Infrastructure Monitoring for Ukraine (IMU)

No. 7/2005

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Table of contents

Foreword ............................................................................................................................. 3
1. Summary ....................................................................................................................... 4
   2.1 Telecommunications ............................................................................................. 6
   2.2 Railways ................................................................................................................. 8
   2.3 Roads .................................................................................................................... 10
   2.4 Power .................................................................................................................. 11
   2.5 Gas ....................................................................................................................... 13
   2.6 Water and wastewater ....................................................................................... 14
3 Appendices ................................................................................................................... 16
   Appendix 1
   Infrastructure indicator evaluation .............................................................................. 16
   Appendix 2
   General description of the infrastructure indicators .................................................. 17
   Appendix 3
   Explanations for the infrastructure indicator evaluations
given in Appendix 1 (August 2004 - July 2005) ......................................................... 21
Foreword

This is the seventh “Infrastructure Monitoring for Ukraine” report issued by the Institute for Economic Research and Policy Consulting (IER) in Kiev. It presents information on the restructuring of six infrastructure sectors of the Ukrainian economy in a standardized manner, which allows for cross-industry comparisons. When developing the evaluation methodology the Institute for Economic Research and Policy Consulting followed the EBRD’s approach. Monitored indicators are qualitative and fall into three broad categories: (1) commercialisation, (2) tariff reform, and (3) regulatory and institutional development. Twenty-one indicators allow for economic and policy-making analysis at different aggregation levels. The indicators are constructed in a way that represents the status of the reforms in each sector at a given moment in time.

Each issue of IMU has a similar structure. A short executive summary outlines major developments within selected sectors of the infrastructure. A general analysis of the Ukrainian infrastructure policies is presented in the second section. The detailed study of reforms in each of the six sectors includes not only an ex-post analysis, but also an outline of major challenges to future development. A description of the reform progress in each infrastructure sector supplements the numerical evaluation and provides a broader view of the situation. Appendixes summarize the evaluations in tabular form and provide methodological explanations and detailed comments for each indicator.

An extensive discussion of the methodology employed was presented in the first issue of IMU. Several marginal changes were introduced in the second issue when more complete information became available to assure time-consistency and cross-industry comparability of the indicators.

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1 For earlier issues, see Infrastructure Monitoring for Ukraine (IMU No. 1, June 2001, IMU No. 2, December 2001, IMU No. 3, June 2002); they can be downloaded from the Institute’s website at [http://www.ier.kiev.ua/English/IMU_eng.html].

1. **Summary**

The indicator for **Telecommunications** decreased marginally from 2.35 to 2.33, mainly because changes in the structure of the industry’s operational management revealed some signs of reduced competition. The newly created regulator (NCRC) became operational only after a considerable time lag, and will most likely remain weak. Overall, most of the government’s initiatives in the sector were socially oriented during the past year, which had a rather negative impact. Yet, the mobile and Internet segments remained the fastest growing sectors of economy.

In the absence of significant structural reforms, the **Railways** sector indicator grew only slightly from 1.73 to 1.78. Ukrsaliznytsia has equalized the rights and competitive possibilities of all service providers having cancelled previously existing discounts for selected transport providers within the transportation tariff structure. Responding to a 50% increase in budget allocations, and trying to meet its mandate to reach a 6.3-fold increase in profits, Ukrzaliznytsia raised both passenger and cargo tariffs by up to 50%. Yet these raises were based on unclear economic concepts and, as usual, were executed without transparency.

The **Roads** sector indicator remains unchanged at 2.30, as very few changes in the roads sector were observed in both operational practice and regulations. Ukraine failed to finish the Kyiv-Odessa toll road in time and within the allocated budget, demonstrating an unfortunate incompetence in performing major reconstruction projects. Among the few positive developments, adoption of the law “On Automobile Roads” by the Verkhovna Rada should be mentioned. The law defines the legal and economic bases for activities in the sector, in particular it allows for roads of common usage to be transferred into concessions.

The indicator for the **Power** sector remained unchanged. Structural reforms in the sector are stagnating. A law on debt settlements in the sector was adopted, but its effectiveness remains to be proven. Tariff reform took the shape of equalising tariffs throughout the country, which may increase the level of cross-subsidization from a geographic perspective, however the effects of this decision will only become evident in the future.

The **Gas** sector development indicator remained unchanged too, as practically no changes were introduced in the sector’s structural framework. Debts for gas by consumers decreased by 6% from January to August 2005, however, the situation remains problematic with increasing debts by industry and by the public utilities. The probable external shock from Russia to increase gas prices for Ukraine, may serve as a stimulus to finally implement reforms in the Ukrainian gas sector.

The indicator for the **Water and wastewater** sector remained unchanged at the level of 1.61, because the sector did not experience any structural changes during the past year. The sector continued to degrade both in the institutional and technological fields. The state demonstrated a lack of strategy to improve the industry’s regulatory framework. The recently introduced scheme of mutual debt compensation between the utilities, the state and the population will probably only worsen the payment discipline. Probably the only positive development is the amendment of the law “On
natural monopolies”, which introduced the participation of consumers into the process of setting tariffs. The new law is expected to prevent enterprises from abusing their monopoly power, as well as making the tariff setting procedure more transparent.

**Graph 1  IER infrastructure indicators for Ukraine**

Source: *Own estimations*

Note: The indicators in this graph are presented without rounding, unlike in the table summarizing the indicators. This allows small changes to be seen.
2. Ukrainian Infrastructure Policies
August 2004 - July 2005

During the past year, several changes occurred in the statuses of the six infrastructure sectors of the Ukrainian economy, but the progress was of almost zero magnitude in all sectors. To a large extent, this can be explained by the political turmoil at the end of 2004, and the primarily social and populist objectives of both the old and new governments. Despite the positive expectations raised by the new law “On Telecommunications”, which came into full force in 2005, the situation concerning the Telecommunications sector was characterized by the government’s rather negative impact, which squeezed taxes and dividends out of the sector to benefit the state’s finances, at the expense of development. In the Railways sector structural reforms were suspended, and in response to the government’s quasi-fiscal goals, Ukrzaliznytsia retreated to the former procedure of non-transparent tariff increases. Concerning the Roads sector, most attention was paid to the Kyiv-Odessa toll road construction, yet the results were disappointing: vested financial and political interests led to soaring construction costs. Strategic planning of the sector’s development is far from having become the everyday concern of the regulator. In the Power sector the most prominent step undertaken was initiating a debt settlement scheme. The efficiency of the scheme has yet to be proven. However, this step is increasingly important for the development of the sector, which suffers from a ban on bankruptcies and from poor financial ratings. The policy in the Gas sector was characterized by a lack of structural transformation, with the sector remaining under the control of the NAK "Naftogaz Ukrainy”. The Water and Wastewater situation was simply degenerating - the government being involved in designing various unclear and non-transparent payment and compensation schemes. In sum, it seems the government was not paying any attention to the structural development of Ukraine’s economy.

