

ICPS newsletter[®]

Energy policy urgent even during economic crisis

Is energy policy a priority when the price of oil is tumbling and the world economy is entering a recession? The energy sector is less vulnerable to business cycles because of the long-term horizon for investment and the low demand elasticity on the part of consumers. The European Union intends to continue implementing its energy strategy in terms of increasing the security and efficiency of energy supplies. The economic downturn in Ukraine means that decisions regarding problems with the natural gas market and electricity cannot be put off. These issues and the prospects for energy integration with Europe were raised at a 4 November 2008 conference in Budapest in which ICPS Senior Economist Ildar Gazizullin participated

Integrating energy infrastructure and policy increases resilience

The main aim of this conference was to look at the prospects for integrating energy networks and legislation in Europe, which would allow Europe's energy sector to respond with greater flexibility to external challenges. Presentations and discussions focused on four key issues:

1. How can one overcome the problem of diverging views and approaches to energy security in Brussels and Moscow?
2. How should EU energy policy be drawn up, given divergences in the interests of EU member states and power companies?
3. What kind of political and economic purpose is there to oil and gas pipeline projects in the Black Sea and Caspian regions?
4. What kinds of investments and legal mechanisms are needed to facilitate the linking up of power grids in the region?

Not all these issues have an unambiguous answer. But it looks like the European Commission could successfully tackle most of them.

EU energy policy extends to Ukraine

On 11 November, the European Commission proposed an EU Action Plan regarding energy security and solidarity that contains five main points: infrastructure needs and diversification of energy supplies; external energy relations; oil and gas reserves and mechanisms for responding to change; energy efficiency; optimizing the use of the EU's own energy resources.

Lower world prices for oil undoubtedly will reduce the pressure to conserve energy, to develop renewable energy sources, and to diversify energy imports. Still, the implementation of Europe's energy policy is already in motion and any adjustments are likely to be to timeframes, rather than to policy priorities.

The EU's energy priorities are of interest to Ukraine as well, and they could be dealt with jointly. Specifically, there is a possibility for cooperation in power sector under the Energy Community, whose purpose is to establish an integrated power market in Southeastern Europe. If Ukraine, Moldova and Turkey join the Community, this could spur energy reform in these countries and establish a huge energy market that functions according to common rules.

The crisis—a good time for energy reform in Ukraine?

Ukraine's brief history of reforms shows that positive changes tend to happen only when the economy is in a pinch. The canceling of barter set-ups in 1999 was the last notable positive change in this sector. The economic growth Ukraine experienced over 2000–2007 gave politicians little incentive to undertake further changes. Will a difficult 2009 lead to the continuation of energy reforms?

Ukraine's political crisis is the main obstacle to getting changes approved today. The start of the Presidential race in 2009 will only fire up more political hostilities. This will weaken the positions of both the Government and the National Energy Regulatory Commission in carrying out reforms because of the inevitable

negative reaction of voters to rising utility rates.

Change will take place, nevertheless, because the inaction of the Government in the face of an ever-worsening economic situation and growing external pressure is becoming impossible. In 2009, the country's GDP will contract for the first time in 8 years. The conditions in the Memorandum of Understanding with the IMF require a steep increase in prices for gas extracted in Ukraine and in rates for residential consumers. Changes are needed in many energy-related matters:

1. There must be a stop to the corrupt schemes in trading and exporting gas and electricity.
2. Any kind of political or commercial interference in the work of the NERC needs to be stopped.
3. Reforms to the wholesale electricity market need to continue.
4. The technological and legislative integration of Ukraine into European markets needs to continue.
5. Economic incentives to reduce pollution need to be more widespread in Ukraine.

In addition to external support, the Government needs support from within. Up until now, the role of the private sector has not been especially positive in transforming the country's fuel and energy sector. Today, however, business has an opportunity to convince itself that, in future, only reforms will ensure financial stability in the energy sector and in Ukraine's economy as a whole. ■

The conference entitled "EU Energy Policy and Infrastructural Development: The role of Visegrad countries" was organized by the Center for EU Enlargement Studies at the Central European University in Budapest, Hungary. Presenters included representatives of top EU, Ukrainian and Moldovan think-tanks and power companies. The reports can be seen at http://web.ceu.hu/cens/conf_nov_2008.

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Consumer mood hits 8-year low in Ukraine

The economic crisis has hit consumer confidence in Ukraine with a vengeance. In October 2008, this was reflected in a 26.6pp drop in the Consumer Confidence Index (CCI) to 69.3, which indicates an exceptionally pessimistic mood among the majority of Ukrainian consumers. The last time the CCI was this low was at the very beginning of such surveys in Ukraine, that is in Summer–Fall 2000, more than eight years ago. Moreover, this is the first time in the history of these reports that the survey recorded such an enormous drop in the consumer mood

Nearly all the components of the CCI showed unprecedented levels and trends in October. For instance, the Index of the Current Situation (ICS) plunged 25.9pp, to 72.6. Moreover, the only time this index was ever so low was in 2000–2001. This dramatic worsening in the ICS is largely the result of extremely negative assessments by Ukrainian consumers of their current financial standing. This index x1 fell 24.7pp to 65.5. Although Ukrainians have never been prone to especially optimistic assessments of their personal material standing, they have never given it such a poor assessment since September 2000.

