

Chapter 4. SOEs and Public Finances

State-owned enterprises (SOEs) dominate economic activity in Uzbekistan and receive oversized government support. While explicit on-budget subsidies to SOEs are modest, off-budget and quasi-fiscal support are extensive. Such backing and the economy-wide low input prices for SOEs distort the structure of the economy, the allocation of capital and labor, and fiscal revenues. SOEs also depend critically on lending by the state-owned banks (SOBs) subsidized by the government. Financial discipline of the SOEs is poor and is also reflected in periodic accumulation of inter-enterprise arrears and restructuring of their obligations to the SOBs and the government.

Sustainable public finances and overall economy efficiency require a reduction and then elimination of the losses of SOE losses and a transformation of their role. Critical reform steps include explicit recognition and consolidation of all financial support to SOEs, imposition of hard budget constraints and better governance of firms, increasing output prices to at least cost recovery levels, and allowing private entry and growth. SOEs' performance depends critically on the existence of a market environment as well as enforced management incentives. As corporate restructuring proceeds, explicit fiscal support to the poor or vulnerable will need to replace support often provided through SOEs, including through prices below cost recovery.

CONTEXT AND RECENT DEVELOPMENTS

The true extent of the state-owned enterprises is unclear but is likely to be substantial. Anecdotal evidence suggests that the Uzbek economy is primarily composed of state-owned enterprises, though more and more private firms operate in some sectors. The authorities use a classification system that categorizes all firms that are less than 100 percent owned directly by the central government as non-state. This definition is inconsistent with international norms and does not provide a proper indication of the extent of either state ownership or control. Under this definition, state-owned enterprises account for just over half of economic activity and more than half of budget revenues, but less than 10 percent of overall employment. Ownership and governance are exercised at various levels of government and through different entities, ministries, and extrabudgetary funds in an opaque manner.

The private sector is in its infancy and is too small to create viable competition for SOEs.¹ Yet, such competition is a critical element of any good governance system. A growing private sector is essential for future growth job creation, and a solid tax base that will help support the transition from a state-dominated economy to one driven by the private sector.

Many non-financial SOEs provide goods and services to consumers or other SOEs at below cost recovery prices set by government without compensating budget subsidies. A complex system of non-market pricing, without regard for profitability, results in an equally complex system of cross-subsidization and arrears between enterprises, with unclear fiscal implications.

¹ The “true private sector” refers to firms that are majority privately owned or where private owners have controlling ownership. Because of the definition of SOEs, enterprises that are not called an SOE (100 percent direct central government ownership) are not necessarily private firms.

Examples of these practices in the utilities sectors include natural gas, electricity, drinking water supply and sewage, centralized communal heating, public transportation, and irrigation water supply and drainage. The government also mandates SOEs to carry out unreimbursed activities that are not in their core business area, such as construction of kindergartens, sports or health facilities, among others.

SOEs receive extensive fiscal support in several ways. These include: (1) economy-wide low input prices for SOEs; (2) on-budget subsidies amounting to around 1 percent of GDP in 2018; (3) a variety of tax and customs preferences (see the chapter on Tax Expenditures); (4) the public investment program which finances a part of SOEs' investment that is not recorded explicitly in the budget (see the chapter on Public Investment Management); (5) the UFRD and government financed concessional loans through SOBs in foreign and domestic currency. This quasi-fiscal activity of SOBs implicit in lending at subsidized rates is estimated at about 2 percent of GDP; (6) Bank deposit rates for some SOEs that are higher than those available to households or private companies; (7) Availability and price of land.

Explicit compensation to SOEs for below cost-recovery pricing or non-core spending is minimal or absent. When the loss of revenue and additional costs are not reimbursed by the government, SOEs incur losses known as quasi-fiscal deficits, QFD (Box 4.1). In Uzbekistan, the quasi-fiscal deficits are substantial, particularly in the gas and water utilities. We estimate the QFDs of SOEs to amount to about 6 percent of GDP a year based on a sample of key sectors, but the amount is likely to be much larger for the economy as a whole.

