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The freight railways of the former Soviet Union, twenty years on: Reforms lose steam☆

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ABSTRACT

Some of the countries of the former Soviet Union have taken steps toward reform of the vertically integrated monopoly freight railways that they inherited following the breakup of the USSR, while in others there have been discussions but nothing more. However, even in the countries most active in reform – Russia, Kazakhstan, the Baltic countries – the reforms have taken directions different from the reform models adopted in either Europe or the Americas, and governments have insisted on maintaining a significant degree of control of the sector, resisting any real yielding to the vagaries of markets. Furthermore, when there has been concessioning or sale of assets to private firms, these events have been marred by allegations of favoritism and discrimination. In recent years, reform momentum throughout the region has stalled, with policy discussions now more often focusing on ways to improve efficiency and increase traffic – especially lucrative transit traffic – with less emphasis on either competition or privatization.

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1. Introduction

When the USSR was dissolved at the end of 1991, the task of restructuring the unified Soviet Railways organization was a formidable one, and of crucial economic importance. The Soviet Railways had actually been a collection of 32 separate railway organizations, operated as a single coordinated system by the All-Union Soviet Railway, SZD. At almost 150,000 route kilometers second in the world to the US system of almost 200,000 route kilometers, SZD was far and away the most densely operated of the world's large railways; its peak haulage of 3.9 million million ton kilometers of freight in 1988 constituted fully one-half of the world's freight rail operations, considerably more than those of the US, China, and India combined. (It also carried about one-fourth of the world's rail passenger traffic.) Furthermore, the Soviet economy was heavily dependent on the railway: SZD carried at least 60%, and often 80 or 90%, of the Soviet tonnage of individual commodity categories such as coal, building materials, metals, ores, and even agricultural products. This reflected in part the focus of the Soviet economy, like other socialist economies, on heavy industry, and in part the poor condition of the very limited network of Soviet roads and highways (EBRD, 1993; Holt, 1993).

An important legacy of the Soviet system – actually going back to the Russian imperial system – was the fact that its track gauge was and remains incompatible with the track gauge of most of its neighbors. In a classic example of what economists term "path dependence," the decision on the gauge to be used for the construction of the Russian railroad system was made in the 1840s, at a time when proponents of narrow, medium, and broad gauged railways were still arguing the advantages of their particular positions, especially with regard to specific physical environments. The Russian 5 ft gauge – still "broad gauge" then and now as compared with what has become the "standard gauge" of 4 ft, 8½ inches – was selected as a compromise by the American engineer in charge, with apparently no consideration of future connection with neighboring countries (Haywood, 1998; Puffert, 2009; Westwood, 1964). As will be discussed below, the result is that even today international railway movements face costly and time-consuming gauge changes at the China–Russia, China–Kazakhstan, Lithuania–Poland, Belarus–Poland, and Ukraine–Slovak borders, among others.

In this chapter we focus on two aspects of the railways of the former USSR: the divergent experience over the past 20 years regarding reforms, and the increasing emphasis on the encouragement of export, import, and transit traffic, especially traffic between East Asia and Europe. Before proceeding, however, we consider two issues that are useful for placing the following discussion in context.

First, it is important to consider what strategies for rail reform have been examined and adopted by other countries. Over the past two decades, countries around the world have begun efforts to restructure their (typically) state-owned monopoly railways into sectors more efficient and supportive of economic growth (Pittman, 2007). A common tactic, especially in Europe, has been the creation of conditions for competing train operating companies (TOC's) to run trains on a common, monopoly track infrastructure. This may be

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effected by simply requiring the vertically integrated incumbent to allow independent TOC's to operate on its track, at regulated access rates. Alternatively, and to forestall incentives for access discrimination on the part of the incumbent, the incumbent may be required to separate into two separate enterprises, one an infrastructure operator and the other a TOC. The former, less disruptive strategy is typically referred to as "third party access"; the latter more radical surgery as "vertical separation." An alternative reform strategy preferred in the Americas has been "horizontal separation": the creation of multiple independent vertically integrated train companies, competing with each other over particular pairs of origins and destinations (so-called "parallel competition") and/or to and from particular origins and destinations ("source competition").

Sweden and the UK have already chosen vertical separation as a reform strategy for their railways – as have some states of Australia – and the competition authority of the European Union has expressed its preference for this model as an outcome of railways reforms throughout the EU (Di Pietrantonio and Pelkmans, 2004; Nash, 2006). As will be discussed below, those countries of the former USSR that have taken significant reform steps have mostly chosen a strategy different from any of these three: a vertical separation strategy that allocates locomotives and thus train control to the infrastructure rather than to TOC's.

