



COMPETITION POLICY IN GEORGIA



TRANSPARENCY INTERNATIONAL GEORGIA
TRANSPARENCY AND ACCOUNTABILITY IN ACTION

COMPETITION POLICY IN GEORGIA

Transparency International Georgia

Tbilisi, 2012



G-PAC is funded by the U.S. Agency for International Development (USAID) and implemented by the East-West Management Institute (EWMI).

The contents of this publication do not necessarily reflect the views of USAID, the United States Government, or EWMI.

CONTENTS

Part 1: Competition Policy	1
Summary	1
Main Findings	1
Recommendations	2
Chapter 1: The Rationale for Competition Policy	3
1.1. Competition	3
1.2. Why Do We Need Competition Policy?	3
1.3. Competition Policy and Market Regulation.....	4
Chapter 2. An Overview of the Situation in Georgia	5
2.1. General Background	5
2.2. The Institutional Framework of Competition	11
2.3. The Law of Georgia on Free Trade and Competition.....	13
Part 2. Competition Case Study: Fuel Market	17
Summary	17
Main Findings	17
Recommendations	18
Chapter 1. Overview of Existing Legislation	19
Chapter 2. Fuel Market Characteristics	20
2.1. Market Structure	20
2.2. Companies Operating on the Fuel Market	23
2.3. Characteristics of Fuel Consumed on Georgian Market.....	26
2.4. The Dynamics of Fuel Prices	30
Chapter 3. The Role of Competition Authority	31

Part 3: Competition Case Study: Food Market	33
Summary	33
Main Findings	33
Recommendations	34
Chapter 1: General Picture	35
Chapter 2: Legal Barriers to Food Market Entry.....	38
3.1. Self-Provision Rate for Dairy Produce	41
3.2. Companies Operating on Dairy Produce Market.....	42
3.3. Main Characteristics of Dairy Produce Market.....	42
Chapter 4: Market of Meat.....	45
4.1. Self-Provision Rate for Meat.....	45
4.2. Companies Operating on the Meat Market	45
4.3. Main Characteristics of Meat Market.....	46
Chapter 5. The Role of the Competition Authority	48

Part 1: Competition Policy

Summary

The importance of free competition has been demonstrated by a number of policy and academic studies. Competition policy (or anti-trust policy, as it is more often called in the US) helps enhance the country's competitiveness on the global market and promote economic welfare. In particular, free competition leads to a better choice of products and services at lower prices to the benefit of society as a whole and can additionally promote innovation and greater productivity. In addition, competition is one of the priority areas for the successful completion of DCFTA (the multilateral negotiations regarding the Deep and Comprehensive Free Trade Agreement between Georgia and the European Union).

This report presents a study of market competition in Georgia. The study uses economic analysis. The report is based on the trends and empirical facts of the Georgian market and of the selected sectors. The first chapter describes the rationale for competition policy. Specifically, it discusses the rationale for competition policy, as well as objectives of competition policy, and the difference between competition policy and market regulation. It also describes the relationship between competition policy and other possible objectives of public policy. The second chapter provides a review of the general situation in Georgia: the general background, the institutional framework of competition, and the Law of Georgia on Free Trade and Competition. The report also provides specific recommendations which the government needs to consider in order to implement effective competition policy.

Main Findings

- Georgia has a highly liberalized economy with few formal (legislative and administrative) barriers. Nevertheless, certain segments of the country's market are highly concentrated; according to economic theory, highly concentrated market structure leads to high profit margins;
- A number of structural problems of the Georgian economy might be caused by lack of competition in the market and an appropriate institutional framework in general, since the process of liberalization and deregulation cannot succeed without effective competition policy;
- Laws regulating competition in Georgia were repealed in 2005. Consequently, there was no effective control over the protection of competition rules and principles, while the situation in different sectors of the economy was determined by market logic. This created risks of well-established market players engaging in anti-competitive practice and abusing their market power;
- Recently passed competition legislation sets forth basic regulations for competition policy, which is a step forward. However, further improvements are necessary for creating conditions that are conducive to free and fair competition in the market as well as effective supervision of the competition;
- Exemptions provided in the legislation (viz., Article 8 and Article 9 of the Georgian law on Free Trade and Competition) do not conform with the EU Regulations and create the possibility of eliminating competition in respect of a substantial part of the relevant market;
- Trends revealed in some sectors of the economy might indicate the possibility of anti-competitive practices and market division, which has a negative impact on consumers, the country's economy, investment attractiveness and economic welfare of the society. To help create a competitive market structure the government has to carry out effective supervision of competition in the market.

Recommendations

Transparency International Georgia believes that, in order to resolve some of the problems discussed in the study, the government of Georgia needs to:

- Improve the regulatory framework with a view to carrying out effective supervision of competition;
- With the aim of increasing the compatibility of the markets of Georgia and the EU:
 - decrease the thresholds of the agreements of minor importance as set forth in Article 8 of the law on Free Trade and Competition;
 - ensure that the exemptions, which do not fall under the competition regulation (Article 9 of the law on Free Trade and Competition), do not create a possibility of eliminating competition vis-à-vis a substantial part of the relevant market;
 - segregate functions effectively of the Competition and State Procurement Agency and the independent industry regulators active in different business sectors;
 - Establish the amount of the Competition and State Procurement Agency's service fee by law;
- Implement the *Leniency Programme*¹ - one of the main tools of struggle against anti-competitive practices by market players.

¹ This programme will be further discussed by the end of the first part of this report.

Chapter 1: The Rationale for Competition Policy

1.1. Competition

Competition is a rivalry among economic agents (market players) to gain advantage on the market. Other definitions of *competition* are as follows: *competition* is the existence of a certain number of economic agents with the same market power that act without agreeing with one another; And also, *competition* is a process which forces an economic agent to take the consumer's requirements (the price, quality, and other characteristics of a product) into account.

Over time, this process [competition] acts as a selection mechanism by which more efficient economic agents replace less efficient ones. Competition is considered the key factor that contributes to faster economic growth and the existence of a more competitive, consumer-oriented economy.

1.2. Why Do We Need Competition Policy?

As economic theory has it, there are failures² on the market, when the market fails to produce an efficient allocation of resources on its own (e.g. the existence of natural monopolies) and, therefore, it is impossible to ensure free competition. However, market failure occurs in markets without natural monopoly features. The dominant position of a company³ might persist even in the absence of legal barriers to market entry (free entry) due to the following reasons:

- sunk costs industries
- network effects
- lock-in effects and switching costs

In the absence of adequate monitoring, companies operating in the market may also resort to actions that increase their profits, but harm society. Such actions can be:

- Collusion
- Mergers of two or more independent companies which lessen competition
- Predatory behaviour
- Exclusionary behaviour

Economic reforms implemented in the country, specifically, the liberalization of the trade and investment environment, privatization, and deregulation can significantly increase the level of competition, but these steps are not always enough to fully resolve all the problems related to competition. In parallel with deregulation, privatization, and removal of formal barriers of entry to the internal market, there is still a danger that dominant incumbents will re-monopolize the market. Therefore, the process of liberalization and deregulation can't succeed without effective competition policy.

Competition policy aims to create the conditions where competition is not restricted in the market to the extent it is detrimental to the society. The ultimate objective of competition policy is to satisfy consumers' needs. Its role is to protect the process of competition rather than individual competitors.

Competition in the internal market is also an important factor that forces companies operating in the market to invest and develop their competitive capabilities. Therefore, the higher the competition in the

² N. Gregory Mankiw, *Principles of Economics*, 2010, Harvard University Press.

³ A company has a dominant position on the market when it holds a significant market share and competitor companies cannot exert an essential influence on its economic decisions.

internal market is, the more motivated the companies are to reduce costs and to produce quality products. The results of academic studies⁴ demonstrate that there is a positive correlation between competition and effectiveness and between competition and productivity, which, in turn, is one of the crucial preconditions for economic growth.

1.3. Competition Policy and Market Regulation

With the aim of ensuring free and fair competition, international practice distinguishes between competition authority and sector regulator. It is important to remember that there is an essential difference between competition policy and regulation. In particular, while the powers of the competition authority are limited to checking the lawfulness of the firms' activities, sector regulators have more extensive powers, such as controlling the decisions of companies regarding tariffs and investment choices. Competition authorities check the legality of a certain business practice and intervene ex-post, i.e. only after the action has already been taken by a firm operating in the market. Meanwhile, sector regulators (e.g. communications, energy and water supply regulatory bodies) act before the action is taken (ex-ante) and can therefore authorize a certain business practice or deny authorization. As a result, their regulation of the sector is a long-term and continuous process, whereas the competition authority's interventions tend to be ad hoc.

Furthermore, competition policy applies to sectors where structural conditions are compatible with normal functioning of competition (so-called liberal sectors). Regulation, on the other hand, applies to special sectors, whose structure is such that one would not expect competitive forces to operate without problems (so-called non-liberal sectors). In particular, regulation would usually concern markets where fixed costs are high and therefore only one firm (so-called natural monopoly) or a small number of firms (so-called oligopolistic market) can operate profitably. Examples might be telecommunications (local loops), electricity (its transmission phase), railways (the network) etc. For this reason, regulatory bodies usually take actions to pursue the objective of economic welfare. As a result, the sector regulator is considered a body whose function is to alleviate the effects of market failures and to replace market forces with regulatory measures.⁵

It is important to emphasize that free competition is considered as the best mean of achieving economic welfare and the main objective of competition regulation is also to increase economic welfare of the society.

Results of academic research⁶ demonstrate that if price of a product/service falls, economic welfare increases. There is also a positive relationship between an indicator of consumer welfare and an indicator of economic welfare. The institutional framework of competition may therefore aim to:

- Protect small economic agents;
- Promote market integration;
- Protect economic freedom;
- Struggle against inflation;
- Protect Fairness and equity among economic agents;
- Supervise protection of environment in the process of entrepreneurial activity;
- Take into account the priorities of the state policy (for example, supporting the implementation of the trade and industrial policy) that impact competition.

⁴ Tirole J., *The Theory of Industrial Organization*, 1988, MIT Press, MA.

⁵ Comments about Chapter 7 of the Modal Law on Competition of the UN Conference on Trade and Development (UNCTAD).

⁶ Massimo Motta, *Competition Policy*, 2003, Cambridge University Press.

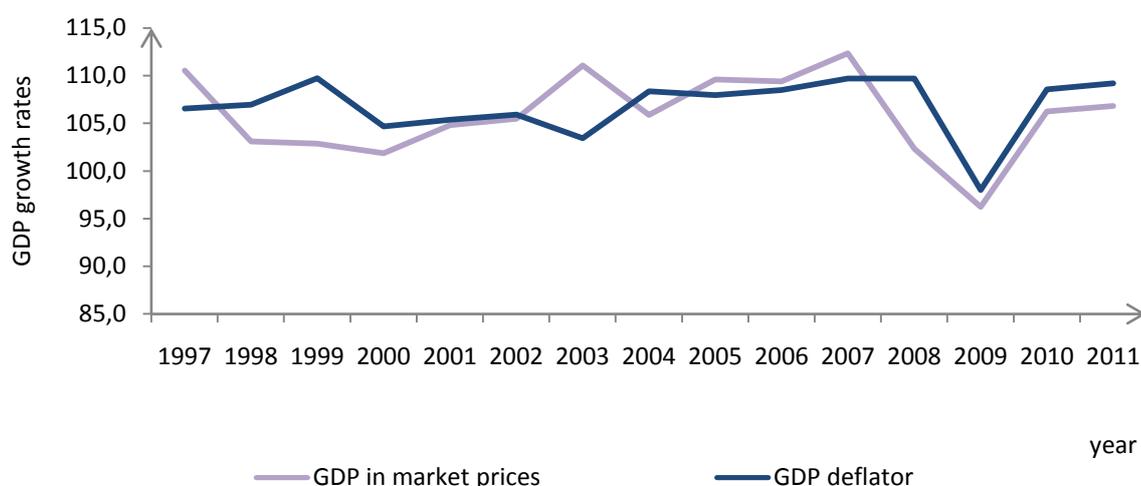
It is the leading role of competition policy in successful implementation of economic reforms that makes its analysis significant. Below, we provide an overview of the situation in Georgia. In addition to the general background, special attention is paid to the essential elements of the reform in the area of competition.

Chapter 2. An Overview of the Situation in Georgia

2.1. General Background

Since the Rose Revolution of 2003, Georgia's economy has developed positively on the whole.

Figure 1: GDP Real Growth Rates (Previous year = 100%)



Source: The National Statistics Office of Georgia

Decrease in the country's economic growth in 2009 was caused by a double negative shock of the 2008 Russian-Georgian war and the global economic crisis and its impact on Georgia.

According to the 2011 World Bank survey, Georgia ranked 18th in terms of Ease of Doing Business indicator,⁷ which is an average weighted figure of 10 various indicators. It is worth noting that Georgia's final score was determined by high score for the following indicators: Registering Property (the 1st place), Dealing with Construction Permits (4th place; the indicator assesses the difficulty, length of time, and amount of the fee for taking a construction permit as part of building a standardized warehouse), Starting a Business (7th place). However, it should also be noted that the country's ranking differs among the components of this general indicator as Paying Taxes (42nd place; related to the influence of the tax burden on entrepreneurial activity) and Enforcing Contracts (41st place; related to the effectiveness of court procedures in resolving disputes).

Notwithstanding the general positive dynamics, it is important to interpret different rankings with caution, since their results largely depend on research methodology, on the basis of which the stakeholders are interviewed in order to obtain a qualitative assessment of an event. This is confirmed by the results of the Global Competitiveness Index study conducted by the World Economic Forum (Geneva, Switzerland). According to the 2010-2011 report of this study, Georgia's position deteriorated compared to 2008-2009 and it currently ranks 93rd among 139 countries (Georgia ranked 90th in the 2008-2009 survey). The index is a complex indicator which assesses the competitiveness of national economies. It

⁷ <http://www.doingbusiness.org/rankings>.

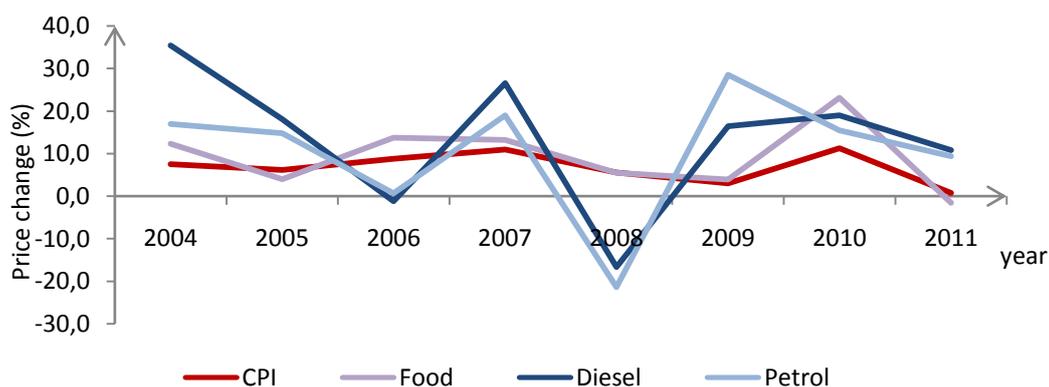
assesses a country's competitiveness on the basis of institutional development, state policy, and the factors that influence the level of productivity of national economy. Therefore, the more competitive an economy is, the bigger potential it has for a faster economic growth and the higher level of per capita income it can achieve. It is also known that economic agents that have to deal with a highly competitive environment on the internal market achieve better results on the international market. Among the components whose low scores reflected negatively on Georgia's final rank in the Global Competitiveness Index, we can single out Effectiveness of Anti-Monopoly Policy (ranked 135th among 139 countries), Intensity of Local Competition (ranked 124th among 139 countries), Extent of Market Dominance (ranked 113th among 139 countries), and Property Rights (ranked 120th among 139 countries).

Georgia's position is also weak according to the 2011 ranking of the annual International Property Rights Index published by the Property Rights Alliance (PRA)⁸. In this ranking, Georgia holds the 113th place among 129 countries and is included in the bottom 20 percent of countries. The aforementioned ranking assesses legal and political systems⁹ across the world in terms of protection of property rights.

"What gives a more adequate view of the economic condition in the country is not various ratings, but statistical information, which confirms that Georgia's citizens are in quite a difficult situation,—even by official data, 20% of Georgia's population are living below the poverty level, 60% below the median consumption (i.e. consumption of an "average" household) level. According to experts' evaluation, 86% of the population are experiencing serious social difficulties" economic expert Vladimer Papava noted.¹⁰

Some of the Georgian economy's recent trends, especially those observed in the past three years, are also worth of attention. We can cite the example of food and fuel price increase. From the second half of 2010, an increase in food prices on the international market also caused inflationary pressure in Georgia. Figure 2 shows year-to-year percentage changes of food and fuel prices in 2004-2011. In order to assess how changes in the food and fuel prices in the consumer basket contribute to the changes in the Consumer Price Index, Figure 2 below gives the changes in the Consumer Price Index as well.¹¹

Figure 2: Food and Fuel Price Change (%) in 2004-2011 with respect to the Previous Year



Source: The National Statistics Office of Georgia

⁸ http://www.internationalpropertyrightsindex.org/ATR_2011%20INDEX_Web.pdf.

⁹ The index is an average weighted indicator of the following major components: the legal and political system, the right to physical property, the right to intellectual property.

¹⁰ Interview conducted by the author, December 2011

Vladimer Papava, "Myths about the Georgian Economy", 2011, Democracy and Freedom Watch:

<http://dfwatch.net/myths-about-the-georgian-economy-11211>.

¹¹ The composition of the consumer basket in different years. See Annex 1.

The figure above shows that, in most cases, the percentage change in the prices of food and fuel precedes the percentage change in the Consumer Price Index.

Georgia is a country with a small and open economy which is heavily dependent on import. We can give the following figures as an example: in 2010-2011, the import of food products exceeded the export fivefold.¹² As for fuel, only imported fuel is consumed on the Georgian market. As a result, price hikes on the world market immediately reflect on the local market. In addition, the aforementioned sectors are especially “sensitive” for the Georgian economy, since food products are consumed by all consumers, including those below the poverty line, and expenses incurred are an important part of the total consumer spending (the share of spending on food products in the consumer basket amounted to 43 percent in 2007-2009, and 38.8 percent in 2010-2011).¹³ The increase in the food prices limits the population’s purchasing power, while the increase in fuel prices influences other sectors and, either directly or indirectly, the population's living standards.

Taking these facts into account, the following question arises: What can be done to avoid this negative influence and, in general, to increase the effectiveness of anti-inflation policy? Free competition is generally considered the best means achieving economic welfare and a major factor that contributes to faster economic growth, poverty reduction, and emergence of a more competitive, consumer-oriented economy. Therefore, it is important that the state pursue a policy that will create an attractive and competitive business environment in the country. This implies establishing fair and equal rules and ensuring a non-discriminatory approach for all players operating on the market, decreasing formal and informal barriers to market entry as much as possible, preventing informal collusive (cartel) agreements between market players that seek to divide the market, and ensuring free and fair competition on the market.

According to some experts,¹⁴ the structural problems of the Georgian economy are mainly caused by the elements of “crony capitalism”¹⁵, as well as by the absence of competitive environment and adequate institutional framework for competition. Consequently, despite the fact that the Georgian economy is characterized by quite a high level of liberalization and a few formal (legislative and administrative) barriers,¹⁶ certain segments of the country’s market (ex. food and fuel market) are highly concentrated. According to economic theory, highly concentrated market structure leads to high profit margins.¹⁷ Moreover, examination of the structure of Georgian economy over the recent years reveals a trend of consolidation of players operating in various market segments. For example, whereas a few dozen economic agents operated in the fuel market before 2004, their number has significantly decreased to five companies in recent years who are major players today.¹⁸

A review of prices of substitute goods supplied by various companies also reveals clear trends of price parallelism¹⁹ (see more detailed data below). These characteristics may indicate the existence of collusive

¹² Source: The National Statistics Office of Georgia. See Annex 3.

¹³ See Annex 2.

¹⁴ Prof. Badri Gelitashvili (Free University), interview conducted by the author, February 12, 2012.