2.1 Telecommunications

2.1.1 Reforms between August 2004 and July 2005

Major changes in the telecommunications sector occurred in the fields of regulating its implementation, operational and organizational structures. It should be noted, however, that overall these changes had a rather mixed impact.

Negative developments occurred in the operational practice and the organizational structure of the sector. Firstly, the budgeting decisions of Ukrtelecom were heavily influenced by political considerations. In order to meet the so-called “socially-oriented” state budget requirements, as much as 83% of Ukrtelecom’s profits were distributed as dividends to the state (i.e., UAH 706 m out of UAH 760 m went into the state’s coffers), and less than 12% were allocated to investments. Secondly, Ukrtelecom completed a merger with Utel (a fixed-line long-distance phone operator). Thirdly, Ukrtelecom applied for a license in the mobile 3G-segment. The last two points demonstrate the clear intention to form a vertically integrated
telecommunications firm. This is clearly in conflict with the need to develop and stimulate competition on the respective markets, and several examples of misuse of market power have already been observed\(^3\).

The mobile service providers could possibly provide a counterweight to these aggregation plans. Several companies have obtained licenses for international phone service provision; and UMC and URS announced that they are developing their own optic fiber lines networks and are setting up international phone connection channels. This segment experienced the most rapid income growth, while fixed lines showed some decrease in profitability.

**Graph 2** Incomes in the Telecommunications sector, UAH m

![Graph showing incomes in the Telecommunications sector, UAH m](image)

*Source: State statistical department of Ukraine*

In the regulation area, at the beginning of 2005 the whole regulatory power, including licensing, radio frequency allocations, and setting of interconnection charges, has been transferred from the central state authority (State Department on Communications and IT) to an independent regulatory body, the National Committee on Communications Regulations (NCRC). However, due to staffing problems, the NCRC was only able to start operations after a four-months delay, hence it did not have a significant impact yet. Besides, the political independence of the NCRC - primarily from the Ministry of Transport and Communications - is not based on a sufficient legal and financial basis, and thus remains an unanswered question.

\(^3\) Recently internet providers have asked the AMCU to intercede, when Ukrtelecom set dumping tariffs for data transfer for its end-users while leaving the tariffs high for intermediate small internet providers. Another example of this type is Ukrtelecom’s refusal to provide additional extension numbers to the mobile operators UMC and Kyivstar (though these numbers had previously been agreed to), which indirectly limits their subscribers’ base growth.
Finally, the Ministry of Transport and the State Committee on Communications and IT have been merged into a single Ministry of Transport and Communications.\(^4\) It remains to be seen to what extent this step will – as was promised – really help “improve the level of the public telephone program”, or whether it was purely politically motivated.

### 2.1.2 Needed future reforms

To date, important characteristics of regulatory development, such as tariff reform or access regulation, have remained unchanged. In the fixed lines segment, Ukrtelecom maintained its practice of subsidizing the extremely low tariffs for local phone calls at the expense of high tariffs for regional and international calls. Within the postal services, tariffs do not cover the actual cost of postal delivery. Moreover, tariff abuse, as an instrument of social policy is a continuing practice: there are differences between tariffs for rural and urban regions; and some privileges for pensioners and veterans are still in place.

There are also at least two other unresolved problems with access regulation in the internet segment: the state has not given up its attempt to gain control over the domain address distribution in the UA-zone, and IP-telephony has so far not been included in any legislation\(^5\), while suffering from expensive licensing fees.

### 2.2 Railways

#### 2.2.1 Reforms between August 2004 and July 2005

During the period under review no significant structural reform occurred in the railways sector. Some changes were made in tariff setting and the contracting policy.

The state continued to use railways for its quasi-fiscal purposes. Seeking for sources of financing the 2005 household, the Cabinet of Ministers (CMU) increased the rate of financial contributions of all state monopolies (including UZ) by 50%\(^7\) and approved a financial plan for Ukrzaliznytsia that assumes a 6.3-fold increase in profits. Thus, all activities of Ukrainian Railways were directed at maximizing profits at any price; in consequence of which most tariffs for UZ’s services were raised. Freight tariffs were

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\(^5\) There is no definition for this service mentioned in the Law “On Telecommunications” (1280-15, Nov.18, 2003).

\(^6\) Licensing was introduced by order of the State Communication and IT Committee (No. 132, June 14, 2004). The cost of a license was set at 6% of the license cost for phone services provision (e.g. UAH 540,000 for international phone services). It should be noted, however, that licensing requirements being absent, no license has been issued so far; and yet Ukrtelecom and other operators have used this government decree to cut IP-operators off from access to their international networks.

\(^7\) Decree by the CMU No 157, February 28, 2005.
increased two times during the period: in July 2004\(^8\) and in April 2005\(^9\). First class passenger tariffs were increased by 50\% \(9\). This decision was officially motivated by the desire of the State Railway Administration (UZ) to upgrade its train infrastructure. While higher tariffs allowed Ukrazaliznytsia to increase its profits and payments to the state\(^10\), the tariff setting procedure remained non-transparent and vague on economic grounds.

**Table 1** Selective freight tariffs, 500 km distance

<table>
<thead>
<tr>
<th>Freight</th>
<th>Weight, t</th>
<th>Tariffs before April 2005, $</th>
<th></th>
<th>Tariffs after April 2005, $</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>domestic</td>
<td>export</td>
<td>import</td>
<td>domestic</td>
</tr>
<tr>
<td>Iron ore</td>
<td>65</td>
<td>2.47</td>
<td>3.96</td>
<td>6.81</td>
<td>3.71</td>
</tr>
<tr>
<td>Scrap metal</td>
<td>51</td>
<td>8.31</td>
<td>17.01</td>
<td>8.31</td>
<td>12.46</td>
</tr>
<tr>
<td>Coke</td>
<td>44</td>
<td>5.23</td>
<td>12.80</td>
<td>5.23</td>
<td>7.84</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td></td>
<td>6.58</td>
<td>8.31</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: Cabinet of Ministers of Ukraine*

Ukrazaliznytsia has also cancelled previously existing privileged transportation tariff discounts for selective transporters in order to equalize the rights and competitive possibilities of all service providers. The contracting policy of UZ was modified. From now on UZ will procure all goods and services on a tender basis, which will improve the cost-efficiency of UZ.

It is still unclear how the profits made by UZ will be used and what logic is behind its investment decisions. Several cases of financial resource misuse are currently going through the courts. For instance, some ex-managers of UZ were accused of misusing a USD 700 m loan given to construct a bridge over Dniper in Kyiv. As a result, the state will be responsible for the repayment of the loan.

