

UKRAINE'S RESILIENCE TO CRISES: STATE-OWNED ENTERPRISES



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1. HOW CRISIS-RESILIENT ARE STATE-OWNED ENTERPRISES?

The state-owned enterprise sector in Ukraine remains substantial, and the largest enterprises remain vulnerable to political influence. They continue posing fiscal risks for the state and the risk of creating economic bottlenecks. This chapter analyses the long-term challenges, as well as the impact of recent crises: the coronavirus outbreak and the energy crisis. In addition, we have included the risks in the state-owned enterprise sector which the Finance Ministry assumed when submitting the draft budget for 2022.

There are 3,500 state enterprises in Ukraine. 1,400 of them are functioning, while the rest are in the process of shutdown or are located in the territories not controlled by the Ukrainian government. The Ministry of Economy declares that most state enterprises should be privatized or liquidated. However, as of 1 July 2021, only 723 enterprises were transferred to the State Property Fund. For the rest, the state's function as owner remains distributed among the 96 authorities to which the various SOEs are subordinated. This is not in line with the OECD Guidelines, according to which line ministries should not act as owner and regulator at the same time.

The government prioritises the management of the 15 largest state-owned enterprises in which it plans to or is already implementing corporate governance reform. These enterprises are natural monopolies, perform a state function or have special obligations in the areas of energy, transport, etc.

The financial performance of the 1,458 SOEs operating in the crisis year 2020 amounted to a total of -51.3 bln UAH (-1.83 bln USD, the sum of income and losses).¹ Six out of ten largest enterprises showed a loss of 84 bln UAH (3 bln USD) and four showed a profit of 7 bln UAH (250 mln USD) (for details, see the analytical brief "[Ukraine's Resilience to Crises: Public Debt](#)").²

Nine state-owned enterprises have supervisory boards appointed under the new regulations. Six of them have supervisory boards with a majority of independent members, and in two SOEs (Naftogaz and Ukrzaliznytsia) the election is ongoing. In other SOEs, heads are appointed by governing bodies, which creates risks for politically motivated decisions.

1.1. WHAT ARE THE RISKS OF INCOMPLETE CORPORATE GOVERNANCE REFORM IN SOES?

The main purpose of state-owned enterprises is to compensate for market failures, so as to perform functions that private players are unable to perform effectively. This includes the fulfilment of state social obligations and direct state functions. Accordingly, when such a socially important state-owned enterprise is under political influence, the management may make decisions that are beneficial to politicians, but not in the interests of sustainable development of the enterprise itself. Also, the state may make political decisions to limit the prices of goods and services provided by a state-owned enterprise, especially in crisis times.

To prevent political influence in state-owned enterprises, Ukraine has been carrying out corporate governance reform of state-owned enterprises for the last seven years to bring their management closer to

¹Data source: [Monitoring of State Property Management Efficiency for 2020](#) Ministry of Economy of Ukraine (by management bodies).

²Taking into account damage to NJSC Naftogaz after revaluations (-33.2 billion UAH); for 2020 revaluations, the damage was accounted for by -19 billion UAH. https://www.naftogaz.com/files/Zvity/Naftogaz_20fs_Consolidated_UKR.pdf

the Guidelines of the Organization for Economic Cooperation and Development (OECD). **The key principles for the implementation of ownership policy** in state-owned enterprises in the public sector³ were adopted in 2018 and include, inter alia, the following:

- Exclusivity of state ownership (state intervention only when there is a market failure);
- Definition of clear commercial and non-commercial objectives for each company's activities;
- Equal regulation of state-owned and private companies, with all state-owned companies becoming joint-stock companies;
- Separation of the functions of the owner and regulator (if the ministry regulates a company, it should not manage it at the same time);
- Professionalism in the management of economic entities, in particular the formation of professional and politically independent supervisory boards;
- Social responsibility of state-owned companies.

For each of these principles, we see the following risks:

The lack of a clear state ownership policy leads to politically motivated decisions.

Ukraine has no clear policy on the state ownership of enterprises. Therefore, the government and the Parliament may take politically motivated decisions to create new SOEs or grant additional functions to existing ones without taking into consideration the long-term consequences.

For example, the Ukrainian Financial Housing Company was established in 2019. In September 2021, the government (by relevant decision of the Parliament⁴) merged the troubled State Mortgage Institution into the new company and issued 20 bln UAH (71 mln USD) in bonds to buy shares in the additional issue of Ukrfinzhill.⁵ One of the stated aims was to provide 20,000 families with housing through mortgage and financial leasing mechanisms.⁶ The declared target groups were internally displaced persons (IDPs) and people receiving salaries from the state or local budget. While the first category may fall under the definition of 'market failure' (IDPs may belong to the risk group for bank or mortgage loans), the motives for providing housing specifically to civil servants are unclear in respect of the second category.

In November 2021, a bill was passed to allocate 500 mln UAH (18 mln USD) to fill the charter capital of the national airline. It is planned to be established in 2022, which has already been announced by the President and the Minister of infrastructure.

