GEORGIA

Review of the Investment Climate and Market Structure in the Energy Sector

2007

Energy Charter Secretariat
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POLICY CONCLUSIONS TO THE IN-DEPTH REPORT ON THE INVESTMENT CLIMATE AND MARKET STRUCTURE IN THE ENERGY SECTOR OF THE REPUBLIC OF GEORGIA

The Charter Conference,

Having regard to the Report from the Investment Group with respect to the In-depth Review on Investment Climate and Market Structure of Georgia

NOTED:

a) That Georgia has recently gone through a vigorous reform programme following the establishment of stability in the country and many steps have been taken towards a better investment climate in general with emphasis on the energy sector. In this respect, the government of Georgia has gone a long way towards liberalising its economy and realising institutional and structural reforms that led to a better investment climate for investors.

b) The importance of Georgia as an energy corridor in the Caucasus region rich with energy resources and its role in presenting an invaluable option for the energy markets in the world, partly satisfying concerns over energy security via diversification of sources.

c) The importance of greater transparency and non-discrimination in this respect pursuant to the ECT, further noted the significant role of existing transit pipelines in hailing geo-strategic importance of Georgia in the region as well as a sign of investor confidence due to their multiplying effect on other potential investors.

d) In particular:

• Welcomed the achievement of the reform programmes in Georgia in the energy sector which is intended to be coherent with the EU’s aquis communautaire regarding restructuring and liberalisation;

• Appreciated that Georgia has embarked on a vigorous reform agenda in the recent years and has been successful to achieve many of the targets. Welcomed the liberalisation of the economy and restructuring of the institutional system bearing fruit in increased FDI, integration with the world economy, and modernised economic structure in many of the sub-sectors. Highlighted that increased competitiveness resulted in increased exports, while higher FDI figures are to bring into the country know-how and modern technology;

• Took note with satisfaction that important milestones have been covered in the energy sector towards a regulatory system that envisages the private sector running energy sector activities ranging from production to distribution, which foresees less political interference and more transparency, yet addressing the vitality of preserving the regulatory structure for the envisaged liberal market system to work effectively and give confidence to entrepreneurs for required investments towards a competitive energy market;

• Appreciated the steps taken for a more efficient and less burdensome bureaucracy that curbed the red-tape, and furthermore commended introduction of the one-window system for entrepreneurs, namely the Georgian National Investment Agency (GNIA) that provides services to entrepreneurs at no cost; but also advised the authorities to boost further the reforms in strengthening the judiciary for a more reliable justice
system and effective implementation of the existing legislation, while employing a balanced approach for sustainability as a developing country with income inequalities;

- Noted with satisfaction the policy approach in the oil sector, and also the ambitious restructuring and privatisation programme pursued in the electricity sector, and that the gas sector is governed by a liberal law envisaging principles of market economy; and highlighted the similar approach in the coal sector with expected private sector involvement which would help ensuring the maximisation of using indigenous sources;

- Acknowledged that, in the energy sector Georgia is going through the liberalisation, privatisation and competition-regulation process simultaneously, and thus drew attention in this respect to the difficulty of preserving a balance between competitiveness and supply security;

- Commended that the liberal approach in energy sector is noteworthy especially in a relatively small country, but considered that implementation should be carefully administered so that the theory matches the practice to create confidence in the market, which is vitally important for attracting future private investments, and that deviation from or inconsistent moves with what is already mentioned in the policies or through implementation may create uncertainty as to future policy and performance of the energy sector;

- Noted with satisfaction that Georgia has developed a Renewable Energy Development Programme to exploit the good potential for renewable energy sources which improve the level of security of supply while reducing CO2 emissions;

- Appraised the establishment of the Energy Efficiency Centre and referred to the need to take further steps for promoting energy efficiency within the market-oriented framework, including institutional build-up of capacity on the public side.
1. Investment Climate

Enjoying from its geo-strategic importance in the Caucasus region, Georgia is developing as an energy corridor for the energy rich countries in the region and presenting an invaluable option for the energy markets in the world, while partly satisfying concerns over energy security via diversification of sources.

After suffering from instability and shadowed by the difficulties arising out of the transition period, the country has recently observed a relative stability in the recent years following the Rose Revolution in 2003. The new government has acted decisively to tackle with the structural problems encountered in a wide range of areas, from ensuring political stability to undergoing economic reforms in the country. On the political front, the system functions well following the turmoil that led to the Rose Revolution. Nevertheless, there are ongoing disputes in the secessionist autonomous republic of Abkhazia and the autonomous region of Ossetia, where there is indeed very little, if any, control of the government, and this may pose risks and undermine political stability.

On the other hand, the government has taken a long way towards liberalising its economy and realising institutional and structural reforms that led to a better investment climate for investors. Due to the vigorous efforts by the government in the recent years, the country is now recognised by the World Bank as the fastest-reforming country, also it now ranks the 35th most open economy and the 85th as the most globally competitive country. To this end, there has been an unprecedented reform in the tax regime which is in harmony with the EU, whereby number of taxes was reduced from 21 to 7 and a flat income tax of 12% was introduced. Towards an efficient and less burdensome bureaucracy, licensing requirements were dramatically reduced with strict time limits to respond to applicants, and furthermore, a one-window system for entrepreneurs (the Georgian National Investment Agency (GNIA) services) was introduced, which is to provide services at no cost to the investors.

Nevertheless, the government faces a major challenge in controlling corruption, which is a persistent and systemic problem. Deficiencies regarding the judiciary and system of justice still pose risks regarding the foreign and domestic investors.

The institutional reforms, creation of a liberal legislative framework, and structural reforms resulted in a noteworthy economic growth. GDP growth rate reached 9.4% in 2006. The trade volume is seeing an increasing pace in the recent years. There are important milestones in foreign investment like the ‘Baku-Tbilisi-Ceyhan Pipeline’ Project which is a clear indication of foreign investors’ confidence in the country. The reforms of business climate and the policy of liberalisation and deregulation implemented by the government contributed to growth of the national income, albeit its effects on the employment have not been strongly witnessed. Georgian trade and exchange systems are considered to be among the most liberal of the transitional economies. Also, Georgia has no quantitative restrictions (quotas) on trade. There is a strongly negative balance of trade, which is offset by inflows of investment and assistance from international donors.

The priority of the government towards a liberal economy has also manifested itself in its efforts regarding privatisation. The government privatised nine times the value of state-owned assets in 2005 as it did in all of 2000-2003, and expects to have privatised all of the largest state-owned industries by the end of 2008. This will certainly help increase government revenues and the struggle against corruption, while care should be taken to ensure fair and stable competition following privatisation. As another sign of the liberal investment regime,
any Georgian or foreign person or company has the right to take part in the privatisation process in compliance with the laws of Georgia. The most recent privatisation activity envisages privatisation of major state-owned energy facilities.

Foreign direct investment (FDI) is the most important source of capital for Georgia. Such investment not only supports new plants and equipment, but also usually entails bringing in modern management methods as well. The Georgian Government is eager to welcome foreign investors. In 2004, FDI totaled $489 million, more than half of which was invested in construction of the now-completed Tbilisi-Baku-Ceyhan oil pipeline and the South Caucasus gas pipeline. Foreign investors are beginning to take notice of the changes in Georgia. FDI reached $539 million in 2005, and inflows of investment exceeding $1 billion are expected in 2007.

The rights of the foreign investor making investment and carrying out entrepreneurial activities in Georgia are protected and guaranteed equally with those of Georgian entrepreneurs, including the right to repatriate profit or any other funds after payment of taxes and other mandatory duties after conversion in the Georgian banking institution. It should be noted that the foreign investor also has the right to freely move any property owned by him out of the country. Investor confidence is further boosted by allowing foreign investors have recourse to international arbitration under ICSID or UNCITRAL rules. The Constitution and the Civil Code stipulates that the right to property is guaranteed and protected.

As a result of the reform programmes vigorously pursued by the new government, there have been highly promising results that were achieved in the recent years. However, there are certain pitfalls as well. The highly liberal labour code, while being business friendly, is also subject to criticism to have gone excessively pro-business, undermining the balance and posing risks for social unrest. The vigorous privatisation effort is seen by some as based too much on theory rather than a balanced approach, not taking into the realities of a developing country with wide income inequalities. Another drawback is the level of implementation regarding the reforms in legislative terms, since much more effort is needed to put the reforms on paper into practice in the field.

2. Market Structure

In general, the country is following the same liberal policies and reform programme in the energy sector as well. According to a recent policy paper, the emphasis is in energy efficiency, security of supply (particularly electricity and gas), market restructuring (including third party access to networks), deregulation and liberalisation, implementing basic market and privatisation prerequisites (metering, cost-reflective tariffs, settlement of debts, enforcement of power and gas market rules), promotion of investment, and enhancing bilateral and regional cooperation in the energy sector. The main concern in the policy document is the power sector, whereby the main goal is to ensure full coverage of electricity demand, achieve economic independence and stability, and assure technical, economical and political security via the best use of the power sector resources and diversify imports.

Oil and gas: Georgia is not a hydrocarbon rich country. There is only a very modest crude oil production, but hopes are high for future discoveries by modern technologies. Oil and gas operations are conducted in accordance with the provisions of the Oil and Gas Law, which defines a uniform policy for the development of oil and gas resources and regulates the relationships between the National Oil Company of Georgia and private investors. The tax regime applicable to players in the sector is not clear enough, as there are discrepancies between the provisions of the Law and what is stipulated in the individual production sharing contracts with investors. Clarification on this issue may be beneficial to reduce the concerns...
of potential investors in the sector. On the other hand, Georgia is applying in certain issues like the calculation of taxable income based on internationally accepted practices.

Government supervision over oil and gas operations in Georgia, including oil refining and transportation, is carried out by the State Agency for Regulation of Oil and Gas Resources (SAROGR), responsible for preparation of contracts, negotiations and signing of hydrocarbons exploration and production (E&P) agreements on behalf of the state: issuing of licenses and all other necessary authorisations, etc., while also setting the regulation price. The granting of rights for exploration and production is by way of a tender or an auction carried out by SAROGR. Access to hydrocarbon resources is granted to investors mainly on terms of production sharing agreements (PSA), risk service agreements, or service agreements. In line with international industry practices, a general type for the right to use oil and gas resources is issued, giving investors the option to choose either of exploration and production but not both. Georgian Oil and Gas Corporation (GOGC) is the state entity participating in exploration and production activities. The state has the possession of most, if not all, geological, geophysical, production and other information needed to evaluate and manage oil and gas prospects and projects, while operating a few fields on “grandfathered” terms. On the other hand, foreign companies operating in Georgia have carried out significant exploration, including seismic data acquisition, processing, interpretation, and drilling of a few exploratory wells. The upstream sector of the oil industry could probably help build up investor confidence by improving transparency and providing more detailed information pertaining to the relevant terms and conditions, while the absence of a single shopping window in negotiations for access to acreage is another drawback.

There are currently two oil pipelines operating in the country: the Baku-Supsa Crude Oil Pipeline, and the Baku-Tbilisi-Ceyhan (BTC) Pipeline. The latter is also known as the ‘main export pipeline’, and both aim at transporting the Azeri oil form Azeri, Chirag, and Gunashli fields. These pipelines are clearly the fruits of a stable investment climate and representative of the investor confidence in the country. They are also helping ensure the stability of the country in the future. The importance of the pipelines stems not only from the direct monetary payments if terms of fees or taxes out of the operation but also from the indirect affects like creation of jobs, the transfer of technical expertise and know-how, the assistance provided to communities along the pipeline route, and grants and donations to various NGOs, or, most importantly, the multiplying effect in convincing other potential investors.

Apart from the Baku-Supsa and BTC pipelines, crude oil is also transported across Georgia by rail, along with considerable quantities of refined products, to the ports of Batumi and Poti, via the privately owned Batumi and Kulevi oil terminals. These shipments are along the TRACECA corridor established in 1993 with the help of EU, linking Central Asia to Europe via the South Caucasus, particularly Azerbaijan and Georgia. However, given the lack of data regarding railway capacity at present in the near future, it is at present not much likely to envisage the perspectives at the moment. Also, there are certain allegations as to the way of operation of the railway company in terms of ensuring fair competition in its transportation business.

In the gas sector, there are various pipelines in the country, such as the Karadag (Azerbaijan)-Tbilisi pipeline and the North-South Caucasus Pipeline (NSCP) which links to the lines from Azerbaijan and continues into Armenia. Systemic deficiencies in the pipelines from the past have been rectified and there have been renovations in the pipeline system in recent years. Main pipelines are operated by the state-owned companies, which include the high-pressure trunk lines, the compressor stations, a number of gas metering/regulation stations, and certain other facilities, and they also have the task of maintaining and operating the entire main gas transmission system. These companies take and monetise in-kind payments for gas transit, and also handles import contracts.
There is an exception to the above, however: The Azerbaijan-Turkey Natural Gas Pipeline (South Caucasus Pipeline – SCP), which is privately operated, is aimed at transporting Azeri gas across Georgia to Turkey in return for an in-kind transit fee. Since the associated gas contracts for this pipeline do not have any destination clauses and re-export restrictions, this enables the pipeline to act as feeder line for the pipelines linking Turkey and Europe (Nabucco and the Turkey-Greece-Italy line), therefore opening possibilities for future transport of Kazakh and Turkmen gas.

In the refinery business, the existing three refineries are currently inoperative due to technical deficiencies, and all refined products are imported. Overall, however, the refined oil products market is competitive and supply is fairly reliable, even though subject to occasional hiccups due to the absence of mandatory oil stocks and problems with quality and illegal operations. Over the last few years, improvement has been quite noticeable in all of the problem areas in this subsector, but much remains to be done.

In the natural gas distribution and utilisation, the Law of Georgia on Power Industry and Natural Gas defines natural gas distribution networks as those operating at low pressure, the notion of a regulatory agency (the Georgian National Energy Regulatory Commission, GNERC), and provides definitions for a license, a reception and a supply point, direct consumer, regulation fee, natural gas, natural gas transportation system, natural gas transportation, natural gas distribution, supplier, natural gas market rules, reliability standards, market, supply and consumption rules, and retail consumer. The law envisages principles of market economy in the sector, while also admitting that the existing market structure is uncompetitive, and calling for cost-reflective tariffs.

The Ministry of Energy is entrusted with the development of policies and their implementation, of principles of regulation, and with the promotion of energy efficiency and the assurance of competition, but is required to gradually relinquish its functions of owner, operator, economic agent and regulator. On the other hand, GNERC is tasked with establishing licensing rules, setting tariffs for the sector activities, and resolving disputes among market participants as well as ensuring compliance to the rules. The domestic gas market is in transition from non-competitive to competitive, free market environment. The constraints are basically the lack of choice in primary (import) supplies, and difficulties pertaining to deficiencies due to chaotic, non-transparent domestic market characterised by non-payment, corruption, accumulating debt to suppliers and a critical degradation of the gas supply system.

In the coal sector, there is only one coal mine operation running on government subsidies. Despite an earlier Presidential decree envisaging privatisation, the state has still the total control over all coal mines. Currently, coal is only consumed by several small local enterprises in Western Georgia. Despite all the economic and technical difficulties, the coal sector of Georgia is still seen by the government as a potentially important contributor to the country’s energy security and economy. Hopes are that the domestic market will expand and that export markets could also become available in Armenia and Azerbaijan. For the time being, however, no practical action has yet been observed, mainly due to lack of funds and investor appetite.

Electricity – The law foresees principles of market economy while promoting domestic and foreign investment in the power sector, assigning to the Ministry of Energy the functions of developing overall sector policies and guidance, setting the principles of regulation, and must approve the national electric power (capacity) forecasted balance, the Electric Power Market (Capacity) Rules, and regulations for maintenance, organisation and operation of power facilities and other technical assets. GNERC, on the other hand, is the regulatory entity granting licenses, establishing tariffs, resolving disputes, and observing compliance with license terms. The market
operation is entrusted to be controlled by the Electricity System Commercial Operator (ESCO), a private (limited liability) company, which is currently state-owned but the shares will be distributed among the market players. ESCO buys and sells the balance electricity and reserve capacity in order to ensure the electricity supply/demand balance. It establishes tariffs and related principles, procedures, charges for pricing, and, the requirement to follow uniform internationally acknowledged principles of accounting. It may be said that Georgia is following the most liberal approaches in creation of a power market structure in this respect.

Generation in Georgia is at hydroelectric and thermal power plants. Total installed HPP capacity is around 2.6 MW based on 60 HPP, of which 19 with installed capacity of over 10 MW and about 80 smaller plants. Thermal power plants have installed capacity of around 1,085 MW.

Interconnections to neighbouring countries include lines to Russia (via Abkhazia), Azerbaijan, and Armenia and Turkey. There are problems with the maintenance and supervision of the transmission network, nevertheless trading activity has been possible using the current transmission network with Turkey and Russia, and an additional line to Turkey in planned ahead. As for the distribution; until mid-90’s, the entire system except the distribution net in Tbilisi was owned and operated by the then-existing vertically integrated monopoly Sakenergo. By the mid 90’s, there were two major power companies in Georgia, both government-controlled: Sakenergo-Generatsia (generation) and Sakenergo-Gadatsema (transmission). Apart from Telasi (Tbilisi Distribution), there were 71 regional distribution networks, 51 of which were turned to municipalities and twenty controlled directly by the Ministry of Fuel and Energy. More than 90% of the high voltage network transmission lines and substations came gradually under the management of two licensees: the Georgian State Electro-System Ltd. and Sakrusenergo Ltd., a private entity equally owned by Georgian and Russian sides.

The collection of payments from direct customers (currently 22%) is almost 100%, while in the rest of the transmission and distribution network, losses due to due to non-payment and illegal use still create a big burden. One criticism is that the prices are simply not affordable and low enough for a certain segment of the population, contributing to the non-payments.

Privatisation and restructuring in the power sector – The energy sector policy prioritises the efficient use of electricity and the substitution of other sources of energy for electricity where it is used for space heating. The document requires increasing energy (electric power) efficiency in the industrial and household sectors, and devising and implementing appropriate ways of using heat supply, co-generation systems, and renewable energy resources instead of electricity, where possible. The most recent privatisation activity concerns privatisation of major state-owned energy facilities, which is called as “the first largest privatisation agreement in Georgian energy sector history” – with the sale of six hydro power plants and the assets of two electricity distribution companies. The total generation assets under private ownership and management are around 1,130 MW of HPP and 770 MW of TPP, or about 40% of installed HPP and most of the available TPP.

Market model – The main players in the market are the Georgian National Energy Regulatory Commission (GNERC), the Electricity System Commercial Operator (ESCO), and the electricity transmission and dispatch organisations. Nevertheless, there is news that the government has intentions to abolish the regulatory authority, which may hamper the reliability of the market model currently envisaged.

Georgia foresees the introduction of third party access in electricity distribution and transmission networks. Electricity buyers will have a right to purchase power from any electricity seller in a gradual phase-out, which foresees all consumers to be free customers by year 2023 and onwards. Electricity transmission and distribution licensees must provide
power pass-through services for eligible electricity buyers at the pass-through tariff set by the National Energy Regulatory Commission of Georgia.

Licenses are required for the market players, and a licensee may not, without the permission of the Commission, hold stock or shares of another licensee, on the competition grounds. An individual entrepreneur or a legal entity which directly or indirectly holds or manages the stock or shares of any licensee may not hold stock or shares of any other licensee in electric power without the permission of the Commission.

Renewable Energy – Georgia has a good potential for the renewable energy sources and better exploitation will improve the level of security of supply while reducing the need for imported energy. While hydropower represents the most readily available renewable energy source, such other important renewable sources as biomass, geothermal, wind and solar also present a good promise. The government has a Renewable Energy Development Programme, which includes certain subsidies and purchase guarantees as well as some tax incentives.

As an overall assessment, Georgia has embarked on a aggressive reform agenda in the recent years and has been successful to achieve many of the targets. The liberalisation of the economy and restructuring the institutional system bore fruit in the increased foreign direct investment, integration with the world economy, and modernised economic structure in many of the subsectors. Competitiveness has been increased to cope with new challenges under the liberal economy for increased exports, higher FDI figures has been observed which is to bring into the country know-how and modern technology. The reform programmes, however, still in the infancy stage and wait for the full and decisive –as well as consistent- implementation, supported by a more reliable justice system.

Georgia has also embraced a vigorous reform package in its energy sector. The country has been able to reap the benefits of its strategic location, which helped the oil and gas pipelines going through the country and illustrating the potential of the country in acting as an important bridge in the energy sector for energy security and diversity. These giant projects also help the country reach a better and stable political future. The liberal approach is noteworthy in a relatively small country, but the implementation should be carefully administered so that the theory matches the practice to create the awaited confidence in the market. This is vitally important for attracting future private investments. In this respect, and deviation or inconsistent moves with what is already mentioned in the policies or through implementation may certainly put clouds on the future reliability of the system.

Figure 1: Map of Georgia

Source: CIA – The World Factbook
**Preface**

The investment climate and market structure (ICMS) reports are based on the Energy Charter Treaty whereby the member states are required to inform the other member states about their energy market structure and the relevant legislation as well as implementation. Undertaken on a peer review basis, these reviews help implementation of the Charter process and serve the purpose of dialogue and cooperation among the member states.

This ICMS report on Georgia aims to inform all relevant parties in the Charter process about the current situation regarding the energy market structure and the climate for foreign investment. The report was prepared by the Georgian authorities with help of the Secretariat and in this respect is a product of close cooperation and intensive efforts. It covers the basics of market structure in energy sector and entails an in-depth analysis of legislative framework as well as the implementation currently observed in Georgia. Following the presentation of the report in the Investment Group meeting and the discussions thereof, the report is intended to lead to recommendations to be made thereof and submitted for endorsement to the Energy Charter Conference. Therefore, the report is aimed to create the opportunity to allow for the peer review process and enable the host country benefit from a dialog with other member states in its energy policies while adhering to the Charter process.
I. EXECUTIVE SUMMARY

Georgia is located at the crossroad between Europe and Asia, neighbouring Russia, Armenia, Azerbaijan, and Turkey; and thus giving the Republic a strategic importance far beyond its size (about 69,700 sq km, twice the size of Belgium). It is developing as the gateway from the Black Sea to the Caucasus and the larger Caspian region, thanks to the coastline along the Black Sea allowing access to world markets.

Georgia is a lower middle income country with a population of approximately 4.7 million people with a 13.8% unemployment rate and a gross national income per capita of USD1,770 (in 2006), and has taken a long way towards liberalising its economy. Due to the vigorous efforts by the government in the recent years, Georgia ranks the 35th most open economy, and the 85th as the most globally competitive country. Since its independence in 1991, the Republic has established its presence by membership in the major international organisations.

Georgia has been a democratic republic since the presidential elections and constitutional referendum of October 1995. The Unicameral Supreme Council is commonly referred to as Parliament; members of which are elected by popular vote on a four-year term. The country is divided into 9 districts, 65 regions, 5 towns, and two autonomous republics: Ajaria, Abkhazia (both on the Black Sea coastline) and the autonomous region of South Ossetia. To a certain degree, there is a lack of firm political control of central authorities and the government’s authority in large segments of its territory undermined seriously, without yet reaching to a final solution, despite the fact that the country reached a relatively stable political era following the Rose (Velvet) Revolution in 2003.

The new government has indeed succeeded in major achievements towards fulfilling its aims. Number of taxes was reduced from 21 to 7 and a flat income tax of 12% was introduced. The government significantly reduced the number of licenses a business requires and introduced a one-window system (the Georgian National Investment Agency (GNIA) services) that allows an entrepreneur to open a business relatively quickly. Strict deadlines for agency action on permits were introduced, and consent is assumed if the agency fails to act within the time limit. The government intends to completely eliminate import duties by 2008, which should reduce costs and stimulate business further.

Georgia is recognised as the world’s fastest-reforming economy in the 2007 “Doing Business” report of the World Bank. Georgia also has shown a dramatic improvement in the struggle against corruption, due to implementation of a strong programme of economic and institutional reform. The government faces a major challenge in controlling corruption, which is a persistent problem. Deficiencies regarding the judiciary and system of justice still pose risks regarding the foreign and domestic investors.

Thanks to the systemic institutional reforms, the creation of a liberal legislative framework, and structural reforms, the economy is growing at a considerable rate. GDP growth rate increased from 5.4% in 2002 to 8.6% in 2003. GDP growth rate reached 9.3% in 2005. Steady growth continued in 2006, and as a result GDP real growth reached 9.4%. Now, the largest share of Georgia’s GDP is produced by agriculture, followed by trade, manufacturing, and transport. The ‘Baku-Tbilisi-Ceyhan Pipeline’ construction project was a strong stimulus for expansion of the construction and service sectors. The reforms of business climate and the policy of liberalisation and deregulation implemented by the government contributed to growth of the national income, albeit its effects on the employment have not been strongly witnessed. Inflation was 6.2% in 2005, but increased to 8.8% in 2006.
Improved collection and administration of taxes have greatly increased revenues for the government. The government privatised nine times the value of state-owned assets in 2005 as it did in all of 2000-2003. It expects to have privatised all of the largest state-owned industries by the end of 2008, increasing revenues and removing a major temptation toward corruption.

Georgian trade and exchange systems are considered to be among the most liberal of the transitional economies. The new law “on custom tariffs” in 2006 reduced 16 tariff rates to 3 (0%, 5%, 12%). Foreign trade plays a considerable role in the stability and growth of economy. The Ministry of Economic Development of Georgia is the central enforcement authority defining, realising and coordinating state policy in the field of trade.

Georgia has no quantitative restrictions (quotas) on trade. For Georgia likewise the countries with transition economy, crucial importance has an opportunity to use the Generalised System of Preference (GSP), providing a preferential tariff mode for production imported from Georgia. Currently preferential mode GSP to Georgia was given by the European Union, the USA, Canada, Japan, Turkey and Switzerland. In 2005 EU, and since January 2006 Turkey provided Georgia the expanded opportunity to make use of tariff privileges (GSP+). Georgia has bilateral agreements regarding free trade with 8 CIS countries. Foreign trade turnover has seen an important increase in the recent years. CIS countries account for 39% of Georgia’s foreign trade turnover, and EU countries account for 24% as of 2006. While Georgia’s main exports are metals and ores, wine, nuts, and aircraft, there is a strongly negative balance of trade, which is offset by inflows of investment and assistance from international donors.

The Government simplified the taxation regime by reducing the number of taxes and abolishing inefficient tax concessions, 21 current taxes payable to the central and local budgets were reduced to only 7 taxes. Abolishing inefficient tax exemptions and concessions will reinforce fair competition in business. In addition, the Government is planning to harmonise the Georgian legislation, including the tax legislation, with that of the European Union, and this policy was already reflected in the new Tax Code.

The government of Georgia received 270.5 million USD from the privatisation process in 2004-2005 which exceeds privatisation income from 2000-2003 by almost 8.6 times. Any Georgian or foreign person or company has the right to take part in the privatisation process in compliance with the laws of Georgia. The full list of the companies that will be privatised consists of 800 assets, and the most recent privatisation activity envisages privatisation of major state-owned energy facilities.

Foreign direct investment (FDI) is the most important source of capital for Georgia. Such investment not only supports new plants and equipment, but also usually entails bringing in modern management methods as well. The Georgian Government is eager to welcome foreign investors. In 2004, FDI totaled USD489 million, more than half of which was invested in construction of the now-completed Baku-Tbilisi-Ceyhan oil pipeline and the South Caucasus gas pipeline. Foreign investors are beginning to take notice of the changes in Georgia. FDI reached USD539 million in 2005, and inflows of investment exceeding USD1 billion are expected in 2007.

The law on Investment Activities and Guarantees establishes that the rights of the foreign investor making investment and carrying out entrepreneurial activities in Georgia are protected and guaranteed equally with those of Georgian entrepreneurs. The foreign investor enjoys the right to repatriate profit or any other funds after payment of taxes (10% withholding tax for dividends) and other mandatory duties after conversion in the Georgian
banking institution. It should be noted that the foreign investor also has the right to freely move any property owned by him out of the country.

The Law provides investment-related dispute resolution procedures and lists the agencies concerned. The dispute between a foreign investor and a Georgian state agency can be resolved in the Georgian court or International Centre for Resolution of Investment Disputes or in any arbitration agency set up pursuant to the procedures established by United Nations Commission on International Trade Law (UNCITRAL). Currently there is one pending case at ICSID in relation to the arbitration clause under the Energy Charter Treaty.

Pursuant to the Georgian Law on Concessions, a Concession Agreement can be concluded on the processing of recoverable and non-recoverable natural resources and the performance of related works and activities. Foreign investors conclude a concession agreement with the relevant state body authorised by the Georgian legislation. Under the law, a concessionaire has the right to repatriate profits and to appeal any unlawful acts or decisions in courts or arbitrage.

By virtue of the Georgian Constitution and the Georgian Civil Code, the right to property is guaranteed and protected both by legislative and administrative/judicial mechanisms. Importantly, the Constitution reads that international treaties or agreements made between Georgia and other parties (states or companies), unless contradictory to the Georgian Constitution or Constitutional Law, are superior to internal normative acts.

As a result of the reform programmes vigorously pursued by the new government, there have been highly promising results that were achieved in the recent years. It indicates that, thanks to the decisive actions taken by the recently implemented reform policy, Georgia surpasses with leading figures on many accounts as regards with availability of a nurturing investment climate; and thus has attained a leading role not only over the other peer countries in the region but also in many instances many OECD countries.

I. 1 Energy Market Structure

The main directions, objectives and instruments of the energy policy of the Government of Georgia have been condensed in a draft document in early 2006. The thrust of the effort is in energy efficiency, security of supply (particularly electricity and gas), market restructuring (including third party access to networks), deregulation and liberalisation, implementing basic market and privatisation prerequisites (metering, cost-reflective tariffs, settlement of debts, enforcement of power and gas market rules), promotion of investment, and enhancing bilateral and regional cooperation in the energy sector. As for the heating systems, all of Georgia’s district heating systems are currently inoperative.

The draft policy document is largely concerned with the power sector and defines the main goal of the entire energy sector as the full coverage of electricity demand, the achievement of “economic independence and stability of the power sector”, and the assurance of technical, economical and political security via the best use of the power sector resources and the diversification of imports. However, the policy document is also concerned with achieving self-sufficiency in primary energy, establishing the country as an important node of energy transit and connecting routes, and creating the foundation of competitive and investor-friendly national energy markets.

Oil and gas: Georgia has, despite its demonstrated petroleum potential, very small proven oil and gas reserves, and as such, current crude oil production is modest. There are fifteen known
oil and one gas fields with reserves estimated at 45 million tons oil equivalent. Most of the fields are heavily depleted, requiring additional exploration or re-development by modern technologies with the hope for major new discoveries.

Oil and gas operations in Georgia are conducted in accordance with the provisions of the Oil and Gas Law, which defines a uniform policy for the development of oil and gas resources and regulates the relationships between the National Oil Company of Georgia and private investors. The Oil and Gas Law specifies the taxes that are applied to investors under production sharing agreements. Additionally, each production sharing contract contains provisions outlining the general regime applicable to that particular agreement, especially in the case of foreign subcontractors. However, there are ambiguities between the two and it remains unclear which tax regime would have precedence and exactly which taxes apply to subsurface users.

The profit tax rate is fixed in the production-sharing contract which typically provides protection against future increases in the rate. Taxable income is calculated in accordance with internationally accepted practices in the petroleum industry rather than in accordance with domestic accounting procedures. Financial results of activities under more than one production-sharing contract may be consolidated. Accounts may be kept in US dollars. Operating losses incurred by contractor parties during the period of preliminary exploration may be carried forward indefinitely and are subject to offset once production starts.

Government supervision over oil and gas operations in Georgia, including oil refining and transportation, is carried out by the State Agency for Regulation of Oil and Gas Resources (SAROGR). It is responsible for the preparation of contracts, negotiations and signing of hydrocarbons exploration and production (E&P) agreements on behalf of the state. SAROGR functions also include the issuing of licenses for oil and gas operations to the investor on behalf of the state, as well as the approval and the issuing of all necessary authorisations, allotments, and permits. SAROGR is also responsible for setting and applying the “regulation price”.

The agreement granting to an investor the right to explore and produce hydrocarbons and use oil deposits is signed between the state and the investor or the winner of a tender or an auction carried out by SAROGR. Access to hydrocarbon resources is granted to investors on terms of production sharing agreements (PSA), risk service agreements, or service agreements, but the law does not limit the modalities of granting hydrocarbons exploration and production rights to these types of contracts. SAROGR issues licenses of general type for the right to use oil and gas resources, and as such the investor has the option to choose either of exploration and production but not both; thus bringing Georgia’s terms of access to hydrocarbons closer to international petroleum industry practices.

Georgian participation in exploration and production of hydrocarbons is primarily undertaken via the Georgian Oil and Gas Corporation (GOGC), established in April 2006. The capital of the company consists of the stock of the 100% government-owned Georgian International Gas Corporation (GIGC), Georgian International Oil Corporation (GIOC), and Georgian National Oil Company (GNOC, “Saknavtobi”). This is to improve coordination of natural gas supplies to Georgia, since each of these companies has contracts for gas supply from different sources (GIGC from Gazprom, GIOC from the Shakh Deniz field in Azerbaijan, and GNOC from domestic sources where it supervises oil and gas production).

The state has the possession of most, if not all, geological, geophysical, production and other information needed to evaluate and manage oil and gas prospects and projects, while operating a few fields on “grandfathered” terms. On the other hand, foreign companies
operating in Georgia have carried out significant exploration, including seismic data acquisition, processing, interpretation, and drilling of a few exploratory wells. The upstream sector of the oil industry could probably help build up investor confidence by improving transparency and providing more detailed information pertaining to the relevant terms and conditions, while the absence of a “single shopping window” in negotiations for access to acreage is another drawback.

Oil transportation – The Baku-Supsa Crude Oil Pipeline was aimed at carrying the oil out of Azerbaijan’s first production sharing agreement (PSA) in 1997 under the leadership of BP from the Azeri, Chirag, and Gunashli fields of Azerbaijan. The Baku-Supsa crude oil shippers enjoy a relatively low tariff of USD5 per ton, since the line was rehabilitated and expanded with funds provided by the shippers. Separately, the Georgian Government negotiated via GIOC a transit fee of an initial USD0.18 per barrel. The pipeline provides a steady income to Georgia from transit fees of around USD10 million per year, most of which goes now to the budget. However, the major benefit is the profit tax on the pipeline operator, which was first collected in April 2006, in addition to the creation of jobs, the transfer of technical expertise and know-how, the assistance provided to communities along the pipeline route, and grants and donations to various NGOs.

The Baku-Tbilisi-Ceyhan (BTC) Pipeline was completed in early 2005, linking Baku with the Turkish port of Ceyhan on the Mediterranean Sea via Georgia, officially commissioned in July 2006, with a capacity of transporting 1 million bpd of oil, mostly to transport Azeri oil from the same fields cited above, but additional Kazakh oil westward is also planned to be carried.

Apart from the Baku-Supsa and BTC pipelines, crude oil is transported across Georgia by rail, along with considerable quantities of refined products, to the ports of Batumi and Poti, via the privately owned Batumi and Kulevi oil terminals. These shipments are along the TRACECA corridor established in 1993 with the help of EU, linking Central Asia to Europe via the South Caucasus, particularly Azerbaijan and Georgia. Certain companies have already expressed their plans to use this alternative transportation system, thus increasing the chances of commercial viability for both terminals, relying mainly on the oil to come from Kazakhstan and Turkmenistan via the Caspian Sea.

National Gas Pipeline System- There are various pipelines in the country some dating back to many decades, such as the Karadag (Azerbaijan)-Tbilisi pipeline and the North-South Caucasus Pipeline (NSCP) which links to the lines from Azerbaijan and continues into Armenia. Social and political cataclysms during the first years of independence had a catastrophic impact on the energy sector, preventing any measurable effort in maintaining or upgrading the pipeline system. Nonetheless, due to decisive actions of the government later, systemic deficiencies have been rectified and there have been renovations in the pipeline system in recent years, decreasing the losses some 3.9% from an earlier level of 6-7%.

Main pipelines are operated by the state-owned Georgian Gas International Corporation (GGIC), which include the high-pressure trunk lines, the compressor stations, a number of gas metering/regulation stations, and certain other facilities. In December 1999, GGIC established an affiliate, the Gas Transportation Company (GTC), and assigned to it the tasks of maintaining and operating the entire main gas transmission system. These companies are currently merged into the GNOC. GGIC/GNOC takes and monetises in-kind payments for gas transit, and also handles import contracts.

The Azerbaijan-Turkey Natural Gas Pipeline (South Caucasus Pipeline – SCP), which is privately operated, will transport gas produced in Azerbaijan primarily at the Shah Deniz non-
associated gas and gas condensate field across Georgia to Turkey. Georgia receives an in-kind transit fee. In 2006, exports from Shah Deniz were already to begin on a small scale. The SCP is important since the associated gas sale-purchase contracts do not have destination clauses and restrictions on re-exports, which allows SCP to act as feeder line for the pipelines linking Turkey and Europe (Nabucco and the Turkey-Greece-Italy line). Should a pipeline across the Caspian be constructed, gas could also be supplied across Georgia to Turkey and Europe from Kazakhstan and Turkmenistan.

There is currently no underground gas storage (UGS) in Georgia. There are two possible areas; depleted or partly depleted oil fields east of Tbilisi and a large aquifer belt on the Black Sea coast.

Oil refining, storage and distribution- Although Georgia has three refineries, none of them are able to meet the demand for quality products. Currently, Georgia imports almost all of the refined products consumed in the country. Overall, however, the refined oil products market is competitive and supply is fairly reliable, even though subject to occasional hiccups due to the absence of mandatory oil stocks and problems with quality and illegal operations. Over the last few years, improvement has been quite noticeable in all of these problem areas, but much remains to be done.

Natural gas distribution and utilisation- The Law of Georgia on Electricity and Natural Gas defines natural gas distribution networks as those operating at low pressure, the notion of a regulatory agency (the Georgian National Energy Regulatory Commission, GNERC), and provides definitions for a license, a reception and a supply point, direct consumer, regulation fee, natural gas, natural gas transportation system, natural gas transportation, natural gas distribution, supplier, natural gas market rules, reliability standards, market, supply and consumption rules, and retail consumer. It requires the development of the sector by abiding to the principles of market economy. The Law also admits that the existing market structure is uncompetitive, but requires that tariffs should be cost-reflective (economically feasible).

The Law envisages that the Ministry of Energy is tasked with the development of policies and their implementation, of principles of regulation, and with the promotion of energy efficiency and the assurance of competition, but is required to gradually relinquish its functions of owner, operator, economic agent and regulator.

GNERC is tasked with establishing licensing rules, setting tariffs for the sector activities, and resolving disputes among market participants as well as ensuring compliance to the rules. The domestic gas market is in transition from non-competitive to competitive, free market environment. The constraints are basically the lack of choice in primary (import) supplies, and difficulties pertaining to deficiencies due to chaotic, non-transparent domestic market characterised by non-payment, corruption, accumulating debt to suppliers and a critical degradation of the gas supply system.

Coal: Most of Georgia’s coal reserves are at three deposits, all mined underground. Indications exist that coal deposits may be found elsewhere in the country, but exploration has been discontinued since the 80’s. Currently the only active coal mining operation is the government-controlled TkibulNakhshiri Co., part of the state coal company SakhNakhshiri which took over all coal mines in the country. The operation is unprofitable and is supported by government subsidies. In 1998, a Presidential Decree foresaw the unbundling of SakhNakhshiri by splitting it into entities based on the existing coal mines and eventually privatising the unbundled assets. Currently, coal is only consumed by several small local enterprises in Western Georgia.
Despite all the difficulties of economic, operational and managerial nature, the coal sector of Georgia is still seen by the government as a potentially important contributor to the country’s energy security and economy. Hopes are that the domestic market will expand and that export markets could also become available in Armenia and Azerbaijan. For the time being, however, no practical action has been taken, primarily due to lack of interest from investors and the limited government funds available for reorganising and revitalising the coal sector.

