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GOVERNANCE OF ENERGY SECTOR IN SERBIA

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Content

GOVERNANCE OF ENERGY SECTOR IN SERBIA

The goal of this paper is to review the regulatory framework and its implementation in energy sector in Serbia in order to assess major governance deficits which could be connected with corruption. The analysis will be based on regulatory review, evaluation of the financial data for SOEs and the public procurement contracts, among several other themes.

Even if it not possible to firmly prove conclusion that bad governance of the energy sector is product of widespread corruption practices and state capture, there is no doubt that governance weaknesses allow and facilitate large scale and small scale corruption in Serbian energy sector.

Corruption issues in Serbia are much politicized; both the government and the opposition try to take initiative by talking about corruption and demanding interrogations, arrests, and court trials; tabloid press is helping them a lot. On the other hand, corruption scandals in the energy sector are relatively rare; no one is sentenced for corruption in the energy sector yet; of course, this doesn't mean that corruption is rare phenomenon in Serbia.

1. REGULATORY FRAMEWORK IN THE ENERGY SECTOR

Main Actors

Energy sector in Serbia is still almost fully state-owned, either by Serbian or Russian state.

Owners, 2015, in %

	Sector	Serbian state	Russian state	Individuals	Other firms
Major companies					
NIS	oil: exploitation, refineries, retail	29.9	56.2 (via Gazprom)	10.8	3.1
EPS	electricity production	100			
EMS	electricity grid	100			
Srbijagas	major gas importer and retailer	100			
Smaller companies					
Resavica	underground coal mines	100			
Yugorosgaz	gas provider in south Serbia	25 (via Srbijagas)	50 (via Gazprom)		25 (Austrian, Gazprom?)
Lukoil	oil products		100 (via		

	retailer		Lukoil)		
Local heating companies	Hot water, district heating	100			

Source: APR (Agency for economic registers), September 2015.

EPS was until recently (July 2015) organized in about dozen production companies (each power and hydro plant was an independent company), four regional distribution companies and one supply company. After the reorganization there are just three companies: production (former companies have been reestablished as internal subsidiaries), distribution (with four subsidiaries) and supply. The main reason for reorganization was not harmonization with the Third Energy Package (as the old structure was also in line with it), but centralization of management responsibilities. Namely, in the old structure each independent company was an independent public enterprise whose management was appointed by the Government. Therefore the CEO of the EPS system was not really able to control the whole system. The new organizational structure will transform EPS into system into a better integrated company.

Transmission has been separated from EPS and established as an independent company (EMS) in 2005. It operates the high voltage network as in the context of the Third Energy Package it is considered to be the TSO – transmission systems operator.

On the other side, Srbijagas is still an integrated company which imports, transports and sells gas. Recently adopted reorganization plan will establish two internal subsidiaries for transport and distribution. According to Srbijagas and Ministry of Energy this is compliant with the Third Energy Package, but there were some complaints at the time as two TSO and DSO will not be fully independent companies.

Russian stake in NIS is a result of contract between Serbian and Russian governments on South Stream gas pipeline and the NIS stake purchased by Gazprom. Lukoil purchased Beopetrol, a local retailer through the privatization process. Resavica is a deep coal mine that was spun off from EPS about 10 years ago.

Regulatory framework

Regulatory framework has significantly changed three times over the last 15 years – in 2004, 2011 and most recently in 2014 new Laws on Energy were adopted. In addition to the Law, energy activities are strongly influenced by international agreements, such as Agreement on Establishing Energy Community (2006) and Energy Agreement with Russia (2008). There are also numerous by-laws (adopted based on the Energy Law) as well as other sector laws which have implications on the energy sector, such as Law on Communal Activities, Law on Protection of Competition, Aid Control Law etc.

The most recent EU Progress Report for Serbia (from 2014) has mostly focused to the following areas:

- Third Energy Package has not been fully transposed, especially Srbijagas has not unbundled transportation from distribution,
- Electricity prices are below cost recovery levels,

- Administrative capacity and independence of the energy and nuclear regulators need to be significantly strengthened.

However, soon after the Progress Report (end 2014) the new Energy Law was adopted with the main proclaimed goal to harmonize Serbian legal framework with the so called Third Energy Package adopted by EU. Interestingly, the Law was also supported by two major opposition parties, so it was almost unanimously adopted, which is not a common situation in Serbian Parliament. It was justified as the opposition's support to Government's EU harmonization policy.

The Law sets the main goals of energy policy as well as the methods for its implementation; sets conditions for reliable, safe and high quality delivery of energy; deals with some issues of consumer protection; sets conditions for establishment and operations of energy activities and for construction of new energy facilities. In addition, it (re)establishes the energy regulator (Energy Agency of the Republic of Serbia), regulates the usage of renewable energy and defines the way in which the energy market is organized (which includes electricity, natural gas, oil and derivatives). Also, the Energy Law envisages the preparation and adoption of the Energy Strategy, which was adopted in the meantime.

The previous Energy Law (adopted in 2011) was aiming to harmonize legislation with the Second Energy Package, but has mostly avoided harmonization with any Third Package provisions which would entail major reorganization and costs. The new Law is fully compliant.

The main goal of the Third Package is to promote competition. It envisages the unbundling of production and transmission in order to prevent transport operators from subsidizing its own production and supply companies. Also, in order to allow the competition, energy transport companies have to allow access to the transportation network to other gas or electricity suppliers on a nondiscriminatory basis. Access fees have to apply the regulated fees consistently in order not to abuse their dominant market position. Third energy package also aims to ensure the independence of national regulator as well as to establish the rules to enable the functioning of retail markets.

The new Law keeps the provision from the old Law on full opening of the electricity and gas markets starting from January 1st 2015. Based on that, households and SMEs will also be able to choose gas and electricity suppliers (large consumers had that options in previous years), but there is also the possibility to choose the guaranteed supply, meaning that there is no obligation to choose from the market.

However, no one still expects new entries into the open market due to the very low electricity price, which is supposedly the lowest in Europe. The old concept of „public supply" has been replaced by the concept of „guaranteed supply". The Law also regulates the procedures for the selection of the guaranteed supplier on a public tender and well as selection of the backup supplier.

According to the Law, all consumers have expended rights to access the data on their consumption and there is also an obligation to monitor technical and commercial quality of gas and electricity supply.

The Law does not envisage electricity price control by either Government or the Regulator. Actually, the Law has a provision that "prices for the guaranteed supply may be regulated". In practice, however, EPS management has to require the price increase from the Regulator, but as EPS management is politically appointed they will not request a price increase without prior agreement by the Government.

Ministry of Energy web site lists numerous relevant by-laws. For electricity, there are 2 Decrees, 15 Rulebooks, 11 Rules, 4 Methodologies and 2 Decisions.

The first Decree defines the conditions for delivery and supply of electricity. It specifies that the operator of the transport and distribution systems (TSO and DSO) have to allow delivery to the user under rules prescribed in the Law, this Decree and special technical and commercial rules. System operators have an obligation to maintain voltage within 10% margin, except for 400 kV systems where the allowed margin is lower, at 5%. The Decree also regulated metering and other technical aspects, such as responsibility for electricity losses.

The second Decree regulates the position of energy protected consumer and endangered heating consumer. Officially, the idea is to assist poor families, but in reality this is a populist tool. Namely, most really poor households do not use electricity, natural gas or central heating, but mostly use solid fuels (wood and coal):

Deciles of Population (by total consumption)

	1	2	3	4	5	6	7	8	9	10
Central heating	3.3	6.5	9.9	13.3	20.8	20.4	22.6	34.2	36.1	37.7
Electricity	4.1	6.9	9.4	12.7	10.4	12.8	10.5	12.5	11.1	11.5
Solid fuel	87.3	78.7	71.8	64.4	59.8	55.1	50.3	39	39.1	32.5
Liquid fuel	0	0.2	\	0	0.4	1.2	0.3	0.2	0.5	1.5
Combined	5.1	5.2	5.3	6.5	5.6	4.5	9	6.5	7.8	8.6
Gas	0.2	2.5	2.7	3.1	3	6	7.3	7.6	5.4	8.2

Source: Household Budget Survey

Anyhow, energy protected consumer is defined as a household whose monthly income is below a certain threshold (about 110 EUR for a one person household to about 250 EUR for the household with six and above members). Also, all households which are eligible for one of two means tested social assistance program (child allowance and financial support to families) are automatically eligible for this program.

Eligible households receive free energy in the following amounts, depending on the energy source:

- For electricity, between 120 kWh and 250 kWh depending on the household size,
- For natural gas, between 35 and 75 cubic meters of gas per month (depending on household size), but only for „heating months" of October to March,

- For district heating, between 25 and 55 square meters (as price is defined as dinars per square meter), also only for months October to March.

For oil and gas, there is an additional Law (Law on Pipe Transport of Gaseous and Liquid Carbohydrates and Distribution of Gaseous Carbohydrates), 4 Decrees, and 16 Rulebooks.

However, one of the important regulations is not in the competence of Ministry of Energy, but Ministry of Trade – Rules on Minimal Technical Conditions for Trade of Oil and Oil Derivatives, which was adopted in 2011. These rules put excessive requirement for the importation of oil. Namely, Serbia had a ban on importation of oil derivatives for years, starting in 2001, and was abolished only in early 2011. The goal of the ban was to protect the domestic oil refinery. However, after the ban was abolished (only few years after the refinery was privatized), this rule was introduced. The most restrictive criterion is the requirement for the importer (and wholesale trader) to have 500 cubic meter reservoirs. At the time this was met by only few companies, so it significantly restricted the competition.

Regarding energy efficiency and renewable energy in addition to the Energy Law, there is also Law on Efficient Use of Energy, as well as five decrees and five rulebooks.

The Decree on Incentives for Preferred Producers of Electricity define categories of preferred producers, introduces incentives (eligibility criteria, period of application of incentives, rights and obligations of producers) and other relevant terms and conditions. Decree also specifies the price at which EPS will buy the renewable energy. The price is much higher than retail price (2-4 times, depending on the type and size of the renewable energy facility) and the difference to EPS is compensated by the fee paid by the final users (set at about 0.1 dinar per kWh).