This incident was supposed to be prevented by a list of regulations, first and foremost by the relevant law. In March 2021, the Parliament passed a bill in the first reading on non-privatization of state property.⁷

³ Government Portal. Ministry of Economic Development develops ownership policy in the public sector of the economy. 10 October 2018. <https://www.kmu.gov.ua/news/minekonomrozvitku-rozrobilo-politiku-vlasnosti-u-derzhavnomu-sektori-ekonomiki>

⁴ Draft Law on Amendments to the Law of Ukraine "On the State Budget of Ukraine for 2021" on the implementation of financial and credit mechanisms for providing housing to citizens of Ukraine http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=71533

⁵ Ministry of Finance of Ukraine. The Government's decision will allow Ukrfinzhill to provide citizens with housing on the terms of mortgages and financial leasing. September 22, 2021.

https://www.mof.gov.ua/uk/news/rishennia_uriadu_dozvolit_ukrfinzhitlu_zabezpechiti_gromadian_zhitlom_na_umovakh_ipoteki_ta_fin_lizingu-3102

⁶ Ibid.

⁷ Draft Law No. 4020 On the List of State Ownership Entities Not Subject to Privatization https://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=69796

The list of facilities that it is advisable to keep in state ownership should include 659 enterprises. They are planned to be divided into separate categories. In particular, they include:

- enterprises ensuring energy independence and the state's defence capability;
- natural monopolies;
- enterprises whose activities are critical for society (in particular, cultural, sport, scientific, educational institutions, and forestry).

The draft law refers to Naftogaz Ukraine, Energoatom, state-owned enterprise Antonov, Ukrzaliznytsya, Ukrposhta, the National Circus of Ukraine, the National Sports Complex Olimpiyskyy, etc. The draft law allows privatization of a minority stake in strategic companies such as Naftogaz, Ukrzaliznytsya, Ukrposhta and four defence enterprises.

The adoption of the bill on the list of enterprises banned from privatisation is the worst manifestation of Ukrainian parliamentarism. That is because the result will be not a list of strategic enterprises but a list [drawn up under the influence of people] who had time to run to the committee and put enterprises on it that are in their constituencies and probably are not strategic at all. If this list were short and concise, it would be useful to the state.

Roksolana Pidlasa, Member of Parliament of Ukraine, Deputy Chairman of the Economic Development Committee of the Verkhovna Rada of Ukraine.

Discussions are underway to return certain enterprises from the privatisation list to government ownership.

Centrenergo. As an anti-crisis solution, the Cabinet of Ministers, pursuant to an order of the NSDC, renewed Ukraine's energy company and transferred state shares in Centrenergo and state-owned coal mines to it.⁸ Following the merger, the Cabinet of Ministers says it plans to privatise Centrenergo. Previously, the company was managed by the State Property Fund. However, without an investor with an established coal supply channel (such as the Krasnolymanska mine) the privatisation of Centrenergo would not make sense.⁹

Oblenergo. In early September, following the decision of the NSDC, the Cabinet of Ministers removed stakes in state-owned regional energy companies from the privatization list and transferred them from the State Property Fund to the Ministry of Energy, and universal service providers to Energoatom.¹⁰ The reasons for this move could be both an attempt to establish greater state control over strategic companies (although the remaining regional energy companies are owned by private companies) and an attempt to set lower prices for electricity (as universal service providers can sell electricity to other regions).¹¹

⁸ Ukraine's Energy and Coal Industry Ministry: Unification of Centrenergo and state-owned coal mines will create a closed cycle of electricity generation (kmu.gov.ua)

http://mpe.kmu.gov.ua/minugol/control/uk/publish/article?art_id=245599563&cat_id=35109

⁹ Courts, debts and fuel issue: why to privatize Centrenergo, Mind.ua

<https://mind.ua/openmind/20197387-sudi-borgi-ta-palivne-pitannya-navishcho-privatizuvati-centrenergo>

¹⁰ The government removed 5 regional electricity generating companies from the list for privatization, Ekonomichna Pravda <https://www.epravda.com.ua/news/2021/09/15/677852/>

¹¹ Big combinators: to reduce electricity tariffs Zelenskyy's office conceded privatization plan, Ekonomichna Pravda <https://www.epravda.com.ua/publications/2021/09/9/677624/>

Turboatom. Turboatom is one of Ukraine's most successful state-owned enterprises, producing turbines for power plants in the former Soviet republics and elsewhere. It was planned to be privatised 12 years ago. In 2020, the head of the SPF stated that privatization advisors were working at the enterprise. But this year, another important company (which was in dire financial straits), SE Electrotyazhmash, was merged with the company. The newly created company is now planned to be placed under the management of the Cabinet of Ministers. Consequently, the lack of a clear state policy towards such companies may lead to sudden changes in their management.

The Cabinet of Ministers' appointment of board members in the absence of capable supervisory boards could undermine the political independence of SOE management.

