



Republic of Bulgaria  
ECONOMIC  
AND SOCIAL COUNCIL

## **OPINION**

on

### **CONSEQUENCES FROM THE ENERGY PRICE SHOCK AND MEASURES FOR ITS MITIGATION**

(on its own initiative)

Sofia, 28 October 2005

By Letter No KHCБ-92-00-70/06.10.2005 of the Confederation of Independent Trade Unions in Bulgaria (CITUB) and Letter No 00234/06.10.2005 of the Confederation of Labour “Podkrepa”, on the authority of art. 14, para 2 of the ESC Operation Regulations, the members of the second group of the Economic and Social Council, have offered a draft of an Opinion on “Consequences from the energy price shock and measures for its mitigation” to be presented, discussed and approved by the ESC plenary session.

On 18 October 2005 the Plenary session of the Economic and Social Council, on the basis of art. 29, para 1 of the ESC Operation Regulations, took decision to constitute an interim commission at the Council for completing the opinion on the basis of the discussions in the plenary session, opinions of independent experts and information from the National Statistical Institute and the State Energy and Water Regulatory Commission, requested by the Council on the authority of art. 6 of the ESC Act.

The Interim Commission adopted a draft of the Council’s Opinion at its sitting held on 24 October 2005 and appointed Mr. Plamen Dimitrov and Mr. Dimitar Manolov, the co-chairpersons of the commission, rapporteurs.

The Economic and Social Council approved this Opinion at its Fifteenth Plenary Session, held on 28 October 2005.

## I. CONSEQUENCES FROM THE SHOCK INCREASE OF THE STATE REGULATED ENERGY PRICES

The Economic and Social Council is seriously concerned about:

- the chaotic information and actions at the beginning of the winter period regarding the energy prices;
- the poor social dialogue on issues directly concerning the living standard of the population and the business conditions;
- the absence of a timely reaction for discussing concrete measures in order to compensate the new blow on the incomes of the population and the competitiveness of economy.

While the countries in the European Union, whose member we hope to become soon, and even the European Commission, consider measures for reducing the consequences from the new world oil crisis and possible compensatory social measures and schemes targeted at mitigating the costs for the households and enterprises, in Bulgaria the governmental intentions are not clear yet.

Devolving the responsibility upon the independent *state* regulatory body – SEWRC (State Energy and Water Regulatory Commission), as well as different kinds of various excuses, do not at all revoke the need of a state policy on prices, which are formed by monopoly and in the absence of real competition and market. In such a situation the general discussion, consultations and effective consideration of the reasons and consequences for a similar decision with the social partners are obligatory, including in conformity with the legal texts of the Labour Code.

The parameters of the price shock have not become clear yet, and the competent authorities have not outlined the short-term and mid-term aspects of the impact that the drastically raised prices have influence on the economic and social development and also on the quality of life of the Bulgarian citizens.

The Economic and Social Council has stated the following facts and consequences:

- The strategy for raising the energy costs for the business is not clear. The ambition so far has been to equalise prices for the business and households and this has been almost achieved. By introducing a new price increase only for the business, they will get ahead of the energy prices for the domestic needs. There is no explanation yet for this step, neither from the executive power nor from the controlling body.
- The energy price shock affects both the business and all households. Moreover, it should be taken into account that a direct and secondary effect is added, due to which the average annual inflation, measured by the index of the consumer prices, will reach 5-6%, and the cost of living will raise by 8-10% at the end of 2005 /referring to data of the CITUB/. Regarding economy and business this means lower sales, new bankruptcies, decreased investments and no new jobs opened. For the population the reduced purchasing power of the incomes will bring about a drop in the consumption and standard of living, which is extremely undesirable with a view to the unfavourable position that Bulgaria occupies in comparison with the other countries in Central and Eastern Europe as well as the will of doing away with the distance to the most backward countries of the community in the period till full membership.