### 2.2.2 Needed future reforms

UZ is definitely performing very well from a financial point of view. However, it is clear that the understanding of the purpose for the existence of UZ must change. The railways should certainly not be seen as a cash cow for the state but as an infrastructure industry that will be able to adjust quickly to changing economic conditions, and will facilitate, not limit, economic growth. Recent developments suggest a need for a strategy of sustainable growth for the railways. Thus, first of all, the economic activities of UZ should be separated from the political ones, which can

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\(^8\) On average tariffs were increased by 25%.

\(^9\) Most tariffs for domestic transportation were raised by 50%, while those for export transportation by less than 50%.

\(^10\) The profits of Ukrainian railways increased by 60% between January and April 2005 compared to the same period of the previous year, reaching UAH 300 m.
easily be accomplished by corporatization.\textsuperscript{11} The responsibility for setting tariffs has to be given to an independent commission – this is the best way to balance the interests of all stakeholders. The tariff-setting procedure has to become transparent, predictable and economically justified, which will not only guarantees high enough tariffs for Ukrzaliznytsia’s sustainable performance and growth, but should also stop the tendency to use tariffs as an easy means of attracting financial resources.

2.3 Roads

2.3.1 Reforms between August 2004 and July 2005

During the above period very few changes were noted in the operational practice and the regulations concerning the roads sector. Ukravtodor started to actively use tendering procedures for subcontract work. However, vested interests and a lack of strategic planning have hindered the development of the sector.

Ukraine failed to finish construction of the Kyiv-Odessa road on time, demonstrating incompetence in performing concession projects. The new deadline for completion is October 2005. Most probably the Kyiv-Odessa highway will not be a toll-road, since discussions about the inexpediency of constructing a parallel non-toll road continue. The project was managed without any general construction plan, and its financing was not monitored by the Treasury. The cost of the project greatly exceeded plan. Thus the Ukrainian Road Administration had to take a new USD 100 m loan from Deutsche Bank\textsuperscript{12} under state guarantee. Additional road reconstruction expense (USD 30 m), as well as funds for credit repayments will be covered by the state roads development budget in order not to affect the maintenance and development of other state-level roads.

Recently the Verkhovna Rada adopted a law “On Automobile Roads”\textsuperscript{13}, which defines the legal and economic basis for activities in the sector. In particular, the law foresees the possibility of transferring roads of common usage into concession. A separate section of the law is devoted to toll roads. Decisions about establishing new toll roads will be made by the CMU: only if the road was substantially upgraded and an alternative non-toll road is available will tolls be approved. Toll roads remain state property and are not subject to privatization. According to the law, fees collected on such roads will become State income and will be used to repay loans incurred for road reconstruction, as well as for road maintenance.

The CMU has created\textsuperscript{14} the Chief State Road Transport Inspectorate within the Ministry of Transport and Communications and transferred to the Inspectorate the main regulatory functions of the State Department of Road Transport. This new body will track observance of road transport requirements by business entities, supervise safety of road transportation,

\footnotesize{\textsuperscript{11} Unfortunately, the corporatization of UZ promised by previous government is currently frozen. \\
\textsuperscript{12} For 10 years for LIBOR+2.7 \\
\textsuperscript{13} No 2862-IV, September 8, 2005 \\
\textsuperscript{14} Decree of the CMU #1190 (Sep 08, 2004)
and be in charge of issuing licenses for passenger and freight transportation on automobile roads. The consequences of this decision could be negative, as the new regulatory body is not independent of the Ministry of Transport and Communications (MTCU). Some doubt remains concerning a clear division of responsibilities and powers between these two state agencies.

2.3.2 Needed future reforms

The road sector needs strategic planning for its sustainable development. Currently it develops too slowly, which limits the development of other sectors closely linked to road infrastructure. More attention should be paid to concession projects. However, to attract money for them the conditions for the concessions have to be profitable for investors, and – what is more important – the stability of these conditions must be assured.

2.4 Power

2.4.1 Reforms between August 2004 and July 2005

Some structural reforms attempting to solve the debt issue were noted in the power sector of Ukraine. However, the effectiveness of the proposed debt settlement scheme cannot yet be evaluated. First results of the recently created the NAK “Energy Company of Ukraine” (ECU) show that the sector is starting to improve its financial performance. Creating the NAK “Energy Company of Ukraine” has halted the privatisation process and has resulted in consolidating under its umbrella most of the state owned companies in the power sector. However, judging from the first financial results of the NAK “ECU” it is possible to conclude that the management of the controlling stakes of shares belonging to the state has improved. In 2004 the NAK “ECU” made losses totalling UAH 763.1 m. In 2005 however, based on an extrapolation of the results of the first half of 2005, the company expects to make a net profit of UAH 604.4 m.

The tariff structure saw some minor changes based on the decision to gradually equalize tariffs throughout the country for all types of consumers and to establish only 2 tariff classes. This decision provoked serious debate since it will increase cross-subsidization not only between small and large enterprises, but will also introduce cross-subsidization on the regional level. The decision runs counter to the logic of cost-reflective tariffs by giving preference to the idea of equal pricing for all consumers throughout all geographical locations.

In July the law “On measures to guarantee stable functioning of enterprises within the fuel and energy complex” entered into force. This law aims at solving the problem of the multi-billion UAH debts existing between the consumers of energy, the power generators, the wholesale market, and fuel suppliers. Most of these debts were accumulated in 2001, when the power generating companies were subsidizing industry by supplying electricity at below cost tariffs. The power generators were also bearing the cost of privileges granted to consumers, and they suffered from low payment rates.
Enterprises, which will elect to participate in the program of debt repayment that will last for nine months, will be shielded from bankruptcy procedures during this period. The procedure for debt settlement is complex and the enterprises entering into it will follow strict procedures with funds, deriving from increases in the wholesale electricity and gas tariffs of the NAK “Naftogaz Ukrainy”, which will flow directly into special accounts foreseen for debt settlement. Eventually the debt restructuring will be financed by the power consumers. If successful, this mechanism may open the door to privatisation in the sector as well as to the introduction of bankruptcy procedures, which is bound to improve the efficiency in the power generation sector. The law, setting up the debt settlement mechanism, entered into force on July 26 2005.

2.4.2 Needed future reforms

The sector is at present in the stage of financial stabilization and improving the management of the state property. Reforms in the sector should proceed through the solutions brought to debt settlement, tariff reform, reduction of cross-subsidization and a clear strategy for developing the sector. An evaluation of whether or not to proceed with privatisation processes in the sector needs also to be undertaken.

The sector now finds itself at a crossroads. On the one hand, the improvement of management through bundling of the state’s stakes into one holding company may be positive in the medium term, especially if the debt settlement scheme will succeed. However, the risk will remain that the sector will be monopolized by the state as has happened with the gas sector. Organizational inertia and the lack of competition, coupled with centralising tendencies, may lead to a less efficient use of available resources. In case the sector is stabilized and the government chooses to go forward with introducing private initiative in the sector the gains may be larger. However, for private interests to bring benefits to the sector the regulatory framework should be strengthened allowing for competition and incentives for investments.

