

UKRAINE ENERGY TARIFFS AND SUBSIDIES

2014-2017



WORLD BANK GROUP



Energy Sector Management Assistance Program

September 2016

Introduction

The World Bank has been assisting energy tariff and subsidy reforms in Ukraine since 2014. The initial assistance included assessments of the poverty, social, and fiscal impacts of reforms as well as recommendations on the options for implementing tariff reforms in an affordable and socially acceptable manner (including support for public communication and scaling up the Housing and Utilities Subsidy (HUS) Program).

The ongoing, second phase of assistance includes assessment of energy tariff and subsidy reform outcomes to date and capacity building and knowledge exchange.

The assessment includes financial analysis of the natural gas and district heating sectors based on 2016 tariff revisions, assessment of targeting performance and fiscal implications of the HUS program, and the findings from focus group discussions conducted as part of a national survey to assess public perceptions and attitudes toward the reforms.

This work is supported by the [Energy Sector Management Assistance Program \(ESMAP\)](#), a global knowledge and technical assistance program administered by the World Bank to assist countries to increase their know-how and institutional capacity to achieve environmentally sustainable energy solutions for poverty reduction and economic growth. ESMAP is funded by Australia, Austria, Denmark, Finland, France, Germany, Iceland, Lithuania, the Netherlands, Norway, Sweden, the United Kingdom, and the World Bank Group.

First Phase of Energy Tariffs and Subsidies Reforms

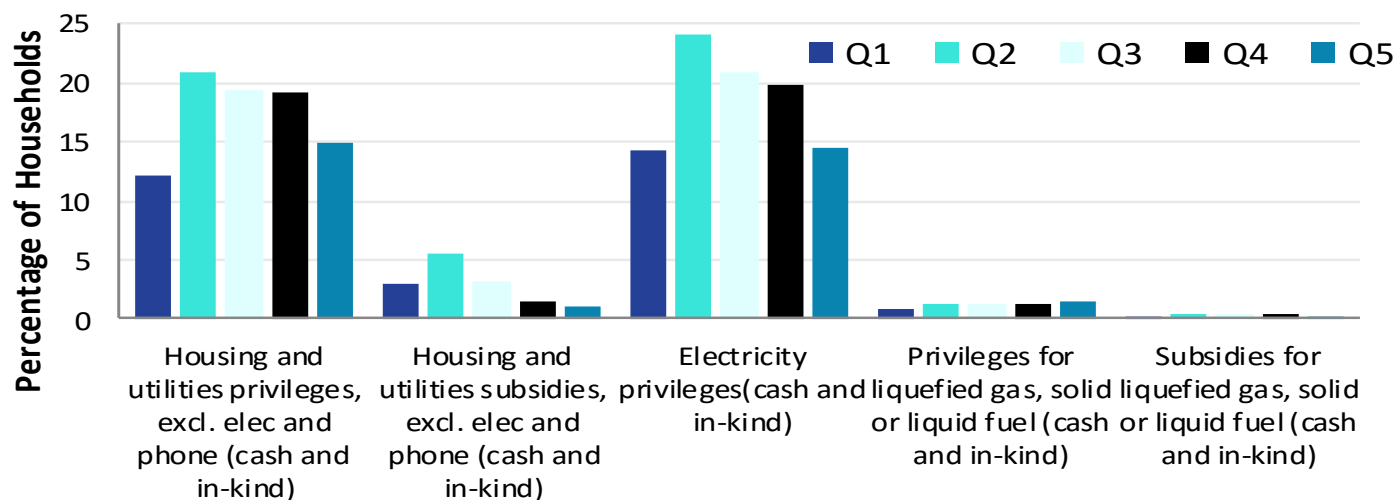
2014-2015

Programs were in place to protect the vulnerable, but those were regressive

Prior to 2014 reforms, **two main programs** with an overall **regressive** performance:

