Regulatory and Competition Reforms in Georgia: Challenges and Problems

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Abstract: As part of regulatory reform, restructuring and privatization has been accompanied by the substantial deregulation of several industries (including telecommunications, airlines, trucking, financial markets etc) and introduction of new regulatory and competition agencies. But actually, the reforms carried out during 1992-2003 have not produced expected benefits.

It is clear that Georgia faces the challenge of re-organizing country competition and regulatory regimes. The Georgian Government attempts to implement major economic deregulation initiatives, aimed at narrowing the scope of regulation, broadening the role for private markets to allocate recourses improving general efficiency and welfare of society.

This paper has the following subjects:

- to examine industry regulatory and competition laws and appropriate enforcement practice to seek the degree to which the existing regulatory regime is friendly to investor and whole society;
- to elaborate suggestions to make regulatory system more transparent and effective;
- To make suggestions for changes of competition law to reflect universal competition principles and rules included in the appropriate provisions of the EU Treaty and the UNCTAD's Set on Multilaterally Agreed Set of Equitable Principles and Rules for the control of restrictive business practices.

1. Introduction

"Recent decades have seen countries around the world embark on bold reforms to improve the state's capacity to regulate economic activity. While evidence of this movement can be found in most fields of regulation, the trend is particularly marked in regulation aimed at controlling the creation or exercise of market power. Regulatory interventions in this area traditionally fall within two distinct categories: utility regulation aimed at controlling the pricing and other behaviour of monopolistic firms that provide essential infrastructure services and competition (or antitrust) regulation, aimed at protecting the competitive process in most other parts of the economy. Regulatory schemes comprise two key elements: rules establishing the boundaries of permissible conduct, and institutions charged with administering and enforcing those rules"[155].

There is a common consensus that for proper functioning the competition and other regulatory bodies must have both functional and financial autonomy. The independence is even more important in developing countries where state owned enterprises still exist.

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[155] Regulatory Institutions for utilities and competition, international experience, by Warwick smith and R.David Gray

As part of regulatory reform restructuring and privatization has been accompanied by the substantial deregulation of several industries (including telecommunications, airlines, trucking, financial markets etc) and introduction of new industry regulatory and competition agencies around the world. As well as in many other countries, creating independent regulatory institutions has become a key element of utility sector reforms in Georgia. However, as it practices evidences, actually, the reforms carried out during 1992-2003 have not produced expected benefits. As to the recent changes in field of economic regulation, it is clear that the Georgian Government attempts to implement major economic deregulation initiatives, aimed at narrowing the scope of regulation, broadening the role for private markets to allocate recourses improving general efficiency and welfare of society. But it is also evident that Georgian regulatory reforms does not produced expected benefits, the regulatory regime in Georgia is not cost effective and competition policy is under the crisis. Presently, Georgia still faces the challenge of re-organizing country competition and regulatory regimes.

In this situation it is necessary:

- to examine industry regulatory and competition laws and appropriate enforcement practice to seek the degree to which the existing regulatory regime is friendly to investor and whole society;
- to elaborate suggestions to make regulatory system more transparent and effective;
- To make suggestions for changes of competition law to reflect universal competition principles and rules included in the appropriate provisions of the EU Treaty and the UNCTAD's Set on Multilaterally Agreed Set of Equitable Principles and Rules for the control of restrictive business practices.
- etc.

2. Regulatory Reforms: Lessons from International Practice

There are some common elements that designers of regulatory agencies need to address. Among them must important issues that still are subjects for continuous debates are: the scope of regulatory activities, independence and accountability, regulatory design, decision making structure, resources and etc.

In designing regulatory systems, policymakers need to resolve two fundamental challenges: how much discretion should regulatory systems contain and how should that discretion be managed to reduce the risk of its misuse.

The utility regulation aims: to protect consumers from abuse by firms with monopoly market power, to support investment by protecting investors from arbitrary action by the government, to promote economic efficiency and development of sound competition.

According to international experience regulation can be carried out by the government ministries, independent regulators, or courts. The nature of the regulatory institutions can affect not only the style of regulation, and strategies, but also the success with regulatory ends is achieved. The choice among these types of regulators is ultimately a pragmatic one. But there is common consensus that if a country government really wants to attract a serious private investments in liberalized

infrastructure sectors, it has to adopt a new style of regulation – regulation by the independent regulatory institutions"(regulation that is limited, transparent and „lets managers to manage").[156]

The rationale for creating specialist institutions lies in the nature of the tasks required by economic regulation, the characteristics of infrastructure industries and conflicting interests of the main stakeholders.