Electricity: The Law on electricity and Natural Gas covers power generation, transmission, dispatch, distribution, import, export and consumption; and foresees principles of market economy while promoting domestic and foreign investment in the power sector. The Law assigns to the Ministry of Energy of Georgia the functions of developing overall sector policies and guidance, but relieves it from ownership, operational, economic and regulatory tasks. The Ministry is responsible for setting the principles of regulation of generation, transmission, dispatch, distribution, import, export and consumption, including direct consumer-related activities, in an environment of transparency and fairness leading to the establishment of an independent power sector regulation. The Ministry must approve the national electric power (capacity) forecasted balance, the Electric Power Market (Capacity) Rules, and regulations for maintenance, organisation and operation of power facilities and other technical assets.

GNERC is the entity which grants licenses for activities in the power sector, establishes licensing terms and rules and grants, modifies and revokes licenses in compliance with the Law on Licenses and Permits, establishes tariffs for generation, transmission, dispatch, distribution, import and consumption of power, resolves disputes within its competence, controls compliance with license terms, and issues certificates in the energy sector.

The Electricity System Commercial Operator (ESCO), a private (limited liability) company, is wholly owned by the Ministry of Economic Development, and is entrusted with ensuring the market functioning under the existing rules. In the future, these shares will be distributed among the market players. ESCO buys and sells the balance electricity and reserve capacity in order to ensure the electricity supply/demand balance. It establishes tariffs and related principles, procedures, charges for pricing, and, the requirement to follow uniform internationally acknowledged principles of accounting.

Generation in Georgia is at hydroelectric and thermal power plants; there are no nuclear power facilities. Total installed HPP capacity is around 2,600 MW based on 60 HPP, of which 19 with installed capacity of over 10 MW and about 80 smaller plants. Thermal power plants have installed capacity of around 1,085 MW.

Interconnections to neighbouring countries include lines to Russia (via Abkhazia), Azerbaijan, and Armenia and Turkey. The backbone of the system is the transmission line covering entire territory. It has been almost a year since the line connecting Georgia with Russia has been disconnected and frequency regulation is achieved through the parallel regime with Azerbaijan. During the last few years, some rehabilitation work has been done on the transmission and distribution system, but with no substantial impact on the system reliability. Parallel operation was restored with Russia in 2000, imports from Armenia became possible, the lines to Turkey were rehabilitated and the Salkhino line to Russia was put back in service. However, maintenance of the transmission network is still not carried out properly, and the dispatch supervision automatic equipment does not match the standards. The system still has no emergency capacity and stand-by equipment and no automatic reconnection equipment.
Until mid-90’s, the entire system except the distribution net in Tbilisi was owned and operated by the then-existing vertically integrated monopoly Sakenergo, which until 1990 operated as a part of the Trans-Caucasian Grid (TCG) covering Georgia, Azerbaijan, Armenia and parts of Southern Russia. There used to be a regional dispatch centre in Tbilisi, which is currently inoperative. By the mid 90’s, there were two major power companies in Georgia, both government-controlled: Sakenergo-Generatsia (generation) and Sakenergo-Gadatsema (transmission). Four service companies were also established. Apart from Telasi (Tbilisi Distribution), there were 71 regional distribution networks, 51 of which were turned to municipalities and twenty controlled directly by the Ministry of Fuel and Energy. More than 90% of the high voltage network transmission lines and substations came gradually under the management of two licensees: the Georgian State Electro-System Ltd. and Sakrusenergo Ltd., a private entity equally owned by Georgian and Russian sides.

About 60% of the electricity is distributed by the distribution companies, up to 22% of electricity is consumed by direct customers (large companies consuming more than 30 GWh/Y), and some 15% is supplied to the autonomous republic of Abkhazia, which is outside the firm control of the Georgian government. The collection of payments from direct customers is almost 100%. Collection on power supplied to Abkhazia is hardly ever done. In the rest of the transmission and distribution network, losses still plagued Georgia as of 2005, mostly due to non-payment and illegal hook-ups.

Privatisation and restructuring in the power sector- The energy sector policy prioritises the efficient use of electricity and the substitution of other sources of energy for electricity where it is used for space heating. The document requires increasing energy (electric power) efficiency in the industrial and household sectors, and devising and implementing appropriate ways of using heat supply, co-generation systems, and renewable energy resources instead of electricity, where possible.

Licenses are required for electric power generation, transmission, dispatch, and distribution, imports and exports. To assure competition, a licensee may not, without the permission of the Commission, hold stock or shares of another licensee. An individual entrepreneur or a legal entity which directly or indirectly holds or manages the stock or shares of any licensee may not hold stock or shares of any other licensee in electric power without the permission of the Commission. The Commission may withhold such permission if it prejudices the interests of consumers or contradicts the law.

Every individual and legal person, who intends to carry out the wholesale trade of electricity and capacity shall become a qualified enterprise according to the conditions set forth by the Market Rules. ESCO awards the status of qualified enterprise. Qualified enterprise is limited to the individuals and/or legal persons registered in Georgia. The main players in the market are the Georgian National Energy Regulatory Commission (GNERC), the Electricity System Commercial Operator (ESCO), and the electricity transmission and dispatch organisations.

The Energy Policy of Georgia foresees the introduction of third party access in electricity distribution and transmission networks. Electricity buyers will have a right to purchase power from any electricity seller in a gradual phase-out, which foresees all consumers to be free customers by year 2023 and onwards. Electricity transmission and distribution licensees must provide power pass-through services for eligible electricity buyers at the pass-through tariff set by the National Energy Regulatory Commission of Georgia.
As regards with the sector privatisation and FDI in generation and distribution, various privatisation deals have so far been completed with success. In addition, some additional generation assets have been constructed from scratch by private investors. The total generation assets under private ownership and management are around 1,130 MW of HPP and 770 MW of TPP, or about 40% of installed HPP and most of the available TPP.

International Trade and Transit in Electricity- In fall-winter 2006-2007, import of electricity from Russia and Armenia has stopped, and during this period, electricity was imported from Azerbaijan. The existing line to Turkey has been used for exchanges of power under annual agreements since the late 90’s, whereby Georgia provided electricity energy to Turkey during the summer and received certain amounts back during the winter, which is particularly important for the Ajara region. To enhance the cooperation with Turkey, Georgia intends to build a second connecting line. Apart for exchanges of power, the existing one has been used for transit of power from Russia to Turkey. Furthermore, construction of another electricity transmission line connecting Georgia with Iran via Armenia is currently in process.

Renewable Energy: Georgia has a good potential for the renewable energy sources and better exploitation will improve the level of security of supply while reducing the need for imported energy. While hydropower represents the most readily available renewable energy source, such other important renewable sources as biomass, geothermal, wind and solar also present a good promise. The government has a Renewable Energy Development Programme, which includes certain subsidies and purchase guarantees as well as some tax incentives.

There are two main ways that renewable is being promoted in Georgia. One is through the Clean Development Mechanism of the Kyoto Protocol, while the other is through a UNDP/GEF (United Nations Development Programme/Global Environment Facility) Project to promote the use of renewable energy resources for local energy supply. The project is expected to enhance the capacity of local entrepreneurs to develop bankable investment proposals, to restructure financing for the projects and to management development and implementation of the projects.

Overall, Georgia has embraced a vigorous reform package in the recent years in its economy in general as well as in the energy sector. The country has been able to reap the benefits of its strategic location in the energy rich Caucasus region and transforming its economy to a market oriented one while struggling with ensuring stability and various challenges in this transition period. Barriers to foreign investments have been lifted to a great extent, despite impediments in applications. Energy sector is also going through the same process and is subject to similar concerns. Supply security and energy independence is a priority issue in the sector. There are still actions needed for ensuring adequate level of investor confidence in the energy market applications, given the relative insecurity over the current establishments like the possibility of abolishing the existing regulatory agency.
II. INTRODUCTION

II.1 Basic Facts about Georgia

Georgia is the westernmost country of the South Caucasus (the southern portion of the region of Caucasus), which occupies the isthmus between the Black and Caspian seas; Azerbaijan and Armenia are also located in the South Caucasus. The name of the republic in Georgian, the official language, is Sakartvelo. It is located at the crossroad between Europe and Asia; between the Black Sea, Russia, Armenia, Azerbaijan, and Turkey. This, indeed, gives the Republic strategic importance far beyond its size. It is developing as the gateway from the Black Sea to the Caucasus and the larger Caspian region. Its location on the “Silk Road” between Europe and Asia has made it a transit conduit for goods being shipped through the Caucasus. It also has a deep and rich historical background, which dates back more than 2,500 years, and Georgian is one of the world’s oldest living languages which is unique, and thus distinct from the Indo-European or Ural-Altaic linguistic groups. Georgians do not call themselves Georgians but Kartvelebi and their land Sakartvelo.

Georgia is a lower middle income country with a population of approximately 4.6 million people and a gross national income per capita of USD1,350 in 2005 (GNI, Atlas method). Georgia has taken a long way towards liberalising its economy. This has clearly manifested itself in the Index of Economic Freedom 2007, whereby Georgia, as a ‘moderately free’ economy, ranks as the 35th (from the 52nd in the previous year) most open economy in the world amongst the 157 countries measured. Significant decrease in corruption in the public and private sectors made Georgia the World Bank’s top anti-corruption performer in its 2006 “Anticorruption in Transition-3” (ACT3) report. Electricity availability significantly improved throughout Georgia in 2006. Two years ago 85% of Georgians outside of Tbilisi were without power on any given day, whereas 98% of paying customers in the said area have continuous electricity supply.

In terms of the global economic competitiveness, Georgia seems to be securing its place in the midst of the list while having a relatively slight advancement of 1 seat upwards, as it ranked the 86th and 85th in the years 2005 and 2006, respectively, as the most globally competitive country in the world out of 125 countries.

Since its independence, the country has also established its presence by membership in the major international organisations cited below:

- WB – World Bank (1992)
- IMF – International Monetary Fund (1992)
- EBRD – European Bank for Reconstruction and Development (1994)

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3 Invest in Georgia 2007, Ministry of Economic Development of Georgia.
• CoE – Council of Europe (1999)

Some of the most basic data which is illustrative of the country in general may be depicted as follows in Table 1 below.\(^5\)

### Table 1: Basic Facts

<table>
<thead>
<tr>
<th>Location</th>
<th>Bordering the Black Sea, between Russia and Turkey, and Azerbaijan and Armenia (South Caucasus, Southeast Europe, Southwest Asia)</th>
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<tr>
<td>Area</td>
<td>69.700 km(^2)</td>
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| Border countries | Land border (total: 1,461 km): Russian Federation 723, Azerbaijan 322, Armenia 164, Turkey 252  
It also has a coastline of 310 km along the Black Sea, allowing access to world markets and a gateway for the Caucasus region |
| Climate  | Continental inland, generally moderate; mild (subtropical) on the Black Sea coast with cold winters in the mountains |
| Terrain  | Mostly rugged and mountainous                                                                                     |
| Population | 4.7 million (July 2006) – Population growth rate: -0.34% (2006 est.)                                             |
| Age structure | 0-14 years: 25.5% (male 9,133,226/female 8,800,070)  
15-64 years: 67.7% (male 24,218,277/female 23,456,761)  
65 years and over: 6.8% (male 2,198,073/female 2,607,551) (2006 est.) |
| Labour and Unemployment | Work force: 2.02 million in 2005 (agriculture 40%, industry 20%, services 40%). Unemployment (2005 est.): 13.8% |
| Education | 11 years of compulsory education, with literacy rate of almost 100%                                                |
| Health   | Infant mortality rate (2006 est.) 17.97 deaths/1,000 live births. Life expectancy (2006 est.) 76.09 yrs            |
| Ethnic groups | Ethnic groups (2002 census): Georgian 83.8%, Azeri 6.5%, Armenian 5.7%, Russian 1.5%, other 2.5%                   |
| Religion | (2002 census): Orthodox Christian 83.9%, Muslim 9.9%, Armenian Apostolic 3.9%, Catholic 0.8%; other 0.8%; none 0.7% |
| Constitutional name | Georgia                                                                                                           |
| Establishment (Independence) | 29 October 1918 (from the Russian Empire) and 1991 (from the USSR)                                              |
| Constitution | August 24, 1995; amended February, April, and June 2004; December 2005; and January 2007                          |
| Political system | Presidential Republic. The Unicameral Supreme Council is commonly referred to as Parliament or Umaghiesi Sabcho (235 seats – 150 elected by party lists); members of which are elected by popular vote to serve four-year terms |

\(^5\) [http://www.privatisation.ge/spp/eng/about/index.html](http://www.privatisation.ge/spp/eng/about/index.html) and US Dept. of State.
| Executive branch | Head of State: President – Mikheil Saakashvili (since 25 January 2004); the president is both the chief of state and head of government for the power ministries: state security (includes interior) and defence  
Head of Government: President Mikheil SAAKASHVILI (since 25 January 2004); Prime Minister Lado GURGENIDZE (since 22 November 2007); note – the president is the chief of state and head of government for the power ministries: state security (includes interior) and defense; the prime minister is head of the remaining ministries of government  
Cabinet: Cabinet of Ministers  
Elections: President elected by popular vote (96.3%) for a five-year term (eligible for a second term); election last held 5 January 2008 (next to be held in late 2013) |
| Official language | Language: Georgian (official), Abkhaz also “official language” in Autonomous Republic of Abkhazia |
| Legal system | Based on civil law system; accepts compulsory ICJ jurisdiction; judicial system comprised of Supreme Court (judges elected by the Supreme Council on the President’s or chairman of the Supreme Court’s recommendation); Constitutional Court; first and second instance courts. |
| National currency | Georgian Lari |
| Exchange rates (as of 16.02.2007) | 1 EUR = 2.24 Lari  
1 USD = 1.71 Lari |
| Capital | Tbilisi, population – 1.253.000 |
| Principal towns | Kutaisi – (241.100), Rustavi – (158.000), Batumi – (137.100), Zugdidi – (105.000 including IDP from Abkhazia), Chirakura – (70.000), Gori – (70.000), Poti – (50.900) |
| Administrative divisions | The country is divided into 9 districts, 65 regions, 5 towns of Republic Dependence (without Abkhazia and Tskhinvali) |
| Time | GMT + 4 hours |

Source: Ministry of Economic Development of Georgia

Georgia is a country of extremely diverse terrain, with high mountain ranges and fertile coastal lowlands. Ethnic Georgians constitute a majority of the population. Georgia was made a part of the Union of Soviet Socialist Republics (USSR) in 1922. After Georgia gained independence in 1991, the country was plagued by civil war and political upheaval. The economy suffered from these events and from severed trading ties with other former Soviet republics, but in the mid-1990s it stabilised when the political strife ended and free market reforms were instituted. Georgia’s first post-Soviet constitution was adopted in August 1995. Beginnings of the 2000 witnessed destabilisation events which led to substantial changes in the political era. In November 2003, many Georgians took part in a peaceful and democratic uprising known as the “Rose Revolution,” spurred by rampant corruption and a failing state. Through the so-called “velvet” revolution, a new government came into power as a result of the new elections following the turmoil. Using an amended constitution during the first 18 months, the new government focused on restructuring power and succeeded implementing reforms and securing stability in the country which suffered for a long time from lack of a decisive and powerful executive to restore order.

Georgia includes two autonomous republics: Ajaria, located in Georgia’s southwestern corner, and Abkhazia, in the northwestern arm of the Republic. Both republics include stretches of
the Black Sea coast. Georgia also contains the autonomous region of South Ossetia, which is located in the north central part of the country. Abkhazia and South Ossetia are bordered on the north by Russia, and Ajaria is bordered on the south by Turkey. There has been a long history of securing firm political control over the said regions which suffered from the separatist movements. The conflicts in Abkhazia and South Ossetia, regions within Georgia seeking independence, took a significant toll, with about 300,000 people displaced, much physical capital destroyed, important trade routes disrupted, and the government’s authority in large segments of its territory undermined seriously, which has not come to a final solution yet. In addition, the spillover from the conflict in Chechnya has weakened Georgia’s control of the Pankisi Gorge and surrounding territory, where there has been rampant smuggling, extortion, and kidnapping. Territorial integrity over the entirety of the country is still an issue to be resolved, adding to the level of uncertainties.

Georgia covers an area of about 69,700 sq km, twice the size of Belgium and nearly twice as large as Switzerland. In terms of utilisation, the Georgian territory can be divided into three parts: arable lands –15.8%, natural habitat (forests, bushes, pastures and hayfields) –70.6%, and, non-agricultural lands –13.6%.

Rugged mountain ranges dominate Georgia’s landscape, constituting about 85% of the total land area. The main ridge of the Caucasus Mountains, or Greater Caucasus, forms most of Georgia’s northern border with Russia and contains the country’s highest elevations, including Mount Shkhara (5,200 m/17,060 ft), Georgia’s highest peak. The Lesser Caucasus mountains occupy the southern part of the Republic. These two mountain systems are linked by the centrally located Surami mountain range, which bisects the country along a northeast-southwest axis. The two largest rivers in Georgia are the Kura (Mtkvari) and the Rioni, and the latter, along with the Inguri and Kodori rivers, flow through a very fertile delta region known as the Kolkhidskaya Lowlands which encompasses the lower Rioni valley.

Georgia’s climate ranges from year-round subtropical conditions on the Black Sea coast to continental conditions, with cold winters and hot summers, in the extreme east. The mountainous regions have cold, wet winters and cool summers, and the highest peaks are perpetually covered with snow. Annual precipitation also varies by region; along the coast it often exceeds 2,000 mm (80 in), while in the eastern plains it measures between 400 and 700 mm (20 and 30 in).

Georgia contains diverse plant and animal life. Land at lower elevations has been extensively reworked for agricultural purposes and contains little of its native wildlife. Dense forests and brush cover more than one-third of the country, mostly in the western and mountainous regions. In the eastern uplands, which are sparsely wooded, underbrush and grasses predominate.

Georgia has a natural resource base that offers strong economic growth potential. Fertile land and a favourable climate enable diverse agricultural production, including a range of fruits and vegetables, livestock, dairy products, nuts, and tea. The country has a long history of viticulture, and some 500 varieties of grapes are cultivated. Recent investments in oil and gas exploration mainly in the Black Sea shelf near the port cities of Batumi and Poti have indicated significant potential. Other physical resources include manganese, iron, coal, copper, gold, granite, limestone, marble, and mineral waters. Dense forests cover one third of the country that provide pulp and timber, and numerous fast-flowing rivers offer good hydropower potential.

Georgia suffered severe environmental degradation during the Soviet period, when economic policies emphasising heavy industry were implemented with inadequate regard for their
environmental consequences. As a legacy of these policies, Georgia now suffers from serious pollution. Air pollution is a problem in the major cities, particularly in Rustavi, which has a giant steelworks and other metallurgical industries. In addition, the Kura River and the Black Sea are heavily polluted with industrial waste. As a result of water pollution and the scarcity of water treatment, the incidence of digestive diseases in Georgia is high. The use of pesticides and fertilisers has increased soil toxicity.

Environmental protection did not become a major concern among Georgians until the mid-1980s, but even then systems to control harmful emissions were not readily available. Georgia’s economic problems have hindered the application of recent emission-control technologies. The protection of upland pastures and hill farms from soil erosion is another pressing issue that the government has not yet addressed effectively, owing to lack of economic resources. The government has ratified international environmental agreements pertaining to air pollution, biodiversity, climate change, ozone layer protection, ship pollution, and wetlands.

The population of Georgia is 4,661,473 (2006 estimate) (with an average population density of 67 persons per sq km) and some 52% of the country’s inhabitants live in cities. Population is concentrated mainly along the coast of the Black Sea and in river valleys, especially the valley of the Kura River, where Tbilisi, the capital and largest city, is located. The next largest city, Kutaisi, is located on the upper Rioni River. Other important urban centres include Batumi and Sokhumi, which are the capitals of Ajaria and Abkhazia, and Rustavi, located on the Kura downstream from Tbilisi. Trends in the population figures may be viewed in the following Table 2.

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban Population</td>
<td>2,412.5</td>
<td>2,365.8</td>
<td>2,338.2</td>
<td>2,308.2</td>
<td>2,280.7</td>
<td>2,284.8</td>
<td>2,266.8</td>
<td>2,252.5</td>
<td>2,257.0</td>
<td>2,310.4</td>
</tr>
<tr>
<td>Rural Population</td>
<td>2,145.9</td>
<td>2,139.1</td>
<td>2,131.6</td>
<td>2,127.0</td>
<td>2,120.7</td>
<td>2,086.7</td>
<td>2,075.0</td>
<td>2,062.4</td>
<td>2,064.6</td>
<td>2,090.9</td>
</tr>
<tr>
<td>Annual Avg</td>
<td>4,531.7</td>
<td>4,487.4</td>
<td>4,452.5</td>
<td>4,418.3</td>
<td>4,386.5</td>
<td>4,357.1</td>
<td>4,328.9</td>
<td>4,318.4</td>
<td>4,361.4</td>
<td>4,361.4</td>
</tr>
<tr>
<td>Urban Avg</td>
<td>2,389.0</td>
<td>2,352.0</td>
<td>2,323.2</td>
<td>2,294.5</td>
<td>2,282.8</td>
<td>2,275.8</td>
<td>2,259.6</td>
<td>2,255.0</td>
<td>2,284.0</td>
<td>2,284.0</td>
</tr>
<tr>
<td>Rural Avg</td>
<td>2,142.7</td>
<td>2,135.4</td>
<td>2,129.3</td>
<td>2,123.8</td>
<td>2,103.7</td>
<td>2,081.3</td>
<td>2,069.3</td>
<td>2,063.4</td>
<td>2,077.4</td>
<td>2,077.4</td>
</tr>
</tbody>
</table>

Source: Ministry of Economic Development of Georgia

Although the recent reform programmes have brought improvements in the economical statistics on many accounts, the unemployment has been on an increasing curve since 2003; it jumped to 13.8% in 2005 from 12.6% in 2004, yet from 11.5% in 2003. More importantly, the increasing unemployment rate is in spite of the decrease in labour force (see Table 3 below).
Table 3: Labour Force

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active population (labour force), thousand person</td>
<td>2,113.3</td>
<td>2,104.2</td>
<td>2,050.8</td>
<td>2,041.0</td>
<td>2,023.9</td>
</tr>
<tr>
<td>Employed, thousand person</td>
<td>1,877.7</td>
<td>1,839.2</td>
<td>1,814.9</td>
<td>1,783.3</td>
<td>1,744.6</td>
</tr>
<tr>
<td>Unemployed, thousand person</td>
<td>235.6</td>
<td>265.0</td>
<td>235.9</td>
<td>257.6</td>
<td>279.3</td>
</tr>
<tr>
<td>Unemployment rate (%)</td>
<td>11.1</td>
<td>12.6</td>
<td>11.5</td>
<td>12.6</td>
<td>13.8</td>
</tr>
<tr>
<td>Average monthly salary, GEL</td>
<td>94.6</td>
<td>113.5</td>
<td>125.9</td>
<td>156.8</td>
<td>204.2</td>
</tr>
</tbody>
</table>

Source: Ministry of Economic Development of Georgia

Georgia has very rich ethnic diversity with nearly 100 different ethnic groups that make up Georgia’s population. Georgians are the largest group, making up about 70% of the population, followed by Armenians (about 8%), Russians (about 6%), and Azerbaijanis (about 6%). Significant numbers of Ossetians, Greeks, and Abkhazians also reside in the Republic.

Georgian has been the country’s official language since 1918, when Georgia briefly gained its independence. The language belongs to the South Caucasian, or Kartvelian, language family and uses a distinct alphabet that was developed in the 5th century. A non-Indo-European and non-Turkic language, Georgian is unrelated to any other major world language. Georgian remained the official language of the Republic during the Soviet period, although Russian predominated in communications from the central government in Moscow. Georgian is not spoken by many of the country’s ethnic minorities, such as the Ossetians and Abkhazians, who speak their own native languages and frequently Russian as well. Russian is the first language of about 9% of the population, yet English is gaining more popularity as the international relations with the western countries, especially with the US further develop in line with the new orientation of the country towards the west.

The Georgian identity has been closely tied to religion since the introduction of Christianity in the early 4th century. After about 100 years of subjugation by the Russian Orthodox Church, the Georgian Orthodox Church, which predated the former, reclaimed its independence after the collapse of the Russian Empire in 1917. During the Soviet period, religious practice was strongly discouraged because the Soviet state was officially atheistic; however, the Georgian Orthodox Church was allowed to function openly. Orthodox Christianity is the religion of about 58% of the Georgian population. About 19% of the country’s population is Muslim, with ethnic Azerbaijanis, Kurds, and Ajars (ethnic Georgians who converted to Islam in the 17th century) being the principal Muslim groups. Judaism is also practiced, although to a lesser extent.

Georgia has an adult literacy rate of 99.5%, owing to the Soviet emphasis on free and universal education. Georgians were among the most highly educated of all the nationalities in the former USSR. Since independence, however, all levels of education in Georgia have been seriously underfunded, resulting in lower educational standards. Most schools are state operated and provide tuition-free education; however, a number of private schools have opened since the early 1990s. Education is compulsory from the first through eleventh grades, and most students enter the school system at age six. The number of enrolment in educational institutions is illustrated in Figure 2 below.8

Institutions of higher education in Georgia include the University of Tbilisi and Georgian Technical University, both located in Tbilisi. Abkhazia has its own university, Abkhazian State University. In addition to the state universities, there are many private (or semi-private) universities throughout Georgia, many with the language of instruction other than Georgian. Many of the private universities above also provide “certificate courses” focusing on professional training. The following Figures 3 and 4 illustrate the background figures regarding higher education.9

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9 http://www.investmentguide.ge/pages/economic_sectors/education/.
Despite centuries of foreign domination, Georgia has maintained a distinct culture, one influenced by both Asian and European traditions. The Georgian language is one of the most representative indications of this cultural individuality. Georgia’s ancient culture is evident in the Republic’s architecture, which is renowned for the role it played in the development of the Byzantine style. The Republic also has a long tradition of highly skilled metalwork, with excavations of ancient tombs revealing finely wrought pieces in bronze, gold, and silver.\footnote{http://encarta.msn.com/encyclopedia_761556415/Georgia_(country).html.}

II.2 Constitutional Framework: Political System

II.2.1 Government

Georgia has been a democratic republic since the presidential elections and constitutional referendum of October 1995. The president is elected for a term of 5 years, limited to two terms; his constitutional successor is the Speaker of Parliament. The president of Georgia is the head of state and is elected for a term of 5 years through universal, equal, and direct suffrage by secret ballot. The current president elected in 2004 is Mikheil Saakashvili.

Parliamentary elections on November 2, 2003 were marred by irregularities and fraud according to local and international observers. Popular demonstrations ensued in the streets of Tbilisi; protestors carried roses in their hands and these peaceful protests became known as the Rose Revolution. Former President Eduard Shevardnadze resigned on November 23, 2003, and the Speaker of Parliament Nino Burjanadze assumed the role of Interim President. President Mikheil Saakashvili was elected to a 5-year term in January 2004. Fresh parliamentary elections were held in March 2004, in which President Saakashvili’s party, the National Movement, combined with Speaker Burjanadze’s party, Burjanadze’s-Democrats, won the majority of seats.

On May 24, 2005, the Parliament passed legislation to decentralise power from the central government in Tbilisi to local government authorities in the regions. Elections were held on October 5, 2006 to elect 1,732 members of 69 local councils and seven city governments.

The Georgian government consists of three branches: legislative, executive, and judiciary. The legislative branch consists of the parliament, the parliaments of the autonomous republics of
Ajaria and Abkhazia, and councils (on the level of local authority). Parliament and council members are elected for a term of four years on the basis of a proportional and majority system.

The executive branch is comprised of the president, the prime minister, state ministers, ministries, state chancellery, state departments, inspections, city governments and regional governments (on the level of local authority). There are several ministries in the Autonomous Republic of Ajaria.

The judiciary is comprised of the Constitutional Court, the Supreme Court and lower (regional, city, district, and town) courts. The Constitutional Court of Georgia has 9 judges who are elected for a 10-year term. A candidate for the chairman of the Supreme Court is nominated by the president and upon approval by the parliament is appointed for a term of 10 years.

The Prosecutor General’s Office of Georgia is a constituent part of the judiciary and is in charge of instituting and proceeding with criminal actions, supervising investigations, ensuring that sentences are served, and conducting criminal prosecutions on behalf of the state. A candidate for the Prosecutor General of Georgia is nominated by the president and appointed by the parliament by a majority of votes. The Prosecutor General appoints prosecutors at lower levels. There is a Prosecutor’s Office of the Autonomous Republic of Ajaria as well as city and regional offices.

II.2.2. Legislature

The parliament of Georgia exercises legislative power. The current chair of the Parliament is Ms. Nino Burjanadze. The parliament chairperson leads the activity of the parliament, ensures freedom of expression, signs acts adopted by the parliament, and fulfils other duties as provided by the regulations. The parliament implements the main directions of domestic and foreign policy, carries out control over the government within the framework of the Constitution, and performs other functions. By majority vote, the parliament ratifies, denounces and abolishes international treaties and agreements. Parliamentary members are elected for 4 year terms on the basis of a proportional and majority system. Deputy mandates are given to those political alliances and election blocs which surpass a 7% threshold in elections held on the basis of a proportional system.

There are 220 parliament members with six factions, while a recent amendment to the Constitution decreased the number of members of parliament (MPs) to 150: 100 will be elected by party lists and 50 in single-seat constituencies.

According to the Constitution, the following can put forward a legislative initiative: the president of Georgia, a parliamentary committee, a parliamentary faction, a member of parliament, the supreme representative bodies of Abkhazia and Ajaria, and at least 30,000 voters.

The parliamentary committees and the president are chief initiators of legislative proposals in Georgia. A draft law, prepared in committee or received through legislative initiative, is discussed at a meeting of the relevant committee. The draft law, together with the opinion of the committee or explanatory note, is then sent to other parliamentary committees and factions and is published in the “Parliamentary Messenger”. Before the committee decides to submit the draft law to a plenary sitting it arranges a committee reading where the draft law is discussed item by item.

The reading is open to the public and thus provides an opportunity for democratic participation by the public and interest groups. If the draft law is initiated by the president of Georgia, the supreme representative bodies of Abkhazia and Ajaria, or constituency, the parliamentary bureau hands
over the draft to the relevant committee. After the parliament adopts the draft law, it is submitted to the president who signs it into law. It is published in an official edition and enters into force on the 15th day after the publication unless indicated otherwise in the law.

II.2.3. Executive

The Government (Cabinet) ensures that executive power is exercised and that the domestic and foreign policy of the state implemented. The Government is accountable to the President and the Parliament of Georgia. The Government includes the prime minister, the ministers, and the state ministers. The Prime Minister is the head of government. Lado Gurgenidze is the current prime minister of Georgia since December 2007. Ministries are established in certain spheres of public and social life to ensure implementation of public administration and state policy. There are 13 major ministries in addition to a number of state ministers who are in charge of implementing state objectives of special importance, currently representing Euro-Atlantic integration, economic affairs, conflict settlement, and civil integration.

Upon the request of parliament, the prime minister submits a report on the implementation of the government’s strategy. Upon the consent of the president, the prime minister appoints other members of the cabinet and is authorised to dismiss its members. If the nominees for the cabinet or the government programme implementation report fail to receive Parliament’s approval, the President of Georgia has one week to resubmit the same or a changed list of candidates for the Cabinet. If the parliament doesn’t approve the cabinet three consecutive times, the president shall, within 5 days, nominate or appoint without parliament’s consent, a new candidate for the prime minister. This new prime minister, on his/her part, is to appoint ministers within five days with the president’s consent. In such cases, the president dissolves the parliament and calls for early elections.

II.2.4. Judiciary

Judicial power is exercised through constitutional control, administration of justice, and other forms provided by law. The judiciary is independent and judicial power is exercised only by courts. Courts martial are allowed to be set up within the system of courts of general jurisdiction only during a period of war.

The Constitutional Court carries out constitutional control, which means it ensures that all laws and other normative documents in the country are consistent with the Constitution of Georgia and do not encroach on Constitutional freedoms. It also considers the constitutionality of referendums, elections, international agreements etc. The court consists of 9 judges who make up the members of the constitutional court and are appointed by the president, the parliament, and the Supreme Court, three by each. The term of office for the members is 10 years, while the Chairman, elected among the members by the court itself serves for one term of 5 years. A decision by the Court is final and cannot be appealed. A law or other normative document or a part of it that is considered unconstitutional by the Constitutional Court has no legal power after the publication of the relevant decision.

The Supreme Court is the highest court in the country. According to Article 90 of the Georgian Constitution, the Supreme Court supervises the administration of justice by courts of general jurisdiction. As a result of judicial reform, the Supreme Court has been established as a court of cassation. Judgments by the cassation chambers of the Supreme Court are final and are not subject to appeal. The so-called ‘supervisory proceedings’ have been abolished, thus resolving cases that had been delayed for decades.
Chapter V of the Georgian Constitution sets forth the principles of judicial independence and the activity of the judiciary. The Chairman and the members of the Supreme Court are elected for a term of 10 years by the parliament, upon nomination by the president. Before commencing the performance of judicial duties, a judge of the Supreme Court takes an oath of office in the presence of the president.

The system of common courts is the justice administration system. All private and administrative arguments, as well as criminal offences are considered by the common courts. The 3-tier system of common courts is based on a territorial principle, with district (city) courts, regional courts and the Supreme Court of Georgia.

Council of Justice is an advisory body to the President of Georgia. It consists of 12 members – equally split among representative of all three branches of the Government. The council derives its authority from the Organic Law on Common Courts. Namely, it is called to “lead the judiciary reform, organise qualification exams, select judges, conduct disciplinary actions against them, elaborate the state policy on judiciary education, etc.”

II.3 Economy

II.3.1. Background and General Overview

In the past, the Soviet Socialist Republic of Georgia was one of the most prosperous and envied locations in the former Soviet Union. However, the political turmoil after independence had a catastrophic effect on Georgia’s economy. The cumulative decline in real GDP is estimated to have been more than 70% between 1990 and 1994, and by the end of 1996, Georgia’s economy had shrunk to around one-third of its size in 1989. Now, the largest share of Georgia’s GDP is produced by agriculture, followed by trade, manufacturing, and transport. Georgia’s main exports are metals and ores, wine, nuts, and aircraft.

Although Georgia experienced some years of growth in the mid-1990s, it was hard hit by the Russian economic crisis of 1998-99. The later years of former President Shevardnadze’s administration were marked by rampant cronyism, corruption, and mismanagement. Public disaffection with the situation led to the Rose Revolution of 2003. The subsequent new government which is currently in charge, led by Mikheil Saakashvili, promised to reorient the government and the economy towards privatisation, free markets, reduced regulation, and control of corruption.

The new government has indeed succeeded in major achievements towards fulfilling its aims. It reduced the number of taxes from 21 to 7 and introduced a flat income tax of 12%. It significantly reduced the number of licenses a business requires and introduced a one-window system (the Georgian National Investment Agency (GNIA) services) that allows an entrepreneur to open a business relatively quickly. Strict deadlines for agency action on permits were introduced, and consent is assumed if the agency fails to act within the time limit. The government intends to completely eliminate import duties by 2008, which should reduce costs and stimulate business.

The World Bank recognised Georgia as the world’s fastest-reforming economy in its 2007 “Doing Business” report, ranking it as the world’s 37th easiest place to do business, in the same league as countries such as France, Slovakia, and Spain. The World Bank’s “Anti-Corruption in Transition 3” report places Georgia among the countries showing the most dramatic improvement in the struggle against corruption, due to implementation of a strong
programme of economic and institutional reform, and reported reductions in the burden of bribes paid by firms in the course of doing business.

Economic growth has remained strong, reaching 9.3% in 2005, and 8.7% in 2006 with a GDP per capita of 1,770 USD. Inflation was 6.2% in 2005, but increased to 8.8% in 2006 (see Figure 5 below). Efforts to improve the efficiency of government operations since the Rose Revolution have required the government to release workers, pushing official unemployment to 13.8% in 2005. A strongly negative balance of trade is offset by inflows of investment and assistance from international donors.

![Figure 5: Annual Inflation](image)

*Source: Department for Statistics of the Ministry of Economic Development of Georgia*

Georgia’s currency regime is based on floating exchange rate principles. Interventions of the national bank of Georgia are targeted against exchange rate fluctuations on the currency market. The foreign exchange fluctuation of the national currency against the USD during the year 2006 may be viewed in the following Figure 6.

![Figure 6: Official Exchange Rate of Lari Against USD for 2006-January 2007](image)

*Source: Ministry of Economic Development of Georgia*

Improved collection and administration of taxes have greatly increased revenues for the government. In two years, from 2003 to 2005, tax collections went up from 13.8% of GDP to

20.8%. The government has been able to pay off wage and pension arrears and increase spending on desperately needed infrastructure such as roads and electric energy supply systems. The government privatised nine times the value of state-owned assets in 2005 as it did in all of 2000-2003. It expects to have privatised all of the largest state-owned industries by the end of 2008, increasing revenues and removing a major temptation toward corruption from the control of state bureaucrats.

Before 2004 electricity blackouts were common throughout the country, but since late 2005, distribution has been much more reliable, approaching consistent 24-hour-a-day services. Improvements have resulted from increased metering, better billing and collection practices, reduced theft, and management reforms. Investments in infrastructure have been made as well. Hydroelectricity output was increased by almost 27% and thermal by 28%, from 2005 to 2006. Natural gas has traditionally been supplied to Georgia by Russia. Through conservation, new hydroelectricity sources, and the availability of new sources of natural gas in Azerbaijan, Georgia’s dependence on Russia for energy supplies is projected to decrease in the near future.

The banking sector is becoming more open to competition from foreign-owned banks. The sector is relatively stable, and is supplying more credit to domestic businesses. Credit from Georgian banks to the economy was 15% of GDP in 2005, compared to 10% in 2004 - still low, compared to the average in the Czech Republic, Hungary, and Poland for 2005, which was 36%.

Foreign direct investment (FDI) is the most important source of capital for Georgia and other post-Soviet states. Such investment not only supports new plants and equipment, but also usually entails bringing in modern management methods as well. The Georgian Government is eager to welcome foreign investors. In 2004, FDI totaled USD489 million, more than half of which was invested in construction of the now-completed Tbilisi-Baku-Ceyhan oil pipeline and the South Caucasus gas pipeline. Foreign investors are beginning to take notice of the changes in Georgia. FDI reached USD539 million in 2005, and inflows of investment exceeding USD1 billion are expected in 2007.

Georgia faces many challenges in attracting foreign investment and growing its economy. In 2006, more than 50% of the population lived below the official poverty line. With only 4.7 million people, most of whom have little disposable income, it is a small market in itself. The major market to which Georgia has traditionally been linked is Russia. (For example, at one time nearly 100% of the Soviet Union’s citrus consumption was produced in Georgia.) In 2006, trade relations were plagued by politically motivated interruptions when Russia imposed bans on all Georgian exports of wine, fruits and vegetables, and mineral water. In October 2006, Russia severed all direct transportation links, as well as postal service and visa issuance. In addition, Russia undertook a campaign of mass deportations of Georgian nationals residing in Russia and closed the only legal land border crossing between Georgia and Russia, diverting traffic into the troublesome regions outside of Georgia’s full control. In light of these restrictions, Georgian businesses are actively seeking new markets for their products in the EU, Eastern Europe, North America, and elsewhere.

The government faces a major challenge in controlling corruption, which is a persistent problem. Shortly after President Saakashvili took office, the administration has performed major reforms to establish a trustworthy civil service. On the other hand, deficiencies regarding the judiciary and system of justice still pose risks regarding the foreign and domestic investors. The new government has promised to tackle this difficult task, which requires balancing the objective of judicial independence with honest, fair, and competent decision making.
International donors are assisting Georgia’s transition to democracy, creation of a functioning market economy, and poverty reduction. Georgia is one of the first countries to receive a compact, in the amount of USD295 million over five years, from the United States Millennium Challenge Corporation, which offers grant assistance to countries that meet certain requirements for good governance and commitment to reform. In 2004, Georgia’s debt to the Paris Club was restructured. Since 2004, the International Monetary Fund (IMF) has monitored a Poverty Reduction and Growth Facility that will terminate in 2007. The World Bank, European Bank for Reconstruction and Development, EU, OSCE, and the UN are all active in Georgia. Their goals are similar, and include assisting in conflict resolution in Abkhazia and South Ossetia, energy and transportation development, legal and administrative reform, health, and many other areas.

