

# Blue Ribbon Analytical and Advisory Centre

Project is funded by EU, co-funded and implemented by UNDP  
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## Executive Summary of the Report

# Transport Policy of Ukraine and its Approximation to the Norms of the European Union

This report is prepared by the Blue Ribbon Analytical and Advisory Centre, a project funded by EU, co-funded and implemented by UNDP. The opinions, conclusions or recommendations presented in this paper are those of authors and do not necessarily reflect the views of the European Union and United Nations Development Programme or any other UN agency.

**Kyiv, 2010**

## General Observations

European integration is one of the principal priorities in the Ukrainian state policy. However, the country's transport system still does not meet the EU standards and requirements and is marked with a significant gap as regards infrastructure, equipment and regulations. Ukraine has declared its readiness to do everything possible to upgrade its transport system by way of signing and ratification of a number of international conventions, as well as participation in international organisations, harmonisation of national regulations and standards of transport operations with the requirements of the European *acquis communautaire*. Movement of the Ukrainian laws towards the EU *acquis communautaire* is not only a tool for enhancement of economic cooperation with the EU, but also a means for further development of Ukraine in general.

Even at this point of time there exist a number of obligations that are binding on Ukraine, as well as political and economic initiatives that stipulate the necessity for bringing the transport system operating standards closer to the European regulations and standards.

In order to implement that, the Ukrainian governmental authorities approved corresponding plans for development of legislative acts. However, the following issues are still topical for Ukraine:

- approval of a new version of the Air Code of Ukraine, consistent with the international air law provisions;
- amendment of the Law of Ukraine «On the Road Transport» (in order to bring it to consistency with Directives 96/96/ C, 2001/9/ C, 2001/11/ C, 96/26/ C;
- amendment of the Law of Ukraine «On Road Traffic» (in order to bring it to consistency with Directive 2000/30/ C)

It seems advisable to develop a legislative basis for specific features of functioning of the EU «Single European Sky» (SES) Programme in Ukraine (its principal provisions may be included into the Air Code of Ukraine), as well as a number of Decrees by the Cabinet of Ministers of Ukraine in order to regulate matters of air space use organisation, regulation of noise emissions by aircraft, and their bringing to consistency with provisions of the European regulations. It is also necessary to ensure legal regulation of pilots' qualification upgrading in line with the requirements and standards of the European Union.

The current crisis is not a reason to postpone reforms, including those in the sphere of transport. It is common knowledge that **during any crisis, structural reforms in the economy develop faster**. Economic entities that demonstrate their limited capacities before and during a crisis will be even less efficient during the period of post-crisis growth. Lack of reforms will actually inhibit changes and possible growth. Taking into account that assumption, authors put forward the following condition: any changes that could bring Ukraine closer to the EU country and enable it to make use of its special geographical location, potentials and opportunities, must be prepared and implemented as soon as possible.

## General Recommendations

The realistic presuppositions for Ukraine are as follows:

1. A realistic direction in improvement of efficiency of the Ukrainian transport system is ensuring a greater degree of openness to allow entry of new transportation companies, attraction of private capital, development of competition in all sectors of transport (including railway rolling stock), preserving state regulation solely for

elements that cannot be eliminated (monopolistic structures) and that are necessary for ensuring of a proper safety level in transport. For that purpose, it is necessary to use other countries' experience in opening of transportation systems market for private capital.

2. The state must monitor efficiency of operations by all transport sectors and to prevent asymmetry in competition among them. In contrast to the EU countries that are concerned about all-round automobilisation, in Ukraine 80% of all freight is transported by railways, which is a certain advantage that is worth maintaining.
3. It is expedient to pursue inclusion of other external transport costs, such as expenditures for road maintenance, elimination of the natural environment pollution and clearance of consequences of road accidents, into prices for consumers.
4. It is necessary to analyse the legal system that regulates transport and transport-related construction and environmental and other matters for their consistency with the EU legislation, so that at the time when the consequent amendments are made it could be possible to carry out the necessary changes aimed at a greater openness of the Ukrainian transport system and attraction of foreign capital.
5. Transport policy must also create a foundation for actions by local authorities concerning formation of integrated public transport systems in conurbations (in urban areas that develop very rapidly). Supporting of the key role that railways play is especially important in conurbations and around them.
6. It is expedient to encourage local authorities to prepare transport development programmes with due consideration of infrastructure development, but with the priority given to public transport and proper use of railways.
7. It is expedient to prepare and overall development plan (General Plan) for the Ukrainian transport, proceeding from traffic volume forecasts, other countries' experience and research work conducted by the country's own research institutions.