While Uzbekistan has taken initial steps to modernize SOE governance and management, such as corporatization of some SOEs, the existing corporate governance framework and practices and financial reporting requirements deviate from accepted standards consistent with efficiency and fiscal discipline. The Government's "Program of transformation of state enterprises and other entities with majority state ownership" highlighted the following problems related to SOEs: "(i) participation of government officials in management bodies of SOEs resulting in conflicts of interests, (ii) lack of a well-functioning system of management of the investment process in SOEs, (iii) non-transparency of SOE governance and lack of regular analysis of their performance, and, (iv) inefficiency of the system of education of staff and management of SOEs, particularly in the area of corporate governance."

The current division of roles and responsibilities between the various government stakeholders involved in corporate management and oversight of SOEs is blurred. Executive decision-making power has often been embedded into the government, diluting SOE accountability. Line ministries have primary responsibility for exercising the state's ownership rights with respect to their sectoral SOEs. Until the recent creation of the State Asset Management Agency (SAMA) – where the authorities intend to transfer the government shares in all SOEs – other agencies, including ministries, local governments, and extrabudgetary funds, also controlled shares in SOEs and exercises their ownership rights. These bodies have different functions and do not have mechanisms that allow them to ensure consistency in their oversight or to streamline their oversight mandate. This overlap of functions weakens SOE accountability.

The government intends to advance SOE reform in several directions. In the energy sector, the authorities have adopted methodologies to set prices on a path to cost recovery to reduce QFDs

and attract private investment. Impressive progress has been achieved, with the average electricity price already raised to \$0.043 by late 2019 from \$0.02 at the start of reforms. Secondly, they intend to liberalize trading, including of electricity and gas. Thirdly, they plan to strengthen the governance of SOEs by separating ownership and management, according to the recently adopted corporate governance code. And, finally, they plan to gradually divest government ownership in SOEs.

Box 4.1. The Nature of Quasi-Fiscal Deficits

End-user tariffs set below cost-recovery, non-payment of bills, and high technical losses hurt the financial performance of utilities, creating operating deficits and direct or indirect (“hidden”) needs for subsidies from public budgets to sustain their operations. Usually (but not always) budgetary subsidies cover cost recovery price gaps. In the absence of explicit subsidies cost-recovery price gaps generate “hidden” (or unrecorded quasi-fiscal) deficits. Hidden deficits also result from bill collection failures or from losses due to inefficient operations. The impact of hidden deficits is mainly felt through reduced investments necessary to expand service, delay of essential maintenance, or deterioration of service. Following a methodology developed by the World Bank, QFDs are estimated based on the following three components:

- Pricing gaps: losses from end-user tariffs set below cost-recovery rates. The cost recovery tariff needs to include operations and maintenance and interest on outstanding debt.
- Collection inefficiency: losses from differences between billed and collected revenue;
- Technical inefficiency: losses above normal technical losses from inefficient operations.

Source: World Bank.

KEY CHALLENGES

Sizeable quasi-fiscal deficits of SOEs

Quasi-fiscal deficits of SOEs consist of losses that are not compensated by budgetary subsidies that reflect prices below cost-recovery levels, collection inefficiency, and technical inefficiency². Quasi-fiscal deficits of SOEs are not easy to estimate because of the lack of accurate information on cost recovery prices, as well as the extent of collection and technical losses. Financial information of the key SOEs is also missing, as are the interest costs on SOE debts or debts incurred by the government on behalf of SOEs.

The estimates of the quasi-fiscal deficits in this note reflect cost recovery levels but do not include interest payments. They also do not reflect fully the capital cost of replacing fully amortized equipment. A more comprehensive estimate of quasi-fiscal losses should reflect these costs in full and result in substantially larger QFDs. Cost recovery prices used also do not reflect true costs because the outlays for providing non-market services incurred by several SOEs, such as kindergartens, health services, and sports facilities are not included.

² The technical inefficiency results from underinvestment in maintenance. Note that this definition does not capture revenue needs or “deficits” related to expansion of capital (new investment projects beyond maintenance). The technical inefficiency results in lost output.