- The experience of the last 4-5 years shows that the step-like rise in the prices of electric power and heat for the household users has not been compensated to the adequate extent, because of which the scope of the households extends and they will have to go through still greater difficulties to cover their costs during the winter months and pay the bills on time. This reduces the consumption of the heat supply service and accordingly questions its advisability particularly in the cities where its price exceeds the capacities of a family of average incomes /e.g. the town of Kazanlak/.
- After the Bulgarian citizens “have prepared” the energy sector for privatisation by paying new higher prices every year, now they have to get convinced that the regionally established private monopoly of the three foreign company, owners of the EDPs (Electricity Distribution Plants), is not offering anything else better than the state monopoly NEC (National Electrical Company). Trying to manoeuvre between the interest of the public and the private companies, the State Energy and Water Regulatory Commission turns out to be in an extremely complicated situation when it cannot make a beneficial move in order to protect the customers and at the same time to satisfy the growing claims of the new owners. And this will last as long as the electricity consumers do not have the freedom to make their choice of the terms and suppliers in an absolutely liberalised market environment.
- The vendors will state their reasons for the groundless rise in the prices of the basic commodities by the oil and natural gas prices;
- The producers will try to overcome the unfavourable effect from the industrial current price increase by raising the prices of the industrial goods or by cutting down the costs mostly for labour;
- The living standard will shrink for a large group of the population in the big cities, beyond the group of the needy, for which the serial increase of the monopoly natural gas prices by nearly 20% will mean a new blow against the income they can dispose of in their capacity of users of the heat supply companies.
- The structure when fixing the final price is not clear because the capacity charge is also increased in some places, for example in Gabrovo it went up twice while it went down in other places. The capacity charge as a portion of the heat supply end-price affects also those that do not use the service itself, generates a lot of questions both about its advisability and its essence as a part of the price formation.
- The inexpensive 50 kWh night-time electricity, used for heating (an element of the first step so far), dropped off from 1 October 2005;
- Bulgaria is the only country where the net prices (without taxes and charges) of electricity in euro and by purchasing power parity increase progressively provided a higher consumption. The market principle – “the more you use – the less you pay” does not apply to our country. The larger part of the countries has taken up the price formation system at which the cost drops down with the increase of the annual consumption. Italy, Portugal, Latvia, Lithuania and Romania are an exception, and in some of them the highest price is the one of the standard consumer group<sup>1</sup>.

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<sup>1</sup> The standard consumer group corresponds to a household with a place of 90 sq. m living area, and 3500 kWh annual consumption of electricity out of which 1300 kWh are night electricity.

Bulgaria has the lowest net nominal price of electricity in Euro. For the standard consumer group **Dc** it is 5,37 Euro per 100 kWh, which over 2,5 times higher than the highest one (Italy – 14,40 Euro) and almost 2 times lower than the average European one (EU – 25 – 10,46 Euro).

Bulgaria, however, occupies the fifth position when ranking by electric power for the standard consumer group **Dc** by purchasing power parity with price of 13.89 PPS<sup>2</sup> or practically it is the same as the one in Italy (13.88 PPS). Slovakia ranks first in this group – with 20.15 PPS, and the last three positions (with the lowest prices) are occupied by countries like Finland – with 6.89 PPS, Sweden – with 6.79 PPS and Denmark – with 6.75 PPS. In other words, the standard household customer in Bulgaria as at 1 January 2005 paid more than 2 times higher price than the standard customer in Denmark by net prices, reflecting the purchasing power parity.

The classification of the countries by end (gross) cost measured by the purchasing power parity for a standard consumer group **Dc**, which involves all taxes and charges, including VAT, identifies Greece as the country of the lowest price level – 8.02 PPS and Slovakia as the country of the highest one – 24.01 PPS. Bulgaria is also amongst the countries with higher prices, occupying the seventh position with a price of 16.66 PPS that is over 2 times higher than the lowest one.

The data in PPS show that countries like Denmark and Sweden, which have the lowest net prices of electricity for the standard consumer group **Dc**, at the same time they have also the highest portion of taxes and charges on those prices: Denmark – 146% and Sweden – 65%, but both countries of high tax burden, included in the price, still have lower gross prices than Bulgaria – Denmark – 16.59 PPS and Sweden – 11.20 PPS. Regarding the tax burden on the prices, Bulgaria with its 20% VAT, included in the costs of the households from the standard group stands in the middle.

- Forthcoming is a considerable rise of the water price;
- Significant losses are calculated in the electricity, heat and water supply mainly due to incorrect customers and poor maintenance.

The Economic and Social Council has also taken into consideration other factors, which will have their impact on the quality of life in Bulgaria:

- The intention of the Ministry of Finance to raise the excise of some commodities before the term set and speedily from 01.01.2006, instead of from 01.01.2008 with the purpose of consuming the inflation “ahead of time”.
- The foreseen decrease of the social insurance burden for the employees by 6 points from 01.01.2006 is for the benefit of the employers and together with the amendment of the allotment between employer and employee to 65.35% leads to keeping the personal social insurance contributions of the employees. The taxation relief for the incomes of the physical persons is absolutely insufficient to cover the increased costs of the energy carriers and the water.
- The increase of the coal price by 10.62% per ton.
- The increase of the firewood price from BGN 35 to BGN 45/ cub. or by 28,57%.

<sup>2</sup> Purchasing Power Standard – artificial common currency used for international comparisons by PPP (Purchasing Power Parity).

