FEBRUARY 2018

SERBIA

- Electricity is the largest component of household energy expenditures in Serbia.
- The power sector in Serbia faced increasing financial difficulty in 2014. High technical and commercial losses along with below-cost provision of electricity to consumers resulted in a revenue shortfall for the state power utility and became a huge burden on the government.
- ESMAP grants supported World Bank cross-sectoral analyses, which fed into advice to the Serbian government on designing electricity tariff reforms paying attention to energy affordability and protecting vulnerable households in the face of price increases.

THE CHALLENGE

Back in 2014, the power sector in Serbia faced the challenge of revenues being inadequate to cover costs, because average tariffs were set below the cost-recovery level and because of high commercial and technical losses. The revenue shortfall was equivalent to approximately two percent of GDP. At the same time, the bottom quintile of households received only 16 percent of the subsidy resulting from below-cost tariffs and low energy prices encouraged excessive use of energy.

THE RESPONSE

The Government of Serbia initiated a comprehensive reform of the energy sector to tackle these challenges. The reform included a major corporate restructuring of the large national electricity (Elektroprivreda Srbije, EPS) and gas (JP Srbijagas) utility companies and raising electricity tariffs to cost-recovery levels. Restructuring of the companies was motivated by efficiency concerns but also necessary to comply with European Union accession requirements.

The Government asked the World Bank to assist it in reforming energy tariffs in a socially responsible manner. From 2015 to 2017, the Bank team used grants from the Energy Sector Management Assistance Program (ESMAP) to fund analyses that informed the policy dialogue on electricity tariff reforms in Serbia, as well as Albania and Kosovo.

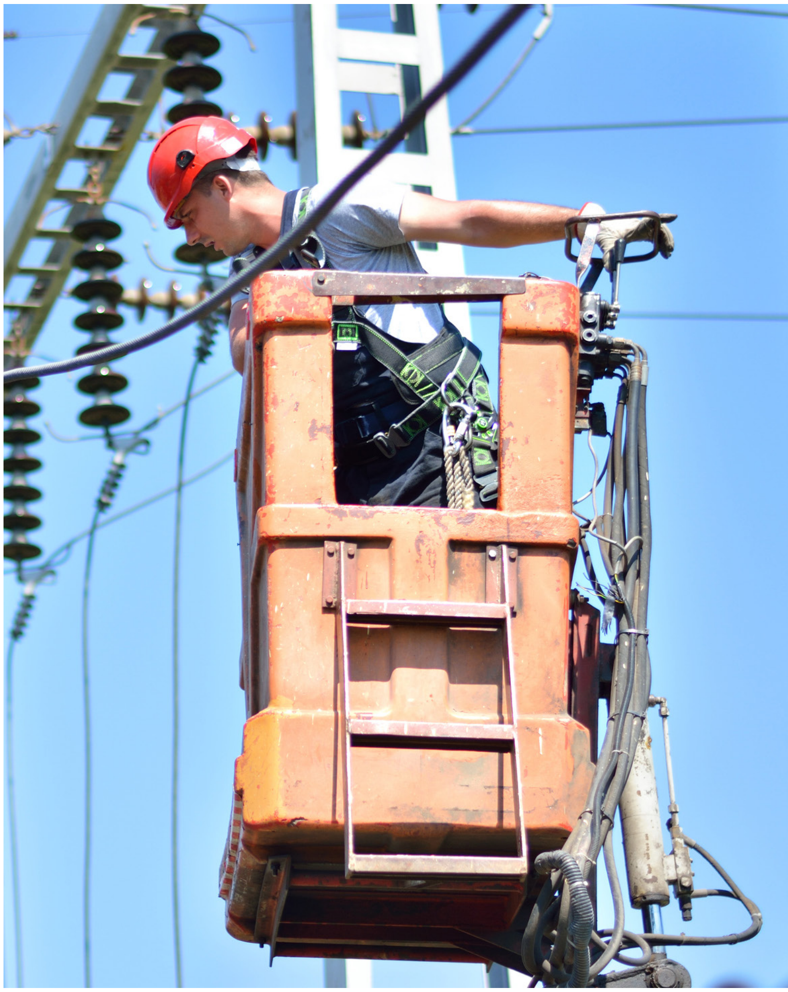
Tariff reforms began in Serbia in 2015. Residential electricity prices were increased by 12 percent (4.5 percent tariff increase plus 7.5 percent excise tax) in August of that year. A further 3.8 percent increase occurred in October 2016 and another 2 percent in October 2017. The changes were aimed at improving the Serbian government's fiscal balance and ensuring the financial sustainability of the energy sector.

