

International Centre for Policy Studies

**Ukraine on the Verge
of Energy Poverty:
How to protect
socially vulnerable groups**

Policy Brief

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The paper, "Ukraine on the Verge of Energy Poverty: How to protect socially vulnerable groups" is a Green Paper analyzing energy policy. It contains an analysis of problems and the means to resolve them that are intended for discussion by all interested parties, including government agencies, business, community organizations, political parties, and the academic and expert communities.

The next phase of working on the analytical brief will involve: summarizing comments and observations that were received during the course of public debate; drafting the final version of the document as a White Paper; holding further discussions and consultations; incorporating changes to the final draft; summarizing the results of this study; and formulating the results as a policy brief.

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Contents

Foreword	4
Overview	6
Thesis: Vulnerable households are not protected against the impact of energy market reforms	7
The Cost of Doing Nothing: Ever-widening energy poverty	9
What is energy poverty?	9
Energy poverty in Ukraine	10
The consequences of energy poverty	12
Flaws in current social benefits policy	14
Social benefits for consumers: Sources and coverage	14
Flaws in the social security system	15
A social policy that is no longer viable	16
Previous efforts to resolve the problem	17
What interest groups will lose from maintaining status quo	19
European guidelines for social policy in the energy sector	21
Normative requirements of the EC	21
Identifying vulnerable population groups	21
How vulnerable consumers can be identified	22
Drafting and approving a social action plan	23
Consultations with social working groups	25
Recommendations	26
Approaches to protection among EC countries	26
Annex 1	29
Annex 2	30
About the authors	31
About ICPS	32
Services available from ICPS	32
Our partners and clients	33
ICPS Publications	34
Projects	36

Foreword



Energy poverty. Being unable to satisfy your basic energy needs. Having to spend the lion's share of your income to heat your home and pay for electricity. In Ukraine, with its cold winters and the probability that utility rates will continue to rise, this picture looks quite realistic. At the moment, most families are not yet feeling this threat: most of them continue to rely on some form of social benefits to help them. But for the most vulnerable and unprotected households, the situation is very different. A distorted and untargeted welfare distribution system means that they are at risk of finding themselves on the verge of energy poverty.

Still, energy poverty should not be seen as a syndrome specific only to transition economies. Even in the wealthy, developed countries in Western Europe, people are starting to suffer from it. Moreover, European politicians admit that this issue is not one with a simple solution that can be applied across all EU countries and simply exported beyond its borders. Instead of offering a set of ready-made solutions formulated in the Directives of the *acquis communautaire*, the EU has suggested that Ukraine develop its own recipe for alleviating energy poverty, one that would take into account local aspects. The point is that energy poverty is not a single problem but a cluster of problems related to the social, energy and economic policies of a given country.

The issue of rate policies and social policy has always been particularly difficult one for government agencies. Any decision in this area, say, to raise service rates, carried with it a threat of social instability. As Bulgaria's recent experience has shown, such concerns are hardly without reason. This often makes the programs and action plans that a country agrees to hostage to the next election, and so they gather

dust in official's in baskets for years, waiting for a green light from those at the top.

It is at this critical juncture that independent think-tanks can play a key role by preparing the groundwork for the necessary reforms to be undertaken. Such research organizations need to foster public awareness of the problems being faced and, ultimately, offer a range of solutions to those who are responsible for making policy.

In this brief, the ICPS analytical team has attempted to break down the problem of energy poverty in order to present it for public debate.

Volodymyr Panchenko
Director, ICPS

Overview

According to the requirements of the Energy Community (EC), Ukraine needs to change its social welfare system as regards consumers of energy. Since the country joined the Treaty establishing the Energy Community in 2011, it has been slowly reforming the energy sector in line with the standards and norms established in EU legislation.

The purpose of this brief is to identify the key problems with protecting vulnerable households that consume gas, electricity and heating services while the energy market undergoes reform.

The formulation of these problems and their detailed descriptions will be the subject of discussions with experts and interested parties, which will make it possible to identify their positions on the prospects for adapting social policy to deal with new challenges in the energy sector. Expert comments provided during the discussion of this brief will form the basis for a paper with recommendations for resolving the identified problems.

Thesis: Vulnerable households are not protected against the impact of energy market reforms

At the moment, Ukraine's system of social welfare is incapable of providing effective protection to household consumers from the fallout of energy market liberalization. Despite the country's international commitments to improve the protection of socially vulnerable social groups, Ukraine has not even identified who these groups are or a mechanism for protecting them under law. Moreover, its government is dragging its feet about changing the social welfare system from, which leaves it as unfocused and ineffective as before.

In this way, certain vulnerable social groups could feel a strong negative impact from this liberalization. Today, prices and rates¹ for most groups of consumers are regulated by the government and are several times lower than is economically justifiable. This means at the early stage of reform of the gas and electricity markets, rates for residential users and certain other categories of consumers such as budget organizations and community enterprises will rise significantly.

But the reform of energy markets contains a number of other risks for consumers as well:

- Providers find it more profitable to provide services to wholesale buyers such as industries, rather than insignificant household users.
- Companies will increase payment discipline as they gain more grounds to cut off deadbeat energy users.
- The need to collect and analyze information when there is the option of choosing among a number of providers and rate plans could be confusing for the unprepared consumer.

¹ In accordance with the Law "On residential services," the terms "price" and "rate" with regard to electricity service may be used interchangeably.

On the one hand, such negative effects should not be an excuse not to liberalize energy markets. All consumer groups, including residential users, will ultimately lose if Ukraine delays reforming the energy market and social welfare system. The quality of services will continue to deteriorate, along with the infrastructure, while the level of unproductive public spending will continue to rise.

