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# Gas market reform in Ukraine and its integration in the European Energy market

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(Thanks to Naftogazbudinformatyka Ltd.)

Presentation to the ETCSEE Conference  
Budapest, 13 June 2018

***DISCLAIMER: All responsibilities are with the author and do not involve FSR or Naftogazbudinformatyka Ltd.***



## The policy framework

- **Independence as key goal**
- **After Majdan (2014), major effort towards implementation of the EU market model**
- **Interconnection with EU and demand decline boosted security of supply**
- **State role remains higher than in EU Member States**
- **Stockholm arbitration in fact did not solve Naftogaz-Gazprom conflict**
- **Transmission (& storage) unbundling still pending**
- **Contacts with Western potential partners started but scope of their involvement remains to be defined**



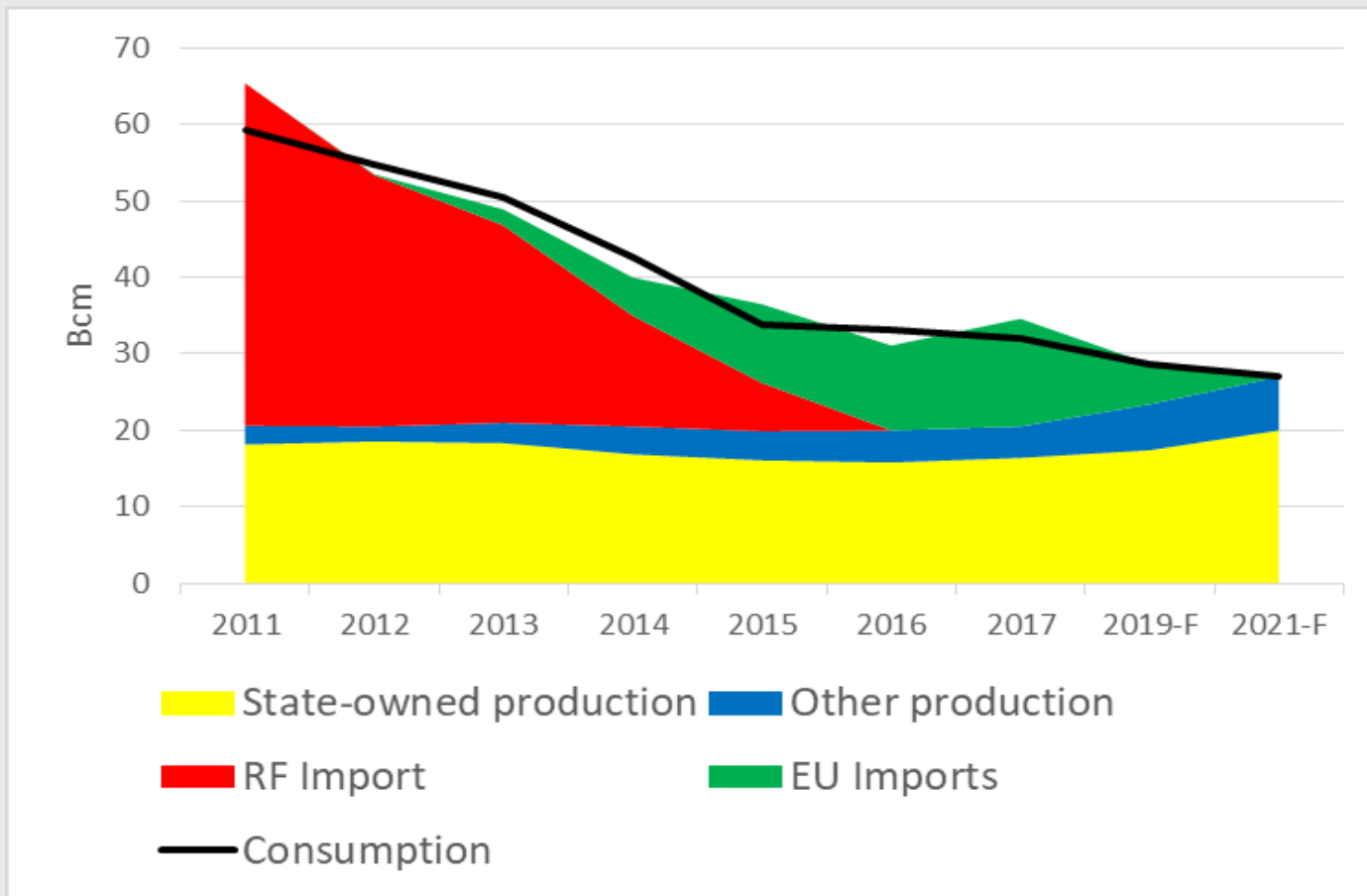
## The market context

**(Assessed from consumers' perspective)**

- **No Russian suppliers in the last 2.5 years as confrontation continues, depriving the country of a key supply source**
- **Domestic production keeps recovering, though slower than expected**
- **Demand stabilizing**
- **Price gap with EU hubs remains significant**



