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PERFORMANCE AUDIT REPORT

UKRAINE

ENTERPRISE DEVELOPMENT ADJUSTMENT LOAN
(Loan 4057-UK)

AND

SECOND ENTERPRISE DEVELOPMENT ADJUSTMENT LOAN
(Loan 4390-UK)

November 16, 2000

Operations Evaluation Department

Currency Equivalents

(Exchange Rate Effective June 2000)

Currency Unit	=	Ukrainian Hyrvnia (UAH)
1 UAH	=	US$ 0.184
US$ 1	=	5.437 UAH

FISCAL YEAR
July 1, 1999–June 30, 2000

Abbreviations and Acronyms

CIS	Commonwealth of Independent States (Former Soviet Union)
EBRD	European Bank for Reconstruction and Development
EDAL	Enterprise Development Adjustment Loan
ES	Evaluation Summary (by OED)
EU TACIS	European Union Program of Technical Assistance for the CIS
GDP	Gross Domestic Product
ICR	Implementation Completion Report
IFC	International Finance Corporation
IMF	International Monetary Fund
OED	Operations Evaluation Department
PIU	Project Implementation Unit
PSD	Private Sector Development
SPF	State Property Fund of Ukraine
TA	Technical Assistance
UCPPS	Ukrainian Center for Post Privatization Support
USAID	United States Agency for International Development
WTO	World Trade Organization

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The World Bank
Washington, D.C. 20433
U.S.A.

Office of the Director-General
Operations Evaluation

November 16, 2000

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Performance Audit Report on Ukraine—Enterprise Development Adjustment Loan (Loan 4057) and Second Enterprise Development Adjustment Loan (Loan 4390)

The Ukraine Enterprise Development Adjustment Loan (EDAL I, US$310 million) was presented to the Board in June 1996. A Second Enterprise Development Adjustment Loan (EDAL II, US$300 million) was approved by the Board in September 1998. EDAL II closed on time in December 1999. However, EDAL I, originally scheduled to close in December 1999, lags behind schedule, since parts of the complex technical assistance component are still under way. The project is expected to close in December 2000. This audit was carried out in parallel with an Intensive Learning ICR for EDAL I which focussed on the TA component.

EDAL I supported privatization and related reforms through three equal tranches totaling US$300 million and a complex US$10 million technical assistance component for post-privatization enterprise restructuring. EDAL II continued and broadened the reform program. The loans are consistent with the country strategy reflected in the CASs for 1996 and 1998.

With the support of Ukraine's President and leading officials, and despite widespread opposition and a lack of broad public understanding of the benefits of privatization and a shift toward a market economy, much of the ambitious reform agenda associated with the two projects was achieved. This included removal of price and trade controls; privatization of 9,500 medium and large enterprises; creation of the legislative and institutional framework to regulate the capital markets; implementation of international accounting and auditing standards throughout the enterprise sector; setting up of an effective modern bankruptcy process; and simplification of licensing, registration, regulation and inspections. Case by case privatization of attractive large enterprises showed relatively disappointing results, but the minimum EDAL II target of three sales was attained. The Government met the conditions of each tranche promptly, so that the adjustment loans were quickly disbursed in both projects. The technical assistance component of EDAL I is still being implemented, but the experience with it so far is quite positive.

The outcomes of EDAL I and II are rated satisfactory, institutional development impact, substantial, and sustainability, likely. Borrower performance was satisfactory in both projects, and Bank performance was satisfactory in EDAL I and highly satisfactory in EDAL II. These ratings are the same as those in the ESs.

The key lessons from the adjustment components of the two projects are that (i) loans combining structural adjustment with complex technical assistance are difficult to manage and subject to delays; (ii) early involvement of participants from a variety of political spheres—

including the Parliament—might have broadened support for reform in the country; and (iii) donors can rally to support a large and ambitious project with well coordinated actions. Lessons from the technical assistance component include: (i) the great value of training Ukrainians, both as consultants and within firms, with each recipient of training in turn training others; (ii) the feasibility of low-cost restructuring of enterprises on a large scale, with Ukrainians providing most of the consulting advice under the supervision of outside consultants; (iii) the feasibility of turning some bankrupt firms around through consultant assistance; and (iv) the value of multimedia training courses, given by Ukrainians to large numbers of managers and officials of privatized enterprises, with Ukrainian firms serving as case studies.

Contents

This report was prepared by Donald Keesing (Consultant), with Alice Galenson as Task Manager. Silvana Valle provided administrative support.

Preface

This is a Performance Audit Report (PAR) on the Enterprise Development Loan (EDAL) I for US$310 million and the EDAL II for US$300 million. The PAR is based on the President's Reports for the projects, legal documents, project files, related economic and sector work, discussions with Ukrainian officials, other donors and Bank Group staff, and the Implementation Completion Report for EDAL II prepared by the Europe and Central Asia Region in January 2000.