The tasks of utility regulation in network industries are complicated by several related reasons/conditions that militate in favor of independent regulatory agency. Among them are: a) scope and nature of investments in utility /infrastructure sectors;

b) Conflicting interests of main stakeholders (Namely: consumers do not care whether the monopoly is natural or unnatural. They simply want to be protected from monopoly prices and monopolistic behavior of suppliers. As to investors, they also need protection. Once they invest in infrastructure sectors and their investments have no value in other uses, they are vulnerable to being held economic hostage. Government regulation is needed to convince investors that they will recover reasonable costs and earn a profit commensurate with the risk they take.

Accordingly, "there are the three related considerations that militate in favor of independent regulatory agencies.

- First, since utility services are perceived to be essential and the majority of consumers are also voters, government's face pressures to use regulation to achieve short term political objectives. Independent regulators with fixed terms and operating at arm's length from political processes are less likely to encounter such pressures."

- Second, the utility investments are typically large and immobile, and investors will be unwilling to take risks in such projects in the absence of credible commitment on the part of the government to ensure opportunities for reasonable return on their investment. Where the credibility of this commitment is in doubt, investors will demand higher returns to compensate for the increased risk, which translates into higher cost of capital and hence higher tariffs. Investors are aware of the pressures faced by political authorities and generally have more confidence investing in countries and sectors regulated by independent agencies."

- Third, creating credible commitments is rendered more difficult by the long-term nature of most utility investments. There may be several changes in power in the government over the life of a typical infrastructure investment. Appointing IR with fixed terms that that are not co-extensive with that of the government may help reassure investors that regulatory treatment of their investments will not change with every change in the government".[157]

In addition, industry regulation often involves making decisions on politically sensitive matters. This is most clearly with public utility regulation. There are no votes

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[156] Utility Regulators: The Independence Debate by Warlock Smith. - The Private Sector in Infrastructure The IBRD/the World Bank, 1997. pp.22-24

[157] Regulation: What the Prime Minister Needs to Know by Bernard Tenenbaum. The Electricity Journal. March.1995. pp 28-33

in rising utility prices, and history is replete with examples justifiable price increases being withheld at the expense of investors and the long term interests of consumers. , Tariff increases are never popular with consumers, who usually constitute a very large proportion of voters, political authorities than often face strong pressures to withhold justified tariff increases to avoid popular criticism. However, the possibility that regulation will be administered in this way creates risk for investors in typically capital intensive and immobile assets. Unless these risks are mitigated investors will withhold investment or demand risk premium, resulting in reduced investment and higher tariffs for end-users. Regulatory risk can deter investors, increase the cost of capital, increase required tariffs and/or reduced proceeds from privatization. To day no fully satisfactory method exists for measuring the impact of particular regulatory system design on the cost of investment capital. However it is clear that if government has different from stakeholders aims and some regulator is not independence commission but government ministry it will not be able to adopt impartial regulatory decision, especially in situation when the part of the industry remains in state ownership. All the above mentioned makes it clear that, Old style regulation is not an option for any country serious about encouraging significant, sustained investment in its infrastructure sector. "Unless the government has made a credible commitments to rules that ensure an opportunity to earn a reasonable returns, private investments will not flow. Weak credibility will be reflected in higher capital cost and thus higher tariffs. In privatization this translates into smaller proceeds from sales of existing enterprises and higher financial costs for new projects"[158].

The design of regulatory institutions involves trade-off between many competing objectives. For example: the goal of independence needs to be balanced with the goal of ensuring adequate accountability; the goal of fostering industry specific focus and expertise needs to be balanced with against the goals of facilitating coordination between industries and realizing economic of scale; the goal of integrating all regulation of particular industry in one agency may be need to be balanced against the goal of integrating economic wide regulation on competition, the environment and other issues. Similar trade-off affect most issues of agency design.

There is no doubt that there are a number of reasons for creating independent regulators. However it should be noted that the independence must be understood as a relative than absolute concept. In any system it is needed to reduce the risk of improper political interference, not to provide ironclad guarantees. According to the international experience three basic notions of independence are:

- An arms relationship with regulated firms, customers and other private interests
- An arm's length relationship with political authorities
- The attributes of organizational autonomy such as embarked funding and exemption from civil service salary rules necessary to foster the requisite expertise and to underpin those arm's length relationship.[159]

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[158] Regulation: What the Prime Minister Needs to Know by Bernard Tenenbaum. The Electricity Journal. March.1995. pp 28-33

[159] Utility Regulators – Creating Agencies in Reforming and Developing Countries. By Warrick Smith. International Forum for Utility Regulation. UK, June 1996

