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Railway transportation tariffs reform: prices are to increase, but the justification for the level of the change is still unclear

In 2007 state monopolist provider of railway services "Ukrzaliznytsya" continued increasing tariffs for both passenger and freight transportations.

In particular, according to Resolution No.58 of the Ministry of Transport and Communications, railways passenger transportation tariffs will be increased by 5% in March. The resolution foresees further 5% tariff rises in May, July, September and November 2007 with cumulative 25% growth against the level of January. Railways administration explained the decision by non-profitability of the passenger transportation: in 2006 Ukrzaliznytsya claimed the loss of about UAH 2.8 bn on passenger travels. Also, from January 1, 2007 the cost of transit freight transportation by rail would increase up to 6-7%.

Apart from non-profitability and thus necessity to improve cost-covering, there are several other reasons to increase the tariffs for various types of transportation services. First, it is the necessity to invest in equipment, 80% of which is now outmoded. Second, the expected accession of Ukraine to WTO requires that any discrimination on the market is eliminated. The latter is especially important for freight transportation.

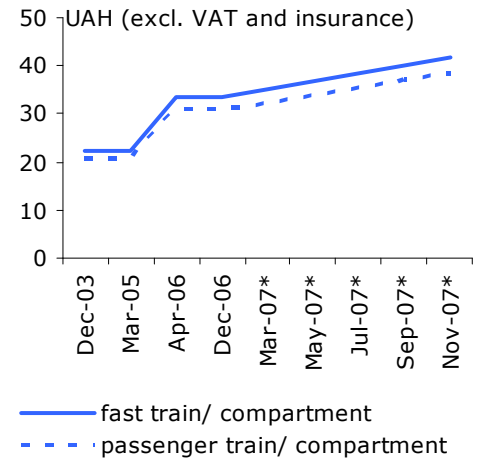
In January the Ministry of Transport and Telecommunications presented to the Cabinet of Ministers draft resolution on tariffs indexation and unification. It also foresees reform of freight classification and 25% increase in current tariffs. The changes proposed in the document are officially explained by the necessity to fulfil the non-discriminatory requirements by the WTO and to correspond with the EU directives regarding services pricing. It is the second attempt to reform tariffs in freight transportation.

In 2006 Ukrzaliznytsya proposed to approve the new Price list for freight rail transportation with equal tariffs for domestic, export and import transportation services. Other positive feature of the proposed list was separation of infrastructure, carriage and locomotive charges in the tariff structure. At the same time, the cost of freight railway transportations were envisaged to increase on average by 30% if the new Price list were enacted. The latter was the major point of critique that prevented the adoption of the list.

It is hardly disputable that Ukrzaliznytsya needs to replace the obsolete equipment for improving the quality of services and that its services should be profitable without cross-subsidisation. Thus, the rise in tariffs seems unavoidable. The major problem here is the justification for the level of tariff change. Tariffs for both passenger and freight transportation services set non-transparently. The consumers still do not know the adequate cost of services they get. Breakdown of expense items by Ukrzaliznytsya is not publicly available, and it is difficult to assess whether they are adequate and where there is space for cost-cutting. Some additional services may become optional to reduce price of basic services.

Also, the revision of tariffs is not the panacea for improving the quality of services. The need in comprehensive railway reform becomes more and more crucial. Without appropriate separation of operational, managerial and regulatory functions of Ukrzaliznytsya, creation of independent regulator in the sphere of transport and dividing of passenger and freight services segments it is impossible to guarantee the transparency of the railway monopolist.

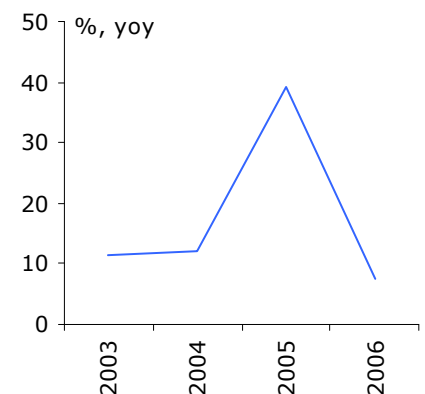
Passenger railway transportation tariffs (distance = 500 km)