Drawing on the findings of the cross-sectoral analyses supported by ESMAP, the World Bank team advised the Serbian government on paying attention to affordability and protecting vulnerable households facing price increases while implementing energy tariff reforms.

Timely assessment of poverty and distribution impacts by the World Bank team provided a strong basis for engagement with the Government from the start. Bank assessments showed that one in five households (two in three households in the bottom income quintile) struggled to keep their homes warm even before the price increase.

Electricity has long been the largest component of household energy expenditures in Serbia, accounting for roughly three-quarters of energy expenditures on average. The World Bank's analysis showed that the substantial increase in electricity prices envisaged could have a significant impact on household energy expenditures, especially in the short-run when households do not have the flexibility to switch energy sources or switch between energy and other types of consumption. The analysis found that the most vulnerable populations were the poor as well as the elderly living alone, who spent a significant part of their household budget on electricity.

The ESMAP grants in effect supported a cross-sectoral dialogue with the Government, resulting in efforts to enhance social protection for vulnerable groups. Since 2014 Serbia had been implementing an energy bill discount program (energy benefit) for vulnerable households, following a requirement anchored in the country's Energy Law. This energy benefit, financed from the central budget and administered directly through the utility billing process, aimed to cushion vulnerable



populations against higher energy expenditures. After implementation of the first tariff increase in August 2015, an inter-ministerial working group, chaired by the Ministry of Mining and Energy, was set up to strengthen the existing legislation with the objective of increasing the program's coverage. The coverage of the electricity benefit was low, at less than 4 percent of all households in June 2014, with low take-up among those eligible because the program had been defined and implemented in ways that made it difficult for many households to qualify for it.

The World Bank team's assessment of the energy benefit program informed discussions with the Government on how to strengthen the program in light of the potential welfare impacts of tariff increases. Technical assistance was provided to improve both the design of the program and its implementation. Fiscal analyses of alternative social protection scenarios were carried out and they underpinned discussions between the Government and IMF on the program's budget, resulting in a significant budget increase for the program by the end of 2015.

THE IMPACT

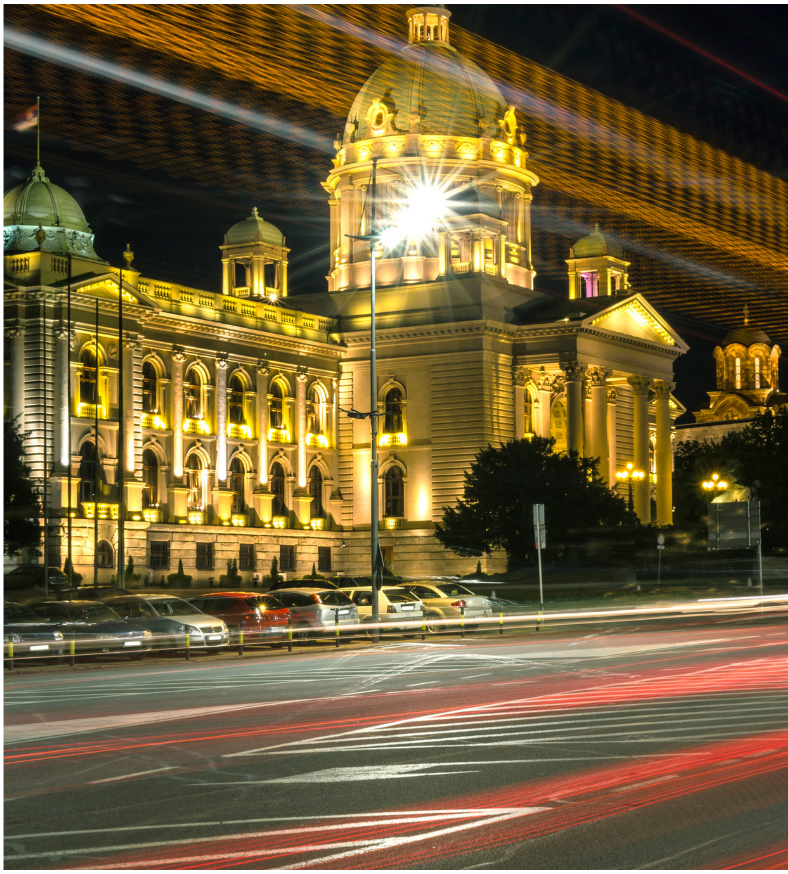
The electricity tariff increases along with restructuring have strengthened the financial sustainability of the electricity supplier, EPS. This was also an important step in the Government's fiscal consolidation efforts to lower public debt to sustainable levels and effectively manage future fiscal risks.

