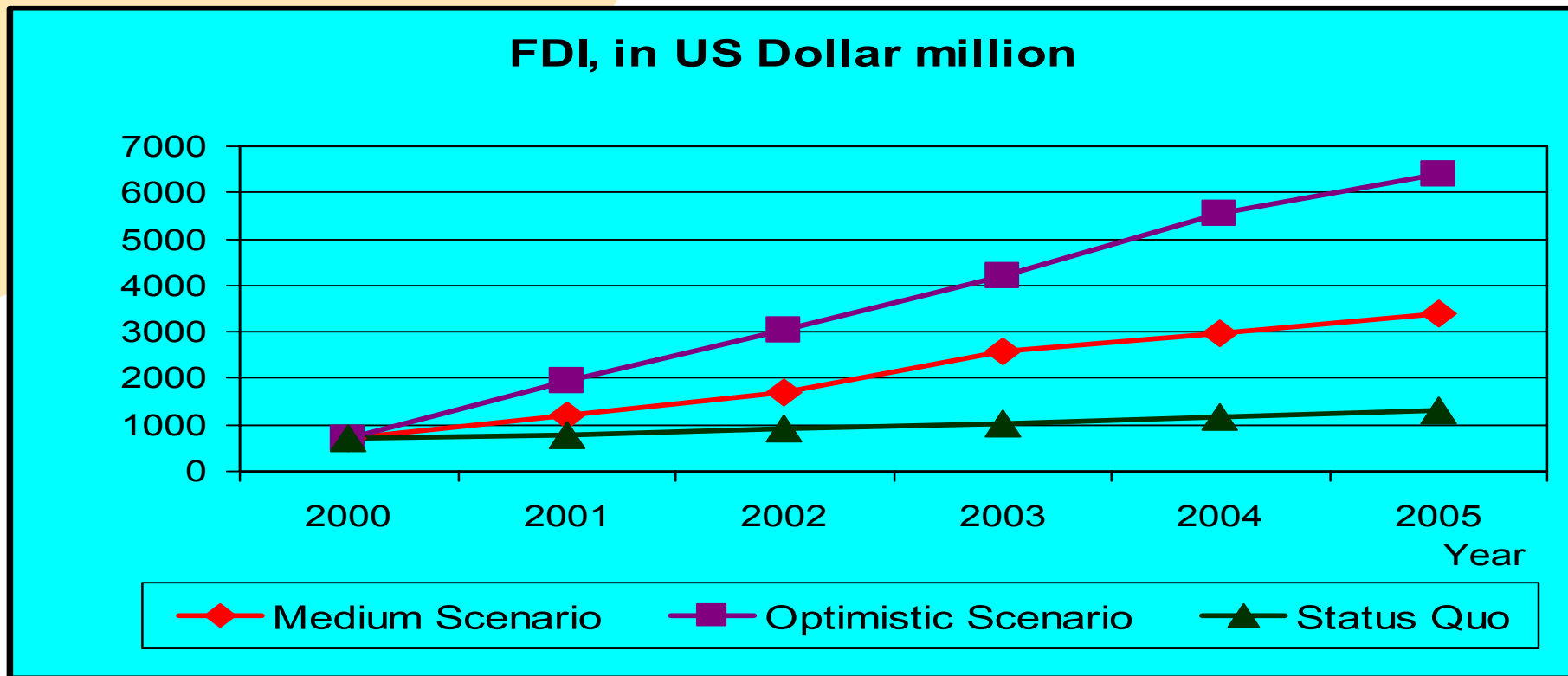
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## Tax and Investment Incentives Score

31	48	78	82	63	70
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# FDI For Ukraine- Possible Scenarios

- Ukraine's government policies will determine the FDI flows over the next 15 years (5 years shown)



- The **Middle Scenario** would generate an incremental GDP growth rate of 4.8% per annum.

# Conclusions for Ukraine

- **With continuation of current policies, FDI flows will not increase from its current level of under **US\$1.0 billion per year** (except for ad-hoc flows related to large privatizations)**
- **Under a middle scenario, with policy actions to reduce in five years 50% of the policy level differential with the Bests-in-Class, Ukraine could increase FDI to about **US\$3.4 billion per year by 2005, resulting in US\$75 billion over the next 15 years****
- **Under a more aggressive scenario, with stronger policy actions to reduce in five years 80% of the policy level differential with the Bests-in-Class, the level of foreign direct investments could increase to **US\$6.4 billion per year by 2005, resulting in US\$100 billion over the next 15 years****

# Proposed Action Plan for Ukraine

## Liberalize Business Activity

1. Finalize and communicate widely the Government's De-regulation Policy, consistent with international standards, and rapidly implement it to simplify and facilitate registration of new businesses, the operations of existing businesses, and import/export of goods.
2. Establish an appropriate on-going mechanism to liberalize business activities, establish deregulation priorities, and monitor legislation to support business liberalization.
3. Eliminate current incentives to excessive Government intervention, such as the right of some agencies to retain part of the fines they impose on businesses.

