

Energy Sector Requires Urgent Reforms

The ongoing energy debates in Georgia are mainly concerned with consumer tariffs, or environmental impact of new hydropower plants. The society is less interested in the condition of energy sector itself and its ability of meeting the basic energy requirements in short and long term without compromising the country's other interests. The superficial-consumerist attitude to energy sector entails major threats. There is a number of fundamental systemic problems that require immediate attention otherwise they can negatively affect country's security and welfare, its aspirations to western development and regional cooperation. An urgent sector reform is needed in order to prevent these threats.

Energy sector has to ensure safe, reliable, sustainable and affordable supply of energy to all consumers in short and long term. In addition it has a strong political role by enabling Georgia to comply with its aspirations of European and Euro-Atlantic integration and regional cooperation. **How prepared is the sector for its tasks?**

1. Energy Policy and Strategy

The country does not have a documented comprehensive **energy policy or strategy**, which would guide the development by providing clear and justified objectives, priorities, estimate of acceptable risks, and the framework for improvements. The counterparts at international negotiations may be supported with strategies developed by qualified institutes and think tanks, while our representatives, usual, are not burdened by much analytical calculations and prepared scenarios. The decisions made based on intuition and own limited experience can't always be successful. Moreover, the lack of clear guidelines makes difficult to assess the righteousness of taken decisions. This raises the temptation to present any, even flawed action, as a success, instead of trying to improve it.

Along with strategy we are also missing other important instruments and concepts:

- Country's official **energy balance has not been compiled since 2001**. Few people know that the country is 60-65% import dependent and this dependence is increasing, that firewood contribution in primary energy supply is comparable to that of all hydropower.

- Due to the lack of **long-term planning** there are no reliable projections of demand in electricity, gas and other energy carriers, the amount of electricity remaining for export, expected energy prices etc. Therefore planning for energy projects and signing beneficial contracts becomes difficult;
- **Hydropower development is conducted without proper analysis of** energy, economic or political benefits. Consequently, it becomes impossible to agree on acceptable environmental, financial and administrative compromises in support of HPP construction, or to assess the security risks due to blocking the construction. This renders the current debate on HPP environmental impact largely unproductive;
- There has been no **strategy for regional energy cooperation** developed. The declarations on becoming an electricity hub remain distant dreams, particularly in view of expected deficit in the coming few years;
- The new Turkey interconnection line will be commissioned in a few months but the tariff, capacity allocation rules and trade arrangements are still in the process of development. Most importantly, the **impact of Turkey interconnection on Georgia's internal electricity market** has not been analyzed and mitigated;
- The lack of long term visions can affect the negotiations on energy clauses of EU Association agreement or and Free Trade Agreements as well as expected negotiations on the membership in Europe's Energy community since we have not properly analyzed **how the country can comply with integration requirements**, what benefits should we expect or what compromises we can afford.

2. Legal and regulatory framework

The quality of **energy legislation is poor**:

There is no unified energy law in place for all types of energy. The important energy resources - coal and oil products, as well as renewable sources of energy and energy-efficiency are left beyond Georgian energy legislation.

The legislation, developed during the first donor led energy reform, has been significantly degraded since early 2000-ies due to conceptually wrong amendments and ad-hoc changes made for one time specific needs. Many important issues remain unregulated. The controversial and incomplete legislation contains contradictory and vague provisions, allowing arbitrary interpretations and thereby leaving space for political influence and/or corruption risks.

Georgia is the only country in the region, which has not adopted **energy efficiency and renewable energy laws**, and this is more a sign of underdevelopment, rather than of economic policy. Indeed, this field is related to modern technologies, research and development, advanced institutions,

commercial, and banking systems and commercial companies. Its implementation requires a high energy consciousness and the subtle mechanisms of economic incentives, which are characteristic of a highly developed society. This is one of the essential elements for European energy cooperation and refusing it means rejecting development and international technological and financial assistance. Most importantly, the internal resources of energy efficiency and renewable energy remain untapped, leading to a growing import dependence and related economic and political risks.

3. Energy Market

Instead of promoting competition, the market is divided into several vertically integrated monopolistic segments. Energo - Pro and Inter RAO UES are involved in both generation and distribution, and partly transmission activities; SOCAR is the gas network owner and gas supplier simultaneously. Controversial commercial memorandums signed, with these companies until 2025-2030 limit their independent regulation and control as well. Some of these companies have already acquired unjustified excess profit, on the basis of these unbalanced agreements, and there is no adequate mechanism for its return. Thus the existing market structure restricts competition and regulation, contradicts with harmonization with European energy legislation and thus with integration process.