## **Railway Transport**

In the longer term railway transport will remain to be the principal carrier of goods and passengers in Ukraine. The Ukrainian legislation defines main principles of management of the railway sector. Ukraine pursues a rather active policy related to participation in international railway organisations and accession to the respective conventions and agreements in the sphere of railway transport, and is a party to main conventions and agreements in the sphere of railway transport, including the EU.

The EU policy in relation to railways is aimed at strengthening of the railway transport positions in competition with other means of transportation, improvement of railways efficiency, and foundation of the Trans-European Railway Network (TEN). The European Union attaches the greatest attention to strengthening of the role of railway transport and redirection of cargo traffic from road transport to other, environmentally friendlier ones. Unlike the EU, where the share of transportation by railways makes up 8%, in Ukraine up to 60% of freight are carried by railways (without pipelines). The EU believes that matters related to infrastructure management, guaranteeing of non-discriminatory condition for access to railway networks, liberalisation of freight transportations, licensing of railway enterprises, etc., to be the principal factors of railway transport development.

In Ukraine, a much lesser degree of attention is attached to matters related to commercial activities by railways, since railways are in the state ownership and matters of opening of the

market of railway freight and passenger transportation are not yet regarded as top priority. Ukrainian legislation does not envisage a special authority to perform functions of division of infrastructure capacities, as is required by the EU system. Concerning industrial standards of the transport system in Ukraine, those are currently in the process of upgrading in accordance with international standards. Since Ukraine acceded to the Convention concerning International Carriage by Rail (COTIF) only recently, practical implementation of alignment of the industrial standards to requirements stipulated by the said Convention is to continue until 2015.

Both Ukraine and the EU provide state financing for infrastructure development, but the significant difference is that the EU engages capital of private carriers, as well as the state, while in Ukraine the support of railway infrastructure is provided through the state funds only. The existing system of railway transport in Ukraine is an aggregate of railways and other state-owned enterprises, which in reality has an extremely low attractiveness for investors and, as practice has demonstrated, does not make it possible to engage, without a state guarantee, necessary investments into replacement of fixed assets. For that reason, the EU experience is worth using.

In accordance with the EU legislation, every member country must establish a regulatory authority in the sphere of railway transport. The main task of that regulator is **guaranteeing of fair and non-discriminatory conditions for access to the railway network and services by all carriers**. The regulatory authority is an independent and separated from any authority for infrastructure management, infrastructure or capacity division authority, or applicant. That authority is independent in its organisation, legal structure, financing and decision taking. The regulatory authority must act as an authority for appeals in the course of resolution of disputes concerning compliance with the stipulations on non-discriminatory access to markets.

In order to increase the capacity of inter-system interaction and safety of the European railway system, the European Railway Agency (the Agency) operates. The principal task of the Agency is to provide the Commission and the EU member states with technical assistance on ensuring safety of transportation.

Over the recent years, many countries have restructured their railway transport in order to increase competitiveness of the transport system of a country as a whole. Reform of railways in the world continues and encompasses ever more countries. Regardless of similarities of problems faced by railways and their principal tasks, different approaches were selected in different countries. All countries, however, strived at ensuring non-discriminatory access to transport system for all carriers. In accordance with the European Directives, access to use of infrastructure must be granted to any carrier. **Open access to the infrastructure will open opportunities for operations by new enterprises**, which will offer new higher quality services. Open access will enable transportation enterprises to introduce new services, including those in foreign carriage, and find new markets.

Therefore, procurement of the necessary numbers of rolling stock, primarily of the new generation that meets industrial standards related to the railway transport, as well as providing private companies to enter the transportation market (grant the necessary licenses, access to railway tracks and networks, etc.) must become a priority for Ukraine. The terms and conditions of payment for use of infrastructure must be the same for all carriers, including Ukrailiznytsia.

Principal directions of railway transport reform are described in the EU White Book, issued in 1996. It defines the main provisions concerning transformation of the European railways, for instance:

- abandoning of the practice of cross financing of passenger transportation;
- unrestricted access to infrastructure and introduction of competition in temporarily monopolistic sectors, etc.

At present, railway transport reform is a first step towards institutional adaptation of the Ukrainian railway transport to the EU standards, as well as application of transparent market tools. The reform primarily requires qualitative improvement of the legislative basis and organisational structure, which requires a systemic comprehensive approach. The most important direction of the reform is ensuring of equal access for all carriers (both state- and private-owned) to the transportation infrastructure (railway networks, railway stations, etc.). In view of Ukraine's striving for integration into the European and international transportation systems, it should be noted that railway transport reform is also required from the perspective of bringing of the Ukrainian legislation closer to the European one.