As regards the general macroeconomic situation, some selected economic and financial indicators are provided below.12

<table>
<thead>
<tr>
<th>Economic Activity</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nominal GDP (GEL min)</td>
<td>6,043</td>
<td>6,674</td>
<td>7,456</td>
<td>8,564</td>
<td>9,824</td>
<td>11,621</td>
<td>13,784</td>
</tr>
<tr>
<td>Nominal GDP (US$ min)</td>
<td>3,060</td>
<td>3,219</td>
<td>3,400</td>
<td>3,995</td>
<td>5,166</td>
<td>6,416</td>
<td>7,744</td>
</tr>
<tr>
<td>GDP per Capita (GEL)</td>
<td>1,299</td>
<td>1,445</td>
<td>1,626</td>
<td>1,880</td>
<td>2,166</td>
<td>2,570</td>
<td>3,132</td>
</tr>
<tr>
<td>GDP per Capita (US$)</td>
<td>658</td>
<td>697</td>
<td>741</td>
<td>877</td>
<td>1,139</td>
<td>1,419</td>
<td>1,760</td>
</tr>
<tr>
<td>GDP growth %</td>
<td>1.8</td>
<td>4.8</td>
<td>5.5</td>
<td>11.1</td>
<td>5.9</td>
<td>9.6</td>
<td>9.4</td>
</tr>
<tr>
<td>Inflation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CPI (year end %)</td>
<td>4.6</td>
<td>3.4</td>
<td>5.4</td>
<td>7.0</td>
<td>7.5</td>
<td>6.2</td>
<td>8.8</td>
</tr>
<tr>
<td>External Balance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Exports (FOB, US$ min)</td>
<td>323</td>
<td>318</td>
<td>346</td>
<td>461</td>
<td>647</td>
<td>866</td>
<td>993</td>
</tr>
<tr>
<td>Total Imports (CIF, US$ min)</td>
<td>709</td>
<td>753</td>
<td>796</td>
<td>1,141</td>
<td>1,848</td>
<td>2,491</td>
<td>3,678</td>
</tr>
<tr>
<td>Trade Balance (US$ min)</td>
<td>(387)</td>
<td>(436)</td>
<td>(450)</td>
<td>(680)</td>
<td>(1,201)</td>
<td>(1,625)</td>
<td>(2,685)</td>
</tr>
<tr>
<td>FDI (US$ min)</td>
<td>131</td>
<td>110</td>
<td>167</td>
<td>340</td>
<td>499</td>
<td>450</td>
<td>1,147</td>
</tr>
<tr>
<td>FDI as % of GDP</td>
<td>4.3</td>
<td>3.4</td>
<td>5.4</td>
<td>7.0</td>
<td>7.5</td>
<td>6.2</td>
<td>8.8</td>
</tr>
<tr>
<td>Fiscal Balance and Debt indicators</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State budget revenues (GEL min)</td>
<td>920</td>
<td>906</td>
<td>1,156</td>
<td>1,344</td>
<td>2,282</td>
<td>3,257</td>
<td>4,430</td>
</tr>
<tr>
<td>State Budget Expenditures (GEL min)</td>
<td>1,136</td>
<td>1,029</td>
<td>1,402</td>
<td>1,522</td>
<td>2,412</td>
<td>3,281</td>
<td>4,464</td>
</tr>
<tr>
<td>Deficit</td>
<td>(216)</td>
<td>(123)</td>
<td>(245)</td>
<td>(178)</td>
<td>(24)</td>
<td>(34)</td>
<td></td>
</tr>
<tr>
<td>Government debt (GEL min)</td>
<td>5,163</td>
<td>4,450</td>
<td>4,843</td>
<td>4,608</td>
<td>4,307</td>
<td>4,076</td>
<td>3,855</td>
</tr>
<tr>
<td>Exchange rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GEL/US (Average)</td>
<td>1.98</td>
<td>2.07</td>
<td>2.19</td>
<td>2.15</td>
<td>1.92</td>
<td>1.81</td>
<td>1.78</td>
</tr>
</tbody>
</table>

Source: Ministry of Economic Development of Georgia

As regards with economic prospects, it should be evident that the realities of global political and economic development determine the international significance of the South Caucasus–Central Asia region in general, and Georgia in particular. The increased interest of the world’s major economic players in accessing the Eurasian markets, as well as diversification of the routes of transportation of Caspian oil and gas, assigns Georgia the role of a pivotal country—a gateway that connects Europe with Asia. In the short and mid-term, successful reforms aimed at creating a favourable environment for international business, and the inflow of FDI, may transform Georgia into a regional hub of dynamic international business activity.

II.3.2. Economic Growth

The systemic institutional reforms, the creation of a liberal legislative framework, and structural reforms in the economy, which followed a period of economic collapse in the early 1990s, has led to constant economic growth in Georgia since 1995. According to the preliminary estimates of the State Department of Statistics (SDS), Georgia’s GDP in 2005 amounted to GEL 11,591.8 million (USD 6,400.5 million, i.e., USD 1,415.6 per capita). Currently, the Georgian economy is growing at a considerable rate. GDP growth rate increased by 3.2% – from 5.4% in 2002 to 8.6% in 2003. Steady growth continued in 2006, and as a result GDP real growth reached 9.4%, providing the creation of 13,783.9 ml. GEL (7,759.6 mln USD) GDP. This was also caused by the development of financial intermediation and the growth of value added in sectors of infrastructure. A comparable rate of growth was only observed in 1997 before the impact of the financial crisis in Russia in 1998, after which backslide in reform policies coupled with political corruption slowed down the pace of economic growth in Georgia from 1997 to 2001.

In 2003 and 2004, GDP growth was observed in every quarter compared with the corresponding quarter in the previous year (see Table 5 and Figure 7). GDP growth rate (9.3%) in 2005 compared to 2004 was 3.4% higher, that was caused by the 12% value added growth in the agriculture due to development of farming and favourable natural conditions. High rate of GDP growth was also caused by the growth of economic activity in the country. The Georgian part of Baku-Tbilisi-Ceyhan Pipeline was finished in the first half of 2005, but value added growth in construction still is high and amounted to 13%. In 2005 among the spheres of economic activity, financial intermediation was one of the strongest and had the great influence on the economic expansion. During this period, the role of financial intermediation in the country economic activity increased greatly. This fact denotes that financial resources became more easily accessible to the private sector.

Growth was mainly due to development of financial (40.4% growth), construction (9.9% growth) and transport and communications (15.1% and 11.9%, respectively) sectors. In 2006 the foreign trade turnover (excluding non-organised trade) amounted to 4.7 mln USD, where the export was 993 mln USD (15% increase) and import – 3,7 bln USD (48% increase). In 2006 the negative trade balance of Georgia was equal to 2.7 bln USD. The ratio of import coverage by export was 278%.

GDP in market prices in 2006 amounted to 13,784 million GEL (7,744 ml USD), and GDP per capita equalled to GEL 3,132 (1,760 USD).

During the recent years, owing to the consistent public reforms and stabilisation in the country, tax revenues have seen a substantial increase and contributed to the balancing the public finance, also helping reduce the foreign debt. This may easily be viewed in Table 6.
### Table 5: Main Economic Indicators, 2001-2006\(^\text{14}\)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth (%)</td>
<td>4.8</td>
<td>5.5</td>
<td>11.1</td>
<td>6.2</td>
<td>9.3</td>
<td>9.4</td>
</tr>
<tr>
<td>Exports (growth, %)</td>
<td>-1.5</td>
<td>8.8</td>
<td>34.5</td>
<td>39.4</td>
<td>34</td>
<td>15</td>
</tr>
<tr>
<td>Imports (growth, %)</td>
<td>6</td>
<td>5.6</td>
<td>43.8</td>
<td>61.9</td>
<td>34.8</td>
<td>48</td>
</tr>
<tr>
<td>Inflation Rate (%)</td>
<td>3.4</td>
<td>5.4</td>
<td>7</td>
<td>7.5</td>
<td>6.2</td>
<td>8.8</td>
</tr>
<tr>
<td>Foreign Direct Investments (in ml. USD)</td>
<td>110</td>
<td>167</td>
<td>340</td>
<td>499</td>
<td>447</td>
<td>1,147</td>
</tr>
<tr>
<td>GDP per capita (in USD)</td>
<td>697</td>
<td>741.4</td>
<td>876.9</td>
<td>1,139.1</td>
<td>1,415.6</td>
<td>1,760</td>
</tr>
</tbody>
</table>

*Source: Ministry of Economic Development of Georgia*

### Table 6: Consolidated Budget (GEL Mln.)\(^\text{15}\)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue and grants</td>
<td>1,063.9</td>
<td>1,157.4</td>
<td>1,320.9</td>
<td>2,283.0</td>
<td>3,257.2</td>
<td>3,117.5</td>
</tr>
<tr>
<td>Total revenue</td>
<td>1,015.8</td>
<td>1,134.8</td>
<td>1,272.5</td>
<td>2,158.3</td>
<td>3,152.7</td>
<td>3,025.6</td>
</tr>
<tr>
<td>Tax revenue</td>
<td>936.6</td>
<td>1,054.2</td>
<td>1,186.3</td>
<td>1,811.2</td>
<td>2,411.5</td>
<td>2,243.9</td>
</tr>
<tr>
<td>Non-tax revenue</td>
<td>79.2</td>
<td>80.6</td>
<td>86.2</td>
<td>274.4</td>
<td>321.8</td>
<td>391.2</td>
</tr>
<tr>
<td>Capital revenue</td>
<td>5.6</td>
<td>8.7</td>
<td>23.6</td>
<td>72.7</td>
<td>419.4</td>
<td>390.5</td>
</tr>
<tr>
<td>Grants received from abroad</td>
<td>48.1</td>
<td>22.6</td>
<td>48.4</td>
<td>124.7</td>
<td>104.6</td>
<td>91.9</td>
</tr>
<tr>
<td>Financial aids received from State Budget</td>
<td>55.1</td>
<td>65.1</td>
<td>69.8</td>
<td>128.2</td>
<td>176.7</td>
<td>162.3</td>
</tr>
<tr>
<td>Total expenditure and net lending</td>
<td>1,237.8</td>
<td>1,409.5</td>
<td>1,609.9</td>
<td>2,418.5</td>
<td>3,280.8</td>
<td>3,019.3</td>
</tr>
<tr>
<td>of which financial aids issued from State Budget</td>
<td>55.1</td>
<td>65.1</td>
<td>69.8</td>
<td>128.2</td>
<td>176.7</td>
<td>162.3</td>
</tr>
<tr>
<td>Surplus(+), deficit(-) excluding debt service</td>
<td>-59.0</td>
<td>-105.4</td>
<td>-120.5</td>
<td>5.5</td>
<td>96.7</td>
<td>172.6</td>
</tr>
<tr>
<td>Debt service</td>
<td>115.0</td>
<td>146.7</td>
<td>168.5</td>
<td>140.9</td>
<td>120.3</td>
<td>74.5</td>
</tr>
<tr>
<td>- Domestic debt</td>
<td>66.3</td>
<td>80.0</td>
<td>95.1</td>
<td>92.4</td>
<td>81.8</td>
<td>49.2</td>
</tr>
<tr>
<td>- Foreign debt</td>
<td>48.7</td>
<td>66.7</td>
<td>73.4</td>
<td>48.5</td>
<td>38.5</td>
<td>25.3</td>
</tr>
<tr>
<td>Surplus(+), deficit(-) including debt service</td>
<td>-174.0</td>
<td>-252.1</td>
<td>-289.0</td>
<td>-135.4</td>
<td>-23.6</td>
<td>98.1</td>
</tr>
<tr>
<td>Financing</td>
<td>174.0</td>
<td>252.1</td>
<td>289.0</td>
<td>135.4</td>
<td>23.6</td>
<td>-98.1</td>
</tr>
<tr>
<td>Government debt (end of period)</td>
<td>4,449.5</td>
<td>4,843.3</td>
<td>4,608.0</td>
<td>4,306.6</td>
<td>4,076.1</td>
<td>3,996.7</td>
</tr>
<tr>
<td>Domestic debt</td>
<td>1,492.4</td>
<td>1,520.3</td>
<td>1,567.9</td>
<td>1,575.8</td>
<td>1,535.3</td>
<td>1,511.2</td>
</tr>
<tr>
<td>Monetary authorities</td>
<td>773.7</td>
<td>772.1</td>
<td>811.3</td>
<td>832.8</td>
<td>832.8</td>
<td>832.8</td>
</tr>
<tr>
<td>Other domestic debt</td>
<td>718.7</td>
<td>748.2</td>
<td>756.6</td>
<td>742.9</td>
<td>702.5</td>
<td>678.3</td>
</tr>
<tr>
<td>Foreign debt</td>
<td>2,957.1</td>
<td>3,323.0</td>
<td>3,040.1</td>
<td>2,730.8</td>
<td>2,540.8</td>
<td>2,485.5</td>
</tr>
</tbody>
</table>

*Source: Ministry of Economic Development of Georgia*

---


II.3.3. Sectors of the Economy

The fastest growing sectors of Georgian economy were industry, agriculture, construction, services, financial intermediation, transport, and communications. The ‘Baku-Tbilisi-Ceyhan Pipeline’ construction project was a strong stimulus for expansion of the construction and service sectors. The reforms of business climate and the policy of liberalisation and deregulation implemented by the government contributed to growth of the national income, albeit its effects on the employment have not been strongly witnessed as illustrated in Table 3 above.

In 2006, trade (13.6%), agriculture (11.3%) and manufacturing (8.6%) accounted for the largest shares of GDP. The highest growth rates were registered in the sectors of finance (40.4%), manufacturing (22.4%), trade (19.7%), mining (18.9%) and transport (15.1%) (see Table 7).

II.3.4. Monetary Policy

The National Bank of Georgia (NBG) – the Central Bank – implements its monetary policy in accordance with the annual programmes, subject to approval by the Parliament. The major goals of the monetary policy are to keep the stable exchange rate of the national currency Lari (GEL) and to maintain the price level within the annual inflation of 5-6%. Monetary policy is based on the strict control of money supply. The policy foresees that within a free-floating foreign exchange rate the NBG should not issue foreign currency for circulation even in the case of high demand. Meanwhile, the National bank of Georgia shall purchase foreign currency on Tbilisi Interbank Currency Exchange (TICEX) to maintain a sufficient level of international reserves. The NBG provides strict control over direct financing of the Government. However, during the last several years the NBG and the Ministry of Finance have been committed to the policy of total substitution of direct crediting by government treasury bills.

Some of the figures relating to monetary policy for the period 2001-2006 are given in Table 8.16

Table 7: GDP Structure in 2006

<table>
<thead>
<tr>
<th>GDP (Min USD)</th>
<th>Total Structure</th>
<th>Growth rate compared to previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Forestry, fishing</td>
<td>862.5</td>
<td>11.3</td>
</tr>
<tr>
<td>Mining and quarrying</td>
<td>79.3</td>
<td>1.0</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>654.5</td>
<td>8.6</td>
</tr>
<tr>
<td>Electricity, gas and water supply</td>
<td>207.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Processing products by household</td>
<td>193.5</td>
<td>2.5</td>
</tr>
<tr>
<td>Construction</td>
<td>521.6</td>
<td>6.8</td>
</tr>
<tr>
<td>Trade services, Repair services</td>
<td>1,053.5</td>
<td>13.6</td>
</tr>
<tr>
<td>Restaurant and Hotel Services</td>
<td>170.2</td>
<td>2.2</td>
</tr>
<tr>
<td>Transport and storage</td>
<td>620.2</td>
<td>8.0</td>
</tr>
<tr>
<td>Communications</td>
<td>269.4</td>
<td>3.5</td>
</tr>
<tr>
<td>Financial intermediation</td>
<td>175.3</td>
<td>2.3</td>
</tr>
<tr>
<td>Real estate, renting and business activities</td>
<td>248.6</td>
<td>3.2</td>
</tr>
<tr>
<td>Imputed rent of own occupied dwellings</td>
<td>186.9</td>
<td>2.4</td>
</tr>
<tr>
<td>Public Administration and defence</td>
<td>665.0</td>
<td>8.6</td>
</tr>
<tr>
<td>Education</td>
<td>276.8</td>
<td>3.6</td>
</tr>
<tr>
<td>Health care and social services</td>
<td>336.1</td>
<td>4.3</td>
</tr>
<tr>
<td>Other community, social and personal services activities</td>
<td>267.0</td>
<td>3.4</td>
</tr>
<tr>
<td>Private households with employed persons</td>
<td>5.1</td>
<td>0.1</td>
</tr>
<tr>
<td>(-) FISIM adjustment</td>
<td>-70.9</td>
<td>-0.9</td>
</tr>
<tr>
<td>(=) Gross Domestic Product at basic prices</td>
<td>6,764.5</td>
<td>87.4</td>
</tr>
<tr>
<td>(+) taxes on products</td>
<td>1,011.6</td>
<td>13.1</td>
</tr>
<tr>
<td>(-) subsidies on products</td>
<td>-32.4</td>
<td>-0.4</td>
</tr>
<tr>
<td>(=) Gross domestic product at market prices</td>
<td>7,743.8</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: Department for Statistics of the Ministry of Economic Development of Georgia

Reserve requirements for commercial bank deposits also play an important role in maintaining money supply: to increase the amount of the Lari in circulation, the NBG shall decrease the reserve requirements ratio and vice versa.

II.3.5. Trade Policy and External Trade

Georgian trade and exchange systems are considered to be among the most liberal of the transitional economies. Unsurprisingly, due to the size and openness of the Georgian economy, foreign trade plays a considerable role in the stability and growth of economy. The Ministry of Economic Development of Georgia is the central enforcement authority defining, realising and coordinating state policy in the field of trade. The ministry coordinates work of all state and private functional structures working in the field of a commercial policy of the country.
Table 8: Money Supply by Aggregates (end of period) (GEL mln.)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broad money (M3)</td>
<td>732.4</td>
<td>863.6</td>
<td>1,060.4</td>
<td>1,511.9</td>
<td>1,911.2</td>
<td>2,661.7</td>
</tr>
<tr>
<td>Money supply (M2)</td>
<td>403.8</td>
<td>462.3</td>
<td>513.7</td>
<td>846.1</td>
<td>1,069.9</td>
<td>1,389.2</td>
</tr>
<tr>
<td>Reserve money (M1)</td>
<td>429.9</td>
<td>509.0</td>
<td>579.9</td>
<td>836.5</td>
<td>1,001.5</td>
<td>1,193.2</td>
</tr>
<tr>
<td>Money outside banks (M0)</td>
<td>348.9</td>
<td>390.8</td>
<td>441.5</td>
<td>616.0</td>
<td>736.3</td>
<td>827.4</td>
</tr>
<tr>
<td>Deposit liabilities (in national currency)</td>
<td>55.0</td>
<td>71.5</td>
<td>85.9</td>
<td>230.1</td>
<td>333.6</td>
<td>561.8</td>
</tr>
<tr>
<td>Deposit liabilities (in foreign currency)</td>
<td>328.6</td>
<td>401.3</td>
<td>533.0</td>
<td>665.8</td>
<td>841.3</td>
<td>1,272.5</td>
</tr>
<tr>
<td>Share of M0 in M2</td>
<td>86.4</td>
<td>84.5</td>
<td>86.0</td>
<td>72.8</td>
<td>68.8</td>
<td>59.6</td>
</tr>
<tr>
<td>Share of M2 in M3</td>
<td>55.1</td>
<td>53.5</td>
<td>48.4</td>
<td>56.0</td>
<td>56.0</td>
<td>52.2</td>
</tr>
<tr>
<td>GEL in circulation</td>
<td>365.7</td>
<td>417.2</td>
<td>473.2</td>
<td>676.2</td>
<td>811.4</td>
<td>929.5</td>
</tr>
</tbody>
</table>

Source: Ministry of Economic Development of Georgia

From September 2006 the new law “on custom tariffs” came into force, according to which 16 tariff rates reduced to 3 tariff rates: 0%, 5%, 12%. Thus, Georgia’s customs tariffs are among the lowest in the world. Furthermore, Georgia has no quantitative restrictions (quotas) on trade.

Under the above-mentioned law, import duties have been abolished on 90% of tariff lines (all non agricultural products except some construction materials). This will help Georgia to raise its investment attractiveness given the country’s liberal business regulations and favourable export regimes.

The purpose of decrease in import tariffs also is:

- Expansion and improvement of the competitive environment by creating of equal market conditions for production of a local and import origin;
- Decrease in consumer prices of import production and raw material and by that improvement of a social and economic condition of the needy population;
- Simplification of customs procedures and by that prevention of corruption at customs;
- With the purpose of creation of uniform interstate and international informational space, harmonisation of customs tariff nomenclature – HS2002.

Introduction of Georgia into the World Trading Organisation (WTO) on June, 14th, 2000 was a significant step for Georgia towards integration into world trade. With this step Georgia in mutual trade has automatically received the right of most favoured treatment with 151 countries of the world. The recognition and realisation of agreements and principles accepted by WTO will allow accelerating considerably full integration of Georgia into the world economy.

Georgia has joined many multilateral trading agreements and the international conventions, among them:

- The Parisien convention on protection of the industrial property (20.03.1883),
- The Madrid agreement on registration of trading trade-marks (14.14.1891),
- The agreement on protection of patents (1970),
- The Viennese convention on contracts of sale and purchase of the goods (11.04.1980).
In foreign trade activities of Georgia, one of priority directions is the mutual relation with the European Union. In 1996 between the European Union and Georgia was drawn up the agreement on partnership and cooperation. The Agreement is adequately extensive and many-faceted: it includes actually all spheres of economy and, the main thing in it is that the EU countries rate Georgia not as country which needs the constant help, but as an equal in rights partner with national treatment.

For Georgia likewise the countries with transition economy, crucial importance has an opportunity to use the Generalised System of Preference (GSP), providing a preferential tariff mode for production imported from Georgia.

Currently preferential mode GSP, to Georgia was given by the European Union, the USA, Canada, Japan, Turkey and Switzerland. In 2005 EU, and since January 2006 Turkey provided Georgia the expanded opportunity to make use of tariff privileges (GSP+), that consists in granting a mode without duties on import of 7,200 products.

**II.3.5.1. Aims of Trade Policy**

Basic aims of the Georgian trade policy are:

- Integration in the world economy and as the member of WTO, assistance in implementation and maintenance of international obligations and principals of foreign trade activities according to the world standards;
- Trade policy liberalisation, simplification of export and import mechanism and also tariff and non-tariff regulation;
- Protection of commodity producer interest, assistance in increasing of local export production and developing internal economic relations;
- Assistance in arrangements for ensuring quality of imported products for protecting consumer rights and ensuring their safety;
- Assistance in preventing smuggling, illegal entrance of drugs, weapon, antiques and cultural values on state customs.

**II.3.5.2. Free Trade Agreements**

Georgia is the party to the agreement on creation of a zone of free trade from April, 15th, 1994 and the report on modification and additions in the agreement on creation of a zone of free trade (02.04.1999).

Georgia has bilateral agreements regarding free trade with 8 CIS countries, by the Parliament of Georgia the agreement is ratified with 6 states – the Russian Federation, Ukraine, Armenia, Azerbaijan, Turkmenistan and Kazakhstan. This circumstance in many respects promoted free movement of the goods without the customs duties and to substantial growth of volumes of trade with these countries. Georgia basically does not apply tariff and non-tariff restrictions in its trade relations with the CIS countries. Reports of withdrawals from a mode of free trade are concluded only with the Russian Federation (on 4 kinds of production).

**II.3.5.3. Import Regulation**

Customs procedures and obligatory documents are in accordance with the customs code and other statutory acts. Customs procedures are adjusted by the customs code on which 15 types
of procedures are certain: holiday of the goods in a free turn (import); re-import, transit, a
premise of the goods on customs warehouses; free trade; internal processing; processing
under the customs control; temporary import or export; a premise and use in free customs
areas; export; re-export; destruction, the application of refusal in favour of the state. The list
of necessary documents for customs registration of export and import of the goods is defined
by the order of Minister of tax incomes (21.11. 2001 №798).

The legal base of what constitutes the trade policy may be cited to include the following
legislation, listed in Table 9.17

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Internal Revenue Code (the Tax Code)</td>
</tr>
<tr>
<td>2.</td>
<td>The Customs Code</td>
</tr>
<tr>
<td>3.</td>
<td>Law on “Customs Duties”</td>
</tr>
<tr>
<td>4.</td>
<td>Law on “Consular Fees”</td>
</tr>
<tr>
<td>5.</td>
<td>Law on “Customs Tariffs”</td>
</tr>
<tr>
<td>8.</td>
<td>Law on “Protecting Consumer Rights”</td>
</tr>
<tr>
<td>9.</td>
<td>Law on “Free Trade and Competition”</td>
</tr>
<tr>
<td>10.</td>
<td>Law on “Assistance and Guarantees of Investing Activities”</td>
</tr>
<tr>
<td>11.</td>
<td>Law on “Advertising”</td>
</tr>
<tr>
<td>12.</td>
<td>Law on “Author’s and Allied Rights”</td>
</tr>
<tr>
<td>13.</td>
<td>Law on “Patents”</td>
</tr>
<tr>
<td>14.</td>
<td>Law on “Standardisation”</td>
</tr>
<tr>
<td>15.</td>
<td>Law on “Trademarks”</td>
</tr>
<tr>
<td>16.</td>
<td>Law on “Origin of Goods and Geographic Indicators”</td>
</tr>
<tr>
<td>17.</td>
<td>Law on “Commodity Exchange and Exchange Trade”</td>
</tr>
<tr>
<td>18.</td>
<td>Law on “State Purchase”</td>
</tr>
<tr>
<td>19.</td>
<td>Law on “Vine and Wine”</td>
</tr>
</tbody>
</table>

Source: Ministry of Economic Development of Georgia

Georgian exports are partially concentrated either on low value-added commodities such as
ferrous metals, copper, aluminium, iron and steel and mineral fuels, or on agricultural produce.
Nevertheless, in parallel with overall economic development and the resulting changes from
the reform policies in recent years, including the increase in industrial output, the share of low
value-added commodities in exports is expected to decrease steadily.

Table 10: Trends in Georgia’s Balance in Trade

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006 (Jan-Sept)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Export (mln USD)</td>
<td>444,0</td>
<td>648,8</td>
<td>866,8</td>
<td>721,9</td>
</tr>
<tr>
<td>Import (mln USD)</td>
<td>1058,0</td>
<td>1847,0</td>
<td>2490,9</td>
<td>2591,1</td>
</tr>
<tr>
<td>Trade balance (mln USD)</td>
<td>-614,0</td>
<td>-1198,2</td>
<td>-1624,2</td>
<td>-1869,3</td>
</tr>
<tr>
<td>Trade turnover (mln USD)</td>
<td>1502,0</td>
<td>2495,8</td>
<td>3357,7</td>
<td>3313,0</td>
</tr>
<tr>
<td>GDP (Mln USD)</td>
<td>3948,0</td>
<td>5200,0</td>
<td>6500,0</td>
<td></td>
</tr>
<tr>
<td>Export/GDP</td>
<td>11,2</td>
<td>12,5</td>
<td>13,3</td>
<td></td>
</tr>
<tr>
<td>Trade/GDP</td>
<td>38,0</td>
<td>48,0</td>
<td>51,7</td>
<td></td>
</tr>
<tr>
<td>Trade balance/GDP</td>
<td>15.6</td>
<td>23,0</td>
<td>25,0</td>
<td></td>
</tr>
</tbody>
</table>

Source: Ministry of Economic Development of Georgia

Figure 8: Dynamics of Georgian Exports and Imports (2001-2006)

Imports are dominated by mineral products, pharmaceuticals, food, and, due to the dependence of Georgia on foreign energy resources – fossil fuels and electricity. The increase in imports in 2003 by a remarkable 45% in USD terms can be attributed to the increase in the purchasing power of the population, as well as to investment projects (BTC pipeline and SCP).

Since 2003, there has been a high growth rate in the foreign commodity turnover of Georgia. For the last few years, there has also been an upward trend in the number of Georgia’s trading partners, now standing at 125 countries. In 2005, trade turnover increased by 35% and reached 3.36 bln. USD. Exports amounted to 866.7 mln. USD (34% higher than previous year) and imports reached to 2,490.9 mln. USD (34.8% higher than previous year). Foreign trade turnover in the first half of 2006 was 2,050.6 mln. USD, from which exports were 470.0 mln. USD and imports recorded a figure of 1,580.6 mln. USD. The growth of negative foreign trade balance is mainly caused by the Russian trade and other economic sanctions. According to most recent study by the National Bank of Georgia, the Russian trade sanctions amounted to damage of 15 million USD, being 0.2-0.3% of GDP in the last three months of 2006. The assessment further refers to some other negative impacts of the sanctions on such other macroeconomic issues as inflation, workers’ remittances.

Source: Ministry of Economic Development of Georgia

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19 Invest in Georgia 2007, Ministry of Economic Development of Georgia.
from Georgian nationals in Russia, and unemployment due to returning workforce from Russia (for more details, see ‘Box 1 – Impact of Russian Embargo on the Key Indicators of Georgian Economy’ in the reference source).

### Table 11: Composition of Registered Exports top 15 (2005)²¹

<table>
<thead>
<tr>
<th>Description</th>
<th>Code</th>
<th>USD (mln)</th>
<th>% in total export</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total exports</td>
<td></td>
<td>866.8</td>
<td></td>
</tr>
<tr>
<td>Ferrous waste and scrap</td>
<td>7204</td>
<td>84.2</td>
<td>9.7%</td>
</tr>
<tr>
<td>Wine of fresh grapes</td>
<td>2204</td>
<td>81.3</td>
<td>9.4%</td>
</tr>
<tr>
<td>Ferro-alloys</td>
<td>7202</td>
<td>80.2</td>
<td>9.3%</td>
</tr>
<tr>
<td>Nuts, fresh or dried, whether or not shelled or peeled</td>
<td>0802</td>
<td>70.3</td>
<td>8.1%</td>
</tr>
<tr>
<td>Aircraft, spacecraft</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Copper ores and concentrates</td>
<td>2603</td>
<td>36.4</td>
<td>4.2%</td>
</tr>
<tr>
<td>Mineral or chemical fertilisers, nitrogenous</td>
<td>3102</td>
<td>35.8</td>
<td>4.1%</td>
</tr>
<tr>
<td>Gold unwrought or in semi-manufactured forms</td>
<td>7108</td>
<td>34.7</td>
<td>4.0%</td>
</tr>
<tr>
<td>Mineral Waters and aerated waters not containing added sugar</td>
<td>2201</td>
<td>32.5</td>
<td>3.7%</td>
</tr>
<tr>
<td>Cane or beet sugar and chemically pure sucrose, in sold form</td>
<td>1701</td>
<td>29.7</td>
<td>3.4%</td>
</tr>
<tr>
<td>Undenatured ethyl alcohol</td>
<td>2208</td>
<td>29.2</td>
<td>3.4%</td>
</tr>
<tr>
<td>Petroleum Oils</td>
<td>2709</td>
<td>23.1</td>
<td>2.7%</td>
</tr>
<tr>
<td>Mineral Waters and aerated waters containing added sugar</td>
<td>2202</td>
<td>20.4</td>
<td>2.4%</td>
</tr>
<tr>
<td>Motor Cars and other motor vehicles</td>
<td>8703</td>
<td>17.9</td>
<td>2.1%</td>
</tr>
<tr>
<td>Portland Cement</td>
<td>2523</td>
<td>17.7</td>
<td>2.0%</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>663.0</td>
<td>76.5%</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td>203.8</td>
<td>23.5%</td>
</tr>
</tbody>
</table>

Source: Ministry of Economic Development of Georgia

CIS countries account for 39% of Georgia’s foreign trade turnover. It was 1,406.1 mln USD in 2005, which increased by 43% compared to 2004. EU countries account for 24% of Georgia’s foreign trade turnover as of 2006. It was 836.7 mln USD in 2005, which increased by 15% compared to 2004 (see Figures 9 and 10 below).

### Figure 9: Trade Turnover in 2006

Source: Department for Statistics of the Ministry of Economic Development

Figure 10: Ten Largest Trade Partners in 2006

Source: Department for Statistics of the Ministry of Economic Development

Furthermore, Georgia’s trading partners for the year 2006 may be seen in Table 12, which indicates a major increase in trade turnover from 3,357.7 mln USD in 2005 to 4,674.3 mln USD.

Table 12: Georgia’s Trading Partners

<table>
<thead>
<tr>
<th>Country</th>
<th>Trade Volumes</th>
<th>% Imports (CIF)</th>
<th>Balance</th>
<th>% Imports</th>
<th>% Trade Volumes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turkey</td>
<td>6447,942.6</td>
<td>124,960.4</td>
<td>-398,021</td>
<td>6447,942.6</td>
<td>13.9</td>
</tr>
<tr>
<td>Russia</td>
<td>637,388.4</td>
<td>75,664.8</td>
<td>-486,058.8</td>
<td>637,388.4</td>
<td>13.6</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>410,841.0</td>
<td>92,355.1</td>
<td>-226,130.8</td>
<td>410,841.0</td>
<td>8.8</td>
</tr>
<tr>
<td>Germany</td>
<td>396,797.9</td>
<td>45,645.2</td>
<td>-305,507.5</td>
<td>396,797.9</td>
<td>8.5</td>
</tr>
<tr>
<td>Ukraine</td>
<td>377,049.8</td>
<td>56,956.8</td>
<td>-263,136.2</td>
<td>377,049.8</td>
<td>8.1</td>
</tr>
<tr>
<td>USA</td>
<td>188,472.7</td>
<td>58,864.1</td>
<td>-70,744.5</td>
<td>188,472.7</td>
<td>4.0</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>177,843.3</td>
<td>62,307.6</td>
<td>-53,228.1</td>
<td>177,843.3</td>
<td>3.8</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>172,870.4</td>
<td>71,808.9</td>
<td>-29,252.6</td>
<td>172,870.4</td>
<td>3.7</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>132,001.6</td>
<td>22,877.5</td>
<td>-86,246.6</td>
<td>132,001.6</td>
<td>2.8</td>
</tr>
<tr>
<td>Italy</td>
<td>126,145.8</td>
<td>24,048.0</td>
<td>-78,049.8</td>
<td>126,145.8</td>
<td>2.7</td>
</tr>
<tr>
<td>Total</td>
<td>3,267,353.5</td>
<td>63,5488.4</td>
<td>-1,996,376.7</td>
<td>3,267,353.5</td>
<td>X</td>
</tr>
<tr>
<td>Foreign Trade, Total</td>
<td>4,674,283.0</td>
<td>99,3053.5</td>
<td>2,688,176.0</td>
<td>4,674,283.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Ratio (%)</td>
<td>69.9</td>
<td>64.0</td>
<td>74.3</td>
<td>69.9</td>
<td>X</td>
</tr>
</tbody>
</table>

Source: Department for Statistics of Ministry of Economic Development of Georgia

II.3.6. Summary of the Tax Code of Georgia\textsuperscript{22}

In order to create an attractive investment environment, the Georgian Government simplified and liberalised the Tax Code. The adoption of the new Tax Code prepared by the Government in the Parliament introduced a new optimal taxation regime that promotes private economic activity in the country.

The Government simplified the taxation regime by reducing the number of taxes and abolishing inefficient tax concessions. It must be noted that the 21 current taxes payable to the central and local budgets were reduced to only 7 taxes, which is unprecedented in the country’s history. Abolishing inefficient tax exemptions and concessions will reinforce fair competition in business. In addition, the Government is planning to harmonise the Georgian legislation, including the tax legislation, with that of the European Union: this policy was reflected in the new Tax Code.

The new Tax Code of Georgia was adopted on 22nd of December, 2004 and came into force from January 1, 2005. The process of drafting the new Tax Code included a series of public hearings and consultations between the government and such various stakeholders as representatives of the business community, the ‘Taxpayers’ Union of Georgia (currently the Federation of Georgian Businessmen – the major national business association and lobbying group), international financial organisations, and interest groups and NGOs. Consultations seemed to be effective and as a result, a number of changes aimed at further liberalisation of the business environment have been made.

The cornerstone of the tax reform is the reduction of income tax rates from 20% to 12%, and the reduction of the social insurance tax from 31% to 20%, thus promoting economic activity not only of physical persons (employees as well as sole proprietors) but also of legal entities (employers). By taking these measures, the Government is refusing to increase budget revenues through preserving or increasing the current income tax and social tax rates, but is rather targeting revenue legalisation and taxable base growth through supporting the expansion of the economic activity of legal entities and physical persons. It must also be noted that the income and social tax rates are low in Georgia as compared to the other countries of the region, thus helping to create a comparably attractive environment for investment (e.g., the income tax rate in Azerbaijan is 12-35%, in Armenia – 10-20%, in Russia – 13%). Through preserving the 20% tax rate, the Tax Code introduced substantial changes in the profits tax (corporate income tax) calculation scheme, intended to stimulate investment and reinvestment processes. Specifically, the distributed dividends of an enterprise established by a resident in compliance with the Georgian legislation shall be exempt from taxes at the source of payment and profit tax shall not be included in the gross income. The government intends in the near future to further decrease the 12% income tax and 20% social tax (constituting 32% altogether) to 25% as combined. In addition, in parallel with accelerated amortisation, enterprises can fully exclude the costs of purchasing or producing fixed assets used for their economic activity from the gross income: i.e. the 100% in amortisation can be applied immediately upon the start-up of the fixed assets. This is expected to considerably promote the fixed asset renovation process. The progress in the tax rates can be seen in Figure 11.

![Figure 11: Tax Rates Progress](source: Ministry of Economic Development of Georgia)

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Specifics of the Tax Law: The adopted law is comprised of two books: general and special provisions. General provisions specify major terms and definitions used in the tax code, rights and responsibilities of the taxpayers and tax authorities, tax administration and enforcement rules and dispute resolution mechanisms, such as the taxpayer’s right to offset overpaid amounts to the budget against other tax liabilities.

Special provisions regulate particular taxes. Seven taxes out of twenty-one of the 1997 tax code are presented in the new tax code, which are income tax, profits tax, social tax, VAT, excise tax, property tax, and gambling tax.

Income tax: In lieu of progressive income tax rate scale (from 12% to 20%), 12% flat rate is introduced in the new tax code. The sole proprietors not using hired labour and complied with other tax code requirements as well as persons involved in agriculture with gross income less than GEL 100,000 are exempt from the income tax.

Profits tax: The 20% tax rate was not altered. Certain profits tax administration provisions were changed; for instance, in contrast to the 1997 tax code, if expected income (profit) in the current tax year will be at least 50% less than in the previous year, taxpayer is authorised to reduce (not to pay at all) quarterly payments, and, some changes were made to the depreciation rules. Currently the government is planning to introduce a further cut in the profit tax rate, reducing it down to 15%.

VAT: The tax rate was reduced from 20% to 18%. However, the number of tax exemptions was significantly reduced. The time for taxable transaction is determined based on the accrual method instead of combined cash/accrual basis foreseen by the 1997 Tax Code.

Excise tax: The circle of taxable transactions has been expanded. In addition, significant increase of excise tax rates can be observed. For instance, excise rate on sparkling wine was raised by 40%, beer by – 67%, vodka – 50%, some other spirits – 25%, imported filtered cigarettes by 125%, imported unfiltered cigarettes by 25%, domestically produced unfiltered cigarettes by 50% and filtered ones by 180%. The tax rates on some oil distillates were increased by 25 % while on others by 50%. The tax rate on brand new motor vehicles was raised by 50%. However, the differences in rates are reduced as motor vehicle’ age increases.

Social tax: The tax rate of 31% was reduced to 20%. Unlike provisions given in the 1997 tax code, no 2% of withholding social tax is levied.

Property tax: New provisions on property tax include individual property tax, property tax of enterprises, tax on motor vehicles, yachts (motor boats), planes, helicopters and tax on agricultural and non-agricultural land.

Table 13 below summarises law provisions on objects of taxation and tax rates of the state and local taxes foreseen by the new tax code.

