

ICPS newsletter

Incentive-creating regulations are a prerequisite for the successful privatisation of Ukrtelekom

The privatisation of the Ukrtelekom open joint-stock company can either be a great benefit to Ukrainian citizens or lead to disaster. To avoid negative consequences, the government of Ukraine should work out a privatisation strategy before selling the shares of the company to a strategic investor. The governmental policy should focus on establishing regulation procedures that will create incentives for managers of the company and its competitors, and that will also comply with public interests. ICPS and Ukrtelekom organised a roundtable devoted to questions of the company's privatisation, entitled "Privatisation of Ukrtelekom: Opportunities and Obstacles"

The goal of the privatisation

According to Stanislav Dovhy, head of the State Committee for Communications and Information of Ukraine, the main goal of the privatisation of the Ukrtelekom is to broaden the list of company services and improve their quality. To reach this goal, the government needs to obtain investments by selling a part of the company's shares to a strategic investor.

"One very obvious point which is unfortunately often forgotten in many countries undertaking privatisation is to answer the simple question of why are they doing it", said Graham Scott, director

of the Law and Economics Consulting Group (New Zealand), who was invited to Ukraine by the State Communications Committee. "Some countries launch privatisation without a clear objective. Later, when the time comes to make strategic decisions, they have no clear criteria for making those decisions". According to Mr. Scott, the goal of the privatisation of a telecommunications company should be to provide its customers with better and cheaper services, and to maximise the price of company assets.

"Generally, this goal can be achieved only if the company is wholly owned by private

shareholders. Sometimes, governments stick to their ownership rights too long, but also sometimes they implement privatisation too fast. In both cases, companies cannot achieve their main goal". Mr. Scott also pointed out that according to economic theory, the goal of privatisation is to improve the efficiency of the use of resources in the company concerned. The implementation of this goal depends on whether the incentives of the new private owners differ from the incentives of the previous owners, and whether they coincide with the interests of society. The incentives themselves are formed by the situation in the market and by public policy. According to Mr. Scott, these two factors determine whether society will benefit or suffer from the privatisation.

Privatisation objectives

Mr. Dovhy said that the key objective of the Ukrtelekom privatisation is to establish effective regulation of the telecoms market, taking into account the interests of all market players and creating favourable conditions for a strategic investor. Other important objectives are to find a strategic investor, to make the company attractive for investments, and to work out a strategy of state support to the company during the privatisation process.

Steve Johnson, director of a company called Millennium Financial Services and the Ukrainian government's advisor on the privatisation of Ukrtelekom, formulated the following objectives for the privatisation: (1) find an optimal strategic investor, who will promote the development of the telecoms sector in Ukraine; (2) maximise budget revenues; and (3) create an international image of Ukraine as a country that has successfully implemented privatisation. According to Mr. Johnson, in order to fulfil these objectives it is necessary to clearly define the conditions

Who is Graham Scott

Graham Scott, director of the Law and Economics Consulting Group (New Zealand) and an advisor to ICPS, is one of the most prominent international experts on public regulation and privatisation. In 1986–93, he headed the Treasury in New Zealand. He was responsible for the privatisation of state monopolies, and for selling the national communication operator—Telecom New Zealand—to a strategic investor. In 1993–99, he was the head of the Electricity Market Company (EMCO). During this period, he managed to create a unique wholesale market for electricity that is not under the control of a governmental regulator.

*Mr. Scott is a well-known expert on public administration reforms; he is regularly invited by the World Bank and the IMF to consult the governments of countries with transition economy. In 1996, the IMF published a book by Scott entitled *Government Reform in New Zealand*. He was also one of the co-authors of the World Bank's publication *World Development Report 1997: The State in a Changing World*.*

Mr. Scott has a great international experience. He has consulted the governments of the USA, Canada, Great Britain, Russia, China, Australia, Macedonia, Latvia, Bangladesh, Singapore, Hong Kong, Mongolia, Thailand, Malaysia, and Indonesia. Mr. Scott worked as an advisor in Ukraine under the framework of the Project to Support Economic and Fiscal Reforms, funded by USAID.

for selling the company with respect to all the participants of the tender, and to improve (under the framework of existing laws) the legal environment in the telecoms market. Mr. Johnson also said that (1) the Government should not begin the tender before adequate external and internal conditions have been created; (2) the largest possible share package should be offered to the strategic investor; and (3) it is necessary to consider the possibility of passing the government's share package to the management of the investor. Mr. Johnson stated that it is important to issue a license to Ukrtelekom to develop G3 mobile communications, and to eliminate all barriers for its operations in different markets.

