

Serbia: What are the biggest problems of EPS? Fiscal Council's latest analysis

Categories : [News Serbia Energy](#)

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The Fiscal Council recently released a study on the public enterprise *Elektroprivreda Srbije* (EPS), which found itself under the radar of the general public because the focus was on their analysis of the 2020 budget proposal, published the same day. However, this study is much more important than the budget analysis: it shows that there are serious challenges facing the country's energy sector that must be addressed within a few years or else it will have serious consequences across the country.

The situation is not alarming for the time being, but it does not mean that it is not a concern, especially since very little has been done in the past decade to resolve these problems. The Fiscal Council sees as a major problem the high investment needs to meet the growing demand for electricity and to meet minimum environmental standards. The total level of investments required by 2027 is estimated at EUR 5.6 billion - up as much as 12.5% of the estimated GDP this year, or some EUR 700 million annually in 2020-2027, compared to current capital expenditures of EPS below EUR 400 million.

Building new capacities

In the last 30 years, EPS has not built any major power generation plant. This has worked for the time being because there was a large inherited surplus capacity from the SFRY, and also because industrial production of the country declined significantly due to the devastation of the country's economy during the 1990s. However, this is slowly coming to an end - the surpluses of electricity produced are decreasing (to some extent due to poor EPS operations and more due to increased electricity consumption, especially industrial). The Fiscal Council estimates that domestic electricity consumption will significantly exceed its current production capacity, so either new capacities to cover this production must be built or large quantities of electricity will have to be imported. Investments for these purposes are estimated at 4.6 billion euros.

The Fiscal Council foresees that, due to the increase in electricity consumption, as well as the closure of outdated electricity generation facilities (TPP Morava, Sremska Mitrovica, Zrenjanin, Novi Sad, etc.), there must be an increase in generation of about 5,000 GWh per year. So far, there are projects to build a new thermal power plant in Kostolac, as well as solar power plants, and plans to revitalize the thermal and hydro power plants in operation, which would lead to an increase in generation of 3,000 GWh. Reducing large losses in the distribution network could lead to savings of 500 - 1000 GWh, which means that generation capacity of 1,500 - 2,000 GWh is lacking.

Of course, we should also mention the accompanying large investments of EUR 1.1 billion into opening new or expanding existing coal mines to provide sufficient coal quantities for existing or new thermal power plants. In recent years, the quantity of coal mined is decreasing, but also its quality (measured through average heat output). Therefore, this would be a necessary step, even without building new capacities.

Environmental standards - an obligation towards the EU, but also to our health

To reach European environmental standards, to which Serbia has committed itself in EU negotiations, investments of around EUR 800 million are needed. The total amount for these purposes amounted to EUR 1.2 billion in 2005, of which projects (primarily to reduce dust pollution) have been implemented so far, amounting to only EUR 400 million, although it was originally planned to accomplish this task by 2015.

This is necessary because Serbia could, in the event of a lack of standards, pay high pollution taxes after 2027 estimated at as much as EUR 500 million a year. Achieving environmental standards, however, is not only important for compliance with EU regulations to which we have committed ourselves, but also for the high pollution emitted by EPS, leading to serious health problems.

For example, Kostolac B TPP alone emits about 130,000 tonnes of sulphur dioxide per year, which is more than all thermal power plants in Germany combined!

How to get these funds?

EPS' profitability was almost 10 times lower than that of comparable companies, with return on equity of only 0.5%, which speaks volumes about its successful operations. This is encouraging, however, because it means that there is scope for reforming the entire enterprise to increase company productivity and to utilize this to finance the necessary investment increase. Measures outlined by the Fiscal Council would lead to savings in the range of EUR 200 - 230 million in the medium term, which would be sufficient to increase investments to the required level.

Too many employees with too high salaries

The first issue is the amount of earnings and the total number of employees of the company - based on a comparison with other similar companies of the region, EPS has both redundancies and over-earnings. Fiscal Council estimates that optimization of staff numbers and earnings could result in savings of EUR 50 million.

High network losses and tolerance of non-payment

Total network losses (EPS and EMS combined) are about 4,500 GWh per year, i.e. 13% of total electricity produced. This is twice the average of CEE countries - which means that investing in reducing technical losses, as well as better control of unpaid electricity through tolerance of non-payment or direct theft of electricity, could bring significant savings. These savings are estimated at EUR 40 million in the event of a reduction in losses, albeit only in the medium term, since they are preceded by the necessary distribution network investments.

Much of the non-payment comes from state-owned companies or entities, including GSP Belgrade, Jumko Vranje, Resavica, the City of Kragujevac, Toplana Bor, Azotara Pancevo, etc. which is a practice that needs to be stopped. If EPS would increase its collection by 1 percentage point from the current 95%, this would bring an additional EUR 20 million in revenue.

Low electricity price

The price of electricity in all regional countries, including those that are objectively poorer than Serbia, such as Northern Macedonia or Albania, is significantly higher than in Serbia. An increase in electricity prices of 15% could increase EPS revenues by EUR 120 - 130 million - only this measure would only make sense if EPS had been reformed beforehand because otherwise the whole price hike would translate into an increase in employee salaries, which has already happened.

Low electricity prices also lead to unreasonable consumption, so electricity is used for heating instead of other energy sources, which are cheaper and less polluting.

Analysis as a warning

The Fiscal Council's analysis is very important because it alerts us several years in advance of the future problems we will face if EPS does not become a normal profitable enterprise with independent and experienced management. In other words - until it becomes all that it is not today.

Such a reform would take at least a few years, but it would lay a solid foundation for the future work of this company. Otherwise, if EPS continues to operate as it has before, any increase in electricity to the detriment of consumers will not lead to new necessary investments, and without them could slow the economic development of the country. The situation, although bad, is not yet alarming, but it can easily become a matter of years if nothing is done about it. That is why this analysis, although seeming alarmist and premature,

is actually drawn up at the right time and in an argumentative way about what needs to be done while there is still time.