Guarantees for the protection of vulnerable households need to be included in the energy and social programs of individual members of the Energy Community.² The negative impact of sharp rises in rates on these consumer groups can be reduced and even eliminated entirely. Overall expenditures can be reduced by an objective reassessment of those who are eligible for assistance and will make it possible for the state to save more money. This can then be directed at protecting target groups when rates start climbing.³

² "ECRB Best Practice Guidelines on the Protection of Vulnerable Household Customers," Andrea Brandstätter, 2007.

³ IMF report (2010).

The Cost of Doing Nothing: Ever-widening energy poverty

What is energy poverty?

Energy poverty occurs when households cannot satisfy their basic needs for energy, that is: to keep their residence at the necessary temperature, to have enough electrical appliances to prepare food, and so on. Typically, energy poor households are those for whom the cost of electricity exceeds a certain proportion of their incomes. For this reason, a slew of Governments of EU countries and international organizations that are working to alleviate poverty use 10% as the threshold for energy poverty.⁴

The criteria of energy poverty can be more complicated and include, not just the cost of energy resources, but also take into account consumption levels, prices and the energy efficiency of homes. Overall, households risk finding themselves below the energy poverty line when three factors coincide:

- low income;
- poor energy efficiency;
- high rates for energy (See Fig. 1).

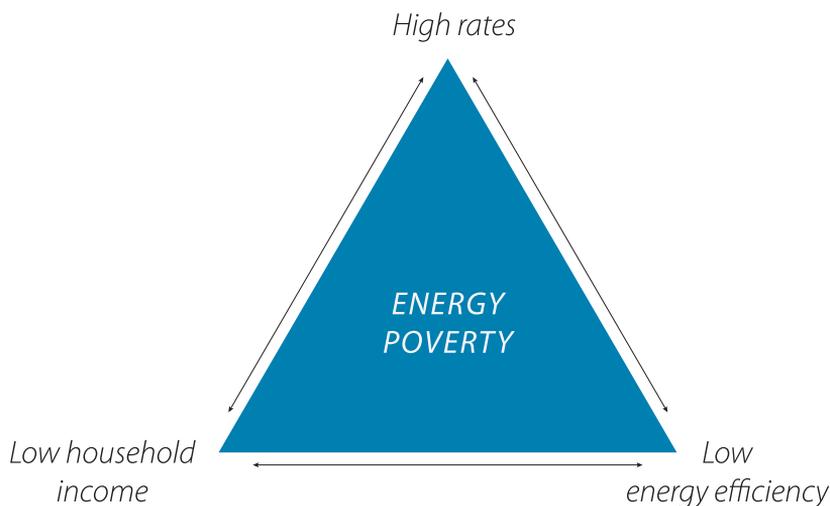
Moreover, these three factors are inextricably connected. For instance, when buildings are poorly insulated, it directly affects the total cost of heating: those who live in buildings that are poorly insulated will pay more and will be at greater risk of finding themselves experiencing energy poverty.

Meanwhile, they risk being trapped by a vicious cycle in which low incomes do not allow them to pay to insulate their homes or upgrade the equipment that generates or delivers energy, resulting in exces-

⁴ See, for example, http://www.decc.gov.uk/en/content/cms/statistics/fuelpov_stats/fuelpov_stats.aspx

sive costs for the energy they consume. Equally dangerous is the widespread habit of wasteful use of energy resources that is encouraged by the existing social assistance system and unreasonably low energy prices.

Fig. 1. Factors affecting energy poverty



Source: Energy Regulators Regional Association

Energy poverty in Ukraine

A large portion of Ukraine's population is already feeling the pinch of high costs for residential services. In 2011, 5.6% of households were spending more than 10% of their incomes just to pay for their heating bills. Estimates are that, if rates for natural gas go up another 33%, nearly 45% of Ukraine's households will be spending more than 10% of their incomes to pay for residential services.⁵

⁵ See USAID (2012).

Table 1. Breakdown of average household spending for residential services

Spending item	Average cost, UAH / household/month	Share of cash income, %	Share of households that pay their utility bills, %
Residential services, total	313.58	9.0	99.9
Heating	137.89	3.4	37.6
Natural gas	77.21	2.3	87.9
Hot water	55.02	1.2	19.6
Cold water	25.82	0.7	69.2
Sewage	18.06	0.5	50.9

Source: 2011 HBS as presented in USAID (2012).

Some Ukrainian households are finding themselves at the threshold of energy poverty for two main reasons:

- **Low incomes.** According to the Household Budget Survey⁶ (HBS), in 2010 fully 38% of households in Ukraine were limiting themselves when it came to non-food goods and services and spent a major part of their incomes on food.
- **Energy inefficiency.** The country's housing stock is highly energy inefficient: nearly 70% of the heat that comes to apartment buildings is lost because the buildings are not properly insulated and consumption is not regulated—there are no meters.⁷

The third factor in energy poverty—high rates and the resulting cost to residential users—is not yet being felt thanks to state regulation. For instance, natural gas rates for residential users only actually cover 20-30% of the cost of this service. Yet raising rates is necessary if Ukraine's energy markets are to continue to be reformed. Depending on what strategy the Government chooses to follow, this increase could come gradually or be done at once. Various options for increasing rates will have various consequences for the social welfare system and the quality of life of ordinary Ukrainians (see Table 2.)

⁶ http://ukrstat.org/uk/operativ/operativ2006/gdn/sdrsd/arh_sdrsd.html

⁷ According to "Reform of local heating supply systems" project.

