



## Georgia's State Energy Policy in the Natural Gas Sector

29 February 2008

According to the Parliament's Resolution adopted in June 2006, the following are the priorities of the Georgian state policy in the gas and energy sector: (a) rehabilitation of gas units, (b) release of such units from debts and their privatization, (c) diversification of gas supply, and (d) formation of a transparent and liberal energy market.

By February 2008, Georgia's entire natural gas sector, with the exception of the main pipeline system and gas generation units of Gardabani (except for those which belong to Inter-Rao<sup>1</sup>), had been privatized. Currently, Georgia receives natural gas from three suppliers. A long-term contract is concluded with only one of them – the south Caucasian pipeline consortium.<sup>2</sup> Apparently the Georgian government has only a verbal agreement on gas delivery with the Russian and Azerbaijani suppliers. Negotiations with the two suppliers are being conducted secretly, making it difficult for the public to determine the terms of those negotiations.

### Enterprises consuming natural gas

The current government, in keeping with Shevardnadze's regime, considered the privatization of the gas units to be one of the main components of improving the gas sector. However, there were significant differences in the form and content of the privatization process.

Currently there are five large private gas consumer companies on the Georgian gas market. These are:

- (1) KazTransGas Tbilisi – distribution in the capital;
- (2) Itera-Georgia – supplier in the regions, which owns 10 distribution companies in economically active Kvemo Kartli and Shida Kartli regions;
- (3) Mtkvari-Energy, which own the ninth and tenth<sup>3</sup> energy blocks of Gardabani;
- (4) Energy-Invest, which owns Rustavi Azoti and Gardabani gas turbine;
- (5) Georgian Industrial Group, which owns Rustavi and Kaspi Cement Works with the equity participation of the German company HeidelbergCement.

From the above listed companies, Itera and Rustavi and Kaspi Cement Works (which are large consumers of natural gas) are the oldest private companies on the gas market. Both companies were privatized in the years 1998-1999.

### Privatization of the gas sector during Shevardnadze's rule: Itera and Gazprom

The Russian company Itera was the main supplier of gas to Georgia from 1996 to 2003. In 1998 the Georgian partners of Itera acquired ten distribution networks in the industrially active regions of Kvemo Kartli and Shida Kartli. Privatization was necessitated by the deliberately

<sup>1</sup> Gas generation units 9 and 10 belongs to Inter-Rao, of which unit 10 is damaged.

<sup>2</sup> The contract was executed in 2002 during Shevardnadze's presidency.

<sup>3</sup> The tenth energy block has been out of service since the breakdown of 2001. At present the company only runs the ninth block.

accumulated debts,<sup>4</sup> which was a traditional scenario for acquiring potentially profitable public companies in the post-Soviet countries of 90s.

Itera demanded that the Georgian government sell it Tbilisi distribution, the main pipelines, and Rustavi Azoti in exchange for writing off the existing debts (according to Itera by 2002 the debts amounted to 91 million USD). The company supported this demand with the fact that it produces its own gas in Russia and has good relations with Gazprom, which allowed it to transport gas along the pipeline system, and with the government of Turkmenistan, from which the gas was purchased.

The Georgian government refused to sell the Tbilisi distribution and main pipelines to Itera, but it agreed to transfer the Rustavi Chemical Company. The stated enterprise is the largest consumer of gas. It uses natural gas not only as an energy supply, but as a raw material as well. By 2003, Azoti had large debts and Itera was its main creditor at that time. Therefore, the Georgian side had to either cover the debts or let Itera have the enterprise. The government chose the relatively easier way and sold Azoti for 500,000 USD to Itera in February 2003.<sup>5</sup>

Relations between Itera and Gazprom began deteriorating in 2002 and reached a critical point in the middle of 2003.<sup>6</sup> The Georgian government, having noted the strained relations between Gazprom and Itera, gradually started pressuring Itera and excluding it from the Georgian market.<sup>7</sup> In 2002, simultaneous and intensive negotiations were initiated with RAO UES and Gazprom about replacing AES in Telasi and removing Itera from the supply chain.