In the autumn of 2021, the government appointed interim board members for Naftogaz and Ukrzaliznytsia, before dismissing all members of the supervisory boards.¹² In both cases, the government, which acts as a general assembly, temporarily renewed the boards of both companies. By the end of 2021, the supervisory boards elected by the Nomination Committee must appoint permanent members of the companies' boards.¹³

The experts, however, say¹⁴ that there is a risk that the decisions of the government-appointed members of the Supervisory Board will be challenged in court: the Companies Act allows the General Assembly (the Cabinet of Ministers) to overrule the Supervisory Board only if it is not mandatory (the Supervisory Boards are legally mandatory in the aforementioned state-owned companies).¹⁵ At the same time, the fact that vacant positions are not filled does not mean that there are no vacancies.

It is important that the composition of supervisory boards, evaluation of their effectiveness, etc, is the responsibility of the government (or other body exercising the powers of the general assembly).

The risk of suspending privatisation processes and preparations for privatisation for an indefinite period. A ban on large privatisation auctions was adopted by the Parliament in March 2020 and remained in force until May 2021.¹⁶ At the same time, the State Property Fund was banned from making preparations for privatisation, or paying investment advisers, etc. Small privatization sites continued to be sold anyway. For example, the Dnipro Hotel was privatized precisely during the ban on large-scale privatization.

Political influence over state-owned enterprises may help politicians to achieve "quick" and socially popular results, but it is dangerous for the state-owned enterprises themselves and the markets in which they operate. The state acts simultaneously as owner, manager and regulator and, according to each role, has a different interest.

¹² Government appoints temporary members of Naftogaz board - Economy Ministry, *Economichna Pravda* <https://www.epravda.com.ua/news/2021/09/27/678207/>

¹³ Cabinet of Ministers of Ukraine. Decree No1155-r of 28 September 2021. Some Issues of the Board of the Joint Stock Company "National Joint Stock Company "Naftogaz of Ukraine" <https://www.kmu.gov.ua/npas/deyaki-pitannya-pravlinnya-akcionern-a1155r>

¹⁴ Oleksandr Lysenko "Naftogaz with supervisory board without powers", *Economichna Pravda* <https://www.epravda.com.ua/authors/614968ca2ce32/>

¹⁵ According to the law On management of state property of 21.09.2006 No 185-V (rada.gov.ua) <https://zakon.rada.gov.ua/laws/show/185-16#Text>

¹⁶ On Amendments to Section V "Final and Transitional Provisions" of the Law of Ukraine "On Privatization of State and Municipal Property" on Resumption of Auctions for Sale of Objects of Large Privatization. <https://zakon.rada.gov.ua/laws/show/1365-20#Text>

1.2. FISCAL RISKS: WILL SOES TURN INTO THE “BLACK HOLES” IN THE PUBLIC BUDGET?

The Ministry of Finance has compiled a list of 28 state-owned enterprises with the highest fiscal risks and published a report on the assessment of fiscal risks and their potential impact on the implementation of the state budget in 2022.¹⁷ Overall, the MoF considers both the potential impact of SOE fiscal risks (>0.5% of GDP) and the probability of such risks occurring (>66%) to be **high**. In this subsection, we describe the key risks and the state-owned companies that are affected:

- shortfall in tax and other income to the budget;
- failure to meet obligations on state-guaranteed borrowings;
- failure to meet obligations in foreign currencies;
- failure to approve financial plans in a timely manner;
- financial deterioration risk.

Budget revenue shortfalls. State-owned enterprises paid UAH 137 bln UAH (5 bln USD) in tax payments (24% of the total) to the budget in 2020, as well as 66.9 bln UAH (2.4 bln USD) in dividend payments and shares of net profit.

While the main contributor to the state budget in 2019-2020 was NJSC Naftogaz Ukraine, in 2021 it was Privatbank JSC that paid UAH 19.4 bln UAH (692.8 mln USD), or 67.5% of the planned rate in 2021.

In 2022, it is expected to receive 48.6 bln UAH (1.7 bln USD) in dividends, which is 68.8%, or UAH 19.8 bln UAH (707 mln USD) more than the forecast for 2021. Of these, according to the calculations by the Ministry of Finance, Naftogaz and Ukrnafta may underpay 13.6bln UAH (485.7 bln USD) to the budget: the first company - up to 10.7 bln UAH (382 mln USD), which is associated, in particular, with the execution of the law on the possibility of writing off part of the dividends against the debts of natural gas market participants¹⁸; the second - UAH 2.9 bln UAH (103.5 mln USD) due to the current appeal of debt on payment of dividends in the courts.

At the same time, the issue of the dividend allocation rate remains debatable. On the one hand, the state as the owner has the right to collect parts of the profit from enterprises; on the other hand, it reduces the resources of SOEs. The net profit could potentially be used by the enterprise to invest and reduce its debt burden and thus increase its sustainability.