Table 2. The impact of raising rates for energy resources

How rate increases are handled	Impact on social welfare system	Impact on quality of life and well-being
Basic (rates remain unchanged for the next 1-2 years)	The social welfare system will continue to provide assistance to more Ukrainian households than is really necessary. This will place additional stress on the budget system, limiting the options for undertaking other state programs and projects.	Social injustice remains. Wealthier households will continue to benefit from lower prices and state support. The quality of residential services being provided will continue to grow worse as infrastructure ages: breakdowns, loss of heat in the networks, and so on.
Gradual (residential services rates rise 30–60% annually)	The number of households who apply for subsidies for their residential services will grow 150%, possibly to as much as 15% of all households in Ukraine. ⁸ Pressure on agencies that provide subsidies will grow.	Even at the first phase of rate hikes, nearly half of Ukrainian households will find themselves spending over 10% of their income on residential services. ⁹ This will force them to cut back on consumption of non-food items and services, or to pay for residential services less regularly.
Shock therapy (natural gas rate is instantly placed on parity with imports, resulting in a 3-5 fold increase)	As more and more households apply for state subsidies, pressure on administrative bodies will be evident, and will only grow worse as the heating season draws closer. Financing for additional sums being paid out for subsidies and benefits will have to be found.	A large portion of the population will find itself suffering from energy poverty as it sharply reduces consumption of energy resources. Random and insufficient centralized residential heating will become the norm.

Source: ICPS

The consequences of energy poverty

When household spending on energy go above a certain acceptable level, consumers have to start reducing the amount of energy that they consume, which tends to affect the quality of their lives. For instance, they may have to selectively heat parts of their residence, sometimes limiting themselves to a single room, heating only at certain times, turning off extra heating appliances, or living without heat altogether.¹⁰ Energy poverty can take on some fairly radical forms when the most impoverished consumers are faced with a choice between eating and heating, when paying their electricity or gas bills is only possible if they give up on basic needs, such as food.¹¹

⁸ USAID estimates.

⁹ Ibid.

¹⁰ See "You Just Have to Get By: Coping with low incomes and cold homes," a 2010 report from the Center for Sustainable Energy (UK) at http://www.cse.org.uk/downloads/file/you_just_have_to_get_by.pdf.

¹¹ See J. Hills, "Fuel Poverty: The problem and its measurement," at <http://www.decc.gov.uk/assets/decc/11/funding-support/fuel-poverty/3226-fuel-poverty-review-interim-report.pdf>

When people live in underheated premises, a slew of problems arise with their health. According to the World Health Organization (WHO), the minimum temperature of a residence that avoids negative consequences is 21°C for the main living area and 18°C for the remaining rooms. In a situation where the temperature of the living space falls below 16°C, the risks of respiratory ailments begin to rise; below 12°C, the cardio-vascular system begins to suffer. The risk of all kinds of illnesses is increased further if the interior living area is overly humid, which is generally higher in inadequately insulated buildings, and the appearance of mould and fungus on walls. The most vulnerable individuals in living spaces that are underheated are elderly people, infants and those with chronic illnesses.

During the winter season, the mortality rates tend to rise, as a consequence of constant chilling among people who live in poorly heated apartments and homes. Low temperatures also cause blood pressure to rise and cardiovascular problems to become more acute. This is particularly hard on people who are over 85 years old. Studies have shown a direct correlation between residential temperature levels and mortality: for every 1°C that the temperature drops below 19°C, the mortality level increases by 2%.¹²

Energy poverty in the European Union

Energy poverty is a real problem, even in European countries where the proportion of poverty is relatively low, especially in countries with a cold climate and relatively high energy rates. The issue of access to energy for low-income households was first raised in Europe during the oil crisis of 1973. As prices continued to rise for fuel and energy, the issue was put on the poverty alleviation agenda in the policies of most EU countries.

It turned out that, on average, nearly 32% of households in the EU experienced some energy poverty. These households are unable to maintain a healthy temperature level, spend a disproportionate amount of their budgets on energy, live in insufficiently heated homes, or are in debt for residential services.¹³ This kind of poverty is more widespread in the new EU members like Bulgaria and Romania, where more than 20% of households are unable to maintain a minimum healthy temperature level.¹⁴

¹² "Vulnerability to winter mortality in elderly people in Britain: A population-based study" by P. Wilkinson, S. Patten den, B. Armstrong, A. Fletcher, S.R. Covets, P. Mangtani, and A.J. McMichael, *British Medical Journal* № 329 (7467), 2004, pp 647 – 653.

¹³ Statistical data on the extent of energy poverty in Europe are based on evaluations of household incomes and living conditions. See http://epp.eurostat.ec.europa.eu/portal/page/portal/microdata/eu_silc.

¹⁴ http://ec.europa.eu/regional_policy/conferences/energy2011nov/doc/papers/bouzarovski_eu_energy_poverty_background%20paper.pdf

Flaws in current social benefits policy

Social benefits for consumers: Sources and coverage

Ukraine's social benefits with regard to energy resources cover pretty much all citizens, without regard to their income levels or real need for such support. The state offers individuals social assistance through two sources that too often duplicate each other:

1. A system of discounts on the payment of residential services and subsidies for such services.¹⁵ More than 22% of households are eligible for one type of discount or another on such services, most of them "children of the war"¹⁶ and war veterans. In 2012, nearly 8% of the country's population was receiving benefits.¹⁷
2. Regulated low fares and rates for gas, heating and electricity that is used for household needs. Most households in Ukraine benefit from this form of assistance.