On the background of the still low incomes in Bulgaria (against planned average salary for the year 2006 – BGN 356, in the year 2005 – BGN 312,17 as at half-year) the average salary during the heating period is expected to be BGN 334,5.

Recognising the fact that:

- 55% of the workers receive a salary lower than the average one;
- the average pension is BGN 133, which is below the minimum work salary;
- the average unemployment is over 12%;
- One person working and one pensioner support the households at the average; the payment of the heat supply bills only for a half-year period becomes impossible for a large part of the people.

Analysing the socio-economic situation and the intentions of the government, the Economic and Social Council notifies that:

**First:** The pressure for a shock rise of the practically monopoly prices serves the interests of individual monopolies, which creates a pro-inflation situation threatening the publicly accepted policy for sustainable and accelerated economic growth of Bulgaria.

**Second:** In spite of all declarations for prompt integration of Bulgaria in the European Union, such actions contradict the good practices for enhancing competitiveness and social responsibility as well as taking into consideration the interests of the civil society.

**Third:** The shock rise of the basic prices and the intention for increasing the excises before the term set within one and the same period of time will have a serious impact on the living standard of the population.

**Fourth:** The increase of the costs for the energy sources together with the excises, coming right after the floods which affected  $\frac{3}{4}$  of the country, and just before the winter, which the meteorologist forecast to be heavy, will have a negative impact on a large part of the population and the small and medium-sized enterprises.

This may cause social tension – latent or open.

## **II. PRICE REGULATION OF THE ENERGY CARRIERS. MEASURES FOR STRENGTHENING THE PUBLIC CONTROL ON THE OPERATION OF THE STATE ENERGY AND WATER REGULATORY COMMISSION**

The SEWRC (State Energy and Water Regulatory Commission) is the one to exercise the regulation on the prices in the branch as provided for in the Energy Act. The Commission is an independent, specialised governmental body. The Council of Ministers appoints its members. The decisions of the Commission can be appealed only with the SAC (Supreme Administrative Court).

Actually, the international practice is that a specialised governmental authority should do the price regulation of this type. At the same time the distinctions are to be found in the requirements set to the members of the Commission and the extent of its independence.

During the past years the making of competent decisions by the Commission has become more and more important. On one hand, this is objectively determined by the circumstance that the prices regulated by the commission directly concern the economy and the living

standard of the population. On the other hand, however, a strong tendency is present with respect to the annual growth of the energy prices and the related services rendered by the energy companies.

Despite the public debates, which the Commission holds before taking important decisions for changes in the prices, in most cases the public does not consider this to be enough and does not understand clearly the mechanisms for the formation of the prices. Most often the arguments given for such an attitude are as follows:

- The business, trade unions and consumers' organizations are not lawfully represented among the members of the Commission.
- It is difficult to refute arguments of the Commission in the public debates because of the scanty information available.
- The public is insufficiently aware of and acquainted with the principles, methodology and mechanisms for the price formation. A wholesome strategy is needed for the regulation of the prices with respect to our EU accession.
- The Commission's decisions can be appealed only with the court.

Without listing other arguments the above is good grounds that in many instances the people will doubt strongly the correctness of the decision made, the competence and responsibility of the Commission members.

It becomes necessary to build a specialised public expert council where the interests of the business, labour and customers will be represented and which at the same time will have not only an advisory but also a preventing influence on certain decisions. This council could be an element of the SEWRC structure by introducing changes in the Energy Act. In order to avoid the risk of attaching a marked operational nature to its activity, the council itself could consider those draft decisions of the Commission that are of particular interest for its representatives.

Other decisions are also possible for strengthening the control upon the Commission. For example: considering the issues at the NCTC (National Council for Tripartite Co-operation); approval of the Commission's decisions by the Council of Ministers; direct participation of the stakeholders in the work of the Commission with a statute of its members. Each variant has at least one of the following shortcomings – non-representation of the stakeholder groups, lack of imperative influence on the part of the public structures, impossibility to appeal the decisions with the SAC, symbolic representation of the groups concerned in the Commission staff, necessity of taking up full-time occupation in the Commission and etc.

At the same time, regardless the creation of a mechanism for strengthening the public control on the decisions of the Commission, in our opinion, it is necessary to extend the grounds for the replacement of its members before the expiry of the mandate if presence of evidences for admitting serious incompetence, subjectivism and failure to execute the decisions of the judicial bodies.

A striking case in this respect, for instance, is non-execution of a SAC judgement on the occasion of increasing the electricity prices revoking Judgement No Lj-009/13.06.2005 of the SEWRC about fixing the electricity prices for the household users in the period from

01.07.2003 to 30.06.2004. The SAC judgement was not applied which was a violation of the laws in the R Bulgaria.