The design of, effective" regulatory institutions involves defining the proper regulatory scope and policies. There is a growing literature on what constitutes an effective regulatory system. According to the widespread opinions, effective regulatory institutions must be characterized by clarity of roles and objectives, autonomy from political system, wide participation by relevant stakeholders, accountability to outside agencies, transparency of decision making process and predictability of decisions. In many large developed countries (such as UK and USA) regulator possess most, if not all, of desirable characteristics", but the economic and social structure of small developing countries may act as obstacles in achieving them". In Low income developing countries the problem of the supply of adequate human capability is quite acute. The problem in low income countries seems to be exacerbated by their prevailing poor governance and corrupted structure. The 2002-DR stresses the importance of clear governance rules for developing countries. It reports that in general lower income countries tend to have more barriers to regulatory reforms and to the introduction of competition". This also implies that poor governance rules not only affect the number of personal that regulatory institutions can employ, but also the ability of such staff to function effectively".[160]

According to the same author "a pervasive feature of many (but by no means all) developing countries is the high level of government corruption, which increases the need for uncorrupt, professionally trained staff in regulation, in order to counterbalance the more difficult governance structure. However government in countries with high levels of corruption may also wish to use utility regulators (particularly Ministry Regulators) as a method of creating jobs – or jobs for favored people. In such a situation the qualifications the professional staff may be doubtful quality and relevance. Also there may be unwillingness on the part of appropriately qualified professionals to work in the regulatory agencies where governance is poor and/or corruption is widespread. In this circumstances, the recruitment policies of the regulatory institutions are likely to be subject to political pressures of various kinds".[161] One of the main conclusions of the studies is that even in the face of some political instability the existence of independent institutions and a professional and competent judiciary can assure better policy stability even in developing countries"

Creating an effective independent agency no easy task for any country and it is even more challenging in countries with limited traditions in regulation through the independent regulators limited regulatory experience and capacity. The two main elements of independence – isolation from improper influences and measures to foster the development and the application of technical expertise can be a source of resistance to improper influences and organizational autonomy helps in fostering technical experience.

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[160]. Modeling the Costs of Energy Regulation: Evidence of Human Resource Constraints in Developing Countries by Preetum Domah, Michael Pollitt, and Jon Stern. http://papers.ssrn.com/so13/papers.cfm/abstract_id=371600

[161] Modeling the Costs of Energy Regulation: Evidence of Human Resource Constraints in Developing Countries by Preetum Domah, Michael Pollitt, and Jon Stern. http://papers.ssrn.com/so13/papers.cfm/abstract_id=371600

Some argue those governance traditions in some countries make independence illusory "If the palace calls, the regulator will comply." First and foremost the independence must be understood as a relative than absolute concept. In any system the goal of independent regulation can only be to reduce the risk of improper political interference, not to provide ironclad guarantees.

Most systems meet these goals through the following safeguarding requirements/ mechanisms:

- Ensuring the regulator is separate from regulated firms, including state-owned firms
- imposing restrictions on conflicting interests
- Imposing restrictions on subsequent employment
- a clear mandates to make relevant decisions free from political direction
- expressing the regulators mandate and key safeguards of independence in a legal instrument that cannot easily be amended or changed
- appointment criteria and processes to reduce partisan appointments
- fixed term appointments, restrictions on arbitrary removal
- exemptions from civil service salaries
- access to ear-marked funding
- rigorous transparency requirements
- appeals from regulator's decisions
- performance scrutiny by public audit offices
- budget scrutiny by legislature [162]

The similar safeguarding mechanisms are introduced by the Georgian Laws "On Independent National Regulatory Bodies", "On Telecommunication", "On Electricity and Gas", "On Securities Market" etc.

As to the scope of activities of the independent regulator, according to the international experience they can be established on three main basis – industry specific (a separate body for each industry); sector-wide (a body established for each more broad sector such as energy or transport); multi-sectoral – a single body for all or most industries. Each of these models has own advantages and disadvantages. For example, a multisectoral agency has several potential advantages including: sharing resources, reducing risk of capture by the industry, reducing risk of political capture etc. It is recognized that multi-sectoral agency offers advantages over the alternatives, especially for small and resource scarce developing countries. "Certainly the arguments for such agencies are especially strong in these cases though the California example is clear evident that multi sectoral agencies are efficient in big countries too" [163].