¹⁵ Crony capitalism – A term referring to an economy in which the success of business depends on close relations of representatives of the business sector with the government sector.

¹⁶ In general, a small number of formal market entry barriers and high profit margins characteristic of a sector make the sector attractive for new entrants, which decreases the likelihood of collusive agreements.

¹⁷ Bain, Joe S., *Barriers to New Competition*, Cambridge, MA, 1956, Harvard University Press;

Sutton John, *Sunk Costs and Market Structure*, 2007, The MIT Press, Cambridge, Massachusetts;

¹⁸ These issues are discussed in more detail in the corresponding parts of the report.

¹⁹ In general, the economic theory considers asymmetry of prices on the relevant market and the existence of differentiated products supplied by various economic agents as factors hindering collusive agreements.

(cartel) agreements or coordinated practices among economic agents operating in the market, producing a negative impact on the consumers and economy.

The likelihood of collusive (cartel) agreements or coordinated practice correlates negatively with the number of economic agents operating in the relevant market and positively with the degree of market concentration.²⁰ Specifically, a small number of economic agents operating in a market increases the likelihood of anti-competitive behaviour, such as collusive (cartel) agreement and coordinated practice, for the following reasons:

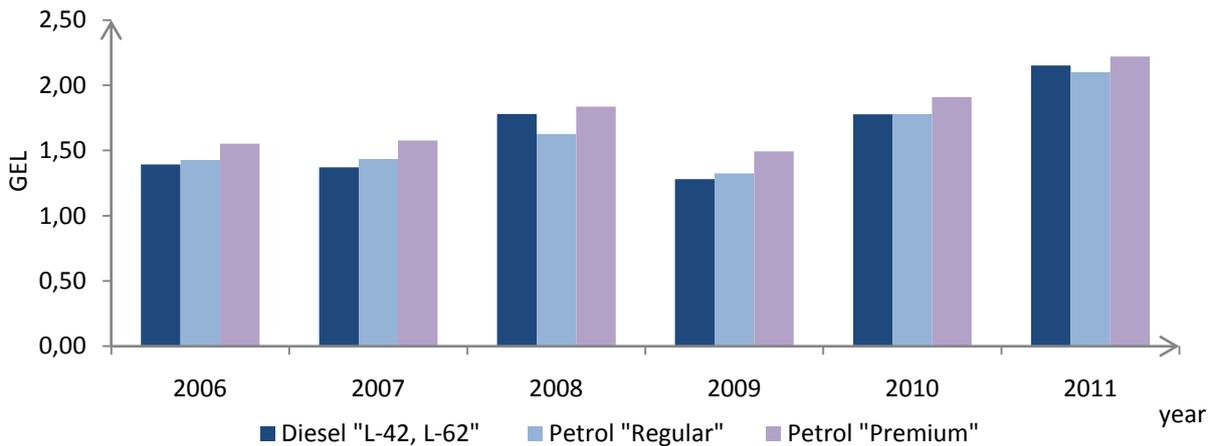
1. A small number of economic agents makes it relatively easy to reach an agreement on the terms of a collusive agreement;²¹
2. A small number of participants in a collusive agreement makes it easier to ensure the fulfilment of the terms of the agreement;
3. When the number of economic agents increases, each of them gets a lesser share of the market. This increases the possibility of violation of the terms of a collusive agreement for the sake of benefit, which, makes it more difficult to ensure observance of the terms of the collusive agreement.

The small size of a country’s market and the absence of information asymmetry on the market are also conducive to the existence of collusive (cartel) agreements.²² Furthermore, academic studies demonstrate that, since economic agents try to maximize their profit, there is a positive correlation between the market share of a specific economic agent and the prices set by the same agent.

Figure 3a shows the average retail prices (in GEL) of 1 litre of fuel (diesel and petrol) in Georgia in 2006-2011, while Figure 3b shows the price (in USD) of 1 litre of petrol (octane 95) in Georgia and some post-Soviet countries in 2010.

As shown in the figures, the prices of the aforementioned group grew sharply in 2009-2011. At the same time, the price of petrol in Georgia is one of the highest among the countries listed below.

Figure 3a: The Average Retail Market Price of 1 Litre of Fuel (in GEL) in Georgia in 2006-2011



Source: The National Statistics Office of Georgia

²⁰ Tirole J., *The Theory of Industrial Organization*, 1988, MIT Press, MA.

²¹ It is implied that sufficient number of economic agents increases asymmetry (e.g. of prices) between the participants of an agreement.

²² Information asymmetry exists when economic agents have incomplete and discrepant information about the decisions (e.g. on prices) they make.

Figure 3b: The Price of 1 Litre A95 Fuel (in USD) in Post-Soviet Countries in 2010

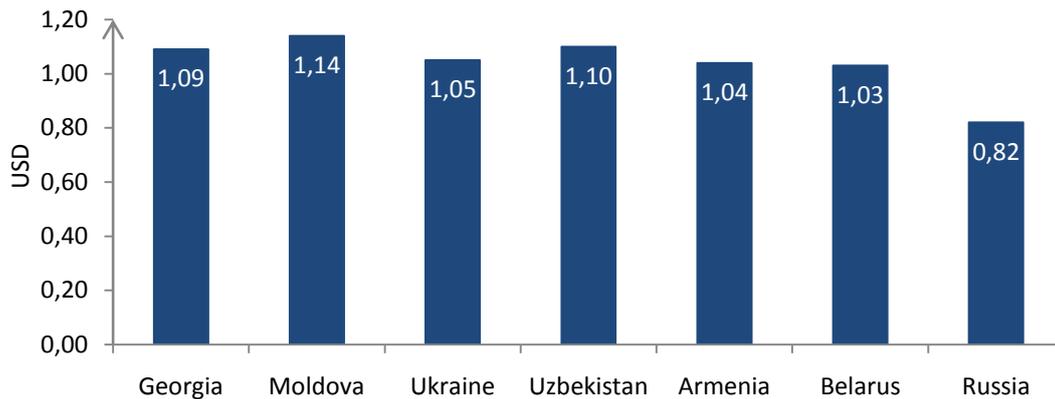
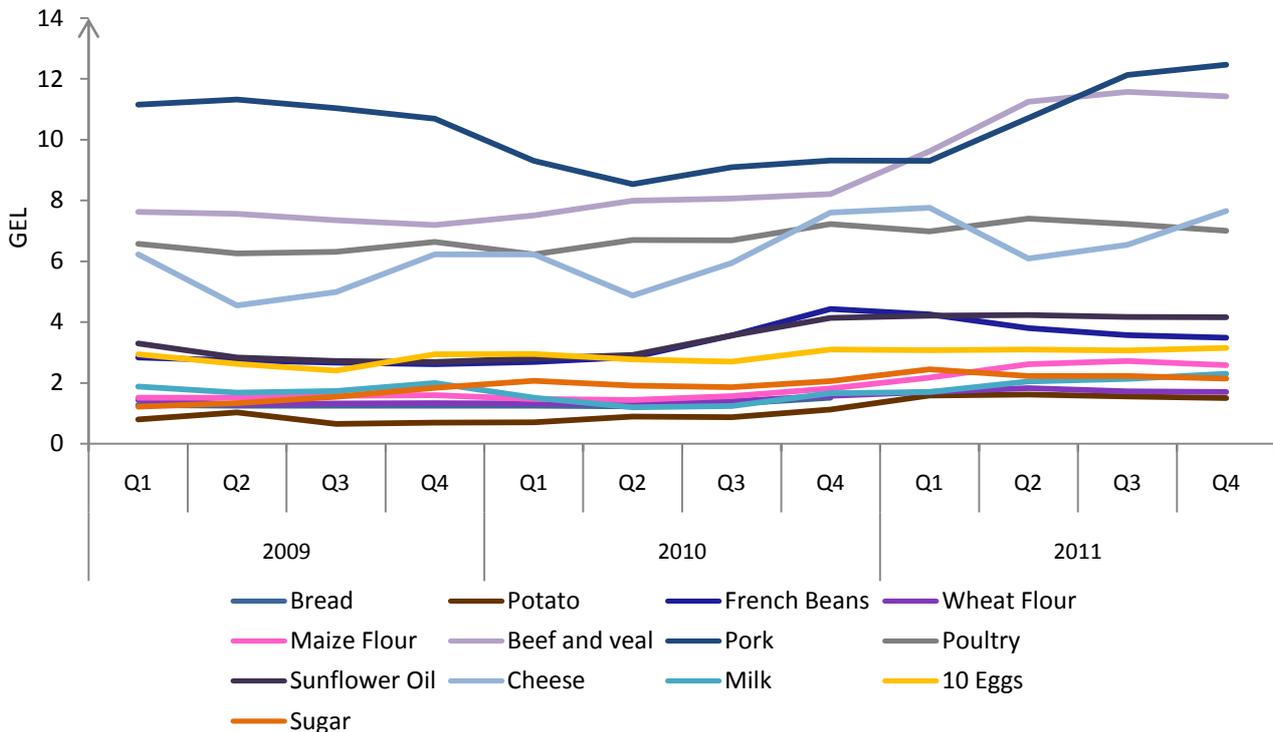


Figure 4 shows average quarterly retail prices of different types of food in Georgia in 2009-2011, while Figure 5 shows average annual retail prices of different types of food in Georgia in 2009-2011.

As the figures show, the prices of food also tended to increase in 2009-2011. Specifically, the highest price increase were recorded on buckwheat, sugar, meat (especially beef), vegetables, greenstuff, animal and plant fats, dairy produce, and flour. These products are included in the consumer basket²³ determined by Decree No. 111/N of the Minister of Labour, Health and Social Affairs of Georgia of May 8, 2003.²⁴

Figure 4: Average Food Retail Market Prices in Georgia (GEL/kg)

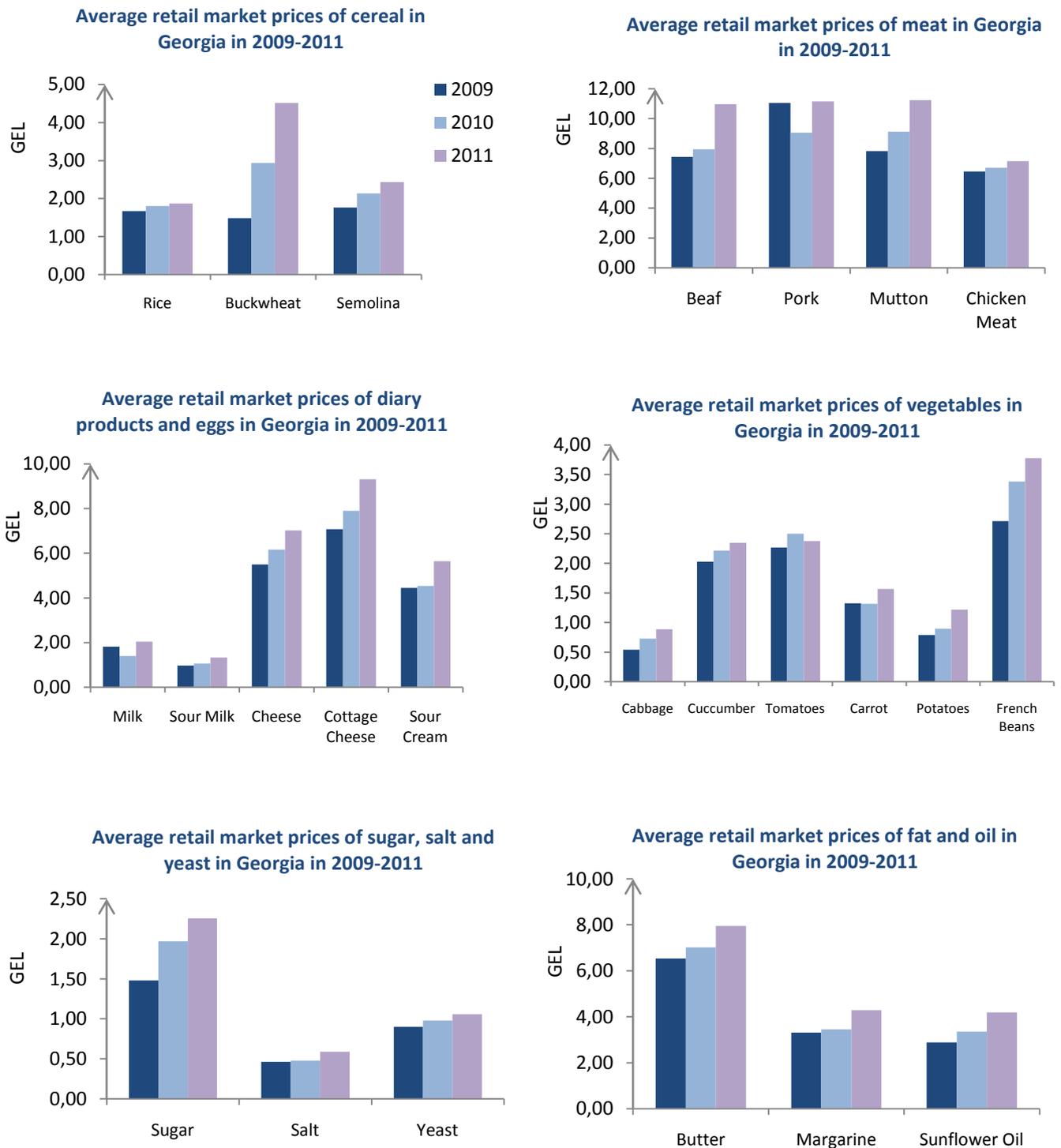


Source: The National Statistics Office of Georgia

²³ See Annex 1.

²⁴ Decree No. 111/N of May 8, 2003 of the Minister of Labor, Health and Social Affairs of Georgia on "On Approving Norms for Physiological Requirements of Food Substance and Energy and Determining Composition of Minimum Food Basket for Calculation of Subsistence Minimum".

Figure 5: Average Food Retail Market Prices in Georgia²⁵



The competition environment in the fuel and food markets, along with some other sectors of the economy, is often criticized. The current situation can only change through appropriate public policy. Given the importance of these segments of the market for the Georgian economy, we selected these two sectors and assessed the competition in the relevant markets.

²⁵ Source: The National Statistics Office of Georgia.

2.2. The Institutional Framework of Competition

This part of the report provides an overview of the key elements of competition policy reform.

Anti-monopoly regulation was introduced in Georgia in 1992, soon after the country gained independence, when the State Council issued a decree on the Restriction of Monopolistic Activities and Competition. The same year, the Division of Anti-Monopoly Regulation, Consumer Protection and Entrepreneur Support was established at the Ministry of Economy. In 1995, the Division was transformed into the Main Division for Anti-Monopoly Policy (Order No. 60, 1995 of the President of Georgia). In 1996, the Parliament passed the laws On the Protection of Consumer Rights and On the Monopolistic Activities and Competition. The Law of Georgia on Advertising was also adopted in 1998. The Division was given the authority to exercise state control on the enforcement of these laws. In 1996, the Division was transformed into the Anti-Monopoly Service, while in 1997, the State Anti-Monopoly Service under the Ministry of Economy was established on the basis of the Anti-Monopoly Service (Order No. 137 of the President of Georgia). According to a study by the European Bank of Reconstruction and Development, the anti-monopoly legislation that was in force in Georgia by 1999 was considered among the best in the post-Soviet countries.²⁶

Gradual restriction of the State Anti-Monopoly Service's powers and its permanent reorganization began in 2000. Following the reforms implemented after the Rose Revolution, the Law of Georgia on Monopolistic Activities and Competition was repealed in 2005. It was replaced by the Law of Georgia on Free Trade and Competition which mainly regulated the segment of state assistance and did not include the basic principles necessary for the existence of competition policy, or the definitions (such as relevant market, dominant position, significant market share etc.), and the basic procedures (regulations concerning of abuse of dominant position, restrictive agreements, decisions and concerted practices etc.) necessary for ensuring competition. As a result of these reforms, the State Anti-Monopoly Service was also abolished. "This decision was motivated by considerations of giving business a freer hand. It was considered expedient to merely control the non-intervention of the state in business in order to avoid unhealthy competition", said Gia Khuroshvili, parliamentary secretary of the Government of Georgia.²⁷

The powers of the post-reform Free Trade and Competition Agency (which was formed through the Law of Georgia on Free Trade and Competition) were limited to the segment of state assistance, and the Agency lacked the appropriate competence in the field of competition. Therefore, since then the framework legislation that regulated competition Georgia has been ineffective in, creating the risk that well-established economic agents engaging in anti-competitive practice and abusing their market power. "The situation hinders the development of competition on the market, contributes to anti-competitive actions of incumbent market players and has a negative impact on consumers', the country's economy, investment attractiveness, and economic welfare of the society," Professor Ketevan Lapachi noted.²⁸

Sector Regulation of Competition

In Georgia, special sector regulation of competition applies in the sectors where regulatory bodies have been created. Specifically, the legislation regulates the sectors of energy, water supply, and communications. At the same time, only the Law of Georgia on Electronic Communications provides the basic principles necessary for the existence of competition policy, definitions (such as the relevant service market, significant market power etc.), and basic procedures necessary for ensuring a competition (related to abuse of significant market power, merger of authorized operators, etc.). In accordance with

²⁶ Slava Petelava, *Anti-Monopoly Regulation in Georgia*, 2008.

²⁷ Interview conducted by the author, March 1, 2012.

²⁸ Interview conducted by the author, December 22, 2012.

the major criterion for the establishment of significant market power in the relevant segment of the communication market, an authorized operator (company) is considered to have significant market power if it holds no less than 40 percent of the market share in the relevant market. The Georgian National Communications Commission is authorized to make a decision to impose specific obligations on an authorized operator that has significant market power in the relevant market and to apply sanctions established by the legislation if these obligations are not fulfilled. The Commission also has the authority to regulate mergers and acquisition of shares of authorized operators.

General Legislative Framework for Competition

According to Paragraph 1 of Article 30 of the Constitution of Georgia, “monopolistic activity shall be prohibited [in Georgia] except for the cases permitted by law. The rights of consumers shall be protected by law.” In those sectors where regulatory bodies are in place, Article 34¹ of the Law of Georgia on the Protection of Consumer Rights provided for the formation of the Service of the Public Defender of Consumer Interests at the regulatory body in order to create additional guarantees for the protection of consumer interests. The law set out the legal, economic, and social framework for the protection of consumer rights in Georgia.

At the same time, Article 195 of the Criminal Code of Georgia introduced criminal liability for monopolistic activity and actions restricting competition. In addition, Articles 159² and 159³ provided for administrative liability for a failure to comply with an instruction of the Free Trade and Competition Agency on ceasing violation of the legislation on free trade and competition and for a failure to provide the Agency with information determined by the legislation. But, as was noted above, at that stage, the authority of the Agency was limited to the segment of state assistance, and it did not have similar powers in the field of competition.

Competition Policy Reform

The need to improve the competition policy in Georgia and the measures to be taken in this direction were highlighted in the report of the EU mission that assessed the country's readiness for a free trade agreement between Georgia and the EU (October 2008).²⁹ Therefore, the reform of the competition policy was considered one of the priority areas for the successful completion of the negotiations between Georgia and the EU on the Deep and Comprehensive Free Trade Agreement (DCFTA). In accordance with these requirements, the Government of Georgia approved the Comprehensive Strategy in Competition Policy in 2010. “The aforementioned document was developed with the active involvement of the Free Trade and Competition Agency and foreign experts, and it reflects all the directions in which the Georgian government plans to implement institutional changes in the field of competition,” noted Professor Slava Petelava,³⁰ division head at the Agency.

“At the first stage of the reform, an independent entity of public law – the Competition and State Procurement Agency – was created through the reorganization (merger) of the State Procurement Agency and the Competition Agency, and it was designated as the body authorized to carry out the activities provided in the Laws of Georgia on State Procurement and on Free Trade and Competition. The Comprehensive Strategy in Competition Policy states that the agency is to become the single authority responsible for competition enforcement in all sectors of the economy. Hence, it is to incorporate the functions of the existing sector regulators in competition area. Through a legislative initiative of the government of Georgia, a draft Law on Free Trade and Competition was also submitted for consideration

²⁹ “Economic Feasibility, General Economic Impact and Implications of a Free Trade Agreement between the European Union and Georgia”, No. 79/2008, Case Final Report Georgia, p. 83-84.