#### *Twenty-five-year strategic agreement with Gazprom*

The Georgian government initiated secret negotiations with Gazprom in 2002, which ended with the signing of a twenty-five year strategic partnership agreement between the Georgian government and Gazprom on July 1, 2003. The information regarding the strategic agreement became public only two weeks after it has been concluded.

The content of the agreement immediately became subject to severe criticism. The agreement envisioned the creation of a joint enterprise with equal representation (equal equity participation) of parties and transfer of the whole gas sector, including main pipelines, to this joint venture with Gazprom.<sup>8</sup> According to David Mirtskhulava, then Minister of Energy, the Georgian side undertook the responsibility to cover all existing debts and the Russian side agreed that the gas price would not increase for the next ten years, although the latter point was not included in the agreement. Instead, the agreement provided that in case of a dispute, the parties would resolve the matter not through international arbitration, but through the Russian court system, casting doubt on the potential to resolve disputes impartially.

In July-September 2003, the Partnership for Social Initiatives (PSI), a Georgian non-governmental organization, and the Caspian Energy Studies Project conducted several open

---

<sup>4</sup> The stated fact is confirmed by the inspection conducted in 1998-2002 by the Chamber of Control.

<sup>5</sup> The debts of the Rustavi Chemical Plant Azoti had already been written off by the state in 1998. By 2003 the debts of the enterprise to Itera already amounted to 120 million GEL.

<sup>6</sup> Until 2002 Itera was the only Russian private company producing gas, trading gas from Turkmenistan and supplying gas to CIS countries. In 2002, Gazprom started monopolizing the gas market and forcing Itera out of the post-Soviet countries.

<sup>7</sup> Persons close to the government were intending to exclude Itera from the Georgian market without due compensation and to replace it with a stronger partner, which would ensure an uninterrupted supply to the country during the pre-election period.

<sup>8</sup> Gazprom would pay 500 million USD only for pipelines.

discussions about the strategic agreement between Gazprom and Georgian government.<sup>9</sup> The government side was represented by the minister of energy at these discussions. Representatives of governmental and non-governmental institutions, energy companies, and diplomatic missions and independent experts also participated in these discussions.

Participants in the meeting expressed concern about the twenty-five year agreement's potential to create a Russian-type monopolized gas market because the right to import, transport, and distribute gas was granted to a single company. In addition, there was a threat that the transfer of the pipelines to Gazprom's subsidiary company would result in the Georgian energy market being completely deprived of the possibility to obtain cheap natural gas pursuant to the agreement concluded with the Shah-Deniz consortium of Azerbaijan,<sup>10</sup> thus making the newly-created Russian-Georgian gas monopoly the sole beneficiary of the cheap Shah-Deniz gas.

Independent lawyers prepared a legal analysis of the strategic agreement.<sup>11</sup> The United States Agency for International Development (USAID) funded the production of the documentary movie about the discussions. All these events intended to achieve the single aim of persuading the Georgian government to either renounce or amend the agreement concluded with Gazprom.

The stated process was temporarily suspended during the Rose Revolution and was completely terminated after the change in government. The organizations and experts involved in lobbying the issue believed that the new government would revise and bring the agreement concluded with Gazprom in line with Georgian state interests on its own initiative. Nobody argued that the government had to completely cease relations with Gazprom. Instead, experts emphasized that it was necessary to protect the market from monopolization and to diversify the gas supply sources.

### **Privatization of the Gas Sector by the New Government: Tbilisi Distribution, Rustavi Azoti, Main Pipelines**

#### *Release of the enterprises from debts and neutralization of competing political and financial groups*

The process of privatization of gas enterprises for the purpose of developing them continued after the new government came to power. Unlike the previous government, which accumulated debts to the enterprises and then sold them to the main creditors,<sup>12</sup> the new government refused to do so, although it was not willing to pay the debts either (particularly because of the fact that there were many questions regarding the origin of the debts owed by gas consuming companies to political and financial groups close to the former government). Therefore, the post-revolution government decided to free the enterprises from the debts accrued during the previous government and sell them by means of tenders. As a result, the government refused to transfer Tbilisi gas distribution and Rustavi Chemical Plant in exchange for the debt owed to Itera, thus penalizing financial and political groups close to the former government.