- The **Housing and Utility Subsidies (HUS)** program reduced utility bills for households with high energy shares, irrespective of their income (that meant also large spenders)
1.33 mil (~8%) HH covered; Annual Cost in 2013: >1.89 billion UAH (0.13% of GDP)
- The **Housing and Utility Privileges (PRIV)** program, together with other energy privilege programs, reduced energy bills (different percentages for different groups, from 25% to 100%)
*3.7 mil (>22%) HH covered; Annual Cost in 2013: >3 billion UAH (>0.2% of GDP)
(excluding transportation and telephone privileges)*

Coverage of HUS and PRIV Programs, by Wealth Status



In 2014, residential heat and gas tariffs were increased, but not to cost-recovery levels...

In UAH terms, **residential gas tariffs increased by ~56%** (on average) in May 2014; **residential DH tariffs increased by ~40%** (on average) in July 2014

- Residential gas supply tariffs remained very low and resulted in significant hidden costs to the economy
 - The difference was significantly affected by currency devaluations
- Residential DH tariffs were still below cost recovery, but to a lesser extent
 - New tariffs do not properly account for heat losses, inflation, maintenance, or depreciation

... and social protection was improved to better protect the vulnerable from the impact of tariff increases

New compensation program: introduced to cover increased costs of gas, DH and hot water expenditures

- Provided when household income is below the subsistence minimum (UAH 1176 / US\$76 per month on ave); targeted at the *bottom 30% of the population*
- Aimed to compensate for increased utilities expenditures
expected coverage 3.7% of HH

Changes to HUS (Oct 2014): strongly progressive design and expansion of the pool of beneficiaries

- Threshold share of energy expenditures that defined benefits became a function of income
- Redesigned HUS to increase the coverage of poorer households, especially households with children, unemployed in small towns and rural areas, etc.
- Majority of beneficiaries under the old rules would be eligible for subsidies under the new rules
expected coverage 32.3% of HH

• **Changes to PRIV (Oct 2014):** changes to make privileges more progressive
coverage remains 22.9% of HH

Main Challenge for the Government was:

To Keep Moving Energy Reforms Forward in a Sustainable Way

Our support: Continuous impact evaluation and dialogue

Analysis of recent, ongoing and considered energy tariff and social assistance mechanisms reforms and their impact (poverty, social and fiscal)

- 2 country-wide social impact assessments of energy and social assistance reforms (at the beginning and end of 2014-2015 heating season) to assess people's attitudes towards reforms and their expectations (*with special focus on regional dimensions*)
- analysis of effectiveness of social assistance mechanisms; identification of existing bottlenecks to their proper functioning
- fiscal, poverty and distributional impact assessment of energy tariff increases, together with the increases in tariffs for other utilities; impact evaluation of different considered changes to social assistance mechanisms (*with special focus on regional differences*)

Continuous dialogue with the Government on how to advance energy and social assistance reforms further

- continuous knowledge sharing with the Government (through briefs and presentations) on impacts of the reforms
- incorporating findings of the social impact assessment into dialogue on social assistance

Continuous support to the Government on implementation of its communication strategy on reforms

Our support: Developing a brand for the simplified HUS

In May-June, 2015, a new brand was developed for the simplified HUS program



**SUBSIDY - A GUARANTEE OF
BALANCE
IN THE SOCIETY AND ECONOMY**



**SOCIAL BALANCE
Housing and Utilities Subsidy**



**SUBSIDY - A GUARANTEE OF
BALANCE
IN THE SOCIETY AND ECONOMY**

The brand was tested in May 2015, through focus groups and presented to the Ministry of Social Policy in June 2015. The Ministry endorsed the brand

- The brand is being used in the training materials for September -October workshops for welfare officers and
- On HUS-related outreach materials produced by the Ministry of Social Policy

Our Support: social protection was further improved to better protect the vulnerable

