

ICPS newsletter[®]

Privatizing the Odesa Port Plant: How to make it happen

One of the key government decisions in October was to suspend privatization of VAT Odesa Port Plant. The Odesa Port Plant (OPZ) has become a hostage to political circumstances because there are powerful interest groups in this sector and each of them has its own vision of the plant's future. On this issue, Ukraine, for the umpteenth time, has proved incapable of agreeing various interests to develop the optimal policy. ICPS has taken a look at various policy options regarding this enterprise

The Odesa Port Plant is one of the biggest ammonia and urea producers in Ukraine. Standing at the end of an ammonia pipeline that goes all the way to Togliatti, a car-making center in Russia on the Volga, this plant is unique. The plant has its own port infrastructure that is used to further ship ammonia and nitrogen fertilizers produced by Ukrainian and Russian companies.

The Odesa Port Plant is also one of the most state-of-the-art chemical enterprises producing nitrogen and nitrogen derivatives in the CIS. Its technology is also relatively efficient in terms of gas consumption, making its positions potentially stronger than those of other Ukrainian enterprises in view of an expected increase in the price for imported natural gas.

Empty discussions yield zero results

The Odesa Port Plant was supposed to be sold for the fourth time this month. Its privatization history began back in September 1993, when the State Property Fund adopted a decree on the privatization of this enterprise.

However, each attempt to sell off this enterprise came to nothing. There have been active disputes and debates around this privatization, top officials of the Cabinet of Ministers and the State Property Fund have been shuffled, yet the process has not gone anywhere. Sometimes, the positions of various participants in this process have even changed 180°.

In addition, arguments in favor of one or another decision regarding the fate of the company always had a lot of holes. Supporters of status quo spoke about the strategic nature of OPZ, while supporters of privatization spoke about Budget revenues from the privatization sale. Yet, there was no objective assessment of what government policy regarding Odesa Port Plant, and the domestic nitrogen sector as a whole, should be.

Meanwhile, other enterprises in this sector were sold into private ownership. Still, nobody answered the question, how Ukraine saw the future of the Odesa Port Plant. The enterprise was developing independently, with practically no state support.

New challenges

Today, the situation is changing. The production of nitrogen fertilizers depends critically on gas, so its competitiveness depends on the price for this form of energy. Clearly, the price for Ukraine's imported gas is about to grow further. ICPS economists say that, by 2012, the price for imported gas will reach European levels, except for the difference in transportation costs.

In addition, there will be a surplus of ammonia and urea stocks worldwide over the next few years, which will put downward pressure on prices. As a result, Ukrainian enterprises will be faced with shrinking profits. It is quite possible that, for Ukrainian enterprises, producing ammonia will become a losing proposition.

For the Odesa Port Plant, the solution is modernization. For example,

By the way...

On 15 October, ICPS specialist Natalia Shapovalova participated in a roundtable called "European and Euro-Atlantic Integration: The Way to Democracy" organized by the Institute for Euro-Atlantic Cooperation jointly with the Bulgarian Policy School.

As part of the "Policy Campaign to Promote Gender Equality in Ukraine" project, ICPS and the Center for Ukrainian Reform Education (CURE) organized a roundtable called "What kind of law does Ukraine need to fight gender discrimination?" on 15 October.

Over 11–13 October, ICPS Director Volodymyr Nikitin and ICPS experts Olha Shumylo and Ildar Gazizullin held a workshop in Yerevan, Armenia, for participants in the "LGI Policy Fellowship for Russian-Speaking Experts" program.

Over 26–29 September, ICPS expert Ivan Presniakov visited Romania to participate in a trilateral forum called "East-East: Partnership Beyond Borders" organized by the Soros Foundation Romania and the Institute for Public Policy in Bucharest. At this forum, representatives of the third sector from Ukraine, Moldova and Romania discussed the state of trilateral cooperation in the region and its prospects, as well as ways to stimulate it through joint efforts and projects by community organizations in the region.

geographically close European markets are interested, not so much in urea, as in ammonium nitrates, including calcium ammonium nitrate (CAN), and complex fertilizers (NPKs). Moreover, there is growing demand worldwide for granulated urea, which is easier to apply.

These products could help improve the bottom line.

OPZ could also invest in further increasing the energy efficiency of its production. Cutting gas costs per product unit would reduce costs and make products manufactured by the Odesa Port Plant more competitive on the global market.