The total amount of financial support for consumers with regard to energy services in Ukraine has been growing with every passing year. In 2011, it was nearly UAH 100 billion or almost 30% of the state budget. IMF estimates put Ukraine's direct and indirect compensation for the difference between the actual rates for gas and heating and the real cost of both at nearly UAH 80bn.¹⁸ The value of dotation certificates for electricity, known as cross-subsidies, were worth nearly UAH 25bn in 2011.

¹⁵ Impoverished individuals who do not use heating services are given subsidies to buy liquefied natural gas, and hard or liquid fuels for household use. See USAID 2012.

¹⁶ Anybody born prior to September 1945 is considered a "child of the war."

¹⁷ The criteria used to determine eligibility for subsidies are outlined in the Provision "On the procedure for awarding and providing subsidies to individuals to cover expenses for residential services and the purchase of liquefied gas and hard or liquid household fuel." See <http://zakon2.rada.gov.ua/laws/show/848-95-%D0%BF/page>.

¹⁸ See IMF 2012 report. The electricity and heating sectors show a similar phenomenon, where the rates set for different consumer groups is such that households enjoy lower prices for energy than industrial customers.

The key element in both sources of assistance is the power company. In the first instance, the Government pays for discounts and subsidies by compensating the costs of the service providers from the State Budget; in the second, government-determined below-market rates mean that the power companies are effectively financing social assistance to consumers. In the end, more than 80% of all spending on social assistance is financed by energy sector companies—the main one being Naftogaz Ukrainy—through lost income. Only about 20% is financed directly by the State Budget in the form of transfers, subsidies and discounted rates.

Flaws in the social security system

The basic problems with both kinds of assistance for energy consumers are the same.

Firstly, this assistance is poorly targeted as the majority of it goes to consumers who are far from impoverished. For instance, although the gas rate is differentiated based on the volume used—if annual use falls below a certain level, the following year a lower rate is applied—, this criterion has little to do with the actual income of individual households. Discounted rates are also allowed without regard to the actual income of the households granted them. According to IMF estimates, only about 20% of all discounts actually go to the poorest category of households in Ukraine.

Secondly, both systems of social assistance offer plenty opportunities for abuse of both fiscal and energy resources on the administration side. Suppliers resort to manipulating thanks to the different rate scales and excessive consumption rates. For instance, natural gas intended for so-called “privileged” categories—market players estimate as much as 2 billion cu m of gas a year—actually goes to commercial customers. Subsidies tied to household spending levels are another source of abuse as local commissions approve the granting of subsidies to categories of consumers who normally would not be eligible for assistance.

Table 3. Main flaws in the residential services discount and subsidy systems

Discount system	Residential services subsidies
Poor targeting	Poor targeting
Duplication of assistance ⁵	Complicated administration
In kind (non-monetary) discounts	Effective advantage to one-person households ⁶
Poor accounting and regulating mechanisms	Poor coverage of households who have no access to services

Source: Data from CASE report “Improving the mechanisms for providing discounts” and “Improving the mechanisms for providing residential subsidies”

Thirdly, when the function of providing social services is delegated to only certain enterprises—mostly state-owned ones—the competitiveness of the market for extracting gas and supplying gas and heating inevitably becomes very distorted.

A social policy that is no longer viable

This kind of system for providing social assistance is unsustainable because of worsening economic conditions in Ukraine and structural changes in the country's energy markets.²¹

The privatization of the electricity sector and the liberalization of Ukraine's electricity markets. With the revival of the privatization process in 2010, the share of private companies on the power supply market has increased. These companies will require timely and complete payment of any losses from selling natural gas at discounted rates to certain categories of consumers or will demand that the state stop artificially regulating rates for services in competitive segments of the market. More over, the liberalization of the electricity market²² means that the regulator has to be removed from establishing rates on domestically produced gas and electricity rates.²³

Growing economic gap in Ukraine. Although both absolute and relative poverty are both comparatively low in Ukraine today, the expected rise in residential rates for electricity and gas could acceler-

¹⁹ Services that are subject to discounted use are also covered by social assistance to poor families.

²⁰ According to USAID estimates (2012), mostly households of pensioners, including those who are still employed, regardless of income level.

²¹ CASE (2010).

²² Ukraine is liberalizing its gas and electricity markets in line with the President's Economic Reform Program and the requirements of the Energy Community.

²³ However, the regulator is also supposed to establish rates for gas and power distribution and transportation, market segments that are natural monopolies.

ate a negative trend to growing poverty in recent years. If the current non-targeted system of social assistance is not reformed, it will only increase social injustice in this country, when most assistance goes to better-off households.

Growing pressure on the State Budget. Over 2010 – 2012, one of the main factors behind the growing deficit, according to the IMF, was energy subsidies.²⁴ Every year, the financial burden on energy companies is growing as the gap between the cost of imported gas and domestic prices for gas and other related services paid by consumers. Meanwhile, consumers continue to use growing amounts of resources at the same time as domestic extraction of natural gas is in decline.

Previous efforts to resolve the problem

The President's Economic Reform Program for 2010 – 2014 includes measures aimed at reforming rate-setting policy and the system of social protection and assistance for vulnerable groups. (See **Annex**) Still, over 2010 – 2012, the steps called for in the annual plans were continually postponed and, for 2012, the progress of this Program remained very poor. The transition to targeted social assistance of all types was not started because every attempt by the Government to make these changes ran into strong resistance from various interest groups:

1. A Government move to institute a more flexible mechanism for funding discounts for Afghanistan veterans and Chornobyl "liquidators" failed.²⁵ All the Government managed to do was to revise and clean up the list of those eligible for such discounts.
2. The Government introduced new criteria for eligibility for subsidies,²⁶ which made it possible to make assistance more targeted. However, these criteria continue to be open to interpretation by local officials, to the advantage of consumers.

