

# Serbia: Power utility EPS financial risks restructuring, challenges for the state budget

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Power utility Elektroprivreda Srbije ( EPS) completed the first of restructuring under the monitoring of EBRD, WB and IMF. However financial challenges and issues are yet to be managed in 2016 when the state which is the owner of EPS expects financial consolidation and stock market IPO.

Due to almost 40.000 employees, the irrational and bad business operations and large uncollected receivables, EPS currently represents the most dangerous risk to the financial stability and future of Serbia

Should the EPS be unable to repay the one billion loan regularly, the state will have to assume the repayment of this debt

Despite the state's intention to improve the business operations of state-owned companies and to provide stable and increasing budget revenues from their profit and dividends in the future, obviously, the state coffers will not be able to count on the payment of profit of the Electric Power Industry of Serbia in the following year either, just as there has not been any such payment this year. Although there are still no consolidated balances for 2014, the authorities estimate that the EPS concluded the previous year with a loss of around 30 billion RSD, and a two times lower deficit is expected for this year.

Major cuts in the largest state system are yet expected because, of all the reforms announced, only the dismissal of 43 directors has been revealed so far. The Plan of Financial Restructuring has been adopted, but the public does not know, and may not even get to know what exactly is in it. Who knows, it may be better this way, because its announcement would certainly "annoy" the citizens because of the planned electricity price increases. However, all joking aside, this document hides the answers to many other questions, too. What, in addition to the electricity price increase, is the state planning to do with the EPS? How many redundant employees are there and have layoffs been planned? Will the salaries, to which the Government frequently refers as being significantly higher than in other companies, be reduced in the EPS? How will the issue of accumulated claims be solved, as the EPS has been unable to collect them for years, even from the state-owned companies undergoing restructuring? Is it possible to reduce the unnecessary transmission grid losses and how?

The Fiscal council warns that, for all this, and primarily because of the size of the company and the bad business results, the EPS currently represents the most dangerous risk to the state's public finance. The financial condition has been aggravating for years and, although the money from the budget has not been spent on the EPS so far, in the future, there is the risk of the state assuming the repayment of its debt for which it has guaranteed. "The

increasing need for liquidity loans is more than alarming”, it is stated in the analysis of the Fiscal Council. The overall debt of the EPS amounts to around one billion euros, and the Fiscal Council fears that, should the due installments of the EPS fall into arrears, in addition to the guaranteed debt, the state could also burden the tax payers with a debt for which it did not guarantee originally. They mention the low, non-economic price of electricity, the excessive number of employees, the poor collection of receivables, distribution grid losses and organizational weaknesses as the issues jeopardizing the financial condition of the EPS.

Firstly, the agreed electricity price increase by 12 percent as of 1<sup>st</sup> August is insufficient for the Fiscal Council, because only 4.5 percent of the increase goes to the account of the EPS, and the rest will end up in the state coffers in the form of excise duty. “Such structure of the price increase does not even nearly bring a sufficient increase in the revenue of the EPS and a new price increase will soon be necessary. A minor electricity price increase, if it is also delayed, will lead to further accumulation of debts of the EPS”, it is stated in the analysis.

Ljubodrag Savić, a professor of the Faculty of Economy, does not deny that the electricity price is among the lowest in Europe, but he also stresses that the salaries in Serbia are also among the lowest. “From the citizen’s point of view, any increase is an attack on the living standard, but it is clear that there is no profitable EPS with such low price. It is a blessing in disguise that the industry has failed so much that, even despite the fact that there have not been any investments in the EPS for almost 40 years, it can still satisfy domestic needs for electricity. But if we are planning growth, it is impossible without industry, as well as without investing in new energy facilities and in the maintenance of the existing”, Savić stated.