In the article "What the prime minister needs to know" Bernard Tanenbaum wrote that: The transition from state-led to market economy is far from complete and market opening will likely continue for a several decades. Before the adoption of

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[162] Utility Regulators Decisionmaking Structures, Resources and Start up Strategy, by Warrick Smith

The Private Sector in Infrastructure The IBRD/the World Bank , 1997

[163] Regulatory Institutions for utilities and competition, international experience, by Warrick smith and R.David Gray

regulatory decisions concerning the regulatory reforms the nine basic design questions must to be answered whenever a new regulatory system is required:[164]

- Should there a single regulator or a commission?
- Should the regulatory entity have jurisdiction over one sector or several? What activities or parameters should be regulated
- What are the control mechanisms for prices and quality
- How are regulatory rules created and enforced
- Should the regulatory entity be independent of government
- Should be regulatory process be transparent
- Who regulates the regulator
- How should responsibility be divided between the regulatory entity and other government authorities?

It is difficult to say whether the Georgian policymakers answered the similar questions ten years ago.

I strongly believe that the creation of the narrow specific independent regulatory bodies for each regulated industry is not economically reasonable. I can not be agree with Georgian, sense" of independence that is different from meaning established in international practice. Independence in Georgia is understood as absolute dimension. However according to the following extracts, it is clear that improper understanding of regulatory independence is not only Georgian problem. For example:"No regulatory entity can be truly independent (it is the creature of government because it was created by government", "What people mean under the independence of Regulatory entity is a government entity that does not have to get the approval of the prime-minister or other high level political authorities to raise (or lower) tariffs", Independence does not mean an absence of accountability. There is still accountability but, it is to the tariff standards in the law, not to the minister'', " The main misunderstanding arises from confusion about the reason for independence," " Independence is not an end in itself but a means to an end. What ultimately matters is not whether the regulatory entity is independent, but whether the government can give a credible commitment to investors and consumer."

At the same time one should remember that: Regulation is not a magic bullet and it won't work in the absence of basic political commitments to protect consumers and investors. In fact the regulation is nothing more than a system that allows a government to formalize and institutionalize these two commitments. If these fundamental commitments do not exist, regulation becomes nothing more than a system of empty formalities".

According to the OECD review of experiences in member countries Scot Jacobs wrote that independent regulators in many countries have not resolved many serious regulatory failures and they have created many new potential problems that have not been adequately assessed. Namely:

- Independent regulators can reduce political will for real reform;

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[164] Regulation: What the Prime Minister Needs to Know by Bernard Tenenbaum. The Electricity Journal. March.1995. pp 28-33

- the risk of capture can be high;
- Independent regulators can slow the larger adjustment of the sector, and therefore lose the potential gains to economic growth and consumer welfare.
- "In many countries the relationship with competition authority is confused. That is, sectoral regulators are responsible for dealing with classical competition problems, under their own statutes rather than under the competition law. The result of this is to fragment competition principles so that different principles apply to different part of the economy. This is extremely risky and has produced conflict and confusion in some sectors in some countries. General regulators are usually not competent to apply competition law – this has been shown by mistakes made in many countries. The OECD is firmly of the view that there should be a single, economy wide framework of sound competition policy principles that is applied equally everywhere. Sector specific regulatory regime and independent regulators should not be able to establish sector specific competition policies."[165]

According to the same author, the second generation of market reforms must take more seriously the question of how can a government can design an independent regulator in order to minimize risk of rigidity, capture, and non-accountability. According to recommendations the future reforms should be based on the following key principles:

- minimize the need of regulation by getting the industry structure right from the very beginning;
- thoroughly assess the design of the regulator in light of the evolution of the industry/sector. Adaptation over time to changing conditions will be essential;
- establish close working relations with the competition authorities to preserve consistency in the economy wide competition policy;
- get the framework conditions right;
- establish clear appeal processes and judicial procedures;
- Balance independence with political accountability,[166] etc.

3. Georgian Regulatory and Competition Reforms

As well as in many postsocialist countries, In the last decade demonopolization, restructuring and privatization has been accompanied by the substantial deregulation of several industries (including telecommunications, airlines, trucking, financial markets etc) and introduction of new regulatory agencies, including the Communications Commission, and the Energy Regulatory Commission etc. In addition the State Antimonopoly Service was created with a broad range of functions in fields of competition and consumer's protection (It should be noted that there were not

[165] Independent Regulators Adopted from "The Second generation of Regulatory Reforms" paper by Scot Jacobs at the IMF Conference on Second Generation of Regulatory Reforms. November 1999, Washington DC

[166] Independent Regulators Adopted from "The Second generation of Regulatory Reforms" paper by Scot Jacobs at the IMF Conference on Second Generation of Regulatory Reforms. November 1999, Washington DC

established clear boundaries of responsibilities among the above mentioned structures, as well as effective appeal system).

