



ANALYSIS OF STATE-OWNED ENTERPRISES: FISCAL ASPECT

Summary

The state-owned and public enterprises threaten to sink the public finances of Serbia. Their overall adverse effect on the public finances had been growing over the past five years and in 2014 this large cost has reached 3% of GDP. This cost includes subsidies, activated guarantees and unpaid taxes and contributions - all of which burdens the state budget. The amount of 3% of GDP equals about 115 billion dinars (1 billion euros) and it is the annual cost paid by the government for the unsuccessful performance of state-owned enterprises. In some cases these costs probably cannot be completely avoided (for example, subsidies to Serbian Railways), but they could be much lower. In the several recent years, the state spending on public enterprises have been growing due to the activated guarantees - including the guarantees issued by the state to Srbijagas.

Instead of making a shift as announced, the situation has been additionally aggravated in 2014. In its Programme of Public Sector Reform Measures of June 2013 (which is still on the home page of the website of the Ministry of Finance), the government committed to promptly bring order in the operations of public enterprises, to resolve the issue of the enterprises in restructuring in the first half of 2014, and to cease issuing guarantees on the borrowings of Srbijagas. In the meantime, not only did the operations of public enterprises remain out of control, but their problems have continued to grow. Presently, there is already a serious risk that the loss-generating operation of the absolutely largest state-owned enterprise, EPS, could become a fiscal cost and completely undermine the public finances of Serbia, due to the scope of the problem. The future status of the enterprises in restructuring was not resolved within the planned time frame, while the changed government's approach to this problem and the new Law on Privatisation do constitute some progress, but they will probably result in the extension of deadline for solving the problem at least to 2015. Meanwhile, a new guarantee has already been approved to the enterprise Srbijagas, and since the problems of the enterprises that do not pay for gas (Petrohemija, Azotara, MSK, etc.) have not been resolved, it is almost certain that in the next heating season Srbijagas will need a new loan guarantee to cover its losses, which will eventually be repaid by the state. Moreover, instead of resolving the future status of Zelezara Smederevo in the first half of 2014, as announced and budgeted, the state has now restarted production in that enterprise and increased the fiscal cost.

Without bringing order in the state-owned and public enterprises, it is impossible to successfully implement fiscal consolidation and avoid a public debt crisis. A large and growing fiscal cost of state-owned enterprises is one of the main reasons for the unsustainable growth of fiscal deficit and public debt in recent years. The analysis of the Fiscal Council indicates that the implementation of fiscal consolidation without covering public and state-owned enterprises - is bound to be a failure. A good example of this claim is precisely the

year 2014, in which the new fiscal cost of only two enterprises (Srbijagas and Zelezara) was bigger than all the state revenues collected from the increase of reduced VAT rate from 8% to 10% and the introduction of solidarity tax. Hence, we believe that all future fiscal savings (reduced salaries and pensions, for example) would be a useless sacrifice without solving the major problems of state-owned and public enterprises concurrently. For that reason, the Fiscal Council has conducted an analysis of the business operations of public and state-owned enterprises to point out the level of costs and risks taken by the state because of them and to emphasize the most important problems faced by each of them individually and suggest possible solutions.

The problems of public and state-owned enterprises are not easy and require sweeping and long-term changes both in enterprises and economic system. It is important to point out that the resolution of one or a small number of causes will not eliminate the problems in the functioning of these enterprises - to bring order in the business operations of public enterprises completely will take at least two to three years. A good example for this claim is EPS. The analysis of the Fiscal Council shows that an increase in the price of electricity is really necessary (see the section on EPS). However, the increase in the price of electricity by itself cannot result in the substantial improvement in the company's operations and major investments. Specifically, it is not encouraging to know the fact that even in the period in which EPS faced major problems with insolvency it did not reduce its unreasonable costs and losses. On the contrary, the salaries of employees were increased (although they are unusually high anyway) faster than in other enterprises; the problem of employees in Kosovo and Metohija was not addressed; failures to pay electricity, even electricity thefts, were tolerated; and to top it all, now the unprofitable units, previously separated from EPS (PD Kolubara-Usluge with 1470 employees) are being merged with the already unsuccessful EPS. Different governments tolerated, in the least, the inappropriate decisions of EPS, and it is possible that in certain cases they initiated them. Until these problems are addressed individually, any increase in the price of electricity may prove to be insufficient. The failure to solve the problem not only would reduce the motivation of EPS to improve the current ineffectiveness of its performance, but there is a substantial risk that such additional funds would sooner or later be spent on the increase of employees' salaries and/or merging of some new loss-generating organisations (Coal Mines, Resavica?). We have used this example to show that a real solution to the issue of state-owned enterprises will require an in-depth and thorough approach to each individual enterprise and several years of work, rather than swift, general and standardised measures, because their effects would be quickly annulled by other forms of wastefulness. By presenting other different examples, we show the disastrous relationship between: high purchase prices, low selling prices, uncollected receivables as a result of sale to insolvent buyers, unjustified assignment of social function to public enterprises, overstaffing, internal wastefulness and other bad business decisions of these enterprises.

The table below shows the basic characteristics of the group of public enterprises (separately for the most important ones - Srbijagas, EPS, Zeleznice Srbije - Serbian Railways), the group of enterprises in restructuring (separately for Galenika and Resavica) and other state-owned enterprises (Telekom, Dunav osiguranje, GSP). These are the enterprises discussed in more detail below. The table indicates the essential causes of problems in their operation, their effects on public finances and necessary solutions. The individual enterprises have been selected by taking into consideration their effects on public finances to date, the importance for the functioning of economy and the potential future contribution to the public finances of Serbia.

