



MEMU Supplement No. 11-2005

Privatization of Kryvorizhstal

The winner of the 're-privatisation' tender for the metallurgical enterprise Kryvorizhstal was Mittal Steel Germany GmbH. 93.02% of the shares of Kryvorizhstal were sold for UAH 24.2 bn (USD 4.8 bn), which is 2.4 times above the starting price of UAH 10 bn (about USD 2 bn) and 6 times higher than the price paid for this enterprise in 2004 (about USD 0.8 bn). Three participants took part in the auction: "SmartGroup" (a Ukrainian company owned by the Russian businessman Vadim Novinskiy), Industrial Group (a Ukrainian company, 40% of which belongs to Industrial Donbass Union and 60% to Arcelor), and Mittal Steel Germany GmbH (Germany). This unprecedented event in the history of privatization attracted extraordinary attention by different political and social groups. This auction was the first in Ukrainian history to be broadcast on TV, directly from the State Property Fund office.

In spite of all the problems anticipated by the pessimists and all the parliamentary initiatives to halt the re-privatisation of Kryvorizhstal, the sale brought in more money to the state than all privatisation deals to date, starting with the first privatisations in 1992. The competition was conducted in two stages. After opening the envelopes with the fixed price propositions, the auction followed. This process insured transparency and an unbiased attitude towards all participants. Some Ukrainian privatisation experts could only compare this tender with the sale of energy assets in 2001, during which no political pressure was observed. Also, this sale by means of an auction has shown itself to be an efficient privatisation mechanism able to achieve maximum revenues. It was highly praised by representatives of the EU as the most transparent tender over the whole privatisation history of Ukraine.

Yet, the final result of this event could have certain unintended consequences. On the one hand, the money received substantially surpassed the privatisation plan for 2005, which could allow the budget deficit to be offset and further social obligations to be met, in particular, financing the Pension Fund deficit in 2005. On the other hand, the question of how to distribute the money is complicated by a highly politicised environment on the eve of the parliamentary elections in the spring of 2006. In this context, the privatisation revenue windfall received could be used by the political parties as an instrument to gain popularity with the electorate and to influence the election campaign. A special parliamentary group has already been organized to coordinate the process of allocating the funds received. The desire of many politicians to be seen as benefactors of the people, primarily for social aims, raises the risk that the money will be ineffectively squandered, thus increasing the inflationary pressures in the economy.

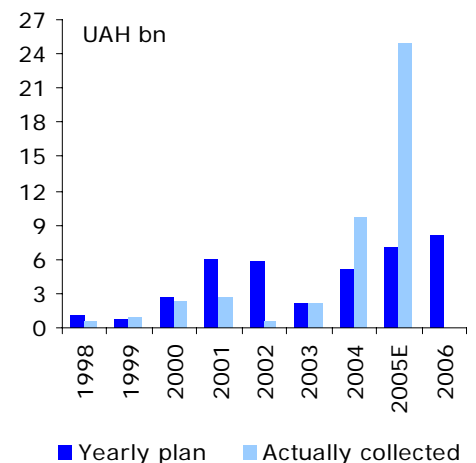
In addition, the successful privatisation of Kryvorizhstal has not yet resolved the uncertainties surrounding the existing property rights regulations as had been expected, in fact it has not even eliminated the risk of continuing property rights revisions. On the contrary, the incredibly high selling price of Kryvorizhstal might encourage more 're-privatisation' efforts. All this could ruin the system of private property and deteriorate the investment climate in Ukraine thus yielding much higher implicit losses than the monetary gains 're-privatisation' might bring in. Instead, efforts to quickly resolve the large volume of legal suits concerning privatisation now before the Ukrainian courts would be a better solution to overcome the investment credibility gap raised in recent months. Although Kryvorizhstal was sold in 2004 under non-transparent conditions, it was sold in accordance with the legislation then in force. This fact allows former owners to contest their property rights in the international courts. A further deterioration of the investment climate in Ukraine is extremely undesirable and would have very serious long-term consequences.

Key indicators of economic activity of open JSC "Kryvorizhstal" in 2003-2005 (UAH bn)

Indicator	2003	2004	2005 (6 months)
Net revenue	7.53	10.10	5.52
Net profit	0.87	2.01	0.79
Accounts receivable	0.57	0.78	0.67
Accounts payable	0.59	0.64	1.57
Profitability of sold products, %	29.7	38.2	30.5
Equity value	5.13	6.52	7.52