But actually, some argue that nothing was changed for main stakeholders - the major expected benefits (reducing prices for services and products, increasing choice and quality) of regulatory reforms have not been achieved. Many issues remain contentious, among them is topic of agency independence that is the subject of continuous debate and different interpretations. The process of designing proper structures needs to resolve two fundamental challenges: how much discretion and how to reduce risk of misuse of independence? As it practice evidences the "independence'' creates problems with accountability in Georgia (as well as in many other countries). Many Georgian policymakers don't understand and/or recognize that "independence" is not an absolute dimension and no regulatory agency is independent from the governing system, since it operates under laws that can be changed. Existing regulatory agencies have problems with clarity, roles and objectives, and are characterized with resource constraints and weak enforcement practice, lack of transparency, independence and autonomy from political system. In addition, comparing the costs of regulation with impacts it is clear that:

- the regulatory reforms are not effective and benefit only narrow groups of people rather than the whole of society;
- The reforms carried out during 1992-2003 have not produced expected benefits (reducing prices for services and products, increasing choice and quality). In addition there are the problems with continuity of supply, quality of services, collective cuts, etc.;
- there are the problems of overlapping tasks between competition and industry regulatory bodies;
- Competition policy in force is weak and fragmented in regulated sectors.

Many experts suggest that utility regulatory agencies should be characterized by:

Independence, clarity, autonomy, wide participation of stakeholders, accountability, transparency of decision making process, predictability of decisions. In addition, the supply of trained staff is necessary for effective work.

According the empirical studies, in spite of improved regulatory agency design the Georgian National Regulatory Commissions are not really independent from political system and characterized by transparency of decision making process and predictability of decisions.

According to the widespread opinion, the independence of a regulatory agency is considered in three elements:

- arms length relationship with regulated firms, consumers and other private interests;
- political independence
- Financial independence i.e. one of the main elements of autonomy (exemption from civil service salary rules).

In the Georgian examples, we can say that our industry regulatory commissions comply only with third criterion, partially comply with second one and unfortunately, we can not say the same about first criterion.

There is an established common consensus on how to ensure that independence is balanced with accountability. The following measures are recommended by international organizations to ensure that regulators are accountable for their action:

- transparency, including open decision making and publication of decisions and the reasons for those decisions;
- prohibiting conflict of interests;
- existence of effective appeal systems
- provision for scrutiny of budgets usually by legislation
- Subjecting the regulators conduct and efficiency to scrutiny by external auditors or other public watchdogs.

Instead the following these tenets in Georgia, many ignore the principles of accountability not only in practice, but also at legislative levels.

It should be noted that the question of how to balance the tension between democratic accountability with the decision making independence of regulatory bodies is notoriously difficult. In some countries the balance is biased toward establishment of independent regulatory bodies whose heads are shielded from political intervention in case-by-case decisions, but at the same time their authority rests on laws that can be revised by parliament.

The debate over the independence of regulatory agencies is not unique to utilities. Confusion exists over what independence entails, why it is important, and how it can be reconciled with accountability. Some governments are reluctant to surrender policy control over regulatory decisions. First and foremost, there is common consensus in literature that independence must be understood as a relative rather than as absolute concept. The goal of the creation of independent regulatory agencies can only be to reduce the risk of improper political interference/intervention, but not to provide ironclad guarantees.

Striking the proper balance between independence and accountability is notoriously difficult. However, the practical evidence is that a growing number of countries seek to achieve this balance through special measures, including:

- provision for scrutiny of the budget;
- Subjecting regulator's conduct and efficiency to scrutiny by external auditors and other independent public watchdogs.

In practice this, independence" creates problems with accountability in Georgia. Many Georgian policymakers don't understand or don't recognize that "independence" is not an absolute dimension and no regulatory agency is independent from the governing system, since it operates under laws that can be changed. It seems that (for example in the case of GNERC – the Georgian National Energy Regulatory Commission) the dimensions of accountability are being neglected in the rush to independence. The clear example is the law "On Independent National Regulatory Bodies" adopted by the Parliament of Georgia adopted on June 21 of 2002. It should be noted that there are a number of general and special legislative Acts operating in parallel

with this law. These Acts regulate both legal and organizational status and the rights and obligations of such bodies as GNERC, GNCC (Georgian National Communications Commission) etc. In addition the law "On Legal Persons of Public Law" provides for the possibility of the assignment of special regulatory powers of the State to subjects of law in different fields. Such a delegation is admissible only according to a special sectoral law.