³⁰ Interview conducted by the author, December 23, 2011.

to the Parliament of Georgia, which was passed it in spring,” noted Giorgi Meladze, head of the Georgian Parliament Committee on Sector Economy and Economic Policy.³¹

As Tato Urjumelashvili, head of the Competition and State Procurement Agency, explained, “an important novelty of the Law on Free Trade and Competition is the prohibition of unlawful restriction of competition between economic agents on the market and of the abuse of dominant position. The component of competition in the Competition and State Procurement Agency plays an important role in the effective fulfilment of these goals. The number of the Agency’s employees has increased. Prior to the merger, the Agency of Free Trade and Competition employed nine persons. As a result of the unification, 59 employees serve both to implement the competition policy and to monitor state procurement operations. In order to improve the employees’ qualifications, they are trained in the framework of a long-term cooperation project with the Swedish Competition Authority. The aforementioned project is carried out with the support of the Swedish International Development Agency (SIDA).”

2.3. The Law of Georgia on Free Trade and Competition

The Law of Georgia on Free Trade and Competition (adopted on May 8, 2012) and the Comprehensive Strategy in Competition Policy were prepared in the framework of the Deep and Comprehensive Free Trade Agreement (DCFTA) between Georgia and the EU. The provisions of the law are mainly consistent with EU regulations in the field of competition. In particular, the draft law:

- Does not prohibit the monopoly (dominant) position of a company or interdependent companies in the market; prohibition only applies to the abuse of this dominant position;
- Defines a company with a dominant position as a company (or interdependent companies operating in the same market) that accounts (account) for at least 40 percent of the turnover in the relevant market;
- Defines the cases, when a company or interdependent companies abuse a dominant position and there is evidence of collusion between companies, which purposefully and unfairly restricts competition (for instance, when a company uses predatory pricing on the market);
- Introduces the concept of concentration regulation (merger control, direct or indirect acquisition of control of companies);
- The state is prohibited from offering aid that could limit or restrict competition, etc.

In the framework of the package of legislative changes on free trade and competition, Article 195 of the Criminal Code of Georgia which provided for criminal liability for monopolistic activity and restriction of competition was repealed. Instead, the Law of Georgia on Free Trade and Competition provides for administrative and civil liability of economic agents that commit actions that significantly restrict competition.

In spite of these positive changes, the law also has a number of shortcomings. Specifically:

- In accordance with the law, the Competition and State Procurement Agency was established through an order of the President of Georgia in January 2012. The Agency is responsible for the enforcement of both the competition legislation and the Law on State Procurement. Accordingly, the newly-created agency replaced the State Procurement Agency and the Free Trade and Competition Agency (operated until the end of 2011). It should be noted that such roles as supervision on the implementation of competition legislation, coordination of state procurement, and monitoring of state procurement are essentially different from one another. For this reason,

³¹ Interview conducted by the author, May, 2012.

combining them within a single agency could create problems in terms of effective implementation of competition policy and effective supervision over state procurement.

Vakhtang Lezhava, chief advisor to the Prime Minister of Georgia, pointed out that this model is used in several European countries and the institutional change was carried out in agreement with the European Commission.³² We believe that, in this case, it is particularly important that the united agency be provided with adequate resources to be able to deal with both of its roles.

- In the original wording of Paragraph 5, Article 1 of the law, in cases where the matters covered by the law “On Free Trade and Competition” were regulated differently by another law in specific circumstances, the latter was to be considered superior. In its published comments and suggestions,³³ Transparency International Georgia emphasized that the draft law must be clear and accurate regarding the interaction of the law with other legal acts in order not to jeopardize implementation of the core principles of the competition law. The fact that the aforementioned provision was removed during the third hearing must be welcomed. However, the provision that replaced it states that the law does not concern price creation. This means that if relevant complaints are received by the agency, the latter’s power will essentially be limited while investigating the cases of abuse of dominant position and the artificial price oscillation tendencies, as it will not have the authority to analyze the components of a price set by a dominant company.
- Article 8 concerns agreements of minor importance, which are not considered as restricting competition (*de minimis* principle employed in the draft) and therefore are not subject to the regulation envisaged by the draft. Specifically, according to the draft, agreements are considered to be *de minimis* and therefore accepted if the combined market share of the parties does not exceed 25 percent of the relevant market for horizontal agreements and 40 percent of the relevant market for vertical agreements. These definitions do not conform to the EU Regulations. Under European Union competition law some agreements between economic agents infringing Article 101(1) of the TFEU are considered to be *de minimis* and therefore accepted if they satisfy the criteria as follows: 1) in case of horizontal agreement the parties’ market share is 10 percent or less, and 2) in case of vertical agreement - it is 15 percent or less. Furthermore, where it is difficult to identify an agreement as a horizontal or vertical agreement, the combined share of the parties to the agreement should not exceed 10 percent of the relevant market.

According to Vakhtang Lezhava, chief advisor to the Prime Minister of Georgia, since regulation of competition among economic agents is a novelty in Georgia, the government of Georgia decided to establish a higher threshold for agreements that are exceptions to agreements restricting competition.³⁴

- Article 9 of the law identifies specific types of agreements that limit competition but may still be exempted from the general regulation outlined in the law. In particular, the exemption applies to agreements that promote improvement of the production and/or distribution of goods, or promote technical or economic progress. It is noteworthy that, the EU regulations that establish these exemptions (TFEU Article 101) set an additional condition: the exemptions must not create the possibility of eliminating competition with respect to a substantial part of the products in question. This important condition is not identified in the presented draft law.

³² The correspondence of Transparency International Georgia with Vakhtang Lezhava, March 21, 2012.

³³ “Comments and Suggestions regarding the Georgian Government’s Legislative Initiative: Draft Law on Free Trade and Competition”, Transparency International Georgia, November 14, 2011, <http://goo.gl/mlwj1>.

³⁴ The correspondence of Transparency International Georgia with Vakhtang Lezhava, March 21, 2012.

- Article 23 of the law allows the agency to charge a service fee paid by the parties that file complaints. The amount of the fee is to be determined through a Georgian Government decree. This provision contradicts Article 94 of the Constitution whereby the rules for the introduction of taxes and fees and their structure can only be defined through a law. In this regard, there is a decision of the Constitutional Court of Georgia N 2/1/187-188, dated January 10, 2003 whereby a fee established through a by-law was declared unconstitutional.
- The draft law grants the authority of ex-ante regulation, monitoring of operators and enforcement of the law in the electronic communications sector to the Georgian National Communications Commission (Article 31.8). At the same time, according to the transitional provisions of the draft law (Article 34.1), starting from January 1, 2016, regulatory functions in the field of electronic communications (such as control over restrictive agreements and concerted practices, etc.) will be shifted to the Competition and State Procurement Agency. In order to ensure effective regulation of competition in Georgia, the abovementioned provision needs to be rendered more specific. The powers of the competition agency and the regulatory body must be separated and the primary powers of the independent regulatory body must not be restricted (for example, one of such powers is the right of the regulatory body to impose specific obligations on a company that possesses dominant market power in order to ensure competition, and to control whether these obligations are fulfilled). Based on international experience, we believe that the development of the country's competitive environment in accordance with the EU Regulations and the recommendations offered by the Modal Law on Competition of the UN Conference on Trade and Development (UNCTAD), is only possible through an efficient division of powers between the competition agency and the independent regulatory bodies working in different business sectors.

According to Vakhtang Lezhava, chief advisor to the Prime Minister of Georgia, extending the framework law regulating competition to all sectors of the economy (including non-liberalized sectors) was a categorical demand of the European Commission. He noted that the sector regulators would retain all the functions of preliminary (ex-ante) regulation.³⁵ However, we believe that it is desirable that such formulation be also reflected in the law.

Kakhi Kurashvili, head of the Legal Department of the Georgian National Communications Commission, emphasized the importance of the sector regulator's powers in an interview with Transparency International Georgia and noted that its main functions should not be restricted substantively: "In the field of electronic communications, which has a sector regulator, the creation of the Free Trade and Competition Agency should ensure additional safeguards in terms of ex-post regulation (for example, impermissibility of cartel agreements and decisions restricting competition by state bodies) rather than restriction of the regulators' powers of ex-post regulation; the sector regulator should retain the responsibility for carrying out the activities in the sector of electronic communications determined by the competition law in the segment where it is already experienced, effective, and competent (for example, regulation of mergers and acquisition of shares)."³⁶

- It is not clear from the law whether the head of the Competition and State Procurement Agency will have the authority to issue an independent normative act (order) regarding competition. If he/she does not have this power, the independence of the Agency will be weakened significantly.

In connection with the independence of the Agency, it is important to note that, under the law, the powers of the Government of Georgia are quite extensive. Specifically, the government is authorized to

³⁵ The correspondence of Transparency International Georgia with Vakhtang Lezhava, March 21, 2012.

³⁶ Interview conducted by the author, March 3, 2012.

determine exceptions from the prohibition of restrictive agreements pursuant to the law (Paragraph 3 of Article 9); the government periodically approves the priorities of the Agency's activities (Paragraph 1 of Article 19); and the Agency shall consider submitted complaints and/or applications in respect with these priorities approved by the Government (Paragraph 2 of Article 19).

- After the second hearing, changes were made to Paragraphs 1 and 2 of Article 25 of the law. According to the new wording, the Agency should finalize its investigation of a complaint within six months of receiving it, with the possibility of extension up to 15 months, depending on the importance and seriousness of the case. The initial wording of the corresponding paragraphs established a three-month time frame for investigation, with the possibility of extension up a maximum of six months. We believe that timely decisions shall be made in order to ensure the Agency's effectiveness and fair competition on the market.
- International experience shows that one of the major instruments in the struggle against anti-competitive behaviour of economic agents on the market is the so-called *Leniency Program* which is not envisaged in the reform discussed above and the package of legislative changes. The *Leniency Program* is a common practice in the United States and the EU countries for the traceability of collusive (cartel) agreements. It is based on the following principle: If an entrepreneur involved in a cartel agreement decides to cooperate with a supervisory body and gives it information that makes it possible to track the cartel agreement, the entrepreneur can be fully or partially exempt from the liability provided by law (depending on the importance of the information). It is advisable to introduce this instrument of struggle against anti-competitive behaviour of economic agents in the Georgian legislation as well.

Part 2. Competition Case Study: Fuel Market

Summary

The fuel prices are very important for competitive edge of any economy and for effective performance of economy as a whole. Therefore, it is important to ensure that the fuel prices do not come under inflationary pressure caused by anti-competitive practices of companies operating in the market. Anti-competitive behaviour of market players may exert a negative influence on the entire economy. This is why it is important to examine competition on the fuel market.

This part of the report delivers a competition case study on the fuel market in Georgia, based on the trends observed on the market and empirical facts. The first chapter provides an overview of current legislation. The second chapter describes the characteristics of the fuel market: Specifically, it discusses the structure of the market, the companies operating on the fuel market, the characteristics of the fuel consumed on the Georgian market, and the dynamics of fuel prices. The third chapter assesses the role of the competition authority. On the basis of the given study, we have also developed specific recommendations which the government needs to consider in order to implement effective competition policy.

Main Findings

- Although there are few formal barriers, an oligopolistic structure has presently emerged on the fuel market;
- It is observed that the fuel market tends to consolidate (the number of market players is decreasing) and the prices are increasing. In 2006-2011 the share of medium-sized companies in the overall fuel retail market turnover has decreased from 20% to 7%, while the employment share of these companies decreased from 47% to 17%;
- A certain anomaly is characteristic of the fuel price dynamics in Georgia – observations show that the price increase in the international market (Platts) is followed by increase in prices in Georgia. However, Georgian fuel prices do not decrease in the wake of decrease in Platts prices;
- The dynamics of the prices of all companies operating on the market is evidently analogous - Essential parallelism of prices is observed among various companies operating on the fuel market as well as in variations of these prices;
- Symmetry, which is evident while observing commercial strategies of the players in the fuel market, might indicate that the companies are trying to coordinate their market strategies;
- The trends revealed while examining this segment have considerable influence on the dynamics of competition in the sector and might indicate the possibility of anti-competitive practices of the relevant market players, which has a negative impact on consumers, the country's economy, and require effective state supervision of the observance of the rules and principles of competition;
- One of the problems of this segment of the market is the lack of transparency, which makes it difficult to conduct a more in-depth analysis;
- The trends revealed during the research might be the result of lack of proper institutional framework for competition regulation in Georgia in recent years, which could not certainly ensure either free and fair competition in the market or transparent and non-discriminatory access to the market;
- The data concerning the import of fuel from Italy to Georgia provided by the Customs Service of Italy and the Revenue Service of Georgia are significantly different. A comparable discrepancy is observed in the fuel import data by the Bulgarian Customs Service and the Georgian Revenue Service.

Recommendations

We propose that:

- The Competition and State Procurement Agency intervenes and undertakes a competition assessment of the fuel market to help create a genuinely competitive market structure. The agency should launch an investigation to establish whether the companies operating in this market are beyond competition;
- The Georgian Revenue Service juxtaposes fuel import data with the customs data of the exporting countries to ensure accuracy of its data.

Chapter 1. Overview of Existing Legislation

The market of oil and oil products in Georgia is regulated by the laws On Oil and Gas, On Licenses and Permits, the Tax Code of Georgia, and several by-laws.

The legislation requires only two types of licenses for entering this market and launching business activity:

- a) The License for Oil Processing;
- b) The License for Oil Transportation (Paragraphs 20 and 23 of Article 6 of the Law of Georgia on Licences and Permits).

The legislation also provides for one type of usage license – the General License for Using Oil and Gas Resources, which, in its turn, includes two types of licenses:

- a) The Special License for Exploration of Oil and Gas;
- b) The Special License for Extraction Oil and Gas (Paragraph 3 of Article 7 of the Law of Georgia on Licences and Permits).

Since the aforementioned licenses are designed for oil and gas exploration and extraction activities (the area regulated by the Law of Georgia on Oil and Gas), and only imported fuel (petrol, diesel) is consumed in Georgia's retail fuel market, the legislation for starting business on the retail fuel market does not require a special license. Therefore, there are no legal (formal) barriers to entry.

However, it is important to speak about the possibility of existence of informal barriers that prevents new players from entry into the market. These concerns have been raised by interviewees of Transparency International Georgia³⁷. This implies that, despite the absence of legal barriers to entry, economic agent wishing to enter to the retail segment of the fuel market faces informal barriers. Otherwise stated, it appears that it is impossible for a new player to enter the fuel market. This fact can significantly reduce the level of competition in the market.

According to Article 185 of the Georgian Tax Code, the import of oil products is subject to the excise tax. The tax amount payable for the import of oil products is determined by their weight (volume), while petrol and diesel are taxable under the following excise rates:

Name of oil product	Size unit	Excise rate (GEL)
Petrol	1 ton	250
Diesel	1 ton	150

The quality of fuel sold in Georgia is among the regulated segments of the market. Specifically, the ecological characteristics of petrol are regulated by the December 31, 2004 Decree No. 124 of the Government of Georgia on the Quality Norms of Petrol, while the ecological characteristics of diesel are regulated by the December 28, 2005 Decree No. 238 of the Government of Georgia on the Norms of Composition of Diesel Fuel, Methods of Analysis and Implementation Measures. Since January 1, 2007, the following types of petrol have been established in the country according to the octane number determined through testing: *Regular* – with the octane number of no less than 91; *Premium* – with the octane number of no less than 95; *Super* – with the octane number of no less than 98.

³⁷ Interviews with respondents who chose to remain anonymous, April 2012.

Chapter 2. Fuel Market Characteristics

2.1. Market Structure

A review of the retail fuel market structure in recent years reveals that the fuel market tends to consolidate. Specifically, whereas several dozens of economic agents operated in the retail fuel market before the Rose Revolution, their number has recently decreased sharply, and only five suppliers operate in the market today. It should be noted that the fewer economic agents operate in the relevant market and the higher is the degree of market concentration, the higher the likelihood of collusive (cartel) agreements and concerted practice is.^{38 39} Furthermore, the share of the turnover of small and medium-sized enterprises operating in this segment of the market has decreased and the share of turnover of large enterprises has increased significantly. Specifically, Figure 6 plots the share of turnover of small, medium-sized, and large enterprises in the total turnover on the retail fuel market in 2006-2011. As shown in the figure, the share of turnover of small and medium-sized enterprises in the overall fuel market turnover is decreasing, while that of large enterprises is increasing significantly. Figure 7 plots the share of persons employed in small and medium-sized enterprises in the overall number of people employed in the country's fuel market in 2006-2011. This share also tends to decrease.

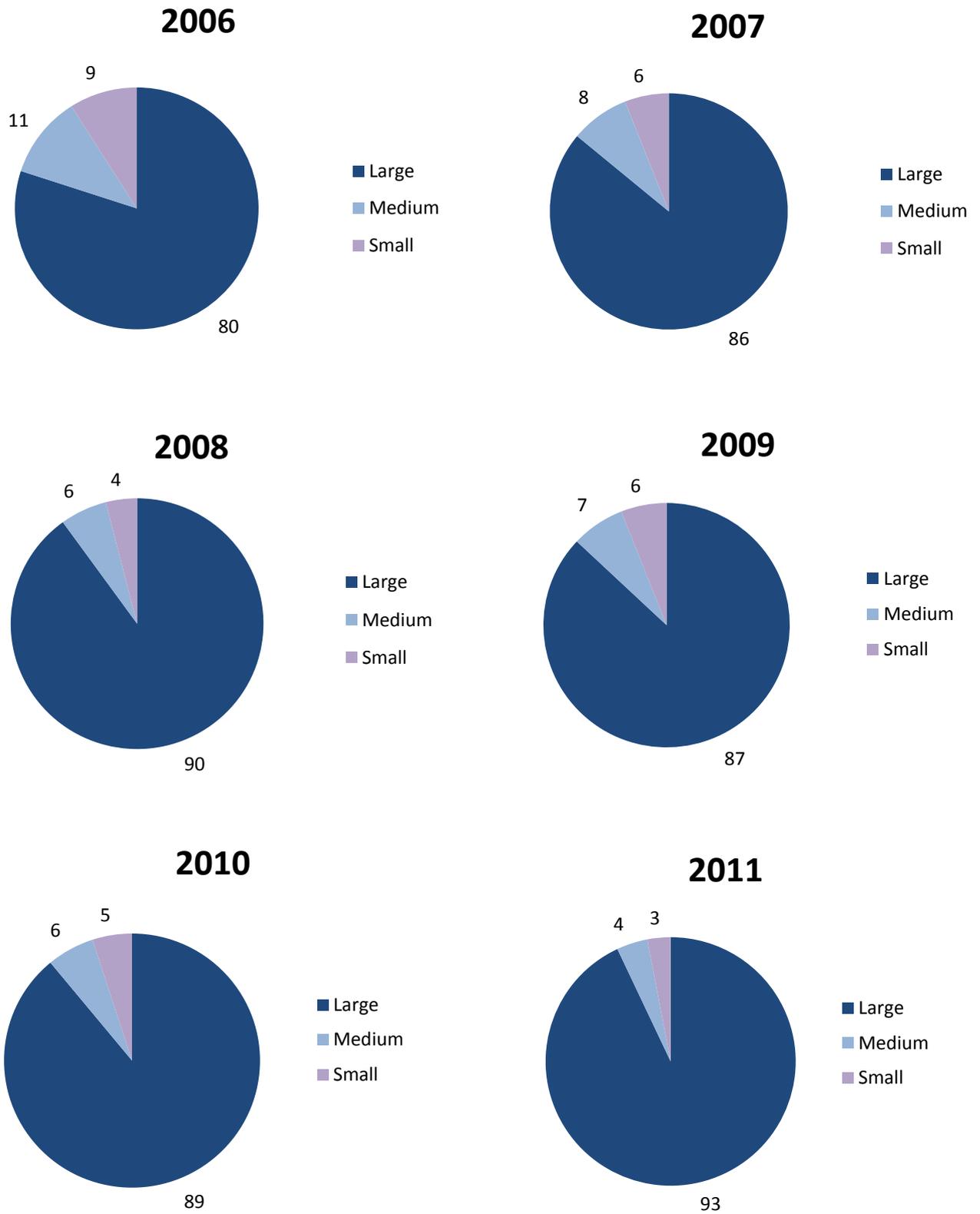
Overall, an oligopolistic structure has presently emerged on the fuel market. This structure is characterized by lower elasticity of demand, resulting from the absence of substitute products.

