



*Where Opportunities Emerge.*

# Attracting Private Capital to Ukraine Through Good Governance

**Radio Free Europe / Radio Liberty  
Briefing**

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**Washington, DC**

**July 13, 2001**

# SigmaBleyzer, UGF and IPCTF

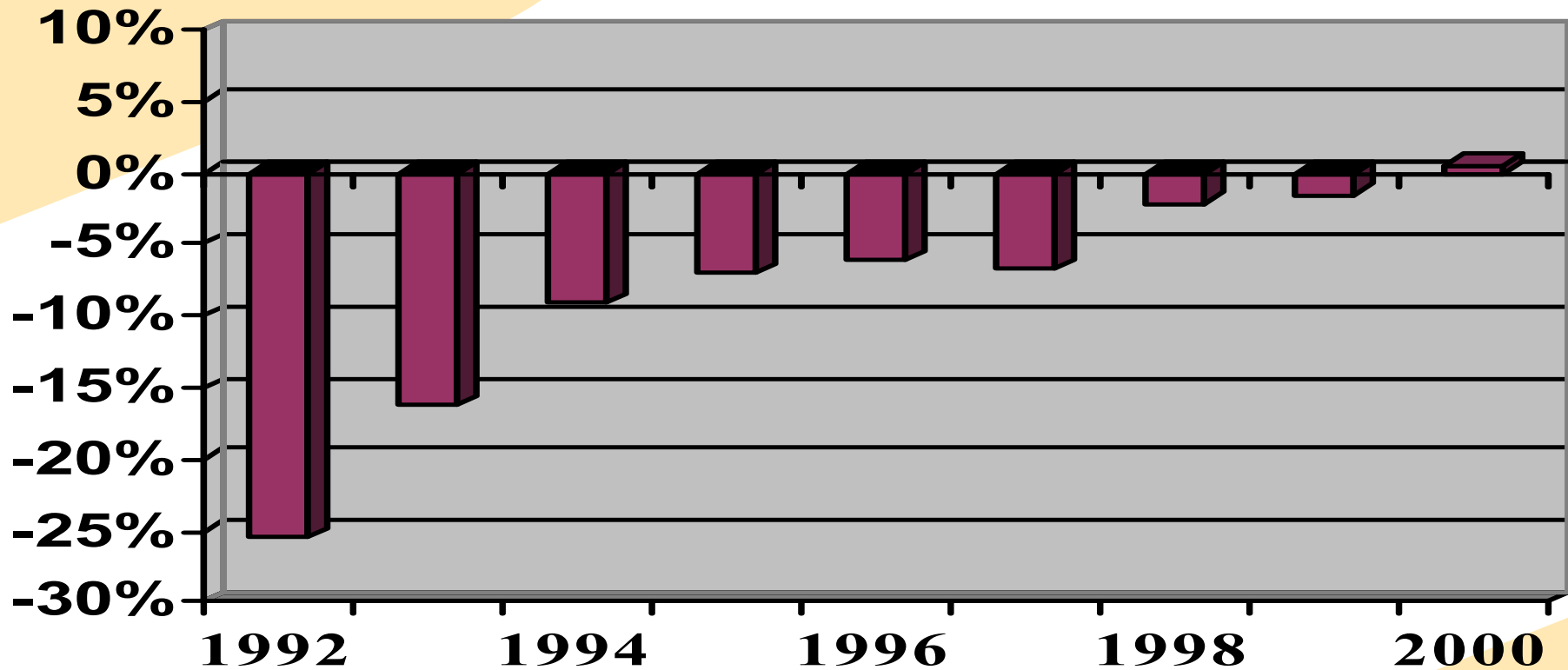
- US company managing one of the premier Ukrainian Investment Banking groups
- Largest Private Equity Fund in Ukraine, one of the largest in FSU
- Seven years in Ukraine, International investors, Institutions, high net worth individuals / families
- Ukrainian Growth Funds (UGF) – over \$100M under management
- Investments in over 70 Ukrainian companies
- Substantial experience in managing and restructuring Ukrainian companies
- Significant number of successful exits
- Significant Ukrainian infrastructure
- Leadership in International Private Capital Task Force (IPCTF)