2.5 Gas

2.5.1 Reforms between August 2004 and July 2005

The structural reforms in the gas sector were mostly stalled with the implicit decision to continue the gas market monopoly under the roof of the state company NAK “Naftogaz Ukrainy”. This precludes structural reform from progressing. The problems described in the previous issues of IMU remain, including implicit cross-subsidization between enterprises and population, cross-subsidization of domestic gas consumption with the proceeds from transit barter gas, insufficient investment in the transit pipeline infrastructure, and absence of cost-covering tariffs for general consumption and for communal, mainly heat-producing, enterprises. Also, since the sector remains a monopoly, private initiative is underrepresented making competition not a reality, but only an ideal notion.
With the overall stagnation of structural reforms in the sector, any external shock may lead to an intensification of the reform agenda in Ukraine. Started during the first half of 2004, the negotiations between the NAK “Naftogaz” and the RAO “Gazprom” concerning the conditions of Russian gas supplies to Ukraine in 2006 and 2007 were mostly unproductive. The unreformed Ukrainian gas sector is not prepared for swift increases in the tariffs of imported Russian gas. However, the question of Russia increasing its prices is just a matter of time, assuming that the world market energy prices continue to increase.

The debt levels for gas consumption, presented in Table 2 contracted by 6%, but still remain at the level of about UAH 5 bn. It is worthwhile noting that the debts of the general population contracted by 12%, which may mean that the purchasing power of the population has grown: this may now permit a review of the general consumption tariffs, keeping in mind that the gas price for Ukrainian households is still one of the lowest in Europe.

Table 2  Debits (in thousands of UAH) for gas consumption and payment rates as of August 1, 2005 for major consumer groups

<table>
<thead>
<tr>
<th>Consumers</th>
<th>Debts as of 1 Jan 2005</th>
<th>Payment rate on 1 Aug 2005</th>
<th>Debts as of 1 Aug 2005</th>
<th>Debt increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>835 266</td>
<td>107%</td>
<td>733 248</td>
<td>-12%</td>
</tr>
<tr>
<td>Budget-financed</td>
<td>15578</td>
<td>95%</td>
<td>18 894</td>
<td>21%</td>
</tr>
<tr>
<td>organizations</td>
<td>Public utilities</td>
<td>2 297 689</td>
<td>81%</td>
<td>2 364 319</td>
</tr>
<tr>
<td>Industry</td>
<td>305 316</td>
<td>99%</td>
<td>241 103</td>
<td>-21%</td>
</tr>
<tr>
<td>Power-generation</td>
<td>895 874</td>
<td>87%</td>
<td>921 469</td>
<td>3%</td>
</tr>
<tr>
<td>Other consumers</td>
<td>233 247</td>
<td>108%</td>
<td>-2 612</td>
<td>-101%</td>
</tr>
<tr>
<td>Debts of previous years</td>
<td>627 255</td>
<td>N/A</td>
<td>606 594</td>
<td>-3%</td>
</tr>
<tr>
<td>Total</td>
<td>5 210 225</td>
<td>97%</td>
<td>4 883 014</td>
<td>-6%</td>
</tr>
</tbody>
</table>

Source: *Energobusiness, own calculations*

2.5.2 Needed future reforms

Structural reforms in the gas sector have been postponed for years and there are no prospects for major reforms in the near future. However, an external shock such as a serious increase in the Russian prices for gas furnished to Ukraine may motivate tariff reform in the sector. The major goal of any such reform should be to eliminate cross-subsidies, to introduce cost reflective tariffs, and to set the price for all gas, including that produced in Ukraine, at the same level for all consumers. Tariff reform will encourage not only more efficient gas consumption, but will also stimulate gas production within Ukraine.
2.6 Water and wastewater

2.6.1 Reforms between August 2004 and July 2005

The water and wastewater sector has not experienced any structural changes during the past year. The sector continued to degrade both in its institutional and its technological aspects.

The central government body directing the sector, the State Committee for Housing and Communal Economy, was merged with the State Committee for Construction within the framework of administrative changes made by the new government of the country. The effect of the merger on the sector remains to be seen.

The law “On the 2005 State Budget” introduced a scheme of mutual compensation for debts between utilities and the state (tax arrears), the state and the general population (compensation of lost savings in Oschadbank), and the population and the utilities (utility bill payments). The planned amount of the compensation is UAH 6 bn. The scheme is likely to worsen the payment discipline by raising the consumers’ expectations of similar rounds of compensations in future, which will hurt the efficiency of performance of enterprises in the industry.

Since January 1st, 2005 the local administrations have to compensate enterprises for losses caused by low tariffs. Thus, the tariffs for water and wastewater services have increased in some regions thereby improving the cost coverage level. However some regions continue their low tariff policies and fail to compensate enterprises for their losses.

Table 3 Main performance indicators for water and wastewater enterprises, 1998-2004

<table>
<thead>
<tr>
<th></th>
<th>Unit</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Water supply</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total revenue</td>
<td>UAH m</td>
<td>976.8</td>
<td>1243.2</td>
<td>1485.1</td>
<td>1456.0</td>
<td>1499.5</td>
<td>1700.9</td>
<td>1934.5</td>
</tr>
<tr>
<td>Total cost</td>
<td>UAH m</td>
<td>1093.6</td>
<td>1453.0</td>
<td>1518.6</td>
<td>1580.5</td>
<td>1713</td>
<td>1970.3</td>
<td>2124.6</td>
</tr>
<tr>
<td>Subsidy</td>
<td>UAH m</td>
<td>59.5</td>
<td>69.3</td>
<td>141.8</td>
<td>53.5</td>
<td>6.5</td>
<td>7.1</td>
<td>25.8</td>
</tr>
<tr>
<td>Profit</td>
<td>UAH m</td>
<td>-57.3</td>
<td>-140.5</td>
<td>108.3</td>
<td>-71</td>
<td>-207</td>
<td>-262.3</td>
<td>-164.3</td>
</tr>
<tr>
<td><strong>Average tariff</strong></td>
<td>UAH</td>
<td>0.281</td>
<td>0.363</td>
<td>0.475</td>
<td>0.509</td>
<td>0.529</td>
<td>0.610</td>
<td>0.665</td>
</tr>
<tr>
<td><strong>Average cost</strong></td>
<td>UAH</td>
<td>0.315</td>
<td>0.425</td>
<td>0.485</td>
<td>0.553</td>
<td>0.604</td>
<td>0.707</td>
<td>0.730</td>
</tr>
<tr>
<td><strong>Cost coverage</strong></td>
<td>%</td>
<td>89.3%</td>
<td>85.6%</td>
<td>97.8%</td>
<td>92.1%</td>
<td>87.5%</td>
<td>86.3%</td>
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|                      |      |      |      |      |      |      |      |      |
| **Waste water**      |      |      |      |      |      |      |      |      |
| Total revenue        | UAH m| 531.7| 642.1| 760.7| 773.7| 820.6| 934.4| 1049.6|
| Total costs          | UAH m| 559.4| 680.0| 723.0| 807.5| 889.7| 992| 1110|
| Subsidy              | UAH m| 31.9| 34.3| 70.9| 0.8| 2| 3.3| 8.0|
| Profit               | UAH m| 4.2| -3.6| 108.6| -33| -67.1| -54.3| -52.4|
| **Average tariff**   | UAH | 0.175| 0.218| 0.280| 0.310| 0.356| 0.426| 0.507|
| **Average cost**     | UAH | 0.184| 0.231| 0.266| 0.323| 0.386| 0.452| 0.536|
| **Cost coverage**    | %   | 95.0%| 94.4%| 105.2%| 95.8%| 92.2%| 94.2%| 94.6%|