²⁴ At the moment, funding for the social security system is divided as follows in the State Budget: around UAH 6-8bn to cover discounts, up to UAH 1bn for residential services subsidies and assistance, nearly UAH 4bn to subsidize Naftogaz Ukraine, the state gas monopolist.

²⁵ See Bill "On state guarantees that court decisions will be enforced" dated September 9, 2011, which gives the Cabinet of Ministers the power to establish the procedure and amounts of discounts and social benefits for a slew of socially unprotected population groups.

²⁶ Starting in 2012, the right to have residential services subsidies is given to those households who consist of only unemployable individuals or families with minor children or Category I or II invalids, whose income per person is no more than 100% of the subsistence minimum, and whose costs for residential services are more than 10% of household income. See USAID report (2012).

3. In 2010, the National Electricity Regulatory Commission (NERC) decided to raise residential rates for gas and electricity. However, after the unions launched a number of demonstrations, the Government shelved any further plans to review rates.
4. In 2013, the Government plans to establish a new procedure for gathering fees for the use of natural resources, in particular to even up the size of the fee for extraction of gas for residential use and for commercial purposes. But these changes will only affect natural gas being extracted at a depth of 5,000 sq m or more.²⁷
5. In 2010, the Volyn Oblast Administration carried out a pilot program to provide energy discounts in the form of cash.²⁸ Although the pilot proved successful, it was never expanded to the rest of the country.

²⁷ See "New tax procedures for oil and gas extraction in Ukraine," R. Opymakh, Energy Policy, Petroleum & Gas №4 (7), 2012.

²⁸ Cabinet Resolution dated September 22, 2010, "On carrying out an experiment in Volyn Oblast to provide compensation in monetary form for the payment of electricity."

What interest groups will lose from maintaining status quo

All the main stakeholder groups stand to lose if the current system of social benefits for consumers of energy and energy services. Power utilities are the one interest group that loses the most from the existing situation, because they are effectively the main “donor” to the social security system. At the same time, though, business is hardly the only group that loses from the status quo.

Consumers also ultimately lose as the quality of services deteriorates and insufficient funding is available for other social and investment programs. The country will continue to experience a vicious cycle of excessive energy consumption because right now there is no incentive for either business or the general population to invest in energy efficiency.

As a separate interest group, the Government is also starting to lose from the situation. Firstly, the number of interest groups that are dissatisfied with the status quo is growing all the time. Secondly, the cost of social assistance for the State Budget is starting to make it difficult for the Government to finance other important policy areas, such as education and health.

Table 4. Losses to stakeholders from maintaining status quo

Type of interest group	Losses
Service providers This includes power utilities, gas extraction companies, and cogeneration plants. Indirectly, the group also includes power distribution companies—the oblgases and oblenergos—, whose rates are also being artificially kept low.	The main negative consequence here is the worsening financial state of energy companies due to dampened rates. This means that their physical plant is deteriorating over time, which reduces the value of the company as a business as well. Investment and production suffer, especially in the gas sector, and eventually loss of market share where there is competition.

Type of interest group	Losses
<p>Households</p> <p>The general population is the least structured group, within which are various categories of consumers who feel the impact of the problem differently. This group includes both individual households and the organizations that represent their interests: tenant associations, unions, and so on.</p>	<p>The losses for different categories of households differ depending on how they consume the services, income levels, and so on.</p> <p>All households experience the loss of quality of life because of low quality services, when providers allow the level of service to fall below established norms or not to meet the conditions of a contract, such as not warm enough temperatures, fluctuating voltage levels in power lines, emergency cut-offs.</p> <p>The poorest consumers cannot fully get the support they need from the social security system because of the in-kind nature of the assistance. For instance, residents of a village, who don't have access to central heating and hot water have no option for taking advantage of existing benefits like subsidies and discounts.</p>
<p>Commercial users</p> <p>Companies use more than half of the electricity and gas supplied in Ukraine. This group, especially the major companies who are consumers and who are relatively well organized in representing their own interests.</p>	<p>Competitiveness is reduced among industrial consumers because of cross-subsidization in the power sector, because they are unable to take advantage of the benefits of switching to direct contracts with gas and power suppliers, and because of the low quality of services.</p>
<p>Government agencies</p> <p>These are mostly represented by the line ministries: the Ministry of Energy and the Coal Industry, the Ministry of Social Policy, the State Committee for Energy efficiency, the national regulatory commissions (NSRC and NCRS), and the Administration of the President. There are also local government bodies and local governments that administrate the system for providing assistance and manage community-owned companies.</p>	<p>For these users, the growing deficit and level of indebtedness of the country and the community enterprises of the fuel and energy sector are one of the consequences.</p> <p>Gas extraction is taking place very slowly and there is not much real progress in energy conservation.</p> <p>The President's Economic Reform Program with relation to reforming social policy and upholding Ukraine's international commitments has been cut.</p>

Source: ICPS

European guidelines for social policy in the energy sector

Normative requirements of the EC

Ukraine's commitments before the Energy Community in terms of offering social protection to consumers are regulated by a series of normative acts. New framework Directives for gas and electricity, Directives 2009/73/EC and 2009/72/EC, are part of the *Third Energy Package* and require member countries to:

1. Formulating an official definition of categories of vulnerable consumers that takes into account the threat of energy poverty.
2. Guaranteeing a high level of social security to consumers, including drawing up specific measures for vulnerable consumer groups.