# Ukraine 2000

- Major turning point?
  - First GDP Growth since independence - 6%
  - High Industrial Output Growth - 12.9%
  - High Agricultural Output Growth - 9.2%
  - Real Income Growth of 8.5%
  - Population deposits in commercial banks up 45%
  - Positive foreign trade and current account balance
  - Stable foreign exchange rate
  - International reserves up 80%
  - External public debt down 17%
- 18 months ago, this outcome would have been just a dream...
  - **IS THIS REAL??**

# What Happened?

## Fiscal Deficit as a % of GDP

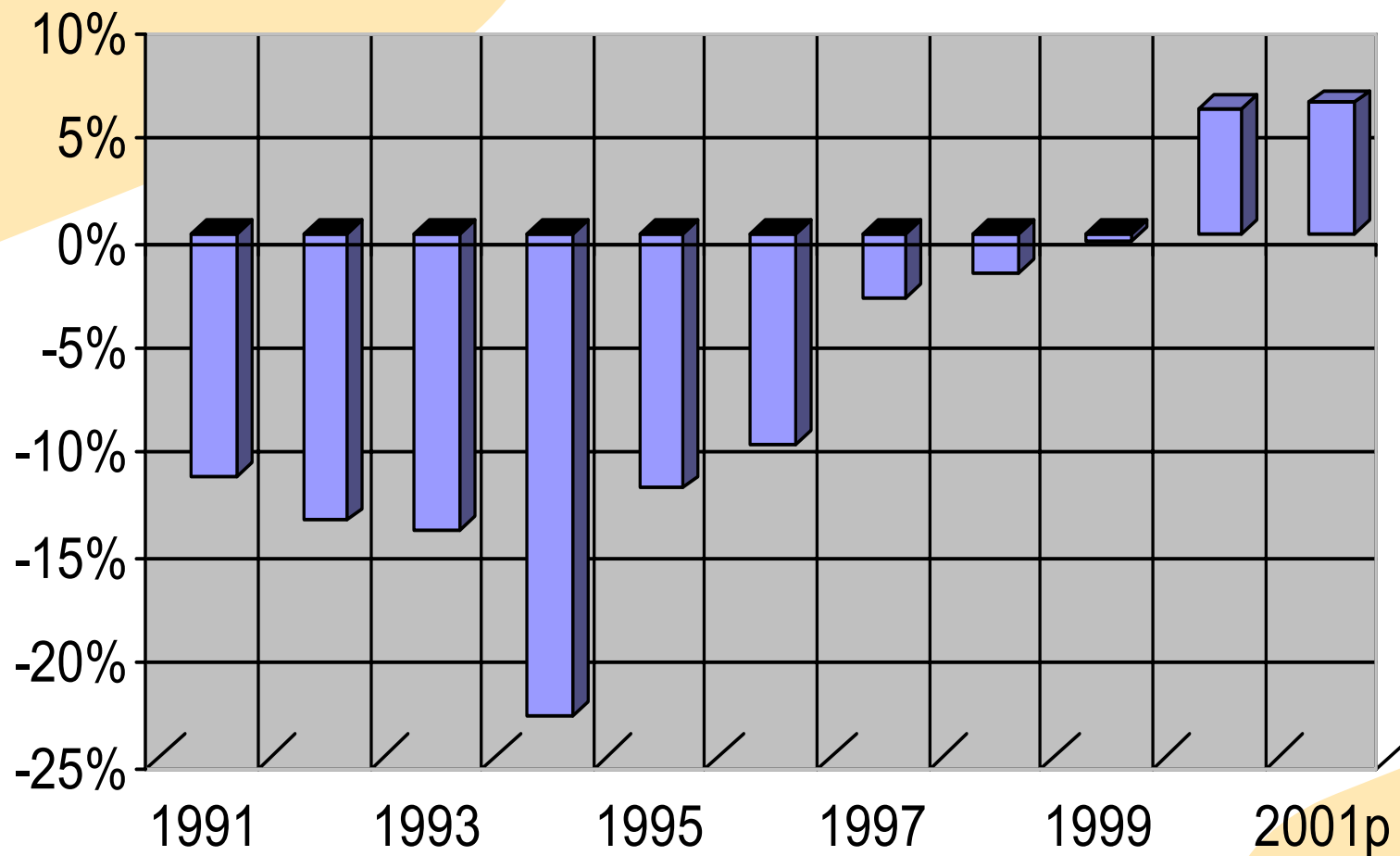


# Any other miracles?

- Land reform, land certificates, titles proceeding
- Barter – down dramatically, cash collections in the energy sector up from 12% in 1999 to 85% of sales – Unbelievable!
- Significant reduction of barter in international trade
- Elimination of Government pension arrears
- Major reduction in Government wage arrears
- Simplification in business registration requirements
- Average number of business inspections by Government agencies down from 70 per year in 1990 to 30 at present
- Introduction of European import certification standards
- Customs procedures improvement closer to European standards
- Approval of Criminal Code, Budget Code, Banking Law, etc.

# Critical Mass of Reforms?

## GDP Growth Rates



# 2001 – Can this Continue?

- January – May: real GDP up by 9% year-on-year - **one of the highest GDP growth rates in the world**
- In May alone, real GDP increased by 10.9% y-o-y
- January – May: industrial output up by 18.8% y-o-y, 20.4% in May alone.
- January – May: agricultural production up by 6.1% y-o-y
- GDP is now expected to grow by 6.2% in 2001, IO by 9%
- The agricultural sector is expected to have a major revival, with grain output increasing from 24 million in 2000 to 35 million in 2001. Sugar beet, the second most important crop, should grow from 13 million tons in 2000 to 18 million tons in 2001 (there is ample evidence that un-registered Ukrainian private capital is returning from abroad for investments in agriculture).

# Now What?

- The **extraordinary** economic performance of Ukraine in the last 18 months is presenting a unique opportunity for a breakthrough
- The new Prime Minister, with the support of the President, is fully aware of the need to take advantage of this window of opportunity and accelerate the implementation of reforms.
- With the likely renewal of international financing from the IMF/World Bank, the country will be able to ensure economic stability over the medium term.
- This macroeconomic stability and the prompt implementation of the investment-generating recommendations contained in the IPCTF report will set the country for sustainable growth and prosperity over the longer term.