### Recommendations

It is recommended to focus on three directions of activities, each of which requiring its own schedule.

First, regardless of structural changes, there exists a need to work on the future concept for development of railways in Ukraine, which is to become a part in the overall General plan for railways. The Ukrainian railways still have a large potential as to freight transportation, and the location of Kyiv and other main cities is instrumental for railways as a means of transportation, for expedite carriage between the country's largest cities.

Second, financial flows must be better organised and as transparent as possible.

Third, it is necessary to carry out organisational changes and ownership changes, which will provide railways, to a reasonable degree, the dynamics needed for operations on the market and competition with other means of transportation. It is those changes that will trigger the necessary processes of management rationalisation and cost optimisation.

1. Primarily, it is necessary to divide or separate:
  - a. political functions: formation and approval of transport policy, specifically, of development programmes, legislative activities, preparation of regulatory acts and tariff principles; the main subjects are: the Verkhovna Rada of Ukraine, the Cabinet of Ministers of Ukraine, Ministry of Transport and Communications of Ukraine, bodies of local self-government;
  - b. the functions of a regulator and a supervisor: enforcement of law, principles of commercial law and technical regulations, protection of consumers' (passengers') rights, anti-monopoly initiatives – controlling of tariffs to the degree that is determined by monopolisation; the main subject is the Railway Transport Supervisory Commission;
  - c. the function of the infrastructure administrator, which can be either a state- or a private-owned company maintaining the infrastructure and collecting payments for access, with account to a strict regulatory mode;

- d. business operations based on granting access to the infrastructure for operators engaged in transportation activities (the main subjects – commercial railway companies);
  - e. other kinds of business or social activities, which, after possibilities of their transfer to other subjects have been studied in every individual instance, should be spun off from the structure or transformed into individual companies and privatised or transferred to special governmental agencies (for example, health protection) or local authorities.
2. The infrastructure administrator must be as soon as possible spun off and made independent from other types of the subject, and also to obligate it to grant access to the infrastructure, on equal terms, both to the Ukrailynytsia and newly founded railway operators on the basis of regulatory acts and tariffs checked by the regulator.

## **Roads and Road Transport**

A lag in the quality of automobile roads and in the development of transport network is observed in Ukraine, especially of public automobile roads, in comparison with the country automobilisation gaps. The level of road traffic safety remains unsatisfactory. Budget funds are allocated for road maintenance, but their volumes are undoubtedly insufficient. Construction, capital repairs, reconstruction and maintenance of public roads of the national significance is done by Ukravtodor.

Priorities of the automobile sector development and road facilities must take into account the specific features of automobile transport as a fast, convenient, dynamic and socially significant type of transports, whose operations carry certain risks as to safety and ecological compatibility, and which must be regulated by international regulatory acts. The sector in Ukraine has a noticeable share of private-owned enterprises, which determines severe competition on the market. The degree of compatibility of the sector with the EU laws is uneven: some segments in the automobile sector meet the EU laws and requirements to a large degree, and other – to a medium degree.

Industrial standards of automobile roads in Ukraine do not meet the EU standards either by the quality or by weight load; therefore, they must be brought to compliance with the EU requirements. Changes must be made in the Rules for transportation of dangerous freight and Rules for transportation of heavy freight to make them compatible with the UNECE conventions and the EU Directives.

Investments into road expansion and the sector development are insufficient. In order to stimulate those, it is necessary to approve the Law of Ukraine on interaction between the state and private partners (state-private partnership). Approval of that Law by the parliament will facilitate attraction of billion-sized investments into the Ukrainian economy. In accordance with that Law, the state-private partnership may be applied in such areas as road facilities, railway, water and air ways with the elements of their infrastructure. The state may guarantee compensation of economically substantiated costs to private partners, allotment of land plots and clearance of all accompanying procedures, as well as pursuance of an effective tariff policy in relation to the subject-matter of the agreement.