Failure to receive dividends from state-owned enterprises is by definition a fiscal risk, but I do not believe it would be unequivocally bad. In my opinion, one of the most important novelties of the draft law on corporate governance in state-owned companies is a change in the approach to dividend policy. I believe we are blatantly harming our state-owned enterprises, especially those which we consider strategic, when we consider them a cash cow for the budget and try to take a fairly high share of profits from them as dividends. Therefore, this conflict between the interests of the state as an owner and as a policy maker should be eliminated. The Supervisory Board in this case is the mediator between these

¹⁷ Ministry of Finance of Ukraine. Information on fiscal risks and their impact on the state budget in 2022

<https://mof.gov.ua/uk/zvity>

¹⁸ Law of Ukraine "On Measures Aimed at Overcoming Crisis Events and Ensuring Financial Stability in the Natural Gas Market" (No. 1639-IX of 14.07.2021)

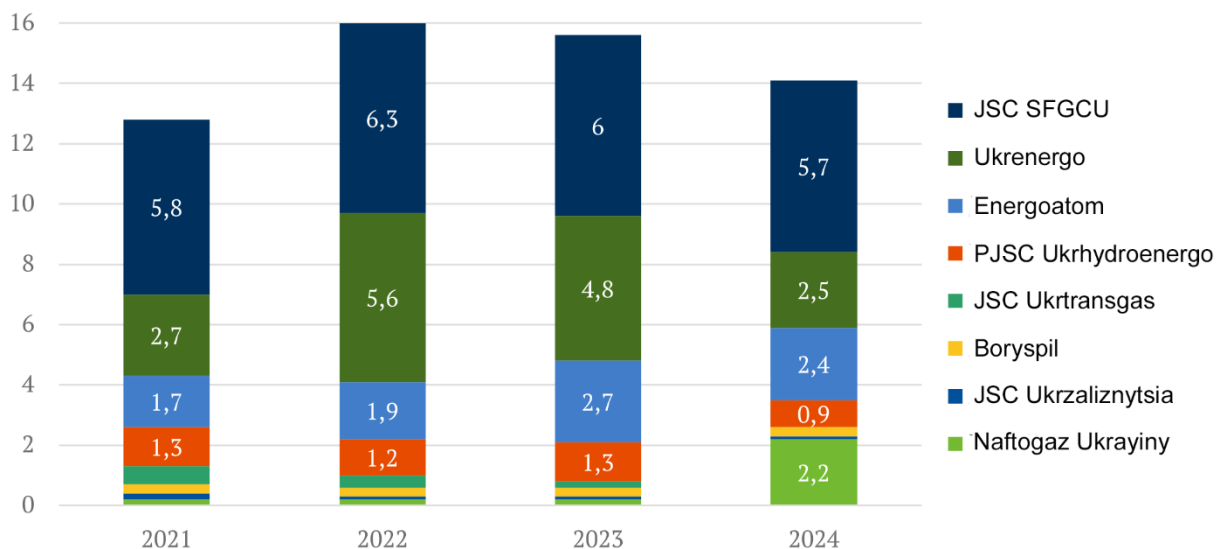
<https://zakon.rada.gov.ua/laws/show/1639-20#Text>

interests, allowing the Cabinet of Ministers to determine more objectively how much of the SOE's net profit can be allocated to the budget. This could be one of the tools to help companies be more resilient to crises.

Roksolana Pidlasa, Member of Parliament of Ukraine, Deputy Chairman of the Economic Development Committee of the Verkhovna Rada of Ukraine.

Failure to meet obligations on state-guaranteed loans. In 2021-2024, SOEs must repay loans received under government guarantees worth 58.9 bln UAH (2.1 bln USD). The largest repayments are due in 2022 (16.1 bln UAH, or 575 mln USD).

Figure 1. Planned repayments of state-guaranteed borrowings by SOEs, bln UAH

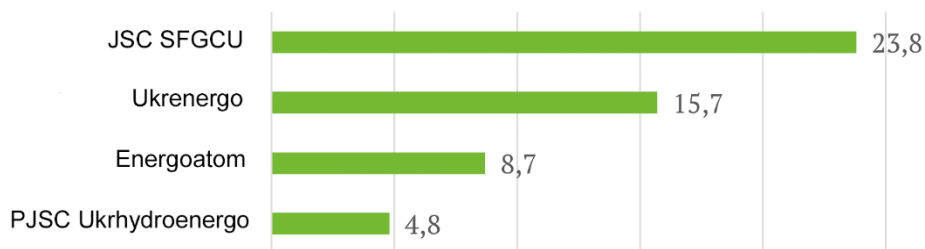


Note: The graph shows the SOEs that are included in the List of SOEs that may be subject to the highest fiscal risks
 Source: Ministry of Finance of Ukraine, "Information on fiscal risks and their impact on state budget indicators in 2022"

Significant amounts in 2021-2024 should be paid, in particular, by PJSC "SFGCU" (23.8 bln UAH, NPC "Ukrenergo" 15.7 blnUAH, SE "NAEC Energoatom" 8.7 bln UAH), PJSC "Ukrhydroenergo" – 4.8 blnUAH).