# 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.**

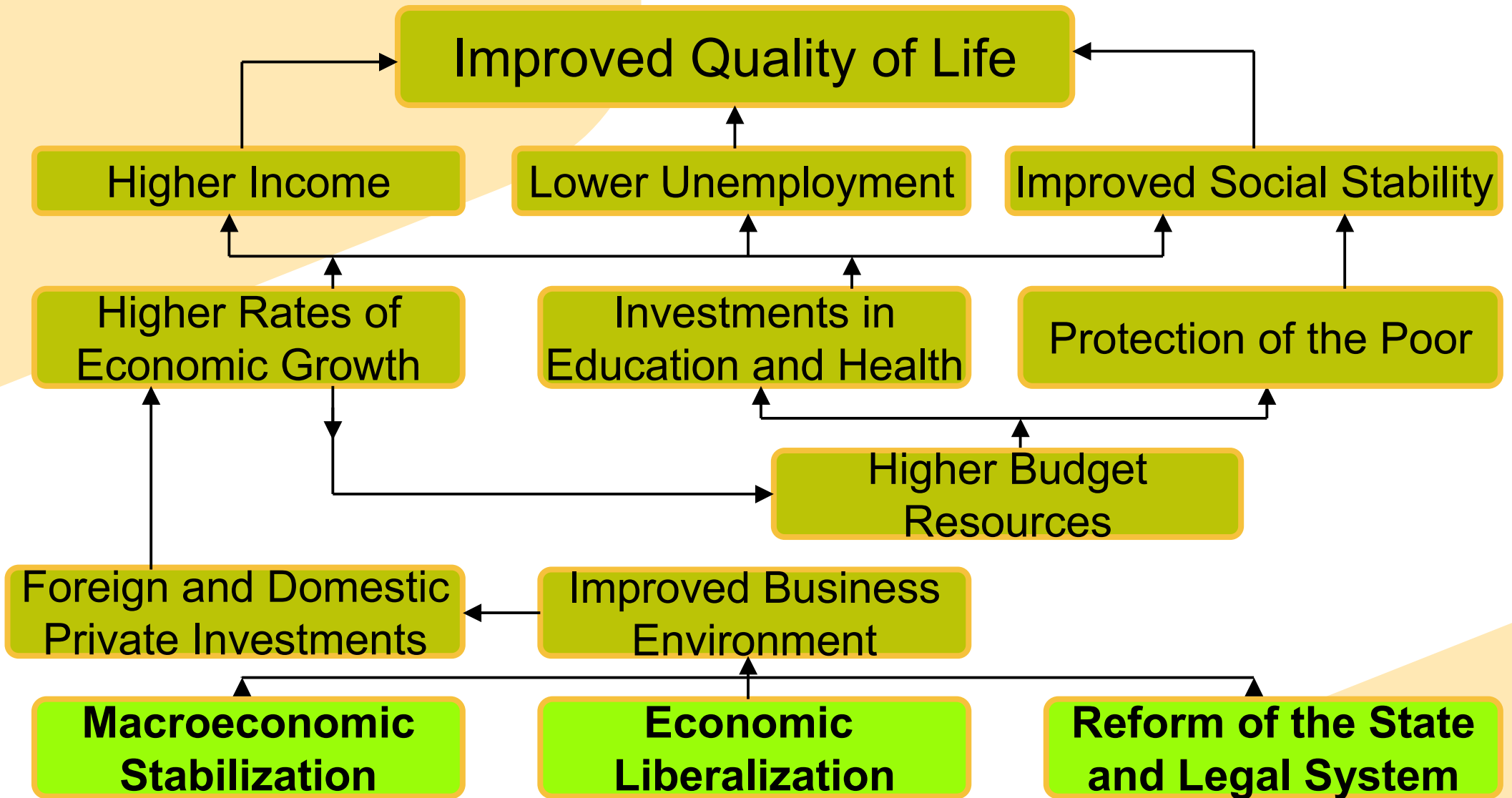
# How to Finance Transition?

- 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?