Energy Agreement with Russia

In 2008 Serbia signed a comprehensive energy agreement with Russia. The main elements were:

- Selling a stake in Serbian Oil Industry (NIS), a company which included extraction of Serbian oil, refinery and a network of gas stations for 400 million USD to Gazpromneft,
- Promise that future natural gas pipeline „South Stream“ will go through Serbia.

The Agreement had a large support in the Parliament, two largest Government parties at the time (Democratic Party of the then President Boris Tadic and Democratic Party of Serbia of the Prime Minister Kostunica) as well as the largest opposition parties at the time (Serbian Radical Party and Socialist Party of Serbia) have supported the agreement. Only several smaller parties (both from the Government and the opposition) have voted against the agreement. The major problems for these parties were that NIS was sold without public tender (implying lower-than-market price) and that there are no explicit guarantees for the implementation of the „South Stream“ project.

In the meantime, the results of the Agreement are mixed. On the positive side, NIS has gone from a loss making company into a very profitable company. Gazpromneft has invested

heavily in the refinery. On the other hand, „South Stream“ project has been cancelled, so a major argument in favor of the agreement has been annulled.

Also, there are other aspects of the Agreement which, in retrospect, make it a failure.
a) Agreement envisages a very low level of royalties for extracting the oil at just 3%, which cannot be changed by the national regulations.
b) NIS has significantly increased production (extraction) of domestic oil. Currently, almost 50% of derivatives sold in the Serbian market come from domestic oil. Of course, there are both good and bad sides of this development.

One of the supporters of the Agreement, previous President Boris Tadic has recently stated that the Agreement should be renegotiated, but has also admitted that there are no safeguards and guarantees in the Agreement that South Stream will be realized.

2. FINANCIAL ANALYSIS OF THE MOST IMPORTANT ENERGY COMPANIES

In the following pages we will shortly analyze the financial situation of five most important energy companies: EPS (electricity production and distribution), EMS (electricity transportation), Srbijagas (natural gas transport and distribution) and “Beogradske elekrane” (Belgrade district heating company) in the period 2010 – 2014. All data is from the Financial Accounts Registry maintained by the Business Registry Agency and all amounts are in million dinars.

EPS

EPS was until 2015 organized as a holding of about 20 independent companies, each with its own financial accounts. However, EPS also had to prepare the consolidated accounts and we will analyze those.

	2010	2011	2012	2013	2014
Total Assets	625,419	1,253,573	1,074,223	1,095,777	1,050,774
Total Debt	139,955	144,332	187,799	190,593	164,552
Equity	457,883	1,014,602	780,953	799,748	783,006
Current Assets	98,033	102,949	118,521	151,335	109,221
Cash and cash equivalents	6,053	5,472	13,460	36,524	31,181
Current liabilities	86,619	96,118	125,668	122,113	86,645
Long-term debt	53,336	48,214	62,131	68,480	77,907
EBIT	5,862	71	4,291	6,658	0
Net profit	-3,202	26,819	-12,338	18,827	-10,477
Business activity cash flow	24,628	31,387	21,203	43,299	21,879
Investment activity cash flow	-27,907	-25,263	-22,637	-16,927	-25,648
Financial activity cash flow	1	-6,736	9,148	-4,867	-1
Net cash flow	-2,765	-612	7,715	22,133	-4,766

Over the last five years total assets have nearly doubled (as a result of asset reassessment in 2011), resulting in also doubling the equity, while overall debt has increased by about 50 billion until 2014 and was then reduced by about 25 billion in 2014, as a result of significant reduction of current liabilities.

EBIT was mostly positive, and net profits have overall been positive over this period, but to a large extent this was driven by reassessment of assets values. Regarding cash flow, it was overall positive over the five year period, mostly due to good result in 2013.

The following table shows the evolution of most important ratios:

	2010	2011	2012	2013	2014
Current ratio	1.13	1.07	0.94	1.24	1.26
Quick ratio	0.07	0.06	0.11	0.30	0.36
Liquid ratio	0.00	0.00	0.00	0.00	0.00
Debt ratio	0.22	0.12	0.17	0.17	0.16
Long term debt ratio	0.09	0.04	0.06	0.06	0.07

Current ratio has somewhat improved, but it has been above one for the whole period, meaning that current liabilities were somewhat lower than current assets. Quick ratio has also improved over time, especially since 2013. Before that it was very low, below 0.1. Debt ratio has decreased, and it is at a manageable level. Long term debt ratio was mostly stable at about 0.05.

In summary, EPS is a fairly poorly run company: profits are either low or non-existent (and even when positive, they are more an accounting trick than a real profit), so investments are almost purely financed by government-guaranteed loans. This is the result of low electricity prices and poor internal management. Labor unions are very strong and are able to extract rents for themselves. For example, average salary is twice Serbian average, although employee education structure is not much better from average. Also, it has to be stressed that EPS financial results are strongly influenced by weather conditions. When the summer is dry and winter is hot, hydro potentials are underused and there is a need to import electricity. As import electricity prices are higher than local retail price, EPS generates losses. On the other hand, if water levels are adequate and winters are warm, EPS manages to produce enough electricity to satisfy local demand and is even possible to generate low profit.

EMS

EMS (Electro Network of Serbia) is a much smaller company than EPS and it is also in a significantly better financial situation.

	2010	2011	2012	2013	2014
Total Assets	65,586	67,985	68,768	86,123	90,853
Total Debt	18,773	19,194	19,919	23,309	26,557
Equity	45,342	47,280	46,794	57,913	59,620

Current Assets	10,940	12,460	11,229	13,018	15,752
Cash and cash equivalents	3,876	3,074	475	1,461	1,201
Current liabilities	4,665	5,310	5,410	9,204	11,366
Long-term debt	14,108	13,884	14,509	14,106	15,192
EBIT	1,310	2,443	1,802	1,626	3,880
Net profit	720	2,112	1,483	921	3,038
Business activity cash flow	4,701	3,894	3,103	4,115	8,251
Investment activity cash flow	-2,609	-4,086	-5,422	-1,828	-7,448
Financial activity cash flow	-718	-590	-583	-1,302	1,110
Net cash flow	1,374	-782	-2,901	985	-307

Total assets of EMS have increased by about 25 bn RSD over the last five years (about 40%) and that was only partially (8 bn, about 33% of the increase) financed by the increase in debt. Equity has increased by about 14 bn. Current assets were stable at about 11 – 15 bn RSD and current liabilities have more than doubled, while long term debt remained more or less constant at about 14 bn RSD.

Both EBIT and net profits were positive throughout the period. Business activity cash flow was significantly positive, while investment and financial cash flows were consistently negative. Resulting cash flow was overall negative.

	2010	2011	2012	2013	2014
Current ratio	2.35	2.35	2.08	1.41	1.39
Quick ratio	0.83	0.58	0.09	0.16	0.11
Debt ratio	0.29	0.28	0.29	0.27	0.29
Long term debt ratio	0.22	0.20	0.21	0.16	0.17

Current ratio has been significantly reduced (almost halved), but was above 1 throughout period. Quick ratio was also significantly reduced, especially in 2012 as a result of reduction in cash and cash equivalents, but has somewhat recovered in 2013. Debt ratio was stable at about 0.28 for the whole period, while long term debt ratio has been constantly reducing (since there was no new long term borrowing).

In summary, EMS is a fairly well-run company. However, since they have a legal monopoly position and guaranteed revenue stream that should not come as a surprise.

Srbijagas

Srbijagas is a company that has witnessed the largest deterioration of its financial situation.

	2010	2011	2012	2013	2014
Total Assets	100,821	136,115	132,101	162,083	192,746
Total Debt	67,521	97,539	131,559	157,845	188,279
Equity	33,073	38,131	0	0	0
Current Assets	47,833	54,455	51,248	46,184	24,783

Cash and cash equivalents	284	140	372	1,167	470
Current liabilities	42,563	49,857	61,970	77,917	116,350
Long-term debt	24,958	47,682	69,590	79,928	71,928
EBIT	3,472	-3,500	-13,009	-90	-2,358
Net profit	881	1,252	-36,739	-49,704	-45,037
Business activity cash flow	-11,690	-19,091	-11,878	-2,613	-15,066
Investment activity cash flow	-5,082	-8,322	2,857	-8,970	-9,195
Financial activity cash flow	18,279	26,844	9,999	12,363	23,530
Net cash flow	1,508	-569	979	779	732
End of period cash	284	140	372	1,167	470

From 2012 the company has no equity anymore, all of it was lost. Total assets have significantly increased (from about 100 to about 190 bn RSD), but total debt has skyrocketed (from 67 to 188 bn RSD) in just 4 years. Company made huge losses in 2012, 2013 and 2014 primarily as a result of inability to collect gas bills from several large SOEs (such as Azotara Fertilizer Plant, Petrohemija and Smederevo Steel Mill) and some municipal district heating companies, in those and previous years. Current liabilities (mostly debt to Gazprom, gas provider) have increased from 42 to 116 bn RSD, while long term debt has increased from 24 to 72 bn RSD (all of the increased was supported by a sovereign guarantee).

	2010	2011	2012	2013	2014
Current ratio	1.12	1.09	0.83	0.59	0.21
Quick ratio	0.01	0.00	0.01	0.01	0.00
Debt ratio	0.67	0.72	1.00	0.97	0.98
Long term debt ratio	0.25	0.35	0.53	0.49	0.37

Needless to say, all ratios have deteriorated. Current ratio was reduced to a fifth (from 1.1 to 0.2), quick ratio is almost zero throughout the period, while debt ratio has reached 1 in 2012 (as the company had no remaining equity). Long term debt ratio has reached about 0.5 and then was reduced to about 0.4, but current liabilities are also a big problem.

Srbijagas is widely seen not just as a poorly run company, but as one of the largest fiscal risks in Serbia. To some extent, that is clearly due to the management's failures. But, to a larger extent, this is the result of the government policy. First of all, Srbijagas was forced to sell gas at local market below their import price for several years (2010-2013). So, even if they were able to collect all the gas that they sold, they would generate substantial losses. However, Srbijagas was also unable to collect even those lower prices as it was forbidden by the Government to cut gas supplies to several state owned companies that were not paying It (Petrohemija, Azotara, MSK, Smederevo Steel Mill) as well as to municipal heating companies throughout Serbia. Also, Government forced Srbijagas to take over ownership in several major debtors, instead of pushing them to bankruptcy. For example, Srbijagas owned the largest chicken processor in Serbia, as well as fertilizer company and glass maker.