As regards the law, On Independent Regulatory bodies it applies to the Georgian National Communications Commission (GNCC), and the Georgian National Energy Regulatory Commission (GNERC), the State Agency for Oil and Gas Revenues, and, every body which under the Georgian legislation will acquire the function of independent regulation of special fields in future and which, under this law and Georgian legislation, is an independent regulatory body".

According to this law, the basic principles of independence are provided (I can say "Georgian principles of independence") and inadmissibility of any type of control with regard to the regulatory body is one such principle.

This law is focused upon securing the independence of the regulatory bodies that explicitly regulated existing sectoral legislation.

It is clear that Georgian legislation ignores one of the main tools for achieving the balance between the independence and accountability of regulatory bodies. It is said that the above mentioned law was adopted to prevent the scrutiny of GNERC by the Chamber of Control.

The transition from state-led to market economy is far from complete and will continue for several decades. The success of reforms depends on the capacities and effectiveness of new institutions, especially the newly established regulatory agencies that regulate relations between the state, market participants and civil society. Creating independent regulatory agencies has become one of the key elements of reform in transition countries. According to worldwide principles, public utility regulatory agencies can be organized on three main bases: industry specific, sectored, and multi sectoral. Each of these models has a number of advantages and disadvantages. There are suggestions that multi-sectoral agencies offer advantages over the alternatives, especially for small and poor countries like Georgia (though in practice they are also effective for countries with big economies - such as California). There is another rule: if more than one agency is involved in regulating utilities, the role of each of them should be defined as clearly as possible, to avoid duplication, uncertainty and turf disputes.

In addition the State Antimonopoly Service was created (in 1997) with a broad range of functions in fields of competition and consumer's protection. It should be noted that clear boundaries of responsibilities were not established. In addition, in parallel with the adoption of new laws and the creation of new institutions appropriate changes and amendments were not made in the existing law (clear examples are the law "on Prices and Price Foundation Principles" and the State Price Control Inspection). "In this regard it is interesting to examine a commentary on the law "On Prices and Principles of Price Formation" of the foreign experts working in Georgia. For example: "The law "On Monopolistic Activity and competition" is the foundation of Georgia's commitment to free and open markets. Under the provisions of this law, the State Antimonopoly Service is responsible for preventing barriers to competition and reducing or eliminating monopoly problems. The long-term success of Georgia's

economic reform program will largely depend on the degree to which Antimonopoly law is enforced. Unfortunately competition policy is jeopardised by the law "On Prices and Principles of Price Formation (1997). (See: CEPAR Economic Commentary Report #6, The Law "On Prices and Principles of Price Formation" A Barrier To Free Markets, Prepared by Larry Morgan, November 1997).

Besides, comparing the costs of regulation with their impact we can conclude that regulatory reforms in Georgia are not cost effective, and benefit only narrow groups of people rather than the whole of society.

According to worldwide practice, regulatory tasks, like other government functions, were traditionally funded from general tax revenues. Presently, most regulatory agencies obtain their income from levies on consumers. The levies may be charged directly (in case of energy regulation in Georgia where the special component is included in consumer tariff structure) or collected indirectly, by imposing a levy from regulating firms; allowing them to pass the cost on to consumers through tariff. This approach is used in many countries. It reduces demands on general tax revenues (from the state budget) and imposes the financial costs of regulation on the primary beneficiaries (consumers). Another approach is funding from state budget ensuring that regulatory agencies have a reliable source of income and thus is a safeguard of agency independence. In countries where the first approach is used, the law, to prevent levies from becoming burdensome establishes a cap of levies. At the same time, levies often are defined by reference to industry turnover, or some other indicators. The maximum of levies varies from 0.5 to 2.0% for different fields.

As to Georgia: the regulatory fee in telecommunication is established at the level of 2,5. And in the energy sector, approximately 1.5%. Besides, the regulated firms are obliged to pay a license fee which partially goes into the commission's budget. At the beginning stage of reform consumers had paid additionally 0.2 Tetry for 1 kvt of consumption of electricity.

In this situation, I don't think those newly established regulatory agencies, especially when the regulated companies fund them, could be really independent from the sector. What is very important,are the levies and regulatory fees in Georgia are established not by the legislative bodies but the commissions? In addition, the best practices show that (besides the levies that are established each year to cover a budget) it is necessary that the budget of regulatory agencies needs to be approved by legislature, but not by the commission. Laws and practices also ignore this principle.