---

<sup>9</sup> Both the discussions and the Caspian Energy Studies Project were funded by a Georgian/Azeri business group based in Baku. The discussions were held at the office of the NGO Georgia for NATO.

<sup>10</sup> This meant that a Gazprom subsidiary would not allow a third party access to the gas pipelines. Instead it would buy cheap Azerbaijani gas and resell it at a monopoly price just like it did in Russia (Liana Jervalidze).

<sup>11</sup> The legal analysis of the agreement was prepared for the purpose of pressuring the government to amend the most disadvantageous provisions of the document according to the interests of Georgia. This was a framework agreement, which had to become the basis for concluding a more detailed agreement.

<sup>12</sup> In order to burden with debts the enterprise to be privatized the gas supplier, its intermediary (Itera and its intermediaries Magti-Energy, Also Trans, Angloil, Burst Energy, Sakhgazi, Transgaz, and Cateco), management of such enterprise and the groups close to top political circles acted in collusion.

Though these actions by the new government were well-founded, the approach became the basis for the practice of ignoring the commitments undertaken by the previous government, which is legally inappropriate.<sup>13</sup> The government justified its refusal to pay the debt owed to Itera by claiming that during Itera's activities gas meters were not installed in all places and a large part of them did not function. The only functioning gas meter was installed on the Russian side of the main pipeline and Itera was basing its claims upon the data provided by this meter.

### *Replacing Itera with Gazprom*

From August 2003, the Russian state monopoly Gazprom withdrew Itera's permission to transport gas along its pipelines,<sup>14</sup> making Gazprom the main supplier of gas to Georgia. From this moment the debts to Gazprom have started to accrue (though at a much slower pace than before). By March 2005 Tbilgazi had accumulated 7.4 million USD in debt to Gazprom.

In 2004-2005 the government<sup>15</sup> initiated intensive negotiations with Gazprom regarding the sale of Georgian state-owned companies – Tbilgazi, Rustavi Chemical Plant, and main pipelines. Gazprom was most of all interested in acquiring the main pipelines.

At one point during the negotiations, the Georgian side was ready to transfer the main pipelines to Gazprom by means of direct sale in exchange for 300 million USD (despite the fact that pursuant to the twenty-five-year agreement, they should have been transferred to the Russian-Georgian enterprise), taking into particular consideration that Gazprom promised to introduce and install new technologies in the energy sector.<sup>16</sup> The parties even drafted a so-called letter of intent, however, no further steps have been taken on the matter.

The special interest of Gazprom in Georgian pipelines was supposedly caused by its aim to create a unified gas infrastructure by interconnecting Iranian, Armenian, Georgian, and Russian pipelines. This would enable the Russian company to control the potential gas flow from Iran to the European Union. By doing so, Gazprom's transport and transit monopoly would also spread to a particular segment of the potential gas export from Iran. Such developments would certainly strengthen the geopolitical role of Gazprom and Russia in the Caucasus and the Persian Gulf. For this reason, Georgian experts and Georgia's strategic partners in the EU and US were against the sale of the main pipelines to Gazprom.

Despite the opposition voiced by experts and western partners, the Georgian government initially continued the negotiations on the transfer of the main pipelines to Gazprom with the justification that the pipelines required significant repair work. The Georgian representative of GasExport noted in a private conversation that the Russian side was promising to support Georgia in solving the issue of South Ossetia in exchange for the transfer of the main pipelines.<sup>17</sup> These negotiations were terminated in August 2005 when the American Millennium Challenge Corporation allocated 49.5 million USD to Georgia for rehabilitation of the main pipelines. Having failed to buy the main pipelines, Gazprom was no longer interested in acquiring Tbilgazi and Rustavi Azoti.

---

<sup>13</sup> If Itera's claims were unfounded, the government had to refute them in court and not ignore them.

<sup>14</sup> Initially Itera was the sole company in Russia that had access to Gazprom's pipelines. Since then Gazprom does not allow anyone else to transport gas along its pipelines, turning the gas market into an absolute monopoly.

<sup>15</sup> The government controlled the gas flow from the countries of central Asia by means of its Eurasian gas pipeline infrastructure.

<sup>16</sup> Namely, they discussed the installation of a gas turbine in Gardabani and production of liquid gas for the region at the stations.

