Since 1993, state-owned national telecommunications companies have, to some extent, been privatised in several countries in central and eastern Europe and the Commonwealth of Independent States (CIS), including Armenia, the Czech Republic, Hungary, Kazakhstan, Latvia, Lithuania and Russia.

In these countries privatisation of the telecoms industry has, at the outset of this process, involved the sale of a substantial proportion of the company’s shares to a strategic investor, which has, with a few exceptions, been a consortium formed by foreign telecoms operators. Privatisation is currently under way or is a declared policy objective in many other countries in the region. The strategy adopted in these other countries has varied. While the governments of countries such as Moldova and Romania have attempted to attract a foreign strategic investor, the government of Poland has, unusually, proceeded directly to an initial public offering of the shares of Telekomunikacja Polska S.A. (TPSA), the dominant telecoms operator, though a strategic investor may be involved later in the process.

Privatisation of Matáv

Among the Hungarian government’s main aims in privatising Matáv were: to accelerate the growth of a market economy by transferring state-owned assets into private hands, to expand the availability and quality of telecoms services, to improve the level of managerial expertise within the company, to

Linking privatisation and regulatory reform

Regulatory reform of the telecoms industry has been a regular, though not invariably, concomitant of the privatisation of the national telephone company in several transition countries. This article examines the relationship between privatisation and regulatory reform in the region. The privatisation of Matáv, the dominant telecoms operator in Hungary, because it is the most advanced, serves as a benchmark for this examination.
inject the capital necessary for the company to carry out an ambitious expansion and modernisation programme, to facilitate Hungary’s integration into the European Union by harmonising its national law with the EU law and policies, and to finance governmental expenditure.

Evolution of the transactional structure

Various schemes to transfer ownership to broad segments of the general population, such as the issuance of compensation coupons, were viewed as being of limited utility in relation to the privatisation of Matáv, given the special characteristics of the telecoms industry. The privatisation of Matáv was therefore structured as the sale to a strategic investor of 30.29 per cent of the enlarged share capital of the company. Through what was then known as the Hungarian State Holding Company, the Hungarian government remained as the majority shareholder. For an indefinite period it was also entitled, as was the British government in relation to British Telecom, to exercise the special rights attaching to a “golden share”. Although the Hungarian government could appoint a majority of the members of the statutory governing bodies of the company, the strategic investor exercised effective control through a four-person executive committee.

After participating in a competitive tender, MagyarCom, a consortium consisting of Aneintech and Deutsche Telekom, became the strategic investor in Matáv, paying US$ 875 million for its stake, with the proceeds of the sale being distributed to the government and a newly established national telecommunications fund.

In addition to the monetary component of its bid, MagyarCom committed to expand and modernise Matáv’s network, and to improve the quality of service it provided. For example, MagyarCom committed itself to increase the number of access lines by more than 15 per cent each year. Failure to satisfy this and other commitments would, depending on the magnitude of such failure, cause Matáv to be liable for escalating monetary and non-monetary penalties, including a calibrated reduction of the exclusivity period.

In 1995 the Hungarian government sold a block of additional shares to MagyarCom, with the result that MagyarCom transformed its minority stake in Matáv into a majority stake of 67 per cent. The transaction was unprecedented in that Hungary became the first government in the region to divest itself of a controlling interest in its national telephone company.

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In the final quarter of 1997 Matáv proceeded with an initial public offering of its shares that yielded a valuation of US$ 5.13 billion for the company as a whole. Both the domestic and international tranches of the offering were reported to be three times oversubscribed. As a result, the government reduced its stake in Matáv to 6.6 per cent while MagyarCom reduced its stake to 59.6 per cent.

Regulatory considerations

The approach of the British government to the privatisation of public utilities in the United Kingdom appears to have heavily influenced the Hungarian government. This approach is characterised by, among other things, the establishment of an independent administrative body to regulate the manifold activities of a public utility and the imposition of a price cap formally linked to an inflation index. The widespread influence of this approach, which in both developed and emerging markets has achieved the status of a regulatory paradigm, can be explained principally by the fact that a very broad range of regulatory issues have arisen and been resolved by the Office of Telecommunications since the privatisation of British Telecom in 1984. As a result, the telecoms industry in the United Kingdom could be viewed as an extensively documented experiment in regulatory reform.