The Memorandum of Understanding on Social Issues (MoU) signed by Ukraine in October 2011 specifies the requirements for social security in the energy sector and requires that each member country:

1. Draft and institute a Social Action Plan;
2. Organize consultations with interested parties in social working groups.

Identifying vulnerable population groups

Clearly identifying vulnerable consumer groups makes it possible to make the social assistance system more targeted, directing it at those households that need this the most. This establishes the threshold of energy poverty and helps determine which categories and in what numbers the population is facing such a threat.

While emphasizing the importance of protecting consumer rights, the Energy Community leaves the formulation of specific steps to the discretion of individual member countries. This is why each signatory to the Treaty must come up with its own definition of categories of vulnerable consumer based on the specific local social security systems, income levels, climactic conditions, and so on. There is, in fact, no general definition of this concept, which is binding on all members of the Energy Community or the European Union.

How vulnerable consumers can be identified

The identification of vulnerable consumer groups can vary in terms of the level of detail and the number of criteria that are applied. A comparison table of official criteria designated by EC member countries can be found in the Annex.

This brief uses a less generalized definition of this category: *consumers are vulnerable when they are unable to satisfy their needs for energy, heating and natural gas to an extent that constitutes a direct threat to their lives, health and well-being.*

Criteria for identification

The set of criteria for identifying vulnerable groups can vary but typically contains certain basic parameters, such as:

- income level;
- age;
- size of family (number of children);
- physical or mental incapacity, including family members;
- presence of individuals receiving benefits or pensioners;
- residence in a rural or urban area.

On the basis of these criteria, a "vulnerability profile" is established, which makes it possible to justify any requests from individual households for the right to one or another support measure.

The parameter that is most widely used in the majority of EU countries is the level of household income. It is the criterion upon which most financial assistance to compensate a certain level of household spending for those whose income is below a certain level is oriented. However, a system to support vulnerable consumers based solely on household income would not be targeted enough. So other criteria,

such as the presence of an invalid in the family or more than two children to raise.

The vulnerability of an individual consumer may be based on not just a low income or inability to work, but also because of the lack of technical and legal knowledge, a lack of understanding of what different suppliers are offering, the rules for rate-setting and paying bills, which increase the risk that the person's rights will be violated. This kind of gap needs to be compensated by informational support for vulnerable consumer groups.

Particularly vulnerable groups

Within the broader group of vulnerable consumers are categories of particularly vulnerable individuals for whom the lack of proper access to energy resources is not merely a threat to their well-being but to their very existence:

Consumers who depend on life-support systems. The protection of consumers who are dependent on electrical equipment that constitutes a life-support system not only need to be completely protected against any cut-off of service because of unpaid bills, but to be ensured that the provider will guarantee uninterrupted power even in emergency circumstances.

Consumers with special needs for access to information. Individuals with problems with their sight, hearing or motor system represent a separate group of vulnerable consumers because they can't read meters and bills. Their protection requires such support as installing meters in non-standard places or providing a hot line for support

Progress among EC countries in identifying vulnerable consumers

Six of the nine countries that are members of the Energy Community, including Moldova, which joined the Community at the same time as Ukraine, have already established vulnerable groups in law. In most cases, this definition has been inserted in legislation that concerns the energy sector and only one country has inserted it into general legislation on social security. Ukraine, Albania and Macedonia so far have not established an official definition.

Drafting and approving a social action plan

The link between the SAP and other EC regulations

The social action plan is a document that contains a list of measures directed at carrying out the commitments contained in the Memorandum of Understanding in social matters. The EC Secretariat con-

sequently requires member countries to use the template of a Standard Social Action Plan (see Annex 2) whose sections match the main articles of the MoU. At the same time, the social action plans are supposed to be agreed with Energy Community's regional strategy through 2021, which was adopted in October 2012.

Basic provisions of the social action plan

The Governments of EC member countries are supposed to ensure that certain goals are clearly stated in their Social Action Plan (SAP):

- Raising the level of social security for all categories of consumers, but especially vulnerable ones;
- Guaranteeing the necessary conditions and job security for workers, especially in the energy sector;
- Improving the effectiveness of mechanisms for informing and consulting with social partners.

Still, the Community has made the SAP sufficiently flexible as a mechanism, leaving it up to each country to decide which concrete measures it will take. The template proposed by the Community Secretariat simply outlines the basic areas for measure to optimize the services of government agencies, engaging social partners, monitoring changes, and so on.

Progress among EC members in drafting and approving their SAPs

Most of the Balkan countries that are members of the EC have already approved their SAP in legislation, with the exception of Albania, Croatia and Kosovo, whose plans were ready but not yet approved as of September 2012. This was preceded by a long process developing the plans, consulting with interest groups within the social working groups, and the evaluation of the drafts by the EC Secretariat. This process also required that existing legislation be amended, such as laws that regulate the activities of trade unions and the Labor Code.

The new EC members, Ukraine and Moldova, have not yet drafted a social action plan or submitted it to the Secretariat for review. During the last Social Forum, it was once again announced that the Community expected Ukraine to do so by the end of 2012. Unfortunately, there is no information available regarding the work of the working group or the status of the draft SAP.

Obstacles to developing and approving a SAP

Officials from EC countries that have already approved their SAP note that there are a number of obstacles to the process that are evident in Ukraine:

- lack of horizontal coordination among the line ministries. The SAP is intended to resolve a series of complex issues of social and energy policy that require cooperation among these agencies;
- the absence of a clearly designated body that is responsible for drafting the SAP. The leading role should belong to the national coordinators meeting the requirements of the Treaty on the Energy Community, but the actual development of the SAP can be the function of other entities;
- the need to harmonize SAP provisions with the current system of social assistance and avoid duplication;
- an inability to establish a social dialog and working mechanisms for consulting with interested parties (see next section).

