



Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 27-Nov-2018 | Report No: PIDC25838

**BASIC INFORMATION****A. Basic Project Data**

Country Georgia	Project ID P169117	Parent Project ID (if any)	Project Name Energy Supply Reliability and Financial Recovery (P169117)
Region EUROPE AND CENTRAL ASIA	Estimated Appraisal Date Feb 25, 2019	Estimated Board Date Apr 30, 2019	Practice Area (Lead) Energy & Extractives
Financing Instrument Investment Project Financing	Borrower(s) Ministry of Finance, Ministry of Economy and Sustainable Development	Implementing Agency Georgian State Electrosystem	

Proposed Development Objective(s)

The project development objective is to increase electricity supply reliability, improve the financial viability of the electricity transmission company, and help the electricity transmission company access capital markets.

PROJECT FINANCING DATA (US\$, Millions)**SUMMARY**

Total Project Cost	58.00
Total Financing	58.00
of which IBRD/IDA	30.00
Financing Gap	0.00

DETAILS**World Bank Group Financing**

International Bank for Reconstruction and Development (IBRD)	30.00
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Non-World Bank Group Financing

Other Sources	28.00
Asian Infrastructure Investment Bank	28.00



Environmental and Social Risk Classification

High

Concept Review Decision

Track II-The review did authorize the preparation to continue

Other Decision (as needed)

B. Introduction and Context

Country Context

Economic growth accelerated in the first half of 2018 to 5.7 percent, supported by a strengthening of both external and domestic demand. Increased inflows of remittance and an acceleration of credit growth fueled domestic demand, while robust external demand boosted export of goods and services, including tourism. The impact of recent developments in Russia (a large export market and source of remittances) and Turkey (an important investors and trade partner) has been muted so far. Annual inflation stood at 3.1 percent in August 2018, within the central bank's 3 percent target.

External inflows remained strong in the first half of 2018. Merchandise exports grew by 28 percent year-on-year, tourism proceeds increased by 24 percent, and money transfers including remittances rose by 18 percent. However, robust domestic demand resulted in a 23 percent year-on-year increase in imports and a slight widening of the current account deficit. Despite a 4 percent depreciation of the Georgian lari (GEL) against the US dollar in August 2018, the effective exchange rate was appreciating for most of 2018 due to the weakening of the currencies of major trading partners, such as Russia and Turkey.

Substantial quasi-fiscal risks emanate from SOE's contingent liabilities. The Fiscal Risks Annex to the 2018 Budget Law suggests that the liabilities of the 76 high- and medium risk SOEs, including power sector, total about 20 percent of GDP. Additional risks stem from contingent liabilities generated by the government's 72 signed Power Purchasing Agreements (PPAs), which provide state guarantees for the purchase of excess electricity from operators on a seasonal basis.

Georgia faces number of structural challenges including a narrow production base, underdeveloped infrastructure, significant skill mismatches in the labor market, high financial dollarization, rural poverty, and inequality. Given its historically high current account deficit, Georgia is also vulnerable to regional developments and the risks associated with a sharp decline in export demand or a reduction in remittance inflows. While the impact of recent developments in Russia and Turkey has been contained, a prolonged and more profound disturbance could undermine the Georgia's prospects for tourism and investment, complicate access to capital and financial markets, and negatively affect economic growth. At the same time, with its strong business environment, Georgia is well placed to attract investors from neighboring countries seeking a more stable operating environment.

Sectoral and Institutional Context

Georgia is heavily dependent on hydropower resources for power generation needs. Installed generation is comprised of 21 percent thermal (710 MW) and 79 percent hydro capacity (2,661 MW), which is provided by storage hydropower stations (HPP) and run-of-river seasonal HPPs.

Georgia's power demand and supply patterns are inverse. Peak demand typically occurs in December, while peak supply capacity is in May and June. Thus, the country has been experiencing shortage of winter firm capacity to meet the seasonal peak demand and has been relying on imported electricity. Overall, the end-user power demand has averaged 3.8 percent growth from 2007 to 2016, despite a 5.3 percent drop in 2009 as result of the global financial crisis. Real GDP grew at an average rate of 4.8 percent during the same time period.



The Georgian power sector has undergone significant reforms over the last two decades with positive outcomes. Extensive regulatory and market reforms, focused on deregulation and privatization, have helped improve service quality in the power sector and the financial viability of sector entities. As result of past reforms, the power sector has gone from near complete operational and financial collapse to reliable energy services provider with sector companies in adequate financial standing. All regions have continuous 24-hour service, up from 2-6 hours of service in the early 2000s. During the same period, collection of billed electricity increased from 20 percent to more than 75 percent, and transmission system losses decreased from 16 percent to less than 1.5 percent.

Improvement of service quality is one of the key pillars of the Governments energy strategy. The Government's energy strategy is laid out in "Main Directions of the State Policy in Energy Sector of Georgia" dated April 2015. The main objective of the energy policy is to increase energy security. Policy directions include: (i) diversification of supply sources and optimal utilization of local resources and reserves to meet all local electricity demand ; (ii) utilization of Georgia's renewable energy resources, including hydropower, wind, solar, biomass and geothermal; (iii) improvements in service quality and protection of consumer interests; (iv) gradual harmonization with the European Union's (EU) Energy *Acquis*; and (v) energy market development and improvement of energy trading mechanisms.

Going forward, the Government will need to address the following key challenges in the power sector. The Government made significant progress in reforming the sector to restore 24-hour electricity supply to all consumers in the country and finance the critical investment needs with significant involvement of private sector. Going forward, the existing approach to financing the investments in power generation and transmission sectors may not be sustainable for the following reasons.