<sup>17</sup> While conducting negotiations on the sale of pipelines to Gazprom the Georgian government was taking active steps to resolve the South Ossetia issue.

At the end of 2005 and the beginning of 2006, the Georgian government resumed negotiations with Gazprom regarding the conclusion of a long-term agreement on gas supply. At the end of January 2006, however, after the explosion that took place on the pipelines incoming from Russia (on the Russian territory) and left the Georgian population without heating for almost ten days in winter,<sup>18</sup> the negotiations were suspended.

#### *Tbilgazi Privatization and KazTransGas*

As stated above, by spring 2005, Tbilgazi had accumulated 7.4 million USD in debts to Gazprom and 120 million GEL to the city budget. After the failure of the negotiations with Gazprom, the government began searching for an investor, which would either import cheap gas or would manage to agree with Gazprom on the supply of the needed volumes of gas at a desirable price.

By government decision, the Kazakh company KazTransGas became such an investor, acquiring Tbilisi distribution from the government. KazTransGas is a subsidiary company of Kazakhstan's state oil and gas company Kazmunaigas and conducts gas transportation in Kazakhstan. The parent company, Kazmunaigas, produces oil and gas in Kazakhstan and has a close relationship with Gazprom. Therefore, the Georgian government believed that Kazmunaigas would be able to persuade Gazprom to allow Kazakh gas transportation along its pipeline system to Tbilisi and thus KazTransGas would supply Georgia with cheap gas from Kazakhstan.

In March 2005, a meeting of experts<sup>19</sup> was held with the attendance of Minister of Energy Nika Gilauri. Georgian experts noted at this meeting that the Georgian government's expectations of KazTransGas were exaggerated, since Gazprom would not provide a third party access to its pipelines and Kazmunaigas would not risk ruining its relations with Gazprom for the purpose of supplying Tbilisi with cheap gas. The government considered the stated opinion of experts to be unfounded and sold Tbilisi Distribution to the Kazakh company. Later it became apparent that the experts' assessment was accurate. The Kazakhstan company failed to supply cheap gas to Tbilisi.

#### *Privatization of Rustavi Chemical Plant*

The decision to privatize Rustavi Azoti was first made by the Georgian government in 1998. At that time only one company—Magti-Energy—expressed interest in acquiring the enterprise. Azoti had accumulated so many debts by that time that the enterprise was transferred to Magti-Energy<sup>20</sup> for the symbolic price of 1 GEL. This caused such dissatisfaction among the population that President Shevardnadze had to get directly involved and quickly annul the results of the tender.

Azoti was finally sold in 2003. It was acquired by Itera for 500,000 USD. Later on the new government revoked this decision as well, released the company from debts (the debt were directly written off and Itera and related financial groups were not compensated), and transferred it to the ownership of the Russian-Georgian business group Energy-Invest.

---

<sup>18</sup> The adviser of the Georgian Oil and Gas Corporation Prof. T. Gochitashvili does not agree with the stated opinion. He believes that the Georgian government managed to resume the gas supply to the consumer sector by importing gas first from Azerbaijan and then from Iran, after Russian had terminated the gas supply to Azerbaijan as well (supposedly due to the breakdown of Shirvanovka Compressing Station).

<sup>19</sup> No such meetings have been conducted since then.

<sup>20</sup> Magti-Energy was owned by President Eduard Shevardnadze's son-in-law and was one of the intermediary companies between different distribution companies and Itera.

Currently, it is not known who owns Energy-Invest. It is known that there is no energy company in Russia with that title and that Energy-Invest has little to no experience in energy or fertilizer production. It imports Russian gas through the offshore group ZMB GmbH registered in Germany.<sup>21</sup>

Hundreds of millions of dollars worth of investments and a guaranteed supply of cheap natural gas are needed to renew the outdated technology of Azoti Works. If the technology is renewed, major rehabilitation and training of personnel are also necessary. Therefore it is difficult to determine at this point whether Energy-Invest possesses the resources or necessary experience.

### **Strained Relations with Gazprom and Azerbaijan Gas**

By the end of January 2006 Georgian gas units, except for the main pipelines and cement works,<sup>22</sup> were sold to Russian-Georgian and Russian-Kazakh business groups related to Gazprom.

