

## Problems in the Energy Sector of Georgia and the Ways of Improvement

Reliability of energy supply has significantly improved in Georgia over the last decade. However, this improvement was not accompanied by adequate institutional, legislative and professional development in the energy sector. On the contrary, the worsening of existing legislative and regulatory framework, decline in institutional capacity and contractual environment, and accumulation of unresolved issues and problems in the sector in recent years has become obvious. This can hamper further sector development and become a serious obstacle for country's energy security independent development, its European and Euro-Atlantic aspirations.

### 1. Main Problems and Issues in Energy Sector

- **Energy Strategy and Energy Policy of The Country.**

There is no strategic document of country's energy sector that would be based on sound analysis of alternatives and would set the vision and priorities for decision making. "Main Directions of Energy Policy" adopted in 2006 is just a collection of declarations and unjustified numbers; Government program - Renewable Energy 2008 (hydropower) - is only a set of procedures. Inadequacy of these documents to their stated goals and the real situation became obvious and they can hardly provide needed confidence and guidance for sector development. Therefore the strategic decisions are subject to arbitrariness and can be easily misleading.

- **Data and Information for Decision Making**

Official Energy Balance of the country has not been compiled and analyzed by statistics department since 2001. Only electricity and natural gas supply information is partly available, without consumption. This indicates the lack of most basic information for decision making and development of the country's energy strategy and reflects the policy of addressing electricity and natural gas problems rather than energy sector as a whole. This makes erroneous strategic decisions highly probable.

- **No Energy Plan Or Process For Planning** – despite of having an access to rigorous planning tools – E.g. MARKAL Georgia model, there has been little effort to develop a long term energy plan or even a sound electricity plan. This indicates a practice of being involved with mostly short term issues in energy sector and confirms the lack of capacity for strategic long term decisions.

- **Poor Quality Of Legislation** – The legal framework formed by the beginning of 2000-ies under donor led reform were continuously amended on an ad hoc basis for immediate needs, without observance of good industry practices and industry standards. The Law on Electricity and Natural Gas and the Law on Oil and Gas have been changed numerous times without consistency and general guiding principles, Electricity Market Rules is vague and hardly usable document. As a result the energy legislation has become unworkable and decision often requires either its arbitrary interpretation. This hampers sector development and prevents the qualified investors from entering the country.

- **Sector Governance** – has made a step back to centralized system and in difference to western model is subject to ministry command who, along with political responsibility, has acquired regulation, management, operations and ownership rights. Regulator is disabled and deprived of functions. There was a strong informal influence of the ministry over all sector entities and even company revenues.
- **Investment.** Unstable and unclear legislation and governance practices have prevented the Western credible investors from entering the country's energy sector. Absence of country energy plan hinders the development of energy and specifically hydropower potential and attraction of investment. The practice of nontransparent tendering and negotiating terms/conditions has detracted credible companies from considering investments in Georgia. This is more alarming in view of growing internal demand.
- **Regulation and Tariff Setting** is controversial and virtually inexistent. Tariffs have been set more than six years ago without proper economic justification, later extended - based on MoUs signed by the government and utility owners. This has allegedly provided significant excessive profits to the energy companies at an expense of consumers. The quality of ongoing tariff discussion confirms the need for better understanding and respect of economic tariff setting principles.
- **Competition on Energy Markets** is practically nonexistent. Sector generators are bundled in integrated companies with distributors and major consumers, without adequate requirement of transparency or operating on a common market platform. No unbundling required, allocation of cheap power from Enguri is done on an ad hoc basis by ministerial decisions. The economic results of such arrangements to the country and consumers needs to be explored.
- **Fossil Fuel Exploration** nearly has nearly stopped because of the lack of strategic vision and unclear policies. Local exploration and production of oil and gas is not adequately supported. Exploration of nontraditional fossil fuels like shale gas is not getting adequate attention. All domestic coal reserves are given to one private company and there is no sign of state policy on coal.
- The plans of implementing **Gas Storage** project prepared by donors have been suspended and gas balancing was transferred to Azeri side with the probable consequence of not acquiring maximum benefit from the transit agreement. At the same time the country missed the opportunity to comply with the EU requirement of having own security reserve.
- **EE & RE** – there is no legislation, action plans, or government agencies and programs in this field. The initiatives of major cities under Covenant of Mayors are supported only by donors. The lack of awareness and vision in this field does not allow the proper policy making. As a result – international obligations under Energy Charter, ENP and Eastern Partnership remain unfulfilled and the perspectives of EU harmonization (Energy Community) or participation and benefitting from worldwide climate change mitigation processes are dim. Most of all a significant energy potential remains untapped.
- **Agreements and MoUs** . There is a number of controversial concealed international agreements and memoranda with investors and government entities of other countries. Privatization agreements, Gas agreement with SOCAR, Enguri agreement with RAO UES, memoranda with RAO UES and Energo-Pro on distribution tariffs need to be revisited for compliance