An OED mission visited Ukraine in April 2000, in parallel with a mission by the Region to prepare an Intensive Learning ICR for EDAL I. The mission met with government officials, donors and other stakeholders. Their cooperation and assistance in preparing this report is gratefully acknowledged.

A draft report was sent to the Borrower for comment. No comments were received.

Ukraine – Performance Ratings

	Enterprise Development Adjustment (L4057)		*Enterprise Development Adjustment II (4390)*	
	ES	*PAR*	*ES*	*PAR*
Outcome	Satisfactory	Satisfactory	Satisfactory	Satisfactory
Sustainability	Likely	Likely	Likely	Likely
Inst. Devt. Impact	Substantial	Substantial	Substantial	Substantial
Borrower Performance	Satisfactory	Satisfactory	Satisfactory	Satisfactory
Bank Performance	Satisfactory	Satisfactory	Highly satisfactory	Highly satisfactory

Key Project Responsibilities

	Enterprise Development Adjustment (L4057)		
	Task Manager	*Division Chief/Sector Leaders*	*Director*
Appraisal	Bernard Drum	Paul Siegelbaum	Walik Grais
Completion	Ragini Dalal	Ira Lieberman	Luca Barbone

	Enterprise Development Adjustment II (L4390)		
	Task Manager	*Division Chief/Sector Leader*	*Director*
Appraisal	Bernard Drum	Gerhard Pohl	Paul Siegelbaum
Completion	Vladimir Kreacic	Gerhard Pohl	Lily Chu

1. Background

1.1 Ukraine's economy deteriorated dramatically following independence in 1991. Officially recorded GDP fell by 50 percent from 1990 to 1994 and continued to decline, more slowly, after that; by 1998 it was down by over 60 percent. Inflation surpassed 10,000 in 1993, and foreign debts (including arrears) rose from zero in 1990 to US$7.2 billion by end-1994. Most of the economy was hard hit by a sharp rise in energy prices and by a precipitate fall in orders from former customers, above all those in Russia, but also in Ukraine itself. However, the situation has improved in the last year or so, with GDP growth projected by the EBRD at 2 percent in the year 2000.

1.2 President Kuchma's election in 1994 led to a dramatic change in policy, aimed at creating the institutions needed for a predominantly private market-led economy. The Government was assisted in its reform efforts by the donor community, working in close cooperation; the World Bank, the IMF, USAID, EU TACIS and IFC have played leading roles, with much support from bilateral donors. A major stumbling block in the relationship with donors was that Ukraine's central bank engaged in transactions totaling nearly US$1 billion between 1996 and 1998 that generated a falsely optimistic picture of its foreign exchange reserves and led the IMF to extend to Ukraine loans that it would not otherwise have given.

1.3 Although official GDP has fallen, this decline has been partially offset by the increasingly vigorous expansion of the private, informal, unrecorded sector. As one indication, the Economist Intelligence Unit estimates that per capita GDP in purchasing power parity was just 37 percent lower in 1998 than in 1990. Inflation has been brought down to a range of 10 to 20 percent per year. A total of 9,500 medium and large firms have been privatized since January 1995, of which 8,500 are at least 70 percent privately owned, and the rest are over 50 percent private. Thanks in large part to vigorous auction programs strongly assisted by IFC, practically all of the roughly 150,000 small scale enterprises are now private, along with 8,000 unfinished construction sites. The EBRD estimates that 55 percent of output was produced by the private sector in 1999, in the same range as other CIS countries. Including the informal sector, this share must have been considerably higher.

1.4 On the other hand, private shareholdings in the 100 largest firms are still no greater than 40 percent. The vast majority of the medium and larger firms, even when private, are now making losses and are far from being internationally competitive. Explicit subsidies are limited to agriculture, where the Ukrainian banks are required to bear much of the load through loans at artificially low rates, and three strategic industrial sectors, energy, metallurgy and chemicals. In agriculture, Ukraine, with much of the world's richest soil, has never recovered from the devastating effects of collectivization in the early 1930s and is no longer the huge exporter of grain and agricultural products that it was before World War I. Exports remain modest compared to the country's potential, even in industry.

2. EDAL I

Objectives and Design

2.1 *Structural Adjustment.* EDAL I included US$300 million for balance of payments support for policy reforms. Its principal objectives were to eliminate trade barriers and price restrictions on imports and exports; to eliminate domestic price controls; to implement the mass privatization (i.e., at least 70 percent private ownership) of 5,000 medium and large scale enterprises out of a list of 8,000 that had been compiled; to resolve several important methodological obstacles to rapid implementation of the privatization program; to continue rapid progress in small scale privatization; to gain Cabinet approval of a list of 10 large monopoly enterprises and initiate work needed to privatize these enterprises on a case by case basis before the end of 1997; to empower a Securities and Stock Markets Commission to oversee and regulate capital markets; to create self-regulatory organizations for intermediaries in the capital markets; and to put legislation into effect governing the operations of stock exchanges and over-the-counter markets, dealers and brokers, independent registrars and depositories, and self-regulatory organizations of capital market participants. Rules were also to be introduced governing investor protection, such as disclosure requirements for publicly traded companies, and prevention of fraud and market manipulation.

