



Boosting gas trading in Ukraine

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Summary

- **A reliable and transparent gas price signal is essential** for a functioning gas market
- **Ukraine is on a good way**
- **Gas exchange cannot be ordered**, but develops if essential conditions are met
- **In Ukraine, four barriers need to be overcome:**
 - Lack of liquidity
 - Administrative barriers
 - Absence of risk mitigation tools
 - Lack of a common platform
- **Ministry should take the lead** to resolve those issues

Background

- Based on interviews with Ukrainian and international gas traders
- Informed by the EU experience of the past decade
- Taking into account the Ukrainian realities (infrastructure, sector structure, legislation)

Structure

1. What is already in place?
2. What is missing?
3. Recommendations
4. Conclusion

What is already in place?

- Ukraine is on a good way
- Good structural preconditions:
 - Significant demand
 - Different supply options and storage
 - Convergence towards European market rules
- Trading already happens
 - Competing suppliers (now also a few foreign ones)
 - Industrial customers
 - Virtual point

What is missing?

1. What is already in place?
2. What is missing?
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What is missing?

1. Liquidity
2. Easy market access
3. Risk mitigation-tools
4. An accepted common platform

-> not one single large fix, but a number of complementary measures

Recommendations

1. What is already in place?
2. What is missing?
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Liquidity

Problem:

- High concentration of imports and production (Naftogaz has about 75% of both)
- Almost no foreign players

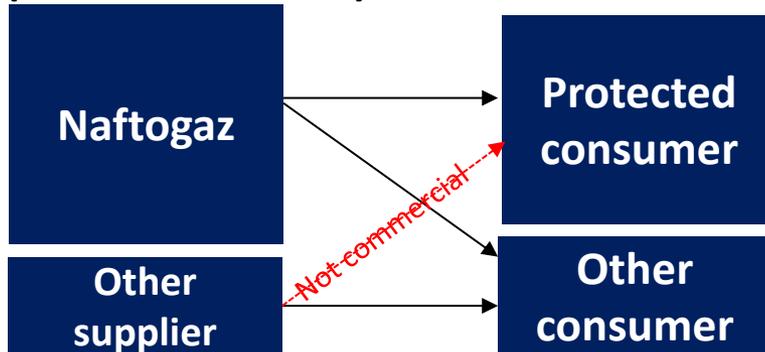
Possible Solutions:

- A gas release program (for UGV)
- Oblige Naftogaz to become a market maker
- A balancing market – to create competitive demand
- New production licenses
- Dis-integration and privatisation of state-owned producers
- Gas release obligation (e.g. 50%) for imports from Russia

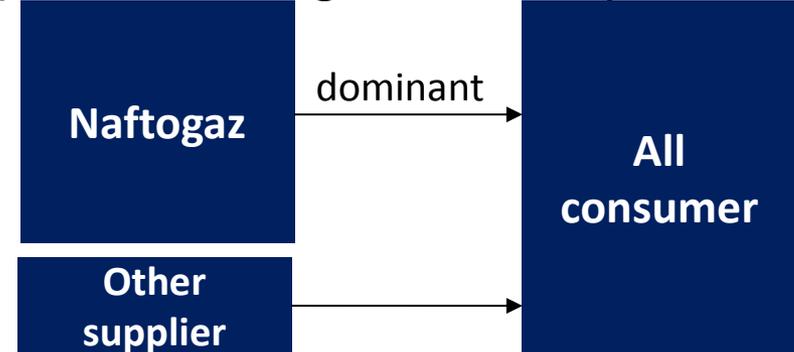
Political timing of gas release program

- If large volumes still go to protected customers, Naftogaz might have to buy-back gas more expensively it had to sell under the gas release program
- But competitive retail market cannot properly work, when Naftogaz is the dominant seller on wholesale market

Gas release makes no sense
(current situation)



Gas release important
(with functioning retail market)



- **Gas release program only makes sense, when there is a working retail market**

Easy market access

- **VAT for gas imports in contrast to EU conventions**

-> needs to be analysed further

- **Insufficient IT system at TSO**

-> implement state-of-the-art processes and IT systems in close cooperation with all market actors

- **High financial guarantee requirements**

-> NERC should run a public consultation on market barriers

- **Limited import capacity**

-> NERC should monitor capacity hoarding

-> implement “use-it-or-lose-it”

Easy market access

- **High entry and exit tariffs**

-> transmission tariff structure needs to be reformed

- **Incomplete unbundling**

-> enforce unbundling plan (make UTG operationally independent from government)

-> pre-privatise UTG

Risk mitigation tools

- **Counterparty risk**

- > Explore setting up a clearing house together with an IFI

- **Regulatory risk**

- > streamline energy policy making

- > strengthen capacity of the regulator

- **Currency risk**

- > abolish currency controls

- > study optimal gas trading currency [\$/€/UAH?]

- **Subsidy reimbursement risk**

- > monetisation of subsidies

A common platform

Problem

- Liquidity fragmentation between different platforms

Solution

- Moderate a discussion between all (also potential) market actors to support a single platform by channelling liquidity (e.g., through gas release program and balancing market)

Conclusion

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Conclusion

Finalisation	Ensuring liquidity	Removing remaining administrative barriers	De-risking gas trading	Common platform
April 2017	Gas release program, and/or Assign Naftogaz the obligation to act as market maker	Decide on VAT treatment NERC should monitor capacity hoarding “Use-it-or-lose-it” shall be properly implement.	Abolish currency controls Study optimal gas-trading currency	Moderate a discussion between market participants and channel liquidity to the chosen platform
Mid-2017	Make UGV an independent actor	NERC should run a public consultation on market barriers Enforce the unbundling plan	Complete monetization of housing and utilities subsidies Explore setting up a clearing house together with an IFI	
End 2017	Balancing market Reform production licenses	Implement state-of-the-art processes and IT at the TSO. NERC should reform entry and exit tariffs		
In 2018 or 2019	Deal with gas imports from Russia Privatisation of production and storage	Pre-privatise Ukrtransgaz	Streamline energy policy making	

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