Second, many of the countries of the former USSR have not fared well on international indexes of corruption. Thus it is perhaps not surprising that there have been allegations of favoritism and discrimination against outsiders in more than one of the episodes of concessioning or privatization that have taken place in the railways sectors of these countries up to now. Clearly it is impossible to be certain either that all such incidents that have taken place have come to light, or, conversely, that those that have come to light are genuine instances of poor practice rather than simply the complaints of the losing companies in the process. Nevertheless with this much smoke there may indeed be fire, and we will note below the principal episodes in which these allegations have been made.

2. The slow and uncertain path to reforms

The countries of the former USSR may be usefully divided into three groups according to their progress in reforming and restructuring the state-run monopoly railroad that they inherited at the time of the dissolution of the Union:

- Countries that have taken significant steps in implementing reforms: Russia, Kazakhstan, and the Baltic countries of Estonia, Latvia, and Lithuania;
- Countries with significant reform discussions and even legislation, but apparently little actual progress yet on the ground: Ukraine, Uzbekistan, and Georgia;
- Countries in which reform has apparently not been seriously contemplated, at least in the political arena: Armenia, Azerbaijan, Belarus, Kyrgyzstan, Moldavia, Tajikistan, Turkmenistan.

Table 1 provides basic statistics on the structure of railways in the different countries and regions.

2.1. Russia

The huge Russian railway system is one of the most densely operated in the world – second only to China in the ratio of the sum of freight ton-kilometers and passenger-kilometers to track kilometers – as well as one of the most freight dominated in the world – third to Canada and the US among large countries in the ratio of freight ton-kilometers to passenger-kilometers. Coal, oil, and metals regularly account for more than half of the freight ton-kilometers carried by the system; add in chemicals, construction materials, timber, and grain, and more than two-thirds are accounted for (see Fig. 1; for further reading on Russian railways restructuring, see ECMT, 2004, 2007; Dementiev, 2006; Oding, 2000; Pittman, 2012; Westwood, 2002; Winner, 2011, 2012).

After a number of years of high level discussion, in 2001 the Russian government approved a ten-year plan for the thorough reform of the Russian railways. The plan called for a distinct set of reforms to be achieved in each of three time periods, though with the details becoming increasingly vague the further one projected into the future. The three period plan may be summarized as follows:

First stage, 2001–2003:

- Creation of the Joint Stock Company Russian Railways (RZhD), which was to remain state-owned;
- Separation of this company and its business operations from the regulatory and policymaking functions of government agencies;
- Divestiture from RZhD of non-core, non-commercial assets and activities such as hospitals, hotels, and schools.

Second stage, 2003–2005:

- Creation of RZhD subsidiary or "daughter" companies for freight hauling, long-distance passenger operations, commuter operations, construction and repair, and infrastructure;
- Implementation of non-discriminatory infrastructure access conditions for independent train operators, and sale of some RZhD rolling stock and locomotives to those operators;
- Implementation of a transparent structure for government subsidies for passenger operations, to replace the historic sizable cross-subsidies from freight.

Third stage, 2006–2010:

- Partial or complete privatization of non-infrastructure subsidiary companies;
- Creation of a competitive market for freight and perhaps long-distance passenger operations.

This reform program may be seen to include many standard components of market-friendly economic reforms urged by entities such as the World Bank and the IMF, including the spin-off of non-core activities, the removal of internal cross-subsidies, privatization, and the creation of competition (World Bank, 2002; Xu, 2004). However, it was not precise as to just how the restructured system would operate.

As it happens, the reforms are far from complete after more than 10 years. The first stage has been successfully completed: RZhD was created and separated from the Ministry of Railways (which is now a component of the Ministry of Transport), and its non-core assets and activities divested. However, other steps have progressed more slowly. Laws and regulations allowing independent train operators onto the system and insuring non-discriminatory access terms have been frequently discussed but for the most part remain to be implemented. Some progress has been made regarding the elimination of mandatory cross subsidies from freight to passenger operations, but the federal and local governments have lacked the resources to assume complete responsibility, and RZhD has not been permitted to remove the cross subsidies entirely.

Partly as a result, the goal of a "competitive market for freight" has proved to be an elusive one. It is true that more than half the freight rolling stock is now in private hands, if in that category one includes the RZhD "daughter companies" such as TransContainer and Freight Two in which RZhD continues to maintain minority ownership interests. This in turn has meant that the rolling stock portion of the regulated freight rail tariffs has been to a large degree deregulated. However, there have been no officially permitted trains on the infrastructure with locomotives not owned and operated by RZhD – and only a few actual trains operating in the shadows of regulation.