* - planned

Source: Ministry of Transport and Communications

Freight railway transportation tariffs growth



Source: State Statistics Committee

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Quarterly trends

| National accounts ** | | Q1 04 | Q2 04 | Q3 04 | Q4 04 | Q1 05 | Q2 05 | Q3 05 | Q4 05 | Q1 06 | Q2 06 | Q3 06 | Q4 06 |
|---|------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------------------|
| GDP | UAH bn | 64.7 | 79.0 | 100.5 | 100.6 | 84.3 | 97.5 | 119.4 | 123.6 | 102.0 | 122.8 | 149.6 | ... |
| GDP (real) | % yoy | 12.7 | 13.7 | 14.0 | 8.5 | 4.9 | 3.4 | 1.4 | 1.7 | 3.2 | 7.3 | 8.0 | ... |
| Households consumption (real) | % yoy | 14.6 | 16.8 | 13.1 | 16.2 | 14.3 | 17.7 | 17.0 | 17.1 | 19.7 | 19.9 | 17.3 | ... |
| State consumption (real) | % yoy | 3.3 | 1.0 | 5.0 | 10.1 | 6.1 | 0.0 | 1.0 | 4.0 | 2.0 | 7.3 | -4.4 | ... |
| Gross fixed capital formation (real) | % yoy | 18.4 | 6.5 | 4.6 | 12.9 | -2.3 | -0.5 | 0.2 | 0.3 | 8.2 | 10.4 | 15.7 | ... |
| Exports of goods and services (real) | % yoy | 18.1 | 19.9 | 10.5 | 8.6 | -0.6 | -14.0 | -12.7 | -15.5 | -19.9 | -11.2 | 1.3 | ... |
| Imports of goods and services (real) | % yoy | 13.8 | 7.3 | 6.7 | 7.8 | 2.8 | 3.2 | 3.9 | -0.9 | 5.6 | 1.0 | 7.1 | ... |
| Agriculture, hunting, forestry (real)* | % yoy | -4.4 | 0.9 | 35.7 | 9.9 | 5.8 | 8.3 | 2.6 | -7.4 | 4.1 | 2.9 | -5.0 | ... |
| Manufacturing industry (real)* | % yoy | 23.9 | 16.3 | 12.5 | 9.4 | 7.0 | 1.8 | -1.1 | 2.0 | -2.9 | 5.4 | 8.9 | ... |
| Construction (real)* | % yoy | 29.9 | 30.6 | 16.4 | 3.9 | -8.4 | -11.3 | -8.5 | -7.5 | 2.6 | 5.7 | 8.8 | ... |
| Trade, repair services (real)* | % yoy | 23.6 | 35.0 | 2.7 | 13.7 | -2.1 | -10.7 | -11.7 | -11.9 | 4.1 | 14.7 | 19.4 | ... |
| Transport (real)* | % yoy | 10.1 | 8.0 | 12.3 | 10.5 | 6.6 | 5.7 | 2.8 | 7.8 | 3.4 | 9.7 | 12.6 | ... |
| Balance of payments | | | | | | | | | | | | | |
| Current account balance | USD bn | 1.4 | 2.3 | 2.1 | 1.1 | 1.6 | 0.6 | 0.4 | -0.1 | -0.7 | 0.0 | 0.5 | ... |
| Current account balance | % of GDP | 11.1 | 15.7 | 10.9 | 5.7 | 10.1 | 3.2 | 1.7 | -0.4 | -4.0 | -0.2 | 1.6 | ... |
| Trade balance in goods | USD m | 933 | 1552 | 774 | 482 | 1020 | -236 | -1131 | -788 | -1288 | -876 | -769 | ... |
| Trade balance in services | USD m | 133 | 198 | 749 | 157 | 188 | 392 | 1035 | 191 | 176 | 401 | 885 | ... |
| Current transfers | USD m | 475 | 758 | 720 | 623 | 626 | 694 | 745 | 780 | 616 | 782 | 846 | ... |
| Direct investment (FDI) | USD m | 333 | 614 | 420 | 344 | 247 | 365 | 477 | 6474 | 662 | 1410 | 1602 | ... |
| Portfolio investments | USD m | 449 | 149 | 1313 | 156 | 397 | 923 | 90 | 1347 | 0 | -264 | 364 | ... |
| Gross international reserves | USD bn | 7.9 | 9.6 | 12.1 | 9.5 | 12.0 | 13.1 | 14.3 | 19.4 | 17.3 | 17.6 | 19.1 | ... |
| Fiscal indicators | | | | | | | | | | | | | |
| Consolidated fiscal revenues | % of GDP | 27.2 | 26.9 | 26.3 | 25.9 | 32.1 | 35.1 | 31.5 | 31.0 | 32.2 | 32.0 | 32.1 | 25.6 ^e |