Beogradske elektrane

This is a company in charge of selling heating (hot water) to residential and commercial buyers in Belgrade.

	2010	2011	2012	2013	2014
Total Assets	27,014	28,929	32,029	29,103	32,695
Total Liabilities	20,653	23,902	25,850	22,585	21,418
Equity	5,132	3,802	4,953	5,037	6,492
Current Assets	5,939	7,573	10,160	7,492	11,851
Cash and cash equivalents	667	569	875	693	4,821
Current liabilities	20,653	23,902	25,850	22,585	21,103
Long-term debt	0	0	0	0	315
EBIT	554	-454	2,896	6,246	5,026
Net profit	-44	-1,317	798	440	5,002
Business activity cash flow	2,118	1,260	1,869	863	5,165
Investment activity cash flow	-2,206	-1,348	-1,562	-1,045	-663
Financial activity cash flow	-20	-10	0	0	-374
Net cash flow	-107	-98	306	-182	4,128
End of period cash	667	569	875	693	4,821

Of all the analyzed companies, this one seems to have the most stable situation – no growth and no deterioration. Total assets are mostly stable, just like total liabilities and total equity. Current liabilities are much higher than current assets, but liabilities are mostly stable, while current assets have increased somewhat. The company has no long term debt.

EBIT has increased significantly during this period, but profitability is very low. Business cash flow is consistently positive, while investment cash flow is always negative.

	2010	2011	2012	2013	2014
Current ratio	0.29	0.32	0.39	0.33	0.56
Quick ratio	0.03	0.02	0.03	0.03	0.23
Debt ratio	0.76	0.83	0.81	0.78	0.66
Long term debt ratio	0	0	0	0	0

Ratios are fairly stable. Current ratio has mostly been around 0.3 (jumped to above 0.5 in 2014), while quick ratio is about 0.03. These ratios are low, but it seems that the company has no trouble in financing. Debt ratio is around 0.8 but all of that are short term liabilities as the company does not have long term debt. In short, company seems to be in a fairly good financial situation, but it is unclear how much of their claims will they be able to eventually collect.

3. CORPORATE GOVERNANCE IN ENERGY SECTOR

There are several types of SOEs in Serbia, according to their legal status. Public enterprises (PE), whose work is regulated through the Law on Public Enterprises (the latest version from 2012) may be established by the state or municipality to perform activities of public interest. In most of the cases, public enterprises are utilities (electricity and transportation at the central level and garbage management, city public transportation, heating, water supply company etc. on the local level). PEs are controlled by their "founder", i.e. by government of Serbia or local assembly. Those institutions directly appoint supervisory board members (5 or 3) and directors (upon public competition), approve their annual work plans, and receive reports. There are around 730 PEs (mostly at the local level), with 130.000 employees. The largest energy companies (EPS, EMS, and Srbijagas) are all public enterprises.

Legal Framework

The Law on Public Enterprises defines most of company's obligations and responsibilities and in cases when PE Law does not cover some issue, it is covered by the general Company Law.

The Law states that PEs are established and they operate in order to "provide a permanent performance of public services and to satisfy adequately the needs of users of products and services", as well as to "develop and improve the performance of activities of general interest". According to law provisions, the government cannot directly interfere with day-to-day operation of the SOE. Also, PEs are not exempt from any general laws and regulations which apply to private sector companies (such as sector regulatory laws, accounting laws, etc.), except some state aid rules. According to the Regulation on Rules for State Aid Granting, "a business entity may be granted compensation for services of general economic interest" which will not be considered as state aid.

The government directly appoints members of supervisory board and director of SOE. According to The Law on Public Enterprises, supervisory board consists of four members proposed by the founder, one of them being „independent member", and one representative of employees. All members are supposed to have appropriate knowledge and skills within field of operation of public enterprise, and there are some additional requests for independent member – he or she may not to be related to the PE and must not be member of a political party. The Law envisages that members of supervisory boards are elected for a period of four years. They have to be experts in one or more areas of activities of public enterprise, to have at least three years' experience in a management position and possess expertise in finance, law and corporate governance.

Director is appointed by the government after public competition, conducted by government's Commission for Appointments. Commission makes short list with three candidates and proposes it to the Government, which can choose anyone or none from the list. However, there are no clear criteria on the basis of which the commission would make the final selection of the candidates who meet all prescribed requirements. Therefore, selection, removal and the method of evaluation of work of directors are still heavily politically dominated processes.

Laws envisage relatively high standards of transparency for companies, both private and state owned. There are some additional requirements for public enterprises, such as producing and publishing quarterly reports on the implementation of the annual business program.

The Law on Public Enterprises has a section dedicated to „work transparency“. It stipulates the obligations of PEs in terms of business transparency. PEs are required to publish on their website the approved annual business program and quarterly reports on the implementation of the annual business program, audited annual financial statements and the auditor's opinion on those statements, the composition and contacts of the supervisory board and director, as well as other issues of importance to the public.

SOEs are subject to the same accounting and auditing standards as private companies. SOEs are obliged by The Law on Accounting to submit their financial statement to Agency for Business Registries. The agency publishes this data on its website, in the Register of financial statements. There is no obligation for SOE to report on their eventual anti-corruption programs.

There is no strict legal framework regarding external monitoring of SOEs' performance. SOEs submit their quarterly reports on implementation of business program to ministry. On the basis of those reports, the ministry drafts and submits to the Government information on the degree of compliance of planned and implemented activities. No further procedure is defined.

The Law on Public Enterprises also envisages accountability of the supervisory board: the chairman and members of the board will be dismissed if the supervisory board fails to deliver annual business program to the founder, for approval, if the founder does not accept financial statements of public enterprise and if SB fails to take the necessary action before the competent authorities in case of suspicion that the director operated to the detriment of the PE. SB „may be“ dismissed if PE does not fulfill the annual business program or does not achieve key performance indicators.

There are numerous mechanisms which are supposed to ensure integrity of members of managing bodies at SOEs. Rules on conflict of interest are prescribed by the Company Law and by the Law on Anti-corruption Agency. Those rules apply to all public officials, and that includes representatives of state in shareholders assemblies, members of supervisory boards, executive boards and directors.

The law forbids SB members and directors to use company’s assets for their own purposes, or use the information they have obtained in their capacity, which is not otherwise publicly available, to abuse their position in company. They are obliged to inform the board of directors or supervisory board of the existence of personal interests in the transaction which the company concludes all in the legal actions undertaken by the company.

The Company Law envisages fine or imprisonment up to one year for violation of the duty to avoid conflict of interest, or up to five years if company suffered damage which exceeds RSD 10 million (USD 100.000). The Anti-corruption agency Law has conflict of interest rules

which include public official's duty to report such conflicts and to excuse him/herself from the decision making process. Conflict of interest is defined as a "situation where an official has a private interest which affects, may affect or may be perceived to affect actions of an official in discharge of office or official duty in a manner which compromises the public interest". Officials are also required to disclose their assets. Part of their assets report is public. However, the number of officials is huge (tens of thousand), so the Agency cannot be expected to carefully analyze all of them.

SOEs have a "double" role in public procurements. They have to implement public procurement rules, as any other public body. However, those competing on the market may effectively skip public procurement rules, when procuring for "further sale". On the other hand, SOE's may compete on public procurements with private companies, as bidders. In rare situations, PEs may be exclusive providers of some goods and services.

SOEs are forbidden to donate to political parties, in money or services. The Law on Financing Political Activities forbids financing political entities, amongst other forbidden funding sources, from public institutions, public enterprises, companies and entrepreneurs who perform services of general interest; institutions and enterprises with state capital; other organizations exercising public authority.

SOE Corporate Governance in Practice

It has been common practice to divide public enterprises between political parties after elections as part of the spoils. Members of supervisory boards and directors are usually party representatives. This politicization has led to the fact that losses are often accompanied by an increase in the number of employees and their salaries, funding various projects that have nothing to do with the work of the company, involving political interests in decision-making, overtaking ownership of failed companies, involvement in political-related sponsorship, and harmful contracts that are likely accompanied by corruption[1].

According to the Fiscal Council, the Government has supported some SOE's bad management decisions. This is illustrated by example of Srbijagas, SOE which tried to collect debt from another SOE, thus blocking its bank accounts. The energy minister reacted promptly, ordering Srbijagas to withdraw the order for payment, saying that "obligations towards the State must be paid, but they also need to make clear criteria by which to deal with debtors[2]". This is clearly example of favoring SOE (as a debtor) over other debtors – citizens or private companies. The Government has also insisted on low prices of SOE's services in order to buy "social peace" (with consequential losses and debts of public enterprises).

Furthermore, provisions of The Law on Public Enterprises were breached on numerous occasions by the Government, especially regarding election of supervisory boards and

[1] http://www.fiskalnisavet.rs/images/izvestaji/analiza_drzavnih_preduzeca-fiskalni_aspekt.pdf
[2] http://www.novosti.rs/vesti/naslovna/ekonomija/aktuelno.239.html:479469-Mihajlovic-Blokiranjem-Zelezare-Srbijagas-nece-resiti-svoje-probleme

directors[3]. The Law came into force on December 25th 2012, and four months later, on April 5th 2013, the Government appointed the president and members of the managing board of PE 'Posta Srbije' based on the provisions of the invalid, previous, Law on public enterprises. Among the appointed members of the managing board were four representatives of the ruling coalition parties - a political scientist (also a member of the parliament); an economist, an agricultural engineer; and a mathematician. Similar appointments were made after the new Law entered into force in several other SOEs (EPS March 2013, EMS March 2013, Srbijagas March 2013). The only difference was that members of supervisory boards (instead of managing boards, as prescribed by the previous law) were elected in a procedure prescribed by the new law.

According to research by Transparency Serbia, there are numerous examples of members of the Supervisory Boards' vocations not being related in any way with SOEs' field of work: for example, a special education teacher (party official and mayor of town of Kladovo) being a member of SB in an SOE in charge of water systems, another special education teacher being a member of a mining SOE's SB, professor of comparative legal traditions and rhetoric at the Faculty of Law being a member of SB in Post Serbia or a philologist of modern languages, being a member of SB in National park SOE.