As to competition policy, it is stressed in my articles published during the 2000-2004:

- "The competition legislation of Georgia requires significant changes. According to analysts the competition law of Georgia needs to be strengthened to encompass all types of anti-competitive behavior. It also needs to reflect universal competition principles and rules included in the appropriate provisions of the EU Treaty and the UNCTAD's set of multilaterally agreed equitable principles and rules for the control of restrictive business practice". "Besides the enactment of a new laws and

appropriate amendments in corresponding laws, the Antimonopoly Service of Georgia needs to elaborate special guidelines for different aspects of enforcement".[167]

- "A common problem in Georgia, as well as in many countries, is that the relationship between the competition authority and sector specific regulators is often confused. It is clear that there are overlaps between industry specific regimes governing access to the networks, and economy wide rules governing the misuse of market power. The amendments made in the Laws 'On Consumers' Rights Protection' and 'On Monopolistic Activity and Competition' make it evident that the first generation of the industry regulatory reforms in Georgia resulted in the fragmentation of the competition and consumer policies. That is, sector-specific regulators are responsible for dealing with classical competition problems, under their own statutes rather than under competition law". For example, in 2000 the Law 'On Monopolistic Activity and Competition" (1996) (Article 5) was amended in the following manner: "The National Independent Regulatory Commission, as well as the Georgian Regulatory State Agency of Gas and Oil Recourses, are the only authorized bodies to provide the regulation and control within the framework of the competence determined in the appropriate law".[168]

- "It is necessary to have a clear interpretation of the functions, dividing exactly the competence and responsibilities of the State Antimonopoly Service of Georgia and Independent Industry Regulatory Commissions. It is also important to strengthen the status and institutional capacities, and to increase the effectiveness of the State Antimonopoly Service; to develop a clear, predictable and transparent process of competition law enforcement, so that investors can be confident that they will be protected from anti-competitive actions of incumbent enterprises, and for the public to be assured that monopoly behaviour will not be the outcome of the transition to the market economy".[169]

- "According to the World Bank-OECD model law on competition "enforcement agency should be independent from any government department and should receive its budget directly from the legislature (and report to the legislature). However, the fact that they are not dependent on government department for its finances does not necessarily mean that they are free from general influences".

What has happened recently is exactly the reverse.

In February, 2004, a new law: "Concerning the Structure, Proxy and Activity Rules of the Georgian Government" was adopted by the Parliament of Georgia. This law required restructuring of the state apparatus. Surprisingly the Ministry of Transport and some other government departments were merged with the Ministry of Economic Development. The same ministry also has the responsibility of privatization and economic reforms. It has proposed legal amendments to create one regulator for all regulated sectors. Further proposing that the existing regulatory regime will be liberalized/simplified to make it cost effective. In 2005, the law on Independent

[167] Georgia, by Ketevan Lapachi, in "Competition Regimes in the World – A Civil Society Report, edited by Predeep Mehta, India, 2006, CUTS International – INSCOS, p.378

[168] "Competition Regimes in the World – A Civil Society Report, edited by Predeep Mehta, India, 2006, CUTS International – INSCOS, 379

[169] Georgia, by Ketevan Lapachi, in " Competition Regimes in the World – A Civil Society Report, edited by Predeep Mehta, India, 2006, CUTS International – INSCOS, p.378

Regulatory Bodies was amended to create one single regulatory body in the transport area, instead of four regulatory departments under the Ministry of Economic Development. The Ministry of Economic Development was made into a super ministry handling many portfolios. Changes were also made in the State Antimonopoly Service of Georgia. This involved two major changes. Firstly, the head of the authority was to be nominated by the Minister for Economic Development and to be appointed by the Prime Minister, whereas earlier it was a Presidential appointment. Secondly, the staff was whittled down, from 150 to 19. However the functions, powers and responsibilities were not changed.

Later, in June, 2005, a new competition law was adopted: "On Competition and Free Trading". The old competition law "On Monopolistic Activity and Competition" (1996) was repealed. Not only that, but it was an absolute disaster. The SAGS (the State Antimonopoly Service of Georgia, that was responsible on the state control over the implementation of the Georgian Laws "On Monopolistic Activity and Competition", "On Advertising" and "On Consumer's Rights Protection) wound up being replaced by the Free Trade Agency under the Ministry of Economic Development, with a much reduced scope, only covering anticompetitive actions by the government. Provisions on anticompetitive practices by the business, abuse of dominance and combinations were removed. Further, the number of staff was reduced to just 12. [170]

The newly adopted competition law does not contain the principal provisions concerning anticompetitive agreements, abuse of dominant positions and concentrations. In the current phase of economic reforms, actually, Georgia has neither a competition law nor a competition authority.