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25 http://www.investmentguide.ge/pages/legal_overview/laws/tax_code/#2#2. Although the number of taxes and certain tax rates were reduced, they were partially compensated by incorporation of number of taxes into the property tax and increase of excise tax rates.
26 http://www.investmentguide.ge/pages/legal_overview/laws/tax_code/#3#3. The new excise tax rate on imported tobacco products was compared to the fixed tax comprised of customs duty and excise tax.
27 http://www.investmentguide.ge/pages/legal_overview/laws/tax_code/#4#4. The new excise tax rate on motor vehicles was compared to the fixed tax comprised of VAT and excise tax.
**Table 13: Summary of Tax Regime**

<table>
<thead>
<tr>
<th>Tax</th>
<th>Object of Taxation</th>
<th>Tax Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>State Taxes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income Tax</td>
<td>The taxable income determined as the difference between gross income for calendar year and the deductions defined by the Tax Code</td>
<td>12%</td>
</tr>
<tr>
<td>Profits Tax</td>
<td>The base is the profit, defined as the difference between gross income and the deductions stipulated by the Tax Code</td>
<td>20%</td>
</tr>
<tr>
<td>Social Tax</td>
<td>Social security levy is imposed on wages, compensation or profit earned for rendered services and income from economic activity(^{28})</td>
<td>20%</td>
</tr>
<tr>
<td>Value Added Tax</td>
<td>Value added created in the process of the production and circulation of goods and services; customs value (included customs fee, customs duty, excise) of all taxable goods imported into the territory of Georgia</td>
<td>The general rate is 18%(^{29}) \nZero rate applies to: a) Export of goods; b) Services related to international air transportation of passengers and goods as well as aviation fuel supplied on board for international flights; c) The supply of gold to the National Bank of Georgia; d) Supply/import of goods (service) intended for official use by diplomatic representative offices; e) Rendering of tourist service; f) Rendering repair services of capital assets</td>
</tr>
<tr>
<td>Excise</td>
<td>The import of excisable goods into the territory of Georgia, the supply of excisable goods, removal of excisable goods from warehouse of an enterprise; transfer of excisable goods produced in Georgia from customer’s raw material to a customer; use of excisable goods of own production for producing non-excisable goods and export of ferrous and/or non-ferrous scrap metal</td>
<td>Tax rates are differentiated based on types of excisable goods, such as alcoholic beverages, tobacco products, passenger motor vehicles, oil distillates and other oil products, gas, ferrous and/or non-ferrous scrap metal, etc.(^{30}) \nZero rate applies to export of excise goods</td>
</tr>
<tr>
<td><strong>Local Taxes</strong>(^{31})</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Tax</td>
<td>a) Property used for economic activities; b) Immovable property owned by physical persons; c) Passenger motor vehicles owned by physical persons; d) Yachts (motor boats), planes and helicopters owned by physical persons;</td>
<td>Tax rates are differentiated based on types of property \nUp to 1% of property value(^{32}) applies to property used for economic activities \nTax rate for immovable property (section b) is differentiated based on family annual income: a) For the families with annual income from GEL 40.000 to GEL 60.000 – 0.05% – 0.2% of market price;</td>
</tr>
</tbody>
</table>

\(^{28}\) No withholding social tax is levied.  
\(^{29}\) Until July, 2005 VAT rate is 20%.  
\(^{30}\) The excise tax rates are fixed ones in contrast to ad valorem rates applied to some excise goods in the 1997 tax code.  
\(^{31}\) The Tax Code establishes minimum and maximum ceilings for the local tax rates. Local self-government and government authorities are authorised to introduce a local tax foreseen by the tax code and determine tax rate within the limits established by the tax code.  
\(^{32}\) The value of a taxable property is an average annual residual value of assets (fixed assets, uninstalled equipment, incomplete capital investments and intangible assets) recorded in the balance-sheet and shall be computed pursuant to the average value of the assets at the beginning and at the end of a calendar year.
e) Agricultural and non-agricultural land owned by physical and/or legal persons and state-owned land used by physical and/or legal persons

b) For the families with annual income from GEL 60.000 to GEL 100.000 – 0.2% – 0.4% of market price;
c) For the families with annual income more than 100.000 – 0.4% – 0.8% of market price

Tax rate for passenger motor vehicles (section c) is differentiated according to the engine capacity and age of motor vehicle and varies from GEL 5 to GEL 300
Tax rate for yachts (motor boats), planes and helicopters (section d) are defined in accordance with a type and engine capacity
For agricultural land (section e), a base tax rate per 1 sq. meter is differentiated according to administrative units and land quality
Base tax rate payable on non-agricultural land (section e) is up to GEL 0.2433

Gambling Tax

a) Income earned from sale of lottery tickets; b) Gambling tables and machines used for gambling purposes; c) Totalisators, bingos and bookmakers (specially organised places where bets are received machine or/and gains are paid by a cashier or /and special machine or other means); d) Incentive lottery prise fund; e) Systemic-electronic games

Tax rates are differentiated based on types of gambling business.
a) for lottery organisers – no more than 20% of proceeds from sale of lottery tickets;
b) for each gambling table in a casino – GEL 5,000-10,000 per month;
c) for each gambling machine – GEL 50-200 per month;
d) for each totalisator, bingo and bookmaker – GEL 300-600 per month;
e) for each incentive lottery – 10% of prise fund;
f) for systemic-electronic gamble – GEL 2,000-10,000 per month.

Source: Ministry of Economic Development of Georgia

Income tax from Georgian sources, on the other hand, is illustrated in Table 14.

Table 14: Income from Georgian Sources

<table>
<thead>
<tr>
<th>Income from Georgian Sources</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>10%</td>
</tr>
<tr>
<td>Interest</td>
<td>10%</td>
</tr>
<tr>
<td>International telecommunication and transportation services, oil and gas transactions and leasing payments</td>
<td>4%</td>
</tr>
<tr>
<td>Royalties</td>
<td>10%</td>
</tr>
<tr>
<td>Management fees</td>
<td>10%</td>
</tr>
<tr>
<td>Insurance proceeds</td>
<td>4%</td>
</tr>
<tr>
<td>Income received in the form of wages</td>
<td>12%</td>
</tr>
<tr>
<td>Income received from performing works and rendering services</td>
<td>10%</td>
</tr>
<tr>
<td>Other items of income from Georgian sources</td>
<td>10%</td>
</tr>
</tbody>
</table>

Source: Ministry of Economic Development of Georgia

33 The base tax rate shall be multiplied to the total area and territorial rate determined by the local self-governmental bodies according to the land location.
34 Deloitte Touche, Guide on Taxation and Investment in Georgia 2007, p. 9.
II.3.7. Privatisation

Privatisation is one of the most dynamic processes underway in the post-revolutionary Georgia. The process is aimed at attracting private capital to state owned assets in order to introduce efficient management, increase investment and boost economic growth and jobs creation.

The government of Georgia received 270.5 mln. USD from the privatisation process in 2004-2005 which exceeds privatisation income from 2000-2003 by almost 8.6 times. This sharp and dramatic increase may be interpreted as the positive outcome of the structural reform programmes implemented in the recent years and is a clear indication of investors’ confidence in the future of the country.

![Figure 12: State Income from Privatisation in 2000-2006](image)

*Source: Department for Statistics of the Ministry of Economic Development of Georgia*

At this stage, Georgia’s privatisation policy is mainly targeted towards the sale of large enterprises. Privatisation of hydropower generation plants, energy distribution companies and telecommunication enterprises started in 2006. Privatisation of land and forest resources will gradually be implemented as well.

The main target of large-scale privatisation is to jump-start economic growth through private sector development. To promote an efficient privatisation process the government utilises various methods to privatisate state-owned property such as tender, auction, lease and redemption, and direct sale. To ensure a high level of fairness and transparency, the government actively works towards establishing international contacts with interested organisations and potential investors. A special web site, www.privatisation.ge, has been created to provide privatisation-related information.

Any Georgian or foreign person or company has the right to take part in the privatisation process in compliance with the laws of Georgia. The full list of the companies that will be privatised consists of 800 assets.

The most recent privatisation activity concerns privatisation of major state-owned energy facilities, which is called as “the first largest privatisation agreement in Georgian energy
sector history”. According to the news released by the Ministry of Foreign Affairs, ENERGO-PRO A.S. and the Ministry of Economic Development of Georgia signed on February 5, 2007 the privatisation agreement for the sale of six hydro power plants and the assets of two electricity distribution companies for the total acquisition price of USD 213 mln. With the acquisition price of 213 mln. USD, total power generation capacity of more than 350 MW and an electricity distribution network covering over 70% of the territory of Georgia, ENERGO-PRO thus becomes the largest participant in the Georgian electricity market. According to the agreement, the modernisation of the existing networks will require an extensive rehabilitation programme which envisages an investment of more than 100 mln. USD and a large-scale modernisation programme for the privatised hydro power plants amounting to an expected total investment of USD 85 mln.

Furthermore, the Enterprises Management Agency (EMA) was established as a legal person of public law by Georgian Presidential Decree #203 of May 11, 2003 on Approving the Charter of the Enterprises Management Agency. The EMA is established to:

- protect the interests of the State through state representation
- promote the increase of state dividends
- coordinate the management of state-owned shares and stocks
- encourage the prompt privatisation of state-owned enterprises

The head of the Agency (the Chairman) is nominated by the Minister of Economic Development and appointed by the President. EMA’s main functions are:

- Accounting for state shares and stocks in enterprises and transferring this information to the Ministry of Economic Development.
- Selecting and appointing state representatives in enterprises, coordinating their activities, and providing necessary information, reviews and reports.
- Signing agreements with state representatives (according to the standard agreements approved by the Ministry of Economic Development) and implementing these agreements.
- Reviewing reports and analysis of information received by the enterprises and state representatives on the following issues:
  - business plans for future developments of enterprises
  - borrowing loans and credits on behalf of enterprises
  - transfer of enterprise property into temporary usage
  - establishment and liquidation of branch offices
  - acquisition of enterprise shares and stocks, and creation of new enterprises through enterprise shares
  - providing enterprises with new investments
  - division of net profit of enterprises
  - reform, merger, division, liquidation and bankruptcy of enterprises
  - mortgage of enterprise assets

j) transfer of the management right of stocks and shares to a third party

k) privatisation of enterprises

l) if needed, requesting audits by means of tender to double-check financial activity of an enterprise

m) development of annual budgets, balances, profits and losses within the framework of its authority

n) preparation for privatisation of enterprises from the Ministry of Economic Development privatisation list

II.3.8. Banking Sector

Banking is one of the most dynamic sectors of the Georgian economy. During the last 5 years, the number of banking service customers has increased very rapidly. Deposits by individuals and companies are increasing by 25-35% each year. Banks are experiencing an average return on assets of 3-5% and return on investments of 14-18%. The main direction of current reforms in the banking sector is to create stable and capitalised banks with a wide range of services, diversified investment portfolios, adequate risk management and high confidence among institutional investors and the population.

The new Law concerning the National Bank of Georgia was adopted in 1994. The law upgraded the supervisory authority of the National Bank over the activities of commercial banks, like licensing of commercial banks and regular inspections and imposition of sanctions. The other new Law on the Activities of Commercial Banks, introduced in 1996, set forth major conditions for the taking up and pursuit of business by commercial banks. Changes and amendments to these Laws made in 2001-2002 can be considered as a sizable step forward in terms of banking regulation. For the time being the bank reform implemented by the National Bank, in accordance with the IMF recommendations, is considered to be one of the most successful sectoral economic reforms in Georgia.

In order to secure the financial stability of commercial banks and protect the interests of their creditors and depositors, the National Bank of Georgia, supported by international financial organisations, elaborated and enforced so-called “prudential regulations”. In 1997, the National Bank of Georgia introduced the rating system for the evaluation of the financial standing of banks -CAMEL (Capital, Assets, Management, Equity and Liquidity). The International Accounting Standards have been applied to commercial banks’ accounting systems since 1 January 2001. The banks were required to reorganise into joint stock companies as of December 31, 2002.

The process of formation of the Georgian banking system, which commenced from 1991 stimulated the development of legislative and normative framework that led to the formation of a two-tier universal banking system, comprising the National Bank, the entity conducting monetary policy regulating the banking system on the one side, and commercial banks on the other side.

Following banking reforms enacted in Georgia in 1994-1997, state banks were completely privatised and restructured. Today 100% of the banking sector is private. Georgia was one of the first countries to completely liberalise capital account transactions and currency regimes. As a result, any limits on capital repatriation and currency operations both for residents and non-residents were cancelled. Residents have the right to have the current accounts opened with banks in foreign countries.
Residents and non-residents of Georgia may make investments in commercial banks based in Georgia under equal terms and conditions. Foreign banks may carry out their banking business in Georgia through their subsidiaries or branches. At present, subsidiaries and branches of commercial banks from Greece, Turkey, Azerbaijan, Russia, Kazakhstan and Germany are operating in the Georgian market.

The reform of the banking system has been implemented by the National Bank of Georgia (NBG) based on IMF recommendations. As the result of the reforms, the number of banks decreased from 228 at the end of 1994 to 21 at the end of June 2004, mostly at the expense of insolvent banks and those that could not meet the NBG’s special requirements. 13 of the existing banks have foreign shareholders including EBRD, IFC, the German Investment and Development Foundation and other international financial organisations.

During the last years, the interest of large foreign banks toward Georgian banking market increased significantly. Some of the top Georgian banks were rated by the international Fitch rating agency. In 2005, the banks were rated B and B-. Georgia’s foreign and local currency rating is B+ based on the evaluation of Standard and Poor’s in 2005, with a positive outlook.

Despite the fact that currently there are 25 banks operating in Georgia, 81% of the system’s total assets, 87% of liabilities, and 86% of deposits are concentrated in the group of 7 major banks.

As a Member of the Council of Europe, Georgia enforced legislative measures against money laundering that also required the improvement of commercial banks’ standards.

**Figure 13: Share of Credit Portfolio in GDP**

In December 2005, as compared to the same period of the last year, the volume of credits granted to the private sector by commercial banks (except for the inter-bank credit) almost doubled. As a result, the indicator showing the ratio of the credits granted to the privet sector the GDP increased from 9.5% in December 2004 approximately to 15% in December 2005. The credits in Lari denomination increased 3.1 times. It is worth mentioning that crediting growth in the national currency, especially in the second half of 2005, was conditioned not as much by demand from the economy as by the surplus of liquidity in the banking system.
Lending activity of the banks was concentrated at private sector, share of which in the loan portfolio amounted to 97%. Together with the expansion of loan portfolio, banks have significantly promoted long-term lending and consequently, share of long-term (over 1 year) loans in total lending has reached 65%. It is of a particular interest that bank loans to the private sector have increased by 80%, while the average lending rates of commercial banks have decreased by 10%.

The confidence in the banking sector over the last years also contributed to the huge increase in assets of the commercial banks, as seen in Figure 16.\(^36\)

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There are certain problems in the banking system. Assets and liabilities of the Georgian banking system are still concentrated in foreign currency. Specifically, 80-85% of liabilities and 60-65% of assets are formed in foreign currency. This fact speaks about a weak savings function of Lari, the national currency. Low level of bank capitalisation, insufficient public confidence in the banking system and large-scale shadow economy significantly impairs the mobilisation of money in the banking channels. This in turn creates the deficit of credit resources in the system and is negatively reflected in interest rates and provision of economy with loans. This is criticised by the business circles in that it requires the least of 15% profit to level the interest burden in loans to any business in Georgia.37

II.3.9. Foreign Direct Investment (FDI)


The Law of Georgia on the Investment Activity Promotion and Guarantees defines the legal basis for realising both foreign and local investments and their protection guarantees on the territory of Georgia. The purpose of the Law is to establish the investment-promotional regime.


The General Provisions of the Law define the investment, investment activity subject (investor) and object. Investments shall be deemed to be all types of property and intellectual valuables or rights invested and applied for gaining possible profit in the investment activity carried out in the territory of Georgia.

According to the Article 2 of the Law an investor shall be deemed to be a natural or legal person as well as an international organisation investing in Georgia.

A foreign investor shall be deemed to be:

a) a foreign citizen;
b) a stateless person not residing on the territory of Georgia;
c) a Georgian citizen permanently residing abroad;
d) a legal person registered beyond Georgia.

Investing on the territory of Georgia may be realised in an object of any form except of the object defined by this Law in Article 9 (Prohibitions and Restrictions in the Field of Investment Activity). Investments in some types of the objects may be realised only on the basis of an appropriate special permit or license (objects as defined in Articles 9 and 12 of this Law).

Legal Status of Subjects of Investment Activity

According to this Chapter of the Law, the investor shall be entitled to open a current and other types of accounts for any currency in the banking institution located in the territory of Georgia, to take loans in banking and financial institutions located in Georgia or from natural or legal persons and to acquire stocks, bonds and other securities and property both in Georgia and abroad.

37 Presentation by Mr. Esborg in the 6th Annual Conference on Oil and Gas held in Tbilisi on March 22-23, 2007.
A foreign investor shall, upon payment of taxes and necessary levies, have the right to convert the profit (income) gained from investments at the market rate of exchange in Georgian banking institutions and the right of unlimited repatriation abroad as well as on exportation of the property being in his possession.

An investor shall be liable to conduct activities in accordance with the effective Georgian legislation as well as legislation concerning the environment and health protection.

Investment Promotion and Registration

For the purpose of promotion the Investment Centre of Georgia is established in the Ministry of Economic Development of Georgia with the following functions:

- Provide service to investors;
- Promotion and facilitation of their activities;
- Obtaining and distribution of the information rated to investment environment;
- Legislative basis and taxation system;
- Elaboration and submission of recommendations on the improvement of investment environment to the executive and legislative state bodies of Georgia;
- Attracting of investments;
- Identification of foreign countries and companies and individual contact with them.

Guarantees for Investments

This Chapter defines the prohibitions and restrictions in the field of investment activity and provisions related to the investment inviolability and compensation in case of investment deprivation.

Article 9 of this Law defines:

a. The list of activities where investing is prohibited (manufacture and distribution of nuclear, biological and chemical weapons as well as building of testing ranges, implementation of scientific-research work related to cloning of a human, producing of narcotics and other activities prohibited according Georgian International Agreements);

b. The list of investment activities admissible only for the Government of Georgia (producing of banknotes, coins, state awards and stamps, activities related to the import, export, movement, retail trade and processing of narcotic and psychotropic means subject to special control, activities related to standard of precious metals, activities related to the energy dispatch); and

c. The list of the activities admissible for investors of foreign country and private investors without granting the right on management (dispatch activities on railways, activities related to the regulation, security and control of movement of means of see transport and air crafts in the territorial waters and harborage and air space of Georgia, activities related to the production and realisation of military-warfare techniques).

This Chapter defines issues related to labour relations, social security and pensions as well as taxation of investment activity, obtaining of the right on property of the land and other natural resources, investment protection during the state of war and military conflict and procedure for
dispute resolution. An investor shall be entitled to hire a foreigner in accordance with effective Georgian legislation. A foreigner not permanently residing in Georgia upon payment of taxes and mandatory levies shall have the right to freely transfer or export the gained income. The minimum number of Georgian citizens to be mandatory elected or appointed to the management body of an enterprise shall not be fixed. Requirements of the law concerning the payment of necessary taxes and fees for social insurance, security and pensions of employees shall not apply to the workers not residing permanently in Georgia. A foreign investor who has suffered damages during the state of war and a military conflict shall not be subject to the terms of compensation worse than those of a local investor. A dispute between a foreign investor and an enterprise registered in Georgia shall be subject to resolution under the agreement of the parties or in the courts of Georgia. A dispute between a foreign investor and a state agency shall, unless the procedure for its resolution is not defined by way of their agreement, be subject to resolution in courts of Georgia or in the International Centre for the Resolution Investment Disputes. Unless the dispute is considered in the International Centre for the Resolution of Investment Disputes, a foreign investor shall be entitled to apply to any international arbitration body which has been set up by the Commission of the United Nations for International Trade Law (UNCITRAL) to resolve the dispute in accordance with the rules established under the arbitration and international agreement (any award of the international arbitration bodies shall be final and not subject to appeal. Its observance shall be secured by the state).

II.3.9.2. FDI Activities

The improvement of the investment climate and the recent change in government as the result of ‘Rose Revolution’ has increased the flow of FDI to Georgia. 30% FDI growth (excluding BTC investment) was evidenced in 2005. The first two quarters of 2006 was distinguished by a substantial growth of non-pipeline FDI, which exceeded 43%. At the same time, the portion of non-pipeline investments decreased during the 2005-2006 indicating the diversification of the sources of private FDI inflow. In the first half of this year total FDI, including pipeline investment, equaled almost USD 428 million and thus reached the level of 95% of entire FDI in 2005. Substantial investment activity is evidenced in communications, banking and tourism sectors. In 2006, the portion of FDI in GDP grew significantly and reached 7.1% by June of 2006.

A significant number of investors currently in Georgia arrived in 2003 – 2006 a period of great opportunity for niche businesses, including those that emerged in the context of Georgia’s privatisation programme.

In comparative terms, Georgia’s standing in attracting FDI ranks high among developing countries of relatively similar size and natural resource endowment.

Overall FDI flow into the CIS region has been rather modest – only 3% of total FDI evidenced in developing countries. In 2001, FDI flows to the CIS countries amounted to USD 7.2 billion, which were well below those to Latin America (USD 85 billion), Eastern Europe (USD 27 billion) and even Africa (USD 10 billion). Most FDI flow into the CIS countries has been linked to natural resource exploitation (e.g., oil and gas development) or/and privatisation of state-owned enterprises, which is now winding down. In absolute terms, over 80% of FDI within the CIS region was directed to Kazakhstan and Russia. Among the CIS countries, and in per-capita terms, Georgia is faring better than most, including such large economies as Russia and Ukraine. It ranks immediately after Kazakhstan and Azerbaijan (major Caspian oil producer countries).
More recent data illustrating the total foreign direct investment figures is also provided below, which is indicative of the sharp increase (more than doubled) in the FDI in 2006 from the previous year.

II.3.9.3. Overview of Ongoing Reforms

The first wave of reforms implemented in Georgia (1995-1997) during the post-Soviet period can be viewed as being only partially successful. Despite certain breakthroughs in many areas, initial successes were reversed. In addition, the incomplete and inconsistent nature of the reforms in most cases created uncertainty and impediments in many sectors of public life. Due to ineffective management, the weakness of institutions, only partial transition to market mechanisms, and a high level of corruption, the unfinished and reversed reforms failed to meet the high expectations of both Georgian society and the international community.

After the smooth, “velvet” transition of power in November 2003, Georgia’s current government has pursued a course of radical and irreversible reforms. The creation of a more favourable business environment is at the core of these policies. As President Mikhael Saakashvili declared at the Davos Economic Forum in January 2004, the priority of the government’s economic policy is openness to foreign direct investments, and the creation of a favourable environment for conducting business in Georgia. The irreversible reform of the
Georgian economy is focused on minimising state intervention and regulations, as well as creating firm institutional guarantees for the protection of investments and promoting international business cooperation in Georgia. This complex task requires a concerted effort to harmonise initiatives across a wide spectrum of policy areas including public administration, legislation, taxation, customs, permits and licensing and judiciary, as well as in the rehabilitation of infrastructure.

**Administrative Reform**

One of the main priorities of the administrative reform is to downsize state administration and significantly reduce regulatory bureaucratic barriers. The major direction of this reform is deregulation, which implies a reduction in the number of controlling agencies and regulatory procedures with which a businessman has to contend when starting or operating his business.

The result of these reforms is the establishment of an efficient and flexible state administration, responsive to both public and business interests and able to function effectively and with minimum expenditure. Redundant and ineffective layers of the state administration are being reformed or abolished; institutions responsible for economic policies, as well as law enforcement and judicial agencies are being optimised and the government institutions are becoming less intrusive and more efficient.

**Legislative Reform**

Despite the fact that by 1997 a quite liberal business related legislative framework was in place, frequent and unsystematic amendments made to laws and other normative acts hampered the development of the Georgian economy. As a consequence, in this environment of constant uncertainty, it was exceedingly difficult for an entrepreneur to make any mid-term or long-term plans. Therefore, despite attractive opportunities, many potential investors avoided the Georgian market.

The ongoing reforms have already established many important precedents and practices which increase transparency and facilitate the participation of stakeholders and interest groups in the process of drafting and amending legislation. Another important innovation is that the enforcement of any proposed change which may impact on the activities of any economic agent shall be delayed until the beginning of the following financial year. In this way the entrepreneur is granted more flexibility and time in order to adjust to changes and thus minimise the risks and costs involved.

In parallel with institutional reforms, Georgian legislation is being harmonised with the legislation of the EU, WTO and other international institutions according to the international legal obligations undertaken by Georgia. As a result, a full scale protection of investments, and also international trade, copyright and other related rights – protection of which was always a pending issue in the post-Soviet regions – will be fully guaranteed and enforced in Georgia.

**Tax Reform**

It is the objective of Tax Reform to stimulate private business activity and encourage investment in the country. Decisive steps were taken towards significant liberalisation of the tax legislation to maximise the pace of its economic development. As the result, the new tax legislation – seemingly the most progressive and liberal tax code in the entire post-soviet area – creates a truly favourable business environment in Georgia.
More than 20 effective taxes were reduced to only 8; tax rates also decreased as well. In addition, the system of tax administration was simplified in order to save the taxpayer’s time.

**Customs Reform**

Given the favourable geographic location of Georgia, the reformation of customs administration is of primary importance. The reforms envisage the creation of proper working conditions for importers and freight forwarders engaged in transit transportation. Pursuant to the agreements signed with the WTO and European Union, Georgia is currently engaged in bringing customs legislation, procedures and rates into compliance with the norms of the WTO and the EU, thus creating unified and simplified procedures for importers, exporters and transit freight forwarders.

As an important precedent of liberalisation in trade, particularly effective steps have been made towards the simplification of customs procedures with Turkey, one of Georgia’s neighbouring countries and a major trade partner. The Green Corridor regime has been introduced at the customs checkpoints on the border with Turkey, encouraging a fast and efficient border crossing. A similar regime is scheduled to be introduced with all neighbouring counties in the course of time.

**Liberalisation of the System of Permits**

A significant lack of investment can be observed within many attractive segments of the Georgian economy for which business activities require special permits (for example, food industry, processing industry, and various services). The requirement of these permits has often discouraged potential business partners and investors, and has also hampered the operations of existing enterprises. The system of licensing permits and certification is being liberalised and simplified. It is now significantly easier to obtain the necessary permits; the timeframe for issuing licenses and permits is strictly limited and fees have been either abolished or significantly reduced. In addition, the list of businesses and goods subject to licensing and certification will be reviewed and greatly reduced.

The commitment of the government to bringing the system of licensing and permits into full compliance with the standards of the EU undoubtedly constitutes major progressive change in this area.

**Judicial Reform**

The legal protection of private businesses and investments is of utmost importance. The role of the independent Judiciary in protecting property rights and investments, as well as in the resolution of disputes, is self-evident.

The judicial reform which commenced in Georgia a few years ago can be considered as one of the most successful reforms implemented in Eastern Europe and the post-Soviet area. Its major goal was to establish a politically independent, unbiased and impartial Judiciary system that would ensure the protection and security of private business in Georgia. This reform was successfully implemented and its positive results can be clearly observed.

**Rehabilitation of Infrastructure**

In common with many other post-soviet economies, Georgia has inherited cumbersome, unprofitable infrastructure. Under-equipped, poorly managed, overstuffed state owned
enterprises that require high maintenance prices place a heavy burden on the shoulders of taxpayers. The reform policies in this area include a two-prong approach – the rehabilitation and optimisation of management, and privatisation.

Ports and railroads, a part of the communication infrastructure which represents a regional and international competitive advantage for the country, and other enterprises and facilities which, due to their unique characteristics, are of some special value, are subject to policies aimed at increasing their competitiveness and efficiency. This will be achieved through the optimisation of management and technical modernisation.

**International Support**

A strict commitment of the Georgian Government to cardinal reforms and their irreversibility has been strongly supported by international financial institutions and the international developmental community, as well as by creditor governments. EU member states have already formally expressed their readiness to allocate to Georgia USD 1 billion. Since the beginning of 2004, Georgia, along with 15 other states, has been involved in the “Millennium Challenge Account” of the United States Government, aimed at assisting developing countries in overcoming poverty and executing legal and economic reforms. The World Bank and IMF have renewed and expanded their area-specific projects and programmes, some of which had been suspended due to the failure of the previous government to pursue reform policies. Altogether, for a country of its size and population, Georgia enjoys perhaps the strongest possible international financial assistance to execute reforms and maximise its economic potential.

The high hopes and expectations of Georgian society for a better future, strong international support, and the current commitment of the Georgian Government to systemic reforms that will allow the current expectations of the broad public to be met: this is a rare combination of crucial factors that create the necessary prerequisite for the success of the reforms. These systemic reforms may in turn contribute to rendering Georgia a model case in post Soviet space and in the Caucasus-Central Asia region as a whole.

**II.3.9.4. Overview of Georgian Legislation**

There has been a broad public and political consensus in Georgia regarding its integration into the international economy through the opening up of the Georgian economy for international businesses and the creation of a favourable investment environment. Based on this consensus, since 1995 the Parliament of Georgia has been working on the development of a package of liberal business legislation. National treatment is applied to all investors and there is no specific regulation that foresees discrimination. Nevertheless, according to the Blue Book of exceptions, Georgia has notified a possible exception related to acquisition of state-owned land by foreign investors, though no specific notification has been made to date.

The promising investment climate regime and its constituent legislative framework may be briefed through the following snapshot.

**Investment and Investors**

By virtue of the Georgian Law on Facilitation and Guarantees of Investment Activities, any property, intellectual and material values or rights invested in the entrepreneurial activities on the territory of Georgia can be deemed as an investment. According to the law, the term investor applies to any individual or legal entity as well as to an international organisation. The law defines the concept of a foreign investor as follows: a foreign citizen; a person other
than a permanent resident of Georgia; a non-resident Georgian citizen; a legal person (company) registered outside of Georgia (in other country).

The Law on Entrepreneurs adopted in 1994 foresees six forms of legal entities allowed to be established in order to perform commercial activities, which are:

1. Individual Enterprise (IE);
2. Joint Liability Company (JLC);
3. Commandite Partnership (CP);
4. Limited Liability Company ( LLC);
5. Joint Stock Company (JSC); and
6. Cooperative.

The obligatory registration procedures under Article 5 require all individual entrepreneurs and companies undergo registration procedures at publicly accessible local company registers, which used to be at the courts and the Tax Department of the Ministry of Finance of Georgia. Foreign companies have right to open and register their representative offices in Georgia. Registration is carried out in the tax office of the region where such representative office is open.

According to the Law of Georgia on Control of Entrepreneurial Activity any person has right to carry out entrepreneurial activity, which may be restricted only by the law according to the Constitution of Georgia. The control of entrepreneurial activity may be performed by the state, local self-governmental and governmental bodies as well as other administrative bodies regulated by the legislation, the purpose of which is the inspection of the financial-economic activity of the entrepreneur as well as the discharge of the imposed obligation, checking for compliance with legislation and impose sanctions as the case may be.

For the purposes of this Law, the control does not mean the issuance of license, permit, certificate, the request of the certificate in trade net and drawing up of the relevant act and activities carried out within framework of the International Agreements and Treaties of Georgia in the field of environment protection and oil and gas resources.

The controlling body is authorised to control entrepreneurial activity only upon the judge order issued upon the information presented by the controlling body in the event of reasonable and justified doubt on the violations of legislative requirements by the entrepreneur, except by ordinary regulatory controlling activities (Article 5), such as inspections made by the tax authorities. The entrepreneur may request the compensation of any damage caused by the unlawful inspection. Evidences gained from the unlawful inspections have no legal force.

The law on “Investment Activities and Guarantees” secures equal treatment and rights to Georgian and foreign investors, except for ownership of agricultural land. Foreign legal and physical persons are allowed to purchase land in Georgia, except for agricultural land. Foreigners may invest in any sectors open for private investment.38

**Repatriation of Profits**

Article 3.1 of the law establishes that the rights of the foreign investor making investment and carrying out entrepreneurial activities in Georgia are protected and guaranteed equally to those of

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38 Invest in Georgia 2007, Ministry of Economic Development of Georgia.
Georgian entrepreneurs. The foreign investor enjoys the right to repatriate profit or any other funds after payment of taxes (dividends are subject to a 10% withholding tax) and other mandatory duties after conversion in the Georgian banking institution. It should be noted that the foreign investor also has the right to freely move any property owned by him out of the country. In accordance with international practice, the abovementioned two rights can be restricted in exceptional cases on the basis of the law and court decision (bankruptcy, commitment of crime, and/or non-fulfilment of civil obligations). In other words, the law clearly specifies the circumstances, in which these two rights (capital repatriation and right to move property out of the country) can be restricted, and eliminates the grounds for discretion by a public official. The existence of the specific law and effective court decision are required to restrict these rights.

Protection of Investments

Special provision in article 7 of the law states that investment is wholly and unconditionally protected by effective Georgian legislation. The above article clearly defines the grounds and procedures for confiscation of investments. In particular, it should be noted that the provided mechanisms prohibit unconditional confiscation of investments and confiscation based on subjective discretion of government officials.

Specifically, the following two rules are established:

Confiscation of investment (a) should be directly defined by the law (such a law does not exist). In addition, there exists another mandatory provision, (b) the relevant court decision on the investment confiscation. In other words, two conditions should simultaneously exist to enable confiscation of investment (law and court decision).

Confiscation of investment in case of immediate necessity should be determined by the Organic Law (in Georgian legal framework, the Organic Law is superior to other laws and normative acts. Notably, the Rules of Procedure of the Parliament of Georgia require a larger quorum for adoption of an Organic Law compared to other laws. It should be noted that only the Constitution of Georgia and Constitutional Laws are hierarchically superior to the Organic Law). In addition to strict legal limitations that in fact make confiscation scarcely possible, confiscation of investment is allowed only with compensation. Compensation covers the market value of the investment as of the moment of confiscation and any loss incurred by an investor from confiscation till reimbursement through compensation.

Illegal Activities Clause

The law determines activities in which investments are not allowed internationally. This includes production of nuclear, bacteriological or other weapons of mass destruction; production and dissemination of illicit drugs; as well as other activities restricted or banned by international treaties and agreements.

Dispute Resolution Procedures

The Law provides investment-related dispute resolution procedures and lists the agencies concerned. The dispute between a foreign investor and a Georgian state agency can be resolved in the Georgian court or International Centre for Resolution of Investment Disputes. If a dispute is not submitted to the above agencies for review, then a foreign investor enjoys the right to apply to any arbitration agency set up pursuant to the procedures established by United Nations Commission on International Trade Law (UNCITRAL). Currently there is one pending case at ICSID in relation to the arbitration clause under the Energy Charter Treaty.
Legal Registration of Private Enterprises

The Georgian Law on Entrepreneurs introduces a simple and easily performed procedure for a company registration. The court has to issue a registration decision within five calendar days following submission of documents necessary to establish a company as determined by law.

Deregulation: Licensing and Permits

The Georgian Law on Principles for Issuing Licenses and Permits defines the complete list of activities subject to licensing, and permits to be granted by authorised state, administrative or local bodies. According to the law, a license is a right granted by the administrative body to perform the relevant activity for an unspecified period of time and under requirements specified by the law. A permit is either a one-time right or right issued for a restricted period of time to perform relevant entrepreneurial activity on the certain territory under requirements specified by law. The law provides a unified list of activities subject to mandatory licensing and permits. The law requires payment of a fee necessary to obtain a license or permit. The amount of the fee depends on the type of activity. By virtue of the law and article 100 of the General Administrative Code of Georgia, the administrative body is required to issue an administrative act on granting a license or permit within one month after an application is filed. In some areas of business activity, the mandatory timeframe for issuing licenses and permits is even shorter.

Concessions

Pursuant to the Georgian Law on Concessions Granted to Foreign Countries and Companies, a Concession Agreement can be concluded on the processing of recoverable and non-recoverable natural resources and the performance of related works and activities. In essence, this agreement falls under the category of lease-concession agreements. Foreign investors conclude a concession agreement with the relevant state body authorised by the Georgian legislation (for example, Ministry of Environment and Natural Resources of Georgia). Pursuant to the law, a concessionaire (a foreign investor) has the same right to repatriate profits as any other foreign investor. In addition, the investor enjoys the right to appeal unlawful acts or decisions, made by the state body, in court or arbitrage.

Expropriation of Investments

The Georgian Law on Procedures of Confiscation (Seizure) of Property for Eminent Domain states that investments are expropriated (i) on the basis of a Presidential Decree, and (ii) under a relevant court decision in favour of the state body or any other person granted the expropriation right. It is noteworthy to mention that both the Presidential Decree and court decision can be issued only in case where there exists substantiated evidence of “sine qua non public necessity”; the expropriation issue can not be decided in the absence of such a condition. It should again be noted that mandatory compensation is paid in case of expropriation.

The Georgian Law on Procedures of Confiscation (Seizure) of Property for Eminent Domain provides procedures for confiscation of property. This organic law clearly defines that property may be confiscated in case of environmental and natural disasters, epidemics and epizooties endangering the health and life of a person(s), or state and public security. The decision to confiscate property is made by the President of Georgia as well as the central, autonomous or local body on the operating territory on which the property is located. It is important to note that property is to be evaluated at the market price and the sum to the amount of the assessed property value is to be transferred before the actual confiscation. The owner has the guaranteed right to file an appeal (on confiscation of property and reparation of
damages) at court in the event of termination of conditions that caused confiscation of property (environmental and natural disasters, epidemics and epizooties).

Protection of Private and Corporate Property

By virtue of the Georgian Constitution and the Georgian Civil Code, the right to property is guaranteed and protected both by legislative and administrative/judicial mechanisms. Importantly, Article 6.2 of the Constitution reads that international treaties or agreements made between Georgia and other parties (states or companies), unless contradictory to the Georgian Constitution or Constitutional Law, are superior to internal normative acts.

In Georgia, the property, investments and rights of investors are protected and guaranteed. The law defines simple and easily understandable schemes to make investments, to purchase (transfer) property or set up a company. The legislation provides clear and strictly defined mechanisms for the protection of property and investments, which, on the whole, ensures a liberal legislative environment for conducting business and making investments in Georgia.

As a result of the reform programmes vigorously pursued by the new government, there have been highly promising results that were achieved in the recent years. The investment climate has significantly and positively improved, which has clearly been put forward by a recent study held by the World Bank, where Georgia was named the year’s number one reformer, improving its overall ranking from 112 to 37, as shown in Table 15. It indicates that, thanks to the decisive actions taken by the recently implemented reform policy, Georgia surpasses with leading figures on many accounts as regards with availability of a nurturing investment climate; and thus has attained a leading role not only over the other peer countries in the region but also in many instances many OECD countries.

Table 15: Business Climate Ranking

<table>
<thead>
<tr>
<th>Ease of...</th>
<th>2006 rank</th>
<th>2005 rank</th>
<th>Change in rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Doing Business</td>
<td>37</td>
<td>112</td>
<td>+75</td>
</tr>
<tr>
<td>Starting a Business</td>
<td>36</td>
<td>59</td>
<td>+23</td>
</tr>
<tr>
<td>Dealing with Licenses</td>
<td>42</td>
<td>152</td>
<td>+110</td>
</tr>
<tr>
<td>Employing Workers</td>
<td>6</td>
<td>71</td>
<td>+65</td>
</tr>
<tr>
<td>Registering Property</td>
<td>16</td>
<td>18</td>
<td>+2</td>
</tr>
<tr>
<td>Getting Credit</td>
<td>48</td>
<td>96</td>
<td>+48</td>
</tr>
<tr>
<td>Protecting Investors</td>
<td>135</td>
<td>133</td>
<td>-2</td>
</tr>
<tr>
<td>Paying Taxes</td>
<td>104</td>
<td>160</td>
<td>+56</td>
</tr>
<tr>
<td>Trading Across Borders</td>
<td>95</td>
<td>149</td>
<td>+54</td>
</tr>
<tr>
<td>Enforcing Contracts</td>
<td>32</td>
<td>56</td>
<td>+24</td>
</tr>
<tr>
<td>Closing a Business</td>
<td>36</td>
<td>98</td>
<td>+12</td>
</tr>
</tbody>
</table>

Note: 2005 rankings have been recalculated to reflect changes to the 2006 methodology and the addition of 20 new countries
Source: EBRD-World Bank, Business Environment and Enterprise Performance Survey (BEEPS), Survey of all of the countries in the Former Soviet Union (CIS), Europe and Central Asia (ECA), as well as Turkey

Furthermore, the reform programmes produced tangible results in decreasing substantially the corruption as measured by international standards (see Figure 19 below).

