

Highlights from the OECD competition market study of Ukraine's electricity sector

Competitive electricity markets play a fundamental role in ensuring a safe, reliable, and affordable supply of electricity, allowing consumers to choose the best pricing and supply option for their home or business. The laws and regulations determining the design and functioning of the electricity sector can enhance or hinder competition, and are thus key for any modern economy.

Ukraine's electricity sector has undergone considerable structural reforms in the past decades. In 2019, Ukraine introduced a new regulatory framework to liberalise its retail electricity market and establish a wholesale market with a competitive market structure. Nevertheless, outstanding obstacles to competition remain. Further reforms are needed to reduce regulatory distortions and attain a fully efficient competitive sector, of key importance as part of Ukraine's future reconstruction efforts

About the project and its outcome

The OECD conducted a market study, with the financial support of the EU Delegation to Ukraine and in close collaboration with Ukrainian stakeholders, to analyse Ukraine's electricity sector from a competition perspective. The project started with a kick-off event in September 2021. It involved several consultations with relevant stakeholders, such as the Antimonopoly Committee of Ukraine (AMCU), National Energy and Utilities Regulatory Commission (NEURC), and market actors, and an in-depth request for information sent to relevant stakeholders in early 2022.

The OECD market study provides a detailed description and assessment of the regulatory framework within which Ukraine's electricity markets operate and an analysis of potential competition issues, arising from structural factors, regulatory distortions or market behaviour, in order to identify concrete reforms based on international experience.

The study submits **22 recommendations** that address issues relating to the wholesale and retail markets, renewable energy and cross-border integration, creating a roadmap to remove obstacles to effective competition and fully reap the benefits of a liberalised electricity sector. Most of the recommendations are designed for the post-war and reconstruction period, when Ukraine will have successfully restored the normal functioning of its economy and can renew its steady efforts towards a competitive electricity sector, supported by this OECD study.

Russia's unprovoked large-scale invasion in February 2022 has affected all aspects of life in Ukraine. Targeted attacks on energy infrastructure have resulted in extensive damage, but Ukraine has managed to maintain a functioning electricity system. It has also succeeded in achieving closer integration with the EU electricity system. The resilience of Ukraine's electricity sector demonstrates its potential. When the war ends, it will face challenges linked to becoming more efficient and more competitive. The OECD study aims to facilitate the sector's success in undergoing that transition, towards better functioning electricity markets in Ukraine in the future. The full results of the study and the recommendations are presented in an OECD report available at <https://oe.cd/4cO>.

KEY FINDINGS

The overall design of **Ukraine's electricity market closely resembles power markets in the European Union**, which make a clear distinction between competitive and non-competitive activities. Electricity transmission and distribution fall into the latter category, which is justifiable by their natural monopoly characteristics and in line with international practice.

The laws governing electricity markets in Ukraine recognise generation, wholesale and retail supply of electricity as competitive activities. However, **specific legislation and regulatory interventions significantly reduce the scope for competition** in all parts of the electricity market, for instance by imposing market segmentation that reduces liquidity and facilitates market concentration.

Moreover, frequent and **short-lived regulatory changes create uncertainties** that have a destabilising effect on the functioning of Ukraine's electricity market and undermine confidence among both investors and potential investors. These include the frequent use of temporary measures, some of which are applied or extended several times.

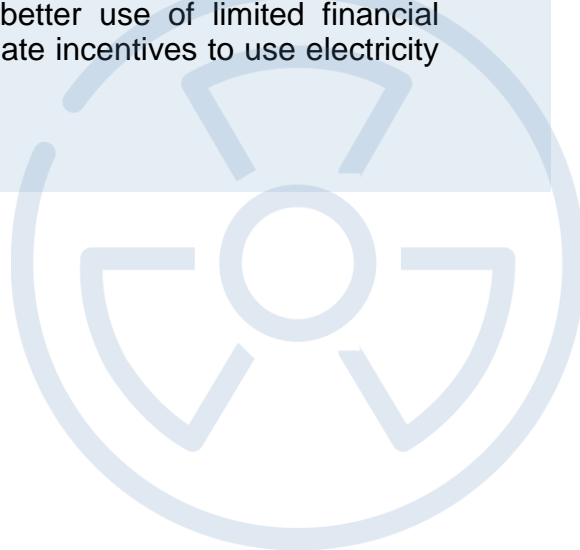
Regulatory intervention appears to be a major concern especially with regard to prices. In the retail market, regulated prices for all households prevent the emergence of competition for a significant section of consumers. In particular, Ukraine regulates electricity prices for households at levels **well below market prices**. This is not only an expensive policy but also detrimental to competition.