- **PRIV and Compensation Program consolidated with HUS program**
 - Due to poor off take of the Compensation Program and poor targeting of PRIV
- **Changes introduced to HUS (Feb 2015): simplified application procedure; streamlined administration**
 - Extended duration of re-certification for benefits
 - Simplified eligibility rules
 - Reduced paperwork necessary to apply for benefits
 - Majority of households receiving PRIV and HUS under the old rules are eligible

Second Phase of Energy Tariffs and Subsidies Reforms

2015-2016

Summary of 2015/16 Reform Impacts

Impact Description	2015	2016
Residential gas tariff average increase and annual average tariff*	180% 2,893 UAH/tcm	470%** 5,885 UAH/tcm
Residential DH tariff average increase and annual average tariff*	58% 509 UAH/GCal	193%** 949 UAH/Gcal
Financial gain/loss for gas sector (UAH billion)	(11.9)	30.3
Financial gain/loss for DH sector*** (UAH billion)	(1,5)	(3,5)
Share of energy expenditure for bottom 30% households	16.6	25.2
Change in number of households living in poverty**** (percentage point) without HUS	21.9	24.3
Simulated share of households eligible to apply for social assistance	43.0	60.7
Fiscal impact of social assistance programs (UAH million and % of GDP)	1.05	2.39
Poverty change (percentage point) with HUS assistance	20.2	17.2

* Comparison of annual average tariff (including VAT) to 2014 (baseline) average tariffs of UAH 1032/tcm for gas and UAH 32/Gcal for DH

** The increase against 2015 is around 104% for natural gas and 84% for heat supply

*** Based on data of 130 DH companies accounting for 79% of overall heat supply by NEURC licensees

**** Total number of households was 14.5 million in 2014

Key Outcomes to Date

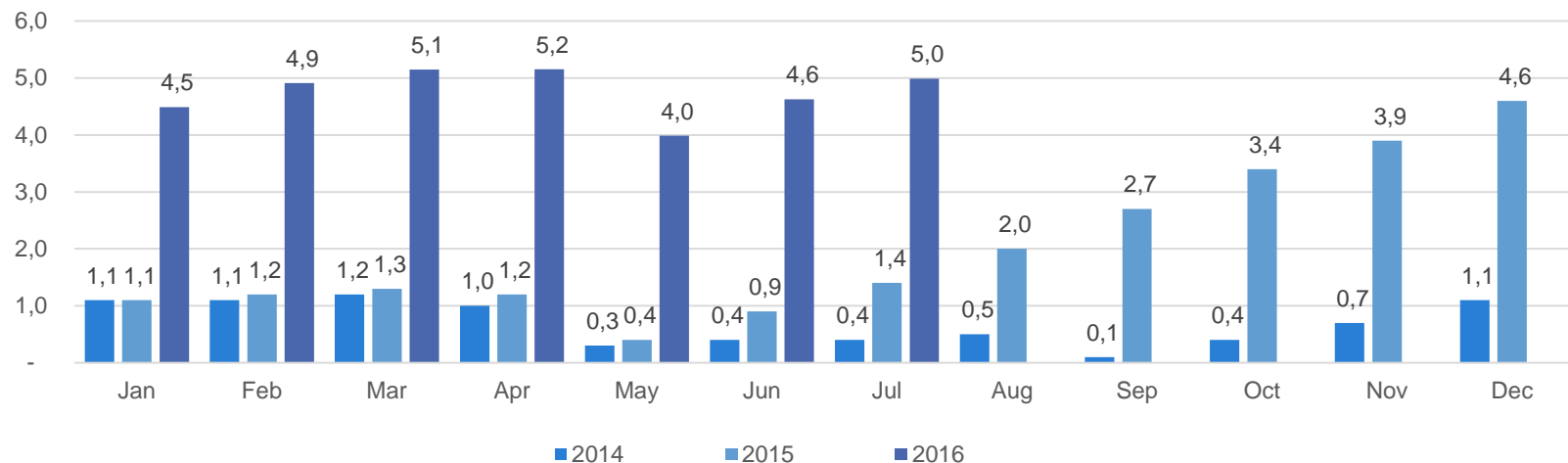
- There is lack of clarity on gas tariff setting arrangements for households and DH companies past the expiry of the existing Public Service Obligation (PSO). The current PSO has shortcomings but its removal will dictate revisions in the settlement scheme of subsidies and this and other implications should be carefully assessed and planned.
- The impressive scaling up of the Housing and Utilities Subsidy (HUS) program in 2015 was a successful mitigating policy measure to the large gas and DH tariff increases. However, undercoverage of the poor and vulnerable like IDPs and labour migrants remains a concern.
- HUS has grown significantly in size and cost- the 2014 reforms resulted in major scaling up with 40% of households covered by the program at a total fiscal cost of around UAH 40 billion or 2.0% of GDP in 2016 (In contrast to 0.13% of GDP spent in 2014).
- The 2016 tariff increases will create further welfare pressure during the 2016-17 heating season.