As for the obligations of PJSC "SFGCU", it has the highest probability of guarantee occurrence: 6.3 bln UAH in 2022, – 6.0 bln UAH in 2023, 5.7 bln UAH in 2024. SFGCU is now preparing a restructuring plan for the "Chinese" loan, but its prospects are weak On 21 January 2022, the next instalment is due in the amount of 96 mln USD.

Figure 2: SOEs that owe the largest guaranteed debts in 2021-2024, bln UAH



Note: The graph shows the SOEs that are included in the List of SOEs that may be subject to the highest fiscal risks

Source: Ministry of Finance of Ukraine

Foreign currency liabilities. Another risk is that borrowings in foreign currencies prevail in the companies' loan portfolios. At the beginning of 2021, five enterprises had 100% of their liabilities in foreign currencies: PJSC “SFGCU”, NPC “Ukrenergo”, SE “Zorya-Mashproekt”, SE “Pivdennyi Machine-Building Plant” and SE “Boryspil” in other state-owned companies, the share ranges from 71.8% to 92.8%.

Figure 3. State-owned enterprises' foreign currency liabilities (%) as of January 1, 2021



Note: The UAH equivalent is calculated based on the agreement's date of enactment

Source: Ministry of Finance of Ukraine

The state fails to approve financial plans on time. Governing bodies and the Cabinet of Ministers of Ukraine must approve financial plans for the next year by September 1 (except for electricity companies, for which the deadline for approval is December 31). However, out of the 35 financial plans for 2022 that must be approved by the Cabinet of Ministers of Ukraine, none had been approved as of September 1, 2021.

Among the financial plans for 2021, the Cabinet of Ministers approved 20 plans already during 2021 (including financial plans of energy companies, seaports, and Naftogaz), and another 3 (including Ukrainian Sea Ports Authority) were approved in 2020, but after September 1.

The Ministry of Finance also points to the risk of deterioration of the financial condition of the largest state-owned enterprises in the next 3 years if the pessimistic scenario is materialised.

Most enterprises do not have their financial plans in place as of 1 January. It is almost impossible to imagine such a situation in private sector enterprises. [...] This leads us to the conclusion that in the vast majority of cases, the state is not the most effective owner of enterprises.

Denys Kudin, Ukraine's first Deputy Minister of Economy

The risk of the financial deterioration in energy companies due to the performance of special duties without receiving compensation for the performance of these duties. Three state-owned enterprises have been entrusted by the government with special duties in the electricity sector.¹⁹ Two producers, SE NAEC “Energoatom” and PJSC “Ukrhydroenergo” (sale of electricity to a guaranteed buyer in certain volumes and at a fixed price), and the transmission system operator NPC “Ukrenergo” are to perform the special duties.

In 2020, **NJSC Naftogaz Ukraine** received 32.2 bln UAH (1.2 bln USD) in compensation from the budget for its special duties on the natural gas market in accordance with the Law of Ukraine on the Natural Gas Market. The company, which was the largest source of dividend revenues to the budget in 2019-2020, is at risk of becoming unprofitable in 2021-2024, which will lead to a reduction in taxes and payments to the state budget.

NEC Ukrenergo and NAEC Energoatom. The companies have special responsibilities to ensure the public interest. The government did not envisage compensation for the costs incurred, which forced the companies to accumulate debts and run a working capital deficit over the last two years. Therefore, the Ministry of Finance expects both companies to be loss-making in 2021-2024 under the pessimistic scenario. This will reduce the budget revenues., accordingly. But while Ukrenergo is threatened by a shortage of working capital and the inability to pay on state-guaranteed loans, Energoatom should avoid such a fate.

There is a risk that the financial condition of infrastructure operators will deteriorate because of quarantine restrictions and tariff regulation. The state owns the largest transportation companies: PJSC Ukrzaliznytsia, Boryspil and Lviv airports, SE UkSATSE, etc. Transport and infrastructure are sensitive to crises and dependent on other sectors. Low solvency and reduced demand from key customers may lead to a shortfall in income and a lack of necessary resources for working capital and investment.

In 2020, Ukrzaliznytsia's losses could have been much bigger. This is [the largest] shock the company has experienced since the Donbas conflict (where [more than 50% of all traffic was formed] was cut off), Crimea. “Deutsche Bahn” received billions in subsidies from the government.

The conclusion to be drawn for the future is to separate the social from the market. If it is a public service obligation (PSO), then the state has to pay for it, where it is a market mechanisms, you introduce market regulation (tariff regulation as an example).

Ivan Yurik, Board Member, Acting Chairman of the Ukrzaliznytsia Board, Chief Financial Officer (CFO) (2019-2020).