In parts of the **wholesale market, prices are constrained by limits that restrict market-based price formation and distort price signals**. Prices that reflect supply and demand are crucial for the competitive generation of electricity and are a major factor influencing investment decisions relating to new generation capacity. Price caps also represent a hurdle to deeper integration with the EU electricity market.

Integration with EU energy markets has been a political priority for Ukraine. Synchronisation with the Continental European Power System represents a major step in this direction. Increasing import and export capacity benefits security of supply and has the potential to greatly enhance electricity market competition. To reap the full benefits of synchronisation, Ukraine needs to adopt the necessary EU market rules and work towards market coupling.

Key recommendations

- 1. Improve price formation in the wholesale market by removing price limits, revising technical price limits, and allowing negative market prices.** Unrestricted price formation is a precondition for effective competition. It should be restricted only if absolutely necessary and only for the shortest time possible. Moreover, after the war, undistorted price formation will help send the right signals to investors, crucial actors for the rebuilding phase.
- 2. Reduce segmentation in the wholesale market to increase liquidity, including by promoting direct marketing by renewable energy (RES) producers.** Market segmentation imposed by regulation distributes electricity volumes over several market segments. This reduces the volumes available in the commercial segments of the wholesale market and hinders the development of liquidity, potentially facilitating market concentration. Low liquidity and high concentration make a marketplace less reliable and trustworthy, and more susceptible to manipulation.
- 3. Improve market surveillance and transparency.** Systematic market surveillance is essential to detect possible cases of market manipulation. Implementation of a market surveillance system closely aligned to the EU's REMIT framework is the best means of achieving this. Market surveillance should be complemented by case-by-case investigations either by the AMCU or the NEURC, depending on the type of potential manipulation and on agreement between the authorities.
- 4. Promote competition in the retail electricity market by phasing out regulated prices for households, simplifying and improving ways to switch suppliers, improving transparency of supply contracts in the business segment.** A phase-out of regulated prices, combined with targeted support for vulnerable households, would enable competition in this market segment and represent a better use of limited financial resources. It would also provide appropriate incentives to use electricity in an economically efficient way.



- 5. Promote renewable energy generation and market participation by developing market-based incentives, implementing a certification mechanism for renewable electricity, and supporting new (non-residential) RES facilities solely through competitive auctions.** Support for RES is needed to reduce greenhouse gas emissions and energy dependence. Integration of RES producers into the normal functioning of the market would reduce market concentration and increase competition. Moreover, designing the right market mechanisms and incentives for different types of renewable energy will be crucial, evolving towards an electricity sector geared for a more sustainable future.
- 6. Enhance cross-border market integration, increasing interconnection capacity and working towards full market coupling.** Integration of Ukraine's wholesale electricity market with EU electricity markets presents a unique opportunity to improve competition over the long-term. Increased interconnection capacities, coupled with the opportunity to import and export electricity, allow new players to compete, reducing market concentration and introducing competitive dynamics. In addition, they offer substantial benefits in terms of system security. These outcomes will be pivotal during Ukraine's reconstruction phase.

Market Studies Guide for Competition Authorities

Competition market studies assess the effectiveness of competition in a given market and, if competition issues are identified, propose recommendations to address them. These recommendations vary in scope depending upon the competition issue, but could include proposals for regulatory reform or to improve the provision of information to consumers. They can also include recommending the opening of antitrust investigations or further specific assessment.

Using the Market Studies Guide for Competition Authorities, the OECD reviews sectors - such as electricity or banking - in specific countries to promote and protect competition in their economies, supporting better outcomes for consumers in terms of innovation and prices, and foster long-lasting growth.

Besides the Ukraine electricity study, Tunisia is also undergoing a similar review in their banking sector to be issued in 2023.