The situation is the same regarding election of directors in SOEs. Although the law requires public competition to be organized for directors of all Public Enterprises, competition was never announced in 6 out of 35 PEs, and it was done within the deadline in 4 PEs only. Until the end of 2014, only two public competitions were closed and directors had been elected – both of them were acting directors prior to election, appointed by the government. In those PE-s in which public competitions were not announced, directors are party officials, one of them president of party, member of ruling coalition (in Serbian Post Office), the other vice-president of another ruling party (in Srbijagas).

Web site Pistaljka (Whistleblower) published[4] research on PEs' transparency, quoting Ministry of Energy that competition for one of the PEs was not announced „because director was appointed on the bases of previous Law on Public Enterprises, in accordance with coalition agreement, as representative of Socialist Party". Research by this website also revealed examples of conflict of interest – government appointing, as representative of state capital, a person which was member of the supervisory board in the same SOE[5]. In addition, there is an ongoing practice to keep CEOs in the "acting" status for much longer than a legal limit of one year.

There is some, but not sufficient transparency in SOEs in practice. SOEs in most cases fail to fulfill all of their obligations regarding transparency, prescribed by The Law on Public Enterprises. SOEs also occasionally fail to fulfill obligations regarding free access to information of public interest.

[3] http://www.transparentnost.org.rs/index.php/en/activities/tekui-projekti/effects-of-the-new-law-on-public-enterprises-politicization-or-professionalization
[4] http://pistaljka.rs/public/banners/javna-preduzeca.pdf
[5] http://pistaljka.rs/home/read/468

Research done by Transparency Serbia, showed that none of 25 PEs included in monitoring sample fully complied with requirements set by the Law on Public Enterprises. In most cases there were no business programs on PEs' web sites, and quarterly reports or financial statements were also often missing. In one case PE had on its website, out of all prescribed data, only the name and contact of acting director[6] The available data was simply not enough to get insight on functioning of SOEs, its SB and director. There are no descriptive annual business reports, which would help to identify what actions, envisaged by the annual plan, were completed. Both quarterly and annual reports consist mainly of tables with numerical data. Therefore, the information that reach the public are very limited, which can increased incentives for corrupt behavior.

Fiscal Council warned in its report on SOEs that transparency of the SOEs must be increased[7]. Reporting on business plans is limited to the annual plans, and it usually lacks clear objectives and operational performance indicators. Business plans are adopted with a delay, sometimes even at the end of the year. Little or no attention is paid to the evaluation of the achieved results. In addition, some companies ignore legal obligation to publicly present the business plans and financial statements or do it with unacceptable (multi-year) lag. Fiscal Council considers that public (in future) must be informed detailed, accurate and timely of the operations of state-owned enterprises.

Supervisory boards formally carry out most of the duties prescribed by the law. The effect of their work is, however, questionable. Even annual plans have been adopted in most of SOEs with large delay. Research done by Transparency Serbia, showed that in some instances Government gave consent for annual plans at the end of the year, and in one case annual plan for 2013 was adopted at the beginning of 2014. On several occasions, when irregularities in the work of SOEs' directors were revealed, it turned out that supervisory board failed to notice any problems. For example in "Resavica" SOE, in which the director was arrested and charged for corruption there was no question raised about accountability of the supervisory board.

One of the main reasons for SBs not being able to perform their duty is the fact that in numerous PEs skills of SB members are questionable. As research performed by Transparency Serbia showed, some SB members do not fulfill conditions prescribed by the law – to have knowledge and expertise within the scope of operation of the PE. It was not possible to determine in which way the government determined if SB members have appropriate skills, since government did not respond to FOI request and hadn't delivered information. Local authorities presumed by education that persons with degrees from faculties within field of work of PEs have skills needed for SBs. So, in reality, Supervisor Boards have become advisory boards of the CEO. If CEO is politically more powerful than SB, he can in many cases simply ignore the SB.

The integrity of SOEs is not ensured in practice. As SOEs are controlled by political parties, there are suspicious that they are used for drawing out money for financing of political

[6] http://www.transparentnost.org.rs/index.php/en/activities/tekui-projekti/effects-of-the-new-law-on-public-enterprises-politicization-or-professionalization

[7] http://www.fiskalnisavet.rs/images/izvestaji/analiza_drzavnih_preduzeca-fiskalni_aspekt.pdf

parties and managing bodies often merely transmit political will without having the possibility to make decision on business level by them.

Current management in energy SOEs

All three largest energy SOEs (EPS, EMS and Srbijagas) are run by political appointees, who are either high ranking officials or ruling parties, or are closely personally related to party leadership.

Aleksandar Obradovic, CEO of EPS, is a member of the ruling party (Serbian Progressive Party) and was, until appointment, the head of party's Energy Committee. He has a bachelor's degree in economics and an MBA from the University of Pittsburg. He has energy sector experience, having worked for the Czech electricity company "ČEZ" and was working on many company restructuring projects as a consultant. He has been an acting CEO since 2012, only elected to be a "proper" CEO in late 2014.

Regarding the Supervisory Board, it is currently headed by the former Dean of Faculty of Electrical Engineering and Rector of the Belgrade University. CVs of Supervisory Board members are not available on EPS web site. This Board was elected in 2014, after the previous Board was disbanded by the Government. There was no explanation for this government's decision. Informally, SB was replaced because the President of SB did not approve strategic plans of the director, but political party which stood behind director was more powerful than one which supported head of SB[8].

Dusan Bajatovic, CEO of Srbijagas is a vice president of the second largest party in the Government (Socialist Party of Serbia). He has been a CEO since 2008, when SPS entered the previous government and was reelected by the new government. He has degrees in economics and engineering. In addition to being a CEO, he is also a Member of Parliament. In summary, Bajatovic is a career politician.

Nikola Petrovic, CEO of EMS is a close friend of the Prime Minister (he was the best man at PM's wedding, and PM is a godfather to his child). According to him, he met current PM when they were much younger, on a basketball court. His CV is not publicly available and one opposition party made a public information request to the Government's General Secretariat asking for his CV. Their request was denied, under the excuse that "the release of CV would violate privacy protection". According to this opposition party, Mr. Petrovic is not eligible for the position of EMS CEO, as he does not have a university degree. So, both his formal credentials and work experience are dubious.

CEO of NIS is Kiril Kravchenko, who is appointed by the majority of shareholders. The Government has appointed, among others, former minister of agriculture (Goran Knezevic) and a wife of the leader of a party that is in the coalition government (Danica Draskovic).

4. WORK OF PUBLIC CONTROL AND COMPLIANCE BODIES

[8] http://www.danas.rs/danasrs/ekonomija/naprednjaci_istiskuju_sps_iz_epsa.4.html?news_id=292851

We will analyze the work of the Energy Regulator, Competition Commission, State Audit Institution, Anticorruption Agency and Commissioner for Public Access to Information.

Energy Law from 2014 has reaffirmed the role of the *Energy Agency* of the Republic of Serbia (which was established in 2005). Its roles are to: 1) regulate prices; 2) issue licenses to energy companies; 3) decide in appeal process, 4) supervise the energy market and 5) implement international agreements. Energy Agency is therefore mostly in charge of ex ante market regulation as its approval is required to change all the main prices. Agency has adopted necessary methodologies, and their work is mostly transparent. However, there are concerns that they are too closely related to both the Ministry of Energy and main electricity and natural gas companies. For example one of the measures that the Government agreed to under the recent program with the International Monetary Fund was to increase transportation fee charged by Srbijagas, so that Srbijagas would have more resources to pay off the debt. However, this decision is neither in the mandate of the Government, nor Srbijagas, but actually requires the decision from the Regulator. Regulator was pressured by the Government into allowing this price increase although it is, according to one interviewed lawyer, clearly excessive and not in line with Law and EU regulations. Namely, Srbijagas is allowed to charge unreasonably high price in order to partially recoup the losses it made in the period of 2008-2014.

Similarly, the Government took the responsibility to the IMF to increase price of electricity, although the price is not regulated by the Government, or (government controlled) EPS. Regulator allowed price increase, but in this case it was justified. However, the general public witnessed months long debate in the public when will the government allow the price increase and what the increase will be, strongly undermining the authority of the Regulator.

Competition Commission is authorized to prevent (and sanction) abuses of the dominant and monopoly position, as well as to ex ante authorize restrictive agreements. However, their authority is very limited in cases when the laws (or other regulations) are anti-competitive or when industry (such as energy) is heavily regulated. We were able to find only one instance when they directly dealt with the large energy subjects – it was in 2011 when they reacted to a statement from Srbijagas that they were willing to provide gas at lower prices to three state owned companies (Petrohemija, Azotara and MSK). In that case, the Commission issued a warning to Srbijagas, saying that Srbijagas has an obligation to provide gas at same terms and conditions to all its clients, especially as a dominant market player.

Competition Commission also prepared the Sector Analysis of the Oil and Oil Derivatives Market for 2013. Among other things, they have found that:

1) Transparency of business records and allocation of joint costs in vertically integrated systems is very low. They need to improve the transparency of allocating costs among business activities and regarding transfer prices in order to allow better monitoring of potential abuses of competition.

2) Legal requirements regarding the minimum technical conditions for energy licenses present significant barriers to entry and impose unnecessary costs for existing companies. However, as these are prescribed by the Government, the Commission can only advise Government to revise the rules.

3) Commission also thinks that regulatory regime should be more stable and that frequent changes of the very bad for the market. "The Practice of frequent changes of rules and replacement of existing barriers with new ones is unacceptable both from the point of view of protection of competition and from the point of view of legal certainty, not only for the existing players, but also for potential entrants."

The main role of *Anti-corruption Agency* in relation to SOEs is to keep a registry of public officials, including all state representatives in SOEs managing bodies, and to file charges for violation of the law – such as not reporting assets or deliberate hiding of information about assets. According to data published on website of the Agency, from January 2013 till October 2014, there were 67 procedures against directors or supervisory board members of all SOEs. Most of them (63) were for failing or being late to report assets at the beginning of the term or after leaving office. There were, however, four criminal charges for "failing to report property to the Agency or giving false information about the property, with an intention of concealing facts about property". These processes are still ongoing.

State Audit Institution has also discovered numerous irregularities, but directors and members of supervisory boards were so far not held accountable. According to research by "Nova ekonomija" magazine[9], SAI did an audit of 53 PEs since 2010 until beginning of 2014 (another 45 were published until the end of 2014) and found "a long list of laws which were violated - the most common non-compliance was with the Law on Accounting and Auditing and practices contrary to international accounting standards, violation of the Law on Public Procurement and the Law on Public Enterprises". There was not a single case in which SAI could give a positive opinion, in other words, it could not confirm what was stated in the financial statements of PEs.