Although he opposes to pursuing social policy through the EPS, because those who do have the money to pay the economic price of electricity are also subsidized thereby, Savić stresses that, before any price increase, it is necessary to change the organizational structure of the company, to rationalize unnecessary costs and to collect debts. “It is not justified to increase the electricity price for regular payers and poor citizens, before collecting from the protected state-owned companies what they owe you”, says he. Savić also opposes to the introduction of excise duties on electricity, particularly because this instrument, agreed with the IMF, is not applied in a large number of EU countries, either. “A price increase is reasonable, but if this money goes to the EPS for the overhaul and for investing in new capacities. In this way, the budget will survive, but will all Serbian citizens also survive?”, Savić wonders.

The Fiscal Council believes that the business operations of the EPS are unsustainable with the existing around 38.000 employees (of this, 4.500 in Kosovo and Metohija), with the salaries significantly higher than the republic average and they estimate that there are from 5.000 to 10.000 redundant employees. Despite the decision of the Constitutional Court from 2010, that the system for calculating salaries and benefits of the employees in Kosovo and Metohija is unconstitutional, their salaries have been - increasing. It is even worse that there are indications that some of the companies previously demerged from the EPS are trying to come back under its wing, whereat, in these companies, the number of employees has increased in the previous years, instead of having declined. The Fiscal Council “strongly opposes to any increase in the number of employees in the EPS and in no case should the

merger of the previously demerged companies be allowed.” In the latest report, they also advise that the severance pay for the supernumerary should not be higher than 200 euros, which is also its amount for the employees of other companies undergoing privatization. Otherwise, if the severance pay is calculated on the basis of salaries in the EPS itself, it could even amount to 800 euros per year of service. In particular, for the workers with 35 years of service, the severance pay would amount to 28.000 euros in such case.

By their own admission, the EPS does not collect 11 percent of its receivables, and the biggest debtors are the companies undergoing restructuring. Although no one from the EPS wanted to comment to NIN on the latest analysis of the Fiscal Council, in some previous responses, the EPS warned that, only in the previous eight years, through the subsidized price, it had “given away” to the citizens and the economy six billion euros, which could have been invested in new plants, as well as that its biggest problem were bad debts. The Fiscal Council also believes that the delivery of electricity to defaulters should be suspended even if they are the companies of special state interest. Of course, it would be better for the EPS if, in a transparent way, the state was helping such companies from the budget to pay for the consumed energy, without burdening the EPS itself thereby.

The Fiscal Council sees the room for further rationalization in the reduction of distribution grid losses, which are the biggest in Europe. “These losses amount to around 15 percent and, in the next few years, they could be reduced by five percent, and they are created due to the use of outdated electricity meters, which enable electricity theft and to the technical issues because of which the amount of electricity that reaches the consumers is smaller than the one that the EPS delivers”. In the Fiscal Council, they remind that these losses can almost be eliminated by introducing “smart” electricity meters, for which the EPS was granted two loans by the European Investment Bank and the EBRD each amounting to 40 million euros back in 2010, but that this job has not been completed yet.

And finally, to make things even stranger, in April 2015, the EPS, the financial state of which is deteriorating rapidly, paid seven billion RSD into the budget through the Deposit Insurance Agency! In the EPS, they do not explain why they have paid their debt towards the state precisely now, as this debt was created from the beginning of 2012 until the end of 2014. Vladimir Vučković explains to NIN that the state had been paying the debts of the EPS to the London and Paris Club and, on this basis, the EPS owed the state seven billion RSD for the last three years.

In addition to not knowing where the EPS got the money to settle its debt now, for the Fiscal Council, it is also debatable that this inflow into the budget has not been posted according to the international accounting standards. “When the state was paying the principal amount of debt to the Paris Club of creditors instead of the EPS, it was not posted as current budget expenditure, which is in accordance with recognized standards, and therefore, now, the EPS payment should not be posted as budget revenue either”, Vučković explains.

It can be assumed that this was done due to the need to make the “bright” picture of the Serbian budget even brighter. The only problem is that the already low “blood count” of the companies which should fill this budget is further aggravated in this way. Hence the fear that the state could assume their debts one day. And so on. Until a new reduction in salaries and



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