¹⁹ Law of Ukraine on the Electricity Market
<https://zakon.rada.gov.ua/laws/show/2019-19#Text>.

For Ukrzaliznytsia, which is one of the largest state-owned enterprises and the largest carrier (83% of freight turnover²⁰ and 26% of passengers²¹), the negative impact of the crisis will be amplified by "traditional" constraints: state tariff regulation, cross-subsidies, and infrastructure depreciation.

In 2018-2020, Ukrzaliznytsia had a significant debt ratio (at 21-23%). This means it is dependent on loan capital. At the same time, in 2021-2023 under both the baseline and pessimistic scenarios it will increase. Meanwhile, Ukrzaliznytsia's current liquidity is expected to improve in 2021-2023 due to borrowing. Thus, under both scenarios, Ukrzaliznytsia is expected to operate at a loss in 2021-2024.

2. HOW TO MITIGATE RISKS FOR STATE-OWNED ENTERPRISES?

In this section, we will describe what we know about existing and potential government steps to prevent risks and minimise their impact. As proactive steps, it is important to develop policies for the management of state-owned enterprises. It is also necessary to improve regulation so that the state takes responsibility for its own social obligations.

2.1. IMPLEMENTATION OF THE MEMORANDUM WITH THE IMF AS A FIRST STEP TOWARDS HIGHER SUSTAINABILITY

In November 2021, the IMF and the Ministry of Finance released a Memorandum on the completion of the first review of the Stand-by Arrangement for Ukraine²². It contains the main arrangements that Ukraine plans to implement for the corporate governance of state-owned enterprises:

Corporatise Energoatom (by the end of the year) and require financial reporting in accordance with the international standards by May 2022. At the end of August 2021, the President enacted a decision of the NSDC "On measures to neutralise threats in the energy sector". In particular, according to it, the Cabinet of Ministers should prepare a bill that would include the corporatisation of Energoatom within a month.²³

Launch supervisory boards at three state-owned energy monopolies - Ukrenergo (until the end of 2021), Naftogaz (until the end of January 2022) and Energoatom (until the end of May 2022). The selection of four independent members of Ukrenergo's supervisory board was announced in August, and the terms of office of the current members expire in October. The Ministry of Economy announced the selection of four members

²⁰ Excluding pipeline transport.

²¹ Excluding urban transport.

²² Memorandum on Economic and Financial Policy 8 November 2021

https://mof.gov.ua/storage/files/%D0%A3%D0%9A%D0%A0_24_11_21.pdf

²³ Decree of the President of Ukraine No. 452/2021 On the Decision of the National Security and Defence Council of Ukraine of 30 July 2021 "On Measures to Neutralise Threats in the Energy Sector"

<https://www.president.gov.ua/documents/4522021-40021>

of the Naftogaz supervisory board by a nominating committee²⁴ (the previous supervisory board was appointed in direct consultation with international partners).

Adopt legislation on the corporate governance of state-owned enterprises. This should bring Ukrainian practices closer to the OECD guidelines for the corporate governance of state-owned enterprises. In particular, it should strengthen the accountability and authority of supervisory boards to appoint and dismiss the chairman of the board. Draft law No. 5593-d was adopted in its first reading on 15 July 2021.²⁵ However, experts note that it needs to be improved.²⁶

An IPO for large state-owned companies, while strengthening the protection of minority shareholders' rights, could be an element of management control and a deterrent against many of the 'creative' decisions that come from the general assembly (namely the Cabinet or general executive bodies.

Roksolana Pidlasa, Member of Parliament of Ukraine, Deputy Chairman of the Economic Development Committee of the Verkhovna Rada of Ukraine.

Adopt a state-wide ownership policy in the public sector and reduce the state-owned enterprise sector. The basic principles of the ownership policy were published back in 2018. According to them, separate individual ownership policies for state-owned enterprises were adopted. However, it did not affect the retention and privatisation strategy for SOEs.

It is important for the state to create a framework in which SOEs can operate in a more stable and predictable manner, with minimal influence from politicians and in line with the OECD Guidelines on the Governance of State-Owned Enterprises. The government and the Parliament have already initiated action in this direction. In particular, a number of bills have passed their first reading:

- A bill on corporate governance in the public sector of the economy²⁷;
- A package of bills on State Property Fund reform and privatisation²⁸;
- A bill on enterprises that must remain state-owned²⁹.