State owned companies also lack transparency in the field of free access to information of public interest. According to **Commissioner for public information's** 2014 annual report[10], 12% of all appeals filed to Commissioner were against SOEs (447 out of 3.929 appeals) for not providing requested documents or information. Commissioner was quoted saying that "public enterprises are amongst those which hide information from public"[11]. Also, out of total of 225 decisions by the Commissioner which were not implemented, about 33% is related to SOEs.

The report also lists all the cases when institutions failed to act in accordance with the Law. For example, Srbijagas did not provide the following information to various parties: a) information on forced debt collection and selected private enforcement companies, b) information on public procurements and financial plans for 2012 and 2013; c) information on 50 larges buyers of natural gas in Serbia: d) copies of contracts with PR and marketing

[9] http://javnapreduzeca.rs/06_kako_se_u_javnim_preduzecima_zakoni_krse_bez_posledica.php
[10] http://www.poverenik.rs/sr/o-nama/godisnji-izvestaji/1772-izvestaj-poverenika-za-2013-godinu.html
[11] http://www.blic.rs/Vesti/Drustvo/469758/Sabic-Drzavna-preduzeca-najvise-kriju-informacije

agencies, as well as expenditures on sponsorships and donations; e) monthly payment of the president of the Supervisory Board; f) contract with Gazprom Germany. In addition, research by Balkan Investigative Reporters Network (BIRN)[12], on spending of SOEs for sponsorships and donations, published in October 2014, was hampered because some SOEs would not deliver requested information (among them Srbijagas), directly violating The Law.

5. NEW ENERGY FACILITIES

During the last decade there hasn't been the construction of new large power capacities in Serbia. The last significant investments were made in the 1980s, before the breakup of Yugoslavia and the events that followed it. Production of electricity and petroleum products was still largely satisfying domestic needs because, gross domestic product decreased, especially industrial production, in the meantime and because Serbia had a favorable energy balance even in the former Yugoslavia.

In recent years the fundamental reconstruction of some old capacities started, as well as construction of new ones. It is important to note that the bulk of the investments were undertaken in accordance with the bilateral government arrangements with Russia and China. Even this procedure was a legal one in the Serbian legal system, this arrangement has circumvented the Law on public procurement and partners were chosen, together with all the relevant terms of contracts, through direct negotiations with partners from both countries. However, direct negotiations, in the absence of competitive bidding, may leave doubt in the fairness of the procedures, i.e. the existence of opportunities and motivation for corruption. However, these arrangements are not seen in Serbia as especially risky for corruption, and there weren't serious accusations in this regard. Because, it is obvious that the arrangement with Russia carrying out economic and strong political motives, while the arrangement with China represented part of the policy of its penetration strategy in Europe on the basis of favorable financial conditions. Since contracts were negotiated at the highest political level, it is unlikely that there was a need for bribery to get the deal.

Below we'll show recent reconstruction of existing facilities and construction or preparation for construction of some new ones.

Reconstruction of refining capacity in NIS

Oil Industry of Serbia (hereinafter NIS) had two obsolete oil refineries when in 2008 ceased to be a state-owned company and became a joint stock company owned by Gazprom Neft and the Republic of Serbia. NIS provides about half of its crude oil from its own oil fields in Serbia.

In accordance with the obligation under the contract of sale of NIS, Gazpromneft soon began a thorough reconstruction of the refinery in Pancevo, whose first phase, with an

[12] http://javno.rs/istrazivanja/krave-muzare-svake-vlasti

investment of about 540 million euros, was completed in autumn 2012. The reconstruction was organized by the NIS. The second phase of modernization of the refinery is under way. So far there were no signs of major corruption or public allegation for corruption, which is probably normal considering that the tasks of reconstruction was organizationally managed and funded by the NIS.

The planned reconstruction of refinery in Novi Sad and announced transformation into a base oil producer has not yet started, probably because of the conditions of the oil industry in the world. For now unprofitable production of oil derivatives ceased to exist, but there is production of lubricants and technical liquids.

However, one case of petty corruption became public: at the end of 2013, after a report by the NIS, several Russian and Serbian nationals were arrested on charges of fixing several NIS tenders. It has, apparently, consisted in submitting information on tenders (how much is NIS is willing to pay, what are offers of other companies) by Russian nationals working in the NIS to representative of one Serbian company. In this way, this company won several tenders of total worth of 23 million EUR. Earnings of arrested Russians were reportedly 303 thousand euros. But now comes the interesting turn of events: mother tongue of one of the arrested is Punjabi and he, according to Serbian law, has the right to a trial in that language. However, for a long time the judge was unable to find a qualified interpreter and is unable to open a court trial.

NIS is seriously preparing for incursion in the production of electricity with gas power plant in Pancevo and coal plant in Kovin.

TE Kostolac

Based on the framework Sino-Serbian interstate arrangements from 2008, agreements on the revitalization of blocks B1 and B2 power plant Kostolac, came into force in early 2012, as well as for the construction of the railway from the port on the Danube of 22 km and some operations totaling 355 million euros, of which The Chinese loan is 293 million (85%) and the remainder represents a Serbian share. Chinese company CMEC took on the job with generators and other equipment and Serbian partners are building the railroad and, later, a port. Both revitalizations have been completed and the capacity of these two blocks significantly increased and reached 750 MW.

After lengthy negotiations, at the end of 2013 an agreement was signed on construction of block B3 Kostolac, brand new thermal power plant of 350 MW, the first in Serbia after three decades. The contract includes the expansion of the capacity of the nearby Drmno surface coal mine from 9 to 12 million tons per year. The loan of Chinese Exim Bank Serbia for the majority financing power plants was signed in late 2014. As with the revitalization of blocks B1 and B2, a leading contractor is Chinese company CMEC. The contract is worth 715.6 million dollars, of which the Chinese loan 608.3, and the Serbian portion of the remaining 107 million. Chinese loan has a twenty years term, of which seven-year grace period and an interest rate of 2.5% per year plus 0.5% for costs.

Some media speculated that the Director General of EPS Obradovic is opposed to such a contract, but he denied it.

The main public objections for these investments were:

- lack of transparency of the decision: the parliamentary session was scheduled only 24 hours in advance and without a public hearing of interested parties,

- the absence of a feasibility study with justification; It was mentioned only while adopting a law in parliament, but it is not available for public inspection, nor International Transparency Serbia could see it, despite several requests to the state bodies,

- environmental side, due to further reliance on thermal power plants, especially on low-calorie lignite whom Serbia has in large quantities; representatives of EPS responded that EPS, with the help of the EU, followed all emission and other environmental standards.

TENT Obrenovac

Power plant Nikola Tesla (TENT) is by far the largest producer of electricity in Serbia, with the participation of more than one half of the total. During 2014 reconstruction of the blocks A1 and A3 was completed, both from the point of increasing capacity, production efficiency, and environmental protection. Funding is a significant part came from the European Union (in particular the EBRD) and Japan's preferential loans, who were supervising the tender procedures.

For TENT B3 block, with planned capacity of 375 MW, the tender was announced even in 2011, but without success. Now there are rumors about involvement of a Chinese firm through interstate arrangement. Block B4 (also 375 MW) is planned and included in the Energy development strategy of Serbia, but is waiting in the line.

TE Kolubara is smaller power plant of 245 MW. It is planned to increase the capacity of two blocks of 350 MW. In 2011 the EPS signed a preliminary agreement with Italy's company Edison, according to which because of significant earlier investments EPS was set to achieve an ownership stake of 36%. This could be the first private sector involvement in the energy sector of Serbia. But the contract is not signed yet, and it seems that the EBRD has blocked the deal because of the pressure from advocates of environmental protection: they changed attitude toward the coal thermal plants and that it is difficult to expect its participation in co-financing this project (planned loan of 400 million). [13]

Solar Power

The solar potential of Serbia came to the public stage at the end of 2011 when the

[13] EBRD's participation was hampered by the incident in 2011 with the forced and badly executed moving of the local cemetery with above large new lignite fields in Vreoci.

representatives of "Securum Equity Partners" came to Belgrade and announced the construction of a large solar park of up to 1,000 MW, by far the largest in the world! After several signed memorandums of understanding, very handy for marketing and presentation of the Government on TV, in the autumn of 2012 a contract was signed about this investment worth 1.7 billion euros. Many in Serbia were skeptical, due to gigantic project and the fact that the investor has been recently established and unknown firm with strange ownership structure and unknown leaders, who wasn't able to provide a bank guarantee. Representatives of the Government and *Securum Equity Partners* argued that it is quite realistic to expect such a large solar project in Serbia.

But in the spring of 2013 it became clear that to the realization of the project will not come and in August the same year the contract was terminated. "Securum Equity Partners' claimed that they were not offered a suitable location for needed 3,000 ha, but the Ministry of Energy said that they offered 30,000 ha, but that the investor apparently had no intention of an investment. The company announced that, due to non-fulfillment of contractual obligations of Serbia, it will seek the damage of 160 million before international arbitration, which did not happen.

It seems to us that the Securum had come to Serbia without intending to build a solar park, but only to seek reparation through a skillfully composed contract. To this purpose in the contract was inserted a provision that Securum will communicate the technical requirements for the location only after the signing of the agreement. Then they delivered hardly achievable technical requirements and accepted just 175 ha out of total 30,000 ha. In such a manner Securum so tried to present the Serbian government as the culprit for the failure and to the collection compensation damages.

On the other hand, it seems that the Government of Serbia naively went into the business. But probable cause is corruption in one form or another. If there was no bribery of the senior officials of the Government, one can be sure it was contracting the solar park for marketing purposes at the time immediately before parliamentary and presidential elections in 2012, which again is corruption - abuse of state for political party interests. A former finance minister (who signed the contract) was known for collecting rating points through extensive marketing of foreign investments, usually supported by large sums of money from the budget of Serbia.