**Figure 19: Results in Decreasing Corruption**

![Graph showing results in decreasing corruption]

*Source: EBRD-World Bank, Business Environment and Enterprise Performance Survey (BEEPS), Survey of all of the countries in the Former Soviet Union (CIS), Europe and Central Asia (ECA), as well as Turkey*

As provided briefly at the beginning of the report, Georgia has impressing scores regarding in many areas of economic freedoms, and this is manifested in the following Figure 20 regarding the ten basic economic freedoms. Georgia scored above world average in 7 out of 10 indicators, with expectations to improve further in 2008.40

**Figure 20: Georgia’s Ten Economic Freedoms**

![Graph showing Georgia’s ten economic freedoms]

*Source: Ministry of Economic Development of Georgia*

The package of reforms pursued by the government includes:

- strengthening the Rule of Law;
- decisive anti-corruption measures;
- liberalising the tax code;
- privatising state-owned property;
- deregulation;
- improving infrastructure;
- investing in public education and human capital.

A system of these interrelated and mutually supportive reform policies will further improve the investment climate in the country and attract FDI. The prospects of economic development in Georgia are rather encouraging. Reforms implemented by the new government proved effective and viable and in less than one year resulted in drastic economic recovery.

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40 Invest in Georgia 2007, Ministry of Economic Development of Georgia.
The Organisation for Economic Cooperation and Development (OECD), according to its recent publication, has also acknowledged the positive developments in Georgia and has improved Georgia’s rating by shifting from the latest 7th position to the 6th. The mentioned assessment is the clear evidence of improved business environment in Georgia, that creates an effective background to enhance stronger trade and economic cooperation with world’s leading countries.  

Also, there are positive developments regarding protection of intellectual property rights. Georgia has joined a wide spectrum of international conventions (a list of which is provided as Annex 3) and its legislation provides for the protection of copyrights, trademarks, and service marks, etc., including appropriate civil judicial and administrative procedures. Georgia, as a member of the WTO, has brought into compliance its intellectual property protection legislative base with the requirements of the agreement on trade-related aspects of intellectual property rights (TRIPS agreement).

Intellectual property field is mainly regulated by the following laws of Georgia: The Patent law; The Law on trademarks; The Law on appellations of origin and geographical indications of goods; The Law on topographies of integrated circuits; The Law on border measures relating to the intellectual property. Respective amendments were introduced into the Criminal Code and the Code of Administrative Violations.

The Georgian National Intellectual Property Centre (“Sakpatenti”) is responsible for granting patents and registering trademarks, for matters concerning examination of objects of industrial property (inventions, utility models, industrial designs, trade marks, service marks) and for matters involving appellations of origin and layout designs of integrated circuits, as well as for the sphere of copyrights and neighbouring rights.

II.3.9.5. A New Facility: Georgian National Investment Agency (GNIA)

GNIA is Georgia’s ‘One Stop Shop’ for investment, easing the way for investors worldwide to take advantage of the opportunities of this promising emerging market. Investment opportunities exist in various sectors throughout the Georgian economy, with emphasis on export oriented ones among many others.

GNIA is the primary governmental authority concerned with regulating and facilitating investment, and stands ready to assist investors. Services GNIA provide range from company registration to site location to partner identification to contracts and licenses acquisition. GNIA’s services are provided at no cost to the investor.

GNIA acts as “one-stop shop” agency for investors assisting them in setting up their business in Georgia, helping in project implementation, performing a liaison role with the Government, providing information on investment opportunities in the country, as well as investment related regulations and laws. In its export promotion activities GNIA helps to find markets for products, undertakes market studies and seeks out partners for joint ventures aimed at increasing the volume of exports and development of Georgian enterprises. GNIA also organises international conferences, business-forums, trade fairs and exhibitions. The Georgian Government considers GNIA as the main national intermediary for bridging gaps between policy development and implementation and the public and private sectors (further information may be obtained at http://www.investingeorgia.org).

III. MARKET STRUCTURE AND PRIVATISATION

III.1. Overview

The main directions, objectives and instruments of the energy policy of the Government of Georgia have been condensed in a draft document in early 2006.\(^\text{42}\) The thrust of the effort is in energy efficiency, security of supply (particularly electricity and gas), market restructuring (including third party access to networks), deregulation and liberalisation, implementing basic market and privatisation prerequisites (metering, cost-reflective tariffs, settlement of debts, enforcement of power and gas market rules), promotion of investment, and enhancing bilateral and regional cooperation in the energy sector.

The draft policy document is largely concerned with the power sector and defines the main goal of the entire energy sector as the full coverage of electricity demand, the achievement of “economic independence and stability of the power sector”, and the assurance of technical, economical and political security via the best use of the power sector resources and the diversification of imports. However, the policy document is also concerned with achieving self-sufficiency in primary energy, establishing the country as an important node of energy transit and connecting routes, and creating the foundation of competitive and investor-friendly national energy markets.

As for the heating systems, all of Georgia’s district heating systems are currently inoperative.

The next sections of this Report provide an overview of policies and important structural market changes in the various energy industry sub-sectors of Georgia.

III.2. Oil and Gas

III.2.1. Upstream Activities

Georgia has very small proven oil and gas reserves (around 11.1 million tons of oil and some 3 billion cubic meters of gas). Current crude oil production is modest (around 2,000 bpd – 100,000 tons per year).\(^\text{43}\) However, the country does have demonstrated petroleum potential, with history of discoveries and production dating back some 80 years. The largest field (Samgori) was discovered in 1974 and during the 80’s production in the country peaked at more than 65,000 bpd. Currently, there are fifteen known oil and one gas fields with reserves estimated at 45 million tons oil equivalent. Most of the fields have been produced for many years and are heavily depleted, requiring additional exploration or re-development by modern technologies in order to prove and tap any remaining potential.

Hopes are that exploration will lead to major new discoveries in East Georgia and on the Black Sea shelf, where good prospects are believed to exist. Offshore exploration is yet to provide reliable data on resources and reserves but it seems at least 4 clearly shaped anticlinales exist in the southern part of the Georgian Black Sea shelf with oil-in-place resources between 70 million and 1.3 billion barrels (9-200 million tons) on each\(^3\). Other sources indicate a much higher overall potential, with estimates of total oil-in-place in the

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\(^{42}\) Main Directions of the State Energy Policy of Georgia, April 2006, s.p.

\(^{43}\) Oil and Gas Journal, December 18, 2006.
country as high as 2.4 billion tons, of which 1.15 billion tons on the shelf. The Adjara region shelf is thought to be gas-prone, and East Georgia natural gas potential could be as high as 125-180 billion cubic meters.

Should the already known onshore fields and the offshore prospects yield confirmation of reserves, Georgia could once again achieve considerable production, possibly exceeding the current consumption of oil (which stands now at around 2.2 million tons per year, about 45,000 bpd), and maybe also that of natural gas (currently about 2.1 billion cubic meters per year). Plans call for boosting oil production to 3.0 million tons per year by 2020, and gas production to 2.0 billion cubic meters by the same date. Should discoveries of new fields and redevelopment of known fields be successful, Georgia could meet from its domestic resources about 25% of gas demand by 2010 and 40% by 2020.

Exploration and production activities are regulated by several laws and decrees, of which the most important are:

- Law on Oil and Gas (16 April 1999), which defines the state oil and gas resources controlling agency and sets out the oil and gas prospecting and production rights and duties of investors, the procedures for granting licences for oil and gas resource use, and the rules related to the transportation of produced oil.
- Order of the Head of the State Agency for Regulation of Oil and Gas Resources of Georgia (9 January 2002), which sets out detailed rules applicable to all entities carrying out oil and gas activities in Georgia.
- Order of the Head of the State Agency for Regulation of Oil and Gas Resources of Georgia (8 May 2002), which is the statute that sets the rules of defining and applying a “regulation price” to oil and gas operations, i.e. the prices used to calculate payments to the agency by the operating company (investor) for covering expenses related to the operation of the agency.

A non-exhaustive list of oil and gas industry laws and regulations is provided in Annex 1 to this Report, along with laws and regulations relating to other energy industry sectors.

Oil and gas operations in Georgia are conducted in accordance with the provisions of the Oil and Gas Law, which defines a uniform policy for the development of oil and gas resources and regulates the relationships between the National Oil Company of Georgia and private investors. The Oil and Gas Law specifies the taxes that are applied to investors under production sharing agreements. In addition to provisions of the Oil and Gas Law, each production sharing contract contains a tax section that outlines the general regime applicable to that particular agreement. The individual production sharing contracts also contain the list of applicable taxes down and provide specific guidance on the payment of taxes and filing of reports. Separate and distinct tax provisions are applied to the contractor parties to the production sharing contract and their subcontractors, in particular, foreign subcontractors.

However, the tax regimes provided by the Oil and Gas Law, the individual production sharing contracts and the Tax Code are not consistent with each other. The Tax Code has been amended in a number of respects to align itself with the tax concessions provided in the Oil and Gas Law. It now specifies the taxes from which companies with oil and gas operations are

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44 Open Society Foundation Georgia: Extractive Industries and Energy Transit in Georgia Background Report.
45 FSU Oil and Gas Monitor, 21 June 2006.
exempt. However, it does not exempt such parties from all taxes provided in the Tax Code.
Therefore, it remains unclear which tax regime would have precedence and exactly which
taxes apply to subsurface users.

The profit tax rate is fixed in the production-sharing contract. The contracts typically also
provide protection against future increases in the effective profit tax rate.

Taxable income is calculated in accordance with internationally accepted practices in the
petroleum industry rather than in accordance with Georgian statutory accounting procedures.
Financial results of activities under more than one production-sharing contract may be
consolidated. Accounts may be kept in US dollars. Operating losses incurred by contractor
parties during the period of preliminary exploration may be carried forward indefinitely and
are subject to offset once production starts.

Activities that are not connected with hydrocarbon business in Georgia and/or relevant
contract areas are deemed to be outside the scope of production sharing contracts and the
related protocol tax regime. In the event that a company is engaged in both hydrocarbon-
related activities and unrelated activities, separate accounting books in accordance with
statutory rules must be maintained to reflect income and loss generated from non-production
sharing contract activities.

Operating companies are not taxable and allocate proportionate income and expenses to
contractor parties in accordance with their participating interests in the project.

Generally, foreign subcontractors are exempt from all forms of taxation at the corporate level
other than income tax withholding at the source of payment. Production sharing contracts
typically stipulate that non-resident subcontractors are subject to no taxes, duties or levies
other than a single tax withheld at the rate of 4% of the gross contractual payment. The sale of
goods or equipment to which title is transferred outside of Georgia and the provision of
services outside of Georgia should not be subject to income tax withholding.

Foreign subcontractors engaged only in hydrocarbon activities related to a production sharing
contract are not required to maintain statutory books and records. Foreign subcontractors
conducting business activity outside of the oil consortia regime are subject to domestic
taxation and are required to maintain statutory accounting records and to file all required tax
reports in compliance with the statutory tax regime.

The employees of contractor parties, operating companies and subcontractors remain subject
to all payroll taxes. This means that all employees are subject to personal income tax and any
local employees are additionally subject to social insurance contributions. Foreign employees
qualify for relief from income tax under any applicable double tax treaty (see Income Tax
Withholding for list of double tax treaties in effect).

Operating companies and contractor parties must charge VAT on petroleum sold locally within
Georgia, which is not intended for export. Export sales are subject to VAT at a zero rate, with the
result that any input VAT incurred on such sales is subject to refund by the Government. All
imports by an operating company, contractor parties, their affiliates, subcontractors, or their
agents are subject to VAT at a zero rate. The import and re-export of goods for personal use by
foreign employees and their family members are subject to VAT at a zero rate.
Government supervision over oil and gas operations in Georgia, including oil refining and transportation, is carried out by the State Agency for Regulation of Oil and Gas Resources (SAROG). SAROG is responsible for the preparation of contracts, negotiations and signing of hydrocarbons exploration and production (E&P) agreements on behalf of the state. SAROG functions also include the issuing of licences for oil and gas operations to the investor on behalf of the state, as well as the approval and the issuing of all necessary authorisations, allotments, and permits. SAROG is also responsible for setting and applying the “regulation price”.

The agreement granting to an investor the right to explore and produce hydrocarbons and use oil deposits is signed between the state and the investor or the winner of a tender or an auction carried out by SAROG. Access to hydrocarbon resources is granted to investors on terms of production sharing agreements (PSA), risk service agreements, or service agreements, but the law does not limit the modalities of granting hydrocarbons exploration and production rights to these types of contracts:

• A production sharing agreement assigns to an investor the exclusive right to conduct oil operations in a defined onshore and/or offshore area, on the grounds of compensatory relations within a certain period of time;

• A risk service agreement grants to an investor the right to conduct oil prospecting in a certain area for a specific period of time;

• A service agreement may be signed regarding particular (specific) or multiple (complex) activities (oil exploration, exploitation of resources, repair of drilling facilities, marketing, etc.).

SAROG must grant to the investor a license for the use of hydrocarbons within a month from the date of signing of the agreement between the state and the investor. However, under the amendments of the Law, SAROG no longer issues “licenses for the right to produce oil and gas” (E&P licenses), but “general licenses for the right to use oil and gas resources” (resource use licenses). The difference between the two is primarily in the fact that, while the E&P license required an investor to carry out both exploration and production, the resource use license does not necessarily do so, leaving the choice up to the investor. Under the terms of a resource use license, an investor who is not interested in production may carry out exploration only, and an investor who is not interested in exploration may carry out production only. At the same time, however, the “general resource use license” does extend to investors the right to carry out both exploration and production, should they choose to do so. The new licensing rules are thus a significant improvement over past routine and bring Georgia’s terms of access to hydrocarbons closer to international petroleum industry practices.

Georgian participation in exploration and production of hydrocarbons is primarily channeled via the Georgian Oil and Gas Corporation (GOIC), established in April 2006 by order of the Georgian Minister of Economic Development. The capital of the company consists of the stock of the 100% government-owned Georgian International Gas Corporation (GIGC), Georgian International Oil Corporation (GIOC), and Georgian National Oil Company (GNOC, “Saknavtobi”), valued at Lari 101.1 million (about USD55 million).

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46 Global Competition Review 2005: Oil Regulation in 11 Jurisdictions Worldwide, Chapter 4 (Georgia) by Victor Kipiani, Irakli Mgaloblishvili, Mikheil Gogeshvili and Mariam Antia Mgaloblishvili Kipiani Dzidziguri.

47 See Новости-Грузия, 29 ноября 2005.
The bringing together under the umbrella of the new holding company of GIGC, GIOC and GNOC aims above all at improving the coordination of natural gas supplies to Georgia, since each of these companies has contracts for gas supply from different sources (GIGC from Gazprom, GIOC from the Shah Deniz field in Azerbaijan, and GNOC from domestic sources where it supervises oil and gas production). However, it also has important implications for the PSA signed with a number of companies, as GNOC is the party that participates in PSA on behalf of the government.

GOGC as GNOC is now in possession of most, if not all, geological, geophysical, production and other information needed to evaluate and manage oil and gas prospects and projects. Teleti Oil Company (Former “Saknavtobi”) is on its own holding the licenses and is the operator of a few fields on “grandfathered” terms, as the successor of operations carried out before the adoption of the current legislation.

GNOC’s functions include, inter alia, partaking in the preparation of oil contracts (PSA, etc.), taking over and dealing in the government’s share of oil production in PSAs, and the set-up of coordination committees in cooperation with the investors for the purposes of overseeing and administrating commercial and operational issues related to the PSAs. GNOC is thus best described as both a quasi-governmental agency with important overseeing and regulatory functions and a government-owned business. It may be expedient to look at the separation of these functions, with regulatory role to be entirely assigned to government offices rather than GNOC, and relieving GNOC from direct government interference in its business operations.

At this time, there are five companies that hold rights over twenty E&P blocks and three companies have won a tender for five more blocks (See Figure 21):

- Former GNOC Saknavtobi (at present Teleti Oil Company) held blocks V, VIA, VIB, VIIA, VIIB, XIA, XI V and Teleti oil field inside of block XIB;
- Frontera East Georgia holds block XII;
- Ninotsminda Oil Company Limited holds blocks XIE and XIF; Canargo Norio Limited holds blocks XIC and North Kumisi, XIG and XIH; Canargo Nazvrevi Limited holds blocks XID and XIII. All these companies are Canargo Energy Corporation’s affiliated companies and they all have one operating company – Canargo Georgia;
- Anadarko Georgia Co. holds blocks IIA, IIB and III;
- National Petroleum Ltd. holds block XIB.

Two more E&P blocks have been held, but relinquished:

- JKKX Ltd. held block IX until 1999, when it was farmed out to Georgia British Oil Co.; the latter relinquished the acreage in 2004;
- Kaheti Oil held block X, but relinquished it in 2002.

As of 2005, there were ten free blocks (I, IIC, IID, IVA, IVB, VIII, IX, X, XA and XIII A. Two of the free blocks (VIII and IIA ) were listed along with four blocks held by GNOC in the bidding round for six blocks held in mid-2006. Based on the evaluation of the bids made by various companies, the following bidders were declared winners:

- Aksai BMC in Block V;
- Strait Oil and Gas Ltd. in blocks VIA and VIB(held by GNOC);
- Global Oil and Energy Ltd. in blocks VIIB (held by GNOC) and VIII.
The immediate hopes for increasing oil and gas production in Georgia are pinned on the relatively shallow reservoirs (up to -2,500 m) in the so-called “Near Tbilisi” zone in East Georgia, particularly on the Ninotsminda (oil-gas), Samgori (oil) and Samgori South Dome (oil) fields, all of which have been produced by methods that led to formation damage. Ninotsminda and Samgori are also producing from deeper zones (around -3,200–3,500 m at both fields and up to -3,700 m at Samgori). However, the potential for re-development at these fields is modest. Better short-term prospects for ramping up oil and gas production exist at the deeper Manavi, Norio, Teleti and Kumisi prospects in the Near Tbilisi zone, where good reservoirs may exist at around -4,500 m.

Figure 21: E&P Blocks in Georgia

![License Blocks of Georgia](image)

Source: Open Society Foundation Georgia: Extractive Industries and Energy Transit in Georgia Background Report

Foreign companies operating in Georgia have carried out significant exploration, including seismic data acquisition, processing, interpretation, and drilling of a few exploratory wells. Canargo drilled a well (#72) at Norio, but encountered only oil shows at the -3,936-3,988 m interval and suspended drilling to re-interpret the prospect. In 2006, CanArgo (Nazvrevi) Ltd signed a MoU which includes the terms of a take-or-pay natural gas supply contract with the Ministry of Energy of Georgia relating to gas sales from the Kumisi gas prospect near Tbilisi. CanArgo plans to drill a well on Kumisi between January and June of 2007, on an up-dip prospect from the WR16 well drilled in Soviet times, which has tested gas condensate from what is interpreted as the gas-water contact. The MoU contains a pricing formula under which gas is initially supplied at USD 55 per thousand cubic meters, increasing to USD 80 per thousand cubic meters (USD 2.28 per thousand cubic feet) by the tenth contract year, after which escalation will be based on European Union heavy fuel oil price changes.
Canargo also sank two wells at the Manavi prospect, one in 2003 and the other in late 2006. The first one (M11) tested “visually significant” flow of oil. The second one (M12) is expected to be tested in early 2007 after sidetracking. Six more wells exist on the prospect, but only the two drilled by CanArgo have penetrated the target formation, and the company is currently assessing drilling and testing data.⁴⁸

At Ninotsminda, Canargo agreed along with GNOC to sell gas to the state-owned Georgian Gas Transportation Co., which will in turn supply the gas to the Gardabani TPP (Tbilresi). The power plant generally operates from October to May, and deliveries will begin in October 2007 at a rate of 200,000 m³ per day priced at 445 per 1,000 m³. The delivery point is the gas gathering plant at Ninotsminda, with the buyer taking responsibility for transportation. The buyer established a USD250,000 bank guarantee as a security of the first gas delivery. Quantities may increase as Canargo intends to perform workovers on existing wells at the field.⁴⁹

In the Black Sea offshore, Anadarko conducted exploration activities at the, IIB and III blocks on the shelf since 2000. The company completed 2D seismic surveys. In 2004 Anadarko also did 3D seismic surveys involving a south-western part of block III together with BP and TPAO, which owns a license on the adjacent territory of the Turkish Black Sea shelf. After processing and interpretation of results, Anadarko decided to continue the exploration efforts in Blocks IIB, IIA and III and will need to find a new partner or partners to share the cost of future possible drilling activity. It is necessary to add that some earlier oil- and gas-in-place estimates based on Soviet-times data indicate a possible large resource potential in the offshore.

The activities of Houston-based Frontera Resources are exclusively focused on the exploration and development of the large geographic area associated with Block XII in Georgia, which it holds on PSA terms. As of the end of 2004, the company has invested approximately USD70 million in its research and operations in Block XII. The company has focused its efforts toward the goal of establishing commercial production from one of the six existing fields in Block XII and it has identified an extensive inventory of prospects for potential new field discoveries.

Frontera currently produces from the shallow reservoirs of the Mirzaani field at a rate of ~100 bbpd. The company also hopes to establish commercial production from the deeper zones at Mirzaani, as well as from the Taribani field, which has already been developed during Soviet times with more than 40 wells, but later abandoned. An exploratory well (Niko #1) drilled at Taribani flowed considerable oil, but encountered technical problems, which Frontera intends to overcome by deploying modern technologies. In addition to the historical subsurface work at the Taribani field, Frontera upgraded and installed new production and storage facilities in anticipation of future drilling in the field. Associated railway loading facilities were also upgraded at the nearby town of Dedopliskaro (approximately 27 km from the Taribani field) in anticipation of future production.⁵⁰ At this time, the company exports minor quantities of oil via rail.

The upstream sector of the oil industry could probably help build up investor confidence by improving transparency and providing detailed information regarding:

- Terms and conditions of PSA;
- Total volumes of extracted oil and gas with a breakdown by license blocks;

⁴⁹ FSU Oil & Gas Monitor, 5 July 2006.
⁵⁰ See http://www.fronteraresources.com/operations/.
• The split of production in license blocks operated by joint ventures and the state share of this volume;
• Volumes and prices of crude oil and gas sales; and
• Financial statements of the companies, including information on bonuses, profits and liabilities paid to the state budget.  

Another drawback that may deter upstream investors is the lack of a “single shopping window” in negotiations for access to acreage, despite the earlier intentions to introduce one. SAROGR still does not have a working database for geological and geophysical information, and the involvement of GNOC in the negotiation process is strong, even though it is supposed to operate on commercial terms and compete with other E&P investors.

III.2.2. Oil and Gas Pipelines and Oil Transit Shipments by Rail

III.2.2.1 Oil Pipelines

Background

Already in the second half of the 19th century, Georgia became a transit route for Caspian oil. The railroad linking Baku and Batumi across Georgia was completed in 1883 and used to transport oil products to the Black Sea. In 1887, a concession was granted to the Society of the Caspian-Black Sea Oil Pipeline, and in 1896 the construction of an 8-inch, 835 km kerosene line from Baku to Batumi began. Construction lasted ten years. When commissioned in 1906, the line was capable of carrying up to 0.9 million tons of kerosene per year. During the late 20s and early 30s, an oil refinery was constructed at Batumi, and the line was converted to crude oil in 1931. As it was evident that the line’s capacity is inadequate to fully support the Batumi refinery, a second larger 10-inch, 834-km line was constructed in 1925-1932. In 1943 the second pipeline was dismantled, as its pipes were needed for urgent construction elsewhere during the war.

In 1974-1980, a much larger 20-inch (530 mm) pipeline was constructed along the same route, first from Samgori (where oil was discovered at the time) to Batumi between 1974 and 1977, and then over the remaining stretch to Azerbaijan by 1980. It was designed to carry up to 5 million tons per year, i.e. roughly the volumes needed by the Batumi refinery at full capacity. As crude oil production, refining and export in the former Soviet Union shifted from the Caspian Sea to other regions—first to the Urals and then to West Siberia—the Baku-Batumi pipeline lost some of its past significance and became marginalised. However, with the opening of new prospects for the petroleum industry in the Caspian Sea region since 1990, the Georgian transit crude oil pipeline route has once again come to the forefront.

To engage in any crude oil and/or refined products transportation activities (including pipelines), businesses need a license issued by the regulatory authority (NOGRC). Entities that have a license for the use of oil and gas resources, an affiliated company or another person, may apply to NOGRC for a transportation activity license covering crude oil and

51 See also Open Society Foundation Georgia: Extractive Industries and Energy Transit in Georgia Background Report.
refined products produced by the entity itself. The application form should contain information about:

- The name and the address of the applicant, tax ID number assigned by the tax agency, the place of registration and the registering entity of the representative office of the legal person in Georgia, if necessary;
- The names of any persons/entities that hold at least 5% of the shares of the applicant, or such a percentage in the applicant’s profit.

The following information has to be attached to the application form:

- A detailed description of the activities that the applicant plans to carry out;
- A detailed description of the technologies and methodology expected to be used by the applicant;
- A detailed description of the crude oil and/or oil products to be used in the factory or transportation facility;
- Information on the financial status of the applicant and the source of the funds to be used for the licensed activities;
- A document evidencing the applicant’s experience and a list of countries where the applicant has worked/operated during the past five years;
- If needed, prior consent of the owner of the land to be used for oil operations.53

The Baku-Supsa Crude Oil Pipeline

In 1994, Azerbaijan signed the so-called “contract of the century” with 10 energy companies. The contract is a 30-year, USD8 billion venture that resulted in the formation of the Azerbaijan International Operating Company (AIOC), which began operations under Azerbaijan’s first production sharing agreement (PSA) in 1997 under the leadership of BP. AIOC has a contract to develop three fields (Azeri, Chirag, and the deepwater portions of Gunashli – ACG), with total estimated reserves of 700 million tons of oil, 119 billion cubic meters of non-associated gas and 7.8 million tons of condensate.

A major problem for the development of the ACG fields was the absence of adequate infrastructure for export to world markets. Until the start of full-scale operations at ACG, AIOC considered exporting “early oil” via two routes, both involving existing pipelines. The first one (the “northern route”) crossed into Russia and led to Novorossiysk; the second one (labeled “the southern route”, the “western route”, or the “Baku-Supsa pipeline”) followed the Baku-Batumi pipeline route and made use of its existing infrastructure where possible.

To support the development of the Western Route Pipeline (Baku-Supsa) and enable the carrying of “early oil” from ACG, the Georgian International Oil Corporation (GIOC, now merged into GNOC) was established by a special Decree of the President of Georgia in 1995. GIOC’s main task was defined as the assurance of the implementation of transit crude oil and natural gas pipeline projects in Georgia. It was designated as the entity to co-operate with western companies and international financial institutions for this purpose. The start-up of GIOC’s operations was assisted by US AID, US TDA, various EU programmes, the World

53 See Global Competition Review 2005: Oil Regulation in 11 Jurisdictions Worldwide, Chapter 4 (Georgia) by Victor Kipiani, Irakli Mgaloblishvili, Mikheil Gogeshvili and Mariam Antia Mgaloblishvili Kipiani Dzidziguri.
Bank and the British Know-How Fund. Over time, GIOC succeeded in establishing credible oil and product transport system in Georgia, including not just the AIOC “early oil” project, but also the Main Export (Baku-Tbilisi-Ceyhan-BTC) Pipeline (see below).

GIOC conducted contractual negotiations with oil companies working in the Caspian region (including companies within AIOC and in Kazakhstan) and facilitated the adoption by the Parliament of Georgia of enabling legislation covering the agreements, including the Host Government Agreement. GIOC is responsible for the implementation of the Host Country Agreement on behalf of Georgia regarding the Baku-Supsa Oil pipeline and collecting the revenues from the pipeline operation and transferring it to the state budget. GIOC also represents Georgia in the Baku-Tbilisi-Ceyhan (BTC) and South Caucasus Pipeline projects (SCP, see below).

Upon the completion of this front-end work, AIOC (led by BP) rehabilitated parts of the existing 20-inch Soviet pipe to a junction close to Batumi and built new sections to Supsa, and elsewhere as needed (at a total cost exceeding USD600 million). The project commissioned the project in 1999. Since that time, AIOC, as the exclusive user of the Baku-Supsa line, has gradually brought its capacity from the initial 100,000 bpd to 115,000 bpd and then 145,000-155,000 bpd, which is fully used. BP carries out periodic inspections of the line and on several occasions has suspended operations (in 2001, 2004 and 2006) for regular maintenance and ascertaining the safety of operations. Currently the pipeline has stopped its operation and BP is undergoing rehabilitation; and it will resume transportation in April 2007.

Pending decisions on the use of BTC and the implementation of cross-Caspian crude oil transportation projects, the capacity of the Baku-Supsa line may be further boosted to anywhere between 300,000 and 600,000 bpd. Such an increase is now quite unlikely, since any incremental output of crude oil in Azerbaijan and some crude oil exported from Kazakhstan is now earmarked entirely for the BTC pipeline.

### Table 16: Baku-Supsa Pipeline Shipments and Transit Revenues in Georgia

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shipments (million bbl)</td>
<td>24.8</td>
<td>36.6</td>
<td>43.3</td>
<td>45.9</td>
<td>46.0</td>
<td>47.1</td>
</tr>
<tr>
<td>Fee per barrel, USD</td>
<td>0.18</td>
<td>0.18</td>
<td>0.18-0.19</td>
<td>0.19</td>
<td>0.19</td>
<td>0.19-0.20</td>
</tr>
<tr>
<td>GIOC transit revenue, mln USD</td>
<td>4.5</td>
<td>6.5</td>
<td>8.5</td>
<td>8.7</td>
<td>8.7</td>
<td>9.3</td>
</tr>
<tr>
<td>Of which: Transferred to the government budget, mln USD</td>
<td>0.7</td>
<td>1.4</td>
<td>3.8</td>
<td>4.3</td>
<td>6.6</td>
<td>6.9</td>
</tr>
<tr>
<td>Of which: Used by GIOC to cover expenditures, meeting GIOC obligations under international agreements</td>
<td>3.8</td>
<td>5.1</td>
<td>4.7</td>
<td>4.4</td>
<td>2.1</td>
<td>2.4</td>
</tr>
</tbody>
</table>

Source: Georgian International Oil Corporation (GIOC)

54 Under agreements of AIOC with Chevron and other oil producers in Kazakhstan, as well as oil producers in Turkmenistan, the Baku-Supsa line is also used to transport some oil shipped by such companies.

55 FSU Oil & Gas Monitor, 15 November 2006.
The Baku-Supsa crude oil shippers (AIOC member companies and companies using their capacity allocations) enjoy a relatively low tariff of USD5 per ton (around USD0.70 per barrel), since the line was rehabilitated and expanded with funds provided by the shippers. Separately, the Georgian Government negotiated via GIOC a transit fee, initially USD0.18 per barrel, but later indexed to inflation (see Table 16).

The share of transit fee revenues transferred to the Government’s coffers is increasing, as Georgia’s obligations (investment and maintenance commitments) under the agreements related to this pipeline were frontloaded. The pipeline thus provides a steady income to Georgia from transit fees of around USD10 million per year, most of which goes now to the budget.

However, the major benefit from the operation of the Baku-Supsa line is the profit tax on the pipeline operator (BP), which was first collected in April 2006 on operations conducted during the second half of 2005. As front-loaded charges designed to recoup the operator’s investment in the rehabilitation of the pipeline decrease and shipments go up, tax revenue will continue to rise until about 2011. From currently committed volumes which run at 46 million barrels per year (from the ACG fields) total profit tax payments will be around USD575 million between 2006 and 2025, peaking at more than USD50 million per year in 2010-2011. Other benefits include the creation of jobs, the transfer of technical expertise and know-how, the assistance provided to communities along the pipeline route, and grants and donations to various NGOs.

In 2003, Azerbaijan, Georgia and Turkey signed a Security Protocol for the East-West Corridor, the route that crude oil and natural gas pipelines will take through the Caucasus to eastern Turkey. This latest intergovernmental agreement between the three countries is meant to provide the foreign companies participating in billion-dollar projects with the assurance that the governments of these states will provide adequate security for the sections of the pipelines that run through their territories. The terms of the Protocol include the actual physical protection of the pipelines, exchange of security information, joint trading and the implementation of anti-terrorist measures. The three states will coordinate their security measures with BP. Under the terms of the agreement, each country is responsible for security and guarding the pipeline on its territory. Each country, including Georgia, has set up special services to carry out security operations on BTC and coordinate with other agencies.56

The Baku-Tbilisi-Ceyhan Pipeline (BTC, Main Export Pipeline)

In September 2002, there was a groundbreaking ceremony for the USD3.9 billion, 1,730-kilometer Baku-Tbilisi-Ceyhan (BTC) Pipeline. The pipeline, referred to as the “Main Export Pipeline” (MEP), was completed in early 2005, linking Baku with the Turkish port of Ceyhan on the Mediterranean Sea via Georgia. Thereafter, the filling of the line with oil began and the project was officially commissioned on 13 July 2006. It is capable of transporting 1 million b/d of oil.

Most of the oil will come from ACG in Azerbaijan, but in addition BTC will also carry up to 500,000 bpd of Kazakh oil westward as plans to use tankers to move oil from Kazakhstan to Baku materialise. Kazakh oil deliveries via the BTC will peak around 2015, largely on the strength of the giant Kashagan field which is expected to come onstream in 2009.57 For the purpose, KazMunaiGaz is planning to build a 10 million tpy terminal at Kuryk near Aktau on the east shore of the Caspian, and later increase its capacity to 20 million tpy. At the same

56 FSU Oil & Gas Monitor, 5 July 2006.
57 OGJ, June 26, 2006.
time, a fleet of tankers will be built, of either 12,000 t or 60,000 t capacity depending on the chosen option for port facilities. Initial deliveries from Kazakhstan via BTC will be around 150,000 bpd from Tengiz, to begin from an unspecified date in mid-2007.

Shipments of oil across the Caspian via BTC could further increase if the proposed Trans-Caspian Oil Pipeline is built. A decision to that effect will be eventually made once it becomes clear that shipments from Kazakhstan can easily exceed the 500,000 bpd that have already been agreed between the Presidents of Azerbaijan and Kazakhstan on 16 June 2006.

On the other hand, Iran has been conducting oil swaps with Kazakhstan since 1997, and has similar agreements with other countries in the Caspian. Under the arrangement, oil is delivered to the port of Neka in Iran for delivery to refineries in North Iran, and in its turn Iran makes available equivalent quantities of oil at its Kharg Island terminal in the Persian Gulf. But current swaps run at about 70,000 bpd and are unlikely to increase, since swaps with Iran were chosen by producers due to the absence of other means of exports, such as pipelines. The inauguration of the BTC would be a factor for the further marginalisation of Iranian oil swaps.

In Georgia, BTC operations are governed by the terms of a Host Government Agreement. GIOC is the Georgian entity which represents the state and acts on its behalf in the project. BTC is operated by BP and owned by a consortium of companies with stakes in upstream operations in the Caspian Sea region:

<table>
<thead>
<tr>
<th>Table 17: Shareholders of the BTC</th>
</tr>
</thead>
<tbody>
<tr>
<td>BP (UK)</td>
</tr>
<tr>
<td>SOCAR (the state oil company of Azerbaijan)</td>
</tr>
<tr>
<td>Chevron (USA)</td>
</tr>
<tr>
<td>Statoil (Norway)</td>
</tr>
<tr>
<td>TPAO (Turkey)</td>
</tr>
<tr>
<td>Eni (Italy)</td>
</tr>
<tr>
<td>Total (France)</td>
</tr>
<tr>
<td>Itochu (Japan)</td>
</tr>
<tr>
<td>INPEX (Japan)</td>
</tr>
<tr>
<td>ConocoPhillips (USA)</td>
</tr>
<tr>
<td>Amerada Hess (USA)</td>
</tr>
</tbody>
</table>

Source: Georgia Investment Guide – www.investmentguide.ge

Table 18 contains data on the expected volumes of crude oil transit by BTC, the tariff and the revenues for the government’s budget in Georgia. Although somewhat behind schedule now, the BTC project will yield substantial benefits to Georgia. Over the planned 40-year lifetime of BTC, the Georgian government expects to raise revenues amounting to some USD2.5

58 FSU Oil & Gas Monitor, 31 May 2006.
60 NewsBase CIS Oil and Gas Special Report, 2006, p. 4, and FSU Oil & Gas Monitor, 21 June 2006.
61 Ibid., 14 June 2006.
billion, or about USD62.5 million per year. The first commercial tanker carrying 700,000 bbl of oil sailed from Ceyhan on June 6, 2006, shortly before the official commissioning of the pipeline in mid-July 2006. By the end of 2006, deliveries via BTC ran at about 400,000 bpd.62

**Table 18: Expected BTC Throughput, Tariff and Revenues to Georgia’s Budget**

<table>
<thead>
<tr>
<th>Period</th>
<th>Throughput, mln tons for the period</th>
<th>Tariff per barrel, ¢</th>
<th>Tariff per ton, USD</th>
<th>Revenues for Georgia’s budget, mln USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004-2008</td>
<td>126</td>
<td>12</td>
<td>0.89</td>
<td>112</td>
</tr>
<tr>
<td>2009-2019</td>
<td>545</td>
<td>14</td>
<td>1.04</td>
<td>566</td>
</tr>
<tr>
<td>2020-2028</td>
<td>450</td>
<td>17</td>
<td>1.26</td>
<td>568</td>
</tr>
<tr>
<td></td>
<td>250</td>
<td>20</td>
<td>1.48</td>
<td>371</td>
</tr>
<tr>
<td></td>
<td>250</td>
<td>22.5</td>
<td>1.67</td>
<td>417</td>
</tr>
<tr>
<td></td>
<td>250</td>
<td>25</td>
<td>1.86</td>
<td>464</td>
</tr>
</tbody>
</table>


III.2.2.2 Crude oil and refined products transit via rail

Apart by means of the Baku-Supsa and BTC pipelines, crude oil is transported across Georgia by rail, along with considerable quantities of refined products, to the ports of Batumi and Poti. These shipments are along the TRACECA corridor established in 1993 with the help of EU. TRACECA links Central Asia to Europe via the South Caucasus, particularly Azerbaijan and Georgia.

In the 90’s Georgia experienced a dramatic decrease of oil transit volumes through the railways. Lack of cooperation between the participants of the Georgian oil transit corridor, lingering historical corruption on the route, and a growing competition from the oil terminals in the neighbouring countries had a negative impact on the attractiveness of the Georgian oil transit railway services. This resulted in a significant reduction of oil volumes and a financial loss for the Georgian Railways, Georgian oil terminals, and the economy of Georgia as a whole.

In August 1999 the Greenoak Group acquired an oil transshipment facility in Batumi (the Batumi Oil Terminal) in a privatisation deal. The Terminal’s history goes back to the beginning of the Caucasus oil history in the late nineteenth century but at the time of privatisation it was a run-down state-owned facility, which had been the target of many international investment companies due to its important strategic location. The local government was looking for investors to develop the potential of the Terminal but was not successful. However, Greenoak Group succeeded by committing to a significant capital expenditure programme over a three year period.

The Greenoak Group is an international investment company, providing capital as well as management resources. The Group activities include oil transportation, shipping and a number of industrial investments. The Group activities include significant investments in Georgia and the Caucasian Region. Mr Jan Bonde Nielsen is the major shareholder and chairman of the Greenoak Group, via Greenoak Holdings Limited, a Jan Bonde Nielsen family trust company. The companies in the Group are Nafrans, Alegrantrans, Batumi Oil Terminal, and Petrotrans in the oil

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62 OGJ, June 19 and June 26, 2006; NewsBase CIS Oil and Gas Special Report, 2006, p. 4.
transportation business, Greenoak Shipping and Tamara I and II in the shipping business, and
Greenoak Capital, Batumitex and the Ajarian Electricity Company in investments.

Greenoak Holdings Ltd. owns 61.9% of Nafrans Ltd, which in turn owns 100% of the Batumi Oil
Terminal, Petrotrans, and Alegratrans. Along with Greenoak Group, Nafrans has three minority
shareholders: ENR Russia Invest (a Swiss listed company), the Hillside Apex Fund (an open-ended
investment company listed on the Irish Stock Exchange and managed by Thames River Capital),
and Nobel Investment Limited, an investment company controlled by BNP Paribas.

Batum Oil Terminal handles the technical operation, maintenance, renovation and new
construction of the Batumi Oil Terminal facilities. The Terminal transships crude oil and oil
products exported by regional producers in Kazakhstan, Azerbaijan, Turkmenistan and Georgia.
During the period of Greenoak’s ownership throughput has increased three times and the
Terminal has been completely rebuilt and modernised at a cost of more than USD60 million.