| Personal income tax | % of GDP | 4.4 | 4.1 | 3.8 | 3.8 | 4.3 | 4.4 | 3.9 | 4.2 | 4.5 | 4.6 | 4.1 | 4.3 ^e |
| Enterprise profits tax | % of GDP | 3.9 | 4.0 | 4.1 | 6.1 | 4.8 | 5.9 | 5.3 | 6.3 | 3.5 | 4.6 | 4.3 | 6.9 ^e |
| Value-added tax | % of GDP | 6.2 | 5.7 | 5.1 | 4.1 | 8.6 | 9.2 | 7.9 | 7.3 | 9.5 | 9.3 | 9.8 | 9.6 ^e |
| Excise tax | % of GDP | 2.1 | 2.1 | 2.0 | 1.8 | 2.0 | 2.0 | 2.0 | 1.7 | 2.0 | 1.8 | 1.5 | 1.6 ^e |
| Consolidated fiscal expenditures | % of GDP | 25.3 | 26.5 | 26.8 | 35.2 | 28.3 | 36.4 | 28.1 | 41.7 | 31.9 | 33.2 | 29.5 | 37.8 ^e |
| Current expenditures | % of GDP | 22.4 | 22.7 | 21.7 | 27.2 | 26.5 | 33.6 | 24.0 | 34.2 | 29.9 | 30.0 | 25.0 | 30.1 ^e |
| Capital expenditures | % of GDP | 2.9 | 3.8 | 5.1 | 8.0 | 1.8 | 2.7 | 4.1 | 7.5 | 2.0 | 3.2 | 4.5 | 7.7 ^e |
| Consolidated fiscal balance | % of GDP | 1.9 | 0.4 | -0.5 | -9.3 | 3.7 | 1.0 | -5.0 | 6.2 | -0.4 | 1.1 | 2.4 | -4.0 ^e |
| Privatisation receipts | % of GDP | 1.5 | 3.7 | 3.5 | 1.0 | 0.2 | 0.6 | 0.6 | 16.0 | 0.1 | 0.1 | 0.1 | 0.1 ^e |
| Labour market | | | | | | | | | | | | | |
| Average wage (real) | % yoy | 19.9 | 18.6 | 14.7 | 15.4 | 15.0 | 19.0 | 19.6 | 26.4 | 23.8 | 22.6 | 18.8 | 11.3 |
| Household income (real) | % yoy | 11.7 | 16.3 | 11.3 | 16.6 | 24.0 | 28.0 | 19.4 | 18.9 | 22.1 | 18.6 | 20.3 | 16.3 |
| Unemployment rate (ILO methodology) | % | 9.3 | 8.3 | 8.1 | 8.7 | 8.7 | 7.1 | 5.2 | 7.8 | 7.9 | 6.8 | 6.4 | ... |
| Banking system | | | | | | | | | | | | | |
| Monetary aggregate M0 | % yoy cum | 29.1 | 25.6 | 37.1 | 27.9 | 28.2 | 39.1 | 31.1 | 42.2 | 36.2 | 25.3 | 23.7 | 24.5 |
| Monetary aggregate M2 | % yoy cum | 45.4 | 44.8 | 51.5 | 32.3 | 38.9 | 37.4 | 31.3 | 53.9 | 39.2 | 36.6 | 36.7 | 34.3 |
| Household deposits in national currency | % yoy cum | 69.4 | 67.3 | 67.9 | 26.2 | 28.3 | 31.6 | 30.4 | 90.8 | 54.6 | 41.1 | 39.7 | 37.3 |
| Household deposits in foreign currency | % yoy cum | 67.0 | 61.7 | 55.2 | 54.3 | 51.8 | 45.4 | 46.4 | 59.1 | 54.5 | 66.2 | 64.3 | 57.5 |
| Com. bank credits in national currency | % yoy cum | 56.8 | 52.1 | 44.3 | 29.4 | 28.3 | 32.6 | 43.4 | 58.7 | 59.8 | 53.7 | 49 | 52.3 |
| Com. bank credits in foreign currency | % yoy cum | 63.6 | 56.2 | 43.5 | 32.2 | 33.1 | 36.8 | 47.1 | 66.3 | 72.0 | 82.1 | 90.4 | 95.4 |
| Long-term com. bank credits | % yoy cum | 141.7 | 102.7 | 82.7 | 57.1 | 49.5 | 53.0 | 70.1 | 84.6 | 87.6 | 86.7 | 76.6 | 79.5 |
| Long-term com. bank credits | % of total | 47.4 | 49.3 | 50.9 | 54.2 | 54.4 | 56.1 | 59.7 | 61.8 | 63.1 | 63.4 | 63.5 | 64.9 |
| Average lending rate on national cur. credits | % p.a. | 17.2 | 16.6 | 17.0 | 17.6 | 17.0 | 15.4 | 15.4 | 16.4 | 15.8 | 15.5 | 14.6 | 15.1 |
| Average lending rate on foreign cur. credits | % p.a. | 12.2 | 12.1 | 12.6 | 12.2 | 12.1 | 11.0 | 11.3 | 11.7 | 11.5 | 11.3 | 11.3 | 11.5 |

SOURCES: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, IER estimates

* change in value added

** preliminary

Notes:
yoy year on year change

p.a. per annum