Challenge #1: Further increase of energy supply reliability. This would be essential for long-term sustainable development of the country to ensure that there is uninterrupted and high-quality of service available to all consumers. The Government is prioritizing regional economic development and therefore power transmission network will need to be strengthened in a way to minimize the disruption of electricity supply in case an outage occurs in any of the lines. In other words, there needs to be enough transmission capacity to avoid blackouts and outages if a particular transmission line fails.

Challenge #2: Deterioration of financial standing of GSE since 2015. GSE was put under bankruptcy protection in 2008 following the court ruling and Rehabilitation Plan was approved for the company in the same year. The bankruptcy protection was the result of inability to repay the debts to MOF and some other payables. The Rehabilitation Plan set out the strategic targets of GSE until 2023.

GSE made progress with improvement of its financial standing in 2009-2014. This was due to improvements in operational and financial efficiencies, including reduction of technical losses; rehabilitation of several key sections of transmission lines and substations; construction of new transmission assets that helped to improve reliability of supply and reduce the spending on recurrent repairs.

Starting from 2015, financial standing of GSE has been deteriorating. Specifically, GSE has seen deceleration of its revenue growth, caused predominantly by slowdown of electricity export growth. Therefore, the actual revenue of EnergoTrans, as per tariff-setting methodology, was significantly lower than projected due to lower volume of exports.

Challenge #3: Financing of new generation and transmission investments with limited impact on public finances. This is becoming an issue given the modality of attracting private investments in generation and direct public borrowing for power transmission needs.

- a. **New investments in electricity generation.** The Government may not be able to sustain the current model of financing of generation investments given the expected impacts on public finances. The investments in power generation were historically facilitated through power purchase agreements (PPAs) signed among private developers and ESCO. This modality of securing generation investments with 100 percent off-take guarantee may not be sustainable given the contingent liabilities it would create for the Government.



- b. **New investments in electricity transmission.** It may not be sustainable to continue financing the transmission investments using only public resources given anticipated impacts on public debt and competing needs for scarce public resources.

Relationship to CPF

The project is consistent with FY19-22 Country Partnership Strategy (CPF) for Georgia. Specifically, the project is well aligned with the Focus Area 1: Enhance Inclusive Growth and Competitiveness. Specifically, the project would support the following objectives under this Focus Area:

Objective 1.1: Support to agricultural modernization and access to markets. The project would improve reliability of supply in two of the regions with significant agricultural activity. Modernization and increased competitiveness of agriculture depend on FDIs to the sector, which would not be possible without reliable electricity supply.

Objective 1.2: Improved Connectivity and Integration. The project would support GSE to start using the scarce public resources to leverage private financing for its investments, including some new investments aimed at improving reliability of supply to domestic users as well as regional interconnection projects to foster increased power trade.

C. Proposed Development Objective(s)

The project development objective is to increase electricity supply reliability, improve the financial viability of the electricity transmission company, and help the electricity transmission company access capital markets.

Key Results (From PCN)

Indicator 1 (Core): System average interruption frequency per year in the project area (number).

Indicator 2 (Custom): GSE exit from bankruptcy protection (yes/no).

Indicator 3 (Core) Private capital mobilized (in million US\$).

Indicator 4 (Core): Direct project beneficiaries.

D. Concept Description

The Project would have three components – construction of Jvari-Tskaltubo 550 kilovolt (kV) overhead power transmission line (OHL) and 500 kV Tskaltubo substation; and support to GSE in accessing commercial financing.

Component 1: Construction of Jvari-Tskaltubo 500 kV overhead transmission line (OHL) and 500 kV extension for Tskaltubo substation (estimated cost of around US\$50 million). Jvari-Tskaltubo OHL and the new 500 kV switchyard at Tskaltubo substation are part of the Jvari-Tskaltubo-Akhaltsikhe backbone, which is required to improve reliability of electricity supply in the Western parts of Georgia. Tskaltubo-Akhaltsikhe OHL with related substations has an estimated cost of US\$60 million and is financed by KfW. The construction works are planned in a way to allow both line segments and the substation to be commissioned in 2022.

Component 2: Technical Assistance (estimated cost of about US\$8 million). This component would support: (a) technical supervision consultant costs; (b) advisory support for financial recovery of GSE; and (b) preparatory work to access capital markets.



Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

ESS1-6, ESS8 and ESS10 are relevant to this project. The project risk rating is High both from Environmental and Social perspective. It is recommended that a comprehensive ESA, RPF, and SEP be developed prior to project Appraisal. ESA should include advanced labor management plan, and community health and safety plans. Experience of the ongoing project suggests that the capacity of the implementing agency to manage social and environmental risks needs to be significantly strengthened.

Note To view the Environmental and Social Risks and Impacts, please refer to the Concept Stage ESRS Document.

CONTACT POINT

World Bank

Artur Kochnakyan, Joseph Melitauri
Senior Energy Specialist

Borrower/Client/Recipient

Ministry of Finance
Ivane Matchavariani
Minister
minister@mof.ge

Ministry of Economy and Sustainable Development
George Kobulia
Minister
ministry@moesd.gov.ge

Implementing Agencies

Georgian State Electrosystem
David Tvalabeishvili
Chairman of Management Board
info@gse.com.ge



FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: <http://www.worldbank.org/projects>

APPROVAL

Task Team Leader(s):	Artur Kochnakyan, Joseph Melitauri
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Approved By

Practice Manager/Manager:		
Country Director:		