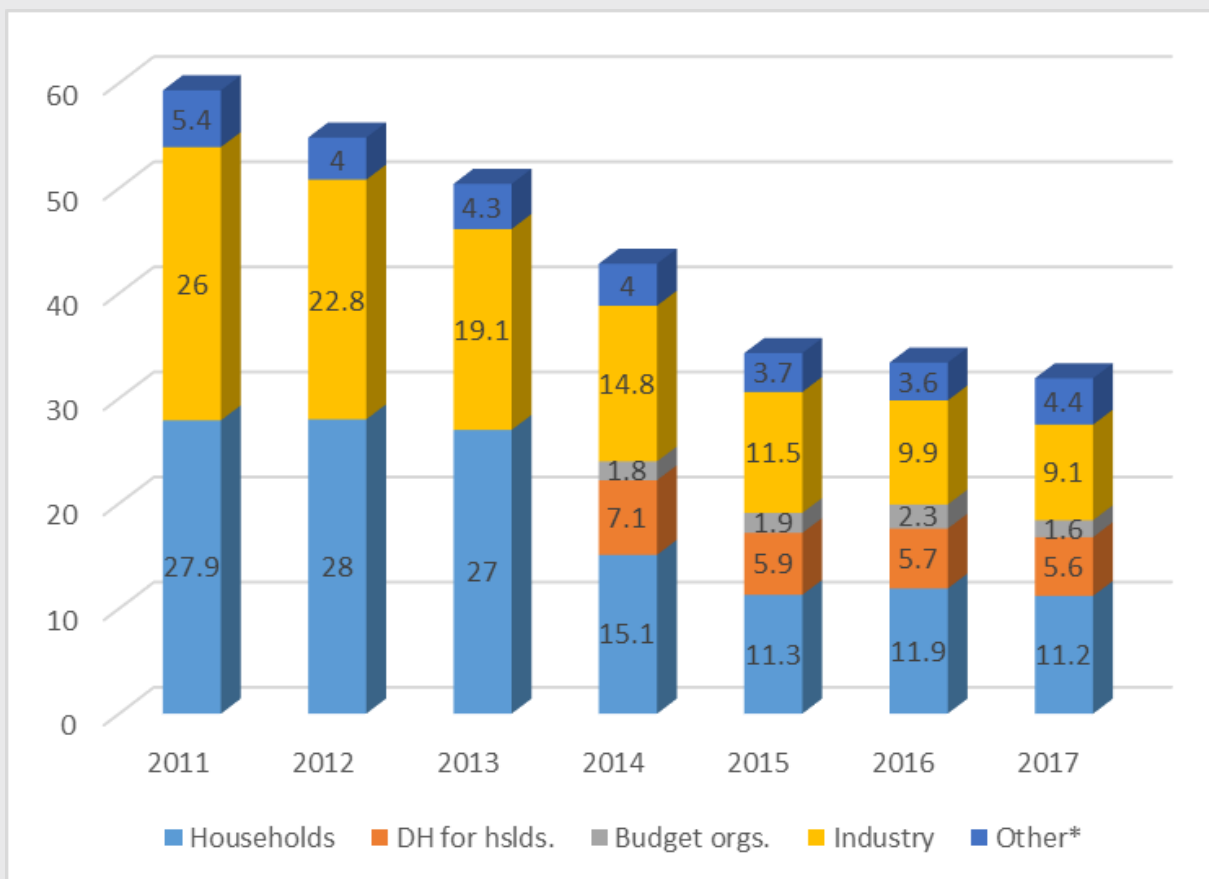
# The supply scenario



Source: Naftogaz; UTG, UGV forecasts, delayed by 1 year



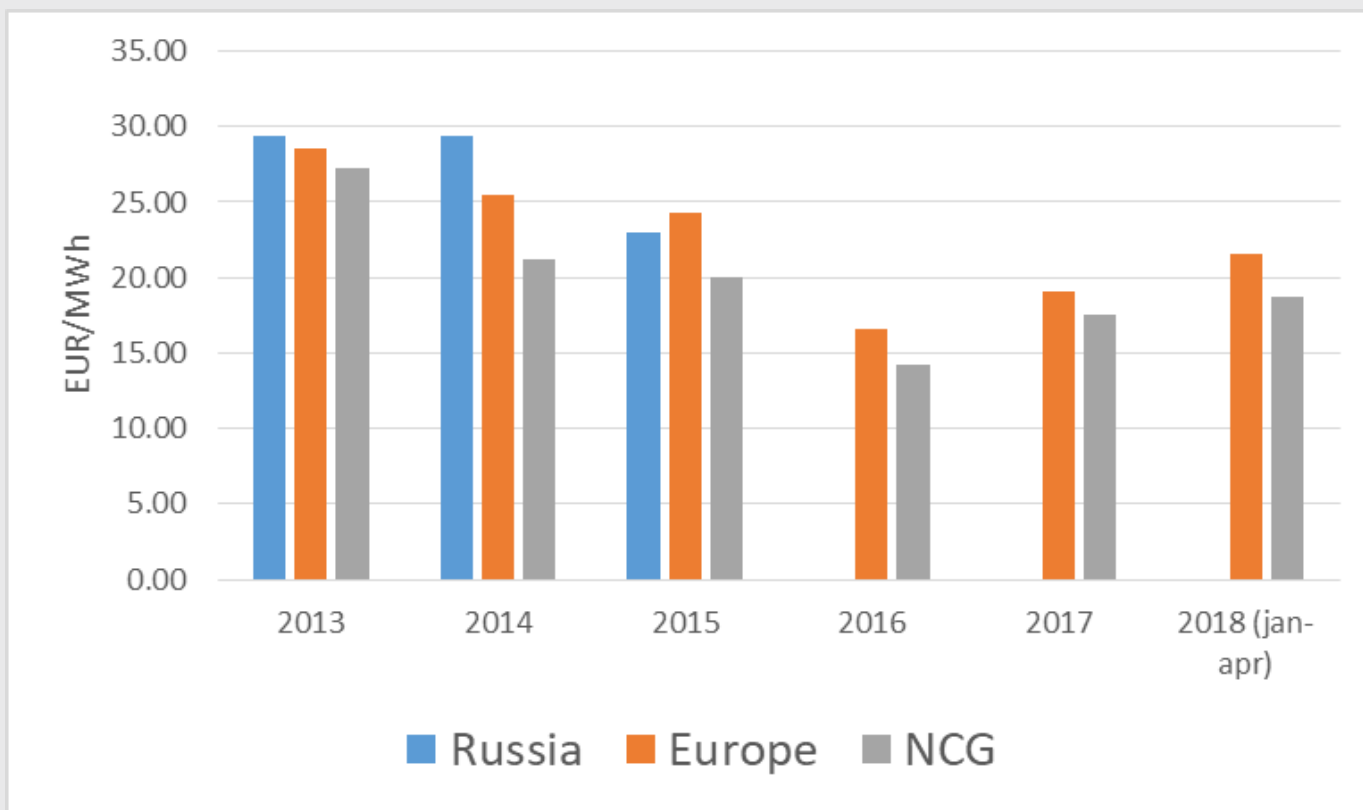
# Market demand



- ***Stabilising after a sharp fall...***



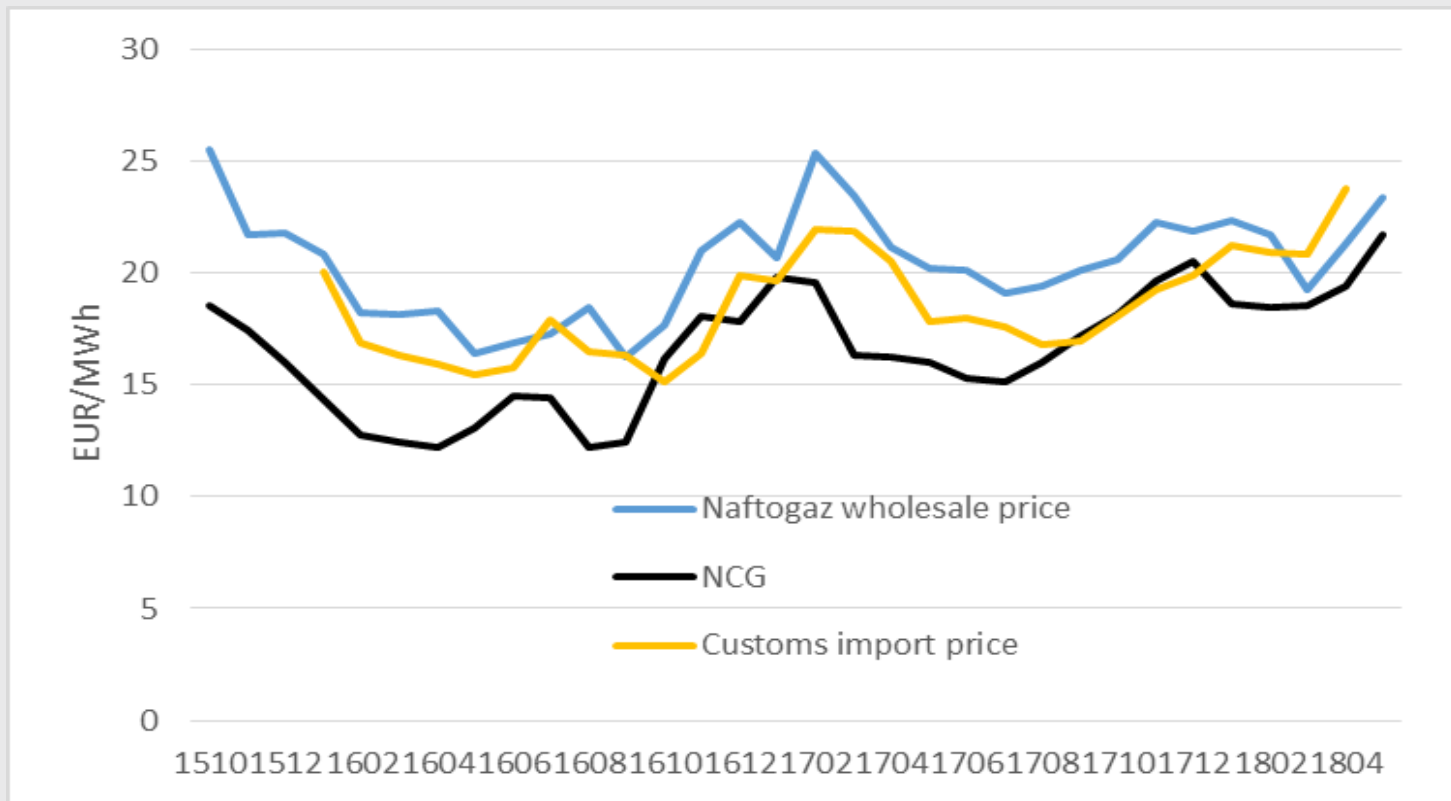
# Import Prices



- ***... as import prices remain above those of European hubs***



# Market vs. official prices



- ***Naftogaz official price linked to Slovak hub, heavily affected by Ukraine market***



## Regulatory framework: A provisional assessment

- **Good implementation of *Acquis Communautaire* (according to the Energy Community Secretariat), but stalled in last 2 years as TSO (UTG) not unbundled**
- **Attempts to introduce daily balancing failed**
- **Market is almost entirely “over the counter”**
- **Exchange based trading slowly developing**
- **Naftogaz of Ukraine acts as “market maker” by selling at posted prices**
- **Traders mushrooming, including large ones from Europe**
- **EFET contracts partly adopted**