In the gas sector, we estimate the QFD due to prices being set below cost recovery at 1.9 percent of GDP. Uzbekneftegaz, the oil and gas company, sets 4 different tariffs for its customers: (i) 320,000 UZS/1,000 m³ for the general population; (ii) 600,000 UZS/1,000 m³ for wholesale customers, such as the electricity company (Uzbekenergo), hot water companies, heating companies, or fertilizer producers; (iii) 800,000 UZS/1,000 m³ for fuel stations (55 per cent of cars run on gas); and, (iv) 1,000,000 UZS/1,000 m³ for construction materials companies. Although the cost-recovery price for natural gas is different for each plant, the company estimates the average cost-recovery price to be around 800,000 UZS/1,000 m³, excluding the financing of the investment program. This is above the tariffs set for the two largest categories of customers — the general population and wholesale customers – which account for two-thirds of domestic gas consumption in Uzbekistan. Using a weighted average tariff for domestic consumption of natural gas, the QFD from the under-recovery of cost is estimated at 1.9 percent of GDP.³ Technical losses in the natural gas sector are estimated at 18 percent. This is equivalent to about 1.2 percent of GDP, using as benchmark the average price of natural gas sold to domestic customers. Commercial losses, reflecting under-collection of revenue because of inadequate metering, are estimated at 7 percent, or 0.4 percent of GDP.

The water utilities also have substantial quasi-fiscal losses. Regulated tariffs were revised up in 2018 to allow for some modernization and development expenses given the high levels of technical losses in the network. Tariffs differ by territory and user. They are the lowest in large urban areas such as Tashkent (280 UZS/m³) and the highest in the arid and isolated region of Karakalpakstan (980 UZS/m³). For businesses, tariffs are double those for the general population. The quasi-fiscal deficit of the water utilities due to under-recovery of costs is 1.1 percent of GDP. Losses from under-collection of revenues amount to about 0.2 percent of GDP and include losses from non-payment, under-billing because of the partial coverage of users by metering.

The electricity company (Uzbekenergo) does not report significant apparent losses from under-recovery of costs – but there are hidden losses. The regulated tariff for individual consumers is 250 UZS/kw and for legal entities it is 330 UZS/kw, while the company reports that cost recovery tariff is estimated at 250 UZS/kw. The cost recovery price indicated does not include all components of the operating cost and does not include debt service. In addition, there are significant hidden losses because 80 percent of electricity generation is from gas, which is cross-subsidized by the gas company (Uzbekneftegaz) through a tariff for wholesale customers (600,000 UZS/1,000 m³) which is set below the cost-recovery level (see above). Had the gas tariff for wholesale customers been set to cover costs, the electricity cost-recovery price would have been higher. Offsetting these losses would have required a budgetary subsidy to the power company, in the absence of which, the company would be running deficits that would eventually need to be covered by the budget. When compared to international norms, losses due to under-collection of revenues are significant in the electricity sector. We estimate such losses at 0.1 percent of GDP. These are lower than the collection losses for electricity in Tajikistan (0.46 percent of GDP), Pakistan (0.27 percent of GDP), or Bulgaria (0.14 percent of GDP), but much higher than in Romania or Vietnam (0.02 percent of GDP).

Quasi-fiscal deficits appear to be large for the district heating companies. They are particularly sizeable in district heating (DH) but are more difficult to calculate because of the

³ Domestic consumption of natural gas was 41.6 bcm in 2017 and 20 bcm was exported.

different conditions prevailing in the various districts and urban areas. Regulated prices have been set at levels significantly below cost recovery, resulting in a dearth of financial resources for investment and maintenance. As a consequence, heating systems in some cities are barely functional. The tariff for DH to residential users is set at UZS83,600 per giga calorie (GC) and at UZS124,500 per GC for commercial customers. The difference between the tariffs for commercial and residential users is subsidized by the budget to the tune of UZS 210 billion in 2018 (0.05 percent of GDP). However, the cost recovery price for the Tashkent DH company is estimated at UZS 194,000 per GC, resulting in a QFD for the Tashkent DH of about 0.2 percent of GDP.

Because of the hidden losses, the Tashkent DH company accumulates arrears to energy suppliers (essentially the electricity company), which are estimated at 1 trillion UZS. At the same time, the company has an estimated UZS 300 billion (0.1 percent of GDP) in receivables because of unpaid bills. The government periodically writes off these arrears. Owing to the lack of maintenance of the DH systems, technical losses are substantial and amount to 0.1 percent of GDP, using as benchmark the subsidized price for commercial users. Commercial losses for Tashkent DH due to the lack of metering are of similar magnitude, estimated at 35-40 percent of the generated energy.

