



# Low Carbon Ukraine

Policy advice on low-carbon policies for Ukraine



Supported by



Federal Ministry  
for the Environment, Nature Conservation,  
Nuclear Safety and Consumer Protection

Based on a decision of the German Bundestag

## Policy reforms supporting Ukraine's green reconstruction

Recommendations for the heat sector

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Berlin/Kyiv, September 2022

Implemented by

 Berlin  
Economics

## Structure

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1. Motivation
2. Rebuild quick vs. rebuild green?
3. Overview – Ukraine's district heat system
4. Policies for a green reconstruction of the district heat system
5. Conclusion

# 1. Motivation

## Economic reasons for a green reconstruction of the heat sector:

Efficiency gains & cost decrease of green technologies

Increase in fossil energy prices & price volatility

Energy supply security

EU accession perspective

**BUT:** Regulatory obstacles & disincentives for mobilising investments in low- or zero-carbon assets for the heat sector

➤ Policy reforms needed to overcome obstacles and mobilise investments

## 2. Rebuild quick vs. rebuild green?

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### Emergency reconstruction:

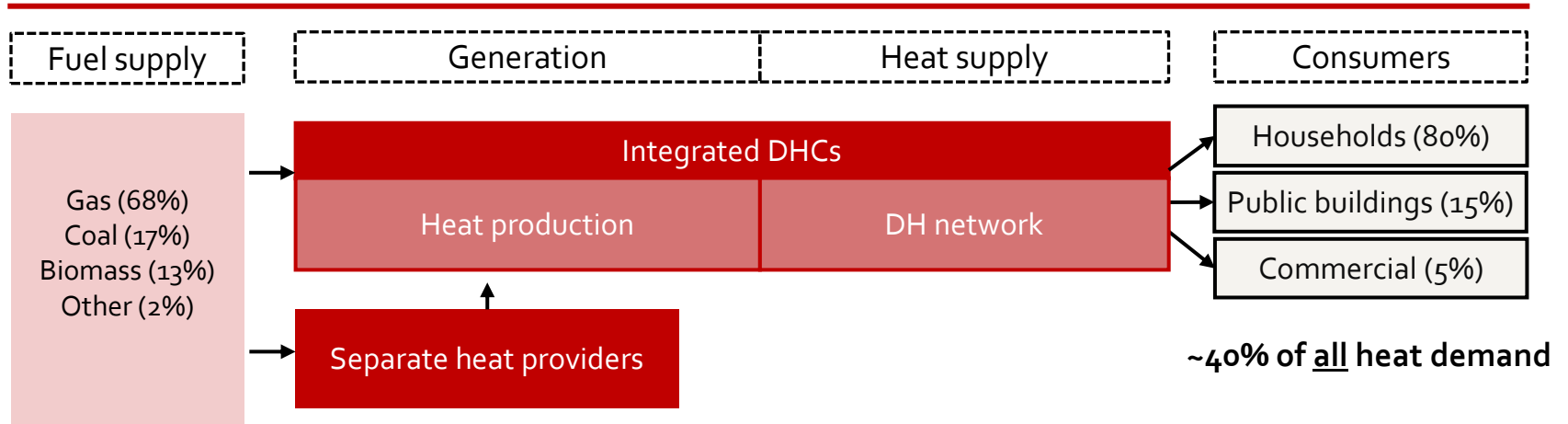
- Ensuring people have a roof over their head and heat for the winter
- **Low investment cost more important than low operational cost**

### Post-war reconstruction:

- “Build back better”
- Emphasis on energy efficiency
- **Low operational cost can lead to lower levelised cost**

- **Emergency measures should prioritise temporary solutions that do not prevent investment into more modern and green assets**

### 3. Overview – Ukraine’s district heat system



#### Opportunities for energy efficiency & decarbonisation

- Biomass CHPs
- Utility-scale heat pumps
- Centralised electric boilers
- Centralised heat storage



#### Obstacles to mobilising investments

- Subsidised / regulated gas prices for DHCs
- Low payment discipline
- Politicised tariff-setting
- Split regulation system (NEURC / MinRegion)

## 4. Policies for a green reconstruction of the heat sector

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### Phasing out gas subsidies

- Phase-out regulated prices for gas provision from Naftogaz to DHCs
- **In tandem:** Gas release program
  - Oblige Naftogaz to sell produced gas on transparent trading platform

### Tackling payment discipline

- Improve bills collection framework
  - Allow for adequate fines and penalties for non-payment (only after end of war)

### Tariff reform – incentive-based regulation

- Improve transparency of tariff-setting
- Take into account the pass-through of costs to consumers
- Include rewards (incentives) and penalties (sanctions) for efficiency and quality of service targets

### Harmonising district heating regulations

- Move from two- to a single-tariff system (unified methodology)
  - Consolidate NEURC and government regulations

## 4.1 Complementary policies

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### Carbon pricing

- An adequate carbon price covering all energy-consuming sectors can efficiently guide investments in low-carbon assets (incl. heat sector)
- Should mirror EU-ETS & prospective EU-ETS-II and gradually converge to EU price levels
  - Avoids economic shock & stranded assets upon future EU accession
  - Diverts EU-CBAM revenues to Ukraine

### Strengthened social transfers

- Targeted or broad-based transfers to compensate households for increased heat tariffs
  - Consumption-independent (incentive for energy efficiency & conservation)
  - Improved HUS transfers (targeted) or per-capita transfers (broad)

## 4.1 Complementary policies (continued)

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### Improved governance of state-owned enterprises

- Remove all irregular obligations of Naftogaz and DHCs, such as...
  - provision of energy services at subsidised prices
  - financial cross-subsidisation inside energy markets
  - Only profits should be disbursed to the national/municipal budgets, being fully fungible (not subject to earmarks for specific uses or supplying “special funds”)
- Ensure that Naftogaz’ and DHCs’ management has the ability to independently manage and run the companies, subject to oversight by the public owner as per international best practice



## 5. Conclusion

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- There are opportunities for the heat sector to cost-effectively improve energy efficiency & boost decarbonisation during reconstruction
- But regulatory obstacles & disincentives for mobilising investments in low- or zero-carbon assets for the heat sector exist

### Key policy reforms:

- Phasing out gas subsidies
- Tackling payment discipline
- Tariff reform  
(incentive-based regulation)
- Harmonising district heating regulations
- Carbon pricing
- Strengthened social transfers
- Improved governance of state-owned enterprises

**Ukraine's green reconstruction is not an expensive luxury but an economic necessity to ensure future competitiveness in a progressively decarbonising global economy**

# Additional reading (will also be published in Ukrainian soon)



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Policy Proposal Series [PPR/03/2022]

## Policy reforms supporting Ukraine's green reconstruction

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[https://www.lowcarbonukraine.com/wp-content/uploads/PPR\\_03\\_2022\\_Policy\\_reforms\\_supporting\\_UKR\\_green\\_reconstruction.pdf](https://www.lowcarbonukraine.com/wp-content/uploads/PPR_03_2022_Policy_reforms_supporting_UKR_green_reconstruction.pdf)



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