The range of handled products includes 8 types of crude oil\(^{63}\) and 15 different refined oil
products. The Terminal’s transshipment capacity is currently 12 million tons per annum and the
reservoir capacity is over 510,000 tons. In 2006, the Terminal handled 12 million tons of
 crude oil and refined products and is looking at possible expansion.

Railcar unloading is done at estacadas with a total capacity of 212 railway tank cars at any
one time and daily turnover capacity of over 850 tank cars (up to 40,000 tons per day). One of
the estacadas can handle heavy crude oil and viscous products.

Vessel loading is performed at three berths (Jetty One – up to 47,000 ton dwt tankers, Jetty
Two – up to 15,000 ton tankers, and Jetty Three -up to 20,000 tankers) and one offshore
Conventional Buoy Mooring location (CBM) capable of handling up to 130,000 ton tankers
with drafts ranging from 12 to 16 metres and length up to 255 metres.

The country is steadily regaining its status as a key railway transit link for Caspian oil. In
2004, Nafrans established a new company (Petrotrans) to provide integrated oil forwarding
and transshipment services from Gardabani on the Azerbaijan border to Batumi. Established
after the Georgian Rose Revolution, Petrotrans has revolutionised oil transportation,
eliminating corrupt practices on the Georgian oil transit corridor. The emergence of Petrotrans
resulted in reducing historically high railcar demurrage costs significantly, cutting the railcar
turnaround to two days from previous ten-twelve days, as well as convenient solutions to oil
transporters of avoiding unnecessary vessels demurrage costs.

Considering the projected increases in the oil production volumes in Azerbaijan and
Kazakhstan, the utilisation of Georgian railway system for oil transport is expected to also
increase significantly. ExxonMobil, which has the rights to export Azeri Light oil, announced
its decision not to use the BTC pipeline and instead signed a five-year contract with the
Azpetrol Company to export 10 million tons of Azeri oil via Batumi between 2005 and 2010.

In September 2006, the owners of the Batumi Oil Terminal and KazMunaiGaz entered into a
strategic alliance in the form of a joint company, Batumi Terminals. The alliance takes into
account the fact that the BTC pipeline is a reality and the Georgian railroad corridor will handle

\(^{63}\) Kumkol, Keimir Blend and Tengiz from Kazakhstan, Urals from Russia, Cheleken and Okarem from
Turkmenistan, Azeri Light and Shirvan from Azerbaijan.
less and less oil from Azerbaijan, and also the fact that oil production in Turkmenistan will be
flat at about 16 million tpy. The true potential for Batumi lies therefore in Kazakhstan, where
production is expected to increase by 100 million tpy by 2015 and reach 170 million tpy.

To tap into this potential, Greenoak has been actively developing the trans-Caspian connection via
its affiliate Greenoak Shipping. Greenoak Shipping is owned together with Interorient Navigation
Co. The company has a 50% shareholding in Caspian Maritime, a joint venture between
Greenoak Shipping and National Iranian Tanker Corporation. Caspian Maritime is involved in
constructing large Articulated Tug Barges and Shuttle Tankers for use in the Caspian Sea. The
vessels will incorporate the latest technology and their design is based on many years of
experience gained in the Norwegian sector of the North Sea. The tankers will range in size from
55,000 to 63,000 t dwt which is the largest size that can be built in the Caspian region.

In May 2006, the Batumi Oil Terminal Co. entered into the tender process for the acquisition
of the Batumi Sea Port and in the summer of 2006 Greenoak paid USD96 million for a 49-year lease
of the port. At the same time, the company paid USD27.5 million for certain assets acquired from
the Georgian Government in January 2006, including a 80-hectare plot of land adjacent to the
Batumi Oil Terminal, the government’s share in BatNefteImpex, and an oil depot. The payment
also settled all outstanding issues with the Government, including a USD6.75 million penalty
charged on Alegratrans. Greenoak Holdings also acquired 18-months service contract rights on
two tank farms associated with the Batumi Oil Refinery (Bartzhana and Sameba).64

The Terminal’s parent company Nafrans announced the successful raising of new capital via
issue of shares to ENR Securities, Thames River, and BNP Paribas Private Equity Fund. BNP
Paribas also extended loans to Nafrans. Greenoak said it intends to build refinery and a
methanol/ammonia production plant in the port. The projects will require estimated USD3.2
bn investments and are supposed to be completed within 3 years.65

The Batumi Oil Terminal provides more than 60% of the revenue of the Georgian Railway.
Its transit corridor supports more than 20,000 workers along the route.66

The Kulevi Terminal represents another private venture in the area. It is being constructed at a
site located between Poti and Analkiya. The Georgian-Austrian company Terminal 2000
launched the construction of the terminal in April 2000. The throughput capacity of the
Kulevi terminal will be around 6 million tons of liquid hydrocarbons, expected to rise to 10
million tons following the second stage of construction. The project also envisions
constructing an oil storage farm with a capacity of 300,000 m3, two 250 meter piers, and
laying pipelines with pumping stations.

It should be noted that information regarding railway transit of oil is among the hardest to
obtain. Neither terminal has a Web site, and the site of the Georgian Railways contains no
information regarding the volumes of transported oil, nor the transit fees collected and
transferred to the state budget. It is desirable for the Georgian Railway company to publish

64 http://www.pfmc.az/cgi-bin/cl2_fmc/item.cgi?lang=ru&item=20051226172410961 (Trend, 7 December
2005).
this information, which would make it possible to conduct cross-comparison of data obtained from the railway, the oil terminals and the shipping companies.67

In an attempt to secure cargo for its own operations, Russia’s Transport Ministry said in early August 2006 that it had begun offering a 50% discount on rail shipments of crude oil and refined products from Caspian countries via selected ports on the Russian Caspian littoral, for subsequent transshipment to Black Sea or Sea of Azov ports. The Ministry said it hoped to make Russian routes more attractive than the TRACECA route and that the rebate applies mostly to shipments from Turkmenistan via the Russian port of Mahachkala on the Caspian. This move, however, apparently failed to secure any new customers for the rail service across Russia.68

III.2.2.3 Natural Gas Pipelines, Transmission and Storage

National Pipeline System

The first high pressure gas pipeline in Georgia was constructed in 1959. The 700 mm line linked Karadag (Azerbaijan) to Tbilisi and had a design capacity of 3.6 bcm/y. Until the mid-70’s gas originated in Azerbaijan, but after the signing of a swap agreement between Iran, the former Soviet Union and a group of western countries, a link to Iran was built and the South Caucasus began receiving Iranian gas. In its turn, the FSU supplied equivalent volumes of gas to West Europe. The swap deal lasted until late 1979, when Iranian supplies were cut off, necessitating the construction of a larger pipeline into the South Caucasus from the north (Russia). This larger 1,200 mm line (the North-South Caucasus Pipeline, NSCP) was built between 1988 and 1994 and has a nameplate capacity of 16 bcm/y. It links to the lines from Azerbaijan and continues into Armenia.

Figure 22: Main Pipelines in the Caucasus

Source: Armrosproject / US AID

67 See Open Society Foundation Georgia: Extractive Industries and Energy Transit in Georgia Background Report.
Table 19: High-Pressure Gas Pipelines in Georgia

<table>
<thead>
<tr>
<th>Pipeline</th>
<th>Construction period</th>
<th>Diameter, mm</th>
<th>Max capacity, bcmy</th>
<th>Anticipated use, bcmy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Karadag-Tbilisi</td>
<td>1959-1968</td>
<td>800-700</td>
<td>3.6</td>
<td>none</td>
</tr>
<tr>
<td>Vladikavkaz-Tbilisi</td>
<td>1963-1966</td>
<td>700</td>
<td>3.0</td>
<td>none</td>
</tr>
<tr>
<td>Saguramo-Kutaisi</td>
<td>1967-1975</td>
<td>700-500</td>
<td>1.6</td>
<td>Domestic only</td>
</tr>
<tr>
<td>Rustavi-Telavi-Jinvali</td>
<td>1969-1975</td>
<td>500-300-200</td>
<td>0.4</td>
<td>Domestic only</td>
</tr>
<tr>
<td>Gori-Khashuri-Bakuriani</td>
<td>1972-1989</td>
<td>500-300</td>
<td>1.0</td>
<td>Domestic only</td>
</tr>
<tr>
<td>Red Bridge-Tsalka-Alastani</td>
<td>1978-1990</td>
<td>500-300</td>
<td>0.8</td>
<td>Domestic only</td>
</tr>
<tr>
<td>Kazakh-Saguramo</td>
<td>1980</td>
<td>1,000</td>
<td>11</td>
<td>Imports from Azerbaijan</td>
</tr>
<tr>
<td>Kutaisi-Sukhumi</td>
<td>1986-1989</td>
<td>700-500</td>
<td>1.6</td>
<td>Domestic only</td>
</tr>
<tr>
<td>NSCP</td>
<td>1988-1994</td>
<td>1,200</td>
<td>16</td>
<td>Imports, transit to Armenia</td>
</tr>
<tr>
<td>SCP</td>
<td>2004-2006</td>
<td>1,050</td>
<td>22</td>
<td>Transit to Turkey, domestic off-take under HGA (imports)</td>
</tr>
</tbody>
</table>

Source: US AID (Advisory Assistance to the Ministry of Energy of Georgia, P.E.D. IQC – Contract No. DOT-I-00-04-00020-00 Task Order #800: Natural Gas Strategy for Georgia)

In parallel to the development of the major supply lines from the east and north, the domestic main pipeline system of Georgia was greatly expanded during the 70s and 80s, eventually reaching all major cities and a number of other municipalities. The latest, and maybe most important pipeline development in Georgia, is the South Caucasus Pipeline (SCP), a 1050 mm line from Azerbaijan across Georgia to Turkey (see on SCP below). Figure 22 and Table 19 present data on the main pipelines into and in Georgia.69

By 1989, 587,000 families and around 3,100 enterprises were using gas. Historically gas consumption accounts for 20-33% (up to 30% in 2005) of total primary energy supply in Georgia. As of 2005, some 260,000 households in Tbilisi and around 150,000 households in other locations had access to gas. Table 20 lists data on gas supply and on transit to Armenia via the NSCP, which was between 1980 and 2006 the only gas supply pipeline to Georgia.

The reason for the decline in numbers of households that use gas and for the three-fold decrease in gas consumption in 2005 as compared to 1989 (about 2 bcmy as opposed to 6.2 bcmy) is in the general state of upheaval through which the country lived in the early 90’s. Georgia inherited from the FSU an extensive natural gas transportation and distribution system, but it also inherited very inefficient energy technologies, including almost fully decayed centralised district heating system.

Social and political cataclysms during the first years of independence had a catastrophic impact on the energy sector. The main pipelines and many distribution networks were considerably damaged. The degradation of the natural gas system eventually caused the almost complete termination of natural gas supply to households during 1994-1997. Non-payment for consumed gas by residential and commercial customers exacerbated the problems. Corruption became systemic and manifested itself in the drastic increase in

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69 SCP not shown. See separate item below.
“technical” and “commercial” gas losses, which combined reached 70-80% of supply. In turn, this precipitated a wave of cross-indebtedness in the sector and general insolvency which prevented any measurable effort in maintaining or upgrading the pipeline system.

Table 20: Gas Supply and Transit in Georgia via the NSCP (billion m³)

<table>
<thead>
<tr>
<th>Year</th>
<th>Distribution in Georgia</th>
<th>Transit to Armenia</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>6.2</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>5.5</td>
<td></td>
</tr>
<tr>
<td>1991</td>
<td>4.6</td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>6.0</td>
<td>0.9</td>
</tr>
<tr>
<td>1993</td>
<td>4.3</td>
<td>0.8</td>
</tr>
<tr>
<td>1994</td>
<td>2.7</td>
<td>0.9</td>
</tr>
<tr>
<td>1995</td>
<td>1.1</td>
<td>1.6</td>
</tr>
<tr>
<td>1996</td>
<td>1.1</td>
<td>1.1</td>
</tr>
<tr>
<td>1997</td>
<td>0.9</td>
<td>1.4</td>
</tr>
<tr>
<td>1998</td>
<td>0.9</td>
<td>1.5</td>
</tr>
<tr>
<td>1999</td>
<td>1.0</td>
<td>1.2</td>
</tr>
<tr>
<td>2000</td>
<td>1.2</td>
<td>1.4</td>
</tr>
<tr>
<td>2001</td>
<td>1.0</td>
<td>1.4</td>
</tr>
<tr>
<td>2002</td>
<td>0.8</td>
<td>1.1</td>
</tr>
<tr>
<td>2003</td>
<td>1.0</td>
<td>1.2</td>
</tr>
</tbody>
</table>

Source: Billmeier, A, Dunn, J. and van Selm, B.: In the Pipeline: Georgia’s Oil and Gas Transit Revenues. IMF Working Paper, 2004

In an attempt to rectify the situation, in 1997 the government established a single operator of the main pipelines, the Georgian Gas International Corporation (GGIC). GGIC is a joint-stock company capitalised by state-owned assets in the gas industry, which include the high-pressure trunk lines, the compressor stations, a number of gas metering/regulation stations, and certain other facilities. In December 1999, GGIC established an affiliate, the Gas Transportation Company (GTC), and assigned to it the tasks of maintaining and operating the entire main gas transmission system. These companies are currently merged into the GNOC.

GGIC/GNOC is the entity that represents the Government of Georgia in the agreements for transit to Armenia via the NSCP and the construction and operation of the SCP. GGIC/GNOC takes and monetises in-kind payments for gas transit, and also handles import contracts.

Georgia’s experience with monetising fees for the transit of Russian gas to Armenia via the NSCP (“Magistral”) pipeline has been positive, but volumes have been relatively small. As shown in Table 20, the quantity of gas transited through Georgia for consumption in Armenia is slightly higher than domestic gas consumption. Georgia is entitled to 10% of the gas transiting the country via the NSCP as an in-kind fee, but this is reduced by the technical losses incurred in transportation, which amount to about 6% of the quantity transported. As a result, Georgia received 30–40 million cubic meters of gas as transit fees in 2002–03, i.e. less than 5% of total domestic consumption. The in-kind transit fees have been handled by GGIC/GNOC. GGIC/GNOC has been able to sell the in-kind receipts mainly to the small-
scale business segment, such as automobile gas (compressed natural gas) stations, at a tariff of
approximately USD95 per thousand m3. According to data provided by GGIC, the collection
rate on these sales is close to 75%. Overall, the NSCP transit fees have thus yielded a cash
flow for GGIC/GNOC of around USD2.1-2.7 million.

Improvement in the gas sector has been achieved only after the rose revolution. Beginning
from late 2004, rehabilitation and upgrades began with funds extended from the government
budget. By 2006, losses in main pipelines decreased to some 3.9% from an earlier level of 6-
7%. Metering systems and control devices are being installed.

In early 2006, Gazprom expressed its desire to purchase the national gas pipeline system of
Georgia. At the time, the Georgian government said that it may be ready to negotiate,
depending on the conditions that it is offered. In particular, Georgia’s Ministry of Energy
indicated that to resolve the issue it would need to be assured of 25-year deliveries of gas by
Gazprom at below market prices, to be left with part of the Russian gas that is transited to
Armenia, and to receive guarantees that the national gas transport system will be returned to
Georgia if Gazprom fails to fulfill the conditions of the sale. Gazprom has indicated interest
in acquiring the Georgian gas transportation system since 2004, and has said the lines could
be used to pump gas to Armenia and Turkey. The suggestion that the gas pipelines may be
sold to Gazprom was quickly rebuffed by a number of legislators, who pointed out that the
Parliament had approved in 2004 a resolution forbidding the sale of strategic facilities without
his consent of the legislature.

On the other hand, extensive rehabilitation and upgrades on the main gas lines is planned over
the next 3-5 years with financial support from the Millennium Challenge Georgia Fund under
a 5-year agreement with the US government. The programme has already extended USD49.5
million for bringing NSCP to an acceptable level of technical integrity and for supporting
ongoing energy sector reforms. The funds were made available to Georgia on the condition
that the gas transportation system will not be sold before 2010, when the agreement expires.
Urgent work will focus in 2007-2008 on six sections of NSCP, and in the meantime feasibility
studies will be conducted on the entire length of the pipeline.

At the same time, Georgia has been looking at ways to diversify its gas supplies and has
negotiated with Azerbaijan, Iran and Kazakhstan. In January 2006, during a cut-off of supply
from Russia caused by an act of sabotage on the supply lines in Russia, gas was delivered by
Azerbaijan for the first time since 1980. The quantities were actually supplied by Gazprom
via existing lines on the same route, as Azerbaijan was short on gas supply. Later minor
volumes (around 2 million m3 per day for a month) were also contracted for import from Iran
at an officially undisclosed price, put by some industry sources at USD120 per 1,000 m3. GIGC
sources said it would be difficult to promptly take Iranian gas, as pressure regulation

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70 Billmeier, A, Dunn, J. and van Selm, B.: In the Pipeline: Georgia’s Oil and Gas Transit Revenues. IMF
71 FSU Oil & Gas Monitor, 11 January 2006.
72 Ibid., 18 January 2006.
73 Ibid., 22 March 2006.
74 Ibid.
75 Cf. US AID (Advisory Assistance to the Ministry of Energy of Georgia, P.E.D. IQC – Contract No. DOT-I-
    00-04-00020-00 Task Order #800: Natural Gas Strategy for Georgia), and the Millennium Challenge
    Georgia Fund.
stations would have to be built on the junction between the Iranian and the Azerbaijani pipeline systems, but expected that the upgrades would be done by mid-March 2006. The deal involved a swap scheme, with Iran delivering to Azerbaijan and Azerbaijan supplying equivalent volumes of gas to Georgia via a repaired 700 mm line. At the time, GIGC said it intends to continue buying Iranian gas even if Gazprom fully resumes deliveries to Georgia.76

In early 2006, Georgia agreed to purchase 2 bcm of gas during the year from the Kazakh-Russian joint venture KazRosGaz at USD110 per 1,000 m3, a price considerably higher than the one requested by Georgia (USD68 per 1,000 m3) and at par with Gazprom’s offer for the year. But earlier Georgian officials were told in Moscow that the Kazakh-Georgian joint venture will not be allowed to use Russian pipelines to supply gas to Georgia, even though the lines are owned by Gazprom, a 50% partner in KazRosGaz,77 and even though KazRosGaz does supply gas to neighbouring Azerbaijan.

At the time, Kazakhstan expressed desire to purchase the gas distribution net in Tbilisi (Tbilgaz), and the deal was finalised in May 2006. KazMUnaiGaz, the national petroleum company of Kazakhstan, acquired Tbilgaz for USD12.5 million. The low price took into account the fact that Tbilgaz was essentially bankrupt, with debts of USD139 million, which will be paid off by the new owner. KazMunaiGaz also undertook to invest USD100 million in the distribution system of Tbilisi.78

The list of creditors of Tbilgaz includes the two Russian companies Gazprom and Itera. In late 2006, the International Commercial Court of the Russian Chamber of Commerce was to hear the case of Itera against the Georgian Ministry of Energy for USD100 million, which Itera claims for gas supplied to Georgia between 1996 and 2002. The Georgian Government has refused to recognise the debt, since in 2003 Itera entered into a gas debt payment agreement with the Georgian company Sistema, which has been assigned the right of debt repayment. The Ministry of Energy acted as a guarantor of the agreement. However, Georgian legislation puts such contracts under the auspices of the law on state debt, which stipulates that only the Ministry of Finance can act as a guarantor of such contracts, and contracts must be approved by Parliament. As none of these provisions was complied to, the contract was from the onset illegitimate and the therefore the debt will not be paid.79

To counter the effects of rising gas import prices, and expert group of the Georgian Parliament suggested in March 2006 to exempt natural gas imports from VAT, which is levied at 18%.80

The Georgian Government does not and has not purchased gas from Russia’s Gazprom. All deals are done by private companies, mainly by gas distribution companies and industries. This policy has been criticised by some observers, who said that putting distributors and relatively small industries in charge for negotiating import contracts with Gazprom is a way to avoid responsibility and transparency.81

76 FSU Oil & Gas Monitor, 1 February 2006.
77 Ibid., 3 May 2006.
78 FSU Oil & Gas Monitor, 25 January and 17 May 2006.
79 Ibid., 16 August 2006.
80 Ibid., 15 March 2006.
81 Ibid., 29 November 2006.
The leading importer of gas from Russia via the NSCP is Energy Invest Co., the owner of a thermal power plant near Tbilisi and the Azoti fertiliser plant in Georgia. In 2006, Energy Invest imported from Russia about 0.45 bcm, and intended to import up to 0.6 bcm in 2007, or 29-35% of total demand. The company said that Gazprom has indicated to it its desire to further raise prices on the Georgian market, from the current USD110 per 1,000 m3 to USD170-250 per 1,000 m3.\(^{82}\)

This prediction was fulfilled in late 2006, when Gazprom said it plans to charge for gas exports to Georgia USD230 per 1,000 m3 in 2007. To counter the immediate effects of the price hike, the Georgian Government said it intended to use subsidies to residential and commercial consumers. At USD230 per 1,000 m3, the import bill for 2007 is expected to be around USD390 million for 1.7 bcm of gas, causing a reduction of GDP growth by some 1.1%.\(^{83}\)

The second largest gas importer in Georgia is KazTransGaz-Tbilisi, the operator of the capital’s gas distribution network, which also buys gas from Gazprom at USD230 per 1,000 m3. The third is the Russian Itera-controlled Sakgazi, which owns twelve distribution companies in various municipalities in the country (cf. below for more on Sakgazi in the section on gas distribution).

**The South Caucasus Pipeline (SCP)**

The Azerbaijan-Turkey Natural Gas Pipeline (a.k.a. South Caucasus Pipeline, SCP) will transport gas produced in Azerbaijan primarily at the Shah Deniz non-associated gas and gas condensate field across Georgia to Turkey. BP is technical operator of the field and the terminal, and Statoil ASA is commercial operator, responsible for gas sales, contract administration, and business development. In addition to BP and Statoil, which hold 25.5% interest each, Shah Deniz consortium partners include SOCAR, Total SA, Naftiran Intertrade Co. Ltd., and LukAgip NV – each holding 10% – and TPAO (9%).\(^{84}\)

Negotiations were finalised in March 2001, and an Intergovernmental Agreement was signed by the Ministry of Energy and Natural Resources of Turkey and the Deputy Prime Minister of Azerbaijan. In 2002, a Host Government Agreement was signed with Georgia. A Natural Gas Sales and Purchase Contract was signed by Turkey’s BOTAS and SOCAR of Azerbaijan. In 2003, SOCAR transferred all their rights and obligations under the natural gas sales and purchase contract to the Azerbaijan Gas Supply Company (AGSC), operated by Statoil. On behalf of its partners Statoil is (1) operator of the Azerbaijan Gas Supply Company, which includes management and administration of the Shah Deniz Phase 1 gas sales contracts with Turkey, Azerbaijan and Georgia, (2) business operator of the South Caucasus Pipeline Company, responsible for the business development and administration functions of the company, and (3) Chairman of the Shah Deniz Gas Commercial Committee, in charge of commercialising the volumes from the full field development of Shah Deniz.\(^{85}\)

The contracts pertaining to the SCP use the terms “Option Gas” for gas that is received by Georgia as in-kind transit fee, and “Supplemental Gas” for additional Georgian purchases.

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\(^{82}\) Ibid., 11 October 2006.

\(^{83}\) Ibid., 8 November 2006.

\(^{84}\) OGJ, 15 May 2006.

\(^{85}\) Intervention by H.E. Hans Wilhelm Longva, Ambassador of Norway to the Republic of Turkey, Global Energy Balances and Turkey, Istanbul, 28 and 29 January 2004.
Article 8 and Appendix 1 of the 2002 Host Government Agreement on the SCP Pipeline suggest that Georgia has a choice between receiving a cash transit fee of USD2.50 per thousand m³ or receiving 5% of the gas transported through SCP as “option gas”. The two options would have equal value if all gas could be sold at USD50 per thousand m³ without any storage or transaction costs. The Georgian authorities have agreed with the operators that Georgia will take gas as in-kind payment for gas transit because it will contribute to a diversification of Georgia’s sources of energy and because they are confident that payments discipline in the domestic gas sector will be improved. This is an optimistic assumption in the light of the widespread non-payment in this sector in Georgia, even though there are some recent signs of improving payments discipline.86

According to the Contract; natural gas delivery will be over 15 years, to start in 2006, but the SCP project is somewhat behind schedule. The pipeline is now complete in Azerbaijan and Georgia and nearing completion in Turkey. Eventually, the capacity of the 36-42” pipeline could be increased up to 20 bcm/y or more with the installation of additional compression. The delivery point is the Turkish/Georgian border. BOTAŞ is responsible for the construction and operation of the line within Turkey.

In 2006, exports from Shah Deniz were already to begin on a small scale. The 442-km section in Azerbaijan, including the offshore production platform, an undersea line, compressor stations and the Sangachal terminal, and the line to Georgia, was completed in early June 2006. But the Turkish section is still under construction and is unlikely to be completed on schedule.87 In 2006, only 850 million m³ were to be extracted from Shah Deniz, with 500 million m³ going to Turkey, 300 million m³ to Azerbaijan and 50 million m³ to Georgia.88 As Shah Deniz comes onstream in 2007, Azerbaijan will cut imports from Russia from 4.5 bcm/y to 1.5 bcm/y89 and more gas will be available to Georgia as well.

Once Shah Deniz reaches its peak Stage One output of 8.6 bcm/y, Turkey will take 6.6 bcm/y and the rest will be divided between Georgia and Azerbaijan. Stage Two of the project will come into operation in 2011-12 with a capacity of 16 bcm. Most of the gas is expected to be shipped across Georgia and Turkey to Greece and Italy and possibly also across Bulgaria and Romania to Central Europe. Given the convulsions of gas supply to the region and the rising prices, Azerbaijan’s Ministry of Industry and Energy has come up with a proposal to shift the Second Stage development of Shah Deniz two years early, to 2010. But in 2007, output is unlikely to reach more than 4-5 bcm. Under the preliminary agreement, Azerbaijan was to receive 1.3 bcm of the output, Georgia 0.8 bcm, and Turkey the remainder. With prices of import Russian gas in Georgia and Azerbaijan skyrocketing and construction in Turkey still underway, Turkey has reportedly agreed to relinquish 0.8 bcm to Georgia, and Azerbaijan has also approached Turkey with a request to relinquish some 1.5 bcm from its 2007 allocation.

With gas supplies in the region at a premium, Georgia was forced to accept Gazprom’s offer to buy 1.46 bcm in 2007 at more than double the 2006 price (USD110 per 1,000 m³ as compared to USD60 per 1,000 m³). But once the start-up problems of Shah Deniz and SCP are overcome, Georgia can gradually stop importing Russian gas, although probably not in

87 FSU Oil & Gas Monitor, 7 June 2006.
88 Ibid., 14 June 2006.
89 Ibid., 29 November 2006.
2007, as three Georgian companies have already contracted with Gazprom to supply some 80% of the country’s annual demand.\(^9\)

In July 2006 Georgia reached a preliminary agreement with Azerbaijan and Turkey to receive up to 1.2 bcm via the SCP in 2007. The Georgian Government said it expects the share of Russian gas on the market in Georgia to decrease to 40% as a result.\(^1\) Sources at the Azerbaijani Ministry of Industry and Energy pointed out at the time that it could not commit itself to the deal yet by confirming prices and volumes, as its own gas balance was still in the works. Negotiations were still underway in late 2006, but sources indicated that Georgia is slated to receive 1.01 bcm in 2007 from Azerbaijan at a price of USD120 per 1,000 m\(^3\). Turkey, which was supposed to receive 2.8 bcm from Shah Deniz in 2007, has reportedly agreed to reduce the volume to 0.7 bcm, with the difference going to Azerbaijan and Georgia. In the longer run, gas from Shah Deniz should be sufficient to completely meet demand in both Azerbaijan and Georgia, and both countries may discontinue imports from Russia by 2012.\(^2\)

Table 21 lists the initially projected gas transit volumes, transit fees and revenues in Georgia during Stage One of Shah Deniz.

| Table 21: Projected SCP Transit and Transit Fees in Georgia |
|---|---|---|---|---|---|---|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
| Gas sales to Turkey, bcm | 2.0 | 3.0 | 5.0 | 6.6 | 6.6 | 8.0 |
| Georgia’s transit fee (5% in-kind, bcm) | 0.1 | 0.15 | 0.25 | 0.33 | 0.33 | 0.4 |
| Assumed sales price, USD/1000 m\(^3\) | 100 | 102 | 104 | 106 | 108 | 110 |
| SCP transit fee, million USD | 10 | 15.3 | 26 | 35 | 35.7 | 44.2 |

Source: Billmeier, A., Dunn, J. and van Selm, B.: In the Pipeline: Georgia’s Oil and Gas Transit Revenues. IMF Working Paper, 2004

The SCP is quite important in the sense that the associated gas sale-purchase contracts do not have destination clauses and restrictions on re-exports, which allows SCP to act as feeder line for the pipelines linking Turkey and Europe (Nabucco and the Turkey-Greece-Italy line). Should a pipeline across the Caspian be constructed, gas could also be supplied across Georgia to Turkey and Europe from Kazakhstan and Turkmenistan. In November 2006, EU signed in Astana an energy agreement with the Caspian and Black Sea countries, seeking in particular diversification of gas supply routes from Central Asia to Europe. The EU is supporting a US-backed plan to build a gas pipeline across the Caspian from Kazakhstan to Azerbaijan, and signed in December 2006 an agreement covering energy supplies and EU investment.\(^3\)

Also in late 2006, Turkey re-opened negotiations with Turkmenistan to import gas via the SCP. Adding gas from Turkmenistan to SCP will provide further throughput for projects leading from Turkey to Europe, such as Nabucco, the Turkey-Greece Interconnector and the Greece-Italy Interconnector. Since Turkmenistan’s gas reserves of 6.5 trillion m\(^3\) dwarf those

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\(^1\) FSU Oil & Gas Monitor, 19 July 2006.
\(^2\) Ibid., 26 July and 20 December 2006.
\(^3\) Ibid., 6 December 2006.
of Azerbaijan (1.8 trillion m³), in the long run Azerbaijan is also going to gain from offering transit capacity to Turkmenistan.\footnote{Ibid., 11 October 2006.}

**Other International Gas Projects**

In late 2006, Russia declared that it is going to launch the Dzaurikau-Tskhinvali gas pipeline construction project to connect North Ossetia in Russia to the self-proclaimed Republic of South Ossetia in Georgia. At present, Georgia supplies gas imported from Russia to South Ossetia. The pipeline was designed by Gazprom’s affiliate Promgaz.\footnote{Ibid., 1 November 2006.}

A link between Georgia, Ukraine and Poland has been discussed for some time now. The idea is to construct a large-diameter, high-pressure undersea gas pipeline from Azerbaijan across Georgia to Ukraine and then use the existing Ukrainian gas network to supply gas to Poland and other countries. The project has been labelled “the Georgia-Ukraine-European Union Pipeline” (GUEU). A feasibility study was scheduled for late 2006, aiming at the specification of the pipeline route and other parameters of GUEU.\footnote{Ibid., 22 March and 9 August 2006.}

In November 2000, Georgia put forward a project for a 37-mile pipeline to carry Russian natural gas to Turkey via the Georgian Black Sea coast. After a September 2001 meeting, Georgian officials announced that representatives from Conoco and Turkey’s Acsoy Group were ready to invest in the pipeline, which would transport 35.3 Bcf per year of natural gas from Kobuleti, Georgia, to Hopa, Turkey.\footnote{Source: US DOE / EIA.} However, there has been little advancement of the project since its inception.

**Gas Storage**

There is currently no underground gas storage (UGS) in Georgia. Most underground formations in Georgia with UGS potential have previously been identified and investigated. Two areas have been screened: Depleted or partly depleted oil fields east of Tbilisi and a large aquifer belt on the Black Sea coast.

In 1991-92, UGS GmbH (Germany) in collaboration with VNIIGAS and SouzNefteOtdacha (Russia) developed a design for an UGS in so-called Southern Arch of the Samgori oil field. The total volume of the storage was approximately 0.5 bcm, and the active gas capacity 0.230 bcm. The estimated cost of the construction was about USD70 million. The project did not see any subsequent action due to the political changes and difficulties in attracting the need investment at that time.

In January 2002, Georgia announced it would like to build two, 88.3-Bcf-capacity underground natural gas storage facilities in the east and southwest of the country as part of the SCP pipeline project. The UGS can support domestic operations, improve gas supply security and reliability in case of short-term interruptions, and potentially serve international markets on the SCP route.\footnote{US AID (Advisory Assistance to the Ministry of Energy of Georgia, P.E.D. IQC – Contract No. DOT-I-00-04-00020-00 Task Order #800: Natural Gas Strategy for Georgia).}
The Rustavi (gas condensate) and Ninotsminda (gas-capped oil field, both located in East Georgia) are considered to be the prime candidates for UGS. The Rustavi field is close to SCP (to which it could be linked by 700 mm lines) and can store 300-440 million m³ active gas. The estimated capital cost is approximately USD45 million. The potential active gas volume at Ninotsminda is around 440 million m³, but the field is a bit further away from the SCP as compared to Rustavi. The estimated capital cost for developing the Ninotsminda UGS is USD120 million.

An EU TACIS project has demonstrated the technical and economic feasibility of a UGS facility at the Ninotsminda oil field, 60 km east of Tbilisi. Estimated unit costs for storage services from that facility are comparable and in some cases more favourable than fee rates charged by EU UGS operators for similar services. In 2003, US TDA provided a USD683,000 grant for a study on the construction of an underground gas storage facility. Washington Strategic Advisors of New York City, New York, conducted the study in 2004. The target market for the initial operations of the proposed UGS is the domestic market. Accordingly, the required volumes of active gas to serve seasonal variations of demand in the country at current consumption levels are modest – around 300 million m³.

Establishing UGS will double Georgia’s security of supply-index and gas supply from Azerbaijan will quadruple the index compared with today’s situation. But foreign investors are reluctant and awaiting major improvements in the energy sector’s commercial performance and abolishment of political interference in the sector’s regulation.

III.2.3. Oil Refining, Storage, Distribution

Georgia has three refineries, a 106,000-bbl/d refinery at Batumi, a 4,000-bbl/d refinery (a small topping plant) at Saritxhala, run by the Georgian-American Oil Refinery (GAOR), and another small topping plant run by Navtobi Ltd. The small topping plants are unable to produce quality products and also raise doubts about environmental pollution.

The Batumi refinery, which is of obsolete design resulting in low yields of light products, has been virtually idled since the early 90’s due to inefficiency, accumulating debt and absence of oil suppliers. Rated at about 5 million tpy, the refinery operated close to capacity since about 1960 to the early 80’s. Maximum throughput was recorded in 1980-81, when domestic crude oil production peaked. Thereafter, a decline began and in 1990 the refinery was already operating at less than 50% of nameplate capacity. During the 90’s, the refinery worked only intermittently at 1-5% of capacity, and operations were discontinued in 2001.

As product demand continued to grow in the country during the 80’s, peaking at about 3.6 million tons in 1990, by that date the Batumi refinery was not able to meet more than 50-55% of domestic refined products demand. Most of the demand was for gasoline (2 million t),
diesel fuel (1 million t), and kerosene (including jet fuel) – about 0.5 million t. Georgia used little fuel oil and other refined products.

Currently, Georgia imports almost all of the refined products consumed in the country.

In addition to the difficulties in providing feedstock, a reason for the idling of the Batumi refinery was the concern about the environment. The refinery lacked water processing and emission control systems and was the major source of marine pollution on the entire Georgian Black Sea coast. Pollution was especially high in the river Kubistskali which flows close to the refinery, through Batumi, and discharges into the sea. Average oil concentration exceeds MPL 2.4 times, maximal – 4 times. Compared to previous years, however, the pollution level has declined 9 times. This is a consequence of the virtual discontinuing of production activities.

The Batumi refinery is undergoing a USD250-million modernisation and expansion directed by Japan’s Mitsui Corporation. As a result, Georgia has been obliged to import over 90% of its petroleum products. Mitsui has undertaken the work without Georgian government guarantees of its investment. The lack of such guarantees caused two other Japanese companies, Marubeni and JGC, to drop out of the project.

In mid-2005, the Georgian government was examining offers for the sale of the Batumi refinery and an oil depot in the city. The asking price was USD20 million for the refinery and USD3 million for the depot. Later reports informed that the depot was purchased for USD4.5 million by Rodio Investments. In early 2007, the Georgian Government re-confirmed its intention to offer for sale the Batumi refinery “very soon”, but did not name a price.

In mid-2006, the Norwegian Greenoak Group, the operator of the oil terminal in Batumi said it plans to build a refinery and a methanol-ammonia production plant in the port. The projects will require estimated USD3.2 bn investments and are supposed to be completed within 3 years. The Georgian government agreed to sell to Greenoak 800,000 sq. meters of land adjacent to the terminal for USD27 mn. Greenoak Group said it plans to finance the project internally, as well as in cooperation with BNP Paribas bank and regional suppliers of energy resources, but did not give information on financing rate, planned refinery capacity and the project terms. Greenoak paid USD92mn for 49 years lease of Batumi port in the summer of 2006.

Earlier, the British-Australian Armstrong Holding ISP said it intends to invest more than USD150 million in the construction of an oil refinery in Georgia. In January 2005, Armstrong won the privatisation tender of the Georgian Maritime Shipping Co., in competition inter alia with Greenoak.

With support from US TDA, Georgia has also looked at the construction of an oil refinery at Supsa, south of the port of Poti, at the termination point for the early oil pipeline from Baku to Supsa. The project at Supsa foresees the design and construction of a modularised two million tpy plant to produce a mix of products to be exported via the Black Sea and also used within Georgia or shipped to Armenia. US TDA funded a Definitional Mission in 1996 and a Feasibility Study in 1997. The Feasibility Study included an Environmental Assessment to

examine air, groundwater, surface water, wetlands habitat, and coastal and marine issues. The project has met little success in finding investors.

In April 2001, new legislation addressing indigenous refining activities was passed by Georgia that removed or reduced excise taxes on feedstock and refined product. Further simplifications were introduced by the 2005 Tax Code. Taxes on refined products include VAT (18%), excise tax (Lari 250 per ton for gasoline, Lari 220 for per ton for gas oil / diesel, Lari 150 per ton for heating oil – mazut). Certain consumers (PSA operators, contractors on the BTC and SCP) are exempted from excise tax and VAT. The measure aimed at simplifying and improving collection of taxes on crude oil and refined products and at curbing tax evasion and illegal commercial activities. Tax evasion and corruption are still rampant in the petroleum sector, although levels are decreasing.

Reserves stocks of oil products are virtually absent, and oil companies are not liable to form compulsory stocks.

New standards on refined products were due for introduction from 1 January 2005, but their implementation was delayed by a year to 1 January 2006. Liquid fuel standards allow sulfur content in gasoline of maximum 150 microgramme per kg, aromatics max 42%, including benzene max 1%. Leaded gasoline is phased out, with lead content limited to max 0.005 g per cubic decimeter. A reason for the delay in the introduction of modern fuel standards was the postponement in the completion of upgrades in Azerbaijani refineries which could only start supplying improved quality fuels from the third quarter of 2005.105

Grades of gasoline available in Georgia include “regular” A-91 and A-92 imported from Azerbaijan, “regular” A-91 imported from Europe, “premium” A-95 and “super” A-98. In late 2006, prices for Azerbaijani “regular” were around USD0.70 per liter, “European regular – USD0.80 per liter, and premium and super sold for around USD0.90 per liter. In late 2006, import of low octane gasoline A-80 was banned, as it was used to adulterate higher “regular” octane grade gasoline A-91 and A-92. A-80 gasoline used to be imported from Turkmenistan.106

Retail refined products quality monitoring is virtually non-extant. For example, while samples are taken from gasoline imports and analysed in labs promptly upon arrival at customs, with relevant certificates issued, the labs are not authorised to check on the quality of retail gasoline. The agency which should do this is the Sakstandart, the government department for standardisation, metrology and certification, but it does not carry out regular check-ups and does not have modern labs and equipment. Sakstandart needs a special court authorisation to carry out check-ups in each separate case. As a result, gasoline and motor oil are frequently adulterated on the road from customs to the retail sales point.107

The industry is represented by the Union of Producers, Importers and Consumers of Oil Products of Georgia. Union sources indicate that more than 50 companies are active in the business, but just 5-6 of them account for most of the import and distribution of refined products. Sources of imports include Azerbaijan (by far the largest supplier), Russia (22-23% of total in 2005), Kazakhstan, Turkmenistan, Romania, Bulgaria, Iran. The Union regularly monitors the market and provides data and estimates on volumes and prices by type of fuel.