³⁸ Limited number of economic agents operating on the relevant market increases the likelihood of anti-competitive behavior – collusive (cartel) agreements and concerted practice – due to the following reasons:

1. Limited number of economic agents makes it relatively easy to reach an agreement on the terms of a collusive agreement;
2. Limited number of the participants of a collusive agreement makes it easier to monitor the terms of the agreement;
3. When the number of economic agents increases, each of them gets a smaller share of the market. This increases the possibility of violating the terms of the collusive agreement and getting a benefit, which makes it more difficult to fulfill the terms of the collusive agreement.

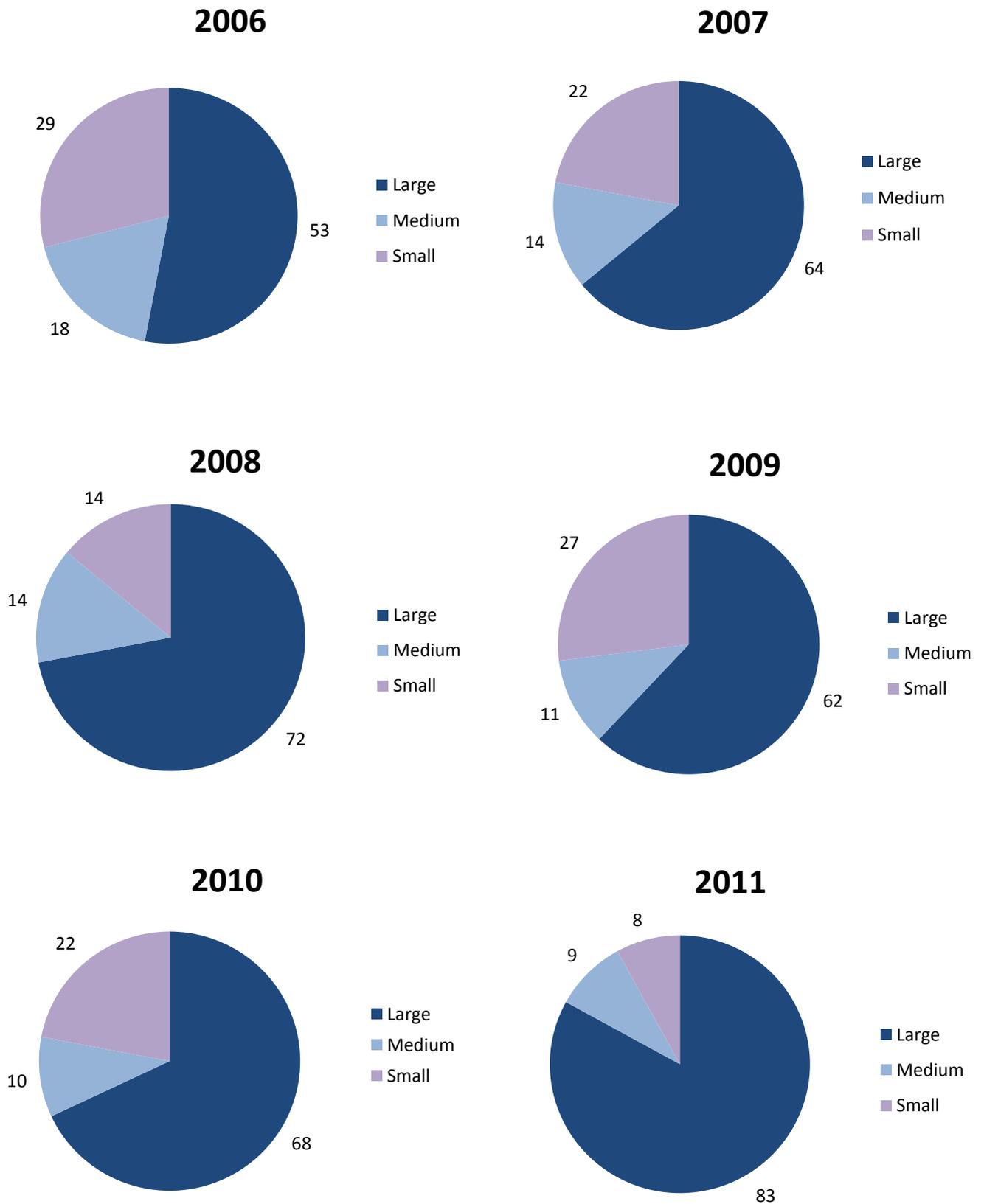
³⁹ Tirole J.; *The Theory of Industrial Organization*, 1988, MIT Press, MA.

Figure 6: The Share (%) of the Turnover of Small, Medium-sized and Large Enterprises in Overall Fuel Market Turnover in 2006-2011



Source: The National Statistics Office of Georgia

Figure 7: The Share (%) of Employees in Small, Medium-sized and Large Enterprises in Overall Employment in the Fuel Sector in 2006-2011



Source: The National Statistics Office of Georgia

2.2. Companies Operating on the Fuel Market

Five companies operate in the Georgian fuel market:

Lukoil Georgia LLC

Lukoil Georgia was founded in February 2002 and started activity in March of the same year. The entire 100 percent of its share is owned by the Dutch company Lukoil Europe Holdings B.V.

According to the map posted on the company's website, Lukoil Georgia has 31 gas stations in Tbilisi and 29 gas stations in different regions of Georgia. The company imports fuel from oil processing enterprises in Bulgaria.

Lukoil Georgia's marketing campaign is run and exclusive distribution services are provided by Unigroup LLC whose partners are Davit Kezerashvili and Giorgi Pirveli.

Sun Petroleum Georgia LLC

Sun Petroleum Georgia operates gas stations of the Gulf company. It was founded in November 2010 under the name of Sonol Oil Products and changed its name to Sun Petroleum Georgia in March 2011. The company is a legal successor of the Santa, Eco, and Magnati companies that operated on the Georgian market before its founding. The 100 percent of its partnership share is owned by American company Energy Investment Venture Ltd. One of the owners of Gulf is Davit Kezerashvili.⁴⁰ The Director of the company is a citizen of Israel, Yaniv Adam, and its Vice-President is Otar Katamadze, who is the son of the Director of Lukoil Georgia LLC, Zaza Katamadze.

According to the map on the company's website, Sun Petroleum Georgia operates 130 gas stations across the country. Some of them are united under the Gulf brand. As stated by the company representative,⁴¹ this company imports fuel from Bulgaria (diesel, petrol), Romania (petrol), Greece (petrol), and Azerbaijan (diesel).

Socar Georgia Petroleum LLC

Socar Georgia Petroleum was founded by Socar Energy Georgia LLC in September 2006. Socar Energy Georgia owns a 100-percent share of the company. Socar Energy Georgia is a subsidiary of the State Oil Company of Azerbaijan Republic (Socar). Initially the company operated on the wholesale fuel market only. But later in 2007 it entered on the retail fuel market as well. Socar Georgia Petroleum holds a dominant position in the segment of oil products imported to the Georgian market from Azerbaijan and Central Asia. Davit Zubitashvili is the company's director.

According to the company's website, Socar Georgia Petroleum currently operates 92 gas stations in Georgia: 62 gas stations are in different regions of Georgia and 30 gas stations are in Tbilisi.

JSC Wissol Petroleum Georgia

Wissol Petroleum Georgia was founded in April 2000. The founders of the company are Samson Pkhakadze, Levan Pkhakadze, Wissol Petroleum, and Silk Road Group. It is a legal successor of Canargo Development LLC that operated on the Georgian market before its founding. Vasil Khorava is the company's general director.

⁴⁰ Netgazeti, December 19, 2011: "Kezerashvili: I am one of the owners of the Gulf company"; <http://netgazeti.ge/GE/85/business/7498/htm>.

⁴¹ Interview conducted by the author with the Marketing Manager of the company, Mr. L. Tevzadze, April 2, 2012.

According to the map posted on the company's website, [Wissol Petroleum Georgia](#) has 43 gas stations in Tbilisi and 32 gas stations in different regions of Georgia. The company imports fuel from Italy. Specifically, [Wissol Petroleum Georgia](#) imports the fuel of the Falconara Marittima oil processing factory of the Italian company Api.

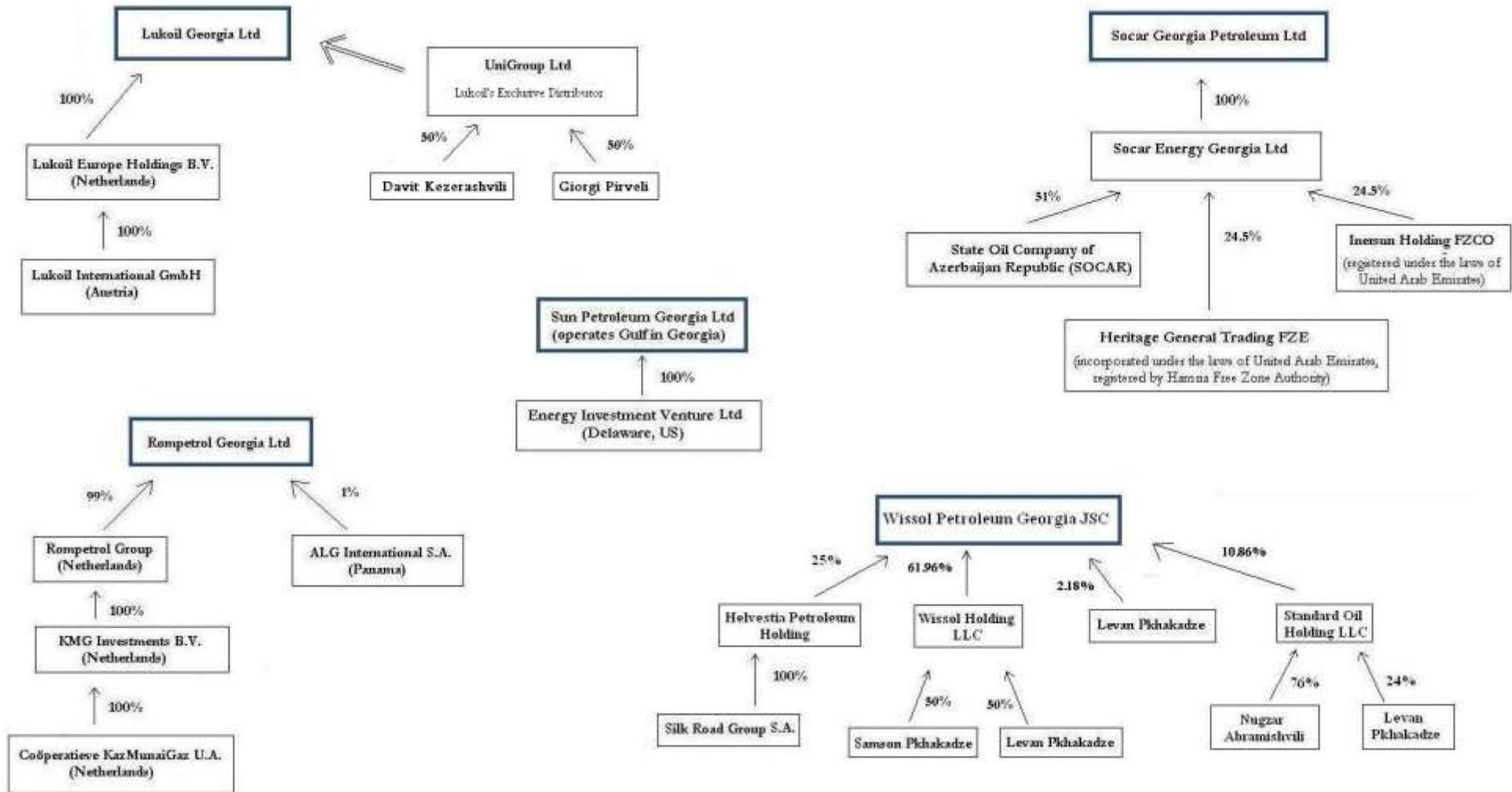
Rompetro Georgia LLC

[Rompetro Georgia](#) was founded in December 2005. Its partners are Rompetro Group NV (the Netherlands) and ALG International S.A. (Panama). Nurken Murzagaliev, a citizen of Kazakhstan, is the company's general director.

According to the information on the company's website, Rompetro Georgia has 19 gas stations in Tbilisi and 32 gas stations in different regions of Georgia.

Figure 8 shows ownership structure of the companies operating on the fuel market:

Figure 8: Ownership structure of the companies operating on the fuel market



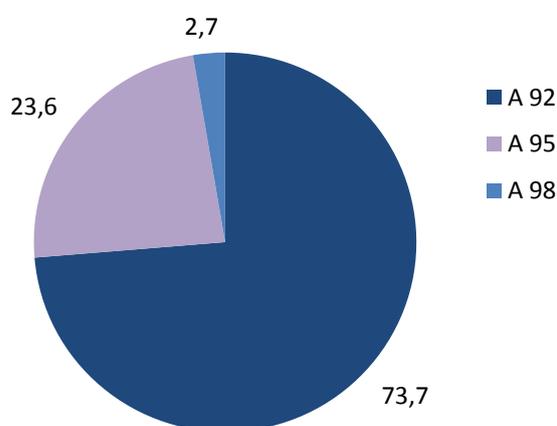
Source: The Public Registry. In the case of Wissol Petroleum Georgia, the consolidated financial Statement, the data of December 31, 2010.

2.3. Characteristics of Fuel Consumed on Georgian Market

Oil and oil products are the largest group of imported commodities in Georgia. Their imports amounted to USD 894 million, 13 percent of the total imports in 2011.⁴²

Georgian market offers the following types of petrol to consumers: *Regular* (A-92), *Premium* (A-95), and *Super* (A-98). The biggest demand is for *Regular* type of petrol whose share in the overall turnover of petrol is 73.7 percent (see Figure 9). It is mainly imported from Bulgaria (35 percent of the turnover of the *Regular* type of petrol), Romania (27 percent of the turnover of the *Regular* type of petrol) and Azerbaijan (26 percent of the turnover of the *Regular* type of petrol)⁴³. In terms of imports of *Premium* type of petrol (23.6 percent of the overall turnover of petrol),⁴⁴ Bulgaria is the main source of import (44 percent of the turnover of the *Premium* type of petrol), followed by Romania (29 percent) and Italy (24 percent). As for *Super* type of petrol, there is relatively small demand for it in Georgia (2.7 percent of the overall turnover of petrol), while the sources of import are Bulgaria, Greece, and Romania.

Figure 9: Share (%) of A-92, A-95 and A-98 Petrol in the Overall Turnover of Petrol on the Georgian Market in 2011



Source: The Revenue Service

Figures 10a and 10b show the breakdown of fuel imported to Georgia by the country of origin:

⁴² Source: The National Statistics Office of Georgia, <http://goo.gl/2l0kq>.

⁴³ Source: The Revenue Service, the data of 2011.

⁴⁴ Source: The Revenue Service, the data of 2011.

Figure 10a: Fuel (Petrol) Import to Georgia

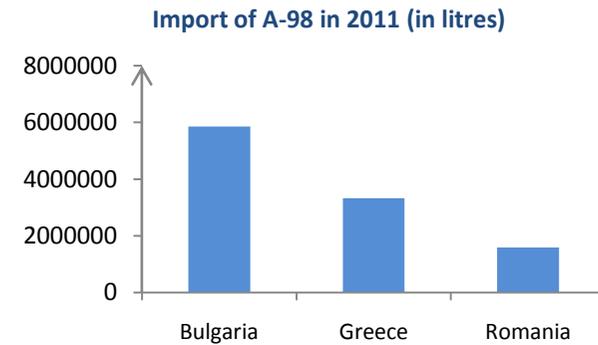
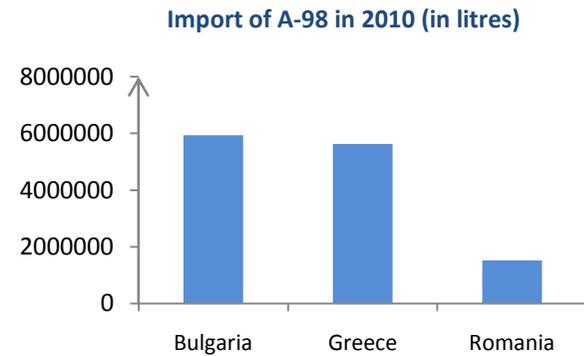
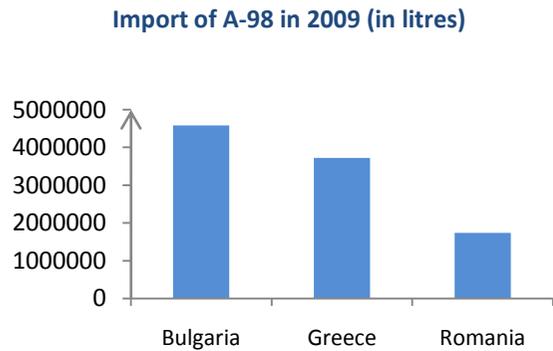
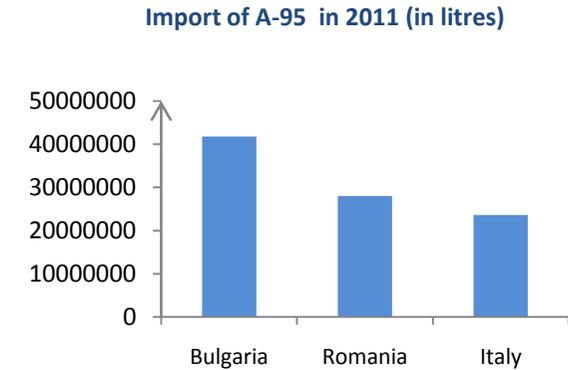
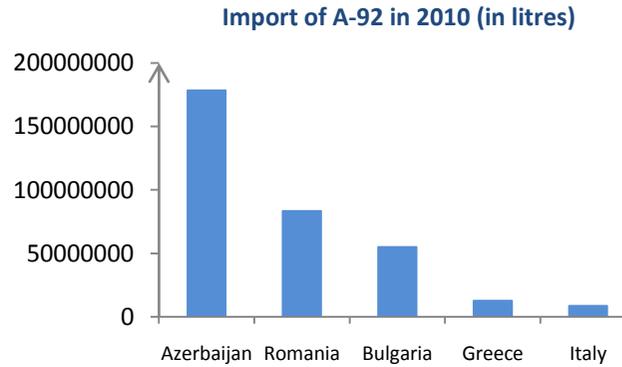
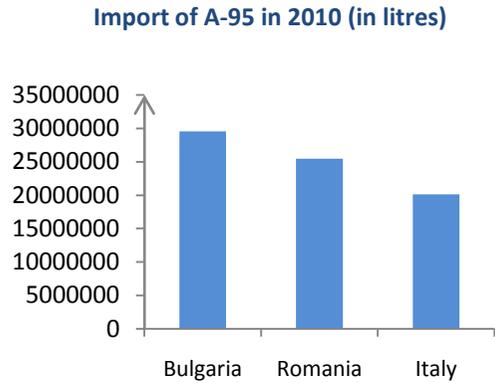
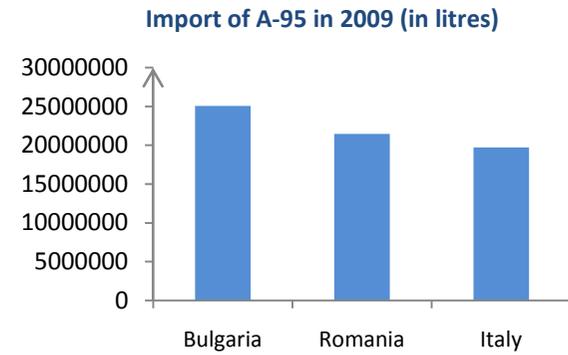
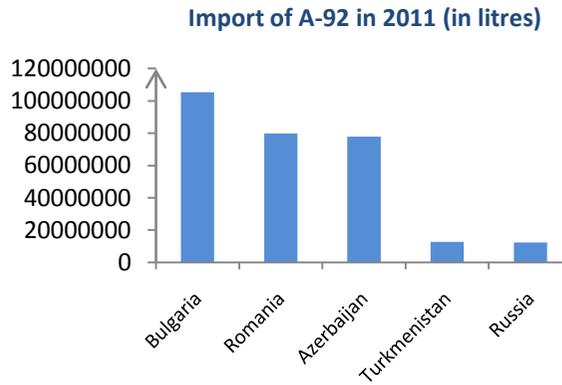
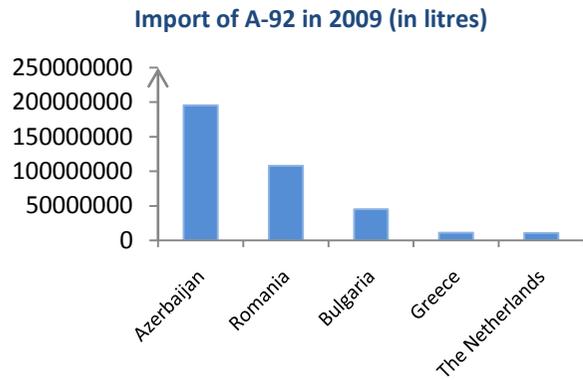
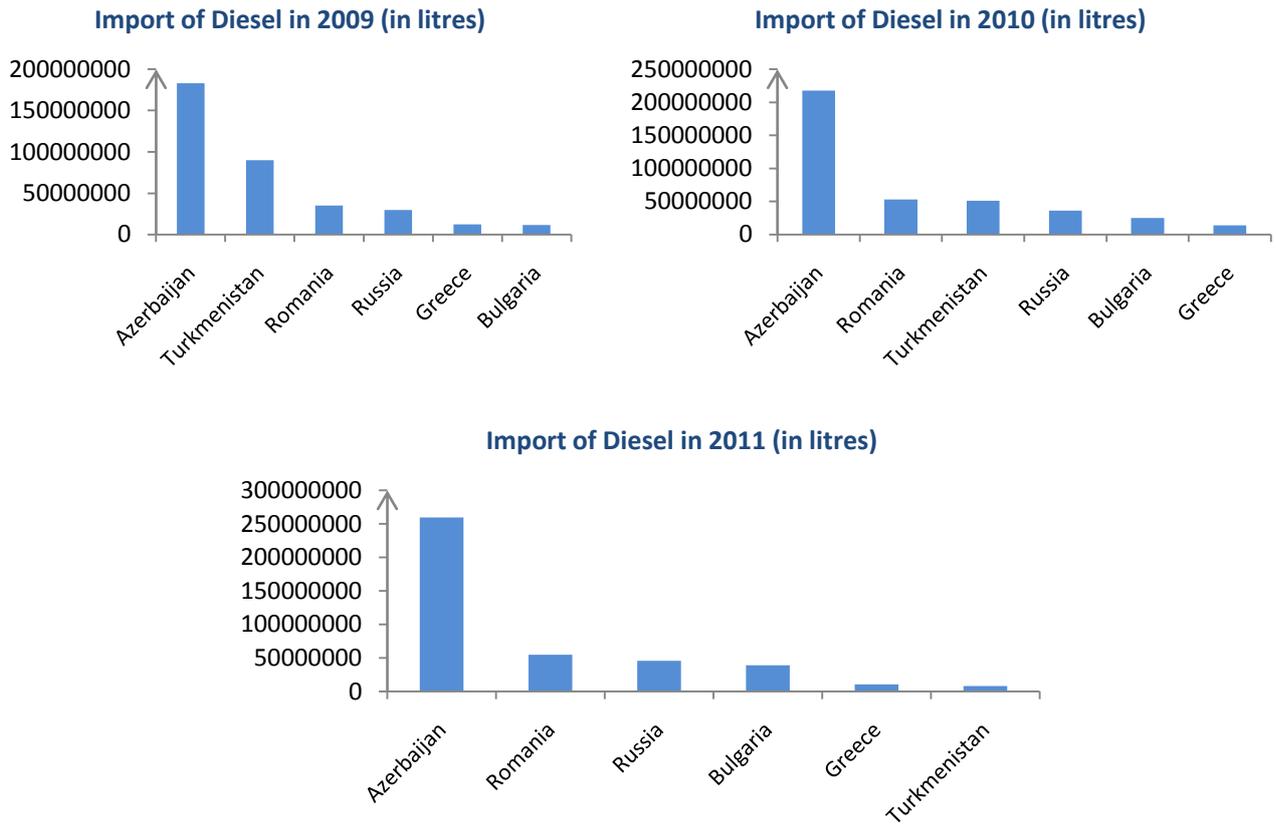