2.2 The preparation process contributed to the momentum of the program, and many of the intended measures were already well under way, with Bank and other donor advice, by the time the project became effective. Donor cooperation was to be a key. The project gave the donors a seat at the policy table, and without their technical assistance, it is likely that few of the policy reforms would have been implemented.

2.3 *Technical Assistance for Post-Privatization Restructuring.* This US$10 million TA component was designed to track how the project was being implemented and what methods were working best. Its lessons will play a major part in the design of a Private Sector Development (PSD) Project now being prepared, to be built around training people and restructuring firms, then injecting investments into the more promising firms to make them more competitive. The component makes much use of experience in Moldova, where remarkable results have been attained through training and use of local consultants to help management restructure enterprises. As many as 28 Moldovans have been among the trainers in Ukraine.

2.4 The TA component was complex partly because it had many objectives, but also because procurement rules resulted in limiting most sub-components to less than US$1 million each. A cause for criticism in the Ukraine parliament and among some of the other donors was that the TA was financed out of a Bank loan, when grants were available from other donors; however, having to repay the loan strengthened the motivation of the authorities to make good use of it. The Government accepted the TA, with reluctance, because it was tied to the badly needed adjustment funds. The TA component was very complex and ambitious, because the desire to draw lessons from the early privatizations was strong.

2.5 A Project Implementation Unit (PIU) was set up under the general supervision of the State Property Fund of Ukraine (SPF) to implement the TA component. It was initially staffed by a local manager, an international procurement accountant and a local lawyer. The monitoring side of the project was placed in the hands of the Ukrainian Center for Post-Privatization Support (UCPPS), which had a complex legal agreement with the SPF, seeking to balance the need of the SPF to exercise the Government's fiduciary responsibility against the need not to micro-manage the operations of the implementing and monitoring units. This part of the project also included consultant assistance to strengthen the SPF. These infrastructure support sub-components were budgeted at US$1.85 million.

2.6 The main elements of the TA component focused on two areas. The first and most important was support for enterprise restructuring. Here the Government, with Bank assistance, aimed to provide at least 15 enterprises with operational restructuring help. The assistance would be used to develop demonstration cases, prepare case studies for management training, support the development of local consulting services, stimulate demand for TA, test various models for restructuring and cost recovery, identify bottlenecks to liquidation, and assist a limited number of individual enterprises. The sub-components here totaled US$5.8 million. They were to include (1) low-cost management assistance; (2) an intensive demonstration case in which a socially important enterprise would be restructured using top quality management consultants; and (3) liquidation and bankruptcy pilot cases, taking two state enterprises through the process of bankruptcy and liquidation, preferably by different routes. A fourth sub-component providing venture capital to consultant firms and services was left to another donor.

2.7 The enterprises selected for post-privatization assistance were to be at least 70 percent privately owned and to have a clear possibility of developing a positive cash flow within the near future. Management would be committed to the project and supported in this by the shareholders. The company would either have light debts and small investment needs, or else the potential outcome of liquidation would be acceptable to its management and shareholders.

2.8 The other area of TA support consisted of an estimated US$2.35 million for the development of three critical functions necessary in a market economy: stimulating the development of professional associations, establishing a commercially oriented database on private enterprises throughout Ukraine, and developing a management training program based on Ukrainian cases. The three sub-components were (1) provision of one consultant and operating resources to assist 10 existing or new professional associations, while helping them recruit and expand their roster of members, raise their members' professional standards, and provide unofficial certifications of professional competence; (2) creation of a firm providing a commercial private company database covering the entire country, if possible in a joint venture with an established foreign business intelligence company, with the Government's interest divested as the firm becomes profitable; and (3) recruitment of high quality academics to develop case study material—preferably multimedia presentations, developed in sessions with enterprise managers—and to deliver the training to managers, preferably through an existing local training institute.

2.9 The TA component was also intended to provide guidance to the other donors about priorities, and to enable the Bank to take a more active role in coordinating donor activities in a variety of areas, such as capital markets development, accounting, bankruptcy, and restructuring of firms.

Relevance

2.10 The adjustment component supported the next key steps in all of the crucial reforms toward a private, market economy that were underway when it was prepared. Balance of payments support also helped to provide critically needed imports and contributed to the emergence of foreign exchange markets. Yet by providing added resources, it allowed the Government to continue some policies and practices that it would have had to reform without this support, for example in fiscal spending and tax policies, which remained unbalanced and uncorrected. The TA component proved excessively complex and difficult for the Ukrainians to manage. However, following EDAL II and adjustments in the Government institutions overseeing the reforms, the TA component, small as it is, is playing a valuable role in keeping the reform process moving forward and demonstrating methods of restructuring enterprises for the planned Private Sector Development project.