At the beginning of 2006 the government initiated the process of gas market liberalization and allowed large gas consumers such as KazTransGas, Itera, Mtkvari-Energy, and Energy-Invest to directly conduct negotiations with GazExport and import gas from Russia on their own. By doing so, the government unsuccessfully attempted to free the gas business from political influence. These companies failed to negotiate successfully with the Russian side and to supply the Georgian energy market with cheap Russian gas.

The relations between Russia and Georgia further deteriorated in 2006 and the Russian side imposed a full economic embargo on Georgia. Simultaneously the price of Russian gas for Georgia increased from 110 to 235 USD. At first, President Saakashvili publicly stated that Georgia would not pay political price in gas. The government issued a credit to private companies that were large gas consumers to cover the price difference between 235 USD and 110 USD and started searching for alternative gas supply. The government requested help from the governments of Turkey and Azerbaijan and the International Consortium functioning in Azerbaijan.

#### *Negotiations with Turkey*

The Georgian government addressed Turkey with a request to allow Georgia to retain part of the Shah-Deniz gas to be transported by the South Caucasus Pipeline (SCP). In exchange, Georgia offered unlimited access of Turkish agricultural products to the domestic market.<sup>23</sup>

Turkey is party to the agreement with Azerbaijan International Consortium, which establishes a preliminary price for a certain amount of gas to be received from the Shah-Deniz gas field in the first phase. This price amounts to 120 USD per thousand cubic meters and Georgia was requesting Turkey to assign part of this gas. Should Turkey have satisfied Georgia's request, it would have to purchase bigger supplies of comparably expensive gas transported from Russia and Bulgaria for its own consumption, which would certainly be non-profitable for it. Turkey

---

<sup>21</sup> It is still unknown for how long this company will be able to receive Russian gas.

<sup>22</sup> By 2006 the Georgian Industrial Group assigned the controlling share in cement works to the German company HeidelbergCement.

<sup>23</sup> Georgian experts believed that further opening up the market to Turkish agricultural products, which already hold a largest portion of the Georgian market, would cause even greater problems to the weakened domestic production.

ultimately did not assist Georgia because Turkey was already dependent on Russian gas (65% of Turkish gas came from Russia) at that time and a further increase of the level of dependence was neither economically nor strategically desirable for the country.

#### *Negotiations with the International Consortium Acting in Azerbaijan*

The International Consortium lead by British company BP operates Azeri-Chirag-Guneshli oil fields in Azerbaijan. The Consortium returns part of the associated gas<sup>24</sup> back to the reservoir in order to maintain the pressure and transfers the other part to Azerigaz in accordance with the terms of the agreement.

From the time that the Baku-Tbilisi-Ceyhan pipeline became operational, the Consortium has significantly increased the oil production from Azeri-Chirag-Guneshli oil field. Thus the volume of associated gas has increased. The Georgian side requested the Consortium to supply a part of the associated gas to Georgia by means of Azerigaz instead of returning it to the reservoir. This would cause a decrease in the pressure of the field, which could not be allowed by the Consortium. For this reason, the Consortium also denied Georgia's request.

#### *Negotiations with the Government of Azerbaijan*

Starting in 2006, Azerbaijan Oil and Gas Corporation has directed significant investments towards the oil and gas fields existing onshore and offshore, which quickly resulted in success. By 2007, the gas production in Azerbaijan had increased to such an extent that it suspended import of Russian gas priced at 235 USD and managed to satisfy the increased demand of the country by its own gas.

Azerbaijan addressed the request of the Georgian government with understanding and, pursuant to the agreement reached in spring 2007, in March Georgia started receiving gas from SOCAR.<sup>25</sup> In accordance with the agreement, SOCAR supplied 238 million cubic meters of natural gas to Georgia in 2007 (120 USD per thousand cubic meters).<sup>26</sup> The agreement was terminated in October 2007. The parties have initiated several negotiations since then. As a result, the gas supply from Azerbaijan was resumed several times,<sup>27</sup> though no new agreement on the volume and the price of gas to be supplied in 2008 has been executed so far.

