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FDI attractiveness of Georgian renewable energy: Are PPAs BACK in GEORGIA?

As the most successful financial support mechanism proposed by the Government of Georgia for project development and FDI attractiveness, guaranteed power purchase agreements (PPAs) have played a core role in the development of renewable energy projects since 2008 and attracted numerous investors to Georgia.

The history of investment mechanisms for renewable energy projects

At the time, despite Georgia's emerging free market economy and stable sovereign rating, international financial institutions (IFIs) were still not willing to finance large investment projects in the country. Thus, PPAs played an important role in creating a bankable environment for project financing. After implementing PPAs in practice, investment in Georgian renewable energy became one of the most attractive business activities from an investment perspective. PPAs allowed Georgia to start building its energy independent future by developing large hydro power plants, including the Dariali HPP, the Shuakhevi HPP, and the Paravani HPP.

On the suggestion of the International Monetary Fund (IMF), which regarded PPAs as long-term financial undertakings for the country that could negatively affect the economy and market ratings, the Georgian government made the decision to stop offering PPAs since 2013 and commenced working on a new investment mechanism that would carry less of a financial burden.

In 2014, Georgia signed the Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU and commenced implementation of a third energy package at the domestic level. This process envisaged opening the day ahead (spot) market in Georgia, which would create new opportunities for the country. The day ahead (spot) market would enable the introduction of other financial incentives to attract FDI similar to PPAs.

The feed-in premium (FIP) tariff was introduced in 2020. The FIP mechanism was slated to be provided for eight months out of the year for a period of ten years, with the financial support of up to 0.015 USD per kWh paid if the price of the day ahead (spot) market would be less than 0.055 USD per kWh.

The mechanism seemed promising and many public and private partnership (PPP) projects were initiated; however, due to social and technical constraints, as well as political instability in the region, the opening of the day ahead (spot) market was postponed several times and projects initiated under the FIP mechanism ceased development due to a lack of financing.

To make the energy market attractive for foreign investments once again, the Georgian government initiated a new support mechanism, which was implemented in December 2022. Under this new initiative, the FIP was replaced with the contracts for difference (CfD) mechanism. Under this new scheme, any renewable energy source project of more than 0.5 MW installed capacity at the preparatory stage had the right to participate in a capacity auction generated by the government.

Within the CfD mechanism, the auction tariff is based on the median tariff proposed by auction participants. Projects that propose a tariff lower than the median tariff at the auction are granted the right to implement the project. The winners of the auction, under the CfD mechanism, will enjoy the right to receive compensation for the difference between their proposed tariff and the tariff of the day ahead (spot) market for 15 years. Respectively, the CfD mechanism guarantees that the winners of the auction will always receive their bidding tariff for the generated electricity. If the price at the day ahead (spot) market is higher than the winning tariff, the difference must be compensated back to the Georgian government.

What needs be done?

At first glance, the CfD mechanism looks promising and can be assimilated with the existing PPA mechanism; however, without the day ahead (spot) market defining this tariff, this mechanism will be difficult to implement.

The Georgian government must find a stable basis to replace the dependence of the CfD support mechanism to the day ahead (spot) market tariff as the latter is yet not operating. Under the current legislative and technical setting of the Georgian energy market, such a mechanism can only be the weighted average tariff of balancing electricity that the market operator offers to its customers (i.e., the balancing electricity tariff). For interested investors, the balancing electricity tariff would be much stronger and more reliable than the day ahead (spot) market tariff.

Once the spot market opens, the balancing electricity tariff can be replaced with the day ahead (spot) market tariff again without any major disruptions to the process. Moreover, as the market price is anticipated to be more than the balancing electricity tariff, this shift will present less of a financial burden for the Georgian government.

Georgia, which has potential of developing around 108 MW installed capacity of solar PV power projects, 1,500 MW installed capacity of wind power projects, and more than 10,000 MW installed capacity of hydro power projects, can become an investment hub once again by offering the proper CfD support mechanism to potential investors.

Considering the above mentioned, the answer to the question of whether PPAs are back in Georgia is NO. However, if properly implemented with important additional regulations, the CfD mechanism can successfully serve the same purpose that PPAs once did in attracting FDI in Georgia's renewable energy sector.

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