Implementation and Outcome

2.11 *Adjustment Component.* All major objectives were attained nearly in full in the adjustment part of EDAL I; the three tranches were disbursed in slightly over one year. Small scale privatization advanced rapidly to well over 80 percent completion, even though delayed in some places by the local authorities. A goal pursued only half heartedly and with unimpressive results was the initiation of case-by-case privatization of at least ten large monopoly enterprises. Although the Cabinet of Ministers met the third tranche condition of approving a list of ten large monopoly enterprises for privatization, this was the start of a persistent problem in both EDALs; the privatization of leading companies was not popular, and the Government put obstacles in its way.

2.12 The first tranche of the adjustment component required that 2,000 medium and large firms be privatized, and the second and third tranches required the privatization of an additional 1,500 each, for a total of 5,000 firms. In the end, 8,000 were privatized by the end of 1997. Continued liberalization of trade and prices was another key part of the adjustment component. Indicative prices for most exports were removed, along with practically all export duties, and remaining non-tariff barriers were neutralized, abolished, or in one case (import quality certification) replaced by progress toward international norms determined by the World Trade Organization.[1] Old barriers to trade were replaced by tariffs of no more than 30 percent. Domestic price controls on all sixteen "artificial" monopolies were abolished. Another aspect was the capital markets development program, built around the Securities and Stock Markets Commission

[1] Two conditions were waived in part because the political situation prevented their approval by Parliament (See Annex B). They remained as conditions of the Agricultural Sector Adjustment Loan, but were later waived there as well.

created previously, in June, 1995 and further empowered by legislation in late 1996. This was closely linked to the promotion of self-regulating organizations for market participants. Capital market development moved forward well along the lines anticipated, with the Commission implementing investor protection and the creation and licensing of independent registrars, depositories and custodians, brokers/dealers, investment advisers, portfolio managers and market trading systems. Sufficient conditions were met so that all three tranches were disbursed within a few months of one another. However, because of the delays in the TA component, project closing has been delayed to December 31, 2000.

2.13 By 1997, mass privatization, although only half completed, began losing momentum; the number of enterprises reaching the 70 percent private ownership level was declining each month, while there was an increasing use of non-transparent methods of privatization such as non-commercial tenders. In April 1997, in a joint letter to the Prime Minister, the IMF, World Bank, USAID and EU/TACIS together voiced concern about these problems and recommended revising upward the end-1997 target to 8,000 medium and large enterprises to become 70 percent private since January 1, 1995. The donors offered advice on how to pursue this goal, and what instruments to use. The Ukrainian authorities accepted these recommendations, infusing the project with new vigor, while raising its privatization targets and improving its methods. As a result, the project's main goals were achieved despite much opposition in Parliament, several ministries, and many factory directors who tried to keep their enterprises off the list of firms to be privatized.

2.14 The project was the responsibility of the SPF. With the Bank playing a central role, the donor community provided valuable support and advice, essential in several areas of the project, coordinating its actions through meetings at least once a month.

2.15 *The TA Component.* This component was not uniformly welcomed. The Government delayed work on it for a year. At least one key Bank official implementing the project was skeptical about the TA component, partly because it could have been financed by other donors on a grant basis, and partly because Ukraine's long history of pervasive Government intervention made it desirable to keep the Government as far from the private enterprise sector as possible while building market friendly institutions through the conditions associated with loan disbursements. After the highly effective first chairman left—he is now first deputy prime minister—the SPF had three leaders in the next year. Little will or leadership emerged, and the fragmented nature of the component made the task of pulling it together a formidable task for Ukrainian leaders and their Bank counterparts. Eventually an energetic PIU team was appointed and launched the program. The PIU started with a budget of US$200,000, to which US$500,000 was later added, and it took over some of the monitoring functions of UCPPS. The budget of the monitoring unit, the UCPPS, was stretched to US$750,000, and it transformed itself into mainly a consulting company working for other donors.

2.16 The TA component was supervised from Bank headquarters, with assistance from staff in the resident mission in Kyiv. The longer than expected time period required for the component has served to keep attention focused on the reforms. As intended, the component has provided guidance to donors about priorities and enabled the Bank to take a very active role in the various reforms taking place in enterprise restructuring, capital markets development, accounting, bankruptcy, and creating a database on the enterprises created and their ownership structures. The component has also become a pilot for the Private Sector Development project being prepared for FY01.

