

## Corruption on the Railway: Causes and Ways of Eradication

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Summary of the study undertaken in the framework of the AML Project reflects types and scale of corrupt deals practiced on the railway of Georgia. Full version of the study provides detailed analysis of mentioned violations.

### 1. Tariffication policy

Tariffication policy comprises rail transport tariffs according to product groups. Rail transport tariffs of various groups are formed in accordance to distance covered and average load of a car. Tariffs of various taxes related to transportation are also included, in particular: car use cost, rent cost, cargo storage cost, cargo weighing cost and other services related to transportation and provision of cargo.

Tariffication policy of Georgian Railway was approved by the Decree #1 of the Minister of Transport and Communications dated 3 January 2002 and since then it is extended annually by the Director General of Georgian Railway.

*Note: Since change of the political authority in 2003 everybody assumed quite fairly that mentioned document was extremely corrupt and enabled to make deals at any stage of rail transportation. Former Minister of Transport and Communications and former Director General of Georgian Railway were charged with specific accusations.*

*Nevertheless, the document that provided the basis for mentioned criminal cases still remains in force; bringing it to conformity with the law would allow answering all existing questions, though no attempts were undertaken to do it so far.*

Drawbacks:

1.1. Service tariffs are not justified economically. Moreover, net cost of service according to products groups is not calculated so far. Tariffs for transportation of specific products are not calculated.

1.2. International transportation tariffs do not consider prices of alternative competitive routes and therefore, in some cases existing tariffs are clearly dumping; on the other hand, occasionally tariffs are higher compared to competitors'. Because of this reason cargo bypasses Georgia; consequently Georgia loses millions of tones of cargo and huge revenues.

Situation is especially complex in oil and oil product transportation sector.

2. Tariffs on oil and oil products and potential for related corrupt deals

International transportation of oil and oil products from Azeri border (Beiuk-Kiasik) to Batumi is the main part of rail traffic of the Railway of Georgia.

Until 5 March 2004 basic tariff for the international rail traffic of oil and oil products for the mentioned section was USD 8.68. Simultaneously so called "volumetric tariff" was introduced by a special article that established special rates for the carriers transporting more than 1.000.000 tones of products:

- a) for oil – USD 5;
- b) for oil products – USD 7.

Simple calculation took place here – neither of cargo owners and carrier companies had enough volumes of cargo in order to be eligible for above-mentioned discount.

It is easy to estimate that by means of administrative resources and in accord with the leadership of the Railway this normative supported the creation of a monopolistic carrier with related corrupt deals.

A private company "Sakrkinigzaekspedicia" was established with management located in the administration building of Georgian Railway, next to the Director General's office. In agreement with the Railway the company started negotiations with cargo owners regarding

transportation by Georgian Railway, by the company “Sakrkinigzaekspedicia” itself in particular.

Cargo owners got unequivocal explanation that in case of refusal administrative resources should be used and the owners could be deprived of conditions for normal work, i.e. possibilities to get discount.

The only function of “Sakrkinigzaekspedicia” was to receive cargo at Georgia-Azeri border and transport it to Batumi or Poti terminal, i.e. the operation anyway included in the functions of the Railway.

Actually classical intermediary was built-in into the scheme; it had monopolized transportation with the only function to receive an offer and transfer it to the Railway. This company did the job easily realizable for 3-4 mediocre employees of the Railway.

“Sakrkinigzaekspedicia” from its part set following tariffs to cargo owners and carriers:

Oil – minimum (5 + 1.1) USD (more often (+1.5)).

Oil products – minimum (7 +2) USD.

Ultimately annual revenue to its “black” cash office was at least USD 15 million- the money belonging to the Railway that apparently had been distributed to different government offices.

In 2004, since change of the authorities, in accordance with ant-corruption activities announced in the country new management of the Railway decided to “launder” the tariff. For this purpose according to the decree dated 5 March 2004 at first stage so called “volume tariff” on oil was increased to USD 6 and on oil products – to USD 8. This was done to legalize the share of the intermediary and add it to the official revenue of the Railway. This enabled to create transparent competitive environment stimulating business development.