Tashkent accounts for most of the losses in DH. The Ministry of Housing and Communal Services is the owner and provider of DH and water supply services, through its regional branches. Tashkent has a special regime through a DH company, which is owned by the city but regulated by the Government. The largest volume of DH services is sold in Tashkent, amounting to 10 million Giga Calories (GC), corresponding to 85 percent of the total volume. Throughout the country, a total of 12 million GC of DH are produced, of which 10 million are bought from the electricity company (Uzbekenergo) and 2 million are generated by heating stations (boiler houses).

Energy inputs to the DH and hot water companies and to the sanitation enterprises are subsidized. Natural gas used for district heating and hot water, is priced at below cost recovery for wholesale consumers. Electricity used in district heating is also cross-subsidized by the natural gas supply company. Moreover, although electricity used for sanitation water treatment is reflected in sanitation tariffs, the cost recovery tariff would have been higher had electricity prices been set to reflect the cross-subsidy to power generation from cheap natural gas.

Quasi-fiscal deficits are also generated by SOEs operating on a commercial basis, for example, Uzkimyosanoat which produces chemicals and fertilizers. The company does not receive budgetary subsidies but gets subsidized loans and government guarantees for loans from foreign banks. Moreover, Uzbekneftegaz provides a cross subsidy by supplying natural gas to Uzkimyosanoat at the below cost-recovery tariff for wholesale customers. Were this cross-subsidy to be eliminated, the domestic market tariffs for fertilizers would have to increase to prevent losses from pricing below cost-recovery. Uzkimyosanoat sells about 15 percent of its production on the export market at a 50 percent higher price than the domestic price. The price gap indicates the opportunity cost of regulating domestic prices at very low levels and is a subsidy from Uzkimyosanoat to users

The existence of quasi-fiscal activities complicates the design of fiscal policy. First, the reported magnitude of government revenues and expenditures does not provide a good indication of the actual intervention of the fiscal budget in economic activities. Second, quasi-fiscal deficits

generate implicit contingent liabilities for the government to the extent that loss-making SOEs or the SOEs that do not invest to maintain and develop their networks will eventually need to receive financial support from the budget. Third, they also impede the prioritization of government spending and result in substantial misallocation of both public and private resources.

Through government financed or guaranteed directed lending, SOBs heavily subsidize the SOEs

State-owned banks provide sizeable concessional lending to SOEs. There are three main ways in which SOBs provide subsidized support to SOEs: through on-lending of resources provided by the UFRD, the government (for housing), or international financial institutions. Lending on concessional terms, in foreign or domestic currency, represents 55 percent of the total bank loan portfolio; half of that is to SOEs and the rest is under different government programs, including housing, entrepreneurship, youth, large farmers, and others. Three-quarters of concessional lending is in foreign currency. The UFRD lends to four of the SOBs through credit lines for concessional lending according to government priorities. The government lends at concessional rates to one of the SOBs for housing development and guarantees about half of SOBs' lending to SOEs, creating a contingent liability for the budget.

The quasi-fiscal subsidy associated with concessional lending to SOEs can be assessed by using as benchmark the difference between the non-concessional and the concessional interest rates on bank loans. This is approximately 6 and 12 percentage points for foreign- and domestic currency-denominated loans, respectively. Based on the concessional loan portfolio of the banking system, we estimate that the quasi-fiscal lending subsidy amounts to about 2 percent of GDP. There are additional quasi-fiscal losses because of higher-than-market deposit rates some banks pay on SOE deposits. Estimating these will require additional information.

Lending to SOEs in foreign currency increases the risk to SOEs. The devaluation of the currency in 2017 created losses for SOEs, which found it difficult to service their loans from SOBs. Loans to SOEs had to be restructured by lengthening the maturities and changing the amortization schedule. The SOBs had to be recapitalized while dividend payments to the budget were suspended to support the recapitalization. Non-performing loans of the SOBs, assessed using the current methodology, jumped to 10 percent of the total, including the restructured loans. Because of the interconnectedness of SOEs and SOBs and the nontransparent nature of government support to them, it is crucial that reforms of SOEs and SOBs proceed together.