Yevhen Hryhorenko, first deputy director of the Central Department of Economic Policy in the Presidential Administration, presented the privatisation objectives as a series of questions. "Does the country have a development strategy for telecoms? Does it have a basic law in this regard? Have the normative underpinnings, based on the strategy, been worked out? Who plays the role of independent arbiter, given that the state is not in a position to judge, but a market player?" Mr. Hryhorenko answered these questions himself: "There is no strategy, and we don't know when it will be ready. This parliament won't adopt the basic law, and the new Parliament will not be able to do before next summer. Experience

This week's event

New workshops for government officials.

New workshops will be held on 11–12 December under the framework of two ICPS projects—"Network for Policy Development in the Government of Ukraine" and "Institutional Capacity to Develop Economic Programs", funded by the Canadian International Development Agency (CIDA). Government officials participating in the projects' working groups will receive training and take part in two workshops—"Establishing communications in the policymaking process" and "State policy: objectives, principles, and capacity".

The two workshops will be conducted by Paul Brown, a professor of public administration at Dalhousie University (Canada) and a consultant to ICPS. Mr. Brown has extensive experience working with the Government of Ukraine with regard to the organisation of projects on policy analysis.

For more information, and to obtain the materials of Mr. Brown's presentation, please contact Andrii Bega at tel.: (380-44) 463-5967, e-mail: abega@icps.kiev.ua.

Data on Ukrtelekom

The Ukrtelekom Open Joint-Stock Company is the biggest telecommunications operator in Ukraine. It services 8.5 million fixed-line customers. The company provides more services than any other operator in Ukraine. Ukrtelekom is a shareholder in other companies that successfully compete in the telecoms market (for example, Utel, UMC, Infokom, and others).

Since 1991, the company has opened 862,000 new telephone lines, 270,000 of them this year already.

The revenues of the company for the first three quarters of this year were 2.9 billion hryvnias (net profits of 359 million UAH). Its tax payments to the state budget comprised 795.5 million hryvnias.

Ukrtelekom privatisation

The privatisation of the Ukrtelekom was started after the adoption of Law "On particularities of the privatisation of the Ukrtelekom OJSC" dated 13 July 2000.

The term for preferential subscription for company's shares that is being conducted now has been extended to 1 December 2002. Svitlana Ledomska, deputy chairman of the State Property Fund of Ukraine, said that by the beginning of December 97.6% of the privileged shares allocated for company employees, 34.7% for former employees, and 1.7% for company managers had already been sold.

The next stage of privatisation will involve the selling of company's shares to a strategic investor. The timeframe for the tender has not been established yet.

shows that it takes at least one and a half or two years to develop an independent regulatory institution". He concluded, "Privatisation is mandatory and inevitable. We must be ready to implement it. So it's high time we make the decisions that need to be made".

Rational regulation is a prerequisite for the privatisation

Before the tender is started, investors should be informed about the principles of regulation of the sector. "When investors see uncertainty, this diminishes the price they are ready to pay for a company", said Mr. Scott. Among the most important issues for policy in this sector are fair rules of competition, regulation of interconnection between operators, and the policy of overall communications network development at the national level.

According to Mr. Scott, it is impossible to establish perfect regulation at once in Ukraine. Moreover the regulation of interconnection contracts is a very complex task that requires great expense and deep technical knowledge. Mr. Scott said, "A pragmatic solution is necessary—transitional provisions that will protect the value of this company".

His point of view is that "Ukrtelekom is not yet ready for competition in all markets".

Mr. Dovhy shares the same approach. According to him, the transitional period should take about five years. "By the end of this period, open competition should be created, since it is the only way to improve the quality of services," said Mr. Dovhy. "The premature liberalisation of the Ukrainian market has led to regulatory deformations and losses of state revenues. We must stop the uncontrolled usage of public resources, since the owner of Ukrtelekom is the Ukrainian public". Reforms in this sector must be focused on fair conditions for operator interconnections.

The government's advisor is preparing a draft statement of the government on policy in the telecoms sector. Helen Kryshalovych, a partner of the Kyiv office of the Squire, Sanders & Dempsey law firm and a member of the advisor's consortium, said that a draft has been already prepared for discussion. Answering the question put by Mr. Hryhorenko, Ms. Kryshalovych asserted that they will indeed be ready for the privatisation. ■

For more information on ICPS activity in the telecoms sector, please contact Hlib Vyshlinsky, tel.: (380-44) 463-6337, e-mail: hlib@icps.kiev.ua.

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