Figure 10b: Fuel (Diesel) Import to Georgia



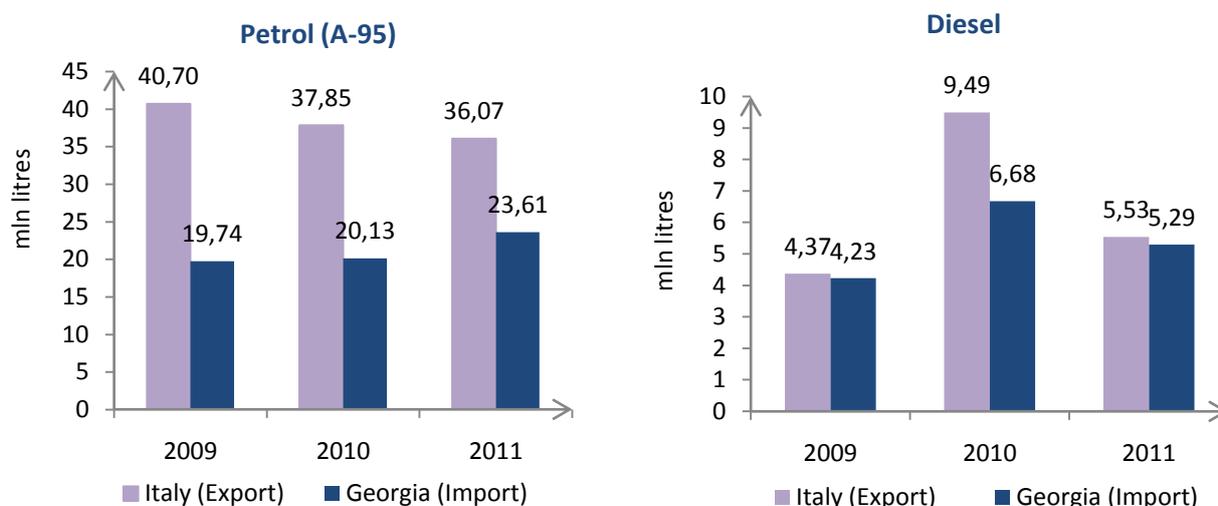
Source: The Revenue Service

As noted above, Wissol Petroleum Georgia imports the fuel of the Falconara Marittima oil processing factory of the Italian company Api to the Georgian market. Its gas stations sell *Api Super* (octane number 98), *Api Premium* (octane number 95), and *Api Diesel*. According to the information provided by the Customs Service of Italy and the Revenue Service of Georgia, no import of *Super* type of petrol (octane number 98) was registered from Italy to Georgia in 2009-2011. If the petrol sold as *Api Super* at the company's gas stations does not correspond with the characteristics of *Api Super* (octane number 98), it is a violation of consumer rights and illegal use of trademark.

Moreover, by comparing the figures provided by the Customs Service of Italy with those provided by the Revenue Service of Georgia, Transparency International Georgia discovered significant discrepancies between the amounts of fuel registered by them. These discrepancies are shown on Figure 10c⁴⁵:

⁴⁵ Source: The Customs Service of Italy and the Revenue Service of Georgia. The figures provided by these bodies are given in Annex 4.

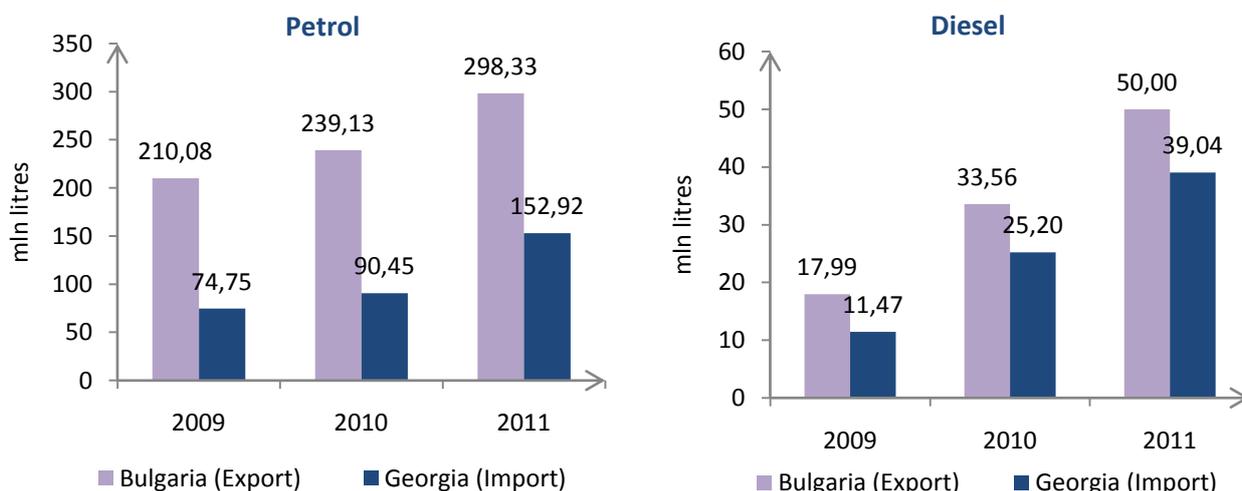
Figure 10c: Fuel Export Data by Italian Customs Agency vs. Fuel Import Data by the Revenue Service of Georgia, 2009-2011



Source: The Customs Service of Italy and the Revenue Service of Georgia

Transparency International Georgia also found significant discrepancies between the amounts of fuel imported from Bulgaria registered by the Customs Service of Bulgaria and those registered by the Revenue Service of Georgia. These discrepancies are shown in Figure 10d⁴⁶.

Figure 10d: Fuel Export Data by Bulgarian Customs Agency vs. Fuel Import Data by the Revenue Service of Georgia, 2009-2011



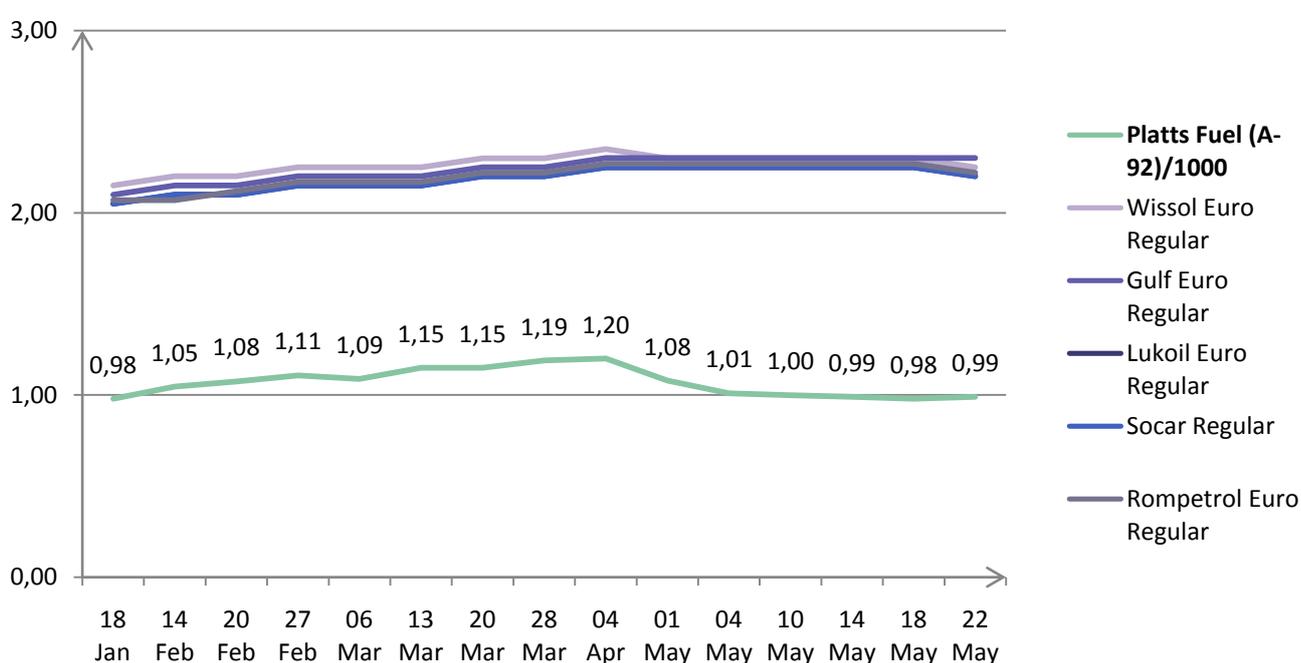
Source: The Customs Service of Bulgaria and the Revenue Service of Georgia

⁴⁶ Source: The Customs Service of Bulgaria and the Revenue Service of Georgia. The figures provided by these bodies are given in Annex 4.

2.4. The Dynamics of Fuel Prices

However, Review of the prices of fuel supplied by the all five companies in the Georgian market reveals an evident trend of parallelism⁴⁷. Furthermore, since only imported fuel is sold on the Georgian market, the dynamics of its prices depends on the fuel prices on international markets, specifically, the dynamics of the Platts prices. Therefore, reviewing this dynamics, it would make sense to assume that there is a correlation between the Platts prices and the fuel prices on the Georgian market. However, a certain anomaly is characteristic of the fuel price dynamics in Georgia – observations show that the price increase in the international market (Platts) is followed by increase in prices in Georgia. While, Georgian fuel prices do not decrease in the wake of decrease in Platts prices; At the same time, the price dynamics of all the players of the market is analogous: an essential parallelism is observed both among the prices set by the all five companies and in the variations of these prices. This dynamics is illustrated in Figure 11: the figure plots the dynamics of petrol (*Regular* type) prices and the Platts prices in 2012:

Figure 11: The Dynamics of Petrol (Regular) and Platts Prices



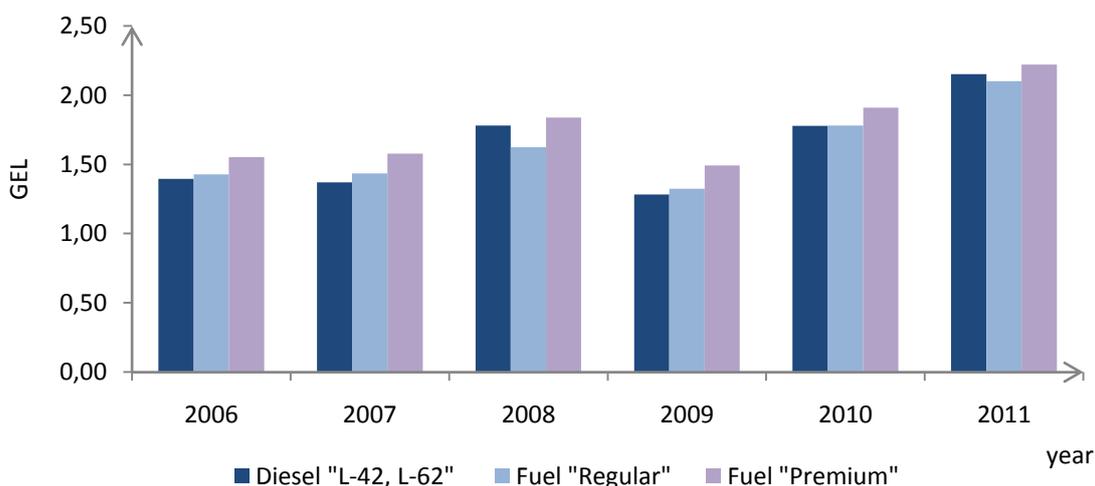
Source: The results of observation conducted by Transparency International Georgia at gas stations, 2012

According to economic theory and positive international experience, parallelism of prices set by various companies is one of the signs of possible existence of collusive (cartel) agreements or coordinated (concerted) practice among the economic agents operating on the market, which impacts negatively on economy and consumers. Therefore, a review of these trends on the market provides grounds for assumption that there may be attempts by market players to coordinate their commercial strategies, which is manifested in the parallelism of prices and the possibility of market segmentation. The oligopolistic structure developed on the fuel market, which is characterized by low elasticity of demand caused by the absence of substitute products, also contributes to this.

⁴⁷ Economic theory considers asymmetry of prices on the relevant market and the existence of differentiated products supplied by various economic agents as factors hindering collusive agreements.

The small size of the country's market and the absence of information asymmetry on the market are also conducive to collusive (cartel) agreements.⁴⁸ Considering the economic agents' striving for maximizing their profits, it has been demonstrated by academic studies that there is a positive correlation between the market share of a particular economic agent and the prices it sets. This trend is also observed on the Georgian market. Specifically, together with the trend of consolidation of players operating on this segment of the market, one can also observe the dynamics of price increase. Figure 12 gives the average retail market prices of one litre of fuel (diesel and petrol) in the recent period in Georgia. As the figure shows, the prices of the fuel tended to increase sharply in 2009-2011.

Figure 12: Average Retail Market Price of 1 litre Fuel (in GEL) in Georgia in 2006-2011



Source: The National Statistics Office of Georgia

Chapter 3. The Role of Competition Authority

International practice demonstrates that, when the structure and characteristics of the market reveal the aforementioned signs (the existence of an oligopolistic structure; suspicions regarding the existence of informal entry barriers; an evident analogy of the dynamics of prices of all market players and an essential parallelism both among the prices set by various companies and in the variations of prices), it is necessary for the competition authority to intervene and launch an investigation to determine whether the companies operating in this market are beyond competition. Since laws regulating competition in Georgia were repealed in 2005 and, consequently, competition authority was, in fact, non-operational, no effective control were executed over the protection of competition rules and principles to ensure free and fair competition and transparent and non-discriminatory access to the market.

There is also the problem of transparency in this segment of the market. Although Transparency International Georgia offered all the five companies of the sector to take part in this study and informed them that only generalized indicators of the sector would be included in the published report, only Sun Petroleum Georgia agreed for interview⁴⁹ (though it did not provide with information requested for the purposes of the study). Other companies (Socar Petroleum Georgia, Lukoil Georgia, Wissol Petroleum Georgia, Rompetrol Georgia) refused to take part in the study.

⁴⁸ Information asymmetry exists when economic agents have incomplete and discrepant information about the decisions (for example, about prices) made by one another.

⁴⁹ Interview conducted by the author with the Marketing Manager of the company, Mr. L. Tevzadze, April 2, 2012.

For this reason, Transparency International Georgia has only highlighted the trends observed in the market and factors conducive that free competition is restricted in this market. The current situation in the market in terms of competition and protection of consumer rights requires the authority regulating competition – the Competition and State Procurement Agency – to intervene, assess the competition, and launch an investigation to determine whether the companies operating in this market are beyond competition.

Part 3: Competition Case Study: Food Market

Summary

Food market is a particularly important segment of Georgian economy, as food is consumed by everyone, including those below the poverty line and spending on these products constitutes a significant share of total consumer spending. Therefore, it is important that the food prices do not increase because of anti-competitive practices by economic agents.

This part of the report provides an analysis of competition on the food market, based on the trends observed on the market and empirical facts. The first chapter describes the general picture on the market. The second chapter presents an overview of the legal barriers to enter the food market. The third chapter assesses the market of dairy products, and the fourth chapter - the market of meat. The fifth chapter analyzes the role of the competition authority. On the basis of this research, we have also drawn up specific recommendations which the government needs to consider in order to ensure effective competition policy and promote competition.