Quasi-fiscal deficits reduce the ability of SOEs to invest

About 90 per cent of SOEs are monopolies in their respective industries and with regulated prices, they do not have proper incentives to improve operational efficiency. The regulated prices for utilities are not only below cost-recovery levels, but also do not account properly for the maintenance costs of the network and the servicing of SOE debt. If these costs were to be included, the quasi-fiscal deficits would be even larger.

However, investment by some SOEs is often funded from the budget under the public investment program. This includes investment in railroads, electrification of railways, purchases of aircraft, and others. These resources have been insufficient to ensure adequate levels of investment in several sectors. This is particularly the case in natural gas, heating, water supply,

and electricity, where technical losses, due to lack of investment for maintenance, are significant and above international norms. Losses in natural gas supply are estimated at 1.2 percent of GDP. Losses in drinking water supply reach 35 per cent of the volume supplied. We estimate the quasi-fiscal deficit generated by these technical losses for water supply at 0.47 per cent of GDP. Technical losses, at 20 percent, are also significant in the transmission and distribution of electricity. We estimate these losses at 0.24 per cent of GDP. They are higher than the technical losses for electricity in comparator countries (Tajikistan with 0.19 percent of GDP, Bulgaria with 0.15 percent, Romania with 0.14, and Pakistan with 0.10 percent).

Summing up: estimates of quasi-fiscal deficits in a sample of sectors

We estimate that the quasi-fiscal deficits of the SOEs in a sample of sectors amounted to nearly 6 percent of GDP in 2018. The estimated quasi-fiscal deficits cover under-recovery of costs, under-collection of revenues, and technical losses above international norms due to under-investment (Table 4.1).⁴ The economywide quasi-fiscal losses are likely to be much larger because of three reasons: (i) our estimates do not include interest costs on debt owned by the SOEs or incurred on their behalf; (ii) lack of adequate information even for the enterprises in the sample makes the estimates tentative; and, (iii) the sample does not include other SOEs with large quasi-fiscal losses, such as the railway company.

Table 4.1. Uzbekistan: Quasi-fiscal deficits of SOEs
(in percent of GDP)

	Under-Recovery of Cost ¹	Under-Collection of Revenue	Technical Losses Above Norms	Total QFD
Natural gas	1.90	0.40	1.20	3.5
Electricity	0.01	0.08	0.24	0.3
Drinking water	1.06	0.19	0.47	1.7
District heating (Tashkent)	0.20	0.10	0.10	0.4
Total 1/				5.9

Source: Uzbekistan authorities and Bank staff estimates.

1/ Because of rounding, the total is not exactly equal to the sum of the components.

POLICY OPTIONS

The evolution of the SOE burden on the budget will depend on several interconnected elements. Firstly, the speed and comprehensiveness of the reform of the pricing for SOEs' goods and services and SOE management. Secondly, the ability of the banks to function as financial intermediaries with no government intervention in the allocation of credit. Thirdly, the divesting (privatization) of SOEs and the ability of the private sector to become the main driver of growth. Fourthly, governance and tax reforms need to reflect the changing roles and circumstances of

⁴ Cross-subsidies between SOEs (for example, from Uzbekneftegaz to Uzbekenerga or to Uzkimyosanoat) are not estimated to avoid double counting. Had, for example, the tariffs of Uzbekneftegaz been increased to full cost recovery, the quasi-fiscal deficit in the natural gas sector would be converted into a quasi-fiscal deficit in the power sector and the fertilizers in the absence of an increase in tariffs in these sectors.

SOEs: they have to be treated as any other economic agent that has to pay taxes and receive reimbursement for services delivered on behalf of the government.

Establish a centralized database of SOEs using a meaningful definition of SOEs. Disclose all quasi-fiscal activities of SOEs.