15№ 2505-IV, March 25, 2005
Source: The State Committee for Housing and Communal Economy

The Verkhovna Rada amended the law “On Natural Monopolies”\textsuperscript{16}, introducing consumer participation in the process of tariff setting. According to this amendment, all changes in tariffs for goods and services provided by the natural monopolies have to be discussed with the public in open hearings. The new rule is expected to prevent enterprises from abusing their monopoly power, as well as making the tariff setting procedure more transparent.

Currently a new strategy for regulatory reform in the sector is being discussed among stakeholders. Creation of a regulatory body for the utilities is also being considered.

2.6.2 Needed future reforms

The sector of water supply and wastewater treatment urgently needs a coherent efficiency-oriented strategy of development. Regulating the network industries in the sector of public utilities should be left to a separate governmental body, which should use specific approaches to regulation such as a yardstick competition between regional monopolies, a price-cap regulation for tariffs, and attracting private investment (focusing on energy-saving investments) through PPP schemes.

\textsuperscript{16} No 1682-III
## 3 Appendices

### Appendix 1

**Infrastructure Indicator evaluation**

<table>
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<tr>
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<th>Telecom</th>
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Appendix 2

General description of the infrastructure indicators

This appendix presents a brief description of the criteria for scoring each indicator.

1. Commercialisation and privatisation

1.1 Ownership

1.1.1 Natural monopoly. A natural monopoly is a network operator. A score of one means that the whole network is state owned; the score increases with an increasing share of corporatised, privatised and newly constructed private fixed networks in the total length of networks. The maximum score is reached with private ownership of all networks.

1.1.2 Potentially competitive businesses. A potentially competitive business is an operator using networks to provide its services; it is a market related to a natural monopoly. A score of one implies that the businesses are part of the state owned natural monopoly. The score increases with separation, corporatisation and privatisation of existing operators, or with increased market penetration by newly established private agents. The maximum is reached when all the businesses are in private ownership.

1.1.3 Ancillary businesses. Ancillary businesses are concerned with network construction, its maintenance, inputs supplies, and social infrastructure. A score of one means that these businesses are state owned. The score increases with the degree of separation, corporatisation and privatisation, or the increase in new private establishments.

1.2 Operation

1.2.1 Natural monopoly. A score of one is given when the natural monopoly is operated as a government department. The score increases with reorganisation into an independent state agency or a company, and the establishment of an independent regulator. The maximum score is assigned if a private company manages the natural monopoly, and only an independent regulator, established by law, can intervene.

1.2.2 Natural monopoly planning and investment decisions. A score of one implies political interference in making business and investment decisions. The score increases as commercial objectives such as profitability and operational efficiency grow in importance. The highest score applies if network extensions and new investment
projects are realised solely based on profitability considerations and reflect marginal social costs.

1.2.3 Private sector participation in service contracts. A score of one means that the private sector does not participate in construction, maintenance or rehabilitation, etc. The score increases with increasing participation in these activities by the private sector.

1.3 Organisational structure

1.3.1 Separation of natural monopoly and potentially competitive businesses. A score of one means no separation between the infrastructure and the service providers’ managements, as well as separation between the managements of different service providers. The score increases with unbundling of the industry. The highest score applies when different services are provided by separate private companies.

1.3.2 Separation of ancillary businesses. A score of one means no separation of ancillary businesses from the natural monopoly or potentially competitive businesses. The score increases with increasing degrees of separation. The maximum score is assigned when ancillary services for the natural monopoly and for potentially competitive businesses are supplied by the market.

1.3.3 Decentralisation. A score of one implies no or minimal decentralisation and increases with increasing decentralisation. Decentralization is both regional and functional and implies autonomy of decision making at the regional level concerning tariffs and investments. The highest score is assigned when the industry is divided into competing regional operators.

2 Tariff reform

2.1 Structure of tariffs

2.1.1 Political vs. regulated operators. A score of one implies strong political interference in tariff setting. The score increases with declining political interference and its transfer from the central government to the corresponding government agency and finally to the regulatory body. The maximum score is reached for full cost reflective tariff setting by an infrastructure operator regulated by an independent regulator.

2.1.2 Natural monopoly pricing. A score of one corresponds to pricing below cost accompanied by a substantial amount of cross-subsidisation. The score increases as the tariff approaches the long-run marginal cost reflecting cost covering levels, with cross-subsidisation declining.

2.1.3 Potentially competitive businesses pricing. A score of one means a lack of cost reflective pricing. The score increases with
markets becoming increasingly competitive and prices approaching market equilibrium levels.

2.2 Payments

2.2.1 *Intra-industry payment ratios.* A score of one implies that arrears are constantly accumulating and transactions between companies within an industry are basically non-monetary. The score increases as monetary settlements are carried out and arrears are approaching zero.

2.2.2 *Final consumer collection rates.* A score of one means low revenue collection from final consumers (households, companies, budgetary organizations) and constantly accumulating arrears. The score increases as progress with revenue collection is made and services are fully paid for. Apart from a non-linear pattern of evaluation grades with respect to payment percentage improvements in each sector, there is non-homogeneity of the patterns across sectors. The six sectors were divided into two groups in accordance with the potential efforts needed to reach higher payment levels. Telecommunications and roads represent the first group, where high levels of payments are relatively easy to achieve. The railroad, power, gas, and water supply sectors were put into the second group, where comparatively small improvements can be defined as considerable successes.

2.2.3 *State indebtedness.* A score of one corresponds to growing arrears for state compensations to privileged consumers. The score improves as this indebtedness is reduced zero.

2.3 State funding

2.3.1 *Subsidies level.* A score of one means that some groups of consumers are heavily subsidised by the state in an explicit or implicit form. Both the depth of the subsidisation and the distribution of subsidies are important. The government may pursue a constant practice of debt forgiving and restructuring. Abstention from implicit and explicit subsidies leads to improved scores.

