

ICPS newsletter

Fuel Crisis Caused by Government Interference

The main reason for the fuel crisis lies in the constant efforts of the authorities to interfere in market mechanisms. This time interference has taken the form of attempts to slow the objective increase of prices for petroleum products and the participation of state organisations in fuel delivery, particularly to agricultural enterprises. We shall not consider here other causes of the crisis, such as instability of legislation and stamp duty rates; these factors have a short-term effects and are present in any stable economy. Moreover, they testify to the constant struggle between the government seeking as much tax revenue as possible and private businesses aiming at profit maximisation. On the other hand, state interference is a long-term factor which destabilises markets and economic activities, creates conditions for monopolisation and corruption, and leads to direct loss of budget revenues

Price restraints

Since the start of this year, world prices for petroleum increased by 80 percent, but the Russian and Ukrainian governments have tried to restrain price increases on petroleum products. In both countries the authorities consider these products to be politically important, as their cost is an element of practically all other prices. Moreover, the petroleum price boom coincided with the start of the grain harvest; that is why the jump in petroleum product cost could mean a considerable increase in prices for bread from the new harvest, while both governments consider this fact unacceptable on the eve of elections.

Soviet practice dictates that officials must adopt a simple decision—administratively limit price increases—but the experience of the past decade testifies that these steps do not solve the problem, for they immediately create a goods deficit. At best, the authorities are forced to cancel their decisions and demonstrate their incapacity to foresee consequences. The latest example is the attempt of the Kyiv City Administration to control prices on sugar and petroleum products. At worst, the government does not acknowledge its mistakes and endeavours to soften the deficit problem by redistributing the limited supply of goods; typical methods of redistribution include imposition of export restrictions, regional limitation of goods flow, state interference in trade in scarce

goods, and direct confiscation of commodity reserves from private businesses. Propensity to this option was shown by the Verkhovna Rada, which on July 20 adopted a resolution obliging the Cabinet of Ministers "to restore control over fuel shipments from oil refineries" and "to examine the question of wholesale supply of fuel and lubricants from filling stations to agricultural producers".

In addition to short-term market instability, a negative result of the "best" option—simple price restraints—will also be an overall loss of confidence in the economic policy of the government. The "worst" option—redistribution—is dangerous, because it leads to decreased output as well as export and import, increasing both the deficit and prices, and also monopolises the market, where under such conditions only companies close to the government can operate, thus favouring corruption.

A particular feature of the energy resources market, inherited from the Soviet economy, that exacerbates the mentioned tendencies is the subsidisation of Russian oil and gas. The Ukrainian government believes that Russian enterprises should supply energy resources at prices that are below world (market) prices, and on credit.

The argumentation of this position is incomprehensible. If the purchase and sale operations are regarded as mutual benefits, it will be possible only in two cases:

- someone compensates price differential to

Russian enterprises. The Russian government can do this in exchange for political concessions from the Ukrainian government, i.e., partial loss of state independence;

- the Ukrainian government also sells to Russia (for example, grain or oil transportation services) at below-market prices. This option is less dangerous but inevitably leads to negative consequences: (i) only one supplier—Russia—can provide the conditionally cheap energy resources; (ii) these special systems require the participation of government or quasi-government structures (so called "intergovernmental agreements"), promoting market monopolisation and corruption; they are opaque and often turn into latent budget subsidisation of certain manufacturers. Such support at the cost of state funds is provided only if the Ukrainian enterprises selling at below-market prices are state-owned (oil pipelines, in particular, are such enterprises).

Both methods of fuel subsidisation have weak spot: they work well under stable external conditions. If the situation is changed, however—for example, the world price for petroleum rises—both methods lose their advantage. Political concessions are cheaper than real profit from the export of petroleum, and intergovernmental schemes need time to be designed and coordinated with all participants. This is what leads to fuel deficits.

Market monopolisation

The efforts of authorities to maintain low prices (which often are unrealistic to begin with) are a reason for the misbalance and monopolisation of the fuel market. Another cause is the direct participation of the state and of its own hand-picked and authorised oil suppliers in agriculture—the second-largest sector of the Ukrainian economy.