To get a consistent picture of all activities of SOEs, including those of quasi-fiscal nature, it is essential for the government to establish a centralized, comprehensive, and public database of SOEs and their finances. This database could be set up perhaps in the State Asset Management Agency. At the same time, the government should modify the current definition of what constitutes state ownership. Any enterprise with a controlling government share (including through an extrabudgetary fund or a local government) will be classified as an SOE. Such a controlling share could be less than 50 percent – perhaps 30 percent – if the remaining shares are widely dispersed, so that no other shareholder group can exercise control. Privatized companies would be those that are controlled by private owners and would not include firms which have sold some of their shares to private agents, but not enough to cede control. The remaining private sector would consist of those firms that have never had state ownership.

It is important for the quasi-fiscal activities of SOEs to be properly measured, reflected in the consolidated budget and the financial statements of SOEs, and fully disclosed. Efficient reform of SOEs and SOBs requires, first, a transparent and comprehensive view of the government support extended to SOEs. The disclosure of quasi-fiscal activities should describe the type of activity, the rationale for performing the activity through an SOE rather than directly through budget financing, and the cost of the activity. Mechanisms designed to provide financial support to SOEs, through concessional lending or tax exemptions, should be disclosed and their opportunity cost made transparent.

Replace the quasi-fiscal activities of SOEs and SOBs with budget subsidies

Explicit budget subsidies to SOEs need to replace all quasi-fiscal and off-budget operations. The government can then contract out public service obligations to SOEs under arm's length commercial contracts and signal to non-SOE suppliers the price against which to compete as a future provider of those services. Romania provides an example of well-planned reforms in electricity, which almost eliminated the quasi-fiscal deficits of SOEs in the sector (Box 4.2). Non-core activities of SOEs for social purposes, mandated by the government, should be accounted for separately from commercial activities and these should be devolved into independent activities with privatization wherever possible. In cases where they remain temporarily with the SOEs, the SOEs should be reimbursed for such activities transparently from the budget.

Estimating the cost of quasi-fiscal activities may be challenging, as SOEs have an incentive to overestimate the true costs of public service obligations. If information asymmetries between SOEs and the government are significant, the SOEs may be overpaid for fulfilling those obligations. On the other hand, governments tend to underestimate the cost of public service obligations. Various methods of calculating these costs that generate quasi-fiscal deficits are discussed in the OECD's Accountability and Transparency Guide for State Ownership (2010).

Directed lending to SOEs should be reduced with immediate effect and eliminated over the medium-term. Bank lending should be on the same terms to all companies, public and private. Government support for specific strategic purposes needs to be provided through explicit and transparent budget subsidies and only in limited and well-defined circumstances.

Adopt and enforce rigorous governance arrangement and financial reporting requirements for the SOEs. Advance privatization.

The authorities need to adopt urgently corporate governance arrangements that create incentives for efficient production and good financial performance, contain fiscal risks, help level the playing field for all enterprises. The size and evolution of quasi-fiscal losses depend on a number of elements beyond prices; these are factors that support efficiency, innovation and good corporate management. Establishing appropriate managerial incentives and arms-length management from the regulator is one part of this. Empirical evidence from countries shows that managerial rewards for good firm performance and penalties for poor performance (with metrics set appropriately) are important determinants of SOE profits and therefore the drain on (or profit to) the budget. For example, if SOEs continue to generate losses after financial and operational restructuring, management may be the problem. Financial sustainability requires that managers be provided with appropriate incentives to avoid recurring bankruptcy.

The SOEs need to start publishing audited financial statements. Reporting requirements have to be introduced along with strengthened governance arrangements to ensure transparency and accountability. The authorities need to move to adopting international accounting and financial requirements (see last item).

External incentives in the form of market competition are equally important for improved performance. Empirical research has shown that firm performance depends critically on the degree of competition or contestability in markets, regardless of ownership type. Profitability and productivity are generally higher when competition is introduced in markets. Studies have also found that privatized SOEs are often shielded by the state from facing the same degree of competition faced by de novo private companies. In other words, they continue to face favorable treatment, a factor accounting for worse performance relative to private companies. Competition may be provided by domestic or foreign firms, and by non-traditional firms in previously monopolized sectors. In order to have true competition in markets, regulations that hinder new private firm entry and growth are critical.