The SEWRC has not obviously taken interest and has not made efforts to influence the agreements for the privatisation of the electricity distribution companies in which the state has assumed the commitment to secure a profit rate for the new owners at the amount of 16 percent. Executive representatives of the Ministry of Energy and Energy Resources kept persuading us that privatisation in the energy sector would not bring about a rise in the prices since the situation was under the control of the SEWRC.

There is no explanation of the fact that using the methodologies for the price formation of the energy carriers, the SEWRC has refused to listen to the opinion of the employers and trade unions about the “viciousness” of the so-called pay-as-you-go principle, set in the methodologies. In this relation no attempt is made to establish standard upper limits for particular costs that inevitably resulted in marked subjectivism when assessing the current and foreseen expenses presented by the enterprises.

But if we pay attention to the formation of natural gas price we notice the presence of speculative actions of Bulgargas EAD, through which the company either “inflates” its expenses or it does not report some of its substantial extra incomes. For example, experts inform that the company has adopted its own accounting methodology for computing the base on which they accrue the 30% expenses recognised by the Budget Act for the realization of the transit gas. The company raises its own costs by using this methodology to the detriment of the budget. At the same time, Bulgargas EAD systematically gives false prognoses for the needed reserves of natural gas for maintaining the pressure in the system at the Chiren gas depository during the winter season. These forecasts are also calculated in the estimates when determining the state price. In addition, in order to prove bigger expenses for the respective quarter, intentionally to raise the price for the next quarter, Bulgargas EAD uses a weighted average currency rate for the last 30 days, but not for the whole three-month period during which it has purchased gas. However, the state regulatory authority overlooks all this.

## **PROPOSALS FOR MEASURES**

Taking into account the gravity of the problems raised, under the conditions of a coming up energy crisis, the Economic and Social Council of the Republic of Bulgaria recommends the government to undertake the following measures:

1. Making amendments and supplements in the Energy Act in order to:

- set up a Public Council consisting of representatives of the business, labour and the customers, which will have the right of exerting preventive influence on the draft decisions of the SEWRC in respect of the monopoly regulated prices. The Council should be an element of the SEWRC structure.
- extend the grounds for replacement of SEWRC members before the expiry of their mandate, in case of evidences available for admitting systematic incompetence, subjectivism and failure to execute the judgements of the judicial bodies.

2. Change of the pay-as-you-go principle when fixing the prices of the energy carriers, the energy and heat supply services and the guaranteed rate of return for the EDP.
3. Revision of the general provisions for the electricity supply from the EDP in their part for advance payment of the electric power supplied and the sanctions when readings are below the preliminary stated consumption..
4. VAT reduction on the electricity, heat and natural gas by 2 percentage points, which is to be the first step towards general decrease of this tax from 20 to 18%.
5. To undertake measures for accelerating the liberalisation of the energy market.
6. Encouraging the public private partnership and promoting the use of the foreign experience in projects for raising the energy efficiency.
7. To develop strategies for energy efficiency of the water supply and irrigation systems (respectively by the MRDPW /Ministry of Regional Development and Public Works/ and MAF /Ministry of Agriculture and Forestry/).
8. Promotion of the energy production from alternative sources and alleviation of the regimes for the construction. Abolishment of the excises on the bio-fuels.
9. Enlarging the scope of the families entitled to energy benefits by raising the MIL (Minimum Income Limit) up to 50 % of the current threshold of poverty in Bulgaria and if necessary – the other admission criteria and parameters have to be specified and detailed.
10. Working up a mechanism for increasing the minimum work salary depending on the threshold of poverty, labour productivity and its correlation with the average work salary for the country.
11. The average energy prices increase for the households and the subsequent direct and indirect negative effects on the prices of the other commodities and services should be recorded in the percentage increase of the work salaries for the budget organizations and activities. The expected price dynamics presumes a twofold amendment of the salaries in order to achieve an annual average increase not less than the GDP nominal growth for the year 2005.
12. Tripartite negotiations about a national regulator for a minimum increase of the work salaries in the branches of the real sector from 01.01.2006, considering the inflation, the economic growth and labour productivity during the preceding year and the forthcoming changes in the tax and social insurance legislation. This regulator will be corrected at the branch (sector) collective bargaining depending on the economic, financial and social indicators and the specific market situation in the respective economic activities.
13. The Economic and Social Council applauds the commencement of negotiations for making a Pact for economic and social development of Bulgaria till the year 2009, comprising concrete measures, parameters and policies for the development by years.

The Economic and Social Council considers that it is necessary for the government and the social partners to make urgent and maximum efforts and implement adequate mechanisms for structuring and promoting the tripartite dialogue in order to achieve actual results in the negotiations as early as the beginning of the year 2006.