As regards management of automobile transport and road maintenance, the following is necessary:

1. Ensuring of a clear and visible financial and organisational division between such directions in the activities by Ukravtodor as road maintenance and construction of new roads.
2. Preparation of flexible and transparent laws to allow leveraging of private capital for construction of automobile thoroughfares, including toll roads.
3. Development of a legal basis to introduce payment for use of automobile roads. In spite of the fact that introduction of toll roads has always been a controversial issue, it is necessary to remember that construction and maintenance of roads in normal condition implies new expenditures. Those are competitive compared to financing and maintenance of other roads that require substantial upgrading and improvement of expenditures for maintenance.
4. Within the framework of the General plan for transport — conducting of an analysis and preparation of a long-term construction plan for construction of main thoroughfares and expressways, as well as a plan for modernisation of national roads.
5. Expansion of application of procedures, specified in the general section, training of staffs at central and regional structural units, as well as concerning preparation of investments in large cities, especially preparation of impact assessment reports, in accordance with the EU standards and bidding procedures.
6. Elimination of legal barriers for use of the «design and build» system to make investments into road facilities (and other investments into infrastructure).
7. Decentralization of management and financing of roads of the national, regional and local significance through delegation of the relevant responsibilities and financing to local authorities.
8. Commercialisation and further privatisation of designing and construction facilities, as well as preservation of sub-units responsible for strategic planning, ordering, control over fulfilment and control over the road condition, in the administration structure.
9. An increase of budget allocations for road construction – conducting of gradual work aimed at maintaining the share of allocations for road infrastructure at the level of 60% of expenditures for railway infrastructure, which is to be around 1.5% GDP.
10. Beginning of negotiations with the EU concerning establishment of an assistance fund (grants) for infrastructure, both in large cities and on the national-significance roads.
11. Making amendments in the Ukrainian legal regulations in relation to acquiring of a profession of a truck driver, consistent with the EU legislation.

## **Air Transport**

At present, over 30 airports of various types are active in Ukraine, 16 of which may be regarded as principal ones. On the market of air services, both domestic and international, there are close to 40 Ukrainian air companies for passenger and freight carriage. Almost 50 foreign companies make regular flights to Ukraine.

The Ukrainian air transport system is currently on the way towards integration to the European one. In order to introduce the concept of the “Single Sky” in Ukraine, the system of collection of the air navigation duties have been brought to consistency with the Eurocontrol standards, and all district centres for air traffic control have been automated. Integration into the Single Air Space, which envisages adaptation of the aviation carriage economic regulation system to the European legislation, is one of the priorities in the sector development.

Experiences of such countries as Poland, the Czech Republic and Hungary, which opened their skies, for low-fair carriers as well, have demonstrated that **the traditional national companies managed to preserve their market segment**. New low-fair carriers have focussed their dynamics on new routes and new consumers. Access to air transportation was extended to many ordinary people who turned out to be the main beneficiaries of the open-sky policy.

In order to take into consideration requirements by the International Civil Aviation Organisation (ICAO), the European Union, the European Civil Aviation Conference (ECAC), the European Organization for the Safety of Air Navigation (EUROCONTROL), as well as changes in the provisions of the Ukrainian legislation that have taken place after the Air Code of Ukraine was adopted in 1993, a new draft Air Code of Ukraine was prepared. That document was submitted to the Verkhovna Rada of Ukraine in April 2009. However, the new version of the Air Code of Ukraine, dated 21<sup>st</sup> of October, 2009, was not approved by the Verkhovna Rada of Ukraine. **Approval of the new version of the Air Code of Ukraine is a burning issue.**

At present, Ukraine is bound by 39 international agreements within the scope of international air law (to include 29 under the aegis of International Civil Aviation Organisation (ICAO), 1 under the aegis of the European Civil Aviation Conference (ECAC), 2 under the aegis of Joint Aviation Authorities (JAA), and 7 under the aegis of the European Organization for the Safety of Air Navigation (EUROCONTROL).

The greatest challenge, however, is posed by a misbalance between the real requirements to the civil aviation today in view of Ukraine's participation in a number of international organisations and agencies, striving towards European integration and new opportunities for national carriers, and the existing aviation system in the country and the regulatory foundation that regulates its activities. One of the principal issues at present is a gradual adaptation of the national legislative basis to international conventions and agreements, as well as to the European *acquis communautaire*.

In order to resolve problem issues in the sphere of legislation, in 2008 the State Aviation Administration prepared a «Plan of actions aimed at implementation of the national programme of adaptation of legislation of Ukraine to legislation of the European Union». The Plan envisages the sphere of *acquis communautaire*, where adaptation takes place, sources of *acquis communautaire* that regulates legal relations in the respective sphere and defines the title of a measure that is to be taken with its assigning to specific structural sub-units, responsible for implementation of that measure.

As stipulated by requirements of the basic *acquis communautaire* on civil aviation, a country that seeks integration must primarily harmonise through legislation and bring to consistency with the European standards the following:

- common European rules for civil aviation: harmonisation of rules and procedures in civil aviation, licensing of air carriers, licenses in the sphere of civil aviation;
- air traffic control: licensing of air traffic controllers, joint measures for development of a new-generation system of the Single European Sky ATM Research (SESAR), regulatory basis for creation of a single European sky;
- air flight safety;
- occupational and operational safety standards: notifications about incidents in civil aviation;
- aviation operational safety: aircraft of third countries that use the EU airports, accidents and incidents in civil aviation, information for passengers about specific features of a carrier, and blacklists of high-risk companies.