2.3.2 *Subsidies procedure.* A score of one is assigned when the subsidies are directed to service suppliers and are provided in non-transparent ways. The score improves as the process becomes more transparent and income compensations replace price compensations.

3 Regulatory and institutional development

3.1 Effective regulatory institutions

3.1.1 *Management selection for competitive businesses.* A score of one means that state officials appoint the management. The score increases when the management is elected by the shareholders and
reaches its maximum when the shareholders are private companies or individuals.

3.1.2 **Independence of regulator, insulation from political influence.** A score of one is assigned when a government department provides the service. The score increases as a state commission is introduced and an independent regulator is established. The highest score applies when an independent regulator acts according to law.

3.1.3 **Transparency of regulations.** A score of one implies an absence of legislation defining clear rules of the game for businesses, and obligations of government bodies. The score increases with the development of legislation and its enforcement, including when the decision-making becomes public. The maximum score is reached when an independent regulator alone regulates the performance of the natural monopolies in an industry in accordance with law, and all decisions are disclosed.

3.2 **Access regulation.** A score of one means that the access right is arbitrarily determined by the state or the state-owned operator. The score increases as access is regulated by an independent regulator, later negotiated, finally determined by market mechanisms.
Appendix 3

Explanations for the infrastructure indicator evaluations given in Appendix 1
(August 2004 - July 2005)

TELECOMMUNICATIONS

1.0 Commercialisation and privatisation

1.1 Ownership

1.1.1 The state-owned monopoly Ukrtelecom still controls about 80% of the fixed-line telephone market and owns the largest primary network. The indicator remains unchanged at 1.7.

1.1.2 Additional competition signifies a positive development in the mobile segment. On the other hand, the contradictory IP-telephony regulations and the integration of Utel into Ukrtelecom show negative tendencies. Hence the score remains at 2.7.

1.1.3 The ownership structure in the ancillary businesses did not change. The indicator remains unchanged at 2.0.

1.2 Operation

1.2.1 The indicator was left unchanged at 2.0.

1.2.2 Ukrtelecom’s decision to transfer its profits to the state in 2005 was politically influenced, and efficiency considerations were forfeited in favour of activities boosting the state’s income. The indicator remains at 1.7.

1.2.3 The private sector continues to increase its participation in many competitive segments. The indicator remained at 2.1.

1.3 Organizational structure

1.3.1 The and Ukrtelecom and Utel merger, as well as later Ukrtelecom’s application for a preferential mobile 3G license signify negative developments. Another negative development within the industry was the merger of MTU and SCCI. The score was decreased from 2.3 to 2.0.

1.3.2 The organizational structure of the auxiliary businesses remained unchanged, and so does the indicator.

1.3.3 The indicator remains unchanged.

2.0 Tariff reform

2.1 Structure of tariffs

2.1.1 The indicator remains at the level of 2.2.
2.1.2 The practice of cross-subsidization of local phone call tariffs at the expense of long distance tariffs, and of rural region tariffs by urban tariffs remained unchanged. So does the indicator.

2.1.3 The regulation on interconnections and inter-payments allowed avoiding deviations from equilibrium pricing. The indicator remains at 3.1.

2.2 Payments

2.2.1 There were no major developments in intra-industry payments. The indicator has not been changed.

2.2.2 The indicator remains unchanged at 3.4.

2.2.3 The state’s indebtedness is planned to be decreased, albeit at the expense of dividend payments. Thus, the indicator remains unchanged.

2.3 State funding

2.3.1 The number of privileged phone user categories and the subsidy level did not change. The indicator has not been changed.

2.3.2 The system of privileges was not changed. As before, price compensation is dominant. The indicator has not been changed.

3.0 Regulatory and institutional development

3.1 Effective regulatory institutions

3.1.1 No changes in this area. The indicator has not been changed.

3.1.2 The establishment of the NCRC solved the majority of the sector’s regulatory problems. However, the political independence, especially from the MTCU is still in doubt. The indicator stays at 2.5.

3.1.3 There were no changes: the temporary regulations have not yet been replaced by regular ones. The indicator has not been changed.

3.2 Access pricing regulation method. Continuing problems with access to the market, including licensing and attempts by the government to gain control over the internet in the UA-zone, has not been solved yet. The indicator remains unchanged.

RAILWAYS

1.0 Commercialisation and privatisation

1.1 Ownership

1.1.1 The basic rail network is 100% state owned. Sales/transfers of local railways take place occasionally. The indicator has not been changed.

1.1.2 Passenger and freight transportation are 100% state owned. The corporatization of freight transportation enterprises is complete. Forwarding enterprises are mostly private. Freight railway cars are partially in private ownership, partially transferred to Ukrtransleasing. The indicator has not been changed.
1.1.3 The construction, maintenance and service enterprises are corporatized. Privatisation of the remaining auxiliary railway enterprises has slowed down. The indicator has not been changed.

1.2 Operation
1.2.1 The railways are regulated by the State Railways Administration, which is integrated into the Ministry of Transport. The Minister of Transport remains the Head of Ukrzaliznytsia. The indicator has not been changed.

1.2.2 The State Railways Administration strives for operational efficiency and profitability of the industry. UZ now issues tenders for its projects. The indicator has not been changed.

1.2.3 Rail line construction and rolling stock maintenance is provided by state enterprises and joint stock ventures, which belong to the state. The indicator has not been changed.

1.3 Organisational structure
1.3.1 The railway infrastructure, passenger and freight transportation services are integrated within Ukrzaliznytsia, but keep separate accounts. Cross-subsidization is transparent, separate accounts for freight and passenger transportation are available. The indicator has not been changed.

1.3.2 Ukrzaliznytsia has been charged with the management of more ancillary businesses. The indicator has not been changed.

1.3.3 The railways are split into 6 regional companies. The South-Western Railway is allowed to issue bonds. The indicator has not been changed.

2.0 Tariff reform
2.1 Structure of tariffs
2.1.1 Tariffs for freight transportation were increased for the purpose of higher profits. Tariffs for passenger transportation in first class cars were also increased in order to reduce losses from passenger transportation. However, the tariff-setting procedure remains non-transparent. The indicator has not been changed.

2.1.2 Cross-subsidisation of passenger transportation by freight transportation persists, but can now be tracked through financial statements. Ukrainian Railways shows profits. The indicator has not been changed.

2.1.3 The tariffs do not precisely reflect the infrastructure and rolling stock operating costs; however overall, the costs are covered. The indicator has not been changed.

2.2 Payments
2.2.1 Intra-industry payments are stable. The indicator has not been changed.

2.2.2 Monetary payments for freight transportation are about 97%. The indicator has not been changed.
2.2.3 State subsidies are provided at levels set in the central state budget and go mainly to financing of vocational training and other non-production related expenses. The indicator has not been changed.