Overview table

	Basic operational characteristics	Sources of problems	Consequences on public finances	Solutions
Public enterprises (group)				
	<p>730 enterprises</p> <p>130,000 employees</p> <p>Operational performance indicators at low level (age and condition of capacity, productivity, etc.)</p>	<p>Internal inefficiencies</p> <p>Insolvency and growing indebtedness</p> <p>Administered, non-market prices below the level of justifiable costs</p>	<p>Annual cost of 3% of GDP: subsidies, activated guarantees, unpaid taxes and contributions</p> <p>Generation of insolvency and consequences on economic activity and public revenues</p> <p>Toleration of arrears and debts that become the state's obligation</p>	<p>Elimination of basic business problems (price disparities, soft budget constraint, etc.)</p> <p>Regulation (reduction) of employment and salaries</p> <p>Professionalization of management and reduction of wasteful spending and corruption</p>
Srbijagas				
	<p>Annual loss of 50 billion dinars</p> <p>Annual liabilities to banks in the amount of 17 billion dinars</p> <p>Collection of payment for the gas supplied - 60%</p>	<p>Many years of low sales prices (adjusted)</p> <p>Taking over of loss-generating entities</p> <p>Gas supply to non-payers</p>	<p>Issuance of state guarantees and growth of public debt – about 800 million euros to date</p> <p>Enterprise's liabilities are paid from the state budget</p> <p>Possible annual fiscal cost of 30 billion dinars</p>	<p>Suspension of gas supply to non-payers</p> <p>Sale of subsidiaries</p> <p>Negotiations on import quantities and prices</p>
EPS				
	<p>Over 38,000 employees</p> <p>Accumulated loss of 121 billion dinars</p> <p>Technological obsolescence: ¼ of transmission lines and substations are in good condition; the average age of thermal power plants is 30 years and of hydro power plants 40 years</p>	<p>Inefficient decentralised organisation - autonomy of subsidiaries</p> <p>Uncollectible receivables for sold electricity</p> <p>Overstaffing and excessive salaries</p> <p>Losses in the distribution network (including theft) are the highest in Europe (15%)</p>	<p>Spreading insolvency on the entire economy</p> <p>Possible issuance of state guarantees for additional borrowings to cover due financial obligations (30 billion dinars in 2014)</p> <p>Inability to pay the corresponding share of profit for 2013 to the state budget</p>	<p>Business and financial restructuring accompanied by the increased efficiency in all operational segments</p> <p>Downsizing and salary cuts</p> <p>Increase in the price of electricity for households</p> <p>Shift in the policy of payment collection and introduction of financial discipline</p>
Železnice Srbije*				
	<p>20,000 employees</p> <p>Annual operating loss of 4-5 billion (accumulated loss at the end of 2013 was 146 billion dinars)</p> <p>Poor condition of infrastructure (low speed of rail traffic, more than half of railroads were built in the 19th century, the length of repaired railroads has been reduced, etc.).</p>	<p>Low administered prices</p> <p>High operating loss that leads to a lack of funds for maintenance and investment</p> <p>Generous subsidies are not used to improve the railway system</p>	<p>Annual subsidies from the state budget equal 13 billion dinars</p> <p>Activated guarantees for the loans paid by the state instead of Zeleznice (over 5 billion dinars were projected for the period 2014-2016)</p>	<p>Abolition of privilege and adjustment of tariff zones</p> <p>Detailed elaboration of financial and operational criteria and setting of measurable goals</p> <p>Changing the current system of non-transparent subsidies and passive state role</p>

Enterprises in restructuring				
Galenika				
	Since 2010, a drastic decline in operating income, accumulation of losses, intensive growth of debt	Inappropriate business decisions of company management (write-off of receivables)	Potential fiscal cost of about 3 to 4 billion dinars in 2014 (for the activation or issuance of new guarantees)	Privatization
	Illiquid and insolvent although the need for short-term borrowing has been reduced recently	Large overstaffing (surplus of about 500 employees)		Downsizing
JP PEU Resavica				
	4,000 employees	A large number of employees in administration	Annual cost of 4-5 billion dinars	Downsizing
	There is no coal exploitation in several mines		Cumulative amount of unpaid taxes and contributions from previous years is about 8 billion dinars	Making arrangements with the strategic partner and enhancing the scope of business and sales
Other state-owned enterprises				
Telekom				
	Operating results have worsened, the market value has decreased	Inefficient state management	Smaller dividends and other income paid to the budget	Privatization
	Decrease in the number of users	Surplus of employees	Contribution to the economic growth smaller than possible	Downsizing and reducing the cost for salaries and wasteful spending
	Decline in the share of total income from mobile telephony	Financing of various state projects that do not contribute to business success		
Dunav osiguranje				
	Over 3,000 employees	High and growing costs of earnings due to the noticeable increase in the number of employees; the cost of advertising and sponsorship are five times higher (for the same scope of business operations)	Collected public revenues smaller than possible	Reducing the cost for salaries (downsizing)
	Loss of about 1.5 billion dinars in 2012			Privatization
GSP Beograd				
	6,000 employees	Low rate of tickets and cards payment collection and generously established system of privileged categories of users	Current subsidies of the City of Belgrade are growing every year - 7.5 billion dinars in 2013	Improvement of payment collection system
	In the period 2010-2013 it continuously has an operating loss (the accumulated loss of about 20 billion dinars in 2013)		Expenditures from the budget of the City of Belgrade for capital subsidies	Review of the level of discount for some privileged categories

*Zeleznice (Railways) is, formally, a joint-stock company.

(Note: The full report Analysis of state-owned companies: fiscal aspect can be downloaded from the website www.fiskalnisavet.rs.)