Analytical note on tariff policy in the field of communal services during the war

On July 29, 2022, the Ukrainian Parliament passed Law No. 2479-IX "On the peculiarities of the regulation of relations in the natural gas market and in the field of heat supply during martial law and the subsequent restoration of their functioning," which established a moratorium on increasing tariffs for gas, heat, and hot water during the war, in particular:

• tariffs for natural gas distribution services;

• tariffs for heat energy, heat energy supply services and hot water supply services for all categories of consumers;

• the price of natural gas for household consumers.

Thus, the fixed price of gas in Ukraine for the population ranges from UAH 7.79 to 11.9 per 1 m3 including VAT, whereas the current price of gas for industry is UAH 34.9980 per 1 m3. This law also prohibits natural gas suppliers from imposing arrears on household customers. On the one hand, this decision ensured some social protection for domestic households, but on the other, it resulted in a significant gap in the purchase and sale prices of gas according to the results of work in the first half of 2022, which, along with the occupation of part of the territory, destruction of infrastructure by Russian aggression, and increased transportation costs, resulted in a loss of UAH 57.2 billion for Naftogaz of Ukraine.

Concerning the price of electricity, the Cabinet of Ministers of Ukraine adopted the resolution "On Amendments to the Resolution of the Cabinet of Ministers of Ukraine dated June 5, 2019 No. 483" on October 28, which extended the effect of special duties assigned to electricity market participants to ensure the general public's interests in the process of the electricity market's functioning. As a result, the population's electricity price will remain unchanged until March 31, 2023 - 1.44 UAH/kWh for consumption volumes of up to 250 kWh per month and 1.68 UAH/kWh for consumption volumes greater than 250 kWh per month. Simultaneously, according to SE "Market Operator" data, the BASE price index for Ukraine's RDN in October 2022 was UAH 3,301.71/MWh (without VAT), or UAH 3.96/kWh (with VAT). This disparity between population tariffs and market prices for energy carriers, as well as the need to repair and restore damaged or destroyed energy infrastructure (as a result of massive missile attacks by Russia on objects of this infrastructure throughout Ukraine, which led to emergency shutdowns and the establishment of special schedules for disconnection of consumers). creates a significant funding gap in energy industry companies, jeopardizing their long-term viability.

The foregoing highlights the critical need for state-level mechanisms to compensate PEK companies for losses and finance the restoration of critical infrastructure. As demonstrated by global experience, there are three approaches to resolving such tasks, all of which involve financing these needs at the expense of:

- household consumers as a result of tariff increases to market levels with an increase in the amount of subsidies for socially vulnerable segments of the population;

- own funds of the respective companies and their beneficiaries;

- state funds (taxpayers) as a result of payment of the difference between tariffs and market prices (subsidy support).

The first approach would be justified in peacetime and would contribute to the recovery of the energy sector, but in a state of war, the expediency of such an approach should be evaluated based on Ukraine's current socioeconomic situation. Thus, according to the NBU's forecast, inflation for 2022 is expected to be 30%, GDP is expected to fall by 32%, the Ministry of Economy estimates that the level of unemployment in Ukraine at the end of the current year will be 30%, and the World Bank estimates that the number of people living outside the border poverty in Ukraine may increase to 25% by the end of 2023, and to 55% by the end of 2023. Furthermore, the government has frozen the growth of the minimum wage until 2023, forecasting only a minor increase in social standards, and has limited the options for receiving social assistance for unemployment. Thus, an increase in tariffs during the war would result in a massive increase in the number of people unable to pay for communal services and, as a result, an increase in the number of subsidizers, for which subsidies would need to be provided in the state budget. It would also be necessary to provide funds for the hiring of additional workers in order to process the significantly increased number of subsidy applications. At the same time, consumers who will not receive subsidies for various reasons, justified or not, will most likely not pay for utility services, resulting in a significant increase in receivables from PEC companies and, as a result, a reduction in their ability to finance infrastructure restoration. It may also increase social tensions among the population. As a result, we believe that using this approach in Ukraine during martial law is inappropriate and socially dangerous. However, given the need to encourage citizens to save and the fact that the population's electricity price is much lower than market prices, it is appropriate to raise the maximum price of electricity when consuming more than 250 kWh per month.

It appears impossible to apply the second approach in conditions where tariffs for household consumers are many times lower than market prices and infrastructure restoration requires significant investments, because the continuation of economic activity in the energy business becomes unprofitable for its owners, and thus recapitalization of companies is not expedient from their point of view. Furthermore, given the significant level of destruction of the energy infrastructure, as well as a significant drop in income, access to attracting additional financing may be limited or non-existent.

We consider the third approach, namely the restoration of infrastructure and compensation for price differences at the expense of the state, to be the most acceptable for the time of martial law. In addition to compensating for the difference in prices for the rapid restoration of infrastructure, repair, or purchase of equipment, we believe it is prudent to extend the state program "Affordable loans 5-7-9%" to PEK companies, as well as to establish such a program for Ukraine's energy sector.

When developing a tariff policy in the field of communal services during the war, it is also worth considering the experience of European countries, whose populations are also subjected to significant increases in gas prices. In particular, in Germany, the plan to assist consumers in paying the price of gas includes the following stages: in the first stage, in December 2022, the state will compensate for the costs of the expected gas bill for that month, based on the amount paid for gas in September. In the second stage of the plan's implementation, from March 2023 to April 2024, the price will be reduced to

12 cents per kilowatt-hour for 80 percent of the expected volume of gas consumption. Overage energy will be charged to the consumer at the price specified in the contract with the supplier.

Recommendations:

The National Interests Advocacy Network "ANTS" recommends following recommendations when formulating a tariff policy in the field of communal services:

during the war, the state's policy of freezing utility tariffs for the population is justified, taking into account the difficult socio-economic situation in the country;

- taking into account the need to promote the saving of electricity, we consider it expedient to increase its prices for household consumers when consuming more than 250 kWh per month;

- the debt arising due to the difference in tariffs must be compensated from the state budget (corresponding changes were made by Resolution of the CMU No. 1192 of October 12, 2022);

- to restore the energy infrastructure, we recommend extending the state program "Affordable loans 5-7-9%" to PEK companies, as well as creating one for the energy sector of Ukraine, by analogy with the already functioning Fund for partial guarantees of loans in agriculture.