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Public utilities tariffs rise: first response to new challenges

Starting from May 1, gas and electricity tariffs for households were increased by 25% according to the decree of the National Electricity Regulation Commission (NERC). This is the first tariffs' revision in the chain of the increases, planned by the Cabinet of Ministers and intended to bringing tariffs to cost-covering level. From May 1, electricity tariffs were increased from UAH 0.156 to UAH 0.195 per 1 kW-h and gas tariff were raised from UAH 185 to UAH 231 per thousand cubic meters.

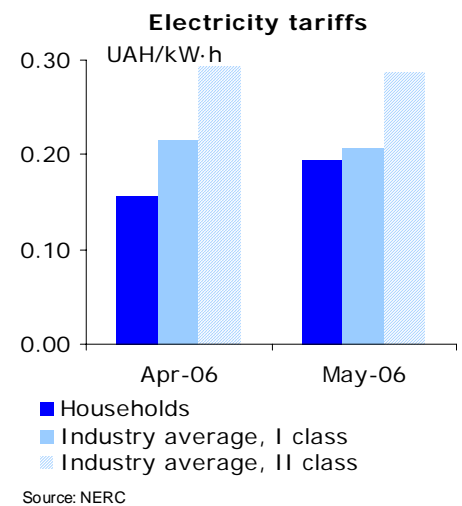
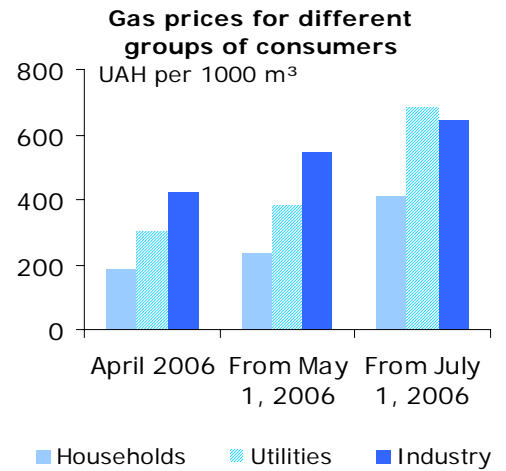
This is the first change in gas and electricity tariffs for households since 1999. As input prices grew (e.g., producer price index and real wages more than doubled in 1999-2006), tariff-cost ratios for electricity and gas deteriorated, and tariffs were not covering costs. In April 2006 electricity tariffs for population covered only 36% of costs of its generation and distribution. Low households tariffs were and still are compensated by higher tariffs for industrial consumers, creating an excessively high burden on industrial sectors. In previous years the NERC has made several unsuccessful attempts to increase tariffs on gas and electricity. In December 2005 the government agreed on gas tariff increase for budget entities and heating enterprises, while tariffs for households remained unchanged, likely due to parliament elections.

The external shock – more than 60% increase in price for imported gas – became a impetus for changes making flat tariffs policy not feasible. In order for enterprises of utility sectors to have sufficient funds to pay their own obligations, including wages to their employees, and to finance the maintenance and renovation of networks, tariffs have to be adjusted to cost covering level. As a result, the government supported the NERC decision to increase tariffs for gas and electricity from May 2006.

This rise of tariffs has already provoked a protest in society. On May 24, the Federation of Trade Unions (FTU) of Ukraine organized a people protest against the decision of the NERC. The FTU claimed that the government violated legislation during the process of tariff increase. In particular, Ukrainian legislation stipulates that the government should agree tariff increases with the trade unions, and it did not. However, this provision is foreseen by the General Agreement signed by the Cabinet of Ministers with trade unions and organizations of employers for 2004 and 2005. The parties failed to sign the General agreement for 2006. Moreover, the General agreement for preceding years also states that the government should set tariffs on the economically justified levels, which was not the case in Ukraine.

Regardless the protests, the Cabinet of Ministers insists on further tariff increase. The next increases are planned from July 1, when price for gas is planned to be almost doubled from current UAH 231 to UAH 414 per thousand cubic meters, and from January 1, 2007 when price is to be set equal to costs. The tariffs increase will lead to higher tariffs for other utility services. At the same time, the government is looking for a compensation scheme in order to soften the negative impact of tariff revision on low-income households. At the moment, such households can apply for state subsidies for utility payments. For instance, in 2005 UAH 361 m were spent on such subsidies. According to official estimates in 2006 the planned tariff increases will cost more than UAH 1.0 bn to the government. In addition, the Cabinet of Ministers considers the possibility of implementing differentiated tariffs for the services depending either on the volume of consumption or housing space.

The necessity of setting cost-covering tariffs for gas and electricity – the key principle of market-oriented economy – is hard to underestimate. Postponement of the tariffs increase for several years has deepened the problem that government have to deal with now under the pressure of the external price shock. Required utility tariffs increase will contribute to inflation and will adversely affect the well-being of households. At the same time, that should create incentives for utility enterprises to improve efficiency and quality of provided services.



