

## **Impact of Power Energy Sector Tariffs on Economic Crime**

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The development of power energy sector of Georgia since the country gained its independence is characterized by significant drawbacks resulting from economic crisis and other factors. 14 billion of Kwatt/hour electricity was generated in Georgia in 1990. Current average annual production of electric ity in Georgia is only 6-7 billion Kwatt/hour.

Dramatic drop of electric power generation clearly characterizes the extent of severe energy crisis in Georgia. This crisis has many reasons; main of those is the current deplorable financial condition of the sector determined by the inefficient management of enterprises and of the sector in general, as well as by the large scale corruption. Structural reforms of the sector are too much delayed, principles of market economy could not be fully implemented, modern legal basis for the regulation of relationships between enterprises in electric power sector could not be established, state regulatory mechanisms of the sector could not be introduced, problems of reimbursement of utilized eclectic power and theft of electric power could not be solved even at an elementary level, etc.

Difficulties caused by shortage of power resources provide fertile ground for the economic crime and money laundering in electric power sector. The issue of uninterrupted power supply has not been solved so far, thus hindering the development of other sectors of economy too. Despite considerable investments attracted in the last decade for rehabilitation of the energy sector the situation still remains critical. Money spent for the rehabilitation and development of the sector for the recent decade amount to USD hundreds of million; though instead of significant progress this resulted in several scandalous court trials related to corruption in the sector.

Apart from purely economic factors economic crime in this sector is determined by objective reasons; main among them are: a) unavailability of an optimal tariffication policy in energy sector; b) outdated tariffication methodology; c) improperly regulated legal relationships between electric power suppliers and consumers; and d) low payment culture of electric power consumers.

“Methodology, rules and procedures for electric power tariffication” approved by the GNERC decision has been operating in Georgia since 1998. At that period mentioned methodology was the first regulatory document passed and operating in independent Georgia, and it played an important role in state regulation of electric power tariffs.

Since 1998 significant changes occurred in the electric power sector (electric power wholesale market was established, a number of structural changes were implemented in power distribution and transfer/dispatch systems, management of certain enterprises was changed, etc.); this necessitated the issue to introduce relevant changes to the existing methodology. Simultaneously characteristic for the market economy legal relationships between the supplier and the consumer in the electric power sector needs to be regulated.

**We believe that following principles should be considered during tariffication:**

- 1. Protection of all categories of consumers from monopolistic prices;**
- 2. Full compensation of reasonable costs paid by licensees;**
- 3. Gaining of optimal profits by licensees;**
- 4. Support of activities directed at improvement of economic efficiency;**
- 5. Improvement of the investment environment and stimulation of investments;**
- 6. Stepwise development of competitive environment on the electric power market;**
- 7. Inadmissibility of subsidizing benefits of any category of consumers at the expense of another category.**

Considering above-mentioned, we think following changes should be introduced to the existing methodology:

1. A rule reflecting electric power losses in tariffs should be changed;
2. A rule reflecting current indebtedness in electric power sector in tariffs should be changed;
3. Methodology has to consider correction of tariffs according to annual results, in the range of predetermined boundary volumes.

In order to regulate legal relationships between power suppliers and customers, we believe, it is a matter of urgency to introduce relevant amendments to regulatory documents. Let's consider mentioned issues in more detail.

Existing methodology of electric power tariffication enables to reflect technical and commercial losses in tariffs. In particular, in accordance with the article 18, item 3 of the methodology: **“During the identification of the volume of commercial losses should be considered situation of previous years, when paying and customer indebtedness was lower than acceptable standards. According to the Law “On Electric Power” licensees have right to cut off customers unable to meet payment obligations in due term. The GNERC will ensure scheduling of reduction of commercial losses for transmission and distribution. Financial losses caused by licensees that failed to meet existing standards will not be reflected in the tariff. Financial revenue of a licensee, exceeding standards identified by the company, is property of the licensee. Decision of the GNERC regarding acceptable level (guidelines) of commercial losses has no power of retroaction.”**

It should be mentioned that the term “commercial losses” means losses resulting from failure to pay costs of utilized power by customers, theft of electric power and losses due to inefficient registration.