²⁴ Announcement on the selection for the position of an independent member of the Supervisory Board of the Joint Stock Company Naftogaz Ukraine, Ministry of Economy of Ukraine, 23.10.2021
<https://www.me.gov.ua/Documents/Detail?lang=uk-UA&id=6808dcd3-c274-479c-bbff-045fc836f774&title=OgoloshenniaProProvedenniaVidboruNaPosaduNezalezhnogoChlenaNagliadovoiRadiAktcionernogoTovaristvanatsionalnaAktionernaKompaniiinaftogazUkraini>

²⁵ Draft Law on Amendments to Certain Legislative Acts of Ukraine to Improve Corporate Governance of Legal Entities Whose Shareholder (Founder, Participant) is the State
http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=72440

²⁶ Ukrainian SOE Weekly (Issue 36, 10–16 July 2021)
<https://mailchi.mp/cfc/ukrainian-soe-weekly-issue-36?e=407cd4f6a2>

²⁷ Draft Law on Amendments to Certain Legislative Acts of Ukraine to Improve Corporate Governance of Legal Entities Whose Shareholder (Founder, Participant) is the State
http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=72440

²⁸ Draft Law on Amendments to the Law of Ukraine "On the State Property Fund of Ukraine" and other legislative acts of Ukraine to facilitate the attraction of investments in the process of privatization and lease of state and municipal property
http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_2?id=&pf3516=4572&skl=10

²⁹ Draft Law on the List of State Ownership Objects Not Subject to Privatisation
https://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=69796

The adoption of these bills in a version as close as possible to the OECD Guidelines should contribute to greater sustainability of the state-owned enterprise sector as a whole and of individual SOEs.

2.2. HOW TO REDUCE THE CRISIS IMPACT ON PUBLIC INFRASTRUCTURE ENTERPRISES?

The following actions were taken by the government and companies to mitigate the impact of crises on infrastructure monopolies in crisis conditions:

Alignment of rail freight tariffs. Ukrzaliznytsia runs certain cargo groups at a loss. From the beginning of next year, the Ministry of Infrastructure will raise tariffs for cargo of the 1st tariff class by 9%. This will reduce the difference between the cost of transporting freight, a step towards improving the tariff policy on rail transport, and potentially bring Ukrzaliznytsia an additional 2.3 blnUAH (82.1 bln USD) in revenues and 117 mln UAH (4.2 mln USD) in tax revenues in 2022.³⁰

Ukrzaliznytsia's purchase of electricity under direct contracts. In the summer of 2021, the Cabinet of Ministers allowed state-owned generation companies to sell electricity to Ukrzaliznytsia under bilateral contracts at special electronic auction sessions with a supply period of up to 36 months. On 30 September 2021, Ukrzaliznytsia started buying electricity directly from another state-owned enterprise, Energoatom. Ukrzaliznytsia is Ukraine's largest electricity consumer: the company uses up to 6 mln MWh annually and spends up to UAH 7.5 bln (267.9 mln USD) on its purchases.

On the one hand, Ukrzaliznytsia received savings (reported to be about 4 bln UAH, or 142 mln USD). On the other hand, Energoatom as a state-owned generating company, which already has special responsibilities, received another obligation to sell electricity at non-market prices, which may contradict the implementation of the electricity market and the implementation of state aid rules.

Liberalisation of the freight market. On 4 December 2021, according to a Cabinet of Ministers decree, the pilot project to attract private traction on selected routes will expire. However, during the two years of operation, the experiment has not been brought to the stage of implementation and the process has been closed off from the public. By allowing private carriers with their own locomotives on the routes, Ukrzaliznytsia was able to focus on infrastructure investment. This would also help to better serve the needs of the economy during peak times (in particular, grain and coal transportation).

Social responsibility and public funding for infrastructure. Despite the economic crisis, Ukrzaliznytsia has received budget funding for the first time in a while: around 3 bln UAH (107 mln USD) for passenger rolling stock renewal and around 1 bln UAH (35.7 mln USD) for infrastructure renewal in 2021. Similar funding (3.8 bln UAH, or 135.7 mln USD) is expected in 2022. At the same time, the railway's investment plans are chronically fulfilled by less than 50%.

Ukrzaliznytsia provides a social service for passenger transportation. In other countries it is usually unprofitable. But let's see what else Ukrzaliznytsia has under its control. Medical institutions, a great number of non-core assets. When we had discussions in terms of support for Ukrzaliznytsia, I asked:

³⁰ Ministry of Infrastructure of Ukraine. From 2022 the tariffs for 1st class railway freight transportation will increase by 9%. 10 November 2021.

<https://mtu.gov.ua/news/33219.html>

where is the cost price of your service for a passenger? Why this service and why should the state subsidize it?

If the state accepts that the economically justified cost of the service is higher than the citizen can afford, then there is such a factor as Public Service Obligation (PSO). [...] The state has the ability to legally cover the cost of this service to the citizen.

Vasyl Shkurakov, First Deputy Minister of Infrastructure of Ukraine:

UkSATSE: Integration of Ukraine into the Eurocontrol Joint Route Charging System. Ukraine's accession to the system, which took place in November 2021, means that the European Air Navigation Safety Organisation will collect the air navigation levy on behalf of Ukraine.⁵¹ This should mitigate the risk of further accumulation of debts from air carriers.