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107 Балтийский исследовательский центр со ссылкой на РИА Новости, 9 Аезжафен 2004г.
Overall demand for refined products in 2006 is estimated at around 1.0 million tons, of which about 50% gasoline and 30% Diesel (see Table 22).

Table 22: Petroleum Products Demand in Georgia, 2005-2006

<table>
<thead>
<tr>
<th>Derivative / use</th>
<th>2005 thousand tons</th>
<th>2006 (est.) thousand tons</th>
<th>Index (%) 2006 over 2005</th>
<th>Structure (%) (2006)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Motor gasoline</td>
<td>420</td>
<td>475</td>
<td>113.0</td>
<td>46.6</td>
</tr>
<tr>
<td>2. Diesel fuel</td>
<td>300</td>
<td>320</td>
<td>106.7</td>
<td>31.4</td>
</tr>
<tr>
<td>3. LPG</td>
<td>20</td>
<td>20</td>
<td>100.0</td>
<td>1.9</td>
</tr>
<tr>
<td>4. Fuel oil (mazut)</td>
<td>13</td>
<td>15</td>
<td>115.4</td>
<td>1.4</td>
</tr>
<tr>
<td>5. Jet fuel (kerosene)</td>
<td>36</td>
<td>37</td>
<td>102.8</td>
<td>3.6</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>789</td>
<td>867</td>
<td>110.0</td>
<td>85.0</td>
</tr>
<tr>
<td>6. Unaccounted for</td>
<td>111</td>
<td>153</td>
<td>137.8</td>
<td>15.0</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>900</td>
<td>1,020</td>
<td><strong>113.3</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Source: Ministry of Economy, estimates as referenced in text

Georgia imports almost all of its gasoline supply (more than 90% of gasoline imports come from Azerbaijan), 100% of diesel fuel and kerosene/jet fuel, and most of the fuel oil. In 2005, customs information and Union data suggested that “official” gasoline imports constituted 338.3 thousand tons, about 5% more than in 2004. Diesel fuel imports ran in 2005 at 252.6 thousand tons, exceeding 2004 levels by 30%. At the same time, the Union believed that annual demand for gasoline is around 420,000 t and for Diesel 300,000 tons. This means that illegal imports of gasoline still make up around 20% of demand, and those of Diesel – around 15% of demand.

While this degree of tax evasion and corruption is quite high, the current status represents a huge improvement over 2000-2001, when about 40% of refined products on the market were believed to be illegal, and especially over the 90’s, when up to 80% of the refined products supply avoided either customs or the taxman. The improvement of the collection rate is evidenced by the surge in customs revenues levied on liquid fuel imports, which in 2005 reached about USD121 million, exceeding 2004 levels by almost 50%. For Diesel, the increase in collection rates was by 256% over 2004 levels. In 2006, “registered” imports, for which customs receipts exist, continued to grow at an annual rate of more than 13-14%, and customs revenue for imports of oil products were up 22.8% on an annual basis.\(^\text{108}\)

Refined products prices on the Georgian market tend to shadow prices on Mediterranean markets (Italy), but, accounting for transportation cost, customs duties and tax, are somewhat lower (by 10-15%) than they should be if all these costs are accounted. This is interpreted by the Union as evidence of continuing smuggling and tax evasion, as well as product adulteration. Union sources believe that most of the illegal supply is from Azerbaijan, where fuel is purchased and transported in trucks fitted with extra fuel tanks with Turkish and Iranian registration, from contractors on the BTC and SCP lines who are entitled to duty and tax-free imports but re-sell the fuel in Georgia, and from small primitive “refineries” along the

Baku-Supsa route that distill pilfered crude oil. The Ministry of Finance and the Union continue their effort to eradicate illegal refined products dealings on the Georgian market.\textsuperscript{109}

The market leader on the Georgian refined products market is LUKOIL-Georgia, an affiliate of Russia’s LUKOIL. LUKOIL-Georgia operates 54 gas stations in Tbilisi and other locations and has a 20-23\% market share. The company, which sells about 9,000 t of gasoline per month, in 2005 paid into Georgia’s budget more than USD21.9 million.\textsuperscript{110} The number one taxpayer in 2006, however, was Vissol Petroleum Georgia, which until mid-2006 operated under the name of Canargo Standard Oil Ltd. The company has licenses for 70 gas stations, owns and operates some 48 stations, and paid into the coffers in 2006 USD24.9 million. It has a market share of around 25-30\%. The #3 retailer is Optimum Ltd, which operates 12 stations, contributed some USD14.3 million of tax and has a retail market share of around 15\%. Other important retailers include Eco-Georgia, Rompetrol-Georgia\textsuperscript{111} and Magnat (15 gas stations each), Nukoil and Magoil (10 stations each). Overall, there are about 400 gas stations, of which 200 in Tbilisi.

Other market leaders include GT Group Ltd. (#1 importer), Sigma Ltd. (best storage facility), and GruzNeftTrans (services related to import of oil products), and Aviasazvaservice Ltd. (aviation fuel).\textsuperscript{112}

Various companies have announced their intention to enter the Georgian refined products market as well, in particular SOCAR Invest Georgia, in which 52\% are held by Azerbaijan’s SOCAR, 32\% by Georgians and the remainder by Turkish partners.\textsuperscript{113}

To improve domestic supply, the Union has suggested to the Government to look at the possibility of producing biofuels, particularly diesel fuel, and in case this is found feasible, to establish a Government-supported programme for the development of biofuels production and the promotion of investment in the sector.\textsuperscript{114}

Overall, the refined oil products market is competitive and supply is fairly reliable, even though subject to occasional hiccups due to the absence of mandatory oil stocks and problems with quality and illegal operations. Over the last few years, improvement has been quite noticeable in all of these problem areas, but much remains to be done.

**III.2.4. Natural Gas Distribution and Utilisation**

The basic law which defines the legal framework of natural gas distribution and utilisation is the Law of Georgia on Electricity and Natural Gas (1997, as revised and amended 1999 and 2005). It set the main provisions regarding natural gas supply, import, export, transportation, distribution and consumption and requires the development of the sector by abiding to the principles of market economy (Art. 1.1.). The Law also admits that the existing market structure is uncompetitive, but requires that tariffs should be cost-reflective (economically feasible, Art. 1.2.a). The Law covers all consumers (Art. 1.2.b).

\begin{footnotesize}
\begin{enumerate}
\item[110] http://au98.ru/m/183384/lukoyl_rasshiryaet_sety_azes_w_gruzii.html.
\item[111] An affiliate of Netherlands-based The Rompetrol Group N.V. (TRG).
\item[113] Day.az, 8 December 2006.
\end{enumerate}
\end{footnotesize}
The Law designates the functions and objectives of the Ministry of Energy. The Ministry of Energy is tasked with the development of policies and their implementation, of principles of regulation, and with the promotion of energy efficiency and the assurance of competition, but is required to gradually relinquish its functions of owner, operator, economic agent and regulator (Art. 1.3.).

The Law defines natural gas distribution networks as those operating at low pressure (0.005-1.2 MPa), the notion of a regulatory agency (the Georgian National Energy Regulatory Commission, GNERC), and provides definitions for a license, a reception and a supply point, direct consumer, regulation fee, natural gas, natural gas transportation system, natural gas transportation, natural gas distribution, supplier, natural gas market rules, reliability standards, market, supply and consumption rules, and retail consumer (Art. 2).

The Law deals in detail with the status and the functions of GNERC, which is defined as the entity set by the Law of Georgia on Independent National Regulatory Bodies established without state assets (Art.4.1). GNERC is tasked with:

- The establishment of the licensing rules and terms for natural gas supply, transportation and distribution, as well as for the granting, modification, suspension and modification of licenses as required by the Law of Georgia on Licenses and Permits (Art. 4.5.a);
- The establishment and regulation of tariffs for transportation, distribution, supply and consumption of natural gas (Art. 4.5.b);
- The resolution of disputes between licensees, importers, exporters, suppliers, and consumers (Art. 4.5.c);
- The control of compliance to license terms and taking measures for violations of the terms (Art.4.5.d);
- Certification (Art. 4.5.e).

Art. 5 through 21 deal with the set-up of GNERC as an independent body, including its financial independence from the government and transparency of its budgets. GNERC is funded via charging a regulatory fee levied on licensees, importers and suppliers (Art. 19).

Article 39 provides a definition of Natural Gas Supplier and its obligations, including delivery of service, development of emergency plans and payment of the regulatory fee.

Article 40 deals with the notion of a natural gas transportation license (transportation license), which is required to carry out natural gas transmission via the system. In the application for a license, the licensee must specify the route of the proposed service, the pipelines and other equipment, including reception and supply points that the licensee proposes to use. The construction of new pipelines or facilities also requires the filing of a transportation license application or its modification if one already exists. Route easements and right-of-way are dealt with in Para. 4 of Art. 39, and the obligations of the licensee in Para. 6. These include the development and maintenance of the system as required by the license, the drawing up and the public disclosure of an investment programme, the compliance to safety, technical and other requirements (including the prohibition of limitations to use) related to the system operation, delivery of service and payment of the regulatory fee.

Article 41 deals with the natural gas distribution license. Such a license is granted for a specific term by GNERC for the operation of a distribution network and the distribution of
natural gas via a particular network (Para. 1). Para. 3 deals with the obligations of the licensee, which include:

- Delivery of service, the drawing-up and public disclosure of an investment programme, the drafting and submission to GNERC for approval of service, accounting, reporting, dispatch, and consumer payment procedures (Art. 41.3a-c);
- Provision of public access on the premises of the licensee to the license and the approved tariffs, the approved service terms and conditions, the operation standards (including those for hook-up of new consumers, Art. 41-3e);
- The payment of the regulatory fee and the compliance to the requirements of the license (Art. 41-3f).

Chapter VII of the Law deals with tariffs. Art. 43 sets the tariff establishment principles, including the prevention of monopolistic practices; cost-effectiveness and assurance of a reasonable rate on return (including the attraction of new investment); the reasonable use of funds by licensees, importers and suppliers for maintenance, management and compliance to the license terms; the possibility to discontinue service in case of non-payment; price and tariff differentiation by groups of consumers, daily and seasonal variations of demand and other factors; and individual direct consumption tariffs for consumers of this type.

Article 44 deals with the tariff establishment procedures. Applications to GNERC for the establishment of a tariff must be substantiated by audit and financial information, procedures for consumer and other stakeholder participation in the process, and other appropriate information. Applications for a tariff establishment or change may be filed with GNERC by a licensee, an importer, a supplier, or a direct consumer.

A tariff must be approved within 150 days from application, with the associated cost of GNERC carried by the applicant (Art. 45).

Article 46 requires the introduction of a uniform accounting standards based on international practices (Para. 1), and the account unbundling in cases where a person holds more than one license or is engaged in other entrepreneurial activities as well (Para 2).

The current status of the domestic gas market can best be described as transitional from non-competitive to competitive, free market environment. The constraints that make the transition difficult are basically two-fold: first, between 1980 and 2006 there has been virtually no choice in primary (import) supplier, and all deliveries have been contracted with Gazprom or companies that have had its consent; second, during the 90’s a completely chaotic, non-transparent domestic market was characterised by non-payment, corruption, accumulating debt to suppliers and a critical degradation of the gas supply system. The adoption of the electricity and Natural Gas Law aimed precisely at creating the basic prerequisites for stability of natural gas supply, promotion of investment in rehabilitation and development of the gas supply system, and transition to competitive markets of all types – import, wholesale, and retail.

Several technical assistance programmes have looked at the Georgian natural gas sector and suggested solutions and strategies for dealing with the most urgent problems. In 1996-1999 Gaz de France audited the gas transmission system under a contract with EU’s INOGATE programme. Results indicated that the entire pipeline system, including two compressor stations that are inoperative since 1992-1993, requires urgent rehabilitation. Flaws include serious deficiencies in design (lack of reinforcement fixtures on slopes, absence of supports on above-ground sections, etc.), serious deficiencies in construction (sections of pipeline laid on improper ground such as rocks, pipe trenches that are not backfilled), deterioration of
facilities (escaping gas all valves; defective or dismantled actuators, inoperative cathodic protection system, torn corrosion protection layers, destroyed fencing, etc.).

The deficiencies of the gas delivery infrastructure prevent the operation of the system at design pressures and, in some areas, have rendered the system completely inoperative. Gaz de France recommended a 4-stage, USD91 million rehabilitation programme focusing on the transborder lines, but most recommendations were never implemented.

In 1997, a more detailed study was done by the International Energy Centre (ENECO) in Tbilisi, which looked at the rehabilitation of the entire main pipeline system of Georgia, including compressor stations and other infrastructure. The findings put the cost of the rehabilitation of the lines only at USD178 million, and the total cost of rehabilitation at USD213 million. Urgent work, to be done during four years, was estimated to cost USD79 million, of which work on the damaged lines USD49.3 million. Again, no action on the findings was undertaken.

Yet another assessment was carried out in 2003 by RAMBOOL. The outcome was not surprising – the entire Georgian gas transmission system was found to be in a poor condition. No scheduled system maintenance has been performed since about 1990. Most, if not all, cathodic protection systems have been stolen and most lines are corroded. No general or preventive maintenance has been carried out either, and only the most unavoidable and urgent “firefighting” action has been undertaken. A quarter of the pipelines are already out of operation and beyond repair, another 50% are operated at only 7 bars to reduce gas losses from the. One-tenth of the main North-South line, which until 2006 was the only gas supply line into the country, must be replaced. The system can only operate at about 30% of its design capacity, and its lifespan, if no action is taken, is 5-7 years.

RAMBOOL recommended only partial rehabilitation and salvage work needed to bring the system to a status where it could operate at 35 bar, meet demand in Georgia and transit to Armenia. The cost of such a “salvage” programme was estimated at €35 million. It is essentially this programme that is currently in implementation on the main lines with assistance from the US Millennium Challenge Georgia Fund. Work began in 2007 and is to be completed in 2008. The main beneficiary is the Georgian Oil and Gas Corporation (GOGC), the owner of the main (high pressure) lines in the country. GOGC is also in charge for expanding the availability of gas in the country, security of gas supply and diversification of supply routes.

Until the early 90s, a vertically integrated government controlled monopoly (Sakgazi) combined gas supply, imports, pipeline operation and distribution throughout Georgia. In 1996, the management of gas distribution companies was transferred to the relevant municipalities, and some 40 local gas distribution companies were established. In 1996, Russia’s Itera became the sole supplier of gas to Georgia. Soon afterwards, Itera purchased five municipal gas distribution companies in privatisation deals with municipalities.

In 1997, Presidential Decree 206 established Georgia International Gas Co. (GIOC, now merged into GNOC), which entered into various MoUs with Itera for the establishment of joint ventures, including one in 2002 that would have merged all the gas distribution companies in the country in a venture owned 51% by Itera. In the meantime, Itera placed its newly acquired distribution assets in Georgia under the umbrella of a single entity where other parties also hold minority interest, and somewhat misleadingly labeled it Sakgazi, a name harking back to the soviet-times Sakgazi monopoly. In 1998, seven more municipal gas companies were sold to the Itera-controlled Sakgazi, bringing the total number of distribution companies controlled by Itera to 12.
Itera has also taken control over several industrial facilities including the cement plant in Rustavi and a small combined heat and power plant in Tbilisi. Sakgazi is one of the three major importers of gas in the country, along with Energy Invest (which operates the Azoti fertiliser plant and a power station near Tbilisi) and Tbilgazi, the gas distribution company of Tbilisi.

Tbilgazi is the largest distribution company. In 2006, it was sold for USD12.5 million to KazTransGaz (KTG), a division of KazMunaiGaz, the national petroleum company of Kazakhstan. KTG took over some USD120 million in debt and also promised to invest USD100 million in the rehabilitation and expansion of the gas distribution system.

Tbilgazi is probably one of the distribution systems that are in a relatively good shape. Still, as of January 2005, only 1,209 km of pipes were functional (62.3% of total). The existing pressure regulation stations and other gas flow controlling equipment are not up to any standard, be it Russian, US or ISO. A reason for the insolvency of Tbilgazi is the extremely inefficient and inaccurate system of accounting gas consumption. According to some estimates, if a working system were to be deployed, it would probably indicate a 50-90% increase in (actual) consumption. Where used, gas meters fail to meet standards and can easily be manipulated. Apart from causing very high “apparent” gas loss in the system; such manipulation is dangerous for the customers. Gas meters should be calibrated at least once per six years, but are not.

Gas loss in the thoroughly degraded and greatly damaged system of Tbilgazi is estimated at more than 260 million m3 per year, or up to two-thirds of total gas supplied, which was 380 million m3 in 2005. But while the technical loss due to the system degradation is in the range of 12%, the remaining 48% (some 220 million m3) are caused by non-payment and outright stealing. And yet this is actually an improvement over 2001-2002, when more than 80% of the gas supplied was either not paid for or “disappeared”.

**Figure 23: Georgia’s Gas Supply System**

Source: US AID (Advisory Assistance to the Ministry of Energy of Georgia, P.E.D. IQC – Contract No. DOT-I-00-04-00020-00 Task Order #800: Natural Gas Strategy for Georgia)
Additional problems arise by the fact that an increasing number of households are using gas for space heating, a service that the mains were never designed for (they were only supposed to feed gas for cooking and occasional water heating). To cope with increased demand, pressure had to be increased, which has not only led to even greater gas loss from leaks, but also to a number of accidents (more than 230 reported in 2002) and fatalities (52 over 2002-2003). Official data indicates that during just the last two weeks of December 2005, there were 33 cases of gas poisoning, of which five fatalities.

Tbilgazi has carried out assessments of a rehabilitation programme, and similar studies have been undertaken by TAHAL Ltd. (Israel) in cooperation with Gastec Holding N.V. (the Netherlands). These assessments indicate that the cost of a phased rehabilitation programme, to last a decade or more, would be in the range of USD64-84 million. With the sale of Tbilgazi to KGT, hopes are that funds will be available to start implementing the rehabilitation programme of the capital’s gas distribution system.

In other municipalities, the status of the gas distribution systems is similar to that of Tbilgazi or worse, with some locations completely lacking any service for many years. There are plans to re-connect some townships and also to build new gas supply and distribution infrastructure in the southeast, where the SCP could provide convenient access to high pressure gas lines (cf. Fig. 21 and 22). However, even after the adoption of a modern legislative framework for the gas sector of the country and the establishment of its institutional framework, including a functional independent regulator, it is obvious that the restructuring of the gas sector on competitive market terms is in its early beginning. As gas from other foreign suppliers apart from Russia becomes available, Georgia should use the opportunity and proceed from emergency and stop-gap measures to the actual implementation of the provisions of the legislation and the gas sector expansion plans.
III.3. Coal

III.3.1. Reserves

Most of Georgia’s coal reserves are of bituminous coal (hard and brown) at three deposits (Tkibul-Shaori, Tkvarcheli, and Akhalcikhe). The largest deposit is at Tkibuli (268 million t of proven reserves and 700 million to potential reserves, 80% of the country’s total). Tkvarcheli is a small mine in Abhazia with reserves of some 20 million t, including coking grades. Akhalcikhe coal is of lower grade and deposits are in complex geological environment, with reserves around 76 million t.

Indications exist that coal deposits may be found elsewhere in the country, but exploration has been discontinued since the 80s.

III.3.2. Mining and Consumption, Sector Management and Market Structure

Georgia used to produce up to 3 million t of coal per year and consume about 4 million t per year, but operational and management problems have caused the virtual cessation of coal mining in the country. By the mid’90s, available mine capacity was down to about 300,000 tpy. All of the coal is mined underground.

Currently the only active coal mining operation is the government-controlled TkibulNakhshiri Co., part of the state coal company SakhNakhshiri (established in 1997 by Presidential Decree No. 457) which took over all coal mines in the country. In 1998, Presidential Decree 196 foresaw the unbundling of SakhNakhshiri by splitting it into entities based on the existing coal mines and eventually privatising the unbundled assets.

TkibulNakhshiri Co. has two functional mines operating at a minimum scale, two mothballed mines and one partially constructed mine. The company’s reserves are estimated at 50.8 million tons of coal. The operation is unprofitable and is supported by government subsidies. Annual output is in the range of 10 thousand tons or less.

The main consumers of coal used to be the Zestaponi Iron and Steel Works and several tea processing facilities. Minor consumers included brick and cement factories and the Georgian Railways. At this time, coal is only consumed by several small local enterprises in Western Georgia.

Despite all the difficulties of economic, operational and managerial nature, the coal sector of Georgia is still seen by the government as a potentially important contributor to the country’s energy security and economy. Hopes are that the domestic market will expand and that export markets could also become available in Armenia and Azerbaijan. For the time being, however, no practical action has been taken, primarily due to lack of interest form investors and the limited government funds available for reorganising and revitalising the coal sector.115

III.4. Electricity

III.4.1. Power Sector Overview, Generation Capacity

The power sector is governed by the Law on Electricity and Natural Gas (1997, as amended 1997, 1999, 2004, 2005 and 2006, 2007). It covers electric power generation, transmission, dispatch, distribution, import, export and consumption. The Law requires the development of the sector by abiding to the principles of market economy (Art. 1.1.). In its objectives, the Law lists the promotion of domestic and foreign investment in the power sector (Art. 1.2.c).

The Law assigns to the Ministry of Energy of Georgia the functions of developing overall sector policies and guidance, but relieves it from ownership, operational, economic and regulatory tasks (Art. 1.3.a). The Ministry is responsible for setting the principles of regulation of generation, transmission, dispatch, distribution, import, export and consumption, including direct consumer-related activities, in an environment of transparency and fairness leading to the establishment of an independent power sector regulation (Art. 1.3.b).

The Law defines the content of the terms transmission, transmission network (lines exceeding 110 kV except those of 35 and 110 kV listed in a license), distribution network (0.4-110 kV except those listed in a license), power distribution, power dispatch, license, licensee, reception point, supply point, direct consumer, regulatory fee paid to the independent Georgian National Energy Regulatory Commission), generation, exporter and importer, the Electricity System Commercial Operator, Power (Capacity) Market Rules, operation of grids in a parallel mode, electric balance overflow, reliability standards electricity(capacity) supply and consumption rules, and small capacity power station (as defined in the Energy Policy) (Art. 2).

The Ministry of Energy is the entity in charge for drafting the national energy policy and submitting it to the Parliament for approval, and, upon approval, for developing and implementing short- medium- and long-term strategies and priorities for the power sector of the country (Art. 3.1), but not for ownership, regulatory or operational activities (Art. 3.2.). The Ministry must approve by Orders the national electricity (capacity) balance the Electricity Market (Capacity) Rules, Natural Gas Balance, Natural Gas Market Rules, and regulations for maintenance, organisation and operation of power facilities and other technical assets (Art. 3.3).

Should the National Policy indicate so, the Ministry may take a decision on deregulation or partly deregulation (Art. 3.4.). In these activities, the Ministry must comply to the public administration procedures, including participation of commission members or other interested parties (Art. 3.5).

The Law defines the Georgian National Energy Regulatory Commission (GNERC) as the entity foreseen in the Law on Independent National Regulatory Bodies (Art. 4.1). GNERC is the entity which grants licenses for activities in the power sector (Art. 4.4), establishes licensing terms and rules and grants, modifies and revokes licenses in compliance with the Law on Licenses and Permits, establishes tariffs for generation, transmission, dispatch, distribution, import and consumption of power, resolves disputes within its competence, controls observance of license terms, and issues certificates in the energy sector (Art. 4.5).

Chapter IV (Art. 22 and 23) of the Law deals with the status, functions and principles of operation of the Electricity System Commercial Operator (ESCO), as a legal entity of private law – limited liability company, 100% of ESCO shares are owned by the Ministry of Economic Development. ESCO buys and sells the balance electricity and reserve capacity in order to ensure the electricity supply/demand balance.
Main functions of the Commercial System Operator are as follows:

- Purchase and sale of balance electricity and capacity (including making medium and long term import/export contracts);
- Provision of reserve capacity for the electric system in compliance with the rules under this Law and Electricity (Capacity) market rules;
- Provision of relevant information to the Dispatch Licensee necessary for planning electricity and capacity supply and consumption;
- Creation and Maintenance of a data base including an integrated register for recording wholesale purchase and sale;
- Determination of amounts of power sold and purchased by the electricity sellers and buyers and submission of information required for financial settlement according to the data received based on the subparagraph (h), 3rd paragraph, clause 35 of this law;
- Implementation of other functions stipulated under this Law.

Chapter V (Art. 24-32) lists requirements specific to licenses and licensing rules. Licenses are required for generation, dispatch, transmission and distribution of power, except self-generators not connected to the transmission and/or distribution net who use the generated power themselves (Art. 24) as well as deregulated plants below 10MW, which do not need license and tariff setting from GNERC (Art 2, z6). Documents and procedures needed for licensing are prescribed in Art. 25-27. License disputes, modifications and revocations are dealt with in Art. 29 and 31. The separate types of licenses in electricity sector and the procedures and rules related to them are listed in Chapter VI (Art. 33-38).

Article 28 requires that a licensee must meter total power flow across its facilities and make the information “available”. Electricity System Commercial Operator shall and the Ministry and GNERC may inspect meters in compliance to the Electricity (Capacity) Market Rules (Art. 28.1).

The sale and purchase of power and the transmission and dispatch of power must be carried out under direct contracts or via Electricity System Commercial Operator (Art. 22.2).

Chapter VII deals with the operation of power grids in parallel mode (Art. 411-433). Contracts for parallel operation must be signed on the condition of zero balance overflow of power upon the expiry of the contract. Such activities are not considered import or export or economic activity and do not require licensing, but must be pre-cleared with Electricity System Commercial Operator and comply with Electric Power (Capacity) Market Rules and Balances.

The authority of the GNERC is to establish tariffs (Art. 42) and tariff establishment principles, procedures, charges for pricing and, the requirement to follow uniform internationally acknowledged principles of accounting are set in Chapter VI.

III.4.2. Generation and Consumption

Generation in Georgia is at hydroelectric and thermal power plants. There are 60 HPP, of which 19 with installed capacity of over 10 MW and about 80 smaller plants. Total installed HPP capacity is around 2.6 MW. There are no nuclear power facilities in Georgia.

There are six stand-alone large hydroelectric plants with the remaining large plants grouped in five cascades. The five largest HPP represent some 70% of the total and the biggest (Enguri, 5x260 MW) supplies about 35% of Georgia’s domestic generation. Enguri is five times the
size of the next largest plant complex at Khami. The Enguri reservoir is approximately 5 km from Jvari village and the powerhouse is 15 km from the dam at Saberio village. The Enguri complex lies along the border with Abkhazia, a location which has complicated plant operations considerably.

Khrami consists of two hydro power plants with a combined capacity of 223 MW. Both power stations are situated in the south of Georgia, approximately 120 km west of Tbilisi. Khrami-I is supplied by the Tsalka reservoir while Khrami-II takes its water from the discharge of Khrami-I as well as the Khrami, Chochiani and Karubalaki rivers. Khrami-I was commissioned in 1947 and Khrami-II in 1963.116

Thermal power plants have installed capacity of around 1,085 MW, most of it at Gardabani near Tbilisi (around 975 MW) which in 2002 split in two after partial privatisation. Tbilsresi currently operates only no. 3-4 units out of the 8 units, with nominal capacity of 270 MW (1x135). Mtkvari operates the newest units 9 and 10 (300 MW each), but unit 10 was damaged in 2001 and is considered beyond repair. There is a potential increase of 4x135 MW in case there will be rehabilitation for units 5, 6, 7 and 8, against the backdrop of a huge investment need. The leading importer of gas from Russia via the NSCP is Energy Invest Co., the owner of a thermal power plant near Tbilisi and the Azoti fertiliser plant in Georgia. In 2006, Energy Invest imported from Russia about 0.45 bcm, and intended to import up to 0.6 bcm in 2007, or 29-35% of total demand.

In addition, there is a coal-fired power plant at Tkvarcheli (Abhazia) which was damaged by war and is believed to be not worth repairing, cogeneration plants associated with industries (the Iron and Steel Works at Rustavi, the Batumi refinery), and a few small thermal power cogeneration and gas turbine plants elsewhere in the country. Of the TPPs, only the two Gardabani plants (Tbilsresi and Mktvari) operate at significant load factors.

During the Soviet era, Georgia’s generation assets became integrated into the Trans-Caucasian Grid (TCG) leaving the country ill-prepared for the abrupt dissolution of the heavily centralised electric power system of the former Soviet Union. A 500 kV line into Georgia from Russia was a key legacy of the TCG era. Maximum generation was achieved during the 80’s (14-15 billion kWh/year), but this was not sufficient to meet demand and by 1990 Georgia was a net importer of power (net about 3 billion kWh/year).117

A period of rapid deterioration of generation facilities lasted through the 90’s, with many plants rendered inoperative or crippled to a fraction of nameplate capacity. In 1994-5, the power system collapsed. Blackouts were common everywhere, but the less lucky did not have power at all throughout the year. Where and when power was available, it was of inferior standards (41-42 Hz instead of 50 Hz). Shortages prompted local governments and consumers to lobby by all means available to be hooked to the system at the expense of others, and corruption spread throughout. All this occurred despite the fact that per capita energy consumption in Georgia (pre-crisis) was 10-12 lower than in the US, and in 1995 it was 17-18 times less (20 million BTU vs. 346 million BTU in the US).

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117 Imports of 4.3 billion kWh and exports of 1.2 billion kWh in 1990.
Table 23: Main Power Plants and Power Balances in Georgia

<table>
<thead>
<tr>
<th>Power plants</th>
<th>Installed capacity, MW</th>
<th>Available capacity, MW</th>
<th>Power generation / supply, million kWh</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2002</td>
<td>2003</td>
<td>2004</td>
</tr>
<tr>
<td>A. Hydropower plants</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Enguri</td>
<td>1,300</td>
<td>800</td>
<td>2989.4</td>
</tr>
<tr>
<td>Vardinili Cascade</td>
<td>220</td>
<td>100</td>
<td>509.9</td>
</tr>
<tr>
<td>Lajanuri</td>
<td>112.5</td>
<td>70</td>
<td>133.9</td>
</tr>
<tr>
<td>Shaori</td>
<td>38</td>
<td>38</td>
<td>146</td>
</tr>
<tr>
<td>Khrami 1</td>
<td>113</td>
<td>100</td>
<td>151.6</td>
</tr>
<tr>
<td>Khrami 2</td>
<td>110</td>
<td>110</td>
<td>210.4</td>
</tr>
<tr>
<td>Vartsikhe Cascade</td>
<td>184</td>
<td>120</td>
<td>840.8</td>
</tr>
<tr>
<td>Rioni</td>
<td>48</td>
<td>48</td>
<td>226.6</td>
</tr>
<tr>
<td>Atshesi</td>
<td>16</td>
<td>16</td>
<td>37.2</td>
</tr>
<tr>
<td>Dzevrula (Tyibuli)</td>
<td>60</td>
<td>80</td>
<td>202.6</td>
</tr>
<tr>
<td>Ortachala</td>
<td>18</td>
<td>18</td>
<td>92</td>
</tr>
<tr>
<td>Zhinvali</td>
<td>130</td>
<td>80</td>
<td>476.1</td>
</tr>
<tr>
<td>Zahesi</td>
<td>37</td>
<td>30</td>
<td>192.5</td>
</tr>
<tr>
<td>Gumati I-II</td>
<td>67</td>
<td>50</td>
<td>181.9</td>
</tr>
<tr>
<td>Total listed HPP</td>
<td>1,155</td>
<td>1,660</td>
<td>6,390.9</td>
</tr>
<tr>
<td>Other HPP plants</td>
<td>130</td>
<td>100</td>
<td>2,025.5</td>
</tr>
<tr>
<td>Total HPP</td>
<td>1,285</td>
<td>1,760</td>
<td>8,416.4</td>
</tr>
</tbody>
</table>

B. Thermal power plants

<table>
<thead>
<tr>
<th>Power plants</th>
<th>Installed capacity, MW</th>
<th>Available capacity, MW</th>
<th>Power generation / supply, million kWh</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2002</td>
<td>2003</td>
<td>2004</td>
</tr>
<tr>
<td>Gardabani-Tbilsresi (gas, fuel oil)</td>
<td>270</td>
<td>270</td>
<td>245.8</td>
</tr>
<tr>
<td>Gardabani–Mtkvari (former Tbilsresi Units 9 and 10, gas)</td>
<td>300</td>
<td>250</td>
<td>267.7</td>
</tr>
<tr>
<td>Gas Turbine</td>
<td>100</td>
<td>100</td>
<td>-</td>
</tr>
<tr>
<td>Total thermal</td>
<td>670</td>
<td>620</td>
<td>513.5</td>
</tr>
<tr>
<td>Total domestic</td>
<td>8,929.9</td>
<td>8,834.5</td>
<td>8,511.8</td>
</tr>
<tr>
<td>Imports</td>
<td>739.7</td>
<td>1,079.8</td>
<td>1,288</td>
</tr>
<tr>
<td>Exports</td>
<td>-251.6</td>
<td>-235.5</td>
<td>-70.9</td>
</tr>
<tr>
<td>Total supply / domestic consumption (including losses)</td>
<td>9,418</td>
<td>9,678.8</td>
<td>9,728.9</td>
</tr>
</tbody>
</table>

Source: Ministry of Economic Development of Georgia

In 2006 power generation on several HPPs is reduced due to the rehabilitation process.

Despite recent effort to remedy the situation, generation and many other parts of the system are still in precarious condition and require huge investment for rehabilitation and upgrades. A number of projects have been completed or are under way. Mtkvari-1 (unit 9) was overhauled with funds from the ERBD and Germany’s Kreditanstalt fur Wiederaufbau (KfW). The World Bank and KfW provided about USD60 million to rehabilitate Mtkvari-2 (unit 10)
while the Japanese Overseas Economic Cooperation Fund (OECF) provided a USD45 million credit for the rehabilitation of the Laganuri and Khrami-II hydro plants, the dispatch centres in Tbilisi and Kutaisi, and associated communications systems. The USD23 million rehabilitation programme at Khrami-II was undertaken by Italy’s Ansaldo Energia under a loan from the Japanese government.

In 2001, the World Bank coordinated a major sector assistance project mainly for installation of communication system, Scada system management contract for the wholesale market, worth USD56.6 million comprised of a USD27.4 million credit from the International Development Association (IDA), and monies from KfW (USD11.4 million), the EBRD (USD900,000), and the government of Georgia (USD16.9 million). In October 2005, Russia’s Power Machines Group signed a USD2.7 million contract for turbine repairs at Gumati-1.

In 2006, a new gas turbine plant was commissioned at Gardabani (Tbilisresi) by Energy Invest, an obscure investment vehicle of apparently Russian origin, with loans from United Georgian Bank and Russia’s Vneshtorgbank. The plant uses two 55 MW Pratt&Whitney FT-8 gas turbines.

A smaller gas turbine plant was under construction in 2006 at Kobuleti (Adjara) by Adjaran Electricity Co., owned by the London-based Greenoak Group that also owns the Batumi Oil Terminal. The USD50-million plant will supply port terminal operations and the local grid and consists of four 15-MW dual-fired GTD-15 turbines by Ukraine’s Zorya-Mashproekt installed by Petroleum Capital Equipment Co, a turnkey contractor. The design of the plant allows for a future conversion to combined cycle generation.

Georgia also hopes to tap its unused hydropower potential, which is estimated at more than 100 billion kWh/y, of which up to 32 billion kWh/year is economically feasible and 15 billion kWh/year is accessible on sites where at least some preliminary work has already been done. The largest such site is the 700 MW Khudoni plant upstream from Enguri, where construction began in 1982 but was stopped in 1989. The plant is about 25% ready and is said to need USD500 million to complete. In 2006, the Georgian Government signed two agreements worth USD5.6 million with the World Bank to fund re-starting construction and assessing transmission connection options for Khudoni.

In November 2004, the USD27 million, 24 MW Khador HPP in the restive Pankisi Gorge (Kaheti region) went commercial, operated by Eastern Energy Corporation, where Chinese companies hold 93%. The Georgian-Chinese venture is between the Sichuan Electric Power Import and Export Co. and Peri (Georgia), which had done the feasibility study. Sichuan Electric plans to operate the plant until 2029. Sichuan Electric intends to build a second, USD10-million, 9.3 MW HPP, also to be located in the Kaheti region.

In 2006, the Government invited expression of interest in three large HPP on the Rioni river, the Namakhvani (250 MW), Tvisi (110 MW) and Zhoneti (110) MW HPP.

Other possible generation expansion projects include a 1,000 MW IPP thermal generation project, part of a 1998 MoU between the Ministry of Fuel and Energy and IDM Energy Corp. (US), which looked at eight sites but did not act on any, a 250 MW coal-fired plant at Tkibuli, and retrofitting older units at Gradabani that are inoperative now with gas turbines.118

Distributed generation has been making significant inroads in Georgia with the effort of Northern Power, a division of the Vermont-based Distributed Energy Systems Corp., and the

118 Ibid.
BTC Co. In 2006, Northern Power signed a third contract with BTC for assembling two Kohler gensets and 4,000 gallon fuel tanks near Borjomi at Kodiani, to sew drainage equipment on the BTC line. Northern Power has already installed 38 such plants on the BTC oil pipeline between Baku and Georgia.119

The pattern of consumption also underwent radical change during the 90’s, with industrial demand rapidly on the decline and residential and commercial consumption steady or even growing. As a result, industry’s share in consumption declined from 36% in 1989 to 16% by 2005, while the share of R&C demand increased from 14% to 26% during that time. Table 24 lists data on power demand in recent years.

On a regional breakdown, the largest power consuming areas are the capital (served by Telasi) with a market share around 30% and Abkhazia (served by Chernomorenergo) with a market share around 15%. United Distribution Co. has a market share of around 25%, but serves all of Georgia’s regions except Tbilisi, Adjara, Kakheti and Abkhazia.

| Table 24: Electricity Consumption by Sector (million kWh per year) |
|-----------------|--------|--------|--------|--------|
| Industry, total | 1,104  | 1,130  | 1,151  | 1,221  |
| Metallurgy      | 500    | 488    | 477    | 465    |
| Chemistry, refining, petrochemicals | 244 | 267 | 314 | 395 |
| Non-metallic sectors | 163    | 151    | 116    | 105    |
| Other industries | 198    | 221    | 244    | 256    |
| Transportation, total | 546    | 535    | 570    | 593    |
| Air             | 35     | 46     | 35     | 46     |
| Road and rail   | 442    | 419    | 454    | 442    |
| Other           | 70     | 70     | 81     | 105    |
| Other sectors   | 5,102  | 5,186  | 5,267  | 5,593  |
| Agriculture     | 256    | 279    | 290    | 326    |
| Services, commercial | 186    | 198    | 221    | 232    |
| Households      | 4,570  | 4,605  | 4,640  | 4,895  |
| Other           | 93     | 105    | 116    | 140    |
| Total           | 6,752  | 6,851  | 6,988  | 7,407  |


### III.4.3. Electricity Transmission and Distribution Infrastructure

In the early 90s, the power transmission system of Georgia consisted of over 98,000 km of lines. High-voltage transmission lines (over 35 kV) included 572 km rated at 500 kV, 21 km rated at 330 kV, 1,456 km rated at 220 kV, 4,940 km of 110 kV lines, and 3,502 km of 35 kV lines.

119 CE/FSU Power Monitor, 4 October 2006.
Distribution nets included 20,371 km of 10 kV lines and over 67,000 km of 0.4-6 kV lines (2,520 at 6 kV and over 64,000 km at 0.4 kV). There are also some 1,750 km of underground cables.

There are two 500/220 kV substations, fifteen 220/110 kV substations, one hundred eighty-three 110/35 kV stations and more than two hundred eighty 35/10 kV substations, with a total capacity of 12,885 MVA.

Interconnections to neighbouring countries include a 500 kV line and a 220 kV line to Russia (via Abkhazia), a 330 kV line to Azerbaijan, and 220 kV lines to Armenia and Turkey, 110 kV connection line to Russia, 110 kV line to Armenia.