In order to reach full integration of Ukraine's air transport system to the European one, it is necessary to:

- conclude an agreement between Ukraine and the EU about Single air space,
- become a participant in a programme for organisation of air traffic in the single European air space (SESAR);
- adapt the European legislation on economic regulation of access to the transportation market, licensing of carriers, rights of passengers and persons with physical limitations, etc.;
- introduce European standards and requirements in the sphere of air flight safety, specifically, Joint Aviation Requirements (JAR), and requirements by the European Organisation for the Safety of Air Navigation, including a Multilateral agreement on payment of en-route fees;
- to expand Ukraine's participation in all-European aviation organisations: the European Civil Aviation Conference (ECAC), European Organisation for the Safety of Air Navigation (Eurocontrol), International Air Safety Association (IASA).

Each of those items requires a separate detailed analysis of economic and social impacts on participants of air transportation market and consumers of aviation services.

### Recommendations

1. **Opening of the sky through signing of an agreement with the EU.** This will include Ukraine into the larger European air transportation market with all its requirements and benefits, raise interest on part of foreign operators and — upon condition of the absolute freedom of business activities in that respect — will entail creation of national operators. Access to air transport for Ukrainians will improve, as well as access of foreign citizens to the domestic trade and tourism.

Ukraine is recommended to pass those legal resolutions regardless of its prospects of the EU accession. Every air carrier of the signatory state will also be able to start any transportation both to and from Ukraine, as well as within Ukraine. At the same time, Ukrainian operators will be able to gain access in other signatory states. Taking into consideration the location of main Ukrainian cities and concentration of population in conurbations, the market of domestic transportation will also develop, along with growth of well-being of the country's citizens.

2. Before fully opening the sky, it is necessary to strengthen national air companies (because it is not yet known whether political support and financial resources will be available) – the more so that at that time there exists a legitimate possibilities to use special tools, which in the EU are regarded as prohibited state support, such as budget subsidies or guarantees of fleet purchase. Ukrainian air companies are too small to exist as individual market players, therefore they will have to create alliances with other companies. The main benefits of participation in an aviation alliance of that kind (without liquidation of an individual status) are as follows: (1) joint services for cargo handling at airports; (2) joint booking offers; (3) convenient transfers between flights. It also appears that, in view of the current depression on the air transportation market, functioning of small and medium-sized national companies in the longer term is unlikely. It may be possible in that case to recommend their full privatisation with the purpose of their capitalisation and integration with the network and the system of services that larger and stronger operators use.

3. While the land where runways and airport structures are located is in full state or communal ownership, it is expedient to open airports for investors, at the same time reserving the right to exercise control over operations, where it may be necessary for the national security considerations. One opportunity is formulation of bidding proposals for airport management. Participation of such investors may be decisive: apart from transport operations, they may also invest into airport satellite facilities, e.g. hotels, conference halls, stores, parking lots. All that must diversify incomes generated by airports.
4. It is necessary **to complete the negotiations preceding accession to the «Single European Sky», and to complete the accession process.** Doing so will make it possible to jointly use the air space over the EU and Ukraine without consideration of state borders in a limited number of sectors, with an optimal efficiency and with regard to operational requirements. That will also promote improvement of quality of air services, improvement of functional capabilities and upgrading of safety of the entire system.
5. It is recommended that air traffic control services be structurally detached from airport bodies – in that aspect Ukraine is in fact ahead of some countries of the EU. Doing so will ensure financial transparency of goals connected with the aviation infrastructure. Performance of tasks related to management of airports and the need for significant investments into airports will not threaten air traffic control services with limitations of possibilities for their development.
6. In the absence of such separation, the situation could grow worse in the event of a considerable growth of passenger traffic, and the priority should be given to investments aimed at increasing capacities of passenger terminals. Meanwhile, along with the accession to the «Single European Sky», it will be necessary to carry additional costs for procurement and upgrading of airport infrastructure, equipment, software, training and hire of additional air traffic controllers, to enable Ukrainian air traffic services to successfully compete with other services in providing air services in their own — and some day, hopefully, in foreign — air space.
7. It is recommended to apply, further to the system of ICAO (International Civil Aviation organization), a system for operating personnel and equipment licensing/certification, developed in the EU. For example, it will be useful for job searching in the Union air companies.