2.17 There were twelve sub-components in addition to creation of the PIU and UCPPS, each carried out by a different consulting firm, most from different countries. These consultants performed well. The model restructuring of a prominent firm was completed in 1998 for US$900,000. The chief lesson learned was the difficulties in communication between Western consultants and former Soviet managers, since words and business concepts have different meanings in the two cultures. Ukrainians, who understand both business environments, are needed to serve as intermediaries. Despite these difficulties, the restructured heavy machine building firm claims to be doing much better. In December 1998 the low cost restructuring of four firms was completed for US$1,200,000, or an average of US$300,000 each, with much participation by Ukrainian consultants and with promising results in most of the firms. By July 2000, the low cost restructuring of nineteen enterprises was completed, with heavy use of Ukrainian consultants, at a cost of US$2,000,000, reaching a level of about US$117,000 each. This brings the average cost well down the curve experienced in Moldova, where the cost has declined over time from US$300,000 to US$45,000 per firm.

2.18 The strengthening of ten professional associations was completed in 1999 for US$950,000 through grants for activities such as conferences, marketing, training, and establishing links with foreign associations. The associations supported included groups of financial analysts, management consultants, accountants, and insurance intermediaries. The sub-component for monitoring by the UCPPS was completed in March 2000. The bankruptcy and liquidation sub-component was completed in April for US$950,000, with generally outstanding results; in both cases, assets were used productively, and negotiations and agreements were achieved with all creditors. The management training component was also completed in April, for US$950,000, by low-cost Ukrainian consultants; they presented excellent courses based on Ukrainian cases covering the major aspects of business management—strategy, marketing, cost management, accounting, etc.—and offered follow-on specialized courses for specialists or managers in each firm. Nearly 700 managers and some government officials attended these courses, and this sub-component is widely considered, both in Ukraine and in the Bank, as the most successful sub-component, rivaled only by low-cost restructuring.

2.19 A data base on private enterprises was developed (US$450,000), and a joint venture with a foreign partner is being created to maintain the data base and disseminate the information; and methodological and technical assistance was provided to the SPF—to develop the privatization program, maintain a website, and help maintain professional information on enterprises—for US$250,000. Strengthening of the SPF by consultants (US$900,000) is the final sub-component, to be completed in November 2000; fifteen strategic enterprises will be promoted abroad, with a conference to present the enterprises to major potential investors.

2.20 Technical assistance for training and restructuring is costly, but is badly needed in Ukraine. EDAL I was a difficult project to manage in terms of timing and the heavy administrative demands of its TA component. Yet the TA component has advantages that are now becoming clear, and which help to illustrate the value of TA that emphasizes training, use of local consultants, low-cost restructuring of enterprises, strengthening of various types of support for restructuring, and experiments in such areas as bankruptcy processes.

2.21 As part of the Intensive Learning ICR, questionnaires were sent to leading private participants in the TA component and to official participants. The results were discussed in workshops in Kyiv on April 12, 2000. Fourteen firms of the 17 invited and many of the professional associations came to the discussion among the private participants, and their answers to the questionnaires were carefully analyzed and summarized in the workshops, which were quite animated. Many private managers have attained promising results: their enterprises were able to increase production and profits, while implementing reorganizations, and some have begun discussions with potential foreign partners. They also understand, in many cases, that it is up to them to save and strengthen their firms, and that the key to this is more and better training, with assistance from local consultants.

3. EDAL II

Objectives and Design

3.1 The Government's immediate challenge when this US$300 million loan was launched in 1998 was to restore the confidence of its financiers, domestic and international, as well as multilateral. Fiscal austerity and structural reforms had to be achieved, even in this election year with a fragmented and increasingly hostile Parliament. This loan became effective in September during the Russian crisis that began with a default on much of Russia's debt in August.

3.2 For the medium term, achieving sustained economic growth and accelerating the transition to a market economy were the Government's overriding priorities. This would require reducing inflation and creating a more stable legal framework and business environment for enterprises, while making the public administration more market friendly. Targeted assistance to the poor was also planned.

3.3 The key objectives of this loan were privatization, capital markets development, enterprise accounting reform, bankruptcy reform, and deregulation. Each had several facets, adding up to an impressive array of needed reforms to improve the business climate for the private sector. The loan also provided foreign exchange for critical imports and support for the development of foreign exchange markets.

3.4 The program in privatization was to continue the achievements of EDAL I, aiming for the privatization of at least 9,500 medium and large firms from January 1, 1995; to complete small scale privatization; to continue the case by case privatization program, ending with 3 transactions brought to final negotiations with investors, 3 prospectuses registered with the Securities Commission, and an additional 10 transactions initiated; to begin to privatize grain storage and distribution facilities (totaling at least 100), as well as 3,600 unfinished construction sites, which up until recently had been virtually untouched by privatization; and to end non-transparent transfers of ownership.