Privatization needs to be advanced to help put the private sector in the driver's seat of the economy; unless governance and market structures change, a public monopoly may be replaced with a private monopoly with equally problematic consequences. Privatized firms may capture markets and the state and in so doing, effectively eliminate forces that would support greater productivity, efficiency and innovation. Thus, privatization (and PPPs) will not deliver their goals, unless a regulatory and market structure provides appropriate incentives, promotes competition between firms, and reduces regulatory barriers to growth, such as poor property rights, restrictions on resource reallocation, including on labor mobility. Improving financial sector performance, concurrently dealing with SOBs, ensuring that banks are not captured by particular borrowers, will support improved performance in the new private sector.

Box 4.2. Reducing the Quasi-Fiscal Deficit in Electricity in Romania

Thanks to an ambitious reform program of a gradual adjustment in price levels to cost recovery and improvements in corporate governance, the quasi-fiscal deficit in electricity was reduced from 3.8 percent of GDP in 2000 to 1.3 percent in 2003 and 0.3 percent in 2013. A key driver of the reform was the alignment with EU regulations as part of Romania's bid for EU membership. In mid-2012, key elements of the electricity part of the EU's Third Energy Package were transposed into the Energy Law, which also restored the operational and financial independence of the energy regulator (ANRE).

A roadmap to gradually phase out regulated prices in electricity has been implemented since 2012. The non-residential electricity market was completely liberalized in 2014. Non-residential electricity is sourced through the power exchange run by the Romanian Power Market Operator (OPCOM). For residential consumption, 30 percent of electricity supply had been sourced through the free market since mid-2014 and the remaining 70 percent remained regulated—supplied by the three state-owned generators—but was gradually liberalized through 2018. Competition in the Romanian electricity market was often hindered by non-competitive sale contracts negotiated by energy SOEs for specific customers, often at below cost-recovery levels. Such practices were discontinued in 2012. Budgetary subsidies in the electricity sector have been directed mainly to generation, focused mainly on renewables and thermal (lignite) generation. The direct budget support to thermal generation has been declining over time, with a corresponding increase in the support to renewables.

Source: World Bank.

Provide support to the poor and vulnerable through the budget

To provide room for SOE prices to rise to cost recovery, SOEs to shed unproductive social activities, and for quasi-fiscal activities to be replaced by fiscal subsidies, the authorities need to scale up budgetary assistance to the poor. The mechanisms for such support could include direct subsidies, conditional cash transfers to targeted populations, and vouchers to eligible population groups for the public service provided. For example, rather than paying SOEs to provide low-cost electricity to certain groups of consumers, the government may wish to give electricity vouchers to low-income residents. In this way, the government ensures that the benefit goes to the intended recipient and does not undermine commercial discipline through direct transfers from the budget. In addition, where markets are competitive, consumers can seek the most efficient provider and use the voucher for that provider.

Replacing the quasi-fiscal energy subsidies with direct support to the vulnerable population groups will help achieve the intended social aims of public policy while generating savings for the budget. Estimations indicate that universal energy subsidies benefit disproportionately the wealthier groups of the population as these groups consume more energy than the lower-income groups. According to World Bank estimates, the electricity consumption of Uzbek households at the top quintile of the income distribution is, on average, 220 kwh/month, much higher compared to that of the bottom quintile, estimated at 140 kwh/month. Similarly, wealthier households spend a larger fraction of their energy budget on gas than poorer households. As a result of these differences, universal subsidies to energy consumption accrue disproportionately to the well-off

households. Based on household surveys, the World Bank estimates that 51 percent of subsidized energy tariffs in Uzbekistan accrue to the top 40 percent households in the income distribution. By contrast, only 30 percent of the benefits accrue to the bottom 40 percent of households, with only 13 percent accruing to the poorest quintile.

In the medium to longer term, advance comprehensive SOE and SOB reforms

These include:

- Implement the international accounting and bankruptcy standards for all enterprises, including SOEs.
- Adopt and implement an effective corporate governance system.
- Advance privatization to help create a viable and dynamic private sector.
- Assess SOBs' financial situation, starting with a proper asset quality review.
- Do strategic privatizations of SOBs once a financial sector strategy is in place. Rationalize the role of any remaining SOBs.