# Provide an Stable and Predictable Legal Environment

1. Create an independent and incorruptible judiciary, separate from the Executive branch.
2. Pass well-conceived new laws or modify existing legislation as needed to provide a more favorable framework for business, including the civil code, the labor code, the criminal code the tax code and others.
3. Establish an efficient legislative process to coordinate and expedite the drafting of laws and regulations.

# Enhance Corporate and Public Governance and Accelerate Privatization

## Corporate Governance

1. Demonstrate corporate financial discipline by closing 10-20 big loss-making state companies within next two years.
2. Enact the Joint Stock Company Law of Ukraine to modernize Ukrainian corporate governance legislation.
3. Require all publicly traded (listed) companies to use international accounting standards and to regular reports and audited annual financial statements.

# Public Governance

1. Implement public administration reform to reduce the size of state agencies, raise salaries of key civil servants, and redefine the Government's role as that of supporting -- not replacing -- private activities.
2. Extend administrative reform to local state bodies.
3. Reduce shadow economy activities by drastically cutting red tape and lowering cost of compliance with laws in effect.

# Privatization

1. Secure the quick approval and implementation of the Land Code to promote private ownership and registration of land.
2. Encourage the independence of the State Property Fund (SPF) by passing the Law on the State Property Fund and subordinating it to the Executive branch.
3. Take early actions to prepare state companies for privatization (including actions to protect minority shareholder rights and transfer social assets to local authorities) and complete expeditiously the privatization of energy sector and other major enterprises under clear and transparent procedures.

# Reduce International Capital and Foreign Trade Restrictions

1. Liberalize foreign exchange transactions and eliminate restrictions on foreign direct investments in certain sectors - insurance, publishing, broadcasting and telecom.
2. Reduce restrictions to imports and exports, including high import duties, the critical import list, export quotas, duties, indicative prices, advance deposits, forex surrender requirements.
3. Simplify and expedite custom services, including procedures for custom clearances and for certification of imported products.

# Facilitate Business Financing by the Financial Sector

1. Increase the independence of the banking sector, including the NBU, improve and enforce commercial bank supervision and prudential regulations.
2. Strengthen the Securities and Stock Market State Commission mandates in security-related activities of all financial institutions.
3. Accelerate the adoption of the Law On the Institutions of Joint Investments.

# Eliminate Corruption

1. Undertake measures to “prevent” corruption, reducing the opportunities for corruption and making corruption more difficult to undertake, starting with key areas such as barter and the energy sector.
2. Develop the legal framework needed to ensure better enforcement of anticorruption measures and impose visible, harsh, swift and certain penalties for corruption of Government officials.
3. Get public support for anti-corruption programs by making people aware of their rights and the rules of the game.

## Reduce Political Risks

1. Demonstrate understanding of the importance that foreign investors place to expropriation, including “creeping expropriation”.
2. Bring tax collectors and local authorities under the control of the central administration.
3. Government enterprises in competition with private business in the same sector should not get preferential treatment.

# Expand Country Promotion

1. Announce and disseminate widely the Government's policy and commitment to implement strong market oriented policies and show implementation progress.
2. Vocally support foreign investment by changing the attitude of officials at central and local levels.
3. Require all Ukrainian embassies abroad to have their commercial section strengthened, and to go on sales drives to better disseminate business opportunities.

# Rationalize Investment Incentives

1. Institute a level playing field by eliminating any special incentives for particular sectors, companies or geographical zones.
2. Enact the new Tax Code that would decrease the number of taxes and surcharges, reduce tax rates, eliminate tax privileges, and rationalize the value-added tax, personal income tax, and corporate income tax systems.
3. After a rational Tax Code has been passed, aim to minimize subsequent tax changes by imposing a moratorium.

# IPCTF Framework – A Tool for Action

- Low correlation between FDI flows and “natural characteristics” (e.g., location, size, resources, etc.)
- High correlation between government policies and FDI flows
- Private Capital likes Uniformity and Business Standards
- Measuring economic impact of government policies based on the gap between a given country and the best in class in each of the nine government policy areas
- Econometric model of a transition economy predicting FDI flows based on government policies
- IPCTF Framework provides a **comprehensive tool** for building consensus and developing an **Action Plan** for any transition economy

# Ukraine 2001 – A Call for Action

- Ten years in Transition
- Approaching the critical mass of reforms
- Significant economic turnaround in the making
- Need investments to sustain and accelerate economic growth
- **Economic Growth is the key to solving social problems and fighting poverty**
- IPCTF Action Plan for Ukraine is a comprehensive plan to successfully complete Ukrainian transition to market economy and democracy
- **Political Will is needed to enact the Action Plan**
- **New Government – new Mandate – new Opportunity –  
CAN YOU DO IT?**

# Ukraine Is Bound to Succeed!

## "Україна приречена на успіх"



**SigmaBleyzer**

*Where Opportunities Emerge.*