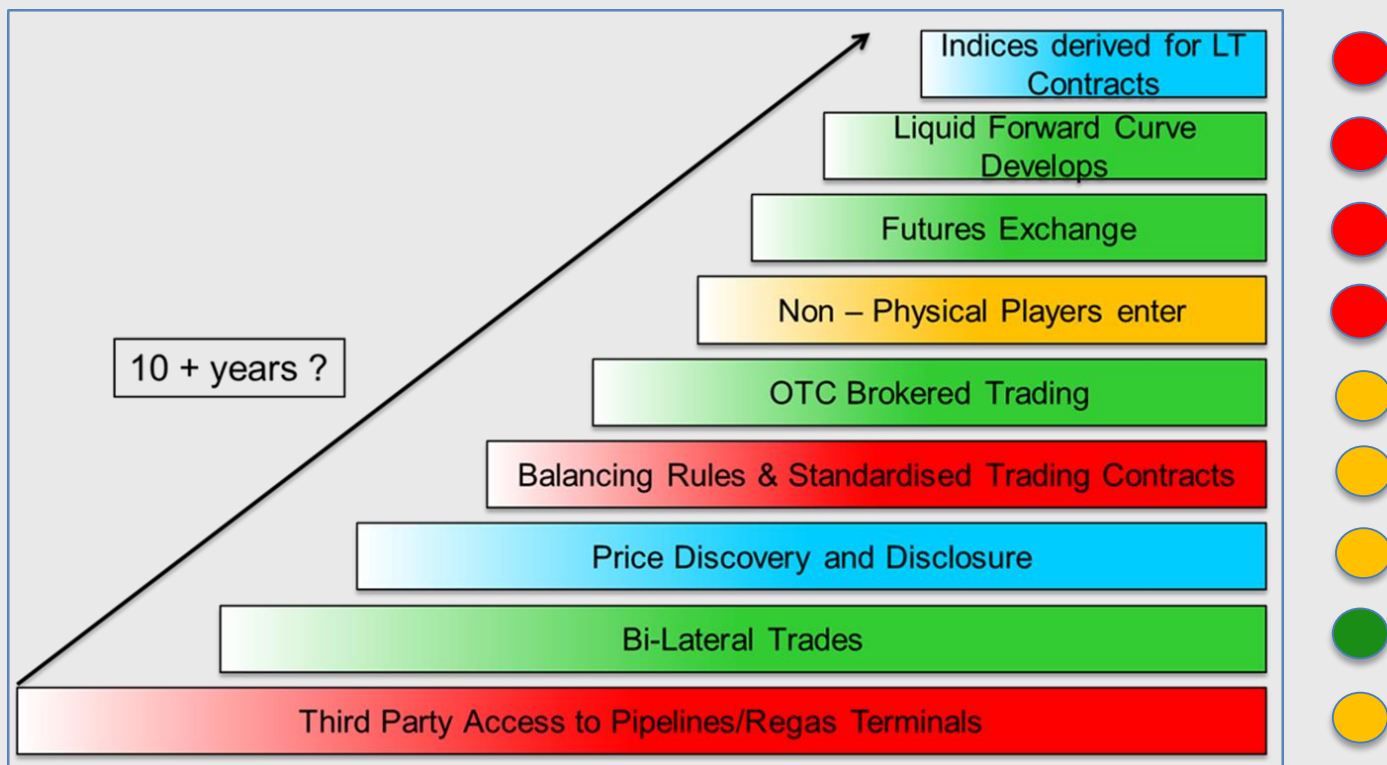


## Focus on transmission access & tariffs

- **Entry-exit tariffs established, reformed as capacity based and generalised since 1.4.2017**
- **Network Code issued**
- **Cost allocation among entry and exit points most questionable**
- **Depreciation criteria at odds with normal regulatory practice, leading to high transmission tariffs that hinder cross-border trade**
- **In fact, Ukrainian transmission tariffs are the highest in Europe, contributing to high domestic prices**