Impact of Tariff Reforms on Households

Over the past 2 years the HUS program has seen a remarkable increase in the number of beneficiaries...

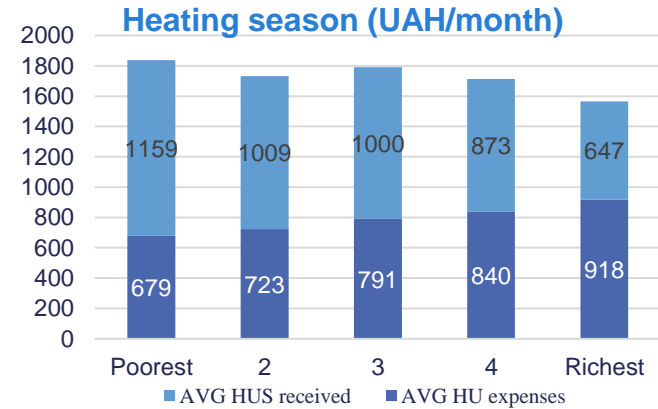
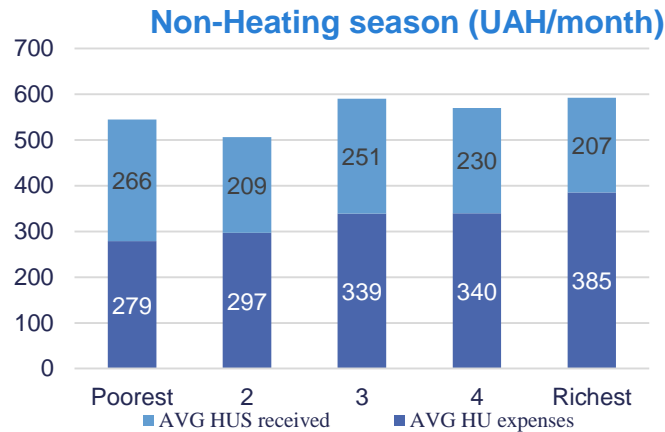
- With technical support from the World Bank the government initiated extraordinary scale-up of the HUS Program from ~1 million to ~5 million households in 2015
- As of July 2016, about 30% of Ukrainian households have been relying on the HUS program (~ 5 mln households)