Main Findings

- Georgia is highly dependent on food import, which is why increase in food prices internationally from the second half of 2010 put inflationary pressure on the Georgian food market;
- The food prices in the Georgian market are characterized with sharp trend of increase in 2009-2011. The highest price increase is recorded on buckwheat, sugar, meat (especially beef), vegetables, greenstuffs, animal and plant fats, dairy products, and flour;
- Food sector is a particularly important sector of the Georgian economy, as food is consumed by everyone, including those below the poverty line (in 2007-2009 expenditures on food made up 43% of the consumer basket, in 2010-2011 – 38.8%). Therefore, it is important that the food prices do not come under inflationary pressure because of anti-competitive practices by economic agents;
- Food market has an oligopolistic structure in Georgia;
- One of the problems of the market is the lack of transparency;
- As natural milk (which varies by seasons) and meat products produced in Georgia cannot fully meet the local demand, import makes up for the shortage. Milk powder and vegetable fat are also used in dairy production;
- While falsification and violation of labelling rules are among the major problems in the market of dairy produce, food safety is the most troublesome problem in the meat market, which is exacerbated by the use of food additives and lack of supervision;
- Trends and symmetry revealed while observing commercial strategies of major players in the fuel and food markets might indicate that the companies are trying to coordinate their market strategies;
- To help create a competitive market structure the government has to carry out effective supervision of competition in the market;
- Institutional factors have had an impact on the dynamics of competition in the food market. 2004 reform, which aimed to change the ineffective soviet-type control system, was suspended by the end of 2006. Inspection of the food producer/distributor companies as part of food safety supervision also stopped. Apart from this, starting in 2007 it was not required to register as a food producer and/or distributor. At this stage of the reform the law of Georgia on Food Safety and Quality gave only the rudimentary food safety definitions and principles, while mechanisms for monitoring food safety and quality were suspended. As a result, no regular state monitoring

of food safety was done, which posed a serious threat to the consumers' health and life. This period saw the incidence of food and water-related poisonings increase;

- Laws regulating competition in Georgia were repealed in 2005. Consequently, there was no effective control over the protection of competition rules and principles. This created risks of well-established market players engaging in anti-competitive practice and abusing their market power;
- In 2009 the European Commission named sanitary and phytosanitary measures (the area of food safety) and competition as a priority areas before starting negotiations on the Deep and Comprehensive Free Trade Agreement (DCFTA) between Georgia and the European Union;
- Recently adopted Food/Animal Feed Safety, Veterinary and Plant Protection Code has combined the basic laws in the fields of food safety, veterinary and plant protection. While, recently passed competition legislation sets forth basic regulations for competition policy. Adoption of the regulations is, admittedly, a step forward in terms of institutional reforms.

Recommendations

We propose that:

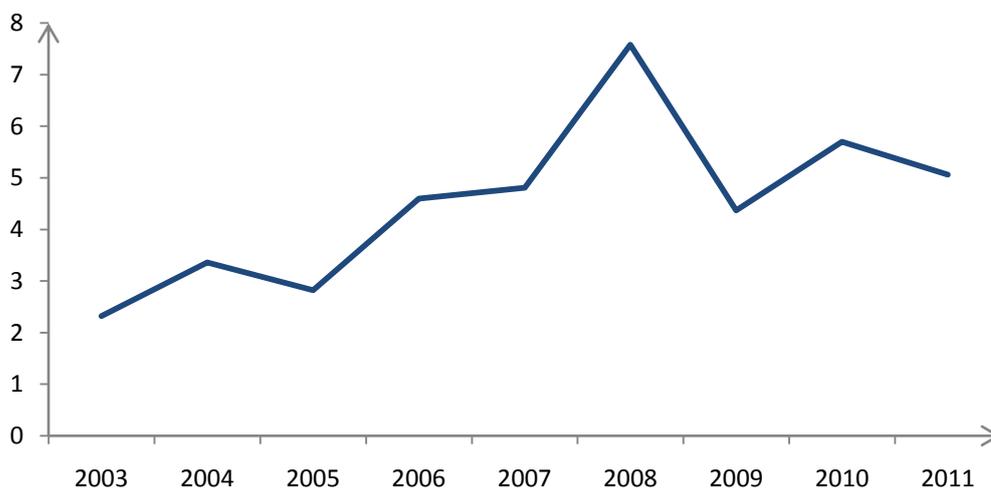
The Competition and State Procurement Agency to undertake a competition assessment and investigate the markets outlined in the report to determine whether the major players in these markets are beyond competition. The Agency should establish:

1. whether the equilibrium pattern established in the examined markets is a natural outcome;
2. whether the statistical regularity that we found is indicative of market players attempting to coordinate their prices;
3. whether the increase in prices on the meat market is caused by a consolidated market structure, which weakened price competition and increased profit margins.

Chapter 1: General Picture

The increase in food prices internationally from the second half of 2010 put inflationary pressure on the Georgian food market; Georgia is highly dependent on food imports. The import-export ratio of food products is illustrated in Figure 13:

Figure 13: Food Import-Export Ratio in Georgia, in 2003-2011



Source: The National Statistics Office of Georgia

As the figure shows, in 2010-2011, the import of food products exceeded the export approximately fivefold⁵⁰, which is why increase in food prices internationally from the second half of 2010 put inflationary pressure on the Georgian food market.

Food sector is a particularly important sector of the Georgian economy, as food is consumed by everyone, including those below the poverty line, and spending on food is significant share of total consumer spending in Georgia (spending on food accounted 43 percent of the consumer basket in 2007-2009 and 38.8 percent in 2010-2011). Furthermore, the increase in the food prices limits the population's purchasing power.

Figure 14 shows average quarterly retail prices of different types of food in Georgia in 2009-2011, while Figure 15 shows average annual retail prices of different types of food in Georgia in 2009-2011.

As the figures show, the prices of this group also tended to increase in 2009-2011. Specifically, the highest price increase is recorded on buckwheat, sugar, meat (especially beef), vegetables, greenstuffs, animal and plant fats, dairy products, and flour. These products are included in the consumer basket⁵¹ determined by Decree No. 111/N of the Minister of Labour, Health and Social Affairs of Georgia of May 8, 2003.⁵²

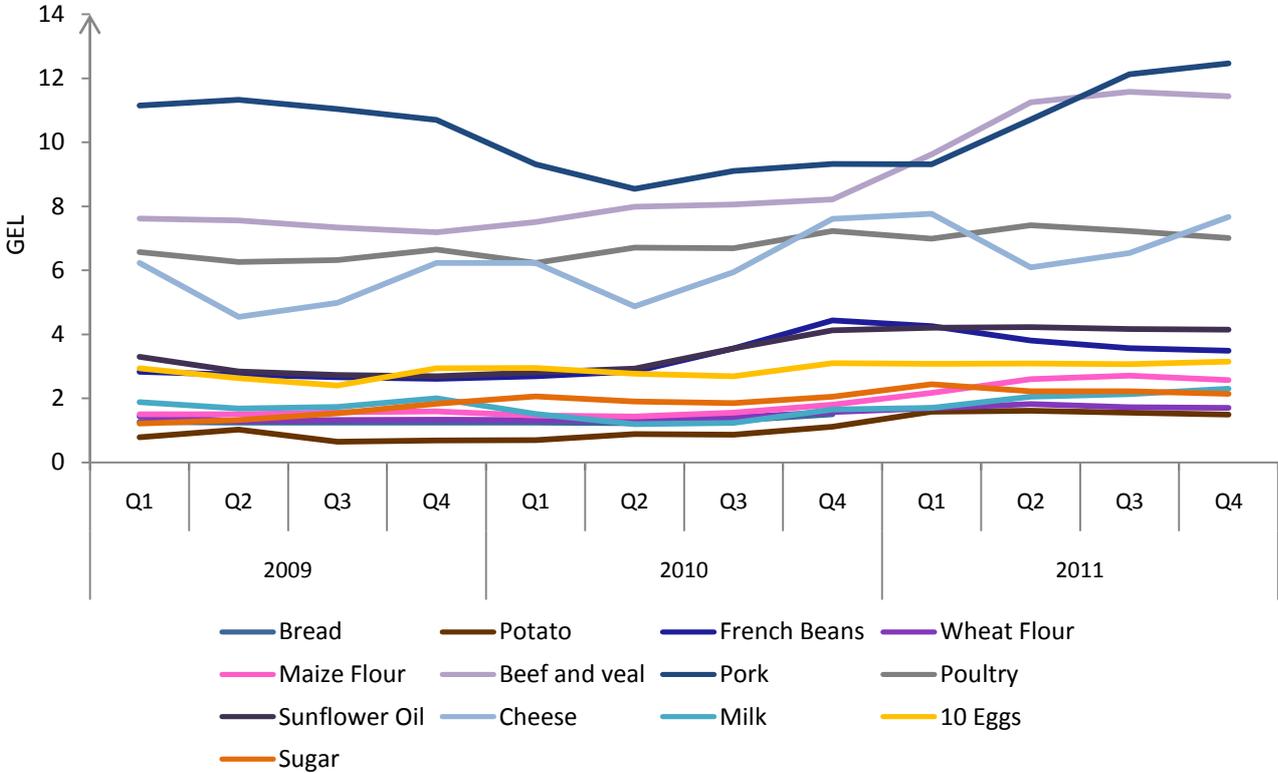
⁵⁰ Source: The National Statistics Office of Georgia, see Annex 3.

⁵¹ See Annex 1.

⁵² Decree No. 111/N of May 8, 2003 of the Minister of Labor, Health and Social Affairs of Georgia on "On Approving Norms for Physiological Requirements of Food Substance and Energy and Determining Composition of Minimum Food Basket for Calculation of Subsistence Minimum".

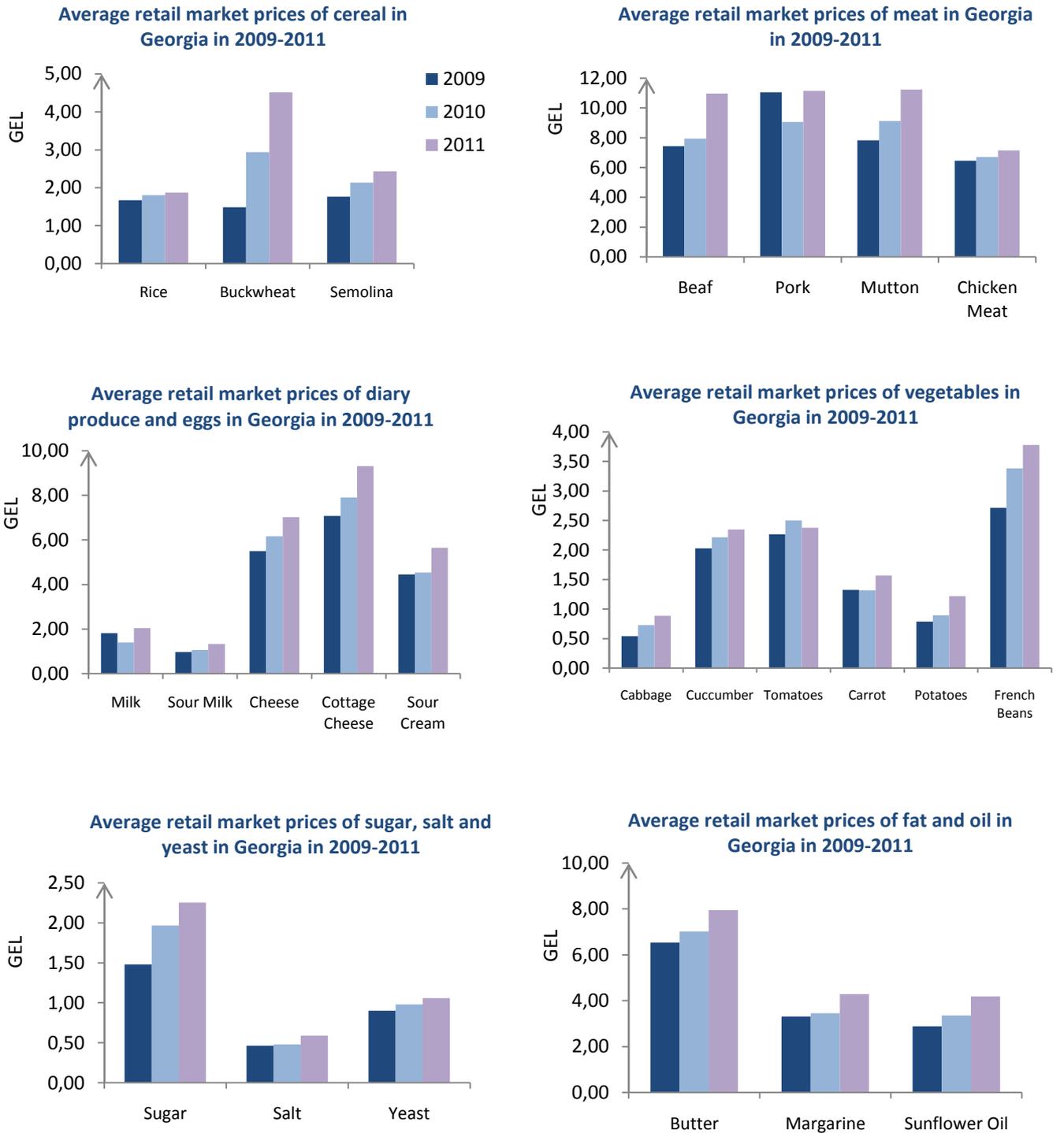
Therefore, it is important that the food prices do not come under inflationary pressure caused by anti-competitive behaviour of companies operating on the market. Thus, the government has to carry out effective supervision of competition in the food market

Figure 14: Average Food Retail Market Prices in Georgia (GEL/kg), in 2009-2011



Source: The National Statistics Office of Georgia

Figure 15: Average Annual Retail Market Prices of Food in Georgia⁵³



⁵³ Source: The National Statistics Office of Georgia.

Chapter 2: Legal Barriers to Food Market Entry

This chapter describes the legal barriers on the Georgian food market that are linked to the mechanisms of state supervision, monitoring, and control in the field of food safety. It also reviews the key elements of the recent reform.

Today Georgia’s legislative framework in the field of food safety consists of the Code of Food/Animal Feed Safety, Veterinary and Plant Protection and by-laws. Institutional factors have had an impact on the dynamics of competition in the food market. Specifically, before the Rose Revolution, Georgia had a Soviet-style system of state control with an overlapping and ineffective scheme. A reform started in the field of food safety In 2004. The Law of Georgia on Food Safety and Quality which regulated food safety and quality in accordance with EU regulations, positive international practice and established the mechanisms of state control, was adopted in 2005. The reform identified 2006 as the preparatory year when the institutional and human capacity for food safety supervision would be built and strengthened intensively with support of international organizations. Respective state control was scheduled to start in 2007.

At the next stage, reforms were suspended by the end of 2006. Inspection of the food producer/distributor companies as part of food safety supervision also stopped. Apart from this, starting in 2007 it was not required to register as a food producer and/or distributor. At this stage of the reform the law of Georgia on Food Safety and Quality gave only the rudimentary food safety definitions and principles, while mechanisms for monitoring food safety and quality were suspended. As a result, no regular state monitoring of food safety was done, which posed a serious threat to the consumers’ health and life. This period saw the incidence of food and water-related poisonings increase. Figures 16a and 16b show the statistics for the diseases whose transmission mechanism may involve food and drinking water (food and water-related poisonings):

Figure 16a: The absolute number of some infectious diseases (food and water-related poisonings) in Georgia in 2000-2011⁵⁴

disease	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Poisonings of bacterial and nutritional origin	280	349	388	449	408	761	1,289	2,035	1,843	2,050	2,649	2,603
Diarrheas of presumably inflectional origin	6,075	6,667	6,104	6,020	6,035	7,431	7,803	1,159	10,987	9,926	19,868	19,576

Figure 16b: The data of the incidence of some infectious diseases per 100,000 persons and 100,000 children (in fractions) in Georgia, in 2000-2011⁵⁵

Disease	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Poisonings of bacterial and nutritional origin	6.3/ 9.2	7.9/ 16.5	8.9/ 15.3	10.4/ 12.7	9.3/ 10.5	17.4/ 18.2	29.3/ 43.3	46.4/ 63.3	42.0/ 54.0	46.5/ 77.3	59.5/ 138.7	58.2/ 143.8
Diarrheas of presumably inflectional origin	136.4/ 502.7	150.5/ 594.3	139.6/ 518.5	139.1/ 485.2	138.1/ 469.4	170.0/ 567.2	177.4/ 631.3	264.2/ 969.6	250.6/ 968.1	225.0/ 872.9	446.1/ 1,742.9	438.0/ 1,711

The legislation regulating competition was also repealed in Georgia in 2005. Consequently, there was no effective control over the protection of competition rules and principles. This created risks of well-established market players engaging in anti-competitive practice and abusing their market power.

⁵⁴ Source: Official statistical data of L. Sakvarelidze National Center for Disease Control and Public Health.

⁵⁵ Source: Official statistical data of L. Sakvarelidze National Center for Disease Control and Public Health.

In 2009 the European Commission named sanitary and phytosanitary measures (the area of food safety) and competition as a priority before starting negotiations on the Deep and Comprehensive Free Trade Agreement (DCFTA) between Georgia and the European Union. In the framework of the preparatory works for the commencement of the negotiations, the government of Georgia approved the Comprehensive Strategy and Legislative Approximation Program in Food Safety and the draft Code of Food/Animal Feed Safety, Veterinary and Plant Protection was developed. The government of Georgia also approved the Comprehensive Strategy in Competition Policy on the basis of which the draft Law of Georgia on Free Trade and Competition was developed. The Code of Food/Animal Feed Safety, Veterinary and Plant Protection and the Law of Georgia on Free Trade and Competition were passed by the Parliament of Georgia May 8, 2012. The code combined the basic laws in the fields of food safety, veterinary and plant protection, while competition legislation set forth basic regulations for competition policy. Adoption of these regulations is, admittedly, a step forward in terms of institutional reform.

According to the legislation, public policy in the area of food safety and quality is determined by the government and the Ministry of Agriculture of Georgia within the limits of their powers, while state control is exercised by the National Food Agency on the territory of Georgia, and by the Revenue Service in cases where products move across Georgia's economic border.

Under the program of approximation of Georgian and EU laws, the state control that had been suspended by the end of 2006 became effective again. Specifically, the requirement of registration as a food producer and/or distributor became effective from January 2010 and for enterprises producing animal feed from November 2011. At the same time, introduction of systems of inspection, traceability, and control of threats is mandatory for enterprises producing and exporting food to the EU from July 1, 2010. It is mandatory for all other enterprises producing food/animal feed from January 3, 2011.

Activity in this sector involves setup costs. A business operator (company) that produces, processes, or distributes food products of animal origin is obliged to observe the General Rule of Hygiene for Enterprises Producing and Distributing Food/Animal Feed approved through the 25 June 2010 Decree No. 173 of the Government of Georgia.

This rule does not extend to:

- a) Business operators that have, under this rule, the status of a small business and directly supply food/animal feed (including products of primary production) to the final consumer or to a local retail outlet that supplies the final consumer directly;
- b) The stages of production, processing, and/or distribution of food/animal feed in which traditional methods are used;
- c) Production, processing, and/or distribution of food/animal feed with a non-factory method that is carried out in a highland region.

For the category of business operators to which the aforementioned rule does not apply, the government of Georgia approved the Simplified Rule of Hygiene for Enterprises Producing or Distributing Food/Animal Feed through its Decree No. 282 of September 10, 2010.

Under the June 25, 2010 Decree No. 173, the government of Georgia also activated state control of food safety which includes scheduled and random inspection of enterprises producing or distributing food by the National Food Agency. Scheduled inspection is held in accordance with the annual program developed according to the priorities determined on the basis of risk assessment. Therefore, entrepreneurs know about the scheduled inspection several months in advance. Random inspection is carried out without a prior notice. In cases where violations are discovered during an inspection, a protocol is drawn up and the entrepreneur is given a recommendation to rectify them. If the violations

bear a high risk to the life and health of humans or animals (critical noncompliance), the production process in question is suspended until they are rectified. In cases when the identified violations do not pose a direct danger to the life and health of humans and animals and it is possible to rectify them without stopping the production process (non-critical noncompliance), the enterprise continues operation, although it is mandatory for the business operator to rectify the violations within a reasonable term.

