

Congratulations to colleagues in Serbia's energy sector on the adoption of the new Law on Energy. Formal and legal barriers should not exist in terms of equal treatment of Serbia in all EU energy associations said Simon Uzunov, Head of the Electricity Unit at the Energy Community (EC) of Southeast Europe

Even in the period in which the "Electric Power Industry of Serbia" and the energy sector of Serbia were one and the same term, their dominant and leading role in the region was undeniable. It is understandable that such position of Serbia within the Energy Community of Southeast Europe exists today as well. This position has been objectively based on performances in energy production and security of supply, construction and connection of network and energy transmission, energy system management at both local and regional level, as well as the development potential and possibilities of diversification, says Simon Uzunov, Head of the Electricity Unit at the Energy Community (EC) of Southeast Europe. According to Uzunov in recent years, Serbia has stood out most in terms of its leading position and initiative in all regional projects, as well as the seriousness with which it approaches the implementation of reforms.

Recently, a new Law on Energy has been adopted in Serbia which has been praised by the Energy Community. In your opinion, what are new and good things brought by this law, what is its significance?

First of all, congratulations to all my colleagues in the energy sector of Serbia on the adoption of the new Law on Energy. The new law is the successful completion of transposition or direct transmission of the European legal system pertaining to energy to the Serbian Law on Energy. This is the first and indispensable part of the work on the road to construction of market environment which will be compatible with the internal energy market of the European Union. At this stage, the adaptation of some elements in other existing laws in Serbia which could possibly present a hindrance or be missing remains to be done, so as to enable the successful implementation of all provisions of the new law. Within the next stage, there is to be a complement to necessary instruments of secondary legislation and regulatory and other acts or their possible adjustment. From the standpoint of the Energy Community, the importance of the Law on Energy is primarily that it opens the way towards the development of the electricity market in Serbia compatible with the EU. This market is ready for integration with the European electricity market. Of course, there are still steps to be taken on this road, but this is the first and the most difficult one, because it requires a critical level of political will and the administrative capacity which cannot be simulated if there is none.

Practically, the full implementation of this law means that formal and legal barriers should not exist in terms of equal treatment of Serbia in all EU energy associations. Thus, the investment climate in the energy sector and the perception of investors' risk are close to the level that exists in the EU member states. The implementation of the law implies that the

environment has been created which can enable the efficient functioning of all forms of competitive energy trading and optimal conditions for the access to and use of the transmission network and distribution systems. It also means that there is an obligation to open all platforms of organized electricity market, which ultimately means creating the conditions necessary so as to achieve the lowest sustainable energy price. The application of the law also means ensuring the protection of consumers at the level which is the obligation in EU member states, including the right to choose and change the supplier as well as the right of new suppliers to join the network and participate in the energy market – both in Serbia and in all EU member states.

As of January 1st, the electricity market in Serbia has been completely opened and now every household has the possibility to change supplier, however, suppliers' interest in the game is very low. Why?

The market is neither linear nor stochastic system and its operation is not easy to analyze, especially if there is not enough known elements. In general, if the number of suppliers is insufficient to cover the interest of consumers, and there are no administrative or financial barriers in terms of new suppliers joining the game, this means that their commercial interest is insufficient as a result of perception of too high risk. It is possible that the difference between revenue (energy price), and costs is too small or uncertain or unstable in the long run. All this points to the possible existence of anomaly, obstacle to the functioning of market and the need. If the situation does not improve by itself over time, it is necessary that the Serbian Energy Agency, as the authority responsible for market monitoring, deal with the analysis of possible reasons.

Is the low price of electricity the only obstacle and how can this be changed?