3.5 The program of EDAL I for capital markets development was to be continued and reinforced, company law amended, taxes on capital market transactions equalized, and registration of stockholders continued. International accounting and auditing standards were to be adopted, supported by education programs and professional quality control. Steps were to be taken to improve the legal framework for bankruptcy procedures, increase implementation capacity, and increase incentives to use the procedures by making them less expensive and less cumbersome. Deregulation was to be addressed by simplifying business licensing, registration, and inspections, and by setting up a permanent public/private consultative group to submit recommendations regularly to the Cabinet for action on high priority regulation issues.

Relevance

3.6 The EDAL II program was relevant and consistent with the 1998 CAS. It followed up on important aspects of EDAL I. The only weak area was the special case by case privatization of especially attractive large companies, which faced considerable political resistance.

Implementation and Outcome

3.7 From 1992 to the closing of EDAL II in June 1999, close to 11,000 privatizable medium and large enterprises, almost the entire universe, had been at least 70 percent privatized; the target of 9,500 since 1995 was exceeded. Several hundred more have been more than 50 percent privatized. Small scale privatization, extending to as many as 150,000 enterprises, was to all intents and purposes complete. Substantial progress had been made and targets had been met in privatizing grain storage and distribution facilities, and 8,000 abandoned construction sites have been privatized, also exceeding targets. Private ownership was only 40 percent, however, in the equity of the country's 100 largest enterprises. Project conditionality was satisfied: case by case privatization of 13 large, attractive enterprises was initiated, and by January 2000, three had been sold. However, the tender procedure selected was unfriendly to private investors, requiring them to take on the full liabilities of the enterprise and keep its entire labor force for 4 to 5 years. Moreover, one enterprise was removed from the list after reputable German investors showed considerable interest in buying it. Subsequently, in March 2000, an especially large enterprise, the Nikolaev alumina plant, was sold to a Russian-owned Ukrainian firm in a tainted procedure that strongly favored the buyer over a rival bidder. The biased rules imposed in these potential transactions and the reluctance to accept non-CIS ownership of a key enterprise were serious flaws in the privatization program.

3.8 The other objectives of the project were well carried out, and the funds were distributed within nine months. The tranches were disbursed on September 15, 1998, March 30, 1999 and June 30, 1999. Responsibility for the project within the Government was given to the EDAL II Monitoring Unit, located in the Ministry of Economy. Shortcomings such as corruption and uneven and unpredictable application of rules continue to hold back progress in the environment for market-based development. One result is that no leading foreign-owned bank is willing to lend to any Ukrainian firm, even at very high real interest rates, and IFC has yet to invest either.

3.9 The reforms supported by the two EDALs have created a framework for a market economy and bear witness to the effective use of adjustment lending to shore up the positive forces in a Government in transition. Ukraine comes out quite well compared to other CIS countries on progress in transition.[2] It scores at or above the average on measures of governance and enterprise restructuring, price liberalization, trade and foreign exchange system, competition policy, banking reform and interest rate liberalization, and securities markets and non-bank financial institutions. It comes out very close to average on small scale privatization. Only in large-scale privatization does it score below average, ranking eighth among 12 countries. As a secondary objective, balance of payments support has helped to provide critically needed imports and contributed to the emergence of foreign exchange markets.

3.10 External factors affecting the project included the financial crisis in Russia that began in August, 1998, and led almost immediately to an extreme reluctance of Ukraine's creditors to roll over its T-bill debt. This forced Ukraine to restructure this debt and caused a severe decline in output in nearly all sectors of the economy. However, the severe devaluation that accompanied this crisis gave a boost to exports and to import-competing industries. By the late spring of 1999, industrial output began to register positive growth, and the Government was able to stabilize the economy.

4. Sustainability of EDAL I and II

4.1 Sustainability is not completely assured. Some questions remain about the enabling environment for private sector development, especially because of the reforms not yet carried out in areas such as pensions, the energy sector, and administration. The present environment is risky for investment, because of changing and arbitrary taxes and regulations and corruption, to the point where leading foreign banks will not lend to Ukrainian enterprises, and firms that can borrow at all may have to pay real interest rates on the order of 45 percent. Not all of the country is ready for further reforms, and there are many vested interests to overcome.

4.2 Nonetheless, the achievements of these projects are unlikely to be reversed. The projects created a large number of privatized enterprises, taught their managers how to operate in a market economy, helped create a capital market infrastructure and the means for its regulation, and liberalized trade and prices. The PSD project now being prepared

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[2] EBRD, "Transition Report 1999: Ten Years of Transition," Table 2.1. This table grades the countries from 1 to 4 on eight indicators that measure the extent of reform that has taken place.

will continue the restructuring and training components, the continued success of which is important, since satisfaction with further extension of a market economy is bound to depend on its results and on the profitability of the privately owned enterprises that have been created. Under these circumstances, sustainability of the achievements of EDAL I and II is rated likely.