# International Private Capital Task Force (IPCTF) Ukraine, 2000 - 2001

- **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

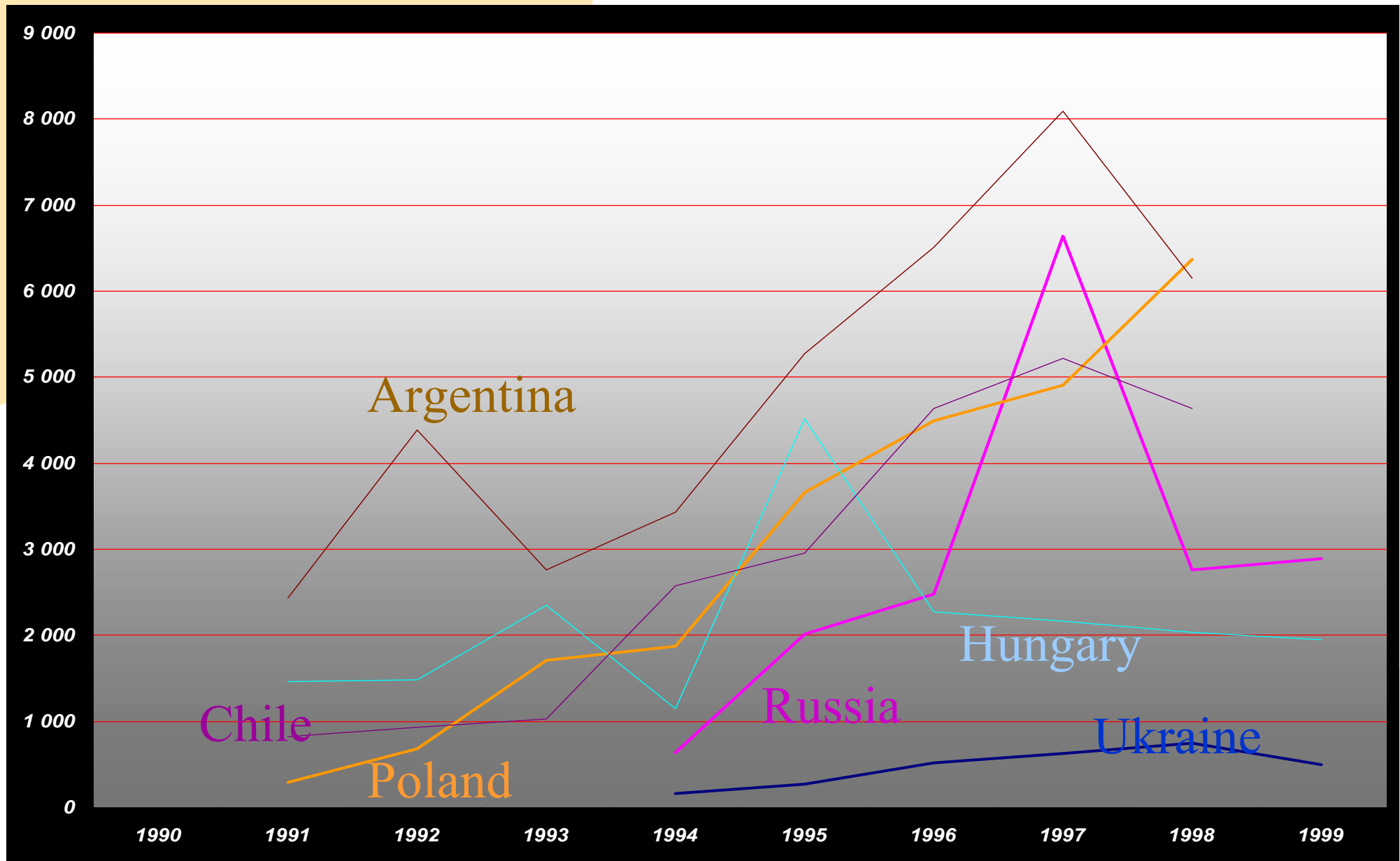
- Argentina
- Chile
- Hungary
- Poland
- Russia