Wind farms

Construction of wind farms is very present in the public in Serbia in recent years, both because of international obligations of Serbia to increase the share of renewable sources in electricity production, and because of several years of advertising announcements that, here, begins the large number of serious projects. But so far none is initiated, nor does Serbia produce any amount of electricity from wind. Several planned projects received a building permit, but that is not enough because it does not provide access to electricity and does not contain the most important thing - the contract on purchase of electric power bills by EPS (PPA Power Purchase Agreement).

Plandište. NIS, otherwise oil company, bought the project (plans and building permit) for the

plant Plandište, with a capacity of 102 MW. Although Prime Minister Vucic personally marked the beginning of construction work in 2013, there is no doubt that it was just a TV cornerstone, but “works” were immediately suspended.

In 2015, NIS signed a memorandum with a Chinese company for the delivery of Goldwind turbines, with an expected loan of Chinese Exim Bank of $ 225 million. There are rumors of possible entry of Chinese company CEE in the wind farm business, with an ownership stake.

MK Fintel Wind. This Italian-Serbian company started in the spring of 2015 work on a small wind farm in Kula and prepares wind farms Veliko Gradiste (also small) and slightly higher in Vrsac with 117 MW (building permit obtained). Currently it is not known whether this company has all the necessary paperwork for the wind farms, including a contract for the purchase of electricity (PPA), or, with considerable risk, began construction believing announcements of the ministry about the recent adoption of favorable secondary legislation.

Čibuk (Kovin). The project was launched by the American company Continental Wind Partners, run by a married couple where the wife (Lydia Udovicki) is a sister of Deputy Prime Minister of Serbia. The planned capacity is 158 MW and an investment of 160 million euros. After many years of preparation, which include a construction permit, implementation of the project has not yet started because of the missing PAA contract. This project was became the largest corruption scandals in Serbia, and its end is not yet in sight. For a description of the affair see section 6.

Problems with the regulations for new power capacity

Regulatory instability. The big problem for potential investors and raising new capacities is obvious instability of the energy regulation: for three years have been passed two completely new laws on energy (2011 and 2014) and several changes in between which are substantially changing business conditions and thus enter the business uncertainty that is undoubtedly very unfavorable to undertake long-term investments, such as those in the energy sector, especially the electric power industry.

An extremely important bylaw - the model contract on purchase of electricity (i.e., PPA, or Power Purchase Agreement) – has a very short existence recently, the half year: between July 2014, when it was adopted, and in December 2014, when it ceased to be because of adoption of the new law. On the new model PPA the Ministry, of course, is working hard for eleven months (as off November 2015). A PPA should address the crucial issues for producers, such as the start of production, delivery conditions, payment mechanisms, procedures in case of force majeure, termination of contracts and the like. The absence of PPA model is certainly not a favorable environment for investment in Serbia. However, potential investors in renewable sources are generally satisfied with statutory improvements and hope that the new model will accept more of their suggestions.

Model PPA should in principle apply to all private investors, but only to a certain extent: the existing incentive mechanism (the Regulation on Incentives for privileged energy) provides for the possibility of exceptions and departures from the general PPA agreement with the

approval of the Ministry of Energy without any restrictions. This possibility should not exist because it directly facilitates corruption. Therefore, in order to protect the government from any suspicions and deeds of its officials, this provision should be abolished in further innovation of by-laws. In fact, although flexibility may be useful in certain situations, in the early stages of development of private investment in the energy sector in Serbia it is still better to have regulation without discretionary decisions than risk the corruption scandals.

Corruption affair: Wind farm Čibuk

This wind farm is planned at 158 MW and with the costs of 160 million euros. Investors, American company Continental Wind Partners, are led by a married couple where the wife (Lidija Udovički) is a sister of Deputy Prime Minister of Serbia. In September 2015, a scandal broke.

First, during the visit of Serbian Prime Minister to Washington in September 2015, a group of US congressmen sent a letter to Vice President Biden, the prime minister's host; The letter, among other things, states: “We are concerned by reports that a small group of people led by Vucic’s brother, Andrej Vucic, and two of his close friends, Nikola Petrovic and Zoran Korac, has consolidated their influence and interest in energy, telecommunications, infrastructure and all major businesses in Serbia”. Nikola Petrović was the best man and man of confidence of Prime Minister Vučić and General Manager of Electric Power Grid of Serbia, charged with issuing permits for connecting wind farms and other producers of electricity to the national grid. The Prime Minister dismissed the remarks and accused "racketeers from Serbia", led by a relative of a member of the Government (an obvious allusion to Lidija Udovički), for the organization of this letter. The vast majority of the media (controlled or influenced by the government) did not reproduced the Congressmen’s’ letter, but did Vucic`s strong reaction and similar statements by the minister of police and other officials.

Secondly, soon after, also in September 2015, one opposition website published a transcript of the alleged telephone conversation between the president of the strongest opposition party (the Democratic Party) and the Prime Minister of Vojvodina (province in Serbia) Bojan Pajtić and Lidija Udovički in which she claims that Nikola Petrovic asked her for two million euros for permission to connect to the national power grid. Later Pajtić confirmed that the conversation took place in 2014 and asked who recorded his telephone conversations, while Udovički refused to enter a plea (presumably in the interests of the company). The Minister of Police claimed that the scandal is invented to offend the Prime Minister and will conduct an investigation. Several media controlled by the government campaigned against Pajtić and Udovički, but at the social web networks dominated criticism of the government. It is interesting that Vučić himself is not seriously involved in the debate, and said that he would wait until the national investigating authorities do their job. Deputy Prime Minister Kori Udovički has remained in place. The affair is not over yet.

Confidentiality agreements. During the latest decade there is an obvious tendency of Serbian governments (regardless of the political coalition) to hide from the public the contents of most of its contracts concluded with foreign states or foreign private companies when it comes to economic agreements (investments, works). Sometimes it does not publish the entire contract, and sometimes his sensitive parts. In prior years, the stated reason for not publishing allegedly was a request of governments' partners, while recently was used another technology: a state body (the Competition Commission or the Attorney General) approved the secrecy of the particular contract and thus provides a quasi-legal basis for hiding a contract or parts of contract from the public. The latest case from 2015 refers to the Smederevo steel mill (in losses), for which the Government of Serbia has signed a management contract with a foreign company: the Commission for Protection of Competition (sic) approved, with reference to the protection of the interests of Serbia, that the whole contract remain secret. Experience shows that the basic motive to confidentiality was concealment of benefits given to a foreign partner at the expense of Serbia. These benefits can be interpreted as a natural incentive to foreign investment, but also as an expression of corruption, i.e., giving unjustified privileges to the investor after secret deals.

So far, the only agreement between the Serbian government and its public enterprises and foreign companies was concluded between EPS and Kostolac, on one hand, and the Chinese company CMEC, on the other hand, for the building blocks in Kostolac B3 November 2013. It was followed by a loan agreement EXIM Bank in December 2014.

According to established practice, the contract on the construction of Kostolac is not known to the public, except for elementary things (construction of TPP, capacity, date of completion, price). So, analysis of the legal and economic provisions is not possible, and therefore no assessment of the feasibility of investments, possible corruption and protecting the interests of Serbia. Loan Agreement with Chinese EXIM Bank is known to the public only because it had to be ratified in the Serbian parliament, since the borrower Republic of Serbia, not EPS.

High feed-in tariffs and limit. The current system of support for development of renewable power industry is based on the favorable purchase (feed-in) prices and the maximum amount of installed capacity by type (for example, 500 MW of wind farms by 2020). The feed-in price is double of the regular price from thermal and large hydro plants.

It is an undeniable fact that the price of electricity from some renewable energy sources (wind, solar) quite rapidly decline thanks to technological advances, but the dilemma of whether they are already virtually equal or are still higher than those of "ordinary" electricity. Contrary to the claims of equal status, one serious recent study concluded that the price of wind farms in the United States rose by 48% from the price of the previous estimates, due to inclusion of various hidden costs.[14]

Anyway, technological progress gives the possibility for investors to expect high profits; it

[14] Randy T Simmons, Ryan M. Yonk, Megan E. Hansen: *The true cost of energy: wind*, Strata & Utah University, July 2015, str. 36.

can be said extra profit. In fact, while the state regulator stipulates preferential prices by looking at historical trends, successful investor, projecting future trends, know that the costs will be lower and profits higher. Based on these projections he is very interested in investing, as evidenced by the considerable interest in the Serbian renewable sources (especially wind) in recent years. On the other hand, existing limits prevent all interested parties to participate in an incentive scheme and then we have the space for corruption. While it would be normal for investors to be approved in an incentive scheme in order of registration (first-come, first-served), it is easy to imagine the wide possibilities for administrative authority to influence the sequence according to their own favorites, including the possibility of bribery. In other words, the current preferentially system (favorable prices plus limits) allows and even encourages corruption.

Ownership of connection to the network. An important issue when investing in the electricity supply concerns the ownership of the connector between production electricity plants to the national grid. According to the current interpretation, this port, including substation, belongs to the EMS, and regardless of who paid for his pitching (private investor in an electricity or manufacturing plant or just a public company) and no matter where it is (and can be located in the courtyard of the manufacturing plant). Such a system is not only an unusual and discourage investments, but also represents a fertile ground for corruption: EMS or its local branch can, if they want, to build the substation instead of investors, justifying the action with their own needs, with a bribe to the one who decides.[15]

6. PUBLIC PROCUREMENT

Public procurement regulation

Public Procurement Law

Public Procurement Law has been a subject of frequent revisions over the last several years. The most recent Law was adopted in 2012 and the implementation started in 2013. It was revised twice in 2015 (once for a marginal issue and the second time the changes were much more comprehensive).

The 2013 Law represented a significant change compared to the previous Law (adopted in 2009) as it tried (and, arguably, succeeded) in increasing transparency, improving the planning procedures, simplifying the way of proving mandatory requirement for participation in public procurement, envisaging establishment of a single bidder registry and the obligation of registering and monitoring the implementation and amendments to public procurement contracts, as well as regulating the implementation of centralized public procurements. Also, the mandates of Public Procurement Office and Republican Commission for Protection of Rights in Public Procurement have been changed.

The Law defines “Procurers” as two types of entities:

1. All state institutions (at central, provincial and local level),

[15] We know one such a case in private life.

2. All legal entities established with the purpose of satisfying general interest needs, which do not have industrial or trade character, if one of the following criteria is met:
    - It is financed by more than 50% from a "Procurer's "income,
    - Supervision over the operations is done by a "Procurer",
    - More than half members of supervisory boards or other management bodies are named by the Procurer.

