

Summary of a meeting with McNeill Watkins of Hagler Bailly

Georgia's Energy Sector

September 30, 1999

"McNeill Watkins of Hagler Bailly discussed the development of Georgia's energy sector since the breakup of the Soviet Union at a CSIS Georgia Project meeting on September 30. He underlined the importance of the sector as a critical factor not only for Georgia's economic future, but also in helping to shape its political future.

Watkins explained that the Soviet legacy of subsidized electricity has proved disastrous for Georgia's energy sector. The Soviet Union developed the Transcaucasia energy sector as an integrated regional network. With the collapse of the Soviet Union, however, Georgia, Armenia, and Azerbaijan were forced to operate their energy systems independently. Post-independence Georgian politicians feared civil unrest if they were to raise prices for electricity and so continued the Soviet practice of billing certain users only nominal prices while providing electricity free of charge to others because of political considerations. The entire system inevitably began to collapse, as distributors found themselves unable to raise the needed revenue to cover operational costs.

Watkins noted that while consumers were initially willing to pay nominal amounts for electricity, now they refuse to make any payments for what is at best sporadic service a few hours a day. Without revenue, the facilities began to either shut down or significantly cut back their hours of operation. The result is a paradox for the Georgian energy sector: there is a desperate need for service suppliers to increase their revenues so they can improve service, but consumers will not pay unless their service is improved.

The Georgian energy sector can be divided into the generating and marketing/distribution subsectors. According to Watkins, one of the generating sector's basic defects is that the industry remains consolidated in its current form, with no prospects of competition in the immediate future. Competition will have to come from outside the country, and as Armenia is the only regional supplier of electricity, there is effectively no competition.

In this sector the privatization of Telasi was quite successful. Two bids were submitted, and the American company AES won the tender. Watkins argued that while some of AES's difficulties were self-inflicted, most were the products of a discouraging business and political environment. AES faced problems with the tax authorities, an all-too-common experience for companies doing business in Georgia. There was also a misunderstanding about who would pay the outstanding debt on Telasi. Watkins suggested that the solution was to privatize the supply of electricity. With increased competition, energy companies will be able to provide better service at lower rates.

Hagler Bailly's main effort in Georgia's distribution sector had focused on two areas: the disaggregation of enterprises and preparation for privatization. The hope is that with the proper

allocation of resources and the diversification of assets, accountability and efficiency would be enhanced.

The self-inflicted problems of AES included the failure to calculate individual electricity usage and to charge appropriately. The meters used to measure electricity are located inside homes and apartments; consequently, cases of tampering and even the bribing of meter readers complicated the process of calculating the use of electricity. Watkins explained that AES had done little to improve the situation.

In contrast, Hagler Bailly's program in Rustavi directly tackled this problem. Meters were placed in secure areas, thus eliminating contact between meter readers and consumers. Once people were able to use electricity continuously for 24 hours, they were happy to pay. Significantly, it was also discovered that as consumers were monitored on an individual basis, their usage dropped, considerably reducing the aggregate demand on service providers.

Distribution

Watkins argued that the best way of relieving Georgia's electricity problem was to import gas while accelerating the search for oil and gas. He acknowledged, however, that the distribution of gas represented the greatest opportunity for abuse in the energy sector-even more than for electricity-because the Russians were inevitably involved with gas. There are five distribution centers in Georgia: Tbilisi (the largest distribution center in Georgia, operated by TbilGas), Rustavi, Batumi, Kutaisi, and Gori. All five are owned by SakGaz, a company that operates from off-shore accounts with offices in the Gazprom building in Moscow.

Revenue Collection

Revenue collection is a problem not only for the Georgian energy sector but for the state as a whole. The Georgian government has been able to collect only 9 percent of its GDP in taxes, the lowest by far in the Transcaucasus. Consumer nonpayment remains a critical hindrance to developing the Georgian energy sector. Companies wishing to do business in the Georgian energy service had to take into account that they could not collect full revenue from customers such as WWII veterans or lawyers. Equally significant, the entire region of Abkhazia is still being served electricity, although no revenue could be collected. The only success case is Batumi, where Abashidze's Soviet-style management results in a greater than 90 percent collection rate.

Money shortage has kept Georgia at an impasse. Watkins explained that Georgia simply could not compensate for its lack of resources, such as gas, and deal with its energy shortage through purchases. The government is in debt to Turkmenistan for \$200 million for previous gas purchases. Without the ability to pay for earlier gas shipments, the Georgian government is in no position to pay for future shipments and, as a result, Turkmenistan is no longer willing to sell gas to Georgia. In fact, there is no supplier willing, or able, to sell Georgia gas besides Gazprom, which remains Georgia's only source of gas.

Regional Politics and the Energy Sector

Watkins discussed another possible threat to Georgia's gas supply, referring to reports that Russia had threatened to cut off Georgia's gas supply if Georgia continues to support the Trans Caspian Gas Pipeline (TCP) project. Considering the Georgian energy crisis and Gazprom's position as the only gas supplier to Georgia, such action could have a devastating effect.

To take precaution against a possible gas cutoff, USAID funded a study for the rehabilitation of a gas pipeline from Azerbaijan to Georgia that had not been used for several years. Watkins, however, did not believe that this pipeline could be reactivated in less than six months and, more importantly, not before winter set in. In any case, there was a question as to whether Azerbaijan could produce enough gas to meet Georgia's needs as well as its own.

Ultimately, Watkins argued that the probability that Russia would suspend gas shipments to Georgia was minimal because Armenia also received its gas through the same pipeline. As the gas ran through Georgia before it reached Armenia, cutting off gas to Georgia would also mean cutting off gas to Armenia, which Russia.