# 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

## Legal Environment Score

17

62

99

93

89

65

## Financial Sector Score

10

39

62

68

74

39

## Governance and Privatization Score

29

30

89

82

80

65

# Benchmarking Results

UKRAINE	RUSSIA	POLAND	HUNGARY	CHILE	ARGENTINA
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## Political Risk Score

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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## Corruption Score

15	21	41	52	74	35
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## Governmental Promotional Effort Score

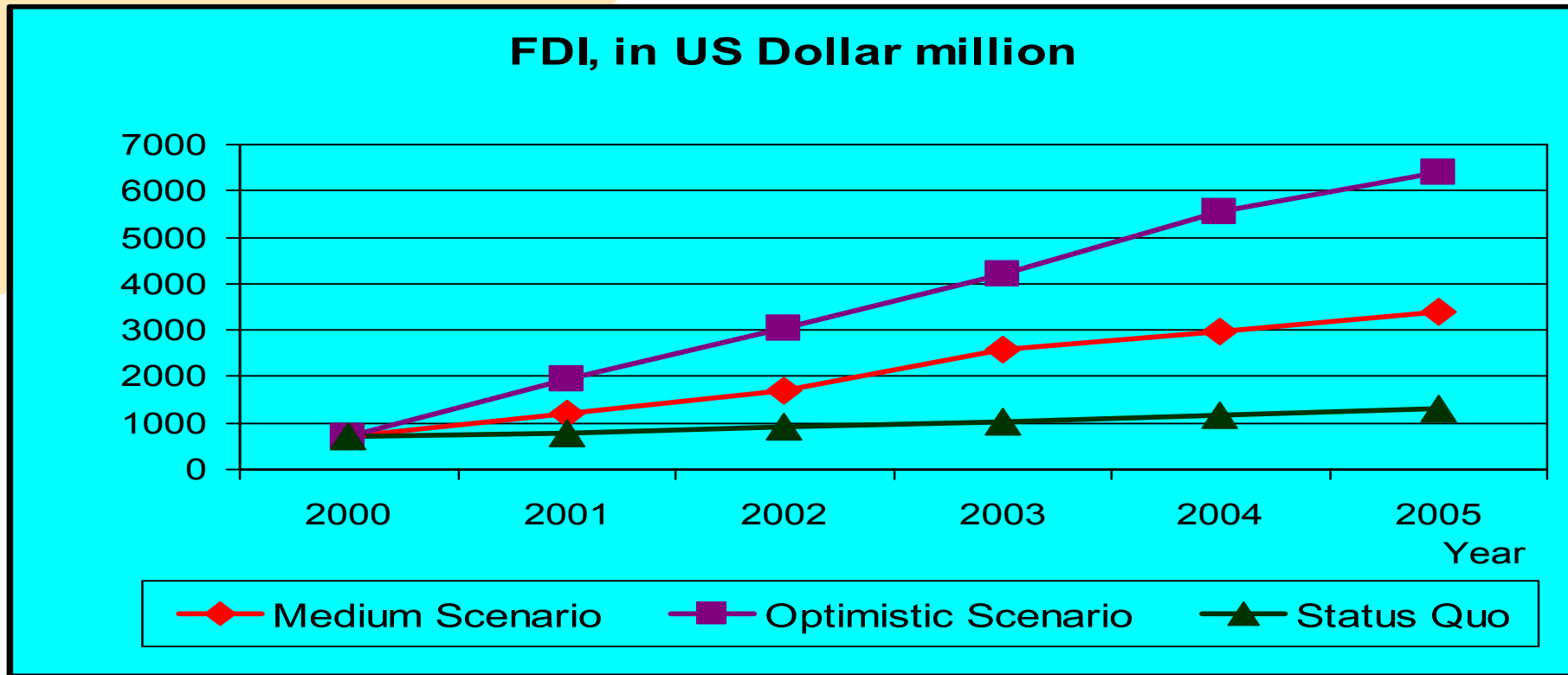
20	30	80	100	90	75
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## Tax and Investment Incentives Score