5. Summary of Ratings

5.1 The audit agrees with the ratings in the ES for EDAL II: the outcome is rated satisfactory, sustainability likely, institutional development impact substantial, borrower performance satisfactory, and Bank performance highly satisfactory. The Bank and donor community did not have the leverage to require the Borrower to adopt rules and conditions more favorable to private investment in the case by case privatizations. The rapid and generally thorough success in implementation of the project was due in large part to staff of the World Bank's resident mission in Kyiv.

5.2 EDAL I has not yet been completed, but less than US$2 million remains to be disbursed. Outcome is rated satisfactory, based on trade and price liberalization; substantial progress in private sector and institutional development, including capital markets, accounting, bankruptcy, and deregulation; and the recent strong progress of the TA component. Sustainability is rated as likely, and the institutional development impact as substantial. Together, the projects have established a basis for the future development of the private sector, and the donor community is exerting pressure to continue moving these gains forward. Bank performance in EDAL I is rated satisfactory; the Bank underestimated what could be attained in privatization in 1997, but recovered quickly, in collaboration with the other leading donors. The TA component, continuing beyond the rest of the project, has kept the attention to reforms alive, and has shed much light on methods of training and advice that work. Borrower performance is rated satisfactory, despite delays in the TA component. The ratings are the same as those in the ES.

6. Key Lessons Learned

6.1 The first lesson, consistent with experience in other countries, is that combining structural adjustment with a complex technical assistance component makes a project difficult to manage. In this case, it has slowed the completion of EDAL I. The objectives of the TA component were sound: to learn how to restructure and improve the competitiveness of firms swept up in the privatization process, and to test out methods of assisting them. The results and lessons are now emerging, and a majority are promising. But the TA component might have been better designed as a separate project, financed partly by grants from other donors.

6.2 A second lesson is that early involvement of participants from a variety of political spheres—including the Parliament—might have improved the country level support for reform.

6.3 Another lesson that emerges from this experience is that a large and ambitious project can rally donors together to support it and coordinate their actions based on a sensible division of labor. In EDAL I and II, many policy reforms were required in synchrony, with advice from many donors. Obtaining timely and intelligent TA in this manner may prove difficult in future projects, but the Bank with its limited resources will have to continue to rely on other donors. The largest of them have more staff in the country and some offer grant money and specialized expert services.

6.4 A key lesson emerging from the TA component, which will be applied in the PSD project, is the great value of training Ukrainians, both as consultants and within firms, with each recipient of training in turn training others; this technique is establishing a network of Ukrainians who can bridge the gap in understanding between Western consultants and former Soviet managers. Other lessons include the feasibility of low-cost restructuring of enterprises on a large scale with Ukrainians providing most of the consulting advice under the supervision of outside consultants; the feasibility of turning some bankrupt firms around through consultant assistance; the value of creating and/or strengthening crucial professional associations; and the value of a battery of multimedia training courses, given by Ukrainians to large numbers of managers and high officials of privatized enterprises, with Ukrainian firms serving as case studies.

Basic Data Sheet

ENTERPRISE DEVELOPMENT ADJUSTMENT LOAN (LOAN 4057-UK)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	310	310	100
Loan amount	310	310	100

Project Dates

	Original	*Actual*
Identification/Preparation		05/95-12/95
Appraisal		05/02/96
Board Approval/Signing		06/27/96
Effectiveness	09/25/96	07/19/96
Closing date	12/31/99	12/31/00

Staff Inputs (staff weeks)

	Actual	*US$(000)*
Identification/Preparation	111.9	361
Appraisal/Negotiation	16.1	49.7
Supervision	80.5	268.8
ICR	13.9	43.1
Total	222.4	722.6

Mission Data

	Date (month/year)	No. of persons	Specializations represented	Performance rating
Identification/Preparation	May 1995	6	PSD Specialists, Capital Markets Specialist, Operations Officers	
	July 1995	1	PSD Speacialist	
	September 1995	6	PSD Specialists, Capital Markets Specialist, Operations Officer	
	December 1995	2	PSD Specialists	
Appraisal/Negotiation	March 1996	2	PSD Specialists	
	May 1996: Negot. June 1996	3	PSD Specialists, Operations Officer	
Supervision:	October 1996	6	PSD Specialists, Capital Markets Specialist, Operations Officers	S
	November 1996	1	PSD Specialist	S
	January 1997	6	PSD Specialists, Capital Markets Specialist, Operations Officers	S
	April 1997	2	PSD Specialists	S
	June 1997	3	PSD Specialists	S
	November 1997	2	PSD Specialist, Operations Officer	S
	January 1998	1	PSD Specialist	S
	March, June, Sept., November 1998	2	PSD Specialist, Operations Officer	
	February, June, October 1999	2	PSD Specialist, Operations Officer	S
Completion/ICR	April 2000	3	PSD Specialists, Operations Officer	

Basic Data Sheet

SECOND ENTERPRISE DEVELOPMENT ADJUSTMENT LOAN (LOAN 4057-UK)