The Georgian side is still attempting—without success—to obtain the whole volume of gas, i.e. 1.5 billion cubic meters, to be consumed in 2008 from Azerbaijan. Supposedly, SOCAR either does not hold such amount of free resources<sup>28</sup> or the parties cannot agree upon the price.

### **Shah-Deniz Azerbaijani Gas from the SCP**

The SCP is one other source of gas supply for Georgia. Pursuant to the agreement executed in 2001 with the SCP Consortium, from 2007 Georgia, as a transit state, receives 5% of the gas transported along the pipeline. In addition, Georgia as a transit state has the priority right to

---

<sup>24</sup> Some oil fields also contain gas, which accompanies oil in the process of extraction. Such gas is called “associated gas.”

<sup>25</sup> Azerbaijani gas is managed by Azerigaz on the internal market and by SOCAR on the external market.

<sup>26</sup> Black Sea Press via IMF, October 30 2007.

<sup>27</sup> The gas supply from Azerbaijan was suspended and resumed on several occasions in the period between the end of October 2007 and February 2008.

<sup>28</sup> SOCAR supplies Iran with 1 billion cubic meters of gas a day at a price of 300 USD per 1000 cubic meters.

purchase a certain volume of Shah-Deniz gas at a prearranged low price. For the first year of operation of the pipeline, that volume amounts to 200 million cubic meters and during the last year of the first phase – 500 million cubic meters. The prearranged price is 63 USD with an annual increase of two percent.

## **The Georgian Oil and Gas Corporation**

The Georgian Oil and Gas Corporation was created in the beginning of 2007 as a result of the merger of Saknavtobi, the Georgian International Oil Corporation, and the Georgian International Gas Corporation. The Corporation represents the Georgian government in the production sharing agreements (with foreign companies) on Georgian gas and oil fields as well as the negotiations conducted with respect to the gas supply (together with the Ministry of Energy of Georgia).

As stated above, in the beginning of 2006 the main gas consuming companies (KazTransGas, Itera, Mtkvari-Energy, Energy-Invest, and International Energy Corporation) failed to agree with Gazprom on the supply of gas for less than 235 USD. Instead, the Georgian government managed to agree with Azerbaijan on the supply of 1.3 million cubic meters of gas a day for 120 USD (per 1000 cubic meters). As a result, a significant imbalance was caused between the prices of Russian and Azerbaijan gas, which should have forced the Russian side to decrease the gas price for the purpose of competing with Azerbaijani gas. If the companies established with Russian partners incurred losses, they would be forced to negotiate with GazExport. If they failed to do so, they would probably become bankrupt and be forced to sell the assets.

In contravention of the principles of a free market, which are part of the official policy declared by the Georgian government, the government decided to purchase the entire volume of gas supplied from Azerbaijan and Russia and sell it to large consumers at a weighted<sup>29</sup> price.<sup>30</sup> Thus, instead of importing cheap gas on its own with the assistance of the parent companies, the Russian-Georgian and Russian-Kazakh gas companies acting in Georgia became beneficiaries of cheap Azerbaijani gas.

It should also be noted that on November 9, 2007 the Georgian government adopted decision #657 pursuant to which the Georgian Oil and Gas Corporation is obligated to cover the majority of the credit issued to gas companies in January 2007 for the purpose of purchasing the Russian gas. By doing so, the government admitted that the Georgian Gas and Oil Corporation was the only company importing gas to Georgia in 2007. It is known that the large distributors of gas have not imported gas during the stated period and therefore they could not have used the credit allocated by the state.

By the same decision the Government instructed the Georgian Oil and Gas Corporation to sell the associated gas designated for the Corporation to Mtkvari-Energy, Energy-Invest, and Tbilisresi for not less than 25 USD (excluding VAT). It is unclear which associated gas the decision refers to and why it should be sold to those companies at such a low price.<sup>31</sup>

---

<sup>29</sup> Average price calculated on the basis of multiple gas prices.

<sup>30</sup> According to the statement of T. Gochitashvili, advisor to the Georgian Oil and Gas Corporation, the Corporation was trying for the whole year to replace Russian gas with cheap Azerbaijani gas. For this purpose, the infrastructure connecting Georgia with Azerbaijan was being developed. As a result of these actions, nowadays the stated infrastructure allows Georgia to receive as much gas as Azerbaijan can potentially supply to Georgia.