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****

# 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 –  
What can the West Do?**

# The Future of FSU is the Key to Stability in Europe

- Is the Evil Empire dead?
- What is really being build in the FSU countries?
- Will CIS become a real Union?
- Ukraine, Georgia, Armenia, Azerbaijan, Kazakhstan and Turkmenistan are critical; How about Russia?
- New Arms Race and Cold War are very expensive options
- US and Russia are now exploring new options
- Bush – Putin plan to improve investment climate in Russia should be expanded to all FSU countries
- Completing the restructuring of the FSU countries by building market economies and democracy is an order of magnitude cheaper option and easier to pursue, but **the time is critical**
- IPCTF framework is the mechanism for Bush – Putin plan for FSU

# Financial Assistance to FSU Countries

- Must be focused on **Economic Growth**
- Minimize government-to-government money transfers and blind pools of money
- The use of proceeds is just as important as the conditionality of lending
- Eliminate adjustment lending and budget deficit financing
- Maximize equity investments in place of debt
- Leverage private capital investments with financial assistance dollars
- Structure financial assistance as “private equity funds” managed by money managers from private sector

# BLEYZER INITIATIVE

- Refocus all multilateral and bilateral assistance to FSU countries on the creation of market economies
- Use IPCTF framework to create capital-friendly environment in the FSU countries and attract private equity capital
- Focus all / most financial assistance on creating private businesses – SMEs and large multinational operations in the FSU countries
- Leverage private capital with donor's money
- Implement comprehensive coordinated assistance program to the FSU countries: use donor capital to create the environment, which attracts private capital
- Use IPCTF framework as a broad umbrella conditionality, but couple it with specificity in the use of funds focused on private businesses creation

# BLEYZER INITIATIVE

## Action Plan

- Convince US government at the most senior levels of the need to actively support the creation of market economy and democracy in the FSU countries
- Convince EU countries of the same
- US must demonstrate leadership in building an alliance of developed countries to promote the market-economy-focused program in FSU countries
- Use IPCTF framework as broad conditionality for all financial assistance to the FSU countries
- Work with the FSU countries' governments to create specific Action Plans for each country using IPCTF framework
- Create a series of satellite private equity funds in the FSU countries to advance Action Plans implementation
- Publicize the program in the Western press to attract private capital

# Ukraine Is Bound to Succeed!

## "Україна приречена на успіх"



*Where Opportunities Emerge.*