The number of households receiving subsidies, mln households

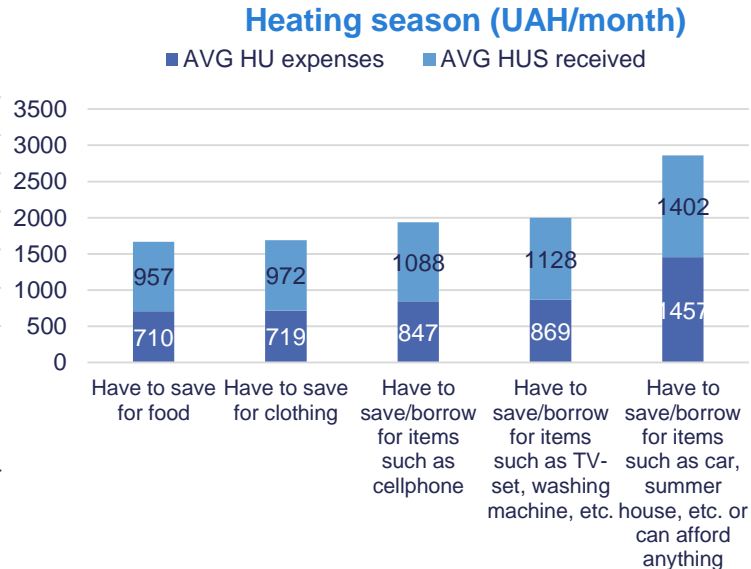
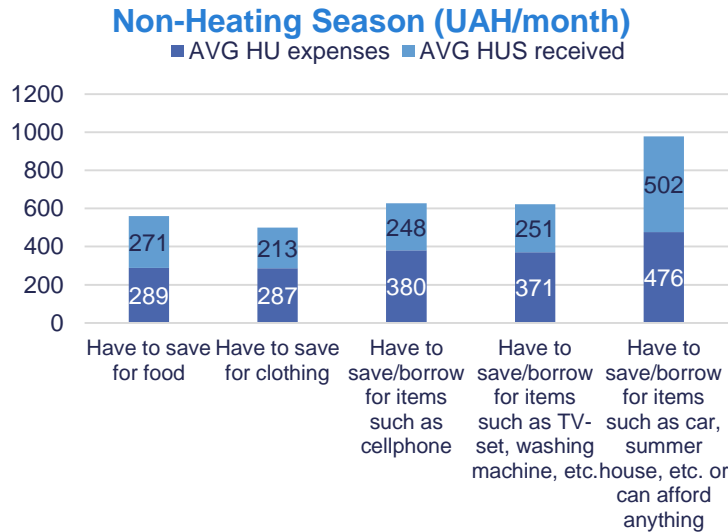


The HUS program successfully cushioned the impact of tariff increases in 2015 and 2016 for the bottom 30%

➤ **Adequacy of support:** HUS represents an important share of HH utility bill, particularly in the case of the low income households during the heating season.



➤ **Targeting:** The nominal amount of support was higher for higher for neediest households ranked by income. However, when ranked by self-reported wealth status, the amount of support is higher for better off households.