Since another replacement of the management of Georgian Railway we have to assume that new directives came from certain groups of authorities to return the tariff to the old rate and re-establish the concept of an intermediary. But the circumstances became stricter. New limit on

transfer was established – 4.000.000 tones; after reaching this limit the tariff would have become :

Oil – USD 5;

Oil products – USD 7;

Basic tariff still remains USD 8.68.

In order to exclude even theoretical chance of a potential competitor, the tariffication policy outlined that any carrier with an ambition to receive “volumetric tariff” had to get a certificate of Batumi Terminal confirming that the latter agrees to receive the cargo.

Then Batumi Terminal that entered the deal created its own carrier company and occupied intermediary’s position. Unsurprisingly, it would not issue the certificate to competitors – this was the last activity to accomplish artificial monopolization.

New monopolist established new tariffs for the real owners of cargo:

Oil – minimum USD (5 + 1.25)

Oil products – minimum USD (7 + 2)

The absurdity of the situation was in the fact that Georgian Railway reduced the tariff, but simultaneously the intermediary increased tariffs for the real carriers by minimum of USD 0.15.

After the introduction of the new tariff owners of cargo, dissatisfied by rise in tariff, re-addressed significant amount of cargo to Iranian direction, this had been practiced for a certain period of time and caused serious damages to Georgian Railway. The dissatisfaction had two reasons:

1. Initially the intermediary requested USD +1.5. After the negotiations the amount was reduced to USD +1.25 - this returned certain part of oil to the TRACECA corridor.

2. Owners of cargo and carriers did not want to ship cargo to Asian and Azeri markets by means of their competitors (Petrotrans).

Apart from the fact that established system is extremely corrupt, above-mentioned tariffication policy standards roughly violate equity principles guaranteed by the Constitution.

In the motivational part of mentioned changes Georgian Railway asserted that the reduction of the tariff aimed at increase of freight turnover, while the certificate requested by the Terminal intended to reduce the car inoccupation rate.

Though actual situation turned out to be opposite, i.e. cargo turnover was reduced dramatically as real owners faced increase, rather than decrease in tariff; therefore, no incentives existed to increase cargo turnover.

Note: in 2004 cargo turnover decreased by 1.868.000 tones compared to 2003, while revenues went down approximately by USD 10 million.

Recommendation: *On the basis of identification of oil/ oil products shipping net cost and the analysis of all external factors unified tariff should be developed, that would put all carriers in an equal position. It is possible to envisage discount after shipping of the certain volume, but this should be a multi-stage standard and the discount should not exceed 3% at each stage.*

Such changes exclude the possibility of corrupt deals and creates competitive environment providing serious incentives for the development of traffic business.

Similar standards could be established for some other types of cargo that are subject to 20% discount according to the tariffication policy and provide opportunity for the establishment of monopolistic system.

Following standard is also included into the tariffication policy:

Fee for use of tank-cars for shipment of more than 1.000.000 tones of oil and oil products is established as 0.07 GEL/hour, for the storage - 0 0.02 GEL/hour.

If less than 1.000.000 tones is shipped fee for the use of tank-cars is 0.50 GEL/hour; for the storage – 0.17 GEL/hour.

This means that in case such types of violations are more, car inoccupation fee is 7-8 times less; this is illogical, reinforces the possibilities of the artificial monopoly and presumably is one of the important parts of the deal.

Car utilization and other taxes will be considered in more detail below.

### 3. Additional levies

#### 3.1. Car utilization cost

Carriers are charged with this cost from the moment of provision of cargo; it is rather high. The cost increases after the first and second twelve hours, then after 24 hours without consideration of reasonable unloading time that should logically be considered in a main tariff for transportation for any type of cargo.

Due to uncontrollable situation at stations and poor registration this provides supportive ground for imposition of this cost and further corrupt deals related to it.

As an example it could be mentioned that for the time being various companies have to pay the Railway more than GEL 30 million that they refuse to pay and even stress in private dialogues that they have already paid “cash” to different officials for inoccupation. I.e. the situation is created when the balance sheet of the Railway reflects accounts receivable that is difficult to collect due to various subjective and objective reasons. Apart from that there are lots of facts of violation of the mentioned standard on the basis of preliminary agreement.