Authors:

Oleksandra Betliy

Anna Chukhai

Institute for Economic Research and
Policy Consulting


Quarterly Trends

National accounts **		Q3 03	Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Q1 05	Q2 05	Q3 05	Q4 05
GDP	UAH bn	75.6	77.1	64.7	79.0	100.5	100.6	84.3	97.5	119.4	123.6
GDP (real)	% yoy	6.8	12.1	12.7	13.7	14.0	8.5	4.9	3.4	1.4	1.7
Households consumption (real)	% yoy	11.2	13.6	14.6	16.8	13.1	16.2	14.3	17.7	17.0	17.1
State consumption (real)	% yoy	19.2	9.0	3.3	1.0	5.0	10.1	6.1	0.0	1.0	4.0
Gross fixed capital formation (real)	% yoy	24.3	9.0	18.4	6.5	4.6	12.9	-2.3	-0.5	0.2	0.3
Exports of goods and services (real)	% yoy	9.8	11.6	18.1	19.9	10.5	8.6	-0.6	-14.0	-12.7	-15.5
Imports of goods and services (real)	% yoy	17.4	17.7	13.8	7.3	6.7	7.8	2.8	3.2	3.9	-0.9
Agriculture, hunting, forestry (real)*	% yoy	-22.5	6.7	-4.4	0.9	35.7	9.9	5.8	8.3	2.6	-7.4
Manufacturing industry (real)*	% yoy	23.0	20.1	23.9	16.3	12.5	9.4	7.0	1.8	-1.1	2.0
Construction (real)*	% yoy	30.9	16.9	29.9	30.6	16.4	3.9	-8.4	-11.3	-8.5	-7.5
Trade, repair services (real)*	% yoy	22.6	29.6	23.6	35.0	2.7	13.7	-2.1	-10.7	-11.7	-11.9
Transport (real)*	% yoy	15.9	11.7	10.1	8.0	12.3	10.5	6.6	5.7	2.8	7.8
Balance of payments											
Current account balance	USD bn	0.7	0.4	1.4	2.3	2.1	1.1	1.6	0.6	0.4	-0.1
Current account balance	% of GDP	5.0	3.0	11.1	15.7	10.9	5.7	10.1	6.3	4.5	3.0
Trade balance in goods	USD m	-155	-381	933	1552	774	482	1020	-236	-1131	-788
Trade balance in services	USD m	362	409	133	198	749	157	188	392	1035	191
Current transfers	USD m	574	584	475	758	720	623	626	694	745	780
Direct investment (FDI)	USD m	390	329	333	614	420	344	247	365	477	6474
Portfolio investments	USD m	-444	-293	449	149	1313	156	397	923	90	1347
Gross international reserves	USD bn	6.7	6.9	7.9	9.6	12.1	9.5	12.0	13.1	14.3	19.4
Fiscal indicators											
Consolidated fiscal revenues	% of GDP	30.1	28.6	27.2	26.9	26.3	25.9	32.1	35.1	31.5	31.0
Personal income tax	% of GDP	5.3	5.1	4.4	4.1	3.8	3.8	4.3	4.4	3.9	4.2
Enterprise profits tax	% of GDP	4.8	5.0	3.9	4.0	4.1	6.1	4.8	5.9	5.3	6.3
Value-added tax	% of GDP	5.8	4.8	6.2	5.7	5.1	4.1	8.6	9.2	7.9	7.3
Excise tax	% of GDP	2.1	2.0	2.1	2.1	2.0	1.8	2.0	2.0	2.0	1.7
Consolidated fiscal expenditures	% of GDP	27.9	28.8	25.3	26.5	26.8	35.2	28.3	36.4	28.1	41.7
Current expenditures	% of GDP	24.2	24.3	22.4	22.7	21.7	27.2	26.5	33.6	24.0	34.2
Capital expenditures	% of GDP	3.7	4.4	2.9	3.8	5.1	8.0	1.8	2.7	4.1	7.5
Consolidated fiscal balance	% of GDP	2.2	-0.2	1.9	0.4	-0.5	-9.3	3.7	1.0	-5.0	6.2
Privatisation receipts	% of GDP	1.0	0.8	1.5	3.7	3.5	1.0	0.2	0.6	0.6	16.0
Labour market											
Average wage (real)	% yoy	19.9	14.9	19.9	18.6	14.7	15.4	15.0	19.0	19.6	26.4
Household income (real)	% yoy	10.0	8.7	11.7	16.3	11.3	16.6	24.0	28.0	19.4	18.9
Unemployment rate (ILO methodology)	%	9.2	9.0	9.3	8.3	8.1	8.7	8.7	7.0	5.2	7.8
Banking system											
Monetary aggregate M0	% yoy cum	30.5	25.3	29.1	25.6	37.1	27.9	28.2	39.1	31.1	42.2
Monetary aggregate M2	% yoy cum	49.9	47.6	45.4	44.8	51.5	32.3	38.9	37.4	31.3	53.9
Household deposits in national currency	% yoy cum	65.0	66.1	69.4	67.3	67.9	26.2	28.3	31.6	30.4	90.8
Household deposits in foreign currency	% yoy cum	70.4	77.5	67.0	61.7	55.2	54.3	51.8	45.4	46.4	59.1
Com. bank credits in national currency	% yoy cum	73.0	61.7	56.8	52.1	44.3	29.4	28.3	32.6	43.4	58.7
Com. bank credits in foreign currency	% yoy cum	57.7	60.9	63.6	56.2	43.5	32.2	33.1	36.8	47.1	66.3
Long-term com. bank credits	% yoy cum	164.0	157.9	141.7	102.7	82.7	57.1	49.5	53.0	70.1	84.6
Long-term com. bank credits	% of total	40.1	45.0	47.4	49.3	50.9	54.2	54.4	56.1	59.7	61.8
Average lending rate on national cur. credits	% p.a.	17.2	17.7	17.2	16.6	17.0	17.6	17.0	15.4	15.4	16.4
Average lending rate on foreign cur. credits	% p.a.	11.7	10.9	12.2	12.1	12.6	12.2	12.1	11.0	11.3	11.7

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