

On the Consumer Tariffs for Electricity

The experience shows that attempts of resolving several problems simultaneously are in general not successful. This complicates the situation further and as a result neither of the problems gets resolved. Similar picture can occur in Georgia with respect to electricity tariffs. The government is trying to comply with its pre-election promises of improve the living conditions of population through tariff reductions. The excessive revenues obtained by distribution companies through the high tariff margins fixed on the basis of memoranda signed between Georgian government and the owners of electricity distribution (and generation) companies, is considered as a source for tariff reduction, and negotiations with the owners (“Investors”) of distribution companies are conducted with this purpose.

- **Is electricity consumer tariff unbearably high?**

Close consideration indicates that this assumption is not well justified:

The proof of tariffs being excessively high is usually obtained through public inquiries, mostly conducted by journalists - not by professional organizations, Indeed, in the street interviews, people often complain on high electricity price, but with the high probability one could expect that with different formulation of questions, people would equally complain on the high cost of medicines, food, school handbooks and other goods. The citizens in general welcome the price reduction of goods and services, but the question is whether electricity and natural gas are unique in this respect - probably not. The improvement of living conditions can be alternatively achieved through increased incomes rather than reduced prices, in other words, this can be considered as a general welfare issue rather than a problem of electricity prices.

Simple comparison to the tariffs of other countries, even to neighboring ones, is also not well justified; Indeed each of the countries has its own base of natural conditions and subsidization policies which are not necessarily applicable in Georgia.

With the other, less subjective criteria we can see that:

- According to available data, **in 2011 the average share of electricity expenditures consumption in total expenditures of households is about 3%**. This means that average economic condition of households will not change significantly through tariffs reduction, since for majority of residents the share of expenditures on electricity consumption in total expenditures is not high. For low income families the share of energy expenditure may be higher than for medium an high income families, however the same is true for their share of expenditures on

other essential goods. Therefore, this problem seems to refer more to social welfare issue rather than high energy costs.

- Existing tariff levels were determined in 2006 and during following 6 years haven't been changed. Therefore, taking into account the inflation during these years we will can see that the real effective value of tariffs has reduced about 35-40 percents. Although initially the new tariffs faced discontent among population this didn't lead to any significant protest. Therefore, what was more or less acceptable back in 2006 cannot be completely unacceptable in 2012. Within this period the share of expenditures on electricity consumption in total income of population reduced from 4.3% to about 3%.
- In 2010 and 2011 there was approximately 10% annual growth in electricity consumption which is quite a high rate. Some growth is observed also in 2012. This indicates that electricity tariffs do not necessarily constrain electricity consumption.

Therefore the postulate on unacceptably high values of electricity tariffs cannot be taken as granted.

- **Will social problems be resolved through tariff reduction?**

As was pointed out several times before (including our previous letter www.weg.ge¹) the tariff reductions bring more benefits to consumers with high income and energy use than to socially vulnerable ones. Artificial reduction of tariffs, at the expence of public resources, increases social inequality. Solution is not so much in energy tariff reductions as in targeted social assistance programs . Tariffs, by all means, should reflect essential justifiable costs associated with secure and stable supply of energy.

- **How the existing consumer tariffs were determined?**

There are several components of consumer tariffs including transmission and dispatch, and energy component, which assures the revenues of generators' and importers. Distribution tariff (margin) should cover distribution company operation. There are also other components which we will not discuss here.

The existing tariffs, particularly consumer tariffs and distribution margin of Telasi were essentially determined in 2006 by GNERC resolution. The distribution margin, that contained a part aimed to guarantee the return of company investments, had to be effective only during one year.

Memorandum of Understanding between the Georgian government and INTER-RAO UES was signed in 2007 and then was renewed in 2010. The Memorandum provided for a long-term extension of consumer tariffs and the distribution margin, and defined investment obligations of JSC "Telasi" , including obligation to builde a hydro power plant with 100 MW capacity.

¹http://www.weg.ge/index.php?option=com_content&task=view&id=164&Itemid=55 electronic version

Georgian side fulfilled its obligation and GNERC through its resolution extended the validity of high distribution margin and therefore consumers tariff till 2015. As far as we know, similar Memorandum was signed between Georgian government and JSC “Energo-Pro” where similarly Georgian side fulfilled its obligation.

The condition of Memorandums on providing upfront revenue for building for building of HPP is unprecedented and one-sided. However, even these conditions were not observed by INTER-RAO UES which kept the excess profit and didn’t start building the plant. We estimate that, the excess revenue received by JSC “Telasi” in comparison to the conditions of initial Telasi investor agreement, from 2006 till now, is about 330 millions Lari. At the same time, it is not known what part of this amount has been spent on investments.

According to publicly available information, Georgian side tries to return these excess revenues through tariff reduction. The perceived prerequisite is that, on the one hand, Memorandum is not a legally binding document and on the other hand, the companies didn’t fulfill their part obligations.

- **Should the tariffs be reviewed?**

Electricity tariffs undoubtedly need to be reviewed since they were determined in 2006 and do not reflect current realities. This, probably, will require careful withdrawal from the signed Memoranda with foreign energy companies, with the due account of all possible consequences.

In order for the consumer tariffs to be normalized, GNERC should review all its components including distribution, transmission and dispatch and other components. Additionally, electricity generation and supply components should be estimated to reflect expected increase in expenditures due to increased import of electricity in winter and possible new hydro plants construction expenditures², following recent increased electricity consumption. Based on these components the final electricity consumer tariff should be calculated.

The distribution tariff values should be determined based on regular tariff methodology and should be reduced to minimal necessary levels and be relieved from excessive components in correspondence with existing law. At the same time, the excess revenues obtained by distribution companies in compliance with the signed memoranda cannot be returned through the distribution margins. The distribution companies need to receive sufficient income to cover their operation and investment costs otherwise this will cause problems in electricity supply.

Since determination of tariff is a prerogative of GNERC, Georgian government should negotiate with INTER-RAO UES and Energo-Pro not on tariff issues but rather on acceptable ways of returning the extra amounts obtained by the companies through tariffs according to Memoranda.

²The current method of reflecting the energy costs in consumer tariffs is quite controversial, however this is a subject of a separate discussion.

Conclusion

Based on the above, the view that electricity tariff is unacceptably high is not supported enough by sociology and economic evidence.

At the same time, electricity consumer tariffs should be optimized in accordance with tariff methodology, at economically sound levels, this shall cause elimination of excess values of distribution margins, however, other components should be reviewed as well. The final outcome may not differ much from existing tariff.

Negotiation with investors should be on the amounts of excess revenues obtained by distribution companies and the methods of their return. Solution of problems of socially insecure population should be addressed through targeted social programs, preferably by means of cash subsidies, without any relation to energy.

We hope that discussion and solution of these problems will not be resolved through simplified and populist measures, but instead, the whole society will use this opportunity for more in-depth understanding of the issues discussed above and we will move from intuitive/instinctive approaches to more justified, rational and system views on these issues.

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