#### Recommendations:

- a) *Reasonable terms of car unloading should be identified and cost for the car use during this period should be included into the main tariff;*
- b) *After the expiration of this term car use cost should be identified uniquely and should be approximated to the established car renting cost;*
- c) *Effective inoccupation registration system should be developed to prevent stations from entering into corrupt deals with carriers for the purpose of inoccupation hidinf.*
- d) *So called “Cargo storage” cost should be cancelled; isolation of this cost from the car utilization cost is illogical and provides the basis for corrupt deals.*

#### 3.2. Car rent

Car rent tariffs are not economically justified and rent mechanism is not transparent either.

This has been providing an opportunity for making deals for years. In particular, rent comprised official and “black” costs. Current system is the same and presumably, old problems are still existent.

#### Recommendations:

*The issue of optimal conditions of selling the car depot to private operators or transferring it for the management should be considered; this would eventually exclude the possibility of deals related to car rent and transferring cars to cargo owners.*

#### 4. Evaluation of damages resulting from the wrong tariffication policy

##### **4.1. Oil/ oil products.**

Minimum of 2 million tones of cargo (mainly oil) was readressed to Iran during 2004; subsequent losses of the Railway were equal to minimum **GEL 20 million**.

By creating artificial monopoly revenues of the Railway - **approximately GEL 22-24 million** – were deposited in the intermediary company.

Total loss incurred by the Railway in this sector is **GEL 42-44 million**.

##### **4.2. Dry and general cargo**

In case of competitive, flexible and transparent tariffs it is possible to attract 4-5 million tones of bulk and general cargo, as well as to activate container traffic.

Mentioned cargo: sulphur clods, different types of ore, bituminous coal, etc. Apart from that after appropriate interventions approximately 40-50 containers might be transported by the railway.

A total loss incurred by the Railway in this sector is **GEL 40 million**.

##### **4.3. Debts**

Unreasonable, deeply corrupt by content system of various levies and fines causes accumulation of uncollected debts and simultaneously provides the basis for corrupt deals.

Indebtedness accumulated in this way exceeds GEL 30 million so far. Several million is a turnover in such kind of deals; this increases transportation costs and makes the Railway noncompetitive.

#### **4.4. Conclusions**

In case of right tariffication policy the Railway could increase revenues by minimum of total GEL **100 million** annually.

#### **Recommendations:**

- a) *“Railway Administration” or any other legally defined permanent unit should be established that would in the shortest possible time prepare new “tariffication policy” considering modern requirements and enabling to react promptly to changes of conjuncture in the region.*
- b) *In the framework of the Georgian-Azeri intergovernmental Commission working group should be formed through participation of ports and railways of both countries that would make joint decisions regarding the implementation of coordinated tariffication policy in order to attract any types of cargo to the TRACECA corridor.*

#### **5. Procurement system**

Main procurement takes place through intermediary companies. The process is not transparent and provides opportunity for deals; consequently, an annual loss incurred by the Railway is at least **GEL 10-12 million**.

#### **Recommendations:**

- Mobile procurement unit should be created that would ensure conclusion of direct long-term contracts with producers.
- For types of production that is impossible to purchase through direct contracts a commission independent from the Administration of Railway should be formed that would ensure organization of transparent competitions.

#### **6. Capital costs**

Real control mechanism is necessary not to allow inflation of registered expenditures for various construction and renovation works. Accomplished work is of low quality, in some cases it is not performed at all, though expenditures are registered for fuel, personnel salary, etc.

Approximately **GEL 5-6 million** is wasted annually in this sector.

### **7. Passenger traffic**

About 70-80 passengers travel without a ticket on each train route; each of them pays GEL 6. So called ongoing car maintenance is also a basis for deals.

Recommendation: passenger economy should be separated and handed to a private operator on a competitive basis.

According to the above-mentioned annual internal reserve of the Railway amounts to minimum of **GEL 150-170 million**. Activation of this reserve is quite realistic in the shortest period by means of relevant reforms. This amount is enough for the investment in rehabilitation work necessary for the Railway, as well as for transferring money to the state budget.