Consultations with social working groups

The Energy Community recommends engaging key interested parties in the process of formulating social policy, such as consumer associations, trade unions, human rights organizations, suppliers and producers. Together, they form what is known as a social working group, a specific type of cooperation that includes monitoring the social impact of implementing the provisions of the Treaty and other norms of European law and to influence this process. Such interest groups are not antagonists but social partners who have organized a type of social dialog. The members of this group have the opportunity to directly represent their positions and the results of their work to the EC Secretariat during its annual social forums.

Recommendations

To successfully reform its energy markets, Ukraine need so ensure that its social and rate policies are in line with the country's commitments to the European Union:

1. Identify groups of socially vulnerable consumers to make social assistance more targeted.
2. Develop a draft Social Action Plan to protect vulnerable consumer groups in line with the requirements and templates of the Energy Community and submit it to the EC Secretariat.
3. Organize consultations with interested parties within social working groups.
4. Approve a schedule for increasing residential rates for gas, electricity and heat.

Approaches to protection among EC countries

The flexibility built into the EC directives offers Ukraine an opportunity to take advantage of the enormous arsenal of plans and mechanisms that provide social assistance to vulnerable consumers. The fundamental principle underlying the Treaty on the Energy Community is that of incentives to take measures that foster the protection of consumer rights using instruments that are oriented towards developing the market, not interfering in it. Among such measures are non-rate means of support based on subsidies and targeted benefits, along with a variety of non-monetary means of protection.

Table 5 outlines the methods of ensuring assistance to vulnerable consumers most frequently used in EC member countries.

Ukraine's social security system is quite complex and offers a variety of monetary benefits intended to protect ordinary individuals through rates, subsidies and compensation. Still, this system seems to be too broad-based and its main flaw is insufficiently targeted assis-

tance. This means that the ideal combination of regulatory and social measures that form the basis of the Social Action Plan will depend on an evaluation of the real level of vulnerability among consumers in Ukraine.

Underlying this assessment, existing monetary measures need to be complemented by non-monetary ones (See Table 5). The formulation of the SAP should also be the outcome of well-argued consultations with interested parties and an assessment of the capacity of the Ukrainian Government to ensure that the new social security system will actually work.

Table 5. Approaches to assisting vulnerable consumers

Monetary measures	
Rate regulation	Rate-based support measures involve selling energy to certain categories of the population at a reduced rate, established by the national regulator. Most countries are gradually rejecting this instrument in favor of other measures that are not so hard on the State Budget or energy providers. Artificially lowering rates is incompatible with liberalizing energy markets, as it complicates the entry of new providers on the market and subjects them to unfair competition.
Subsidies	Subsidy systems are a way to coordinate energy policy with the social security system that make it possible to avoid distorting prices for energy and to maintain competition on the market. Subsidies and compensation to vulnerable consumers can be sufficiently effective, provided that the right to receive them is defined by very clear criteria. Still, subsidies often err in terms of targetedness by making the range of the system too broad and consumption norms that are not properly calculated.
Non-monetary measures	
Codes of behavior at companies	Rules of behavior regulate the relationship between providers of services and consumers and contain a detailed description of obligations and protection for all sides. The main principle is access to clearly formulated information about rates, the mechanism for delivering and challenging bills, as well as the quality of delivery. Consumers can require a supplier to avoid advertising that does not reflect reality or is intended to deceive, or to provide individual assistance to those who need it, such as consumers with poor vision, elderly people and other consumers with special needs.
Protection from being cut off and seasonal support	Measures that prohibit cutting of certain groups of the population from the power grid have become the de facto standard in consumer protection policy in the EC. These measures may be seasonal in nature to protect the health of a wider circle of individuals when temperatures get extreme. In this case, they are often combined with seasonal subsidies. However, protection from being cut off has to be available year-round for particularly vulnerable categories of consumers, such as those on life-support systems. In this case, the suppliers are given the additional burden of ensuring uninterrupted energy supplies in emergency situations.

Live database of vulnerable consumers	Developing a centralized database with information about vulnerable consumers would considerably ease the work of government office that are involved in protecting them. Such databases should be built on criteria established for identifying the typical vulnerabilities of separate groups of the population. This will make it possible for those groups eligible for assistance to be maximally covered by various programs without automatically being offered support by all of them, since they are unlikely to be considered vulnerable on all aspects.
Tracking systems	Installing metering devices allows consumers to have additional control over their own energy consumption and encourage them to regulate that consumption. The installation and use of metering devices can be financed through targeted programs in the State Budget or community enterprises, or simply paid for by the individual consumer.
Public awareness campaigns	Public awareness campaigns involve disseminating explanatory information among the general public regarding consumer rights, the rules of economic consumption, rate proposals for energy resources, how to challenge a bill, and so on. Such campaigns can be initiated by both state bodies that want to see overall energy efficiency go up and by utility companies who want to be seen as socially responsible market participants.