Thus, according to a resolution of the Cabinet of Ministers dated December 10, 1998, the Naftogas Ukrainian state joint-stock

company and the Ukrnafta open joint-stock company were charged with allocating 2 million tons of oil in 1999 to the State Committee for Material Reserves for processing, and delivery of petroleum products to farms according to a list of the Ministry of the Agroindustrial Complex. The Ministry of Finance was obliged to allocate 450 million UAH, returnable, to the State Committee for Material Reserves to purchase another 1.5 million of oil. The government planned that agricultural enterprises would pay off the petroleum products with grain, in an equivalent defined by the state, and state enterprises were appointed to be the operators. By July 15 the government fulfilled 67 percent of the delivery schedule for petroleum and 81 percent for diesel.

In this brief analysis we examine neither the influence of these schemes on the viability and financial state of agricultural enterprises nor the most effective ways of financing seasonal agricultural work. Our aim is to show why the government scheme led to a fuel deficit overall and, in particular,

to an even worse shortage of low-octane petrol and diesel used by agricultural producers. There are several causes:

1. If state companies authorised by the government take over large parts of the market, the market becomes monopolised.

The government provides state and quasi-state enterprises with tax privileges, low-interest loans and better economic conditions compared to private competitors. Centralised delivery of fuel has led to lax budget limitations for agricultural enterprises—they consider it acceptable not to pay for fuel, and the state does not penalise them. That is why the state applies administrative and forceful mechanisms to protect "its own" authorised suppliers. Under such conditions, private enterprises that are not involved in the government-designed schemes sustain losses, become noncompetitive, and leave the market. Here we mean not only supplying the countryside but the overall market of petroleum products, as conditions for the development of quasi-state enterprises are much better.

Monopolisation of the fuel market gives opportunities to a limited number of suppliers to increase their prices and abuse their monopolistic situation to put political pressure on the government.

2. If government-designed schemes do not work or work incompletely, deliveries are stopped.

Agricultural enterprises wait for "free" fuel provided by the government until the last minute, and private businesses do not venture to enter the market monopolised by the state. This will lead to loss of the harvest and the further decline of Ukrainian agriculture.

Thus, government efforts to provide assistance to agricultural enterprises, as well as attempts to help the poor through price restraints, lead to much worse results than the free action of market mechanisms would. Meanwhile, systematic repetition of mistakes for eight whole years testifies to the existence of certain powers obviously benefiting from maintaining this policy.

*Hlib Vyshlinsky,
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Educational Reform Begins At the Local Level

The goal of ICPS's Educational Reform Strategy project is to make the process of developing educational policy more substantial and constructive by means of systematically holding seminars to define the strategic tasks and resources needed for educational reform in Ukraine. As part of this project, a seminar on "Guidelines for the Working Group on Implementing Municipal Educational Policy" was organised by the Lviv city rada, the Institute for Policy Technologies, and ICPS on July 14 in Lviv

The seminar worked on four guidelines:

- preparing and conducting research;
- developing a system for assessing schools and programs;
- training staff for the educational sphere;
- institutional development of a system of educational management at the municipal level.

Separate tasks and methods to carry them out were defined for of these themes, with the following overall goals:

- to convince government of the necessity to reform education;
- to ensure that changes are made in the direction needed for society;
- to raise municipal education to a qualitatively new level corresponding to international standards.

The implementation of educational reform at the local level is slowed by many factors, among which participants of the seminar noted the following:

- different approaches to understanding the place and role of research in the process of educational transformation;

- the current assessment system, which does not perform the function of changing the educational system in the proper direction needed for society;

- inertness and conservatism of educational structures;

- conflict between the current educational system and the goal of reform.

A schedule for educational reform measures was designed at the seminar.

In the short term (within 6 months) the following was planned:

- to create an informational and analytical group and a reform committee that will study the progress of educational reform and experience of other cities and countries;

- to organise seminars and training sessions to acquaint teachers interested in educational reform with changes in the assessment system; and to gradually prepare schools to make these changes.

In the medium term (within 3 years) it is planned:

- to create an independent institute of educational research;
- to prepare inaugural documents and proposals for the creation of an institute which will do assessment work (independent inspection, independent center of testing and certification);
- to formulate requirements for the new assessment system and to test it;
- to develop drafts of changes in curricula corresponding to changes in educational content.

Plans for the long term (within 10 years) included the following tasks:

- to build an infrastructure of independent experts and researchers, analysts and advisors for the educational sphere that will facilitate social dialogue and societal participation in decision making on the development of education;
- to prepare programs, textbooks, and manuals addressing changes in the assessment system and in educational content.

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