As party to an association agreement with the member states of the European Union, the Hungarian government was also required to take account of the EU’s official policy, which favoured increased competition within the telecoms industry by liberalising the conditions of market entry. While the Hungarian government willingly embraced the essence of this policy, the need for liberalisation had to be balanced against the need to improve drastically the performance of Matáv, which enjoyed a complete monopoly in relation to both the operation of telecoms facilities and the provision of basic telecoms services. For this reason, the 25-year concession for the provision of domestic and international long-distance services granted to Matáv included an eight year exclusivity period, during which time Matáv was expected to maximise revenue for the purpose of funding development costs. The national concession for domestic and international long-distance services was augmented by 29 regional concessions for the provision of local telephone services, with such concessions also providing for an eight year exclusivity period. Shortly after the initial phase of the privatisation was completed another 25 regional concessions were granted on a similar basis as the result of a competitive tender. Matáv was ultimately granted a total of 39 regional concessions. These concessions cover 72 per cent of Hungary’s territory.

Matáv continues to operate within a nascent regulatory environment. Systemic regulatory risk is more likely to be acute within such an environment, though such risk will never be absent so long as an industry is subject to regulation. Much of this risk relates to the performance of the regulator. Regulators are generally classified according to their degree of autonomy in relation to the governmental bureaucracy. Between 1993 and 1998 the telecoms industry in Hungary was regulated primarily by the Telecommunications General Inspectorate, an administrative body under
the control of the Ministry for Transport, Telecommunications and Water Management. At the local level, Matáv and the local telephone operators are also regulated by regional authorities, which are under the supervision of the Telecommunications General Inspectorate. Recently, the Telecommunications General Inspectorate has achieved greater autonomy as a result of its transformation into the Communications Authority of Hungary.

So far the most significant controversy involving a Hungarian regulatory authority relates to a formal complaint to the Competition Council by local telephone operators and the mobile telecoms operator unaffiliated to Matáv. These operators have alleged that Matáv abused its dominant position by influencing the Minister for Transport, Telecommunications and Water Management during his review of Matáv’s tariffs. According to the complaint, Matáv is permitted to earn “abusive” and “arbitrary” profits from the interconnection charges that must be paid to Matáv by these operators for calls that originate within their networks. Whatever may be the merits of the complaint, the allegation of undue influence equates with regulatory capture. Regulatory capture is evidenced by an institutional bias in favour of the dominant operator. This bias can be explained by a combination of factors. Before the privatisation, the dominant operator would have been integrated within the governmental bureaucracy. Mental habits and personal loyalties formed before the privatisation may be resistant to formal regulatory change. After the privatisation, the dominant operator may be able to manipulate the flow of information to the regulator, as it can be extremely difficult for a regulator with limited resources at its disposal to penetrate such a complex business and operational structure.

Interconnection charges and other conditions for interconnection imposed by the dominant telecoms operator are regularly contested by competing operators. The situation in Hungary is therefore exceptional. The Hungarian interconnection regime, which is based on a complex revenue-sharing arrangement, is, however, not among the more progressive. European law and policy is now promising on virtually unrestricted access to the public switched telecoms network by competitors of the dominant telecoms operator. A cost methodology based on long-run incremental costs is increasingly being applied to the calculation of interconnection charges. Such a cost methodology is not likely to be effective unless accounting separation is implemented, so that the dominant telecoms operator distinguishes between its network and service-related activities. Accounting separation, which is often overlooked in relation to regulatory reform, has not been mandated in Hungary nor in many other countries in the region where the national telephone company has been privatised.

Despite a few minor setbacks, expansion and modernisation of the public telecoms network in Hungary has so far been achieved in accordance with the parameters contained in Matáv’s concession contract. Matáv is not subject to a conventional universal service obligation but it is understood that the Minister for Transport, Telecommunications and Water Management is considering the imposition of such an obligation, which might include a defined minimum service to be provided to all users at an affordable price.

The success achieved in relation to the expansion and modernisation of the public telecoms network is quantifiable. Before Matáv was privatised, as a result of chronic under-investment in the telecoms industry, there was a relatively low teledensity level, with approximately 16 access lines per 100 inhabitants. In addition, there was a relatively high level of unsatisfied demand for telecoms services, with 700,000 potential subscribers already on the waiting list. Although exchange technology was rapidly improving with the installation of digital switches, much of the network was antiquated. By the time of the initial public offering the teledensity level within Matáv’s concession areas had been increased to 30 access lines per 100 inhabitants, the waiting list had been reduced to 34,000 potential subscribers and 66.2 per cent of Matáv’s exchange capacity was digital, as compared with 32.5 per cent at 31 December 1993.