Source: ICPS

Annex 1

Identifying vulnerable consumers

Country	Criteria
Albania	No criteria to identify vulnerable consumers.
Bosnia & Herzegovina	Pensioners with the lowest level of pension and individuals who are receiving financial assistance from the state.
Croatia	The Act of Social Welfare provides certain recipients of social support the right to have a portion of their residential services, such as electricity, gas, firewood, and so on, covered. The criteria that allow people to apply for this coverage include a level of income below the minimum set in the Act and the lack of sufficient living space.
Kosovo	Consumers whose income level, state of health or physical handicaps provide grounds to receive assistance in line with the rules of the Regulatory Agency for Energy and the Ministry of Labor and Social Welfare.
Macedonia	No criteria to identify vulnerable consumers.
Moldova	Pensioners, invalids and single mothers with children under the age of 16 who are studying in secondary school, who live in a single-room apartment and have an average monthly income that is below the established limit.
Montenegro	Members of households that are connected to power grids and gas supply systems are considered vulnerable if the households consist of individuals: 1) who receive social welfare and whose status has been established by an authorized body; 2) who suffer from physical handicaps, special needs and a poor state of health and thus could find themselves in danger should electricity be cut off.
Serbia	The status of vulnerable consumers is granted to members of households: 1) who receive social welfare based on the decision of an authorized agency, 2) whose life or health could be under threat because of restricted power or natural gas deliveries because they are very ill and incapable of working.
Slovenia	System operators are forbidden to supply electricity at a level lower than the limit that is acceptable for the health and lives of consumers, taking a number of factors into account, including the time of year, the location, and so on.
Ukraine	No criteria to identify vulnerable consumers.

Source: Adapted by ICPS based on Energy Community data. at <http://www.energy-community.org/pls/portal/docs/1296177.PDP>

Annex 2

Social measures in the President's Economic Reform Program for 2010–2014 and subsequent annual Action Plans

Rate policy reform	<p>Phasing in transition to a single price scale for natural gas for all categories of consumers. Legislation to set a timetable for bringing prices in line with a single scale was scheduled to be adopted in 2012.</p> <p>Approving a schedule for bringing heating rates to an economically viable level for 2012–2015. Introducing a differentiated scale of rates for centralized water supplies and sewage based on volume consumed and including an investment component.</p>
Social assistance policy reform	<p>Taking steps to increase targeted nature by identifying real needs for assistance and services among socially vulnerable individuals and expanding the necessary authorities among social services inspectors.</p> <p>Introducing new approaches to evaluating the personal incomes of individuals who are applying for social assistance.</p> <p>Dropping the ban on utility companies' cutting off deadbeat customers. This step could improve payment discipline and make the social assistance system more targeted, as only really vulnerable consumers will be protected against being cut off.</p>
Protection for vulnerable consumer groups	<p>Setting up a consolidated database of those individuals who receive social assistance and integrating it with databases of other socially vulnerable groups, including invalids.</p> <p>Installing gas meters for apartment dwellers and private houses where gas is used to heat water and cook. In 2012, plans were to cover 20% of the general population for tracking purposes.</p> <p>Developing a State Targeted Social Assistance Program for Families for the period to 2016, to increase social security for large and impoverished families</p>

Source: ICPS

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About ICPS

Established in 1994, the **International Center for Policy Studies (ICPS)** is a top independent think-tank in Ukraine. For nearly two decades, ICPS has been actively involved in implementing democratic principles of governance in Ukraine.

ICPS has evolved from studying the approaches and methods of leading think-tanks and governments in the West to applying the principles and tools of public policy in Ukraine, before then going on to train others. Constantly importing the key elements that make successful reforms, ICPS ultimately helped change the understanding of why reforms fail and how to make them work in Ukraine.

We are now at the point where we are consolidating our knowledge and skills in each component of policy-making and implementation into an effective reform cycle. While confined by the scope and time-frames of individual projects, we were unable to implement the entire cycle of a particular reform to demonstrate its advantages over the outdated approach still widespread in Ukraine. The prospect of renewed financial support will enable us to carry this important work out, to make a significant contribution to overcoming Ukraine's long-standing problems, to successfully move the country towards integration with the European Union, and to improve transformation processes in the entire region.

The ICPS mission is to promote reform and social change in Ukraine and advocate for European principles of governance through high-quality analytical products. ICPS aims to make a sustainable impact by building effective partnerships, applying international best practice, and providing innovative solutions.

Services available from ICPS

Thanks to its extensive experience in economic and other spheres, ICPS is able to assist its clients, be they private business, government agencies or international organizations, to make better strategic decisions based on certain key principles: having all stakeholders and interest groups involved in the process; presenting and analyzing all opinions and positions; and providing independent conclusions and recommendations. We emphasize the continuing expansion of our knowledge base and capacities and offer consultative support for the reform process.

Our partners and clients

We see our partners and clients as organizations and individuals whose interest in reforms ranges from understanding and conceptualization to implementation and monitoring. ICPS is accountable to them for the quality of our products. These organizations represent all sectors, including:

- Government at all levels;
- Business and civil society;
- Political parties, academia and the expert community;
- National and international donors and development partners.

We maintain our already extensive base of partners and clients and attract new ones through high quality products that serve their needs, while also constantly improving our communication and forms of cooperation.

As of March 2013, Volodymyr Panchenko is the director of ICPS.

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- *Transformation*, an economic bulletin about countries with transitional economies;
- *Regional Trends*, an analysis of the economies of Ukraine's oblasts and their prospects;
- *Consumer Confidence*, a monthly analysis of the consumer mood in Ukraine, jointly with GfK Ukraine;
- *Inside Ukraine*, a monthly review of current political events in Ukraine providing a deeper analysis of key trends in domestic and foreign policy in Ukraine
- *Policy Studies*, an irregular series of studies of key issues in state policy, around 10 issues a year
- *European Focus*, a publication that shapes discourse on key issues in Ukraine's policies regarding European integration and EU policy towards Ukraine
- *Economic Insights*, an analysis of economic trends intended to help with strategic decision-making
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