Yes, it is possible that the low price of electricity still represents an obstacle, although probably not the only one, to more effective market opening. Standard administrative measure would be a further gradual increase in the price of energy at “inert” part of the market as long as the interests of consumers and suppliers do not start interacting. But it should be borne in mind that the introduction of the market is not an end in itself, but it is introduced, among other things, precisely so as to form the optimal, sustainable energy reference price (which requires efficient, operational and liquid market). The administrative change of price itself for the purpose of stimulating the market is a form of price regulation which at some stage needs to be removed. In addition to energy price, there is always a number of other factors which should be taken into account, such as the transparency of the price structure, incentive mechanisms, information available to consumers about the possibilities and procedure regarding the change of the supplier, the suppliers' access to cheap energy sources, production portfolio which is available to the supplier, conditions of balancing, balance responsibility and the cost of system services on the market, the type and character (portfolio) of consumers with each supplier... If there is a dominant supplier

in the system, as it is the case with Serbia, there is a possibility that the entry of another big and ambitious player be the deciding factor in terms of price change and the start of the game “on the whole field.”

In what way should market be initiated?

It is wrong to seek the universal key for market initiation. In each particular case, the competent regulator should be allowed to supervise the process and, if necessary, do the analysis, and decide whether and how to proceed within the procedures available to it. It should be borne in mind that since January 1st very little time has passed in order for things to change considerably, even in an ideal environment. Maybe a bit more time should be given so as to “awake” the system by itself.

The regulated price of electricity in Serbia is the lowest in the region. In your opinion, how does that affect the overall energy climate, investment plans...?

The Energy Community has been established because of the market and around it. The regulation of electricity price is treated at best as a “necessary evil” that, despite the fact that it is considered “necessary”, still needs to be removed. It is wrong to think that the public service must be regulated because of the “public interest”. – It is entirely possible and feasible, and as well sustainable at an optimal price, to conform to the public interest through market principles and mechanisms. Regulation is needed only when pricing the approach to divisible resources without congestion, as with the usual use of transmission or distribution systems, due to the principle of non-discrimination and effective avoidance of abuse with regard to the “third party” access. Therefore, the price deregulation is the priority.

What should be done?

It is necessary to replace the price regulation with the market mechanism of the reference price formation. The basic mechanism of market activation is raising the regulated price to a level comparable with the price that could be obtained on the market if it effectively functioned. Comparison with the energy price level in the region itself is not relevant in this context, but may be indicative. The current level of regulated electricity price in Serbia is probably below the required level, and it should probably be increased. But the increase in price without the sensitivity analysis and without the control mechanism of the market reaction is likely to lead to the arbitrary solution.

It is more important to respect the attitude of the Serbian Energy Agency and to create the optimal conditions for market opening using the adequate analysis. The level of energy price affects the operation and development of the system in several ways. If the price is too low, it may adversely affect the sector’s liquidity and the cash flow. It also affects the incentives for greater energy efficiency and energy saving, the entry of new technologies, the costs covering for system maintenance, the protection of the environment from pollution and prevention of climate changes, the conditions of return of capital and attracting new

investors. For all these reasons, the Energy Agency is authorized to do the analysis, and it also carries the responsibility for determining priorities in the formation of regulated energy price. However, one should bear in mind that this process is not perfect and that regardless of the regulator's efficiency, free pricing on market principles overcomes these issues in a more efficient manner.

The “Electric Power Industry of Serbia” shall undergo reorganization for EPS to become profitable and efficient company. Is it possible and in what way can EC with its experiences assist in this process?

With regard to reforms of the “Electric Power Industry of Serbia”, good news is that the corporatisation of public company is being considered, which would, in addition to the possibility of changing the capital structure, introduce the application of the Law on Commercial Companies as well, and bypass obstacles arising from the implementation of the Law on Public Enterprises, which represents a positive step towards market way of doing business. The Energy Community participates in the formation of fair and open market as the basis for equal performance of all participants in the game. EPS already has a comparative advantage in its size and capacity diversification, in its knowledge of the local consumption and the environment, in the possession of the built and affirmed identity. Having this in mind, EPS does not need a special formula for the efficiency and profitability if the conditions on the free market are complied with.

What might be the risks?

