

The Need for Market-Based Tariffs for Heat and Electricity in Ukraine

Position Paper

This position is addressed to the European Commission, energy sector stakeholders, government representatives, local authorities, and energy investors. It emphasizes the need to implement market-based mechanisms for determining heat and electricity tariffs in Ukraine to ensure tariff transparency and economic justification. The position highlights the importance of adjusting price signals for consumers to promote the modernization of energy infrastructure and encourage investments in renewable energy sources (RES) and energy efficiency.

Despite steps towards the liberalization of the energy market, such as the corporatization of national gas companies and the delegation of tariff-setting authority to local governments, market mechanisms in Ukraine have not been fully implemented. The cost of heat and electricity for the population remains opaque and often does not cover the real economic costs of production and supply. This limits the potential for modernizing district heating (DH) plants, distorts price signals for consumers, and hinders investments in energy efficiency and renewable energy sources (RES).

✓ Current Challenges

Administrative Regulation and GDP Losses:

State intervention in tariff-setting through political decisions blocks the functioning of the energy market, especially for producers and traders, leading to losses of 7-15% of GDP. Despite the increase of the electricity price limits and the introduction of gas price indicators, tariffs still do not reflect the real cost of energy.

Investment Deficit and Technological Degradation of DH Systems:

Due to insufficient market incentives in tariff policy, companies cannot cover the costs of modernization. According to Carbon Tracker (2018), thermal generation in Ukraine remains one of the least efficient in the world. More than 60% of thermal boilers and heat networks have exceeded their operational lifespan and need replacement or insulation, leading to increased energy losses.

Declining Number of District Heating Consumers:

The constant reduction in the number of DH users due to the lack of investment in its modernization and politicized tariffs exacerbates the issue. In some cities, such as Uzhhorod, DH has been abandoned entirely, while in others, the number of consumers has halved.

Economically Unsound Transition to Individual Heating:

The transition to individual heating, as demonstrated by Armenia and Georgia, is economically unjustified and environmentally harmful. DH systems were designed for mass service and remain an essential resource for providing basic heat supply during the winter months, particularly in times of war.

Stagnation of RES and Energy Efficiency Development:

The absence of market-based tariffs reduces investment opportunities in RES and energy-efficient technologies, necessary for Ukraine's compliance with the EU's Directive 27 on the transition to renewable energy sources. This also hampers the development of the production of high-quality energy-efficient materials and equipment required for the European market.

District heating remains an essential element of infrastructure for supplying heat to households and businesses. However, without market-based tariff mechanisms and investments in the modernization of DH systems, the sector will continue to degrade, reducing its consumer base and leading to further financial losses and dependence on fossil fuels.

★ Recommendations

- **Implementation of Market-Based Tariffs:** Market-based tariffs for heat and electricity should be introduced to reflect real costs, ensuring transparency and creating opportunities for investment in modernization and energy efficiency. This will attract private capital and create favorable conditions for economically justified RES projects.
- **Support for DH Infrastructure Modernization:** Government support for DH modernization (through subsidies, tax incentives, or preferential loans) will reduce energy losses and improve the long-term sustainability of utilities, contributing to the economic stability of communities.
- **Stimulating the RES Market and Energy-Efficient Material Production:** Creating favorable conditions for RES investors will help Ukraine reduce its dependence on fossil fuels. Building production capacities for energy-efficient equipment and materials will meet demand both domestically and abroad.
- **Improvement of Regulation and Reduction of Political Influence:** Minimizing state interference in the energy market will ensure transparent and stable rules for all participants. This will allow heat producers and suppliers to use market instruments to maintain competitiveness.

! Conclusion

Market-based tariff mechanisms are key to restoring and modernizing Ukraine's energy infrastructure. Transparent and fair tariff-setting will foster investment in district heating, support RES development and energy efficiency, and enable Ukraine to meet its international obligations.

Contact Information:

Natalia Lytvyn - Project Coordinator at NGO Ecoclub and Energy Transition Coalition

✉ n.lytvyn@ecoclubrivne.org

Mykhailo Lukyanyk - District Heating Coordinator

✉ lukyanyk@ecoclubrivne.org

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Contacts of NGO Ecoclub
+38 (067) 363-62-26
office@ecoclubrivne.org