# Gas Hub Development: Where Does Ukraine Stand?



Source: P. Heather, OIES; FSR's own assessment

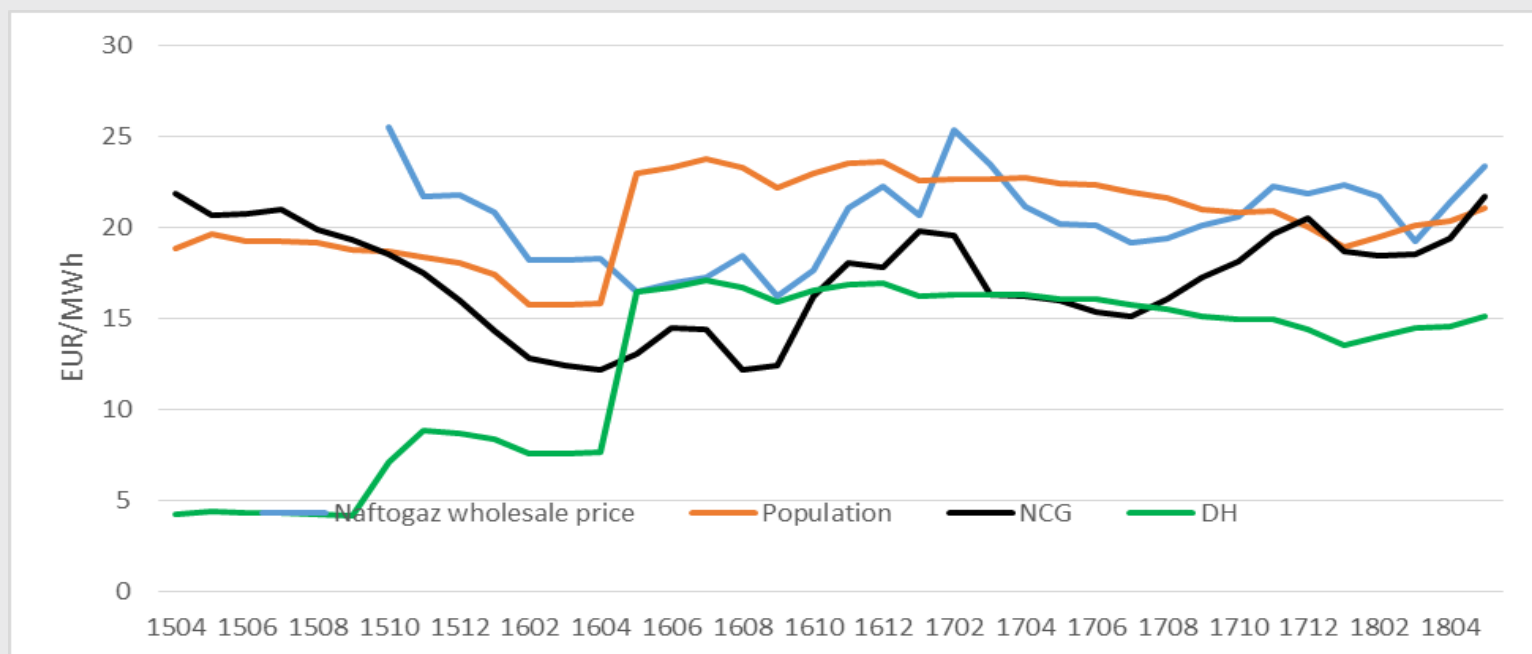


# Market Concentration

- **State-owned Naftogaz Group controls (2017 data):**
  - 80% of domestic production
  - 62% of imports
  - 100% of transmission and storage
  - 30% of the unregulated market (industry)
- **The Firtash private group controls 70% of distribution and retail supply**
- **“Bilateral monopoly” clash between Naftogaz (up/midstream) & Firtash Group (retail):**
  - Hamper development of healthy competition
  - Increase room for political and regulatory uncertainty and meddling



# The regulated market: households, budget organisations & district heating



Source: Naftogaz; Reuters

- ***Retail prices remain under strict government control***
- ***Alignment with wholesale price not implemented for 18 months, leading to subsidies growing again***



## Issues in the regulated market

- **Regulated market still significantly subsidised despite price hikes**
- **Subsidies covering about 60% of households and district heating, requiring > 2 Bn. EUR (World Bank estimate)**
- **After price hikes, substantial under-payment emerging**
- **Price increases may have adverse social and macro-economic impact, face political opposition**
- **Distribution unbundling far from complete**
- **70% of distribution controlled by a private conglomerate**
- **Room for gas diversions from regulated to industrial market, boosting unfair competition**



## Conclusions

- **Little progress in market development as daily balancing arrangements face difficulties**
- **Market prices remain well above Europe's, also due to high transmission charges**
- **Stockholm arbitration did not solve stalemate; but Western TSOs' involvement may be getting closer**
- **Retail market progress hampered by conflict between dominant stakeholders**
- **Small customer prices frozen, subsidies increase and their reform stalling, triggering unfair competition in the deregulated market**



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# Thanks for your attention!

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