Source: The State Property Fund of Ukraine

Privatisation Revenues



E-estimated with respect to revenues from Kryvorizhstal
Source: State Treasury

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Quarterly Trends

National accounts **		Q3 02	Q2 03	Q3 03	Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Q1 05	Q2 05
GDP	UAH bn	64.1	60.0	75.6	77.1	64.7	79.0	100.5	100.6	82.5	95.0
GDP (real)	% yoy	4.3	10.0	6.8	12.1	12.7	13.7	14.0	8.5	5.0	3.2
Households consumption (real)	% yoy	8.9	14.4	11.2	13.6	14.6	16.8	13.1	16.2	16.4	14.6
State consumption (real)	% yoy	-18.8	17.8	19.2	9.0	3.3	1.0	5.0	10.1	5.2	2.2
Gross fixed capital formation (real)	% yoy	3.8	20.4	24.3	9.0	18.4	6.5	4.6	12.9	-2.6	-0.9
Exports of goods and services (real)	% yoy	15.3	9.8	9.8	11.6	18.1	19.9	10.5	8.6	0.1	-2.5
Imports of goods and services (real)	% yoy	10.4	16.2	17.4	17.7	13.8	7.3	6.7	7.8	6.6	2.1
Agriculture, hunting, forestry (real)*	% yoy	2.1	-13.7	-22.5	6.7	-4.4	0.9	35.7	9.9	5.9	8.5
Manufacturing industry (real)*	% yoy	8.0	15.4	23.0	20.1	23.9	16.3	12.5	9.4	7.8	3.2
Construction (real)*	% yoy	-1.2	24.8	30.9	16.9	29.9	30.6	16.4	3.9	-5.9	-9.0
Trade, repair services (real)*	% yoy	8.8	15.1	22.6	29.6	23.6	35.0	2.7	13.7	-1.5	-3.2
Transport (real)*	% yoy	7.9	11.5	15.9	11.7	10.1	8.0	12.3	10.5	7.3	6.8
Balance of payments											
Current account balance	USD bn	0.8	0.7	0.7	0.4	1.6	2.3	1.7	1.2	1.7	0.6
Current account balance	% of GDP	6.4	7.0	5.0	3.0	13.5	15.5	8.8	6.2	10.8	3.2
Trade balance in goods	USD m	155	-42	-155	-381	933	1552	774	482	1051	-228
Trade balance in services	USD m	247	399	362	409	332	153	377	270	257	355
Current transfers	USD m	517	526	574	584	475	758	720	623	624	692
Direct investment (FDI)	USD m	156	454	390	329	334	614	422	345	231	355
Portfolio investments	USD m	-592	640	-444	-293	60	-406	781	-511	-114	-86
Gross international reserves	USD bn	4.1	6.2	6.7	6.9	7.9	9.6	12.1	9.5	12.0	13.1
Fiscal indicators											
Consolidated fiscal revenues	% of GDP	28.2	31.7	30.1	28.6	27.2	26.9	26.3	25.9	32.1	35.1
Personal income tax	% of GDP	4.9	5.7	5.3	5.1	4.4	4.1	3.8	3.8	4.3	4.4
Enterprise profits tax	% of GDP	4.1	5.1	4.8	5.0	3.9	4.0	4.1	6.1	4.8	5.9
Value-added tax	% of GDP	6.4	6.3	5.8	4.8	6.2	5.7	5.1	4.1	8.6	9.2
Excise tax	% of GDP	1.9	2.2	2.1	2.0	2.1	2.1	2.0	1.8	2.0	2.0
Consolidated fiscal expenditures	% of GDP	26.4	29.2	27.9	28.8	25.3	26.5	26.8	35.2	28.3	36.4
Current expenditures	% of GDP	na	26.3	24.2	24.3	22.4	22.7	21.7	27.2	26.5	33.6
Capital expenditures	% of GDP	na	3.0	3.7	4.4	2.9	3.8	5.1	8.0	1.8	2.7
Consolidated fiscal balance	% of GDP	1.7	2.5	2.2	-0.2	1.9	0.4	-0.5	-9.3	3.7	1.0
Privatisation receipts	% of GDP	0.3	1.0	1.0	0.8	1.5	3.7	3.5	1.0	0.2	0.6
Labour market											
Average wage (real)	% yoy	21.2	19.1	19.9	14.9	19.9	18.6	14.7	15.4	15.0	19.0
Household income (real)	% yoy	100.8	8.6	10.0	8.7	11.7	16.3	11.3	16.6	24.0	28.0
Unemployment rate (ILO methodology)	%	9.2	8.8	9.2	9.0	9.3	8.3	8.1	8.7	8.7	-
Banking system											
Monetary aggregate M0	% yoy cum	46.0	37.0	30.5	25.3	29.1	25.6	37.1	27.9	28.2	39.1
Monetary aggregate M2	% yoy cum	46.5	54.6	49.9	47.6	45.4	44.8	51.5	32.3	38.9	37.4
Household deposits in national currency	% yoy cum	103.6	74.7	65.0	66.1	69.4	67.3	67.9	26.2	28.3	31.6
Household deposits in foreign currency	% yoy cum	55.1	70.2	70.4	77.5	67.0	61.7	55.2	54.3	51.8	45.4
Com. bank credits in national currency	% yoy cum	42.3	71.2	73.0	61.7	56.8	52.1	44.3	29.4	28.3	32.6
Com. bank credits in foreign currency	% yoy cum	37.3	48.4	57.7	60.9	63.6	56.2	43.5	32.2	33.1	36.8
Long-term com. bank credits	% yoy cum	85.8	156.4	164.0	157.9	141.7	102.7	82.7	57.1	49.5	53.0
Long-term com. bank credits	% of total	25.3	37.4	40.1	45.0	47.4	49.3	50.9	54.2	54.4	56.1
Average lending rate on national cur. credits	% p.a.	23.5	17.2	17.2	17.7	17.2	16.6	17.0	17.6	17.0	15.4
Average lending rate on foreign cur. credits	% p.a.	11.9	12.6	11.7	10.9	12.2	12.1	12.6	12.2	12.1	11.0

SOURCES: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, IER estimates

* change in value added

** preliminary

Notes:
yoy year on year change

p.a. per annum