It's really very disappointing that neither in governmental circles nor in foreign donor organizations located in Tbillisi (if not take into account conclusion of GEPLAC, and –Tacis project, and one or two independent expert's negative comments that in fact had no result) at the stage of the legislative amendments there was not even a single opponent who would have criticized the above mentioned legal changes. This obviously says about shortage of professionally qualified lawyers and economists as well as a lack of state approaches in governmental circles of Georgia.

Taking into account all the above mentioned, the changes in competition law and policy, made since 2004 are obviously step back on the way of competition policy development and is not appropriate to the course of reforms recognized by the country,and its aspiration for getting in Euro Atlantic Structures. Today, Georgia does not have either "a legislative base or an appropriate institute to protect competition. In such kind of conditions, without improvement of competition policy there might be a serious risk for Georgian commodity markets to be developed with clannish principles and become as a field of anticompetitive activities for already established market powers (the signs of it are already visible). All this will reflect on the investment image of the country and the results of economic development too in the long-term perspective.

[170] Georgia, by Ketevan Lapachi, in „Competition Regimes in the World – A Civil Society Report, edited by Predeep Mehta, India, 2006, CUTS International – INSCOS, p.378

Concluding Observations

Taking into account all the above mentioned, it is clear that the industry regulatory system needs to be reformed, taking into consideration international experience, best practice and recommendations. Georgia needs to develop its institutional approaches which better exploit the complementary expertise and perspectives of utility regulators and competitive agency. Georgia needs to reform its industry regulatory system to ensure successful reforms that reflects all industry specific characteristics as well as national economic and regulatory environment

It is likely that the Georgian Government will attempt to implement major economic deregulation initiatives, aimed at narrowing the scope of regulation, broadening the role for private markets to allocate recourses,and improving general efficiency and welfare of society, though the many conceptual issues are a subject of debates. Economic deregulation initiatives are a vital for improvement of the investment climate of Georgia. In this situation, it is necessary to establish a common understanding of important issues involved with: identifying priorities of reform, defining a key terms that are unavoidable in the regulatory debate; identifying some universal obstacles to the design of effective initiatives; noting important capacities and concepts that should guide legal changes and institutional design etc., It is not too early to begin a critical assessment of the performance of independent regulators to determine if improved design can avoid a future problems" and answer the questions: how effective is the existing regulatory model; what are the major political-economic factors which impede the implementation of competition and regulatory laws; agency independence can be understood; how to balance independence with accountability; how to ensure the proper boundaries between competition and Industry regulation; in which way regulatory institutions influence the governing environment, etc. Therefore it is needed:

- to provide complex analysis of the legal and institutional bases for public utilities regulation and competition, including the recent changes of competition law and concepts for future reforms of regulatory system elaborated by the government
- to explore the costs and benefits of regulatory activities;
- to highlight the potential gains from the future reforms of regulatory system;
- To make suggestions for improving competition and regulatory law in Georgia to make regulatory system effective.

Taking into account experiences of the OECD member countries, the future regulatory reforms must take more seriously the question of how can government design an independent regulator to minimize risks of rigidity, capture, and non accountability According to recommendations the future reforms should be based on some key principles:

- minimize the need of regulation by getting the industry structure right from the very beginning;
- thoroughly assess the design of the regulator in light of the evolution of the industry/sector/national economy;
- establish close working relations with the competition authorities to preserve consistency in the economy wide competition policy;

- get the framework conditions right. The regulator must work within the general framework of quality control for regulation that is established government-wide (these include public consultation, transparency, and regulatory impact analysis);
- establish clear appeal processes and judicial procedures, etc.

The competition legislation of Georgia requires significant changes by strengthening its provisions on all types of anticompetitive behavior. It also needs to reflect universal competition principles and rules included in the appropriate provisions of the EU Treaty and the UNCTAD's Set on Multilaterally Agreed Set of Equitable Principles and Rules for the control of restrictive business practices; the interaction between the competition and public utilities regulatory regimes should be defined clearly, there should be a single, economy-wide framework of sound competition policy principles that is applied equally everywhere; independent regulators should not able to establish sector-specific competition and consumer policies.

In this condition, fulfillment of legislative amendments concerning reforms with batch principle and in strong coordination conditions is the most important question to avoid necessary discrepancy among different normative acts and unpredictable consequences.

The severest crisis of competition policy and non-effectiveness of the system of industry regulation puts in agenda the necessity of serious reforms of the system of economic regulation. This demands strong political will and a group of highly qualified reformers supervised directly by the President of Georgia. The group that will be able to make reformative decisions proved economically, in consideration of not short-term effects but long term economical interests.

I hope that the Government of Georgia will show its appropriate political will for serious regulatory reforms within the united institutional frames, otherwise the energy, time and expenditure spent on reforms will be aimless formality.