The backbone of the system 500 kV transmission line covers entire territory of Georgia. The route is Russia-Enguri-Zestaphoni-Ksani-Tbilsresi (Gardabani). It has been almost a year since the 500 kV line connecting Georgia with Russia has been disconnected and frequency regulation is achieved through the parallel regime with Azerbaijan. During the isolated functioning of the system as RPM auto-governors are out of order at all HPP and on top of that there is no hot or cold reserve capacity in the system, making it extremely unstable.

During the last few years, some rehabilitation work has been done on the transmission and distribution system, but with no substantial impact on the system reliability. Parallel operation was restored with Russia in 2000, imports from Armenia became possible, the lines to Turkey were rehabilitated and the 220 kV Salkhino line to Russia was put back in service. However, maintenance of the transmission network is still not carried out properly, and the dispatch supervision automatic equipment dos not meet even minimum standards. On top of that, some 35, 110 and 220 kV transmission lines and substations have been completely or partially looted, most of the 220-500 kV relay protection and automation is obsolete, rapid-action differential-phase protection is inoperative, and only standby protection is functional. The system still has no emergency capacity and stand-by equipment and no automatic reconnection equipment.

Figure 25 illustrates the outlay of Georgia’s electricity transmission system.

Figure 25: Georgia’s Electricity Transmission System

Source: Ministry of Economic Development of Georgia
The dispatch centre in Tbilisi controls power plants over 10 MW, all transmission lines over 110 kV and some 110 kV lines, and lines to neighbouring countries. There are twelve area control centres controlling power plants of 10 MW or less, most 110 kV lines and all 35 kV lines. The area control centre in Kutaisi has some enhanced functions covering West Georgia. Lines of voltage lower than 35 kV (10 kV and less) are controlled by distribution control centres.

In 2007, the State Power Grid of Georgia intends to rehabilitate the 200 kV Alaverdi transmission line together with the Gldani, Marneuli, Lisi and Digomi high-voltage substations with a €10 million credit from Germany’s KfW and Power Grid’s own funds.

Until mid-90s, the entire system except the distribution net in Tbilisi (“Telasi”) was owned and operated by the then-existing vertically integrated monopoly Sakenergo, which until 1990 operated as a part of the Trans-Caucasian Grid (TCG) covering Georgia, Azerbaijan, Armenia and parts of Southern Russia. There used to be a regional dispatch centre in Tbilisi for the TCG, which is currently inoperative.

By the mid 90’s, there were two major power companies in Georgia, both government-controlled: Sakenergo-Generatsia (generation) and Sakenergo-Gadatsema (transmission). Four service companies were also established, mainly to perform jobs for Sakenergo-Generatsia. Apart from Telasi (Tbilisi Distribution), there were 71 regional distribution networks, 51 of which were turned to municipalities and twenty controlled directly by the Ministry of Fuel and Energy.

More than 90% of the high voltage network (35-110-220-330-500 kV) transmission lines and substations came gradually under the management of two licensees: the Georgian State Electro-System Ltd. and Sakrusenergo Ltd., a private entity 50%/50% owned by Georgian and Russian sides.

Georgian State Electro-System Ltd. was established in 2002 by merging JSC Electrofadatsema (grid operator) and Electrodispatcherizatsia-2000 (dispatch). A 5-year management contract for the merged company was awarded to ESB International (Ireland), which took over on March 3, 2003. The company manages the 35-110-220 kV transmission lines (except “Adjara”) and the 35-110-220-500 kV substations. Sakrusenergo Ltd. manages the 500 kV and 330 kV transmission lines and the 220 kV “Adjara” line.

In 2005-2006 work began on the 500 kV line and substations. For the purpose, Germany’s KfW extended a €12.5 million loan, to be used for the installation of automatic protection devices and the partial rehabilitation of the Zestafoni substation. Fichtner was selected for the preparation of the tender documentation, and Siemens won the tender. Project was commissioned in 2006.

In addition, US AID extended USD27.4 million to Georgian State Electro-System Ltd. for installation of equipment in support of the creation of the Georgian electricity wholesale market. The funds will be used to rehabilitate the company’s metering and telecommunication facilities, as well as to repair metering at the balance division points between the Georgian United Distribution Co. and Georgian State Electro-System Ltd.

The existing five distribution companies are the following:

- Telasi, operating in the capital – Tbilisi. The company is the largest distributor of electricity in the country, with about 30% market share. In January 1999, AES Corp. (US) acquired 75% of Telasi and took over management, but re-sold Telasi in July 2003 for USD83 million to RAO UES (Russia);
• The regional distribution companies of Adjara and Kakheti, all of which have previously been offered for privatisation. In mid-2006, the bankrupt Kakheti was sold to USD5.01 million to TBC Energia, a Georgian company;

• Chernomor-energo, which operates in the break-away region of Abkhazia outside Georgian control;

• United Distribution Co. (UDC) and the regional distribution company of Adjara cover all regions of Georgia outside the area of the other four companies with a coverage of nearly 70%. In February 2007, UDC and the regional distribution company of Adjara were sold to Energo-Pro, a Czech company, in a USD132 million deal, which also included the sale of six HPP with an installed capacity of 362 MW.

About 60% of the electricity is distributed by the distribution companies, up to 22% of electricity is consumed by direct customers (large companies consuming more than 30 GWh/Y), and some 15% is supplied to the autonomous republic of Abkhazia, which is out of the control of the Georgian government. The collection of payments from direct customers has been sorted out and is almost 100%. Collection on power supplied to Abkhazia is hardly ever done. In the rest of the transmission and distribution network, losses still plagued Georgia as of 2005, mostly due to non-payment and illegal hook-ups (“commercial” loss, about 20% of total electricity supplied), but also to “normative” or “technical” loss believed to be caused by the system itself. The regulatory rate for the “normative” loss is 4.41% of electricity supplied”.

III.4.4. Privatisation and Restructuring in the Power Sector

III.4.4.1. Sector Structure and Management, Pricing Policies

Policy Principles

The energy sector policy (as outlined in the Main State Policy Directions in the Energy Sector, cf. Attachment 2) prioritises the efficient use of electricity and the substitution of other sources of energy for electricity where it is used for space heating. The document requires increasing energy (electric power) efficiency in the industrial and household sectors, and devising and implementing appropriate ways of using heat supply, co-generation systems, and renewable energy resources instead of electricity, where possible.

A heavy emphasis is placed on the improvement of the power system reliability and security, which should be achieved by the following measures:

• Refurbishing and rehabilitation of existing facilities:
  – In the first instance, rehabilitation of the existing hydro power plants;
  – Rehabilitation of the existing thermal power units and introduction of modern technologies such as combined cycle gas turbines;
  – Complete rehabilitation of the existing connections to the power systems of the neighbouring countries;
  – Rehabilitation of the high voltage transmission network and dispatch control system.

• Construction of new facilities:
  – Immediate deregulation of small (less than 10 MW) HPP (completed, Order #68 of MOE, dated 2 August 2006);
- Phasing out of the use of thermal generation and imported power in base load mode, and replacing these sources with hydro generation for base load demand, including by the construction of new HPP;
- Use of alternative energy / electric power resources in a way that places traditional and alternative energy resources on an even playing field;
- Providing reserve capacity in high-voltage transmission lines connecting West and East Georgia and construction of new facilities in order to assure energy system stability;
- Construction of new high-voltage power transmission lines to neighbouring countries;
- Operation of the power system in parallel mode with the power systems of the neighbouring countries, whenever technically feasible;
- Expansion of the Trans Caucasian Energy Corridor.

• Provision of reserve system capacity, by mandating that all wholesale buyers of electricity maintain (purchase) reserve capacity of at least:
  - 10% during 2006-2009, from domestic or imported sources;
  - 10% during 2010-2012, including at least 5% from domestic sources;
  - 10% during 2013-2015, entirely from domestic sources;
  - 15% during 2016-2019, entirely from domestic sources.

• Improving metering, by installing full metering at the level of communities (in large cities first), to be followed by complete individual metering in electricity distribution companies; indeed, individual metering has already been completed in all of the big cities and is expected to be finalised as for the remaining countryside areas by 2008;

• Attraction of domestic and foreign investment by:
  - Developing the appropriate legal and economic environment for attracting investment, via the following actions:
    ◆ Reduction of the number of required licenses and permits to a minimum, and maximum simplification of the procedures for issuing licenses;
    ◆ Deregulation of power plants commissioned after the 1 of January, 2007.
  - Implementing transparent privatisation in the energy sector so that reliable power supply to end consumers could be ensured, defining and differentiating the rights and the responsibilities of stakeholders (state vs. investor) involved in the privatisation process;

• Achieving economic stability of the sector, by the following means:
  - Liberalisation and deregulation of the sector, development of competition;
  - Restructuring of the commercial and economic relations, including:
    ◆ Introduction of direct contracts between power generators and wholesale electricity buyers;
    ◆ Implementing debt settlement measures to relieve the energy sector of debt accumulated in previous years;
    ◆ Enforcement of Electricity (Capacity) Market Rules;
• Developing and implementing sound tariff policies, including by tariffs that protect customers from monopolistic prices and at the same time assure the long-term electricity system development in a financially and technically feasible manner.

- To achieve these goals, the tariff methodology may include (depending on the type of customers) seasonal tariffs, peak load (day and night) tariff, step tariffs (based on consumption volume), long-term pre-set tariffs (including marginal tariffs), and marginal tariffs.

- Seasonal and peak load (day and night) tariffs should be based on the principle of neutrality, i.e. their use should not be mandatory for electricity sellers and consumers and only apply as agreed between the seller and the consumer;

- The use of neutral step tariffs (based on consumption volumes), long-term pre-set tariffs and marginal tariffs will be mandatory for electricity sellers and their consumers, except for customers connected to communal meters, who will not be billed by using step tariffs;

- Electricity generation tariffs should be gradually deregulated;

- Tariffs should reflect different service costs as associated with different categories of customers.

• Promoting bilateral and regional cooperation:

- Electricity exchange with the power systems of neighbouring countries;

- Long-term cooperation with the operators of the electric systems of the neighbouring countries in order to support access electricity export and import as required;

- Harmonisation and implementation of the relevant legal framework in order to create a regional power market;

- Efficient and effective use of the benefits derived from the location of the country, promotion of import-export and transit;

- Development of energy transportation infrastructure to ensure interconnection between Europe and Asia, East-West and North-South;

- Ensure the diversification of electricity sources.

Licensed Activities

The Law on electricity and Natural Gas defines a “license” as the right to conduct the activities provided by the Law vested, by decision of the Georgian National Energy Regulatory Commission, in a person who meets the requirements set forth in the Law. A “licensee” is a person vested, by decision of the Georgian National Energy Regulatory Commission (GNERC), with the right to conduct the activities under the Law.

Licenses are required for electricity generation, transmission, dispatch, and distribution, imports and exports. GNERC is vested with the right to grant licenses in the sector of electricity and natural gas and regulate the activities of licensees, importers and suppliers. GNERC’s main functions include the establishment of the licensing rules and terms for the generation, transmission, dispatch, import, export and distribution of electric power as well as for the supply, and granting, modification, suspension, and revocation of licenses, in accordance with the Law of Georgia on Licenses, the Law and licensing rules. GNERC grants licenses indefinitely for the following activities (but not import, export and supply):

• Power generation;

• Power dispatch;
• Power transmission;
• Power distribution.
• Natural gas transportation
• Natural gas distribution

There are specific legal dispositions for particular types of licenses:

• For dispatch, only one license may be issued in the country.

• For transmission, a license will specifically list the 35- and 110-kilowatt transmission networks and respective substations used for grid or/and inter-grid transit of electric power; other 35-kilowatt networks shall be a part of distribution facilities. The list of the power transmission lines intended for grid or/and inter-grid transit of electric power shall be approved by the Ministry of Energy of Georgia.

Power generation, transmission, dispatch and distribution without the relevant license granted by the Commission are prohibited except for any person, generating electricity for solely his/her personal use and not switched to the transmission or distribution network. Such persons and entities do not require a license.

A license applicant must, apart from complying to other laws, provide specific information on available physical assets and facilities (including technical standards compliance and audit report), EIA report, points of switching on to the network (except for a power dispatch license), system layout, etc. The EIA report is subject to a one-window procedure and the persons who provide audits, etc., are identified in the licensing rules.

In the license, GNERC must list the type of service referred to in the license application, location of the service facilities and territory across which the license shall apply, the issue date, as well as the terms and conditions for modification, suspension and revocation of the license.

The licensee may not, without the prior permission of the Commission, terminate, decrease or increase the service under the license except when such termination or decrease occurs due to the consumer’s failure to pay for the service or/and for technical or safety considerations. Save for these exceptions, in case of termination or reduction of service, the licensee must submit an application for termination or decrease of service to the Commission. The licensee must surrender the license after obtaining permission from the Commission for termination or decrease of service. In such case, the Commission may modify the license or revoke it altogether. However, the licensee is not obliged under to resume the provision of the service if another licensee receiving the service, a direct consumer, or any other natural or legal entity fails to fulfill the obligations under the contract or the approved terms and conditions of the service.

Licensees have to abide by the terms and conditions of the license, and licensees importers, exporters, suppliers and consumers have to abide by the legal acts of the Commission and the Ministry.

Licensees must, within their reasonably affordable expenses, act according to the minimum cost principle in consideration of economic effectiveness.

Importers, exporters, suppliers and licensees must submit to the Commission, the Ministry, and make available to the public specific information, including last annual performance report, next year’s action plan, and any other information that the Commission or the Ministry
may deem necessary except as provided by law. The holders of generation licenses issued on
the grounds that his/her contract on electricity sale is on competitive terms must submit to the
Commission all the reports and information that the Commission may deem necessary for
assuring the safe and stable operation of the transmission network and the capacities switched
thereo, but this information is excluded from the publicity requirement.

Licensees must meter the total amount of electricity passing through its facilities and make
this information available. The Electricity Market Commercial Operator shall and the
Ministry and Commission may perform inspections of the meter-readers in accordance with
the Electricity (Capacity) Market Rules.

Licensees, importers, exporters, suppliers and consumers may file an application with the
Commission for consideration of disputes within the competence of the Commission.

A license may be modified in accordance with its terms and conditions and may be revoked for
violation of these terms and conditions or of the Law and the Law of Georgia on Licenses and
Permits. Otherwise, the Commission may modify, or revoke the license only by the prior consent of
the Licensee. However, in modifying the license, the Commission may demand that the licensee
fulfil the requirements different, including stricter than, those specified in the initial license.

To assure competition, a licensee may not, without the permission of the Commission, hold
stock or shares of another licensee. An individual entrepreneur or a legal entity who directly
or indirectly holds or manages the stock or shares of any licensee may not hold stock or shares
of any other licensee in electric power without the permission of the Commission. The
Commission may withhold such permission if it prejudices the interests of consumers or
contradicts the law.

Licenses are personal, i.e. the transfer of a license to any other person without the permission
of the Commission is prohibited. To protect the provisions of the Law and safeguard public
interests, the Commission may approve, disapprove or otherwise limit certain activities of the
licensee, including merger of the activities licensable under this Law, acquisition and/or sale
of fixed, assets and shares, expansion of the sphere of licensee’s activity, and reorganisation
of the structure, change of ownership or/and organisational-legal form of the licensee.

A generation license authorises an individual entrepreneur or a legal entity to produce
electricity and connect relevant facilities to the transmission or distribution network at
particular reception points. A generation licensee must, in compliance to relevant Electricity
(Capacity) Market Rules, submit to the Commission an application approval of the service
charges, terms and conditions set out in the electricity sale contract. No such approval is
needed if the Commission establishes that the generation licensee generates electricity for his
own use only, for export only or sells the product on a competitive market. The licensee must
provide capacity to the dispatch licensees, comply with the Electricity (Capacity) Market
Rules, to the operation of Electric Market production means and transmission and distribution
facilities, pay the regulation fee established by the Commission and otherwise comply with
the requirements of the license.

A transmission license granted by the Commission authorises a legal entity to provide
transmission services by means of the transmission network. The transmission license
contains a list of specific facilities between the reception point and the supply point. If it is
necessary to directly connect the facilities of a generation licensee to those of a distribution
licensee or a direct consumer, the Commission may require that the reception and supply points be separated by a minimal section of the transmission network.

If new transmission facilities are needed, the licensee may file an application with the Commission for the modification of the license. The Commission assesses the need for such a facility, its compatibility to the national sector policy, the provisions of the law, and may grant a modified and authorise the licensee to construct the new facility on the approved route. The licensee has the right to obtain a permit for the use of lands needed for the construction.

The licensee must operate the transmission network in compliance with the Electricity (Capacity) Market Rules, draw up and submit to the Commission and the public an investment programme, develop instructions for the safe, reliable, non-discriminatory use and maintenance of the transmission network and connected facilities. The licensee must deliver the specified transmission service and pay the regulation fee established by the Commission. In compliance to the Electricity (Capacity) Market Rules, the transmission licensee must design, build and manage the system in a way that provides its stability even when one or more elements necessary for the normal operation of the system fails under natural disasters or other Acts of God.

A dispatch license granted by the Commission authorises a legal entity to carry out the administration of the Power Grid of Georgia through central and regional dispatch services. Only one dispatch license may be granted at any given time.

The licensee must assure the reliable operation of the power grid, fulfil the demands of all the relevant licensees, importers, exporters and direct consumers on a least-cost basis. However, if a the transmission licensee or a direct consumer contracts with a holder of a generation or import license and then fully or partly fulfils his demand order for electricity or/and contracts with a transmission licensee, the dispatch licensee is not responsible for the delivery of a standby service with electricity (capacity), unless the distribution or export licensee or direct consumer pays the charge set by the Commission for such a service.

The dispatch license holder must install and operate all facilities needed for the operational management and electric sustainability of the power grid, work out modes and use the relevant dispatch instructions that will promote the effective operation of the Electric Market and the full satisfaction of the requirements of licensees, exporters, importers and consumers, in accordance with the Electricity (Capacity) Market Rules. The dispatch license holder must comply with the instructions of the Electric Market, including the instructions for limiting and terminating electricity supplies to violators of market rules.

The licensee must draw up an investment programme and submit it to the Commission and the public, deliver service in accordance with the Law and the subordinate legal acts, and pay the regulation fee established by the Commission and comply with other requirements of the license.

A distribution license authorises an individual entrepreneur or a legal entity to distribute or sell electricity within a particular distribution network. The license during periods of emergency assure the compliance to the established load limits and modes, but prioritise electricity supply to facilities of special importance, to the extent to which they pay for the electricity. The licensee must assure timely, full and guaranteed payment for the supplied electricity and service in compliance to the market rules. A distribution licensee who violates this provision is liable in the manner prescribed under the law. If so requested by the
Electricity Market, a distribution licensee must open a letter of credit with a bank, in compliance with market rules.

The licensee must provide to consumers distribution services in compliance with the rules established by the Commission and the investment programme of the licensee.

The licensee must obtain from the transmission licensee or/and dispatch licensee as well as from generation or/and import licensee rights on the relevant distributable electricity (capacity).

The licensee must develop collection procedures, work out and submit to the Commission for approval terms for service, accounting, reporting and dispatching, and collection of electricity fees, draw up an investment programme and submit it to the Commission and the public, deliver service in accordance with the Law and its subordinate regulations, and provide, at its premises, public access to certain documents and information.

The distribution licensee must transmit (in consideration of the relevant tariff) through its distribution network electric power for the persons authorised to sell electricity directly to consumers as well as for buyers (including consumers).

Importers of electricity must comply with legislation, including the Law on Electricity (Capacity) Market Rules, electricity (capacity) balances and the tariffs set by the Commission, and pay the regulation fee established by the Commission.

Exporters must comply with the laws of Georgia, including the Law on Electricity (Capacity) Market Rules and electricity (capacity) balances.

**Market Participants**

The key players that set the scene for the Electricity Market are the Georgian National Energy Regulatory Commission (GNERC), the Electricity System Commercial Operator (ESCO), and the electricity transmission and dispatch organisations.

GNERC’s role on the market is to set the rules and conditions of electricity generation, transmission, dispatch, distribution, import and export, including issuing, modifying, seizing and/or canceling licenses (in essence, high-level market entry-exit control). GNERC also acts as an arbiter in disputes between licensees and the consumers within its competence. It also regulates electricity import related activities. To the extent that GNERC observes license compliance in the parts related to vertical and/or horizontal concentration, it also has a say on matters related to power market competition.

ESCO was established on 7 August 2006 in accordance to the amendments introduced to the Law of Georgia on Electricity and Natural Gas (dated 9 July 2006).

Two electricity transmission licensees operate in Georgia. The Georgian State Electricity System Ltd. (GSE) has a transmission license on the majority of transmission assets in the country, which it also owns. ESB International (Ireland) has been managing the GSE since 2003 under a contract and is charged with improving the technical and financial performance of the company. Sakrusenergo is the other entity which has a transmission license. It owns the important 500 kV transmission line “Kavkasioni”, which is connected with Russia and provides interconnectivity of many electricity transmission lines. Holders of electricity transmission licenses (without the right to sell and purchase electricity) can transmit domestically generated or imported electricity to distribution companies, direct customers, or to neighbouring countries’ energy systems. Transmission tariffs are set by GNERC.
GNERC has issued one electricity dispatch license to GSE.

**Market Model**

Every individual and legal person, who intends to carry out the wholesale trade of electricity and capacity shall become a qualified enterprise according to the conditions set forth by the Market Rules. ESCO awards the status of qualified enterprise. Qualified enterprise is limited to the individuals and/or legal persons registered in Georgia. Figure 25 illustrates the structure of the electricity market in Georgia.

ESCO is managed by a General Director.

The objectives of ESCO are determined by its functions listed above.

In September 2006, new Market Rules adopted by the Ministry of Energy of Georgia (Order #77 dated 30 August) have entered into force. Under the amended Law on Electricity and Gas, enacted on 1 September 2006, local organisations consuming electricity must buy 32% of electricity from TPP, power importers and new power plants put in operation after 2004. From October 2006 to March 2007 this quota will be 49%. In addition, consumer organisations must reserve 10% of their total consumption.

Also under the amended Law, small HPP (under 10 MW) were deregulated from September 2006 and are now free to sell electricity at unregulated prices without applying for a license. The objective of this measure is to attract investors in small HPP.  

**Third-Party Access**

The Energy Policy of Georgia foresees the introduction of third party access in electricity distribution and transmission networks. Electricity buyers will have a right to purchase power from any electricity seller, according to the following market opening schedule: For annual consumption at least 30 million kWh in 2006-2009;

- For annual consumption at least 15 million kWh in 2010-2012;
- For annual consumption at least 7.5 million kWh in 2013-2016;
- For annual consumption at least 3 million kWh in 2017-2018;
- For annual consumption at least 1 million kWh in 2019-2022;
- For all consumers – from year 2023.

Electricity transmission and distribution licensees must provide power pass-through services for eligible electricity buyers at the pass-through tariff set by the National Energy Regulatory Commission of Georgia.

**III.4.4.2. Sector Privatisation and FDI**

In generation, the following privatisation deals have been completed:

- Already in 1993-1994, 19 small HPP were privatised (total ~90 MW installed), and 11 more were privatised in 1995-1997 (~60 MW) Two more HPP (total 180 MW installed) were leased by 1996 to private operators;

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• In 1999, AES Corp. (US) negotiated a 25-year management contract on the Khrami HPP (~220 MW installed). In early 2000, AES Corp. also acquired units 9 and 10 of the Gardabani TPP (~300 MW installed each) via a joint venture with the Ministry of Fuel and Energy, and structured Gardabani the assets as a new entity, the Mktvari Energetika LLC. AES’s Georgian assets were acquired in mid-2003 by Russia’s RAO UES for USD83 million;
• In June 2006, the Czech Energo-Pro purchased for USD132 million a package of assets including six HPPs (Atshesi – 16 MW, Dzevruli – 80 MW, Guma ti I and II -76 MW, Lajanuri – 113 MW, Rioni – 48 MW, and Shaori – 38 MW) and two distribution companies (UDC and Adjara);
• In September 2006, the Vartsikhe HPP (184 MW) was reportedly sold to the London-based steel and metals trader Stemcor Ltd. for USD57 million.

In addition, generation assets have been constructed from scratch by private investors in Kakheti (Sichuan Electric and Peri, 24 MW HPP at Khador), Gardabani (2x55 MW gas turbine by Russia’s Energo-Invest) and Batumi (4x15 MW gas turbines by Greenoak – U.K.).

The total generation assets under private ownership and management are thus around 1,130 MW of HPP and 770 MW of TPP (of the latter, 300 MW at the inoperative unit 10 at Gardabani-Mktvari), or about 40% of installed HPP and most of the available TPP.

Other important privatised electricity sector assets include:
• AES TransEnergy, established in early 2000 between AES Corp. and the Ministry of Fuel and Energy for the purpose of exporting 650 GWh of power from Georgia to Turkey. Exports began via a 220 kV line in 2000. In 2003, RAO UES (Russia) took over the interest of AES in the venture.
• Telasi, the distribution company of Tbilisi, sold to AES Corp. in 1999 and re-sold to RAO UES in 2003;
• United Distribution Co. and Adjara Distribution Co., sold to Energo-Pro of the Czech Republic in 2006;
• Kakheti Distribution Co., sold in 2006 to TBC Energia of Georgia;
• The 500 kV and 330 kV transmission lines and the 220 kV “Adjara” line, managed by Sakrusenergo Ltd. (Russia).
• The 220 kV transmission lines (except “Adjara”) and the 220-500 kV substations, managed for Georgian State Electro-System Ltd. by ESB International (Ireland) under 5-year management contract, which expires on March 3, 2008.

In this way, up to 100% (except Abkhazia) of distribution by volume is now in private hands, and the entire high voltage grid is under the private management. The remaining distribution company in Abkhazia is also listed for privatisation, along with some generation assets that have not yet been privatised. The government plans to continue owning the high voltage grid and the national dispatch and control centre.

III.4.5. International Trade and Transit in Electricity

In fall-winter 2006-2007, import of electricity from Russia and Armenia has stopped. During this period, the electricity is imported from Azerbaijan (subject to the return during the flood), based on the contract between ESCO and AzerEnergy. Similar contract was signed between
Adjara Energy Company and Turkey. Therefore, during the winter period, deficit of energy system is filled from the countries mentioned above.

The existing 220 kV line to Turkey has been used for exchanges of power under annual agreements since the late 90’s, whereby Georgia sent up to 125 MW to Turkey during the summer and received up to 100 MW of power during the winter. The exchange with Turkey is particularly important for Adjara, where consumption peaks during the winter at more than 100 MW, and also as a back-up source of supply for Georgia during emergencies, e.g. in the winter of 2005-2006.

To enhance the cooperation with Turkey, Georgia intends to build a second connecting line. Apart for exchanges of power, the existing one has been used for transit of power from Russia to Turkey. The Russian RAO UES has occasionally complained that Georgia has tapped into the transit flows as well, but this has hardly been substantiated.\textsuperscript{121}

Construction of 400 kV electricity transmission line connecting Georgia (Ksani Substation) with Iran via Armenia is in process.

In March 2006, US TDA extended grant for a feasibility study for the construction of a 500 kV line from Zestafoni to Gardabani, which, apart from serving the Georgian market, could potentially be used for exports of hydropower from Georgia to neighbouring countries, particularly Armenia and Azerbaijan.\textsuperscript{122}

In mid-2006, during the low demand season, Georgia was able for the first time over many years to discontinue imports from Russia when repairs of three units at the Enguri HPP were completed and an extra 600 MW of capacity added to the system. Enguri’s capacity was brought up to 800-850 MW and four out of its gensets became operative with financing provided by and EBRD credit and EC grant. In March 2007, another 200 MW unit is expected to be brought online, and thus available capacity in Georgia will make imports from Russia redundant during peak season as well. Other HPP have also been upgraded, and construction of some new HPP is nearing completion.

In addition to rehabilitating domestic generation capacity, Georgia has followed a policy of diversification of imports getting power supplies not just from Russia, but also from Azerbaijan, Armenia and Turkey.\textsuperscript{123} However, the country still needs thermal power generation capacity, especially during the winter, which means that it needs reliable gas supplies to be able to use the generating capacity to fullest and avoid imports of power.

### III.5. Renewable Energy (Wind, Biomass, Solar, Geothermal)\textsuperscript{124}

Renewable energy is an important priority for the energy sector because there is good potential and better exploitation will improve the level of security of supply while reducing the need for imported energy. Hydropower represents the most readily available renewable energy source that is currently exploited and there is still significant potential for further

\textsuperscript{121} CE/FSU Power Monitor, 6 September 2006.
\textsuperscript{122} CE/FSU Power Monitor, 22 February, 1 and 15 March 2006.
\textsuperscript{123} Ibid., 9 August 2006.
\textsuperscript{124} http://www.investingeorgia.org/en/investing/key_sectors/?id=171.
exploitation.\textsuperscript{125} There are also other important renewable energy sources that present a good promise. These include biomass, geothermal, wind and solar.

The government has a Renewable Energy Development Programme which is incorporated in the Decree of the President of Georgia ‘On the Development of the Utilisation of Non-traditional Energy Sources in Georgia’, signed March 3, 1998. The Programme includes:

- Provision of a 10-12\% subsidy by the government to the producers of ‘environmentally clean’ energy;
- Guarantee by the government to producers to purchase energy at favourable prices;
- Carrying out reduced tax policy for environmentally clean energy producers.

There are two main ways that renewables are being promoted in Georgia. One is through the Clean Development Mechanism of the Kyoto Protocol, while the other is through a UNDP project to promote the use of renewable energy resources for local energy supply. This UNDP/GEF (United Nations Development Programme/Global Environment Facility) Project started in April 2004 and will last for four years. It also includes funding from the German public development bank, KfW. The objective of the project is to remove the key barriers to the increased utilisation of renewables for local energy supply. It will address the legal and regulatory barriers to provide fair and competitive access to the market for renewables, to ensure the collection of payments and to encourage investments in renewable energy. It will introduce leveraged financing for a pilot renewable energy fund/credit line to overcome financial barriers and it will address public awareness and capacity barriers. The project is expected to enhance the capacity of local entrepreneurs to develop bankable investment proposals, to restructure financing for the projects and to management development and implementation of the projects. The project, implemented by the Ministry of Environment and Natural Resources, has already undertaken more than 10 feasibility studies, one on the use of geothermal in Tbilisi. The fund will have a total of Euro 5.11 million (from KfW) plus USD 2.0 million (from GEF).\textsuperscript{126}

\section*{III.5.1. Wind Energy}

The total potential of wind energy in the country is estimated to 1,450 MW.\textsuperscript{127} In Georgia the average wind speed is between 5-9 meter/hour. The economically efficient share of wind energy in Georgia amounts to an annual 3-4 TWh and it is planned to start work on it, in particular in the Black Sea area, on the Likhi mountain range (Mount Sabueti) and near Samgori. It is planned to construct the wind generators, which will produce power of 3,500 mw per year.

Currently there are only a couple of small 6 kW units. A wind atlas has been prepared. This, in itself, will help the future exploitation of the resources. Four main regions have been identified for best potential: the high mountain zone of the Caucasus, the Mtkvari river valley, the South Georgian highland and the southern part of the Black Sea region. These four regions have average annual wind speeds of more than 6 m/second at 30m height.\textsuperscript{128}

\textsuperscript{125} Detailed information regarding the hydro sources is provided for in Section IV.4 above.
\textsuperscript{126} In-Depth Review of Energy Efficiency Policies and Programmes, 2006; www.encharter.org.
\textsuperscript{127} This is estimated to be 2,300 MW according to a recent Secretariat report (In-Depth Review of Energy Efficiency Policies and Programmes, 2006; www.encharter.org).
\textsuperscript{128} In-Depth Review of Energy Efficiency Policies and Programmes, 2006; www.encharter.org.
The effectiveness of these generators can be greatly increased if they will work in parallel regime with the hydro power plant. Such projects will greatly increase the supply of electricity to mountainous regions.

In March 2007 Memorandum was signed between government of Georgia, “Karidan” Corp and JSC, wind energy” on construction and exploitation of 24 MW Wind Power Plant.

**III.5.2. Solar Energy**

Because of the location of Georgia, the annual duration of solar radiation in the majority of areas ranges from 250 to 280 days, approximately 1,900-2,200 hours per year. Total annual potential of solar energy in Georgia is estimated at a level of 108 megawatts or 34 billion toe.

A five year programme envisages the introduction of the development of technologies and modern methods for the use of solar energy, including photo-electric transducer systems, foreseeing real opportunities for our country. Considering conservation measures for electricity in the twenty year period could save 500 mln. kWh, the number of families to be equipped with solar-water heaters is up to 43,000.

**III.5.3. Thermal Waters**

The geothermal resources in Georgia are estimated to 220/250 million cubic meter (100 million cubic meter proved) with a water temperature from 50°C up to 100°C. According to the Secretariat’s recent study in 2006, Georgia has considerable potential of middle and low temperature thermal water (33-108 degrees C). Today we can find about 300 thermal water outlets where temperature varies from 30°C to 110°C, with 200,000 cubic meter of water per day. Currently functional wells provide 80,000 m³ per day. The temperature of water varies from 60°C to 110°C. This is equivalent to 50,000 PS. water whose temperature varies from 50 to 100 degrees C, daily predicted resources are evaluated for 0,45 million cubic meter which is equivalent to annual 1.5-2.0 million PS. The theoretical resources amount to 1,800-2,000 MW, making it very attractive for future exploitation.

**III.5.4. Bio-Energy**

Bio-energy is important in rural areas where there is good potential to use farm waste. Between 1993 and 2005, over 250 biogas digesters were installed and there potential for expansion is greater. Using crops as resources, there are some regions of Georgia where two yields per year are possible. There is some support from multilateral donors. There are some NGOs working in this area and the National High Technology Centre of Georgia, Laboratory of Renewable Energy is focusing on bio-fuels and biogas.

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## ANNEX I: STATUS OF GEORGIA’S DOUBLE TAXATION TREATIES

<table>
<thead>
<tr>
<th>Country</th>
<th>I round</th>
<th>II round</th>
<th>Initialising</th>
<th>Signing</th>
<th>Ratification</th>
<th>Entry into force</th>
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<td></td>
<td></td>
<td>1999; 2000; 2002; 2005</td>
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</table>

# ANNEX 2: BILATERAL INVESTMENT AGREEMENTS

## Total Number of Bilateral Investment Agreements Concluded, 1 June 2006

<table>
<thead>
<tr>
<th>Reporter</th>
<th>Partner</th>
<th>Date of Signature</th>
<th>Date of Entry into Force</th>
</tr>
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<tbody>
<tr>
<td>Georgia</td>
<td>Armenia</td>
<td>4 June 1996</td>
<td>18 February 1997</td>
</tr>
<tr>
<td></td>
<td>Austria</td>
<td>1 October 2001</td>
<td>1 March 2004</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td></td>
<td>8 March 1996</td>
<td>10 July 1996</td>
</tr>
<tr>
<td>Belgium and Luxembourg</td>
<td></td>
<td>23 June 1993</td>
<td>3 July 1999</td>
</tr>
<tr>
<td>Bulgaria</td>
<td></td>
<td>19 January 1995</td>
<td>6 August 1999</td>
</tr>
<tr>
<td>China</td>
<td></td>
<td>3 June 1993</td>
<td>1 March 1995</td>
</tr>
<tr>
<td>Egypt</td>
<td></td>
<td>10 August 1999</td>
<td>…</td>
</tr>
<tr>
<td>France</td>
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<td>3 February 1997</td>
<td>13 April 2000</td>
</tr>
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<td>Germany</td>
<td></td>
<td>23 June 1993</td>
<td>27 September 1998</td>
</tr>
<tr>
<td>Greece</td>
<td></td>
<td>9 November 1994</td>
<td>3 August 1996</td>
</tr>
<tr>
<td>Iran</td>
<td></td>
<td>27 September 1995</td>
<td>22 June 2005</td>
</tr>
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<td>Israel</td>
<td></td>
<td>19 June 1995</td>
<td>18 February 1997</td>
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<td>Italy</td>
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<td>22 April 1997</td>
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<td>Latvia</td>
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<td>5 October 2005</td>
<td>5 March 2006</td>
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<tr>
<td>Moldova</td>
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<td>5 December 1997</td>
<td>25 February 1999</td>
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<td>The Netherlands</td>
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<td>1 April 1999</td>
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<td>11 December 1997</td>
<td>12 June 1998</td>
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<td>30 July 1992</td>
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<td>7 March 1994</td>
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<td>Uzbekistan</td>
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<td>4 September 1995</td>
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</tr>
</tbody>
</table>

ANNEX 3: INTERNATIONAL AGREEMENTS ON INTELLECTUAL PROPERTY RIGHTS

• The Paris Convention for the protection of the Industrial Property (1994)
• The Patent Cooperation Treaty (1994)
• The Berne Convention for the Protection of Literary and Artistic Works (1995)
• WIPO Copyright Treaty (2001)
• WIPO Performances and Phonogrammes Treaty (2001)
• Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks (2002)/(2003)
• Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure
• Hague Agreement Concerning the International Deposit of Industrial Designs (2003)
BIBLIOGRAPHY

2. Agreement 006.03 on Crude Oil Sales Dated 5 May 2003 Between Ninotsminda Oil Company Limited and Sveti Ltd.
3. Agreement 007.02 on Crude Oil Sales Dated 13 August 2002 Between Ninotsminda Oil Company Limited and Sveti Ltd.
4. Agreement For Drilling Rig Services Between Ninotsminda Oil Company And Great Wall Drilling Company Limited For The Drilling of The Manavi Oil Discovery In Georgia, Dated 21 June 2004
5. Agreement Number 1 Dated 20 March 1998 on Joint Investment Production Activity for Development and Further Exploration of Bugruvativsk Field Between Ukrnafta, Lateral Vector Resources Inc., and IPEC
6. Agreement On Crude Oil Sales Dated 04 February 2005 Between Ninotsminda Oil Company Limited & Primrose Financial Group
7. Amendment dated 17 September 2002 of Clause 9.3.1 of Amendments and Additions to the Agreements No. 01 of 20 March 1998 on Joint Investment Production Activity for Development and Further Exploration of the Bugruvativske Field Between Ukrnafta and Lateral Vector Resources Inc. and IPEC
8. BTC Pipeline Security Concept 2000
11. Deloitte Touche, Guide on Taxation and Investment in Georgia 2007
13. Farm-In Agreement Dated 7 September 2003 Between Ninotsminda Oil Company Limited and Georgian British Oil Services Company Limited (Ninotsminda PSC Area)
14. Farm-In Dated 4 September 2003 Between CanArgo Norio Ltd Covering: The Norio (Block Xl(C)) and North Kumisi Production Sharing Agreement, Georgia
15. Host Government Agreement of 18 November 1998 as Amended and Restated 28 April 2000 Between the Government of Georgia and the MEP Participants
16. Host Government Pipeline Agreement Between and Among the Government of Georgia and the MEP Participants (Appendix 1 as Amended 28 April 2000)
17. Host Government Pipeline Agreement Between and Among the Government of Turkey and the MEP Participants (Appendix 2 as Amended 28 April 2000)
19. Intergovernmental Declaration Dated 18 November 1999 on the Principles for Implementing the Transcaspian Pipeline Among Azerbaijan, Georgia, Turkey and Turkmenistan

20. Joint Statement Dated 16 May 2003 on the Baku-Tbilisi-Ceyhan Pipeline Project

21. Law On Environmental Permit Dated 15 October 1996


23. Law On Oil And Gas 1999. (Supplement 35/Page 1)


26. MEP (Main Export Pipeline) Agreement Dated 18 November 1999 Between Azerbaijan, Georgia and Turkey


29. Production Sharing Agreement Dated 12 December 2000 Between State Agency for Regulation of Oil and Gas Resources in Georgia, Georgian Oil and CanArgo Norio Ltd.

30. Production Sharing Contract Between Georgia, Georgian Oil and JKX (NAFTOB) Limited (Covering West Georgia Black Sea Offshore) Dated 15 February 1996


33. PSC Of 15 February 1996 Between Georgia and Georgian Oil and JKX Navtobi Limited (Covering: Ninotsminda, Rustavi and Menavi)

34. Tax Code of Georgia as Adopted on 22nd of December 2004

35. Trans-Georgian Petroleum Exploration, Production and Refinery Projects In Georgia Dated 1 August 1994