<sup>31</sup> There is a small amount of associated gas at the Ninotsminda field, which is supplied to the population of Sagarejo.

According to official statements made after the suspension of the Azerbaijani gas supply, during the winter months (December, January, and February) Georgia would consume the gas retained in exchange for transit of gas to Armenia.<sup>32</sup> According to the explanations provided by the Oil and Gas Corporation, the gas to be received as a price for Armenian transit was reserved for consumption during the winter months. However, the gas transportation company has the gas retained as a price for Armenian transit documented as received and distributed in 2007 on a quarterly basis. Thus, there are discrepancies between the official verbal explanations and the data contained in official documents, which requires more clarity on behalf of the government.

## Conclusion

The negotiations regarding the supply of cheap gas conducted by the Georgian government with Turkey, the International Consortium, and the Azerbaijani government make it obvious that the government is fully aware of the tools available to Georgia as a transit state and is trying to make use of them. It should also be noted that during the past year the government managed to ensure the full supply of natural gas to the country and react to the problems caused by the aggravated relations with Russia in a timely manner. However, significant problems remain in the government policy related to the gas sector in respect to the following:

- (a) Privatization: The aim of the Georgian government to sell the large gas companies to those investors that would import cheap Russian gas was not achieved. Instead, Russian-Georgian and Russian-Kazakh business groups became recipients of Azerbaijani gas.
- (b) Gas supply: The attempt of the Georgian government to receive the needed volume of gas (1.5 billion cubic meters) solely from Azerbaijan conflicts with its aim to diversify gas supply sources, which is the most important element for ensuring energy security.
- (c) Establishment of a liberal market: Currently the Georgian Oil and Gas Corporation is the main supplier of natural gas, which is a step towards increasing state control over the gas market and not towards its liberalization.
- (d) Gas supply security: The government failed to execute a long-term contract<sup>33</sup> on the supply of gas either with Azerbaijan or with Russia, which threatens market stability.
- (e) Transparency of negotiations:<sup>34</sup> The current gas supply agreements with Azerbaijan and Russia appear to be verbal. In this situation it is unquestionably difficult for the public to have complete and trustworthy information about the terms of the negotiations, which causes significant threats both in terms of energy and the

---

<sup>32</sup> During the winter months Georgia consumes on average 6 billion cubic meters of gas. Gas transit to Armenia amounts to about 200 million cubic meters annually.

<sup>33</sup> The long-term contracts on gas supply are considered to be one of the prerequisites for gas supply security on the western market.

<sup>34</sup> Georgian Oil and Gas Corporation advisor Prof. T. Gochitashvili disagrees with this opinion. He believes that “the commercial negotiations are not open for public; therefore indication to the “secret” conduct of negotiations should be considered inadequate.”

economy. Some experts suspect that the Georgian government has offered the Azeri side significant Georgian assets in exchange for cheap gas.<sup>35</sup>

- (f) Strategic approach: To date, the government does not have an established long-term energy balance,<sup>36</sup> which would define the role of each source of energy (hydro, gas, renewable sources, etc) in the general energy balance. In 2007 Georgia consumed only 1.75 million cubic meters of gas.<sup>37</sup> Though the potential for gas consumption to increase has not been established, the government has resumed talks regarding the construction of a gas storage facility, which betrays the government's lack of a strategic approach to the energy sector.

Author: Liana Jervalidze  
Energy Expert  
Transparency International Georgia

---

<sup>35</sup> Here the Georgian government uses the same strategy as it did in 2005 when privatizing main gas consuming companies to Russian/Georgian and Kazakh/Russian/Georgian business groups hoping that Russian and Kazakh partners would supply the Georgian market with cheap Russian and Kazakh gas.

<sup>36</sup> We are referring to long-term energy balance, which should indicate the role of each source of energy (hydro, gas, renewable sources) in the general energy balance.

<sup>37</sup> Cement factories, one of the largest consumers of natural gas have decided to use Georgian coal as a cheap source of energy instead of expensive imported gas. So gas consumption either will decrease or remain the same in the coming years.