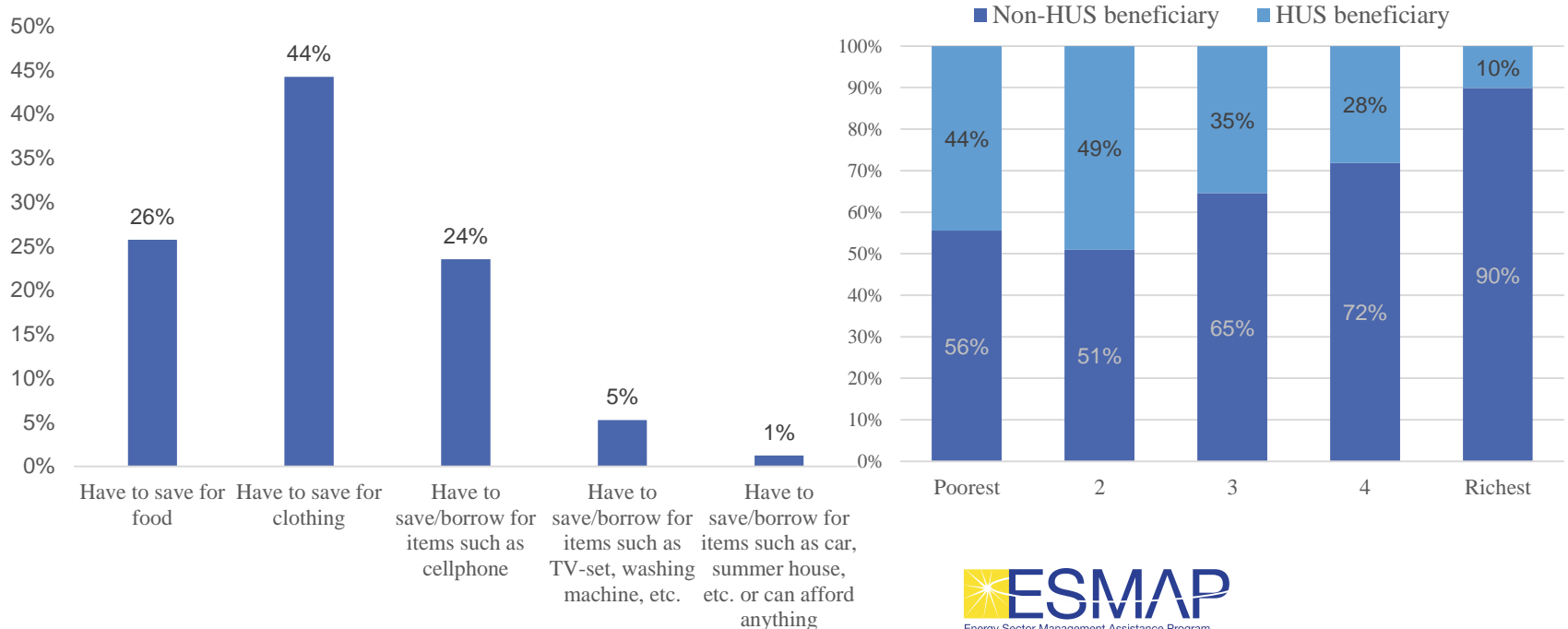


Note: Estimates based on a nationally representative survey fielded in August, 2016. Sample size 3040 households. Quintiles estimated based on household per capita income. Heating season estimates are asked retroactively for the last season.

While a major share of total HUS budget was targeted to the neediest households, there is significant under-coverage of low income households

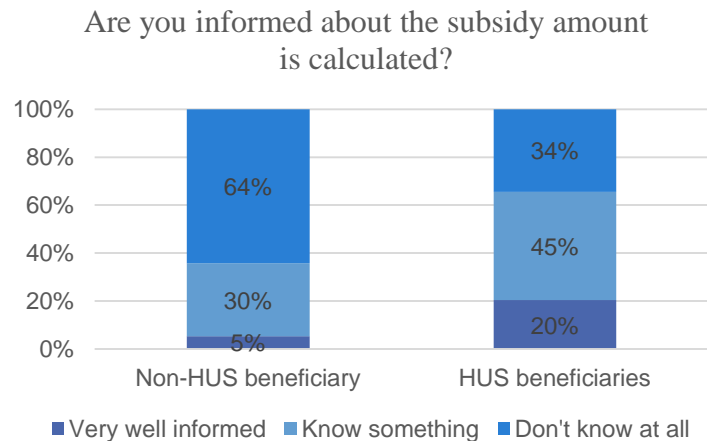
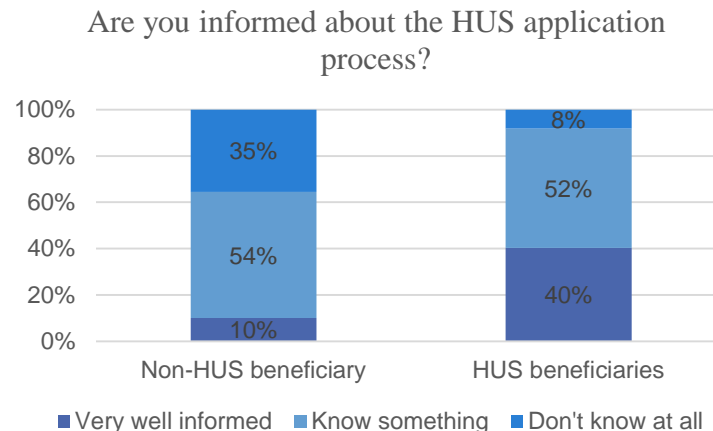
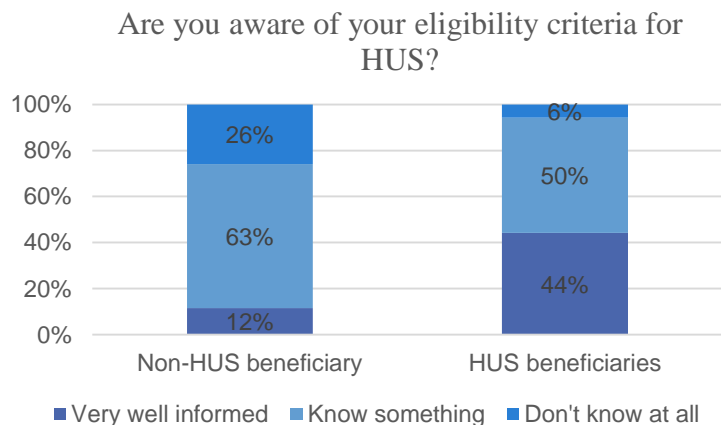
- About 60% of the HUS program budget reached poorer population who cannot afford basic goods.
- However, program needs to reach a higher share of poor. Current share of non-beneficiaries among the poorest two quintiles is over 50 percent.