2.3 State funding
2.3.1 The government still relies on (privileged) passenger transportation funding at the expense of Ukrzaliznytsia. The indicator has not been changed.
2.3.2 Subsidies are paid to the railways (service provider). The indicator has not been changed.

3.0 Regulatory and institutional development

3.1 Effective regulatory institutions
3.1.1 The President of Ukraine appoints the top management, although the government body operating the railways is formally independent. Management decisions are increasingly insulated from political interference. The indicator has not been changed.
3.1.2 The railways regulator is part of the government and is integrated with the rail line operator. The indicator has not been changed.
3.1.3 Tariffs are fixed by legislation. A transport tariff policy is being developed to increase the transparency and efficiency of tariff setting procedures. The indicator has not been changed.

3.2 Access pricing regulation method. Access is regulated with government permission. Ukrsaliznytsia has cancelled previously existing discounts for selected transport providers within the transportation tariff structure in order to equalize the rights and competitive possibilities of all service providers. The index was increased from 1.0 to 1.3.

ROADS

1.0 Commercialisation and privatisation

1.1 Ownership
1.1.1 Roads are 100% in state and communal ownership. The indicator has not been changed.

1.1.2 Individuals (private entrepreneurs) provide 85% of bus passenger transportation. Individuals own 30% of all medium and large buses. Corporate entities and open joint-stock societies have a 15% share of the market. The indicator has not been changed.

1.1.3 The social infrastructure, services, and automobile maintenance enterprises are mostly private. Publicly owned companies provide most of the road maintenance and construction (at least as main contractors). The indicator has not been changed.

1.2 Operation
1.2.1 Regulation and management of the road network are separated from each other. The regulatory body (Ukrainian Road Service) is
the principal managing body of the State Joint Stock Company “Motor Roads of Ukraine”. The indicator has not been changed.

1.2.2 More emphasis was put on developing concession projects. A project to construct a state owned toll-road is under way. The indicator has not been changed.

1.2.3 Road construction and maintenance is provided mostly by state owned corporations and by some private firms. Most construction work is done by the local subsidiaries of the State JSC “Motor Roads of Ukraine”. The indicator has not been changed.

1.3 Organisational structure

1.3.1 Roads management is separated from freight and passenger transportation services. The indicator has not been changed.

1.3.2 Road construction and maintenance are separated from transportation; some services are contracted out. The indicator has not been changed.

1.3.3 Roads are financed and operated at both the central and regional levels. Municipal authorities can make investment decisions on local road construction using the vehicle tax funds they collect. The indicator has not been changed.

2.0 Tariff reform

2.1 Structure of tariffs

2.1.1 The government sets tariffs for passenger transportation. The indicator has not been changed.

2.1.2 Officially road funding derives from an excise tax on fuel and certain other taxes. These taxes are only partially directed towards road maintenance. The indicator has not been changed.

2.1.3 Several attempts by transport providers to raise tariffs of intra-city passenger transportation in response to rising fuel costs have succeeded. The indicator has not been changed.

2.2 Payments

2.2.1 Payment arrears between enterprises decrease. The indicator has not been changed.

2.2.2 Payments are monetary. Compensation for privileged passenger transportation remains an unresolved issue. The indicator has not been changed.

2.2.3 The state still finances the sector at an inadequate level. The indicator has not been changed.

2.3 State funding

2.3.1 The number of privileged passengers remains high. Compensation levels are inadequate. The indicator has not been changed.

2.3.2 Subsidization of privileged passengers is frequently put onto the shoulders of service providers. The indicator has not been changed.

3.0 Regulatory and institutional development
3.1 Effective regulatory institutions

3.1.1 Only the management of the road operation services is appointed by the government. The indicator has not been changed.

3.1.2 Road Service of Ukraine, the regulatory body in the sector, is organisationally separated from the government. The indicator has not been changed.

3.1.3 The Transport Ministry has approved a program to adapt the Ukrainian transportation laws to EU standards in 2004. The indicator has not been changed.

3.2 Access pricing regulation method. Access is regulated by licensing. Tenders for servicing city bus routes were introduced. The indicator has not been changed.

POWER

1.0 Commercialisation and privatisation

1.1 Ownership

1.1.1 The controlling stakes in 13 (out of 27) regional distribution companies (oblenergos) were sold. All of the stakes in the distribution companies still belonging to the state were united in the Energy Company of Ukraine holding. The indicator has not been changed.

1.1.2 The nuclear, hydro and fossil fuel generating plants were separated into different companies. The nuclear and hydro generating plants remain 100% state property, while three fossil fuel generating companies were partially privatised, however the state remained the major owner. All of the state stakes in power plants, with the exception of the nuclear stations, where united in the Energy Company of Ukraine holding. The indicator has not been changed.

1.1.3 Social infrastructure, construction and maintenance are still treated as part of the natural monopoly. The indicator has not been changed.

1.2 Operation

1.2.1 The regional distribution companies are corporatized, some of them are in private hands, all are regulated by the NERC. The grid is operated as a part of Ukrenergo. The indicator has not been changed.

1.2.2 Decision-making is still politically influenced. This is likely to diminish due to pressures from private investors (guaranteed profitability). The indicator has not been changed.

1.2.3 Construction and maintenance are managed by the oblenergos. Private sector participation gradually increases. The indicator has not been changed.

1.3 Organisational structure
1.3.1 Generation, transmission and distribution are separated into independent companies. State stakes in the power sector, with the exception of nuclear stations, are united in Energy Company of Ukraine. The impact of this decision will be assessed in the following period. The indicator has not been changed.

1.3.2 There is a minimal degree of separation. The private sector is marginally involved. The indicator has not been changed.

1.3.3 Decentralisation is not a high priority in this industry.

2.0 Tariff reform

2.1 Structure of tariffs

2.1.1 Political interference in tariff setting for certain types of consumers persists, although pressure is being exerted by the independent regulator and by decrees of the Cabinet of Ministers. The indicator has not been changed.

2.1.2 Cross-subsidisation of households and preferential tariffs for coalmines are still in effect, further geographical cross-subsidization is being introduced through equalising the tariffs throughout the country. The indicator has not been changed.

2.1.3 Real competition at the wholesale power market is noted. Power generating companies compete by bidding. At the same time the absence of modern meters allowing instantaneous consumption measurements prevents the customers’ consumption to be billed according to the load curve. The indicator has not been changed.

2.2 Payments

2.2.1 The situation is stable, but some settlements are still made in non-cash form. The indicator has not been changed.

2.2.2 The average level of cash payments by the oblenergos to the wholesale electricity market is stable. The indicator has not been changed.

2.3 State funding

2.3.1 The poorest people are subsidised, the number of privileged categories remains substantial. The indicator has not been changed.