We think that mentioned so called “commercial losses” by no means should be reflected in electric power tariffs, as on the one hand, they result either from bad management of a power supply enterprise, or (and this is more likely to be happening) from corrupt deals between the power supplier and a customer. On the other hand, in case of reflecting of stolen electric power in a tariff conscientious customer is obliged to pay; this is a customer that honestly pays for utilized electric power according to approved tariffs. In the first case reflection of

“commercial losses” in the tariff means stimulation of bad management and support of corruption; while in another – absolute injustice. Both cases are unacceptable. Such conciliatory approach towards mentioned losses resulted in a fact that official figures of actually covered costs for utilized electricity have been for years increasing only slightly, or not at all.

In 1998-2003-ies tariffs of electricity raised by 270.6%. This increase had a direct impact on the increase of crime in electric power sector. A new tariff introduction procedure easily ensures decision-making and legalization of tariff increase. This encourages corrupt deals. As a result of corrupt deals officials on certain posts appropriate money necessary for the development of the sector; part of this money they compensate by means of tariff increase, thus increasing the tax burden of honest customers, and manage to prevent nonpayment-related disastrous situations in the sector. We are far from stating that the tariff reduction would be the best way to decrease economic crime, though we believe that improvement of legal regulations and cardinal enhancement of management is a matter of urgency.

Indebtedness of energy enterprises is another problem. The term “indebtedness of the energy sector”, totally incomprehensible for the market economy, was established in the field. Debts could not be attributed to “a sector” or “a field” as such. Debt to the similar enterprise could be attributed to a specific enterprise or physical entity – a customer. But as market relationships are not actually in place in the electric energy sector and the relationships between suppliers and consumer entities or physical entities are not regulated by direct agreements, it is basically unclear who is indebted to whom and why. This creates very supportive foundation for crime. It is easy to avoid responsibility on consumed energy, when it is not defined who you are responsible to and what is the degree of punishment for this responsibility. It is easy to attribute responsibility to an abstract “sector” or “field.” This is

very well supported by existing methodology; items one and two of its article seven envisage coverage of debts by tariffs.

E.g. in accordance with the article seven, item one **“in order to improve existing financial situation in the electric energy sector during the tariffication of generation, transmission, dispatching and distribution it is envisaged to consider the coverage of indebtedness inside the electric energy sector and to other creditors.”** Whereas according to the second item **“deadlines, conditions and rules of coverage of indebtedness by means of tariffs are identified by the GNERC. Extra charge on tariff will be considered for the coverage of debts.”**

This type of approach resulted in permanent increase of electricity tariffs, thus supporting one of the main economic crimes. No matter how much is stolen in electric energy sector, finding of additional resources preventing outgrowth of crisis into the disaster is possible by means of raising tariffs. Therefore, we believe the content of the mentioned item of the article seven is unacceptable and it should be extracted from the mentioned document.

In accordance with the existing methodology during the identification of retail tariffs prognostic structure of electric power, generated inside the country and imported, is considered. As a rule, electricity imported and generated in thermoelectric power stations is much more expensive than electric power generated in hydroelectric plants. But if prognostic structure differs significantly from the structure of actually consumed electricity, and usually this happens at the expense of the increased share of cheap electricity, individual distribution companies gain undeserved profits as a result of increased tariffs; while consumers face undeserved losses. It is necessary to improve these inadequacies. The methodology should necessarily consider tariff correction at the end of the year and reimbursement of extra money paid by consumers.

One of the main indicators of economic crime in electric power sector is a very low level of collection of electricity cost. Due to inefficient registration of electricity, criminal deeds of dishonest consumers and some of the distribution companies employees the amount of stolen electricity reached disastrous levels. It is a source of illegal income for them. The solution of

the problem is primarily related to the regulation of legal relationships between suppliers and consumers. Agreements regulating duties and responsibilities of suppliers and consumers are unavailable in the sector. Criminal Code does not appropriately regulate the responsibility for theft of electricity.

In parallel with the improvement of electricity tariffication methodology it is an urgent necessity to implement major activities regarding regulation of legal relationships between electric power suppliers and consumers.

There are many other important problems, but the size of the article does not allow considering them all. We believe presented material is enough to identify main contours of existing situation. Finally we would like to mention that we have developed the project of new methodology of electricity tariffication that will be submitted to the GNERC for consideration and approval. This would deprive electricity tariff of the function encouraging economic crime in the sector.