Special requirements for the production and procession of food products of animal origin were introduced in July 2011.⁵⁶ According to these requirements, it is only allowed to kill domestic animals and poultry for meat in an enterprise (a slaughterhouse) operating under the veterinary-sanitary supervision of an authorized body. Therefore, special requirements were imposed on the storage enterprises (industrial refrigerators) and on the sale of animals, food products of animal origin, and raw materials of animal husbandry.

In addition, through the March 7, 2012 Decree No. 90, the government of Georgia approved the Special Rule for Hygiene of Food of Animal Origin which determined the requirements concerning the system of Hazard Analysis and Critical Control Points (HACCP). It should also be noted that the regulations connected with the introduction of the system of traceability are included in the Code of Food/Animal Feed Safety, Veterinary and Plant Protection, while the aforementioned rule provides for the activation of the system of HACCP. Specifically:

1. If a business operator is a slaughterhouse or carries out thermal processing of fresh milk, it is mandatory to introduce the system of Hazard Analysis and Critical Control Points (HACCP) based on the principles of the Code of Food/Animal Feed Safety, Veterinary and Plant Protection of Georgia;
2. After the introduction of the system of Hazard Analysis and Critical Control Points (HACCP) in the slaughterhouse, the following requirements have to be met:
 - a) An animal or a batch of animals received must be accompanied by information provided in Article 6 of this rule, or the aforementioned information must be provided to the slaughterhouse within 24 hours of the moment it receives the animal or the batch of animals;
 - b) It is disallowed to receive an animal or a batch of animals from a quarantine zone, except for the cases where this is permitted by the National Food Agency;
 - c) An animal or a batch of animals delivered to a slaughterhouse must be healthy, insofar as the slaughterhouse can ascertain this.

This rule also establishes special hygiene requirements for the meat of domestic hoofed animals, poultry, and rabbits, as well as for fresh milk and dairy products. Specifically, the rule determines special requirement for the packaging and labelling of liquid milk.

Under Paragraphs 1 and 2 of Article 24 of the Law of Georgia on Licenses and Permits, two types of permits are issued for import of products subject to veterinary control:

- The permit for transit of products subject to veterinary control;
- The permit for import of products subject to veterinary control.

Experts have highlighted a number of shortcomings in the Code of Food/Animal Feed Safety, Veterinary and Plant Protection. Namely, as expert Rezo Kobakhidze explained, “the Code takes under control falsification of veterinary medicines and means of plant protection and imposes fines but it does not

⁵⁶ The Law of Georgia on Veterinary; July 4, 2-11 Order No. 2011 of the Minister of Agriculture of Georgia “On Approving the Rules of Veterinary-Sanitary Safety “.

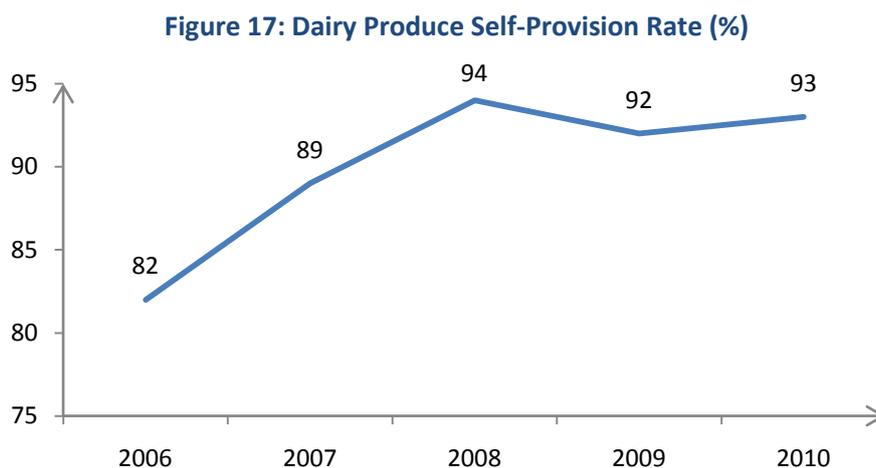
even contain a definition of falsification of food, which puts food safety in an abnormal and unequal condition, since some types of food falsification (e.g. those relating to quality, composition, contents, etc.) can make food unsafe.”⁵⁷ Elene Shatberashvili, a representative of the Elkana Biological Farming Association, highlighted issues of biological production which “are still unregulated by the legislation and constitute a significant hampering factor for the development of the sector. Particularly, it has been determined by the standard of Codex Alimentarius and the requirements of the EU legislation, as well as by the legislative experience of up to 60 states (including the US), that a product can only be labelled as a bio-product on the basis of a certificate that confirms compliance with the universally recognized principles of bio-production. Therefore, producers that do not have a bio-certificate are prohibited from making a note on the label (any combination containing the words “eco”, “bio”, “organic”) that leads consumers to believe that the product was produced in compliance with the standards of bio-production. The thing is that the requirements of bio-production are quite strict and involve additional costs. For this reason, according to international experience, determining the basic principles of bio-production, confirmation of compliance with these principles (certification), and corresponding labelling are the only effective means that enable both the producer and the consumer to protect themselves from dishonest producers. These requirements are not in force in Georgia up to now. The current situation prevents honest producers from establishing themselves on the market under fair competition and confuses the consumer. For this reason, it is very important that an adequate regulation be adopted in compliance with the international standards that ensures the protection of producers and consumers from dishonest producers.”⁵⁸

Considering the fact that dairy and meat products belong to the category of high-risk products, we selected these segments of the food market to assess competition.

Chapter 3: Market of Dairy Produce

3.1. Self-Provision Rate for Dairy Produce

Georgia's self-provision rate for dairy produce is illustrated in Figure 17:



As shown in the figure, the amount of natural milk produced in Georgia (which varies by seasons) cannot fully meet the local demand. Milk powder and vegetable fat are used in dairy production. Import of dairy produce also makes up for the shortage.

⁵⁷ Interview conducted by the author, June 2012.

⁵⁸ Interview conducted by the author, July 2012.

3.2. Companies Operating on Dairy Produce Market

The Georgian market of dairy produce has the following structure: Large companies that hold large shares of the market coexist with small companies with small market shares. Specifically, the players of the market include the following companies:

Georgian Eco LLC (Eco-Food)

The **Eco-Food** was founded in 2004. Since 2006, the trademark of **Eco-Food** has been owned by Georgian Eco LLC. The company has introduced and implemented an integrated system of food safety and quality management in accordance with the requirements of the ISO 22000:2005 and ISO 9001:2000 standards. In May 2007, Eco Food received the certificates of the UKAS (Great Britain). The company produces 50 types of products.

Sante GMT Products LLC

The **Sante GMT Products** has been operating on the Georgian market since 1997. It holds three international certificates: 1. the ISO 9001 certificate that assesses the work of the management; 2. the HACCP certificate that assesses the certified systems of food safety management; 3. the ISO 22000 certificate that assesses the observance of the norms of food safety. The company produces 43 types of products.

Chveni Permeri LLC

Chveni Permeri is a subsidiary of JSC Nikora. It was founded in 2008 and produces several types of dairy products. The company has introduced the ISO 9001:2008 quality management system and the ISO 22000:2005 (HACCP) food safety management system. Chveni Permeri produces 31 varieties of products.

Wimm-Bill-Dann Georgia LLC (Soplis Nobati)

The trademark of **Soplis Nobati** is owned by Wimm-Bill-Dann Georgia LLC. In 2011 PepsCo company became the owner of Wimm-Bill-Dann Georgia.

The companies operating on the market also include **Natural+ LLC** and **Lactalis Georgia LLC** which mainly imports the products of the President company.

The major companies on the market are **Georgian Eco LLC** and **Sante GMT Products LLC** which control more than 70% of the market.⁵⁹ The market share of Soplis Nobati has also been increasing in the recent years.

The founders of these companies are listed in Figure 18.

3.3. Main Characteristics of Dairy Produce Market

Georgia's dairy market is characterized by a moderate degree of product differentiation. As it is known, dairy products belong to the category of high-risk one. Falsification and violation of labelling rules are one of the major problems of this market. As Dr. Zurab Tskitishvili explained, the dairy products supplied on the Georgian market contain raw materials and fats of non-milk origin. In such cases, the international practice prohibits the use of the original names of dairy products (for example, milk,

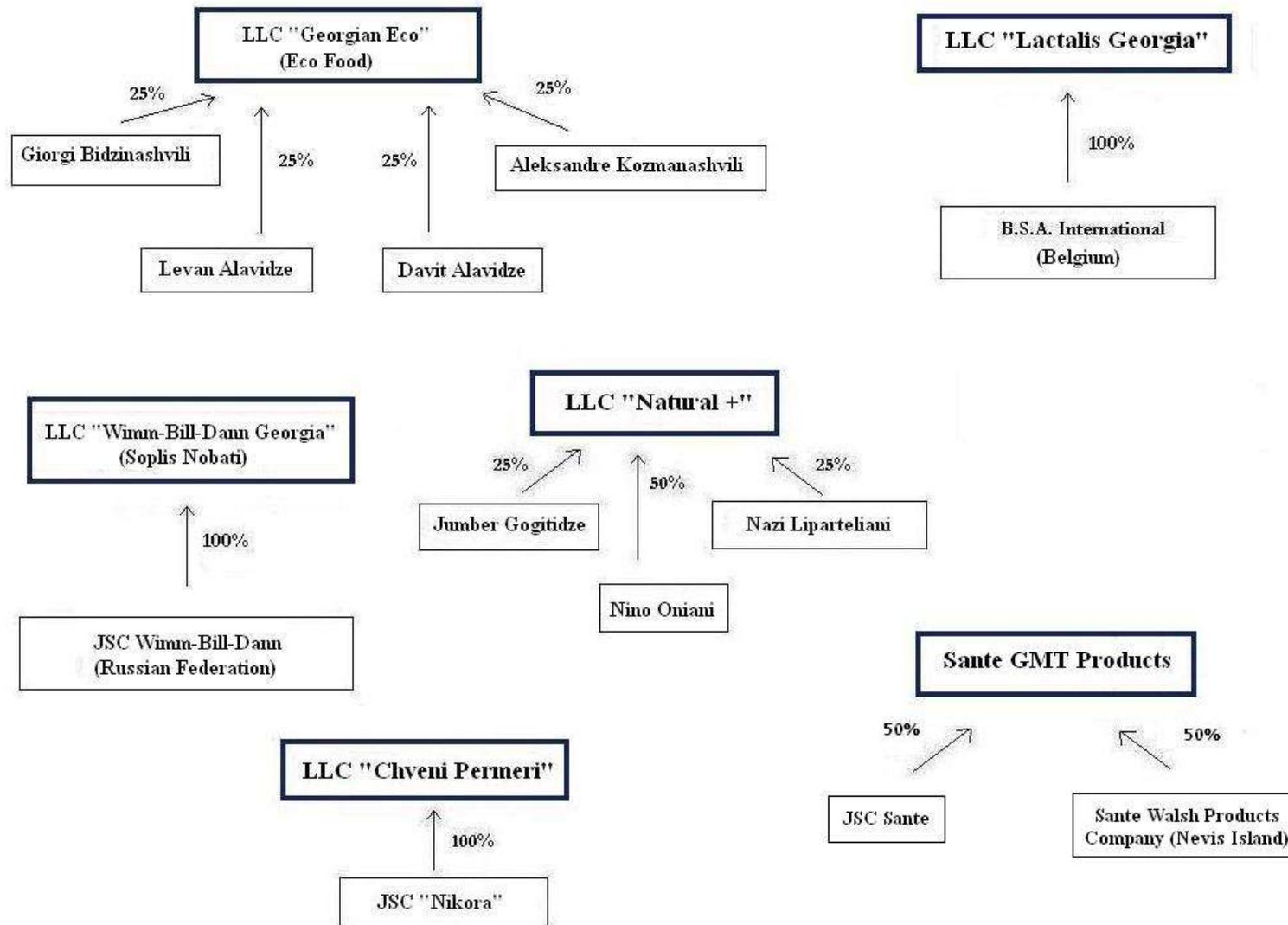
⁵⁹ Expert assessment based on interviews with company representatives.

butter, cream, cottage cheese, etc.) on the label. Dr. Tskitishvili also noted that Georgian legislation does not establish the body responsible for the enforcements of the product falsification and quality norms.⁶⁰ Ms. Lia Todua, an expert at the Center for Strategic Research and Development of Georgia, also confirmed that there have been cases where laboratory tests of dairy products conducted by her organization revealed the presence of plant or animal fats differing from milk fats in dairy products.⁶¹ These cases violate the norms provided in the international standards according to which a products cannot be named a dairy product if the component of milk (for example, fat) in it has been replaced with other substances (for example, other types of fat). Producers also violate the labelling requirements for dairy products established by the Georgian legislation.

⁶⁰ Interview conducted by the author, June 15, 2012.

⁶¹ Interview conducted by the author, March 15, 2012.

Figure 18: Companies Operating on Dairy Produce Market

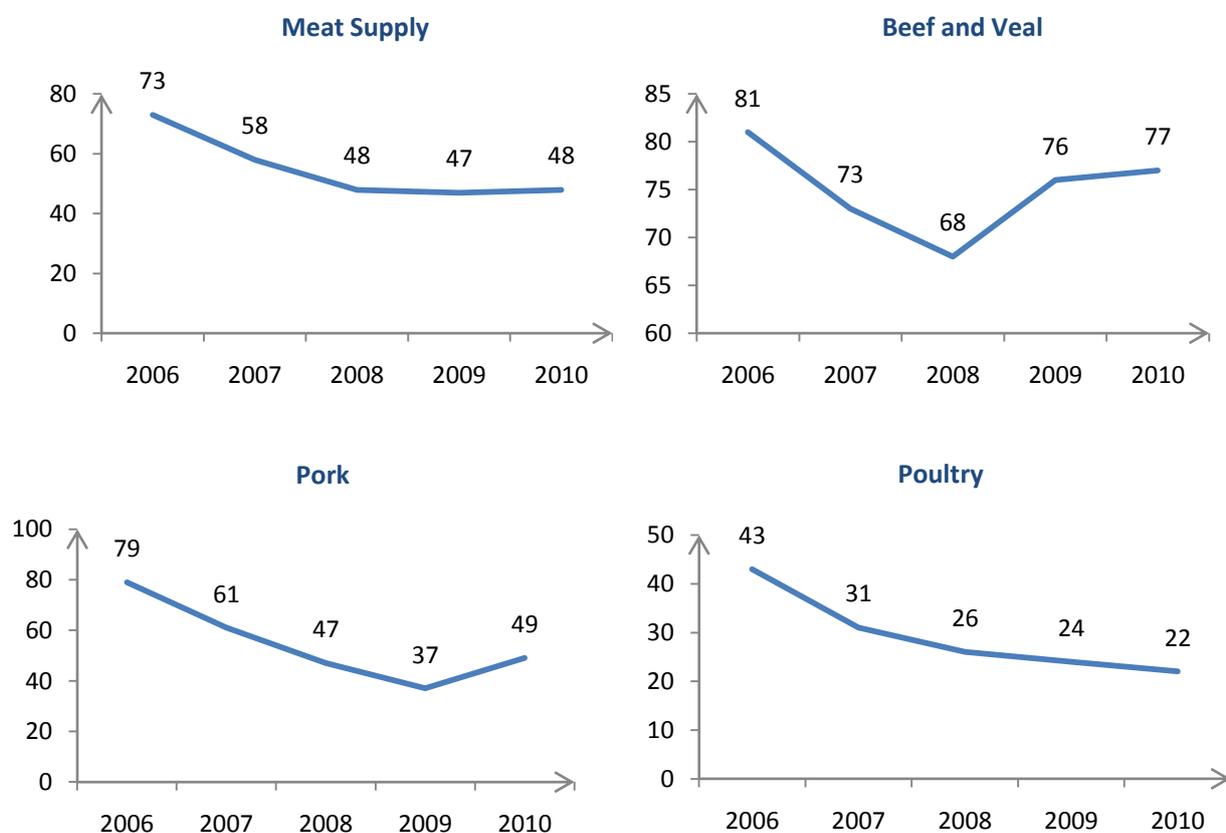


Chapter 4: Market of Meat

4.1. Self-Provision Rate for Meat

Georgia's self-provision rate for meat in is illustrated in Figure 19:

Figure 19: Meat Self-Provision Rate (%)



As shown in the figures, the amount of meat produced in Georgia fails to meet the demand on the local market. Import makes up for the shortage.

4.2. Companies Operating on the Meat Market

There are mainly five companies that operate on the meat market in Georgia. The founders of these companies are listed in Figure 20.

Meatana LLC

The Meatana company was founded in 2007. It holds the ISO 22000 certificate that assesses the systems of management of meat product safety introduced in the company and the quality of management. Meatana produces 50 types of meat products.

JSC Nikora

JSC Nikora was founded in 1998. In addition to the company of meat products, the company's holding unites enterprises that produce semi-prepared food, fish products, dairy products, ice-cream, bread and pastry products, frozen pastry products, soft refreshment drinks, and wines. The company has

introduced the ISO 9001:2008 quality management system and the ISO 22000:2005 (HACCP) food safety system. Nikora produces more than 50 types of meat products.

Shirnhoffer LLC

Shirnhoffer was founded in 2005. Its main activities are import and wholesale supply of sausage products in Georgia. The company has an exclusive right to import and distribute the products of the Austrian company Shirnhoffer.

Leader-Food LLC

Leader-Food was founded in 2010. The company produces more than 30 varieties of meat products.

Vake Sausage Factory LLC

Vake Sausage Factory was founded in 2008. However, this brand of meat products has existed since 1961. It produces 20 varieties of frankfurters, eight varieties of small sausages, and up to 90 varieties of sausages.

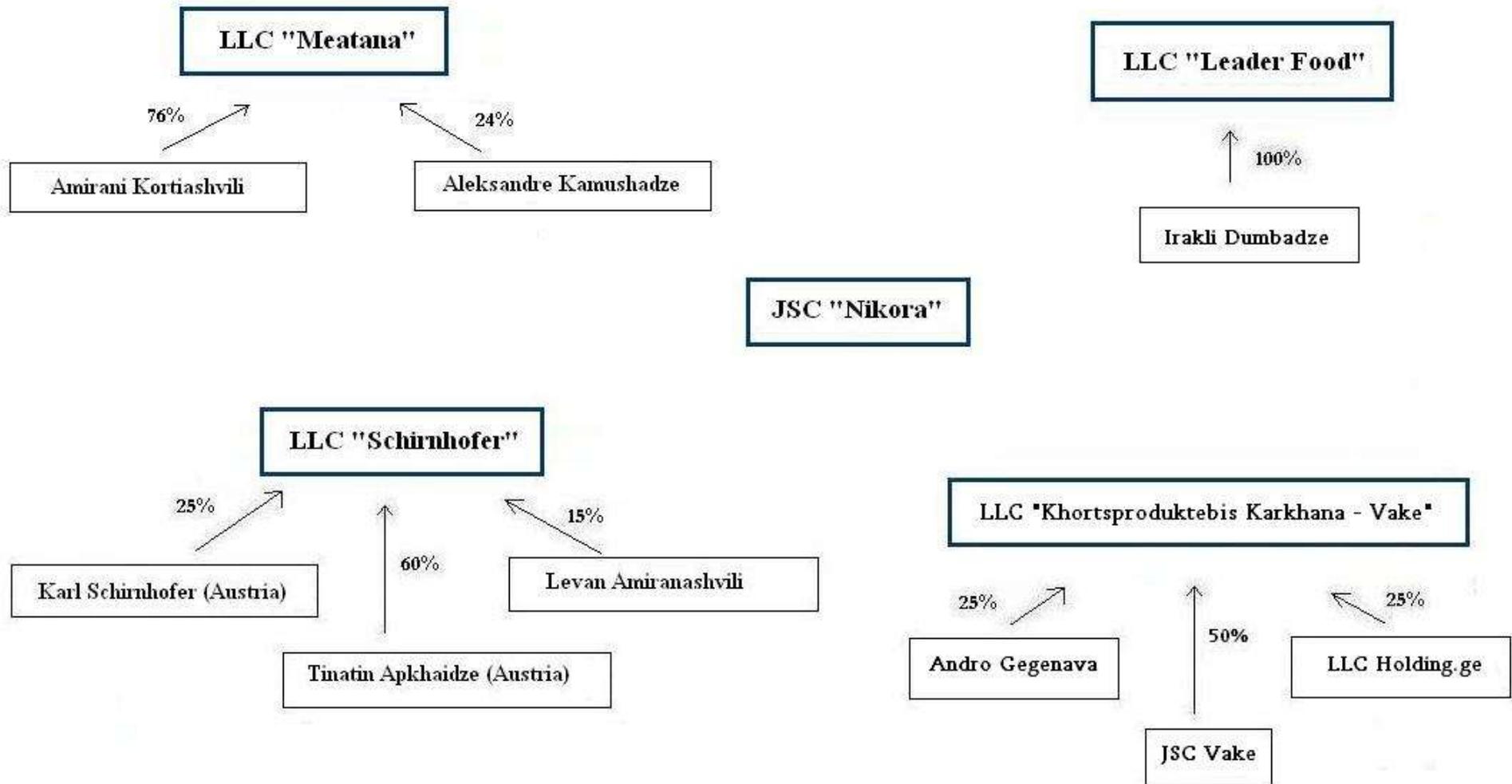
4.3. Main Characteristics of Meat Market

The food safety is the most troublesome problem in the meat market, which is exacerbated by food additives and lack of supervision. Namely, expert Mr. Rezo Kobakhidze⁶² has pointed out that “the safety of raw materials, auxiliary materials, semi-prepared products, and ready-made products, as well as their reliability and stable availability, is not guaranteed on the Georgian market. In addition, no corresponding laboratory control is exercised on animal feed, raw materials, semi-prepared products, or/and ready-made products to check for veterinary medications, including hormonal medicines, growth stimulants, vitamins, the contents of food additives used in meat products, and safety of packing materials. The lack of a monitoring system is also a problem.” Ms. Lia Todua, an expert at the Center for Strategic Research and Development of Georgia, heightened cases where laboratory tests conducted by the organization established that meat products in the distribution network were contaminated with harmful bacteria and the requirements of food safety were violated.⁶³

⁶² Interview conducted by the author, June 2012.