4. Governance Style

During the last decade, the sector has returned to a **centralized-administrative management model** and is almost completely subordinated to the Ministry, which enjoys political, regulatory, operational and ownership rights. The regulatory bodies in developed countries are independent organizations of highest professional qualification that provide the guarantee of stability to investors. In Georgia GNERC, as well as Oil and Gas Agency, are strongly devalued and disabled. Staffing of these agencies with the personnel of inappropriate qualification is an indicator of attitude towards these most important bodies. The Ministry used to have a strong, informal influence on the sector enterprises, their operations and even income. The most important decisions (including tariffs) made by the Ministry and were rubberstamped by the Parliament and Regulator.

These governance methods are more characteristic to post-Soviet authoritarian system, rather than a western market model. Such a concentration of power is especially dangerous, in the conditions of imperfect legislation, competition, lack of transparency and the absence of strategy framework, especially once the sector is dominated by large foreign state owned energy companies, whose interests can be much broader than only making profit through successful energy business in Georgia.

The level of **transparency** in energy sector, as well as the availability of public information has significantly decreased, in recent years. For example, previously public the financial reports of distribution companies are no longer available. Unknown are the terms of memorandums with

foreign state energy companies, which affect almost all citizens and therefore should not be hidden from them.

5. Professional and Institutional Development

Insufficient attention was paid to education, research and development thus hampering introduction of new technologies. Centralized decision making prevented the growth of institutional capacity and professional experience thus the internal systems need to be developed.

• *What are the consequences?*

The listed systemic deficiencies have many negative results;

Strategic investors with proper resources and experience, who tend to avoid vague, unstable working environments, are hesitant to enter the sector. As a result, over the last decade no significant hydro power plants have been commissioned. A number of initiated projects were impeded by financial or technical problems. In 2012 the country shifted from net electricity export back to net import, and winter electricity supply is likely to be difficult in coming years if the demand grows further.

Due to insufficient support, the development of indigenous fossil traditional (oil and gas) and non-traditional (shale gas and oil) energy resources is hampered and external dependence is growing. About 80% of licensed territories have not been unexplored with modern technologies. All coal reserves of the country are owned by one private company, and no signs of state policy in this field are visible to encourage its use. The renewable solar, wind, biomass and geothermal energy resources are underdeveloped even in remote areas where there is no energy network.

The level of energy security needs improvement. The stability of electricity supply in winter is largely dependent on neighboring countries. The donor supported project of building underground natural gas storage was not implemented as a result the country is losing the security advantage as well as likely the benefit from transit agreement. There are no established energy emergency action plans and mechanisms, which any country taking seriously own security should have.

Thus, we find ourselves in a situation, where on the background of major problems; having no strategic vision, quality legislation, transparency, competitive market, strong regulator, effective governance and professional personnel, we are facing the strong players in a tough political environment and want to defend unknown long and short-term energy interests of our country and our citizens. Reader can evaluate the success chances of such an undertaking themselves.

What is the solution?

The described systemic problems are largely due to many years of naïve and childish attitude of our society, when it was not interested in basic systemic development but was rather satisfied with short-term, real or illusory PR results.

*Of course, we should not overlook the significant achievements in energy sector. Rehabilitation of hydro plants and continuous energy supply, construction of new lines and reinforcement of power transmission network, construction of gas network and gasification of regions, stable tariffs, and start of hydropower construction should be duly valued and continued. But at the same time we should be aware of the resources and opportunities spent to achieve these results. We should make sure that we don't pay extra by **money, sovereignty, or political perspectives of the future?***

In order to avoid the dangers of statehood, implied by the current state of the sector, the openness of the new sector leadership and its first steps taken towards reforms, with the help of the donors must be used, in order to demand more transparency, professionalism and fundamental systemic changes. We must be protected not by the personal decisions and personal relations of politicians, but by systems of legislation, regulation, market, strategies, and professional organizations of modern standard. This requires the program of reforms and modernization of the whole sector as well as energy ministry. Without a systemic solution, the further accumulation of problems is unavoidable.

Reform, is by far the most profitable investment project in Georgia's energy sector, which is far more advantageous than any infrastructure project. Proper systems and professional institutions will help avoid the emerging problems, create stability and energy security, attract investment and accelerate the development. This is the opportunity to rise to new levels of technological and organizational development and knowledge, which should not be missed. It is time for the society to take its future more responsibly.

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