Supported by the ESMAP grants, the Bank team's engagement with the Government and its emphasis on protecting economically vulnerable households in the face of price increases had a positive impact. On December 31, 2015, the Government approved the Decree on Energy Vulnerable Customers to ease the eligibility criteria and increase coverage of the energy benefit. Among other aspects, the new energy consumption qualification thresholds for 2016 were set at significantly higher levels than before. Another obstacle that was removed had to do with energy bill payment arrears; arrears no longer affected eligibility for deductions on a household's current bill. Further, the program budget was raised from RSD 900 million in 2015 to RSD 1,650 million in 2016. As a result, a higher number of beneficiaries became eligible for the maximum bill deduction. From January to August 2016, some 82 percent of all claimants were eligible for 100 percent of the legally allowed deduction, and an additional 15 percent were eligible for a deduction of their entire bill, which is significantly higher than before. Around half of the total amount of the benefit went to households in the bottom quintile, reflecting a strong means-testing component in the eligibility rule.

The World Bank team continued to support the Government in the design and implementation of the energy benefit program in 2016 when changes in the beneficiary identification mechanism switched the burden of identifying vulnerable groups from the Centers for Social Works to local governments. In 2016, local governments were required to process all applications for energy benefit. Between 2016 and 2017, from January to August, the average number of beneficiary households increased from around 42,000 to 64,000. In 2017, the benefit was extended to cover a new beneficiary group: households that have members with disabilities.

MOVING FORWARD

Serbia has made significant progress in reforming its energy tariffs and providing protection for vulnerable populations. Analytics and technical assistance, supported by ESMAP, contributed to informing these reform efforts. It is important to maintain the momentum as Serbia completes its energy sector reform agenda -- further electricity tariff increases are planned until full recovery of economic costs is achieved.



However, energy benefits such as price discounts, progressive tariffs or social tariffs are usually considered temporary solutions applied, for example, at times of energy tariff restructuring and complementary to other social protection measures. Since they are focused primarily on ensuring short-term energy affordability and are not aimed at long-term energy poverty alleviation, they tend not to be sustainable. In the medium and long-term, it will be important to promote energy efficiency measures and protect vulnerable households under a broader social protection system rather than through parallel benefit programs administered by particular sectors.

CONCLUSION

The multi-sectoral technical assistance and analytical activities financed by ESMAP from 2015 to 2017 achieved the objective of supporting the Government with tariff reforms and at the same time protecting vulnerable households against price increases. The team was able to produce evidence-based analysis that supported the ongoing policy dialogue on energy tariff reforms and addressed energy affordability. As a result, the energy benefit program was redesigned to expand access. A higher number of beneficiaries became eligible for maximum bill deduction in 2016 and the average number of beneficiary household increased from around 42,000 in 2016 (January to August) to 64,000 in 2017 (same period).

ESMAP's $20 million Energy Subsidy Reform Facility (ESRF) was set up in 2013 to help countries remove fossil fuel subsidies while protecting the poor. ESRF provides technical assistance to governments, develops tools for assessment and decision-making, and facilitates knowledge-exchange for a global community of reformers.

ABOUT ESMAP

The Energy Sector Management Assistance Program (ESMAP) is a global knowledge and technical assistance program administered by the World Bank. It provides analytical and advisory services to low- and middle-income countries to increase their know-how and institutional capacity to achieve environmentally sustainable energy solutions for poverty reduction and economic growth. ESMAP is funded by Australia, Austria, Denmark, the European Commission, Finland, France, Germany, Iceland, Italy, Japan, Lithuania, Luxembourg, the Netherlands, Norway, the Rockefeller Foundation, Sweden, Switzerland, and the United Kingdom, as well as the World Bank.

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