Key Project Data *(amounts in US$ millions)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	300	300	100
Loan amount	300	300	100

Cumulative Estimated and Actual Disbursements *(amount in US$ millions)*

	FY98	*FY99*	*Total*
Appraisal estimate	300.0		300.0
Actual	100.0	200.0	300.0
Actual as % of appraisal			100
Date of final disbursement: June 30, 1999			

Project Dates

	Planned	*Actual*
Identification/Preparation		01/97-07/97
Appraisal	11/97	10/17/97
Board approval/Signing		09/15/98
Effectiveness		09/18/98
Completion/Loan Closing	12/98	12/31/99

Staff Inputs (staff weeks)

	Actual	*US$ (000)*
Identification/Preparation	62.4	242.5
Appraisal/Negotiation	30.5	66.6
Supervision	33.4	93.0
ICR	3.76	13.2
Total	130.06	415.3

Mission Data

	Date (month/year)	Number of Persons	Specialization	Performance Rating
Identification/ Preparation	January 1997		PSD Specialists, 1 Economist, 1 Capital Markets Specialist, 1 Operations Officer	
	March 1997		PSD Specialists, 1 Economist, 1 Accounting Specialist, 1 Bankruptcy Specialist	
	May 1997		PSD Specialists, 1 Economist	
	June 1997		PSD Specialists, 1 Economist	
	July 1997		PSD Specialists, 1 Capital, Markets Specialist, 1 Accounting Specialist, 1 Bankruptcy Specialist	
Appraisal/ Negotiation	November 1997	2	PSD Specialists	
		1	Capital Markets Specialist	
		1	Negotiations	
	February 1998	1	PSD Spcialist	
	April 1998	1	PSD Specialist	
	July 1998	1	Economist	
	September 1998		PSD Specialist	
Supervision	October 1998-June 1999 resided in the field, constant supervision	2	PSD Specialists	HS
	November 1998	1	Operations Officer	S
	February 1999	1	Bankruptcy Specialist	S
	April 1999	1	Capital Markets Specialist	HS
	May 1999	1	Bankruptcy Specialist	S
	June 1999	1	Accounting Specialist	
ICR	July 1999-present, reside in field	2	PSD Specialists	HS
	October 1999	1	Operations Specialist	S

Annex B: Results for Key Objectives of EDALs I and II

EDAL I Adjustment	
Eliminate trade barriers.	Done
Eliminate price restrictions on imports and exports: • Imports • Exports	 • Done, except import quality certification condition replaced by progress toward WTO norms. • Done, except live animals and skins (condition waived).
Eliminate domestic price controls.	Done, except live animals and skins (condition waived).
Mass privatization of 5,000 medium/large scale enterprises.	8,000 privatized.
Resolve obstacles to implementation of privatization program.	Done.
Continue progress in small scale privatization.	Rapid progress to well over 80% completion.
Cabinet approval of 10 large monopolies to be privatized, and initiate work needed.	List approved; work initiated, though problems persisted.
Empower Securities and Stock Markets Commission to oversee/regulate capital markets.	Done (legislation).
Create self-regulatory organizations for intermediaries in capital markets.	Done.
Legislation governing stock exchanges and over-the-counter markets; dealers; brokers; registrars and depositories; self-regulatory organizations.	Done.
Rules governing investor protection.	Done.
EDAL I TA	
Operational restructuring assistance for at least 15 enterprises: • Low-cost management assistance. • Demonstration case restructuring socially important enterprise. • Liquidation and bankruptcy pilot cases.	 • Low cost restructuring for 19 enterprises done. • Done. • Two pilot cases done.
Assist development of 10 professional associations.	Done.
Establishment of commercially oriented database on private enterprises.	Done.
Development of a management training program based on local case studies.	Nearly 700 managers trained in restructuring using Ukrainian case studies.
Strengthening of SPF.	Done.

Annex B: Results for key objectives of EDALs I and II (continued)

EDAL II	
Privatization of at least 9500 medium/large firms.	Nearly 11,000 firms privatized.
Complete small scale privatization.	Done.
Continue case-by-case privatization, with 3 transactions to final negotiations, 3 prospectuses registered, additional 10 transactions initiated.	Privatization of 13 enterprises initiated, of which 3 sold and one removed from list; process not entirely satisfactory.
Begin privatization of grain storage and distribution (at least 100), and 3600 unfinished construction sites.	Grain storage and distribution targets met; 8,000 construction sites privatized.
End non-transparent transfers of ownership.	Not completely done.
Continue EDAL I capital markets development—amend company law, equalize taxes on capital market transactions, register stockholders.	Done.
Adopt international accounting/auditing standards.	Done (legislation).
Improve legal framework for bankruptcy procedures, increase implementation capacity, increase incentives to use them.	Done (legislation).
Deregulation—simplify business licensing, registration and inspections; set up public/private consultative group.	Done.