Who should finance OPZ's development?

To finance such a large undertaking, the enterprise needs major capital. At the moment, it will be practically impossible to find it. Firstly, changes in the world market will mean shrinking profits. Secondly, the state has not been allocating Budget funds to develop the Ukraine's nitrogen industry.

This means the only way out for OPZ is to attract an investor who will support the development of the Plant. Given the current political competition, the government has been ignoring this need. Nor do Ukraine's other manufacturers of nitrogen fertilizers support the idea of developing the Odesa Port Plant's production capacities. While they are interested in using its port infrastructure, as a manufacturer, the Plant is a major competitor for them. Thus, OPZ has been left on its own with its problems.

Monopoly: Criticized, but not dealt with

The main argument of those who are against privatizing the Odesa Port Plant is that the new owner will have monopoly status in the shipment of ammonia and nitrogen fertilizers. They argue that the new owner will be able to raise docking and loading fees for other enterprises without justification.

However, the Plant was, is and will likely remain a monopolist for the foreseeable future. The country could have begun to resolve the issue of monopoly many years ago. After all, there is no fundamental difference between a state monopoly and a private monopoly, in terms of abuse of monopolist position.

Current proposals regarding the regulation of OPZ's activity call for these functions to be handled by the Ministry of Industrial Policy. However,

this institution cannot be a regulator, as it does not meet the key criteria of independence and impartiality in regulating. Firstly, MIP is part of the executive branch of government, while any regulator should be an independent institution. Secondly, UkrKhimTransAmiak, a Ukrainian state-owned company and one of the key parties interested in transportation, is directly subordinated to the Ministry. This would clearly present a conflict of interests between regulatory and management functions.

Thus, the plant has become hostage to a problem that nobody has dared to resolve. Certainly, the Odesa Port Plant itself cannot resolve the issue of regulating its activity instead of the state. However, precious time, when global prices are still high and natural gas is not so expensive, is slipping away.

What should be done?

ICPS analysts say that this problem needs to be urgently tackled. By making OPZ hostage to political confrontations, the government is likely to take the Plant from gradual modernization to deterioration. Moreover, the inability of the state to carry through this oft-initiated privatization process undermines the authority of Ukraine's government, giving rise to accusations of inconsistency and ineffectiveness.

First of all, Ukraine must clearly formulate a policy regarding the Odesa Port Plant. Do we privatize it or do we leave it in state hands? If the country chooses the second option, what will be the policy regarding its development? That is, if this is the decision, those investor's obligations written into the agreement for the sale of OPZ need to be transferred to the state.

Another important issue is the integrity of the company: Does the country need to separate its port infrastructure? Current analysis shows that the process of separation will be long, more than two years, and will cost considerable money. ICPS analysts say it makes sense to commission a feasibility study from an internationally-recognized consultancy as soon as possible in order to have an updated picture of the situation.

In any case, the break-up of the company will not resolve the problem of monopoly, nor can it resolve this problem in

principle. The port infrastructure will still be a natural monopoly. ICPS analysts say the only acceptable way to resolve this problem is to ensure a regulatory framework that will make it impossible to abuse this monopolist position, no matter who owns the enterprise.

According to ICPS analysts, a sectoral self-regulating body should be set up, consisting of:

- producers of nitrogen fertilizers—six enterprises, including the Odesa Port Plant;
- UkrKhimTransAmiak, the Ukrainian state-owned company;
- consumers (growers' associations);
- the Cabinet of Ministers;
- the relevant Verkhovna Rada committee.

This body could distribute quotas for trans-shipment and approve fees. As it would include all stakeholders among whom potential conflicts might arise, its operation would ensure unbiased regulation while considering the interests of all stakeholders.

If Ukraine tries to resolve these problems in an active and constructive manner, this will make it possible:

- to maximize Budget revenues from privatization;
- to support the development of the Odesa Port Plant and its competitiveness;
- to improve the country's investment image;
- to ensure lack of discrimination towards other market participants. ■

To see the policy paper called "The Future of the Odesa Port Plant: Policy options" (in Ukrainian) prepared by ICPS specialists, visit our website at: http://www.icps.com.ua/doc/Policy_paper_OPZ%20U.pdf.

In advocating public policy principles that provide for open discussion and the input of all stakeholders, ICPS is looking into the possibility of raising this problem at a roundtable. Information about the date and time of this event will be provided later.

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