So, all legal entities in which Government bodies have a controlling stake or effectively control the entity, are "Procurers", except in cases where these entities are established for industrial or trade purposes. Also, public procurements in the area of water supply industry, energy, transportation and postal services are regulated by the Law, and that same Law envisages that the Government has an obligation to annually publish the list of procurers. Regarding energy, the Law says that "energy sector" includes only the following activities:

1) Exploration and drilling of oil and gas as well as exploitation of coal
2) Construction and management of facilities and networks for production, transportation or distribution of electricity, gas and heating
3) Supplying these networks with electricity, gas and heat.

Corruption case: Kolubara Coal Mine

In early 2011, an investigation was launched into alleged corruption scandals of former management of coal mine Kolubara (the largest state mine within the Serbian Electric Power Company) from the 2004-2008 period. Several persons were arrested, led by directors. Two affairs were mentioned, both related to the operations with the privately owned firms. According to the first, there were irregularities in the sale of scrap iron. Total value was small. The trial was held, and the accused Dragan Tomic, a former mine manager, was acquitted.

A second indictment against Tomic includes 12 former Kolubara executives and 16 owners of private companies that worked with Kolubara. According to this indictment, Tomic allegedly paid private companies for unnecessary lease of mining equipment and services. Kolubara was overcharged for the number of hours put in by the private companies, and Kolubara executives did not follow public procurement procedure. Total damage was assessed at 8,4 million euros. This indictment was issued in early 2012 and amended indictment was issued in early 2015. The allegations were based on the report of the Anti-Corruption Council which showed discrepancies in the quantities of electricity imported and exported by EPS from 2010 to 2012. The trial is still pending.

In principle, it seems that the regulatory framework is adequate. EU's most recent progress report stated that "Serbia is moderately prepared in this area" and also that "Good progress has been made in the past year, notably by adopting amendments to the Law on Public Procurement and increasingly using open tender procedures", but also that "Significant

efforts are needed across the board to improve competition, efficiency and transparency in public tenders."

Institutions

The main regulatory/controlling institutions are Public Procurement Office, Republican Commission for Protection of Rights in Public Procurement and State Audit Institution.

Public Procurement Office is in charge of monitoring the implementation of the PP Law. Among other things, it maintains the PP Portal, prepares reports, provides advices to both procurers and bidders and adopts some bylaws.

One of important recent changes was that all tenders, as well as all tender documents, have to be published on the Public Procurement Portal by all procurers in all types of procurements, including procurements of small value. Also the Law has introduced mandatory terminology and publication of many relevant information (such as data on changes and implementation of the contract, negative references, quarterly reports by the procurer…). The access to the Portal is free and it is managed by the Public Procurement Office.

Republican Commission for Protection of Rights in Public Procurement is an independent body in charge of protecting bidder's rights. Also, they decide on PP appeals, follow the implementation and execution of their previous decisions, have the right to annul the public procurement contract, to penalize procurers and persons responsible for the procurerement. In the first half of 2014 there were 1,422 complaints, claims, lawsuits, etc. submitted to the Commission. The Commission decided in 1282 cases: 224 procurement procedure decisions were completely annulled, 393 public procurement procedures were partially annulled, and 236 requests were rejected. It is not known how many cases are still pending, or what the total backlog is.[16]

7This committee has a very important role in the procurement process. Since it decides on disputes in cases which include the interpretation of complex regulations or unclear legal situations, it represents potentially a serious barrier for corruption, but on the other hand, it can also be corrupted.

The State Audit Institution is the highest institution responsible for auditing of public resources spending. Among other things, they can also audit spending of public resources in public procurements.

Latest EU Progress Report says that "In the coming year, Serbia should in particular: 1) strengthen the capacity of the Public Procurement Office and the Republic Commission for the Protection of Rights in Public Procedures; 2) swiftly implement the public procurement strategy in particular on ensuring the sound implementation of existing legislation and on further alignment with the EU Concessions Directive.

[16] *The Report of the Republican Commission for January – June 2014 (the last published report)* http://www.kjn.gov.rs/sw4i/download/files/cms/attach?id=119.

In general, we may say that the Law is mostly good, but that there are many problems in its implementation.

Centralized public procurement

The Law on Public Procurement provides the possibility of centralized procurements in the public sector, whether it is obligatory under special legislation, or voluntary for individual sectors or segments of Government. Thus, centralized procurements are mostly used for providing consumer goods for the Republican administration, procurements for medical and scientific organizations at the national level, or procurements for the Belgrade municipal administration, etc.

Corruption affair: Resavica coal mines

On January 27, 2015 Vladan Milošević, the general director of the public company Resavica which operates nine underground coal mines in Serbia has been arrested on the charge of corruption. In a statement, Serbia's Minister of Internal Affairs Nebojša Stefanović said that Milošević, a high-level member of the ruling SNS party, was caught with a bribe of 14,000 euros of marked money delivered by a local transportation supplier of Resavica. The handover has been filmed by the police. Resavica is a long-term loss-making enterprise, but with plans to heavily invest in developing few of its coal mines (Štavalj, Soko, Poljana) and even building thermo power plants near Sjenica, Despotovac and Kovin with a help of Czech, Russian and Chinese partners.

The basic idea behind this concept is lower prices when procurement is conducted for a large number of public sector institutions jointly and reduced corruption in single institutions. So far the results are mixed. Besides some success, there are serious problems in the realization of the concept. First, due to the complexity of planning and integration of procurements, in some institutions there are considerable delays, which can hamper their normal functioning. Secondly, the resulting prices are not always lower than before mostly due to the lack of market knowledge in comparison to specific institutions (for example, the biological institute is far better acquainted with the world market of some specific substances than a state agency). Third, centralized procurements can lead to compromising the competition in the market by focusing the procurement on a couple of major suppliers (with their collusion), with the elimination of small and medium-sized enterprises. And fourth, corruption in individual institutions is certainly reduced, but there is a possibility of large centralized corruption in the agencies for centralized procurements.

For example, there is an ongoing procedure conducted by the Commission for the Protection of Competition related to the public procurement of property insurance in EPS. Namely, EPS is trying to insure all of its property through a single tender (in order to reduce the price), and only one consortium (including all the major insurance companies in Serbia) has answered the call. Commission for the Protection of Competition is investigating whether this is an example of a cartel, but insurers claim that none of them has enough capacity to insure all of EPS's assets.

Due to the perceived difficulties with centralized procurements in Serbia, the Public Procurement Office has reasonably suggested gradualism in its use, in accordance to their administrative capacity and experience. Furthermore it suggested to start with voluntary involvement of institutions and with public procurements of simpler and more standardized goods, and then eventually to continue towards a more comprehensive approach.[17]

Corruption affair: EFT

Serbian businessmen Hamović and Lazarevic and their London-based firm EFT (Energy Financing Team) are long-term corruption suspects in the Balkans area. They are major electricity trading company in this part of Europe. Main accusations against them in Serbia relates to the period 2001-2004, when allegedly improper contracts with them caused considerable damage to EPS on two grounds: (1) service oil processing in the mazut and (2) periodic trade (buying/selling) electricity, when EPS was buying electricity at price higher than market price, while the deal was agreed without a tender but by direct negotiations.

The Assembly of Serbia in 2004 formed an Investigative Committee, whose president was today's prime minister of Serbia Aleksandar Vucic. The Committee has examined the allegations, but found no evidence of wrongdoing. Then in 2007, the police filed a complaint against EFT, but nothing further happened. In 2013 the Minister of Energy submitted criminal charges against Hamović and Lazarević. On this basis the prosecution requested the police investigation, but court proceeding is still pending. One can guess whether Hamović and Lazarević are clean or well connected.

System of public procurement in practice

The volume of public procurement

Total public procurement in 2014 was 427.7 billion RSD, or about 3.6 billion Euros, which was 10.8% of GDP in the same year. Public procurements carried out in accordance with the Law on Public Procurement reached 298.4 billion in 2014, and these will be analyzed below.

The difference of 128.6 billion RSD in procurements was not carried out in accordance with the PP law, because there was a legal basis for their exemption: purchase of some energy products (29% of value), acquisition of exclusive rights in the field of performing activities (15%), purchase from loans from international Financial Institutions and organizations (13%), purchases below the lower limit for small purchases (11%), etc.[18]

Types of procurement procedures

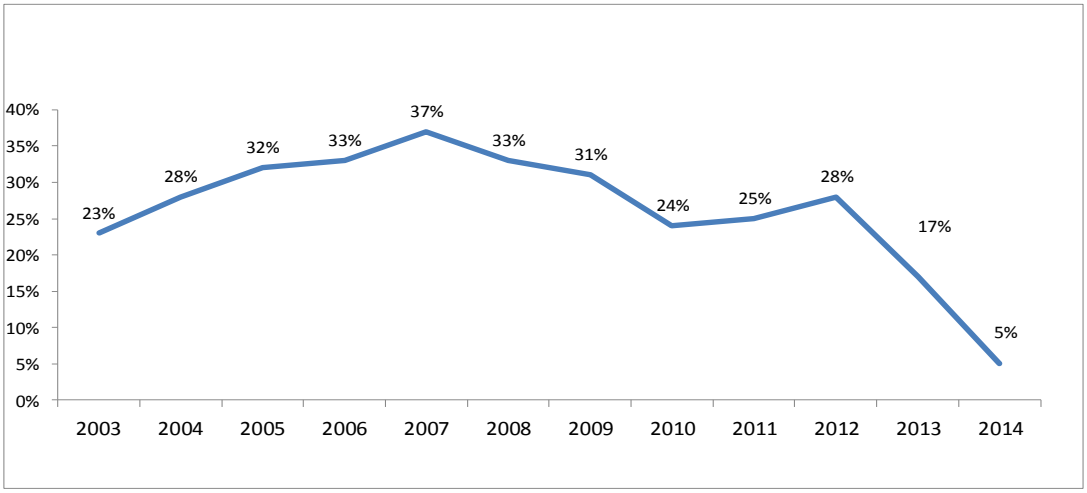
[17] Centralized public procurement, Public Procurement Administration, Belgrade, August 2015

[18] Izvor: *Izveštaj o javnim nabavkama u Republici Srbiji za period 1.1.2014-31.12.2014. godine*, Uprava za javne nabavke, 20.4.2015./Source: Repot on public procurements in Republic of Serbia for the period *1.1.2014-31.12.2014., Public Procurement Office, 20.4.2015*

One of the most important indicators of the character of public procurement system are the predominant types of procedures: whether transparent and competitive procedures (open and restrictive) prevail or non-transparent and non-competitive ones (negotiated procedures without publication of the call). PP Law predicted several types of procedures, starting from the "open" (full competition and transparency) trough transitional forms (restricted procedure with publication and negotiation procedure with the publication) to the highly uncompetitive and non-transparent negotiation procedure without publication. Excluding competition and transparency the existence of this last procedure is treated as an exception to the rule, which could be only justifiable in some circumstances (lack of valid bids, the urgency and specificity of procurement).