⁶³ Interview conducted by the author, March 15, 2012.

Figure 20: Companies Operating on the Market of Meat Products



Chapter 5. The Role of the Competition Authority

The prices of dairy and meat products on the Georgian market have been increasing sharply in recent years. Figures 21 and 22 show the average retail market prices of dairy and meat products in Georgia in 2009-2011.⁶⁴

Figure 21: Average Retail Market Prices of Dairy Products in Georgia in 2009-2011

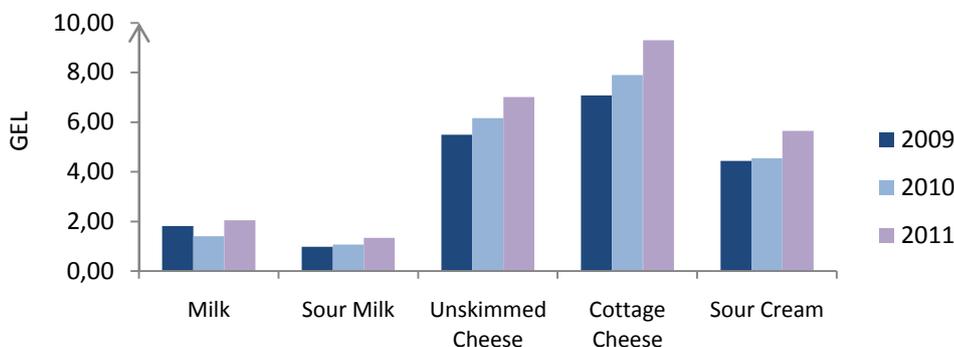
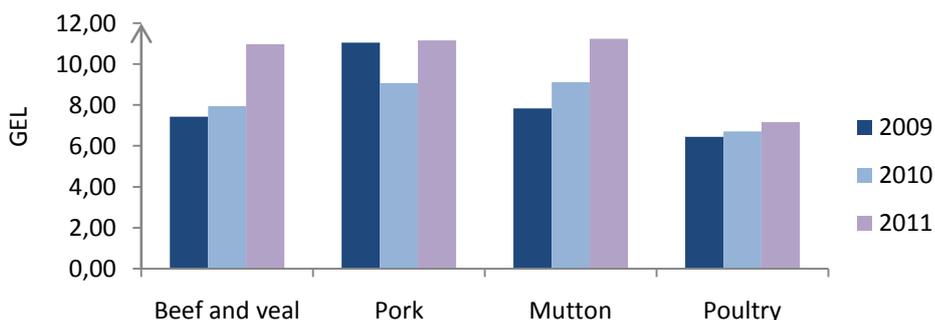
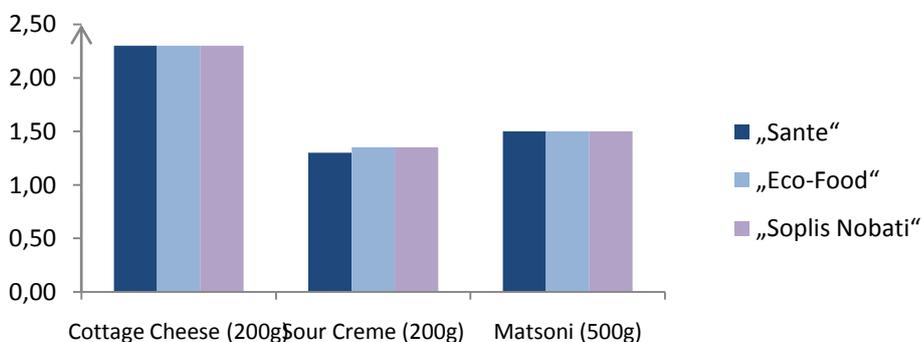


Figure 22: Average Retail Market Prices of Meat in Georgia in 2009-2011



In addition, a review of the prices of substitute dairy products supplied by the major companies of the market reveals the trend of an evident parallelism.⁶⁵ Figure 23 shows the dynamics of the prices of substitute dairy products of Georgian Eco, Sante GMT Products, and Soplis Nobati:

Figure 23: The Prices of Dairy Products of Georgian Eco (Eco Food), Sante GMT Products and Wimm-Bill-Dann Georgia (Soplis Nobati) (in GEL) in 2012



⁶⁴ Source: The National Statistics Office of Georgia.

⁶⁵ The economic theory considers the asymmetry of prices on the relevant market and the existence of products of different quality supplied by various economic agents as factors hindering collusive agreements.

As noted earlier, the mechanisms of supervision, monitoring, and state control in the field of food safety and quality were suspended in 2007, which posed a serious threat to the consumers' health and life. Special requirements for the production and processing of products of animal origin were only put in place in Georgia in July, 2011⁶⁶. Under these requirements, it is only permissible to kill animals and poultry for meat in a slaughterhouse operating under the supervision of the authorized body. Therefore, special requirements were introduced for storage enterprises (production refrigerators) and for the sale of animals, products of animal origin, and raw materials of animal husbandry.

As a result of the introduction of the new regulations, some of the slaughterhouses have been closed, since they no longer met the requirements of production and processing of products of animal origin established by the legislation. At present, Tbilisi is mainly supplied with meat by the 2 slaughterhouses: Iber Meat Georgia LLC (the village of Natakhtari) and Agroline Limited (the village of Teleti). At the same time, due to the introduction of the new regulations, the market shows a trend of price increase and parallelism of the meat prices from both slaughterhouses.

According to economic theory and positive international experience, parallelism of prices set by various companies is one of the signs of possible coordinated (concerted) practice among the economic agents operating on the relevant market, which negatively impacts on the economy and consumers. In addition, both segments of the food market are characterized by a medium degree of product differentiation. It is also important to take into account that toughness of price competition in the country is argued to depend from institutional factors. Yet, the differences among the market structures are also largely influenced by policy regime.⁶⁷ Since the institutional framework regulating competition was repealed in Georgia in 2005 and the competition authority was, in fact, non-operational, this created grounds for sectors of the economy to count on market logics and no efforts were made to ensure free and fair competition and transparent and non-discriminatory access to the market. Therefore, there may be attempts to coordinate commercial strategies of the companies operating in both dairy and meat products markets which is manifested in the parallelism of prices and the possibility of market division. The oligopolistic structure developed in these markets is also conducive factor. Positive international experience shows that, in cases where the market structural characteristics show these signs (the presence of oligopolistic structure; essential parallelism between prices set by all companies), it is necessary that the authority that regulates competition to intervene and launch an investigation to establish whether the companies in the relevant market are beyond competition. Specifically, the Competition and State Procurement Agency should determine:

1. whether the equilibrium pattern established in the examined food market is a natural outcome;
2. whether the statistical regularity that we found is indicative of market players attempting to coordinate their prices;
3. whether the increase in the prices on the meat market is caused by a consolidated market structure that weakened price competition and increased profit margins.

In addition, Transparency International Georgia believes that there is also a problem of transparency in these segments of the market. Despite the fact that the organization offered the companies operating in this sector to take part in the study and informed them that only generalized indicators would be included in the final report, only a representative of the Chveni Permeri⁶⁸ provided us with complete information requested for the purposes of the study. Representatives of Georgian Eco and Soplis Nobati agreed to an

⁶⁶ The Law of Georgia on Veterinary, the July 4, 2011 Order No. 2-101 of the Minister of Agriculture of Georgia "On Approving the Rules of Veterinary-Sanitary Safety".

⁶⁷ Sutton John, *Sunk Costs and Market Structure*, The MIT Press, Cambridge, Massachusetts, 2007.

⁶⁸ The author's interview with the Executive Director of the company, Mr. I. Nikolaishvili, April 2012.

interview, but did not provide us with the requested information, while representatives of Sante GMT Products and all other companies operating in the segment of meat products refused to give interviews.

For this reason, Transparency International Georgia has only focused on the trends in these segments of the market that are conducive to restriction of competition and makes it possible to restrict free competition. We recommend that the situation in these segments of the market in terms of restriction of competition and protection of consumers' rights requires that body regulating competition – the Competition and State Procurement Agency – to intervene and launch an investigation to establish whether the companies in the relevant market are beyond competition.

The Consumer Basket⁶⁹

2004-2006	2007-2009	2010-2011
Bread and Bread Products Rice, long-grain Buckwheat Semolina White wheat bread Grey bread Macaroni products Roll with raisins Cookies Waffles with cream Wheat Wheat flour Maize flour	Bread and Bread Products Rice, long-grain Buckwheat Semolina White wheat bread Macaroni products Cookies Waffles with cream Wheat Wheat flour Maize flour	Bread and Bread Products Rice Buckwheat Semolina Wheat bread Macaroni products Cookies Waffles with cream Wheat flour Maize flour
Meat and Meat Products Beef and veal Pork Mutton Poultry Chicken legs Canned stew meat Canned pork Smoked sausage Boiled sausage Sausage	Meat and Meat Products Beef and veal Pork Mutton Poultry Chicken legs Canned stew meat Boiled sausage Sausage	Meat and Meat Products Beef and veal Pork Mutton Poultry Chicken legs Canned stew meat Boiled sausage Sausage
Fish Fish Frozen fish Smoked fish Canned fish in tomato sauce	Fish Fish Frozen fish Canned fish in tomato sauce	Fish Fish Frozen fish Canned fish
Milk, Cheese and Eggs Unskimmed milk Condensed milk Milk powder Matsoni (sour milk) Cheese Cottage cheese	Milk, Cheese and Eggs Unskimmed milk Condensed milk Matsoni (sour milk) Cheese Cottage cheese Sour Cream Eggs	Milk, Cheese and Eggs Milk Condensed milk Matsoni (sourmilk) Unskimmed cheese Sulguni (cheese) Cottage cheese

⁶⁹ Source: The National Statistics Office of Georgia.

Sour Cream Eggs		Sour Cream Eggs
Oil and Fat Butter Fat Margarine Mayonnaise Sunflower oil Walnuts Nuts	Oil and Fat Butter Margarine Mayonnaise Sunflower oil Walnuts Nuts	Oil and Fat Butter Margarine Mayonnaise Sunflower oil Walnuts
Fruits and Grapes Tangerine Orange Lemon Persimmon Pomegranate Banana Apple Pear Grapes Plum Peach Raisins	Fruits and Grapes Tangerine Orange Lemon Persimmon Kiwi Banana Apple Pear Grapes Peach Raisins	Fruits and Grapes Tangerine Orange Lemon Kiwi Banana Apple Pear Grapes Cherries Peach Raisins
Vegetables Greens Spinach Harico vert Cabbage Cucumbers Tomatoes Eggplant Carrots Beetroot Onions Garlic Mushrooms Watermelon Melon Canned green peas Tomato sauce Pickled capers Pickled cucumbers Potatoes French beans Black pepper	Vegetables Greens Green stuff (spinach, leek, etc.) Harico vert Cabbage Cucumbers Tomatoes Eggplant Carrots Beetroot Onions Garlic Watermelon Canned green peas Tomato sauce Pickled capers Pickled peppers Potatoes French beans Black pepper	Vegetables Greens Harico vert Cabbage Cucumbers Tomatoes Eggplant Carrots Beetroot Onions Garlic Watermelon Canned vegetables Tomato sauce Pickles Potatoes French beans Spices
Sugar, Jam, Honey, Syrups, Chocolate, Confectionery	Sugar, Jam, Honey, Syrups, Chocolate, Confectionery	Sugar, Jam, Honey, Syrups, Chocolate, Confectionery

Sugar Jam Natural honey Chocolate bar Caramel Ice-cream	Sugar Natural honey Chocolate bar Caramel Ice-cream Baby food	Sugar Natural Honey Chocolate bar Caramel Ice-cream Baby food
Other food Vinegar Mustard Salt Yeast Chewing gum	Other food Mustard Salt Soda Yeast Chewing gum	Other food Ketchup Salt Yeast

Annex 2

The Share of Food and Fuel in the Consumer Basket⁷⁰

	Food	Fuel (petrol, diesel)
2004-2006	41.2	3.0
2007-2009	43.0	2.7
2010-2011	38.8	3.1

Annex 3

Figures of Import and Export of Food

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Food import (million USD)	172.5	335.6	387.8	513.2	714.7	784.1	643.1	785.6	986.4
Food export (million USD)	74.3	99.8	137.4	111.6	148.6	103.4	147.2	137.7	194.8

⁷⁰ Source: The National Statistics Office of Georgia.

Annex 4

Data provided by the Customs Service of Italy

DICHIARAZIONI DOGANALI REGISTRATE IN ITALIA

PAESE DI DESTINAZIONE GE 076 GEORGIA

CLASSIFICAZIONE DELLA MERCE - TARIC	QUANTITA' IN KG			
	2009	2010	2011	totale
27030000(01/01/1972-31/12/9999) Torba	4 500			4 500
27079999(01/01/1972-31/12/9999) Oli provenienti dalla distillazione dei catrami di carbon fossile - altri		2		2
27090090(01/01/1989-31/12/9999) Oli greggi di petrolio o di minerali bituminosi - altri	8 093 332			8 093 332
27101145(01/01/2002-31/12/9999) Benzine speciali con numero di ottani 95 >= RON < 98	29 709 673	27 624 924	26 330 443	83 665 040
27101921(01/01/2002-31/12/9999) Carboturbi		5 527 448	5 167 537	10 694 985
27101925(01/01/2002-31/12/9999) altro			37 390	37 390
27101941(01/01/2002-31/12/9999) Oli da gas - aventi tenore in peso di zolfo <= 0,05	3 704 731	8 040 689	4 688 957	16 434 377
27101981(01/01/2002-31/12/9999) Oli per motore per compressori o per turbine	5 331	886	3 173	9 390
27101983(01/01/2002-31/12/9999) Liquidi per trasmissioni idrauliche	6 160	33		6 193
27101987(01/01/2002-31/12/9999) Oli per cambi	349			349
27101999(01/01/2002-31/12/9999) altri oli lubrificanti ed altri	314 479	270 855	419 354	1 004 688
27121090(01/01/1972-31/12/9999) altra	0	200		200
27122090(01/01/1997-31/12/9999) altra	5		72	77
27129099(01/01/1997-31/12/9999) altri			1 888	1 888
27132000(01/01/1972-31/12/9999) Bitume di petrolio		7 247 363		7 247 363
27150000(01/01/2002-31/12/9999) Miscele bituminose	14 918	10		14 928
Totale	41 853 479	48 712 409	36 648 814	127 214 702

Data provided by the Revenue Service of Georgia

Product code	Country	2009	2010	2011
		Amount (litres)		
27101141000 Petrol A-92 (Regular)	Italy	8,766,042	8,606,586	873,885
27101145000 Petrol A-95 (Premium)	Italy	19,743,170	20,134,899	23,614,793
27101941000; 27101945000 Diesel	Italy	4,229,682	6,677,502	5,294,426

Data provided by the Customs Service of Bulgaria

Year	Petrol (thousand litres)	Diesel (thousand litres)
2009	210,084	17,994
2010	239,134	33,560
2011	298,334	49,999

Data provided by the Revenue Service of Georgia

Product Code	Country	2009	2010	2011
		Amount (litres)		
27101141000 Petrol A-92 (Regular)	Bulgaria	45,105,668	54,932,494	105,260,067
27101145000 Petrol A-95 (Premium)	Bulgaria	25,059,755	29,581,976	41,808,172
27101149000 Petrol A-98 (Super)	Bulgaria	45,84,720	5,933,706	5,855,975
27101941000; 27101945000 Diesel	Bulgaria	11,472,899	25,196,996	39,038,503

Transparency International Georgia extends its thanks for the support rendered in the completion of this report to Giorgi Meladze (Head of the Committee on Sector Economy and Economic Policy of the Parliament of Georgia), Vakhtang Lezhava (Former Chief Advisor to the Prime Minister of Georgia), Jondo Baghaturia (Member of the Parliament of Georgia), Tato Urjumelashvili (Competition and State Procurement Agency, Head of the Agency), Eka Gabadadze (Competition and State Procurement Agency, Communications Manager), Kakhi Kurashvili (Georgian National Communications Commission, Head of the Legal Department), Tea Tkeshelashvili (Georgian National Communications Commission, Leading Specialist of the Department of Strategic Development), the Embassy of Italy to Georgia, Fabrizio Bovino (Embassy of Italy, Commercial Attaché), Antonio Lo Parco (Customs Service of Italy), Vladimer Papava (Georgian Foundation for Strategic and International Studies, Senior Research Fellow), Ketevan Lapachi (International Black Sea University, Professor), Slava Petelava (Competition and State Procurement Agency, Head of the Department), Tengiz Kalandadze (National Food Agency, Head of Food Safety Department), Levan Izoria (Doctor of Law, Professor), Badri Gelitashvili (Free University, Professor), Zurab Tskitishvili (Expert on food safety, Doctor), Rezo Kobakhidze (Georgian Consumers Federation, Vice President), Lia Todua (Center for Strategic Research and Development of Georgia, Researcher), Elene Shatberashvili (Elkana biological farming association, Lawyer), Nino Khachidze (Internet edition www.tspress.ge), Irakli Nikolaishvili (Nikora Dairy Brand, Director), Lasha Tevzadze (Sun Petroleum Georgia, Marketing and Public Relations Manager), Giorgi Kotrikadze (Association of Oil Product Importers and Distributors, Head of the Association), Beka Kemularia (Solidarity for National Interests), Shalva Alavidze (Georgian Eco, Marketing Manager), Nunu Porchkhidze (Wimm-Bill-Dann Georgia, Head of Legal Department), and other respondents who preferred to stay anonymous.

Special thanks are due to Zviad Shvangiradze (Rezonansi, a Georgian daily) for his support.



USAID | GEORGIA
FROM THE AMERICAN PEOPLE

EAST • WEST
MANAGEMENT
INSTITUTE

Policy, Advocacy, and Civil Society Development in Georgia (G-PAC)

“საჯარო პოლიტიკის, ადვოკატირებისა და სამოქალაქო საზოგადოების
განვითარება საქართველოში

On the Cover: *Horse Race* by Leonid Afremov, www.afremov.com