Share of total transfers by wealth status (left panel, heating season) and share of beneficiaries and non-beneficiaries by income quintile (right panel). (August, 2016)



Awareness of low income non-beneficiaries is low and should be addressed through an outreach effort and improved customer service

Figures show awareness about HUS eligibility and application process among the poorest 40%. Shown by beneficiary and non-beneficiary status (2016)



On average, among the poor population, many non-beneficiaries are uninformed about the HUS program eligibility criteria and application process. On average 26% don't know about eligibility rules, 35% don't know about application process, and 64% about the subsidy calculation.

To help explain the tariff reforms in 2015, support was provided to a national communication campaign led by Cabinet of Ministers

- WB / ESMAP supported the Government to communicate energy tariff reforms and mitigation measures, including:
 - Opinion research to assess public attitudes about reforms
 - Messaging workshops with Government agencies and donors to design key campaign messages
 - Seven training sessions for 278 journalists and media monitoring to enhance press coverage of reforms
 - Development of an animated ad for print, internet, and TV
 - Training of social workers at HUS to improve their customer orientation
- Focus group discussions were conducted in 10 regions before/after the 2014-15 heating season and were used to inform the campaign's messages and TV ad
- In regions where media training was conducted, the quality of reporting on energy reforms improved
- Ad appeared on 15 Government websites and 19 TV channels for 4 weeks
- However, last winter the public's information needs were not being met; focus groups in 2014 and 2016 demonstrate that citizens need more localized and detailed information about tariffs and HUS eligibility
- Significant progress has been made in recent months to communicate



Communications for the next phase of reforms

Recent focus groups show mixed attitudes and a need for better information

- Many people see the reform as necessary but oppose tariff increases based on perceived gap between tariffs and incomes
- Government communication efforts are seen as partial, inconsistent, and uninformative (lacking content on tariff structure, how tariffs will be used)
- Bills are under-utilized as sources of information
- People prefer more personal and detailed information (from local authorities, utilities, building managers) on how reforms help improve service quality and accountability

The Bank is supporting communication through the following activities

- Second round of opinion research to understand attitudes about latest tariff increases, awareness of HUS support, and to evaluate the effectiveness of last year's communications
- Second round of journalists' training sessions from September – October to inform reporters and provide regionally tailored information about tariffs and HUS
- Offering support to improve coordination among donors' public outreach efforts on tariffs and energy efficiency
- Offering support to designing a crisis communication plan and conducting media training for Government spokespersons