Further evidence that the main aims of the Hungarian government have been realised is the very positive response from the investment community to Matáv’s initial public offering.

By any measure Hungary has created a coherent and stable regulatory framework. That it is not as transparent as it could be is evidenced by the fact that the concession contract is not a public document, unlike the licences granted to operators in countries where the telecoms industry is similarly regulated, such as South Africa and the United Kingdom. This lack of transparency is, however, the norm throughout the region.

If the privatisation of Matáv can be judged an overall success, how does the outcome of this process in other countries in the region compare?

Regional comparisons

Czech Republic

In 1995, the Czech government closely followed the Hungarian precedent when it privatised SPT Telecom. TelSource, a consortium formed by PTT Telecom B.V. and Swisscom, became the strategic investor when it acquired a 27 per cent stake for US$ 1.4 billion. SPT Telecom, like Matáv, was granted an exclusive right to provide domestic and international long-distance telecommunications services. This right
was coupled with an obligation to achieve specified expansion and modernisation targets. One notable difference was that SPT Telecom did not have to cede any of its control over local telephone services to competing operators except in a few marginal areas. Based on limited publicly available information, it is evident that the company has significantly expanded and modernised the public telecommunications network. Although TelSource, unlike MagyarCom, has not increased its stake in the company, the company has attracted substantial funds for capital expenditure by accessing the domestic and international capital markets.

The configuration of regulatory bodies in the Czech Republic, with jurisdiction shared between the Ministry of Finance and the telecommunications office within the Ministry of Transport and Communication, is similar to what prevailed in Hungary until the establishment of the more autonomous Communications Authority of Hungary. The regulatory framework created in the Czech Republic betrays many of the strengths and weaknesses that have been observed in relation to Hungary. But these weaknesses should not detract from what otherwise appears to be a successfully pursued privatisation strategy.

**CIS and the Baltic States**

In marked contrast to the experience of the Czech Republic and Hungary is that of the countries constituted within the CIS and the Baltic States. In these countries regulatory reform has been limited, with the result that the regulatory framework is often ill defined, if, indeed, it has been reformed to any significant extent. Although this has not always been an impediment to foreign investment, the results of such investments have not been uniformly positive. Where the national telecoms company has been privatised, it has tended to remain formally entrenched as the dominant telecoms operator. Even so, the segment of the market delimited by mobile telecoms operators has exhibited robust growth.

Although the obligation to harmonise national laws with EU law and policy does not presently extend beyond the Baltic countries, the dictates of the World Trade Organisation may occasion regulatory reform. This is equally true of countries such as the Czech Republic and Hungary, where regulatory reform has been the most extensive, because, as yet, there exists no definitive indication of how their domestic telecoms industries will be regulated after expiration of the exclusivity period.

**Poland**

Compared with the other countries in the region, Poland can be classified as a hybrid. In Poland the conditions of ownership and regulation have firmly supported the position of TPSA as the dominant telecoms operator. As Poland harmonises its telecoms law with EU and other international norms, which generally favour rapid liberalisation, the company will no doubt encounter increased competition from other operators. Since its transformation in 1991 from a state-owned enterprise into a joint-stock company, TPSA has been wholly owned by the State Treasury. Although the State Treasury’s rights as the sole shareholder are now exercised by the Minister of the Treasury, the Minister of Telecommunications continues to have overall responsibility for regulating the domestic telecoms industry. It is understood, however, that the Polish government intends to establish an independent regulatory body, which will result in further separation of the functions of ownership and regulation in relation to the company.

**Conclusion**

In the future, the process of regulatory reform in both developed and emerging markets could be shaped as much by technological change as by deliberate regulatory intervention. This can be observed even in countries where the process of regulatory reform has been the most retarded. Throughout the region mobile telecoms is already an attractive alternative to fixed-line transmission, especially if the quality of service differential is relatively narrow. Moreover, as technology improves, telephony services that circumvent conventional tariff structures, such as Internet telephony, could become another potentially significant source of competition. However, the market pressures induced by technological change are not for the time being an adequate substitute for regulatory reform throughout the region.

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