The Index of Propensity to Consume x5, which is generally more volatile than other components in the CCI, continues to register at a high level. And although it has fallen 27.0pp to 79.6, indicating that the majority of Ukrainians are not prepared to make major household purchases at this time, it still indicates that a significant proportion of Ukraine's consumers continue to have relatively high buying power. Moreover, given the devaluation of the hryvnia and accelerating inflationary processes, for many consumers, major purchases are one way to preserve their savings by putting the money into durable goods.

Data from the expanded survey indicate that, in October 2008, the absolute majority of respondents traditionally connect a worsening in their personal material standing with growing inflation.

Among the reasons given for not wanting to make major purchases at this time, Ukrainian consumers most often blamed the lack of money and more restricted access to credit.

The Index of Economic Expectations (IEE) also plunged, 27.1pp to a record-low 67.2. In other words, the overall economic situation in Ukraine and its prospects have never been so poorly rated by the country's consumers. Short-term expectations were particularly pessimistic, which can be seen in the biggest plunge in this index x3 among all the components of the IIE: it nosedived 36.7pp to 54.1. Interestingly, most Ukrainian consumers expect changes in their personal material standing to be less negative than the economic situation as a whole. This is supported by the dynamic of the index of expected changes in personal material standing 2, which fell 26.0pp to 71.4.

Ukraine's consumers rated the country's longer-term economic prospects somewhat more positively, although still largely pessimistically: the index of expectations of economic growth over the net five years x4 fell 18.7pp, to 76.0. The reasons for the worsening economic situation given by most Ukrainians, according to the expanded survey, were growing inflation and unemployment, as well as ineffective economic policy, cutbacks in industrial output, and political instability.

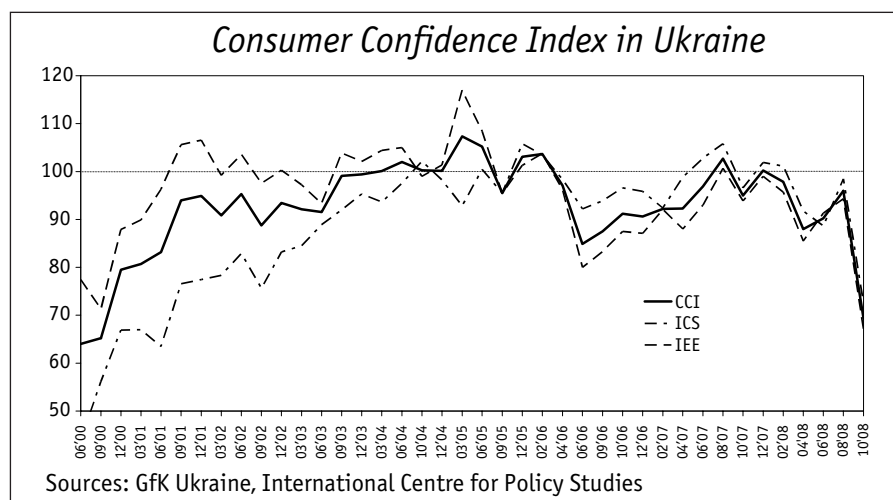
Against the background of an economic and financial crisis, inflationary expectations have barely changed: the IIE

slipped only 0.6pp in October, to 186.5. This can be explained by the fact that inflationary expectations have been very high among Ukrainian consumers for a long time already. Notably, for all eight years that this survey has been run, the IIE has fluctuated within a relatively narrow range, that is, 170–190. Expectations of changes in unemployment, on the other hand, grew considerably worse in October, with the IECU skyrocketing 34.8pp to 143.4. With cutbacks in many industries, recent massive layoffs in some sectors of the economy, and negative economic forecasts, this level of expectations is hard to call overly pessimistic, although they are considerably ahead of the real unemployment rate, which the State Employment Service claims has hardly moved in Ukraine.

Over September–October 2008, the consumer mood worsened and became pessimistic in all regions of the country. The worst were in the East, where there is a concentration of enterprises in sectors that were the first to feel the impact of the economic crisis. Thus, the CCI for the region took a nosedive, plunging 34.9pp to 59.2. The most optimistic were residents of the capital, whose CCI only wend down 5.2pp, to 85.8. Interestingly, the readiness of Kyivites to make major purchases has remained neutral. Moreover, in September–October this index actually inched up 1.6pp to 100.0. One explanation for this might be retailer efforts to maintain sales of durable goods at a high level through various special offers and discounts. Given the relatively high buying power of Kyiv consumers and the cheaper hryvnia, this kind of actions are likely to result in a temporary spike in sales of certain categories of goods.

The worsening consumer mood was seen across all types of settlements in October 2008. The lowest CCI, at 63.8, was registered among residents of major cities, while the highest, 75.7, was in mid-sized towns. Consumers proved equally pessimistic by age and income groups as well in September–October 2008. Naturally, the least pessimistic remain young and better-off consumers, whose CCIs were 78.9 and 75.1. The worst consumer mood was, as is traditional in Ukraine, demonstrated among older consumers, whose CCI was 60.1, and those with below-average incomes, whose CCI was 54.5. ■

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