On the other hand, the negotiation procedure is popular with procurers from the public sector, not only because it is procedurally simpler than others, but also because it allows corruption. However, the new law on public procurement and, in particular, the decision about the need for the contracting authority to inform the PP Office before the start of the negotiation procedure and obtain its opinion, has significantly reduced the number of contracts concluded after the negotiation.

The negotiated procedure without publication, in% of the total value



Source: Report on Public Procurement in the Republic of Serbia for the period 1.1.2014-31.12.2014. , the Public Procurement Office, 04/20/2015.

As shown in the chart above, the share of the riskiest processes from the point of corruption has been significantly reduced: from about 30% over the past decade to just 5% in 2014. On the other hand, the share of open, competitive procedures reached 85% in 2014 and 86% in the first half of 2015.[19]

Number of bids in public procurement

[19] *Izveštaj o javnim nabavkama u Republici Srbiji za period 1.1.2015-30.6.2015. godine*, Uprava za javne nabavke, 27.10.2015./*Report on public procurements in Republic of Serbia for the period1.1.2015-30.6.2015, Public Procurement Office, 27.10.2015*

Since the competition in public procurement is the strongest barrier to corruption, but also a way to ensure lower prices of goods and services for the public sector, monitoring of the procurements from the standpoint of competitiveness is of the utmost importance. The following table shows the trends in public procurement in Serbia:

Average number of bids by contract and share of tenders with just one bid in %					
	2011	2012	2013	2014	2015 ½
Average number of bids	3.2	2.7	2.7	2.6	2.7
Share with one bid, in %	39.7	41.8	36.8	42.6	43.6

Source: Report on Public Procurement in the Republic of Serbia for the period 1.1.2015-30.6.2015.

The average number of bids is very low and ranges in recent years below three, which is lower than EU average (5.4), Slovenia (3.6), Croatia (3.3) and Montenegro (3.1). To a large extent this is the result of the a very high number of purchases with only one bidder, which in the last period was about 40% of all purchases.

The causes of this phenomenon cannot be explained by the characteristics of the Serbian market given the considerable openness of the country to imports of goods and services. Two other reasons are relevant: the complexity of procedures and mistrust among the bidders.

Corruption affair: Kolubara – pumping the water

After the floods of 2014, a tender was organized for the pumping of water out from two large surface coal mine fields at Kolubara. There was a scandal: BIRN claimed that the tender was organized unnecessary (the time is lost) and that is furnished in favor of the winner, which was politically well-connected firm with no experience in these matters. The World Bank, which was the financier of pumping, reacted and said that the tendering procedures carried out in accordance with the law. The affair beds, but no one denied the claim that it was an inexperienced company that won the fine-tuned tender. Moreover, after the signing of the contract a well-known Dutch company was hired to do most of the work as a subcontractor.

The complexity of the procedure is the result of the chosen concept of public procurement. Namely, one important way to combat corruption is to remove the discretionary decision-making rights in the public sector by prescribing permitted procedures in vulnerable situations, which should direct the one who decides in a good direction. This logic has significantly influenced the design of public procurement system in Serbia as well as the legal and sub-legal regulations: a very complex and highly formal system has been created, in which attempts are made to plan and decide in practically any situation on the basis of prescribed rules.

Removing the discretionary decision certainly reduced the maneuvering space for corruption in the public procurement system, but has brought other problems that must be kept in mind. The complex and formalized system has its flaws, which bring negative effects from extending the duration of the proceedings, through impossibility of small businesses to learn all the nuances of a complex system to higher administrative costs for all participants.

Thus, the survey of 1009 enterprises, conducted in June 2015 showed that 32% of the bidders considered the process as very complicated, 31% consider it as medium complicated, and only 28.5% said that it is not particularly complicated.[20] (Of course, the system is much more complicated for procurers in the public sector, who need to implement almost all procedures.) Therefore, the majority of companies in Serbia have not been able to participate in public procurements, as their employees have not enough knowledge about the public procurement system. The same survey showed that only 34.6% of the surveyed companies thought that the Law was very well or well known, while the knowledge of the Law was considered mediocre (30.6%) or very poor (32.0%). There is no doubt that insufficient knowledge of a complex system leads to frequent withdrawal from participation in procurement procedures or to participation with a high percentage of rejected applications.

Lack of confidence in the fair functioning of the public procurement system is quite widespread in Serbia: those who participate in public procurements say that in 35.3% of the cases they "knew" or believed that the procurement was fixed. The reasons which led them to such a belief are: technical specifications, terms and other conditions of (57.3%), lower than the realistic price (11.1%), pure feeling and buzz/gossip (31.6%). Also, 30.2% believe that in their industry two or more bidders collude and "dictate the rules" in the market, and therefore the procurement itself.

Similarly, when asked about the first association to the term “public procurement” 35.2% respondents had negative associations: for 20.8% of them a first association were red tape, complicated problems, stress, etc., and for 12.4% of them feelings of corruption, crime, robbery, money laundering.

The methods of corruption in public procurement

Some possible methods and strategies of corruption, of which we will mention the important ones, are the result of certain specific legal provisions:

- Liberal regime for low-value procurements offers the possibility to split the purchase into more smaller fragments, thus implementing the process of low-value procurement rather than the more complex and more transparent tender procedures,
- The existence of different types of procurement procedures, with different degrees of competitiveness, enables the use of less competitive processes rather than optimal. The most popular method is negotiation without publication; this allows

[20] *Istraživanje stavova o javnim nabavkama*, Stata.rs, jun 2015./Opinion survey on public procurement, Stata.rs, Jun 2015

easier selection of the favorites whether because of the alleged urgency of procurement or because allegedly there are no other bidders,

• The existence of exceptions to the application of the Law leads to attempts of abuse, so that regular procurements are proclaimed as exceptions.

The second group consists of purchases that are not covered by the Serbian public procurement system, but are present in every system:

- purchase of unnecessary goods or excessive amounts of necessary goods,
- formulation of discriminatory technical specifications,
- formulating unclear or contradictory tender documentation,
- adjusting the assessment system with the selection criteria to match the favorite,
- conflict of interest,
- subsequently modify the contract through annexes etc..[21]

Public procurement in the energy sector

Although a large part of the energy sector is in state-owned hands (whether Serbian or Russian), just a part of all procurements in the energy sector is done in accordance with the PP Law. The following are exempt from Public Procurement Law:

- Petroleum Industry of Serbia, which is considered to be a privatized company although it is owned by Gazprom, a state company from Russia, and the state of Serbia has a minority share,
- Largely Srbijagas, the state enterprise for the supply and distribution of Russian gas, because gas is purchased under a long term agreement with Gazprom so this most important item of procurement is not organized in accordance with the procedure under the Law on Public Procurement,
- Public procurement under international agreements, such as Serbian-Chinese arrangement for investments in the energy industry,
- Public procurements conducted by the rules of international financial organizations that fully finance a project.

Data on public procurement in the energy sector is quite limited. Aggregate data for the entire energy sector does not exist in the Public Procurement Office, which uses other classifications. Therefore, we only reviewed the largest contracts of the entire public sector for 2014 and the largest contracting authorities. Furthermore, we cannot draw-out reliable conclusions for the entire energy sector from the data below.

Among the largest public sector contracts, of a total of 108, 54 are contracts that belong to the energy sector, meaning public companies in the electric power and gas distribution, which is a half of the total number.

All these contracts were concluded after the prescribed tender procedures. The average number of bids per tender in the energy sector was only 2.2, which is below the average for

[21] See, Saša Vavrinec i Ivan Ninić: *Korupcijska mapa sistema javnih nabavki u Republici Srbiji*, OEBS, avgust 2014/ Saša Vavrinec and Ivan Ninić: *"Corruption Map of Public Procurements in the Republic of Serbia "*, OEBS, August 2014.

the entire public sector. The average is raised due to tenders for bank loans, since there were 4.4 bank bids per tender (15 tenders, 66 offers). It is obvious that competition in the banking sector is strong, because of considerable certainty that the loan will be repaid.

With other tenders in the energy sector the number of bids per tender was only 1.3, which means that usually there was only one bidder. For one part of the tenders there is a justification:

- Many tenders (for example, the first four by size) were given to related (daughter) companies: EPS Electric Power regarding the procurement of electricity and RB Kolubara with a daughter company. Namely, there are still contracts between parent firm and specialized daughter companies for the services of maintenance, construction works and related service activities,
- In a number of tenders, very specific equipment is purchased so it was perhaps inevitable that this equipment be bought from a specified supplier for technological reasons.

However, there is still a significant number of tenders where more bidders could apply, so we can conclude that in the energy sector the competition is obviously insufficient.

7. MAIN POLICY RECOMMENDATIONS

Improvement of the governance of the energy sector in Serbia entails several reform changes:

- Enforcement of comprehensible and transparent legal framework and effective competition in a free energy market,
- Reduction of direct involvement of political circles in operational management of energy enterprises, allowing professional and independent management to lead and modernize energy SOEs,
- Improvement of the long-term rule-based energy policy,
- Increased administrative and financial capacities of the controlling and regulatory state authorities,
- Introduction of mandatory international corporate governance standards for SOEs such as the OECD Guidelines on Corporate Governance of State-Owned Enterprises,
- Fighting state capture by improving accountability and transparency through provision of public data and enforcement of information disclosure mechanisms in state-owned energy enterprises, regulatory bodies, controlling authorities and policy decision makers,
- Introduction of good decision-making procedures for selection of large investment projects based on deep analysis and sound economic and financial criteria,
- Streamlining public procurement: simplifying procedures and increasing transparency.