with the interests of country's energy security and economic development its plans for European and Euro-Atlantic integration. Careful and qualified action is needed here.

- No **research and development** or innovation policy in place – this is a common country problem but strongly affects the energy sector.
- **Inadequate institutional capacity and qualification in the sector.** Lack of independence in centrally managed system, absence of processes characteristic for energy sectors of developed countries (planning, strategy development, information availability, competition, etc.) restricted the institutional and professional development in the sector. The organizations and employees were deprived of initiative and participation in high level high quality decisions. The sector was governed informally as one entity and the key sector organizations had limited possibility of defending their independent interests and developing institutional capacity

Thus, the lack of transparency and good governance in absence of documented strategy and sound legislation creates the policy and legislative instability, vulnerability to external and internal political influences and possibility of corruption. Such a situation hampers the sector development and constitutes a threat to country's energy security, its sustainable and democratic development, and contradicts with its aspirations to EU harmonization and energy cooperation including prospects of energy transit. These problems and issues can be illustrated by numerous facts and real life cases.

## 2. High Priority Tasks

Energy sector is facing a number of operational and strategic challenges that need to be addressed as soon as possible:

- **Country's Energy Strategy, policy and energy outlook** needs to be started immediately in order to create the support and direction for strategic decisions.
- International Energy relations
  - EU association and Energy Community – thorough barrier analysis and clear road map for action plan are needed; In coordination with the Ministry of Foreign Affairs, relations with European Commission and European Energy Community (EEC) need to be intensified for preparation of membership in the EEC;
  - Georgia's transit function for Southern Gas Corridor – clear and stable legislation compliant with international standards and development of country's vision on this issue with the account of its sovereign interests;
  - Regional energy market - consequences of Turkey interconnection on internal electricity market need to be analyzed; Diversification of export market and potential for seasonal swap of electricity needs to be assured as a condition for hydropower development;
  - Participation in Climate Change mitigation processes – EE & RE, NAMA development etc.;
- Fundamental **reworking of legislation** based on market principles and best industry practices in order to support country's aspirations to Euro-Atlantic community;

- **Institutional rebuilding** – rethinking the role of the ministry to be responsible for the whole sector (rather than only electricity and Natural Gas), **Restoring the independence and capacity of regulatory and licensing agencies**, etc.;
- **Developing the market model** for Georgia, **unbundling** and introduction of **competition**
- Revisiting and renegotiating sector agreements; bringing them in compliance with the best industry practices, strategic interests and international obligations of the country;
- Attraction of **investment** and providing clear and stable conditions to the investors to increase the generation capacity due to demand growth on electricity. Setting clear criteria and standards for **Environmental Impact Assessments** to balance the interests of investors and the country.
- **EE & RE**. Development the vision, enacting legislation and setting up corresponding institutions and action plans;
- Development of technical norms and standards, grid code and international trading mechanisms (partly covered);
- Tariff and regulations on new Turkey interconnection line, Etc..

**Immediate actions are due in order to resolve the problems and issues in foreseeable future. This requires a strategic change and move away from business as usual practice. A realistic program of actions has to be developed and effectively managed with the help of strong expert support and coordination of all stakeholders under shared vision. Now is a sensitive transformation moment. An expedient action can be highly productive, while the failure to act - highly damaging.**

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