Loans from international financial institutions to replenish working capital. For example, the EBRD extended a loan to UkSATSE as part of the EBRD Solidarity Package, the main purpose of which was to ensure uninterrupted operation of critical infrastructure. The loan agreement of 25 mln EUR for three years was signed in July 2020.⁵²

Deferral of dividend payments by state-owned enterprises. In times of crises, the government may relax requirements for payment of dividends and a portion of net profits for previous periods. For example, in 2020, the government allowed Ukrzaliznytsya to pay dividends based on its financial and economic results for 2018-2019 six months later.⁵³

3. CONCLUSIONS AND RECOMMENDATIONS

Ukraine's public sector remains large, poorly managed and overburdened with non-essential functions. The state is reforming corporate governance in the top 15 state-owned enterprises, which have the greatest influence on the economy, operate in the energy, transport and defence sectors and own 81% of the assets of all SOEs.

State-owned enterprises remain vulnerable to political influence over their activities. It can take the form of politicians' willingness to transfer the state's social obligations to SOEs without adequate compensation, and interference in business operations, particularly in procurement. This risk is exacerbated by the fragility of corporate governance reform and the lack of a clear ownership policy.

State-owned enterprises have a high potential fiscal impact and, according to the Ministry of Finance, the probability of occurrence is high. The state risks missing out on tax and dividend revenues from SOEs. State-owned companies risk to have insufficient financial resources to repay state-guaranteed debts on time, and

⁵¹ Government Portal. Ukraine's technical integration into the Eurocontrol Common Route Charging System received the necessary regulatory backing, 18 May 2021.

<https://www.kmu.gov.ua/news/tehnichna-integraciya-ukraini-do-spilnoi-sistemi-marshrutnih-zboriv-vevrokontrolyu-otrimala-neobhidne-normativne-zakriplennya>

⁵² Government Portal. UkSATSE attracts long-term EBRD loan to maintain liquidity, Vladyslav Krykliy, 10 July 2020.

<https://www.kmu.gov.ua/news/ukraeroruh1-zaluchaye-dovgostrokovij-kredit-yebrr-dlya-pidtrimki-likvidnosti-vladislav-kriklij>

⁵³ Government Portal. Ministry of Infrastructure initiated deferral of dividend payment to Ukrzaliznytsia, 4 June 2020.

<https://www.kmu.gov.ua/news/mininfrastrukturi-iniciyovalo-nadannya-ukrzaliznici-vidstrochki-z-viplati-dividendiv>

the financial position of state-owned transport and energy providers could deteriorate due to mobility constraints and quasi-fiscal activities.

In a memorandum with the International Monetary Fund, Ukraine reaffirmed its commitment to continue reforming the state-owned enterprise sector in line with the OECD Guidelines on Corporate Governance of State-Owned Enterprises, which should make them more resilient to future crises.

In addition to the steps described in the previous sections, the state should implement policies for state-owned enterprises to make them more crisis-resilient in the following ways:

- Keep only strategically important SOEs under state ownership and get rid of non-performing and unnecessary ones.
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Enterprise sorting (triage) should be the basis of a state ownership policy, which the state should formulate and publish for the companies that remain state-owned. Other enterprises should be privatised or liquidated.

Nadiya Kobyljak, Senior Project Manager of the Reform Support Team of the Ministry of Econom.

- Strengthen the enterprises that remain state-owned so that they become more capable and that they receive more attention from the government and the professional community.
 - Separate the function of the state as owner, regulator and policymaker, thus balancing the influence on SOEs and minimising potential conflicts of interest. The function of the owner should not be performed by the body which implements the policy in the sphere of the enterprise's activity.
 - Make capable supervisory boards at strategically important enterprises according to the signed memorandum with the IMF.
 - Strengthen supervisory boards and give them exceptional powers in line with OECD best practice. Supervisory boards should serve as a buffer between enterprises and the general assembly (government or ministries). At the same time, it is important that the supervisory boards are professional, balanced and collectively appropriate in accordance with public ownership policy.
 - Optimise the expenditure of budget funds on state-owned enterprises, and do not consider the deduction of a portion of the net profit of state-owned enterprises only as a source of filling the budget.
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What the Parliament can do is to be more conservative in planning income from state-owned enterprises and spending on state-owned enterprises. One striking example currently on the Parliament's radar is the initiative to write off debts, including those guaranteed by the state, for the Kharkiv aviation plant. Although I believe this issue can be discussed in the context of that plant, it is a dangerous precedent. The fact that the Parliament can write off debts for a single state-owned enterprise by an individual act relaxes the management, which understands that the state can save the plant if anything happens.

Roksolana Pidlasa, Member of Parliament of Ukraine, Deputy Chairman of the Economic Development Committee of the Verkhovna Rada of Ukraine.

- Determine the economically justified cost for public service obligation (PSO) services and cover their cost from the budget. This applies primarily to energy and transport.
- The Parliament should not "bail out" individual enterprises by writing off their debts, because this would set a dangerous precedent for the management of other enterprises.
- Enact legislation to ensure liberalization of services in those sectors where it is possible (particularly freight railways) and independent regulation in the natural monopoly sectors