The obligations imposed to EPS through the system of provision of public services might be a risk, in the case if the price of such services is regulated at insufficiently high level. In such case, the complaints and disputes function of the Energy Agency is available, which should be effective. The Energy Community has an obligation to examine the application of any company for possible abuse or violation of principles of the Treaty establishing the Energy Community, or the adequate legal framework of the EU and in this case it may initiate proceedings against violation of the right against the contracting party in question. There is still a question of domination of the “Electric Power Industry of Serbia” over the electricity market in Serbia, which should be monitored by the Energy Agency, and the aim is to control the possible restriction of competition and the entry of new participants into the market.

The European policy in relation to the construction of coal power plants and nuclear power plants has been quite tightened while at the same time, there is a growing influence of renewable sources. How to find a balance between “clean” and “dirty” energy?

The European policy takes into account the common trend of increasing the percentage of renewable energy in its consumption according to the adopted targets and consensus in the policy of implementation of energy savings through energy efficiency and reducing

greenhouse gas emissions, so as to prevent climate changes. Without denying the importance of these policy measures which represent the obligation accepted in the Energy Community as well, beyond that, each EU country has its own development policy. Such policy, for example, may exclude nuclear power plants in one country, but allow their construction in another. Coal is not completely abandoned, although it is true that new capacities until recently based on conventional technology are not being built, but solely on the basis of “clean coal technology”, where emissions are kept to a minimum, and with the use of high-efficiency filters. After a period of euphoria, renewable sources have reached saturation level.

The investment trend is continued, but now in the investment framework which is more sustainable than before, with much lower incentive measures or even without them. Hydro-capacities still have the advantage and if there are no serious environmental consequences, these projects are the most popular ones. Pumping reservoirs are also in a revival, in the context of balancing the production of unpredictable renewable parks. Electricity production from natural gas has been temporarily abandoned due to the crisis in the gas sector and the high price, but that can be changed. New technologies for the conservation of energy (batteries) are also gaining in importance. It is expected that the energy efficiency should exert a stronger effect on the energy supply of any production technology.

Dispersed production capacities are being used more and more and there is an increasing number of virtual capacity projects where instead of a new production facility, a transmission line is built up to unused capacity in the neighboring country. Volatility creates problems in the transmission system, but these effects are planned and can be successfully overcome with “smart” networks. Reasonable and effective development policy can be built on the basis of available local and regional potentials and within the accepted limits and obligations. The only question is how to achieve the most favorable price for energy and the capacity needed to meet its own consumption. This is already closer to the market way of thinking, which is one more reason for the Energy Community to insist on faster and more effective development of market and the infrastructure of connecting.

Recently many investments have not been initiated in the energy sector in the region, although many projects have been singled out at EC level as well. What do you think is the biggest problem?

In addition to more or less secondary reasons for the lack of significant investments in the energy sector in the region in recent years, such as the economic crisis, geopolitical interests, events in the east of Ukraine, propulsion of renewable sources and technological revolution, climate changes, according to investors and large financial institutions participating in the investment climate creation in the region (World Bank, EBRD), it can be confirmed that the main reason is the delay in the implementation of reforms and the development (opening) of the electricity market. With all contracting parties in the region of

Southeast Europe market should have been opened back in 2008 for all consumers except households. Effectively, it has been opened today, including Ukraine and Moldova, less than two percent based on the total consumption. In this kind of environment and in the case where the level of regulated energy price is relatively low compared not only to the market price, but also to the level required for the efficient return of capital, it is probably very difficult to make a positive investment decision.

Serbia as an example for others

How do you see the role of the Serbian energy sector within the Energy Community of Southeast Europe?

In the field of electrical power engineering, Serbia has brought several significant initiatives to the region and it has been the first or among the first to come forward with original projects such as market merging (“market coupling”), the establishment of power exchange, coordinated allocation of transmission capacities, as well as regional balancing of electric power systems, the establishment of association for cooperation in safeguarding the security of electricity supply...Such initiatives may sometimes present a challenge for some of the other contracting parties of the Energy Community or for the process of coordination and harmonization at the regional level. Without regard to this, contracting parties of the Energy Community today may take Serbia as an example only and try to follow its step.