2.3.2 Subsidies are paid to theoblenergos. The indicator has not been changed.

3.0 Regulatory and institutional development

3.1 Effective regulatory institutions

3.1.1 The management is appointed by the state. The indicator has not been changed.

3.1.2 The NERC is governed by decrees issued by the President and the Cabinet of Ministers, there is no law defining its rights and obligations. The indicator has not been changed.

3.1.3 More transparency has been introduced into the distribution of moneys for power supplied to the wholesale market. A decision has been taken to pay the generating companies in proportion to the
amount of electricity they have supplied to the market. This should take away the discretionary power to shift non-payments to specific power generators, however, this decision does not affect any previously accumulated debts and their coverage. The indicator has not been changed.

3.2 Access pricing regulation method. Access is regulated by the NERC, but without a strong legislative base. The indicator has not been changed.

GAS

1.0 Commercialisation and privatisation

1.1 Ownership

1.1.1 The trunk pipeline and the distribution net are 100% state property, however, NAK Naftogaz is corporatized. The indicator has not been changed.

1.1.2 The share of state ownership in gas extraction is very high, private companies are marginally involved in gas imports. The indicator has not been changed.

1.1.3 Private involvement in the wholesale segment of the industry decreased after Itera left the market. The construction, maintenance and service efforts are carried out mainly by NAK Naftogaz, but unrelated businesses were split off. A private company is carrying out some contracts for trunk pipeline modernisation. The indicator has not been changed.

1.2 Operation

1.2.1 NAK Naftogaz is subject to supervision by the government and the President; it can however operate as a market company. The indicator has not been changed.

1.2.2 The commercial objectives remain poorly defined, although commercialisation has increased and debt accumulation for consumed Russian gas was stopped, as was illegal siphoning. The indicator has not been changed.

1.2.3 Employing private companies to repair and maintain the pipelines has started. The private sector is involved in gas deliveries to enterprises. The indicator has not been changed.

1.3 Organisational structure

1.3.1 NAK Naftogaz was split into extraction, transportation and sales. The indicator has not been changed.

1.3.2 There is a minimal degree of separation. The indicator has not been changed.

1.3.3 Decentralisation is not foreseen for this industry.

2.3 Tariff reform

2.2 Structure of tariffs
2.1.1 There still is government interference in tariff setting for some types of consumers. The indicator has not been changed.

2.1.2 Industrial enterprises have choices; NERC determines the price of transportation. Households and utilities are invoiced at below-cost prices. As a result under-investment in the network persists. The indicator has not been changed.

2.1.3 NERC sets ceiling prices on natural gas for final consumers according to a Cabinet of Ministers’ decree. The indicator has not been changed.

2.2 Payments

2.2.1 Arrears accumulation persists. A debt settlement scheme was introduced. The indicator has not been changed.

2.2.2 The payment discipline situation in the sector improved slightly, and overall debts for gas consumption decreased by 6% between January and July 2005. However, some of the causes for non-payments persist, especially in the case of public utilities, which suffer from non-cost-reflective tariffs and the low payment discipline of final customers. The indicator has not been changed.

2.2.3 The state remains among the major debtors; Naftogaz bears the costs of supplying gas to households. The indicator has not been changed.

2.3 State funding

2.3.1 The poorest households are subsidised; delayed debt repayments by enterprises continue. The indicator has not been changed.

2.3.2 Subsidies are paid to the public sector. The indicator has not been changed.

3.0 Regulatory and institutional development

3.1 Effective regulatory institutions

3.1.1 The government appoints the management, although NAK Naftogaz is formally independent. The indicator has not been changed.

3.1.2 NAK Naftogaz is subject to government control. The indicator has not been changed.

3.1.3 Gas auctions were abolished, distribution costs and the price of the natural gas received in lieu of a Russian gas transit fee are non-transparent. The indicator has not been changed.

3.2 Access pricing regulation method. Access is regulated by the NERC, but without a strong legislative base. The indicator has not been changed.

WATER AND WASTEWATER

1.0 Commercialisation and privatisation

1.1 Ownership
1.1.1 The natural monopolies (water distribution and drainage systems) are mostly in communal ownership (88%), 5% are state owned, and 7% are privately held. The index remains at the level of 1.3.

1.1.2 Most potentially competitive businesses (water supply and wastewater treatment) are still integrated with the natural monopolies and are mostly in communal ownership. The indicator has not been changed.

1.1.3 Construction and maintenance are integrated with the natural monopolies and are also mostly in communal ownership. The indicator has not been changed.

1.2 Operation

1.2.1 Water and wastewater services are provided by local monopolists administered by local governments, which are also the owners of the companies in most cases. The indicator has not been changed.

1.2.2 The political influence on decision-making is very strong, local governments pursue goals of social support. The indicator has not been changed.

1.2.3 Private sector participation in service contracts is low; where it exists it is mostly due to the participation of international financial institutions. The indicator has not been changed.

1.3 Organisational structure

1.3.1 No separation. The indicator has not been changed.

1.3.2 No separation. The indicator has not been changed.

1.3.3 Companies operate only under the supervision of the local authorities. Local governments became less dependent on the central executive powers due to a legal change concerning tariffs and investments. The indicator has not been changed.

2.0 Tariff reform

2.1 Structure of tariffs

2.1.1 All tariffs are approved by municipal officials. In several regions tariffs for water and wastewater were increased despite political pressures for reduction. The indicator has not been changed.

2.1.2 Tariffs for residential consumers remain at below-cost levels. The tariffs for industrial consumers are higher than residential ones. Even with cross-subsidisation the tariffs do not cover costs in almost all regions. The indicator has not been changed.

2.1.3 Potentially competitive businesses are integrated parts of the natural monopolies, pricing of the services is not separated. The indicator has not been changed.

2.2 Payments

2.2.1 Payment arrears are significant. Major creditors of the industry are the power distribution companies. The indicator has not been changed.
2.2.2 The collection rates from households remain high (94%). However, the total debts for utility services grew by 6.4%, now amounting to 3.2 bn (July 2005). The indicator has not been changed.

2.2.3 The local governments fulfil their obligation concerning financing of privileged consumers by more than 50%. The indicator has not been changed.

2.3 **State funding**

2.3.1 The poorest households are subsidised. The amount of subsidisation varies substantially between regions. The indicator has not been changed.

2.3.2 Subsidies are paid to the water supply and sewage companies. The indicator has not been changed.

3.0 **Regulatory and institutional development**

3.1 **Effective regulatory institutions**

3.1.1 Regional governments appoint the management of the water supply and wastewater monopolies. The indicator has not been changed.

3.1.2 There is no independent regulator. The State Committee for Public Utilities is slated to be the regulator for the industry, although there is no clear definition of the committee’s regulatory responsibilities and procedures. The indicator has not been changed.

3.1.3 Although clear tariff regulation guidelines are available they are not obligatory for local administrations: tariffs continue to be set arbitrarily. The indicator has not been changed.

3.2 **Access pricing regulation method.** There are no rules for access. The indicator has not been changed.